Walter Deemer's

MARKET STRATEGIES AND INSIGHTS

...for Sophisticated Institutional Investors

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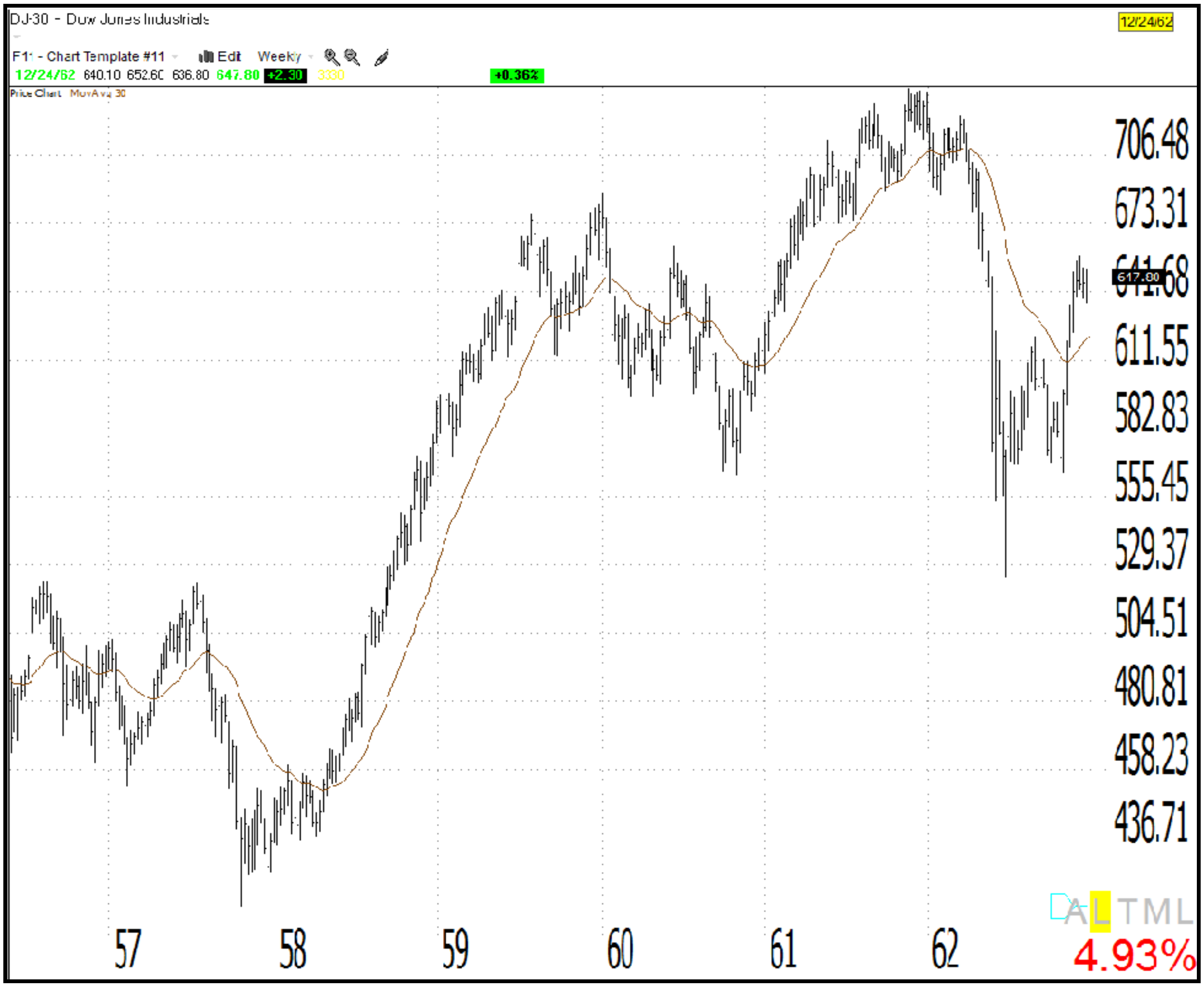
BULL MARKET EXTENSIONS

The Four-Year Cycle tells us that the stock market should make its next major low sometime in the first half of next year. Since this is starting to look like an unrealistic expectation, though, the time has come to look at what implications this possible failure has for the long-term outlook. In order to look forward, however, we first need to look back.

Since 1949, the stock market has made major lows every four years pretty much like clockwork: 1949, 1953, 1957, 1962 (which was an exception), 1966, 1970, 1974, 1978, 1982, 1987 (a second exception), 1990 (eight years after the 1982 low, so not an exception), 1994, 1998, 2002, and 2008 (a third exception). I first started writing about these exceptions in 2007, when we were dealing with another one. At that time I called the two previous exceptions to the four-year major low rule that we experienced in 1957-1962 and 1982-1987 "Bull Market Extensions", because the scheduled major low was pushed forward in both cases. I warned at the time that the two prior bull market extensions did not end at all well – and as it turned out, the bull market extension of 2007 was distressingly similar to its two predecessors.

It is starting to become more and more likely that we now have a fourth bull market extension on our hands, since it is becoming more and more unlikely that the stock market will be able to stage a bear market and make a Four-Year Cycle low on schedule by the first half of next year, or approximately four years after the March 2009 low. Given this, the time has come for us to look back at the past three bull market extensions, to see what lessons they may hold for us in the current situation. Our review begins on the next page – but if you want to cut to the chase, all three of the previous Bull Market Extensions were followed by a much-more-severe-than-usual bear market.

CHART 1: Dow-Jones Industrial Average (Weekly), 1957-1962

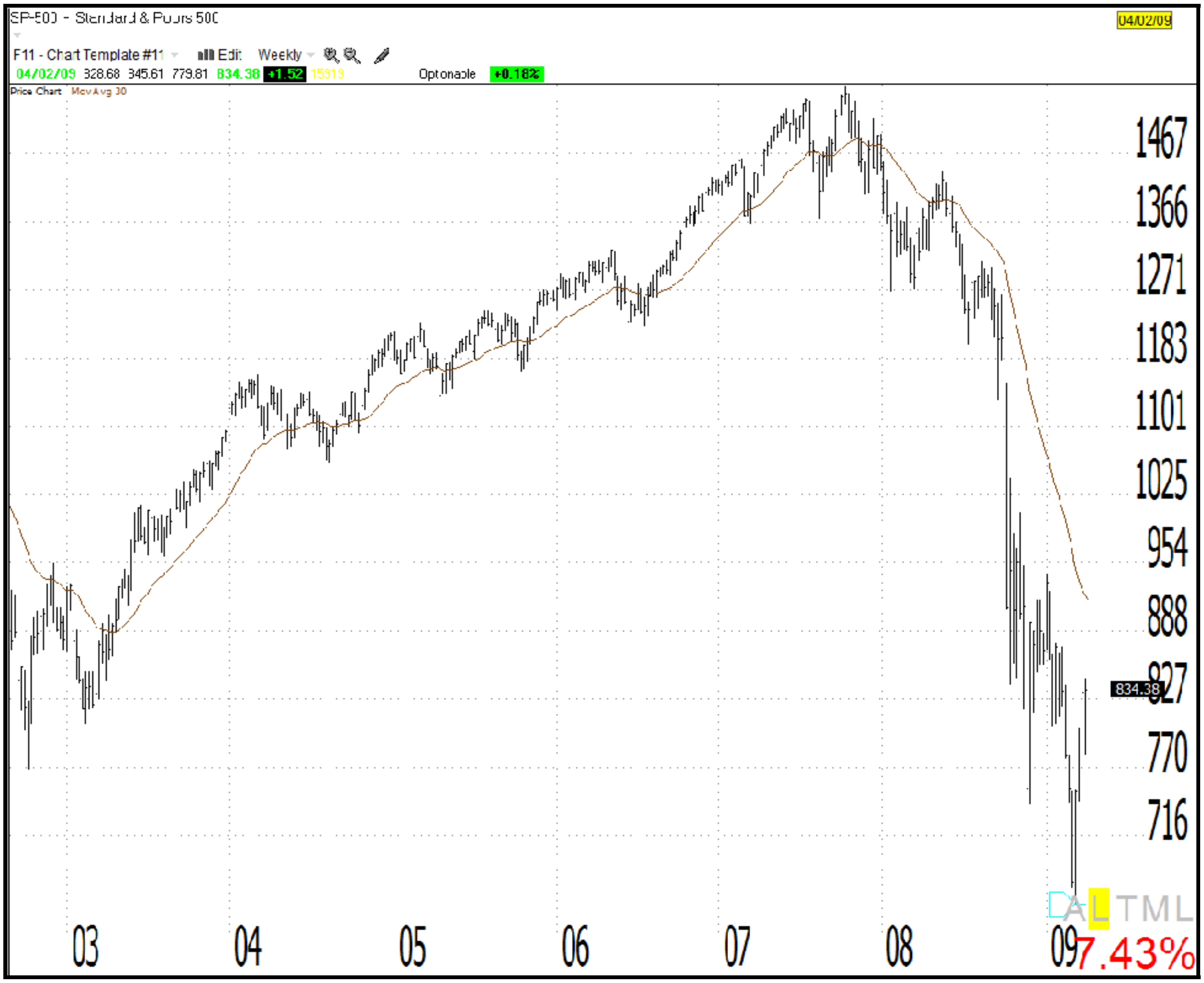


Bull Market Extension I was in 1961. The stock market made a rather emotional major low in October 1957 (the "Sputnik low", when Russia unexpectedly launched an earth satellite before we did and thereby cast grave doubts on our nation's scientific leadership). This meant that the next Four-Year Cycle low was due in late 1961, but the market staged a very speculative rally in early 1961 led by bowling, vending and electronics stocks, and the blue chips were able to keep going until December of that year. As a result, the Dow-Jones Industrials made a top in late 1961 rather than the scheduled bottom. Afterwards, it plummeted 29.3% to its June 1962 low in what became known as The Crash Of 1962.

CHART 2: Dow-Jones Industrial Average (Weekly), 1982-1988

Bull Market Extension II was in 1987. The stock market made a major low in August 1982, so the next Four-Year Cycle low was due in the third quarter of 1986. The market, however, staged a high-level consolidation during the second and third quarters of 1986 and then embarked on an ever-giddier advance to the Dow's August 1987 high of 2746. Less than two months later, though, it traded at 1616 – a 41% plunge known forever after as the Crash Of 1987.

CHART 3: S&P 500 (Weekly), 2003-2009



Finally, there was Bull Market Extension III in 2006 and 2007. The Four-Year Cycle low had been made in October 2002, so the next one was due in late 2006. The market, however, completely ignored this and peaked a full year later, in October of 2007. It then staged the most severe decline since the Great Depression – 58% -- which led to the Four-Year Cycle low in March of 2009.

The Four-Year Cycle, it must be remembered in all this, is a behavioral cycle, not an economic one; the bull and bear markets that occur within it serve to correct (and usually overcorrect) the excesses of the preceding bull or bear market. With those behavioral roots in mind, the fact that the bear markets which followed the three Bull Market Extensions were – without exception – more severe than average: 29%, 41% and 58%, can, I think, be attributed to the fact that the extensions gave the excesses of the preceding bull market more time to build up – which meant that there were more of them to be corrected by the subsequent bear market. Whatever the case, I don't think the fact that all three Bull Market Extensions were followed by more-severe-than-usual bear markets can be dismissed as a statistical fluke.

How long could the Bull Market Extension last? The one in 1961 peaked at the time the next Four-Year Cycle low was scheduled to occur. The ones in 1987 and 2007, though, saw the market continue higher for a year after the Four-Year Cycle low was due. Based on this and this alone, the market could – could – continue to go up until the first half of 2014. Bull market extensions are exceptions to the rule, though, so I wouldn't place a whole lot of confidence in that first-half-of-2014 possibility.

And why did the Bull Market Extensions occur in the first place? Frankly, I don't have the answer to that one; excessive speculative activity in the stock market played a major role in the 1961 advance and, to a lesser extent, in the 1987 advance, but it was not really a factor in 2007. For what it's worth, though, I suspect that when the history of this Bull Market Extension is finally written the Fed's quantitative easings will be seen as one of the biggest reasons why it came to be.

-- Walter Deemer