

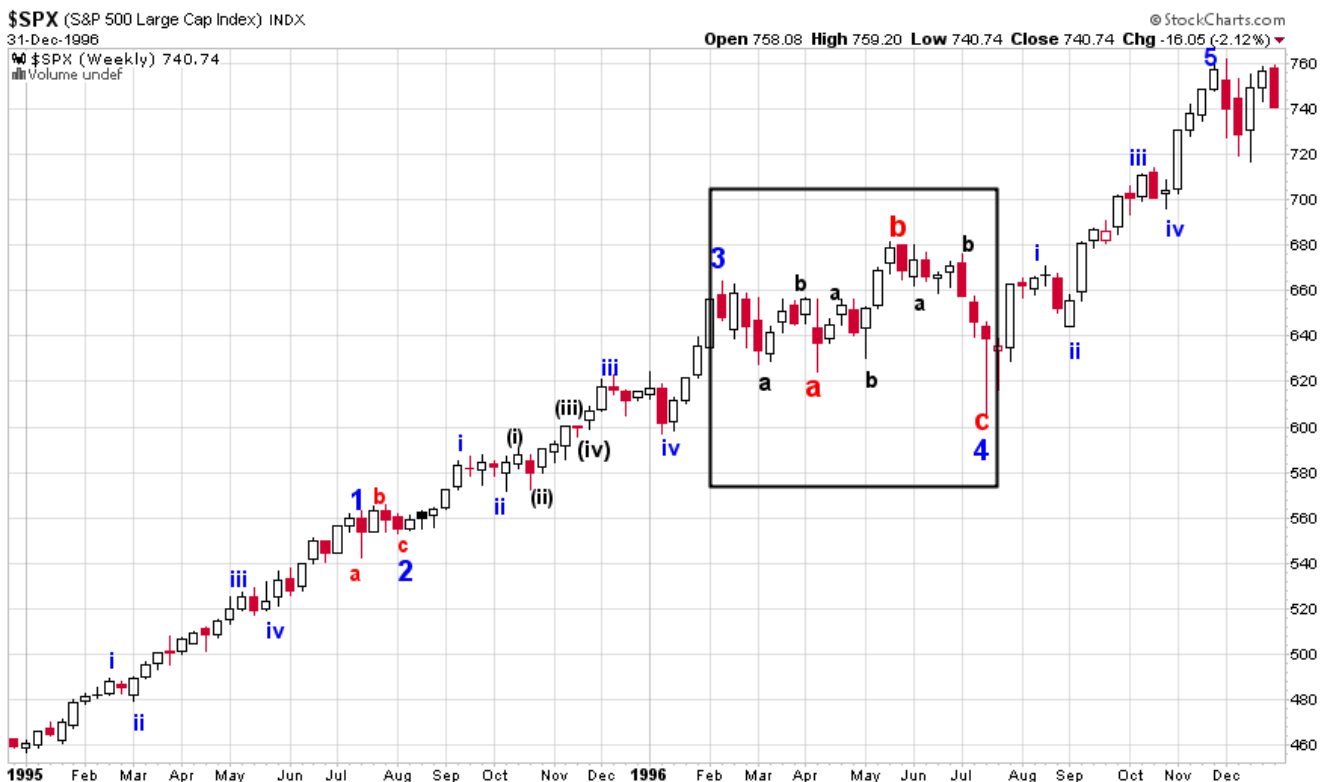


## Exceptional Bear Market Letter™

May 1, 2008

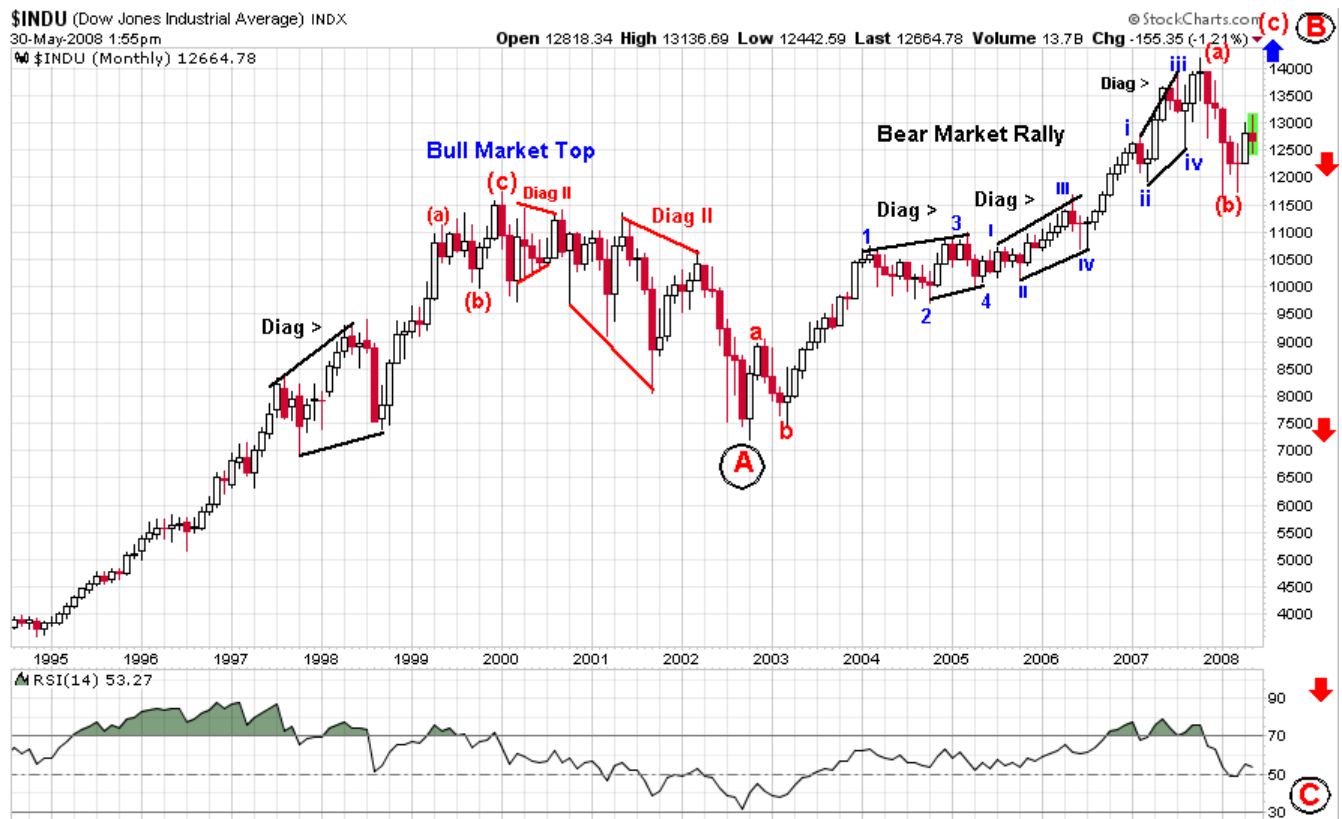
### The Big Picture – Where do we go next?

In order to give you a clear picture, there are a few concepts you need to understand. The Market is a *fractal*, meaning that the parts share the same basic 5-wave pattern from the tick chart to the multi-century chart. Elliott called the relative size “degrees of trend”. The example below is the last Bull Market sequence in the S&P 500 lasting two years, simplified in the weekly candles.



As you see, each five waves sub-divides into another five, now if we look at the daily chart many more subdivisions within these become apparent. Likewise each correction sub-divides into a smaller version of the same pattern if we zoom in. Upside moves are labeled with **numbers**, while corrections are labeled with **letters**. Elliott's 3 rules\*\*\* are always observed.

If we look at the section of the **graph inside the box** we see the entire **wave 4** correction, composed of an **a-b-c**, with each of these subdividing into another **a-b-c**. As you can see the simplest correction has a counter trend rally, **b**, sandwiched between waves **a** and **c**. This is analogous to the current Larger Bear Market. **Wave 3** above is analogous to **Bull Market Top** below; **a** above is analogous to **A** circled below; **b** above is analogous to the **B** circled below. Finally **c** above is synonymous with the **C** circled bottom some 3-5 years away.

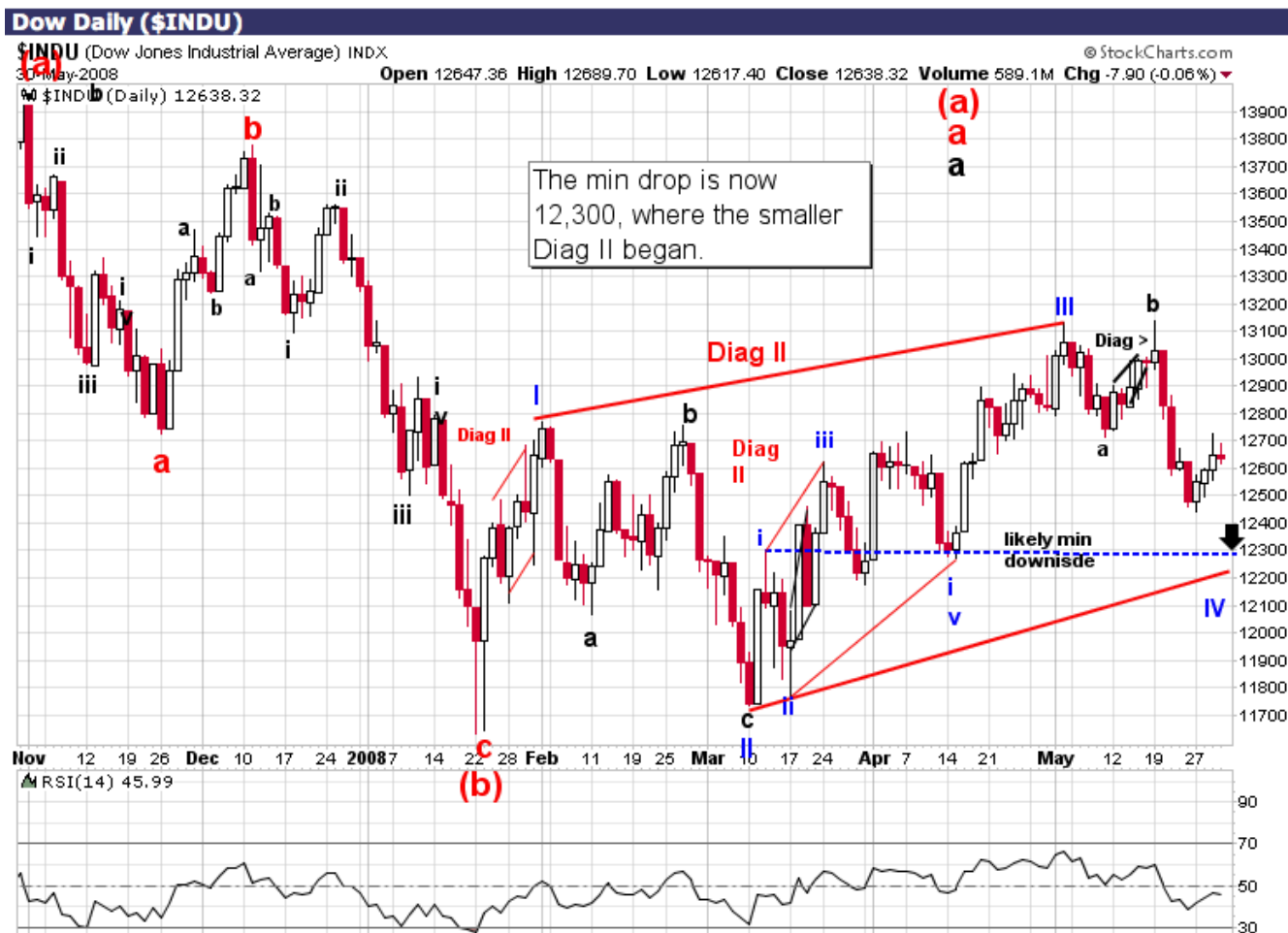


As you can see, a **Bear Market** is no more than a correction at a high degree of trend. In its simplest form it has three waves, where the middle **b wave** often makes a new high, also know as a **Bear Market Rally**. Since the **b wave** is corrective, its subdivisions are also corrective. You see numerous **Diagonal Triangles\*** presaging the dramatic reversal ahead. The **Bear Market** began in **March 2000** and it it will likely take another 3-5 years for a total of 12-14 years for just the first leg. A **wave 4** correction typically contains 5 of these legs, alternating in direction.

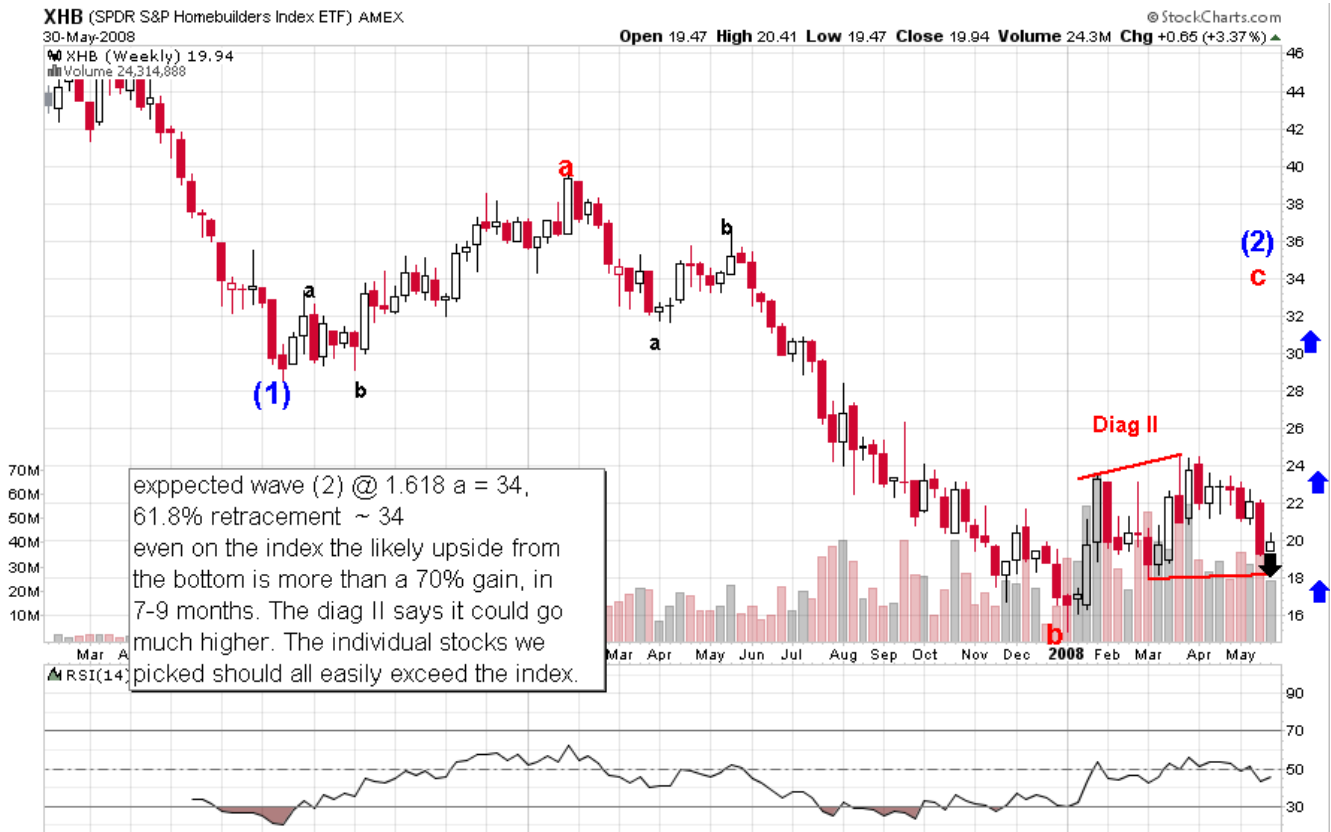
Now if we take a closer look at the structure that completed the **Bull Market Top** in the monthly chart, there is an **(a)-(b)-(c)** to complete the move. To the top right, an almost identical structure in process should take the **(c) wave** to a new all-time high. In 1928 this structure occurred taking the market up a big percentage, only to crash in October 1929, we are at an analogous juncture.

Next we can see in the Dow daily two compound waves, labeled (a) at the top left and (b) in February. The (c) wave that began the move is a *Diagonal II*,\* telling us this will be a long, final blow-out ahead.

Wave V of *Diagonal II* = wave 1 of a 5-wave (c) where 1, 3, 5 are upside moves; and waves 2, 4 are corrections. We are now in the final leg down of the Diagonal II which should complete within the next week or so in the Dow.



In the meantime, the **Homebuilders, XHB** will be progressing in powerful **c wave**, and although it will not reach new highs, on a percentage basis they promise some of the highest returns.

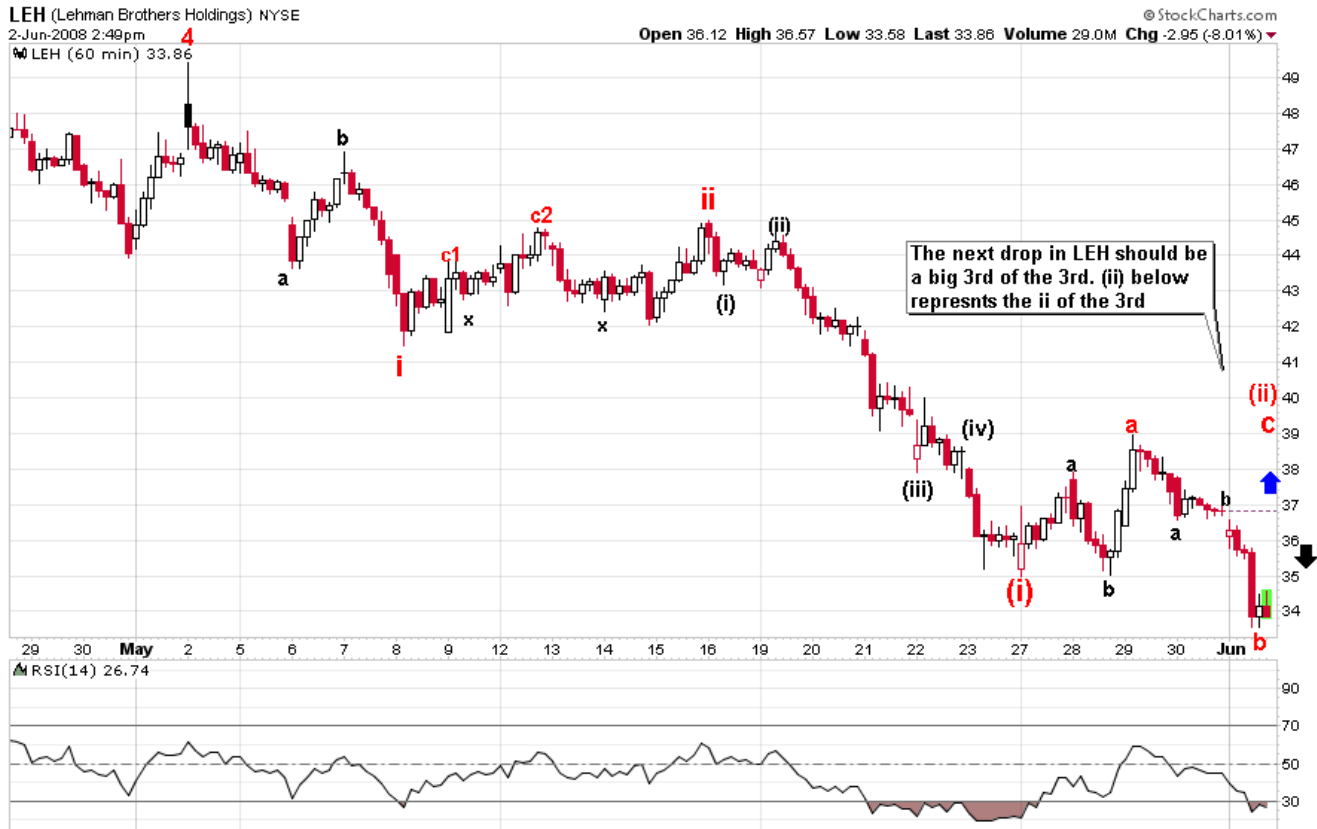


Although this appears to be a small Diag II, it is quite large considering this is a weekly chart, whereas the others are denominated in daily candles.

Likewise the **Fianicals** have substantial upside also indicated by the Diag II, a leveraged fund UYG would double the the upside.



Of the financials, not all are going up, some like Lehman, may go the way of Bear Stearns, and must drop **below 20** on the next move. Once this bounce to wave ii completes, you should be able to short near 39 for a 100%+ profit. Those of you who think of technical analysis as something akin to voodoo, should watch this one especially. You will see that the fundamentals always lag the technical indicators. in this case the fundamentals will be revealed only when Lehman announces a substantial write-down of its bond portfolio.



By the way, with the S&P down about 4% year-to-date, and the average hedge fund underwater, take a quick look at our timer-tracked performance. Our Current portfolio includes 4 homebuilders or a combination with the index short; three financial stocks or a combination with the index (some long and some short); plus either short the Emerging Markets, short China or short the NASDAQ.

[Timer Tracked](#)

Eduardo Miahyes

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- \*A **Diagonal Tringle** (Diag >) is a terminal move where wave 4 overlaps wave 1 and the subdivisions are corrective waves. It indicates dramatic reversal ahead, often after a Spike. Once complete, it swiftly retraces at least to where the first diagonal began (wave1).

- **\*\*A Diagonal II (Diag II)** is similar to a Diagonal triangle, in that wave 4 overlaps wave 1, but the subdivisions are those of an impulse wave. These occur at the beginning of a long move.
- An **ipulse wave** is a move in the direction of the primary trend, what we normally think of as a (5 wave) bull move. However in Bear Markets, they occur to the downside in **waves A** and **C**.

**\*\*\*Elliott's 3 rules.** (*except in Diagonal Triangles*)

**wave 2** does not exceed the origin of **wave 1**,

**wave 4** never overlaps **wave 1** of the same degree,

**wave 3** is never the shortest.



*“Opportunistically timed investments that maximize wealth”*