Exceptional Bear Market Letter

March 27, 2009

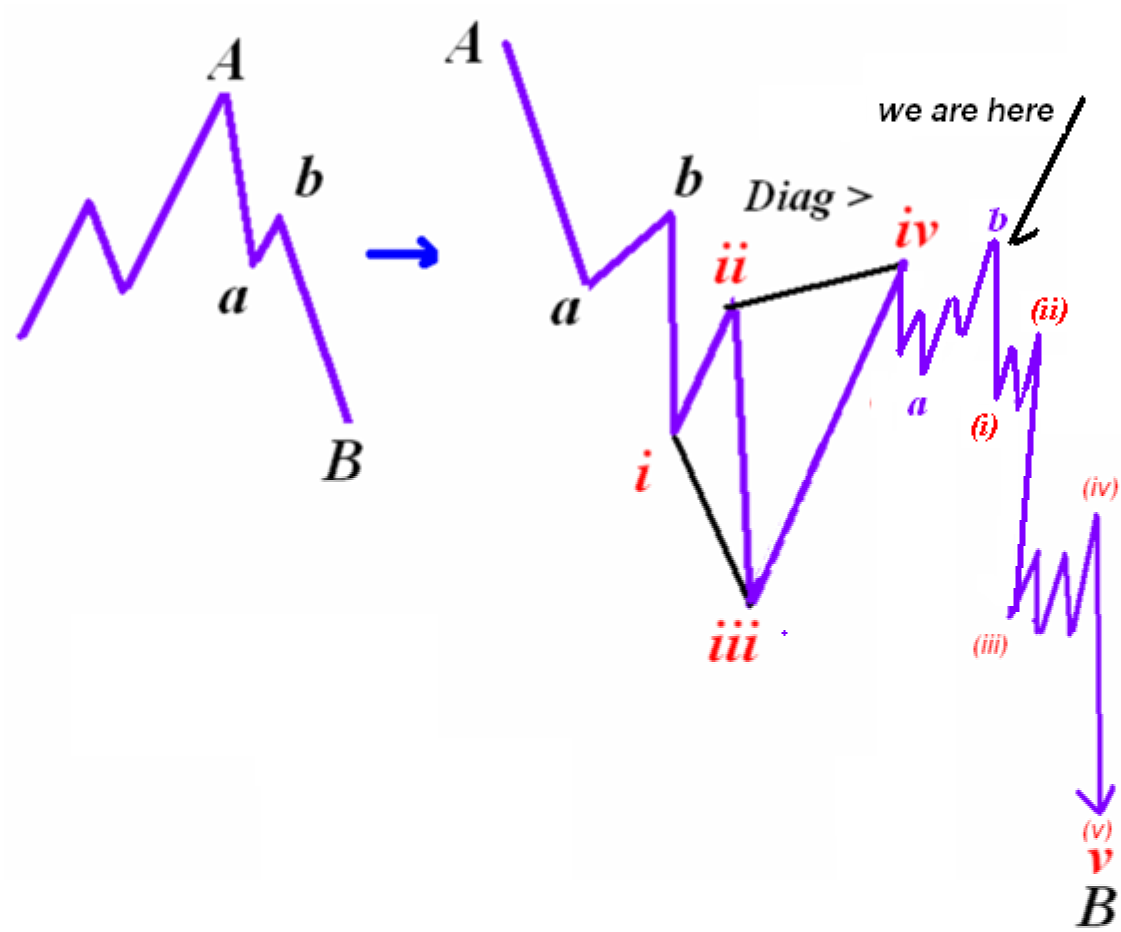
Down to the final Trough in 5

The major theme in stocks this week remains *"things are not as bad as we expected",* but is a slower pace of economic contraction a reason to become irrationally hopeful? Have we forgotten that the economy in the 4^{th}Q shrank at the fastest pace since 1982, or that jobless claims hit another record high this month? Such is collective psychology, which irrationally waxes and wanes between euphoric optimism and extreme pessimism and back again. That is why the big picture perspective which we provide you is so important.

The Wave Principle is a study of *history* as reflected on chart patterns. As a discipline it requires both a high aptitude for pattern recognition and many years of experience. Perhaps one in a thousand does it well. While a good handle on Elliott may allow you to decipher good from bad analysis and to act with conviction when required, do-it-yourselfers beware - a little knowledge is highly dangerous. It is far more cost-effective to hire this expertise rather than attempting to acquire it on your own. It should be considered a *cost* of investing, just like a cost of doing business, rather than an expense. In a Bear Market the rate of your wealth's compounding or its dissipation is entirely dependant Market Timing and Asset Allocation.

It is only by stepping back, with an Elliott perspective that we can see beyond the primitive limbic brain, which drives sentiment. Just as a pendulum must reverse at its nadir, so must sentiment - we are there now. The reversal is followed by a sudden coming to terms with reality, rewarding those who were correctly positioned, while sending others progressively in denial, scrambling.

Below you see the **A-B** transition pattern to the *upside* in its simplest form, followed by a more detailed diagram on the right. A ***Diag >*** indicates *dramatic reversal ahead*, once the ***vth*** wave, often a Spike, completes. Barring a failure, the market must take out the previous low of wave ***iii*** in order to trough. After bottoming a Diag > swiftly retraces at least to where it began labeled wave ***i***



Below is the Full **Dow** chart showing the entire ***Diag >.*** Most of the others share this same pattern. In order to see it more clearly I have magnified it in the others so that you can see what is going on now.

Beware of the Bounce - tis but a **Bear trap**......bad news is being brushed aside *temporarily*, a case of unrealistically hopeful expectations, which can only be shattered. Only exceptional Elliott analysis can identify this, not two weeks ago Prechter announced the final trough was in, once again he was all wrong. So forget fundamentals, Dow theory moving averages and other interpretations, these are secondary indicators which fail at times like this! We are back to the point where a major bankruptcy will likely tip scales of psychology to a pessimistic extreme. It could be General Motors's bankruptcy... hopefully voters are starting to realize that nothing is too big to fail, after all dinosaurs have long been extinct...

Right now fundamentals *which are always a secondary to* collective psychology, are being completely ignored. Market Psychology is completely deluded and set up for a sudden adjustment back to reality. These are of necessity violent, as violent as a human stampede for the exits in a crowded theater at the first whiffs of smoke.

Unemployment is not 8.5%, the statistics have been euphemistically camouflaged ... when you include all those who have stopped looking for work, those who are under-employed, and those working part-time of necessity, the figure is 16% or more, the highest in a quarter century by far. On the horizon, the next wave of foreclosures will include commercial real estate and prime mortgages. How can it be you ask that **SRS**, our Real Estate ETF, staged a desperate attempt set off all stops in the last couple of days? Irrational and extreme to the same degree that the imminent reversal will be - the bottom is about to fall out, particularly in Real Estate.

Meanwhile the G20 took the spotlight off themselves and put it on the Emerging Markets.... the IMF now has nearly a trillion dollars to ease the credit crunch in Emerging Markets...which does absolutely nothing to improve the soundness of the G20 financial systems.

Going forward, we wont be seeing many bank write-offs, banks can now hide their losses under accounting shenanigans... but does this restore anyone's shattered trust in the financial system? Like the Emperor with no clothes, we are just pretending the banks are solid and the economy on sound footing.

When first quarter earnings start to trickle out, they will not likely exceed consensus estimates. These are fundamentals...while they provide a glimpse of future market activity in Bull Makets when the trend is aways UP, the Bear plays by a different set of rules.   Far worse the *Bear in Bull's clothing*, will be the ruin of many, "*by their fruits you will know them*"... Like the rally fueled by Greenspan's Fed after the dot com bust, this rally will be an extreme replay: both on rocket fuel & steroids. This time the Mother of all Rallies will culminate in the Mother of all Bubbles, come Crashing down to kick off ***Great Depression II***. (*Much like the first World War, which was called the Great War until the second even greater world war took place)*

Yes the trough and subsequent rally keep getting put off, but there is lots of money to be made in the meantime on the short side. Although the majority of hedge funds are short individual investors continue irrationally hopeful.

At a time when others lack a compass, there are no better map of the territory.

Regards,

Eduardo Mirahyes

"Opportunistically timed investments that maximize wealth"