Exceptional Bear Market Letter™

November 30, 2015

The pitfalls & opportunities of incrementing Bear Market Magnitude

Benoit Mandelbrot discovered *fractal geometry*, *(the link contains a video of Mandelbrot's last presentation on fractals in 2010).*

As shown below, Mandelbrot studied *"roughness"* to conclude that the British coastline becomes far longer, as the yardstick used to measure drops from 200 km to 50 km.

The image of the British Coastline on the left uses the 200 km as the yardstick, to conclude a 2400 km perimeter. By simply taking a measure of 50 km the coastline measures 3400 km, 1000 km or a *42% longer* than the image on the left. *Source: Wikipedia*

Analogous to shortening the yardstick to measure the English coastline, and assuming mastery of *New-Wave Elliott*™, Bear Market portfolio turnover increments, scaling-out partial positions in lock-step with the flow of augmented volatility, to increase *turnover* and compound *profitability*.

For those who don't know what they're doing, elevated turnover could mean mindlessly chasing returns, to result in higher transactions costs, without a commensurate boost to returns. However, if 70% or more of Swing-Trades are profitable, such trading translates into winning performance, which far outweighs other considerations. Similarly, *diversification into <u>losing</u> asset classes,* such as long equities, offsets gains with losses, to the detriment of performance.

The built-in diversification of asset-class investing

Asset-class investing, timed with the flow of the market's larger trend, has diversification already built-in. *The right kind of diversification* - one that will prevent catastrophic losses from a single company going under, such as Bear Stearns on the long side of the market. On the contrary, in 2008-2009 ***inverse Financial ETFs*** earned the highest returns of any inverse asset class. In other words, the downgrade in *long financials'* market multiple was expressed as a dramatic appreciation of their reciprocal, ***inverse Financial ETFs.***

In the example of the British coastline, *reducing the yardstick 75%, augments the length 42%.* Likewise, consistently scaling-out overbought securities in a volatile Bear Market, and replacing the position at bargain prices, compounds portfolio returns at a *far higher rate than ever before.* Enough to make clients stand up and take notice. Obviously, the rush of new money seeking a home guided by your expertise, could boost your career path tremendously.

The *<u>New-Wave Elliott™</u>* chart below shows the US Equity Market's history since 1900, classified as Bull Markets (green), Bear Markets (red), and Bear Market rallies in (blue). Transcending magnitude is shown in purple, with arrows pointing *up or down* to indicate an increase or decrease in magnitude. *It is original.* Notice that in both Bull & Bear Markets, magnitude transcends higher before the *Supercycle* segment, and back down afterwards. It's the *Supercycle* segment, that can *make or break investors for a lifetime*.

US Market 1900 to present color-coded by degree of trend
& identified as Bull, Bear or Bear Market Rally

Why most invest professionals are consistently on the wrong side of Bear Markets

Bear Markets are as jagged as the British coastline. Trading them with a long yardstick *(of which buy & hold is an extreme),* results in frequent *"round-trips"* back to, or below cost. Even Big Picture volatility, as surmised from a weekly chart, cannot optimize swing trading in Bear Market declines with a *Buy & Hold* strategy. To persist in a *Bull Market strategy* in a ***Supercycle*** Bear Market *freefall, while expecting Bull Market returns,* is what *Einstein called "insanity".*

That's why the vast majority of investors *herd* to their own detriment. They sell when they should be buying, and buy right at the top, just prior to the plunge. Ask them how they are doing, and they will relate only their singular triumphs, while their infinitely larger, *cumulative losses remain in denial.*

Bear Markets are wildly volatile

Bear Markets are characterized by wild volatility swings, as opposed to the smoothness typical of Bull Markets. Why? Because a ***Supercycle Bull Market drops two semi-log steps in magnitude, to 25% of the baseline volatility, while a Supercycle Bear Market increments volatility to 400% of baseline.*** For those who know a bit of physics, the difference between *smooth* Bull Markets and *jagged* Bear Markets can be conceptualized via Newtonian Mechanics. Just as *doubling the distance to a light source drops its intensity by 75%, halving the distance to the same light source increments luminosity 400%. Both gravity and Bear Markets operate by the same natural laws.*

Magnitude disparity between bearish impulses and upside corrections describes Supercycle magnitude

The major difference in the Bear Market ***Supercycle*** **(C)** wave, lies in the magnitude disparity between the *Bearish impulse waves* and their *upside corrections*, *which remain dwarfed two semi-log steps lower.* This translates into a Crash, as the upside, wave 2 & 4 corrections become *mere pauses,* before a subsequent plunge.

The real cost of the Fed's Market Manipulation: highly magnified severity & duration of the subsequent Depression

Bear Markets transcend magnitude during Bear Market Rallies. When a Bear Market, ***Supercycle (IV)*** intended as a *simple* **A-B-C** correction, to ***Alternate*** with the *complex* ***Supercycle (II)*** is forced up artificially as in 2009, it also transcends magnitude. The cost of Fed manipulation is a *Bear Market Monster* beyond imagination. The fallout is unprecedented highly magnified severity & duration of the Depression which sequences the market crash - one *which would never have occurred*, had the market's self-correction been allowed to *proceed naturally.*

The Fed's silver bullet

The consequence of Market Manipulation is a Bear Market Monster that can no longer be reversed by the Fed's *silver bullet – buying blanket futures in all exchanges.* If my deductions on magnitude are accurate, the next plunge will transcend ***Grand Supercycle*** degree, to ***16x*** the scale of *any bear market in the last 200 years.* This time, Fed's silver bullet will be as effective as police bullets bouncing off the original *King Kong,* as he climbed the Empire State building. At market magnitude beyond imagination, ***the Fed's silver bullet can no longer reverse a Crash that's both beyond Fed manipulation.***

Eduardo Mirahyes

Exceptional Bear

"Opportunistically timed investments that mazimize wealth"