October 3, 2012

Below is an explanation of how we analyze bonds, carried out as detailed by David Ogilvy in the NY Times bestseller *"Ogilvy on Advertising"* as the prime example of his marketing genius in the maxim: ***"show them how it's done".*** Ads of the second razor catching the hairs of the beard before they could bounce up, led to the blockbuster success for Gillette's first double-edged razor. At the time, the prevailing thought was ***"why would we ever need more than a single blade, won't a second pass will achieve the same effect"?*** Now razors have 4 blades…

Market Analysis

Our primary tool for market analysis is the Elliott Wave Principle, often backed by the co-incidence of Cycles. However, our version of Elliott differs drastically from the one outlined in Frost & Prechter's ***Elliott Wave Principle.*** After 22 years of empirical observation, our version of Elliott has been highly refined and advanced.

As in the ***80/20 Rule***, where 80% of portfolio performance results from 20% of its stocks, excellence in the application of Elliott comes down to ***90% aptitude for pattern recognition***, and 10% experience. In essence, although experience is certainly a crucial element, no amount of experience can begin to compensate for the lack of aptitude. This is precisely why many who attempt to learn Elliott claim that it doesn't work!

With that said, one way our annotations differ from those of *other* Elliott Practitioners by the inclusion of ***a-b transitions*** *(labeled in purple to distinguish them from corrective waves),* they occur after *each and every directional change*, and are often accompanied by a shift in the ***degree of trend***, or magnitude. Although RN Elliott originally discovered them, he did not develop them entirely, from his perspective, they only occurred from a low, which he described as an *A-B Base.* Robert Prechter, who is responsible for popularizing Elliott's work, discarded this pattern entirely, attributing it to the *delusion* of an old man. *Prechter reasoned that since neither he nor Frost had never seen such a pattern that it could not possibly exist". (you can draw your own conclusions .)*

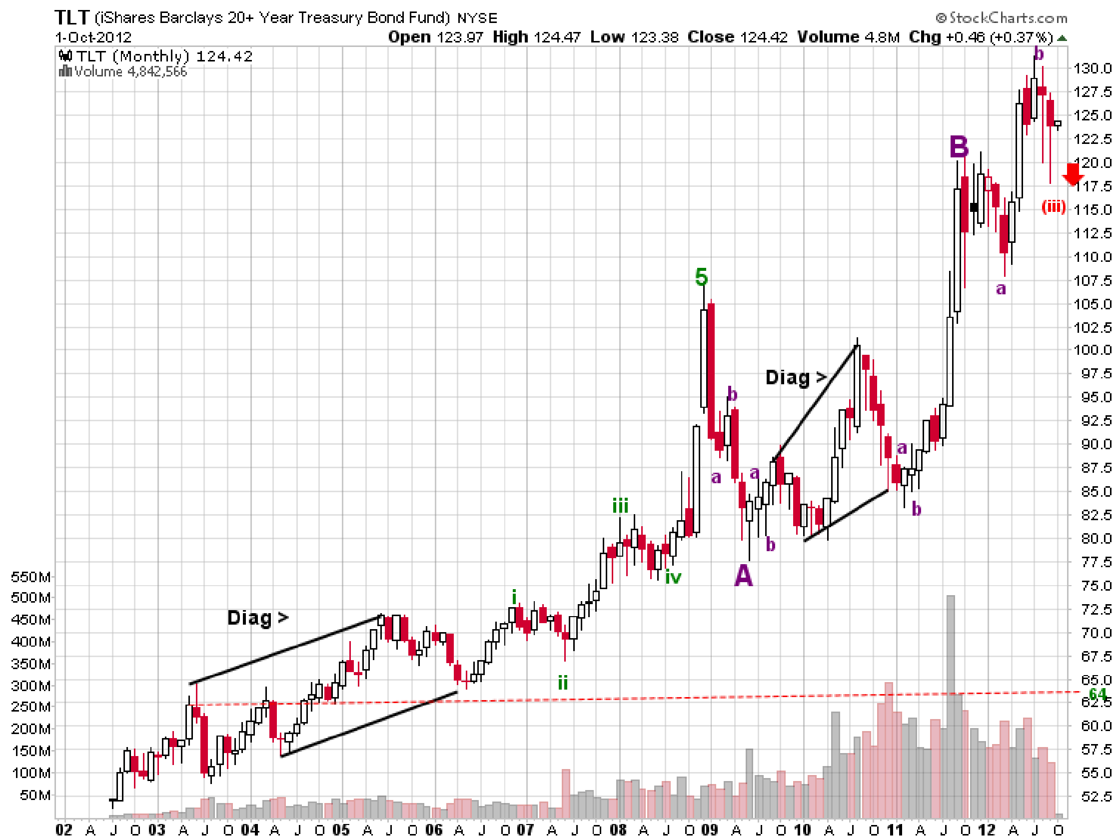
Of all the tools for projecting the market, only Elliott precedes each and every reversal, with an ***a-b transition,*** *proportional in magnitude to the subsequent move.* Like big paws on a puppy, they preview the size of the future full-grown dog. In, Nature all is proportional, and usually constructed for maximum efficiency.

How we analyze Bonds

In Elliott, a careful examination of the ***"forest-to-the-trees"*** is the only sound approach. At the very minimum, the good Elliott practitioner starts with the big picture, and works his way down through the monthly, weekly and daily-interval charts, to arrive at the hourly chart. I often dissect patterns all the way to 10-min intervals, to see the ***"structure of the leaves".*** Below is the un-levered chart for the big picture, since the levered ETFs we use are relatively new, and lack the long-term perspective. As in stocks we use Relative Strength, the RSI, found at the bottom of most our charts, to gauge sentiment.

In the chart below **5** denotes the orthodox top, where the final 5-wave count ends, and the reversal begins. **B** and **b** are part of the reversal, which like crown molding transitions, or marks the reversal and is ***proportional in magnitude to***

the subsequent move. From that point on the transition to the reversal is in process. As you might surmise a transition that requires _three years_ indicates a massive, long-term reversal. ***Obviously bonds have a long plunge ahead!*** Here there are two targets which retrace the first "touch point" of the ***Diag***

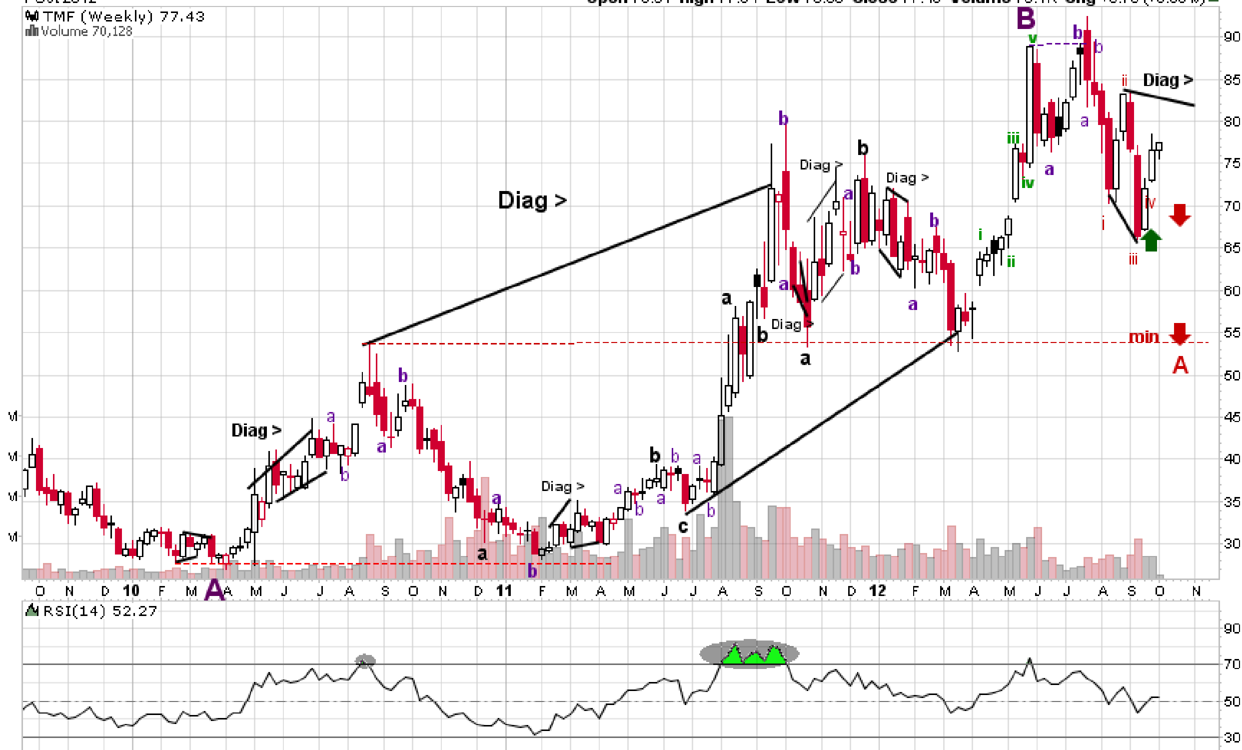


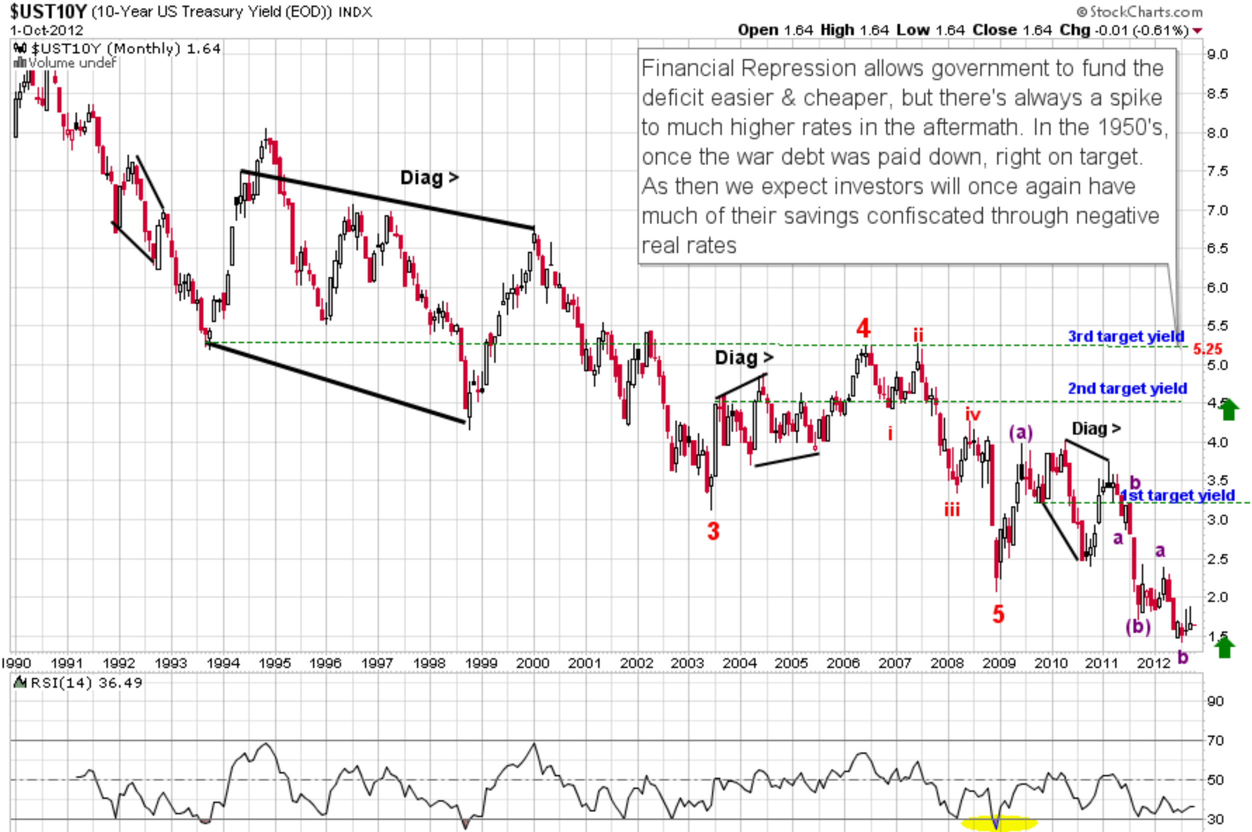
>s on the way up, those are roughly 88 and 64.

The Bear Market in Stocks began in 2000, the equivalent for bonds has just kicked off in 2009***.***

Note that orthodox top **5** above in 2009 confirms the orthodox low in _yield_ below, where a similar ***a-b transition*** is in process. The **b's** are called ***irregular tops.***

TMF - Weekly

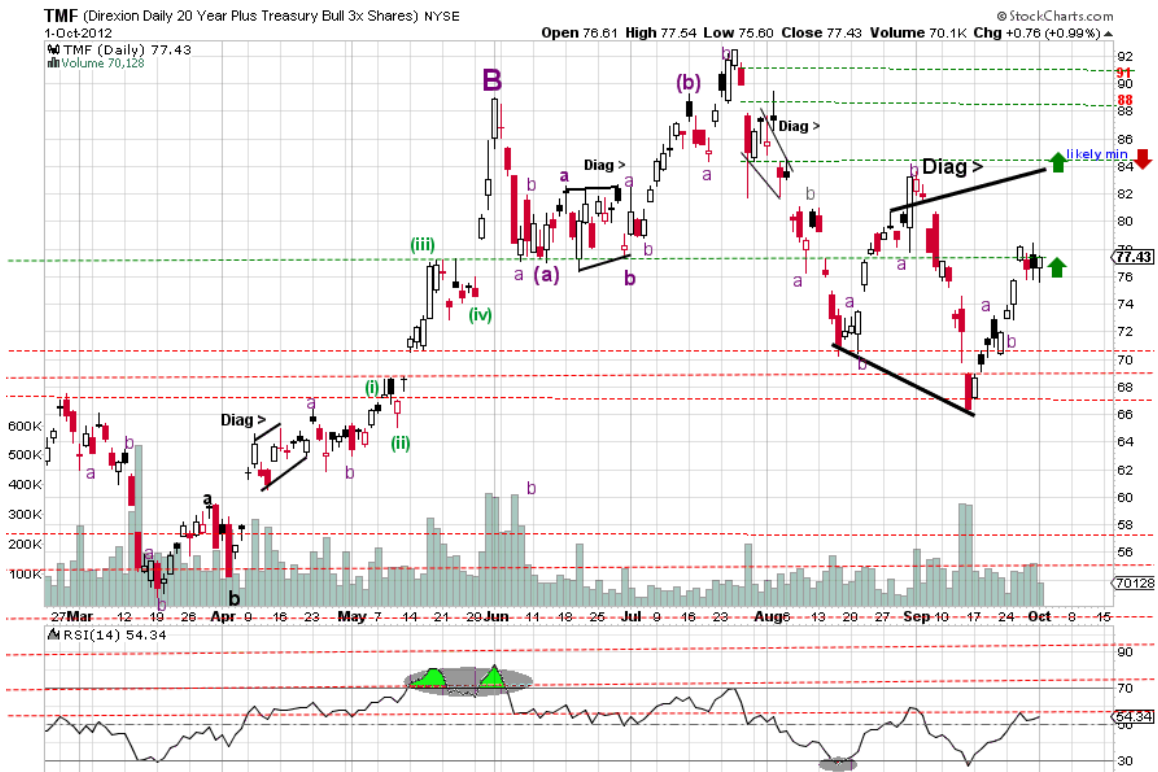




Below is a close-up of the ***A-B transition*** in the weekly Bond chart in the long, levered fund

TMF - Weekly

As you see, the *price of T-bonds* has irrevocably started down, but first a bounce to the minimum of 84 in the Daily chart below, is highly likely. Eighty-four overlaps the highest *un-retraced* initial *"touch point"* of the ***Diag*** **>** just to the left of it, in the Daily chart below. However the gap up to ~90, is also probable high.



Above you can match the charts by the **Bs.**

We currently hold half a position of **TMF** at a cost of 76, and will buy the second half, should it drop to 73.5, otherwise we will sell at 83.5 and look to buy the reciprocal fund **TMV.**

We employ funds that have both long and short counterparts of the same asset class, so that once our upside target is met we can reverse and go with the long-term flow. What's more, optimal liquidity is generally found in these levered ETFs which are traded by the big boys. As an added benefit, they allow you to easily *customize your level of volatility (risk)* by adjusting the cash, to partially or entirely *"back out"* the leverage. While most investors' investment universe consists of either long positions or cash, ***inverse funds*** allow you to effectively ***"go short"*** through a ***"long"*** fund, without having to worry about margin calls or accrued dividends.

Below is that reciprocal fund, TMV, showing a likely low near 47.6, where we would likely buy a partial position, to scale-in, as we attempts to get the lowest average cost.

I completed the *Elliott Wave Advanced Tutorial* taught by Elliott Wave International, in 1990. To date, I am still the only individual who has ever *skipped-over* the Basic Course on the first go-around, and gone right into the Advanced Tutorial, without any previous knowledge of Elliott. For me, the fact that *five* individuals, who were been interviewed in Jack Schwager's 1989 in his original two-volume *"Market Wizards",* attributed their success to Elliott, as either the primary, or a confirmatory tool, was all the convincing I needed to register for the $2500 *(in 1990)* plus expenses, to fly to Gainesville, Georgia for the 3-day course.

Bonds are dollar equivalents, so with the dollar now being devalued by $85bn per month by the Fed, it should not be long before the bond buyers, who are fast losing purchasing power, to force interest rates higher. Over 60% of our T-bonds are held by foreign entities, namely the Chinese and Japanese governments. Similar to the way the Kings of England would reduce the gold content of coins to

fund wars, Operation Twist compounded by QE3 are in essence the same sort of Financial Repression. Sooner or later lenders will revolt.

The Bear Market for bonds just kicked off in 2009, as measured by the ***orthodox top*** in price and the ***orthodox bottom*** in interest rates. Of all the tools for projecting the market, only Elliott clearly follows a transition with each reversal, which provides an approximation of the subsequent move's trajectory by its size. ***While bonds often move inversely to stocks, in Bear Markets they tend to nose dive together.***

Since the market is a ***fractal,*** meaning that its patterns remain the same, no matter how much they are blown-up or shrunk down, the big picture gives us the ***"lay of the land",*** the shorter intervals provide the insight that a scientist might derive from viewing a slide through a microscope. As Benoit Mandelbrot was fond of saying ***"once you see fractals detailed for the first time"*** they become only logical and obvious.

The Critical *Degree of Trend*

While Elliott dissects the market into 5 waves, regardless of the time frame, it's of paramount importance to understand the *relative perspective* provided by the ***degree of trend***. To illustrate, five waves of ***Cycle degree*** require between 60 and 70 years to complete. Of these five, ***"corrective waves" 2 & 4*** become Bear Markets enduring approximately 8-12 years. One degree higher, at ***Supercycle degree,*** the same five waves should complete in approximately ***300 years!*** Therefore, it should come as no surprise that a ***Supercycle Bear Market requires no less than 25 to 30 years to run its course***. For example, the Bear Market that ended in 1932, thought to have come out of nowhere in 1929, actually had its origins in 1908-1909, as confirmed by the *record low* P/E & ***q ratios*** in recent ground-breaking research on historical "valuations" work done by Smithers & Co.

Therefore, those who claim to have *out-performed* in good markets and bad, are only kidding themselves. No one who was active in the market in 1932, still works today. Although two Bear Markets of ***Cycle degree*** occurred in the interim, these are a ***log*** step smaller than the current ***Supercycle Bear Market.*** As in 1932, a portfolio of stocks held from now to the trough must lose at least 90% of its value. The inverse is also true, this Bear Market present one of the greatest money-making opportunities of our lifetimes.

Yours,

Eduardo Mirahyes
Exceptional Bear

"Opportunistically timed investments that mazimize wealth"