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May 2010 – Update 2

Crash

It always sounds more than a bit stupid and alarmist to predict a crash, but I did it in 2007 and nailed it. I am going to do it again now (whether I'm right or not remains to be seen).

I think there is a very high probability that the markets are going to crash within the next two days to two weeks.

There I said it.

It doesn't make me feel any better, however.

If I am right then we will be ushering in the full force of phase two of the *Great Debt Deflation*. This is the lead up to what may potentially be the largest-ever financial crisis the world has seen.

I don't say these things lightly. It is not for shock value. I am actually now so nervous I can't sleep at night. I get these feelings rarely. I am not lying when I tell you I have only felt like this in 1994, 1997/8, 2000 and 2007.

The facts

I don't get magic gut-feelings from nothing. I get them when the vast array of facts point to a cataclysmic event; when the probability of a horrific event is extremely high.

I don't need to tell you about the risk of a domino effect of sovereign defaults bigger than anything we saw in the early 1930's. I think you know my thoughts on this already.

I think the current list of dominoes is: Spain, Portugal, Ireland, Italy, Greece, Latvia, Romania, Hungary, China, UK and Japan. It could eventually extend to South Korea and possibly even the US, but that one is much farther down the line.

Let me remind you that the ten largest debtor nations on earth have total debts of \$135trillion. If that chain of sovereign events is ignited there will be no stopping it.

I cannot even begin to imagine what the consequences will be. We need to take one step at a time. It's just too much to get my head around in one go.

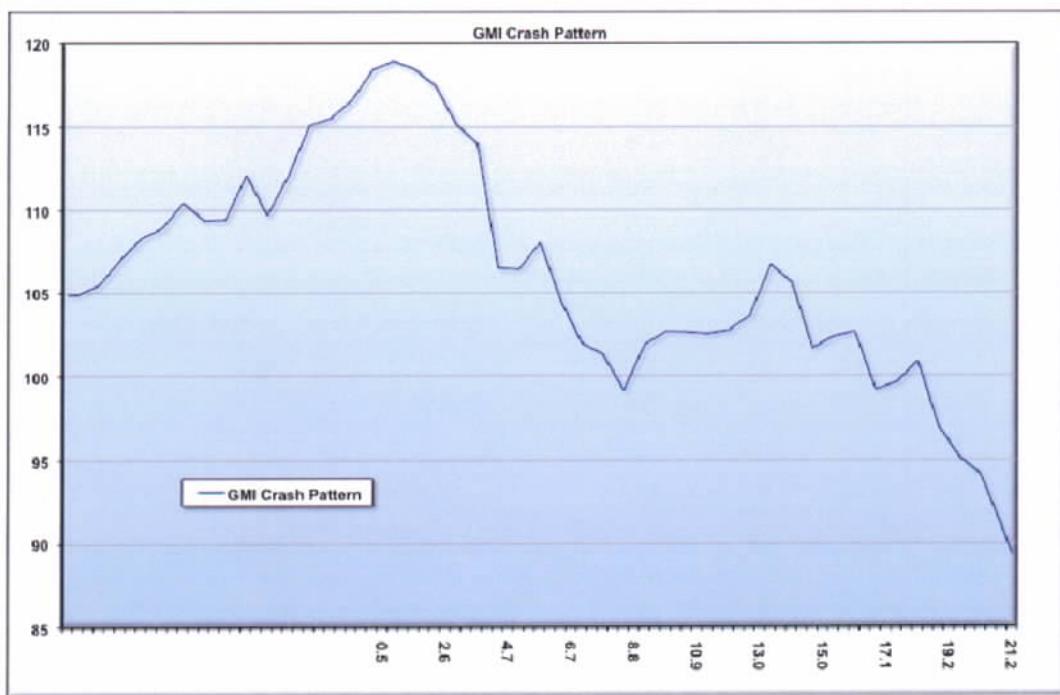
The chart patterns

The reason I am now getting the goose bumps and a dry mouth is because of the current patterns that the markets are exhibiting.

The GMI Crash Pattern

Markets that crash tend follow very similar patterns. The pattern that I take the most seriously is the GMI Crash Pattern. It is one of the key patterns seen ahead of waterfall declines.

Let me remind you of the pattern...



Essentially, the pattern is that of a sharp decline, followed by a failed rally that does not reach the previous high. In Elliott Wave terms this is referred to as a Wave 2 rally. What follows is a collapse.

Let's look at the current pattern in the SPX: it is exhibiting the same pattern (overleaf). What spooks the hell out of me is the "flash crash" of a week or so ago that no one believed happened. At first they blamed a fat finger, but in the end no evidence was found.

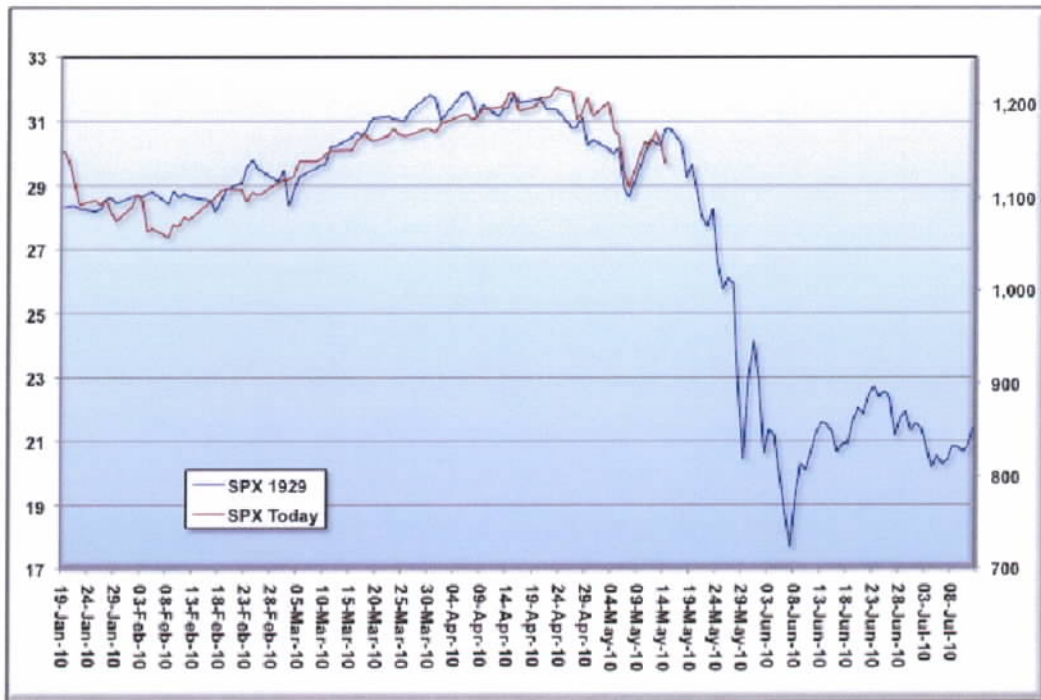
It was a real decline based on liquidity that had vaporised and a market that was incredibly long and crowded. It is a bad omen.



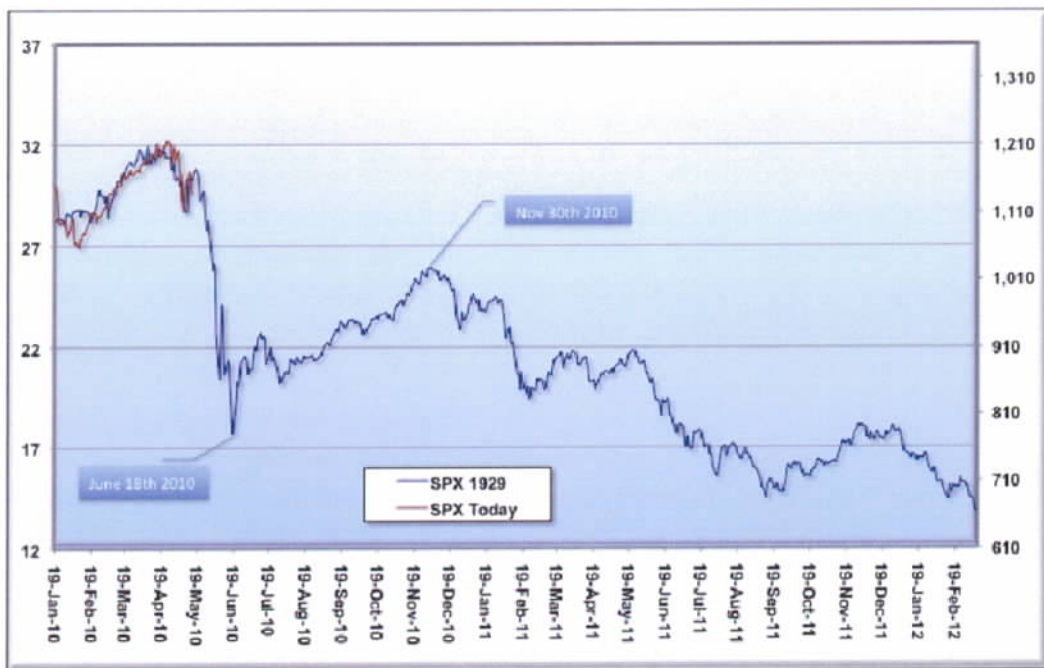
So as you can see from the chart above, we have the potential for this to be a failed rally. Due to the huge amounts of Demark top patterns that I have talked about for some time, I have to err on the side of expecting this rally to fail. Market breadth is falling apart too, as it should in a failed rally.

Repeat of 1929

What made me sit up and really take notice was how similar this current chart looks to the peak in 1929. Here is the chart...



It is a very similar pattern. However, when I show you the longer-dated chart (slightly rescaled) you get the full stomach-churning picture...

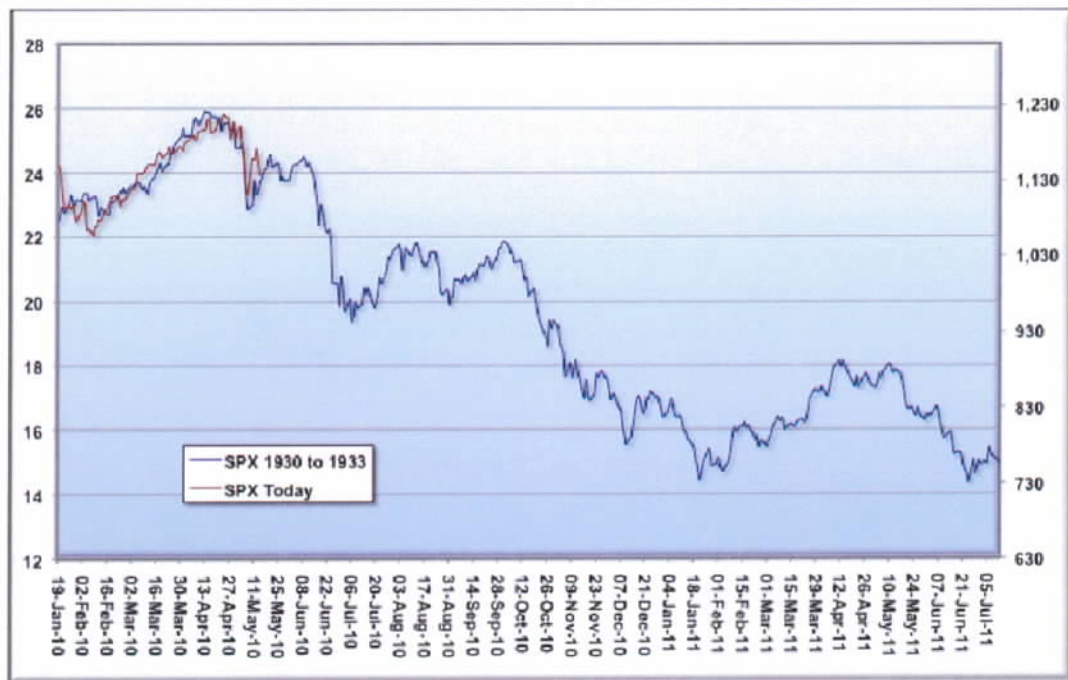


If we are to follow the 1929 crash we will not see bounces of more than one day, and a violation of the low will lead to a full crash. This suggests that we have two days before we go into collapse and will hit 800 by June 18th, hence the need to rush out this note.

1930 is the most likely outcome

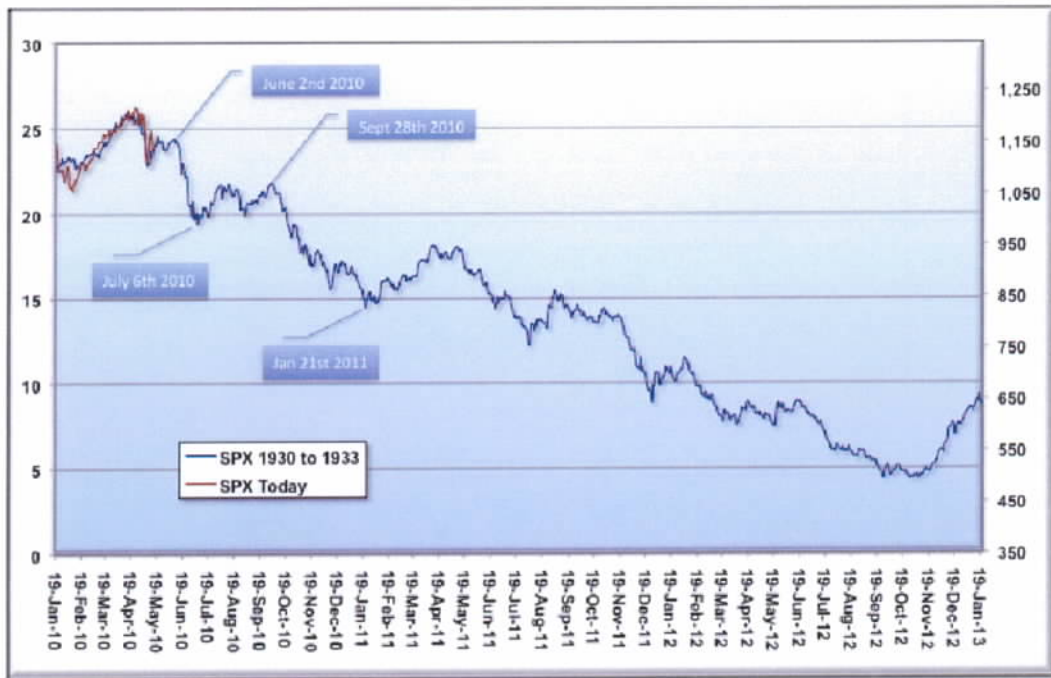
The next most similar chart is the crash of 1930, which historically speaking is a better fit (a backdrop of sovereign defaults after an initial financial crisis).

This chart, although initially less violent, has the sovereign debt crisis written all over it: gut-wrenching declines for a few years and a market down 90% from its peak...



The 1930 pattern gives us another small bounce before the collapse. This bounce would be completed next week before crashing into July, before consolidating and then falling sharply into next year. One week is not a lot of time to prepare for this either.

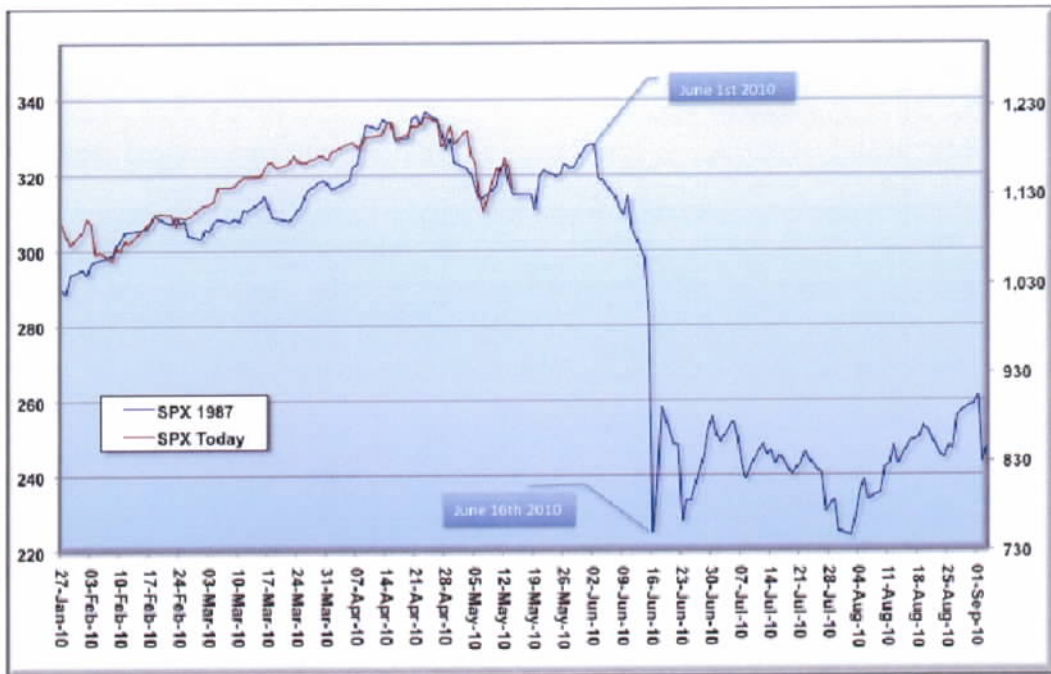
See the longer-dated chart for what I think is the most likely outcome, should the pattern evolve (overleaf). Remember it will never be a perfect re-run but a close fit initially, after that who the hell knows...



I don't know about you but the chart above scares the shit out of me...

1987... too close for comfort

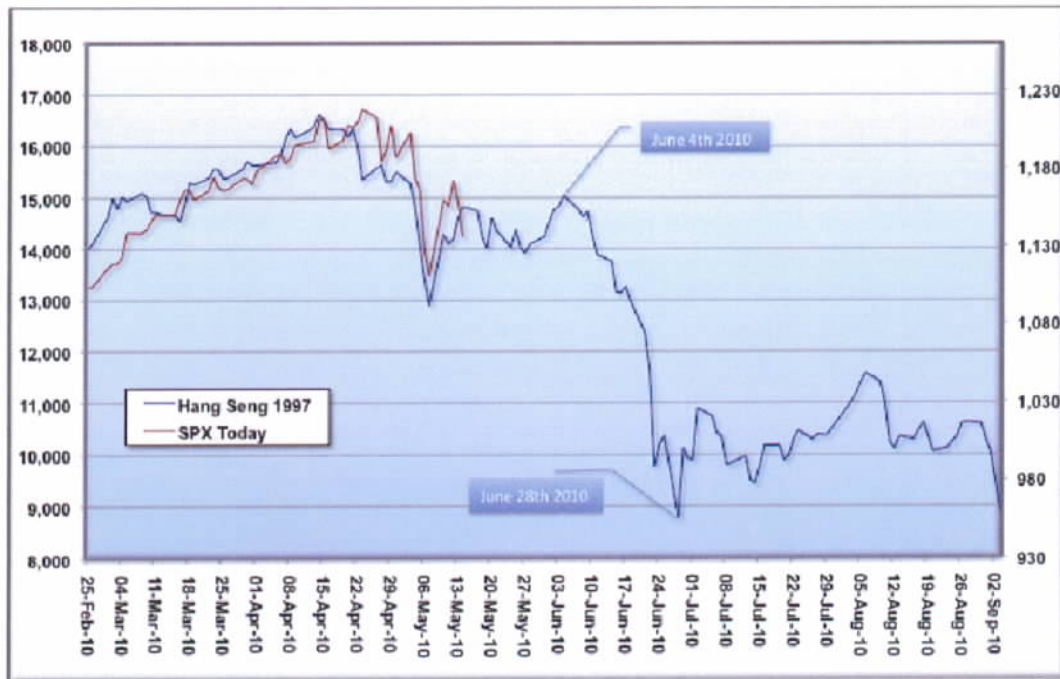
Anyway, the next chart is the 1987 crash, which also fits perfectly...



The 1987 chart also suggests that a bounce is coming, followed by the collapse starting on June 1st. That's nine working days...

1997 Hang Seng

The finally historical chart I want to produce as evidence is the 1997 chart of the Hang Seng. This pattern is almost identical and suggests a top in June 4th. Twelve working days...



A perfect fit

So now you can see why I am getting concerned. This pattern is a very good fit for many of the major crashes in the last 100 years. There are many more charts I could show but I think you get my drift...

Global meltdown

So, that's the SPX... what about other markets?

We have many other markets forming a rather rare chart pattern called a *Megaphone Top* (I'm not bullshitting... ..Google it). A *Megaphone Top* is also called a broadening top. You can see it clearly here in the Eurostoxx, overleaf.

A break of the recent low is the crash starting point...



The very same pattern is in the Footsie too...



And Australia...



Meanwhile we have two major markets in full crash mode already. Here is China...



And here is the IBEX...



Forget emerging markets...

And if I were you I'd rather not try to make the assumption that emerging markets will save you. They won't. Correlation goes to one. The most crowded trade and illiquid market get killed the most.

It is written.

A peek into the future – total crisis

What makes me fear that this is *The Big One* that ushers in the biggest crisis the world has ever seen, can be seen clearly on two long-term charts.

The Dow Jones overleaf, is forming a gigantic head-and-shoulders top. If the crash that I am predicting happens then we will break the neckline of this monster and the writing will be on the wall for peak-to-trough declines of 90% to 95%. I know it sounds stupid, but trust me it isn't. I am a serious student of market history going back 400 years. I don't do this for publicity. (I don't do publicity full stop.)