CHAPTER 1

BULLS VERSUS BEARS, AND THE WINNER IS . . .

Bulls debating bears has almost become a pastime sport on CNBC, or as I have heard it called, "the bull parade." Every day you can see the talking heads on TV argue their bullish or bearish cases. So many market prognosticators display their diametrically opposing viewpoints that they all sound equally convincing. One view is the prediction of a U.S. economic collapse, like Peter Schiff's in *Crash Proof* (John Wiley & Sons, 2007). Others, like the well-known market timing strategist Don Hays, predict "the greatest economic boom in world history" far ahead into the future. These equally convincing viewpoints leave most investors completely confused, less confident, and often misguided. To add to the confusion of the market prognostications, market gurus, traders, and investors alike are usually way too bullish at the top and too bearish at the bottom.

In this book, you'll learn how to navigate your financial future in what is shaping up to be the market roller-coaster ride of a lifetime ahead for U.S. and world markets. To wisely position your finances for the boom and bust periods that are ahead, let's look back to the past market debates in one of the biggest boom and bust period of this generation, 1995 through early 2008. Understanding the past psychology versus the actual realties will help you better position your investments for the future.

In the bull market run that started in early 1995, Oppenheimer's bearish chief investment strategist, the late

Michael Metz, advised clients to be cautious and raise cash right when they should have been buying stocks with both fists. At the same time, Elaine Garzarelli, chief market strategist of Lehman Brothers, debated the exact opposite. Elaine was so bullish in 1995 that she was fired because her views seemed so outrageous and contrary to the consensus sentiment after a very difficult 1994 market. However, the more bearish Michael Metz became on the stock market, the more airtime he received. As stocks rallied ahead, Elaine's bullish views were vindicated and she was granted celebrity status on Wall Street. When Michael Metz showed up at the floor of the New York Stock Exchange with his full bear suit on, he was most likely avoided as though he had some kind of transmittable disease because of his wrong bearish stock market calls.

At the very height of Elaine's fame, she had a change of fortune. On July 26, 1996, Elaine issued her widely advertised "Sell All Stocks Now" call right as stocks again launch-padded to new all-time highs. She ultimately had to reverse her bearish call after missing a huge bullish move by "making new changes" to her market timing model.

Probably the most advertised bullish market call early in the bull market came from Ralph Acampora in June 1995 as the Dow Jones Industrial Average (DJIA) was approaching 5,000. Ralph was the chief technical strategist for Prudential Securities, and he put out a detailed report titled "DOW 7,000." Ralph made a great call and caused quite a stir when he issued that report.

As the bull market was preparing to turn bearish in 2000, the three biggest bullish talking heads were Al Goldman, chief strategist of A.G. Edwards; Abby Joseph Cohen, chief market strategist of Goldman Sachs; and Joe Battipaglia, head of investment policy at Gruntel. These three famous bulls—Al, Abby, and Joe—had incredible airtime, and each became famous as a result. To their credit, they were correct on being bullish in the previous bull market run. To their detriment, they overstayed their welcome.

Another bull that received major airtime at the top was Brian Finnerty, head of Nasdaq trading, C.E. Unterberg, Towbin. I remember watching Brian on CNNfn on January 27, 2000, recommending JDS Uniphase (JDSU). In his very gruff voice, Brian said, "JDSU gave us a great number yesterday . . . JDSU is trading at 200 times earnings. But is that overvalued? I don't know." Shortly thereafter, JDSU then went on a slide from $155 to $1.55, only a small decimal change, but an enormous price change!

Also on CNNfn we had the famous Liz Ann Sonders, then managing director of Campbell, Cowperthwait (currently chief investment strategist of Charles Schwab and Co., Inc.) say this regarding JDSU, "Love it both long term and short term." She, too, loved the stock market and went on to recommend AOL, CSCO, Enron, and Broadcade before those stocks imploded 70 to 100 percent.

My personal favorite example of watching a talking head on the TV getting humbled was Ned Riley, chief investment strategist at State Street Global Advisors. Ned was a "perma-bull," and to prove it he was quoted as saying, "I'll be recommending the QQQ (Nasdaq 100) until the day I die." (*Sources:* CNN, *Moneyline Weekend*) He not only was married to the market, but to individual stocks as well. He was strongly recommending Elan Pharmaceuticals (ELN) in late 2001 on CNBC. This was his favorite pick, and he still loved it all the way down from the 60s, where he recommended it, to the mid-20s. ELN continued to head down, and the stock was one of *the* biggest losers in terms of the pure speed and pain of its fall. The stock bottomed at $1.03—so much for the experts.

In 2000, Al, Abby, and Joe's bullishness was diametrically opposed to the bearish outlook Don Hays, chief investment strategist of Wheat First Butcher Singer, had at the time. Don was calling for a big smash in stocks after being a long-running bull. As turmoil was sweeping through the world financial markets like an uncontrolled maelstrom in 2000, Al, Abby, and Joe were table-pounding bullish all the way down. On each big bear market rally in Nasdaq 2000, these three strategists were immediately paraded all over CNBC spewing the only action they understood to take—*buy, buy, buy.* Investors who listened to their advice saw their equity go bye-bye in the market devastation that followed.

Don Hays, however, kept his clients out of harm's way, albeit early on his bearish market call. After the Nasdaq 100 had collapsed 83 percent, Al, Abby, and Joe were avoided like the plague by the media. Don Hays—or as I like to call him, "Big Daddy Don"—then came out of his bear cave with his full bull suit on right at the bottom. Don has remained a bull, looking for "a new golden era of prosperity" for the United States even as stocks have been getting crushed in 2008.

Is It Doom or Boom?

Don Hays sees a new golden era of opportunity with low inflation ahead for the United States. He sees the market as the "most undervalued in 29 years." This outlook is greatly contrasted with Peter Schiff of Euro Pacific Capital. Peter is a stockbroker and controversial author of *Crash Proof.* At one time he was on the TV almost weekly debating any bull that came his way on why the U.S. economy is about to get annihilated. You can see Peter's past debates on his web site at www.europac.net. They are very lively and entertaining to watch. Peter sees the U.S. dollar on the verge of a complete and utter collapse.

He is still advising all his clients to get all their money out of the now rising U.S. dollar to buy high-dividend-paying foreign stocks, even as markets world wide implode.

Don Hays, however, thinks the United States is in the "second wave of the technological revolution." He sees a long and mighty boom coming on as new consumers and workers in India and China will keep demand high and wage inflation low. Peter is 100 percent out of U.S. stocks and dollars and sees mass inflation and financial destruction for U.S. assets ahead. Don Hays is 100 percent invested in U.S. stocks and sees great times ahead for U.S. stocks, bonds, and the U.S. economy. Peter points out that the huge trade and budget imbalances in the United States and the zero savings rate are leading to a U.S. economic meltdown. The bulls, conversely, see all the newly created wealth in investors' retirement and Keogh accounts as evidence of U.S. economic strength and power.

Personally, I can see both arguments having some credibility and possibilities. This is why it is imperative to have a strategy to protect *and* profit regardless of the boom or doom market calls you are hearing professed so loudly. I refer to this as having a short-side strategy. A short-side strategy employs stocks long *and* short for bull or bear markets ahead. It is a strategy that addresses the twin forces of inflation and deflation, which is called stagflation. It is an easy-to-understand commonsense strategy, regardless of your level of sophistication in the market.

Discover the Upside of Down provides you with proven indicators for spotting major market direction changes. My short-side strategy will help you recognize warning signs so that you are ahead of boom or bust times and positioned properly for both. I will share personal stories of triumph and failure that will be both educational and entertaining. You will see why most investors should deploy some form of a short-side strategy today and for the foreseeable future. Later in the book I will also share with you an incredible market timing indicator I discovered to help you execute on this short-side strategy.

Bulls and Bears in Ojai

In 2005, I went to an enlightening stock market conference for professional investors and traders in Ojai, California, called "Minyans in the Mountain Retreat." Minyanville is a very cool interactive web site (www.minyanville.com) where great minds share their keen market views. This Ojai conference had some brilliant strategists and forecasters all sharing their outlook, mostly on the U.S. stock market.

I was highly impressed but amazed at how such successful market forecasters could have such deep convictions so opposite each other. Tony Dyer, a market strategist of excellent insight, predicted a rip-roaring bull market to come. He showed how undervalued the markets were and his argument was very sound. John Succo, a proven and brilliant hedge fund manager of Vicis Capital, envisioned a coming economic hurricane to wipe this country off the face of the economic map. His views stem from how many additional dollars of debt are now required to generate a single dollar of gross domestic product (GDP). In John's own words, "In 1980 it took $1 of new debt created by the Fed to generate $1 of GDP. In 2000, it was $4 of new debt for $1 of GDP. In 2007, it takes $6." John goes on to say, "So as liquidity grows (inflation), the forces of liquidity reduction (deflation) grow as well. At some point, the probabilities of deflation (debt reduction) will become manifest."

John sums this up well with, "So as things look better, they are actually getting worse." I quote John here because *Discover the Upside of Down* explores the possibility of an economic collapse in detail.

This is important for you as an investor today to understand because of the potential consequences to your portfolio, as well as our country, which could develop if this deflation thesis is in fact correct. We will thoroughly explore the global ramifications in this book. Most importantly, you will need a well-defined strategy for protection, then profit, if such a dire forecast were to materialize. What if this global economic boom were in fact built on reckless amounts of debt taken on by the U.S. government and real estate speculators? What if this asset inflation in stocks and real estate were to suffer a collapse resulting in forced debt reduction? Are you fully prepared with a strategy to protect and profit if such a dire scenario were to unfold? Will you recognize the proven and dependable signs to get out before calamity strikes?

The Ojai conference had many roaring bulls and growling bears of equal stature and intelligence standing at polar opposites. One of my favorite presentations at the Ojai conference was from Steve Shobin. Even as a technical strategist, Steve believes that fundamental analysis is just as important as the technical side of the market. Steve Shobin is not only one of the most brilliant market technicians, but he is also one of the all-time great human beings. Steve's strategy is not to live or die on a big market call. Steve looks at both sides of the market and trades on both sides of the tape.

My sense at the time in Ojai was that the audience and the guest panelist were overall bearish, which was a short-term bullish signal for the market from a contrarian's point of view. This was an outstanding and very educational conference that brought me home asking the question, "What if? . . ."

You should ask yourself this same question, *What if the market bears are right and financial destruction lies dead ahead?* The bullish and bearish forecasts all had a ring of truth to them. The irony was that both John's bearish views and Tony's bullish views had equal merit. With the combination of low interest rates and a flowing river of liquidity, how can the market and the economy fail to boom again like the bulls predict?

There's a flip side to that bullish coin, however. If the combination of prolific money supply growth and chronic twin deficits in the United States continues, how can the dollar possibly avoid an outright collapse, or, at the very least, a currency crisis of some kind? The real question is: How does one safely trade or invest in an environment where you can protect and profit if a boom or bust lies immediately ahead? Throughout this book I will be emphasizing just such a strategy.

My contention is that if asset prices can stay elevated, then the prodigious net worth of U.S. investors will result in manageable levels of debt. If the U.S. dollar or bonds don't collapse and foreign central banks and investors choose to finance our debts and deficits, then we can avoid the financial catastrophe of stagflation.

The other side is that eventually this debt-induced boom will prove largely false as stocks, bonds, or real estate experiences an outright price collapse. If this happens, the U.S. economic boom will go *ka-boom,* just as the bears are forecasting.

Here's where I come down on all of this after 21 years of studying markets. I have seen flash-in-the-pan strategists come and go, and they all have one thing in common. They have made a big market call, bullish or bearish, at the wrong time and their fame was short-lived. The short-side strategy that I describe is flexible and positions your portfolio for protection and profits on both sides of the market in domestic and global stocks as well as in noncorrelated markets.

The Bad News Bears

The bears have taken the biggest beating in this respect by looking foolish with end-of-the-world market calls at the wrong times. I'd have to say that Robert Prechter wins as the number one Bad News Bear in terms of bad timing. Robert put out two books looking for market devastation. Both of these books called for the end of the bull market right as the bull was ready to run like never before. His first book, *At the Crest of the Tidal Wave* (New Classic Library, 1995), came out literally at the bottom of the stock market in early 1995. His second book, *Conquer the Crash* (John Wiley & Sons, 2002), came out at the next bottom in 2002. This is horrible stock market timing, but a perfect time to market these books as fear gripped investors at the bottom.

Peter Schiff is now by far the most vocal bear and is often featured by the media. Investors have seen Peter on TV because of his daunting comments of a currency collapse coming in the U.S. dollar. To his followers, this call appears to be slowly playing out as the dollar in 2008 hit all-time lows on the U.S. Dollar Index. Peter's call on gold was right on the mark as gold went to new highs. His calls on a collapsing U.S. economy and stock market have many of Peter's followers waiting in great anticipation. Could Peter Schiff of 2008 be what Michael Metz was in 1995, or could Peter be correctly bearish right in front of a market collapse?

Peter is advising his clients to put all their money in foreign stocks and gold. However, foreign stocks closely follow the U.S. market in terms of direction, as is widely evidenced by recent and historic bull and bear market moves in U.S. stocks. Peter is buying high-dividend-paying stocks as his strategy for client protection but even high-dividend-paying stocks can crash.

A short-side strategy addresses both sides of the market and depends solely on neither. Only time will tell if Peter's dire U.S. economic call is correct. One thing is correct: Peter may or may not be a market genius, but based on his successful media recognition, he is a marketing genius.

The other bear who took it on the chin in the late 1990s was Gail Dudack, market strategist of UBS securities at the time. She was one of the "Elves" on the Louis Rukeyser show, *Wall Street Week.* I personally thought the show was the best, and it was truly one of the all-time great shows to watch on the stock market. The "Elves Index" was created by the late Lou Rukeyser in 1989 and it had a very poor track record of market timing results. He had 10 panelists voting on the market's direction. The index was so bad that it became a contrary indicator, so when the Elves were bullish on the stock market, that was the signal to start getting cautious. He was getting pretty upset with Gail Dudack on his TV show because she had a long-running bearish stock market call. As the Nasdaq bubble train was gaining a full head of steam, Gail dug her feet in even more and stayed true to her bearish outlook. You could see the frustration on Rukeyser's face as he resorted to mocking her bear market calls live on the show. In November 1999, right near the all-time climactic top in Nasdaq, he replaced her with Alan Bond. The "Elves" then became almost uniformly bullish right at the top in March 2000. I spoke to Gail right after that firing and told her that redemption was shortly coming on her early, but correct, market call. Of course, the dot-com bust began just a few months later!

What about the long-term outlook espoused by today's popular market forecasters? In the bull's corner, you have Don Hays, who thinks gold, oil, and commodities of all kinds have built up potential bubbles like that of Nasdaq 2000. Don sees a continued long-running U.S. economic boom like the world has never seen. This view is 100 percent diametrically opposed to Peter Schiff, who is calling for a U.S. economic apocalypse. Whom can you believe and which judgment can you trust?

What if you are a bear only shorting stocks, or are in cash and Don Hays is right and stocks resume their boom higher and higher? What if Peter Schiff is right and a severe crash is right around the corner and you are 100 percent long stocks in your 401(k)? This is why, in this new era of volatility, that *both* sides of the market need to be addressed even by the most bullish or bearish of investors.

Because you, and everyone else, do not know for sure if a protracted decline is ahead, you must first position yourself for protection, then profit. Your strategy should provide you stock market crash insurance in case the U.S. stock market is a gigantic house of cards ready to collapse. Because you don't know if a boom is to resume once again, you must also be in a position to profit if Don's new golden age of prosperity were in fact to happen. You must learn how to be prepared with crash protection for either future scenario. In this new era of market volatility I see ahead, you must be willing to look at both sides of the marketplace, long and short.

No one can see the future—absolutely no one. If an unexpected event like the U.S. or Israel attacking Iran occurs, as some have predicted, then stocks will implode and the bulls will be wrong. If the dollar reverses and money continues to flood into U.S. assets, then the bears will have egg on their faces. The fact is that the credit buildup in the United States has never been so incredibly high. The other side is the fact that huge amounts of net worth have also built up in stocks and real estate in this long and mighty boom.

I will help you recognize the many classic signs of a market top so that you can make wise and timely adjustments to your portfolio. These signs often present themselves after the Fed has been cutting interest rates and bullish sentiment rises to an extreme like the stock market top in late 2007. I will also show you how bull markets climb a "wall of worry" and die in an atmosphere of euphoria, and how to easily recognize both.

From a long-term viewpoint, stocks are perched up very high and there is precedent that a long-term bearish or sideways trend is likely. Any unexpected outside event like a dollar collapse, an interest rate crisis, or a surprise attack on Iran could send stocks into a great and mighty crash. If one of these scenarios were to happen, it would create a giant global margin call where assets fall below all the massive amounts of debt stacked up against stocks and real estate. This giant global margin call would negatively impact stocks and economies around the world. The exposure to stocks and real estate has never been higher, as evidenced by the largest percentage of U.S. household ownership of stocks and real estate in the new century. The affinity for stocks and real estate is further evidenced by the record high levels of margin and mortgage debt so investors have the highest exposure possible to these two major asset classes.

From a cyclical point of view, the bullish case could very well take place whenever the Fed is aggressively cutting interest rates and flooding money into the system. From a long-term secular point of view, the warnings made by the bears should convince investors to be prudent regardless of which side of the fence they are on. Most believe that Peter Schiff's nihilistic viewpoint of getting all your money out of the country is over the top, but the warnings cannot be ignored. He was correct on his call of a falling U.S. dollar. What if Schiff is right about the U.S. economy and stock market devastation is yet to come? Are you prepared, or are you a long-only investor?

Don Hays is one of the better investment strategists I witnessed from 1987 to 2007, so bears must also beware. With all these confusing and conflicting, but convincing arguments, you must position your portfolio with a safe and sensible strategy to protect and profit in future boom or bust, bull or bear markets. My philosophy is not to be a hero on a big market call, but to present a flexible strategy to make money with some peace of mind regardless of what scenario the talking heads on TV say will happen. *There is the bull side, the bear side, and money to be made on both sides.* Learn to focus on keeping your portfolio most heavily on the right side but positioned on both sides of the market. As the legendary trader Jesse Livermore once said, "There's only one side of the market that counts and that's the right side."

The Bull Parade

I truly never thought we would see the kind of market hysteria with the bullish gang on CNBC like we saw in 1999, but I was wrong. A new member was added to the bullish gang, and you can hear him screaming stuff like "The Bull is alive" and "BUY, BUY, BUY" or "SELL, SELL, SELL" every single day. Jim Cramer has now become the leader in the bull parade, fully equipped with loud horns and crazy sound effects used during his daily market show. Jim has become a larger-than-life symbol to investors worldwide because of his keen insights and his crazed antics. He is a former successful hedge fund manager who gained his fame when *60 Minutes* did a piece on Jim trading stocks for his hedge fund. It was a great piece to watch, and at the time I thought Jim was just some wild man day trading stocks. Then, to my amazement, CNBC hired him and gave him his own TV show.

Jim is very sharp and a well-liked guy. He has been able to wisely capitalize on the general state of bullishness and excitement that exists in the stock market. The truth is that Jim has become the face of the market. As he has become Mr. Market himself, people all want to know, "What does Cramer think?"

Cramer has become so big that *BusinessWeek* featured him on the front cover of the September 2005 issue. When I saw this article, it gave me great pause as I remembered the now infamous *BusinessWeek* cover titled "The Death of Equities" in 1979. It took a couple of years after that cover story before the market reached its final secular bottom and then roared ahead. That article put a long-term secular bottom in for the stock market as stocks eventually went on to the longest bull market run in U.S. history. Stocks went on to become a table-pounding buy-and-hold for decades.

I have to wonder if *BusinessWeek* positively featuring Mr. Market himself on the cover in 2005 isn't also setting up for a new secular move, this time putting in a long-term secular market top. Again, it took a couple years before stocks reversed course from the 1979 article. Having Mr. Market himself featured positively on the front cover of *BusinessWeek* in 2005 could be as contrarian as "The Death of Equities" front cover was in 1979. If the *BusinessWeek* contrarian indicator holds true, then we saw the top in 2007 and we are on the cusp of the best time to deploy the short-side strategy presented in this book. A front cover article in *BusinessWeek* is a great indicator of the nation's emotions near the peak or bottom of a long business cycle.

I will say this about Jim Cramer and the power of CNBC. Jim's TV show has made him so popular that he could become the next president of CNBC. If the DJIA goes to 39,000, like Japan did in the 1980s, then Jim even has a chance of being elected president of the United States—he is that famous. Personally, I admire the guy for what he has accomplished and, given the current and likely future state of U.S. politics, I'll be Jim's first vote if he runs for president.

If It Looks Like a Bubble . . .

The Bond Bubble

Bonds have been in a long bull market since the early 1980s. Bond prices collapsed in the 1970s as oil exploded and inflation ripped through the economy. The Fed pumped too much money under Presidents Nixon and Johnson, which led to rip-roaring inflation, resulting in crashing stocks and bonds. A prudent investor should note some eerie similarities between the present and the 1970s period of stagflation.

As I write, we are having a similar crisis, yet yields on bonds have stayed low. The Fed has been inflating the money supply as it did in the 1970s, yet bond prices are stable and rising, as bonds are responding more to the deflation side of the stagflation equation.

Commodities of all kinds also raced to new all-time highs in the big 2001 through 2008 run. This can be seen in the Commodity Research Bureau (CRB) index, which is a basket of commodities that comprise the index. The CRB posted record highs as oil exploded to triple digits in 2008. This put the 2001 through 2008 upside move well ahead of the 1971 through 1974 146.7 percent gain in the CRB index.

Gold touched $1,000 an ounce in 2008 and registered new cycle highs like in the 1970s, yet all we hear about is that there is "little to no inflation." The bond market has been ignoring these traditional inflationary warnings, which has many economists and bond bears raising their eyebrows. To add to all of these bearish bond indicators, the U.S. Dollar Index has been weak for the first several years of the new century. To top it all off, the Federal Reserve cut interest rates in 2007, and aggressively in 2008. These rate cuts are like pouring gas on a slow-burning fire. A wild fire of inflation could spread and eventually send bond yields through the roof and bond prices into the abyss. If inflation does spiral out of control, then interest rates will likely double or triple, like they did in the 1970s. This is when the Federal Reserve will need to follow the proven formula for fighting inflation, which is cutting the money supply and hiking interest rates.

A simple way to play the downside in bonds is to put money into the Rydex Juno Fund (RYJUX). If the 30-year Treasury bond is to fall 10 percent, then the Juno Fund is designed to go up 10 percent. (Go to www.rydexfunds.com for more information.) The market professionals short bond futures to hedge against rising interest rates, but the futures market is no place for novice investors. When the charts on bonds finally do top out and line up with the fundamentals, get short. As bonds reverse course, the 25-year bull market will be over and a generational bear market will begin.

Paul Volcker fought 1970s inflation by cutting the money supply, forcing up interest rates. Once the inflation fight begins, bonds will fall out of bed as interest rates rise. More recently, the huge money supply buildup in the Greenspan and Bernanke era has been the lifeblood of stocks, real estate, and debt creation. If the money supply is ever to be cut, then the current slow-motion real estate decline will move into fast forward. This would kill consumer spending, which would take the economy and stocks down like in the 1930s, creating a daisy chain of destruction, where one negative event feeds upon the other. This would result in what will likely be coined "The New Great Depression of the Twenty-first Century." The difference this time is that it will feel more like the New Great Depression but combined with inflationary pressures in a New Era of Stagflation.

The forces of deflation in a stagnant economy combined with rising inflationary pressures is what I call the Stagflation Equation (Stagnation + Inflation = Stagflation). Deflation is what happened to Japan when its economic miracle turned into a nightmare. Interest rates dropped to low levels, but Japanese investors had no desire to borrow and take on additional debt, no matter how low interest rates went. As the U.S. mortgage debt bomb explodes, debt will be shunned once again, especially for highly speculative purposes.

Bonds are currently setting up to be one of the great short opportunities eventually leading to one of the great long-term buying opportunities in the future, once the Fed fights inflation rather than igniting it. This is important to know as bond prices typically fall first, leading to severe stock market reversals within 6 to 12 months. In the new environment of stagflation, stocks can go down even as bond prices hold up. Bonds can suddenly reverse as the Fed starts to cut money growth as it focuses on reducing inflation from the dramatic rise of costs for goods and services in the economy. That will be the loud bang that pushes U.S stock momentum down the mountainside like a cascading avalanche.

This is why I named Chapter 6 "Nothing but Downside." When these events come to pass, there will be nothing but downside in stocks, bonds, and real estate for quite some time in the future. This will most certainly happen once the Fed is forced to cut the money supply and hike interest rates. Another reason for the chapter title is that investors who buy at the top experience nothing but downside, and investors who sell at the bottom see nothing but downside.

The Real Estate Bubble

Real estate has been in a bull market for 50 years, but hit a serious bump in the road in 2005. This bump is looking more like a major pothole based on all the negative news concerning the state of real estate in 2006, 2007, and 2008. The question to ask is, "What if the pothole is the Grand Canyon—then how significant is the downside yet to come in real estate?" We will explore that question in the book with interesting stories and real life experiences.

The fact is that this real estate bubble is not a domestic one, it is a global phenomenon. At the top in 2005, *The Economist* magazine called the housing boom "the biggest bubble in history," with "world residential real estate values escalating from $40 trillion to over $70 trillion" in the last decade's bull market run. The article pointed out that the $30 trillion increase in world residential real estate values is just about equal to the GDP of the entire advanced world. Housing prices in the United States, Australia, Spain, Ireland, and the United Kingdom exploded in price during the 1995 to 2005 bull market run. *If it looks like a bubble, acts like a bubble, and feels like a bubble, then it must be a bubble!* The evidence of the air slowly coming out has been seen on a weekly basis since that article came out. You know this is a serious concern of the Federal Reserve by the Fed's aggressive policy actions. The Fed cut interest rates in 2007 and 2008, which is exactly what they did in 2001 when they tried to slow down the Nasdaq crash. Nasdaq fell over 80 percent before the bottom finally hit. How far can real estate prices fall before they reach their ultimate long-term bottom? Again, read on as I explore a 1929 downside scenario to come from a debt contraction cycle that has begun. The problem with bubbles is that when they burst, they typically overdo it to a downside extreme like they overdid it on the upside explosion.

The Commodity Bubble

The CRB posted a high in 2008 exceeding its best move ever of 146 percent from 2001. Speculative momentum buying sent gold, oil, copper, silver, platinum, and almost every other commodity to dizzying heights. The U.S. dollar hit its lowest level ever and that boosted the price of real assets that are priced in terms of depreciated dollars. The commodity bulls believe that the combination of a continued weak dollar and the apparent insatiable appetite from China and India for energy and metals will propel prices much higher far into the future. The famous commodity investor, Jimmy Rodgers, has come out with another book that encourages investors to buy China and commodities. Jimmy was interviewed on Bloomberg TV in November 2007, saying he is getting all of his assets out of the United States and out of U.S. dollars. He said we have "a lunatic Fed chairman" that is going to blow up the U.S. currency with his reckless Fed policies. He sees the commodity run as early in its bull market. With the price of oil and oil stocks running wild both up and down so violently, one has to wonder if we aren't once again seeing another price bubble like Nasdaq 2000.

Regardless of what the commodity bulls think, the easy money has most likely been made in commodities. If the U.S. dollar does have a currency crisis, then commodities will have another blow-off-like run before putting in a final top. As the China bubble blows, the perceived insatiable demand for commodities is withering and the commodity bubble appears to be popping. More details on this later in the book, but suffice it to say that looking ahead, investors and traders will also need a short-side strategy in commodities. Long-only investing in commodities will no longer work because, as they say on Wall Street, "trees don't grow to the sky."

The Stock Market Bubble

The secular boom in stocks has been a very long one indeed. Stock prices have enjoyed the best of all worlds in the "Goldilocks" economy, not too hot and not too cold. As real estate has its "perfect storm," investors continue to pour money into stocks even as prices fall. Stocks are competing with weak real estate and unattractive bonds. In 2007, stocks experienced a merger and acquisition boom that lowered the supply of stocks outstanding. This propelled the DJIA and the Standard & Poor's (S&P) 500 to all-time record highs in 2007 right before they severely corrected into bear market territory in 2008. Money goes where it feels the safest and is treated the best, and over the long haul that has been in stocks. The concern of many investors, including myself, is how bad will the economy and stocks get if real estate weakens considerably or interest rates finally start to rise?

From a wide-angle viewpoint, stocks, bonds, commodities and real estate still look very high and overvalued. This does not mean that certain stocks in hot sectors or the market cannot rise substantially. It also doesn't mean the real estate market can't have a mild recovery and quite possibly, yet unlikely, boom ahead. With bond yields so low, many see stocks as undervalued relative to bonds, and mortgage rates favorably disposed to future gains in home prices. If I am correct about the coming substantial rise in interest rates, then stocks and real estate will not look as cheap or desirable as the economy falls and jobs are lost. The other concern is that the first two years of a new presidency can be very difficult and volatile for the stock market.

How does everything seem to you? Do you think stock prices are attractive and cheap? Do you think real estate prices are low, undervalued, and affordable? Do interest rates look attractive to you with low, single-digit yields? There is a case to be made that from a long-term secular point of view, there could be nothing but downside pressure in stocks, bonds, and real estate.

This book is not intended to be pessimistic, but a realistic explanation why most investors should have a short-side strategy to counter the new economic force of stagflation. More importantly, this is a strategy to deploy no matter which camp you fall into, bull or bear. So let's *Discover the Upside of Down* with my message summarized in nine words: Bull or Bear, Boom or Bust, Long *and* Short.