PART I

ANATOMY OF A SUPER BOOM

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Dow 38,820 by 2025 may seem incredible at this current juncture in our economic, political, and financial history, but as you will find out throughout these pages, it is mathematically reasonable and requires no big leap of faith. Moves of this magnitude have happened several times before at similar points in history with such regularity and clear causes that you will agree by the book's end that the potential for another super boom is undeniable.

When *Stock Trader's Almanac 2011* first hit the street in October 2010 and this forecast became widely known, skeptics wrote, e-mailed, blogged, and invited me on the air for cross-examination. My good friend and colleague Barry Ritholtz e-mailed me the same three letters he posted to his blog, *The Big Picture*: "WTF?" After explaining the logic behind my prediction, he followed that up with a post that the move was well within the average annual historic market gains. Despite the initial skepticism, others began to agree a boom was possible.

But why make such a bold forecast? Many before me have been burned by predictions that never came to be. It amazes me how well remembered the follies are and how forgotten the bulls'-eyes.

The simple answer is because I believe it will happen. My father's super boom prediction in 1976 was historic. Since inheriting the family business I've kept a careful lookout for signs of another super boom. Several years ago, those signs began to emerge.

From December 2004 to February 2005, we at the Hirsch Organization ran a three-part piece on war and peace and the market in our *Almanac Investor eNewsletter*. The full piece first appeared on page 42 of the *Stock Trader's Almanac 2006*. Our 2006 book, *The Almanac Investor: Profit from Market History and Seasonal Trends* (Wiley 2006) also featured a chapter on "How War and Peace Impact the Markets," including the prospects for a 500 percent move.

Part One answers the foundational questions about 500 percent market moves, or what I've dubbed super booms: What are they? Where do they come from? What causes them and what is their impact on the market? This part also addresses the current economy and its role in the next super boom.

CHAPTER 1

The Boom Equation

We always live in an uncertain world. What is certain is that the United States will go forward over time.

—Warren Buffett

When we made our super boom prediction in fall 2010 that the Dow would reach 38,820 by 2025, many people reacted with stunned disbelief. With unemployment high, the great recession hardly in the rearview mirror, mounting global debt, and most people saturated with negative news from friends and family, skepticism was rampant. That came as no surprise to us—all bold predictions are first lambasted before proven true.

Throughout this book, we demonstrate that the coming super boom is not only plausible, but mathematically and historically probable. Moves of this magnitude have happened several times throughout history, and they have always been preceded by tumultuous times and economic weakness. In fact, big moves happen with such regularity and clear cause that we have successfully identified why they happen, how they happen, and when they happen. Most importantly, we show

what to invest in before and as they happen. By examining the past, we are able to shed light on the future.

The Late, Great Technician

Few stock market prognosticators could call 'em as well as the late, great technician, George Lindsay. An intense student of market cycles and repetitive price patterns, George could, from memory, reproduce a chart of stock market prices for every one of the last 150 years. We started publishing George's work in 1968 in our first *Stock Trader's Almanac*. At the time, George was editor of *George Lindsay's Opinion*, a highly respected newsletter that predicted the course of the stock market for the calendar year month by month. We featured his forecast for 1968 in our first *Almanac* and it was a breathtaking bull's-eye. In the following year, we presented his groundbreaking pattern for identifying market tops in price charts using technical analysis, what he called Three Peaks and the Domed House. It was 63 years ago that George discovered the Three Peaks pattern he would become famous for.

George made numerous predictions, both bold and accurate. In 1987, John Brown, who had merged the Lindsay letter into his own, *The Advisor*, published a letter directly from George dated July 1, 1987. George died shortly thereafter, but not before communicating his prescient feeling to Brown that, "It now seems likely that the last high will come some time in August 1987." Again, he was right on the money. Beginning on August 25, 1987, from a high of 2,722.42, the Dow fell 40.6 percent over 39 trading days to an intraday low of 1,616.21 on October 20, 1987.

In 1991, four years after George's death, in recognition of the outstanding contributions he made to the field of technical analysis, the Market Technicians Association bestowed its Annual Award upon George Lindsay.

George's most impressive forecast was made in July 1969 (see Figure 1.1). Appearing in our *1970 Stock Trader's Almanac*,

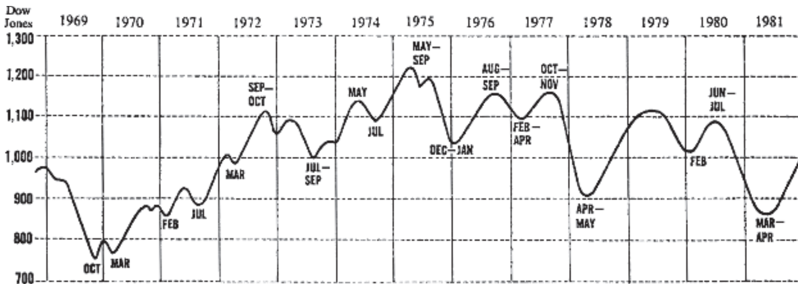

FIGURE 1.1 George Lindsay's Prediction

it showed the Dow gaining virtually no ground over the next 12 years. As the years unfolded, the Dow spent most of its time in the 800–1,000 range, in line with George's forecast. George's prediction as it appeared on page 41 of the *1970 Stock Trader's Almanac* is compared to the Dow's actual performance from 1969 to 1981 (Figure 1.2).

Of course, George had no way of foretelling what disasters and problematic events would occur during the dozen years covered in his forecast. The Cambodian invasion in 1970; the

FIGURE 1.2 Dow Jones Industrials, 1969–1981

oil embargo by the OPEC cartel in late 1973 and the subsequent quintupling of oil prices; and the taking of American hostages in Iran in 1979 may have knocked the market a little off course from George's forecast. But he was unmistakably, remarkably close.

Inspired by George's prediction, my father, Yale Hirsch, began looking at the 500 percent stock market boom after World War I in the 1920s (a speculative bubble fueled by low margins), as well as the 12 tough years that followed, containing the twentieth century's only depression and a stagnant stock market. After the World War II victory rally, the market drifted, going virtually nowhere from May 1946 to June 1949. But from the bottom in June 1949, the Dow logged another 500 percent bull cycle during the 1950s and 1960s to the top in February 1966.

As George had anticipated, the previous boom and bust pattern repeated itself with a similar 12 years of consolidation from 1969 through 1981. In other words, the cycle of war and peace followed by runaway inflation and inflation followed by a 500 percent move in the stock market had developed into a predictable pattern. With that as the background, Yale predicted in March 1976 that the Dow would rise to 3,420 by 1990, based on this simple equation: war + peacetime + inflation = 500 percent rise. Yale's prediction of Dow 3,420 was a 500 percent move from the 1974 intraday low of 570.

I was 10 years old when Yale made this incredible forecast. Weaned on recurring stock market patterns, I remember as a child flippantly assessing stock chart patterns in my pajamas as I kissed my father goodnight. Though I fought entering the family business with youthful pride, as this prediction turned into reality, I was drawn into the business. When the S&P 500 hit the 500 percent move mark in July 1990 and the Dow crossed 3,420 in 1992, I was hooked and set out on a course to build and improve upon Yale's groundbreaking forecast and lifelong work.

Finding the Next Five Hundred

The first inklings of another potential 500 percent move in the stock market began to materialize in September 2002 as the first major downdraft of the secular bear market that began in January 2000 with the dot-com crash came to a close. The war drums were beating to invade Iraq, and the stock market was plunging going into the midterm elections. After four bullish e-mail alerts in early October as the market capitulated, on October 16, 2002, seven days after what would later be recognized as the market bottom, I published the headline "BUY! BUY! BUY!" 18 times across the top of the *Almanac Investor eNewsletter*.

This contrary point of view and gutsy prognostication brought an onslaught of e-mail and telephone calls from irate readers shocked at how I could make such an irresponsible recommendation at such a dire time for the country, the market, and the world. Contrarian investing is *believing* you are right when market sentiment, pundits, and even subscribers tell you you're wrong. Though it made me uneasy, I trusted in my methodology and was convinced that since so few agreed, I must be on the right track.

This bold buy prediction hearkened back to my father, Yale Hirsch's, October 1974 "BUY! BUY! BUY!" headline and set in motion a process over the next eight years that culminates now in the super boom forecast.

I latched on to the potential for a long, sideways period similar to what George Lindsay forecasted in 1970 in our *Almanac Investor eNewsletter* 2003 Annual Forecast. Our initial forecast of a Dow in the 7,000–11,000 range was tempered by the awareness that exogenous events could expand or augment that range. As we saw from 2007 to 2009, the credit bubble pushed up the top end of that range, and the financial crisis deepened the low end.

Our long-term outlook for the market was restrained, and we expected it to behave as it did in the 1970s, going sideways for 12 years. We said, *"We would not be surprised for the Dow to*

remain range-bound between 7,000 and 11,000 for the better part of the decade unless of course the global hot spots implode, oil prices go through the roof, and economies worldwide fall apart." For the past several years we have traded the patterns, remained alert to exogenous events, and responded to changing conditions and important market indicators.

How War and Peace (and Inflation) Impact the Market

In December 2004, we began a monthly three-part series analyzing the impact of war and peace and inflation on the markets. The intent was to discover and document the anatomy as well as the nuances of a historical cycle based on Yale's original work in 1976 (and on George Lindsay's original work in 1969), studying the patterns that caused super booms. If we could isolate, identify, and extrapolate the indicators and patterns, we believed we could use those data to spot the next big stock market and economic boom.

The first question we needed to answer was what makes the market range bound during wartime and rise during peacetime? The simple answer is inflation. The government empties the treasury during a war. It also focuses on foreign issues rather than domestic concerns and the economy. The result is a sustained rise in inflation. Only after the economy settles down and Washington refocuses on domestic issues will the stock market soar to new heights.

History never repeats itself exactly, but an understanding of stock market behavior during the three major wars of the twentieth century provided important insight into market action during the current war in Iraq and Afghanistan and on terror. Here are the keys.

Four Basic Tenets of Wartime Markets

1. *No significant new highs.* The Dow has never made a significant high during wartime. The lack of a big breakout can

be attributed to muted investor enthusiasm. Every time the market tried to break out of its range, inevitably a negative exogenous event pertaining to the war, another crisis, or economic weakness of some kind dampened spirits. The market fleetingly poked above the previous highs as it did in 1973 and 2007, but the moves were short-lived and not technically significant.

2. *The war machine props up the market.* After the initial shock of a new war, the market forms a floor near the prewar low. The combination of government spending, investor bargain hunting, and good old American pride help insulate the market from breaching that prewar low.

3. *The market (as always) is a barometer.* Markets rally on sustained good news and fall on sustained bad news. The markets also tend to be more reactive early in wartime. By the end of a prolonged engagement, investors tend to be more callous about news. The markets will also anticipate the end of the war by moving to a high-water mark. This contributes to the inevitable letdown when peace breaks out.

4. *Wartime presidents do not lose.* Presidents tend to shape their political decisions pertaining to a foreign war around the presidential election cycle, making unpopular decisions only after they are reelected, while creating as much good news as possible leading up to the election. The rhetoric from the incumbent administration is always that conditions are improving, while challengers call for change. Domestic issues, a weak ticket from the incumbent party, low approval ratings for the president, and the lack of a sitting president or strong VP running ushered a new party into the White House in 2008. Like Harding in 1920 and Nixon in 1968, Obama came into office with a country clamoring for change.

Not Your Daddy's CPI

Inflation increases significantly during wartime as Figure 1.3 illustrates. Very simply, war is expensive. The upsurge in inflation brought on by war is the catalyst for huge gains in the

markets once peace and prosperity return. During the three previous 500 percent stock market moves—or for that matter, the last hundred years—war and subsequent inflation have been constants.

There are challenges in evaluating the inflationary pattern this time around. The U.S. Department of Labor's Bureau of Labor Statistics (BLS) has tweaked and manipulated the Consumer Price Index (CPI) so many times over the past 30 years or so in an attempt to mask inflation that the indicator may very well not detect a true upsurge in inflation in the years ahead. No one is really sure how this new and improved version of the CPI will react in a hyperinflationary environment. We may see a 40 percent to 50 percent increase in the CPI—or we may see another 200 percent rise.

We consider the CPI a dubious metric at best. The BLS has become obsessed in its efforts to tweak the data. Modern calculations, we feel, do not represent real-world inflation rates. Small increases in the government's assessment of inflation are significantly larger in the real world. But regardless of our grousing, it remains the prime standard in gauging inflation for economists and investors.

Going forward, the value of the dollar, the increased cost of a gallon of milk, or a can of chicken noodle soup, may be a better measurement of inflation than the CPI. The important idea is that prices are going to rise sharply in the near future, which will power the next secular bull market as it has in past postwar economies.

During these postwar booms, the Dow moved up despite many unsettling events: the Korean War; the French defeat and withdrawal from Vietnam; McCarthyism; revolts in Poland, Hungary, Argentina; the Egyptian seizure of the Suez Canal and war with Israel, France, and Britain; the civil rights movement; the Cuban missile crisis; the Kennedy assassination; and more. No market follows historical trends perfectly; however, the biggest trends, the most important, all have an impact. The first step is identifying which events will have

impact. The second is measuring and forecasting the size of that impact.

War: What Is It Good For?

Without doubt, the single most important noncyclical influence impacting the stock market is war. That nine years of foreign conflict may be drawing to an end bodes well for the markets. As the chart in Figure 1.3 illustrates, the market has failed to make any significant headway so long as the country is embroiled in a significant and lasting conflict.

The markets have been stuck in a trading range since the dot-com stock market bubble popped in 2000 and the Iraq War began on March 19, 2003. While there have been large rallies and pullbacks, there has been no real advance since 2000. Moves that leave the previous highs behind for good—the greater than 500 percent moves that have historically occurred between all of the major wars the United States has been involved in—have not happened.

Figure 1.3, "500+ Percent Moves Follow Inflation," provides the big picture. The Dow and the CPI are plotted together with highlighted sections showing the long-term range-bound markets surrounding World War I, World War II, and Vietnam. The long super booms and bull markets are bracketed with the Dow's performance. The correlation between war, inflation, and the subsequent catch-up of the market is impossible to ignore. Consolidation during wartime possesses roughly the same percentage range, giving the appearance of launching pads for the 500 percent moves. The inflation/catch-up correlation is clear. World War I inflation (up 110 percent) was followed by the 504 percent rise in the stock prices during the 1920s. The inflation of World War II (up 74 percent) led to a rise of the Dow of 523 percent. Finally, the inflation due to the Vietnam conflict of over 200 percent and the subsequent super bull market with the Dow rising 1,447 percent is a stunning corroboration of the historic pattern.

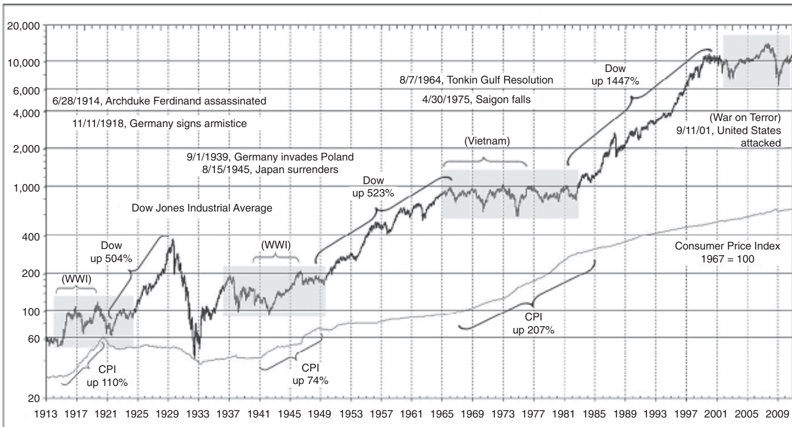

FIGURE 1.3 500+ Percent Moves Follow Inflation
Source: © Stock Trader's Almanac.
CPI source: Bureau of Labor Statistics.

Booms and Busts of the Twentieth Century

As government spending increased dramatically in response to the global financial crisis and the Great Recession, it is clear there is more at play than just wartime inflation coming home to roost. But it's important to realize that all three previous secular bear markets associated with the three major wars of the twentieth century were also affected by financial crises that required a great deal of non-war-related spending to stave off. The subsequent booms were driven by peace, inflation from war and crisis spending, and enabling technologies that created major cultural paradigm shifts and sustained prosperity.

The Rich Man's Panic of 1901–1903 and the panic of 1907 preceded World War I. Henry Ford perfected his automobile assembly line in 1913 as World War I was brewing, but cars did not really begin to replace horses until after the war, at which point the stock market boomed.

World War II helped get us out of the Great Depression. But it was not until the rise of the middle class in the 1950s,

when our predominantly agrarian society morphed into a more industrialized and more urban society and demand surged for houses, appliances, and cars, that the stock market took off again. And the television connected the nation and the world.

As the Vietnam War began to wind down in the mid-1970s, oil crises, Watergate, and Mideast turmoil plunged America into stagflation, that nasty combination of recession and inflation. The advent of personal computers drove the first phase of the last super boom. Then, the Internet and cell phones created the Information Revolution, fueling the greatest boom since the Industrial Revolution.

Super booms of the past were conceived during wartime and financial crises, which produced elevated government spending, rising inflation, and pent-up demand. They were weaned on peace, stable political leadership, and effective governing. Finally, they were fed a steady diet of cultural paradigm shifting, enabling technology that changed the world and the way the average person lived. As the boom gains traction and heightened consumer spending spurs business and economic growth, the so-called “animal spirits” of businesses, entrepreneurs, and investors are restored, shifting the boom into high gear. Finally, the boom reaches overdrive before falling back to earth.

We are not there yet, but that is where we are headed.