Tesseract Asset Management

Empowering Investors Through Innovation

100-Year Market Theory

"Ever-changing Market Dynamics, *or is it*?"

Kevin A. Tuttle
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Prologue:

Kevin A. Tuttle, CEO & Chief Strategist of Tesseract Asset Management, LLC (TAM), began developing his theory just after the inception of the **Long-Only Growth Portfolio SMA** (separately managed account) in December of 2000. While studying the technical configuration of the top ten bear markets in U.S. history the theory began to take form.

As a professional market technician, Mr. Tuttle's analysis resulted in a number of key discoveries which served as a catalyst to further refine TAM's longer-term money management process; hence, the creation of a new Investment Philosophy in early 2001. This set the framework regarding the management of assets in the Long Only Growth Portfolio (LOGP) SMA and ultimately set in motion the formation of a new company – **Tesseract Asset Management, LLC** in January 2012.

After receiving vast interest on this new Investment Philosophy from numerous clients and newsletter followers, Kevin broadly published the *100-Year Market Theory* on July 15th 2004 through TAM's technical newsletter **The Morning Cup of Jo** titled, *"Ever changing market dynamics, or is it?"* via the world wide web on Emmy award-winning Minyanville.com.

On November 7th 2005, the Theory's corresponding **100-Year Dow Chart** was highlighted on a CNBC "Street Signs" segment with host Ron Insana. After which, on November 28th 2005, two other prominent market technicians, John Bollinger (the creator of the Bollinger Bands) and Dick Arms (the creator of the Arms Index – TRIN) also appeared on "Street Signs." Both, by means of their own indicators, presented similar technical conclusions regarding a comparable long-term technical channel within the U.S. equity markets over the next 10 to 15 years; giving even more credibility and acceptance of Mr. Tuttle's theory.

In October of 2006, Mr. Tuttle re-published his theory in the book **Master Traders: Strategies for Superior Returns from Today's Top Traders.** (Co-authored with Fari Hamzei to become an Amazon.com best-seller in Investment/Trading book category)

TAM's *100-Year Theory Dow Chart* has also been represented in numerous financial works.

- "Active Value Investing" by Vitaliy Katsenelson; Wiley Publishing (September 2007)
- "Pounce" by Ken Stern; St. Martin's Press Publishing (March 2009)
- Several Financial Firm, Advisors & Money Managers for individual use

- The Theory utilized the long-term fundamental valuation analysis completed by Yale Professor of Economics Robert J. Shiller. In July 1997, Mr. Schiller co-authored a paper in *The Journal of Portfolio Management* called, "Valuation Ratios and the Long-Run Stock Market Outlook." This, for a number of reasons, is where Kevin determined Dr. Shiller's work was directly relevant and applicable to his technically-based theory.

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— Technical Inspiration for Serious Investors —

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The 100-Year Market Theory & Corresponding Dow Chart

Introduction:

The 100-Year Market Theory is the first U.S. Equity Market theory to ever combine long-term fundamental valuations with technical analysis over an extended period. Hence, its premise is not focused on the next few ticks; rather it provides a basis for the foundation of our investment management process. This framework allows us to disseminate the increasing complexity of market dynamics and properly prepare for what may be in store for U.S. equity markets in the future. One of the most vital, yet underutilized, tools is provided by lessons from the past.

During the last century, in spite of countless trials and tribulations, the United States has asserted itself as the center of global commerce and the epitome of capitalism. This dynamic has been the foremost driver powering the rapid ascent of the domestic equity markets over the last 100 plus years. Historical evaluation through technical analysis offers the ultimate reflection of market psychology capturing the political, social, entrepreneurial and economic landscape. As such we are all students of history. At present the equity markets pose not only new challenges, but new opportunities. It is through this theory we strive to face them with a firm understanding of the past.

As Oliver Wendell Homes once said;

"*When I want to understand what is happening today and try to decide what will happen tomorrow; I look back because a page of history is worth a volume of logic*."

The question we must continually ask ourselves is,

"What can be deciphered from past market cycles which could be applied to today's environment in order to achieve a superior investment management philosophy?"

Theory Assumptions & Disclosures:

- The material presented is not solely technical in nature. The chart incorporates the 10-year smoothed average Price/Earnings ratio of the S&P 500 Index as a broad measure of the markets' fundamentals. Although not without imperfections, in our judgment it's the only true time tested fundamental metric with long term reliability.
- The Dow Jones Industrial Average prices are in logarithmic form, while the P/E ratios are arithmetic.
- The data is considered to be factual in nature and sources believed to be reliable.
- This study is a matter of opinion from Tesseract Asset Management, LLC and should be considered as such.

The 100-Year Market Theory

This theory is founded on the premise…

"Excess market valuations, due to extreme price movement upward over extended periods, may take years to wane as earnings catch up with prices."

A critical component of any technical study centers on the timeframe and context in question. As such we must define a few key technical terms to help us put the timeframe in the proper perspective.

Secular Trend:

- A very long-term trend in which the market remains for an extended period
- Historically lasts for a time period of 5 to 20 years
- Consists of two or more cyclical trends.

Cyclical (Primary) Trend:

- A trend that occurs within the secular trend
- Generally lasting from 2 to 6 years.

Secondary Trend:

- Normally defined as a correction in a bull market or rally in a bear market
- Typically lasts a few weeks to months.

"It is important not to get caught up in the semantics of defining bull & bear markets – but to rather focus on pre-defined trend analysis and where the market stands from a technical perspective. The interpretations are at the hand of the individual and can be determined by how and when the markets move in and out of its phases starting from the shortest term tends through the longest."

~ Kevin A. Tuttle, CEO

The following table and graph show that over the last 100 years the Dow Jones Industrial Average (DJIA) has been through **three – now four – secular consolidation periods, one secular bear market and four secular bull markets**. This interpretation is from a mega-macro perspective and obviously, on a more micro view, there have been numerous shorter term bull, bear and consolidative periods. In actuality, all of the most devastating past cyclical bear markets - giving exception to the Great Depression - have occurred within secular consolidative channels. However, for the illustration of the underlying theory, we only need to take into consideration the larger macro point of view for now.

Data Range		Price Action	Duration	P/E Ratio
Jan 1906	July 1924	Secular Consolidation	18 Years, 7 Months	Declining
July 1924	Oct 1929	Secular Bull Market	5 Years, 3 Months	Increasing
Oct 1929	July 1932	Secular Bear Market	2 Years, 9 Months	Declining
July 1932	March 1937	Secular Bull Market	4 Years, 8 Months	Increasing
Jan 1937	Jan 1950	Secular Consolidation	13 Years	Declining
Jan 1950	Jan 1966	Secular Bull Market	16 Years	Increasing
Jan 1966	Oct 1982	Secular Consolidation	15 Years, 9 Months	Declining
Oct 1982	Jan 2000	Secular Bull Market	17 Years, 3 Months	Increasing
Jan 2000	Present	Secular Consolidation	7 Years +	Declining

1906-1924 (Secular Consolidation)

As illustrated in the table, the first (and thus far the longest) secular consolidation began in January 1906 at the 100 resistance level, respectively, and didn't breakout until December 1924 - almost 19-years later. All the while (and conceivably more important), the P/E (Price Earnings Ratio) remained in a downward trend virtually the entire period. This secular consolidation encompassed 11 cyclical cycles which included as large as 48% drops and corresponding gains in valuation.

Beginning 1922, the P/E ratio finally broke above its downward trend and began its ascent back above 10 in 1925. Notably, the market's last re-test of the bottom side of the channel was in 1921 where it again turned from a cyclical bear to a cyclical bull market. In July of 1924, it finally broke the 100 technical resistance level and successfully re-tested the neckline in October of that same year. This changed the phase from secular consolidation to secular bull.

1924-1929 (Secular Bull Market)

Once the market broke free of this consolidation, it gained in excess of 300% in just over 5-years and ended its reign just below the 400 mark in September 1929. Noticeably during this time, the P/E multiple blasted off like a rocket and reached an above 32 multiple followed by the great market crash of 1929 ("Black Tuesday") which preceded "The Great Depression." When this happened in October of 1929, the market broke its smaller cyclical bull trend and subsequently changed the dynamics from a secular bull to a secular bear.

1929-1932 (Secular Bear Market)

The Great Depression's secular bear market lasted approximately 3years compared to the secular consolidation periods, each ranging13 to 19-years. This watershed abandonment dropped the market an astonishing 89.5%!

This downtrend and corresponding secular bull does not fit the typical consolidation/uptrend technical price pattern. On the other hand, the corresponding P/E multiple does fit the cycle of valuation change and had the same overall effect as the secular consolidation/bull periods. In other words, the vast drop-off during the Great Depression achieved the same result as a longer-term consolidation – wringing out the excessive overvaluation within the market. It is for this reason why we define it the only secular bear market – versus a secular consolidation period – of the 20th century.

1932-1937 (Secular Bull Market)

In 1932, the P/E multiple, after again declining below the undervalued 10 level, broke above its downtrend as the market began its next secular bull phase. This phase began in July 1932 and lasted for just under 5-years with an approximate 385% return before it entered its second (and much longer) secular consolidation period.

1937-1950 (Secular Consolidation)

In March 1937, the market hit the bottom side of the 'floor & ceiling' resistance from the 1929 crash – Black Tuesday – at approximately 195. This again coincided with the P/E valuation reaching the overvalued 22 level. Once breaking its cyclical uptrend, it initiated another cyclical bear market and began a second secular consolidation lasting 13-years and endured subsequent drops equating to as much as 50%.

1950-1966 (Secular Bull Market)

By January 1950 the market broke free of the second secular consolidation phase at 195 and successfully retested technically in July. This began a 400% secular bull market that lasted over 16-years.

1966-1982 (Secular Consolidation)

In 1966 the P/E multiple crossed back above the 22 level as the market stalled out in the region of 1,000. Once the market broke the smaller cyclical bull trend, the third secular consolidation phase began and persisted nearly as long as its previous advance – 16-years. Similar to the 1906-1924 consolidation phase, this one also endured 11 separate cyclical segments which boasted market drops and succeeding gains of as much as 46%.

1982-2000 (Secular Bull Market)

By 1982, a majority of the P/E valuations had been washed out and in October the market broke above its relative resistance at 1,000. It successfully re-tested the 1,000 for the following three months and began the largest secular bull market in history. It sustained almost 18-years and provided over a 1,000% return during its tenure. Even "Black Monday's" crash in 1987 held the market's mega long-term uptrend and merely appeared as a blip on the radar.

2000 to Present (Secular Consolidation?)

As we all remember in January 2000, following the massive bull market, the P/E multiple hit an unforeseen level of 43. Later that year, the market broke its smaller cyclical bull trend and began one of the top five downturns in American history. This downturn came to rest in March 2003 at approximately 7,200 for the Dow Jones Industrial Average (DJIA) equating to a 38.5% drop. Simultaneously, the P/E multiple descended and broke the upward trend it began in late 1982. It is our belief this began the fourth secular consolidation period.

Conversely, the P/E has continued to remain above the historic overvalued level of 22. Since the March 2003 transition from a cyclical bear to a cyclical bull, the market has again approached and breached the previous highs without ever once having the 10-year smoothed average P/E multiple drop below the overvalued 22 level.

What comes next?

As previously stated, ***the ability to analyze the past is one of the most important tools we have to understand today***. For this reason, following the review of the aforementioned historical technical price trends and their correlation to the P/E multiple, we are obligated to make some key observations:

- Subsequent to every macro technical uptrend, a macro consolidation period or excessive sell-off has immediately followed and correlated in length of time.
- Consolidation periods have ranged from 13 to almost 20-years in length, not including the excessive market sell-off of the 'Great Depression.'
- P/E valuation trends have corresponded to every technical market uptrend, consolidation period and massive downturn.
- Market breakdowns have all occurred after the P/E multiple breached the 22 "overvalued" level and proceeded to break its upward trend.
- Breakouts from consolidation periods or new uptrends have not resumed without first having the P/E ratio multiple drop below the "undervalued" level of 10.
- The first market sell-off and corresponding bottom of a macro consolidation period normally constitutes the floor of the larger technical channel which has begun.
- All historic technical market channels have contained a plethora of 30 to 40% price fluctuations.
- Within all the prior secular consolidations, there have been multiple occasions in which the market has broken above the channel for a relatively short period of time only to crash back through and start a cyclical bear market that journeyed toward the bottom of the respective LT channel.

Distilling data to increase probability of success - that's the name of the game!

Resulting from this work, it is our contention that in all likelihood the market has entered yet a fourth consolidation period whose relative channel logically ranges from a 7,200 low to a 12,000 high. Also, inherent within this contention is the idea that the channel will not end until the P/E multiple again crosses back below the undervalued 10 level. This will most likely not transpire for many years to come and be aptly relative to the length of time of the latest Bull Run – nearly 18-years. Based on our analysis, we believe the channel began in 2000 – well, you do the math...

There are many people on Wall Street who, for whatever reason, will argue the market dynamics have changed and the P/E valuations will never return to historical levels. Maybe they believe this because of the vast amount of assets flooding the marketplace and the limited supply of equities. Perhaps it's because of the decrease in the amount of equities paying dividends – which creates higher valuations. Or maybe it's simply a bad case of straight-line thinking. Nonetheless, the valuations remain higher than ever before, even after the start of a major consolidation in the stock market.

Straight-Line Thinking

Straight-line thinking occurs when a trend has been set for an extremely long period of time and individuals forget other periods when a different dynamic was in place. They unconditionally and wholeheartedly believe everything will remain status quo. Let me provide a real life example of how long-term trends can shape psychology and one's decision making.

Over the years in this business, we have heard many opinions:

- *"Invest for the long haul."*
- *"You can't time the market."*
- *"Just buy and hold…you'll be better off."*

Given the fact the U.S. equity markets have just concluded the largest and most magnificent up-trend ever produced, some of these comments made sense – at the time they were spoken. But ask yourself what the consequences would have been if you were a new investor and blindly bought in 2000 based on these conventional theories? Ouch!

Let's review one more example to drive home the point…

What if you turned 45-years old in 1966 and started planning for your retirement in 15-years? For the previous 16-years (1950-1966), you had not seen the market do anything but increase over 400%. The market was in a Secular bull phase. Hence, you purchased equities representing the index, expecting similar results, and held on until you retired. Over this period you would have paid taxes on any gains and received the same amount of principal back – plus any dividends paid over that period of time – minus inflation. By the way, inflation back in the mid to late '70s was hovering around 10 to 15%. It is clear that over that period you would have lost real money (inflation adjusted).

Secular Consolidation Phases

Secular consolidation phases have occurred three times within the 20th century. Very possibly it is happening again. But don't confuse our message herein. There will continue to be an abundance of opportunities to make money in the marketplace over the next 10 to 15-years. By looking back at the chart, you'll notice during the secular consolidation periods there were multiple cyclical periods which provided ample price fluctuations and massive opportunities to be involved with; in both directions.

For example, the 1906 – 1924 consolidation made a round trip respectfully from 70 to 105 at least six times and the 1966 – 1982 consolidation made a round trip respectfully from 720 to 1,000 at least five times.

Our Objective

Our objective as professional money managers is to avoid repeatedly swimming against the tide and ideally wait for the tide to work in our favor. The ability to do this successfully will ultimately improve the consistency of results and any portfolio's overall risk / reward dynamic. In today's environment, it is not only important, but essential to have the ability to swim in both directions - particularly if P/E valuations revert to historical levels within the context of our theory.

Clearly, no one can predict with a 100% certainty what will happen over the next 5, 10 or 15-years. But what we do know, ***with absolute confidence***, is every successful money manager must have a disciplined yet adaptive strategy, built on a solid foundation, to deal with the potentially turbulent times ahead.

-Special Report-

100-Year Market Theory Update

Published April 2007

Following the early 2007 accent of the Dow Jones Industrial Average (DJIA) above the latest secular consolidation, dating back to January of 2000, we have received many inquiries about our 100-Year Market Theory and the corresponding Dow Chart. As such, we feel it is an appropriate time to pen this update and release our **"New" 100-Year Dow Chart** reflecting updated data.

To order your own personal copy, please visit: www.TAMPortfolios.com

In our original analysis, we stated the U.S. equity market – represented by the DJIA – has gone through eight secular (long-term macro) phases since the beginning of the 20th century (including three bulls, four consolidations and one bear). Since the market has gone above the secular consolidation, the questions asked were, "Has the consolidation phase come to an end?" and "Is the market beginning a new secular bull phase?" The intent of this document is to assist in answering those very questions.

The first step in determining such a change is to define the conditions which must transpire to conclude its actual occurrence. Throughout the course of this document, we broke down our analysis into smaller sub-trends/phases (cyclical and secondary) to identify the components of the larger secular trend/phase.

Once comprehending the concept of diminishing timeframes and associated trends within trends, it becomes much easier to ascertain where the market is in relation to a greater trend. This technical methodology assists in defining and identifying the beginning/ending of each phase. Accordingly, by defining when, where and what causes the end or continuation of a smaller trend, one can establish if the next larger and subsequent trend will continue or change to an alternate phase.

At any given point the market exhibits numerous phases/trends simultaneously that leave multiple interpretations depending on the timeframe. Not unlike the three phases/trends to describe secular markets (bull, bear and consolidation) there are also cyclical (primary) trends within the broader secular phase identically defined. This analysis can be isolated further to the lowest level and even applied to a day-trader looking at minute charts.

The four main classifications are:

Secular Trend:

- Viewed generally in monthly logarithmic charts
- Consists of two or more cyclical trends
- Typically last five to twenty years

Cyclical Trend:

- Also referred to as "primary"
- Viewed generally in weekly charts
- A smaller trend within the secular trend
- Typically last one to six years

Secondary Trend:

- Deemed "corrective" or "counter cyclical"
- Viewed generally using daily charts
- Usually defined as cyclical bull corrections or cyclical bear rallies
- Typically last from one month to one year

Minor Trend:

- Also referred to as "counter corrective"
- Viewed primarily using daily and occasionally hourly charts
- Very short-term moves traditionally insignificant to investors and mainly used by traders
- Typically last only days or weeks

If this seems confusing please refer to an excerpt from the original **100-Year Market Theory**…

"It is important not to get caught up in the semantics of defining bull & bear markets – but rather to focus on pre-defined trend analysis and where the market stands from a technical perspective. The interpretations are at the hand of the individual and can be determined by how and when the markets move in and out of its phases starting from the shortest term tends through the longest."

The methodology becomes clearer via a graphical illustration. **Figure I** is an one-year daily chart of the SPX which begins with a secondary correction in September of 2005. By October, the market had bounced off the longer term cyclical bull trend (black) and broke upward through the secondary correction (red).

From there it successfully re-tested the break and changed into a secondary bull (blue) that lasted until May of 2006. Here, the secondary trend changed again by breaking the uptrend and successfully re-testing (even if for only one day). This time the cyclical trend was tested twice before breaking back above the secondary bear. After yet another successful re-test, the market provided a second confirmation when it broke above the resistance from the last peak.

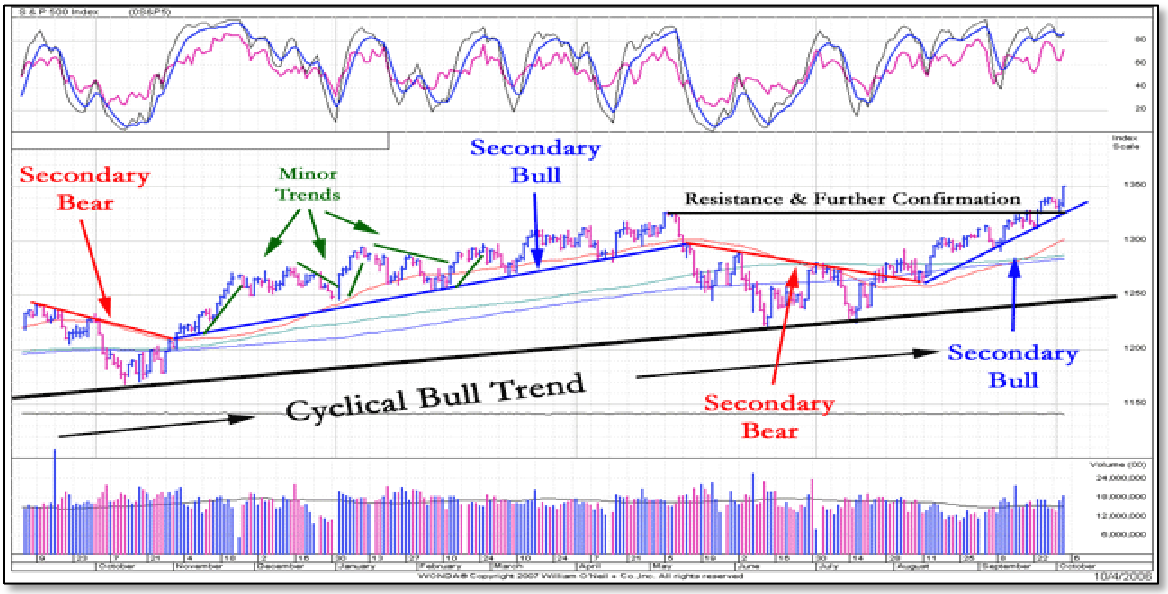


Figure I

Two secondary corrections took place within the example and yet the market (in both instances) held its cyclical bull trend. Hence, the larger trend retained precedence. However, if either of the secondary corrections did have enough power to break below the cyclical bull trend, we would have then looked for a confirmation consisting of a larger re-test and continuation downward on a grander scale.
Again, by understanding the lesser, one can gain an unambiguous comprehension of the dynamics which alter the greater. Our analysis is similar in that it incorporates changes in both the cyclical and secular trends. Ascertaining a secular change from consolidation to bullish is fairly intense and requires a more thorough examination because such shifts are actually continuations onward - instead of directional changes.

Confirmations, evident in all the historic secular transitions from consolidation to bull, are partially from a continuation of the cyclical bull above and beyond the secular consolidation resistance (SCR). From there, the market traditionally shifts into a secondary corrective bear phase, successfully re-tests the secular consolidation breakout, ends the secondary correction and continues its upward journey.

As we noted in the first rendition of the **100-Year Market Theory**, there have been numerous occasions where the market has surpassed the topside of the long-term channel only to disappoint. This is precisely why we place great importance on bottom-up analysis and a specific sequence of events required to determine an indisputable change. Analyzing the first three secular consolidations provides a foundation for the essential guidelines.

The First Secular Consolidation:

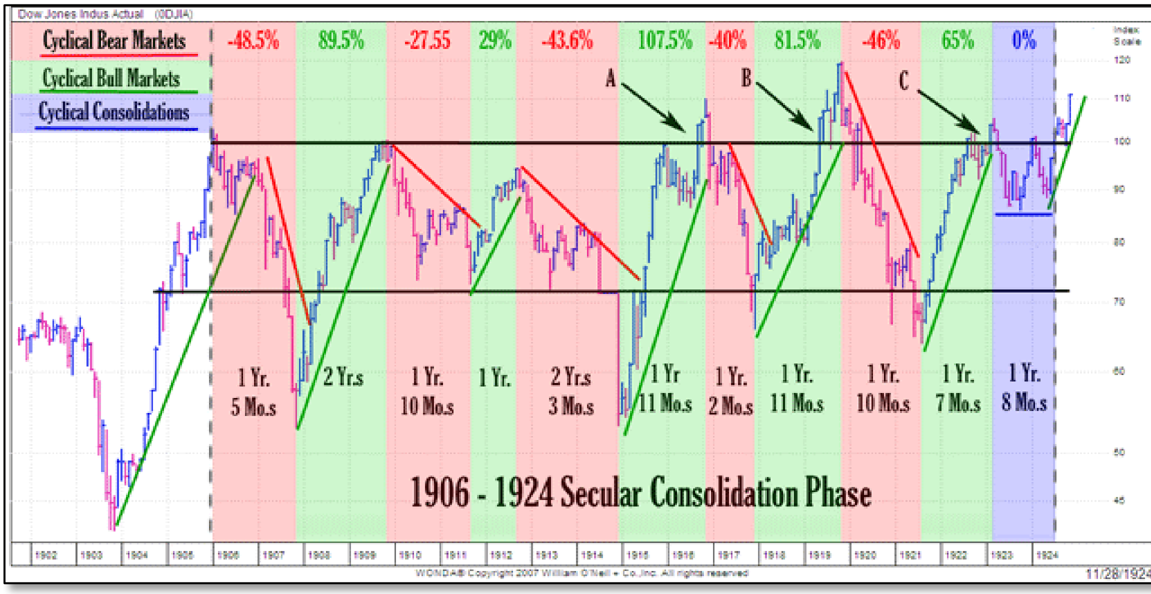


Figure II

The first secular consolidation from 1906-1924 is shown in a weekly chart (**Figure II**). The consolidation phase depicted outlines and separates all the smaller cyclical cycles within. Each shaded area portrays both the length and depth of each cyclical bear, bull and consolidation period. This particular nineteen year affair consisted of eleven cyclical trends (five bears, five bulls and one consolidation). What should be noted are the three attempts the market made to cross above the consolidation resistance level which all ended poorly for investors (**Points A, B, and C, Figure II**). The focus of our work is distinguishing the A, B and C attempts from the 1924 success.

Outlined in **Figure III** is a one year daily graph illustrating the end of the third cyclical bull phase (**Point A from Figure II**). This happened ten years into the secular consolidation and depicts the first attempt at the 100 SCR level, succeeding breakout and utter failure.

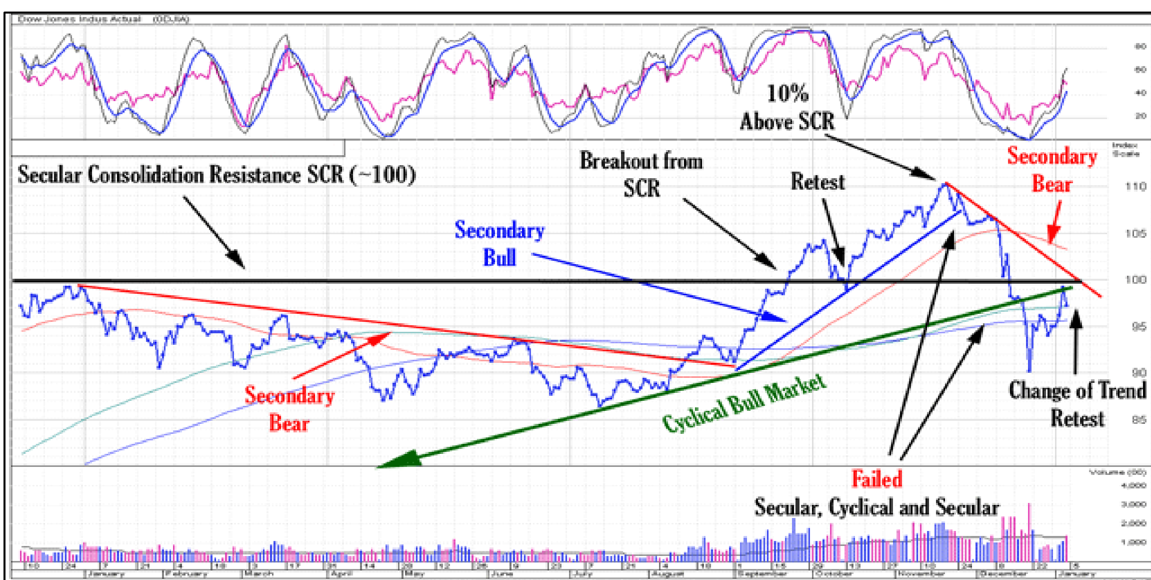


Figure III

In December of 1915, the DJIA made its first attempt at breaking the secular consolidation resistance (SCR) since late 1909 and began a secondary correction that lasted almost seven months. The correction bottomed in July of 1916 when it bounced off the larger cyclical bull trend. This resulted in an August break upward from the secondary downtrend (red) and a September successful re-test which changed the secondary phase from bear to bull and sent the market on a straight "beeline" for the SCR.

On September 22, 1916 it broke-out on 2.5 times Average Daily Volume (ADV). By mid-October, it had successfully re-tested the breakout and continued upward to the tune of 10% above the SCR. Two months after (11/21/1916), the market topped and broke back through the secondary bull trend (blue) and re-tested the SCR breakout for a second time in December. This, from a macro standpoint, was not yet technically concerning.

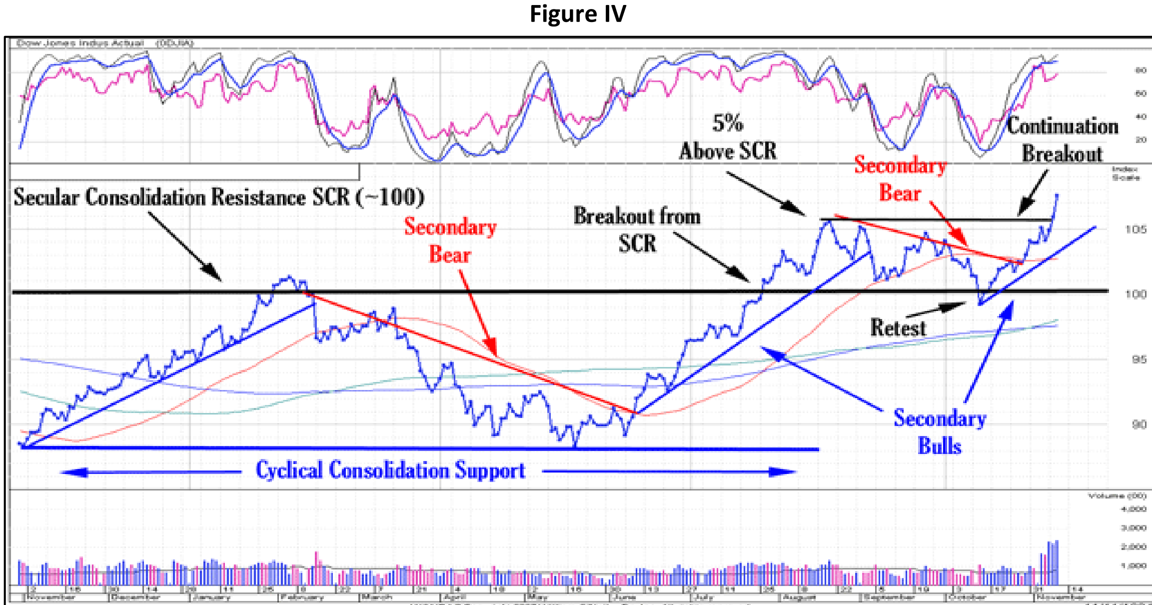
However, within the next few days the market dropped back below the SCR on massive volume which also corresponded to a break of the two year cyclical bull trend. This began a new cyclical bear phase with a January confirming re-test. Thirteen months from the peak (12/19/1917), the market bottomed at 66 - corresponding to a 40% drop in value.

One conclusion drawn from this is by solely using a 'cross above resistance' indicator to determine a change of phase will most likely create false positives. In very similar fashion, points B and C from the secular consolidation chart above (**Figure II**) have similar technical underpinnings.

- **Point B** (the 1919 top) actually re-tested the SCR breakout twice and lasted just over five months until it peaked 19% above. When breaking back below the SCR and cyclical bull trend, the resulting change of phase lasted twenty one months from the top and crumbled an astonishing 46%.
- **Point C** (the 1923 top) was similar in nature but not as devastating. The market attempted to breakout twice at the end of 1922 on a much smaller scale. Once consolidating it retried in January of 1923. This episode only lasted two months before dropping back below the SCR and creating a 1 ½ –year cyclical consolidation.

Understanding past failures is only half the equation; we must also examine the victories. **Figure IV** illustrates the successful breakout from the approximate 19-year secular consolidation.

Figure IV



When compared to the prior failure, the beginning technical events are similar in nature. It is only after the first top, preceding the SCR breakout, that its success becomes apparent.

On July 28, 1924 the market surpassed the SCR on 1.75 times ADV and by August 20th increased an additional 5%. The resulting peak changed the secondary phase from bull to bear. Similar to its predecessors, it re-tested the SCR breakout - but this time it toed the line, broke back above the secondary bear downtrend and followed through by breaking the secondary bear top with a continuation/confirmation breakout. From the re-test on October 14th, the market was off to the races in a new secular bull which ended on September 3, 1929 at 386 – a 286% increase.

The Second Secular Consolidation:

Unlike the first, the 1937-1950 secular consolidation (**Figure V**) only contained seven cyclical phases (three bulls, three bears, one consolidation) and lasted just over thirteen years. The first cyclical transformation was one of the shortest, yet most devastating bear markets of all time. It lasted about 1-year but managed to shed 50% of its value. Conversely, this secular channel also created one of the greatest cyclical bull markets to ever appear in a secular consolidation phase. The 1942-1946 cyclical bull market delivered gains in excess of 130% and lasted just beyond four years. The end of this astonishing cyclical run (Point A) came about eight years into the consolidation when it attempted to break above the 195 SCR level for the first time.

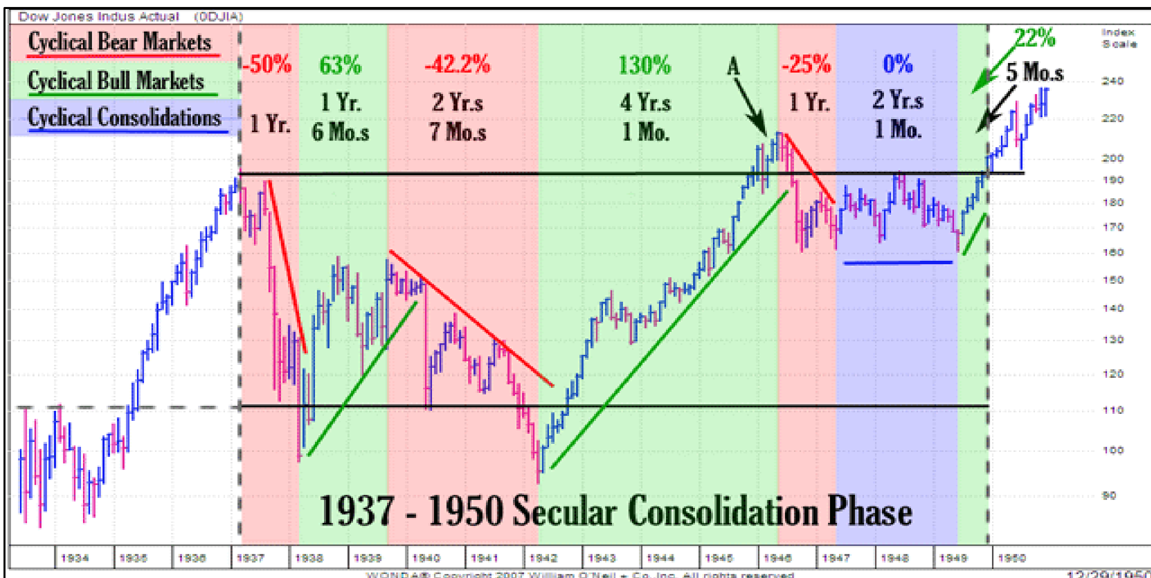


Figure V

The technical action is comparable to the 1916 top (**Figure III**) in that when the market crossed 195 on January 9,1946, it failed less than one month later while still continuing to hold the larger cyclical bull trend. It immediately made a second attempt on March 21st but topped out on May 5th at 213 (9.2% above the SCR). This changed the secondary – not cyclical – phase from bull to bear. From there only a few technical confirmations were needed to substantiate a change in the secular phase from consolidation to bull. First was a successful re-test of the SCR breakout followed by a break back above the most recent secondary bear.

By July 29, 1946 the market re-tested the SCR and again began to move upward. On August 14th it hit the secondary bear trend, stopped dead in its preverbal tracks and persisted to decline back below the SCR on August 27th and signaled a technical failure. The SCR cross correlated to a break of the longest cyclical bull trend within a secular consolidation as of yet. The failure led to a 25% decline over a one year period.

By mid-1949 the market completed a two year cyclical consolidation and began another cyclical bull. Interestingly enough, it only took five months to attempt the 195 resistance once more. On December 5, 1949 it took-out the SCR level on 1.5 times ADV. On January 13, 1950 the market re-tested the breakout but never changed secondary phase from bull to bear while doing so; somewhat unconventional. The advance peaked at 229.2 (17% above the SCR) on June 12, 1950. This time the market did finally break the smaller secondary bull trend when re-testing the SCR.

Seven months from the original SCR break (July 13, 1950) the market successfully re-tested the SCR. From there it continued its confirmation by surpassing the secondary bear trend and completing a continuation/confirmation break from the last peak. The successful completion changed the secular trend from consolidation to bull which lasted just over 16-years, returning over 400%.

The Third Secular Consolidation:

The third secular consolidation began on February 9, 1966 at 1001 (**Figure VI**). This was very similar to the first macro channel given it encompassed eleven cyclical trends (five bears, five bulls and one consolidation). Also similar was that it had three separate attempts (Point A, B and C) at crossing the SCR level which the first (Point A) occurred seven years into the consolidation.

Without going through each incidence, suffice it to say they were all similar in their failure patterns as demonstrated in the prior examples (1916 graph and 1946 description). Additionally comparable is that all the failures lead to some of the most devastating cyclical bear markets in history. Accordingly, the final breakout was also technically similar in that it…

- Broke above the SCR on massive volume
- Began a new secondary bear trend
- Successfully re-tested the SCR
- Broke above the secondary bear
- Confirmed again with a follow-through break above the recent secondary bear top

As we all know, these events kicked off the largest secular bull market in U.S. history which lasted over eighteen years and returned more than 1000%.

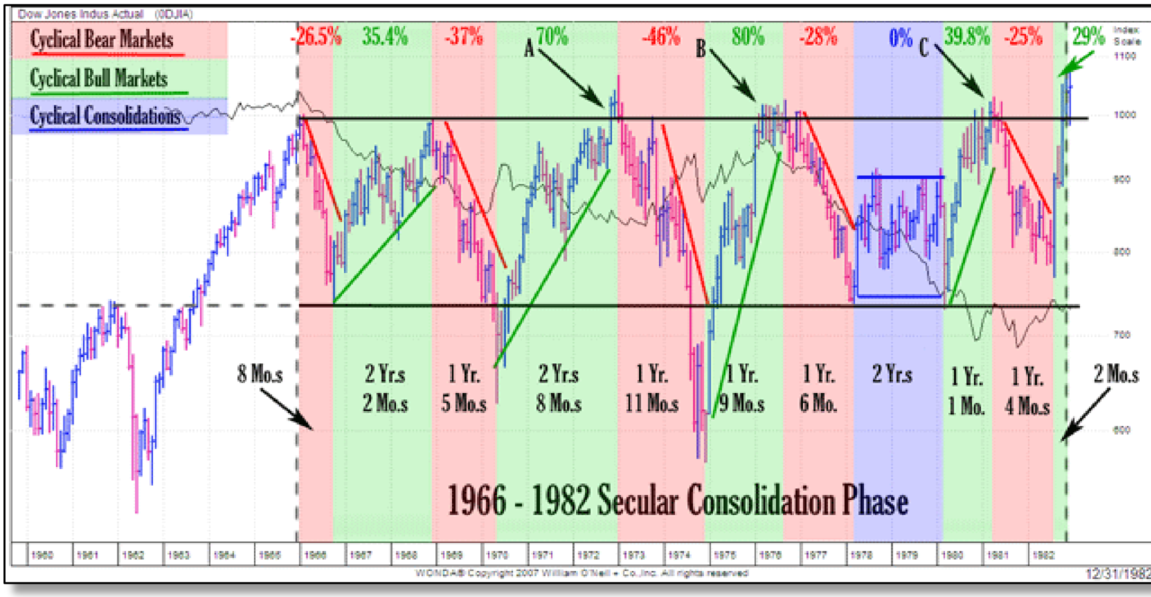


Figure VI

The Fourth Secular Consolidation:

On January 14, 2000 the market topped at 11,750 and entered what we viewed as the fourth secular consolidation phase (**Figure VII**). Since that point the market has gone through three cyclical phases (one bear, one consolidation and one bull - which it continues to reside in as of this update. Coincidently, this consolidation most resembles the 1937-1949 period because of the length and number of its cyclical cycles. Almost seven years into the channel – September 27, 2006 – the market broke above the SCR on 1.2 times ADV (**Point A**).

Figure VII

Hence the $64 thousand question; "Is *the market transitioning into a new macro secular bull phase or is this just another 15 – 20% fake-out?*

Now that we've dissected what occurs during successful and unsuccessful transitions from a secular consolidation, it's time to apply the analysis to present day. The first step is to reduce the timeframe to a weekly chart and definitely find the cyclical bull market trend (**Figure VIII**). This was simple considering the market has managed to bounce off of it six times in the last 3 ½-years.

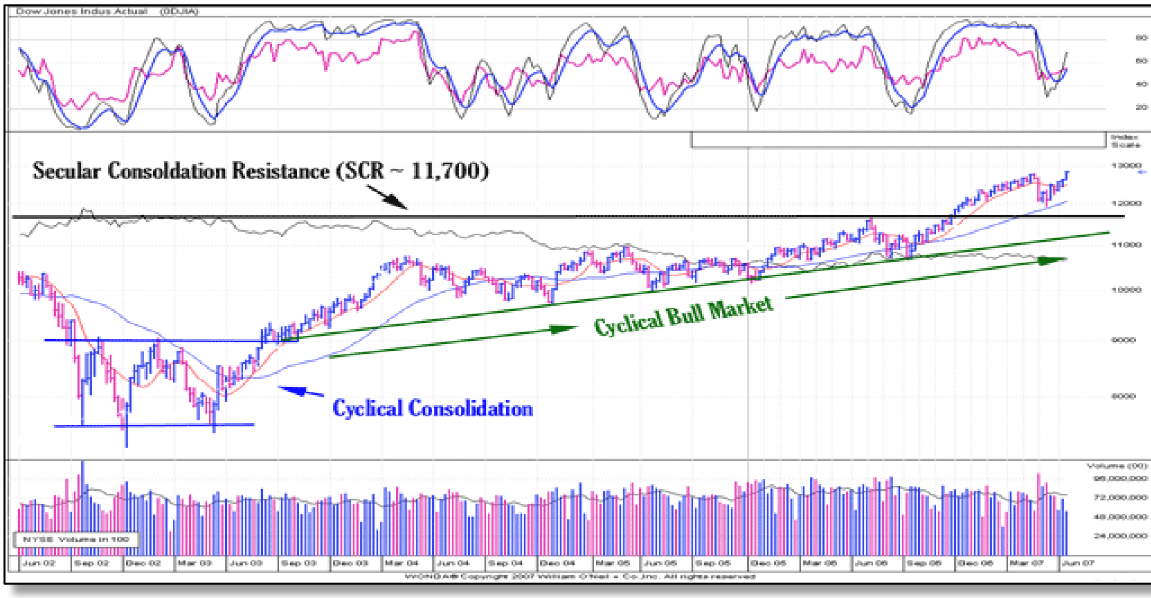


Figure VIII

Now we dive deeper to evaluate the subsequent minor timeframe from a daily graph (**Figure IX**)…

This chart begins with the market's first attempt at the SCR in May of 2006. The failure to surpass brought about a secondary shift from bull to bear which re-tested the larger cyclical bull twice before starting anew. After the re-test and completing a divergent bottom the market began a secondary bull. On September 27, 2006 the market pushed its way above the SCR on only 1.1 times ADV and climbed in excess of 9% above before topping.

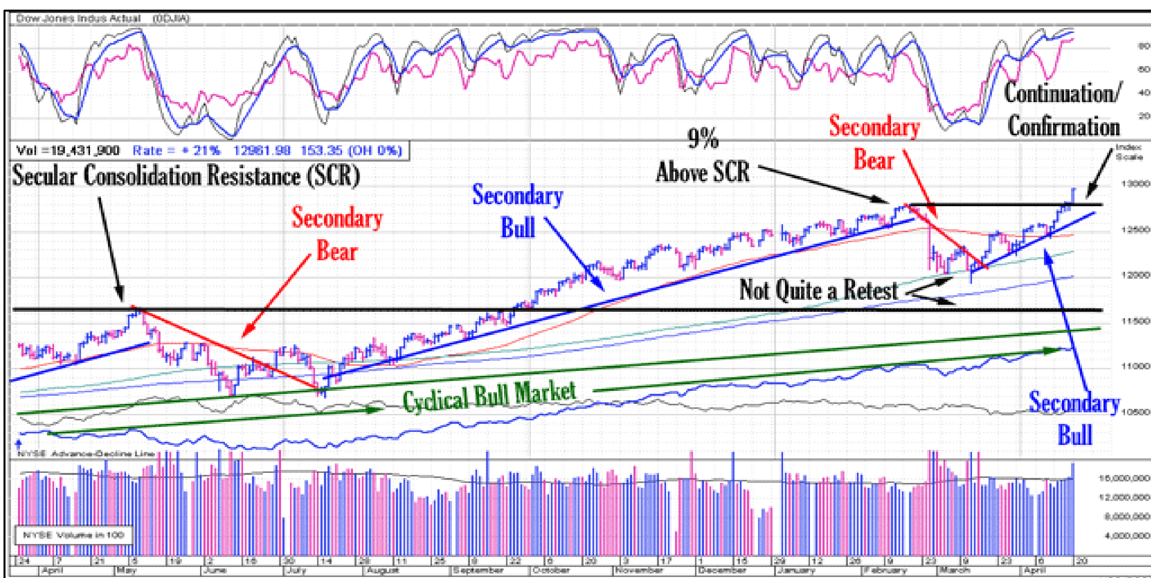


Figure IX

The February 27, 2007 drop changed the secondary trend from bull to bear and started the market heading for a SCR retest. Interestingly enough, it never actually made it down to the SCR and on March 14th, it put in a divergent reversal day (lower intraday low which closed at the high). Not more than three days later it broke back above the secondary bear trend and changed the short-term back to bull. On Friday April 20th, the DJIA surpassed the secondary bear top on 1.2 times ADV bringing forth a continuation/confirmation.

Nonetheless, there are still some lingering issues that fail to provide 100% confirmation that this is a true change of secular trend. Until this point, our update has been exclusively technical in nature and has failed to address one of the most noteworthy facts contained in the original 100-Year Market Theory which read…

Distilling data to increase probabilities [of success] - that's the name of the game!

Resulting from this work, it is our contention that in all likelihood the market has entered yet a fourth consolidation period whose channel logically ranges from a 7,200 low to a 12,000 high. Also inherent within this contention is the idea that the channel will not end until the P/E multiple again crosses back below the undervalued 10 level. Most likely this will not transpire for many years to come and be aptly related to the length of time of the latest Bull Run – nearly 18-years.

By simply taking a glimpse at our New Dow Chart, you can plainly see that not only has the 10-year smoothed P/E multiple not yet crossed the undervalued level of 10, it hasn't even dropped back below the overvalued level of 22. From a valuation standpoint - this is very disconcerting. Under no circumstances throughout history has there ever been an occasion where the market has successfully broken above the SCR and changed phase from consolidation to bull without first reducing the excessive overvaluations inherent within the multiple.

With that being said, there are also a few additional concerns on the technical front which have to be taken into consideration such as:

- All of the other secular channels have had failures before successfully transitioning
    - The fourth has had no failures as of yet
- All previous "first" attempts/failures occurred seven to ten years into the channel
    - This consolidations first cross of the SCR took roughly seven years
- The market's failed attempts have surpassed the SCR by as much as 19% before fading
    - At present it is roughly 9% above the SCR
- All previous secular consolidations consisted of seven to eleven smaller cyclical trends
    - The market has experienced only three cyclical trends thus far
- All of the other secular channel breakouts successfully re-tested the SCR
    - A true retest has yet to occur
- The recent SCR cross had the lowest relative volume within all four consolidations
- The SPX has yet to confirm a breakout and won't happen until it crosses 1,553
- The majority of failures have led to devastating downturns

Conclusion:

However daunting the contrary conditions may appear, they do not negate the fact the Dow Jones Industrial Average has reached new highs and managed to hold above both the secular consolidation resistance and the cyclical bull market trend for now.

Most professional money managers look at the horizon to ascertain possibilities, weigh risks and evaluate potential scenarios in order to manage the road they are on. The intent of this analysis is to help determine the best course of action depending on one's investing time horizon and risk tolerance. That perspective is different for everyone and the implications of the 100-Year Market Theory pertaining to personal strategies are left in the hands of the individual. Understanding the nuances within the various timeframes ensures a comprehensive awareness of the multiple interpretations for the potential road ahead.

At this juncture, our view at TAM is it's not critically important to determine if whether the market has moved into a new secular bull phase or is just a continuation before failure. What we do believe to be meaningful is:

If the market does break back down through the current *secondary, cyclical* and *secular* consolidation levels, it would make the latest move a massive false-positive which will have **DRASTIC** ramifications on our future outlook for the U.S. equity markets.

November 7th 2007:

Mr. Tuttle, in his periodic **Morning Cup of Jo** newsletter penned a piece called "To Jibe, or Heave-to."
To paraphrase, this article stated the following…

- We've increased our bearish concern…
- The resolve to this lack of clarity will be resolved sooner than later…
- If the market does in fact break these levels "Sell what you Can!" because it will be like a pack of lions chasing a stampede of antelope

January 16th 2008:

Kevin, using a special market update called **Quick Market Note**, penned a piece stating…

- The 10-year Treasury yield is telling us the U.S. Economy is heading for a recession
- If the bulls cannot get their act together the southbound bus is leaving the station
- This would break the 4-year cyclical bull trend

From that day forward the SPX continued a trend which turned into the greatest bear market in history since the Great Depression and lost 54% of investors' worth.

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