UNION SECURITIES LTD.

TECHNICAL SCOOP FOR APRIL 9, 2009

Charts and technical commentary by David Chapman

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SUCKER RALLY!

Sucker rallies (or bull traps) in a bear market are a time-honoured tradition. Bear markets see many rebounds, ranging from feeble rises of maybe 10 per cent over a period of a couple of weeks to ones that last years and recoup anywhere from 50 per cent to even over 100 per cent from the low. Call it from the little sucker to the really big sucker. Little suckers bring a wave of short-term euphoria that "This is the end of the bear," while really big suckers make everyone forget about the previous drop, and then just when they believe it won't happen again, they are slammed in the teeth. The former are wonderful for nimble traders; the latter are wonderful for those who possess a healthy skepticism and realize that this is a nice party but it will eventually end badly.

During the really big sucker of 2003-07 there were those who warned about the dangers (bubbles in housing, bubbles in private equity and hedge funds, bubbles in derivatives). It is no surprise that those doing the warning were often referred to as pariahs, nutcases, perma-bears and worse, while mainstream media and the portfolio managers who were the backbone of the bull market kept on cheering the rise in the market. The perma-bears have resisted the temptation to say "I told you so". Today, after the biggest stock market collapse since the Great Depression, many portfolio managers rationalize the collapse, remain upbeat (even when they are down 40-50 per cent) and say that stocks are at great valuations now, and that you have to think long-term.

Sucker rallies in a long-term bear market are the opposite of mini-bears in a long-term bull market. Two excellent examples of mini-bears in a long-term bull were the stock market crash of 1987 and the 1998 Asian/Russian/LTCM collapse. Over the past hundred years we have had three long-term bear markets: The Great Depression and War 1929-49, the inflationary 1970s (1966-82), and the current one (2000 to date). No word yet on when the current bear will end his rampage.

But sucker rallies can be fun. Just realize that they are sucker rallies, and not the end of the bear market.

What are the reasons for sucker rallies?

- Bearish sentiment is usually very high and even at extremes.

- The high volatility VIX indicator at a major low is usually at extremes.

- Economic numbers are showing signs of improvement, leading the pundits to declare that the worst is over.

- Stock valuations are low. Value managers in particular tout the huge under-valuations seen in the market. Trouble is, stocks can become even more undervalued.

- When a rally does get under way, many jump in from fear they will miss the move, thus fueling a further rally.

Why do sucker rallies come to an end?

- Overconfidence creeps back into the market even as economic numbers may be beginning to slide.

- Bullish sentiment rises.

- The longer the rally goes on, the more are sucked back into the market as the smart money is selling. Sucker rallies are usually on low volume.

- Rally ends suddenly as reality sets back in.

What kind of sucker rallies do we get?

- Failed suckers – these are usually short-lived lasting a week to a most a week or two lifting the market less than 10 per cent from any low.

- Mini-suckers – usually rallies of 10 to maybe 20 per cent from any low, lasting a few weeks to a month or so at best.

- Big suckers – usually more than 20 per cent and could even rise as much as 50 per cent from any low. Big suckers can last a number of weeks but usually no more than a couple of months or so.

- Really big suckers – can last for months and even years and gain 50 to 100+ per cent from the lows. It is usually during really big suckers that the pundits declare that the bear is dead and that we have entered a new great bull market that will go on for many years.

We are going to take a look at the three big bear markets of the past century. Of course this one isn't over yet, and if the previous two are any guide it won't be over until somewhere between 2016 to 2020. It is the sucker rallies, though, that give investors an opportunity to make back some lost money and to restructure their portfolios for the next stage of the bear market. Just remember that sucker rallies often end suddenly and violently. So when the uptrend line goes – get out. Once a rally gets underway one can usually determine a major up trend line as opposed to short term up trend lines.

THE 1929-1949 BEAR

Over the past century, the bear market of the Great Depression and World War II was the mother of all bears. The worst decline was the 89 per cent collapse from 1929 to 1932, and in 1949 the market was still down 57 per cent in real terms from the 1929 highs. It took until 1954 to take out the highs of 1929.

Over the years there were many failed suckers. Our chart above can't really show them. There were a few mini-suckers, especially in the last years, from 1946 to 1949. There were nine big suckers that rallied anywhere from 26 to 63 per cent off the lows – good, tradeable rallies. The two most prominent big suckers were from November 1929 to April 1930 (52 per cent off the lows) and from April to November 1938 (63 per cent). We also shouldn't ignore the 100 per cent rally that started off the July 1932 lows. It was impressive but pretty short-lived, ending two months later in September. While these rallies were strong and over 50 per cent we still called them big suckers because the time frame was so short.

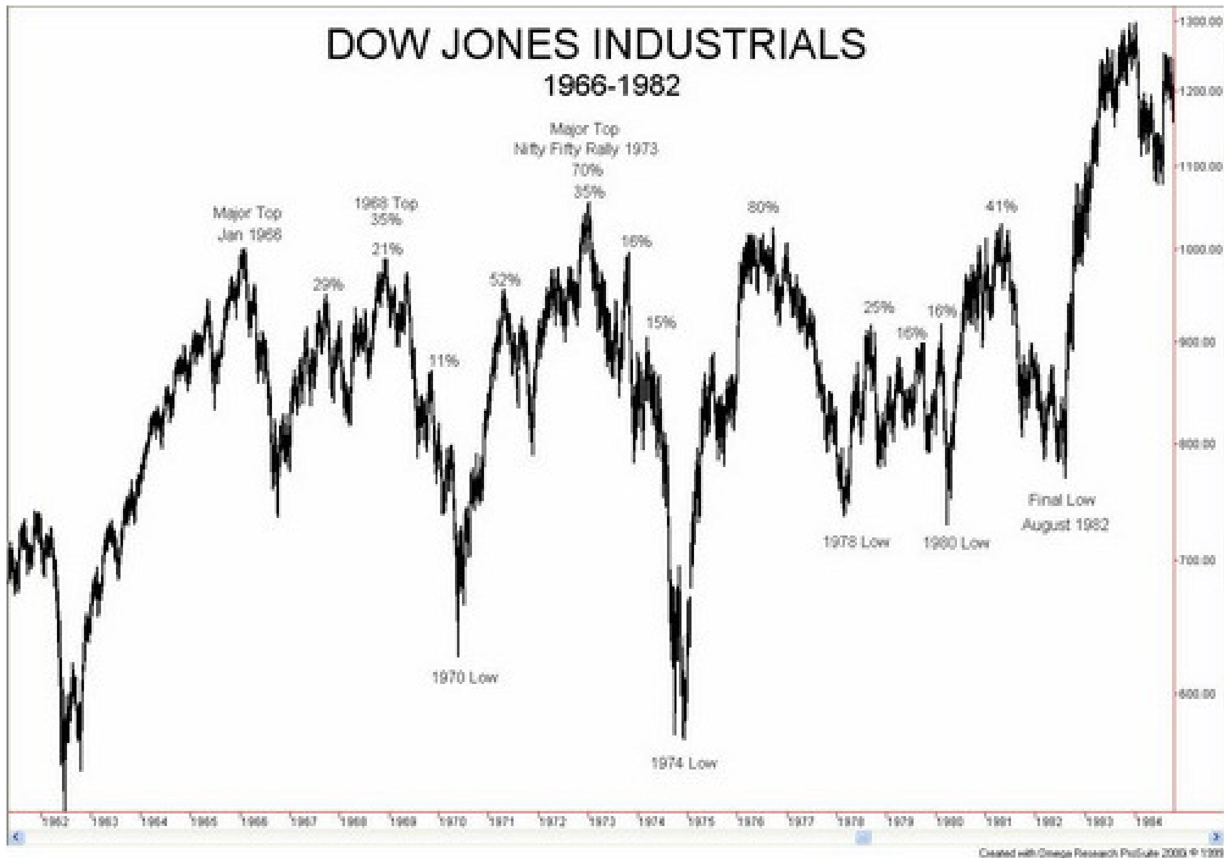
The best ones, though, were the two really big suckers. The first started at the secondary low in March 1933 and, with some interruptions, eventually gained 293 per cent from the lows, topping in March 1937 – a period of four years. The first phase gained 129 per cent before a six-month correction set in. Still, even at the final highs in March 1937 it was down 50 per cent from the 1929 highs.

The second really big sucker started in April 1942 and went through until June 1946. It was not as impressive as the first but it still gained 130 per cent off the 1942 lows and also lasted four years. Many considered the 1942 lows as the final lows of the Great Depression.

After the June 1946 top there was a mini-panic and three years of chopping around with a number of failed suckers until the final low in June 1949. While it took until 1954 to overcome the 1929 highs, the sense that we were putting the long nightmare of the Great Depression and War behind us really didn't happen until after the 1962 mini-bear. Four years later the market topped for the next 16 years.

For the period 1929 to 1949 there were: two mini-suckers (average gain 15.5 per cent); nine big suckers (average gain 44 per cent); and two really big suckers (average gain 211 per cent).

THE 1966-1982 BEAR



The bear market of 1966 to 1982 was very different from the 1929-49 bear market. Whereas the 1929-49 bear could be characterized as a massive collapse followed by years of trying to regain a foothold, the 1966-82 bear was a series of sharp ups and down over 16 years. The major collapse was the 46.6 per cent collapse from January 1973 to December 1974. That was also the lowest point of the 1966-82 bear.

There were fewer sucker rallies than in the previous period. There were numerous failed suckers and quite a number of mini-suckers. We didn't label failed suckers (under 10 per cent). We noted five mini-suckers, two big suckers and two really big suckers, although neither went on for any great period of time.

Mini-suckers were seen in the 1968 to 1970 market (one), the 1973-74 bear (two), and the period between the 1978 and 1980 lows where there was really just a series of ups and downs. The two big suckers were the rally from the 1966 lows following the collapse from the 1966 top. This big sucker rally was actually made up of two phases of big suckers, the first gaining 29 per cent and, following another sharp pullback,

the second phase gained 21 per cent for a total gain from the 1966 lows of 35 per cent.

The second big sucker was seen at the end of the 1966-82 bear when a sharp rally got underway out of the 1980 lows that added on 41 per cent in just over a year. A year later, in August 1982, the market made its final low.

The two really big suckers occurred in the middle of the bear. The rally out of the 1970 lows was impressive, gaining 70 per cent overall in 32 months. There were two stages, from May 1970 to April 1971 (52 per cent) and from November 1971 to January 1973 (35 per cent). The second stage became known as the Nifty Fifty rally because so few other stocks participated in it. A classic sucker rally. What followed was the devastating 1973-74 bear.

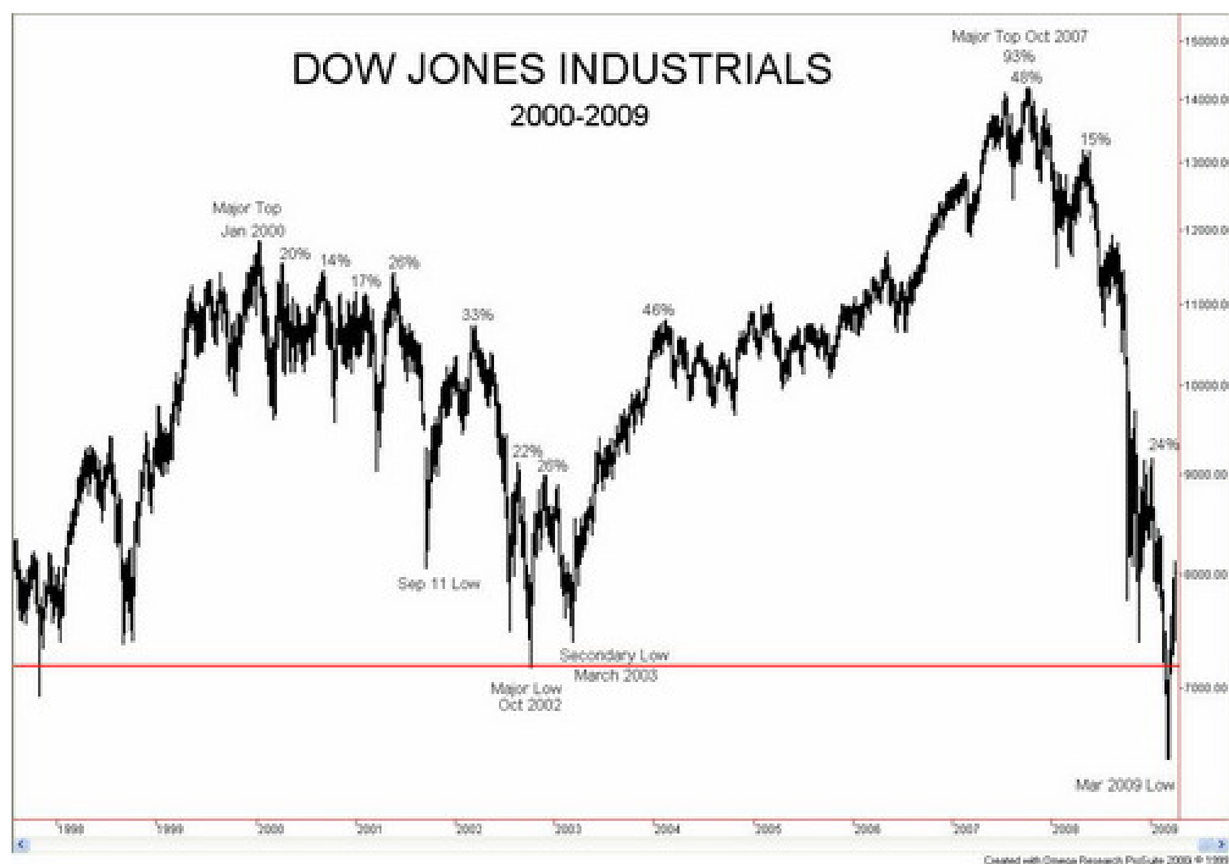
The second really big sucker was from December 1974 to May 1976 – a period of 17 months, and an 80 per cent gain off the 1974 lows. Short for a really big sucker, but the gain was impressive. Naturally it was quickly followed by another significant collapse into 1978.

The 1970s was a period of rampant inflation. While the Dow Jones Industrials lost only 24 per cent to the lows of 1982 from the highs of 1966, in inflation-adjusted terms it was far worse. For the entire period, those who pursued commodities, particular energy stocks and gold and precious metals stocks, were able to make major gains. Oil prices were rocked by the Arab embargoes and finished the period with the Iranian hostage crisis that sent them soaring to $40 (over $100 in today's terms). Richard Nixon took the world off the gold standard in August 1971, when gold was $35 an ounce. Following the collapse of the Bretton Woods agreement and the onset of floating currencies, gold soared to $850 by January 1980.

In 1984 the stock market finally firmly passed the 1,000 mark, marking a period of some 18 years before investors saw the return of their money from 1966. (On an inflation-adjusted basis it was well into the 1990s before they recouped their money.) So much for "buy and hold".

For the period 1966-82 there were: five mini-suckers (average gain just under 15 per cent); two big suckers (average gain 38 per cent); and two really big suckers (average gain 75 per cent).

THE 2000–PRESENT BEAR



Once again, today's bear market and the 1966-82 bear market are as different as night and day. If there are similarities, they are with 1929-49.

This bear is far from over and we expect it will not make its final bottom any sooner than 2016, and we could go as long as 2020. Of course it may fool us and go on even longer, but based on our minimalist list of past big bears that is our current best prognosis.

As to how deep this one will take us, it is still anyone's guess. We suspect that the Dow Jones Industrials will at some point go as low as 4,000. That could occur on either of our two potential cycle anniversary dates of sometime in 2012 or 2016. That would make any low in 2020 a higher low. We have seen prognosis from super bears such as Elliott Wave guru Robert Prechter that the lows will be in the area of 1,000-1,300, and from Kondratieff Wave cycle analyst Ian Gordon, who also is calling for 1,000-1,300 for the Dow Jones Industrials. This is in keeping with a forecast that this bear market will test the highs of the 1966-82 bear market, which were in the 1,000 area.

We have said before that this bear shares some characteristics thus far with the 1929-49 bear. It is not replicating it, but we have some uncanny similarities. The Great Depression/War bear saw the first phase of its collapse top in September 1929 and bottom in July 1932. This time we topped in January 2000 and bottomed in October 2002. The collapse wasn't as devastating as in 1929-32, though: 40 per cent compared to 89 per cent (although the tech-laden NASDAQ lost over 80 per cent).

The 2000-02 fall was punctuated by numerous sucker rallies. We note five that we could call big suckers

and a couple more mini-suckers. Only one had any duration: the 33 per cent rally out of the September 11, 2001 low that topped in March 2002. All of the others were swift ups and downs. Many of them had gains of over 20 per cent, while a couple of smaller ones were squeezed into the series of ups and downs that occurred between January 2000 and May 2001.

As with the 1930s that saw a really big sucker rally between 1932 and 1937, we had one between October 2002 and October 2007. There was a secondary low in March 1933 and again in March 2003. The 1933-37 rally subdivided into two phases and so did the 2003-07 rally. The first phase of the 2003-07 rally gained 46 per cent and the second phase gained 48 per cent from its lows in 2004 for a total gain from the 2003 lows of 93 per cent.

In 1937-38 there was a financial panic; in 2007-08 there was another. The current financial panic collapse saw a mini-sucker, a failed sucker and a big sucker before finding its most recent bottom in March 2009. What is different about this collapse is that while the 1937-38 panic did not take out the 1932 lows, this time we did take out the 2002 lows. This is telling us that this phase of the bear has far more potential to the downside. Our target of 4,000 could easily be seen by 2012 but in between there is the potential for at least one sucker rally and maybe two or three as the period is punctuated by a series of ups and downs.

The current rally is already up 26 per cent from the March 2009 lows. It already qualifies as a big sucker. We may have longer and further to go. We are looking for a rally that could take us to 11,000 to 11,500 over the next several months. But it could also tail off near 9,000. A rally of that former magnitude would see us up at maximum 78 per cent – really big sucker territory – or we could be up only about 40 per cent if the latter target is hit, a respectable big sucker.

The period 1938-42 saw four sucker rallies, three big suckers and a mini-sucker. Each rebound failed to take out the high of the previous rally. The final low in 1942 was only marginally below the low of 1938. This time we could be considerably below the March 2009 lows (6,443) if the 4,000 target were realized. Irrespective, the rules are the same. This is a period to restructure for longer-term investors. It is also a period for more aggressive investors to recoup some losses. But investors should never be fooled into believing that the bear market that got underway in January 2000 is anywhere near over. We are just moving into another phase.

The current rally has been running into resistance in the 8,000 area for the Dow Jones Industrials (850 for the S&P 500 and 9,000 TSX Composite). As we move towards the close April 9, 2009 we appear to be trying to close over this resistance zone. This is good news if the rally is to continue from here. Support for the DJI is important at this stage at 7,600/7,700, for the S&P 500 800 and the TSX Composite 8,700. Only firmly below these levels would we say the current rally is in trouble. But a close over these levels could turn us higher with targets in this move to 9,000 DJI, 900 and higher for the S&P 500 and 9,500/10,000 for the TSX Composite.

For the period 2000 to present there have been: three mini-suckers (average gain 15 per cent); six big suckers (average gain 25 per cent); and one really big sucker (93 per cent).

The current big sucker has already attained the average gain big sucker gain this decade but remains below the average big sucker of the 1929-49 bear (44 per cent) and the 1966-82 bear (38 per cent). Is there more to come or is this it for this phase?

Stay tuned.

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Note: Charts created using Omega TradeStation.   Chart data supplied by Dial Data.

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