

PHASES & CYCLES®

THE BIG PICTURE

Current market turmoil is a consequence of excesses that build up every four years or so. We now know that this time the excess occurred in the US real estate and mortgage markets. This phenomenon of a multi-year rise followed by a correction is commonly known as the four-year cycle. While this pattern is sometimes mentioned in the media, there is also another very important cycle that is rarely, if ever, mentioned – the sixteen-year cycle (*). Many investors, especially in Canada, do not understand the impact of this cycle on investment trends.

Shortly after the end of World War II, the Dow Jones Industrial Average (DJIA) rose 800% from 1950 to 1966. However, for the next sixteen-years (1966 to 1982), while the US suffered from Vietnam, Watergate, and high oil prices, the DJIA made very little progress. At the same time, the Toronto market, driven by the Resources, tripled from 790 to 2402!

After the commodity bubble burst, trends reversed abruptly in 1982. US blue chips, which had been depressed for so long, took off in August 1982 and by the peak in 2000 the DJIA had increased almost 1,300% as it rose from 800 to 11,750. At the end of the Cold War, the superiority of the US became evident and culminated with the technology bubble in 2000. While the US was having it's 'day in the sun,' the TSX only rose 740% as prices for oil, gold and other commodities fell over 70%. Moreover, the Canadian dollar lost one third of its value, deficits snowballed and Quebec separation became a constant threat.

Since most investment experts have been in the business less than 20 years, the experience of consistent underperformance by Canadian investments during the 1980's and 1990's gave rise to the prevailing view that Canadian investors should only invest one third of their assets in Canada.

The investment trends that changed so abruptly in 1982, reversed again in 2002. Now, five years after 2002, US global supremacy is waning, deficits are rising and the US dollar is declining. After doing so well for so long, the Americans are suffering just as Canadians did during the previous 20 years. Who would have believed five years ago: that the Canadian dollar would be at par with the US dollar; that taxes would be much lower; that the Federal government would have huge budget surpluses; that oil prices would be at \$100 a barrel? Not very many people!

Remember that since the sixteen-year cycle started in 2002, we are not even half way through it yet. This means that even if there is a setback (such as

the Crash of 1987 during the previous sixteen-year cycle) the major trend is likely to continue for a long time to come.

In summary, the major trend during the previous cycle was for *financial assets*, while the major trend now is for *real assets*!

Commodities are real assets. They (Energy, Materials including Golds) represent 43.5% of the S&P/TSX Index, while they are only 14.9% of the S&P 500 Index. Strategists, portfolio managers and investors should remember the major impact of this very long term cycle when they follow the conventional wisdom by investing two thirds of their assets outside of Canada.

Happy New Year! We hope that 2008 will be a good year for you in every way.

(*) Editor's note: Phases & Cycles often publishes on the existence of the 40-year cycle and the strength of the Resources at the tail-end of the cycle (just as today). Dave's research on the 16-year cycle and his comments on the 4-year cycle confirms the nesting characteristics of cycles (how a shorter cycle "fits" into a longer one) and proves once again the importance of cycle observation for investors

Phases & Cycles Inc.,
2020 University, Suite 1903, Montreal, QC H3A 2A5
Tel.: (514) 393-3653 E-mail: RonMeisels@phases-cycles.com www.phases-cycles.com
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