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Get out of stocks, Robert Prechter warns

'Winter is coming. Buy a coat,' market forecaster says

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With the stock market lurching again, plenty of investors are nervous, and some are downright bearish. Then there's Robert Prechter, the market forecaster and social theorist, who is in another league entirely.

Mr. Prechter is convinced we have entered a market decline of staggering proportions - perhaps the biggest of the last 300 years.

In a series of phone conversations and e-mail exchanges last week, he said that no other forecaster was likely to accept his reasoning, which is based on his version of the Elliott Wave theory - a technical approach to market analysis that he embraces with evangelical fervour.

Originating in the writings of Ralph Nelson Elliott, an obscure accountant who found repetitive patterns, or "fractals," in the stock market of the 1930s and '40s, the theory suggests that an epic downswing is under way, Mr. Prechter said. But he argued that even skeptical investors should take his advice seriously.

"I'm saying: 'Winter is coming. Buy a coat,'" he said. "Other people are advising people to stay naked. If I'm wrong, you're not hurt. If they're wrong, you're dead. It's pretty benign advice to opt for safety for a while."

His advice: Individual investors should move completely out of the market and hold cash and cash equivalents, like Treasury bills, for years to come. (For traders with a fair amount of skill and willingness to embrace risk, he suggests other alternatives, like shorting the market or making bets on volatility.) But ultimately, "the decline will lead to one of the best investment opportunities ever," he said.

Buy-and-hold stock investors will be devastated in a crash much worse than the declines of 2008 and early 2009 or the worst years of the Great Depression or the Panic of 1873, he predicted.

For a rough parallel, he said, go all the way back to England and the collapse of the South Sea Bubble in 1720, a crash that deterred people "from buying stocks for 100 years," he said. This time, he said, "If I'm right, it will be such a shock that people will be telling their grandkids many years from now, 'Don't touch stocks.'"

The Dow, which now stands at 9,686.48, is likely to fall well below 1,000 over perhaps five or six years as a grand market cycle comes to an end, he said. That unraveling, combined with a depression and deflation, will make anyone holding cash “extremely grateful for their prudence.”

"Probably Saying The Same Thing"

Mr. Prechter is hardly the only market hand to advocate prudence now, but nearly everyone else foresees a much rosier future once current difficulties are past. For example, Ralph J. Acampora, a market analyst with more than 40 years of experience, said he moved entirely out of stocks and into cash late last month. Now a partner at Alverita, a wealth management firm in New York, he said recent setbacks suggested that the market would drop another 10 or 15 per cent, probably until September or October, before resuming another “meaningful rally.”

Over the next several years Mr. Acampora expects an “old normal market,” characterized by relatively short-lived swings that will provide many opportunities for smart investors - one that resembles the markets of the 1960s and 70s. “I’ve lived through it,” he said.

Like Mr. Prechter, he is a past president of the Market Technicians Association, the leading organization of technical market analysts, and he said that his colleague has done “some very good work.” But Mr. Acampora doesn’t agree with Mr. Prechter’s long-term theories, either intellectually or emotionally.

The “mathematics don’t work,” Mr. Acampora said, because such a big decline would imply that individual stocks would need to trade at unrealistically low levels. Furthermore, he said, “I don’t want to agree with him, because if he’s right, we’ve basically got to go to the mountains with a gun and some soup cans, because it’s all over.”

Still, on a “near-term” basis, he said, “We’re probably saying the same thing.”

Similarly, Larry Berman, who co-founded ETF Capital Management in Toronto and recently ended his term as the president of the technicians association, says he sees a “classic” short-term negative market trend developing now. But he doesn’t use the Elliott Wave theory, saying Mr. Prechter is trying to “measure the market in decades, which is too long a time frame for practical trading purposes or for risk management.”

"Socionomics"

Mr. Prechter, 61, lives in Gainesville, Ga., where he runs Elliott Wave International, a forecasting and publishing firm. He graduated from Yale University as a psychology major in 1971, dabbled as a singer, drummer and songwriter in a rock band and became a technical analyst for Merrill Lynch.

Mr. Prechter became fascinated by Elliott’s writings, which suggest that the market moves in predictable if complex patterns. Along with A.J. Frost, Mr. Prechter wrote “Elliott Wave Principle,” a 1978 book that predicted the emergence of a great bull market - a forecast that was largely fulfilled. By 1987, he was widely regarded as an expert in technical analysis. Articles in The New York Times said he was known as “the market’s leading technical guru” -- and more. An article in October that year said he had “emerged as both prophet and deity, an adviser whose advice reaches so many investors that he tends to pull the market the way he has predicted it will move.”

He has far less day-to-day influence now, after years spent developing a theory he calls “socionomics,” which holds “social moods” as the cause not only of market cycles but also of economic and political events. A grand cycle is ending, he says, and the time for reckoning is near.

In 2002, he published “Conquer the Crash,” which predicted misery ahead. Even so, he said in 2008 that the market would soon rally sharply - then said late last year that stocks were about to fall and that the great decline would resume.

Since 1980, the advice in his investing newsletters, when converted into a portfolio, has slightly underperformed the overall stock market but has been much less risky, losing money in only one calendar year, according to calculations by The Hulbert Financial Digest. Mr. Prechter said he disagreed with the methodology used in these measurements, but offers none of his own.

For his part, Mr. Acampora says that the Elliott Wave has some validity as an indicator but that "it's only part of the story" of technical market analysis, which also needs to be buttressed by economic and fundamental research.

Mr. Prechter says his unifying theory, socionomics, is a "young science."

"We're quantifying it," he said. "We're working on it." In the meantime, he contends, it has enabled him to "look around the corner" and prepare for a dangerous future.