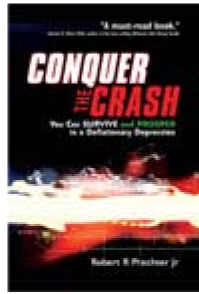


In this three part interview, Elliott Wave International president Robert Prechter discusses his new book, "Conquer The Crash: How To Survive and Prosper in a Deflationary Depression."

During the 1980s, Bob Prechter won numerous awards for market timing as well as the United States Trading Championship, culminating in Financial News Network (now CNBC) granting him the title, "Guru of the Decade." In 1990-1991, he was elected and served as president of the nation-al Market Technicians Association in its 21st year.

He has also published a seminal book on Elliott wave analysis titled, "Elliott Wave Principle – Key To Market Behavior," three books on the major practitioners of wave analysis, and books on his own views in *Prechter's Perspective* and *At the Crest of the Tidal Wave*.

Part 1

In your professional career, you've made a number of long-term market forecasts that lie far outside of conventional opinion. Is there a reason why you have so often stood outside the crowd?

I make my forecasts using the Wave Principle. I don't rely on any data external to the market. I study the charts and interpret the waves as best I can. News is not helpful – in fact, it's counter-productive. I could do this on a desert island as long as I had access to the charts. This method often places my forecasts outside of public opinion because the majority relies on news, which is always bullish at tops and bearish at bottoms.

Majority opinion cannot be any other way, because the herding nature of human beings forms a popular consensus, which creates the market's trends and turns.

Your first big public forecast was made in 1978 in your book, "Elliott Wave Principle – Key To Market Behavior," which you wrote with A.J. Frost. Can you tell us more about this forecast and the financial climate that it was made in?

It's easy to forget, but the late '70s were a period of widespread financial worry. People were fairly resigned to a gloomy view of the stock market and the economy. Inflation and gas prices were skyrocketing, and interest rates were on their way to new all-time highs. Portfolio strategists were calling for the final smash of the secular bear market that began in 1966. A public opinion poll showed that the U.S. public was more negative about "the future" than at any time since the poll's origination in the 1940s.

In 1978, the Dow moved as low as 740 but it never came near the 1974 low at 577. In the book, I described, along with A.J. Frost, "the current bull market in stocks…which should accompany a breakout to new all-time highs."

Which of course it did.

Yes. We knew that wave 5 had begun and would overcome the gloom.

When you called for the Dow to reach as high as 4000, people thought you were crazy – just as some think of you today.

Who, me?

You also successfully forecast the crash in 1987, didn't you?

Nobody specifically predicted a "crash" before it started, including me. But I did tell people to sell, right when the sentiment indicators showed the majority bullish. In fact, that was one of the reasons I turned cautious. Then the Dow fell 900 points, which back then meant something!

Haven't you also nailed gold and silver?

Yes, for over 20 years. They have been my most consistent markets.

But allow me to caveat my own track record. In the '90s I made the biggest mistake of my career. Even though I predicted that "Investor mass psychology should reach manic proportions" in the stock market, I never imagined that the mania would carry on as long as it did. Wave 5 continued higher throughout the '90s, and I got off too early.

Did that turn you bullish?

Quite the opposite. I think my basic interpretation of the long-term financial picture is correct. I'm not timing a five or ten-year trend here; I'm attempting to pinpoint the termination of a 200+ year move and a killer bear market. The higher it went, the more bearish I got.

Let's talk about your current long-term forecast. You've just written a book titled "*Conquer The Crash*."

All signals point to the fact that wave 5, which is the final leg up of our great bull market, topped in early 2000. Mass psychological trends are now fueling a corrective move that will decimate stock prices.

I believe it's time for people to prepare for a vast economic disaster, which will include a deflationary crash and an economic depression as bad or worse than the one suffered in the early 1930s.

When will it begin?

It is already in progress!

I'm not sure the world is ready for this.

Has it ever been? Disasters of this magnitude always catch the general populace off guard. Today is no exception – too few are even remotely prepared for this crash.

What should we do?

My book is subtitled "***How To Survive and Prosper in a Deflationary Depression***," and it will tell you exactly how to do just that. There's still time to prepare for this impending financial disaster, but not much. Once things really get going, the panic will make it more difficult to protect yourself.

You've got to start preparing now.

Part 2

To someone not educated in both monetary trends and the Wave Principle, the coming of a second Great Depression is an idea that's very hard to swallow.

Understandably. Deflation and depression are exceedingly rare. As I mention in the forward to my new book, sustained deflation hasn't occurred for 70 years, and the last one was so brief that it only lasted 3 years.

During the past two centuries, there have been just two depressions; one in the nineteenth century, and one in the twentieth. Most economists now believe that deflation and depression are utterly impossible in our modern economy, if not ever.

But there's an enormous wealth of historical evidence that suggests that this rare event is about to occur.

What evidence?

Let me begin by stating an undisputed fact that every first year economics student learns about stocks: A stock certificate may have an objective value on one basis or another, but is still only worth what someone else is willing to pay for it.

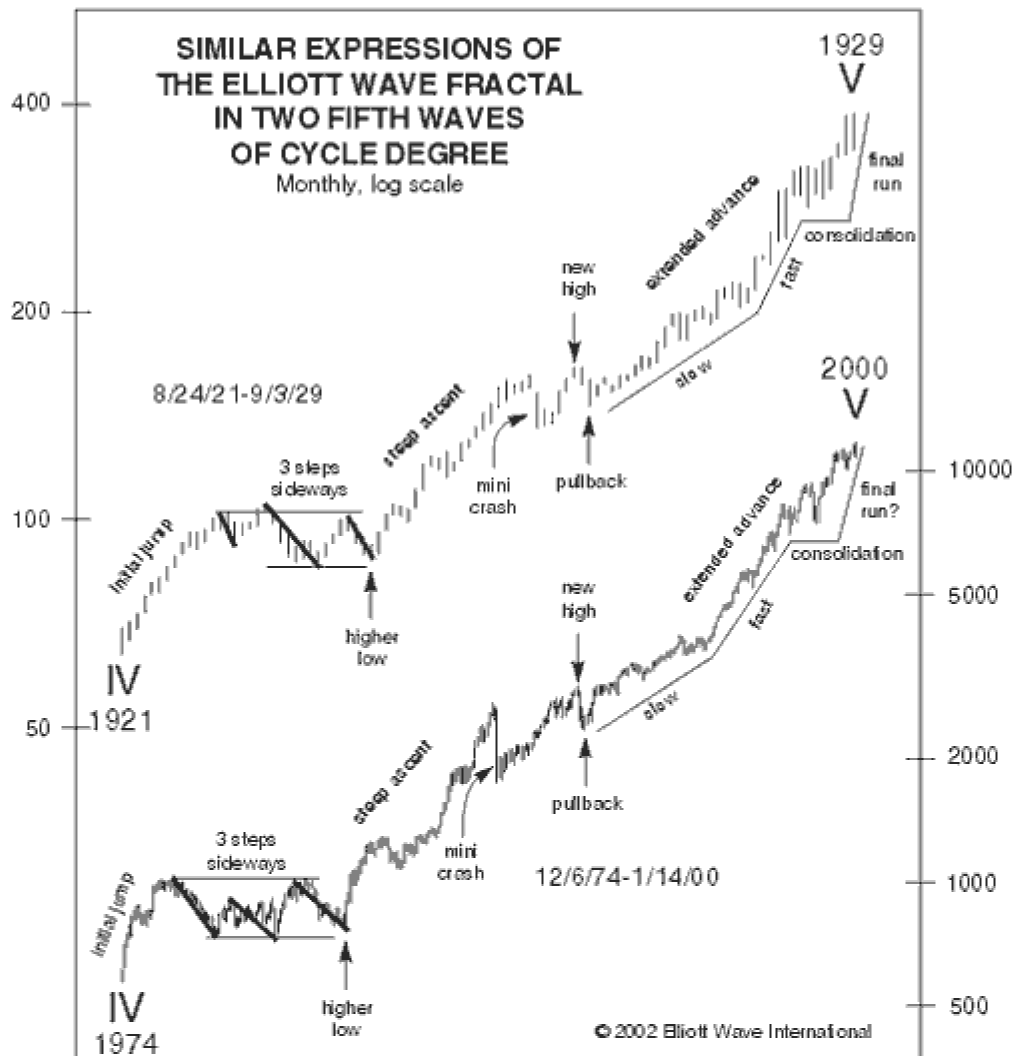
When we look at a 100 year chart for the Dow, we're not looking at a record of the prosperity of the corporations involved. We're looking at an intimate record of what people felt that stocks were worth. When the Dow crashed in 1929, it wasn't a reaction to a sudden drop in corporate profits. That came afterward.

Bear markets are a fear-based mass psychological phenomenon, which changes the value of the shares.

So how does that relate to today's market environment?

It doesn't matter that today's Dow index comprises different companies from those in 1929. Human beings' hard-wired, cyclical impulses of fear and hope have remained the same.

Keeping in mind that a stock chart is a record of mass psychological impulses towards fear and hope, let's compare two charts; one from 1929, and one from today's markets:



That's uncanny, isn't it? Though they were trading stocks of different companies, investors in 1929 and today's investors have shown amazingly similar habits of valuation.

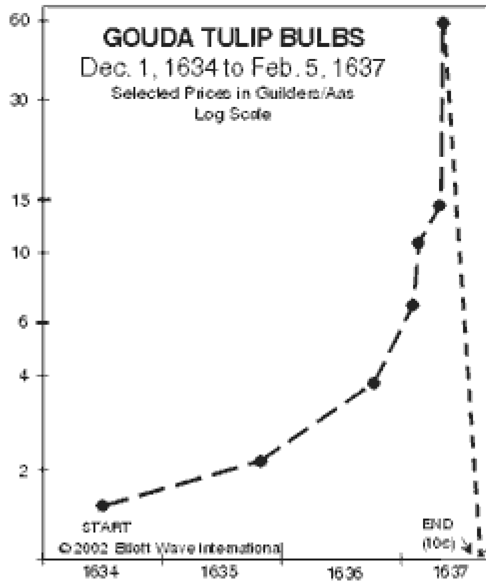
Stock prices are determined by impulsive human nature in a interacting in a social setting. Because human nature does not change, history tends to repeat itself, even in stock prices.

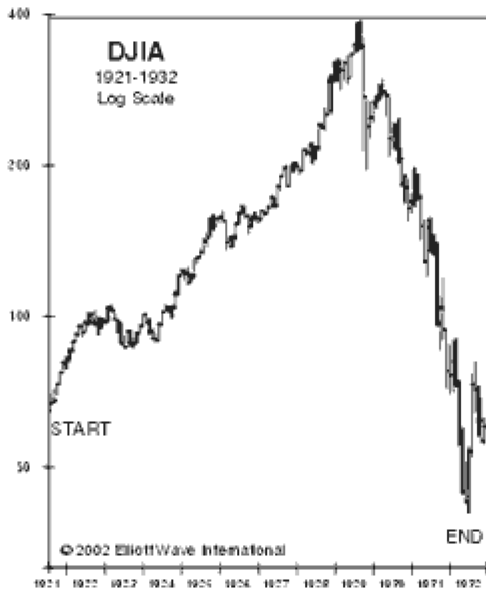
For those not already immersed in the Wave Principle, do you have more historical evidence to support your claim?

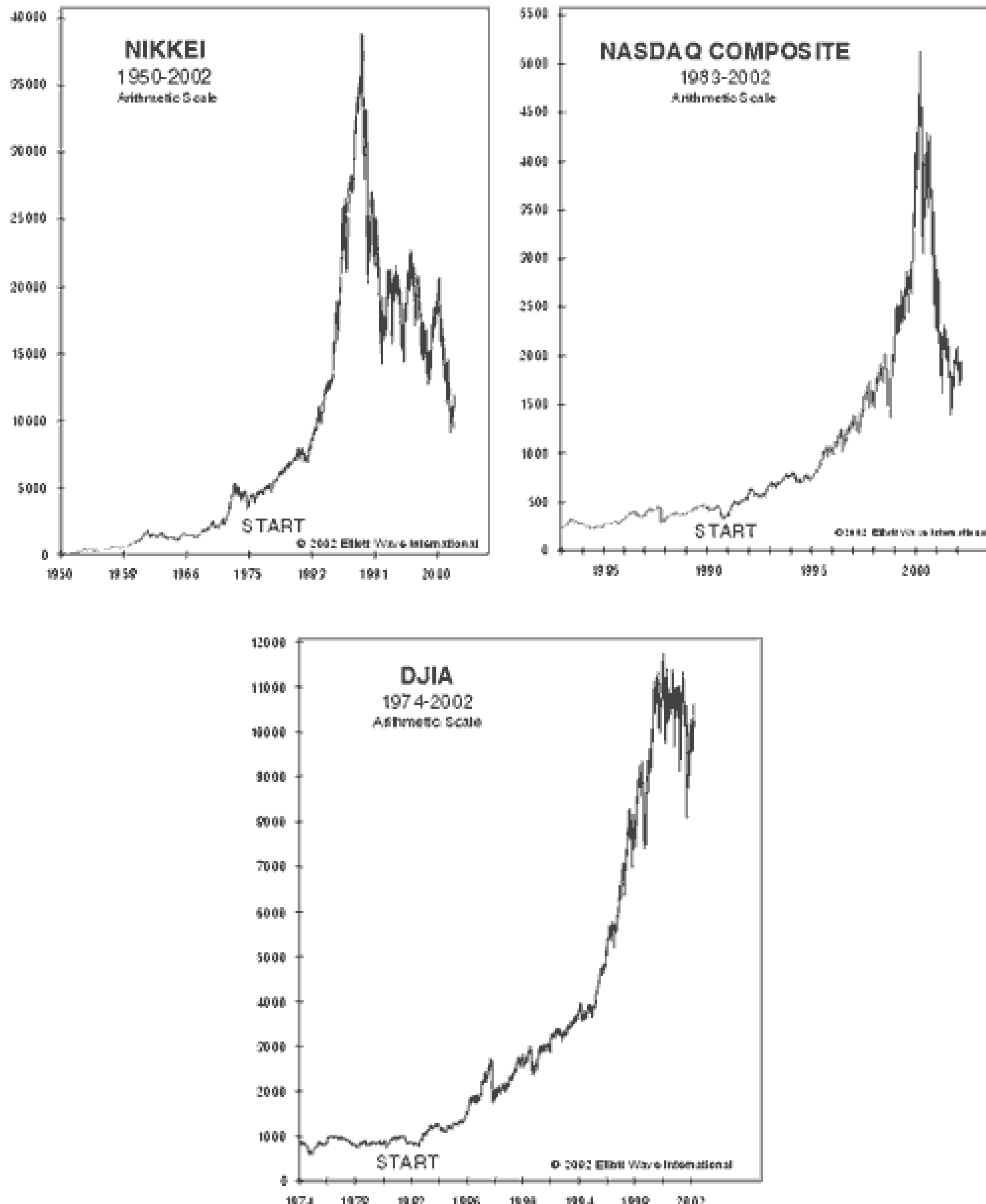
I conducted a research into famous market manias and their aftermaths. Here's what I found:

Famous Market Manias

And Their Aftermaths, 1600-2001







A bull market mania is a rare event that produces a powerful, persistent rise with remarkably fewer, briefer and/or smaller setbacks. They occur at times of historic overvaluation and usually involve broad participation from the public.

Of the most extreme cases of overvaluation in history was the Dutch Tulip bulb mania in the 1600s. I mean, it's a pretty flower – but the bulbs weren't made of gold. When people finally realized this, a mass psychologically-induced wave of fear sent prices to below the point where the mania began. That's another important characteristic of a market mania.

And we all witnessed the same psychological patterns with the Nikkei wipe-out throughout the nineties. We've seen it happen elsewhere, but still can't believe that it could happen here.

As you look at each of these charts and think about the specifications of a market mania, (powerful price runs, broad participation, rampant, unrealistic optimism) doesn't it seem likely that that's exactly what we experienced in the great market boom of the mid to late nineties?

Well, some people said it was a New Economy.

Yes, just like the New Era of 1928 and the Japanese Miracle of 1989.

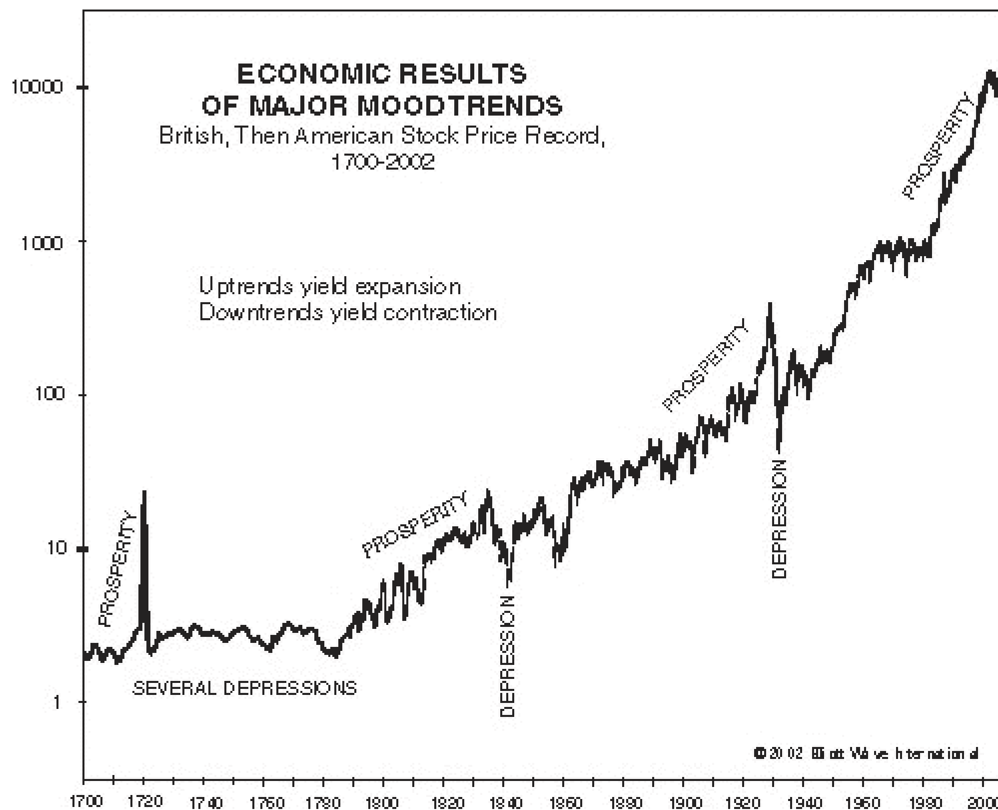
Look, I don't expect these arguments to convince everyone outright that we're staring down the barrel of the greatest financial disaster of our lives – but shouldn't they should give you reason to stop and think?

That's all I'm asking of anyone. Don't stay convinced of something merely because popular consensus refuses to question it. The crowd has been wrong many times before – and it will be wrong again.

Can you tell us more about some of the evidence presented in your new book, "*Conquer The Crash*?"

To me, the most convincing arguments rely on discussions of the Wave Principle. But I also spend 5 big chapters on monetary trends and the Federal Reserve. There is important information there that 1 person in 10,000 properly understands.

*(**Editor's Note:** Read more about monetary trends and surprising facts about the Federal Reserve in Part 3 of our interview.)*



Part 3

Your historical market studies and research into the Wave Principle have led you to believe that stock prices are preparing to crash. We've heard some of your arguments for why this is already happening.

But in *Conquer the Crash* you also give a good deal of attention to discussing and helping readers prepare for a severe monetary deflation. Can you tell us more about this?

First I want to make sure that everyone understands what deflation really is. A common misunderstanding is that inflation occurs when the prices for goods rise, and deflation

occurs when they drop. That's not exactly true. General price changes are merely effects of a change in value of the money itself – not the other way around.

So what causes changes in the value of money?

Changes in monetary valuation are caused by changes in mass psychology. The same is true for the stock market. A severe deflation like the one we are now facing has always required a certain economic pre-condition: A major buildup of credit, which is itself the result of a certain state of social psychology.

Our economy today rests upon masses of consumer and corporate credit. Today, the U.S. owes a collective $30 trillion in debt. That's nearly 3 times our annual GDP. We've become entirely dependant on it.

The economic theory that has seen the U.S. economy grow progressively larger and more powerful since World War II is that a wide-spread facilitation of credit will stimulate production, which will in turn create jobs and generate more capital to be re-invested in the economy.

That's a model that's been successful for economies around the world thus far. Where do you see the problem with it?

It's gotten way out of hand. The Federal Reserve Board allows our banks to lend out all of their deposits (and in some cases, even more than 100%). This money, once loaned, is allowed to be re-loaned many times over, multiplying the amount of debt.

What this means is that we've got great multiples more credit afloat in our economy than we have actual money. It's terrifying, but true.

As strong as our economy may still seem to everyone, it's actually rife with weakness. The only thing keeping it afloat right now is a mass societal consensus that it's going to be O.K. How long can that hold?

As the stock market continues to decline, people will continue to lose their jobs and production will decrease. Knowing that there's not enough money out there to cover all the endangered debt, banks will begin to panic. They will become desperate to retrieve their liquid assets. When the general ability to repay debt decreases, so will banks' willingness to lend more.

This is what will finally trigger a massive deflation.

But wait. Won't the Fed prevent this from happening?

That's a huge misconception. The Fed will be powerless to stop it.

Realize that the Fed doesn't actually lend money to consumers. It merely sets the interest rates at which banks lend each other money. The hope is that banks will take these lower rates as a cue to pass the lower rates down to the consumers, thus facilitating more credit – but it can't guarantee that this will happen.

In 2001, the Fed lowered its discount rate from 6 percent to 1.25 percent. That's the heaviest cut in such a short time ever. But what if this strategy fails, as it did in Japan? It certainly hasn't "saved the economy" so far. What will they do if the economy continues to contract? Lower the rates to zero?

Then what?

When people are losing jobs and the purchasing power of the dollar is rising, consumers won't want to borrow money that they will have to pay back with much more valuable dollars later on. Also, having been burned by bankruptcy and loan defaults, banks will be considerably less willing lend this money in the first place.

This will have disastrous effects on our credit-based economy.

Scary. So what should we do to protect ourselves from this possibility?

Depending on your circumstances, there are a number of ways that you can first protect yourself from a deflationary crash, and then actually profit from it.

Most important, get out of debt. Because the value of the dollar will be rising, one of the best investments you can make now will be to hold cash.

What about the other markets?

Conquer the Crash **explains exactly what you should do in regard to bonds, real estate, stocks, commodities, precious metals, insurance, and more.**

It won't be necessary for you to keep your money in a coffee can under the bed. There are a number of "Safe Banks" around the world that, because of their conservative policies, you will be able to trust with your money. *Conquer the Crash* lists several.

Also, you'll learn about "inverse index funds," an interesting way to short the market on its way down. And it tells you exactly how risky real estate investments are and what you should do about them now.

Obviously those with substantial personal fortunes stand to benefit from the wealth-protecting measures you outline in *Conquer The Crash*. But do you have to be wealthy to take advantage of the strategies in this book?

Absolutely not. *Conquer the Crash* offers strategies for financial protection in two different tiers.

For investors with deeper pockets, it offers international-level protection by giving advice about safe banks and precious metal storage. For the average investor, or even for those with no money in the markets at all, there are countless chapters devoted to important concerns like, "What to do with respect to your employment" and "What to do with your pension plan."

A lot of the advice is preventative. It tells you what not to do. And it's going to be very important not to make mistakes. Only one or two missteps and you may find yourself in a very dangerous financial position along with the masses.

Final words?

The publisher will make most of the money from sales of this book. Anything we make will be spent on getting the word out about the crash. I know this disaster is coming, and I want to do everything that I can to protect people from it.

Read *Conquer the Crash*, and then have your friends and loved ones read it. You can read it in a day, and it may keep you weathered from a storm that will be blowing for years to come.