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Discussion Paper No. 1

ASX200 to Hit 3750 – Myth or Reality?

"History repeats itself because nobody listens" - Laurence Peter

Overview

The Bull Market that originated in March 2003 is reaching maturity. It is timely therefore to consider how previous bull markets ended.

This paper presents analytical evidence suggesting a dramatic wealth-destroying ending is possible. The worst case scenario would be a repeat of 1987. Such an event would result in the ASX200 falling to 3750, 41% below its July 2007 peak. Statistically, a more probable scenario is a move to around 4975. This would require a correction from today's close of 18% for the ASX200 and 20% for the S&P500.

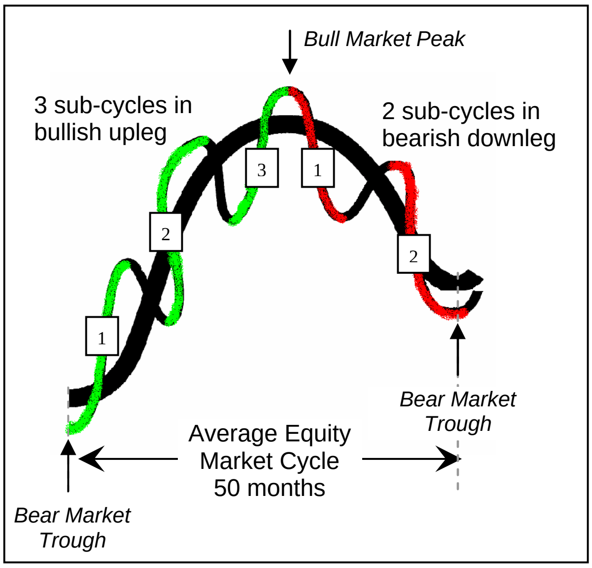

Figure 1: Market Cycle Model – Based on the Dow 30

Background

Yelton Fiscal[1] conducts research into market cycles across a broad range of markets and financial instruments. Much of their research is US-centric; however with the globalisation of equity markets they have shown their analysis is applicable to most global equity markets.

Yelton has analysed cycles of the Dow 30 back to 1899. Their analysis reveals the average long-term cycle duration is 50 months trough to trough (see Figure 1). The last recorded trough for most global markets was March 2003. The last recorded peak was potentially July 2007.

Post World War II, the average bull market duration is 38 months and the average bear market duration is 12 months. The current bull market persisted for an above-average 53 months, assuming the peak was in July 2007.

Within each bull market there is an average of 3 sub-cycles, and within each bear market there is an average of two. Five bull market sub-cycles powered global equity markets into the peak of October 1987. Most global markets (including the US and Australia) are currently positioned in their 6th sub-cycle.

History

Over the last 100 years there have been 8 occasions in which the major global markets have experienced either 4, 5 or 6 bull market sub-cycles. There are no occasions in which there have been 7 sub-cycles.

Yelton Fiscal analysed corrections in time and magnitude following over-extended bull markets (ie: those with 4, 5, or 6 sub-cycles). Their results are as follows:

Year	Duration	% Decline
1923	7 months	-18.5%
1934	5 months	-24.4%
1961	7 months	-26.4%
1979	6 months	-16.1%
1987	2 months	-41.2%
1990	3 months	-22.5%
1994	3 months	-11.1%
1998	2 months	-21.0%
Average	**4.4 months**	**-22.7%**

[1] Whilst not well known in Australia, Yelton Fiscal Inc provides their research to over 100 of the top fund managers around the world. I have spent the last 4 years studying their methods and approach.

Bear Phase Potential: US Equities

Given global equity markets are currently in their 6th bull market sub-cycle, we would expect the <u>minimum</u> correction in the US equity markets to be the average of 22.7%

The S&P500 peaked at 1556 on 16 July 2007. It dropped 11.8% to 1372 one month later. If this correction is complete then the US equity markets have experienced the shortest duration, and second shortest magnitude correction in at least 100 years. Probabilities therefore suggest the correction is incomplete.

Bear Phase Potential: Australian Equities

The ASX200 peaked at 6437 on 13 July 2007. It dropped 14.8% to 5483 on 16 August. Given major markets tend to move with similar magnitudes, we could conclude the Australian equity market has further to fall.

Assuming the ASX200 experiences a decline similar in magnitude to that of the Dow 30 then we could expect the ASX200 to correct to around 4975 (See Figure 2). Similarly, the S&P500 would correct to around 1145 (see Figure 3).

In Perspective

Considering the strength of the bull market over the last 4 years a correction to 4975 would take the ASX200 back to the level at which it was trading in mid 2006. Similarly, the S&P would fall to the level at which it was trading in early 2005. Such moves do not appear unreasonable given the strength of the equity markets over this time.

A repeat of 1987 would see the ASX drop to 3750, the level at which it was trading in late 2004. Similarly, the S&P500 would fall to 870, the level at which it was trading in early 2003. These moves would retrace most of the bull market and therefore appear unlikely.

In Conclusion

Statistical analysis of prior market corrections suggest global markets have not yet completed their corrective phase. A fall to 4975 for the ASX200 and 1145 for the S&P 500 appear probable. Such moves would require the ASX200 to fall 18% from today's close and the S&P500 to fall 20%.

Your comments on this paper are most welcome.

Figure 2: ASX200 from inception of bull market in March 2003 to present.

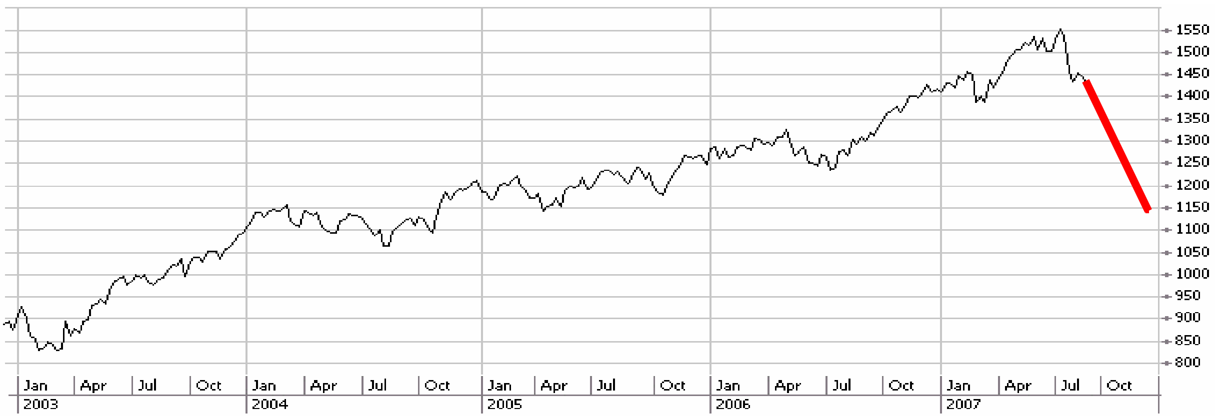

Figure 3: SP500 from inception of bull market in March 2003 to present.