Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert:	Murray Gunn **Elliott Wave International**
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Dennis Tubbergen:

Welcome back to RLA radio, I'm your host, Dennis Tubbergen. Joining me on today's program once again as a returning guest, Murray Gunn. Murray is a market analyst for Elliot Wave International. You can learn more about Elliot Wave at their website, elliotwave.com, there is a free book resource available there as well I would encourage you to check out. Murray, welcome back to the program.

Murray Gunn:

Thank you, Dennis, pleasure to be here.

Dennis Tubbergen:

Murray, as we are speaking, I am on the west side of the Atlantic, you're on the east side of the Atlantic, and there was some excitement in the UK here, over the past couple of weeks. The Bank of England came in and pretty much shored up the gilt market, or for U.S. listeners that might not be familiar with that term, the long-term bond market. Can you fill us in a bit as to what happened?

Murray Gunn:

Sure. The global bonds have been in a bear market since, really, 2020. Elliot Wave International, we were warning our subscribers since 2020 that a bond bear market was coming. Yields have been rising in global bond markets since then, and it's obviously been accelerating this year. This year's been probably the most historic bond bear market in terms of price, when yields go up, price goes down, in history. What happened in the UK was just an acceleration of that trend. The conventional analysts have blamed it on the fact that the UK government decided to announce a policy of unfunded tax cuts. As usual, with the conventional way of looking at things, people try to put a rationalization as to why things happen. You can look at the movement of the 10-year bond gilt here, and the yield did accelerate higher over those few days, but the fact of the matter is, it was already moving in that direction anyway. From our analysis point of view, from the price part and recognition point of view, it was just part of that trend.

It caused a bit of a panic over here. It certainly got the headlines, which is... I'll come onto that in a minute, about sentiment. It caused a panic, it caused the Bank of England to step in and buy long dated bonds in an intervention, because if they hadn't, a lot of pension funds in the UK would've had trouble meeting margin calls on some of their leveraged investments that they had been structuring at what we call the long end of the gilt market.

Dennis Tubbergen:

Murray, thank you for that explanation, but it just strikes me that the very fact that pension funds are using leverage, or borrowing money to invest, strikes me as really a symptom of how artificial these markets seem to have gotten, in my view. What's your perspective?

Murray Gunn:

I think that's very true. The government rules and regulations, as usual, have unintended consequences. Much like what happened in the U.S. with the housing boom back in the late nineties and into the mid-noughties it was government policy that encouraged that sort of lending to be done in the housing market. Government policy here for pension funds has made it easier for the derivative industry to structure, and what we call synthesize investments into the long end of the gilt market, and for pension funds, in order for them to meet their obligations. What's interesting is that as markets move, as things develop, as with every derivative... Warren Buffet famously called derivatives weapons of mass destruction. He also said famously that when the tide goes out, you can see who's been swimming naked. A lot of these pension funds, their leverage was hidden until we got this big volatility in bonds this year. That's what has exposed some of these pension funds, to find that they were swimming without any underwear on.

Dennis Tubbergen:

A fitting analogy, I might say. Murray, this just happened in the UK, this problem though is probably not going to be confined to the UK. Don't you think that we're going to see this again? The Bank of England will probably intervene, but won't other central banks around the world be faced with the same scenario?

Murray Gunn:

I think, with regard to the specific investments, derivative investments that were being used at the long end of the UK bond market, they're specific to the UK. There's not the same extent that goes on in other markets, other developed markets, like the U.S. There's not really that problem there. In general, yes, your point is correct. The more volatility we have, and even with what's gone on this year, we're not at extreme levels of volatility. There's still scope for more volatility in bonds, more volatility in equities. When we have fast moves in the market, and with derivatives like this, and being exposed to margin requirements, it's not particularly the direction of the move, it's more the speeds of the move that takes place. If we get fast moves in bonds again, and fast moves in equities, which we haven't really seen this year so far, it will expose pension funds, investment funds, and others, as to anyone who's been leveraged.

Dennis Tubbergen:

If you're just joining me, I'm chatting today with Mr. Murray Gunn. He is an analyst with Elliot Wave International. You can learn more about Elliot Wave at elliotwave.com, and there is a free book resource you can take advantage of there as well. Murray, just shifting gears a bit here in the U.S., the number one economic concern, according to recent polls, is inflation. The Fed here has been talking tough, that they're going to continue to raise rates until inflation is subdued, they get it under control. Give us an update on the inflation situation in Europe.

Murray Gunn:

If you want to see a historic chart which will make your eyes pop out, I would suggest looking at a chart of the consumer price inflation rate for Germany, which has just gone into double digits on an annualized basis, to over 10%. That's the highest rate certainly since the end of the second World War, and the chart is pretty vertical. There has been a big issue with consumer prices going higher here in Europe. A lot of it is to do with the cost of energy. Obviously, natural gas prices over here continue to be very high, through the roof. People are blaming that on issues with regard to the war in Ukraine, and geopolitics with Russia.

The basic fact remains that European central banks, in concert with the other central banks around the world, maybe not as much to the extent as the U.S., but in the last number of years, they've been engaged in basically the proper definition of inflation, which is monetary inflation. We've become used to defining inflation by consumer prices, but actual inflation is an increase of the money supply, and specifically, credit and debt in an economy. That's been rampant in Europe, and especially in the U.S. over the last few years. The fact that we're getting this consumer price inflation problem now really shouldn't be a surprise to anyone, especially the central banks.

Dennis Tubbergen:

Murray, in the time we have left, the action that central banks are taking, in my view seems to be, to use an old analogy, a lot more bark than it is bite. They're talking tough, but it seems like they're probably not doing enough to get inflation under control, in my view. I think the debt levels dictate that they probably can't. Would you agree or disagree with that statement?

Murray Gunn:

I think that it's a very fair point. There's a real balance here. I think the central banks would be quite happy to see the market do its work for it, low-end yields going up, stock markets coming down, the economy slowing. We just had employment data today, as we're speaking on this Friday, and it showed a drop in the unemployment rate in the U.S., and that's something The Fed will not really particularly want to see. The Fed will want to see a weakening labor market, because that has been associated historically with consumer price inflation dropping.

Dennis Tubbergen:

We're going to leave it there. The clock says we are out of time for this segment, but I will return after these words with my special guest, Mr. Murray Gunn.

I'm Dennis Tubbergen, you are listening to Retirement Lifestyle Advocates Radio. I have the pleasure of chatting once again today with Mr. Murray Gunn. Murray is an analyst with Elliot Wave International. I certainly encourage you to check out their website at elliotwave.com. There is a free book resource available there as well, I would encourage you to take advantage of. Murray, in the last segment, we were talking a bit about the bond market, and you used the term sentiment. I think a lot of investors, and a lot of folks saving for retirement maybe aren't even familiar with that term. Can you talk a little bit about Elliot Wave's work, and the role that sentiment plays in your forecasting?

Murray Gunn:

Sure. The Elliot Wave principle is what we call a fractal-based model of the economy, discovered by a man called Ralph Elliot in the 1930s. He discovered that human herding behavior causes markets like the stock market, which is a leading indicator of the economy, to really exhibit certain identifiable and repeatable patterns throughout time. These patterns, he discovered that they repeat at every time scale. The principle enables cycles of herding behavior to be anticipated from the very short term to the very long term. It is human beings that drive markets full stop, at every time scale. That's why, as Elliot Way principal practitioners, and what we call technical analysts, we don't study the economy to think that the economy's going to lead the stock market. We study human behavior because that's the driver of the stock market, and that is sentiment.

Dennis Tubbergen:

Murray, let's talk a bit about your specific forecast. You analyze, I think, European markets, but can we talk about your forecast for stocks in general? Year to date, here in the U.S., the major stock market indices are down between 20% and 25%, depending on what day it happens to be. Where do you use these stocks moving from here?

Murray Gunn:

Continued downtrend, really. When we last spoke in June, I think it was, I reiterated that our view that the bounce in the global stock markets from the 2020 pandemic low was the final rally in a multi-decade bull market, and that 2021 in particular, based on our cycle analysis, could have marked an historic juncture in the topping process. It certainly seems to be coming bearing out that way, especially with the bear market in bonds, of course. The rise in yields in the bonds, that's what we call the risk fee rate, that feeds directly into equity market valuations.

It's really the fact that social mood is turning, what we call social mood. We mentioned sentiment earlier on, you can think of social mood as long-term sentiment, but we might talk a bit more of that in a minute. It's really because social mood has been turning negative. Yes, we've been bearish for a while, and continue to be bearish. There's nothing in our pattern recognition analysis that tells us that there's an end to this down trend anytime soon. Yes, we continue to be bearish, and another 10%, 20% over the next few months wouldn't surprise us.

Dennis Tubbergen:

Let's talk a little bit more about social mood. I know Elliot Wave has, to my recollection anyway, really invented a science called Socionomics. It'd be interesting, I think, for our listeners if you chatted a bit about that.

Murray Gunn:

Sure. Robert Prechter's socionomic theory stems really from hard evidence that it's the trend in social mood that determines social actions, not the other way around, as most people think. Most people think that if something negative happens, the mood of society then turns negative. The socionomic studies, historical studies suggested the negative mood trend comes first, before the negative action, and of course, vice versa for positive action. For example, conventional thought would be that recessions cause businesspeople to be cautious, whereas, this socionomic way of looking at that would say that it's cautious business people who cause recessions. Because social mood is the driver of everything, it tends to show up first in the stock market, because that's where people can action very quickly. The trends in stock markets can anticipate social actions, and social actions can help us anticipate where we are in the stock market cycle.

I think I mentioned the last time, a clear example of this was what happened in Russia at the start of this year. The Russian stock market topped out in 2007 and had been in a bear market since then. A negative mood trend in Russia had been in place since 2007. At the end of last year/the start of this year, well before Putin went into Ukraine, we suggested to our subscribers, based on the pattern recognition and the socioeconomic analysis, that it was very probable that Putin would actually have this negative social action of going into Ukraine, whereas a lot of people were still judging whether that would happen or not.

Another good example, Dennis, is what's happened in Italy just recently, with the election of the first far right government since Mussolini. The Italian stock markets topped out in 2000, that's 22 years ago, and it's still less than half the value it was back then. There's been an obvious negative social mood in Italy for two decades. It is unsurprising to socionomists like ourselves that Italian politics has lurched to the right.

Dennis Tubbergen:

Murray, where do you see bond markets going from here? Is there more downside in this bond bear market that, as you mentioned in the first segment, has really been historic?

Murray Gunn:

We think so, yes. Certainly, our pattern recognition analysis suggests that yields can continue to move higher. The one really interesting aspect Dennis, this year, has been the fact that corporate bonds have held in relatively well, and we think that could be the next shoe to drop in the bond bear market. Yields in corporate bonds have risen along with bond yields in general, but they've not seen a level of underperformance that has historically been seen as the world has moved into recession. One reason for that could be that corporate borrowers took advantage of the basically free money that was on offer in 2020, to what they call term out, or lock in their borrowing for a few years. Now, that's starting to be needing to be rolled over, that debt, and next year, many corporates will find it very difficult to finance their operations as they roll over that debt. Of course, that will increase credit downgrades and defaults.

Dennis Tubbergen:

Murray, in the time we have left, I'd like to chat, if we could, a little bit about currencies. The U.S. dollar has been strong relative to its trading partners. I always like to remind people that a strong U.S. dollar index doesn't mean the dollar is gaining in purchasing power on an absolute basis, but relative to other currencies, it's strong. Do you see the strong dollar trend continuing?

Murray Gunn:

Yes. It's interesting. In, I think it was 1971, the Treasury Secretary in the US, John Connally, said to his global peers that the dollar was "Our currency, but your problem." That attitude seems to be prevailing today, with the relentless appreciation of the U.S. dollar. It's obviously adding to problems in emerging markets, making their external debt more burdensome, and in developed economies, where import prices are rising. Just today, the German import prices were rising at their fastest pace in 50 years. The strong dollar is a problem.

Some people have suggested we could get something like the Plaza Accord, which came in 1985, to weaken the dollar. We think that, because social mood is turning negative now, whereas it was broadly positive back in the mid-eighties, that's unlikely. Our path and recognition analysis suggest that the dollar could actually be close to a significant turning point. It looks like we're still in for a little more appreciation, but that should be the last wave in the dollar's appreciation trend, with 2023 looking more like a period of potential dollar depreciation.

Dennis Tubbergen:

Quickly, in the time we have left Murray, any comment on commodities? Oil prices have been all over the place, with a recent announcement by OPEC to cut production. Oil and other commodities, what's your forecast?

Murray Gunn:

At the start of this year, our analysis was suggesting a top in commodities, at least an interim top, was very possible around the level of, I think it was 331 on the Commodities Research Bureau index, the CRB index. We alerted our subscribers to that. That forecast was made purely on the basis of price pattern recognition and ratio analysis, which is what we do. It was actually in June that the CRB topped out pretty close to that level, I think it was 329, and it's down about 15% since then.

In the medium term, and in the next period, our outlook for crude oil is currently bearish, looking for another decline towards about $60 a barrel range. After that, based on our analysis, it should start another advance, which should take it above this year's high. On gold, the outlook from price pattern is not that clear, but a rally in 2023 still looks quite probable. You look at industrial metals like copper, that certainly looks like it's topped out, and that now is in a significant down trend. That would be consistent with a slowing global economy.

Dennis Tubbergen:

The clock says we're going to have to leave it there. My guest today has been Mr. Murray Gunn. Murray is an analyst with Elliot Wave International. The website is elliotwave.com. There is a free book resource available there I would encourage you to take advantage of. Murray, always a pleasure to catch up with you, and get your perspective. Thank you for joining us today. I would love to have you back down the road.

Murray Gunn:

Many thanks, Dennis. It's been a pleasure as always.

Dennis Tubbergen:

We will return after these words.