The Australian Share Market
A History of Declines

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A HISTORY OF DECLINES

Summary:

1. Australia may enter a recession as early as next month
2. There is currently no evidence that a major low is in place
3. Even when a low point is made we continue to believe that a bull market will not occur till after an extended transitional period
4. History shows that the ASX has a tendency to double-dip
5. Double dips in recent history tend to be more severe

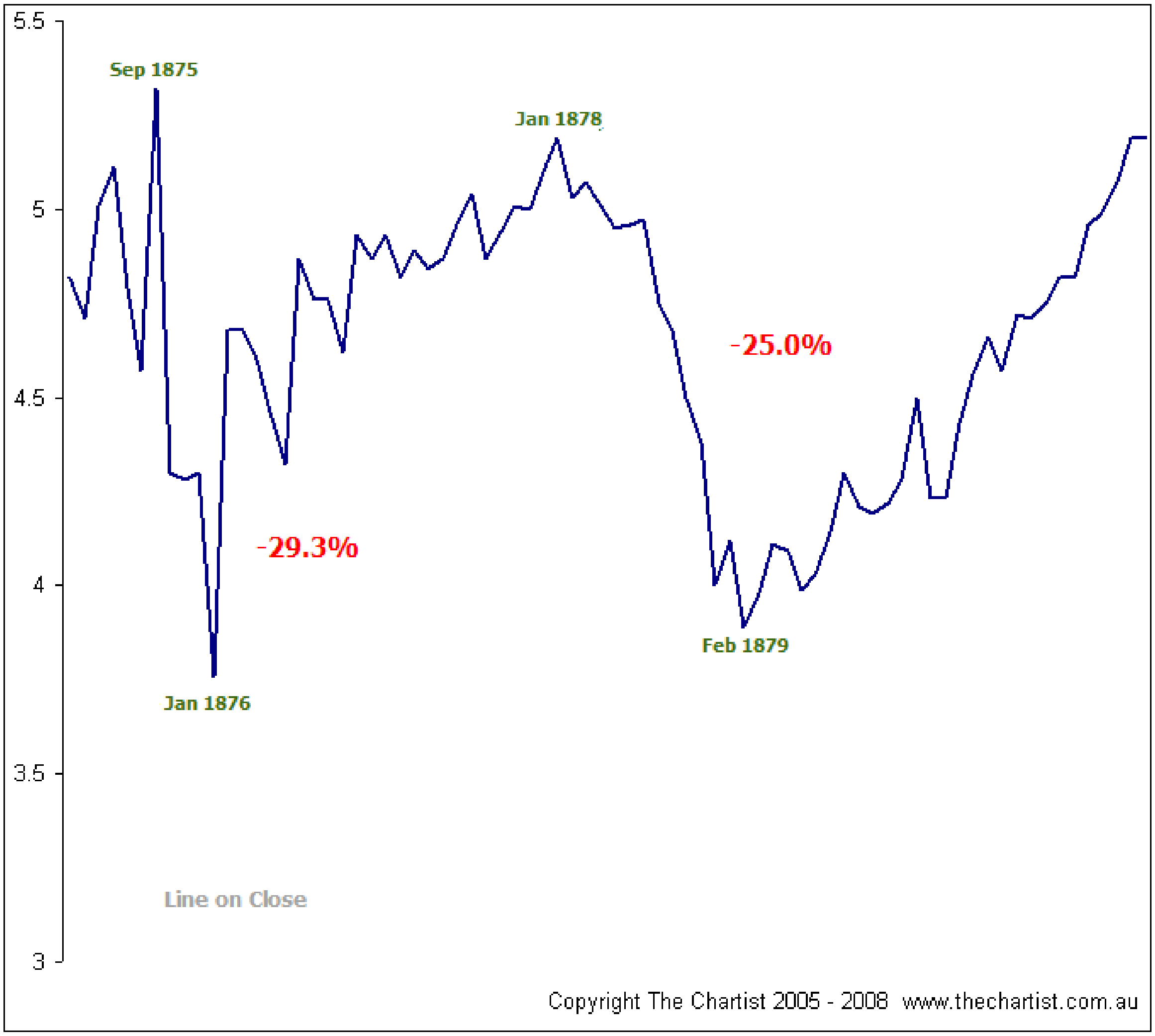
In January this year, as the US unemployment rate ticked higher, we suggested that recession was imminent even though it was not being discussed by the broader media. It's only in the last few months that its being accepted that a recession is now underway. The unemployment rate here in Australia is also moving higher off a February low of 3.9%. It stands at 4.3% currently with the next data released in early November. Should the unemployment rate hit 4.4% we believe a recession is in the making, but stress that this is not widely accepted or discussed in the broader media or even by the vast majority of experts.

Indeed the vast majority of experts are making loud noises regarding the outstanding value that ASX shares offer at these current lows. That may or may not be the case, suffice to say that most experts never saw the events of this year unfolding nor expected the severe declines most shares have endured to date.

We will however let the charts tell us when the trend is changing. At this juncture a move back above 4800 is required before doubt about ongoing weakness can be removed.

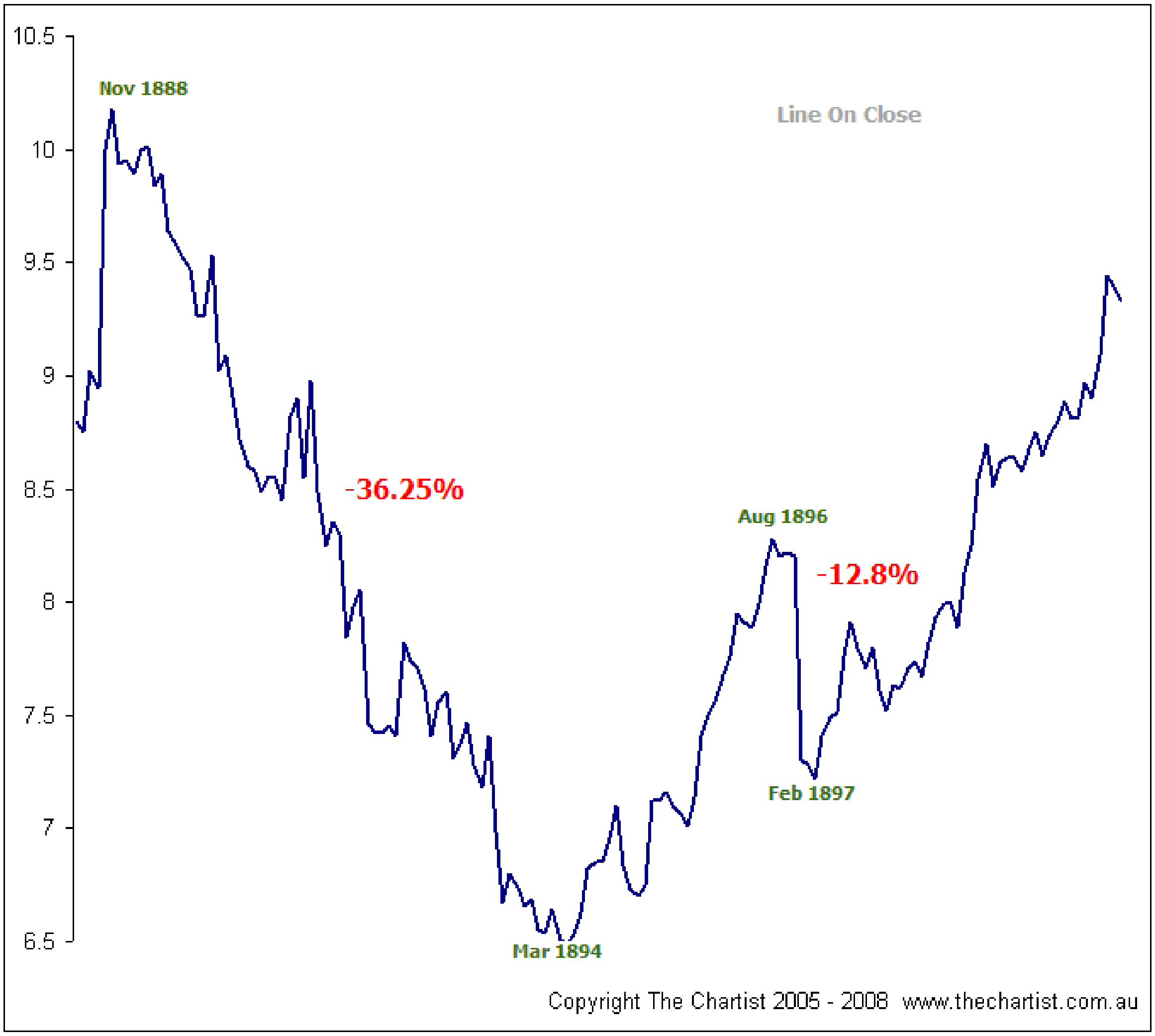
This report is not about the future of the market or whether a low is imminent, nor is it an attempt to explain the past events. It is a view of history that clearly shows that the ASX tends to 'double dip' after any significant decline. A 'double dip' is where a false sense of security occurs creating a rally but then gives way to a secondary decline that, in some occurrences, is more severe than the first. We investigate 8 declines stretching from 1870 to 2002 to show the consistency of the pattern.

Why is this important? Because many market pundits are telling us that now is the time to buy. However, if history repeats, the first signs of strength could be a suckers rally rather than the start of a new bull phase.



Data Source: Wren Research www.wrenresaerch.com.au

Our first chart goes back to 1875 where an initial drop of 29.3% was followed two years later by a secondary decline of similar proportions. The interim bear market rally almost recovered the initial decline and would've instilled confidence about a continuation of recovery.



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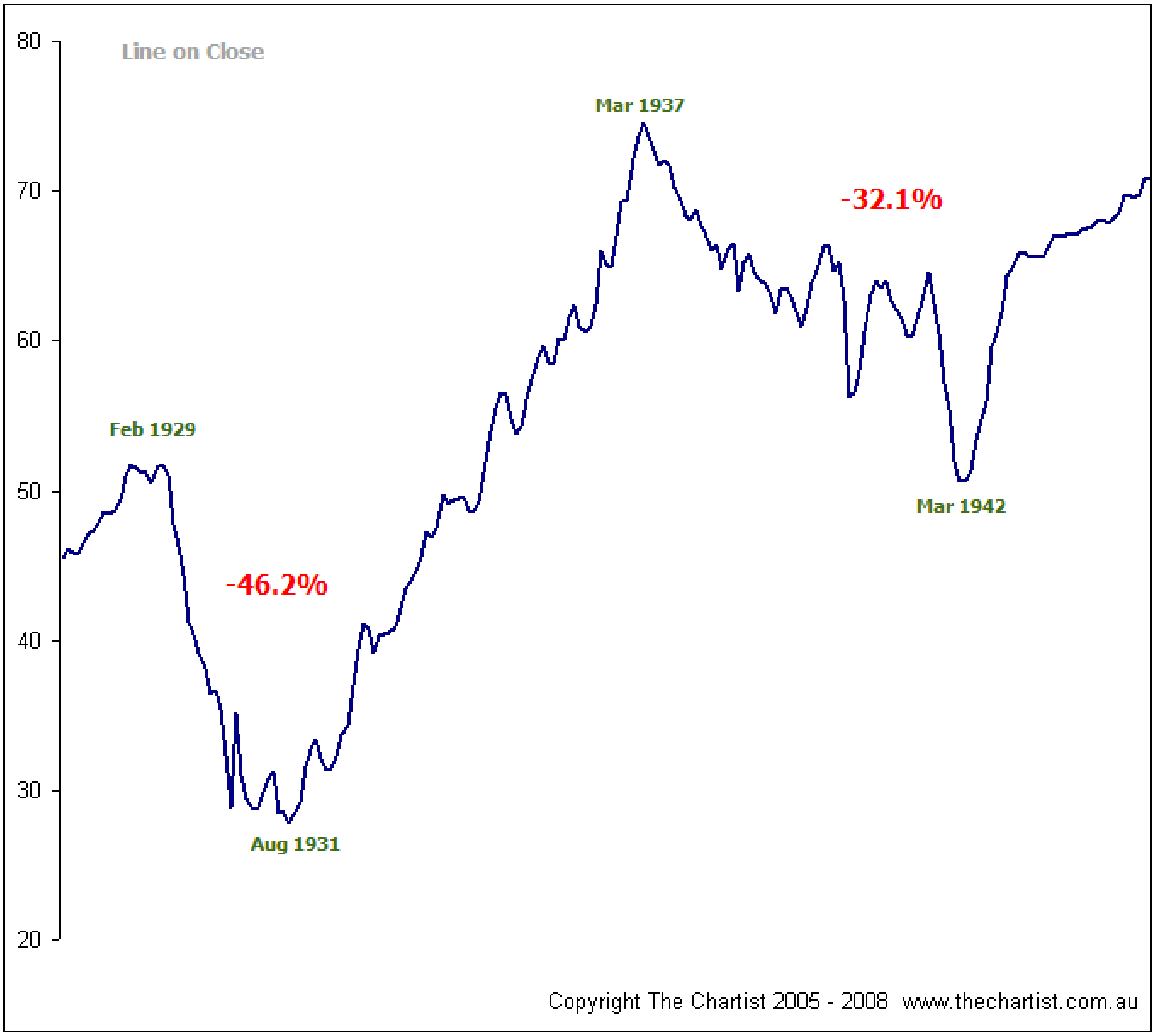
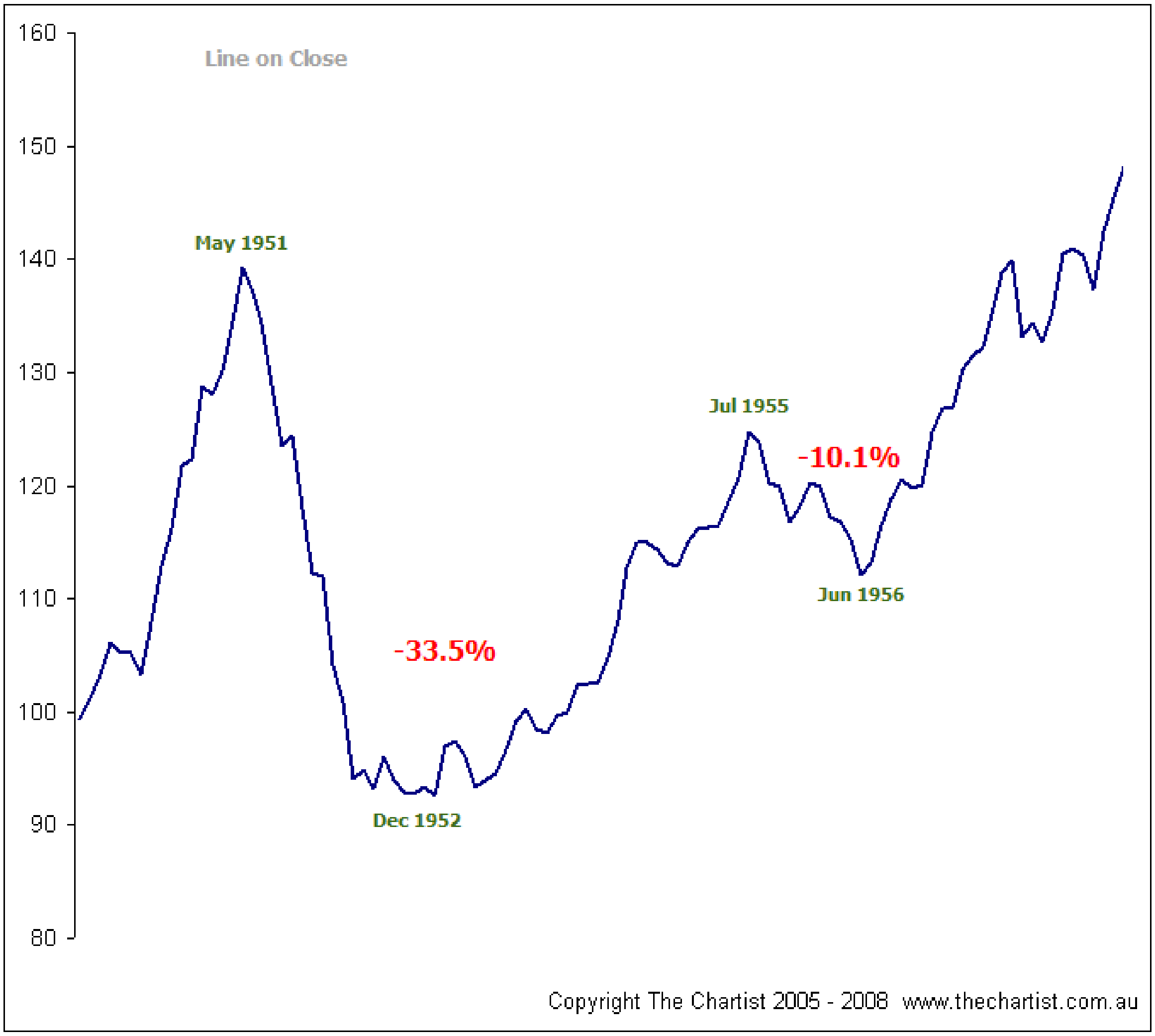
The decade following the first example the market dropped a more severe 36.25% over a 6-year period. A relief rally did occur but was again followed by a secondary decline, this time a less significant 12.8%. It is difficult to gauge what type of decline will impact on investor psychology as all market participants have differing risk profiles. A 12% decline is probably not significant enough to discourage the majority, but following a larger and more prolonged decline the swiftness of this secondary drop does indicate a lack of confidence.

We now move forward to 1929 but we do know that the Dow Jones suffered a 50% decline from January 1906 to November 1907 that is not reflected in our ASX data. We acknowledge that ASX data prior to 1980 is compiled from the individual exchanges in each state and that prior to 1950 the data has been back adjusted on an indexed basis.



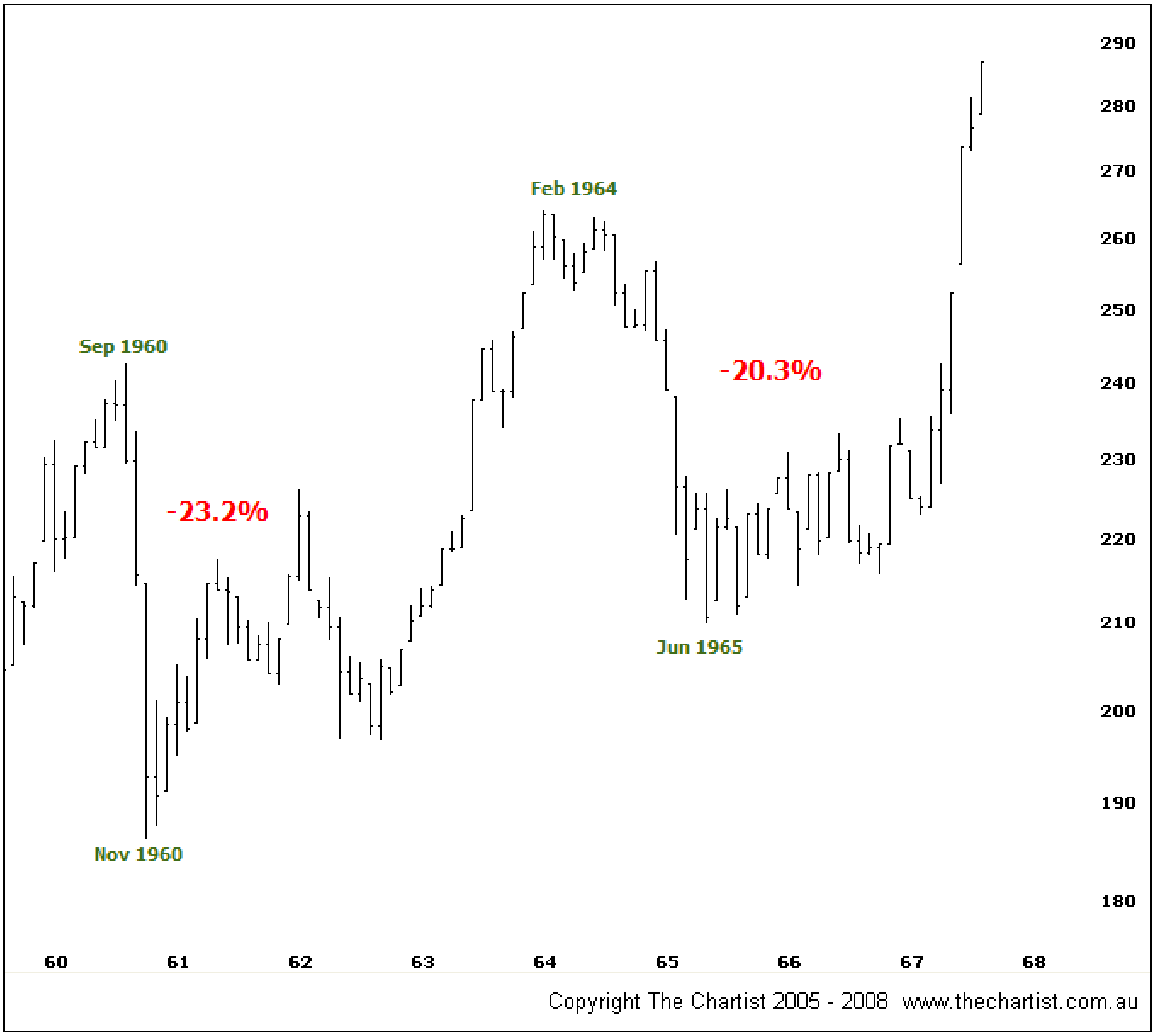
Data Source: Wren Research www.wrenresaerch.com.au

The 1929 crash is being widely recognized in the current environment although it's my opinion that a 1987 to 1994 event may be a better comparison. After it's initial 46.2% decline to August 1931 the market did make a sustained trend into new high ground before dropping a second time by 32.1%. This is the only example where the 'double dip' may be disconnected and considered non-correlated but I am offering it for its historical significance.



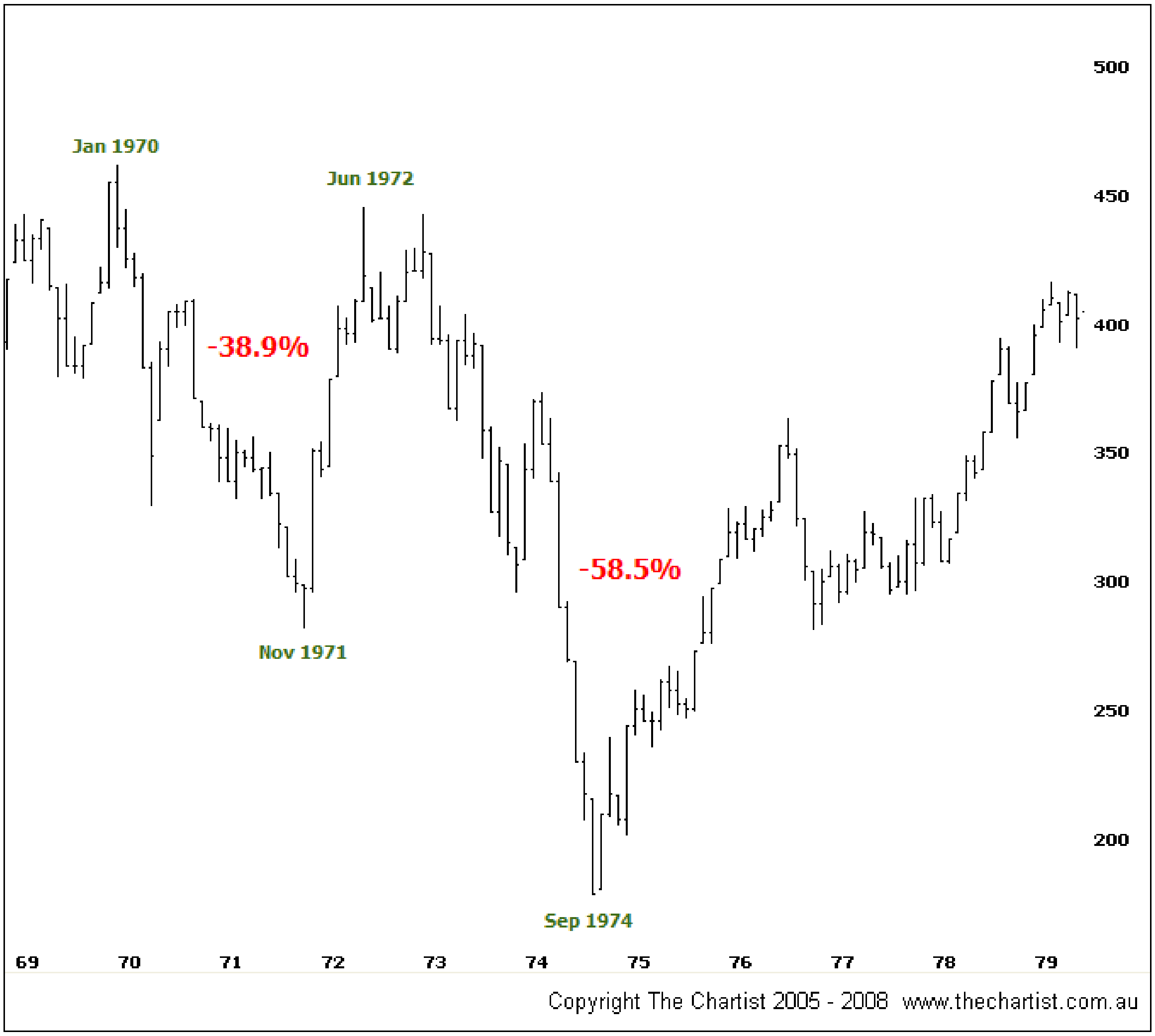
Data Source: Wren Research www.wrenresearch.com.au

A very similar pattern to that seen from 1888 to 1897; an initial steep descent caused by a serious bout of inflation followed by a secondary and shallow dip caused by the Suez crisis. Whilst the second dip is 10% it does take 12-months to unfold which for the vast majority of retail investors is a disconcerting length of time especially when they are new to the markets on the heels of a bull run. I feel this is also a good example of how many people are currently feeling, that is, a new bull is imminent because we've decline already for nearly 12-months. The examples on the following pages will show why that theory is naïve.



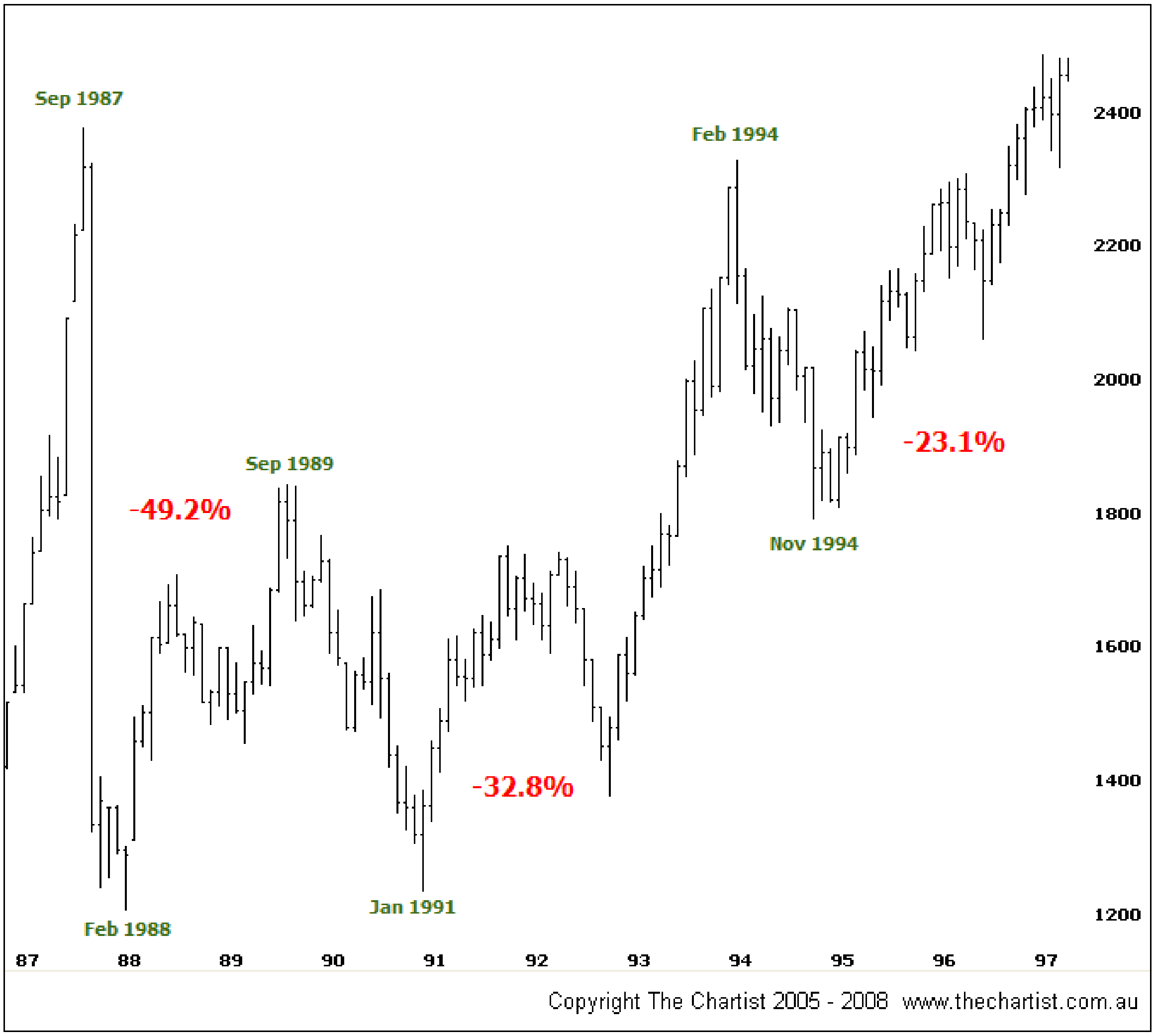
Data Source: Wren Research www.wrenresaerch.com.au

Data post 1955 provides the full monthly ranges offering more specific measures of the intra month price action. A credit squeeze – the opposite to what we're seeing today, caused quite a stiff decline of 23.2% from September 1960 through to November. Again we see an example of the market crawling back but the secondary fall was just as sharp and more prolonged. The rally that followed was the start of the Poseidon boom.



Data Source: Wren Research www.wrenresaerch.com.au

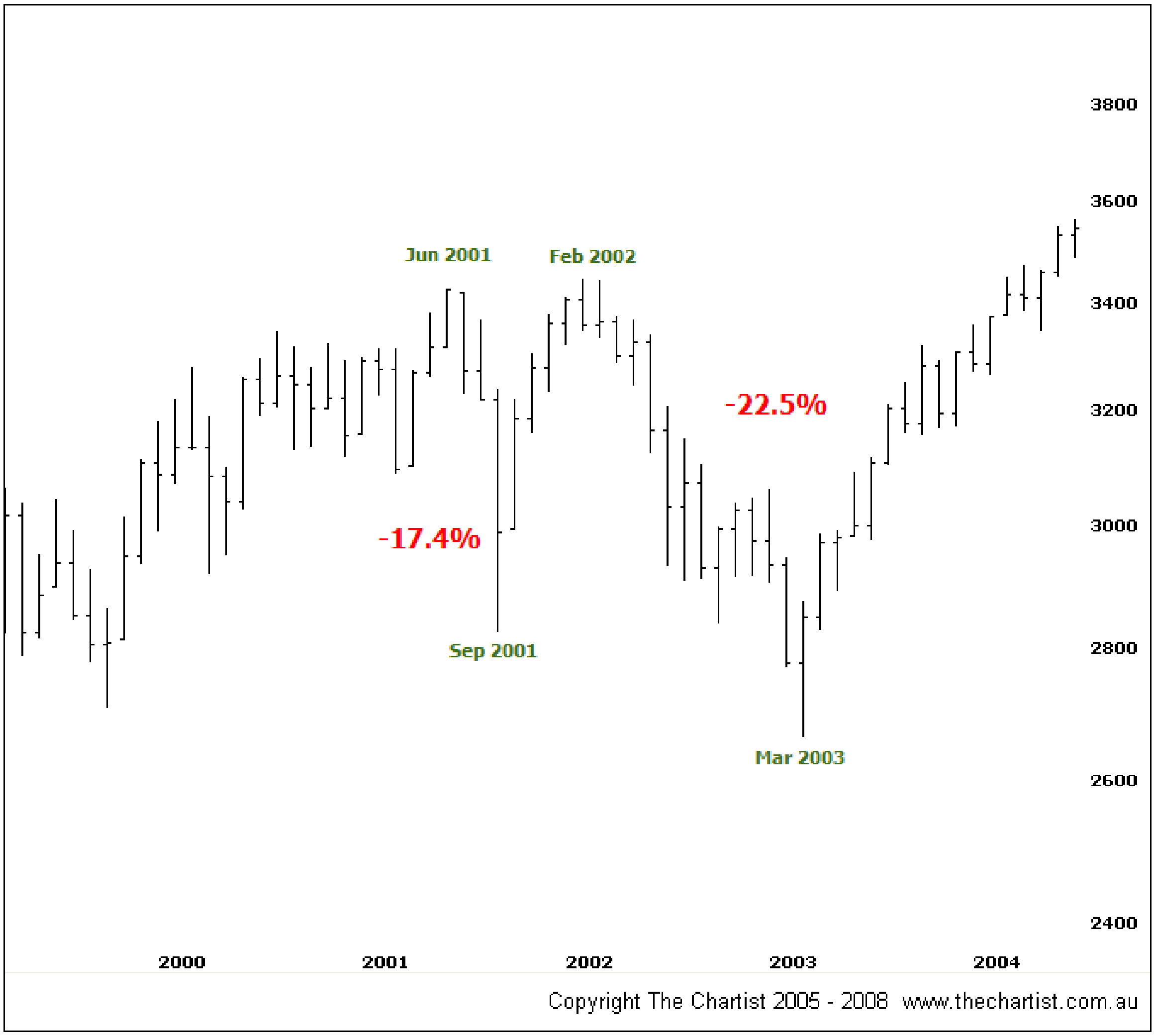
Whilst most of the current generation fears a repeat of 1987 the events of 1970 through 1974 are rarely, if ever, discussed and in my opinion was a much more severe situation. Not only do we see a very rich example of the 'double dip' but we also see an example of a very prolonged decline, one that took 4-years before the bottom was made. Prices were unable to make a new high until September 1979, some 9 ½ years from the initial high. This period of time contained the OPEC oil crisis, Watergate, Yom Kippur War, high interest rates and high inflation.



Data Source: Wren Research www.wrenresearch.com.au

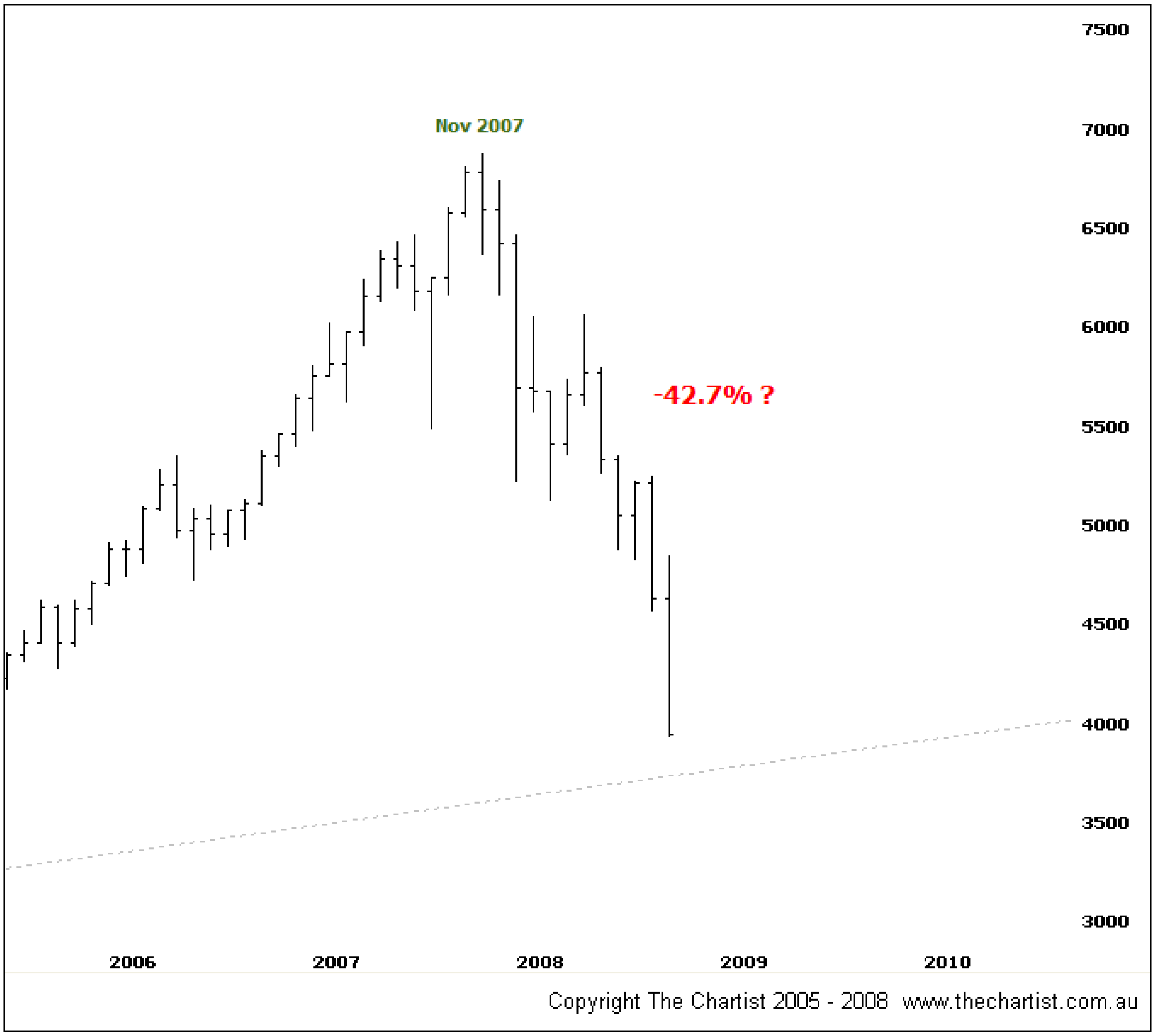
The crash of 1987 is likely to resonate the most with current investors. In a single day the local market dropped some 25% but continued to fall into early 1988 eventually declining a total of 49.2%. The market chopped wildly for a number of years and offered two examples of the 'double dip', one in September 1989 measuring 32.8% and another in February 1994 of 23.1%. New highs weren't made again till November 1996, almost 10-years after the initial highs.

It is my opinion that this is what we're going to see over the coming years. Whilst the February 1988 lows weren't penetrated it would have been an extremely frustrating roller coaster period for investors.



Data Source: Norgate Investor Services www.premiumdata.net

The Tech Crash hit the US markets from early 2000 but didn't reach our shores. It wasn't until the S&P 500 started rolling over in early 2001 that Australia started to moderate. However, with the tragedy of September 11 we saw a quick 17.4% decline followed by a quick reversal. By this stage it was becoming obvious that the US had entered a bear market and we 'double dipped' through to March 2003.



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As at writing the All Ordinaries Index is 42.7% off its November 2007 highs and will most likely continue lower in the near term. History shows that this decline is only the 4th worst on the list. 1929 was the only time when an immediate 'double dip' technically didn't occur, but all modern day declines have shown serious secondary 'double dips'.

Will we see the same again?

If we commit to listening to the experts offering this as a great 'value buying opportunity' we should be aware of being caught out by a 'double dip'.

The Chartist will be continuing to follow the market and its patterns with the knowledge that a double dip may unfold. When evidence suggests its likelihood we will be advising subscribers accordingly.

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