



# ***Elliott Wave International***

**Robert Prechter**

## **Preparing to Survive and Conquer the Crash**

From J. Taylor's Gold & Technology Stocks

**Robert R. Prechter Jr.**



On January 12th, I received an email from Ms. Becca Daws who works with Robert Prechter's Elliott Wave International. She said she and Mr. Robert Prechter had read "with great interest" a piece I had written on January 11th, that appeared at [www.howestreet.com](http://www.howestreet.com) and that she would like to send me a copy of Bob's latest book, "Conquer the Crash." I responded that I had already purchased a copy of that book, but wondered if Mr. Prechter or if not him, someone at Elliott Wave would be available for an interview. Ms. Daws answered in the affirmative that Mr. Prechter would be available. So it is a great honor I pass on to you the March 8th exchange I had with this very unique market analyst considered by many to be among the brightest and most creative minds in the investment world. I trust you will find Bob's views

fascinating and more importantly, life sustaining.

Robert R. Prechter, Jr., CMT, is founder and president of Elliott Wave International. He has been publishing market commentary since 1976. In 1984, Bob set a record in the options division of the U.S. Trading Championship with a real-money trading account. In December 1989, Financial News Network (now CNBC) named him "Guru of the Decade." Bob served for nine years on the board of the Market Technicians Association and in 1990–1991 served as its president. During the 1990s, he expanded his firm to provide analysis for institutions on every major financial market in the world. Bob has written 13 books on finance, most notably the two-volume set, *Socionomics: The Science of History and Social Prediction*. His recent title, *Conquer the Crash: You Can Survive and Prosper in a Deflationary Depression*, was a New York Times and Wall Street Journal business best seller. In 1999, Bob received the CSTA's first annual A.J. Frost Memorial Award for Outstanding Contribution to the Development of Technical Analysis. In 2003, Traders Library granted him its Hall of Fame award. Recently Prechter has made presentations on his socionomic theory to MIT, the London School of Economics, and academic conferences.

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**TAYLOR:** Your latest book, *Conquer the Crash*, is divided into two parts. Part I suggested that a stock market crash, a monetary deflation, and economic depression was likely to occur soon. Your book was published in 2002. About that same time our Federal Reserve did express some concern about some deflationary pressures, but they assured us there was no need to worry about that because some of our most brilliant minds at the Fed studied the Japanese deflation; they assured us the same would never happen in the U.S. because, having analyzed the Japanese problem, they knew how to deal with it for America. If need be, we were told, the helicopter printing presses could be put in the air to print as much money as required to keep deflation from occurring. Now here we sit two or three years later, and all talk of deflation is gone from the mainstream, the equity markets have rallied sharply, and commodity prices appear to be on a tear. I've been talking about deflation and a market crash to my subscribers, too, during this time frame and many of them are beginning to

think I was way off the mark. Now that all seems, on the surface at least, to be going very well for the U.S. economy, do you today still hold the same view about the markets and our economy as you did in 2002?

**PRECHTER:** I wanted to finish that book at the top of a rally, which I did, in March 2002. The big recovery you mention has brought the Dow back to about where it was then, which is fine. Remember, people need time to get their houses in order. Anyone who bought *Conquer the Crash* three years ago has moved his accounts to safe banks, transferred his insurance policies, flown overseas to arrange for safe banking, insurance, and annuities, bought a core holding of gold at lower prices, paid off his mortgage and gotten out of debt, obtained overseas visas for his family, sold his business and investment property, stashed his money in safe cash equivalents, and generally gotten in shape to weather Primary wave 3 down. Once it starts, there will be pandemonium, and it will be too late to act with a calm mind. Waiting to put out that book would have been a mistake. Anyone who followed the advice is now ready to sit out the main part of the crash with no financial worries.

As for the Fed, I take five chapters in the book to explain money and credit and why the Fed cannot prevent deflation. The helicopters quote is just bombast, and it plays well to people's imaginations, but such a thing is out of the realm of feasibility, even as a metaphor. The Fed—like government—is not proactive, either, so the fact that it isn't worried about deflation any more is hardly a comfort. It's behind the curve every time. The Fed didn't begin lowering rates until the bear market was underway, and it didn't really worry about deflation until the bottom in the first quarter of 2003. Now that the recovery is nearly over, again the Fed isn't worried about deflation. The Fed is a contrary indicator. I think Japan is the correct model for what is about to happen here, but social trends are not identical replicas of former times; they take different paths to the same end. You have to spot the sameness despite surface differences.

As for commodities, the rally of the past three years is mostly an illusion because of the dollar's collapse. If you had owned Swiss francs and New Zealand dollars, you would have done just as well and earned interest to boot. So it's not so much a commodity rally as a dollar decline. That's the problem with a rubber currency; you can be fooled as to what's really going on. But I've developed something called the Stable Currency Benchmark (SCB) to take care of that problem. Now you can compare every market in the world regardless of local currency fluctuations. If you want to learn about it, go to [www.stablecurrencybenchmark.com](http://www.stablecurrencybenchmark.com).

**TAYLOR:** Didn't we already have a "crash" in the stock market beginning in 2000, during which time trillions of dollars of value were shaved off of stock prices? What makes you think the worst is not yet over for stocks?

**PRECHTER:** In two and a half years, the S&P lost half its value, and the NASDAQ lost nearly three-fourths. But that was just a hint of what's coming. Remember, in the first decline in 1929, the S&P also lost 50 percent, and the market staged a big recovery. Everyone said that the worst was over. Then the market lost over 80 percent of its value in two years before bottoming. And that was off a "Supercycle" top. The current top is one degree larger, which means that the ultimate damage will be worse. It's easy to see how such a resolution is possible when you realize that the Dow's dividend yield in 2000 was half what it was at the top in 1929. The overvaluation of dividends this time reflected the higher degree of the top. At major bottoms in the past century, the dividend yield has been between 6 and 16 percent, and it's currently 2 percent. But perhaps the biggest reason that we can be certain that the bear market isn't over is that investors, analysts, and economists never turned bearish. They always turn bearish before the start of a major bull market, and they usually

stay bearish through the first third of it at least. And they stay bullish for at least the first half of a bear market, which is exactly what they've done over the past five years.

**TAYLOR:** I think one of the most difficult things for investors to grasp is the timing of these events. When you watch for deflation to unfold or the stock market to crash, the days turn into weeks and the weeks into months and sometimes the months into years. We get caught up in the events of the day, which always seem more real than the big picture data so that watching the long term is, to most people, like watching paint dry. When you predicted a crash would occur “soon,” what did you mean by “soon”? And what would be your current time horizon for the next leg down in the equity markets?

**PRECHTER:** This market has been as sluggish as a snail crawling through molasses, and it is frustrating. Even the bulls aren't happy. But you can't order the market around. All you can do is identify what it's doing. I have thought time and again that the stock market was primed for its next wave of collapse, but I guess it will happen when it's time. Forget “soon.” If anything, it's overdue. As for the next good bottom, I'm expecting it in the 2010-2014 period.

**TAYLOR:** In your book you say that the Fed is ultimately powerless to stop a deflation. Can you explain why that is so?

**PRECHTER:** In a nutshell, the Fed has to protect the value of Treasury bonds because T-bonds constitute its reserves and are the source of its power. Its operations are transparent, so if it began to print currency (the “helicopter” analogy), creditors holding over \$30 trillion worth of dollar-denominated debt would know it, and they would sell. And that would make the dollar value of the credit supply contract, maybe even crash. You can't build massive credit inflation and expect to avoid deflation. Also, the Fed is a bank, and it's privately held. The idea that a bank would ruin its own reserves by buying oceans of worthless debt, which would then be the backing for its cash, is a pipe dream. The government might ultimately seize the Fed and order hyperinflation, but as I said, the Fed and the government are not proactive. By the time they get going on any such plan, we'll already be at the bottom of the deflation.

**TAYLOR:** One argument you hear as to why another depression won't happen is because now we have FDIC insurance, which they argue will keep banks from becoming illiquid. Also, can't the Fed simply print more money to ensure a liquidity crunch doesn't happen?

**PRECHTER:** There is no money in the FDIC. The FDIC is one of the reasons why we will have bank failures and a depression. That government guarantee has prompted banks to take inordinate risks and lulled depositors into letting them do it. The FDIC isn't an answer; it's one of the causes. No, the Fed can't just print money to cover defaults, for reasons I just mentioned. Printing money is not primarily what it's been doing in the first place. It's been encouraging the assumption of debt.

**TAYLOR:** In your book, you give a list of the two safest banks in all 50 states. I don't want you to name those banks, because I want my subscribers to buy your book. But could you tell us: what characteristics of those banks make them safer than most others?

**PRECHTER:** They hold more liquid investments. I want a bank that holds a lot of T-bills, not a bank loaded to the gills with real estate and consumer IOUs. When the real estate market crashes (which it will: Japan's prices are down 80%–90%), consumers will have nothing left to mortgage, and they won't be able to pay off their other debts.

**TAYLOR:** Bob Hoye and Richard Russell both talk about a dollar short squeeze. They point out that when you take out a loan, you are really taking a short position against the dollar. As Bob Hoye says, when the margin clerks take over, people will be forced to cover their shorts, which in turn will result in a massive demand for dollars and thus a sharp rise in the value of dollars, vis-à-vis all those items that were sold to raise cash. Bob Hoye also talks about the senior currency always getting stronger in a post bubble era, such as the one we in the U.S. have just begun to unwind. I believe you are very bullish on the dollar longer term. Do these dollar short perspectives and Bob Hoye's reference to historical post bubbles ring true to you?

**PRECHTER:** [Bob's reference] is a great analogy, with one twist. Borrowers think that they're "long" inflation. When you're long, you can just sit with a position when it turns against you, but when you're short and it turns against you, you have to go find capital. So they're long cars and big-screen TVs, and they're short the dollar and don't know it.

At the most fundamental level, I am not necessarily bullish on the dollar relative to other currencies. I am bullish on the dollar relative to goods and services. In other words, I think prices are going to fall. At the market timing level, we turn bullish and bearish on the dollar based on wave patterns. We were very bullish in December, but the Dollar Index has rallied in three waves, which means it's likely to go to a new low. If you care about such things, you have to keep up with our analysis, because markets give you new information every day.

**TAYLOR:** Some other rather intelligent folks like James Grant and Jim Rogers argue that now is the time to purchase "stuff" because of the enormous amount of money that is being created by the Fed to try to fend off deflation. And another deflationist thinker is Antal Fekete, a mathematician from Eastern Europe and Professor Emeritus, Memorial University of Newfoundland. Antal argues that there is a "linkage" between lower interest rates and rates of inflation such that the efforts by the Fed to inflate debt away by printing more money is actually selfdefeating. Antal says that when additional money is created, a portion of it goes to buy commodities but that a much greater part of the newly created money is used to speculate in long-term government Treasury instruments, which, compared to commodities, are far less risky. Antal argues that this is the answer to Greenspan's recent long bond rate conundrum. And he argues that the yen carry trade provides a tremendous opportunity for speculators to play this game. Moreover, he contends that as the dollar gets weaker the yen carry trade is even more attractive because the long U.S. Treasury is funded with constant yen borrowings of very short duration in this yen carry trade transaction. Does Professor Fekete's argument make any sense to you, and if so, would it be compatible with your longer-term view of U.S. Treasury rates?

**PRECHTER:** I think owning stuff as an investment right now is a bad idea, but I come from a historical perspective. Prices for stocks, commodities, and suspect bonds always fall during a deflation. And early in every deflation, investors are convinced that they can buy commodities and survive, because that's what worked in the previous inflationary bear market. But the Kondratieff cycle alternates the monetary condition of each bear market between inflationary and deflationary. Bulls on "stuff" think it's the 1970s, just as bulls on stuff in 1930 thought it was the 'teens. I've read the material you cite, but I'm wary of mechanical explanations for financial events. I think their prime motivator is social mood, which isn't mechanical. I have a book called Socionomics that explains this hypothesis. In my opinion, some stuff has recently risen in price (not all stuff because many agricultural commodities are down) along with stocks only because we have been in this recovery period, which is really a recovery of confidence, which has fueled the assumption of more debt, which is buoying the price of some stuff. When stocks turn down, look out; stuff is going to fall, too.

**TAYLOR:** Another deflationist and one who advocated a gold-backed currency system was central banker and former Federal Reserve economist, John Exter. Are you familiar with John's work, and if so, would you care to comment on it and whether his views are compatible with yours?

**PRECHTER:** Oh, yeah, I read Exter back in the '70s. He's been waiting for a crash a lot longer than I have! Exter is a thinker, not a blaster, which I like. Of course, he's right that gold is the only honest money. But I'm not up on his current market views.

**TAYLOR:** Still another deflationist and friend of mine who was named in your book is Ian Gordon. Ian loves economic history, which makes him a big fan of yours. That love of history also caused him to pay attention to the Kondratieff cycle. Ian arranged to chart some key financial information dating back to just after our Revolutionary War. The picture that emerged would seem to fit fairly closely with the Grand Supercycle that you talk about on page 33 of your book. As I'm sure you are aware, Ian has carved out each Kondratieff, which lasts 50 to 60 years or so, into spring, summer, autumn, and winter. He has identified certain investments that do very well for each of those "seasons" and others that are very poor investment choices for each season. Assuming that you are aware of Ian's work, do you find that his conclusions are compatible with yours?

**PRECHTER:** As far as I can tell, we agree on everything except gold. Also, I might be a little more bearish on stock prices than he is.

**TAYLOR:** I want to ask you some questions about strategies for protecting wealth during a deflationary event, but first I have a few questions on different topics I would like to ask first. In the future, how do you envision America if your scenario of a collapse in the stock and real estate markets unfolds? What will our nation's social structure look like? Will we have a totalitarian government to keep things in order? How high might the unemployment rate be?

**PRECHTER:** We're racing headlong toward outright authoritarianism. That's one of the traits of very large bear markets. We had creeping socialism until Janet Reno, but that's when the trend hardened. Congress's terrorism laws ignore individual rights and the Constitution. Since taking office, Bush has issued threats and commands to about a dozen governments. In his inaugural speech, he claimed that God wants him to democratize the world, by force. How one can state a more anti-American agenda I can't imagine. Democracy was anathema to the Founding Fathers, as was using force on neighbors for anything but self-defense. If you don't think this righteous vision will lead to conflict, you don't understand human nature. The army's sexual torture at Abu Gharib and Guantanamo was sick behavior, and it wasn't aberrational; it was policy; the worst photos are so bad that they won't release them. It's as if Saddam were in charge. This makes the U.S.'s Japanese interment camps of World War II look quite benign by comparison. I've been on record that Hillary will be President. I have no doubt that she will jam the authoritarian ratchet even harder, and Bush will have laid the groundwork for her. Hillary gave us a glimpse of her vision when she got a couple hundred lawyers in a room and drafted that intricate list of punishments for physicians. She's the closest thing to a Stalinist that we've ever had, and she's a philosophical leftist, not just an emotional or pragmatic one. So yeah, I guess you could say I think we are moving toward totalitarianism, but it won't be "to keep things in order." It will destroy all order. Government fosters hostilities among people. Free people help each other and create their own order.

**TAYLOR:** I see the CRB has only recently broken though multi-decade highs. How much further can this run? And on a related topic, how much further can the real estate bubble be extended?

**PRECHTER:** I think they're both essentially over. The January drop in home sales was the biggest in years. Oil is the laggard, so it will probably be the last commodity to peak. I can't give you a price, but our oil analyst has been stellar all the way, and he says it needs a couple more waves on the upside before it's over.

**TAYLOR:** Some geologists suggest that global oil production will shortly be in sharp decline in the years ahead even as the Chinese economy continues to grow at breakneck speed. If we assume for a moment that this view is correct, might a global depression like you envision offset the effect of declining supplies on oil prices? In other words, do you have a forecast for oil prices as we enter the next depression?

**PRECHTER:** I hate that kind of reasoning. We didn't hear it when oil was at \$12 a barrel, did we? That kind of talk comes out near tops, not when you should buy anything. I think that, at the bottom of the depression, oil will be closer to \$10 a barrel than \$60.

**TAYLOR:** What about China? Will they be a part of this global deflation, or is this nation a non-stoppable growth machine, as Jimmy Rogers argues that it is?

**PRECHTER:** On a larger scale, China will dominate the current century, just as the U.S. did the last one. But how can China remain an unstoppable growth machine if its major trading partners collapse? Jim Dines turned bullish on China in 1973. That's a call! Now it's time to look for reasons to be bearish for awhile. I mean, the whole world knows the China story now. Just as the whole world knew the Internet story in 1999. China is due for a major setback—what I would call wave two—sort of like the U.S. experienced from 1835 to 1842.

**TAYLOR:** In *Conquer the Crash*, you provide a host of very detailed policies people can carry out to protect themselves from the harm that most Americans will unfortunately suffer through. Could you perhaps tell our readers generally how we should protect ourselves against the impending depression?

**PRECHTER:** Get all your wealth as liquid as possible, and store it in the safest, most liquid institutions you can find in the world.

**TAYLOR:** A friend of mine, James Turk, whom I believe you may know, has started GoldMoney.com, which allows individuals not only to own electronic gold but to use GoldMoney to settle transactions with/make payments to other GoldMoney holders in units as small as fractions of grams of gold. The unit of measure of this electronic gold currency is a gold gram. I'm assuming you know about GoldMoney, and if so, would you care to opine on whether this might be a viable way to own gold, given the rough times you see ahead?

**PRECHTER:** It's a super idea: real money with no inflationary mechanism. I wrote up GoldMoney in a recent *Elliott Wave Theorist*. The only question is whether some government will try to shut it down, but my guess is that it will weather the times. Money should be provided by private, profit-seeking entities. That's the only way to insure honest money.

**TAYLOR:** Many of us have believed we have already entered a new secular gold bull market. Those of us who identify ourselves as deflationists think that, ultimately, gold will distinguish itself clearly as money and not a commodity, as commodities tank and gold rises against all currencies, even a stronger dollar. Correct me if I'm wrong, but I believe you are still bearish on gold? And if that is

true, how do you justify your suggestion that investors should own some gold, silver, and platinum at this time?

**PRECHTER:** I turned bullish at the low in February 2001 and suggested in *Conquer the Crash*, which was 2002, that investors own some gold. I don't advocate buying gold and silver now. In the November issue I called for a peak to occur in the \$450's, and I think the high at \$457 was the end of the rally. As I read cycles, they all point lower through the rest of this decade.

**TAYLOR:** The folks at the Gold Anti-Trust Action Committee as well as Blanchard & Company make a rather strong case, in my view, that policy makers have been manipulating or—to use a more polite word—“intervening” in various markets to engineer market outcomes that are favorable, from their political perspective. In other words, they are not allowing the invisible hand of Adam Smith to do its job in the gold markets as well as bond, currency, and equity markets. Do you subscribe to government agency and central bank manipulation of the financial markets, and if so, won't there be a limit to the extent natural market forces can be conned?

**PRECHTER:** I don't buy it. The manipulation charge is a refuge for people who have been wrong a long time. You know: “Silver is supposed to be \$100 an ounce, but it isn't, and it can't be due to my missing something because I'm smarter than the market; so it must be manipulation.” Besides, whenever the authorities do try to influence a market, it backfires on them. You might remember the Treasury's gold sales of the late 1970s. The more gold it sold, the faster gold went up, which is only logical if you think about it. The markets are too big to manipulate for more than very brief periods. Face it: People just haven't been in love with gold and silver over the past 25 years, and that's why they have languished.

**TAYLOR:** At what point might you concede that gold has bottomed and is now in a primary bull market?

**PRECHTER:** If gold and silver both go through their December highs in terms of all major currencies, I will concede that it's a new bull market.

**TAYLOR:** Just shortly before the last great equity bull market began, you were basically all alone in predicting we were about to enter a major bull market. What did you see then that caused you to so correctly predict the equity bull market, and what will you be looking for to tell you the next bull market in stocks is about to begin? And when do you think we might be ready for the start of the next great bull market in equities?

**PRECHTER:** What we had then was a completed wave pattern, substantial dividend payouts, and a large contingent of bearish analysts and economists. When that happens again, we'll have a buying opportunity. But to take advantage of it at the right time, we have to be even more patient, because at the coming bottom, the technical readings will exceed those of 1974–1982 in every category.

**TAYLOR:** What has surprised you most regarding your predictions and how the markets have behaved over the past 10 years?

**PRECHTER:** That every move took longer and went further than I thought it would. To understand markets, we must study history, and recorded financial history—which doesn't go back very far—has no examples of anything like what has been happening. In the past, bubbles resolved with immediate crashes. This is a multi-bubble. I wish we had charts of the Roman Empire for edification.

That was a long topping process.

**TAYLOR:** Your work has been greatly admired in the past, but all great thinkers, independent though they are, usually will give credit to some other great thinkers who went before them. What great thinkers, philosophers, or economists do you admire and consider to be important in shaping your understanding of the world and the way it works?

**PRECHTER:** Ralph Nelson Elliott taught me most about how the world works, and Ayn Rand taught me the necessity of consistency and non-contradiction. I could name a host of others, but I wouldn't want to embarrass any living people.

**TAYLOR:** Can you explain to my subscribers and me how to subscribe to your letter?

**PRECHTER:** We give away a ton of free reports on our Web site. Just go to [www.elliottwave.com](http://www.elliottwave.com) for the whole story. Most of your readers would probably want what we call our Financial Forecast Service, so go to our store and click on that one. Or you can call 800-336-1618 or 770-536-0309.

**TAYLOR:** I want to thank you for your willingness to share your insights with our readers. You know, Bob, I have been remiss in not subscribing to your letter. When we finish this discussion I am going to do so.

**PRECHTER:** Jay, you're providing such a great service that I would be happy to set up an exchange. Regardless of how things turn out, it's a rare pleasure to talk to someone who understands the deflation argument.

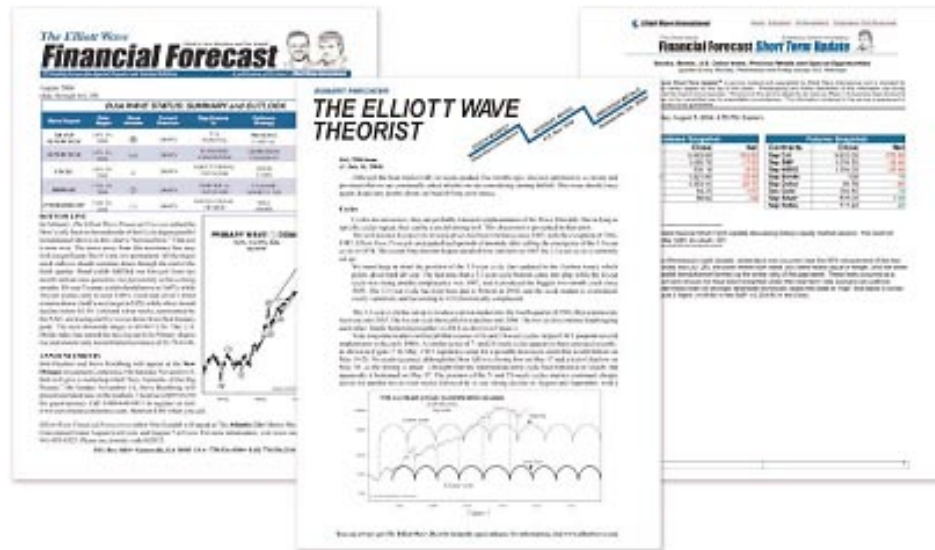


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