The Great Depression and Today - Sobering Parallels Abound

By: Simon Maierhofer

The market has been up, which puts investors in a good mood. It is this feeling of security, however, that preceded every major market meltdown. Think back to the 2000 and 2007 stock market highs and compare it today. 1929 was no different. In fact, the parallels are fear inspiringly similar. If there's ever been a lesson to be learned from history, it's RIGHT NOW.

It's been said (and perhaps you are getting tired of hearing it) that history may not repeat itself, but it certainly rhymes. Furthermore, those who don't learn from history are doomed to repeat it.

If there is just one time you want to take a lesson from history, it is RIGHT NOW. The parallels between today and the Great Depression are numerous and strikingly similar. This 5-minute history lesson might be the best investment you'll ever make.

Watch out! Even this rally parallels the Great Depression

The first leg of the Great Depression reduced the Dow Jones (DJI: ^DJI) by 48%. The first leg of the 2007 bear market reduced the Dow Jones by 53%. Both times, the initial declines were followed by powerful and persistent rallies.

The five-month rally from November 1929 to April 1930, lifted the Dow Jones (NYSEArca: DIA) by 49%. So far, the five month rally from the March 2009 lows has lifted the Dow Jones by some 46%. The time frame and percentage gains are certainly too close for comfort.

Even though the S&P 500 (SNP: ^GSPC) was not around during the Great Depression, the modern day picture mirrors the Dow. The Nasdaq (Nasdaq: ^IXIC) may have already provided a window into the future as it declined over 80% from its 2000 technology (NYSEArca: XLK) bubble, to its 2009 low.

When talking about windows for the future, we can't omit the juicy fact that the Dow Jones measured in the only true currency - gold (NYSEArca: GLD) - has also declined to an extent similar to the 1929 - 1932 market meltdown (more about that later).

From humorous to sobering - parallels that sting

Did you know that the Great Depression was preceded by a great real estate boom centered in Florida? The Florida real estate bubble burst in 1926, three years before equities. Just as we've seen recently, investors took their leftovers from the real estate bust and poured it into stocks. Talk about jumping out of the frying pan into the fire.

Just as in 2007, no one foresaw a decline, let alone the seriousness of the decline. On December 4, 1928, President Coolidge sent the following message on the state of the Union to the reconvening Congress: "No Congress of the United States ever assembled, on surveying the state of the Union, has met with a more pleasing prospect than that which appears at the present time. In the domestic field there is tranquility and contentment and the highest record of years of prosperity. In the foreign field there is peace. You may regard the present with satisfaction and anticipate the future with optimism."

Jim Cramer - the modern day Harvard parallel?

The Harvard Economic Society, previously esteemed for its pessimism, turned bullish a few months before the market topped. In fact, the Society remained bullish all throughout the downturn until it was dissolved just before the depression ended.

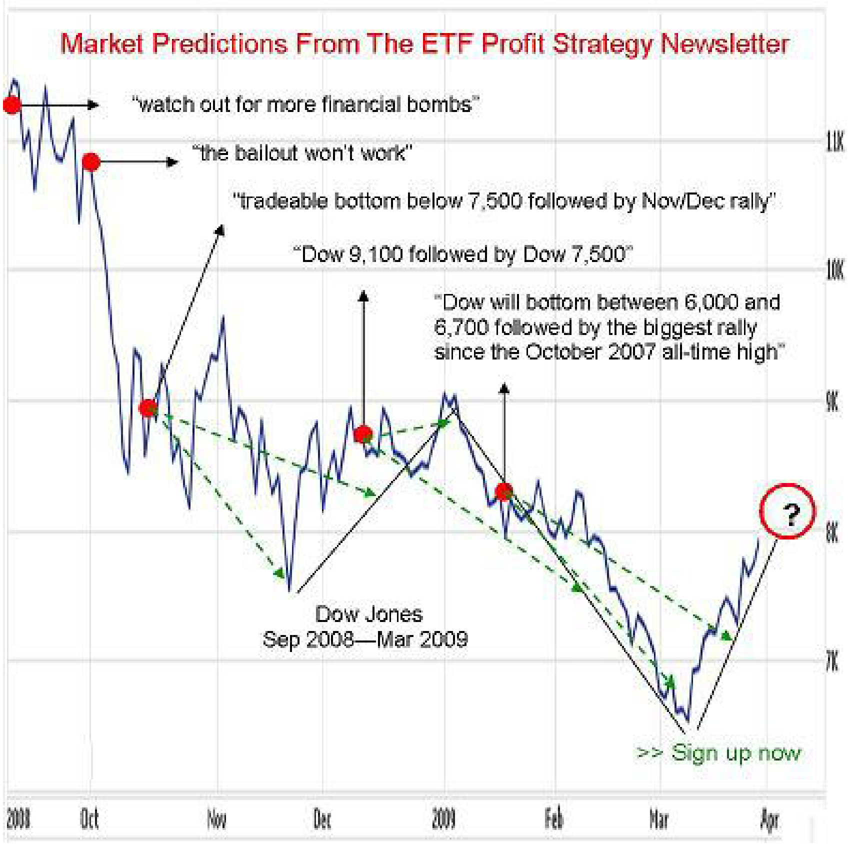
One of the many blunders that lead to the untimely (though not soon enough for investors' welfare) demise of the Society, was its

March 24th, 1930 assessment that; "The outlook is favorable." This was just days before the onset of the above mentioned second leg to new lows. The second leg reduced the Dow by another 47%, but it didn't stop there.

There are many modern-day parallels to the Harvard Economic Society. The Blue Chip Economic Indicator survey, a survey of private economists, is just one of them. According to the survey, 90% of economists believe that the current recession will be declared to have ended this quarter.

Nobel-Prize-winning economist Paul Krugman, who believes the worst of the global crisis is over, is likely to be another one.

Interestingly, economists also believed that in March 2009 the market's worst was yet to come, when the Dow traded below 7,000. Contrary to the general climate, the ETF Profit Strategy Newsletter's contrarian view has been keeping subscribers one step ahead of the market.



Realists beat optimists

In December 2008, the Newsletter declared Dow 9,000 to be an opportunity to load up on short ETFs. This window of opportunity opened from January 2nd to the 6th. In the following 90 days, short ETFs went to record double and triple digit gains, while the S&P 500 (NYSEArca: IVV) lost 30%.

On March 2nd, at a time when an atmosphere of doom permeated Wall Street, the Newsletter issued a Trend Change Alert with a target of Dow 9,000 - 10,000 and S&P (NYSEArca: SPY) 950 - 1,050. As the following excerpt from John Kenneth Galbraith, author of "The Great Crash 1929", observes; contrarian (or realistic) investing pays big dividends.

Before reading Mr. Galbraith's astute assessment, take a moment to put it in context with today's environment. Consider that the market just rallied about 50% from its March lows and the worst seems to be over, while compelling values abound (allegedly).

"The worst continued to worsen. What looked one day like the end proved on the next day to have been only the beginning. Nothing could have been more ingeniously designed to maximize the suffering, and also to insure that as few people as possible escape the common misfortune. The fortunate speculator who had funds to answer the first margin call presently got another and equally urgent one, and if he met that there would still be another. In the end all the money he had was extracted from him and lost. The man with the smart money, who was safely out of the market when the first crash came, naturally went back in to pick up bargains. The bargains then suffered a ruinous fall. Even the man who waited for volume of trading to return to normal and saw Wall Street become as placid as a produce market, and who then bought common stocks would see their value drop to a third or a fourth of the purchase price in the next 24 months. The Coolidge bull market was a remarkable phenomenon. The ruthlessness of its liquidation was, in its own way, equally remarkable."

Other parallels that can be found are the government's assurance that things are fundamentally sound, an increase in mergers and acquisitions, falling car prices, increasing Ponzi schemes (Madoff vs Ponzi), new tools to leverage money, credit expansion/contraction, etc. The Great Depression even had its own Warren Buffett and Jim Cramer.

If that isn't enough, consider this: Research shows that the decline in industrial production over the last nine months has been as bad, if not worse than the nine month following the 1929 peak. The world stock markets have fallen even faster this time around compared to 70 years ago. The volume of world trade is drying up at a faster pace than the Great Depression and government surpluses are the lowest in 100+ years.

Red across the board, not seen in 70 years

Thus far, this bear market has humbled large cap stocks (NYSEArca: OEF)along with small cap stocks (NYSEArca: IWM), growth funds (NYSEArca: IWF) along with value funds (NYSEArca: IWD), defensive sectors along with aggressive sectors, real estate (NYSEArca: ICF) along with commodities (NYSEArca: DBA).

This unique "red across the board" behavior has not been seen in the 70s, 80s or 2000 bear markets. The only other similar time period to be found is during the Great Depression.

Of course you can't simply build your entire financial future around parallels to past history. If, however, such parallels as the ones discussed above, harmonize with trustworthy indicators with an accurate historic record, the composite advice should not be ignored. In fact, ignoring those indicators as a composite would be a foolish thing to do.

History has taught us that in periods of time when investors are enthusiastic about stocks and their future prospects (1929, 2000, and 2007) has turned out to be the worst times to buy, and almost always preceded a major market decline.

The implications of the above mentioned composite indicators will do more than merely touch peoples' financial futures. Prudent investors will take precautions now to protect their family and financial nest egg. The brand-new September issue of the ETF Profit Strategy Newsletter includes an analysis of the current rally (are higher prices ahead or is a top in place?), a target range for the ultimate market bottom, ETF profit strategies, and practical ways to thrive and survive in the coming years.

As mentioned above, the Dow's recent decline measured in gold is a near replica of the 1929 - 1932 decline in stocks. Eventually, the Dow measured in inflated dollars will catch up with the real value metrics reflected by gold. At that time, many will wish they'd learned from history. We simply must 'learn from the mistakes of others because you can't possibly live long enough to make them all yourself.'

http://www.silverbearcafe.com/private/08.09/sobering.html