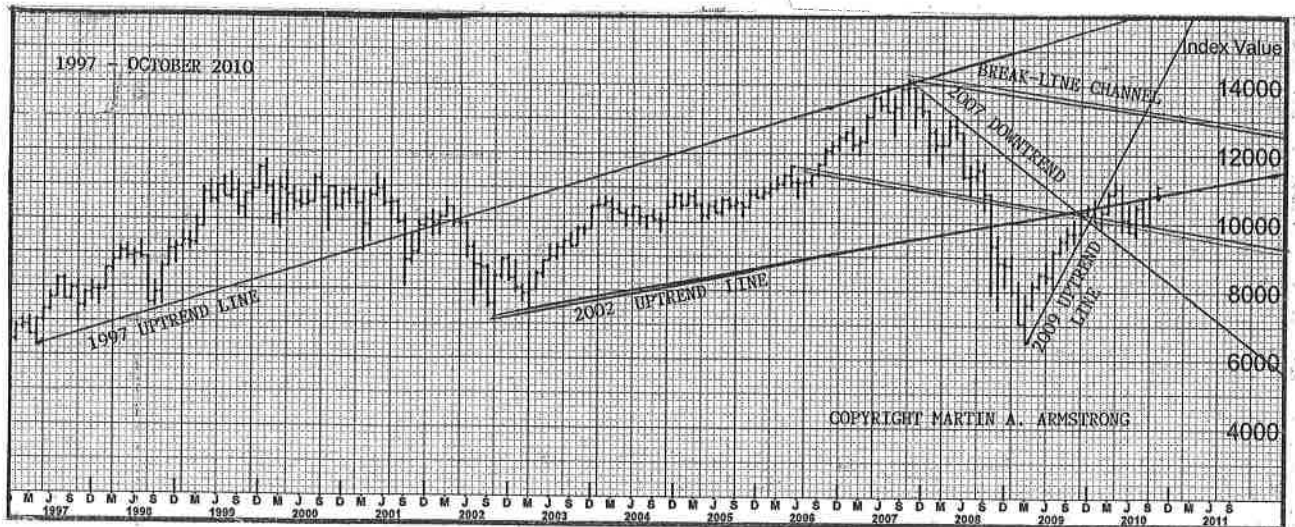


SO You Thought Stocks Only Go Up In Boom Times?

DOW JONES INDUSTRIALS MONTHLY



Martin A. Armstrong
Former Chairman of Princeton Economics International, Ltd.

Please send comments by mail to:

Please REGISTER for Special Updates

Martin A. Armstrong
FCP Fort Dix Camp
#12518-050
PO Box 2000
Fort Dix, NJ 08640

ArmstrongEconomics.COM

Copyright Martin A. Armstrong All Rights Reserved

This Report may be forwarded as you like without charge to individuals or governments around the world. It is provided as a Public Service at this time without cost because of the critical facts that we now faced economically. The contents and designs of the systems are in fact copyrighted.

A C K N O W L E D G E M E N T S

I would like to thank all the former employees, associates, sources, and contacts for their ongoing support and efforts to contribute to the writings I have been able to continue through their great efforts. I would also like to thank those who have looked after not just myself, but my family, and shown them support and kindness.

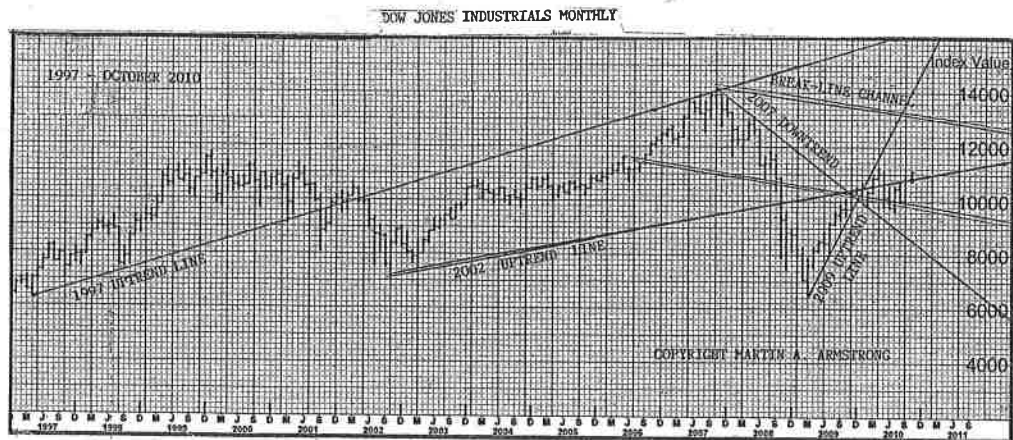
The purpose of these reports is to broaden the understanding that is so vital to our personal survival. Government cannot save us, and will only assist the very economic disaster we face. This is a Sovereign Debt Crisis that threatens our core survival. There is no plan to ever pay off debts. The majority of debt increase is paying interest perpetually to roll over without any long-term plan. What you see in Greece and in the States, we have run out of other people's money. The socialists keep pointing to the rich. But to fund the deficits, we need to borrow now from foreign lands. We ran out of money domestically and to support the current system like Greece, we need foreign capital. But all governments are facing the same crisis and we are on the verge of another widespread government default. Adam Smith warned in his Wealth of Nations that in 1776, no government paid off their debt and had always defaulted. We will have no choice either.

There is no hope that politicians will save us, for they only form committees to investigate after the shit-hits-the-fan. They will NOT risk their career for a future problem that may hit on someone else's watch. There was a politician and a average man standing on top of the Sears' Tower when a gust of wind blew them off. The average man being a realistic-pessimist, immediately sees he is about to die and begins praying. The politicians, the ultimate optimist, can be heard saying "Well so far so good!" as he passes the 4th floor.

At Princeton Economics, our mission was simply to gather global data and to bring that together to create the world's largest and most comprehensive computer system and model that would monitor the world capital flows. By creating that model, all the fallacies of market and economic theories were revealed. The world is far more dynamic and every change even in a distant land can alter the course of the global economy. Just as has been shown with the turmoil in Greece, a CONTAGION takes place and now capital begins to look around at all countries. We can no more comprehend the future but looking only at domestic issues today than we can do so in every other area, such as disease and the spread of flus.

We live in a NEW DYNAMIC GLOBAL ECONOMY where capital rushes around fleeing political changes and taxes just as it is attracted by prosperity. All the people who migrated to the United States in the 19th and 20th Centuries, came for the same reasons as those still coming from Mexico - jobs and prosperity. In the 19th Century, America was said to have so much wealth, its streets were paved in gold. We must now look to both the past and the entire world to understand where we now are today,

SO You Thought Stocks Only Go Up In Boom Times?



By: Martin A. Armstrong

Former Chairman of Princeton Economics International, Ltd
and the Foundation For The Study of Cycles

SO

you thought that stocks only go up in boom times? Sometimes the opposite takes place. Understanding **CAPITAL FLOWS** is the most important aspect of the economy, yet it is the most overlooked and misunderstood trend in the financial history of man. **CAPITAL FLOWS** come in two kinds - **DOMESTIC** and **INTERNATIONAL**.

Capital revolves within a domestic economy shifting from stocks, bonds, and real estate creating bubbles in one and then moves to the next. But there are times when that domestic flow is completely altered that can accelerate a given trend or reverse it entirely to the bewilderment of domestic investors. It is this latter combination that often causes the fundamental analysts to run around in circles. However, the greatest problem that this presents is domestic ignorance dominating both politics and academic circles lacking international experience. Adam Smith in his *Wealth of Nations*, did not sit in an office studying statistics. He observed what was taking place in the real world, and wrote about it. Universities today merely regurgitate theories without observation. Politicians do not want to hear about **INTERNATIONAL CAPITAL FLOWS** for that implies that they cannot do as they like if global capital presents a check and balance against the whims of politicians.

Nevertheless, there is a **DOMESTIC** as well as an **INTERNATIONAL** element to capital flows. **DOMESTICALLY**, government regulates everything with no understanding whatsoever about how the **REAL** economy functions. Every **DOMESTIC** act has international implications as well that they just never consider. Make something illegal like drugs or alcohol, and you create tax-free underground economies that breed crime. The Prohibition of the '20s made the Mafia who they were, just as drugs are fueling gangs and undermining political stability in Mexico.

The drug laws are destabilizing South America and are costing tens of thousands of lives of innocent people. They are no different than Prohibition, which created the Mafia and the profits then led to the expanding into everything else, which is precisely what is taking place with the drugs funding gangs. You cannot regulate human nature. Speeding laws are more for economic gain than safety outside of residential. They do not prevent speeding, and the local state governments would go broke without them.

California is trying to now legalize marijuana and the Feds are saying they will criminally prosecute those in California even if the state legalizes the trade. When Canada was considering legalizing marijuana the USA was lobbying against it for it felt it would then have to defend on two borders as if they can ever win the "War of Drugs" anyway. That is like trying to stamp out pre-marital sex. Good luck!

Even the theory of Anti-Trust is nuts for it arose from an era of consolidation in the railroad industry and that caused politicians to pass a law to prevent a natural economic process. With any technology development, there are often a multitude of companies that start up, and they begin to merge. The bigger companies lack the ability to create something from scratch for the bigger a company becomes, then it becomes like government - more bureaucratic and that kills innovation for the very same reason communism failed due to central planning. The bigger the company, the more bureaucratic it becomes, and the less likely it is capable of innovation. This leads to the natural process of take-over.

Because the big companies become too bureaucratic as Apple did in kicking out its original innovator Steve Jobs, the company was in a slow death because the bureaucrat knows only how to run cutting costs, but never how to build. Once Jobs returned, then Apple took off again with his vision.

Microsoft was accused of Anti-Trust for it kept acquiring start up companies and that was feeding its innovation. However the politician saw that as costing jobs in all these small companies. The theory to support Marx's nightmare is that the big company then becomes dictatorial and can force prices higher by a monopoly. That idea is absurd as communism that was a monopoly of overall property and production that proved the theory was flawed. There can be no such absolute power that is sustainable be it in government or the corporate world. In the corporate world, there is always alternatives and competition that will emerge underground. The Italian Mafia began during World War I counterfeiting food stamps during the rationing days. When Prohibition came in, that is where their profits were made and that led to bribing judges, starting unions, and creating families.

General Motors was the accumulation of many independent car companies. The DOT-COM Bubble saw the same consolidation. It was the Marxists of the late 19th Century that saw greed and evil in the consolidation of the railroads. On July 2nd, 1890 the Sherman Antitrust Act was passed, named for Senator John Sherman, a Republican from Ohio. His law stated:

"Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared illegal."

This was the same man who passed the Sherman Silver Purchase Act of 1890 that had caused the Panic of 1893. He virtually sent the nation into bankruptcy by overvaluing silver because of a gold-silver arbitrage where gold fled to Europe and silver poured into the USA stripping it of its gold reserves. J.P. Morgan led a consortium of banks to lend the US Treasury gold to recapitalize the nation.

Sherman's ideas demonstrate the primitive lack of comprehension of international capital flows. To think that one can overvalue silver domestically higher than the rest of the world shows the dangerous power that can exist in the hands of politicians. The Sherman Antitrust Act is as deeply flawed and a waste of money not to mention its complete lack of economic comprehension that caused the financial panics of the 1890s - one of the worst periods in American financial history.

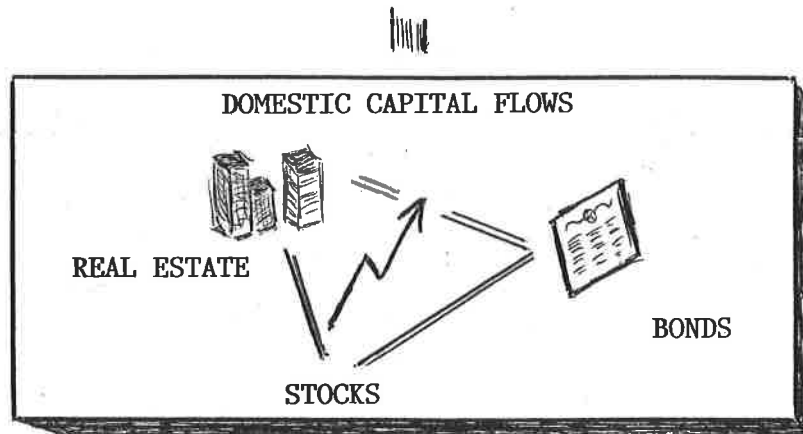
EVERY BILL PASSED BY CONGRESS, WILL IN FACT INFLUENCE GLOBAL CAPITAL FLOWS. EVERY JUDICIAL DECISION BY THE SUPREME COURT ON ECONOMICS WILL ALSO INFLUENCE INTERNATIONAL CAPITAL FLOWS!

Raising and lowering taxes have a profound effect upon capital flows BOTH domestically as well as internationally. Thailand was raising a withholding tax on foreign buying of government bonds trying to deflect capital flows internationally.

It is critical to understand that this is the real mover and shaker behind all events. Until government begins to change its ways and academics begin to grasp the scope of the global economy, we are still in for a very volatile ride. Everything is linked on a global level and we cannot act unilaterally in isolation. It is impossible!

INTERNATIONAL CAPITAL FLOWS

CURRENCY



What we must comprehend is that there are domestic capital flows that are always at the heart of the economy. **CAPITAL CONCENTRATION** drives the economy insofar as money is attracted to one particular segment and that concentration of capital will then push the prices higher in that sector. This is how a bubble forms such as the DOT-COM when people started buying anything in a sector that becomes hot. This was the 2007 Mortgage bubble whereas in 2000 we had the DOT-COM bubble. Now we have the BOND BUBBLE. People ran out and bought Goldman Sachs 50 year bonds, but have no real intention of holding them for that long. They assume they will be able to sell them at any time.

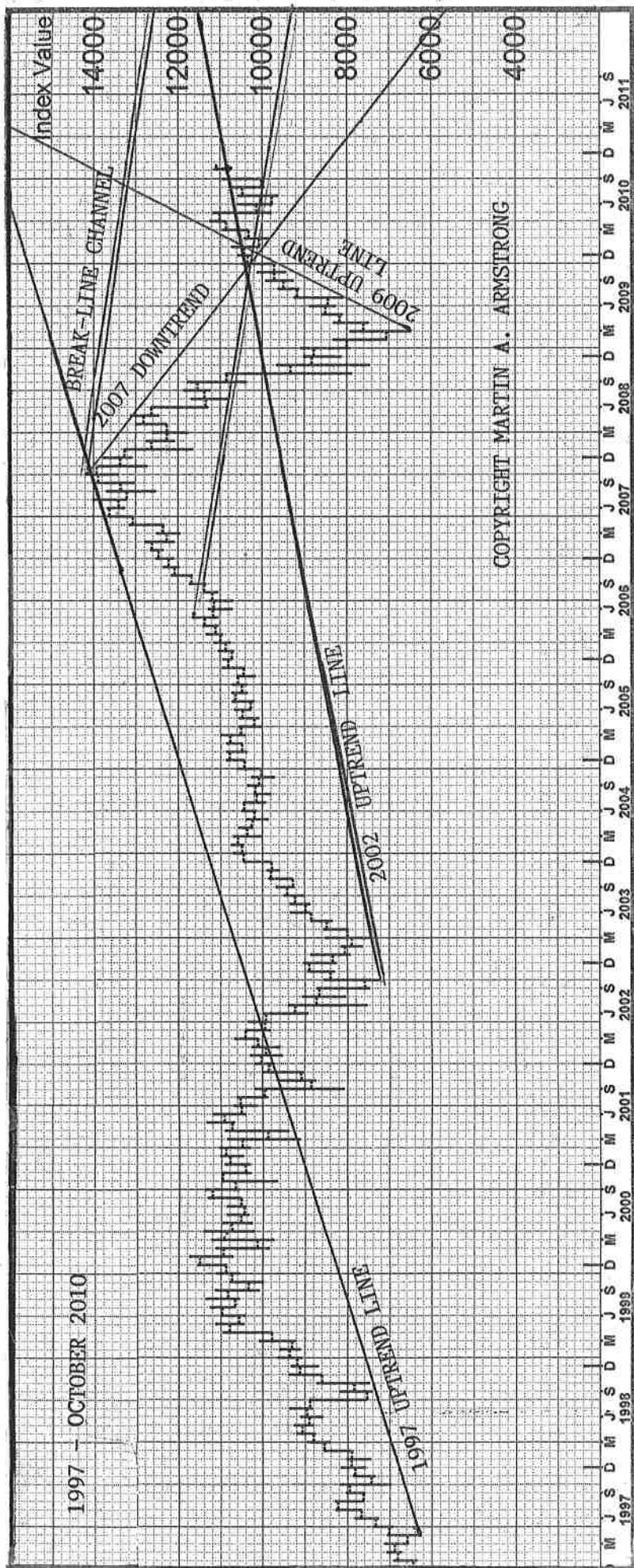
Against this DOMESTIC CAPITAL FLOW that is the circulation of domestic capital from one segment to the next, we then have the INTERNATIONAL CAPITAL FLOWS whereby those values are now translated into the currency of all foreign investors. When those assets domestically are rising also in terms of the foreign currency, then international capital from that currency base will be sent into that domestic segment. This is how we get MAJOR BUBBLES like 1929 in the US or 1989 in Tokyo.

The more currencies that decline against the domestic currency in question, the greater the international capital attraction that will further the domestic advance. In contrast, a declining domestic currency will have the opposite effect.

The key to figuring this mess out is always the differential. If the currency declines by 5%, but the domestic assets in question rise by 20%, then foreign capital will still flow inward. It is when we are in situations as the 1987 Crash where the currency declined by 40% and the expectation was it would decline again, the decision was to sell for the stock market was not seen as rising equal to the decline in the currency. This results in a massive INTERNATIONAL CAPITAL FLIGHT. The same took place in Japan in 1989, and in the Asian Currency Crisis that followed the Asian investment bubble.

The world is far more complex than the universities teach. This is why a MBA is a show of ability, but not knowledge. Schools do not train students for the real world. They do not understand this international impact and that is reflected in our political decisions as well.

We have different timing bands for each segment as to how long they last. Real Estate is the longest and that is what peaked in 2007 on this move. We had the DOT-COM bubble in 2000 and now we have the bond bubble that is getting ready to burst (One Reason Goldman sold 50 year bonds, they are selling the high in bonds as they sold the high in real estate). Never listen to what Goldman proclaims - just follow what they do. We are in the last throes of a bond bubble and the Dow Jones Industrials closed for the first time above 11,025 on a monthly basis showing the shift is underway once again.

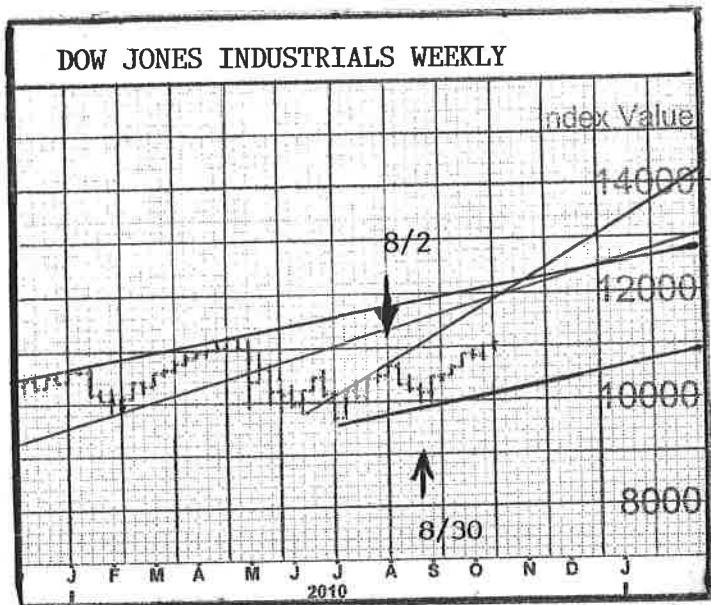


Those who are new to this form of analysis are writing and starting to realize that **TIMING** is the most important aspect to understand. You can count waves, draw technical lines, and these will give you a different view of the market in question. But **ONLY** cycles will tell you when. Anything else is subjective and comes down to opinion, which everyone has. The only hardcore black and white is **TIME**.

Add to **TIME**, technical analysis gives us the map so we can look at where we are, and where we might be going. Technical analysis provides the price objectives, but when you cross into the world of pattern recognition, we return to the world of subjective analysis.

Now we must add the **CAPITAL FLOW** analysis both **DOMESTICALLY** as well as **INTERNATIONALLY**. This provides the real understanding of how and why markets move as they do. This also incorporates the shift from **PUBLIC** to **PRIVATE CONFIDENCE** that can be traced throughout history.

For example, the stark difference between Genoa and Venice services as a important factor in comprehending **CAPITAL FLOWS**. During the 17th Century, Venice was very protectionist. Genoa was a city of free flowing capital. Venice never truly seized the banking industry as did Genoa and Florence, where the latter was the home of the famous Medici. The protectionistic policy/State Monopoly in banking that developed, provided a self-restraint upon Venice. The Genoese began to acquire shares in the Venetian public debt in 1617, and by 1673, they held 30% of the entire national debt of Venice. By 1685, the Venetian court had to rely on foreign capital to survive. Their idea of the state bank creating a monopoly, led to the decline of Venice. Here we have the same issue where the USA has become dependent on foreign capital and the interest is an export of capital undermining America the same as Venice declined and fell. History offers a list of the follies of man and how we have made the same mistakes over and over again.



The DIRECTIONAL CHANGE that we were then looking for came the last week of August and the high came the first week of August 2nd. I had warned that WHATEVER WE GOT THE LAST WEEK OF AUGUST SHOULD BE FOLLOWED BY THE OPPOSITE TREND THEREAFTER!

This DIRECTIONAL CHANGE came out on target. We have now achieved a monthly close above 11,025. Despite the overwhelming view of a second dip and the crash of the Stock Market, the market zigged instead of zagging. This does not change the economic decline. Instead, we are starting to see a shift from bonds to stocks that still appears to be in the cards for what is coming after June 2011. This is giving more support to the idea that we face a bond bubble. Because the USA is now dependent upon foreign capital much as Venice was during the 17th Century, there is a real danger ahead of a economic apocalypse. The swing to the Republicans will not make things better for they will be then fighting only to gain the throne of the Presidency in 2012, just ahead of the Mayan target in December 2012. So changing horses in midstream right now will not solve any problems for political forces still will not recognize that they are the source of our problems. Without someone looking into a mirror on Capital Hill, we are screwed!

The CAPITAL FLOWS domestically are - a - changin'. We are starting to shift gradually from bonds to stocks. This is not yet massive

and in fact, we may not see the full blown shift become obvious to everyone until 2012. That is the furthest we can see the interest rates remain low. Thereafter, we are looking at a very significant change in trend that may indeed be influenced by political events.

The primary support for the Dow Jones Industrials lies at the 9645 level on a key monthly closing basis. The lowest we fell in 2010 was to 9774.01. Thus, this is the key closing support and thus everything has remain quite bullish.

Achieving the monthly closing ABOVE 11,025 is a positive sign that the low is in place. We still have monthly closing resistance at 11,832. But closing above that would tend to be much more immediate than the 11,025 number.

During November, we will see support forming at 10700-10720. followed by 10595. This should provide a solid support base. As we look ahead into December, this will still be firm rising slightly to 10810. Technical support will lie at 10260 for December. Thus, we will need to look at the major yearly numbers as well (on the next page).

If the week of October 11th remains the high, we could see a 6 week consolidation, with a rallied into year-end. Keep in mind that the MAJOR monthly closing resistance stands at 12,842. This will be close to the major yearly resistance which also stands at 12,567.

The big turning point will be June of 2011. If the Dow retests support precisely to the day, then we should see a very strong bull market thereafter going into the high for the top of the next 8.6 year wave in 2015.75.

This is a shift that we must come to grips with. The Fed is trying to inflate its way out and that is pretty much what took place between 1932 and 1937. Roosevelt took gold from \$20.67 to \$35 devaluing the dollar and the stocks rallied with gold. Today, we have seen gold rise and the stocks rebound. We are establishing this critical link once again signaling that the end truly is just around the corner.

When we look ahead into 2011, the resistance will stand at the 12500-12900 level followed by 13340, The primary support begins as high as the 10608 level assuming we close 2010 ABOVE that area. This should be a very important pivot area even into 2012. Above the market, we will have this 11800-11935 level as critical pivot resistance also for the next two years into 2012.

Well below the market, we have the 7400-7290 area that will also be major pivot support for the next two years. Thus, this pivot range is:

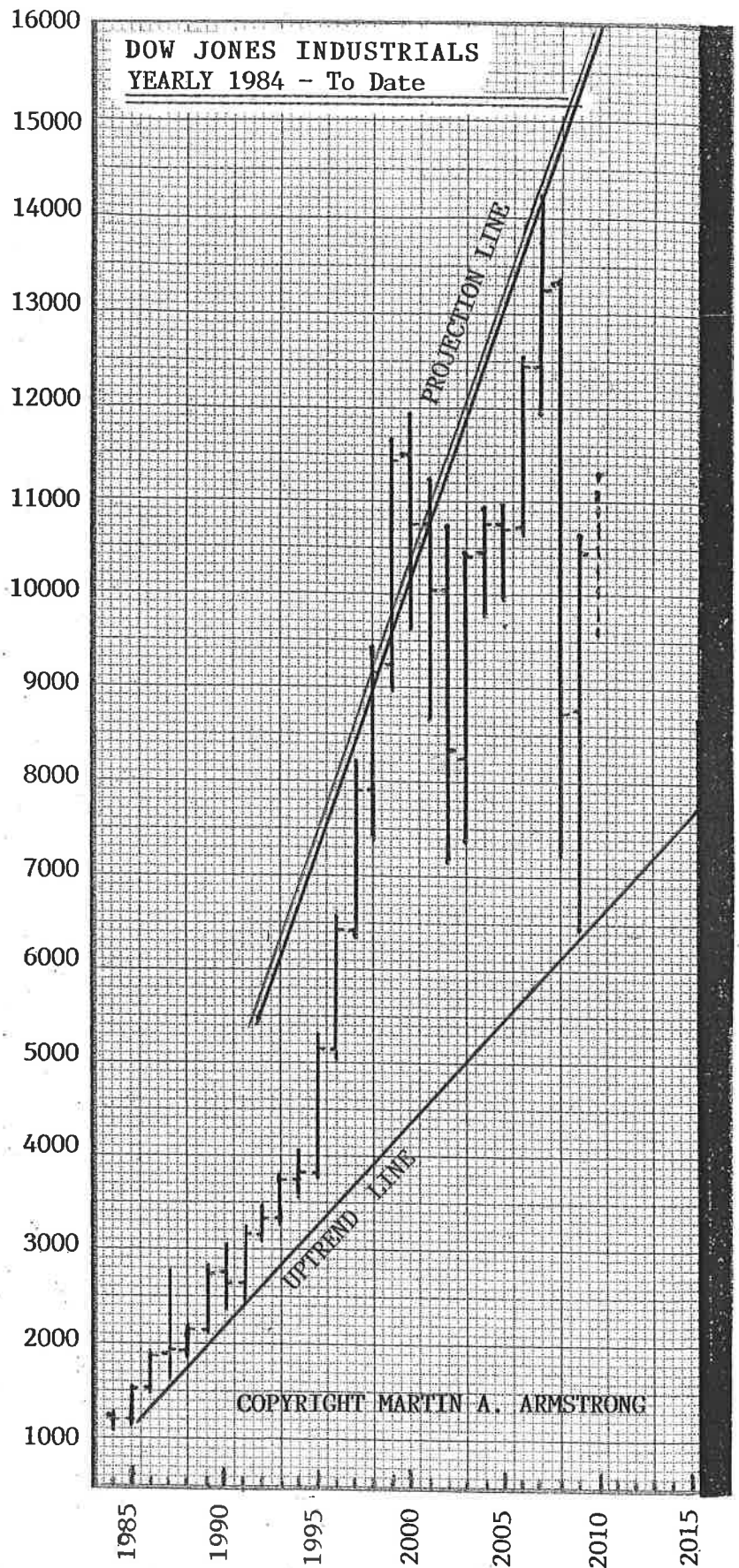
11800-11935

7400-7290

The PROJECTION LINE performed well so far picking the high in 2007 and this now stands at 16088 in 2011, 16644 in 2012, 17200 in 2013, 17756 in 2014, 18311 in 2015 and 18867 by 2016. Exceeding this starts the BUBBLE!

Many have argued that this is an economic crisis fueled by the lack of a gold standard. I will deal with that in an upcoming book, but it is sufficient to say that really means nothing. It is the DEBT that is now destroying Western society regardless of what we call money. The Romans, Greeks, Byzantines, and countless others all fell and they too had a gold standard long before paper money was invented. The serious issue is the constant borrowing and spending. Returning to a gold standard is not going to solve the problem nor put Humpty Dumpty back together again.

Looking into the future, it does appear that 2015 is going to be a YEARLY PANIC CYCLE with massive huge volatility into 2016. We will not be able to avoid it. There is no way our politicians will stop borrowing and give up power. It will NEVER EVER HAPPEN! So we will be thrust into a debt crisis of untold proportions. If 2010 just closed above the 10608 level, this will be suggesting that indeed we will be off and running to new record highs after June 2011.



COPYRIGHT MARTIN A. ARMSTRONG