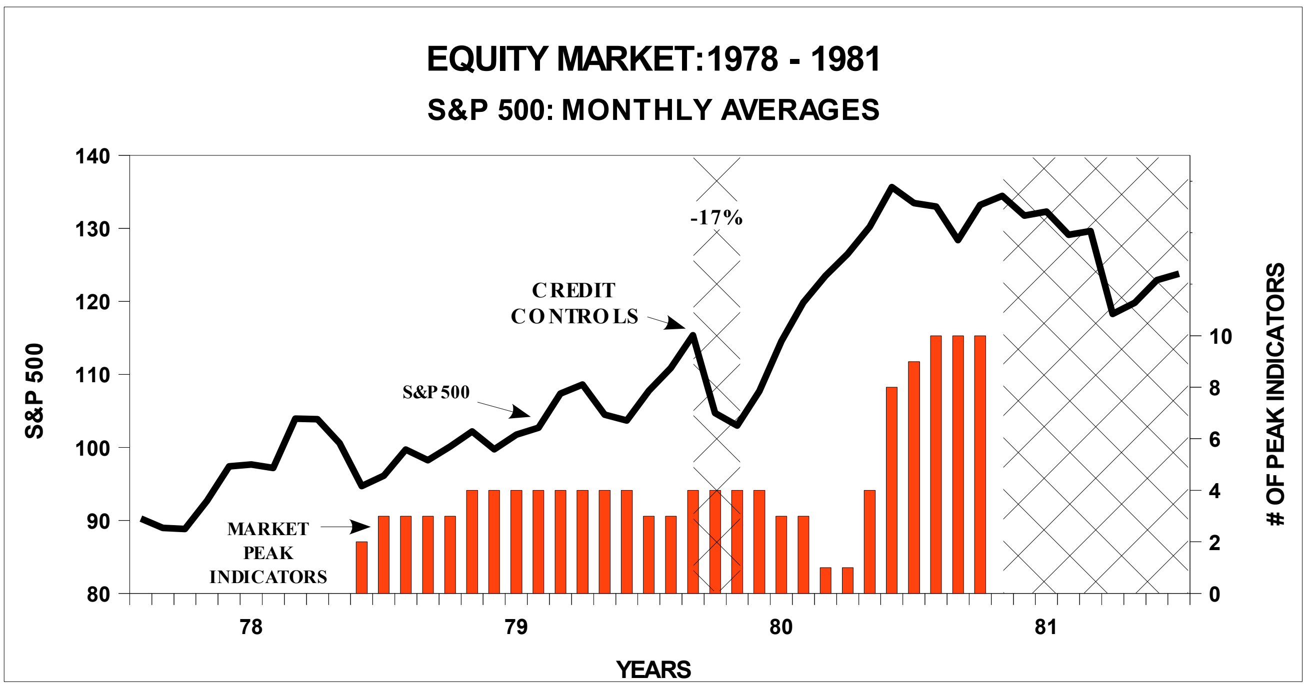
BUSINESS CYCLE DEVELOPMENTS

When the scientific methods fail, there's something else operating. There's only **one** of six **Market Trough Indicators** signaling, so market weakness over the next few months is expected.

The frequent intermediate declines, usually three per year, don't fall -17%+ without being connected with some exogenous shock. There are only two **Market Peak Indicators (MPI's)** signaling, so this decline is connected to either the August 2nd budget bill or the European debt crisis or both. Seven days before the budget bill, on July 22nd, the bill-impacted health care and defense stocks, which make up more than 20%+ of the weight of the S&P 500 started to seriously drop. This, coupled with the European issues, qualifies as sufficiently serious for exogenous material.

There are only two occasions when the **MPI's** did not signal any market peak – Credit Controls of 1980 and the 1990 Gulf War, and they wouldn't be expected to do so, because these were event-driven, outside the dynamics of consumer spending and liquidity measures within the economy. They both led to recessions; however, the 1980 recession lasted only one quarter. The reason for this was Congress reversed its self within a few weeks and that triggered an S&P rebound. Credit Controls caused the S&P to fall -17% for 30 days and the Gulf War impacted the S&P by -20% for 62 days.



Notice above there were four **Market Peak Indicators** flashing before Credit Controls were implemented. They reversed and then returned prior to the two-tier top of November 1981 (in oils) and the balance of the market averages in April 1981.

Technically, recessions are two quarters back-to-back and no recession is expected to follow this shock. When recessions are discussed and there's anxiousness concerning one, they don't materialize, because consumer spending behavior and corporate inventories are adjusted, along with the recession chatter, which is prevalent today. It's possible to get one negative quarter, but two is not anticipated.

Not having any recession is very relevant, because only two of six **Market Trough Indicators** are needed to re-enter the market on weakness **when there is no recession**. Currently, the *Diffusion Index of S&P 500 Industries* is the only **MTI** signaling. From the date of the 2nd **MTI**, the market typically declines a *monthly average* of -7% (+/- 7%) for an average duration of 3 months (+/- 2 mo.).