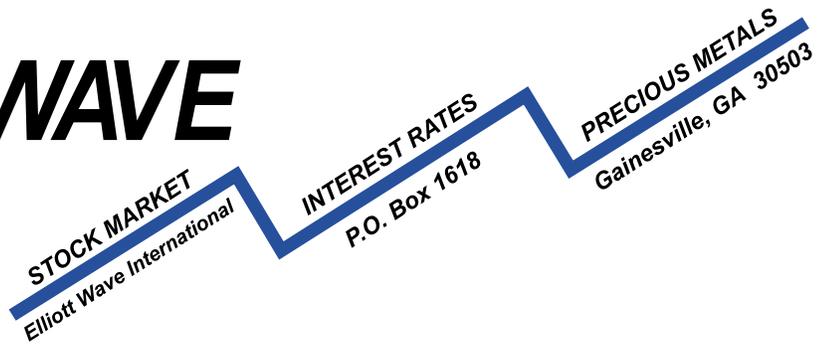


ROBERT PRECHTER

THE ELLIOTT WAVE THEORIST



September 11, 2001

Special Report

ELLIOTT WAVES and SOCIAL REALITY

by
Robert R. Prechter, Jr.

**We here at EWI have lost dear friends in the World Trade Center attack.
We grieve for them and for those of you who have suffered the loss of loved ones.**

As terrible as today's tragedy is, we must pause to point out another tragedy, which is that so few understand why it happened, what will happen next and what they can do about it. This issue of *The Elliott Wave Theorist* will try to present an unemotional account of these issues.

Sometimes it takes an appalling drama to stir people from lethargy and make them pay attention to matters of grave importance. If your friends and family have yet to wake up to the Wave Principle's crucial message, please do your part to help them realize where we are in the social cycle and why it matters. For this issue, we will suspend our ban against re-transmission so that you may distribute it to others as you see fit.

Comfort and safety come from *understanding*. If you can see the big picture clearly, both past and future, you will be able to make fruitful decisions calmly.

As this issue is being composed and issued in a single day, please excuse any passages that appear rough or incautious.

Understanding the Engine of Social Trends

The radical thesis of *The Wave Principle of Human Social Behavior and the New Science of Socionomics* (New Classics Library, 1999) was unmistakably manifest in the raucous social comedy of the 1990s, and now it is playing out in the first act of a developing worldwide social tragedy that will last years. The primary thesis of this book is that *changes in social mood cause and therefore precede changes in the character of social events*. In contrast to this idea, most people erroneously try to divine the implications of events in attempts to forecast financial markets and people's collective feelings. Their approach *cannot* work because *markets are driven by natural trends in mass psychology*, and events resulting from those psychological trends come *afterward*. It is the changes in such trends, as indicated by turns in the stock market, that signal a coming change in the tenor of social events.

An equally radical thesis underlying socionomics is that *social mood is patterned, and it is patterned according to the Wave Principle*. Since these patterned mood trends precipitate social events, you can *forecast the character of social events* by tracking the trends and patterns in the primary meter of social mood, the stock market.

You can always get *The Elliott Wave Theorist* instantly upon release: for information, visit www.elliottwave.com.

Socionomics explained why global atrocities *followed* the 1929-1932 crash and continued during most of the rest of the bear market pattern, which ended in 1949. It also explained why the worldwide peace initiatives and unprecedented acts of reconciliation of the 1990s *followed* nearly half a century of social mood uptrend. The dramatic, historic pictures shown in *Socionomics* to convey the power of these moods were not placed there simply for academic purposes. This is real life we're talking about. You have to live near those events to sense that fact.

Forecasting the Tenor of Social Events

Such observations have not simply been reflections on the past. In 1978-1983, *Elliott Wave Principle* and *The Elliott Wave Theorist* forecast a rising stock market, boom times and "no war for at least ten years."

At the Crest of the Tidal Wave (NCL, 1995) then forecast the next major change, saying in no uncertain terms that severe social unrest would follow the onset of what was then the approaching — and is now the developing — Grand Supercycle bear market. Here is the book's introduction to that topic:

SOCIAL IMPLICATIONS [excerpted from *At the Crest of the Tidal Wave* (1995), p.432-433]

While the Wave Principle is the single best method for anticipating the behavior of markets, its value at times goes way beyond even that great benefit. As explained in Chapter 12, the effects that a change in market trend will have on society are not in evidence at the start of the trend. They become intensely manifest by the time of its termination. Is it too early to begin projecting events that will result from the approaching bear market in social mood? To be sure, this book contains dozens of very specific financial forecasts, which are at root social phenomena. Forecasting social events outside that realm, however, is an even more complex and less exact science. Nevertheless, a few observations appear suited to the limited scope of this book.

A long term trend toward a positive social mood always leads to times of peace and political cooperation, such as we enjoy today. An extreme trend change in social mood toward the negative always leads to calamities. The average level of conflict during the bear market will be far greater than it was during the bull market and will lead to periods of turmoil, not just in financial markets, but in society. Indeed, the trends now implied by long term market patterns have *always* produced dramatic social upheaval. The last time a bear market of the currently projected magnitude took place was 1720 to 1784, a period that began with a market crash, ended with the Revolutionary War, and led to a deep and global five-year depression.

The coming trend of negative social psychology will be characterized primarily by polarization between and among various perceived groups, whether political, ideological, religious, geographical, racial or economic. The result will be a net trend toward anger, fear, intolerance, disagreement and exclusion, as opposed to the bull market years, whose net trend has been toward benevolence, confidence, tolerance, agreement and inclusion. Such a sentiment change typically brings conflict in many forms, and evidence of it will be visible in all types of social organizations. Political manifestations will include protectionism in trade matters, a polarized and vocal electorate, separatist movements, xenophobia, citizen-government clashes, the dissolution of old alliances and parties, and the emergence of radical new ones. Tariffs will become popular, regardless of the fact that virtually everyone knows they are dangerous and wrong, because they are a consequence of an increasingly negative psychology involving fear, envy and a misguided attempt at self-defense. Xenophobia will be practiced regardless of people's generally good intentions, because fear and hatred become pervasive in major bear markets regardless of whether or not they are justified. There will also be a danger that governments will impose police-state type controls as a consequence of the bear market. Such periods often end with emotional political oustings, whether by vote, resignation, impeachment, coup or revolution.

The worst economic and social programs are years away, but advance planning is incalculably better than trying to react when it is too late.

Predicting Wave Form

At the Crest detailed a number of specific forecasts with respect to the bear market, including the expected pattern of the entire wave, the likely years for the end of each wave, downside price targets in the Dow, etc. (For a diagram, see Figure 5-12 in the book.) One of the most specific predictions was this one, showing the exact form that the first wave down would take:

How the Pattern Will Start [excerpted from *At the Crest*, p.82]

Regardless of which specific long-term pattern ultimately unfolds at Grand Supercycle degree, there is no question that the first (or only, under the milder scenario) Supercycle degree decline will be of the *zigzag* family. It will be composed of *three* waves, to be labeled A-B-C or W-X-Y. **Every initial decline through Primary degree** (the “first” waves), and probably through Cycle degree (wave A), **will be composed of five waves in order to be compatible with the larger trend.** The declines of 1929 and 1937-1938 were “A” waves within Supercycle and Cycle degree bear markets respectively. Figures 5-8 and 5-9 show pictures of what these first declining waves looked like. **Expect the first major decline of the coming bear market to reflect the form of these waves.**

The figures at the bottom of page 4 show the recent development of S&P and NASDAQ price change from those indexes’ all-time highs in the first quarter of 2000. Can you see that they are the same Elliott wave form? And it was *predictable*.

Wave Form as the Key to More Specific Timing in Social Forecasting

An Elliott wave analyst can even put a fine point on when the best and worst social times will occur. The *Socionomics* book explains that wars always erupt during or immediately after “C” waves in bear markets of Cycle degree or larger. More important, *the bigger the corrective process, the bigger the war.* We are in only wave (a) of the Grand Supercycle bear market, which will have to do mostly with *financial* destruction. So shocking though they may be, events to date are in fact correspondingly and comparatively mild, like Hitler’s takeover of Czechoslovakia was to ensuing events within Supercycle wave (IV). Within wave (a), wave **c**, which should unfold from 2002 to 2004, will bring greater acts of conflict and instances of physical danger. Yet as *At the Crest* explained, the worst global horrors — and this is good news for now — will not occur until *wave (c)* of the entire Grand Supercycle, which is not due for several decades.

Forecasting Styles of Social Events

Here is another esoteric point but one of great value. A section on “Nuances” in Chapter 15 of *Socionomics* explains that negative social themes due to appear in any approaching bear market first express themselves in milder form in the preceding fourth wave of one lesser degree. Stop for a minute until you get this idea. Here is a more detailed explanation: Social mood repeatedly traces out five waves up followed by three waves down. The negative themes in “wave four” within the “fives waves up” presage those that will dominate, *more dramatically and on a much bigger scale*, in the ensuing “three waves down.”

This is true of the styles of cultural trends. For example, *Psycho* came out in 1962, at the end of a fourth wave correction of Primary degree. In the larger bear market of 1966-1982, slasher films (the *Halloween* and *Friday the 13th* series) were a dominant theme.

It is also true of the character of social events. In an earlier fourth wave from 1916 to 1921, collectivists took over Russia. In the larger fourth wave that followed, from 1929 to 1949, collectivists took over nearly half of the earth’s population, in Germany, Italy, Eastern Europe and China.

Examples of the "How The Pattern Will Start," as shown in *At the Crest of the Tidal Wave* (1995):

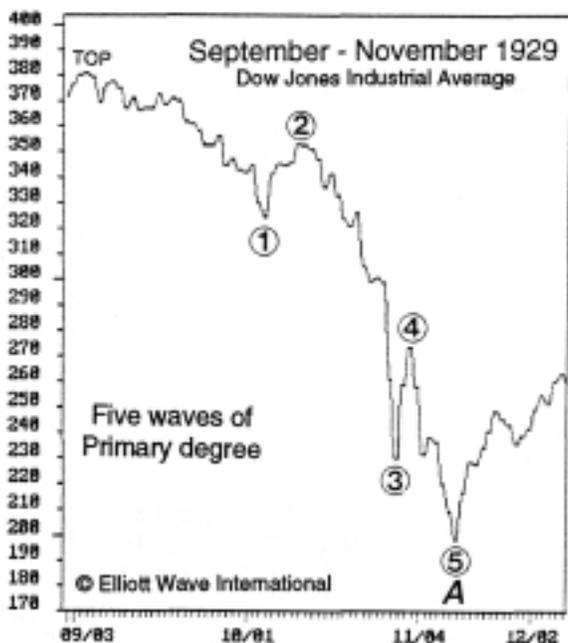
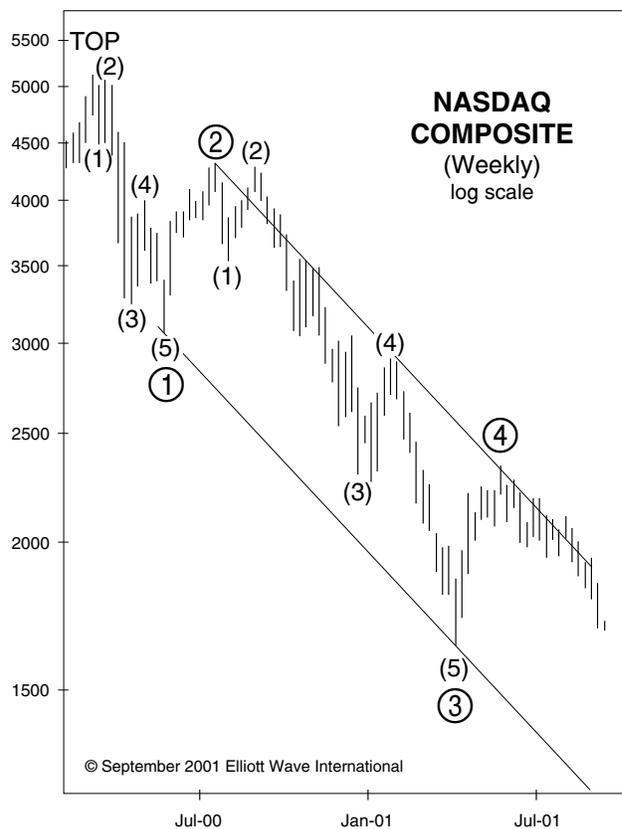
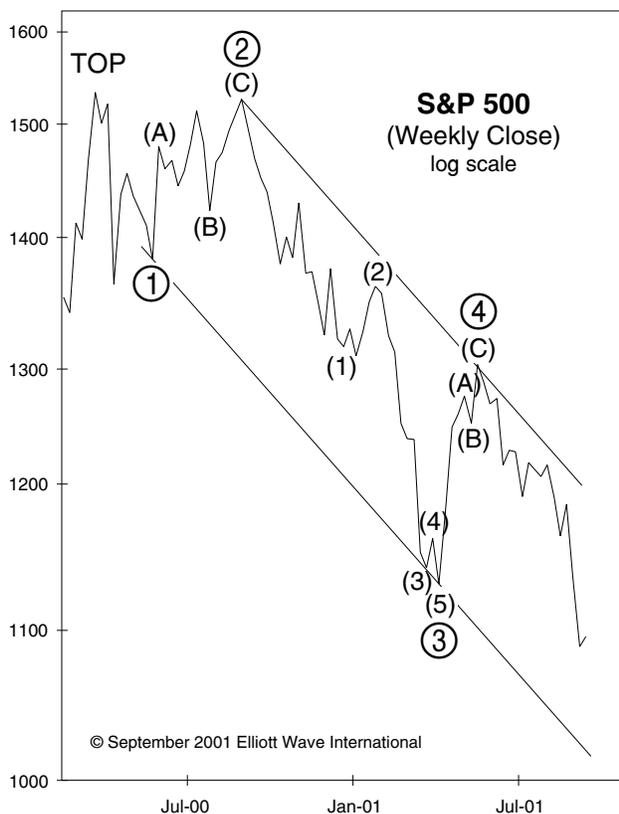


Figure 5-8



Figure 5-9

Initial pattern nearly fulfilled in five waves of Primary degree since 1Q 2000:



In the current case, the most recent fourth wave of Cycle degree or higher took place from 1966 to 1982, roughly, “the ’70s.” Aside from a slew of terrorist incidents in the 1910s,* a decade dominated by a long bear market in stocks, *the idea of “terrorism” as a social force began with the 1966-1982 bear market.* A 10-volume chronology of American social history over the last 100 years (American Decades, Manly Inc.) lists *no* acts of terrorism in the 1920s, 1930s, 1940s, 1950s or the 1960s. In early 1970, when the Dow was in year four and the Value Line Composite in year two of a Cycle-degree bear market, the age of terrorism began. An Arab terrorist strike killed one person and injured 23 in Munich. On February 21, 1970, another group of suspected Arabian terrorists hijacked a Swissair flight and crashed it. On September 6-9, 1970, Palestinian terrorists hijacked five planes and blew up three. Unlike the earlier period of “scattered terrorist bombings” in the 1910s, this era was distinguished by the frequency, extent and organization behind the attacks. As the bear market continued, the events grew in size and complexity. The increasing sophistication of terrorist tactics and their rising political power is revealed by the progression from the scattered strikes in 1970 to the PLO raid on the Olympic Village in Munich in 1972 and eventually to a state-sponsorship takeover of the U.S. embassy in Iran in 1979. The worst of it ended approximately when the bear market did, as Iran finally released U.S. hostages in January 1981. In those first terrorist acts committed against the United States, we caught a glimpse of the style of conflicts that we would have to endure when the bear market of next bigger size arrived, which it certainly has done.

Neither is this point made only in retrospect. Page 435 of *At the Crest* lists 43 speculations as to specific social actions that will take place during Grand Supercycle wave (IV). Several of them have already come to pass. One of them reads,

“Foreigners will commit terrorist acts on U.S. soil.”

Here is a summary of today’s event, which truly is “more dramatic and on much bigger scale” than those that occurred during the previous fourth wave of the 1970s:

New York, Sept. 11 (Bloomberg) — The attacks on the World Trade Center and Pentagon today are the worst acts of terrorism ever on U.S. soil and change the scope of foreign policy, experts say.

Never before has a large-scale terrorist attack on the U.S. been coordinated successfully in more than one U.S. city. At this point, no organization has taken responsibility.

“It’s just an attack of extraordinarily sophisticated planning,” said Michael R. Fischbach, a professor of history specializing in the Middle East at Randolph-Macon College in Ashland, Virginia. “The world that we know has now changed.”

“Americans’ whole attitude about daily life, about foreign policy will be forever changed,” Fischbach said.

*The first act of terrorism listed in *American Decades* is the explosion of the Los Angeles Times Building in October 1910, which was linked to organized labor. The last one of note was a bomb that rocked Wall Street on September 16, 1920. The scars of that blast can still be seen in the façade of 23 Wall Street, then as now the offices of J.P. Morgan Inc. The financial attack centered on Wall Street became physically manifest. Almost the same thing has happened today.

“The world that we know has changed” is a correct statement, but it did not change “now.” It changed between January 14 and March 24, 2000, a two-month period during which the three major U.S. stock indexes signaled the end of a Grand Supercycle uptrend that had been in force for *216 years*. We are only now beginning to feel the lagging results of that change.

The 1966-1982 period had many other unfortunate characteristics that we will see again to a larger extent in the current bear market. However, the “preceding fourth wave” at *Grand Supercycle degree* actually refers to 1929-1949. As the Grand Supercycle bear market pattern unfolds over the next few generations, eventually it will bring on the kinds of conflicts that ruled *that* correction.

Do you recognize the value of this information? Most people understandably fret over whether or not an action is “a one-time event” and speculate on whether “the worst is over” without *any idea* of how to answer these questions. Socionomics can answer them, and it does. Right now, we can say with confidence, *we are at the beginning of a long period of social unrest, and while it will wax and wane with the waves, overall it will intensify*. The best time to prepare was two years ago, but it is *not too late* to do so now.

A Side Point

During the 1990s, we studied the history of skyscraper construction and issued several reports on the correlation between the erection of tall buildings and the late stages of positive long-term social mood trends. As EWT stated in April 1996, “Of all the cultural relationships we consider here, the link between stock prices and the tallest buildings is one of the most fascinating because it is literally etched in stone.” We concluded that skyscrapers are “monuments to peaking social mood.” Some people take such studies as frivolous. They are not. Now that we are in a negative social mood trend of greater magnitude than any since the construction of the first skyscrapers in the 1890s, we should hardly be shocked that the forces expressing the emerging downtrend in mood have aimed their sights at these towering structures, symbols of the productive optimism of Grand Supercycle wave (III).

Why Now?/What’s Next?

Generally speaking, the most shocking news in the social context comes in two places: in declining *fifth* waves and in declining *C* waves. The stock market is not in a *C* wave. Since the all-time high, it has been in wave **a** of what will eventually be an **a-b-c** decline. *Within* wave **a**, it is almost certainly in wave (5), as you can see in the two charts at the bottom of page 4.

If the stock market is indeed in wave (5) down, then this wave will end within days or weeks and lead to a substantial (A)-(B)-(C) rally (or perhaps a triangle) for wave **b**. Then wave **c** down will begin. If this assessment proves correct, it is good news for the short term. If instead the “big crash” is upon us, we should know shortly after the markets’ reopening. Rest assured that *The Elliott Wave Financial Forecast* (perhaps with an Interim Report) and the *Short Term Update* (to be published next on Wednesday night, whether markets are open or not) will keep you abreast of all our conclusions regarding the stock market, and bonds, gold and the U.S. dollar as well.

What To Do

We have already discussed in detail what you should do with respect to your finances. A full list of useful and necessary services is in the back of *At the Crest*. You can still study and act on our “Bear Market Strategies” page, which we composed a couple of years ago and have updated continually, in our “subscribers only” section at <http://www.elliottwave.com/subscribers/subonly.htm>.

What to do about your physical safety is a more difficult problem for most people. Obviously, living in a populous area or near a military or important infrastructural site is dangerous in times of social unrest. If you are tied to a job site, decisions are even more difficult. In the early days of World War II, some smart people vowed to get out of the way of the danger by moving to some sleepy islands out in the Pacific called the Philippines. You won't always guess right. We will try to keep an eye on the world's social trends for you in coming issues of EWT, but I have no pretensions of being expert on physical safety. At best, we will try to direct you to those who are.

A Long-Term Development

Today's terrorist focus on the United States is *not* an isolated, inexplicable situation. The founding fathers, notably George Washington and John Adams, warned our new country against foreign entanglements. They begged us, in Washington's words, "in regard to foreign nations...to have with them as little *political* connection as possible." (Source: <http://www.virginia.edu/gwpapers/farewell/transcript.html>.) Contrary to this advice, many U.S. presidents of the twentieth century, usually citing altruistic motives, have insinuated our government into foreign hives to such an extent that we have finally stirred one set of bees into reacting. Though no one has yet "taken credit" for today's atrocities, the actions of the perpetrators are surely irrational, perhaps based on dreams of global domination or the hope of a glorious reward in the next world. That is, generally speaking, what the founding fathers feared: the mire of foreign political irrationality. The environment in which we are currently beginning to suffer results from decades of redirected government policy, and the underlying cause of *that* change is the initially brave but ultimately reckless set of shared emotions underlying the magnificent ascent of Grand Supercycle wave (III). This is not to affix blame on "us." Many everyday Americans have decried our "police the world" policies, and our leaders' penchant for well intentioned meddling has just been part of the social pattern. Its outcome was therefore predictable. Tens of times during the past decade, we at EWI cringed as our president issued yet another threatening ultimatum to various other countries' governments (at least seven, which we documented in EWT at the time). We thought, "*Does he know what this attitude will lead to, how many Americans it will ultimately endanger?*" All the while, and in keeping with the waxing mood of invincibility, our "fundamentals" — in terms of national intelligence, security and military preparedness — were going to seed. Don't let anyone tell you that these attacks and our lack of preparation are a surprise. They are the result of feelings of complacency and overconfidence born of the final decades of GS (III). Ironic as it may seem, the suffering in bear markets is greatly the consequence of cavalier policies adopted late in bull markets.

The Utility of Socionomics

Are Elliott waves and socionomics purely academic toys? They are not. Like good philosophy, they are not just *theoretically* correct; they are *practical* and useful in everyday life. At major junctures, understanding the change at hand can mean the difference between success and failure, life and death. The people who started successful businesses in 1949 and 1982 or went bankrupt in 1933 and 1975 understand the first point. The people who got out of Europe in 1938, or who stayed there, would understand the second.

In coming months and years, others will repeatedly be shocked over "surprising" single events, which they do not understand as being part of a larger pattern. At least you will know *that* we are in a pattern and even, most of the time, *where* we are in it. From that, you can make important decisions that will guide your life.

Getting the Word Out

In response to a question about how EWT's long-term stock market forecast would be remembered, the February 2000 issue responded as follows:

"Most people will not be paying as much attention to the stock market after it falls, so in a few years, **most of today's investors will not care who predicted what. Their focus will be on other things.**"

People have also asked me in the past two years why I have stayed off television. Forecasting unrest during good times is like singing to rocks. Nobody's listening. Then once the unrest begins, you can't be heard over the cacophony. Everyone's singing, and most of it is off key. Besides, you cannot communicate a book like *At the Crest*, much less *Socionomics*, in 2½ minutes. You have to sit down and read it.

If anyone asks you why these things are happening, just give them one short answer: "Read Prechter's *socionomics* book." This is not an ad for the sake of selling books; we don't make much money on book sales. The point is to help people understand an important aspect of life and perhaps save their own. Tell anyone you know that they can have it for half price, if they mention this issue of EWT. Then tell them, "Yes, you should have read it two years ago. But better late than never."



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The Elliott Wave Principle is a detailed description of how markets behave. The description reveals that mass investor psychology swings from pessimism to optimism and back in a natural sequence, creating specific patterns in price movement. Each pattern has implications regarding the position of the market within its overall progression, past, present and future. The purpose of this publication and its associated services is to outline the progress of markets in terms of the Elliott Wave Principle and to educate interested parties in the successful application of the Elliott Wave Principle. While a reasonable course of conduct regarding investments may be formulated from such application, at no time will specific security recommendations or customized actionable advice be given, and at no time may a reader or caller be justified in inferring that any such advice is intended. Readers must be advised that while the information herein is expressed in good faith, it is not guaranteed. Be advised that the market service that never makes mistakes does not exist. Long term success in the market demands a recognition of the fact that error and uncertainty are part of any effort to assess future probabilities.

