

Where We've Been and Where We're Going: A 2009 Review and 2010 Forecast

A massive market advance in 2009 is only half the story; be ready for more big moves ahead

by Ryan Henry

When the S&P 500 index plummeted 25% in the first ten weeks of the year, few would have guessed that, by year's end, 2009 would be a great year for investors. Now, calling it a great year feels like an understatement. Not only were the early losses reversed, significant gains were realized, making 2009 the best year for market returns since 2003. In reality, 2009 brought significantly better opportunities than 2003, despite the fact that 2003 gave investors a marginally better annual return. In 2003, the S&P advanced 44% off that year's lows to realize an annual gain of 24.4%. In 2009, the S&P advanced an unbelievable 65% off the year's lows to end with a 23.5% gain on the year. To repeat, that's 65% - in a little less than ten months. It might be hard to appreciate just how big the 2009 advance is, so let's put it into an historical context. The mid to late-90s gave us the biggest bull market any of us have ever seen and possibly ever will. During that five-year stretch, the S&P advanced 210%. That's an impressive sum; however, at no point did the S&P advance as quickly as it did in 2009. Over a two-year span from 1995 to 1996, the S&P gained 64%. The same two-year return was realized in 1997 and 1998. So during the greatest bull market, it took two years to accomplish a move that compares to the ten-month advance in 2009. Needless to say, the size of this year's advance gives it a place in the history books.

After such a banner year, the question burning on many investors lips is, what does this mean for 2010? There is no shortage of forecasts out there, and they seem to lack consensus. On one hand, there is a bearish argument that focuses on how ahead of itself this market has become. To be sure, it's hard to understand how the stock market can advance 65% when unemployment remains at 10% - only the second time this has occurred since World War II. On the other hand, the bullish argument consists of expectations of continually improving numbers in terms of employment and earnings. From where we stand, there's nothing you can hang your hat on in any of these forecasts. Economic data changes quickly, and the market reaction to this data often doesn't even make sense. There's a better way to determine the market's agenda.

Instead of chasing headlines or trying to predict economic figures, we can determine where we are going based on the predictable behavior of the masses. While many things change, the progression of human behavior remains the same, so much so that it can be seen loud and clear in the way stock market indexes move. Forecasting future market movement based on predictable human behavior is the essence of the Elliott Wave Theory. This theory seeks out identifiable price patterns on the charts of the stock market indexes, based on the historically proven progression of social mood. Once it is determined where the indexes are in a pattern, it can be determined where they are headed. You may or may not buy into why the theory works; either way, it does. During 2009, many forecasting or trading methodologies took a beating. This isn't surprising because the 2009 advance stretched just about every possible way to measure an overbought market. On many technical indicators that determine market turning points, all-time highs were established, and even still the advance didn't pause. Such behavior will run havoc on a trading system - but "Elliott" stood its ground. The theory is strictly focused on price movement as can be seen on a price chart, and at no point did price indicate a high. Instead, higher prices were consistently indicated, and that equates to very significant gains for those who listened.

Now, the Elliott Wave Theory has a thing or two to say about what 2010 has in store.

First and foremost, know that it would be very rare to see an advance like this one just fade away. Normally this type of strength begets more strength. But despite the unbelievably direct nature of the 2009 advance, this won't occur in a straight line. Instead, expect the ten-month advance to find a high soon. This is because the advance has almost completed its expected price pattern, and when that happens, the trend will turn down. This is expected to lead to three to five months of declining price action. On the S&P 500, it is reasonable to expect the decline to work its way down into the 850-950 area. Once this multi-month pullback completes, expect a resumption of a long-term uptrend that should eventually carry the S&P 500 back above its 2007 high.

Ryan Henry is the author and lead analyst at www.wavespeak.com, an investment analysis firm that boasts an impressive seven-year track record. Wavespeak provides market index forecasting and stock trade recommendations through a newsletter that is published three times a week. Wavespeak's analysis is driven by the Elliott Wave Theory, but also includes consideration for Fibonacci Mathematics, intermarket relationships, breadth, volume, and money flow analysis. Wavespeak provides free samples of current market forecasts on its website.