



“Fundamental & Technical Trading Ideas for the Active Investor”

2014 Forecast

31st October, 2013

Forecasting - S&P ASX 200 (XJO) and Dow Jones Industrials (\$DJ)

- Each year we look to do a 12 month forecast using alot of the predominate cycles and use wave theory to find a best fit.
- Apart from underestimating the strength of 2013, our post GFC, 2011 and 2012 forecast including our forecasted bust cycle on commodities has been fairly accurate.
- We will look at the dominant cycles as our guide, the 10yr, the 20yr and 30yr cycles and our reliable 60 yr cycle. The 4 year US Presidential cycle has also been quite useful combined with the usual seasonal influences like the strongly consistent Xmas rally and the best 6 months cycle. These all form part of the basis for making our yearly forecast.
- The truth is that some years are much more predictable than others to forecast and next year is one of the more consistent years.
- Not since 2007 have I been so excited about the cycles ahead and the opportunities that they are likely to present. While the last quarter of the 7th Year presents us with our best shorting opportunity for the decade, the fourth year often provides us with best long trade for the decade. This seasonal trade has historically averaged over 48% return within a 18 month period for the Dow Jones Index and has averaged over 45% return for the All Ordinaries.
- The Mid Term Year, in the 4 Year Presidential Cycle has such a strong influence on Equity markets and has been such a consistent cycle it's hard to look past the statistics.
- Although the XAO is the best source of historical data on the ASX Indices, we have used the findings and replicated these over to the more popular XJO Index, as these indices have consistently had a strong correlation and most people monitor the XJO.

2014 Forecast - A Year To Go Short And Long

- Our 2014 forecast suggests that Equity markets could experience a sharp decline in the first half of next year (2014) between 15-20%.
- An equally impressive rally between 15-25% could occur from this mid year sell off point taking the index back to old highs or even making new highs by year end 2014.
- The strong rally in the second half of 2014 will be matched by an equally strong rally for the whole of 2015. Staying long from Mid 2014 could reap massive returns if we see the usual sharp sell down unfold in mid 2014.
- 2014 could be the most important investment year of the decade as the average rally from the Mid Term low point has historically gained an average over 48% for the Dow Jones Index and almost 45% for the All Ordinaries within 18 months of that low.
- The next 12 months could be the most important trading period for the decade ahead - weathering a possible sharp sell off followed by one of the strongest rallies means getting our timing right in 2014 will be critical to getting superior returns. If we get our timing right and the markets follow the norm, then we could potentially see our portfolio grow over 40% within 24 months.

S&P ASX 200 (XJO)

2014 Forecast

- From a seasonal aspect, normally if we haven't had some sort of correction by the Sep/Oct window then generally we will not see one before late December/ early January of the 4th year. The Xmas rally has a strong bullish bias from Mid November to early January.
- Due to the overlapping nature of this trend to date October through to January can carry the strong 2013 year forward to this date but most often it is more often an overlapping top or consolidation period, so a mild rally is most common here so seeing only slightly higher levels is most likely - 5500 to 5600 is most likely to contain this rally. 5700 is possible but a much lower probability.
- Our 60 year cycle is calling for a 9 month pause or consolidation period. Our 10, 20 and 30 Year cycles, as well as the Mid Term Election cycle are suggesting some weakness in the first half of 2014 is most likely when looking at historical precedent.
- January highs are very common in the 4th and Mid Term years so we could be on the back foot from the start of the year. March is potentially a minor low, while April is typically one of the strongest months, so a B wave rally into late April is quite possible before another leg down into the middle of the year. Feb and March highs are also possible.
- May through to November is typically when lows are found. In particular July and October were the most prolific. In the case that markets stayed weak into late Year, Oct or Nov, generally most of the damage was done in the first six months so any further weakness in the third quarter is generally only marginal - indicating that best to start buying around June if we see a descent decline.
- Since 1982 the XAO has dropped in the Mid Term Year on average by 18.81% from its early year high. A 5600 high might see a pullback towards 4600, a 5700 high could see a pullback towards 4700. A pullback into the 5000 - 4800 looks more probable although history has shown that our market has a habit of making panic lows so something deeper is always a real chance.
- The usual second half of the year rally can start from as early as July/ Aug, while often it doesn't begin until Oct/Nov. Since 1982 the average end of year rally on the XAO stands at 15.16% for the Mid Term Election Year and the XAO has gained 44.77% on average from its midterm low to its subsequent high for the following pre election year. A 4700 low would mean a move to 6815 by late 2015 or a 4900 low could see the index get back to 7105 an all time new high before Dec 2015.



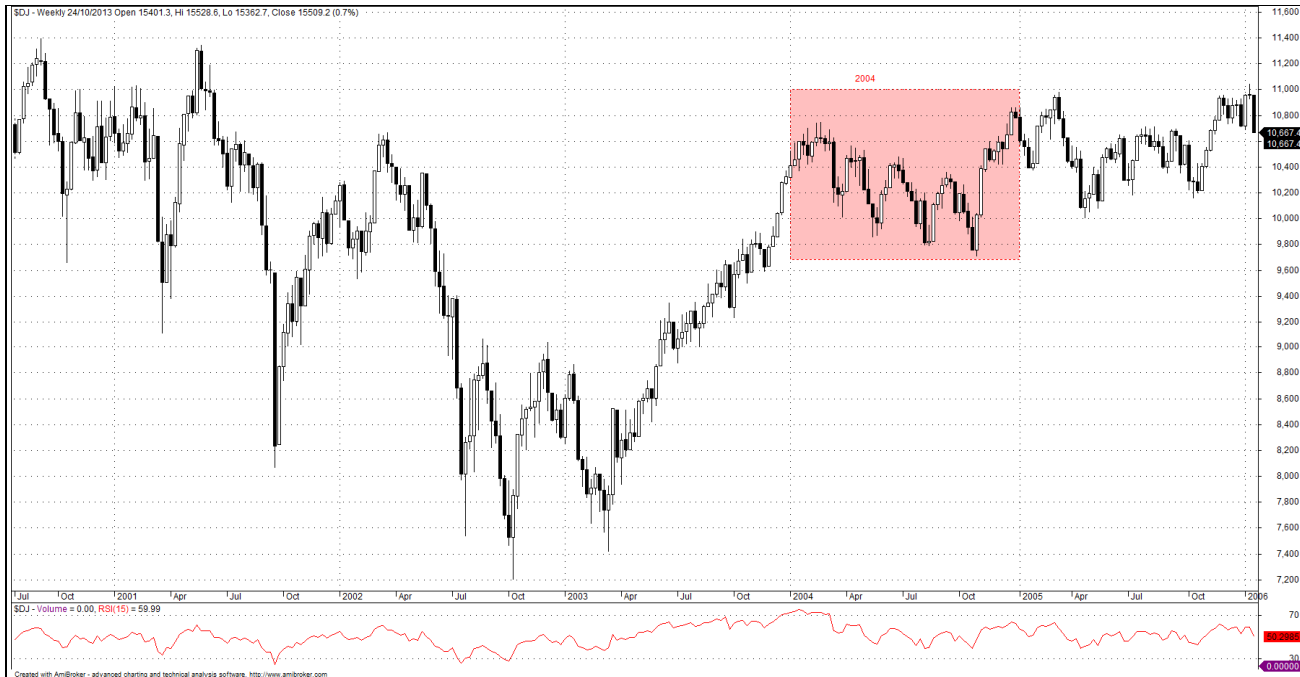
- A rally towards the 16000 region is quite likely in the short term and markets often stay firm through the mid Nov to early Jan period.
- Something higher is possible but a much lower probability as strong resistance is present at 16000. 16700 would be the next key resistance point.
- The 10, 20 & 30 Year cycle has a strong history of weakness in the 4th Year. It's basically a consolidation year, a year to consolidate the previous year's gains with a shock somewhere in the middle. It normally experiences a sharp drop into the mid Year zone, typically July is the most common month and sometimes this consolidation year can have a retest of the low or a higher low later in the year around the October/ November period. (Looking at charts to follow: 1984 is the blue print as this historically is the closest to the norm and the most common set up).
- The Mid Term Presidential Cycle Year is often a volatile year with sharp corrections coming in the first half of the year and then often followed by a strong bounce to finish the calendar year off. The last 8 Mid Term years (since 1982) have averaged a drop almost 17% followed by an equally impressive end of year rally averaging over 20%. Looking back even further historically on the Dow Jones shows even greater variance in these large swings back and forth.
- Since 1913 the Dow has dropped -20.9% on average from its post election year high to its low in the following mid term year. If we got a pullback from 16000, that might take the Dow back towards the 12800 level. A 16500 high might bring it back to 13200.
- Typically the End of Year (Xmas) rally is a very strong one with average gains above 20% when we review the last 32 years of data and even higher if we review longer term historical data.
- Not only does the main US index finish this cycle year firmly (2014), the following year (2015) is normally even stronger.
- Since 1914 the Dow has gained 48.6% on average from its midterm low to its subsequent high the following pre election year. (sourced from 2014 Stock Traders Almanac). A 12800 low would mean a move to 19200 by late 2015 or a 13200 low could see the index get back to 19800 before Dec 2015.



Looking at the 10yr, 20yr and 30 yr cycle - there are definitely some consistent themes

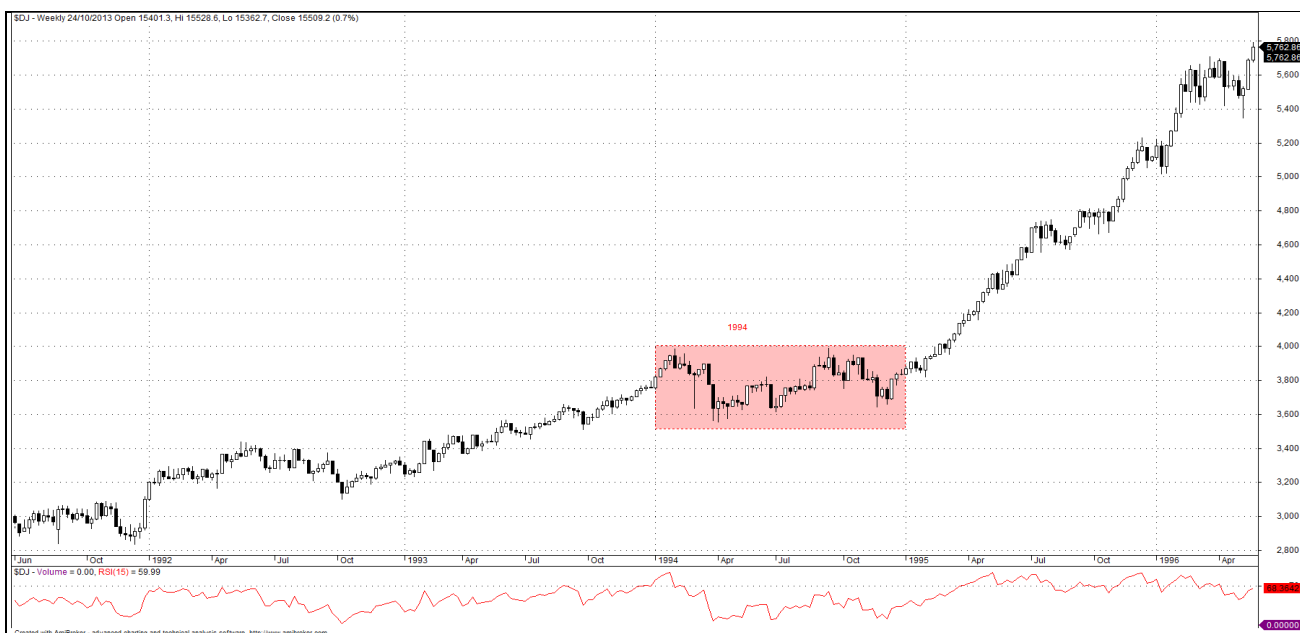
Dow Jones Industrials Index (2004)

- 2004 was a consolidation year, after the gains achieved in late 2002 and 2003 the calendar year was in retreat mode until the 3rd quarter
- The correction started early in the year and the end of year rally didn't start until the last quarter
- The size of this pullback was 1046 points or 9.73% and the end of year rally saw an increase of 11.95% from the low



Dow Jones Industrials Index (1994)

- Like the previous 4th Years, 1994 was another sideways consolidation, with a sharp dip into a mid year low and a secondary low occurred in November before a late year rally.
- The low in 1994 was the last pullback before a fierce bull market rally occurred.
- The size of the early year pullback was 10.88% correction before finishing the year higher rallying 12.42% off its lows.



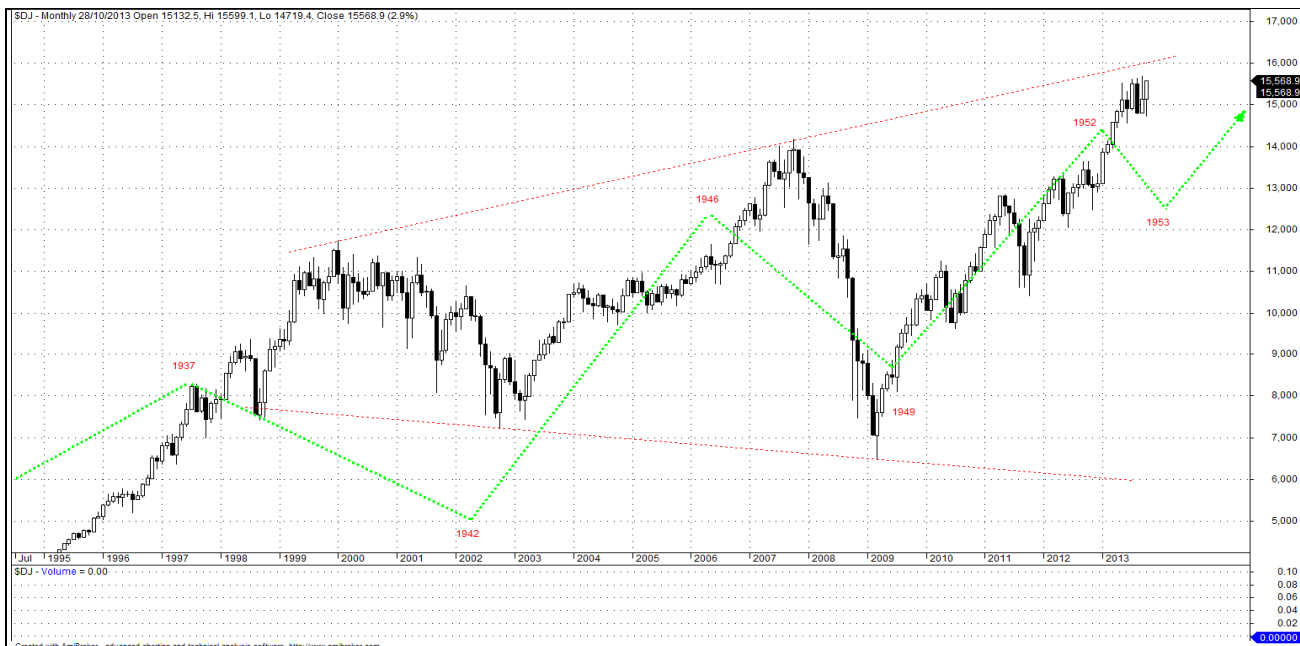
Dow Jones Industrials Index (1984)

- Again we see this sharp sell off from the start of the 4th year until the mid year point before an end of year recovery.
- The midyear pullback corrected 16.76% from its highs and rallied back in the third quarter by 16.33% from the midyear low.
- From the July 1984 low, the index basically didn't look back and rallied hard into the following year also. 1985 followed up with an extremely bullish period also. This is the blue print for most 4th Years.



Looking at the 60 Year Cycle - Apart from 2013 it has been a great road map

- Looking at the 60 Year cycle, until last year this cycle has been an excellent road map. 1942 and 2002 were both solid lows. 1949 and 2009 were also important pivot lows. 1946 and 2007 were key highs, so recently the high turned 12 months late. 1951 and 1952 had small pullbacks less than 6 months in duration similar to 2011 and 2012. 1953 had a 9 month pause/pullback while we didn't get this occurrence in 2013. Our highs have often run 12 months behind so early 2014 would be ideal time for a consolidation or pullback before another bull leg commences.



Looking at the Shorter Term Cycles - There is even stronger consistencies

4 Year Presidential Cycle - Mid Term Election Year or often referred to as the 4 Year cycle on the XAO

- We have shown the similarities in the 10 year cycle. The 4 Year Presidential cycle has the same sort of consistency when we look at how compelling the Mid Term Election Year cycle is. (2014)
- Often referred to as the Year of the Bottom Picker, the Mid Term Election Year has marked so many bear market lows it's uncanny.
- If it's not marking some of the major lows like 2002, 1998, 1990, 1982, 1978, 1974, 1970, 1962 then it's normally marking the first key higher low 2010, 1994, 1986, 1966 all following a major low.
- Again it has strong similarities to the 10 year cycle with a larger than normal early-mid year pullback before a large late rally to complete the calendar year
- The swings up and down are well beyond the average market swings so this excessive volatility can present some outstanding opportunities.
- One from a shorting point of view early in the year and secondly for a long point of view in the second half of the year with a sharp bounce a key feature of this cycle.

Dow Jones Industrials Mid Term Election Years

	Dow Jones Industrials Index										
	Mid Term Years	2010	2006	2002	1998	1994	1990	1986	1982		Average
Early Year High		11258	11670	10673	9368	3986	3012	1923	887		
Month		April	May	Mar	July	Feb	July	July	Jan		
Mid year Low		9614	10683	7197	7400	3552	2344	1731	770		
Month		July	July	Oct	July	Apr	Oct	Aug	Aug		
Points Drop		1644	987	3476	1968	434	668	192	117		Drop
Percentage Drop		14.60%	8.46%	32.57%	21.01%	10.89%	22.18%	9.98%	13.19%	132.88%	16.61%
Dec High		11625	12530	9043	9335	3866	2663	1972	1078		
Points Rally		2011	1847	1846	1935	314	319	241	308		Rally
Percentage Rally		20.92%	17.29%	25.65%	26.15%	8.84%	13.61%	13.92%	40.00%	166.38%	20.80%

- Similar to the 10 Year cycle, the Mid Year cycle has experienced a sharp pullback generally in the first half of the year followed by a strong recovery into the closing months
- July and August are the most common time periods for a low to be marked in this period
- Most experienced a larger than normal pullback, not the usual 6-10% variety but upwards considerably in the 15-21% category. 16.61% was the average for the last 32 years and 8.46% was the smallest correction while 32.57% was the largest
- Historical information sourced from "The Stock Trader's Almanac" supports these figures going back much further in time, since 1913 the Dow has dropped -20.9% from its post-election year high to its subsequent low in the following mid term year.
- The recovery that followed the pullback averaged an impressive 20.80%, 8.84% being the smallest rally while 40% was the largest for the last 32 years
- Looking at more historical data again from "The Stock Trader's Almanac" shows that the average gain stands at 48% from the mid Term low to the high in the following pre -election year, so the market could really push on in 2015

Dow Jones Industrials 4th Year cycle and Mid Term Election Year

- Thought it might be useful to overlay the 4 year cycle with the 10 year cycle and see if the results varied
- In this case it's a slight negative as the performance is slightly under the normal period, but the averages are very close to the larger study

Dow Jones Industrials Index - 4th Yr and Mid Term Yr						
1994	1974	1954	1934	1914	Average	strip out 1954
3986	904	280	112	83		
Feb	March	Jan	Feb	Mar		
3552	570	280	85	53		
Apr	Dec		July	Dec		
434	334	0	27	30		
10.89%	36.95%	0.00%	24.11%	36.14%	17.99%	23.98%
3866	610	404	104	56		
314	40	124	19	4		
8.84%	7.02%	44.29%	22.35%	7.55%	20.62%	12.74%

All Ordinaries Index (XAO) 4yr Cycle (Mid Term Election Year)

- It's all interesting the US market having a very well defined Four Year Presidential Cycle, but how does this reflect towards the Australian Share market and more specifically the XAO (similar to the XJO)
- The findings show a strong correlation to the US markets and to the 10 Year cycle, the same early year weakness followed by a late end of year rally. The first quarter marked most peaks.
- Like all the other cycles the movements are larger than normal. Large corrections are followed by large recoveries. The average drop in the Mid Term Year for the All Ordinaries Index over the last 32 years stands at 18.81%, 12% is the smallest correction, which is considerably larger than a normal pullback.
- The rally following has averaged over 15% by the end of the year with only 1990 failing to kick on. Interesting to note that the only failed rally in the Mid Term Election year went on to rally the following year by over 41% within a 9 month period.
- Looking 12 months ahead after the Mid Term Year low shows the All Ordinaries just slightly underperforms the Dow Jones which was over 48% up, while the All Ordinaries only averaged an impressive 44.77% return before the end of the following Year. The smallest 18 month rally was 16.75% in 2003 and the largest was 110.69% in 1987.

	XAO											
	Mid Term Years	2010	2006	2002	1998	1994	1990	1986	1982			Average
Early Year High		5049	5352	3444	2894	2350	1714	1247	596			
Month		Apr	May	Feb	Apr	Feb	Jan	May	Jan			
Mid year Low		4194	4726	2842	2386	1815	1267	1094	443			
Month		May	June	Oct	Oct	Nov	Dec	Aug	July			
Points Drop		855	626	602	508	535	447	153	153			Drop
Percentage Drop		16.93%	11.70%	17.48%	17.55%	22.77%	26.08%	12.27%	25.67%	150.45%		18.81%
Dec High		4899	5657	3048	2814	1943	1267	1464	526			
Points Rally		705	931	206	428	128	0	370	83			Rally
Percentage Rally		16.81%	19.70%	7.25%	17.94%	7.05%	0.00%	33.82%	18.74%	121.30%		15.16%
High in next 12 months		5070	6873	3318	3156	2238	1696	2305	775			
		Apr-11	Nov-07	Oct-03	Dec-91	Dec-95	Nov-91	Sep-87	Dec-83			
Points up in 18 mths approx		876	2147	476	770	423	429	1211	332			Rally
Rally in 18 mths approx		20.89%	45.43%	16.75%	32.27%	23.31%	33.86%	110.69%	74.94%	358.14%		44.77%

Intra Year Cycle - Xmas rally

- Historically when we look at the best 45 days of the year, it generally begins two days before thanksgiving and ends around the the fifth trading day of January. Historically this period has outperformed all other periods by 4.3 times and has an annualized rate of return over 25% looking when we look at data all the way back to 1900 for the Dow Jones. (sourced: Jay Kaeppel's - Seasonal Stock Market Trends)
- Last year for example the XJO rallied from its Nov 16 low of 4334 to 4751 on the 7th of January, a rally of 417 points or 9.62% in only 33 trading days.

Intra Year cycle - Best 6 months strategy

- The Best Six months strategy is still turning out incredible results. Investing in the Dow Jones between November 1 each year and selling out on 30th April each Year consistently has outperformed the other six months.
- Since 1950 investing from May 1 to Oct 31 each year would have generated a negative return over the last 52 years. Investing \$10,000 at the start of this period would now be worth less than \$8,900 after 52 years with the average gain only mounting to 0.3% being invested for all of these 6 month periods.
- The other 6 month period (Nov 1 to April 30) would of seen your \$10,000 grow to \$765,055 over the same 52 years at an average return of 7.6%.
- The last four years are even more compelling for the Dow Jones, 13.3% in 2012, 10.5% in 2011, 15.2% in 2010 and 13.3% in 2009 were achieved in the best 6 months, Nov 1 to April 30, while the opposite -0.9% in 2012, -6.7% in 2011, 1.0% in 2010 and 18.9% in 2009 were achieved in the other 6 months.
- Basically most of the negative surprises in the equities markets occur between May and October. Our June to July low just squeezes into this normal seasonal bias, so early year weakness might come in the form of a topping pattern, with a small seasonal rally in April.

2014 Forecast - Summary of the Details

- A 45% return for only being invested in the broader Australian share index for less than 18 months is something to possibly get excited about. Imagine if you get your portfolio selection right, that return could even be enhanced.
- The 4 year cycle, The Presidential cycle, the 10 yr, 20yr and 30 yr cycle all paint a similar picture for 2014.
- The 4th year cycle (2014) is like the 7th Year cycle, it's one of the most reliable and consistent of all the cycles.
- They all suggest a correction in the first half of 2014 is highly likely, starting in the first quarter and often commencing early January. Most experienced a larger than normal pullback, not the usual 6-10% variety but upwards considerably in the 15-21% category.
- After this sharp pullback in to midyear or third quarter a large rally unfolded often exceeding the high again a larger than normal rally towards the 15-20% variety, which often marked a retest of the previous early year high.
- The kicker here is that the Mid Term Year is often the low in a bear market or the year a bull market commences.
- The Mid Term Year is often referred to as the Year of the Bottom Picker, due to it being the last reasonable low point before a very strong bull market rally often commences.
- The year following the Mid Term Year is often a very bullish year and the 5th Year of the decade is referred to as the Year of Ascension as until recently there had never been a negative year in the market since its inception.
- If we are lucky enough to follow the normal pattern and get a substantial pullback next year in the markets, we should be looking to position ourselves for the normal monster rally that follows. Our most bullish 18 month period on average for the decade.
- In Elliott Wave Terms, this will be like buying into a Wave 2 low before the most bullish wave, the Wave 3 commences, which is normally an impulsive move higher and the strongest of all the bullish Waves.

What Sort Of Levels Can Be Projected Into 2015 Based On This Historical Data And Statistical Averages

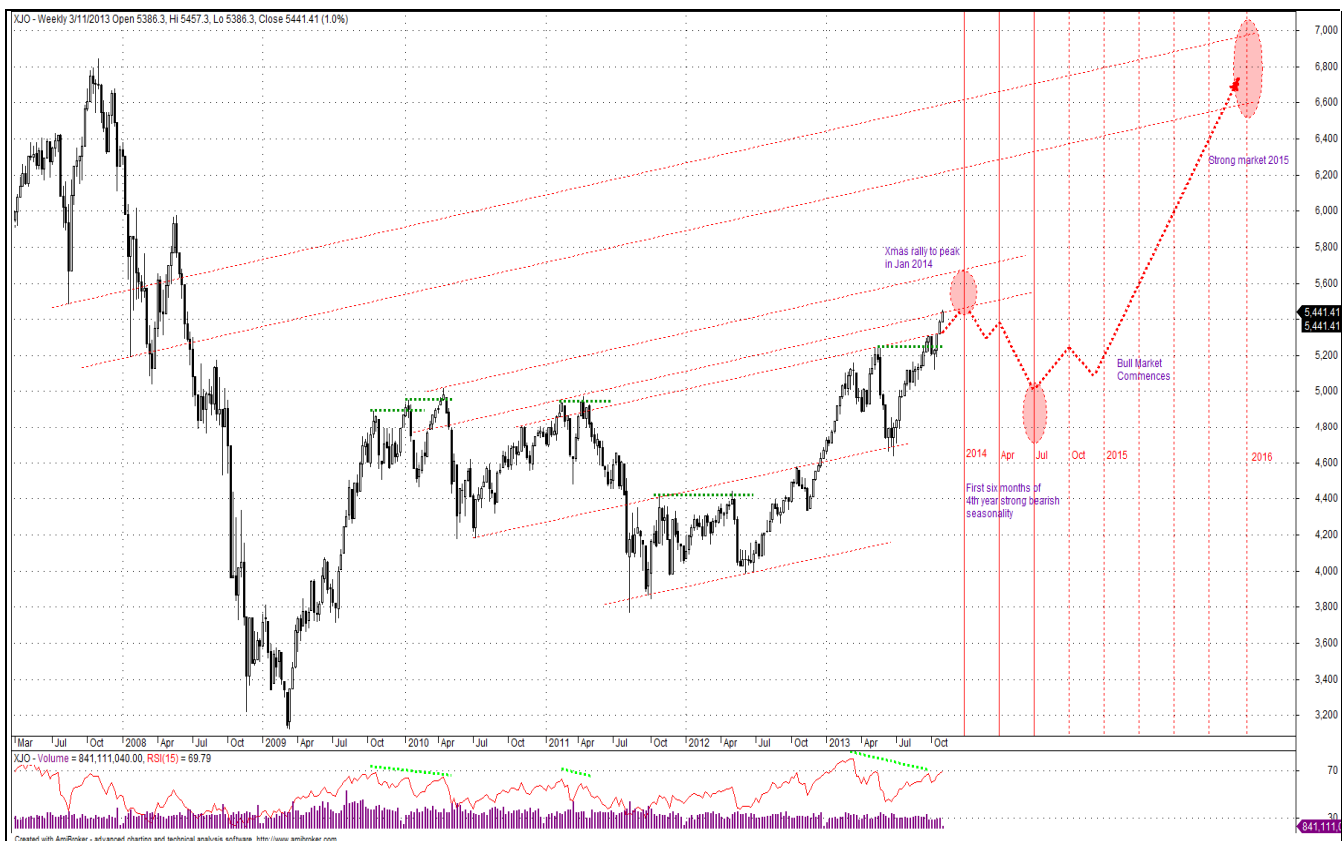
Dow Jones Industrials Index (\$DJ) 2015 Projection

- The average drop in the Mid Term Year for the Dow Jones Industrials Index over the last 32 years stands at 16.61%, 8.5% is the smallest correction.
- Projecting a high of 16000 gives us a target low between 14600 (8.5% min correction) to 13300 (16.61% average correction)
- Projecting a high of 16700 gives us a target low between 15300 (8.5% min correction) to 13900 (16.61% average correction)
- Since 1913 the Dow has dropped -20.9% on average from its post election year high to its low in the following Mid Term year. If we got a pullback from 16000, that might take the Dow back towards the 12800 level. A 16500 high might bring it back to 13200.
- Since 1914 the Dow has gained 48.6% on average from its midterm low to its subsequent high the following pre election year. (sourced from 2014 Stock Trader's Almanac). A 12800 low could mean a rally back towards 19000. A 13200 low would mean a possible rally to 19600 by late 2015.
- Using some of the key technical levels a 13600 low would mean a move to 20100 by late 2015 or a 13900 low could see the index get as high as 20600 before Dec 2015. (using the average rally for this period)



S&P ASX 200 Index (XJO) 2015 Projection

- The average drop in the Mid Term Year for the All Ordinaries Index over the last 32 years stands at 18.81%, 12% is the smallest correction.
- Projecting from a high of 5600 gives us a target low between 4900 (12% min correction) to 4550 (18.81% average correction)
- Projecting from a high of 5700 gives us a target low between 5000 (12% min correction) to 4650 (18.81% average correction)
- This 18.81% correction does appear to be a bit excessive and most people might be a bit skeptical of such an event. It's worth noting that one of the characteristics of our market is our nature to panic into most lows. History has shown that we tend to panic into our lows and over sell so these events are often not at these panic lows for very long.
- The rally following has averaged over 15% by the end of the year with only 1990 failing to kick on. Interesting to note that the only failure (1990) was followed in 1991 with a strong rally that ended up 41% before year end.
- Looking 12 months ahead after the Mid Term Year low shows the All Ordinaries just slightly underperforms the Dow Jones which was over 48% up, while the All Ordinaries only averaged an impressive 44.77% return before the end of the following Year.
- Since 1982 the XAO has gained 44.77% on average from its midterm low to its subsequent high the following pre election year. A 4700 low would mean a move to 6815 by late 2015 or a 4900 low could see the index get back to 7105 an all time new high before Dec 2015.



If We Are Wrong With Our Forecast - What Is the Next Most Likely Outcome

- What are the exceptions to the general rule and have we had any other secondary cycles occurring on any occasions
- There didn't appear to be any exceptions to the general rule for the both the Dow Jones Industrials and the All Ordinaries markets looking at the last 32 years. 1990 was a small variance from the norm in that the end of year rally did arrive slightly late.
- Looking back historically to 1913 the figures were more pronounced so these moves seemed even more extreme
- The only variable was the variance of the moves, smaller pullbacks and smaller recoveries
- 8.5% pullback on the Dow Jones was the smallest pullback in 2006 and 11.7% for the All Ordinaries in the same year
- The only other observation was that the 10yr cycle overlap with the Mid Term Year (which 2014 is) produced slightly under the averages so the returns could come in slightly under the averages for the Australian market
- Our biggest mistake could be under estimating the possible moves and relying on the averages. This could be one of the larger ones, this rally into the 2014 high could go higher than anticipated, the pullback in mid 2014 could pullback deeper than the average correction and the rally that follows could be larger than normal. All these possibilities are probable and this is probably our greatest risk when doing any forecasting.

How It Might All Unfold Next Year

- The key issues going forward that could disrupt this bullish run would include some sort of tapering of the bond purchasing program by the Fed and the eventual change in monetary policy as rates obviously can't stay near Zero for ever.
- I think the market is preparing itself for the eventual tapering of the QE program, though this might cause some short term profit taking. The main fear I see is when US rates are eventually raised. This is likely to happen sometime next year if the improvement in the US economy continues.
- Obviously markets can get stretched from a valuation perspective and this can cause some profit taking but often a catalyst normally gets things really moving. (particularly if we are going to get a larger than normal pullback next year)
- Normally when interest rates are lifted coming out of an improving business cycle is when equity markets tend to experience some sort of sell off. As per comments recently, when rates were lifted in late 1993 after the market rallied from its 1990 low, equity markets had a sharp selloff initially on this change in rate environment.
- Once the market has a sell off on the back of an increase in rates then the market will eventually realize that rates are heading higher because the economy is improving and this will eventually be viewed as a positive thing longer term and then the bull market can commence. This will be something to monitor early next year.
- Also markets have been climbing the wall of worry so once we see a peak of good news and the economy looks like it has been cured then normally tops come in at these good news peaks.

For professional and timely advice on how to maximize your returns on your portfolio please call

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There are no certainties in the share market, only probabilities.

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