Dow Theory's Russell Says Major Crash Coming

The day after the "flash crash" in the stock market on May 6th, Richard Russell, the octogenarian author of the Dow Theory Letters, said:

> Something dramatic lies ahead…Most players believe that yesterday's "sell-off" was a direct result of the mess in Greece…but that seems too simple and obvious to me. The far more important question is whether the entire advance from the March 2009 low is fated to be wiped out…my suspicion is that the stock market is back in the grip of the bear.

Russell founded the Dow Theory Letters in 1958 and has a remarkable record of calling tops and bottoms in the markets ever since. He believes in the basic tenets of Dow Theory which were first discovered, refined, and then explained by Charles Dow who began publishing a little newspaper in 1889 called *The Wall Street Journal.* Following his death in 1902, others took up the torch. One of the best known was George Schaefer who was fond of quoting Dow: "It is always safer to assume that values determine prices in the long run." When Schaefer started his own advisory service, "Schaefer's Dow Theory Trader," he wrote in his June 18th, 1949 report:

> The philosophy of Charles Dow always gave first consideration to values, then to economic conditions and third to the action of both the Industrial and Rail [Transportation] Averages. When the low point of a bear market is reached, values will be the first indication of a change in trend. In the past 17 years only three opportunities have presented themselves to buy stocks at great values. Now the fourth opportunity is making its appearance.

According to Russell, "Schaefer's forecast turned out to be uncannily accurate. In June the Dow turned up from its 161.60 low, and a great bull market began. Schaefer stayed with the bull market through thick and thin until 1966. On February 9th, 1966, 17 years later, the Dow topped out at a value of 995.15."

Today, Russell admits that "the arrival on the scene of derivatives, options, futures, puts, calls, etc. makes the market game bigger, more manipulative, more hazardous — and far more deceptive than ever before. In the end, however, the 'hidden ingredient' for market success is the practitioner's own instincts or intuition. Market analysis…is an art, not a science."

In his remarks following the "flash crash", Russell wrote: "If this…rally [from March 2009] is fated to fall apart, the losses and troubles will be fearful; and traumatic. This is true because I've never seen a time when so many people were [so] unprepared to withstand a crumbling market or a sinking economy."

The writer at Pragmatic Capitalism told his readers that Russell "is one of the few men who is still around to tell us about the Great Depression and how similar today's economy feels." All of which reinforces Russell's latest forecast: "If we don't get a bounce next week, it's 'Katie, bar the door.'"

> I search Saturday's Wall Street Journal and right on the front page I read, "The recovery is beating expectations as data show consumer and manufacturing strength."
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> Then I look at the latest issue of Barron's and right on the cover I read, "STRONGER THAN EVER – America's biggest companies are sitting on loads of cash and ready to earn higher profits than ever before…."
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> And I ask myself, "Am I seeing things? The April 26 high for the Dow was 11205.03. The Dow is selling as [I] write at 10557 down 648 points from its April high. If business is even better than expected, then why is the Dow down over 600 points? And why, if there were 674 new highs on the NYSE on April 26, were there only 20 new highs on Friday, May 14?
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> The fact is that I've been seeing deterioration in the stock market ever since early April, and this in the face of improving business news….
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> Clearly something is wrong. But what could it be? Much as I love Barron's, I trust the stock market more. If I read the stock market correctly, it's telling me that there is a surprise ahead. And that surprise will be a reversal to the downside for the economy, plus a collection of other troubles ahead.

According to Dow Theory, if the Dow Jones Industrial Average and the Dow Transportation Average both fall below their May 7th lows of 10,380 and 4,298 respectively, then, Russell says, "I see a major crash coming." Such declines "would be the clincher. Such action would signal the certain resumption of the primary bear market."

Photo: AP Images