**Sand Spring Advisors LLC**

# The PEI Cycle and Consumer Confidence

**by,**

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When I sat as head of Proprietary Trading at Societe Generale in August 1997 and read the economic forecasts of Martin Armstrong, I wasn't sure whether I was reading the work of a crackpot or a real cycle visionary. At the time, he was forecasting a single forthcoming day -- July 20, 1998 – as a major high in economic sentiment and financial markets.

Within a year, I ended up voting with my feet by actually going to work for Mr. Armstrong at his Princeton Economic Institute. Once there, I then witnessed Mr. Armstrong run a huge equity index short position in S&P, NASDAQ, DAX, and CAC futures from July 20, 1998 (which indeed turned out to be the high tick of that summer) through until mid-September 1998 when he covered his short (because his "momentum oscillators were all oversold and turning back up.") Armstrong effectively captured the entire downswing of the market related to the Russian ruble and LTCM crisis. He then promptly retired to his beach house, and effectively stopped trading for several weeks, awaiting a better opportunity to get short once again.

Armstrong liked trading from the short side, because in his words: "Market advances tend to take years to transpire, and you have to take a great deal of systematic risk that is under-appreciated to participate in them. But when markets fall, they tend to fall quickly, and if one can get short with defined risk, one can make a great deal of money in a brief period of time."

1999 was not of course as sweet to Mr. Armstrong. Not only did the financial markets come roaring back to new all-time highs (leaving his July 20, 1998 high almost as a paltry peak compared to the market excesses of late 1999), but the USD-JPY collapse of October 1998 also hurt Mr. Armstrong. Armstrong believed at the time that Japan was in worse financial shape than the U.S. and thus at risk of seeing their currency implode versus the U.S. dollar. Instead, it was Mr. Armstrong who imploded – doing so at the same time as such legendary speculators as Julian Robertson and Wolfgang Flottl – as the dollar went down in a rush from 145 to 111 over a matter of days.

Now sadly enough, Mr. Armstrong sits in jail – accused of subsequently hiding his currency losses from Japanese investors who purchased his unsecured Princeton Economic International notes that were repayable in yen.

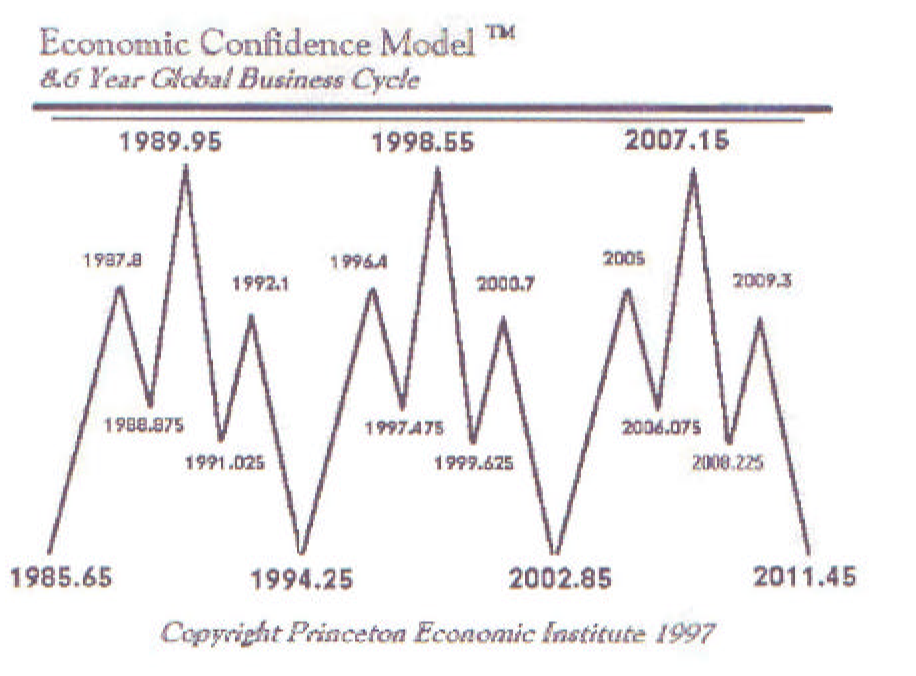
But almost 5-years after such events, he has yet to be brought to trial. Instead, a U.S. bankruptcy judge still holds Mr. Armstrong in contempt of court for not surrendering all of his assets when such were demanded, even though Armstrong's broker Republic Bank has subsequently made all of Mr. Armstrong's Japanese investors 100% whole (thereby admitting back-office transgressions on the Republic Bank side of this mess). Indeed, Mr. Armstrong now holds the Guinness Book of World Records title for the longest prisoner to be incarcerated on simple contempt of court charges (beating by several years Susan MacDougal who went to prison after refusing to testify in the Clinton Whitewater case). What is worse, the U.S Government apparently lost many of its files on his case when the World Trade Center came tumbling down on 9/11. If they ever had a good case against him of fraudulent behavior, they may not have such any longer. So instead, they have simply left him to stew in jail.

Mr. Armstrong's Icarus-like fall from grace is indeed sad for a gentleman who was such a naturally gifted student of financial history and world monetary policies. I worked with many of his cycle models, and they were *very* real. To this day, I remain amazed in particular by Armstrong's "panic cycle" forecasting tool that helped pinpoint upcoming trend reversal moments to the week and often to the day. Unfortunately, if these models still exist, they have been mothballed by Armstrong's son or relegated to the mind of a man now left behind bars. Even though multiple hedge funds expressed interest to buy Mr. Armstrong's firm, the receiver for his firm did not encourage these advances. How strange and sad this is, particularly when one considers that I personally took calls from the CIA in October 1998 expressing a keen interest in Mr. Armstrong's models. When Armstrong declined to share them with the CIA after several meetings, conspiracy theorists might even think that the CIA could have had a hand in stealing them.

Yet, overall, I don't know what to believe. Marty Armstrong was a brilliant person, but still an enigma full of hubris, ego, and bravado as well. In ways he regularly cheapened his natural brilliance with over-the-top assertions such as claiming to have "the best database in the world." Yes, he had a good database, but I'm also sure that it was not close to being the best.

But away from the man himself, what of the PEI Economic Confidence Model itself that we here at Sand Spring Advisors have been keeping alive in our analysis and commentary these past few years? What of the forthcoming PEI cycle date of December 31, 2004 that we have spoken of repeatedly?

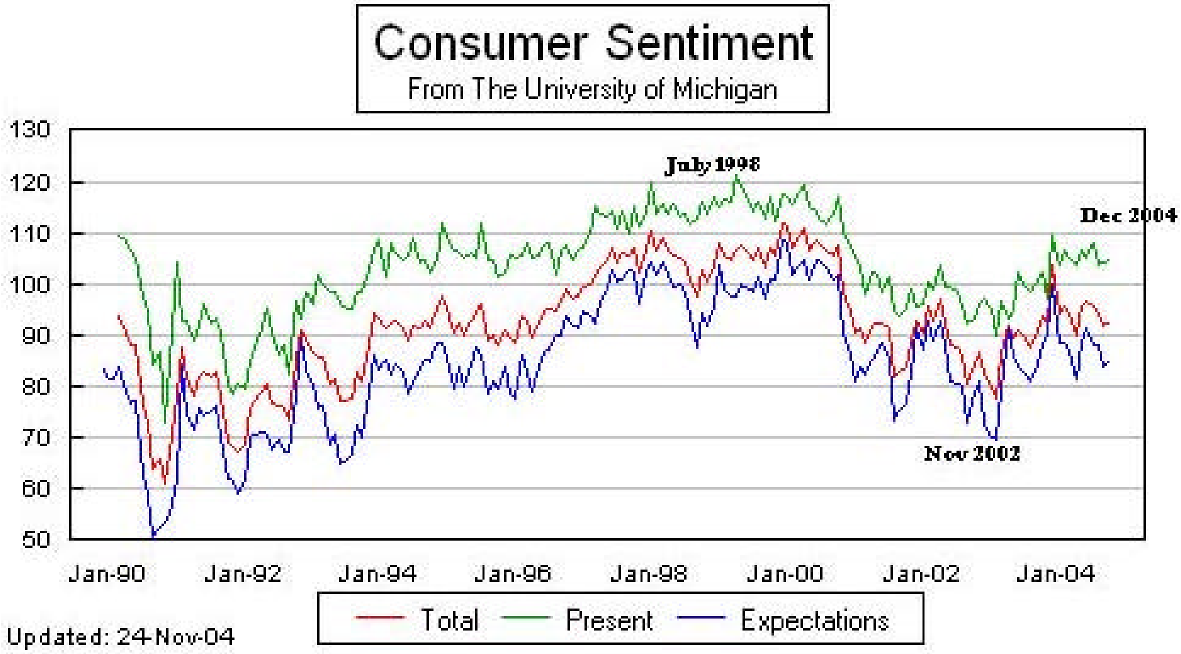
Below we show Mr. Armstrong's idealized PEI cycle map, with July 20, 1998 expressed as 1998.55, and subsequent cycle dates of 1999.62 (Aug. 17, 1999); 2000.70 (Sep. 13, 2000); 2002.85 (Nov 6-7, 2002), and 2005 (Dec 31, 2004-Jan 2,2005) marked.




But wait a second, many might say – Armstrong has 1999.62 shown as a low, when in actuality this was a period of frothy equity market ebullience. He also predicted Nov. 6-7, 2002 as a low, while the actual market bottom that year transpired a few weeks earlier. Surely, Armstrong critics would argue: his cycle map has not been very precise in recent years.

But wait a second, again. Away from the fact that cycle dates are notoriously difficult to interpret in advance in terms of being a high or low (but instead simply being a time window where a turn of some sort should occur), let's look at the very name that Armstrong gave this indicator – the Princeton "Economic Confidence Model." Now let's compare the PEI idealized rhythm to another measure of economic confidence – namely the University of Michigan Consumer Sentiment Index.

In these terms, the picture looks quite different. Armstrong was actually reasonably prescient. While markets may have zoomed to further highs in 1999, economic confidence did not. Instead, consumer sentiment consistently edged lower on this index into late 1999; bounced for a bit in early 2000, and then nose-dived again into late 2002. Armstrong then predicted a rise in economic confidence from Nov. 2002 into late Dec. 2004-early Jan 2005 (obviously fast approaching), before another fall into early 2006.




Thus one could argue that in consumer sentiment-terms, Armstrong actually didn't do that badly – even if in market terms, 1999's blast-off was not what one would have expected.

At present, we approach another significant PEI "Economic Confidence" turn date as of year-end 2004. In our mind, this date window is of increased importance because of all the pi* Fibonacci relationships to past market highs and lows depicted below.

Armstrong's shorter 8.6-month cycle rhythm for the market has been holding its high-to-high rhythm pretty well.


Could it be that the average American consumer does the typical "shop-till-they-drop" routine through the holiday season, but then faces a nasty debt-induced hangover in early 2005? That would be our best prognostication. Late December might also therefore be a logical time for at least a temporary high in inflation hedges such as foreign currencies and gold.

The good news on the PEI cycle map is that Armstrong originally forecast the 2005-2006 malaise as a relatively minor one, to be followed by another spurt higher in consumer confidence into 2007.15 (Feb. 24, 2007).

If that latter forecast comes true, and Armstrong is still in jail, may the Gods show him pity someday in Heaven.

For those who have never read any of Armstrong's eclectic musings, one of his last articles from 1999 explaining how he stumbled on his 8.6-year cycle may still be found at: http://www.armstrongdefensefund.org/martypei/buscycle.htm .

We also post a few more interesting index charts below. Given the complete-looking Fibonacci rhythms depicted here, an equity top should indeed be near.


$NYA - NYSC Composit Index, 60
11/26/04
O: 7055.2000 H: 7058.8900 L: 7046.6400 C: 7046.6900
-8.3800
Fib Target
702-708
0.382 (6061.2798)
0.500 (5746.2663)
0.618 (5431.2529)
0.764 (5041.7575)
0.910 (4652.2620)
1.000 (4411.4636)
6146.5533
12/27/04 - 04:30
#3736


$VLE - Value Line/A, Weekly
11/26/04
O: 1694.0600 H: 1735.6400 L: 1690.6000 C: 1730.9100
+36.8500
Value Line Index
0.000 (1734.7045)
0.090 (1652.6284)
0.236 (1519.8690)
0.382 (1387.1095)
0.500 (1279.7373)
0.618 (1172.3650)
0.764 (1039.6055)
0.910 (906.8461)
1.000 (824.7700)
0.000 (1731.8967)
0.090 (1638.9484)
0.236 (1488.6029)
0.382 (1338.2575)
0.500 (1216.6621)
0.618 (1095.0667)
0.764 (944.7213)
0.910 (794.3758)
1.000 (701.4275)
678.6443
1998
1999
2000
2001
2002
2003
2004
12/14/07
#1031

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