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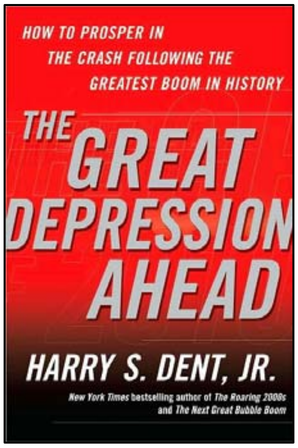

The Great Depression Ahead:

How to Prosper in the Crash Following the Greatest Boom in History

Author: Harry S. Dent, Jr.
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About The Author:
Harry S. Dent, Jr. is the president of the H.S. Dent Foundation, an economic think tank and research team that works to provide long term economic forecasting. In 1992, Dent predicted the boom of the 1990s in his bestseller, *The Great Boom Ahead*. A Harvard MBA, Dent is also a Fortune 100 consultant and noted speaker.

General Overview:
Harry Dent believes economists have long been too shortsighted in trying to find the signs of the next boom or bust. He asserts that the economic future can, with the right tools, be forecast years and even decades in advance. In *The Great Depression Ahead*, Dent shows how the culmination of three bubble collapses – stocks, real estate, and commodities – along with generational spending drops in 2010 will lead us into a deep economic depression through the early 2020s. He also offers advice on how citizens can protect themselves during this tumultuous period.

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Principles that Drive Change

Economists regularly assert that it's impossible to predict major events or trends far into the future. Elections, wars, stock market crashes, weather crises, etc. It's a complex time, they say. However, over the past years, decades, centuries, and millennia, our understanding and prediction abilities have grown exponentially, which gives us greater predictability and control over our lives; our great-grandparents would be amazed.

Scientists and professionals in many fields of research have used what we know about life cycles to predict future events with great accuracy. It's time that economists join in as well.

To make an accurate economic prediction, it's vital to understand that there are many different cycles. The complexity of making predictions about what will happen in the future means we must first determine which cycles matter more and how they impact and affect each other. For example, our economy has peaked every 40 years. Commodity prices have peaked every 30 years. Most decades start off weak and end stronger. Every four years, the stock market takes a significant correction, and every four months, it does so on a smaller scale.

Every 500 years, there is a major boom in innovations, such as the printing press or computers. Every 250 years, there are major revolutions in institutions, like the American Revolution and the Protestant Reformation. And every 5,000 years, humans make major leaps in civilization, like moving from towns to city-states, or to a global economy.

Our economy functions on the logic of cycles. Demographics are key in driving long-term growth and changes in these cycles. The current patterns in births, deaths, spending, and retirement give us insight into the coming decades of depression, coming off the greatest boom in history.

The Great Crash of Late-2009-2010

We are about to enter the first "winter season" in the American economy since the 1930s. The signs have long been pointing that way, even as American investors have ridden the bull market all the way to the top. The long-term peaks in our economy occur every 40 years, due primarily to "generational spending trends" (1929, 1968, and 2009). Oil and commodities prices peak every 30 years (1920, 1951, 1980, and around late 2009).

Baby boomers are slowing their spending, which coincides with a soon-to-bust commodity bubble. The year 2008 was scary, but with the coming deflation of three great bubbles – stocks, real estate, and commodities – life is about to change. From 2010 to 2012, we will see the biggest economic and banking crisis since the 1930s.

This coming depression was foreshadowed by the crash of the Japanese blue-chip stock market, the Nikkei, in the 1990s. Japan's baby-boom generation came of age and then slowed its spending about a decade before the American baby-boomers. The Nikkei dropped 80% from 1990 to 2003, and real estate in Tokyo declined more than 60% from 1991 to 2005.

Japan's "dramatic downturn" shows two things:

1. Bubbles *always* deflate once they reach an extreme point.
2. Trends ride a generation's peak spending and productivity levels.

In the U.S., the crash of 2000-2002 (along with the collapse of the dot-com industry) seemed to some investors like the long-anticipated drop. However, the credit bubble that started deflating in 2008 will deflate much more between 2010 and as late as into early 2010.

The boom our economy has been experiencing since the 1980s is due to three major bubbles:

1. The technology bubble, which peaked in early 2000.
2. The housing bubble, which peaked in 2005-2006.
3. The oil and commodity bubble, which should peak between late 2009 and mid-2010. Commodity prices started to build in 1998 and accelerated into 2003, "exactly 30 years after a similar bubble buildup in 1973."

To summarize, we are at the peak "of the most dynamic boom that occurs in a modern-day 80-year New Economy Cycle, which occurs over two 40-year generational boom and bust cycles." In the major stock crash arriving between late 2009 and late 2010, all assets – including stocks, commodities, and real estate – will deflate.

The next global boom will start in 2023 and last until around 2036.

Demographic and Technology Cycles

By far, the most important factor driving our economy is demographic trends. The easiest demographic cycles to track are generations: new ones are born about every 40 years. As each generation grows up, their spending grows and then peaks between the ages of 46 and 50 (the Spending Wave). In every generation, we can track spending and investment trends to predict booms 40 years in advance.

"We enter the workforce between ages 20 and 21" and actually start "to earn money to contribute to the economy in our 20s and beyond." We now get married at about 26 and have children around 28. Starter home purchases peak at age 31 and rentals peak at age 26 (when people tend to get married). "Trade-up home" purchases peak between 37 and 42, and peak spending per family occurs between 46 and 50.

With all this detailed information about spending trends, "why can't we predict most key trends in our economy decades in advance? The answer is that we can!"

The technology cycles are vastly important, as well. "Every 60 to 80 years we get clusters of radical new technologies." The last such cycle occurred from 1914 to 1929 and the new cycle ran from 1994 to 2009. Technologies are adopted at a predictable rate, in an "S-curve." For instance, it wasn't until 1914 that 10% of the population owned a car. When installment financing became available in 1921, 50% of Americans owned a car. Ninety percent of the urban population owned a car in 1928, and by 1942, 99.9% of U.S. households owned a car.

"It takes the same time" for a new technology to go from "0.1% to 10% of businesses, customers, or households as it does to go from 10% to 90%." Eventually, there are fewer people to market to and growth slows in the latter half of the cycle.

When the market is satisfied, that's when the bubble boom deflates and leading technology companies "begin to shake down to a few leaders" that can offer better products for lower costs. Businesses need to foresee the "survival of the fittest" battle that will arrive between 2008 and 2012. This "shakedown" will "determine the leaders for many decades to come."

The 80-Year New Economy Cycle is peaking in 2009, at the end of a massive growth boom. The shakeout will lead to deflation through about 2020. The bubble boom creates "excess asset valuations" and then flushes the excess out in a depression. Depression and deflation then "set the stage for expanding new technologies" in the recovery stage.

Commodity, Geopolitical, and Recurring Cycles

Through the 1990s, the fundamental demographic and technology cycles "largely explained the advances in the economy and markets." In the early 2000s, this started to change as there was a divergence between stock performance and earnings (adjusted for interest rates). In other words, "stocks were approximately 50% lower than they would have been in the growth trend of the 1990s."

The big culprits were oil and commodity prices as current oil prices are higher than the 1970s levels (adjusted for inflation). A final wave in the oil bubble will come in mid-2009 to mid-2010 at the latest, and oil prices will reach $180-plus per barrel. Oil prices will then plummet to prices closer to $40-$60 or even lower. Commodity and energy stocks should be the last investors sell off (between late 2009 and mid-2010) before that bubble bursts.

The geopolitical cycle is a new cycle. Every 32 to 36 years, there are alternating periods of 16 to 18 years when "the general geopolitical trends and environment are first favorable for stocks and valuation and then unfavorable."

The U.S. is very deeply affected by the geopolitical cycle. In 2006, the geopolitical trends were reminiscent of the 1960s and 1970s (the Cuban Missile Crisis, the JFK, Bobby Kennedy, and Martin Luther King, Jr. assassinations, recession, etc.). Today, splashed across the news are reports of the wars in Afghanistan and Iraq and continuous terrorist attacks since the major 9/11 attack.

This geopolitical cycle points downward into 2018 or 2019, with things getting worse before they get better as the oil bubble's crash will lead to bigger problems in the Middle East and third world countries.

One of the most consistent cycles (and one acknowledged by most stock analysts) is the four-year presidential cycle. There are minor to substantial corrections every four years "into the midterm election cycles" in the U.S., with stocks hitting "intermediate term bottoms" between summer and fall of years like 1962, 1974, 1986, 1998, 2006, and 2010.

The reason behind this regular cycle is that the Federal Reserve and government often do more to stimulate the economy leading up to the presidential elections, and then must cut back and tighten into the midterm elections, "when there is less at stake."

So what do all these combined cycles mean for the stock and economic scenarios into the next few decades?

The Dow forecast, taking all cycles into account, predicted the first minor crash bottoming in October 2008. A "bullish scenario" for the Dow follows this minor crash with a "major bounce" to about 12,500 by September 2009. Then, the next crash will see lows around 7,200. A more bearish scenario wouldn't even allow for that much of an initial recovery (only to 10,100 or so) and would predict a deeper crash to below 4,000.

The Greatest Bubble Ever in Real Estate

Never in the financial history of the world have we seen a real estate bubble like the one we've just passed through. In 2006, houses reached double the price they should have been "compared with historical inflation and replacement cost trends, rents, and consumer income." It just couldn't continue like that, so there was a milder deflationary period between 2007 and 2008. The next deflation cycle in real estate will be more serious and start in late 2009.

The far-reaching implications of the heavily inflated real estate values also reach into the world of bank loans.

After the stock bubble burst in 2000, housing was viewed as a safer investment. Flows of investment left the stock market and shifted to housing. Interest rates were dropping and speculation in real estate grew in appeal. In addition, banks and mortgage companies saw a chance to profit and offered liberal financing, short-term adjustable-rate mortgages, and teaser loans.

Surprisingly, home prices do not grow with the economy as stocks do. Instead, they correlate long term with inflation or replacement costs. For this reason, most of the decline in U.S. home prices will occur between late 2009 and mid-2013. Mortgage rates will rise drastically in 2009 and the rest of the economy will be in collapse by mid-2010. Homes in places like Florida, Arizona, and Southern California – where speculation in real estate was common – will decline in value nearly 60%.

Large trade-up homes, vacation homes, and "McMansions" will be the hardest hit in the continuing home devaluation burst.

Echo Boomers on the Move

The force driving the economy is people. That's all the economy really is; just a group of people making, losing, spending or saving money. Now and into the Next Great Depression, people are moving. Migration flows "are highly demographic driven."

Here's what we know:

- Young households will drive immigration and domestic migration, not older people.
- The echo boomers (the children of the baby boomer generation) will migrate in greater numbers to the Southeast, Southwest, and Rockies.
- Cities that are regularly the most attractive to domestic migrants have between 1 million and 2 million people in them.
- Immigration from other countries is going to slow dramatically in the face of rising unemployment.
- U.S. policies restricting immigration will negatively impact the economy, as "immigrants contribute to economic and demographic growth beyond their social costs."

Among cities, the most attractive to the main movers (age 25 to 27) are medium-sized inland cities with between 1 million and 2 million people.

Immigrants, a hotly debated topic, do create social costs (education and medical care, especially) but they also add an average of "$80,000 more in taxes over their lifetimes above these social costs." Additionally, immigrants arrive ready to work; "essentially, we bypass the unproductive years of their lives and get them in their prime." The flow of these workers into the U.S. fills millions of service jobs. The Americans who would take those jobs would demand higher wages, which leads to higher prices for consumers.

The real estate sectors most appealing for investors after the major crash (between 2010 and 2012) will be 1) affordable rental apartments and starter homes for echo boomers and 2) vacation homes for baby boomers.

Rising East and Aging West

The world is approaching a major demographic shift away from the Western world. By 2010, European and North American populations will begin aging rapidly and slow down long term. Simultaneously, Asian and emerging nations will "continue to grow explosively."

We saw this age and peak process in Japan in 1990. Europe, the U.S., Russia, and Australia/New Zealand will follow in 2010. China will follow between 2020 and 2035. Southeast Asia, Latin America, India, South Asia, and the Middle East will follow in the decades beyond.

Birthrates are declining all over the world, although such rates are still higher in Africa, the Middle East, and South Asia. All the while, life expectancy continues to rise.

United Nations population projections show that world population will peak in 2065 and then gradually decline after that. If this slowing occurs as projected, it will be the first decline in world population since the Ice Age, between 12,000 and 25,000 years ago.

Interestingly, as this phenomenon occurs, emerging countries will undergo increasing populations while Western and developed nations will see falling populations. By 2025, "ten megacities will exist in South Asia and nine in East Asia, dwarfing all other regions."

What follows is an overview of the 10 major regions of the world and their impending demographic trends:

1. *Europe*: Slowing decline for decades. No resumption foreseeable. Economic and political power has shifted from Europe and its aging populations will slow growth, unless higher immigration can save them.
2. *Russia and Eastern Europe*: Decline. Instability, internal terrorism, already-peaked innovation wave.
3. *North America*: Economic growth drops until the early 2020s, rebounding into the early 2040s. Will eventually suffer a "more pronounced, long-term decline, but not as much as Europe." Immigration could help.
4. *Latin America*: Decades of growth ahead, with peak in spending between 2055 and 2065. Impacted by the commodity bust from 2010 to 2015.
5. *East Asia*: Spending waves peak throughout the region between 1990 (Japan) and 2015 (China). China will start to slow with the West (2010) and will decline substantially between 2020 and 2024.
6. *Southeast Asia*: Peak innovation between 2015 and 2030, peak spending between 2040 and 2055 before "moving into a long, slow cooling period."
7. *Australia and New Zealand*: Slowdown less likely than in U.S. because immigration there is still desirable. Innovation wave peaks in 2015 then declines, but not drastically, and rises between 2025 and 2050.

8. *South Asia*: India has not yet peaked in its spending wave and won't until 2065. Will be the main "economic engine of the world thirty years from now."
9. *Middle East and North Africa*: Wide disparities among countries in the region, depending on political, cultural, and natural resources.
10. *Sub-Saharan Africa*: South Africa reaches its innovation peak in 2015, spending wave peaks between 2005 and 2010, with significant numbers of young people and immigrants into 2075. Nigeria has potential for development and growth.

Clustering Risks and Returns

Risk is part of investment. One of the major problems with economic advisors and economists in general is that they make assumptions which are proving no longer to be true. Some of these assumptions were:

- "Investment returns and correlations between investments would act as they have in the past."
- Nothing new would occur.
- The returns farthest from the expected results (huge losses and huge gains) were the least likely to happen.
- Investment returns are independent of each other, so one day's results are isolated and happen in a vacuum.

The 1987 crash, the dot-com bust, the subprime mortgage crisis of 2008; all of these circumstances should teach us that we don't always know the odds. Things change and they can change quickly and without much warning, if you don't know what signs to look for.

With stocks, people expect to make money; it's just a question of how much. Bell curves, a mathematical representation of a normal distribution of results works in graphing many things, like people's heights, IQs, etc. The problem with a bell curve in representing possible distributions of stock market returns, however, is that to be "99% sure of what you will get, you have to be willing to accept anywhere from -48% to 66%."

Then, consider that the so-called "low-probability events" happen close together. Unlike when there are people's heights being measured for the bell curve graph, the months and years of stock results impact each other. When things are going well, it often breeds more good returns, and when things are going south, many investors sell off and the stocks fall harder.

A more accurate representation of risks and returns has a higher and sharper peak because "more days tend to be near the average than the normal" bell curve would show. In addition, "fat tails" on either end show that "extreme up or down days are far more common than standard risk tools imply." And, the peak is thinner because fewer days fall into the "middle category of being mildly above or below average."

We are entering an extreme economic period in which we fully expect that risks cluster to "the downside." In this economy, "traditional asset allocation strategies" are going to fail.

Strategies for Winter: Profiting in a Deflationary Economy

The winter season (2008-2023) will see deflation in all traditional assets. Commodities, real estate, and stocks will see horrible declines in the first half of the coming decade. At first, safe havens will be strong currencies, high-quality bonds, and cash equivalents.

The slight recovery our economy will experience will run from mid-2012 to 2017. Many will assume that this is the end of the depression. However, a final recession (less extreme) will last from 2017 to 2020 or 2022.

Major buying opportunities will appear in mid- to late-2012, and mid- to late-2022. A broad commodities boom won't reassert itself until the early 2020s. Housing will bottom between 2012 and 2015.

A conservative investor should follow this simple plan for 2009-2035:

- 2009 to mid-2010: Cash, money market, safe currencies (Swiss Franc).
- Late 2010 to late 2022: Long term bonds: treasury, corporate, and international.
- Mid-2012 to mid-2017: Stocks: Japan, multinational, and health care.
- Late 2022-2035: U.S. large-cap multinational, health care, India, and real estate.

For business owners, the most important steps to take to survive the coming winter:

1. Hold off on capital expenditures and loans until the depth of the downturn, when assets and real estate will be cheap and interest rates low.
2. Sell down parts of your business that you don't want to keep long term.
3. Cut unnecessary costs.
4. Outsource "nonstrategic functions."
5. Pay off high interest loans now.
6. Structure leases or loans to mature between mid-2011 and mid-2013.

Political and Social Impacts of the Next Great Depression

The coming winter will be more or less severe based on how companies and governments respond. We need prepared organization to handle the coming crisis in oil and commodity prices, pollution/global warming, trade protectionism, income inequality, and terrorism. Organizations from the smallest businesses up through multinational organizations must become more nimble, fast-acting, and efficient while also becoming "zero waste."

Inequalities and imbalances in our country and the world will be addressed during this economic winter. Affluent nations will have to figure out how to address the "grave challenges of aging societies."

Globalization, at first a scary idea in the face of economic fallout, is necessary for developed and developing countries to succeed into the future.

We have witnessed (and benefited from) the greatest boom in history, from 1983 to 2007-2009. We will not see this type of boom again in this century. The next "golden era," probably between 2100 and 2160, will probably see the Middle East and Africa as the leaders of the world with human evolution and progress reaching new peaks on the 500-Year Mega Innovation Cycle.