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SOCIONOMICS IN A NUTSHELL

Understanding socionomics requires comprehending the contrast between two postulations:

- (1) The standard presumption: Social mood is buffeted by economic, political and cultural trends and events. News of such events affects the social mood, which in turn affects people's penchant for investing.
- (2) The socionomic hypothesis: Social mood is a natural product of human interaction and is patterned according to the Wave Principle. Its trends and extent determine the character of social action, including the economic, political and cultural.

The contrast between these two positions comes down to this: The standard presumption is that in the social setting, *events govern mood*; the socionomic hypothesis recognizes that *mood governs events*. In both cases, the stock market is seen as an efficient mechanism. In the first instance, it presumably revalues stocks continually and rationally in reaction to events; in the second, it revalues stocks continually and impulsively as the independent social mood changes. We will now investigate five presumed "outside forces" to see which of these views their relationship to the stock market supports.

The Economy

The standard presumption is that the state of the economy is a key determinant of the stock market's trends. All day long on financial television and year after year in financial print media, investors debate the state of the economy for clues to the future course of the stock market. If this presumed causal relationship actually existed, then there would be some evidence that the economy leads the stock market. On the contrary, for decades, the Commerce Department of the federal government has identified the stock market as a leading indicator of the economy, which is indeed the case.

If the standard presumption were true, then changes in the economy would coincide with or *precede* trend changes in aggregate stock prices. However, a study of Figure 1 will show that changes in the economy coincide with or *follow* trend changes in aggregate stock prices. Except for the timing of the recession of 1946 (which supports neither case), all economic *contractions* came upon or after a *downturn* in aggregate stock prices, and all economic *recoveries* came upon or after an *upturn* in aggregate stock prices.¹ In *not one case* did a contraction or recovery precede a change in aggregate stock prices, which would repeatedly be the case if investors in fact *reacted* to economic trends and events. This chronology persists back into the nineteenth century as far as the data goes.

The socionomic hypothesis explains the data. Changes in the stock market immediately reflect the changes in endogenous social mood. As social mood becomes increasingly positive, productive activity increases; as social mood becomes increasingly negative, productive activity decreases. These results show up in lagging economic statistics as expansions and recessions. The standard presumption has no explanation for the relative timing of these two phenomena.

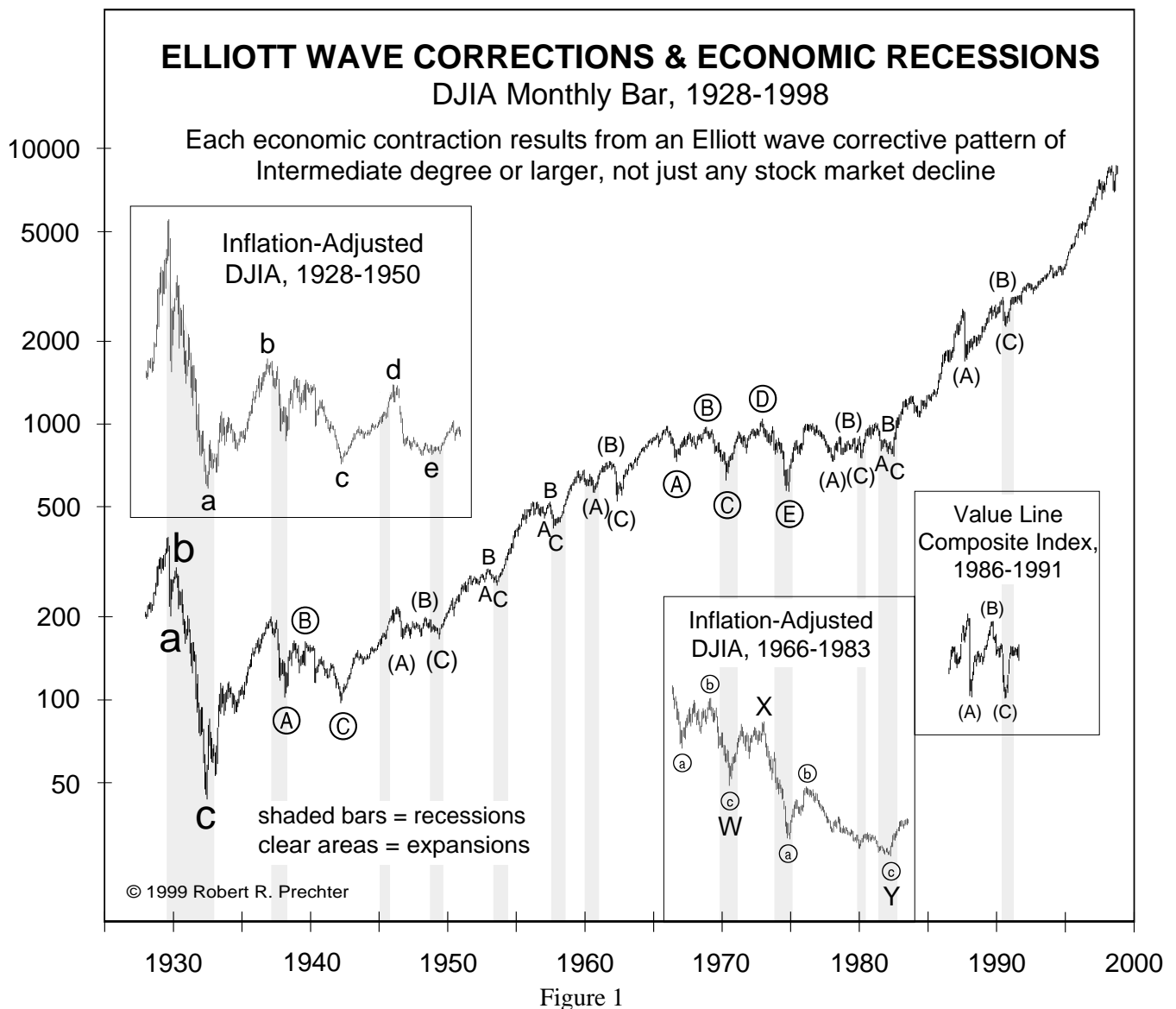


Figure 1

Politics

The standard presumption is that political trends are a key determinant of the stock market's trends. As an election approaches, commentators debate the effect that its outcome will have on stock prices. Investors argue over which candidate would likely influence the market to go up or down. "If so-and-so gets elected, it will be good/bad for the market," we often hear. If this causal relationship were valid, then there would be evidence that a change in power from one party's leader to another affects the stock market. On the contrary, there is no study that shows such a connection.

A socionomist, on the other hand, can show the opposite causality at work. Examine Figure 2 and observe that strong and persistent trends in the stock market determine whether an incumbent president will be re-elected in a landslide or defeated in one. In all cases where an incumbent remained in office in a landslide, the stock market's trend was up. In all cases where an incumbent was rejected by a landslide, the stock market's trend was down.² In *not one case* did an incumbent win re-election despite a deeply falling stock market or lose in a landslide despite a strongly rising stock market.³

The socionomic conclusion is this: When social mood waxes positive, as reflected by persistently rising stock prices, voters desire to retain the leader who symbolizes their upbeat feelings and who they presume helped cause the condi-

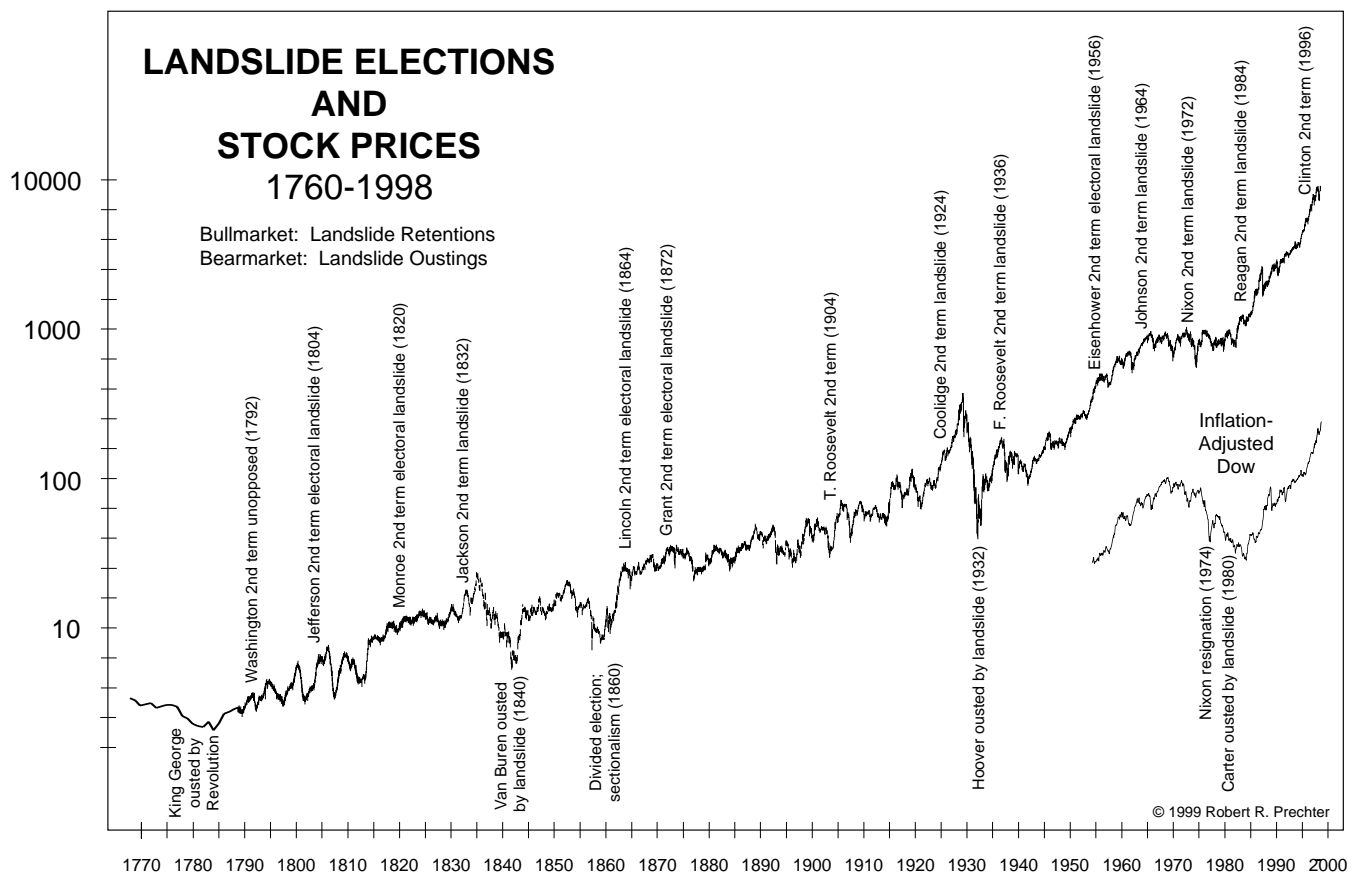


Figure 2

tions attending them. When the social mood becomes more negative, as reflected by persistently falling stock prices, voters decide to throw out the incumbent who symbolizes their downbeat feelings and who they presume helped cause the conditions attending them. *The political policies of the incumbent and his challenger are irrelevant to this dynamic.* The key is a desire for change *per se*, not any particular type of change. The standard presumption has no explanation for reconciling the relationship between these phenomena.

Peace & War

“Surely,” says the supporter of the conventional view, “if war broke out, that would affect social mood and the stock market.” Such a comment would be, and is, an utter assumption. It is unsupported by argument or history. As to argument, many people assume that war is a dangerous enterprise that would cause concerned investors to sell. Many historians, on the other hand, argue that war is good for the economy, which by conventional logic would make it good for the stock market. As this reasoning is contradictory, so is the historical record. The Revolutionary War took place entirely during a falling stock market in England. The Civil War took place entirely during a rising stock market in the U.S. World War I saw the stock market rise in the first half and fall in the second half. World War II saw the opposite, as the stock market fell in the first half and rose in the second. During the Vietnam War, it went up, down, up, down and up, finishing about unchanged. In sum, there is no data to support the conventional view, and all the data taken together contradict it.

Socionomics, in contrast, points out a *consistent* correlation with a *consistent* rationale. Because social mood governs the character of social activity, a persistently *rising* stock market, reflecting feelings of increasing goodwill and social harmony, should consistently produce peace, and a persistently *falling* stock market, reflecting feelings of increasing ill will and social conflict, should consistently produce war. Figure 3 bears out this expectation. Long rises in the stock market unerringly result in climates of peace. Similarly, we find that major wars virtually always erupt during or immediately following “C” waves of Elliott wave corrections above Cycle degree. The Revolutionary War took place

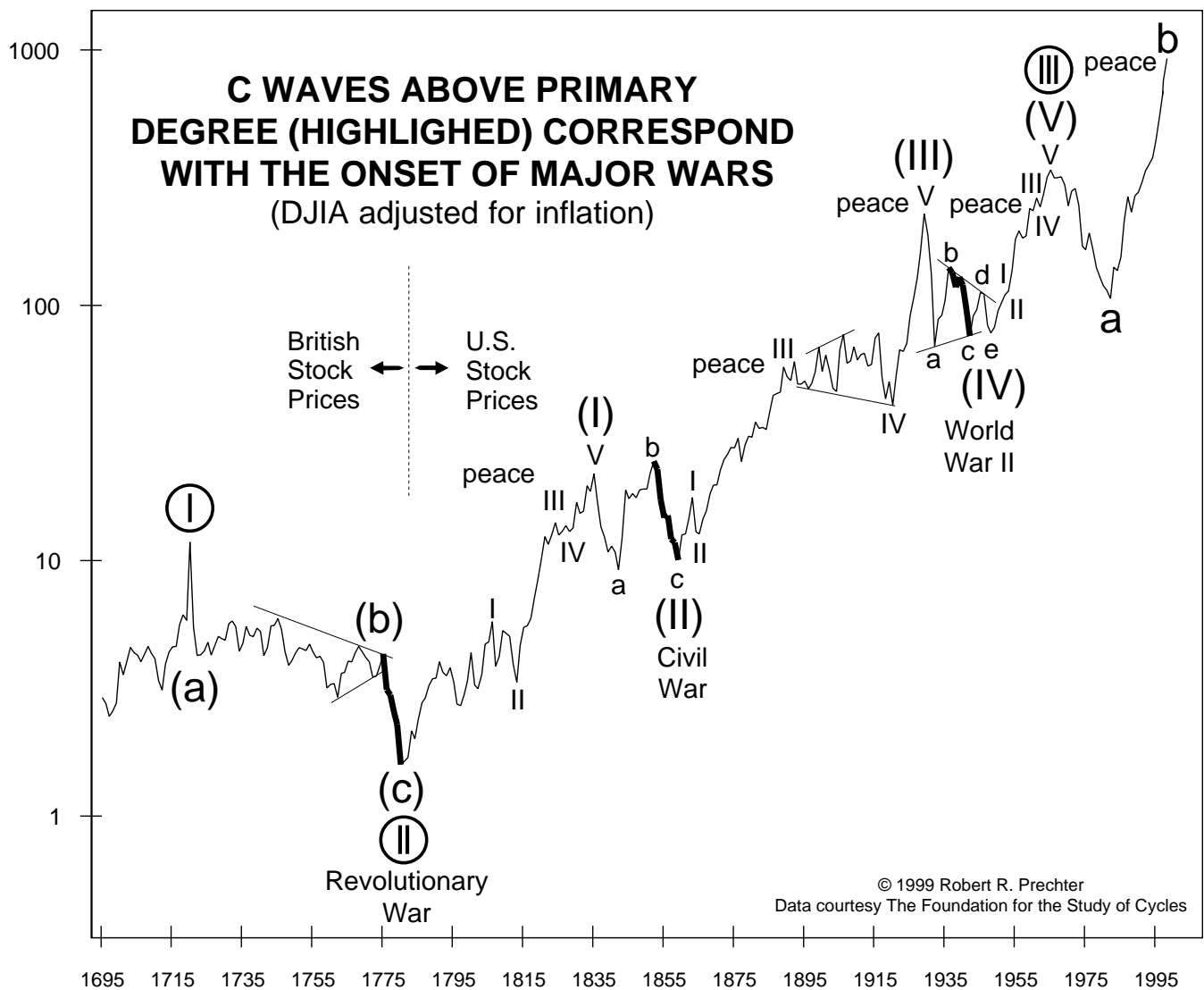


Figure 3

during wave (c) of the Grand Supercycle bear market from 1720 to 1784. The Civil War broke out shortly after the end of wave c of the Supercycle bear market from 1835 to 1959. World War II started during wave c of the Supercycle bear market (in inflation-adjusted terms) from 1929 to 1949. In every case, a rising social mood eventually brings an end to the war.⁴

Demographics

Currently fashionable is the idea that demographics determine stock market trends. It was discovered, when sliding birth data around on top of a chart of the stock market, that there is a four-decade correlation when birth data are moved forward 46-49 years. The explanation for this correlation, roughly stated, is that people spend and invest more when in their 40s, so the stock market will go up and down with the percentage of people in their 40s. It seems so sensible to the conventional mindset that people across the country have embraced this thesis.

The first problem with this case is that when data may be moved around at will, apparent correlations appear often. I can find three different multi-decade periods of correlation between immigration data and the stock market when I am allowed to slide the two series around until they fit. The second problem with this case is that the available data prior to the mid-1950s diverges so significantly from this postulation that it disproves any causality. At least four studies^{5, 6, 7, 8} have debunked the assertion.

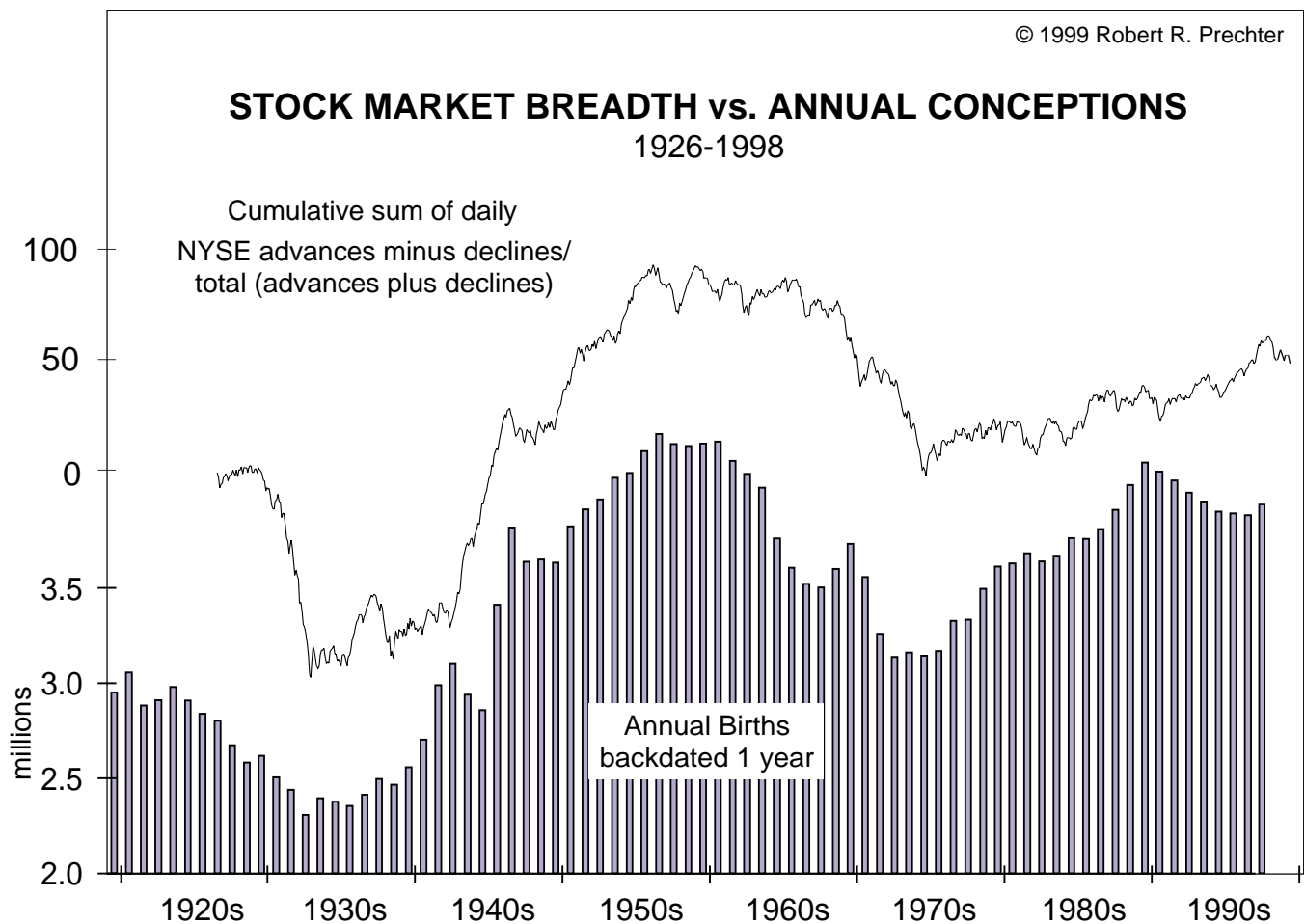


Figure 4

What is the socioeconomic position on demographic causality? Think about it for a minute. We have already seen that social mood determines the trends of the economy, politics, and the conditions for peace and war. Might social mood also determine demographics?

Figure 4 shows that demographic data line up almost perfectly with the stock market, particularly when it is expressed in terms of the advance-decline line, which reflects how many stocks are going up or down. This is a broad measure that better reflects the full population's participation in national demographics (as opposed to data on the economy, which can be propelled by a narrow list of industry leaders). The data shown in bars is annual birth data, lagged by one year to reflect (within three months) the number of annual *conceptions*. The major stock market lows of 1932 and 1974 coincide exactly with the major nadirs in procreational activity. The peaks in procreational activity correspond to peaks in the a-d line.

There is not enough data to be certain of a causal relationship, but it is nearly twice as long a correlation as the one that convinces so many people of the "demographics determine stock prices" case. More important, and in contrast to the aforementioned case, this correlation holds *throughout all the available data*, which dates from 1908 for conceptions and 1926 for the a-d line; no data contradict it. The socioeconomic hypothesis can account for this correlation. As people in general feel more energetic, confident and happy, they have more children. Conversely, as people in general feel more sluggish, fearful and unhappy, they have fewer children. Thus, social mood determines aggregate procreational activity. Once again, the hypothesis is simple and elegant and explains the data.

Nuclear Explosions

“O.K., Bob,” a skeptic might say, “Maybe I can accept the idea that social mood determines the economy, politics, peace and war, and maybe even the birth rate. But you can’t claim, as you appear to be doing, that no outside forces affect the stock market. I mean, what if, out of the blue, somebody detonated a nuclear bomb in a major city? You can’t say that wouldn’t affect people’s mood or the stock market!” Clearly, this person has yet to incorporate fully the socio-economic point of view. What does he mean, “out of the blue”? This is the same fictional “out of the blue” that we have already debunked in economics and politics. Every social act has an antecedent in mood, so nuclear explosions are unlikely to be an exception. Not only do I claim, based on the fact that social mood is patterned, that the detonation of a nuclear bomb would have no effect on social mood, but once again, the causality is the other way around: *Social mood determines the penchant for exploding nuclear devices.*

Figure 5 demonstrates that the socio-economic hypothesis governs even here. As you can see, the stock market (adjusted for inflation), which is a direct reflection of social mood, correlates almost

perfectly with the rate at which governments detonate nuclear bombs. The reason is this: As social mood becomes more positive, people become more confident, trusting and content. They feel little need to prepare a defensive or offensive force. As social mood becomes more negative, people become more fearful, distrusting and angry. They are impelled to prepare to defend themselves or attack an enemy. As in politics and economics, if you would like a view to the future in this area, just watch our most responsive and precise reflector of social mood, the stock market. Its trends will tell you when to expect more or fewer nuclear explosions, and whether they are more likely to be deployed defensively or offensively.⁹ The blackest moods of this century occurred in 1932 and 1942, the latter time providing the social impetus to develop the nuclear bomb in the first place.

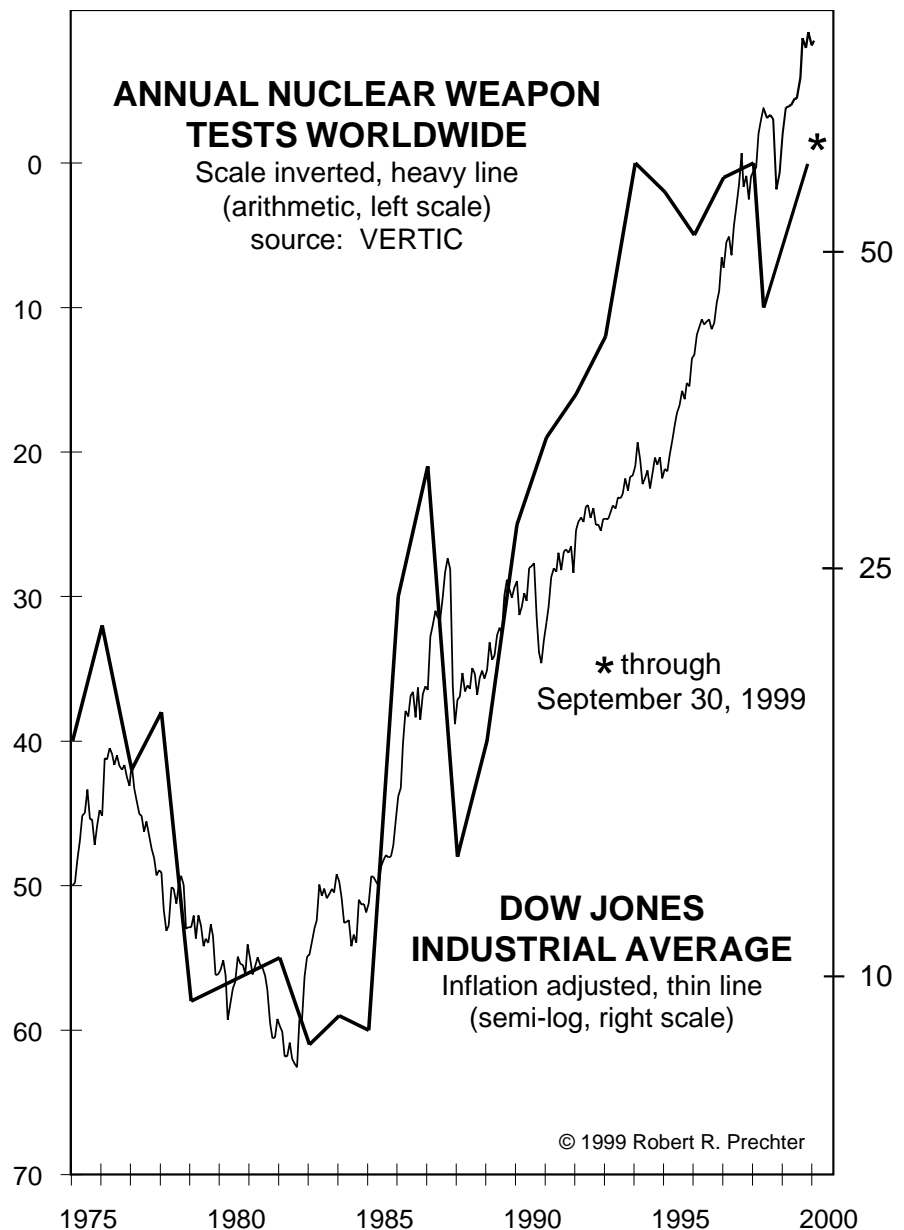


Figure 5

The Degree of Mood Change Determines the Degree of the Results

The socio-economic hypothesis suggests that the extremity of social behavior should be directly proportional to the extremity of the social mood swing. This is indeed the case. The longer, further and more broadly the stock market rises, reflecting a waxing positive mood, the more consistently the economy expands, the more citizens vote to “stay the course,” the more children people produce and the more broadly peaceful is the resulting social climate. The longer, further and more broadly the stock market falls, reflecting a greater swing toward negative mood, the more deeply the economy contracts, the more citizens vote to “throw the bums out,” the fewer children people produce and the greater is the resulting social tension and conflict. Small stock market corrections beget recessions, mild defeats at the polls and minor wars. For example, the Primary degree correction of 1959-1962 led to a mild recession in 1960 and the Cuban Missile Crisis of 1962, a near minor war. (Had 1962 been an election year, the incumbent would have lost.) The Primary degree correction of 1987-1990 led to the moderate Gulf War in 1990 and a brief recession in 1991. In 1992, the incumbent lost the election by a small margin. The larger Cycle degree correction of 1966-1974, in contrast, led to two major recessions (in 1970 and 1974), the ousting of a president by resignation and the comparatively severe Vietnam War. Larger stock market corrections, such as those highlighted in Figure 3, beget depressions, political upheaval and all-out war. Corrections of Millennium degree, such as the Dark Ages, destroy economies, political systems and entire nations. Conversely, small uptrends produce moderate benefits, while uptrends of the highest degree produce the greatest social achievements of mankind such as the Renaissance, the Industrial Revolution and the Information Age.

Summary

As social mood becomes more positive, people buy more stocks, behave more productively, vote for more incumbents, have more children, blow off fewer bombs and act peacefully toward their neighbors. Conversely, as social mood becomes more negative, people sell more stocks, behave less productively, vote for more challengers, have fewer children, blow off more bombs and act belligerently toward their neighbors. All this correlation is consistent with the idea that all these activities have a common engine, which is social mood. Of course, social mood dynamics produce countless other manifestations, such as trends in art, music, entertainment, mores and fashion, to name but a few.

Because social mood change, as revealed by stock market's form, is patterned according to the Wave Principle, we can propose a larger socio-economic hypothesis, that the Wave Principle ultimately shapes the dynamics underlying the character of all human social activity. The Wave Principle, in brief, is the engine of history.

NOTES

- 1 The converse is true as well, as long as we define “downturn in aggregate stock prices” as the onset of an Elliott wave correction (see letter labels in Figure 1). Thereafter, the resulting recession may occur in wave A, C or both.
- 2 To this summary we may add Richard Nixon, who, after being re-elected on a landslide as the DJIA rose to an all-time high, was forced to resign during the 1973-1974 bear market.
- 3 Narrowly contested elections sometimes hinge on near-term market trends and/or the lagging performance of the economy, as in the cases of Truman and Bush.
- 4 This is where historians get the bizarre notion that war is good for the economy. Actually, each war is triggered by an extreme low in mood, typically in the climate of economic depression. The social mood then reverses naturally and brings about both increased productivity and peace.
- 5 *Bank Credit Analyst*. (1997, January and 1999, March), Toronto.
- 6 Holt, Derek. Royal Bank of Canada, as quoted on Bloomberg, June 20, 1997.
- 7 Poterba, James M. (1998, October). “Population Age Structure and Asset Returns: An Empirical Investigation.” Massachusetts Institute of Technology, Cambridge.
- 8 Prechter, Robert R., Jr. (1999, September 17). Debate with Harry S. Dent, presented by Bill Good Marketing, Chateau Elan, Braselton, GA.
- 9 In the last two decades, there has been no Elliott wave correction large enough to induce anything beyond nuclear weapons *testing*. The next “C” wave of larger than Cycle degree will undoubtedly impel the use of nuclear weapons for offensive purposes.



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