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The Leading Edge

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THE JULY ISSUE

How the 4-Season Economic Cycle Stretched An Extra 20 Years

Why Its 60-Year Rhythm Remains Unchanged...

Inside This Issue

And What It Means For Investing and Business

My interest in cycles was born in college in the early 1970s. I had a great finance professor who inspired me. And my first father-in-law was a private investor who regularly read a bunch of newsletters about debt, inflation, and cycles. Mostly classic gold bugs back then… but I got the bug (and bad!).

The first credible long-term cycle I discovered was from the Russian economist Nicholai Kondratieff. It was called the Kondratieff Wave, or the K-Wave for short. He first published this theory in his 1925 book, *The Major Economic Cycles*.

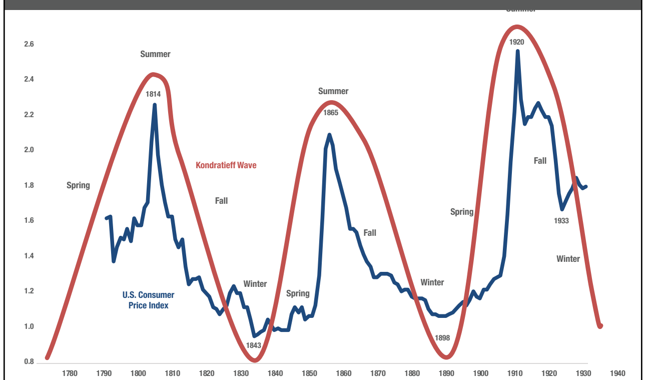
What struck me right away was that the chart of inflation that drove it looked just like an EKG, only it was a 50- to 60-year rhythm, not a 1-second sinus rhythm.

The inflation peaks were 50 years, 56 years, and 60 years (between 1814, 1864, 1920, and 1980). And just like a normal heart beat, which can vary from 60 to 72 to 86 beats per minute (on average), the K-Wave follows a variable pattern that is affected by different cycles rolling through as gravity would affect objects in orbit.

This first chart illustrates this point clearly.

Note how inflation is like temperature in our annual seasons. The booms are like the more

K-Wave Like an EKG: Inflation Peaks Every 50-60 Years
U.S. Consumer Price Index



Source: Historical Statistics of the United States 1789-1945 U.S. Department of Commerce, Bureau of Labor Statistics, Lawrence H. Officer, 'What Was the Interest Rate Then?' MeasuringWorth, 2019.

temperate, favorable seasons of spring and fall, with the busts the more extreme or less favorable of summer and winter.

Right from the outset, I've disagreed with most economists on the difference between macro-economic and micro-economic behavior. While they see these phenomena as independent, I see them as subsets of each other, like the modern theory of fractals. Patterns within patterns.

There can be 5,000-, 2,500-, 500-, 250-, 60-, 30-, 4- and 2-year inflation cycles that are similar but on different scales. It's the same for boom/bust cycles: 1,500-, 500-, 250-, 80-, 60-, 40-, 10- and one-year cycles, all similar but on different scales.

Climate cycles repeat in four seasons from a one billion-year cycle to a 250 million-year one… down to a 100,000-, 41,000-, 22,000-, to as little as a 10-11 year one… and, of course, our one-year annual seasons.

People can spend the most money at age 46 to 47 overall, but they spend the most on childcare at age 35 and on nursing homes at age 84.

Macro to micro, differing mostly in where and how long.

The Power of Four

Early in my study of cycles, I also noted the power of four.

There are four seasons to our human life cycles… our annual climate seasons… our technology and business cycles… and ever-expanding climate cycles, even those that last for which long as a billion years!

When there is a cluster of key cycles unfolding simultaneously, as is almost always the case, the best way to tell which one is the most important is by looking for the one that most clearly divides into four seasons.

Consider how even the Western Civilization Cycle has broken down into four seasons:

- Greece, innovation;
- Rome, growth boom;
- The Dark Ages, shake-out;
- And Europe and North America, maturity boom into recent times.

If you look in my first book, *Our Power to Predict*, you'll see my estimated plot of inflation and those four seasons back to 500 B.C., which I learned from a 10,000-page encyclopedia called *The History of Western Civilization*. That's a near 2,500-year cycle, half a 5,000-year Civilization Cycle… like agriculture (8,000 B.C.) to the wheel and writing (3,000 B.C.) to the computer and internet (2000 A.D.).

My 500-year Mega-Innovation/Inflation Cycle breaks into two 250-year Political/Social Revolution cycles.

The last 500-year cycle saw the transition from gunpowder to the atomic bomb… from the printing press to computers… from tall sailing ships to jet airplanes.

That's what I mean by "mega." It's more than things like steamships to railroads to autos every 45 years. The last Revolution cycle brought us democracy in America, and the one before that, the Protestant Reformation against the domineering Catholic Church in Europe.

And, as you've guessed by now, and as the first chart notes, the K-Wave has four seasons as well…

But There Was a Disruption

In the 1800s, the average worker didn't have the impact on the economy that the post-World War II Bob Hope generation did. That was the first generation to grow up middle class thanks to the introduction of Henry Ford's assembly line in 1914 and the resultant mass-production revolution to follow.

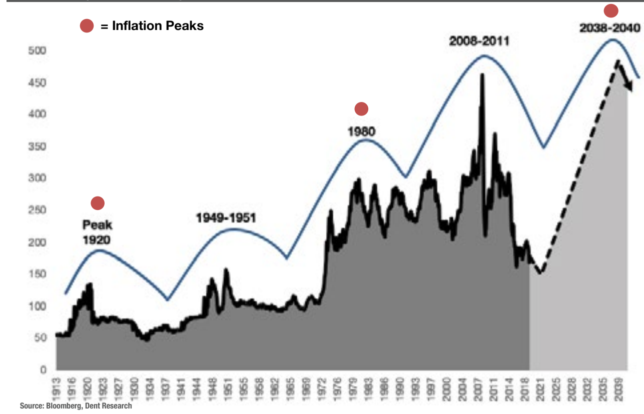
Do you know that home ownership accelerated from 44% to 62% in just 20 years, from 1940 to 1960 – because of this new middle class that had higher incomes and GI benefits after the World War? That made the everyday person an important economic driver and brought generational spending cycles more prominently into the mix.

Since 1942 and that first middle-class generation, the 40-year Generational Spending cycles have become the primary drivers of booms and busts in our economy, replacing the 30-year Commodity Cycle that once held that power. That stretched the K-Wave to two generations, and hence, from 60 to 80 years.

Before demographics disrupted the K-Wave, commodity prices would peak on a rough 30-year rhythm, like 1814, 1837, 1864, 1893, 1920, 1949-51, 1980, and 2008 to 2011. The next peak is projected for 2038/40. But overall consumer and wholesale price inflation rates, which are the primary rhythm of this cycle, peaked every other commodity cycle, or about every 60 years (1864, 1920, 1980, and 2038/40 projected).

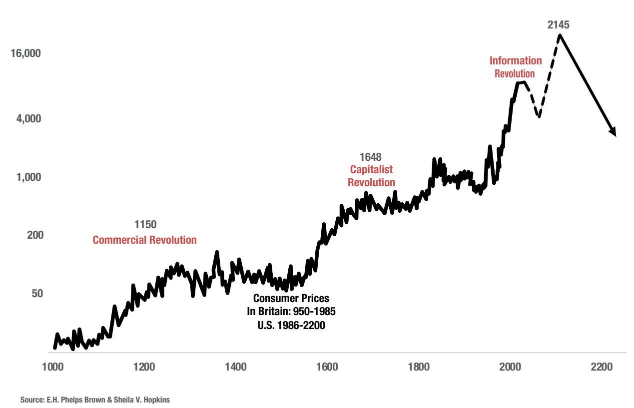
30-Year Commodity Cycle: 2 Times = K-wave/Inflation Peak

CRB Index (PPI before 1947)



Both of these cycles, commodity and inflation, have been stronger and more consistent since the greater 500-year Mega-Innovation/Inflation Cycle bottomed around 1896. This new up cycle into around 2140-45 also forebodes major demographic growth and innovation progress.

500-Year Cycle: Inflation Creates Progress - Big Time Since Late 1800s



In the December issue of *The Leading Edge,* I showed that such progress has occurred since the late 1800s in spades and how we're only half way through it. But we have major hurdles to get over first, like the unprecedented debt and financial asset bubble since the mid-1990s.

This big inflation and innovation thrust we got when the Baby Boomers entered the workforce, the information revolution, shows up within this Mega-Inflation cycle. It won't peak until we see lifespans of 100 to 120-years-plus and much higher standards of living.

Still, whether 50, 60 or 80 years, the K-Wave cycle has four distinct seasons:

- A spring boom with moderately rising inflation;
- A summer recession with peaking inflation and wars;
- A fall bubble-boom with falling inflation; and
- A winter depression with a deleveraging period and deflation in prices.

The previous K-Wave cycle was classic. There was a spring boom from 1897 into 1912, an inflationary recession era from 1913 into 1921, a fall bubble boom from 1922 into 1929, and a winter depression season from 1930 into 1942. That was the shortest K-Wave cycle since the early 1800s.

Guiding Your Investment Strategies

I harp on this four-season element of key cycles because it's important. At Harvard Business School, I learned that business, technology, and industry cycles are broken into four stages or seasons: innovation, growth boom, shake-out, and maturity boom.

My first (and dream job) out of Harvard was at Bain & Company, a strategic consulting firm to Fortune 100 companies. They classified businesses into four stages as well: question marks (new growth areas with high potential), stars (high growth/ high investment businesses), cash cows (maturing businesses with high margins, low investment, and high cash flow), and dogs (declining businesses that should be sold or in which investments minimized).

The point in these business school cases and in Bain analysis is that **you must have a different strategy in each stage!**

Businesses often fail because they keep doing something that succeeded in the last stage, but that doesn't work in the new stage. The very nature of competition and key success factors changes, and often 180 degrees.

In the innovation stage, creativity and constant testing is critical. But in the growth boom stage, it's all about marketing, distribution, and systems for growth… the opposite of the innovation stage. That's why few entrepreneurs succeed past that creative innovation stage.

I have extended this same insight to investors. Each season of the economy favors certain investment sectors or classes.

Rising inflation in the spring and summer economic seasons does NOT favor bonds. Rather, real estate, emerging markets, and commodities are the investments to turn to.

Downturns don't favor stocks and most risk sectors… although real estate and commodities are favored in the summer recession as they both correlate with inflation. The deflationary winter economic season is, in fact, the narrowest, favoring only cash and high-quality long-term bonds like Treasuries and AAA corporates. Most other financial asset prices suffer a reset, as do debt levels, after the fall bubble boom season that favors all risk assets, except commodities.

So, why have one portfolio allocation for all seasons? It simply guarantees you will underperform the best sectors in each.

Better is to apply asset allocations for the benefits of diversification among only the favored sectors:

- Stocks, real estate, and commodities in spring;
- Commodities, precious metals, emerging country stocks, and real estate in summer;
- Stocks, long-term bonds (including junk), and real estate in fall.
- Cash equivalents, safe haven currencies, long/ short trading systems, hedge funds, and high-quality long-term bonds in winter.

Then Boomers Got Involved…

As I mentioned earlier, the K-Wave theory encountered a problem. It called for the next economic winter or Great Depression in the 1990s, 60 years after the 1930s and following a nice little bubble fall-like boom from 1982 into 1989 with sharp initial crashes in 1987 and 1990. It looked a lot like 1922 to 1929.

The late 1980s and early 1990s were filled with great depression-themed books like *The Great Depression of 1990* by Ravi Batra (1987), *The Great Reckoning* by James Dale Davidson and Lord Rees-Mogg (1991), *Bankruptcy 1995* by James Figgie (1993), and *At the Crest of the Tidal Wave* by Robert Prechter (1995).

I read all of those books and loved them for the great knowledge of cycles presented (although I thought Batra's analysis was the thinnest). I learned a lot about longer-term cycles from Prechter and Davidson.

But I had just innovated my Generational Spending Wave and it was very bullish through 2007… and the most bullish for the 1990s. In contradiction to the K-Wave cycle, it only forecast a major downturn or depression-like economy for Japan. So, I didn't buy into the Great Depression forecasts of the time. Instead, I published *The Great Boom Ahead* in late 1992. Like my first book, *Our Power to Predict* in 1989, I explained how and why I foresaw a 12 to 14-year downturn and crash in Japan while the rest of the world boomed in the 1990s.

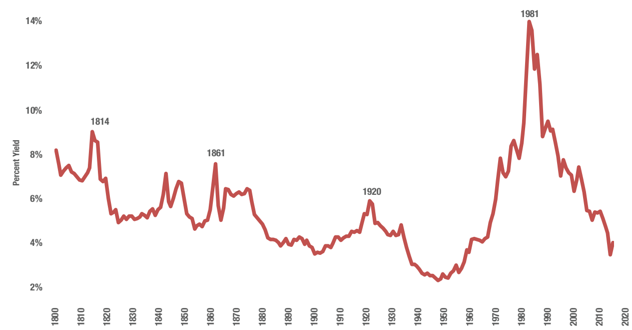
Here's a longer-term chart that uses long-term Treasury bonds to more consistently track inflation rates with less volatility from war periods and etc.

You can see that the most recent cycle saw a much higher inflation peak in 1980. This was still in line with the K-Wave's average 60-year rhythm peaking in 1864, 1920, and 1980.

So, what happened?

Inflation Explodes into 1980 Peak: Massive Boomer Workforce Entry

U.S. Long-Term Treasury Interest Rates



Source: Historical Statistics of the United States 1789-1945 U.S. Department of Commerce, Bureau of Labor Statistics, Lawrence H. Officer, 'What Was the Interest Rate Then?' MeasuringWorth, 2019.

The K-Wave got stretched in the magnitude of inflation from the massive Baby Boom generation entering the workforce, as I explained in my 1989 and 1992 books. I showed that the best correlation with inflation was with workforce growth because young people require high cumulative investment while offering little or no productivity until 2.5 years after they enter the workforce and finally become productive working and spending citizens. Then they expand both supply and demand in a low-inflation boom environment like 1983 to 2007.

But, the more important insight was that the length of the overall cycle from spring through winter got stretched to around 80 years… because the altered cycle was driven by two 40-year generational spending booms and busts instead of two 30-year commodity booms and busts.

By 1989, and in my first *Our Power to Predict* book, I had my Generational Spending Wave model and my Inflation model. I also had my new 80-Year Four Season Economic Model, which used the demographic model to forecast the booms and busts and the inflation model to forecast inflation – the two key variables.

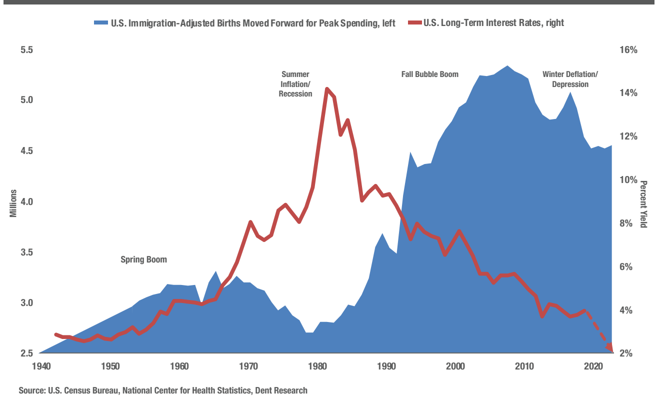
I essentially re-invented the K-Wave model around two generational spending booms that lasted 40 years each, or about 80 years, instead

of two commodity booms that lasted closer to 30 years each, or around 60 years.

This meant I had the capacity to more precisely project the seasons, with boom tops and bottoms, as well as inflation tops and bottoms.

Here's that new model using the Spending Wave of the Bob Hope and Baby Boom generations and how it stretched the cycle to 80 years.

Expanded 80-Year Cycle: 40-Year Spending Wave-Driven, Not 30-Year
U.S. Immigration-Adjusted Births Moved Forward for Peak Spending



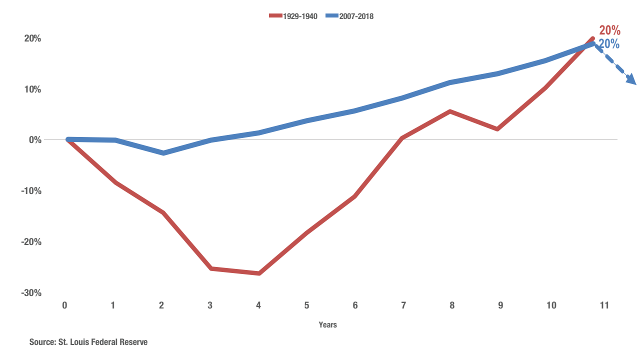
The spring boom, with its mildly rising inflation, was from 1942 to 1968, around the Bob Hope Spending Wave. Stocks, adjusted for inflation, peaked in late 1968. The summer inflation/recession season was from 1969 through 1982, in the declining wave of that generation and with the highest inflation rates in modern history thanks to massive Baby Boomer workforce entry.

Then the Baby Boom launched the strongest fall bubble boom season in modern history, with falling inflation rates from 1983 to 2007. And the winter season dawned right on cue, from 2008 forward, with initial deflation and financial deleveraging in 2008 to 2009, in a breakdown that looked just like 1930 at first.

Then the Fed and global central banks stepped in and fought deflation and deleveraging with massive money printing, the first such major effort outside of war periods. They declared war on the winter economic season. Now we have an even bigger bubble in financial assets like stocks, even though the economy has been as weak overall as in the 1930s.

Pay particular attention to this next chart…

This Winter Season vs. Great Depression Are Similar in Real GDP
Real GDP Growth From Peak, 11-Year Periods



It shows that, from the top of the fall peak in 1929 through the depression into 1941, real GDP cumulatively only advanced 20%. It was the slowest such period in history… until recently.

In the same 11-year period, from the top in 2007 through 2018, cumulative real GDP was 19%!

So, why the great bubble in stocks into 2019?

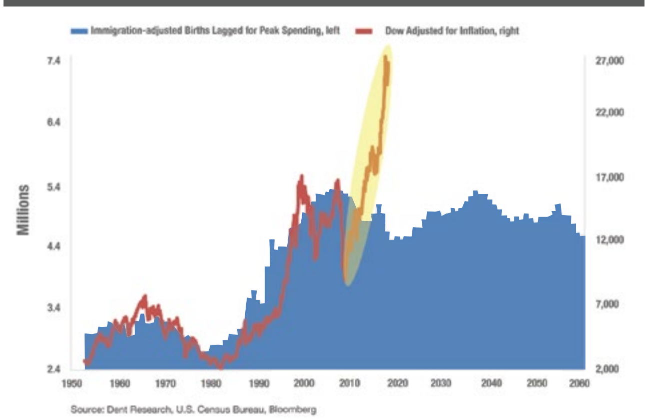
Stock buybacks!

Earnings per share have grown 119% faster than actual corporate earnings since 2009 as large companies used near-free money via central banks and artificially high cash flow to buy back their own stocks and dramatically shrink the number of shares outstanding.

That 119% greater EPS than earnings is the exact difference between where stocks are today and where my Generational Spending Wave says they should be.

Wall Street has become totally divorced from Main Street! Hence, there will be a great reset in stocks and financial assets ahead to create a crescendo in the winter season.

QE Creates Frankenstein: "Markets on Crack"
Births Lagged for Peak Spending vs. The Real Dow



And my expanded Hierarchy of Four Primary Cycles (including the Spending Wave) sees its weakest period just ahead, between 2020 and 2022, when a 1929-to-1932-like crash is most likely to occur.

I've explained this in detail in previous editions of *The Leading Edge,* but to reiterate here: We will see the worst downturn and crash on the backside of this winter economic season as opposed to seeing the worst on the front end like we did during the last winter season from 1930 to 1942.

If I'm right about that, this winter economic season will end up being worse in cumulative real GDP than the last one from 1930 to 1942, as the dotted line projection hints at. That will prove that "something for nothing" stimulus policies aimed at suppressing the debt and bubble problems rather than dealing with them, is the worst approach after all!

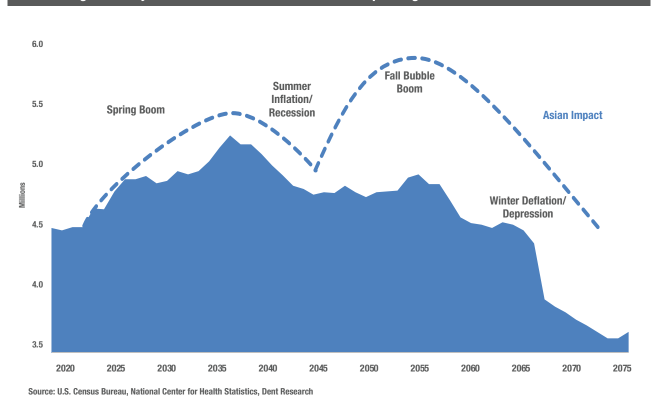
We could have been over the worst of this depression and debt crisis by late 2010 if central banks hadn't intervened so aggressively with their QE and bail-outs.

Looking to the NEXT K-Wave Cycle

As I look at both the demographic trends from my Spending Wave in the U.S., then add to that the more critical insight that India and Southeast Asia will be the strongest drivers of the next global boom and they both peak around 2055…

I get the following view of the next four-season economic cycle… and it's back more towards the 60-year rhythm again, and even shorter to make up for the over-sized cycle from 1942 into 2022.

Next K-Wave/Four-Season Cycle Shorter: 2023 – 2073, 50 Years
U.S. Immigration-Adjusted Births Moved Forward for Peak Spending



Given that the world will continue to shift, increasingly rapidly from a western- and developed world-dominated economy to an eastern and emerging world one, I have added dotted lines to the demographic boom and bust cycle to reflect the dominance of India and Southeast Asia in the next four-season cycle. It will magnify the spring boom, and then the next fall bubble boom even more, as the U.S. and Europe fade ever more after the spring boom peaks in 2036/37.

Recall, as I stated earlier: The inflation cycle has maintained its 60-year rhythm despite the last cycle expanding from 60 years to 80 in its four seasons. The primary timing and rhythm of this cycle has NOT changed.

The K-Wave cycle that peaked in 1864 saw a 54-year four-season cycle. The one that peaked in 1920 saw 46 years. The one that peaked in 1980 stretched to 80 years. Now, the next one will likely last between 51 and 57 years, from 2023 into 2073-79.

Add all four of those cycles and you get 231 to 237 years, or an average of 58 to 59... near 60 years!

This stretch in magnitude of inflation and boom, and in time from spring through winter, was just that… a temporary anomaly. That means the next cycle will be less than average, at about 50 years.

When do my demographic cycles project the top of the spring boom? Around 2036 to 2037.

When does the next commodity and inflation cycle predict peak inflation? Around 2039 into 2040-plus… and that recession should last into around 2044 in the U.S.

The next fall bubble boom should start around 2045 and peak around 2055/56… and be dominated by the trends in Asia, especially India, China, and Southeast Asia.

The next winter economic season looks to be from 2057 into around 2073 or so. However, depending on the strength in Asia by then, that fall bubble boom could extend into as late as 2064, and the winter depression could last as late as 2079.

My four primary cycles suggest the worst of that will occur between 2069 and 2073, more towards the end of the Spending Wave cycle outlined in the chart above.

Europe fades more quickly after its 2011 demographic peak and Greece crisis. The U.S. will fade more so after its 2036/37 peak. Yet, we'll still be the largest economy in dollars for most of that boom, with China a close second and India rising fast.

China and India will be the largest and most dominant economies by the next fall bubble boom peak around 2055. India could ultimately be the largest as its population and workforce exceed even China's and its urbanization likely approaches 70%-plus. It could even be #1 by 2070.

Now you know the future of the world with a clear outline of the next, all-important four-season K-Wave cycle. Most K-Wave forecasters of the past have yet to figure out what happened in the weird, present cycle. None of them are likely to see the shorter cycle ahead.

About Harry S. Dent Jr.

Harry Dent studied economics in college in the ’70s, but became so disillusioned by the state of his chosen profession that he turned his back on it. He spent the ’80s coming up with a radical new approach to forecasting the economy; one that revolved around demographics and innovation cycles.

Since then, he’s spoken to executives, financial advisors, and investors around the world. He’s appeared on “Good Morning America,” PBS, CNBC, and FOX. He’s been featured in *Barron’s, Investor’s Business Daily, Entrepreneur, Fortune, Success, U.S. News and World Report, Business Week, The Wall Street Journal, American Demographics,* and *Omni*.

Harry has written many books over the years. In his book *The Great Boom Ahead*, published in 1992, he stood virtually alone in accurately forecasting the unanticipated boom of the 1990s. In 1998 he authored the best seller: *The Roaring 2000s*. In T*he Next Great Bubble Boom*, he offered a comprehensive forecast for the following two decades. In *The Great Depression Ahead*, he outlined how the next great downturn could unfold in three stages. In *The Demographic Cliff*, he showed why we’re facing a “great deflation” after years of unprecedented stimulus. His last bestseller, *The Sale of a Lifetime* showed all the opportunities that will abound once the great reset has begun. His newest book, *Zero Hour*, warns of the greatest political polarization since the Civil War and why we’ll see a major revolution.

Harry got his MBA from Harvard Business School, where he was a Baker Scholar and was elected to the Century Club for leadership excellence. He has been a Fortune 100 business consultant at Bain & Company, CEO of several small companies, a new venture investor, and founder of Dent Research.