It's Still a 20-Year Bear Market

Thanks to the last fortnight's relentless rally, the ASX All Ordinaries Index is up a whopping 37% from its low. Many commentators are now calling March 6 the bottom and citing all kinds of statistics – from house price growth to credit spreads – to justify their opinion. So is that really it? Have we taken the pain, learned our lessons and consigned that horrible bear market to history?

Perhaps. I have no idea what the market is going to do. But there are a couple of points worth considering.

Firstly, it's not uncommon for extended bear markets to be interspersed with significant rallies. The graph below shows Japan's Nikkei 225 Index from 1984 until today.

It is almost exactly where it was 25 years ago. Yet, since the bubble burst in 1989, there has been one 40% rally, two of more than 50% and one, in the early years of this decade, of more than 100%. A three-month rally does not guarantee the bear market is over.

Moreover, most Western economies today have much in common with Japan of the 1990s: a massive debt bubble that is going to take decades to deflate; interest rates close to zero; and forecast fiscal deficits that will leave their respective governments with truly worrisome debt burdens of their own.

While the stimulus has undoubtedly worked and the risk of a Great Depression has almost disappeared, few of the imbalances that got us into trouble have been corrected. Particularly in Australia, some have been exacerbated. Reserve Bank Governor Glenn Stevens had this to say at an address to The Anika Foundation Luncheon last week:

"The households of the Western world are currently feeling that they can no longer consume as they did, in part because the earlier spending is now seen to have been based on an unrealistic set of assumptions about long-run income and wealth. To that extent, there is no real way around a period of adjustment involving lower consumption for a while."

In the US, that adjustment process has begun. The savings rate (the percentage of disposable income that is saved every year) has risen to 7%, from less than zero at the height of the housing bubble.

Australians, however, aren't so easily disuaded. The savings rate is up, but only to 1.8% in the June quarter. And total debt managed to grow 3.4% over the year to 30 June (what credit crisis?). That's down substantially on the 12.6% average of the past 30 years, but it's still more than underlying economic growth.

This credit bubble doesn't need to deflate now. It doesn't need to deflate any time soon. But it is a Ponzi scheme and whether it collapses overnight or takes 20 years to deflate, the implications for the stockmarket are severe. The All Ords was 3,950 when I originally suggested preparing for a 20-year bear market. It’s up 8% since, but I haven’t changed my view.