MARKETS

History suggests stock markets are near a peak

Study of long-term data shows a fairly neat seven-year cycle, driven by greed and fear

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Marilyn Monroe starred in the movie *The Seven Year Itch*in 1955, about a platonic relationship between a pretty girl and a married man, which included the famous scene of her dress being lifted by wind through a grate from a pass-ing underground train.

By the standards of the time, it raised eyebrows, but the scenes that did not make the final cut seem, these days, to be witty and amusing rather than shocking.

Perceptions regarding long-term stock-market analysis can be similar – a bit tame though mildly entertaining.

Share prices incorporate the myriad news that affects a market or company. They are the ulti-mate expression of Adam Smith's "invisible hand" of the market-place.

Astudy of the last half-century of the Hang Seng Index can be revealing. Spooked by the 1967 riots, the index touched a low of

65. Then, in the early 1970s, the Hong Kong stock market was dis-covered by hot global money.

The index crossed the 200 threshold in 1971to soar to a peak of nearly 1,800 by early 1973, a rise of some 27 times since 1967.

The subsequent collapse was caused by the abandonment of the post-second world war Bret-ton Woods currency accord and the oil shock.

The index crashed through the 200 level to bottom out at about 150 by December 1974.

Peaks are important, because they show market sentiment at a major turning point. The charts indicate that the true value of the market at the 1973 peak was about 250, rather than 1,800 – and even that was a big rise from just a few years earlier.

Peaks of 40 years ago look insignificant against later highs –the top of 31,850 on October 29, 2007, has never been surpassed.

Moving back in time, the previous record was the dotcom peak of 18,301 in March 2000. Further back was the Asian Tiger peak of 16,647 in early August 1997 (just after Hong Kong was handed over to China). Before that was US Federal Reserve chief Alan Greenspan's interest rate peakof 12,157 in January 1994, the market having doubled in 12 months.

Even further back, the index peaked at 3,968 before the notori-ous "Black Monday" of October 1987; in mid-1981 it broke through 1,800 before failing; and then to the 1973 peak of just under 1,800. The peak before the Hong Kong disturbances was in 1965, when the index broke 100.

So, over the last half-century, the market has recorded peaks in 2007, 2000, 1994 1987, 1981, 1973 and 1965 in a roughly seven-year cycle. Markets do not work in straight lines; they overshoot and undershoot, so we can give or take a year or two, or even a peak.

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Hong Kong might not have made a high in 1997 but for its proximity to the Asian Tigers, being already a mature market. Excepting that peak, the pattern is preserved.

Herein lies a key lesson in behavioural finance: "*Plus ça change, plus c'est la même chose*" – roughly the more things change, the more they stay the same.

We believe, as we look at the markets in a modern context, that we are more sophisticated and different, but history tells us that the human psyche is inclined to do similar things.

Perhaps it is based on the average experience of market participants. It takes seven years to train investors or dealers to the point where they can make res-ponsible decisions about other people's money – but training is not the same as experience. They are the classic suckers of beha-vioural finance, showing greed by doubling up at the top with borrowed money, and fear by panicking at the bottom.

Now, 2014 should fit worryingly into the market's seven-year itch, but this cycle looks squashed – unpowered by the liquidity caused by printing money or falling interest rates that kept us going for 50 years.

The underperforming Chi-nese economy is unlikely to push the Hang Seng to a peak this year; otherwise, the charts indicate that it should be nearer 28,000.

Regardless of our situation, Wall Street has seen maybe 50 new highs in the last year, and we know that the Hang Seng can't resist a fall on the Street. Could 2014 signal the start of another decline – perhaps a weaker one, as we have not seen a full peak?

Market troughs tend to occur some one and a half years after the peak, which takes us nervous-ly to 2016. However, most West-ern economies seem robust, so perhaps we should push our con-cerns out to 2018, especially if we can find the energy for a boom before then.

The behavioural cycle has been flattened out or deferred this time. But it would be very brave to say it has been broken.

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The stock exchange in Central. In October 2007, the Hang Seng Index soared to a record 31,850 points. Photo: Edward Wong