

INTERVIEW WITH DAVID L. SMITH Economist, Futurist, Market Strategist



David L. Smith is a Dartmouth- and Stanford-trained economist whose contrarian views and uncanny forecasts have intrigued audiences since the early 1980s. Over a 30-year career he has participated in and observed financial markets as a securities analyst, mergers and acquisitions specialist, investment adviser and President and CEO of an NASD securities firm and, for the past 18 years, as the author of *Cyclical Investing*, a highly regarded economic and financial newsletter. *The following interview was conducted by The Financial Forum on October 11, 2002.*

Q: What sets you apart from other economists?
Smith: You mean besides being right most of the time?

Q: (Laughs) Like when?

Smith: Like in 1984 when everyone thought oil prices would continue rising forever, I said they would collapse, as they did beginning in late 1985. I said that the collapse of oil prices would trigger euphoria in the stock market, and it did.

Q: When else?

Smith: In 1987, when everybody was excited about the soaring stock market, on October 16, I unequivocally advised my subscribers to sell all their stocks, and on October 19 the Dow dropped

22%. Then right after the crash when the conventional wisdom said stay out of the stock market, I said get back in on October 31, eleven days after the crash. In 1987 I also predicted there would be a war in the Persian Gulf and a spike in oil prices sometime between 1990 and 1992.

Q: So what have you done for us lately?

Smith: I urged my subscribers and audiences to exit the stock market on January 4, 2000, when the Dow traded at 11,326 and the NASDAQ just over 4,000.

Q: So to what do you attribute this clairvoyance?

Smith: My forecasts have been accurate for four reasons. One: Unlike mainstream economists, who tend to be “sunshine pundits,” I am not a cheerleader for the economy or the stock market, but rather a cold-eyed realist, and, therefore, I am willing to contemplate bad news. That means I don’t get caught by surprise when bad news happens. Two: I differ from the conventional wisdom in that I don’t practice “demon extrapolation.”

Q: What is that?

Smith: Demon extrapolation is the very human tendency to project the immediate past into the indefinite future. It’s like driving by looking in the rear view mirror. You always miss the turns, which is where most economists go wrong. I am always on the lookout for signs of a turn, so I don’t miss them.

Q: You said there were four reasons.

Smith: Third: I am an independent economist, not tied to an institution, and, therefore not subject to what you might call “institutional bias.”

Consequently, I don’t get wedded to a position, like Abby Joseph Cohen did in the 1990s, with catastrophic results ever since, and that enables me to change appropriately, and profitably, I might add, with the times. I think things through independently and feel no compunction to run with the herd. In fact as a contrarian, I feel uncomfortable whenever I am in agreement with the conventional wisdom, which is often wrong, but never in doubt.

Q: And four?

Smith: After participating in and writing about the economy and financial markets for 30 years, I have developed some fairly unique and useful insights into how things work.

Q: Such as?

Smith: One of these is that the contest over the price and availability of oil is the dominant theme

of our time. Look at the history of the last 20 years and you will find extraordinarily useful correlations between oil prices on one hand, and economic activity, inflation, interest rates and stock prices on the other. Oil is the world's most critical commodity, the one issue we are willing to go to war over.

Q: Any other insights?

Smith: Yes. I take a very long-term view of the economy and the stock market, particularly in relationship to what might be called "megacycles," the periodic transformation of the human enterprise driven by new technology and energy forms.

Q: Such as?

Smith: The industrial revolution, for example. The mechanical technology of the factories and their products, like steam engines, replaced the agricultural technology of the farms, and coal displaced wood as the prime energy source, and the world was transformed. People moved from the farms to the cities, farmers became factory workers, industrial capital replaced land as the prime measure of wealth, industrial goods replaced food as the critical measure of production, industrial Britain replaced agrarian France as the dominant global power. There was a second industrial revolution in the early twentieth century when electro-mechanical technology replaced mechanical technology and oil replaced coal as the prime mover, and again everything changed. Now we are in the midst of another such megacyclical transformation as electronic technology replaces electro-mechanical technology.

Q: How does this long-term view make you a better forecaster?

Smith: Back in the late 1990s, when virtually all economic forecasters were talking about perpetual "blue skies" they expected from the new economy and how stocks would continue rising forever, I could draw on the lessons of history which alerted me to clouds in the silver lining.

Q: Meaning what?

Smith: Previous megacycles always unfolded in three stages: Stage one, new energy and technology produce growth, euphoria and soaring stock prices. Stage two: the euphoria is overdone, stocks crash, depression and turmoil, like the Great Depression in the 1930s. Stage three: recovery, mature economic growth and sustained appreciation in stock prices. It was clear to me

that the 1980s and 1990s were stage one of the current megacycle, like the 1920s of the last one. So in the late 1990s, as euphoria and greed washed over the stock market, I was apprehensive, knowing there was a stage 2 stock market crash in our future. When the conventional wisdom kept saying "Things couldn't be better," as a contrarian I figured that if they couldn't be better, then they were bound to get worse. These insights, combined with some fundamental and technical analysis led me to advise my audiences and newsletter subscribers to exit the stock market on January 4, 2000. I have yet to recommend that they get back in, and since then the Dow has fallen as much as 31% and the NASDAQ by as much as 76%.

Q: Where do you see things headed now, as of October 2002?

Smith: I don't think we're done with the stage two of the megacycle. There is probably some rough sledding ahead for both the economy and the stock market.

Q: How much longer do you think it will go on?

Smith: Frankly, I don't know, and it doesn't bother me that I don't know. What is important is to know what it looks like when the turn is at hand and how to react profitably when it happens. In fact, I'm looking forward to the day when things look irremediably bleak, mainstream economists are throwing up their hands in despair, investors are fearful and depressed, so that I can then be the messenger of hope and good tidings.

Q: Has your "cold-eyed" realism cost you some speaking engagements?

Smith: One that I know of, and probably others I don't. Meeting planners have to decide whether they want to expose their audiences to someone who will tell it like it is and help them make profitable decisions, or whether they want someone to make their audiences feel good by restating soothing nostrums of the conventional wisdom and make bad decisions. It's the choice between profit and popularity. There is always an opportunity, even in a crisis. In fact the Chinese symbol for "crisis" is combination of "danger" and "opportunity." And while at times I may bring a disturbing message of crisis at hand and warnings of danger, I also bring an encouraging message of opportunity within the crisis. The important thing to remember is, if you don't see the danger, you can't seize the opportunity.

Q: Thank you.