As mainstream commentators ponder the spectacular failures of the Efficient Market Hypothesis and Asset Pricing Theory, some are beginning to recognize the value of the socionomic perspective.

In an August issue of The Economist, the magazine’s Buttonwood column related how the price/demand relationship differs radically in the contexts of finance versus economics. “Financial markets do not operate in the same way as those for other goods and services,” the unnamed author observes.

The column discusses classical Demand and uses computer software as its example. As computer software gets more expensive, fewer people buy it, the author notes, and as it becomes cheaper, more people buy it. But when the price of a stock goes up, the quantity demanded goes up with it, and the opposite occurs on the way down. This is the converse of the software example and not at all what is taught in college economics classes.

The Buttonwood column, named for the tree under which 24 brokers signed the agreement to form the New York Stock Exchange, concludes, “Surely there are rational investors who can profit from market booms and panics? There are some, but not enough. Such rational beings are simply overwhelmed by the force of the herd.”

Three years ago, Robert Prechter and Wayne Parker introduced the socionomic theory of a “Financial/Economic Dichotomy” in the well-known Journal of Behavioral Finance.¹ Their paper stated that financial markets and the markets for goods and services are impelled by different motivating factors, and they used computer sales as their economic example.

We are delighted to see important socionomic ideas gain exposure in a mainstream publication such as The Economist. However, socionomic theory proposes a different view of precisely why crashes occur. The article reads:

“Financial markets do not operate in the same way as those for other goods and services. When the price of a television set or software package goes up, demand for it generally FALLS. When the price of a financial asset rises, demand generally INCREASES.”

—The Economist, August 12, 2010

The behavior of economic markets is compatible with the Law of Supply and Demand, while the behavior of financial markets is not. In economic markets, demand generally rises as prices FALL and vice versa. In financial markets, demand generally rises as prices RISE and vice versa.”

—Prechter and Parker (2007)

We regularly release new socionomic reports. If you would like us to email you whenever we release a resource, you may request notification here: www.socionomics.net/1009-email-updates
The feedback mechanism … seems pretty clear. A period of rising markets and steady economic growth creates the incentive for investors to speculate with borrowed money. This speculation drives prices even higher, until some shock … causes the boom to implode.

Socionomics points out that the “feedback-until-shock” concept fails to account for why economic growth or shocks would occur in the first place; assumes that the loop cannot collapse under its own weight; in the absence of a satisfactory exogenous shock, requires that a boom go on forever; and does not account for the genesis of a mania at one time versus another or in a particular market versus another.

The Socionomic Theory of Finance (STF) and its associated Elliott wave model of financial price behavior resolve all of these issues: They explain that waves of economic growth and contraction derive from waves of social mood; they describe how markets trend and turn naturally, without exogenous catalysts; they reveal why “exogenous shocks” have no predictive value; and they describe developments that presage manias and crashes. Financial market trends and reversals are unconscious expressions of herding, not the result of rational cogitation. In The Wave Principle of Human Social Behavior (1999), Prechter explained the effect herding has on even a rational investor’s aversion to selling: “Even the person who thinks he should take action experiences a strong psychological pressure to refrain from doing so.” And in the “Financial/Economic Dichotomy,” Prechter and Parker accounted for the revisionist tendencies of post-crash analysis. They said, “respondent-stated reasons for the huge stock market decline appear to be belated rationalization for actions born of panic.” But perhaps most crucially, they explained what causes the moves from rise to fall and back again: “The ceaseless dynamism of waves, fluctuating between optimism and pessimism” causes trends, peaks and nadirs in the markets. “Because price trends continually stop and reverse, there can be no continuously reinforcing feedback loop.”

Prechter and Parker’s paper went far further in challenging economics-based financial models, which assume that markets are rational and operate through the forces of supply and demand. Economics-based models fail to recognize bubbles when they are under way, much less can they predict them. The Elliott wave model, in contrast, has manias and crashes built into its fractal form. Economics-based models also justify institutionalized easy credit and other maniacal behaviors such as the adoption of financial derivatives. In short, classical models exacerbate manias rather than predict and protect against them.

In this limited space we cannot express the full utility of the “Financial/Economic Dichotomy” paper. Last year, the Socionomics Institute made it freely available. In light of The Economist article, we’d like to offer it again. Click here to read it now.

Differentiating Economics and Finance

- Financial and economic markets operate differently.
- In the financial markets, when prices go up, so does demand. It is the opposite in the market for goods and services: when prices go up, demand goes down.
- While supply and demand are behind pricing in economic markets, non-rational herding is behind the price moves in the financial markets.


citations

Dave Allman: Hi, Dr. Casti. Thanks for joining us today.

John Casti: Thanks, Dave.

You were talking about “social behavioral patterns” back in 1989, for example in Paradigms Lost. What a great title!

That book was a collection of about six mini-books, each one addressing a major unsolved problem in modern science. One of the unsolved problems was the “nature-versus-nurture” question. That is, to what degree is human behavior genetically programmed in—as opposed to the dominant influence being the environment in which you live? In its more modern incarnation, it’s usually termed “evolutionary psychology.” The book didn’t come to any definitive conclusions. My objective was to look at these big questions of modern science and the competing paradigms and see who holds which positions and why. Just for fun and to make it easier to read, I structured each of the questions as a kind of jury trial. I presented the prosecution and defense.

“I chose most of my books’ topics not because I was an expert on them, but because I wanted to understand the topics better.”

In Mission to Abisko (1997), another compilation, you touched on something that you do very well—the popularization of science, making it accessible to the masses. Should this be a main goal of socionomists—to explain ideas in a “Popular Science” way?

I guess it depends on your tastes in these matters. As you mentioned, my own tastes are to make things as clear as possible. In fact, I have chosen most of my books’ topics not because I am an expert on them. Instead, I wanted to understand those questions more deeply myself. I thought that one of the best ways I could come to understand them was to try to explain them to somebody else. Almost all the books I have written have that character. With socionomics, I received a lot of feedback on the manuscript from friends and so on. I kept sharpening and sharpening my view of the whole topic. Eventually I was able to convey it with almost an outsider’s inside perspective. It was especially difficult in the case of socionomics because, as you know yourself, you have to ask people to suspend their disbelief about the way the world actually works. And that is a pretty tough requirement.

Especially for people who spent a small fortune to be indoctrinated into traditional economic thought, for example.

Right. I must have given in the order of 100 presentations about socionomics since my first article about it in New Scientist nine years ago. I’ve spoken about it in pretty much every corner of the world. Almost without exception, the reaction is very encouraging and positive. I think that Bob Prechter would probably tell you the same story. But, having people tell you, “Gee, it caused me
to think differently about everything” is not the same thing as people saying, “I changed my mind about this particular belief I once held.” This notion that events cause people to feel a certain way or that events drive social mood is so deeply wired into the human mindset that it’s almost impossible for some people to abandon it. In fact, even though audiences on the whole are encouraging about socionomic observations, I have also had people in the audience who were so bothered and so troubled by the idea that underlies socionomics—that mood is the factor for events, not the other way around—that they were unable to even discuss the matter in a rational way. And these were academics, who are supposed to rely on scientific observation to arrive at their conclusions about the world. Some became angry and stomped out of the lecture room, some slamming the door on the way out.

You can say that a revolution or terrorist attack is more likely to take place when there is a particular social mood. This is why socionomics is very important.

Yeah, I get that at home. Well, at least you know you were heard! So, do you think that there are better sociometers than the markets?

I do not think that we will find any with all of the very useful properties of the financial markets. I do wish that we could measure mood directly with brain probes because it would make life infinitely easier for expositors of socionomics. Then nobody would imagine that Mood Matters is about financial markets. I wish I could have used all the same charts in Mood Matters, but not labeled them as movements of the financial markets. I wish I could have just labeled the vertical axes “social mood” and left it at that.

Iben Browning was a brilliant climatologist who had some very good forecasts and some great insights, but of course the media built up an earthquake forecast he had made that did not materialize. Forever more they referred to Browning as the climatologist who forecast the earthquake that didn’t happen.

There are plenty of examples [like that one]. These days, most of the people who are serious about forecasting do not put themselves in the position to get trapped. Even if you had a 100 percent surefire method of forecasting specific events, which no one does, you would then face bigger challenges. Number one, who do you tell? And number two, how do you get them to take action? These are not scientific questions. These are social, political and psychological issues that reside far outside the laboratory.

I am head of a project at our Institute that has the grand title of Extreme Events in Human Society. The focus of the project is to acquire insight into the likelihood of human-generated extreme events like the financial crises, terrorist attacks, political disturbances, revolutions, and so on. When I first set up this project I said, “We are not going to be in the business of making point-in-time forecasts like, ‘This country is going to have a revolution at this time and such-and-such a party is going to come into power.’” Such forecasts are lunacy; nobody can do that. To even hold out the prospect that you can borders on scientific fraud.

On the other hand, you can shed light on the environment within which events unfold and say that when the environment is in a certain state, it biases the likelihood or unlikelihood of events of a certain type. So for example, you can say that a revolution or terrorist attack is more likely to take place in a period when you have a particular social mood than at other times. This is why socionomics is very important.

Could simulations play a role in studying socionomics? Have such market simulations already been done?

Yes, agent-based simulations—that is the technical term for that sort of modeling—is the ONLY way I see to do experiments of the sort the scientific method asserts are necessary to test hypotheses such as the Central Hypothesis of Socionomics. In fact, this line of investigation is one of the principal threads in the research plan for our project on extreme events here in Vienna. I cover this in Appendix B of Mood Matters.

What do you see as the major challenges for socionomics research?

(1) A lack of understanding of how social mood shifts within a population. Here agent-based simulations are going to be of huge help. And (2) the question of time lags in the two arrows constituting the Central Hypothesis. This time-lag problem is especially critical if you want to use the Elliott

"You can say that a revolution or terrorist attack is more likely to take place when there is a particular social mood. This is why socionomics is very important."
John Casti’s just-published book, *Mood Matters: From Rising Skirt Lengths to the Collapse of World Powers*, continues to bring socionomics to the attention of the academic media. Two of the world’s most prestigious science journals published lengthy reviews of the socionomic hypothesis in their September issues. One write-up was favorable toward Dr. Casti’s book and socionomics, the other less so.

The first review appeared in *Nature*, the world’s most highly cited interdisciplinary journal. In it, David Berreby, a science journalist and author, agrees with Casti that “reason [has been] dethroned as the ruling explanation for people’s conduct” and that “the search is on for another framework in which human behavior can be modeled.” He applauds Prechter and Casti in their search for a new understanding. He correctly cites several key aspects of socionomic theory, including that “financial data are reservoirs of social information that can be tapped to predict crises.”

But Berreby objects that the assignment of “a single mood at a given time to a particular collective, whether that is the population of a city, country or even the world” is untenable, because “each of us belongs to more than one social group, so how can we have one belief about the future?” For the record, Prechter addressed this idea over a decade ago in *The Wave Principle of Human Social Behavior and the New Science of Socionomics* (*HSB*) (1999):

> Smaller aggregations are imbedded within larger ones. People can be members of several aggregations at once … . Together, all the waves (of social mood) of all the aggregations weave the fabric of social life.¹

Berreby further criticizes *Mood Matters* by claiming that its topic, socionomics, appears to be based only on examples and correlation. However, by necessity the book contains a small fraction of the published research supporting the socionomic hypothesis. Critics should consult, at a minimum, the two “General References” that Casti highlights in his book, *Human Social Behavior and the New Science of Socionomics* and *Pi-oneering Studies in Socionomics*, as well as the seminal paper “Financial/Economic Dichotomy” (Journal of Behavioral Finance, 2007), which connects waves of social mood with the human impulse to herd in contexts of uncertainty.

In his review for *Science*, which has the largest paid circulation of any peer-reviewed, general science journal in the world, University of Oregon physics professor Richard Taylor is unabashedly positive. He writes that socionomics “presents an effective argument for why the financial market serves as the optimal choice of

---

Wave model to project the social mood meter into the future.

What about the practical application of socionomics? Could a socionomic-led research firm say to major corporations such as fashion consultants or the auto industry—people who lay out half a million dollars for a 15-second spot during the Super Bowl—“Here’s the ad you want to run because this is where people are going to be heading”? It’s the whole “Should you be selling muscle cars or hybrids? Barbie dolls or Troll dolls?”

I think that is completely doable. In fact, the project I am heading in our Institute in Vienna has a consortium of companies and government agencies. They want us to give them some insight into, for example, how things are likely to unfold in the economic and business arenas over the next 20 years.

---

**TWO POPULAR SCIENCE MAGAZINES REVIEW THE SOCIONOMIC HYPOTHESIS**

by Chuck Thompson

---

Turning Heads: Casti’s tome is a far-reaching introduction to socionomics.

We regularly release new socionomic reports. If you would like us to email you whenever we release a resource, you may request notification here: [www.socionomics.net/1009-email-updates](http://www.socionomics.net/1009-email-updates)
The Socionomist—October 8, 2010

sociometer.” He also
lauds socionomists’
“meticulous detec-
tive work of the time
times involved in major
events,” which reveal
the “tell-tale manifesta-
tions of socionomics.”
Regarding socionomi-
cics’ assertion that mood
drives events and not the
inverse, Taylor lists key
elements of historic events that failed to affect the fi-
nancial markets. He goes on to write, “This unexpected
insensitivity to world events addresses a historic puzzle:
why the financial market traces out recognizable pat-
terns as a function of time?” He asks, rhetorically, that
if we believe the conventional wisdom that the “market
is driven by irregular and diverse events, why would
these cumulate in a distinct pattern?”

Taylor commends Casti for wisely declaring early
on that his book is deliberately one-sided. This is as
it should be, “because [Casti’s] purpose is to trigger a
reaction against the established beliefs of the financial
world,” Taylor writes. He concludes that by
publicizing the relationship between events and
social mood, Mood Mat-
ters “reveals the extent
to which the latter deter-
mines our future.”

[Virtually every major
tory encounters three
phases on the road to
adoptions. Reviews like
those in Science and
Nature are an indica-
tion that socionomics is moving beyond phase one—being
ignore. Next is phase two—being debated. Eventu-
ally, in its third and final phase, we trust that the
theory will be accepted as self-evident.]

CITATIONS
1Prechter, R. (1999). The wave principle of human
social behavior and the new science of socionomics.

FROM THE FIELD: SOCIONOMICS AT WORK

Mass Arrests in Turkey’s Ergenekon Case

[Ed.: This month’s From the Field submission is a letter from subscriber Cenk Sener of Turkey. In 2001, reports
say, evidence emerged of an upcoming Turkish coup d’etat attempt. The newly elected government took little action
regarding the plot for over half a decade. Then in 2007 it suddenly launched a massive investigation and began
making arrests. Many in Turkey and elsewhere believe the plot to be an invention or an exaggeration by the Turkish
government and an excuse to jail dissidents.

[The Socionomist welcomes quality contributions. For submission guidelines, please email Ben Hall at
institute@socionomics.net. We work with contributors to edit accepted submissions for clarity and length.]

To The Editor,

I’m Cenk Sener, a Turkish expat living in Ukraine, a
dedicated Elliottician and a subscriber to The Sociono-
mist for some time. First, I want to state that I enjoyed
Alan Hall’s recent article about authoritarianism in the
April and May issues. It sparked an idea that I want to
share with you.

First, some history: Since 2002, a party with Islamic
roots has been in full power in Turkey for the first time in
the republic’s history. This
dramatic shift is explained
using the socionomic ap-

Cenk Sener

social behavior and the new science of socionomics.
native party was given the chance. The new party, only six months old at election time, won a landslide victory. Then as mood and markets rose, the new incumbent party was re-elected in July 2007 by an even bigger landslide than before.

But as mood began to diverge heading into the 2007 peak, the ruling party became intolerant of criticism. The summer of 2007 was actually a transition period from election victory to increasing criticism and rising polarization inside the nation. [Ed.: This is reminiscent of Nixon and Republicans’ experience up to and after the 1972 landslide victory in the United States.]

Hall’s article about authoritarianism mentioned two things that I observe in Turkey. First, there is now an increase in blocking the information flow. A wide internet ban has been implemented; even YouTube is forbidden. Also there is pressure on the media to support the ruling party.

There has also been an increase in court battles, which brings me to my main observation. The most famous lawsuit centers on an alleged coup d'état plotted by a group called Ergenekon. The government first heard about the plot during the positive mood of the early 2000s. Then it officially launched its investigation into the plot in 2007. Many people think the investigation to be an invention or exaggeration by the ruling party to silence opposition. The government suit accuses a wide spectrum of citizens, including soldiers, academics, opposition party leaders, journalists, writers and more.

"The mass Ergenekon arrests picked up dramatically with the start of the bear market, and once it ended, so did the arrests."

Habeas corpus has been suspended, and most of the accused are being held in prison during the trial without any charges. In fact, no one knows for sure whether the group called Ergenekon really exists.

After reading Hall’s paper, I wondered how the government’s mass arrests in this particular case compared to social mood as reflected in the Turkish stock market. I searched the Internet to find the dates of

We regularly release new socionomic reports. If you would like us to email you whenever we release a resource, you may request notification here: www.socionomics.net/1009-email-updates
the biggest mass Ergenekon arrests (10 or more people) and marked them on the weekly chart of the ISE National 100 Index, which I have included in Figure 1.

These arrests follow the social barometer quite nicely. First, there were no arrests for almost the entire big bull market. Then near the peak of the mood, during a correction within a 5th wave of a multi-decade rise, which itself had a big divergence in the RSI to show waning optimism, the Ergenekon mass arrests began. The arrests picked up dramatically with the start of the bear market. Once the 17-month bear phase ended, so did the mass arrests. Only two occurred after the bull market started up again, and one of those was at the very beginning of the bull market, just after the bottom, while mood was still very negative.

Now with the possible return of the bear and the start of wave C down, Ergenekon arrests have started again, though not yet with the numbers we had before.

My forecast is that if social mood declines again as I project, the frequency and size of the mass Ergenekon arrests will increase again. Further, elections are scheduled for Turkey next year. If the social mood declines as I predict above, the current ruling party will lose. Of course, if before the election the regime transforms into either an open dictatorship or one with a democracy mask—like in Iran—then by the end of the big bear market, the regime will have to build many new prisons.

With my best regards and friendly greetings,

Cenk

Cenk Sener received his B.S. degree in electronics and telecom engineering from the Istanbul Technical University. He is currently working as the technical director of the Ukraine branch office of a German IT company.

---

**Manifestations of a Declining Mood: September 2010**

### Increasing Authoritarianism in the Land of the Free

Our April and May issues of *The Socionomist* forecast increased expressions of authoritarianism in concert with declining social mood. We noted that some of those expressions would be initiated as societies attempt to deal with their fear of terrorism—even in the absence of terrorism itself.

In the past several weeks, in fact, we have noted three significant new expressions in the United States:

1. **Secret GPS Installations Upheld**

   On August 25, *Time* Magazine reported on a recent ruling by the U.S. Court of Appeals that applies to California and eight other Western states. With no need for a search warrant or to inform vehicle owners, “Government agents can sneak onto your property in the middle of the night, put a GPS device on the bottom of your car and keep track of everywhere you go,” the magazine reported.

   One dissenting judge wrote, “1984 may have come a bit later than predicted, but it’s here at last.”

2. **Mobile Airport-Style X-Ray Machines See Inside Cars**

   In his May study on authoritarianism, Alan Hall warned:

   [Image: Batten Down the Hatches: Left, a graph courtesy The New York Times shows that the number of agents on the northern border has ballooned more than four-fold this decade (data courtesy Customs and Border Protection); right, a half-page ad, USA Today, Sept. 1, 2010.]
A single successful U.S. car bomb or improvised explosive device (IED) would expand airport-like security measures to a far broader landscape. The Department of Defense is already preparing for this eventuality.

Our forecast is coming to pass even despite the absence of such an attack. According to Forbes magazine on August 24, a Massachusetts company has sold U.S. and foreign government agencies:

… more than 500 backscatter X-ray scanners mounted in vans that can be driven past neighboring vehicles to see their contents … . Law enforcement agencies have also deployed the vans to search for vehicle-based bombs in the U.S.

The executive director of the Electronic Privacy Information Center calls the surveillance vans “one of the most intrusive technologies conceivable.”

3. Document Checks Well Inside the Northern Border

Fearful, xenophobic societies do their best to secure their perimeters—often at the expense of freedoms formerly held dear. On August 30, The New York Times reported a dramatic increase in U.S. Border Patrol transportation checks miles inside the United States’ northern border. The article describes increasing surveillance on a Chicago-to-New York City train—even though that train never crosses into Canada:

Armed Border Patrol agents routinely board the train, question passengers about their citizenship and take away noncitizens who cannot produce satisfactory immigration papers.

A University of Rochester international services director “whose foreign students, scholars and parents have been questioned and jailed” says, “It’s turned into a police state on the northern border … . It’s essentially become an internal document check.”

Socionomics saw this coming long ago. A list of prescient forecasts in the October 2003 Elliott Wave Theorist included these items:

“The U.S. will increase restrictions on immigration … . The U.S. will require internal travel papers.”

National Geographic’s Border Wars television series chronicles U.S. surveillance and control efforts along the U.S. Mexico border. Critics say the series sensationalizes the immigration problem and that advertisements “all work to invoke fear and reinforce stereotypes associated with immigrants.” It is a resonant message in America today; the premiere episode scored the highest ratings in the history of the channel. Only a few years ago the National Geographic Channel kept its focus squarely on the Earth’s beauty and the diversity of its cultures. What a shift in values has been wrought by the long-term change in trend for social mood.