Issue 201
28 February 2001
In its 17th year

Fullermoney

Global Strategy and Investment Trends by David Fuller www.stockcube.com

Historic evidence that interest rate cuts will lift stock markets by yearend 2001 is impressive.

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The Chart Seminar 2001 will be held in London (twice) and Zurich. Value added to our Point & Figure services.

Interest rate cuts versus the recession risk

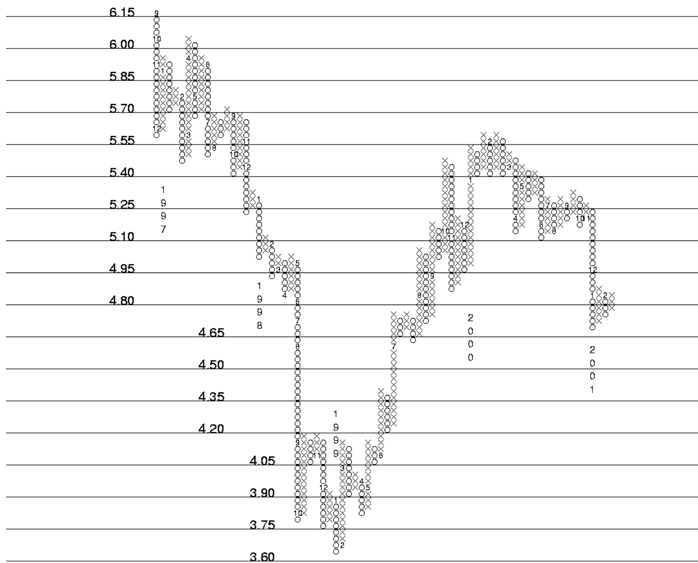
It's been a tough time for sacred cows - No, this is not another BSE or foot-and-mouth story; I'm talking about the stock market. Two of the most popular sacred cows for equity investors, fattened by nearly two decades of above average performance, at least in North American and European markets, have been "Buy and hold", and "Buy the dips". Unfortunately for the unwary, both have gone belly up over the last year. Does the same fate await one of my two favourite investment maxims - "Don't fight the Fed"? Many think so, following the latest swoon by stock markets, which has done some technical damage. Biting the hand that feeds them, they blame Greenspan for stoking a NASDAQ bubble and then deflating it with higher interest rates from late 1999 through May 2000. Is this irrational criticism? As for the Fed's rate cuts in January, these have received flop reviews in stock markets over the last month. When charts wilt I don't dismiss bearish arguments lightly, as you will see in this issue. However at trying times like these, I often defer to the historic record. The message on rate cuts is clear - if they don't support most stock market indices this year then the global economy, not just the US, is in one heck of a mess! The 19 interest rate cycles from 1914 to 1998 produced an average gain of 22.6% for the DJIA after 12 months*. Moreover, the Dow fell on only two occasions - 1929 and in 1932 during The Great Depression. The NASDAQ certainly formed an enormous bubble up to March 2000 but the excesses were confined to TMT stocks, so unlike some analysts, I think comparisons with 1929 or Japan in the late 1980s are an exaggeration, to put it mildly. Meanwhile, short-term oversold conditions are evident for most stock markets, as mentioned in FMP138 (23rd February) and strong rallies are required to establish new support levels. What is my other favourite maxim? "Buy-low-sell-high", of course and I'm adding another - "I never met a financial crisis that I did not like". These are interesting times and if bearish news drives many stocks lower in the next few months, which has to be a possibility, this will create superb opportunities for equity investors. Meanwhile, I remain cautious and have looked elsewhere for profits - from bonds to pork bellies and of course my old favourite, dollar/yen. **See table on page 3.*

Interest Rates and Bonds

■ **Further rate cuts are inevitable, despite higher PPI and CPI data, and they will not be limited to the US.**

■ **Quality long-dated government bonds yields have edged higher on inflation concerns and switching to high-rated corporate debt but could test their January lows as global GDP growth continues to slow.**

Euro-bund 10 Year Bond Yield (0.03)



UK Gilts (Mar LIFFE) (Daily)

Greenspan has his eye on consumer spending. Of course the Fed Chairman watches many economic indicators but his immediate concern is consumer confidence. If this continues to weaken it would have a knock on effect throughout the economy, with international consequences. January's higher than expected PPI and CPI inflation data was due primarily to energy costs, notably natural gas prices, which have subsequently weakened. There are other inflationary pressures but these concerns are outweighed by the risk of global recession if monetary policy is not sufficiently stimulative during the current slowdown. I would not be surprised to see Greenspan lop another 50 basis points off the Federal Funds Rate, taking it to 5%, before the next FOMC meeting on 20th March. The Bank of England's Monetary Policy Committee and the European Central Bank are also likely to reduce rates in coming weeks. I believe the ECB has fallen behind the curve because it underestimates the economic risks and is also concerned about the euro's recent weakness.

US 10-year Treasury bond yields are ranging above their September 1998 to February 1999 base - *not illustrated* - The sharp decline from November 2000 to early-January 2001 fulfilled most of the downside potential and yields encountered support from the upper region of their former trough. Judging from the chart it would not be surprising to see further ranging near current levels, during which the January lows are likely to be tested. Similarly, 10-year Euro-bund yields are ranging following a smaller overall decline than their US equivalent. The overhanging top formation should limit rally scope during this phase and eventually push the Euro-bund yield somewhat lower.

Strategy for bonds - From an investment perspective I continue to favour FM200's strategy, which was to move conservative funds into shorter maturities, from 3-year instruments to bills, subject to your risk profile. Quality-rated corporate bonds remain a more speculative alternative, and new subscribers should refer to colleague Mark Glowrey's suggestions in last month's issue. As for high-yield bonds, I maintain it is too early in the cycle as we are likely to see some rescheduling, from Turkey's pre-devaluation borrowing to marginal telecoms. In futures trading, I have taken my first loss for many months on an expiring long position in March UK gilts, repurchased too soon during the reaction from January's high. However I rolled this position into the June contract, in anticipation of firmer prices as junk bond problems arise.

Global Stock Markets

- **The outlook for corporate profits continues to weigh on stocks but historical evidence following rate cuts is impressive.**

- **Japanese equities are cheap on some measures but a surge in money supply growth and a weaker yen are required to lift the Nikkei significantly.**

Stock markets sag as company results fall short of expectations. Corporate profits inevitably determine share performance over the long term. However since it is extremely difficult to predict company results a year or more ahead, given all the variables, markets are often volatile in response to sudden changes in sentiment. In recent weeks, concerns over global growth and earnings have weighed heavily on most share indices. As they slide, the ranks of bearish pundits invariably increase and some predict a deep recession following the burst NASDAQ bubble. Many analysts legitimately question the quality of reported earnings, which are often inflated by accounting sleight of hand. If the more bearish assessments are correct it will take more than rate cuts to stem the downtrends for share prices. However, previous interest rate cycles suggest a more bullish outlook, as we can see from the data below, from an interesting report by Otto Waser of PBS (Private Bank Switzerland), Zurich, info@pbsbank.ch, drawn to my attention by astute friend and subscriber Iain Little, MD of P&C, Zurich, iain.little@pandc.ch.

The evidence supporting "Don't fight the Fed" is compelling. With the exceptions of 1929's crash and the Great Depression, it paid to buy DJIA stocks, which provided 12-month returns from 6.4% (1960) to 83.8% (1914). The Dow closed at 10646.15 on 2nd January 2001, the day

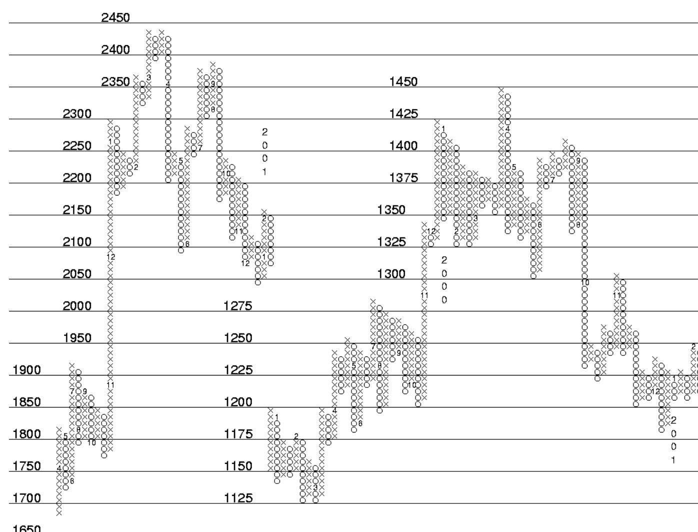
before Greenspan made his first rate cut of the year. If it matched the average return of 22.6%, we could expect 13052.18 around yearend. Even a repeat of 1960's 6.4% gain, taking the DJIA to 11327.50, would be a reassuring prospect for most investors, given recent market jitters. Instead, if the Dow and other US indices all register declines for the year, this would almost certainly be due to a deep recession. Should that happen, there would be no safe haven in Europe or elsewhere, given the historic correlation of stock indices in other countries to the US. Analysts who expect a down year, despite rate cuts by the Fed, cite various reasons from the NASDAQ bubble, which some equate to 1929 and the Nikkei's peak in 1980, to corporate debt, notably although not exclusively among telecoms. Bearish forecasters also cite valuations, which were historically high prior to Greenspan's cuts, with the DJIA near its all-time best rather than after a significant decline. These arguments cannot be dismissed lightly, at least not while charts for most stock market indices remain weak. There is even some concern over stagflation, following higher PPI and CPI data for the US economy in January. If cost pressures continue to rise, central banks would be less willing to lower short-term rates. I suspect inflationary pressures (partly due to energy costs) will subside, enabling further rate cuts to revive the US economy. If so, 2001 should be an up year for most stock markets. However I would like to see some bullish evidence from the charts of major indices, which look at least temporarily oversold but need sharp rebounds to offset recent technical damage.

Japan's Nikkei Stock Average is testing its October 1998 low at 12787.9. If that goes, the lowest levels for Japanese equities since 1986 will produce a few headlines. Are they at bargain levels? Peter Bennett, savvy subscriber, chart reading-economist, portfolio manager and friend thinks so, peter.bennett@jmfinn.com. He likes Japanese equities on a value basis, particularly price to cash flow. Peter says forget multiples because Japanese companies hide profits to avoid high corporate taxes, unlike in the US where accounting tricks are used to inflate earnings. I agree that Japanese stocks have fallen to interesting levels. Unfortunately, that will not be enough, with the money supply edging up to only 2.4% when it should be at least ten percentage points higher given Japan's ongoing and destructive deflation. Moreover the yen needs to be much lower. In fairness to Peter, he is taking a 5-year view on Japanese stocks, although he would not be surprised if the rewards come much earlier. I think he is right, because I expect Hayami to be carried out of the BoJ on his shield.

Chart review of topical and representative stock market indices - The point & figure charts shown are based on closing prices and taken from our website. Anyone interested in this chart service, which is updated daily, should register online at www.fullermarkets.com. Price levels mentioned below refer to market closes.

The Fullermarkets World Market Indicator (2000) has reversed January's short-term buy signal and reaffirmed the overall downtrend. A move back above 2100 is required

FWMI (10pt) and MSCIWI (5USD)



Dow Jones Performance Following Initial Rate Cuts By the US Federal Reserve

Year	Rate*	3 Months	12 Months
1914	5.0	10.6	83.8
1921	6.5	- 14.2	16.4
1924	4.0	10.9	31.5
1929	5.0	4.2	- 28.3
1932	3.0	- 40.2	- 40.0
1933	3.0	79.2	76.3
1954	1.8	8.2	39.3
1957	3.0	0.7	29.2
1960	3.5	- 7.0	6.4
1970	5.8	17.2	6.7
1971	4.8	12.7	24.0
1974	7.8	33.8	42.1
1975	6.3	6.0	28.2
1980	12.0	10.6	17.3
1981	13.0	- 1.7	17.9
1984	8.5	6.5	21.7
1990	6.5	11.5	10.7
1996	5.0	3.2	26.3
1998	4.8	12.5	20.7
2001	6.0		
Average		**8.7**	**22.6**

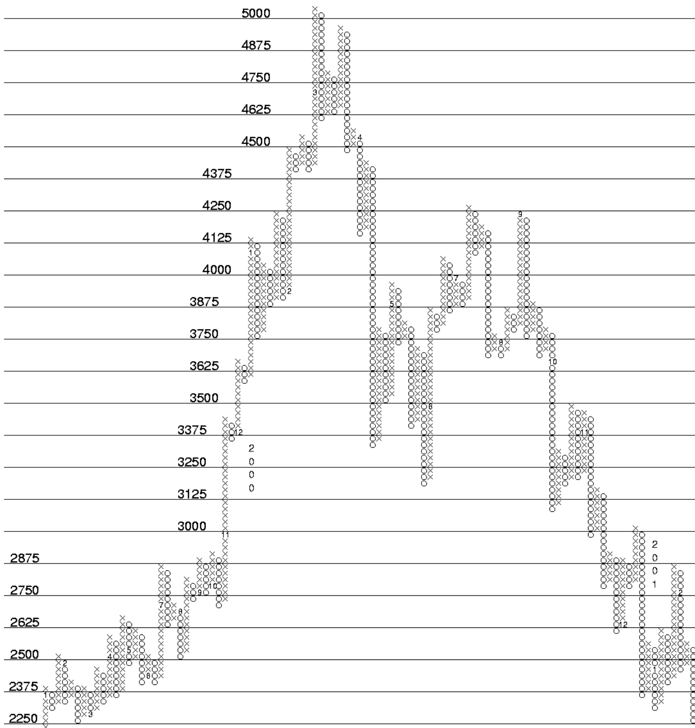
*Discount Rate, rounded to nearest decimal point.

to suggest a loss of downward momentum beyond a brief recovery. *The FMWI is unweighted and calculated in local currencies.*

The Morgan Stanley Capital International Indicator (1130) not only failed to maintain January's rally but has also fallen sharply to test the February-March 1999 lows. While this latest decline looks somewhat oversold, a strong rebound is now required to question the overall downtrend. *The MSCII is capitalisation weighted and calculated in US dollars.*

The US NASDAQ Composite Index (2286) - *see overleaf* - extended its downtrend but this has shown a loss of

NASDAQ Composite Index (25pt)

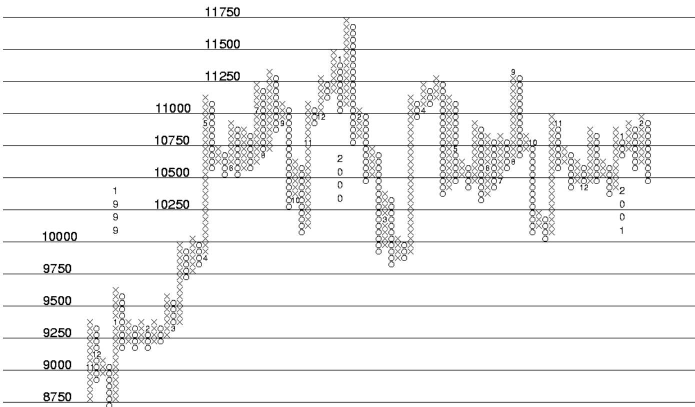


consistency in recent weeks, due to January's somewhat larger rally, a push well into the previous range and a wider pattern centred on 2500. Inconsistencies following a persistent downtrend often signal that a bottoming out process has commenced. However a rally back above 2625 is necessary to support this hypothesis. **The Dow Jones Industrial Average** (10442) could not close above 11000, which would have taken out range highs dating back to October. A move above this level is necessary to remove pressure from underlying trading.

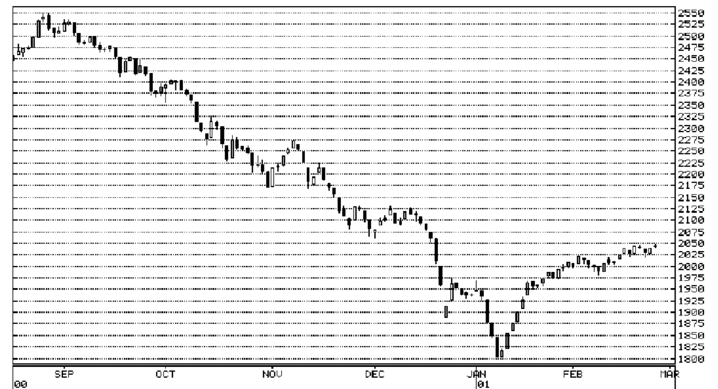
Japan's Nikkei 225 Stock Average (13201) continues to test its important 1998/99 trough. A close at 14100 remains necessary to demonstrate support here and break the 5-month progression of lower or equal rally highs. **The Topix 2nd Section Index** (2028) has broken its downtrend and staged the best rally for many months. Interestingly, this index led in 1999, albeit from a considerably lower level.

France's CAC 40 Index (5417) has extended its orderly decline following September 2000's failed upward break and has now taken out the January low of that year. While the latest fall looks somewhat overextended, a move to 5700 is needed to test overhead supply and 6000 to end the progression of lower rally highs.

Dow Jones Industrial Average (50pt)

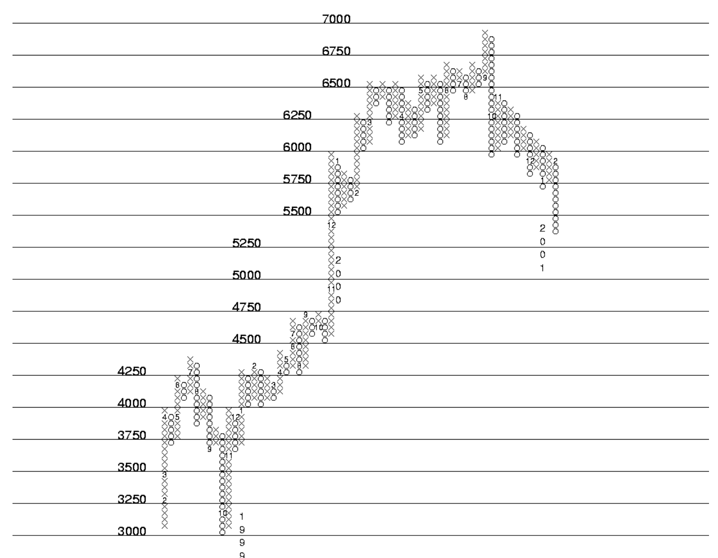


Tokyo Topix SE 2nd Section Index (Daily)



Nikkei 225 Stock Average Index (100pt)

France CAC 40 Index (50pt)



Germany's DAX Index (6195) has been ranging lower since the March 2000 peak and is now testing the important July 1988 high. A move to 6550 is needed to question the downtrend which would be broken at 6800.

Switzerland's SMI Index (7654), although showing relative strength, has fallen back from its July 1998 and August 2000 peaks. A rally to 8200 is needed to offset some further test of underlying trading.

The UK's FTSE 100 Index (5939) had also shown global relative strength, by moving sideways, but is now pressuring the lower side of its long trading band. A rally to 6350 is required to reaffirm prior support here and break the last high.

Strategy for stock markets - I'm looking for a short-term technical rally in response to recent oversold conditions. However, beyond a bounce, I don't feel sufficiently confident to issue share recommendations at this time. For readers primarily in equities and who invest globally, I suggest allocation should be based on your view of the US economy. If you expect either a soft landing or V-shaped recovery, I would be overweight in Asia and the US. Conversely, if you expect a more prolonged economic decline, I would have a very defensive portfolio of UK, European and US stocks, favouring companies with low multiples and high, covered dividends. I haven't done much futures trading, concentrating on other markets, which I have found less challenging recently. My NASDAQ long, purchased in December, was stopped out at a loss on 26th January, exceeding a profit on the OMX long expiring that same day, which I bought following Greenspan's initial rate cut. I may do a little buying but only for a bounce from the recent oversold condition. Currently, I hold only the Nikkei, purchased lightly over the previous three months as the 1998/99 lows were tested. I'm showing a small loss on the expiring March contract and will probably roll this position into June.

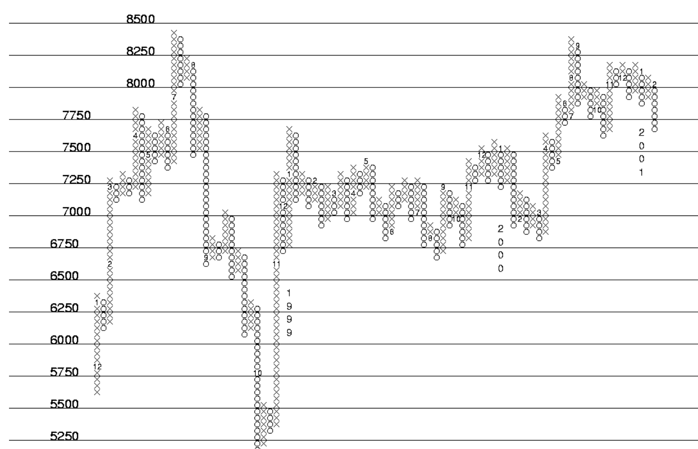
Currencies

■ **Risks for the US dollar as the premier reserve currency have been exaggerated.**

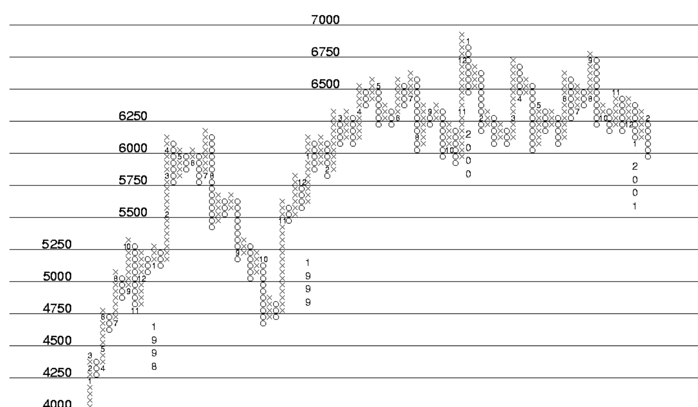
■ **Charts suggest a broad trading range for the US dollar versus the euro but renewed strength against the yen in coming weeks.**

The consensus view is usually a contrary indicator. Remember all those bearish stories surrounding the dollar when the US was still resolving last year's presidential election? It was fashionable to talk about a possible dollar collapse due to a combination of factors from the weak NASDAQ, to a hard economic landing and the current account deficit. There was even a suspicion in some quarters that George W Bush's Administration would be either less effective and/or less committed to a strong currency. Really? Pinch me but wasn't multilateral intervention required to rescue the euro only last September? Arguably, the US economic slowdown engineered by Alan Greenspan and the NASDAQ decline have had very little effect on the dollar, which I maintain is experiencing a normal medium-term pause within its secular bull market against European currencies. Commencing in 1995, this long-term advance is underpinned by relative economic strength, which has favoured the greenback until very recently and should do so again, possibly before yearend now that Greenspan is lowering rates. The current account figure is wildly misleading because US multinational

Switzerland Swiss Market Index (50pt)

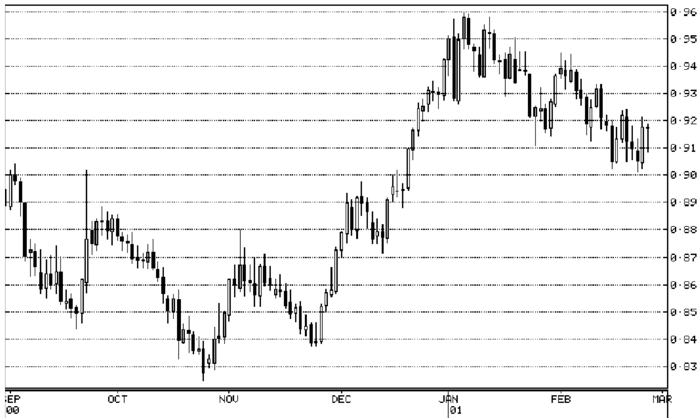


United Kingdom FTSE 100 Share Index (50pt)

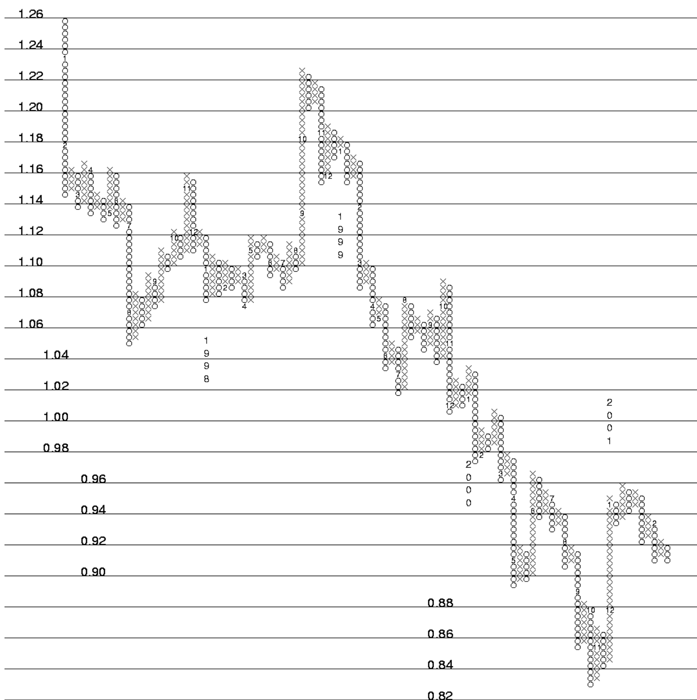


Germany DAX Index (50pt)

Euro / US Dollar (Daily)



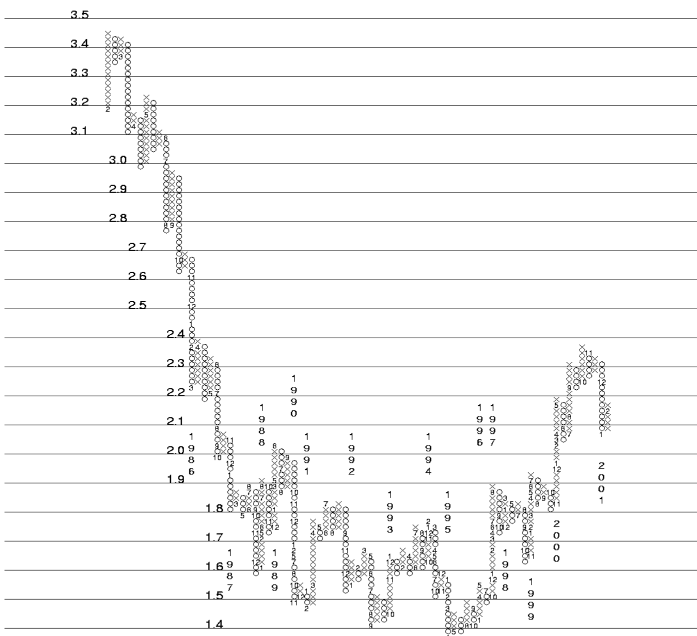
US Dollar per 1 Euro (0.004)



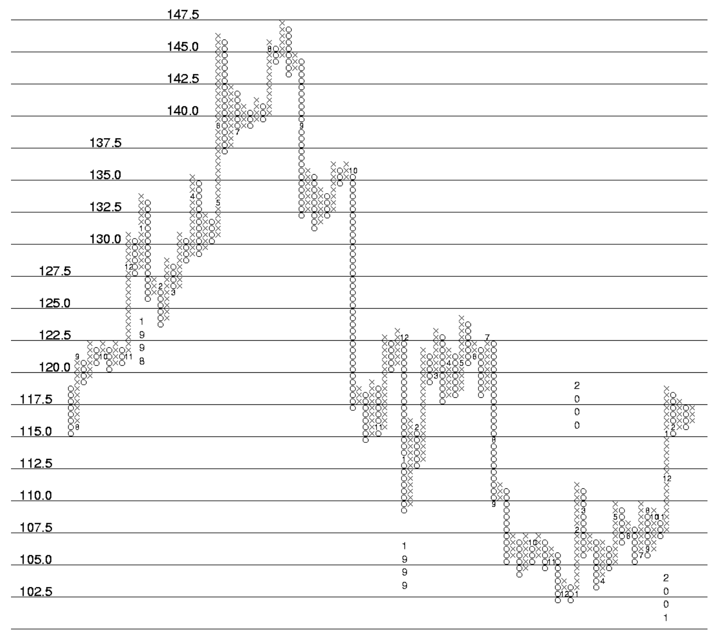
companies at least partially own much of what the US imports, oil excepted, and most of what America sells to other countries is produced outside the US. As for President Bush, far from appearing out of his depth, he has fielded a highly experienced team in record time and received bipartisan plaudits for the tone of his Administration. Treasury Secretary Paul O'Neill has been unequivocal in his preference for a strong US dollar. For the greenback to collapse, as many pundits have long predicted (hoped?) US multinationals in addition to citizens of other countries would have to abandon it. This requires a better reason than we have heard so far. Just as importantly, what are their alternatives? Would anyone want to hold yen while Japan's interest rates are rock bottom low and the economy still in a slump? As for the euro, are there not more questions than answers regarding the long-term future of this romantic experiment? The dollar won't always be strong and it is ranging at present but the long-term trend is up.

Look at the long-term charts for perspective. Even though sentiment has swung against the euro recently, many people believe that its primary trend against the US dollar is now upwards. I maintain that the greenback has only paused for a year or so within its long-term bull market. For chart evidence I offer historic p&f data against the mark (DM0.02 scale). Note first the dollar's 10-year bear market from February 1985 until April 1995. That decline had become quite choppy from 1987 onwards, which is a type-3 (of 3) base characteristic as taught at The Chart Seminar. Veteran subscribers will recall this chart and its base formation characteristics that I have been discussing since late 1995. To me, the ranging pattern from 1987 through late 1999 looks like a huge base, capable of supporting a lengthy recovery by the dollar. However such a move would inevitably be punctuated by several medium-term corrections. Now look at the p&f chart of the euro against the dollar ($0.004 scale), remembering that we are look at the euro in dollars while the first chart showed the

German Mark per 1 US Dollar (0.02)



Japanese Yen per 1 US Dollar (0.5)

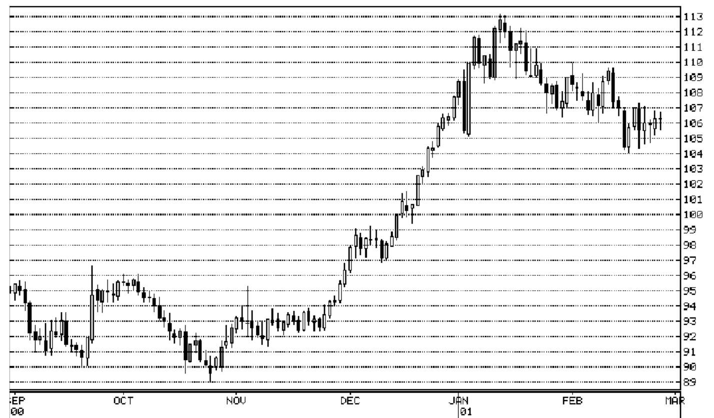


dollar in marks. Readers will recall that sentiment lurched from *eurorevulsion* during September through November to *europhoria* at yearend 2000. Now people are talking the single currency lower, suggesting that it is becoming oversold. On charts we can see that following last year's climactic acceleration against the dollar, into the upper region of my long stated target range of $0.83 to $0.79, the euro traded sideways for a few weeks before rallying persistently to record its best gains since the January 1990 launch. A move of this magnitude is often followed by a lengthy, ranging pull back, forming the V-bottom with right-hand extension base as taught at TCS. The extent and duration of this pullback can vary widely, with deeper extensions usually resulting in longer pauses before the recovery continues. There may be some psychological support near $0.90 and looking at the p&f chart, the euro would re-enter its trough at $0.88, which should cushion downward scope. The daily candlestick chart would provide initial evidence of a change in consistency. Since the down days are generally larger, an upward dynamic is required to question the ranging downward bias. Given sentiment and chart action, I suspect the euro has completed most of its retracement from January's high near $0.96. Overall, I expect the euro to weaken a bit further against the dollar before firming to test chart and psychological resistance in the $0.96 to $1.01 region. I anticipate many months of ranging activity, mostly in the mid to lower $0.90s region, before the euro eventually falls to new lows. In other words, the dollar resumes its long-term advance against the European currencies.

The yen tends to steady when the euro weakens and vice versa. I have long maintained that a steadier euro would increase pressure on the yen, which few people outside of Japan will want to hold if they can choose between two stable reserve currencies which offer much higher yields. Meanwhile the market's hate/love relationship with the euro continues and Japan's maverick central bank governor, Masaru Hayami, has done his best to talk the yen up, to the consternation of the Finance Ministry. Judging from the charts, Hayami will be no more effective than the ECB when it first tried to check the euro's slide. Looking first at the euro/yen p&f graph, two things stand out: the extent to which the yen fell (including ecu data for the pre-1999 period) and the explosive rally which broke its 2-year downtrend. These gains are now being consolidated and chart support begins at ¥102.5. I suspect any move under ¥100 by the euro, should it occur, would be short lived and its medium to longer-term upside potential against the yen is likely to be considerable. As for dollar/yen, the large underlying base suggests that the current pause to consolidate gains will not be lengthy. Note the difference between this pattern and the aborted base in 1999, characterised by a failed push above ¥123. I would expect any easing beneath ¥115 to be short lived. A rally over ¥118 will indicate that the reaction low has been seen.

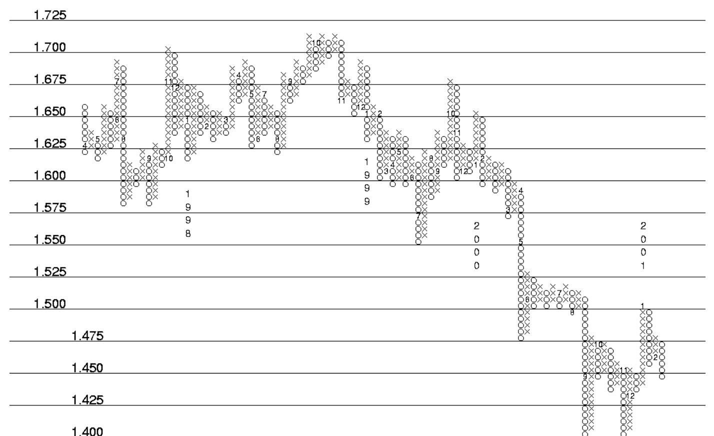
Sterling is currently rangebound against the US dollar. Good support for the pound was encountered near $1.40 in September and November but psychological resistance near $1.50 rebuffed the recovery. I would not be surprised

Euro / Japanese Yen (Daily)



US Dollar / Japanese Yen (Daily)

US Dollar per 1 Pound Sterling (0.005)



Australian Dollar / US Dollar (Daily)

to see sterling extend this 10¢ range for a number of months. While a close over $1.50 would indicate some further recovery, the chart is dominated by overhead supply suggesting that the pound will eventually head lower.

The Australian dollar should encounter at least temporary support near its November low and the psychological US$0.50 level against the greenback - *see previous page* - Overhead supply continues to reverse the A$'s yearend rally. However traders will be reluctant to sell aggressively on the first look at previous support. Watch for an eventual upward dynamic, similar to the key day reversal on 22nd November, to signal rally scope.

Strategy for currencies - My big trend-running position remains long dollar/yen, protected with a loose in-the-money stop relative to my average entry point. I increased this stake by 30%, first during the January reaction and again on a retest of the early-February low. I also raised my stop slightly after the bounce from 6th February's low near ¥114.36, which broke the short-term downtrend but I'm still giving this trade breathing room. There is a risk that I could be stopped out if there is a deeper consolidation, in which case I will be annoyed at giving back so much profit. I'll feel safer if the early-Feb low holds and the dollar can maintain a move back above 118. Looking ahead, I intend to manage this position in the event of further strength. Using my Baby Steps buy-low-sell-high tactic, I hope to harvest volatility within the overall uptrend, lightening gradually on further strength and replacing longs on minor reactions. Meanwhile, the interest rate differential is like a deposit account. I nibbled at euro/yen in early Feb and protected it with a breakeven stop after the small bounce. That was soon hit and I re-entered near ¥107, purchasing a little sterling/yen as well. The short-term trend for these two is against me at the moment but I'm not too concerned, suspecting that the reaction is mostly over. These last two purchases are short-term trades in what have proved to be the more volatile forex crosses, relative to dollar/yen, and if they bounce I'll either take the profit or use breakeven stops, subject to market strength. While there are other opportunities in the currency markets and the firm comments on these in its Daily Market Analysis for spot currencies and also currency futures, I continue to concentrate entirely on trades against the yen.

Commodities

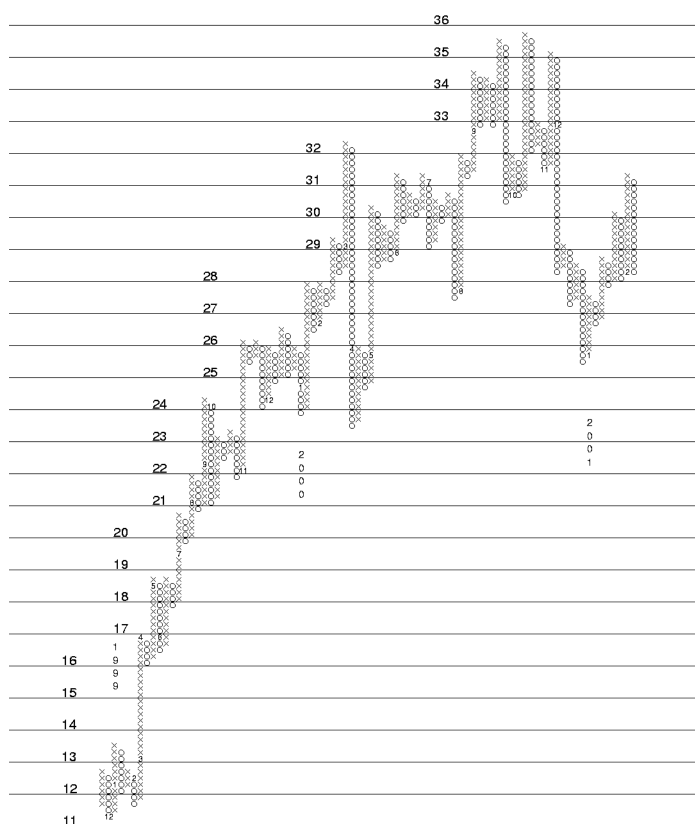
- **Is OPEC slowly losing control of the oil market?**

- **Grain and soybean prices remain historically cheap; demand is increasing and any weather threat to this year's crops could lift prices substantially.**

- **Pork bellies have extended their recovery but weaker demand continues to weigh on most metals.**

Supply cuts by OPEC are less effective at these levels. When OPEC slashed oil production in late-1998 and early-1999, they had the whip hand. Demand was rising in line with global growth and cheap energy prices meant that non-OPEC producers had little incentive to develop any but low-cost sources of supply. Also, UN sanctions on Iraq were curtailing oil exports from Saddam's pariah regime. Two years later everything has changed. Demand is falling in line with slower global GDP growth, partially due to the Cartel's earlier success in lifting petroleum prices. The non-OPEC oil industry has been revitalised by high prices and production is rising. Developmental programmes underway will increase energy supplies for many years. Iraq is a major producer once again. As petroleum prices slipped last month, OPEC countered with a 1.5 million barrel a day reduction but this has only had a limited effect. They will almost certainly announce another production cut of at least 500,000 barrels in the next few weeks. In theory, OPEC could go on cutting for some time but it won't because market forces are now working against it. Once the Cartel states sense

Crude Oil NYME 2nd Month Continuation (0.2USD)



Natural Gas (Mar NYME) (Daily)

their loss of control, many will pump more oil than official quotas stipulate. We have been here before. These cycles take time to complete so energy-import costs could remain uncomfortably high for several more months, particularly among developing countries, which usually have weaker currencies than the US dollar. Nevertheless the long-term trend for petroleum prices is likely to be downward, at least until global growth is stronger and higher-cost production becomes uneconomic. Meanwhile, technology continues to reduce some production costs, notably for oil sands. See also The Global Economy section.

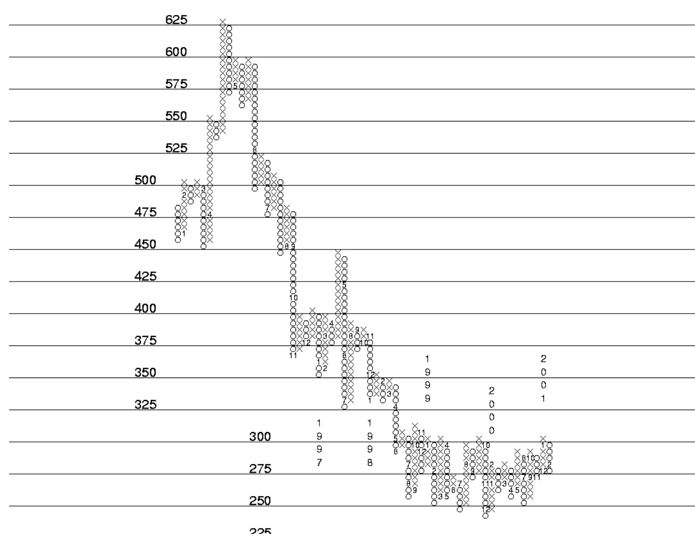
Grain and bean complex prices have been depressed by surpluses. Higher yielding and disease-resistant strains, more effective fertilisers and reasonably stable weather in key agricultural regions have contributed to a global surplus of coarse grains and soybeans. The US dollar's strength last year also weighed on prices. In recent weeks analysts have raised estimates for South American crops, which are approaching harvest. There has been concern over loss of demand due to BSE fears, which could lower beef consumption. Soybeans have fallen most on forecasts that high prices for natural gas - a key component for some fertilisers - would encourage US farmers to switch from planting corn to soybeans as the latter crop requires fewer chemical nutrients. Not surprisingly, current expectations for US grain and bean prices are very low, as we can see from the charts. Traders, who are clearly short, have discounted most possibilities except for higher demand and weather-related crop disruptions. Both are distinctly possible. The ban on meat and bone meal feed will restore confidence among people who like beef, and livestock farmers will have to fatten their herds on grain and bean meal supplements. Weather - always the most critical variable for agricultural commodities - is obviously a wildcard but few meteorologists would argue that patterns of precipitation are becoming more stable. Unexpectedly, heat may be damaging Argentina's corn crop while heavy rain is delaying Brazil's harvest of what was expected to be record crop. Any threat to the US summer crop cycle, for which the planting season is approaching, should trigger at least a short covering rally. Charts for corn and wheat show base formation development, while the recent decline in soybeans looks overstretched.

Pork bellies are rallying on expectations of increasing demand. Fast-food chains are enticing humanoid carnivores with more crispy bacon, which comes from pork bellies. Fearing a stampede away from beef burgers due to the BSE scare, drive-in restaurants hope that people will eat rashers for breakfast, bacon and chicken sandwiches for lunch and pork in its various forms for dinner. You could say, with apologies to that old stock market adage - Bulls make money; bears make money, but pigs get eaten. I don't know if bellies prices will live up to that tongue-in-cheek porky retort…'and pigs can fly'…but we have another chart breakout. I'm looking for a test of last year's top area in the 81¢ to 97¢ region.

Gold retests its lows - *not illustrated* - Investors continue to shun the yellow metal and this is unlikely to change significantly until inflation is a serious concern. That could happen later in this decade, subject to how much money the Bank of Japan and US Federal Reserve print in response to economic problems. I believe a massive Japanese reflation is inevitable. Meanwhile, gold bullion is testing its 1999 low at $251.95, an interesting level because it sprang the last big short covering rally. Gold is not expensive by historic measures but a clear upward dynamic is currently required to prevent it from become

Soybeans (May CBT) (Daily)

Wheat CBT 2nd Month Continuation (5USc)



Pork Bellies (May CME) (Daily)

Coffee (May CSCE) (Daily)

even cheaper. Silver had a sharp rally in mid-January, only to fall back even faster and is approaching its 1997 low near $4.20. The big advance in platinum and particularly palladium appears to be over. This was due primarily to a dearth of supplies from Russia. However, historically high prices for any commodity inevitably encourages lower consumption, substitution, increased production and the recycling of scrap, as we are now seeing.

Nickel has been a barometer of global GDP in recent years - *not illustrated* - It plunged during the Asian crisis, rebounded strongly in 1999, topped out in the second quarter of 2000 and has been ranging lower subsequently. Some further test of the 1993 and 1998 troughs appears likely.

Strategy on commodities - I've dabbled in commodities for 30 years and currently find myself more active in these markets than for a very long time. Shades of the early 1970s? I hope not, because of the inflation that followed, although I should remember how to play that scenario. So far the main parallel is historically low prices, so I'm concentrating on buying bombed out markets in anticipation of rebounds. These are occurring more frequently in the agricultural sector. The strategy has been sound but I haven't always followed my exit strategy in using the Baby Steps tactic as taught at The Chart Seminar. I think this was due to personal distractions, which is not an excuse, but part of life. Ideally, in markets that are historically cheap, I buy only after weakness, preferably in an overstretched downtrend that is beginning to lose momentum. I do this incrementally and I'm not worried about stops during the accumulation stage in markets that are near historic lows, partly because I trade well within my risk capital allocated for this exercise. If/when the commodity starts to rebound, I can either lighten a little on the Baby Steps basis or place a breakeven stop, which gives me a free ride. I should move that stop upwards on further strength and lighten positions near previous resistance levels. Occasionally these positions take off and run on unexpected news developments but usually they range in base development before eventually heading higher, in which case I should revert to a trend-running strategy. Currently, my worst position is in soybeans, where I rolled the expiring March (CBT) contract into May at a loss, a little in excess of an earlier profit in the January contract. The total current position is not large and I will probably average down since beans look increasingly oversold and are at their lowest level since the important 1994/95 trough. I intend to lighten in the event of a rebound. In March wheat (CBT), I gave back most of the profit by not selling following a rally to previous resistance - a tactical error as my just in-the-money stop was hit on the subsequent retracement. I could buy back at a lower price in the May contract but am holding off (ditto corn) to concentrate on soybeans which is usually the more volatile contract. I also erred in not placing an in-the-money stop after the rally in March coffee (CSCE). The rally was retraced and I took a medium-sized loss on rolling into May, which has been mostly recouped following the recent downside failure. I now have an in-the-money stop and will probably lighten somewhat on further strength in what looks like a developing base prior to the Brazilian crop season. I took a good profit on the expiring March pork bellies (CBT) long and rolled into the May contract, which extended the rally so I have been raising an in-the-money stop. I'm interested in cotton (CTN) as an eventual purchase, as it has now broken the 1999-2000 lows, returning to levels not seen since 1987. I'm hoping cotton falls further prior to the US crop season.

The Global Economy

■ **The US economy will remain extremely competitive, with the help of Greenspan's timely rate cuts and we should see evidence of improvement from mid-2001.**

■ **Euroland's economic performance is slowing and will not outperform the US beyond the short term. The UK may do better because of fiscal spending prior to the General Election.**

■ **Japan needs a much more decisive monetary stimulus to revive its economy.**

■ **The latest round of OPEC supply cuts will prolong the oil crisis.**

Interestingly, the US has become the focal point for collective concerns. Is this because it was the engine for global GDP growth in recent years? I believe so. With a sharp slowdown underway in the States, anxiety levels have risen everywhere. Moreover it has become fashionable, at least in Europe, to trash the US's previous success. We are told that much of the heralded productivity and earnings gains were accounting tricks. Many predict an economic crunch in the US due to debt and a further NASDAQ collapse. We even hear that Greenspan is part of the problem rather than the solution! I suspect behaviourists among you will detect strands of masochism, envy and hubris in these US-bashing comments. This does not mean that the stories are entirely rubbish. Over the last few years I have often mentioned the dangers of leverage when the US economy weakened. I have also criticised creative accounting to boost earnings. Needless to say, these are not exclusively US problems, although I'm told

Europe's corporate management is generally more virtuous. Corporate debt, heralded by some business schools as smart use of other people's money, is a global problem as bond markets have been telling us for some time. While lower short-term rates are a partial solution, I will be amazed if this economic slowdown does not produce some high profile corporate defaults. Developing country debt could also be a trouble spot, aggravated by the high cost of energy due to the OPEC cartel's production cuts. I am much less concerned about personal debt, since this is mostly the result of mortgages and can actually spur people to work harder and earn more.

While endeavouring not to underestimate the US's economic problems, I try to view them in perspective. Over the last decade the US has achieved more economically than other countries, so it has the financial, technological and psychological reserves to rebound quickly from a slowdown. Yes, the country has often been prone to excesses and nothing 'exceeds like excess'. Therefore the technology bubble is more of a problem for the States because that is where most of the new economy growth occurred. Should the NASDAQ Index halve again, as many predict, consumer confidence could collapse. While theoretically possible given the propensity of markets to overshoot in both directions, I believe this is unlikely now that Greenspan has moved decisively and will obviously cut rates as required. President Bush's tax cuts can only boost corporate and consumer sentiment, even though they will be phased in over several years. In the event of a lengthy recession, US company debt would obviously be a major problem. However I suspect the American economy will prove to be more resilient than many expect, because of the monetary and fiscal stimulus, plus a can-do culture. As for government finances, the US remains in an enviable position. Lastly, the current account deficit is largely a meaningless statistic because the US produces a great deal of what it imports, energy aside, and most of what it sells to other countries is sourced outside the States. While economic data over the next few months may cause additional concern, I expect to see clear evidence of improvement from mid-2001.

Are those bullish GDP growth forecasts from the ECB and Euroland finance ministers just whistling in the dark? I believe so. They are hoping to 'talk the economy up' during a global slowdown. This won't do any harm but it probably won't help much either. Euroland's bureaucrats get mixed reviews at best from seasoned observers of the economic scene. After years of stagnation due to Socialist, egalitarian policies, the region's economies were finally jumpstarted by a weak euro. Charitable observers cite some helpful deregulation and a less onerous tax burden. Yes, those are steps in the right direction but Europe's efforts to become more competitive always resemble the commuter running to catch a train that has just left the station, as I have said before. In the global economy it is those countries with the least meddlesome regulations and most competitive tax regimes that are likely to do best over the longer term. Consequently, it is still harder or more expensive to launch, staff and run a business in Europe than most other developed countries. In other words, it is more difficult to make money in Europe, whether as an entrepreneur or young person joining the job market. There may be tradeoffs in terms of welfare and quality of life but claims that Europe will now outgrow the US over the next few years remain delusional or hubristic.

The euro's rebound, triggered by multilateral intervention, is desirable globally but of little short-term benefit within the region because it makes exports less competitive. Euroland's spokesmen see a defensive advantage because only 13% of exports go to the US. This overlooks critical behavioural factors. Euroland does not live in a metaphorical goldfish bowl. Its citizens observe the US's sharp slowdown and immediately become more cautious. Consequently business and consumer confidence across the region is slowing. Most economic data is weaker than consensus forecasts. The decline in unemployment has slowed and remains unacceptably high at over 8%. The number of people out of work in Germany actually rose in January to 9.3%. Euroland's economic cycle has been less volatile than the US, largely because it did not experience similarly strong growth in the mid to late 1990s. Remember, Greenspan raised rates in 1999-2000 to prevent the economy from overheating. The ECB raised rates not because of economic strength but to check inflationary pressures exacerbated by the euro's weakness. Inflation is a diminishing threat today, despite high oil and gas prices, and I think the ECB has fallen behind the curve of events by not lowering rates to cushion Euroland's economy. Ironically, Europe's bureaucrats are criticising Ireland - the region's best performing economy - for lowering taxes and increasing fiscal spending! Euroland is a romantic experiment; some would say a grand folly, in which there are plenty of highly paid officials vying for power but with little democratic accountability. The ECB will always be less secure and more of a political football than if it represented a European federation, for which there is limited public support. As for the euro's role, some people say it will boost growth when no longer a virtual currency, because the public will welcome greater regional transparency due to a single currency. I suspect the benefits of transparency have already accrued. I expect some

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anxiety and public dissatisfaction before and after the January 2002 changeover from national money to euro paper and coinage. This would not help GDP growth.

Conditions for an economic recovery in Japan are not in place. Embattled Bank of Japan chief Masaru Hayami had quite a week prior to the G-7 meeting in Sicily on 17th & 18th February. Hayami, who has long regarded the yen as a virility symbol, was doing his best to stem the currency's decline. "The yen's value, which has tripled since 30 years ago, is good because it suggests that other countries appreciate our currency highly", Hayami said. "A stronger yen is in our nation's interest." Remember, this is the guy who published a book in 1995 - *The Day the Yen Gained Respect* - shortly after its deflationary spiral-inducing surge to ¥80 to the US dollar. Unfortunately for Japan, the economic recovery long forecast by Hayami has yet to appear, partly due to the yen's overvaluation, which is way out of line with comparative GDP performances over the last decade. Meanwhile, Japan's money supply (M2+CDs) has edged up to only a meagre 2.4% - much too low to fuel growth. This is obvious to every student of economics but Hayami continues to insist that he has done enough. Traditionally, policy battles occur behind closed doors in consensus-seeking Japan. However the criticism of Hayami is becoming more frequent and outspoken. Consider the remarks of Makoto Utsumi, a former vice finance minister, speaking just before the recent G-7 meeting:

"The debate in which politicians, economists and even the Finance Ministry are asking for further quantitative easing, with the BoJ being stiff and not responding - that's extremely sterile. The BoJ should know how to boost the money supply. The most important thing is that the BoJ, instead of shutting the door to the outside, should use more of its own wisdom. The most problematic situation would be the BoJ going into its own cave as outsiders grow too loud, which I think is the case right now."

This is an extraordinary statement by Japanese standards. Unfortunately for Japan, Hayami may have to be carried out on his shield before monetary policy becomes sufficiently accommodative for the economy to fulfil its recovery potential. Currently, the BoJ buys about ¥400 billion ($3.5bn) of government bonds from investors, without repurchase agreements, each month. While offering some cushion, this has been insufficient to reverse Japan's economic decline. Hayami also cut the largely symbolic discount rate 15 basis points to 0.35% on 9th February but this will have no appreciable affect because it is still higher than the key interbank rate, which he raised to 0.25% last year because "the recovery was established". Meanwhile, Japan's runaway budget deficit can only increase while the economy remains weak. This is on course to reach crisis proportions and there are only three ways out - large tax increases, significant cuts in public spending or a large monetary reflation, which would weaken the yen. The first two are unconscionable because they would plunge Japan into a depression. Consequently the BoJ has no sensible choice but to inflate. Japan's economic problems can only worsen while Hayami prevaricates.

OPEC has dealt another blow to global GDP growth but the effect will be temporary. In January, OPEC announced cutbacks of 1.5 million barrels a day. Cartel members are already talking about another reduction of 500,000 barrels if prices slip. These measures will boost incomes for oil exporting countries, many of which also have a political agenda given the Israeli/Palestinian impasse. Since most countries import oil, a further period of high prices can only exacerbate the global economic slowdown. Negative consequences of expensive petroleum products will be greatest among developing countries, which have fewer financial resources, are less efficient users of energy and generally have weaker currencies. However as with most cartels, OPEC will be unable to control prices beyond the medium term. Demand is already declining. Much more significantly, higher prices have revitalised the global oil industry, which has embarked on a new round of exploration and development of both old and new fields, using the latest technology. This will enable them to re-tap oil-producing regions previously thought to be depleted for commercial purposes. Petroleum companies will develop sites further offshore. Vast reserves of oil that were not worth developing when crude was at 10 to 15 dollars a barrel - from Alberta's tar sands to oil shale - are coming into production. The industrialised world now has a much greater incentive to accelerate development programmes for fuel-efficiency and alternative energy sources. Finally, when OPEC finds that it can no longer control the market through supply cuts, member states will increase production in a falling market.

And Finally…

The Chart Seminar 2001 - My two-day seminar on chart reading using Behavioural Technical Analysis will be held at Le Meridien Waldorf hotel in Aldwych on 10th & 11th May and 29th & 30th November. TCS is also returning to the Zurich Marriott on 12th & 13th July. For a brochure and enrolment form, email sarahhewett@fullermarkets.com.

Value added Point & Figure services for stock - My colleagues have been enhancing our venerable point & figure chart services with comprehensive Weekly Reports, highlighting important developments for indices, sector breadth and sector highlights. Share coverage includes 'Most Persistent Uptrends: distance from potential support' and 'Base Formations: distance to top of base'. If you would like to know more about these p&f services, please email research@fullermarkets.com.

The target date for FM201 is Friday 23rd March.

"There are three ingredients in the good life; learning, earning and yearning."

Christopher Morley

Best regards - David Fuller

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