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**In its 17th year**

# Fullermoney

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

## Japan's economic crisis has increased global risks but continues to create interesting opportunities for investors and speculators.



## As the BoJ reflates, Japan's Government commences a support operation for the Nikkei

**Never underestimate the desperate determination of a cornered, wounded animal -** Have you heard the latest news on Japan's beleaguered banks, relayed by my analyst colleague Will Chawner? Following last week's news that Origami Bank had folded, we hear that Sumo Bank has gone belly up and Bonsai Bank plans to cut back some of its branches. Karaoke Bank is up for sale and is (you guessed it!) going for a song. Meanwhile, shares in Kamikaze Bank have nose-dived and 500 back-office staff at Karate Bank got the chop. Analysts report that there is something fishy going on at Sushi Bank and staff there fear they may get a raw deal. Unfortunately for Japan, the facts are worse than farce. Some observers regard this as divine retribution for the nation that inflicted Karaoke on a tuneless world. Perhaps, but when I see all that s*** I think there must be a pony in there somewhere. Actually, there are three thoroughbred ponies for adventurous investors/speculators. The first is our old friend the yen, which a number of readers shorted months ago. This has metamorphosed from a deposit account into an extremely profitable trend. Facing the abyss, BoJ Governor Hayami has capitulated (well, sort of) and embarked on a "quantitative easing". In other words, he is printing money in an effort to stem Japan's destructive deflation. Pity the forests because to succeed this will require one heck of a lot of paper. Hayami's quid pro quo (or should I say yen pro quo) is that Prime Minister Mori and the other bozos on their way out have to stop all the stealing and pork, which has created Japan's runaway budget deficit. Most Japanese politicians make light-fingered Bill and Hilary look like Mother Teresa! As for pony number two, a large wad of Hayami's newly printed mini-yen will be channelled into the Japanese stock market. The Government is desperate to reverse the Nikkei's slide because Japanese banks, which hold a considerable portion of their reserves in shares, are now under water in terms of capital adequacy requirements. Some observers will say it won't work, that governments have no business dealing in markets and should concentrate on the underlying problems. I disagree because the two are not mutually exclusive. Many Japanese companies have been restructuring but the immediate problem is a crisis of confidence resembling a maelstrom. The Nikkei was falling because of capitulation selling while others were afraid to buy. However the bearish psychology will reverse if Japan's Government convinces investors that it is committed to support buying in order to lift the stock market. The third pony will be an opportunity to short JGBs, where yields are approaching record lows but will rise sharply when Japan's economy eventually recovers and the BoJ's reflation turn deflation into inflation. Charts will show us when the timing is right - *see also "The Triple Play" on pages 11 & 12.*

**Imitating Mir -** Elsewhere, stock markets have been doing their best to preview the Mir space station's final descent. Some of the declines look climactic but aside from a position in the Nikkei I'm sitting this out, preferring Euro-bund futures until I see evidence that the US stock market has bottomed. Meanwhile, British Telecommunications' woes typify one of the problems - see "Debt is a four-letter word" in the Global Stock Market section commencing on page 4. The "Don't fight the Fed" club - I'm a member - will not be reassured by stock market performances during the first quarter of 2001. However the yearend 2001 tally will be more revealing and Greenspan could shave another 200 basis points off the Federal Funds Rate from its current level of 5%, if needed to boost the US economy.

## Interest Rates and Bonds

- **Japan's savers pile into JGBs, creating another bubble.**

- **A second wind for quality long-dated government bonds, due to stock market jitters.**

- **Short-term interest rates will fall.**

**For many Japanese investors it must feel as if, "Life is cruel and then you die".** The world's most prodigious savers have had a rough time. The biggest stock market bubble in history burst in 1990 and has been followed by a bear market of record duration. Simultaneously, house prices in Japan became so expensive that families desperate to jump onto the property ladder were signing ten-generation mortgages! Property values are still falling today. Reeling from these disasters, Japanese investors pushed money offshore in search of higher-yielding and safer returns, only to panic and repatriate capital at huge losses when the yen soared in response to the Bank of Japan's restrictive monetary policies. Still seeking safety, the public piled into the government-run postal savings system or stashed cash under the mattress, metaphorically speaking. In Japan, home safes outsell refrigerators. Fearing for their future, Japanese citizens have the highest savings rate in the world at 30% of earnings. Unfortunately, the post office just cut the rate it offers on savings accounts to 0.11%. Consequently the public is switching in droves to so-called Chukoku funds, which hold medium-term government debt and pay a fixed rate, currently 0.51% per annum. Private investors parked ¥5.4 trillion ($46.7 billion) in these funds last year, double the amount from 1999, according to the Investment Trusts Association. Japan remains a rich country, despite earlier losses in stocks, property and overseas investments liquidated after adverse currency moves. BoJ Governor Masaru Hayami estimates that ¥1,380 trillion ($11.8 trillion) is "sitting in households". This would include approximately ¥252 trillion ($2.1 trillion) remaining in postal savings, equal to almost a third of Japan's government debt. The country's more adventurous private and corporate investors have been piling into 10-year government bonds (JGBs). They have been rewarded as yields have fallen 40 basis points this year, providing a gain of 4.3%, including interest, in under three months. JGBs now yield 1.150%, the lowest level since 1998 when they briefly spiked to 0.750%. If more savings are channelled into Japan's 'only game in town' yields can fall even lower because the economy remains in a deflationary spiral. However this can only be a bubble in the making, which will burst as Japan's economy eventually recovers. Meanwhile, Japan's ballooning government debt has reached third-world proportions at 130% of GDP. Pressure on the BoJ to reflate out of this mess is intensifying. As it prints money the yen will fall further, with Japan's deflation ultimately replaced by at least mild inflation. A more competitive currency and surge in money supply will eventually put a sustainable floor under the Nikkei, which would then discount an improved economic performance. This will encourage consumer spending by Japanese households, which will feed through to corporations. As Japan finally sustains a significant GDP recovery, interest rates will inevitably rise, driving JGB yields considerably higher. They could easily reach 3.5%, a level not seen since the early 1990s. Where might the Japanese invest when they next experience inflation? It could be gold.

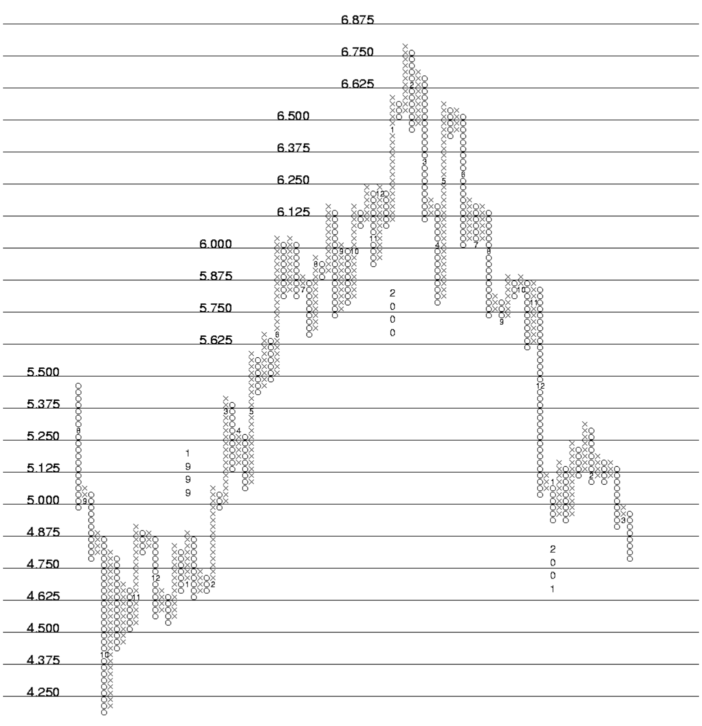
**Meanwhile, the decline in JGB yields has steepened.** This is an ending characteristic, although there is no evidence that a floor is at hand. Therefore a further test of the 1998 trough down to 0.750% is likely. For yields to decline beneath this level, Japanese investors will have to fear accelerating deflation. Meanwhile, we can only guess when and where JGBs will eventually bottom. Looking at the p&f chart, I would not be surprised to see the psychological 1% level exceeded and new record low yields are possible.

The bottom will be evidenced by one or more of the following - a downside failure, a rally that exceeds 4 units of scale on the 0.025 three-box reversal chart shown and a higher high. The people who are buying and/or holding JGBs today, which includes capitalisation-weighted international bond funds, stand to lose a lot of money if they do not spot the turn. Astute traders, who wait for the turn and then short JGBs, should make a bundle.

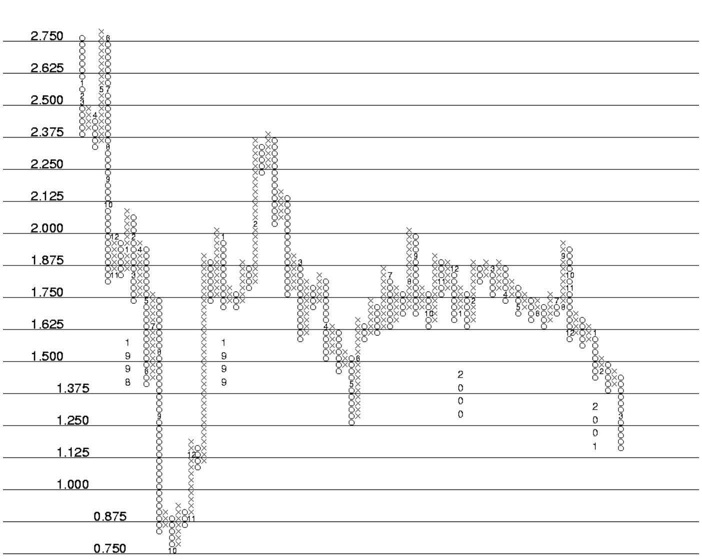
**North American, European and Antipodean long-dated government bond yields are breaking their early January lows.** We are witnessing the flight to quality as investors switch from riskier corporate bonds and stocks. This window of opportunity has been profitable but might not remain open very long. Of the three possible economic scripts discussed today - brief economic slowdown, stagflation and deflationary recession - the first two are bearish for 10-year government bonds. Therefore we should watch the charts closely for timing. Australian bond yields have fallen persistently but are likely to find at least temporary support near the December 1998 low at 4.75%. US 10-year yields eased beneath lateral trading from the upper-side of their September 1998 to February 1999 base and need a move to 5% to question a further test of this trough down to 4.175%. UK 10-year gilt yields have broken under their January low and also require 5% to remove pressure from the January 1999 trough down to 4.16. Swiss bonds would have to break the sequence of lower rally highs, currently requiring 3.54%, to question their downward bias. The equivalent level for Euro-bunds is 4.86%. Swiss and Euro-bunds could have the better downside scope, judging from their smaller retracement to date of the 1999 to early-2000 yield rally.

**The ECB is behind the curve and Euroland's growth will suffer.** A combination of hubris, 'whistling in the dark' and inflation fears has kept the European Central Bank from cutting rates. However it is unrealistic to expect Euroland's economy to remain largely unaffected when the US juggernaut has slowed to a crawl and the Japanese economic crisis worsens. In addition to experiencing an export slowdown, Europe's business leaders and consumers are looking at the US and Japan and becoming more cautious, knowing that some of those problems could occur at home. Germany - the world's third largest economy and accounting for approximately a third of Euroland's GDP, remains the regional soft spot. Higher import prices following the euro's earlier slide and its recent

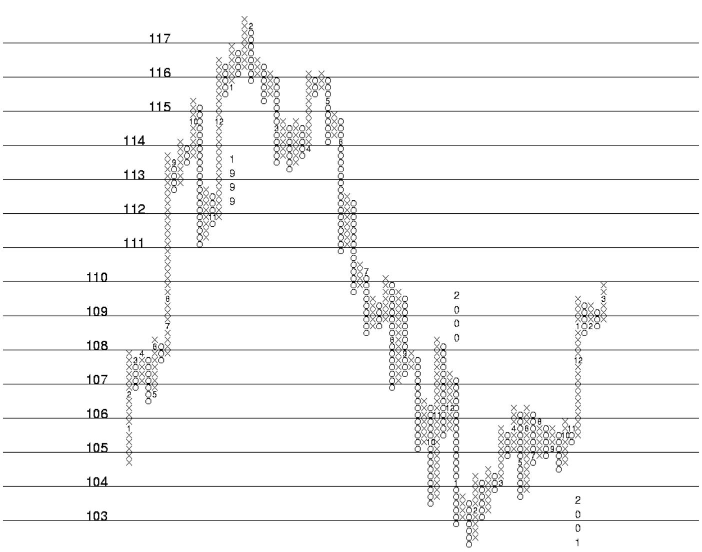
**US 10 Year Bond Yield (0.025)**




**Japanese 10 Year Bond Yield (0.025)**




**Euro Bund Futures EUREX 1st Month Continuation Close (0.2)**



dip back under $0.90 have also influenced the ECB. Ironically, suspicion that the ECB's delay on rate cuts will cause Euroland's economy to weaken as the US recovers is now weighing on the euro, adding to short-term inflationary problems. This reactive central bank is squandering what little credibility it has because everyone else knows the European economies will not resist the global tide of ebbing growth. The Bank of England's Monetary Policy Committee was looking in the rear view mirror when it demurred on another rate cut. The foot-and-mouth disease crisis will weaken the economy by devastating farmers, causing a slump in the tourist industry and generally damaging morale. In the US, Greenspan will have to surprise the markets with unexpected, or unexpectedly large, rate cuts to check the negative wealth effect caused by a weak stock market.

**Mark Glowrey's update on corporate bonds -** Short-term interest rates and Treasury bond yields continue to fall as investors seek security in cash and government debt. 3 month LIBOR now stands at 4.88% and 10-year Treasuries maintain their uptrend to reduce yields to 4.79%. Accordingly, other credits have weakened. The 10-year US swap spread (see chart), which we follow as proxy for high quality non-governmental credit spreads, has found support at 80 basis points over the 10 year Treasury Bond and resumes its longer-term uptrend from the late '96 lows to stand at T+96bp. Looking at Corporate bonds, spreads are widening in Tech, Telecom, Auto and Investment Banking paper. Telecom debt continues to suffer from both continuing supply and increasingly risk adverse investors. In January's edition of Fullermoney, we focused on the British Telecom 8 5/8% Dec 2030, then trading at 107.5 and yielding 7.96%. The bond has since given back 3.6 points of its post-issuance gain to now yield 8.27%. This is against the background of a firmer US long bond, rallying from 5.55% to 5.28% over the same period, increasing the bond's spread over governments by 49 basis points to the current T +299 basis points. Other Telecom company paper is also suffering, further weakened by negative outlooks from the major credit agencies. Recent 10-year bond issues from Deutsche Telekom, KPN and Telefonica are currently trading in T+ 209 to T+350bp range. Further down the credit curve, Tech stocks issues are weaker against a background of deteriorating credit quality. Current yields for the issues we looked at in FM200 are as follows: Lucent 2029 (BBB3) 9.66%, Apple 2004 (BB) 7.74% and Level 3 2008 (B) 15.8%. On a lighter note, we would like to welcome our local metropolitan district, the Royal Borough of Kensington and Chelsea to the Triple-A club. Although small in size, our pleasant and well-administered local government has managed to beat Japan, Italy and Belgium on the credit rating front. Not bad for a population of 180,000! Well done the Royal Borough! *(Yes, Mark, it's because they have increased my council tax by nearly 12% this year.)*

**Strategy for bonds -** From a conservative investment perspective, I'm maintaining FM200's strategy, which favours shorter maturities, from 3-year government instruments to bills. Quality longer-dated issues should remain firm while the global stock market sell off continues, due to a flight to quality. However I would be reducing exposure during this rally and/or protecting remaining positions with tight trailing stops to minimise the risk of profit erosion when equities rebound. I would avoid JGBs even though they are still performing on the charts. Those who have to hold them are running enormous risks if unprotected by tight stops. I would also avoid capitalisation-weighted government bond funds, or use stops, because Japanese government debt now leads the world at 27.3%! There are opportunities in corporate bonds, discussed by colleague Mark Glowrey above, and yields have pushed higher during the stock market sell off, which has fanned concerns about corporate debt. I would enter the corporate bond market cautiously as there may be some high-profile bankruptcies or defaults, which would temporarily weigh on better quality issues. In futures trading, the surge by UK gilts quickly turned last month's trading loss when rolling from March into the June contract, into a good profit, which I booked a little too soon. I have traded gilts actively because of the frequent ranging and now have buy orders under the market if the price eases during the next stock market rally. This strategy may be too conservative as the foot-and-mouth tragedy could deflate the UK economy more than people currently expect. Meanwhile, I bought Bund futures in mid-March because they have lagged recently, due to the ECB's concern over inflation. I think this risk is overstated and the charts indicate further short-term potential for Bunds.

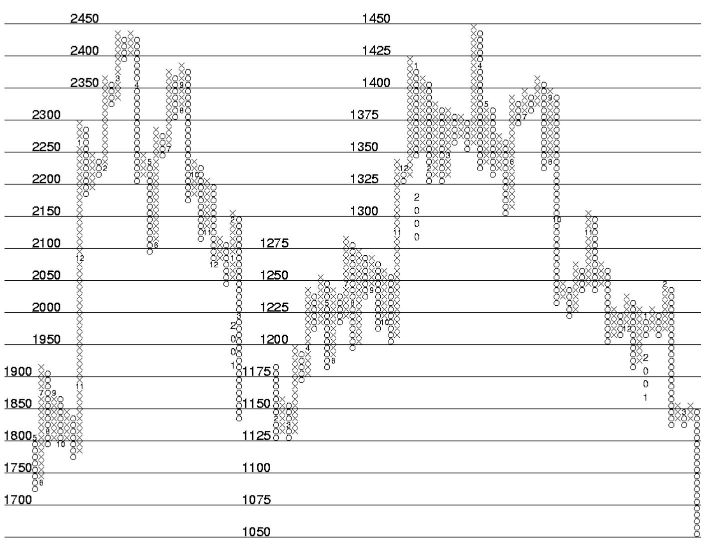
## Global Stock Markets

**■ So far, corporate debt problems and falling profits have outweighed rate cuts and "Don't fight the Fed" sentiment.**

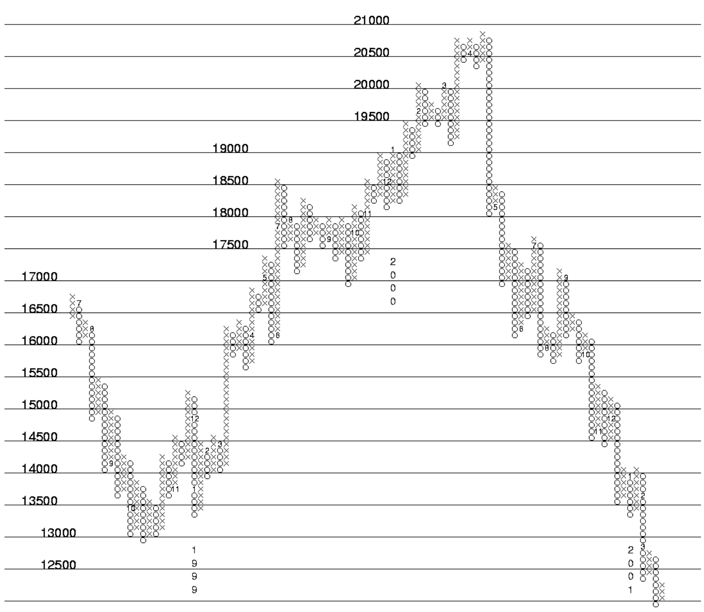
**Debt is a four-letter word.** British Telecommunications typifies what worries me most about stock markets. Fifteen months ago BT was flying high at 1520p. Instead of using an inflated share price as an opportunity to raise cash through rights issues (secondary offerings), as they would have in earlier cycles, BT's option-incentivised management followed the popular late-1990s corporate trend, leveraging its balance sheet with debt for an acquisition binge. This once conservative company eagerly boosted its once modest debt to £30bn! Meanwhile, BT's purchases have been falling in value in line with the burst TMT bubble. Operating margins continue to be squeezed by intense competition and now the global economic slowdown. The firm is caught between the proverbial rock and a hard place. Moody's is about to lower BT's credit rating, currently A2, by a notch or two, which won't help plans to reduce debt by £10bn. A rating of BBB would raise interest payments on nearly £13.8bn of recently issued bonds. BT's management has said it will not destroy shareholder value by selling assets below their true worth for the sake of a credit rating. Reassuring words but how does the company get out of its bind? A big rally by the share price would do nicely but few investors will hold their breath while waiting for this to happen. Corporate shareholders - an unforgiving lot - will demand and receive management heads. The next CEO faces some unpalatable choices. Presumably the juicy 4.25% yield will go immediately and there will be a large rights issue, neither of which will thrill shareholders. The BoE's Monetary Policy Committee will soon throw BT and similarly hard-pressed companies a bone in the form of a rate cut but the hard times will be around for a while. Unfortunately, BT is not an isolated case. Many telecoms companies around the world and firms from numerous other industries are highly leveraged in an economic downturn. I fear more bad corporate news lies ahead.

**Investors' hopes are in the hands of central banks.** The good news is that CBs will respond to the economic slowdown with further rate cuts. Historically, these have been good for stock markets*. In the nineteen previous interest rate cycles between 1914 and 1998, the DJIA showed an average gain of 8.7% following the first Discount Rate cut and 22.6% after twelve months. The Dow will have to motor if it is to approach the first tally, having closed at 10646.15 on 2nd January 2001, the day before Greenspan made his first rate cut of the year. On four occasions in previous cycles the DJIA recorded a minus figure after three months - 1921, 1932, 1960 and 1981. The average decline for these years was -15.8%. More importantly, the twelve-month average gain was a modest 1.7%, largely due to a 40% decline in 1932 during the Great Depression. Net that out and gains for the other three years averaged a healthy 13.6% one year after the first rate cut. I maintain that if the DJIA is not above 10646.15 by the close on 2nd January 2002, then the global economy, not just the US, will have been in one heck of a mess. In this event, the main culprits are likely to be debt default and Japan's seemingly endless problems.

**FWMI (10pt) and MSCIWI (5USD)**




**Nikkei 225 Stock Average Index (100pt)**



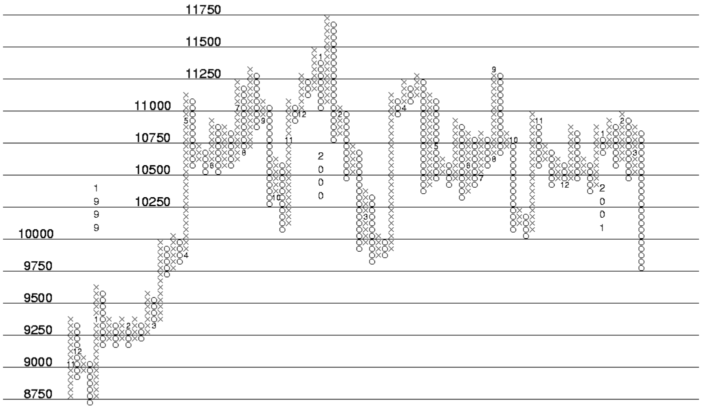

**See table in FM201.*

**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 refer to market closes.

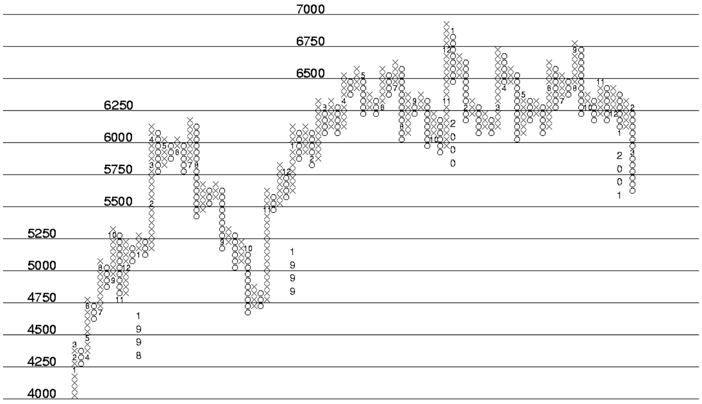
**The Fullermarkets World Market Indicator** (1830) remains weak and a strong rebound is required to check downward momentum beyond a pause. *The FMWI is unweighted and calculated in local currencies.*

**The Morgan Stanley Capital International Indicator** (1050) has plunged in the last two months and this move is beginning to look climactic. *The*

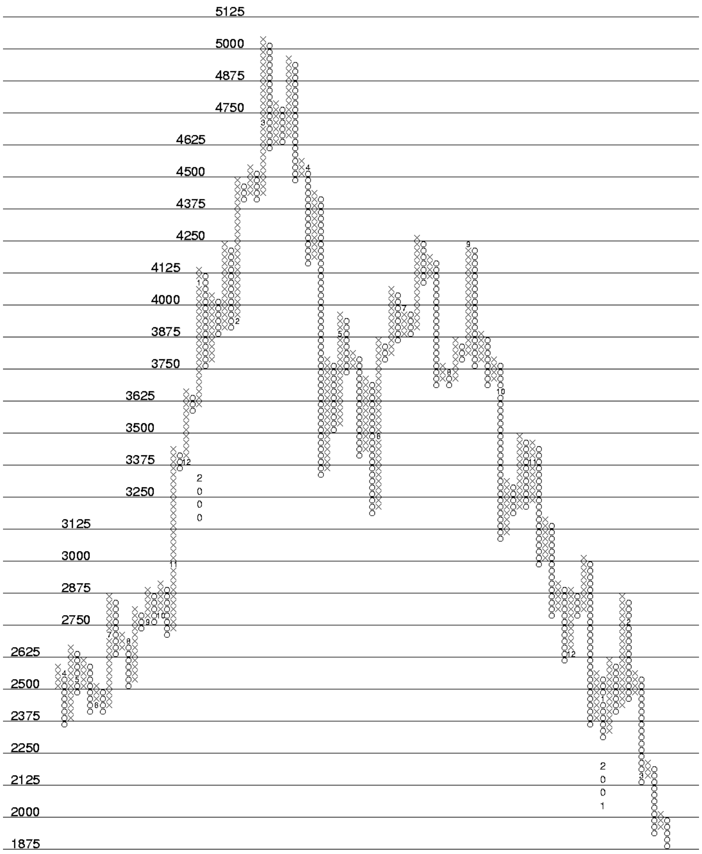
**Dow Jones Industrial Average (50pt)**




**United Kingdom FTSE 100 Share Index (50pt)**




**NASDAQ Composite Index (25pt)**




*MSCII is capitalisation weighted and calculated in US dollars*.

**The US Dow Jones Industrial Average** (9487) has broken beneath the psychological 10000 level and a sharp rebound is required to offset the top-heavy appearance of this chart. **The NASDAQ Composite Index** (1830) remains persistently weak in what could be the final capitulation phase. A closing-basis rally of at least 4-units of scale (100 points) is needed to question downtrend consistency beyond a brief pause.

**Japan's Nikkei Stock Average** (12854) - *see previous page* - fell beneath its important 1998/99 floor before rebounding to break the short to medium-term trend's dominant consistency characteristic - a progression of lower or equal rally highs evident since September 2000. This is potentially significant and a further rally would confirm a downside failure

**The UK's FTSE 100 Index** (5540) resembles the DJIA, only worse having shown less upside follow through in 1999 and a more decisive downward break recently. Overhead resistance is extensive since much of the floating supply in recent years has changed hands above 6000. A move above this level is required to suggest a downside failure.

**Strategy for stock markets -** Japan aside, I don't like the technical action despite a short-term oversold condition. Rally attempts have been feeble, selling persistent and too many support levels have given way. This has negated bullish breadth divergence evident earlier in the year. Once again, I do not feel sufficiently confident to issue share recommendations in this environment, although adventurous value-oriented investors might wish to consider Japanese equity funds at these levels. For readers primarily interested in equities and who invest globally, I suggest allocations 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 suspect there will be 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. Once again I haven't done much futures trading, forgoing the selling opportunities because I do not like to be short knowing that there will be interest rate cuts. However I may chance my luck in one of the lagging but top-heavy indices such as the DJIA or FTSE. Going against the trend, somewhat rashly at the time, I did roll my loss-making Nikkei longs from the expiring March contract into June. I did this because Japanese officials were beginning to discuss the possibility of a buffer stock support programme for the market. Further stories produced a key day reversal for the Nikkei 225 Average on 15th March, defining a low of at least near-term significance at 11433.88. Apparent government-related buying on 21st March produced the biggest percentage gain in over three years at 7.5%, breaking the short-term downtrend. Now protected with an in-the-money stop, the Nikkei futures long is my strategic toe-in-the-water, in line with The Triple Play analysis on page 12.

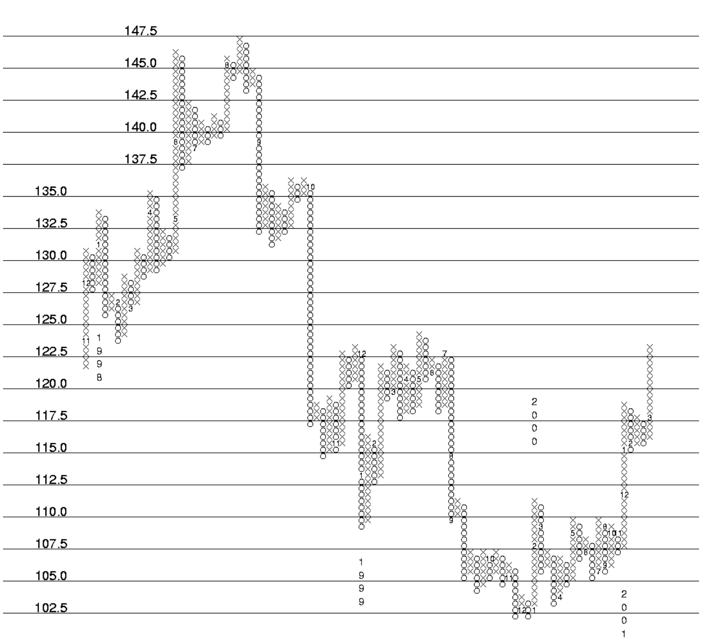
## Currencies

■ **For a "vulnerable" currency the US dollar is not doing too badly.**

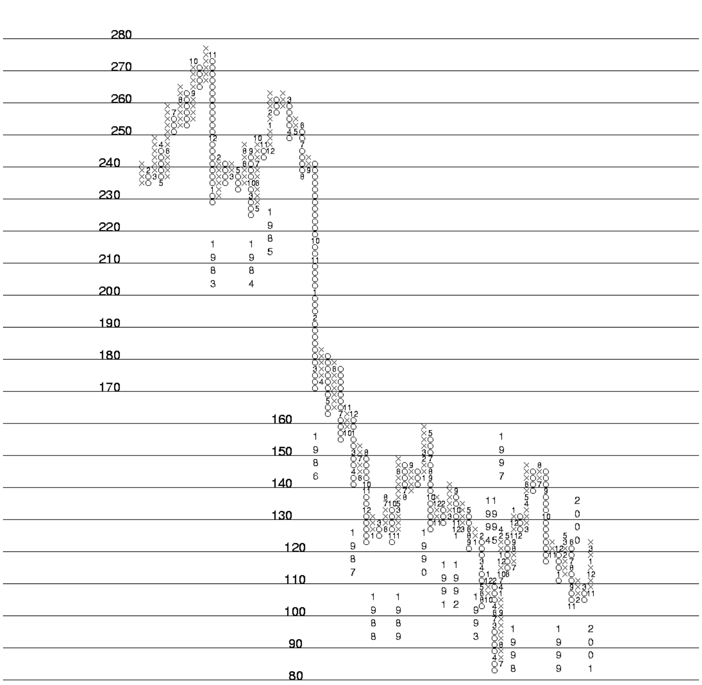
■ **Hayami is being isolated by the Cabinet, which appoints members to the BoJ policy board.**

**It's the dollar versus the untested and untrusted.** We inhabit a tri-polar currency world consisting of the US dollar, the euro and the yen. All other currencies are now satellites revolving around these three. Six years ago the greenback was reviled for historic reasons well known to most subscribers. Perceptions changed as the US economy improved dramatically relative to its main trading partners, enabling then Treasury Secretary Robert Rubin to forego competitive devaluation. Fast-forward to 1999 and the euro - a grand experiment or folly depending on your perspective - was launched with such hype that European currencies had appreciated up until October 1998. The brand new ECB was extremely concerned about this strength but was soon able to relax as the single currency glided lower from its inception. When the ECB tried to pull out of this dive, nothing happened until it was finally rescued by multi-lateral intervention in September 2000. That prompted a reappraisal and after drifting a little lower, the euro rallied sharply on forecasts that Euroland's GDP on the way up would pass US growth on the way down. It happened, sort of, only few of the people actually in a position to shift currencies (rather than just talk about them) believe it will last. Despite reforms, Euroland remains more heavily regulated and taxed than the US. A one-shoe-fits-all monetary policy is perceived as inappropriate for the majority at any given time. The Swedes, Swiss and Brits don't want to join the euro club. The majority of currency traders are a pragmatic lot who know the euro has yet to be tested by a recession, although they suspect one could be around the corner. The ECB, rather than inheriting the Bundesbank's authority has seemed uncertain and reactive. It doesn't help that Wim Duisenberg has become a figure of fun, partly due to that dead sheep on his head masquerading as a hairstyle. However

**Japanese Yen per 1 US Dollar (0.5)**




**Japanese Yen per 1 US Dollar (2)**

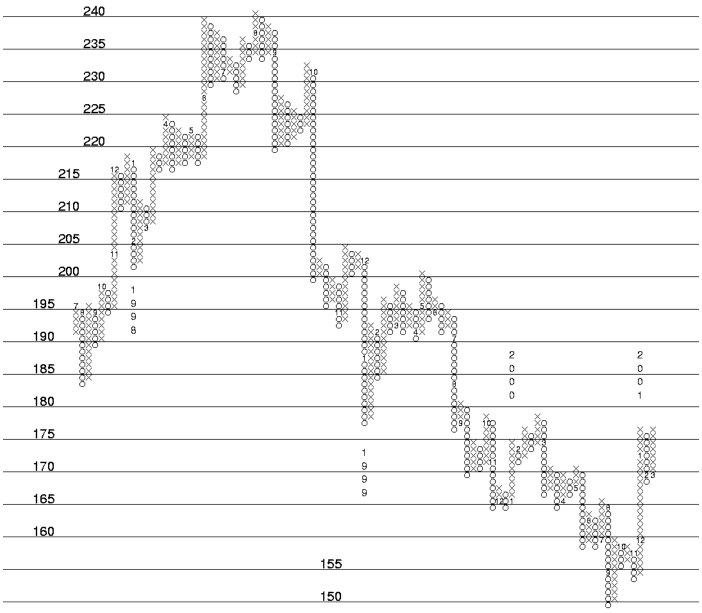



even he looks like a safe pair of hands relative to the BoJ's geriatric governor Masaru Hayami, for whom an overvalued yen is a virility symbol even when the economy is falling apart. No one outside of Japan will pay up to 550 basis points for the dubious privilege of holding yen when it is in a downtrend. Untrusted, the yen's main support comes from the repatriation of capital by Japanese multinational companies that need funds to shore up the parent firm's balance sheet.

**Significantly, Hayami is being isolated.** Under Bank of Japan law, which was revised in April 1998 to give the BoJ independence on policy, the Cabinet has authority to appoint members to the BoJ's policy

**Japanese Yen per 1 Euro (0.5)**


**Japanese Yen per 1 Pound Sterling (1)**




**US Dollar per 1 Pound Sterling (0.005)**


board, with consent of both chambers of parliament. According to Jiji Press, Eiko Shinotsuka who is a Hayami clone on the BoJ's policy-setting board, will not be reappointed when his term expires on March 31st 2001. Gakushuin University Professor Miyako Suda is the likely replacement. Suda, who is 52, has said she doesn't oppose quantitative easing to boost money supply, adding that a weak yen can help support growth.

**Review of currency point & figure charts -** *These closing-basis charts are available on our website www.fullermarkets.com and updated daily.*

**Dollar/yen** - *see previous page* - The ¥2 scale shows that the dollar is still historically cheap against the yen and won't actually complete a long-term base until it sustains a move over ¥160. The ¥0.5 scale, shows the dollar resuming its basal advance after a 2-month consolidation and heading for a test of lateral and psychological resistance near ¥125, where no more than a brief pause is likely given underlying support and momentum.

**Euro/yen and sterling/yen** - Declines to ¥104 and ¥167, respectively, would be required to signal a lower phase of base extension. However this is unlikely given the overstretched prior declines and decisive breaks of downtrends. The recovery would be reaffirmed at ¥113 and ¥177.

**Sterling/dollar -** This is still rangebound but with a downward bias since resistance was encountered at $1.50 in January. A move to $1.475 is required to offset a further test of the September and November lows at $1.40.

**Australian $/US$ -** The Aussie has slumped under the psychological US$0.50 level. However this latest decline looks overstretched and the mid-November to early-January rally may have defined the penultimate low. A move back above US$0.52 would provide some evidence of a bottoming out process.

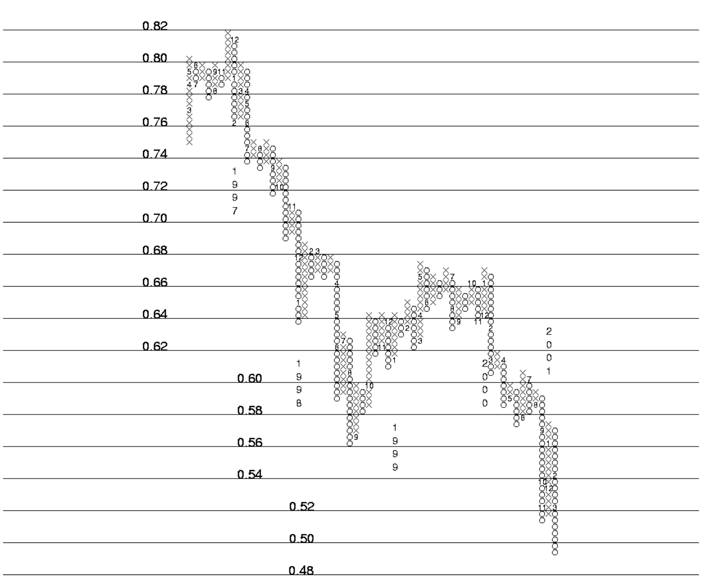
**Euro/dollar -** The euro is drifting in a probable V-bottom, right-hand extension, medium-term base formation. If so, the trough under $0.88 should cushion downside risk and a move to $0.936 would indicate at least a test of the January high just under $0.96.

**Euro/sterling -** The euro has backed away from lateral resistance near £0.64 and a move to £0.6225 would suggest some further base extension before the euro's recovery carries somewhat higher.

**Euro/Swiss franc -** This small base has formed near historic support and should lead to some additional recovery.

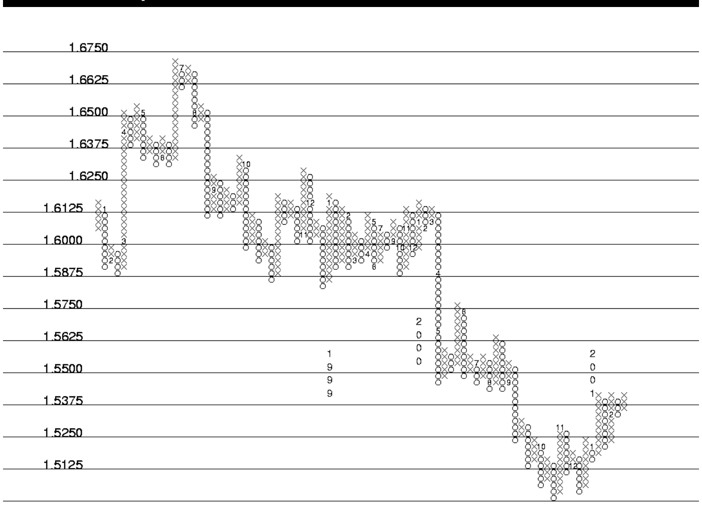
**Strategy for currencies -** My big trend-running position remains long dollar/yen, which I trade by shorting the yen IMM futures contract. I recently rolled this from March to June, leveraging up once again as the spot rate broke clear of ¥120. I then raised my stop to somewhat below this level, not wishing to give back profits taken on the earlier contracts. I may be pressing my luck as the stop is a bit tight, so it is really a money control decision with some technical justification. Were the position smaller, I would probably use the mid-point danger line (MDL) for my stop, as taught at The Chart Seminar. That would place it around ¥117. The short-term risk is that a lot of people have jumped aboard this trade, judging from the bullish forecasts and they will also have stops. However one of my TCS rules-of-thumb is that if a market has further to go *now*, it should maintain the breakout. I think the yen will fall a lot further, as readers know. However that is just an opinion and targets matter little in this business. It's chart reading and tactics that count, and these are always easier if the trend is orderly, which it has been for dollar/yen so far. If stopped out I'll reassess and hopefully have an opportunity to rebuild at a somewhat lower level, subject to the chart action. Meanwhile, I may lighten a little in the event of further near-term strength, using the Baby Steps tactic, which would include possibly reacquiring those dollar longs on orderly easing within the overall upward trend. If successful, this strategy would continue to gradually lower my average purchase price. Should the dollar accelerate towards the ¥130 to ¥135 region, I would lighten and raising stops in anticipation of another ¥6 or more reaction. An orderly trend would suit most of us who are long dollar/yen and it has obliged so far. I find euro/yen and sterling/yen more difficult to trade because of their greater volatility. However I am

**US Dollar per 1 Australian Dollar (0.004)**

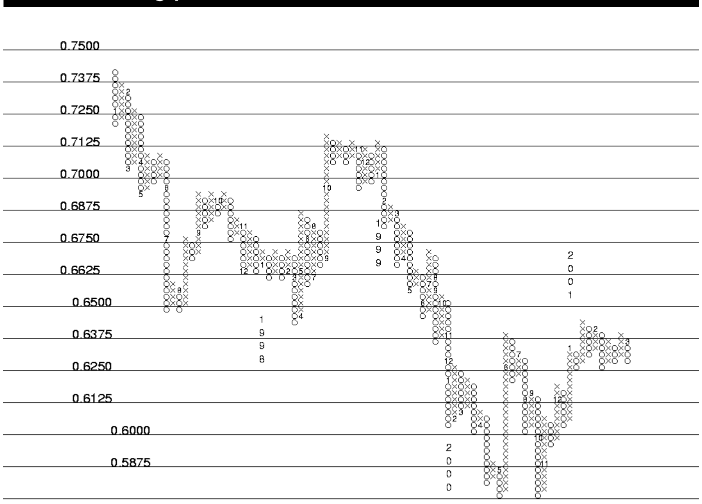



**US Dollar per 1 Euro (0.004)**


**Swiss Franc per 1 Euro (0.0025)**




**Pound Sterling per 1 Euro (0.0025)**



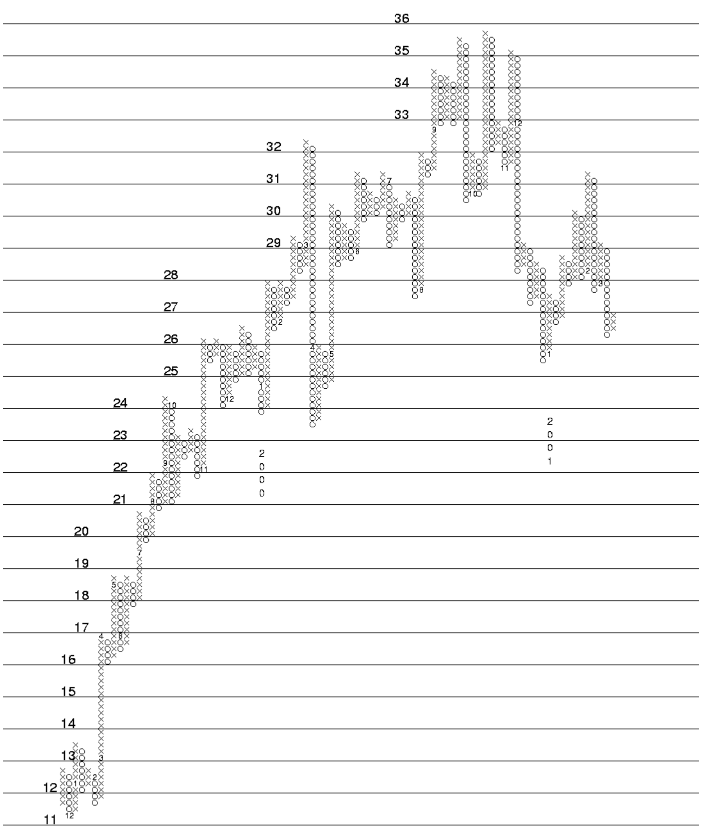
currently long euro/yen, regarding the single currency as becoming somewhat oversold generally. This is only 17% of my dollar/yen position and I'll either trade it out relatively soon or leverage up in the event of favourable chart action, including a clear break above the January high just over ¥113. I'm not trading any other cross-rates at this time.

## Commodities

■ **OPEC continues to lose control of the oil market despite another production cut.**

**Demand for industrial commodities is falling.** With the entire global economy slowing, an inventory build-up among producers is weighing on prices for most commodities. OPEC is trying to fight the market by reducing production quotas another 1 million barrels a day. This has had little effect because demand is falling. Moreover, while oil-exporting countries had little to lose in honouring the cuts when crude traded near $10 in late 1998 and early 1999, it is a different story today. They know the good times won't last so there will be cheating on quotas. Additionally, high prices over the last eighteen months have boosted non-OPEC production considerably, with more due to come on stream while prices remain above $15. Prices may range for a while longer in an extended phase of top development, as supplies of some refined petroleum products remain in short supply but barring a significant accident, prices are heading lower over the medium term. Base metals are unlikely to rally significantly until after the global economy shows evidence of strengthening once again. The gold story will gradually become more interesting as reflation efforts by Japan and other countries increase the supply of money in circulation. Prices for most agricultural commodities remain flat due to abundant supply but any weather problems in the new crop cycle that is about to commence would lift prices sharply from today's historically low levels.

**Crude Oil NYME 2nd Month Continuation (0.2USD)**




**Strategy on commodities -** The pork bellies long, first mentioned in FM200, has paid off handsomely, surging back to highs of recent years. I've taken the profit. This is financing some of my more dodgy positions in coffee, soybeans and wheat. However my strategy is to buy lightly on weakness while prices are near historic lows. I'll also lighten on a decent rally, in line with my Baby Steps tactic detailed in FM201. There haven't been many rallies recently but we are only now entering the interesting seasonable period, running from late-March through July.

## The Global Economy

■ **Monetary authorities in two of the main economic blocks are behind the curve.**

**Financial markets sense that the European Central Bank is not addressing the risk of a sharp economic slowdown, while the Bank of Japan is only beginning to face reality.** Only the US Federal Reserve has been pressing hard on the monetary accelerator to fend against the four horsemen of potential recession 2001/2 - debt, previous rate hikes, OPEC production cuts and slumping stock markets. That's unfortunate because these are not quintessentially US problems. Sure, the US was host to the NASDAQ bubble but investors/speculators elsewhere joined in and TMT stocks in all other countries mirrored the move, up and down. Wall Street didn't invent corporate leveraging of balance sheets, applauded by business schools everywhere in the 1990s. While the US refined and exported the latest strain, including issuance of debt rather than equity to finance stock buyback programmes, governments in most other developed countries changed legislation at the behest of their corporate sector, which eagerly embraced the fad. Today there is little of a short-term nature that governments can do to counter recessionary consequences of another cut in oil supplies, other than lower taxes, and the market will provide a longer-term solution as we have seen before. What central banks *could* do is address monetary problems but only Greenspan and his Federal Reserve colleagues have recognised, let alone tackled the problem so far. The Bank of Japan's policies in recent years have been ruinous, as I have long said. BoJ Governor Masaru Hayami encouraged an overvalued yen during a deflationary slump, kept money supply barely above 2%, bizarrely interpreted bankruptcy, rising unemployment and economic suicides as evidence of recovery and rationalised the latest deterioration as contagion from the US slowdown. OK, the BoJ is now reflating but the quantitative easing will now need to be massive and the blinkered Hayami hasn't exactly seen the light on his personal road to Damascus. It's more a case of being dragged kicking and screaming in the only remaining direction available to the BoJ - the road to inflation via printed money. Euroland's central bank is less pathological than the BoJ but it is preoccupied with inflation over 2%. This was a small price to pay for the orderly devaluation in 1999/2000, which helped Europe to its best growth for many years. The recovery is now threatened by interest rates that are too high given the US slowdown, Japan's ongoing woes which have impeded Asia generally and with Germany's economy underperforming neighbouring states. In the UK, the Bank of England's Monetary Policy Committee is focused on consumer spending which occurred before the foot-and-mouth epidemic hit farming and tourism. The current siege and blow to morale can only pare UK GDP growth. In conclusion, there is a clear and present danger that an inevitable global slowdown could turn into a recession in 2001/2 because most central banks, anxious not to create too much liquidity as occurred in 1998, have fallen behind the curve in today's more dangerous economic environment.

## And Finally…

### The Triple Play

**Once in a generation opportunities for investors and speculators, courtesy of Japan's fiscal and monetary policy blunders.**

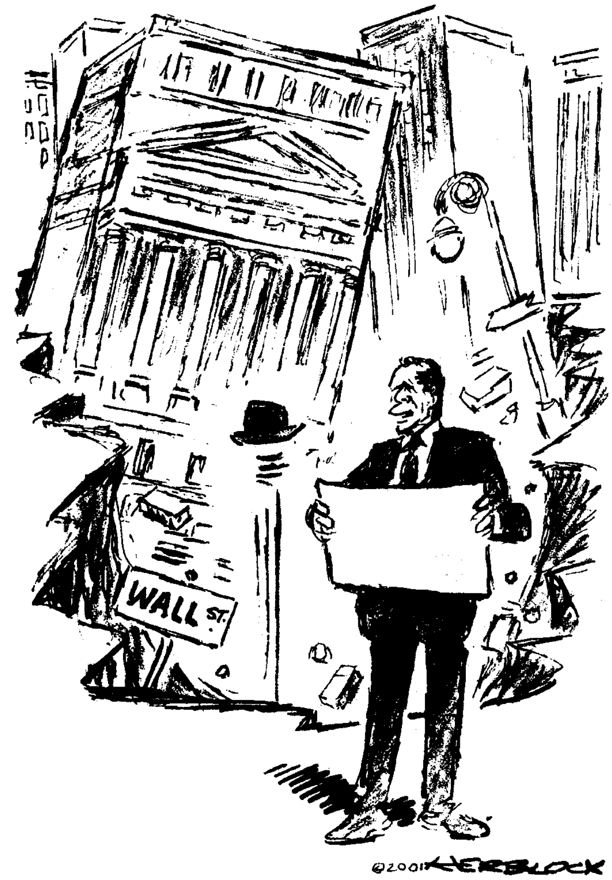
**Many of the best market opportunities follow disasters.** Japan certainly qualifies, being the sick economy of the developed world, seemingly trying to re-enact The Great Depression. It won't get that bad because Japan remains a rich country, despite its wealth-destroying fiscal and monetary policies of the last 11 years. Moreover, the Bank of Japan and Ministry of Finance are now reversing course because they have no other sane choice. This is creating unprecedented opportunities for investors and speculators - first in the yen, soon in the Nikkei and eventually in JGBs.

**1. Short yen -** Only a massive monetary reflation will enable Japan to pull out of its deflationary spiral. Following years of procrastination by BoJ Governor Masaru Hayami, during which the yen has been much too high and monetary growth much too low, compounding Japan's economic deterioration, the central bank is now reflating. The only remaining question is the speed of this policy reversal, which would probably accelerate with Hayami's departure. The yen's downtrend is now clearly established. Economists are rapidly revising targets, with many now looking for ¥140 against the US dollar. My own forecast issued 6 months ago was that we would see at least ¥160 within two years. I continue to favour yen shorts against the US dollar and other high-yielding reserve currencies, using charts for timing short-term entry and exit points, and selecting trailing stop levels.

**2. Long Nikkei -** Japan's Nikkei 225 Stock Average peaked at 38,957.44 on 29th December 1989. It fell to 11,433.88 on 14th March 2001 - the lowest level since1984, before rebounding on a key day reversal. The catalyst for this rare rally was another hint by Finance Minister Kiichi Miyazawa that the MoF is preparing to support Japan's stock market. This emergency measure is under consideration because the share market, shunned by Japanese private investors in recent years, has continued to slide partly due to the unwinding of corporate cross-holdings as companies restructure. Consequently, Japanese banks, which still have a high proportion of their reserves in equities, are now under water in terms of their capital adequacy requirements. The international rating agency Fitch IBCA Duff & Phelps is currently reviewing 19 Japanese banks for possible downgrades. Although Japan's share indices remain in overall downtrends, a government buffer stock operation, presumably funded with yen straight off the printing press, would cushion downward risk. The last major stock market support programme occurred in Hong Kong in 1998 and helped propel the Hang Seng Index to a new all-time high within 18 months. Japan's economy is in greater trouble and its stock market capitalisation is much larger than Hong Kong. Nevertheless many Japanese stocks are now cheap on a price to cash flow basis. Assuming the BoJ reflates aggressively as it needs to and the Government finances a share-buying buffer stock programme, this longest equity bear market for a developed country should be in its final stage. I am starting to ease back into the Japanese market, commencing with derivatives for manoeuvrability, to be followed by funds and individual stocks. This will be a gradual process of accumulation because if Japan's officials procrastinate, as we have often seen before, the market could fall to an even better buying region. Services on Stockcube Research Limited's websites highlight technically promising Japanese stocks.

**3. Short JGBs -** Japanese 10-year Government Bonds yield a meagre 1.15% - lowest in the world by far. However Japan's government debt has the worst credit rating among developed countries, having soared to a third-world 135% of GDP and still climbing! This paradox exists because as the only performing market in Japan over the last year, JGBs continue to attract domestic support. The BoJ has also been a buyer of Japanese government debt as part of its reflation effort. Additionally, capitalisation-weighted international bond funds have had to buy JGBs as Japan's Government borrowing increased to 27.3% of world sovereign debt - more than any other country. As the Japanese economy eventually recovers interest rates will rise, unleashing a bear market in JGBs, which I suspect will be the biggest ever seen in terms of wealth destruction. However those who wait for the trend to reverse and short JGBs, would profit in proportion to the Japanese economy's rebound and the extent of inflation this produces. Meanwhile JGB yields are still falling as this massive bubble continues to expand. I reckon the eventual low could be anything from a few months to a couple of years away. The charts should tell us.

**There you have it - the strategic triple play.** Stay short yen protected with trend-running stops. Consider accumulating Japanese equities on easing, using the Baby Steps tactic taught at The Chart Seminar. Wait for technical evidence that yields have bottomed before shorting JGBs




*'Now here's my plan for putting personal social security funds into the market.'*

International Herald Tribune

**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. Come along to learn, contribute, profit and enjoy. I'll also be speaking at the IIR Conference on Behavioural Finance - www.iir-conferences.com - at Millennium Hotel, Knightsbridge, London on 24th & 25th April.

The target date for FM203 is Friday 20th April.

"The end of wisdom is to dream high enough to lose the dream in the seeking of it."

William Faulkner

Best regards - David Fuller

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