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In its 18th year

Fullermoney

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

Are energy stocks the new investment fashion, capable of running for a year or two?

Another election landslide by Labour would be bad for the UK economy and parliamentary system

Ronnie Biggs saga a metaphor for New Labour - A moment of welcome public relations for the UK's tourism industry, recently trampled by foot-and-mouth disease - Ronnie Biggs of 1960's Great Train Robbery fame gave up Brazil's sunshine and Lambada dancers because he missed England's green and rolling hills, pubs, national health service and presumably the rain. Poor old Biggs flew home to be unceremoniously escorted back to prison by 113 police, further reducing their presence on the streets, only hours before the UK's other tired man in the spotlight, Prime Minister Tony Blair, ritualistically visited the Queen before announcing a General Election, to be held on 7th June. Biggs and New Labour have more in common than you might think. From the beginning both showed daring, panache and a common touch, making them popular icons. Today, the glamour is gone and both look beyond their sell by date. Will justice for the UK Government be served at the election as effectively as it has for Biggs recently? Not according to opinion polls, which suggest the electorate is in a forgiving mood despite the sleaze, arrogance, spin and general incompetence. Some pundits expect another landside, even though the Government is at least partially responsible for the wasteful Dome, derailed trains, a national health service that doctors say has deteriorated despite promises, soaring crime, fewer police on the beat, encroaching bureaucracy and a foot-and-mouth incident that became an epidemic. Last but not least, Gordon Brown's 45 stealth taxes purloin more money from the public every minute than Biggs ever dreamed of stealing in a lifetime, and the Chancellor is a lot less fun. I suspect and hope the UK electorate will deliver Labour a wakeup call on 7th June in the form of a much-reduced majority. The Conservatives may not be ready for government but democracy will be better served if they gain enough seats to at least form an effective opposition. How might this happen? Given Labour's substantial lead in the polls there will be little tactical voting to keep the Tories out, unlike 1997. Much of the Government's support is only skin-deep and in 2001 traditional Labour voters are more likely to abstain than Conservatives. The Press has no interest in a one-sided election, which is dull and won't sell newspapers, so most of its editorial fire is directed at the incumbent party. Tony Blair is portrayed more often as a smarmy control freak than the articulate prime minister with a common touch. Gordon Brown, having previously been flattered as an "iron Chancellor" because he is the first Labour minister at the Exchequer not to screw up the economy from day one, is vulnerable on taxation, obfuscation and because of his belligerent personality.

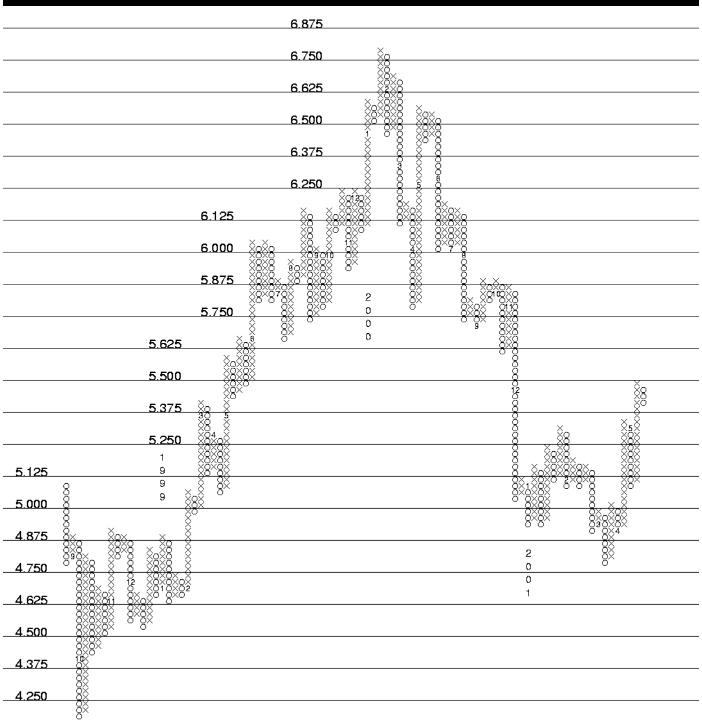
This lucky Chancellor benefited from a favourable global environment until recently, yet in the Conservatives' last five years inflation was no higher, unemployment fell considerably faster and GDP growth was stronger at 3.1% compared with 2.6% in the four years (1998 through 2001), assuming this year's official forecast of 2.5% is met. I suspect a majority of UK voters would prefer the robust US economic model, introduced by Margaret Thatcher, rather than Euroland's welfare state towards which Blair and Brown are taking us. As the election approaches, stories of a rivalry between a Prime Minister and Chancellor of the Exchequer are more compelling than for those in opposition. Therefore we are likely to hear more about a Blair versus Brown power struggle than Hague versus Portillo between now and Election Day. William Hague has languished in the opinion polls, partially because his party has often been in disarray following its huge defeat in 1997, before he became leader. The press had written him off but as a skilful debater Hague can turn this to his advantage under the election spotlight. Conservatives won the opening skirmish against an overconfident Government by being first to release a manifesto and focusing the initial debate on taxation. They will claim, with some justification, that this election should also be viewed as a referendum on keeping the pound rather than joining the euro. If Hague emerges as a doughty underdog, Labour's big lead will shrink. Bookmakers' odds on the number of seats Labour would win were 406-411 recently, compared with their landslide tally of 417 in 1997. I couldn't resist adding to an earlier short position.

Interest Rates and Bonds

- **Further cuts in short-term interest rates are possible.**

- **Long-dated government bonds in North America, Europe and the Antipodes show inflation jitters.**

US 10 Year Bond Yield (0.025)

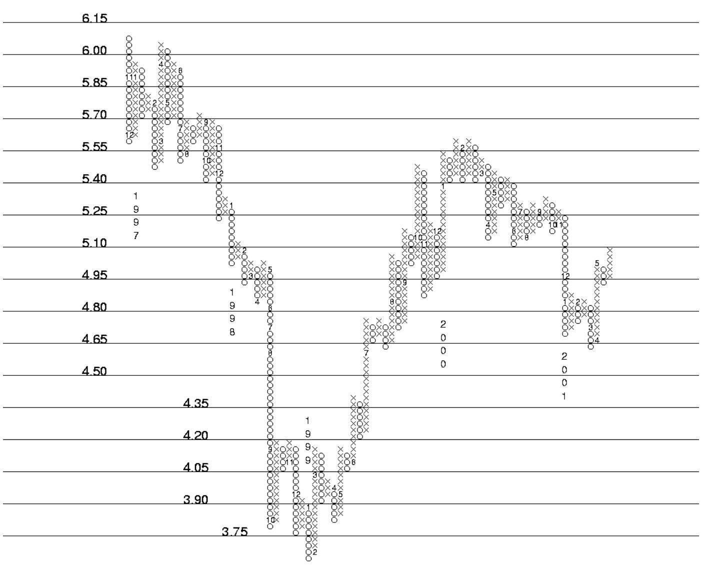


The US Federal Reserve may not have completed its rate-cutting cycle. Following Greenspan's rapid easing of the Federal Funds Rate by 200 basis points, it's appropriate to ask if that's it? Possibly, but despite inflationary pressures, particularly from energy prices, the Fed could still lop another 100 points off short-term rates. However that may not be necessary and it would probably worry the bond market. Therefore any additional rate cuts by the Fed, should they occur, would probably be reversed following two consecutive quarters of economic improvement. As for the European Central Bank, it continues to advertise for economists but could do with a PR firm. Duisenberg and his acolytes took a hard line on prices only to do a sudden U-turn on 10th May with the President claiming "monetary developments no longer pose a risk to price stability". Of course Euroland's inflation has continued to edge higher, not least because of the euro's weakness. Perhaps the ECB should disband and start all over again. Anyway, with Q-1 GDP coming in below the downwardly revised official forecasts, there is a contracting-growth argument for lower rates. The UK's risk of recession will increase if the Bank of England's Monetary Policy Committee does not continue to lower rates.

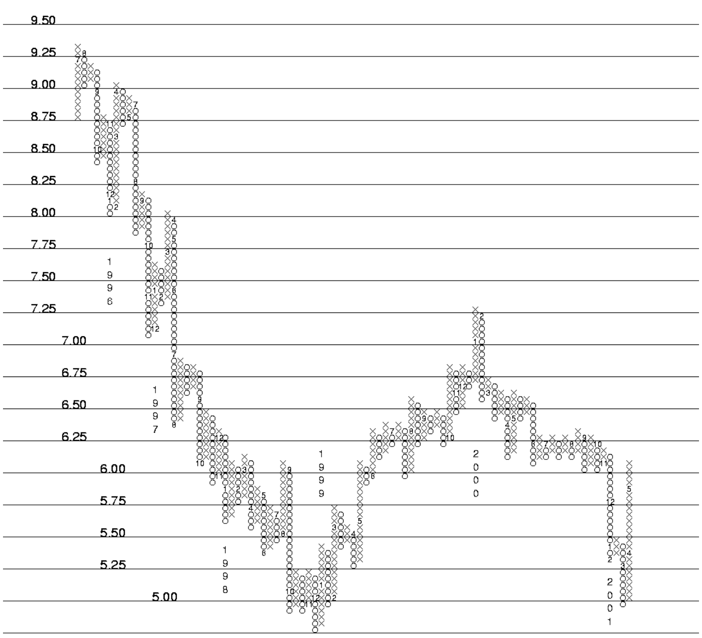
Investors conclude that central banks have brought back the punchbowl. That's good for stocks but bad for long-dated government bonds. Inflation rates have been nudging upward for months and now gold has stirred from its slumber. Investors have bought stocks and sold bonds, driving the latter's yields back to the underside of their 1999 to 2000 top areas evident on the charts. These are potential resistance levels and while some stagflation is likely, slower global GDP growth should prevent or at least delay for quite a while, a return of the inflationary psychology that plagued the 1070s and early 1980s. However, if/when North American, European and Antipodean government bond yields eventually push well into their former top areas, this would provide an additional inflation warning. Paradoxically, JGB yields remain much lower and have retraced over half of their March to April rally. These continue to be supported by the Bank of Japan, Japanese investors hedging against their domestic deflation and capitalisation-weighted bond funds. The danger period will arrive when investors see a genuine economic recovery for Japan. The first hint on charts would be a rally to 1.5% by 10-year JGBs.

Strategy for bonds - From a conservative investment perspective, I'm staying with FM200's strategy, which favours shorter maturities, from 3-year government instruments to bills. Spreads betw#een long-dated government and corporate bonds should narrow if the March to April lows for stock market indices hold. However I would tread cautiously in this market as there could be some notable defaults, which would temporarily weigh on better quality issues. In futures, I still think it is too early to short JGBs - the third leg of FM202's Triple Play. The best opportunity in this market could still be many months away, subject to how Japan's economy performs. I have no bond futures positions at present.

Euro-Bund 10 Year Bond Yield (0.03)



Australian 10 Year Bond Yield (0.05)



Japanese 10 Year Bond Yield (0.025)

Global Stock Markets

- **Has Japan found its Margaret Thatcher or will Koizumi prove to be no more effective than his predecessors?**

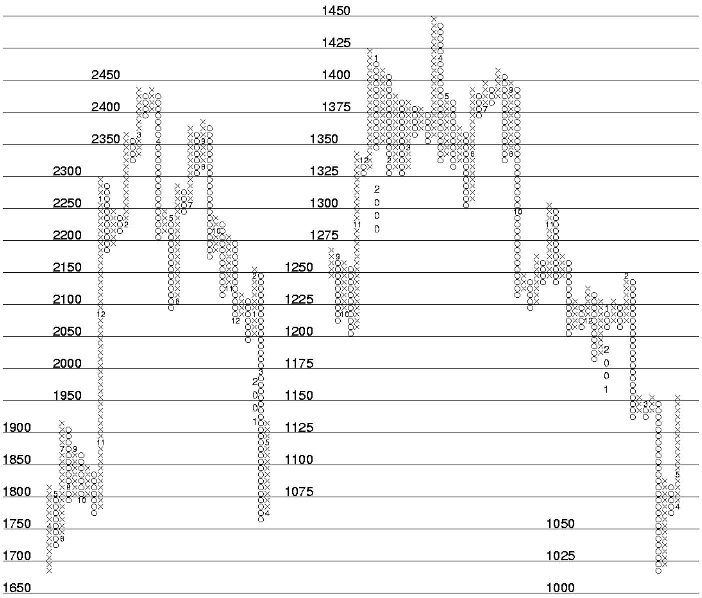
- **Is the bear market ending or over? (Follow up from FM203).**

- **Energy is set to become a dynamic industry in an otherwise generally slow-growth economic environment.**

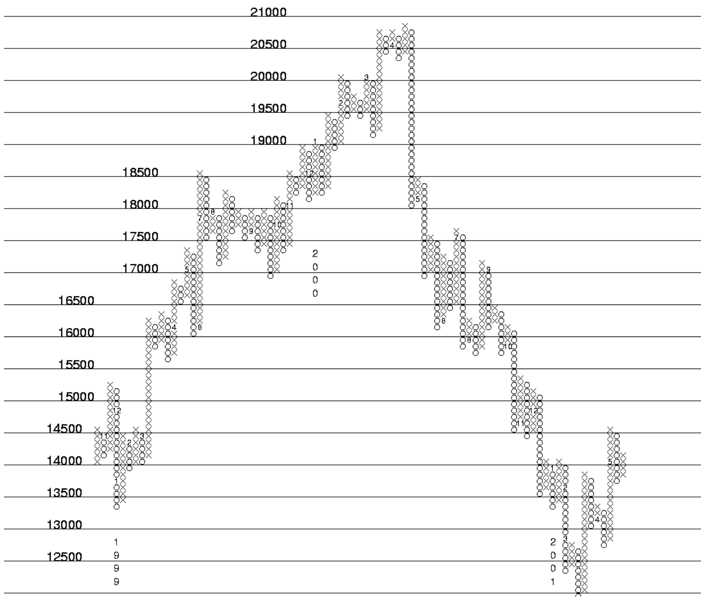
Public support is the key for Japan's trendy new Prime Minister. When a visiting Japanese businessman sidestepped a mischievously dangerous question on UK manufacturing capabilities some years ago, by saying he was sure there were many things that Japan would like to import from the UK, he was asked to name something. Looking nonplussed for a moment, he then replied - "Margaret Thatcher". Today, everyone is wondering if Japan has found a leader who can emulate not only Thatcher's hairstyle but her reforming zeal as well. The answer is probably yes because Junichiro Koizumi was swept to power by LDP grass-roots support rather than the establishment. The Hashimoto-type factions don't like him, especially after he broke with tradition and ignored their factional strength in selecting his cabinet. However Koizumi is untouchable while he maintains public support, currently running at an unprecedented 80%. The new PM knows he must move quickly, particularly with any painful reforms if he is to survive, let alone succeed. The situation is interesting and while economists will disagree on what reforms and policies Japan actually needs, the most important factor may be sentiment. If the Japanese, who have been in a psychological state of funk for the last decade, actually believe that things are going to improve, they will start to spend and invest once again. Presto! Japan Inc could catapult from bottom to top of the performance table among larger developed economies much more quickly than most people currently expect. Of course it could also turn out badly once again. Koizumi might provide the wrong prescription or his best efforts may be frustrated by rivals protecting their power bases. Nevertheless the initial signs are promising. Koizumi is using public support to change Japan's ossified system. The stock market has signalled investor approval. I maintain the Nikkei 225 Average bottomed at 11433.88 on 15th March with a key day reversal. Some base extension is likely and may have commenced but I would not be surprised to see a retest of 20000 within eighteen months, with Topix and especially the Second Section of smaller companies doing even better. Additional gains would depend on the success of Koizumi's economic reforms.

Interest rate cuts have put the bear in hibernation but many indices will remain rangebound. Interestingly, a few national indices escaped the bear, notably Australia's All Ordinaries Index. With timely cuts in short-term rates by the RBA, a soft currency and perhaps the defensive appeal of a natural resources-based economy, the All Ord only wavered

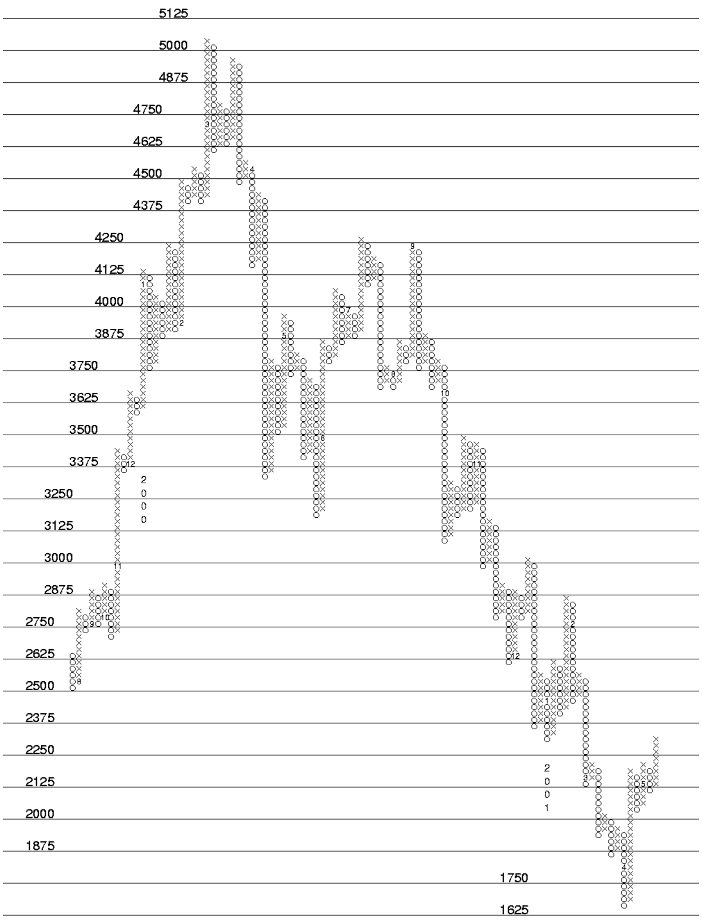
FWMI (10pt) and MSCIWI (5USD)



Nikkei 225 Stock Average Index (100pt)



NASDAQ Composite Index (25pt)



within its ranging uptrend before pushing to an all-time high. I do not believe this is just a downtrend deferred, at least not over the medium term. In Ireland - still Europe's fastest growing economy - the ISEQ reached a new high recently. For the US, the DJIA fell 20% before rebounding sharply. Historically, the best overall gains for stock markets have occurred during global cycles of monetary easing and higher rates have caused most bear trends. The bullish influence of lower short-term rates has only been negated by severe deflations. Alan Greenspan has all but eliminated the risk of a Japanese-style deflationary spiral in the US by slashing rates with record-breaking speed. In Europe the ECB jeopardised GDP growth by delaying too long before its U-turn on 10th May. Nevertheless, given the high correlation for Europe's stock markets with the US, downside risk should be limited to retests of the March-April lows, at least until investors begin to discount the next rise in short-term rates which should be many months away. "Don't fight the Fed" has long been one of the best market maxims, especially following 5 rate cuts (250 basis points) as we have now seen. Therefore the greater risk for investors is on the upside, although there are good reasons for expecting most national indices to underperform in 2001-2002, relative to previous rate-cutting cycles. While problems of growth, valuations and debt are certainly not unique to the recent bear market, they should not be dismissed lightly. GDP growth a year from now is extremely difficult to forecast but high energy prices are a major concern and I would not rule out knock-on effects from the burst TMT bubble, even though the Crash of '87 had little economic effect, no doubt due to the decisive monetary easing that followed. High valuations in the West result from investors' optimistic expectations following - until last year - many years of returns above the historic mean. This cannot be maintained without the 'new paradigm' - a hypothesis that stretches credulity. Corporate debt, encouraged by the fashion for leveraging balance sheets, remains worrying particularly in a global economic slowdown. I believe charts reflect these factors, showing significant overhead supply for many indices and shares, and insufficient base development where prior weakness has occurred. I maintain that we could see years of ranging activity during which earlier excess are corrected. This would create an overall market neutral environment, punctuated by rallies and sell offs in response to interest rate cycles. If so, index-tracker funds, recommended by so many financial advisors, would disappoint but there would be increased scope for discretionary fund managers to show their mettle. If any major stock market outperforms in this environment it is likely to be Japan, provided (and this is a big qualification) the Government doesn't backslide on reforms once again. I'll give Junichiro Koizumi the benefit of doubt because the public is on his side. However, if Koizumi loses support due to an even weaker economy over the next year or two, which is a real possibility, there are many among the LDP old guard who would love to take his scalp. Meanwhile, Koizumi was elected Prime Minister as a reformer and he 'hit the ground running' by appointing a nonconformist Cabinet. Japanese companies continue to restructure and many are competitively valued on a cash flow basis. The cash-rich public, which bought stocks in the late 1980s with gusto to rival the NASDAQ mania of 1998 to early 2000, is out of the market today. When they move back into stocks (the precondition is an established uptrend) Japanese equities should outperform Europe and North America, at least in terms of local currencies.

The Bush Administration is determined to reduce dependence on energy imports. The main threat to US economic development is not the NASDAQ's former bubble, low savings rates, corporate debt or the misunderstood current account deficit. Instead, it is energy costs and shortages. This problem, which is global, has been with us since mid-1999 and is a major contributor to the current economic slowdown. Unfortunately, the Clinton Administration did more to impede than promote US energy development. However environmental considerations and conservation need not be incompatible with the development of energy resources, which are a priority of the Bush Administration. The President's recently released energy task force report is realistic in saying "America in the year 2001 faces the most serious energy shortage since the oil embargos of the 1970s". Coincidentally, the International Energy Agency, which is linked to the Organization for Economic Cooperation and Development, has also issued a warning on energy security risks. The Bush Administration's report states that without decisive government action energy shortages will "undermine our economy, our standard of living and our national security". This is unlikely to be a short-term problem as the 163-page report estimates (conservatively, I believe) that US energy consumption will increase by 32% in the next 20 years. A task force, led by Vice President Dick Cheney, recommends easing regulations that block construction of electric, gas, coal and nuclear power plants because conservation alone cannot match demand with supply without undermining the economy. The public and business will know that this is no scare story, particularly in California where rolling blackouts have been a frequent occurrence for months. New York will be similarly vulnerable in the event of a hot summer. Significantly for energy companies, the report proposes $10bn in tax credits over 10 years. I watched CNN's two-part interview with Dick Cheney on Lou Dobbs' Moneyline, shown on 15th & 16th May. While the Vice President is interested in all sources of energy production and economically sensible conservation, he particularly emphasised two areas - refineries and nuclear power. A dearth of new or modernised refineries is a major cause of the gasoline shortage. Nuclear power has been generally out of favour since the 1979 Three Mile Island and 1986 Chernobyl disasters and there is the ongoing problem of highly radioactive waste storage. Nevertheless the technology has not stood still and with the critical proviso that contamination is prevented, nuclear power is the most feasible, efficient and clean source of energy. Currently the US receives only 20% of its electricity from nuclear power, compared to 75% for France, according to the Energy Information Administration. In their recent International Energy Outlook 2001, they had forecast a decline in US nuclear energy to 12% in 2020, partly because in 2000 nearly one-third of America's nuclear power stations were 30 or more years old and the last building permits were issued in 1976. Clearly this will change, judging from the Bush Administration's energy task force report. In Europe, I think Belgium, Germany, the Netherlands, Sweden and Switzerland will have to reassess their plans to gradually shut down nuclear power industries. I believe energy will be one of the most important industries in coming years. Investors who agree should consider companies involved in all aspects of energy, from the building of power plants to the production and refining of oil, with price charts being the final arbiter of share selection and timing. Companies involved in the development of alternative energy sources from fuel cells to so-called renewables such as wind, wave and solar power will also qualify for US tax breaks and will offer some speculative opportunities.

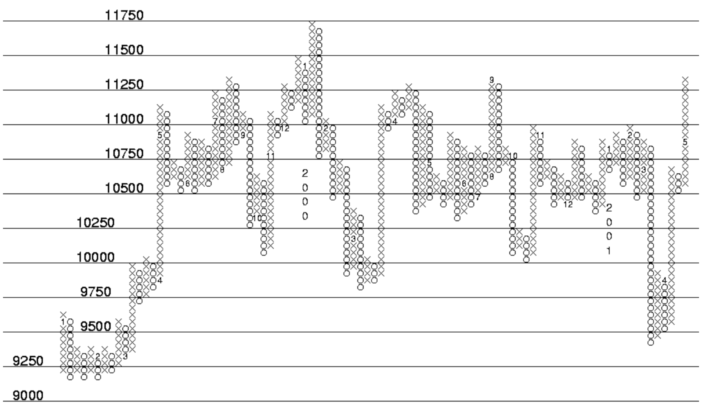
Chart review of topical and representative stock market indices - *The point & figure charts shown are based on closing prices and taken from our website. Anyone interested in this chart service, which includes analysis and is updated daily, should register online at www.fullermarkets.com. Price levels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

The Fullermarkets World Market Indicator (1910) has continued to recover, providing further evidence that the February-March downward acceleration was a trend-ending signal. *The FMWI is unweighted and calculated in local currencies.*

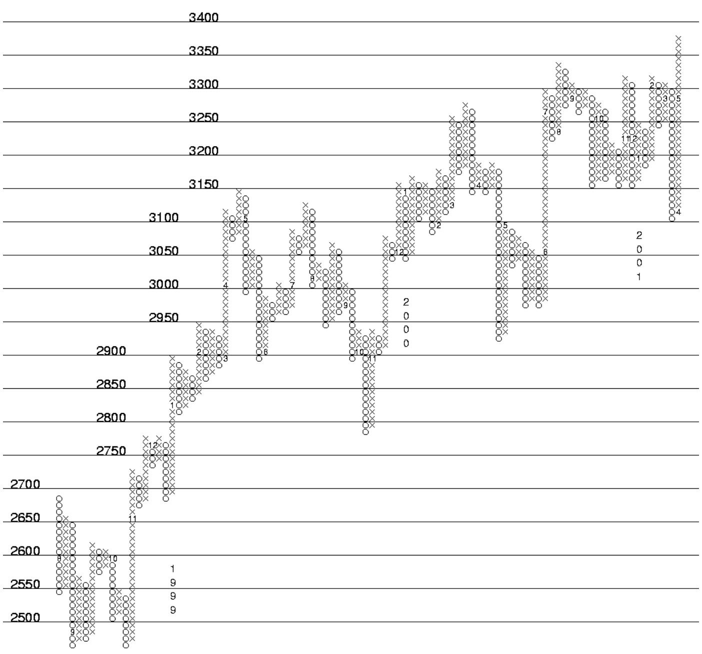
The Morgan Stanley Capital International Indicator (1156) has similarly extended its post-climactic sell off rebound, scoring the best gains since late 1999. This indicates that a low of at least medium-term significance was established in March. However supply evident above 1200 could make additional upward progress more laboured. *The MSCII is capitalisation weighted and calculated in US dollars.*

The US's Dow Jones Industrial Average (11105) *- see overleaf -* has followed its downside failure in March with a test of the broad two-year band's upper boundary. This should provide at least temporary resistance and although a new all-time high is distinctly possible, it would probably prove difficult to maintain. **The NASDAQ Composite Index** (2243) has resumed its recovery following the capitulation-decline from late January to early April. That it

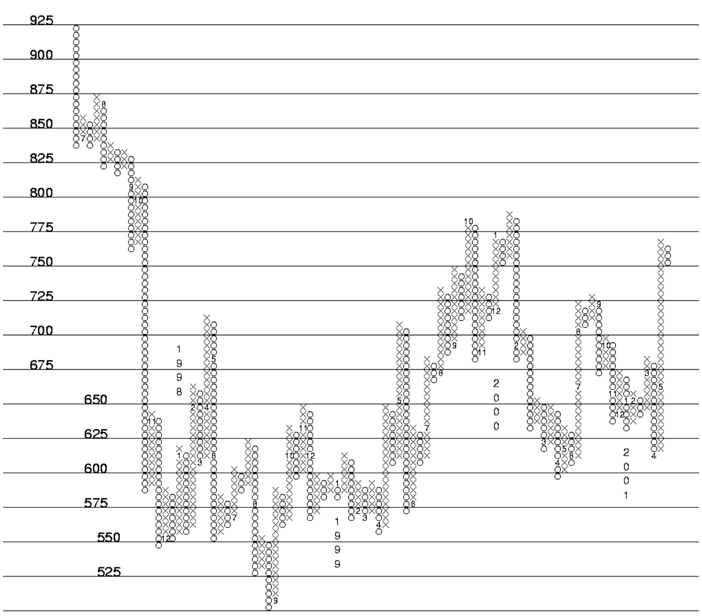
Dow Jones Industrial Average (50pt)



Australia All Ordinaries Index (10pt)



Australia All Mining Index (5pt)



can do so after a consolidation during which only a third of the initial gains were retraced is a bullish indication, providing further evidence that the final low occurred in early April. At some point there will be a pullback and base extension but a decline to 2075 is currently required to question overall upward momentum.

Japan's Nikkei 225 Stock Average (13895) - *see previous page* - could not maintain the early-May move over 14000 but not much erosion of support has occurred. While a decline to 13600 would suggest a lengthy base extension, the more likely prospect is a resumption of the recovery, signalled by a move to 14600.

Australia's All Ordinaries Index (3362) has followed March's downside failure with a punch to new all-time high ground. It has a long history of not maintaining upside breakouts and a move under 3300 would suggest another medium-term failure. However higher reaction lows are the long-term trend's most important consistency characteristic and a move under 3100 is necessary to check this slow-moving bull market. **The All Mining Index** (738) is retesting the January 2000 high near 785 after a lengthy phase of base formation extension within what has been a very choppy pattern. While the region of last year's high may cause some temporary resistance, the build-up of underlying support since late 1997 and speed of the recent rally are bullish.

South Africa's JNB Gold Index (1252) shows a similar base to the All Mining Index above. While we will not have confirmation of base completion until support has been encountered near or above the previous rally high within this large and ranging pattern, followed by an additional upside breakout completing the first step above the base, these 'sleeper' patterns are usually resolved by dramatic advances. This is because they have been overlooked and all the floating supply has changed hands within the base, leaving a vacuum of supply when sentiment eventually improves.

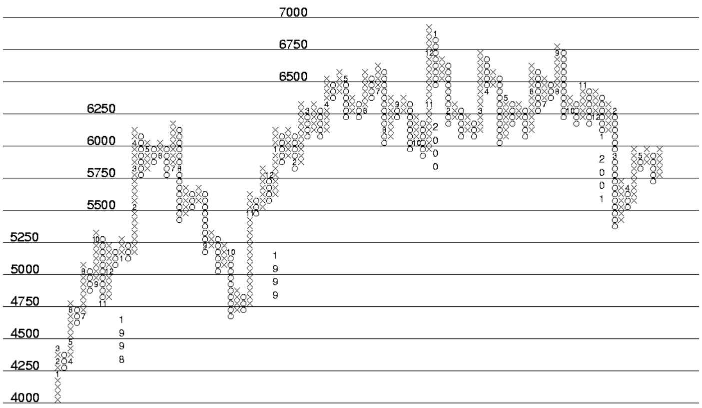
Vienna's ATX Index (1197) was largely a wallflower during the 1999 rally. However it shows a very large and still developing base, capable of producing a better relative performance provided this potential is not delayed by a break in this year's progression of higher reaction lows.

Ireland's ISEQ Overall Index (6344) has shown the best relative strength in Europe this year, pushing to a new all-time high recently. While a move under 5750 would indicate an upside failure, a break of the higher reaction lows, with the last at 5100, would be required to reverse the ranging upward bias.

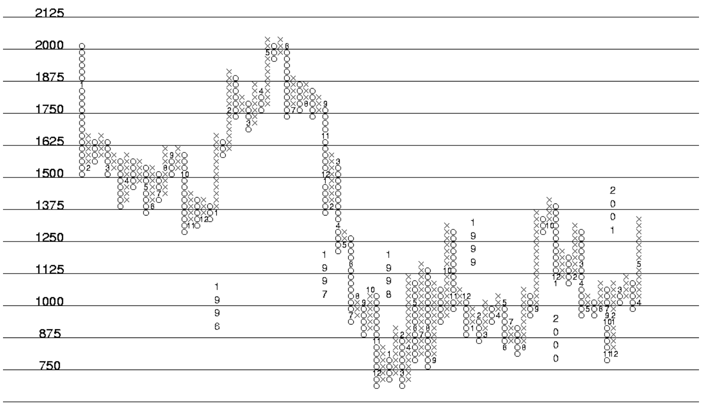
The UK's FTSE 100 Index (5898) is testing overhead resistance once again. Somewhat higher scope would be indicated at 6000, while 5650 is required to suggest another sell off.

Strategy for stock markets - Technical evidence, in my view, shows that in April most stock markets passed the inflection point where fear of declining profits is

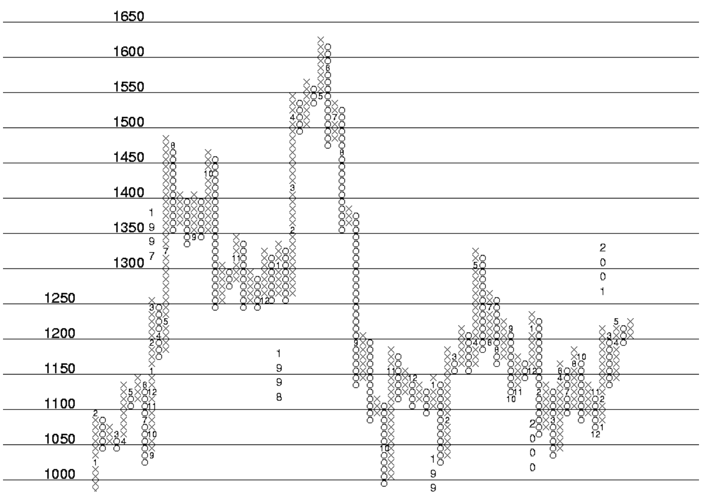
United Kingdom FTSE 100 Share Index (50pt)



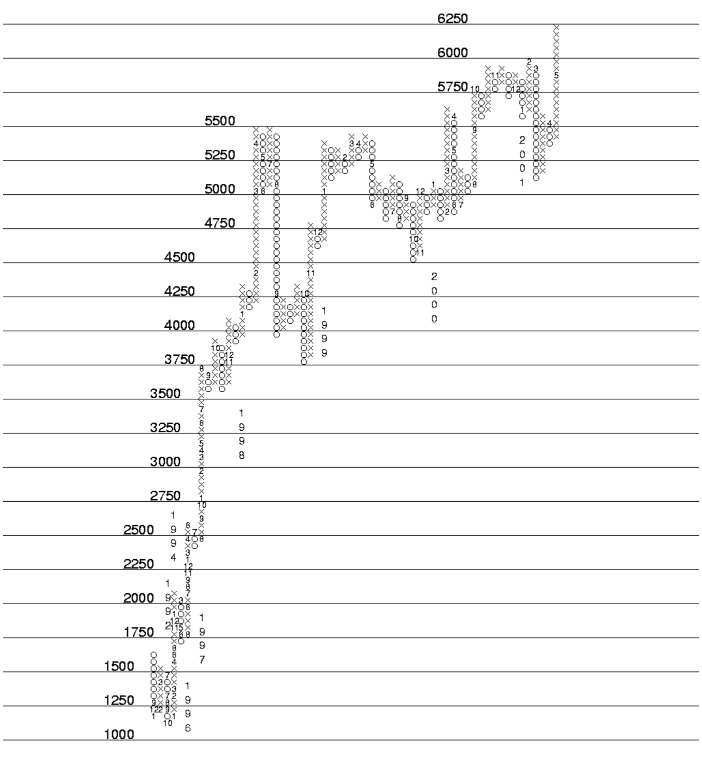
South Africa JNB Gold Index (25pt)



ATX Vienna SE Index (10pt)

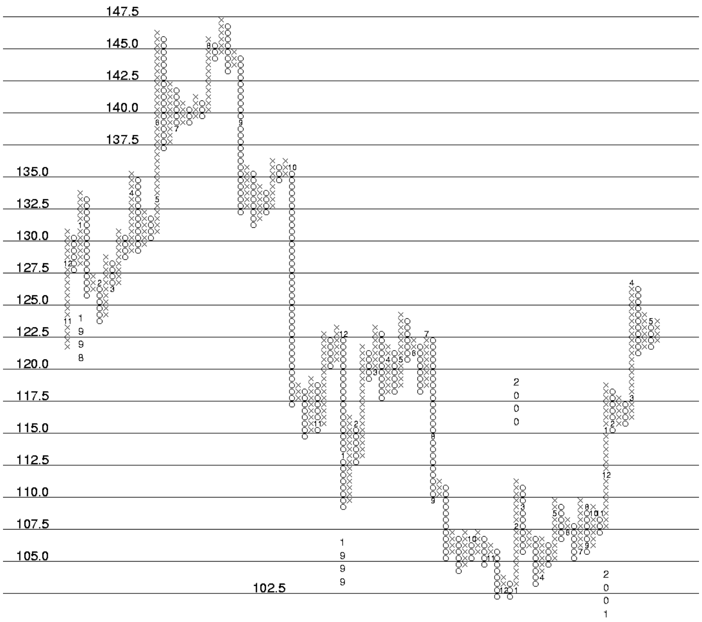


Ireland ISEQ Overall Index (50pt)



offset by the bullish implications of falling interest rates. "Don't fight the Fed" remains one of the most helpful investment mantras, especially given the US market's dominant influence. I now conclude that we have seen lows of at least near-term significance for all important stock market indices. However, while fear is always greatest near market lows, there are some good reasons, well known to readers, for believing that stock markets are due for a long period of modest overall returns relative to what investors have been conditioned to expect. This does not mean that there will be fewer opportunities for profit. However timing is likely to become even more important and two of Wall Street's favourite mantras from the last cycle - "Buy and hold" and "Buy the dips" - which had been elevated to Holy Grail status in some minds, could now be counter productive. I anticipate a primarily ranging environment, not dissimilar to what some of us recall from the late 1960s into the early 1980s. Instead of big, all encompassing bull markets we had medium-term 'sweet spots' mainly due to rate-cutting cycles. These were followed by bearish phases, usually as rates rose. Some of the declines were severe - notably 1973/4. If you agree, partially or wholly with my hypothesis, index-tracking funds will generally disappoint unless they target a particularly fashionable sector. However discretionary fund managers should have a better chance of outperforming their benchmarks. Success, as always, will depend in part on our ability to identify the big themes and fashionable trends early on. I see at least two big stock market themes - one global and one national. My global candidate is energy, with the US leading the trend due to Bush Administration policies. I like the big oil companies. These have shown relative strength for a while but many are underpinned by several years of base building, capable of supporting further and potentially substantial gains if I am correct on the theme. Some suggestions, with buying ranges in brackets are: Conoco ($33 to $28), Chevron ($96 to $88), Occidental Petroleum ($30 to $27), Phillips Petroleum ($67 to $60), Texaco ($71 to $65) and Unocal ($39 to $35). There are interesting speculations in the nuclear and fuel cells fields - USEC ($11 to $8) sells uranium fuel enrichment services for commercial nuclear power plants. The stock has seen a big rise this year but it had been left for dead previously. USEC's base can support higher levels; its estimated p/e is 26 and it yields 5%. Two very speculative fuel cell stocks are Fuel Cells Technologies

Japanese Yen per 1 US Dollar (0.5)



(C$1.80 to C$1.40) and H Power ($14 to $10). I'm hoping for pullbacks following the initial flurry of interest. Another theme is Japan's potential recovery, about which I have written at length in recent issues, including 'The Triple Play' in FM202. I'm going for big bases such as Mitsui OSK Lines (¥340 to ¥290), a marine transportation company specialising in oil and other raw materials. In textiles, I like Gunze (¥525 to ¥460) and Teijin (¥685 to ¥600). In stores, Jusco (¥2800 to ¥2500); motors, Yamaha (¥1050 to ¥950; brokers Nomura (¥2650 to ¥2200); property, Mitsubishi Estate (¥1200 to ¥1050) and electrical, Yokogawa (¥1300 to ¥1150). Among Japanese investment trusts, I own Atlantis Japan Growth Fund, quoted in London, which I mentioned in FM203. However, the discount to NAV has narrowed to an historically low 11%, so I would prefer a pullback following the early high at $10.36 before considering an additional purchase. The risk with Japan, which I would probably ride out and use as a further buying opportunity, is that Junichiro's reforms temporarily plunge the economy into a deeper slump before it recovers. That could produce a one to two year base extension, with the market recovering well before the economy. Elsewhere, in what might be a question of semantics, I'm wondering if the flurry of interest in mines and gold is a temporary fashion rather than a big theme at this time? However, for gold bugs, who will be long in tooth but I suspect are not quite an extinct species, the investment trust to have is Merrill Lynch World Mining (formerly Mercury World Mining) of Julian Baring fame, now run mainly by his colleague of many years, Graham Birch. The managers still don't use charts, to my knowledge, but they have forgotten more about mining shares than I'll ever know. In a display of disastrous timing (fool's gold), I bought this fund years ago and then tucked it away for the cyclical recovery that has taken much longer than initially expected. I'll hold on because the price has risen since its 1998 low to the highest level since early 1994, outperforming the mining indices, which show large bases. It also trades at a discount to NAV of almost 19%. In futures, I kept my NASDAQ long because it never showed any downward dynamics during the recent consolidation. This is a trailing stop play. I repurchased Nikkei futures near current levels.

Currencies

■ **Are "criminals" preventing the euro from recovering today but likely to rescue it around yearend?**

■ **Behavioural conditions for another advance against the yen are almost in place.**

A cash hoard from Eastern Europe and the "black economy" is being converted from German marks into dollars, temporarily weighing on the euro. It's enough to turn Wim Duisenberg's hair white. All those people holding billions of mostly marks and to a lesser extent notes denominated in Euroland's other national currencies are having to ditch this paper before it ceases to be useable money on 28th February 2002. Understandably, most are unwilling to swap their German money etc for euros because currently, this can this only be done by opening a bank account. That would raise the possibility of questions as to how the lucre was acquired and whether or not it was taxable. The Bundesbank confirms that none of the "black economy" cash hoard is being converted into euros. Most is being swapped for US dollar notes, plus a small quantity of Swiss francs and sterling. Since the mark and other Euroland currencies are pegged to the single currency, these transactions can only weigh on the euro. My guess is that conversion of this clandestine cash will be mostly completed before yearend. If so, one source of supply depressing the euro will be drying up from October onwards. After 1st January 2002 some of this money will inevitably be converted into euros for diversification and convenience. Therefore "criminals" will ride to the euro's rescue next year, loving those 1000-euro notes, enabling them to carry lots of dosh in a holdall.

The dollar and other reserve currencies are no longer overbought against the yen. Two months ago the crowd was forecasting ¥130 to ¥140 for the US dollar versus the Japanese currency. That indicated a short-term overbought condition and recently most people were forecasting indefinite ranging in the ¥126 to ¥120 region. Following the sell off on 23rd May, this consensus has probably been lowered to ¥122 to ¥115 or thereabouts, with some economists citing foreign demand for Japanese stocks. We can conclude that a significant proportion of the 'yen carry' speculators are back on the sidelines, despite interest rate differentials that remain highly attractive. I agree that Westerners will put more money into the Japanese stock market if it shows further relative strength as I suspect. However many who are allowed to hedge currency risk will do so, locking in the return on rates in addition to likely currency appreciation against the yen. The key fundamental factors in my view are Japan's quantitative easing and the flow of funds by Japanese investors. Today, not even the Japanese Government and BoJ have any idea how much money they will have to print in order to boost the supply in circulation significantly, stem the long-running

Japanese Yen per 1 Euro (0.5)

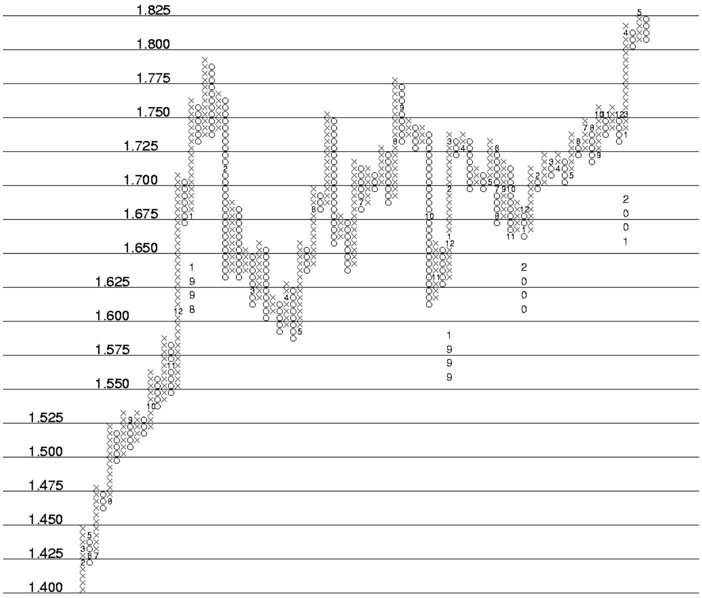
deflation and underpin a sustainable economic recovery. We do know that they are not pleased with the yen's recent rally, which can only delay economic recovery. My hunch is that Japan's monetary stimulus will need to be massive and proportionally much greater than we will see from the US or Euroland. As for Japanese institutional and private investors' many trillions of yen currently earning negligible returns in Postal Savings Accounts and JGBs, some would flow into a performing local stock market, having no effect on the yen. However I believe a tsunami of Japanese money will slosh overseas in search of higher yields, especially as the yen weakens further. After all, what would you do with personal savings if your currency had no yield and the government was printing money at a record pace?

Review of currency point & figure charts - *These and hundreds of other closing basis charts are available on our website www.fullermarkets.com and updated daily. All comments refer to closing levels for US trading hours.*

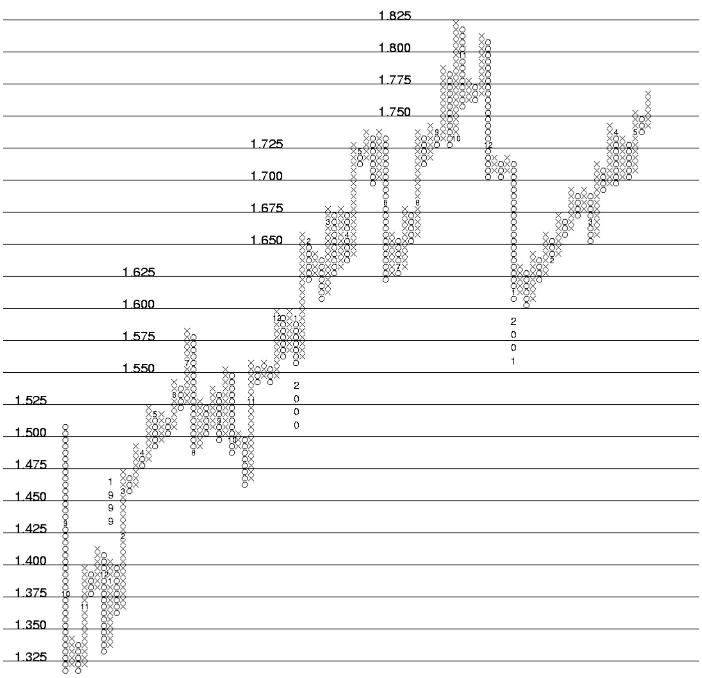
Dollar/yen - (¥119.76) April's larger reaction within the uptrend pared bullish sentiment, leading to a medium-term consolidation. This will be extended because the sequence of higher reaction lows since July 2000 has been broken - *not shown on the chart which was produced a day earlier.* This loss of consistency will worry speculators until the dollar rallies back up into the mid-¥120s region. A clear technical improvement will occur at ¥124.5, taking out the late-April high. There are short-term uncertainties but the base and earlier sharp advance suggest substantially higher levels over the medium to longer term.

Euro/yen - (¥102.43) The euro rolled over within its lengthy consolidation of the first and explosive leg of a primary recovery - *latest reaction not shown*. However support evident below ¥102.5 should now cushion downside risk, which is limited to base formation extension. The main uncertainty is the depth and length of this pause before a larger base supports a resumption of the recovery, confirmed

Singaporean Dollar per 1 US Dollar (0.005)



Swiss Franc per 1 US Dollar (0.005)

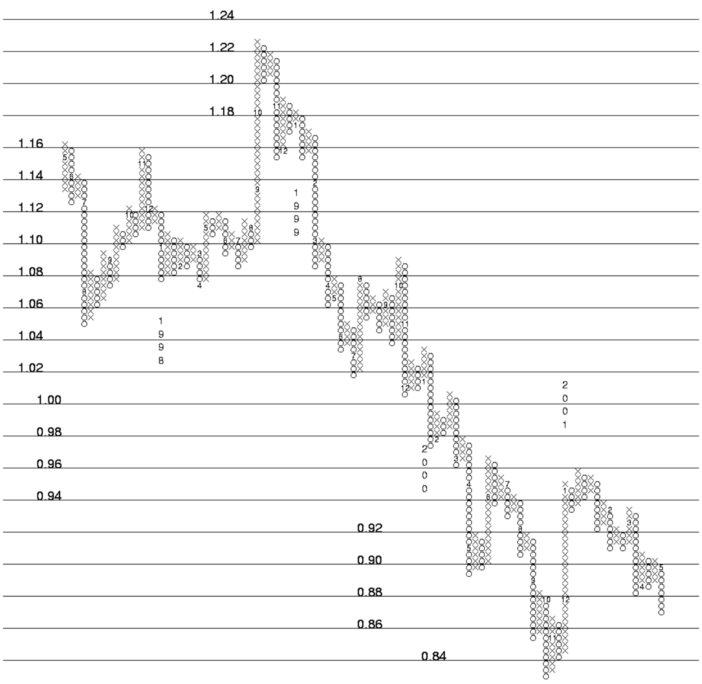


by a clear break over ¥113.

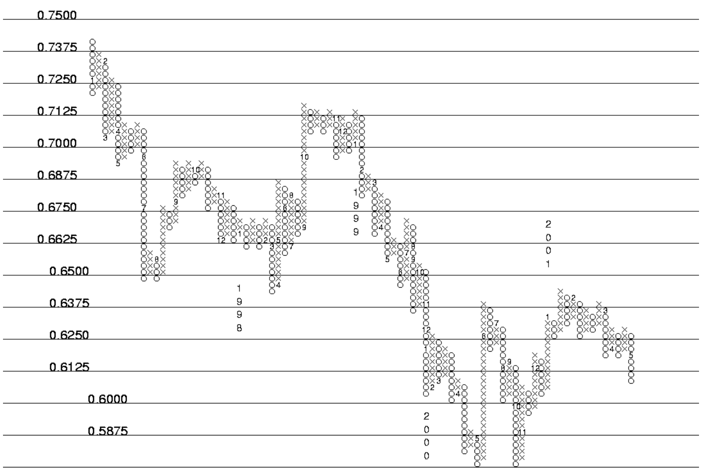
Dollar/Singapore $ - (S$1.81) The greenback has paused following its break above 1998's devaluation highs against the S$. While very large patterns following strong earlier advances can be unreliable, the current implication is that a renewed uptrend is underway. A move under S$1.775 is needed to question this bullish hypothesis and S$1.750 for evidence of an upside failure.

Dollar/Swiss franc - (SF1.78) The most important development within the last year was the sharp reaction in Nov-Dec 2000, breaking a two-year uptrend for the dollar. This year's two-thirds retracement has been much more

US Dollar per 1 Euro (0.004)



Pound Sterling per 1 Euro (0.0025)



gradual, suggesting that at least temporary resistance is likely to be encountered as the October high near SF1.82 is more nearly approached. Meanwhile, a reaction in excess of 8-units of scale (SF4) is required to check this year's ranging uptrend. On a longer-term basis, the historic underlying base that began to form in 1995 - *see SF2-scale chart on website* - suggests that whatever resistance the dollar encounters over the next year or so, it will eventually resume its primary uptrend.

Euro/dollar - (0.8562¢) Similarly (but shown conversely to dollar/Swiss franc above) the euro's retreat to retest its yearend 2000 trough is much more gradual than the rally from that low. While the euro is still easing, it should encounter at least temporary support as last year's floor is more nearly approached. Watch for an eventual break of this year's downtrend, currently requiring a recovery of at least 7-units of scale (2.8¢).

Euro/sterling - (0.6037p) The euro is also easing against sterling, albeit at a more gradual pace, following January's failed push over the June 2000 high after resistance was encountered from extensive overhead trading. While this is probably a base extension, a rally of 5-units of scale (£0.0125) is needed to question the current drift.

Strategy for currencies - I continue to favour short yen as a medium-term strategy, although this has been ranging with a downward bias in recent weeks. Suspecting that short yen against the dollar below ¥120 is low risk, I currently have a moderate-sized position, partly because I am going to be away from the markets for three weeks following completion of this issue. I have a much smaller position in euro/yen but feel this is becoming interesting once again because the euro's overall slide is likely to provoke the ECB into jawboning and perhaps further intervention. Other candidates for short yen are the Australian and Canadian dollars plus sterling, subject to timing. In a bull market, I prefer to buy on easing, occasionally topping up on breakouts if underweight. Elsewhere, the psychological trap for many Europeans is that they want the euro to go up generally (you may have noticed all the bullish forecasts over the last year or more) because it is their base currency. However privately, they don't have much confidence in the ECB or the official Euroland growth forecasts. Nevertheless a retest of the lows against the US dollar, should it occur, would create a buying opportunity for three reasons. The euro would be undervalued, subject to intervention and there is likely to be a surge of demand for the notes, once they are issued in January 2001, because no Eastern European or any other holder of cash (as opposed to bank accounts) will have any. Currently, the swapping of marks and other European cash before it ceases to be usable next year is weighing on the euro.

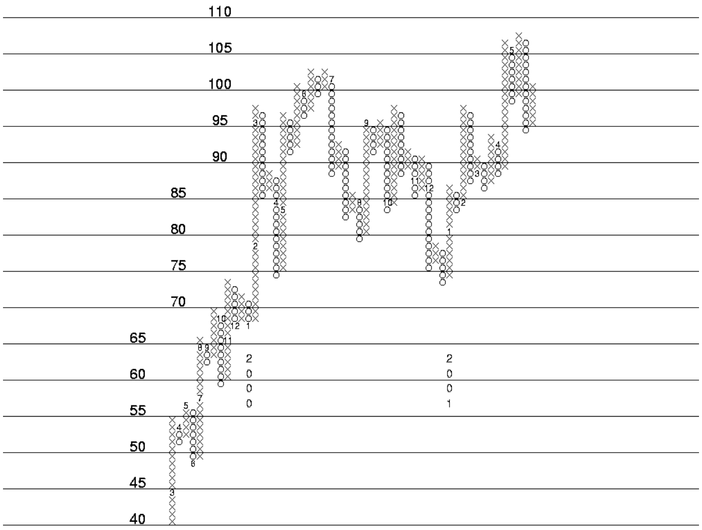
Commodities

- **The fundamentals for gold are improving.**

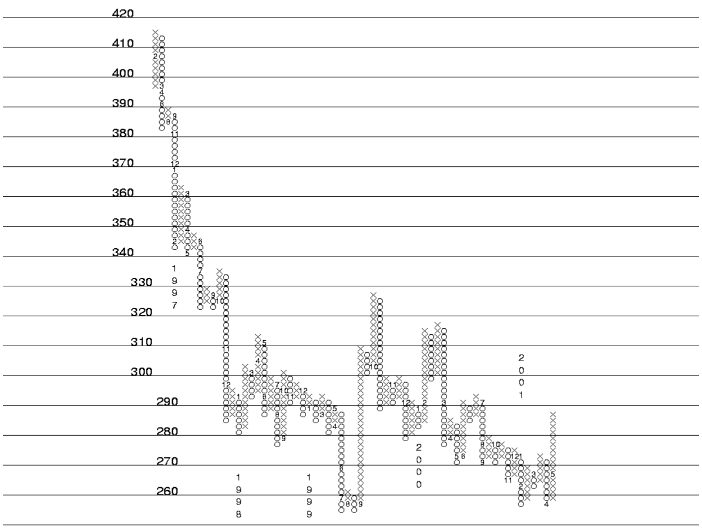
- **Petroleum contracts remain propped up by OPEC production cuts and refining problems.**

Gold is forming a large base. I last commented on the gold chart in October 2000 (FM197), making four points. It had broken under $270 at the time, indicating scope for a retest of the mid-1999 trough down to $251.70, in what looked like a right-hand extension of a large base, $280 was needed to reaffirm the low and bullion appeared well supported when quoted in weaker currencies such as the German mark or Swiss franc. On 18th May gold bullion surged over $280, providing the best evidence of a base since the pattern's initial spike in 1999. Both moves involved short covering, with the earlier rally sparked by a European central bank decision to limit sales to 400 tonnes per annum following complaints from the poorer gold-producing countries that CBs were undermining their economies. Needless to say 400 tonnes is still a lot of bullion, at least when investors and speculators are disinterested in gold, so the fundamentals need to improve before that base formation can support a significant recovery. I believe this is gradually occurring. While gold has risen sharply against weak currencies such as the South African rand, the low US dollar price has deterred financing for mining activities by Western countries. Consequently production has been declining and for many years the supply of newly mined gold has been substantially outweighed by demand. Nevertheless with central banks selling, additional demand is required to lift gold bullion beyond temporary short-covering rallies.

Gas Unleaded NYME 2nd Month Continuation (1USc)

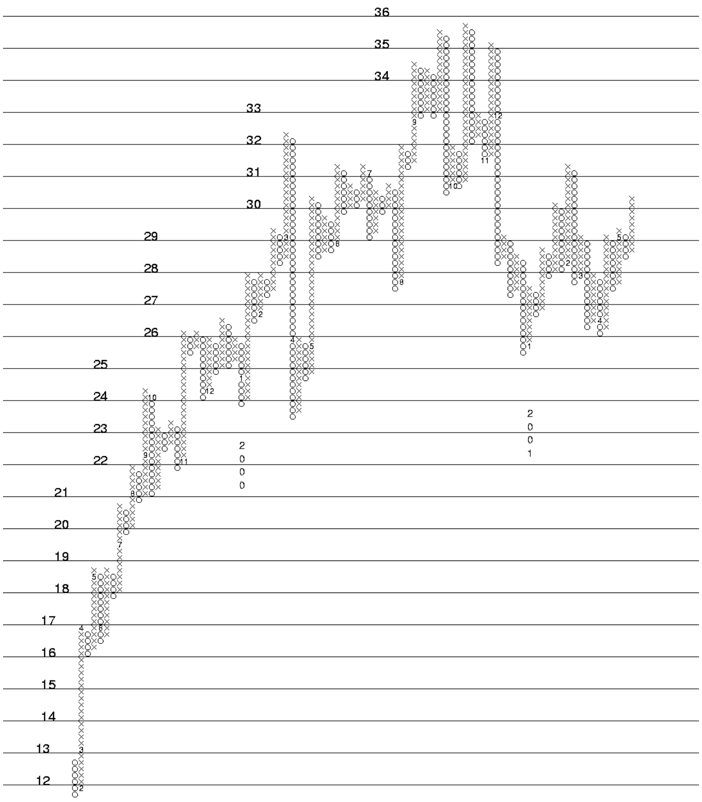


London Spot Gold (2USD)



Behaviourally and in a generational change, many people now regard deflation as a greater threat than inflation. Politicians and eventually the central bankers that they appoint will reflect this consensus. Consequently, in the likely event of slow global growth central banks are likely to err on the side of too much rather than too little monetary stimulus. Inflation is ultimately a monetary phenomenon, with a time lag before people realise what is going on and an inflationary mentality becomes entrenched, as we last saw in the late 1970s and early 1980s. In Japan it is a deflationary mentality that is entrenched today but the Bank of Japan's quantitative easing will eventually change this. Fearing deflation the US Federal Reserve is reflating aggressively and the European Central Bank will remain under pressure to follow this lead. It is fear of inflation that would remonetize gold as a store of value. Finally, Middle Eastern oil-exporting countries have been major purchasers of gold in the past. Their treasuries are filling once again due to two years and counting of higher oil prices. They fund the Palestinian political organizations that are increasingly in conflict with Israel. Unfortunately, the previously unthinkable - another Arab/Israeli war - is now possible. In this event, the Islamic states involved would not want to hold all of their reserves in US dollars. They will have some reservations about the unproven euro and won't want to buy yen. Gold is cheap and an historic store of wealth, particularly in times of uncertainty. Timing is the critical factor, as always. While I would be surprised to see gold complete its base in the near term, by maintaining a push above the 1999 high and lateral resistance near $340, risk of a sustained break beneath the lows just above $250 should be small. Before last week's upward dynamic I thought gold could spend several more years in a ranging pattern near present levels. While this is still a possibility, my current outlook is for sideways to higher trading

Crude Oil NYME 2nd Month Continuation (0.2USD)



and if bullion now holds above $275, we can expect further tests of overhead resistance.

Vice President Dick Cheney says the US hasn't built

a new oil refinery for 25 years. The two previous administrations were complacent on energy, believing Saudi and Kuwaiti gratitude over the Gulf War would ensure low prices. Understandably, the oil producers feel they have repaid that debt. For Western oil companies, the economics of refineries were unappealing, given low prices, tightening environmental regulation and protests. Energy policies in most other developed countries were similar. Germany's Government is actually committed to phasing out nuclear power, although this is now likely to be postponed indefinitely. The Bush Administration is determined to decrease US energy dependence but there is a long time lag between implementation of new policies and their effect in the market. Consequently outdated and overstretched refining capacity and OPEC's production cuts are keeping petroleum prices higher for longer than most people expected. Gasoline prices are particularly susceptible to the refining problem and judging from the chart, it would be premature to conclude that we have seen the peak. Crude oil shows top formation characteristics but support has been encountered near $26 (NYME) this year. Consequently, further ranging is likely, over the short to medium term and a retest of the upper boundary cannot be ruled out.

Strategy for commodities - I'm still positioned for seasonal rebounds in depressed agricultural commodities but have scaled back somewhat due to a pending holiday and the dollar's strength, which weighs on prices. Coffee had a good bounce, now partially retraced in what looks like base extension. Soybeans have firmed and are historically low but weather concerns will be required to inspire more than a technical rally. US wheat yields will be lower this year, mainly due to insufficient moisture in early May. However recent rain has eased concerns, elevating currency considerations to the main influence on price. Gold and silver are likely to attract further speculative interest following their recent firming and the strong performance of mining shares.

The Global Economy

■ **Second-half rebound or lengthy slowdown for the global economy?**

We could see a sustained period of moderate to slow GDP growth and a global recession cannot yet be ruled out. I think economic trends for the next twelve months or more are a difficult call, unlike last year when interest rate hikes, high oil prices and the TMT crash were always likely to slow growth more than most economists chose to acknowledge. The main improvement today concerns rates, where the Fed has led central banks in monetary easing. However there is little chance that growth will take off as we last saw following rate cuts in response to the 1998 financial crisis. Today, petroleum prices remain high following the latest supply reductions. This is especially true for gasoline, where the squeeze has been intensified by refining problems, and the overall effect is more damaging for the global economy now that it has slowed relative to 1999 when OPEC's cuts began to lift energy prices. Moreover oil's latest rally has added to inflationary pressures that concern the ECB in particular. There is a risk of stagflation - economic stagnation coupled with sufficient inflation to worry central banks. The ECB, handicapped with the Bundesbank's *Friedmanesque*, monetarist's charter more appropriate for an overall inflationary environment such as the late 1970s and early 1980s, painted itself into a dangerous corner. Ignoring the clarion call to cut rates until his U-turn on 10th May, Wim(*sical*) Duisenberg now needs luck in the form of a strong US economic rebound. Meanwhile, he is likely to lose even more face as Euroland's growth continues to slow, causing unemployment to rise. The UK's foot-and-mouth epidemic now appears to be under control but not soon enough to save the tourism industry's summer season. This will compound Britain's GDP slowdown, already occurring in response to stealth-tax increases and the global economic trend. The US economy surprised everyone with a Q1 growth rate of 2% YoY, double the consensus forecast. This has raised hopes for a V-shaped recovery but that is unlikely, given wealth-effect problems caused by the TMT stock slump, corporate layoffs and debt concerns. Japan's interesting, albeit belated policy shifts are promising for the longer term but a spate of bankruptcies and more radical restructuring could first make economic conditions worse, as new Prime Minister Junichiro Koizumi has stated, before a sustainable recovery occurs. In conclusion, global economic risks are still on the downside and a recession cannot be ruled out, despite some evidence, albeit inconclusive, that the US economy may be bottoming out. The most likely outcome is a period of slow global GDP growth extending well into 2002. If this is too pessimistic, I'm probably underestimating US rather than European GDP.

And Finally…

The Chart Seminar 2001 - We had a terrific group of delegates for TCS on 10th & 11th May, including the usual high proportion of referrals plus some very senior people and old friends. This contributed to interesting discussions, particularly regarding long-term market cycles and why we may need to recall the environment of three decades ago for perspective on potential developments over the next few years. My next seminar will be a return to the Zurich Marriott on 12th & 13th July, a good time of the year to visit that fine city. For a brochure and enrolment form, email sarahhewett@fullermarkets.com.

Away from Office - Please note that I will be away until 18th June on my cycling Tour de Gourmand des Pyrenees.

The target date for FM205 is Friday 29th June.

"Wherever there is a crowd there is untruth."
Soren Kierkegaard

Best regards - David Fuller

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