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In its 18th year

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

Many stock market indices are challenging or breaching their March lows and further weakness would be a bearish indicator for the global economy.

Japan's deflationary spiral is intensifying and the BoJ remains a major cause of the problem

Hayami remains defiant as Japan sinks - International Monetary Fund Deputy Managing Director Stanley Fischer, who some say never saw a currency he didn't want devalued, is the latest luminary calling for a policy reversal from the Bank of Japan. "Obviously, neither Japan or the rest of the world wants the yen to go crazy, but there is some room for expansionary monetary policy that would weaken the yen", Fischer told reporters after a recent meeting with government and central bank officials in Tokyo to discuss IMF lending conditions. He is right, of course, but BoJ Governor Masaru Hayami - who makes Wim Duisenberg look competent - wasn't impressed. The Governor is pathologically committed to a strong yen, regardless of the deflationary consequences for Japan's crumbling economy, a problem that he has compounded in recent years. It was Hayami who orchestrated intervention, with US participation, to strengthen the yen in August and September 1998 after it had fallen to ¥147.66 against the US dollar. As the yen's rally helped to snuff out Japan's incipient economic recovery in 1999, the Ministry of Finance instructed the BoJ to intervene again, this time by selling the currency. Under the Japanese monetary system's rules Hayami had to oblige but he countered by sabotaging a series of MoF interventions, selling bonds to mop up excess liquidity in a process called sterilisation. The BoJ Governor confidently stated that he saw evidence of economic recovery but unfortunately for Japan this has proved to be a mirage. Discredited, Hayami has had to reflate and is now purchasing ¥400 billion ($3.18 billion) of Japanese government debt a month. However this has proved to be a case of too-little-too-late as money supply has crept up to only 3.2 percent (M2+CD, June YoY), much too low for an economy in recession and also trapped in a deflationary spiral. Against a chorus of domestic and international calls for the BoJ to increase its purchases of Japanese bonds, Hayami remains not only defiant but is also holding the democratically elected government to ransom. At the BoJ's latest press conference on 17th July Hayami acknowledged that "downside risk" for the economy is "intensifying somewhat" while adding, "At last week's board meeting we unanimously agreed to maintain the current policy to counter such a severe situation". Dismissing the latest pleas from Finance Minister Masajuro Shiokawa and Economic Policy Minister Heizo Takenaka, for a boost in money supply to counter recession, Hayami responded, "It's essential that the government implement structural reforms to make our current strong easy (*sic*) monetary policy more effective and make Japan's growth sustainable". This beggars belief, so it is not surprising that people are calling for Prime Minister Junichiro Koizumi to sack Hayami. He can't, at least not until the Governor's five-year term expires on 19th March 2003. The BoJ finally gained independence in 1998 after a long power struggle with its former supervisor - the Ministry of Finance. In March of that year former Prime Minister Keizo Obuchi appointed Masaru Hayami Governor of the central bank. Hayami had joined the BoJ in 1947 at the age of 22, shortly after General Douglas McArthur presided over Japan's post-WWll reconstruction. Allegedly, McArthur, said to his interpreter, what's a yen? On hearing it was a Japanese word for circle, the General decreed there would be 360 yen to the dollar to match the number of degrees in a circle. In 1981 Hayami left the BoJ for private industry but caught the Prime Minister's eye in 1995 when his book, "The Day the Yen Gains Respect", was published shortly after the Japanese currency's brief surge to a ruinous ¥79.75 against the US dollar. As for the BoJ's independence, a monetary policy free from political interference is usually a good idea but unfortunately for Japan, in the long sad history of duff central bankers Hayami is setting new records. He is certainly in violation of BoJ Article 2*, which sets out the central bank's main responsibility - "Currency and monetary control shall be aimed at, through the pursuit of price stability, contributing to the sound development of the national economy". Perhaps this loses something in translation but clearly Japan does not have price stability and its deflation is primarily the result of restrictive monetary policy, despite zero interest rates. With the country's economic crisis worsening one can only speculate as to what drives Masaru Hayami because his actions appear insane. The eventual irony for Hayami will be a much weaker yen than would have occurred if his policies had helped rather than hindered the Japanese economy.

*The BoJ's website is www.boj.or.jp/en/about/about_f.htm..

Interest Rates and Bonds

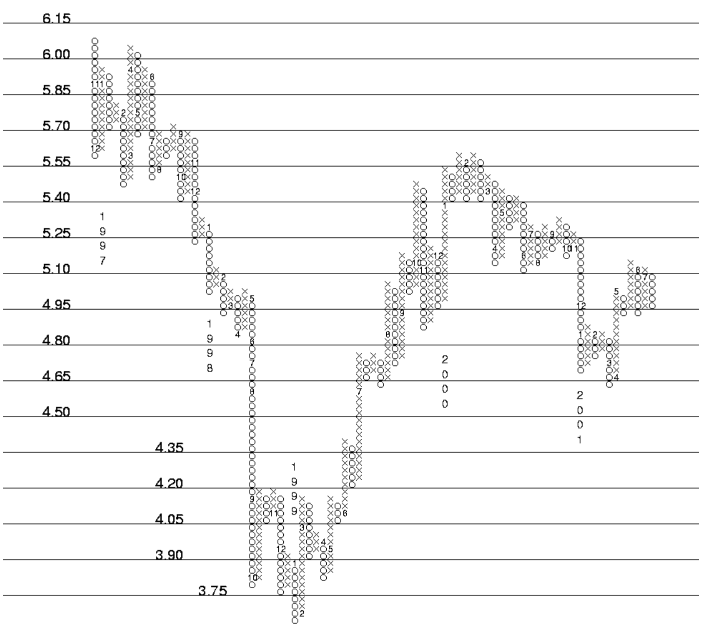
■ **The ECB and BoE will have to cut short-term rates.**

■ **Weak stock markets and the reaction in petroleum prices have lowered government long-dated bond yields.**

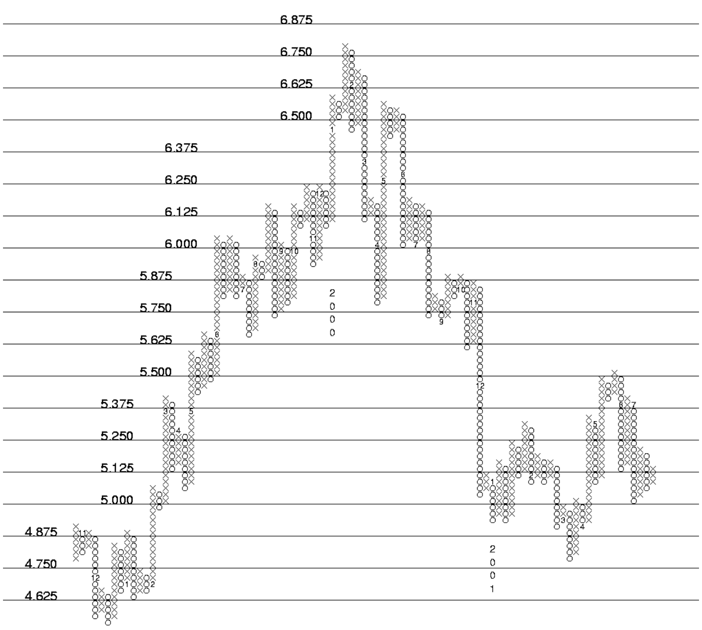
Europe's GDP growth is still slowing. For Euroland and the UK, economic risks are on the downside and have been made worse by complacency on growth and the ECB's rigid charter on inflation, which does not make allowances for external factors such as the OPEC supply cuts. Fortunately for the ECB, oil prices are well off their highs for the year and natural gas, which is not controlled by OPEC, has slumped. This has reduced inflationary pressures somewhat. In the UK, fiscal spending has kept some sectors of the economy reasonably firm but manufacturing is in recession. The arguments for rate cuts are compelling. In the US, Greenspan has stated that while he expects evidence of recovery before yearend, any pickup in growth could be nominal and/or delayed. Believing risks for the US economy also remain on the downside, he will cut up to another 75 basis points off rates if necessary.

There is no significant inflation warning from long-dated bonds. Gold bugs will have to wait even longer for a serious inflation scare, judging from bond markets. Yields encountered resistance beneath their 1999/2000

Euro-Bund 10 Year Bond Yield (0.03)



US 10 Year Bond Yield (0.025)



top formations and eased recently in line with lower petroleum prices and stock markets. However OPEC still has the capability to squeeze oil supplies with further cuts over the short to medium term and the next stock market rally will lead to some profit taking in bonds. With yields already historically low, it would probably require a further and marked deterioration in global GDP growth for yields to fall beneath their March 2001 lows.

Strategy for bonds - From a conservative investment perspective, I'm staying with the strategy first mentioned in FM200, which favours shorter maturities, from 3-year government instruments to bills. Spreads between long-dated government and corporate bonds have eased recently, despite stock market weakness and while the main trend remains down, this could be challenged if the March lows are decisively broken by leading share indices. I would continue to tread cautiously in the corporate bond market, as there is still a possibility of some notable scares and/or defaults, which would temporarily weigh on even the better quality issues. I am not tempted to trade bond futures because I do not anticipate a big trend in either direction. Prices are heavily influenced by stock markets at present, moving conversely to share indices. JGBs have weakened recently, perhaps as more people assess the long-term risks. While the chart signals in July have been bearish, we have seen periodic shakeouts in recent years that did not mark the beginning of the bear market, which I believe is inevitable but unlikely to occur while there is no end in sight to the deflation. The BoJ remains a major buyer of Japanese Government debt but it does back away from the long end when yields fall too low, only to resume purchases when they rise.

Global Stock Markets

- **Markets are not responding to rate cuts as they have in previous cycles.**

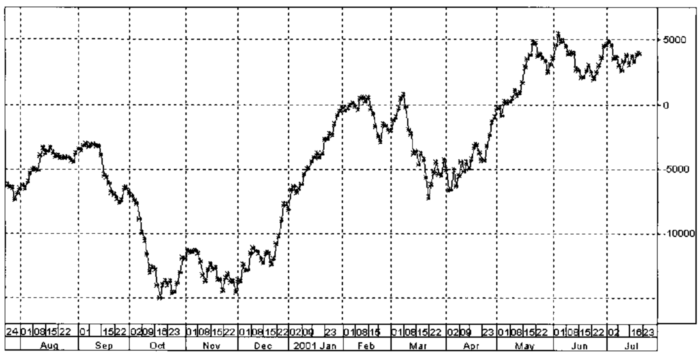
- **Will the TMT bubble leave a generation of investors disillusioned?**

- **The rise and fall of Baltimore Technologies.**

- **Record insider selling on the NASDAQ.**

What's happened to the bullish response following interest rate cuts? "Don't fight the Fed" remains one of the most reliable stock market adages but seven months after the first of six cuts totalling 275 basis points, where is the beef? One problem is that the Fed is acting mostly on its own. The ECB and BoE have shaved only 25 basis points off their rates to date. The BoJ had already cut rates to almost zero and it has been slow to boost money supply. A major problem for markets, which won't go away quickly, is the loss of confidence by investors reared on "buy and hold" and "buy the dips". People had profited from years of above average performance but the TMT blow out and global economic slowdown are taking

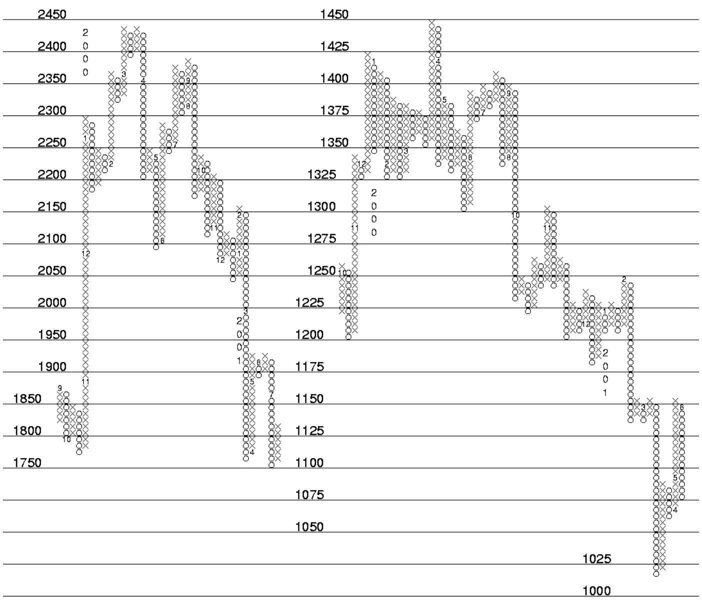
NYSE Cumulative Advance/Decline (Daily)



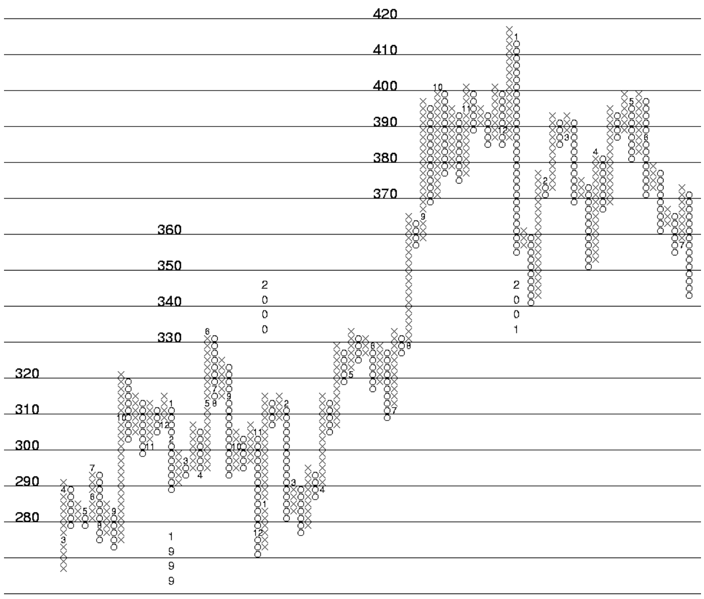
equities back to their historic mean - a readjustment process that could be lengthy. European investors were late arrivals at the stock market party but embraced the US approach. In Japan, the public barely surfaced beyond a brief and traumatic fling in the TMT bubble, an experience that has sent them back into foxholes for who knows how long. Worst of all were the corporate excesses - the leveraging of balance sheets with debt, financing stock repurchase programmes with borrowed money, expensive takeovers and dodgy accounting to inflate earnings. We can expect further skeletons to fall out of the corporate closets. Nothing exceeds like excess and this has damaged growth and disillusioned investors. Despite these considerable problems, interest rate cuts remain a powerful tonic. If Greenspan lowers the Federal Funds Rate once again and if the European banks also cut, and if Japan gets serious about targeting the stock market, their action might just pull a jackrabbit of a rally out of the equity hat, if not a bull. Meanwhile, the technical picture in Europe and Asia is hardly reassuring. It is marginally better in the US, thanks to the rate cuts, which have contributed to relative strength led by the Dow Jones Transports Index and the NYSE's Cumulative Advance/Decline.

The burst TMT bubble will have a lasting effect on sentiment. In terms of investor confidence, this has been a damaging bubble because it came at the end of a long boom for equities in North America and Europe. Consequently a higher percentage of the public had invested in stocks and just about everyone held some tech shares because of their runaway performance. A lot of these people have lost money over the last two years or at least given back a large slice of earlier profits. Many investors are accustomed to thrills and spills in the markets but few will have made money and then lost it so quickly as in TMT, and the shakeout is not entirely over. How serious will the repercussions be in terms of sentiment? Needless to say we won't hear more stories of people leaving their jobs to become full-time investors and day traders. For perspective we have to look at previous bear markets. The TMT blow out, even if it isn't over, is unlikely to have the same overall affect of 1973/74's all-embracing bear, which took many people out of the market for years. Certainly it will be less serious than

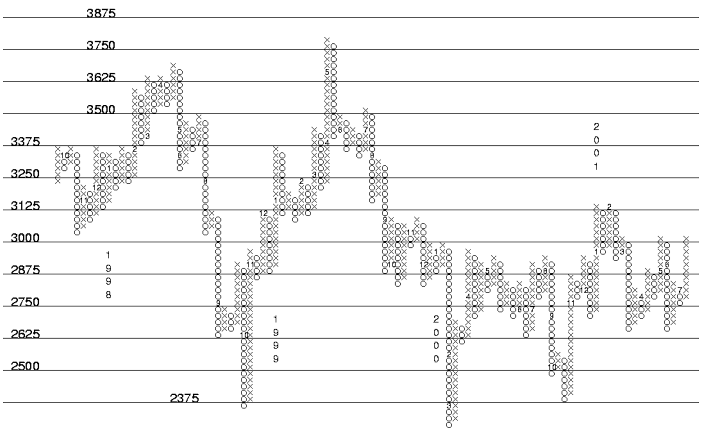
FWMI (10pt) and MSCIWI (5USD)



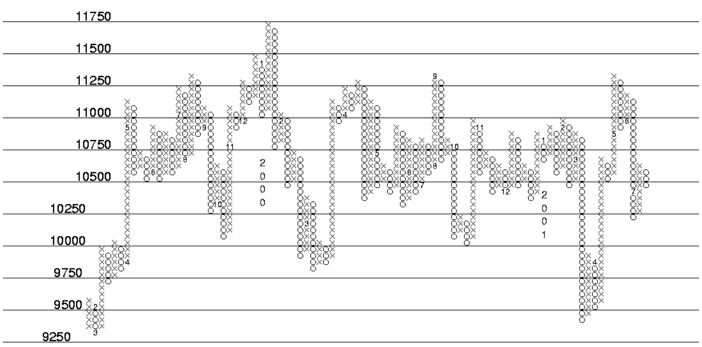
Dow Jones Utilities Index (2pt)



Dow Jones Transport Index (25pt)



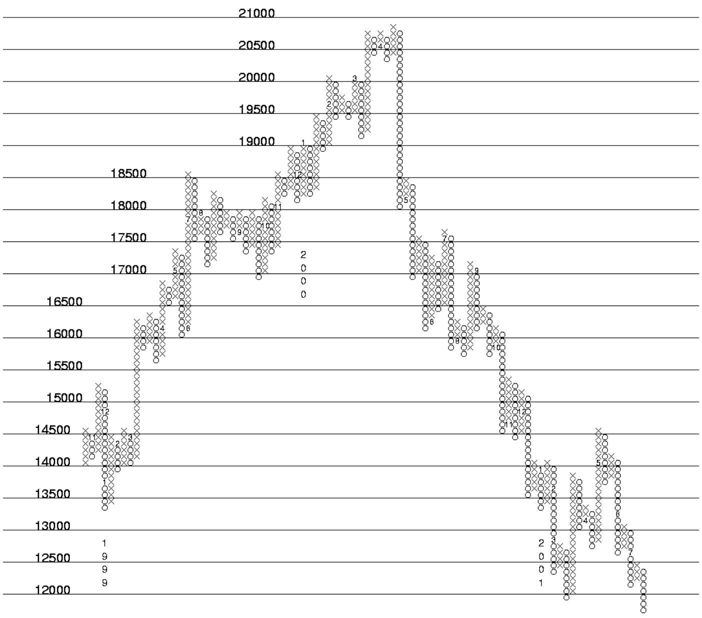
Dow Jones Industrial Average (50pt)



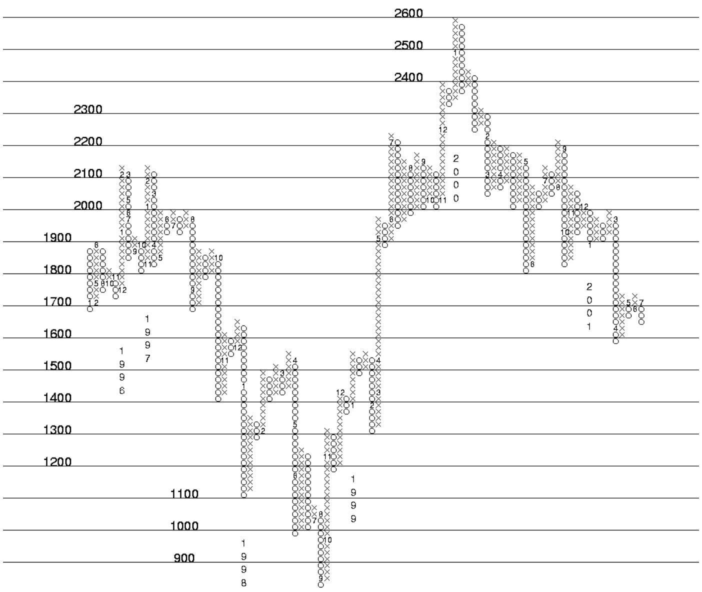
Japan's bubble of the late 1980s, which hammered both share prices and property values. The Japanese public was heavily involved near the top, while also taking out multi-generational mortgages, which will be passed on to people who, sadly, have yet to be born. Needless to say Japan's Government is finding it difficult to lure investors back into equities or the housing market. I suspect the burst TMT bubble will have a longer lasting affect on sentiment than The Crash of '87, which was over shortly after it started, although few investors knew this at the time. Also, there were no adverse economic consequences following 1987, unlike the two other historic bear markets mentioned above. Unfortunately, the TMT bubble is a major contributor to the current global economic slowdown.

Baltimore joins the 99 percent club. A good example of the TMT boom to bust cycle, Baltimore Technologies Plc had only six employees in 1996, when it was purchased by the financer Dermot Desmond and Fran Rooney, formerly manager of Ireland's woman's national soccer squad, who had also worked in Ireland's civil service and trained as an accountant. The company had a good product and became Europe's largest maker of computer security software. Rooney proved to be a master promoter, whose greatest coup occurred in September 1998, when he persuaded US President Bill Clinton, then in Dublin for peace talks, to demonstrate his company's security technology on Ireland's national television. Like so many other tech CEO's Rooney's mantra was "get big fast", and Baltimore issued several press releases a week detailing new product announcements, contract wins and alliances with other technology companies. Baltimore's shares took off, soaring to a peak of 1480p on 25th February 2000. The company was in and out of the UK's capitalisation weighted FTSE100 Index twice that year, moving in line with the NASDAQ Index. Rooney persuaded financial analysts that Baltimore could become one of the world's top ten software companies. However in line with many other tech companies, it never made any profits but had a high burn rate, which has proved to be its undoing. Fast forward to July 2001 and Rooney resigns as analysts estimate that if the company maintained Q2 spending levels of £21 million, there would be no cash left by early next year. Baltimore's shares fell to a low of 14.5p on 6th July, down 99 percent

Nikkei 225 Stock Average Index (100pt)



Singapore Straits Times Index (20pt)



from the high, before bouncing on takeover rumours. There is speculation that Microsoft, IBM or RSA Security might take over Baltimore. That may be the last hope because it won't be easy for the company to raise more money. Unfortunately, there are a lot of TMT stories similar to Baltimore Technologies'.

Let's hope Alan Greenspan is right because a lot of company insiders don't share his optimism. According to the Vickers Weekly Insider, which surveys directors' share dealings, selling by board members of NASDAQ companies now exceeds buying by five to one, the highest ratio ever recorded. For New York Stock Exchange companies, the latest sell to buy ratio by company directors is six to one, the highest level for twelve years. This data suggests that company directors do not expect an economic rebound this year and are selling shares in their own firms despite low prices in many instances.

Chart review of topical and representative stock market indices - *The 3-box reversal 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 or www.chartanalysts.com. Price levels mentioned refer to market closes.*

The Fullermarkets World Market Indicator (1787) has not maintained the break under its climactic-looking March low but requires a bigger rebound to reaffirm more than temporary support here. Additional weakness would be signalled at 1740. *The FMWI is unweighted and calculated in local currencies.*

The Morgan Stanley Capital International Indicator (1066) rebounded well from its accelerated low in March but has subsequently retraced almost two-thirds of its rally. A move to 1155 is needed to reaffirm this year's low at 1015 and signal an additional recovery. *The MSCII is capitalisation weighted and calculated in US dollars.*

The US's Dow Jones Industrial Average (10576) remains rangebound in a top-heavy pattern following strong gains through January 2000. A sustained push over 11300 is required for a bullish outlook, suggesting that the long trading band was a platform of support. Conversely, a retest of the March/April low would look likely on a move to 10200.

The Dow Jones Transport Index (2975) is currently steadiest of the main US indices and testing the May high at 3000. A move to 3025 would demonstrate further strength and a push towards the 1998/99 peaks up to 3775 would look possible at 3150.

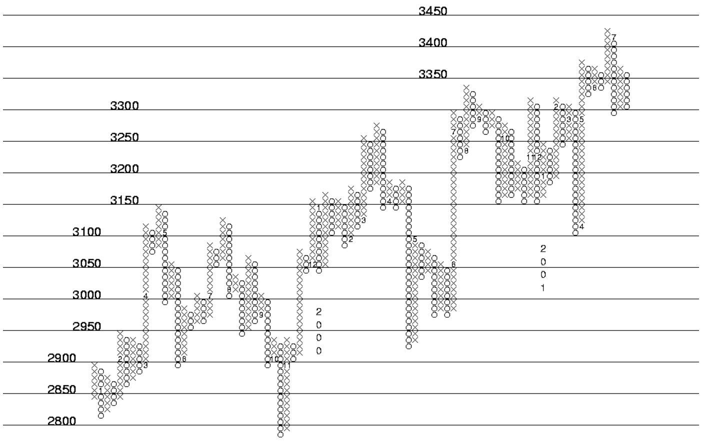
The Dow Jones Utilities Index (349), which sometimes leads, has drifted onto its important April and January lows between 350 and 340, and needs 374 to remove pressure from this region.

Japan's Nikkei 225 Stock Average (11609) has fallen beneath its March closing low, reaching the lowest level for sixteen years. A rally to 12500 is needed to break the sequence of lower rally highs and revive the base building hypothesis.

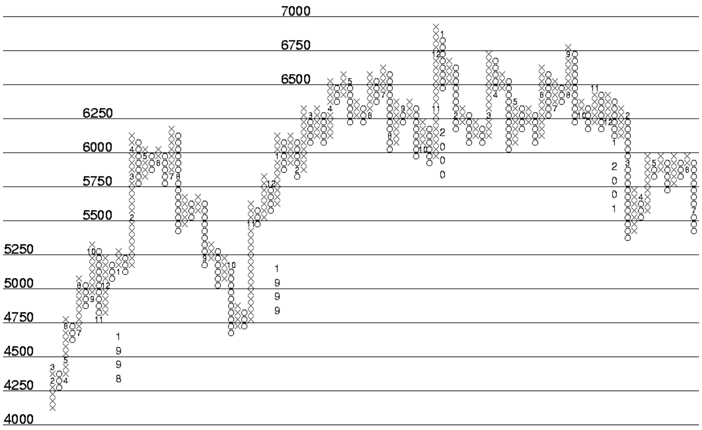
Singapore's Straits Times Index (1627) is another example of Asia's relative weakness. A move to 1740 is currently required to offset a test of the January 1998 to April 1999 trough evident below 1540.

Australia's All Ordinaries Index (3373) - *see overleaf* - has reacted following its push to an all-time high in June. It also has a long history of not maintaining upside

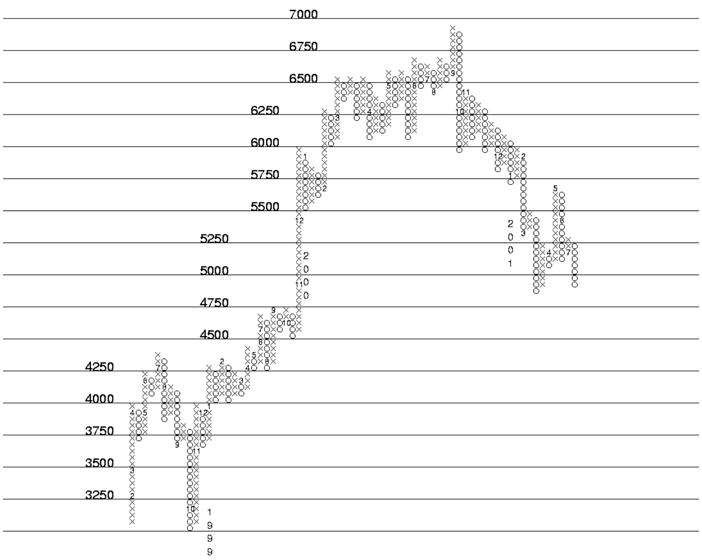
Australia All Ordinaries Index (10pt)



United Kingdom FTSE 100 Share Index (50pt)



France CAC 40 Index (50pt)



breakouts. Nevertheless it continues to show relative strength and requires 3280 to signal an additional test of underlying trading. The last important reaction low within the long-term ranging uptrend occurred in March at 3100.

France's CAC 40 Index (4959) is typical of the European indices currently testing their important March lows. A move to 5300 is required to remove pressure from this area and reaffirm prior support.

The UK's FTSE 100 Index (5435) looks top heavy and needs 6000 to remove the downward bias and suggest a test of the broad band highs established over the last three and a half years.

Strategy for stock markets - At the bottom line, technical action remains a concern. My long-term hunch is that stock markets will range for years, with the above historic average returns up until 2000 replaced by below average performances. I am on the lookout for a late-summer rally in response to a developing oversold condition but haven't yet seen the upward dynamics to jumpstart a significant rebound, although they should occur near current levels if we are to see a bounce from the March lows. I am inclined to be bullish during a rate-cutting cycle, even if the US has been easing monetary policy largely on its own. The best chart action so far this year was the climactic-looking downward acceleration by indices in February and March, followed by rebounds to question some of the downtrends. However these gains have been retraced by European indices and most of Asia is even weaker. The US has held up somewhat better and remains the main influence on global equity trends but until the May rally highs are taken out, it too remains susceptible to retests of the March-April lows. There have been some favourable developments, such as continued firmness by the NYSE Cumulative Advance/Decline data and the Transport Index's rebound. However the Utilities Index is testing its March low and often leads. Against this background I am not inclined to issue any further share recommendations following my one toe-in-the-water this year in May, confined to a few energy stocks and several Japanese companies with large base formations. I think energy will remain a favoured sector, despite some watering down of the Bush Administration's proposals, but share performance will be influenced by OPEC's ability to keep the oil price above $25 (NYME). As for Japan, we know that a developed country's economic crisis is eventually a seedbed of opportunity for investors. However the Japanese economy continues to deteriorate and despite new Prime Minister Junichiro Koizumi's encouraging rhetoric, little has been achieved during his first three months in office. The Government has talked about targeting the stock market and it needs to because Japan's banks will not meet their capital adequacy requirements if the Nikkei stock average, currently 11609, is below approximately 13000 when the next six-month review occurs on 30th September. The London-quoted but dollar dominated Atlantis Japan Growth Fund, first mentioned in FM203 and where I have a small position, has eased a little further at $8.63 but is outperforming the Nikkei. The discount to NAV has widened to 16.75 percent. I will be tempted to nibble again if AJG weakens further, as is quite likely, regarding it as a long-term strategic play. AJG seldom hedges and I do think anyone with a significant position in Japan should be hedged against a weakening yen. My suggestion for captive equity investors is to maintain primarily defensive portfolios, favouring stocks with well-covered yields. Where good rallies occur, I would lighten following a loss of momentum. I would not pay up for anything. Growth oriented investors taking a long-term view could commence nibbling at sector-leading tech companies on easing. I'm not doing much in futures, feeling uncertain about the trends but if there is another sell off I might be tempted to buy lightly once the dust has settled. Currently, I'm more inclined to short.

Currencies

■ **The euro is cheap but could still retest its lows against the US dollar, necessitating further intervention.**

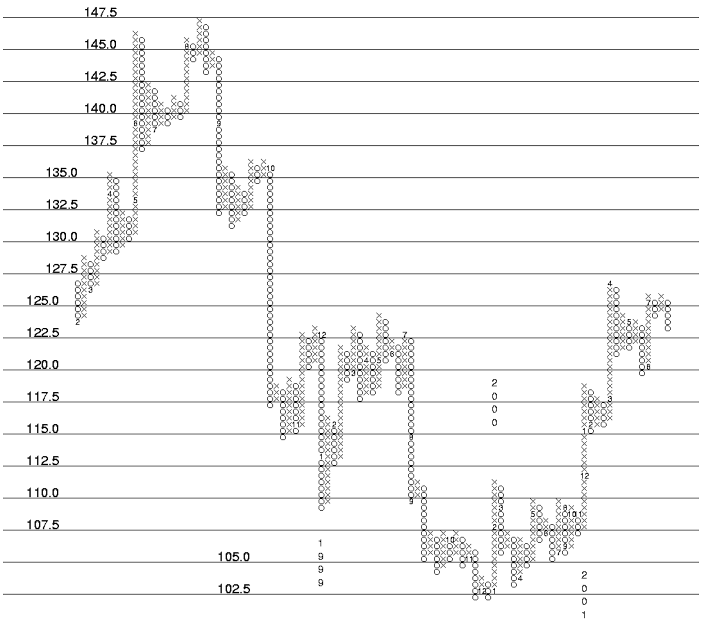
■ **The yen is experiencing no more than a medium-term pause within its long-term bear market.**

Rumours, jawboning and short covering may not be enough to lift the single currency beyond technical rallies. The euro remains a suspect and experimental currency relative to the US dollar. Investors have little confidence in the ECB, which ignored the first rule of central banking - DON'T FORECAST! A central bank that publicly predicts market trends unwittingly sets targets for speculators. Forecasting is never easy and few central bankers, regardless of other qualifications, have the training, experience or objectivity to anticipate market or economic trends. Wim Duisenberg and colleges at the ECB, plus the politicians who appointed them, forecast that the euro would be a strong currency, that there was no risk of recession in Euroland and that the region would outperform the US economy. Arrogantly and naively, these views were stated as certainties. Some bureaucrats, influenced by economists from the investment banks, repeated that periodically fashionable but analytically suspect story about a dollar collapse. Once credibility is lost it is difficult to regain. This is why the euro will continue to trade below any theoretical fair value, periodic rallies aside. As an explanation for the euro's recent trend, we hear from pundits about capital flows due to a corporate and investor preference for US assets. This has been important in the past but I believe it is now overstated. The main source of selling pressure recently - seldom mentioned beyond these pages - is the move out of Deutschmark notes and other Euroland national currencies, held by people who do not wish to reveal this money, before it ceases to be legal tender early next year. They dare not place hidden cash in bank accounts for various reasons and since they cannot acquire euro notes before 1st January 2002, most of the money is converted into dollars. This ranges from Eastern European holdings to black economy money within the euro region. While it is impossible to know the extent of this hoard, which has been accumulated over decades, the Bundesbank estimates it could account for up to 50 percent of Deutschmarks issued. This one off factor can only weigh on the euro while it persists. My guess is that most of the conversion will have been completed by Q4. From January cash conversion flows will favour the euro, if only because no one can acquire the new paper until then. Theoretically, the euro should be above current levels before yearend and firmer in Q1 2002. However this will require confirmation on the charts, which so far show only steadying above last year's lows following intervention fears. While the US Treasury and Federal Reserve do not want to see the euro weaken further this year, barring a deep recession they will not abandon the mantra, "a strong dollar is in our interest", introduced by Robert Rubin in 1995. As US Treasury Secretary Paul O'Neill repeated on 18th July, "we have not changed our policy on the dollar, and we are not contemplating it". Nevertheless, while US manufacturing and agricultural lobbyists continue to press for a change in policy, however futile their efforts, currency traders will remain uneasy. They remember the devaluationist policy up until 1995 and for anyone with primarily US dollar assets, a return to those earlier days is a reoccurring nightmare. The way for O'Neill and Greenspan to appease the lobbyists, without abandoning the strong dollar policy, is to participate in another round of multi-lateral intervention if the euro retests last year's lows in the next few weeks. Looking further ahead, I cannot envisage more than a good medium-term rally by the euro, which could reach parity against the dollar in 2002, before the greenback extends its 6-year uptrend, supported by comparative GDP growth rates.

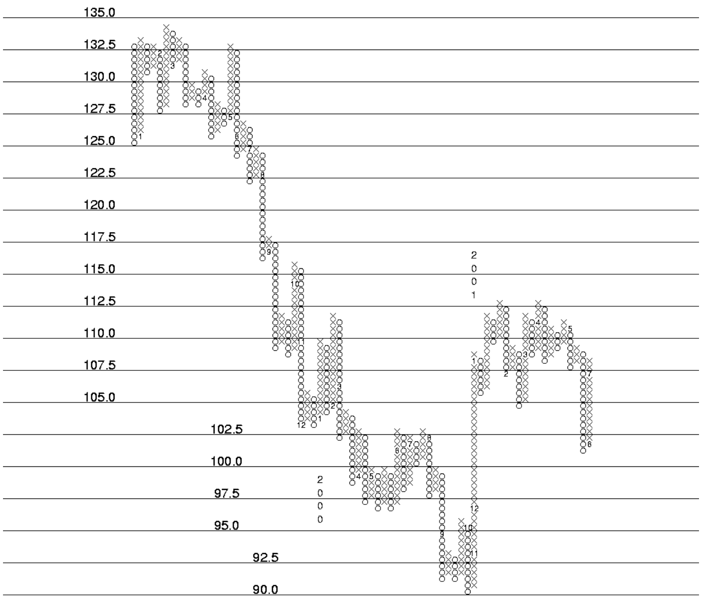
Euro notes are shrinking. To the regret of criminals and flash Harry types, there will be no lighting of cigars with 1000-euro notes. The largest denomination will be 500 euros and it will not be available in all 12 countries' national colours. Greece, Ireland, Portugal and Spain have decided not to print the 500-euro note. The first three countries have also declined to print 200-euro notes. "There won't be much need for that kind of money, so it's too expensive to adjust the printing machine", said Angela Esteve from the Bank of Spain. Does she know something we don't? Meanwhile, the big fear among Euroland's central banks is that few people will know how to spot counterfeit euros. No doubt criminals are busily preparing for the launch of euro notes in January 2002. Will counterfeiting boost Euroland's money supply? That would be a small consolation.

Factors propping up the yen are slowly dissipating. An economist friend of mine mentioned that while he felt a much weaker yen was a "no brainer", he found the short-term moves extremely difficult to forecast, even with charts. He is not alone. The action is choppy, which indicates market uncertainty. Instinctively, most of us are wary of "obvious" market situations because in markets

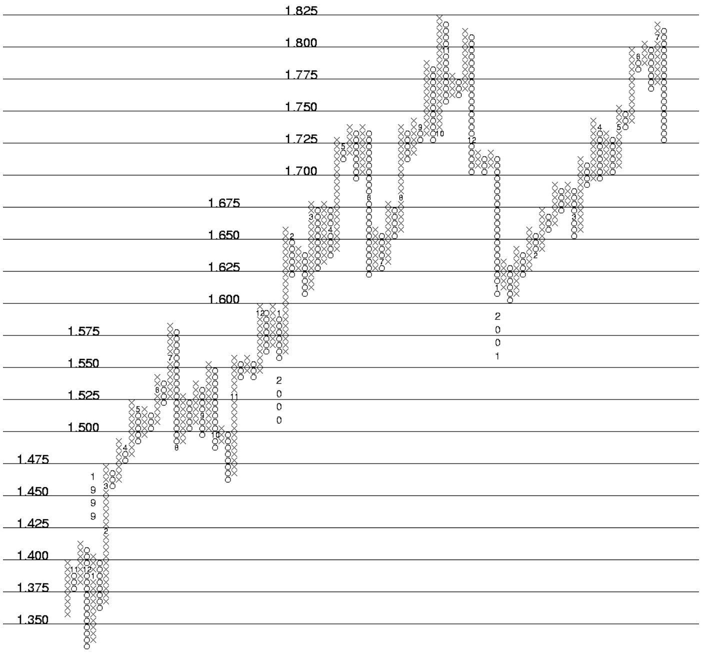
Japanese Yen per 1 US Dollar (0.5)



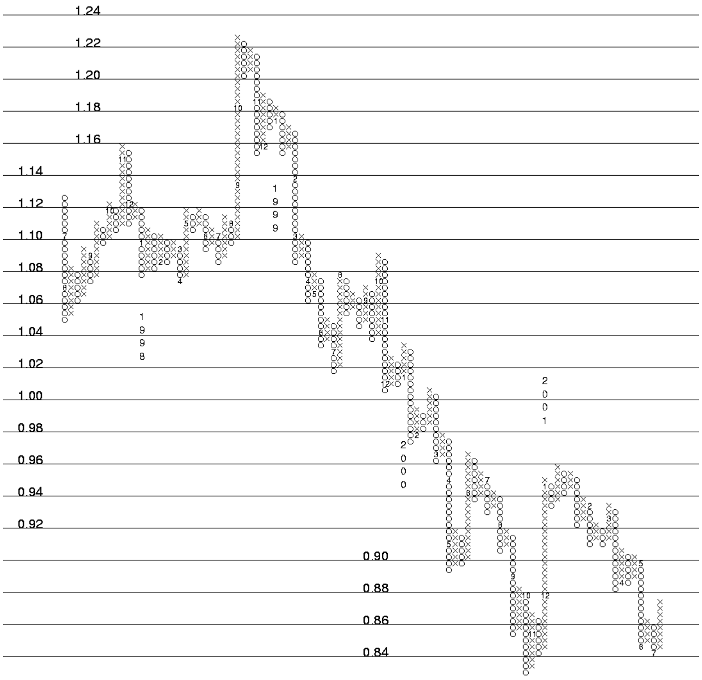
Japanese Yen per 1 Euro (0.5)



Swiss Franc per 1 US Dollar (0.005)



US Dollar per 1 Euro (0.004)



there are no certainties and a consensus view is usually a contrary indicator. Nevertheless, in an uncertain world a weaker yen seems one of the safer forecasts for all the reasons cited in earlier issues. At the bottom line, Japan is a rich country becoming poorer every day as the deflationary slump persists. With a third-worldly budget deficit of 135 percent of GDP and climbing, Japan has no sane option other than reflation, which means printing trillions of yen. The alternative would be to tragically re-enact The Great Depression experienced by the US in the 1930s. So what's holding the yen up? Repatriation of capital, mostly by corporations to shore up the parent company's balance sheet. This includes banks, which have capital adequacy problems due to the weakness of Japanese shares. Remember when Japanese firms were trophy buying, from Hawaii to Australia's Gold Coast, then famous US golf courses and even one of New York's most prestigious landmarks, Rockefeller Centre? As these are sold the money flows back to Japan on a 'needs must' basis. The euro's weakness has also been a factor since Japanese investors diversified heavily into European assets a few months before and after the single currency's launch. Because this money is channelled back to Japan, the yen often steadies as the euro weakens. A factor curtailing the yen carry trade has been the frequent jawboning by Japanese monetary officials who favour a policy of actively managing the currency. This has kept the market choppy, unnerving some speculators. There is also some confusion because a number of analysts, myself included, say the yen's main trend can only be downwards. However, even Prime Minister Junichiro Koizumi says there is no policy to weaken the yen. I see no contradiction here and Koizumi is technically correct. Governments that announce a preference for a weaker currency soon find that it has fallen much further than they would like. However Japan's policy of quantitative easing (money printing) will weaken the yen because a vast increase in its supply will be necessary to stem deflation now that the economy is deteriorating once again. Last but not least, the major obstacle in the path to a weaker yen is BoJ Governor Masaru Hayami, who regards Japan's currency as a national virility symbol. While Hayami has been discredited and isolated, he remains in charge of monetary policy and is not reflating rapidly enough. Moreover he cannot be sacked until his term expires in March 2003. Nevertheless there appears to be rebellion from within Hayami's own fortress. According to Bloomberg columnist David DeRosa, the BoJ's Head of Research Junio Okina wants the bank to begin a programme of purchasing foreign assets without sterilisation. In other words, according to DeRosa, "he wants to raise the money supply and sell yen at the same time". This is another humiliation for Hayami who can only delay the yen's decline, necessitating an even bigger fall over the next few years before Japan's economy can mount a sustainable recovery.

Review of currency point & figure charts - *These and hundreds of other 3-box reversal closing basis charts are available on our websites www.fullermarkets.com, shortly to become www.chartanalysts.com and are updated daily. All comments refer to closing levels for US trading hours.*

Dollar/yen (¥124.24) - Following a rebound in June the dollar encountered resistance at ¥125.5, beneath its April high in early July. Overall, this looks like the latter stages of a medium-term consolidation of the strong November 2000 to early-April 2001 gains. If this is too optimistic, look for a move under ¥122, constituting a warning and ¥119, which would show potentially significant pattern deterioration. Meanwhile, I would not be surprised to see a retest of the April and July highs shortly, where I expect no more than brief resistance to be encountered.

Euro/yen (¥107.82) - Overall, this pattern looks like a V-bottom base with right-hand extension, as taught at The Chart Seminar. The additional push into overhead trading following the May reaction, which just breached ¥100 on an inter-day basis, supports this hypothesis. While we could easily see further ranging and the volatility of these patterns often makes them difficult to predict in the short term, I expect additional base development to take place mostly within the middle to upper region of the ¥112.5 to ¥100 range, followed by an upward break, probably before yearend.

Dollar/Swiss franc (SF1.7362) - Another sharp reaction from resistance near SF1.82 provides further evidence that the dollar will continue to trade beneath this medium-term peak. A close at SF1.825 is required to signal renewed strength by the greenback. Currently the more likely development is sideways to somewhat lower ranging and a test of the January low at SF1.60 is possible over the next several months.

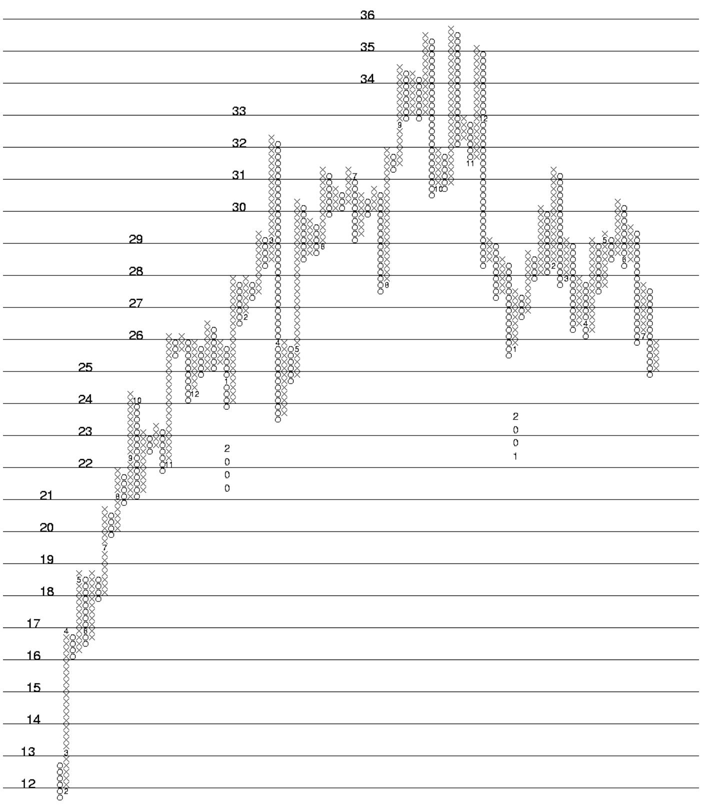
Euro/dollar ($0.8687) - Similarly (but shown conversely to dollar/Swiss franc above) the euro's retreat to test its yearend 2000 trough was much more gradual than the rally from that low. Consequently the overall pattern still looks like a medium-term base. However the euro's recent steadying is less pronounced that the Swiss franc's against the dollar. Therefore it is still too soon to rule out some further weakness, despite a clear contrary indicator only a month ago, when there was a consensus forecast that a new low for the euro was imminent. However since July has produced the euro's best rally of the year, a break of $0.84 is required to indicate a retest of last year's lows before sideways to higher ranging occurs.

Strategy for currencies - I maintain that short yen is the big play among easily tradable currencies. The choice is between sell and hold, or to manage the position more actively with the help of daily charts. I favour the latter approach but it really depends on one's temperament and time available for monitoring. Tactically, this isn't easy within a broad ranging pattern as it is impossible to know when the eventual upward break will occur. Also, a lot of minor support and resistance levels (what I call levels within levels) will be broken in short-term whipsaw moves reflecting uncertainty. What works best for me in trading bands is the Baby Steps strategy of buying the US dollar against the yen lightly on easing and reducing positions on a similar basis during rallies, while retaining a core long position. Naturally, during a lengthy ranging phase such as we are seeing, one will do best by closing all longs on tests of the upper boundary. However one does not know there is an important upper boundary until it has been reaffirmed at least once. The trading risk is that one holds on too long initially, learns to progressively lighten positions on firmness and is then on the sidelines when the next decisive upward break occurs within the overall uptrend. Of course there is always the option of jumping back in, but at an opportunity cost. Conversely, the money control risk with buying on easing in a range is that the market continues to head lower. While I don't expect the dollar to fall under its May lows, requiring a close at ¥119 on a p&f ¥0.5 scale or ¥118 on an intra-day chart, I had better pay attention if it happens. I trade mainly the dollar and euro against the yen but any other high-yielding significant currency will do. As for euro/dollar, I have no position at present but would rather be long the single currency than short, preferably on another test of last year's lows, where I believe the possibility of intervention is high.

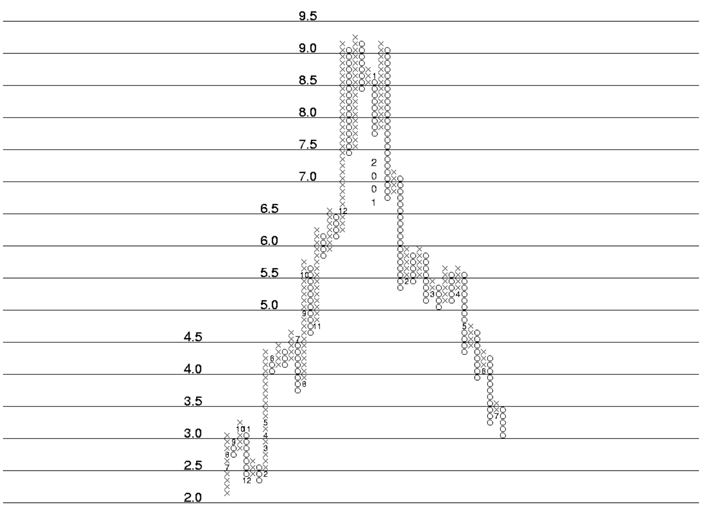
Commodities

- **Crude oil looks top heavy but has steadied near**

Crude Oil NYME 2nd Month Continuation (0.2USD)



Natural Gas NYME 2nd Month Continuation (0.1USD)



Aluminium High Grade LME 3 Months (10USD)

$25 (NYME), while natural gas' decline is beginning to appear overextended.

■ **Most base metals remain weak in line with the global economic slowdown.**

Further supply cuts by OPEC appear necessary to extend this top area. Judging from the chart, the oil producers' cartel is gradually losing control of the market, due to falling demand, increased production from non-OPEC sources, probable breaching of OPEC quotas and the substitution of natural gas where possible. Lateral support in the $25 region (NYME) was tested in early July and has held temporarily, following statements from OPEC that there would be further production cuts if necessary. This could buy a little more time in top formation development but a push back into the $30 region is required to question the medium to longer-term downward scope indicated by this pattern. Natural gas continues to range lower following its accelerated peak in December 2000. This decline is beginning to appear overextended but a break in the progression of lower rally highs, with the latest at $3.5 is needed to check momentum beyond a brief pause. The fundamental factor driving this decline is the rapid development of natural gas fields.

Aluminium is breaking beneath lateral support. A global economic slowdown can only be bearish for base metals and this is reflected in the chart of aluminium, which appears to be in the latter stage of top formation development. Only a sharp rebound from current levels, which appears unlikely, would prevent a downward break and negate lower scope into the 1998/99 trough down to $1160. In previous cycles, metal prices fell until producers announced production cuts.

Strategy for commodities - Historically low prices for agricultural commodities produce periodic short covering rallies, which can be sharp, as we have seen with the soybean complex recently. However without the outside chance of significant crop deterioration, these gains have proved difficult to maintain, partially due to the US dollar's strength. I may short aluminium, which looks overpriced relative to other base metals.

The Global Economy

■ **A problem for the global economy - monetary policy is not that stimulative, US excepted.**

■ **Will consumers support the US economy while businesses retrench or will they become cautious as layoffs increase?**

■ **The global economy is still slowing but there is light at the end of the proverbial tunnel.**

Euroland's short-term rates remain too high at 4.50

percent, at least for the core economies. The ECB is hard to defend, as I have said before but even with a genius in charge the challenge would still be daunting. An inflation target of below 2 percent is a liability when OPEC's supply cuts have boosted costs significantly - a problem compounded by the euro's weakness. Consumer price increases vary widely among the 12 countries that have adopted the euro but rose to their highest average level for eight years at 3.4 percent in May (YoY). While inflation dipped in June, due to lower oil and natural gas prices, the ECB would be raising rates if last year's GDP figures had been maintained. Unfortunately, Euroland's growth is slowing and unemployment rising, especially in Germany which will slip perilously close to recession this year. This prompted German Chancellor Gerhard Schroeder's recent call for the ECB to fulfil its "responsibility for economic development" by cutting rates to stimulate growth. This looks like a no win situation for Wim Duisenberg and any other ECB President, at least until the central bank's Charter is changed. Meanwhile, the main stimulus for the European region's economy is the euro's weakness, which aggravates inflation.

In Japan, which has suffered from an overvalued currency in addition to other well-documented problems, the monetary stimulus has been woefully inadequate for an economy trapped in a deflationary spiral. Although Japanese interest rates remain near zero, this does not help when bank lending is declining 3.8 percent (June YoY) and the economy continues to shrink. The BoJ has been forced to target consumer prices and is reflating by purchasing 400 billion yen ($3.19 billion) of government debt each month. Consequently money supply has edged higher at 3.2 percent (M2+CD) but this is still much too low for an economy experiencing the destructive cycle of falling prices, output and profits. The International Monetary Fund's Deputy Managing Director Stanley Fischer has joined the chorus saying Japan should adopt an "expansionary" monetary policy to help revive its economy. Japan's ruling LDP Secretary General Taku Yamasaki said recently, "I favour implementing inflation targeting". More tersely he added, "I'd also hope for an intellectual approach from the BoJ". The beleaguered central bank's Governor Masaru Hayami, like Wim Duisenberg, hears but does not listen.

Greenspan's race against time. No one could accuse the Fed Chairman of being too cautious following this year's rate cuts of 275 basis points. Greenspan has more than reversed the 1999-2000 rate hikes and has been very concerned about the rapid economic slowdown they helped to engender, in conjunction with the steep rise in oil prices and the burst TMT stock market bubble. The US economy's virtuous cycle of capital spending spearheaded by technology, which led to productivity increases and helped to contain inflation, has ground to a halt. The rule of thumb, applying to both financial markets and economic cycles is - the bigger the boom, the bigger the bust. Companies from both the so-called new and old economy scrambled to expand in 1999-2000. This year the top priority is to cut costs and reduce inventory in an effort to stem deterioration in the bottom line. Consequently the US economy would certainly be in recession were it not for consumer demand, which has obviously slowed but not as much as some analysts feared. The critical question is, will consumers be spooked by rising unemployment before companies recover? Not if Greenspan can help it and the Bush Administration has pitched in with tax cuts which will soon add to the public's spending power. Interest rate cuts and tax breaks are certainly the right prescription for boosting the patient's immune system but confidence is fragile at the best of times. Unemployment history is not encouraging since on every known occasion when the number of people out of work has risen by more than half a percentage point, a recession has followed. US unemployment fell to 3.9 percent last October and has subsequently risen to 4.5 percent. Moreover a lengthy slowdown and/or another stock market sell off, should it break the March-April lows for leading share indices, would weigh on consumer sentiment. Meanwhile, the US economy will get no help from Europe or Asia, where economies are generally in worse shape. Against this background a mild case of stagflation in the US and particularly Europe is inevitable, while Japan's deflation is worsening.

The global economy is likely to weaken further before US interest rate and tax cuts lead to recovery. Unfortunately, there is still only one engine for the global economy, given Europe's monetary and fiscal inertia and Japan's deflationary morass. Disconcertingly, now that Greenspan has played most of his interest rate cards, only the US consumer stands between a worldwide slowdown and recession. This is a shaky pillar because consumer debt is rising in the US and corporate layoffs will not help confidence. Clearly, economic risks remain on the downside but it is possible to avoid a global recession. The Bush Administration's tax cuts are giving US consumers a little more spending power. Argentina's pending devaluation and debt default may prompt the ECB and other central banks to ease monetary policy. Petroleum contracts have fallen back from their highs due to slowing demand, increased production from non-OPEC sources and quota breaches by the Cartel's members. Only another cutback by OPEC, which remains possible, is likely to check the slide in prices. Lower costs for energy would lighten one of the main weights on the global economy. In conclusion the situation remains worrying. However, further reflation, including interest rate cuts in Europe and a boost in Japan's money supply, plus lower energy prices would enable that light at the end of the proverbial tunnel to shine a little more brightly.

And Finally…

New websites - From Monday 30th July Fullermoney will be gaining its own website at www.fullermoney.com. Fullermarkets chart libraries will be rebranded under the name of Chartanalysts. On-line subscribers will be able access our extensive charting and analysis services including weekly market reviews and stockpicks at www.chartanlysts.com. Fullermoney subscribers can register online for a free 1-month trial to the full service, including UK Equities, European Equities, International Equities and our new combined Currencies, Commodities and Financial Futures modules.

The Chart Seminar 2001 - We had a small but distinguished group of delegates for TCS in Zurich on 12th & 13th July - dates that overlapped with too many people's summer holiday. However the participants' level of experience ensured wide-ranging discussions, which I am pleased to say, are often a feature of the course. My final venue for the year will be in London on 29th & 30th November.

"Mom? Ed asked me to marry him. But before I say yes, I want to see how he performs in a down market."

Reprinted from The Wall Street Journal

Final thought and question - Opinion polls confirm that most investment managers are optimistic, but selling by directors of NYSE companies is exceeding buying by six to one. Which group do you suspect is better informed?

The target date for FM207 is Friday 24th August.

"There is no tool to change human nature. Too often people are prone to recurring bouts of optimism and pessimism that manifest themselves from time to time in the build-up or cessation of speculative excesses."

Alan Greenspan 18th July 2001

Best regards - David Fuller

Fullermarkets a division of Stockcube Research Limited Suite 1.21 Plaza 535 Kings Road London SW10 0SZ UK
Website: www.fullermarkets.com ***Email:*** research@fullermarkets.com ***Tel:*** +44 (0) 20 7351 5751 ***Fax:*** +44 (0) 20 7352 3185 ***Single Issue Price*** £35