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In its 18th year

Fullermoney

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

The worst is over for global stock markets for the medium term. However overhead resistance is now slowing rallies for indices and a partial retracement of recent gains is likely in coming weeks.

Japan can choose economic recovery through radical reflation or slide into depression.

An open letter to Japan's Prime Minister Junichiro Koizumi -

Dear Prime Minister,

It is time to act - You encouraged high expectations, both at home and abroad, by campaigning as a reformer who would tackle Japan's economic problems. Consequently, the Japanese electorate gave you a clear mandate for change. They wait, expectantly, but so far you have done very little. Political popularity has a short shelf life and the clock is ticking for both you and the Japanese economy. Move wisely and quickly, and you can still be Japan's man of destiny. But if you continue to prevaricate, your window of opportunity will close, consigning you to the ranks of nonentities who have governed Japan for too many years. I do not doubt your sincerity but I believe you do not have a financial background. Worse still, people from the Japanese financial community tell me that you do not have good economic advisors among your most senior colleagues. They believe your inaction is not due to complacency or lack of will, but confusion as to which policies should be pursued. This is understandable because the stakes are very high. However you *do* know what has not worked. Japan will not somehow muddle through, as your predecessors have hoped, with pork barrel fiscal spending and tax increases. Moreover, these policies and the Bank of Japan's monetary suicide have created a budgetary crisis, leaving the Japanese economy on course to tragically re-enact The Great Depression of the 1930s. Fortunately, this can be avoided and there is still time to change tack, but you will have to adopt radical policies.

Emergency rescue plan for Japan's economy - Prime Minister, nothing will improve until you break the deflationary spiral. Therefore you should immediately announce an inflation target of between 2 and 4 percent. BoJ Governor Masaru Hayami will resist this policy, as you know. The entire financial world now recognises that he is a liability, so if you cannot pressure Hayami into immediate retirement, legislate against the BoJ and replace him with the Bank's Head of Research, Junio Okina, or someone of similar views. The new Governor can then retire all of the BoJ's present voting members. Simultaneously, replace Finance Minister Masajuro Shiokawa, who by his own admission has little knowledge of economic matters, with the current Vice Minister for International Affairs, Haruhiko Kuroda. Surround yourself with senior advisors who favour the following radical policies for implementing the inflation target and jumpstarting the economy. Instruct the BoJ to print money considerably in excess of what it currently spends each month on the purchase of Japanese Government Bonds and short-term instruments. The Government itself should invest these additional funds in Japanese property and the stock market, buying sufficiently to reverse the downtrends. As prices for real estate and shares rise, Prime Minister, confidence will improve throughout the economy. This will unlock some of the public's prodigious savings. As consumers spend, the economy will expand. Corporate profits will rise, encouraging further investment. The contraction in GDP will be reversed. Substantial tax cuts, including Capital Gains, would hasten the recovery.

Do not prevaricate - Do not be swayed by faint hearts and reactionary views, Prime Minister. Cassandras will warn of hyperinflation, which is always a monetary problem. Therefore it can be prevented by an enlightened BoJ, which should commence raising interest rates and sterilising excess liquidity once CPI inflation moves over 2 percent. The yen *will* fall significantly against other reserve currencies, increasing import prices. However this has long been inevitable because your currency is still near historically high levels, compounding Japan's economic problems. More deflation over the next year would only ensure an even weaker yen in future. A softer currency will help to break the deflation. Moreover, it will boost operating profits for export companies, with a knock-on benefit throughout the economy. People will worry about a sharp rise in JGB yields. This is inevitable as the economy improves because despite a ballooning budget deficit, yields have remained much lower than for other developed country government debt, due primarily to Japan's deflation and also the BoJ's buying programme. Should Japan's economy continue to weaken, the risk of an eventual collapse by JGBs can only increase. However, Prime Minister, you will be able to cushion the fall in bond prices by reflating aggressively today and targeting the property and stock market, as I have proposed above. As these assets appreciate in price due to economic recovery, growing confidence and increasing demand from investors, the Government will have huge profits on purchases made near the lows. These positions should be sold gradually in a rising market, and the money released can be used to repurchase and retire government debt.

Restructure, as the economy recovers - A major restructuring of the Japanese economy and the banking sector in particular, Prime Minister, is certainly required. If this had occurred ten years ago Japan would not have experienced years of economic stagnation and destructive deflation. However, if banks were compelled to write off non-performing loans today, as the BoJ suggests, this would only force many more companies into bankruptcy, compounding deflationary problems. Given the continuing economic deterioration, you may have to rescue several banks over the next few months. Once radical reflation has revived the economy, root and branch restructuring should commence, following the US model where culturally compatible.

Show the leadership Japan needs - Prime Minister, Japan is a great country but it is also in decline as you are well aware. Its problems are largely self-inflicted and they have yet to be addressed. If you do not seize your opportunity to jumpstart the economy by radical reflation and an overhaul of the BoJ prior to longer-term reforms, the result for Japan will be tragic. Your country will slide into depression, inflicting appalling psychological and economic damage on generations of your citizens, and Japan would surely lose its status as the world's second largest economy. Fortunately, this sad fate need not be. You can set Japan on a course towards sustainable recovery, as I have outlined above. Show the leadership Japan now requires and you will be remembered as its greatest prime minister. Dither, as have your predecessors, and you will probably be replaced within two years. The choice could not be more obvious.

I wish you every success,

David Fuller

Interest Rates and Bonds

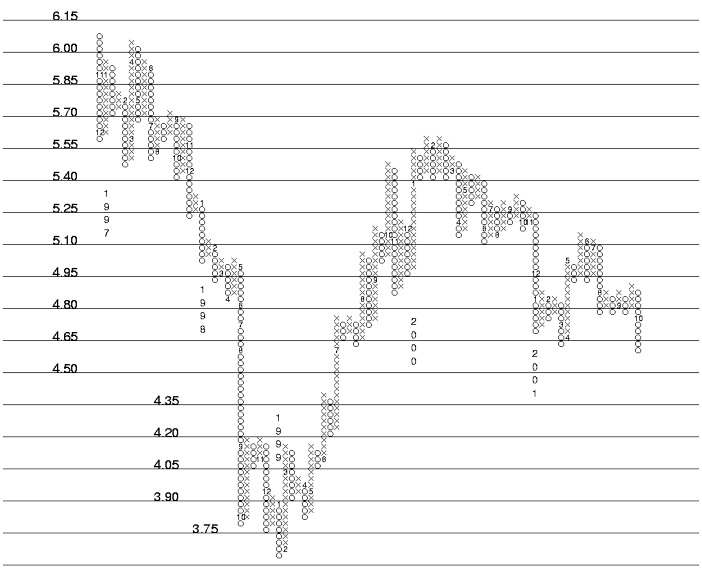
■ **Some further rate cuts are likely, especially in Europe.**

■ **Deflationary pressures are favourable for long-dated government debt but much of this has been discounted and bond prices often move inversely to stocks.**

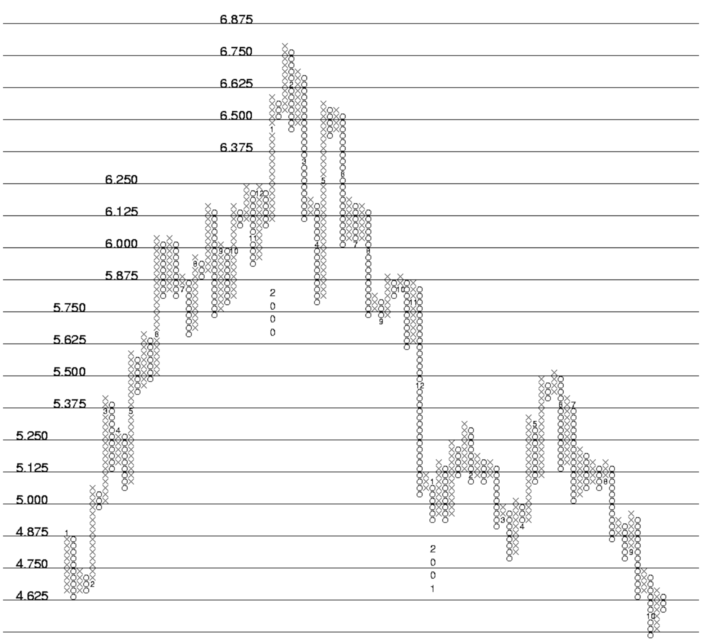
Waning inflation leaves central banks room for further rate cuts. Lower prices for petroleum products and the global economic slowdown have ended the late-1999 to early-2001 inflationary blip. This is good news for central banks, which should err on the side of leniency in establishing monetary policy over the next few months, because economic risks remain on the downside. I maintain that the European Central Bank and the Bank of England's Monetary Policy Committee are still behind the curve of events. Consequently they have the most scope and likely cause for making additional cuts. The US is near the bottom of its rate-cutting cycle but it would probably require a blistering stock market rally from current levels to prevent Greenspan from shaving another 25 to 50 basis points off the Federal Funds Rate, which he has already reduced this year from 6.5% to 2.5% in nine steps. He will be concerned about the economic effects of rising unemployment and blows to consumer and business confidence due to terrorist attacks - recent and feared.

Long-dated government bond yields could move somewhat lower but it is now late in the cycle. Euro-bund 10-year yields have only recently broken their March low and probably have the most downside scope among quality issues. A move over 4.89%, which appears unlikely, is required to indicate a downside failure and offset scope for a further decline towards the August 1998 to June 1999 trough evident below 4.2%. The downward cycle for US 10-year rates, which are usually higher than those of Europe, has fulfilled much of its potential and is approaching

Euro-bund 10 Year Bond Yield (0.03)



US 10 Year Bond Yield (0.025)



an important region of prior support from the 1998 lows down to 4.175%. However a move to 4.675% is currently required to question downtrend consistency. JGB yields have backed away from the higher side of their narrow three-month range and 1.45% is still required to suggest higher scope, reaffirmed at 1.50%. Since bond prices often move inversely to share prices, due to the so-called flight to quality, a further stock market rally will draw funds away from the fixed interest sector, putting upward pressure on yields.

Strategy for bonds - From a conservative perspective, my strategy since FM200 has been to favour short maturities - from 3-year government instruments to bills. Given the substantial gains in this sector my strategy would be to lighten positions on strength and also use tight trailing stops to lock in most of the profits, in the event of a correction, which could be caused by a further stock market rally. I would continue to tread cautiously in the corporate bond market, as there is still a risk of some notable scares and/or defaults. These would temporarily weigh on even the better quality issues. Among futures, I am occasionally tempted to buy Euro-bunds for small, short-term trades when stock markets appear vulnerable.

Global Stock Markets

- **Markets are becoming inured to profit downgrades.**

- **High price/earnings ratios matter less in a well-established bear market.**

- **Earnings should be considerably higher in Q3 & Q4 2002 (YoY).**

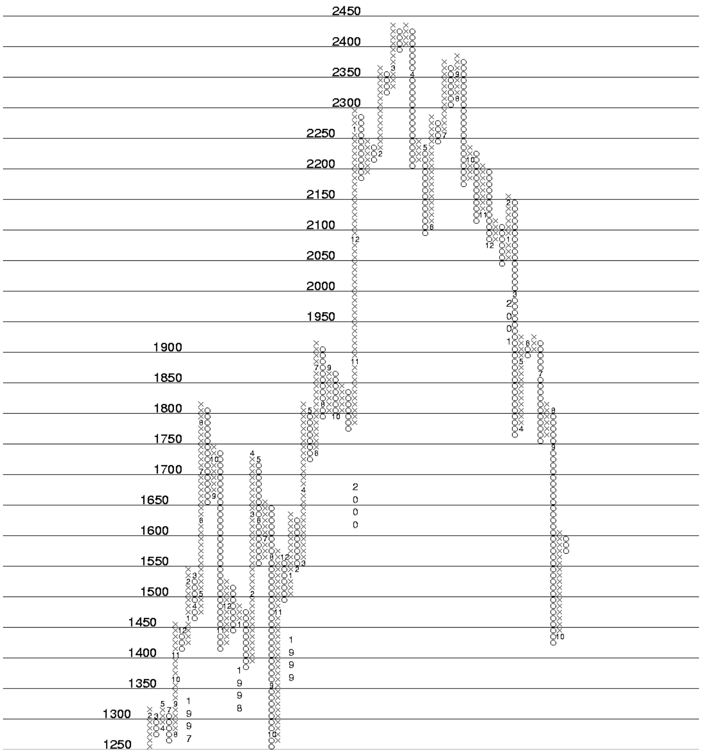
- **Stock markets have gone from deeply oversold to somewhat overbought on a short-term basis.**

- **Is the bear market over?**

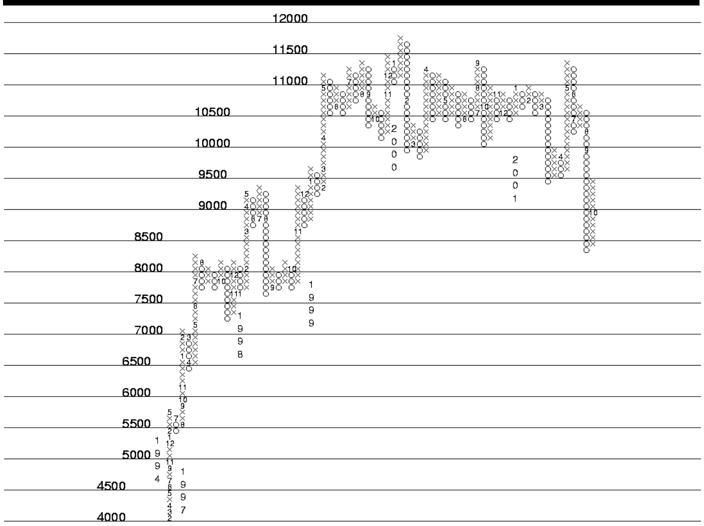
Earnings warnings by companies are becoming old hat. In the waning days of the last bull market, investors had become so accustomed to announcements of corporate profits above consensus expectations, that anything less was a disappointment. Many knew the figures were massaged by creative accounting and stock buybacks but it didn't matter because the US economy would boom forever, or so people hoped, boosting GDP growth everywhere else. Even as petroleum prices surged and the Federal Reserve moved to curb an overheating US economy, we were told that tech was interest rate and recession proof, not that a serious slowdown was seen as remotely possible by believers in the new paradigm. When profit downgrades commenced, the offending stocks were punished by juries of investors as seldom before. These corporate offences were doubly heinous because every other company was doing so well, or so it seemed. Today, bad news is the norm. It still has an effect but we see far fewer of the downdraughts, which were so frequent last year. Since bad news has become the norm, it is at least partially discounted by the bear market. Investors accept that earnings will generally be worse following the atrocities on 11th September. Moreover, this is a convenient excuse for companies to write off everything but the kitchen sink in Q3 and Q4 2001. Stock markets will probably take this in stride, provided there are no further horrendous attacks by terrorists. This hypothesis alarms some fundamental analysts, especially as the price/earnings ratio for the Standard & Poors 500 Index has never been higher.

How important is a new all-time high for the Standard & Poors 500 Index's p/e ratio? On 11th October the S&P's p/e, based on reported profits over the last twelve months, touched 35.99, breaking the 1999 record of 35.82. While no amount of analytical spin could present this information as bullish, the record matters a lot less following a major decline by all stock market indices. High valuations within a mature bull market indicate that investors are chasing stocks, at a time when earnings

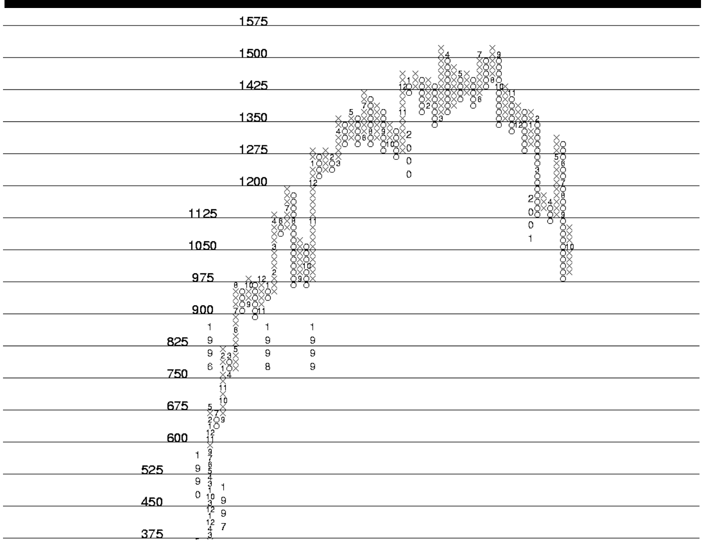
Chartanalysts' World Market Indicator (10pt)



Dow Jones Industrial Average (100pt)



S & P 500 Composite Index (15pt)

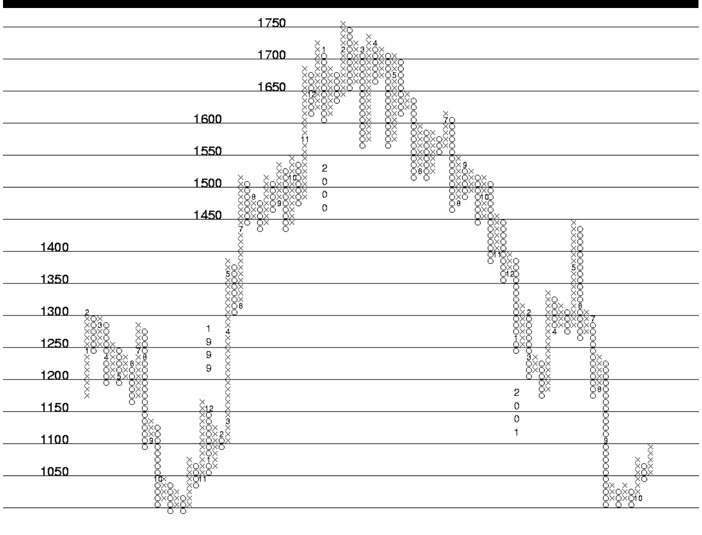


are probably inflated by creative accounting and are certainly unsustainable over the longer term. In a bear market reflecting economic slowdown, p/e ratios can still rise because earnings are slumping, especially if there are accelerated write offs, as we are seeing today. Consequently, where high multiples in a bull market indicate a bubble, in a bear trend they can denote the trough for earnings.

Write offs in Q3 and Q4 2001 should mean higher earnings for the same period in 2002, even if the recession has not ended. Few corporate treasurers will squander an opportunity to redress any previous accounting excesses in an economic downturn, especially now that they can blame bad news on terrorist attacks. Consequently, earnings for the remainder of this year are likely to be so bad that a rebound is assured in Q3 and Q4 2002, regardless of whether or not the world is in recession. Furthermore, the inevitable layoffs still to come will lower overheads and increase productivity, as will lower interest rates. Stock markets may have already begun to discount the improved outlook for earnings during the second half of 2002 (YoY). However, assuming this script is correct, higher earnings next year could prove difficult to sustain in an environment of moderate global growth.

European fund data (a contrary indicator) suggests that September's lows for stock market indices will hold for at least a few months. Net inflows into stock market funds by European investors are only 13 percent of the pace for 2000, according to a recent article in The Wall Street Journal Europe. In September, some fund management companies experienced their net biggest outflow of funds for three years. Apparently, a survey of 500 people who currently do not own stocks, indicated that only 19 percent would consider buying equity funds in future, down from 50 percent six months ago. One leading firm reported that 75 percent of capital flowing into money market funds this year occurred in September. These statistics are contrary indicators and provide further evidence that stock markets reached lows of at least medium-term significance on 21st September. However the subsequent

Tokyo Topix Index (10pt)



rebound has created a short-term overbought condition. As rallies approach overhead supply evident on charts from the March to approximately August ranges, buyers will become more cautious. Also, short covering has helped to fuel the recent rally and this source of demand is temporarily diminished. Some traders will be tempted to open new short positions near psychological resistance levels on the charts. Anyone who bought near the March to August lows, hoping for a double bottom, which some were predicting at the time, and rode the market down in September, will be tempted to lighten as prices approach or exceed their entry points. Therefore upside scope from here on should be more laboured and we can expect a partial retracement of the rally before long. However, barring another devastating terrorist attack, which is presumably a declining risk, the 21st September lows for indices should hold for at least the next few months. Moreover, the partial retracement is likely to be a consolidation leading to some additional gains over the medium term.

If the lows are going to hold for at least a few months, does this mean that the bear market is over? It could be, because of the declines already seen, extremely bearish sentiment, the US-led massive monetary reflation and likely fiscal stimulus. Obviously we can all provide plenty of reasons why the bear market may not be over, from valuations to insider selling, bullish commentary from investment institutions (at least publicly), the synchronised global economic slowdown, debt problems and last but not least, the medium to long-term downtrends for stock market indices. However, as we have seen before, fundamental news is often worst near a bottom and we certainly saw a panicky environment during the first three weeks of September. Consequently, I believe we have at least seen the end of a bearish leg and that a medium-term recovery has commenced. As for the longer-term picture, I maintain that the super-cycle bull market ended in 1999/2000. Therefore I suspect new all-time highs for indices will be few and far between over the next decade or more. Ranging activity will be the norm, producing medium-term bull and bear trends, usually in line with monetary cycles. Accordingly, the September lows could be vulnerable when investors next discount rising interest rates, if not before, due to worrying developments in the war against terrorism and their possible economic implications.

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.chartanalysts.com. Price levels mentioned refer to market closes. The charts were updated through 22nd October's closes. The figures for indices in brackets were taken at approximately 10:15am on the 24th.*

Chartanalysts' World Market Indicator (1570) has seen its best bounce since June 2000, following a climactic downward acceleration. This rebound provides further evidence that the September low at 1420 will hold for at least a few months, particularly if most of the recent gains are held during the current reaction.

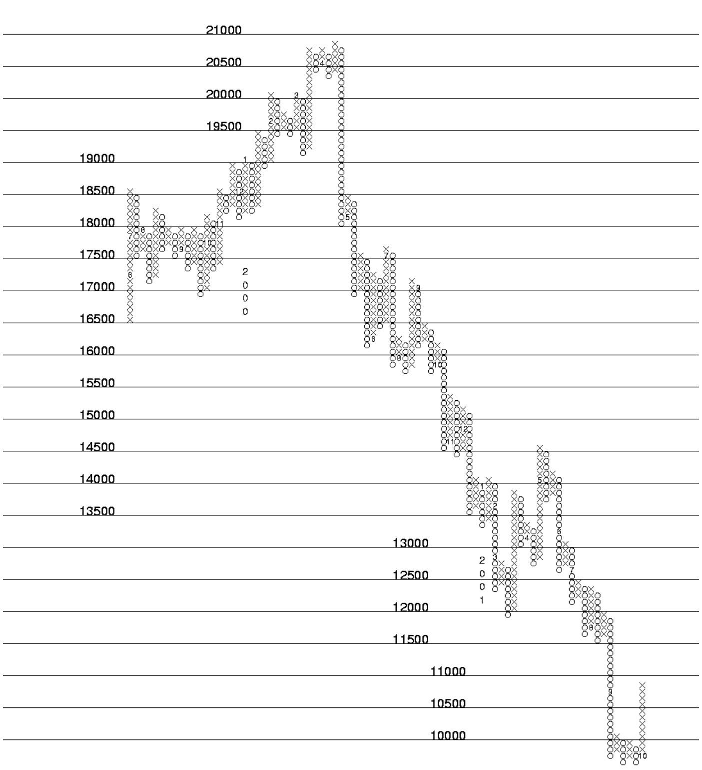
The US's Dow Jones Industrial Average (9340) rebounded following September's plunge but the rally has been checked by initial overhead resistance from the large top formation. A move to 9500 is needed to suggest a downside failure and some additional recovery. **The Standard & Poors Composite Index (1084)** bounced from its important August to October 1998 floors but the rally has hesitated beneath initial resistance from last April's low. A move to 1100 would suggest some additional recovery but overhead trading indicates that upside progress would be laboured.

Japan's Tokyo Topix Index (1100) has firmed above its important 1998 lows near 990. A move below this level is needed to offset current scope for some additional recovery, as there is no chart resistance evident until 1170. **The Nikkei 225 Stock Average (10802)** has rebounded following its accelerated decline and subsequent loss of momentum. A decline to 9500 is required to negate scope for some additional recovery towards initial resistance at 11500.

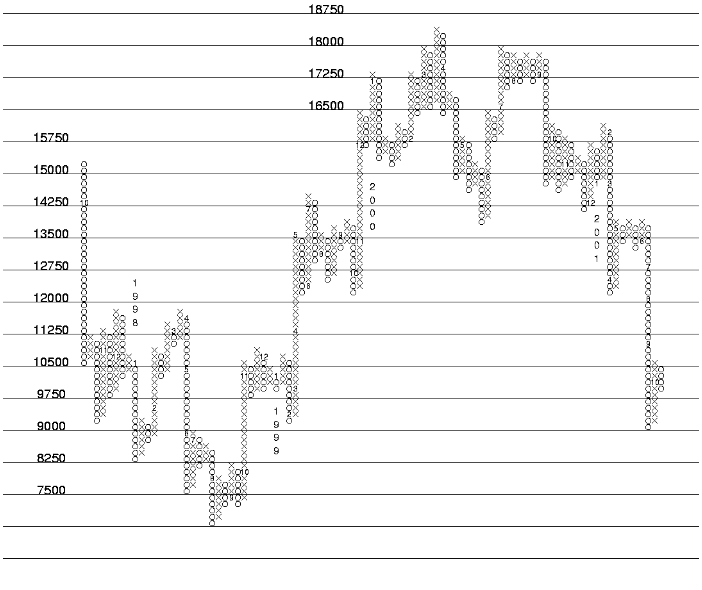
Hong Kong's Hang Seng Index (10243) - *see overleaf* - has paused following its bounce. However some further recovery remains probable, provided the low at 9000 is not breached, and would be signalled at 10650.

Australia's All Ordinaries Index (3182) - *see overleaf* - rebounded strongly but this recovery has slowed in overhead supply. While some further gains would be indicated at 3180, a further retracement and consolidation seem likely before this is attempted.

Nikkei 225 Stock Average Index (100pt)

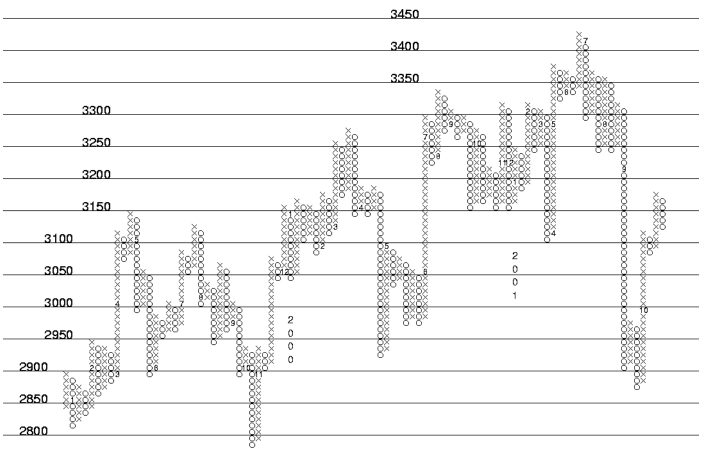


Hong Kong Hang Seng Index (150pt)

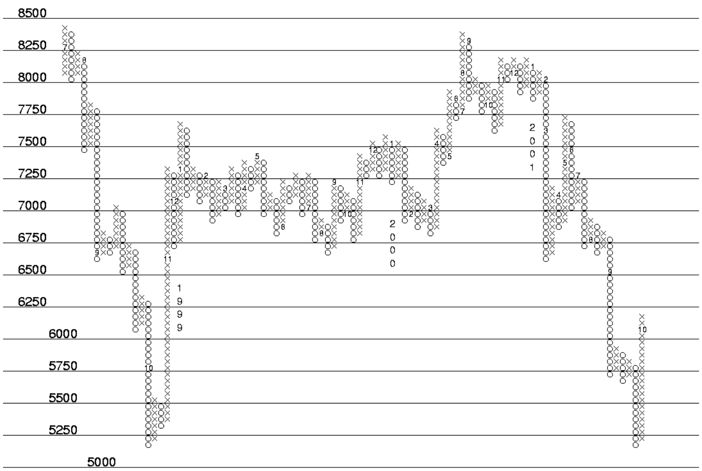


Italy SE MIB 30 Index (300pt)

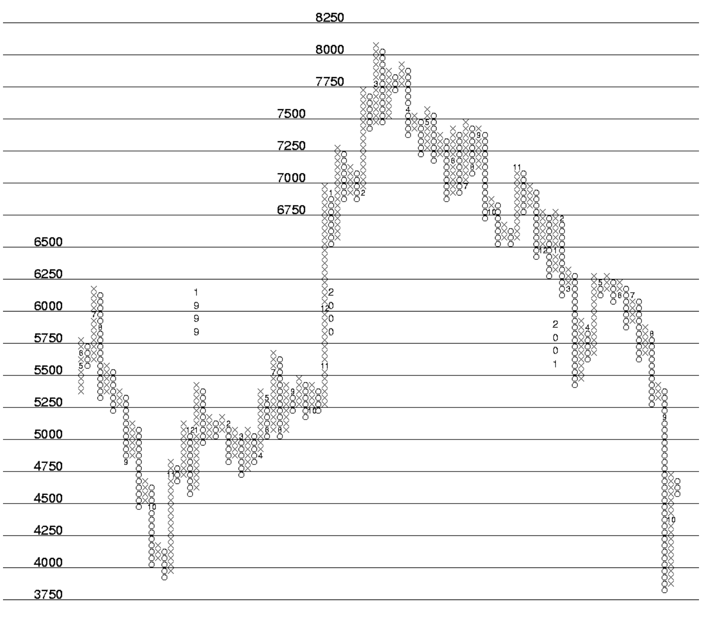
Australia All Ordinaries Index (10pt)



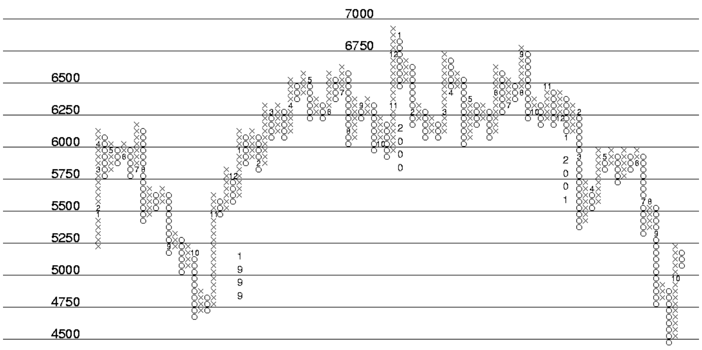
Switzerland Swiss Market Index (50pt)



Germany DAX Index (50pt)



United Kingdom FTSE 100 Share Index (50pt)



Germany's DAX Index (4813) is extending gains in response to September's climactic decline, following a brief pause. While some additional consolidation is likely before long, support should be encountered above the low at 3800 during this process, prior to a more gradual recovery as overhead supply is approached.

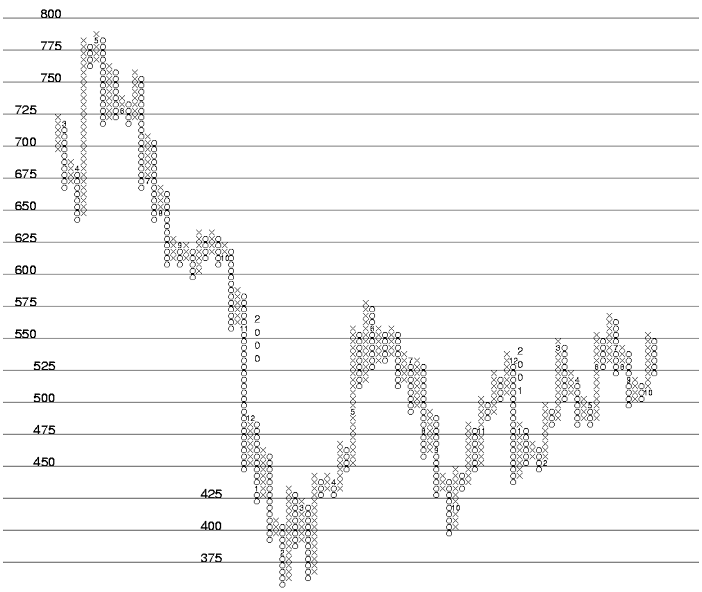
Italy's MIB 30 Index (32203) encountered good support near its 1998 low following September's climactic plunge. While some consolidation of recent gains, beyond a brief pause, is likely before long the low at 24300 should hold during this phase and significant supply from the downtrend does not commence until 35400.

Switzerland's SMI Index (6342) has also rebounded from its 1998 low, which is evident at 5150. While the rally should now slow, a move below this level, which seems improbable over the next few weeks, is required to offset some further recovery. However overhead supply mostly above 6750 appears formidable.

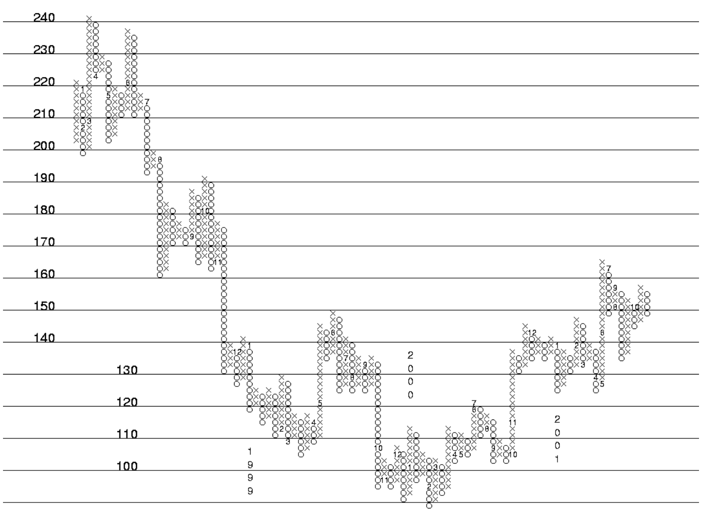
The UK's FTSE 100 Share Index (5252) broke its short-term downtrend on the move to 4950 and is now consolidating recent gains. However the FTSE 100 did not become as overextended on the downside as most Continental European indices. Therefore the low appears more susceptible to an eventual test, although a further rally towards supply evident above5300, from the large top area, may occur first.

Strategy for stock markets - Last month I concluded that stock markets were beginning to look more interesting following climactic declines but that it would be a brave investor who bought for more than a technical bounce. We've seen a good rebound and were it not for charts of the DJIA and FTSE 100, I would feel there was strong technical evidence for concluding that the bear market was over. Despite these reservations, I've seen enough to conclude that indices have bottomed for at least the next three to six months. A proviso is that we do not see another horrendous terrorist attack. We know this is a risk, but hopefully declining now that security forces are alert and extensive counter-terrorist measures are being taken. In conclusion, following last month's climactic endings for indices, I conclude that the greater medium-term risk is on the upside. Consequently, I'm now willing to recommend a few shares, which have the following merits - relative strength over a number of months, evidenced by base characteristics, higher yields than government bonds and low multiples (estimated). These initial recommendations are conservative choices because in a deflationary environment I think yield will remain an important consideration for many investors. The three stocks are Scottish & Newcastle (SCTN, p/e 11, yield 5.34%), Northern Foods (NFDS p/e 9.8, yield 5.2%) and Boots (BOOT, p/e 12.9, yield 4.2). They happen to be UK stocks but I would consider any companies from other markets with similar criteria. I wouldn't pay up and I'm suggesting buying ranges, which for monitoring purposes will remain open for two months (FM211). These are SCTN 525p to 495p, NFDS 148p to 134p and BOOT 625p to 585p. Closes on the point & figure charts shown below the lower ranges mentioned would indicate some chart deterioration but in that event I would hold given the overall basing characteristics. For monitoring purposes I'll take prices between this issue and FM211's release date. For investors who want more action, note the change in relative performance for tech stocks. Where the NASDAQ so often under performed during the last eighteen months, it is out

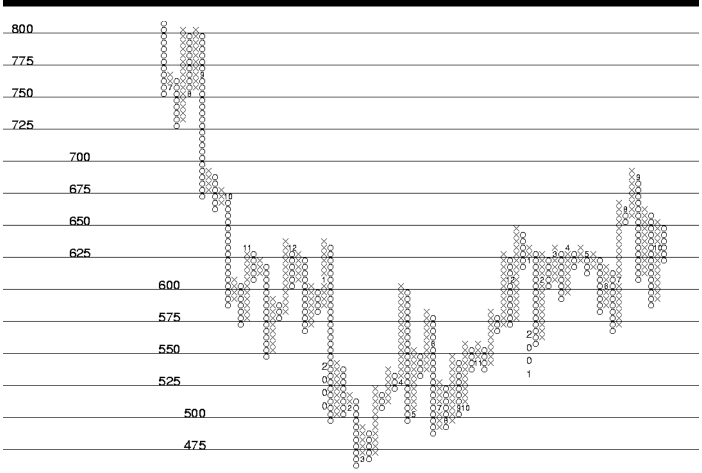
Scottish & Newcastle (5pt)



Northern Foods (2pt)



Boots Co. (5pt)



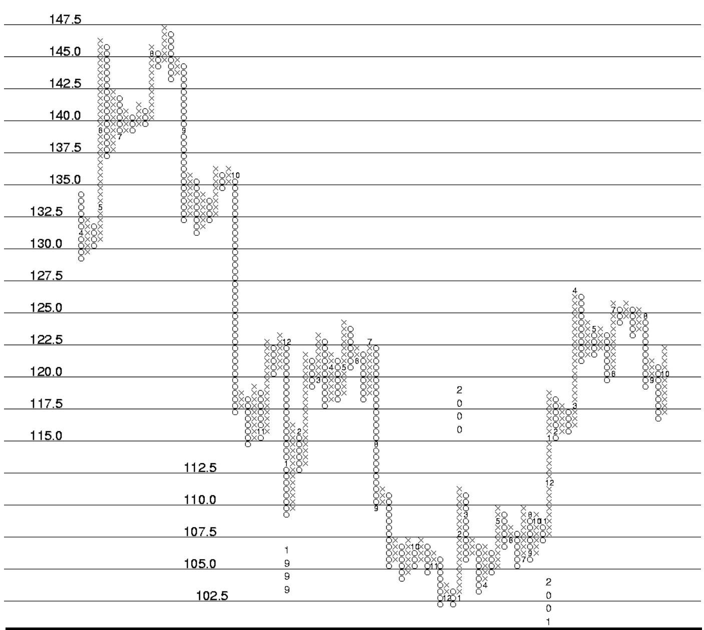
performing the DJIA and S&P on most days. The TMT stocks to consider are sector leaders that generate profits. From a speculative perspective, volatile conditions have created opportunities in stock index futures. I will continue to play these lightly from both sides, as last discussed in FMP156 on 16th October. Following strong rebounds in Europe, the Nikkei is currently one of my preferred longs, at least while the short-term uptrend is intact. As the rally in stock market futures progresses, and some are resuming recoveries following small consolidations, the risk of pullbacks and base extension phases will increase. Therefore I will look to short on near-term overbought conditions, particularly where overhead resistance is evident on the charts.

Currencies

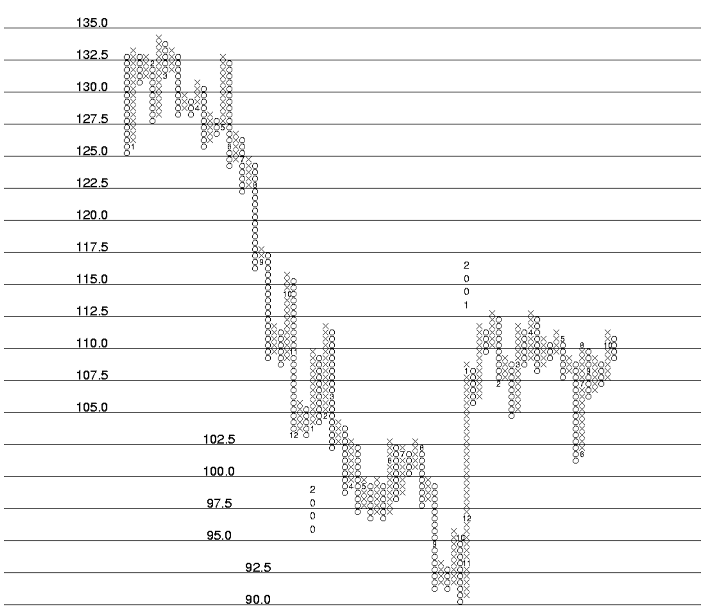
■ **Base extension against the yen is in its latter stages.**

Base extension, as we are seeing against the yen, has all the excitement of watching paint dry, seemingly offering little hint of the move to follow. Actually, the process is psychologically debilitating, particularly if one has little understanding of Behavioural Technical Analysis. Prices march up the hill, only to fall back, repeating this sequence over and over. For those with positions, an emotional downer follows each psychological lift. Tactically, it's a bummer because most people buy on the rallies and are then stopped out on the reactions. The experience is doubly frustrating if there is a clear macro case for an uptrend, only the market keeps signalling that it is not ready to support a major move. Confidence is gradually undermined by the choppy action. This lowers expectations at a time when the technical structure is improving, due to a convergence of trading within the range. These patterns are often followed by explosive moves, once demand has absorbed available supply within the base. Consequently many people who initially anticipated the move are not aboard when the eventual breakout occurs. Moreover, having been whipsawed previously, they are understandably reluctant to jump back in at a higher level as the uptrend resumes and is extended. Some chart traders advocate waiting for a sustained breakout. This sounds OK but is often difficult to implement, if only because in seeking confirmation we can too easily miss an important part of the move. It was this type of tactical difficulty, which I'll summarise as a promising macro economic story matched by favourable but incomplete base formation activity, that spawned my Baby Steps buy-low-sell-high strategy for leveraged trading in probable bases many years ago. After all, understanding the likely script is never more than half the battle. You and I can only deal with the reality that the market provides. My script for the yen is that it will eventually move much lower against all other reserve currencies, for the many reasons previously detailed in these pages, of which the most important is Japan's deflationary spiral. Remember, the US did not pull out of its depression until the dollar was devalued against gold in 1934. As for charts of other reserve currencies against the yen, all have two similar characteristics - a sharp rebound commencing in late 2000 to break the downtrend, followed by months of ranging. For most, the overall base activity resembles V-bottom with right-hand extension, as taught at The Chart Seminar. Only the dollar/yen chart is somewhat different with its rounding trough formed between September 1999 and December 2000. Interestingly, the Swiss franc moved to a new recovery high against the yen in early October, although it has been unable to extend this upward break. As both

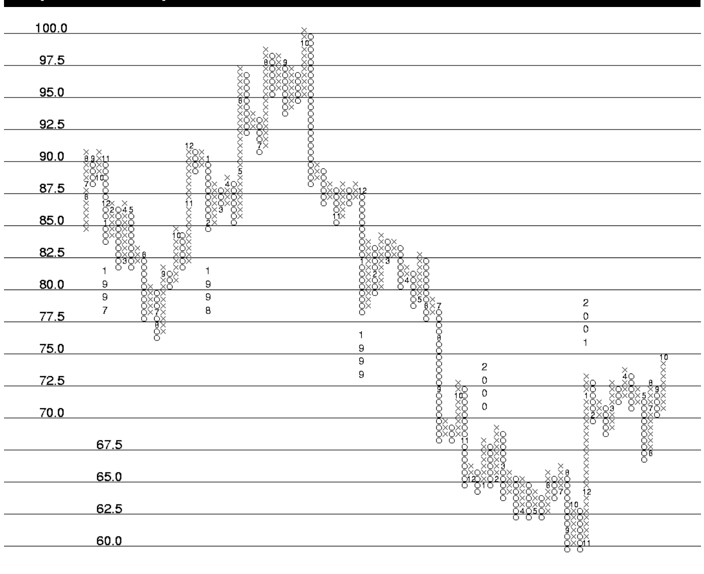
Japanese Yen per 1 US Dollar (0.5)



Japanese Yen per 1 Euro (0.5)



Japanese Yen per 1 Swiss Franc (0.5)



the euro and sterling are currently closer to the upper side of their base extensions, it is likely that they will move to new highs for the year against the yen before the dollar. However, if I am right in believing that another significant up leg will commence before too long, possibly within the next few weeks although this is always the most difficult factor to anticipate, we should see decisive upside breakouts by all other reserve currencies against the yen.

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

Dollar/yen (¥122.45) - The dollar did not maintain its break under the May and August lows, indicating that the reaction was no more than a base extension phase similar to what euro/yen experienced several months ago. The overall pattern, dating back to January 1999, resembles a large base with H&S characteristics, now in its latter stages. A move under ¥116, which is unlikely, is required to indicate a lower phase of pattern development before the upper boundary is challenged and eventually broken.

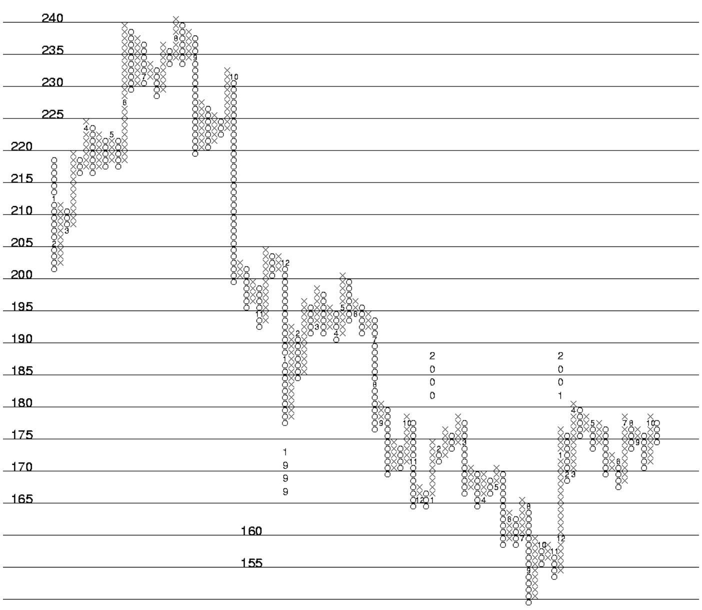
Euro/yen (¥109.27) - Significantly, the early-October gains broke a progression of lower rally highs within the right-hand extension phase of this base. Since reaction lows have also been rising following the shakeout in May, we can assume that demand is regaining the upper hand, even though the recent push above ¥110 has not been maintained. A move to ¥106.5 is needed to indicate a more lengthy retrenchment but we are more likely to see support near current levels, followed by a successful challenge of the January and April highs near ¥112.5. Once they are decisively taken out, there is very little chart resistance until ¥122.5.

Swiss franc/yen (¥73.88) - This is the first reserve currency to break above the January and/or April highs against the yen. While it has eased following this move, a decline to ¥69.50 is necessary to indicate an upside failure and additional base formation extension. However the more likely development is a consolidation near current levels followed by renewed strength.

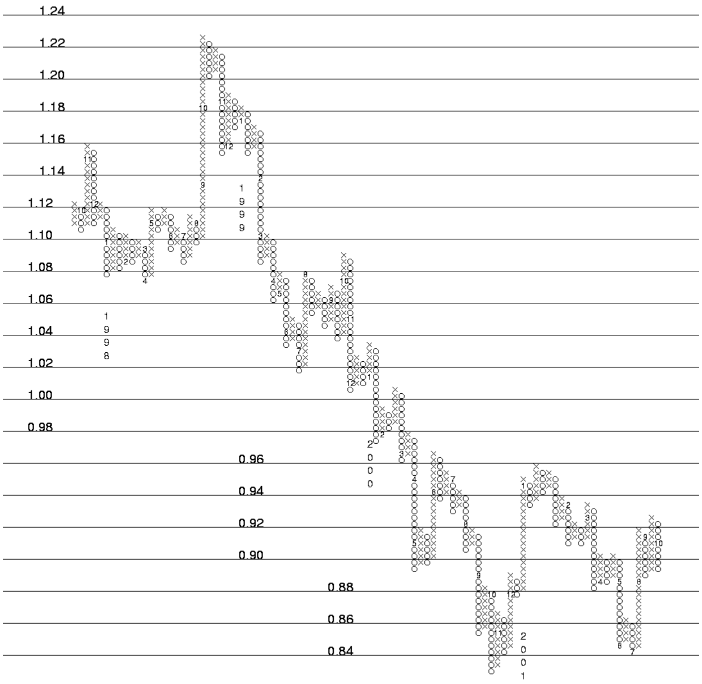
Sterling/yen (¥174.75) - The pound recently backed away from its July high at ¥178 but a move under ¥170 is needed to indicate more than temporary resistance here. Instead, look for a successful test of lateral trading in the ¥178 to ¥180 region.

Euro/dollar ($0.8892) - The euro has drifted lower recently, not maintaining its push over the August high. Nevertheless the overall pattern continues to resemble base development and a retest of the lows appears unlikely. Instead, further ranging near current and mostly higher levels is probable, eventually leading to a successful test of the January peak near $0.956. However this pattern is unlikely to support more than a medium-term rally for the euro, which could test parity, before the euro weakens once again as the dollar

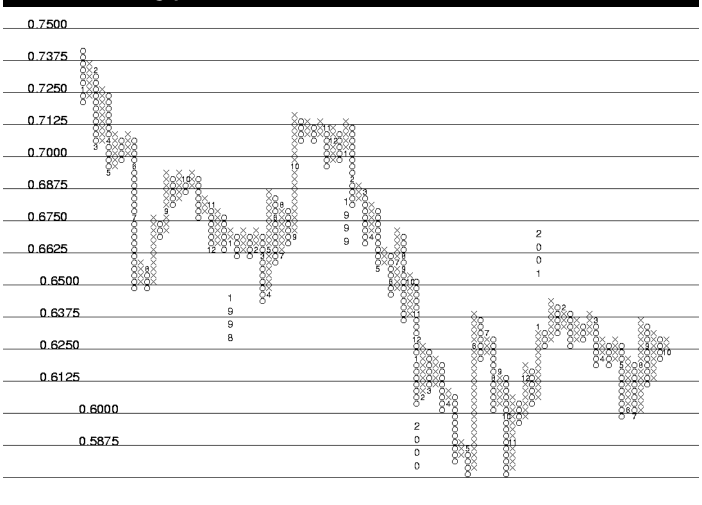
Japanese Yen per 1 Pound Sterling (1)



US Dollar per 1 Euro (0.004)



Pound Sterling per 1 Euro (0.0025)



resumes its long-term uptrend.

Euro/sterling (£0.6245) - *see previous page* - Similarly, the euro continues to show base development against sterling, only the overall relative strength is somewhat better than for euro/dollar. Currently, £0.6175 is required to check the rising lows, further delaying a challenge of the upper boundary between £0.6350 and £0.6425.

Strategy for currencies - Once again, short yen is the outstanding macro opportunity in my view. Meanwhile the action alternates from quiet to choppy in what looks very much like base formation extension prior to a significant additional recovery. This hypothesis is supported by similar chart patterns for all other reserve currencies against the yen. Tactically, I favour either buy and hold, taking advantage of yield differentials while waiting for the bases to be completed, or a Baby Steps buy-low-sell-high range trading strategy. The latter has increased returns, lowering the overall entry cost for core positions. However the Swiss franc's upward break, while not confirmed by the others, increases the likelihood that these bases are nearing completion. Therefore lightening on rallies increasingly risks an underweight position when the next upward leg commences. As for deciding which of these will do best against the yen, from current levels I suspect it could be the euro, at least until the single currency has fulfilled more of its medium-term potential against the dollar. However sterling offers the best interest rate differential and on a short-term basis, whichever of the reserve currencies has under performed against the yen and consequently looks oversold, probably provides the best opportunity. I trade mainly dollar/yen, euro/yen and occasionally sterling/yen, and I have increased my positions recently. I'll probably do so again, as breaks above the year's earlier highs occur, particularly as I will be able to protect current positions with in the money stops.

Commodities

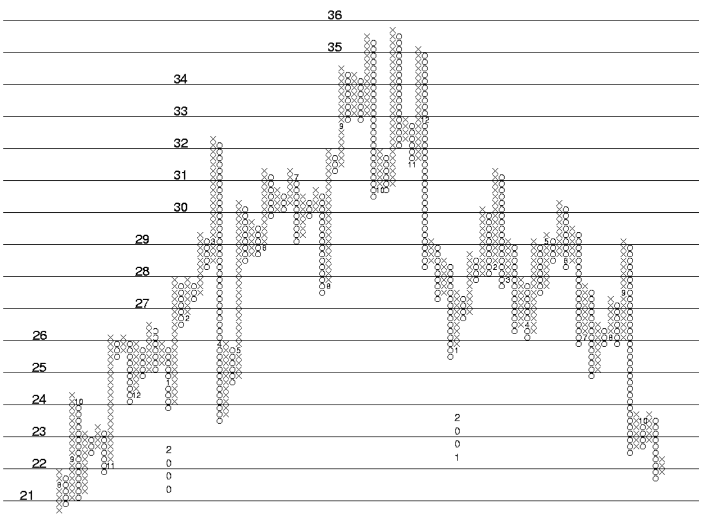
■ **It would require further production cuts by OPEC and/or a military threat to supplies from the Middle East to lift crude oil back up into its top formation.**

■ **Gold has experienced an upside failure and further base extension is assured.**

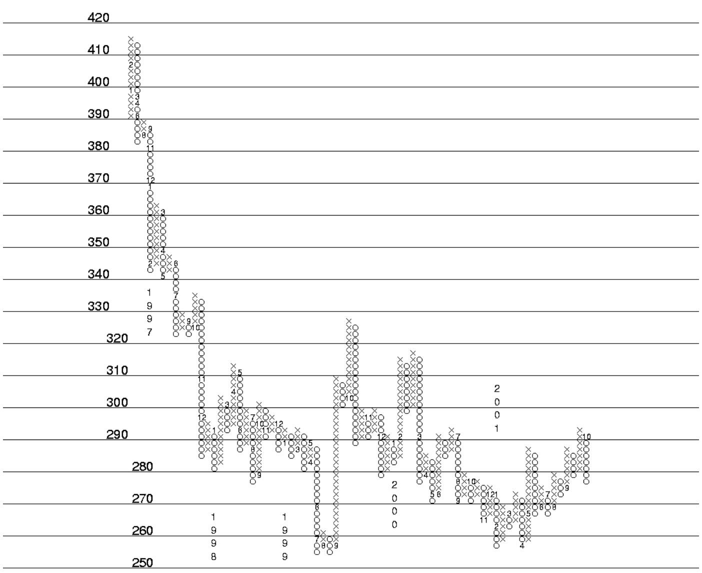
■ **Nickel is approaching former support and production cuts may kerb supply.**

Oil completed its top in late September. Subsequently, it ranged beneath this pattern before drifting lower, despite talk of further supply cuts. OPEC is in a difficult position, and not just because no cartel for a widely produced commodity has ever survived beyond the medium term. The cuts commencing in 1998 have been the single biggest contributor to the current global economic slowdown. This has reduced demand at a time when non-OPEC production has increased due to higher prices. Knowing this, the Cartel states have undoubtedly pumped more than their agreed quotas. They would certainly like higher prices but further production cuts, even if enforceable, would be extremely

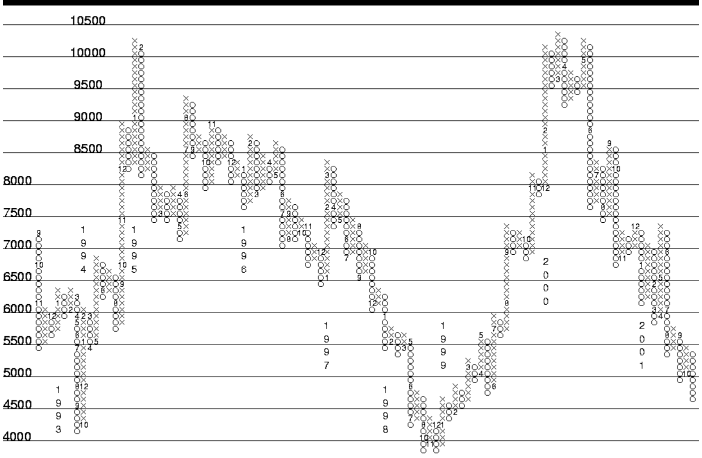
Crude Oil NYME 2nd Month Continuation (0.2USD)



London Spot Gold (2USD)



Nickel LME 3 Months (100USD)



provocative, especially given the difficult political balancing acts for most Gulf states following terrorist attacks by Islamic fundamentalists on the US. Consequently, it would require further supply reductions and/or a broadening of the US-led counter terrorist effort beyond Afghanistan, to trigger a rally back up into the top formation. Even in this event, the gains would probably be short-lived. Oil is heading back below $20 in coming months. That will be good for the global economy.

Expectations for a higher gold price were always incompatible, beyond the short term, with falling bond yields due to deflation concerns. Fear following attacks on the US produced a rally in September but this could not maintain a break above the year's earlier high at $286. Consequently gold is now likely to see a further test of underlying trading during an additional base extension phase, which is likely to be lengthy. A move to $294 is required to challenge this hypothesis.

Base metals have fallen in line with the strong dollar and global economic slowdown. Nickel, the most widely used industrial metal, is now approaching prior support from its 1993 and 1998 lows between $4100 and $3800. Short covering as those levels are approached should steady the price somewhat but production cuts and an economic recovery will be required to lift them significantly, judging from other cycles for base metals. The first item of good new was an announcement by Phelps Dodge on 23rd October that it will lower production of copper. Other mining companies are bound to follow this lead. The speed with which prices bottom out and commence the next upswing will depend on the extent of cutbacks and commencement of the eventual economic recovery. This is unlikely before the second half of 2002.

The Global Economy

- **Terrorism will have a diminishing effect on the US and global economy.**

- **Only the US can lead the global economy out of this slowdown.**

The first response to terrorism is to stop doing what we were doing at the time. Immediately following the shocking events of 11th September, our behaviour patterns changed. For over a week most of us watched television as never before, glued to CNN and other twenty-four hour news channels. This kept us out of shops and restaurants, causing consumer spending to plummet. The main beneficiaries, economically speaking, were telecoms companies, because we contacted family and friends as seldom before. However social spending such as dining in restaurants is recovering but it will take longer for conspicuous consumption to return. Prior to the attacks, few of us realised that we were at war with Islamic fundamentalists. This new realisation is frightening and it has made us more reflective. We are more appreciative of what we have - family, home, security despite the new concerns, freedom and our health. Some of the previous small irritants and gripes now seem less important. Life feels precious, as does time. Marriages dates have been moved forward, divorce petitions withdrawn and we feel less litigious. Patriotism is fashionable once again. These sociological changes are certainly not exclusive to the US but they are understandably most evident in that country, which was attacked as never before. From Congress to the cities and rural hinterland, Americans have never been more united in living memory. Although this unity will wane over time, particularly among rival politicians, it can only be reinforced by any additional terrorist attacks. While these would temporarily damage the US economy, with a knock-on effect around the globe, anything less than a nuclear attack (hopefully extremely unlikely) will have a diminishing effect on sentiment. In other words, the US will soon learn to live with terrorism, as have people in the UK and most other countries. Meanwhile, a more cohesive America will emerge from this crisis as an even more influential economic power, even though changes to the global economy before 11th September suggest a slower rate of growth than occurred in the late 1990s.

The ECB claims not to see a risk of recession but that is Europe's direction. The duff forecast of the year from many economists, was that Euroland would somehow be insulated from the US slowdown. This was never likely because in chart parlance, the base was insufficient for Europe to be immune to global trends. In other words, Euroland's overall economic performance had been flat prior to 1999, due to Maastricht Agreement constraints and the perennial problem of over regulation. Improved growth in 1999/2000 owed much to a surge in demand from the US. Subsequently, the one area where Europe had a technological lead - telecoms, has been a disaster area. Euroland's slowdown has been less dramatic than in the States because growth has fallen from a much lower peak. Consequently, the region's unemployment remains considerably higher than in the US and job creation is much slower. Finally, the ECB has been last to see the obvious danger signs, due to its hubris and incompetence. The central bank no longer has the excuse of inflationary pressures but nevertheless remains behind the curve of events, despite a 50 basis point rate cut to 3.75 percent on 17th September. Euroland is still heading towards recession, although the outlook for the second half of next year is improving due to lower interest rates and oil prices.

Japan's deflation is intensifying. Both deflation and

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inflation are primarily the creation of monetary policy, and the Bank of Japan's collective feeble-mindedness has long been obvious. Governor Masaru Hayami has been reflating but only due to intense domestic and international pressure. Money supply has now moved up to 3.7 percent (M2+CD) but this is still much too low considering that the economy has stalled; asset prices have been declining since at least mid-1999, while bank lending has been falling since 1996 with the current rate being 4 percent per annum. Apparently, Hayami isn't even looking at aggregate economic data for Japan because he claims that cheap imports are the main cause of the country's deflation. While it is true that imports of consumer items such as food and clothes have contributed to lower prices, independent studies show that aggregate import prices are actually rising and domestic prices are falling. Meanwhile Japan's economy shows the classic signs of intensifying deflation - falling output, prices and profits. This crisis, which has a knock-on effect throughout Asia, can only be compounded by the Japanese Government's own dithering, plus weakening growth in the US and Europe.

Following the attacks on 11th September, the US recession will be somewhat deeper but end sooner. GDP for Q3 and Q4 2001 can only be weaker than what would have otherwise occurred, primarily due to the psychological shock. However the Federal Reserve has responded with further rate cuts and a massive infusion of liquidity. Appropriately, the Government has also increased fiscal spending and there is more to come, including help for lower paid workers. Together with increased military spending, this can only foreshorten the US recession, provided there are no further terrorist attacks of devastating proportions. Terrorism obviously remains a risk but in future it will be much harder to finance al-Qaeda and any similar groups, let alone for their cells in the West to remain undetected. With or without further terrorist attacks by Islamic extremists, for which the economic effects are not limited to the country hit, only the US is currently receiving both a monetary and fiscal stimulus. Therefore it is likely to recover more quickly than other countries from the global economic slowdown.

And Finally…

Conferences, speeches and seminars - In Dublin on 1st October, I provided a day's training on Behavioural Technical Analysis at the ACI Ireland Conference, working with highly-motivated delegates from twenty-two countries. They were primarily interested in currencies, interest rates and stock market futures. Needless to say the latter provided the best teaching examples, due to the many trends and climactic endings on 21st September. Technical analysis always works best when markets are really moving, which of course is when we need it most. I also enjoyed addressing the Society of Technical Analysts in London on 10th October, speaking on Investor Psychology Applied to Today's Markets. The STA is a thriving organisation - I'm told over a hundred people attended and it was a treat to see many old friends. I plan to attend more of their monthly meetings and recommend the STA to anyone interested in technical analysis and also living in the London area. You can read about it on www.stauk.org. My final venue for The Chart Seminar 2001 will also be in London on 29th and 30th November. I'm looking forward to it, particularly because I suspect the markets will be even more interesting, due to the depths of the economic slowdown and recoveries to follow, which markets always anticipate. We may even have some significant currency breakouts by then. Please note: I will be in the US from 7th to 12th November. If you would like a brochure for yourself, a colleague or friend, visit www.chartanalysts.com or contact Helen Gent, tel: (0)20 7351 5751, email helen@stockcube.com.

FMP updates from the website for postal subscribers - I'm please to announce that the two to three single-page updates between the main issues of Fullermoney are now available from our website, by prior arrangement. If you are a subscriber and not currently seeing the updates, please email Mark Glowrey - mglowrey@stockcube.com. Please note: the updates are not available by fax or post.

The target date for FM210 is Friday 23rd November.

"The man who is swimming against the stream knows the strength of it."

Woodrow Wilson

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Best regards - David Fuller

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