**Issue 217**
21 June 2002
**In its 19th year**

# Fullermoney

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

## Capitulation selling is evident in stock markets once again. Consequently current weakness will be followed by a technical rebound before long but medium to longer-term risks for equities are still on the downside, gold shares excepted.



## During reversion to the historic mean, most of the "surprises" for equity bulls are unpleasant.

**"I look at my stock portfolio and feel like the victim of a drive-by shooting".** I suspect many investors identify with this quote, reported in the US press recently. It is not the threat of terrorist attacks that is spooking people, as we often hear from the media. Investors understand the threat from extremists but also realise that they are less likely to be personally injured by terrorist attacks than they are to win a National Lottery, at least in most developed countries. Far more stressful is the almost daily injury inflicted on their equity portfolios during a post super-cycle bull market reversion to the historic mean for valuations. This process is brutal for the unwary and likely to last for years. Meanwhile, a generation of investors, including most professionals, has to unlearn cherished mantras of 1990s such as:

"Buy and hold."
"Buy the dips."
"Stocks are low risk."
"Stocks always outperform all other investments."
"This stock is OK for the long term."
"Tracker funds are best."

**Reversion to the mean seldom occurs quickly.** Wall Street enjoyed an eighteen-year bull market, significantly interrupted only by the Crash of '87. This ended in 1999/2000 after some of the biggest speculative excesses, and as everyone now knows, greatest financial scandals ever seen. Variations on this cycle occurred in most other stock markets. Can all this be unwound in two or three years, after which markets return to the good old days? Of course not, according to every shred of logic and centuries of financial history. It may feel like a near death experience to some, but viewed in perspective, the shakeout is a necessary and ultimately healthy process, leading to a more stable financial environment and better corporate governance. Meanwhile, the reversion will not occur uninterrupted. Stock markets will experience many medium-term rallies, such as we saw from last September's lows. There will be rotational rallies within sectors. However, declines will be steeper than recoveries, at least until the bear market overshoots the historic mean for valuations and reaches its eventual low. When will that be? Probably not during the next few years but almost certainly within the next ten or twenty. It is impossible to be more precise because there are too many variables, such as central bank policies, but we should know when we get there. How will we know? Judging from past cycles, most big-capitalisation US and

European stocks will trade at P/E Ratios near 10 and yield 4 to 6 percent. Behaviourally, many people will say, "I'll never invest in the stock market again", just as they said in the 1930s, 1974, 1987 (briefly) and as they have been saying in Japan during the last few years. Meanwhile, most of the market "surprises" will be on the downside.

**Who will do best in this environment?** Probably the better hedge fund managers, defined as those who have made money over the last year. Other investors willing to go long or short, in line with the medium-term trends revealed by charts. Conservative investors who shift a significant proportion of their assets to bonds, cash and some gold. Younger savers who are investing for their eventual retirement by placing a fixed amount of their salary in equity plans every month, provided they ignore what will be a slowly growing chorus advocating that one get entirely out of stocks. The consensus view is always a contrary indicator. Moreover, there are few who will remain more bearish beyond the eventual low than a late-in-the-cycle capitulated bull. Are emerging markets a safe haven? Some will outperform periodically, as we have seen with Asian markets and Russia since last September but most will be hammered when global sentiment turns really bearish.

**Are stock markets becoming temporarily oversold?** Most definitely. North American and European indices are accelerating downwards. Increased volume indicates some capitulation selling. Press articles are overwhelmingly bearish. Central banks, especially the US Federal Reserve, will attempt to head off panics. I suspect Greenspan intervened on Friday 14th June, as he most likely did on 21st September last year, and would do again in the interests of "maintaining an orderly market". However we are unlikely to know for sure as the Fed does not announce stock market interventions, which are usually purchases of S&P 500 Index futures. Moreover, Greenspan won't attempt to defend a particular level for the S&P, let alone buy a major recovery, and he would lighten any positions during the next significant rally.

## Interest Rates and Bonds

■ **Central banks are backing away from rate hikes,**

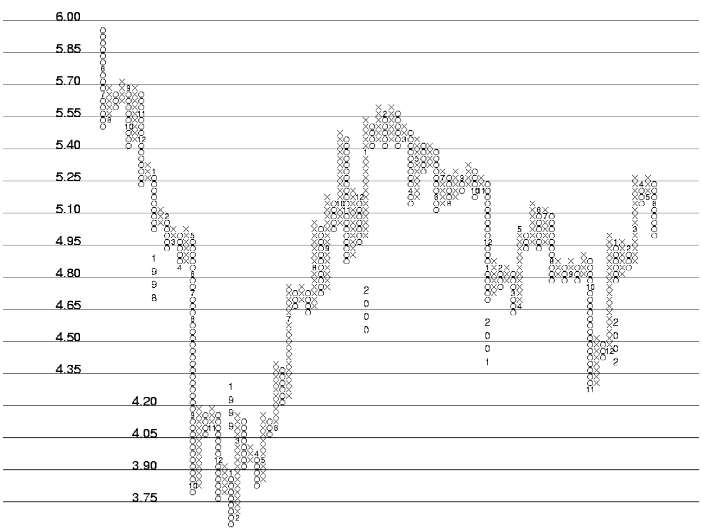
■ **Government 10-year bond yields should retrace more of their advance from the November lows.**

**Despite the cheerleading for GDP growth, what we have is stagflation.** In 1Q 2002, the US saw the better recovery among major economies, although that's not saying much. Moreover, the more recent data has been decidedly mixed. With the stock market weak and consumer spending declining, Alan Greenspan is understandably in no hurry to hike the Federal Funds Rate from its 40-year low. Europe and Japan were counting on the US to pull their economies higher, and there has been some improvement, although not enough to qualify as a genuine recovery. Wim Duisenberg wants to raise rates to fight inflation, which has been aggravated by the rounding up of prices following this year's introduction of euro notes and coinage. However with growth anaemic and the euro strengthening, higher rates would compound Euroland's problems. Similarly, the Bank of England's MPC would like to raise rates to curb property prices but a hike is not warranted by any other data. Consequently there is no compelling case for higher rates at present and if stock markets continue to weaken, there will be calls for central banks to ease monetary policy once again.

**Could 10-year government bond yields test their November lows?** When asked this question recently by a very experienced subscriber, my immediate response was no, even though I have been expecting lower long-dated bond yields. I said the charts didn't indicate tests of the November lows by US or European 10-year government bond yields, inflation was edging higher and the price of gold firm. Judging from the charts, a further pullback and lengthy base extension is the most likely outcome. However

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


**Euro-bund 10 Year Bond Yield (0.03)**



on further consideration, I was hasty in ruling out a major rally by bonds. The script would be fear of a slide back into recession and weak stock markets. Equities are the key variable. If they don't recover, let alone head lower, there will be a further shift of financial assets from shares to fixed interest investments.

**Strategy on bonds -** I'm maintaining FM216's change in tactics, which for conservative accounts, favoured a reduced position in 3-month government bills and an increased weighting in longer-term maturities. For capital appreciation, I continue to favour quality corporate bonds - single A or higher. Debt reduction will be an important theme for the next several years, as companies seek to replace borrowing with equity financing. Consequently there could be a squeeze on lower-risk corporate issues. In futures, I rolled my long position in Euro-bunds into the September contract and this is now protected with an in-the-money stop.

## Global Stock Markets

- **Fear reigns and Enronisation has poisoned the well of public sentiment towards the stock market for a generation.**

- **Weak stock markets will limit economic growth.**

- **Reversion to the historic mean remains the big theme. The question is how long will it take?**

**Reputations take time to build but can be destroyed very quickly.** When first writing about Enronisation in FMP168 (6/02/02), I said, "This is a terror attack of the mind (as opposed to a terrorist attack)". Most people feel they can cope with the enemy within who happens to be a sociopath, often living off the state while scheming to kill innocent people. However terrible their deeds, only a very small proportion of the population are directly affected. In contrast, many millions of Americans feel betrayed by the self-aggrandising CEOs to whom they entrusted their savings by investing in the stock market. I'm not talking about the dotcom speculators who should have known what they were doing. The people most shocked, and we can be certain anger will follow, belong to the middleclass and have invested in the stock market, either directly and/or through their retirement funds. While it is unpleasant enough for them to live through a market meltdown, most would deal with that philosophically. However the lasting stench left by corporate rip-offs will linger for many years. All the more so because it continues. CEOs of debt-burdened, loss-making companies continue to walk away with seven or eight figure settlements. Once feted like pop stars, these people are now viewed as pariahs. It's little consolation that most corporate management teams are responsible, hardworking and honest. They are tainted by the excesses of too many financial scandals. The investing public will neither forgive nor forget quickly. Enronisation has poisoned the well of public sentiment towards the stock market for a generation.

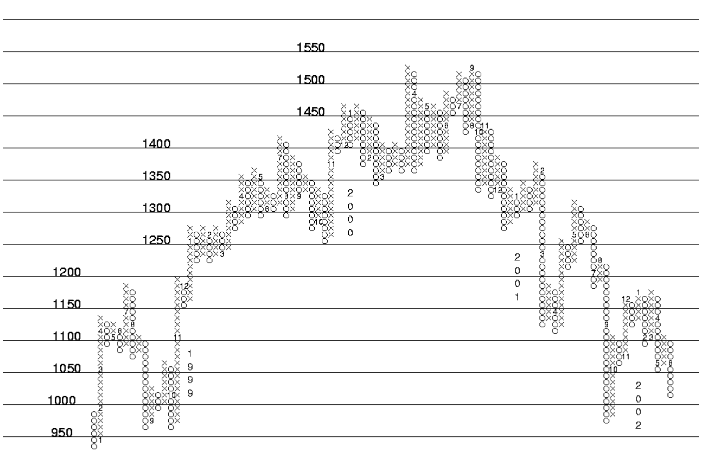
**The economic consequences will be profound.** In a bull market, let alone a bubble, liquidity is abundant. Almost any company can raise capital via initial or secondary offerings of shares. However in the 1990s, many corporate management teams were so high on the opiate of their share options incentive packages, that they leveraged balance sheets and used the money for stock buybacks. Amazingly, in doing so they received the blessings of business schools and a gullible investment community, which described dividends as "an inefficient use of capital". The legacy of these excesses, foolishly condoned by many professional investors, will last far longer than the bubble years. Few debt-burdened companies will be able to earn their way back to financial probity. Subdued stock markets will ensure that the window for IPOs and secondary offerings opens briefly and only for the best companies. Asset sales will generally be at a substantial discount to their purchase price. Debt financing will hold little appeal in a low-growth, deflationary environment. The high level of corporate defaults will continue. While the greatest lapse in corporate governance occurred in the US, it was by no means limited to that country. The TMT bubble spread across all developed countries. Management matched the US for recklessness, if not always corruption. Europe is no more likely escape the US's economic problems than its stock markets are to uncouple from Wall Street. Japan seeks to recover through exports and is therefore in no position to take up the running.

**You won't hear much about reversion to the mean from investment institutions.** We never do when they are on the wrong side of the historic mean in terms of valuations. Instead, they will talk about looking for value and investing for the longer term. Fortunately there are isolated examples of value in the markets, even on generally overvalued Wall Street. However, with the economic background likely to be difficult more often than not and with growing disillusion among the investing public, value is more likely to be ignored, at least until it reaches historic extremes in terms of cash flow, dividends and multiples. Arguably, only Japan has a number of companies that qualify on the basis of cash flow. In terms of dividends, the S&P 500 currently yields an historically low 1.36 percent. We will eventually see the dividend yield much closer to 4 percent, judging from past corrections following once in a generation super-cycle bull markets. Currently more companies are cutting dividends, rather than raising them. So how do we get to 4 percent? Partly through further sell offs, but mainly due to a reversal of the 1990s fashion, which proclaimed that dividends were "an inefficient use of capital", due to taxation. Going forward, pension funds in particular will demand bigger payouts, rather than see corporate cash used unprofitably by serial acquirers, such as Dennis Kozlowski of Tyco, Ken Lay of Enron, Bernie Ebbers of WorldCom, Gary Winnick of Global Crossing and John Rigas of Adelphia.

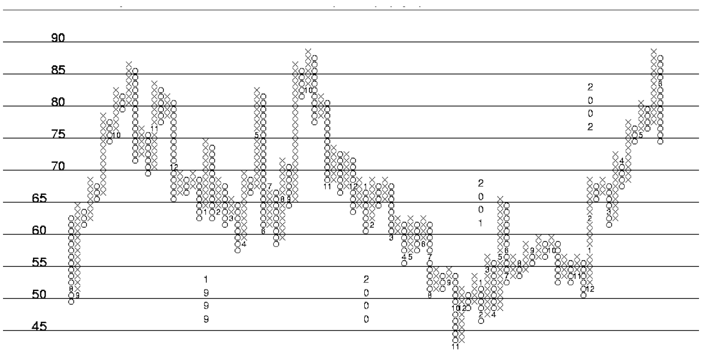
**Reversion to the mean is a lengthy and periodically brutal process.** Having written about this extensively, starting with FM213, I'll summarise briefly here. Many investors hope that markets revert quickly to their historic mean. Two arguments cited in favour of this are the current trend and the proliferation of hedge funds, which can sell shares short. It's possible to have a rapid reversion, especially because a widespread loss of confidence such as we are seeing can result in a crash. However these are rare among stock markets and would be resisted by central banks. Also, there is no evidence that the ability to sell short hastens declines. Today's short seller is tomorrow's buyer, so bear trading increases liquidity, results in more ranging and narrows peak to trough extremes. Anyone hoping for a major crash from current levels should consider the worrying economic implications against the present global economic background, which is considerably less robust than in 1987. Consequently, a crash would probably be followed by a multi-year convalescence, during which most stock markets were unable to maintain rallies. My guess is that the more likely course will be a series of bearish phases followed by some intermediate-term recoveries, for at least a decade, not unlike what occurred on Wall Street following the 1948 to 1966 super-cycle bull market. Back then, the bearish phases were more dramatic than the recoveries and it took 8 years to reach the trough in 1974. A characteristic of reversion to the mean, is that markets don't just fall back to it - they overshoot on the downside, creating great buying opportunities. Meanwhile, corporate debt will be a drain on earnings and limit dividend increases for years to come. Tighter accounting standards, which are certainly to be welcomed, will suppress corporate profits relative to previous expectations. Capital flows away from stocks during reversion to the mean, because they are no longer viewed as a certain bet to outperform other investments, such as bonds, property, cash, collectables and precious metals. Post-bubble and Enronisation related disillusion among investors is increasing and will persist for a generation.

**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.*

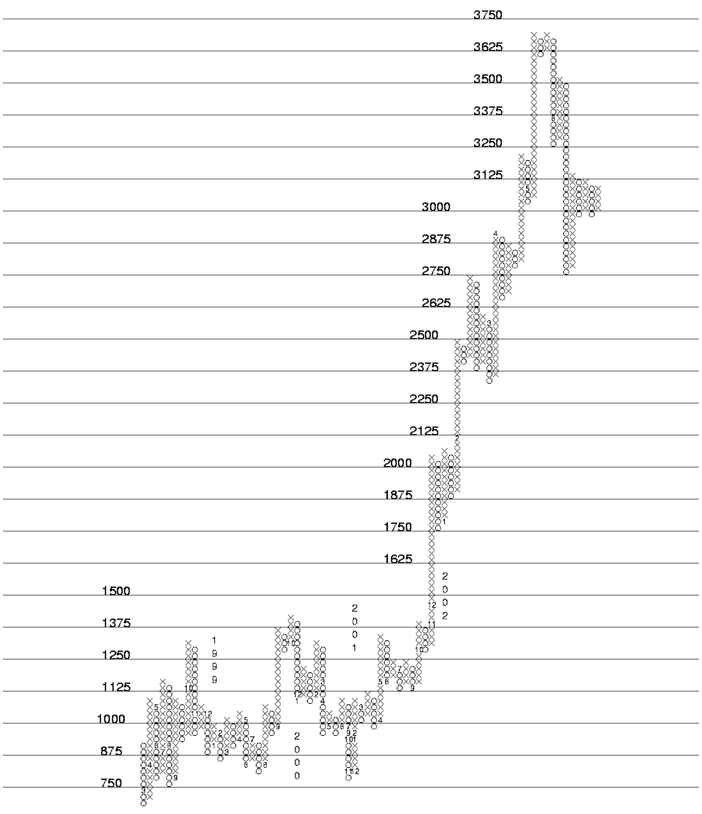
**S & P 500 Composite Index (10pt)**




**Philadelphia Gold & Silver Index (1pt)**



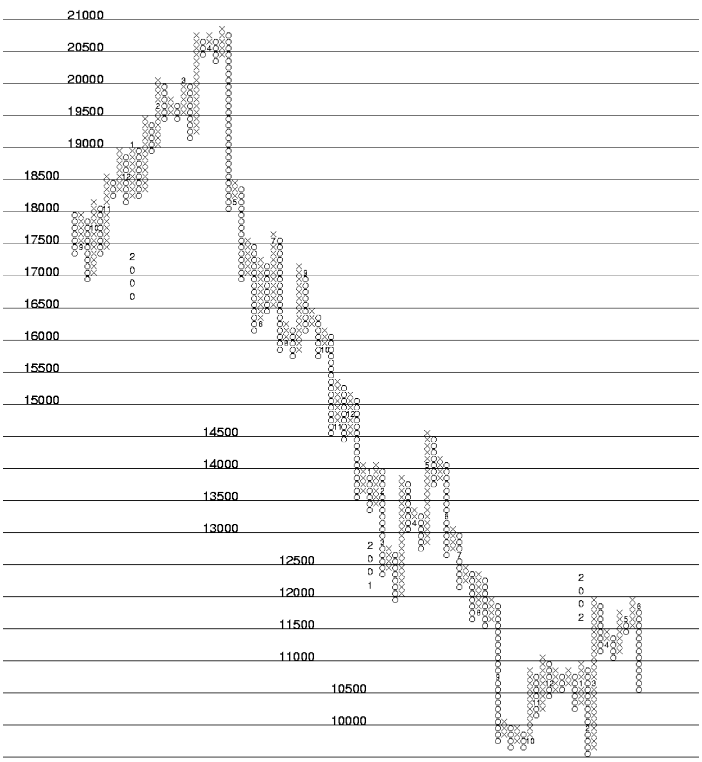

**South Africa JNB Gold Index (25pt)**



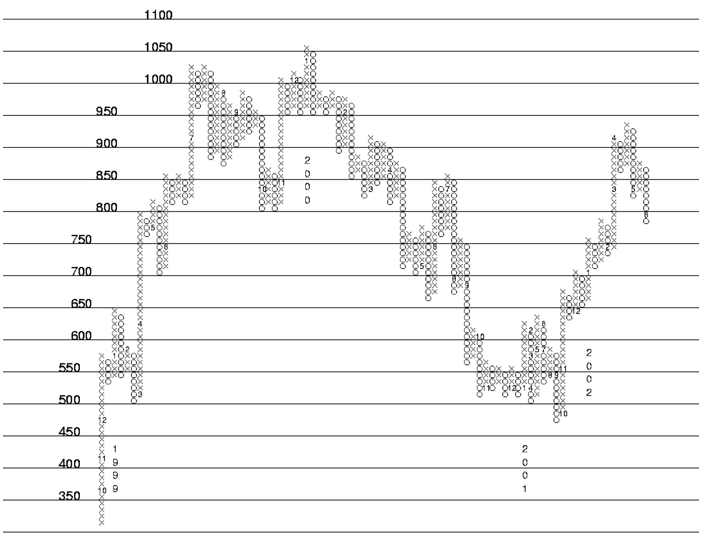

**The US's S&P 500 Composite Index (1033)** is approaching the psychological 1000 level and the September low at 970, areas where some steadying may occur. However, the dominant chart features are a large top area and overall downtrend. A rally to 1110 is needed to reaffirm more than temporary support near last year's low. **The Philadelphia Gold & Silver Index (75.89)** fell back sharply from lateral resistance in the 86 to 93 region, breaking short-term uptrend consistency since March, evidenced by the progression of rising lows. Consequently at least several more weeks of ranging near current levels is likely before this multi-year base formation is completed.

**South Africa's JNB Gold Index (2956)** has similarly lost its upside momentum. A move to 3150 is needed to reaffirm support from the recent low at 2750 but a lengthy consolidation of strong gains since last November's breakout is likely.

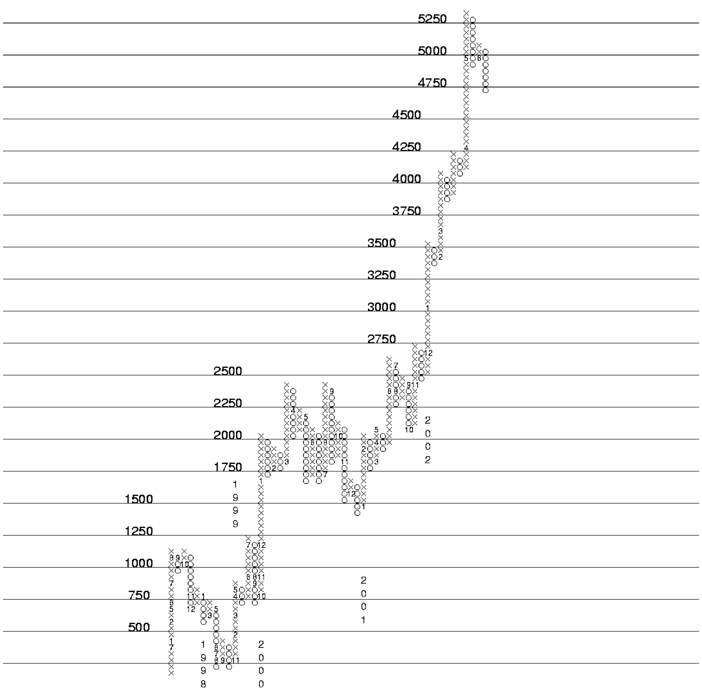
## Nikkei 225 Stock Average Index (100pt)



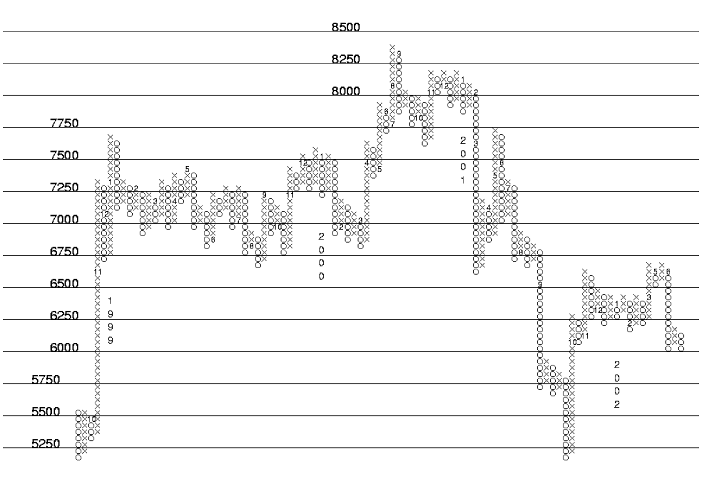

## South Korean KOSPI Index (10p)




## Russian RSF Index (50pt)




## Switzerland Swiss Market Index (50pt)




**Japan's Nikkei Stock Average (10476)** backed away from lateral resistance near 12000 for the second time and promptly broke initial support at 11000. This suggests a potentially lengthy base building process centred on current levels and even this hypothesis would be questioned by a breach of 9500.

**South Korea's KOSPI Index (776.36)** has deteriorated further after encountering resistance beneath the 1995 to 2000 highs just over 1000. A rally to 880 is necessary to check current scope for a further retracement of the strong gains since last September's low.

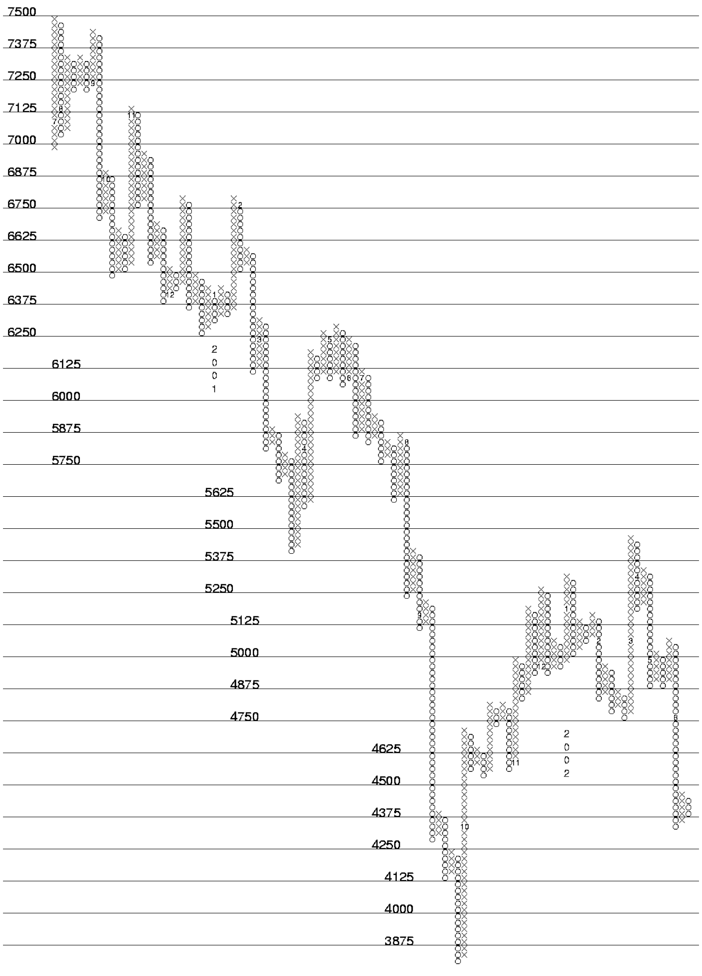
**Russian RSF Index (4657)** has been one of this year's best performers but it accelerated in April and early May. Acceleration is the 1st (of 3) trend-ending signals as taught at The Chart Seminar. A rally back above 5000 is required to question current scope for a further and perhaps substantial correction of gains.

**Germany's DAX Index (4354)** *-see overleaf-* remains has broken beneath this year's earlier lows and needs 4475 to delay a further test of the September 2001 trough down to 3800.

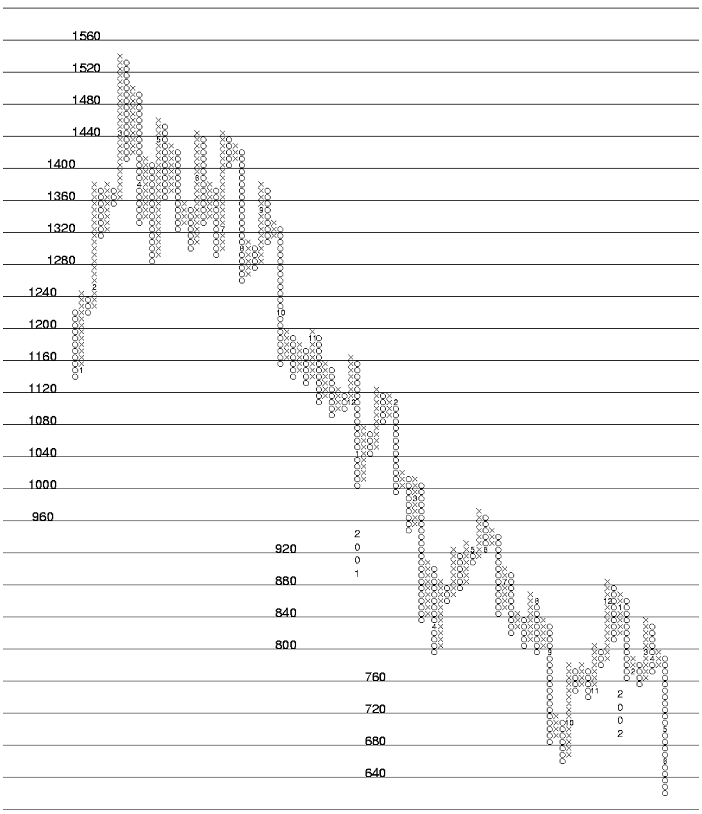
**Sweden's OMX Index (611)** *-see overleaf-* has broken its September low and while the decline since March is beginning to look overextended, a rally back above 680 is required to suggest a downside failure.

**Switzerland's SMI Index (5971)** has rolled over beneath supply from its large top area. A rally to 6700 is needed to offset current scope for a further decline towards the September low at 5150, at least.

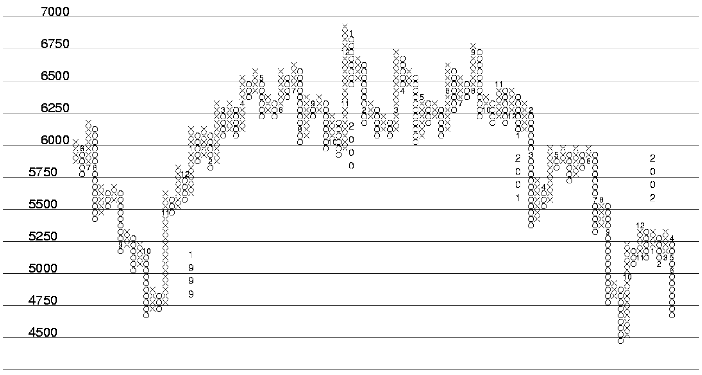
German DAX Index (25pt)




Sweden OMX Index (8pt)




United Kingdom FTSE 100 Share Index (50pt)



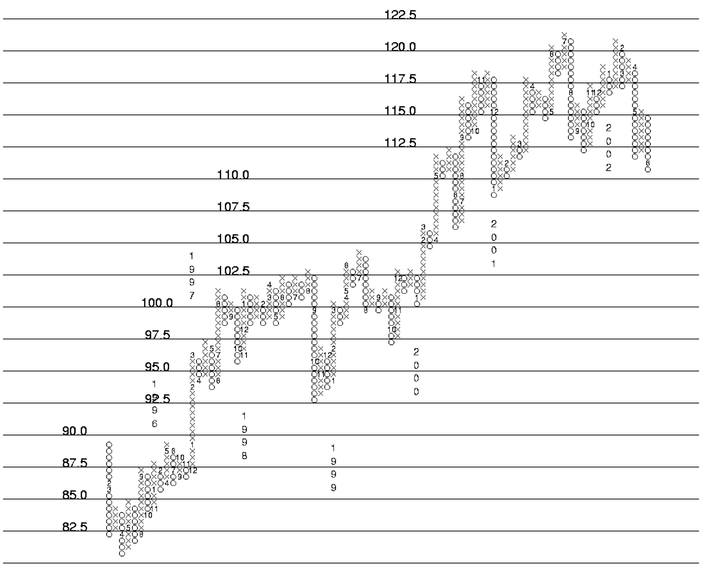

**The UK's FTSE 100 Index (4652)** is approaching its September low at 4450 and some support may be encountered near this level. However, overhead supply and a primary downtrend are the dominant technical characteristics and both appear capable of forcing additional weakness.

**Strategy for stock markets -** The question I'm asked most frequently is are we seeing capitulation selling? In other words, is the bear market in its climactic stage, after which a significant rally will occur? Well, any downward acceleration indicates a degree of capitulation selling in proportion to the move. It is also an ending, almost invariably followed by a rebound. However the problem for investors is that we have been seeing periodic sharp sell offs since March 2000. That is what happens during a reversion to the mean following super-cycle bull markets. We certainly saw capitulation selling last August and September, and it was followed by a significant rally, helped by lower short-term interest rates. European and North American indices are closing in on those lows once again and today there is less scope for lower short-term rates, and who would bet on further cuts producing more than a technical rally? If one is considering buying equities, the time to do it is when markets are slumping. The rallies in this post super-cycle bull market environment are for selling into, because they continue to resemble a ball bouncing down a flight of stairs. If one is looking to sell, there will probably be a better opportunity in the next few months. Consequently I am not advocating any change in strategy because I don't want more equity exposure and I don't think it is a good time to sell the few high yielding stocks recommended last October. While I am surprised that gold shares pulled back sharply, the sector has often been volatile. I'm content to remain overweight in gold stocks, suspecting recent activity is a consolidation, and may add to positions. My trading decision last month to open a long in Nikkei futures was the triumph of hope over experience. If there is one tactical lesson in this post super-cycle bull market environment, it's don't chase any rally. My preferred speculative strategy is still to short after a technical rally loses momentum.

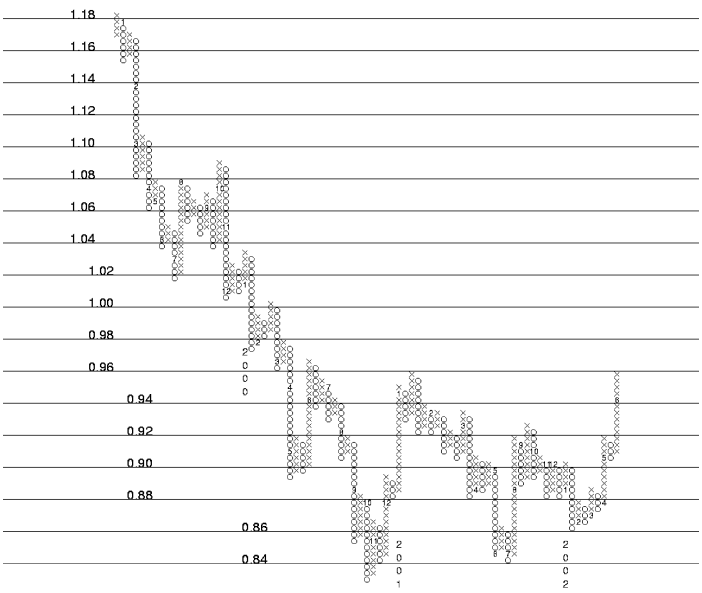
## Currencies

■ **The big flow of funds story for euro/dollar is not concern over the US economy, which remains stronger than Euroland. Instead, it is a rebalancing of central bank reserves, which are overweight US dollars.**

**US Dollar Index (0.5)**




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



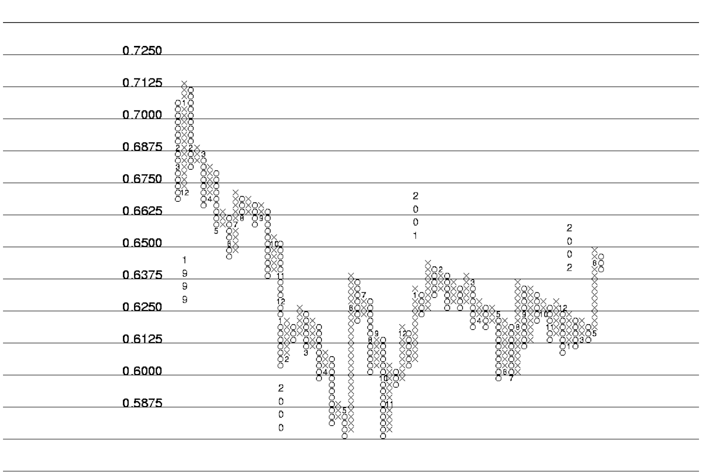

■ **The Japanese Government has shown its determination to prevent the yen from appreciating further.**

**The euro wins by default rather than any profound macroeconomic point.** Perhaps you've seen the same reports, usually quoting the Bank for International Settlements, saying that over 75 percent of global central bank reserves are in US dollars. That sounds like too many eggs in one basket for comfort, even if the US is the world's only superpower and the dollar is the basis for calculating most international settlements. What percentage of the CBs' assets should be in dollars? I have no idea and they probably don't either. However, assuming the above 75 percent figure is correct, that is way above the US share of world trade and economic activity, not that the dollar will ever sell down to those levels, at least not in my lifetime. However I would like to know what the percentage high/low range for total CB reserves in US dollars between 1970 and 1995. I would be very surprised if the mean was not below 75 percent. What will influence central bankers in future? Strange though it may seem, they are probably people who respond to events, pretty much like the rest of us. Therefore sentiment will be the overriding consideration. If CBs think the dollar is going to appreciate or at least hold its value relative to the alternatives, they will stick with the greenback. Conversely, if they see it falling, many will extrapolate that trend and shift some of their reserves to other currencies. The main alternatives have to be reasonably liquid and politically safe. If liquidity is an important consideration, the yen and the euro are the only alternatives. Very few CBs would buy the yen today, so the euro wins by default, rather than any inherent appeal. After trend sentiment, yield is the main consideration. The dollar currently scores low on interest rate differentials, besting only to the Swiss franc. The euro's return is OK at 3.75 percent. Less liquid currencies such as sterling and the Australian dollar yield more, but not significantly so. Finally, there is gold but this is still unfashionable within developed country central banks, which among investors are generally the last to see a trend change.

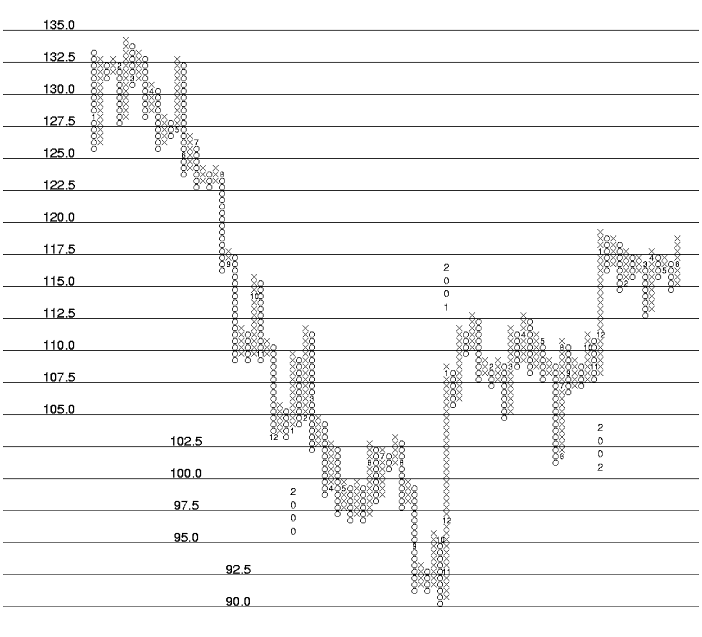
**The Japanese Government has sold yen on four separate occasions in recent weeks.** Knowing that export earnings contributed half of the 1Q GDP improvement - a period when the yen was weaker - the last development Japan's monetary officials want is an appreciating currency, maverick Hayami excepted. Consequently they intervened on four occasions when the dollar slipped below ¥124 in recent weeks. A trend is a trend until it is broken, so I would assume that the BoJ on the MoF's instructions would intervene again, if necessary, which it may not be. Where had demand for the yen come from? Some came from the international investment community, including Japanese investors, who shifted a proportion of financial assets away from the US and Europe in favour of Japan. However a greater source of yen buying probably came from currency speculators unwinding yen carries (short positions). Another large source of demand would have been capital repatriation by overseas subsidiaries of Japanese companies. What about in future? In reverse order, why should Japanese firms continue to repatriate capital if the Government is signalling to them that they will be able to get more yen for their dollars and euros, etc, if they wait? Most won't. The yen carry trade is understandably volatile. Having unwound yen short positions, might speculators re-enter the market to lock in interest rate differentials if they see the yen weakening? I believe so. This leaves investment demand, which will probably favour Japan in terms of equities but certainly not bonds. Also, many of the overseas investors buying Japanese stocks can and will hedge their currency risk if the yen is declining. These factors combined are a recipe for a weaker yen, particularly when Japan's money supply increases. This may not occur until BoJ Governor Hayami is replaced as of 20th March 2003.

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

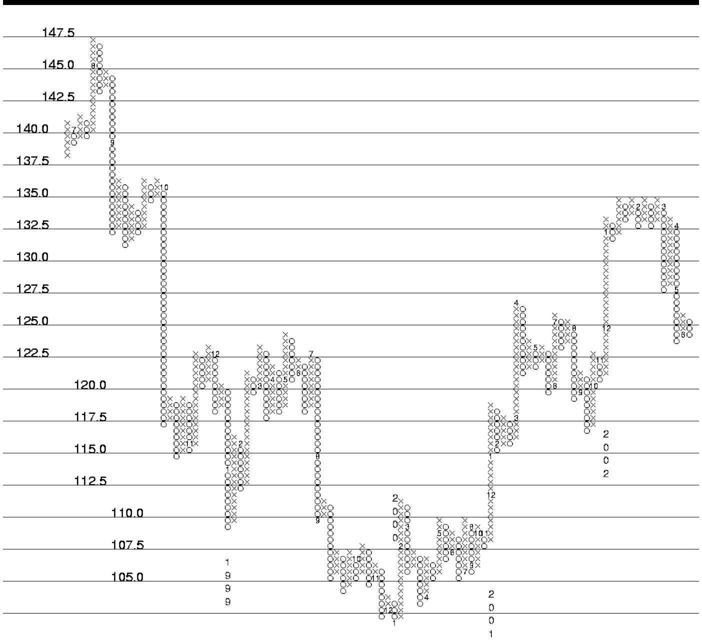
**Pound Sterling per 1 Euro (0.0025)**



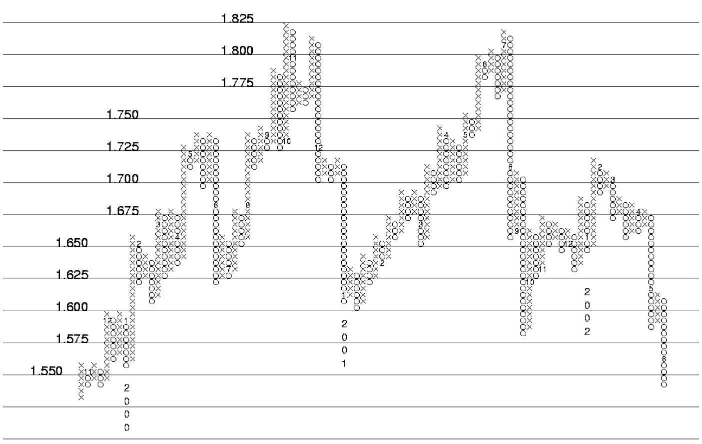

**Japanese Yen per 1 Euro (0.5)**




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




**Swiss Franc per 1 US Dollar (0.005)**




**US Dollar Index (110.95)** - *see previous page* - This remains barely steady following a renewed break beneath the September 2001 low, mostly completing a large top with H&S characteristics. A move to 115.5 is required to question current scope for further weakness and indicate a downside failure.

**Euro/dollar ($0.9496)** - *see previous page* - The recovery since January's low at $0.86 remains consistent with the base building hypothesis long advocated in these pages. The pattern is large and the ease with which the euro has rallied since April suggests that it is nearing completion. There may be some temporary resistance near $0.96.

**Euro/sterling (£0.6382) -** The euro appears to be consolidating gains following a surge to its highest level since October 1999. The underlying pattern resembles a base capable of supporting an additional recovery once the current digestion of recent gains is completed.

**Euro/yen (¥118.11) -** This year's pattern continues to resemble the first step above the base, as taught at The Chart Seminar, and a move to ¥112 remains necessary to question this hypothesis. The push above April's high at ¥117.5 suggests this lengthy consolidation is nearing completion, prior to a test of the early-1999 highs above ¥125.

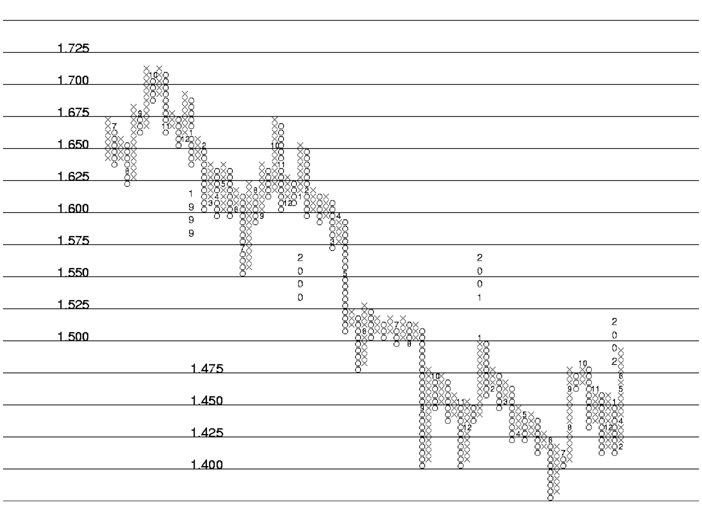
**Dollar/yen (¥124.54) -** The dollar is the only major currency to fall back into its base against the yen, although it has not fallen sufficiently into this pattern to confirm an upside failure. A decline to ¥123 is currently required to signal some additional test of underlying support before the large base supports a test of the year's upper region.

**Dollar/Swiss franc (SF1.5567) -** The greenback has finally broken down from its top area against the Swiss franc and needs a rally to SF161.5 to indicate an extension to this pattern before some further weakness is seen. There will be no significant improvement until the dollar reverses its tendency since December 1999 to fall faster than it rises against the Swiss franc.

**Sterling/yen (¥185.24) -** The pound has found support above its large base and not maintained last month's decline

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


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




**US Dollar per 1 Australian Dollar (0.002)**


beneath the March low. A fall to ¥180 is currently needed to delay a recovery towards this year's highs and indicate a further test of underlying support.

**Sterling/dollar ($1.4871) -** Sterling is breaking above the October 2001 high, an event of no small significance since it ends the sequence of lower rally highs following the October 1998 peak. Since there is also a higher low, we now have a developing uptrend emerging from the base formation.

**Australian dollar/US dollar (US$0.5623) -** The Australian dollar's surge against the greenback encountered resistance near the January 2001 peak and lateral trading around US$0.57, and has spilled over into a consolidation. However the strength of the base breakout suggests that we will see no more than the first step above the base, which could take a few months, before the Australian currency rallies further into overhead trading.

**Strategy for currencies -** The forex markets are exciting once again with base breakouts against the dollar and to a lesser extent versus the yen. In markets, what was strongest eventually becomes weakest, and vice versa. So it is with the US dollar, unless you believe that Japan is absolutely determined to cap the yen's recent rise against the greenback. Persistent MoF-instructed intervention is sufficient evidence for me. Therefore I remain bearish of two currencies - the US dollar and the yen. However, intervention, interest rate differentials and long-term chart patterns cause me to favour yen short positions over dollar bear trades. Also, currency speculators may wish to exercise a little caution with dollar shorts where the trend has lost momentum, signalling that a correction is underway. For the sake of simplicity, I continue to concentrate my short positions in the yen. My biggest trade is euro/yen, followed by sterling/yen and I also have some dollar/yen, which I retain only because of the intervention. If my UK tax efficient system allowed, I would also have Norwegian Krone/yen, which continues to offer a 700 basis points interest rate differential. With euro/yen, I have utilised my Baby Steps buy-low-sell-high tactic, lightening a little on rallies within the current trading range and replacing on easing. I would not be surprised to see a breakout above ¥120 in the next few weeks, and if the yen is weak against everything, I may leverage up a bit more. I'll use the same tactics on sterling/yen but am unlikely to commence Baby Steps lightening below ¥188. With dollar/yen, I may not lighten under ¥130. Whenever any of these positions are clearly in the money, I use stops, for money control purposes and to alleviate stress.

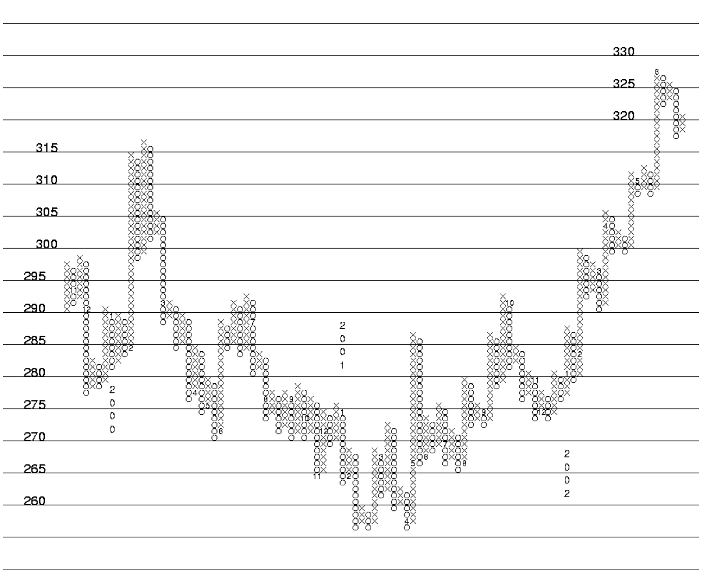
## Commodities

- **The rationale for gold is still improving.**

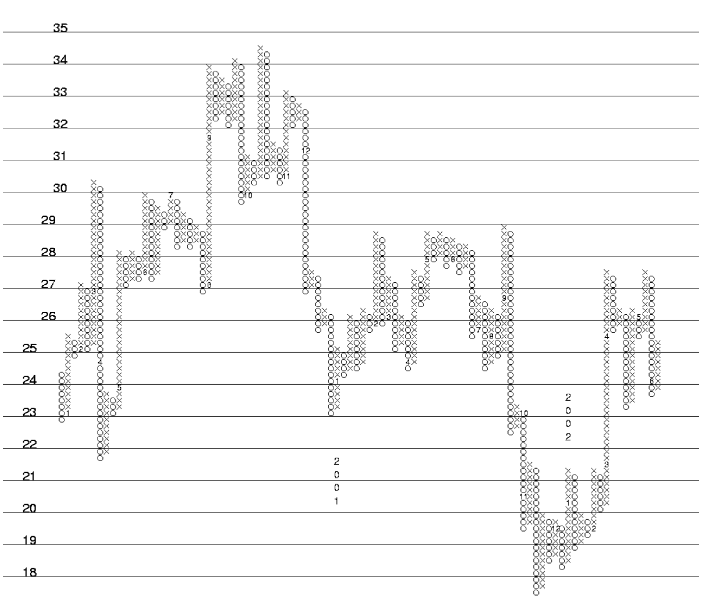
- **The weaker US dollar is helping commodity prices to firm.**

**A weakening US dollar is the latest bull factor for gold.** In the short term, gold is consolidating this year's

**London Spot Gold (1USD)**



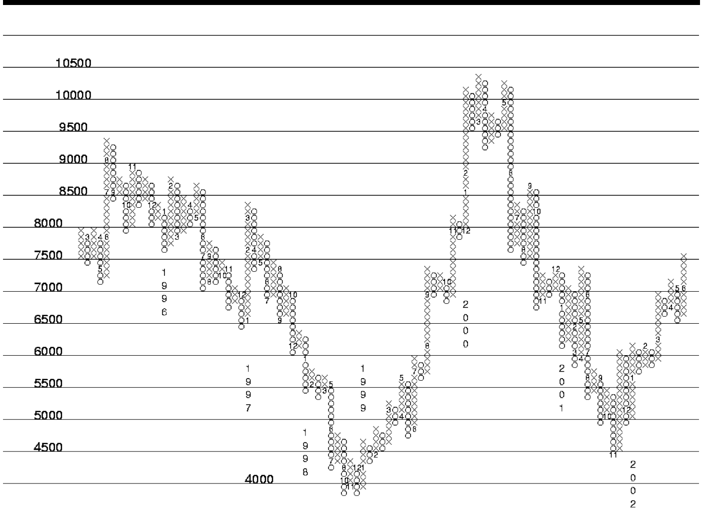

**Crude Oil NYME 2nd Month Continuation (0.2USD)**



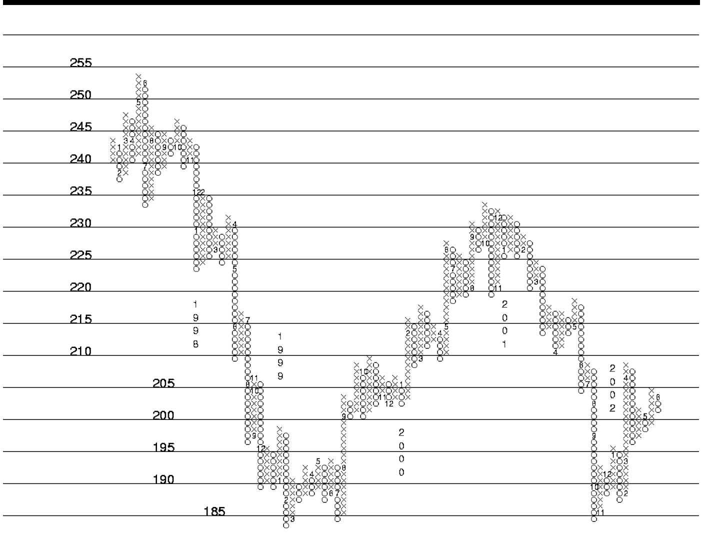

earlier gains. However there is no shortage of factors likely to fuel its next significant advance. While gold has appreciated against all currencies this year, it is US dollar weakness that will contribute most to remonitizing gold in the minds of many investors. In recent years, the dollar has become a barometer for the well being of not only the US but also the global economy. Behaviourally, given a healthy US economic locomotive, all other countries felt they had at least some reason of optimism. While the US is the only superpower today, this status and its significance was overhyped in the 1990s, as I've said on previous occasions. Therefore once concern over the US economy and especially the dollar becomes prevalent, all else appears less secure. Of course this is an oversimplification but so eventually is the sentiment driving all investment fashions. Paradoxically, a weaker dollar raises more doubts concerning the US economy, even though this will improve operating profits for US multinational companies, and it feeds anxiety over the current account deficit. The cue for currencies capable of replacing the dollar of yesterday as a symbol of strength, enterprise and security has never been so empty. The euro has been promoted by default rather than merit. No wonder gold is increasingly viewed as a store of value. Weak stock markets add to gold's lustre. The prospect of interest rates remaining numerically low for somewhat longer than forecast earlier this year delays a negative influence for gold.

**What about central bank sales?** Those who fail to see gold's investment appeal, or more likely fear it, never tire of warning that central bank sales could swamp the market at any time. Yes, in theory, but even central bankers have human characteristics. With over 75 percent of their reserves in US dollars, according to the Bank for International Settlements, central banks are likely to be far more concerned about a weakening greenback than a firming gold price. Moreover, they know that gold is cheap relative to paper assets and property. Consequently

**Nickle LME 3nd Month Continuation (100USD)**




**CRB Index NYFE (1pt)**



it is a value play. The CBs would step in, if necessary, to stem a possible derivatives meltdown involving mines that are still overhedged, not to mention the bullion banks. That would interrupt but not end the emerging bull market evident on the charts. I maintain that gold could easily undergo an overall bull market lasting for a decade or two, first as a value play and much later as another bubble. My minimum long-term target remains $1000. A generation has passed since we last saw gold fever. In the minds and hearts of men, no acquisitive fever has ever burned longer or hotter than gold fever.

**A weaker US dollar is assisting commodity price rises.** The case for higher industrial and agricultural commodity prices on economic considerations is weak. However as most are priced in US dollars, the greenback's weaker trend reverses bearish pressure on commodities. This point is not lost on commodity traders who had previously been mostly short. Consequently most are pushing up from historic lows or at least losing downward momentum. The economic case for oil is weakest, Middle East tensions aside, due to flat demand and increased supply capacity following the 1999/2000 surge in prices. Moreover the chart shows extensive overhead resistance. Nickel, first cited for its recovery potential in FM209 (25/10/01) as historic lows were approached and the first supply cuts announced, continues to lead the recovery among base metals. However lateral resistance near current levels could still pose a problem. The CRB Index bottomed at its 1999 low and the recovery would be reaffirmed at 209 (NYFE).

## The Global Economy

■ **Among major economies, the US will still have the best growth, but it will be lower than people hope.**

■ **Not so self-sufficient Europe suffers from global, structural and currency problems, resulting in stagflation.**

**Talk of Japan's GDP matching the US is misleading.** Japan avoids a 4th consecutive quarter of economic contractions with a 1.4 percent gain in 1Q 2002 and suddenly people are saying it could match or even exceed US growth this year. OK, we all wish Japan well and many of us hold some Japanese shares or funds, so we are inclined to be optimistic. Let's aspire to be realistic as well. I regard the Nikkei's welcome relative strength as a separate issue. Remember, it was discounting a slide into the economic abyss last September, which Japan should be able to avoid. Also, cost cutting does wonders for corporate profits, at least initially. However in comparing prospects for the Japanese and US economies, it is the former that has been ravaged by deflation. People on Wall Street only fear that America could suffer the same problem. Fortunately, Alan Greenspan is well aware of the deflation risk, so short-term interest rates remain at a 40-year low, while US money supply is growing at more than 3 times Japan's current rate of 3.5 percent (M2+CD). The US economy is experiencing a massive fiscal stimulus - from military spending to subsidies for steel producers and farmers, while Japan's earlier fiscal excesses leave it little room for expansion. Japan wins on personal savings versus debt, but this is a fallow resource if people leave their money in home safes, rather than spend it on consumption. The US has a problem with corporate debt but surely the percentage of non-performing loans remains higher in Japan, where banks are unwilling to lend.

**Sociologically, America continues to attract top brains from around the world**, plus unskilled and/or linguistically challenged workers, eager to succeed by working their way up the employment ladder. In contrast, homogeneous Japan may have the world's most orderly society but it is also an ageing population. Both countries have somewhat overvalued currencies but this is being addressed by trends in the forex markets. Japan has one probable advantage - it is less likely to experience a serious terrorist attack. The Japanese Government, which will know more about how the country's economy is actually functioning than most outside commentators, even if the various ministers can't agree on what to do about it, has shown its concern by intervening to weaken the yen on four occasions recently. They all know just how vulnerable Japan's export earnings are, which contributed half of the recent improvement in GDP. I maintain that the US economy will grow at a minimum of 2 to 3 percent this year. Japan could do better than anyone would have dared hope 6 to 9 months ago but the US economy remains infinitely more robust.

**Unfortunately, it could be a long time before the US economy shows anything like its 1990s vigour.**

That was the bubble economy, characterised by irrational exuberance, speculative excesses and a serious lapse in corporate governance, as everyone now realises. Regard for corporate CEOs has declined accordingly. The public's confidence in the stock market is waning in line with the vanishing capital gains. Equities are reverting to their historic mean, in terms of valuations - a process that will take many years and include a temporary downside overshoot, judging from previous cycles. This will inevitably curtail corporate investment and expansion. Consumers will curb spending and increase savings, especially when house prices dip. Much of this will represent a healthy consolidation but it will often be individually painful. GDP growth will be slower, with recessions occurring more frequently, possibly on an average of every 4 years as we saw in the 1960s and 1970s, usually in line with interest rate cycles. Tax revenue is declining, along with corporate profits and capital gains. Therefore state and federal budget deficits will become much worse, necessitating spending cuts and/or higher taxes. A cushion for the US economy will be the extent to which the dollar declines against the euro, and being comparatively self-contained, it will remain less vulnerable to external shocks.

**European self-sufficiency is a myth.** Sure, Euroland member states trade extensively with each other, for geographical and common market reasons. However, they are also dependent on exports, like everyone else, especially Germany. Euroland's sales to the US won't recover for a very long time, and operating profits on what it does export will also be eroded by the recovering euro. Neither Asia nor any other region is in a position to take up the slack, in terms of Euroland's exports. Meanwhile, the same old structural problems of over regulation and over taxation remain. Moreover, Socialist employment policies merely postpone rather than prevent unemployment from rising and deter hiring when growth does pick up. Politicians remain upbeat on growth prospects, especially those running for re-election, but there is very little evidence of economic recovery. The euro's move from virtual to actual currency has been inflationary, as everyone knew would be the case, everyone but the politicians and central bankers at the ECB, that is. This will not help retail sales. All of the above is a recipe for stagflation. The ECB hints that interest rates will have to rise, which certainly wouldn't h.elp prospects for economic recovery.

## And Finally…

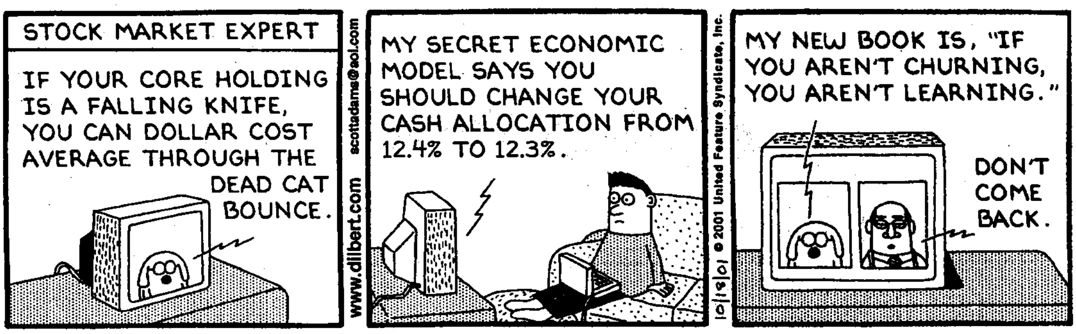
**Check the "Comment of the Day" on www.fullermoney.com -** Viewers appear to be enjoying the daily comments, judging from the increasing visits to this new site, and also the letters received. Although there is a lot of work involved with the additional research and writing, I'm enjoying the process. The www certainly brings out my sense of wonder. It's the universal library and I feel as if I'm on the command deck of Information Enterprise, boldly (and sometimes stumblingly) going where I've never been before, finding data on virtually anything almost immediately, and able to share some of what interests me with a much larger audience, most of whom I don't know and will never meet. As an aside, if you also enjoy what you do, have you ever wondered what you would have done professionally, had you lived in a different era or grown up without the freedom offered by democracy? It doesn't bear thinking about, does it. Back to my new website, I get a buzz working with Dreamweaver as well - it's awesome. Now if only we had 48-hour days, without doubling the 24-hour a day ageing process…

The target date for FM218 is Wednesday 17th July.

*"In wisdom gathered over time I have found that every experience is a form of exploration."*

*Ansel. Adams*

Best regards - David Fuller

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***Website:*** www.fullermoney.com ***Email:*** research@chartanalysts.com ***Tel:*** +44 (0) 20 7351 5751 ***Fax:*** +44 (0) 20 7352 3185 ***Single Issue Price*** £35