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

The expectation of war against Saddam Hussein will continue to weigh on stock market sentiment. Upside scope is limited to a medium-term rally, once this crisis is resolved. Military action would produce some convulsive reactions in other markets but is unlikely to alter primary trends, with the possible exception of oil.

2 Interest Rates & Bonds

The Bank of England and European Central Bank will cut rates because of weak growth, stock markets and consumer/business sentiment. This background is extending the bull market in government bonds, but short-term and especially longer-term risks are increasing.

3 Global Stock Markets

The "equities represent value" discussions indicate that valuations are no longer insane, but what is the relevant reference point? Remember, bad things happen in the post-bubble environment. Also, the last secular bull market commenced in 1982, with the S&P yielding 6.21%.

7 Currencies

The nomination of Toshihiko Fukui as BoJ Governor has led to fears that he will be another Hayami, but this is unlikely. The US dollar should experience a temporary rally once the problem of Saddam Hussein is resolved.

10 Commodities

Petroleum prices should fall back sharply if Saddam Hussein is removed from power. Base metal prices are rising, due to previous cutbacks in production by mining companies, demand from China, military considerations and the dollar's decline. Gold is consolidating gains in the first step above its multi-year base, prior to renewed strength over the medium to longer term. The CRB Commodity Index is temporarily overextended, having reached its highest level since May 1997.

11 Global Economy

The outlook for the global economy continues to weaken, but a resolution of the Saddam Hussein impasse should provide temporary respite. Meanwhile, petroleum prices continue to trade at global recession levels.

Will this decade's credit creation become the biggest bubble of all?

Once any asset class becomes really popular, unwary investors are exploited. Stock market manias and financial abuses are bedfellows. We know this from the 1990s, Japan in the 1980s, and history records numerous other incidents during every century since stocks were first traded. The more people want shares, the more supply increases, including half-baked and trendy concept companies, floated on hope and opportunism but seldom realistic earnings potential. Worse still, stock market manias lead to moral drift, to put it politely, by many CEO's, their investment bankers, salesmen/analysts and auditors. When gullible investors, including many professionals, fail to recognise the bubble and do not exit before it bursts, they are fleeced.

When investors flock to government bonds, as we have seen during the stock market slump, this demand inevitably attracts increased supply. Is it wise to chase yields down to their lowest levels for many years, when governments are on a borrowing binge? Can Japanese 10-year government bonds, currently yielding 0.79 percent, be a safe long-term investment when Japan's debt has soared to third-world levels and continues to increase? Some people say JGBs are a good investment, by virtue of their performance relative to other Japanese assets. They are right, for a while, as is anyone buying into a bubble before it bursts. However consider what will happen if/when the Bank of Japan stops buying at an ever increasing rate and yields rise to 3 percent, 6 percent, or higher, as they surely must if Japan has a future as a viable economy. Are US 10-year bonds yielding 4 percent a good long-term buy, now that the Government is on a borrowing binge to stave off deflation and finance the war against terrorism? Only if we can justify purchasing them as an act of charity, or if we expect an economic depression.

Is property a good investment following accelerated prices and when former dentists - who became day traders - are now buy-to-let specialists? Only if we believe estate agents and overlook the cyclical history of property prices.

Is the dollar a good investment when it yields little and the Federal Reserve is increasing the supply as seldom seen before in US financial history? Only relative to a currency that is being debased at an even faster rate, which brings me to credit creation. The long-term history of paper money is a sorry tale, which many people have forgotten, if they ever knew it. Since statistics can be tedious, just look at prices during any earlier, pre-1980s era. Catch one of the ever-popular, often-repeated Abbott and Costello films from the 1940s and early 1950s, in which wealth is described as the guy in a $100 suit. Confidence in the paper money of developed countries improved after sky-high interest rates in the early 1980s checked the last inflation cycle. However the US Government now needs more dollars than ever before, to increase fiscal spending, fund the military, rebuild nations, expand social programmes and pay down debt. Unfortunately, the US economy is not growing anywhere near fast enough to generate sufficient wealth to finance this spending through tax receipts. Consequently the Fed is printing many more billions of dollars, mostly through credit creation, than can be justified by GDP growth.

The Bank of Japan is involved in even faster credit creation, relative to GDP. This monetary expansion will almost certainly increase again, once the new BoJ Governor takes over on 20th March. Short of an economic miracle, the European Central Bank will eventually follow this lead. Today, we are still in a deflationary environment, which could persist for several more years. Governments will respond with even more credit creation, and none want an appreciating currency, not even China, which has the strongest economic growth. Governments love paper money because they can increase its supply indefinitely, to fund expenditure and placate the populous, at least until the next inflation cycle becomes a political liability. Remember, inflation cycles beget deflation cycles, which beget inflation cycles, and so it goes. Against this background, I will add to my precious metals positions on setbacks, such as we have seen recently.

Interest Rates and Bonds

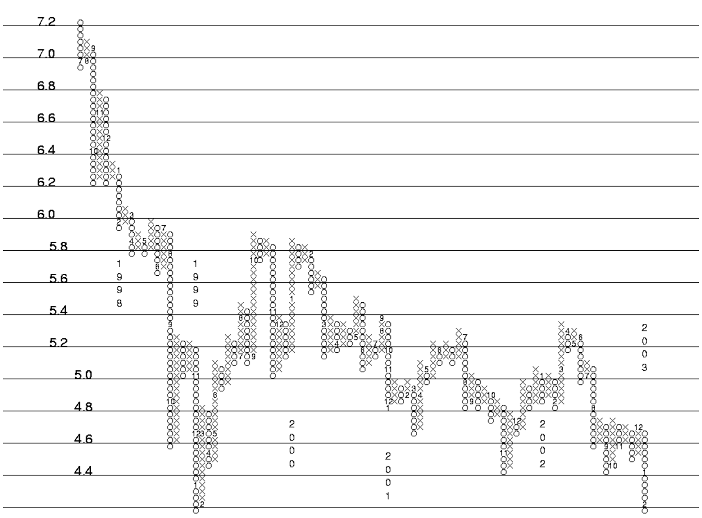
■ **The Bank of England and European Central Bank will cut rates because of weak growth, stock markets and consumer/business sentiment.**

■ **Weak stock markets and economies have extended the bull market in bonds, but short-term and especially longer-term risks are increasing.**

Central banks are pushing on the metaphorical piece of string. Lower rates have, at best, only slowed the bear market decline in stocks and cushioned the economic decline. Consequently investors no longer regard further cuts as a panacea. The only restraining factor for central banks is inflation, from government services charges to energy costs and house prices. What we are experiencing in most developed economies is stagflation. We will probably see some economic improvement following the liberation of Iraq, before post-bubble problems, especially debt, necessitate even lower rates from the BoE, ECB and other central banks where they remain comparatively high.

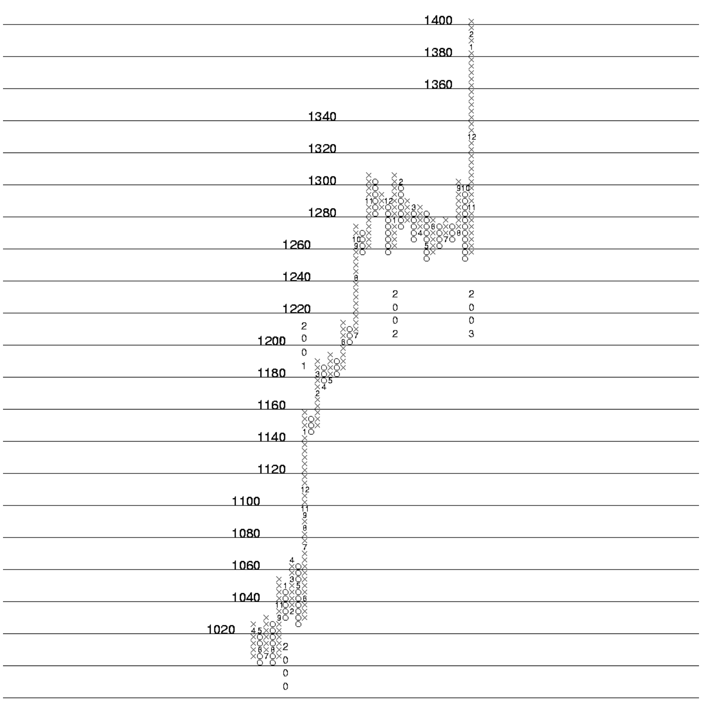
Watch for a rally in government bond yields shortly after the Saddam Hussein problem is resolved. This would be in response to a technical rebound by stock markets. Neither is likely to last beyond a few months, at most, because of the post-bubble problems of slow

UK 10 Year Bond Yield (0.04)



US 10 Year Bond Yield (0.025)

MSCI Euro Dollar Index BBB Rated Total Return (4)



growth and deflationary pressures. Once a post-Saddam stock market rally fades, government bond yields are likely to retrace their rally. However, the seeds of another inflationary cycle and bear market for bonds are being sown, although it may take several more years before they sprout. Debt is the legacy of burst bubbles. Government debt is soaring, as countries combat deflationary pressures from slow growth and lower tax receipts. Corporate debt is a huge problem, exacerbated by leveraging during the bubble years, often to boost the value of stock options and for serial takeovers. Today's corporate debt problems are compounded by little or no pricing power. Consumer debt is high in many countries, especially the UK and US, and exceptionally vulnerable to a downturn in house prices. Consequently, inflation is now regarded as the lesser evil. A few more years of stagflation and every debtor will be a born-again inflationist, not least governments, which will pump and pump, mainly through credit creation.

Strategy on bonds - Are bonds still a better investment than stocks? Absolutely, but they won't maintain the performance of recent years, unless global depression beckons. That is certainly a risk in a post-bubble environment but should be avoided by credit creation, barring some horrendous and hopefully preventable mishap. However, I would shorten maturities and/or stand aside on the first sign of military action against Saddam Hussein, in anticipation of a setback in response to a temporary rally by stock markets. One could lengthen maturities once again after the stock market rally lost steam. At best, the bull market in government bonds could either move somewhat higher for a few more years or plateau. However, every holder and potential buyer of bonds should ask themselves the following question. If they need to borrow all that money, do I really want to lend them my capital, other than for philanthropic reasons? My hunch is that anyone buying 30-year bonds today will see much of their capital destroyed by the next inflationary cycle. Total returns from corporate bonds should continue to outperform stocks over the next few years, helped by higher yields and somewhat lower risks. However a diversified portfolio is required because defaults increase in the post-bubble environment, as we continue to see. In futures, I would use close trailing stops on longs and switch to a short position on the first evidence of a downward dynamic by prices in the event of a war against Saddam Hussein.

Global Stock Markets

■ **European valuations - are comparisons with the 1990s relevant or do we need to compare them with post-bubble deflationary environments?**

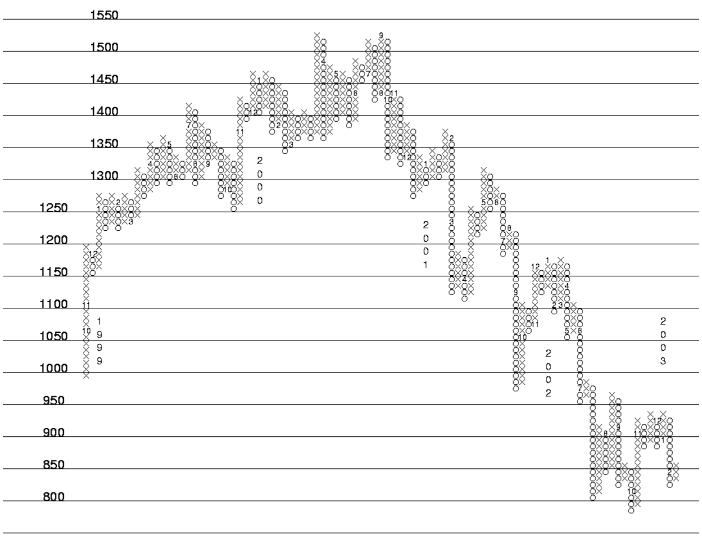
Bad things happen in the post-bubble environment. This remains my mantra following burst bubbles. The latest "shock" has come from Royal Ahold NV, the Dutch owner of the US Giant and Stop & Shop supermarket chains, which sacked its two top executives after discovering that earnings were inflated by at least $500 million in 2001 and 2002, according to Bloomberg on 24th February. Now Ahold is no wonder tech or telecom name from the bad old 1990s. It's old Europe, having been founded in 1887, but it caught the 1990s bug and metamorphosed from a cereal company into a serial acquirer, spending over $19 billion on acquisitions. These turned a Dutch grocer into the world's largest food distributor, and a not insubstantial debtor, with at least 12.3 billion euros of debt.

Many readers, I suspect, will have some personal experience of corporate mergers. How often do these add value? Some obviously do but it can easily take 3 years to successfully absorb one substantial business, relative to the parent company. Did Ahold have some special genius for expansion management, when it mushroomed to over 9000 operating units spread across Europe, the US, Argentina and Brazil? Could anyone really manage that, let alone during an economic downturn? Now I doubt Ahold is a giant scam along the lines of Enron or WorldCom, and sincerely hope not, but we have yet to hear from their auditors, Deloitte Touche Tohmatsu. Meanwhile, the Ahold story is another leaf in the lengthening book on post-bubble problems for corporations around the globe. Needless to say, it is another hammer blow for investor sentiment, adding to concerns about management policies of the 1990s, not to mention corporate ethics.

"Equities represent value" discussions indicate that valuations are no longer insane, but what is the relevant reference point? Today, after a 3-year bear market, and counting, we can have a discussion about valuations. Whether stocks are attractive or not depends in no small part on one's reference point. Compared to the early 1990s, valuations in Europe and especially Asia look attractive. However that was in the middle of Europe's secular bull market and Japan's bubble had only just burst. If we know one thing today, we know that we are not in the middle of a secular bull market. Some of us, myself included, believe we are in the early stages of a long-term bear trend, with Japan's market performance over the last 13 years being the most recent approximate guide. I first said this shortly after Wall Street's bubble burst in March 2000, only to be told that we could argue all day about the difference between Japan's inept post-bubble economic management and what would occur in the US and Europe. We hear less about this today. Regrettably, I see no evidence that we have mastered the art of damage control in a post-bubble economic environment. In many respects, the US's excesses were worse than those of Japan. Irrefutably, the global economic environment is much worse today than in the 1990s, a problem compounded by sky-high oil prices and the necessary war against terrorism.

What sort of eventual valuations might we expect? Unless one accepts the late-1990's rationalization that equities had somehow become less risky because of our collectively smarter economic management (sic), the only relevant valuation comparisons are with the worst bear markets in history. We should expect single figure Price to Earnings Ratios - based on S&P's earnings, not EBITDA - to be the norm. Additionally, yields for many mature industries will equal or even exceed the P/E multiples. Consider this:

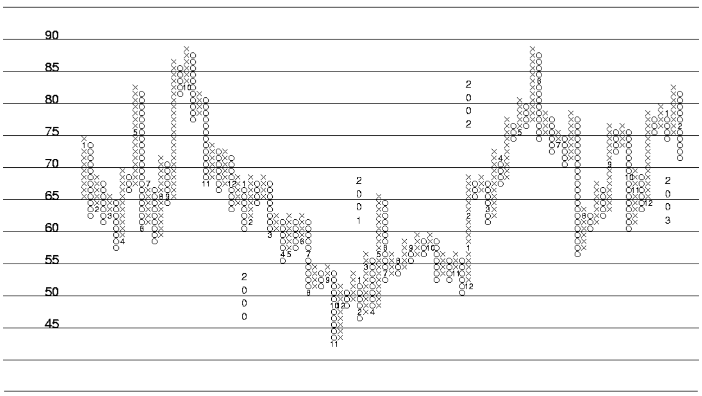
S&P 500 Composite Index (10pt)



NASDAQ 100 Index (15pt)

Nikkei 225 Stock Average Index (100pt)

Philadelphia Gold & Silver Index (1pt)



S&P 500 Index Yield Comparison

1Q 2003	**1.66%**
2Q 1982	**6.21%**

Highest Ever DJIA Yields

1Q 1938	**9.20%**
1Q 1943	**8.64%**

Remember, the last secular bull market commenced in 1982, with the S&P yielding 6.21%. OK, high inflation contributed to the S&P yield at that time. However, there had been no prior bubble. We had only seen the lengthy, generally bearish phase following an earlier super-cycle bull market ending in 1966/68. Perhaps DJIA yields will not get anywhere near their record levels in 1938 and 1943, shown above. Nevertheless, I'll wager that they will have to rise a long way from the current level of 2.53% before another secular bull market commences. Also, note how long it took before yields rose to exceptionally attractive levels following the end of super-cycle bull markets in 1929 and 1966/68.

Could stock markets bottom out at much lower yields this time, because inflation is low? Yes, in theory, but that would not necessarily be followed by a bull market for some time. Another lesson of secular bear markets, especially following burst bubbles, is that there is a long laterigrade phase, during which markets do little more than range sideways. We have seen a lot of this with Japan. Also, I do not assume that inflation will be near current levels beyond the next few years, especially given all the credit creation (effectively the printing of money) that is occurring. Remember, inflation cycles beget deflation cycles, which beget inflation cycles over the very long term.

What is the mechanism by which yields reach very attractive levels? There is a scissors effect. Stock markets eventually move lower and yields rise. If we are lucky, most of the rise in yields will result from GDP growth and dividend increases, in which case stock markets will reach their bear market lows well before yields rise enough to attract sufficient investor demand capable of fuelling the next secular bull market, which may not commence this side of 2020. It takes a long time for investors to regain their confidence and belief in the stock market after a burst bubble and secular bear trend.

Australia S&P ASX 200 (20pt)

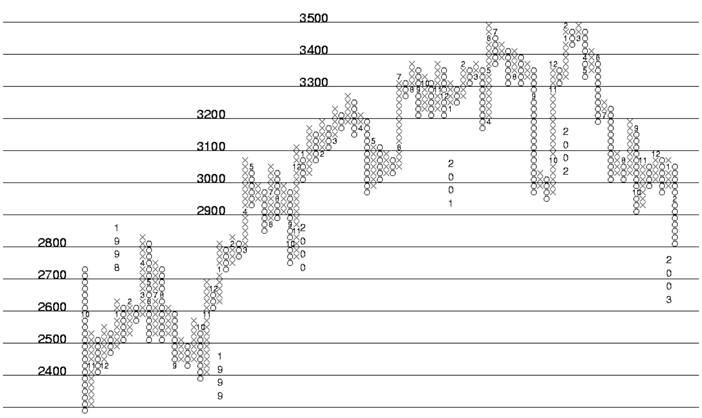


Chart review of topical and representative stock market indices - *The 3-box reversal point & figure charts shown are based on closing prices and taken from our website. Anyone interested in this chart service, which includes analysis and is updated daily, should register online at www.chartanalysts.com. Price levels mentioned refer to market closes.*

The US's S&P 500 Composite Index (837) steadied above its July and October 2002 lows but remains well within the overall downtrend channel. A rally to 945, which seems unlikely this side of a war against Saddam Hussein, remains the minimum required to question the ongoing bear market hypothesis. Another downward step may be close to hand. **The NASDAQ 100 Index (994)** has held up better than most but remains vulnerable to a test of the October low. This would be further indicated by a move to 945. **The Philadelphia Gold & Silver Index (70.28)** has encountered resistance once again from the upper side of its massive developing base formation. Nevertheless if it can maintain the sequence of rising reaction lows, as seems likely since the previous one is at 60, a further test of lateral resistance in the 88 to 93 region can be expected within a few months.

Japan's Nikkei 225 Stock Average Index (8359) is retesting its lows for the last 4 months. The descending triangle pattern suggests that another downward step will soon follow. Interestingly, the BoJ has been a buyer at the lows, but only from the commercial banks. A move to 8800, which seems unlikely, is needed to question lower scope.

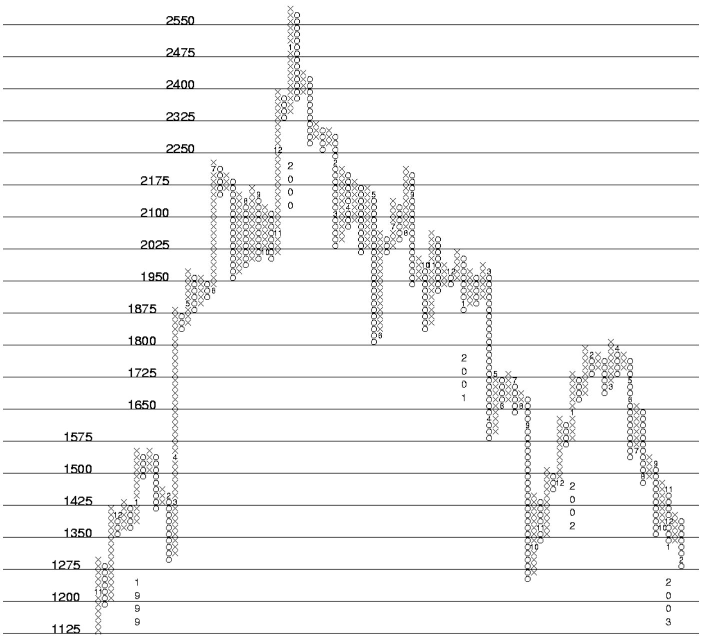
Australia's S&P ASX200 Index (2796) had long been a relative strength standout in this global bear market, but that is over following recent completion of a large, multiyear top. A move to 2870 is needed to delay further downward scope.

Hong Kong's Hang Seng Index (9134) is pressuring lateral and psychological support near 9000 once again. A move to 9900, which seems unlikely, is required to offset a downward break, which could be sharp.

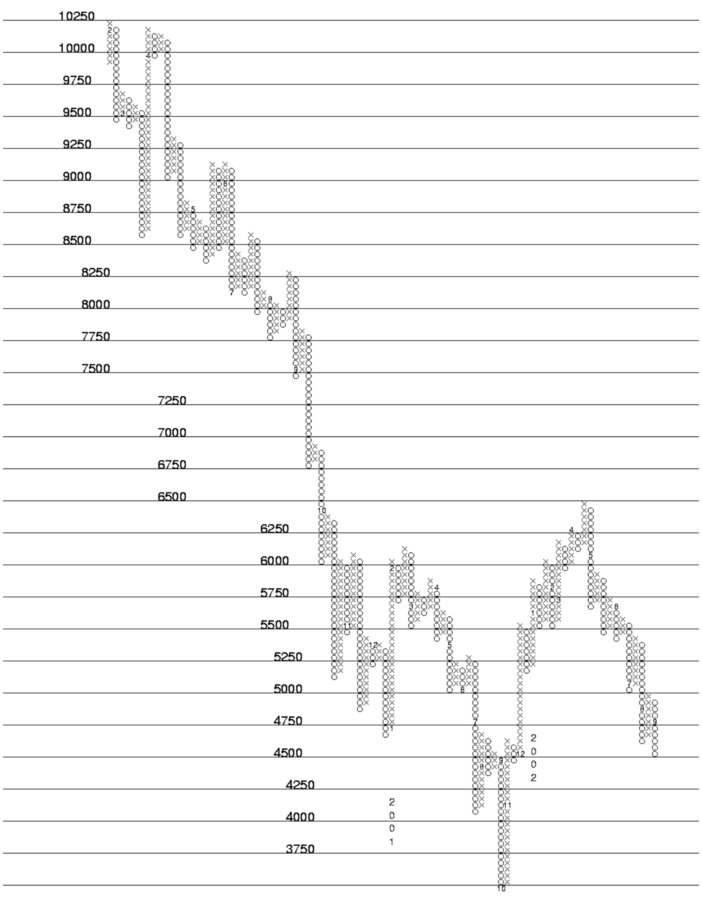
Singapore's Straits Times Index (1271) has been ranging down towards its climactic September 2001 low at 1245, ever since the March 2002 bear market rally peak at 1800. While some steadying may occur near the former floor, a break in the progression of lower rally highs would be required to suggest more than another small rebound.

Taiwan's Weighted Price Index (4432) has broken lateral support near 4500, opening the door for a further decline

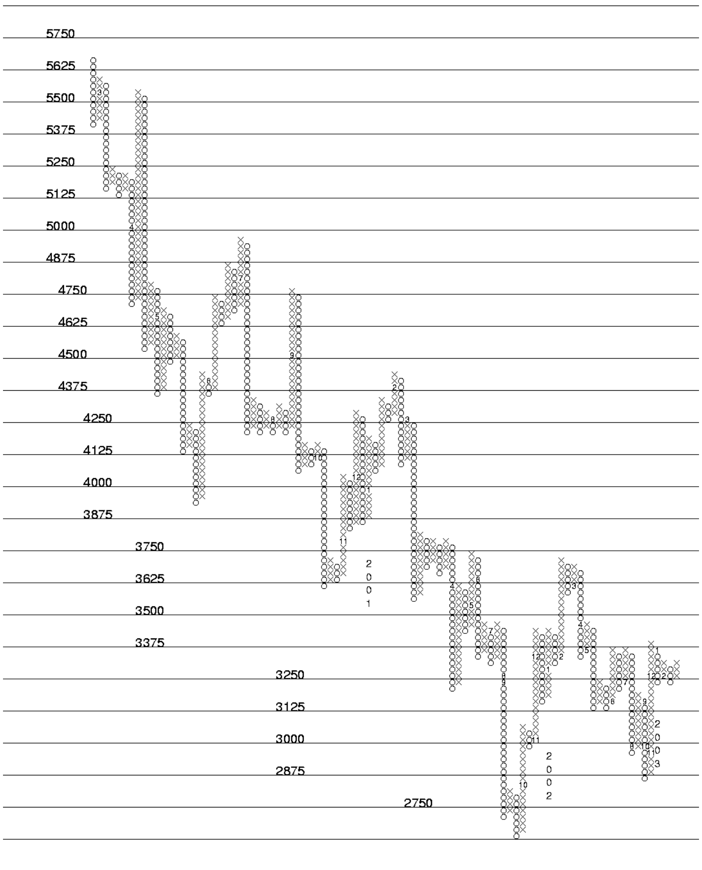
Singapore Straits Times Index (15pt)



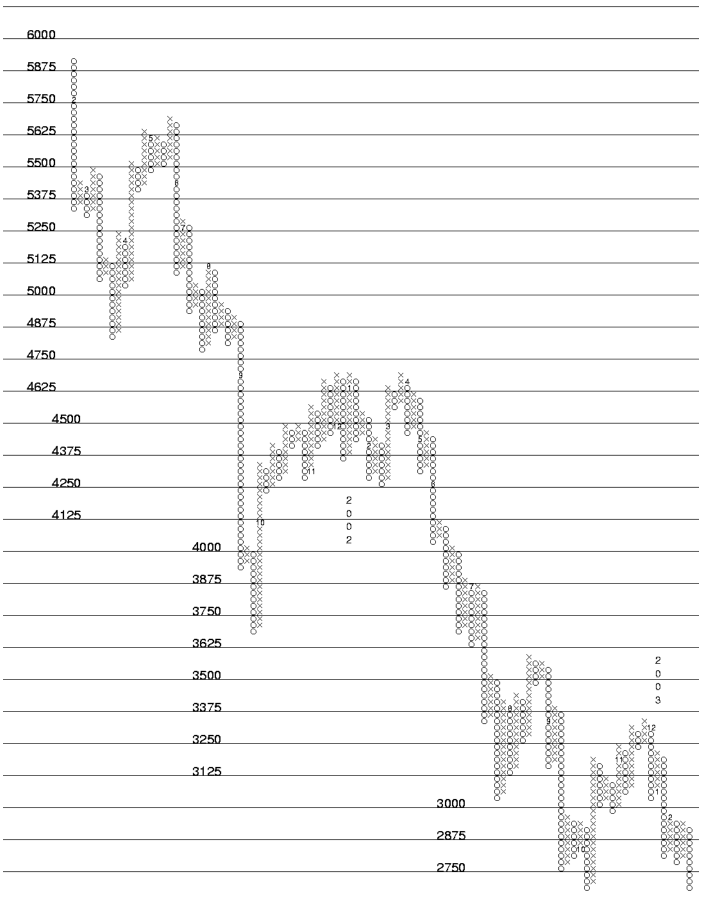
Taiwan Weighted Price Index (50pt)



India BSE Sensex Index (25pt)



French CAC 40 Index (25pt)



towards the October low at 3900.

India's BSE Sensex Index (3277) currently shows relative strength and what may be a developing base formation. However the failed nudge above 3350 suggests that it is now susceptible to a break under 3225, indicating a further decline towards the lower side of the pattern formed since the September 2001 low at 2625.

France's CAC 40 Index (2715) has broken down from a small ranging pattern and a move over 3000 is required to offset current scope for a test of the September low at 2675, at least.

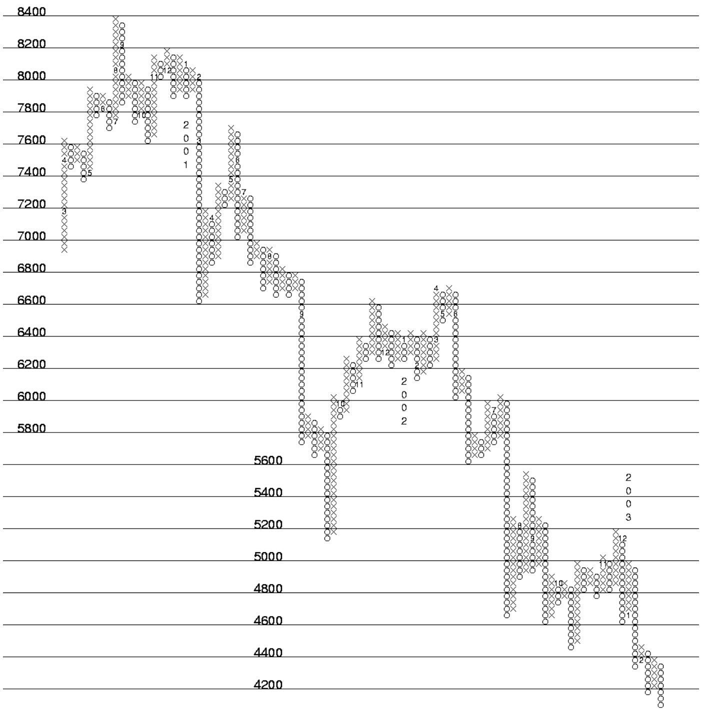
Germany's DAX Index (2513) has extended a break under the October low at 2600 and 2750 is required to signal a downside failure and offset current potential for an additional decline.

Switzerland's Swiss Market Index (4083) is extending its downtrend and needs a move above 4400 to delay a test of the next area of psychological support at 4000, at least.

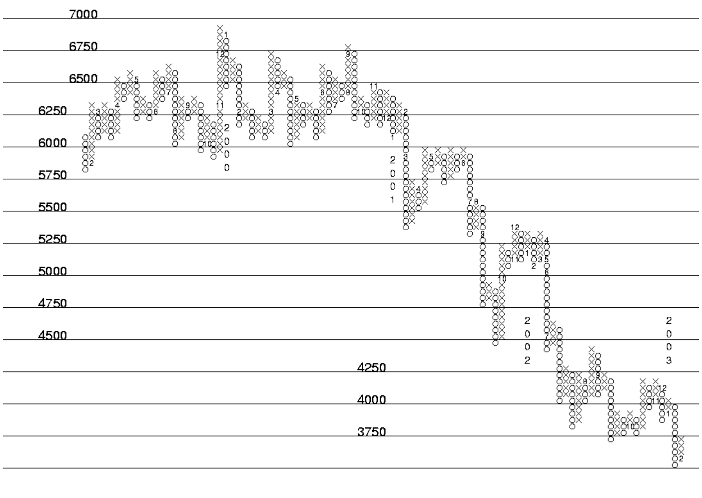
The UK's FTSE 100 Index (3570) has encountered resistance from the lower side of its July 2002 to January 2003 trading range, and is susceptible to at least a retest of 3500.

Strategy for stock markets - Once again, in a secular bear market I will only consider buying stocks after capitulation selling, defined here as markets in freefall and a VIX Index (OEX Volatility Index) reading over 50. Precious metal mining shares are the only exception. Whenever the market is down someone asks me if we are seeing capitulation selling. I say no, capitulation selling is not a frequent event. However we saw it in September 2001, July 2002 and October 2002, and we may see it again shortly, if investors are convinced that war against Saddam Hussein is both inevitable and imminent. Following capitulation selling and then at least one day's upward dynamic to signal that it has ended, one can buy almost any depressed share or stock market index and profit from a trading rally. Techs or any other sector where there are likely to be substantial short positions rebound very sharply following capitulation selling, but one needs to buy before it is obvious to everyone that a rebound is underway. For trading, I mostly use futures, and I covered my NASDAQ short position too early. Unless there is an unexpected rebound before the Saddam situation is resolved one way or another, I probably won't open any further shorts. However I plan to buy for a bounce on the first evidence of firmness following any military move against Saddam, particularly if it has been preceded by capitulation selling. Since the Philadelphia Gold and Silver Index shown above has the only large base formation in stock markets, I remain a long-term bull of gold and other precious metal mining shares, which I hold via a few individual shares and funds, mentioned in previous issues. However these have been drifting recently and may be vulnerable to a further setback when industrial and financial stocks next rally. My strategy is to buy the mines on weakness and lighten on good rallies. I may add to my

Switzerland Swiss Market Index (40pt)



United Kingdom FTSE 100 Share Index (50pt)



small holding of high-yielding defensive stocks in UK tax-efficient ISA accounts, if capitulation selling occurs, hoping to lighten on the next rally.

Currencies

■ **Is the nomination of Toshihiko Fukui as BoJ Governor another own-goal by Japan?**

■ **The US dollar should experience a temporary rally once the problem of Saddam Hussein is resolved.**

It is not difficult to argue that Japan's Prime Minister Junichiro Koizumi either knows little about economic management, or that he has no real power. Whatever, after insisting for months that he wanted a "dedicated deflation fighter", the nomination of Toshihiko Fukui looks distinctly conservative. Koizumi described Fukui, a 67 year old veteran with 40 years at the BoJ, as "a trustworthy and stable banker who understood the economy", according to the Financial Times. The market's initial response has been disappointment, with many commentators saying there will be no real change from the disastrous Hayami regime. In a Bloomberg report, Shigenori Okazaki, chief political analyst at UBS Warburg (Japan) Ltd, said Koizumi's failure to select someone from the private sector to head the central bank indicates his sway over his own party may be waning.
The same article contained this damning quote from Edwin Merner, president of Atlantis Investment Research Corp in Toko, which manages $600 million: "The fact that Fukui was chosen shows how bad the state of the government is: yet another old boy, no new life, no new nothing, just more of the same, slow rot."

Is Fukui's appointment further evidence that in terms of the economy, Japan has never missed an opportunity to miss an opportunity? Possibly, but anyone would be better than Hayami, who was much more interested in keeping the yen from falling than in using the full range of monetary policies to fight Japan's destructive deflation. We can assume that the MoF and BoJ will work together, in contrast to the policy and verbal war waged under Hayami's regime at the central bank. Various officials at the MoF have often stated their preference for a weaker yen, with Finance Minister Masajuro Shiokawa calling for a dollar/yen rate of between ¥150 and ¥160 not long ago. This would require more radical reflation than we saw under Hayami. We can probably assume that Fukui's approach will be business as usual - until something goes wrong. Most government bureaucrats are crisis oriented rather than proactive. With the Nikkei and Topix indices testing their lows and poised to resume a 13-year bear market, Japan is probably on the brink of its next crisis. A stronger yen, which we have seen against all currencies since the announcement of Fukui's appointment, certainly won't help export companies' operating profits or the stock market.
To my knowledge, no country has ever escaped from an outright deflation without devaluing. Toshihiko Fukui presumably knows this as well. I never expected the next BoJ Governor, whomever he might have been, to commence his tenure with an announcement of radical reflation, including devaluation by means of massive credit creation. That would have been provocative and could easily have roiled the markets far more than we have seen to date. It would be far better to declare a willingness to work closely with all other branches of the government, in a determined effort to end deflation and revive the economy. This will certainly include more radical monetary measures than occurred during Hayami's 5-year tenure at the BoJ.

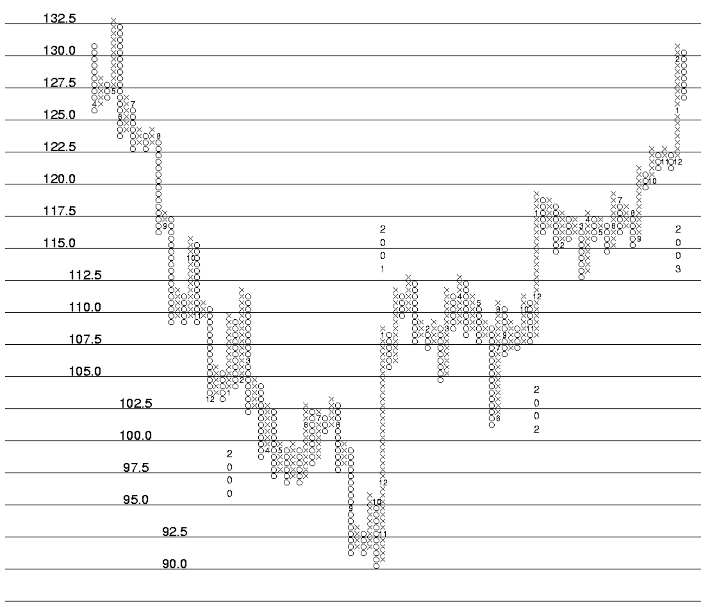
Traders have sold the dollar against most other currencies, ensuring that a technical rebound is not far off. This has already occurred against sterling - the other war currency. Elsewhere, the dollar has lost downward momentum recently, although it could easily weaken somewhat further if war appears imminent. This would be another example of, 'sell the rumour, buy the news'. Consequently the more the dollar is sold immediately prior to any war against Saddam Hussein, the more it should rebound shortly after a military operation commences. However a dollar rally would probably not be sustainable against the euro and Swiss franc, because the post-bubble trend is still to move away from the dollar. Also, credit creation in the US (the equivalent of printing money) has been massive relative to what we have seen from the ECB and SNB to date. The US will continue to create new dollars, to fight against double-dip recession and deflation, to fund the budget deficit and fight a war against terrorism.

Shorting the dollar against the yen at these levels could be a dangerous strategy. Traders are now hoping that the yen will follow the lead of other currencies and experience a strong rally against the dollar. Some technicians refer to "head and shoulders top characteristics", and I've heard forecasts ranging from ¥110 to ¥80, the latter level being the all-time low reached in 1995. Japan's current account surplus and the US's current account deficit are most often mentioned as the fundamental factors. Well, anything is possible in markets, but I would rather be on the other side of this trade, although it isn't ideal because neither the yen nor dollar is a strong currency. As for the supposed H&S top, important tops occur following big gains. For dollar/yen, the neckline that they refer to is near ¥115, only 5-yen above a base. Also, in a large trading band one often sees H&S characteristics, which usually don't indicate anything other than choppy ranging. Also, size matters, and one can just as easily identify an inverted H&S bottom, which is the bigger pattern - see P&F chart below. Look at a much longer-term chart and one sees an even bigger H&S shape, with the head occurring in 1995 on the decline to ¥80. Remember, dollar/yen has come down from over ¥358 in March 1971, a few months before President Nixon scrapped the Bretton Woods fixed exchange rate agreement, and also dollar convertibility into gold. A point to remember with supposed H&S patterns - if they go wrong and take out the right shoulder, in this instance near ¥126, the head is often challenged as traders stop out and/or reverse positions. A war against Saddam Hussein could provide the trigger for a dollar rally against the yen. Fundamentally, both dollar and yen credit creation will inevitably continue, ensuring that they eventually fall further against other viable currencies, not to mention gold. However the Japanese government and MoF are determined to weaken the yen, evidenced by repeated intervention. This will have a greater chance of success once Hayami is no longer there to sterilise excess liquidity.

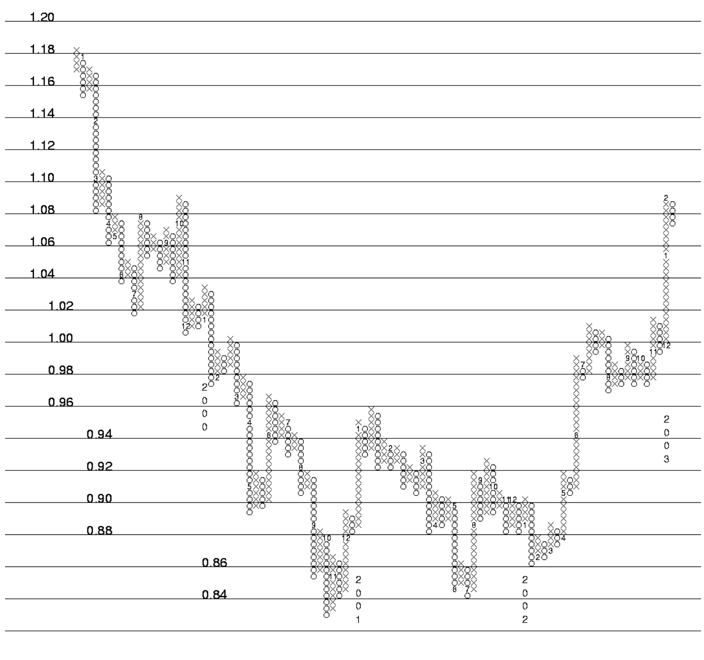
Chart review of important and topical currencies - *These and hundreds of other 3-box reversal closing basis point & figure charts are available on our website, www.chartanalysts.com and are updated daily. All comments refer to closing levels for US trading hours.*

Euro/dollar ($1.0774) - A consolidation of the strong December to early-February gains is underway. This is likely to continue and the euro could dip somewhat lower before the underlying base supports a move above psychological resistance near $1.10.

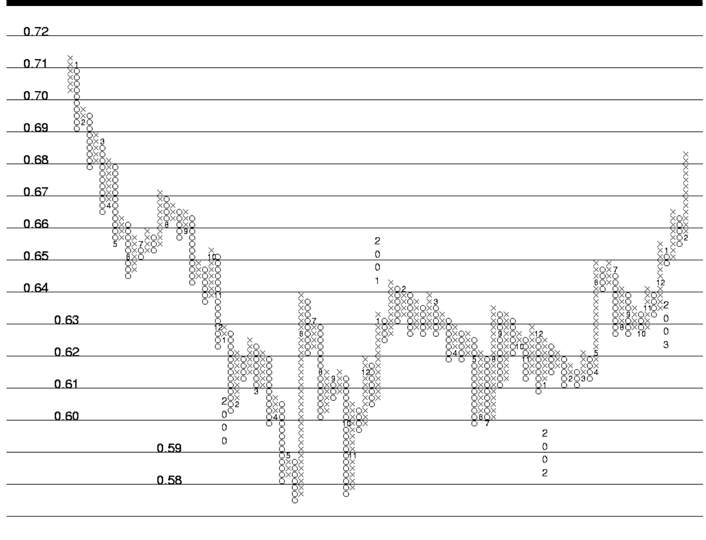
Japanese Yen per 1 Euro (0.5)



US Dollar per 1 Euro (0.004)



Pound Sterling per 1 Euro (0.002)



Euro/yen (¥126.42) - Here also a consolidation is underway. Further ranging is likely and the euro could ease a little further before the long-term uptrend is reaffirmed and the early-1999 highs cleared.

Euro/sterling (£0.6804) - This advance is becoming temporarily overextended. Therefore some reaction and consolidation is now likely before the euro's base supports higher levels.

Sterling/yen (¥185.76) - Sterling's gradual uptrend was checked by lateral and psychological resistance evident up to ¥205. While strong support near ¥180 should cushion downside risk, the recent upside failure and break of initial support at ¥190 suggests that another lengthy ranging phase is likely before the uptrend is reasserted.

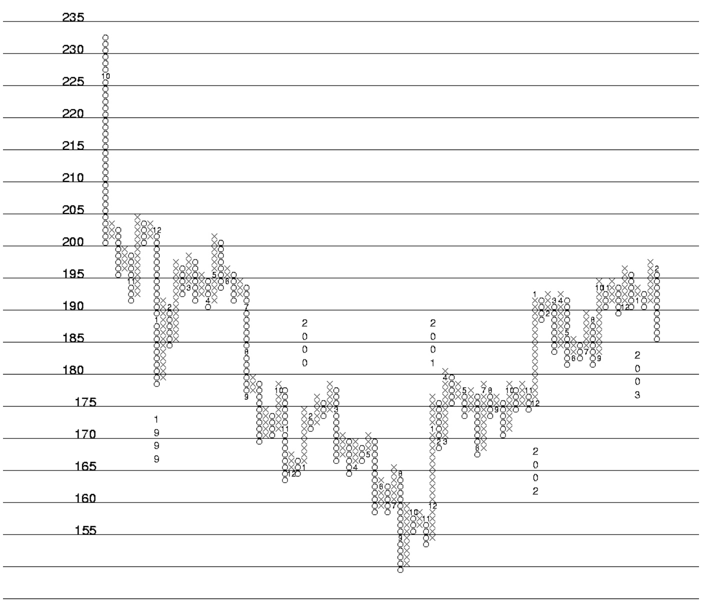
Dollar/Swiss franc (SF1.3621) - The dollar has lost downward momentum follow a temporarily overextended decline towards the important October 1998 low at SF1.315. However upward scope remains limited to a temporary technical rally before the large top area and downtrend lead to further weakness.

Dollar/yen (¥117.74) - The dollar has drifted back once again and is not far from psychologically important lateral support down to ¥115. A rally back to ¥121.50 would provide the first evidence of increasing demand relative to supply by breaking the recent progression of lower rally highs. However ¥126 is required to reaffirm the floor dating back to February 2001.

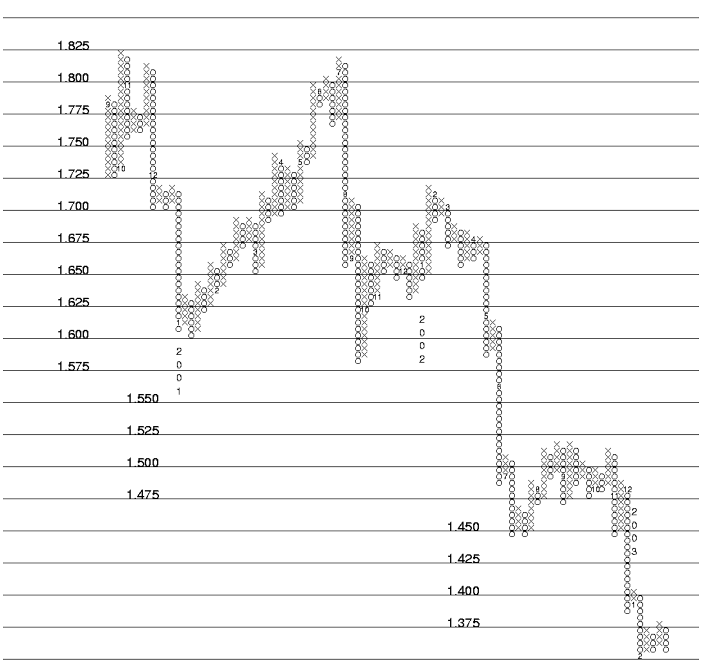
Sterling/dollar ($1.5780) - The pound fell back from prior resistance above $1.65 (partially shown) more quickly than it rallied, suggesting that the upper boundary will not be retested quickly. However support evident from $1.58 should now cushion downside risk and lead to sideways trading.

Australian dollar/US dollar (US$0.6049) - This advance, resumed after a brief consolidation, is beginning to appear overextended. However downward risk looks limited to additional periods of sideways ranging before overhead trading is further tested.

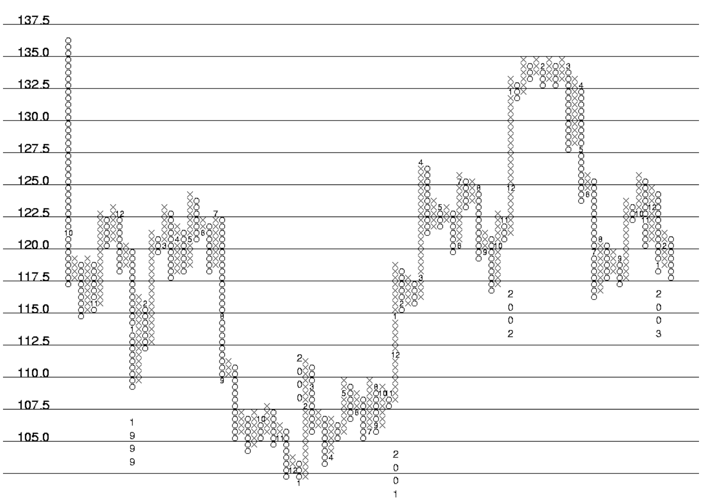
Japanese Yen per 1 Pound Sterling (1)



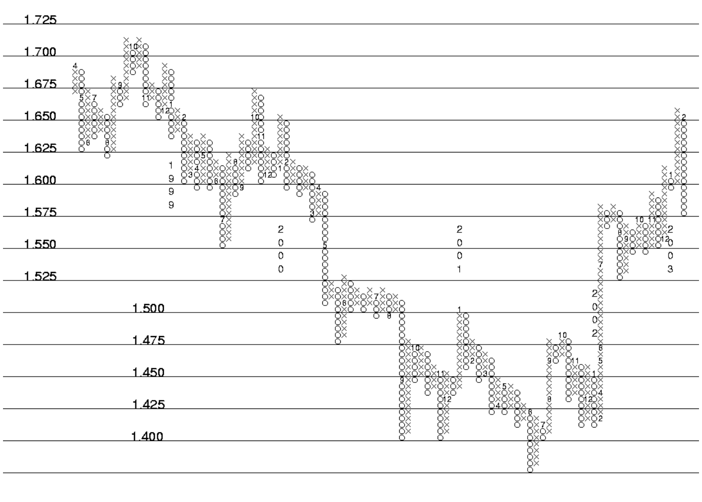
Swiss Franc per 1 US Dollar (0.005)



Japanese Yen per 1 US Dollar (0.5)



US Dollar per 1 Pound Sterling (0.005)



Strategy on currencies - Is the yen cross still a good trade despite Toshihiko Fukui's appointment as next BoJ Governor? I believe so, and suspect even Jack the Ripper would be preferable to Hayami, but we have to be careful because most yen bears are disappointed, which emboldens the yen bulls. If you have been following the Audio comments you may recall that I gradually sold all my sterling/yen longs during the last rally. I also jammed up my euro/yen stop after lightening somewhat, protecting my biggest position because it had lost upward momentum after reaching ¥130. This was triggered early in the euro/yen setback. I though about lightening my modest dollar/yen trades when some were in profit, but didn't, allowing the gain to slip away. I'll hold but probably won't add unless the price breaks under ¥115, and then only lightly. I used the Baby Steps tactic to repurchase some sterling/yen, buying at lower levels than previously. Sterling's weakness has presented this opportunity and I'm prepared to nibble down to ¥180, although I would be surprised to see that level, given chart support. I'm hoping for a sterling rebound shortly after any military move against Saddam Hussein, and would lighten positions on that rally. Similarly, I suspect that could lift the dollar and I will lighten next time it rallies, perhaps commencing at ¥122. I'm keen to repurchase some euro/yen hoping to start below ¥126, but I'll be more cautious this time, at least initially, because the current reaction is bigger than we have seen for a number of months, albeit still within the overall uptrend. Also, too many people own the euro and there may be a further correction, coinciding with any military move against Saddam. At some stage I'll probably give up a slug of profits due to selling the yen during its rallies, but it has been a profitable trade over the last 3 years and I see no evidence that it is over. The key has been to not get overextended and to allow for "surprisingly large" setbacks within the overall trends. There are many other yen crosses to trade on a buy low, sell high basis, but I concentrate on the 3 above because they are available on my UK-based spread-betting facility, which eliminates CGT. I'm not trading euro/dollar at the moment, having sold too soon. I would be tempted in the event of a post-war setback and suspect there are currently a number of stops near $1.0650. Expect plenty of volatility in the event of war, including a number of contra-trend reactions.

Commodities

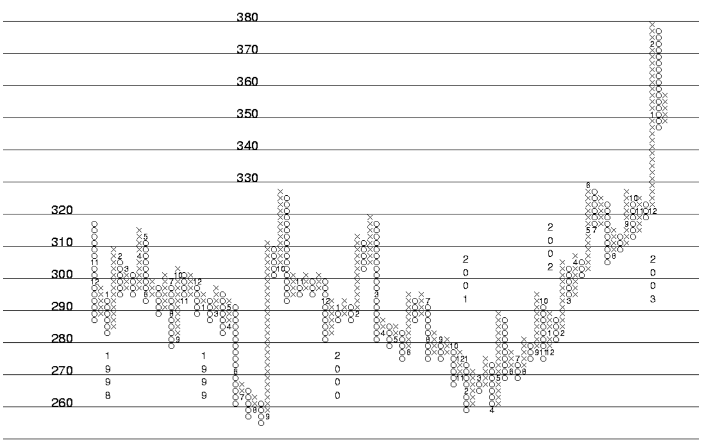
■ **Petroleum prices are at crisis levels for the global economy.**

■ **Base metal prices are rising, due to previous cutbacks in production by mining companies, demand from China, military considerations and the dollar's decline.**

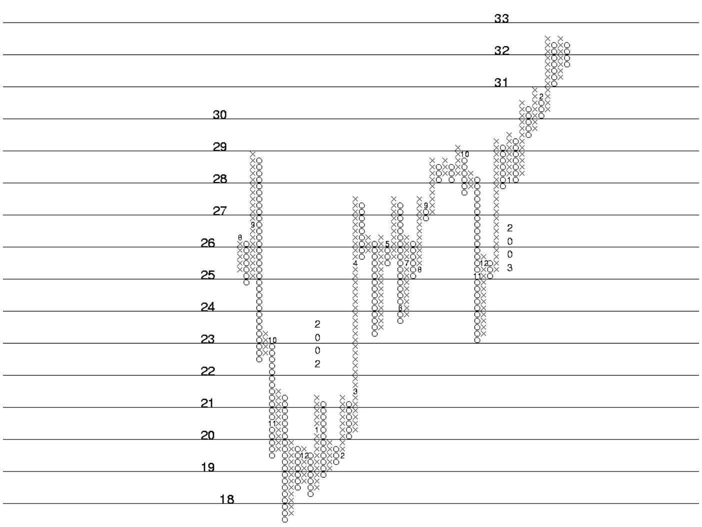
■ **Gold is consolidating gains in the first step above its multi-year base, prior to renewed strength over the medium to longer term.**

■ **The CRB Commodity Index has reached its highest level since May 1997.**

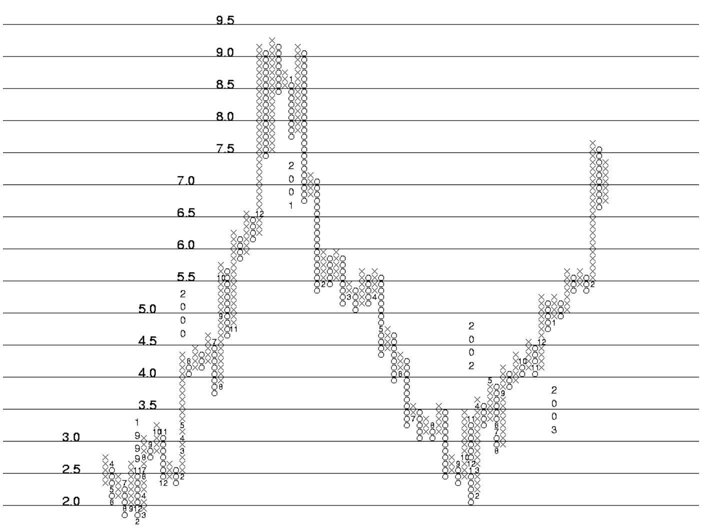
Gold CMX 2nd Month Continuation (2USD)



Crude Oil NYME 2nd Month Continuation (0.2USD)



Natural Gas 2nd Month Continuation (0.1USD)



No petroleum supplier/trader dare be short while uncertainty over Iraq persists. Consequently dealers are understandably scrambling for supplies. The Venezuelan crisis and talk of "the oil weapon" have not helped. There is no uncertainty about the consequences of oil above $35 (NYME) for anything other than a brief period - it will result in global recession, even though the dollar has fallen back from its highs in 2000/2001. This may now be inevitable.

However there should be some respite once the Saddam Hussein problem is resolved, especially if he and his kind are removed from power. If that happens in the next few weeks, the price of oil should fall sharply.

Significantly, industrial metal producers had reduced output in 2001, in response to weak prices. Nickel has more than doubled since its November 2001 low, reaching its highest level since June 2000. Demand from China, military expenditure and a weaker dollar are the other contributing factors. A move under $8200 is now required to offset further scope towards the 2000 peak area up to $10320. Tin has just completed a base formation. A break back below $4500 is necessary to question current potential for at least a test of lateral resistance commencing at $5000.

Following completion of its base on the break over $330, gold bullion moved steadily to a closing high at $378 (intra-day $389.05). This has spilled over into what is likely to be a multi-month consolidation - forming the first step above the base, as described at The Chart Seminar. Look for further ranging centred on $360, prior to a resumption of what I believe is a secular bull market. Why? For all the reasons mentioned in previous issues and on my website, of which the two most important are - gold is a value play and people are once again becoming aware of the long-term risks in paper money.

Petroleum prices are the main factor behind the CRB's rise. However most other commodities show base formation activity capable of supporting higher prices in years ahead. Over the shorter term, gains are beginning to appear overextended. When a downward reaction exceeds 7 points on this closing-basis chart, we will have seen at least a penultimate high for the medium term.

The Global Economy

■ **The outlook for the global economy continues to weaken, but a resolution of the Saddam Hussein impasse should provide temporary respite.**

■ **Petroleum prices continue to trade at global recession levels.**

The IMF has issued another downgrade for Euroland's GDP growth. It now expects the euro region's economy to expand by 1.3 percent this year, down from a forecast of 2.3 percent just five months ago, according to a Bloomberg report on 21st February. You will have spotted the pattern. For the last 3 years the IMF has issued increasingly downbeat forecasts for regional or global GDP growth, looking 15 months ahead. Nevertheless each has proved to be too optimistic, necessitating several downgrades as time elapses. These people are not unintelligent, so what is going on? They are inclined to optimism because the usual steps to revive growth - monetary and fiscal stimulus, as recommended by the IMF and other groups of economists have been taken, but to little effect.

The problem is partly behavioural but also a matter of experience. The IMF's analysts were accustomed to reasonably strong economic growth, short recessions and a rapid bounce back from setbacks, as occurred following the Asian crisis in 1997 and the Russian debt default/Long-Term Capital Management collapse in 1998. Although the US's "record economic expansion" proved to be less than reported, the global economy also swept past the Y2K hysteria without missing a beat. We had an accelerated rate of technological innovation and a wonderful new invention called the Internet. We claimed we were collectively more sophisticated. Graduate schools had banished the business cycle. Sceptics had been discredited and looked increasingly like cranks. Against this background economic projections were likely to err on the side of optimism, not unlike analysts' estimates for corporate earnings. As for perspective, few active economists have any experience of today's environment. Yes, they had lived through Japan's burst bubble but that occurred during the 1990s boom elsewhere. Today, following the technology and telecoms bubble, which had a much more wide reaching affect, all developed economies are underperforming at the same time. Forecasters had little prior experience of deflationary pressures, and the shadowy war against terrorism was unprecedented.

Problems from the deflationary conjunction remain. America's last great bubble burst over 73 years ago, when the US economy was important but with nowhere near the global influence of today. It takes many years to recover from the debt overhang, bankruptcies and loss of confidence caused by burst bubbles, as we continue to see with Japan, where contrary to annual forecasts, a sustainable recovery remains elusive. Germany, the world's third largest economy, is almost certainly now in recession. The UK's "economic miracle" is based on little more than a now fading consumer boom in response to a house price bubble. China's economy is thriving, relative to everywhere else, as global manufacturing continues to relocate there, but this is compounding deflationary pressures elsewhere. Crucially, the price of crude oil has broken well above its 2000/2001 highs, trading above $35 (NYME) recently.

This is massively deflationary. There is also the war against terrorism and uncertainty over Iraq. While this is a convenient excuse for underperformance by corporations and governments, no one would doubt that it is a deterrent to consumer spending and corporate capital expenditure.

Oil prices remain a critical variable. Whenever the price of crude oil has traded above $30 for more than a brief period, global recession has followed. While analysts rightly point out that developed countries are generally much more energy-efficient than in the 1970s, neither this factor nor the dollar's recent slide can offset the damaging effects of an oil price that has now broken above $30 a barrel, especially as GDP growth was already weak. Some respite can be expected once the Iraq situation is resolved, one way or another, although the Venezuelan problem remains. Meanwhile, no large industrial consumer/supplier of oil is going to be caught short, just in case war causes damage to oil installations in the Middle East. Every week that oil prices remain high, increases the likelihood that global GDP growth in 2003 will be considerably weaker than analysts were predicting at yearend. For this outlook to change, a quick resolution to the Iraq impasse is required, without any damage to installations. This would improve sentiment generally, quite likely producing a temporary economic rebound. Unfortunately, the post-bubble problems of debt, deflationary pressures and stagflation are much more difficult to resolve.

A snapshot view of the regional and country outlook:

US confidence is experiencing an inevitable knock following the burst bubble, compounded by the War against Terrorism. Ever more credit creation is required to sustain modest growth, and GDP increased only 0.7 percent in 4Q 2002, with most of this coming from government expenditure. When house prices slide, double-dip recession will be inevitable.

Germany, once the engine of Europe, has stalled and will not be easily jumpstarted. The Socialist Schroeder Government is too weak and lacking in vision to tackle necessary structural reforms, especially as there is little public support for changing the welfare state. Germany has little recourse to monetary or fiscal policies, since the ECB controls the former while the Stability Pact makes it difficult to increase government spending.

The rest of Euroland is inevitably weakened by Germany's problems, many of which are replicated in the region's other countries. Euroland's consumer sector remains weak and a stronger euro is squeezing operating profits from exports.

The UK's economy is deteriorating rapidly, due to steeply rising taxes and falling revenues. Britain's housing bubble has burst, ensuring that the economy's private sector will continue to contract relative to an inefficient public sector, funded by rising taxation and borrowing.

Most of the Middle East, Central/South America and Africa remain dysfunctional, mainly due to bad governance. This depressingly familiar problem is compounded by the global economic slowdown.

China's growth is certain to be less than reported by the government. In fact the statistics hardly ever vary. Nevertheless China has boomed relative to other regions of the globe, due to cheap land and labour, a pro-business government, a very competitive currency peg, and a Gadarene rush by the world's manufacturers to relocate in the PRC.

While much has been heard about the deflationary pressures exported by global manufacturing's relocation in China, it is a boon to many commodity exporters. Also, developing Asia, particularly Thailand, is now benefiting from Chinese tourists, in addition to exports of commodities.

Developed Asia faces greater challenges, with its economies experiencing increasing competition from China, unless they are able to maintain a technological edge. Smaller countries such as Singapore, South Korea and Taiwan will find this difficult, because they lack the scientific research base of larger countries such as Japan. However as a high-cost region, Japan is feeling the deflationary consequences of China's emergence more than most. This will not change anytime soon, even if Japan uses monetary policy to devalue the yen and China eventually revalues the yuan from its current level of 8.3 to the US dollar.

India is the only other country that can be remotely compared to China. It too has an enormous, low-cost and often well-educated labour force, and land is also cheap. India is a growing force in software writing and accountancy, and a less bureaucratic regime would open up many more opportunities.

The first target date for FM226 is Friday 21st March.

> *"Doubt is not a pleasant state of mind, but certainty is absurd."*
>
> Voltaire

Best regards - David Fuller

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