# Fullermoney

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**In its 20th year**

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

## Sentiment towards stock markets has improved following the war, not surprisingly, despite global economic problems and SARS.

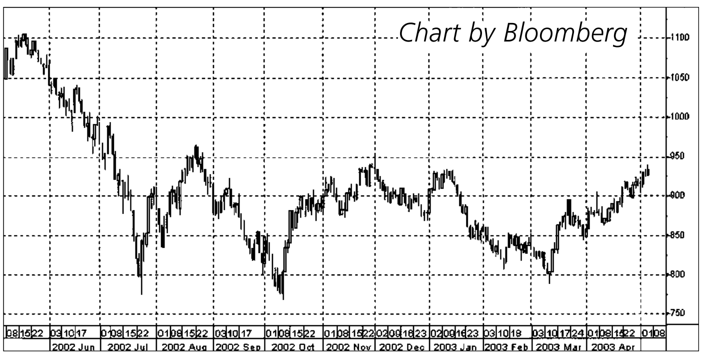


## The medium-term rally in stock markets is testing important resistance levels and there is no evidence that it is over.

**Stock markets have risen on both good and bad news, and remain steady despite short-term overbought conditions.** "Don't fight the tape", is one of the oldest and best market adages. Yet people do, because we are conditioned by what has gone before. As a species, we humanoids often find it difficult to change an opinion, not to mention inconvenient and even embarrassing. One resists, rationalises, and procrastinates. Even the consciously willing, flexible and adaptable find it difficult to change a market view, because there is usually conflicting evidence. Also, rational, intelligent and reasonable people can look at the same data and see three different things. In markets, we can see what we want to see, and we can see what we think we are going to see. Both usually cost us money. The art of investment is to see what is actually there. We can be objective about this. For timing, we need to recognise change when we look at our charts.

**Let's start with a disconcerting reality - no one actually knows where the S&P 500 Index will be tomorrow, a week, a month or a year from now.** We can only guess, based on what we see and have experienced before. Some people actually claim to know where the market will go, but even if sincere, they probably hear voices in their heads, like Joan of Arc. I won't go down that path. You and I look at our charts, and this is where the debate heats up, particularly today. The bears have been saying that the S&P and most other indices are still in long-term downtrends, evidenced by moving averages. They also cite important resistance points on the charts, including 950 to 965 for the S&P. Almost everyone is aware of these factors. Many of today's bears also cite various technical systems, too numerous to list, as further evidence that Wall Street and other stock markets are unlikely to rally from here. They also repeat, "Sell in May and go away". I believe the

**S&P 500 Index: 934 (Daily)**



moving averages are important, but they are also lagging indicators. Prior resistance levels are significant, but the market will always be well above its floor before they are tested and eventually broken. Sell in May has sometimes been good advice and sometimes not.

**Since there will always be more remaining bearish data than new bullish factors as markets rally from a low, I believe we should look for evidence of change.** Today, ask the following questions. Did we see very bearish sentiment and some climatic selling at the low? Has the market established support, which has been successfully tested at least once? Is resistance being eroded? And crucially, are we seeing more upward than downward dynamics, defined here as bigger upside than downside days? Looking at this daily candlestick chart for the S&P 500 Index, the answer is yes. Are other stock market indices now confirming or refuting what we see on Wall Street? I believe it is the former. I could add other factors but view none as more technically important today than what I have just listed. Unfortunately, this evidence guarantees nothing.

**Every technician knows that stock markets are at a critical juncture.** When the technical evidence starts to deteriorate, I aim to tailor my view and portfolio accordingly. Meanwhile, the medium-term technical rally that I have previously discussed, which I maintained would get a second wind once the war to liberate Iraq commenced, does not appear to be over on the basis of any actual market evidence. I'm less interested in conjecture. Therefore, before this rally clearly loses momentum, it stands to gain more converts as resistance is further eroded. A behavioural danger for the future will be when almost everyone concludes that the secular bear market is over. I don't think it is, for reasons discussed previously and also in this issue, but I'm not worrying about that today. *Note: I'll post further charts on my website shortly, so that you can see the dynamics mentioned above more clearly.*

## Interest Rates and Bonds

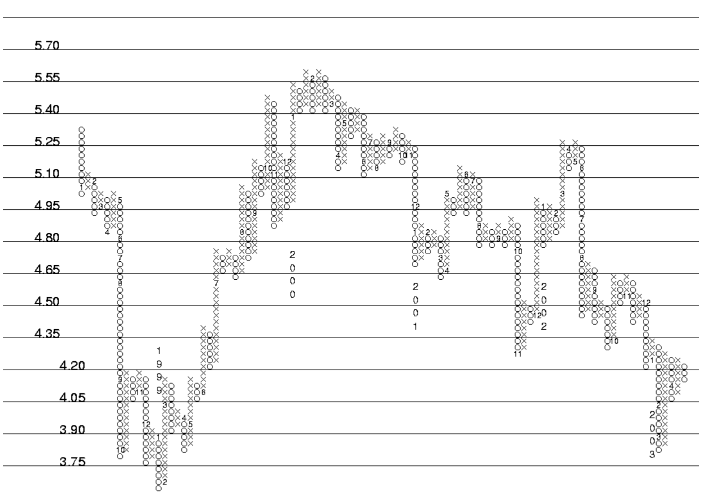
■ **Further rate cuts by the BoE and especially the ECB are likely, but prospects for another reduction by the Fed are waning, despite expectations.**

■ **The next big move in European and US long-dated government bond yields is likely to be upwards, assuming Japanese-style deflation is avoided.**

**Euro strength represents a potential deflationary crunch for the ECB.** Shock and awe in Frankfurt is caused by the soaring euro, which has caught the ECB by surprise. It is more accustomed to worrying about a currency that is too weak. Consequently the central bank is unprepared and 'masterly inactivity' will soon compound Euroland's economic problems. The ECB will need to cut rates but the currency markets expect this, so the single currency's uptrend is unlikely to experience more than a brief pause. Looking further ahead, the ECB will attempt to talk the euro lower, but this will only work for short while. It will

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

**Euro Bund 10 Year Bond Yield (0.03)**



then threaten intervention, which would almost certainly be unilateral, because the US is unofficially delighted with the euro/dollar rate. Looking even further ahead, the ECB will eventually have to print. This script outlines the growing risks with long-dated Euro-bunds. If the market begins to accept this view, 10-year yields will rise. Technical evidence of the change in sentiment will be moves above this year's resistance between 4.23 and 4.32 percent. Alternatively, traders may conclude that the ECB will demur over euro strength, in which case Euroland is more likely to follow Japan's deflationary path. Evidence would be a breach of the March low at 3.81 percent by 10-year yields.

**Most economists expect another rate cut by the Fed, but this is not necessary.** Lower oil prices, the dollar's decline and a more upbeat mood following the war are providing an infinitely greater economic stimulus than would result from another paring of rates that are already at a 40-year low. In fact, a rate cut could backfire, by suggesting that the Fed knows something we don't. Greenspan should prepare the market for an eventual rate increase. Meanwhile, US 10-year bond yields appear to be basing. If so, the October 2002 and March 2003 lows at 3.575

percent should hold, followed by a push over 4.025 percent, opening the door for a test of the ranging pattern's upper boundary.

**Strategy on bonds -** Two issues ago, I advocated a shift to short-dated maturities among government bonds, and/or standing aside, on the first evidence of military action against Saddam Hussein. I added that one could repurchase as and when the anticipated stock market rally lost momentum. After a sharp rise in government bond yields (fall in bond prices) yields have drifted somewhat lower once again. I regard this as a further opportunity to reduce positions, or at least shorten maturities, if one has not already done so. While there is a possibility that government bond yields range over the medium term, only serious deflation would cause the next big move to be downwards rather than upwards. I believe the US will avoid this problem, and hopefully the ECB will wake up and take appropriate action. Consequently, I conclude that the bull market in government bond yields is ending or over. In futures, I'm waiting for a technical signal to short. High-yielding corporate bonds have had a spectacular rally in recent months. Consequently the best gains have probably been seen, a view also expressed by Warren Buffett recently. I rate corporate bonds a hold.

## Global Stock Markets

■ **SARS has only delayed medium-term rally scope.**

■ **2003 still has a reasonable chance of being an up year, especially on Wall Street, despite SARS.**

■ **The third year of a US presidential cycle is usually bullish, as the incumbent party stimulates the economy.**

**The fog of war has lifted but was temporarily replaced as a concern by uncertainty and fear over SARS.** This publication had long contended that most stock markets would rally once the war for regime change in Iraq commenced. My reasons were that purchases had been deferred due to uncertainty, and that people were frightened by the economic implications of worst-case forecasts. In the event, the rally started a week early, probably triggered by Fed intervention. There is little sign that it is over but it has run into resistance, and not just from the charts. SARS came from nowhere to dominate the public consciousness, judging from recent newspaper headlines, just as people were looking beyond the war in Iraq. This is bad for stock markets because SARS can only damage the global economy, much of which was already on life-support. Asia, especially China, was the notable exception, Japan aside. However China, is most affected by SARS and investors are left to ponder how far this virus will spread. While the latest evidence suggests that infections outside China have been contained, a cure has yet to be found; the death rate among those who have contracted SARS is approaching 10 percent, and there are reports of public panic in Beijing. Even if the number of people who die from SARS remains statistically insignificant, we have

**-PrePre-Presidential Election Year Record Since 1915**

| | |
|---|---|
| 1915 Wilson (D) | WW1 in Europe, but DJIA up 81.7% |
| 1919 Wilson (D) | Post-Armistice 45.5% DJIA gain by 3rd Nov, 30.5% for year |
| 1923 Harding/Coolidge (R) | Teapot Down scandal - DJIA down 3.3% |
| 1927 Coolidge (R) | Bull market resumes, DJIA up 28.8% |
| 1931 Hoover (R) | Depression - stocks plunge, DJIA down 52.7%, S&P falls 47.1% |
| 1935 Roosevelt (D) | Persistent gains - DJIA up 38.5%, S&P 41.2% |
| 1939 Roosevelt (D)<br>2.9% after 23.7% Apr-Dec | WW2 clouds - DJIA falls<br>gain), S&P down 5.5% |
| 1943 Roosevelt (D) | US at war and prospects improving - DJIA gains 13.8%, S&P 19.4% |
| 1947 Truman (D) | DJIA up 2.2%, S&P unchanged |
| 1951 Truman (D) | Korean War - DJIA gains 14.4%, S&P 16.5% |
| 1955 Eisenhower (R) | DJIA up 20.8%, S&P 26.4% |
| 1959 Eisenhower (R) | DJIA gains 16.4%, S&P 8.5% |
| 1963 Kennedy/Johnson (D) | Vietnam War approaching - DJIA up 17%, S&P 18.9% |
| 1967 Johnson (D) | Vietnam War - DJIA gains 15.2%, S&P 20.1% |
| 1971 Nixon (R)<br>6.1%, S&P 10.8%, NASDAQ | Vietnam War - DJIA up<br>27.4% |
| 1975 Ford (R) | Vietnam War era ends - DJIA gains 38.3%, S&P<br>31.5%,NASDAQ 29.8% |
| 1979 Carter (D) | DJIA up 4.2%, S&P 12.3%, NASDAQ 28.1% |
| 1983 Reagan (R)<br>17.3%, | DJIA gains 20.3%, S&P<br>NASDAQ 19.9% |
| 1987 Reagan (R) | DJIA up 2.3%, S&P 2%, despite October Crash but NASDAQ down 5.4% |
| 1991 Bush (R)<br><br>NASDAQ 56.8% | Gulf War - DJIA gains 20.3%, S&P 26.3%, |
| 1995 Clinton (D) | Bubble commencing - DJIA up 33.5%, S&P 34.1%,<br>NASDAQ 39.9% |
| 1999 Clinton (D)<br><br>S&P 19.5%, NASDAQ | Bubble inflates/Millennium fears - DJIA gains 25.2%, 85.5% |

| | | | |
|---|---|---|---|
| **Average Pre-Election** | **DJIA** | **S&P** | **NASDAQ** |
| **Year Gains Since** | **1915** | **1931** | **1971** |
| | **16.2%** | **12.8%** | **34.6%** |

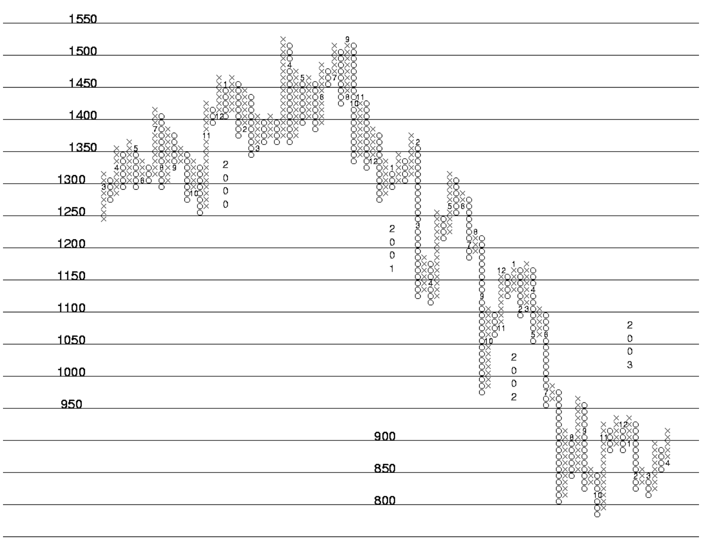
already seen that economic damage is far greater. As people stay home, airline, hotel and restaurant bookings have slumped by up to 80 percent in regions worst affected. Inevitably, the knock-on effects are considerable because there are few who profit from SARS, other than manufacturers of facemasks and some biotech companies. China's economic loss will seldom be another country's gain. Those who export to China will experience a downturn, while SARS remains a problem. Those who import from China will experience some delays. Stock markets will reflect these problems, although not equally. Asian markets will underperform while SARS remains a concern, because it has the most cases. Also, many international investors were overweight Asian equities because of the region's higher growth, Japan excepted, in the pre-SARS environment. They are now repatriating funds and some of this money will be reinvested in US and European equities.

**Historically, the third year of a US presidential election cycle has shown the best gains.** There is a very good reason - the incumbent party does all it can to stimulate the economy in time for an election day 'feel good' factor. Veteran subscribers will recall this point and the statistical evidence that I have published in past cycles, measuring performance from the low of second year of a four-year presidential cycle to the high of the following year. I'll update and reproduce those statistics in FM228. The data below covers 1st January to 31st December performance for the third year of presidential cycles since 1915.

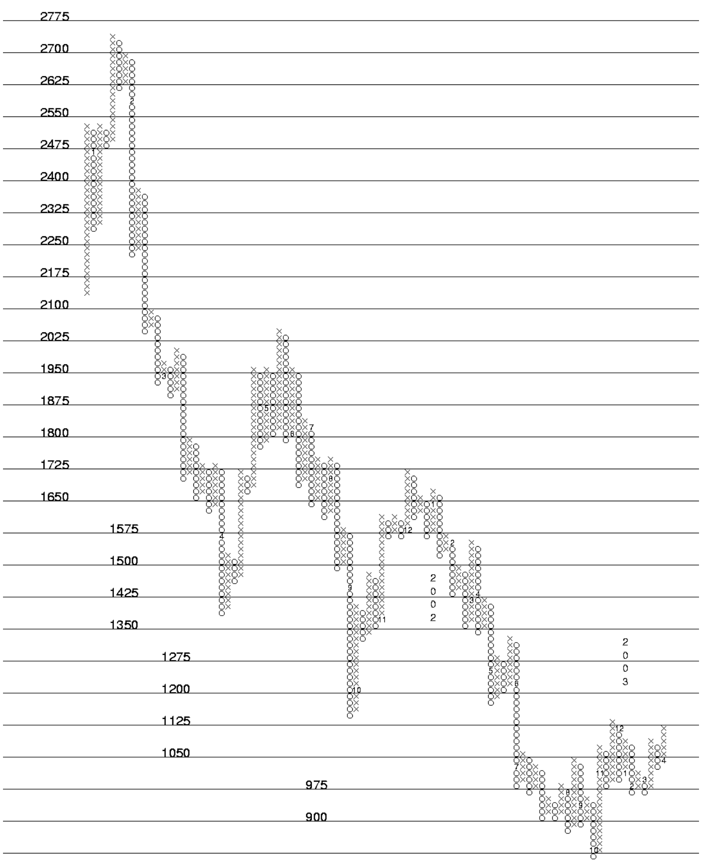
**Could 2003 - a pre-presidential election year - end with gains?** To do so, it would have to surpass the following levels on 31st December 2002 - DJIA 8341.63, S&P 879.82 and NASDAQ Composite 1335.51. As of early May, all were above their yearend 2002 levels. The US Government could hardly be more stimulative in terms of fiscal and monetary policy, and the war to liberate Iraq has been successfully concluded. However, the stock market faces stiff headwinds - this is a post-bubble secular bear market; deflationary pressures persist; companies have little pricing power; valuations on Wall Street remain way above previous bear market lows; the global economy is weak; debt problems are considerable and have increased in many instances; terrorism is still a concern, and now we have SARS. Consequently the first decline for a pre-presidential election year since 1939 has to be a real possibility. Nevertheless if any developed country stock market scores a numerical gain in 2003, it is likely to be the US, due to an economic stimulus that will not be matched elsewhere. There is also the soft dollar, which helps America's export earnings and makes US stocks cheaper for European investors. SARS could even support US stocks, assuming it does not become a pandemic, by siphoning investment cash away from Asia. While strong gains on Wall Street would lift most other equity markets, Europe is likely to lag, due to weaker growth and the euro's strength. An early peak to the SARS scare is required to lift Asia's stock market indices this year.

**Chart review of topical and representative stock market indices -** *The 3-box reversal point & figure charts*

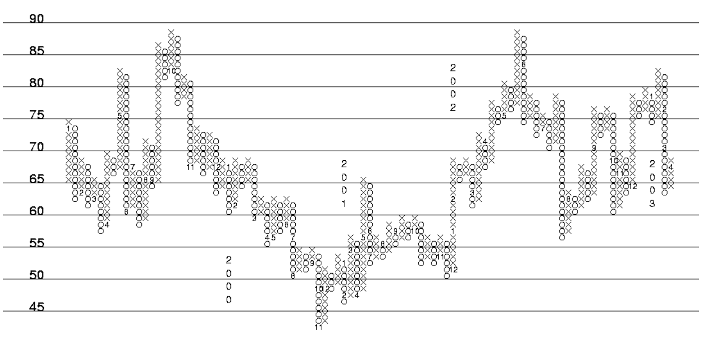
**S&P 500 Composite Index (10pt)**



**Nasdaq 100 Index (15pt)**



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



**Nikkei 225 Stock Average Index (100pt)**


*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. Please note, these charts were prepared before the final prices shown in the comments below.*

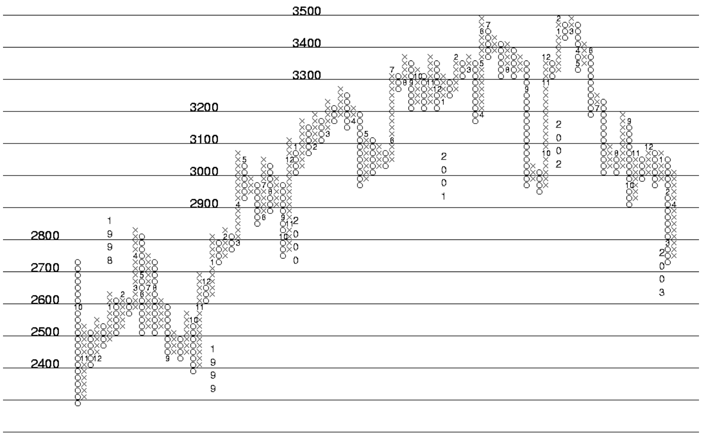
**The US's S&P 500 Composite Index (926)** has recovered towards the upper side of its trading range, which has the characteristics of a small base. The important psychological resistance is centred on 950, and a move to 845 is currently required to indicate a retest of the July to March lows.
**The NASDAQ 100 Index (1144)** has continued to hold up better than most and shows evidence of a small base. Moreover it has pushed well into significant lateral resistance in the 1125 to 1150 region, prior to completing this pattern.
**The Philadelphia Gold & Silver Index (68.81)** fell back sharply from the upper side of its massive developing base formation, delaying completion of this pattern for at least several more months. Nevertheless it has steadied and maintained the sequence of rising reaction lows. Consequently a move to 62 is required to offset current scope for sideways to higher ranging within the overall pattern.

**Japan's Nikkei 225 Stock Average Index (7907)** fell back from initial resistance evident at 8400, in price action consistent with its ranging decline since last July. While it has steadied following a new low in April, a move to 8500 remains necessary to question the medium-term downtrend.

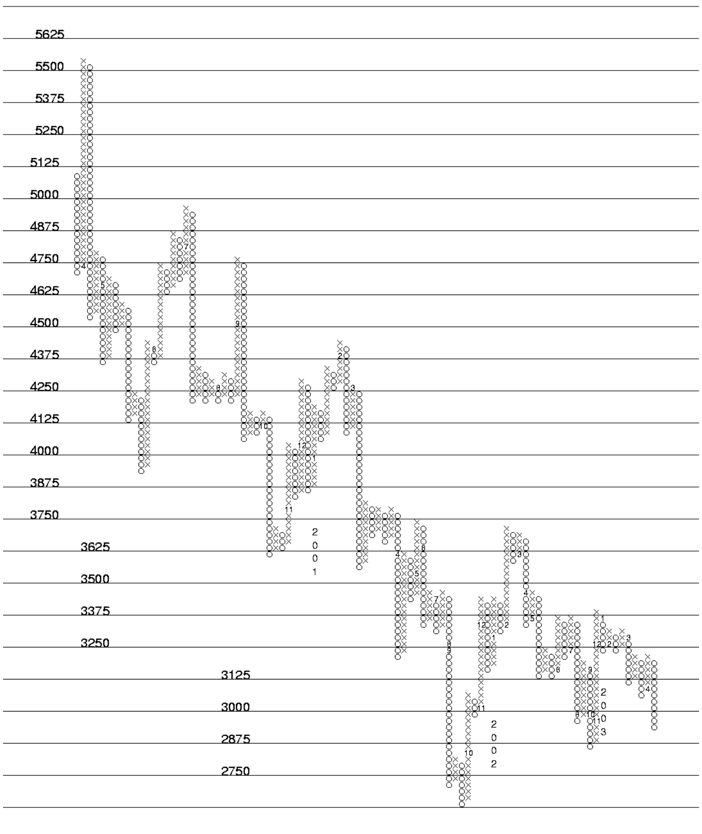
**Australia's S&P ASX200 Index (2977)** has rallied into the underside of its large, multiyear top, scoring its best gains since 4Q 2001. However psychological resistance near 3000 and overhead supply suggests that some retracement of recent gains is now likely.

**India's BSE Sensex Index (2975)** has extended its reaction from the yearend 2002 high at 3375 and is approaching last

**Australia S&P ASX 200 (20pt)**




**India BSE Sensex Index (25pt)**

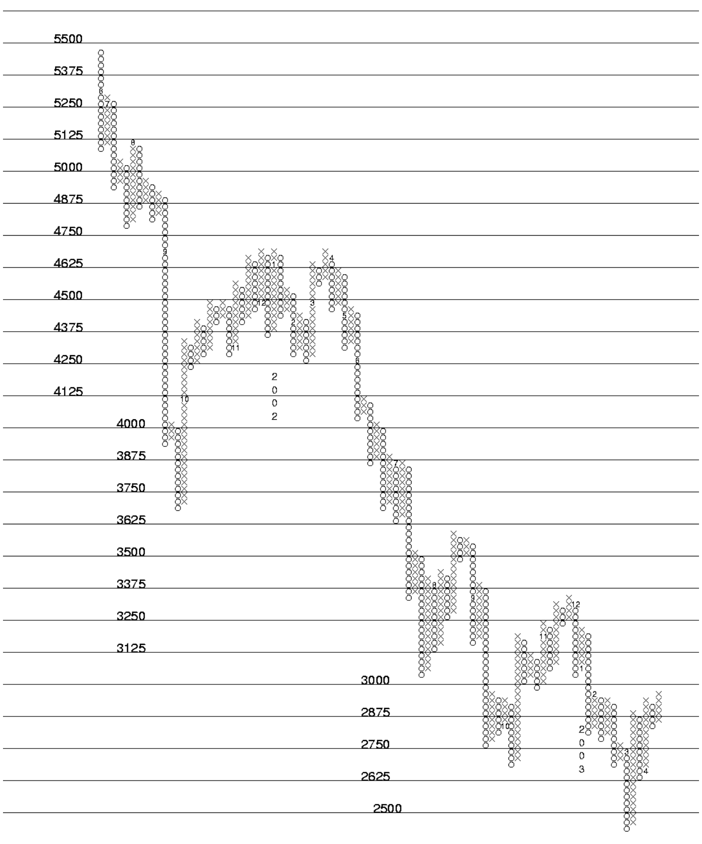



September's low at 2850. A break below this level would further question the base building hypothesis. Conversely, a rally to 3225 is required to reaffirm strong support near current levels.

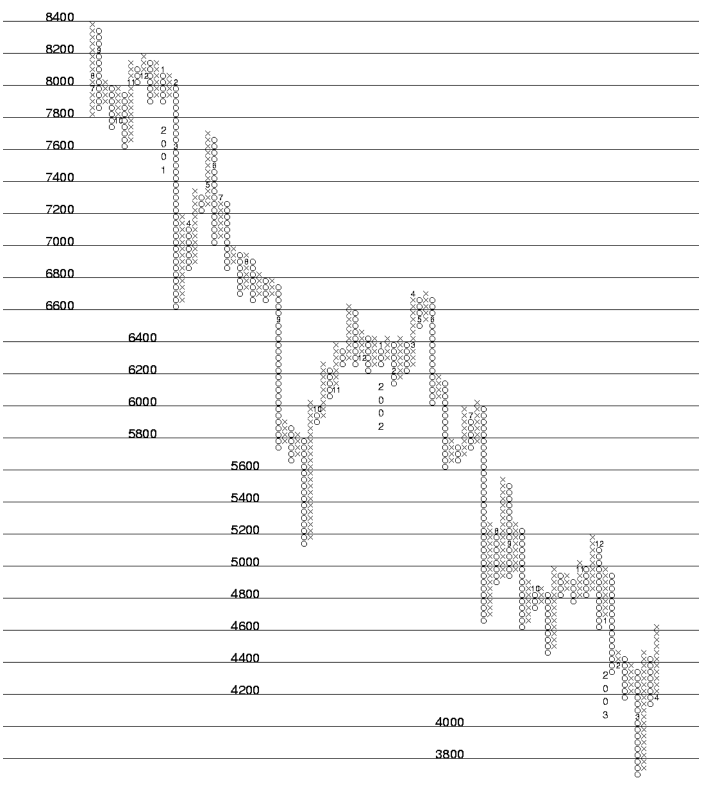
**Thailand's Bangkok SET Index (375)** - *not illustrated*- has been a relative strength standout in recent years and shows evidence of a multiyear base. Nevertheless, overhead resistance continues to impede upside progress and a move to 330 would indicate pattern deterioration.

**France's CAC 40 Index (2996)** - *see overleaf* - rebounded sharply in mid-March and early April but momentum has slowed beneath lateral and psychological resistance near 3000. Some further consolidation may be necessary before higher levels can be sustained.

**French CAC 40 Index (25pt)**

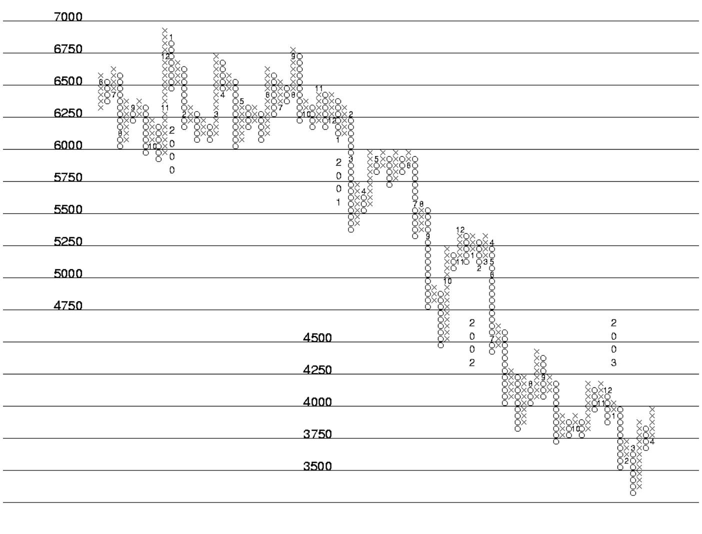



**Switzerland Swiss Market Index (40pt)**




**Germany's DAX Index (2995)** - *not illustrated* - also extended its rally but is similarly encountering both psychological and lateral resistance near 3000. Here also some consolidation of recent gains is likely.

**United Kingdom FTSE 100 Share Index (50pt)**




**Switzerland's Swiss Market Index (4579)** extended its rally in early April but is now hesitating in a region of overhead supply, which may impede upside scope. Any further near-term gains may be difficult to maintain without some prior support building.

**The Netherlands' AEX Index (286)** - *not illustrated* - has similarly approached overhead supply, which should make any additional gains difficult to maintain and is likely to force a partial retracement before long.

**The UK's FTSE 100 Index (3952)** has seen its best rally since late September and early October 2001 but overhead supply and psychological resistance near 4000 should provide some resistance.

**Strategy for global stock markets -** Is the current environment difficult for traders and investors? You bet. Ranging markets are never easy. However this does not mean that we should ignore stock markets. In fact, I've stepped up my own participation recently, reinvesting family ISA accounts and moving a bit of personal pension fund cash into stocks. Previously, my often-stated preference was to buy only following panic selling, and to sell tiring rallies. I mostly used futures, and was more interested in selling rather than buying opportunities, because of the overall bear trend. I don't think the secular market bear is over, but stocks may have fallen sufficiently for it to be interrupted by some significant medium-term rallies, similar to what we saw in Japan on several occasions, following the initial 50 percent drop. I maintain that the post-war, pre-presidential election environment has a decent chance of producing such rallies, and that Wall Street's lows for the S&P 500 and other leading indices will continue to hold, possibly into 2004. Consequently, I expect fewer buying opportunities produced by panic selling. Therefore, I am easing my way back into shares, buying mostly high-yielding companies, such as Sainsbury and Tomkins in the UK, and a few tech leaders such as Intel. I may buy Nokia and Vodafone, particularly if there is a setback. Will I establish substantial positions relative to capital? Absolutely not. Valuations are not sufficiently attractive for the environment. I have long maintained that valuations would eventually return to levels competitive with previous bear market lows, and I'm reassured that Warren Buffet and other notable value players are looking for better opportunities on Wall Street, which will continue to influence trends in other stock markets. So why have I bought Intel? It's a chart play, for a rally. Am I using stops with the shares? No. However I'm active in futures, albeit with small positions. Last month, I mentioned in this section that I was lightly short futures, but would probably reverse on the first upward dynamic. I did, but recently closed those positions and am would short again, hedging against my share portfolio, when the rally falters. With futures trades, I often use stops. My investment/trading positions and tactics are mentioned on the Fullermoney Audio, available to all subscribers on www.fullermoney.com (login name required). I have core longs in gold shares and funds, which I acquire on weakness and aim to lighten on rallies.

## Currencies

■ **If current global economic trends persist over the next several years, we are going to see a fiat money printing contest by leading central banks.**

**The burden of responsibility felt by the world's only remaining economic and military superpower is considerable.** It sees a feckless Euroland, dysfunctional Japan, mercantilist China and rogue states from the Middle East to North Korea. The scope for WOMD proliferation has never been greater. The Cold War's brinkmanship policy of mutually assured destruction (MAD) is not a deterrent to terrorist fanatics.

**One may disagree with aspects of these perceptions, but they are far from delusional.** For better or for worse, and I believe it is the former, the US will not rely on a corrupt United Nations for peace and security, nor will it retreat within its own borders and hope against odds that the next 9/11 doesn't happen. There will be no policy of benign neglect towards totalitarian regimes from the neo-conservatives who run Washington today.

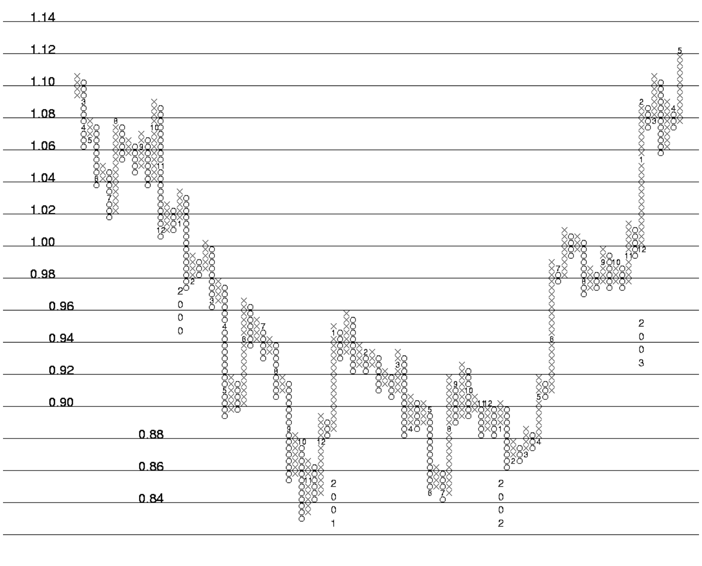
**By inclination, George W Bush began his presidency with a humble foreign policy, but following 9/11, it resembles Teddy Roosevelt's, "Speak softly and carry a big stick".** Following Afghanistan and Iraq, this does not mean that other pre-emptive strikes and regime change wars are being planned, and America has never sought an empire. The US's first option will always be to negotiate in pursuit of its goals of national security and global democratisation. However negotiation will be backed by overwhelming military strength, for the protection of America's homeland and also its allies.

**This requires a great deal of money -** far more than the US economy could generate even if it grew at 5 percent per annum anytime soon, which it won't. Need $50 billion for the war against terrorism - print it. Need $75 billion for the war against Saddam Hussein's regime - print it. Need $380 billion for the defence budget - print it. Need $40 billion for homeland security - print it. Need umpteen $ billions for foreign aid - print it. I exaggerate to make the point because many of these programmes overlap and the world's largest economy generates an enormous amount of tax revenue, even while experiencing tepid growth. However this money is soon gobbled up by all the other expenditure in a developed economy, including social programmes. The US economy is on track to record a budget deficit of $304 billion in fiscal 2003, according to Bush Administration figures, and the deficit could easily be considerably higher, according to private estimates. The government will borrow, of course, but it will also monetise a considerable portion of this debt.

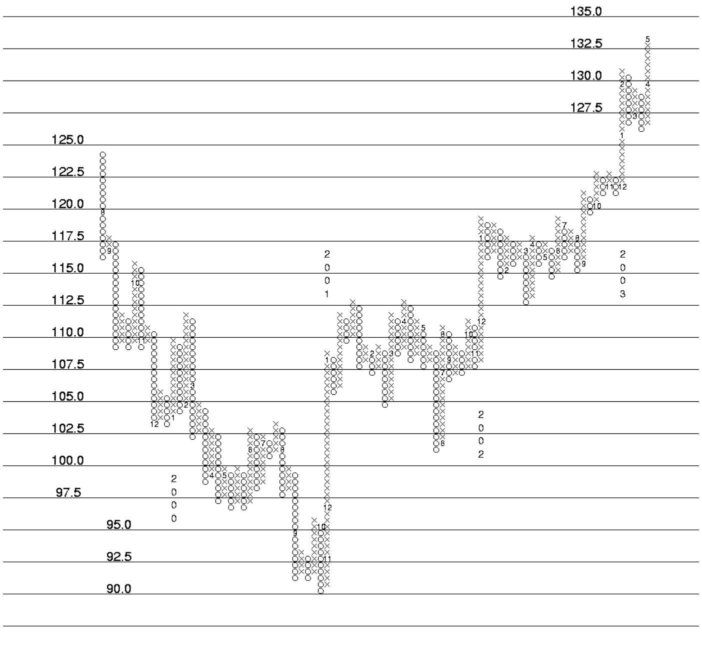
**How can the US monetise debt without the dollar collapsing?** The dollar has weakened, of course, and there is still no sign that it has reached a significant floor against the euro, which has now recovered from depressed levels. Privately, US officials are delighted to see the dollar fall back from its strength up until mid-2001. Their solution to that problem was effectively - if the entire world wants US dollars, increase the supply. US Treasury and Federal Reserve officials know that GDP growth is the key. If the US economy continues to grow faster than Euroland and Japan, there is no chance of the dollar collapsing, although additional supply will weaken it, as we have seen. Also, among foreign holders of US dollars, Japan, China and Euroland have the biggest positions by far. China is diversifying into euros but with the yuan pegged to the greenback, it will not be overly concerned about the dollar until it is prepared to revalue or float its undervalued currency. This is not likely to happen anytime soon, judging from statements by Chinese officials. In Japan, bureaucrats fear nothing more than an appreciating yen, so they are very unlikely to sell.

**How will Japan and Euroland respond to their economic problems, compounded by a weaker dollar?** The Japanese have repeatedly intervened in forex markets, selling yen for dollars to prevent their currency from rising. This has been modestly successful over the years, but too often intervention was undermined by former BoJ Governor Masaru Hayami, who sterilised (mopped up) the yen released. The new Governor, Toshihiko Fukui, will not sterilise and Japan's MoF will certainly intervene again, if necessary. Moreover, I maintain Japan will be forced to adopt radical monetary reflation. While Japan does not have the US's geopolitical and military responsibilities to finance, it does have a much weaker economy. Therefore I believe we will see a flood of credit creation (the modern equivalent of printing money) coming from Japan over the next few years, to prevent its deflation from spiralling. In Euroland, the very last thing any export or tourist industry wants is an appreciating euro. The ECB will be under increasing pressure if the euro moves higher over the medium term, as is probable, not due to economic strength in the region but because it is seen as the "least ugly" choice among the three highly liquid reserve currencies. Market trends often overshoot and this could easily happen to the euro. If so, the ECB's first strategy would be to

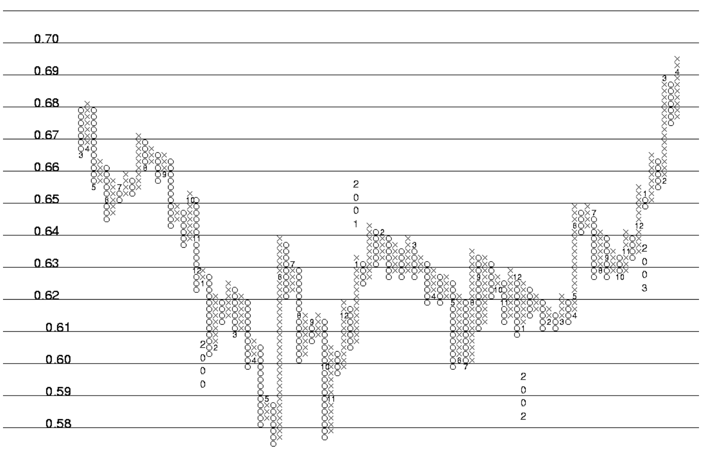
## US Dollar per 1 Euro (0.004)



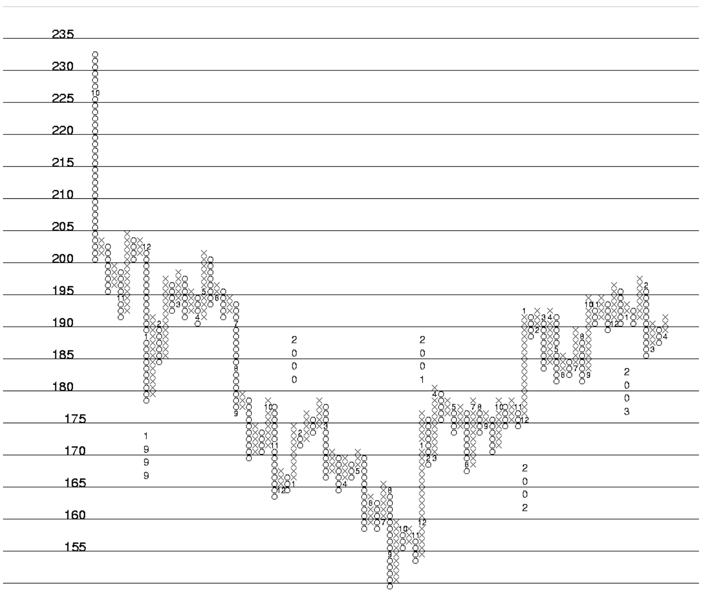

## Japanese Yen per 1 Euro (0.5)




## Pound Sterling per 1 Euro (0.002)




## Japanese Yen per 1 Pound Sterling (1)




reduce interest rates, but this would have little effect as they are considerably lower in the US and Japan. Consequently the ECB would be forced to intervene, first verbally and then by selling euros for dollars. However this would almost certainly be unilateral rather than multilateral intervention, and therefore unlikely to work for long. The ECB would be left with no alternative but to increase the supply of euros. The long-term beneficiary of fiat money creation will be the price of gold.

**Chart review of important and topical currencies**

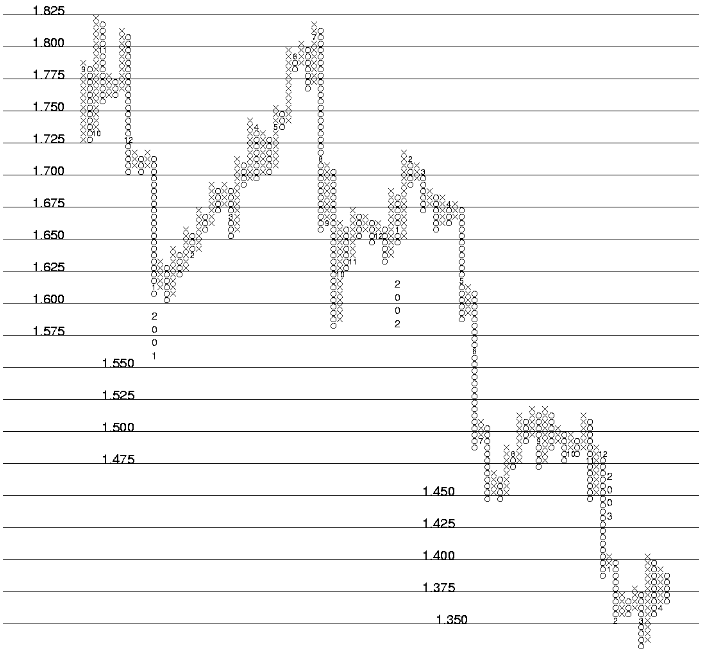
**-** *These and hundreds of other 3-box reversal closing basis point & figure charts are available on our website, www.chartanalysts.com and are updated daily. All comments refer to closing levels for US trading hours. Please note, the charts were completed before the comments and prices shown.*

**Euro/dollar ($1.1336) -** The euro has extended its advance and while the choppy nature of the last pause suggests that some further consolidation could be seen, a move under $1.08, which appears unlikely, would be necessary to check upside momentum beyond a brief pause.

**Euro/yen (¥134.10) -** The euro has resumed its uptrend following a 2-month consolidation and reached the early-1999 peak at ¥134 - not shown, see www.chartanalysts.com (requires subscription). This is unlikely to provide more than temporary resistance and a move under ¥128, which appears unlikely, would be required to question overall momentum, which has increased in recent months.

**Euro/sterling (£0.7044) -** Following a 1-month consolidation, the euro has resumed its steepening uptrend. A move under £0.6820 is currently required to check upside momentum beyond a brief pause.

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




**Sterling/yen (¥190.38) -** The pattern remains choppy because this is a less dynamic trend than we see for Continental European currencies against the yen. Nevertheless we appear to have seen the reaction low and sideways to higher ranging is likely, towards psychological resistance near ¥200.

**Dollar/Swiss franc (SF1.3367) -** The dollar is easing towards its October 1998 low at SF1.315 - not shown - once again. A move over SF1.405 is now required to remove pressure from that former floor.

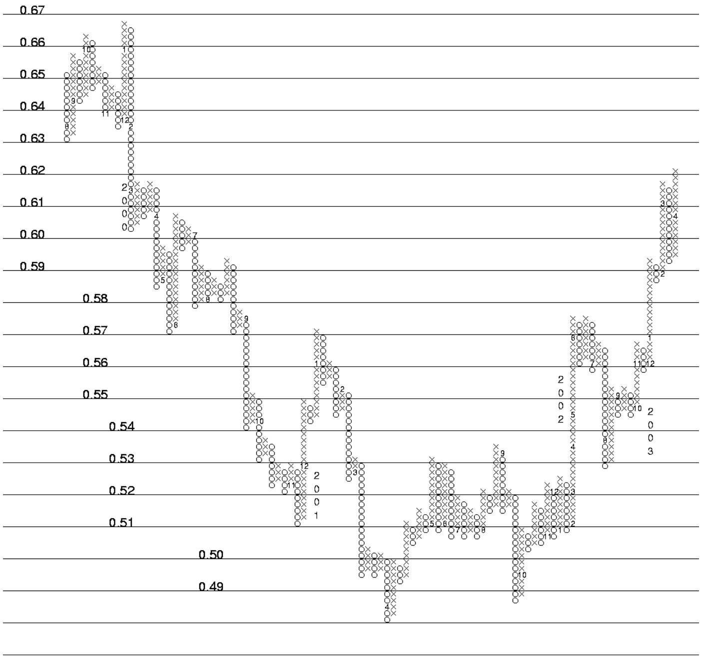
**Dollar/yen (¥118.31) -** The dollar remains rangebound against the yen. A move to ¥117 is required to indicate renewed pressure on prior lows down to ¥115, dating back to February 2001. Conversely, a move to ¥122 would suggest a further test of overhead resistance.

**Sterling/dollar ($1.6095) -** The pound has rebounded from support established between late June and early December 2002. A decline to $1.55, which appears unlikely, is now required to offset scope for sideways to somewhat higher ranging.

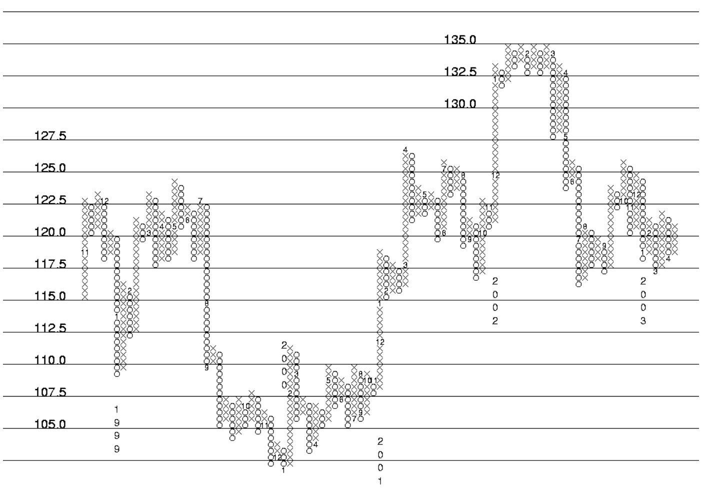
**Australian dollar/US dollar (US$0.6373) -** The Australian dollar has resumed its advance following a consolidation. While historic resistance - partially shown due to insufficient space - is formidable, and the latest rally is beginning to appear overextended, a move to US$0.6140 is currently required to question upside momentum beyond a brief pause.

**Australian dollar/yen (¥75.37)** - *see overleaf* - The Australian dollar has finally broken above prior resistance dating back to January 2002. A decline to ¥72 is now required to question higher scope towards the next area of former resistance evident between ¥77.50 and ¥82.00.

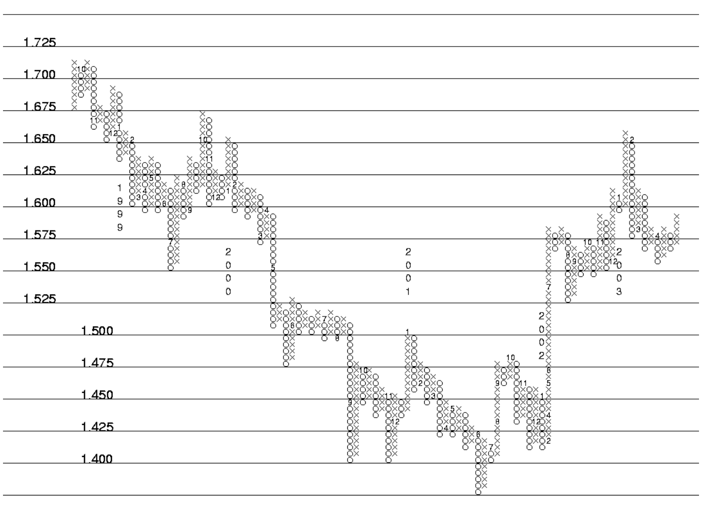
**US Dollar per 1 Austrailian Dollar (0.002)**



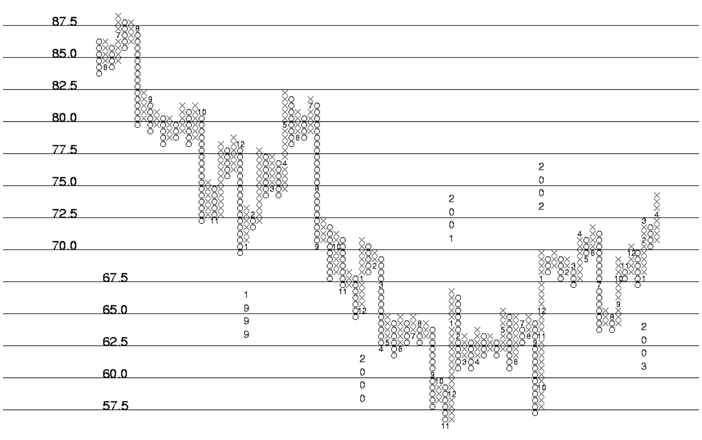

**Japanese Yen per 1 US Dollar (0.5)**




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



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




**Strategy on currencies -** The euro is certainly in form, evidenced by its resumption of gains against all other viable currencies. While long euro has become the most profitable trend in recent months, it's an increasingly crowded pitch. Bold forecasts of additional gains are a sign of complacency, sometimes unwittingly used to mask an intuitive perception of growing risk. Remember, the strongest trend in the world usually becomes the weakest just after it stops. This does not mean that one should take profits on long euro trades, let alone reverse them without a dramatic technical signal. One-way traffic is extremely profitable, while it lasts. The appropriate tactic for trends that are gathering momentum is the trailing stop. What could trigger the euro's next correction? A further rally on Wall Street; a warning from a Euroland monetary official; complaints by euro-zone company spokesmen, or gravity. As one who frightens easily in a fashionable trend (not necessarily a tactical virtue), I sold my remaining euro/yen too soon, easing them out on the Baby Steps basis. A trailing stop would have been preferable, as the euro remains the currency in form, but I thought we might see more ranging before the single currency moved higher. I would consider reacquiring on any pullback within the trend that appeared to be no more than a consolidation. The same tactics apply to leveraged euro/dollar positions and other euro crosses, especially the trailing stop. Overall, I continue to prefer yen shorts to US dollar shorts, although both currencies have been equally weak recently. I maintain that Japan's deflationary problems necessitate a weaker yen. While this is debatable, just like any other view, we know that Japanese monetary authorities are determined to prevent the yen from appreciating, especially against the dollar. Consequently, I have been willing to sell the yen lightly, whenever it firmed towards ¥117 against the greenback, and partially reduce on rallies back above ¥120. However I'm less interested, given all the other in form yen crosses, such as Australian dollar or Canadian dollar/yen, and for UK tax-favourable spread-betting, sterling/yen. Therefore I'm temporarily phasing out dollar/yen. I would certainly regain interest if the dollar broke under ¥115, as many suspect, or if the greenback established itself above ¥122, which I think is more likely.

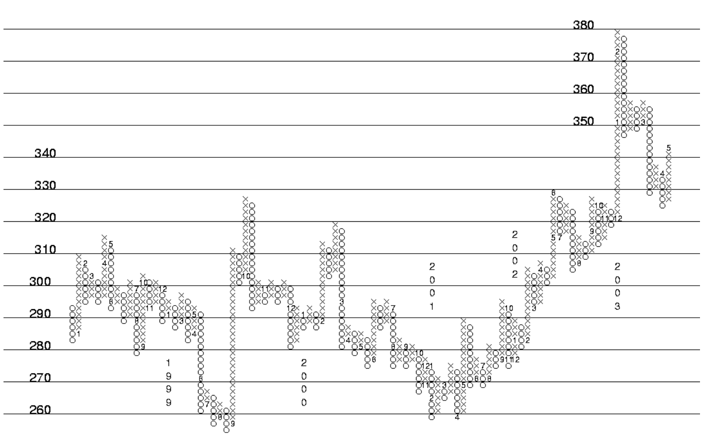
## Commodities

■ **Gold is forming its first step above the base, in the very early stages of a secular bull market.**

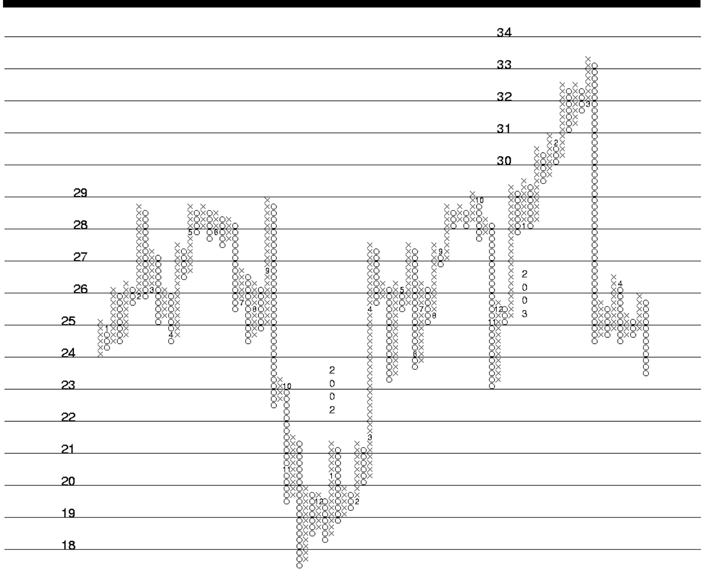
■ **For crude oil, upward scope remains limited to top extension before lower prices are seen.**

**In terms of perspective, I believe that gold today is where stock markets were in 1981.** Back then expectations were low and most people didn't want to know. However canny investors, including Warren Buffett, were accumulating stocks. He had actually commenced buying equities in 1978, as a value play. Buffett bought silver bullion in 1997, around current prices, and I believe he still holds it. I maintain that gold near today's prices is a value play, especially given the outlook for fiat currencies (paper money) as more central banks fight slow growth and deflationary pressures. Silver usually tracks gold's directional moves, but with a higher beta. Technically, the US dollar price of gold is ranging in 'the first step above its base', as taught at The Chart Seminar. I maintain it will range for months, mostly between \$330 and \$380, before extending its recovery. Remember, there are lengthy pauses in the early stages of long-term bull markets, because most people

**Gold CMX 2nd Month Continuation (2USD)**




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



are not involved. I believe this is the accumulation phase for gold and silver. Central banks with large reserves of US dollars are among the buyers of gold bullion. People have been quick to observe that gold has only risen in response to the dollar's fall. True, but that's the way it starts.

**Shortly after its early-March peak, crude oil plunged over a 7-day period, in the sharpest decline for many years.** The long-term continuation chart - partially shown - *see www.chartanalysts.com (requires subscription)* - shows a huge multi-year top, with peaks in October 2000 and March 2003. The latter peak was slightly higher and the subsequent fall much swifter. After the late-2000 fall, crude oil encountered support just above $25 and ranged up to $31.2, before eventually resuming its decline in September 2001. This time, a steeper decline following the March peak suggests a shorter period of top extension ranging before crude oil falls further towards its November 2001 low at $18, despite OPEC cutbacks and a delay before significant production from Iraq is seen.

## The Global Economy

- **The short to medium-term outlook is improving - probably.**

- **The price of oil will remain a key variable.**

- **Severe acute respiratory syndrome (SARS) is a potentially serious economic problem, especially for Asian economies.**

- **The global economy's macro picture remains worrisome.**

**While the current flow of historic GDP data is dire, it should improve in the next few months, at least in the West.** Both the build-up to war and its unfolding have been bearish for the global economy. For months, including during the UN inspections process in Iraq, business and consumer spending declined due to uncertainty, first over whether or not there would be a war and then over its timing. Once the war commenced, spending was further delayed as people watched events, uncertain of the conflict's duration and whether or not there would be any related problems, such as higher oil prices, turmoil in the Middle East and increased terrorism, as some had forecast. This cloud of uncertainty is now lifting. Militarily, the war was an outstanding success for Coalition forces. While winning the peace was always going to be the more difficult challenge, and this process has only just begun, there has been no cause for undue pessimism so far. It would be premature to rule out further terrorist attacks but, arguably, Coalition resolve and the US's awesome display of firepower are more likely to deter than encourage al-Qaeda and its kind. Against this background, it is highly likely that there will now be some pickup in business and consumer activity, particularly in the US. We should see the evidence by mid-year. Whether this is a blip on the global economic screen or a significant rebound will depend on events yet to unfold, not least being the trend for petroleum prices. The other major factor is SARS - already a serious economic blow to East Asia, previously the world's fastest growing region.

**OPEC attempts to halt the oil price slide.** Oil producers benefited, because the UN Security Council's delaying efforts before regime change in Iraq kept prices higher for longer than would have otherwise been the case. However with only minimal damage to Iraq's oil installations during the war, petroleum prices never spiked to levels predicted by many. Now OPEC is worried, because it remembers what happened following the last Gulf War. Saudi Arabia increased production in 1991, as a debt of gratitude to the US, and petroleum prices slumped. No similar move by the Saudis is in prospect, but the war premium is gone and oil production from Iraq should resume in the next few months. Middle Eastern governments are not happy to see the US in control of Iraq and, being authoritarian, fear the introduction of democracy in a predominantly Arab state. Ineffectual in the face of US military power, and with even covert support for terrorism a high-risk strategy, the Middle East has only one weapon - oil. Consequently Gulf States are meeting to discuss a cut in production, in which they hope non-OPEC states such as Norway and Russia will participate. This firmed the oil price in mid-April, pushing it back above $30 (spot NYME).

**The stakes are high.** Oil producers understandably want high prices for their primary export. Conversely, oil-importing countries, having struggled with slow GDP growth and recession in recent years, partly due to increased costs for energy since mid-2000, want lower prices. While talk of another supply cutback by producers has lifted the oil price recently, OPEC is less influential than before and stands to lose further control over the petroleum market. Historically high prices for oil in recent years have led to increased production outside OPEC, while technology has assisted in the more efficient use of energy. Russia, which is second only to Saudi Arabia in terms of oil exports, is unlikely to cooperate with OPEC on production cuts. Since Russia is also a major exporter of armaments, often to totalitarian regimes, the Kremlin has an interest in other countries' confrontations, because these can boost both military expenditure and the price of oil. Russia has just lost one of its major arms buyers and it may also be cut out of Iraq's future oil development as well. Consequently its pressing need is to boost revenue by increasing oil production, while hoping that geopolitical factors lead to higher prices. OPEC ministers know that their ability to manipulate oil prices will be further eroded by renewed production from Iraq. Prior to the war of liberation, Iraq was producing 2 million barrels a day, in the so-called oil for food programme, permitted under UN sanctions. Furthermore, it was exporting additional oil illegally, mainly through the pipeline into Syria. While that route has been closed and there is currently no oil flowing from Iraq, this is about to change. With the help of US petroleum engineers, Iraq's production should approach pre-war levels within a few months. More importantly, Iraq has the potential to produce from 4 to 6 million barrels a day within the next two years. While OPEC will hope for Iraqi support in controlling production, the country's next regime is likely to be friendly towards the US. Moreover it will have compelling domestic reasons for maximising oil production. Against this background, OPEC members are likely to conclude that their own efforts to curb production, in the interests of higher prices, will do little more than subsidise other oil exporters. Consequently supplies are likely to increase from all oil-producing countries, driving the price down to the $20-$15 range, from which it is unlikely to stray much over the next several years, offering some assistance to the global economy. However, demand for oil is certain to rise, not least from China, as global GDP growth eventually improves. This should prevent the price of oil from returning to $10, a level last seen in 1999, and considerably higher prices are likely over the longer term.

**SARS is a problem for the global economy and especially Asia, although its extent is currently unknowable.** The death rate from SARS is climbing towards 10 percent of the people infected. However this figure could increase since most who die from SARS live for 3 to 5 weeks after the disease is first diagnosed. The recovery percentage to date is 54 percent, and should also climb. Clearly, SARS is less lethal than AIDS, although it is much easier to catch. Therefore SARS is more of a worry than AIDS, for most of us. You and I, presumably, are very unlikely get AIDS. However, were we to visit Beijing, Hong Kong, Singapore or anywhere else with the misfortune to experience an outbreak of SARS, there would be a small risk. Most people will avoid unnecessary risk to their health, especially if it is life threatening and there is no accompanying gratification. Consequently, any region with more than a handful of SARS cases is experiencing a slump in business travel, tourism and consumer spending. Statistically, SARS is a minor event so far. However, until the rate of infections and deaths are clearly in decline, I would not underestimate its economic consequences in the regions affected. The very good news is that SARS cases have been quickly identified and isolated, outside of China. However even if China now succeeds in controlling the spread of SARS, this will not necessarily eliminate the risk that it could mutate and reappear at a later date.

**For anyone seduced by "new paradigm" talk in the late 1990s, today's economic environment must look like a perfect storm.** It is just over 3 years since the biggest bubble in history burst, and the fallout continues. Debt problems at government, corporate and consumer levels have mostly increased; confidence continues to wane; deflationary pressures remain, compounded by China's role as manufacturer of last resort. Additional ingredients in this recipe for a dysfunctional global economy are expensive oil, terrorism by Islamic extremists, the war for regime change in Iraq, a deterioration in European/North American relations, a house price bubble in a number of countries, not least the UK and US, and now SARS. Short of a doomsday rock, this must be close to 'the full Monty'. What next? The case for a partial recovery is outlined above. Beyond this, I maintain that we will see a sustained period of slow GDP growth over the next decade or more. This will be characterised by pockets of deflation, leading to stagflation and eventually another inflationary cycle in response to credit creation.

## And Finally…

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> "When it comes to politics, you can never totally rule out sincerity."
>
> Jean-Michael Helvig

Best regards - David Fuller

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