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

The global stock market recovery remains intact, albeit maturing. Asia continues to lead and Europe is now lagging, in line with GDP growth prospects. While this rally should carry into 2004, significant peaks are probable next year, with the timing most likely determined by Wall Street.

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The Chart Seminar: Nov 6th and 7th in London is a sell out. Technische En Kwantitatieve Analyse seminar and conference on Nov 14th and 15th.

Riding merrily towards the next storm

On cycling and market cycles. During a recent holiday my wife and I bicycled from John O' Groats to Land's End, some 1185 miles in 21 days, covering Mrs Fuller's mostly scenic, hilly, restaurant route. When not totally focussed on the views, map reading, unavoidable traffic and physical challenge for this 61-year-old scribe, the contemplative journey reminded me that cycling and financial markets have a lot in common. There are frequent ups and downs. When riding with the prevailing wind (trend), it's both easy and fun. However pedalling into a headwind (against the market trend) requires much effort for slow progress. The difference is enormous. We were riding touring bikes with panniers, which contained everything we needed for 3 weeks. Thus loaded, our speed over gently rolling terrain could vary from the mid-20s (mph) to low single figures, depending on the prevailing wind's force and direction, which is in one's face more often than not on the North to South route. And there were a great many hills, which I usually enjoy for the challenge and views, especially when there is a nice freewheel down the other side. My odometer recorded a top speed of 46.2 mph coming off Dartmoor, but to reach that beautiful and austere terrain, I laboured at a lowly 2.7 mph on the 1-in-4 climb up from the village of Chagford. As with market cycles, my accelerating freewheel (trend) was almost invariably followed by a sudden, sharp reversal. My bike has 27 gears and I had to use them all on the most challenging days, especially the lower ratios. As with markets, failure to shift in time with the changing terrain and I was hurting. Too much wine at lunch and I couldn't read the Ordnance Survey map (chart) as effectively, invariably to my cost as I became lost, not to mention the understandable partner consternation, resulting in my being temporarily relieved of a responsibility happily entrusted to me most of the time. Losing one's bearings on a map, or in the markets, is a distinctly uncomfortable experience.

From methane to mediocre. For me, cycling is the best way to see the countryside. Walking is too confined and inefficient, and one does not really commune with nature when behind the wheel of a car. On a bike, one sees and smells everything. Cycling through vast expanses of flowering, honey-scented heather on a sunny day in the Scottish Highlands is glorious. Yes, pedalling is hard work at times but some of us thrive on exercise. It's also the route to guilt-free dining. Happiness for this cyclist was managing to lose weight despite eating for England at some very fine establishments. One appreciates the highlights all the more for having endured some of the inevitable lowlights, including rain, midges, suburban or urban squalor and worst of all by far - dangerous traffic. And not all country smells merit another deep breath. I concluded that Britain's livestock produce almost as much methane as our House of Parliament or the EU Commission. If their gas output could

be captured and stored as easily as it is produced, there would be no more blackouts or other energy crises. To keep in touch, I picked up a copy of the Financial Times wherever possible, which I had time to read more comprehensively than when back at the office. It's a good paper, but has its editorial peccadilloes. I could do without the daily gratuitous Bush bashing, which I suspect the FT hopes will establish its European credentials. For contrarian thinkers, there are the reassuringly sceptical articles on gold. And the 'pink one' has a long history of publishing very silly articles on technical analysis at least once a year. The latest one, which summarised technical analysts as, "those who believe that future price movements can be divined from the patterns in past data", was given short shrift by my colleague Tim Parker on 10th September, in the www.fullermoney.com Comment of the Day.

It's not about patterns. Most critics of technical analysis think it is mainly about pattern identification. Yes, there are chart patterns and many of the books on technical analysis have over emphasised them, in my view. Technical Analysis is a broad church but few of the experienced chart readers I know emphasis patterns - an identikit attempt to classify and simplify the infinite permutations and flow of price action. The beauty of the price chart is that it plots the net result of supply and demand. In other words, for investors and traders, the chart provides a clear picture of the net flow of money into and out of every share, bond, currency and commodity. And for those who understand the basics of what I call Behavioural Technical Analysis, they also reveal changes in crowd psychology - from uncertainty to irrational exuberance or panic. For this investor/trader, charts have made all the difference. I'd be flying blind without them.

From 'wall of worry' to increasing confidence before the approaching storm. Paradoxically, markets are least risky when a majority of investors regard them as most risky, and vice versa. While a market slump obviously discounts bad news, it can also create an impression of increasing hazards, not least among those who contribute to capitulation selling. When someone sells in a falling market, the last thing they want to believe possible, let alone see, is a sudden rebound. Similarly, those who pile into an accelerating uptrend do not want to hear about risk, let alone see a sudden downturn. Last March, after three years dominated by selling pressure for equities, and with widespread fears over the war against Saddam Hussein's regime, few commentators were willing to predict more than a short-term rally for shares. However in the last seven months a powerful stock market recovery has discounted the 'Baghdad bounce', accommodative monetary policy, economic recovery in the West and strong GDP growth in most of Asia. Consumer and corporate sentiment continue to improve, unemployment is falling and following generally better results due to downsizing by companies, fundamental analysts are raising earnings forecasts and talking about 'top-line' profits. In other words, markets have priced in a fair amount of good news, although it hasn't been one-way traffic recently. Most stock markets experienced a minor bout of anxiety during the second half of September, especially in Europe, triggered by the US dollar's fall and an unexpected decision by OPEC to cut oil production. Psychologically, hurricane Isabel, described as potentially the worst for years, probably contributed to Wall Street's concerns. These events led to some bearish comments about unfavourable seasonal factors and reminders that stock markets have experienced the occasional downdraught in October. However US stock indices rebounded faster than they fell and most emerging markets surged to new highs for the year. Only European indices lagged, and this was due to concern over the euro's strength. Consequently, there is still no clear evidence that the global stock market recovery is ending. As seasonal jitters wane, investors are likely to focus on prospects for a yearend rally, which would also be viewed as a favourable sign for 1Q 2004. Nevertheless, a perfect storm of factors likely to end this excellent medium-term rally is already visible on the distant horizon.

Factors likely to end the stock market recovery in 2004. The US dollar - there is a fine line between an orderly and necessary currency adjustment, and a feeling that it is out of control and therefore a crisis. We are sailing close to that line. Interest rates - the bubble in government bonds burst in June. A further stock market rally and/or evidence of additional economic recovery would lift yields, eventually undermining equities. Higher short-term rates would have the same effect on stocks. The US deficits - Regardless of who wins the US presidential election in November 2004, both the White House and Federal Reserve are likely to introduce deficit-reduction measures, which will curb spending.

Interest Rates and Bonds

- **Short-term interest rates are likely to remain on hold in the major economies, although evidence of further economic recovery will obviously increase scope for hikes.**

- **Long-dated government bond yields appear to be in a base extension phase, prior to further gains.**

Strategists are expressing different views on short-term rates, partly because central banks have yet to make up their minds. The Fed is unlikely to raise rates until at least well into 2004, as it remains focused on avoiding deflation and boosting GDP growth sufficiently to help the budget deficit. The ECB has the best economic case for a rate cut, especially if/when the euro extends its gains against the dollar. However it remains to be seen whether or not Jean Claude Trichet, the new ECB Governor, is more flexible on policy than his predecessor. Despite minimal GDP growth in the euro zone, some analysts forecast a rate hike by the ECB, which would be suicidal without clear evidence of economic recovery. The BoE's Monetary Policy Committee is edging towards a rate hike. Japan will keep rates near zero, given their history of failed recoveries over the last dozen years. The clearest case for rate hikes is in booming emerging markets, although they may wait longer as most have appreciating currencies. South Africa will continue to cut rates, to curb the rand's rise.

Japanese 10 Year Bond Yield (0.025)

US 10 Year Bond Yield (0.025)

Only growing concern over recession and deflationary pressures would prevent long-dated government bond yields from rising further. Currently, an increasingly synchronised global economic recovery is unfolding, led by Asia's emerging markets. While the US's "impressive" growth is undoubtedly flattered by creative accounting, and will be difficult to maintain when politicians address deficit problems from 2005, it is still improving. Euroland's economy is lagging but should experience some lift from the recoveries elsewhere. Meanwhile, technical evidence continues to suggest that the government bond bubble burst in June, when markets reflected deflationary fears and hopes for government support buying. Japanese 10-year government bond yields would certainly be much higher if it were not for the BoJ's massive buying programme. US bond yields would be higher if it were not for foreign purchases, led by Japan and China, partly to offset upward pressure on currencies against the dollar. Consequently the recent, modest rally in long-dated bonds looks like no more than a technical reprieve and base extension phase, prior to a test of the September highs for yields.

Strategy on bonds - I have no investments in long-dated government bonds, which I think are very risky. For this reason, and regarding bond prices as likely to be in the top extension phase of a secular bear market, I resisted the temptation to buy futures for last month's predictable technical rally. If I had a position today, I would be short, but have been content to watch, as the initial transition from bull to bear trend is often choppy.

Global Stock Markets

■ **The medium-term rally for all stock markets, within Wall Street's secular bear trend, remains on track.**

Climbing the 'wall of worry'. Stock market investors had a minor anxiety attack during the second half of September. Some of you may have noticed that this coincided with hurricane Isabel, the worst storm to hit the US Southeast coast for quite a while. At the risk of sounding like an analytical fruitcake, I'll make a behavioural connection. We investors can be an anxious lot, grateful for the markets which provide opportunities to increase our financial well being, but only too aware that they are a double edged sword. For that reason, to our occasional chagrin and against our better judgement, after one of those nocturnal nature calls, some of us are known to switch on the TV and briefly check overnight market action on Bloomberg or CNBC, to see if everything is OK. It's not unlike looking in on your sleeping children when they were young. What does this have to do with hurricane Isabel? A random storm reminds us that safety is finite. Even Mother Nature, generally benign, creates chaos from time to time. This can serve as a wakeup call, even for those far away from the storm, heightening our perception of risk. I certainly would not have used the headline, "Winds of change", for the warning in my October 1987 issue, which veteran subscribers may recall, if the severe hurricane that flattened so many trees in London had not crystallised my perceptions regarding risks in the stock market at the time. Clearly others had the same intuitive feeling. Hurricane Isabel, I believe, triggered a similar perception of vulnerability and risk among some market commentators, leading to a number of reminders that markets do sometimes crash, including an article from The Wall Street Journal, written in early October and posted on my website Comment of the Day for Wednesday 8th October. Right or wrong, as time will prove, I debunked that comparison on my website and in the Subscriber's Audio. While the hurricane and falling dollar, which we also had in 1987, was sufficient to trigger a small correction, parallels with earlier crashes stop there.

There are four main differences between October 1987 and October 2003. Back then stock prices had risen for three years, during which the S&P 500 index climbed from 147.82 to 336.77, a gain of 128 percent. Investors everywhere were euphoric. Investment managers believed 'portfolio insurance' (hedging with futures) offered them protection against a sell off. And most importantly, short-term interest rates were rising. Despite these important differences, I certainly don't want to be complacent, especially during what I maintain is a very good medium-

term rally (technical bull, as some have called it) within a secular bear market. Therefore I'll continue to monitor price chart action very closely, concentrating on trend consistency and dynamics, rather than the psuedo-technical stuff that we sometimes see. A wobble or two aside, as I have frequently mentioned in the Subscriber's Audio, my guess is that the ranging, liquidity driven market recovery will continue through at least yearend. It might just carry well into 2004, not least because the Bush administration will do everything within its considerable influence, with the help of a currently accommodative Fed, to prop up the stock market during an election year. If I'm wrong, the main trigger for an earlier peak would probably be the US dollar's weakness. If correct, I still maintain that we will see a very important stock market peak sometime next year. Timing may be determined by central bank policy on interest rates, or widespread perceptions that the dollar's decline is no longer a necessary adjustment, but turning into a crisis.

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

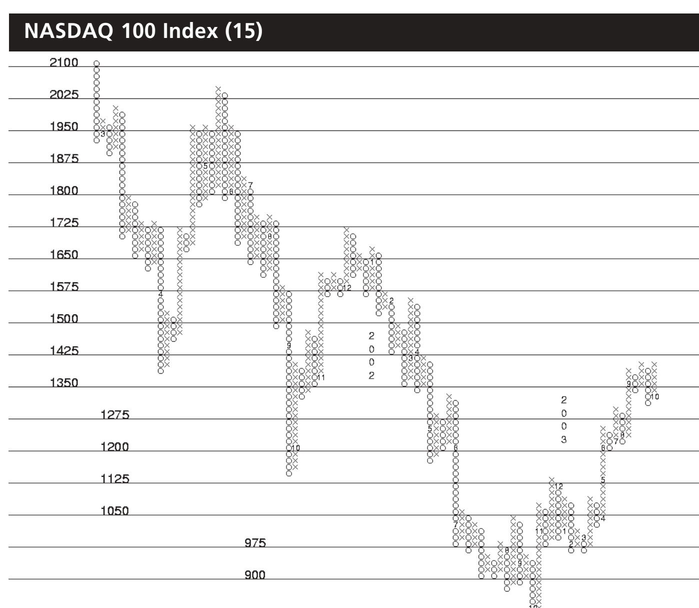
The US's S&P 500 Composite Index (1046) has been consolidating around the psychological 1000 level, above the small base. A clear break below this level is now necessary to offset somewhat higher scope. **The NASDAQ 100 Index (1413)** has also been consolidating above its small base. A decline to 1290 is now required to indicate a deeper correction before a further test of overhead trading occurs. **The Amex Gold Bugs Index (198)** saw a downside key day reversal on 25th September - see website Comment of the Day for that day and also the 26th - in response to its temporarily overextended advance. Consequently some further ranging is likely before the February to June 1996 peak is further challenged.

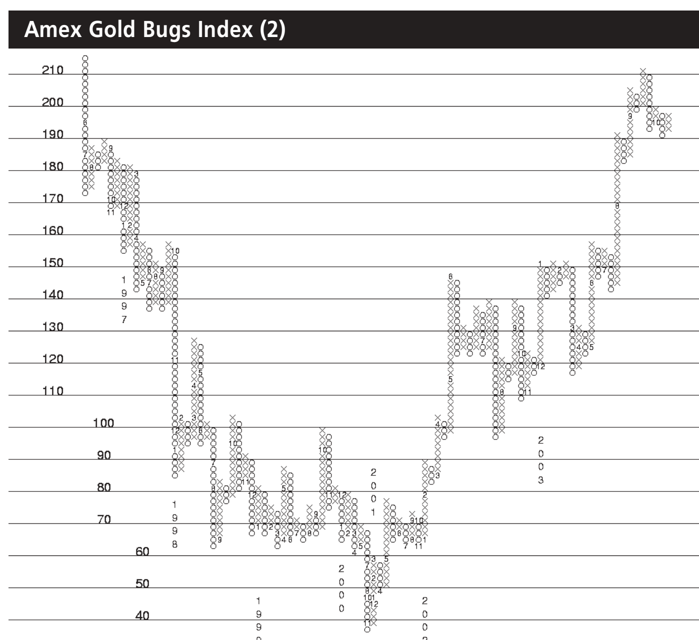
Japan's Nikkei 225 Stock Average Index (10786) is consolidating gains following the advance to 11000. A decline to 10200, which appears unlikely, would be necessary to offset near-term scope for additional gains and to suggest that a potentially lengthy base extension phase had commenced.

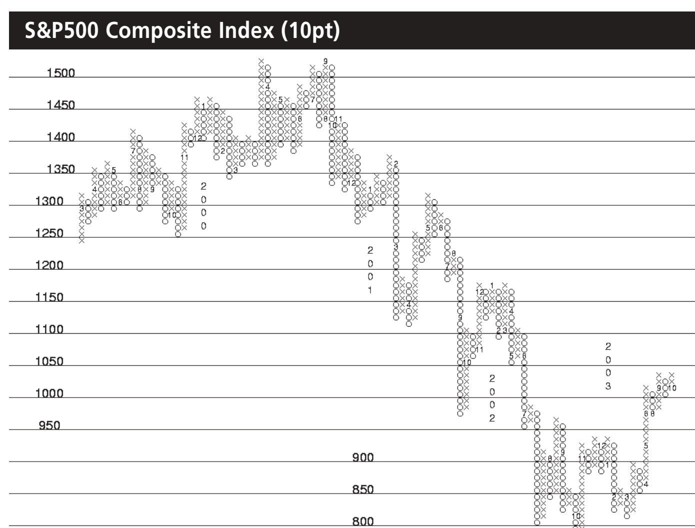
Australia's S&P ASX200 Index (3276) has extended its consistent push into the large, multiyear top in the best gains since 4Q 2001. A move under 3160 is needed to check upward progress beyond a brief pause.

Singapore's Straits Times Index (1750) has extended its rally towards previous resistance from lateral trading evident near 1800. Nevertheless, a break in the current progression of higher highs and higher lows would be necessary to indicate more than a brief pause.

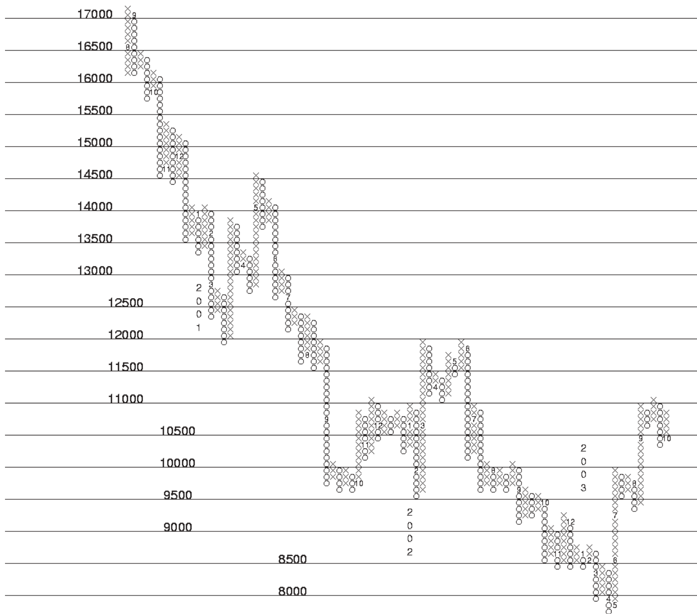
Thailand's Bangkok SET Index (578), a relative strength standout in recent years, appears to be completing a





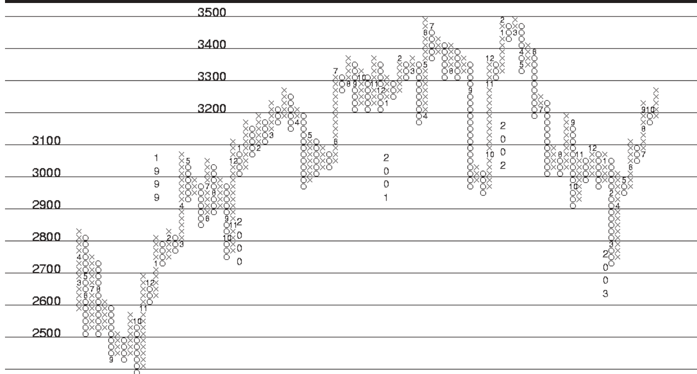


Nikkei 225 Stock Average Index (100pt)

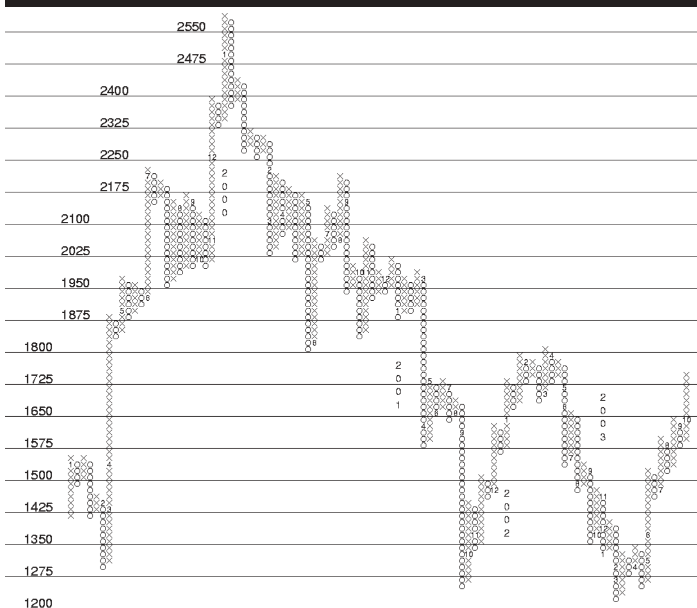


consolidation above the 1998 and 1999 peaks. A decline to 545 is now required to suggest an upside failure and deeper correction before the large underlying base supports further gains.

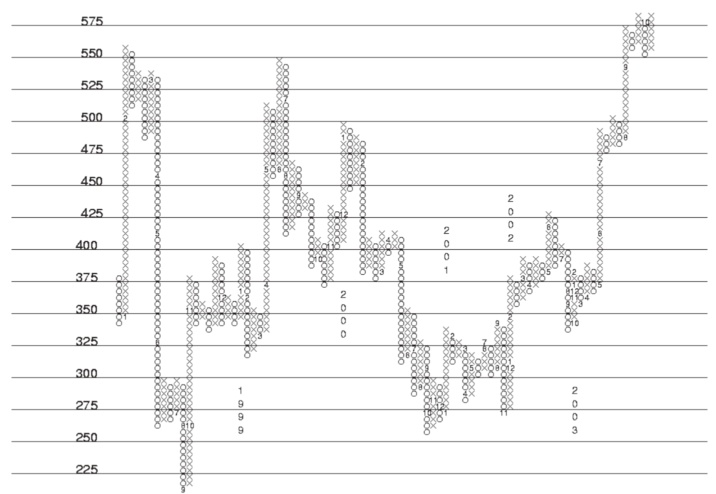
Australia S&P ASX200 (20pt)



Singapore Straits Times Index (15pt)



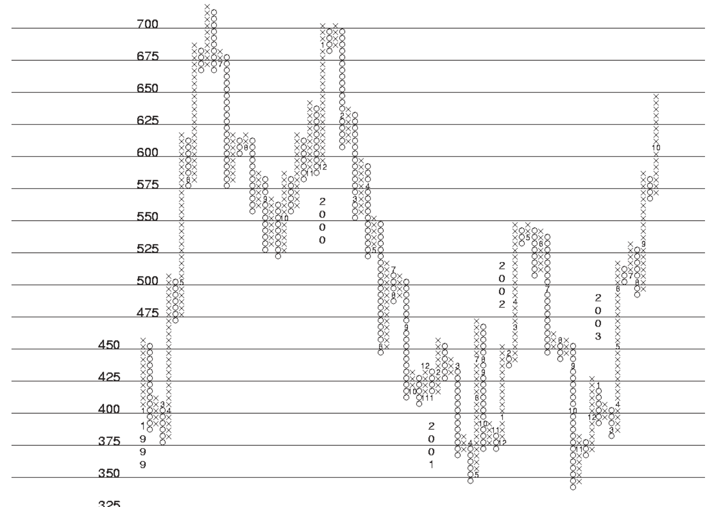
Thailand Bangkok SET Index (5pt)



Indonesia's Jakarta Composite Index (644), another relative strength standout recently, shows some acceleration and is approaching psychological resistance from the 1999 and 2000 peaks at 715 and 700, respectively. Consequently further near-term gains are likely to be followed by another reaction in coming weeks.

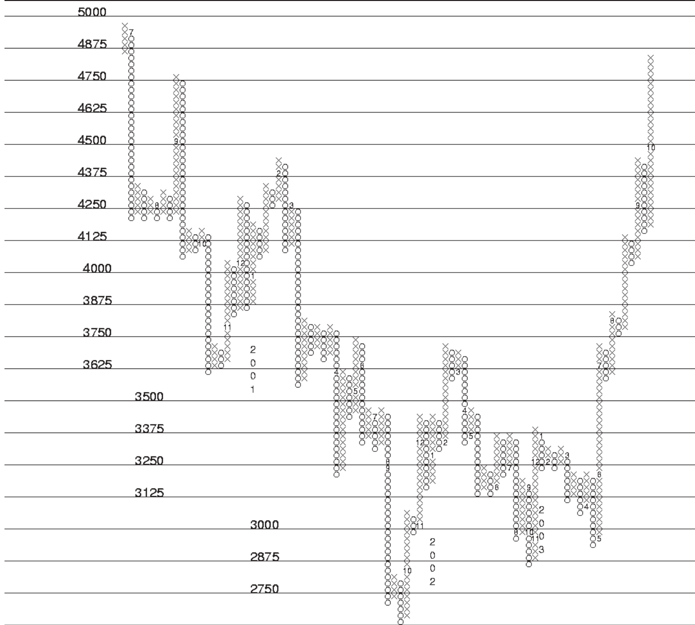
India's BSE SENSEX Index (4849) - *see overleaf* - has powered ahead once again following a brief but larger

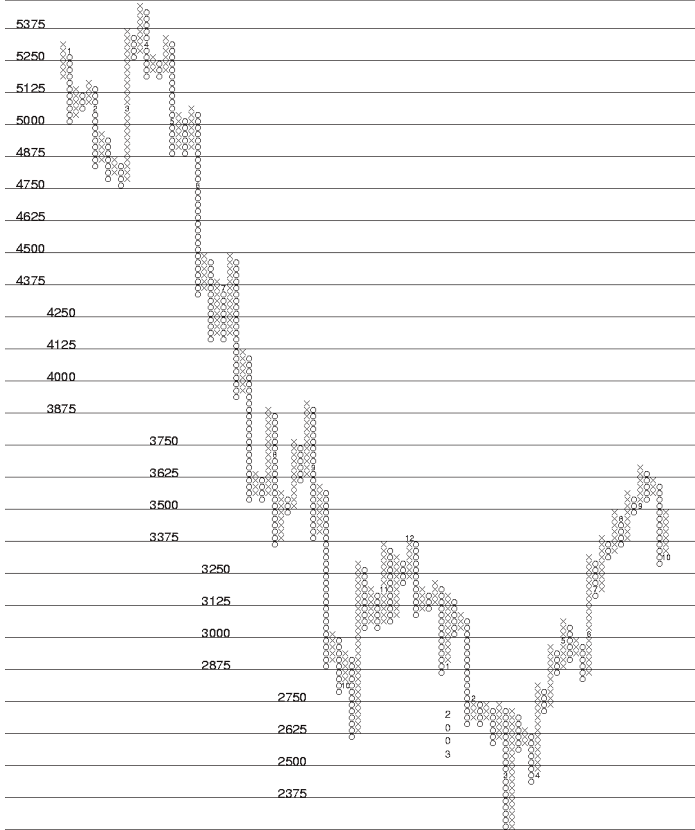
Indonesia Jakarta Composite Index (10pt)



correction than the small reactions seen previously within this advance. However the main consistency characteristics are the 3-column step sequence, one above the other, and the progression of higher highs and higher lows. Until they are interrupted, the path of least resistance remains upwards.

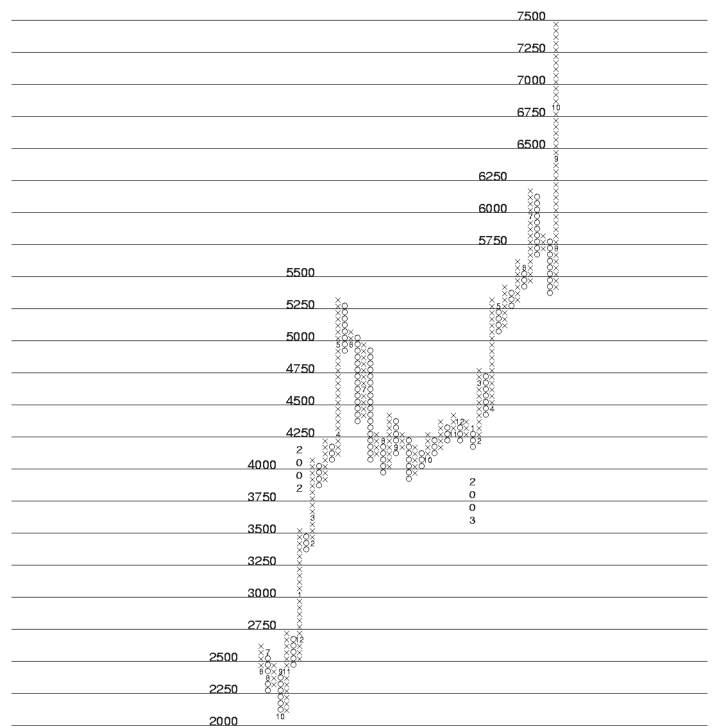
Germany's DAX Index (3541) - *see overleaf* - fell sharply to break its uptrend consistency in September, following a lower high. While it subsequently recouped nearly two-thirds of that decline, the September high at 3650 is unlikely to be cleared without some further consolidation. Additionally, a break of the recent low at 3275 would suggest that a medium-term peak had been reached.

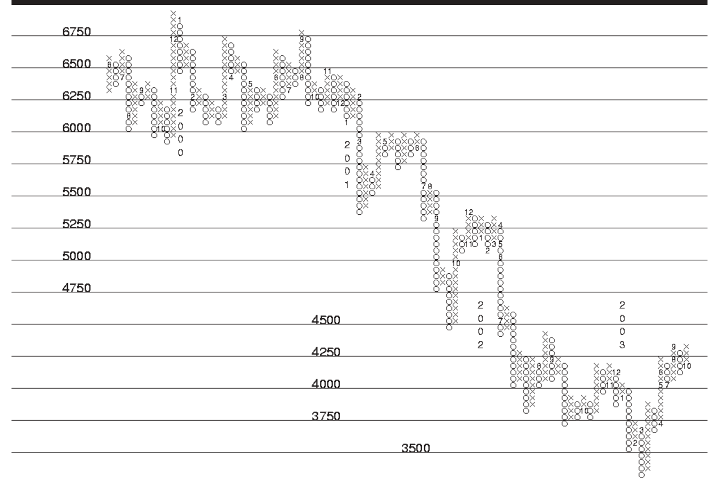




Russia's RSF Index (7397) has been a spectacular performer in recent years. However the advance is accelerating once again, suggesting that further near-term gains will spill over into another correction within the next few weeks.

The UK's FTSE 100 Index (4360) bounced back from its September correction faster than it fell, suggesting that no more than temporary resistance will be encountered just over 4300, before somewhat higher levels are seen.





A decline below 4000, which seems unlikely, remains necessary to offset this scope.

Strategy for stock markets - At this stage of what I have always maintained would be a good medium-term recovery within Wall Street's secular bear trend, I feel it is important to repeat that I am becoming less bullish with each new high for indices and also each passing month. Improving market sentiment at this stage of the rebound is a contrary indicator, saying more about what people have done, rather than what stock prices will do. Consequently September's mini crisis of confidence was good news for those of us who have substantial investments in shares, especially as no technical damage occurred except for some of Euroland's indices, affected by concern over the strengthening single currency. One could see that coming and I have no European investments. I have resisted the temptation to put more money into stock markets, because my intention is to lighten on further strength, probably commencing with some of my UK tax-efficient spread-bets in UK shares -

currently Vodafone, Lloyds TSB and IMI. I also have some previously mentioned high-yielding shares in family ISAs (also tax advantageous in the UK, but restricted to UK-approved positions), which are scheduled for culling over the next few months, hopefully on further strength. I lightened my Asian stock market position slightly, taking profits on a quarter of my Aberdeen New Thai Investment Trust plc holding, which I still like, using the proceeds to buy shares in the Merrill Lynch New Energy Technology plc investment trust (closed-end fund). This was mentioned in the Subscriber's Audio, where I provide daily updates on market action and my personal strategies. Despite this small switch, I estimate that Asian stocks, funds and investment trusts still account for at least 70 percent of my portfolio, as all have continued to appreciate, especially UFJ, the Japanese bank purchased in mid-May, which has subsequently gained nearly 400 percent. My other Asian positions are in Atlantis Japan Growth Limited, Fleming Japanese Investment Trust plc, JP Morgan Fleming Indian IT plc - all UK-listed investment trusts, a spread bet position in Nikkei futures which I have been building since May and protecting with trailing stops, and various other Asian funds specific to pension schemes. I'm somewhat concerned over the yen's strength, which is currently a drag on the Nikkei. I would have preferred futures in the Thai SET or Indian SENSEX indices, but they either don't exist or are unavailable through my spread-bet facilities. Gold shares, funds and futures remain approximately 15 percent of my equity portfolio, following the earlier cull. Here my best current performer is the Merrill Lynch World Mining Trust plc, now out stripping the Merrill's Gold and General Fund (a unit trust) partly due to its diversification throughout the mining industry. Unfortunately I don't own the high-performing P&C Gold and Natural Resources Fund - *see my website Comment of the Day for Friday 19th September* - as the minimum would have involved a greater concentration in one fund than I wished to make at the time of launch. My worst performing precious metals investment is a stale bull position in Durban Roodepoort Deep, a high-cost producer which I view as a long-term option on a rising gold price. I am unlikely to buy any other South African mines in future because of the increased tax levies. In general, I think precious metal mining shares have run ahead of the actual metals, and prefer the latter. I hold a long position in palladium futures. My biggest disappointment is a very small position, fortunately, in the US biotech speculation - Hollis-Eden Pharmaceutical, purchased in July. This more than doubled but has subsequently retraced most of the gain due to an unexpected private placement, which diluted the share and understandably upset investors. I like the story, which includes radioprotectants, but not the management tactics. I'm holding on for the time being.

Currencies

■ **US dollar weakness remains the main theme, but most of the medium to longer-term trends are choppy.**

■ **Among reserve currencies, it is still a case of which looks least ugly?**

Central banks can strengthen or weaken their currencies, at a price. Want a stronger currency following a sustained period of weakness? Raise interest rates sharply relative to other currencies and sterilise excess supply, as we saw in South Africa in late 2001 and 2002. Want a weaker currency? Lower rates will help, subject to other considerations such as the current account, but printing money is the surest way of devaluing a currency, as we have seen with the US dollar over the last eighteen months. Public denials aside, it has long been obvious that the US Federal Reserve and Treasury want a soft and more competitive dollar, to offset deflationary pressures and hasten economic recovery. From mid-2000 to mid-2002, the ECB wanted a stronger currency to salvage its reputation and also the euro's. Now it's worried about a too strong euro, although it has done little about it. Japan's Ministry of Finance has been intervening to prevent the yen from appreciating for years. The Bank of China's last big move was a 40 percent devaluation against the US dollar peg in 1994 and it is now ignoring calls from other countries for the renminbi to be freely floated. The bottom line: no central bank wants a strong currency in the current environment of deflationary pressures and slow GDP growth for many countries. However some countries are willing to do more to weaken their currencies than others, notably the US.

Volatility is likely to persist, because no major currency is an obvious buy-and-hold, and most of the medium-term adjustments have probably occurred. Therefore we may have seen the last of the multi-month trends for a while, following moves of the last two years or more. In some respects, the euro remains the least ugly choice among reserve currencies, as I have been saying over the last two years. Consequently the single currency often bounces back quickly following a sell off, particularly against the US dollar. However a sustained advance from current levels by the euro is most unlikely, because everyone knows it will damage Euroland's modest prospects for economic recovery. This is a recipe for volatility, with the euro's rallies generally faster than its declines. Today, the yen appears to be a much more viable currency, given better prospects for Japan's economy and the inability of the MoF/BoJ alliance to hold ¥115 against the dollar. Rule number 1 of forex intervention - Don't give the market a fixed target. Keep speculators off balance, by waging a guerrilla war. Make tactical retreats and let them think they are winning. Then, when the market is technically overstretched, hit it hard before disappearing again. Traders are mercenary and have no market loyalty, nor should they. Therefore if they can't beat you, they will join you.

Currencies of several commodity-producing countries have had a good run. This is due to gold's overall uptrend and because hedge funds are bullish of commodities, due mainly to extrapolations of demand trends from China, rather than inflationary expectations. This fashion is not sustainable beyond the medium term, because commodity exports are very price sensitive. Additionally, there is less scope for productivity increases in modern farming or mining, than is the case with most manufacturing.

Asian currencies continue to appreciate but a renminbi revaluation any time soon is unlikely. As one of the big three reserve units, the yen receives most of the

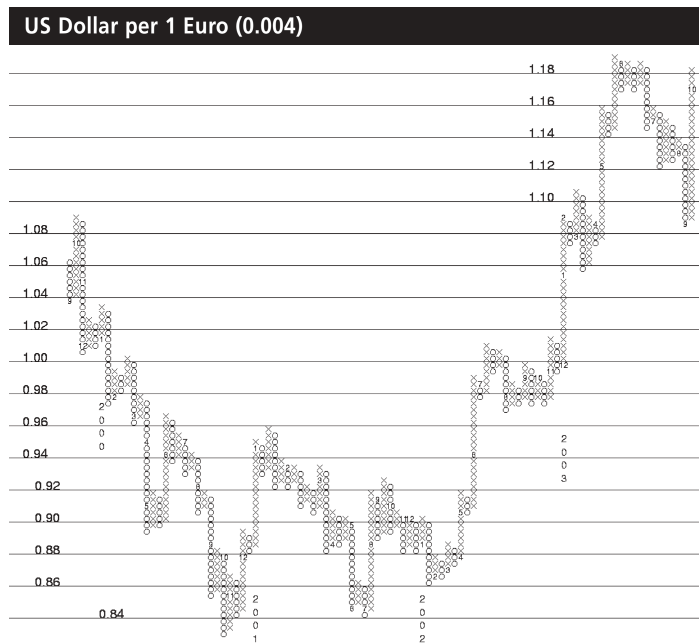
headlines among Asian currencies. It has been appreciating since June, despite massive intervention by the MoF/BoJ alliance. Short of printing much more aggressively, which the BoJ currently appears unwilling to do, Japan will face a continued headwind in the form of a strong yen, due to interest in its stock market from global investors, and overall currency trends for Asia. Freely-floating currencies of Asia's smaller economies continue to appreciate due to comparatively strong GDP growth, especially for countries that have both commodity exports and a developing manufacturing sector, such as Thailand and India. Further, significant appreciation could jeopardise GDP growth, especially during the next global downturn, probably commencing in 2005. Despite considerable talk of an imminent renminbi revaluation, and the promotion of schemes to potentially profit from such a move, this appears a distant prospect. China has repeatedly quashed rumours of a revaluation and has little incentive to strengthen its currency at a time when many other countries seek to weaken theirs. With a comparatively weak stock market - *see charts on www.fullermoney.com, Comment of the Day for Monday 6th October*, China will probably want to ride out the next global economic downturn before considering a revaluation of renminbi from its current peg at 8.3 to the US dollar.

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 are sometimes completed slightly before the final comments and prices shown.*

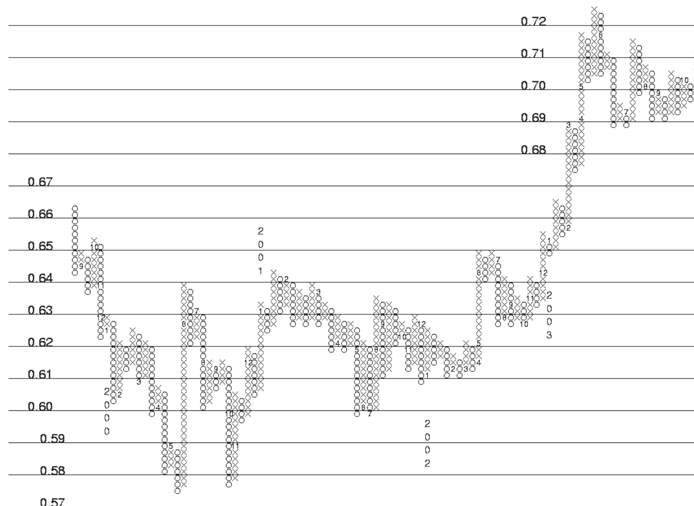
US Dollar Index (92.18) - This fell back to its June low much faster than it rose from that level, suggesting that no more than temporary support will be encountered from lateral support near 92.5 before somewhat lower levels are seen.

Euro/dollar ($1.1687) - September's rebound by the euro

US Dollar per 1 Euro (0.004)



Pounds Sterling per 1 Euro (0.002)



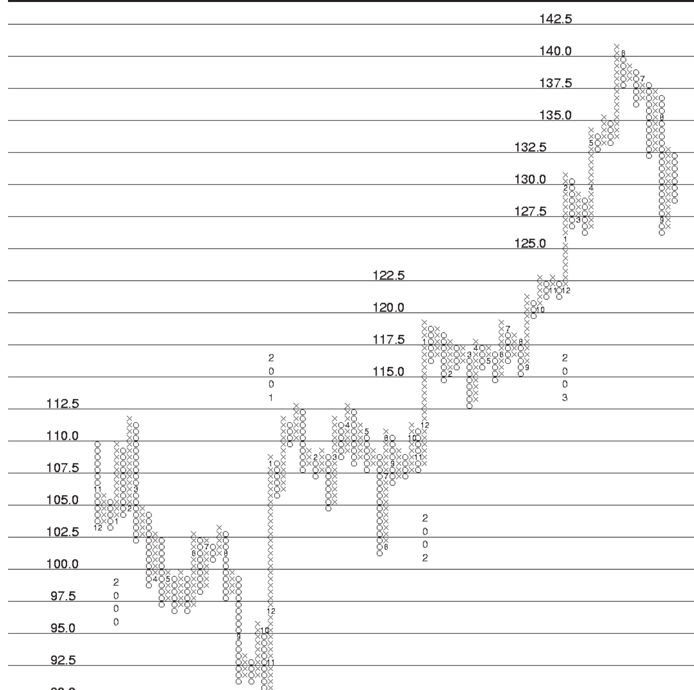
was much stronger and faster than the June to August ranging decline, suggesting strong support near $1.08. However some further consolidation near current levels is likely before the May peak is successfully challenged and cleared.

Euro/sterling (£0.7017) -The euro's trading range since the May high is probably a lengthy consolidation of gains before some further gains. However a sustained break below £0.6880 would question this hypothesis.

Euro/yen (¥127.35) - Following its break of the July low, the euro fell rapidly before encountering support from the March low. A fall to ¥125.50 is now required to indicate renewed vulnerability rather than current scope for sideways to somewhat higher trading.

Australian dollar/US dollar (US$0.6911) - The ease

Japanese Yen per 1 Euro (0.5)

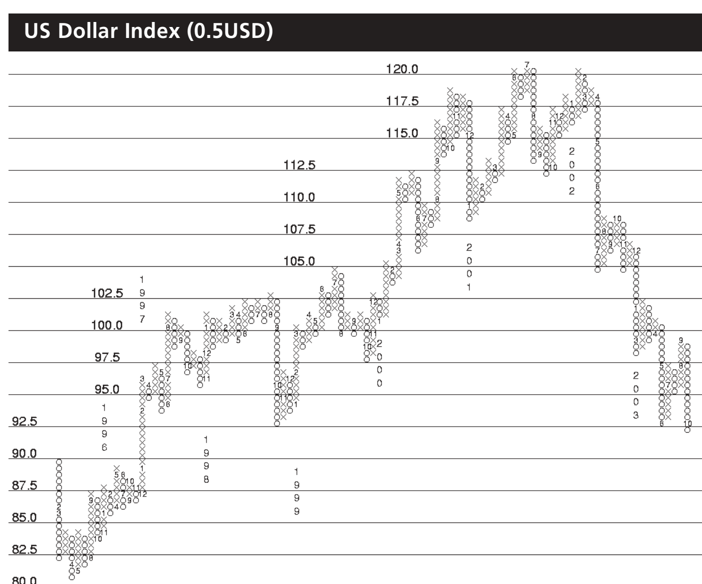


with which the Australian dollar pushed up through its July high in September suggests that no more than a penultimate peak was established at US$0.68. However given historic resistance near current levels - *not shown due to insufficient space, see www.chartanalysts.com* - some additional consolidation may be seen near current levels before gains are extended.

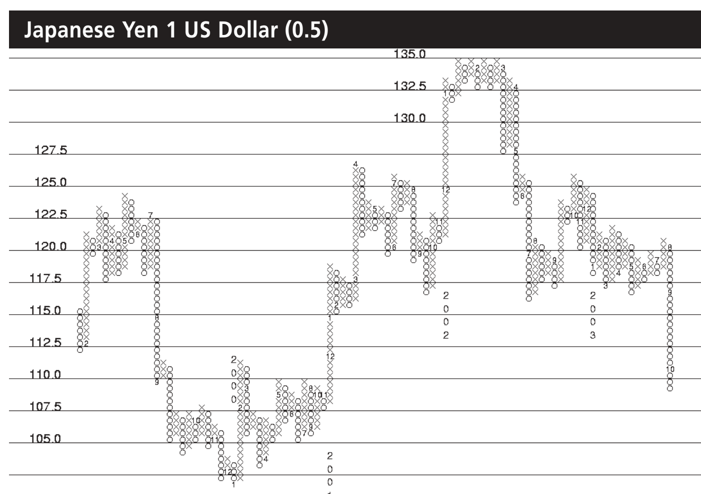
Sterling/dollar ($1.6658) - *not illustrated* - The pound is approaching potential resistance from its June high near $1.6850 and also historic trading - not shown, see website above. However a break in the progression of rising lows, with the last at $1.57, is required to offset current scope for sideways to somewhat higher trading.

Dollar/yen (¥108.96) - The dollar fell sharply once it broke lateral trading in the ¥117 to ¥115 range, to test psychological support near ¥110, which is near the upper side of its September 1999 to November 2000 base. Looking temporarily overextended, the dollar is likely to range between support from the upper region of this base and resistance now commencing at ¥115.

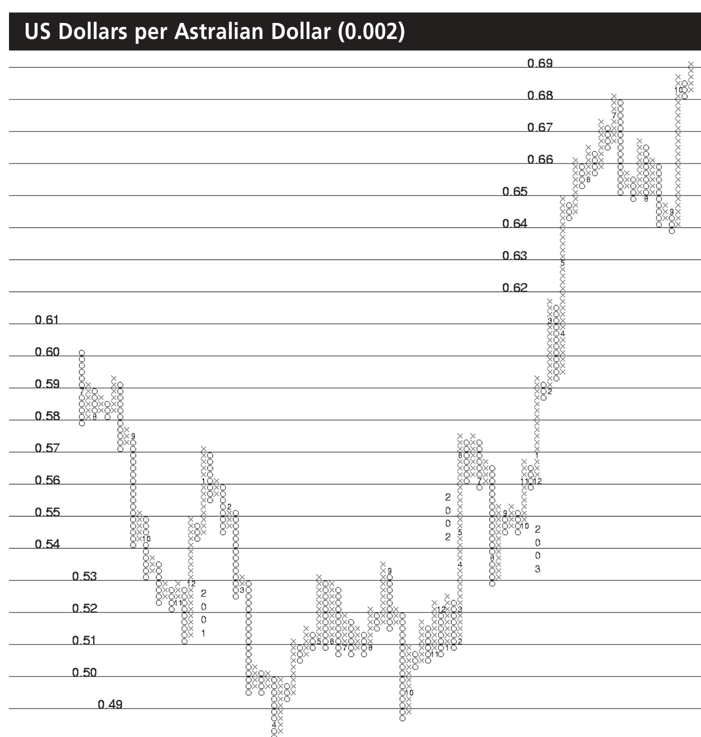
US Dollar Index (0.5USD)



Japanese Yen 1 US Dollar (0.5)



US Dollars per Astralian Dollar (0.002)



Dollar/rand (R7.0238) - *not illustrated* - The dollar has broken beneath its April to early-September lows and now requires a push back above R7.25 to suggest a downside failure and revive the base building hypothesis. This is likely as the overall decline looks overextended.

US Dollar/Taiwan dollar (TD33.700) - *not illustrated* - The greenback has fallen back from its highs once again and appears susceptible to a further decline towards its July 2002 low at T$32.9.

Strategy on currencies - For a number of years my biggest trades, and often my best returns, were in currencies. No more. The draw for me is trend consistency and the potential for persistent moves. Vulgar as it may seem, I make no apologies for declaring that I only invest or trade markets for the money. While I've always enjoyed research and writing, I don't enter markets for the action, preferring other forms of entertainment and excitement. I'm not in the markets for therapy, although I commend therapy as a means of self-discovery. I'm not in the markets for sport, although I enjoy sport and keeping fit, or at least trying to. When buying or selling, I want the odds heavily on my side. That assessment is obviously at least partly subjective, but when I buy or sell short I want it to feel like shooting fish in a barrel. That's just what it felt like in currencies up until June. If I were trading them today, it would feel like kayaking in category 4 rapids - very exciting, but that's not what I'm looking for in the markets. When I review the currency strategy section of my previous letter (this can be a humbling experience) two out of my three ideas were wrong. I'm not in the excuse game, so that result can only mean that I've either lost my way or the markets have become more choppy. I shouldn't try to deny the former, but the charts are definitely ranging more and often quite sharply, than occurred prior to June. I still like the euro, but not as much on the first test of its May-June highs against the greenback. US dollar weakness is the most obvious feature of currency markets today but everyone knows this.

Consequently many traders are short, which increases the risk. If I were managing a currency fund, heaven forefend, I'd probably be lightening a long euro position against the dollar on strength, looking to replace on small setbacks, prior to further gains. I would be short the dollar against a stable of Asian currencies, protected with trailing stops. I would only short dollar/yen after an intervention rally and I would commence covering on tests of the previous lows. I would be waiting to short the rand.

Commodities

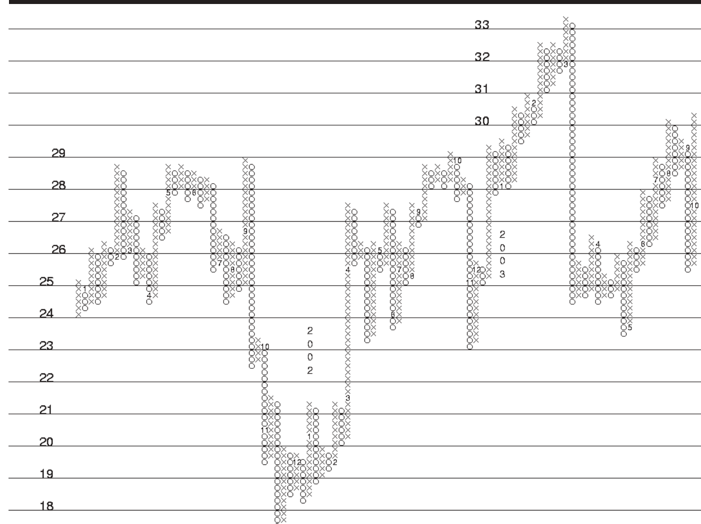
■ **Gold's recent upside failure suggests more ranging before the uptrend is extended.**

■ **Crude oil remains a drag on the global economy, due to supply concerns.**

Gold is still in the early stages of its secular bull market. Most subscribers are very familiar with my views on gold and other precious metals, described at length in FM231 (22/08/03) and in earlier issues. Therefore I'll confine these comments to a brief summary on the short-term technical action. Bullion rallied to a new recovery high in September, but could not hold this move. This suggests that we will see further ranging at current to slightly lower levels - extending what I have long described as the first step above the base evident below $330, before the overall uptrend resumes. While gold's recovery to date has generated some interest, it is unlikely to be fully in the investing public's consciousness until inflation is a widespread concern. This will obviously take time because the global transition from a deflationary to inflationary environment is in its very early stages. Therefore we can expect gold to spend much more time ranging than trending. My personal strategy at this stage of the cycle is to buy gold and other precious metals or shares on weakness, and lighten on rallies. I currently have a long position in palladium futures but have reduced my investments in gold shares - see also Strategy for stock markets.

Gold CMX 2nd Month Continuation (2USD)

Crude Oil NYME 2nd Month Continuation (0.2USD)



Oil traders dare not be caught short of supply. OPEC's latest production cuts, disruptions to supplies from Iraq due to sabotage, and lingering concerns over strikes in Nigeria and Venezuela have firmed prices once again. However prices over $30 a barrel (NYME) should remain difficult to maintain. Nigeria, Venezuela and Iraq need oil revenues, and will overcome obstacles to production sooner or later. Meanwhile, supplies from Russia and other non-OPEC producers will increase while prices remain historically high. Additionally, OPEC cannot afford to lose much more of its current share of the market. I maintain that a price of crude oil in the low to possibly mid-$30 region is top of the range. This view is supported by the chart, which appears to be in a lengthy phase of top formation extension.

The Global Economy

■ **The US is on course for a further recovery but there is much spin in the impressive statistics.**

■ **The US economic rebound will carry well into next year but will face more difficult economic conditions following the November 2004 presidential election.**

■ **Europe's fledgling recovery faces a renewed headwind from the firm euro.**

■ **Greater Asia is increasingly the world's growth engine, and this produces its own turbulence.**

US GDP growth - from real to hedonic. Governments of developed countries can be reasonably certain that they will buy an improvement in GDP growth with a simultaneous and sustained monetary and fiscal stimulus of massive proportions, which is exactly what the US has done. The inevitable tradeoff will be a large budget deficit, and often a trade deficit, as we have seen. A monetary stimulus of US proportions also sows the seeds for a future inflationary cycle, although this problem may not emerge for several years, especially if there are offsetting deflationary pressures, which we have also seen in recent years. Governments following radical Keynesian economic strategies similar to those pursued by the US Federal Reserve and Bush administration know they are erring on the side of deficits

and future inflation. However the obvious choice for most governments in a weak and disinflationary economic cycle, and certainly those approaching an important election, will be to stimulate growth, by whatever means possible, including cheerleading by the President, Treasury Secretary John Snow and other top officials. The electorate will never forgive them for failing to revive the economy, and if they succeed, deficits and inflationary problems can always be tackled at a later date.

Following 9/11, the Bush administration is also on a mission - to fight terrorism at its sources, seed democratisation in those regions, overhaul homeland security, and modernise and strengthen America's military. These ambitious goals obviously require massive funding, well in excess of what even a recovering US economy can generate. Moreover, if other countries are unable or unwilling to support the US in its war against terrorism and nation building efforts in troubled regions, the Bush administration will be more single minded in pursuing its objectives, as we are seeing, from protectionism to devaluing the dollar. The Bush team would like to generate tax revenues of the late 1990s, which soared due to capital gains in the stock market bubble years. If not already aware of the importance of crowd psychology in stimulating markets and economic growth, today's government certainly learned from the second Clinton administration. This realisation is almost certainly behind the creative license taken when reporting some economic data, such as information technology expenditure. Both the Clinton and Bush administrations have used 'innovative' accounting to boost GDP growth. Consider computers, where processing power has steadily increased but prices have declined due to technological advancement, miniaturization and competition. In calculating GDP, Clinton's economic team decided not to record the sale of a computer at its actual price. Instead, they reported much higher revenue, reflecting their assessment of the value of the computer to the economy. Critics of this practice describe it as 'hedonics'. You can read more about this creative accounting in an article entitled, "The truth behind much vaunted US GDP growth", by V Anantha Nageswaran, posted on my website on Monday 29th September.

Why haven't more analysts blown the whistle on the US's hedonic GDP figures? Good question. The perpetrators of creative accounting, in its various forms from government hedonics to Enron-type fraud, range from those who feel the raw data doesn't tell the full story, to others who choose to deceive, to hide the truth. Unquestionably, there has been a massive, international collusion by most of those in the know, due to vested interests. The US government continues hedonic reporting because positive spin boosts confidence, which leads to better real numbers in terms of consumer and capital expenditure. Most of the financial community colludes because it has a big vested interest in bullish news, which increases share prices and turnover, leading to more investment banking deals. Other governments collude because whatever they think of the Bush administration's geopolitics, they need a prosperous US because their own economies are overly reliant on exports to America. Yes, because it is misleading. But we shouldn't be surprised if more countries adopt hedonic accounting. Everyone loves good news and it sells.

Creative accounting is the least of the US's longer-term economic problems. The US economy will be nowhere near strong enough in 2004 to peg back the government's budget deficit. Debt levels for consumers and corporations are too high, despite low short-term interest rates, for a spending boom to occur. Moreover, long-term rates have bottomed and are very likely to head higher. The dollar's decline will not make a big difference now that manufacturing is much smaller than the services sector of the economy. However it will nudge the inflation rate higher, and the US economy would be vulnerable to rising interest rates, which would have a particularly adverse effect on heavily mortgaged homeowners. Most importantly, whoever wins the presidential election in November 2004 will have to tackle the US's deficit problems. This will mean less government spending and perhaps higher taxes. In conclusion, the dénouement for the US economy is likely to be in 2005-2006, when the risk of recession will increase significantly.

Corporate and consumer sentiment in Euroland has improved somewhat in recent months. It could hardly be otherwise, given the strong rebound by stock markets since March, the economic recovery outside Euroland and low short-term interest rates, albeit unchanged since the ECB's 50 basis point reduction to 2 percent in June. There was also some welcome relief for exporters from the euro, which retraced some of its gains during the June through August period. However this proved to be short lived, as the euro rebounded strongly against the dollar in September. Consequently Euroland's recovery, where it occurs, is likely to be modest relative to the US and especially Asia. Moreover, if the US economy weakens in 2005-2006, as forecast above, it is highly unlikely that Euroland will avoid recession during those years. Meanwhile, most of the old structural problems, discussed at length in previous issues, remain.

Superficially, the UK economy looks in better shape than Euroland. Yes, it has better GDP growth and lower unemployment. The unproductive reality is that this is

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due mainly to Chancellor Gordon Brown's high-tax, high-borrowing, public sector spending and hiring surge. The result is a mushrooming public sector, while private industry continues to suffer. Consumer spending - another strong contributor to UK GDP growth in recent years, was boosted by an unsustainable level of mortgage equity withdrawal. Private consumption is likely to tail off as households reduce debt and increase savings, in anticipation of higher interest rates.

Currency fluctuations are becoming a problem for developed Asia once again. No other region of the world has developed so rapidly as Asia, with the help of globalisation and the transfer of technology. And success leads to problems of excess, as we have seen from Japan's bubble of the late 1980s to the Asian crisis of 1997-8. We can expect more turbulence in future, as the occasional by-product of rapid change, and governance will remain a key determinant of both successes and setbacks. China is the elephant in the garden of Asia, and most other countries cannot avoid being affected by developments in the PRC, although this is less relevant for Southern Asia. China's massive 40 percent devaluation against the US dollar in 1994 inevitably weakened the price competitiveness of other countries in the region. This led to the Asian crisis of 1997-8, as countries that had borrowed heavily in US dollars to finance expansion were forced to devalue. They experienced deep recessions before staging at least partial recoveries with the help of austerity measures, some financial restructuring and more competitive currencies. However performance has varied considerably, with developing Asia achieving the higher growth rates, not least because they benefit from China's rapid development more than they are hurt by head-to-head competition with the PRC. For instance, Thailand supplies commodities to China and is also a popular holiday venue for newly affluent Chinese citizens. In contrast, South Korea has little to offer China. However it has much higher wages and consequently faces increased competition across its major industries. Given the renminbi/dollar peg, the US currency's rapid devaluation against most other Asian currencies in recent months could trigger another economic crisis, if it continues. Countries most at risk are South Korea, Singapore and Taiwan. Malaysia is unaffected as the Malaysian ringitt is pegged to the US dollar, as is the Hong Kong dollar. Japan has a net trade surplus with China but the yen's appreciation against the dollar/renminbi hits operating profits of export companies. As Japan has had an export-led economy over the last 55 years, there are inevitably question marks over the domestic economy's ability to lead economic recovery.

Do China's stock market doldrums indicate an economic problem? Of the many share markets that I monitor, China has the worst performance this year by far - *see charts on www.fullermoney.com, Comment of the Day for Monday 6th October*. The market isn't always right but one should not dismiss the probability that China's comparatively weak share prices reflect growing problems, perceived by local investors. One factor, for certain, is liquidity. Markets thrive or dive on expansions and contractions in liquidity, and China has tightened monetary policy to curb property development and speculation. Andy Xie of Morgan Stanley says there is also concern over possible US protectionism - see link to his article in the above mentioned Comment of the Day. We often read about the "inevitability" of China's growth to economic superpower status. Yes, but this progression will not be linear, and India has the potential to become an even greater superpower - see FM231.

And Finally…

The Chart Seminar: Nov 6th and 7th is a sell out - Stockcube's next chart seminar will probably be in May. If you would like early notification, once the venue is finalised, email Joanna Mugnier - jmugnier@stockcube.com or tcs@stockcube.com. Meanwhile, attending Fullermoney subscribers (FMs) at the November's TCS, please introduce yourselves.

Amsterdam seminar and conference in November - On 14th November I'll be conducting a 1-day course on Behavioural Technical Analysis in Amsterdam, for the institutional subscribers of the Dutch magazine - Technische En Kwantitatieve Analyse. I will also provide the keynote address for their Annual Conference on 15th November. Details are available on their website - http://www.belbelsymposium.nl/.

Subscriber's Audio - All subscribers to Fullermoney have access to my daily Audio recording, available from my website - www.fullermoney.com. All you need do is request a password via the site. There is no additional charge for the Audio, which provides my latest thoughts on these fast moving markets.

"October. This is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August, and February."

Mark Twain

Best regards - David Fuller

Fullermoney a division of Stockcube Research Limited Suite 1.21 Plaza 535 Kings Road London SW10 0SZ UK
Website: www.fullermoney.com ***Email:*** research@chartanalysts.com ***Tel:*** +44 (0) 20 7352 5435 ***Fax:*** +44 (0) 20 7352 3185 ***Single Issue Price*** £35

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