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In its 20th year

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

The global stock market recovery has entered its latter stages, and shows some loss of upward momentum in the US and especially Europe. It also faces a headwind from the next cycle of higher short-term interest rates. Asia (excluding Japan and Mainland China) should continue to experience the best performance, at least until Wall Street's trends deteriorate.

Stock markets climb a narrowing psychological ridge.

In markets, real risk is generally the opposite of what is perceived. A market truism states that the crowd of investors and speculators is never more bearish than at a bottom, or more bullish than at a top. The reason is capitulation. Once investors finally lose hope and throw in the towel during a declining trend, cutting their losses, very little selling pressure remains. In a temporary vacuum of supply, short covering and a small amount of bargain hunting will spark a strong rebound. Conversely, when those waiting for a pullback in a rising market eventually conclude that risk is on the upside, they become born-again bulls and buy aggressively. Prices surge briefly before falling back in a vacuum of demand.

Sentiment runs to extremes at reversal points because people talk their book. If I sell following a persistent decline, I'll need to feel very bearish to rationalise my decision. Conversely, if I pile in after many other people, I'll need to espouse a very bullish case to justify my speculation. I probably won't have to search far for my rationalisations, because the financial press is extremely good at seductively mirroring the consensus view. Consider how bearish people were early this year, or just before any other major rally. Recall the crowd's self-justifying rationalisations during the mania in 1999 and early 2000. These recurring price cycle dramas can take place quickly in isolated incidents but usually last for a number of months or even years with major asset classes such as bonds or shares, before the trend reverses.

Where in the behavioural cycle are stock markets today? Inevitably, there is a subjective element to any assessment of the investor/speculator crowd, to which we all belong. Opinions will vary, not least because we may be looking at different markets. A UK/European-focussed observer will agree that sentiment has improved considerably over the last seven months but is far from euphoric. This begs the question, is Europe leading or lagging? I believe it is most definitely the latter, both in terms of economic recovery and the stock market cycle. Developing Asia is leading, Mainland China excepted, due to monetary tightening by the government. Led by Thailand, Asia's other developing country markets are racing higher and economic activity is booming. Incidentally, this is not an argument for a switch from emerging Asia's best performing markets to the European laggards, unless you suspect Euroland is about to match Thailand's 8 percent GDP growth. I prefer to stay with relative strength, at least while Wall Street's main share indices are moving sideways to higher. Given the US stock market's huge influence, I hope to be mostly out of stocks before Wall Street resumes its secular bear trend. And if against all historical evidence the US stock market surprises me by not peaking before end-2004, I'll probably remain invested in developing Asia, subject to trend consistency. Meanwhile, most guests on US financial TV channels are more bullish than we have seen for years. Sure, we don't have the euphoria of the late 1990s, but huge bubbles are usually once-in-a-generation affairs. Whenever I listen to Wall Street's retail spokesmen, most appear very bullish. This sentiment was reflected by a Sunday Times (UK) article on November 2nd: "Ready to save the world - the latest figures show that America is an economic superhero, growing at its fastest rate for 20 years."

Is Wall Street priced for perfection once again? I don't think it is that extreme, but with the S&P 500 Index trading at 30.41 times earnings and yielding only 1.69 percent, it is certainly not priced for disappointment. Sure, 3Q GDP growth of 7.2 percent was impressive, even allowing for 'hedonics', but the stock market has already discounted a recovery. Does it get better from here? Perhaps, in terms of additional non-inflationary growth, which entices more people out of the money market funds and into equities. Let's enjoy it while it lasts, so long as price charts remain in uptrends, whether you have invested in Wall Street or as I have done, in emerging Asia and to a lesser extent precious metals. Meanwhile, to keep our feet on the ground, we need to think about the endgame. My headline analogy is that stock markets are climbing a narrowing psychological ridge. While this was inclusive, I'm really focussing on Wall Street because for better or worse, few stock markets will uncouple from the US trend for long. The assumption, if we are to climb higher on the narrowing ridge, is that further non-inflationary growth will occur, enabling the Federal Reserve to keep interest rates at 1 percent well into 2004. It's possible, but we all know that market perceptions can change rapidly. Step off the left side of this narrowing ridge and the US economic recovery - pumped up by steroids in the form of excess liquidity, tax cuts and heavy fiscal spending - starts to fade, perhaps due to debt levels. Investors are left worrying about falling profits. Step off the right side of the ridge and US GDP growth is too strong, causing investors to conclude that the Fed is behind the curve of rising interest rates. Which will it be? No one knows, although I suspect it will be the latter. What is certain is that investor perceptions will change, sooner or later. Identifying that transition will remain a preoccupation of this scribe.

Interest Rates and Bonds

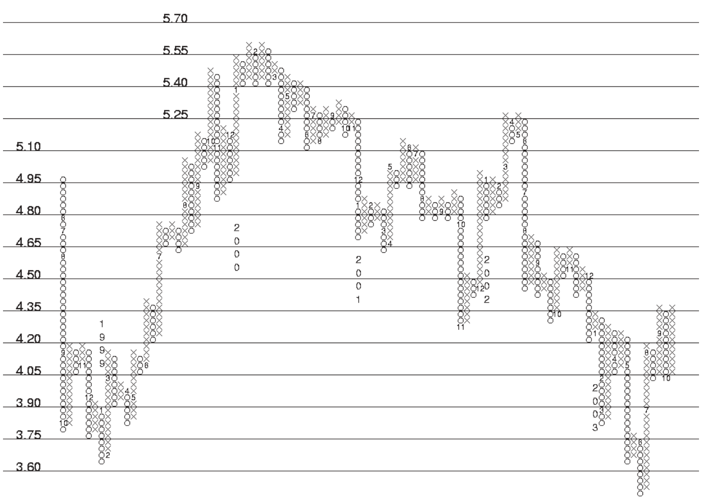
■ **The cycle of higher short-term interest rates draws nearer.**

■ **Australasia and Europe are leading upward pressure on long-dated government bond yields.**

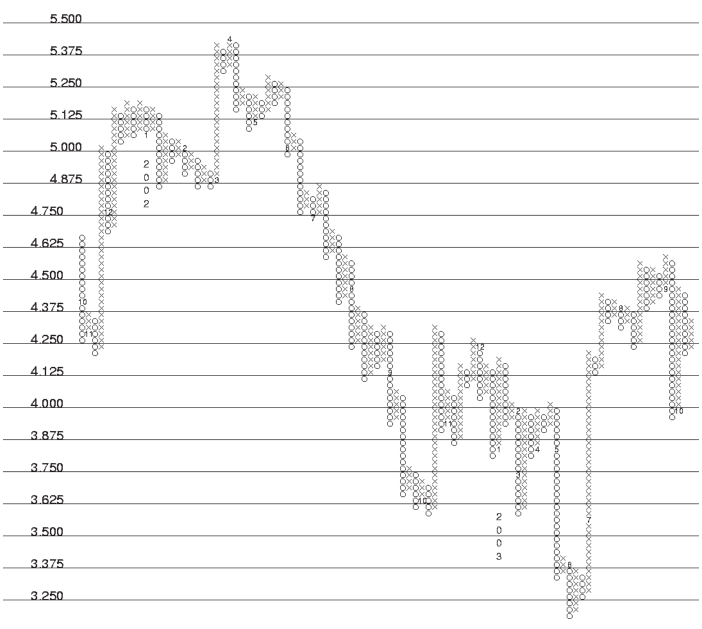
People have become used to low borrowing costs, not least those with mortgages, but these rates can't last. The world appears headed for a synchronised economic expansion for the first time in many years. Europe is the odd region out but can only benefit from growth in Asia and North America. Meanwhile, property bubbles are inflating once again, mostly due to low borrowing costs. Many central banks are preparing to lift short-term rates. The Reserve Bank of Australia hiked rates for the first time in 17 month on 5th October and we may see the Bank of England's first hike later this month. The Federal Reserve is on record as saying that rates will remain low well into 2004. However, if US GDP does not fall back to around 4 percent in 4Q 2003, as many analysts forecast, and I believe there is a good chance it will not, the Fed will rethink its timing on the next rate hike.

Japan and China are holding down US bond yields. This is the opposite of what most commentators have been forecasting. They worry that foreigners - mainly the governments of Japan and China - will dump US Treasuries and the dollar. I maintain the opposite view - they will increase their purchases of US government debt, in order to prevent their own currencies from soaring. This is

Euro Bund 10 Year Bond Yield (0.03)



US 10 Year Bond Yield (0.025)



why 10-year Euro-bund yields are poised to resume their rally, while the US 10-year rates continue to range in what I suspect is an extended phase of base formation development, prior to eventually moving higher.

Strategy on bonds - Once again, I have no investments in long-dated government bonds, which I think are in the very early stages of a secular bear market. If I had a position today, I would be short, but remain content to watch, as the initial transition from bull to bear is often choppy.

Global Stock Markets

■ **The medium-term rally: it gets more difficult from here on.**

■ **My best-case and worst-case scenarios for share prices in the year ahead.**

■ **Technical focus on emerging markets, Part 1: Eastern Europe rapidly fulfilling its upside potential for this cycle.**

The easy part of this technical bull within Wall Street's secular bear market is over. An important premise of this letter, earlier in the year, was that a significant medium-term rally would commence with the onset of the war to remove Saddam Hussein. For perspective, it is worth recalling the bullish factors mentioned in these pages, before assessing market prospects in the months ahead. Sentiment - a contrary indicator when views are polarised, was understandably pessimistic in early 2003 following a 3-year decline by most stock markets, not to mention uncertainty over the Iraq war. Consequently, valuations had become more realistic in the US, reverted to near the average mean in Europe, and were historically attractive in Japan and also most emerging markets. Government long-dated bond yields were at their lowest levels for many years. Meanwhile, central banks were committed to a major monetary expansion. Last but not least, I published two historic tables showing that the DJIA scored its best gains on average in the pre-presidential election year - see FM227 & FM228. Today, valuations on Wall Street are arguably expensive, with the S&P 500 Index trading at a p/e of 20.5 and yielding 1.9 percent, despite bottom-line earnings improvement and, more recently, some top-line growth. Asian and emerging markets are no longer undervalued. In fact some commentators question whether or not emerging market bubbles are forming. Sentiment is not euphoric but has improved sufficiently for most US-based strategists to conclude that Wall Street's bear market is over. Meanwhile, government long-dated bond yields have risen significantly since June and we await the first rate hike by a Western central bank, almost certain to be the BoE. Yes, economies are improving but further GDP growth can only lead to some tightening of monetary conditions by central banks, which would be bearish for stock markets. Consequently the risks in all stock markets are considerably higher today than they were in March, and can only increase with any additional gains. What about the US presidential election year? It is Wall Street's second most bullish year on average.

Best-case scenario - the technical bull carries well into 2004. This would probably require a continuation of the moderate economic recovery experienced by developed countries, without the evidence of increasing inflationary pressures that would prompt central banks to commence a series of short-term rate hikes. In the best-case environment, long-dated government bond yields would range in an extended phase of bottom development, rather than push significantly above their June highs. There would be no exogenous shocks to confidence and the financial system, such as a devastating terrorist attack, serious default and/or derivatives crisis. The US dollar would range or drift gently lower. In this benign environment, Wall Street and the European stock markets would keep their ranging recoveries largely intact, recording average gains of at least 10 percent from current levels. We could even see some upward acceleration. Japan would probably do somewhat better, provided the yen was not too strong, while in-favour emerging markets should continue to register the best overall gains.

Worst-case scenario - the global stock market recovery is now ending. First there was the correction during the second half of September, which unsettled investors. While share indices rallied in the first half of October, they did so on declining volume and resistance was encountered near the September highs, indicating an overall loss of momentum. Then downward dynamics for many indices - an indication of selling pressure, were seen in the third week of October. Should Wall Street's main indices break their September reaction lows for more than a day or two, bullish sentiment would dissipate. As for the economic background, Wall Street is vulnerable to either a recovery that appears to be fading or one that is sufficiently robust to put upward pressure on interest rates. In the latter case, long-dated government bond yields would resume their rise, putting further pressure on equities. If the overall environment remains a secular bear market for Wall Street, as I believe, once the rally ends US indices are likely to fall back at least as rapidly as they rose from the March trough, and they would break beneath that low and also the October 2002 floor. European indices would follow this lead. Japan would experience an extensive pullback and base extension phase. Emerging markets would fall sharply, but find support above their March lows in most instances.

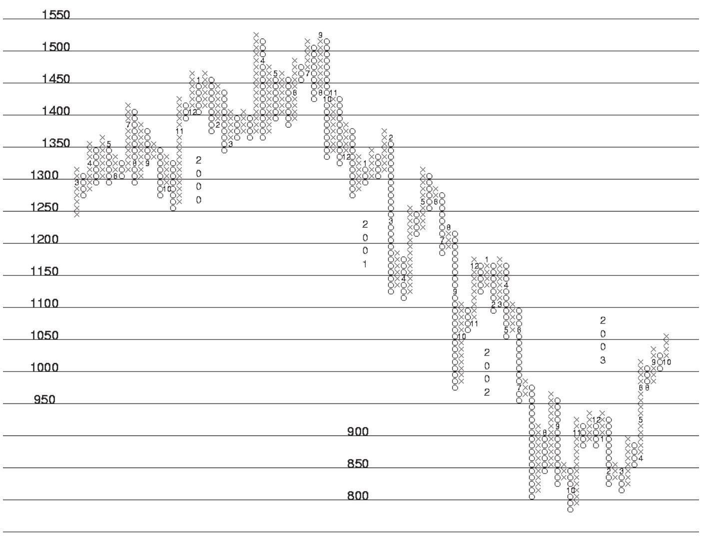
The muddle through scenario - US and European share indices trade sideways for many months. Provided government long-dated bonds also ranged, we would have a neutral environment for global stock markets. In this event, there would be trading opportunities in the developed markets, both up and down, based on fashion changes among sectors, plus special situations. Portfolios would probably be re-weighted in favour of defensive issues, especially stocks with comparatively high, covered yields. In-form emerging markets would continue to provide the best relative performance, as investors sought growth and capital appreciation.

Conclusion on global stock markets - While there is no conclusive evidence that the medium-term rally is over, technical action among the developed markets shows the first evidence of deterioration since the March lows. Needless to say, Wall Street's performance will remain a key influence on sentiment in other countries' stock markets. We can be sure that the Bush Administration will do everything within its considerable influence to keep the rally alive, as part of a necessary 'feel good factor'. So far, the Fed has remained compliant and accommodative. Nevertheless, equities are no longer in the "sweet spot" of 2Q and 3Q 2003. Consequently risks in stock markets have begun to increase relative to rewards.

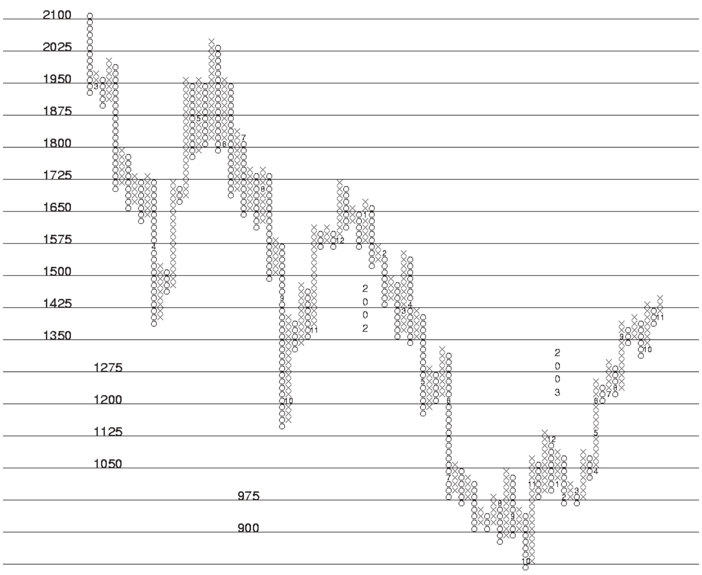
For investors, Eastern Europe is likely to be much more interesting than Western Europe over the next 10 years. This hypothesis is based on several assumptions: Eastern Europe will experience stronger GDP growth than Western Europe; an increasing number of international investors will favour emerging markets over the next decade or more, and an equity culture will develop more rapidly in the East, albeit from a negligible starting point. Of these, the first two are the most important by far, and the increased interest among international investors is partly based on another assumption: Wall Street remains in a secular bear market, which will approximately resemble its performance during the late 1960's to early 1980s, at best, or more likely the Nikkei from 1990 to 2003. As Wall Street goes, so go Europe's bigger stock markets, with the UK slightly lower beta and most of Euroland's indices slightly higher beta than the S&P 500 Index. Medium-term rallies aside, that's not a great story for equity investors. Consequently they will turn East, as they did in the 1970s and 1980s, only this time East includes Eastern Europe. American investors may also look at Central and South America, subject to governance. The good news is that Eastern Europe should experience several major rallies during the next decade or more, just as we have seen in 2003, which generally outperform Western Europe's indices and the US. The bad news is that being high beta, most will also fall back more sharply during the bearish phases, although generally bottoming out at higher levels than in the previous cycle.

What about Eastern Europe's markets today? If already there, I would hold on, until US stock market indices break their sequence of higher reaction lows. Since I'm not there, largely due to oversight and a preference for emerging Asia, I would be reluctant to join the party at this stage of the cycle. I don't like buying something that a lot of other people have purchased at considerably lower levels. It smacks of the greater fool theory - 'I know I'm a fool to pay this price but I'm hoping even greater fools come along and bid it higher'. Therefore my coverage of Eastern Europe in these comments, and in reviewing the charts below, is a familiarisation campaign for you and me. There will be lots of time to monitor their performance, and also assess the economic and political background. When global stock markets next take a beating, and that could be 2 or 3 years away, although it might occur sooner, Eastern Europe will be on my 'watch to buy list'. For me, this will be a chart beauty contest, in terms of relative strength and early leadership - the same characteristics that caused me to single out

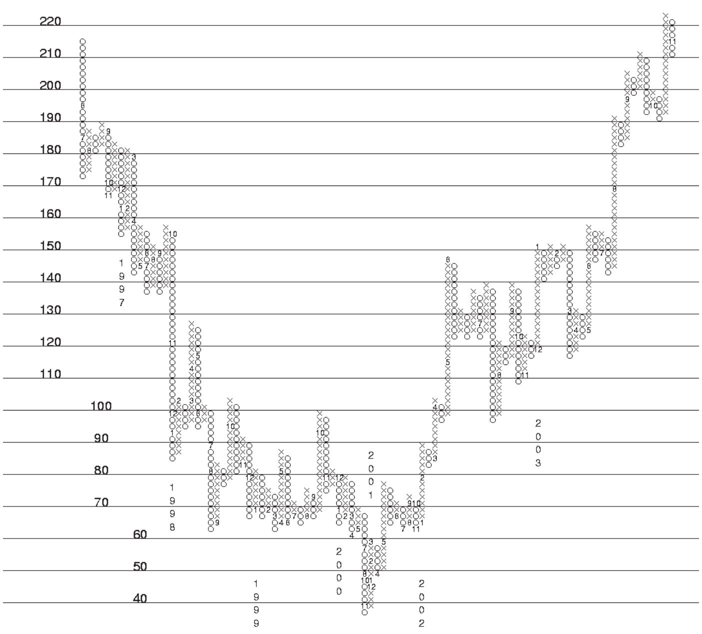
S&P 500 Composite Index (10pt)



Nasdaq 100 Index (15pt)



Amex Gold Bugs Index (2pt)



Thailand and India earlier in the year.

Part 2 of my technical focus on emerging markets will be in FM234.

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's (1053) rally has slowed considerably, evidenced by its ranging with a slight upward bias since June. The last two reactions were 3 units of scale (30 points on this 10-point scale). Nevertheless a decline of at least 4 units of scale and a break in the progression of rising lows, currently requiring a decline to 990, is needed to provide clear evidence of trend deterioration. **The NASDAQ 100 Index's (1429)** rally has outperformed the S&P but also slowed recently. A decline of 5 units of scale (125 points) and a break in the rising lows would check the upside bias. **The Amex Gold Bugs Index (213)** has extended its overall uptrend following a brief reaction and consolidation. A decline beneath 190, which appears unlikely, would be required to offset current scope for sideways to higher ranging.

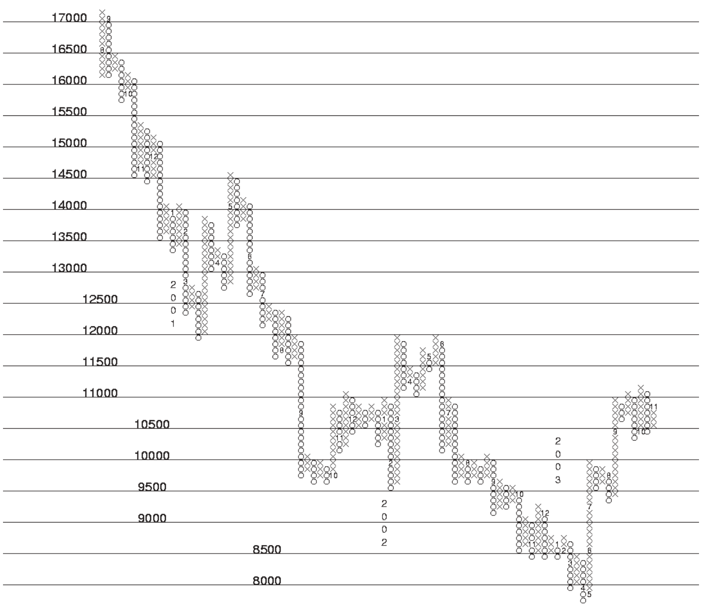
Japan's Nikkei 225 Stock Average Index (10837) has twice failed to maintain nudges over 11000 in the last two months. Consequently a sustained break above this level is now required to delay prospects for further ranging and possibly a pullback and potentially lengthy base extension phase, which would be indicated by a clear breach of the September reaction low at 10300.

Thailand's Bangkok SET Index (671) has completed a brief consolidation above the 1998 and 1999 peaks. While the latest gains are becoming temporarily overextended, suggesting another brief consolidation before long, a decline to 545 remains necessary to indicate an upside failure and more significant correction before the large underlying base supports further gains.

India's BSE SENSEX Index (5075) has resumed its advance following a brief consolidation. For trend monitoring purposes, the main consistency characteristics are the 3-column width 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.

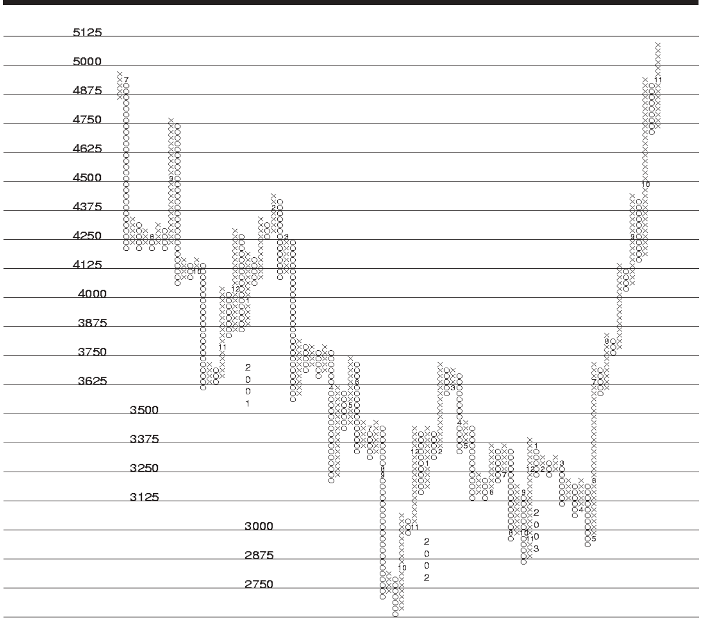
Germany's DAX Index (3725) - *see overleaf* -fell sharply to break its uptrend consistency in September, following a lower high. However it has subsequently recovered and also pushed above the September high at 3650. A close at 3450 is now required to indicate an upside failure and reaffirm resistance near the September high.

Nikkei 225 Stock Average Index (100pt)

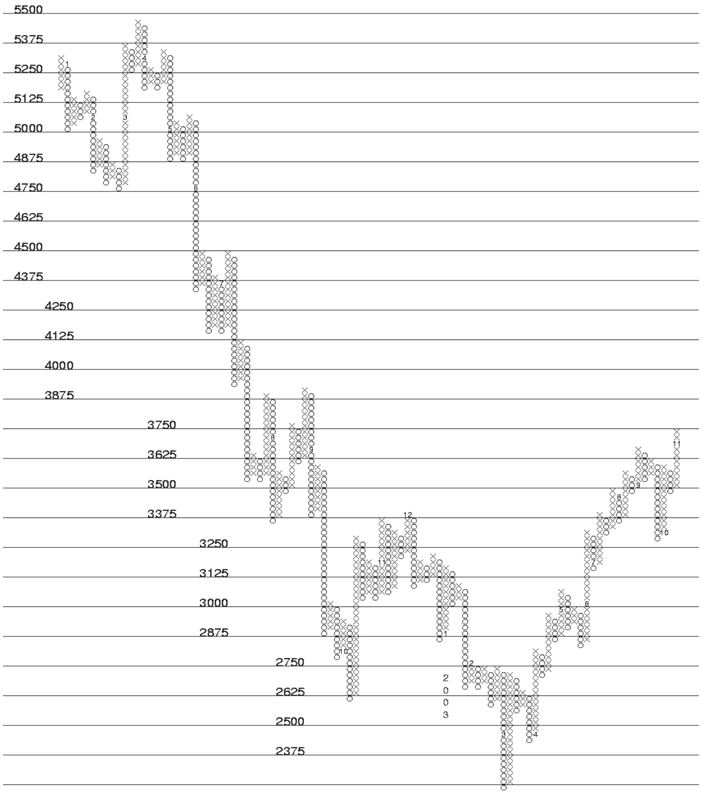


Thailand Bangkok SET Index (5pt)

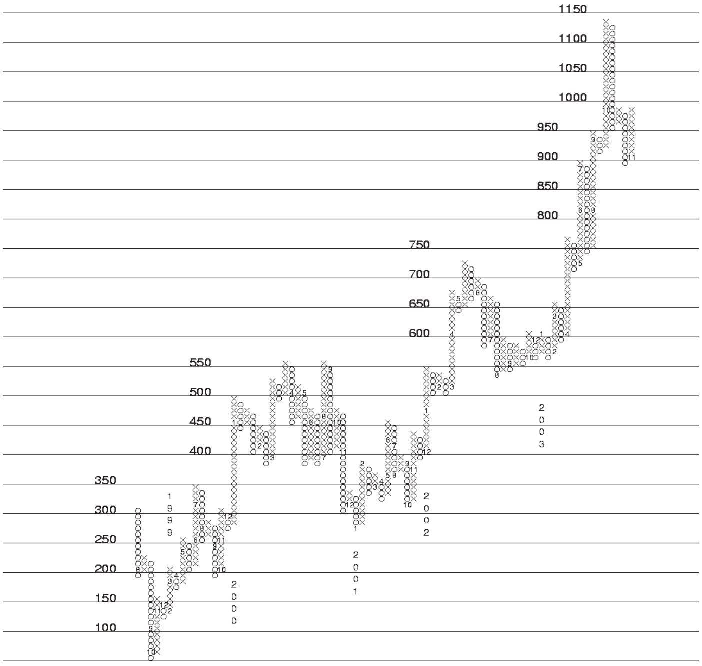
India SENEX Index (25pt)



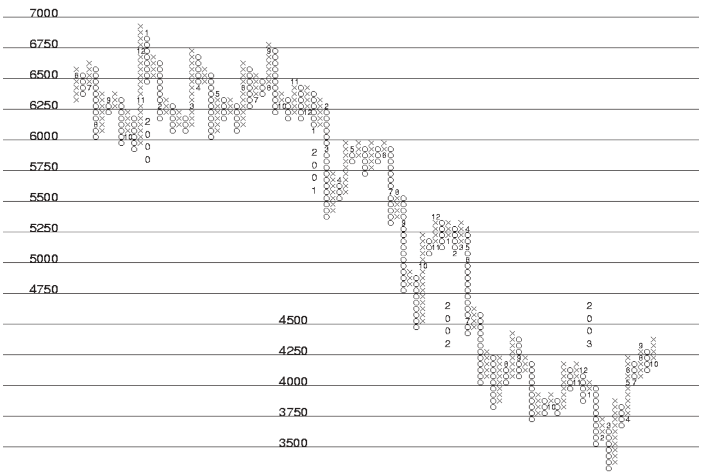
German DAX Index (25pt)



Russian CRTX Traded Index (10pt)



United Kingdom FTSE 100 Share Index (50pt)

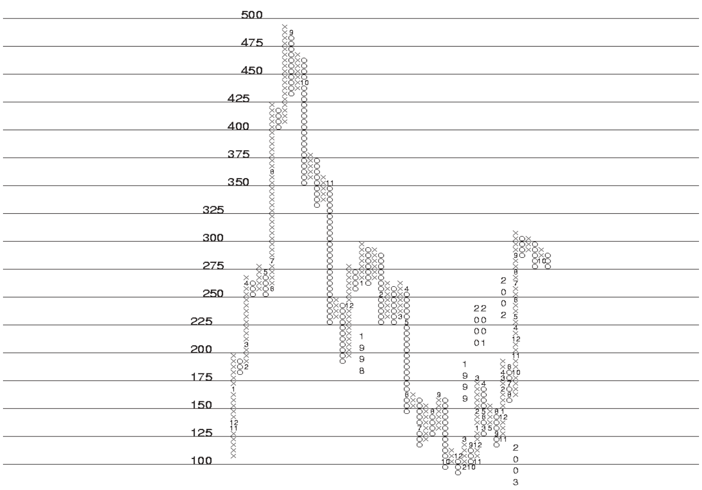


The UK's FTSE 100 Index (4301) broke its progression of higher lows in September but bounced back from that correction faster than it fell. Although that rally carried it to a new recovery high, the latest upside break was not maintained. While the uptrend may be tiring, a decline beneath 4100 is necessary for clearer evidence of a loss of momentum. Conversely, a close at 4375 would reaffirm the ranging uptrend

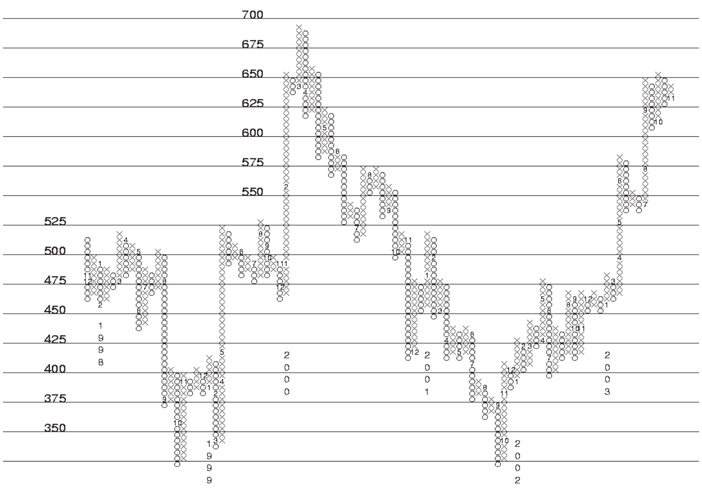
Russia's CRTX Index (968) - a spectacular performer in recent years, accelerated higher in early October but has subsequently seen its sharpest correction for years, breaking the sequence of higher lows. All this indicates that a peak of at least near-term significance has been reached.

Estonia's Tallin SE Main Index (275) rose consistently for a number of months before accelerating in September. It has subsequently lost upside momentum and a move to 310, which looks unlikely, is needed to offset current scope for an additional correction.

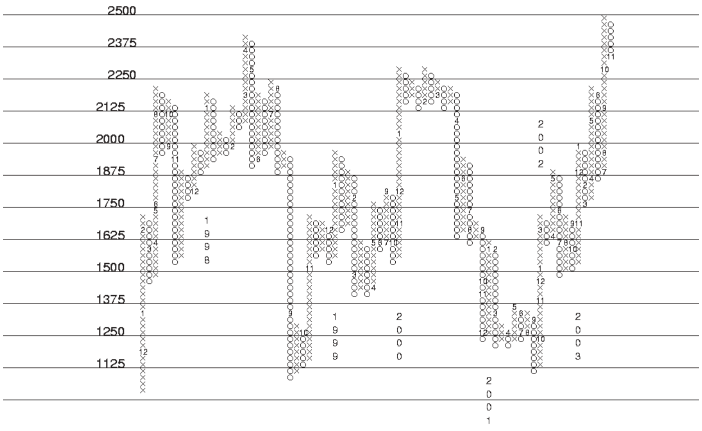
Estonia Tallin SE Main Index (5pt)



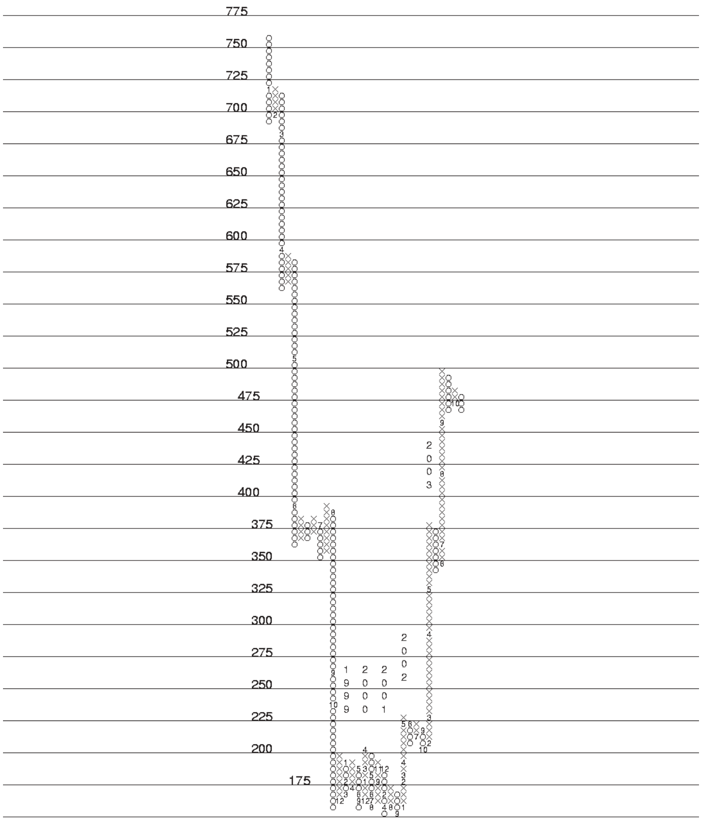
Czech Republic PSE PX50 Index (5pt)



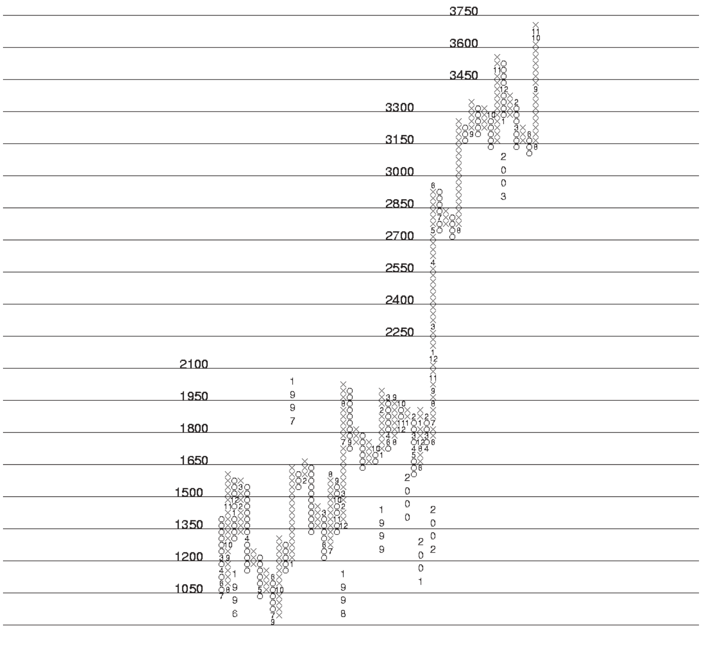
Hungary Traded Index (25pt)



Latvia RICI Equity Index (5pt)



Slovenia SBI Index (30pt)



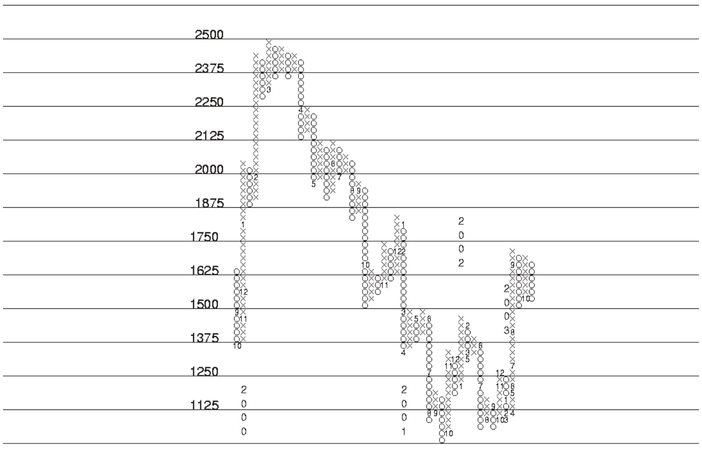
Czech Republic's PSE PX50 Index (638) saw some acceleration in August and early September, and has not maintained the latest upward break. A decline to 625, breaking the sequence of higher reaction lows, would provide further evidence of resistance from the 2000 peak area up to 690.

Hungary's Traded Index (2333) accelerated above prior peaks dating back to 1997 before pausing to consolidate. A close above the psychological 2500 level is now required to reaffirm the uptrend.

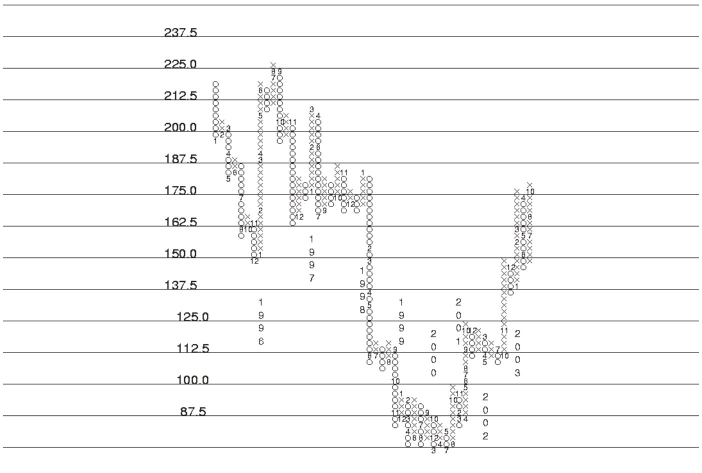
Latvia's RICI Equity Index (462) has seen its first lower high, following strong gains, since 220 in July 2002. Consequently a close above the psychological 500 level is required to question near-term prospects for an additional reaction.

Poland's WSE WIG 20 Index (1559) accelerated to a peak in early September and is currently rangebound. A rally to 1725 is needed to reaffirm the prior uptrend.

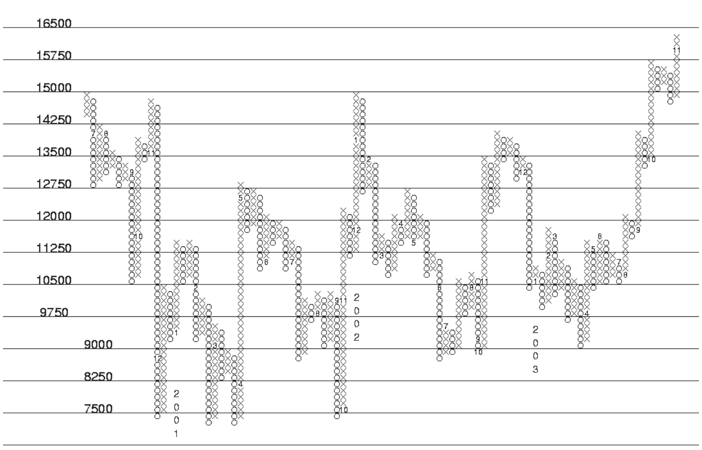
Poland WSE WIG 20 Index (25pt)



Slovakia SAX Index (2.5pt)



Turkey ISE National 100 Index (150pt)



Slovenia's SBI Index (3696) - *see previous page* - has pushed rapidly to a new high following a lengthy reaction and consolidation. A pullback to 3300, which appears unlikely, is required to confirm an upside failure and suggest top development.

Slovakia's SAX Index (176) - *see previous page* - is edging above its March high and a decline back beneath 160, which appears unlikely, is needed to offset current scope for some additional gains.

Turkey's National 100 Index (16338) surged higher in September and early October before pausing near former highs, and has now resumed its uptrend following a brief consolidation. Consequently a close at 14850 is required to indicate an upside failure and offset current scope for higher levels.

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. Waning upward momentum for Western indices and Japan reveal that supply and demand is now more nearly in balance than at any other time since the rally commenced in March. While this does not mean that the medium-term recovery is over, or signal that it cannot carry well into 2004 (my best case scenario), it is a warning. Preferring to err on the side of caution, I have considerably reduced my equity exposure since mid-October. My first move, mentioned on the Subscriber's Audio, was to close a large (for me) long position in Nikkei futures, which I had been building since mid-May. I did this on 22nd October, two days off a new recovery high, because the Nikkei had failed to maintain a break above the September high and psychological 11000 region. The next day's 5 percent fall would have triggered my trailing stop, and it caused the Nikkei to register a weekly key reversal. *You can see this key and also charts for other Asian markets and positions mentioned below on Comment of the Day for 31st October. All were discussed in the Audio for that day.* While I would reconsider purchasing Nikkei futures in the event of a sustained break above 11000, which I expect at some stage, there is also a possibility that we could first see an additional pullback and base extension phase. That too would create another buying opportunity. Meanwhile, I am content to watch. Unfortunately, I did not respond so quickly to some technical deterioration in my Japanese bank share - UFJ Holdings - a significant position by virtue of its strong rise since May. However I have placed some opportunistic sell orders above the market. My other Japanese investments are mainly in pension schemes, including funds and the two UK-listed investment trusts (closed-end funds), Atlantis Japan Growth Ltd and the Fleming Japanese Investment Trust plc. I took a tiny profit on my Merrill Lynch New Energy Technology plc investment on 20th October and switched the money back into the Aberdeen New Thai Investment Trust plc. I don't like trading that actively in shares or ITs, but having looked at New Energy Technology plc's top 10 holdings (something I should have done earlier), and seeing that 7 were losing money and only one of the shares - Garnesa Corp Technologica SA, a Spanish company - had what I would consider a reasonable valuation and good chart, I concluded this was too much of a concept investment for me at a mature stage of the global rally. This switch was mentioned at the time on the Subscriber's Audio, in line with my usual policy. I'll probably hold Aberdeen New Thai and also the JP Morgan Fleming Indian IT plc until they either accelerate sharply or US stock market indices break their rising lows, because Thailand and India remain my two favourite markets. Now in cash-building mode, there is only one other share/fund that I am currently considering as a purchase - the US NYSE-listed dollar-denominated Malaysia Fund Inc - a closed-end fund managed by Morgan Stanley, which I've been mentioning on the Audio recently. I have been saying that Malaysia is a catch-up candidate now that controversial Prime Minister Mahathir has retired. However I'll only buy Malaysia Fund Inc if I sell something else first, such as UFJ Holdings or some of the high-yielding/defensive UK stocks previously mentioned in FM232 and earlier issues. I have placed sell orders above the market for some of these, and they are currently more than fully hedged following short positions in the FTSE 100, DAX and NASDAQ 100, opened when I sold my Nikkei futures. Carelessly, I did not follow my Audio-stated strategy of placing in-the-money stops to protect the initial profits in these hedge trades and 2 of the positions are currently losing money. In a further reduction of my equity exposure, I took profits on the remainder of my position in the Merrill Lynch World Mining Trust plc, which I have held for years. I sold too soon, as the chart pattern remains consistent, albeit with a steepening uptrend. As discussed on October 31st's Audio, subscribers need not worry about MLW unless it accelerates again and/or breaks under 185p. I continue to hold the Merrill's Gold and General Fund (a unit trust). In FM232 I estimated my equity/related weighting at 70 percent in Asia and 15 percent in gold shares or precious metals. Obviously this has changed somewhat following the sales and hedging mentioned above. Bottom line: I like emerging Asia far more than any other equity investments at the moment, but these are no longer cheap and have almost certainly seen the best portion of their move for this medium-term cycle.

I hope to be entirely out before the next global downturn for equities. I like gold and other mining shares for the long term but feel they are currently expensive relative to the metals. Consequently a significant portion of my metals-related investment is in palladium futures. Lastly, people frequently ask me about gold funds. To my knowledge, the best performing of these, although still a comparatively new fund, is the P&C Gold and Natural Resources Fund - *see my website Comment of the Day for Friday 19th September.* The P&C Fund has some gearing and can invest in physical metals in addition to shares. Being a small fund - under $20 million, it is more flexible than most of the others. Unfortunately, it has a high minimum investment.

Currencies

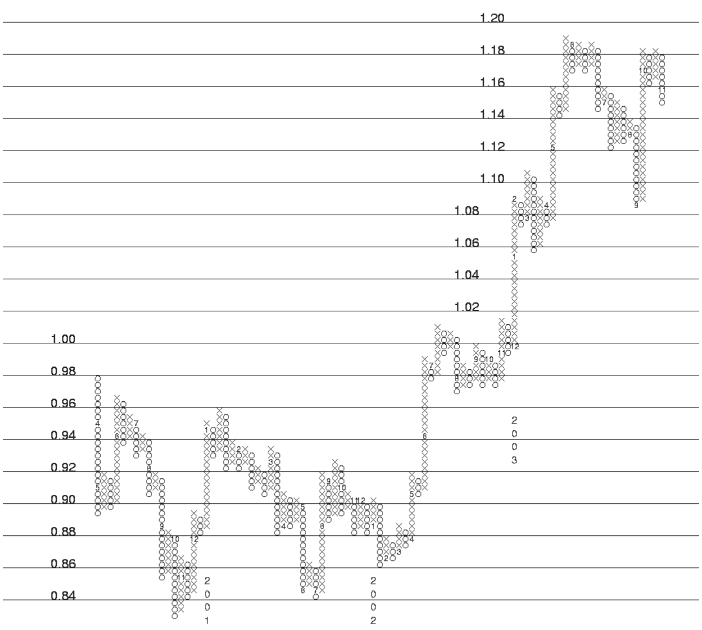
■ **Temporary stability as confusion reigns.**

Governments play 'pass the parcel' with strong currencies. What is a humble currency speculator supposed to do in this environment, when no central bank or government wants a strong currency? Of course, some will do more to avoid currency strength than others. The US has successfully flooded the globe with trillions of dollars in recent years through credit creation - the electronic equivalent of the printing press famously mentioned by Fed Governor Ben Bernanke. Japan counters by purchasing up to $25 billion greenbacks a month. China isn't about to let its renminbi float while the US dollar remains weak. These are the heavyweight champions of soft currencies. Relief followed by hubris briefly enabled the ECB to enjoy a strong currency, at least until Euroland's exporters and politicians protested. And they didn't have to protest for long because there is little inherent reason why Euroland's second division economy would attract currency speculators, aside from periodic trend momentum. Other countries, from Switzerland to Thailand, have actively and volubly resisted currency appreciation in this forex version of the children's game - 'pass the parcel'. The net result is a period of mild confusion among forex traders, during which most trends are short term, resulting in occasional volatile ranging. This has introduced an element of stability in forex. However stability is a transient visitor to markets, and it won't last. It remains to be seen what will eventually produce the next big trend among reserve currencies but GDP growth differentials, supply and interest rates are usually among the factors.

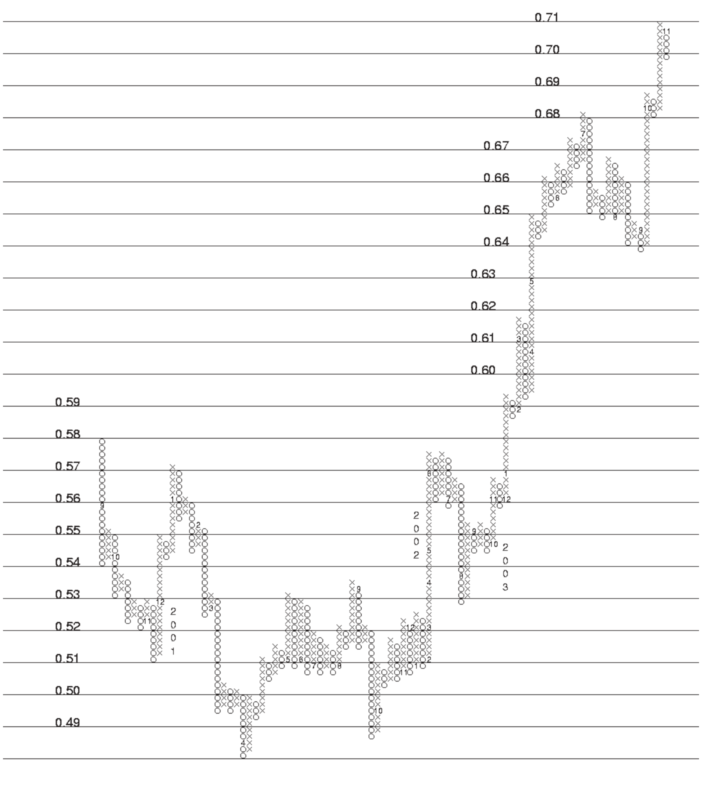
Chart review of important and topical currencies - *These and hundreds of other 3-box reversal closing basis point & figure charts are available on our website, www.chartanalysts.com and are updated daily. All comments refer to closing levels for US trading hours. Please note: the charts are sometimes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

Euro/dollar ($1.1493) - While the euro rallied in September and early October more quickly than it fell from June to August, indicating strong support near $1.08, it has backed away from resistance just over $1.18. This suggests some further consolidation near current levels before the May peak is eventually cleared.

US Dollar per 1 Euro (0.004)



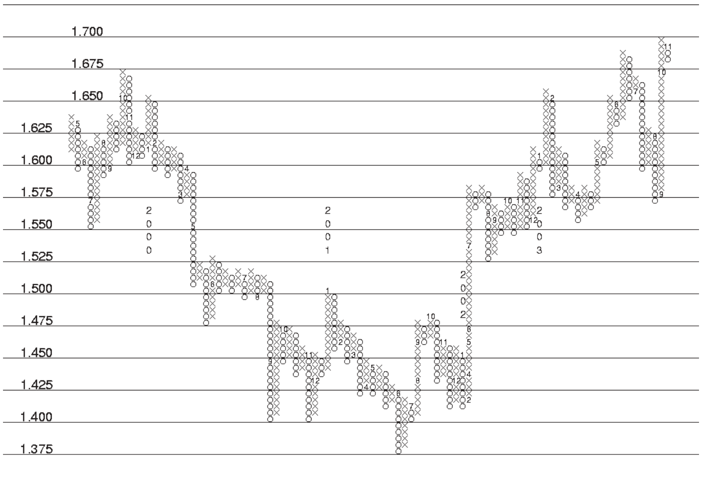
US Dollar per 1 Australian Dollar (0.002)



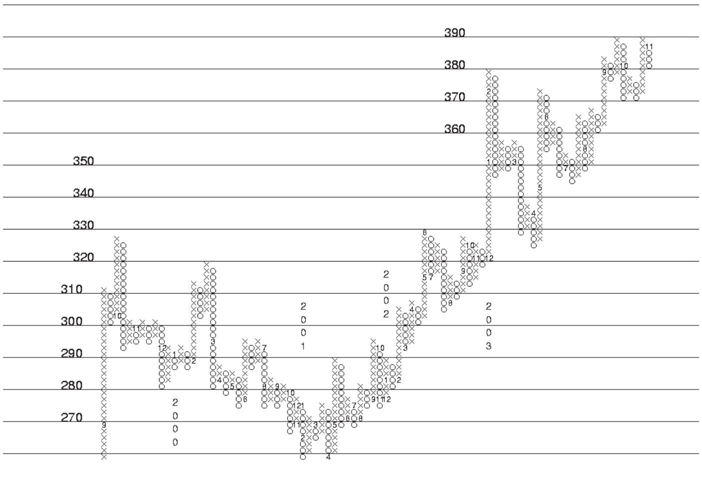
Australian dollar/US dollar (US$0.7006) - The Australian dollar's latest advance is becoming overextended and the overall trend has become less consistent, suggesting that it is in its latter stages. While a move below US$0.68 would indicate overall top development, a close at US$0.71 would reaffirm the uptrend.

Sterling/dollar ($1.6784) - *see overleaf* - The pound has not maintained its push over the June high at $1.685 and there is prior resistance in this region - *not shown, see www.chartanalysts.com.* Consequently a close at $1.70 is needed to reaffirm scope for somewhat higher levels.

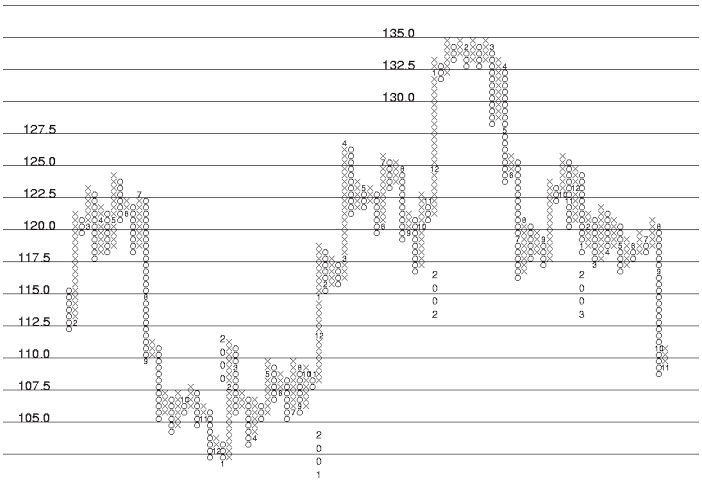
US Dollar per 1 Pound Sterling (0.005)



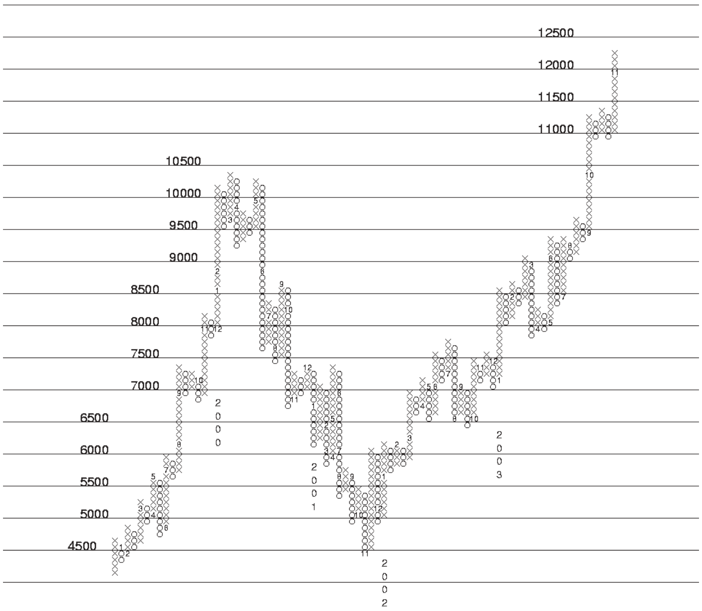
Gold CMX 2nd Month Continuation (2USD)



Japanese Yen per 1 US Dollar (0.5)



Nickel LME 3 Months (100USD)



Dollar/yen (¥109.68) - The dollar's decline remains temporarily overextended and it is encountering some support from the upper region of its September 1999 to January 2001 base. A period of ranging near current levels appears likely.

Strategy on currencies - For a number of years my biggest trades, and often my best returns, were in currencies. However I don't like what I perceive as the current risk/reward ratio, so I'm just observing. US dollar weakness has been the most obvious feature of currency markets for some time. Consequently many traders are short, which increases the risk, and the dollar has lost downside momentum. 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. Trailing stops on dollar shorts against the floating Asian currencies (mentioned last month) would have been hit. 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 - *not illustrated*.

Commodities

- **A clear breach of $370 is required to prevent gold from extending its uptrend before long.**

- **Nickel leads industrial metal prices higher.**

Gold's next significant move will be on the upside. The chart shows a progression of rising lows ever since bullion tested its 1999 floor in early 2001. Rising lows confirm that gold is under accumulation. I maintain that the current pattern, which followed the upward spike on base completion from December 2002 to early February 2003, is the first step above the base. In the early stages of secular bull markets, these patterns can take a long time to form, as I have mentioned before. However this one appears to be nearing completion. Judging from the chart, a close at $368 is required to delay an upward break beyond the next few weeks. I maintain gold will move much higher over the next 10 to 15 years, because fiat currencies (paper money) will never retain their value over the long term. Some governments may aspire to monetary discipline, but they just can't resist the temptation to print too much of the stuff, in order to buy their way out of trouble. I favour owning gold and/or other precious metals, and often the companies that mine them, provided the latter do not run ahead too quickly. Those who own gold will need to be patient. Upward spikes are likely to be infrequent, and followed by lengthy reactions. Most secular bull markets progress at the pace of a tortoise over many years, before finally running like a hare.

Nickel prices are soaring. A building boom in China and signs of a synchronised economic recovery are sufficient reason for nickel prices to strengthen. However the price rise has been further fuelled by a shortage of refined metal and speculative demand from funds. A decline to $10800 would be required to check near-term scope for additional gains.

The Global Economy

■ **The US economy surges 7.2 percent on 'steroids', and this growth rate is unsustainable.**

■ **Europe will continue to underperform North America and Asia.**

■ **The best and most sustainable growth is coming from emerging Asia.**

Real GDP growth for the US, inflated by 'steroids' and 'hedonics'. This publication has long maintained that the US economic recovery would pick up in the second half of 2003 and carry into 2004, due to improved sentiment following the war to liberate Iraq, tax cuts, plus a record monetary and fiscal stimulus - these latter two representing the steroids mentioned above. This unprecedented boost to the economy is occurring because the US Federal Reserve is determined to head off Japanese-style deflation, not to mention the 1930s variety. It has done so by keeping short-term rates at 1 percent and flooding the economy with liquidity. With the additional help of cheerleading from Alan Greenspan and Ben Bernanke, cheap money has encouraged consumer borrowing and spending, while all the excess money sloshing around the system has led to an orderly devaluation of the dollar. Coincidentally, the Bush Administration has been on a mission following 9/11 - to fight terrorism at its sources, seed democratisation in Iraq, overhaul homeland security, modernise and strengthen America's military, and win the November 2004 presidential election. Monetary and fiscal steroids have certainly inflated the US economy, which with the help of creative accounting (hedonics) carried over from the Clinton Administration, registered a 7.2 percent gain in 3Q - a growth rate to rival emerging Asia, if taken at face value. For more on hedonics, read "The truth behind much vaunted US GDP growth", by V Anantha Nageswaran, posted on my website on Monday 29th September.

Problems ahead for the US economy, especially in 2005-2006. Some highly respected economic forecasters expect US economic growth to dip sharply in 4Q and fizzle out in 2004, mainly due to high debt levels and the risk to long-term interest rates posed by a weak dollar. While theoretically possible, I would not be surprised to see the US economy remain robust well into 2004, due to momentum, improved consumer and business confidence, lower unemployment, perhaps a synchronised global recovery and a Fed determined to err on the side of accommodation. The biggest risks for the US economy in 2004, I suspect, will be the possibility of a weaker stock market and/or higher long-dated government bond yields. Bearing in mind that all historical evidence suggests Wall Street's recovery is no more than a technical bull within a secular bear trend, bullish sentiment could easily dissipate if the economy either disappoints or does too well. Evidence of fading growth would revive concerns over corporate profits at a time when US equities are optimistically valued. However the more likely possibility, I suspect, and greater risk would arise if the economy continues to surprise on the upside, hedonics not withstanding. In this case, investors would conclude that the Fed was behind the curve, causing Wall Street to discount a series of rate hikes. Concern over higher rates would worry more than the stock market. It would jeopardise the housing market, curtailing both consumer and corporate spending. Of course there is also a middle path, in which the US economy does moderately well, without evidence of overheating. In this event the Fed would be reluctant to raise rates in 2004, prior to the election, as this could appear political to some observers and even influence the outcome. In conclusion, I maintain the greatest danger period for the US economy will be in 2005-2006, because whoever wins the presidential election in November 2004 will have to tackle the US's deficit problems. This will mean less government spending and also higher taxes if the Democrat Party manages an upset victory. Higher interest rates would increase the risk of a hard economic landing.

Euro headwind adds to Europe's economic problems. Most of these are self-inflicted - too much regulation, uncompetitive tax rates and a cushy welfare apparatus that undermines the work ethic. Euroland's single monetary policy inevitably means that it is inappropriate for individual countries more often than not, and where it is appropriate, this is due to luck rather than design. Additionally, the Maastricht Treaty's misnamed Stability Pact has eviscerated the fiscal policy option during an economic downturn. Even the larger countries dare not breach the 3 percent ceiling on budget deficits more than marginally. While recoveries in North American and Asia can only help Europe's economies, the euro headwind threatens to dent operating profits for the region's export companies. Moreover, the ECB appears to underestimate this risk. Superficially the UK economy looks in better shape than Euroland, not least because of stronger GDP growth and lower unemployment. However the unproductive reality is that this is 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. Yes, the layers of bureaucratic administrators and politically correct central and local government appointees are back. 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 during the next round of short-term interest rate increases, likely to commence this November.

There is little evidence of hedonics or deficit-generated growth from emerging Asia. No one understood the lessons of the Asian Crisis of 1997/98 more clearly than Thaksin Shinawatra, Thailand's Prime Minister since February 2001. Governance is always the critical variable with emerging markets, and is responsible for Thailand's world-leading economic growth. It continues to benefit from its fast-growing manufacturing sector and commodity exports to China, along with other emerging economies in the region. Thailand also has the additional advantage of a booming tourist industry. Hazards for emerging Asia include variations in governance which can slow growth due to bad policies and/or corruption, too rapid currency appreciation, and terrorism. However the most persistent recurring problem is cyclical overheating. China is the first to experience this recently and a significant credit slowdown has been in effect for several months. This could halve capital expenditure, according to economist Andy Xie of Morgan Stanley. The implications for equity investors are obvious - *see the Shanghai A-Share Stock Price Index in my website's Comment of the Day for Monday 3rd November.* Developed Asia has somewhat slower growth due to cost competition with China - see also FM232. Japan's main problem is continuing deflation, which has yet to be adequately addressed by the Bank of Japan.

And Finally…

Amsterdam seminar and conference in November - Shortly after our sell out venue for The Chart Seminar on 6th and 7th November, I'll be conducting a 1-day course on Behavioural Technical Analysis in Amsterdam on the 14th, for the institutional subscribers of the Dutch magazine - Technische En Kwantitatieve Analyse. I will also give the keynote address at their Annual Conference on 15th November. Details are available on this website - http://www.belbelsymposium.nl/.

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> **"It is in the arena of ideas that the blade of the mind gets sharpened."**
>
> John Maudlin

Best regards - David Fuller

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