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In its 20th year

Fullermoney

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

The global stock market rally found a new tailwind in December and has sailed into the New Year, led by emerging markets. This has reaffirmed uptrends for share indices and understandably emboldened investors. However, a number of short-term overbought conditions are becoming apparent.

Riding the global stock market tiger with President George W Bush - his perceived fate will be a far greater influence on Wall Street this year (and therefore other markets by association) than the Fed, the US/global economy, US deficits, the dollar or any other known factor.

How can we tell if it is still safe to invest in this stock market rally? It has already lasted much longer than most people dared hope when the rebound commenced in March 2003. Today, a majority of investors feel more confident, but the obvious bargains have already been snapped up. The traditional yearend forecasts provided us with a kaleidoscope of views, albeit mostly tinged with bullish hues, which will be interpreted as warnings by some contrarian thinkers. The annual spate of forecasts are fun, if you like that sort of thing, but I'm not concerned with trying to guess when the stock market cycle will peak. Most of us can think of reasons why it might end sooner rather than later, and we can just as easily make a case for the rally carrying well into the second half of 2004. Long ago, I learned to watch the market for evidence of change, and that I should move with it. Some signals are easier to see than others. For instance, I'd like to see an accelerated rally, beyond what we have seen recently. This would be an additional gift and forewarn of sudden change, because it would also be unsustainable. Forewarned is forearmed and it is preferable to lighten positions in a firm market. Conversely, a sudden, sentiment-snapping sell off without prior acceleration would be more stressful and costly. These are harder to anticipate, and in order to protect against further profit erosion, we would have to hedge and/or sell into a soft market. Of course the market doesn't care about what any of us want individually. It's just a manic/depressive mob, within which we are individual participants, striving to maintain our analytical objectivity. With this in mind, the simplest and probably most revealing conclusion that I can offer is that we can safely ride the global stock market rally until the S&P 500 Index and other leading indices break their sequence of higher reaction lows.

Which type of trend ending will we see, sooner or later? Will it be unsustainable acceleration or some loss of upside momentum followed by a sharper reaction than we have observed since the March 2003 lows? Some individual emerging markets may accelerate, relative to their earlier gains, and arguably have already commenced this process. However this is much less likely for developed country indices, if you believe as I do, that Wall Street is experiencing no more than a very good medium-term rally within a secular bear market. Memories of the last market slump and a realisation that it could return, whether fundamentally due to economic overheating leading to higher interest rates, or insufficient GDP growth and renewed deflationary pressures, should prevent the investor euphoria in developed country markets that we last saw in the late 1990s. Any genuine euphoria is much more likely to occur in emerging markets. Meanwhile, keep a close eye on the charts because there is unlikely to be any better guide. The reality is, no one - absolutely no one - can reliably say when stock markets will peak, although many will claim to have done so after the event. We can only guess. For what it's worth, I give a low probability to the rally rolling over in January beyond a shallow consolidation; a high probability that we will see a significant correction before midyear, and I'd be astonished if the uptrends persisted uninterrupted up to the US presidential election in November. It should pay to run with these rallies, as long as the reaction lows are rising. However there is no reason why we should buy into the increasingly bullish hype. Remember, sentiment is always most bearish at the bottom and bullish at the top.

Historically, the presidential election year is the second most bullish on average for Wall Street. However, the results vary considerably, not least in terms of whether or not the incumbent party wins. This fascinating, logical and extremely important fact is illustrated in a graph and table originally published by Ned Davis Research and reproduced in The Week, from Wachovia Securities. You can see both on the Fullermoney website's, Comment of the Day for 6th January. Here are the most relevant statistics. Over the last 100 years there have been 9 Republican Party incumbent wins, producing an average gains of 14.6 percent for the Dow Jones Industrial Average. This is slightly better than the average 12.1 percent return when an incumbent Democrat wins, based on 7 instances. However, when the incumbent party lost, the average gain over 10 such cases is only 4.2 percent. Aside from the exquisite ethical dilemma this may pose for Bush-hating investors everywhere, it is perfectly understandable. A Bush win represents continuity and global stock markets have been on a winning streak since last March, despite no shortage of ongoing concerns over GDP growth sustainability, US deficits, the dollar, debt, interest rates, deflation or inflation, and terrorism. As known concerns, these are already at least partially discounted and would therefore be trumped by the uncertainty of a Dean/Clarke victory, or any other Democrat Party ticket. Markets don't like uncertainty, as we know, and the one certainty about Howard Dean that we do know, based on his campaign to date, is that he would repeal all of the Bush Administration's tax cuts. It is very unlikely that the US stock market would respond favourably to the prospect of such large tax increases. We can be certain that the Ned Davis Research chart mentioned above will be distributed widely, due to its relevance. In conclusion, if Bush/Cheney, Bush/Powell or Bush/whoever else retain a comfortable lead over Dean/Clark or any other Democrat ticket, we can expect a much better 2004 from Wall Street and most other markets in its sphere of influence, than if the Democrat Party nominees appear likely to retake the White House. My guess is that President Bush will be re-elected, but a lot can happen between now and the November election.

Interest Rates and Bonds

■ **Mixed outlook on short-term rates, but there is more upside than downside scope.**

■ **The next big move on long-dated government bond yields should be upwards.**

The market may be complacent on US short-term rates. If so, this is understandable, given reassurances by various Federal Reserve Governors that US rates will remain on hold for a considerable time. Why might the Fed have a change of heart and raise rates more than most investors expect in 2004? The answer is because it has created highly inflationary conditions, which are temporarily held at bay only by cheap imports from developing countries and the absence of an inflationary psychology among Americans.

US 10 Year Bond Yield (0.025)

Euro Bund 10 Year Bond Yield (0.03)

The latter is understandably a lagging indicator. As for the Euroland, the next decision to raise or cut rates will be determined by the euro, assuming the ECB has any sense. Since the euro is the only one of the big three reserve currencies that has not yet been actively managed lower, deflationary pressures created by its further appreciation should alert the ECB to the need for a rate cut. The BoE's next move on rates will be another 25 basis points hike, but this may be delayed a little longer by sterling's present strength. South Africa's rates should decline further, given the rand's appreciation during the last two years.

Long-dated government bond yields are in a base extension phase. I maintain that the secular bear market in these instruments (bull market for bond holders) ended in June 2003. Accordingly, I also believe conditions now favour a secular bear market for government bonds although this will probably take time to become apparent. Following last year's initial spikes, their price and yield charts are ranging, which is consistent with a base extension phase for yields (top for futures prices). The biggest bear markets among developed country bond markets should be in JGBs and US Treasuries. Briefly, Japan's yields reflect government support and the long deflation. The latter will end once the BoJ gets monetary policy right. US T-bond yields do not yet reflect the Fed's inflation targeting and are being kept down by Japanese and Chinese buying, which won't always be there to the same extent.

Strategy on bond - I am lightly short JGB 10-year and US 30-year Treasury futures, and will manage this position on my Baby Steps trading strategy of selling short in small quantities on rallies and partially covering on declines, during the top extension phase.

Global Stock Markets

- **The recovery rally has probably entered its latter stages but remains intact until the sequence of higher reaction lows since March is broken.**

- **Gold Bullion Securities (GBS LN) is a timely arrival.**

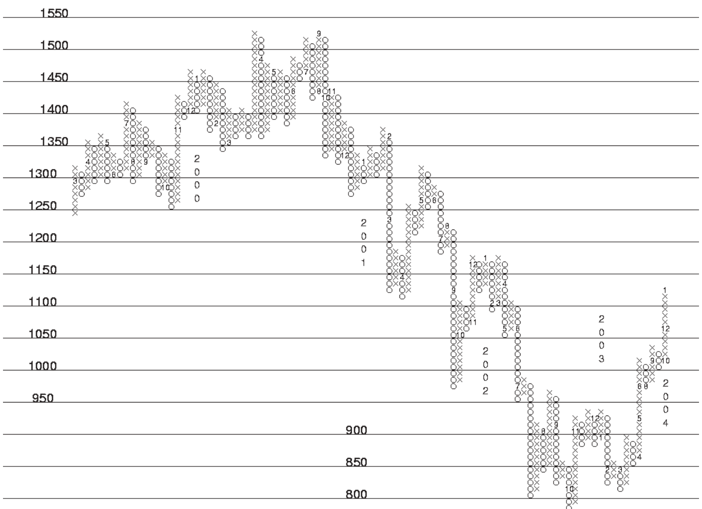
Some overextended rallies aside, there is no other evidence that the global stock market rally is ending or over. In my previous letter (FM233), I mentioned three scenarios for stock markets - best case, worst case and muddle through. Worst case is already off the table - stock market indices have yet to break the sequence of higher reaction lows, which define uptrends. Muddle through, in which most stock market indices range sideways for many months remains a possibility, provided the highly influential US indices do no worse than move sideways. In this event, some emerging markets would continue to outperform, especially those of Asia. Meanwhile, my best-case scenario, which would see stock market indices rally well into 2004, remains possible. The necessary background conditions are a benign interest rate environment, including no further rise in long-term government bond yields, and a generally moderate global economic recovery, untroubled by evidence of increasing inflationary pressures. Additionally, there would be no exogenous shocks to confidence, and the dollar would do no worse than continue to drift gently lower. These favourable conditions still apply today. However many stock market indices were strong at yearend 2003. Further appreciation at this pace over the next few months would increase the risk of a sharp reaction before midyear.

Almost everyone wants the stock market rally to continue. This is not yet the contrary indicator that it may seem on first glance. Wanting the rally to continue is not the same as believing it will be extended well into 2004. I see almost as many bearish as bullish forecasts, although the latter are ascendant. Behaviourally, this is still the second psychological perception stage (of three) experienced during a market advance. Cheerleading aside, there is little evidence of euphoria. Who are the main cheerleaders? Heading the list is President George W Bush, albeit only in terms of the economy, as he is probably too smart to mention the stock market at this stage of his re-election campaign. Next we have Alan Greenspan, who would like to salvage his legacy by avoiding recession and outright deflation. Then we have all the other governments around the world, which would also like to see the first positive year for stock markets of this millennium extended throughout 2004. Additionally, we have most of the financial community, anxious to restore some of its reputation, not to mention generate those bonuses of the late 1990s. Last but not least, the millions of investors around the globe who seek to increase their wealth in stock markets. Meanwhile, for stock market indices a trend is a trend, until it is broken.

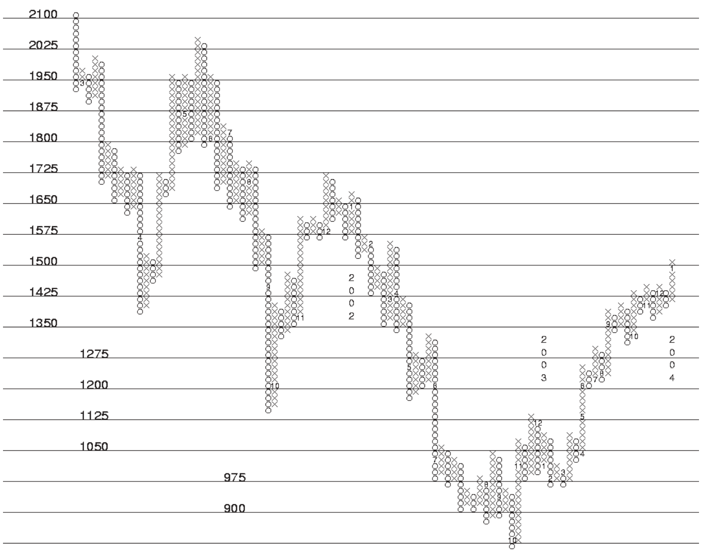
Of course wanting the rally to continue is no guarantee that it will do so. I maintain that we are in the latter stages, in terms of upside scope if not time, for this predictably good medium-term rally within Wall Street's secular bear market. We have seen a loss of momentum, not least in the NASDAQ, which leads in both directions. Sooner or later in 2004, assuming no exogenous shock, either the synchronised global economic recovery will siphon funds away from stock markets, or central banks will tighten monetary policy. Moreover, the latter two events could coincide. Any of them would be sufficient to end the rally. Meanwhile, emerging Asia, led by Thailand and India, is likely to maintain its superior overall performance so long as Wall Street continues to range sideways to higher.

Gold Bullion Securities is the right vehicle at the right time. Launched on the London Stock Exchange on December 9th, GBS LN is the second such vehicle backed by the World Gold Council, the first being Gold Bullion Securities Ltd (GOLD AU) listed on the Australian Stock Exchange on 28th March. The Australian company is Australian dollar dominated while the London vehicle is quoted in US dollars. A similar US-listed vehicle is likely to be launched in the US in 2004. GBS is a gold bullion tracker, providing investors with a low-cost and convenient means of participating in gold's moves. It will also be far less volatile than gold mining shares. GBS can only increase investor interest in gold. Many conservative investors will

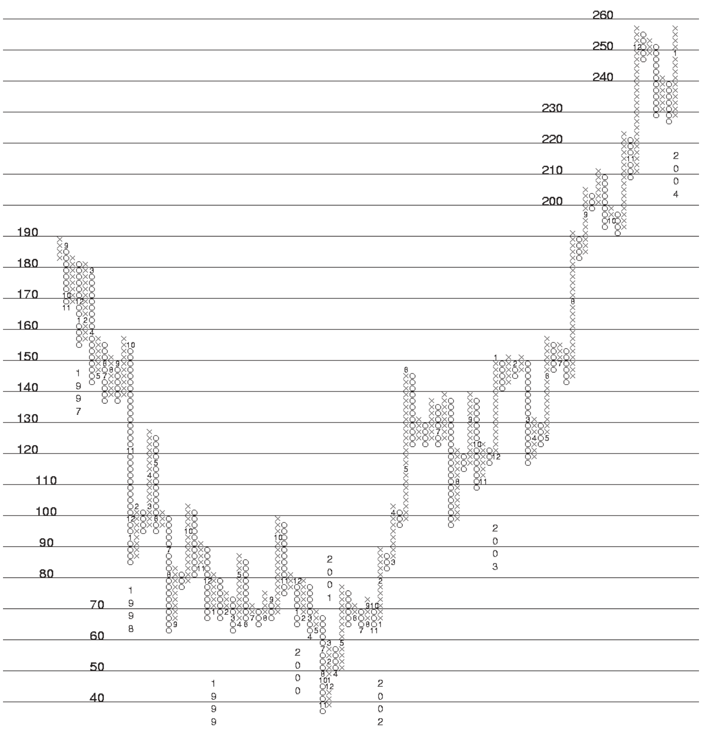
S&P 500 Composite Index (10pt)



Nasdaq 100 Index (15pt)



Amex Gold Bugs Index (2pt)



be more interested in gold-backed securities than mining shares. Over time, this is likely to lower stock market valuations for gold producers.

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.*

This section contains Part 2 of my technical focus on emerging markets.

The US's S&P 500 Composite Index's (1127) has resumed its rally following a lengthy consolidation. The last two reactions were 3 units of scale (30 points on this 10-point scale). Consequently a decline of at least 4 units of scale and/or a break in the progression of rising lows, which ever comes first, is needed to check current momentum. **The NASDAQ 100 Index (1522)** has seen a potentially significant break above its October to mid-December highs. A move below 1425 would be necessary to suggest an upside failure. In the event of further gains, which appears likely, a decline of 5 units of scale (125 points) and a break in the rising lows would eventually be required to question the present upside bias. **The Amex Gold Bugs Index (244)** recently saw its biggest reaction since the first step above the base evident between June 2002 and June 2003. Nevertheless the overall upward trend is unchallenged and a move to 224, which seems improbable, would be required to confirm more than temporary resistance near the December high.

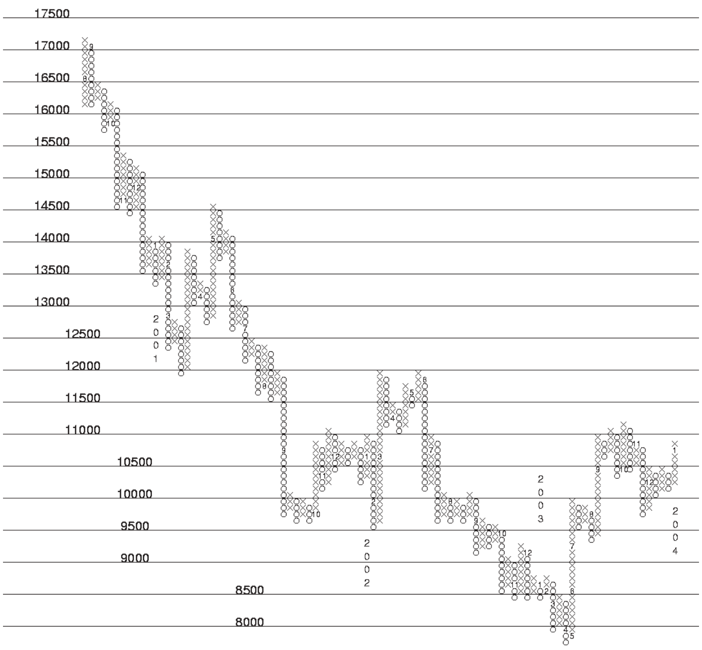
Japan's Nikkei 225 Stock Average Index (10837) probably saw its reaction low in November. A move back below 10000, which seems unlikely at present, is required to offset current scope for a test of the September-October highs.

Australia's S&P ASX200 Index (3297) is testing its October high and also the upper region of the mid-2000 to mid-2002 top area. While this was never going to be overcome easily, a break in the progression of rising lows, currently requiring a decline to 3160, is required to check the overall upward bias.

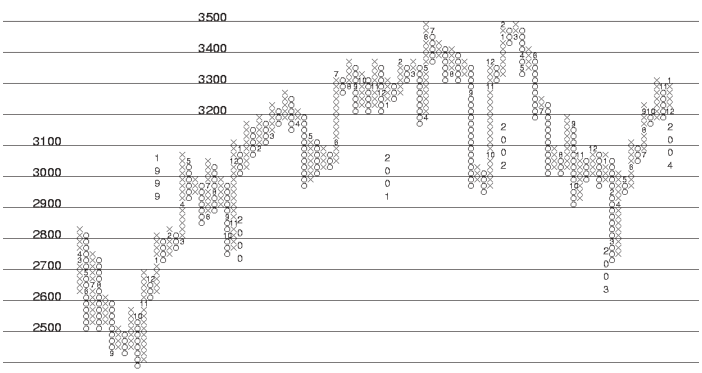
Thailand's Bangkok SET Index (773) is now accelerating at a rate that is unsustainable beyond the short term. Consequently a reaction is probable before long and may occur near the psychological 800 level. Nevertheless, the strong rally to date is well supported by a multiyear base, partially shown. For perspective, it is worth recalling that the SET Index reached 1789 in early 1994.

India's BSE SENSEX Index (6108) has also accelerated at a rate unsustainable beyond the short term. Additionally it is in the region of the 2000 peak - not shown, *see*

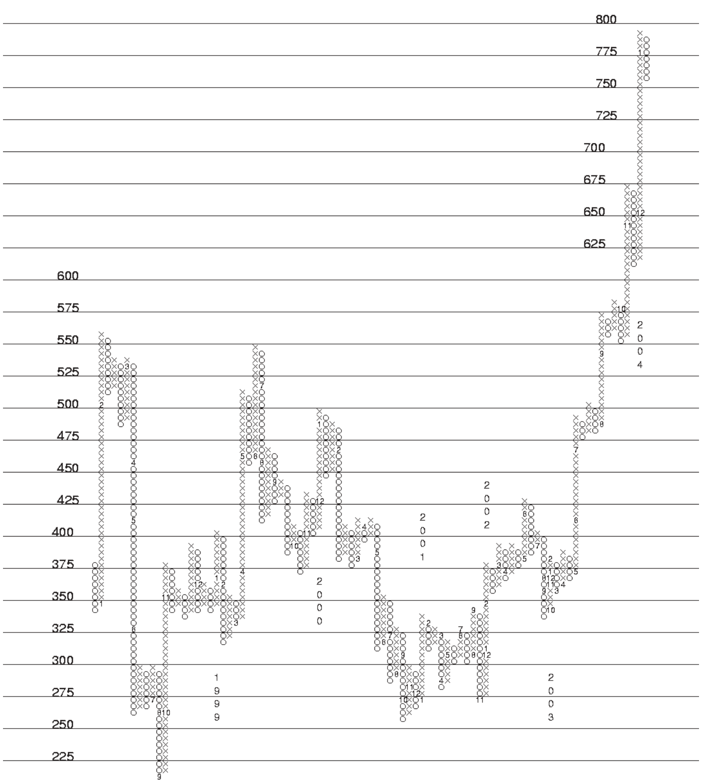
Nikkei 225 Stock Average Index (100pt)



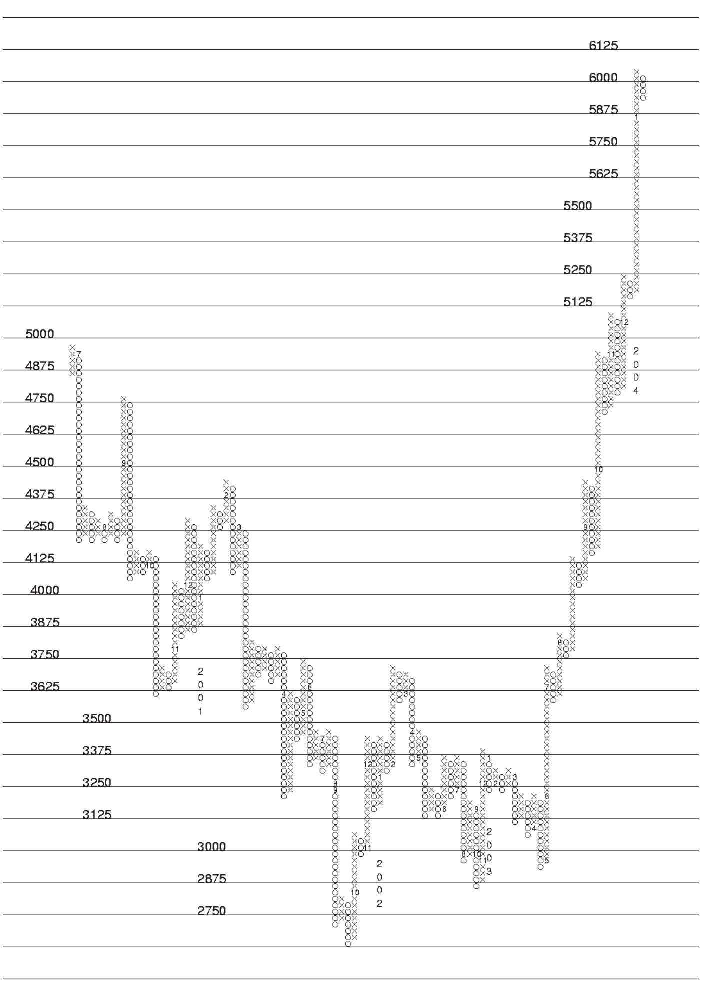
Australia S&P ASX200 Index (20pt)



Thailand Bangkok SET Index (5pt)



India SENEX Index (25pt)



www.chartanalysts.com - and the psychological 6000 level. Another reaction is probable before long, although this is unlikely to damage sentiment unless it is clearly larger than corrections seen since September.

Germany's DAX Index (4045) - *see page 13* - consolidated its push over the September high and has now reached the psychological 4000 level, which may lead to a pause. Nevertheless a move back beneath 3625, which appears unlikely, would be required to further question the overall uptrend since last March.

The UK's FTSE 100 Index (4494) - *see page 13* - has resumed its advance following a rising consolidation. A decline of 5 units of scale - 250 points from the last recorded high on this 50-point scale chart - would be required to question the overall upward bias.

Brazil's Bovespa Index (23399) - *see page 13* - is becoming somewhat overextended after a persistently strong rally. However there is no reason to expect more than a temporary pullback and consolidation at this stage.

Argentina's General Index (52065) - *see page 13* - has accelerated in recent months. Therefore a sharp reaction is likely before long.

Mexico's IPC Index (9127) - *see page 14* - consolidated gains just above its March 2000 peak and has renewed its advance, which is well supported by the underlying base. A reaction to 8300 is required to offset higher scope and signal a potentially lengthy correction.

South Africa's JSE Africa Industrial 25 Index (6968) - *see page 14* - is approaching potential psychological and lateral resistance near 7000 but there is currently nothing on the chart to suggest more than another small reaction and consolidation.

China's Shanghai A Share Index (1687) - *see page 14* - has rallied strongly from its January 2002 and January 2003 lows, reaffirming solid support in that region. While overhead supply may now slow this recovery, if most of the gains from November's lows are maintained during the next reaction as seems likely, an additional rally should occur thereafter.

Hong Kong's Hang Seng Index (13203) - *see page 14* - has completed a consolidation near psychological resistance and lateral trading in the 12000 area. A decline to 12100, which seems unlikely, would be required to offset current scope for higher levels.

Strategy for stock markets - Bottom line, I maintain that Wall Street is seeing no more than a very good medium-term recovery within its secular bear market. Given the influence of price trends in the US, I will proceed on the conservative assumption that rallies for other stock markets are more likely than not to be reined in, once the S&P 500 has ended its current advance and commenced a downtrend. Naturally, a number of other strategists will disagree with both premises, and no one had cornered the market in good guesses. Fortunately this does not matter, at least not yet, because the global stock market rally caught a second wind in December, which has carried into the New Year. Consequently, my prior concern over not wanting to see the progression of rising lows since last March broken by leading share indices (they have held) has temporarily been replaced by the possibility of trend acceleration. While some increase in momentum is not an immediate worry, given that the September to November ranges appear to have been rising consolidations on the charts, surging market activity beyond the very short term would look climactic. We would see this first in emerging Asia, notably Thailand, Indonesia and India, plus some of the South American markets. Meanwhile, second wind not withstanding, I would resist the crowd temptation to become more bullish with each new high for indices and also each passing month during which the uptrends are maintained. 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.

Having commenced reducing my equity exposure in mid-October, I then built it up again from mid-November, as discussed in the daily Audio. This commenced with an increased concentration in Thailand and India (I never have a balanced portfolio) via the Aberdeen New Thai Investment Trust Plc (ANW LN) and the JP Morgan Fleming Indian IT Plc (JII LN). During the autumn turbulence I gained small profits in NASDAQ 100 and FTSE 100 futures hedge shorts but foolishly held a DAX short too long. This loss was partly offset by trading longs in Nikkei and Hang Seng Index futures following their reactions but I should have held these positions longer. I subsequently rebuilt the HIS futures long, within its yearend trading range, and doubled up on the breakout. This trade, protected with trailing stops, is now my biggest leveraged speculation by far, and was discussed extensively in the Audio for 2nd January, available to all subscribers who have received or requested a login name. I purchased a small position in the UK company Fenner Plc - a Peter Bennett pick with a promising chart. I sold the Japanese share UFJ Holdings, purchased in mid-May and my biggest unleveraged percentage gain of last year, and put half the proceeds in the new London-quoted Gold Bullion Securities Ltd (GBS LN). The remainder was invested in a Japanese recovery speculation, disconcertingly named Zero Inc (4697 JP), spotted on the charts by my colleague and Japan analyst Will Chawner, and the UK share Croda International (CRDA LN), another Peter Bennett value pick. I just switched a portion of my Thailand position (ANW LN) into the closed-end US-listed Malaysia Fund Inc (MF US), mentioned as a possibility in FM233. While I had not previously purchased a closed-end fund (investment trust) selling at a premium to NAV, I made an exception in this case because of Malaysia's catch up potential, and not being able to find an equivalent fund selling at a discount. A rough estimate of my equity weighting would be at least 85 percent Asia (mostly emerging), up to10 percent gold shares and mining funds (this figure is down due to my gradual shift to the actual metals - precious and industrial - mostly via futures), 4 percent UK high-yielding stocks and less than 1 percent in a US biotech speculation.

Currencies

- **The US dollar's decline is becoming temporarily overextended.**

- **The euro's main trend will remain upwards until the ECB becomes aggressive in an effort to check its advance.**

Even the most obvious trends, such as the US dollar's, do not move in straight lines beyond a few weeks. Having fallen sharply in recent weeks, the greenback has commenced a short-term technical rally, mostly on short covering, as I complete this issue. However this is unlikely to lift the dollar significantly, despite heavy and sustained buying from the Chinese and Japanese governments, which are recycling their trade surpluses with the US in an effort to prevent the renminbi and yen from appreciating. While this has kept the dollar's decline orderly over the last two years, it is unlikely to reverse the greenback's primary trend anytime soon. Overriding factors remain the supply of dollars and overall momentum. These outweigh unilateral intervention and also improving US economic data. Everyone knows the Fed targeted inflation and therefore obviously the dollar as part of that effort.

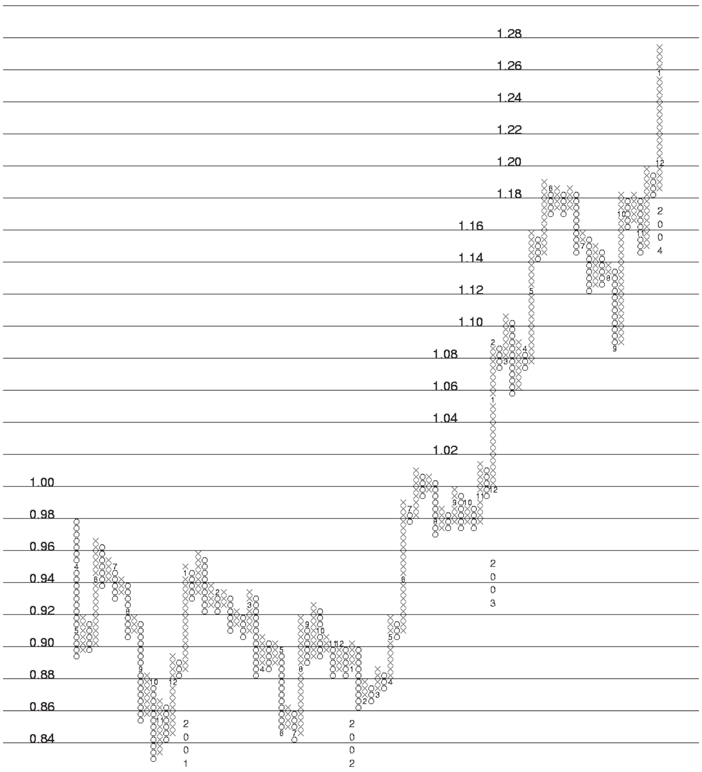
Greenspan, Bernanke and Co are succeeding, albeit at the cost of devaluation, having long flooded the market with dollars. Everyone knows about the US's ballooning trade and current account deficits, which have understandably made currency speculators very wary of the dollar over the last two years. This situation is regarded as a disaster by many observers, and not least gold bugs, who believe it will eventually end in hyperinflation for the US and a collapse of the dollar. They could be right, but I rate this as no more than a 20 percent chance, although the US will certainly have an inflation problem within the next 10 to 15 years. Meanwhile, the Fed and US Treasury are hoping that the US can somehow grow its way out of the debt and deficits problems, before the inflation genie is not only out of the bottle but also wreaking havoc. They might just get lucky, not least because the US's main trade partners have a big vested interest in seeing that the dollar does not collapse, at least not relative to their currencies. In other words, in this new millennium no country wants a strong currency, as I have said before. Faced with the unpleasant shock of a soaring exchange rate against the US dollar, they too will eventually resort to inflationary measures, to a greater or lesser degree. It's not so much a case of wanting inflation, although it is convenient for debtors, but of seeing it as infinitely preferable to the threat of deflation, at least until public awareness of this monetary theft leads to outrage, as we last saw in the late 1970s and early 1980s. Meanwhile a gradually increasing awareness of the monetary shift described above is slowly remonitizing gold in the eyes of investors. Bottom line for the dollar: I do not expect it to commence a bottoming out process until we see multilateral intervention by the world's leading central banks, including the Fed. This will only occur when the dollar's decline is widely perceived as an overshoot, and a serious threat to the developed world's financial system.

The euro remains the least ugly of three reserve currencies in the eyes of forex traders. While no country wants a strong currency, as I mentioned above, some are willing to do more to prevent it than others. The ECB has done very little to halt currency appreciation, relative to what we have seen from the US in recent years and from Japan over a longer period. Until this changes, it will continue to trump all other factors, including Euroland's comparatively modest GDP growth.

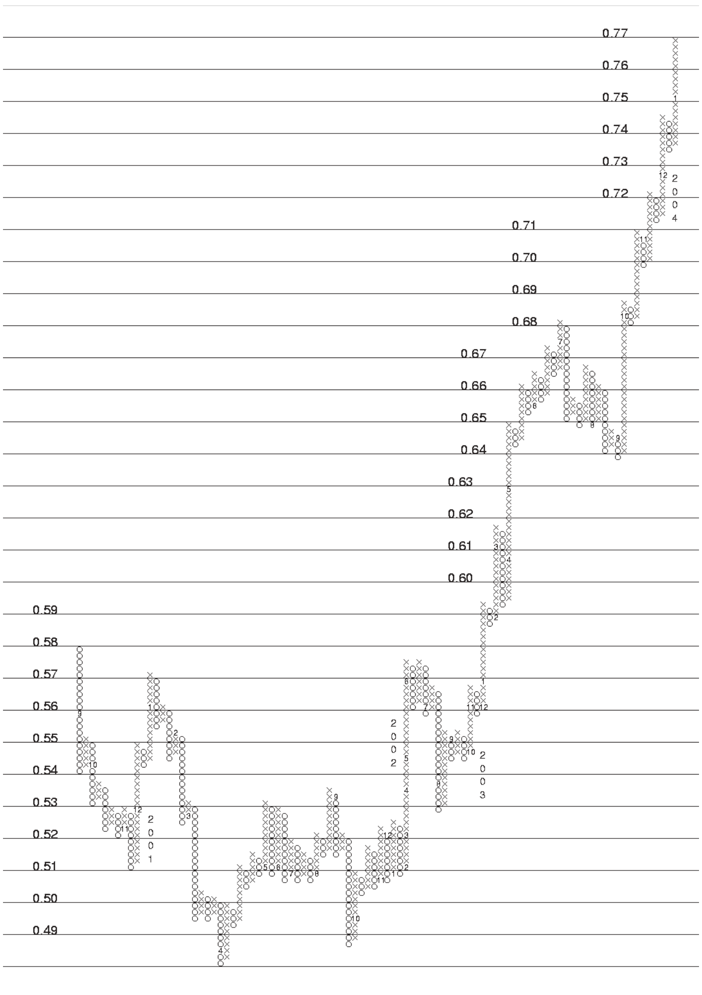
Chart review of important and topical currencies
- *These and hundreds of other 3-box reversal closing basis point & figure charts are available on our website, www.chartanalysts.com and are updated daily. All comments refer to closing levels for US trading hours. Please note: the charts are sometimes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

Euro/dollar ($1.2724) - The euro has advanced steadily since breaking above its May to November trading range. Consequently this move is beginning to appear overextended. Nevertheless, underlying support should limit downside risk to small reactions before higher levels are seen.

US Dollar per 1 Euro (0.004)

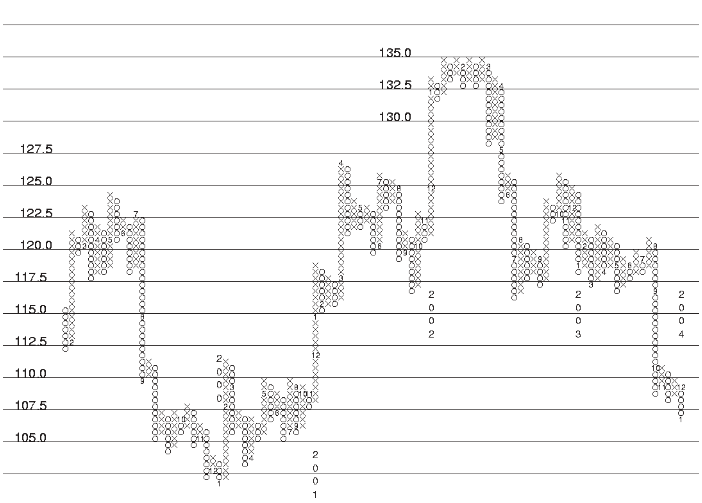


US Dollar per 1 Australian Dollar (0.002)



US Dollar per 1 Pound Sterling (0.005)

Japanese Yen per 1 US Dollar (0.5)



Australian dollar/US dollar (US$0.7006) - *see previous page* - The Australian dollar looks increasingly overextended. Nevertheless, downward reactions since September, of which there have been four evident on this chart, have been consistently small - between 3 and 5 units of scale on this US$0.002 scale. Watch for a change in consistency, which would warn of a loss of momentum and potential for a bigger correction. The possibilities would include upward acceleration relative to what we have seen since the beginning of October, a closing basis reaction of more than 1¢ (6 or more units of scale), an upside failure, a lower high, a lower low or a trading range of more than 3 column width. Just one would ring a technical alarm bell and changes of consistency within previously strong trends tend to occur in bunches.

Sterling/dollar ($1.8311) - Sterling's advance is beginning to appear overextended. Consequently this rate of advance is unsustainable beyond the short term. Unfortunately, there are fewer consistency characteristics to monitor than for Australian dollar/US dollar above, so the sterling/dollar chart is not as easy to work with. However, the next 3-box reversal on this $0.005 scale will be a warning, particularly if it exceeds the 5-unit reaction seen in November. Additionally, the region of $2.00 would be an important psychological barrier, should sterling rally that far.

Dollar/yen (¥106.17) - The dollar's decline has slowed as it has entered its September 1999 to January 2001 base, extending down to ¥101.5. A period of ranging near current levels appears likely. A rally to ¥109.5 is currently required to question current scope for an additional test of the 1999-2000 trough.

Strategy for currencies - I'm currently running euro/yen and SF/yen longs, opened in November and mentioned in the Subscriber's Audio. These are now protected with trailing stops. I would use the same tactic for euro/dollar at this stage, not least because the euro has moved well above its May to November trading range, evident beneath $1.20. I would favour technical trailing stops for all currencies that are very strong against the US dollar, including the Australian and New Zealand dollars and sterling, because there will be periodic shakeouts. As previously stated, I would only short dollar/yen after a BoJ intervention rally and I would commence covering on tests of the previous reaction lows. I have been waiting to short the rand, and the dollar has now fallen back to important support near R6. While this cross-rate is beginning to look promising on charts, I'm wondering if there will be a lengthy basing process as the dollar remains generally weak? If so, the interest rate differential would prove expensive.

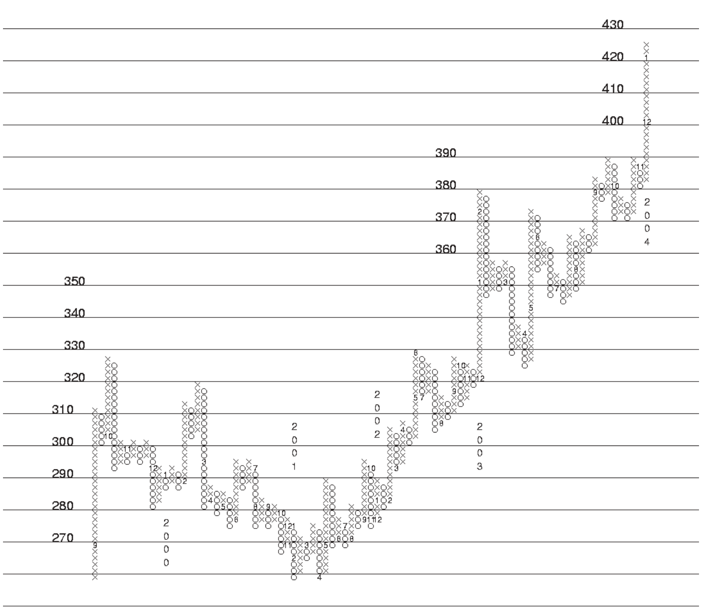
Commodities

- **Gold bullion completes its first step above the base, in US dollar terms - further gains to follow.**

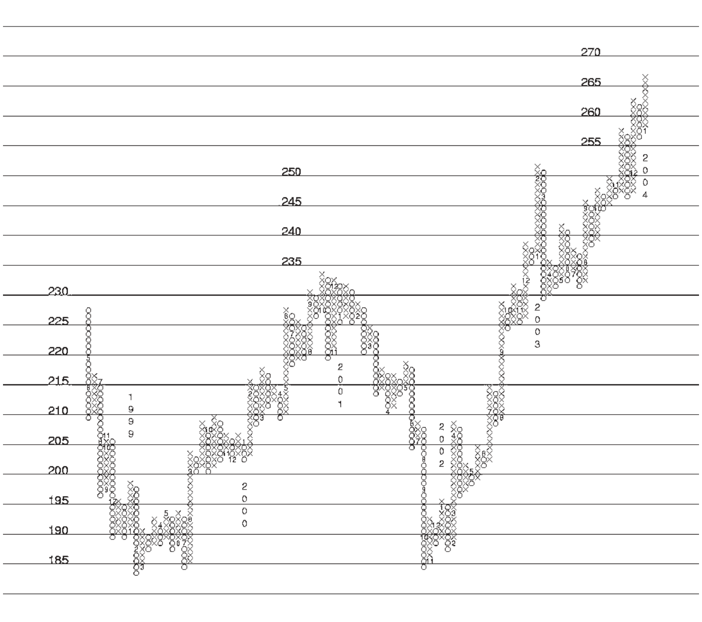
- **Platinum continues to lead the advance among precious metals - silver has improved its relative performance recently and palladium should eventually follow.**

A scarce asset, gold should extend its push into the lower to mid-$400 region. It is a fallacy to regard the gold price as primarily an indicator of fear. Gold is an asset and like any other, its price reflects supply, demand and sentiment. Today, the supply of gold bullion is largely determined by price and central bank activity. As the price in US dollars and all other reserve currencies has been ranging gradually higher since mid-1999, we can assume that supply will also increase, at least in terms of new production. However this is always a gradual process due to three reasons: gold is a scarce commodity; new mining ventures are expensive, and there are time lags before new mines become productive or output at established mines can be increased. Additionally, mine output never increases proportionally to a rising price for bullion because mining companies use the opportunity to process lower grade ore.

Gold CMX 2nd Month Continuation (2USD)



CRB Index NYFE (1USD)



Conversely, when the price is low, mines concentrate efforts on their richest veins, in order to remain profitable. The currencies of gold-producing countries can also hamper output, even when the US dollar price of gold is rising, because a producer's appreciating currency may offset much of the higher price, to the detriment of operating profits. We are currently seeing this in Australia and South Africa.

The greatest known supply of gold by far - approximately 28,000 tonnes, is already above ground and held by central banks. Europe's central banks have been the largest sellers of these reserves for many years, with a predictable influence on price during bullion's secular bear market from 1980 to 1999. In September 1999, following protests from developing country producers of gold, fifteen European central banks, including those of Germany, the Netherlands, Switzerland and the UK, agreed to limit combined annual sales to 400 tonnes for the next five years. With the help of this arrangement, known as the Washington Agreement on Gold (WAG), bullion bottomed at $251.95. However, an immediate upward spike in the price to $340 was short-lived, because central banks continued a policy of lending gold to bullion banks such as JP Morgan Chase, which encouraged Barrick Gold Corp and many other mining companies to hedge against falling prices by selling future production forward. Inevitably, this policy proved to be a double-edged sword for the mines - offering some protection against falling prices but exacerbating gold's weakness in the process. And when a sufficient number of investors concluded that gold was an undervalued asset relative to most stocks and bonds, and began to bid the yellow metal's price higher, hedging by mining companies reduced rather than enhanced profit potential. Sensing that a long-term advance in the gold price is underway, few mines are interested in hedging at today's prices. Even Barrick has announced that it will conduct no further hedging. However it still has 16 million ounces of future production hedged, currently worth over $6.5bn. It won't be easy to unwind this in a rising market.

The greatest obstacle in the path of higher gold prices is central bank sales. Since 1999 European central banks have sold over 1594 tonnes of bullion from their reserves under the WAG. The biggest sellers, according to the World Gold Council, have been the Swiss National Bank (871 tonnes) and the Bank of England (345 tonnes), with this latter amount offloaded near the lows. Sales from non-European central banks have been small, and some have been buyers, notably from Asia. The WAG expires in September 2004, but is likely to be renewed, albeit with some changes. Commenting at a recent gold conference in Dubai, Giacomo Panizzutti, who retired last year as the secretariat supervising the WAG said, "I strongly believe the agreement will be extended, probably for a slightly larger amount of around 2, 300 to 2,400 tonnes, and for another five years. Such an increase of about 300 to 400 tonnes should not be a problem and should be easily absorbed as long as the market remains as well supported as it is just now". This is probably correct although some potential buyers of gold may be cautious until a new WAG is reached. Additionally, stronger prices beforehand would probably lead to a higher tonnage agreement, and vice versa. Should the WAG not be renewed, the price of gold would be susceptible to a potentially significant, albeit temporary correction, due to supply fears. Meanwhile, it is generally acknowledged that the WAG's fifteen European member countries, which still hold approximately half of official reserves at 14,000 tonnes, would like to sell more gold. Among other countries with large bullion reserves, the US and Japan agreed not to sell shortly after the WAG was announced in 1999. Any moderate increase in gold sales by the WAG fifteen are more than likely to be offset by purchases from Asian central banks, some of which maintain a small fixed proportion of their reserves in bullion.

Scrap gold represents another potential source of supply. When gold bullion soared over $800 in early 1980, scrap metal poured onto the market, from former industrial uses, ornaments and jewellery. We can assume that this will happen again, at some point. However the price of gold would probably have to at least double from current levels to flush out a significant increase in scrap metal.

Investment demand for gold will persist for many years, more than absorbing new supply from mines, central banks and scrap. Gold is back in fashion and this trend should persist, albeit punctuated by the usual periodic corrections, for many years. If I'm right, this won't only be in response to the US dollar's decline. Remember, no central bank wants a strong currency, which jeopardises export operating profits and therefore economic growth. We live in a fiat money (paper currency) world, dominated by Keynesian economic policies. Governments/central banks will always try to print their way out of trouble. This eventually devalues currency against most assets, particularly those in short supply. Gold is a hedge against stealth devaluation caused by the printing of money in excess of GDP growth. Consequently, investors are slowly beginning to realise that gold is now a value play. Due to government decree, gold is no longer money, in the sense that it is not used as a medium of exchange. However, it is being remonetized in the eyes of people who know about the long, sad history of fiat money, and who also understand what central banks are doing today.

Gold remains in the early stages of a secular bull market, likely to last for a generation, due to credit creation, currency debasement and asset bubbles in other markets. As for the central banks of China, Japan and other nations dependent on exports to the US, it is unlikely they have thought through the long-term implications of accumulating mountainous reserves of dollars. While the US is a borrower nation that may be in deep water, China, Japan and Euroland have become lenders who are also in over their heads. They can't stop buying US dollar reserves because a collapse of the greenback would hurt them most of all. Consequently the dollar is unlikely to collapse against other currencies, although it will certainly move somewhat lower against the more viable units. Instead, other nations will increasingly resort to the printing press over the next decade or more, if only to prevent their currencies from soaring to ruinous levels. This is an eventual recipe for global inflation. Therefore gold will see a much bigger rise than most people currently expect, against all fiat money. As with most of the great bull markets, this is unlikely to occur quickly. Instead, we are likely to see a long, slow, ranging advance over the next 10 to 15 years, with the best gains occurring towards the latter stages, when inflation is a major factor in the investment community's collective conscience.

Platinum is the runaway leader in the precious metals' bull market, having completed its base in 1999. The white metal has now risen 477 percent from its low over four years ago ($142.48 on 25/06/99 to $821.90 on 12/12/03). A backwardation has emerged due to demand from the technology, automotive, jewellery and investment industries. This requirement for platinum is unlikely to abate anytime soon, with the possible exception of the automotive industry, which can switch to palladium for the control of gasoline engine emissions. Consequently more platinum is required from South Africa, Russia and other mining nations to offset the supply shortfall. However the RSA's production is falling due to the rand's strength.

Palladium has been very much the laggard among precious metals, following its bubble in early 2001. Strong demand from the automotive industry in 1999-2000 resulted in a shortage of supplies, lifting palladium to an all-time peak that year, from which it subsequently fell nearly 87 percent ($1084.28 on 29/01/01 to $145.84 on 17/04/03). While a post-bubble supply hangover has weighed on palladium, which was temporarily priced out of the industrial market, platinum's runaway advance can only encourage the automotive industry to undergo expensive retooling and switch back to the cheaper metal. Additionally, demand for palladium by the cosmetic jewellery industry can only increase at these prices, especially in Asia where the metal is used for gilding. Further gains by other precious metals can only increase investment interest in palladium, as a catch-up candidate. This could easily result in the price doubling or tripling from today's depressed level, long before we saw a similar move from current prices by any of the three main precious metals. Meanwhile, palladium's chart pattern provides clear evidence of base formation development.

Silver is beginning to outperform gold. Historically, silver's price action has been a high-beta version of gold, more often than not. However the grey metal lagged in this cycle and did not reach its bear market low until just over two years ago ($4.081 on 23/11/01). Investor apathy and less demand from the photography industry were contributing factors. Nevertheless silver's relative performance has improved recently and from here on it should outperform gold on the upside more often than not. The price recently completed a large base formation. This is attracting investment/speculative demand. Unlike gold, there is no need for a Washington Agreement on Silver, because central banks do not own it and therefore cannot pose a supply threat. Consequently a moderate increase in demand for silver can cause a disproportionately large move in the price.

Strategy on commodities - I continue to hold a position in palladium futures, which I have accumulated during the base formation stage to date. Palladium is a 'sleeper', lagging way behind the other precious metals, mainly because of its bubble in early 2001. However it should eventually stage a significant catch-up rally. I repurchased silver futures in early December. This position is now protected with a trailing stop, which is loose due to silver's volatility. I bought more silver during a recent consolidation of gains and aim to increase this holding at opportune moments, while the uptrend remains consistent. I will also consider lightening this position on the better rallies. I also hold the new UK-listed Gold Bullion Securities (GBS LN) in my self-administered pension fund. A recent purchase of copper futures was stopped out at a small profit. I aim to gradually build positions in several industrial metals and am considering a few agricultural commodities as well. The Subscriber's Audio is the best way to remain appraised of any trades/investments that I am considering or actually hold, in commodities or any other markets.

The Global Economy

■ **The US economy is much more likely to experience inflationary than deflationary pressures in 2004.**

■ **Developing Asia's economies are overheating.**

■ **Japan's monetary policy is once again jeopardising an opportunity to break out of the deflationary cycle and establish sustainable economic growth.**

■ **The euro headwind is increasing and threatening Europe's fledgling economic recovery.**

The US Federal Reserve targeted inflation over two years ago, and it has succeeded. Everyone has been worrying about deflation in the US following the NASDAQ's burst bubble, Japan's experience, 9/11 and the flood of cheap imports coming from developing countries, particularly China. Consequently the Fed launched the biggest monetary reflation in US and perhaps world history, flooding the system with liquidity, not least to weaken the dollar. This was matched by the Bush Administration's record fiscal spending, not least because of its war against terrorism. Even a shocked, indebted economy had to rebound following this infusion of monetary and fiscal steroids. In 3Q, US GDP grew 8.2 percent, considerably more than generally expected, albeit with the help of 'hedonics' (creative accounting) particularly in terms of IT spending. Combine these measures with a synchronised global economic expansion for the first time in many years and we have an inflationary cocktail. Even job creation - always a lagging indicator and not least during a period when companies were concerned about deflation and trying to reduce debt, is now increasing, especially in government sectors. Today, deflationary pressures have mostly abated in all sectors of the US economy except for durable goods, which are only 11 percent of GDP. At the opposite extreme, house price and services inflation have been apparent for a long time. Helped by the soft dollar, America's corporations are slowly regaining pricing power for the first time in several years. Import prices are now increasing due to the dollar's decline and also commodity inflation. Long-term inflation expectations reported by the University of Michigan are currently at 2.8 percent and likely to reach at least 4 percent next year. Nevertheless, the Fed has clearly stated that it will err on the side of inflation. Why? Because it knows how to check inflation - just raise interest rates. Given the US's tragic experience of the 1930s and having witnessed Japan's ongoing deflation, the Fed understandably fears deflation much more than inflation. Also, Greenspan & Co would like to avoid any accusation that it contributed to an incumbent president's re-election campaign defeat. Clinton's "it's the economy, stupid" slogan in 1992 helped to defeat the former President Bush, who felt he lost because Greenspan kept interest rates too high for too long.

Short of a massive exogenous shock for the US economy, Fed policy ensures that it will fall behind the curve in terms of higher interest rates, even if consumers reduce debt somewhat and spend less in the next few months, as seems likely. Meanwhile, capital expenditure and inventory rebuilding are likely to offset most of the decline in consumer spending, ensuring further GDP growth. Consequently, only a significant sell off in the US stock market is likely to further delay a gradualist shift in Fed policy and the first rate hike may occur sooner than most people currently expect. Deflationary pressures are unlikely to return until the next recession, likely to commence in 2005 as the White House and Federal Reserve tackle US deficits.

Asia's developing economies have led the global economic recovery, so it is not surprising that they are providing the first evidence of inflationary pressures. China experienced the first signs of overheating, then Thailand and it's spreading throughout the region. Initial evidence came from rising property prices and a construction boom. More recently strong GDP growth has produced China's biggest ever consumer-spending boom. Demand in the rest of Asia is returning to levels not seen since before the financial crisis of 1997/98. Only currency appreciation against the US dollar-pegged renminbi is delaying higher interest rates in Asia's developing economies (ex China). In linking its currency to the dollar, China effectively imports US monetary policy, guaranteeing higher inflation in 2004.

One could be forgiven for thinking that over the last dozen years Japan never missed an opportunity to miss an opportunity. "Inflation is always and everywhere a monetary phenomenon." Milton Friedman first uttered this basic truth during his Wincott Memorial Lecture in London on 16th September 1970. For years Japan's government has been trying to spend its way out of a destructive deflationary cycle. It hasn't worked, beyond cushioning the rate of economic decline. The main reason is Japan's monetary policy. The Bank of Japan, under its former Governor Masaru Hayami, said it had done all it could in terms of monetary stimulus. However all the

BoJ ever did was maintain low interest rates and buy Japanese Government Bonds. While this pumped money into ailing commercial banks, they reinvested most of it in more JGBs. Very little liquidity re-entered the economy. Japan's money supply has remained woefully low for an economy still experiencing net deflation, registering only 1.6 percent (M2+CD) in November. Today, with a synchronised global economic recovery underway, Japan has a favourable external environment for breaking out of its deflation. However the firm yen is jeopardising this effort. Japan has been intervening massively in the currency markets in an effort to stem the yen's rise against the dollar. It might have more success if it announced a minimum inflation target of 2 percent and flooded the economy with newly printed yen. This would stimulate the economy, speeding up the cycle of consumer spending and corporate capital expenditure.

Europe remains a nice place to visit but an expensive location for a business. Now the visits are becoming more expensive, especially for tourists from the US, who are also deterred by concern over terrorism and possible anti-Americanism, fanned by the war against Iraq's former regime. Meanwhile, European companies, already hamstrung by socialist employment policies, unions and high taxes, face an increasing headwind as the euro appreciates. This has a direct impact on operating profits for Euroland's exporters, and when they suffer domestic industries are eventually affected. The region's countries have little manoeuvring room because fiscal policy is hostage to the Maastricht Treaty's misnamed Stability Pact, which deters nations from exceeding budget deficits of 3 percent beyond the medium term. Additionally, a one-shoe-fits-all monetary policy is controlled by the European Central Bank, which has a deflationary mandate. Nevertheless, Euroland's economy could only improve given the comparatively robust recoveries underway in the US and especially Asia. However factors cited above will ensure that Europe's GDP growth continues to lag. Consequently it will not make a significant dent in the region's high unemployment. This, in turn, will limit consumer spending. Moreover, Europe's modest economic improvement is occurring just as signs of overheating are emerging from Asia and when inflationary pressures appear set to increase in the US. Therefore global interest rates will have turned upwards before Euroland's economic recovery becomes self-supporting. The UK's GDP growth is stronger than Europe's but flatters to deceive. The unproductive reality - Chancellor Gordon Brown's high-tax, high-borrowing, public sector spending and hiring surge is producing most of the growth. The result is a mushrooming public sector, including new layers of bureaucratic administrators plus politically correct central and local government appointees. Meanwhile, private industry continues to struggle and the main non-public growth of consequence is related to property inflation and the stock market rebound.

And Finally…

The World Money Show - I'll be participating in this classy conference, hosted by my friends Kim and Charles Githler, at the Gaylord Palms Resort, Orlando, Florida, from 2-5 February. I'm scheduled for 1 keynote presentation and several workshops on my favourite financial topics. Attending subscribers, please introduce yourselves. When not speaking, I'll mostly be on the exhibition floor, where we have a booth (# 932) listed under our Investors Intelligence (US division) name, near the Financial Times and the International Showcase Theatre.

> **"Judgment comes from experience; experience comes from bad judgment."**
>
> Simon Bolivar

Best regards - David Fuller

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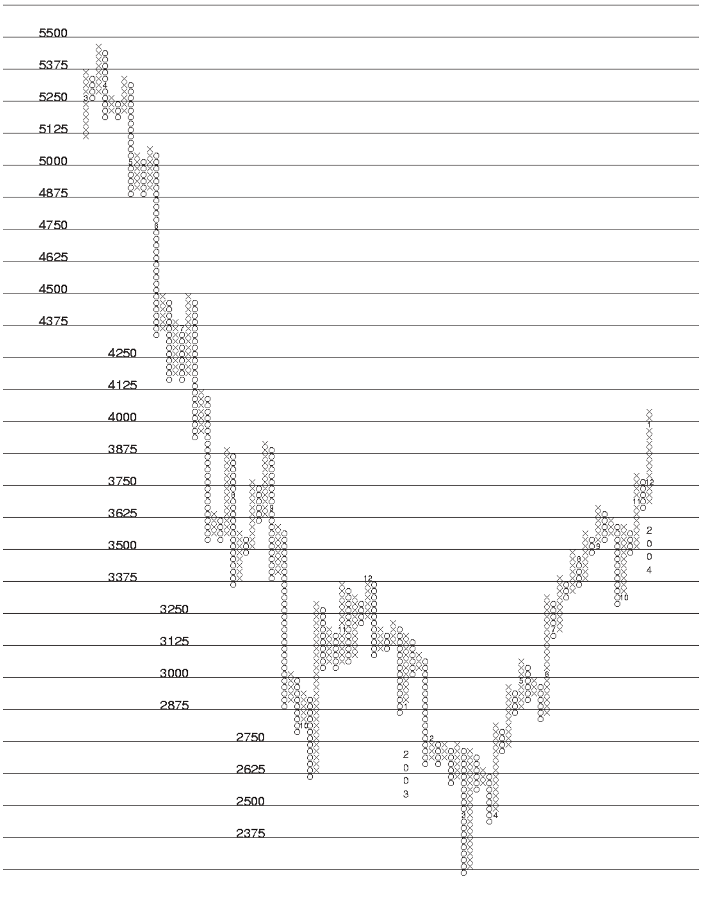
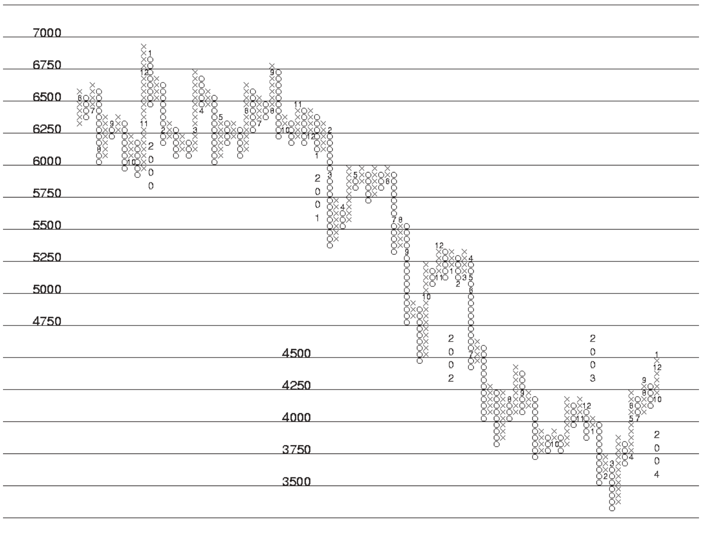
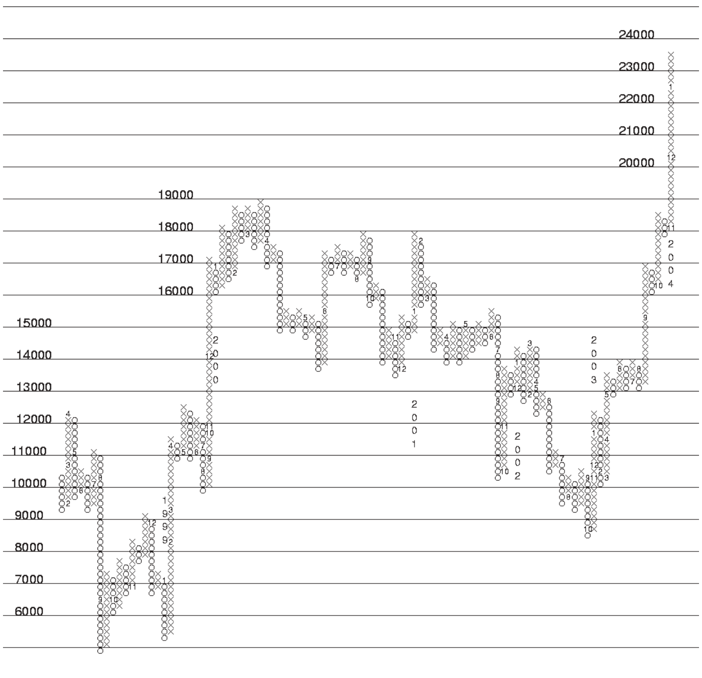
German DAX Index (25pt)



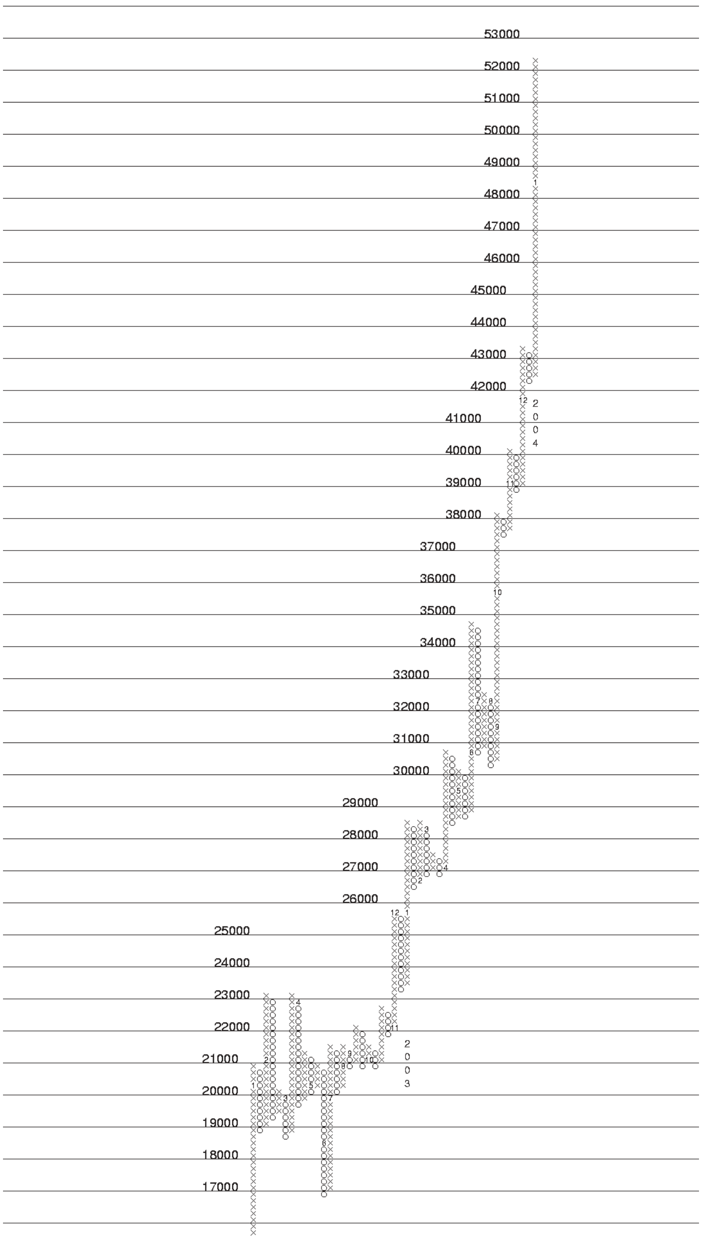
United Kingdom FTSE 100 Share Index (50pt)



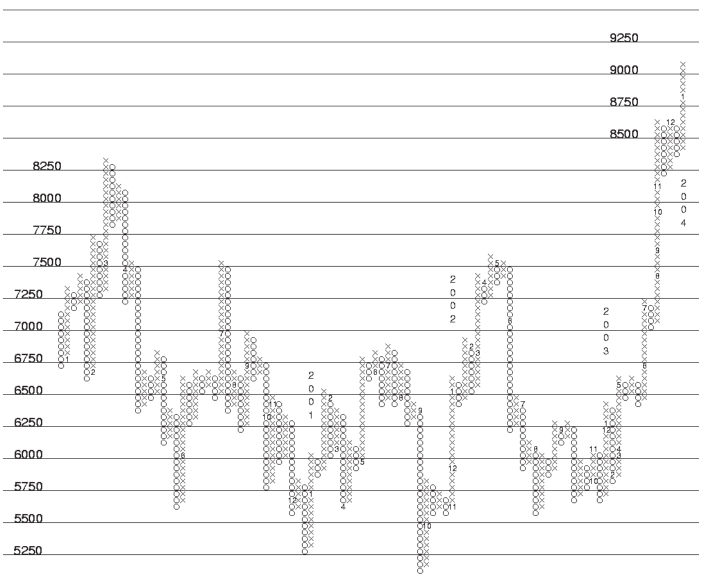
Brazil Bovespa Index (200pt)



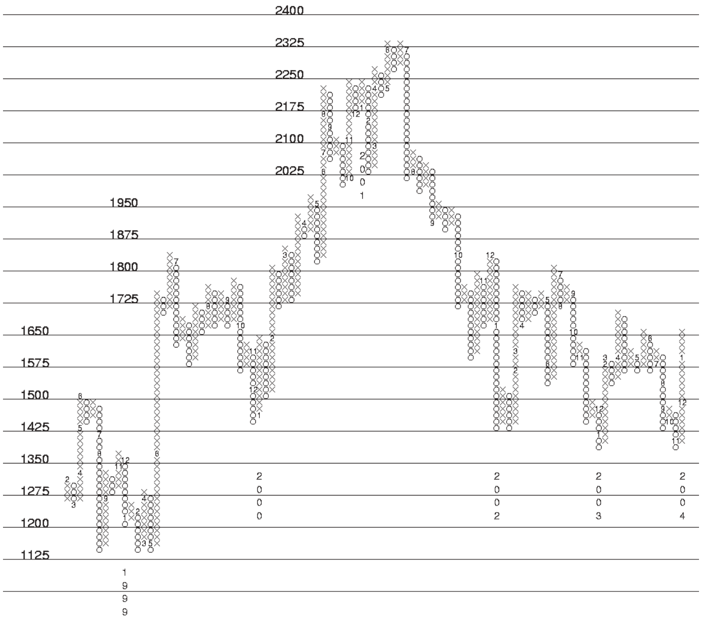
Argentina General Index (200pt)



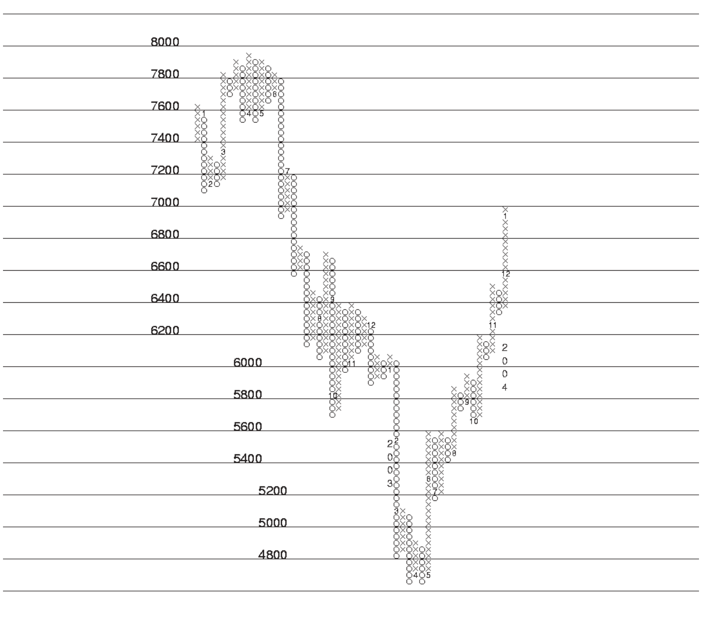
Mexico IPC Index (50pt)



China Shanghai A Index (15pt)



JSE Africa Industrial 25 Index (40pt)



Hong Kong Hang Seng Index (100pt)