

DJIA-led rally supports the base building hypothesis.

The predominant chart pattern in Europe and the USA is V-bottom with right-hand extension, as taught at The Chart Seminar. I have been mentioning this formation ever since stock markets accelerated lower in September, creating the 3rd most oversold condition of my career, after October 1987 and December 1974. A climactic sell-off is followed by an equally dramatic rally, initially on short covering. This gives way to a more gradual, ranging recovery, as we saw in November and December, which slowly loses momentum before spilling over into a correction. It is not unusual to see at least one-third of the rally retraced during this right-hand base extension phase, which often last longer than the initial recovery. The pattern eventually supports somewhat higher levels. While I had wondered last month if the Enron(isation) of stock markets could overwhelm the base building hypothesis, we now have technical evidence that it has not. Asian share indices had very little pullback, while those of Europe and the US have now broken their ranging downtrends from the December-January highs.

Consequently, we may have seen the reaction lows during the period of base extension. Significantly, Japan has seen a major downside failure. While I believe the Koizumi Government's measures to deter short selling will create future liquidity problems and increase overall volatility, Japan's stock market is now less of a focal point for concern. Meanwhile, the big long-term theme, I maintain, is reversion to the historic mean on Wall Street, with Europe's markets moving accordingly. However most stock market indices should range somewhat higher over the next few months. After all, there is plenty of liquidity about. The US's 'guns and butter' economy will "surprise" on the upside this year, even as growth lags elsewhere. Cost-cutting and write-offs will boost earnings for many corporations in 3Q and 4Q 2002. Currently, stock markets are overbought on a short-term basis following the latest rallies. Therefore a partial retracement of gains since the February lows is now likely before the sideways to higher bias continues. Stock markets may not encounter sustained selling pressure until the next cycle of short-term interest rate hikes is underway.

Best regards - David Fuller

US Dow Jones Industrial Average: 10587 (Daily)



Nasdaq 100 Index: 1495 (Daily)



German Dax Index: 5235 (Daily)



Japan Topix Index: 1075 (Daily)



Charts supplied by Bloomberg

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