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

Indian summer for global stock market rally

First the good news - Western stock market indices continue to range higher in an orderly fashion. Trends for Asia's leading markets have slowed, but there is no evidence that they are experiencing more than consolidations within uptrends. The rise in government bond yields has been temporarily checked. Sentiment has continued to improve. This is resulting in and also reflecting better economic data, with Asia and the US at the forefront. Economic recovery and especially cost cutting have lifted corporate profits. Last but not least, liquidity remains abundant.

And the early warning signs - Long-dated government bond yields bottomed in June. On average, as I recall, a significant peak in bond prices leads stocks by approximately 6 months. However this lead time can vary considerably, from almost coincidental in the event of a generally unexpected hike in short-term rates by leading central banks, to more than 6 months if there is little cause for rate increases by monetary authorities. While the latter conditions apply today, we should assume that the next move by the Fed, ECB, BoE and BoJ will be to increase rates, although not even they know when. This event will be anticipated by stock markets and most strategists expect rate hikes next year. Meanwhile, sentiment towards stock markets continues to improve. The crowd's consensus view is a good leading, inverse indicator of risk and reward, because it reflects what investors have done. In other words, if they are mostly bearish, as we have seen at every major low, the next change will be to become less bearish and commence buying stocks. Conversely, if they are mostly bullish, they already own stocks (otherwise they would be schizoid) and the next big decision will be to commence selling. Recently, several investment managers, after expressing understandable satisfaction with their performance since March, have asked me if I still believe this is just a very good rally within a secular bear market? Reading between the lines, they suspect it won't last, although it would be nice if it did. Nothing is certain but the weight of history strongly suggests that Wall Street will range within a broad sideways trading band, at best. Japan and most emerging markets should do better, although not during downturns for the US market.

How will the current rally eventually end? - It could accelerate, which is less difficult to assess technically, but is more likely to end with an overall loss of upward momentum. In this case, an important danger signal would be a clear increase in single-day downward dynamics, relative to the upward dynamics that have characterised most market action since March. Breaks in the progression of higher reaction lows by a number of indices would signal trend deterioration. Lead indicators could be bank shares, which reflect confidence, as do high-beta stocks such as technology.

How I'll play it - I have yet to reduce my equity exposure, preferring to run with orderly trends while they persist, but I'm very unlikely to increase positions. Meanwhile, I become less bullish as markets rise and would lighten on further strength, especially in the event of trend acceleration by leading indices. I expect to see significant peaks in 2004, but hopefully not earlier. I may rotate some holdings, and this would be mentioned first in the Subscriber's Audio. Currently, my positions and approximate weightings are unchanged from FM231.

Best regards - David Fuller

Charts by Bloomberg

US Nasdaq 100: 1381 (Daily)

Japan Nikkei 225: 10990 (Daily)

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