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FullerMoney is published monthly by Chart Analysis Limited, 7 Swallow Street, LONDON W1R 7HD, United Kingdom. Telephone 01-439 4961. Telex 269884 CHARTS G.

Annual subscription rates: U.K. and Europe £96, U.S.A. and rest of world U.S. \$198 or the equivalent in your local currency.

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Searching for future trends

Why SA golds will rise and rise

The biggest bull market gains usually follow an avalanche of selling as bearish sentiment reaches hysterical proportions. There are many examples to prove this point so I'll just mention two stock market classics. Remember end-'74, when the worst global stock market crash since '29 caused many sagacious investors to conclude that "capitalism as we know it is dead"? That spawned the best recovery for years and some big capitalization stock markets haven't had a decent bear market since.

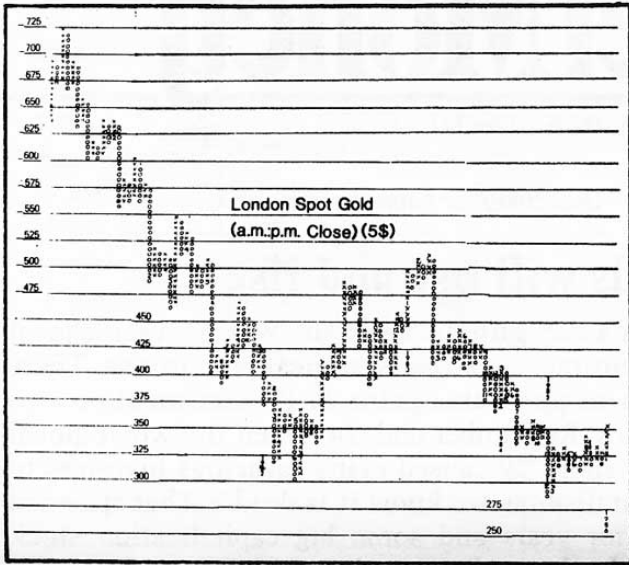
For a relevant special situation example, we have the Hong Kong Index which has nearly tripled following panic over the island's future thirteen years before it would cease to be a British colony. Near the market lows editorials in leading newspapers were concluding that Hong Kong was finished and that communist China would inherit a ghost town in 1997 (a view I first refuted in FM3, May '84).

These are textbook examples of stock market panics prior to sustained recoveries, but the recent hysteria concerning South African gold shares tops them both. First pundits told us that the gold price would fall to \$100 during a global deflation. Then the same political commentators who were wrong after Sharpeville and wrong after Soweto are hoping to be third time lucky in forecasting that the RSA will be over-thrown. Others speculate that either the Boers in retreat or ANC terrorists will nuke the mines. Finally left wing activists who condone repressive regimes all over the world, single out the RSA and pressure public sector pension funds to sell their South African shares.

The result of all this hysteria and anti-South African sentiment has been one of the greatest sector dis-investments by the West in stock market history. Who bought the SA gold shares that everyone else was selling? South African pension funds as a hedge against inflation in their own country. They are long term holders who probably won't be tempted to sell in volume until the next buying panic.

When will that occur? Probably over the next two or three years as the dumping of these shares has been completed and the bullish fundamentals are gradually emerging. For example, the dollar's decline last year has taken the pressure off gold which has established a floor near \$310 and broken up through lateral resistance this month. The big decline in USA inflation is over but Western governments want interest rates lower so the real return on deposits should contract. That makes gold less expensive to hold, while the high yield on SA gold shares makes them a 'tails I win, heads you lose' situation.

At this stage of the recovery cycle I expect gold's upward trend to be laboured. In other words the occasional rally will be followed by lengthy reactions and consolidations before another upward



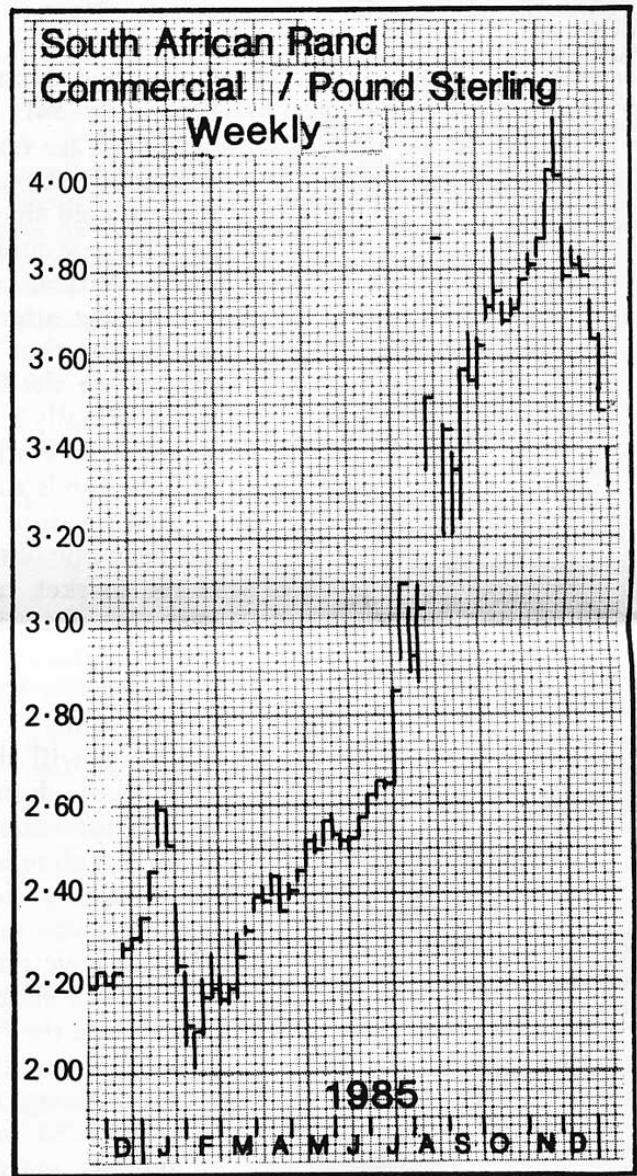
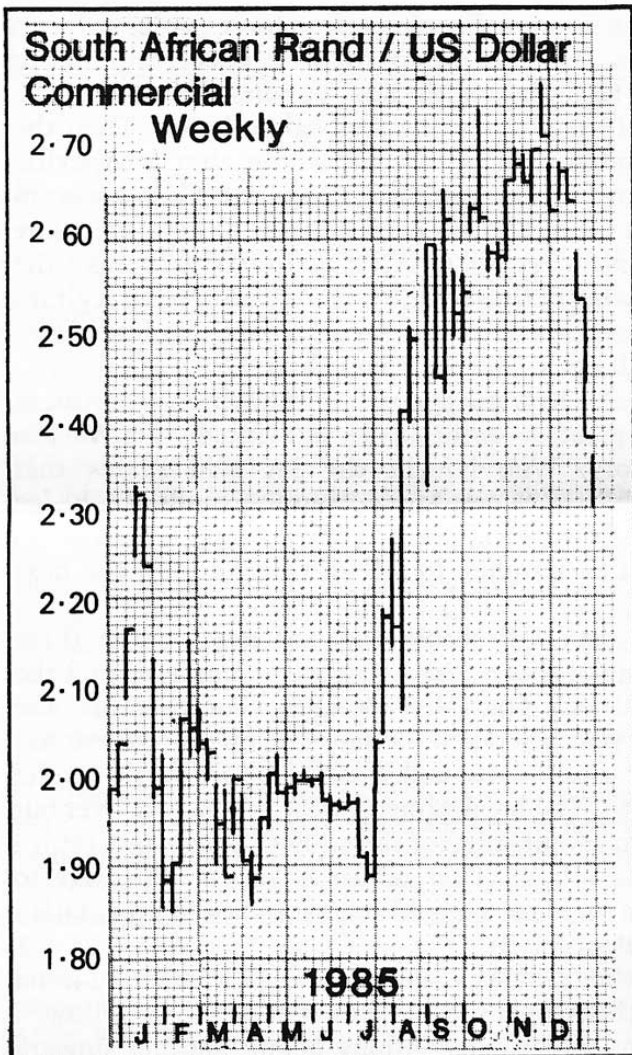
step occurs; nevertheless, the overall bias for bullion is now upwards. This will make gold products appear more desirable and sustainable western growth rates are creating the prosperity that enables people to afford more luxury items.

With a turbulent year ahead for many financial assets (see FM20), investors will rediscover gold shares and gold funds. This will be good for all gold shares but

most of the blue chip mines, in terms of reserves and yield, are in South Africa. However, their total combined capitalization is probably smaller than any of the one hundred largest companies traded internationally and, as already mentioned, most of the SA gold share holdings are locked away in South African pension funds.

Therefore a tiny shift of fashion in favour of gold shares will catapult the South African prices into orbit. If bullion is rising as well, the yield advantage relative to all other stock market sectors will be maintained. That will balance the so-called political risk factor which is already of less concern now that the gruesome murder of blacks by blacks is no longer a regular front page news item in the West.

SA gold shares and the rand factor – In November an FM fund manager said to me over dinner: "David, you've had a great forecasting year but what about those South African golds?" I repeated my comments from FM16 (August) when I described SA golds as "a steal" representing outstanding value due to their intermediate and quite possibly short-term upward potential. In that issue I recommended that FMs add to

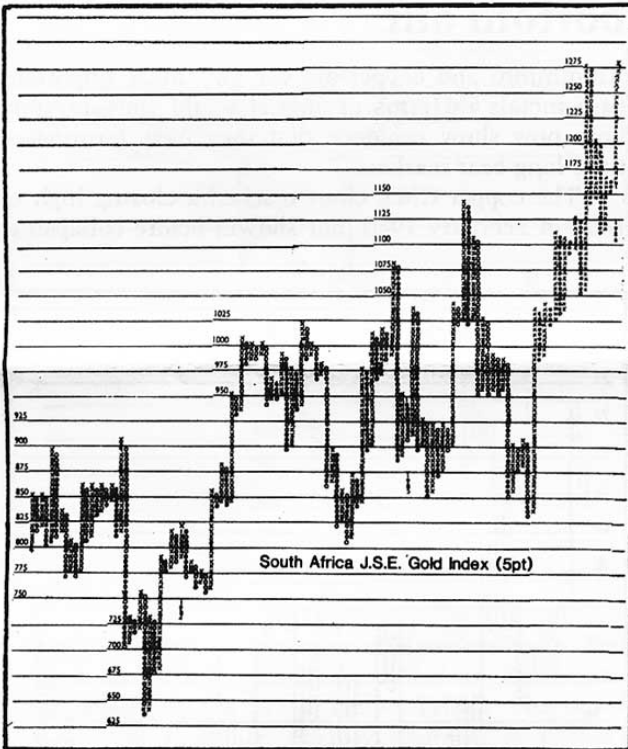


their original 50% stake and that a prudent risk would be to have 20% of one's equity portfolio in this sector. I have advocated a bullion hedging policy (utilized once with success) to limit risk in the event of a further decline in the gold price, but I didn't recommend hedging the rand.

That would have been a good strategy when I recommended an initial purchase in FM8 (Oct '84) as political fears and the RSA's own economic problems caused the rand to collapse until August '85 against the dollar, while its peak against sterling was reached last month. Subsequently it has staged a significant recovery so holders of SA golds are now benefitting from the yield, bullion price and also the rand.

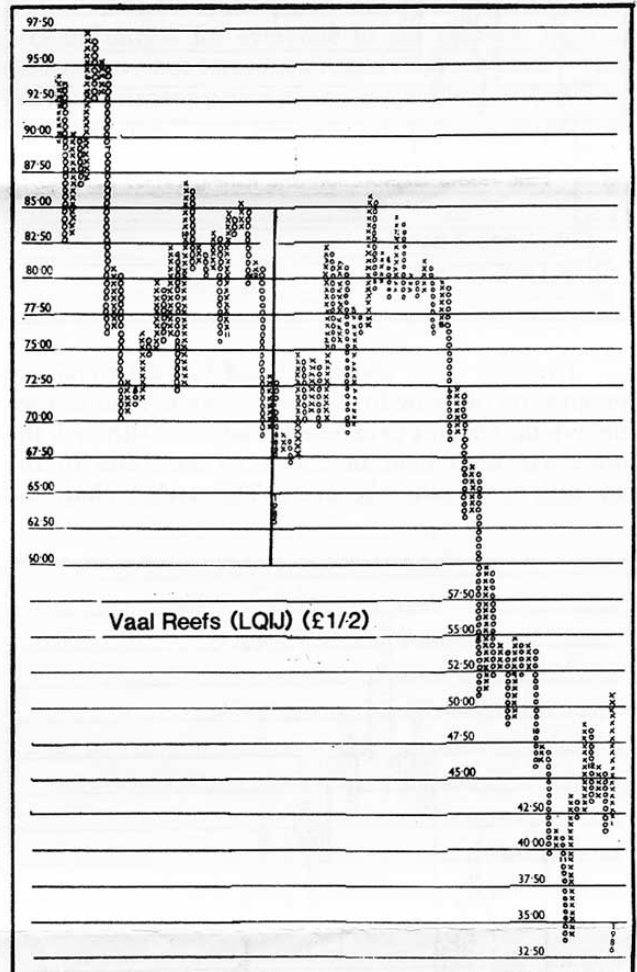
The chart segment taken from CURRENCY shows the dollar peaking at R2.78 against the commercial rand in August, and backing away from that level in December. The subsequent downward break confirms that the dollar will not easily test its highs against the rand if at all. Some support may be encountered near the January '85 high at R2.32, but any rally should be contained by supply from the top area evident above R2.56.

A changing gold price, not to mention political factors, should ensure that the rand remains volatile, but the probability is that it has finally bottomed out against the dollar. The rand was a hard currency during gold's last bull market, and since it traded as low as R1.19 in March '84 (not shown), there is considerable scope for a further recovery.



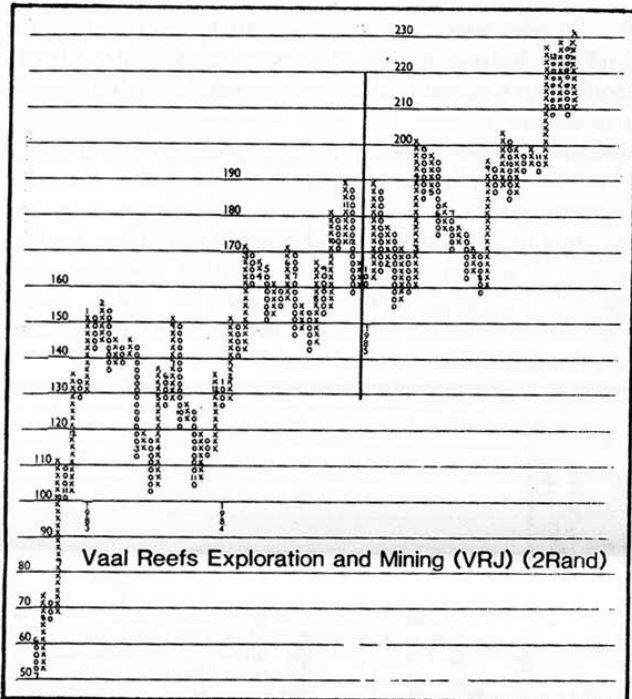
Sterling has fallen further against the rand since its December peak than during the early '85 tailspin for the pound. Last year's advance from a low at R2.00 to R4.27 leaves plenty of room for sterling to fall further against the rand.

In conclusion, currency volatility, political factors and the bullion price will ensure that South African gold shares remain volatile; nevertheless, their recovery potential over the next few years is enormous. Despite South Africa's unique political problems, I don't regard the best mines as speculations, not with current yields of 12% or more, underpinned by the world's largest reserves and a gradually rising bullion price. If it weren't for the so-called political risk, grossly exaggerated in my view, SA golds would classify as the best blue chip investment grade shares available anywhere today.

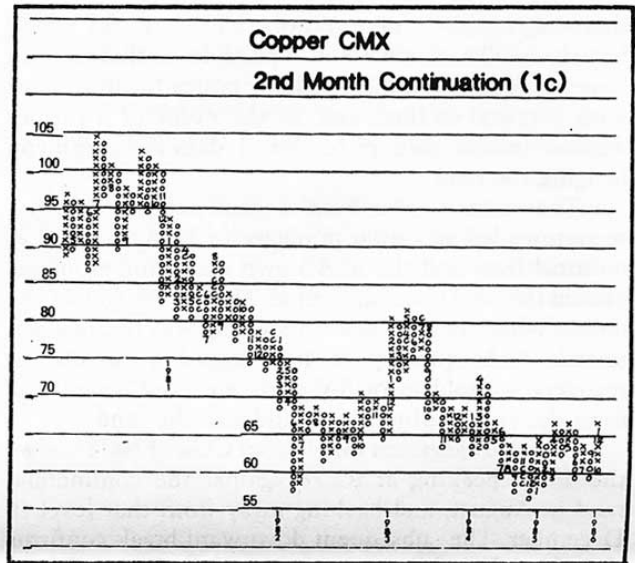


SA gold charts – The South African Gold Index chart, taken from INTERNATIONAL (reduced), illustrates the volatility of this sector over the last two and a half years. Significantly, last November's run to 1275 was the most decisive upward break shown. Also, the subsequent December reaction encountered support near last year's peaks, indicating that a new, higher trading range has now been established. FM technicians will note at a glance that this chart can support an extensive advance. I'll forecast 2000 before 1000 for the J.S.E. Gold Index.

As SA gold shares are traded in rand, US dollars and sterling, I have shown one important mine from the FM portfolio, Vaal Reefs, in all three currencies. The rand and sterling charts contain more back data so I have added vertical lines to all three at the beginning of '85's trading.



The rand chart shows a broad upward trend and progression of rising lows. There is more than enough underlying support to extend the advance although the price has been held in check recently due to the strength of the rand's recovery. The sterling chart and

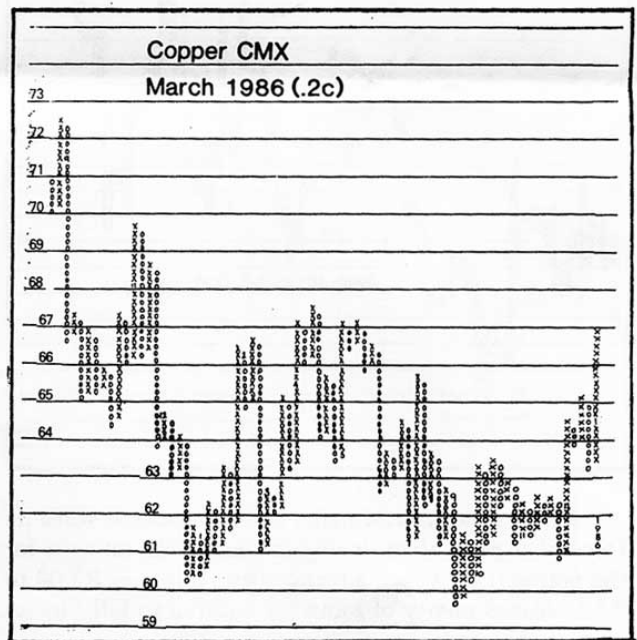
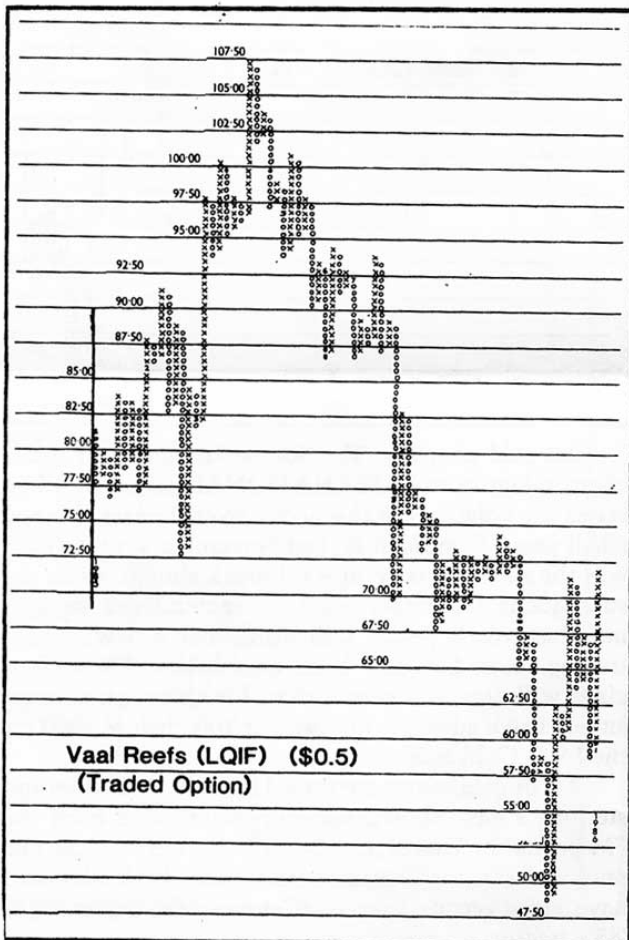


dollar denominated London price show declines of over 50% from the March and April highs, ending in classic type 2 bottoms characterised by powerful rallies which broke the previous downward trends. FMs who don't already own SA gold shares should buy Vaal Reefs or any of the other mines listed in the portfolio table, on reactions.

Aluminium and copper bottom out

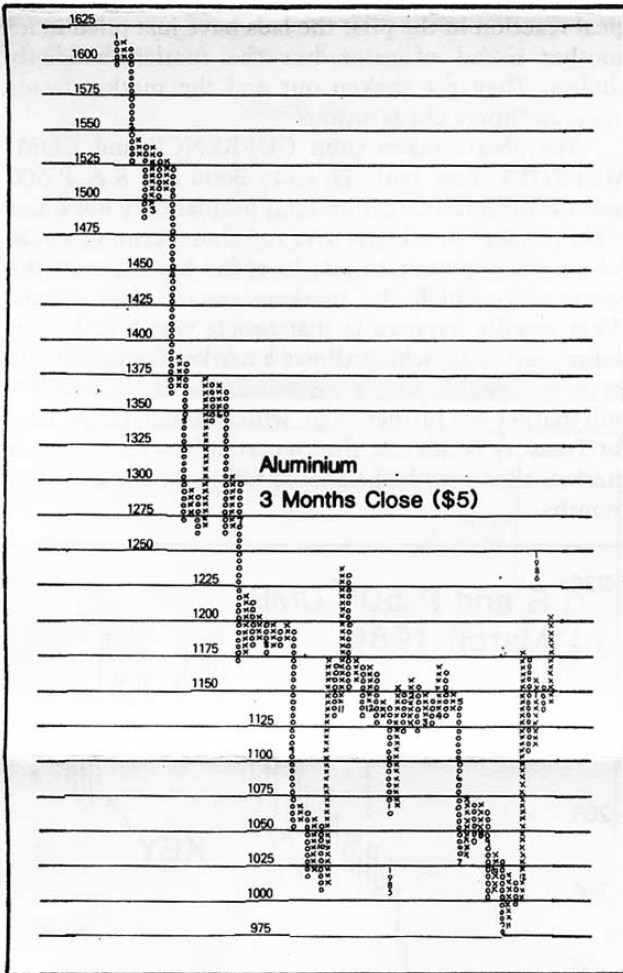
Aluminium and copper are the two most important base metals in terms of annual world consumption. Both now show evidence that they have terminated their long bear markets.

The copper CMX chart reached a closing high of 145¢ in February 1980 (not shown) before collapsing.



The price didn't reach a significant low until June 1982, when it rallied from 57¢ (see 2nd month continuation chart). Those 1982/83 gains were not maintained but copper repeatedly encountered support in the upper 50¢ region.

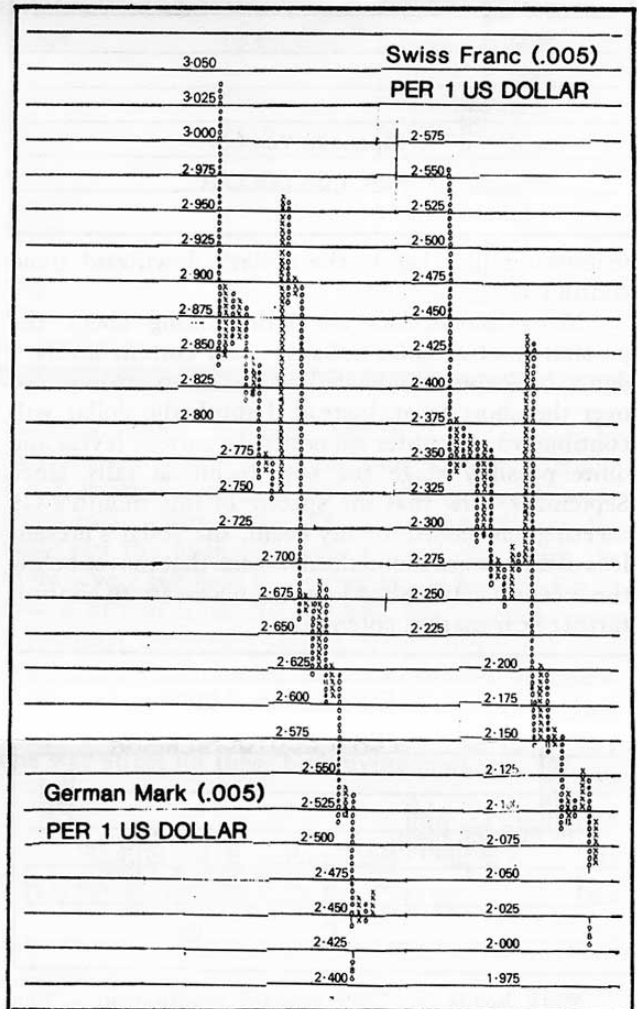
The most significant development for copper last year was the failed downward break in September (see the March 1986 contract on the 0.2¢ scale). That reaffirmed the strength of support near 60¢ and the price is currently challenging the April closing high at 67.4¢. Although temporary resistance is likely to be encountered near this level, the overall pattern resembles a base formation in its latter stage of development. Strong support below 63¢ should now cushion downward risk and eventually support a further recovery.



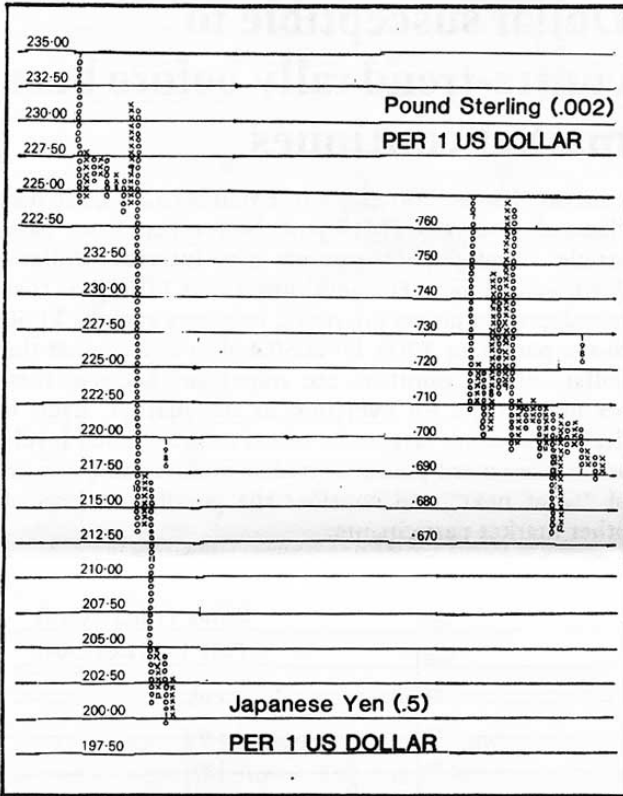
In similar price action the dollar aluminium price (based on L.M.E. quotations) failed to sustain the September/October break below \$1000. The subsequent rally has been even stronger than copper's, clearing the April high on the way to challenging the November '84 peak at \$1235. Aluminium is becoming susceptible to a pause and consolidation of these latest gains, but support now centred on \$1150 should cushion downward risk. Like copper, aluminium should experience an additional recovery in '86.

Dollar susceptible to contra-trend rally before bear market continues

I did not discuss currencies in FM20 because little had changed since my FM19 (end November) front page article: "Roundphobia points may interrupt dollar's downward trend". For new subscribers I'll repeat that roundphobia points are round numbers such as \$1.50 to the pound, or Y200, DM2.50 and SF2.00 against the dollar. Round numbers are important because they become targets for everyone in the market. Even if dealers have not targeted a round number, such levels are reassessment points as traders ponder the question of "what next" and consider the possible actions of other market participants.

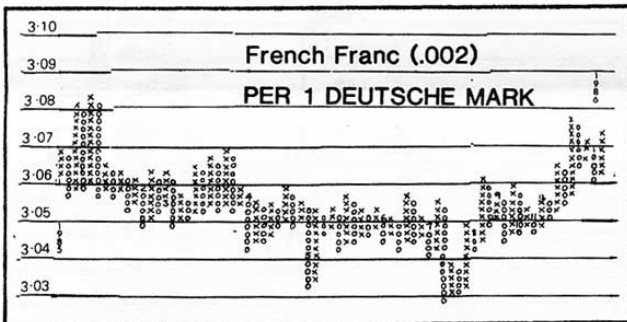


The dollar's decline close to so many significant target points in November was reason enough to suspect the pause that has subsequently occurred. Furthermore, the dollar's decline following the September Group of 5 meeting approximates the sharp break that commenced in July '85 and also the original plunge from the February/March '85 peak (not shown on the chart segments selected from CURRENCY). Both of those declines were followed by significant



technical rallies before the dollar's downward trend continued.

Many economists are still talking about the possibility of a dollar collapse from current levels. I don't think this is indicated by the charts, at least not over the short term. Instead, I think the dollar will continue to encounter support near current levels and quite possibly stage the best technical rally since September, now that the spectre of this month's G5 meeting has passed. In any event, the dollar's present loss of downward momentum means that moves below the recently established lows are necessary to confirm further bear market potential.



Mark heads for EMS upward revaluation – The EMS has been very stable during the last two years as the dollar first soared and then plummeted against European currencies. Now that the dollar appears headed for a less volatile existence, at least over the short term, other currency relationships will come under closer scrutiny. The EMS is an obvious starting point because it contains an important reserve currency – the German mark.

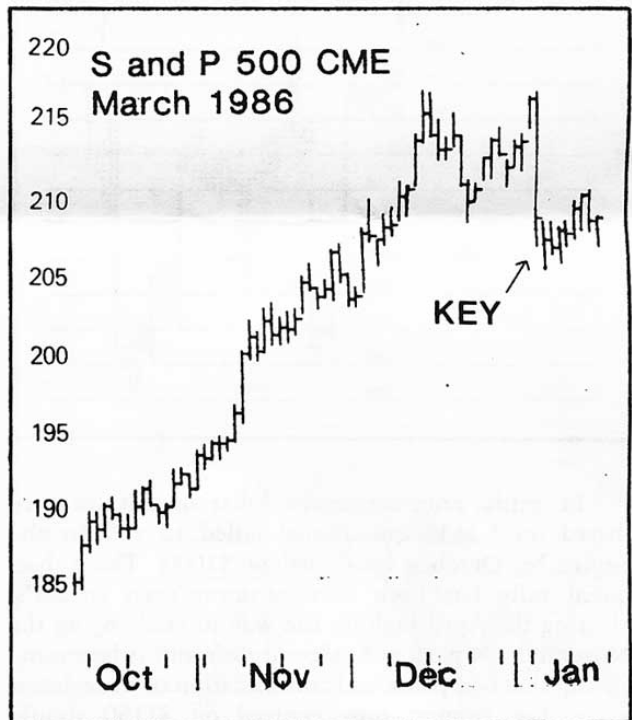
I've illustrated my point with a section of the mark's chart against the French franc, found in our

publication, CURRENCY. This shows a decisive break above FF3.06 last month, and that level held during the subsequent consolidation, suggesting that further upward pressure will occur in coming weeks. The next step should be a run to FF3.10, followed by a formal revaluation. It would take a decline back below FF3.05 to neutralise this upward potential.

Temporary lid on USA bonds and equities

The inevitable correction for USA bond and stock market runaway uptrends occurred in textbook fashion with dramatic key reversals. Those are the portfolio withering one day blow-outs, following a new high, that slam lids on markets. Just imagine the psychological reaction in the pits: the lads have just piled in for another round of gains but the market suddenly chokes. They get shaken out and the market heads lower as others cut positions.

The charts taken from CURRENCY and COMMODITIES show both Treasury Bond and S & P 500 Index futures rallying from their mid-January lows, but I don't expect new highs over the short term. It would take a brave punter to pile in today having seen the speed with which the markets reacted downwards. What usually happens is that people watch and wait, doing very little, which allows a market to consolidate gains and establish new support levels. If the primary bull market has further to go, which should be the case for Treasury Bonds and almost certainly is for the stock market, then new highs should follow in the next few months.

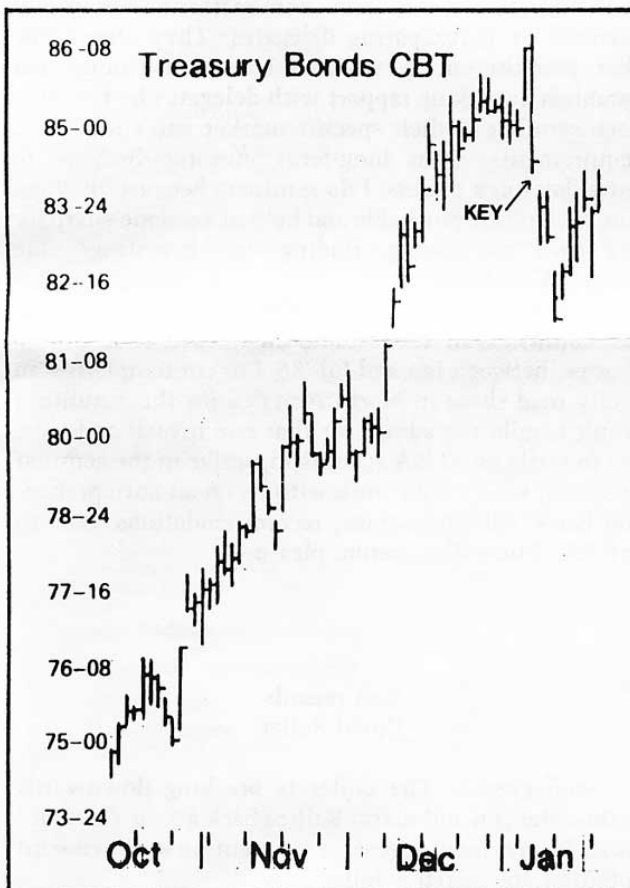


European bourses overheating – FM20's leader article focused on the strength of most Continental

FM Share Portfolio

	Market	Share	Price Then	Closing Stop (c/s)	Price Now	Strategy
FM7 SEPT 84	Holland	Nederlandsche Middenstandbank	FL149	FL210	FL240	hold/unchanged
FM8 OCT 84	S. Africa	Vaal Reefs	R173*	none as cushioned	R231.5	hedge by shorting
	S. Africa	Randfontein	R202.5*	with hedge	R265	Apr '86 COMEX
	S. Africa	Kloof	R17*	profits from	R26.25	futures if London
	S. Africa	President Brand	R51*	April '85 COMEX	R56.5	bullion closes
	S. Africa	Harmony	R26*	short (\$340.4 to \$312.5)	R38.25	below \$338 for two consecutive days.
	S. Africa	Unisel	R17.2*		R21.5	
FM10 JAN 85	U.S.A.	McDonald's	\$57 ⁷ / ₈	\$67	\$76 ⁷ / ₈	hold/unchanged
	Germany	Daimler-Benz	DM626	DM1100	DM1427	raise c/s to DM1200
FM11 MAR 85	U.S.A.	Gillette	\$58	\$65	\$71 ³ / ₄	hold/unchanged
FM12 APR 85	Hong Kong	Cheung Kong	HK\$15	HK\$18	HK\$21.3	hold/unchanged
FM18 OCT 85	U.S.A.	Atlantic Richfield	\$64 ¹ / ₄ *	\$59	\$59 ⁷ / ₈	hold/unchanged
	U.S.A.	Colgate Palmolive	\$29 ¹ / ₂ *	\$27	\$30 ⁷ / ₈	hold/unchanged
	U.S.A.	General Mills	\$53 ³ / ₈ *†	\$53	\$57 ⁷ / ₈	hold/unchanged
	Japan	Fuji Photofilm	Y2015*	Y1930	Y1960	hold/unchanged
	Japan	Kyocera	Y3835*	Y3500	Y4550	hold/unchanged
	Japan	Shiseido	Y1220*	Y1200	Y1390	hold/unchanged
	U.K.	Marks & Spencer	167.5p*	165p	174p	hold/unchanged
	U.K.	Mowlem	312p	270p	314p	hold/unchanged
	U.K.	Redland	345.5p*	300p	363p	raise c/s to 310p

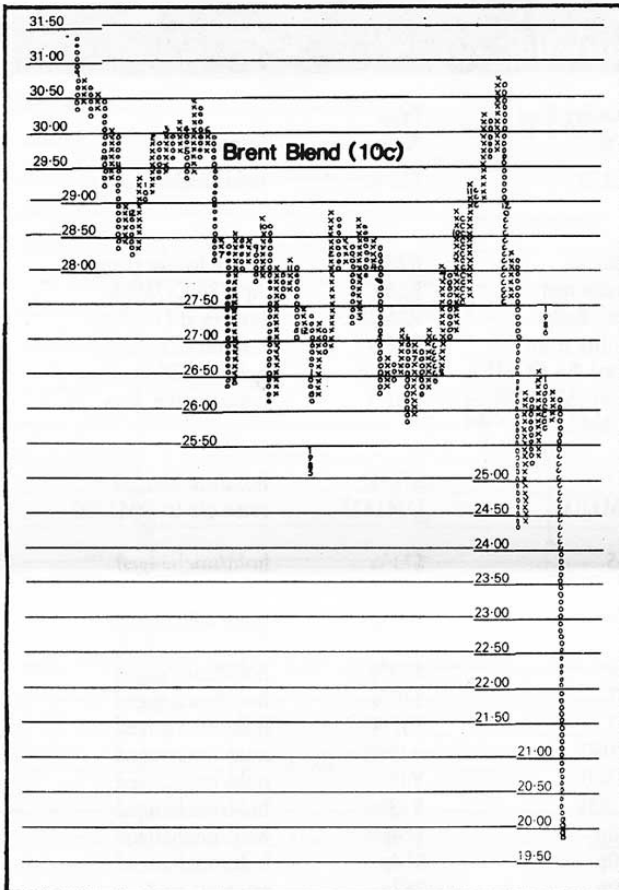
* Average price - SA golds includes FM16 purchases. † adjusted for distribution.



European stock markets, which I illustrated by marking the month by month moves on the German F.A.Z. Index. I concluded that the present acceleration could easily carry above 700, (it reached 714 on Jan 16th) but the further it went beyond that point the more severe the next correction would be. The F.A.Z. saw a hiccup from 702 to 690, but a much more substantial correction should occur within the next few weeks. Furthermore, most Continental European markets should reach significant peaks within the first quarter of '86. This year will not be a repeat of 1985's one way street for these high flying markets.

Share portfolio review

This month's small correction in most stock markets has pushed a few portfolio constituents close to their closing stop levels, most notably Atlantic Richfield and Fuji Photofilm. On the plus side Germany's wunderbar company, Daimler-Benz, has surged again and FMs now show a paper profit of 128%. Redland has also moved to a new high despite a correction in the UK market. Gold bullion's breakout has enabled me to raise the hedge trigger price to \$338. If gold flops, which I doubt, FMs would have a chance to book another futures profit while retaining their high yielding shares.



Brent Blend bore-hole

I suspect that many years from now market historians will still cite 1985/6 when discussing the demise of the commodity cartel. They have collapsed before, of course, and no price support programme has ever survived a sustained period of increased production in an environment of decreasing consumption, but seldom have the consequences been as costly as the ITC and OPEC failures.

Acting in unison, commodity producers can cushion a decline or cap a rise, but they can never control a market over the long term. Moreover, they guarantee destruction of the support programme by trying to avoid a downturn during the cyclical recession for their commodity. Too high prices inevitably lead to increased production, less consumption and substitution. Free market forces, despite all the uncertainty and all the perceived injustices, are better for everyone over the long term.

The second oil collapse was a long time in coming, but it could hardly be more spectacular. The chart of Brent Blend looks as though it has fallen down one of the North Sea bore-holes. A bounce should occur before long now that the much discussed target level of \$20 has been exceeded, but the problem for oil producers is that this latest decline only started in November, following over two years of trading in the \$26 to \$30 region. My guess is that most producers will

try to off-set the loss of revenue due to lower prices by increasing production. If so, it will be some time before market confidence in a floor price is restored.

They said it couldn't be done

When we announced that The Chart Seminar would travel to Dubai, Bahrain, Kuwait and Istanbul in Jan/Feb '86, many well-meaning friends and advisors said we would be forced to cancel due to weak oil prices and the departure of many multi-national companies and ex-pat workers. The pessimists almost convinced me, but they overlooked two important facts. Both permanent and temporary residents from Middle Eastern countries have been attending The Chart Seminar world-wide for years. Also, the majority of our delegates attend because a colleague or client at one of our venues over the last 18 years recommended The Chart Seminar.

As a result we get block bookings from central and commercial banks, brokers and multi-national companies. Some firms have sent scores of delegates over the years and usually have at least one or two people attending each venue. That degree of brand loyalty is based on more than habit. They know that The Chart Seminar has up-dated technical analysis by providing fresh concepts and insights that cannot be found in textbooks, always incorporates trading tactics and disciplines, shuns the gimmicks, fads and pretensions of get-rich-quick schemes that lose, is conducted as a workshop emphasising discussion and practical drill, with all test cases and demonstration examples selected by participating delegates. They also know that over the entire two days I never use notes and establish a working rapport with delegates by tailoring each seminar to their specific market and time frame requirements, from long-term investors/hedgers to intra-day forex traders. I do seminars because they are fun, rewarding, profitable and help to keep me sharp for my own forecasting, trading and investing. One succeeds by doing.

North American tour – Following my 20 city tour (19 countries) of the Middle East, Pacific Basin and Europe, between Jan and Jul '86, I'm contemplating an 8 city road show in North America for the autumn. I won't handle the admin for that one myself and have yet to settle on a USA agent firm, active in the seminar business, who would work with us on an entrepreneurial basis. All suggestions, recommendations, etc., to my PA, Karen Warrington, please.

Best regards
David Fuller

Stop press – The dollar is breaking downwards against the yen and mark. Rallies back above Y205 and DM2.49 are now necessary to neutralise downward potential and signal a dollar rally.