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In its 18th year

Fullermoney

Global Strategy and Investment Trends by David Fuller **www.stockcube.com**

Economic risks are still on the downside but investors, influenced by interest rates, are beginning to look beyond the current problems.

Will uncertainty and history tempt the European Central Bank into a costly blunder?

The 'Duis' and don'ts of a central banker - The economic evidence is not encouraging, judging from the three largest economies. In reverse order, German business and consumer confidence has been declining for many months and most GDP estimates for 2001 are now well below 2%. Japan has probably slipped back into recession. The US economy - for so long the engine of global growth - has slowed more rapidly than most analysts expected. Consequently it should not require too many PHD economist whiz kids in Frankfurt to conclude that risks for the global economy are on the downside. Yet ECB President Wim Duisenberg recently claimed there are "no indications of a risk of a global recession". When questioned on the warnings, he replied, "I hear but I do not listen". What's behind these responses, which have been described as complacent and arrogant? I believe Duisenberg is fighting for his job and having been criticised as weak and vacillating, he is now trying to sound tougher than Bundesbank officials from pre-euro days. Also, inflation remains above the ECB's target of 2%, largely due to the euro's previous weakness and OPEC's oil supply cuts. Presumably even Duisenberg would regard a lower oil price and reduction in moderate inflation, achieved by recession, as a Pyrrhic victory but he may not see (or feel free to acknowledge) the risks. French politicians have enthusiastically promoted Euroland as a disciplined and self-contained economic zone, largely immune to problems currently experienced by the US and Japan. France only backed Duisenberg in 1998 after an informal agreement allowing BoF Governor Jean-Claude Trichet to assume control of the ECB halfway through the current eight-year term. Today, Duisenberg is not an easy man to defend but Trichet's role in the near-collapse of Credit Lyonnais is under investigation. He was the Government's representative on the Board of Credit Lyonnais, which had to be bailed out with approximately 17 billion euros of public money. Perhaps Trichet was only the piano player, oblivious to mischief performed by others. Meanwhile the investigations into Credit Lyonnais have prompted quips that allowing him to run the ECB would be equivalent to Britain appointing Nick Leeson Governor of the Bank of England, or President Bush replacing Alan Greenspan with one of the Nobel Prize-winning geniuses who ran Long-Term Capital Management in 1998.

"History is bunk". Someone should remind the ECB of Henry Ford's most famous quote. Part of the central bank's complacency is probably due to a rear-view mirror perspective. Officials will recall The Crash of '87, which prompted a rapid expansion of global money supply in response to recession/depression fears. This proved to be an overreaction as overheating followed. There was a similar response and result following the Asian Crisis, 1998's Russian default and Long-Term Capital Management's collapse. Y2K fears prompted another surge in money supply from central banks. Given those experiences and with the US Federal Reserve reflating rapidly while the Bank of Japan has commenced a quantitative easing, the ECB may conclude that it is better off to focus on its 2% inflation target. It would be ironic, not to mention painful, if this inaction contributed to a global recession.

Interest Rates and Bonds

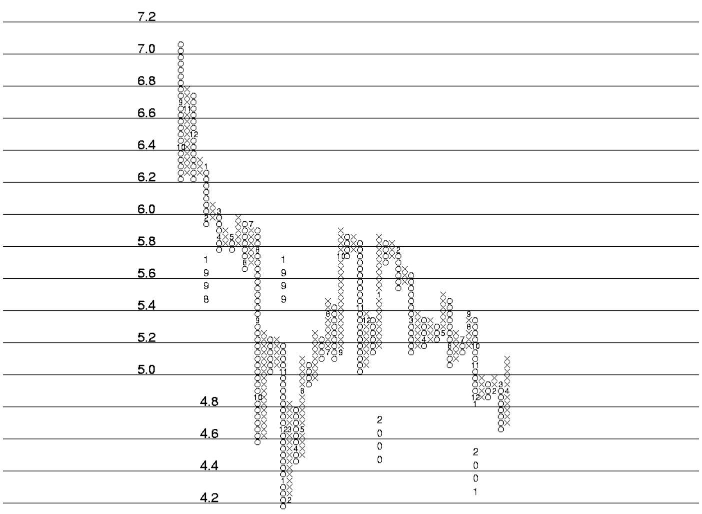
■ **Further cuts in short-term rates are likely and the ECB should participate before long.**

■ **Possible implications of the rise in long-dated government bond yields.**

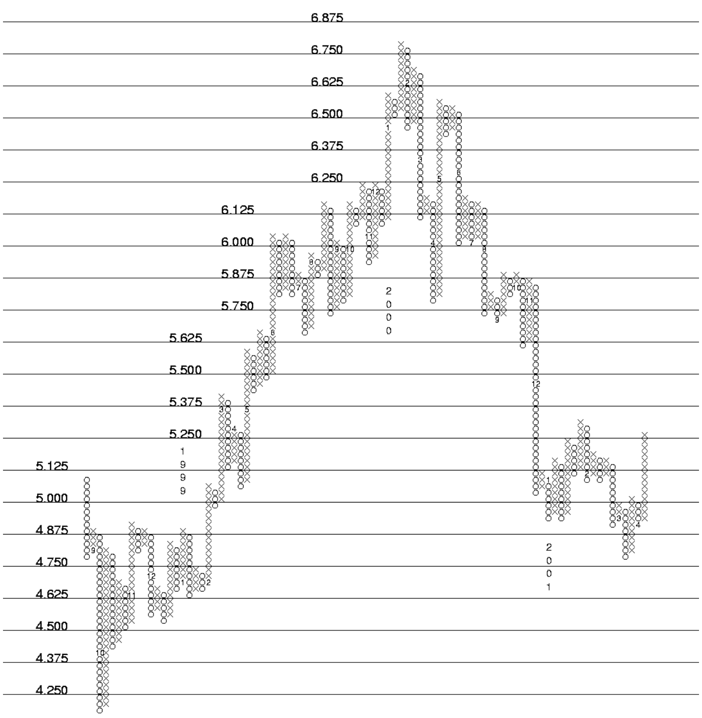
There is still a case for further rate cuts. Since February 2000, I have maintained that estimates for global GDP growth were too optimistic. The initial problems were a tripling of oil prices and rising short-term interest rates, followed by the TMT share collapse, which eventually dragged down old economy stocks as well. Today, most analysts continue to revise their economic forecasts downwards. Is it time to take a contrary view and look for signs of recovery? After all, to counter a rapidly decelerating economy, the US Federal Reserve has made three 50-basis point cuts so far this year. The Bank of England, Bank of Canada and Reserve Bank of Australia have all made at least two rate cuts in the last four months. Even the maverick Bank of Japan has acknowledged a deteriorating economic environment and returned to its near-zero rate policy. Among major central banks, only the fledgling ECB has yet to cut, citing inflation above its 2% target - a minor problem that it helped to create by ignoring evidence of Europe's slowdown and therefore undermining confidence in the euro. There is certainly a clear case for lower rates in Europe and I would not be surprised to see most other central banks continue policies of monetary easing. I maintain that economic news will be mostly negative through at least mid-year but this is a lagging indicator. A continuing stock market rally would provide the best clue of economic recovery ahead.

Long-dated government bond yields have rebounded from their late-1998/early-1999 troughs. On the charts, downtrend consistency has been broken as bonds have been sold against a background of generally weak economic news. This is a major warning for bond bulls and asks the important question - have yields bottomed for the medium to longer term as well? The short answer is possibly but there are conflicting factors. A steepening yield curve, caused by flat to declining short-term rates which central banks control, plus rising long-dated rates determined by the market, indicates economic expansion if it persists beyond the short term. We last saw this in Europe and North America from late 1998 through early 1999.

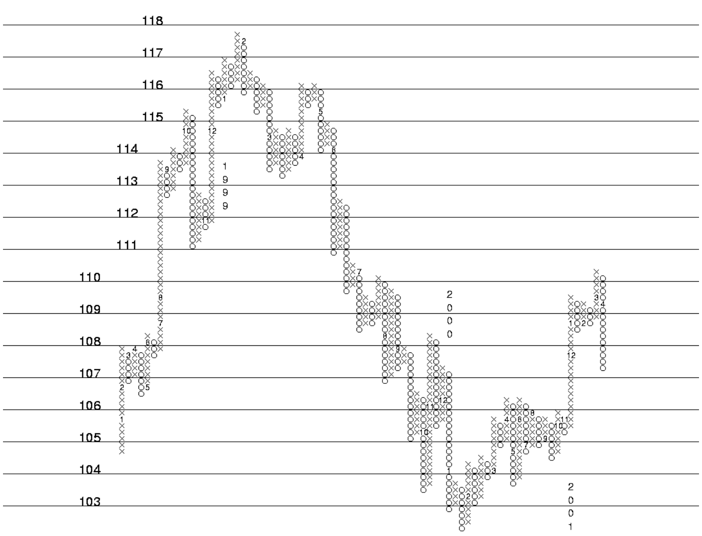
UK 10 Year Bond Yield (0.04)



US 10 Year Bond Yield (0.025)



Euro Bund Futures EUREX 1st Month Continuation Close (0.2)



However it would be premature to expect a replay of this cycle, judging from corporate profits, rising unemployment and falling GDP. The other possibility is that bonds were technically overbought due to momentum investing in the bull market that commenced fourteen months ago, plus a "flight to quality" during the stock market sell off. Some of that money was always likely to leave bonds when stocks rallied, as we have seen recently. Looking at point & figure charts for long-dated bond yields, downside failures occurred in February and March, and yields are near their highs for the year. While overhead trading, particularly evident above 5% for UK 10-year Gilts should impede upward progress for at least the short term, a decline to 4.6% is now required to reinstate the yield decline. The equivalent level for Bunds is 4.59%. US yields would need to fall back under 5% to question the base building hypothesis. My hunch is that yields for US, UK and Australian long-dated bonds are bottoming out in what is likely to be a lengthy process, during which the March lows could be retested and even exceeded by a small margin. Bunds would normally be expected to follow this group but may have some additional downward scope since they are further away from their 1998/99 trough and the ECB will be the last central bank to commence its cycle of rate reductions. For those interested in Bund futures, the EUREX (1st month continuation) needs to rally back above 109 to indicate a downside failure. Japanese 10-year bond yields have also rallied following their downward acceleration in February and March towards the 1998 low. Fundamentally, one can make a case for JGB yields falling even further as the BoJ buys to prop up commercial banks and as part of its quantitative easing, which will need to be massive before a sustainable economic recovery is established. However, everyone knows that JGBs have an uncompetitive yield and are in oversupply. Therefore Japanese long-dated bond yields would soar without continued deflation and government support.

Strategy for bonds - From a conservative investment perspective, I'm maintaining FM200's strategy, which favours shorter maturities, from 3-year government instruments to bills. The additional policy of reducing long-dated exposure during the previous rally and introducing tight stops, as protection against profit erosion when stock markets rallied from their oversold condition, was important as bond prices fell sharply in the first three weeks of April. They appear temporarily oversold but I would not look for more than a technical rally as most government long-dated bond yields have probably seen their lows for the year. Spreads between long-dated and corporate bonds should narrow if the recent lows for stock market indices hold. However I would tread cautiously in this market as there may be some notable defaults, which would temporarily weigh on better quality issues. I would continue to avoid JGBs and capitalisation weighted government bond funds. Japanese government debt represents 27.3% of the global total and climbing. JGB yields are likely to rise considerably when Japan's deflation ends, even with the BoJ buying and retiring issues as part of its quantitative easing. In futures trading, my strategy of buying after reactions showed a loss of momentum and selling out on the rallies, which worked

Euro-Bund 10 Year Bond yield (0.03)

Japanese 10 Year Bond Yield (0.025)

consistently for over a year, came a cropper recently as prices paused briefly within a decline and then accelerated lower. They look very oversold but I don't expect to make a profit on this last trade in Gilts and Euro-bund futures, which I will trade out on a rally. My next position in this sector will probably be a short but first I want to see the extent of any top extension, which I suspect could be lengthy.

Global Stock Markets

- **Is the bear market ending or over?**

- **The economic news will remain mostly bearish but investors are beginning to anticipate the next economic upswing.**

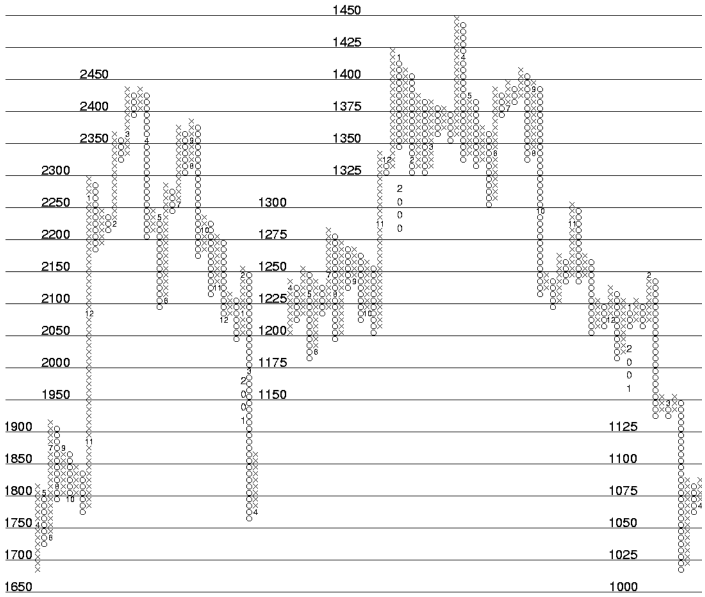
Market peaks and troughs are determined by technical rather than fundamental factors. Bull markets peak when euphoric demand from people willing to throw money at an uptrend wanes relative to the numbers who wish to sell. Conversely, bear markets end when capitulation selling eventually declines relative to new demand. Consequently how high will prove to be too high and how low will prove to be too low is a technical/psychological question, rather than a fundamental issue. However, value assessments provide perspective. We know that valuations for TMT companies "were off the charts" in late 1999 and early 2000, although this could also be said at least a year before their peaks. Today, NASDAQ valuations are a lot lower but few analysts would call them cheap. The US Standard & Poors 500 Index price/earnings multiple has declined from 36 to 26 over the last year but that is still well above levels seen at most previous bear market lows. Moreover the dividend yield is hardly enticing at 1.1%. Perhaps these measures are redundant, as many claimed a year or two ago but to accept this argument one has to embrace the "new paradigm" theory. Presumably Warren Buffet would sooner believe in the tooth fairy. European valuations are somewhat lower but does anyone really expect these markets to significantly outperform the US for any reason other than patriotism? Some fundamental analysts do see value in Japan, not in terms of p/e ratios or dividends but in terms of cash flow and book value. OK, but accepting this requires some optimism regarding Japan's economy, following its 'lost decade' and counting, not to mention the ongoing and destructive deflation. I am inclined to defer primarily to behavioural/technical factors. Consensus views on the NASDAQ have changed in the last year from "recession proof" to "they'll never recover". Just before the peak, Time Magazine and Newsweek covers depicted the NASDAQ as Superman. Last month bear market cover stories featured in Time, Newsweek and US News & World Report. There have been numerous articles recently drawing parallels between Japan's economy and The Great

Dow Jones Performance Following Initial Rate Cuts By the US Federal Reserve

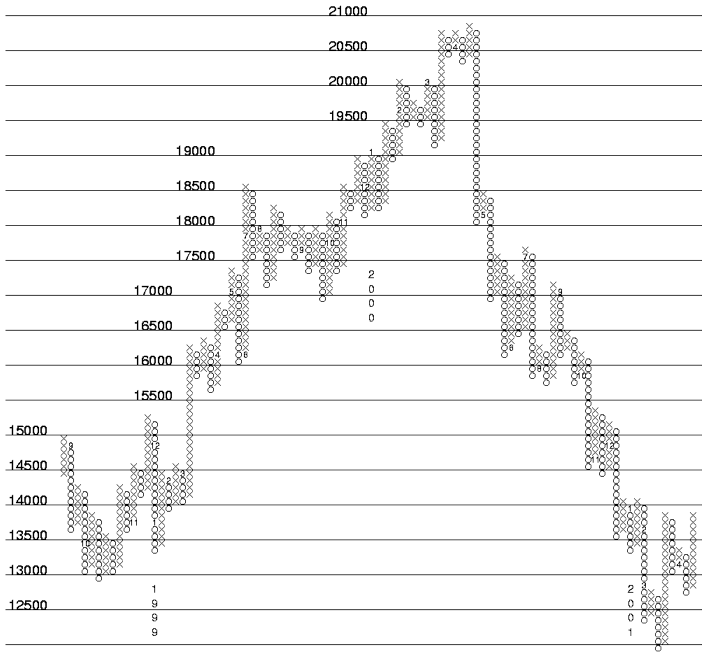
Year	Rate*	3 Months	12 Months
1914	5.0	10.6	83.8
1921	6.5	- 14.2	16.4
1924	4.0	10.9	31.5
1929	5.0	4.2	- 28.3
1932	3.0	- 40.2	- 40.0
1933	3.0	79.2	76.3
1954	1.8	8.2	39.3
1957	3.0	0.7	29.2
1960	3.5	- 7.0	6.4
1970	5.8	17.2	6.7
1971	4.8	12.7	24.0
1974	7.8	33.8	42.1
1975	6.3	6.0	28.2
1980	12.0	10.6	17.3
1981	13.0	- 1.7	17.9
1984	8.5	6.5	21.7
1990	6.5	11.5	10.7
1996	5.0	3.2	26.3
1998	4.8	12.5	20.7
2001	6.0 **	-7.2	
Average		**7.9**	**22.6**

*Discount Rate, rounded to nearest decimal point.
**Federal Funds Rate from here on.

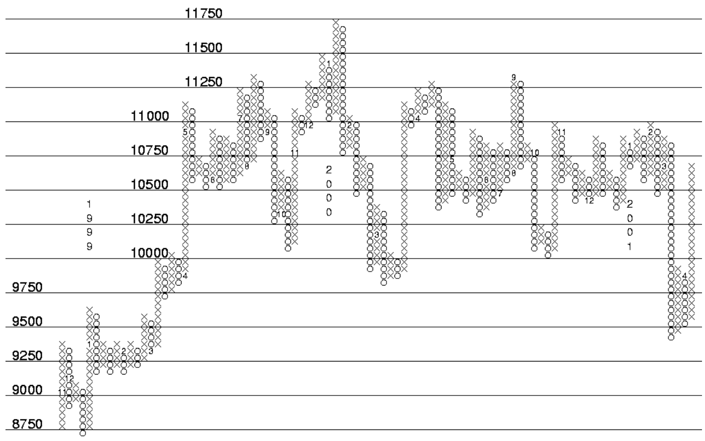
FWMI (10pt) and MSCIWI (5USD)



Nikkei 225 Stock Average Index (100pt)



Dow Jones Industrial Average (50pt)



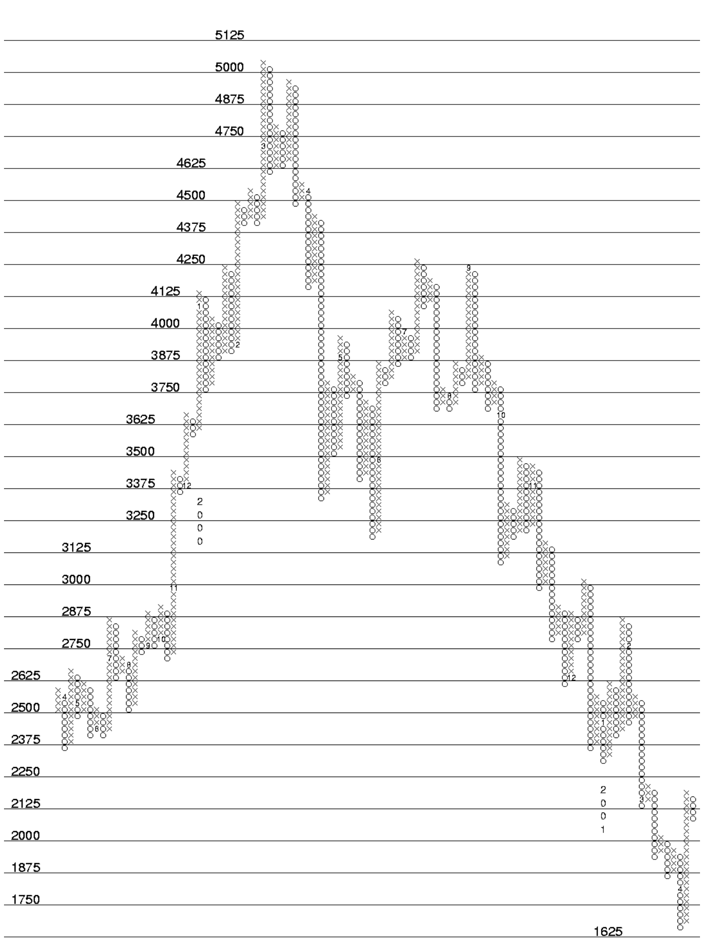
Depression of the 1930s. Stock market sentiment on a global basis has been bearish generally. As for the charts, downward accelerations in March were climactic but for how long? FMP142 (6th April) cited upward dynamics as evidence for a technical rally, which has now exceeded the highs formed during the brief rebound in late March. This indicates that we have seen lows of at least near-term significance. On long-term charts, it is too soon for the recoveries to confirm more than a loss of downside momentum. Japanese indices and the NASDAQ have achieved the best rebounds, in line with prior extremes of bearish sentiment. I give odds of 65% and 55%, respectively, that they have established sustainable floors. However we won't have clearer evidence as to whether these and other stock markets have bottomed until we see where support is encountered during the next reaction. Overhead supply for the DJIA, S&P 500 and most European indices is considerable. Consequently, even if a number of indices have seen their lows for the year, they are unlikely to rally beyond the middle to upper region of prior trading ranges.

Stock markets will recover well ahead of the economy. Everyone knows this but if GDP growth continues to slow, share rallies in response to lower interest rates will prove difficult to sustain. We are currently in the 20th cycle of lower interest rates for the US since 1914 and for only the fifth time the DJIA closed lower (-7.2%) three months after the Fed's first cut. However the historic evidence on rate reductions over a longer time period is compelling. On only two of the previous 19 cycles (1929 and 1932) was the DJIA lower 12 months following the first cut. Better still, the Dow failed to show a gain on only one occasion a year after the third rate cut. In this year's rate-cutting cycle, Greenspan's third 50-point reduction occurred on 5th April and he lowered again on 18th April. Arguably, he is ahead of the cycle, which should help the economy as it faces declining corporate profits, debt problems and layoffs. I maintain that most economic data will be negative through Q2, at least. As for Euroland, everyone except ECB officials believes the single-currency's central bank is behind the curve. We can only guess as to when Japan's crisis measures will check deflation and spark a sustainable recovery. Consequently, there are no grounds for complacency regarding the global economy, especially with energy prices remaining high following additional production cuts by OPEC.

Chart review of topical and representative stock market indices - The 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.fullermarkets.com. Price levels mentioned refer to market closes.

The Fullermarkets World Market Indicator (1868) has bounced following its downward acceleration, which may have been a trend-ending signal. However the recovery to date is not sufficient to confirm this. *The FMWI is unweighted and calculated in local currencies.*

NASDAQ Composite Index (25pt)



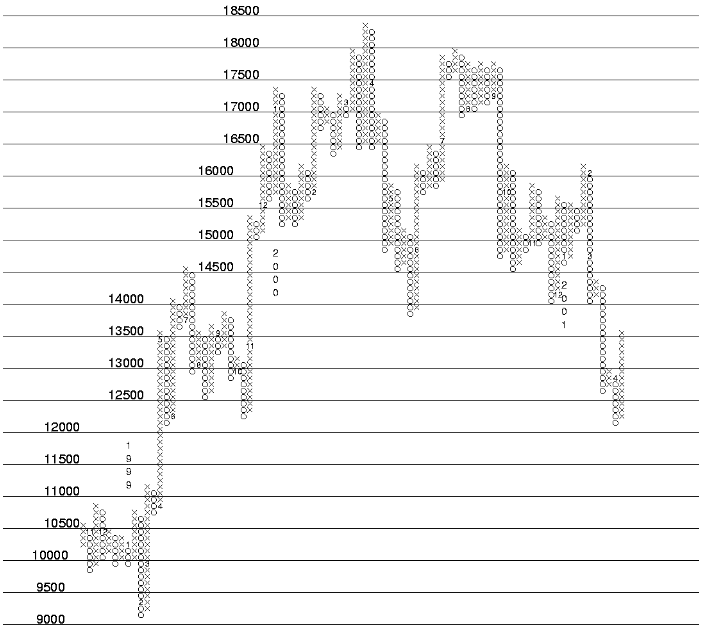
The Morgan Stanley Capital International Indicator (1128) has rebounded following its climactic plunge. If it can hold above 1085 during the next reaction a further recovery will be indicated. *The MSCII is capitalisation weighted and calculated in US dollars.*

The US Down Jones Industrial Average (10580) has not maintained its break beneath the psychological 10000 level. While at least temporary resistance can be anticipated from the May 1999 to February 2001 band highs, recent strength has questioned the top formation implications of this pattern. A decline back into the March/April trough is required to reaffirm a bearish picture. **The NASDAQ Composite Index** (2163) has rebounded after what resembled a capitulation-decline from late-January to early-April. Given the proximity of important support established in 1997/98, the low at 1650 may be sustainable. However a pullback below 1950 would now suggest at least a base extension phase.

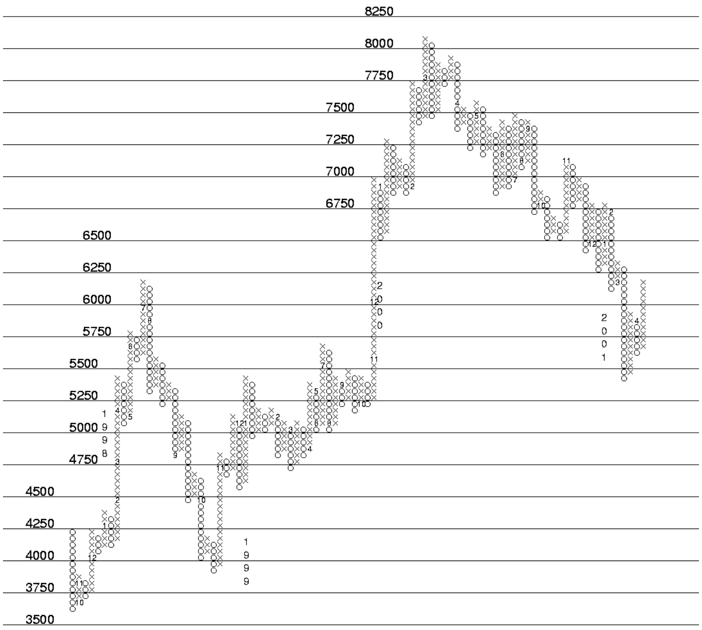
Japan's Nikkei Stock Average (13715) encountered support above its March trough and has not maintained its break under the important 1998/99 floor. Currently, it is testing resistance in the 13800 to 14100 region and a decline to 12600 is needed to indicate more than a temporary pause here.

Hong Kong's Hang Seng Index (13311) - *see overleaf* - has checked its downward momentum with the best

Hong Kong Hang Seng Index (100pt)

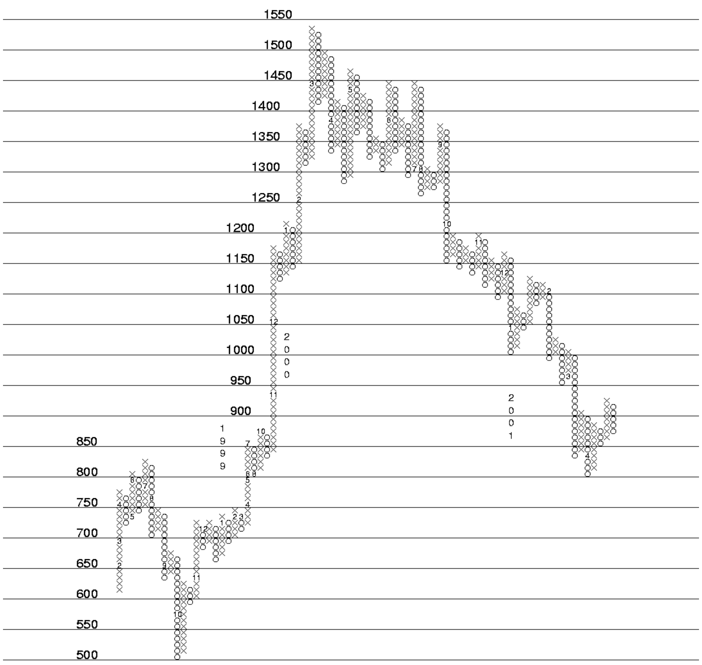


Germany DAX Index (50pt)

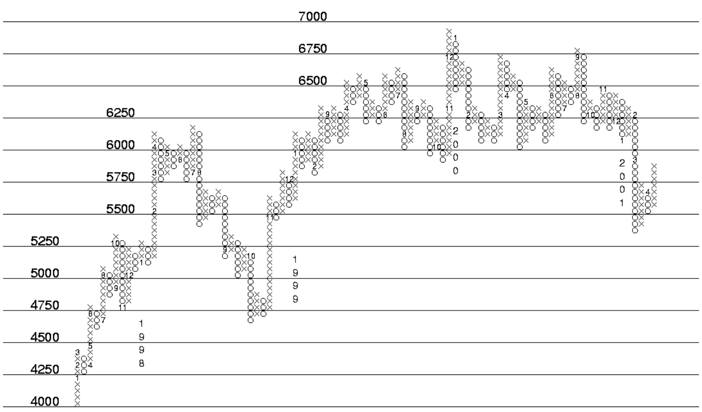


France CAC 40 Index (50pt)

Sweden OMX Index (10pt)



United Kingdom FTSE 100 Share Index (50pt)



rally since December. However there is important lateral resistance near 14000 and a push well above this is needed to provide clearer evidence of a sustainable low.

France's CAC 40 Index (5449) has seen its best rally since the September 2000 peak. This followed a climactic acceleration and the sequence of seven consecutive lower rally highs (the downtrend's main consistency characteristic) has been broken. If support can now be encountered near or above 5250, a further recovery towards overhead trading will follow in coming weeks.

Germany's DAX Index (6127) has seen its best rally since the March 2000 peak, following climactic acceleration. If support is encountered near or above 5950 during a consolidation, the medium-term downtrend will be tested before long.

Sweden's OMX Index (888) saw one of the biggest falls among European indices, taking it back to the large platform of trading, which launched the last bull market's climactic acceleration from October 1999 to March 2000. A break under 800 is required to indicate renewed vulnerability rather than a base-building and recovery phase.

Switzerland's SMI Index (7238) - *not illustrated* - fell rapidly to its lowest level since October 1998 but did not maintain the break under lateral trading near 6750. A move to 6800 is now required to reaffirm overhead resistance.

The UK's FTSE 100 Index (5879) has rallied back to potential resistance from extensive overhead trading and needs to push over 6000 to suggest a downside failure. Conversely, the prior decline would be reaffirmed at 5300.

Strategy for stock markets - It is probably time to start accumulating equities once again, judging from the climactic downward accelerations mentioned above. However this view is based primarily on short-term technical/sentiment indicators at the early-April lows and the Fed's rate cuts. Moreover a near-term overbought condition had developed as I completed this issue. I still believe that valuations in the West and the fundamental economic background globally hold considerable risks. Therefore I am proceeding cautiously and waiting for technical evidence that we have seen more than temporary lows for major stock market indices, before making my first share recommendations of the year. The next reaction will be revealing and support needs to be encountered near or above recent lows, followed by further evidence of base formation development. When I do issue share recommendations, I will select stocks that either bottomed before their respective indices and/or showed superior relative strength during the recovery to date. In previous market cycles, I have found that many shares showing early relative strength, as a bear market gives way to a significant recovery, often outperform throughout most of the bull run that follows. Presumably, their technical strength is matched by superior fundamentals, real or imagined. Meanwhile, my favourite market is Japan, as mentioned in last month's FM202 - *see The Triple Play.* Many will disagree due to Japan's ongoing economic stagnation and deflation, not to mention potential supply if Japanese banks unload their equity portfolios. I believe these problems have finally become a catalyst for change by the government, albeit on a 'needs must' basis. The quantitative easing announced by the BoJ in early April is a welcome reversal of policy. While it remains to be seen whether Junichiro Koizumi will become an effective prime minister, he is the first brought to power by grass-roots LDP support rather than a backroom deal by politicians. That has to be good for democracy, although Japan still requires a viable two-party system. Japan's Government had to target the stock market prior to its fiscal yearend on 31st March, because of the banks' capital adequacy requirements. These will be reviewed again at end September. Consequently the Government needs to either purchase shares directly from the banks and/or ensure the Nikkei Stock Average closes above its end March level of 12999.70. I don't want to read too much into this but if global investors believe the Nikkei has a government-intervention floor at 13000, they may regard Japanese stocks as a one-way bet until the index rallies well above this level. In addition to Nikkei futures mentioned last month, I did place my ISA money (the UK Government's Independent Savings Account small tax break) into the Atlantis Japan Growth Fund just before the 5th April deadline. This is a UK-quoted investment trust selling at a discount to NAV, drawn to my attention by subscriber Peter Bennett of JM Finn & Co in London. My in-the-money stop for June Nikkei futures was triggered. I'm looking to buy back either on a reaction or evidence of a sustained break above 14200 (spot). To date I resisted the temptation to short one of the top-heavy indices such as the DJIA or FTSE following their return rallies, because I don't want to fight the Fed. I am long NASDAQ 100 Index futures but may come out soon, suspecting that near 2000 (spot), most of the initial rally has already occurred.

Currencies

■ **MoF jawboning has complicated 'yen carry' trading but the Japanese currency should resume its decline in coming weeks.**

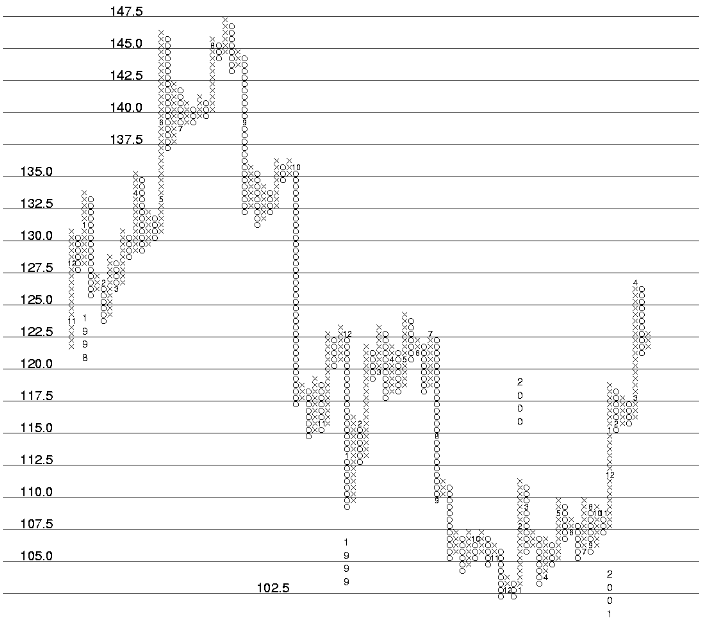
■ **The euro has looked oversold recently but will always trade below value without a federal government.**

Reading between the lines of Ministry of Finance statements on the yen. The first half of April saw some heavy jawboning from MoF officials, especially by Haruhiko Kuroda, Vice Finance Minister for International Affairs. Kuroda, along with his boss Kiichi Miyazawa are the main spokesmen for the yen now that Masaru Hayami at the BoJ has been effectively muzzled, except for parroting others' comments. Kuroda's heaviest volley came on 6th April, when the dollar was above ¥125 and the euro near ¥113.

"Recent movement of the yen has been very rapid and, judging from economic fundamentals, the movement cannot be justified. We will take appropriate action in the market against currency movements that deviate from economic fundamentals. Some action will be needed if this movement continues."

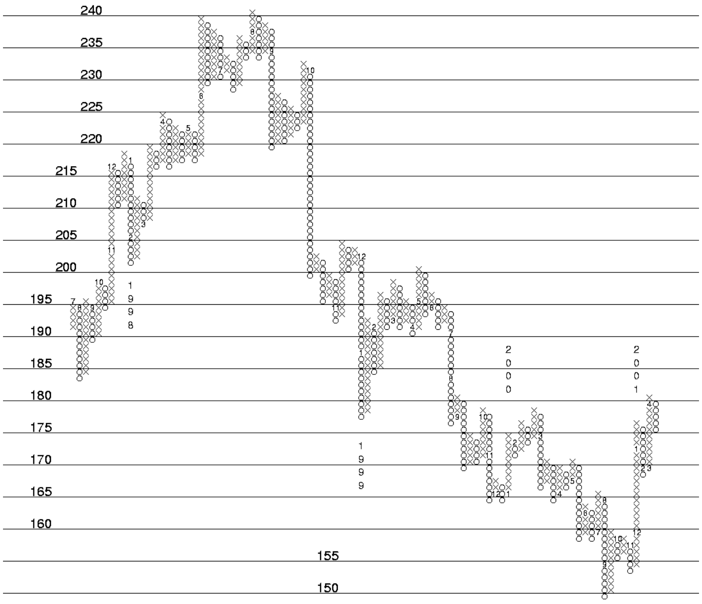
Taken literally, Kuroda's mention of "appropriate action" would suggest the possibility of intervention in support of the yen. Should we take this at face value? I certainly don't think so and despite Kuroda's comment on fundamentals, most analysts would agree that Japan's economic performance remains decidedly below par relative to the US and Euroland. That's why Japan has embarked on quantitative easing. It is printing money - literally trillions of yen - until money supply (M2+CD) surges from its current 2.6% and the decline in consumer prices is halted. Belatedly, this reflation is necessary and will need to be massive given the established deflation in Japan. While

Japanese Yen per 1 US Dollar (0.5)

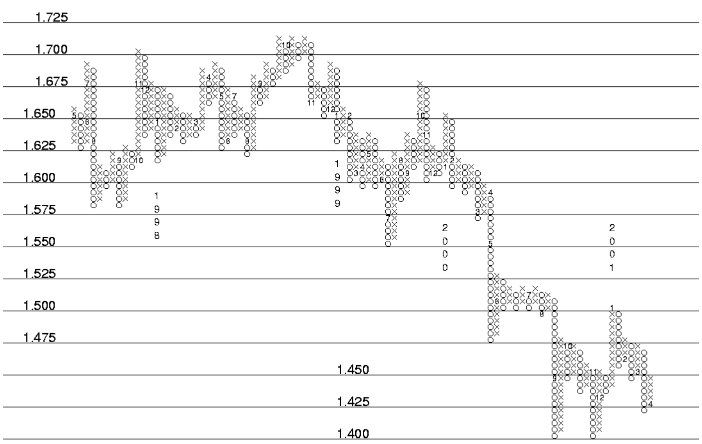


Japanese Yen per 1 Euro (0.5)

Japanese Yen per 1 Pound Sterling (1)



US Dollar per 1 Pound Sterling (0.005)



the country's monetary spokesmen are technically correct in saying that they are not targeting the yen, their actions can only weaken the currency against the US dollar, euro and most other reserve currencies over the next year or more. OK, so why the jawboning from Kuroda and others? In reverse order of importance, there was some political pressure. From the Asean states to China, other Asian countries had complained about the yen's decline, which put pressure on their own currencies. A weaker yen meant that they had to either accept a loss of competitiveness or allow their own currencies to weaken. The latter course was not attractive to countries that had fixed exchange rates and/or large dollar-denominated loans. In the US, a group representing manufacturers complained about the yen's weakness, which put their representatives at a competitive disadvantage. While not insensitive to these views, Japan's government would have been more concerned about a too rapid depreciation in early April when many analysts were confidently predicting ¥140 or more to the dollar. Mostly importantly (and this is pure conjecture on my part), I suspect the Japanese Government would have given advance warning of the quantitative easing to major institutional investors and corporations. After all, if they can invest offshore, earning a decent yield and 25% plus on yen depreciation, there will be some very big profits to repatriate at a later date. However, the Japanese were facing a short-term loss, having repatriated capital last year and probably up until their fiscal yearend of 31st March 2001. The Government would want to help its own, which it could do by talking the yen up. Obviously this won't work beyond the short term because of the quantitative easing. Nevertheless, having caught Western speculators by surprise and triggered stops, the jawboning has created a window of opportunity, allowing locals to switch from yen to dollars and euros at a more favourable rate of exchange.

Euroland's founding fathers knew that you could not have a federation without a single currency. They appear to have overlooked the problems for a single currency without a federation. Therefore the euro remains a romantic experiment or *la grande folie*, depending on your point of view. As such, it is destined to trade below fair value without the European federation for which there is no groundswell of public support. The only exception would be if the market lost confidence in the US dollar. This will happen some day, for fundamental reasons that cannot be known today. Meanwhile, a dollar collapse due to the misunderstood current account deficit or any other factor remains a pipedream of *yankophobes.*

Review of currency point & figure charts - *These and hundreds of other closing-basis charts are available on our website www.fullermarkets.com and updated daily. All comments refer to closing levels for US trading hours.*

Dollar/yen - This reaction is now larger than the mid-January to early-February pause and the break above 1999's highs has not been maintained. Consequently it will have pared bullish enthusiasm, possibly leading to several more weeks of ranging, mostly in the mid to lower ¥120s region before the dollar's uptrend is resumed.

Euro/yen and sterling/yen - The euro has backed away from its January high near ¥112.5 and needs a close at ¥113 to reaffirm recovery scope. Meanwhile, a decline to ¥104 remains necessary to indicate a lower phase of base extension. Sterling has not maintained its nudge above lateral trading at ¥178 and is therefore susceptible to some additional consolidation of prior gains before the recovery is reaffirmed by a close at ¥181.

Sterling/dollar - This remains rangebound but with a downward bias since resistance was encountered at $1.50 in January. However support was encountered above the lows and $1.4150 is required to indicate a test of the September and November floor at $1.40.

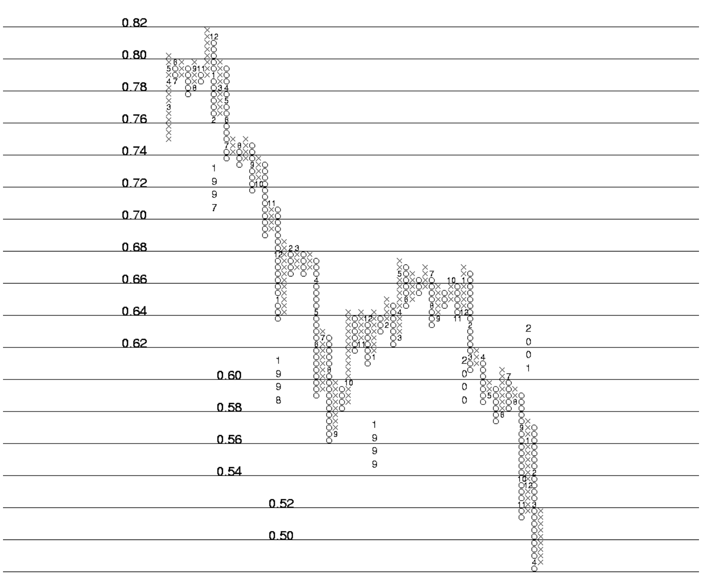
Australian $/US$ - The Aussie may have established an important low following the overstretched decline to US$0.48 but will have to push well above initial resistance at US$0.5120 to confirm this.

Euro/dollar - The euro has been drifting in a probable V-bottom, right-hand extension, medium-term base formation. If so, the trough under $0.88 should continue to cushion downside risk and a move to $0.9080 would suggest somewhat higher ranging.

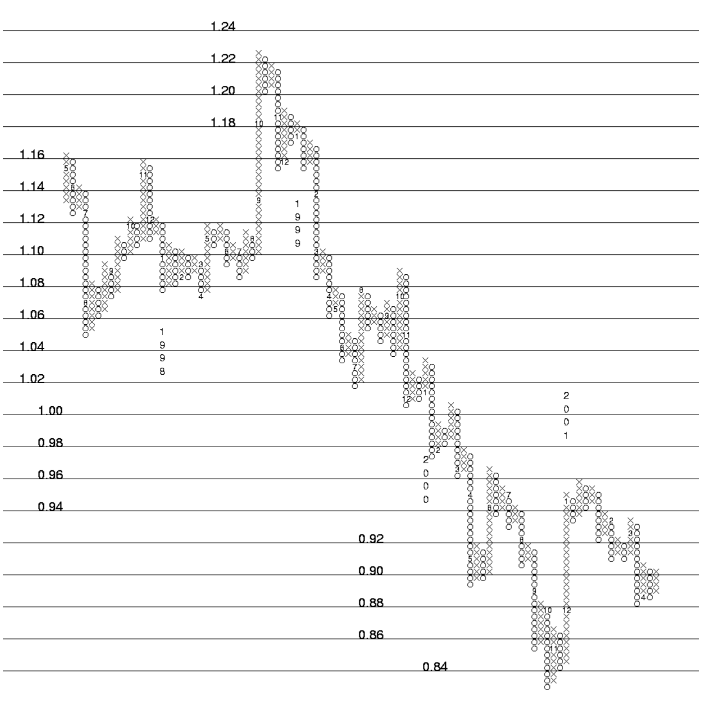
Euro/sterling - The euro has traded sideways to lower following its failed break above the June 2000 high in January 2001. A move to £0.6300 is required to check a phase of somewhat lower base extension before the euro's recovery carries a little higher.

Strategy for currencies - Many subscribers have been running a short yen position for at least six months. This trade (Part 1 of The Triple Play detailed in FM202) has become more complicated due to recent jawboning by the MoF and others. Nevertheless last month's tactics have been appropriate so far. Followed to the letter, I would have

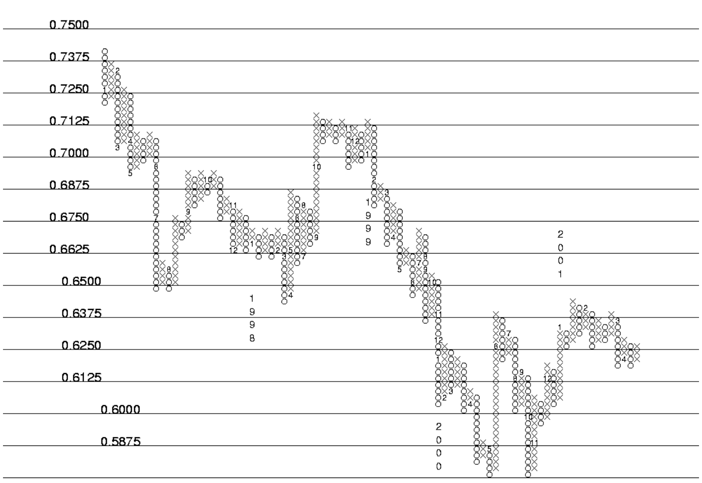
US Dollar per 1 Australian Dollar (0.004)



US Dollar per 1 Euro (0.004)



Pound Sterling per 1 Euro (0.0025)



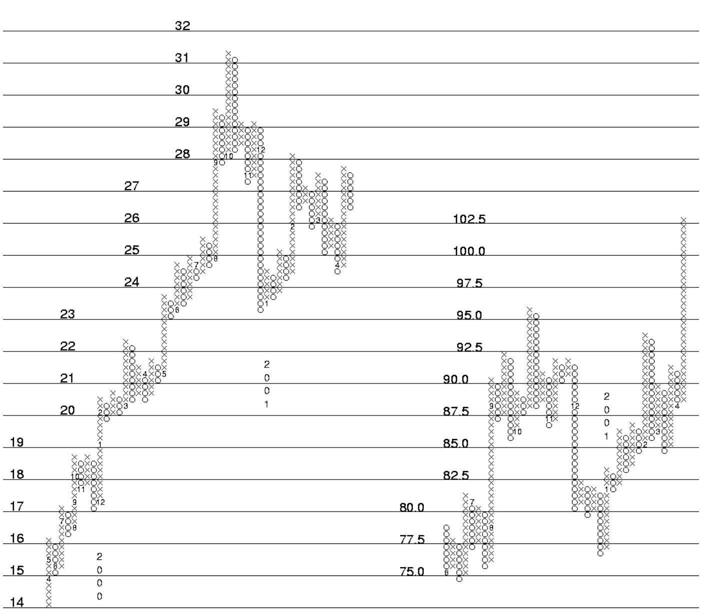
taken a few profits in dollar/yen during the rally to the high to date at ¥126.84 on 2nd April, enabling me to replace at lower prices on the reaction which so far has not triggered stops under ¥120, down to ¥117. Also, I would have traded out euro/yen on the test of its range highs, as stated, because it never saw a clear break above the January high just over ¥113, although it did nudge briefly above the year's earlier peak. Instead, I pressed my luck by averaging up again, hoping for the p&f breakout that did not occur, necessitating higher stops for risk control. These were hit on the subsequent reaction, taking a bite out of my overall profits for short yen trades. I mention this because trading is always both an analytical and emotional challenge. When the latter holds sway, one's performance usually deteriorates. I'm re-establishing yen shorts but will do so more conservatively. I have noticed a number of dollar/yen downside forecasts recently in the ¥119 to ¥117 range, which I regard as a contrary indicator, suggesting that many traders have closed yen shorts. Consequently, I suspect any move under ¥120, even if we see it, would be short-lived. My long-term target (always guesswork) is for a minimum of ¥160 within two years. I think euro/yen and sterling/yen will remain more volatile than dollar/yen and need to be traded accordingly. That said, a p&f close above ¥113.5 by euro/yen would suggest an upside run. When this occurs, I'll probably introduce a tight stop, perhaps just under ¥111, to protect against the possibility of an upside failure. I'm not trading euro/dollar but if I were, I would rather buy than sell the euro under $0.88.

Commodities

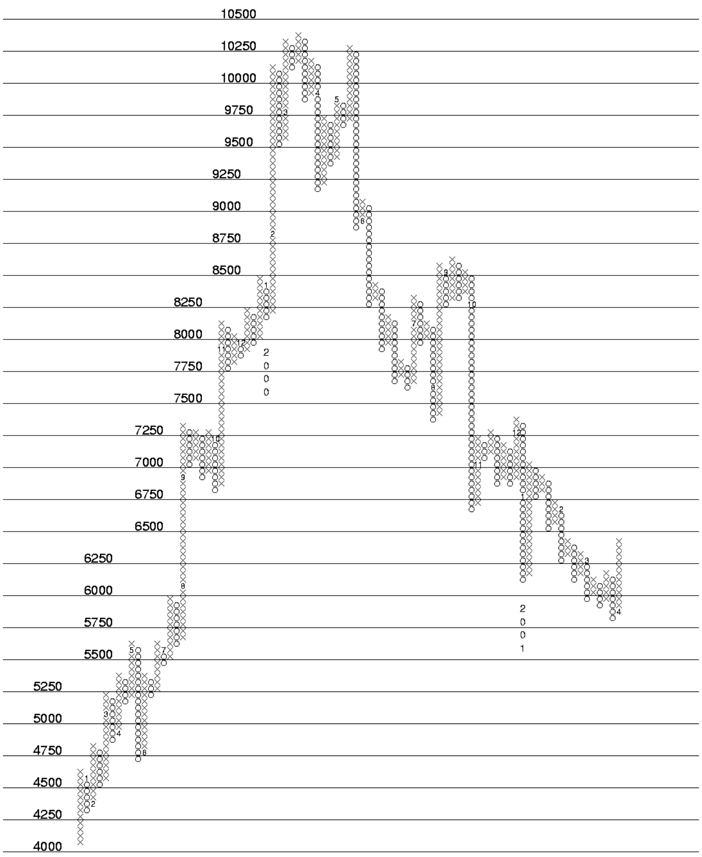
■ **The history of cartels suggests that OPEC's medium-term gain will lead to their longer-term loss.**

Oil prices would be at least 50% lower without OPEC's production cuts, judging from other commodity markets. Understandably, prices for most industrial commodities have taken a beating during the global economic slowdown. Petroleum is the exception due entirely to OPEC's cuts, including two this year which have kept supplies tight, especially for gasoline. OPEC is not a charity and will understandably put its interests first. However cartels usually work against the long-term interests of producers. Oil in the new millennium will be no exception. OPEC is leaving prices too high for too long because it likes the revenue and renewed political clout. This is reducing demand while revitalising the oil drilling and production industry. Research into fuel economy and alternative sources of energy is back on the agenda. All of this takes time but the longer petroleum prices stay high, the further they are likely to fall over the next few years. As OPEC eventually loses market share the cutbacks will no longer prop up prices as they have done in recent months. Producers will chase the market down by exceeding agreed production quotas. Once the taps are turned on it will take a long time to consume the additional supplies of oil. Meanwhile, slow GDP growth, particularly in developing countries, will make the world a more dangerous place.

Crude IPE June 2001 (0.2USD) & Gasoline NYME June 2001 (0.5USc)



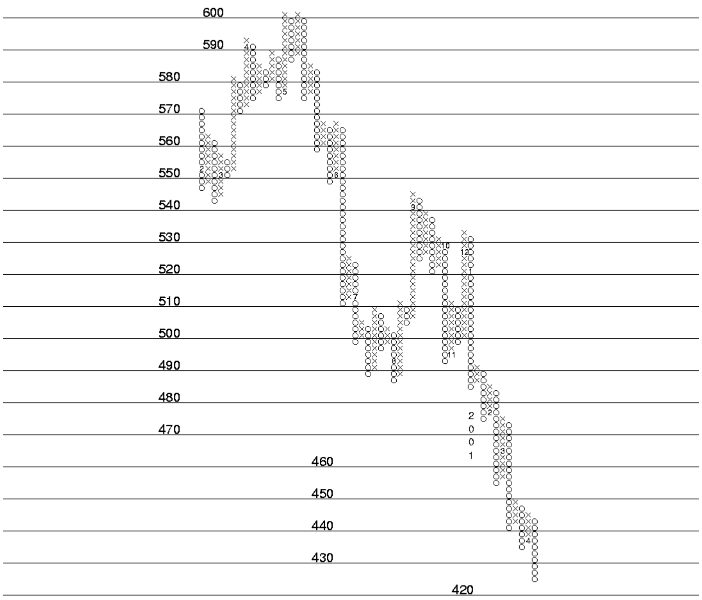
Nickel LME 3 Months (50USD)



Nickel has been a cycle leader among base metals in recent years. It fell to its lowest level since July 1999 recently before rebounding to break the short-term downtrend. However without base development this pattern is unlikely to support more than a technical rally. The recent low is likely to be retested, at least.

Recent declines for many agricultural commodities look overstretched. Abundant supplies, the strong dollar and now waning demand have weighed particularly heavily

Soybeans CBT July 2001 (2USc)



on prices of agricultural commodities in recent months. However at these historically-depressed levels and with the US crop cycle commencing, commodities such as corn, soybeans, wheat and cotton are susceptible to sudden rebounds due to production scares, usually weather related.

Strategy for commodities - I remain positioned for seasonal rebounds in depressed commodities such as coffee, soybeans and wheat. These have been loss leaders so far although wheat has steadied and coffee's burst of short covering on 23rd April suggests that recovery scope now outweighs downward risk. My aim is to buy lightly on weakness while prices are near historic lows and lighten somewhat on rallies within ranges while retaining a core long position, which I'll protect with a trailing stop in the event of a trending recovery.

The Global Economy

■ **Risks are still on the downside although lower interest rates will help.**

■ **Analysts worry about the US but Japan's problems remain much more serious.**

■ **Is stagflation making an unexpected return?**

Some improvement is evident although many economic problems remain. Higher short-term interest rates in 1999/2000, the bubble in TMT stocks and the OPEC cartel's supply cuts have been major contributors to slower global GDP growth. While the interest rate cycle has turned positive, led by the Fed's 150 basis points cuts in Q1, a further monetary stimulus will probably be necessary and it can take months before the economy responds. In Europe, the ECB has slipped further behind the curve, having overestimated regional growth while remaining preoccupied with inflation. Ironically, this has probably compounded Euroland's cost pressures by weakening the euro in line with waning business and consumer confidence in the region. The BoJ's capitulation following market and political pressure is a necessary step in the right direction but there could be a long delay before its new policy of quantitative easing has a noticeable effect on Japan's weak economy and ongoing deflation. This year's earlier US-led interest rate cuts did not prevent a further sell off by stock markets but most developed-country share indices show that at least a near-term bottom was reached in late March and successfully tested in early April. Moreover it is still early in the rate-cutting cycle, which the ECB has yet to join. Interestingly, for the much-maligned TMT sector, the late-January to early-April sell off looked climactic and the bottoming out process may have commenced. However this could be lengthy, as confidence will not be easily restored. The main economic problem in 2001 is the continued high cost of energy following additional cutbacks by OPEC's cartel. Unfortunately, this is largely beyond the influence of monetary and fiscal policy. When growth is strong the world can withstand a de facto tax increase imposed by more costly petroleum products - at least for a while. However a weakening global economy is obviously more vulnerable, particularly developing countries, which often have weaker currencies but must import oil priced in US dollars. GDP growth will continue to slow in Q2 and possibly beyond. Global conditions are unlikely to improve significantly until the US economy rebounds. Meanwhile, there could be some notable debt defaults.

The US's economic downturn is mainly cyclical, unlike in Japan where the problems remain systemic. In Europe, the focal point for collective concerns over the last year or more has been the US, often due to behavioural reasons that readers may wish to contemplate. I'll limit my comments to the most frequently cited issues which are the NASDAQ bubble, the current account deficit, the dollar and debt. Pessimists have enjoyed comparing the TMT bubble to Wall Street in 1929 and Japan in 1989. There is quite a difference because for each NASDAQ stock that soared in 1999/2000, there was at least one old economy stock that fell. The earlier bubbles cited embraced all US and Japanese shares. Moreover, the long deflations that followed were caused by disastrous monetary blunders. Today there is not a shred of evidence that Alan Greenspan and the other Federal Reserve Governors will repeat those mistakes. For the entire US stock market, the NASDAQ fourteen months ago contributed to less of an overall bubble than occurred in 1987. While The Crash of '87 terrified many people, economic damage was minor due to a timely monetary response. The US current account deficit is probably the most misleading and therefore misunderstood statistic in history, as I have often discussed at length. Briefly, US overseas affiliates create much of what the country imports and most of what it sells to other nations is also produced offshore. This is evidence of US prowess in the global economy and makes a nonsense of the current account deficit worries. Similarly, a lot of those "foreign-owned" dollars belong to US corporate affiliates. As for everyone else, they won't abandon the US dollar until they lose confidence in it relative to the alternatives. Meanwhile, the yen is not trusted and the euro untested. Company debt is a problem and the genuine "It's different this time" statistic. Too much of corporate USA leveraged balance sheets in the last bull market by borrowing, often to finance share buyback programmes. In earlier cycles, when stock options played a smaller role in remuneration and before share prices were targeted as a key measure of managements' success, companies made secondary offerings and paid down debt when the market was strong. A lengthy economic slowdown would aggravate today's debt problems, which can only be cushioned somewhat by lower interest rates. Personal debt is unlikely to be much of a problem unless house prices tumble and US unemployment rises sharply from its current historically low levels. These largely cyclical difficulties look enviable compared to Japan's ongoing economic malaise. Many of the systemic problems are a legacy of one-party democracy, with all the abuses this entails. Corruption, cronyism and pork barrelling has too often prevented the deregulation required. The Bank of Japan's monetary policy has been an unmitigated disaster as I have often discussed at length. Money supply growth remains woefully low at 2.6% (M2+CD) YoY for the ongoing deflationary conditions. The yen is still overvalued, judging from Japan's deteriorating trade balance, despite declining domestic demand. Most of the banking sector remains technically bust and the yield curve is too flat for a conventional bailout. Business and consumer confidence has been shattered. Although massive fiscal spending in previous years has prevented economic collapse, it has also ballooned Japan's government debt to a third-worldly 135% of GDP and climbing. Fortunately the way out of this mess is not a mystery and at long last Japan's government appears to have embarked on the necessary path of reform. In an essential U-turn, the BoJ has commenced a quantitative easing, targeting money supply and consumer prices. This will weaken the yen and eventually stem deflation. Hopefully, the government will securitise the commercial banks' bad debts. Appropriately, Japanese companies continue to restructure, improving operating profits. Private savings are more than sufficient to fuel a strong economic recovery once confidence is regained. Meanwhile, Japan's problems have contributed to a weaker Asian region generally.

High prices for energy will result in stagflation. Expensive petroleum products are a tax on private consumption and corporate spending, resulting in slower economic growth. However they also keep PPI and CPI data higher than other economic factors would warrant, resulting in stagflation. This problem is compounded by a soft currency, which boosts oil-import bills. The inflation component of stagflation should be much less severe than in the 1980s because there is very little inflationary psychology. However that could change over the longer term if global GDP growth remains low and central banks reflate too aggressively. In Europe, rates were raised last year not because of overheating growth but to fight inflation, which had pushed over the ECB's intended ceiling of 2%. It has remained above this level due to high oil-import costs and the euro's earlier weakness. While higher rates have had little effect on Euroland's inflation rate, they have slowed growth, risking economic stagnation. This could become a problem for the UK as there will be a price to pay for meat and livestock imports following the foot-and-mouth slaughtering, while this year's loss of tourism will slow the economy. Soaring gasoline prices have introduced a stagflation threat to the US. The risk of a hard economic landing and/or stagflation is greatest in South America, Asia and Australasia. Japan's outright deflation continues.

And Finally…

The Chart Seminar 2001 - My two-day seminar on chart reading using Behavioural Technical Analysis will be held at Le Meridien Waldorf Hotel in Aldwych on 10th & 11th May and 29th & 30th November. TCS is also returning to the Zurich Marriott on 12th & 13th July. For a brochure and enrolment form, email sarahhewett@fullermarkets.com. Come along to learn, contribute, profit and enjoy.

The target date for FM204 is Friday 25th May.

"One of the greatest tragedies of life is the murder of a beautiful theory by a gang of brutal facts."
Benjamin Franklin

Best regards - David Fuller

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