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In its 18th year

Fullermoney

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

Most stock market indices are barely steady near their March lows and further weakness would be a bearish indicator for the global economy.

Too little recovery and too much overhead supply

From purple Lamborghinis to 'for sale' signs - The economic recovery, you will have noticed, remains as elusive as Tantalus's grapes. You remember - Zeus's kid who found himself in deep water over unauthorised disclosures. The water ebbed when he tried to drink and overhead grapes drew back when he reached for them. Today's economists know the feeling, because that long-awaited economic recovery is proving to be a moveable feast, always visible in the next quarter, until we get there. There is a reason, of course, shades of Tantalus's grapes. A friend/subscriber living in Austin Texas was invited to a dotcom Christmas party back in December 1999. The wunderkind MOPS (millionaires on paper) at this newly floated firm had purchased purple Lamborghinis. Many were building palatial homes, financed by loans against their share options. Why sell a good thing? Today, I'm told, there are plenty of 'for sale' signs around Austin and other technology breeding grounds. Conclusion - it will take time for the global economy to recover from the TMT debacle, as I have said previously. Of course stock markets will bottom at least six months before we see indisputable evidence of economic improvement. While interest rate cuts are the right monetary prescription, shares are not responding as they have in most previous cycles. Unfortunately, too many charts for stock market indices are dominated by overhead supply and downtrends. Although a number of these are still encountering support near or above the important March lows, chart readers will have also noted the bearish descending triangular characteristics, evidenced by flat support and lower rally highs. These patterns suggest that supply still outweighs demand. Consequently rallies above the early-August highs are required to improve the technical picture.

Silly season - Meanwhile, in Europe and North America it's late summer, otherwise known as the silly season. This hasn't disappointed. England's cricketers finally won a test match against Australia, if not the coveted Ashes. The ECB has been on holiday, ensuring an unprecedented gaff-free month from that less than august body, enabling the euro to stage a blistering rally. With sentiment undergoing one of its periodic reversals, helped by a rumour that Greenspan may resign, I think the single currency will at least test its January highs near $0.96 against the dollar, have a wobble nearer to yearend on changeover uncertainty and rally a bit further in the first quarter as cash hoarders swap dollars for the new notes. A year or so from now, when the novelty of euro notes has worn off, Euroland's same old problems should cause the single currency to trade below theoretical value. I would not be surprised to see it retest lows against the dollar, especially if the US economy is outperforming

Europe once again, as is likely.

Prescription Viagra - Sentiment also indicates that people are less bearish of the yen, which is probably a good reason to sell the Japanese currency. Among those of us who are yen bears, the well-known obstacle is Governor Masaru Hayami, who first joined the BoJ in 1947. For Hayami, a strong yen is prescription Viagra. Prime Minister Junichiro Koizumi's Government is so frustrated with the BoJ Governor that it is threatening legislation enabling it to sack Hayami before his term expires on 20th March 2003. That probably won't be necessary and I maintain that for professional investors short yen is one of the best macro plays, providing a tidy return on interest rate differentials while we wait for the trend to resume. In chart terms, the other reserve currencies are either in base extension phases or forming the first step above their bases against the yen. This process takes time but is usually followed by explosive advances.

Political liabilities - Dubya may not be a safe pair of lips but he has done more to unite Europe, albeit in consternation, than the Maastricht Treaty or the single currency ever could. Domestically, the US President can count himself unlucky, having inherited a weakening economy and vanishing budget surplus. Consequently the Republican Party will be vulnerable at the 2002 Congressional elections. No wonder Al Gore has upped his profile after a long European holiday, during which he reinvented himself, yet again, this time as a bewiskered pseudo-scientist looking type from the Jurassic Park film trilogy. While the liberal press groans, rumour has it that Al fancies his chances for the presidency in 2004. That's Dubya's best hope of holding onto the White House for a second term. In the UK, that dwindling band of ageing Conservative Party members are about to elect either Kenneth Clarke or Iain Duncan Smith as their next leader. Wags have said that the Conservative's women voters will reject Clarke because he reminds them of their husbands - too fat, too old, too lazy and covered in fag ends. In contrast, the little-known Duncan Smith reminds them of their fathers returned from the war. As a paid-up member of the Conservative Party I briefly considered voting for Clarke because he might provide a more effective opposition, therefore strengthening the Party. That theory is suspect and I'm voting for Duncan Smith, although it might as well be Dunkin Donuts for all the country cares. Labour will be in power until the electorate wearies of them as they did the Tories after too many years in power.

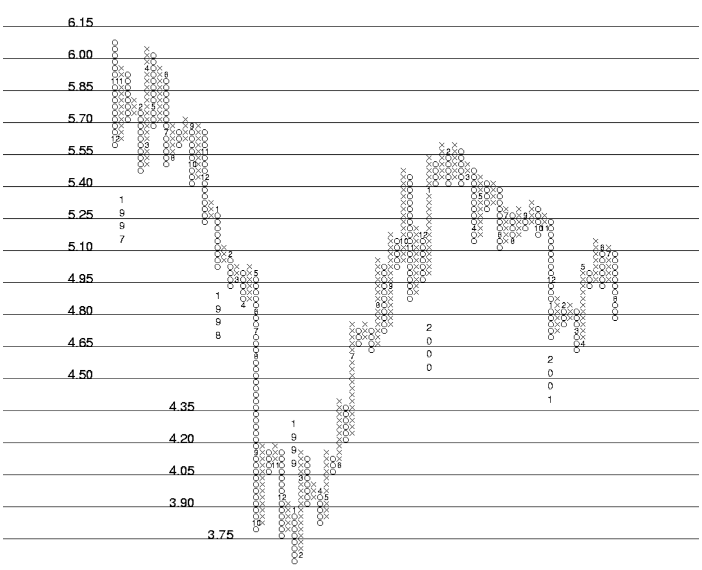
Interest Rates and Bonds

- **Further rate cuts are likely.**

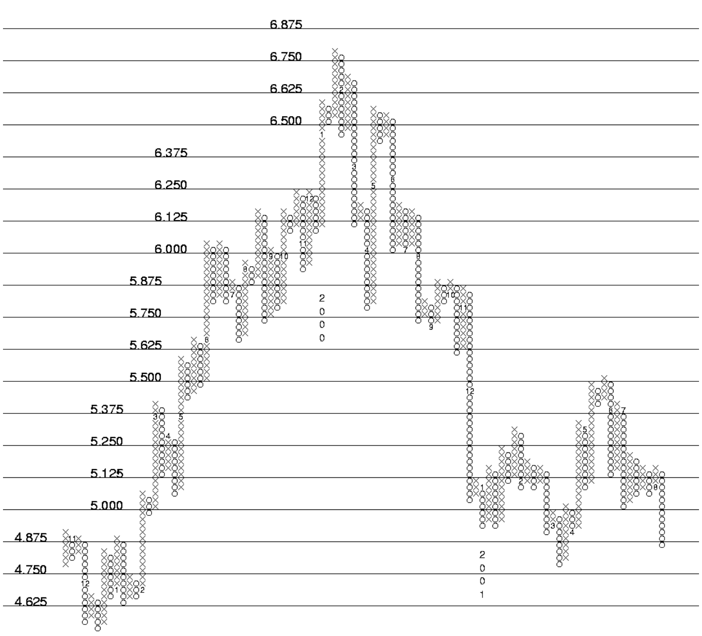
- **North American, European and Antipodean long-dated government bonds should continue to move inversely to stock markets.**

Greenspan has provided the lead once again. While there is some evidence that the US economy may be

Euro-Bund 10 Year Bond Yield (0.03)



US 10 Year Bond Yield (0.025)



bottoming, the Fed Chairman correctly believes that risks remain on the downside. Therefore he could still shave another 50 basis points off the Federal Funds Rate, probably in two quarter-point cuts, taking it down to 3 percent before yearend. The ECB's next opportunity to cut rates from their current level of 4.5 percent will be on 30th August. Although Euroland's average level of inflation remains above the ECB's official ceiling of 2 percent, cost pressures are easing, helped by this year's slump in natural gas prices. Consequently, with GDP growth in Europe's larger economies continuing to slow and cost pressures easing, the case for rate cuts is compelling. The UK's Monetary Policy Committee should look beyond house prices, which are a lagging indicator, and cut rates.

US long-dated government bond yields are leading in a test of the March 2001 lows. North American and European yields encountered resistance beneath their

1999/2000 top formations and eased in line with moderating inflation pressures and weak stock markets. With the global economy soft, bonds are currently seen as a safe haven even though yields are historically low. However yields rallied sharply from the March lows earlier this year so it would not be surprising if some support is encountered as those levels are approached, particularly if stock markets steady. Japanese Government long-dated bonds remain uncompetitive internationally but continue to attract local demand due to deflationary pressures, weak stock and property markets, plus BoJ purchases of Government paper, which were increased 50 percent in August to 600 trillion yen per month.

Strategy for bonds - From a conservative investment perspective, I'm staying with the strategy first mentioned in FM200, which favours shorter maturities, from 3-year government instruments to bills. Spreads between long-dated government and corporate bonds have widened somewhat recently and this divergence would increase if more stock market indices break their March lows. I would continue to tread cautiously in the corporate bond market, as there is still a possibility of some notable scares and/or defaults, which would temporarily weigh on even the better quality issues. Long-dated government issues have performed well recently, mainly as a hedge against weak stock markets. Investors and traders in this market would see further gains in proportion to another slump in global equities. However, that would probably be a temporary window of opportunity, as yields will probably rebound sharply during the next substantial stock market rally, as we saw last March and particularly from the October 1998 lows. Tactically, with both short and long-dated government bonds, I would use trailing stops to protect recent gains and commence taking profits if shares slump.

Global Stock Markets

■ **Stock markets are not yet responding to interest rate reductions as they have in most previous cycles but further cuts will occur.**

■ **Most stock market indices remain in downtrends and many are pressuring their important March/April lows.**

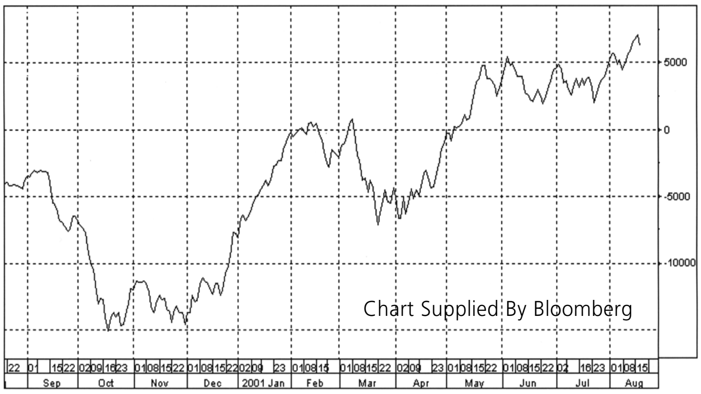
So far, "Don't fight the Fed" psychology has been outweighed by concern over corporate profits and debt. The table below, depicting Dow Jones Industrial Average performance following initial rate cuts by the US Federal Reserve, first appeared in FM201. It shows why "don't fight the Fed" has become such an important maxim for investors. In the nineteen previous cycles of monetary easing commencing in 1914, the DJIA failed to close higher twelve months following the first cut on only two occasions, both during The Great Depression. Consequently, I mentioned that if the DJIA was not above 10646.15 by the close on 2nd January 2002 - its level before the first cut of this (20th) cycle - the global economy, not just the US, will have been in one heck of a mess. I added that the main culprits were likely to be weak corporate profits, debt default and Japan's seemingly endless problems. Evidence to date is not encouraging. The DJIA failed to close higher three months following the Fed's initial rate cut for only the 5th time in 20 cycles and it is lower today despite 7 reductions totalling 300 basis points. While a lot can happen in the remaining four months of this year, especially as the ECB will also resume rate cuts, there are plenty of reasons for concern. GDP growth has stalled in the US, Japan and Germany - the three biggest economies. Corporate profits are generally weak; debt problems are increasing despite lower interest rates, and Japan's ongoing slump could spark deflationary contagion fears. According to a Wall Street Journal article on 17th August, recent losses at NASDAQ firms, including write-downs, have erased five years of profits. Their analysis "looked at earnings excluding extraordinary items going back to September 1995 for about 4200 companies listed on NASDAQ, which is heavily weighted toward technology stocks but also includes hundreds of financial and other growth companies. For the most recently reported four quarters, those companies tallied $148.3 billion in losses. That roughly equalled the $145.3 billion in profit before extraordinary items these companies have reported since September 1995." Weak profits, and not just on the NASDAQ, cause some analysts to forecast that earnings will rebound strongly in 2002. This is certainly possible but in most instances stronger GDP growth will be required if gains are to occur from increased turnover rather than cost cutting.

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

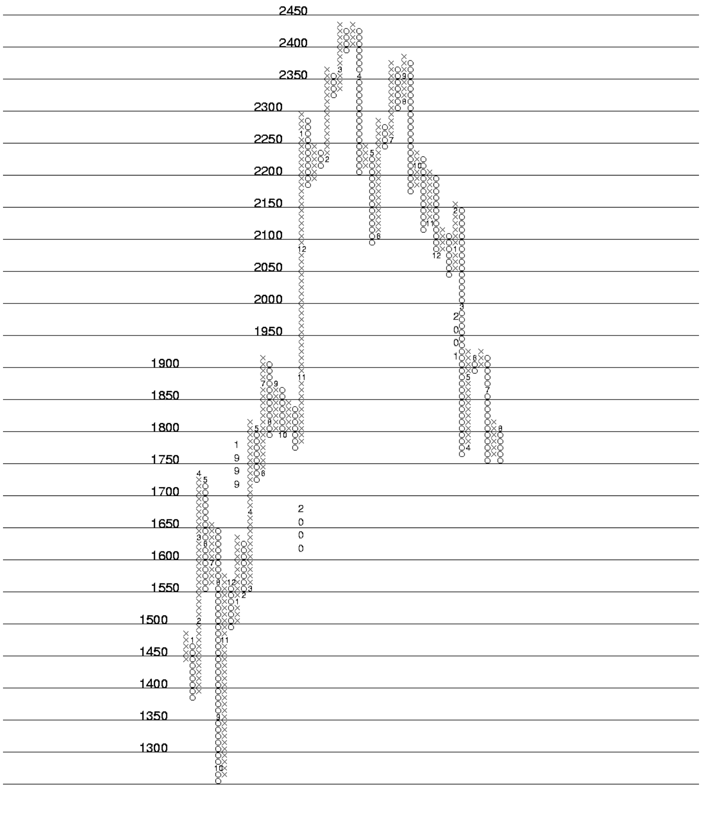
Year	Rate*	3 Months	12 Months
1914	5.0	10.6	83.8
1921	6.5	- 14.2	16.4
1924	4.0	10.9	31.5
1929	5.0	4.2	- 28.3
1932	3.0	- 40.2	- 40.0
1933	3.0	79.2	76.3
1954	1.8	8.2	39.3
1957	3.0	0.7	29.2
1960	3.5	- 7.0	6.4
1970	5.8	17.2	6.7
1971	4.8	12.7	24.0
1974	7.8	33.8	42.1
1975	6.3	6.0	28.2
1980	12.0	10.6	17.3
1981	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.

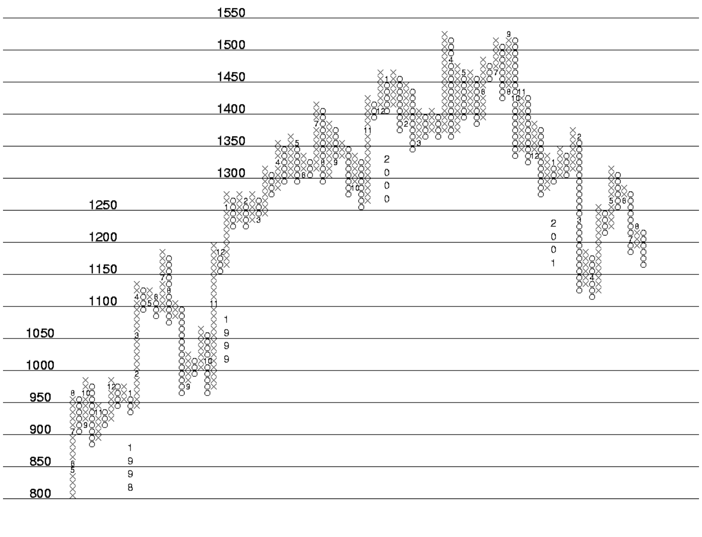
NYSE Cumulative Advance/Decline (Daily)



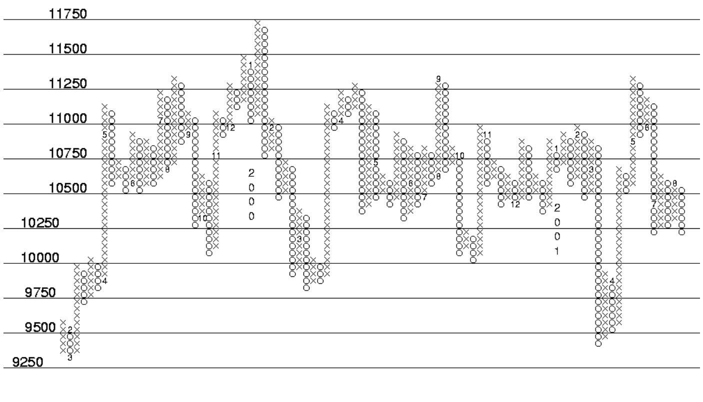
Chartanalysts World Market Indicator (10pt)



S & P 500 Composite Index (10pt)



Dow Jones Industrial Average (50pt)



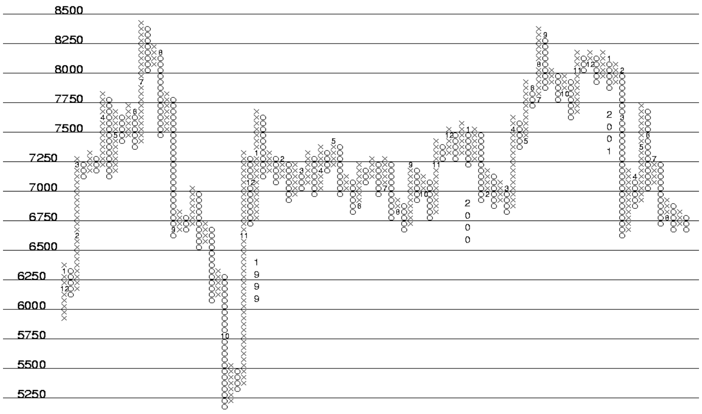
Notes on DJIA After Rate Cuts 2001 Cycle
1st cut on 3rd Jan (6.5% to 6%)
2nd cut on 31st Jan (6% to 5.5%)
3rd cut on 20th Mar (5.5% to 5%)
4th cut on 18th Apr (5% to 4.50%)
5th cut on 15th May (4.5% to 4%)
6th cut on 37th Jun (4% to 3.75%)
7th cut on 21st Aug (3.75% to 3.5%)

DJIA closed 2nd Jan (day before the first cut) at 10646.15.
Close on 2nd Jan 2002 will be the level for 12-month comparison.
Close on 19th Mar (before 3rd cut) was 9959.11.
Close on 17th Apr (before 4th cut) was 10216.73.
Close on 14th May (before 5th cut) was 10877.33.
Close on 26th Jun (before 6th cut) was 10472.48
Close on 20th August (before 7th cut) was 10320.07

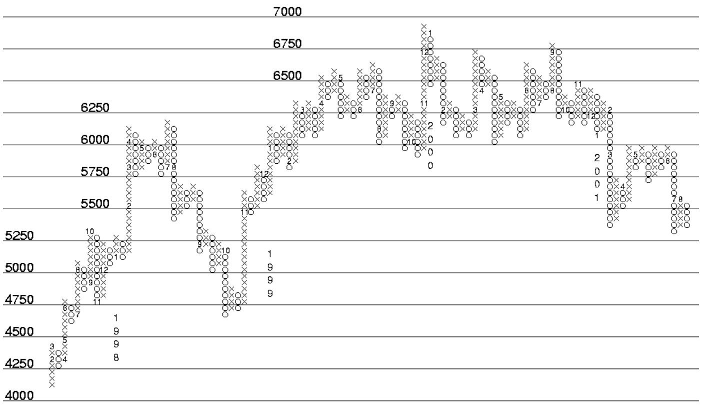
Closes above the early-August rally highs by indices are required to offset current scope for another sell off. Earlier in the year, strong rebounds following accelerated lows in March raised the possibility that a bottoming out and base building process had commenced for stock market indices. Today this hypothesis is being challenged as many indices are pressuring or breaching those former lows, particularly in Europe. Most remain in overall downward trends and show bearish descending triangle characteristics, evidenced by lower rally highs to retest lateral support from the lows. While US indices continue to outperform Europe - not surprising given the rate cuts - most are also pressuring support, which if breached, would signal another sell off. Australia's S&P ASX 200 Index had shown considerable relative strength but recorded an important upside failure in late June - early July. In all instances, rallies above the early-August highs are required to question current scope for additional declines. If this were to occur due to further interest rate cuts or whatever, reviving the base building scenario, it would validate the NYSE's Cumulative Advance/Decline total, which remains one of the few outright bullish technical indicators.

Chart review of topical and representative stock

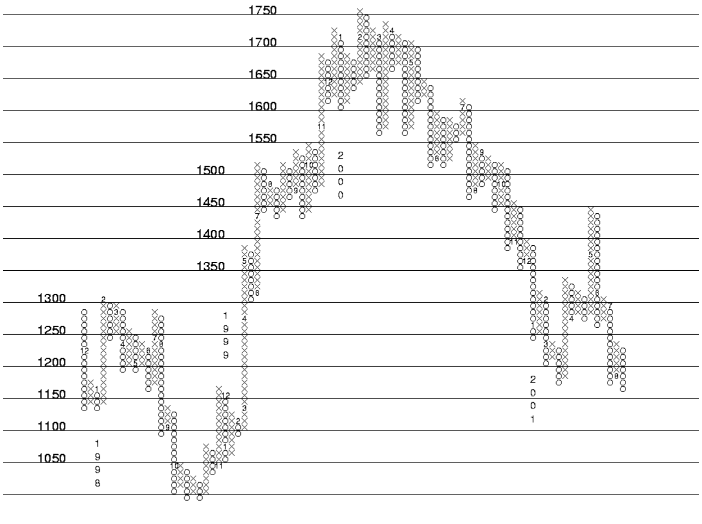
Switzerland Swiss Market Index (50pt)



United Kingdom FTSE 100 Share Index (50pt)



Tokyo Topix Index (10pt)



Germany DAX Index (50pt)

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.*

Chartanalysts World Market Indicator (1745) is testing the March - July lows and needs 1820 to offset current scope for a downward break. *The CWMI is unweighted and calculated in local currencies.*

The US's Dow Jones Industrial Average (10222) remains rangebound in a top-heavy pattern and is currently pressuring the July lows. A close at 10650 is needed to question the current outlook for renewed weakness to test the March trough down to 9400. **The Standard & Poors 500 Composite Index** (1160) continues to back away from its large top area and currently requires 1230 to question a further test of the March - April trough down to 1110. However a move over 1320, breaking the last important rally high, is necessary to challenge the overall bear hypothesis.

Japan's Tokyo Topix Index (1165) is testing its March and July lows and needs 1240 to remove pressure from here and question scope for an additional test of the 1998 trough down to 990.

Germany's DAX Index (5247) has broken its March 2001 low and requires 5900 to indicate a downside failure and 6300 to break the overall downtrend in force since the March 2000 peak.

Switzerland's SMI Index (6663) is testing its broadband lows extending back to December 1999. A move to 6900 is required to remove pressure from this level down to 6600

The UK's FTSE 100 Share Index (5409) looks top heavy and still needs 6000 to remove the downward bias and question the distinctly overall bearish characteristics of this pattern dating back to 1998.

Strategy for stock markets - I still don't like these chart patterns. While I am wary of fighting the Fed, especially when another round of interest rate cuts is underway, too many indices are pressuring or breaking their important March lows. Rallies above the early-August highs are the minimum required to improve the technical picture. Inevitably, some shares have been rallying in what has been primarily a ranging environment recently, albeit with a slight downward bias. However I cannot get interested because too many charts suggest that sentiment could deteriorate sharply if the March lows for most indices are decisively broken. While that would eventually create a buying opportunity, I would still rather be short than long at present. Those who have to be in the stock market should be overweight in defensive shares and avoid cyclicals. However I would prefer cash. My one toe-in-the-water recommendation of individual stocks earlier this year - a few energy issues and Japanese companies with large bases - is not working overall and I suggest selling these positions, which may not perform for some time. I still have a small initial stake in the London-quoted but dollar denominated investment trust, Atlantis Japan Growth Fund, where the managers are now 25% hedged against the yen. I aim to increase this as a long-term core holding and eventually add the Dublin listed unit trust, Morant Wright Japan Fund (in line with my Triple Play first mentioned in FM202) but I hope to buy lower. Meanwhile, I'm currently lightly short DJIA and FTSE futures and may increase positions, protected with trailing stops, if the ranging downtrends are extended.

Currencies

- **The euro has reaffirmed its September - October 2000 lows against the dollar and should at least test the January 2001 highs near $0.96.**

- **The US dollar has commenced or resumed a medium-term correction against most other currencies (the yen excepted) but there is no change in the Treasury's strong dollar policy.**

- **Statistics showing a large US trade deficit do not allow for globalisation.**

- **Koizumi's Administration increases pressure on the Bank of Japan.**

Sentiment has changed particularly towards the US dollar. In currency markets, when the strongest experiences a correction, it usually becomes the weakest for a while. This is what we have seen with the US dollar recently. As the adage states, "bull markets climb a wall of worry", and from time to time the worries reverse sentiment, if only temporarily. When the greenback recently tested last year's highs against European currencies -psychological resistance levels - it was harried by a growing crescendo of protests from US manufacturers, hints of intervention and rumours that the Bush Administration was questioning Robert Rubin's strong dollar policy. A frightening looking chart of the trade-weighted dollar made the rounds, encouraging talk of a bubble and even the IMF jumped in, citing the oldest dollar scare story of all - the trade deficit. Never mind that most of this is nonsense - markets move on sentiment and that has changed. People have been selling dollars and buying anything else tradable, especially the euro. Now that the single currency has clearly held at last year's lows, it could test and eventually clear this year's resistance just under $0.96. I maintain that it could also achieve parity against the dollar, probably in the first half of 2002, when there will be a rush for euro paper. I also believe that this is no more than an extension to the euro's medium-term recovery, which I first wrote about approximately a year ago. In other words, I don't think we are seeing anything more than a year or two's pause in the dollar's secular bull market, which commenced in 1995.

The Bush Administration will welcome a dollar correction but the US economy would have to be much weaker for it to abandon the strong dollar policy. A weaker US economy has eroded confidence in the dollar, which has lost its interest rate advantage against a number of other currencies, although the yen is a notable exception. The strong dollar was aggravating a decline in operating profits for many US export and/or multinational companies. Consequently, there is little doubt that US Treasury Secretary Paul O'Neill will not be troubled by a dollar correction, although this does not mean that he is abandoning the strong dollar policy introduced by Robert Rubin and handed on by Larry Summers. With a competitive economy the US has far more to gain from a generally strong rather than weak currency, notably capital flows and lower inflation. Therefore in the unlikely event that the dollar's correction threatened to turn into a rout, as we saw with the euro's decline, there is little doubt that O'Neill would repeat the mantra, "we believe a strong dollar is in our interests". Simultaneously, the ECB would soon be under pressure from European export and/or multinational companies to curb the euro's strength. The only exception would be if Euroland's GDP growth persistently outstripped a weak US economy. While theoretically possible, this is unlikely given current regulatory and tax regimes.

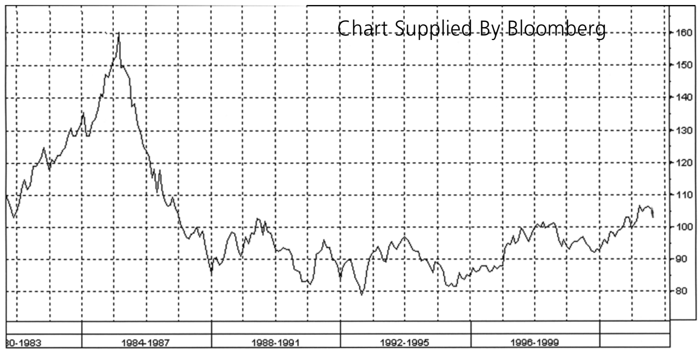
That frightening trade-weighted US dollar chart that you have probably seen is misleading. Talk of a "dollar bubble" has been encouraged by an overextended looking trade-weighted dollar chart making the rounds recently, showing the greenback closing on its 1985 peak. Shades of Mark Twain's "Lies, damned lies and statistics", the chart does not compare like with like, as I mentioned in FMP150. Relative to 1985, the US has much more trade with Mexico and South American countries today. Moreover many of the currencies in that Index (reproduced below) do not circulate widely outside the country of issue (i.e. Latin America, Asia, the Middle East and Eastern Europe). Since the issue of concern is potential moves among tradable currencies, I have included another US dollar trade-weighted chart, based on Federal Reserve data and reproduced from Bloomberg. Figures in this Index are taken from the Major Currency Index, which is a weighted average of the foreign exchange value of the US dollar against a subset of the broad index currencies that circulate widely outside the country of issue. Countries included in the Major Currency Index are Australia, Canada, Japan, Sweden, Switzerland, the United Kingdom and the twelve euro nations. Prior to 1999, the Index was based on the G-10 Currency Index, which the Fed discontinued in 12/98. This chart, far from approaching its 1985 dollar bubble high, appears to be consolidating above a multiyear base. For the record, against the mark and yen, the dollar peaked at DM3.453 and ¥262.8 in February 1985. With these currencies at DM2.130 and ¥120.2 recently, talk of a yen bubble would be more accurate.

Thorough research debunks the "US trade balance problem". I have long maintained that the so-called US trade deficit, cited as a major concern by the IMF and many other sources, is the most misleading financial statistic available. I quote from a well-informed paper on the subject in the May/June edition of Foreign Affairs (P.O. Box 420209, Palm Coast, FL 32142-0209 US, email: ForAff@email.cfr.org), written by Joseph Quinlan, Senior Global Economist at Morgan Stanley Dean Witter and author of *Global Engagement: How American Companies Really Compete in the Global Economy*, and Marc Chandler, Chief Currency Strategist at Mellon Financial Corporation. They correctly point out that "the trade balance is no longer a valid scorecard for America's global sales and competitiveness…In 1998, US foreign-affiliate sales topped a staggering $2.4 trillion, while US exports - the common but spurious yardstick of US global sales - totalled just $933 billion, or less than 40 percent of affiliate sales." While there is obviously a long delay before accurate data becomes available, we can assume that America's enthusiasm for globalisation ensures that US foreign-affiliates account for a considerably higher proportion of exports today as companies operate on the Rule, "make where you sell". Understandably, as Quinlan and Chandler point out, US multinational companies wish to be close to their customers, operating on a "think local, act local" basis. However foreign-affiliate sales are not currently counted as exports in compiling the trade figures. Quinlan and Chandler point out that "corporate America now has some 23,000 majority- and minority-owned affiliates strategically positioned around the globe. Together they rank among the world's largest economic producers, boasting a combined gross output of $150 billion in 1998 - greater than the GDPs of most nations, including Mexico, Sweden, Taiwan, and South Korea. US affiliates also contribute significantly to the GDPs of their various host nations. In 1998, they accounted for more than 16 percent of the GDP in Ireland, more than 9 percent in Singapore and Canada, and more than 6 percent in the United Kingdom." The authors say, in 1998 "30 percent of the affiliate exports went to the United States". This policy of selling to yourself would increase the reported trade deficit. Again, these statistics are very likely to be higher today. Understandably, successful US foreign-affiliate companies recycle a significant amount of capital to the US, forming part of the so-called US current-account deficit of 4.5 percent of GDP, which worries the IMF and others. While there is no guarantee that these companies will continue to invest in the US, why shouldn't they, assuming the country remains reasonably successful relative to Euroland and Japan? The same would apply to foreign-owned affiliates in the US. In conclusion, capital flows are a two-way street but surplus money is attracted by safety and opportunity. It is misleading to imply, as some forecasters have, that the US dollar is beholden to hot money attracted by the NASDAQ or any other temporarily hot market. However, if an economy is in trouble, as we have seen with Japan, there will be pressure on companies to repatriate capital to shore up the parent firm's balance sheet.

Trade-Weighted Dollar Since 1978

This Chart is misleading

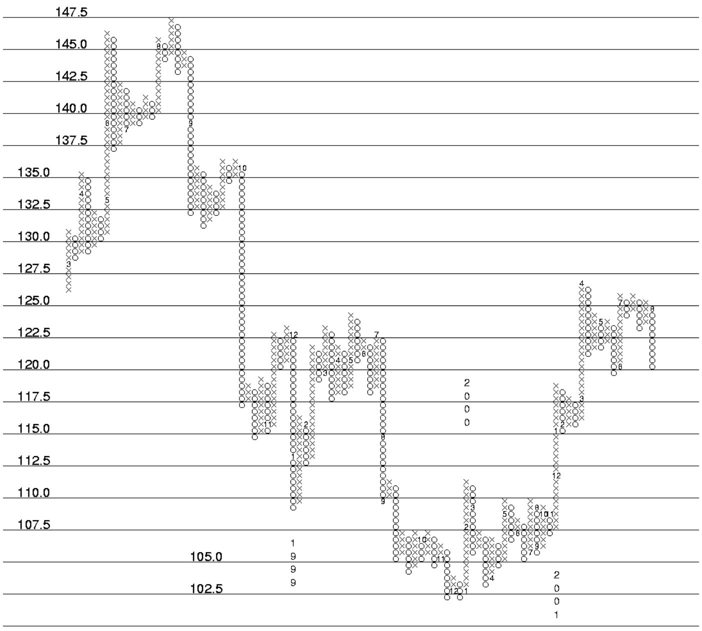
US Trade - Weighted Fed Resr $ Index (Monthly)



Can you imagine the Bush Administration threatening to curb Alan Greenspan's power? It's inconceivable, isn't it, even if you are not a fan of Dubya. However this is exactly what is happening in Japan. The Koizumi Government is threatening the BoJ's independence because maverick Governor Masaru Hayami isn't doing enough to increase Japan's money supply, which has edged up to only 3.3 percent (M2+CD), woefully inadequate for an economy trapped in a deflationary spiral. Kozo Yamamoto heads a group from the ruling LDP, which is demanding that Hayami halt the decline in consumer prices by printing more money. Since Hayami has long ignored such requests, their newly brandished legislative club is the threat of legislation, giving parliament the authority to dismiss BoJ governors and reduce the number of central bank board members to five from nine. Under current rules, Hayami cannot be replaced until his five-year term expires on 20th March 2003. The BoJ Governor has responded by increasing his monthly purchases of Japanese bonds by 50 percent to 600 trillion yen. More radical measures to reflate the economy are not only required but inevitable. These should eventually weaken the yen significantly. Meanwhile, Japan's Vice Finance Minister Haruhiko Kuroda has suggested that the MoF may act to weaken the yen. I maintain that the longer Hayami procrastinates, the worse it will be for Japan's economy, leading to a bigger overall decline by the yen than would have otherwise occurred.

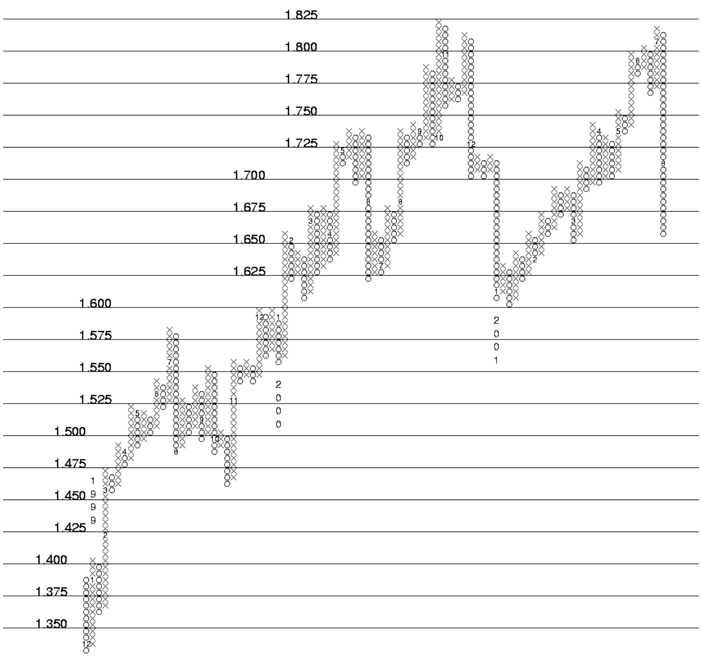
Review of currency point & figure charts - *These and hundreds of other 3-box reversal closing basis charts are available on our website www.chartanalysts.com and are updated daily. All comments refer to closing levels for US trading hours.*

Japanese Yen per 1 US Dollar (0.5)

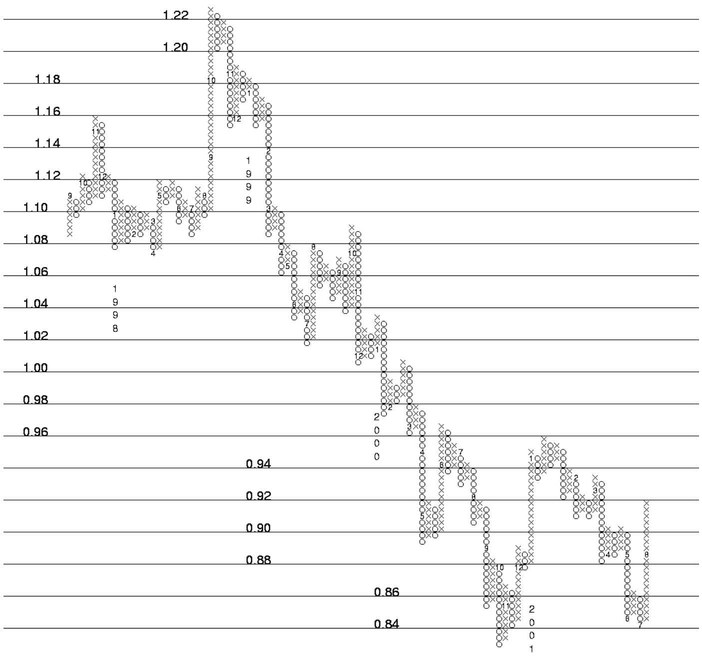


Japanese Yen per 1 Euro (0.5)

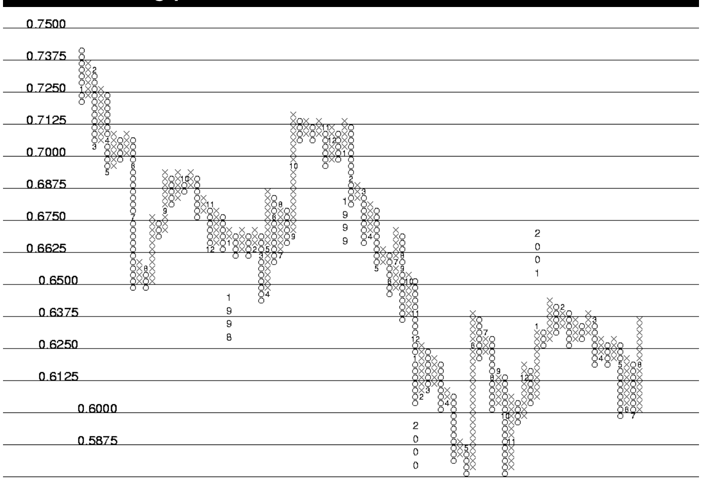
Swiss Franc per 1 US Dollar (0.005)



US Dollar per 1 Euro (0.004)



Pound Sterling per 1 Euro (0.0025)



Dollar/yen (¥120.05) - The dollar's pullback towards its May low at ¥119.5 signals a more lengthy consolidation and the greenback needs to hold here to avoid a base extension phase such as we saw with euro/yen several months ago. Meanwhile, further ranging appears likely and a move back to this year's upper boundary is required to reaffirm support near current levels. Once the April high at ¥126.5 is decisively cleared the dollar should advance rapidly towards its 1998 peak at ¥147, at least.

Euro/yen (¥110.15) - Overall, this pattern continues to resemble a V-bottom with right-hand extension, as taught at The Chart Seminar. The additional push into overhead trading following the May reaction supports this hypothesis. I expect trading to take place mostly within the upper region of this year's pattern followed by a break over lateral resistance near ¥112.5, probably before yearend.

Dollar/Swiss franc (SF1.6580) - The speed and persistence of the dollar's fall from resistance near SF1.82 provides further evidence that it will continue to trade beneath this medium-term peak, perhaps well into next year. Over the near-term, the dollar's decline is likely to slow as it approaches previous support from the January low at SF1.60, leading to some ranging action.

Euro/dollar ($0.9171) - Similarly (but shown conversely) the euro's rebound from its October 2000 low has reaffirmed that floor. While this recovery is likely to slow as psychological resistance near $0.96 is approached, the overall pattern continues to look like a medium-term base. Therefore the January 2001 high will probably be broken and parity could be tested within the next nine months.

Euro/sterling (£0.6314) - As with euro/dollar above, this pattern continues to resemble a base, only it looks more substantial. There is lateral resistance evident near £0.6425 which may take a while to overcome but a breach of the May-July lows near £0.5975 is necessary to question the base building hypothesis prior to a further recovery.

Sterling/dollar ($1.4520) - *not illusrated* **-** The last significant development was the failed break beneath $1.40 in June. While some further recovery remains possible, action will probably be confined mostly to the $1.50 to $1.40 region.

Strategy for currencies - Short yen remains the outstanding macro opportunity in my view. However the action has been choppy for several months, which makes tactics challenging for traders. I know some patient, long-term investors who have established yen shorts against the dollar, euro and other comparatively high yielding and tradable currencies. Subsequently, they do very little, often to the consternation of their bank dealers, remaining content to clock up interest rate differentials while waiting for the main trend to develop. Occasionally, they sell a little more yen when it strengthens and take a few profits as it weakens, although these opportunities have been infrequent recently. Tactically, in the present ranging environment I find that stops, which are a good idea in theory, too frequently lead to whipsaws. Therefore my preferred tactic remains Baby Steps, meaning that I buy the dollar and euro lightly on easing against the yen and trade some of the positions out on rallies. Naturally, during a lengthy ranging phase such as we are seeing, one will do best by closing all longs on tests of the upper boundaries, as I have mentioned before. However one does not know there is an important upper boundary until it has been reaffirmed at least once. The trading risk is that one holds on too long initially, learns to progressively lighten positions on firmness and is then on the sidelines when the next decisive upward break occurs within the overall trend. Of course there is always the opportunity of jumping back in, but at an opportunity cost. Conversely, the money control risk with buying on easing in a range is that the market continues to head lower. Such tactics require that one trade well within the capital risked for this exercise and it isn't easy, otherwise everyone would be rich. I trade mainly the dollar and euro against the yen but any other high-yielding, marketable currency will do. I hope to leverage up when these next trend, using stops for money control, as I did during the initial recoveries. As for euro/dollar, while favouring the single currency, I was a little too conservative in holding out for a further test of last year's lows. However this does not trouble me much as I have euro/yen. If I had euro/dollar, I would take partial profits on a test of the January 2001 highs and only consider increasing the position following sharp setbacks within the base.

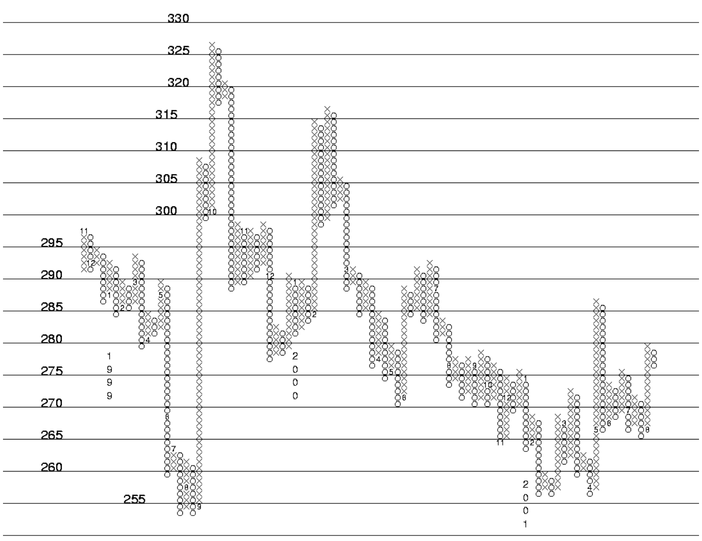
Commodities

■ **A further correction by the US dollar would lead to firmer prices for many commodities.**

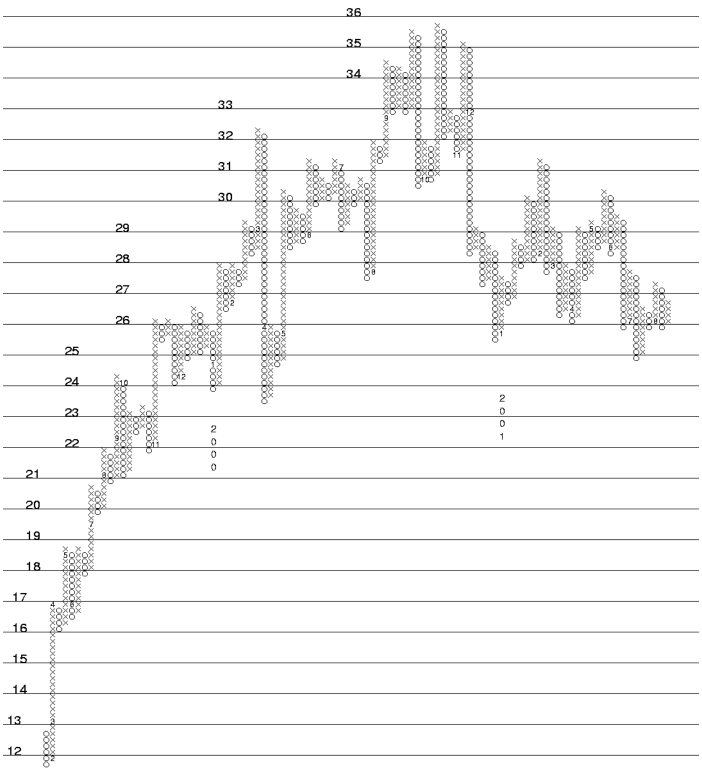
The US dollar is a key variable for commodity prices. Historically, supply has been the main influence on commodities because it can change much more quickly and dramatically than demand, particularly within the agricultural sector. However, long periods often elapse without any significant change in either supply or demand. In contrast, currencies are seldom static and the dollar's strength up until July weighed heavily on commodity prices. Inevitably, the greenback's recent correction has firmed prices for a number of raw materials, partially due to short covering. If it reacts further against the euro over the next nine months, as is quite likely, this would provide additional support for prices of many commodities currently trading near historic lows. Nevertheless, supplies remain abundant in most instances and demand is unlikely to increase before global GDP growth expands once again.

Gold continues to show evidence of base development but the process is likely to be lengthy. While a less strong dollar would lend some support to the gold price, deflationary rather than inflationary concerns are currently ascendant. This will not help to revive gold's

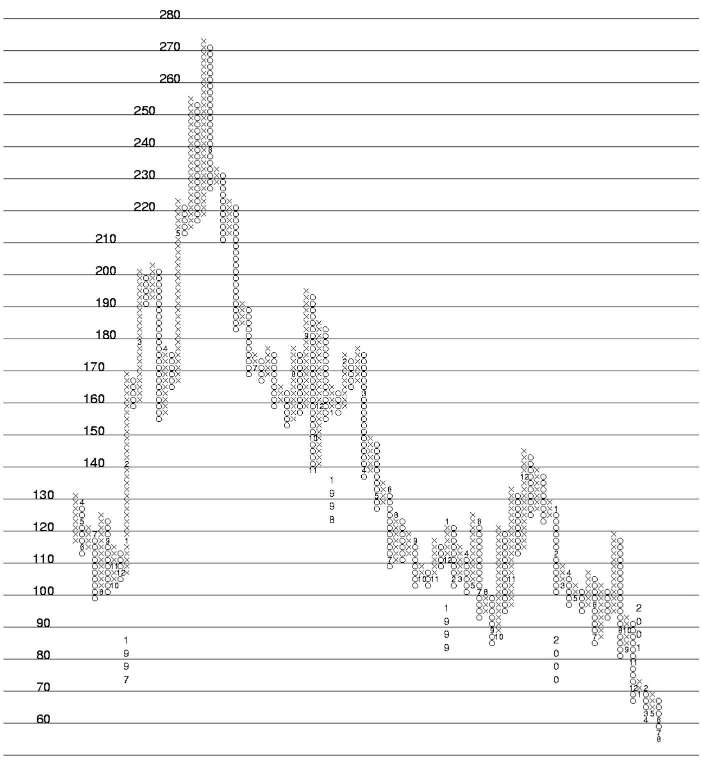
London Spot Gold (1USD)



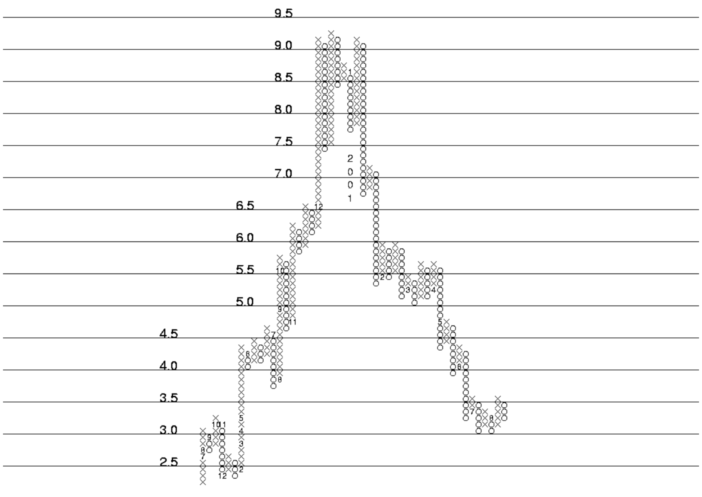
Crude Oil NYME 2nd Month Continuatiion (0.2USD)



Coffee CSCE 2nd Month Continuation (2USc)



Natural Gas NYME 2nd Month Continuation (0.1USD)



monetary role. Bullion has experienced periodic short covering rallies but a sustained recovery depends on a significant fundamental change, involving at least one of the following factors - reduced output due to mine closures, net central bank accumulation rather than sales of gold, a loss of confidence in the US dollar and widespread inflation fears. Gold bulls are a patient lot, and they need to be. Bullion's base extension could be lengthy. I'll revise my view on the timing when there is a sustained push back above $290.

Further supply cuts by OPEC are probably required to prevent a decline in oil prices in coming months. Judging from the chart, the oil producers' cartel is gradually losing control of this market, due to falling demand, increased production from non-OPEC sources, probable breaches of quotas and the substitution of natural gas where possible. Lateral support near $25 (NYME) held in July but the rally was brief. The large, ranging chart pattern looks like a top formation in the latter stages of development. Consequently, a push back into the $30 region remains necessary to question the medium to longer-term outlook for lower prices. Natural gas prices have broken their downward momentum recently. However the rally to date has been small and $3.6 (NYME) is currently required to signal an additional recovery. The main fundamental factor behind this year's steep decline is the rapid development of natural gas fields following the 1999 - 2000 spike in prices. Consequently, the eventual bottoming out process for natural gas is likely to be lengthy.

Coffee's decline is becoming overextended. This is one of the more extreme declines among commodities. It has occurred despite rising demand due to the success of Starbucks and other coffee shops. The problem for growers has been supply, notably from Vietnam, a relatively new producer, which has now replaced Columbia as the second largest exporter of coffee after Brazil. Coffee is now so low, even allowing for the strong dollar, that it is beginning to change the fundamentals. Some Central and South American farmers are abandoning the crop. Mexico's coffee output fell 16 percent in the 2000 - 2001 season, largely because farmers had less capital for fertilizers and pesticides. While it takes time for the supply/ demand equation to change, short of a dramatic weather development such as frost or drought, coffee's recent decline to 48.1¢ (CSCE) takes it close to a sustainable low. The next significant move should be upwards.

The Global Economy

■ **An ongoing problem - monetary policy is not sufficiently stimulative, US excepted, although it will become more so.**

■ **Economic winners and losers as the euro rebounds.**

■ **Best and worst case scenarios for the global economy.**

Lower inflation and weak GDP growth pave the way for additional rate cuts. Inflationary pressures are abating, due partly to the global economic slowdown but primarily because the price of natural gas, which soared to $10.71 at yearend 2000, has fallen back to $3. Consequently electricity prices are lower, notably in the US. The increasing use and availability of natural gas has weakened OPEC's control over energy prices, despite further production cuts for oil. A less strong dollar has also helped. These events have opened the window to further monetary easing. Greenspan has room to shave up to another 50 basis points off the Federal Funds Rate, currently at 3.50%. This would probably occur in quarter-point steps. The ECB is shamefully behind the curve of economic events, due to ineptitude and a duff charter. However even the embattled Duisenberg should appreciate that a series of reductions are required, commencing with the ECB's next meeting on 30th August. Similarly, the BoE's Monetary Policy Committee should recognise that recent strength in house prices (their main concern) will prove ephemeral in what is likely to be a lengthy economic slowdown. As for the BoJ, its monetary efforts remain culpable, as these pages have repeated for over a year and most commentators now concur. The evidence is money supply growth of only 3.3 percent -woefully inadequate for a destructive deflationary spiral due to falling demand, prices and output. Additional efforts to reflate the global economy are necessary and inevitable. This will cushion economic contraction in proportion to the measures taken, with the US eventually leading the next recovery.

US manufacturers would gain most from a euro recovery towards parity with the dollar. While it would be an exaggeration to say that Christmas has come early for US exporters, given global economic weakness, their lobbying for a softer dollar is being answered, not due to a change in US policy towards its currency but because of the swings and roundabouts of markets. This will make US exports to Europe and other regions more competitive, in direct proportion to the dollar's correction. Additionally, US multinationals will see their operating profits rise as foreign affiliate sales are consolidated in dollars. These gains will only be pared slightly by higher import prices because the global economy is still weakening, most commodities are priced in dollars and China (a key supplier) has pegged its currency to the greenback. American consumers will have to pay a little more for imports from Europe and other regions where currencies are strengthening. While the ECB and Euroland's politicians will save face because of the euro's rebound, the region's industrialists won't be pleased other than by the prospect of lower interest rates. The single currency's weakness was a key factor behind GDP growth for Euroland's core economies in 1999/2000.

The range of possibilities, from brief downturn to lengthy recession. If the world gets lucky, US consumers will spend just enough to keep the economy out of recession while simultaneously paring household debt. Further rate cuts by the Federal Reserve would help US corporations to lower debt and an easier dollar would improve operating profits. In Europe, the ECB and other central banks would cut rates and regulatory impediments aggressively, leading to a soft landing. In Japan, the BoJ would *really* press on the monetary accelerator to stem deflation and the Government would use some of the printed money to target its stock market, while cutting taxes and promoting restructuring. Last but not least in the good luck department, OPEC would prove unable to keep oil prices at current levels. Led by the US, the global economy resumes a sustainable, albeit moderate rate of growth in 2002. In a worst-case scenario, US consumer spending plummets because of another stock market slump, layoffs and weaker house prices. The ECB and BoJ remain obdurate and/or well behind the curve of events. Corporate debt defaults and bankruptcies increase. Japan's deepening slump sparks fears of deflationary contagion. Competitive devaluations increase and the US dollar soars again before slumping. Argentina and Turkey default. OPEC, incensed by further carnage in the Israeli/Palestinian conflict, continues to reduce oil production, succeeding in keeping prices high for longer than expected. The global economy becomes gridlocked in a deflationary recession.

The economic problems are closer to hand than their solutions. Needless to say no one knows how the global economic situation will develop over the next couple of years but the end result should fall between the best and worst case scenarios above. Unfortunately, many of the problems appear far from resolved. The TMT bubble, while most damaging in the US was also an international development. Judging from previous manias, it takes at least a couple of years to recover from such excesses and it is likely to be longer before venture capital flows freely once again. Corporate debt is a problem as many companies, including old economy concerns, leveraged their balance sheets in the 1990s. This dubious procedure was encouraged by the fashion for targeting the share price as a measure of management's effectiveness. Consequently, where companies would have previously sought capital by issuing equity in a rising stock market, they borrowed in the last cycle, often to boost earnings per share by using the money raised to repurchase their own stock. Inevitably, problems arise in an economic slowdown, such as we are seeing, because both earnings and share prices are weak but companies are still saddled with the debt, which delays recovery. Against this background, even an appropriate monetary and fiscal policy mix, such as we are seeing from the Federal Reserve and Bush Administration is unlikely to produce a quick recovery. UK and Euroland economies saw fewer excesses in the 1990s, telecoms excepted, but neither did they experience the same level of GDP growth. Today, growth is slowing and unemployment rising, especially in Germany which accounts for 30 percent of Euroland's output. The ECB is way behind the curve of economic events and while it will regain some credibility following the euro's rebound, this will not help exports and operating profits. Moreover government and union regulations are impeding the corporate restructuring that is required. This will only postpone additional unemployment in Europe and probably push it higher than would have otherwise occurred, while delaying economic recovery. In Japan, support for Prime Minister Junichiro Koizumi's Government is waning because despite all the talk of reform, he has done little to date and the deflationary slump has worsened. An unrepentant Masaru Hayami at the BoJ, who is resisting the radical monetary reflation required, makes Koizumi's problems much worse. Japan's deflation is primarily a monetary problem. However Hayami has yet to set an inflation target and money supply has edged up to only 3.3 percent (M2+CD), woefully inadequate under the circumstances. Consequently the Government is threatening legislation to curb the BoJ's power, but this would be highly controversial and presumably take time. In conclusion, the global economic outlook remains worrying with the three largest economies showing negligible growth. Nevertheless the news is not all bad. There is some evidence that the US economy is bottoming in response to Greenspan's interest rate cuts. Further reductions are inevitable in the US and especially Europe, and this can only help. Significantly, a big fall in the price of natural gas has lowered the "energy tax" but oil prices are still impeding recovery.

And Finally…

ACI Ireland Conference - I will address the annual ACI - Financial Markets Association Conference on 1st October, speaking on Behavioural Technical Analysis. This is always a fun event - www.aciireland.com/timetable.htm.

The Chart Seminar 2001 - My final venue for the year will be in London on 29th and 30th November. For details and an enrolment form visit www.fullermoney.com.

The target date for FM208 is Friday 21st September.

"Some things are what they are regardless of what they were."

John D Barrow

Best regards - David Fuller

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