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In its 18th year

Fullermoney

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

The global economic slowdown will be deeper following attacks on the US, but could be shorter in duration as central banks and governments respond with additional monetary and fiscal stimulus.

Global stock markets have seldom been more oversold

A technical rally has commenced but fear and uncertainty will remain - In the bear market's latest downward leg most stock markets had fallen since May. Trends for the main indices began to accelerate following breaches of the March-April lows and this turned into a rout after the heinous terrorist attacks on 11th September. Heavy selling persisted through Friday the 21st, following widely publicised rumours that the FBI had reason to suspect a second wave of terrorist attacks on Saturday the 22nd. I would not be surprised if the US Federal Reserve purchased index futures on Friday, in one of its secondary roles, which is to help maintain orderly markets. We may never know because such action would not be publicised but Greenspan has done this before. Fortunately, there were no further attacks on the 22nd, enabling a rally to commence on the 24th, in response to one of the most oversold conditions that I have ever seen in 36 years of monitoring markets. According to estimates, the Fed may have pumped up to $100 billion into the US economy since the attacks. If true, this would compare very favourably with the post-LTCM collapse/Russian debt default of 1998 and the yearend 1999 liquidity injection in response to all those Y2K scare stories. That latter move was a big mistake, further inflating the TMT bubble and eventually contributing to the global economic slowdown, as Greenspan and other central bankers drained liquidity and raised interest rates last year. The difference today, compared to the 1998 and 1999 liquidity injections, is that the economy is weak and has just suffered two horrendous blows - economic and especially psychological. Consequently there is no prospect of a similar-scale stock market rally to what occurred in the late 1990s. However, the Fed's latest reflation can only assist an oversold rally. Beyond that, global stock markets have much to worry about, commencing with the simultaneous slide of all economies towards recession, woefully late and/or inadequate policy responses in Euroland and Japan, hazards associated with the necessary counter terrorism efforts, and the continuing risk of further attacks against the US and possibly its allies. Economic news will remain weak well into 2002. Nevertheless, having long said that economic spokesmen for governments, the IMF and most banking/broking firms were too optimistic about global GDP growth, I now believe that recent and pending monetary and fiscal stimulative measures by the US and other countries will end the recession more quickly than would have otherwise occurred, albeit from a somewhat deeper level than would have pertained if there had been no terrorist attacks.

Bin Laden's first margin call? - Finally, oil will remain the key variable. Having soared to $30 (spot NYME) on 14th September, it then plunged below $22 before steadying as I completed this issue. News services attributed the slide to OPEC's inability to maintain higher prices now that demand has slumped, particularly for airline fuel. I believe there could be another factor behind oil's sudden weakness. Bundesbank president and ECB Governing Council Member, Ernst Welteke, announced on 22nd September that he was investigating some unusual market moves just before the attacks on the 11th, because "It is becoming ever more obvious that there must have been activities in international financial centres carried out by players who have the necessary professional knowledge". In other words, he is talking about the ultimate insider trading. Shortly after the attacks, when I first heard about the selling of airline and insurance stocks, I was sceptical about rumours that terrorists may have been involved. However, there was too much evidence of unusual activity for these and other sectors likely to be affected for this to be dismissed as entirely coincidental. Bin Laden's al-Qaida organisation has been recruiting for years. A number of these people would have known of the imminent attacks, in addition to the 19 terrorists who hijacked and crashed the planes. Events under scrutiny in addition to short selling of airline and insurance stocks, include the purchase of put options for these shares and also stock market futures, and Welteke also mentioned increased buying of oil and gold futures. He added, "Before the attacks, we had a rise in oil prices which cannot be explained by fundamental data. That may mean that people bought oil contracts, which they later sold at a higher price." Or, assuming Welteke is right about terrorists trying to profit from their crimes via the markets, perhaps they didn't sell in time. Did al-Qaida operatives receive their first margin call and panic? Wouldn't that be a little bit divine retribution!

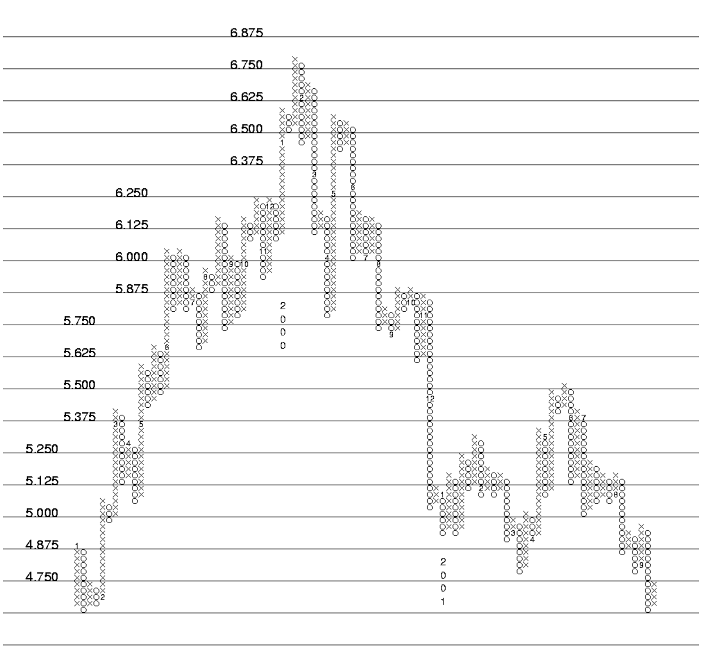
Interest Rates and Bonds

- **Further rate cuts are likely, especially in Europe.**

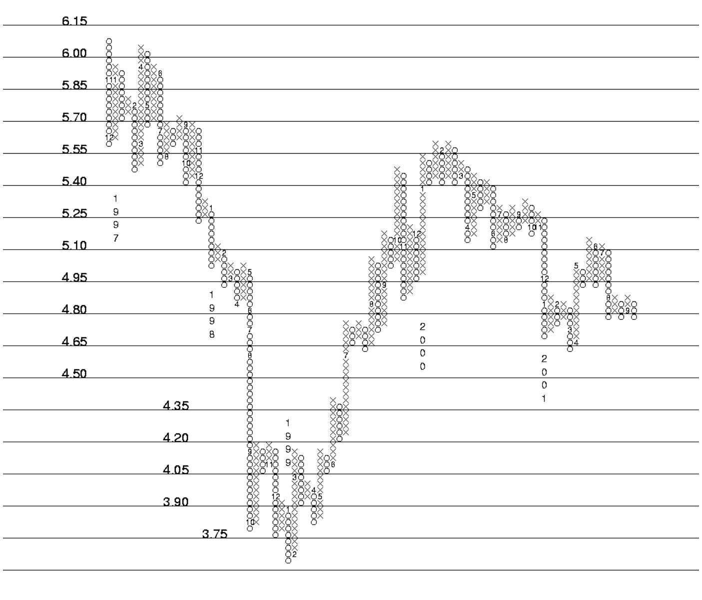
- **North American, European and Antipodean long-dated government bonds have been moving inversely to stock markets and this is likely to continue for a while longer.**

Now even the ECB recognises that economic risks are on the downside. The European Central Bank has been way behind the curve of events but better late than never in recognising the need for lower rates, even if it cites terrorist attacks on the US as the reason, rather than this year's obvious (to everyone else) weakening of Euroland's economies. With a steadier euro and provided oil prices do not rally too much during some of the

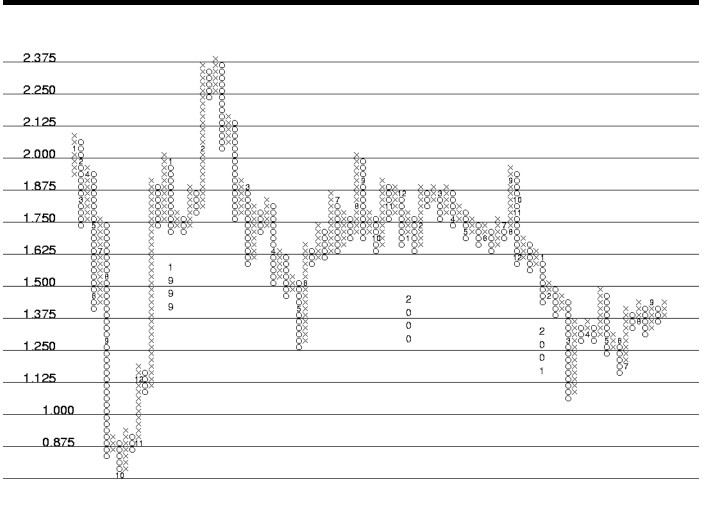
US 10 Year Bond Yield (0.025)



Euro-bund 10 Year Bond Yield (0.03)



Japanese 10 Year Bond Yield (0.025)



counter-terrorism manoeuvres that lie ahead, the ECB will have scope to lower rates substantially from the current level of 3.75 percent. Arguably, the greatest scope for lower rates is in the UK, since they remain high among developed economies at 4.75 percent. Consumer spending will fall sharply, as it has elsewhere and house prices, always a lagging indicator are certain to reflect weaker global economic conditions over the next year or two. The US Federal Reserve has led the rate cuts, taking the FFR down to 3 percent in eight steps. This was my downside target prior to the attacks, which may necessitate further easing.

Government long-dated bond yields have fallen sharply, especially in the US, due to the so-called flight to quality as stock markets slumped. Consequently they are vulnerable to profit taking during a technical rally for equities, as we last saw in April. However, judging from the charts and economic events, North American, European and Antipodean bond yields would not rally back to their May-June highs. Moreover, they could move somewhat lower, especially in Europe, if the bear market in stocks is extended in coming months. JGB 10-year bond yields have firmed and a move to 1.45 would suggest higher scope, reaffirmed at 1.50.

Strategy for bonds - My strategy since FM200, from a conservative investment perspective, has been to favour short maturities - 3-year government instruments to bills. Given the substantial gains in this sector and the probability of a technical rally by stock markets, I would take some profits, moving temporarily to cash, and or use tight trailing stops to lock in most of the gains, in the event of a correction. I would continue to tread cautiously in the corporate bond market, as the possibility of some notable scares and/or defaults has increased. This would temporarily weigh on even the better quality issues

Global Stock Markets

- **Despite the sell off, there is still an earnings and valuations problem.**

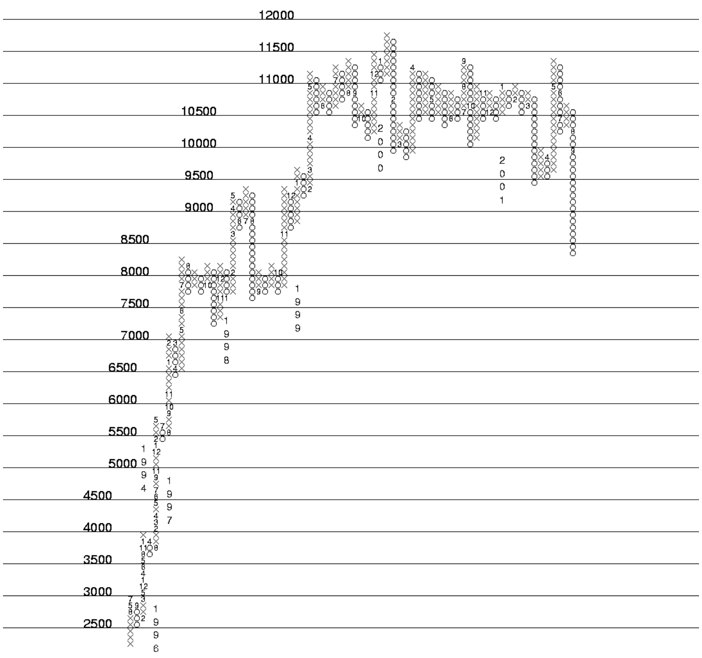
- **As a lead indicator, breaches of the important March/April lows by indices have pushed hopes for an economic recovery into 2002.**

- **The bear market has entered its latter stages but upside scope is currently limited to an oversold rally.**

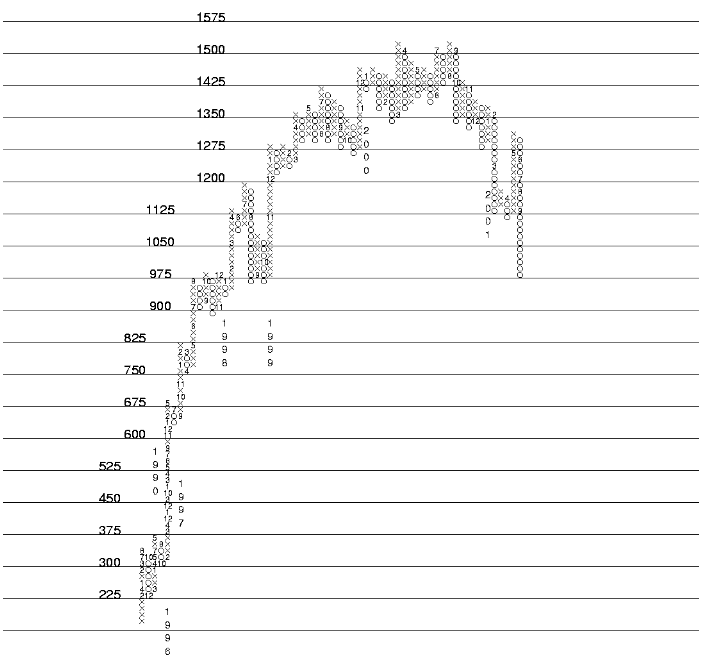
The outlook for earnings is still deteriorating. The global economy was weakening prior to those horrific attacks in the US and they can only reduce GDP growth in Q3 and Q4 2001. Moreover, a setback for the US affects all other countries. Initially, investors understandably singled out insurance companies and airlines as the main corporate casualties. Insurance payouts will obviously be massive. However these companies will soon benefit from higher premiums and probably increased business as more firms and individuals top up their insurance coverage. Nevertheless their share prices will reflect a risk premium for some time, as investors weigh the possibility of further disasters. The immediate problems for airlines are considerable, not least because of a slump in air traffic, which is likely to recover slowly. Nevertheless, battered share prices have gone a long way towards discounting these problems and the industry is an obvious candidate for government support. No country can afford to be without its major airlines. Uncertainty, caused by the very necessary war against terrorism, will affect most industries on a global basis, defence contractors excepted. Consumer sentiment in the US had reached an 8.5-year low before the attacks, which are hardly conducive to retail therapy. The mood, at least for a while, will be reflective, anxious and reserved, rather than ostentatious as we often saw in the 1990s. Consumers will save, which is a good thing overall but won’t help corporate profits over the next few months. Less travel will hit tourist industries everywhere. Increased insurance premiums, especially in urban areas, will add to overheads. Most of these factors have an immediate effect on corporate profits. It will take time for increased fiscal spending to filter through the US economy at large. Consumer confidence will continue to be influenced by uncertainties, reflected by the stock market. Moreover, property prices are the next shoe to drop. The US stock market in particular has been unwinding record overvaluations. These are coming down, but not as fast as the stock market, because earnings are tumbling as well. The re-rating of equity valuations is often described as a reversion to the mean. Yes, but these events usually overshoot, just like market prices. The apt parallels in terms of valuations are 1973/74 and 1980/82. Not many stocks around the world have reached those levels, although they are getting closer.

There is little chance of an economic recovery before Q2 2002, at best. One reason why stock markets were falling so fast, even before the despicable attacks on the US, was that the psychologically significant March/April lows were being taken out. Prior to that many were hoping for a double bottom by indices, with the US leading an economic recovery before yearend 2001. US Treasury Secretary Paul O’Neill was a proponent of this theory, as were most economists from the main banking/broking firms. These people know that the stock market is a leading indicator and likely to bottom at least 6 months before the economy. Even before indices moved decisively beneath their March/April lows, the hoped for V-shaped economic recovery had become U-shaped, to use the conventional alphabet labels. Unfortunately, neither description presents an accurate image of what is actually happening because the world’s economies are still weakening. Viewed in

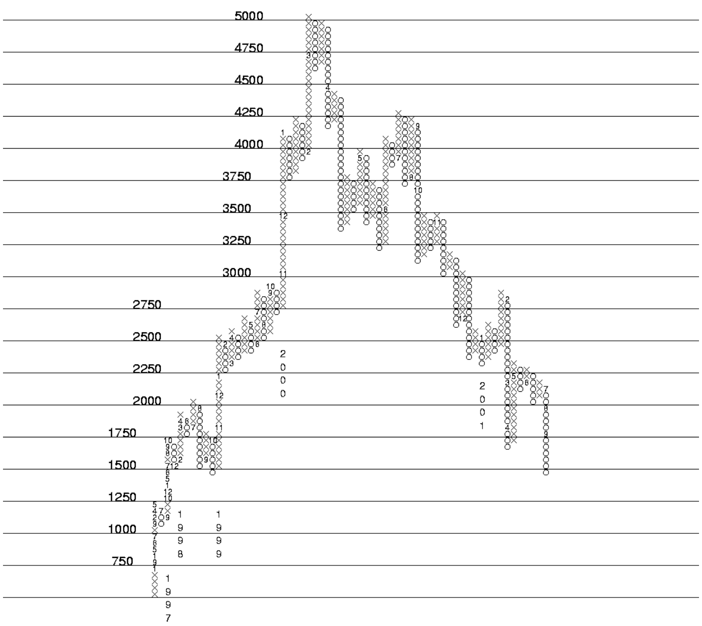
Dow Jones Industrial Average (100pt)



S & P 500 Composite Index (15pt)



NASDAQ Composite Index (50pt)



historical context, this doesn't look too bad because no major economy is "technically" in recession, defined as two consecutive quarters of contraction. Behaviourally, however, it feels a lot worse because everyone now senses, at least privately, that recession is unavoidable. The consensus view has now caught up with events and will no doubt become overly pessimistic, judging from past market and economic cycles. Meanwhile, returning to that 6-month rule of thumb lead period for stock market indices versus an upturn in the global economy, on a best-case scenario GDP won't improve before Q2 2002.

We should become less bearish with each additional down leg for indices, in contrast to market sentiment. This is an obvious point from any analytical perspective but difficult to recall when a black mood envelops trading. The consensus is a contrary indicator and sentiment is always most bearish at the bottom. Sentiment has certainly deteriorated in recent weeks. However, viewed in perspective, most investment bank/ broker spokesmen, not to mention the politicians, have consistently underestimated the deterioration in economic conditions, not to mention those bullish forecasts from some of the last cycle's revered stock market gurus. The good news for battered investors is that we have now seen historically significant bear market declines, particularly for Asian and European indices. However, US indices have lagged, NASDAQ excepted, and given the very large top areas following one of the biggest bull markets in history, it would be premature to predict more than a technical rally at present. Moreover, during most previous bear markets the early downside leaders not only recorded the biggest overall declines, they kept underperforming until US indices bottomed. Thereafter many of the previously weakest indices scored some of the biggest gains in the next bull market. Meanwhile, there is no precise way to predict the depth and time frame of a bear market. Technical measurements, former support levels, cycle theories and valuations offer perspective but are seldom more accurate than an interested observer's hunch. Mine is that we are now in the bear's latter stages. The only certainty is that many people will claim, after the event, to have accurately called the bottom.

Market panics are a short-term phenomenon. A triple whammy consisting of more economic bad news, breaks of the March/April lows by stock market indices and unprecedented terrorist attacks on the US recently combined to trigger a panic, evidenced by the freefall commencing in late August. Panics are a short-term phenomenon because an accelerating market trend soon creates a deeply oversold condition, having discounted most events known and feared. Moreover, the level of anxiety evident during a selling panic is unsustainable for long. The process is ultimately cathartic and therefore usually followed by a V-shaped rebound. Today, the technical conditions for a rally, initially on short covering, are in place. The likely trigger would be less concern over further terrorist attacks on the scale of 11th September and/or the successful launch of US counterattacks. However, there is insufficient evidence to conclude that the bear market is ending, unless there is no rally and markets plunge considerably further from current levels. While possible under the current circumstances, crash endings for stock markets are rare. Most bear trends are characterised by a step sequence of sell offs, punctuated by technical rallies and/or ranging phases, as we have seen to date.

Chart review of topical and representative stock 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.*

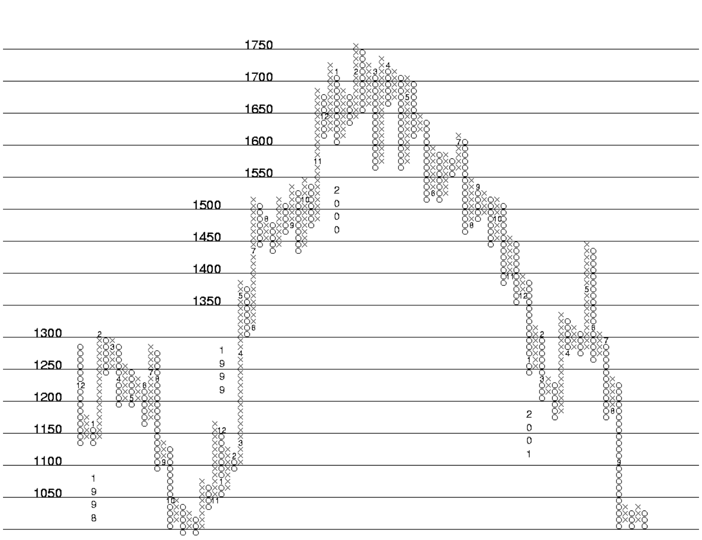
The US's Dow Jones Industrial Average (8603) is temporarily overextended following its plunge. However that move completed the top formation and a rally above 9500 is needed just to suggest a downside failure. **The Standard & Poors 500 Composite Index** (1003) is similarly overstretched and testing the August to October 1998 lows, which launched a 2-year advance to the peak. Some steadying is likely but this pattern cannot support more than a technical rally within the overall downtrend. **The NASDAQ Composite Index** (1499) has breached its April low to test the important 1998 floor near 1450. This might support a bounce but a move over 2000 is needed to revive the base building hypothesis.

Japan's Tokyo Topix Index (9693) looks overstretched and shows some loss of momentum at its important 1998 low near 990. While a rebound is now possible, a push above initial resistance at 1170 is needed to provide evidence of a double bottom. **The Tokyo SE Topix Second Section Index** (1766) recently broke its January 2001 low. A push above 1900 is required to suggest a downside failure.

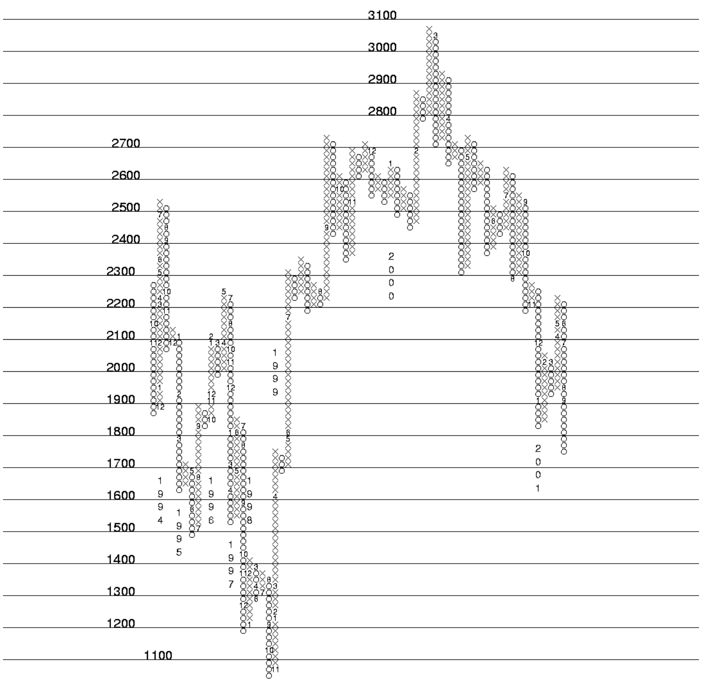
South Africa's JNB Gold Index (1195) is quietly steady in what has long looked like a developing base formation. A move below 1100 is necessary to suggest a retest of underlying support.

Australia's All Ordinaries Index (2962) - *see overleaf* - looks temporarily overstretched and shows some loss

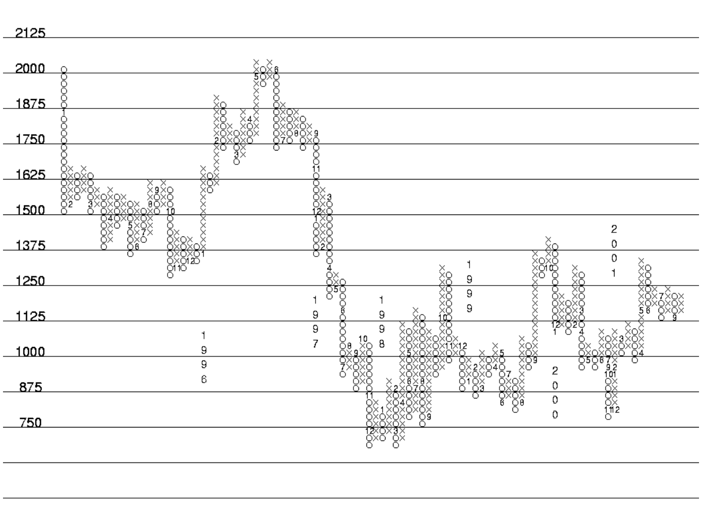
Tokyo Topix Index (10pt)



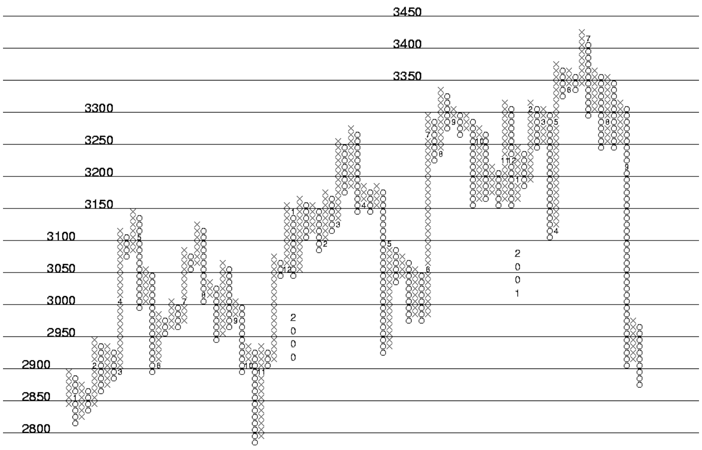
Tokyo SE Topix Second Section Index (20pt)



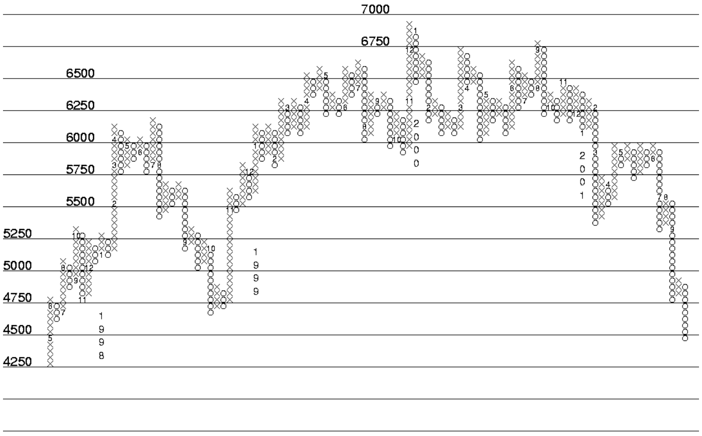
South Africa JNB Gold Index (25pt)



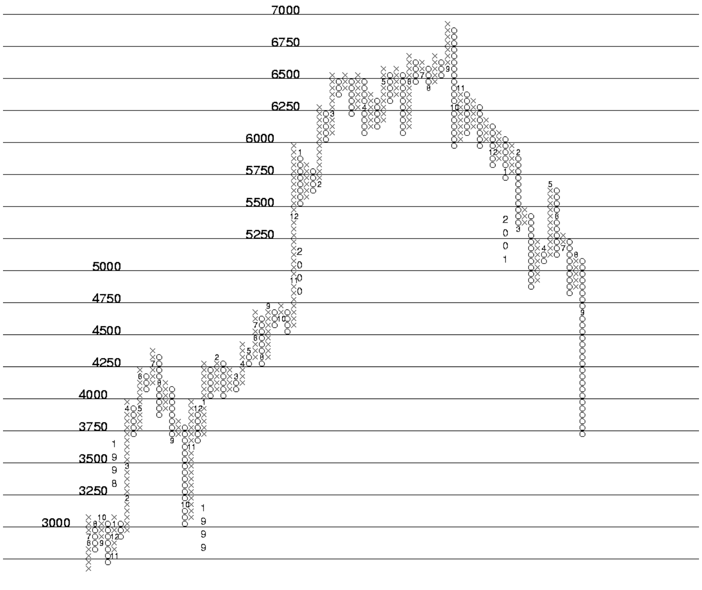
Australia All Ordinaries Index (10pt)



United Kingdom FTSE 100 Share Index (50pt)



France CAC 40 Index (50pt)



Germany DAX Index (50pt)

of momentum near 2900. More importantly, however, it has decisively broken the long-term ranging uptrend by taking out the March 2001 low at 3100 and also the April 2000 floor at 2920. Consequently this pattern is unlikely to support more than a temporary technical rally.

France's CAC 40 Index (3871) looks very overstretched but some V-bottom, right-hand extension is necessary to support more than a technical rally.

Germany's DAX Index (4019) is very similar to the CAC 40 only more overextended, having fallen over 50 percent. Here also some basing activity is needed to sustain more than a temporary bounce.

The UK's FTSE 100 Share Index (4569) is temporarily overstretched but less so than other European markets and it has an enormous top formation to limit rallies. A rebound to 4950 is needed to check medium-term downtrend consistency.

Strategy for stock markets - Stock markets are beginning to look more interesting following climactic declines. However it would be a brave investor who bought for more than a technical bounce. The chart action over the last two years reminds me too much of 1973/74, the worst bear market of my lifetime to date. It is now virtually certain that the DJIA will have its first down year following the commencement of an interest rate-cutting cycle since the 1930s. I've said all year that if this happened, the global economy, not just the US, will have been in one heck of a mess. I fear this is the case, despite reassuring comments from politicians. Nevertheless stock markets are leading indicators and have taken another big step towards their eventual lows. Captive investors should remain overweight in defensive stocks. Contrarian thinkers could commence cost averaging in leaders from the hardest-hit sectors such as airlines and insurance companies. I've stayed with my small initial stake in the Atlantis Japan Growth Fund, which I will increase at some stage, and eventually add the Dublin listed unit trust, Morant Wright Japan Fund but I'm in no hurry. I've covered my FTSE and DJIA bear trades and won't consider shorting again until a bounce has corrected the short-term oversold condition. I am playing this lightly on the upside, in several of the most overstretched indices.

Currencies

■ **The Swiss franc is a haven during uncertainty but its relative strength is unsustainable beyond the short-term.**

■ **The dollar remains in a medium-term correction against the euro but there is no change in US policy towards its currency.**

■ **The yen's recent strength is unsustainable and intervention is occurring.**

The Swiss franc has always been a bolthole during a crisis. Switzerland's reputation for financial probity remains and the country is low on an international terrorist's hit list. However the case for a Swiss haven is less compelling today than during the eras of high inflation and competitive devaluation among developed countries. The National Bank of Switzerland will not be pleased to see its currency at a new all-time high against the Euroland countries, which are its main trade partners, especially during a global economic slowdown, which could easily tip the country into recession. We can expect jawboning and possible intervention by the NBS if the Swiss franc appreciates further. Historically, the US dollar has usually been a haven when military action actually commences. We will soon know if this is to be repeated but two factors could prevent the dollar from rallying more than briefly against the European currencies. The greenback had commenced a cyclical correction before terrorists attacked and the US is still regarded as their main target.

Sentiment and cyclical factors continue to favour the euro over the dollar for the medium term. The US economy and markets are no longer seen as the obvious choice now that America is heading into recession. While Euroland is close behind, the single currency had fallen a long way against the dollar before steadying a year ago following multilateral intervention. That low was tested in July and held, so a recovery was underway before the terrorist attacks on 11th September. Long-term charts show a double bottom base formation capable of extending the ranging recovery. Conversion out of the Deutschmark and other cash hoards, which had weighed on the euro, is now a waning factor. Once euro paper is available it will enjoy temporary status as a collectors item. I maintain the euro will exceed its January high near $0.96, probably before yearend. A move over parity is possible during the first half of 2002. Thereafter, US economic recovery and a somewhat tighter monetary policy should favour the dollar, which commenced a long-term secular recovery in 1995. Paul O'Neill and Alan Greenspan believe the market should determine the dollar's value and they will not object to a cyclical correction, especially with the US economy in recession. However there is no change in the view originally stated by Robert Ruben, "a strong dollar is in our interests", which has been reaffirmed repeatedly by the current Treasury Secretary.

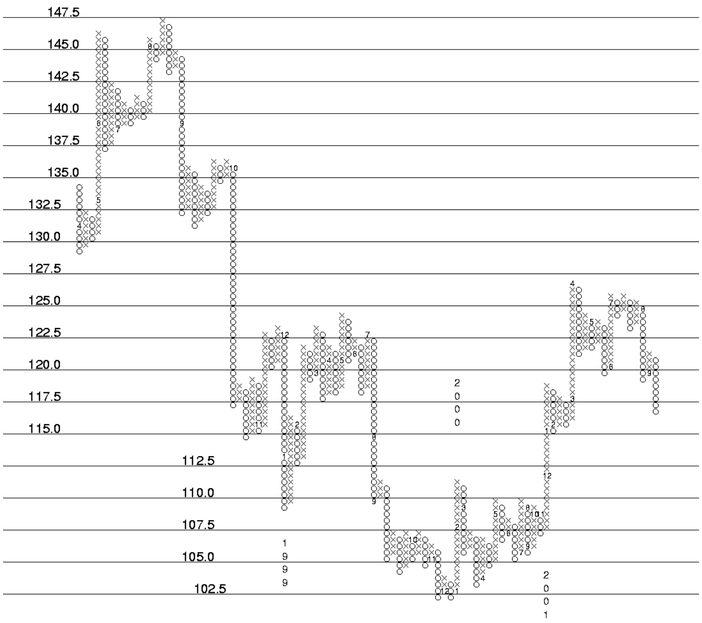
The US dollar reached ¥122 against the yen on 11th September, just before the terrorist attacks. Following the grim news, traders understandably sold the dollar generally, unwinding some of the yen carry trade in the process. However these positions were small because the dollar had been ranging against the yen since its April high near ¥126. The greenback's retreat has been orderly, with little of the panic evident in stock markets. Subsequently, Japan's Ministry of Finance has instructed the Bank of Japan to intervene by selling yen on at least four occasions, commencing at ¥117. The interventions have been small and occurred during Asia's trading hours, where volume is light. Having embarked on this path, they are likely to continue, if necessary, and may switch intervention to the European or US trading hours, where it would send a stronger signal. Japan can ill afford to have the yen appreciate while the economy remains weak with deflationary pressures intensifying. Although it is extremely unlikely that either the US Federal Reserve or European Central Bank would participate in the intervention, neither would object to a weaker yen. Fears of currency repatriation, primarily by Japanese companies for half-year (fiscal) accounting purposes, will wane after 30th September. Until there is chart evidence of a downside failure, indicated by a rally back above ¥121, the greenback could ease a little further towards underlying support. When that happens, I suspect textbook chartists will refer to the overall pattern as a multiyear reverse head & shoulders base. The yen is destined to weaken significantly over the longer term, for all the reasons mentioned in previous issues. However the short-term moves remain more problematical, not least because BoJ Governor Masaru Hayami is in open opposition to the Government's call for a radical reflation.

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.*

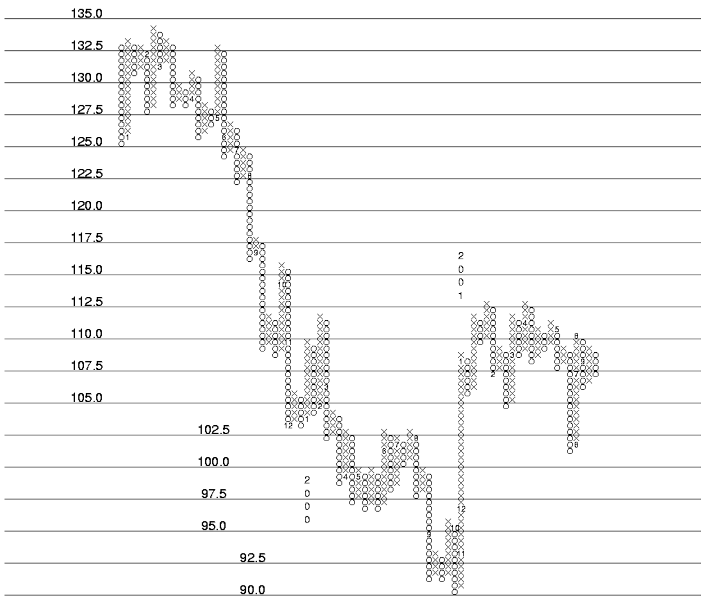
Dollar/yen (Y117.21) - *see overleaf* - The dollar's break beneath its May and August lows signalled a base extension phase similar to what euro/yen experienced several month's ago. There is minor support at current levels down to ¥115. A move over ¥121 is required to reaffirm this and indicate a failed break beneath the April to early-September range. The additional build-up of support resulting from the base extension should eventually sustain a significant advance.

Euro/yen (¥107.52) - *see overleaf* - Overall, this

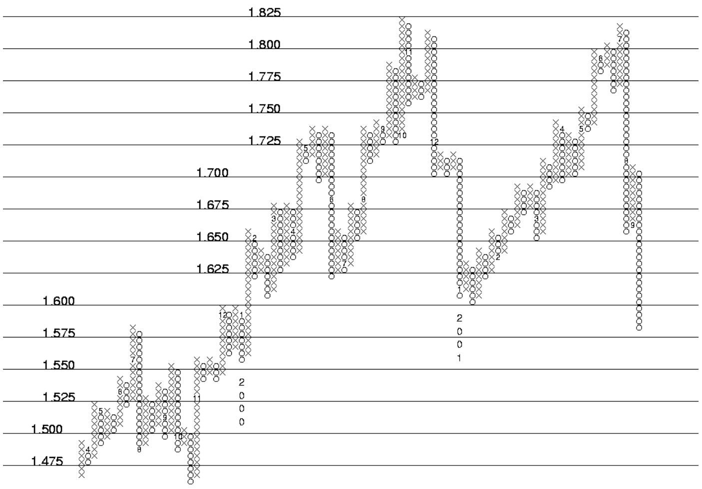
Japanese Yen per 1 US Dollar (0.5)



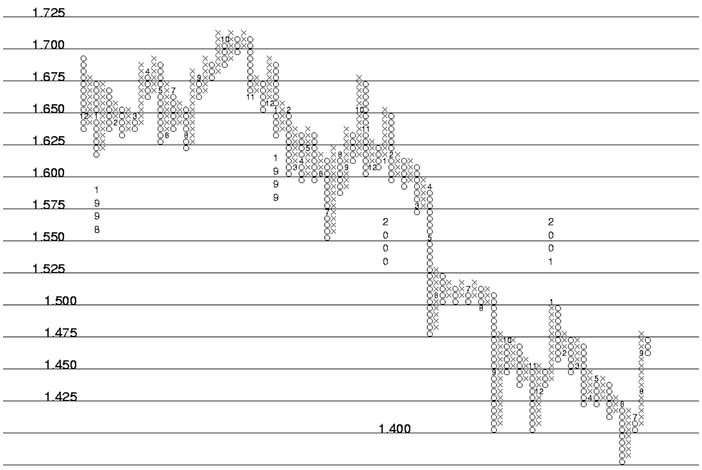
Japanese Yen per 1 Euro (0.5)



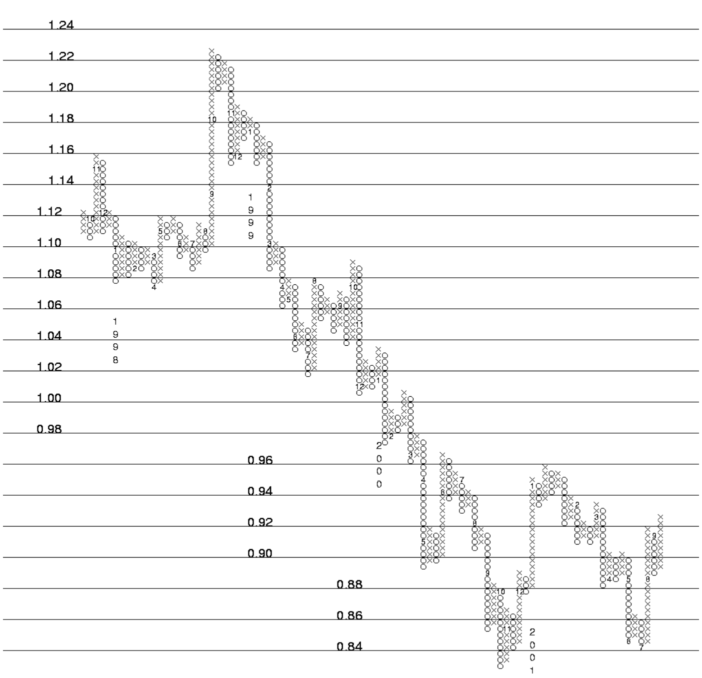
Swiss Franc per 1 US Dollar (0.005)



US Dollar per 1 Pound Sterling (0.005)



US Dollar per 1 Euro (0.004)



pattern continues to resemble V-bottom with right-hand extension, as taught at The Chart Seminar. Since the highs have been gradually declining within the extension phase, a move to ¥110.50, clearing the June to August rally's best level, would provide evidence that this lengthy consolidation had entered its latter stages. A clear break above ¥112.5 would signal another up leg.

Dollar/Swiss (SF1.5932) - 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, probably well into next year. However, the move is becoming overstretched and although it has broken the January low, underlying trading *(not shown, see our website charts)* should at least slow the decline before long.

Euro/dollar ($0.9170) - The euro's steady rebound after encountering support above the October 2000 low is consistent with base formation development. While this recovery is likely to slow as psychological resistance

US Dollar per 1 Australian Dollar (0.004)

near $0.96 is approached, it should be cleared during a medium-term recovery and parity could be tested before mid-year 2002.

Sterling/dollar ($1.4620) - The pound has continued to push higher following its failed break beneath $1.40 in June. While some further recovery remains possible, potentially significant resistance is evident near $1.50.

Australian $/dollar ($0.4910) - The Australian $ has fallen steadily following its failed nudge above lateral trading near $0.5280 but at least temporary support should be encountered near the April low at $0.48.

Strategy for currencies - Short yen remains the outstanding macro opportunity in my view. However the action is choppy within broad trading ranges, which makes tactics challenging for traders. Tactically, the choices range from buy and hold, clocking up interest rate differentials while waiting for the main trends to resume, to active trading. Because the action is choppy, in keeping with ranging base extension patterns, the trading approach is challenging. Taking a macro view, I prefer my often-mentioned Baby Steps tactic of buying lightly on easing and lightening on the rallies, while maintaining a core long position against the yen. Inevitably, this has its moments of pressure when one of the candidate currencies falls suddenly, as did the dollar recently and the euro in May. Nevertheless, the tactic has usually outperformed alternative trading programmes from the banks, which I occasionally see. I Baby Step trade mainly the dollar and euro against the yen but any other reserve currency will do. The best candidate on any given day is usually the one that has just seen a reaction against the yen. If I'm right in expecting the euro to recover further against the dollar over the next 6 to 9 months, euro/yen should offer more scope on a buy and hold basis than dollar/yen. This could also apply to a more actively managed position, subject to volatility.

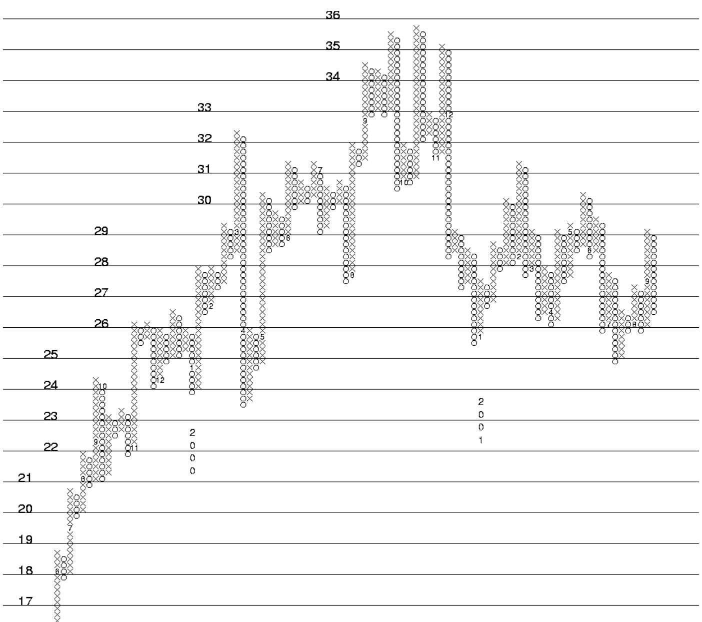
Commodities

- **The long-term chart for crude oil continues to show top development but this is a nervous market and any threat to supplies from the Middle East would produce further spikes.**
- **Gold continues to show evidence of base development, which is bullish for the very long term but without a serious inflation threat, near-term rallies within this pattern will be difficult to sustain.**

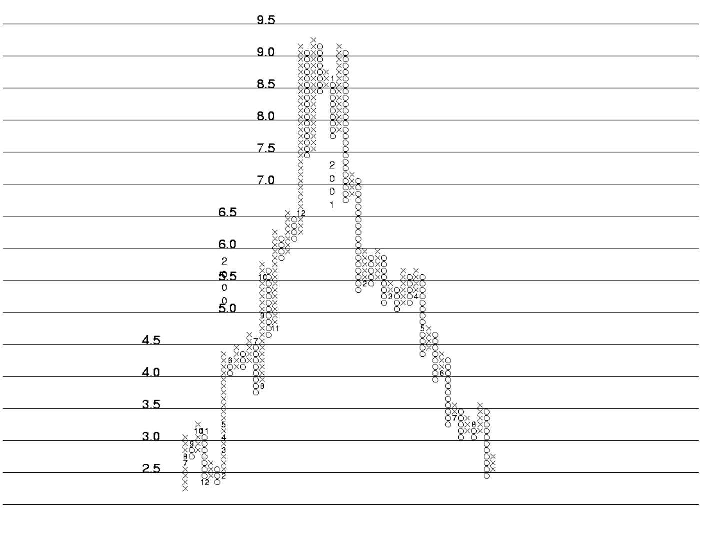
Once crude oil completes its top, we can expect a bear market as has occurred for natural gas. This requires a sustained break under $25 (NYME, 2nd month continuation). This level gave way on the 24th, just after the chart shown was prepared for publication. OPEC cut production again on 1st September, an event that had been anticipated by the market and prices for all petroleum contracts understandably spiked on 11th September. However those latter gains were not maintained but small backwardations (premiums of spot over futures' prices) indicate that supplies are still tight for some contracts. Consequently this market will remain extremely sensitive to military developments in the Middle East. Once concern over supplies from this region abates, the price will decline further because demand has fallen and non-OPEC production continues to increase. The price of natural gas shows what happens when supplies are abundant and there is no cartel to squeeze the market.

Gold is unlikely to sustain rallies while government bond yields are in overall downtrends. Simultaneous strength in gold and bonds is incompatible beyond the very short term. While fixed-interest investments have benefited from concern over stock markets, their

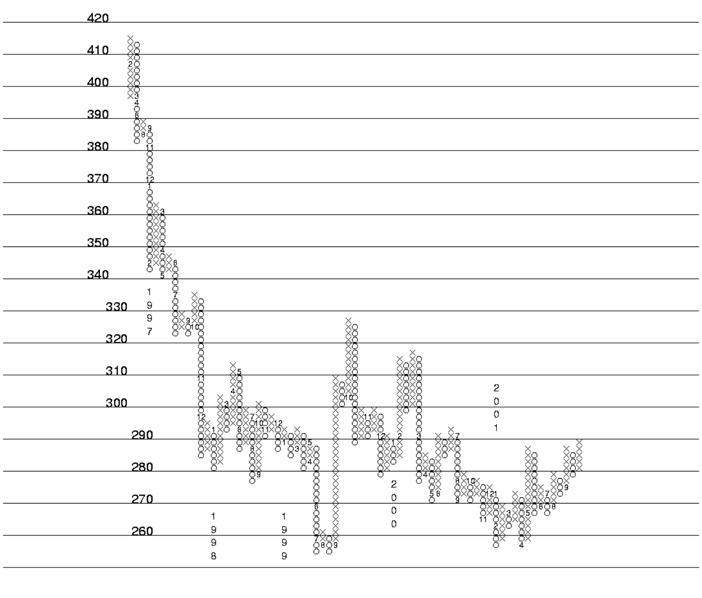
Crude Oil NYME 2nd Month Continuation (0.2USD)



Natural Gas NYME 2nd Month Continuation (0.1USD)



London Spot Gold (2USD)



trends also reflect deflationary pressures. In previous centuries gold has been the universal store of wealth but its appeal today or in the future depends on a loss of confidence in fiat currencies. This will happen some day but it could be years away. Meanwhile, gold had been edging upwards, mainly on concern over the US dollar, the recent high price of crude oil and events surrounding the terrorist attacks on 11th September. This is more than enough to trigger rallies but they are likely to be short-lived, as we have seen in recent years. Nevertheless, the $2-scale p&f chart shows rising lows since April and $276 is currently required to break this upward bias.

The Global Economy

- **Attacks on US will deepen the global economic slowdown but could also hasten the eventual recovery.**
- **Oil prices are the most critical variable.**
- **The US economy will lead the world out of recession.**
- **Japan's economy requires radical measures.**

The global economy was heading for recession before the attacks. A recurring theme in these pages, ever since the TMT bubble burst, has been that most economic forecasters were too optimistic. Subsequently, the IMF, all the big banking/broking firms and most recently US Treasury Secretary Paul O'Neill have been revising GDP forecasts downwards. No doubt these institutions and their spokesmen have felt under some pressure to remain upbeat, especially O'Neill, since the incoming Bush Administration had been criticised by Democrats for expressing concern over evidence of softening in the US economy, even before last November's presidential election had been resolved. Today, I suspect they are still too optimistic, having underestimated contagion from the TMT fallout and especially the length of time that oil prices would remain at historically high levels. However the gap between official expectations for America's economy and likely results has probably narrowed considerably. At ground level, corporations and consumers have been much more realistic, judging from sentiment indicators. US consumer sentiment, which had long been more upbeat than in most other countries, reached its lowest level for 8.5 years before the dreadful attacks by terrorists on the US. This tragedy can only disrupt America's economy in the short term, with a knock-on effect globally. In Europe, sentiment has generally been worse, especially in Germany where unemployment is twice that of the US. The situation in Japan remains chronic. Consequently the main engines of the global economy are either already in recession or heading in that direction. Among developing countries, China's official GDP, which is reported soon after each quarter ends and seldom varies beyond plus 7.9 to 8 percent (YoY) should be taken with a pinch of salt.

Oil is the wildcard. A tripling of the oil price has always caused a global recession, as we saw in 1973/74, 1980/82, 1990/91 and as is very likely in 2001/02. Today the economic problems are well known - the burst TMT bubble, debt, surplus goods and capacity, deflationary pressures personified by Japan and of course the high price of oil. Of these, oil remains the most important by far, because each price rise represents a massive tax on both corporate spending and personal consumption. OPEC's latest production cut was on 1st September, increasing this year's reductions to 3.5 million barrels a day, totalling 13 percent of what was being exported at yearend 2000. OPEC's stated target is an average of $25, based on their benchmark formula, which is up to $1 lower than the Brent blend contract price traded on the IPE. This traded up to $30 (Nov) three days after the attacks on 11th September, but slumped below $22 on the 24th - welcome respite for the global economy if this decline is mainatined, let alone extended. Under normal conditions, we could expect increased production from non-OPEC suppliers and the economic slowdown to weaken petroleum prices. However these are not normal conditions. Clearly the US and other countries will urge Saudi Arabia and other oil-exporting countries to increase production. The Saudis, at least, have agreed to do so but oil is now more politicised than any time since the last Arab/Israeli war. Oil-distributors and users, fearing disruptions, understandably stockpile supplies when tensions rise. Meanwhile, even after the recent decline petroleum prices remain uncomfortably high for a world on the brink of recession. We can expect further volatility and anything less than a sustained drop in prices will be bad news for the global economy. Long-term charts offer encouragement, as they have show top formation development over the last 18 months and an important support level has just been broken.

The US economy was first to receive a significant monetary stimulus and following the attacks, there is now an expansionary fiscal policy.
Everyone is worried about the US economy, which had problems enough before the horrendous attacks on 11th September - expensive oil, the burst TMT bubble, corporate and consumer debt. The suicide hijackings were an assault on individuals, infrastructure and the national psyche. Understandably, the economy went into seizure, aggravated by the temporary grounding of commercial aircraft to reduce the risk of additional attacks. This is very likely to push the US economy into recession for Q3 and possibly Q4 2001. It was already heading in that direction and psychological scars resulting from events on the 11th will remain. People will understandably be less inclined to travel for a while. Consumer spending had hit an 8.5-year low just before the attacks and is certain to decline further. However, the US economy was the first to receive a significant monetary stimulus this year. It will also be first to receive an expansionary fiscal policy in 2001/2002. Following the recent tax rebate, the Government will assist airlines, insurance companies and the rebuilding of Lower Manhattan where necessary. While the contentious missile defence programme will be mothballed, there will be a huge increase in conventional and anti-terrorist military spending, including recruitment, surveillance and security. The budget surplus is history but with a low level of government debt relative to most other countries, the US can run a deficit for a while, confident that it can reduce debt once again when a sustainable economic recovery is underway. Last but not least, human tragedy on the scale we have just seen is a unifying event. I have never seen the diverse American public more united. A positive *can do* attitude will be the cornerstone of US economic recovery, which should commence in 2002, leading the world out of recession. The only event that I can envisage which would alter this outlook would be further and even more devastating terrorist attacks on the US. Unfortunately, we now know that the previously unthinkable is now possible, although hopefully not to be repeated.

In contrast to monetary and fiscal stimulus in the US, the European Central Bank, hampered by a duff charter focussing on inflation only, has been very slow to understand economic risks caused by the high price of oil and burst TMT bubble. Consequently the ECB fell way behind the curve of economic events and did not commence monetary easing in time to prevent a recession, likely to be deeper and last longer than in the US. Moreover, with its "Stability Pact" to pare back budget deficits and without a surplus for many years, Euroland has less scope for fiscal stimulus, even if it suspends or alters the Pact. Europe remains an economic passenger, heavily dependent on the US growth engine, which has now stalled. As this restarts next year, there will be fewer first class carriages for Euroland because industry rather than the consumer will lead America's next recovery. Meanwhile, many of the old structural rigidities remain and the region will have to adjust to a new and not overly popular currency. The UK will fare better but it has also been slow to lower interest rates. Japan's economic problems are now chronic, and worsening by the day as the Government dithers and the Bank of Japan remains recalcitrant. With Japan's deflation worsening daily, the task of implementing appropriate policies is severely hampered by an ideological power struggle between a democratically elected government and its central bank.

Japan needs radical measures to solve its economic problems. Conventional policies, let alone the status quo, will not break the country's deflationary spiral. In many respects, Japan's governing institutions have presided over the greatest procrastination in modern history. Yes, we saw massive fiscal spending on pork barrel projects, which cushioned economic deterioration while running up government debt to 135 percent of GDP and still climbing, without tackling the underlying problems. Yes, interest rates have hovered near zero for many months and the Bank of Japan is buying ¥600 billion ($5.1bn) of Japanese government bonds each month but money supply has edged up to only 3.4 percent (M2+CD). Clearly these measures are not working. Japan's bureaucrats ("the best in the world", we were told a decade ago) have lived in hope that the economy would somehow muddle through. Unfortunately, it is on course for a depression, although this is still avoidable. Japan's Prime Minister, Junichiro Koizumi, was elected because he promised radical reforms. His main proposal - to compel banks to write off bad loans, driving debt-ridden companies into bankruptcy, would be suicidal under the current circumstances. First, Japan needs to jumpstart its economy. Specifically, it needs a wave of consumer spending. To achieve this Koizumi should cut taxes, especially on capital gains, and announce a minimum CPI inflation target of 2 percent. Simultaneously, the Ministry of Finance should instruct the Bank of Japan to print many trillions of yen. The BoJ's current policy of injecting liquidity by purchasing JGBs from banks isn't working because yields are low and lending institutions just plough capital back into more government paper, taking a small turn which is not nearly enough to reduce bad debts, which continue to climb. Instead, the MoF should invest newly printed money into the Japan's stock and property markets. These are currently very depressed, contributing to the national malaise. However, once stock prices and property values were appreciating across the board, sentiment would begin to improve. Japan has the world's most prodigious savers. Once rising stock and property prices reversed the negative wealth effect, consumer spending would increase, with a knock-on benefit throughout the economy. Of course no policy is without risks. Badly managed, a massive reflation could result in hyperinflation. However, Japan would have ample time to avoid this problem, despite a substantial decline for the yen against other reserve currencies. Once a sustainable economic recovery was underway, and this could not occur in isolation, the BoJ should begin to lift interest rates. Simultaneously, the MoF could gradually take profits on its stock and property market purchases, using the proceeds to pay down government debt. The economic restructuring and economic reforms required should be undertaken against the background of a sustainable recovery, which they would help to extend.

And Finally…

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

Society of Technical Analysts Meeting - On 10th October my topic at a meeting of the STA in London will be Market Psychology Applied to Today's Markets. This will be held at the Institute of Marine Engineers, 80 Coleman Street, from 6:00 to 7:15pm - www.sta-uk.org.

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.chartanalysts.com or contact Claire Sukhlal, tel: (0)20 7351 5751, email claires@chartanalysts.com.

The target date for FM209 is Friday 19th October.

"An appeaser is one who feeds a crocodile - hoping it will eat him last."

Winston Churchill

Best regards - David Fuller

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