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In its 19th year

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

Technically, most stock markets are deeply oversold; there has been more capitulation selling and the Fed is probably intervening. Therefore a medium-term rebound is increasingly likely before yearend but the final low could be years away.

In times like this, the priority is to take few risks, avoid stress by opting for safety, maintain liquidity and wait for the bargains eventually created by reversion to the mean.

It's "Massacre of the Innocents". By choice, we would rather not identify with this particular picture by the 17th century Flemish master Peter Paul Rubens, but today many investors do. Reversion to the mean is a brutal process, as I've often mentioned. When the secular trend changes, most of us are understandably caught out because this only occurs approximately once a generation. The experience is both costly and shocking. An understandable defence is denial, which may be psychologically helpful but does the portfolio no favours. I'm not just talking about private investors - you've probably seen the legion of experts on CNBC, telling us that everything will be OK, quite soon. And to be fair to that channel, they now field a few super-bears to alarm us or delight the masochists. In truth, even those who understand the post bubble environment and turned bearish early are surprised and frightened by what they now see.

Reversion to the mean is frightening. Those who wisely read history to interpret the present, understand that everyone loses in a major downturn for stock markets, which inevitably has economic implications. It is little consolation to know that the market system itself will eventually be strengthened by this searing process of tempering, as in the making of steel. Similarly, the bargains that will eventually be available are less comforting right now, knowing that we cannot fast forward to that day. Some of my contemporaries fear that they won't live long enough to enjoy the next super-cycle bull market, or if they do, they'll be too old for it to matter. Could I be wrong in suspecting that it could be years before stock markets reach their final, capitulation lows, coinciding with the widely heard refrain: "I'll never trust the stock market again"? Of course, but history's examples show that we seldom reach post bubble bargains, defined here as 10 times earnings and yields of 4 to 6 percent, quickly. Could stocks bottom out at much higher valuations? Yes, but that would also go against the grain of history. Meanwhile, hoping won't make it happen. Will we get a good rally before long? Probably, and the intra-day rebound on 15th July provides further evidence that the Fed is quietly intervening. However, Greenspan and other central bankers will only try to head off a panic, as I have said before. Therefore I suspect the next rally will be one to sell into, and a trap for those who wait until it is clearly underway, and then buy.

What should we do? Back the odds, because this is no time for heroics. Quality bonds may not be very exciting but they are much less risky than stocks in this environment. During a lengthy reversion to the mean, it is better to lighten equity positions during rallies, rather than buy the dips. I would increase liquidity by raising cash, which is even less exciting than bonds, but reassuring and necessary if we wish to take advantage of real bargains, when they appear. Be patient. Don't lose touch with the markets - we need to monitor them even more closely, to learn, understand and be responsive to change. Watch the price charts, monitor sentiment and valuations, looking for historic extremes. We are living through another fascinating chapter in financial history.

Interest Rates and Bonds

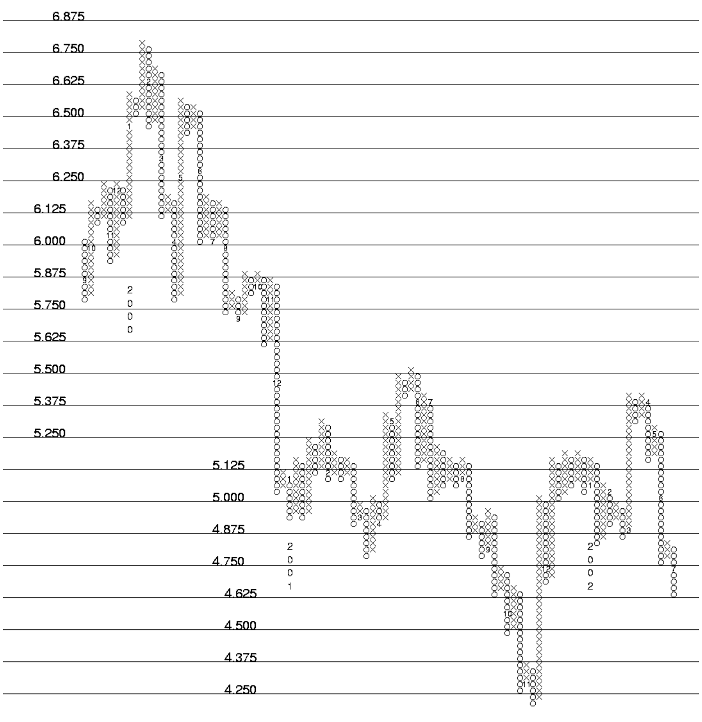
■ **Central banks will not raise short-term rates while stock markets weaken, but they might lower them.**

■ **Government 10-year bond yields should retrace more of their advance from the November 2001 lows, with the timing subject to stock market trends.**

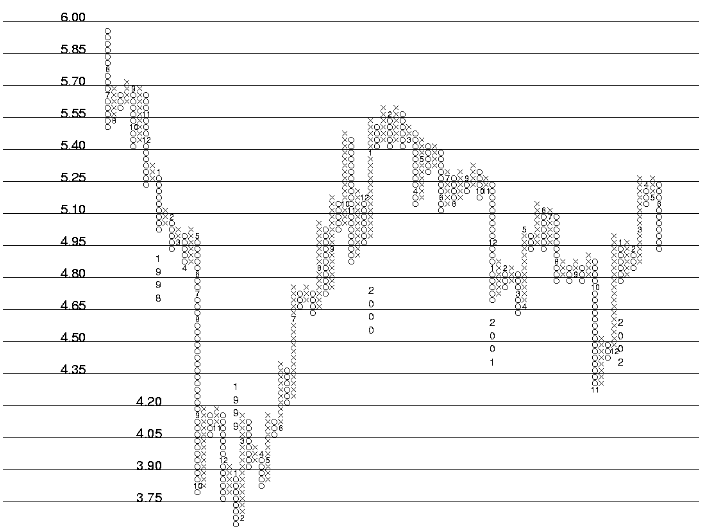
The central banks fear deflation most of all. If anything keeps Alan Greenspan awake at night, it is likely to be concern that all his monetary pumping does not revive the US economy beyond a temporary recovery. The last thing he needed was the current black mood and loss of confidence following corporate scams and accountancy scandals, causing many people to fear that the US is caught somewhere between Japan's post bubble era and the 1930s. The outlook should be considerably better than those two examples, given the Fed's early reflation and the economic recovery currently underway. However the impossible, at least in terms of 1990s expectations, is now possible and this risk needs to be taken seriously. Greenspan understands this, but what about the ECB? It has been complacent on recovery prospects and is saddled with a deflationist mandate. Moreover the euro launch provided many businesses, large and small, with an excuse to push up prices under the cloak of unfamiliarity with the new currency, to the embarrassment of politicians and the ECB. Euroland is in greater danger of moving down the Japanese path of the last decade than the US. However the euro's strength and weak growth should stay the ECB's hand on rate hikes and the case for further cuts grows daily. I see little chance of higher short-term rates until stock markets are clearly in another intermediate-term recovery.

US 10-year bond yields have now retraced two-thirds of their recovery from last November's low. Euro-bunds have lagged recently but should follow the US lead. The main question concerns timing, which will probably be dictated by stock markets. Therefore if equities experience a summer or yearend rally, the decline in bond yields will be interrupted. Conversely, if equities continue to plunge, then bond yields will fall rapidly on the flight to quality. I rate the odds of a technical rebound for stocks before yearend, in excess of the very brief rallies in recent months, at somewhat better than 50/50.

US 10 Year Bond Yield (0.025)



Euro-bund 10 Year Bond Yield (0.03)



Strategy for bonds - From a conservative investor's perspective, I favour being overweight in quality bonds. These start with Western government issues from short to long-term maturities. The 10-year Euro-bund is as good as any and yields more than the US equivalent. It should also provide some capital appreciation, especially if equities fall further over the next few years, and the euro is likely to remain a hard currency for at least the medium term. For capital appreciation, I also continue to favour quality corporate bonds - single A or higher. There will be opportunities in high-yield issues but given the default rate and uncertain economic outlook, this is for bond analysts who really know what they are doing. I do not have the experience or analytical skills to do this, and would leave it to specialists with a proven track record, if so inclined. With investment grade bonds, I would generally prefer to buy and hold the actual issues, rather than pay fees, albeit modest, in most bond funds. However among funds, I favour the US-quoted closed-end (investment trust) Munienhanced Fund Inc, which holds investment-grade municipal obligations - Bloomberg code MEM US. Among individual UK bonds I would be happy with the Boots 6-year issue, yielding about 5 percent. Remember, bond prices will almost certainly weaken when stock markets experience significant (medium-term) rallies. If you don't like bonds for some reason, there is nothing wrong with cash. There are times to be aggressive in the markets and occasions when capital preservation should be the priority. In this environment, I prefer capital preservation to the lure of most speculative opportunities.

Global Stock Markets

- **The outlook for corporate profits has seldom been more uncertain.**

- **Global GDP growth in 2003 is likely to be lower than generally expected.**

- **The double-edged sword of leveraged balance sheets is taking its toll.**

- **A bull point for investors - markets are currently oversold and interest rates are low.**

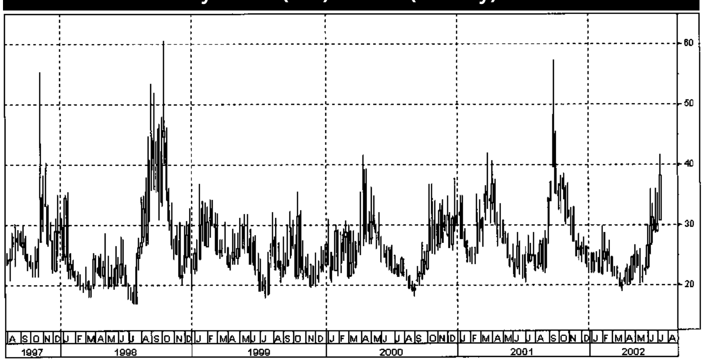
Corporate "surprises" during a post super-cycle bull market environment are almost always negative. First we saw the reckless borrowing and spending, including takeovers that have added little value in most instances. More recently, we have seen the corporate fraud, scams and dodgy accounting. While the worst examples have come from the US, corporate foolishness and shenanigans have certainly not been limited to that country. I assume there is more to be revealed, as companies move towards honest and prudent disclosure, if only to avoid the courts. Unfortunately, the bad news will not cease with improving standards of boardroom integrity. While one assumes that there is a limit to excesses and that the majority of companies are honest (and isn't it outrageous that one even has to say this), few CEOs have any experience of the post super-cycle bull market environment, which will probably intensify some of the deflationary pressures. Governments, economists, financial analysts and corporate management are likely to underestimate economic problems. Most talk of a rebound in 2003 but this is likely to be much less than what is hoped for and needed.

There is no engine for global growth. The US economy still leads but only because of military spending. Data on consumer spending may bounce around a bit but the trend will be downward as households increase savings. Asia may appear somewhat more healthy than the West, if only because savings rates in the region are higher and it has already gone through many of the problems experienced elsewhere today. However Japan is still in no position to lead a global recovery and could easily fall back into recession due to the yen's rally. Asia's former little tigers have done comparatively well recently but are heavily dependent on exports to the US. These will decline due to slow GDP growth and a weaker dollar. No other country or region is in a position to take up the running.

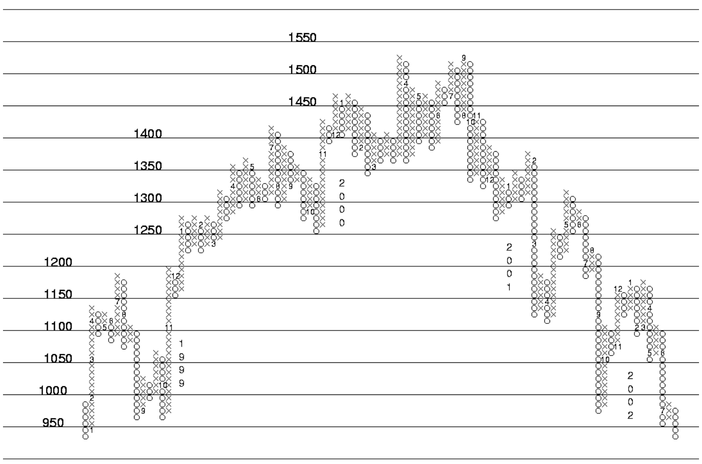
Debt will weigh on corporate profits for years. One of my forecasts from the second half of last year was that corporate profits would rebound in 3Q and 4Q 2002, if only because of last year's write offs. However I also added that any improvement would be difficult to maintain. Debt is the main reason. In the late 1990s, when the self-serving fashion was to leverage balance sheets, often to use borrowings for stock repurchases to kite earnings and enable CEOs to cash in their options, this publication stated the obvious - leverage is a two-edged sword and companies would suffer in the next economic slowdown, let alone a recession. These debt chickens have come home to roost. How do you climb out from under a debt mountain? Bankruptcy and default is the only quick way, which does no favours for shareholders and bondholders. Selling non-core assets is a popular route but these change hands for less than they are worth in a depressed market. Today, most companies would be delighted if they could float more shares to pay down debt, but how can they get a good price in this market? Restructuring helps, and the US has an advantage over the more heavily regulated Europe in this process. You can earn your way out of debt but this takes years. Of course not all companies are burdened with debt, but many are, and this doesn't help the business environment.

Technical conditions for a rally are falling into place. Stock markets have accelerated downwards in climactic fashion. There is clear evidence of capitulation selling. Sentiment is grim. Press headlines are uniformly bearish and feature the corporate scandal du jour. The CBOE OEX Volatility Index, known as VIX, surged to 41.64 on 11th July, the highest and therefore most bullish reading since the 21st September peak of 57.31. Last but not least, there is technical evidence that the Fed has been intervening recently, has I mentioned in FM217's leader (21/07/02), FMP182 (28/07/02) and in my Comment of the Day on www.fullermoney.com. Consequently markets should be close to a medium-term low. Could this be THE low? I don't think so. Valuations are not low enough for a reversion to the mean overshoot, which is all the more likely now that the well of public confidence in the stock market has been poisoned by scandal. I continue to expect

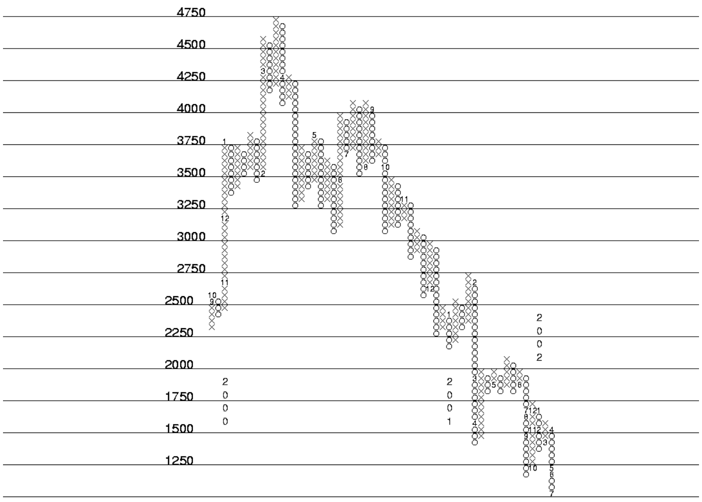
CBOE OEX Volitility Index (VIX) : 40.29 (Weekly)



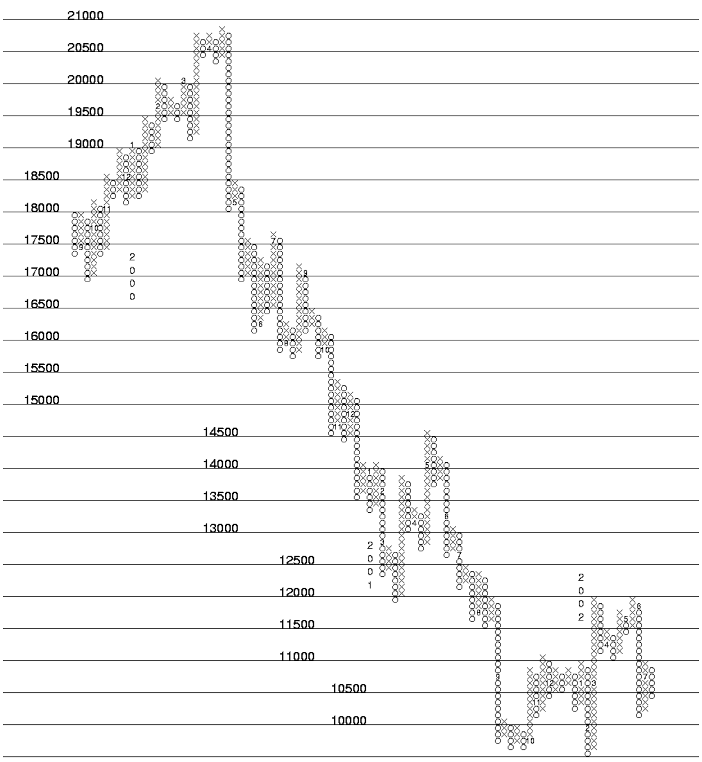
S & P 500 Composite Index (10pt)



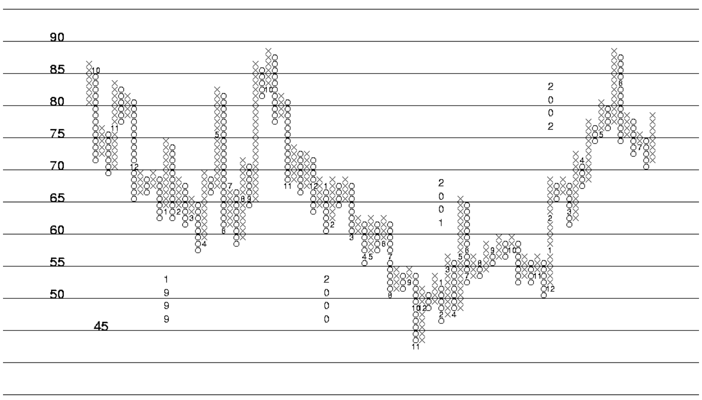
Nasdaq 100 Index (50pt)



Nikkei 225 Stock Average Index (100pt)



Philadelphia Gold & Silver Index (1pt)

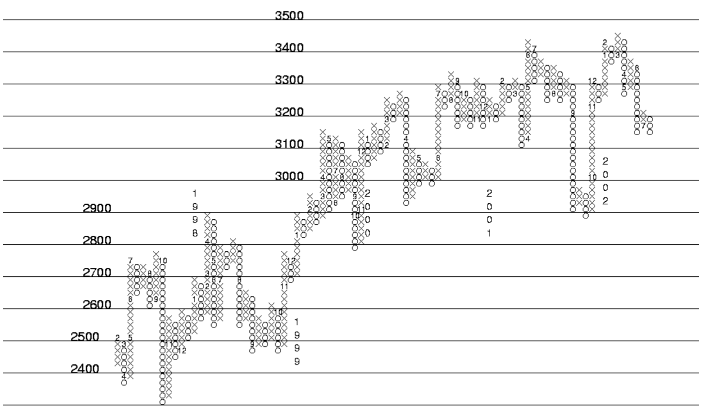


a series of medium-term recoveries, such as we saw from late September to January, followed by bigger sell offs. This pattern could last for years. I maintain we won't see the secular low until big-cap stocks sell around 10 times earnings and yield 4 to 6 percent.

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 S&P 500 Composite Index (921) has broken down through the psychological 1000 level, its September 2001 lows and also the August-October 1998 lows. There has been much talk of the "Head & Shoulders" formation from technicians and in the press recently, including the Financial Times. Several subscribers have asked me to comment on this H&S analysis. OK, while I welcome the FT's conversion to technical analysis and the link in common between all chart readers is price, I've always been wary of textbook pattern identification, especially with the H&S, since an approximate variation of its characteristics inevitably appears in most ranging markets when an uptrend is eventually followed by a downtrend. Take the S&P. There is a little H&S encompassing the December 1999 high at 1460 (left shoulder), the March 2000 peak at 1520 (head) and the September 2000 high at the same level (right shoulder). This qualifies by the book definition - just - because the intra-day peak in March was 1552.87 versus the September high at 1530.09. And what about the H&S, also evident on the p&f chart shown, encompassing the July 1999 high at 1410, the twin peaks (double top?) at 1520 and the January 2001 high at 1370? And why shouldn't the May 2001 peak at 1310 be considered a right shoulder? Looking at other markets, how many H&S formations do you see in the FTSE 100 chart at the end of this review? If you find all this pedantic, I agree. H&S identification is pedantic, and I say this as someone who is first and foremost a technician. Rather than play the identikit pattern identification game, what counts for me is that the main trend is down, albeit temporarily overextended, and the S&P has been taking

Australia All Ordinary Index (20pt)



out support levels ever since the second peak at 1520. It currently requires a move back above 1000 to suggest a downside failure, following a break of the August-October 1998 and September 2001 lows. **The NASDAQ 100 Index (1000)** has not seen an upside reversal (requiring 150 points from the low on this 50-point scale) since March. However the decline has slowed near the psychological 1000 level and it has seldom fallen for this long without a technical rally. A bounce aside, there is no evidence that the end of bear market low is at hand. **The Philadelphia Gold & Silver Index (76)** has checked its decline for at least the short term. Consequently a move to 69 is required to indicate a further test of underlying trading rather that a push back up to lateral resistance at 88.

Japan's Nikkei Stock Average (10601) has backed away from former support and now initial resistance at 11000. It needs to regain this level to reaffirm support from the lows down to 9500 and 12000 to provide clear technical evidence that the current range is a base capable of supporting a significant recovery. Conversely, a new low would reaffirm the bear.

Australia's All Ordinaries Index (3146) has been outstanding in terms of relative strength but the overall pattern continues to look top heavy. A decline to 3120 would reaffirm this year's decline.

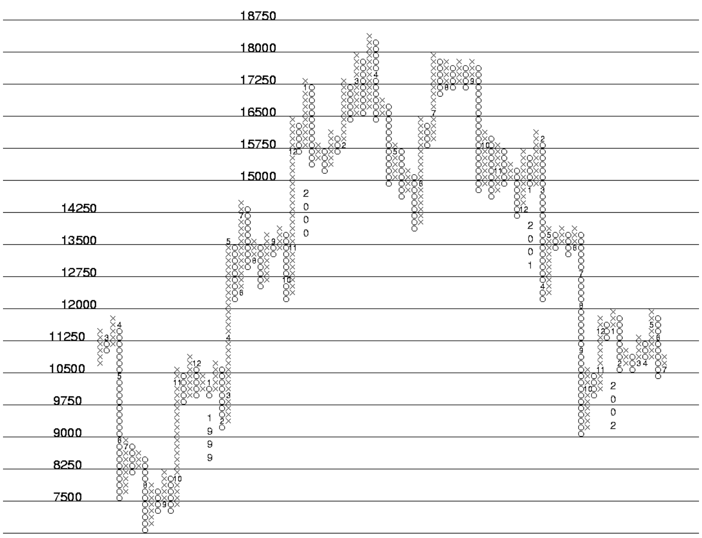
Hong Kong's Hang Seng Index (10648) did not maintain June's break under the 10500 level. However a move to 12000 is required to significantly improve this pattern.

Taiwan's Weighted Price Index (5416) - *not illustrated*- has rebounded from the psychological 5000 level to test initial resistance near 5500. If it can push above this and break the sequence of lower highs since the April peak at 6400, some additional near-term strength would be indicated.

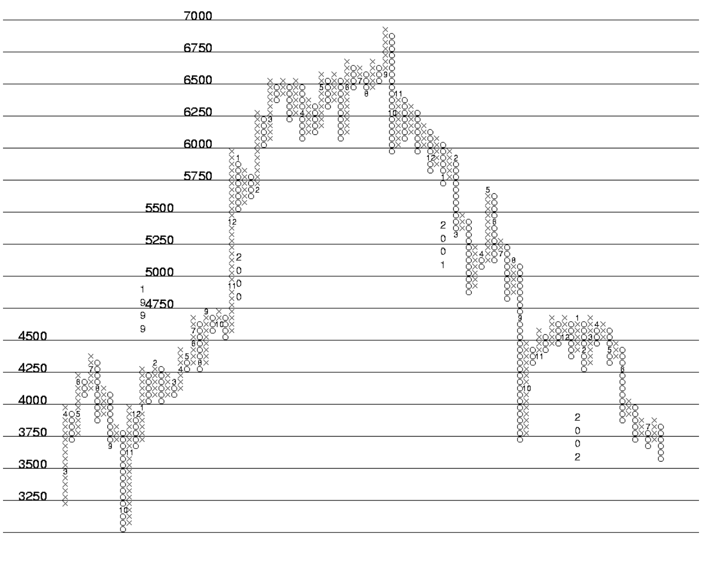
France's CAC 40 Index (3513) has broken beneath its September low. Consequently a move to 3900 is required to indicate both downside failure and recovery scope.

Germany's DAX Index (4130) is barely steady and requires 4500 to reaffirm support from the September low

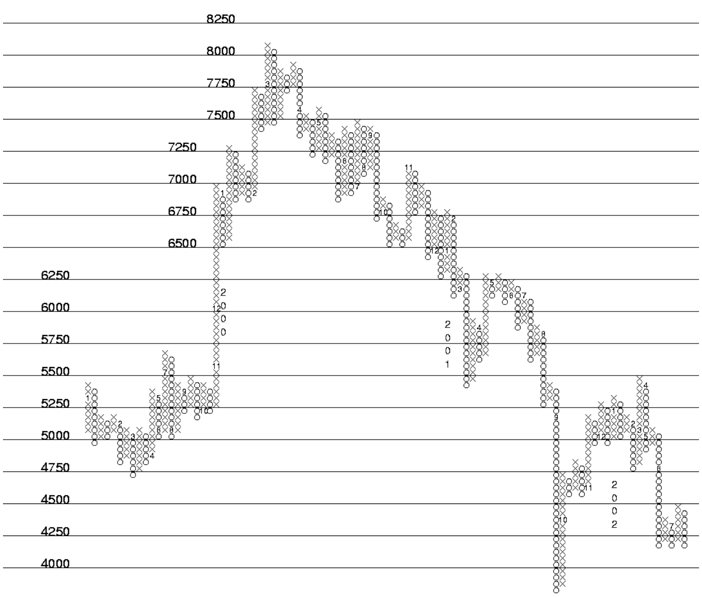
Hong Kong Hang Seng Index (150pt)



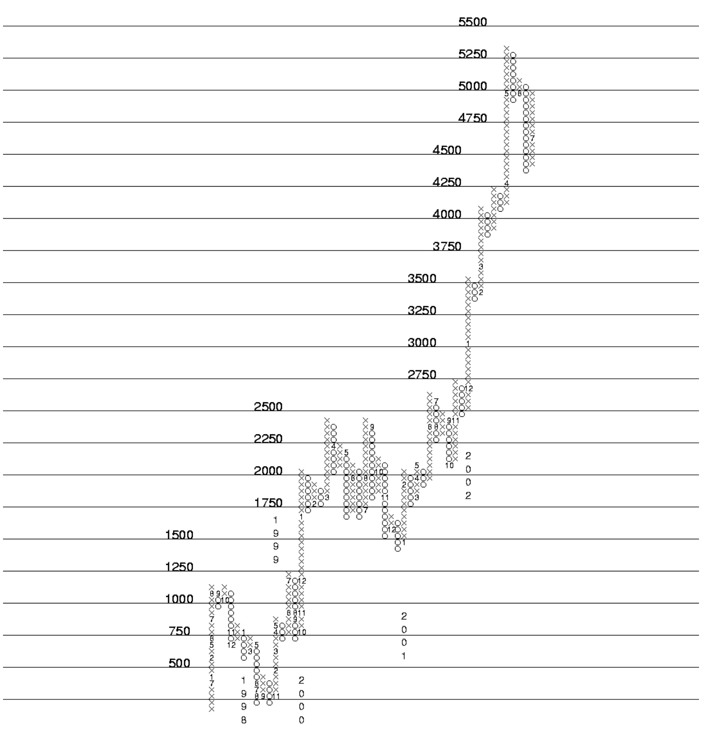
France Cac 40 Index (50pt)



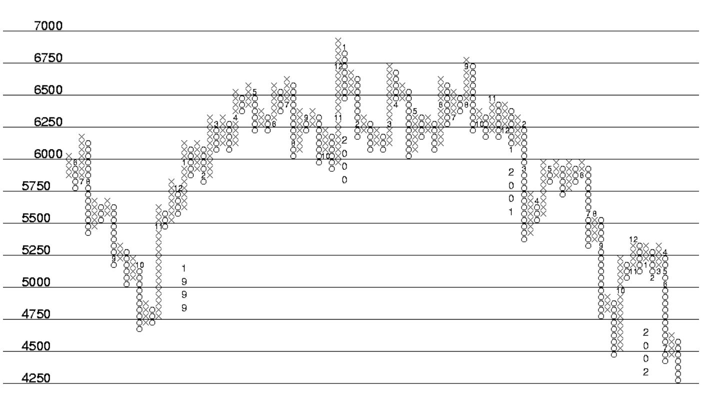
German DAX Index (50pt)



Russian RSF Index (50pt)



United Kingdom FTSE 100 Share Index (50pt)



at 3800 rather than a retest of that level, as currently indicated.

Russia's RSF Index (4816) has rebounded following its largest correction since the August 2000 high. However at least temporary resistance is likely to be encountered from the May peak up to 5300.

The UK's FTSE 100 Index (4224) has breached its September low and requires 4650 to indicate a downside failure and technical rally scope, rather than a near-term extension of the primary downtrend.

Strategy for stock markets - The questions I'm asked most frequently are have we seen capitulation selling; will we get a summer rally, and if so is this a time to buy? We have certainly seen some capitulation selling but this usually occurs in waves, generally over a period of years, during a reversion to the mean. Therefore we have certainly not seen the final capitulation or the reversion overshoot, in my view. As for another medium-term rally, the chances are improving because the market's slide looks temporarily overdone. Should one buy for a bounce? Only as a trade, assuming you wish to participate. You've probably heard the old adage - "buy when there's blood in the streets", and we've seen a bit of the red stuff but the big trend is still down. If we do get a decent rally from near current levels, and I think the chance is at least 50/50, recently hammered techs should do best, if only because of short covering. However if one wants stocks that should fall less if we do not get the rally, and will eventually attract investment demand, I favour those with good "free cash flow" (cash from operations reduced by capital expenditure, demonstrating how much money is available to service or reduce debt, invest, make acquisitions or buy back stock), high (5% plus) dividends and low multiples, in that order. I'm not going to recommend any shares in this category, because I think there will be a better buying opportunity, if not soon, certainly over the next couple of years or more. I think this is a time to be very conservative. While the current environment is not unprecedented, it is certainly not normal, in terms of what people have experienced in the 1980s and 1990s. This is the most dangerous environment since at least the early 1970s. Veteran subscribers will remember my table showing the DJIA's performance one year following initial rate cuts by the US Federal Reserve, last published in FM212 (25/01/02). New subscribers who have not seen this important statistical tally can find it on www.fullermoney.com, in the Current Issues/Archives section. During 20 cycles of monetary easing dating back to 1914, the DJIA failed to finish higher one year following the initial cut on only 3 occasions, 1929, 1932 and 2001. I mentioned repeatedly in 2001, that if the DJIA could not record a gain that year, following many rate cuts, then the global economy would be in trouble. It is. Should investors sell? I think we will see a better selling opportunity between now and yearend. Consequently I'll stay with the only 3 shares that I recommended last year - UK companies: Boots, Northern Foods and Scottish & Newcastle, in FM209 (25/10/01). Although weaker over the last month, these have performed reasonably well, being value plays. My strategy is to sell these on the next medium-term rally, as they offer good rather than great value. During a reversion to the mean, I favour buying only when stocks appear ridiculously cheap. There are not enough candidates today. I have favoured mining funds and mining shares this year, including the UK-quoted Merrill Lynch Gold and General Trust, Newmont Mining (the world's largest gold mining company) and Silver Standard Resources - the best performer to date. These last two are listed in the US. While gold shares have seen significant corrections since their May-June highs, I believe this is a buying opportunity. I have increased my Newmont stake and repurchased some of the Merrill Lynch World Mining Trust (an investment trust/closed-end fund holding gold and industrial metal shares), which I had sold too soon in late April. I also retain a small stake in the UK-quoted but dollar-denominated Atlantis Japan Growth Fund, which has benefited recently by not being hedged against the yen. With dollar/yen back near its September low, I hope manager ED Merner now hedges, especially as the MoF is fretting about the yen's strength. Consequently, further intervention is likely. In futures, my preferred strategy has generally been to short after rallies tire but despite being bearish I've been too cautious and missed much of the more recent decline. Overall, I think investors should have a higher percentage of assets in bonds than equities, until the latter are trading at levels representing exceptional value. A US-quoted investment trust investing in investment-grade municipal bonds is mentioned in "Strategy for bonds", in the previous section.

Currencies

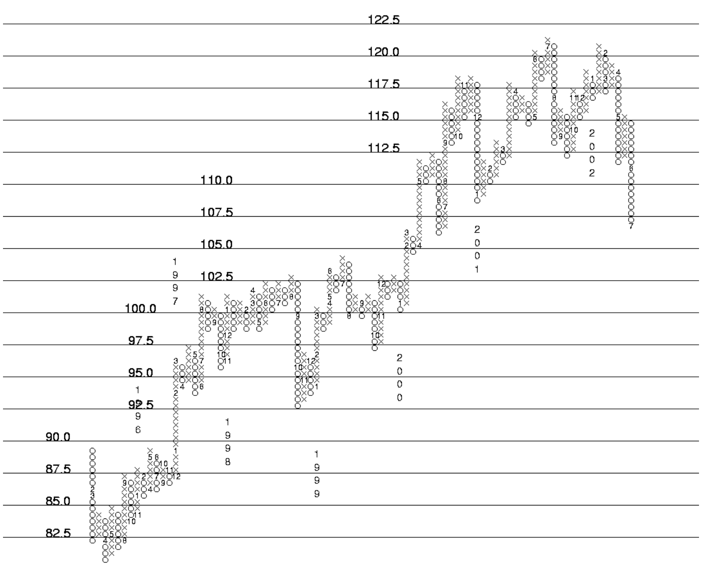
■ **The euro is consolidating earlier gains but currency flows, particularly from central banks, will continue to favour the single currency over the medium term.**

■ **Japan's government will continue to fight the appreciation of its currency and charts suggest they will succeed.**

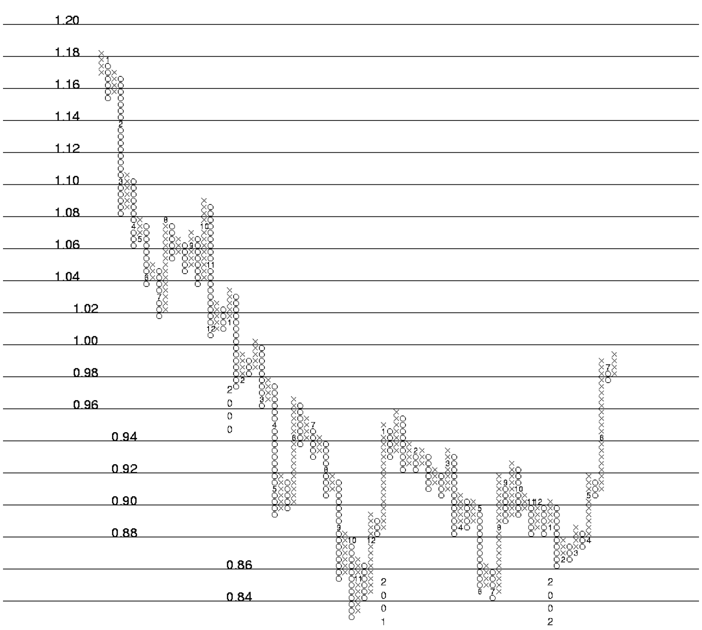
What percentage of global central bank reserves remains in US dollars? There is a big lag in Bank for International Settlements statistics but I suspect the figure is not far off 70 percent. This is obviously high, even though the dollar will remain the basis for most international settlements. What should the percentage be? It certainly won't fall anywhere near US GDP, which is less than 25 percent of the global total. The key variable is confidence in alternatives to the dollar. With Japan's economy still in crisis and the Government wanting a weaker yen, there is only one viable alternative - the euro. While the Swiss franc, sterling and the Australian dollar have all been firm recently, these are not sufficiently liquid to absorb central bank diversification from dollars. The euro wins by default and I maintain it will rally to at least the $1.10 to $1.15 region against the greenback, if not quickly, within the next year or two. However there is a catch. Euroland and the ECB will not be happy with that additional gain, particularly if it occurs within the next few months, as this would compound the region's problems of slow economic growth. Moreover Europe's corporate regulation would delay restructuring, weighing on corporate profits, while government budget deficits would rise due to the fall in tax receipts. Conversely, a weaker US dollar will provide an additional boost to the US economy, already helped by the lowest interest rates for 40 years and high fiscal spending due to the necessary war against terrorism. Consequently, I also maintain that the dollar's decline is cyclical, rather than secular. Meanwhile, the Bush Administration's justified criticism of CEO and accountancy firm ethics, which will lead to improved standards, is paradoxically hastening the flow of funds away from US assets.

Japan remains the most interventionist country in terms of its currency. Bank of Japan, acting on the Ministry of Finance's instructions, has intervened on numerous occasions during the last few years, mostly to prevent the yen from appreciating but also the halt the currency's more rapid declines. However with a chronic deflation problem, Japan fears yen strength more than

US Dollar Index (0.5)



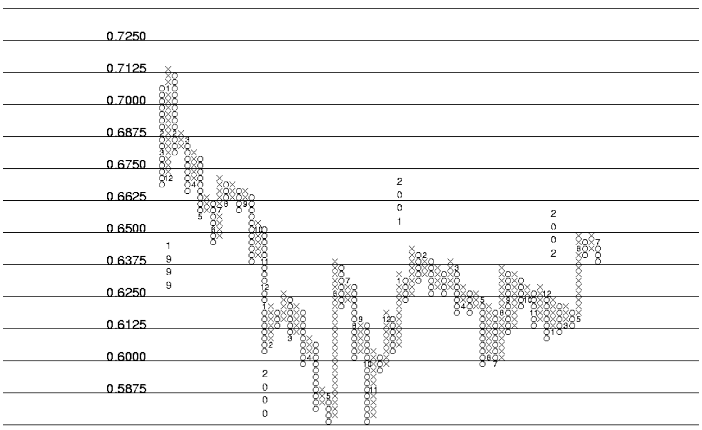
US Dollar per 1 Euro (0.004)



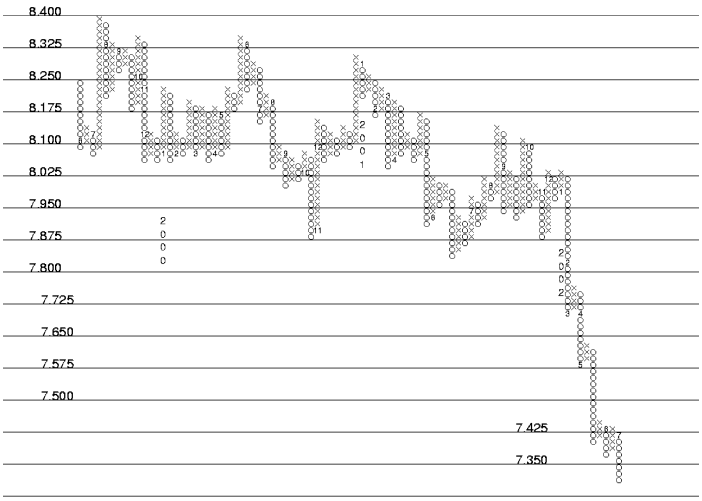
weakness. The yen has been strong recently, prompting intervention and considerable jawboning, with little success to date. Efforts have not been helped by a series of contradictory statements from the MoF's hapless Governor, Masajuro Shiokawa, who has become the laughing stock of foreign exchange. Additionally, BoJ Governor Masaru Hayami, while paying lip service to the hazards of an appreciating yen for export earnings, has at least partially sterilised recent intervention. Meanwhile currency traders, who are very good at running short-term trends, feel they have the MoF on the run and are extrapolating trends, which on longer-term data show the major currencies approaching or already in probable support from their bases against the yen. A Bloomberg report on 14th July was headlined, "Japan wants yen at 125-130", against the dollar - *see www.fullermoney.com for the full item, available by link on "Comment of the Day" for 15th July.* While markets can do anything in the very short term, I would not want to bet against the MoF, given its track record in managing the yen's level during recent years. Judging from the comments, it will continue to intervene, until it succeeds.

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

Pound Sterling per 1 Euro (0.0025)



Norweigian Krone per 1 Euro (0.015)



US Dollar Index (106.22) - *see previous page* - This remains barely steady following a further decline, although some loss of momentum is now evident on daily charts. However the overall pattern suggests that upside potential remains limited to temporary technical rallies before we see an additional decline towards the broad trading band evident from 104, which occurred mostly between July 1997 and January 2000, is seen.

Euro/dollar ($0.9913) - *see previous page* - Recovery from the large base formation has slowed near the psychological $1.00 level. Nevertheless a move to $0.9720 is required to indicate a more extensive pullback and consolidation before underlying support sustains higher levels.

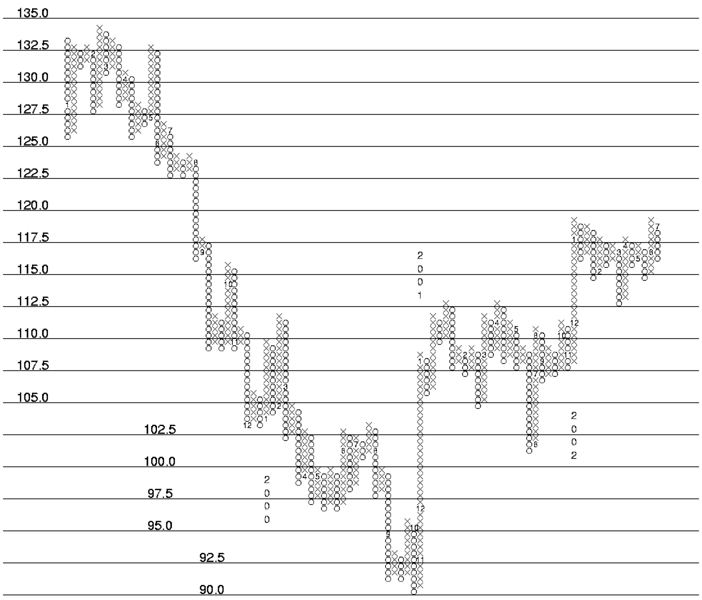
Euro/sterling (£0.6380) - The euro appears to be consolidating gains following a surge to its highest level since October 1999. The underlying pattern resembles a base capable of supporting an additional recovery once the current digestion of recent gains is completed. Higher levels would be signalled by a move to £0.6500.

Euro/Norwegian Krone (NK7.3270) - The euro has slumped this year against the high-yielding Norwegian petro-currency. However this decline looks overextended and has slowed in recent weeks. A move to NK7.435 would break the progression of lower highs and indicate that a low of at least near-term significance had been reached.

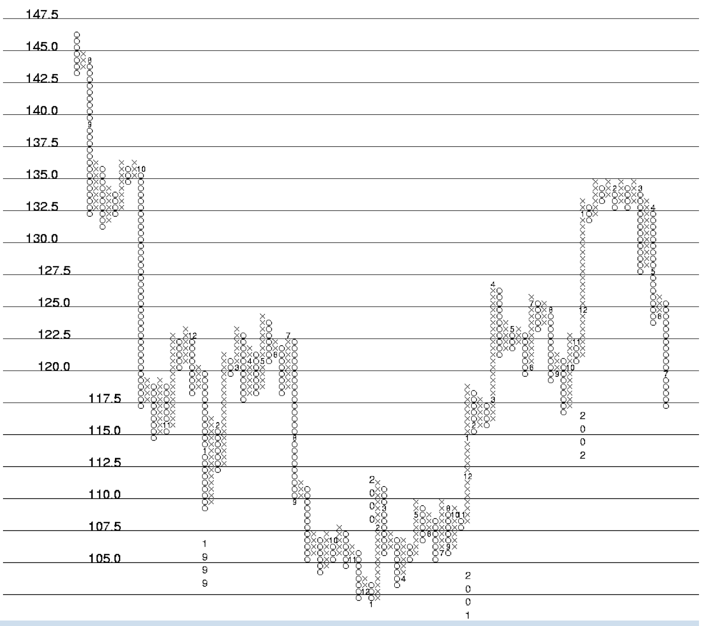
Euro/yen (¥115.79) - The euro has continued to back away from its January high of just over ¥119, delaying completion of what looks like the first step above the base, as taught at The Chart Seminar. A breach of the May low at ¥114.5 would indicate some further easing before the uptrend is resumed, confirmed by a push over ¥120.

Dollar/yen (¥116.88) - The dollar is the only major currency which has failed to maintain its base breakout against the yen. However this decline looks overextended and is close to the next area of potential support - the September low.

Japanese Yen per 1 Euro (0.5)



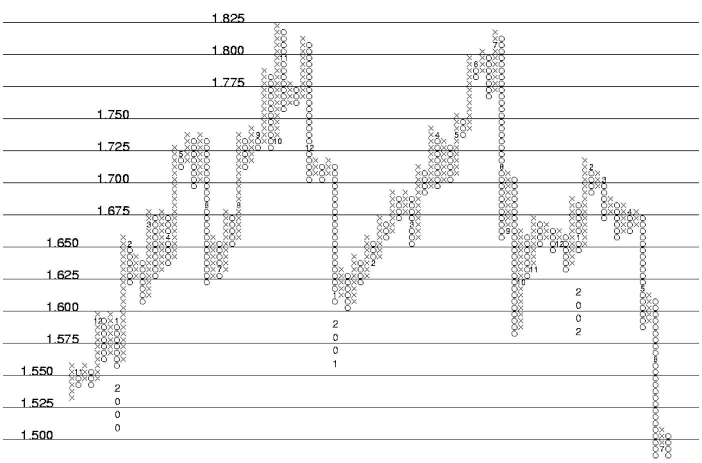
Japanese Yen per 1 US Dollar (0.5)



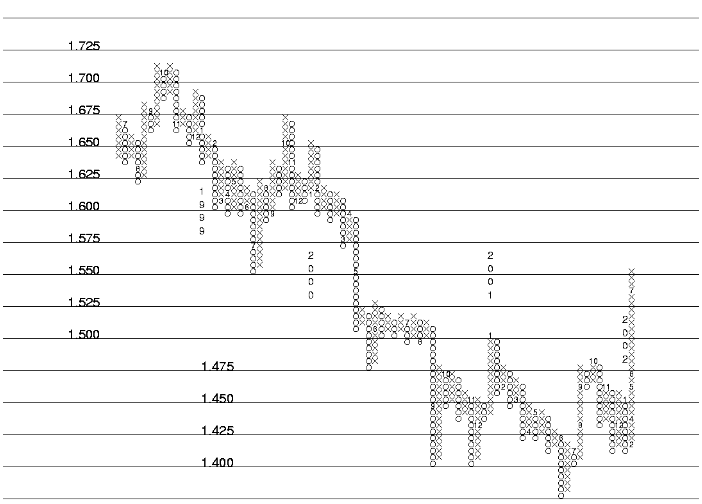
Nevertheless a sharp rebound is required to signal a new floor and recovery scope towards this year's highs.

Dollar/Swiss franc (SF1.4832) - The greenback remains barely steady, although some loss of downward momentum is evident and the decline looks somewhat overextended.

Swiss Franc per 1 US Dollar (0.005)



US Dollar per 1 Pound Sterling (0.005)



Nevertheless a rally to SF1.51 is needed to break the sequence of lower rally highs and indicate some additional recovery towards extensive overhead supply.

Swiss franc/yen (¥78.77) - The SF has slipped following an upside failure in June. This suggests some further ranging before the overall uptrend is resumed.

Sterling/yen (¥181.55) - The pound is ranging above its large base and needs ¥186 to reaffirm support from this pattern and indicate a further recovery towards the year's highs.

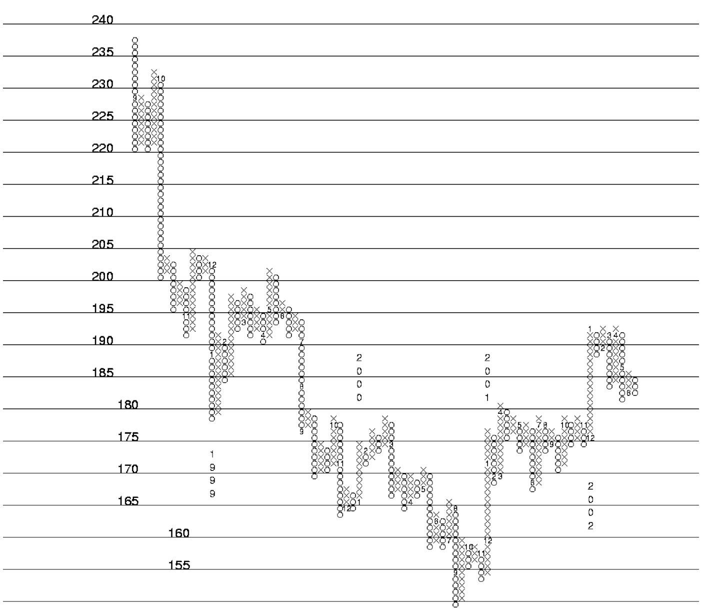
Sterling/dollar ($1.5536) - Sterling surged higher following its break above the psychological $1.50 level. However this move appears temporarily overextended and there is extensive overhead resistance - *partially shown*. However downward risk appears limited to a consolidation before somewhat higher levels are seen.

Australian dollar/US dollar (US$0.5588) - *see overleaf*- The Australian dollar's surge against the greenback encountered resistance near the January 2001 high and lateral trading around US$0.5700. It is currently testing the early-July low at US$0.5580 and a move below this level would suggest some further retracement of this year's earlier gains.

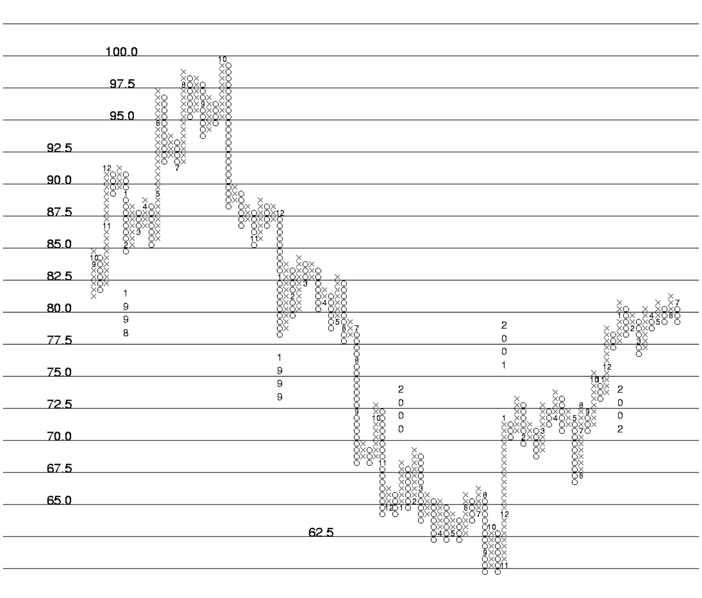
Australian dollar/yen (¥65.42) -*not illustrated*- The Australian dollar has fallen back to the first level of important support from its base, evident at ¥65. However a push back above ¥67.50 is required to reaffirm support and indicate a failed break beneath the March low at ¥67.

Strategy for currencies - I've been too bearish of the yen recently, backing MoF intervention, because it has worked before on numerous occasions. I've also attached more significance to the underlying bases than short-term downtrends. These have caused a fair amount of profit erosion recently, against many of the yen cross-

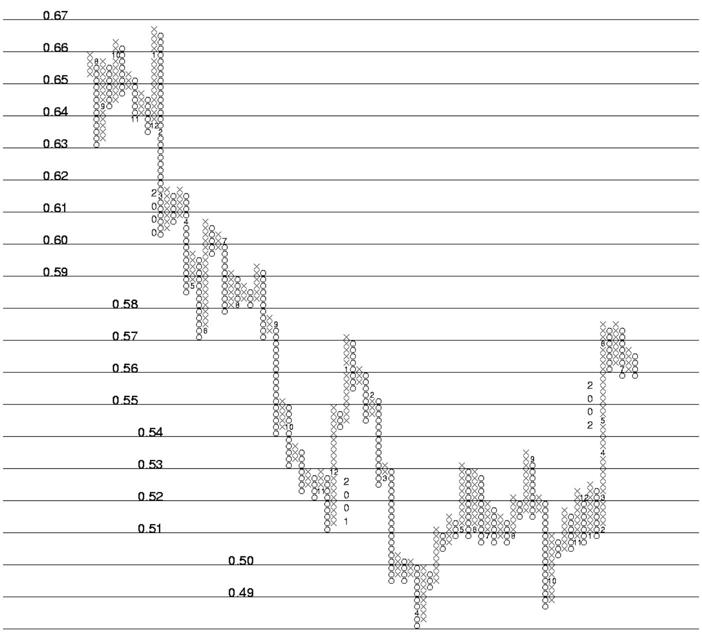
Japanese Yen per 1 Pound Sterling (1)



Japanese Yen per 1 Swiss Franc (0.5)



US Dollar per 1 Australian Dollar (0.002)

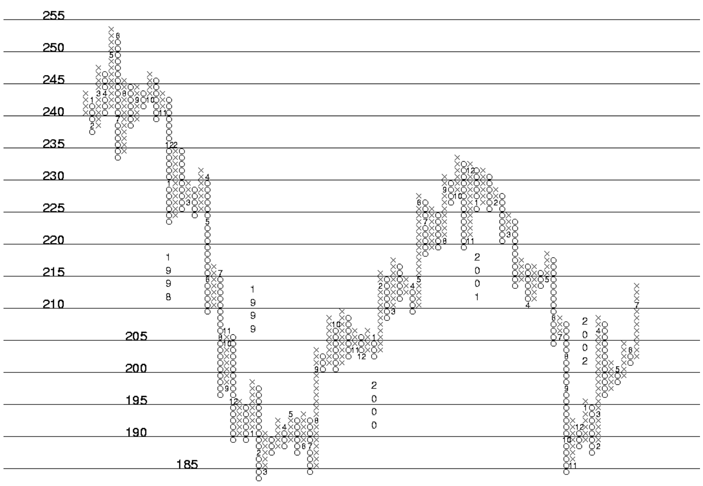


rates, questioning the overall strategy. Moreover, Koizumi's appointed Minister of Finance, Masajuro Shiokawa could not have been more inept recently, undermining confidence in the Government's intervention policy. Nevertheless, I'll express what for better or worse is now a minority view in forex markets. Japan has little choice but to persist with intervention, and handle the statements of intent more effectively, or it's bye-bye economic recovery. Yen carry positions have been substantially unwound. One of my consultancy clients, who lives in Austria, told me that his window cleaner had seen his yen mortgage converted into euros on the bank's insistence. Many forex traders, employed by banks, are currently long yen, leaving the market susceptible to a squeeze. If I had just returned from a holiday away from the markets and trading, instead of about to depart on vacation, I would short the yen for the reasons above and because many of its trends look overextended. The safer trades, at least on a medium-term basis, are probably euro/yen, Swiss franc/yen and Norwegian Krone/yen, although I'd prefer to see the latter closer to ¥15.5 because despite the tempting 700 basis point interest rate differential against the yen, the NK looks overstretched versus the euro. Assuming the MoF comes back with more intervention and credible PR, and keeps Hayami in line, the dollar should be close to at least a good technical rebound against the yen. As for euro/dollar, I'd be doing some Baby Steps lightening near parity and replacing below $0.985, during the consolidation, to lower overall entry levels and as a cushion against some further profit taking before the uptrend is resumed. With everyone bullish of the euro, short-term risks have increased. Few medium to longer-term trends are uninterrupted by corrections.

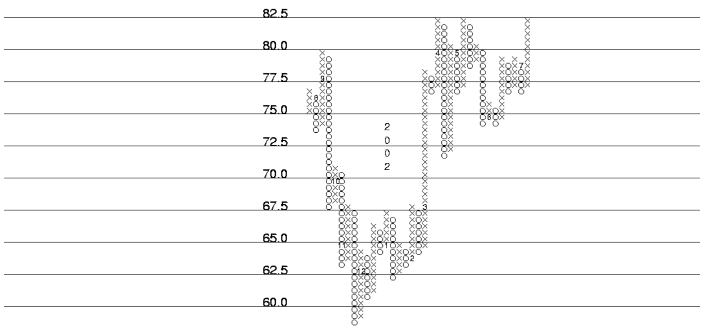
Commodities

- **The weak US dollar is lifting commodity prices.**
- **The CRB Index continues to firm, albeit from historically depressed levels.**

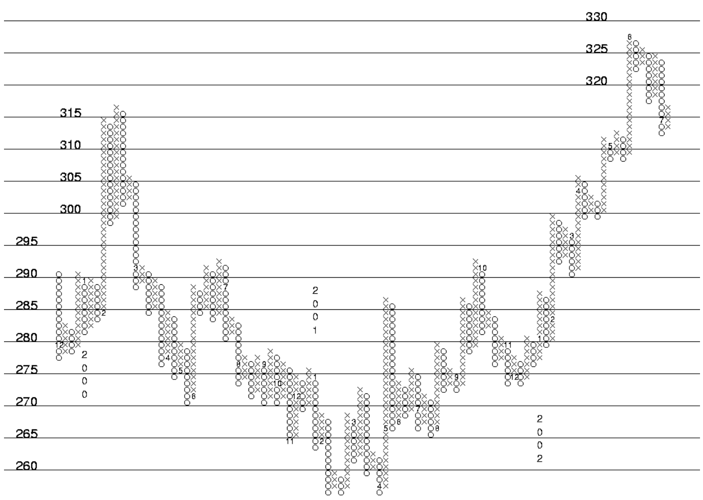
CRB Index NYFE (1pt)



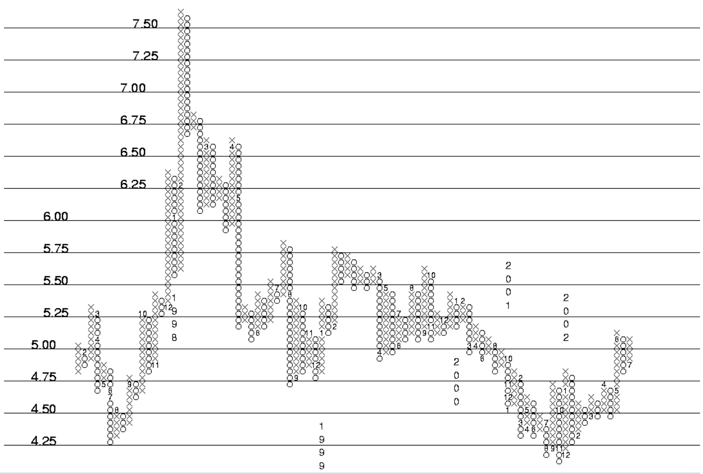
Gas Unleaded NYME August 2002 (0.5USD)



London Spot Gold (1USD)



London Spot Silver (0.05USD)



■ **OPEC's squeeze is sustaining and even lifting oil prices.**

■ **Gold is still consolidating this year's earlier gains.**

The CRB Index bottomed in October 2001, near its 1999 lows. A small base formed over the next 4 months and launched a recovery. Following a consolidation of those gains the CRB is appreciating once again. While slow economic growth and deflationary pressures are not bullish for commodities, many were so depressed that low prices were curtailing production. Turbulent weather has lifted some of the agricultural commodities. Petroleum prices have been sustained by OPEC's cutbacks. Last but not least, a weaker dollar exerts upward pressure since nearly all commodities are priced and traded in the US currency.

Petroleum traders expect OPEC to hold quotas at their lowest level in 11 years. They could be right but this seems unduly pessimistic to me. I have long maintained that high prices in 2000 provided such a boost to production capability, especially outside OPEC, that any rally in prices above the Cartel's publicly stated target of approximately $25 for a barrel of crude would be unsustainable beyond the short term, as it would soon attract additional supplies. However, there are other factors. OPEC, off the record, would like a price nearer $30, especially following the dollar's decline. Oil is also sometimes used as an instrument of foreign policy for the Middle East's producers. Western dealers are holding more supplies than usual, just in case the eventual toppling of Saddam causes temporary chaos. The US has been replenishing its strategic reserves. The demand for gasoline in the West is greater during summer months. The price for gas unleaded (NYME) is pushing above 82.5¢ - an upside breakout. At current levels, petroleum prices are a negative factor for global GDP growth, especially in developing economies.

Have we seen the reaction low for gold during this pause in the uptrend? It's too soon to say, although the price has steadied above the small late-April to early-May range. A break in the progression of lower rally highs since gold accelerated to its June high near $327 on this closing-basis chart, would provide some evidence that demand was exceeding supply once again. Meanwhile, there is lateral resistance in the $330 to $340 region, established in the late 1990s - *see www.chartanalysts.com as not shown on this graph.* I continue to regard gold as value play and in the early stages of a long-term cyclical recovery. Anything that it does on the upside in the short term is a bonus. Silver, which is a gold proxy without the threat of central bank sales, is currently firmer.

The Global Economy

■ **US GDP growth leads among major economies but that isn't saying much.**

■ **Debt will remain a serious problem and government deficits can only increase.**

The post bubble global economy will underperform expectations more often than not. In this environment, confidence will inevitably be lower than during a decade of growth and booming stock markets. Consequently there will be less capital spending, because companies do not have the same level of profits; they cannot easily raise money with secondary offerings of equity, and many are burdened with debt. Corporate debt is this cycle's BIG problem. How do they get rid of it? If they can't replace debt with equity, corporations have to restructure (sack people), sell non-core business assets, or earn their way back to prosperity. Since no one will pay a premium for unwanted businesses, we are talking about fire sales. Meanwhile, earning one's way out of debt can take a very long time, due to the burden of interest rate costs, especially during a deflationary environment.

Consumers are gradually forsaking conspicuous consumption and becoming born-again savers. They no longer have capital gains or fat bonuses and concern over job security is rising. House prices are booming but this is largely based on debt, rather than an increase in disposable income. Homeowners are not fools. They read newspapers, watch business channels and monitor the stock market. Fewer will extrapolate house price increases and raise spending accordingly. Instead, many will focus on lowering debt and boosting savings. This is a positive development for the longer term. However it is also a recipe for slower growth over the next few years than governments have predicted.

Government deficits will soar, and nowhere more than in the US. The war against terrorism is very expensive but nearly all Americans regard it as vital to their long-term security. Consequently government spending will continue at its current pace but revenue will not rebound as hoped. Huge capital gains and corporate profits of the 1990s, which produced large surpluses, have vanished off the horizon.

A weaker dollar improves US operating profits but few other countries are in a position to increase imports. Therefore the US budget deficit will soar over the next several years and taxes are likely to rise, especially if Democrats increase their numbers within Congress. The UK's deficit will also explode, as previous and significant tax rises have weakened the economy and public sector spending is soaring. The Labour Government, which claimed to have eliminated "Tory boom and bust", will have to find a new slogan. Japan has no choice but to increase its deficit, in hope of avoiding a depression. Euroland is currently constrained by its "Stability Pact", which will have to be reinterpreted or fudged in other ways.

America's economy will outperform Europe and Japan because it remains on a 'guns and butter' footing. Military spending will remain massive, regardless of the deficit. Greenspan, criticised by the first President Bush for not doing enough to help the economy, will do everything in his power to combat a slump. Consequently the Fed Chairman's foot remains firmly on the monetary accelerator. Corporate USA, for all its current ethical problems, still restructures faster than companies anywhere else. Euroland's growth was nothing to shout about during the good years and now it faces a stronger currency, to which companies cannot react quickly by restructuring because of EU regulation. Meanwhile, there has been less monetary and fiscal stimulus in Euroland than other developed regions and consumers are wary of price gouging following the single currency's introduction. Japan's fledgling recovery is likely to be snuffed out by the mismanaged yen. Any economy experiencing a destructive deflation, defined as falling output, prices and profits, needs a weaker currency. The yen was obliging, at least until the Government panicked earlier this year and talked the currency up, while BoJ Governor Hayami sterilised funds in circulation.

Debt shocks, falling stock markets and oil prices will continue to curb GDP growth, but interest rates will stay low. Brazil has $132 billion in dollar denominated debt. As the real sinks, Brazil's indebtedness, measured in terms of its own currency, climbs higher. Since March, the value of Brazil's debts in local currency has increased by 19 percent, or the equivalent of $25 billion dollars - *see "Brazil's Dollar Denominated Debt Doomsday Machine", by David DeRosa - www.fullermoney.com Comment of the Day for 9th July 2002.* Turkey owes $30 billion in foreign debts and the currency is in freefall. Demand for International Monetary Fund and World Bank capital is likely to outstrip supply and there will be further 'debt shocks'. Weak stock markets can only be bearish for global growth. Petroleum prices, although off their highs of recent years, remain at punitive levels against a background of slow GDP growth or recession. At least there won't be a central bank induced monetary squeeze. They dare not raise rates while stock markets are on the floor.

And Finally…

I'll be away until 12th August - It's summer break time, so I'm off to a nephew's wedding in LA and then to Scotland, where in the life-long losing battle to get fit, I will participate in Mrs Fuller's bicycle tour from John O' Groats to Land's End. Ages range from 21 to 60 and I'm not the former. So…if I survive Britain's crazed camper van drivers, horizontal rain, midges and the haggis, I'll be back in the office on 12th August, hopefully less fat.

Mark Glowrey will be guest editor for the www.fullermoney.com website, while I am away - The free "Comment of the Day" on this site is mainly for subscribers, and I'm delighted to see that many of you visit it regularly, judging from the daily hits, which have established an uptrend. Don't miss Mark's updates, which will include a number of research reports.

The target date for FM219 is Friday 23rd August.

> *"I have a new philosophy. I'm only going to dread one day at a time."*
>
> *Charles Schulz*

Best regards - David Fuller

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