

**The global economy is in a long-term cycle of mostly below trend GDP growth among developed countries, albeit currently improving in the US and Japan. In this environment, emerging markets will experience the best gains by far, during the medium-term bullish phases for global equities. Governance will be a key variable among these emerging markets, and the key to investor confidence.**

## 2 Interest Rates & Bonds

Further rate cuts by leading central banks are on hold, although there is an economic case for them in Europe. A technical rally in long-dated government bonds is now likely but the bull market is over.

## 3 Global Stock Markets

The Wall Street-led summer consolidation is ending, with Asian markets providing the leadership, closely followed by Europe. Market sentiment - an invaluable contrary indicator - is still cautious but will inevitably become more optimistic as stock markets rise. Why Thailand, India and Japan remain my favourite stock markets during this rally.

## 7 Currencies

Trends among the major currencies have lost consistency, suggesting an increased level of uncertainty, typical of trading range markets. The problem: every central bank wants a soft currency. Consequently gold is the winner.

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Gold is no longer money, but that makes it an increasingly important asset play, particularly during an extended period of credit creation, which sows the seeds of future inflation. Supply problems have kept petroleum prices firm but the next significant move should be downwards.

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Sunny days for the US economy should continue into next year but storm clouds cannot be kept at bay indefinitely. Some respite for Euroland is likely, but this region will continue to underperform the global economy. Asia still has the best growth prospects.

## 12 And Finally...

The Chart Seminar will be held in London on 6th & 7th November 2003.

**Further gains by most stock market indices provide additional evidence that the summer consolidation is ending or over. 'Wall of worry' considerations aside, until support rather than resistance levels begin to give way, the path of least resistance remains on the upside.**

**Going with the flow.** As investors in Europe and North America return from summer holidays, they are discovering that share prices have mostly risen, despite numerous warnings and forecasts of significant reactions in recent weeks. One should always listen to those warnings, along with the bullish forecasts, especially when they are based on historic precedent or logic, but the final arbiter is always supply and demand. If stock markets do no worse than range sideways to higher, as we have seen since March, then demand clearly has the upper hand, for whatever reasons. One very important reason, I suspect, is that many institutional investors feel they are underweight equities relative to bonds. This has kept reactions by stock market indices small, sustaining bullish sentiment, which increases as markets rise. My guess is that share indices will experience a wobble or two in September or October, as gains are consolidated, before rallying through yearend during this historically bullish pre-presidential election year - see *tables in FM228 and 227*. I maintain Asian indices will register the best gains for the duration of this very good medium-term rally. My three favourites are Thailand, India and Japan.

**Some respite for long-dated government bonds.** I have previously mentioned that the spike in long-dated bond yields threatened to become an uninvited guest at the stock market party. There is a fine psychological balance here. Historically, an end to the cycle of falling government bond yields has often provided stock markets with additional liquidity for a further rally of approximately six months, as investors rebalance portfolios by selling some of their fixed-interest holdings in favour of equities. I maintain that government long-dated bond yields reached their lows for the cycle in June, and we have seen some institutional investors adjust weightings accordingly. However, when bond yields continue to rise, often against the background of higher short-term rates as well, confidence in stock markets is undermined. Today, central banks do not appear about to raise short-term rates but many investors suspect the cycle of rate cuts has ended. If bond yields continue to rise from current levels, they will approach a psychological inflection point where a positive influence on

shares suddenly becomes negative, as investors discount weaker economic growth and therefore lower corporate profits. The government bond market needs to be monitored closely and as I complete this issue, there is some evidence that the rise in yields is losing momentum. Consequently a technical rally in bond prices may have commenced. If so, this could temporarily stem the recent flow of funds from bonds to equities, but more importantly, it would lower the risk of a sudden end to the medium-term stock market rally.

**Gold remains in the accumulation phase.** I maintain that gold is in the early stages of a secular bull market. Central banks are fuelling bullion's ranging recovery through credit creation (effectively printing money). Moreover, in this environment of generally sluggish economic growth and deflationary pressures, all central banks want soft currencies. No wonder gold is gradually being re-monetised in the eyes of investors. For more on the gold story, have a look at some of the articles posted on my website in recent months.

## Interest Rates and Bonds

■ **Further rate cuts by leading central banks are on hold, although there is an economic case for them in Europe.**

■ **A technical rally in long-dated government bonds is now likely but the bull market is over.**

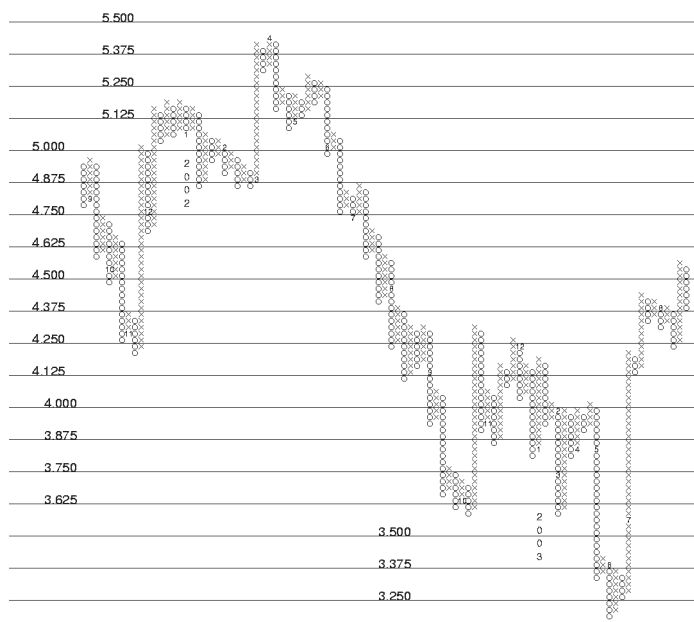
**The ECB and BoE are now less inclined to cut short-term rates.** While falling GDP data for 2Q 2003 certainly provides a case for lower rates in Euroland, the ECB can claim that this is backward looking and that the recovery elsewhere will spill over into Europe during the second half of 2003. Maybe, but the ECB has consistently overestimated Euroland's growth prospects. It also continues to criticise the region's larger countries for exceeding the Stability Pact ceiling on government debt. Consequently the risk that the central bank will be less accommodative than circumstances require remains. Meanwhile, I maintain that the Stability Pact is a dead duck in practice, ignored by governments which will treat it as no more than a guideline. The UK's Monetary Policy Committee is less likely to cut rates again, because it fears re-igniting house price inflation. Also, sterling has weakened since its May-June highs. The Fed's next move on rates is likely to be an increase, but not anytime soon and not without ample warning.

**There is little chance of US and Japanese long-dated bond yields testing their June lows.** In Japan, monetary authorities presumably hope that the recent floor of 0.43 percent will never be tested. Having seen the cycle lows, downside scope is now limited to a partial retracement of the rally in a base extension phase, which could be lengthy before yields move higher over the medium to longer term, subject to GDP, supply, inflation and sentiment. Euro-bund yields are unlikely to diverge significantly from those of the US. However having fallen less and subsequently risen less recently, and with Euroland's weaker economies, they have

Japanese 10 Year Bond Yield (0.025)



US 10 Year Bond Yield (0.025)



Euro Bund 10 Year Bond Yield (0.03)



the best chance of retesting and possibly even exceeding the June low temporarily. Meanwhile, US T-bond futures show a loss of downside momentum, indicating scope for a technical rally - see *charts on [www.chartanalysts.com](http://www.chartanalysts.com) and occasionally [www.fullermoney.com](http://www.fullermoney.com).*

**Strategy on bonds** - I do not assume that the Fed and BoJ will pump up their bond market bubbles once again, although this is a possibility. Having seen the secular bull market, I assume it is only a matter of time before what is likely to be a secular bear market continues. Therefore I have no investment interest in long-dated government bonds. For captive players, there may now be a window for a technical rally, which once underway, would provide an opportunity to lighten positions. From a futures perspective, the current oversold condition and some loss of downside momentum would deter me from shorting at today's levels, and there is a speculative case for long positions, protected initially with stops under the recent lows, which could then be raised if a rally occurs. Personally, I'll wait for a rally, and look for a short selling opportunity when it loses momentum.

## Global Stock Markets

■ **The Wall Street-led summer consolidation is ending, with Asian markets providing the leadership, closely followed by Europe.**

■ **Market sentiment - an invaluable contrary indicator - is still cautious but will inevitably become more optimistic as stock markets rise.**

■ **Why Thailand, India and Japan remain my favourite stock markets during this rally.**

**Narrow trading ranges during the pause by share indices, which mostly occurred between June and mid-August, reaffirm underlying demand.** This will come as no surprise to Fullermoney subscribers. A 3-year decline by stock markets, following the NASDAQ's burst bubble in March 2000, gave investors ample time to significantly reduce their stock market exposure relative to bonds. 9/11 and anticipation of the war against Saddam Hussein added a terror discount to share prices. Meanwhile, the US was engaged in a record-breaking monetary and fiscal reflation, including significant tax cuts. Moreover, the Fed Chairman Alan Greenspan and Treasury Secretary John Snow tackled bearish sentiment with a cheerleading campaign on behalf of economic recovery. It all added up to a dream scenario for stock markets, and the pendulum of sentiment started to swing away from its bearish extreme just before the war to free Iraq commenced. Actually, upside dynamics (bigger upside than downside days) - frequently mentioned in FM, the Subscriber's Audio and illustrated on my website - provided evidence of increasing underlying demand relative to dissipating selling pressure, well before the March rally commenced. This supply/demand imbalance in favour of the bulls continues, evidenced by narrow trading ranges during the summer consolidation, a tendency for markets to rally more quickly than they fell during this pause, more

daily upside than downside dynamics and most recently, a resumption of the medium-term uptrends by many indices. Significantly, no stock market index experienced a substantial shakeout following the strong March to early-June rally. In fact, very few reactions exceeded 8 percent and most were considerably smaller. Consequently, breaks beneath the July or early-August reaction lows (whichever is lower) by leading indices are required to check current scope for further gains. Such additional reactions appear unlikely, not least because sentiment has been very cautious. Even the bulls are bullish-lite. Many institutional investors, recognising that they are overweight bonds and underweight stocks, are rebalancing portfolios in favour of equities. Others were wary having seen many predictions for significant shakeouts and retests of the March lows, from theoretical technicians (rather than chart readers focussing on price action and sentiment), not to mention fundamental bears. With investment managers returning from holiday and share indices breaking on the upside, hopeful bids are being replaced by market orders.

**I'm still bullish but will become less so as stocks rise.**

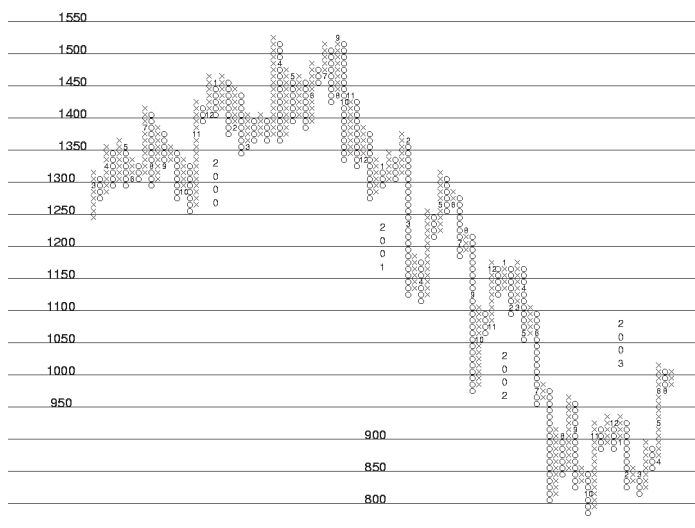
One of the key reasons for my optimism has been the overall bearish sentiment earlier in the year, which was not matched by confirming price action. Taken at face value, sentiment is a much better indicator of what people have done, rather than of what the market will do. In other words, people talk their book. We can assume that most bears have sold and that most bulls are long, otherwise they would be schizophrenic. Incidentally, we don't need to depend on the numerous sentiment indicators cited by some technicians, in order to read the crowd's mood. Sentiment indicators and surveys have their use but can be overly elaborate to the point that one sometimes can't see the wood for the trees. Conclusions that a particular indicator has worked X-percent of the time are the least helpful, because once these studies enter the public consciousness, they understandably become less accurate, not least because people anticipate and discount. I seldom look at such indicators, because market sentiment is all around us, in the press, research reports and on financial TV. As a general comment on all types of indicators, of which there are thousands, they are always fascinating but I have seen more people drown on indicators than I care to mention. Give me the plain old price action any day. If we hope to make money in the markets, there is nothing that we can do that is more important than monitoring supply and demand, revealed by the price chart of course. Returning to the markets, extreme pessimism understandably dissipated as it lost credibility during the rally commencing in March. However recent caution during the June to early-August trading ranges remained a bullish indicator. Overall market sentiment will understandably improve as markets rise. Claims that the secular bear market is over, or that a new bull market has commenced, are opinions rather than facts. Moreover these opinions are not only a by-product of the crowd's increasingly long positions, they are also used to bolster confidence. In other words, if I think the market is only going up 5 percent before it falls, the odds don't look too good if I'm long, and I'll sleep restlessly. However if I convince myself that it could gain 50 percent, I'll sleep like a

happy baby. As stock markets rise, it would be a good idea to interpret increasingly bullish sentiment as an indication of declining buying power, because more of the players are long. And remember, history suggests this is a technical bull within a secular bear market - see previous issues.

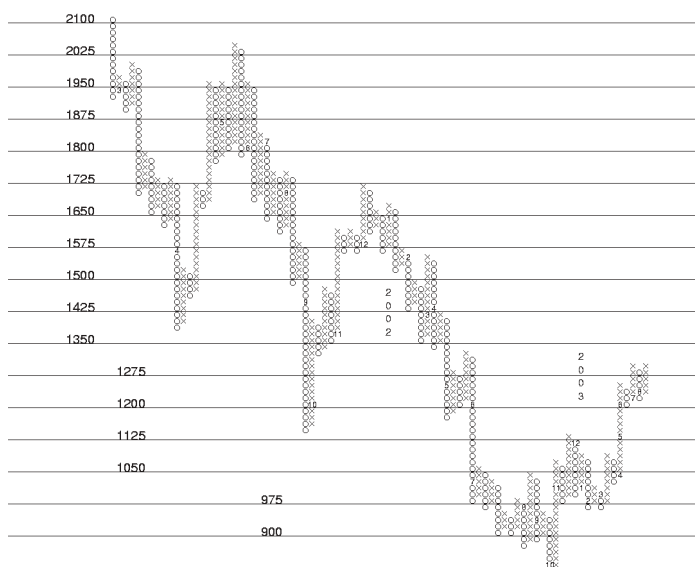
**When sentiment turns in favour of equities, individual selection of markets, sectors and shares is a beauty contest.**

So once convinced that they should buy stocks, what have investors looked for? Briefly, Wall Street receives a point for growth prospects, but loses two for high valuations and currency risk (exaggerated in my view). Europe gains a point for currency (also exaggerated), and another for valuations, but is marked down on growth prospects. There is little to differentiate Euroland's stock markets and the UK's economic model continues to be refashioned along European lines. There is more to differentiate Asian markets, but most score strongly on growth prospects, valuations and chart formations. No contest, in my view. Asia also has charisma, which is very important in a beauty contest. Like it or fear it, China is a big story. The best way to play China, I maintain, is to buy markets that benefit from its growth, rather than face head on competition from the PRC. Thailand wins hands down, with its commodity exports and tourist industry. What first attracted my interest in Thailand last March, which made it my favourite stock market, was the SET Index's very large base formation relative to all other share indices. You can't hide supply and demand, and there is usually a story or two behind the chart action. There is, and its not just trade with China. Thailand is an emerging market. These often have better growth prospects than developed markets but they can often be unstable. Consequently political stability and also vision are crucial factors in assessing emerging markets. I can remember when Singapore, before it became a developed market, was often described as having the best 30-year growth record in the world. This was because Singapore had the best government in the region, in terms of creating a stable and prosperous society, led by Lee Kuan Yew. Thaksin Shinawatra, Thailand's Prime Minister since 2001, is definitely in the Lee Kuan Yew mould - exceptionally bright, very knowledgeable on economic and business matters, a strong leader with a clear vision for his country and hopefully incorruptible. Thailand is certainly not in the most stable region of the globe so its need for good leadership is even greater. Under Thaksin Shinawatra Thailand has paid off its IMF loans and the economy grew by 6.7 percent annualised in 1Q 2003. He has also cracked down heavily on the drug trade, a big problem for Thailand, and recently captured Asia's most wanted al-Qaeda and Jamaah Islamiyah terrorist, the Indonesian known as Hambali. These actions have gained Thaksin Shinawatra powerful allies in the West, not least in Washington. You can read more about his background in the Global Economy section. India remains my second favourite market because of its improving growth rate, forecast by central bank Governor Bimal Jalan to be 6 percent this year, partly due to the good monsoon. India's economic strengths range from software to diversified manufacturing. Like China, India has a virtually inexhaustible supply of inexpensive and increasingly educated managers and workers. Japan remains

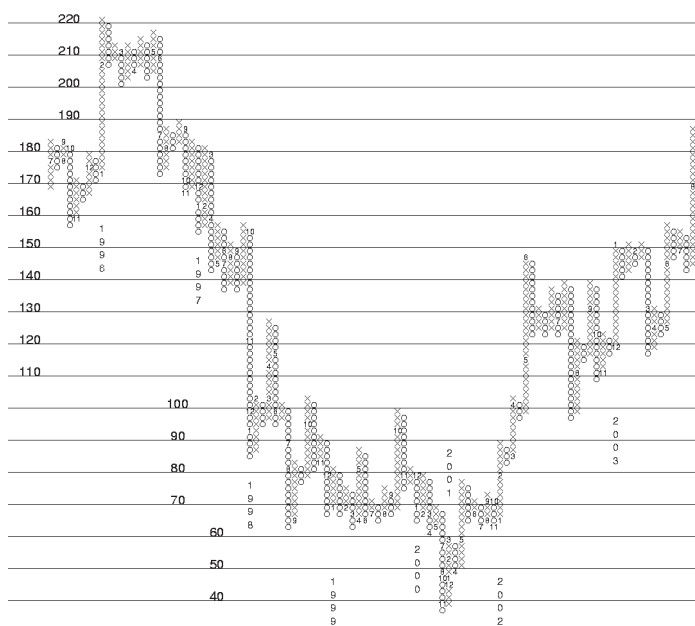
**S&P 500 Composite Index (10pt)**



**Nasdaq 100 Index (15pt)**



**Amex Gold Bugs Index (2pt)**



my third favourite stock market for 3 reasons. After a 13.4-year bear market, it is an obvious recovery candidate, and the one big cap, highly liquid and well know market in Asia. Significantly, the government has been targeting the stock market since April. Under the new BoJ Governor Takahiko Fukui, who assumed office on 20th March, the central bank is now working with the LDP Government and the MoF in their efforts to jumpstart the economy.

**Chart review of topical and representative stock market indices**

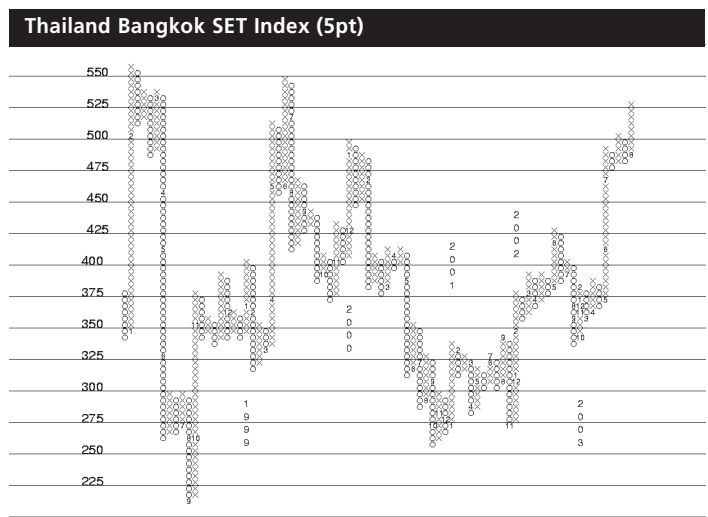
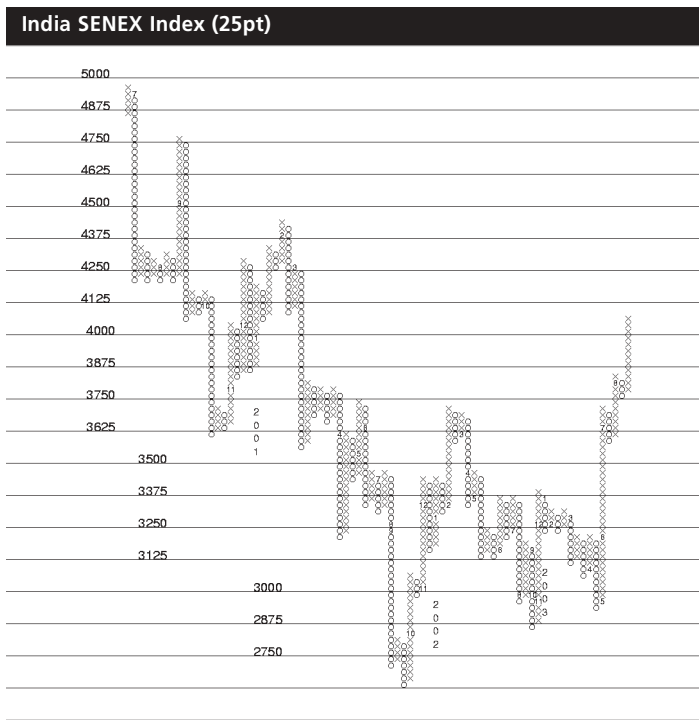
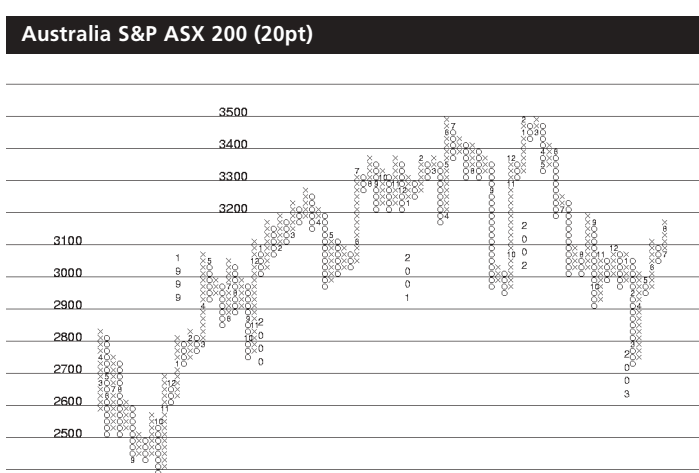
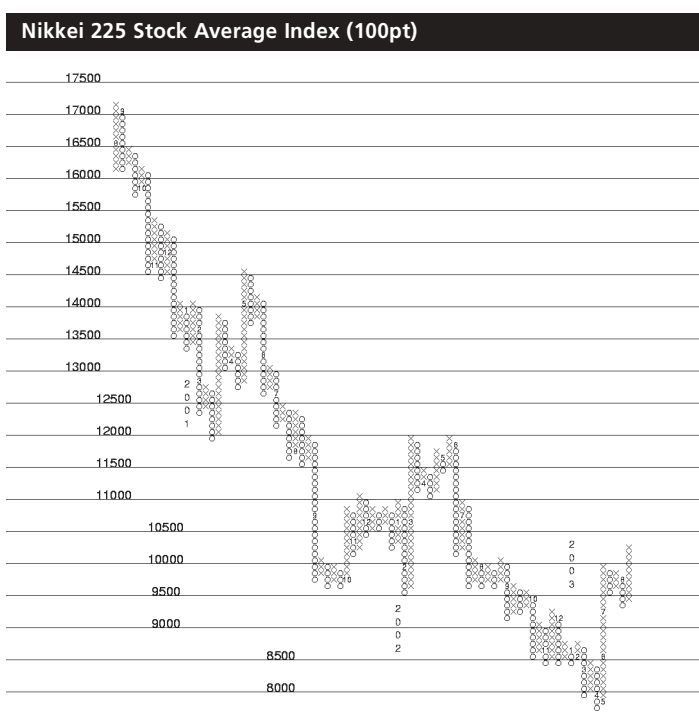
- *The 3-box reversal point & figure charts shown are based on closing prices and taken from our website. Anyone interested in this chart service, which includes analysis and is updated daily, should register online at [www.chartanalysts.com](http://www.chartanalysts.com). Price levels mentioned refer to market closes. Please note, these charts were prepared before the final prices shown in the comments below.*

**The US's S&P 500 Composite Index (1002)** encountered resistance near the psychological 1000 level and a consolidation is still underway, above the small base. A move below 950 remains necessary to question somewhat higher scope over the medium term. **The NASDAQ 100 Index (1285)** is also consolidating above its small base. A move under 1200 remains necessary confirm a deeper correction before a further test of overhead trading occurs. **The Amex Gold Bugs Index (188)** of unhedged gold mines has extended its break above the 2002 to early-2003 highs. While this advance is becoming temporarily overextended, downside risk appears limited to a temporary consolidation of gains.

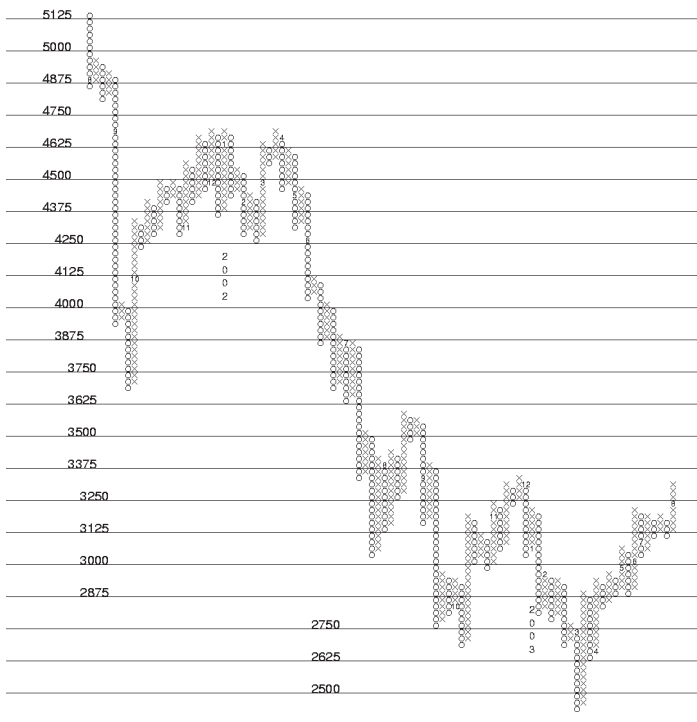
**Japan's Nikkei 225 Stock Average Index (10292)** has resumed its recovery following a brief consolidation near the psychological 10000 level. A move under 9600, which appears unlikely, would be necessary to suggest an upside failure and further consolidation before higher levels are seen.

**Australia's S&P ASX200 Index (3171)** has edged further into its large, multiyear top in the best gains since 4Q 2001. A move under 3030 is needed to check upward progress beyond a brief pause.

**Thailand's Bangkok SET Index (521)**, a relative strength



### France CAC 40 Index (25pt)



standout in recent years, has resumed its uptrend following a brief pause near the psychological 500 level. A break beneath 475, which appears unlikely, is required to indicate an upside failure and deeper correction before the large underlying base supports an additional test of the 1998 to 2000 peaks up to 555.

**India's BSE SENSEX Index (4056)** - see *overleaf* - may encounter some temporary resistance near the psychological 4000 level but a move under 3750, which appears unlikely, is needed to check momentum beyond a pause.

**France's CAC 40 Index (3280)** has resumed its recovery following the June-July consolidation. A break in the progression of higher or equal lows, with the latest at 3100, is required to indicate an upside failure.

**Russia's RSF Index (6214)** saw its biggest correction for 12 months in July but encountered strong support near the May 2002 peak and has now cleared the July 2003 high. Consequently a decline beneath 6000, which looks unlikely, is necessary to question scope for additional gains.

**The UK's FTSE 100 Index (4253)** has resumed its recovery following a two-month consolidation. A move below 4000, which seems unlikely, would be needed to check current scope for somewhat higher levels.

### Russian RSF Index (50pt)



**Strategy for stock markets** - I'm still reasonably comfortable with what is close to my biggest position in equities for at least 5 years, but I will be reducing exposure on further strength, starting with UK positions. A point worth repeating and emphasising, I am not becoming more bullish as share prices rise. I'm becoming less bullish, because markets are no longer oversold and have fulfilled more of their upside potential in what I regard as no more than a medium-term bull run, albeit probably a very good move, which has a good chance of carrying well into 2004, provided long-dated bond yields don't spike higher from current levels. Meanwhile, I have once again reduced my position in gold shares and funds, which is now down to approximately 15 percent of my equity portfolio. This was done mainly by selling South African positions, such as Harmony. I've topped up holdings in Asian stocks, funds and investment trusts, which presently account for about 70 percent of my portfolio, which is never balanced, and my Stockcube contributory pension scheme has been invested in the manager's Pacific fund since early June, having been switched from European equities which I held previously for the currency. My biggest equity exposure is a long position in Nikkei futures, which I increased by 20 percent on the early-August reaction. Most of this is protected with a trailing stop, which gives me close to a free ride, in that I am unlikely to lose more than some of my profit. Targets are 100 percent guess work, so of no analytical value, unlike overall trend consistency. However we all have expectations, hopefully based on rational criteria. In the Subscriber's Audio, I frequently mentioned at least 10,000 for the Nikkei 225 before a significant correction. After moving a little above this level, there was a pullback of 8.6 percent by early August (based on daily high/low/close data, not shown), more than twice the size of the May and June consolidations, which were too small to register on the p&f chart shown earlier. Consequently the Nikkei is now in the

### United Kingdom FTSE 100 Share Index (50pt)



slower, ranging stage of its Type-2 (of 3) bottom as taught at the chart seminar. In conforming to this pattern, I would not be surprised if the Nikkei ranged sideways to higher, reaching my minimum 50 percent guesstimate of 11,400, before there is an extensive pullback and base extension phase. I own only one Japanese share - UFJ Holdings Inc, purchased in mid-May and mentioned on the Audio, which has outperformed everything else I own. I continue to regard UFJ as a lead indicator for Japan, at least in this stage of the stock market recovery. It remains on course for my minimum guesstimate of ¥400,000, a level last seen in February 2000. My additional Asian stock market investments are a Japan fund in another self-administered pension scheme, and the following investment trusts (UK-quoted closed-end funds) - Aberdeen New Thai (increased with funds from the latest gold share sales) and JP Morgan Fleming Indian (both first mentioned in FMP202 on 7th March 2003), Fleming Japanese and Atlantis Japan Growth Fund. The remainder would be approximately 15 percent mostly UK high-yield shares - Boots, Sainsbury, Northern Foods, Lloyds TSB, IMI (a very recent addition) and Vodafone. I also have a small position in the US biotech speculation - Hollis-Eden Pharmaceuticals, which is trying to develop a practical "radioprotectant" (no not from those dreadful little portable music players which chatter) that can be used on a widespread basis in the event of an act of terrorism such as the detonation of a nuclear device or "dirty bomb", or an attack on a nuclear power plant. Let's hope we don't need it.

## Currencies

■ **Trends among the major currencies have lost consistency, suggesting an increased level of uncertainty, typical of trading range markets.**

■ **The problem: every central bank wants a soft currency. Consequently gold is the winner.**

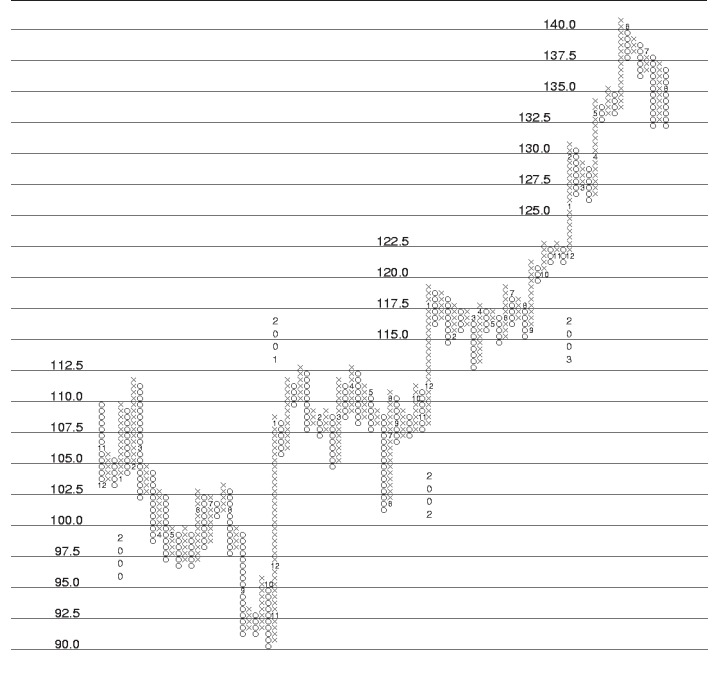
**Risks have increased for currency traders and/or opportunities are fewer.** When primary trends lose consistency and become choppy, it signals two possible outcomes. They have either paused and will range for a lengthy period in larger patterns, relative to what has occurred in prior months, before resuming, or they are in the process of topping out before a substantial reversal of the previous trend. Looking at the charts, I see a number of at least medium-term trend endings among the big trends - euro/dollar, euro/yen, dollar/Swiss franc and Aussie \$/ US dollar. At this stage, there is no clear evidence that the contra-trend reactions are over. However, some retracements, including euro/dollar and euro/yen, are slower than the prior moves to highs in late May. This suggests that the highs are at least likely to be retested. However before that occurs, a clear upward dynamic is required to check the current reversal of prior positions by traders.

**A major factor behind the uncertainty is that central banks have made it clear, in actions if not words, that they do not want an appreciating currency.** I cannot remember when this last occurred on a similar scale. This need not necessarily lead to a beggar-thy-neighbour policy of competitive devaluations, although that is a possibility. More likely, monetary reflation by the Fed and BoJ will

US Dollar per 1 Euro (0.004)



Japanese Yen per 1 Euro (0.5)



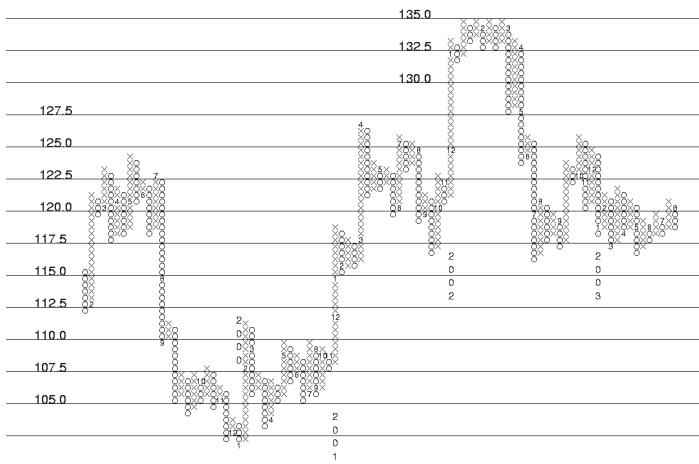
increase pressure on other central banks to do the same, to prevent their currencies from catapulting higher. The mantra becomes: reflate or die. When no central bank wants an appreciating currency, and is willing to increase its supply to offset demand, the clear winner is gold. Gold bullion is becoming the investor's currency. For weekly charts of gold in 10 different currencies, see [www.fullermoney.com](http://www.fullermoney.com), Comment of the Day for Wednesday 13th August.

### Chart review of important and topical currencies

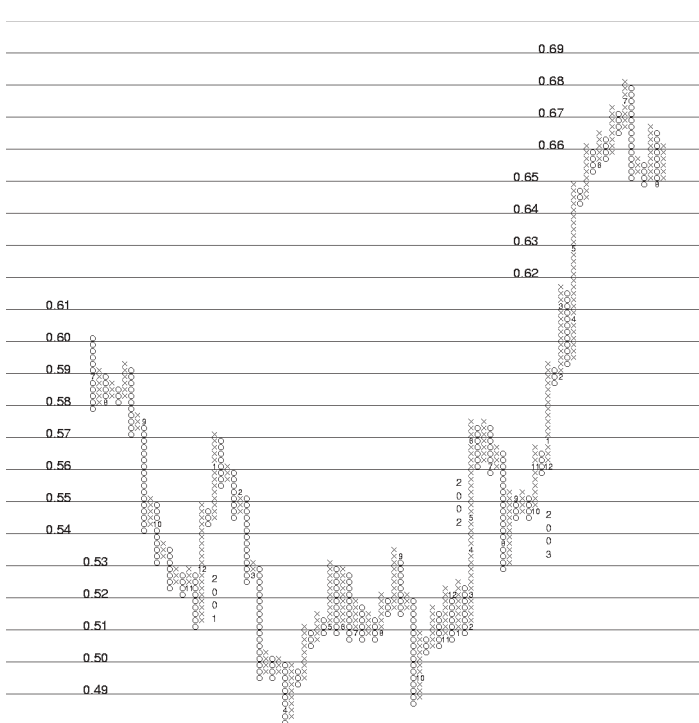
- These and hundreds of other 3-box reversal closing basis point & figure charts are available on our website, [www.chartanalysts.com](http://www.chartanalysts.com) and are updated daily. All comments refer to closing levels for US trading hours. Please note, the charts were completed before the comments and prices shown.

**Euro/dollar (\$1.1126)** - The euro has drifted downwards

### Japanese Yen per 1 US Dollar (0.5)



### US Dollar per 1 Australian Dollar (0.002)



once again, taking out its July low in the process. While support is evident from \$1.1040, an upward dynamic and break of the progression of lower rally highs is now required to check the decline and signal a possible retest of the highs.

**Euro/yen (¥131.77)** - The euro is falling towards potential support from its July low. However the extent of this reaction has caused trend damage and here also an upward dynamic and break of the progression of lower rally highs will be necessary to indicate a probable retest of the highs.

**Dollar/yen (¥118.38)** - While the dollar remains rangebound against the yen, its failed break beneath the September 2002 and March 2003 lows at ¥117 could be important. However a move to ¥122 remains necessary to reaffirm support and further recovery scope.

**Australian dollar/US dollar (US\$0.6635)** - The Australian

dollar encountered resistance in the region of its important highs reached in 1998 and 1999 - *not shown*, see [www.chartanalysts.com](http://www.chartanalysts.com) - and the subsequent sharp reaction indicates that a peak of at least near-term significance has been seen. While it is currently ranging, a move to US\$0.646 would indicate renewed weakness.

**Strategy on currencies** - Unusually for me, I have no currency positions at the moment, due to the risk-increasing trend inconsistencies that are evident. Also, I'll be leaving on the major part of my annual holiday immediately following release of this issue. However some interesting possibilities for light speculation are developing. The Australian dollar looks like a sell on rallies against the US currency, provided a decisive break above US\$0.68 does not occur. Also, should the greenback fall back to the lower side of its narrow range against the yen - to ¥117 or lower, this would probably provoke further BoJ intervention, making yen crosses interesting once again. However I'm wary because of the trend damage in euro/yen, Swiss franc/yen, etc due to the unwinding of previous yen shorts and demand for the currency from investors who have rediscovered Japanese stocks. Consequently I will hope for lower levels and some clear technical signals before selling the yen. As for Euro/dollar, I previously mentioned \$1.14 to \$1.10 as a buying range, and the upper level, at least, is clearly too high. The possibility of a temporary downside overshoot cannot be ruled out until we see clear technical evidence that the euro has bottomed. Being reluctant to anticipate because of the damage to trends that had been very consistent, and being far from convinced that long-term trend reversals are underway, the sensible policy is to wait for dynamic signals, as taught at The Chart Seminar.

## Commodities

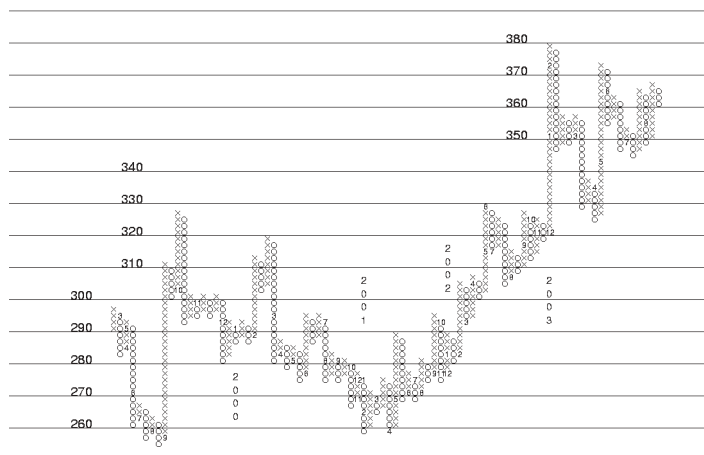
■ **Gold is no longer money, but that makes it an increasingly important asset play, particularly during an extended period of credit creation, which sows the seeds of future inflation.**

■ **Supply problems have kept petroleum prices firm but the next significant move should be downwards.**

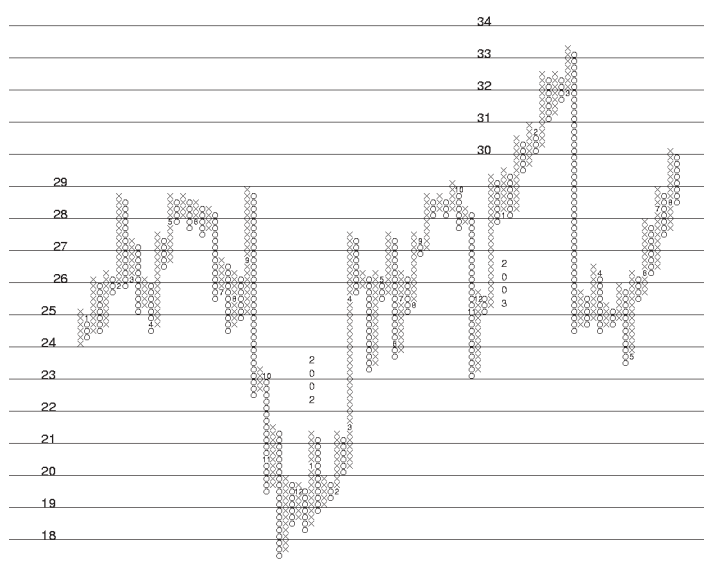
**Gold will not be re-monetised, except in the minds of investors.** For better or for worse, we live in an era of Keynesian economics, where central banks control credit creation, which they will use to fight deflationary pressures when they arise, ensuring that they will almost always err on the side of inflation. The message for investors is that fiat currencies (paper money) will remain a depreciating asset over the longer term, as we have seen throughout their history. Occasional experiments aside, such as Malaysian Prime Minister Mahathir's proposal for a gold dinar, gold-backed currencies are very unlikely to return for a number of reasons. A universally agreed gold standard today would tip a credit-hungry world into a severe depression, ensuring that the system was soon abandoned. For this reason alone, influential governments and central banks will not even contemplate returning to a gold standard. Additionally, the yellow metal is a scarce commodity, so there would



### Gold CMX 2nd Month Continuation (2USD)



### Crude Oil NYME 2nd Month Continuation (0.2USD)



not be enough of it for a gold standard, even if a nought were added to the current price and all private holdings of gold confiscated by central banks. Lastly, a gold standard in today's globalised world would be open to manipulation, by speculative cartels if freely traded or hostile and opportunistic governments if not.

**Gold will remain a scarce and generally appealing commodity, with a unique long-term record as a store of wealth.** Inevitably, gold's price will fluctuate, in response to events and fashion, just like any other asset. It will be most fashionable when fear of inflation is a focal point of investor concerns, as we have seen before. This is not the case today, although gold's price trend has turned upwards, after bottoming against all fiat currencies between 1999 and 2001 - see weekly candlestick charts of gold against 10 different currencies on [www.fullermoney.com](http://www.fullermoney.com), Comment of the Day for Wednesday 13th August 2003. Clearly, a gradually increasing number of investors recognise that gold is a value play, especially relative to paper assets, and they know that the seeds of a future inflationary problem have already been sown by excessive credit creation. Paradoxically, by ensuring that gold is not officially money,

central banks have probably ensured that its appeal as a store of wealth will be greater than ever before, during the next era of spiralling inflation, perhaps 10 to 20 years from now. Meanwhile, credit creation and the bubbles it creates are gradually re-monetising gold in the eyes of experienced investors.

**Gold is in the early stages of a secular bull market against all currencies.** The comparison I have often made during the last 2 years is that the gold price today is where the S&P 500 Index was in the early 1980s. Consequently it will often be overshadowed by other trends, as we saw with the government bond market bubble until it burst in June, the housing market and the stock market rally since March. We can expect lengthy periods of ranging, as we saw during the multiyear base formation stage evident below \$330, and subsequently during the current pattern which I have often described as the first step above the base. Nevertheless gold's long-term trend is now irrefutably upwards. I suspect this will be a stealth bull market for a number of years and the euphoric stage could be at least a decade away. Nevertheless there are good reasons for suspecting that the 2001 to 2018(?) advance will be the best yet for gold. With markets, one extreme move is often followed by another in the opposite direction, and gold experienced a 20-year bear market. Gold's recovery commenced from record low levels against the Dow Jones Industrial Average, which reached 41.8 times the price of gold in June 1999, and is still over 26 times higher and currently rising. The historic mean for the Dow/Gold ratio is around 5. To put this in perspective, credit creation (effectively the printing of money) led by the US and Japan is massive and will almost certainly continue, because every central bank wants a soft currency while slow GDP growth and deflationary pressures persist. As gold enters a more fashionable stage of its investment cycle, there are many more people able to purchase it, not least citizens of China, who are now allowed to own gold. The probable launch of a gold exchange traded fund (ETF) in the US and UK later this year (one already trades in Australia) can only lift gold's investment profile by making it much more accessible to the public.

**The price of crude oil is still a drag on the global economy** - Many commentators, myself included, thought the price of crude oil would be closer to \$20 (NYME) several months following the war to free Iraq, rather than hovering near \$30. So why were we wrong, despite a plunge to nearly \$22 shortly after the war commenced? One factor is continued supply disruptions, due to strikes and related inefficiencies in Venezuela and Nigeria. However the bigger miscalculation concerned Iraq. Crude prices fell initially because US-led forces were very successful in protecting Iraq's oil installations during the war. However they had not calculated for the scale of looting that followed and proved ineffective in containing it. This has made it much more difficult to boost production, which languishes near 600,000 barrels a day, compared to approximately 2 million prior to the war. Additionally, remnants of the forces loyal to Saddam Hussein have carried out sabotage against pipelines, which are hard to defend. Meanwhile, unlike 1991, Saudi Arabia has less reason to feel grateful for the US's defeat

of a belligerent neighbour's government. Consequently it has not acted in its sometimes role as a swing producer. Demand has been increasing against this background, not least from China. Despite gradually rising consumption of oil, supply remains the key variable. Today's prices will stimulate renewed efforts to increase production worldwide, by an industry that had curtailed oil exploration and development of fields, in the belief that prices would be \$10 lower a few months following the war. Needless to say, today's petroleum prices give Iraq, with the help of the US, Nigeria and Venezuela every incentive to boost production, although it may take a while. Therefore a price of crude oil in the low to possibly mid-\$30s region should represent the top of the cycle. This view is supported by the chart, which appears to be in an extended phase of top formation development.

## The Global Economy

■ **Sunny days for the US economy should continue into next year but storm clouds cannot be kept at bay indefinitely.**

■ **Some respite for Euroland is likely, but this region will continue to underperform the global economy.**

■ **Asia still has the best growth prospects.**

**Aggressive reflation by the Fed and US Treasury has won the initial battle against deflation, but at a price.**

First the good news - the US economy is growing near the higher range of estimates. Naysayers abound, of course, and I share many of their long-term concerns. However Fullermoney's global economy section is only relevant if it can help to identify behavioural economic trends, which will affect sentiment and influence markets. So here is a brief summary of events over the last 3.5 years. After the NASDAQ bubble burst in March 2000, sentiment deteriorated in line with falling share prices, dishonest research from analyst salesmen, corporate scandals, shock and preoccupation with global terrorism following 9/11, declining economic growth, deflationary concerns and uncertainty during the countdown to war against Saddam Hussein's regime. Despite a massive monetary stimulus by the Fed and increasing fiscal spending, economists feared a liquidity trap - the economic problem famously described by Keynes as "pushing on a piece of string". The war was always likely to provide an inflection point, and as stock markets continue their Baghdad bounce, sentiment has improved. This has fed through to the economy, evidenced by stronger than generally expected GDP growth for the US. One does not require a doctorate in economics to understand that a combination of record monetary and fiscal stimulus, the removal of a major preoccupation and uncertainty (the war), a softer dollar, significant tax cuts, and a cheerleading campaign by Fed Chairman Alan Greenspan and Treasury Secretary John Snow will boost the economy.

**The most visible negative consequence of this medium-term victory against deflationary pressures is a ballooning government deficit.** And since June we

have seen a dramatic upward spike in long-term interest rates following the bursting of a government bond market bubble, inflated by Fed credit creation and jawboning by Greenspan, Bernanke and colleagues. Greenspan's new dilemma is that the US cannot simultaneously have massive and expanding deficits, a world-leading and sustainable economic recovery among developed countries, and low long-term interest rates. Higher long-term rates will threaten any economic recovery as increased borrowing costs deter corporate spending and personal consumption. Moreover, in the current economic cycle the US economy is particularly vulnerable to the effects of high long-term interest rates, because the Fed's credit creation and increased government spending largely deferred the post NASDAQ bubble corrective recession. Consequently debt levels for the government, corporations and consumers remain unusually high - much too high for a sustainable economic expansion if long-term interest rates are also rising. The Fed has been playing for time, hoping that the economy would muddle through sufficiently to avoid a Japanese-style liquidity trap, and that growth would be sufficient to reduce debt levels. It might still work, but it could just as easily make matters worse over the long term, by inflating asset bubbles and increasing debt, particularly among consumers. Meanwhile, the Fed's immediate problem is the government bond market rout. If long-dated Treasury prices do not steady in a technical rally of their own accord, and soon, the Fed may decide that it has no choice but to intervene and support the market. If so, this would be another problem deferred. Whichever way all this plays out, one die is cast - the Fed is erring decisively on the side of inflation. This is not a problem for today, and perhaps not for some time. Nevertheless the seeds for another inflationary cycle have been sown through credit creation (the electronic equivalent of printing money), and how!

**Poor Germany, saddled with a weak and Socialist government, locked in the euro at an uncompetitive rate, enduring a mostly stagnant economy over the last decade, with little influence on the ECB and fiscal policy penned in by the so-called Stability Pact.** GDP

data for 2Q confirmed that Germany's economy slipped into its second recession in as many years and short of an unlikely and dramatic rebound in the second half of 2003, Germany will complete its worst 3-year economic performance since at least 1950. No wonder so many Germans feel despondent. As Germany goes, so goes the rest of Euroland, given the region's interdependence. The 12-state region's 7.89 trillion economy remains stagnant, with Italy and The Netherlands also in recession. This won't do, and it will be a catalyst for change, albeit slowly, because Euroland is increasingly run by an unelected inner circle of self-serving bureaucrats. First to go is the Stability Pact, supposedly limiting budget deficits to 3 percent of GDP, because it is already dead in practice, if not by decree. The welfare state will be pared back a bit, particularly the absurdly generous payments to able bodied people who choose not to work. Similarly, early retirement benefits will be made less generous, albeit after tough battles with unions. This will help, somewhat, and core Euroland

will remain a civilised place to live, but second division in economic terms because the system is very unlikely to encourage a work ethic to rival the US, let alone Asia. Moreover, the 12 countries that comprise Euroland today are likely to be outworked by up and coming new members from Eastern Europe. Meanwhile, Euroland should experience a growth blip over the next 12 months, because short-term interest rates are lower, the euro has fallen back from its May-June highs and the global economy is improving. Stock markets point to a somewhat better economic performance, although there may be little evidence of this in 3Q, due to the extremely high temperatures recently and a big drop in tourism, not least because previously popular regions of France saw many of their cultural events cancelled by strikes. Switzerland is also in recession, partly because of its close economic links to Euroland. Superficially, the UK economy looks good by comparison, with low unemployment and marginally better growth than Euroland. The unproductive reality is that this is due mainly to Chancellor Gordon Brown's high-tax, high-borrowing, public sector spending and hiring surge.

### **Asia's potential is enormous. I'm not just talking about China, which captures most of the headlines.**

While China is obviously enormously important, the main difference between it and Asia's other newly industrialised countries, current and previous, is size. Size matters because when China jumps into the pool, everyone else in the vicinity is soaked. In other respects, China's rapid metamorphosis from poverty to economic success story follows a familiar and proven blueprint for the region - an autocratic government prioritises GDP growth and organises the workforce; it provides incentives for managers and local entrepreneurs; it entices foreign investment, technology and expertise; it clones other's products to jumpstart its own industries; it keeps the currency artificially low, and it remains mercantilist. While this blueprint is not unique to Asia, it works particularly well in the region, where the work ethic is strong, education prized and aside from the political cadre, class is mainly an issue of wealth. Inevitably, the process includes a business cycle, in common with all other economies. However this may have more of a boom-to-bust-to-boom appearance, because rapid growth produces its excesses. For this observer, "its déjà vu all over again". Led by Japan, Asia was the big growth story in the 1970s and 1980s. When Japan went off the rails, due to its property and stock market bubbles, Asia's so-called little tiger economies continued to thrive until their financial crisis in 1997. Wall Street's inflating tech and telecoms bubble overshadowed Asia's convalescence. Today, Asia's world-leading growth, currently spearheaded by China, is once

again a very significant global trend, considerably more important than in the 1970s and 1980s. Thirty years ago, all of Asia was either developing or underdeveloped. In the 1980s, only Japan was a developed economy and world economic power. Today, Asia has a number of developed economies - Japan, Singapore, South Korea, Taiwan and Hong Kong. Malaysia is rapidly joining this group. More importantly, the developed regions of mainland China are considerably bigger than all the little tigers combined.

**While nothing is certain in life, Greater Asia has three potential economic superpowers - Japan, China and India.** Each faces formidable and different obstacles. While Japan's political and economic mismanagement spans nearly a generation, this is short term in the greater scheme of events and eminently solvable. Moreover, Japan appears to be emerging from its difficulties, and it still has vast wealth, world-class companies and state-of-the-art technology. Japan's biggest problem by far is demographics. Land scarcity is a less important issue in this era of globalisation. Even if Japan is destined to never again be the relative economic power that it was in 1989, it should remain a formidable and comparatively stable economic force. China is the most obvious candidate for economic superpower status. Paradoxically however, China's greatest assets - people and landmass - are also its greatest liabilities. China is an empire, perhaps the last of this dated system, if we exclude voluntary attempts to form empires, such as Euroland. There is no reason to assume that China's empire will survive in perpetuity, where all others have failed, however unlikely China's partial fragmentation may seem today. Xinjiang province in Northwest China was invaded and annexed approximately 50 years ago, having previously been an independent sovereign state called East Terkestan. The region's Kazakhs, Uygurs and Turkic people are mostly Muslim and will always want independence from China. Similarly, Tibet was invaded and annexed in 1949-1951, and Tibetans will always want to be free of China's rule. While these regions could, in theory, regain independence from China with the assistance of global pressure, as did Mongolia with Russia's help in 1921, the PRC is currently more interested in consolidating its empire, including the annexation of Taiwan. These issues will remain sources of tension and potential conflict. Additionally, leading 1.3 billion from a primitive Maoist society to a modern economy is a daunting challenge. While a succession of authoritarian governments have managed China skilfully so far, the greater challenges lie ahead and will include social problems, from wealth disparity to the universal human desire for democratisation. Although most other Asian countries continue to manage this latter transformation

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successfully, China's huge population will not make the progression any easier. And China does need democratisation to become a fully developed country. It is not by chance that no totalitarian regime has achieved this status. India shares China's mixed blessings of landmass and enormous population. Among major problems, it has an extremely tense relationship with neighbouring Pakistan, not least over the disputed region of Kashmir. There is also religious intolerance and fanaticism within India, particularly between Muslim and Hindu extremists. However India has already made the transition to democracy, albeit beset with corruption - a problem that has contributed to India's inefficiencies relative to China and most other countries of Greater Asia. Consequently some observers, including people of Indian descent, believe the country has too much democracy. This is both mistaken and unduly pessimistic. India's increasingly educated population can and most certainly will considerably reduce the problem of endemic corruption, once it becomes more involved in the political process. Meanwhile, India is far less dependent on manufacturing - now the most competitive portion of the global economy by far, than other developing countries. Its rapidly growing prowess in financial services and particularly software development have transformed India's economic prospects, and this country could be an economic superpower within 30 to 50 years.

#### **Asia's so-called little tiger economies continue to recover, grow in number and some are thriving.**

Briefly, Asia's developed regions are progressing in the difficult transition from casualty to beneficiary of China's rapid growth in manufacturing. Hong Kong is probably in the most difficult position, as it is no longer the gateway to China. Developing Asia is the main beneficiary of China's economic prowess, as suppliers of commodities, and a few countries also have booming tourist industries. Thailand heads this list, not least because of its commercially savvy government, led by Prime Minister Thaksin Shinawatra. He has a Masters Degree in Public Administration & Criminal Justice from Eastern Kentucky University and a Doctorate Degree in Criminal Justice from Sam Houston State University. A successful businessman, he is the founder and

former Chairman of Shin Corporation Public Company Ltd - a holding company that invests in diversified telecommunication, media and advertising businesses. Thaksin Shinawatra was Thailand's Minister of Foreign Affairs 1994-1995, Deputy Prime Minister 1995-1996, and following the Asian Crisis of 1997, he was swept to power in the 2001 election. Under his administration Thailand's GDP growth has progressed from 1.7% in 2001, to 5.3% in 2002 and an annualised 6.7% for 1Q 2003. Barring political instability and religious extremism, Indonesia (too big to be called a little tiger) and The Philippines have considerable growth potential among developing Asian countries. Vietnam appears to be next in the queue.

## **And Finally...**

**The Chart Seminar: Nov 6th and 7th 2003** - Yes, there will be a public venue for TCS this year, held in London. Please note these dates, if you or any of your colleagues and friends are interested. We will email and post the new brochure and enrolment form shortly. The early booking rate expires on 1st October and numbers will be limited to 50 delegates - no exceptions. For further information, email [tcs@stockcube.com](mailto:tcs@stockcube.com) or call Mark Glowrey on +44 (0)20 7349 2127. Colleague Tim Parker will share the teaching with me, and introduce some new material. TCS cognoscenti - the new broolly is sensational. Haven't attended before but potentially interested? Read the delegate testimonials on [www.fullermoney.com](http://www.fullermoney.com).

**Annual cycle trip** - Please note - I will be away from the office from 22nd August until 15th September, so there will be no FMP updates or Audio before the second half of September, and allow me a couple of days to catch up. In my absence, colleagues Tim Parker and Mark Glowrey will be posting comments, articles and research on the Fullermoney website.

**"Habit rules the unreflecting herd."**

William Wordsworth

Best regards - David Fuller

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