

Stock markets - is the rally over or will the July lows hold and support a further recovery?

Short-term technical evidence is mixed but marginally favours the bulls. The script in FM218 (17/07/02) called for a medium-term rebound in response to climactic selling, which equalled and exceeded in some respects, what occurred a year ago. FM219 (23/08/02) and subsequent comments in these pages and on my website, concluded that US and European indices had probably seen their lows for the year, although not the final post super-cycle bull market reversion to and beneath the historic mean for valuations. My expectation was for a further, albeit initially slower recovery, relative to what we saw in 4Q 2001. The easy portion of these forecasts was for a technical rebound. Trend acceleration is unsustainable beyond the short term and therefore always an ending, followed by at least a temporary reaction. The key day reversals on 24th July were very dynamic signals, supporting the medium-term recovery hypothesis. However short-term uptrends were broken in late August and early September. Consequently the recovery, such as it is, has clearly been slower than what occurred in 4Q 2001. This is not surprising because there have been no further interest rate cuts, unlike last year, confidence is lower following the additional bear market, corporate scandals and deflationary pressures. Moreover, markets are increasingly focussing on prospects for a US-led removal of Saddam Hussein's regime, probably before yearend. A war premium reflected by the price of oil is another problem for a weak global economy, already experiencing deflationary pressures.

Against this background, my medium-term optimism can only be more problematical. However I still back the upside, because of the short to medium-term reversal signals, but will watch three levels on index charts which would provide bearish warnings. These are the early-September lows, the early-August lows and the late-July lows. For the S&P 500 Index, these are near 870, 830 and

775, respectively. The recovery hypothesis would be increasingly compromised by successive breaches of these levels. However if the lows hold, regime change in Iraq should spark a good rally. Meanwhile, I'm impressed by the basing characteristics of stocks like Nokia and Vodafone, and I opened a long trading position in NASDAQ futures yesterday.

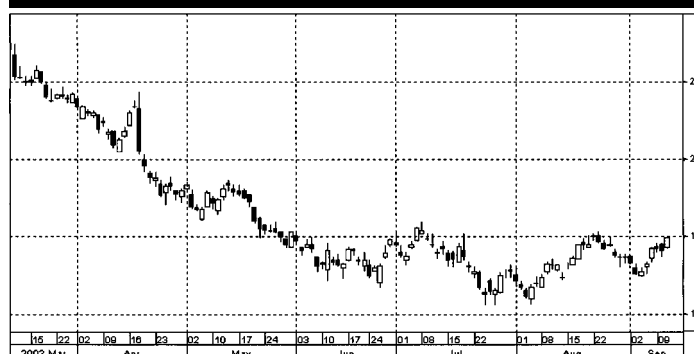
Best regards - David Fuller

Charts by Bloomberg

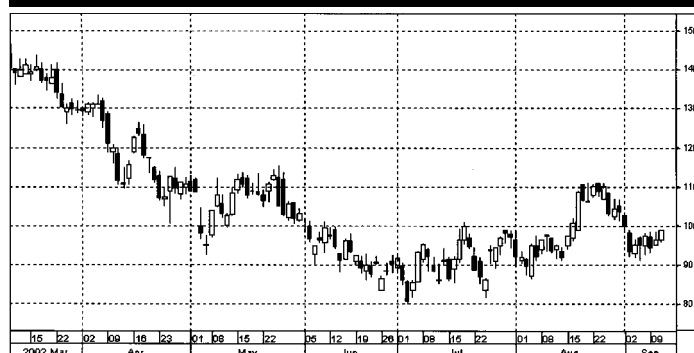
Standard & Poors 500 Index: 909 (Daily)



Nokia: £14.87 (Daily)



Vodafone: 98.5p (Daily)



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