

**Annual Issue Price £250**

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**“THE WORLD NEEDS MORE SHOPPERS!”**

**Sunday Times 18<sup>th</sup> August 02**

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**Regular readers are aware how we at Barmac enjoy the absurd mutterings of the 3<sup>rd</sup> estate from time to time, but the latest offering by the Sunday Times was met with great hilarity and much guffawing.** The article suggests that the world's current malaise is caused by a lack of consumer demand in Europe and Japan and that if the good citizens of these two huge economies could be persuaded to start spending on credit (just as the heroic yanks have and to a lesser extent us Brits) then the global economy would regain its poise and resume the bull market! The author (a Mr Geoffrey Dicks) highlights the benefits of the multiplier effect and castigates the high savings rates in Japan and Europe, but fails to question the cause and effect of run away consumerism in the Anglo-Saxon economies compared with a deflationary Japan and a stagnant Europe.

Here at Barmac we suspect that the high savings rates experienced in downtrodden Japan will be coming to an economy near you soon. As Joe public realises that his job is not safe, his bonus is questionable, his state pension is uncertain, his private pension is evaporating, his equities have almost halved and that he is leveraged upto the eyeballs with credit cards/car loans/mortgage debt he will start to save an increasing proportion of his income. He will thus be mirroring the actions of his Japanese predecessors of 10 years ago and will consequently help usher in deflation.

The threat of deflation cannot be over exaggerated. This is because we have witnessed interest rates plummet over the last eighteen months and money

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supply grow dramatically without the slightest hint of a reflationary effect. We are thus left pondering the scale of the underlying deflationary forces at play in the Anglo-Saxon world.

Therefore, the possibility of consumers coming to the rescue in Japan or Europe is highly unlikely as these two export dominated economies cannot create enough consumer demand without a strong rebound in confidence that only a US recovery could create. Catch 22!

## **IS THE LOW IN YET?**

No matter whom we talk to or whom we listen to this appears to be the one abiding question posed by all investors. Our answer is that no one will know for several months to come but our gut feeling is that certainly for Europe and North America it probably is not.

Regular readers are familiar with many of the arguments that we believe are pertinent to this question (end of 18yr bull market, stock bubble, still overpriced markets, reversion to mean, negative wealth effect as all that cash goes to money heaven as stocks dive, low savings ratio that can only increase etc.etc.etc.) but we would like this month to analyse why we suspect the bottom is a long way off due to the market psychology of investors.

On July 25<sup>th</sup> after the 489-point rally on the Dow and a move of over 300 points low to high on the Ftse many commentators postulated the bear's demise. This is a sure contra sign that the low is not in. We believe that when the true low is in it will not make the papers and no one will notice.

At present although it has been widely reported that many investors "threw in the towel" during August the "crowd" is still overwhelmingly invested.

In the UK net redemptions of unit trusts although seemingly huge, represent less than a 2% withdrawal. In the US according to a Sindlinger & Co survey of US households, 57% are in the market. Unbelievably, this is still above the first quarter 2000 level! Sindlinger explained, "People have lost too much not to hold on" so what we may be witnessing is the old "rabbit in the headlights" syndrome. This 57% involvement in the stockmarket is in itself a major multi-year sell signal. In the US prior to the 1990's the extreme

high was 35%. As the bear grinds on this figure should revert to the mean also and head back to the 25% figure witnessed in the 80's.

The general psychology has remained far too complacent at the lows with a CNBC poll on the 24/7 (the absolute low) asking investors what they were going to do? "Hang on" came the reply from 83% of them. This strongly suggests to us that the bear has hardly begun, as it cannot finish its work until investor sentiment has led to the crowd finally disinvesting and vowing never to buy equities ever again. The low at that point will not be trumpeted by newspapers or analysts because by then markets will have ceased to be of any interest to the public. The bear market low will be like a whimper in the night as it was in the early 80's when PE ratios have worked their way back from the current stratospheric levels. Even now the PE on the S&P is well over 30x, which is a level more normally associated with market tops not bottoms. The long-term average is half this level so we can perhaps look to markets halving again assuming just a return to the mean.

Such a dramatic fall is possible but we suspect that this bear will not have a dramatic end. No, we feel it will wear all investors down over a much longer period of years as the market slowly works its way back to the long-term average (or lower) valuation. This process will be punctuated by major rallies as we have seen on Tokyo over the past decade but will inevitably work prices, valuations and market participation down.

Interestingly, many analysts have suggested that investors should expect more modest returns in the future of perhaps 7%. They know not what they say! Consider this, if the long term return on equity is to be 7% then that implies a PE yield of 14 ( $100/7=14$ ), and as most market real PE's are much higher it implies fresh falls or relative long term underperformance to return to the average.

## **HOW IS THE US (and consequently the UK's) RECOVERY SHAPING UP?**

The self-delusionists and the stock/unit trust sellers have promised us all that Alan Greenspan's rate cuts would lead to a dramatic rebound in the US and global economy and that 2002 would be a year of recovery.

Well as we observe the numbers as they come through, that recovery seems to be moving further and further into the future and may well take the form of a double dip (at best). As we have stated many times before, this is not a typical cyclical business recession caused by high interest rates to choke off demand and as such any recovery (if we get one at all) will not follow the standard post war format.

*Remember Japan is our template and it has endured a decade of depressed demand and deflation that as yet may not have unwound the excesses of its 1980's bubble economy.*

The US Commerce Department handed out its initial estimate for the second quarter's GDP on August 2<sup>nd</sup>. The numbers didn't look too hot. Second-quarter GDP grew at a sluggish 1.1%pa, down significantly from the first quarter's revised 5.0% growth rate. Added to that on August 28<sup>th</sup> figures showed consumer demand and confidence falling in the US a fact mirrored in the UK (so who will come to the economies rescue now?).

Some of the numbers inside the GDP report were even more disconcerting. The executive summary is as follows:

- Businesses aren't investing
- Consumers aren't consuming
- Government (UK & US) spending is on the rise

It all sounds terrific.

According to the report, US business investment fell for the seventh straight quarter. Meanwhile, with the pace of consumer spending slowing to a crawl - About the only folks who are spending money these days are bureaucrats...and that's not usually a good thing! Federal government spending soared during the quarter at a 7.4% annual rate whilst in the UK we are all familiar with the "iron chancellors" "prudent" spending plans which will see Govt spending rise to approx. 42% of GDP from 36% in the mid 90's. This massive increase is unlikely to be met solely by taxation alone despite the huge hikes due in April (NI etc.), due to a failure of economic growth to meet the underlying 2.75%pa base growth assumption. So UK Govt plc will likely as not start borrowing money to

fund its laughable spending plans (but who is laughing? Only us at Barmac at the ludicrous fun of it all, because Her Majesties loyal opposition seem incapable of even a school boy economic critique of current spending plans).

In other disquieting news from the windy city...the Chicago index of area business activity fell to 51.5 in July on a seasonally adjusted basis from 58.2 in June, while the new orders index tumbled a similar amount.

Thus we would appear to have shrinkage of consumer spending, profits, business activity and stockmarkets all of which beg the question recovery what recovery?

An interesting anecdote to the above notes relates to Unilevers results, which were deemed to be a positive. If we are to believe Unilever, business is booming. The company raised its full-year earnings forecasts, saying its top brands had proved resilient to the global economic turmoil. - Apparently, consumers are cutting back on everything but Dove soap, Lipton tea and Hellman's mayonnaise. The shares jumped 5.3% on the news. But before we pop the champagne corks, we should point out that Unilever's market-pleasing result cost about 28,000 jobs globally.- The company proudly boasted that its restructuring programme, called "Path to Growth," has "succeeded" in firing 28,600 workers out of a planned 33,000 and has closed 75 factories, with 60 still to go.

- Is this really growth? It looks a lot more like shrinkage. Closing factories and firing workers might be exactly the right thing for Unilever to do at this exact moment. But over the long haul, neither companies nor economies can grow by shrinking. Growing companies and growing economies tend to hire workers, not fire them. It is probably not a good omen that one of the best profit performances of the quarter is the result of a company shrinking itself.

The following notes are reprinted from an article by Robert Prechter of Elliott Wave International and we believe offers a sobering insight into the nature of stock and economic cycles.

## **A MYTH EXPOSED**

**By Robert Prechter.**

*How many times over the past decade have you heard glowing reports about the "New Economy"? Hundreds, maybe thousands of times, right? It's been everywhere. While the number of references to the "New Economy" in US and global publications hasn't reached anywhere near its year 2000 zenith of 4247, the mainstream continues to grasp for the illusion. In 2001, mainstream publications mentioned the vaunted "New Economy" 2408 times. Even in early 2002, following high-profile scandals on Wall Street, the term "New Economy" was still garnering an enormous amount of interest. In the first 3 months of this year, the press tossed around the term at nearly a 1000-times annual rate. Economists continue to celebrate the broadening "service economy" and proclaim that economic growth in the new Information Age has been "unprecedented" in its vibrancy, resilience and scope. Rhetoric is cheap. Evidence is something else.*

*You may well be aware that we have not had anything near a New Economy, and that all that talk is bogus. But what you may not know - and what you are about to discover - is that the economic expansion of recent decades in the world's leading economic power, the United States, much less the rest of the world, is even far less impressive than most investors have been led to believe. In fact, economic expansion during the late great "boom" period, which lasted from 1974 to 2000, was demonstrably weaker than that during the previous boom, which lasted from 1942 to 1966. Both periods sported a persistent bull market in stocks that lasted about a quarter century, so in that sense, they are quite similar. But one noticeable difference is that the DJIA gained only 971% during the previous expansion, but a remarkable 1930% during the most recent one - twice the amount.*

*This tremendous bull market in stocks is the great "boom" that people have felt in their bones. Yet as you are about to see, the economic vigour and financial health of the boom period from 1974 to 2000 - the one that has received so much radiant press - failed to measure up to those of the 1942 to 1966 by every meaningful comparison. Please take*

*a look at these comparative measures of "Economic Health":*

*Gross Domestic Product (GDP)*

- *From 1942 to 1966, the average annual real GDP growth rate was 4.5%.*
- *From 1975 through 1999, it was only 3.2%.*

*Industrial Production*

- *The average annual gain in industrial production from 1942 to 1966 was 5.3%.*
- *From 1975 through 1999 it was only 3.4%.*

*Combining GDP and industrial production figures, we may generalize from the reported data that the economic power of the most recent boom period was one-third less than that of the previous. But that's only the beginning. To grasp the full measure of the underlying weakness in these "fundamentals," one must look beyond economic figures to the social balance sheets that underlie the results. Here are three examples:*

*1). Consumer Debt*

*At the end of 1966, consumer debt was 64% of (US) annual disposable personal income. That is considerable, but compare that to the end of 1999, where consumer debt was 97% of disposable income.*

*2). US Federal Budget Deficit*

*From 1942 to 1966, federal budget deficits were not sustained. The only consecutive years of deficits were in the war years of 1942-1946. The average annual federal deficit was less than \$9 billion. In the current era, the annual federal deficit averaged \$127 billion, which is far greater, even when adjusted for inflation.*

*3). Personal Savings Rate*

*During the boom of the '50s and '60s, the personal savings rate followed a fairly flat trend, bottoming at 6.5% of disposable personal income in February 1969.*

*It's no secret what has become of savings in our time. The personal savings rate dropped persistently, falling to a record low of 0.5% in March 2000. Despite media hype to the contrary and a widespread desire among gullible investors, it has not been a "New Economy" at all but rather a comparatively lacklustre one.*

*Collectively, these statistics reveal that the economic advance in the United States has been slowing on a major-trend basis, a trend that is still*

manifest today. More than just a single or double-dip recession, the persistent deceleration in the U.S. economy from 2000-2002 portends a major reversal from economic expansion to economic contraction. But we need not rely on hypothesis or statistics alone. The 20th century provides two great precursors to the current situation. The phrase in vogue in the 1920s was that the economy had entered a "New Era." Economists of the day, as President Hoover ruefully recalled in his memoirs, gushed over the wonderful economy, just as they are doing today. Were the Roaring Twenties truly a New Era, or was such talk a spate of hype spurred by the good feelings associated with a soaring stock market?

According to data from Professor Mark Siegler of Williams College (MA), from 1872 through 1880, the annual inflation-adjusted Gross National Product of the United States rose from \$98 billion to \$172 billion, a 68% gain. >From 1898 to 1906, real GNP rose from \$228.8 billion to \$403.7 billion, a 56% gain.

In contrast, from 1921 through 1929, during the Roaring Twenties, GNP in the supposed "New Era" rose from \$554.8 billion to \$822.2 billion, only a 48% gain.

This latter performance was particularly poor given that the stock market enjoyed a greater percentage rise from 1921 to 1929 than it had done in any equivalent time in U.S. history.

Similarly to today, the economy of that time failed to keep pace with the advance in stock prices and under-performed the prior expansion. The aftermath was the Great Depression. And if you are over 20 years old, you surely remember the "Japanese Miracle" of the 1980s. The country's corporate managers lectured and wrote books on how they did it, and the world's CEOs flocked to emulate their style. The Japanese Nikkei stock average soared, and foreign investors poured into the "sure thing." Was the Japanese economy truly miraculous, or once again, were economists ignoring economic statistics and simply expressing the good feelings associated with its stampeding stock market?

Japan's growth from 1955 through 1973 was extremely powerful, averaging 9.4% per year. But its economic growth from 1975 through 1989 averaged only 4.0% per year. This relatively poor

economic performance coincided with a record-breaking stock market boom. Just as in the U.S. in the 1920s, the economy in Japan's celebrated years failed to keep pace with the advance in its Nikkei stock index and under-performed the prior expansion. This double dichotomy signalled an approaching reversal of multi-decade importance in both stock prices and the economy.

Since the top of its own boom, the Nikkei stock index has plunged 70%, the economy has had three recessions in a dozen years, and the banking system has become deeply stressed.

The "New Era" of the 1920s ended in a bust. The "Japanese Miracle" of the 1980s ended in a bust. What do you suppose will happen to today's "New Economy"? More to the point, are the recent rallies in the stock market the sign of a bottom and imminent recovery? You can decide for yourself. But I suspect that when historians return to this time they will discover the slow but persistent regression in both U.S. and worldwide growth over the decades in the latter half of the twentieth century and wonder why so few recognized it as a signal of the coming change.

### **Productivity Without Profits**

Considering that the sharp decline in profit margins effectively started in 1997 at the height of the high-tech boom, it has to be assumed that this precipitated the economy's slowdown, rather than the other way around. It was the looming profit malaise that ushered in last year's investment bust and recession, even though consumer spending remained unusually strong.

While the overall profits slump is ominous and shocking, even more frightening is the extreme divergence in their performance between sectors. Certainly the greatest irony of all is that the worst profit numbers by far have been coming from the one sector for which Wall Street was trumpeting unprecedented miracles of profit and productivity growth: the new high tech. That these poor profits were even heavily inflated by gains in the stock market is meanwhile common knowledge.

The subsequent plunge in the Nasdaq has seen all the gains and profits since 1995 wiped out. As we have said before this was the heart and soul of the

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late 90's bull market and the removal of those gains and the mammoth loss of wealth has and will have inevitable consequences on both the US and European economies.

This profits implosion in the high-tech sector has to be judged against the backdrop of literally exploding output. In a speech to the Washington Economic Policy Conference of the National Association for Business Economics (March 27, 2001), Mr. Greenspan boasted of the overwhelming role of the new technology in U.S. industrial production:

*"In total, high-tech goods - semi-conductors, computers, and LAN equipment - currently represent less than 8 percent of total manufacturing output. However, their production, as we measure it, rose at an average annual rate of 50 percent in the second half of the 1990s, and taken together, they contributed two-thirds of the increase in manufacturing output between 1995 and 2000."*

To all appearances, Mr. Greenspan regards the preponderance of business investment in information as a great boon for the economy. To us, it suggests grossly excessive investment into improved information at the expense of investment in production equipment.

What the miserable profit numbers really say is that the new information technology grossly lacks profitability.

### **New Tech as Profits Destroyer**

Yet the high-tech sector clearly played an outstanding role in creating incomes and wealth in recent years in the United States. But the crucial point to realise is that this occurred completely through valuation gains in the stock market, not through income and profit creation from current output.

**During the final run of the late bull market, the tech-heavy NASDAQ came to account for over a third of U.S. market capitalization - yet tech profits never surpassed 1% of total profits. As a result, this rapidly-created paper wealth vanished just as quickly once the speculative bubble burst.**

Ironically, Corporate America's merger and acquisition mania has played a key role in driving stock prices to stratospheric levels, as companies typically pay vastly in excess of actual market prices. The conventional argument for this strange

practice was that the big premiums regularly paid and capitalized in balance sheets represented our old friend "goodwill," reflecting big future gains in operating efficiency.

As with so many other triumphant boasts about America's new entrepreneurial efficiency, this high-riding claim, too, is proving complete nonsense. Writing off huge amounts of goodwill in their books, now running altogether into hundreds of billions of dollars, has become the emblem of America's new entrepreneurial culture.

What's more, the profits debacle implicitly makes shambles of the trumpeted productivity miracle. Normally, high productivity growth and high profit growth go together. America's flagrantly opposite experience in this respect has been the great exception. Most ludicrously, the high-tech sector stands out with the biggest productivity gains and the worst profit performance.

In conclusion what appeared to be an economic miracle was simply a mirage created by tech companies and Govt agencies counting increases in computing power and barter sales agreements as tangible productivity and income growth. We are now all too well aware of some of the strange accounting practises of tech companies where hardware sales would be paid for by the producer via soft loans to the purchaser. Equally squalid and shortsighted was the practise of advertising on each other web sites and although no cash changed hands booking the notional revenue as actual advertising sales.

We must therefore be aware that the unravelling of the tech orgy and its consequences for the global economy will take many years.

### **PROPERTY**

**Last month we promised to highlight how to hedge domestic house prices against the forthcoming bear market. Due to lack of space we will include this article next month.**

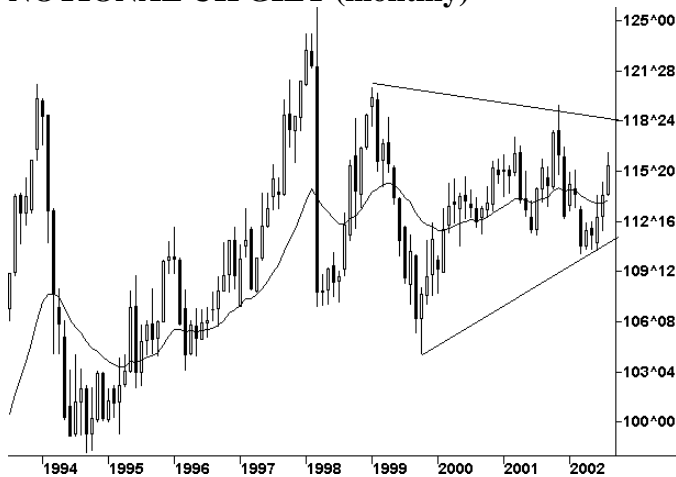
**However, as a cautionary word we suggest that no-one commits themselves to further domestic property investment (especially buy to let) at present as this market is a definite bubble market. "Buyer beware."**

## INTEREST RATES AND BONDS.

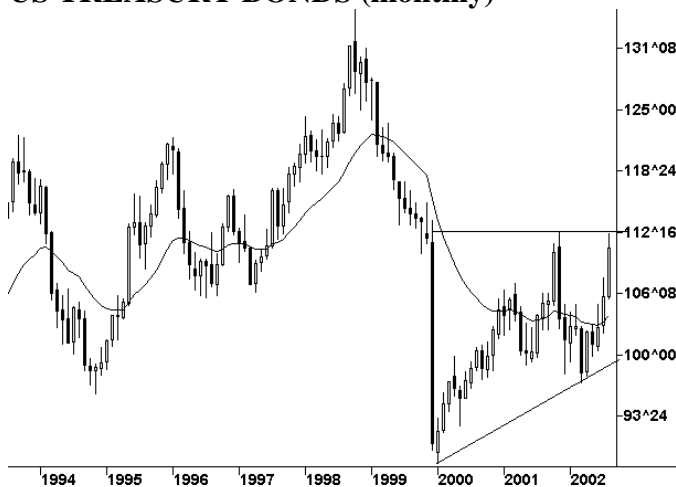
1. **Govt bond rallies are hitting resistance and are overbought.**
2. **Central Banks will cut rates when stock falls resume.**

The recent bond market rallies appear to be running out of steam and heading into logical resistance levels. Both the UK gilt and US Treasury bond futures are headed back toward long-term resistance at 118 and 112 respectively. We would anticipate a period of correction as the markets back off these key chart levels. The rallies in Government bonds may well resume after a month or two of consolidation but we would favour a switch from longer dated stocks to shorter durations as interest rates come under yet further pressure.

### NOTIONAL UK GILT (monthly)



### US TREASURY BONDS (monthly)



**The US Central Bank will almost certainly cut rates yet further if and when markets fall to new lows.** This is evident from the various comments coming from Greenspan. However, we suspect such short-term cuts will be in vain. After all the dramatic cuts witnessed over the last twenty months have had no discernable effect as yet.

Such rate cuts in the US will be quickly followed in Europe and the UK where there is still more scope for cuts. We suspect however such cheap money will do nothing for either the stockmarket or the economy. Indeed we do not think it will save **WHAT WILL BE** an ailing housing market IN 2003 either.

## GLOBAL EQUITY MARKETS

- **Equities have rallied from July lows but will soon retest those lows at least as the rebound trend loses momentum.**
- **Perhaps now is a new selling opportunity.**
- **Between 1929 and 1932 the Dow declined over 85%.**
- **The Nikkei looks set to hit new lows.**

**The rallies we have seen on both the US and UK markets have lacked conviction and appears to be rolling over already.** The views expressed earlier relating to the return to the mean concept and the currently historically expensive markets need not be repeated here but the bear market analysis leads us in no doubt that all shocks and surprises will be on the downside.

If we firstly examine the charts of the Dow and the S&P (below) we can see the current nature of the technical breakdown.

### DOW JONES



The chart for the Dow above shows the short-term nature of the rebound. It can be clearly seen that the retracement rally has broken its uptrend and fallen below the key 8800/9000 level. A temporary rally back to 8800 may occur upto the anniversary of 9/11 as we suspect the US authorities will try to avert an unpatriotic decline upon that anniversary. Thereafter however, we believe the Dow could be headed for new lows in an impulsive selling wave. The long-term picture on the S&P below illustrates the position for most key markets perfectly.

### S&P COMPOSITE 500



The above chart illustrates perfectly the now famous “head and shoulders” top formed over the past 4 years on this index. The key support level of 950 was breached during the summer declines and we have only witnessed in August the market returning to “kiss goodbye” the key support before falling back at least to recent lows. We suspect that before the year is over new lows will have been established and we are currently witnessing a golden selling opportunity.

### The FTSE 100



The Ftse chart above is remarkably similar to the Dow and S&P with the same prognosis. Those

foolishly optimistic people who state that the UK is not in the same boat as the US only need look at the three above charts in order to realise that the UK is inexorably tied to that of the US. The only real variance between the two markets is one of degree with the Dow trading on a higher PE rating. This will be no protection for UK investors.

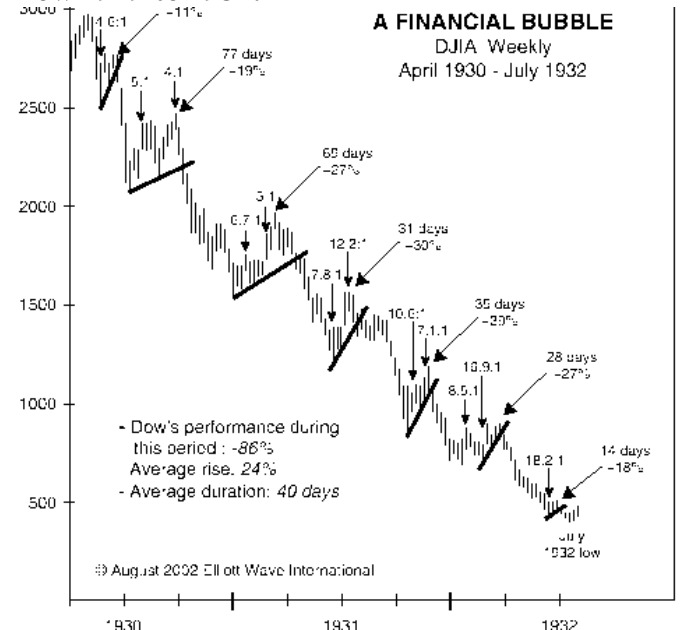
### DAX XTRA (weekly)



The Dax above confirms all the above bearish comment with the August rally looking miniscule and insignificant. This and most other European bourses look ready to roll over yet again.

**THERE CAN BE NO DOUBT. –NOW IS THE TIME TO SELL EQUITIES NOT TO BUY.**

### Dow 1929 to 1932.



The chart above illustrates the pattern of large falls followed by reaction rallies of upto 33%. The recent rally of the Dow has followed this pattern exactly

with a 23% retracement. We believe new lows are inevitable and the market will follow a similar pattern of failed rallies and new lows over the next few years.

### NIKKEI (weekly)



For nearly twelve months the key Japanese index has ranged between 9400 and 12,000 creating a clear trading range with a gently rising floor. This pattern looks like a huge bear flag with the floor at 9500 coming under pressure. ***This floor looks likely to break imminently and we would short the index on any move below 9300 with a stop of 9750.***

Assuming a new break below 9300 we would expect the market to trade at least to 8500 and perhaps even further. The Japanese market cannot hope to recover until the Yen has declined to a competitive level and the world economy picks up to allow their world-class exporters to grow. Sadly that scenario looks a long way off.

### CURRENCIES

- **A quiet month on all crosses as the Dollar steadies before further falls.**
- **Euro consolidates recent gains but will shortly resume its appreciation.**
- **Sterling to gain against the Dollar and Yen but fall vs Euro.**

**Since the fireworks of early summer the Euro has consolidated its gains whilst the Dollar has had a contra-trend rally.** We do not expect the current calm to last beyond the early autumn before market trends re-assert themselves.

If we first look at the Dollar index we can clearly see the break away fall from the triple top at 120 with the dramatic falls stemmed by a temporary bear rally. This rally may persist for a month or so with the index perhaps trading back up to 110 but

the respite is likely to be temporary. The primary bull trend has clearly been smashed and may act as resistance and cap any rally. The Dollar is likely to decline against all major currencies apart from the Yen as Greenspan's massive bubble is slowly deflated. The world supply of dollars is so vast that the decline could well last for many years as Central Banks rebalance their foreign reserves.

### DOLLAR INDEX (monthly)



**The dollar Euro cross has witnessed a short period of gentle consolidation since hitting 1.02 in July.** This currently looks like a standard flag and would look likely to support an advance as long as 95.00 is not broken. We would expect the uptrend to resume shortly with the Euro becoming the strongest of the reserve currencies. This new move would be confirmed on a break of 102.00 and traders should take advantage of what should be a powerful move.

### EURO vs DOLLAR (weekly)



**The Yen Dollar cross below** should provide a rare spot of dollar strength. We would expect that the dominant trend from the 95 yen high will cap dollar weakness and eventually lead to a reversal of the recent dollar falls. If the dollar is to strengthen the first clear cut trading clue will come if the yen 83.00 (120.50) level is breached which should herald a retest of the recent dollar high of 75.00(133.00). However, a break above 87.00 (114) may signal yet further yen strength and a complete collapse in dollar sentiment.

### YEN vs DOLLAR (inverse monthly)



**The pound** has experienced a slight pause in its decline against the Euro but we expect Euro strength to resume shortly. The contra trend move of the past few weeks has hit resistance at 1.60 and that top will be confirmed with a break of the gentle uptrend at 1.56. If and when this level is breached Euro strength should carry the rate towards the 1.50 mark.

### STERLING/EURO



**The sterling dollar cross** has seen the pound consolidate recent explosive gains following the explosive break out from the huge two year base evident below the 1.48 level. These gains may take a few more weeks to digest but we would expect renewed sterling strength to be signalled on a move beyond 1.60. Conversely the consolidation may delay the onset of new highs for a month or two if the 1.51 level was to be breached. Traders should be ready to short the Dollar at 1.59 and trade sterling upto 1.65 at least.

### STERLING/US DOLLAR



**Sterling yen cross** perhaps provides the most clear-cut chart of all (only euro yen is perhaps more precise) with the pound finding powerful support at 180 (the 2001 trading range high). As the triangular range proceeds towards its apex we can perhaps anticipate a break out at 188 ( 120 yen/euro). If this level is breached we will probably witness a surge in the pound upto at least 200yen with only a slight pause at 192. The gain would be at least 1200 points and is a must nap trade.

### STERLING/YEN (weekly)



## KEY TRADING ACTION

1. **BUY POUND/SHORT YEN ON ANY MOVE OVER 188**
2. **BUY EURO/SHORT YEN ON ANY BREAK OVER 120**
3. **SHORT DOLLAR/BUY EURO ON ANY MOVE OVER 1.02**

## COMMODITIES

- **Oil price held high by Gulf tension**
- **Gold consolidates recent gains**
- **Wheat goes ballistic**
- **Coffee is almost there**
- **Cotton steadies before more strength?**

**Crude oil has been pushed to a new high for 2002 by tension in the gulf.** A decline below \$26 is required to offset a further test of the 2000-2001 top area. The global economic environment is not conducive to higher oil prices, which are impeding GDP growth. However, as we are all aware this is a rigged market as OPEC is maintaining production cuts. We suspect these cuts will not hold if tension eases. The west has been stockpiling as a hedge against shortages in the event of a war in Iraq. Consequently, there will be continued upward pressure on prices, which could explode if a war unfolds unfavourably. Over the longer term, oil near \$29 is unsustainable in the current economic environment and will eventually return to a more normal level once the war premium has evaporated.

### **NYMEX OIL (weekly)**



**Gold is still consolidating earlier gains.** We have seen a 10 percent reaction from the June High during this process to date, by no means an exceptional move. However both short-term activity and the considerably bigger pullback by gold shares suggests that this consolidation could persist for several more months. This process might just take gold a little lower for a brief period, but the large multi year base should cushion downside risk. Gold remains a value play relative to financial assets and it is also a hedge against deflation. However, it is inflation fears that really fuel bullion rallies and the opposite anxiety has been expressed recently. On a macro view, continued deflationary pressures can only result in more counter measures by central banks. Eventually, every central bank always has and always will, we suspect, eventually pull the monetary levers and print money, because they fear deflation even more than inflation.

They will fight the problem at hand - in this case deflation, to prevent it spiraling out of control. They will eventually encourage a little inflation, confident or at least hoping to prevent rising CPI and PPI problems from becoming a problem. The US Federal Reserve, wishing to stimulate the US economy to finance the war against terrorism, has been printing for some time. We suspect Japan will appoint an inflationist to replace BoJ Governor Hayami next March. There is every likelihood that the ECB's deflationist mandate will be reviewed as Euroland's economies generate little growth and unemployment rises. This should be very bullish for gold over the next decade.

### **GOLD (monthly)**



**Well we all like to crow from time to time but we think Wheat highlights the power of charts perfectly.** As regular readers will recall we mentioned wheat's sub \$3.00 trading range several times during 2001/2 and placed it on our "sleeper" watch list. All we needed to know was that if it broke above \$3.00 at any time it would have broken out of a multi year trading range that had acted like a straight jacket. We were confident that any move over \$3.00 would lead to a powerful move. Well like everyone else we love our best-laid plans to be fulfilled or even exceeded and wheat really could not have followed the script more diligently!

Since the break out in early July the price has run up 25% to over \$3.70 a bushel (whilst stockmarkets have crashed and burned). There has been no fancy analysis or technical wizardry worthy of Hogwarts here. Just watching a chart patiently until something out of the mundane occurs. Anyone can do it and as regular readers are aware other "sleepers" include coffee and Japanese Govt bonds.

In the short term the blast off by wheat may be slightly over-extended but although some retracement is likely this new bull market has a long way to go so buy on any weakness above \$3.20.

### WHEAT (weekly CBOT)



Cotton has been good value for all Barmac readers since being first recommended in our September issue on a potential rebound from an accelerating low below \$30.00. We have traded in and out several times to good effect. The current period of sideways consolidation looks capable of supporting new highs and traders could place buy orders at

\$47.50 on a move above the consolidation/flag down trend line as indicated on the chart.

### COTTON (weekly)



**Coffee (below)** may be about to awake from its multi-year bear market. We realise we have been banging on about the potential reversal of coffee prices for some months now but any reversal will be explosive and could easily quadruple prices over coming years. At present we have a potential floor between \$40 and \$60. The rising floor and current "pop" above \$52.50 suggest a run back to \$60 at least.

*We suggest that traders buy above \$53 with a stop at \$47. We think that we can scale in aggressively as the price confirms reversal action above \$60*

### COFFEE (weekly)



### COCOA

**Wow! Yet another winner.** We appear to be on a golden run at present and when we re-tipped cocoa in June at \$1600 we were delighted for it to have reached \$1800 by July's issue. We advised raising

the stop to \$1700 and would track that upto \$1850 now that it has reached \$2000. A gain in only two months of 20%.

#### **COCOA (weekly)**



#### **FINALLY**

We cannot finish this issue without a word about the anniversary of 9/11. We extend our heartfelt sympathy to all those readers who lost a friend or relative. The devastation caused by that attack not just on the twin towers but also on the world order will live with us all forever. We do not believe the worlds recession and stockmarket declines have been caused by the attack as markets were already in terminal decline long before the attack.

However, how the West responds via the “war on Terrorism” could eventually have ramifications on the world order and financial markets as far reaching as the assassination of Archduke Ferdinand in Sarajevo. That attack ended the 19<sup>th</sup> century and led ultimately to WW1 carnage, end of Austro-Hungarian empire, End of GB as the world superpower, the Russian revolution, Hitler and WW2, the final solution and the “cold war”.

We seldom know what we start and the West (Bush) needs to be sure of his ground and his facts before attacking Iraq. If it is a search for revenge or a diversion from an economic depression Bush had better be aware of how unforeseen consequences can flow from even the best laid plans. We make no moral defence of Saddam and would wish for his removal before he nukes someone but we are aware of the fatal lessons of history and chance.

As a reminder of the waste of war we reprint the famous poem Dulce et decorum.

*Gas! GAS! Quick boys!...  
If you could hear, at every jolt, the blood  
Come gargling from the forth-corrupted lungs,  
Obscene as cancer, bitter as cud  
Of vile, incurable sores on innocent tongues, -  
My friend you would not tell with such high zest  
To children ardent for some desperate glory,  
The old Lie: Dulce et decorum est Pro patria mori.*

#### **Wilfred Owen died Western front 1918**

Regards  
Andrew McCarthy  
Andrew Bartles.