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## **NO REBOUND IS POSSIBLE UNTIL THE WAR BEGINS BUT EVEN THEN THE TREND IS STILL DOWN.**

### **1.GLOBAL ECONOMY**

**Iraq to cap equities  
US equities still not cheap.  
Debt problem still growing.**

### **5. INTEREST RATES AND BONDS**

**Bonds do look vulnerable to extra supply.  
Bonds to go higher before war?  
More interest rate cuts to come?**

### **6.EQUITIES**

**Dow to test Oct low.  
European bourses to weaken further**

### **8.CURRENCIES;**

**Dollar remains weak but oversold.  
Euro is least ugly.  
Yen will eventually collapse**

### **10.COMMODITIES**

**Gold looks due a pull back  
Oil still just a war trade  
Cocoa hits new high  
Cotton may be running out of steam.  
Wheat falls back to long-term support.**

**Discretionary managed portfolio up 2%  
since launch on Dec 2<sup>nd</sup> whilst Ftse down 600  
points.**

**The global equity markets will not and cannot stage a significant rally until any conflict in Iraq either commences or is resolved by Saddam abdicating. The US will attack in the next month without any doubt and markets will continue to be spooked by this prospect until the shooting begins.**

Thus investors can save themselves a great deal of time and money by ignoring equity markets (apart from short sales) until all the uncertainty has been resolved. Markets will not rise over the next few weeks whether we like it or not. The real question to paraphrase "A Question of Sport" is what will happen next? Any postulation obviously depends upon the nature and the outcome of the Iraq war but we do not expect a repeat of the first Gulf war when markets took off on a powerful multi month advance. Certainly, a rally is likely given a clean and quick US triumph but as equities were in a bear market before the prospect of war or 9/11 for that matter, then any relief rally will not mark the beginning of a new bull market.

Thus, at present the best case scenario of a quick clean US triumph will provide at best only a bear rally of say 15 to 25%.

We are left to wonder what will happen if Saddam somehow entangles the allies in a messy war of house to house clearances (it would be suicide for Iraq to fight with tanks in open desert with ageing kit and poorly trained troops) all reported on CNN. Or, if they somehow managed to embroil Israel via a dirty bomb or biological attack we all know Israel would retaliate and that would destroy any Arab quiescence. The ramifications of such a complication would be catastrophic for global

equities. A new Viet-Nam has certainly not been discounted despite the recent falls and if Saddam did manage to involve Israel then oil could at least double from current levels to \$70 a barrel.

We are therefore not so confident that the arrival of war will end market nerves and our comments below highlight the many other reasons to remain deeply sceptical of ALL rallies.

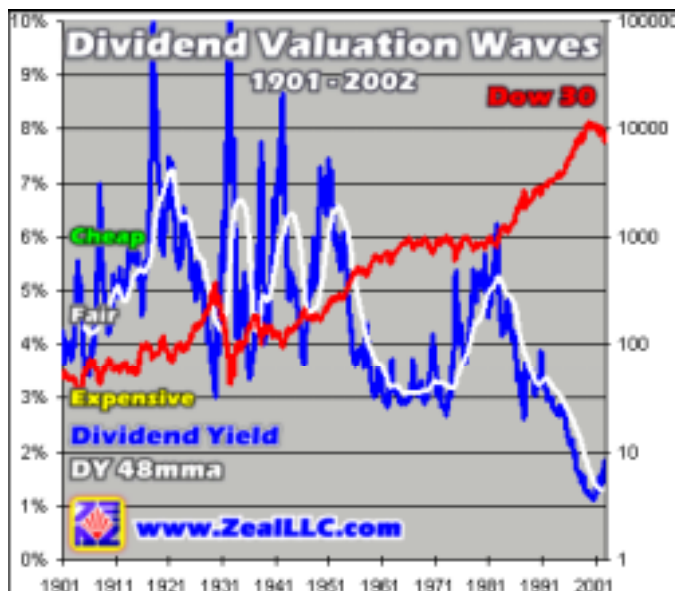
This war in our view will not therefore be a repeat of the '91 Gulf war for equities.

**We say *Caveat emptor!***

### ARE MARKETS CHEAP HISTORICALLY?

We suspect that they are not especially in the US and an analysis of the long term waves of undulating dividend yields provides a great perspective on what is or isn't cheap.

The Dividend Valuation Waves endlessly undulating across the vast seas of time have much more apparent effects on general stock-price levels from this graph's perspective. Note how each time the dividend yield 48mma rose towards the 6% cheap level, stocks rallied quite dramatically in the following years.



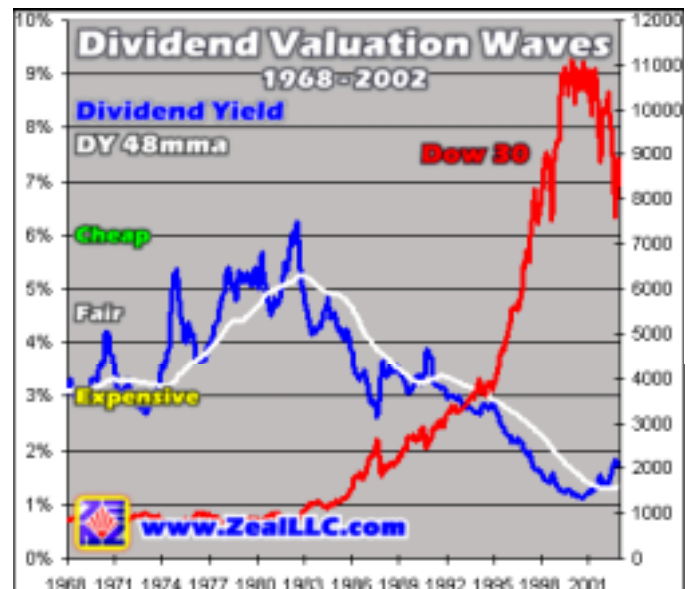
On the opposing troughs of the waves, when stocks became far too overvalued and dividend yields plunged towards the 3% expensive range, stocks generally fell in future years as secular bear markets stepped in to maul out the speculative excesses and

restore healthy fair-value balance to the financial-market world.

Dividend yields are a crucial strategic general valuation indicator and extremely important for long-term investors to monitor!

It is also quite provocative to note that the all-time dividend yield low happened as US equity markets peaked during the spectacular 2000 stock mega-mania bubble. General dividend yields were squeezed down to an excruciating 1% in the mania bidding frenzy for bubble stocks, a dismal level so incredibly low that it may not even have a past precedent in a major world market in all of history. We'll come back to this stunning observation a bit farther below.

**Now, a brief look at the Dividend Valuation Waves in our modern market era is in order.**



We found this graph particularly stunning and illuminating. It is really interesting that since 1968 we have witnessed almost one perfect dividend valuation wavelength. Stocks languished during the early years of this period when dividend yields were low and didn't begin soaring until after dividend yields had spiked up towards high levels signalling undervalued stock markets near the halfway point. Every long-term stock investor on Earth needs to digest and understand the implications of this graph!

In the late 1960s everyone was bullish and stock valuations were far too high. The bulls would pay dearly for their folly too, as they would have to wait

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17 agonizing years to earn any profits at all and they totally missed out on one of the greatest bull markets in modern history in gold. The markets exact a heavy and often lethal price from those who foolishly try to play the game with no regard for carefully buying low and selling high!

While perma-bulls blissfully frolicked unaware of the imminent danger they were in during the late 1960s, dividend yields were too low signalling expensive stock levels. A prudent long-term contrarian equity investor could have recognized this signal and sold out of stocks to avoid the coming nearly multi-decade bear market. Dividend yields alone would have provided contrarians with all the correct guidance they needed to sell high in the midst of a frenzy when the rest of the equity world was blinded by vast greed.

Fast forward to the early 1980s. Stocks had traded sideways for 17 painful years and magazine covers widely declared that stocks were dead. The sexy thing to invest in was gold, commodities, real estate, and other tangibles because of their recent spectacular bull markets. Yet, the gold bull was already over and stocks were quietly laying the foundations for their greatest rally in history.

A prudent contrarian who understood Dividend Valuation Waves could have bought stocks in the early 1980s on high dividend yields that signalled unsustainable undervaluation in general equities. He or she would have then been long for most of the enormous 1980s and 1990s bull market. Dividend yields do matter and provide fantastic long-term buy signals when they get too high.

Around 1995 dividend yields were once again plunging to the expensive level, and they signalled that the bull market in US equities that ran for 13 years was probably nearing its end. Amazingly, probably due to Alan Greenspan's unprecedented monetary inflation that spawned the greatest equity speculative mania in history, the stock markets rocketed even higher as the monetary floodgates burst open and crushed dividend yields to all-time lows by the end of the millennium. The future price the markets will pay for this unsustainable anomaly will be dreadful.

General US equity dividend yields around 1% are flabbergasting. They are just dismal and so trivial that it makes owning stocks for dividends all but useless today because the cash dividend streams are so meagre. What does it all mean?

There are a couple of ways to interpret this stunning anomaly.

The Wall Street perma-bulls would simply argue that dividends don't matter anymore and that low dividend yields are meaningless in this brave new era of endless bull markets they are desperately hoping for. Interestingly, these are the exact same folks who swindled investors in 1999 and 2000 by telling them that earnings and valuations didn't matter then either. We all now know what a Big Lie that was! Wall Street also falsely claimed at the times that the late 1920s and mid-1960s were "New Eras" as well. They never learn.

The contrarians, on the other hand, would argue that market history repeats itself and valuations do matter. If Dividend Valuation Waves have always undulated through market history, then they will probably keep on meandering into the future. Periods of high stock valuations signalled by low dividends will be followed by nasty secular bear markets that eventually lead to low stock valuations signalled by high dividend yields.

Low dividend yields, especially the record-low levels seen above, strongly signal the time to sell general US equities, not to buy!

By proposing that Congress end the double taxation of dividends, President Bush has done Wall Street, and other stock markets by proxy, a favour. If ratified by the Senate, this legislative change can only lead to increased payouts in future.

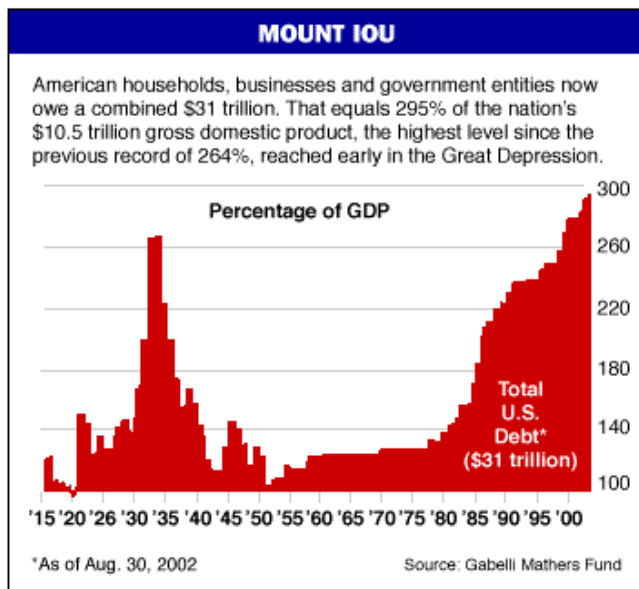
**With leaders like this...**

- Note this comment on Euroland's economy from ECB President Wim Duisenberg last month:  
*"The risks to the downside have somewhat increased, but mainly due to the lack of the disappearance of uncertainty".*

Yes, that is really what he said. Forecasters take note: when bullish predictions go wrong, it's "mainly due to the lack of the disappearance of uncertainty"

## US TOTAL DEBTS CONTINUES TO MOUNT.

BUBBLES HAVE LONG BEEN part of the financial firmament. The "tulipmania" in 17th-century Holland and the notorious South Sea Company stock bubble a century later in England are lowlights of economic lore. History is replete with numerous other examples of financial manias followed almost ineluctably by huge price busts, down to our own era. Japan is still paying the price of deflation and economic narcolepsy a decade after bubbles in its stock and real estate markets popped. Debt collapses in Asia and South America punctuated much of the 'Nineties. The bursting of the U.S. tech-stock bubble in early 2000 led to the vanishing of more than \$5 trillion in wealth, at least on paper. Now, many worry that a U.S. housing bubble, lofted by four-decade lows in mortgage rates, could explode, consumer spending and economic growth.



Curiously, however, one reads almost nothing about what may be the biggest bubble of them all -- the huge ballooning of total debt in the U.S. That measure, an aggregate of the borrowings of all

households, businesses and governments (federal, state and local), zoomed up from about \$4 trillion at the beginning of 1980 to \$31 trillion as of 2002's third quarter, according to the latest available Federal Reserve flow-of-funds data.

While some observers see no cause for alarm in these figures, others fear that this debt surge could be edging the U.S. economy toward the abyss of a bust - - and then into a depression.

Reality check:

Credit-market debt now equals 295% of gross domestic product, compared with 160% in 1980 and less than 150% during much of the 1960s. More ominously, debt as a percentage of GDP exceeds the previous record reading of 264% from early in the Great Depression -- when the aftermath of the Roaring 'Twenties borrowing binge collided with a sharp economic contraction. And today's debt load is clearly starting to pinch consumers and businesses: Credit-card charge-offs of bad loans exceed 7% of total debt outstanding, compared with the previous peak around 5%, reached in the mid-1990s, according to Standard & Poor's.

U.S. personal bankruptcy filings in last year's third quarter jumped some 12% from the level a year earlier. And when 2002's total is in, it will almost certainly eclipse 2001's record 1.43 million.

Meanwhile, mortgage delinquencies are soaring, particularly among less creditworthy borrowers. In the "sub-prime" market, delinquencies have jumped to 8.07% from just 4.50% in 1999, according to Loan Performance, a San Francisco tracking firm. This market, which caters to people with chequered credit histories, accounts for about 10% of the \$5.8 trillion of U.S. mortgage debt currently outstanding. Delinquencies on Federal Housing Administration loans, which make up about 15% of the dollar amount of U.S. mortgage debt, are at a 30-year high of 11.8%. The typical FHA borrower is a first-time homebuyer with limited funds.

Despite the big home-price jump seen in many regions, soaring mortgage debt and drooping stock prices have severely crimped the net worth of U.S.

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households. According to the latest Fed numbers, net worth at the end of the third quarter had fallen to just 4.9 times disposable income, about 22% below the 6.3 at the end of 1999.

During recession, interest rates can be lowered to stimulate the economy by making it cheaper for businesses to invest and consumers to buy big-ticket items. Lower interest rates also boost asset prices, by raising the capitalized value of future income streams.

Depressions have a different dynamic. They tend to come after years of debt build-up, when monetary easing no longer works because interest rates are already near zero. Thus, no further debt-service relief is available for overburdened businesses, consumers or governmental units -- especially if deflation causes their incomes to fall. Even if rates hit an irreducible zero, the real burden of debt rises during deflation. Borrowers still have to repay their debts in current dollars while their revenues and collateral fall in value.

In a frenzy to raise cash, debt holders sell assets and cut spending. As a result, the value of the collateral underlying existing debt suffers. Deflationary forces are only exacerbated by businesses cutting prices to stimulate demand in a vain attempt to burnish cash flows. In addition, as unemployment rises, consumer demand falls.

Oft-bearish Morgan Stanley economist Stephen Roach also views the U.S. debt load as a serious problem. *"There's no question that we have a debt bomb, but I'm not sure how long the fuse will turn out to be,"* he says. *"It won't detonate if the economy remains strong enough to continue to generate enough real consumer-income growth and corporate cash flow to support the debt. Otherwise, we'll experience the darkest scenario of debt deflation, as a result of the worst set of policy mistakes committed by the Fed since the Great Depression."*

One of the first economists to delineate the perils of debt bubbles was Yale's Irving Fisher, who wrote the seminal academic article on the subject in 1933, near the depth of the Great Depression.

In his 1933 article, Fisher asserted that gross "over-indebtedness" lay behind America's three biggest economic calamities to that time -- the Panics of 1837 and 1873 and the Crash of 1929. In each, the debt explosions were sparked by technological developments that transformed the economic landscape (canals in 1837, railroads in 1873, autos and radio in 1929), the advent of new industries, the exciting prospects of new lands or markets (e.g., the Homestead Act's opening of the West in the 1870s), or some combination of these factors. The new developments fired investors' imaginations, Fisher contended, encouraging overconfidence -- and greed. Fraudulent claims entice people, too, although there's generally "a very real basis for the 'New Era' psychology before it runs away with its victims," Fisher acidly commented. Sound familiar?

Of course, there's no inevitability to depressions. Fisher maintained that if Washington had taken immediate steps to reflate the economy -- to stimulate it by monetary means -- after the 1929 Crash, the corrosive debt deflation that ensued might have been avoided. Instead, the Fed raised rates for a time, choking the supply of money and credit in an attempt to balance the budget. Protectionist trade measures compounded the policy bungles.

At what level does debt turn lethal? No one knows for sure. Some contend that today's debt level of \$31 trillion, or 295% of current GDP of \$10.5 trillion, is somewhat artificial. About \$10 trillion of the debt consists of the borrowings of financial players -- banks, savings institutions, finance companies, issuers of asset-backed securities and government-sponsored enterprises such as Fannie Mae and Freddie Mac. These entities mostly use their borrowings to fund corporate loans, mortgages, auto loans and credit-card balances. So, in a sense, about a third of today's aggregate debt total is being double-counted. That wasn't true in the early 'Thirties, when the ratio of U.S. debt-to-GDP hit its previous high of 264%, because the financial sector was far less developed at the time.

If the U.S. debt bomb ever explodes, the detonator probably will be the residential mortgage market. Home loans account for \$5.8 trillion, or nearly 70%, of the U.S.'s \$8.2 billion in household debt.

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Academic studies show that changes in home prices have nearly double the impact on consumer spending than does the "wealth effect" from rising or falling stock prices. After all, stock ownership is more concentrated in higher-income groups, and nearly 70% of U.S. households own a home.

And home prices have been on a tear, rising nearly 50% over the past six years (UK prices have doubled over the same period), bolstered by falling interest rates and looser credit standards. Consumers have tapped this surging equity value through wave after wave of cash-out mortgage refinancings, (see last months Barmac which dealt with UK cash financing that has accounted for 6% of consumer demand) transforming homes into ATMs. Refinancings have totalled \$2.5 trillion over the past two years. In addition, Americans' home-equity loans stand at around \$800 billion.

At the same time, Americans' equity in their homes, net of debt, has dwindled to 57%, compared with 85% a half-century ago, even with the recent powerful surge in home prices. Economist Gary Shilling calculates that 39% of U.S. homes are owned free and clear -- and that the remaining homeowners have debt burdens exceeding 80% of the value of their homes. In other words, many Americans have little margin of safety should home prices level off or should they fall as much as 20%, as they did in many overheated areas in the late 'Eighties. A possible dangerous scenario that faces the UK home owner in at least equal measure.

**In the following essay by our favourite Austrian economist Dr Richebacher**, he highlights the fallacy in relying upon the US consumer and productivity growth to create recovery. He argues that growth can only be achieved as a result of capital formation via savings. These savings are then made available for capital investment that can lead to sustainable economic growth.

**PANACEA DU JOUR**  
**by Kurt Richebächer**

*It used to be elementary knowledge among economists that rising investment in tangible assets - factories, offices, machinery and other forms of*

*equipment - is paramount for economic growth and general prosperity.*

*First, it generates demand; employment, incomes and tangible wealth while the factories and the equipment are built and produced. Once the capital goods are installed, they increase supply, employment, incomes and productivity. The key point to see is that investment is the one and only GDP component that adds both to demand and supply.*

*But mainstream American economic thought seems to overlook this reality. It places, first of all, an unusual emphasis on consumption as the prime mover of economic growth, and there is furthermore a general disregard of what is happening to saving and capital accumulation. Alternatively, the emphasis is on autonomous changes in productivity growth through new technologies as the root cause of economic growth and profitability. This is a radical departure from the thinking of the old economists. Measured by the rate of productivity growth, the U.S. economy appears to be in excellent shape, definitely better than the whole rest of the world. But measured by its record-low rates of saving and capital accumulation, it is in most miserable shape. What is the right interpretation?*

*For America's policymakers and economists, productivity growth seems to be that great magic that solves all problems and that will sustain an economic recovery. It appears to be a widespread view that the measured stellar productivity growth is the main warrant of a mild recession and of an impending recovery.*

*The crucial point to see about productivity growth is that, by itself, it only means that hours worked have risen less than real GDP. But there is nil economic merit in this effect unless it is accompanied by an improvement in some other kind of the economy's performance such as growth of output, profits or investment.*

*In the case of the United States, in actual fact, everything else is deteriorating. That is probably the main reason for the general, singular focus on productivity growth.*

*Looking at the whole post-war period, the United States actually experienced its most vigorous and*

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definitely its most healthy economic performance in the 1960s. Its rates of national saving and of capital investment were then at their highest in the whole post-war period, and so were its rates of business profits. The main purpose of moderate borrowing on the part of the consumer at the time was the financing of new homes, and the main purpose on the part of businesses was the financing of new investment in plant and equipment, that is, in tangible assets. In essence, it was overwhelmingly borrowing for capital formation.

This pattern of borrowing began to change gradually in the 1970s and rather dramatically in the 1980s. From then on, debt growth went exponential. Consumer debts have since skyrocketed by 473% and business debts by 382%. These numbers compare with simultaneous GDP growth by 283%.

A drastic change in the use of the new debts was the other striking new feature of the developing borrowing binge. Exploding credit quantity implied plunging credit quality. Consumers started to borrow like crazy to finance increased current spending, and businesses borrowed like crazy no longer to invest in plant and equipment, but to finance financial transactions - mainly leveraged stock buyouts, mergers, acquisitions and stock repurchases - that were thought to be more appropriate for quickly raising shareholder value.

Ever since firms and retailers invented consumer instalment credit in the 1920s, U.S. economic growth has become heavily geared to consumer spending and borrowing. But this traditional consumption bias took a big leap in the 1980s and in particular in the late 1990s. The most striking characteristic of both periods were exploding consumer debts and collapsing national saving.

In the 1980s, in actual fact, the haemorrhage of national saving had caused great and widespread concern. Many American economists expressed their strong misgivings about the implicit negative effects on capital investment. This time, in diametric contrast, nobody seems to care or even take notice.

There seems to prevail a widely accepted view that credit creation makes old-fashioned saving from current income superfluous. As to the equal utter lack of interest in capital formation, the apparent explanation is a singular focus on productivity growth. Why are saving and investing even necessary, if the U.S. economy is enjoying stellar productivity growth without them? What's wrong with this view?

In short, everything.

It's macroeconomic nonsense. Productivity growth is not the panacea for which American policymakers and most economists seem to take it. If there is insufficient demand, as today, increasing productivity can only result in increasing numbers of unemployed workers, declining capacity utilization and, ultimately, slower growth. What really induced generations of economists of all schools of thought to elevate saving to an indispensable, key condition for economic growth?

The basic reason is that it is the limiting factor for capital investment. Short of nirvana, all resources are scarce. Due to this elementary wisdom, new capital investment can only come about to the extent that somebody makes the resources for the production of the capital goods available. That somebody happens to be mainly the consumer. By saving, that is, by spending less than he earns, he effectively releases the necessary productive resources for investment.

But this necessary release of productive resources is true only for saving from current income, coming implicitly from current production. The attendant release of resources is what makes this kind of saving indispensable for investment and economic growth. In essence, capital formation represents the surplus of production over consumption, and that has to be made possible by saving. To quote Friedrich Hayek on the subject: "Saving is not synonymous with the formation of capital, but merely the most important cause which normally leads to this result."

A lot of energy has been devoted to whether there will be a double-dip into recession. This is the wrong question. What really matters, instead, is whether capital spending will rebound after its steepest decline in the whole post-war period. This is also a question that can be answered with reasonable

foundation from the available data. If yes, the U.S. economy has a chance for a sustained recovery. If not, it will be Japanese-style near-stagnation and sub-par growth for years to come. We think the prevailing conditions speak overwhelmingly for the latter.

## INTEREST RATES AND BONDS

- **European rates to fall further**
- **Bonds to set new highs on deflation and flight to quality**
- **Supply of Govt bonds set to explode in next few years.**

The ECB is still behind the curve and will have to cut by at least another 50 basis points. Despite its deflationist mandate, the ECB is under increasing pressure to cut rates. Having been too optimistic on GDP growth, and with the euro strong, there is now little reason not to lower Euroland's short-term rates by another 50 basis points from the present level of 2.75 percent. Moreover European rates will almost certainly move even closer to the current US level of 1.25 percent later this year, before they next rise. Norway has slashed 100 basis points from its rates in recent weeks, and a substantial additional decline from the current level of 6 percent is probable, in a further effort to weaken the currency. As a petrol currency with a short-term rate of 7 percent, the Norwegian krone had become a collector's item during the last two years. Only concern over the UK house price bubble is deterring the Bank of England's Monetary Policy Committee from cutting rates more aggressively as the economy weakens.

The key Government benchmark bonds are all challenging their recent highs as a "flight to quality" and fear of deflation combine to send yields lower. We suspect that bond prices will remain relatively strong until war actions become clear. The recent price action looks to support new highs but a setback is almost inevitable as soon as investors lose their fear of the unknown. Although, deflation will support strong bond prices investors need to watch carefully the ballooning budget deficits currently being built up in both the UK and the US.

This potential rocket fuelled increase in supply is certain to curtail the potential gains during the latter part of this year and into '04. Indeed, we suspect the growth in supply will create conditions of sub-par returns on Govt bonds.

If investors expect a significant economic recovery (we don't) then corporate bonds at present, offer far more profit potential.

### UK GILT 8% 2013



**UK Gilts both individually (above) and collectively (below) are challenging recent highs.** The cusp has been met and new highs will probably signal renewed strength that could carry prices back toward the 1998 highs. However, a failure at current levels could see prices back toward the spring low. Political events will govern price action in the short term with supply issues not likely to weigh on the market for a few months yet.

### UK GILT (LIFFE)



The US Treasury (below) looks set to break out of a triangular consolidation that should support a run to new highs in the next few weeks. We wonder if this

may prove to be one last hurrah for bond markets as deficit funding grows due to economic malaise.

### US TREASURY (comex)



### GLOBAL EQUITY MARKETS

- Until the war begins all rallies will inevitably roll over
- Dow to break October lows, as support is broken.
- Ftse to fall in sympathy
- Japan continues to drift.

Whilst the current uncertain political situation persists in the Gulf there is no chance of a sustained equity rally. Any equity strength will be ephemeral in nature and short lived. No investor either professional or private is likely to commit monies whilst an unresolved threat of war hangs over the markets. Thus investors and speculators alike should ignore the temptation to play any rallies this side of the commencement of hostilities. With war unlikely to begin until at least the end of Feb it would pay most investors to sit on their hands and simply observe market action or go short. The threat of war is not the only concern that may drag equities lower but a natural two-way market with countertrend rallies cannot exist under current uncertainty.

Bottom line:

All equity markets to fall to new lows before war begins. Then a relief rally is likely to ensue the strength of which will be determined by how relatively straight forward a US military victory is gained.

**The Dow and all other US indices** are likely to follow the lead from the UK and Europe and break the October lows before any substantive rally begins. The overwhelmingly bad news flow and massive debt burden will drag US equities down and the chart technical picture would suggest that this process has already begun.

The Dow below has broken key support at 8300 and appears to be pressuring the low of the current small consolidation. A move below 7850 will open the way for a fast move toward 7200 and beyond.

The Nasdaq appears to sport a very similar bearish pattern with a clean break through support at 1325 that now has become overhead resistance. The bearish hypothesis is only eased if the Dow and Nasdaq can move above 8300 and 1325 respectively.

### DOW JONES IND



### NASDAQ COMP.



**The Ftse 100** has already exceeded the October low reflecting widespread weakness across all the European bourses. The slight bounce witnessed over the past week or so looks suspiciously like a temporary rebound from oversold conditions and we

would expect the Ftse to renew the declines on renewed Wall St. weakness.

The Ftse would need to exceed 3780 (61.8 retracement level from recent low) to suggest a low of more than very short-term significance has been established.

### FTSE 100



**The Japanese market** continues to slowly ebb away. There have been no dramatic falls over the past month, as prices seem to have temporarily stabilized at current levels. However, upside potential remains limited unless the Nikkei can exceed the key 9250 level to establish a higher high and to challenge the bear trend in existence since early 2000.

### NIKKEI



### FOREX

- **Bernanke's dollar devaluation.**
- **Dollar is oversold and may be due a short covering rally.**
- **Yen is still the weakest link.**
- **Euro due a rest?**

**Using Bernanke's logic, since the Fed understandably fears deflation, has a weak economy and must help the government in funding an expensive war against terrorism, why not replicate Roosevelt's devaluation now and create a little "positive inflation"?**

It could boost GDP growth and lift the stock market, as occurred in 1934. Roosevelt was right to devalue the dollar against gold and there is a case for devaluation today, in the effort to avoid outright deflation and a possible depression. Without a gold standard no formal procedure is required. Bernanke's speech has effectively and rather cleverly set the trends in motion. And since it was delivered in a style appropriate for a professor of economics at a business school, no foreign government has accused the US of competitive devaluation. Incoming US Treasury Secretary John Snow can deflect any future criticism by paraphrasing Robert Rubin's mantra, "a strong dollar is in this nation's interests", without specifying when, while the Fed persists with credit creation.

**The Dollar has taken a battering against all major currencies over the past few months.** However, it is now very oversold and could be due a short covering rally. The trend against the pound remains intact whilst the pound trades above £1.60 but trend runners should tighten stops to this level.

### DOLLAR/POUND



**Against the Euro** the Dollar has been hammered by the in form Euro and the trend is now looking overextended. We suggest that traders should use a trailing stop of 4 cents with any correction unlikely to carry back beyond 1.04 before the Euro kicks off again.

## EURO/DOLLAR (weekly)



The Dollar Index has continued to decline and is overdue some sort of rally. The sentiment toward the dollar is unremittingly bearish which suggests that a rebound rally could happen. Watch for a move over 100.5 and a small counter trend rally may develop on a move back toward 104/5

## DOLLAR INDEX (weekly)



The Euro has continued gaining versus Sterling as long predicted in these pages. The move out of the huge multi-year triangle suggests that the current trend is only young and could well carry toward the 140 level. At present however, some resistance has been encountered at the "roundaphobia" 1.50 level which may provide some temporary delay before the Euro makes further gains versus the pound.

## EURO/POUND



Regular readers will be well aware that we are long-term bears of the Japanese unit. We eagerly await the appointment of the replacement of Hayami, which may well herald, a policy of active devaluation. In the meantime the Yen has been sliding against the Euro and to a lesser extent the pound. The move at present may be slightly overcooked but should continue strongly after a minor correction.

## YEN/POUND



The Dollar has not enjoyed quite the rally versus the Yen the other reserve currencies have. Indeed, over the past month it has gently weakened. Last weeks pop-up in strength may herald a turnaround as the Dollar is due a bout of relative strength versus all currencies. These two look likely to vie as to which is the weakest but as long as the dollar remains above 113 the bull case remains in place. In the immediate short term a move to 125 looks possible.

### YEN/DOLLAR (weekly inverse)



### COMMODITIES

- Gold is overbought and due a reversal.
- Oil keeps on building the war premium.
- Cocoa rallies on war also.
- Coffee is preparing for another step higher.

### GOLD (weekly)



Last month we warned rather prematurely that gold appeared overbought. Since then we have had confirmation of what we were looking for with gold spiking dramatically up on a key reversal day on Feb 6<sup>th</sup>. Additionally the weekly chart below highlights a dramatic reversal week and selling spike. The overwhelmingly bullish sentiment (always a good contrarian indicator) and chart evidence looks conclusive and we expect prices to

move back toward \$350 and below but support should be found at \$330 if the yellow metal were to fall that far.

Bottom line:

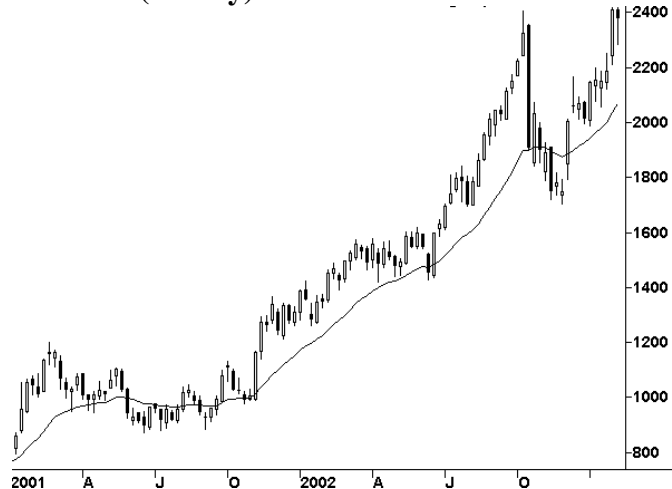
Gold looks a great short at present

**Oil prices have continued to strengthen as the threat of war has become ever more likely.** As much as \$15 a barrel may well be premium and a quick and clean war should see prices tumble. However, prices may well spike even higher as the shooting becomes ever more imminent. We do not think oil is tradable due to the high potential volatility together with sky-high option prices. We would stand aside and simply watch the show.

### OIL (Nymex weekly)



### COCOA (weekly)



**Cocoa is being squeezed higher at present due to its own war premium.** The situation in the Ivory

Coast has driven short term trading and has led to the contract to be almost constantly in backwardation. Our good friend Peter Rhodes has been on top of this commodity throughout the move and has called almost every turn via his commodity e-mail service. The latest price action has seen prices return to the 2400 highs and this key resistance needs to be overcome to confirm the ongoing bull case. This is a risky market at present as war markets always create uncertainty, volatility and quixotic behavior.

### COFFEE (weekly)



Coffee has continued to consolidate the gains made from the bear market low of Oct 2001. The aromatic bean is tracing out a triangular correction and if 70c a 1b is exceeded then a new leg up should begin. As regular readers will recall we believe that the new bull market in coffee is likely to see price gains that exceed 100c over the next year or so.

### COTTON (weekly)



Cotton has held on to recent gains but any move below the important \$50 level might signify a corrective phase.

### WHEAT (weekly)



Wheat has suffered a major reversal since breaking out from a multi year trading range below \$3.00. The pull back appears to have found support on the \$3.00 support level and prices ought to remain above if wheat is in a bull market. Traders can probably buy wheat on weakness with a stop of \$3.00 with a price target of over \$4.00.

### FINALLY

The Barmac discretionary service was launched at the end of November with the remit to be managed identically to the highly successful break-out portfolio, which is up over 45% since Oct 3<sup>rd</sup> 2000. Thus, we will be using active asset allocation and stop loss levels on all holdings. In the past two months since launch equity markets have declined globally by around 15%. Despite this our portfolio has seen gains of approx +2% using our usual low risk strategy. If readers or advisers are interested in utilizing our services for both pension schemes and investment portfolio's please telephone 0113 257 4506 or e-mail [a.mccarthy@bpr.co.uk](mailto:a.mccarthy@bpr.co.uk).

Regards

Andy McCarthy & Andrew Bartles