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JOINING THE EURO; THE TRIUMPH OF HOPE OVER EXPERIENCE!

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The "Iron Chancellors" famous five, -economic tests that is, are a hoot that should fool no one. The decision to join the Euro has nothing whatever to do with economics and everything to do with politics. The tests are extremely subjective and one person's pass would be another's fail. So the tests are not only fudge, but also a smokescreen as the Government attempts to convince the rightly sceptical British public that joining the euro is solely an economic question. The a priori assumption being if and when the tests are passed we would all be complete fools not to wish to join.

The political objective the Euro represents is the unstoppable creation of a centralised beaurocratic super state. After all every tin pot third world dictator knows the first rule of state creation, control of the levers of power and legitimacy is to print your own money.

Unfortunately any thoughts the British public may have to cry freedom are steamrollered at present by the huge and well financed (by the UK taxpayer) pro-EU lobby and Government spin machine.

Despite all this we still suspect that it would be prudent to recall the events of September 1992 that gave cause for the then chancellor Lord Lamont to sing in his bath. The pound was then pegged at DM 2.40 and that rate nearly crushed the UK economy. The current DM effective exchange rate is even higher at **DM2.75**. We have to ask incredulously in an ever-changing world who would give up their independence and flexibility to be at the "heart of Europe?"

We chuckle at the last phrase as those europhiles that would have us all emulating Lord Halifax in

1940 darkly mutter that the UK will face all sorts of barely concealed threats of retribution from a bullyboy Europe if we should dare to remain "semi-detached." This is the same EU that has only two net contributors with Germany being the second. No wonder most EU members think it is a great club they get free membership and handouts! Do turkeys vote for Christmas?

Most annoyingly to us is the fact that rich advanced countries like Holland, Sweden and especially France are net beneficiaries. How can this be so?

Great Britain needs to realise that the EU member states are only too aware that UK plc runs a huge trade deficit with the continent and is as such a key market for both industrial and agricultural products. Finally, the UK controls a vast majority of Europe's oil reserves and a large proportion of the EU's fishing grounds.

So we ask what retribution could the EU really exact upon a Britain that chose to be part of a EU trade zone (The Common Market) but not part of a political super state (to challenge the US? An oft-vocalised thought made by the perhaps subconsciously still imperialistic French and German politicians)?

There are only two net financial contributors to the European Union - Germany and the UK. Every other country (yes, even France) receives more money back than it puts in. The UK imports more EU goods than it exports to the region.

Despite these two factors, some people claim the UK will miss out if we don't join the euro. Worse still, they claim we will lose influence.

What influence? If a net financial contributor and net importer has little influence in the EU, why will it have more by surrendering self-rule and joining the euro?

If Germany feels hamstrung by the euro, why would it be any better for the UK? We could go in at a lower exchange rate, they say. Does anyone seriously believe that euro zone countries would allow the UK to join at a competitive rate?

For the sole gain of eliminating currency transactions by joining the euro the UK would surrender its status as an independent and self-governing democracy, to be ruled by an unelected,

unaccountable and therefore often corrupt group of bureaucrats in Brussels.

An EU that will likely as not replace "dim Wim" with the now officially innocent (by a French court) Trichet. The was the man who was innocently unable to spot the corrupt accounts of Credit Lyonnais. Obviously, a safe pair of hands will run the European Central Bank!

If Germany could hold a referendum on leaving the single currency, at least two-thirds of the population would vote to do so according to the recent German polls.

IF THE EURO IS SO GOOD WHY DOES EX-BUNDESBANK EXECUTIVE SAY BRITAIN WOULD BE FOOLISH TO JOIN?

We reprint a Sunday Telegraph interview with Wilhelm Nolling an insider in Europe who can perhaps provide a telling insight into the Euro debate. Wilhelm Nolling is a card-carrying member of Germany's economic establishment. For 10 years, until 1992, he was an influential director at the Bundesbank - the central bank that underpinned his country's post-war economic renaissance.

Before that, Nolling was a well-known politician, serving in both Houses of Parliament as a member of the centre-left SPD. Now 69 years old, and Professor of Economics at Hamburg University

"Germany is suffering its worst economic crisis in decades," he tells me in his oak-panelled office. "We are in bad shape and euro membership has played a major role in limiting our policy-making room for manoeuvre."

Across Germany, for all kinds of historic reasons, public criticism of the "European project" is politically taboo. Yet no domestic opinion poll has ever shown majority support for the euro. And no German referendum was held before monetary union was launched in 1999.

"The present euro zone structure is devastating for Germany," he says. "Our economy is bleeding. And I am convinced the UK would be crazy to join - you should stay out for as long as I can foresee."

What is undeniable to Nolling's fellow Germans is

their current economic predicament. The euro zone's largest economy is technically in recession, with 11 per cent unemployment. Germany is forecast not to grow at all this year and, with prices falling for the past two months, the spectre of deflation looms large.

"Deflation has already arrived, in that our economic dynamism has disappeared," Nolling says. "There is no willingness among the private sector to invest, and euro zone rules have cut back public investment to an extent we haven't seen since the war."

Nolling singles out the European Central Bank for particular criticism. "The ECB's interest rate cuts have been far too timid. The Bundesbank would have cut much faster and deeper, following the example of the US Federal Reserve."

Last week, of course, the ECB finally did cut rates - by 50 basis points to 2 per cent. With inflation of 1.9 per cent, the euro zone is flirting with negative real rates.

"The point is that it is simply not in Germany's economic interest to allow major parts of our policy to be implemented by bodies which are not responsible for Germany."

I probed him further on the UK's prospective euro membership - both of us conscious of Gordon Brown's impending assessment. "Why on earth would you want to join?" he asks. I trot out the Europhile line about losing influence in Europe if we don't.

"But what influence would you gain if you did?" he retorts. "Your policies would be restricted by euro zone rules. And if Germany can't get the interest rates it needs, why should the UK? You will end up being treated like Ireland or Greece - and a big country like yours deserves more."

But how about that other pro-euro argument - that not joining would undermine our crucial trading links with the Continent? "That's completely untrue," says Nolling.

"The UK is in good standing in the single market - the euro zone will always want to sell you goods and buy goods back. That applies whether you're in the euro or not."

Nolling points out that Europe's economic woes are not limited to Germany. Even the ECB admitted last week that during the first quarter of this year,

growth in the euro zone as a whole was zero. There is now a real possibility that Germany's recession could spread to other euro members.

"Just compare your country and the major euro zone economies and it's clear you're doing much better," Nolling says.

He says the UK still benefits from sterling's ignominious exit from the exchange rate mechanism, the progenitor of full monetary union. "The pound broke free in 1992. Since then you've been able to conduct your own policies and you should keep it that way."

So, will Germany ever leave monetary union? Even asking this is heresy, of course - or at least it was until two weeks ago, when the heavyweight French newspaper *Les Echos* wrote an editorial asking that question. "It's not realistic, for now, because we're so committed politically," Nolling says.

"But the whole system could eventually collapse, given the problems when one central bank has to steer an entire continent of nation states. Certainly, the more countries that join, the more ungovernable it will become," Nolling says. "In that sense, the euro was born to die."

Given Germany's economic problems, I ask, and if the euro is inherently unstable, how does Germany view a possible UK referendum on British membership?

"Many Germans privately feel that given the chance, they would have voted against, and we wouldn't be in this mess," he says. "**That's why we feel the UK is a very privileged country.**"

ENOUGH FOR NOW ABOUT THE EURO WHAT ABOUT THE GREENBACK?

The decline in the dollar so far, opined John Snow, has been "really fairly moderate." To many observers, this suggested that U.S. monetary officials expected more. Maybe they even wanted more. For weren't they now saying that a moderate decline in the U.S. dollar would be good for the economy? George Soros and other currency speculators hit the bid, selling dollars, and thus giving the U.S. Treasury Secretary what he seemed to be asking for.

Snow had spoken honestly at the G8 meeting in Europe. He gave his views of a strong dollar as one in which people had faith, not necessarily one in which they wanted to store their wealth. "The

problem is," explains Bill Fleckenstein, "you cannot get your currency to go down a little bit to where you want it, and then assume it will stop there. Once these things are put into motion, they always go longer than you think possible, and they always overshoot. I think we have an incredibly dangerous period in front of us, as our financial, economic, and balance sheet situation is far riskier than the last time we had a dollar crisis, which was in 1987." The economy was overheating then. Now it is stagnant or even contracting. The world is swimming in dollars. The US has run up monstrous amount of debt outstanding. The size of the US trade deficit, \$1.5 billion a day, is just gargantuan. Plus, there is trillions of dollars' worth of derivatives exposure. So, if you wanted to set the stage for a potential dramatic accident, it's been set. We are left to ponder at the economic folly of the last seven or eight years as the west has tried to speculate its way to ever-greater prosperity. So many people have been misled into thinking the policies were all good or manageable. How this all plays out is not yet knowable, but it's a given that we face financial and economic turmoil. When the US government, against a backdrop of precarious fundamentals, stands up and says, "Sell our currency," which is basically what Snow did, it's a recipe for disaster.

The fabled resource investor John Myers has a warning for all investors with his analysis of the future price of crude oil. His interesting essay reproduced below from the "Daily Reckoning" provides much information that is both thoughtful and new (at least to us at Barnac). Certainly, the implications of a prolonged period of strong oil prices would be significant on all stock markets.

AMERICA'S OIL CRUNCH

By John Myers

There is a new Middle East taking shape - one filled with Muslim extremism, teetering sheikdoms, and perhaps falling governments. It is a Middle East that could send oil prices soaring. The recent bombing in Saudi Arabia underscores just how shaky this region is - an area that holds two-thirds of the world's oil. And while America's occupation

of Iraq may have given Wall Street a temporary high, the hangover could be devastating. We anticipate a hangover that features stubbornly high oil and natural gas prices.

Many investors will recall that high-energy prices were a major part of the equation that made the 1970s one of the worst decades on record for stock investors. Well... the oil market of 2003 may not be so different from the oil market of 1973. One important difference, however, is that the United States relies far more heavily on foreign energy supplies today than it did 30 years ago...and that's not a good thing.

In his book, *Jihad vs. McWorld*, Benjamin R. Barber writes: "*The world still spins on the energy of fossil fuels - non-recyclable and irreplaceable. The United States represents an especially foreboding case study, for here is one of the world's richest countries using up its own resources in an orgy of consumption that's reflected neither in elevated living standards nor in proportionately larger GDP. Nor have we learned much from two major crises in supply and our ever more debilitating dependency on foreign oil...*"

The United States is a geological pincushion. More oil wells have been drilled in the continental United States than the rest of the world combined. Yet, U.S. oil production continues to decline with each year, resulting in less and less domestic production.

Consider the following facts:

- *The United States accounts for less than 4 percent of the world's oil production, but consumes more than 30 percent of world oil supplies.
- * Since 1970, U.S. crude oil production has declined by nearly 50 percent, falling from 11.3 million barrels per day (mb/d) to 6.1 mb/d. Over the past few years, U.S. production is declining at a rate of 4 percent per year.
- * Since 1970, U.S. oil reserves have fallen by more than 40 percent, or from 38 billion barrels to 22 billion barrels.
- * The average oil well in the continental United States pumps about 300 b/d. The average well in the Middle East produces 10,000 b/d.

- * Of the 530,000 operating oil wells in the U.S. in 2000, 78 percent were "stripper wells," each of which produced less than 10 barrels per day. These wells accounted for 0.3 billion barrels of production in 2000, or about 15 percent of total U.S. crude oil production.
- * The last elephant oil field (more than a billion barrels) discovered in the United States was in Prudhoe Bay, Alaska, which elevated U.S. crude production for nearly two decades. Now, as Prudhoe Bay empties out, domestic crude production is set for a steep decline.
- For the Lower 48 States, the apex in the oil discovery rate was hit in 1957. U.S. proven oil reserves peaked five years later in 1962. Another decade later, U.S. oil production peaked.

Since then, America has come to depend on ever-greater amounts of foreign oil. "Oil reserves have fallen so far to the point that annual U.S. oil consumption is now equivalent to about 1/4 of total proven reserves," writes the Hubbert Peak of Oil Production (<http://www.hubbertypeak.com/us/>). "This means that, if the U.S. had to supply its own oil, and no new discoveries occurred, its oil would be gone in four years! By importing 55 percent of its oil, the inevitable is being postponed. But for how long can this continue?"

Indefinitely, as long as the U.S. government can guarantee available and cheap oil supplies delivered from the Middle East. If it cannot, then the United States faces severe challenges for the future. America is heavily addicted to foreign crude oil. Of the 78 mb/d that the world consumes in petroleum, the United States siphons off almost 20 mb/d. Even though new technologies have reduced petroleum use on a per-capita basis for the United States, our SUV-loving population consumes ever-increasing amounts of oil. With America's largest oil pools in severe decline and little expectation that any significant oil fields remain to be discovered, the United States is quickly heading towards a future where it will import two-thirds of the petroleum it burns.

Oil dependency also means that the U.S. is vulnerable to supply interruptions from Mid East wars or striking oil workers. How high will the oil price go? That, too, depends largely on what happens in the Middle East. The signs are not promising. Saddam Hussein was a cruel leader, but for many years the United States tolerated him because, in a perverse way, he helped stabilize the region. And a stable Middle East is an oil-producing Middle East. With him gone, the United States must try to create stability in the region. This will probably prove to be an impossible task. After all, the American peacekeeping mission was driven out of Beirut. How can we hope to bring stability twenty years later to Iraq?

During the 1991 Gulf War, oil prices rose above \$40 a barrel. Adjusted for inflation (as measured by changes in the Consumer Price Index), \$40 in 1991 translates to about \$60 in 2003. Civil strife in the Arab world could propel oil prices above \$50 a barrel range. Large-scale civil strife in Saudi Arabia, could send the oil price rocketing as high as \$100 a barrel. Skyrocketing oil prices would bring far more harm than good to the economies of the world. But there is a silver lining: investors can profit from rising oil prices. Even if the Middle East somehow manages to become an oasis of tranquility and harmony, the bull market in oil is just beginning. Global oil supplies are running down - even in the OPEC countries - while global demand continues to escalate.

We hope that the smouldering geopolitical bonfires in the Middle East do not erupt into a conflagration. We hope for peace in the region, but we do not expect it. So we suggest you prepare your portfolio for escalating civil strife and terrorist activity in the Middle East. Prepare to profit from a volatile bull market in crude oil by buying a basket of carefully selected oil and gas stocks.

NASDAQ LOOKING LIKE 1999?

Wired is a magazine for businessmen / tech-heads who want to stay up on the latest in the high-tech world. It is extremely well written, and fun to read. You get to learn about the "next big thing" here. The problem is, if there is any resounding lesson of the last few years, it is that the exciting futuristic

companies are often the worst investments... "Pioneering don't pay," as Andrew Carnegie said. Wired magazine just updated its **Wired Index** of the 40 most "innovative thinking" companies. The index originally came out in 1998. Only **10 of the original 40 companies even exist today**. If you had invested in the excitement, you could have made a lot of money-but only if you sold in time. And the best way to have sold in time would have been by using a trailing stop.

These days stock investors are partying like it's 1999-all over again. Shares of Yahoo, for example, are up nearly 200% from their lows less than a year ago. The stock is extraordinarily expensive, trading at well over 100 times annual earnings. If Yahoo continued to make the same amount it's making, that would mean it would take a private buyer over 100 years to recoup his investment in Yahoo...

It's not just Yahoo. Yahoo actually is cheaper than a basket of the major tech stocks... *The Wall Street Journal* reported on 13/06 that the stocks that make up the Nasdaq 100 (the 100 largest tech-oriented companies) now trade at over 200 times past years earnings. That doesn't mean to me that Yahoo is cheap. It means that we're back to the La-La Land of 1999-2000.

Among Wired magazine's new Wired 40 are the following companies: **Google, eBay, Amazon.com (the river of no-returns), Yahoo, Netflix, Nvidia, EMC, Comcast, JDSU**, and some biotech companies, among others. Many of these are the trendy stocks that are up by triple digits in the last few months. We will be watching this little lot closely over the next few months. Don't forget your stop loss.

DIRECTORS SELLING STOCK WHILST MARKETS RISE.

Insider selling jumped 150% last month to \$3.3 billion in the US (where figures are easy to compile), according to Thomson Financial, easily exceeding the five-year historic monthly average of \$2.4 billion. By contrast, insider buying totalled a paltry \$119 million, well below its 5-year historic average of \$180 million.

"The resulting rise in the sell/buy ratio could signal that the stock market's advance has run its course,"

Bloomberg T.V. speculates. "The insider sell-buy ratio is the highest since May 2001, a period that predated a big fall in the U.S. stock market."

What should we deduce from the fact that the informed investor is selling the very same stocks at the very same time that the uninformed investor is buying?

INTERST RATES AND BONDS

- **Fear of deflation will ensure more easy money from all Central Banks**
- **Bond yields still falling from deflation fears but a new bubble is inflating and an overshoot could happen.**

The ECB's 50 basis point cut on 5th June is unlikely to revive Euroland's economy. It helps, of course, but won't curb the euro's strength for long. Therefore the ECB will remain under pressure to slash short-term rates towards the current US level of 1.25 percent. Only house price inflation (which appears to be easing in the south at least) stands between the BoE's Monetary Policy Committee and the next UK rate cut. However with sterling now rising as a high-yield currency, UK short-term rates are unlikely to remain at 3.75 percent for much longer. A majority of economists now expect the Fed to cut rates by 25 basis points to 1 percent on 25th June. However this would be of little economic help but might increase fears for the economy. Consequently the Fed may choose to retain what little firepower it has left for a later day.

The current declines in bond yields look like a classic overshoot and the huge increase in liquidity should lead to a rebound soon unless a Japanese style deflation grips the West. The case for lower yields is tenuous and based on the deflationary view (although compromised by the massive reflationary surge in liquidity in the US) although that has seldom prevented market trends from reaching extreme valuations.

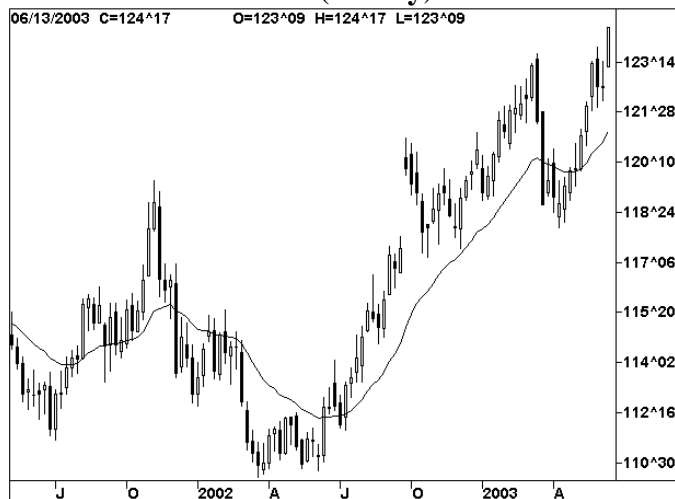
The US and Japan are engaged in a very aggressive monetary reflation. In fact, the Fed and BoJ would welcome evidence of inflation, as a sign that deflationary pressures were waning. However a yield-starved market fears deflation more than inflation. This calculated gamble by investors is

based on hopes that inflation will remain at bay, and that central banks will continue to buy government bonds in their efforts to revive GDP growth. Looking at the charts, bond investors/speculators may be right, for a while, but this is not a scenario for restful sleep. Yields are plunging and this is likely to be followed by an upward correction.

The bond markets are currently gripped by a huge contradiction; fear of deflation versus a dramatic increase in liquidity, which would normally lead to inflation. The outcome of this contradiction will dictate all markets (equities, property, bond, forex and even commodities) over the next decade.

The chart below of UK gilt still looks strong but watch for any sign of a failed upward dynamic below 121.

UK NOMINAL GILT (weekly)



The US Treasury bond is enjoying a ballistic upward acceleration that often leads to a reversal. We suspect that Treasuries may well blow off and retreat back to at least support at 115 as triangular consolidations are generally revisited (not usual for reversal triangles however). The highs currently being set may last the summer at least unless evidence for deflation begins to build strongly despite huge dollar issuance/

US TREASURY (weekly)

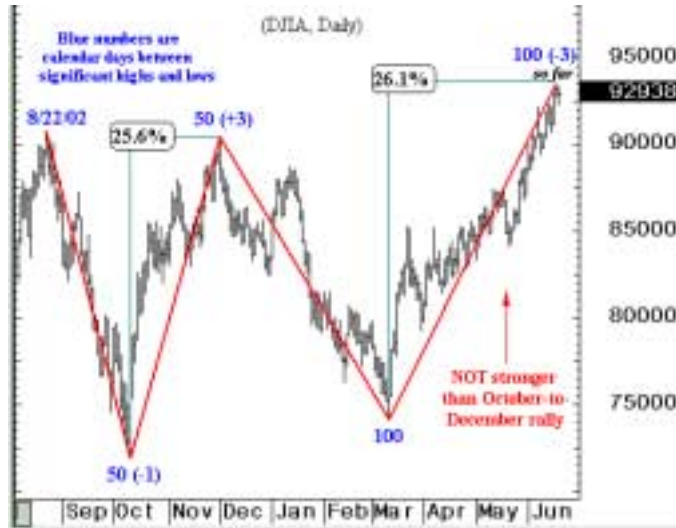


EQUITIES

- **The rally is normal and no more than a bear bounce**
- **Markets “climb a wall of worry.” But the Baghdad bounce is fearless!**
- **The Nasdaq is back to 2000 fantasyland valuations.**

Yet again we read another technician say that they are bullish because the current rally is so “strong.” we disagree. The chart below shows the rate-of-change of the rally from the March low compared to the preceding advance from October-to-December 2002. The October-to-December rally gained 25.6% in roughly 50 days. To date, the rally from the March low has gained approximately the same percentage, BUT it has taken nearly twice as long. Another way to look at it is that the rally from October-to-December gained roughly 49 points-per-day, while the rally from March has gained just over 28 points-per-day. So the advance is not only slowing, but REALLY slowing. The peak NYSE advance/decline ratio in the October-to-December rally was 3.64:1 the day of the closing high, November 27, 2002. Thus far, the peak a/d ratio in the rally from March is 3.32:1 on May 30. Since this reading, the a/d ratio has registered a series of two lower highs against a rising price trend, on June 4 (3.16:1) and June 16 (2.64:1), indicating a lessening in the upward thrust of the advance. Peak NYSE volume was 1.99 billion

shares traded on November 21, 2002, days before the December 2 high. In the rally from March, peak volume was 1.78 billion shares on March 21, the day of the initial lift-off high, and tied on June 6.



The reason the rally SEEMS stronger is because of the amount of TIME it has been unfolding, 9 months. But during all this time, the [Dow Industrials] still has only retraced a “normal” Fibonacci 61.8% of wave 1 down from the March 19, 2002 high (10,673). The reason people seem to think that this rally is so strong is mostly psychology, which is reflected in various sentiment surveys.

The old adage is that markets climb a “wall of worry” and new bull markets are confusing places, as investors constantly and nervously fear a return of the bear. We have previously illustrated the fearlessness in the VIX volatility index and all the current sentiment surveys are currently registering levels only ever seen at bull market tops!

The latest Investors Intelligence survey (www.investorsintelligence.com) shows the bears retreating even further, to 16.1, another sixteen year low. The bulls increased to 60.2, widening the spread between the two to 44.1 basis points, the largest gap since February 1987. The S&P 10-day Daily Sentiment Index (MBH Commodity Advisors, 847-446-0800) is at 81.5% bulls, a new bear market extreme. And Market Vane’s Bullish Consensus is at 56 for stocks, the exact same level as January 4, 2002, the price high for S&P last year, and September 4, 2000, two days prior to the first major drive down of nearly 30%.

Nasdaq rejoins lala land

Meanwhile, the P/E ratio of the Nasdaq is in nosebleed range. The Wall Street Journal recently reported the trailing 12-month P/E ratio of the Nasdaq 100 at 227, based upon reported earnings. Compare that figure to the estimated P/E ratio for the next 12 months – 36 (as optimistic as ever). The Thompson First Call estimate is even lower: 32, based on pro-forma earnings or EBBS (Earnings Before Bad Stuff).

But these rich valuations are not limited to the Nasdaq alone with the S&P now moving strongly above a P/E of 32, a level so rich that it is way higher than all of the significant market tops of the twentieth century. Indeed it was only first exceeded in the late nineties.

So in our view the evidence is clear that the recent rally is not the birth of a new bull but more likely a powerful (it has certainly surprised us) liquidity fed bear market rally. With extremely stretched sentiment measures we expect prices to fall back sharply (maybe 10% or more) during the next month. We may well then witness an attempted retest of the current highs before a more sustained decline sets in later in the year.

The Nasdaq (below) has enjoyed a powerful advance over the past three months. Evidence of a pullback would develop on a turn below the trend line at 1625 which would open the way for a test of the May lows at 1480.

NASDAQ



The Ftse 100 is still advancing within a narrowing channel that is looking overstretched at present. We suspect a drop below the support trend at approx 4125/50 could open a test of the May lows at 3900

after temporary support at 4000 is overcome. A move above the upper trend is unlikely to last more than a couple of days and would probably signify a top.

FTSE 100



The Dax has been one of the best performing markets over the past quarter aided by appreciation of the Euro. The current advance is vulnerable to profit taking and a drop below 3150 would open the way to a look at 2750.

DAX (weekly)



Of all the markets we examine the least expensive by far is Tokyo. On all the accepted measures of value the Japanese market is incredibly cheap compared with Europe and especially the US. Stocks on average trade on a book to sales ratio of less than 1/3 of US counterparts. However, as we all know Tokyo has been both relatively and absolutely cheap for a number of years now. Investor psychology is in tatters and global

investors have been underweight for years as they consider Japan a basket case. As all contrarians will recognize these are the perfect conditions for a surprise rally. Although we are unsure the bear will end in Japan now, we suspect the current advance may well carry on beyond 10,000. A dramatic downturn on Wall St could blow this rally of course so a stop should be placed at 8500.

NIKKEI (weekly)



FOREX

- The trend is your friend but is the Euro overextended
- Dollar to rally and drag the pound along?

Last month we postulated that the dollars' decline was over-extended and perhaps due to reverse. We have seen nothing over the past month to change our view as the dollar index chart below shows that the declines have at least paused for the time being. Certainly sentiment is still very bearish toward the dollar with bulls being at a multi-year low of 14%. Although, not long-term bulls of the greenback due to supply issues we are watching for an upward dynamic to indicate a trend reversal and anticipate an advance toward 100.

If the index were to pass beyond 94.5 it would signify that the reversal was underway and traders could buy the dollar with a stop at 92.

DOLLAR INDEX



The main beneficiary of the dollars decline has been the Euro. This advance appears to be clearly losing momentum with a consolidation building between 116 and 118.5. We suspect that the range will resolve shortly and traders should go with the break using 117 as a stop.

EURO/DOLLAR (daily)



Sterling has enjoyed a recent bout of strength and risen toward the important \$1.70. The long-term chart below illustrates the significance of the \$1.70 zone, which will almost certainly curtail sterling's advance for at least the short term. If this resistance area were overcome then the pound would probably ramp up toward the \$2 range not seen since the early nineties. We do not feel this scenario is likely at present and suspect that the cross will choppily trade between 1.70 and 1.58 for a few months yet.

POUND/DOLLAR



The pound like the Dollar appears to attempting to halt the declines against the Euro. A small base is almost complete along with a break of the trend line, which could support an advance back toward €1.46. Traders would expect to use a stop of €1.40

POUND/EURO



The chart for the Yen cross tells the story wonderfully. The pound's advance has been choppy within a broad channel and at present is approaching a point of double significance. The upper channel line currently crosses through the 200-yen level and as such we suspect that psychological resistance may well stem the pound's advance for a short time. We do suspect that this resistance will be overcome after a short-term consolidation but we would look to go long above 200 with a stop of 199.

POUND/YEN

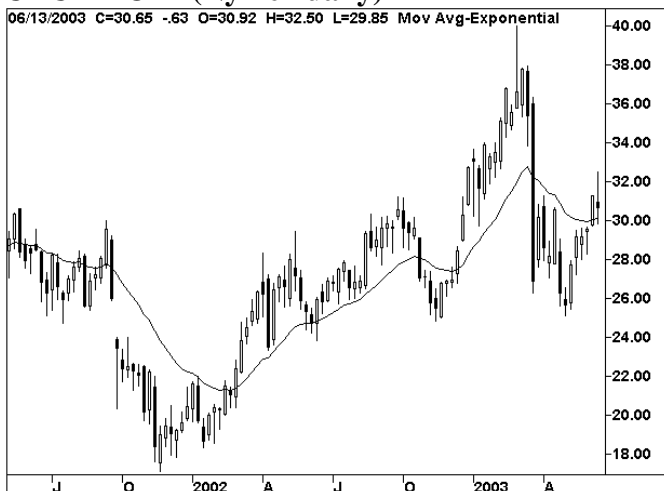


COMMODITIES

- Crude's advance is not likely to continue once Iraq supply comes on tap during July.
- Gold's decline will continue unless \$3.68 is exceeded.
- Copper remains depressed whilst the global economy slows.
- Cocoa looks oversold whilst coffee is range bound.

The recent rally in oil to \$32 looks unsustainable as Iraqi supplies come on tap. Despite the very long run positive backdrop for oil (see earlier article) the price looks likely to test the recent lows of \$25. We suspect that this may prove to be a "gimme" trade as short of a new terror outrage oil can only slide.

CRUDE OIL (Nymex daily)



Our predicted decline in Gold has started and we still expect prices to fall to at least \$325 and perhaps lower. However, any move over the new stop of \$368 would start to negate this scenario and we would stand aside.

GOLD



The weak global industrial economy has seen copper prices along with other base metals remain subdued. The prospects for copper would improve on an advance over \$8000 and a pop over \$9000 would complete a reversal pattern. This would likely indicate that the Global economy was picking up some steam.

COPPER H.G. (monthly nymex)



The decline in cocoa prices looks overdone and the market's technical background suggests a rebound looks likely. Last month we warned of a

serious decline in cocoa, which has duly occurred as prices fall over 400 points. Certainly, the recent narrowing of contango highlighted by our friend Peter Rhodes would support the rebound view. Traders would be wise to use a trailing stop starting at \$1400 if they wish to follow the technical.

COCOA (weekly)



Coffee is range bound at present with a dangerous switchback ride between \$60 and \$70 building the potential for a substantial breakout at some time in the future. Traders should sit and await developments with a move beyond \$58 and \$70 providing a great opportunity. We would suggest that any range traders adopt square and reverse stops at these levels.

COFFEE (weekly)



WHAT IFS, WELLINGTON, EARL GREY, AND THE UNSUSTAINABLE WELFARE STATE! A flight of fancy.

This week marks the 188th anniversary of the battle of Waterloo. To paraphrase ABBA we all know that "Napoleon was defeated." We often forget that victory was only secured once Blucher's Prussian forces arrived to help turn the battle.

Britain as a maritime power had long benefited by standing aside from all European conflicts. Thus during the 18th century as Europe fought itself to a standstill during the seven years war Britain emerged unscathed and as a global superpower.

After Waterloo and throughout the 19th century it was natural for Britain to view both France and Russia with suspicion, after all France was a global rival whilst Russia was long suspected of having designs upon India (hence the Afghan wars). To counterbalance these two potential rivals Germany was Britain's natural ally. Germany was a continental power without an overseas empire and therefore no threat to Britain.

In 1904 a new radical Liberal Government was elected to power. This Government was to have an unknowing but devastating affect on the course of world history.

The new foreign secretary Earl Grey was a Francophile (some things never change with Liberals) despite the above and sought an alliance with France. This meant that Russia was drawn into the arrangement, as she was Frances' great European ally. Again this would appear to be contrary to Britain's national interests. The balance of power within Europe had been de-stabilised. Germany felt threatened, constrained and surrounded by a global conspiracy. Thus the wheels were set in motion for WW1.

If Britain had not come to aid France in 1914 the war would have lasted only a few weeks. Millions of people would not have died in Flanders. Britain would not have been impoverished due to the costs of WW1. We can fancifully bound on and assume that Russia may well have avoided the Bolshevik revolution and there would have been no Joe Stalin and no Cold War.

As we are now on a roll we can further the great what ifs to the point that the undefeated Germany would

not have been so beguiled by a little corporal from Austria. So both WW11 and the Holocaust would not now be history. Thus the course of world history was irrevocably altered by the election of the Liberal Government in 1904 and its policy of continental involvement. By God have they got a lot to answer for?

So where does this flight of fancy lead (if anywhere?), well maybe to the point that historical involvement with continental Europe has brought nothing but disaster and heartache and that Britain can and has long survived as an independent trading nation. Perhaps therein lies a lesson or more possibly the fanciful ramblings of eurosceptics.

But there is one further legacy still topical today. The 1904 election heralded the beginnings of a welfare state that has so grown that now in the UK no one blinks an eyelid at the prospect that over 40% of GDP is state controlled. This dramatic switch of resources from private to public control has irrevocably altered the way we live and are taxed. No Edwardian could have imagined the eye watering tax rates now enjoyed by the British people. Demographics offer a challenge to the current status quo that will lead to a dramatic revision of current provision or decline into a banana republic. We comment not about the welfare system but wonder if those stiff Edwardians envisaged the dramatic consequences of their actions back in 1904!

FINALLY.

We hope this has given you food for thought and no doubt we will be receiving a sackfull of e-mails as usual on the issues we have raised.

Regards

Andy McCarthy and Andy Bartles