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## **GLOBALLY STOCK MARKETS ARE POISED AT KEY TURNING POINT.**

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**Bullish sentiment at extreme**  
**Nasdaq PE over 100**  
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**The charts of the world's major market indices (Ftse, Dow, S&P, Nasdaq etc.) are all displaying a similar pattern of price action.** After the strong advance following the "Baghdad bounce" which topped at least temporarily in June, the blue chip markets have ranged narrowly sideways as bulls and bears wrestle for control.

The question being asked by all investors is simply this; is the rally merely pausing for breath in a new bull market, or is a topping reversal process underway?

Obviously we do not know the answer (although judging from sentiment indicators "the crowd" believes it does and is long) but we have our suspicions. The fact is however, that no view is currently necessary as markets back and fill sideways. We advocate simply awaiting developments with all traders and investors to watch for a breakout of the current range.

For all UK investors the key levels are 3950 and 4225 with the Dow and S&P's range being 8950 to 9350 and 975 to 1015 respectively. We would advocate masterful inactivity whether you are bear or bull until these key market levels are finally breached. It may take some time as the Ftse for example has flirted with 4000 since April and has broadly traded sideways since Easter. We would anticipate a move of **10%** or more on a final breach of the above parameters, which could see the Ftse and the Dow hit 4600 and 10,000.

But this would not be the Barmac Journal if we were to look only upon the Sunnyside of things. We like to fret and gnaw in dark corners and we find plenty to concern us. The graph below is largely self-explanatory but is indicative of a hot market.

## STOCKS ARE EXPENSIVE AND INVESTORS ARE EXUBERANT

In the past seven weeks, more than 70% of the independent, or nonbrokerage-firm-affiliated, newsletter advisers surveyed by Investors Intelligence were bulls (chart below). The week ended June 13, the figure was nearly 80%, the highest percentage since March 1987. At the same time, the ratio of S&P 500 companies' stock prices to their earnings remains nearly double the historical average range of 15 to 19.



Source: Wall Street Journal

### Plenty to fret about

The implications of the above chart are certainly sobering as investor sentiment hits a peak not seen since the ominous year of 1987. Perhaps a more shocking observation is the fact that bullish consensus currently exceeds the levels recorded throughout the stock bubble of the late 90's!

A new bull run would normally be heralded by low readings like the ones seen in '88 and '94. The current stratospheric levels at present are a huge warning to market participants.

Investors Intelligence.com's survey of private investors confirms the above lack of fear with Bullish consensus running at levels not seen since 1987!

If these were the only technical flashing a warning we would perhaps be less fretful and although we hate to repeat ourselves from one issue to another some facts do bare repetition. The S&P's current PE ratio is historically extremely high at a level associated with market tops and not bottoms. We realise that PE ratios are not great market timing indicators and may remain high for perhaps many years but we also know for 100% certain that PE ratios will be much lower at some stage in the years to come. A high PE is not the sort of background that one would expect a new fully-fledged bull

market to emerge from. But prices could still rise for months before Newton's law catches up.

Now added to the already downbeat and party-pooing facts outlined above are the antics of company insiders. We have commented previously about the latest filings but feel obliged to repeat ourselves. Company Directors are selling their own stock at a ratio of 13.4 times stock bought. This is yet another multi-year high and portrays the rather obvious fact that those in the know think shares are not cheap and are selling to those not in the know!

### Nasdaq over 100!!!!

Last month we mentioned how much of the rally had been fuelled by the more speculative stocks on the Nasdaq (Yahoo etc) and this indicated frothy speculation and not solid investment. Well now we can state that collective madness is an epidemic as the market PE for the Nasdaq 100 exceeds 100. Now who thinks that is cheap?

Investors in the small cap Russell 2000 have also displayed an aggressively speculative hunger illustrated by the outperformance of not only the index but also by certain of its' constituents. Those stocks with no earnings have seen prices grow in excess of 39% whilst the under \$5 stocks (penny shares) have rocketed by 50%. In the UK the small

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cap index and the Ftse Mid 250 have also dramatically outperformed the blue chips. To paraphrase the seventies drink advertisement with a cartoon polar bear (how appropriate) *“it’s frothy man!”*

## **ROCKET SCIENCE AND YOUR CALCULATOR or how much do we all owe?**

Now we move onto our favourite “Iron Man” Gordon the Moron. He laughably upped the Treasuries underlying UK growth assumption last year much to our chagrin to 2.75% from 2.5%. Then in his last budget predicted above trend growth that would yield a high tax take and pay for all Labours profligate tax and spend policies.

Oh how we scoffed! Sadly we were right as the tax take tanks along with the economy whilst the Governments spending grows without check. The UK will in the current year borrow at least £37 billion! That is £649 per person.

And it is getting worse as the total Government spend has nearly doubled since '96 to almost £400 billion pa.

THUS every man, woman and child has to shoulder the burden of £7000 of Government money wasting each year.

Now for some interesting anorak type facts, you may wish to play with your calculator now.

The UK has 57m. people of which 25m work. Of those that work 7m work, for the state in one form or other and as such create no wealth (NHS is the world’s third largest employer after the Chinese Red Army and the Indian Railways and probably less efficient and more Stalinist!). Thus the wealth creating portion of the economy rests with only 18m souls to shoulder this burden of responsibility.

These poor burdened souls in reality cover the tab for the UK of £400 billion that amounts to a staggering **£22,000** per each working individual.

We think people might not mind so much if health care was first rate, the elderly and handicapped respected and taken care of, the railways always ran on time and our politicians displayed great integrity and tried to minimise interference in our everyday lives.

**BUT THEY DON'T** and **WE DO** because all Governments no matter how well intentioned are profligate with our money which they waste whilst

many of their welfare policies turn out to be counter-productive due to their lack of understanding of economic systems.

**BUT GB IS NOT ALONE!** Our good friends in the US have equally profligate politicians hell bent on spending and wasting their electors money. "U.S. budget deficit put at \$455 billion," says the headline in the Herald Tribune. Seems expenses -notably the occupation of Iraq - have been running ahead of income; the deficit is now 50% higher than February's estimate.

The cost of maintaining U.S. troops in Iraq has risen to \$4.6 billion a month, not to mention the soldiers who are killed every day. The poor squaddies have been left in a hot and hostile place, where their only role seems to be to help desert malcontents to improve their aim.

When a study was made of how much the federal government is likely to need to pay for all its' promises, reduced by what it is likely to collect in taxes, the calculation must have sent sparks flying from the economists' computers. As it turns out, the shortfall comes to \$44 trillion... or about half a million dollars per family.

That doesn't count the private debt in America - estimated to be another quarter of a million per family.

What does all this mean? We don't know, other than big trouble.

## **The FED rendered powerless.**

The United States Federal Reserve Board, once the most powerful central bank in the world, now risks being reduced to a nearly powerless bystander.

For more than five decades, interest rate cuts have been the Fed's weapon of choice to cushion the economy from the fallout of stock market crashes ... waves of corporate bankruptcies ... a rash of bank failures ... the Y2K crisis ... terrorist threats ... even war. Now, that weapon is virtually out of ammo.

In theory, the Fed could lower rates even further -- to three-quarters of a percent, half a percent, even zero. But in practice, any further cut would risk a collapse in the dollar ... threaten the \$2 trillion money fund

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industry ... and push millions of elderly retirees nearer the poverty line.

So what does the Fed do? Ans. Print money!

In the UK rates are at 3.5% the lowest for 50 years and yet the economy stumbles along only thanks to home debt refinancing.

We ask what will happen if houses start to fall nationwide and debt refi slows?

### **Pension black holes.**

If you think that the "new, new" economy is looking a little green around the gills, you ought to take a look at the "old, old" economy - namely General Motors. This beleaguered American institution continues its fruitless toil. Day by day, it hammers away at selling cars, but barely makes any money doing so. Meanwhile, over in the finance division, GMAC makes a few bucks here and there by lending money to auto-lessees and to home-buyers (especially to home buyers!), but then it has to hand most of those profits over to GM retirees. Is this any way to make a dollar for shareholders?

Every day is a struggle. In the largest-ever corporate bond sale, GM is selling about \$17 billion worth of bonds in order to shore up its foundering pension plan. "Although GM touted the debt issuance as 'an overall effort to accelerate improvements in GM's balance sheet and financial flexibility,' the truth is that GM is merely substituting one debt, much of it off-balance sheet, for another debt that remains on the balance sheet," observes a very sceptical Apogee Research. "Can anyone realistically consider this outcome a positive indicator for GM's future prospects?... This is nothing more than a red flag signalling the escalating pension obligations are placing a menacing burden on the interests of common shareholders.

"Simply put," Apogee continues, "the \$17 billion of debt-raised proceeds is not going toward R&D or product development or improved manufacturing processes, any of which might conceivably improve the fortunes of the common shareholder. Instead, the proceeds will go to support the growing needs of GM's substantial retiree base. "All together, GM's under funded pension liabilities total a staggering \$75 billion. Even the largest-ever \$17

billion corporate bond sale, therefore, is literally a drop in the ocean. - It's possible, of course, that GM will "pull a Houdini" and wrestle free of these daunting liabilities. On the other hand, it's possible that it won't. GM may simply wriggle and writhe in its financial shackles until drowning in its own liabilities.

We wish GM well, and wouldn't dare to predict the mighty company's demise. But neither would we stand in line to become a GM equity-holder, as a GM equity-holder, in turn, must stand at the end of a very long line of pensioners and bondholders.

The good news is that GM is only one of the 30 stocks in the Dow Jones Industrial Average. The other 29 are probably in much better shape.

Our favourite Austrian economist relays in the following essay the shocking and devastating fact of just what the US consumer has been borrowing money to buy. – Necessities.

### ***THE LAST ANALYSIS***

***by Kurt Richebächer***

*Mr. Greenspan has been hailing the wonderment of the U.S. economy's new resilience, both to the bursting of the stock market bubble and to the various shocks from terrorists and the Iraq war.*

*But the cause is obvious. What, for the time being, has prevented a deeper and longer recession in the United States is more and more of the very same consumer-borrowing-and-spending bubble, which has been propelling U.S. economic growth over the past several years.*

*Yet two things have changed. The first one is the collateral behind the consumer borrowing and spending binge. Rising stock prices have been replaced by rising house prices. The second is that it needs more and more rampant credit and debt creation to master just marginal GDP growth.*

*Our highly critical assessment of the U.S. economy's performance during the past two to three years, in fact, finds its major justification in the atrocious discrepancy that has developed between extremely promiscuous monetary and fiscal stimuli and their extremely poor economic effects.*

*Between 2000 and 2002, the federal budget has swung from a surplus of \$295 billion into a deficit of*

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\$257 billion, heading for a \$400-500 billion deficit in 2003. During the same two years, total non-financial credit zoomed \$2,520 billion and financial credit by another \$1,879 billion, both adding up to \$4.4 trillion.

What was the effect of this credit and debt deluge on the economy? GDP during these two years grew in real terms by \$248 billion and in nominal terms by \$621 billion. To us, this is an outright policy disaster.

Yet, American consensus economists are definitely consistent in their approach. Undeterred by data that overwhelmingly point to the enduring weakness of the economy, they stick to the same forecast of the U.S. economy's imminent, strong recovery. Though there is no trace of the generally predicted post war snapback, optimism about the U.S. economy and its imminent, strong recovery remain the order of the day. Betting on the government's third tax cut, further Federal Reserve easing, a weaker currency, and still more mortgage refinancing, the consensus expects economic growth to accelerate to 3-4% in the second half of this year, compared to the dismal sub-2% in the first half. In striking contrast, Mr. Greenspan and the Fed have become distinctly more cautious in their utterances about the economy's prospects. The Fed's latest Beige Book admits that economic activity remains sluggish. Although "the unwinding of war-related concerns appears to have provided some lift to business and consumer confidence," the report said, "the effect has not been dramatic."

Consumer spending was said to have "remained lacklustre." Labour markets were described as "weak" and manufacturing activity as "mixed." In particular, one remark concerning consumer spending shocked us: "Overall consumer spending was soft in April and May. Retail sales picked up some after subdued sales in March, but most reports indicated that sales remained below the level of a year ago."

This weakness in consumer spending is ominous, considering that new borrowing and mortgage refinancing are setting ever-new records. Both new and existing home sales rose to record highs last year, with mortgage origination totalling \$2.5 trillion. According to estimates by the Mortgage Bankers Association, mortgage origination this

year is set to reach even \$3 trillion, with over \$1.7 trillion of re-financings.

This mortgage-refinancing binge has had two effects. One is the change in net new borrowing by the consumer, which rose by a record amount of \$768 billion during 2002. The other effect is the amount 'saved' by private households through the refinancing of existing mortgages on their interest payments. Considering that 30-year fixed rates for mortgages have plunged by more than two percentage points over the past 12 months, from well over 7% to almost 5%, these savings have played an important role in bolstering disposable consumer incomes.

Pondering where all this money went, we took a look at the pattern of consumer spending from 2002's first quarter to 2003's first quarter. What we found greatly surprised us. Apart from a temporary, minor surge in the sale of motor vehicles, expenditures on consumer durables were flat over the year. Among non-durable goods, the major increases in spending were on food, gasoline and fuel. Actually, 63% of the higher consumer spending was on services, and mainly on housing and medical care. It was a discovery that has shocked us - because we learned that the American consumer's heavy borrowing is largely financing expenditures on essentials.

The other, equally important conclusion to be drawn from these facts is that consumer spending, despite ever-new records in borrowing, is not able to lead a sustained recovery. So far, it has prevented a deepening recession, but it is much too weak for more than that. The obvious indispensable further condition for sustained, stronger economic growth is higher business fixed investment. Mr. Greenspan has certainly realized this, having said in a recent speech, "the central question about the outlook remains whether business firms will quicken the pace of investment."

Scrutinizing the GDP numbers and also the necessary conditions for a broad recovery in business fixed investment, we see no chance for it to happen. But first a clarification of facts: Over the 12 months to the first quarter of 2003, non-residential fixed investment has declined in nominal terms by \$21.7 billion and in real terms by \$17.6 billion. The decline occurred across the board, but it was centred in structures, that is, in non-residential buildings.

*Business investment on equipment and software, measured in current dollars, increased slightly, by \$10 billion, or 1.2%, implying virtual stagnation. Measured in real terms, however, one item - computers and peripheral equipment - showed a sharp increase by \$56 billion, or 21%. For many bulls, this is one ray of hope in the economy's overall dismal picture. But we see nothing but hedonic pricing. In current dollars, business spending on computers rose by just \$4.4 billion. Pondering the possibility of a broad recovery in business capital investment, we can only repeat what we have stressed many times before. Profit prospects are the key question in this respect. But scrutinizing the various macroeconomic components that ultimately determine aggregate profits, we note a preponderance of negative influences. The greatest potential threat to profits is a return of private households to higher savings, which is sure to happen when the mortgage refinancing frenzy abates and long-term interest rates stop falling.*

*Positive influences from the macro perspective during 2002 were the sharply widening federal budget deficit and rising residential building. Major negative influences were the continuous rise in the trade deficit and declining net investment, mainly due to the continuous rise in depreciations.*

*The fact is, there are no reasonable signs of an imminent pickup in U.S. economic growth in general and of business fixed investment in particular. In the last analysis, all the prevailing optimistic forecasts are based on the conviction that the Fed and government have the infallible means to generate a recovery under any circumstances. The chorus calling for the Fed to open its money spigots further has become deafening.*

The problems facing the Anglo-Saxon economies as highlighted above by the good doctor are growing despite ramping house prices and debt refi. The US and UK both appear hell bent on borrowing their way out of the mire. But the coming destruction of each currency leaves no scope for a plan B!

## INTEREST RATES AND BONDS

- **Central Banks will continue to provide “easy money”**
- **Bonds suffer severe set-back as supply and inflation spooks the market**
- **Muni’s crash as state deficit worries surface.**

**The ECB may delay because of firm stock markets and the euros reaction.** Euroland needs lower rates more than any other developed economic region. However due to the Maastricht Treaty, Euroland is unable to function like other regions, and with Germany and France continuing to ignore the so-called Stability Pact regarding budget deficits, the ECB may hang tough on rates, at least until the euro strengthens once again. We saw the same problem in Japan, when Masaru Hayami was Governor of the BoJ.

The UK’s weakest GDP growth in 10 years is reason enough for another rate cut by the BoE’s Monetary Policy Committee. In the US, a record monetary and fiscal stimulus should be more than sufficient to lift the economy, despite high debt levels and corporate reticence towards expansion.

**After the so-called “flight to quality” in government bonds in recent years, investors are beginning to realise the risk.** With financial instruments (and governments) whatever the demand, supply will eventually prove to be inexhaustible. If governments can raise money cheaply because the investment community is preoccupied with deflation fears, it will do so. We have certainly seen this in Japan, which currently has the biggest government bond market in the world, 42 percent larger than US government debt. Paradoxically, Japan also has the lowest yields, with the return on 10-year JGBs falling to a record 0.43 percent on 13th June - qualifying as the greatest bubble of them all. “The Emperor has no clothes” statement came from a BoJ official who described JGB yields as “ridiculous” in mid-June, and it spooked the market. No wonder institutional demand for Japanese government debt has slumped recently. With supply increasing, everyone knew that JGB yields could only reach such low levels because the BoJ was a massive buyer, creating the moral hazard for investors and prompting the quip – “a risk-

free return has become a return-free risk.” If the BoJ is now questioning the logic of its JGB policy, some holders of Japanese government paper are understandably going to sell.

**Today, there are bubbles in all government bond markets, due to concern over deflation.** The recent spike in yields, commencing in mid-June, suggests that the worldwide government bond bubble has begun to deflate. Nevertheless there is an argument stating that yields could range near their lows for a lengthy period. This is just possible, especially if governments increase purchases of their own debt, but it is a forecast that one would expect from those who are over invested in these issues.

Additionally, given the low returns, there would need to be a reasonable prospect that government bond yields could fall considerably lower, to justify the risk. This could only happen if Euroland and the US succumb to Japanese-style deflation. It may be a valid concern for Euroland, but there are currently no grounds for doubting the Fed’s resolve and tools for ensuring that deflation does not envelope the US.

Greenspan and Co should win their battle, over time, at the eventual price of higher inflation. Indeed, we suspect that if the Fed does avoid outright deflation they will cause instead a terrible inflation that will destroy bonds as an overvalued market swings back to undervalue. In all probability, this would put such upward pressure on the euro that the ECB would have to reflate also.

**The charts of both UK gilt futures and US Treasuries** show a potentially catastrophic downside failure as excessive supply fears mark a significant top unless deflation takes a vicious hold. We would not buy bonds and suggest that all investors remain underweight all but the shortest durations.

The charts are both oversold and may find some temporary support at current levels but we expect further falls to follow once 118 (gilt) and 108(US) are breached with another 10-point fall likely.

### US TREASURY BOND (weekly)



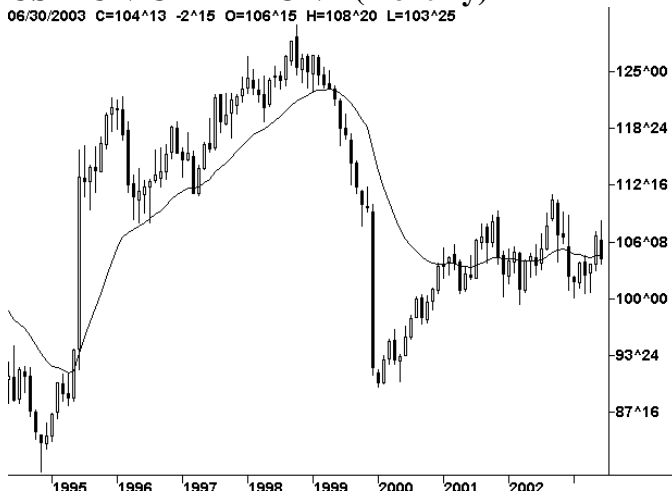
### UK GILT (weekly)



**Not even deflation could save Muni bonds as warned here in our December issue.** US Federal state governments are running huge budget deficits with the likes of California potentially staring at a potential default in the next few years. State authorities cannot crank the printing press however, to pay their bills unlike the FED. Many states have been living well beyond their means and as the economy stalls and local taxes tank. We would advise all investors steer well clear from such bonds despite attractive yields. The bear in such markets will not end until the crash has made front pages across the US and major cities are declared bankrupt. The chart below illustrates the important shelf of support at 100 and any move below this will herald the next leg down.

## US MUNICIPAL BOND (monthly)

06/30/2003 C=104^13 -2^15 O=106^15 H=108^20 L=103^25



## EQUITIES

- Reversion to mean is a long term certainty
- PE ratio not supportive
- Markets pause after strong surge due to electoral cycle optimism.
- “Technicals” break down on speculative markets
- Asian markets show relative strength.

The Bank Credit Analyst is always worth reading and the editor Peter Bennett's most recent research is on “reversion to mean” (that is the overall value of the market will revert back to its long term trend value whether valued in PE ratio, dividend yield or simply market price) a subject close to our hearts here at Barmac. In his article he has identified the long long-term trend for the US market based upon the mean valuation over a period in excess of 175 years. By simply taking two standard deviations from the trend as his overvalued/undervalued boundaries a trend channel has been established. It is extremely interesting to note that in over 175 years the market has in 100% of occasions, either risen or fallen from the two standard deviation extreme back to or beyond the long-term valuation.

Thus we can say with absolute certainty that both the UK and US markets will fall in value over the next five to ten years and as a result a buy and hold approach to equities is suicidal.

However, there is one problem with reversion to mean, it can stay at an extreme for a number of years and as such has no helpful timing implications over a typical one to two year view.

**With reversion to the long term mean in mind** the PE ratio for the S&P 500 index at over 33 is not going to help the bull case. If every picture tells a story the graph below would indicate that US equities are on borrowed time and any rally is almost certainly an opportunity to lighten up on stocks.



The major market averages appear to have paused over the last few weeks with the last high posted in June. Markets have churned since then and have seen a number of weekly reversals as can be seen on the Dow below. A move below 9000 would open the door to further declines toward initial support at 8500, whilst any upward dynamic could carry to 10,000.

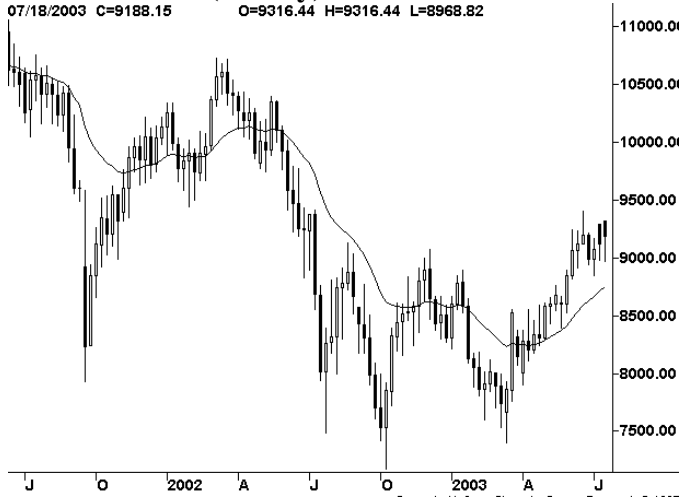
**The technical picture just keeps getting worse for the short term.**

The valuable Investors Intelligence (II) reports that there was a RECORD 531 buying climaxes in the stock market during the week ended 18 July (www.chartcraft.com). The previous record was just a few weeks ago at 325 buying climaxes. II notes that since the early 1990s there have been only five weeks with more than 200 buying climaxes (one in April 2002 at the Small-Cap Index all-time high), one with

300 and now this record 531. As we have discussed previously, buying climaxes (when a stock hits a yearly high and yet closes the week down) are a sign of distribution and provides additional support for the bearish case.

### DOW JONES (weekly)

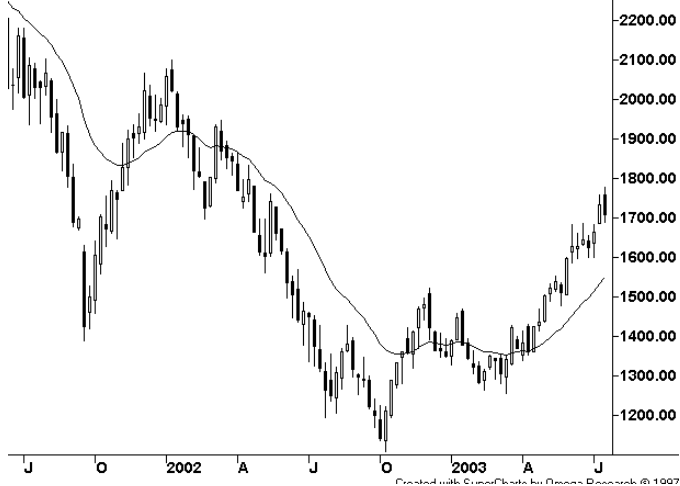
07/18/2003 C=9188.15 O=9316.44 H=9316.44 L=8968.82



The Nasdaq below also shows a reversal week ending 18/07 as the bull trend appears to blow off.

### NASDAQ (weekly)

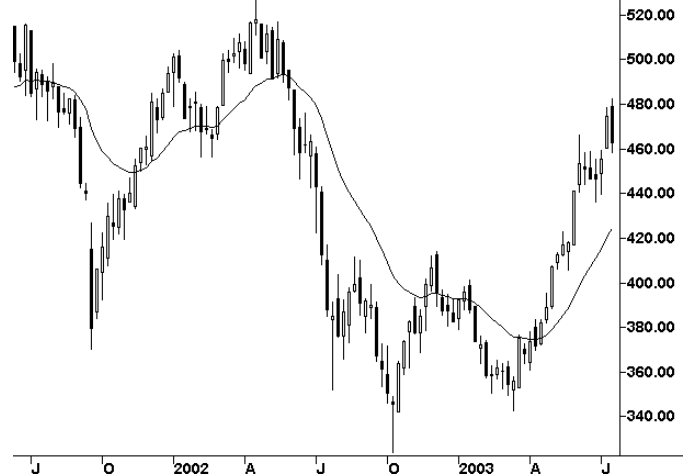
07/18/2003 C=1708.50 -25.43 O=1757.43 H=1776.10 L=1688.82



The hugely speculative nature of the rally has been best illustrated by the relative strength of the tech orientated Nasdaq and the small cap Russell 2000. The Russell as mentioned earlier has seen the best rallies in those stocks with no earnings and the penny shares. The current rally has just witnessed a reversal week after a very frothy rally. New highs are needed to dispel the negative sentiment.

### RUSSELL 2000 (weekly)

07/18/2003 C=462.60 -12.10 O=479.00 H=482.25 L=458.25



The Ftse 100 is also challenging the up-trend and any further weakness would open the door for a steep sell off. Conversely a move over 4200 would be extremely positive with 4500 being an obvious target. Traders and investors should sit firmly on hands and await the break.

### FTSE 100



The internal technical deterioration of the various stock averages is highlighted below on the chart for the suddenly born again TechMARK 100.

Although, the TechMARK has recently hit new highs during July it is interesting to note that the internal momentum of the rally is slowing. This non-confirmation of the market high is to be found on all the major averages and is yet more evidence of an internal weakening of the strength of the current rallies. We suspect that any move lower than 800 would signal a sell-off of at least 10% or more.

## TechMARK 100



The German market has outperformed the UK due to the higher beta of the German market. The current bear rally is approaching an area of major psychological resistance at 3500 and is likely to be dragged down toward 3000 if the US markets crack.

## GERMAN DAX (weekly)



Even the miserable old Nikkei has joined in the fun of late. The rally on the Japanese index looks likely to consolidate over the next few weeks or so but it may well have legs yet. Unlike all the other major markets the Japanese market is historically cheap and on a reversion to mean basis it is set to rise through the next revaluation cycle.

But, we should be all aware that although it is an almost 100% certainty that Japanese stocks will outperform over the next 10 to 20 years they may well go lower first (maybe much lower) and/or stagnate at a low rating for another 5 to 10 years. So Japan is not a one-way bet unless you really are a true long-term investor!

## NIKKEI DOW (weekly)



## FOREX

This is what we said as our summary headline last month;

- *“Dollar oversold*
- *Euro overbought”*

This month we suspect that the trend begun during June and July will continue although some “backing and filling” will occur.

The DOLLAR index (below) has rallied 5% in its first leg of recovery from around 92 to 98. The Dollar may well pause for breath before resuming the advance to beyond 102. We are not to be confused with long term Dollar bulls, indeed we are actually very bearish of the greenbacks long term prospects mainly thanks to the excessive increase in supply by our printing magnate Mr Greenspan and his various henchmen. But the poor old dollar is due a few months respite and we feel sure that the recent relative strength will continue for several months. For this story to hold we should not see a new low on the dollar index. Active traders should buy the dollar on any fall back toward 93.00/94.00 with a stop at 91.00. We expect the dollar to be a relative safe trade as currency traders book all their profits on recent dollar shorts.

### DOLLAR INDEX (weekly)



The Dollar/Euro chart merely reflects the above comments. We stated last month that they are “two sides of the same coin.” Thus we have witnessed the Euro burn off some of the recent advance and would expect this trend to gently continue toward the 1.05 mark for the rest of the summer and into the autumn. We would favour traders buy the dollar index rather than sell euro to take advantage of the dollar rebound.

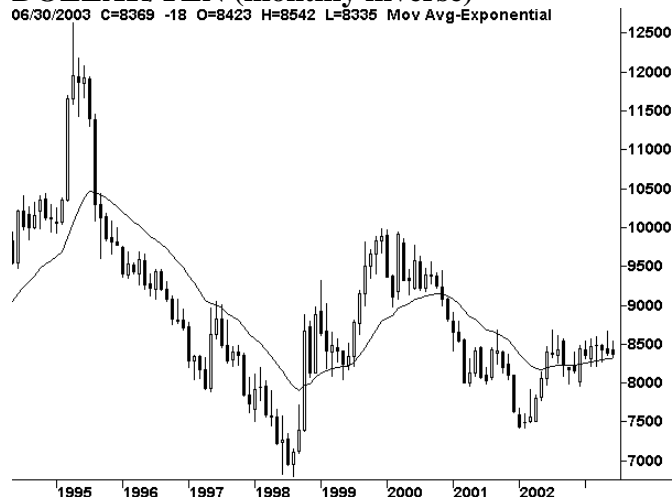
### DOLLAR/EURO (weekly)



The Dollar/Yen cross has continued to trade quietly between 117 and 120 (84.00 and 86.00 on inverse IMM futures) as the two currencies that are increasing supply most aggressively spar to see who will be the weakest over the next few years. This cross would become interesting on a dollar break above 120 and we would advocate following the move with a trailing stop. A move below 116

would open the way for a substantial dollar decline. We are staying tuned to see how this cross plays out over the coming months but the monthly chart below illustrates how quiet this cross has been. In our experience quiet markets normally explode at some point!

### DOLLAR/YEN (monthly inverse)



Sterling is currently short term oversold vs the buck with the ROC below 25 and resting on the trend support, thus signaling a short term sterling rebound of 3 or 4 cents. Sterling looks to be capped by overhead supply at 1.68 to 1.75 and may well trade choppily versus the dollar for some months to come or until the dollar recommences its global declines later in the year.

### STERLING/DOLLAR



Another prediction last month for the euro was “a return to the mid 140’s looks likely and we suspect that the pound will trace out a similar path as the dollar over coming months versus the euro.” Things

have unfolded quickly with the pound hitting our initial target during early July. We expect a further rally to at least equal the July high if not exceed it during the coming few months with perhaps 1.475 being a likely target area.

## STERLING/EURO



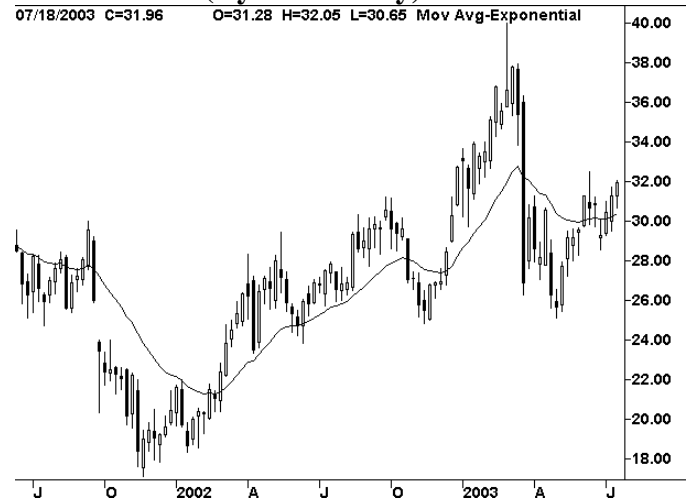
## COMMODITIES

- Oil's quiet strength continues
- Gold's rally falters
- Cocoa breaks down on perfect chart action
- Stops hit on soybeans as advance reverses

**Delays in resuming Iraqi production and concern over supplies from Nigeria have kept oil prices firm.** While coalition forces successfully protected Iraq's oil installations during the war, they did not prevent the looting of vital equipment. Additionally, there have been incidents of sabotage by the remnants of Baathist forces loyal to Saddam. Since supply concerns over Nigerian production remain, petroleum dealers have stockpiled reserves. This has kept petroleum prices firm but not pushed them sufficiently high for the US and other countries to release supplies from their strategic reserves. Nevertheless, production from Iraq can only increase in coming months, and few doubt that this country will be a major supplier of crude oil in future years. Nigeria will pump, because oil is its primary source of revenue. As for the all-important chart, this shows a top in March, characterised by a severe reaction against the prior uptrend. Against

this background the current rally looks like a typical and extended phase of top extension beneath the year's earlier high. While some further near-term gains cannot be ruled out, the next big move should be downwards.

## CRUDE OIL (Nymex weekly)



**Last month we felt gold's rally looked likely to falter and retrace recent gains back toward \$330.** Thus far we have witnessed an initial decline to \$340 and a rebound to \$351 and we would advocate stops against the physical market at \$358. We anticipate that the decline will resume shortly, and are looking for a low at or around \$330. Long term we are mildly bullish as gold could prove to be a strong store of wealth in the face of a potential dollar collapse.

## GOLD (weekly)



**In June we felt that traders should trade a break of 1800 on cocoa and we have duly witnessed a**

classic break of support and a concerted drive down. Hopefully eagle eyed traders will have spotted the move unfolding and garnered some very healthy profits. The move does not look to be over and after a brief rally prices are heading lower once more. A protective stop on shorts should be placed at 1600 and we believe that prices could hit the 1200 level before the falls subside.

### COCOA (weekly)



No such excitement in the Coffee market as prices drearily trade broadly sideways within the 58 to 70 range. Unless and until a change in the market background occurs to drive prices we advocate standing aside and awaiting developments.

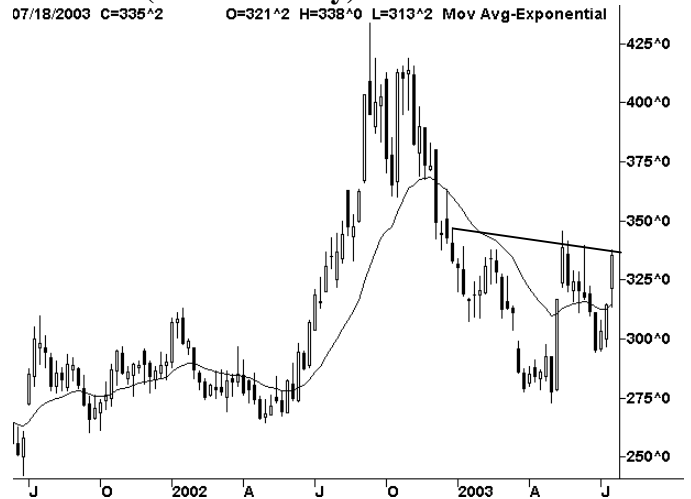
### COFFEE (weekly)



After a huge rally late last year and the subsequent fall back to support at \$3.00 wheat has quietly traded gently higher above the base. We

suspect that wheat may be building a platform to launch an assault on last years high at \$4.30 and would look to buy on a tick above \$3.50. As usual until and unless such a development occurs we would advocate masterful inactivity.

### WHEAT ( CBoT weekly)



The collapse in Soybeans should have triggered everyone's stops at \$612 and locked in a small gain. The market has since rolled over in dramatic fashion and looks set to fall further in the near term. We would advocate instituting short sales with a stop at \$600.

### SOYBEANS (CBoT weekly)



### FINALLY

As always we would thank all our readers for their interesting comments which we try to read

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and reply to (although sometimes there are so many that our response is slower than we would wish so please stick with us) and look forward to receiving many more as the markets play out the final stages of the current bear rally over the next few months.

Regards

Andy McCarthy & Andrew Bartles