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## WAITING FOR THE BIG BREAK-OUT!

### BARMAC MARKET DIRECTIONAL INDICATOR:-

**SELL SIGNAL** -issued on 10<sup>th</sup> March & confirmed on May 2<sup>nd</sup>.

#### 1.GLOBAL ECONOMY

Equity market "Jailbreak"

Tech-Wreck has farther to go.

Deflation Redux

Browns spend, spend, spend!

G.M. subsidies.

#### 6. INTEREST RATES AND BONDS

Govt short-term rates turn up

Long-term bonds short-term bounce?

#### 6.EQUITIES

No fear in the VIX

Market break.

Tokyo loses momentum.

#### 8.CURRENCIES;

Dollar rally to continue

Pound strengthens as rates rise

#### 9.COMMODITIES

Oil how high now?.

Gold to go lower

Metals reverse

Softs broadly soften.

*"Tonight there's going to be a jailbreak"*

*Thin Lizzie*

Since the start of 2004 the worlds leading equity market indices have traded in relatively orderly and tight trading ranges. The Ftse for example has been stuck between 4300 and 4550 since late '03. The Dow and many others (Nasdaq, CAC, DAX, S&P, etc.) have had similar constrained ranges of typically 7 or 8%. They have all been jailed!

At present the trading patterns are as yet unbroken but we do know that a break-out will happen sooner or later as tension rises.

The interesting part lies in the magnitude and power of the move out of this current trading range. Tight ranges act like a huge coil waiting to spring and the longer and tighter the range becomes then the greater the explosive force of any unwind.

If we examine four previous examples of tight range-bound action on the Ftse 100 we can glean an idea of the latent power and potential of what kind of action a chart break-out might well lead to;

#### Example #1

March '86 to December '86 saw the Ftse stuck between 1530 and 1700 a range of just 10%. The break-out that followed saw the Ftse **advance 40%** to 2443 prior to the "Black Monday" crash of '87.

#### Example #2

January '88 through January '89 saw the Ftse trade between 1700 and 1880 for a typical 10% range. As can be seen from the chart below the range was blown away with a nine-month advance that carried **Ftse 35% higher** to over 2400

### Example #3

From September 1994 to March '95 the Ftse shuffled between 3150 and 2950, a range of just 7%. Once the 3150 level was breached the Ftse advanced virtually un-interrupted for 12 months to 3800 and a **gain of over 20%**

### Example #4

From October 2001 to May 2002 the Ftse was caught between 5000 and 5350 a range of only 7%. However, by the end of July 2002 the index had swept down to a low of 3600 for a **swan dive of 30%**.

### Example #3

#### Ftse 100 (Sept '94 to March '95)



### Example #1

#### Ftse 100 (Mar '86 to Jan '87)



### Example #4

#### Ftse 100 (Oct 2001 to May 2002)



### Example #2

#### Ftse 100 (Jan '88 to Jan '89)



It is clear that the historical precedent has been clearly set. A range lasting six months or more should lead to a dramatic move of at least 20%.

But the current range has all the more potential because so many other global markets are also range bound. So we suspect that before maybe even the summer's end, the Ftse and all the worlds other key indices will begin a synchronised move strongly out of their trading ranges. We do not know the direction of the move (we guess down but we will not pre-judge the opportunity) but would advise all participants to be ready to trade in the direction of the break or cover their positions. **The next move by equities will be fantastically powerful and carry the Ftse either above 5000 or more likely below 3800.**

It is now time to anticipate and rehearse your trading actions for when, and not if, the break comes.

You have been warned so adopt the scout's motto and be prepared for windfall profits.

More on one of the potential drivers of the move below.

**Beware the "Tech-Wreck" has plenty of scope to cause more damage over the coming year.**

Four years and five months ago, on March 10, 2000, the Nasdaq Composite Index, representing the cream of U.S. technology and innovation, closed the trading day at an all-time high of 5,048.62.

This past week ... even after the most massive government effort to pump up the economy in recent history ... and even after nearly 20 months of intensive Wall Street cheerleading ... the index closed at 1,821.

If you invested £10,000 in a portfolio representing the average Nasdaq stocks at their peak, you'd have only £3,700 left today.

Despite all the double- and triple-digit gains many tech stocks have enjoyed since late 2002, you'd still be looking at a loss of 63 %.

This is the harsh reality of tech-stock investing in the twenty-first century. And if July is any indication, the tech stock woes are far from over.

The main problem for Tech stocks is LOST PRICING POWER.

We could talk about the string of profit warnings from tech companies that have come out in recent weeks. But the key is the prices the techco's can charge. Many companies are having a real tough time charging what they used to. Prices of most things are going up all around us. But in the technology world, falling product prices seem to be the norm.

"Why's that?" We ask ourselves and we answer our own question; typically, as a technology matures, the price falls. That's true whether you're talking about a Texas Instruments calculator, a Dell computer, a cellular phone call, or a Sun Microsystems server. Prices drop. Almost always. So usually, the only way to restore pricing power is to come out with new, killer applications and technologies that you can charge more for. That's

how the industry maintained its pricing power in the past.

Now, we don't see hardly any new killer apps. It's just not happening in most tech sectors. Typically, the only new products we see are enhancements and embellishments of stuff that has already been out there for at least a few years.

In 2003, IBM pulled in about \$89 billion worth of revenues. Now that sounds like a ton of business. But it's not much when you realize that IBM pulled in nearly \$88 billion of sales in 1999.

Thus we now know what their top-line sales growth was for the past five years? Less than one percent! That's an average of under two-tenths of a percent per year. Pathetic.

Now if we consider these figures. TOTAL sales growth over the past FIVE years:

Sun	Microsystems	—	3.2%
Intel		—	2.8%
Micron	Technology	—	0.5%
Oracle		—	2.8%
Qualcomm		—	3.5%

Applied Materials — 2.1%. Plus, don't forget the techs with negative sales growth in the past five years ...

"Lucent,	down	22.4%
"Gateway,	down	14.6%

**FREE PASS?**

Some people on Wall Street still seem to believe that the technology business deserves a free pass on basic economics simply because they produce hot, exciting products.

Our main point is that tech companies are no different from any other company. They have revenues. They have expenses. If they lose control over either one, you get lower profits — or losses.

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Forget all the mumbo-jumbo just look at tech companies as a business person would — not as an investor or as an analyst. You'll see an industry that's STILL priced ridiculously high, despite the two-thirds wipe-out from the peak to today.

Wall Street analysts haven't quite figured this out yet. When they do, watch out. Tech stocks could plunge a lot further.

The UK's No.1 inflation hawk sees runaway prices everywhere he looks. But watch out, warns MoneyWeek. The risks of a "lost decade" aren't done yet...

## **DEFLATION REDUX** **by James Ferguson**

*Investors have every right to feel mighty confused right now. Economists are famously incapable of agreeing on the solution to any problem. But you would hope that they might agree on what the problem is in the first place.*

*Is it inflation or deflation that most threatens the British economy? For most of the last three years, there was no such disagreement. Collapsing equity markets were pushing down asset prices, and China and India were pushing down the prices of finished goods and services respectively. With the lesson from Japan's "lost decade" of deflation fresh in central bankers' minds, the policy response was clear...*

*Cut rates to super-low levels, and increase public spending to bridge the gap until asset prices recovered and pricing power returned. But the policy may have worked too well. Over the last six months, a consensus has emerged that interest rates around the world were kept too low for too long. As a result, the global economy now faces a potentially dangerous inflationary spiral.*

*The case was most provocatively put in a recent cover story in The Economist. "Suppose a Martian returned to earth today, a quarter of a century after his last visit," the magazine said. "He would note that America's economic slack is disappearing fast,*

*that its nominal GDP has risen by 7% over the past year and that inflation is around 3% and rising. From this he might guess that short-term interest rates should be around 4% - ie, positive in real terms. Tell him that America's interest rates are currently 1% [they have since risen to 1.25% of course] and he would probably jump on the next plane back home."*

*This view is shared by Anatole Kaletsky, The Times's formidable economics commentator. He reckons the current US combination of an "ultra-lax" monetary policy and a falling dollar is reminiscent of the conditions that triggered the great inflation beginning in the mid-1960s. America today, says Kaletsky, is guilty of the seven deadly sins - of easy money, lax fiscal policy, devaluation, war, protectionism, high oil prices, and spiralling public spending.*

*In normal times, any one of these might be sufficient to push up inflation. "All seven operating together would be a sure-fire recipe for prices to take off," says the Times' man. "The Fed is doing too little, too late," he concludes "to keep US inflation under control."*

*Here in Britain, the most high-profile inflation hawk is undoubtedly Mervyn King, Governor of the Bank of England. In recent speeches, he warned that the UK economy is very near the limit of what it can produce in terms of both manufacturing and services - a situation that normally pushes up prices. Unemployment is just 4.8% and consumer spending remains robust. Most menacingly, house prices are soaring at an annualised rate of 15%.*

*Thus UK interest rates have already risen four times in the seven months. The consensus is that they will rise another 1% in the next year.*

*But hang on - how can the threat of deflation have disappeared so quickly? Stephen King, chief UK economist at HSBC, argues in a persuasive new report titled 'Dicing with Debt' that the threat of deflation has not gone away, it has just mutated into a different - and far more virulent - form.*

*The deflationary pressures of two years ago were*

what Mr King calls the "good deflation" of rapidly improving supply-side driven growth. Under the circumstances, there was really no need for central banks to lower rates as much as they did. The effect of cutting rates so low was to stimulate investment in risky and unproductive assets - "notably housing". Unfortunately, because of the debts built up when rates were low, we now face "bad" debt-deflation - which is a far more worrying condition.

"De-leveraging can take place in an uncontrolled manner," says Stephen King, "and rates of economic growth can slow swiftly." He is not the only economist worrying about the prospects for debt deflation. Roger Bootle, managing director of Capital Economics, fears we are much closer to a crisis than the central bankers would have us believe. He notes that, once you include capital repayments to interest costs, debt-servicing costs in the UK are currently 19% of post-tax income - close to the 1990 peak of 21.8%.

If interest rates rise to 5.5% in line with market expectations, debt-servicing costs will far exceed the 1990 peak. At some point, it is inevitable that households will start to repay their debts, which means they will have less to spend in the shops. Shops will be forced to drop their prices, which in turn will swell the real value of debt yet further. A similar debt-deflation was what caused the negative-equity recession of the early 1990s.

If Messrs King and Bootle are right, what does this mean for investors? Well, interest rates would fall again much sooner than anticipated - and from lower peaks. But Britain would also face a more calamitous near-term response by the economy, not least a collapse in house prices.

This chimes with MoneyWeek's view that the residential property market is highly vulnerable to a crash. It is at odds with the view of those academic and political economists who believe inflation is the real threat.

The question of "inflation or deflation?" has a major bearing on the outlook for every other investment class, too. A period of higher inflation is traditionally bad for bonds, but can be positive for

equities. If, on the other hand, we face a period of debt deflation - in which house prices fall and household savings start to rise - then you should expect economic growth to stall. The Bank of England will start cutting interest rates again, and fast.

Equity investors would be hit by falling corporate profits; bond-holders would be rewarded not only by rising bond prices, but also an increase in the real value of their assets. Which of these two scenarios is right? At this point, the situation is far from clear. But that will change over the coming months...as the Bank of England's baby-step rate rises really start to bite.

In the meantime, cash - with its ever-higher return and inherent flexibility - remains the asset class of choice.

Curiously, Britain's current inflationary bubble has manifested itself in house prices. Yet neither house valuations nor even average mortgage costs are included in the new official measure of inflation, the more Euro-friendly CPI.

Since Gordon Brown gave the Bank of England freedom to set rates, it was inevitable that the measure he told it to target would become a political issue. But it now seems so far removed from reality, it's impossible to tell whether Britain actually has any inflation or not. The old measure, the RPI is already growing at nearly twice the rate of the CPI - a rate of 2.8% versus just 1.5% per year.

### **Browns fraudulent Spending Review:- Or Borrow more, Spend more, Tax more**

Regular readers would expect Barmac to ridicule the "Iron Chancellors" spending review and as we hate to disappoint people we have found plenty to guffaw at! Gordon Brown's entire Spending Review was a fraud, of course. He has no intention of sacking 100,000 public sector drones (remember this is the same man who has created over 500,000 non-productive public sector jobs since 1997).

Indeed, Dear Prudence told the Commons Treasury Select Committee that - in truth - public sector employment will actually rise over the next year.

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In fact if the 2002 Spending Review had been implemented, there would already be 45,000 fewer 'back-room' staff on tax-funded salaries today so we think we know how to treat Brown's promise to cut 100,000 jobs.

Interestingly, the free-market think-tank Reform reckons we'll be subsidising an extra 360,000 civil service posts - net - within 3 years. "For every 'head office' job cut," notes Merryn Somerset Webb in MoneyWeek, "another four new public-sector jobs will be created, of which only one will be a nurse, teacher or police officer.

So much for improving public-sector efficiency. But the best is yet to come! Efficiency doesn't come cheap, though. So Culpability has set aside £300m for a new "efficiency challenge budget". No, really. That's what it's called. And that's how much it will cost.

Gordon's plan is working brilliantly so far, don't you think? Efficiency really has never been so challenged.

In May, public sector pay growth outstripped private sector wage inflation for the 20th month on the run. Excluding bonus payments, public sector pay growth stood at 4.4% annualised in May, compared with just 4.1% in the private sector. So not only is New Labour failing to reverse its recruitment binge; it's paying over the odds for it, too

We find Gordon Brown's shamelessness the more offensive because Britain simply can't afford either his economic or employment miracle. Massive public sector job creation makes countries poorer and less competitive and any sense of full employment a short-lived chimera. But regime change in Leicester South won't change his plans.

So we may as well accept the New (old) Labour mantra. Borrow, spend, tax. Borrow, spend, tax. Borrow, spend, tax. Borrow, spend, tax. Borrow, spend, tax. Borrow, spend, etc.etc.etc.

### **General Motors and desperate sales**

General Motors reports a harrowing sales decline. The automaker's sales plummeted more than 12% in

June, despite a dazzling array of "incentive" programs...could it be that the consumer is simply tapped out?

"Fortunately for GM, July is a new month," Automotive News hopefully observes. Unfortunately, GM's incentives have become so lavish that sales won't necessarily mean profits. This is getting good. In the US GM will rebate you \$250 if you DON'T buy one of their cars (but 'test-drive' it)! You can't make this stuff up! Additionally you also get \$5,000 back if you're a returning customer. It makes you wonder about the value of GM's 'brand.'"

- We also wonder why most of GM's creativity seems to reside in its marketing department. Why not re-deploy this talent into the automotive design department?

- Time will tell if GM's groundbreaking incentive programs are also bank-breaking. "The first of GM's current innovations was the payment of \$250 to anyone who test drives a GM car or truck and then purchases a non-GM brand," Automotive News reports. "That sounds like an open invitation to steal from GM. Drive a GM model that you have no intention of buying and pick up \$250 to help with the down payment on the Ford or Toyota or Chrysler of your choice. Paying rebates on the other guy's merchandise is definitely a first in automotive marketing.

- "Next came a round of huge bonuses to owners of GM vehicles who buy another GM model," Automotive News continues. "OK, loyalty payments aren't new, but \$5,000 loyalty bonuses certainly are. That is the amount GM paid in June to buyers of 29 car and truck nameplates.

Coming soon: Cash rebates on tech stock purchases?

### **Interest rates and Bonds**

- **Merv keeps turning the screw on the housing market.**
- **The Fed follows suit**

- **The Bond markets work off their oversold condition.**

**It's getting serious now! The house price boom that every TV programme loves is starting to hurt the "real economy" (you know the one that involves work, production and investment into future production).**

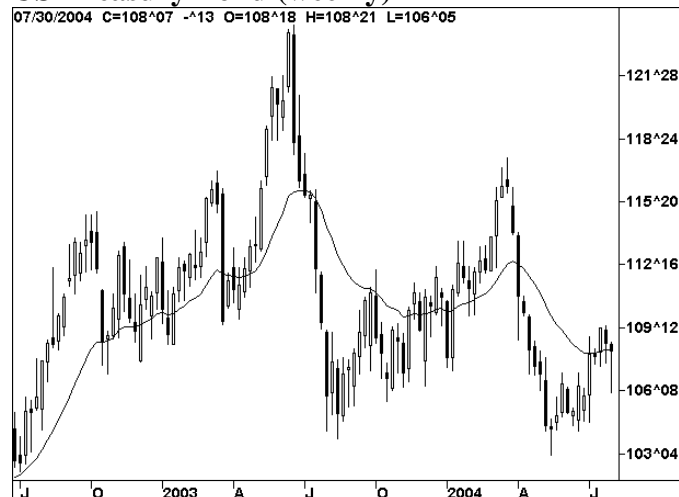
The B of E has today raised rates to 4.75% in order primarily to cool off the huge excess speculation in the UK housing market (who could logically believe that price growth could carry on exponentially after the gains of the last four years). We suspect that "Merv the swerv" is prepared to ratchet rates up to 5.5% until the housing market cracks, but unfortunately the UK economy may well crack along with it. Merv possibly believes it will be better to have a relatively small bust now than a huge one if the housing bubble was allowed to carry on growing unchecked.

The B of E may also feel that it has to act as a counterbalance to Browns monetary profligacy that threatens to unbalance the economy and trigger stagflation. Brown's huge budget deficits and fiscal stimulus are at odds with the banks tightening stance so relations between the two must surely be strained.

**In the US "bubbles" Greenspan has reluctantly begun the process of raising rates that may prick the stock and real estate bubbles evident in our former colony.** The current CPI is 3.1% with interest rates of 1.5% so currently the Fed lends money at a real -1.6%! We suspect that US rates will be positive when the current round of rate hikes finishes and that the Dow etc will be merely a percentage of its current self.

**Following the worst ever May and June for Treasuries and Gilts we have seen a small bounce in July.** The bounce could well continue for a few weeks yet as Central Banks increase base rates. But the continued avalanche of supply from Brown and Bush (or Kerry) will however, eventually overwhelm the rally. All three certainly do not believe in small Government

### US Treasury Bond (weekly)



### Gilt 8% 2013

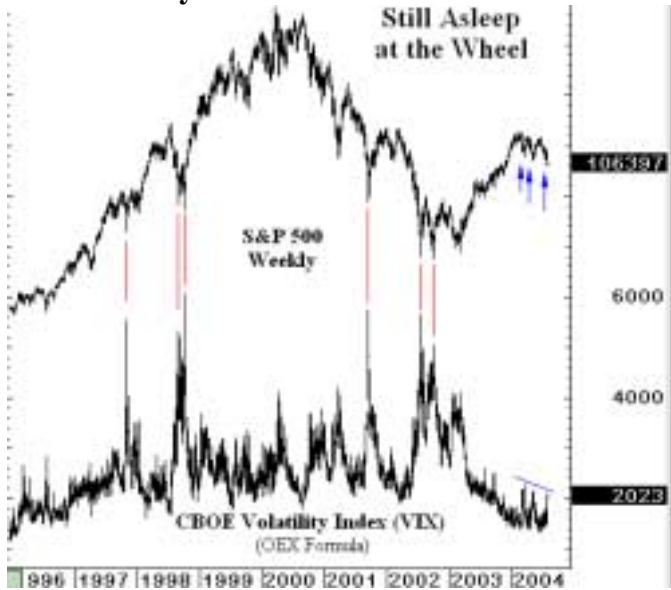


### EQUITIES

- **Still no fear as VIX is comatose.**
- **Warning equities ready to crack**
- **Global equities remain range-bound**
- **Even Tokyo has lost momentum**

**Despite negative market action all year and summer equity declines the VIX is still languishing at all-time lows.** The continued "snooze" by this measure of fear in the market (calculated using option premiums and momentum) indices that their continues to be no fear. Thus clearly there remains real scope for significant market falls. Indeed recently each new fall has been met with less fear so clearly no sign of any kind of bottom here. A key low would need the VIX to hit 4000 plus.

**VIX volatility on S & P**



Investors should forget all the rubbish news about the oil price, Iraq and the earnings season. All anyone needs to do is simply focus on the various major market charts to determine where equities will go next. As discussed at the front of this issue all markets are trapped in trading ranges but the “jailbreak” could well be imminent as interest rates slowly climb. We simply say **“WATCH FOR THE BREAK”**

**Ftse 100**



Key levels for Ftse are 4575 or 4300, a sustained move beyond these two key levels will open moves to over 5000 or below 4000.

**Dow Jones Industrials**



**Key for Dow: 10,600 and 9,900.** A breach of these levels will open 12,000 and 8,000.

**S & P 500**



**S & P keys are 1,150 and 1,080** targeting 1,250 or 950.

**Nasdaq Composite**



The Nasdaq appears to be leading to the downside as it pressurises support. The key level remains the 1860 level that was breached recently. Only an immediate return above 1860 would negate the negative implication of recent weakness. The downside target would be at major support established at the November 2002 high at around 1500.

The charts for both Germany and France display near identical patterns with clearly defined trading ranges. The advice remains constant; Watch the key levels and go with the break.

**CAC level is 3,500**  
**DAX level is 3,700**

### French CAC



### German DAX



### JAPAN 2<sup>nd</sup> Section



The Japanese market has been led up by the dramatic gains on the otc. Market. The 2<sup>nd</sup> section has blasted up and more than doubled over the past 18 months. However, the market may well be about to seriously reverse with a massive non-confirmation apparent on all momentum studies (MACD shown above). As the index hit consecutive major new highs momentum significantly failed to confirm the move indicating serious technical erosion. Certainly the index looks likely to be drawn back to the spring lows in the short term. We suspect that the OTC market will thus lead the “blue chips” down just as it led them up.

### CONCLUSION ON EQUITIES.

The year’s major opportunity is at hand. Once the many trading ranges break traders will be able to play a very clear and simple trade in the direction of the move. History tells us that this should be worth at least 10 to 20% over the next 6 to 12 months. We are excited so hopefully are our readers at this mouth watering prospect.

### FOREX

- The Dollar recovery continues slowly
- Pound, Euro and Dollar crosses are all at key levels.

The Dollar’s counter-trend rally that began in February crawls on. As regular readers are aware we believe that the dollar will progress toward 96/98 levels on the Dollar index before the bear re-asserts

itself. Thus we expect further upside action over the next few months. The Dollar index below needs to hold above 88.00 to maintain the positive bias. Any progress toward 92.00 could signal the onset of the major leg up to our targeted region. Traders should be long with a stop at 88.00

### DOLLAR INDEX (weekly)



The Euro/Dollar cross (below) is a virtual mirror image of the dollar index. So we are looking for the Euro to decline below 1.2000 in coming weeks and this to open a swift decline toward 1.1500.

### EURO/DOLLAR (weekly)



Cable (below) is yet another chart that is nicely poised but as yet has not revealed clearly how the current triangle is likely to resolve. The cross has built a large triangle via a strong up-trend and a pair of tops. Any breach of the triangle is likely to lead to a profitable move of at least 10 cents.

Obviously, our script would lead us to expect dollar strength and a dollar advance toward the mid-£1.70's, but we would not trade against a move over £1.87.

### Dollar / Pound



The Euro/Sterling cross also finds itself at an interesting turning point. The tightening “wedge” evident below looks likely to resolve with Sterling strength which would corroborate the Dollar index chart. This would tie in with our script of short term Euro weakness followed later this year or next by the resumption of the Euro bull/Dollar bear. Key levels to watch are £1.53 and £1.50.

### Euro / Pound



### Bottom line on Forex

Dollar rally appears to be still on track although all crosses appear “paused” in short term patterns. We expect renewed Dollar strength / Euro weakness to occur shortly leading to the counter trend bottom for the Euro during the autumn.

## COMMODITIES

- **Commodities (CRB) fall as global liquidity shrinks**
- **Oil shows no sign yet of weakness**
- **Gold ambles lower**

**The CRB has clearly stalled lately and is carving out a triangular consolidation.** Whether this represents merely a pause in the bull trend or a reversal is unclear but as global liquidity is drying up with the Fed raising rates and a bust through the floor at 265 would herald further weakness in the commodity markets.

### CRB INDEX (weekly)



### CRUDE OIL (Nymex daily)

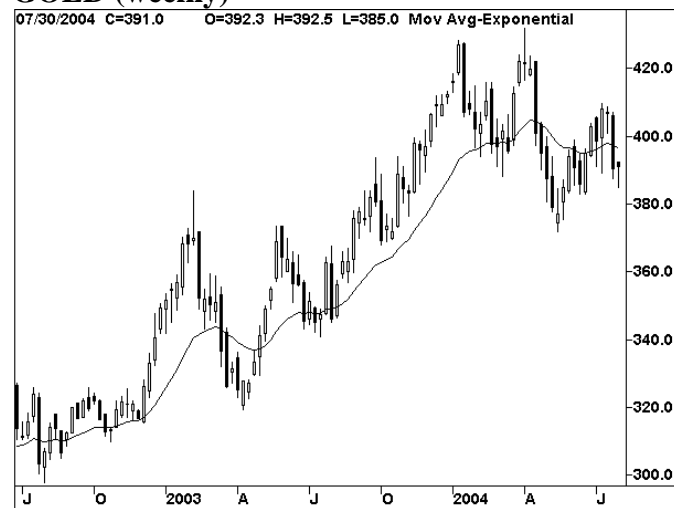


**Oil continues to defy gravity as global supply concerns; Yukos and Iraq combine to drive prices higher.** However, the US strategic reserve is

overflowing. So we suspect that at some stage this summer Bush will unlock the strategic reserve to create a dramatic price reversal ahead of the election. Oil is a tough play at present as it is being bandied about via war and politics and is likely to remain very volatile. We suspect the current advance will collapse soon with prices back to the mid \$30's but the days of cheap oil are over.

Supply will be a major concern over the next ten years as China and India industrialise and over the long term oil can only go much higher. But for the present the current rally looks overcooked and susceptible to a "shocking" correction.

### GOLD (weekly)

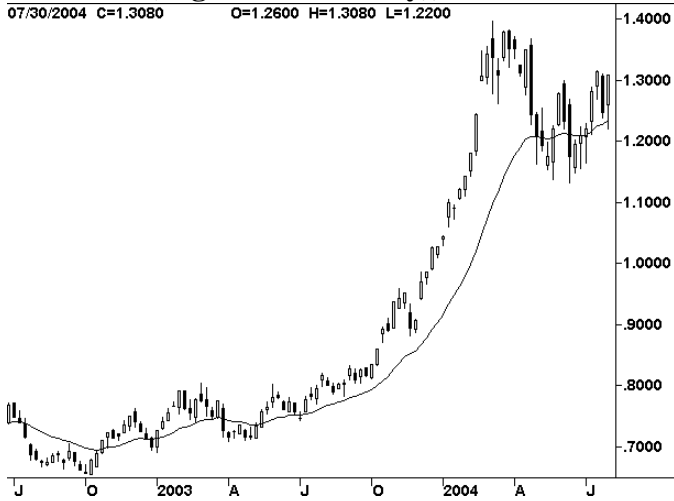


**Gold peaked out in January and has slowly worked lower since implying that inflation concerns are easing.** We would expect gold to soften further as global interest rates creep higher and the global economy weakens. As deflation re-appears and the dollar bear resumes during 2005 we suspect the gold market will resume its upward bias.

**The main industrial metals shown below have lost all upward momentum** and have posted lower highs recently. The two metals now require an upward dynamic to ease the danger of a further deterioration as supply increases and global growth wanes.

Breaks of the recent lows would indicate serious weakness of commodities and the economy.

### COPPER (High Grade weekly)



### Aluminium (weekly)



### SOFTS

#### COCOA (weekly)



**After steep declines over the last year Cocoa has mounted a significant rally. We would not chase**

higher as there remains significant overhead supply at the 1750 level.

### COFFEE (weekly)



**Coffee's recent weakness has continued** and the price action looks likely to lead to yet further price erosion. Support exists between \$60 and \$65 and should cushion the downside. Coffee has been in a long long bear market over the last few years and we suspect that the chart should be worth following for signs of life once the current falls ease off.

### SOYBEAN (monthly)

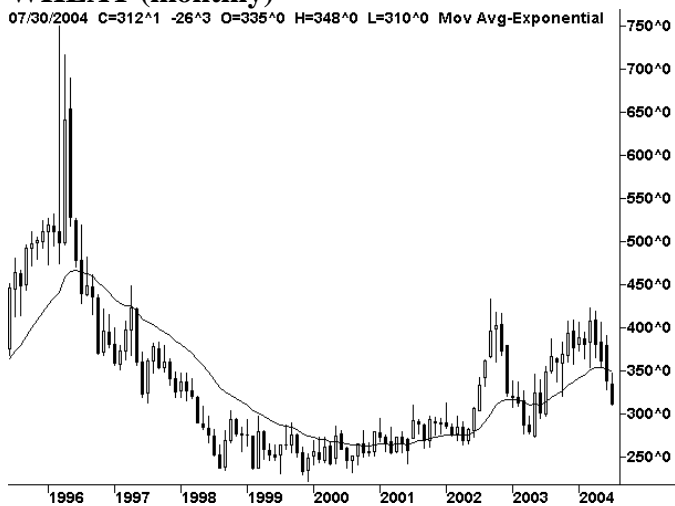


**Phew! The phrase "roller-coaster" could have been invented for this chart.** The dramatic rises of the past two years have been erased in short order. We are glad we advised everyone to place a stop at \$8.75 that has allowed all to profit. It's a pity we did not suggest shorting despite saying last month that we thought it would remain weak.

Our new advise: Stand aside and watch and enjoy the show.

**Wheat has also reversed its recent strong run and looks set to test the 2003 low at 290.** We see no reason to buy but would be loathe to chase any lower with a short. So yet again our advice is to stand aside for the short term until a significant low has been established.

### WHEAT (monthly)



### FINALLY

**Stop press: As we were writing this edition the US markets appear to be testing the lower bands of their trading range. We watch with interest to see if the decisive break has arrived.**

As ever we welcome your feedback and if you have any comments we would be delighted to hear from you

**Regards**

**Andy McCarthy & Andrew**