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info@barmacjournal.co.uk

EU AND US GANG UP ON CHINA AS CURRENCY AND TRADE TENSIONS GROW.

BARMAC MARKET DIRECTIONAL INDICATOR:-

SELL SIGNAL -issued on 22ND MARCH
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Treasury Secretary Snow has just fired a cannonball across the bow of China's ship of state, the first salvo of a currency war. At the same time EU commissioner and well-known mortgage applicant Peter Mandelson was on TV to announce the imposition of EU protectionist trade barriers on Chinese cotton garment exports.

Snow told China flatly that unless it revalues its currency, the U.S. will retaliate with massive trade barriers. And he's starting to make good on his threat, slapping punitive quotas on a series of Chinese exports to America.

He has no choice. America's trade deficit with China is the largest single-country deficit in the history of the world. It's hammering the dollar and driving thousands of U.S. manufacturing companies into the red. These companies have been desperately lobbying the U.S. government to force China to revalue its currency sharply up -- or else they're going to wither and die.

The Chinese authorities are equally desperate. They want to keep their currency -- the Yuan -- cheap because that's the only way they can keep their manufacturing costs low and give their industries a competitive advantage.

If they revalue the Yuan upwards, their exports will almost immediately become more expensive -- and less competitive -- on world markets. The downturn could shatter the fast-growing but fragile Chinese economy. So they adamantly refuse to do it.

Of course trade wars never help any country and protected industries grow increasingly backward, high cost and uncompetitive. Such a "beggar thy neighbour" attitude is reminiscent of the thirties and very dangerous for global economic well-being!

Historically Wall Street is still very high

The chart below places the historical context perfectly and illustrates the dramatic blow out in 2000 and the subsequent residual high valuation.

We love charts like this because they set in clear context current valuations and although not predictive of market trends for the forthcoming weeks or months, a chart like this certainly highlights the fact that long term returns are going to be stunted until the overvaluation has been worked off.

S&P 500 Price-to-Normalized* Earnings Still Sit at the Top End of a 100 Year Range



Placing this Rally in an Historic Context

Equities have risen sharply since the bear market lows set in October 2002. Investors who have held onto stocks over this two and a half year period have been handsomely rewarded, as the S&P 500 has risen by 48%. The important question for investors to ponder is whether this powerful bull market can last and, if so, for how long? History argues that rallies starting from low valuations tend to endure, while those starting from high valuations are usually given back and sometimes agonizingly so.

For example, the last major US equity bear market started in February 1966 when P/Es were at the high end of their historical range. This bear market lasted until August 1982. There were four very powerful rallies over this period when the market was up 32%, 66%, 76% and 38%. But, the index lost close to 50% of its value in real terms over the entire period (look at the Nikkei since '90 and a very similar pattern emerges). In the meantime, the P/E was taken down from the high end to the low end of its historical range, thereby setting the stage for the most impressive secular bull market in modern history.

From 1982 to 2000, earnings increased by 120% and stock prices rose six-fold in inflation-adjusted terms. Valuations were pushed up to a level not seen in more than 100 years. In the chart above, we see that valuations have come down significantly over the past several years but still sit at the high end of their historic range. It is doubtful that the rally from October of 2002 marks the beginning of the next secular bull market. It would be an unprecedented development if it were indeed the case.

So, if we are not on the cusp of a major bull market then what are we facing? What can investors expect out of the stock market over the long term, say over the next decade?

Our view is reliant upon mean reversion. Basically, a generational-long period of expanding p/e ratios is followed by an approximately similar duration of p/e ratio contraction, creating the conditions for the next bull market, and so forth.

A secular bear market does not mean perpetually declining stock prices, let alone disaster. In fact, we will see some good medium-term technical bulls within the secular bear trend, such as the March 2003 through February 2005 advance, but these will be unsustainable. Additionally, in a secular bear we should expect lower average returns and more frequent market declines. In other words, we have a trading environment.

If Wall Street is in a secular bear market, does this mean that equities in all other countries will conform to the same pattern? Not precisely, but they are very unlikely to completely uncouple from the US market's gravitational pull. During downturns some will under perform Wall Street. However the big difference is that some will do very much better during the medium-term rally phases.

THE GREAT WEALTH DECEPTION

by Dr. Kurt Richebächer

This is the most important economic question in and for the world: Has the U.S. economy's rebound since 2001 been aborted, or is it only delayed? Our rigorous disagreement with the global optimistic consensus over this question begins with four observations that we regard as crucial:

1. In the past four years, the U.S. economy has received the most prodigious monetary and fiscal

stimulus in history. Yet by any measure, its rebound from the 2001 recession is by far the weakest on record in the post-World War II period.

2. Record-low interest rates boosted asset prices and, in their wake, an unprecedented debt-and-spending binge on the part of the consumer.

3. What resulted was a badly structured economic recovery, which - due to grossly lacking growth in capital investment, employment and wage and salary income - never gained the necessary traction to become self-sustainable.

4. Sustained and sufficiently strong economic growth implicitly requires a return to strong business fixed capital spending. We see no chance of this happening. Above all, the outlook for business profits is dismal from the macro perspective.

This takes us to the enormous structural changes that the Fed's new monetary "bubble policy" has imparted to the U.S. economy over the years. While consumption, residential building and government spending soared, unprecedented imbalances developed in the economy - record-low saving; a record-high trade deficit; a vertical surge of household indebtedness; anemic employment and income growth from wages and salaries; outsized government deficits; and protracted, unusual weakness in business fixed investment.

None of these shortfalls is a typical feature of the business cycle. Instead, they are all of unusual structural nature. Yet the bullish U.S. consensus simply ignores them, bragging instead about the U.S. economy's resilience and its ability to outperform most industrialized countries.

To be sure, all these structural deformations tend to impede economic growth. Some, like the trade deficit and slumping investment, do so with immediate effect; others become repressive only gradually and in the longer run. Budget deficits stimulate demand as long as they rise. An existing budget deficit, however large, loses this effect. Rather, it tends to become a drag on the economy. In the past few years, clearly, the massive monetary and fiscal pump-priming policies have more than offset all these growth-impairing influences.

Assessing the U.S. economy's future performance, it is necessary to distinguish between two opposite macro forces: One is the drag on the economy exerted by the various structural distortions; the

other is the enormous demand-pull fostered by the housing bubble and the associated rampant credit creation.

Measured by real GDP growth, the demand-pull driven by the housing bubble has, so far, overpowered the structural drags, provided you believe in the accuracy of the GDP numbers. We do not. Yet even by this measure, as repeatedly explained, it is actually by far the U.S. economy's weakest recovery on record in the postwar period. In fact, measuring the growth of employment and wage and salary income, there has been no recovery at all. Our stance has always been and remains simple. Asset bubbles and their demand effects invariably fade over time; structural effects invariably worsen over time if not attended to. It is our strong assumption that the negative structural effects are overtaking the positive bubble effects.

We come to another feature of economic recoveries that American policymakers and economists flatly ignore. That is its pattern or composition.

Past cyclical recoveries were spearheaded by three demand components: durable consumer goods, residential building and business fixed investment, regularly following prior sharp downturns caused by tight money during the recession. Importantly, the tight money had always created pent-up demand in these three categories, which promptly catapulted the economy upward when monetary policy eased. For sure, the pent-up demand played a key role in the recovery dynamics.

With its rapid and drastic rate cuts, the Fed rewrote the rules of the traditional business cycle and related policies. It managed a seamless transition from equity bubble to housing bubble. Consumer spending on durable goods continued to forge ahead during the 2001 recession at an annual rate of 4.3%. Residential building never retreated, while business fixed investment took an unusual plunge.

From 2000-04, consumer spending soared by 27.3% on durable goods and 25.4% on residential building. Government spending, too, rose sharply, by 13.9%. Together, the three components accounted for 123% of real GDP growth.

But in the rest of the economy, it was all misery. Despite a modest rebound, business nonfinancial fixed investment in 2004 was still down 0.2% from 2000. Exports of goods posted a minimal gain of 0.1%, whereas imports of goods shot up by 16.5%.

Thanks to the sharp decline in interest rates over the last few years, sharply inflating house prices have been a rather common feature around the world. Still, there is one crucial difference among the countries concerned. There are countries in which the rising house prices have fueled borrowing-and-spending binges by private households, and there are others where these binges are completely absent. Typical for the first pattern are all Anglo-Saxon countries; typical for the latter are most eurozone countries.

Even among the Anglo-Saxon bubble economies - meaning countries where the house-price inflation led to borrowing-and-spending sprees - the United States is a unique case. It concerns the official and public attitude to such bubble-driven economic growth.

The United States is the one and only country in the world where monetary policy was systematically designed toward the goal of inflating the market value of assets - stocks, houses and bonds - virtually making wealth creation through inflating asset prices their explicit goal.

In Britain and Australia, the associated borrowing-and-spending binges are even worse than in the United States. Yet there is a general apparent reluctance to embrace this growth model as an unmixed blessing. Central bankers who celebrate this as "wealth creation" and even explicitly animate people to exploit the possibilities of easy credit to lift their spending on consumption are unique to America.

For generations of economists, it used to be a truism that "wealth creation" implies capital formation in terms of generating income-creating tangible assets. The emphasis was on capital formation and the associated income creation. To indiscriminately put this label of "wealth creation" on rising asset prices in the absence of any income creation is plainly a novel usurpation of this concept. It is in essence wealth creation through a stroke of the pen.

Measured by their net worth (market value of household assets minus debts), American households have amassed unprecedented riches in the past few years, despite spending in excess of their current income as never before.

The first question springing to mind in the face of this "wealth miracle" is its cause or causes, leading

immediately to the next question: whether or not this drastic increase of house prices relative to the consumer price index has to be seen as a "bubble," which sooner or later have the habit of bursting.

In old textbooks, you would read that higher saving increases capital value. But in the U.S. case, capital values have soared while personal and national saving has collapsed. What else, then, has the power to lift asset prices?

Everybody knows the answer, but few want to admit it: Lured by artificially low interest rates and easily available credit, private households have stampeded as never before into the purchase of homes, boosting their prices. Artificially low interest rates and easily available credit are, actually, the key features that specifically qualify an asset bubble.

The growth of home mortgages exploded from an annual rate of \$368.3 billion in 2000 to an annual rate of \$884.9 billion in 2004, compared with a simultaneous increase in residential building from \$446.9 billion to \$662.3 billion. Altogether, the United States experienced a credit expansion of close to \$10 trillion during these four years. This equates with simultaneous nominal GDP growth of \$1.9 trillion. America's financial system is really one gigantic credit-and-debt bubble.

Our general misgivings about "wealth creation" simply through rising house prices has still another reason, however, and that is the way housing values are calculated. The conventional practice in America is to treat the whole existing housing stock as being worth the last trade. We do not think this makes sense, considering that current sales are always marginal to the whole capital stock.

This way of calculating wealth creation naturally explains the extraordinary rapidity with which it can deluge an economy, creating trillions of dollars of such wealth in no time. For sure, this contrasts wondrously with the tedious process of generating prosperity through saving, investment and production.

In earlier studies published by the International Monetary Fund about asset bubbles in general, and Japan's bubble economy in particular, the authors repeatedly asked why policymakers failed to recognize the rising prices in the asset markets as asset inflation. Their general answer was that the absence of conventional inflation in consumer and

producer prices confused most people, traditionally accustomed to taking rises in the CPI as the decisive token for inflation.

It seems to us that today this very same confusion is blinding policymakers and citizens in the United States and other bubble economies, like England and Australia, to the unmistakable circumstance of existing rampant housing bubbles in their countries. Thinking about inflation, it is necessary to separate its cause and its effects or symptoms. There is always one and the same cause, and that is credit creation in excess of current saving leading to demand growth in excess of output. But this common cause may produce an extremely different pattern of effects in the economy and its financial system. This pattern of effects is entirely contingent upon the use of the credit excess - whether it primarily finances consumption, investment, imports or asset purchases.

A credit expansion in the United States of close to \$10 trillion - in relation to nominal GDP growth of barely \$2 trillion over the last four years since 2000 - definitely represents more than the usual dose of inflationary credit excess. This is really hyperinflation in terms of credit creation.

In other words, there is tremendous inflationary pressure at work, but it has impacted the economy and the price system very unevenly. The credit deluge has three obvious main outlets: imports, housing and the carry trade in bonds. On the other hand, the absence of strong consumer price inflation is taken as evidence that inflationary pressures are generally absent. Everybody feels comfortable with this (mis)judgment.

Our view

The amazing US credit expansion is being felt the world over with bubbles in UK housing, oil and commodity prices and China. But inflation has held low due to the deflationary manufacturing bubble in China and India. When the air is finally let out of the system financial markets had better watch out.

YET MORE ON HOUSING

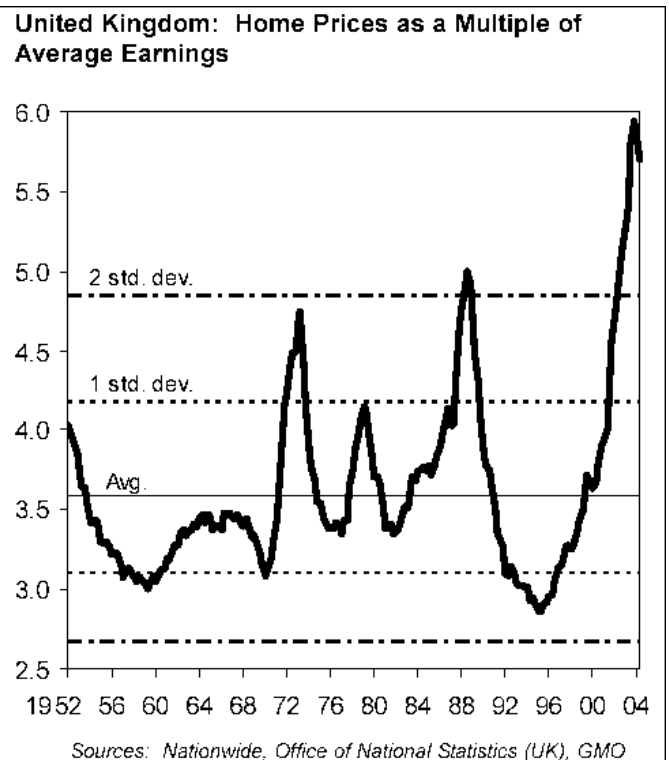
Just take a good hard look at the chart below. Then think of the recent news stories about the “iron chancellors” decision to spend our taxes on helping

so called “key” workers buy houses and the revelation in the Daily Mail that 93% of the UK is unaffordable to nurses, coppers etc etc.

The current unsustainable house price bubble may already be letting out some air but the return to normality could be long and very painful.

NO MORE COMMENT JUST LOOK AT THE CHART!!!

EXHIBIT #1



Many thanks to Steve Bennett of Barclays for highlighting the excellent Jeremy Grantham of GMO's view of the above astonishing chart:

“The increased role that housing price increases have played in sustaining the expansion of credit and consumption in the last several years has made us realize that we have not put enough research effort into this area and we are attempting to address this. But fortunately as a long-term reader of *The Economist* I am well aware that house prices are also mean reverting around a trend line multiple of household income.

Our quants in our London office reviewed the data and found, to our mild surprise, that for the last 45

years this trend seems to show no clear upward trend in this ratio as we would have guessed; Brits seem willing to spend only the same fraction of their income on housing over time – although they certainly have a lot of fun roller coasting around this flat trend.

Exhibit 1 shows the data and it makes a very worthy exhibit for the Bubble Hall of Fame: on the modern data, current housing prices in the U.K. are over **3 standard deviations** above trend, having as recently as 1995 been more than 1 standard deviation below it. This is about as extreme an event as the recent March 2000 U.S. equity bubble. This is remarkable, since March 2000 was the largest deviation from trend in modern U.S. equity history.

I have absolutely no doubt that the consequences will be similar, and that U.K. housing will also return to trend or below.

How painful would a correction be? To start with London, we could look at the last bubble that built up in the late '80s and broke in the early '90s. Viewed with hindsight from today's 3 sigma (standard deviation) event, the 1990 event looks like a bona fide member of the GMO bubble club where we draw the boundary at 2 standard deviations, which seems (at least to us) to be reasonable although it is quite arbitrary.

A 2-sigma event is the kind that would occur on the upside (i.e., a bubble) every 40 years **if the data were a normal distribution.**

Yes, we know the real world actually has more outliers than a normal distribution, that is to say, its distribution is 'fat tailed' and therefore there will be more 2 sigma events than there 'should' be.

But like arcane sports rules, these rules although arbitrary are the same for every asset class. In any case, even in our world of fat tailed distributions, we have **only found 28 good examples** of previous bubbles including: stock markets around the world, currencies, and commodities. As frequent 4 GMO Quarterly Letter – April 2005 Jeremy Grantham readers know only too well, I am patiently waiting for the current 28th bubble, the S&P 500, to go all the way back to trend – about 750 versus today's 1150. It fell to within 10% of trend in 2002, but still no cigar.

But, as also often mentioned by us, **all** the other 27 identified bubbles did indeed move all the way back

to (or below) the trend that existed prior to those bubbles forming.

The U.K. housing data in **Exhibit 1** shows, in addition to the **current mega bubble**, two prior substantial bubbles that both fully mean reverted. An interesting point, though, is that the 1990 bubble, although held responsible (rightly or wrongly) for considerable damage to the U.K. economy as it broke, did not involve as much pain getting back to trend as you might think because the trend line average income was also rising rapidly. It rose for two reasons. First, inflation was high by today's standard, averaging 4% a year for the 5-year decline, and despite GNP problems, average real incomes did surprisingly well. Nominal income gains for the 5 years totaled about 30% – about twice what you could expect today in the U.K. under recent conditions. So although the U.K. house price to income ratio had to fall by 24% to get to trend from a peak of 4.7 times to a trend line of 3.6 times, the typical home owner's house was more or less the same **nominal price at trend** as it had been at the peak!

$$(4.7 \times 1 = 4.7, 3.6 \times 1.30 = 4.7)$$

All the real pain from the decline of house prices then came not from the move to trend, but from the typically disturbing tendency for down cycles to over correct.

Prices bottomed at 2.9 times income, or another 20% below trend. Today, though, in the U.K., the price/income ratio would have to fall by 37% to merely get to trend, and today's lower inflation and lower income growth will cushion far less of the decline, perhaps only half. Once again any overrun would inflict additional pain. And any unexpected help from accelerating inflation in reducing the ratio would in the U.K. come with an equally unexpected sting in the tail: their floating mortgage rates would of course rise with inflation, leaving most people worse off, all things considered, than if inflation stayed low.

A damned if you do, damned if you don't situation if ever there was one."

Our view.

Mr. Grantham certainly echoes our view of the danger the UK housing market presents and the future consequence for the UK economy as the bubble unwinds. Evidence for the start of the "**Great**

housing collapse” as we think it will be called in the future is still patchy but certainly houses are not selling quickly now and asking prices are not being met.

The moral of the story is rent if you can!

Eurovision and Europe

Hopefully our readership have full and interesting lives (so why are you reading this?) and as such would not have watched Terry Wogan present another woeful display of no hope tunes followed by the hilarious voting sequence. As usual various countries voted for (so we have read honest gov!) and supported their regional friends (Slavs, Scandinavians etc.) in a high profile display of local nepotism.

This hilarious vision though has hit a very raw nerve in both France and Holland where the EU constitution (you would need a strong one to stomach that dogs dinner) is subject to plebiscite in the next week or two and allegedly hardened the no vote camp.

The French and Dutch have suddenly realized that with no veto the EU could suddenly become a very scary place as EU votes run along Eurovision lines. Meanwhile here in blighty we can but hope and pray that the whole EU project gets put to sleep before it costs us even more money and jobs (48 hour week – the cheek of Johnny Foreigner).

UK GENERAL ELECTION

Faced with the choice between soft socialists (Tories), moderate socialists (Labour) and neo Trotskyites (Liberal), the British people plumped for the middle ground. So B & B have the mandate to continue rolling back the Thatcher economic reforms which allowed the UK to enjoy superior growth through the 90's to date. But regulation, deficit spending and EU intervention has stemmed the tide of economic liberalization in the UK. Perhaps the most obvious result is the collapse of inward investment, which in the 80's and 90's laid the ground for the UK's superior economic performance compared with the rest of the EU. Foreign corporations understand that interfering nanny states are bad for business and so prefer the

much more lightly regulated and taxed states such as flat tax Poland!

INTEREST RATES AND BONDS

- **Have UK and EU rates topped**
- **Yield curve flattens – is this recession in 2006?**
- **UK & US bonds rally to key resistance**

The likelihood of UK (and especially European) rates moving higher appear to be receding by the day as inflation remains muted and the housing market continues to cool. With much of the EU stuck in slough of despond EU rates may even be cut later this year and in the UK “Merv the swerve” is also becoming more likely to preside over cuts in rates as the year progresses.

This mood is being especially helped by the bond market rallies of the past couple of months (see the two charts below) that have seen bond yields fall dramatically. This rally reflects a growing market perception that growth is slowing and inflation fears are ebbing.

Whether this proves to be the case or not, the pressure for rate rises has all but evaporated and cuts are being penciled into the agenda for the Autumn.

In the US however despite falling bond yields we suspect that short term rates will be increased further by Greenspan thus creating a flat yield curve (line?). Consumer demand appears weak on both sides of the Atlantic and the above moves in interest rates look to be signaling at the very least a mild downturn

UK GOVT Securities index

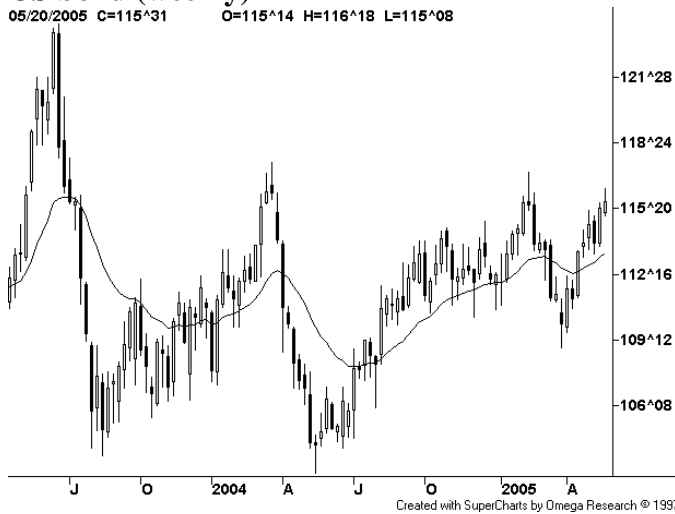


However looking at the two bond market charts both are at key resistance levels and could falter at present levels. A strong move over 104 by the UK gilt market could signal a continued series of advances and a reduction in UK bond yields.

A similar break above 117 by US Treasuries would likewise suggest a summer of falling yields.

The previous resistance levels marked by the previous trading highs could well prove difficult and we would not as yet open any long positions until a clear break has been established.

US bond (weekly)



GLOBAL EQUITIES

- All markets have steadied
- Technical levels to watch for the sign that the rally might have legs
- The current state of play on the Barmac Indicator

The last couple of weeks have seen most equity markets steady after the steep declines of late March and April. The rebounds so far have not as yet conclusively reversed the trend to up but have established a floor with one or two smaller indices such as Swiss and Finland marching on to new highs.

The likely hood at present appears to be a slow summer with the need for sustained break to new highs or below the recent lows to signify renewed vigour.

If we are mistaken then watch for a widespread dynamic to new highs by the majority of market

indices, which will probably, lead on to a tradable advance. We suspect breadth and commonality between various markets will be the key to safely timing any entry.

FTSE 100



The Ftse is still maintaining the two-year-old advance and has defined the major trend with a second touch in April. Whilst the Ftse remains above the April/May lows we think the index will push gently sideways to higher BUT any breach of the recent lows could herald severe weakness.

UK SMALLCAP with Barmac



The Barmac Indicator has so far this year behaved beautifully with a well-timed sell in March. Since then the minnows have fallen over 7% with the related Ftse AIM market down 20%. As can be seen in the lower panel of the above chart the indicator is slowly clawing its way back to positive territory. Last year a similar move occurred through June but did not persist. As a result we will treat any such move with a degree of caution unless all the

other major markets are moving to new highs and thus confirming the move.

DAX



The Dax is currently challenging the spring highs as are a number of the EU bourses. A sustained push above resistance could be traded safely with a stop in the 4350 zone (just below the recent high). The Dax shares commonality with the main French, Swiss, Austrian, Dutch, Belgian and Swedish markets.

However, we must re-iterate we are not wildly bullish merely following the EU markets higher with a tight stop.

S & P (weekly)



The major US indices (couple shown above and below) are following a similar path at present. The current rally appears to be unwinding recent oversold conditions and the question remains:- is this a counter rally in a new downtrend or a strong renewal of the bull rally?

We don't know the answer yet! However, the market will tell us soon. We continue to look for a series of new highs from a wide variety of global indices and the positive emergence of most markets from the next consolidation.

If the above proves positive then US markets will likely follow the current leaders (France Germany etc.) higher.

If not watch for the S&P to crack 1140, which will likely unleash some very nasty selling pressure.

RUSSEL 2000 (weekly)



FOREX

- **Dollar rally unfolds as predicted last month.**
- **Sterling could also strengthen versus weak Euro.**

The Dollar index chart below highlights perfectly the strong rally experienced by the Dollar over the past month. Without wishing to gloat too much (but just a little) we have been predicting a dollar rally since early Feb as downside momentum weakened and sentiment toward the dollar became universally bearish. We think that the dollar rally is not over yet with the advance likely to carry on for the rest of the summer until bearish sentiment is wiped out.

However in the very short term, the dollar is overbought and due perhaps a small reversal. This could well be prompted by a French "non" vote that may contrary to popular opinion force a short-lived rally on the Euro.

DOLLAR INDEX (weekly)



The dollar index (above) looks good for a run to at least the resistance/congestion area around the 90 level. Certainly if the rally is to hold the dollar has no business trading below 84 in the next few weeks.

STERLING/DOLLAR



The above chart of “cable” highlights the charge made by the buck over the past couple of weeks. However, the lower panel showing 21 day momentum is on its knees and such a short term extreme needs to be worked off before any meaningful progress is likely to occur for the US unit. However, once the consolidation/retracement has run its course we would expect the September lows to be challenged.

Meanwhile the Euro has declined to the lower band of its gently rising trend channel against Sterling. The recent strength of the pound is probably a function of dollar strength causing euro

selling as the two main traded currency blocks. We expect that the euro should bounce at current levels (maybe once EU referendums are out of the way) but a downward breach of the trend channel could signal a renewed push toward the £1.40 level.

STERLING/EURO



COMMODITIES

- **OIL** corrects to below \$48 as predicted but a bounce appears to be occurring
- **Gold** continues to build a large triangle consolidation. Silver likewise could follow gold out of this consolidation.
- **Copper** tops
- **US housing** slowdown could affect lumber
- **Soybeans** look very interesting.

Oil had seen a fast decline to around \$47 a barrel before any floor has been found with prices currently hovering near \$50. We suspect that oil will likely trade the \$45 - \$55 range for the summer with any downside breach an opportunity. We would be wary above \$50 as we think that an overheated oil sector is due a long consolidation before the next meaningful leg up begins. But with such a politically sensitive commodity global events could cause a sudden surge and price spike at any time so we would certainly not risk short positions at the top of the range.

Long term we re-iterate our long standing view that oil is in a secular bull market and set for much higher prices in the years to come.

OIL Nymex (weekly)



Since Gold peaked in October the yellow metal traded broadly sideways tracing out a triangle consolidation. This type of pattern normally resolves with a strong push out of the pattern that is quite tradable. Certainly a push beyond \$450 should see at least another £20 or so with a downside break likely to challenge \$400 and then £380. We will surmise the direction of the likely break but gold shares have been rallying this last couple of weeks.

GOLD (weekly)



The chart for silver is very interesting at present with a very clear trend supporting all the action since 2003. We have no reason to expect the trend in motion to break but if it were to break, we would short with a stop at \$7250.

If on the other hand silver were to overcome the \$7500 price level we would not be surprised to see

the highs challenged or even surpassed. We would suspect that silver will resolve in the same direction as gold so look for leadership from one metal to the other.

SILVER (weekly)



The Platinum chart below looks oh so tempting! We had to include this metal and would definitely short with a stop at \$875. The decline out of the multi-month trading range looks very bearish unless swiftly reversed.

PLATINUM (weekly)



Good old Dr Copper appears to be losing upside momentum and forming a rounding top. Although the chart is not conclusive as yet we would like to see a strong upward dynamic to end the sense of downward drift. Perhaps old copper is calling for a gentle slowdown this summer in global activity.

COPPER (weekly)



The major driver behind the ramp in US lumber prices throughout 2004 was the US housing boom and the record level of construction orders. This demand appears to be slowing as lumber posts a lower high and it could prove to be very susceptible to a slowing economy in 2006. A move over \$420 would suggest that the slowdown in economic and housing activity was not being felt as yet if at all. Watch lumber it is a good bellweather.

US LUMBER (weekly)



The chart for beans looks very interesting with the dramatic sell-off now halted at previous areas of support and a good first step above the base established. We would look to establish longs on a clear break above \$6.50 to complete the break out of the very tight congestion area currently

constraining trading. The long-term fundamentals for soybeans looks very good with Asian demand growing quickly as industrialization increases urban demand for a greater variety of foodstuffs.

We suspect that Soybeans could be a spectacular trade when the break out occurs.

SOYBEANS (weekly)



AND FINALLY

Nice to see that the UK Government is able to maintain its 100% record of ineptitude when it comes to military procurement contracts. We were amused to read about the wonderful new aircraft carrier set to be delivered in 2012. This wonderful addition to the Senior Service has only one drawback. The purpose built aircraft that are scheduled to fly from the new ship will not be available before 2014.

And they want us all to carry i.d. cards that are so technical that at present they will cost £90 each (times 60million people) and will need the biggest computer programme ever designed for peacetime use. Can they and will they deliver on time and budget?

You could not make it up could you?

Regards

Andy McCarthy & Andrew Bartles