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# JAPAN – HAS IT AT LAST CROSSED THE RUBICON?

## 1. INTEREST RATES & BONDS

**Rates will continue to fall with even the ECB joining in.**

**US bond yields appear to be backing up. JGB's are the next bubble so be ready to short them soon.**

## 2. GLOBAL EQUITY MARKETS

**Is the ending or over?**
**Japan may well have turned the corner.**
**NASDAQ has bottomed?**
**Dow rebounds to create failed downside break….potentially very bullish.**

## 3. CURRENCIES

**Yen pauses in its downtrend following jawboning by the BoJ.**
**The Euro is oversold but will always trade below par due to risk premium due to not being a true sovereign currency.**

## 4.COMMODITIES

**Nickel stages a sudden surge but it is unlikely to herald a sustained move.**
**Soybeans and other agriculturals are oversold and could stage dramatic rebounds shortly.**

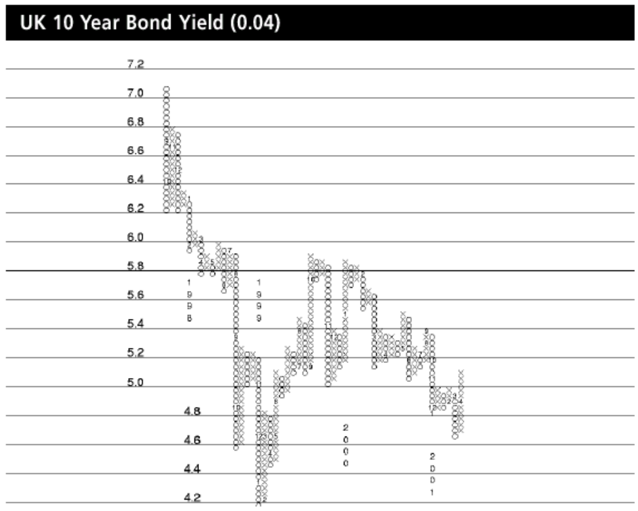
**Special situations help to change sentiment** – just about everyone who wasn't already out of the market dumped Japanese stocks last year. Japan's percentage of global equity capitalisation fell to 10% - it's lowest level for at least fifteen years. The country's economic problems, well by no means unique, seemed interminable. Japan's highly educated and wealthy population have had enough, and want change. The election this month of the "hair apparent" and would be reformer Junichiro Koizumi as Prime Minister. Even if Koizumi waters down his reform policies, it would appear that Japan has crossed a political rubicon. Over at the BOJ, deflation-abetting governor Masaru Hayami had his fangs pulled a few weeks ago and will probably retire shortly as highlighted in this newsletter. Meanwhile, as a born again quantitative eraser Hayami is no longer a problem as he is keen to reflate the economy. The government targeted the stock market in March and will continue to do so, because commercial banks cannot meet their capital adequacy requirements if the Nikkei falls below thirteen thousand. These changes make Japanese stocks a potentially world beating recovery story, in line with the analysis highlighted in last month's newsletter. Even if Japan's political logjam has not being broken it is shifting in a much more positive direction, which can only improve sentiment. The BOJ's reflation, which is likely to be massive, will boost money supply over the medium to longer term, weaken the yen and eventually reverse the deflationary cycle. This will unlock Japan's record high savings and increase private consumption, enabling the economy to recover. A gradually declining yen will lift earnings for Japans better export companies, with a knock on effect throughout the economy, even if global GDP growth remains slow. Many Japanese companies have restructured in recent years and are cheap on a price to cash flow basis. On the all important charts, the Nikkei bottomed with a key day reversal on the 15 March, rebounded strongly to break its medium term down trend and appears to have completed its consolidation of the initial gains. The Nikkei will reaffirm full recovery scope on a clear break and sustained move above 14,250. This positive position for the Nikkei can only be helped if the global melt down in technology stocks is nearing its end which appears to be the case. Certainly the Dow Jones has shown remarkable strength in rejecting its down side break and re-establishing itself back in the trading range of 10,000 – 11,500. Equally beneficial to the Japan recovery story, is the concerted round of interest rates cuts in the rest of the Western world economies. Even Wim Duisenberg has joined the interest rate cutting party this month. As all the Western worlds economies cut their key interest rates dramatically, as forecast in this newsletter back in October, the demand in the global economy will pick up gradually and furnish the resumption of GDP growth globally. This can only assist the recovery in Tokyo especially if coupled with a decline in the value of the Yen. Such a decline has occurred over the last seven months but would need to continue perhaps to 145 to 150 Yen per Dollar in order to unleash what may turn out to be a dramatic recovery rally on all of Japan's indices.

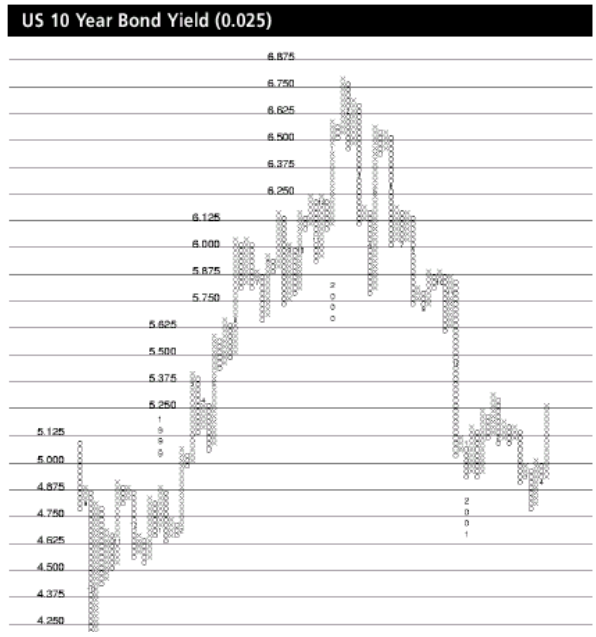
## INTEREST RATES AND BONDS

- **Further cuts in short term rates are likely as the ECB joins the party.**
- **Possible implications of the rise in long dated government bond yields.**
- **Keep watching JGB's for the bond market short of the decade.**
- **If the U.S slowdown is easing watch corporate bonds for their recovery potential**.

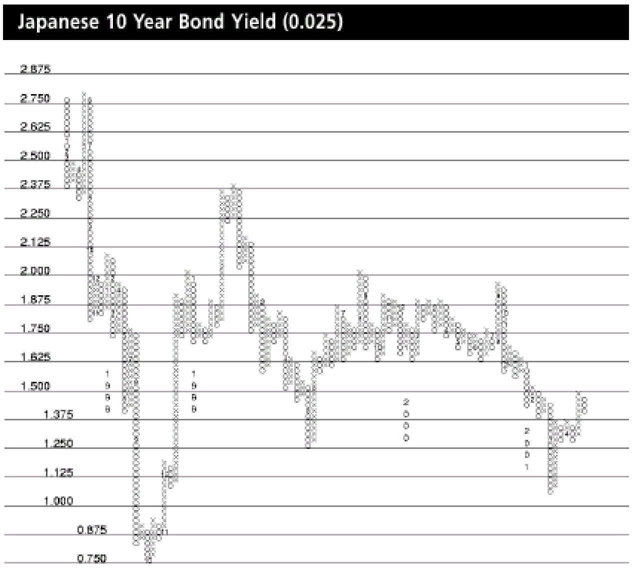
**There is still a case for further rate cuts**. Since early 2000 estimates for global GDP growth have been far too optimistic. The initial problems were a tripling of oil prices, rising short term interest rates and ultimately the TMT share collapse, which eventually dragged down old economy stocks as well. Today most analysts continue to revise their economic forecasts downwards. Is it time to take a contrary view and look for signs of recovery? After all, to counter a rapidly decelerating economy, the US Fed has made dramatic rate cuts so far this year. It has been followed by the Bank of England, the Bank of Canada, the Maverick Bank of Japan and finally even the ECB. There is certainly a clear case for lower rates in Europe and the US and we would not be surprised to see most central banks continue policies of monetary easing. We maintain that economic news will be mostly negative through at least mid year but this is a lagging indicator. A continuing stock market rally would provide the best clue of an economic recovery ahead. Any economic good news may well be masked by the lagging indicators such as job lay offs and poor GDP growth figures for the first and second quarters of 2001. It is our job to anticipate what is actually happening in the world's economies and just as back in late 2000 we believed that a global recession was probably already underway we now believe that the first swallows have arrived to predict a fledgling rebound. Obviously, this rebound at the moment is only tentative and could be blown off course by some economic shock or other, or poor economic management. Also there remains the risk of the deflating TMT bubble which could yet cause some headline making corporate failures. However, we believe that the charts will provide a good early warning and presently they appear to be signalling a soft landing.

**Long dated government bond yields have rebounded from their late 98 early 99 lows.** On the charts, downtrend consistency has been broken as bonds have been sold against a background of a generally weak economic news. This is a major warning for bond bulls and asks the important question – have yields bottomed for the medium to longer term as well? The short answer is maybe. There are conflicting factors at work, a steepening yield curve, caused by flat to declining short term rates, plus rising long dated rates determined by the market, indicates that the market is expecting economic expansion and therefore ultimately inflationary risks. We last saw this in Europe and North America through late 98 and early 99. However it would be premature to expect a replay of this cycle, judging from corporate profits, rising unemployment and falling GDP. The other possibility is that bonds were technically over bought due to momentum investing in the bull market that commenced fifteen months ago, plus a "flight to quality" during the stock market sell off. Some of that money was always likely to leave bonds when stocks rallied, as we have seen recently. Looking at the charts for long dated bond yields downside failures occurred in February and March and yields are back near their highs for the year. It is our belief that yields for US and UK long dated bonds are bottoming out in what is likely to be a lengthy process, during which the March lows could be re-tested and even exceeded by a small margin. Japanese ten year bonds yields have also rallied following their downward accelaration in February and March towards the 98 low. Fundamentally one can make a case for JGB yields falling even further as the Bank of Japan buys to prop up commercial banks and as part of its quantitative easing, which will need to be massive before a sustainable economic recovery is established. However, everyone knows that JGB's have an uncompetatative yield and are in dramatic over supply. Therefore Japanese long dated bond yields would soar without continued deflation and government support.




**The Bank of Japan's monitory policy has be an unmitigated disaster as we have often discussed at length.** Money supply growth remains woefully low at 2.6% YoY for the ongoing deflationary conditions. The Yen is still overvalued judging by Japan's deteriorating trade balance, despite declining domestic demand. Most of the banking sector reminds technically bust and the yield curve is too flat for conventional bale out. Business and consumer confidence has been shattered. Although massive fiscal spending in previous years has prevented economic collapse, it has ballooned Japan's government debt to a third worldly 135% of GDP and climbing. Fortunately the way out of this mess is not a mystery and at long last Japan's government appears to have embarked on the necessary path of reform. In an essential U turn, the Bank of Japan has commenced a quantitative easing targeting money supply and consumer prices. This will weaken the YEN and eventually stem deflation. Hopefully the government will securitise the commercial bank's bad debts. Appropriately, Japanese companies continue to restructure, improving operating profits. Consequently as Japan recovers and the economy picks up strength we can ultimately expect that the massive increase in J Bond Yields and the consequent bear market in capital values of Japanese government paper. This may not occur for a few months yet but once economic recovery in Japan becomes apparent to all then JGB's will provide a once in a lifetime shorting opportunity.




**The corporate bond market which suffered greatly during 2000 and as yet has only posted modest returns during 2001 could be set for a dramatic capital appreciation over the next 12 to 18 months.** As the global economy has slowed and the fear of bankruptcy has risen the yield on corporate paper has risen and risen. Both UK and US triple B rated paper have running yields of around 9% and redemption yields perhaps in excess of 12 or 13%. These exceptionally high yields reflect the fear of default in the corporate bond market. However the risk of default outside the vulnerable TMT sector is not excessive currently, indeed as and when it becomes apparent that a recovery has been truly established both here and in the US fear of default will diminish dramatically. This coupled with the benign effect lower interest rates will have on corporate balance sheets, will lead to a dramatic re-rating of corporate bonds on both sides of the Atlantic. The yield premium over US treasuries should narrow to a more respectable 3% from the current redemption yields in the low teens which could signal capital gain of between 15 to 30% over a relatively short period. The key is to invest in a diverse and well managed fund or funds, and to await evidence of a cyclical turn in global GDP.

## GLOBAL STOCK MARKETS

- **Is the bear market ending or over?**
- **The economic news will remain mostly bearish but investors are beginning to anticipate the next economic upswing.**
- **Has the Dow Jones completed a failed downside break – an extremely bullish signal.**

Market peaks and troughs are determined by technical rather then fundamental factors. Bull markets peak when euphoric demand from people willing to throw money at an uptrend wains relative to the numbers who wish to sell. Conversely, bear markets end when capitulation selling eventually declines relative to new demand. Consequently how high would prove to be too high and how low would prove to be too low is a technical/psychological question, rather than a fundamental issue. This is why so many value investors are completely thrown out of kilter when markets are either ramping up irrationally or in dramatic swallow dives, which plummet to unforeseen valuation troughs. However, value assessments provide prospective. We know that valuations for TMT companies 'were off the charts" in late 1999 and early 2000, although this could also be said at a least a year before their peaks. Today, NASDAQ valuations are a lot lower but few analysts would call them cheap. The US S& P price earning multiple has declined from 36 to 26 over the last year but that is still well above levels seen at most previous bear market lows. Moreover the dividend yield is hardly enticing at 1.1%. In the UK the situation is somewhat similar with PE ratios round about the 20 level and the dividend yield well below 3%. Perhaps these measures are redundant, as many claimed a year or two ago but to accept this argument one has to embrace the "new paradigm theory". Presumably Warren Buffet would sooner believe in the tooth fairy. European valuations are somewhat lower but does anyone really expect these markets to significantly outperform for any reason other than patriotism? Some fundamental analysts do see value in Japan, not in terms of PE ratios or dividends but in terms of cashflow and book value. As far as Japan is concerned one needs to be optimistic regarding Japan's economy and the ending of its currently destructive deflationary environment.

Views on markets can change very quickly. Last year the consensus view on the NASDAQ changed from "recession proof" to "they will never recover". Just before the peak, Time magazine and Newsweek covers depicted the NASDAQ as Superman. But last month bear market cover stories featured in Time and Newsweek illustrating just how quickly the view of markets can turn from Bull to Bear. There have also been numerous articles recently drawing parallels between Japan's economy and the great depression of the 1930's. Stock market sentiment on a global basis has been bearish generally. As for the charts, downward accelerations in March were climactic but for how long? Last month we sighted upward dynamics as evidence for a technical rally, which has now exceeded the highs formed in the brief rebound in late March. This indicates that we have seen lows of at least near term significance on both the FTSE, the Dow Jones and the NASDAQ. On long term charts, it is too soon for the recovery's to confirm more than a loss of downside momentum. Japanese Indices and the NASDAQ have achieved the best rebounds, in line with prior extremes of bearish sentiment. We suspect that we have probably seen if not the absolute low the relative lows on both Japan and the NASDAQ and any further lows will only be incremental from here. They may well have established sustainable floors. However we will not have clearer evidence as to whether these and other stock markets have bottomed until we see where support is encountered during the next reaction sell off. Overhead supply for the Dow Jones, the S&P and FTSE and other European indices is quite considerable. Consequently, even if a number indices have see their lows for the year, they are unlikely to rally much beyond the middle to the upper regions of their prior trading ranges. Indeed the Dow Jones currently has now not only recovered from its downside break but made a sustained strong push back into its old trading range in the 10,000 to 11,000 area. This move is dramatic and would imply a downside failure. If that is proven to be the case then we could well expect the Dow to push on to new highs fairly quickly. The table below we published two months ago illustrates the degree of growth experienced on the Dow Jones industrial average once interest rates cuts have begun. Since the first cut on the 2 January the Dow has plunged and since recovered all its losses. If history is to repeat itself then this table provides a very useful insight as the direction of the Dow over the next 6 to 12 months.

**Dow Jones Performance Following Initial Rate Cuts By the US Federal Reserve**

| Year | Rate* | 3 Months | 12 Months |
|---|---|---|---|
| 1914 | 5.0 | 10.6 | 83.8 |
| 1921 | 6.5 | - 14.2 | 16.4 |
| 1924 | 4.0 | 10.9 | 31.5 |
| 1929 | 5.0 | 4.2 | - 28.3 |
| 1932 | 3.0 | - 40.2 | - 40.0 |
| 1933 | 3.0 | 79.2 | 76.3 |
| 1954 | 1.8 | 8.2 | 39.3 |
| 1957 | 3.0 | 0.7 | 29.2 |
| 1960 | 3.5 | - 7.0 | 6.4 |
| 1970 | 5.8 | 17.2 | 6.7 |
| 1971 | 4.8 | 12.7 | 24.0 |
| 1974 | 7.8 | 33.8 | 42.1 |
| 1975 | 6.3 | 6.0 | 28.2 |
| 1980 | 12.0 | 10.6 | 17.3 |
| 1981 | 13.0 | - 1.7 | 17.9 |
| 1984 | 8.5 | 6.5 | 21.7 |
| 1990 | 6.5 | 11.5 | 10.7 |
| 1996 | 5.0 | 3.2 | 26.3 |
| 1998 | 4.8 | 12.5 | 20.7 |
| 2001 | 6.0 ** | -7.2 | |
| **Average** | | **7.9** | **22.6** |

**Stock markets will recover well ahead of the economy.** Everyone knows this but if GDP growth continues to slow share rallies in response to low interest rates will prove difficult to sustain. We are currently in the 20$^{th}$ cycle of lower interest rates for the US since 1914 and for only the 5$^{th}$ time the Dow Jones closed lower minus (7.2%) three months after the FEDS first cut. However the historic evidence on rate reductions over a longer time period is compelling. On only two of the previous 19 cycles (1929 and 1932) was the Dow Jones lower 12 months following the first cut. Better still, the Dow failed to show again on only one occasion a year after the third rate cut. This year's rate cutting cycle, Greenspans third 50 point reduction occurred on the 5 April and he lowered again on the 18 April. Arguably, he is ahead of the curve, which should help the economy as it faces declining corporate profits, debt problems and lay offs. We maintain that most economic data will be negative through quarter 2, at least. As for Euroland, everyone except the ECB officials believes the single currency's central bank is behind the curve. We can only guess as to when Japan's crisis measures will check deflation and spark a sustainable recovery. Consequently, there are no grounds for complacency regarding the global economy, especially with energy prices remaining high following additional production cuts by OPEC.

## GLOBAL CHART REVIEW

**The US Dow Jones has not maintained its break beneath the psychological 10000 level.** Such failed downside breaks are extremely bullish. There is resistance around the band highs but recent strength has questioned the top formation implications of this pattern.

A pull back to below 10000 would be required to re-establish the bearish picture. We are currently long the Dow with a stop at 10750. If the Dow breaks 11000 trade the break with your stop at 10950.

**DOW JONES**


**The NASDAQ has also rebounded from what resembled capitulation selling.** The lows of late 98 should hold and as such we would not be surprised to see the March low prove to be the absolute low for this market. As previously stated in last month's issue we suspect we have a major opportunity to buy the NASDAQ now on a 5 year view. We suspect that the NASDAQ will rally towards the 2400 to 2800 level before the current rally runs into resistance. A break below 1950 will suggest a base extension phase.

**NASDAQ**


**Japans Nikkei** has encountered support above the March low and has not maintained its break under the 98/99 floor. This is positive whilst the markets holds above 12600. The market now needs to break above 14200 and hold to bolster the next leg of the up move. As stated many times Japan looks to be the most attractive play at present with a 5 year view but a trading position possible with a stop at 13000.

## NIKKEI


**The FTSE has rallied back to potential resistance from the March lows.** We do however have a benign background of falling interest rates and perhaps a lead from Wall St. If the FTSE makes it back above 6000 we also then have the same potential set up conditions already in place on the Dow with a failed downside break which more often than not leads to a break to the upside of the trading range.

## FTSE 100


**The two key European bourses are exhibiting remarkably similar patterns.** Both have just seen their best rallies since mid 2000 and have bounced of climactic declines. The CAC appears to have broken it's recent downtrend and has scope for further recovery.

The German DAX has traded consistently lower with a dramatic sell-off in late March. The recovery will take on greater significance if the primary trend is broken at around 6400. This again would not only provide an investment opportunity but also a trading opportunity with the stop placed below the break at around 6350.

## GERMAN DAX INDEX


## FRENCH CAC INDEX


# STRATEGY FOR STOCK MARKETS

It is probably time to start accumulating equities once again, judging from the climatic downward accelerations mentioned above. However this view is based primarily on short-term technical/sentiment indicators at the early April lows and the Feds rate cuts. We still believe that valuations in the west and the fundamental economic background globally hold considerable risks. Therefore we are proceeding cautiously and waiting for technical evidence that we have seen more than temporary lows for major stock market indices. The next reation will be revealing and support needs to be encountered near or above recent lows, followed by further evidence of base formation development. Meanwhile, our favourite market is Japan as mentioned previously and in other issues. Many will disagree due to Japan's ongoing economic stagnation and deflation, not to mention potential supply if Japanese banks unload their equity portfolios. We believe these problems have finally become a catalyst for change by the

government, albeit on a "needs must" basis. The quantitive easing announced by the Bank of Japan in early April is a welcome reversal of policy. While it remains to be seen whether Junichiro Koizumi will become an effective Prime Minister, he is the first brought to power by Grassroots LDP support rather than a backroom deal by politicians. It has to be good for democracy, although Japan still requires a viable two party system. Japan's government had to target the stock market prior to its fiscal year end on the 31 March, because of the banks capital adequacy requirements. These will be reviewed again at the end of September. Consequently the government needs to either purchase shares directly from the banks and or ensure the NIKKEI stock averages closes above its March level of 12,999. We do not want to read too much into this but if global investors believe the NIKKEI has a government intervention floor at 13,000, they may regard Japanese stocks as a one way bet until the index rallies well above this level. For longer term investors we believe that the NASDAQ now will represent excellent value on a five year view, but we would not rule out a return to the lows and a subsequent period of base building.
**Finally we would trade the Dow, CAC, Dax and FTSE on breaks above the key levels highlighted in the market review**.

## CURRENCIES

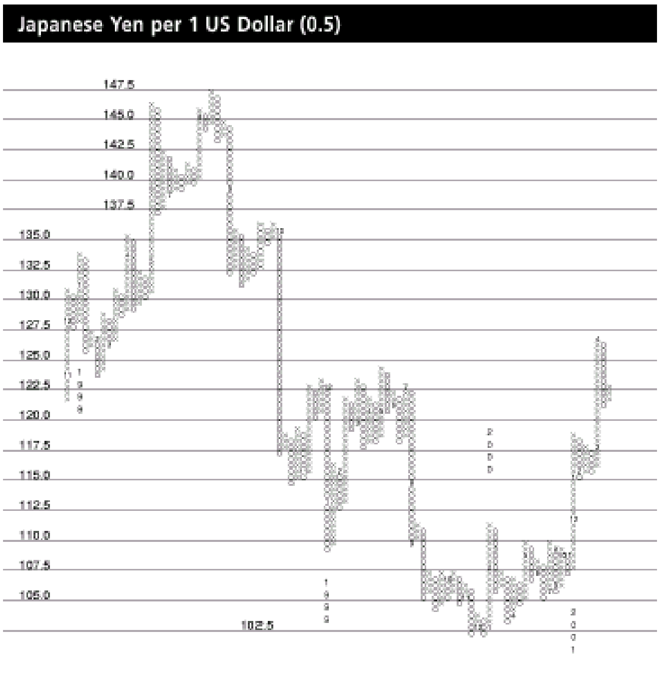
- **Ministry of Finance Jawboning has complicated "Yen Carry" trading but the Japanese currency should resume its decline in coming weeks.**

- **The Euro has looked oversold recently but will always trade below value without a federal government.**

**Reading between the lines of Ministry of Finance statements on Yen.** The first half of April saw some heavy Jawboning from MOF officials especially by Kuroda, Vice Finance Minster for International affairs. Kuroda, along with his boss Miyazawa are the main spokesmen for the Yen now than Hayami at the BoJ has been effectively muzzled, except for parroting others comments. Kuroda's heaviest volley came on the 6 April when the dollar was above 1.25 and the Euro near 1.13.

*"Recent movement of the Yen has been very rapid and, judging from economic fundamentals the movement cannot be justified. We will take appropriate action in the market against currency movements that deviate from economic fundamentals. Some action will be needed if this movement continues*".

Taken literally, Kuroda's mention of "appropriate action" would suggest the possibility of intervention in support of the Yen. Should we take this at face value? We certainly don't think so and despite Kuroda's comment on fundamentals, most analysis would agree the Japan's economic performance remains decidedly below par relative to US and Euroland. That's why Japan has embarked on quantitative easing. It is printing money – literally trillions of Yen – till money supply soars from its current 2.6% and the decline in consumer prices is halted. Belatedly, this inflation is necessary and will need to be massive given the established deflation in Japan. While the country's monetary spokesman are technically correct in saying that they are not targeting the Yen, their actions can only weaken the currency against the US dollar, Euro and most other reserve currencies over the next year or more. So why the jawboning? We suspect that Japan's government would have been concerned about a too rapid depreciation in early April when many analysts would confidently predicting Yen 140 or more to the dollar. Most importantly we suspect the Japanese government would have given advance warning of the quantitative easing to major institutional investors and corporations. After all, if they can invest offshore, earn a decent yield and gain 25% plus on Yen depreciation, there will be some very big profits to repatriate at a later date. However, the Japanese were facing a short term loss, having to repatriate capital last year ran probably up until their fiscal year end, the 31 March 2001. The government would want to help its own, which it could do by talking the Yen up. Obviously this will not work beyond the short term because of the quantitative easing. Nevertheless, having caught western speculators by surprise and triggered stocks, the jawboning has created a window of opportunity allowing locals to switch from Yen to Dollars and Euro's at a more favourable rate of exchange.




The above chart shows that the Dollar has been unwinding an overbought situation. We would expect the Dollar to test and eventually break the recent highs in the next 2 to 3 months.

**Sterling /Yen**


The pound has broken decisively out of its downtrend and may consolidate the gains made to date for a little longer before the next up leg begins. In the meantime the "carry" should provide an adequate compensation.

**US DOLLAR VS STERLING**


The pound has been pressuring the lows at $1.40 again but has thus far staged a reasonable bounce. We think the cross rate will make its mind up soon with a break out of the triangle that has been building over the last few months. Whichever way the move breaks this should provide a very tradable move with a stop placed back at the trend line.

**EURO Vs POUND**


Since the pound appeared to post a double top in 2000 the cross rate has traded gently higher in a channel. We would expect the pound to break down out of this channel eventually. If this occurs the move could well carry well beyond the lows seen in December (1.55). This should provide an easily controllable trading opportunity with the stop placed just within the channel line.

**Eurolands founding fathers knew that you could not have a federation without a single currency.** They appeared to have overlooked the problems for a currency without a federation. Therefore the Euro remains a romantic experiment or le grande folly, depending on your point of view. As such, it is destined to trade below fair value without the European Federation for which there is no ground swell of public support. It holds an inherent risk premium. The only exception would be if the market lost confidence in the US dollar. This will happen someday, for fundamental reasons that cannot be known today. Meanwhile a dollar collapse due to the misunderstood current account deficit or any other factor remains a pipe dream of yancophobes.

## STRATEGY FOR CURRENCIES

As many subscribers are aware and have been doing themselves we have been running short Yen position for at least 6 months. This trade has become slightly more complicated due to the recent jawboning by the Ministry of Finance and other. The position we still believe will furnish considerable profits throughout the rest of this year and most of next. Stops should be placed under Yen 120 against the dollar and Yen 170 against the pound. A signal to either increase one's position or alternatively re-establish Yen shorts will be clearly given on a break above 180 for sterling against Yen. 127 for Dollar against Yen and 113.5 for Euro against Yen. Our long term target (always guess work) is for a minimum of 160 Yen within 2 years. We think Euro/Yen and Sterling/Yen will remain more volatile than the Dollor/Yen cross rate and needs to be traded accordingly.

## KEY TRADING POINT

- Short Yen v Long Dollar to benefit from 5% interest rate carry above Yen 120.

- Long Sterling v Yen above 170 again to benefit from interest rate carry and for consideration capital appreciation.

- Long the Euro v the Yen on any break above 113.5.
- Short pound v Euro on break down out of channel at 1.60

## COMMODITIES

- **The history of Cartels suggests that OPEC's medium turn gain will lead to their longer term loss.**

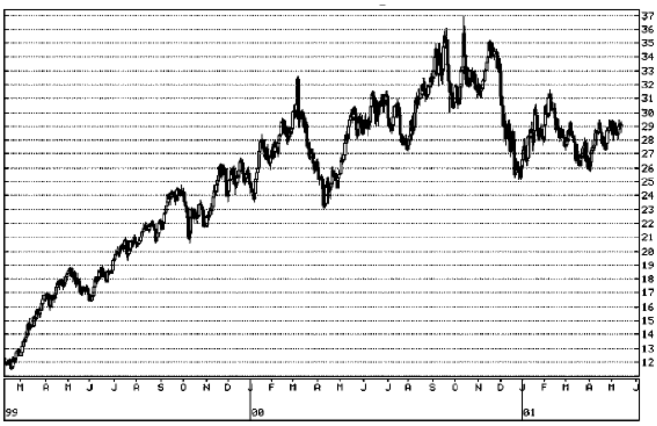
- **Gold is now testing the upper trend line of its trading range but as yet has not broken.**

- **Nickel has seen a strong recovery from oversold conditions and has also broken the downtrend.**

- **Recent declines for many agricultural commodities now look overstreched.**

**Oil prices would be at least 50% lower without OPEC's production cuts, judging from other commodity markets**. Understandably, prices for most industrial commodities have taken a beating during the global economic slow down. Petroleum is the exception due entirely to OPEC's cuts, including two this year which have kept supplies tight, especially for gasoline. OPEC is not a charity and will understandably put its interests first. However, Cartels usually work against the long term interest of producers. Oil in the new millennium will be no exception. OPEC is leaving prices too high for too long because it likes the revenue and renewed political clout. This is reducing demand while revitalising the oil drilling and production industry. Research into fuel economy and alternative sources of energy is back on every countrie's agenda. All of this takes time but the longer petroleum prices stay high the further they are likely to fall over the next few years due to overproduction and new sources of oil coming on tap. As OPEC eventually looses market share the cutbacks will no longer prop up prices as they have done in recent months. Producers will chase the market down by exceeding agreed production quotas. Once the taps are turned on it will take a long time to consume the additional supplies of oil. Meanwhile slow GDP growth, particularly in developing countries, will make the world a more dangerous place. Thus potentially the only real long term bull story for oil would be production dislocation caused by political uncertainty and war in the Middle East which is an increasing possibility with slower GDP growth. However, the market may have one last hurrah left as the summer progresses if the market senses supply shortages heading into the next North American winter. Any break above $31 could lead to a retest of last year's highs. Alternatively, a move below $25 would be very bearish for the oil price.

Crude Oil (NYME) $29.13 2nd Month Continuation (Weekly)



## GOLD

**As has been discussed in recent issues gold is still trapped within its falling wedge pattern**. However, recent strength over the last month or so sees the yellow metal challenge again the upper boundaries of its range. If the upper boundary is broken and the first consolidation remains above this trend line we believe we will see a reasonably strong run on gold perhaps up to the 290 to 300 region. This move will almost certainly be quite tradeable. As to whether this would mark the commencement of a new bull market we are less certain off. Although gold has been in a 20 year decline and as such almost certainly has fulfilled most of its downside potential, any upward move out of this wedge would not necessarily signal the completion of a base formation. As discussed in this publication in recent issues we do believe a major bull market for gold is not too far away, but a breakout of the tightening wedge formation would not necessarily be a powerful enough signal to signify the beginning of such a move.


## NICKEL

**As highlighted last month nickel has been in a consistent downtrend which has been typical of most of the industrial metals**. As can be seen from the chart this downtrend has been broken and has led to a fairly strong rally. However this rally has formed straight from a "v bottom" and shows no base development. Thus we think it is unlikely that the pattern will support substantially higher prices in the near future. In deed we suspect this rally may well peter out and lead to a retest of the recent lows.


**Recent declines for many agricultural commodities look overstretched.** Abundant supplies, the strong Dollar and now waning demand have weighed particularly heavily on prices of agricultural commodities in recent months. However at these historically depressed levels and with the US crop cycle commencing, commodities such as corn, soya beans wheat and cotton are susceptible to sudden rebounds due to production scares, usually weather report related. The chart for soya beans amply illustrates the size of the declines over the last twelve to eighteen months which have been dramatic. Thus any good news could well lead to a very sharp short covering rally.

Interestingly one of our readers has pointed out that recently soya bean meal and some of the other soya bean complex contracts has started to move towards backwardation or are already in backwardation. As many of you maybe aware this is quite frequently a good sign that a strong recovery move may well be on the cards. Watch the soya bean charts for confirmation that a short covering rally has begun.

## AND FINALLY

Keep the e-mails coming we really enjoy the insightful analysis that our readers bring to our market studies.
If you are interested in learning more about behavioural analysis and technical trading techniques please e-mail us at city@bpr.co.uk to find out details of our 2 day courses and half day trading seminars

Best Regards

Andy McCarthy and Andrew Bartles