

Mid-August 1984

THE INTERNATIONAL INVESTMENT LETTER

*A market letter doesn't have
to be dull to be good*



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Summer madness

It started last month in San Francisco – where else – when Fritz Mondale blew his big chance to do something exciting and bold. Against all advice he played the conventional option and nominated a woman as his running mate person, because there happen to be more of them than any other category of voter in the US. We should have known that a man who had recently suffered a hart attack would not, could not, stride boldly forward; but we had hoped. Anyway, the dream ticket of Fritz Mondale and Sammy Davis Jr is not to be, and no one is more relieved than the Teflon Man. Ronald Reagan knew that when Fritz spoke Americans would sleep peacefully at night and during his daytime speeches as well. What worried the President was the prospect of Sammy Davis Jr dancing circles around him, while the sight of 30 million blacks in yamulkas would have reassured every American but Jessie Jackson. Sammy would have proved that in the land of the blind (Democratic Policy Committees) the one-eyed man is king. Perhaps that's what put Mondale off – he didn't want to be overshadowed.

Gerry Ferraro proved that she was a match for the other Jerry – Falwell – when she said that RR wasn't a Christian. Asked how he felt about that remark, the President replied that he had turned the other cheek, which must have added a few million more votes to his forthcoming landslide. As the representative from Queens, Ferraro should hold the gay vote – which aids the Democrats – but win or lose she will never be able to clasp Fritz's hand. The PR advisors are mortified at the prospect of Fritz and Gerry inadvertently touching, which might cause Middle America to wonder who was minding the kitchen.

It wasn't only America that suffered from summer madness. Britain experienced its worst earthquake in 100 years, which the police and the striking miners blamed on each other. The Times reported the first plague of vipers ever seen outside the House of Commons, prompting Margaret Thatcher to paraphrase JFK with: Asp not what your country can do for you, but what you can do for your country. It was enough to turn Boy George's hair white.

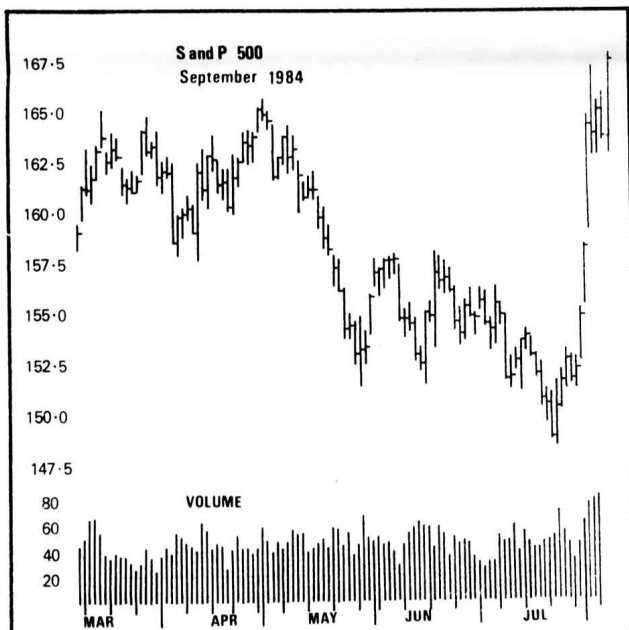
The Western press reported that Konstantin Chernenko had cracked a joke, but this was angrily denied by Tass which described the incident as a crude CIA smear. That prompted Sheik Yamani to warn that if the price of crude fell banks would fail; a forecast that doubled the share price of Incontinent Illinois. This famous bank was nationalised by the free enterprise laissez-faire capitalist US Government, while communist China floated the Foshan Trust and Investment Corporation, in the first public offering to Chinese citizens since Mao closed the Shanghai stock market. When stories of the Foshan success spread, rumours followed that Merrill Lynch would soon have a sales desk in 300 of

China's tim sum parlours. That caused Wall Street to catch Olympic fever and prices pole vaulted up through the bar charts. Not to be outdone other bourses sprang from the block trades up over every hurdle in the market. The Olympic event that most influenced Wall Street was that new cabaret act known as synchronized swimming. Grinning fund managers, every one a master of imitation, produced an awesome display of identical buy orders. Pamplona couldn't have staged a better bull run, provided you weren't among the gored shorts. And that wasn't all: when two US swimmers tied for first place, each gaining a gold medal, bullion dealers deduced that a spate of similar results could produce a temporary shortage of the yellow stuff. Up went gold and everything else. The weight of cash put paid to the deflationary crash.

That was some rally, that was

The near perfect strategy would have been to sell anything that moved until July 31, and then buy everything. I didn't warn you that the biggest buying stampede in US stock market history was about to occur, but if you lowered stops on those stock market futures short positions as advised in FM5, the bear tack profits were protected.

With most of the rally occurring over three days, the question, "What next?", is even more absorbing than usual and difficult to answer. The safest forecast is that we will not get a replay of the August '82 aftermath which many Wall Street analysts are now forecasting. Markets seldom experience consecutive cycles that are similar because people adopt a strategy that would have been successful last time. That changes the next cycle. For example, in '82 many



people waited for the market to react, but the first significant pause did not occur until late October. The spectacular volume earlier this month tells us that investors jumped in much faster and more aggressively.

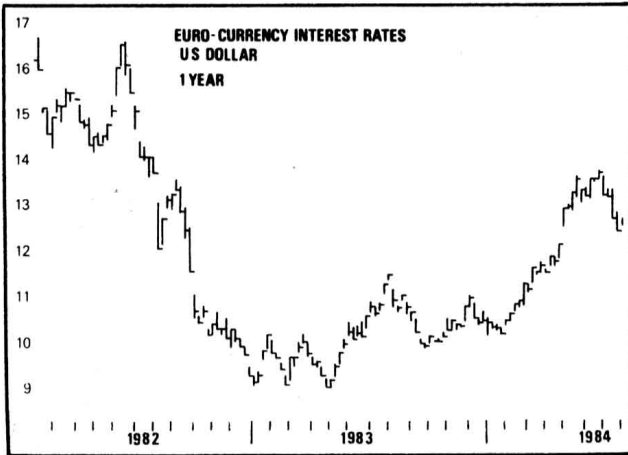
We know that in '82 the bear market metamorphosed into a bull overnight. This month's rally may not have turned the bear market into a wall trophy, but it has certainly put it on ice. The move is totally out of character with a typical bear market rally and, therefore, is very unlikely to be just a three day wonder. Any dramatic move leads to a widespread reassessment of investment strategy and this reappraisal leads to at least a partial reversal of previous policy. Since fund managers were content to accumulate cash before the rally, the anxiety over being too fully invested has been replaced by the fear of being left behind. Therefore investors will continue to buy shares on any setback ensuring that the July lows for most stock markets are not challenged over the short term. The US and UK index lows could hold for the rest of the year.

After the bull and the bear, it's the schizoid market

Bull or bear terminology may not help us in forecasting global stock markets over the intermediate (3 to 6 months) term. Investors everywhere will alternate between sweet dreams of expanding PE ratios during a low inflation, stable growth, high technology boom, and a nightmare of debt crises, deflation and currency turmoil. I expect lots of volatile churning action over the next few months as quick draw fund managers duel with each other. To appreciate the size of their funds, consider that Wall Street had its first 20 million share day in 1968, reached 50 million in 1978, 100 million in 1982 and we have had two days of over 200 million shares traded so far this month. Markets gyrate on swings in crowd psychology that change much more frequently than fundamental economic developments. Stock markets are too emotional to be handled safely right now so I don't intend to participate until the dust settles. Next month will be a better time to decide whether to go long or short. In the meantime I'll discuss some of the more important charts so that you can spot further improvements or deterioration.

Interest rates provided a sneak preview

One of the most important charts in our weekly service, CURRENCY, is the US dollar one year euro-currency rate. Following a steady advance this rolled over late last month and completed a small top on the move below 13%. Falling interest rates have fuelled many a bond and equity bull market. 1982 was no exception as you can see from the far left side of this chart, when a mid-year peak at 16.5% was followed by a collapse to 9% by year-end. Could rates now decline to 9% or below by Christmas? I doubt it, because the US economy is too strong and the interest rate chart shows a large base formation between 11% and 9%.



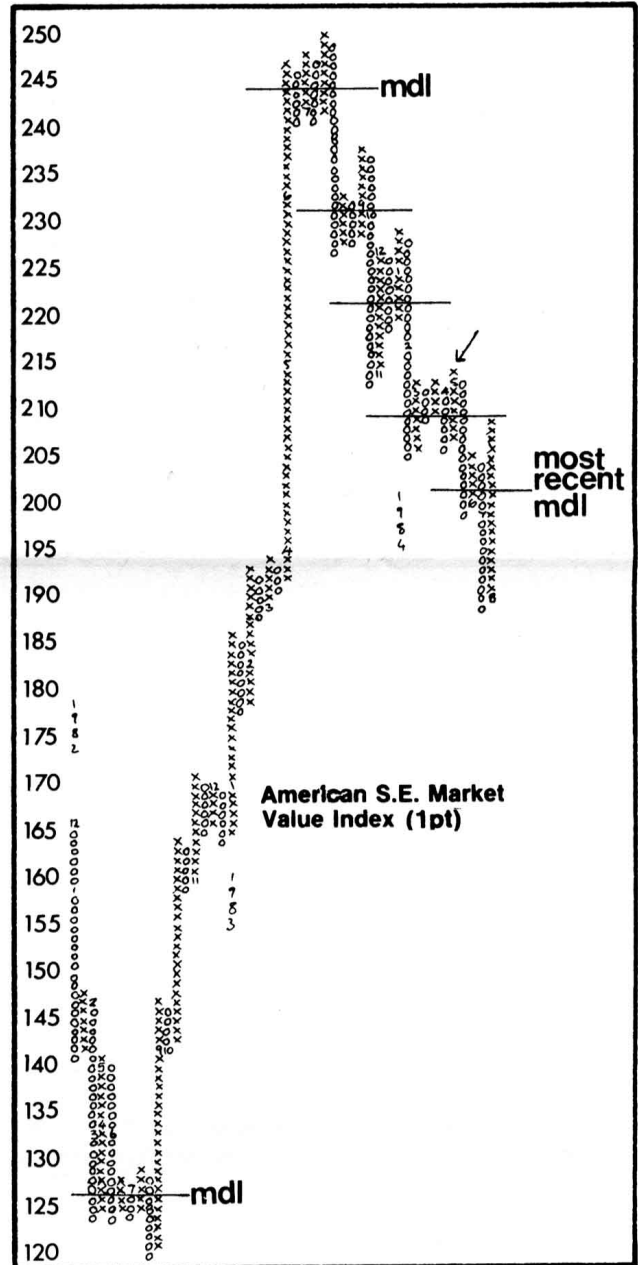
Nevertheless I won't rationalise the turn; rates have declined recently and an upward reversal would be necessary to prove the bond and equity bulls wrong. For instance, a move back to 13.5% would pole-axe the rallies and you could short everything in sight. Conversely, if US one year rates fall to 9% every stock market will hit a new high for the year. Watch this chart.

Chart levels to watch

FMs who have attended my chart seminars will know of the importance attached to the mid-point danger line (MDL). Briefly, once a market breaks out of a sideways trading range, draw a line through the middle of that range. If a new trend is forming the price should not react significantly back into its previous range. If it does, and crosses your MDL, you have an abort signal and can close or reverse your position before the crowd of investors/traders realise what is happening. Therefore the MDL provides you with an early warning signal enabling you to react before the herd which will be focusing on the obvious support or resistance points.

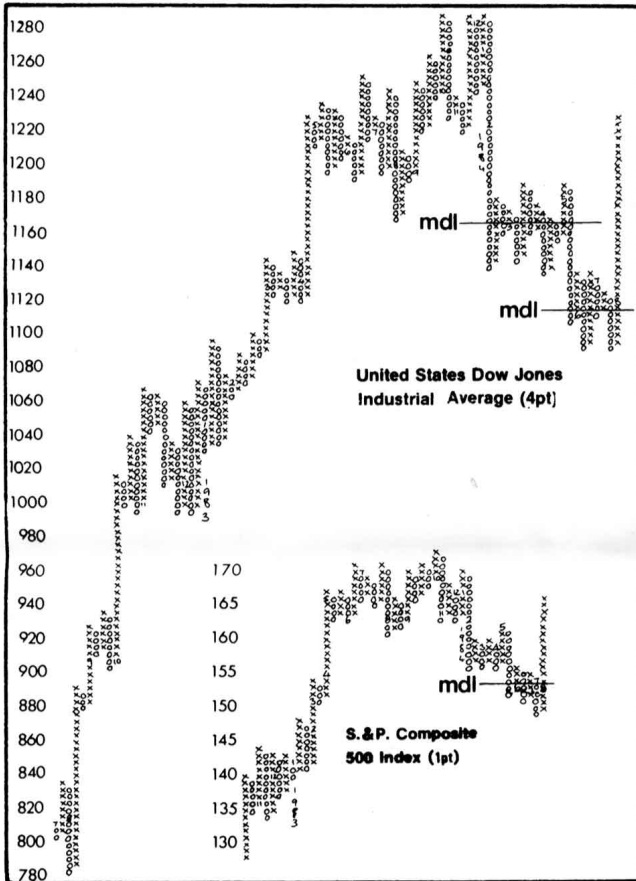
The American SE Market Value Index provides a good teaching example because the MDL buy signal occurred on the rally back above 125 in August '82, and the sell signal came in July '83 on the fall back below 243. Thereafter the Index continued in an orderly staircase downward trend until this month's MDL violation at 201 on the chart. Once an MDL is penetrated you can assume that the market is either reversing or becoming more erratic and therefore less predictable. Bulls will probably interpret the August '84 MDL penetration as a buy signal, but due to other chart considerations discussed below, I am more cautious and conclude that the bear market has been side-tracked.

While the American SE Index experienced a larger percentage decline from its peak until end-July, it has not had a greater technical rally this month, and remains well below its May high (marked by an arrow) in contrast to the other Wall Street market indices. Therefore we know that small high technology shares



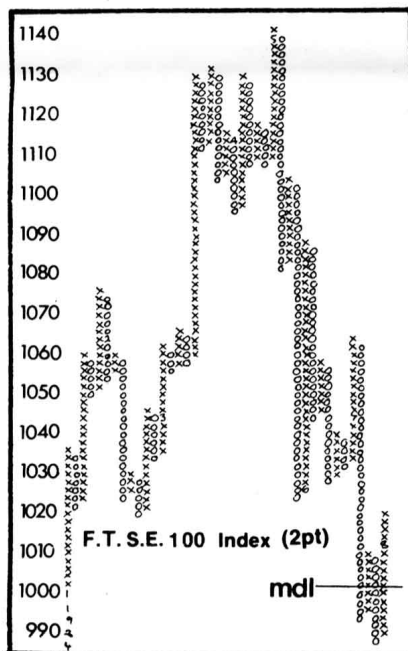
are not leading the present rally as they did in the last cycle. Fund managers have favoured the blue chips, and a list of new highs contains many defensive issues such as foods and utilities. These companies are not the customary leaders of a new bull market or even a second stage advance. A good rally based on the sudden change in expectations from higher to lower interest rates is understandable, but if the fundamental reason is a declining rate of growth, that will prove an insecure prop for a bull market.

On the S and P Composite 500 Index, the mid-point danger line was penetrated by the rally back above 152, confirming that the previous downward move had aborted. Initial support is now at 155, and while that holds, a further rally remains a real possibility, although the large top area will make further gains more difficult to achieve. A move below the MDL, which is unlikely in the short term, would



suggest that the August rally had been no more than an extension of top formation development.

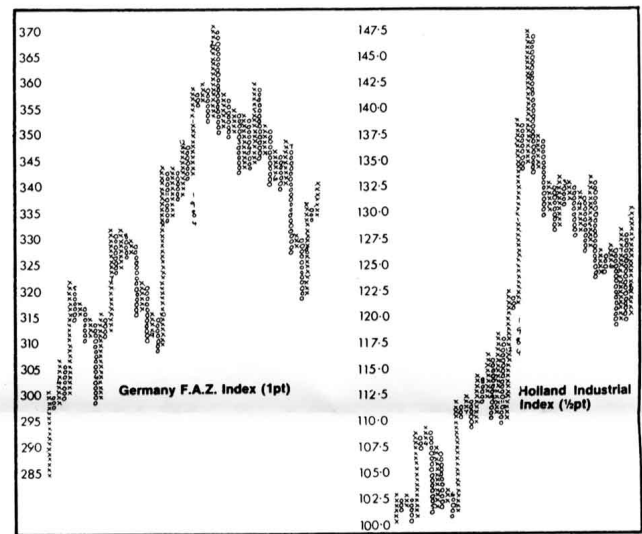
The DJIA never confirmed the July downward break so its MDL at 1160 was less helpful. On this chart the critical MDL is now at 1112, a long way below today's level, so the DJIA could ease back to the mid-1100s without damaging the bull hypothesis. Some psychological resistance has been encountered



near 1200, a "roundphobia" level, while the next obvious resistance point is in the region of the peak.

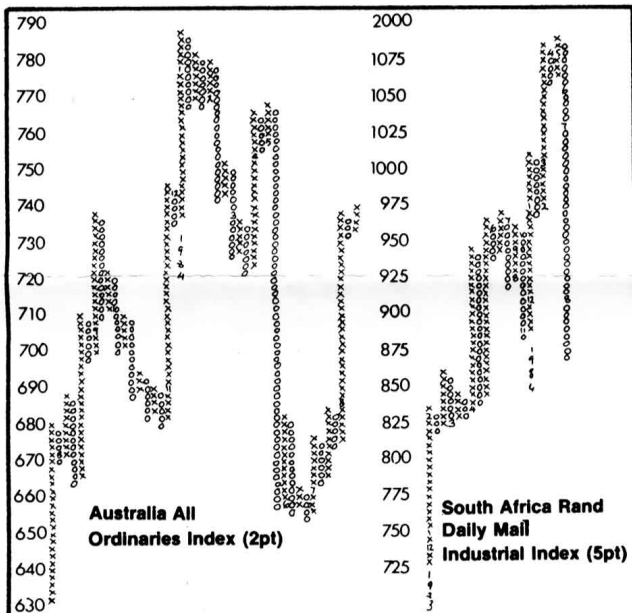
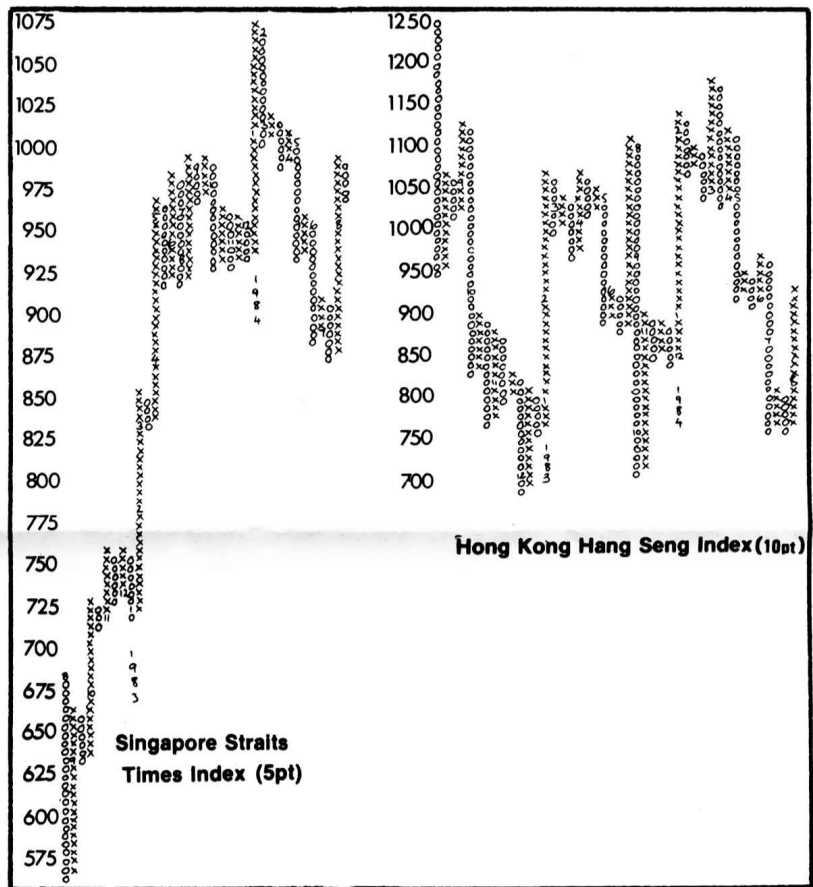
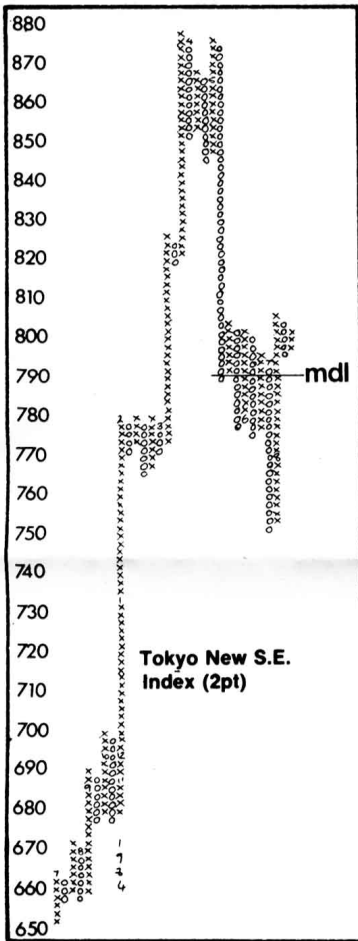
The FTSE Index MDL at 1000 provided a warning on the way up, but is too far away to be useful now. That certainly doesn't mean that a decline all the way back down is necessary before we have a bearish chart reading. If a rollover top formation develops between approximately 1050 and 1100, you will see it on the chart, and on completion you could draw in the first MDL for monitoring a new downward trend. I feel that the special situation created by the unofficial miners' strike makes the UK market an unacceptable risk for the bulls. This will remain a problem beyond eventual settlement of the strike because investors will then count up the overall cost to the country.

Germany's FAZ Index and Holland's Industrial Index have not rallied back into the top areas; however, both have recovered sufficiently to indicate that the recent lows will hold for the short term. I do not have space to show the entire bull market advance prior to this year's top formation development, but if you saw the full charts in our weekly publication, INTERNATIONAL, you would probably agree that the present activity hardly resembles a launching pad for a new bull market. The best that I can now envisage for these two markets is further churning within the top formations.



The Tokyo New SE Index confirmed that the 750 low should hold for a few months by moving above the previous MDL. This line is no longer significant since the Tokyo Index will have to complete a new trading range before another useful MDL can be identified. Looking at this chart, which had risen steadily from the August 1982 low at 512 (not shown), I don't see enough consolidation for the high to be tested. This move resembles a heaven sent opportunity to sell Japanese shares or unit trusts if you did not do so following my blow-off warnings in April (FM2).

Singapore's rally is more impressive but now looks over-extended. The 1000 "roundphobia" level should



possible but resistance in the 1000 to 1100 range should prove impenetrable for at least the short term.

The Australian All Ordinaries Index has one of the best rallies after establishing a floor area between 680 and 652. A pause is now likely because the memory of the May collapse will make investors reluctant to chase prices higher without a good reason. That would have to be another upward spurt on Wall Street which would be especially bullish for Australia which is less dependent on America as an export market. The expectation of a slower US growth rate will weaken the fundamental case for European and Far Eastern export sectors.

South Africa's Industrial Index lagged at the top and has not rallied because of the latest hike in interest rates. I envisage no upside potential beyond a temporary technical rally.

Stock market summary and conclusion

Wall Street's rally has put a floor under most stock markets which will hold for at least the next couple of months. Many of these rallies now look overextended, therefore a reaction and consolidation of gains should take place. Any significant additional move on Wall Street will be received by other stock markets as if it were a command to follow, particularly if it is another

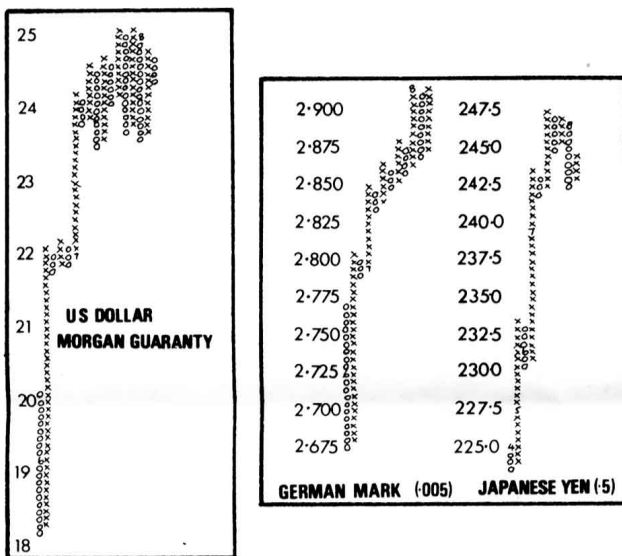
provide at least short term resistance, but the July closing low at 870 may be safe for the rest of the year.

The Hong Kong market remains within a big trading range, but has established more support in the 750 to 800 range. A further rally above 900 looks

of those overnight 30 point DJIA sprints. Speculators/traders/hedgers could short stock exchange futures in anticipation of a one quarter to one half retracement of the rally, and/or go long if new inter-day highs for this month are achieved. However, these strategies are very risky and most FMs should take a holiday from trading, until the dust settles, secure in the knowledge that they are still receiving a real return in US dollar deposits.

A churning dollar increases risk of a shake-out

The US dollar has edged higher against most European currencies, including a break above DM 2.90 against the German mark. While the long term trends remain bullish, the sensitive charts show that the risk of a shake-out is increasing. The churning activity evident on the Morgan Guaranty Index following the June-July advance has left the dollar looking top heavy. A clean break above +25.1% is necessary to confirm further upside potential, while a break below +23.5% would complete a small top formation, confirming a further reaction to follow.



The dollar's upward stalk against the mark is easy to monitor because of the unbroken progression of higher highs and higher lows. A lower reaction low would confirm a loss of upward momentum and a correction to follow. DM 2.865 is the first pressure point, and if penetrated (basis the London close), you could buy mark IMM futures for a rally, protecting this position with a stop at the August low.

The first downside pressure point on the spot yen chart is at Y242.0. If penetrated you could purchase yen futures for a rally, also using the August low for your stop point. Once established, raise stops as the futures

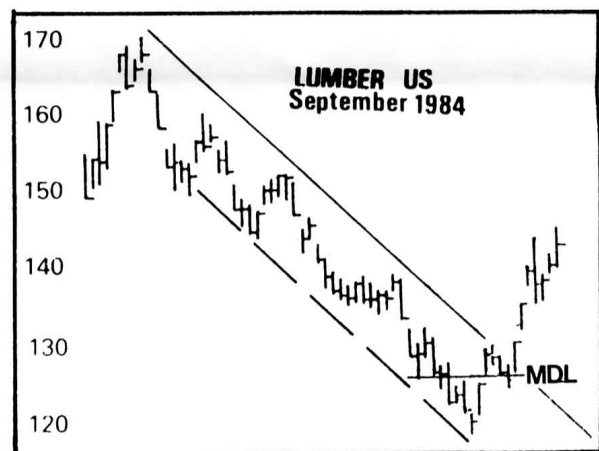
rally and take profits if the trend accelerates.

These trading suggestions do not contradict my earlier advice to hold dollar deposits which continue to provide a high real return in a currency that remains within its primary upward trend. They offer FMs a hedging strategy to enable you to protect against or profit from a short-term dollar shake-out. Contrarians will have noted that the financial press now contains more articles forecasting a further dollar rise in contrast to earlier views that the US currency was "grossly overvalued".

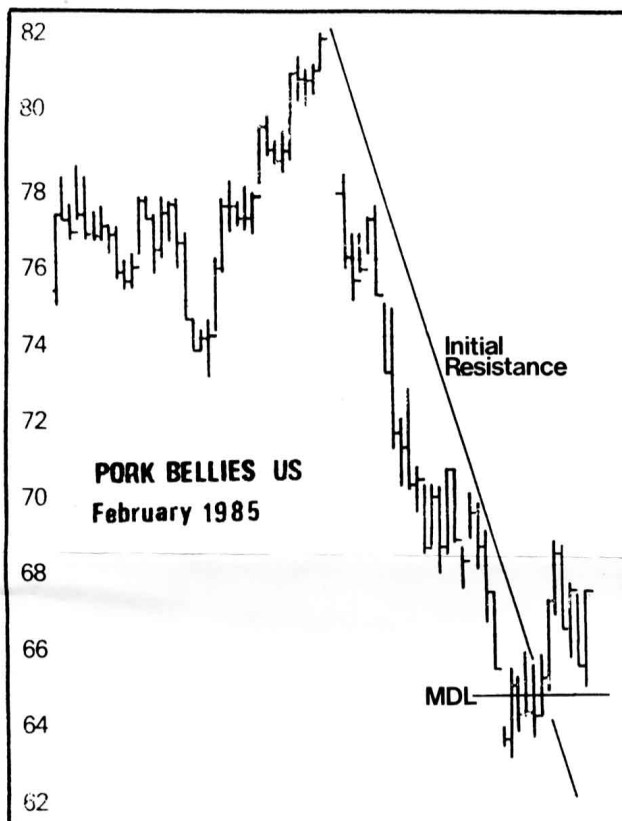
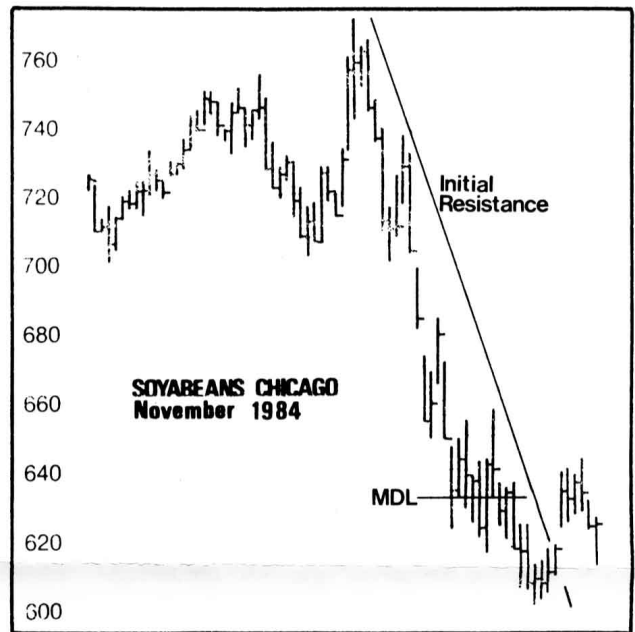
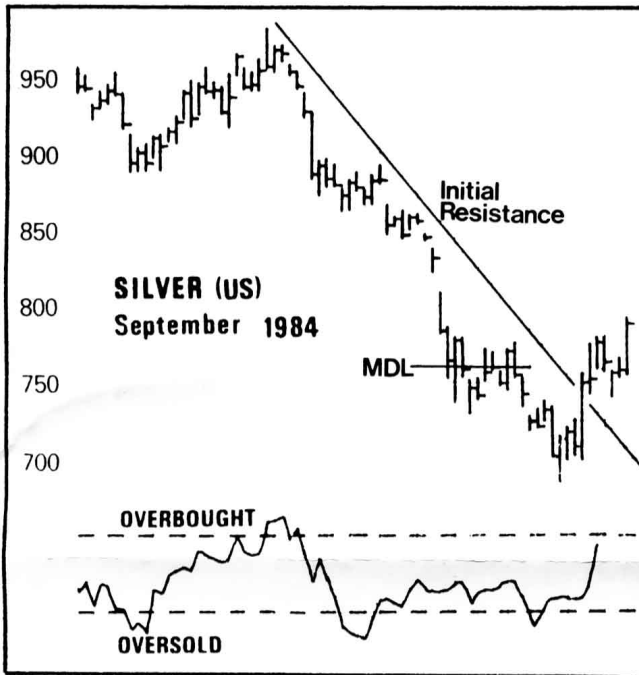
Commodities would extend technical rallies on a dollar shake-out

This month's bond and stock market rally spilled over into a more modest recovery in commodity prices as shorts ran for cover. If Wall Street took off again you could expect a further rally in most commodities which would be profitable for nimble traders. A dollar shake-out would also extend the recoveries with depressed food and industrial commodities leading, plus silver. I hasten to add that it would probably take a collapse in the dollar or a second Wall Street advance as dramatic as the first, to turn commodity technical rallies into bull market trends, but that is a separate matter.

I mentioned in FM5 that lumber would respond quickly to any change in US interest rates, and you can see that it has broken the recent downtrend channel on the daily line and bar chart. The rally could carry further provided the MDL spanning three week's trading is not crossed.



COMEX silver broke its short term downtrend and pushed above the MDL at \$7.55, suggesting that recent lows will hold for a while. A move above \$7.80 that holds for at least 24 hours would confirm further recovery potential.



Pork bellies fell a long way very quickly so a second stage technical rally could easily occur. This would be confirmed by a 24 hour break above initial resistance at 68.7 cents. The MDL at 64.6 cents is suspect because it spans only one week's trading.

Soybeans pushed up through the MDL at \$6.32, confirming a trend break, but have struggled to remain above that level. This commodity will obviously be

more weather sensitive than the others shown, and a move above \$6.43 is necessary to indicate further rally potential.

Give the pits to the miners

There is a lesson in Britain's costly miners' strike for all of us. We know there will always be anarchists, and demagogues to lead them. We also know that political and economic chaos will bring these people to power, but that is not their only route. In a normally peaceful and law abiding society, any union representing a nationalised industry is a tempting target for extremists. There is no need, let alone merit, in keeping anyone on a free country's government payroll other than the military and the minimum requirement of government administrators. Socialist humbug would have us believe that nationalised industries are benevolent caring institutions, selflessly serving the public and protecting the needy. In reality they act as if they exist solely to provide jobs for the boys.

The trouble with applying Britain's "softly softly" approach to a political strike is that it is too easily mistaken for weakness. When a small, organized group of anarchists such as Scargill's flying pickets run riot, many decent people are intimidated, the economy suffers and the price of an eventual peace is too high for the other 55 million inhabitants. Under a well-organized dictatorship there would, of course, be no such problem – Scargill and his cohorts would have been thrown into prison long ago and the mines would be producing coal economically for the country. That form of government would also be too high a price to pay, because even the most benevolent dictatorships (a rarity) preside over a cowed, uncreative people who function like automatons.

I described this strike as one of Britain's periodic

class struggles in FM 2, and said that even a Government victory would prove expensive. On the other hand, if the revolutionary socialists are to be able to claim victory, the long-term implications for Britain would be catastrophic. Scargill has become Labour's virility symbol, relegating the lightweight Kinnock to the role of puppet. When boasting that the miners would engineer a Labour victory at the next general election, Scargill told a grinning Kinnock that "You have only one lesson to learn from Mrs Thatcher – when you do become the Government of the day, show us the same loyalty to our class that she has shown to their class".

That sort of rhetoric could produce a string of other political strikes, of which the dock dispute was the first, unless the "softly softly" approach is replaced by decisive action in the national interest. I recommend the following steps. The Government should declare a national emergency, banning all political strikes in sympathy with miners, including the refusal to cross miners' picket lines. Troops should be used to assist the police in containing miners' pickets. This would free many police who could spend more time protecting working miners from intimidation. The militant NUM leaders should be placed under house arrest on a charge of insurrection.

Initially, these shock measures would be greeted with cries of "police state" from the anti-Thatcher ranks, but they would restore order and halt the damage currently inflicted on the economy. Simultaneously, the Government should announce a privatisation plan for the mines, not by floating them on the stock exchange which would not work because, taken collectively, they are a big money loser, but by giving each pit to its local miners. This would not set a dangerous precedent because the coal mines are arguably a special situation and they are the only publicly-owned extractive industry in the U.K. The miners in each pit would then be free to set their own manning and wage levels and production targets. They could democratically elect their own officers and arrange whatever outside financing or participation was necessary, including selling the pits to another party. The NUM would become redundant and the Government would save £2 million a day in subsidies. Efficiency would be increased because miners would drift away from uneconomic pits of their own accord, and find jobs where production was expanding. Most significantly, the Government would have taken another step in reducing Britain's proletariat by turning the miners into entrepreneurs. Everybody wins except for the Labour Party.

South Africa to have a chart association

Heaven investors everywhere are being saved by the chart. While I was in South Africa my old chum, Rod

Holness, who founded Holcom Commodity Brokers (Pty) Ltd, told me that he and his brother Tony are going to start a South African Chart Association. It will be modelled after the Market Technicians Association in the States and the Association of Chartists and Technical Analysts in the UK, which was the inspiration of my predecessors at Chart Analysis in 1969.

You can be certain that with the Holness brothers involved the SA annual chart convention will be a spectacular event. If you hold it at Mala Mala, Rod, we can all visit the market cycle (see FM5) for inspiration. FMs who want to receive the convention details when Rod launches the association should contact him at: Holcom Commodity Brokers (Pty) Ltd., 1st Floor, Abercom House, Oxford Park, Santon 2199, Johannesburg, South Africa.

Regards,
David Fuller

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