

CHARTWORKS

July 24, 2002

STOCK MARKET

- By a number of impartial measures, the speed of the loss of confidence and degree of "oversold" ranks with the greatest registered over the past 100 years.
- Achieving this is within the window of "around June", which is not bad for a model laid down two years ago. On the estimate made in May of this year for a low at the end of June, it's a few weeks late.
- The rally will likely run until late August – early September when the bear has been expected to resume.
- Wall Street has experienced great financial distress which, in the past, has always been followed by commercial distress in Main Street. The financial contraction in the face of massive Fed easing since January, 2001 confirms that Mr. Market and his margin clerks rule.

ChartWorks

July 23, 2002

GOLD SHARES

Our May 24 memo noted that both gold and gold shares had registered a rare simultaneous "overbought" condition, which had occurred only 7 times since 1970, the last was in 1993. Typically, the senior stocks sold off by 24% to 31% over the next two months with greater declines for more speculative stocks.

The advice was that most gold shares would take a tradable correction within the bull market. The high for the XAU was 86.8 on June 3 and for gold was 327.8 on June 5. The June 5 ChartWorks recommended selling or shorting gold shares, particularly Barrick and Placer.

The XAU has taken out our target of 63 (-27%) and short covering is appropriate. As in any bull market, long-only accounts could "buy the dips".

GOLD

For gold's nominal price, the correction measured from the high of 327.8 to originally 295. This was against a rising support band, which is now at 305.

Long positions could be established near this level with the risk limited to 295.

The July 17 ChartWorks noted that the dollar index had registered a Double Capitulation on the weekly reading. The last such reading was at 95.82 in April, 1987 when it weakened to 94.82 in ten days and rallied to 101.7 in August.

The low for the dollar index was 104.1 on July 19 and it has bounced to 106.6 today, from which a test of the lows would be appropriate. The recovery could then run to late August. The longer term will be discussed in Friday's Pivotal Events.

CHARTWORKS

JULY 17, 2002

STOCK MARKET and DOLLAR INDEX

Near Term:

Our July 10 piece, "Decennial Anomaly", demonstrated that the second year following the end of decade typically produced an important low in the mid-June to mid-July window.

We have this and typically the stock market regained the June high by the end of August. Also, the more pronounced the plunge, the stronger the rally. Independently, the long term model expected new lows for the bear to be set around June, from which a 5-6 week recovery would follow.

Confirmation:

Beyond recognizing that both models have been satisfied with a low, its importance is indicated by the registration of "Double Capitulation" on the Dow and the dollar index. That the \$ is on the weekly reading provides considerable confidence in a tradable rally starting immediately. Of course, golds will resume their correction. The initial target for the Dow is 9000.

Another Statistic:

The August 25, 2000 Pivotal Events included: " The August-September Transition: Since the 1932 low, the typical pattern for the move from Month 8 to 9 has the DJIA recovering from around mid-August to the first week in September. Within this, if the August rally came out of a consolidation from a significant top earlier in the year, the probability of an important failure after early September increased."

Overview:

After improving from November until April, the Boom Indicators have deteriorated one notch. This was based upon credit spreads and is at -12 out of the worst possible reading of -14. Since this reading turned from +12 in February, 2000, we have considered that each expected rally would be a rebound within a bear market.

The last sustained recovery in the Indicators ran from October, 1998 to January, 2000. Again referring to the long term model, it expected another acute phase of the contraction to begin after August and run until around December.

INSTITUTIONAL ADVISORS

JULY 15, 2002 BOB HOYE

STOCK MARKETS

- Our long term post-bubble model which clicked in in July, 2000 has been reliable. It expected the high for this year to be set around March (4) with new lows for the bear being set around June.
- Our July 5 Pivotal Events and ChartWorks noted the huge number of stocks registering capitulation at close to the end of the month, which was a short term target made in early May. The July 5 editions made the point that the recent lows needed to be tested.
- The liquidation, both voluntary and involuntary, is reaching the severity we expected. But it is achieving it somewhat later than we thought on the near term view made in May.
- On the long term target made two years ago, it is close enough to be an outstanding call.
- Obviously, the trading entry is difficult and two tools can provide some guidance on extreme conditions.
- On a closing basis, the Nasdaq has tested the low of 1357 on July 2. In turning up, the MACD is providing bullish divergence, confirming the likelihood of a tradable low. This was a critical part of our similar conclusions made at the critical low at the end of March, 2001.
- Outside research such as Lowry's 90% reading would confirm the low for this move.

WRAP:

We are in a speculative spike to the downside, in which case to get the turning level and the day ahead of time is next to impossible. However, the above tools should help.

Leading Wall Street strategists who did not anticipate the plunge are staying with their year-end targets for the Dow. This would require rallies of up to some 40%. The April 30 ChartWorks noted that from the two-year complacency level (i.e. March 1931 Dow), the return to that level took 54 months. On the similar condition for the Nikkei in late 1992, it took 49 months to reach the breakeven.

CAPITULATION:

On this model, the ultimate discipline to bring in the "buy" is an improvement in demand and price. Generally, this has yet to occur.

PIVOTAL EVENTS

FRIDAY, JULY 12, 2002

BOB HOYE

Stock Market:

Whether to the up or the down, we usually find reversals excruciating. This is the case this week.

Our July 5 edition expected a test of the lows to complete early this week and the action has become severe enough to set up the reversal. Universal dismay seems to have been reached on

Wednesday. Mediocre performance with some bias to the upside as the market climbs a suddenly discovered wall of worry would be an ideal start and the test of the recovery could occur in about 10 days.

The June 27 ChartWorks provided a list of stocks registering capitulation readings with the conclusion that it was time to begin scaling in. The model, for this year, called for the high for the year in March (✓) and new lows for the bear to be set around June. Once stabilized, the rebound has been expected to last for around 6 weeks. This would now take us to early September, the traditional time for a turn towards a liquidity crisis. The low for this year has been expected around December and, while the contraction could be severe, we are uncertain if it will be severe enough to end the bear market.

Perspective:

With our models on industrial commodities, the yield curve, credit spreads, and the stock market favourably working out to March 1, we added some investment policy comments to our outlook for the rest of the year. In declaring a victory on the upside, our March 1 edition noted: "We now await the resumption of the contraction, which should be noticeable around mid/year. This would be foreshadowed by renewed adversity in the usual financial series and moved from the subtleties of Wall Street to Main Street with headlines about more defaults. Investment managers have to make reports to their clients and the prudent ones avoided passing on the ravings of the analysts who were only doing their jobs in attempting to make rational another great buying mania. Regrettably, the compulsion to rationalize afflicted the Fed as well and the bragging about the miracle of productivity was equally absurd.

Prudent advice to clients could avoid glowing reports about a policy-engineered recovery (what's happening now is on schedule and ephemeral), but could include some instruction about the hazards of benchmarking performance from lower grade securities, for example." The edition concluded with the following question from The Economist in Year 2 after the 1873 bubble: "Why the Stock Exchange is Likely to Have More and Greater Frauds in it Than Any Other Market?" - The Economist, March 27, 1875

Equity Wrap:

It is appropriate to look to some stability or change in other items that would support a stock market rally.

- Despite calamitous reports, rapidly widening credit spreads have stabilized since late June. (Junk got whacked on Thursday.)
- Base metal prices have recovered from 506 on June 26 to 538 today.
- Crude oil prices have recovered from 25.31 on June 19 to 27.25 this morning.
- The treasury curve from 30 years to 3 months has flattened from 386 bp on June 27 to 363 this week (a new "flat" for the move).
- The decline in the Baltic Freight Rate has stabilized. Recriminatory Legislation: Policymakers, through the Fed, hyped the boom and then the establishment claimed it was managed under the increasingly infamous "Goldilocks" scenario. After publicly glorying in the mania, they are suffering considerable chagrin and will scapegoat anything in sight. Extremely dangerous political tantrums. The more socialist the politician, the more vitriolic the attack. Democrats are viewing CEOs with the same intensity as Republicans view terrorists. While this may be rhetorical, the attacks after the hype confirmed our observations

that policymakers exacerbate both upside speculation and downside liquidation. Our February review, Recriminatory Legislation, is updated and attached.

CREDIT MARKETS

Bond Future:

A few weeks ago, we noted that, while the plunge in the stock market could be severe, the associated bond rally would not be as sensational. So far, this has been the case and the future has moved up to "congestion" around the 105 level.

Obviously, completion of the stock market test is running a few days late (1) and traders can wait for the rollover before adding to short positions. Investors are content with the returns and safety of principal obtained from 3-4 year treasuries.

Credit Spreads:

Less sophisticated equity managers are discovering the significance of credit downratings and the increasing precipitation of "Fallen Angels" as issues lose investment ranking. Along with discoveries of malfeasance, this is definitely symptomatic of a post-bubble contraction. In effect, Ms. Market is again relentlessly rationing credit, which had been the fuel of the late speculative rise in stock prices. A Victorian term provides adequate description – credit stringency. This prevailed during an enlightened period when central and commercial bankers, as well as investors, knew that fiddling with interest rates would not prevent a post-boom contraction. On the model, problems were expected to return after March, become noticeable around June, and after August market conditions would accelerate to considerable distress by December.

Yield Curve:

Significant steepening has been expected to resume after August.

COMMENTS FOR METAL PRODUCERS

Base Metal Prices:

Some firming has been possible in July with the summer stock rally. Prices are up a little since late June, with our index rising from 506 to 538. Beyond discounting the plunging dollar, this could be signaling the rebound in the stock market. It is worth emphasizing that June's scheduled collapse in the stock market and corporate securities is anticipating a severe decline in business activity. Our target for December remains at 350.

Dollar Index:

This will stabilize and rebound with the stock market and could be extended by the mounting credit crisis prompting (after August) a flight to the liquidity unique to short dated U.S. treasuries. Technically, it registered a capitulation in late June.

Gold:

The scheduled correction in real and nominal terms continues. Offsetting the goldbugs' enthusiasms about the weakening dollar, commodities are outperforming gold. In both measures, gold can resume the uptrend in September.

(1) Where is the Plunge Protection Team when it is really needed?

Gold shares now are vulnerable to a brief rebound in the general stock market. The July 3 ChartWorks set out targets and parameters for the next entry point.

Aug-Sept 2003	FRI 8th	TUE 9th	WED 1-th	THU 11th	Noon FRI 12th
Swap Spread	55	54	52	51	52
Junk Spread	730	725	729	742	-
Treasury Curve	376	369	364	366	366
Base Metal Prices	522	523	530	527	538
Gold	312.1	316.1	314.7	317.2	315.2
S&P	977	953	921	928	928

Post-Bubble Year 2, Seventh Month

"What this market is saying is that dozens and dozens of perfectly solvent corporations and foreign governments are headed for certain receivership and default and this is simply utter nonsense." - **Barron's**, July 6, 1931

"There can be little doubt that we have very narrowly escaped a panic. The great mercantile disasters which have followed so rapidly one after another ... would, in former times, have ... shaken the foundations of credit." - **The Economist**, July 10, 1875

In both cases, confidence recovered until March and then the contraction resumed. The period from 1873 to 1895 was called "The Great Depression" with prevention or remedies seriously discussed by leading economists until 1939. With belated discovery of the next "Great Depression", analysis of the "old" one was rapidly abandoned.

PIVOTAL EVENTS

JULY 12, 2002

RECRIMINATORY LEGISLATION

BOB HOYE

If there was such a thing as a country dude with market sense in 1929, he might have mixed some metaphors when looking at the runaway stock market: "The sky is going to darken as the chickens come home to roost and the sound of barn doors being slammed will be deafening."

While today's concerns are ostensibly about the Enron, Andersen, and WorldCom debacles, it is essentially officialdom outraged by another financial hangover and seeking relief by again

slamming doors after the horse has bolted. Seemingly without knowledge of financial history, both politicians and their bureaucrats boasted that the good times of the 1990s were due to brilliant policymaking. Actually, it was the sixth such rush of reckless speculation and abuse of the credit markets otherwise celebrated as a new financial era.

Similar control delusions accompanied previous outbreaks and the collapse of speculative abilities forced an equally rapid discovery of hubris, chagrin, and allocation of the blame. Prosperity has many fathers and financial calamity is an instant orphan.

Using previous examples, defaults have statistically clustered into the 2-3 years following the dramatic climax of a new era. Typically, these have occurred twice per century since the first one erupted with the notorious South Sea Bubble in 1720. A pamphlet's complaint effectively described all subsequent new eras: **"The poor English nation run a madding after new inventions, whims, and promotions ... They can ruin men silently, undermine and impoverish, fiddle them out of their money by strange, unheard of engines of interest, discount, transfers, debentures, shares, projects, and the Devil and all of figures and hard names."**

In those days, the "board" was called the court of directors and they made appropriate contributions to politicians who could assist the company's ambitions. With the consequent contraction, everyone became furious and in 1721 the House of Commons passed the Bubble Act which, quite simply, outlawed a runaway stock market.

Fortunately, it was repealed just in time for the next bubble, which climaxed in 1772. Sacrificing its dignity to the urgency of widespread offense and chagrin, the House then passed another Bubble Act. Interestingly, no such recriminatory legislation was passed with the collapses of the 1825 and 1873 New Eras – no doubt due to the macho common sense of 19th Century liberalism.

However, the U.S. establishment wasn't as enlightened. The credit pressures that accompany the culmination of a new era became all too evident in the summer of 1873 and the leading New York newspaper editorialized that there was no need to be concerned. The pitch was that the Treasury System was superior to a central bank in maintaining a boom. (America was between central banks.)

After decades of condemning the excesses of the old system, Wall Street spokesmen and academics in 1929 celebrated the wonders of the new Federal Reserve System, ensuring that nothing could go wrong. Understandably, there was a lot of recrimination to go around and those dedicated to perfecting financial history came up with Glass-Steagall and Securities and Exchange acts of the 1930s' "New Deal".

The intention of both acts was to prevent another runaway financial boom, which legislators saw as the cause of the depression. Glass-Steagall separated banking from stock brokerage and the SEC insisted that proper accounting and reporting would prevent extravagant claims and promotions. Its drafters boasted that it would "put a policeman on the corner of Wall and Broad".

Fortunately, the historical imperative was fulfilled as, at least, Glass-Steagall was tossed out just in time to assist ours - the greatest financial mania ever. After basking in false glory, the pols are really pissed and scapegoats must be hammered. The "perfections" of the Treasury System, the

Federal Reserve System, and then the SEC are quickly forgotten with talk of a more perfect agency; some are finding solace in tightening up insider reporting, which is just another method of socializing stock markets.

As anyone outside academe knows, the bigger the boom, the bigger the bust, and those with the monopoly on the currency have played a big part in the excesses. As run by unopposed adventurers in public policy, we have seen the most reckless depreciation of the senior currency in 400 years, which fostered the greatest CPI inflation in 400 years and the most reckless financial boom in 300 (bubbles started in 1720).

When it comes to laying the blame, the underlying shredding the wealth policies pushed by statist intellectuals upon gullible politicians must be included. As for speculators, all they have been trying to do is discount relentless but official currency inflation, first in tangible assets, then in financial assets, and now most know that these phenomena don't last forever.

This time around, the clean-up committee should include those who understand the markets and exclude fanciful theories about intervention that have been little changed since Old Rome came up with the New Deal following the bust of 33 AD.

CHARTWORKS

June 5, 2002

GOLD AND GOLD SHARES RARE SIMULTANEOUS OVERBOUGHT (UPDATE)

As advised on May 23, gold and gold shares both registered an "overbought" condition. There have been only 7 such simultaneous readings since 1970; the last in 1993. Within their bull markets, a correction for both has been expected to start in early June.

As we have been mentioning over the past month, in a market that has been expected to rise for a number of years, the key is not so much upside targets but entry points in time and price on the corrections. This one could last about 6 weeks.

Gold: Two technical measures suggest that gold's price could correct to 300. Producers should use this to aggressively cover forward sales. The resumption of the trend after August could seriously damage incorrigible bears.

Gold Shares: Sell or short the compulsive forward sellers such as Barrack and Placer, to name only two.

Gold - through June 4, 2002

A 50% correction from \$272 and test of the percentage band should provide support around \$300.

In the early stages of Gold's last three strong phases (1970-1975, 1976-1980 and 1985-1987):

1. The long term moving average turned up.
2. The price corrections overlapped the breakouts, but held the long term average.
3. The price breakouts then began to hold at the upper percentage band.
4. Breakout levels became supports as the market walked its way progressively through previous resistance levels.



