

# THE INTERNATIONAL INVESTMENT LETTER 13

(July 2007)

*The game that has been played since the collapse of the Bretton Woods system  
in the early 1970s is drawing to a close.*

*The dollar's status as the world's reserve currency is gradually coming to an  
end!*

The author: Francis D. Schutte graduated (Master in Applied Economic Sciences) in 1972 at the Antwerp UFSIA University. He soon became an active member of the Belgian financial world. Initially, he operated with a Belgian broker, subsequently with a renowned Canadian research house and with an American Bank. At that time, he became a registered representative with the Montreal and the New York Stock Exchanges. It was only when he was operating with the First Continental Bank of Illinois, that he added technical research to the fundamentals. A couple of years later, he started his own business, became a member of the Belgian Stock exchange and a well know figure in the Belgian financial world.

As founder and first President of the BFTA (Belgian Federation of technical analysts and past-vice president of the IFTA (International Federation of Technical Analysts), he managed different Common Investment funds and even ran a successfully an open portfolio in a financial magazine. Weekly, he published his own market letter and his international advice could be read in many financial publications.

In 1989, he was one of the few predicting the Great Crash of the Japanese stock and real estate markets. He travels all over the world and has a sharp insight of the actual geopolitical and economic situations.

# GENERAL

## Recession – Depression (Deflation) or Inflation? :

Economists still haven't come to end as to whether the depression of the 1920's was due to a crash of the stock markets or the stock markets crashed because of the depression.

Bearing in mind the actual state of the crap politicians that run the scene, which emphasize Sucker, Football, Tennis and other sports with the Gladiators of the 21<sup>st</sup> century - but also War and are talking about a planet Earth that is heating up, are no better then Nero, Constantine and all of those last Roman emperors running the show, the odds that some serious research will be made about this really important matter, is extremely small.

Economist and financial advisors all see either a continuation of the actual pattern of Inflation that eventually will become a Hyperinflation (German or Zimbabwe style) as politicians tend to inflate their debt away, give the herd the impression that they all become billionaires and in due course, collect higher taxes as the latter tend to be calculated as a percentage on the inflated value, and by doing this ruin the country.

## Made in Japan versus Made in China

For Japan, what happened before and after 1990 has been forgotten or has passed by unnoticed by most analysts.

After WWII Japan and Germany had become the manufacturing countries by excellence. Until 1989, a lot of imported products carried the label "made in Japan". In those day, made in China was mainly for cheap toys. Today this has changed a lot.

As the Yen and Japanese products became too expensive, it was logic that production slowly slipped away to China, Korea and Vietnam. In 1998, the Japanese Real Estate market was at an absolute top with the price of land in Tokyo being the most expensive in the world. Japan was an island and densely populated, and it was said that there was NO way but up for Real Estate! (Remember the coffin hotels?!)

But 1990, it all started to happen. The Japanese Stock market collapsed, the Real Estate market dried up and prices started to crumble. The stock, real estate market and Yen collapsed all together. The tune was set for a depression.

In an ultimate effort, Japan increased the already high Money Supply drastically, squeezed back the interest rates all the way to a negative figure. But nothing helped. The Stock markets, real estate and the Yen didn't care and continued their fall.

What people thought was impossible, started to happen: over a period of 24 months, the average value of Japanese Real Estate fell by 80 % of the 1989 level.

Over the same period of time, the Nikkei fell from a level of almost 40,000 to below the 10,000 (about 7,400) . The average value of the Japanese shares fell by more than 80 %!

The cherry on the cake was that in 1990 the value of the Yen against the Dollar, Pound Sterling and Euro fell by an average of 40 %!

Adding these factors, the 1992 final value of an initial investment of € 100,000 made in 1989, was a poor € 12,000!

The Japanese economy is still in the doldrums and personally, I think it will stay there for some time, as it is very hard for them to compete with China.

April 17, 2007 (Bloomberg) -- The yen may extend its decline against the euro and the dollar before a government report that economists forecast will show Japanese consumer confidence fell last month.

A drop in confidence may lead consumers to cut spending and give the Bank of Japan a reason to keep its borrowing costs the lowest among major economies. The yen dropped to an all-time low against the euro and the lowest in seven weeks versus the dollar yesterday after Group of Seven financial officials refrained from criticizing the yen's weakness in a weekend meeting.

## The Argentina affair (1999 - 2000)

The crisis affecting this country was largely unnoticed. Just like it is today with the Chinese Yuan, the Peso was pegged to the Dollar, hereby making imports cheap, producing a constant flight of Dollars away from the country and a progressive loss of Argentina's industrial infrastructure, which led to a massive unemployment. Today, the same can be said about the USA where 70 % of the manufactured goods are imported.

Meantime, government spending continued to be high (Falkland war, the state's takeover of private debts) in a similar way to what the US is spending today on the War in Iraq. Massive tax evasion explained a large part of the evaporation of funds towards offshore banks.

The possible solution (abandonment of the exchange peg and a voluntary devaluation of the Peso) was considered a political suicide and a recipe for economic disaster. As a matter of fact, the USA - for obvious reasons -was STRONGLY opposed to such an action.

2001, people began withdrawing large sums of money from the banks, turning Pesos into Dollars and sending them abroad, causing a run on the banks. Government had no alternative then to freeze all bank accounts and this action resulted in the CACEROLAZO (banging pots and pans demonstrations).

2002, the fixed parity with the Dollar was abandoned and the Peso fell from 10,000 to 4 pesos for \$ 1 . Additionally, all bank accounts denominated in Dollars were de facto converted in Peso at this official rate.

The quality of life was lowered dramatically; many businesses went bankrupt and imported products became inaccessible as salaries were left as they were before the crisis.

Today, Argentina has managed to return to growth with surprising strength; GNP jumped 8.8% in 2003, 9% in 2004 and 9.1% in 2005

Conclusion: There is absolutely no guarantee that politicians will be able to inflate away their financial problems. Even with low interest rates and exponentially growing money supply, all of the sudden a Depression can set in and last for 15 years or more!

### The American scene

Today in the USA, the situation is more or less similar to the settings in Argentina before the crisis. The major difference being that the Dollar still is seen as a Reserve Currency. This status is both an advantage, but also a dangerous disadvantage. During the 1920's the Pound Sterling had the same status. Today, against the Swiss Franc, its exchange value has fallen to 5 % of its 1920 value.

Henri Ford was a MANUFACTURER....but WAL-Mart is a SERVICE (distribution) provider!

**Henry Ford paid his employees well.** Ford theorized that if he paid his workers well, their wages would indirectly lead to more sales of his automobiles. Ford was right. His employees spent

their wages and in doing so, laid the foundation for the automobile owning middle class.

Ford's strategy was a winning proposition for both his employees and his company. This strategy contrasts sharply to Wal-Mart's take no prisoners approach that will ultimately destroy its customers.

70 % of all goods on the shelves in Wal-Mart are IMPORTED!

Today the USA is the new Argentina. Because of the fact that the Chinese Yuan is pegged to the Dollar, the American consumer is able to consume cheap 'Imported goods' hereby devastating the American industrial system and destroying the Middle Class. Because of the fact that the natural correcting forces have been blocked, Goods are manufactured abroad, hereby killing local employment and creating huge imbalances on the Balance of Trade and Payments.

"The consumer may believe he/she is getting a deal, but discounts increasingly will come at the expense of jobs and/or production cuts. As the Americans keep shopping, the American economy is boosted, but so is the trade deficit that is weakening the currency."

As the overall Debt keeps on rising, the purchasing power of the consumer decreases. This situation is now also slowly but surely endangering the Chinese economy as the debt limit of the consumer has been reached and there is less and less money left to buy (imported goods) and to pay for imports.

In addition, China's economy is awash in inventories of finished goods. Car inventories are around 600,000. Mobile phone stocks

are well over 70 million. *Air-conditioning* stocks are close to 9 million and inventories of most appliances are 30-50% higher than one year ago...if Wal-Mart were a country, it could be one of China's top customers starting to faint.

## The Spanish situation

Last year, several occasions the Spanish national bank warned that the Spanish banks' involvement in the Real Estate market was dangerously high. Some bank treasures have an exposure of more than 50 % and up to 80% in Real Estate.

Only weeks ago, the Spanish national bank almost ran out of Foreign Exchange. They found themselves in a situation where they had enough funds left to pay for 12 days of imports! They sold off 80 tons of Gold, British gilts and US Treasuries and issued a huge amount of government Bonds in order to stay afloat.

Last year over 800,000 new homes were constructed adding to the already huge stock of unsold ones. Many were sold to speculators and Spaniards that borrowed up big, the majority at floating rates interest rates. Today, average Spanish household debt is 135 % of disposable income!

Since Spain is tied to the Euro it cannot devalue its currency a very painful deflation is inevitable!

"Spain is going to face the very direst of economic circumstances...a cycle of recession, deflation and widespread private sector default...a depression in fact." (B. Connolly of Bank AIG)



## The Italian job

A derivative blow-up at the Italian bank Italease has sent tremors through Milan's banking fraternity and exposed the hidden dangers of exotic credit instruments.

The bank has paid off €610m (£419m) in recent days to counterparties in what amounts to a massive margin call after interest rate rises in Europe caused hedging and derivative losses by clients to mushroom out of control. The share price has tumbled 9pc so far this week, and is down 64pc since the troubles first began to emerge in April.

"These derivatives were very complex and suddenly turned against us," said Pierantonio Arrighi, the bank's spokesman.

The losses still looked manageable at €225m in December. They then jumped to €400m by March, and then €600m by early June, in a classic derivatives spiral, at which point the bank faced the choice of cutting its losses or risking disaster.

It appears that the derivatives teams were caught off-guard as the European Central Bank stepped up the pace of interest rates rises, hitting credits swaps sold as hedges to clients.

While the debacle poses no systemic risk to the Italian banking system, it sheds light on the murky world of credit derivatives - viewed by regulators as the most risky and untested of the \$410,000bn (£203,000bn) derivatives market (seven times global GDP).

The funds are heavily exposed to collateralized debt obligations (CDOs), typically packages of mortgages sold as securities. The lead fund lost 5pc of its value in April and May.

It is unclear whether United Capital faces the same crunch as two Bear Stearns hedge funds, which came to grief as rising default rates on sub-prime property ate into the top A-rated tranches of this form of debt.

BBB-rated tranches of sub-prime debt from the worst hit 2006 vintage have crashed to a record low of 54.06 from near par of 97 in February, according to the ABX index. These bond-like assets have, in effect, lost half their value.

### The supprime market

The American Real Estate Bubble has been coming down for some time now. Foreclosures figures are rising. People that borrowed money (sometimes 100 % and more) to buy a house get into trouble because interest rates are picking up and/or they are losing their income or get into a position where they are unable to serve their debts. Many debtors have started to use their credit cards to pay for their mortgage!?

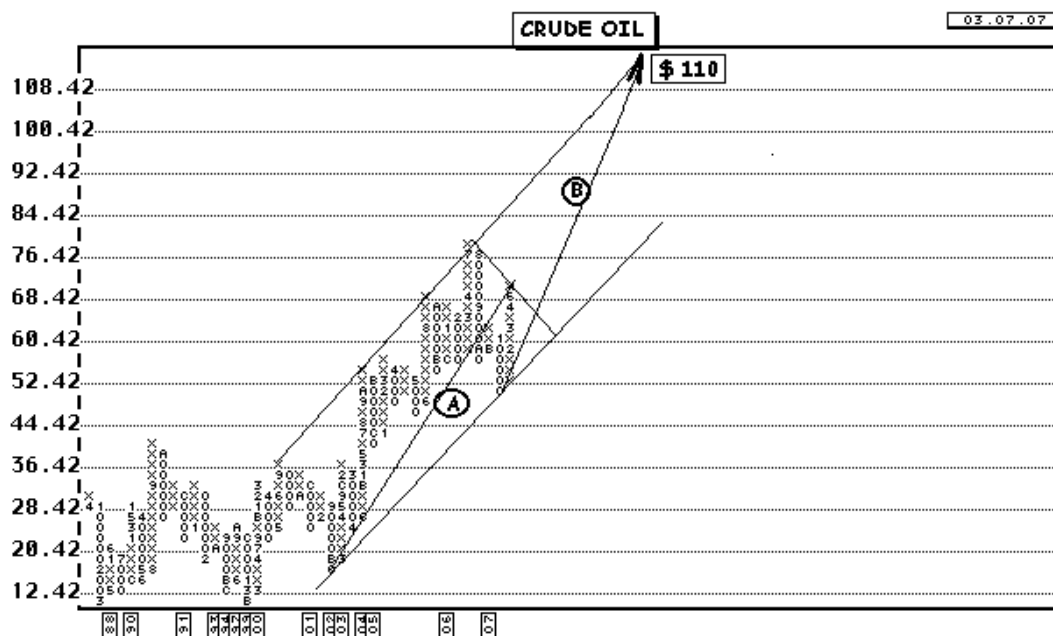
The final point being that the collateral (the House) has fallen in value and hence fails to cover the outstanding risk of the Mortgage. Banks and Mortgage companies are now having a problem as these Mortgages were packed in CDOs and sold to investors, hedge funds, etc...

Bearn Stears' action to salvage CDOs has been covered in details by the financial press.

Conclusion: The global financial world is full of booby traps and land mines. The Door is rotten, we now only need to wait until something or somebody breaks through it!

### CRUDE OIL ( \$ 72 per barrel)

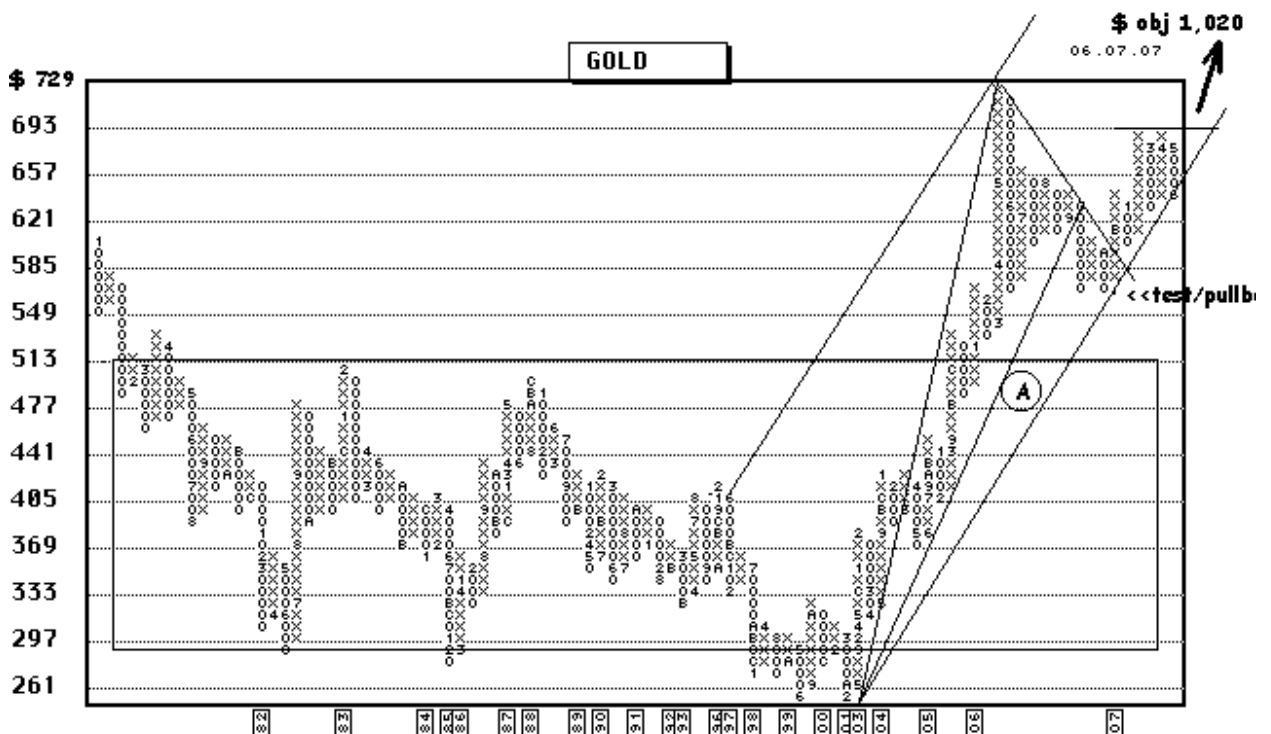
Crude Oil broke out of a reversed Head and Shoulder formation that is leading the way to \$ 80. Since it broke out, for some dark reason there has been little or no news coverage. I expect leg B to be equal to leg A. This brings medium term Oil price objective up over \$ 110 per barrel. A weaker Dollar will probably partly offset this Oil price hike on expressed in €uro and other stronger currencies.



## GOLD & SILVER: (640 \$, 485 €)

Continue to accumulate Gold and Silver on price weakness

Charts below: Watch for the actual test of \$ 696 (resistance) and for Gold breaking out in Aussie, Euro and Rand. Expressed in Yen it has already broken out. Assuming the huge up channel stays intact, once gold breaks out (I think it will), \$ 1,020 will be the next target. Stops on this route will be \$ 720 and \$ 860. Bearing in mind that countries like Spain had to sell 80 Tons in order to built up liquidity so it could pay for its imports, I think Gold is performing extremely well. Early summer is also traditionally is a rest time.

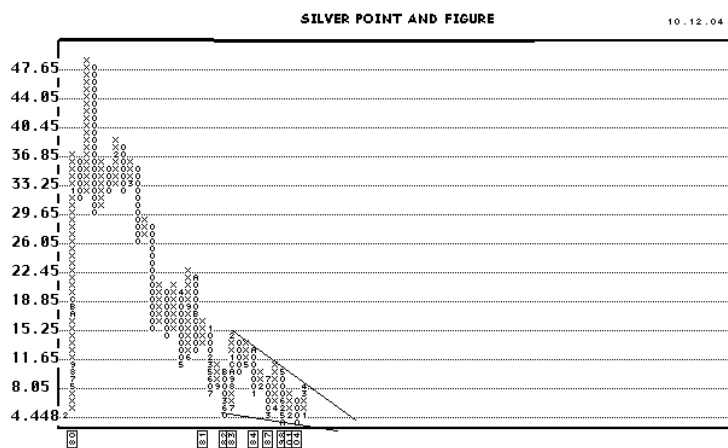
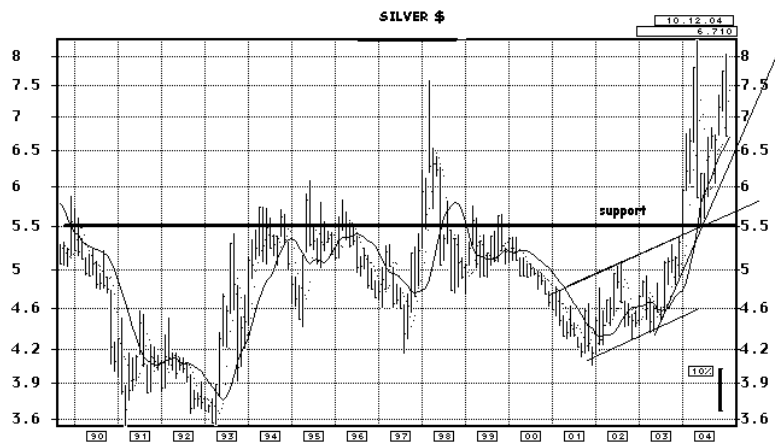


Gold and Silver are the only available REAL MONEY. Their value is constant. Each time Gold and Silver go up, you basically see the value of FIAT MONEY decrease.

The long-term gold bullion price target on the graph to the right is US\$3,400/oz!

The Silver price (\$ 12.50) is a lot more volatile, but keeps on moving in the wake of the Gold price, and here the objective remains 11 \$. We have reached the end of the second **Rounded Bullish pattern** that became a parabolic spike. Most of the time, such a movement, which is a near vertical ascension of prices, also have sharp vertical declines. Rounded bullish patterns are typical for -long term- rising trends.

But just look at the long term picture on silver. What an amazing base it has formed over all these years. When will it have reached its take-off point? We will have to wait and see. It seems that despite the change from silver based photography to digital photography, the prospects for silver are good. Also, the US silver stockpile is essentially depleted.



The long term Silver chart left has barely changed... Note the accumulation pattern. Assuming the silver price moves to \$ 11, the long term downtrend will be reversed and we could again see the historic levels of \$ 48. (Remember the Hunt brothers?)

**Note:** Assuming my price objectives for Silver in DOLLAR and EURO are correct, the Euro will rise to 1,40 \$ ! (medium term objective)

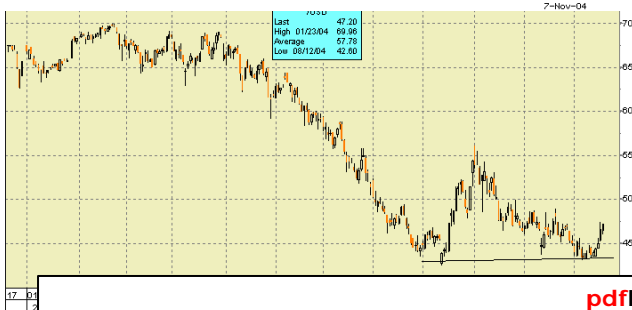
## OTHER COMMODITIES

Palladium: is a screaming buy!



**Most commodities are screaming buys.!** These also show similar charts (but less dramatic) when expressed in Euro and non-dollar currencies (to be continued). Other commodities with similar patterns are Lead, Wheat, Corn, Soybeans, etc...

LUMBER MONTHLY \$



COTTON YEARLY \$



D. Schutte  
(2007-07-01)

14

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## CURRENCIES

**I am still bullish for the Euro and the SWISS and bearish on the \$ and the £ !**

**If the Dollar cannot make it above the Federal Reserve Traded weighted index (0,8250) soon, the dollar could well go into a freefall.**

The Dollar decline is about to enter a new, more frightening phase as it also starts to plunge against the Japanese Yen. Next, somewhere down the road, it will also have to give in against the Chinese yuan.

### A Possible scenario:

*"The day will come when foreign investors simply say 'no' to this arrangement - refusing to fund America's consumption binge without getting a meaningful concession on the terms of financing. That's when the dollar collapses, US interest rates soar, and the Stock and Real Estate markets plunges...and accidents happen. Under such a crisis scenario, a US recession would be all but inevitable. And a US-centric global economy would undoubtedly be quick to follow. Unfortunately, with America's current-account deficit now in the danger zone, that day of reckoning could well come sooner rather than later."*

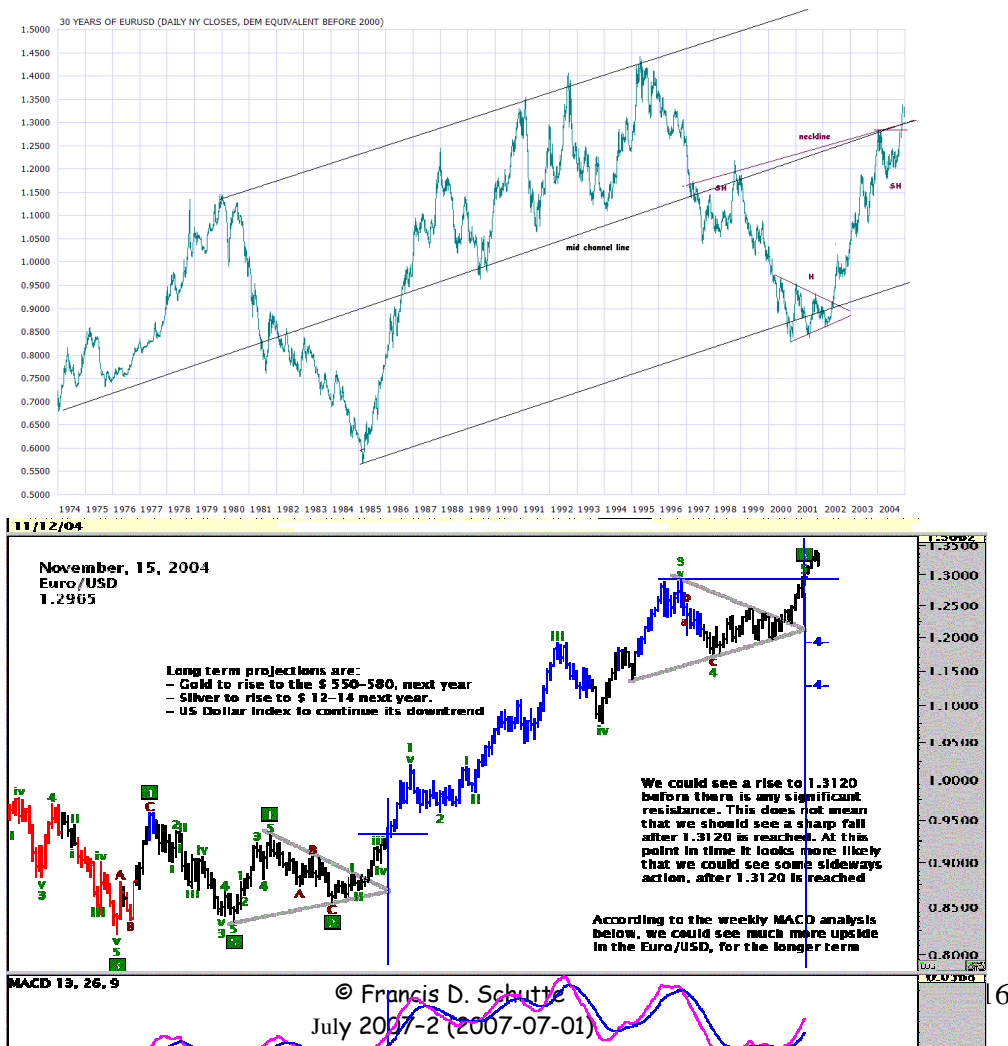


So much debt is held by foreign institutionals, that the Dollar fixing is probably made outside the USA ! We have reached that point, where the Dollar will already suffer as "those foreigners" just buy "less" debt. When the Dollar decline started in 1985, little debt was held by non-Americans. Today 9,000 billion dollars are kept overseas. One third of this amount is in hands of Central Banks.

## 1. The US Dollar (1.33 € nov 29)

Coming weeks are decisive for the Dollar/Euro entering the top (weaker) range of the 30 year chart below. Plenty of indicators point in this direction, however, I am awaiting a positive test of the actual support levels. If the levels hold, this *portends a further 30% depreciation in the dollar from current levels to the region near 1.62 !*

30 Year chart below: As we've lifted off the mid-channel level of 1,20 the long term objective of wave (V) after actual correction (wave IV) could well be as low as 1,65 \$ for 1 € !? . Resistance is only to be encountered from 1,40 to 1,45.



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**2. The Yen (\$/yen) :** Amazing is the head and shoulder pattern on the 30 year Dollar/yen chart below, and the actual pullback towards the neckline that was successfully tested. Next objective here is the 1995 bottom, but the objective of this Head and Shoulder pattern is way lower! Will the \$ also fall all the way to the bottom of this downtrend?



If you own your banker \$ 100,000, you have a problem, but if you own your banker \$ 1,000 billion, he's got the problem.

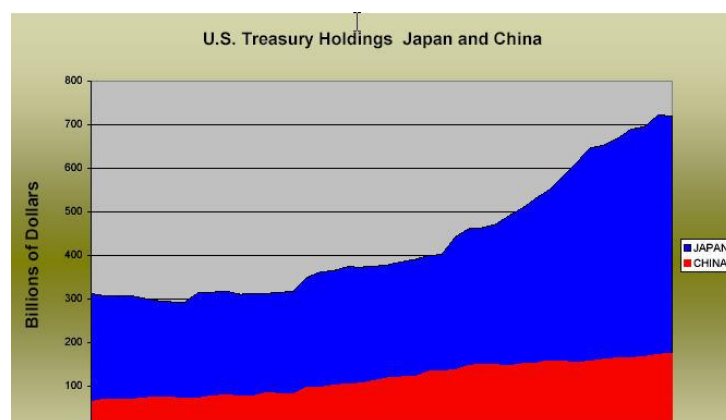
US foreign debt amounts to a staggering 3,300 billion dollars (30% of BNP). Japan is the biggest holder of this

debt or about 720 billion \$. All of this debt is managed by a Mister Asakawa. In fact, it is thanks to him that the Americans can go out shopping for X-MAS and keep on paying for the mortgage and other debt they have. He's like a Japanese Santa Claus.

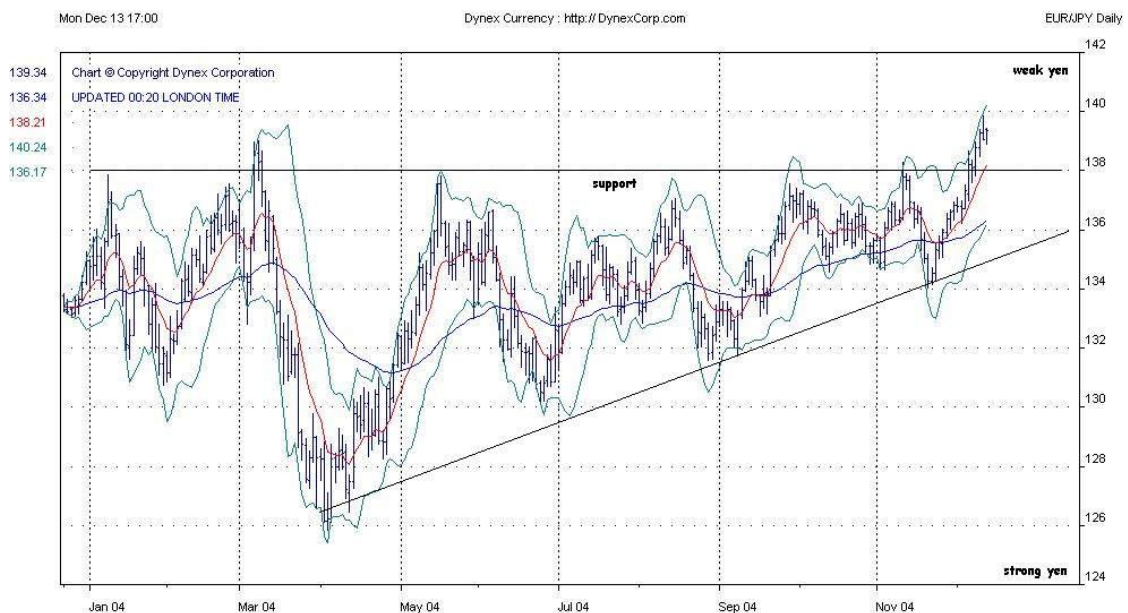
Over the last months, the Dollar lost 8% versus the Yen, or Mr. Asakawa lost about 57,6 billion dollars. Even for Japan, this is an enormous amount of money.

Mr. Asakawa goes to bed with his remote system (well known by traders) that sounds alarm each time the Dollar falls out of a previous determined support channel. And he hasn't been sleeping a lot recently!

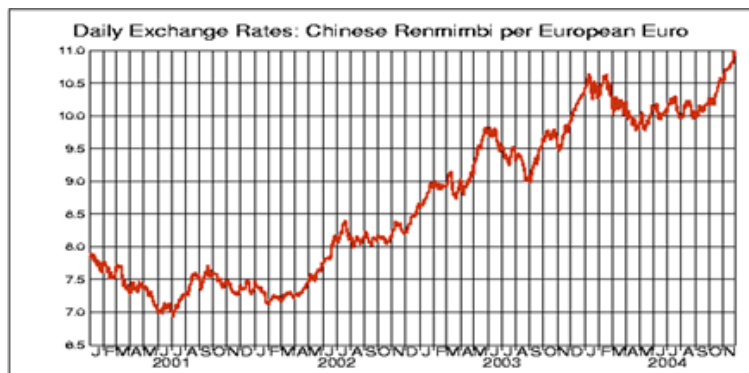
Unbelievable is that 280 millions of Americans sleep tight every night not understanding that a simple phone call made by Mr. Asakawa could, in a couple of seconds, ruin the American Holliday Period.



**(Euro/Yen):** The yen has broken out of the triangle discussed in an earlier edition, indicating that Japan is trying to keep pace with the falling dollar. (note: inverted chart)



**3. The Chinese yang or Renminbi:** The weak Dollar means renewed attention on the Renminbi's perceived extreme undervaluation, which is best reflected in China's growing share of world exports. China's share of world exports has risen from 1.8% in 1990 to 6% in the first five months of this year. How long will the Chinese currency be able to keep the link with the us \$ ? As the \$ slides, Chinese imports



Francis D. Schutte  
July 2007-2 (2007-07-01)

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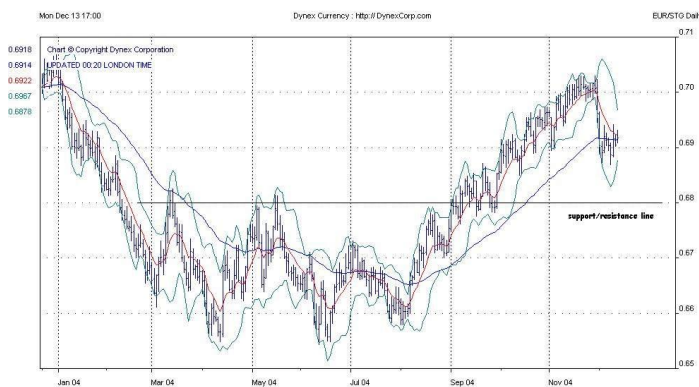
also become more expensive.

**Export Taxes:** If you can't make your products more expensive by moving up your currency, tax your Exports!

**H**ONG KONG, Monday, Dec. 13 - The Commerce Ministry in China announced Sunday night that it would impose tariffs on some textile exports, a step that could avert a trade war with the United States and the European Union over a new influx of low-cost Chinese garments that had appeared likely to flood Western markets starting Jan. 1.

#### **4. The wonderfull falling POUND STERLING :**

*To me, the British market has always been a forerunner of what was about to happen*



*else where!* Few recall those days when the Sterling was on the Gold Standard? Not that far away! When it went off the Standard, the Sterling's Role as world currency quickly vanished. Today, what is left over keeps on weakening in the wake of the falling \$ ...(see how the Sterling followed the reaction of the Dollar).

#### **5. The South African Rand: (€7.70 \$5.80)**

**The 7,50 € level keeps on being a strong Support/Resistance level!**

Can you believe it? No interest rate cut! The Rand initially weakened to the R5.92 level, before re-assessing itself. Under the illusion that the growth South Africa is enjoying now is long term, the Reserve Bank, continues to ignore the level of the Rand. These are mistakes, which cannot be rectified as can inflation, or interest rates levels. These industries take years to establish, as do ordinary exports, so once destroyed will take more than years to repair.

The Gold Producers continue to suffer the erosion of their margins, which will continue to result in job losses as the lower quantities of higher ore are turned to, to save what can be saved of the margins. The gold production falls tell the story, as do the job loss figures. As to the future of the industry, that is the first casualty of the Rand. Only strong rising prices for commodities could and will bring some relief!

**Note:** Unlike Europe and in a lesser extend the USA, South African finance is very much in technical analysis. I am sure they must be aware of the potential for Gold, Silver, and other commodities mined by this country. On top, the Reserve bank has enough forex to aim for a *STABLE* currency.

**6. The Swiss Frs:** The Swiss continues to strengthen against the Euro (and off course versus the \$) as money continues to flow in this direction. Resistance is about to be encountered but the long term objectives are the 2002/2003 levels.

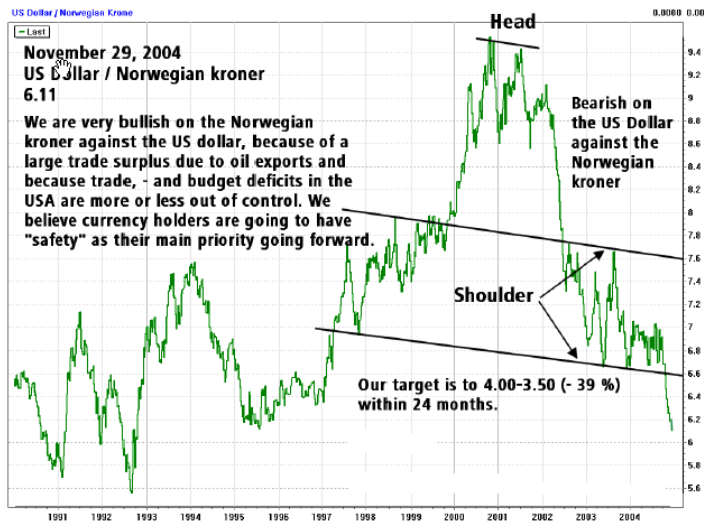
**7. The Canadian Dollar:** Will we again see 1 to 1 : Canadian Dollar to US Dollar?



**Chart above:** As the Greenback has reached the bottom of the trend channel and Canadians have started to write sarcastic jokes about liberal Americans trying to illegally cross the border into Canada..., resistance is encountered. Will the Greenback fall through the floor of this channel? As a matter, it already has! 1,50 surely could be the next support/resistance level, but I would not bet on it!. As of the down wave, long term level of 1 to 1 is possible if the Greenback gets into trouble. After all, Canada also has commodities and Oil. If my measured move is correct, leg # 2 will equal leg # 1 and the objective is 1,05 (this statement is technical premature, but possible)

## 8. Norwegian Krona:

Currency with Oil and no ties to the Euro and a clear picture!



## THE BOND MARKETS

" US Treasury-Bonds are an accident waiting to happen."

STAY AWAY AND/OR SELL BONDS IN ALL CURRENCIES !

I expect strong selling in the bond market between now and July 2005. Either the market will precede or follow the nose diving Dollar.

The only way to persuade foreign investors to hold on to US dollars is to pay them enough interest. This time, on November 19<sup>th</sup>, even Al Greenspan warned investors to stay (sell) us-denominated assets. The USA has both a structural budget problem and a private saving problem. The rebalancing will need real interest rate adjustments.

Ten Year Treasury Note Yield (\$TNX) IND.X  
09-Dec-2004.



Five Year Treasury Note Yield (\$FVX) IND.X  
09-Dec-2004.



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21

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The charts above are these of the 10 and 5-years U.S. Treasury Bonds (any new emission in 30-years being inexistent) . *On the charts shown above, clear trend reversals can be seen. These are the start of a major increase in interest rates and a secular bear market in Treasuries.*

The name of the game ? :

*Bonds and Stocks go up and the Dollar goes up... Gold, commodities and Crude Oil fall.. Bonds come down, Stocks fall and so does the Dollar,... Gold, commodities and Crude Oil go up.*

Chart below: See the distribution that is in the make...just below the 1998 top of 135! A break below 110 and 90 will certainly take the bottom out of this market.



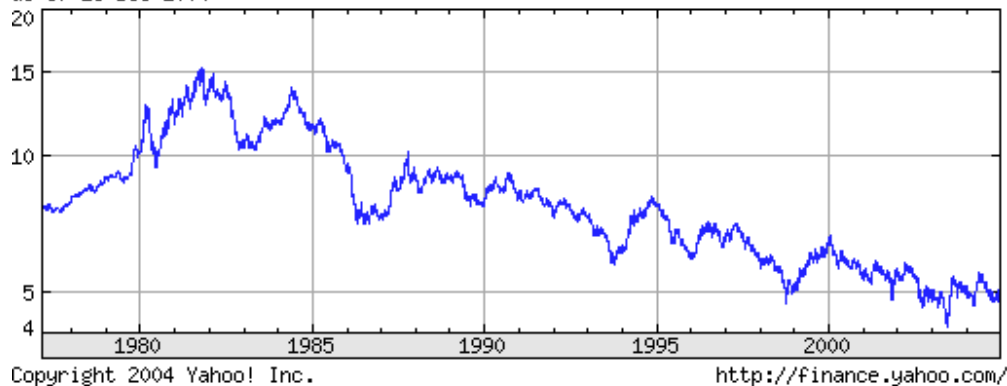
"Just look at what happened in 1987," "Back then, as the dollar went into a tailspin, overseas investors cried and began to exit U.S. financial markets in droves. This set also off a panic by U.S. investors . First they sold bonds. Then they sold stocks."

I expect the same to happen, except that this time additional damage will be done to the Real Estate Market.

Chart above: The 110 level is a very dangerous one...the distribution pattern is getting larger and larger ! Who's thinking that this one will break out and move to higher levels ? Really think there is room for a lower yield on 30 year T-bonds?

Chart below: The very long term 30 year T-bond...

CBOE 30-YEAR YIELD  
as of 13-Dec-2004



## STOCK MARKETS..the "after bubble.."

May 2005....the ultimate SELL and STAY away before much lower markets...but I don't want to take to risk of waiting that long because the weak Dollar will not be able to offset the potential gain of these markets! As a principle, I stay away of a stock market with a weak currency.

### 1. Wall Street:

#### Howling at the 1987 Parallel



The Big One is almost on us, if we compare 2007 to 1987. A lot of sites have noted the close parallel of 2007 to 1987,

including one of the [guestbloggers to this site](#). One of my favorite blogs, The Big Picture, posted this parallel today. If it holds, Timber!!!

**Chart below: SPIC 500 expressed in South-African Rand (this is one of the many).**  
**A quick simple look reveals that the new highs in all the indices are illusory in nature and that they are still in a firm down trend when priced in stronger currencies.**



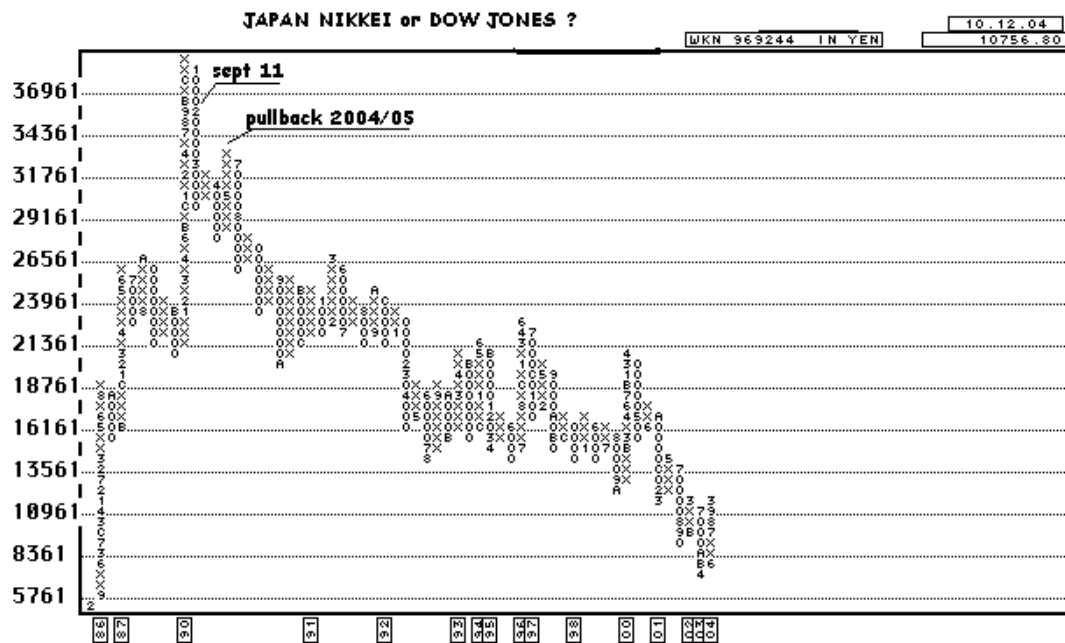
To the delight of U.S. Investors, the long-missed euphoria in the markets permeate the air as prices move higher and higher, fast. The crush to buy U.S. Equities in the aftermath of a tough election race has taken the S&P500 to levels unseen in over 3 years, and up 12% from its low point for 2004. This major bellwether for equities has been able to cross some important technical milestones in the process as well. The Nasdaq-100 is running right along and cooperating with the S&P's leadership, reaching levels last traded way back in January 2002, up 21% from this year's low point. **The actual retracement is mainly a 61,8 % bear market correction that could run out of steam end once the year-end window dressing is over.**

**Chart below: Is it the Nikkei or the Dow Jones do be?**

See how the market retraced after the first down leg after the 38.000 high was hit. Nothing to be afraid off with officers as George and Al being in charge!?



The Nikkei fell from a high of 38000 to a low of 8000. This is a loss of 30.000 points over 14 years. The index was smashed by a 4,75 factor. Applied to the Dow Jones, the calculated figure is 2.500....



The Dow, S&P, and Nasdaq are all showing prominent topping and preparation for a sell-off. What we see now, in my opinion, is not the final move into a big slide, but a smaller up move to be followed by a small recovery, choppiness and then the bigger wave down to 8450-8400, followed by a larger down leg next spring or fall to 7,000 and 6,000 Dow. Some would say this is a crash, but I view it as a long, tortured adjustment headed to the bottom. We do not need, nor should we wish for, a smash like 1987, when the entire game nearly went into the drain. Slower is better.

**Chart below:** Do you really think the stock markets can keep going up as earnings decrease?





I just can't agree with those advocating that the excess of money keeps on spilling into the stock markets because there is no other way to go. And if correct, it is a extremely dangerous game! *Technically speaking, many charts look Bullish...but when looking at the whole picture, a completely opposite outlook is created.*

## 2. Gold and Silver Shares

*There is no advantage of buying a Dollar denominated Gold Stock if it goes only up by as much as the Dollar falls. Therefore it is important is to find a way of Goldmine-price-definition in Euro or any other stronger currency. Only this will allow asserting the potential profit of investing in Gold Shares correctly.*

*"The 20-year bear Gold market in gold has weeded out marginal gold producers and significantly curbed exploration and production.". "If gold was \$1,000 an ounce, it still takes four to seven years to open a mine," Buy South African Gold stocks on weakness.*

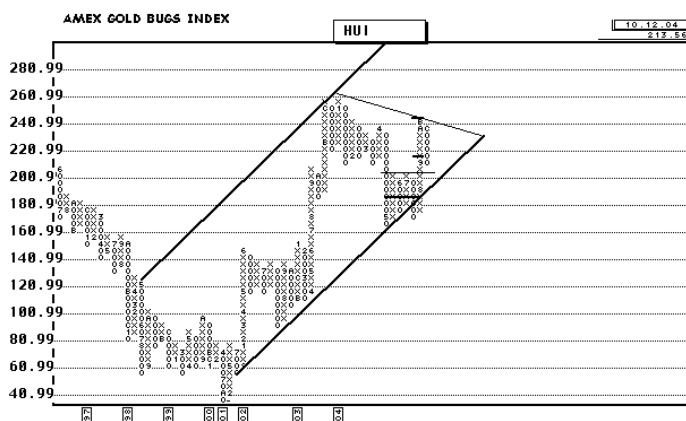
### The South African Royalty tax prospect - crushing new ventures.

While the Rand moved on and upwards and South Africans prayed for a cut in interest rates, international eyes turned again to the prospect of a revenue based Royalty tax on precious metal mining companies. This week it was Anglo Platinum that joined A.B.S.A.'s attack on the concept of Royalties on revenue, nor on profits. With this uncertainty, let alone the reality hanging in the air over South African investments, the investing public

have to factor in the worst case. This is a 4% Royalty on revenue. This would kill the Junior mining sectors, not only in Platinum, but gold and diamonds. The intransigence in government appears to be politically driven by an unwavering belief that mining is robbing the citizens of South Africa of its wealth (which is partly true).

Since the start of the current bull market in Gold in 2001 the Gold share index HUI appreciated by more than 600%. Still lot of denial does exist among fund managers regarding the strength of this current bull. It seems that the first phase of this bull market in Gold (which was characterized by denial) is in its latest stage and phase two (which will be characterized by acceptance)

will be launched by slashing Gold's 16 year high of \$430. Expect some serious inflow of investment capital during this second phase of the bull market in Gold and watch out what will happen with the high quality junior mining firms. They can go ballistic but it requires a stomach of steel in order to keep them during severe corrections. They tend to rise faster as their senior brothers but also the opposite is true, they fall much harder during corrections.



**Chart left: The BULLISH reverse on the "The Gold Bugs Index" (HUI) did not make it, instead the index broke down. However, the UPTREND is still alive.** A break of this index above the 260 level would clear a lot of resistance and open the way for higher levels. As the neckline of the huge reversal pattern on the HUI has already been tested, I don't expect the index to fall a lot below present level.

The South African Gold Mine Index looks a lot different...and not nice. As long as the Gold price expressed in Rand doesn't break out, nothing much will happen here.



### 3. Oil Stocks: New positions were acquired during the recent price reaction.

Oil & gas reserves  
Oil & Gas equipment and service  
Oil & Gas integrated  
Oil & Gas Pipelines  
Oil & Gas drilling and exploration

Amerada Hess (\$ 79/85) - obj. \$ 116 (ahc)  
Baker Hughes (\$ 41/43) - obj. \$ 61 (bhi)  
BP (\$ 59/58) - obj. \$ 68 (bp)  
Exxon (\$ 50/50) - obj. \$ ? (xom)  
Halliburton (\$ 36/39) - obj. \$ 70 (hal)  
Imperial Oil (\$ 57/56) - obj. \$ 63 (imo)  
Marathon Oil (\$ 38/37) - obj. \$ 60 (mro)  
**Oxy petroleum (\$ 57/57) - obj. \$ 96 (oxy)**  
Royal Dutch (\$ 53/57) - obj. \$ 64 (rd)  
Schlumberger (\$ 62/65) - obj. \$ 90 (slb)  
Total (\$ 106/105) - obj. \$ 141 (tot)  
Martin Marietta (\$ 46/51) - obj. \$ 67 (mlm) ..  
construction



**Chart right:** Royal Dutch has finally broken with a very nice objective of \$ 64.

### 4. Insurance stocks:

In this sector, there are several looming Dangers. To be discussed in depth in a later issue.

### 5. Bank and other financial stocks:

The derivatives market is based largely on "insuring interest rate risk". According to the Federal Reserve, most of these derivatives are held by **J.P. Morgan** (jpm), **HSBC** (hbc) and **Bank of America** (bac). Perhaps one of these large institutions will fail? Fannie Mae (fbm) keeps on extending its distribution formation..

A banking collapse with interest rates at 1% can be compared to a drought after the last water supplies have already been used. Under this situation, there will be no place to hide. Grim.

### 6. Defence:

Lockheed (\$ 57/59) - obj. \$ 78 (lmt)



## 6. Euroland: (Which is "bad" and "which" is "worse", Euroland, Australia, Africa or the US ?)

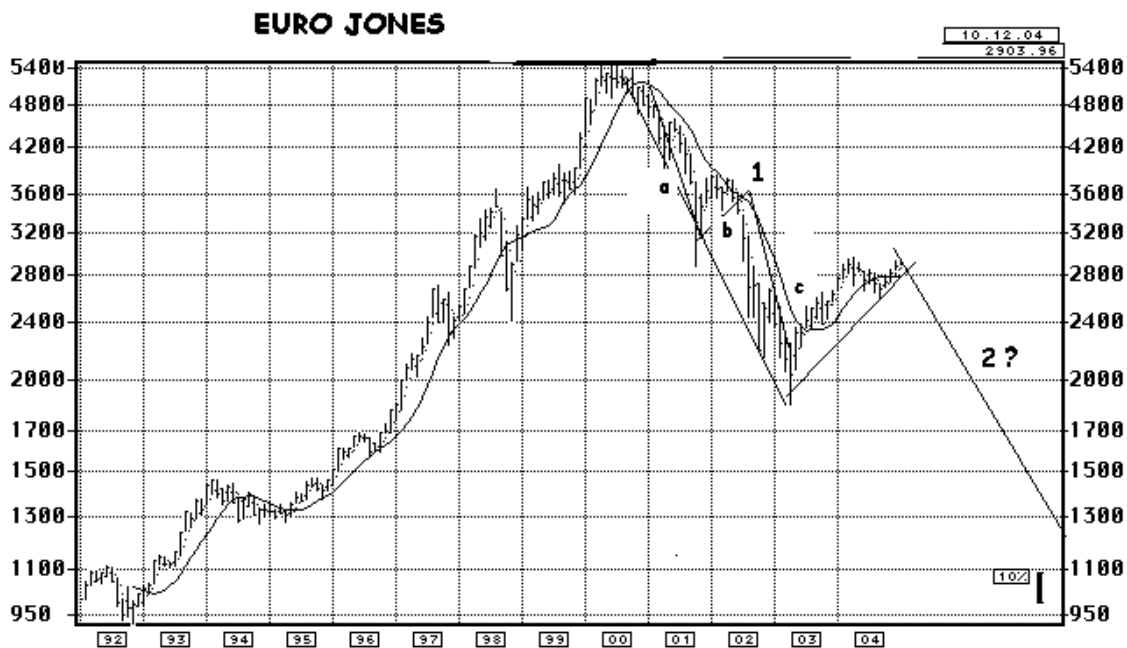
The Euro is at the base of a huge European inflation masquerade. The question being how long it will take before the markets start to understand what the outcome will be. When they do, **GOLD** will surge!

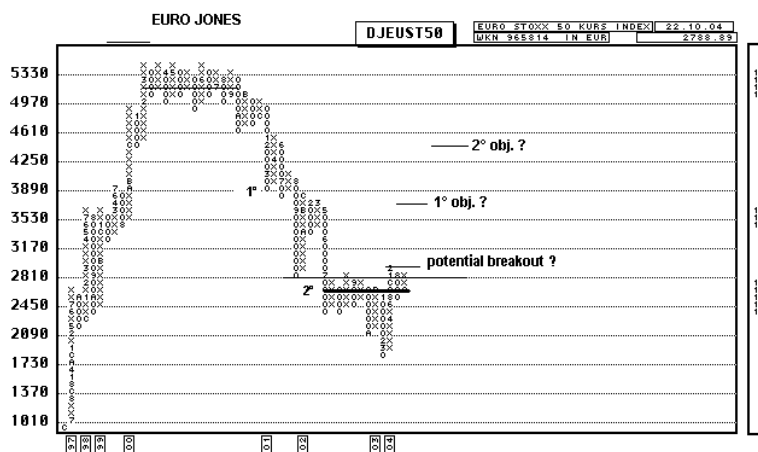
The question being "if" and if so, how long it will take before the Euro takes over the role as "key currency"? It might take over for some time, but I think that ultimately, Gold and/or Silver will.

### a) European Dow Jones:

It seems to me that the European markets are following the American dream of a new Stock Market After-Bubble. It is still too early to judge whether or not this will happen. Again, I cannot agree with those investing in these markets, because...as they quote: "there is no other alternative!"

My scenario is on of an ongoing Bear Market correction in which I don't want to see anybody locked in. Leg 2 of this Bear Market, should be equal to leg 1 ! See how it already happened during the 1<sup>st</sup> leg down: a, b & c





When looking at the charts, technically breakout is surely possible as several stocks already did. The question being how these markets can continue to go up as I also think of the fundamentals: historically low interest rates, reversed yield curve (UK), high hidden inflation, high growing unemployment, bad export figures, and you name it...

## b) Britain: (FTSE 100)



**Chart above:** This is the long term P&F chart of the Footsie and not of the SPIC 500! They look dangerously similar. Note the reversed Head and Shoulder pattern...which for some reason, I don't buy. Personally, I think that the actual correction is just "a bear market rally" with a new down leg to come that will equal the 1<sup>st</sup> one. Note the perfect 5-step down wave.

Britain plays the role of "the bird in the cage" . In other words, a lot of times, it will show the way to other markets in the world.

In 1996, the New York Federal Reserve did a study on what indicators were the most reliable predictors of a recession. The only one of six indicators that was reliable was an inverted yield curve.

The Bank of England has been steadily raising rates to keep inflation in check and to rein in the white-hot housing bubble. Since inflation is rising, they should continue to raise rates. But with an inverted yield curve and a very strong pound, raising rates might not be wise, as that could push the country into recession.

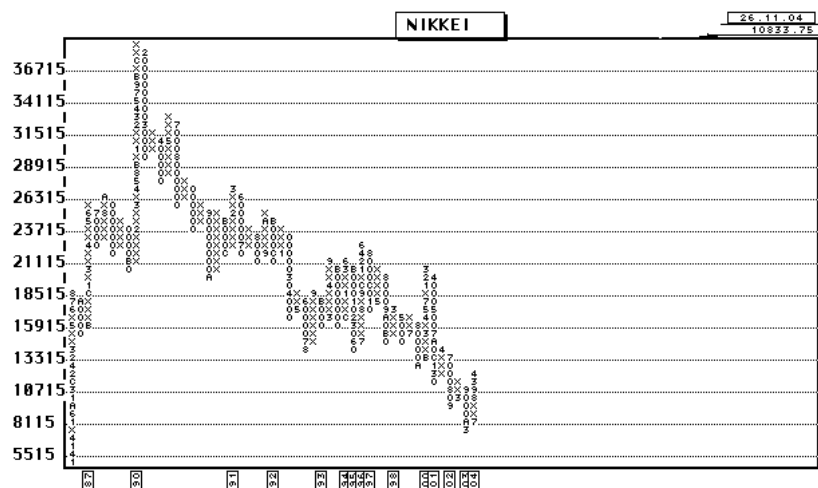
## 7. Japan:

*Will this happen to the rest of the world?*

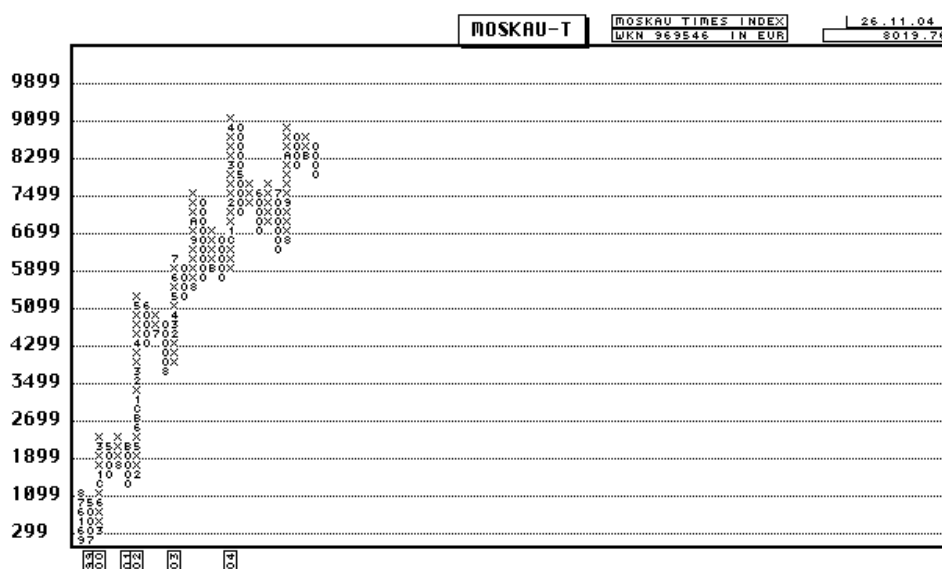
Not very exciting...! Still in a steady downtrend.

### Note:

*The retracement after the top of the Nikkei. At this point the same is happening in Euroland and the US.*



**8. Moscow:** Probably one of the most exciting markets is the one of the former communist republic of Russia.. It is like a never ending story that keeps going and going....and apart from a strong stock market, the Ruble is also doing extremely well...





## THE REAL ESTATE MARKETS

*The world is sitting atop the biggest property bubble in history with the biggest bits in China and the US, in my view. If there is one statement that marks a bubble in Real Estate, it's the "they are not making any more land" comment. It's an indication that real estate is viewed as a one-way-speculative bet.*

The fate of the bubble is no longer under the control of policymakers. I am watching the equity markets and the real estate markets, but especially the real estate markets for evidence of a tipping point from an inflationary environment to a deflationary environment. Certainly we think a decline in housing is likely to be the Key, but leading to a housing decline is likely to be rising interest rates so I am watching British (the bird in the cage) U.S. interest rates go up very carefully. Also, some other key markets in addition to housing and stocks I want to watch are the dollar with a view of what impact a declining dollar may have on interest rates.

1. Japan property : Japanese real estate used to be the most expensive in the world. How many times did I hear that Tokyo had no more office space left and that in this city you could find hotels with rooms as small as coffins? After all Japan is an island and Real Estate is clearly in short supply. **But in 1990 it all happened.** The Stock market came down, the Yen came down and so did the Japanese Real Estate Market. Prices have in average fallen to  $\frac{1}{4}$  of the 1990 value, and I am not so sure it's all over!

2. In the UK, property triggers the alarm bell. Does the reversed yield curve and the weaker Sterling start to take its toll? ..story of real estate boom in the 90's

3. In Spain, the market has dried up and prices should start to slide any time now.

The bank of Spain has repeatedly issued warnings to borrowers and to lenders about the risks of over-extending credit. It is particularly worried about the impact of a rise in Euro interest rates or an increase in unemployment on the ability of Spanish families to repay their debts.

4. France, has been discussed in an earlier edition

5. The Netherlands:

The office market has a dramatic vacancy of 10% ! The market has become extremely expensive with plenty of wind inside the bubble!

## 6. In the US,

I hope I'm right about interest rates staying low. Else, a deflationary bust like the 1930s will be upon us. Debt will be the cause. All the assets that this debt drives will be consumed by the demolition: stocks like Fannie Mae, Freddie Mac and loan guarantors and banks writing derivatives (a type of financial security whose value is dependent on another security) on these loans.

Real Estate has lost the basics of stones and mortar. Instead, it has become a huge latex balloon. In 1928, in Florida, Real Estate was more expensive then it is today. For the same reasons that are used today! An European real estate appraiser would open big eyes if he was to see what is sold for "how much". Most real estate in Florida and Spain surely is not built to last multi generations as it is in Europe. However, prices and even "rental prices" have lost any common sense. Even if one discounts for an overvalued Dollar, and convert prices in Euro, I would still be reluctant to buy or rent this poor quality.

WASHINGTON (Reuters) - U.S. housing starts unexpectedly plummeted 13.1 percent last month, the biggest dive in nearly 11 years, as groundbreaking activity fell sharply across the nation, a government report showed on Thursday. Housing starts slid to a seasonally adjusted annual rate of 1.771 million units in November from an upwardly revised 2.039 million clip a month earlier, the Commerce Department said. Starts have not fallen so precipitously since they tumbled 17 percent in January 1994.

Wall Street economists had expected starts to ease only slightly to a 1.980 million unit pace from the 2.027 million rate initially reported for October. Low mortgage lending rates, which averaged around 5.7 percent in November, had been supporting the housing sector despite five short-term interest-rate rises from the Federal Reserve this year. Permits for future groundbreaking, an indicator of builder confidence, also proved disappointing, slipping 1.5 percent to a 1.988 million unit pace. Analysts had looked for a 2.000 million permit-issuing rate. The department said starts fell 14.2 percent in the Northeast, 19.4 percent in the Midwest, 13.2 percent in the West and 10.4 percent in the South, the region that boasts the lion's share of housing activity.

We are seeing rising real estate values approaching 20 pct per year in many regions of the US. However, there are signs that the building industry is offering large incentives to sell their inventory in not a few markets of the US. One example is the Las Vegas market....

Any talk of a major dollar crisis before the real estate bubble peaks is premature. The growth of debt in the household sector has reached the key 12 to 17 percent rate that precedes housing and economic downturns. This is happening now. So, what is the time scale of the onset of the real estate bubble collapse? I said that I expected this collapse in 2005. I stand by this prediction. It will take some more interest rate rises; I expect that a further one percent rise in the US 10 year Treasury will be the end of the real estate bubble. Unless we first see a reversed Yield curve as in Britain. That will happen in 2005.