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MELTDOWN STAGE IV. No. 6 THINKING OUT LOUD!

I hope I can do that which I have told you I will try and do! I said that I after I had received *Michael White's latest book* I would try and summarise my ideas about the future that lies ahead for us as investors. There is the longer term future which we all face in the down cycle of a Kondratieff Wave. We do not know how long it will last but suspect it must be somewhere around 2008/10. We have to recognise that as far as stock markets are concerned the real general market fall has not progressed far. This is partly due to the operations of the "*Plunge Team*", who appear to have decided it has to keep up the morale of the American consumer and to try and prevent the foreigner from moving too much money out of the U.S. Financial Sectors. It is desirable to try and keep the Dow over 10,000. As of last week it succeeded brilliantly in this respect.

Have we any idea what the market or our feelings may be when we do reach the bottom? I have written so often that house prices will have fallen by 80%. No one will begin to feel bullish about anything. Let me repeat just once more the story of my own experience in 1948 when one of the most intelligent people from the City sent me out of a board meeting because I had bought a share in a company that had a debenture. To these gentlemen, who had experienced the horrors of the 1930s, even by 1948 the very thought of a young man going out and buying shares in a company that had a debenture was utterly shocking. I genuinely believe that before this Kondratieff Wave is finished you and I will be feeling like that. *Steve* has already told us we must not contemplate buying back I.B.M. until it reaches \$55. Yet this last week one small market rally causes the stock to rise \$4 or \$5. You will have read in the press that at the bottom of bear markets the P/E on the Dow is 9 or 10 and the yield is 6.

Let us come back to earth a bit and try and assess what we may have to face for the rest of this year. I think I have already said that we expect a rally towards the end of June, which may continue through to of August. Do not get excited because the worst part of the present down trend is then going to start and it is not going to finish until the end of November. Not that the end of November is the end of the Kondratieff Wave it is merely the end of a phase when people will believe that the Future is better discounted in stock markets.

Let me now try and come back to today. Having been made to be totally wrong by the amazing efforts of the *Plunge Team* I have been trying to prevent Fund Managers feeling bearish on any days this week. For some extraordinary reason the Friday Option Closing Day following Mothering Sunday in the U.S.A. has invariably always produced an extremely strong market. If you regard that as a good reason for accepting my technical analysis I wish us both luck.

Arch Crawford and many other technicians expect this stock market to commence falling again next week. I have had a number of these technical documents sent to me. I have enclosed one headed *Contrarian Chronicles by Bill Fleckenstein*. I do not normally receive his material, but I know him by name. The sub heading is *Market Reality is still a 40% drop from here*.

It is the "from here" bit that I find difficult. We have listened to the lies promulgated by American officialdom as government statistics. I e-mailed to you today's *King Report* just to show you how much

nonsense might have been published in one day. One young economist will be working hard on these figures taken at their face value explaining why the future is so great. What did it do to me? It told me that the Money Supply that has been blowing up bubbles for months is now turning into inflation. Recently I sent you the document explaining that inflation is not just a rise in prices, but that it can only be created by an environment of excess money supply, and that money supply itself must lead to inflation. I do not think there is any point in repeating the reasons why it has not shown up so far, except to say that at regular intervals the official statisticians have removed from the Indices anything capable of rising. Do not let me leave you with the impression that there have not been price rises. We have seen what the easy availability of credit has done to house and stock market prices. This I believe has indicated that it has been the financial sector which has had the greatest ability to lay its hands on credit and to use it to leverage itself up, knowing that the Fed will never willingly tighten money as long as the economy is behaving so badly.

Various people keep trying to tell me that the economy is recovering. It is more than just an inventory rally. If that were true why do so many corporate managements refuse to admit that they can see any improvement in their business? Our dreaded fate is that if there is any day when manufacturing industry obtains pricing power, it will show up so fast in the inflation figures that the Fed must set out to deal with the inflation before too many people take their money out of the U.S.\$. The day it raises interest rates to deal with that inflation is the day that any rally in the American economy is killed stone dead. That I hope expresses briefly the economic position we are trying to cope with. What we are trying to interpret is what stock market action is likely to be, even from next week. If you have fought tooth and nail like the *Plunge Team* to get the Dow back over 10,000 you are not going to give way easily, because you have a shrewd idea that next time it goes under 10,000 it is probably going to be impossible to stop it. To me this means more *Plunge Team* operations. I have already written that the *Plunge Team* has recognised that the stock market conditions which caused the *Lowry System* to give an "intermediate sell signal" are the same ideal conditions for them to squeeze the bears. If we are ever caught in the same trap again it must be our fault, because we have had a least two warnings and the last one was very painful indeed. As far as Hedge Funds operating outside America are concerned, I believe they have an almost impossible task. The behaviour of their markets is very much controlled by what happens after they are closed the evening before any subsequent Wall Street action. There are massively too many Hedge Funds trying to do the same things but the market makers, not unnaturally, are trying to read what these gentleman may do. The trouble is they all want to do it at the same time and the market makers sees them coming and says "Whoopie, champagne for lunch today". It is not my problem to tell them how to resolve this peculiar position, but perhaps it is my right to say I do not believe they are facing up to the reality of the problem. I have to mention it here because it just does not affect the market for Hedge Funds, but for all investors. It does mean that we have a permanent trading market and very seldom do we have an investment market.

Just to add to the problems ahead I believe most of you already know that *Ian Notley* has been expecting a rally in the High-Techs. I have not discussed it because I was not prepared to accept the fact that stock markets were in a condition where I believed that was possible. There has to be the great final sell-off, which probably occurred last week. This week we have seen how a number of High-Techs have endeavoured to rally sharply. It started with a gap opening up on Tuesday. That gap has to be closed before the Index can go ahead again. It was followed yesterday by the most amazing gap up openings in most of the stocks that *Notley* had published in his weekly notes - that arrived on our desks yesterday morning. Again I believe those gaps have to be closed too. Indubitably that will not apply to all the stocks. I will try and get permission from Ian to send to you the second page of his notes in which he sets out a relatively small number of companies that he reckons are in a position to advance at the present time. These are the ones that have not gone broke and, we hope, not likely to go broke. I hope he will agree that by the time his clients have had the list for a week it is possible to send the list to you.

Just looking at the names of the companies there a number I have not heard of. There are companies like Cisco whose accounting system I hate and I swore I would never suggest anyone bought them. Do

not think I am making the suggestions I am asking permission to show you a list on which Cisco and Motorola are amongst the larger companies whose names appear. I have already told you that he believes the old leaders in the High-Tech sectors like Microsoft and I.B.M. have ceased to be leaders and our task as Fund Managers is to find the new leaders, because if we can spot them we know what the followers are going to do. With any luck it will mean that we hold the marketable ones whilst other people play about with the rest. In the whole of Ian's list there is not one European, which affects most of those who read these Letters. In due course I hope *Carolyn Woodyatt* can come to our aid.

If we are going to have new leaders it means that a lot of sectors that have recently been providing leadership will begin to behave very badly indeed. Certainly the banks and most other financials would be on that list. It may be that if you can stomach the risks for a while the Freddie Macs of this world will continue to attract a certain amount of investors. You, as readers of *Doug Noland's* work, will probably say "Not at any price for me".

I believe one of the leaderships that is going to disappear is the almost ceaseless rise in the Small Caps. I think you can see on the chart that these are starting to boil over and bitter experience has taught us all the impossibility of selling once the desire to sell these type of stocks really gets going. The trouble is that any sell off in the Small Caps will undoubtedly lead to a similar operation in the Mid Caps where so many investors have felt so cosy and clever for the whole of this year.

This brings me back once more to *Notley*. No one would claim I have always agreed with him but as far as pointing out likely sectors which are either ceasing to appear so attractive or unlikely to become so attractive, I have never met any Service that is so useful to me. I have already said that I do not feel entitled to pass on all *Notley's* words of wisdom, except to the smallest investment groups who cannot afford to take his Service.

At an earlier stage in this Letter we arrived at the fact that the C.P.I. is now showing an uncanny rate of inflation considering everything that is not showing in the C.P.I. We have even had Mr McTeer of the Fed admitting that if conditions continued like that, the Fed could not possibly ignore it. Not all the media reported those words, although it certainly came across my tape whilst McTeer was speaking.

I think we accept the fact that the Fed will delay any action for as long as possible. It is just a question of how long is that period. If yesterday the \$ appeared to be strong then when I woke up this morning I could only describe the \$ as looking weak. We had today in London an afternoon Gold settlement at \$310.10. This is the reaction of the rest of the world to all that propaganda by *J.P. Morgan Chase* saying that Gold shares are due to have a 20% correction etc. I think most of us hoped that analysts from the big Houses had ceased issuing investment information that was purely to suit their employers' books, but I suppose when you have such an enormous position outstanding as far as *J.P. Morgan* is concerned it is impossible to turn round quickly. Let me reiterate that like *James Dines* on the longer term there is only one type of investment to hold, and that is Gold shares. When he talks about Gold moving to \$3000 I do not argue with him because I know it has to happen. Like so many things in the investment world it is a question of "when". Here again, as in the equity investments, we are fighting official intervention. It is not just the Fed it is most of the other Central Banks who have all been selling off their Gold, but are now caught in the awkward position where most of their Reserves are in U.S.\$s. If the U.S.\$ collapses so do their Reserves so effectively, except for very short intervals of time, there really is no haven in other currencies. People still regard the Swiss currency as a haven but this is purely psychological. We have seen a steady rise in the South African Rand and the Canadian \$ in particular, whilst the Australian \$ rose earlier. These are only mini moves and who wants to put too much money into these currencies? Those who believed in the market leadership of some of the South African Gold shares already hold a substantial stake in what had been a dreadfully weak currency.

If we do not like the U.S.\$ as a currency in which to keep our money are we prepared to keep our Bond holdings in U.S.\$s, and hope that the organisation with which we have hedged our \$s is going to be one

that will pay up at the end of the day? Do not forget that very many of them will not be doing so. I enclose a fascinating letter from *James E. Sinclair to the Chairman of Newmont Mining*. If you are someone who does not appreciate all the dangers of Derivatives I do hope you will find time to read this letter. It is only a little over two pages and opened my eyes in a big way. That brings us back to what do you do with Bond money? In America we have seen so much of it moving into Corporate Bonds as opposed to Treasuries but I think many of those have been doing it at spreads that may have looked beneficial until you remember there are only 9 Triple A corporations in America these days and the spread they are choosing may not be excessive in the terms of the actual rating of that corporation.

You must be bored with hearing my views about how to invest money. The ordinary private individual should not be holding Equities except those in Gold and possibly Silver. It may be tedious receiving such low interest on your uninvested money but it is basically down to deposits with banks which are genuinely too big to be allowed to fail. Does that sound too dull? It depends whether you have enjoyed making anything from 100% to 200% in the Gold share market over the past period when others have been losing money. You do not have to have a large percentage of money doing that to feel that you have been left out. This is no place to discuss the difference between being invested in hedged or unhedged Gold mines. The rumours are that *AngloGold* have realised their policy is the wrong one. Can we believe that *Barrick* is also now going to change? Do not forget they are dealing as insiders as they are effectively members of the Gold cabal. Readers of these Letters have received the advice that as in any other industry you put your money where you believe there is the best management. The list has been quite small. It has been *Harmony, Goldfields, Agnico Eagle and Newmont* right from day one. Others have now joined the gang. The square old gentlemen like myself is probably left wishing he had taken some money out of something else and bought *Durban Deep*. If you get a chance to go to their presentation on Thursday 23 May 02 I hope you take the opportunity.

I have avoided discussing *Middle East Wars*. I think the Americans have now realised that the temperature in the hot months in Iraq is not suitable for American soldiers to fight in decontamination suits. I do not necessarily believe this prevents trouble between Israel, Syria and the Hizbollah. The *Foreign Report* tells me that the Israeli attack into Gaza was halted by threats from the Egyptians that if Israel advanced into Gaza, Egypt would no longer regard herself as being banned from entering the Sinai Peninsula. That story sounds true to me.

As you will notice I have avoided giving any detail about U.S. stock markets in the period ahead. I wish I could. All I can hope is to use my old friendships to give me guidance as to the periods when it is likely stock markets will go up or down. I do send you the work of a number of chartists and I use the expertise of a whole lot of people when writing those illegible morning faxes. Please remember that unless someone reminds me I forget to note that they are becoming illegible again. I try to remember to write large, but it is somehow difficult in the early hours of the morning. I hope we are getting better at e-mailing them later in the day. They may be too late for except for those operating on Wall Street only.

I wish that I could get more Fund Managers out of the habit of believing that they are going to make money during bear markets. In the environment in which we live they are not going to do so. There are going to be rallies and strong sectors. Are you that type of investor? I still believe that the right policy is to say how do I reduce the risk of losing my client's money? There will almost invariably be odd occasions when there look like being irresistible rallies which if we do not try to make use of we shall consider we are neglecting our duties. Please do not try and be too clever too often. As in all good bear markets you cannot win. You may be successful in one three month period, but you sure hand it back at some later period. Please do not hate me if I have waffled.

E.B-H

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