

"When everybody had bought to capacity and started to sell, there was no one else who wanted to buy and collapse was inevitable."

W.D. Gann, from his 1930 book 'Wall Street Stock Selector', describing the 1929 Wall Street stock market panic.

Rene Rivken where are you ?

Back in November last year, a bull was hard to find. Most so called "experts" were calling the market down even further. Some even gloated that they had got out having foreseen the October collapse in advance.

World stock markets have had a strong run this year, and are now back at all time highs. This development is as we forecast back in November '97, a brave call and counter to most of the prevailing sentiment at the time. But in November of last year, all the selling of stock by those who wished, had been done, so the markets had nowhere to go but up.

For April / May of 1998, we have the opposite situation developing. This issue explains, and the subject of liquidity is where we start.

The Japanese government has spent most of this year (though they denied it) propping up their stock market to a level approaching 18 000 points on the Nikkei. The purpose being to add strength to the balance sheets of major Japanese banks. March 31st is the financial year end for Japan, hence the urgency in the first quarter of this year.

Japan has now spent an absolutely massive amount of money, mainly on lavish public works schemes, trying to reflate its economy. John Maynard Keynes likened this sort of action to pushing on a piece of string to try and move the string forward.

Tracing these budgetary spending announcements back we find the sums involved are ¥13.2 trillion on April 1st 1993, ¥6 trillion on the 2nd Sept 1993, ¥15.2 trillion on 3rd Feb 1994, ¥7 trillion 4th April 1995, ¥14.2 trillion Sept 5th 1995, and now the recently announced package of ¥16 trillion. ¥16 trillion is \$A 186 billion, or about two times the size of the Australian government's annual budget. A lot of money.

This is not the only source of liquidity flowing around the world at present. The G7 group of nations, through the IMF and World Bank have also in the last twelve months announced huge packages of support for several South East Asian nations.

So we saw a US \$43 billion rescue package for Indonesia, \$US 57 billion for South Korea, \$US 15 billion for Thailand and a little less for Malaysia. Where does this money go, and how is it spent ?

Perhaps a better question to ask is what happened to all that investment over the last few years ? The answer is in the following example; The Financial Review, October 8th 1997, cites the case of Nikon Industries, a maker of electric appliances, based in the Philippines. *"In the past two years, Nikon Industries borrowed \$US 150 million, originally to buy manufacturing parts. Instead, the company spent the money on local real estate, and lost it mid 1997 when the effects of the financial crises hit the country, and the price of land fell"*.

23 separate Philippine banks lent Nikon the money. This illustrates why the Asian growth miracle has been brought to an abrupt end, and why this business cycle recession will be so keenly felt in south East Asia.

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Stop press

As we go to press for April, the German Parliament ratified their nations entry into the single European currency. This is a most historical event that passed unnoticed in Australia.

The single currency now has a high probability of success. Given the likelihood of French and German agreement on this issue, but noting their historical wars and differences over so many centuries, the event is really quite unprecedented in world history.

It has the potential to bring great prosperity and peace to Europe, indeed the world next decade, but we will experience a tough two years of recession in between. Our next Indicator will be an issue examining all the cycles, including the Long (Kondratieff) wave that will help EIS and you, our subscribers, see how the next couple of years should unfold.

The Nikon example illustrates that businesses should stick to what they know best, their core business.

But back to the discussion about liquidity. The rescue packages bailout the banks and institutions that lent the money, and puts a floor under asset (mainly real estate) values, for the time being at least. It also gives creditors the confidence to roll over outstanding loans to borrowers.

What the South East Asian nations just went through, in fact, was an old style 19th century bank run. But it is not enough to satiate world buying capacity just yet though.

Europe has also seen some interesting developments;

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| European inflation rates: | |
| Britain | 2.5% |
| Germany | 1.3% |
| Spain | 2% |
| Italy | 1.5% |
| France | 1.3% |
| This is helping European bond rates to come down, and move their respective stock markets to even higher levels. | |

in the main, central bank selling of large gold reserves, and very tight controls on government borrowings. The European Union (EU) is close to introducing its single currency. To do so, the eleven member nations have agreed to impose strict conditions upon themselves to bring their national accounts and banking regulations into close alignment.

Hence much of the central bank gold sales was not unexpected, and generally seen in advance by the larger speculative hedge funds, who took large short gold positions in anticipation of these sales.

In the lead up to the introduction of the EU single currency on Jan 1st 1999, quite a few European nations had to 'doctor' their accounts to comply with a few benchmarks set as preconditions to join the Union. France used its nations pension funds to this effect, Germany dropped its public hospital debts off balance sheet, Italy imposed extra taxes. The gold sales added to the liquidity, as has the continual

squeeze on government borrowing.

The US economy has by all accounts been moving ahead strongly. Inflation is down, interest rates going lower, so too unemployment, and those in the information technology and finance areas making a lot of money. It all adds up to economic nirvana and a rising US stock market.

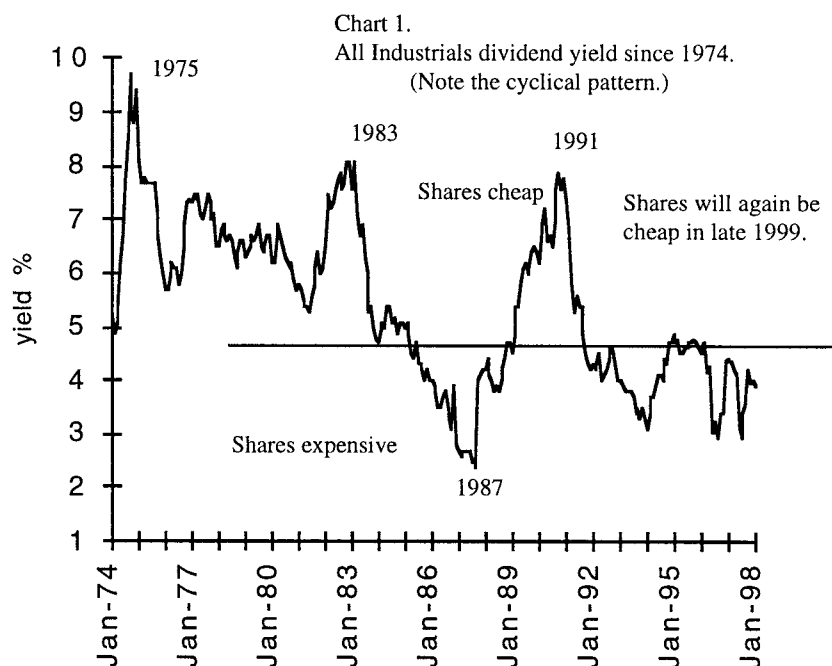
In Australia, the public just cannot get enough shares either. The recent Pioneer float of one third of Caltex was heavily oversubscribed, so too the TEN network float (Telstra was five times oversubscribed) and the upcoming NSW TAB float has investor interest running at record levels. So for the time being at least, the world has not yet bought to capacity.

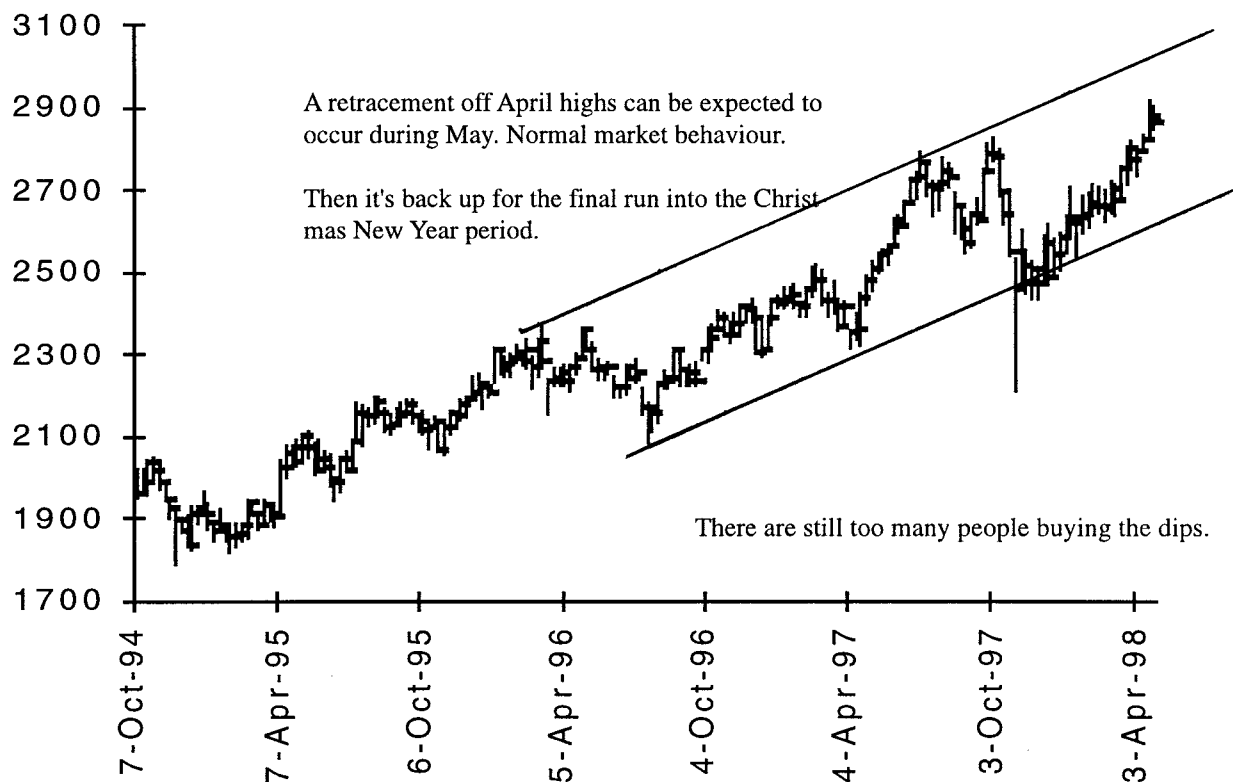
But the buying power will come to a halt eventually.

Notably, anecdotal evidence EIS is watching indicates that a lot of investors purchased Telstra on credit, using overdrafts and credit cards. The second Telstra payment is due in November this year, which will soak up further buying power. EIS remains confident of our cycle timing for a decade cycle peak in the first quarter of 1999, followed by an extended stock market bear market.

Note that airline sales seem to be slowing somewhat.

Fortune Magazine reports, March 16th 1998, that America's big three auto makers, Chrysler, GM and Ford have a "mountain of cash", and are now starting huge share buy backs. (\$US 16 billion will have been spent by June) Large auto makers always have surplus cash at the top of every economic cycle, and EIS has found this a reasonable economic indicator,





though not a statistical one by any means.

An election is due here at home, (must be held by March 1999), so our Federal government will be doing every thing possible to keep public enthusiasm high, confidence high and the economy bubbling along. That usually rules out an interest rate rise before such an election.

Sales of expensive watches (starting at \$1500 and going up to \$7000) increased over the summer months here, as they do when moving into the cycle peak.

So the thing to watch is liquidity, and the timing on when stock market buying power is likely to be finally exhausted.

By the way, W.D. Gann wrote, what we quoted on page 1 at the start of this article, in 1930. He wrote the following on November 23rd 1928, in his usual forecast for the forth coming year.

From page 36, 1929 annual stock market forecast, issued Dec 1928 to clients:

"Sept 1929; one of the sharpest declines of the year is indicated. There will be a loss of confidence by investors and the public will try to get out after it is too late.....A black Friday is indicated and a panicky decline in stocks with only small rallies.

Readers would know black Friday indeed proved the final high, the day buying power was finally exhausted.

Chart 2.
Share Price Index (futures market)

The current shape of the market.

Review of some company reports

"Amway, which turned over \$157 million in Australia in financial 1996/97, hopes half of its 720 000 orders a year will be made on the internet by the end of its new sites first year – potentially cutting administration costs by \$2 million."

"The Australian grocery industry has cut operating costs by about \$200 million and reduced inventories levels by about \$250 million since 1995. At least \$1.1 billion in costs savings is achievable." Grocery Industry Supply Chain Committee study, conducted by Coopers & Lybrand.

"The best performing manufacturing companies are streamlining their operations so well that they are contributing to a general fall in prices across the economy," Ken McGuire, Corporate Director of the 5 000 member Association of Manufacturing Excellence (US), visiting Australia to lead continuous improvement programs.

"McDonalds plans to cut corporate costs and introduce a new cooking system to produce better food with less waste." McDonalds, concerned in March about loss of market share to Burger King.

Gold

Prices of commodities are generally determined by supply and demand. In the case of gold however, we need to add the psychological factors of fear and greed, since gold has traditionally been used also as a store of wealth and medium of exchange.

Demand for gold remains strong, at record levels actually, according to the figures from the World Gold Council. Demand has for some years now been in excess of supply, the difference having been met by Reserve Bank gold selling, and producer forward selling. EIS noted for you late last year that all the charts were indicating a gold price in the process of bottoming. We have not changed our view.

We note with interest, comments from the Managing Director at Eltin Mining, the nations biggest industry contractor, who said that;

"All the fat had been trimmed from Australian gold mining operations and there was little chance of costs being further lowered." AFR Feb 13th 1998

It has been speculator short positions that has driven gold prices to new lows. Something must now occur to change that sentiment, and then get the herd to begin positions in the opposite direction.

Watch for a gold mining company defaulting on a gold loan, or going out of business and therefore unable to deliver on its forward sales, putting pressure on gold supply and forcing speculators to cover short positions.

From May 8th, the eleven European countries joining the new EU union will have their central banks no longer able to sell gold, at least until next year, so as we noted in our Feb forecast, central bank selling will not this year worry the gold market.



The economics for the remainder of 1998

The Asian crises, in its mildly deflationary effect, is prolonging this decade cycle for most of the western world, and will give most western economies another year of rising asset prices, especially in the stock markets.

As our stock market continues its rise this year, look for declining savings rates. Savings rates decline because of the illusory effects of rising asset prices, ie we all begin to "feel" wealthier, therefore spend more. (At these times it is unusual for a change of government, should an election be called.)

The spending will soak up as many shares as can be bought. Watch for even more products from stock brokers in an ever expanding array of methods to sell yet more shares on even tighter margins.

It is at this point in the cycle that wise investors decide to do the opposite, ie take profits, (and also losses), and commence building a cash position.

The start of the decade cycle downturn is now less than twelve months away. And the start of the decade cycle downturn is marked by the stock market final all time high.

Next EIS courses

May 2nd, Charting the Stock market

May 14th, Business cycles

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