

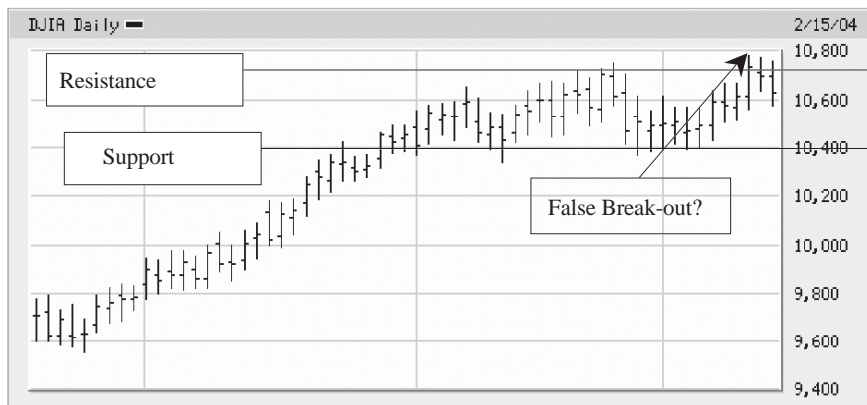


20 February 2004

TOP OF THE POP...

THE SITUATION – There is more than a 60/40 chance that the US stock market may be in the process of forming an important top. Our clients and long-term readers know that (in our opinion) last year’s stock market rally was infact a powerful upward correction in an ongoing primary bear-market. Now, we “feel” that this stock market advance is nearing it’s end and the bubble may “pop” soon. “But why?” you may ask. Below I present a list of items which show that an important top may already be in place -

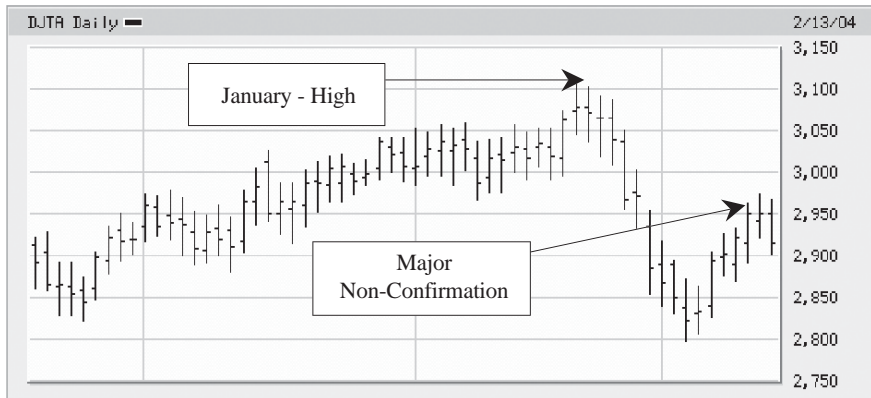
On the 26th of January, the Dow Jones Industrial Average formed a closing high of 10,702. Thereafter, the Dow went into correction mode and declined to test the 10,400 level. From there on, the Dow rallied again and on the 17th of February, the Dow “bettered” its previous high by closing at 10,737. However, since then the Dow has been unable to stay above the important 10,702 closing high registered nearly a month ago. A top will be in place if the Dow drops and closes decisively below “support” around the 10,400 level.



Dow Jones Industrials – 3-Month Chart

Now, I’d like to bring your attention to the performance of the Dow Jones Transportation Average. This average (as the name suggests), is made up of the transportation companies in the US. To put it simply, the performance of this average reflects the movement of goods and services in the US. A rally in this average suggests that goods and services are being transported

at a healthy pace and this in turn suggests better times ahead. However, a declining average suggests that there is a “problem” in the movement of goods and services within the country. Take a look at the 3-month chart of the Dow Jones Transportation Index. On the 22nd of January, the Transportation Index formed a closing high at 3,080. Over the next few days, the index dropped to 2,822. Once this correction was over, the Transport Average rallied (but unlike the Dow Jones Industrial), it FAILED to better its previous closing high recorded at 3,080. According to the Dow Theory, any move (break-out) in one average if unconfirmed by the other average is often deceptive and useless for predictive purposes. Therefore, what we are seeing now is a major non-confirmation by the Dow Jones Transportation Index. While the Industrial have managed to better their January highs, Transports (so far) haven’t confirmed. This is a major bearish omen as far as the future of the stock market is concerned.



Dow Jones Transportation – 3-Month Chart

FACTS & FIGURES - Next, take a look at the following statistics –

Margin Debt on the NASDAQ has now surpassed its all-time high recorded just before the tech-bust in early 2000. What this suggests is that investors have (once again) become complacent as they now borrow/leverage like never before.

Insider selling is at a record-high. The senior management of listed companies is “quietly” distributing its own stock to the naive investing public. Why are they dumping their own company’s stock? You tell me!

Equity Mutual-Fund managers are extremely bullish and optimistic about the future. The latest figures reveal that “Cash to Total Assets Ratio” of equity funds is at a record-low and stands at just above 4%. In a nutshell – fund managers are loaded with stocks upto their gills. Whether these managers are right or wrong only time will tell, but, there has only been one other month in history where equity mutual fund cash was as low as it is now. That month was January 2000 and the rest is history...

Throughout the 1970s, for every dollar of increase in GDP, there was \$1.75 increase in debt; throughout the 1990s, for every dollar of increase in GDP, there was \$3.64 increase in debt. But for the period of 2001-03, every dollar increase in GDP required an increase in debt of \$7.11. This is double the 1990s' ratio, and four times that of the 1970s. To put it mildly - the world's biggest economy is becoming increasingly dependent on debt.

The US trade deficit for December widened to US\$ 42.5 billion. For the entire year 2003, the trade deficit rose to a record US\$ 489 billion. The American consumer continues to spend its head off while Asia continues to prosper by meeting the needs of the world's greatest, well...consumer.

Stephen Roach of Morgan Stanley notes that trouble usually begins when the current account deficit of any economy hits 5% of annual GDP. The US economy has reached this point with its current account deficit now exceeding 5% of GDP. Conclusion - Time to be ultra careful with your stock positions.

DOLLAR & METALS – You may remember that we first turned negative about the dollar two and a half years ago. We advised you to switch out of your dollar holdings and suggested you invest in the Euro and in gold. Those who acted on our recommendation are now sitting on huge profits.

Below is a chart of the US Dollar Index which basically tracks the performance of the US dollar against a basket of major world currencies. Over the past 6 months, the dollar has fallen relentlessly within its downward sloping channel. Back in January, the dollar hit its channel bottom and managed to stage a weak rally. However, at the beginning of this month the dollar hit its channel top and has been falling ever since. Short-term support may come in around these



US Dollar Index – 6-Month Chart

levels, but the world's reserve currency could drop all the way back to its channel bottom (which is declining every day). This would equate to a further drop of 4-5% from current levels.

Okay, let's talk about gold and metals. As Central Bankers around the world continue to print "paper" money like their lives depend on it, you can expect gold, silver and other commodities to keep soaring. We know that gold/silver are in the early stages of a primary bull-market which will probably last for a few more years. Turning to the short-term – Over the past few weeks, gold has been testing the 400 level. At the end of January, gold dropped below the 400 level and it held below 400 for almost a week. People were expecting it to drop further. That didn't happen. Then, in early February gold climbed back above 400 – and it's been there ever since. We believe gold has successfully completed the "test" of the 400 level and a correction low is in place. Similarly, silver has also successfully completed its correction and both metals are now getting ready to advance further. How high will they go? Wish I knew...

On the same token, gold and silver mining stocks have also completed their own correction and this is an excellent opportunity to add to your existing positions.



Gold – 6-Month Chart

STRATEGY – This is a tough market by any standards and the Central Bankers are ensuring you won't get any income by holding cash or money market instruments. In fact, the establishment wants you to speculate in highly risky and overvalued assets. The "verdict" is that it will be smooth sailing for a few months and trouble will only hit after the elections. Well, we have always questioned the consensus view. Nothing would surprise us at this stage. The stock market is giving off subtle messages which warrant extreme caution. We would sincerely advise you to liquidate your stock positions without further delay. This doesn't include gold/silver funds and select Asian equities. At this stage an ideal mix would be Euro denominated cautious hedge funds, gold/silver holdings and limited Asian equities.