

SPECIAL REPORT
FROM THE DESK OF PHILIP GOTTHELF

Military Isn't Alone In Meeting Resistance



I begin with a picture of the Dow Jones Industrial cash index which appears to be tracking the progress of our military as it pushes toward the capture of Baghdad. Once all ain, prices are contained by 8500 resistance that represents an approximate mid range of the choppy consolidation in existence since July, last year. Current support is 8100 which is being probed as I write. A bust below 8100 suggests another retreat beginning with 50% of the spike from the March 12th 7416 low to the 8522 March 21st high... 7969. Coincidentally, this is where the 20-day and 40-day moving averages approximately converge.

Stock markets are showing some divergence with more strength in the tech sector as reflected by the Nasdaq cash chart. However, the slight optimistic edge is couched in considerable vulnerability. See how the market has halted at 1100 resistance that can be derived from the prior continuation of the 2002 collapse last June. Interestingly, the

gap that parallels the DOW's spike occurs where the 20-day and 40-day averages intersect.



The downward slope of the current correction channel would normally represent a possible continuation pattern, but for the gap that may be filled.

Fundamentally, it stands to reason that Internet retailers can get a boost from at-home shoppers who fear attacks against "soft targets" like shopping malls and public gathering places. So far, it hasn't happened. Still, televisions are filled with warnings about such potentials. After the experience in the Maryland/D.C. area with a pair of despot snipers, we can understand how current psychology is being affected. If we can buy on the web, who needs to risk the mall?

In addition, specialty communications and military companies stand to gain from a more prolonged campaign. As Rumsfeld has said, "We are at the beginning" of the struggle rather than the middle or end. The rise in U.S. casualties coupled with the lack of Iraqi surrender

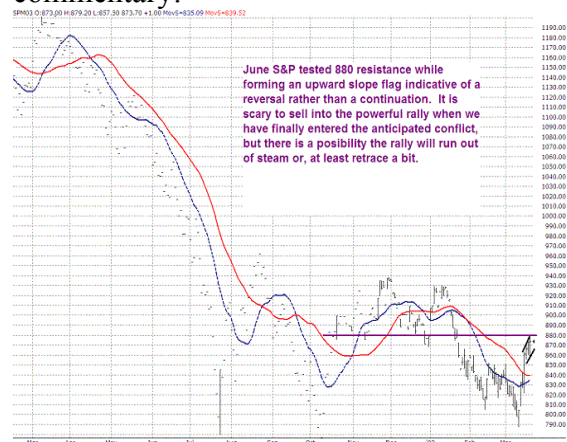
foretells a nasty mess similar to Viet Nam. While we may overcome the enemy, our occupation can become a nightmare of “hit-and-run” ambushes and enduring public unrest. A box of food and tea is hardly a peace offering to those who have lost life, limb, and property. We (the U.S. and U.K.) will be viewed as occupiers allied with Israel...another occupier.

All this speculative analysis sours investor attitudes and stalls stock market progress. Once again, experts have called the recent burst to interim highs a “sign” that the bottom has been made. Once again, the market has failed to carry through. Once again, stuck pundits are saying it is an expected retracement... a “breather” before the uptrend resumes. Who do you trust?

I have little doubt the U.S. and U.K. will prevail in stage one... defeating the organized Iraqi army and disposing of Saddam. I wonder if the reconstruction and “befriending” will go smoothly. I am wondering what will happen if the Republicans lose control of Congress and Democrats block the Iraq objective to discredit Bush 43 as they were able to do with his father. I am wondering whether U.S. politics will jeopardize what our current president has set in motion and plunge the world into a more widespread conflict.

This is not to accuse Democrats of the potential for World War III. The current Administration and Congress may do that by default. It is to say that the starkly contrasted differences between our political parties can disrupt the current plan with bickering over everything from lost lives to the \$71 billion war budget.

Last week I interpreted the S&P flag as a potential bear pattern and traded accordingly despite the lack of downward penetration in the 20-day or 40-day averages. Recall the chart and commentary:



The very next day, prices zoomed through our stop and subsequently collapsed. Thus, even with correct analysis and timing, the recommendation failed because the stop was set too close.

Like gold, the technical picture could have gone both ways. Unlike gold, the breakout above the flag seen on Friday failed to carry prices higher and the same strategy (as used with gold) would have failed. The question of the day is, “Should we sell a bust below 85600 support?”

Gold Remains Confused

After years of neglect, gold is reassuming prominence as an investor barometer. It was dropped from *The New York Times* and *The Wall Street Journal* as an economic indicator... considered a relic of a bygone era. Lately, gold has become a fixation of everyone from FED governors to diehard stock advocates. It is an audit trail for the CIA, Interpol, and FBI. Gold is back as the international monetary instrument, albeit an instrument of the Axis of Evil.



Just as I was becoming proud of my strategy of selling gold on a bust below 33050 technical support, the yellow metal begins a staircase rally in a wide channel that may still represent a continuation flag. Spot April remains the active month, however, we moved into June to give ourselves time.

We have not been stopped out (yet), but a faltering military campaign along with a jittery stock market could tip the scale in favor of a rally... despite the technical pattern. Our stop is necessarily wide because of the very volatility we are seeing. April gold must challenge 34250 before we can say technical strength has gained sufficient momentum to question last week's bust.

Conspiracy Theory

I can hear the comments already, "I thought Gotthelf was somewhat rational, but he's flipped on this gold issue..." For those who follow gold, you are probably aware of the lawsuits filed claiming conspiracy to manipulate prices and defraud investors holding the metal. There are charges against the FED and separate claims against Barricks. For the most part, the accusations appear outlandish and frivolous. Conspiracy is always intriguing... even to the point of believing there is an underlying "they" who inevitably target your (our) stops.

"They took me out of the market!" Who is "they?"

More seriously, I maintained that Saudi Arabia had an agenda when it helped to plunge oil prices during the 1991 Gulf War. They wanted to punish Iraq for its aggression by lowering the value of oil and forcing Iraq to sell more to achieve the humanitarian quotas set by the United Nations sanctions. Oil became the underlying economic weapon and political football.

As I have reported, gold is physically on the move from the Middle East to "safe havens" like Indonesia and Malaysia. Muslim wealth is represented in a considerable gold hoard that has been a focus of law enforcement for tracking terrorist funds. If gold's value rises, terrorist wealth represented in gold increases. Thus, it is not beyond the realm of possibility that the West wants to suppress gold while we wage war against terror. The larger the gold movement or sale, the more conspicuous. A 25% decline in gold from almost \$400 to \$300 represents a major hit on terrorist hoards.

At the same time, there are signs that Saddam and his party are taking steps to convert wealth before the U.S. and U.K. usurp the Iraq economy and monetary system. Saddam knows the U.S. seeks to freeze his paper assets. Gold is much harder to confiscate because accounting is much more clandestine. Gold exquisitely fungible, meaning that an ounce in Baghdad is transposable into an ounce in Bahrain, Qatar, or even Switzerland. The apparent preference is for Muslim custody, but anyplace besides Iraq is better when the final occupation is secured.

Saddam's assets are being converted in fungible international monetary assets and it should be extremely pleasing to long-time gold bugs that their favorite asset is the one chosen... for now. Thus, the fundamental battle may be between the purchasing pressure exerted by Middle East accumulation and the selling power of Western Central banks or producers themselves.

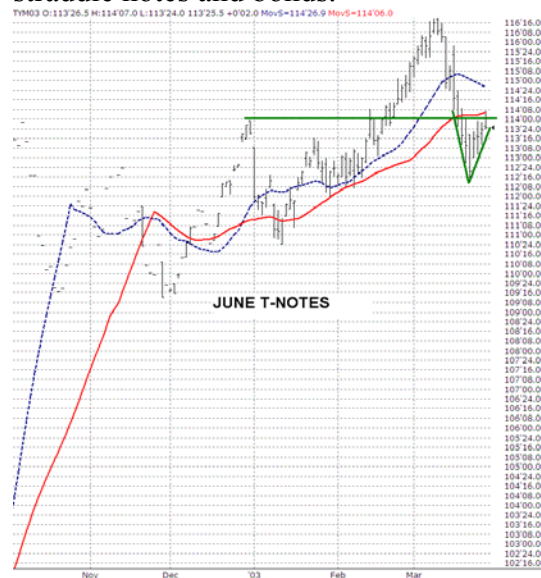
Why might producers sell now? Consider that mines have received a substantial profit potential from gold's trek above \$300/ounce. However, much of the 2002 production was hedged and prevented immediate profitability. With the expiration of 2002 hedges, mining companies were reasonably vocal about selling less production forward. The reaction was highly supportive. But when prices reached beyond \$340 in the spot market and the Dollar appeared to be reversing against the Euro, temptation and common sense prevailed. Producers are selling and their action is reflected in the price.

Forward sales above \$300 present an interesting dynamic. The logical presumption stock watchers make is that gold sector performance will decline along with gold's price. This is not necessarily the case because 2001 and 2002 gold may have fetched far less than metal sold above \$300. Don't overlook the price just 3 years ago. Therefore, the modest decline seen since stocks became encouraged may not impact gold producers' bottom lines and the gold sector (i.e. gold funds, stocks, and properties) could become a shining star among implosions in other areas like manufacturing, autos, hotels, transportation, and even energy.

But, I'm a commodity analyst. I shouldn't try to advise subscribers about stocks unless I am talking about the broad indices.

Interest Rates

Our recent interest rate trades have been based upon an assumption that rates would neither go up appreciably or down. The strategy has been to short strangle or straddle notes and bonds.



Some subscribers experienced mass hysteria when June T-Notes dipped below our short 114 strike. Despite my reassurance that they would probably support above 113, the plunge to 112 represented \$1,000 exposure. Had the May options provided a touch more premium, I would have rolled the strangle down. That would have been nice considering this week's action. Ah, 20/20 hindsight!

Seasonally, interest rates should climb as we approach April 15th and tax borrowing is completed. Thereafter, rates have a tendency to drift lower. The FED has decided to stay out of it, for now! ☺