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REPRINT

Louise Yamada Resurfaces

Citi's 'Technical Foul' Liberates Her Technical Research Team

There was little doubt, from the day last Spring when **Citigroup** axed its entire technical research department, "to cut costs," that **Louise Yamada** and her merry band of technical analysts would not ride quietly into the sunset. One of the Street's top-ranked and most highly respected research teams, even in the midst of conflict-of-interest scandals that thoroughly enmeshed not just their firm's fundamental analysts but also tainted its chairman, the former **Smith Barney** technical team had remained unfailingly faithful to the tenets of technical analysis, and to their clients. Not even big bad investment bankers had dared to muck with their storied chartroom or the analytical methods pioneered by Louise's mentor, **Alan Shaw**. Until, that is, poof, they were banished. Or make that liberated. Freed to recreate themselves as an entirely independent institutional research unit, it took Louise and her cohorts 8 months of dealing with lawyers, real estate agents and such—all the while maintaining their daily market and stock tracking routines—but it all came together this fall. **Louise Yamada Technical Research Advisors LLC** issued its first "Technical Perspectives" on Oct. 3. They've come fast and furious since, and Louise isn't missing a beat. **KMW**



What's changed, beyond having your name on the door?

Not a whole lot, except that we're now a much leaner organization. Just Ron Daino, Jonathan Lin and myself, plus two very loyal support staffers. But **Alan Shaw** is even here today. Do you want to say hi?

Sure.

Alan Shaw: Hi, Kate. I've been having a great time looking at everything stuck up on the walls in Louise's new offices.

Shades of your storied Smith Barney chartroom?

Alan Shaw: That's such an awful, sad story, let's not dwell on it. There are plenty of charts stuck up on the walls of this new office.

Some habits, you just don't break. So what are Louise's new charts saying to you?

Alan Shaw: Well, I'm a not necessarily in the mainstream, but I think what's starting to show up is the second cyclical bear market in the series of bear markets we're going to have for the next 15 years. It has already started. You may remember that this view goes back to the last research piece I did before retiring—

I remember it well. [w@w 3/29/04]

Alan Shaw: That's right. You wrote about my specula-

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Victor Juhasz

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tion that the 10,000 level on the Dow might turn out to be like the 1,000 level—and like the 100 level before it.

Something of a barrier, in other words?

Alan Shaw: Exactly. And that does seem to be what is playing out, amazingly enough. Jonathan has updated the chart for me and when I superimpose it on the original that we put in that piece, it tracks almost to the line, so far. Louise has just been showing me some other charts here that would turn your hair grey, I tell you. If you turned them upside down, you'd think you had to be 100% long. But when you look at them the right way, you see that you've got to be really short. We're talking about big names: **Pfizer (PFE), Merck (MRK), Eli Lilly (LLY), Procter & Gamble (PG), Gannett (GCI)**. So this market doesn't look very healthy.

There is no place to hide? Those are traditionally defensive big caps—

Alan Shaw: That was exactly Louise's point in a technical alert she just sent out to clients. "A 'defensive' strategy may not defend."

That's really a definition of a bear market, isn't it?

Alan Shaw: Yes, the winner in a bear market is the person who loses the least.

What do you make of the way the big brokers have been shedding technical analysts?

Alan Shaw: It's unbelievably short-sighted. I haven't let the whole Smith Barney thing go yet—that's my problem. Sometimes I still wake up in the middle of the night and can't get back to sleep. But I'm trying to get it out of my system. I even wrote a letter to the editor of the *New York Times*, but it was never published. [See page 4.]

When? After Citigroup jettisoned your old department?

Alan Shaw: I didn't actually write it until the *Times* ran a big story on **Sandy Weill** a few weeks ago, called *Laughing All The Way From The Bank*. It was pretty fawning, but you know the *Times*. They had to include a quote from someone praising Chuck Prince for "dismantling" Sandy's legacy, piece by piece. That's when I saw red. What Citigroup has dismantled was the *only* part of Smith Barney's whole research operation that still had *any* credibility and longevity—experience—or whatever you want to call it. If that's not a sin, I don't know what is. I said in the letter that it was no coincidence that Citigroup stock put in its high for the year on the very day they announced the bloodletting. What they *still* don't realize is that they didn't cut costs, *they*

cut revenues. All sorts of clients have walked away. Big institutions. Top-producing retail brokers. It's a shame. But I'd better turn you back over to Louise. She can't afford to air all that dirty laundry in public.

Louise Yamada: Alan's a dear. They told us they were eliminating the department back before Easter—and he's *still* angry.

He has that luxury. You've been too busy, I take it, working to get Louise Yamada Technical Research Advisors, LLC off the ground—

It's all been a blur, on so many levels. But what's more interesting than all the personal upheaval is the way that *both* Alan and Jonathan's theory about 10,000 turning into the same sort of barrier for the Dow as 1,000 and 100 were *and* our alternative thesis that we could see a rebound in this market, rather like 1934-'37, look like they could work out.

That's what I want to focus on. But first, congratulations are in order, on getting Louise Yamada Technical Research Advisors up and running.

It is a journey I never want to take again. If there are joys in entrepreneurship, they're still to come. I admit, though, that there *is* a nice feel to having the firm be your own. A nice peace in not having to fight bureaucratic pressures. That battle has really become a global issue in

the investment business. I flew to the Netherlands a couple of weeks back. **Jacob van Duijn, Robeco's** chief investment officer, had invited me to speak at his retirement dinner. He's a very good and old client, so I went. And what was the conversation at that dinner? How the investment business is being run today by business managers who know *very* little about the money management process. The other very pointed observation Jacob made was that the investment business used to be all about the client. But now it is all about the money. It's too bad, but it's clearly not just a U.S. phenomenon.

In any event, LY Advisors is a purely independent research shop now?

That's right. There are just five of us, a close-knit group. A prime part of our motivation in setting this firm up was to keep Alan's legacy to the profession of technical analysis and to the markets alive. I'd been running the department for 5 years, on top of Alan's 46, and you just don't toss all that accumulated knowledge on the junk heap—

Citigroup manifestly disagreed—

No comment. What I *can* say is that we've seen an enormous, and enormously gratifying, outpouring of support from clients. The impetus to start this firm really came from them. Still, we pretty quickly discovered that to preserve the work, we'd have to do it on a much smaller scale, and focus on institutional clients. Several peo-

ple on our old staff were without what I would call safety nets, and we managed to get them re-employed at Smith Barney, which was nice. Nonetheless, we weren't able to hammer out an arrangement to service all the retail brokers who were so upset to lose the department. Already, it's been a real eye-opener, just trying to get some long-time institutions clients to pay. On the other hand, we came in 5th in the latest *Institutional Investor* poll, even though we had not published as scrap of research in months!

But now you are very much back—and resumed publishing just in time to make a dramatic call. Was that market or marketing driven?

It was no ploy. I think the market is at a crossroads here; it's not just floating along anymore. There's some real damage that could be done. It was actually unsettling to resume publishing on Oct. 3 and have to issue an intermediate-term sell on Oct. 7. I assure you, the market didn't turn down for us. But it was intriguing that we were seeing all these vulnerabilities and that within days, the Lowry's data was also giving a sell signal. When we went back and looked at it, we saw that there had been a very quick widening of their negative spread. Something we hadn't seen in their work since 1999. Of course, it's entirely typical, when you see such rapid deterioration, to have the signal followed by a rally. Only after that reaction does the next leg down really begin.

So the sharp rallies we've seen in some recent days haven't given you second thoughts?

We're *always* questioning. You know that. But this market keeps doing things that align with events in the '30s.

For instance?

One of the interesting things going on beneath the surface is that if the market truly is in the process of turning down here, we didn't get the traditional 4 to 9 months' early warning signal from the advance/decline line—known in the trade as a negative divergence—that we usually get before a major market decline. What's intriguing is that there have been only two other instances, in the 80 years of data we have on this indicator, when the A/D line failed to send this signal—and both occurred in periods when small and mid-cap stocks were in structural outperformance cycles—like now. In both 1936-'37 and 1977, the A/D continued to advance to new highs, right into or near the top. What's extraordinary is that those periods were *both* repair phases of structural bear markets—like now. I take that as a warning not to derive complacency from today's positive A/D line, which has maintained a good bit of strength throughout the small and mid-cap outperformance leadership cycle. Other signals may be telling a truer tale here.



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So you're not exactly comforted, either, by the way smaller caps have been leading the market?

In a word, no. What's interesting is that the sort of dominating outperformance by the small and mid-cap stocks that we've seen since 2001, may very well be characteristic of structural bear markets, in particular the repair phase, since the large-cap names that create the structural bear in the first place remain depressed and in need of an extended time to repair. Therefore, the smaller, more agile names seem to flourish in the repair phase. You'd have to say, looking back on it, that 1975-'83 experienced a small- and mid-cap outperformance cycle lasting eight years, as did 1934-'37 (when the outperformance cycle in small caps ultimately extended out into 1945).

Maybe we should back up here and talk about your notion that we're experiencing a "structural" bear market. After all, anyone smart or lucky enough to have been invested in the S&P 400 or 600 for the last several years is in bull heaven.

There's no doubt that we have seen some very generous equity market advances over the past three years, since the secondary lows in March 2003. So generous, in fact, that some investors might have forgotten the pain of the 2000-03 period in which Nasdaq lost just a hair shy of 78% of its value. So you're right, it's probably a good idea—especially since we got those sell signals on Oct. 7—to review the technical observations that lead us to define this environment as a structural bear market. Actually, it's very important to understand this, because *we still have no conclusive technical evidence that the structural bear that began in 1999-2000 is completely behind us.*

Now, when you call a bear market "structural" you mean—

We simply use the word "structural" when other analysts might say "secular," for instance. We're using structural to describe the very long-term picture, as opposed to "cyclical," which we use to identify shorter-term moves. Historically, the secular bear markets that we've observed have typically spanned 13-16 years, while cyclical moves have been

NewsBite

An Unpublished Letter To The NY Times

An Informed Response To NY Times' Sandy Weill Valedictory

I, like I am sure thousands of others, read the recent NY Times Sunday business section feature on **Sandy Weill**, [*Laughing All the Way From the Bank*, NY Times, Sept. 11, 2005] with great interest. But, in my case, I also read with mixed personal emotions.

I retired from Citigroup (Smith Barney) in 2004, after a 46-year career with the firm and its predecessors.

In the 1960's, under the guidance of the late Ralph A. Rotnem CFA (Harris, Upham Director of Research and a devout student of the stock market), I was given the opportunity to explore the field of technical stock market analysis, and I initiated a concerted technical effort within the Harris, Upham Research Department. When Harris, Upham merged with Smith Barney in 1976, the HU technical research group was welcomed into the combined SB research effort, and I was given a position on the combined firm's prestigious Investment Policy Committee.

Post Sandy Weill's takeover of Smith Barney (via Primerica) in 1988, our paths would cross primarily at corporate events...President's, Chairman's Council trips, etc. But Sandy would often contact me for a technical read on Citicorp stock, surely exhibiting his fascination with the equity's performance.

Your article's mention of Sandy's wealth/success reminded me of my favorite Sandy Weill story. To fully appreciate it, you must recognize that Sandy "forced" us all to be restricted shareholders of Citigroup by deducting a portion of our annual bonuses and investing those sums in the shares. It goes like this:

Sandy and I were walking with our wives to dinner at a Smith Barney affair in the mid-1990's, when Sandy came to a sudden halt and asked, "How does the stock look now?" It was then trading in the 50's, and I remember that my response pleased him greatly: An upside breakout was underway, with a technical price target readable into the mid-70's. "Gosh," Sandy exclaimed. "I'll be a billionaire." I turned, shook his hand and quipped, "It's all relative, isn't it?"

So why did I begin this missive expressing "mixed personal emotions?" Earlier this year (in February), the entire technical research department at Smith Barney was terminated, and the firm's by then long-famous Chartroom, with its irreplaceable collection of hand-posted graphics capturing a half century of market history, was unceremoniously shuttered.

A number of "reasons" were offered, but we learned the real reason was to "save" a few million dollars. In fact, the decision already has cost the brokerage firm millions of dollars in commission revenues from both the private and institutional platforms, especially the latter.

The next-to-last paragraph of the feature, talking about the "dismantling" of Sandy's legacy really harkened me to reflect on the dismantling of my own. I doubt that the decision to eliminate in one fell swoop the technical research operation I spent my career building was a direct move by Chuck Prince, but I humbly suggest that he should demand a direct accounting from those who were responsible for dismantling the one area of Smith Barney's research department that still commanded ongoing respect and credibility, and that was consistently recognized in both internal and external polls as providing very valuable service to clients.

Finally, I note with interest that the timing of this year's high in Citigroup's stock coincided with the announcement of the firm's decision to eliminate technical research. Just a coincidence?

Yes, Sandy, as you told the Times reporters, "The performance of the stock is nothing to shout home about." For that matter, it's nothing to shout anywhere about!

Alan R. Shaw CMT
Shelter Island, N.Y.,
Sept. 13, 2005

much shorter, like the 2.5 year cyclical bull market we've experienced in small- and mid-caps off the 2003 bottom.

In other words, you reject the sunny notion that the bear market ended somewhere between October 2002 and March 2003, and so it's been back to the races ever since?

We have yet to see evidence of that. As technicians, until we see evidence to the contrary, we have to question whether the equity markets carry risk of new lows, and so might be considered still to be in the declining phase of this structural bear market, or whether they have entered a multi-year repair phase.

Those are patterns you've seen in previous bear cycles, if I'm correctly interpreting the very long-term chart you published a week or so ago?

Right. We showed the chart [opposite] of the DJIA from 1896 to the present to illustrate how each of the market's three previous structural bear markets was broken into two parts—a declining phase (marked with an "A" on the chart) defined by prices falling to lower lows into a pivot low; and a repair phase (labeled "B") defined by generous cyclical rallies (not unlike those of the past three years). Those "B" phase rallies, however, fail to put in place sustainable new highs in the indexes. The declines following those rallies hold above the pivot low, but not necessarily above one another.

So what you're saying is that you're still not sure if we've seen the absolute lows in this bear market, but you are sure that's what we're in?

It sure looks like it! A further observation can be made regarding the bear market experiences illustrated in our chart based on the Elliott Wave Theory of Alternating Cycles, which states that a current cycle should be *less* like the immediately prior cycle and *more* like the alternate cycle.

Thanks for defining it.

My point is, if you look at the profile of the 16-year 1905-1921 structural bear market, you can see that it was basically a horizontal formation around a 1914 pivot low that delineated Phase A from Phase B (and which occurred, it's interesting to note, in an extended environment of both rising interest rates and inflation). So then what happened? That horizontal bear market formation very clearly did *not* repeat in the 1929 bear cycle. But it did alternate to repeat in the *following* cycle—during the 1966-'82 structural bear market. That was another 16-year horizontal bear market organized, if you will, around a 1974 pivot low that set Phase A apart from Phase B. (And it's very intriguing, I think, to note that this alternate cycle also occurred in an environment of rising interest rates and inflation, meaning amid conditions matching the those of the prior alternate cycle, 1905-21.)

Then what do you make of the fact that the 1929 Crash ushered in such a different beast?

It clearly was a very different bear manifestation, wasn't it? The 1929-'42 structural bear market didn't establish its pivot low until it fell for three years into 1932, and until it had wiped out 89% of the Dow's value. That was what we define as Phase A. After that carnage, the repair phase lasted for the following 10 years—during which investors (the few hardy souls who were left) experienced some extremely generous cyclical rallies. But they were also bludgeoned by the Dow's devastating 1937-'38 decline of 47.7%. What I also find remarkable is that entire structural bear market period, starting with the Crash and continuing through the Depression, occurred against an environment of deflation and falling interest rates. Need I point out that that was completely the opposite of the environment in which the previous and subsequent structural bear markets took place—but quite similar to what we have been living through since early 2000?

Oh, happy days.

Well, it does look like we've been alternating cycles, considering the similarities between the 1929-42 period and the structural bear market we have experienced from 2000 to present.

Does that imply, though, that at least we've probably seen the market's "pivot low" for this structural bear? Even though the Dow didn't crash nearly as badly?

Those are questions, alas, that we'll only be able to answer in hindsight.

Some help that is!

Well, there are a further observations that we can make. For one, the dreadful magnitude of the 1929 Crash in the Dow, was essentially replicated in 2002-2003. Just in the Nasdaq, instead of the Dow itself. While the blue chip average actually declined only 37.85% in the recent ordeal, the Nasdaq (on which so many of the bubble stocks traded) crashed nearly 78%, as I said. I know this is something of a stretch, but consider what would have happened to the Dow, if it instead had been the locus of the internet mania. If you adjust the Nasdaq bubble into Dow points, you find that it would have risen almost to Dow 20,000! (Actually, 19,958.35) Then it would have plunged during 2000-2002 to a low of 7286.37, or by 63.5% in "Dow equivalent points" over three years. So that would qualify as a crash.

Can't you really make up a what-if like that for all seasons?

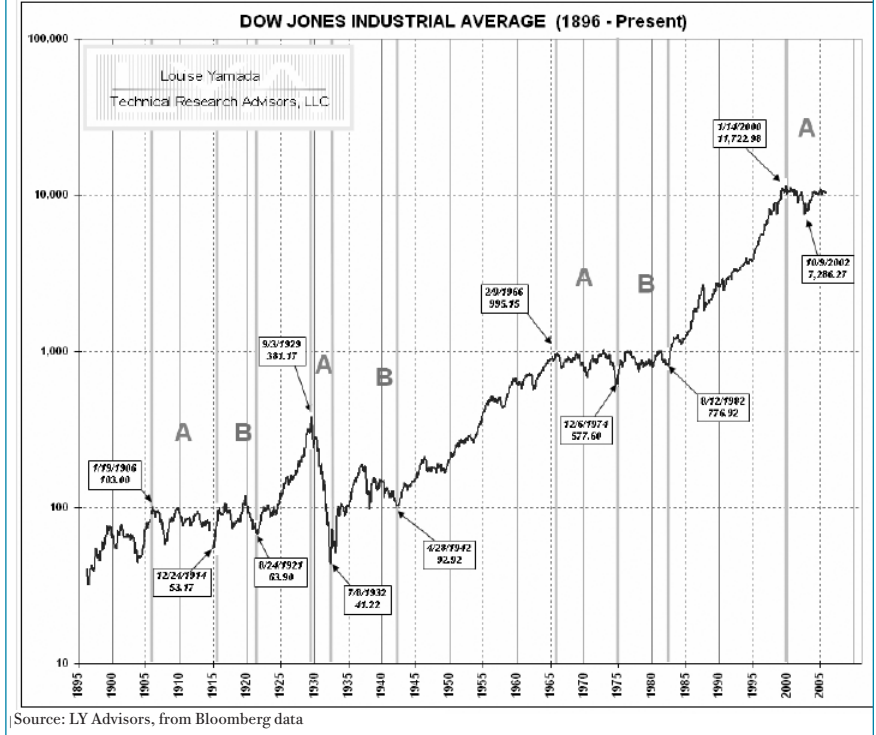
Well, that really is how the numbers work. What I am getting at, though, is that during each of the structural bear markets that took place in the 20th Century, the DJIA pretty fairly represented "the market." Today, however, investors deal in many different markets of very different character. For example, in the Nasdaq, technology (defined as computer and telecom areas) comprises 60% of the index—and those stocks, in the main, were responsible for creating the 1999-2000 bubble and subsequent bursting. But we also have the NYSE Composite which, after many decades of mergers between ever-larger large-cap stocks, has been left with components some 80%-plus of which are small- and mid-cap stocks. Maybe that's why we run into that bit of an anomaly in our definition of this secular bear market. As you pointed out earlier, while some indices (for instance, the Dow, S&P 500 and NASDAQ) seem to fall neatly into a repair phase (B), there are others (like the NYSE, S&P 600 Small Cap and S&P 400 Mid Cap) are not acting as they should in a "repair phase." In fact, even though the rallies in the Dow and the S&P 500 since 2002 have fallen far short of achieving—much less exceeding—their 2000 highs, which is just what we would expect in a repair stage, or even in an ongoing (stage A) decline, other indices haven't been nearly so "well-behaved." The the NYSE, the S&P mid- and small-cap indices have all exploded to new all-time highs. Indeed, they boast spectacular gains off their 2003 lows, of 70%, 89% and 104%, respectively. Whether these small and mid-cap averages can somehow be considered still to be in "repair" stages, or whether they've dancing to their own bull market drummer remains to be proven. I can note, though, that it's not unusual for the smaller, more agile stocks to outperform during a repair stage of a structural bear market.

It's not?

No, after all, the secondaries outperformed handily for 8 years between 1977 and 1983, during the last secular bear market and the first stirrings of the late, great secular bull market. Likewise, small- and mid-caps outperformed from 1934 through 1937—and essentially kept up that pace all the way through 1945. And that even makes sense on some level, since it's the collapse of the large-cap names that kick off a structural bear market in the first place.

What does all this add up to, Louise, in terms of where your

Figure 1. Dow Jones Industrial Average (1896-Present)



charts say the major averages head from here?

Well, the Dow is the worst-looking of the major indices. There's no question it never made it out to a new high. And we got those strong intermediate sell signals in early October. As we said at the time, it's not particularly surprising that the market would rally smartly after registering such dramatic negative signals, but today's [Thursday, Nov. 3] rally pretty much took it to what we thought likely would be the top of any kickback rally. If it now turns down, we'd watch the 10,000-10,200 area for support. If we break that, you're probably going back toward 9,700. Going below that would be a major problem, because no matter how hard I squint at this chart, it's hard to find much support below there.

What about the S&P 500?

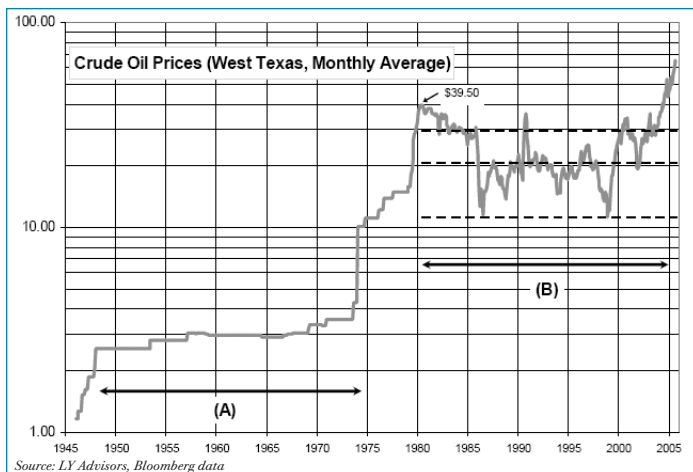
That picture isn't as grim, probably because it contains far more small- and mid-cap stocks. It probably has support in the 1120-1130 area. But what I think is particularly interesting is that our volume momentum study, which is an exponential of up and down volume, has really been putting in place lower peaks on every rally, going all the way back to the beginning of '04. So the potency of the cyclical rally has been falling off; each major rally has had a little less up-volume thrust, if you will.

So the old bull has been showing signs of age?

Yes. The market needs more energy—and, interestingly, it was energy stocks that took the bull up, the last time. When it lost that energy leadership, it fell apart.

Yet you still like the energy sector, long-term?

Energy is mostly likely in a long term bull cycle. My colleague, Ron Daino, has done a fascinating study of the long-term price history of crude, showing how it has tended to have these step-up function price increases, followed by long plateaus of more or less stable prices. Ron first did the study when we finally saw oil go through \$40 a barrel. At that point, his charts were giving him targets into the \$50s and then up to \$67. He said, "Oh my gosh, what's going on?" Then he went back to



look at the history and it was fascinating that in the 1940s there was a three-year step-up in the price of oil, which was followed by a 24-year plateau. It was upwardly trending, but a plateau nevertheless. Then you had a six-year step-up in the price of oil in the 1970s. And it, believe it or not, was followed by 24-year plateau which was completed when oil went through \$40 a barrel. So, you can certainly ask whether we may be in yet another multi-year step-up in the price of oil. If you were to ask how long it might last, I'd have to say that that same Elliott Wave principle of the alternation of cycles that we talked about earlier would suggest three years, similar to the '40s experience. There's also the possibility that the step-up could last longer. But even three years would take us just to 2007 before it would start to stabilize.

What a delightful prospect for global consumers.

We've had a theme of quite a while which we call "Looking for inflation in all the wrong places." Rising energy prices, unfortunately, fit it to a "T." Energy in this country is much less of an industrial commodity than it is a consumer good. We use 50% less of it to produce goods than we did in the '70s.

Mostly, because we produce a lot fewer goods here.

Exactly, manufacturing has been outsourced to a very great extent. Which means energy is more and more a *consumer good*. Everybody is moving south to retire, everything has to be air conditioned, as well as heated. Plus, we plug in everything today: computers, cell phones, iPods, etc.; everything has to be recharged. So energy is an amazingly consumer-oriented commodity that is inflating.

Never mind that the government doesn't count it as part of "core" CPI inflation?

Right. There's no inflation if you don't eat and don't drive! Or heat or air condition your home. My view is that consumer essentials are where inflation in going to show up for us in the 21st Century: in food, water and energy—and not to mention in health care. "Looking for inflation in all the wrong places" has been one of our strong working hypotheses for quite some time. Remember, the composition of the CRB index today is only 18% industrial, 18% gold, and 18% energy, while it is 52% agricultural. And, when you consider agriculture, you can't get around factoring in water, because agriculture uses 87% of the world's fresh water supply. But what's really interesting to me is that I see the concept of inflation undergoing an enormous shift. What will be inflating will be consumer consumption essentials, like food, water and energy. Meanwhile, deflationary forces, stemming from the enormous surge of labor deflation out of China, India and other emerging nations will continue to push inflation out of capital goods, and out of virtually anything

that has to be manufactured, even in the face of rising raw materials costs.

The Chinese and Indian manufacturers are just going to absorb rising raw materials costs?

I think they'll have to, because they can't risk the orders going elsewhere. There are so many "elsewheres" now competing with such low labor costs that even inflationary materials prices, whether for metals or energy or what have you, will still be absorbed to produce a cheaper product. So the CPI, which measures products inflation, will continue to be under pressure, even as consumers are squeezed by the rising prices of the true essentials, like food, water and energy.

Which will be rising—why?

Demand, pure and simple. It's rather shocking to reflect that when I was born there were fewer than 3 billion people on the globe and now there are 6 billion and that total is projected to rise to 8 billion in the next couple of decades. If you think about the globe being finite in its land and finite in its water and finite in its oil, it's not hard to come to supply/demand relationships that suggest pricing power in those essentials.

You're not sketching a very hospitable environment for the stock market.

Rather like this year. Despite quite a bit of volatility, the major averages haven't done much of anything. In fact, most investors would have been far better off focusing throughout 2005 on outperforming stocks, groups or industries rather than on the market. I think the last time Ron did the math, if someone had had a chunk of their portfolio in energy, for instance, those holding would have returned anywhere from 31% to 82%. That's why our bottom line message is that we'd only continue to participate in sectors here that have strong momentum characteristics and have been strong outperformers—an exclusive group that is shrinking continuously—and that's probably a market message in itself. In fact, when you look at our momentum measures on the various sub-industries in the S&P 500, what jumps out at you is the sheer length of our Avoid and Sell lists, where the groups that have been underperforming the benchmark reside. Because they represented over 60% of the weight of the S&P, at last count, this week's bounce doesn't particularly surprise me, but I'd use it to sell into strength. Basically, anytime more than 50% of the index's capitalization weight is negative like this, a sustained market advance is highly unlikely to gain traction.

Alan mentioned you also have a lot of sickly-looking charts of individual stocks?

I just put a number of long-term charts, going back to the early 1980s, into a special research alert, and called it, "Defensive May Not Defend."

Why so many very long-term charts?

In this case, so that you can really see the kinds of bull markets that these stocks enjoyed. Where they are coming from. I'm talking about traditionally defensive stocks of many communications and big pharma companies, like a Pfizer, a Merck, a Lilly. Their charts look just awful. And behind them, I could show you a whole raft of other charts, of consumer staples companies like **Anheuser-Busch**, (BUD), and possibly **Colgate** (CL) rolling over, **Kimberly Clark** (KMB) rolling over, **Sara-Lee** (SLE) rolling over, **Gannett** (GCI). The monthly charts of **Entercom Communications** (ETM), **Westwood One** (WON), and **Viacom** (VIA) likewise look perfectly dreadful. And you can add three more media stocks to that list: the **Tribune Co.** (TRB), the **New York Times Co.** (NYT) and **Dow Jones** (DJ). [[Instant Embarrassing Disclosure: KMW still owns a few](#)

hundred shares of her former employer, DJ, in a dividend reinvestment plan she forgot to jettison with the rest of her DJ holdings soon after she left the company.] All of them are capitulating, as are the shares of **SBC Communications** (SBC) and **Verizon** (VZ). I mean, punch up a few of those monthly charts. All you will see is these humongous tops. Or take **Coca-Cola** (KO). How bad can it get? The stock has already halved between 85 and 40 and looking at the chart, there's still a potential for more downside. The story is much the same at **Coke Enterprises** (CCE). There are also a lot of consumer staples whose charts trace out what I call suspicious patterns. Names like **Heinz** (HNZ), **Bell South** (BLS), **Disney** (DIS) and **Clorox** (CLX). What's just amazing to me is that at this point there are so few of the traditionally defensive consumer names that *don't have awful-looking chart*. But there are a few, like **Philip Morris** (MO) and **Wrigley** (WVY) and **Pepsi** (PEP) and **Johnson & Johnson** (JNJ) and **McGraw Hill** (MHP) and **Procter & Gamble** (PG) that look okay.

I hear a "but" in your voice—

I'm a little suspect because these stocks had a break out, which has now retreated. Likewise, I don't know what's happening fundamentally with **General Mills** (GIS). But at the very least—unless it's the last to go—there's still an up-trend on that chart without these massive 4-year distributions that are visible in the rest of the consumer staple universe.

So you're having trouble finding stocks you think worthy of investing in at this juncture?

Right. Except in energy and to a certain degree in the materials stocks. And even in energy, where we still have a long-term, structural, bullish outlook, and long-term up-trends in place on the charts, we'd avoid buying most of the stocks at the moment. It appears that the energy stocks are simply taking a well-deserved breather, after accelerating so strongly at the end of the third quarter. But we'd rather watch the progress of the correction before jumping in. We also think that before this unwinding is over, we may see the final capitulations of some of the stocks that were bubble market leaders.

Such as?

I wouldn't hesitate to put **Wal-Mart** (WMT) in that category. Wal-Mart's chart is another that I worry about. I mean, the chart has this 6-year formation where the weight of the evidence is of a top, with failures to go higher and where it has started to roll a little. I'm not sure what the fundamental message is, except that perhaps we're being way too myopic in thinking that only the giants of American business can succeed in global markets driven by the deflationary pulse out of the Far East. I did a quick review of the ADRs listed on the NYSE recently, to try to get a feel of the global technical field, and found, basically, that most stock sector constituents are behaving pretty much the same way,

no matter where, around the globe, they're domiciled. But there were a few eye-catching exceptions.

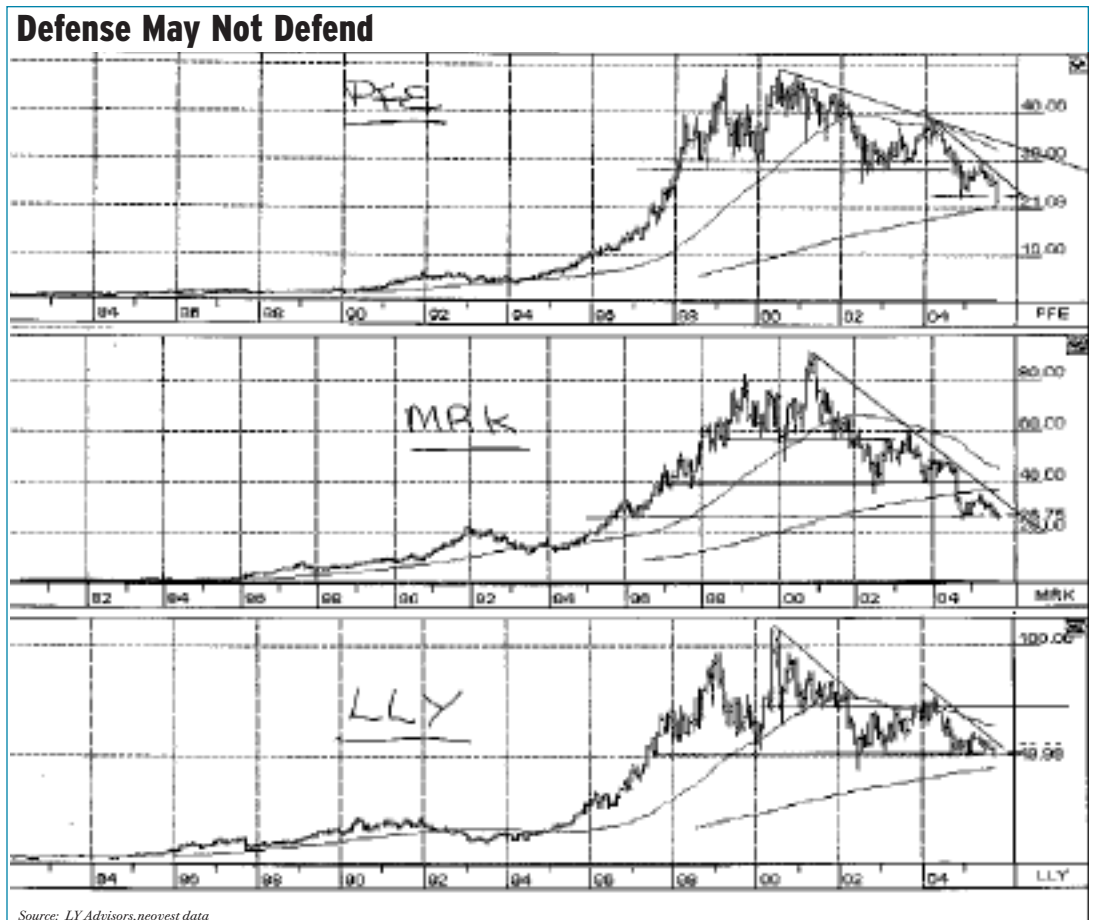
Where?

Particularly in the brewing and beverage industries. While the likes of Coke and **BUD** in the U.S. are in clear bear markets, there are a number of global beverage companies whose charts actually tell quite bullish stories here. For instance, **Compania de Bebidas Das Americas** (ABV), **Quilmes Industrial** (LQU), **Coca-Cola Hellenic Bottling** (CCH), **Diageo** (DEO), **Coca-Cola FEMSA** (KOF) and **Formento Economico Mexicanos** (FMX). Global telecom stocks, as represented by the ADRs, by contrast, offer up a miserable looking stack of stocks, perhaps suggesting that the market is over-saturated with telecoms. So I'm wondering if what I am seeing in the ADRs might not be part and parcel of a process of creative destruction getting underway, that will tell us which companies—and countries—emerge as leaders of the 21st century. Might not the Chinese prefer to do business with a Korean company than a U.S. company? Or someone in the Mideast might prefer "Mecca Cola" to Coke.

So your message is to be very selective in stockpicking here—and everywhere around the globe?

Well, I think that the fact that we've only got 30% of the S&P weight on our buy and hold list suggests that cash isn't a bad place to be at the moment. Especially since the dollar may even strengthen. Ron has an observation of a little head and shoulders bottom here in the dollar.

Enough said. Thanks for coming back, Louise.

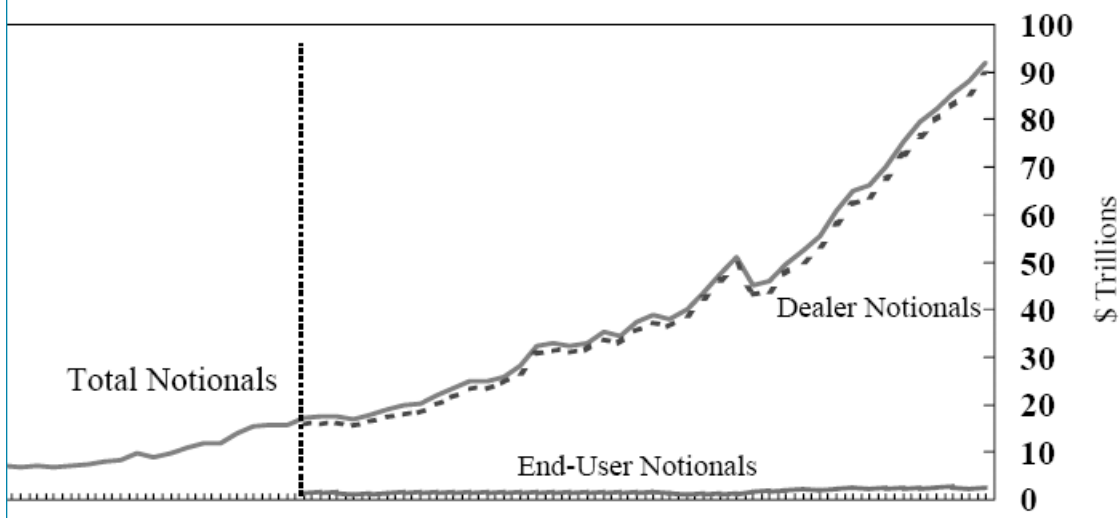


Source: LY Advisors, neovest data

What's Wrong With This Picture?

Talk About Asymmetrical Risk!

Derivatives, Notionals by Type of User Insured Commercial Banks



The chart above comes straight out of the Comptroller of the Currency's Bank Derivatives Report for the second quarter of 2005. Page 6. It reflects the latest available data, but I have to admit that it's not a lot different from charts of the same data series I've looked at in numerous previous editions of that report.

So what's the fuss? I took a fresh look at the report because I got a call last week from an old *Barron's* colleague-turned portfolio manager who wanted to point out to me that the trillion dollars in JP Morgan's credit derivatives that Frank Partnoy and I discussed in last issue's w@w interview, are but a tiny fraction of JPM's exposure to derivative instruments. To get a handle on that, consider that old JP's bank alone accounts for \$47 trillion with a "T" or nearly half of the \$96

trillion in notional value of derivative contracts that were outstanding at last count. Or consider that JPM devotes nearly 4 pages (62-65) of indecipherable small print to derivatives valuation and "disclosure" in its latest annual report. But what really hit me square in the eyes as I stared at the chart above, is that for all the rapid growth of activity in the derivatives markets, what this chart fairly shouts is that Mr. Greenspan's wunderkind--and liquidity it's purportedly adding to the system--are the ultimate in financial markets chimera.

Trading volume in the derivatives market is almost entirely incestuous. "End-user" notionals (that virtually flat line along the bottom of the chart) have gone nowhere for 15 years!
KMW

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