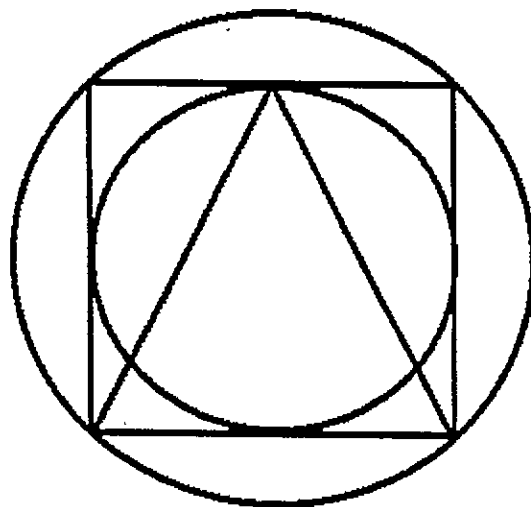


**THE  
AUSTRALIAN  
TECHNICAL  
ANALYSTS  
ASSOCIATION  
NEWSLETTER**



**NOVEMBER 1993**

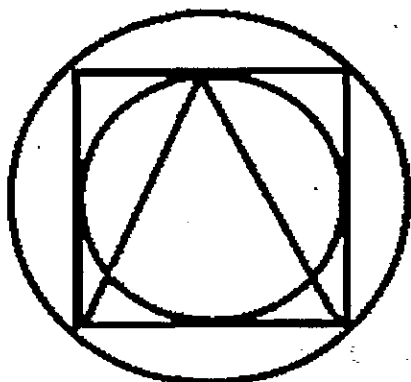
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## YOUR COMMITTEES

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### Other States:

As our interstate numbers grow to a critical mass in a state, formal meetings will be held in the capital city. If you wish to help create an informal group that will lead to that critical mass, call or write to DW Hunt in NSW.

### Disclaimer

The views and articles in this newsletter are the author's and do not necessarily reflect the views of the Australian Technical Analysts Association (A.T.A.A). The A.T.A.A. therefore, does not warrant the data, views or opinions expressed in this Newsletter. Trading or investing in stocks, currencies, bonds, commodities via forwards, futures, physical markets or options involves risk. If you trade or invest, it is your own decision and you alone are responsible for the outcome.

## PRESIDENT'S ADDRESS

This year has marked some major achievements for our Association.

Our membership base has continued to grow as well as the levels of services that we are now able to provide. These include prominent speakers from around Australia and overseas guest speakers, an expanding technical video library for members, discounts on selected seminars, and a richly informative newsletter.

News just to hand is that our successful campaign to host the next available IFTA conference has paid dividends for our nomination as host city for 1995. This will be a tremendous opportunity for us all to meet with fellow analysts and traders from around the globe, exchange views and ideas, and extend a warm Aussie welcome of course.

We will be releasing the results from our Data Survey early next year. It has been circulated to all known data providers in Australia. The purpose of the survey was to collect information relevant to analysts to determine a suitable source of market data, and enable new traders to view the options available.

Many traders and analysts have been attempting to pick tops on our local sharemarket in the past 12 months, shorting nearly every MINOR time and price square. When the time is ripe for a top, the opportunity has then passed to those in 'tune'. Darwin once said that the most effective life forms blended into their environment and adapted to changing conditions. We must also adapt to changing market conditions and become part of the trend once a MAJOR squaring has been identified, and follow through when confirmation is established. In this way a trader can learn to SEE, and guarantee his own success and survival.

One of the greatest lessons I have learned over the years trading the markets is to "externalise" any hopes, fears and expectations, and maintain a high level of ACTIVITY. You need to MAKE things happen. The removal of fear can only occur when we face the dangers constantly. Through this process will come a level of UNDERSTANDING, one that will open doors for you that you once thought were locked or non-existent.

Wishing you and your families a prosperous, richly rewarding, and peaceful Christmas holiday.

Charles Balas  
President.

## WELCOME

Welcome to the following new members:

Mr Lawrence Hulse	Greensborough	VIC
Mr James Mc Gregor	Point Piper	NSW
Mr John Den Hollander	Sydney	NSW
Mr Michael Slaughter	Moe	VIC
Mr Andrew Masson	New Lambton	NSW
Mr Louis Kovan	Dee Why	NSW
Mr David Jackson	French's Forest	NSW
Ms Marcia Capel	Grays Point	NSW
Mr Ivars Bergamanis	Warrandyte	VIC
Mr M.K. Braithwaite	Melbourne	VIC
Mr Ben Wells	Glenorie	NSW
Mr Simon Jackson	Sydney	NSW
Mr Phillip Smith	Sydney	NSW
Mr Collie James	Kew	VIC
Mr Ross Druitt	North Rocks	NSW
Mr Graeme Bibby	Birmingham Gdns	NSW
Mr Bruce Barnard	Auckland	NZ

## VIDEOTAPE LIBRARY

The ATAA is building up a collection of videotapes that will be available for members to borrow.

Currently twelve tapes are available:

"What it Takes to be a Great Trader" This is an address given by Jack Schwager to the US Market Technicians Association. It is based on the observations he made when compiling his popular book "Market Wizards". The tape was reviewed in our January 1993 Newsletter on page 38.

"Technical Analysis in Just 52 Minutes" by Dr. Alexander Elder, a professional trader, teacher of technical analysis and practising psychologist. The tape provides a broad introduction to technical analysis. It includes basic chart patterns, trendlines, support and resistance, computerised analysis, trend following indicators (focus on moving averages) and much more. The tape was reviewed in our September 1993 Newsletter on page 28.

"MACD and MACD-Histogram" MACD measures the intensity of bullish or bearish pressure and helps you trade in the direction of the dominant market group. Divergences between MACD-Histogram and prices identify important tops and bottoms.

"Stochastic" One of the most popular technical indicators, Stochastic identifies short-term tops and bottoms. It helps you find buying points in uptrends and shorting points in downtrends.

"Relative Strength Index (RSI)" RSI confirms trends and helps to forecast their reversals by measuring closing prices, which are the most important prices of the day. You learn RSI trading rules

and hear comments by professional traders.

**“Directional”** This system answers two essential questions: Is the market in an uptrend, a downtrend or a trading range? If it is in a trend, is it moving fast enough to warrant using a trend following method? Directional also helps you catch very young bull markets.

**“Williams %R”** This simple, but powerful indicator measures the power of bulls and bears to close prices near their edge of the daily range. It helps you decide when to pyramid winning positions.

**“Elder Ray”** This new indicator shows whether bulls or bears are in control and whether they are becoming stronger or weaker. You can use Elder Ray as a stand alone system, or as a pin point entry technique with many other systems.

**“Triple Screen Trading System”** How to combine oscillators with trend following indicators, so that their negative features cancel each other out, while their positive features remain undisturbed. How to analyse markets in more than one time frame and find better trades. This is Dr Alexander Elder's own trading method.

**“Day Trading with Gerald Appel”** Gerald Appel shows how he trades S&P500 futures, but stresses that his methods do not apply to other markets and longer time frames. His technique is based on channels, tick volume, spreads between S&P futures and cash and other factors.

These videotapes are in VHS format and are available for loan to ATAA members free of charge. You are only asked to pay the postage (maximum \$2.80) and packing (No 1 Australia Post padded postbag 75 cents) to return them promptly when you have

finished watching them.

We lend these videos on a first-come-first-served basis and maintain a waiting list. The videos are posted to you as soon as your turn comes around.

In order that the maximum number of members may take advantage of the library, you are asked to view the video tape and return it within one week. Members consistently taking too long to return video tapes may be dropped to the end of the waiting list for further borrowings.

While we will place you on the waiting list for more than one video tape, you will only ever be sent one at a time. It is administratively too complex to record orders of preference when asking to be placed on the waiting list for several videos. Each one will be sent to you when your turn for it comes around.

For the last eight video tapes, availability of which were announced at the Sydney October meeting, special conditions were applied to ensure an orderly distribution. All requests made at that meeting were selected randomly for placement on the waiting lists. In addition, no one requesting a video tape at that time will receive a second tape until everyone has received at least one tape. Interstate members who telephone Colin Nicholson before the 15th of December will be added to this list so that they too will receive one of their choices before those at the Sydney meeting receive a second tape.

If you would like to borrow any of the videotapes, contact Colin Nicholson at Sydney meetings or on (02) 436 1610, to be placed on the waiting list.

## INTERNATIONAL MARKETS

### TECHNICAL DANGER SIGNALS FLASHING

Like many other technical analysts, I did not expect the world's stockmarkets to expand into the bubble of recent weeks. In fact I thought that it was possible for reversals to occur during my absence overseas in September/October. However, now that sharp rises have taken place, the scene is set for sharper reversals than would have ordinarily been the case. The probability for imminent correction is high.

I have included the table of my investment model which indicates strong signs of change in bonds and stock indices and indications of higher short term interest rates internationally. The model is based on similar techniques to that of my talk to the A.T.A.A Sydney in April (See Newsletter July 1993). ROC represents rate of change as calculated by my FIRM ROC method. RARI represents the multiple of my weighting percentage of indicators and SPEC ROC. DOUBT/OPPOS indicates that moving averages and ROC signals are not in alignment, DOUBT 50/0 indicates markets in which my weighting is less than 50% and/or ROC is less than + zero. You might recall that my speculative parameters were 65% +/-10). SOB does not stand for Son of a Bitch, but Short term Over

Bought as measured by Cutler R.S.I on weekly data. Similarly, SOS is not the international distress signal, but the Short term Over Sold signal. I am reluctant to take new positions when markets, with a volatility above 1.0 are overbought or oversold. The plus/minus signals on SOB/SOS indicate that the markets are retreating from overbought/oversold levels, so that reversals are either under way or imminent. The CL sign represents a cluster signal on the weekly averages, which has been explained, at Sydney meetings, a number of times by Dawn Bolton-Smith <sup>(6)</sup>.

Up until November 1, the preferred investments were in stocks in Hong Kong, New Zealand, Australia and the UK, with some diversification in 90 day Euroyen lending, and US T-Bonds. In the week ending November 5, the markets showed a marked change. I have had sell signals in Hong Kong (50%), New Zealand, Australian (50%) and UK stocks, As well as US T-Bonds. US Eurodollars are showing signs of increased short term interest rates. German bonds and Euroyen markets are holding but with warning signs.

My preferred investment at time of writing would be in US dollars on call or short term deposit and in Euroyen 90 day notes, possibly 50-50. New Zealand bonds will be harmed by the election result, and should reverse on next model assessment.

suggests that this move will commence in the coming three months (probably before Xmas). It is definitely time to urgently review investment strategies, even if you do not agree with my market warnings, and pay close attention to markets as the November 17 NAFTA and December 15 GATT deadlines approach.

One always hesitates to forecast doom and gloom, but the investment model indicators have proved consistently reliable since 1986, and were in fact short going into the 1987 stockmarket crash.

Will Slatyer - November 8, 1993

The investment clock suggests that the next move internationally is from paper assets to commodities, and my investment model

Editor's Footnote

④ A cluster signal occurs when all three moving average lines (D B-S uses 5/15/30) converge with price. This is usually followed by an explosive move.

FIRST SYSTEM - LIQUID ASSETS INVESTMENT RECOMMENDATIONS (FLAIR)  
Friday November 8, 1993  
HIGH VOL INDICES

BASE COMPARISON USD	FX ROC	INT RETURN	CPY	SPEC ROC	INVEST INDEX	RARI	DOUBT OFFRS	DOUBT SO/S		VOL
1. TIEFX YEN	-19.9	-	-1.9	+129.3	+107.5	+88			SOB	3.6
2. HANG S'ENG	+ 1.2	-	-8.0	+ 76.2	+ 69.4	+40	50%		SOB	2.5
3. AOI	+ 3.3	-	-1.8	+30.5	+33.1	+22	50%		SOB	1.3
4. NZ 3YR BND	+ 4.6	10.0	-1.5	+ 7.5	+20.6	+17			SOB	1.7
5. USD INDEX	-	3.13	-1.6	-	+ 1.53	+6	50%			1.0
6. GOLD FIX	-	-	-1.6	+ 4.8	+ 3.2	+2	CL-			1.6
7. NIFE BAR	+ 4.6	-	-2.2	+47.6	+50.0	-	X	X	SOB	1.7
8. NZSR40	+ 4.6	-	-2.2	+33.1	+35.5	-		X	SOB	2.2
9. SFE 10YR	+ 4.4	12.0	-2.2	+ 5.8	+20.0	-		X	SOB	1.2
10. SFE 3YR BND	+ 4.4	12.0	-2.2	+ 2.6	+16.8	-		X		1.2
11. DEM/USD	- 2.1	6.56	-1.2	-	+ 3.26	-	CL-	X		1.5
12. SFE BAR	+ 4.4	-	-1.8	- 0.0	+ 2.6	-	50%	X		1.3
13. FT100	- 8.1	-	-1.1	- 3.7	- 5.5	-	50%	X	SOB	1.0
14. IMM EURD	-	-	-1.6	- 8.8	-10.4	-	CL	X		1.3
15. CHF/USD	- 3.9	4.68	-0.9	-	- 0.12	-0	X	X		1.5
16. LIFFE 3MO	- 8.1	-	-1.1	+ 4.5	- 4.7	- 2	50%	X		1.5
17. NIKKEI	-19.9	-	-1.9	-43.3	-65.1	-31	CL-	X	CL-	1.5
18. TED SPREAD	-	-	-1.6	-100.3	-101.9	-117	50%	X	SOS	6.7

LOW VOL INDICES (LESS ATTENTION TO SOB/SOS)

1. LIFFE BUND	- 2.1	6.0	-3.9	+ 9.4	+ 9.4	+7				0.4
2. NZD/USD	+ 4.6	5.15	-2.2	-	+ 7.55	+ 5	X			0.4
3. DJIA	-	-	-1.6	+ 3.1	+ 1.5	+ 1				0.6
4. AUD/USD	+ 4.4	4.75	-1.8	-	+ 7.35	+3		X		0.6
5. CRB INDEX	-	-	-1.6	+ 8.4	+ 6.8	-		X		0.6
6. S&P 500	-	-	-1.6	+ 3.0	+ 1.4	-		X		0.6
7. JAPAN BOND	-19.9	6.0	-1.9	+15.9	+ 0.1	-	50%	X	SOB	0.4
8. CBOT TBOND	-	8.0	-2.7	- 5.3	+ 0.0	+0		X		0.6
9. LONG GILT	- 8.1	9.0	-1.8	+ 0.8	- 0.1	-0		X		0.6
10. GBP/USD	- 8.1	5.87	-1.1	-	- 3.33	- 2	CL-	X		0.8
11. JPY/USD	-19.9	2.50	-1.9	-	-19.30	- 9	X	X		0.5



# A STROLL THROUGH WORLD MARKETS

*This is the text of a talk given to the Sydney meeting in August 1993 by Russell Lander; Technical Analyst at Dicksons Securities Ltd, Fellow of Securities Institute of Australia, regular columnist (since 1967) and radio commentator. This report prepared by DW Hunt.*

*"An analyst's role is to find out how he or she can analyse the stock market or commodities without having any grounds to confuse." Russell Lander.*

I come before you tonight, really as a heretic I think, in the pure technical mould. I am not able to make a living purely on charts, unlike some other members of the gathering here tonight. I've always mixed fundamentals with charting on the basis that if you get the fundamentals right you should get the charting right and vice versa. In the last 12 months I've done 75 company interviews with senior management in my role as an analyst at Dicksons, but I've always kept a foot in the charting camp as well.

I'm a heretic on a number of grounds, actually. I've discarded Elliot Wave some years ago as being a hindrance to analysis and cannot use it. In fact the last Elliott discussion I had with a serious follower, and I've no doubt some people use it successfully, was on a table napkin at a restaurant. The conversation went something like this "Well, if this is a 3, then this follows, see. But if its not, then this follows. But on the other hand if its this, its that, you see". It was a kaleidoscope of lines that I've kept for years, because to me it typifies the difficulty in Elliott Analysis.

I've also discarded Patterns, basically, as a valid form of charting and I find support and resistance, as a concept, never works in practice: You can look at the lines and say "it should do this", but it never does. You might say "What's he got left?". Kondratieff Wave theory has gone long ago.

I look at basic trends and moving averages and that's my lot. I know that there are many other things you can look at. I've looked at many of them, not all of them. I think that Coppock Indicators have their moments and I think On Balance Volume has its moments. I'm left in the end with permutations around moving averages and trends, but I think some patterns are intriguing. I think long base patterns with a break out are intriguing and I think they are probably the most reliable patterns in the market. I don't think patterns tend to work out in the stock market, as they used to, because of the speed of transactions and the speed of the market.

So, what I thought I would do tonight is show you some of the trends that I think are relevant at the moment, in markets around the world. And then to throw it open to discussion on

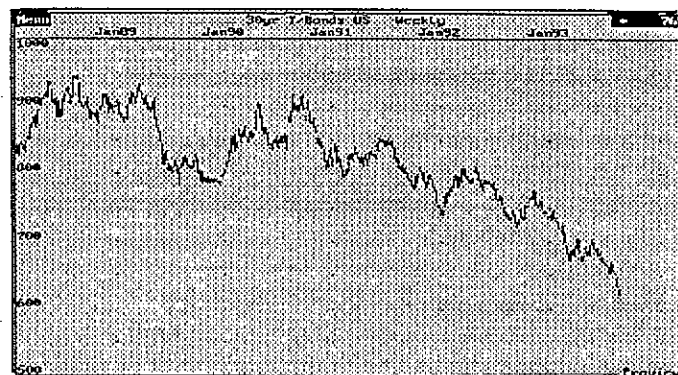
the basis that I've got all listed Australian stocks in my system here on monthly, weekly or daily charts mostly, but certainly weekly or daily. I can give Price range and Volume and a few indicators as well. So, rather than have a long talk, I can give a short run through the charts I see as interesting at the moment, and you can say what you think are interesting and we can throw them up on the screen and have a look at them.

Just as a matter of interest, I started my charting career sitting along side Ivor Jones. Ivor Jones used to work for Ord Minnett and he came aboard in 1964. He was South African. He'd been to New York and he'd picked up some Technical Analysis in New York. Nobody really knew much about it (charting) except for Dr Garretty. Dr Garretty, was running his Trendex in those days. It was regarded by most people at Ords in those days, hopefully not so today Cam (Gorrie), as being interesting but not applicable.

Ivor saw some very interesting patterns in 1964, which he thought were base patterns. He was going to project them upwards, which he did. But there was a serious drought in that year and all the patterns broke down. So it turned out it was a top and a number of people were retrenched in the subsequent slump and he was one of them. So he went back to South Africa and started up his own brokerage firm. He was the foundational thinker in Equinet. So there's Ivor Jones, all that way back, and you've got Equinet as a result of his being pushed back to South Africa in hard times. Interesting the way the worm turns. So the moral of the story is: You never fall out with people you are working with in case you end up working for them.

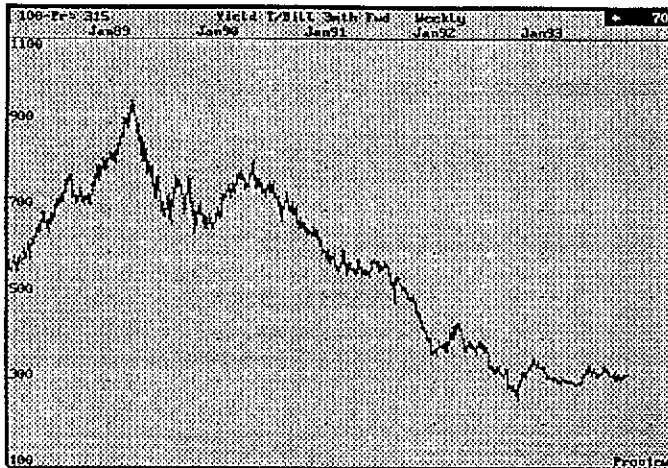
## INTEREST RATES: BULL'S ENGINE ROOM

I'd like to show some of the Interest Rate markets around the world. You've got 30 Year Bond rates at their lowest levels ever in the States, as far as I know, and you'll notice that it is still falling.



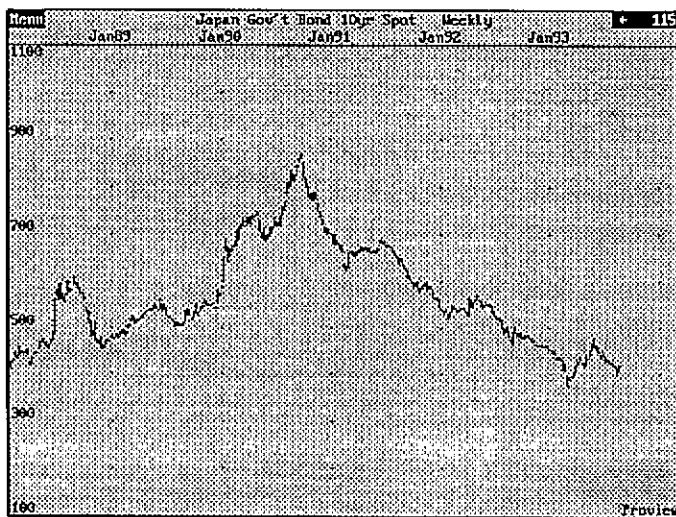
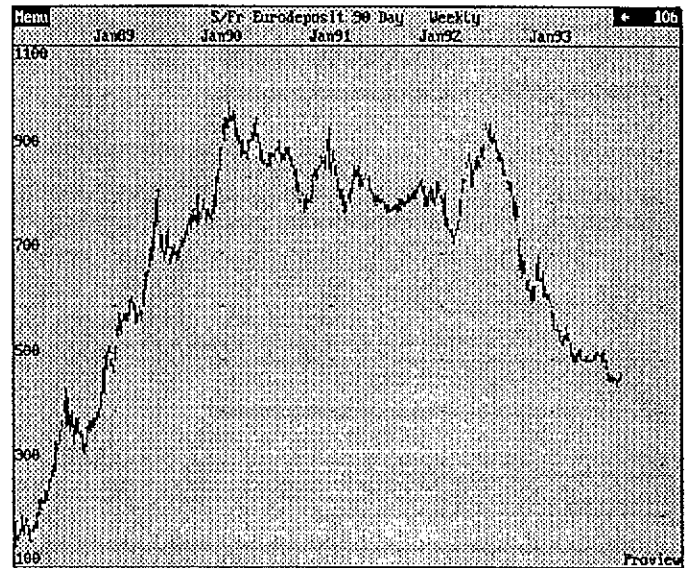
I've been confronted, in the stock broking world, for the last 18 months, by people who say interest rates can only go up now because they've fallen so far. But the trend is still down now right across the world, as far as I can see.

Look at T-Bills in the States, this is a weekly chart over five and a half years:



There is some indication that they have fallen as far as they will. When you see rates around 3.0%, then it is possible that they have bottomed, but that the slope of the yield curve will come down a bit.

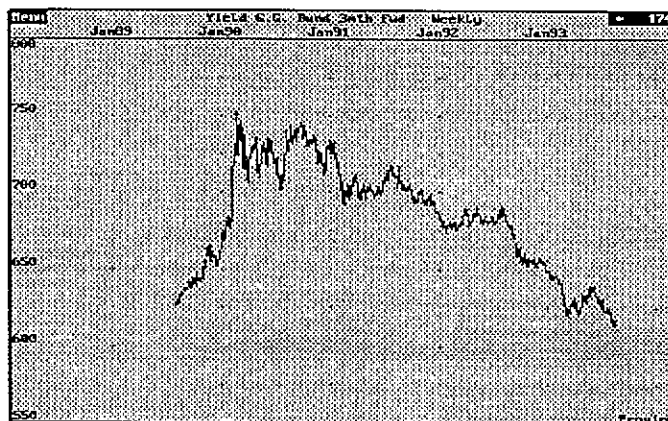
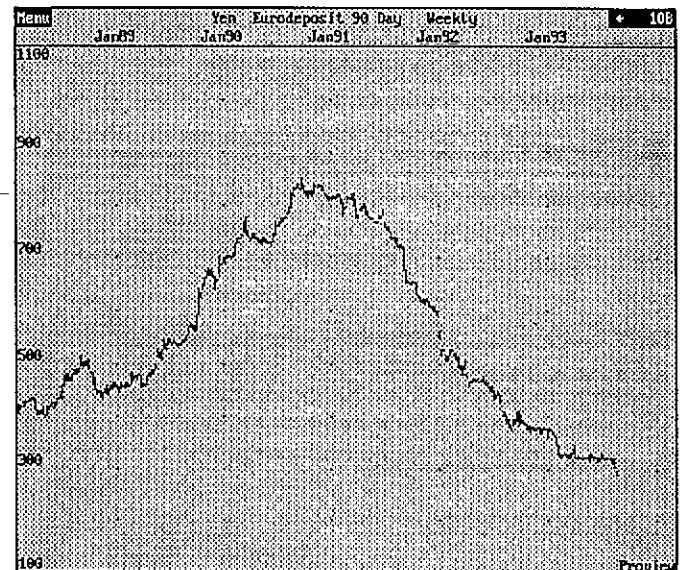
Then, we go to Germany. Germany is a late starter in the interest rate stakes, but rates are still coming off the boil there. You can see they are under 7% coming down to 6.5% now and they must come down.



So, then we look at Japan and we find that 10 year Bond Yields had a bit of a rally, but they are starting to fall again. The yield is just under 4%. They are going to come down a little bit further yet.

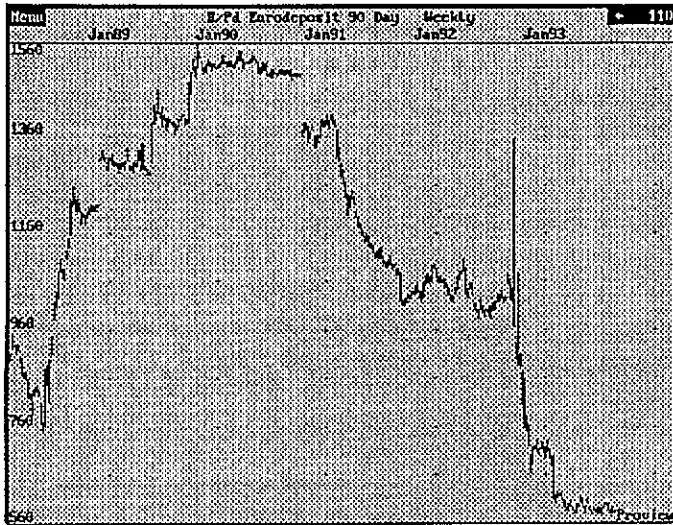
We come now to Swiss Eurodollar Rates. The falling trend is still well established there.

The Euro-Dollar yen rates looked as though they'd bottomed, but they are now again falling and look as though they might come under 3%.

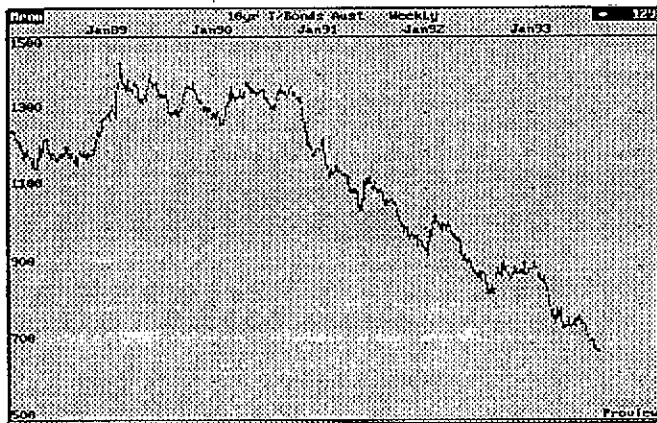


The last of this particular bracket is the Sterling Euro Deposit rates. It looks like a consolidation pattern. I think they are going to come off further. Currently, they are yielding about 5.8%.

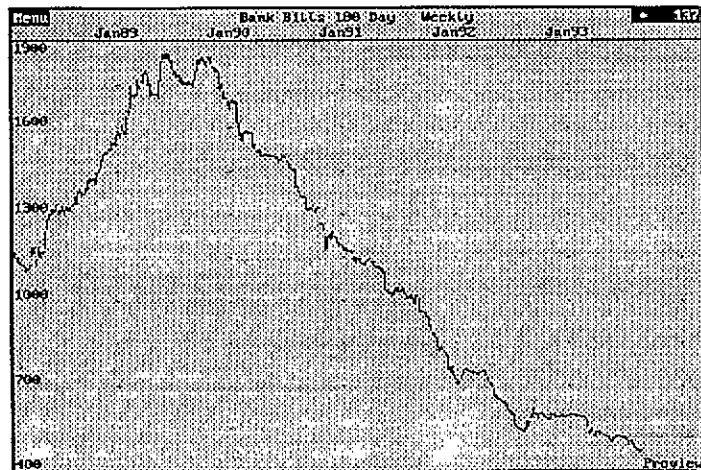




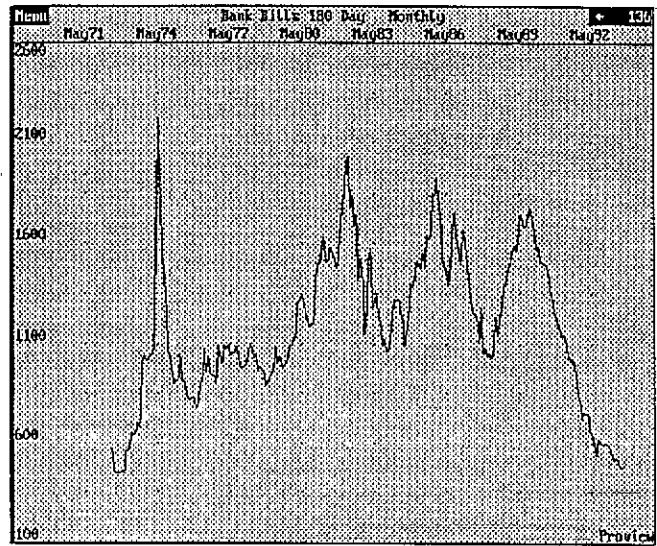
What about in Australia? 10 Year Bond yields in Australia were 5.4% when I joined the industry and I remember getting a Housing Loan at 3.875%, and I'm not that old. I think we are going back to that. I think we could see long term bond yields in the mid 5%.



In 180 day bank bill yields, you may have said they had bottomed a few months back. In fact, they are still falling and we are going down towards 4.5%.

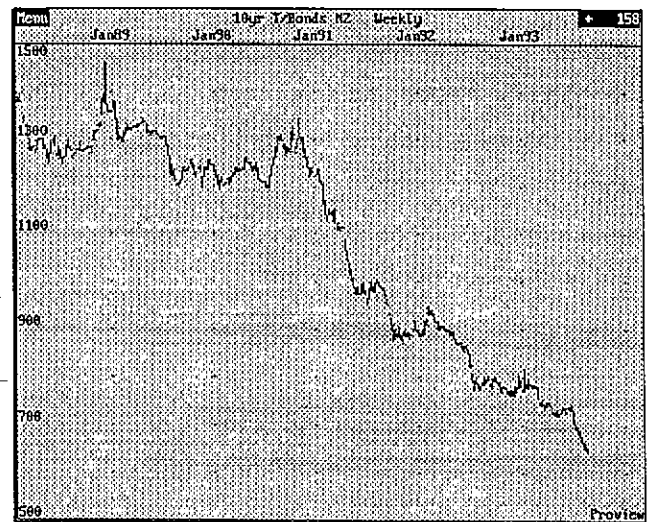


(When asked about the possibility of a double bottom at 4.7% with the low in the early 1970's Russell replied "Do you think people have memories that long?")



The first thing I'm pointing out is that interest rates are falling around the world and the trend is intact.

I might show you one other market which is worth showing : New Zealand 10 Year Bond Yields.



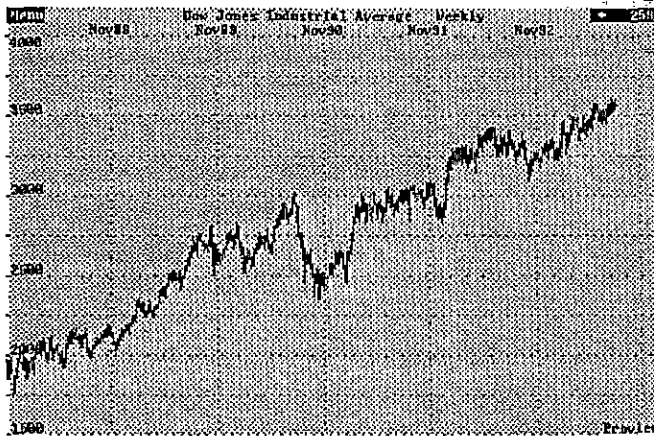
You might laugh at things New Zealand, but actually they have been leading us down the hill. They have been leading Australia in some ways for the last 18 months. Rates there are approaching 6.5% at the moment.

### STOCKMARKET INDICES

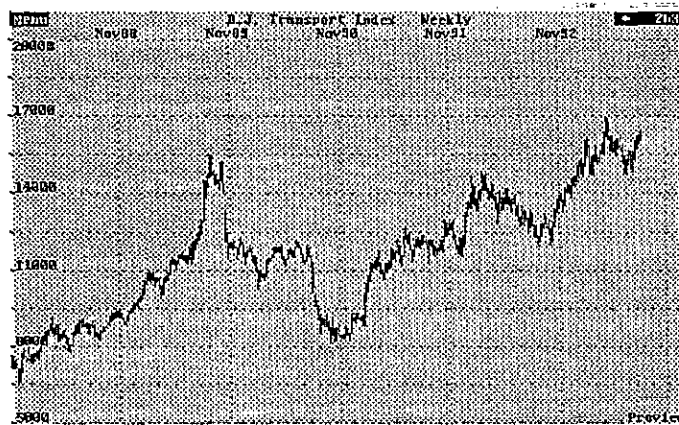
I think we might leave interest rates there and move the focus



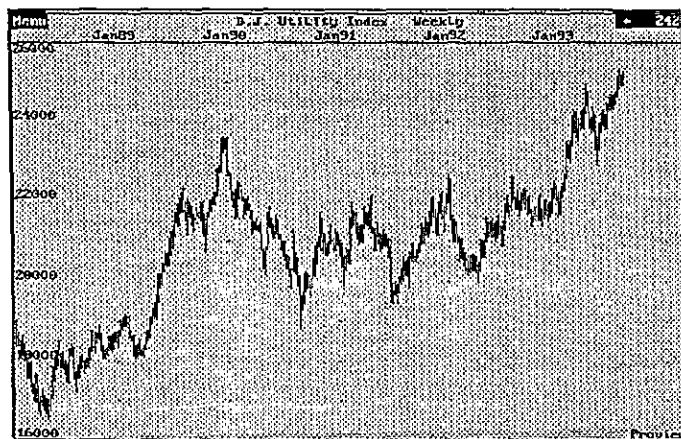
to stock market indices, because they are the other side of the interest rate story. First, the Dow Jones Industrial Average, which we shall put into a log scale:



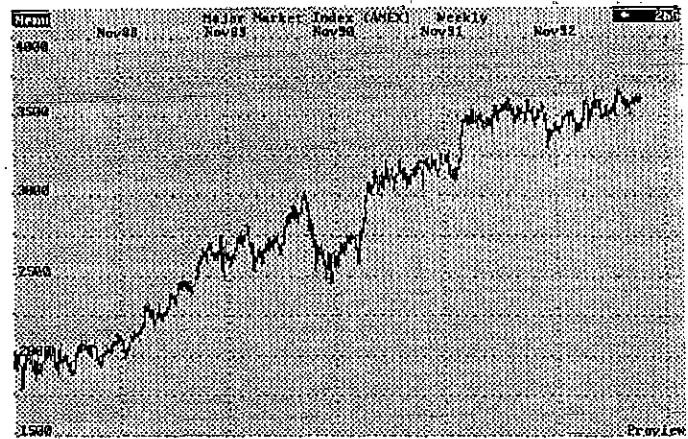
Over the last 2 years or so, what I hear, from Technical Analysts, is that the Dow has topped and it is wedging out. I don't believe it. I have always thought it was in an uptrend. It is not guilty yet, it is going on.



The Transport index is in a similar mode, having had a slightly different pattern in the period running up to the end of 1989.



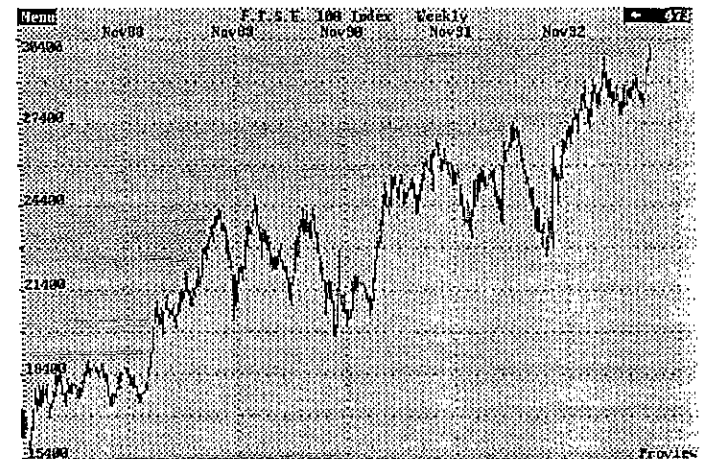
The Utilities Average is responding very well to interest rate trends.



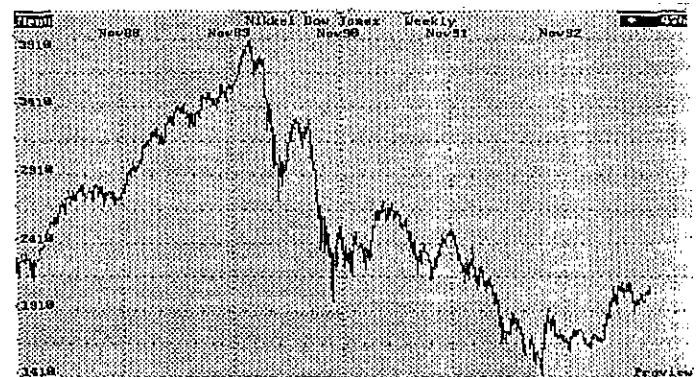
The Major Market Index (which I think is made up of about 15 leading American stocks) looks a little bit like the Dow.

The Dow Jones has really stalled, if you relate it to the performance of some of the other markets, as you well know.

The UK market has taken on a new lease of life. It had a bit of a correction, but it is on its way again. So, you're looking at all time highs in the FT-100:



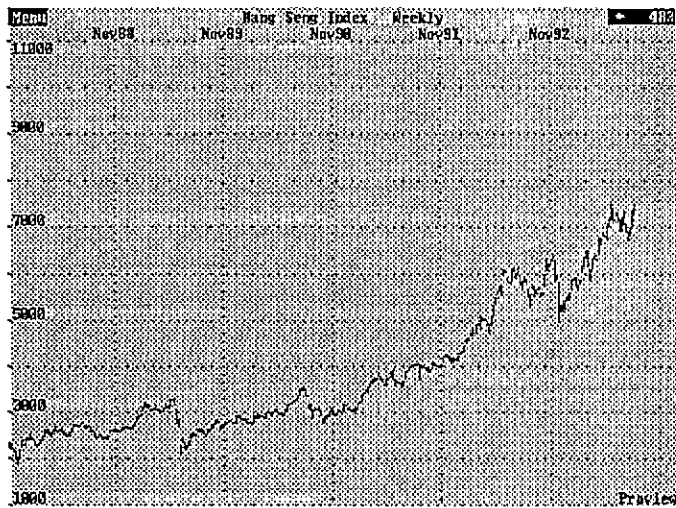
The one that has yet to prove its mettle is Tokyo:



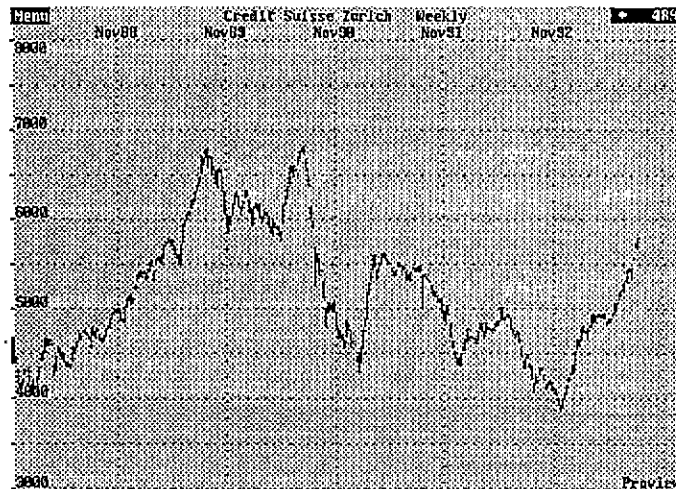


I know some analysts are saying that we've seen a rally in a bear market. In fact, I've got a friend who's saying the Nikkei is going down to virtually nothing. I'd be more inclined to say it has broken its downtrend, as a trend watcher, and it is now following other markets in an upward move. I don't know how far up its going to move, but I have to say it has come out of downtrend. If it goes above its recent high it must be very difficult to argue that it is simply a correction in a bear market. That theory becomes uncomfortable the further time goes on.

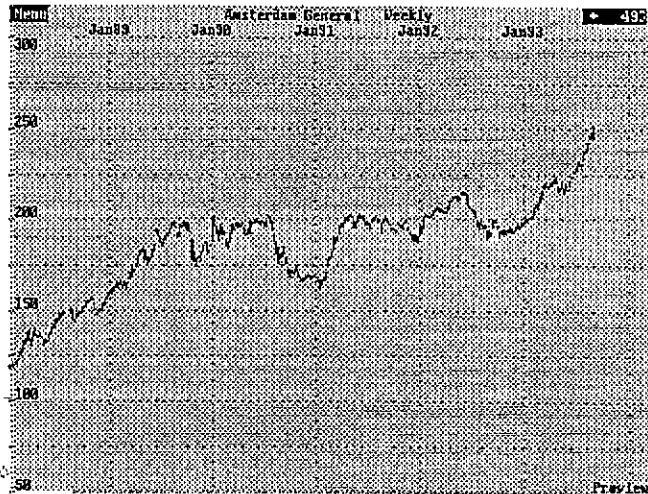
I want to show you how many major markets, not necessarily in geographic order, are in primary or secular uptrends at the moment. This is the Hang Seng very close to reaching all time highs:



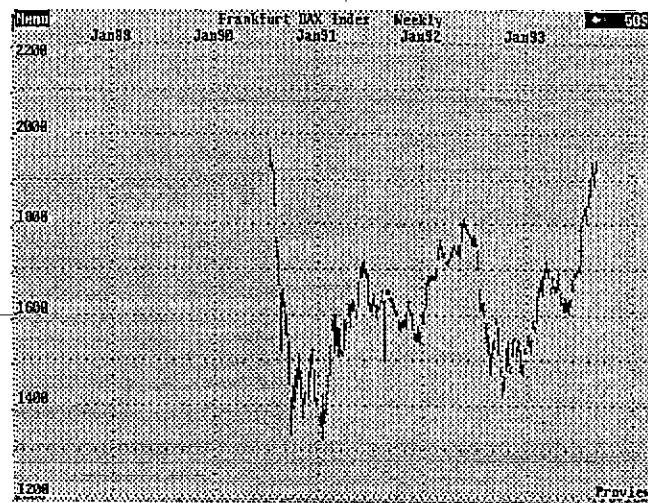
European markets have been under performing for the last two years. They are now coming out of down trends. The Swiss market is a late starter:



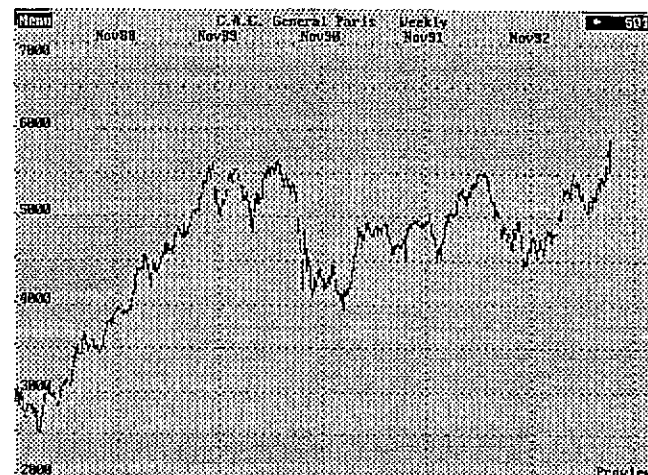
The Netherlands, for example, is at all time highs:



The German market has picked up quite well:

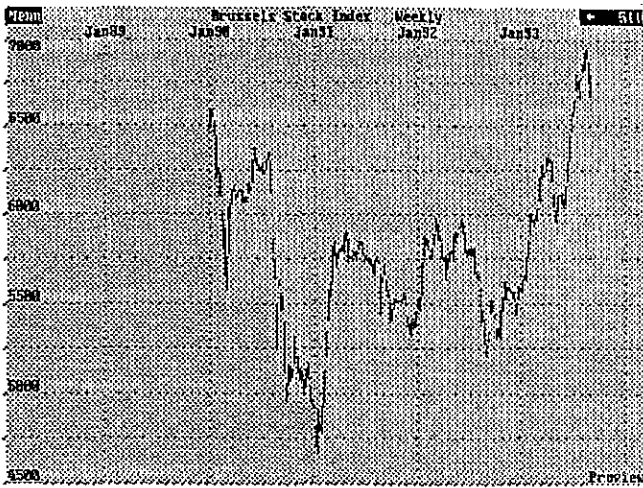


It would not take much to blow the DAX into new high territory. The French market has had a good rise. I think it is actually at an all time high:



Belgium is probably not regarded as a major market, but it is worth looking at. It is at an all time high:

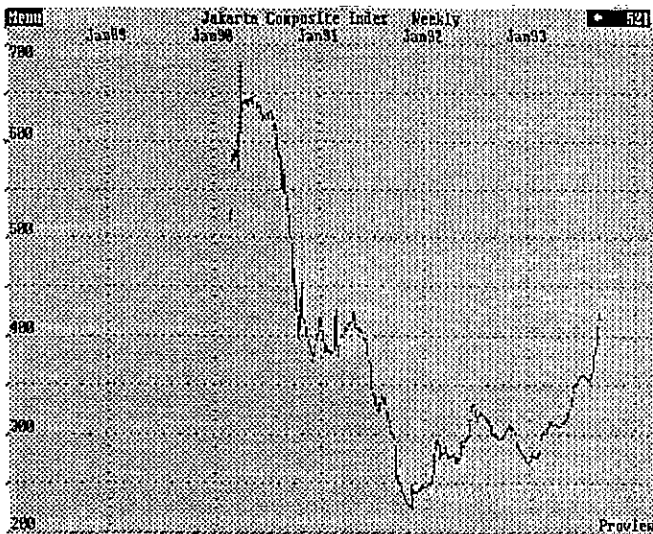




The Italian market is labouring but it is out of its downtrend.

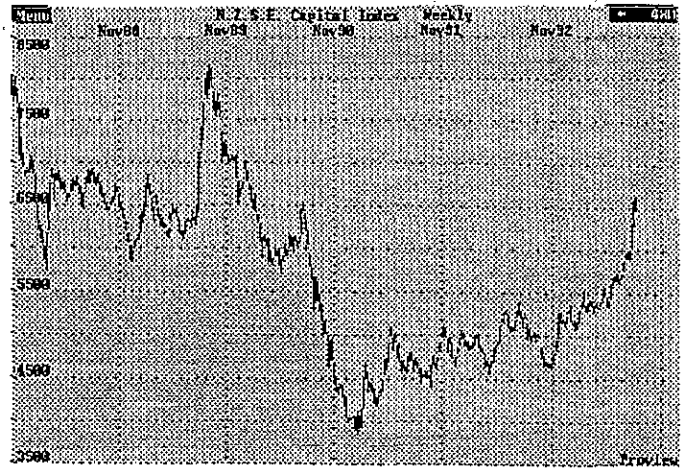
If we look at Canada you've got a market that is very close to its best levels since the crash. The Toronto market is very close to its all time high.

Nearer to home you've got a raging bull market in Singapore. It seems that all the markets around China are really getting a head of steam up at the moment. The Malaysian market is in a clear bull trend at the moment.



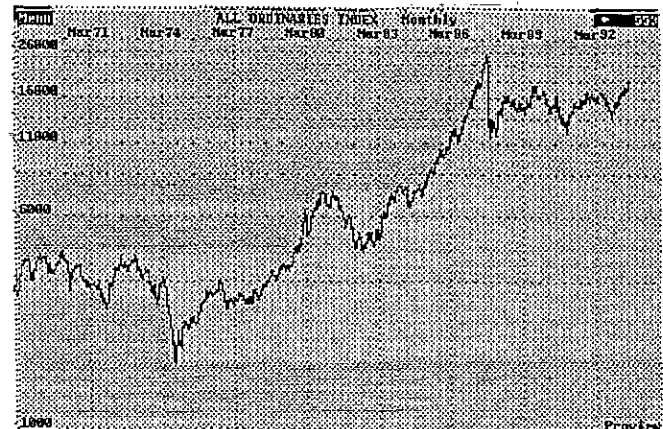
That's the Indonesian market, which has been a terrible graveyard for British capital. I remember going to England about 3 years ago. All the institutions had gone into Indonesian stocks and the market immediately halved. It is just coming out of it now. If we go to the Philippines, you've got a market at all time highs.

Then we talk about New Zealand. New Zealand was, of course, the market which led the world down before the crash by about 6 months.

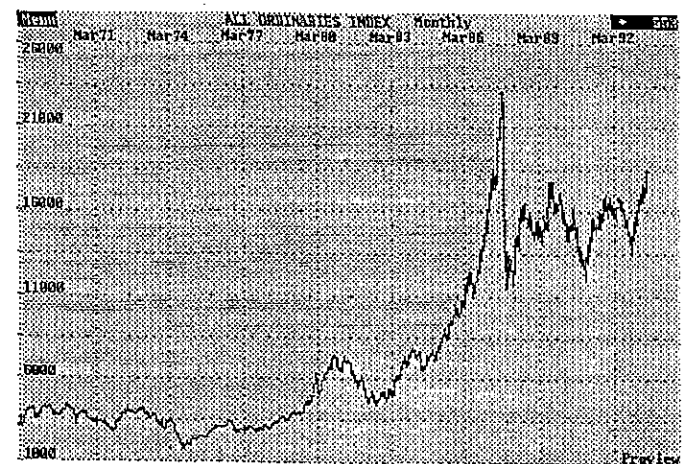


New Zealand is outperforming the Australian market at the moment.

We come to our own market: the All Ordinaries. If you look at the long term chart going back 25 years in log scale, we are coming out of the longest base pattern we've ever had since Captain Cook trod these shores:

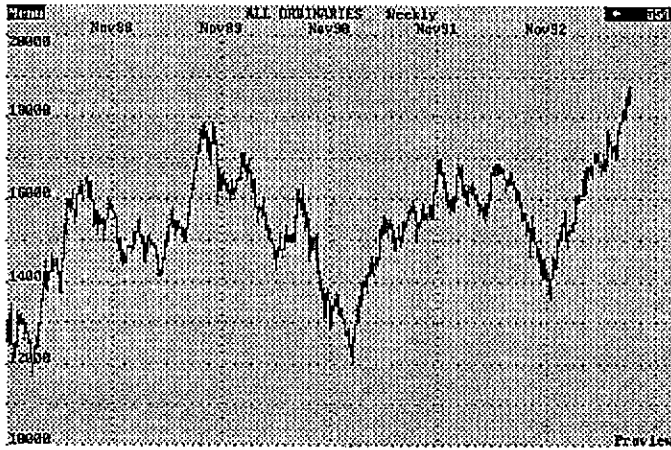


I think it is a very bullish situation we are looking at in Australia. On fundamentals, I take the point that a lot of stocks are on very high Price Earnings ratios, certainly on prospective earnings.

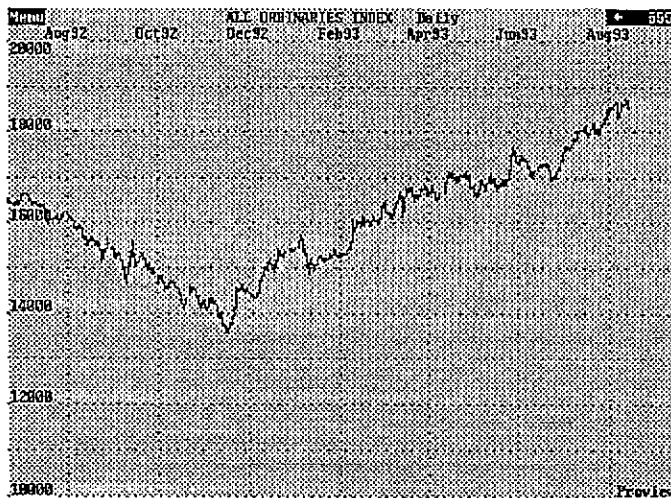




If you go back to the period 1982/3, it is amazing how low share prices were then in relation to subsequent years. I think the fundamentals are going to improve dramatically in Australia in the next 2 to 3 years. And P/Es, which appear high now, are going to appear low.



The beautiful thing about the Proview system, at the moment, is that the crash has fallen off the weekly chart. The Crash of '87 is no longer with us and we can get on with serious investing.



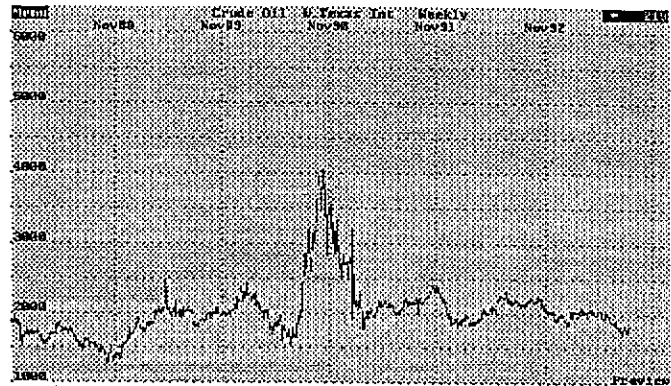
That's the All Ords on a daily basis, it went up 14 points today. Just looking at some of the sectors there, though it is not worth looking at many sectors of the All Ords, because they are dominated by a single stock. The Bank Index is a very good example of what's happening. The Bank Index is in fact very close to an all time high, because a number of the bank stocks themselves are in that position. For example, National Australia Bank, Advance Bank, Bank of Melbourne and Metway Bank.

The one that, of course, is the odd man out at the moment is the gold sector, which is undergoing a correction and nobody seems to now what to do. A young fellow in my office today said "I have a client who doesn't know whether he wants to sell his gold shares here or not". He asked me what I thought. I don't know what you would have said, but I told him why don't you tell him to sell half and then you are not wholly wrong. I couldn't think of anything

else to say to him. What would you have said Merrill? Merrill Armstrong replied "Yes, exactly the same thing." Sell half, we need the brokerage. Laughter.

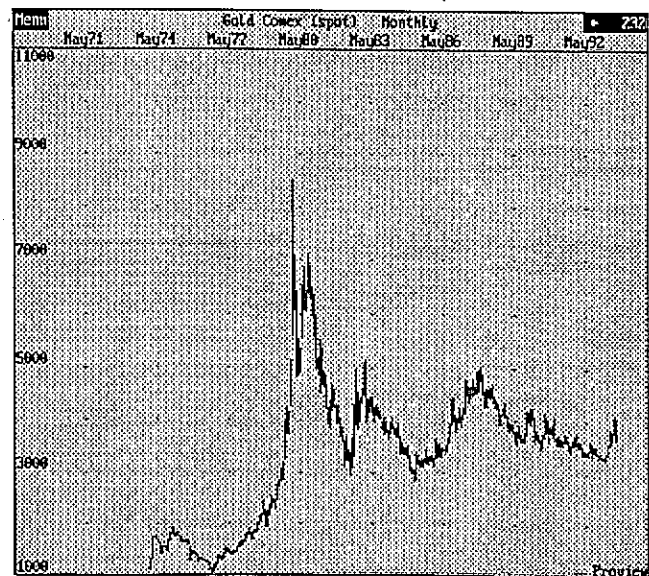
## COMMODITIES

Then, just to round this out, and look at what's going on in the world, I've got a few commodity charts.



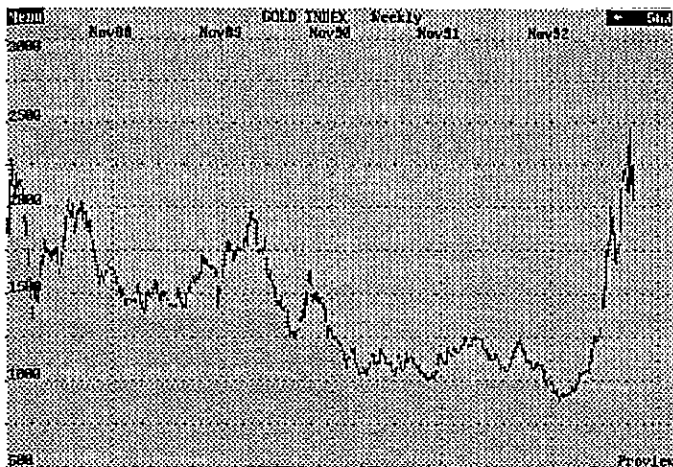
The first one is Crude Oil which is a classic example of support levels which don't work when you need them. The Arabs have gone to sleep on the job and the price is going to fall. I suppose all you could say on the charts is that there may be a minor rally in the making there. Oil is historically low. It's probably going to have a rally for reasons we don't understand and probably never will.

## Gold Gold Gold

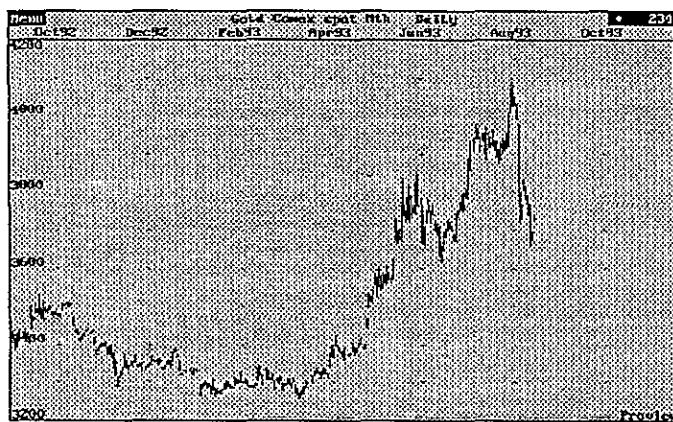


My view on gold is that this spike that we've got at the moment, is the first shot in the dark that Gold is going to turn. This is the first sign of it. We may go back to \$360 or less, but it is going to come again. That's my theory, I suppose I've got an eye on South Africa, what is happening there. I'm tainted by fundamentals. I think that gold will benefit from improving fundamentals around the world for gold jewellery.



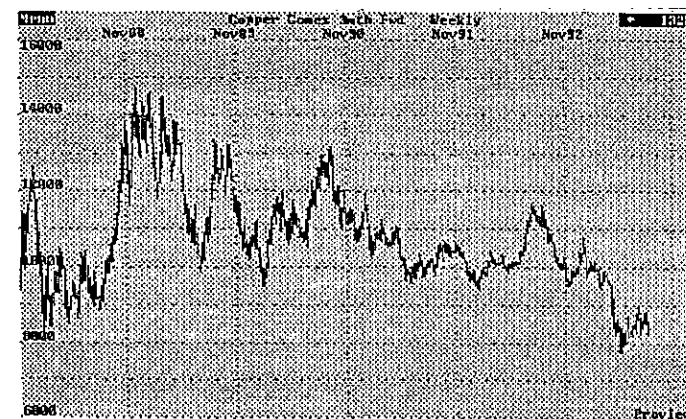


There must be pent up demand for gold jewellery. So I think gold has had its first rally in a longer term move. Now the daily chart smacks of overselling with a gap forming there.



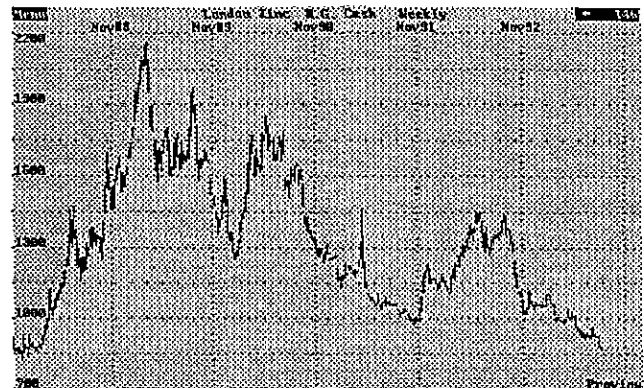
I think the gap on the way up is closed and I'd be happy to settle with that as a full correction of what we've had, but it may take a few weeks to sort out.

So, I'm actually a silent bull on gold, silver and platinum. I'm not very bullish yet on the other metals, because I can't see any real light, but I'd really like to. Copper is just completing a minor rally, an intermediate rally, whatever you like.

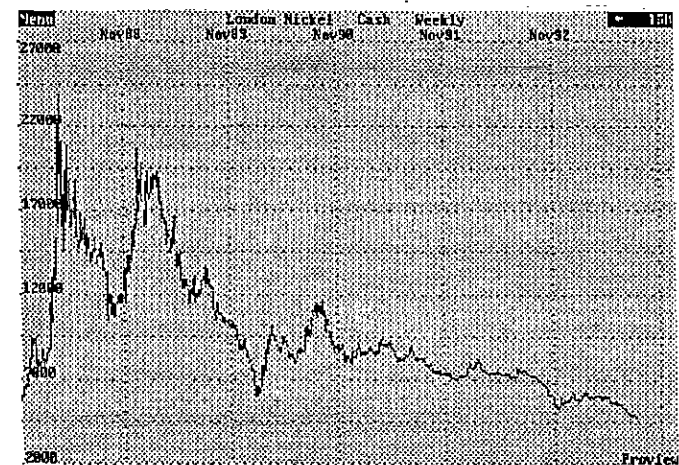


And it seems to me it is still open ended in depth, as they say in

the mining industry. If you look at the other major metals, they are suffering from the end of the cold war. So much metal is not going to be used any more for hostile purposes. They are going to be recycling all the old weapons. So lead is still in trouble. Zinc, I would say, is in deep trouble.



I can remember many mining companies coming round and saying "Zinc is the metal of the future, Zinc is it. That is where we are steering ourselves". MIM has been guilty of saying that in recent years. "Cars are going to be smothered in zinc to stop them rusting out. There is going to be seven year guarantees". All of this stuff and the market says "we don't like it very much and its going down because of the end of the Cold War."

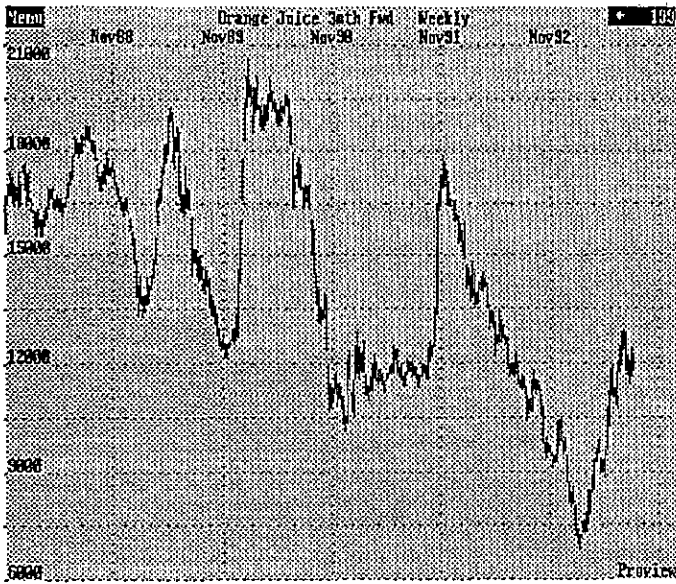


Now we look at Nickel. Same problem, a very nasty looking chart. If we put it into log scale it makes it look even worse. If anybody's feeling strange with vertigo we can invert the chart.

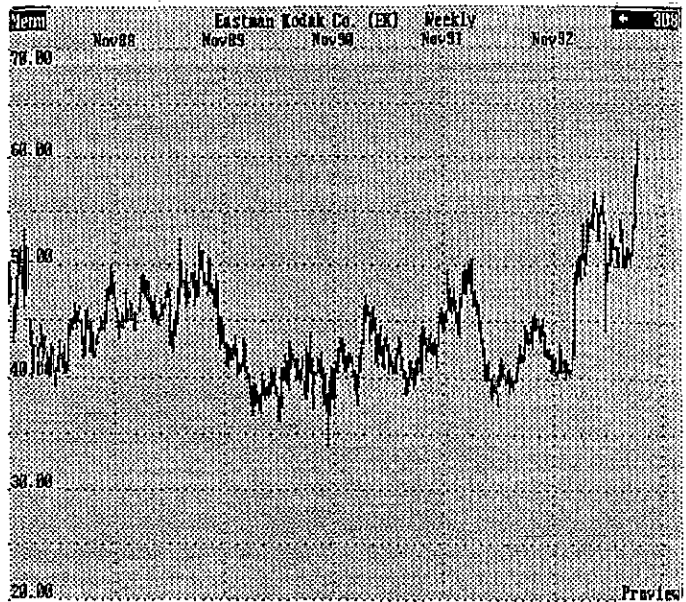
If you put Zinc into a daily chart, it is a well of tears.

If you look at Aluminium, it is a little bit better, but not that much better. Aluminium is, at best, forming a base and maybe has still got some down side. If you really want to get encouraged about metal prices have a look at the tin price. There it goes heading South at a great rate. So, there is not much joy in the metals. If you want excitement I'd recommend you go into Orange Juice. It is not for the faint hearted.

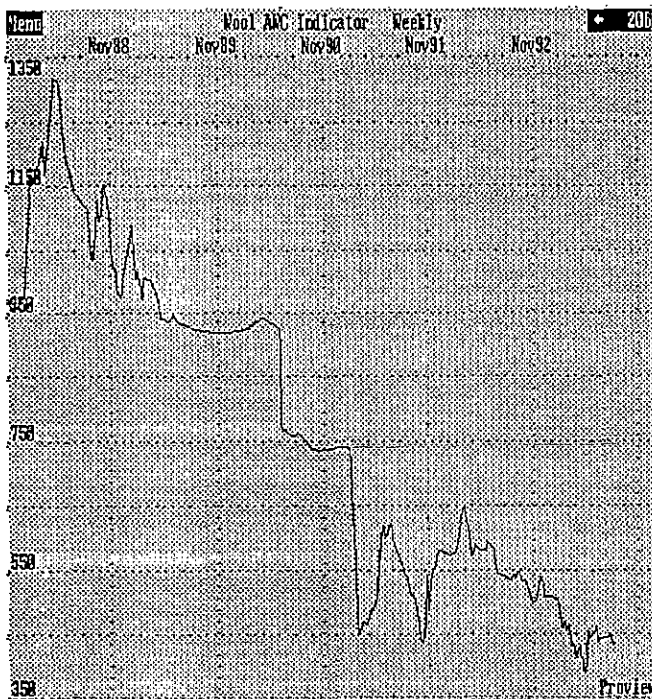




Another one that took my eye was Cotton. I suppose you could say it is forming a base, although it doesn't look very encouraging on a daily chart at the moment.



Eastman Kodak, an American stock, which I thought looked pretty good. I haven't got a monthly chart of it. There seems to be a nice base. It does not look too bad on a Point & Figure Chart.



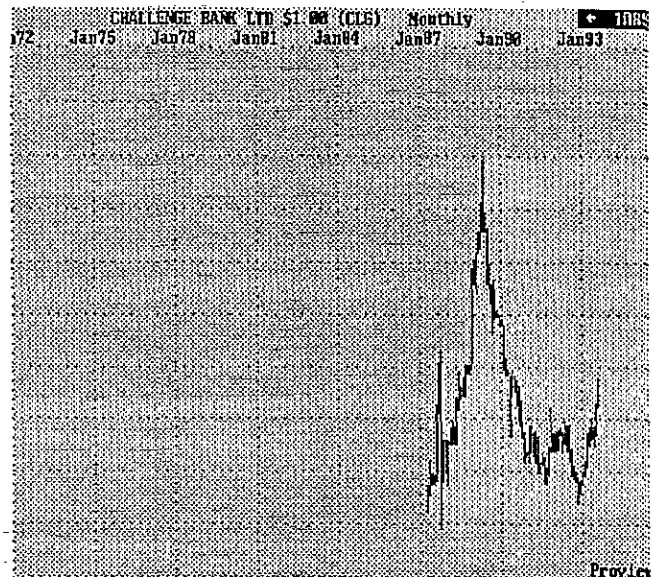
And of course Wool. Everybody wants to know about wool, because you've probably all got properties. Wool prices are still on the way down and the bottom has not yet been seen.

### INDIVIDUAL STOCKS

I thought I'd now show to you a few individual stocks which appear, to me, to be forming good bases.

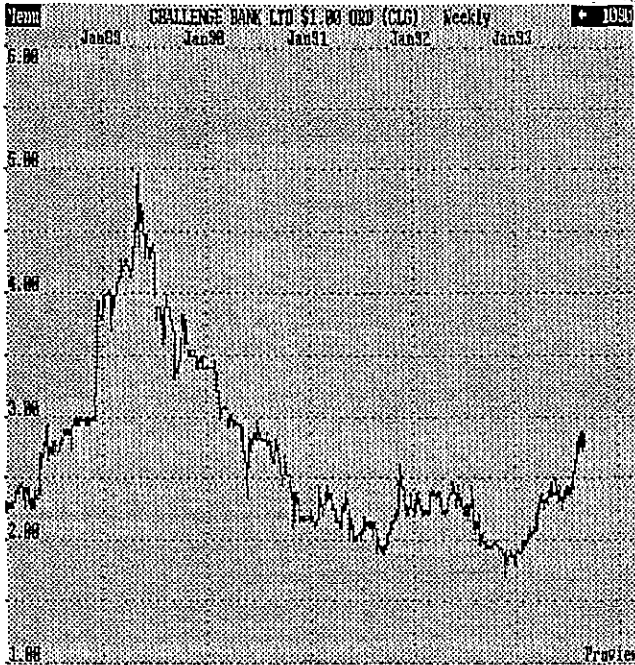
There are so many stocks that are now going up in a near vertical fashion, that it is very hard to say much about them on a chart, except to say that it is still in trend. It is much more comfortable to be able to say: "Here is a stock that is breaking out. It has got a lot of good base work in it and it has got some upside potential". United Technologies is another one which looks good in the States at the moment.

In Australia, I think the best looking chart is this fellow - Challenge Bank:

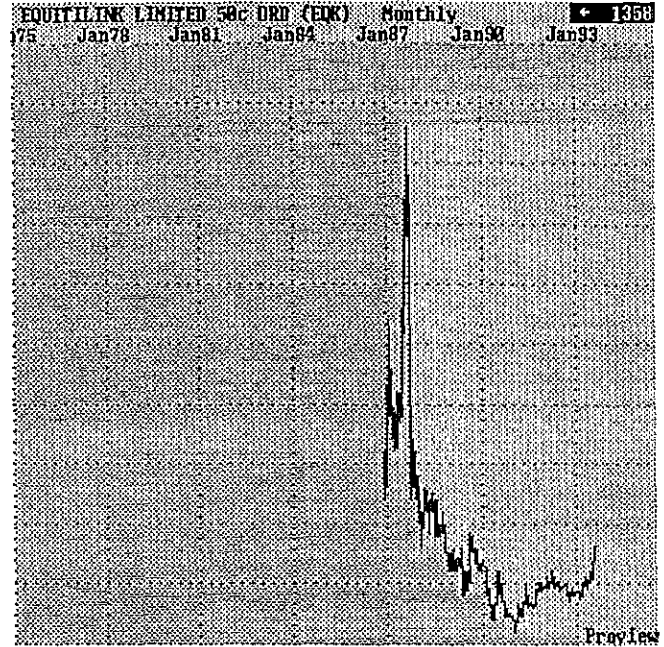


That's a monthly chart.

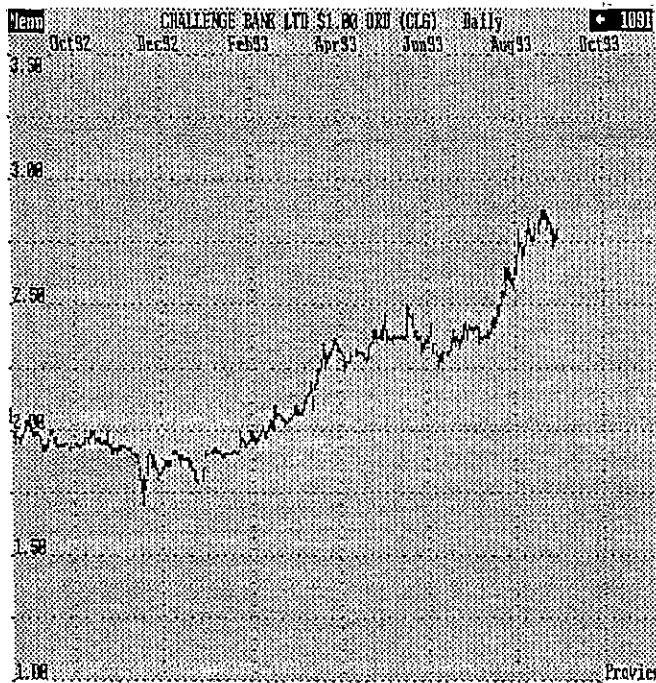




That's a Weekly.

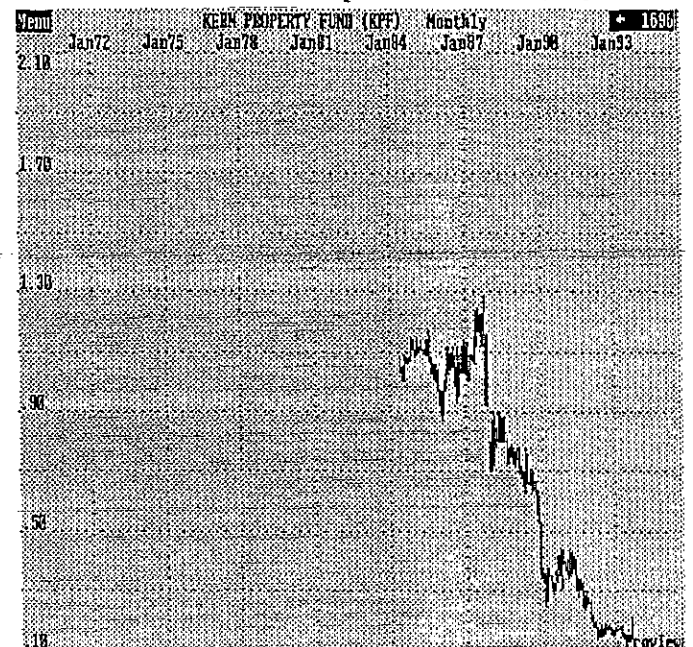


It is a very good turn around situation and a clear trend reversal. If you put the monthly chart into a Point & Figure I suppose it is quite a nice little base.



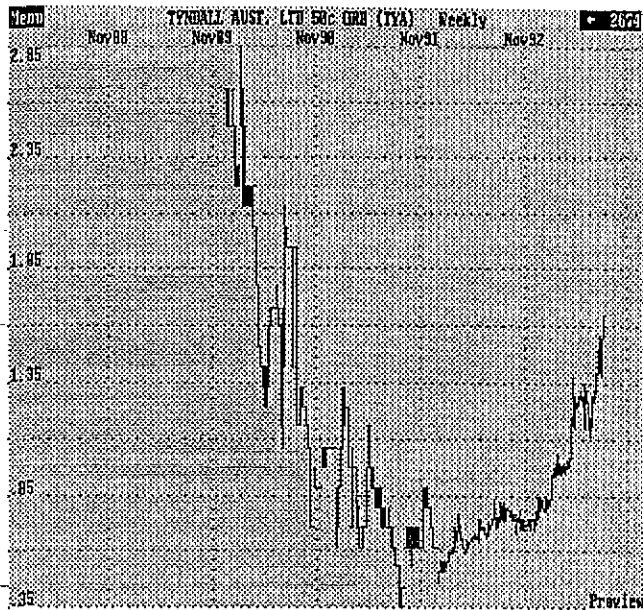
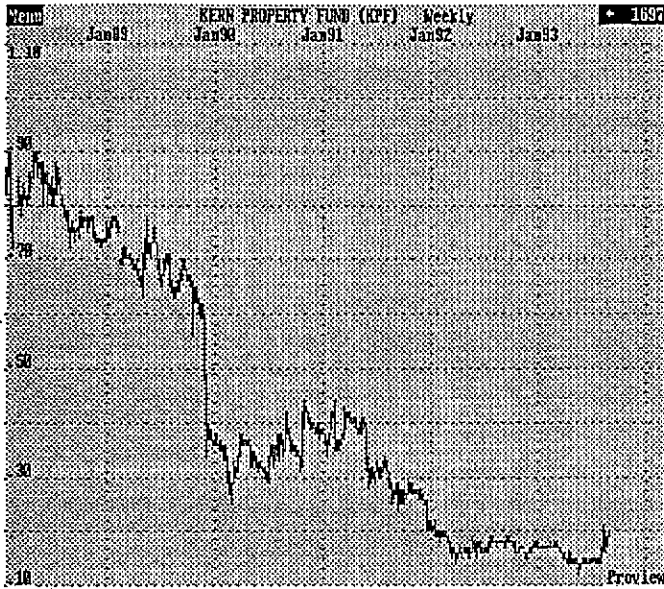
And that's a daily. The daily chart is fairly typical of the banks. I think Challenge is a really very good chart.

I think Equitilink shapes up as a good chart. I have to confess to having bought some for myself.



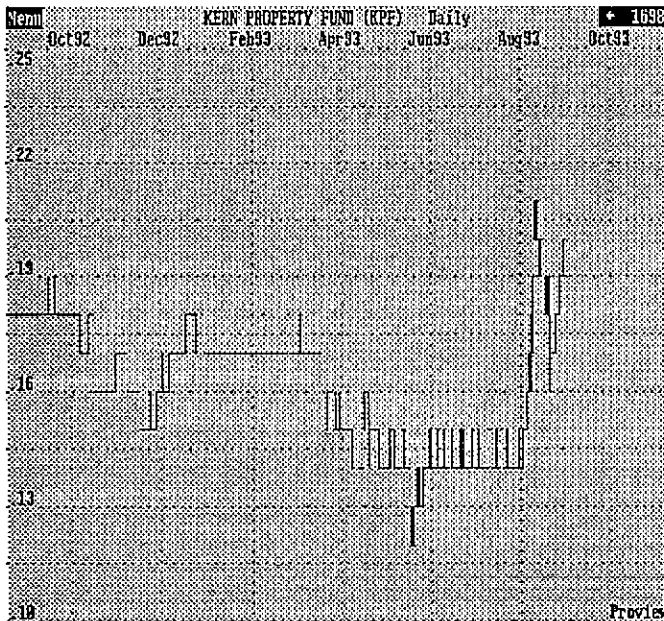
Kern Property Fund, a turn around, for those that don't like high priced shares.





Tyndall Australia, which some will remember from the boom as Clayton Robard. You probably want to forget about it as Clayton Robard, but it is certainly in a turn around situation.

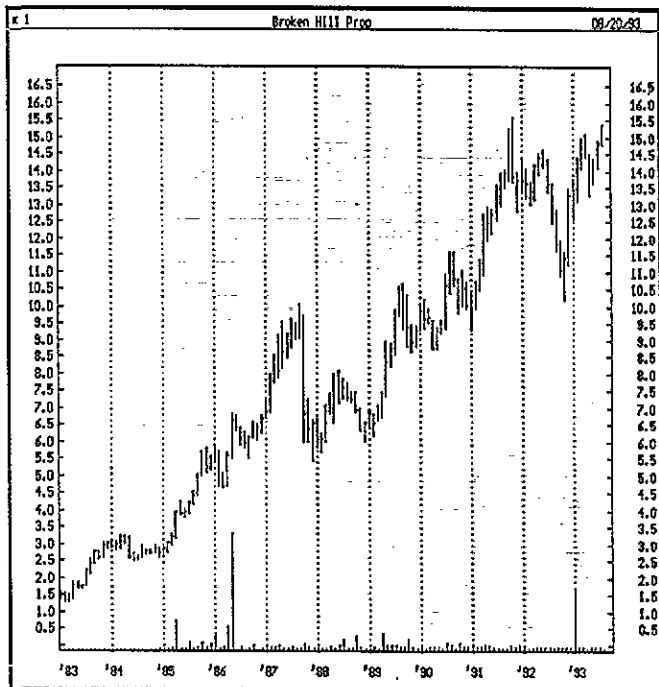
I don't want to give you the impression there aren't some terrible things happening in the market. There are a few stocks on the skids at the moment, like Vox and Brash's. I don't want to give you the impression it is all beer and skittles. CSR was down 30 cents today, so they've had another leg down and, if you were a pattern follower, you'd have them on about \$3.75 on first stop.



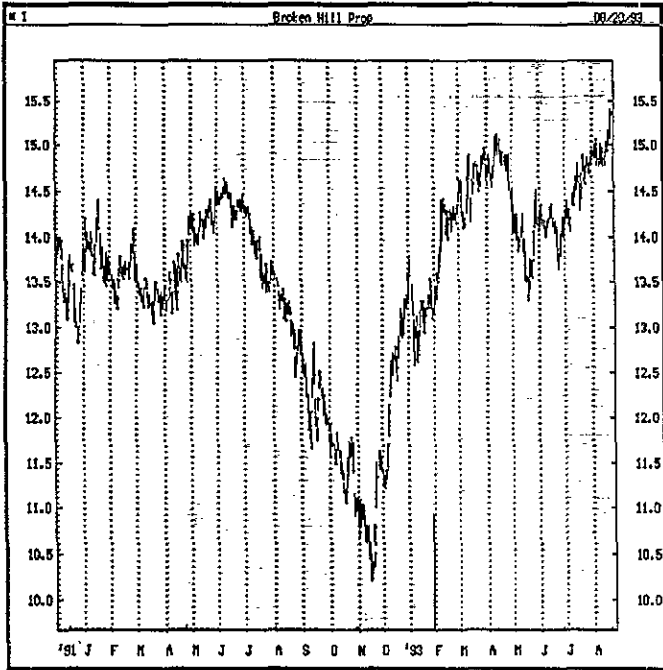
You can see it is starting to move on a daily chart.

Trustee companies have had a terrible press in recent years. Perpetual didn't escape the wrath of the market, but if you look at the weekly chart on Perpetual, it seems like a good turn around from a long base.

There is a little company in Perth called Australian Medical Technologies. Which I thought was a good chart: a long sweeping base and its tending to break topside at the moment.



BHP is in a long term uptrend. BHP shows you the virtue of not buying and selling, just getting on with it and holding quality stocks. I'm telling this against the broking industry, we badly need brokerage. It pays you probably not to sell some stocks. BHP's long term chart shows a secular uptrend. It has under performed the market in recent times. So, if you weigh it up against the All Ordinaries, you find it has lost its momentum since the end of 1991. It has really lost its way. This ties in with what we know. That second and third line stocks have made the running in the last year and a half or so: the rats and mice.



If you look at BHP on a daily chart, it has got nothing much to be ashamed of, and it looks as though it might break out into new high ground in the next few months.

1982 was when to buy BHP - not one broker recommended it.. The NRMA used to put out a questionnaire to 6 broking firms, on what they should do with their portfolio. And if all the brokers agreed they'd go and do it. They are good performers these days because they've realised they should be doing the opposite. The stocks tend to go ex-broker circular, they tend to fall after circular. There is a book on it "Where are the Customer's Yachts?"

Advance Bank just keeps on getting better and better. I admit it looks very heady. What goes up must come down and all those sort of things, but at the moment these stocks are trending very strongly. I believe Advance Bank is underpinned by its prospective dividend yield in the range of 5% to 6%, which is going to look pretty good in the current interest rate regime. So, I think banks, although they are historically high in price, are not going to come down in a screaming heap. You don't want to be in banks that do the taking over, you need to be on the receiving end.

### COMMENTS ON STOCKS

Russell then threw the discussion open and talked on stocks requested by the audience. The following is a summary of the exchange.

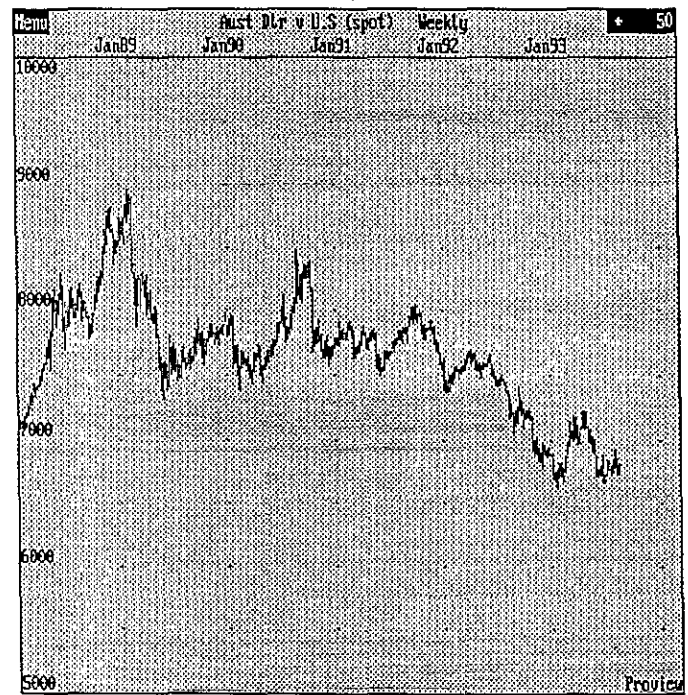
All the insurance stocks are looking good at the moment and FAI probably looks the most interesting. Here is another stock that just fell off the deck at just the right time. It starts to look a bit like the price of gold, I'm not saying there's any other similarities there. Its broken the long term down trend and is now moving ahead and I guess there is some more value in it. I am not a holder of the stock.

Pioneer International is a great stock for people who don't like excitement in their lives and there are people like that. It may break out from that pattern, but my betting is it won't - it is a boring stock. Foster's is the same - there is no head on Foster's. If you overlay Lion Nathan it is the same. Power Brewing is a mystery - Ron Brierly is fairly astute but I don't know why he would buy it.

Orbital on a weekly chart: You could say it is in reverse gear. On a daily chart it is just showing the first sign of breaking that intermediate trend from February.

On Keycorp, I'd say its reached its target and I'd say sell half. Laughter.

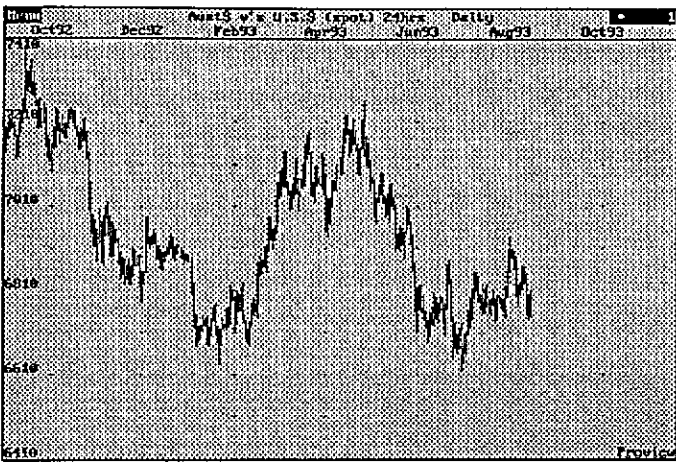
ANZ is a heavy chart and its turned over. SELL HALF: Laughter.



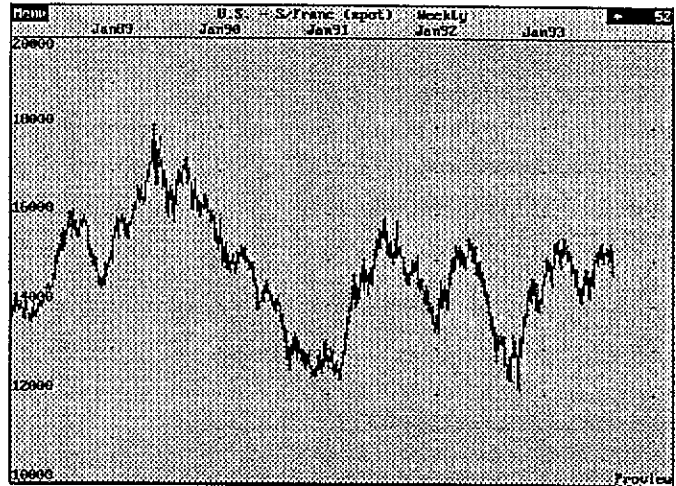
The Aussie Dollar is really battling at the moment. Perhaps still in a long term downtrend and on the daily chart it is not that much better.



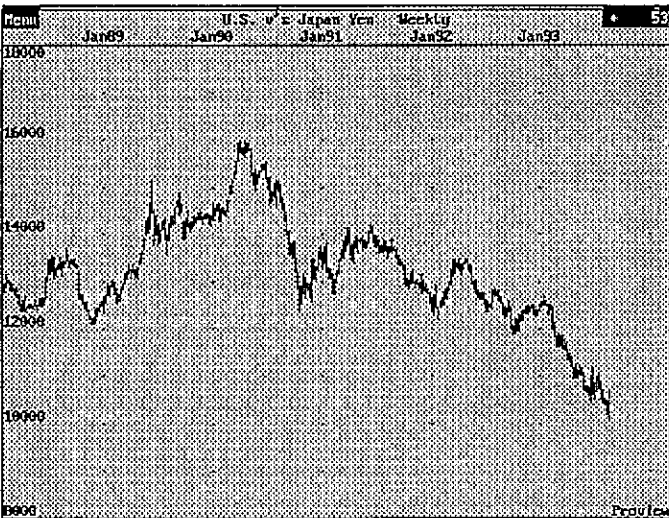
The weak currencies at the moment are the Swiss Franc and the British Pound.



I've always thought it was a waste of time chasing currencies overseas. I've actually tried trading currencies, its really very nerve racking. It keeps you up at night and affects your digestion. I'm really not made for it. You've got the all time high in the Yen against the US Dollar.

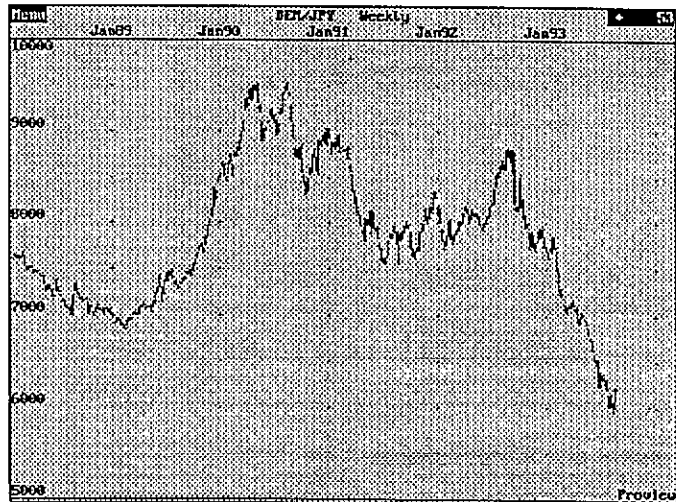


So, don't give up on that holiday at the end of the year. British Musuem and all that stuff.



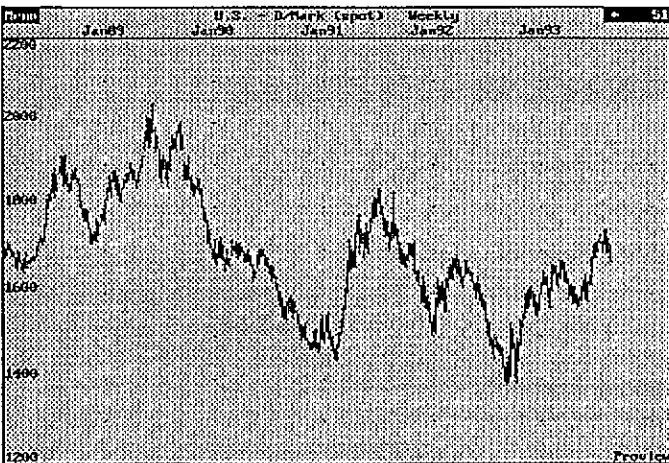
The US Dollar is gaining a little at the moment against the German Mark.

The DEM against the Japanese Yen (DEM/JPY) is in a pretty definite down trend.



In fact it is the best down trend I have ever seen, you could almost say it was contrived.

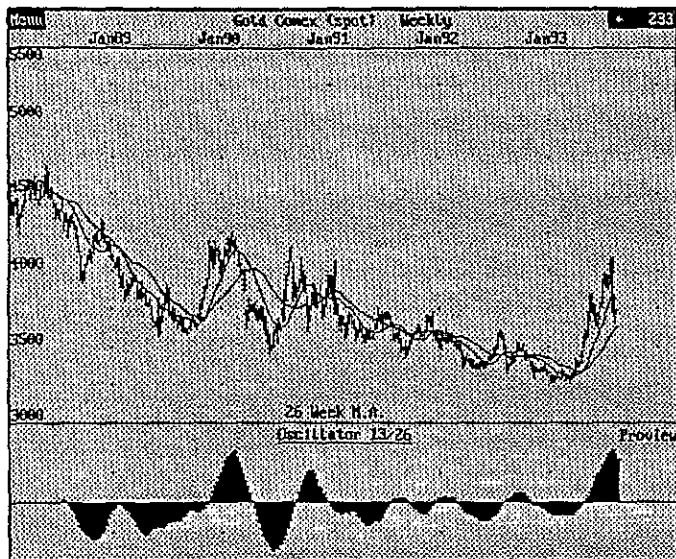
The French Franc against the US Dollar is weak.



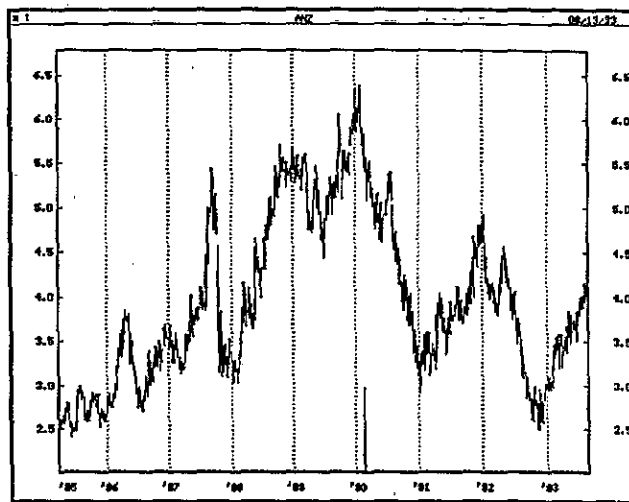
### MOVING AVERAGES

I look at simple things such as 13 week and 26 week moving averages on weekly charts and use the trade off between them. Most people usually look for non-conformities. Look at gold, everyone of the downward dips. I think everyone of those downward dips has been at a higher plane than the preceding one, except for the one that is a misfit. That really says to me that the downward momentum in the commodity is slackening.





ANZ vs Westpac: ANZ is now leading the charge.



This non-conformity is the primary reason to look at it for a trade. I know some people trade on trends in the Oscillator rather than the underlying stock, but I am working for a broking firm that is really very conservative and I have to try to make a living. I've got to talk to a level that is acceptable in their eyes. Most people are interested in charts now at Dicksons, but they are not interested in going to the next generation or systems. So you keep it fairly simple. On daily charts I think something arbitrary like 8 or 9 days and 30 days. Quite a wide spacing. It is a matter of personal preference.

I like Moving Averages that tell a story. Look at a stock like AGL: Some years ago AGL had a very bad name because they went into property development and Oil exploration and things got very murky. It took a lot of persuading to tell someone that the tide had turned. If you looked at a moving average you'd see it coming out.

Comalco has been an extremely boring stock. Even the management are not very bullish on the outlook for the metal price so the only thing going for it at the moment is some cost cutting and a weak Australian Dollar. It is really on its five year average.

Santos is in a revival phase, I think it is in an uptrend. My preference is to invest in Sagasco, which could catch the eye of Santos at some stage. I think it has a more attractive exploration programme dollar for dollar. The best oil stock has been Ampolex. It just keeps on improving - the last pattern shows it is a bit tired, but will continue. Bridge seems to be a turnaround situation.

I use trend lines as mental stop losses. Dicksons don't take stop losses. It is not worth it. Do Ord's take stop loss orders Cam? Cam Gorrie: "No".

AWA is coming out of a dark period. It is a buy. It is suffering from the end of the Cold War, the need for its war equipment is diminishing. They have some very good accountants on board. They make a profit, but a cash flow loss. These are the things you should have a look at.

I don't think that the payment of dividends influences the levels of stocks. It makes it sound more edifying to buy for a dividend - *you've done it for a reason*. Many high performing stocks do not pay a dividend and may never pay a dividend.

The Price/Earnings multiple is one of the most difficult concepts to grapple with for investing. If the P/E is low it can either be that the stock is unrecognised and is about to perform or it is about to go into losses and the market doesn't like it. If the P/E is high it could be the earnings are paltry or because they are going to get better. I think that to look at a market P/E is better.

This run in the market is happening with the market P/E at 15. All the fundamental tomes say that is too high. P/E's were quite high in the 1960's, when interest rates were low. I can remember Woolies at a 25 P/E in the old days. Its very difficult to use P/E's and dividends.

To determine if this great bull run is over you must know that one market will break first. In 1987 NZ broke first. I don't know where it will be - probably in the currently strong Asian markets. When that happens look to take profit here. Within our market, look at the performance of individual stocks. Adsteam broke its trend in April 1987 signalling the end. I have no claim to calling the top in 1987. When I look back, these were the signals. Markets may top out in the next 6 months, but in my eyes there are no signs yet. It is as big a crime, in my eyes, to call it too early, as to call it too late. This is particularly true in stockbroking.

Brokers don't normally put out wholesale selling recommendations, because ultimately they are wrong. They might say sell some or switch: to get double brokerage. Laughter. They do this because the client could take the money and invest it with another broker.

It is impossible to run a brokerage without a positive outlook on the market. We don't tell clients when to sell because we don't know. I think the concept of selling half is good because it does something about the problem. We are all adults in this room and we don't rely on brokers to tell us what to do. DO WE? MUCH LAUGHTER.



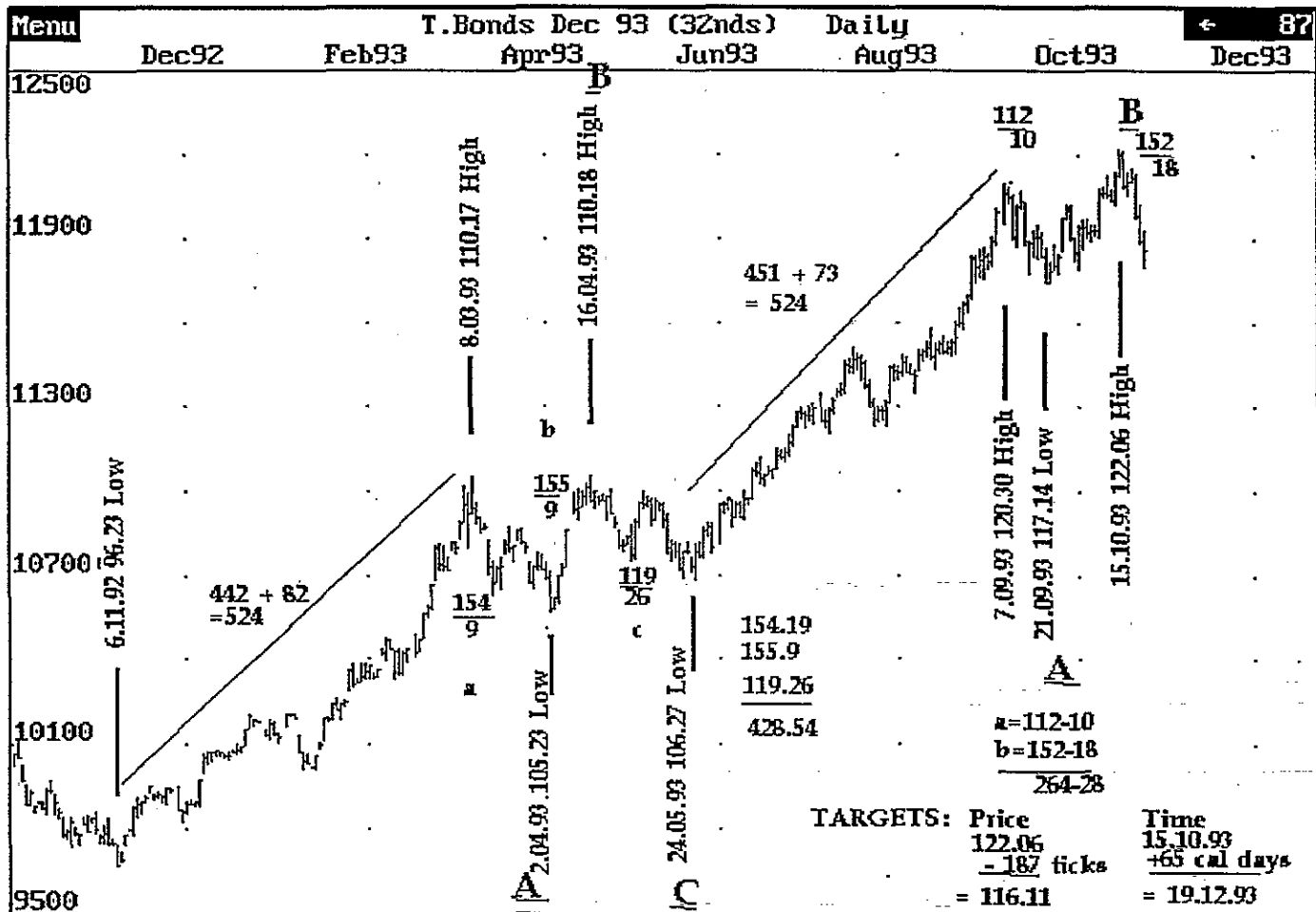
# MARKET SYMMETRY

## MORE GANN TECHNIQUES FROM NICK FLAMBOURAS

When studying a market using the Gann technique, we are primarily concerned with time and price balancing. To balance time and price we have learned to square the high, the low and the range. These are our basic tools for identifying trend change dates. However, there are other ways to work with time and price to find these important balance points: a time and a price objective.

With this method, we balance the Impulse wave (the wave in the major direction of the trend) with the corrective wave or waves. Thus, if an Impulse wave registers 442 ticks<sup>(6)</sup> in 82 days, we would expect an A-B-C correction to work out 442 ticks in 82 days. This doesn't mean it has to be exact, although sometimes it is. Close should be good enough. We would then look for one of our reversal patterns to enter the market.

Take an example using the 1993 December T-Bonds to illustrate the point. Note that the corrective waves A-B-C add in price to 428 (the impulse wave was 442) 14 ticks off. As the Impulse Wave was 82 and all three waves added to 54 days, time was 28 days off.



The move from May 24, 1993 to Sept. 9, 1993 was 451 ticks in 73 days, adding price and time gives 524. The impulse wave from Nov. 06, 1992 to Mar, 1993 was 442 ticks in 82 days, adding price and time gives us 524: A PERFECT BALANCE BETWEEN BOTH IMPULSE WAVES.

To project to where the wave that started on Oct. 15, 1993 should terminate we take the following steps firstly for PRICE:

- 1) Look at the last Impulse wave which was 451 in 73 days.
- 2) Adding A-B gives us a total of 264 ticks in 28 days.
- 3) Subtract 264 from 451 and are left with 187 ticks.
- 4) Subtract the 187 ticks from the Oct. 15, top at 122-06 to get a price objective of 116-11.

Secondly, to find our TIME objective we take the following steps:

- 1) Subtract the 28 days (which encompassed the A-B wave) from the 73 days (which made up the last Impulse wave) ie 45 market days. Now 45 market days are approximately 65 calendar days.
- 2) Add 65 calendar days to Oct. 15, and we get a time objective of Dec. 19, 1993.

We now have a rough estimate of a price and time objective. That is, we are looking for 116-11 by Dec. 19, 1993. This type of analysis takes time and study to fully grasp, so use your own charts to study and you will be amazed at the results. Good Trading.

Nick Flambouras. October, 21 1993  
 Gann Research Educators 330 South Wells Suite 700 Chicago  
 Illinois USA 60606  
 Phone (312) 987 9057 Fax: (312) 987 9049

#### Footnote

① a tick is 1/32 of a percent and is the minimum price fluctuation in the CBOT 30 Year Treasury Bond Futures Contract.

## EDITOR'S ERRATA FROM SEPTEMBER 1993 NEWSLETTER.

### PAGE 4 COLUMN 2

*Apologies to Mr Flambouras for the date missing in his article for the forecast October Top in the CBOT 30 Year US Treasury Bond Futures. It was omitted in the rearranging of the Forecast Table to fit into our Newsletter. It was Oct. 18 1993, just 1 market day from the ALL-TIME HIGH so far (a weekend intervened). A nice call, Mr Flambouras: two and a half months in advance. Apologies to the readers who like Mr Flambouras's methods. Congratulations to those who picked our typo and asked for the date. Hope you got short on it!!*

## A MESSAGE FROM A GANN OLD TIMER

*The following is a letter received that confirms Mr Flambouras's credentials as a Gann teacher and trader.*

My name is Robert Courter. I worked with W.D. Gann from 1944-1952. Our relationship went further back than this, as my Father and Mr. Gann were friends. My Father was a Master Astrologer as was Gann. Both taught me the art at a very young age.

As I reflect back on my youth. I can honestly say that my Astrological teachings and my love of Charting price action in the Soybean markets, afforded me a way to support my family - handsomely.

My other love was Ice Skating. I trained students in 1940 and 1952 who went on to compete in the Winter Olympics representing the United States. I opened my own rink in 1961 but still continued my other love, trading. Although my trading has slowed down considerably over the past few years due to my health and age (I recently celebrated my 80th birthday) I still trade when my health permits.

Nick Flambouras was introduced to me in 1978 through a mutual friend. At that time I was impressed with Nick's extended knowledge of Gann's geometrical forecasting methods. He told me he had been studying astrology for the past 3 years as he believed this was the foundation of Gann's work. I agreed, saying Gann was without a doubt one of the best Astrologers I had ever met.

I believe at the beginning of our friendship I taught Nick to understand the reasons and the methods used by Gann to forecast the Grains. Over the years he has begun to teach me how to apply the same methods to the Treasury Bond markets.

We have never stopped communicating and at the time of writing this we speak to one another at least once or twice week.

It is my belief that Nick is definitely on his way to becoming one of the best Financial Astrology analysts I've ever met.

I'm writing this letter because Nick told me he was travelling to Australia early next year to teach a course in both the Gann Method of Trading and Financial Astrology. It is my sincere belief that anyone fortunate enough to study under Nick Flambouras, will benefit themselves 10 fold over the coming years.

Sincerely,



Robert Courter

*Members should have already received a brochure on the WD Gann courses Mr. Flambouras will present in Sydney in February 11-13 1994 (WD GANN FORECASTING & TRADING WEEKEND) & February 18-20 1994 (WD GANN ASTRO-FINANCIAL COURSE). If you haven't received a brochure or would like more information call (02) 545 2605.*



# BUSINESS CYCLES AND THE NUMBER 56

The second in a series of articles dealing with the 56 year cycle, by David McMinn.

*'One of the greatest pains to human nature is the pain of a new idea'* Walter Bagehot.

The understanding of business cycles has remained limited, despite much research over the past 150 years. However, financial crises, which are the most dramatic phase of the business cycle, occur preferentially in patterns of the 56 year cycle established by Funk, 1932 & McMinn, 1993. Eleven principal 56 year sequences of crises have persisted in US and Western European economic history since at least 1760. These sequences comprise 10 found in the 36 year sub-cycles based on multiples of 9 years (i.e.: 9, 18, 36, 54) and Sequence 09 (1769, 1825, 1881, 1937, 1993) [McMinn 1993]. The sequences have been numbered 01 to 56 with 1761, 1817, 1873, 1929, 1985 being designated Sequence 01. The ensuing discussion examines the relationship between this 56 year cycle and business cycles.

## THE ECONOMIC CYCLES

There are commonly considered to be four economic cycles determining business activity:

The **Juglar cycle** consists of prosperity, crisis and liquidation and persists for 7 to 11 years, with an average time span of about 8 years. This is partly based on the sub-cycles in multiples of 9 years, which are associated with the 56 year cycle.

The **Kuznets cycle** of about 15 to 25 years is derived from growth rates rather than absolute expansion and contraction in economic activity. This cycle was mainly associated with the US construction industry before 1914, but was also found in German, UK and French economic growth rates prior to World War I. It is not relevant to 20th century business trends. The Kuznets cycle was derived from analysis of population changes, building construction, capital formation, income, etc.

The **Kondratieff wave** of 45 to 60 years duration is found in economic history of capitalist economies. It is directly linked with the 56 year cycle.

The short term **Kitchin cycle** averages about 40 months and was deduced from commodity prices, bank clearing interest rates, etc during the 1890-1922 period for the USA and the UK. Since World War II, a Kitchin cycle of four years and another of 40 months has been evident in Western Europe and the USA respectively.

## THE KONDRATIEFF WAVE

In the 1920's, Professor Kondratieff (1935), the famous Russian

economist, studied price trends and raw material production levels in capitalist countries. According to his model, capitalism was self-regenerating after long periods of economic decline. His thesis on long waves hypothesised that Western economies fluctuated with major peaks every 45 to 60 years. Kondratieff believed his long wave averaged 54 years, which closely approximates to the 56 year cycle. His theory incorporated two phases:

**The Rising Wave:** This is a long expansionary period of 20 to 30 years which contains numerous years of prosperity. This growth phase experiences expanding investment in capital goods and implementation of new technologies developed during the preceding downwave. Escalating inflation and rising interest rates are also evident. Furthermore, in this expansion phase, advanced economies require raw materials and new markets for their increased output. This fosters the development of new territories and stimulates growth in lagging economies.

**The Downward Wave:** A peak in price levels is apparent, which coincides with rampant inflation, speculation, high commodity prices and war:

1814: War of 1812  
1864: The American Civil War  
1920: World War I  
1974: Vietnam War

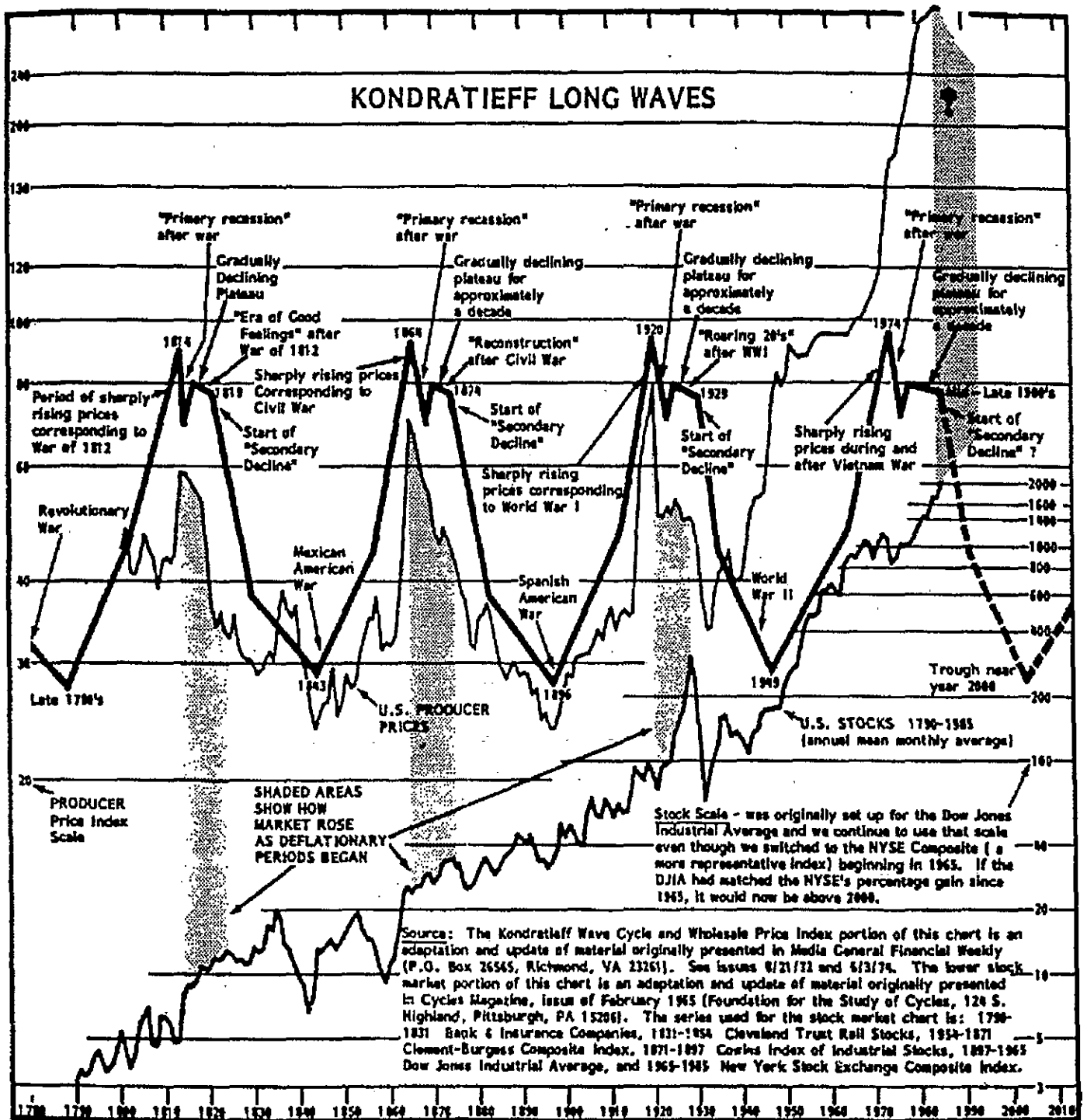
These peaks are followed by a 'primary recession' and a subsequent plateau stage, during which inflation slows, unemployment rises, the finance sector is buoyant and temporary political stability is achieved. There is also declining capital investment, a levelling out in labour productivity and a falling return on investment. This plateau phase lasts for 10 to 15 years. A major slump is experienced leading to a 'secondary depression'. There is little investment in physical capital and the agricultural sector is chronically depressed. Technological inventions are made, the benefits from which are only fully felt in the ensuing up wave. Real take home pay of the average worker may actually increase for those with employment. This strong contractionary phase persists for up to 25 years.

The long waves for the US economy are:

Kondratieff Wave	Trough	Peak	End of plateau	Trough	Duration
I	1788	1814	1819	1843	55 years
II	1843	1864	1873	1896	53 years
III	1896	1920	1929	1949	53 years
IV	1949	1974	?	?	

Years in *italics* occur in the 36 year sub-cycles (Series 1 & 2) (Table 1, McMinn, 1993).

## Kondratieff Long Wave Cycles



SOURCE: Growth Fund Guide, Growth Fund Research, Inc., Box 6600, Rapid City, S.D. Copyright 1985.

Time spans for these long waves differ according to reference source and also from country to country. Even so, the broad 45 to 60 year trend of expansion, peak and downswing applied consistently over the past 200 years. Kondratieff noted a high degree of parallelism in the long cycles experienced in capitalist economies in the USA and Western Europe. This parallelism applied to price indexes, wage levels, interest rates, trade, production and consumption.

Many eminent economists do not believe such long waves exist in US and Western European economic history (Michaels et al, 1981). Kondratieff based his theory on only 2.5 cycles, which was inadequate to confirm its validity. Paul Samuelson, once described as the dean of US economists, believed Kondratieff waves were 'nonsense' and a 'statistical absurdity'. With this the distinguished economist Charles Kindleberger agreed stating 'Kondratieff is like astrology'.



The 11 principal 56 year sequences may be numbered 01, 03, 05, 09, 12, 21, 32, 41, 48, 50 & 52. On the rising wave, economic growth is recorded, with recessions and depressions of short duration. The principal 56 year sequences occurred infrequently in this phase (notably Seqs 32 & 41) and thus relatively few major crises are evident. Additionally, the Kondratieff peaks for the USA all fell in a narrow range of the 56 year cycle between Sequences 46 and 54:

1814: Seq 54  
1864 & 1920: Seq 48  
1974: Seq 46

These take place around the 'cluster' of principal Sequences 48, 50 & 52.

The beginning of the 'secondary depression' is marked by a major panic:

1819: Seq 03  
1873: Seq 01  
1929: Seq 01

This secondary depression was protracted, because five of the 11 principal 56 year sequences occur in a 12 year time span (Seqs 01, 03, 05, 09 & 12). Further severe depressions were precipitated by the 1837 and 1893 crises (both in Seq 21), prior to the Kondratieff lows for the USA of 1843 and 1896. The 1949 low fell in Seq 21, although some sources believed this low to have taken place in 1938 after 1937 (Seq 09).

Extrapolating from previous Kondratieff waves, the crash of 1987 (Seq 03) could have been expected to have ushered in a depression in the late 1980's (1987 & 1989: Seqs 03 & 05), with a recovery in the early 1990's and another crisis/downturn in the mid 1990's.

#### Panic Seq US Depressions

1819 03 1819-21 (Seqs 03, 05) and 1825-29 (Seqs 09, 12).  
1873 01 1873-79 (Seqs 01, 03, 05) and 1884-85 (Seq 12).  
1929 01 1929-33 (Seqs 01, 03, 05) and 1937-39 (Seq 09).  
1987 03 Not followed by downturn. ? Crisis/downturn mid 1990's.

This trend was not repeated in the current Kondratieff wave, with a US recession occurring in 1990 after 1989 (Seq 05). Whether the predicted crash of 1993 (Seq 09) and downturn eventuates remains to be seen. Simple extrapolations from historic trends are tenuous, as history never repeats itself with a high degree of certainty.

Kondratieff (1935) regarded the rising waves to be 'considerably richer in big social changes in life of society' than are periods of the down waves. According to Snyder (1984), mass psychology progressively changes through the Kondratieff cycle. At the beginning of the rising wave (The current wave: 1950's), conservatism, social/political stability and a strong work ethic prevail. Near the top of the wave (The current wave: 1960's & 1970's), there are major social upheavals and radical changes in lifestyles. Optimism prevails and there is discontentment with

traditional values with new sexual mores emerging. The plateau sees the rise of social and political conservatism. However, euphoria pervades the economy, as people speculate and over extend themselves with credit (1920's & 1980's). This over optimism ends in a major panic as in 1819, 1873 and 1929. At the beginning of the Kondratieff secondary depression, the initial problems are viewed as temporary phenomena rather than profound changes in economic trends. As the depression persists, disillusionment is increasingly apparent, shattering people's risk free view of the world which prevailed in earlier decades. Unions strengthen as workers seek to maintain their living standards while social unrest is aimed at insulating people from economic hardship. Laws are passed to protect the well being of the populace and conservative values and lifestyles are adopted. The sexual excesses of the up wave give way to modesty and romance with less tolerance towards aberrant sexual behaviours. (Previous cycles: Victorian morality of the 1870's/90's and Hitler sent homosexuals to the gas ovens in the 1930's/40's) This does not mean that old mores necessarily return, as many freedoms established on the up wave are maintained.

Due to the hard times, the work ethic is emphasised as concern about security prevails and there is a willingness to settle for less, with value being placed on work, success and saving. On the positive side, a sense of community emerges in the face of a common enemy (depression) and people become more co-operative and accommodating. Religious fundamentalism and political extremism (both right and left) resurge in a clamour for radical solutions. Racism increases as scapegoats are sought to vent frustrations. (Previous cycles: Anti-semitism in Europe during the 1870's/80's and 1930's/40's.) Lastly, socialism becomes more popular with the masses as there is a reaction against laissez faire capitalism, which is widely blamed for the adverse conditions. The conservatism and work ethic remain through the beginning of the subsequent up wave and social stability persists during this growth phase.

Significantly, Kondratieff only covered the period after the late 1780's. Prior US trends diverged markedly from the Kondratieff model. The inflationary peak of 1780 happened within 34 years of the subsequent peak of 1814 - a much shorter time span than in the following waves. The 1780 peak did not have an ensuing plateau phase, as the 1780's were depressionary. The English 'wave' of 1745-1788 had no inflationary peak although there was a general upward movement in price levels during the period. As for the USA, the UK similarly recorded continued inflation after the 1974 peak, in contrast to the strong deflationary trend following the peaks of previous waves. Despite such discrepancies, long cycles are valid, but the classic Kondratieff wave of expansion peak, plateau and depression need not persist in economic history. The 56 year cycle, and thus presumably the Kondratieff wave, is envisaged as changing progressively and never repeating itself exactly.

Various researchers have extrapolated Kondratieff waves back into earlier centuries (Goldstein, 1988). There are also some indications that a 50 year cycle in wars and inflation was experienced in ancient Rome. Theoretically the 56 year cycle should persist throughout human history, although meaningful analysis is restricted by poor information for earlier eras.

The big question arises whether the Western economies will soon experience the harsh reality of a protracted Kondratieff secondary depression. The exact timing of this major down turn is impossible to predict. The Kondratieff wave, at best, is only a broad general trend in economic life and leaves much to be desired in its predictability.

## THE 56 YEAR SEQUENCES & WAR

Kondratieff (1935) considered that 'wars originate from real, especially economic, circumstances and take place during the expansion phases of the long waves'. It has also been noted that war tends to manifest near the peaks and troughs of the Kondratieff waves:

### Peaks:

1814: War of 1812  
1864: US Civil War  
1920: WW I  
1974: Vietnam War.

### Troughs:

1843: US-Mexican War  
1896: US-Spanish War  
1949: WW II & Korean War

The 56 year sequences have some relevance to wars, as many financial crises are related to revolution and to the beginning and ending of war.

### War years in the 36 year sub-cycles:

Year	Seq	War
1745	41	Jacobite rebellion. (English crisis: December)
1756	52	Beginning of the Seven Years' War
1761	01	Ending of the French and Indian War
1763	03	Ending of the Seven Years' War (English & Amsterdam crises: September)
1781	21	Ending of US Revolutionary War (US deflation)
1792	32	French Revolution (English panic: January 1793)
1801	41	Peace of Amiens Crisis (Europe)
1812	52	War of 1812 (US depression)
1848	32	Year of Revolutions (Continental crisis: March) Ending of the US-Mexican War
1864	48	US Civil War (French crisis: Jan; US panic: Apr)
1866	50	Austro-Prussian War (European panics: May)
1913	41	Second Balkans War (US & European crises)
1940	12	World War II (US near panic)

There may be a time lag for a crisis to manifest after a war (Kindleberger, 1989), as follows:

1857	41	After the 1854-56 Crimean War
1866	50	After the American Civil War
1920	48	After 1914-18 World War

Kindleberger also commented that a major crisis may occur about 10 years after the ending of war. For example:

War	Ended	Seq	Crisis	Seq
Seven Year's War	1763	03	1772	12
Napoleonic Wars	1815		1825	09
Crimean War	1856		1866	50
US Civil War	1865		1873	01
World War I	1918		1929	01

Goldstein (1988) believed that 'the long wave upswing periods are characterised neither by more wars than on the downswings nor by wars that last longer, but by much bigger wars. (These) are more costly, more destructive and have greater political and economic impact.' Furthermore, from the 17th century on, 'most of the major inflationary periods appear to be connected to wars'. Usually the peak war occurred at the end of the expansionary phase of the long wave, although World War II was the notable exception, manifesting near the low of the wave.

Interestingly, periods of hyper inflation in US and European economic history have always been associated with revolution and war as in:

USA: Late 1770's. Revolutionary War. Over issue of Continental bills of credit. These were virtually worthless at the end of the war.

France: 1790's. The French Revolution. Over issue of assignats.

Austria: 1811. Napoleonic Wars.

USA: 1860's. Confederate paper money became worthless at the end of the Civil War.

Germany, Austria, Poland & USSR: Early 1920's. After WWI.

Hungary: After World War I and World War II.

Eastern Europe: Early 1990's. Collapse of communism.

Although war-induced financial crises happened fairly frequently in economic history, a definitive 56 year cycle linked directly to wars could not be established.

## LINKS BETWEEN MAJOR/MINOR CYCLES

Interrelationships between the 56 year sequences and the 9 year sub-cycles has been established by McMinn (1993). The existence of such links between the major/minor business cycles have been discussed extensively in economic literature. Kitchin (1923) believed that Juglar cycles were merely aggregates of usually two, sometimes three, minor cycles each lasting about 40 months. The Juglar cycles averaged about 8 years, but ranged in duration from 7 to 11 years. Kondratieff (1935) believed that the long wave and the shorter cycles were interrelated in some manner and that 'the intermediate cycles are strung on waves of the long cycles'. During the rising waves, these intermediate cycles were characterised by brevity of depressions and intensity of the upswings, while for the downward waves the opposite applied with intense depressions and shorter periods of growth. Schumpeter (1939), a famous economist, thought time spans of these economic cycles were related as



follows:

One Kondratieff wave equals 6 Juglar cycles.  
One Juglar cycle equals 3 Kitchin cycles.  
One Kondratieff wave equals 3 Kuznets cycles.  
(The latter was not mentioned by Schumpeter).

This view is oversimplified. Nevertheless, the short and long term cycles are interrelated.

The Juglar cycle and Kondratieff wave are linked as crises manifest when the 56 year sequences intersect the 36 year sub-cycles based on multiples of 9 years (McMinn, 1993). Analysis of the Juglar cycle has regarded the following crisis years as major turning points in economic trends:

*1810, 1818, 1825, 1836, 1847, 1857, 1866, 1873, 1882, 1890, 1900, 1907, 1913, 1920, 1929.*

The years presented in *italics* fall in the 36 year sub-cycles Series 1 & 2 (Observed: 7. Expected frequency: 2.7). The years 1825 and 1881 fall in principal Sequence 09. Importantly, the major crisis years of 1818, 1836 and 1847 'merge' with the years 1819, 1837 and 1848 respectively, all of which are found in the 36 year sub-cycles:

Years	Seq	Crisis
1818/1819	03	US (November 1818 - June 1819)
1836/1837	21	English (Dec 1836). US (May 1837)
1847/1848	32	English (October 1847). French (March 1848)

Since 1929, business fluctuations are generally regarded by economists as being offset by government anti-cyclical policies, which have thus prevented major crises from occurring. However, this may be a result of good fortune rather than good planning and due to undetermined very long term trends associated with the 56. Interestingly, for early crises, the periodicity of Western European crises between 1551 and 1866 was roughly 10 years (Kindleberger, 1984), a pattern which may be dependent upon sub-cycles of 9 years.

The Kuznets cycle could, at least in part, be based on the sub-cycles associated with the 56. Although there was some variation from one measure of economic activity to another, Kuznets dated troughs in his cycle at 1878 and 1896, with peaks at 1873, 1892 and 1913. The latter three years approximate to a 20 year sub-cycle between Sequences 01, 21 and 41 respectively. After World War I, Kuznets viewed the following peak as 1921 and trough as 1931 (Seq 03).

The Kitchin cycle, a short term cycle, could not be related to the 56 even though some connection probably exists.

The four main economic cycles are viewed as expanding and contracting by as much as -20% to +25% from the ideal. In contrast, crises in the 56 year cycle occur in specific sequence years. The 56 is very influential in economic trends, indicating when major market turns for the worse are likely to be evident.

## THE SECULAR TREND

Discussion of very long cycles appears to be generally ignored by economists, as it is hardly relevant to short-term economic forecasting, which is their main area of concern. The poor records for earlier periods also make it difficult to assess the great waves of economic activity which persisted over hundreds of years. Such cycles have been postulated to exist in European economic history by Gaston Imbert and J G Kretschmann (Braudel, 1984), with four great waves being evident since the 13th century:

1250 - (1350) - 1507/10	About 260 years duration
1507/10 - (1650) - 1733/43	About 230 years duration
1733/43 - (1817) - 1896	About 160 years duration
1896 - (1974) - ?	Unknown duration

Braudel regarded the first figure of 1250 to be contentious and that the beginning of the 12th century may be more accurate. The first and last dates of each line represent the troughs of each wave, while the peaks are as follows:

1350	Black Death and resultant economic decline.
1650	Peak follows the 'extended' 16th century. Amsterdam rose to economic pre-eminence. (For Spain and Italy, this peak could be placed as early as 1600).
1817	Peak is approximate and varies from country to country.
1974	This is widely regarded as the peak of the current Kondratieff wave.

The upward secular trend is characterised by expanding production, population, trade, culture, money supply, etc. Social order prevails, capital accumulates and government is stable and able to govern. These factors are favourable to ALL economies. The downward secular trend shows up with healthy economies being only found in the centre of the world economy. Peripheral nations suffer stagnation or decline. Hostilities increase due to the difficult times and population levels may remain static or fall. Strangely, culture may flower on the downside in contrast to the general demise. For example:

Italian Renaissance: 15th century
Spanish Golden Age & the court of Louis XIV: 17th century
Romanticism: 19th century

According to Braudel, a nation tends to become divided against itself (as in wars of religion) during the rising portion of great waves. Conversely, the down wave brings different parts of a country together, a response to the difficult times being experienced.

The problem arises in giving validity to the secular trend, because of the very long time spans involved and only four great waves have been cited since 1250. Thus, this trend is difficult to establish. Even so, the concept of great waves appears plausible, particularly given the long periods of economic expansion and contraction found throughout European history at least since Roman times.

The Kondratieff waves have been linked with very long cycles. According to Braudel (1984), 'by adding to their movements to the upward or downward secular trend, the Kondratieff waves either reinforce it or attenuate it'. The 56 year cycle could also be expected

to superimpose on the secular trend. Nevertheless, the study by McMinn (1993) only gave meaningful data for the post 1760 era. This prevented appraisal of the great economic waves and their possible relationship to the 56 year cycle.

Of concern is that the secular trend indicates that the European economy could soon experience a century or more of chronic economic decline. Such a scenario could arise from various causes: disease, war or environmental collapse, all difficulties causing increasing concern in the late 20th century. However, the time spans within the secular trend are poorly defined and open to speculation.

## THE AUSTRALIAN EXPERIENCE

Australia was first settled by Europeans in 1788, but it was not until the Pastoral Boom of the 1820's that this country experienced its first business cycle. During the ensuing 170 years, Australian economic activity has often diverged strongly from trends in Western Europe and the USA. Long term Kondratieff cycles appear not to be valid for Australia. Pope (1985) concluded that 'the claim for a full scale Australian 40-50 year Kondratieff in real output and prices over the last century or so .... is not sustained at this time'. Only a few Australian crisis years align with the principal 56 year sequences on the Atlantic as follows:

Year	Seq	Crisis
1808	48	Crisis. US trade embargo.
1812	52	Liquidity crisis.
1828	12	End of the Pastoral Boom.
1866	50	Panic (Queensland: July).
1893	21	Bank Crisis (May).
1920	48	1920-21 recession.
1929	01,03,05	Australian 1929-33 depression.
1937	12	Recession.
1960	32	Horror budget (November).
1987	03	Black Tuesday (October 20).
1989	05	Real estate collapse.

A 56 year cycle was not confirmed and problems arose in assessing Australian financial trends because:

Low population levels following the first European settlement in 1788 meant that early economic data need not reflect mass psychology and therefore the 56 year cycle. (The non-Aboriginal population reached 1 million in 1858).

There is limited historical data (post 1820) on which to base the 56 year sequences.

The Long Boom (1860-90) completely countered cycles in the USA and Western Europe.

Australia has had few major panics and only three great depressions, commencing 1840, 1890 and 1929. Thus there were few comparative dates on which to base the 56.

## CONCLUSIONS

The 56 year cycle does have a major impact on the:

- 45 to 60 year Kondratieff wave.
- 20 year Kuznets cycle.
- 9 year Juglar cycle.

This implies that these three cycles may arise from one very complex cycle and are directly interrelated. Unfortunately, no link could be confirmed with the short term Kitchin cycle of three to four years. However, the 56 year cycle only indicates when crises may occur and does not give market tops or bottoms. Furthermore, the 56 year cycle has, to date, only been at a very elementary stage of refinement and thus cannot give detailed results or precise forecasts. Much objective research needs to be done to determine the intimate relationships between the 56 year, sun-moon cycles and the four main cycles of economic literature.

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David McMinn (066)89 1278

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## LES HOSKING ON FUTURES

*Les Hosking, Chief Executive Officer of the Sydney Futures Exchange, addressed the Sydney meeting of the ATAA on July 19 1993. The following is a transcript of his address, prepared by Colin Nicholson.*

Before I get on to what I think are some of the things you are interested in like new products, it is important to go over the functions and development of an exchange. It is important to understand this, if we are to understand where futures markets are going in the next five years, including whether we will ever see things like greasy wool futures again.

I have no intention of forecasting for you what are going to be successful futures contracts in the next five years. I feel rather inadequate to address you as far as forecasts and technical analysis are concerned. I also cannot tell you what will be a profitable trade on the futures exchange in the next five years.

The preceding presentation of Super Charts (see September Newsletter) does hone in on one very important area of the futures markets and that is technical analysis. The direction of futures markets is very much along the lines of technology in providing more opportunities in our markets because of the type of data that we can provide on line very quickly for you to interpret and trade against. The irony is that, while it is very important to keep futures markets operating to give you that source of data, some of the bigger business is going off-market to places where there is no data available. It is going into black holes that you cannot actually find out about.

Technology is as much a part of the futures industry now as anything else. Back in the days when Will Slatyer and I were trading along with others in this room (we were in the gallery of 2 O'Connell Street, 5 O'Connell Street and 6 Australia Square) we could actually sit there and leisurely draw point and figure charts of markets as they moved. You could do it quite accurately and draw your trend lines as you went. These days, there are maybe, in the Three Year Bond market on the Sydney Futures Exchange, up to twenty people on the bid and twenty people on the offer. It is very hard for us to tell you whether 05 traded before 06 and back to 05. The accuracy of capturing the data in these massive markets is very difficult and that is part of the reason why I say that technology will eventually govern what is available to you as far as products are concerned.

### What Is A Futures Market?

It is the inherent nature of futures markets that they do provide you with data dissemination very quickly. You can see what is happening on the trading floor very quickly. That is because there is sufficient price discovery on the trading floor. There is this liquidity on the floor that does not corrupt the market intelligence that is flying around creating the market information. So this is the value of Futures markets. They do that better than any other market in the world. They discover price, they are more liquid and

they disseminate the data more accurately and more efficiently than any other market that I know of...even the stock market...even with SEATS.

Now, this is probably part and parcel of the history of futures markets and why people tend to distrust them. Let us take an example: It is just coming up to ABC news time and I can picture the news reader saying that there was chaos in the financial markets of Australia today. Guess what will be in the background: The Sydney futures Exchange trading floor. That is what it is depicted as: chaos. And so my mother and maybe all of you, from the very first time that we started to think about technical analysis, looked at futures markets and thought: A bit of a mystery that one....highly risky, highly speculative and so on. So, despite all the substantial economic and social benefits that we provide, futures markets have always had this bad image: this speculation, this mystery, this intrigue.

Futures markets are controversial. The whole market operates on the necessity for people to speculate. You cannot have just a wool grower meeting a wool processor, without having a whole heap of speculators in there ready to transfer the risks from one to the other. The wool grower may perceive that he wants to hedge in the morning, while the wool processor perceives that he wants to hedge in the afternoon. In the meantime who creates the price all day? Not the futures broker, because he will not do it for nothing, but the speculator. he is the one who trades. So, futures markets have this pervasive role of speculation. It is their inherent efficiency, their inherent price discovery, it is the thing that actually makes the market tick.

As I say, the television news will show the trading floor with these guys in their coloured jackets, the locals down there that are trading away. Some have even got charts under their arms, looking at the SPI chart while they are trading the market. It looks like chaos. So, when the financial futures markets came along, the banks and the institutions, at the first blush, looked at them and thought that cannot be a serious market place, not what those guys do. So there was a problem that we had to overcome with that.

You have got films like "Trading Places", you have got press reports about triple witching hours, I cannot even go home any more, because people don't trust me. Admittedly, yes, there has been some colourful history to futures markets since the Civil War in the United States, when they started over there. And, of course, in Australia at the Sydney Futures Exchange, we have had our moments in the market place: cattle squeezes, bull squeezes. Will and I have been involved in a few, on the defensive side I might say, rather than the aggressive side. But they have been there and they have given us a problem.

Why I am saying all this is because it does tie in with the very thing that is important for you people and that is price discovery, liquidity, data dissemination and the way a futures market functions and why some of them have now failed, like wool, cattle, gold and why some of them are still operating, like bank bills and treasury bonds. It is

the ability to report trades and to do it accurately. There is no other market in the world where you can see the best bid, the best offer, the last trade and, in many cases, the size of the trade, identifies the seller and the buyer, gives you the best of the market in some markets if you are connected to a broker and it is disseminating as it happens. You think about it. There is no market in the world that provides that sort of service, only futures markets do it. And yet, ironically, they have that aura of suspicion.

At 11:30am exactly, when the balance of payments figure comes across the desk, you will see it on the news: people are on their mobile telephones and saying what the latest figure is and within seconds, on the futures exchange trading floor, it has been interpreted and disseminated around the world in a reaction. It is so fast that people think that they must have got the information at 11:29am. It is not, it is because the information is transferred through to the reaction so quickly and so efficiently that it happens that way. It goes back to this end: we are reliant on that sort of information.

The other thing about futures markets which is important as far as people understanding them and actually using them is that, not only is the information fed into the pit as quickly as that, but when it gets in the pit, there is no order of priority because you have been there a long time or because you have more business to do than somebody else, or that you are a bigger local, or better capitalised like a bank or so on. The order of priority is who is there first and what is the price. So there is an absolute efficiency about the operation of the market. I can bid five for one lot and have priority over the Commonwealth Bank who is bidding four for twenty million lots. They have to get me out of the way first. They cannot jump over the top of me and trade with the Commonwealth Bank, you cannot trade preferentially. Every trade in the pit is done on a fair and open basis, with no discrimination because of size.

As a matter of fact, that has led to some people being suspicious of the markets again. We have had farmers suspicious that speculators have preference on the floor as opposed to their hedgers. We have had institutions suspicious about futures markets and the preference shown on the floor because of the locals being there as opposed to the genuine capital raising business. But the futures markets have this level of clean efficiency.

What is all this leading to? Why am I saying all this? It is basically because, in the future, we are going to see those sort of markets under considerable threat. I just thought that I should raise the issue. At the moment, futures markets are very efficient price discovery vehicles, but they are also very expensive to run, because they are very capital intensive. In the trading floor area, \$20 million is being tied up and most of the floor members of the exchange are only earning a dollar or so in commissions per trade. So they are very difficult markets to continue with. Whereas there are massive over the counter markets which have developed in many, many products, including agricultural products, though more particularly in financial instruments, where you will never hear about the prices. It is very difficult to discover what is the actual traded price of gold, because what is in the newspaper is not a true reflection of what it has been priced at all through the day. In other words, the public auction system is virtually being by-

passed. It is either going to be by-passed into the over the counter markets, where there is no disclosure, or into regulated futures markets where the market information is disseminated the way we do it.

What has caused that is basically financial futures markets. They have sped the whole game up. All of the major banks and institutions and so on, look at whether it is necessary to go through a futures market or whether it is more advantageous for them to trade over the counter, with corporate treasurers or growers, with undisclosed prices. They can get a better margin out of that. There is a tendency towards undisclosed prices. Technical analysts could wither on the vine unless prices are provided to them.

There is a saviour in all of this. I have given you the gloom. Now I will give you the good news. It is that, if there are people out there who are providing a service to a grower via a forward option or a very exotic type of over the counter product, they in turn have a risk. It is those people who in turn are coming and using the futures market. So it is the banks who are now our major users.

In the good old days when gold was king on the SFE, that wonderful little 50 ounce Australian dollar denominated gold contract that we had, 85 to 88 percent of SFE turnover was retail ie. private client business. It shifted down to about 70 percent as the back months started to go up in premium because how many banks can knock back a thirty percent return on their gold if they sold the distant months and held the gold in storage? But predominantly, at their peak, the wool, cattle and gold futures markets, were around 80 to 85 percent retail. Today: four percent of SFE business is transacted by private clients...and falling. In the US market: the same. Whereas the US markets were the playground of the doctors and dentists in pork bellies, not any more. The way a private investor gets into the US market these days is via a Commodity Trading Adviser or fund manager or a pooled management fund or something like that. Very few have direct accounts unless they are very, very large.

So, the game has changed as well and that is part of the reason why agricultural futures may never come back, why the types of products we knew before may never be back. Maybe it is why COMEX has not really responded to what is a steep rise in the gold market. You would have thought that the turnover on that exchange would have increased quite considerably, but it has not. There has been a little bit of a flutter, but it is not going up, because the game has changed.

I will give you a couple of statistics that will enhance that. In 1992, there were \$5 trillion in interest rate swaps open around the world. In the same year there were \$4 trillion in interest rate futures traded around the world. This relationship is very reflective of the way the futures industry and derivative markets work these days. They both back what I said about the banks taking the risks.

The swaps market is what we call the over the counter derivatives market. So banks are writing swaps with their corporate customers and with other banks that are almost as standardised as the futures markets. For just about every one of those swap deals that are going on in the OTC derivatives market, there is now a futures trade occurring on the futures market. So, keep that in mind when we get back to whether energy contracts will survive or whether cattle



or wool contracts will develop in the next couple of years.

We have actually done the same thing at the Sydney Futures Exchange. That was global. The SFE is now the seventh largest exchange in the world. The largest in this time zone. Our business is on the yield curve only and, as I said, our turnover is predominantly banks and institutions: 85 to 90 percent of it.

That is compared to years ago, when, in the good old days, it was corn and it was soya beans and it was gold etcetera. To give you a better feeling for how it has changed, the following are some of the comparisons that I can give you. I am sure you do not perceive these markets to be as big or as small as they are.

First of all the SFE contracts. We have three contracts in the interest rate futures. That is, the 90 day bills, the three year bonds and the ten year bonds. And we have the SPI. Each one of the three interest rate contracts trade in excess of 20,000 contracts a day, which converts to about five million contracts a year. The SPI very rarely goes over about 2,000 contracts a day. We think the SPI is an illiquid contract, which is one reason why we are trying to reduce it down to about a quarter of its current size.



Who would have thought that the bank bill contract at 20,000 contracts a day would be bigger than gold on COMEX, silver on COMEX, wheat on Board of Trade, fifteen times larger than pork bellies, hogs, the British pound and live cattle on the CME. The SPI contract is twice as large as the cotton contract, the heating oil contract and the soya bean meal contract. Now, all of these huge agricultural contracts in the US which people perceive as being big over there are all smaller than any one of our interest rate contracts.

To put it in perspective, last year the SFE traded 15 million contracts in financial instruments, while the Chicago Board of Trade traded 120 million contracts in US treasury bonds alone, so we are still not any where near as big as any of the majors. The CME traded 40 million contracts in eurodollars. The S&P 15 million, the deutschmark contract 12 million.

So the day of the agricultural contract is almost gone as a commodity that can be readily adapted to a futures market and may never come back. Where does that leave us? That leads into:

What will be the instruments of the future?

On the SFE, certainly our life blood is going to be financial instruments. We think it will survive a few more years on the back of fixed interest. However, as I do not need to tell you, fixed interest is pretty flat at this point in time, and the yields are not quite as good as they used to be. So there is a bit of diversification in mind. Where is it going to go as far as the major investor is concerned? Is it going to go into gold? Is it going to go into equities? Is it going to go into energy? Or is it going to go into commodities?

Well, we think that it will go, in the first flush, into equities, not because of anything other than that it is the market in which we see the fastest area of liquidity creation. It is easy to convert interest into liquid markets in the equities area. There are already markets pre-designed and the infrastructure is already there. The stock market is able to readily respond to a resurgence of interest in equities. It is there, it has been bleeding to death waiting for us.

The over the counter area of the market easily responds to a resurgence in equity trading and there are obviously fundamental reasons why equities might be a good bet for the time being.

So, there may be this move from predominantly fixed interest investment by institutions down to a little bit more equities investment. The old ratio many years ago used to be 60% fixed interest and 40% equities. Then it turned around the other way and these days it is not easy to gauge. We hear from the institutional users of our market that they are still a little bit frightened about moving too far away from fixed interest, because although the yields on fixed interest are not as good as they used to be, they are wary of the stock market. How long is this market going to last and how far is it going to go down when it turns? There is still a little bit of reservation there.

In fact, although I have given the OTC market a little bit of a bagging in the sense that the futures markets in some way lose business there in the style of trading that goes on, they are also a good barometer and a good measure as to what is the most active investment these days.....If you can find who is trading what.

The gold market is a fairly active market in the local London area. It is a quite active market in Hong Kong in the cash market. It is not being translated into an active market at COMEX, but who knows, it might as the price moves up. So, we are seeing that gold market activity out there and making our decisions as to whether the next step is to put a gold contract back on the SFE.

Now, in doing so, it brings me to a point where we ask how do you measure whether these contracts will survive and be successful on a futures market? What are the ingredients in saying: Alright, we have got this little wish list out here - Gee we would like to have a gold market. Gee we would like to have a silver market. Gee wasn't it good when we traded the cattle market? Gee wasn't it good fun when we traded the wool market?

## Wool

Well, let us take them in reverse order, the wool market: Would that be a successful futures contract now? The initial reaction I got from

ABC journalists and God knows who else a year ago was that there is no more Wool Corporation, there is no more floor price. It is going to be volatile for every body, there are going to be volatile prices.

Rubbish. The only thing that happened when the Wool Commission walked away from the floor price was that they handed the whole risk to the grower. The mug grower got it again. They have been copping it on the chin for the last few years at the front end and now they have just walked away and handed them the risk. Why? well, if you are a mill or a wool buyer selling forward, what risk have you got? You have got three million bales of wool there and so, as a mill, you have no risk. As a buyer selling forward, you have no risk.

The price is not going to go up. David Clarke and the Australian Wool Realisation Committee are sitting there like vultures in a tree waiting for the damn thing to move up ten cents and they will sell the lot. So, who has got the risk? The wool grower. So, in that sort of a market, why do you need a futures market?

The futures market is supposed to be a risk transfer mechanism. When the wool grower perceives that he has got a risk if the price is going to fall, he trades with a wool mill, who perceives that he has a risk if the price goes up. And they are supposed to meet there



occasionally and trade. If they don't, the likelihood is that the wool grower runs the risk for a little while and so does the wool mill.

So, until they get rid of that stockpile, until there are a few other people in the train that want to take a risk from here to here to here, there is no use listing a wool contract as far as I am concerned. The wool market will not survive on just the wool growers. They have never used our market place, never understood our market place. We have spent millions of dollars trying to educate them. We sent Will Slatyer around the countryside year in and year out. He busted his gut trying to get growers to understand. It is one of those things: the market place will not survive on just one sector.

The most efficient markets in the world are the ones like the US T Bonds contract, the CME Eurodollar contract, the S&P 500, the SFE financial instruments. They are so efficient because there are multiple risk takers and transferrers in the system. That is the sort of market we want.

## Live Cattle

Now, the live cattle market. The big concern we have about live cattle is, depending upon what type of cattle you have got, that the cattle market now is vertically integrated. The Japanese own the

farms, the cows, the processing sections in Australia, the ships that take them up to Japan and the supermarkets in Japan. So, where is the risk for them? When the Japanese decide to step back or when the Americans decide to flood the market with their beef, the only people that again have got a risk are the growers. And we cannot put markets up just for them.

What needs to be done is that there has got to be some risk perception in the market place, just as with wool. You have to have banks or institutions or brokerage houses or something go to the farm gate and buy the cattle from the grower and he may, if he trades options or something, takes a forward contract or whatever, perceive he does not have to manage his risk. The person who has bought these things and then does not have any place to sell them, needs a risk transfer mechanism. If they go and sell them forward to someone else, they will need a risk transfer mechanism. Once that chain starts to roll, then maybe we will have the justification for a futures contract.

## Gold and Silver

So, that brings us back to gold and silver. Well, actually I am a little bit more encouraged there, because I read in the papers that the producer has in fact written forward contracts though Macquarie and other banks and are now, because gold is going up, deciding to unwind those forward contracts and let the market run a bit and therefore run uncovered. That is a sucker play if ever there was one, but that is what they are doing.

It is as though the textbook was never written or was thrown out the window thirty years ago. Here are these gold producers, that have probably paid some pretty hefty margins to get set directly over the counter with the banks. It is probably like life insurance, if you can get out of it, unwind the forward sales early, you will have to pay a penalty. So, they are now unwinding those long distance production hedges and they are running the gauntlet of the gold market continuing to rise. And they will do that rather than trade in gold futures contracts, with a \$2,000 initial deposit, \$1.17 fee and about \$5 a trade.

I am encouraged to hear that they are doing this, because surely that has got to be a justification for a gold market. That is what it takes, people prepared to take a risk and others prepared to take the opposite side. The more people that are in the chain taking risks, the more I am encouraged.

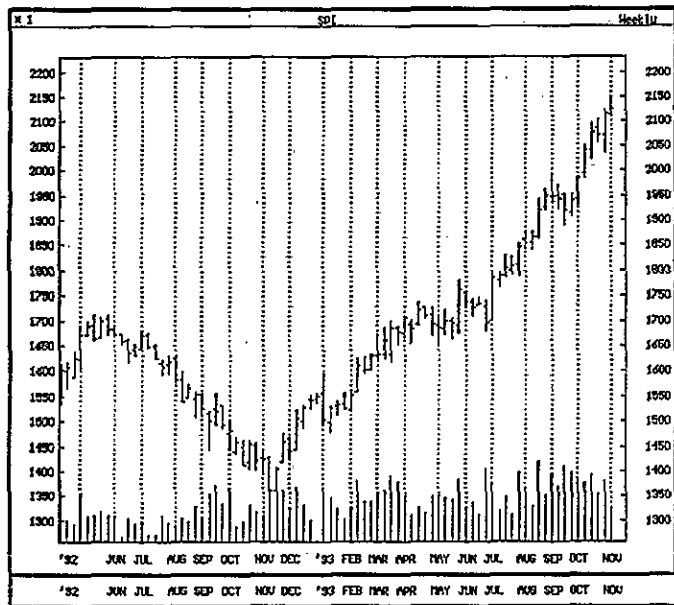
The gold producer is now in the chain taking the risk. Macquarie Bank has said: Yes we will unwind our hedge, but they have probably got themselves back to back anyway and need to unwind themselves. So there is a chain reaction. The more of those links in the chain, the more active a market you have got and the more justification there is for a standardised product.

So, it is not scoop news, but the SFE is seriously considering putting a gold contract back on its floor and it will probably do it, we prefer to do it, linked to the major liquidity provider in COMEX, because the more unified the 24 hour market we will have, the safer it will be perceived by the larger users and therefore the more they will be willing to take on this risk transfer mechanism futures provide. Also, the other thing I have not touched on at all here and I won't, is the counterparty risk elimination that futures provide.



The gold market may come back in the form of futures trading either on COMEX and on SFE or just on COMEX, because it is the established market, but it will only do so if there is a continuance of this risk taking that is now going on in the market place. Also, if the gold price keeps going up. If gold falls, well, we are back in the same old boat again I suppose.

## Share Price Index



And finally, SFI. Well, it has been a real sleeper for a long time hasn't it, in the sense that ever since the 1987 crash, there has been very little interest in the retail sector as far as equity markets are concerned. Particularly taking risks in the equity markets. There has been more significant investment in the fixed interest markets. So, there has been no willingness for people to speculate, take the risk, or even have a bit of perceived risk transfer.

Our Share Price Index contract has been ticking over through locals on the floor, who are capable of getting the finest margin out of that market. They can stand there and buy at 1701 and hopefully it will go up to 1702 and they will make \$100, but if it doesn't, they are in the safest position on the floor to trade out at 1700.9, 0.8, 0.7, 0.6 etc.

Going back to these locals, I have really got to emphasise that futures exchanges are reliant on that population to provide these efficient markets. We do not have enough of them in Australia. On the Chicago markets, all the ones that I said to you before are successful, are heavily populated in the pits by local traders, individuals prepared to take this risk transfer mechanism from one hedger to the other hedger. The more of them, the more liquidity, the more stability in price and the less volatility you are likely to experience. Some of the markets in Chicago: pork bellies, live cattle and grains would not be in existence today had it not been for the fact that for 75 to 80% of their existence, they have been priced by individuals on the floor, that is locals. The hedgers intermittently use these markets.

To give you a better comparison: How many markets have never been very properly priced cash wise? The wool market for instance: supposedly you know the true value of wool in what I would describe as a public auction place when the wool auctions are on between 2.00pm and 5.00pm on Tuesday to Thursday. The rest of the time: guess. There is no public market. The AWC tries to publish an indicator price, but it is about as useful as a hip pocket in a singlet. That sort of inefficiency is still in many, many cash commodity markets around the world.

That sort of inefficiency is another factor that is inhibiting liquid futures markets, because I am not prepared to take a risk as a futures trader unless I know where that cash market is. I can do it on the SPI because the ASX is determining the cash price. I can do it in bank bills because the interbank market is determining the rate. I can do it in bonds because there is a cash bond market being widely disseminated. So, where there is live cash data that is regularly trading and widely disseminated, you can trade the futures easier. That is why futures markets on financials have been so much more successful in that sense. So, there is another reason why the agricultural markets are not going to go anywhere until they catch up to this global market place we have now, where whatever you say is reported by Reuters and Telerate and is interpreted by the market practitioners within seconds.

I suppose you are getting the drift here that I am a little sceptical towards agricultural markets and even gold. Who knows what the real price of gold is? Is the fix in London a trustworthy vehicle to tell you what the price of gold is, compared to how bond markets trade? Do all the gold bullion houses around the world every second of the day tell some centralised place that I have just traded gold at \$US360 an ounce? You do not get this in gold, but you do in financial markets. You can see on Reuters the US T Bond rate and you can trade the US futures in T Bonds, but gold is a little bit different. There is an inside edge there that discourages people from trading.

## Summary

What I have just tried to do is say that the futures markets of the future are not going to change very much, they are just going to get bigger in the area of financial instruments. If there are some opportunities in metals or some other cash commodity markets, they may evolve into active futures markets, but I am a bit sceptical because of the cash market pricing.

That is another reason why I think the equity markets will see more meaningful business done. That is because there is a properly functioning cash market which is giving you price information that allows you to trade proper functioning futures markets which are giving you instant price information.

## Price Data

Instant price information is what the markets these days demand. Technical analysis is useless in many of these commodity markets because they are not giving you enough prices.

I could tell you some horror stories about some of the data that is

actually disseminated out of futures markets. I caution you into finding out how data is captured and disseminated on certain futures markets, because you might be getting fairly corrupt data. Unless you have got pretty good systems to filter it, this data could cause an awful mistake. So, there are some dangers in that area.

## The Future

So, in the next five years, I think we are going to see a stronger concentration by futures exchanges, not on futures products, but on the liquidity they have got, on more accurate reporting of data, on extending trading hours and on creating more liquidity and efficiency in the biggest products.

Why I say that goes back to who are our biggest users: the institutions that demand that sort of liquidity and the major commodity trading advisers who manage about \$US30 billion of futures funds in the US. Those people are demanding that sort of information.

The CTA industry in the US spends about \$US15 million a year buying tick data from the Chicago Board of Trade and the CME. The SFE earns about half a million dollars a year selling tick data to those CTAs. That is the name of the game: accurate data that can then be massaged by the users.

I cannot forecast for you any new contracts that are coming around the corner. I see some growth in our SPI contract because I really believe that a twenty five times the index product will provide a more liquid market, allow more people to take risks and allow more people an opportunity to trade. It will not just be an institutional market. It will be a locals market, a retail customers market, a stock broker market, an arbitrage market and an institutional market. So, there will be an efficiency there that we have already got in our interest rate markets.

I do not think a wool market will come back for many months, if not years, because of the stockpile and the lack of risk being taken. Hopefully we can work out a cattle market, because there are some risks out there. It is a matter of how you specify it and we have done quite a bit of work on it.

The name of the game is that the futures exchanges are, all around the world and the SFE in particular, concentrating on very clean data, quickly disseminated so that you can make money. I prefer to provide you with three very liquid futures markets with integrity of price, than ten little ones trading a couple of thousand contracts a day because it would be nice to trade them.

## Trading Floor Versus Screens

How long is the SFE trading floor going to stay there? Well, we experimented with screens and you might perceive that a screen market gives faster data, faster price distribution and might be even more efficient. Some of you may be devotees of computer screens and think that they solve all ills. Well, it is not right. There is an old saying among die hard floor traders such as myself, that the only difference between the Loch Ness Monster and a good

screen dealing system is that two people have actually seen the Loch Ness Monster.

So, I think that futures market trading floors will be there for many years, one of the reasons being that we create the liquidity we have been talking about. The market floor has the ability to provide liquidity which has not been evidenced yet in screen dealing systems, because there are no locals in screen dealing systems yet. The price discovery mechanism is still inefficient. If I want to trade 1000 lots at a price in a screen dealing system, I have to get in a queue. There is a preference shown, they do discriminate against you on a time basis. Whereas, on the trading floor, everyone has equal go, we all trade at once. Many screen dealing systems make you wait, so you can hear the news, but because you keyed in a nanosecond later than a little old lady in Blacktown with one lot, you wait. Or, you have to drive the price over the top, which creates the volatility we do not want in markets. Until we fix all that up, and we have been working on ways of doing it since 1989, we cannot replicate a trading floor and I do not see it seeing the light of day.

## Questions

*It is not always possible on the tape to identify the questioner or to hear the question asked. However, the answers seemed to be of sufficient interest to reproduce on their own.*

Answer: You would be surprised at how many people do have the



perception that a smaller (SPI) contract is more expensive. It has been very hard for us to explain to people that, although we are reducing the contract size to a quarter and the perception of the institutions is that they are going to have to pay three more fees, they will actually save. We estimate that an institution with a hundred lot order has a slippage of one big point at least on the way in and on the way out. Therefore, for each contract they trade, they are losing \$100 in slippage on the way in and on the way out, or \$200 on a round trip. Yet they are complaining about three times \$1.17.

Answer: The (SPI) contract is inefficient, that is the fact of the matter and it has got to be changed.

Answer: We are going to announce that, until the contract trades at a daily average basis of 10,000 lots, we will not charge any fee at all.....this says that we are serious, doesn't it? They will accept that if a contract is that liquid, it is worth \$1.17, so we are not going to collect any money until it is.

Answer: The commissions are negotiable and most of the brokers have said simply: Well, when the SPI had \$100 tick movements,



we had to charge a commission which reflected the risks that we were taking over night. So, let's say the average commission was \$10, all the brokers I have spoken to have said that they will be either halving or even quartering their commissions, to reflect the lower risk.....I can give you the name of a few brokers if you want.

*Will Slatyer: You did not mention the individual stock contracts?*

Answer: Certainly we are moving along that track. We are listing individual equity futures contracts, that is futures on individual stocks. This was tried in 1984 by the Australian Financial Futures Market, but it was not successful, which is not surprising in that we would not be successful trading BHP shares on the SFE, so they would not be successful trading BHP futures on the ASX.

We have brokers who specialise in futures, we have the infrastructure for trading, we understand price discovery, but they don't. They know how to sell equity in stocks.

We are in the process of finalising the most difficult aspect, which is how to handle the delivery of the share futures contracts, which I expect will be through the registry of the delivery company. Once we have solved that, which will be within two weeks, we will then be seeking to list these contracts through the usual regulatory channels and we have an anticipated start date of mid January 1994.

We are doing three companies only. This news broke in the Australian Financial Review about two weeks ago and I have had several letters from major companies asking whether their shares could be listed as share futures, because they realise the benefits of having the enhanced tradeability their shares will have with institutions and others if there was a futures contract.

Derivative markets do enhance both the holder of equity portfolios as well as the tradability of those shares. So, at least they have learned that out of derivative markets and how futures are a much more efficient and cost effective way of portfolio management than are options. The likes of AMP and National Mutual are very, very keen for individual share futures. They would like to see them on the range of stocks in their portfolio, but they accept that they will enhance the liquidity of only a few stocks in the first place.

*Dawn Bolton-Smith: That should give us time to get our charts all in working order.*

Les Hosking: Well, let's hope the equity markets are still moving upwards at the time of listing.

*Dawn Bolton-Smith: Does it really matter?*

Answer: No. I suppose it goes back to the wool market. Timing is everything. We went out and did an intensive marketing campaign on the wool growers as to why they should hedge their wool. Some of them did actually hedge and guess what? The wool market went up and went up and went up and here they were, all short futures and long wool and having to pay margins to those rotten futures brokers. So, I don't want to have people hedging their portfolios with futures and seeing the All Ordinaries go through the 2000 barrier with no stops and us calling margins. In

some ways, it might be better if we introduced these contracts on a bear market.

*Question: What are the three companies?*

Answer: BHP, News Corp and National Bank. The major criterion is that they must be quite active in the London market because we believe that we will get quite a bit of business out of the London market after the ASX has closed.

Answer: The fifty leaders contract was an absolute disaster. I blame myself because I listened to the institutions who said they would trade that in preference to the SPI and never did. We have spent at least nine months analysing the smaller SPI contract and going to each position holder and asking in the market place. We expect that the existing users of the market, the AMP and all the institutions, plus the locals, will continue to use the market, only they will do it twice as much or four times as much. Plus, because we have a smaller size contract, we will get new business that has never come near us before. Also, if we get to an optimal level of about 5,000 contracts a day the huge Commodity Trading Adviser pool in the US will come and trade the market. Their first measure of a liquid futures market is, no matter what the contract size, no matter what else, if it does not do more than about 5,000 a day and an open position of about 30,000 a day, they won't go near it.

So, over all, we think the liquidity will evidence itself on the floor in the pit as opposed to at the moment where there has been an inherent liquidity there, but it is just not meeting each other because of the cost and the size of the contract. That is, the important part about designing futures contracts is, not so much the risk transfer element, but you must have a chain of risk and also you have got to have as many players as possible to trade those markets in all sectors. So, you can't have just a growers market.

A typical example is when we started off currency futures (Australian Dollar versus US Dollar) the major banks were saying to us that we had to have a \$5 million contract, because that is the parcel that they trade. But we said, well no, we are actually going to have a \$50,000 contract, because we want the littlest investor, the speculator, in there. Because, in those days, they said, look get those damned speculators out of the way, that is they just did not understand that futures markets have this wide cross-section and until they do, they will not be successful markets.

*Question: There are now a lot of index funds. Would they not support a fifty leaders contract?*

Answer: Yes, we have spoken to those people and I think the SPI will benefit from that as opposed to the fifty leaders contract. It was a dead mistake to list the fifty leaders. It was too close to the SPI. We did not have enough evidence of liquidity in the SPI to list another one anyway. So, we shot ourselves in the foot and we should have known, because we agonised about whether we would list a three year bond as well as a ten year bond for ages and only did so when we were certain there was sufficient liquidity and additional arbitrage in the market to trade both sides of the yield curve. And here we were saying we would list both an All Ordinaries and Fifty Leaders contract. They looked exactly the same and we were only doing 1,500 trades a day in the SPI. It was crazy.

*Dawn Bolton-Smith: The Twenty Leaders Options has also been a disaster, they do not even publish the figures in the Financial Review any more.*

Answer: I think the explanation I gave you on the Fifty Leaders has told you why. Once one is there, then you may as well concentrate on the liquidity in that, do all you can on that one and forget about hedging about the place.

It is one of the reservations I have about Gold in that, whilst COMEX is there and ultimately COMEX is going to be a twenty four hour market through GLOBEX screens, it will be a market that will be available to you in this time zone live. Then it is going to be hard for us to compete with that. That is why we think, well why don't we get back into bed with COMEX now and provide the liquidity here and have them flow it on to us.

We are thinking the same on oil. We would like to trade the West Texas Crude here in Australia on behalf of NYMEX. NYMEX and the SFE happen to have the same screen dealing system, so we might link them together.

So, there is only one liquid market and that is now in New York. With technology the way it is going, it is quickly going to go through the rest of the world via screen dealing or something like that. We are really a bit suspicious about spending our hard earned dollars in listing things that may fail for the usual traditional reasons: There is already one there.



I believe that is another reason why the SFE going into individual equity futures is an exciting move in a different direction. If it is successful, then we might see an IBM on the floor. You may see the top Japanese stock or the top British stock. Just one, that is all you need, dragged along with the indicator, and you may be able to trade those markets in Australia. That seems to me to be a much more promising new venture than digging up the old bones and trying to dust them off.

*Question: Would foreign stocks have to be denominated in foreign currency?*

Answer: Well that is a question I am not yet convinced on: Whether it should be their currency or our currency. There are two sides to this argument. The gold market really liked our Aussie dollar gold contract and it depends on where you are directing some of the business and whether there is sufficient hedging there. I tend to believe that you trade it in your own local currency and let the market place sort out its currency hedge as opposed to trying to give people an invested currency problem.

Basically we start with the question of whether there is any risk out there. If there is none or insufficient risk, it is not even worth looking at.

Answer: You mean the trading on the floor itself? The local has equal ranking with the employee of the bank or anyone else as far as whoever has the best price is entitled to trade and it is the seller's preference as to who he trades with.

Answer: The futures markets are traditionally set in eight sided tiered pits, like a little amphitheatre. So, we all stand around in a circle and eyeball each other. At 8:30am the bell rings and, if I want to sell ten lots of SPI at 1700, I shout out "Ten at 00". Just the last two numbers and the quantity. And I push my hands out like that. If someone wants to trade with me, he just says "But it".

Now, if 200 people are doing that, it might sound a bit chaotic, but it works in a sense that, before the bell rings, we go through this pre-market phase of saying "Well, I am going to be at the bid at 97". Another fellow will say "I am going to be at the offer at 98". So, we get a market between us, an indicative market, so that when the bell rings, there are going to be sellers at 98 and there are going to be buyers at 97. Now, someone may jump in and actually offer at 97, to try to get the jump on others. That will happen today, but let's see what he does tomorrow and the next day. The pit culture sorts itself out, since you have got to live with these fellows, to deal with them every day.

So, the market opens, and from there on it is the true open outcry price discovery market. The best price is shouted to all in the pit and all the pit have an opportunity of trading with the seller and it is the seller's discretion as to whom he trades with. Not on the basis of credit risk though, it is merely on the basis of efficiency more than anything else.

This is why screen dealing markets are not as efficient as floors, because let us say, as is typical in the bank bill market, there will be blocks of 500 go through. The trader will say "500 at 2". The pit will be in uproar to accept: "Buy 100, buy 20, buy 50, buy 200, buy 500....." Now, some of the smarter ones will not say "Well, you can have 2 and you can have 3 and you can have 5 and so on", because that means that you have to write out all these damned chits. So, if somebody says "Buy 500", he will say "You" and leave the rest alone, because it is one chit.

Now, on a screen dealing market, it is like you are in the queue with a 2 and a 10 and a 20, down to the 500. You just have to sit there. These open outcry types of interchanges just cast the business through so much faster than a screen dealing system, it is phenomenal.

Answer: The technical description is an open outcry two way public auction. Most public auctions are one way, I am the seller and you all put the numbers up. Whereas this is two way: you all tell me what you want to buy at and I tell you what I want to sell at simultaneously. It is very efficient.

*Rob Gray: How can you go about educating private traders when you say that they should come in at the smaller SPI*



contract?

Answer: It is almost compulsive that the SFE puts out a lot more private trader educational information into the market place with the introduction of the smaller SPI and, more particularly, the IEFs as we call them, the equity futures. So, upon the formal announcement of the SPI and when it is going to be listed, there is going to be quite an intense private client education program. There are going to be a lot more sessions down at the exchange at the auditorium and a lot more information available from the exchange as far as contracts and how to trade them. The brokers are fully behind this and they are quite hungry for these contracts, because the margins in the interest rate products are down to such lean and fine levels, they want something new. So, I think you will find you will be readily accommodated with education programs on how to trade futures.

*Question: You mentioned a few markets we should stay away from because of corrupt data?*

Answer: LME. Others? We all now, as exchanges, provide information to what is called the Futures Industry Institute, which is an organisation in the US set up by the Futures Industry Association. That organisation will only take data from what it believes to be exchanges that properly capture the information and disseminate it. Also the giant CTA Industry in the US will not go anywhere else, they will not get data except from that place, though some of them come direct to us because they know us.

It is very hard for me to say that any exchange outside of the top ten provide sufficient liquidity to give you reliable trading data and price discovery. I think SIMEX in Singapore is the twelfth on the list of top futures exchanges, whereas we are the seventh. They are a very reliable market. I must say that when you get down to the level of the Hong Kong Futures Exchange, the integrity of their data is starting to slip. It is not very well captured and not at all filtered and they do not spend the money that we spend attempting to ensure that whatever is traded in the pit is properly recorded as far as sequence of trades and volumes.

It is quite a tricky area. Back in the good old days, you could sit there and do it manually as you heard it, but you have got to trust us these days. The SFE's record turnover day was 210,000 earlier this year. At 11:30 when the major turnover was happening, because of the balance of payments figure, we traded 60,000 contracts in seven minutes. The price changes in that period of time were very, very rapid. Now if we do not collect that accurately and there are people who rely on tick data information, it is not a very nice situation. Beyond the top ten futures exchanges that can afford to do it, the integrity of the data starts to fall away.

Answer: Yes I accept that (the SPI options) is an inefficiency. The new options display unit software is being worked on now. It is an inefficient market. I think the schedule for the new software to be on the floor is first of August.

*Question: Why was the SPI opening time moved from 9:30am to 10:00am?*

Answer: I am trying to remember the reason. I think it was

because people believed that the price discovery efficiency was not adequate for the full half hour before the stock market opened. There was a burst of activity at 9:30am and then there was very little that went on from 9:30am to 10:00am. You had half an hour of inactivity, which is as bad as having no quotes. Futures markets look best and are most efficient when they are actively pricing, just the same as any auction. So, until we get a genuine half hour of guts before the ASX opens, we will reduce it down to what is an optimal level.

Answer: I am totally against that (the break in trading for lunch), but it is tradition, history. The latest excuse that I have been given is that the only time we see our clients is when we take them out to lunch. Now, in the US market, they start at 7:30am and trade until 2:00pm and then they go and talk to their clients. They give continuous markets and then stop early. We could do the same and then go to SYCOM.

We experimented. We tried Aussie dollars during the lunch hour, but they just won't accept it.

*Zoran Gayer: Why do you trade the SPI ten minutes before and after the ASX?*

Answer: Oh, just so we can get a bit of business out of the ASX.



*Zoran Gayer: You talked about technical analysis and charts, how do you devise a half hour chart in a day which has two hours forty minutes in the morning?*

Answer: I have never been told about it. I will have a look.

Answer: That is a concern to me because we try to filter that a little bit better than that. First of all, the volume adjustments are to line up the accurate submitted chits with what the price reporter is estimating the volume that is going through the pits as it is happening. So, as all of these trades are being shouted out, the price reporter is calling into the microphone the bid, ask, last trade and estimated volume. Every half hour, there is a comparison of what has been submitted by trading chit versus what the actual volume is to see whether we can get..... unfortunately, we have not got anything more than compulsory submission of chits for the morning session and the afternoon session, so we do not finally line up the actual volume with the estimated volume until 12:30 and 4:30.

Very soon we are going to go to half hour time bracketing, whereby all trades done between 9:00 and 9:30 must be in the hands of the exchange by 10:00. That way you will get much closer alignment of the volumes.

## HORSES FOR COURSES

At the Sydney meeting of the ATAA on October 18 1993, Chris Talbot gave a very interesting address on the psychology of trading. The following is an outline of that talk, which Chris has kindly prepared for us.

We are all interested in "getting more" out of the markets. This means many things to different people:

The intellectual satisfaction of getting things "right".

The ability to trade (or if we are non-trading analysts, enabling other people to trade) more effectively and, by definition,

Achieve a consistently enhanced market performance (make more money) with a minimum of anxiety and stress.

Get all of the above with a sense of satisfaction and, if you like, a sense of emotional achievement.

There are, of course, many factors which go into getting all of these things from the market and there is quite obviously a limit to what can be dealt with in a limited amount of time. Also, there are issues which, at times, are best dealt with on a one to one basis, particularly when they deal with matters personal or specific to the individual analyst or trader. However, in my experience, one of the major keys to getting the most from our participation in the markets and their analysis is:

### MATCHING THE ANALYSIS APPROACH AND TRADING SIGNAL GENERATION WITH THE PERSONALITY STRUCTURE OF THE TRADER.

This is the case whether you are acting as a trader/analyst, or as a pure analyst providing market intelligence to other individuals who use your information as part of their decision making process. It is a complete waste of time generating information which is not going to be used.

Therefore, it is necessary to match the analysis output to the sort of input that effectively enables the trader to trade better. Whilst this may sound like a self evident statement once it has been made, very often it is not consciously or effectively built into the design of the analysis approach.

Another way of saying the same thing is "make the analysis and its output fit the trader, don't try to make the trader fit the system". Trying to make the trader (even if the analyst is the same person) operate with an inappropriate system will have two particular effects:

At best, you will have a trader who suffers high anxiety when they are in or, according to the system, "ought" to be in the market.

The trader will not take all of the signals and, indeed, will probably ignore the "system", of whatever type, as soon as the going inevitably gets a "bit rough". This, of course, causes even more

anxiety.

It is this phenomenon which, together with the "over curve fitting" approach, explains why there is often a "performance gap" between historical testing/paper trading results and the results of a system operated live in the market. It is also the reason why one trader can enjoy excellent results from a system and another perfectly competent trader may not be able to replicate anything like the same performance. In the latter case, there may be absolutely nothing "wrong" with the "under-performing" trader, although that is often the erroneous conclusion which will be reached.

So, what are the personality traits which influence the suitability of a system for a particular trader? There are many and the most important are briefly discussed below. However, before proceeding to discuss them, it must be clearly pointed out that there is no perfect trader and that even the most extreme personality types can and do make very effective traders, provided they receive the "right" input from the analysis function.

The first and probably most fundamental issue to be considered is whether the trader is suited to an OBJECTIVE or a SUBJECTIVE trading system.

An objective system, often referred to as "mechanical", is one that generates clear, inflexible trading signals. For example, buy when the close is above the, say, 23 day moving average...no ifs, buts or maybes!

A subjective system may be of the type which requires the trader to make a decision which may be based on a collection of variable data, such as recent market volatility, the level of, say, the 14 period RSI and the day's volume, coupled with a feel for sentiment. It is interesting that, in my work coaching traders (this is, of course, not a particularly scientific study mind you), I have observed that many individuals consider that objective systems are not intellectually "macho". To which I respond that it is even more macho to drive a Ferrari with the proceeds of trading, if an objective system is going to produce better results with more equanimity. Objective traders often place the creativity into the system design process and then move on to the next challenge.

Neither basic approach is inherently superior, unless, of course, you ask an individual trader and then you will discover that most traders will favour one or the other type of system. As things seem to be, most traders tend to operate with a mixture of both approaches, but, in my experience, almost all traders become "more comfortable" as they operate a system which is close to the particular extreme which suits their personality. It is almost pathetic to observe a person who is strongly biased toward mechanical systems attempting to judge a number of intangible factors before "putting on a trade". Equally, it is something to behold when a subjectively inclined trader is supposed to sell a market because the moving averages have crossed, but when he "knows" that the market is oversold and is "certain" to rally. The thing to bear in mind is that both types of systems can produce consistently excellent results when in the hands of the "right" type of trader.

The next important feature of any system or approach is the activity



level which is required to properly operate in the market. Some systems require the monitoring of very short term data and probably relatively frequent trading. Others require, and indeed rely on, only long term periodic data and infrequent trading. Simply, a person better suited to infrequent market action will "go crazy" and no doubt feel considerable stress and dissatisfaction, if attempting to trade on Stochastics calculated on 15 minute price plots. Conversely, ask a person who favours a high level of activity (who needs to be kept busy) to trade only when the weekly close crosses the 35 period moving average and you will have a very frustrated trader, who will probably not be able to keep his hands away from the telephone. There will be a constant search for justification to modify, refine and fiddle with the basic position. I often hear traders tell me that this is just the way they are and there is nothing that they can do about it, which, of course, is quite true if that is what they believe. There are ways of dealing with this issue, although I don't have the time to deal with it now.

The third factor is what I refer to as the "convincer strategy". This is simply what is necessary to convince a trader to act on a trading signal (objective, subjective, high or low activity) and then to keep taking the signals consistently over a period of time, even when the "system" experiences a run of losses. This is a most fascinating issue, because there is a wide variety of factors which go into making any one person sufficiently confident to follow a set of criteria.

For some, it may be as simple as following the advice of a respected individual who enjoys a good reputation for accurate and tradeable market calls. I must comment, though, that I do not, for a variety of reasons, think that this is a good basis for a trading system: at the end of the day, each trader is best served by having his or her "own" trading support system, even if it includes the advice or opinions of another person as one of the criteria.

Other traders may require a large volume of data extracted from exhaustive analysis of past market history and not until they have compiled and fully analysed the results of their own research, will they be able to take a position in the market with any degree of equanimity.

Some, regardless of the course of the data, need to have written rules, whilst, to others, the idea of having to abide by a series of rules is impossibly restrictive and even repugnant.

It often takes traders a great deal of time to figure out by trial and error what best suits them in a trading system. Until a suitable system has been established, the trader will almost certainly experience considerable anxiety in trading and most likely a distinct lack of discipline in the application of the system. Whilst a disciplined approach to trading has many factors to support it, there is no doubt that a "comfortable" system which supports rather than confronts an individual's natural personality structure is one of the cornerstones of a satisfactory and workable trading system. A system which continually challenges a trader's personality structure will almost certainly lead to a lack of discipline and results which fall short of expectations.

The logic which can be derived from all of the above is that careful consideration should be given to the type of system which the

trader needs to dovetail into his own personality structure and preferences. It is then a matter of going to look for the type of system that fits. There is a wide variety of theoretical analysis approaches and an infinite range of variations on each theme which are available to be moulded into a system that suits the individual; and each individual is a "one off".

The old saying "never fit a square peg into a round hole" is nowhere more appropriately applied than in the business of trading. The individual may be thought of as the square peg and the variety of approaches which we have available to us these days means that there is just no excuse for not creating the square hole. If you go to the trouble of defining the shape you are looking for, then there is a great deal better chance that you will find it. Although it is a lot easier if professional help is sought, even using some common sense introspection and conscious trial and error, the result will be a much shorter path to finding a system which provides what most of us are looking for: tangible rewards and a sense of personal satisfaction from our participation in the markets, the definition of which will vary from person to person, just as systems do.



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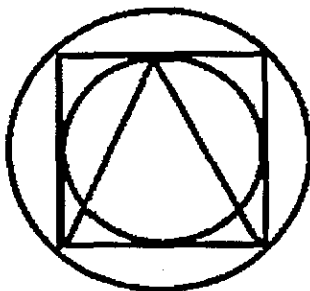
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