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**GETTING TECHNICAL** |  Online Exclusive  
By MICHAEL KAHN

## What Happens to the Market Af

**THIS WAS A BIG WEEK** for world news. The chief United Nations weapons inspector, Hans Blix, filed his report on Iraq Monday and President Bush gave his State of the Union speech Tuesday. Both of these events made war more likely -- and sooner rather than later. And, for good measure, the hard-line incumbent Likud Party gained strength in the Israeli elections, too.

So, what did the markets do? They sold off in anticipation of these events and they sold off after these events. And not just in the United States. Bourses in Europe are not faring well, with both the main German and French indexes closing in on their October lows. Great Britain, our closest ally in the war on terror -- and possibly Iraq -- has already seen its market punch through major support from its twin July and October lows.

These events do not bode well for us here in the United States, although our main indexes are still well above their own respective major support levels. They are outperforming other country indexes, suggesting that the U.S. is still the market of choice for investment.

When the current uncertainties ease, whether from peaceful means or war, dollar-denominated financial assets may be in store for quite a rally. How is that possible, even if the overall state of the stock market here is still not that attractive?

Recently, I saw a study comparing market action before and after the last three times we began a major military conflict. Price action in January closely mirrors the paths seen before the Korean War, Vietnam and the Gulf War in that it saw a bearish two-week period before the actual start of fighting.

The three patterns diverged from there, but all were in rally mode about two weeks after that. Uncertainty cleared up once the actions and reactions of war become known. (Of course, we still may be a few weeks away from any fighting in Iraq.) Why? The market hates uncertainty and will rally once that uncertainty goes away.

What could be more uncertain now than how any war with Iraq will go? Some of our allies oppose President Bush's policy on Iraq, and Americans are deeply divided. Even market sentiment reports are pointing to different conclusions whether they are investor surveys, price action in the tradable volatility indexes or investors' actions in the purchase of bearish- and bullish-oriented mutual funds.

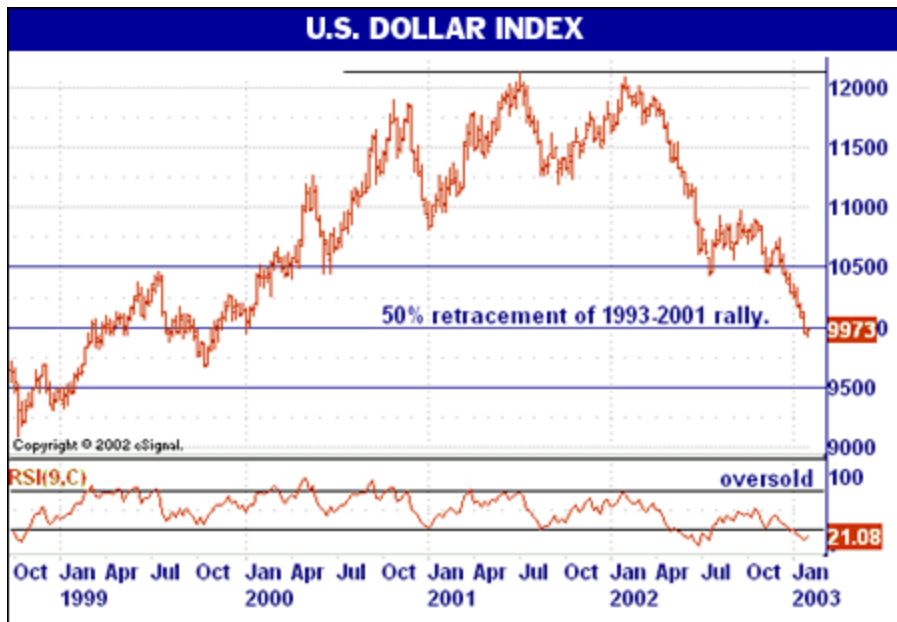
There are myriad reasons to be bearish. And while I am not about to become a bull, I am heading the market. What happens when something throws a bullish match on the kindling? That match can be in the form of a peaceful resolution in Iraq. It might be the capture of Osama bin Laden, assuming that he is still alive. Maybe companies will start to publish positive outlooks.

All this means that if the Dow Jones Industrial Average remains so susceptible to outside influences and continues to bounce around with back-to-back-to-back triple-digit reversals, then any big news will grab the market and send it moving—fast.

I am unwavering in my belief that the major market direction is sideways for the next few years. This does not mean that it will be a lifeless market, and indeed the signs tell us that big cyclical rises and falls are going to be the norm. Within that framework, we buy the lows and sell the highs and since we are not near either one right now, there's not a lot of confidence in any pundit's short-term predictions.

Let's turn to the U.S. dollar, which has taken a huge hit and is seemingly falling every day (see chart 1). This has implications for demand for U.S. stocks and dollar-denominated assets like gold and oil. In the absence of other influences, if the dollar falls, then the prices of gold and oil must go up. That can partially explain the rallies in these markets and in the Commodities Research Bureau index as a whole.

**CHART 1**



If and when the dollar reverses course and heads appreciably higher, all things dollar-related are going to get a jump-start. Watch out, stock market bears! And watch out, European stock market bulls! Isn't it a good bet that the relative performance of the U.S. markets will suck in even more money from overseas as the greenback strengthens?

So, is it time for speculation in the U.S. stock market and the unloading of gold and oil? Not so fast. The uncertainties are still there, and we cannot know what will happen in any war.

Sure, the market can rally big time on news of peace -- that match thrown in the tinderbox. It can also sell off quite sharply on the next terrorist attack or backlash from any military operations.

This all means is that keeping it light is the way for investors to go for now.

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