

Fullermoney

Global Strategy and Investment Trends by David Fuller

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Please note: This is a compilation of Comment of the Day for Subscribers, which appeared on the www.fullermoney.com website during the last week. Subscribers are encouraged to login at their convenience, to read the daily coverage and use the many other site facilities, including the Library of charts.

Monday 2nd October 2006

Puru Saxena: Banana Republic! - My thanks to Pradeep Venkat Rao for this [article](#) by Hong Kong based hedge fund manager Puru Saxena for Safehaven. I almost didn't read it, feeling that I have seen enough of the gratuitous USA-bashing articles, laced with schadenfreude. There is a bit of that but also enough serious content to merit interest. The article is posted in the Subscriber's Area - don't miss the two graphs, and here is a brief sample which will be familiar ground for veteran investors:

Finally, the biggest "Cover-Up" award must go to the officials who determine the Consumer Price and the Producer Price Indices (CPI and PPI). These "inflation-barometers" are a total fraud! Remember, the Federal Reserve's biggest motive is to conceal the ongoing inflation and manage the inflation expectations, or else the viability of the Federal Reserve itself may come into question. Therefore, both the consumer and producer prices are massaged, seasonally and hedonistically adjusted to keep inflationary fears under check. So, by keeping the CPI and PPI artificially suppressed via voodoo accounting and understating the inflation menace, the Federal Reserve maintains the public's confidence in the US dollar as a great store of value. After all, as long as the masses continue to believe in the "inflation-controlling" powers of the Federal Reserve and the other central banks, the more inflation and credit they can create!

My view - For many years, and well before the recent focus on inflation by central bankers, I can recall the veteran commentator Richard Russell of Dow Theory Letters fame saying that the USA faced a choice of "inflate or die". Well, we certainly have seen plenty of inflating by the USA.

But you know what - there are no virgin countries in this respect. It is really just a question of which nations are more promiscuous in terms of their monetary excesses. As an aside, this is why the long-term risk is an eventual acceleration of inflation, before any serious deflation. And not surprisingly, the Rake's Progress in terms of inflation depends on needs must. The USA's current need for inflation, provided it can be largely hidden from public perceptions, is higher than for a country less hooked on debt and asset appreciation. But I am talking about a question of degree - not trend.

This is why I have previously described the recent central bank jawboning on inflation as humbug. After all, they created most of it. So I agree with Puru

Saxena when he says that the Fed and other central banks are in the business of managing inflation expectations. And in an uncertain world, we can be reasonably confident that central banks will go on creating inflation, at least until it is seen as public enemy number 1.

Inflation is really just another form of stealth taxation on savers. And as with indirect taxation, few governments can resist the temptation to take as much as they can, without killing off the economic goose.

Why does the USA need inflation? The answer is because of debt, deficits, government expenditure for various pork barrel projects, foreign wars, competitive pressures from globalisation and not least the increased cost of energy. And guess what - China needs inflation to offset non performing bank debts and prevent a slowdown that would sidetrack growth necessary to absorb more workers arriving from rural regions and to keep the government in power. India needs inflation to reduce the costs of its energy subsidies. Europe and the UK need a degree of inflation to lower the cost of their entitlement programmes.

In a fiat currency world (and this won't change) there is no country that does not require the steady drip-feed of stealth inflation. Singapore, which has arguably had the best economic governance of any country for at least the last 30 years, needs a degree of inflation, if only to help prevent its currency from appreciating to punitive levels for the economy.

We have lived in an entirely fiat currency world since 1971. Inflation was allowed to rip until it became self-feeding to the point of being a political liability. That led to Paul Volker's appointment as Fed Chairman, Yasushi Mieno at the BoJ and other appointees charged with the responsibility of lowering inflation. They succeeded to the point that deflation, aided by globalisation, became a greater fear than inflation.

Today, I maintain that we are several years into a new long-term cycle of gradually and erratically rising inflationary pressures, for which services and resources are the early pressure points. And of course there is asset price inflation. Central banks are close to halting their mild phase of interest rate increases, having slowed GDP growth somewhat and benefited from the temporary oil price correction.

From an investment perspective, I will retain a significant inflation hedge position for many years to come. Gold and its sister precious metals are among the more conservative choices. And since all markets fluctuate, I am most tempted following periods of market weakness and can leverage up on the next rally. Similarly, I should have tight trailing stops when prices accelerate higher and gold moves from back page obscurity to the front pages of newspapers and magazines. However promising gold's long-term outlook, no one should be surprised by periodic sharp corrections, which remain a feature of any actively traded market.

Email of the day (1) - On my portfolio (from a trial subscriber):

"I have no idea what positions you hold."

My comment - [Every investment or trade that I make is listed in Fullermoney, as it occurs, under the heading of "My personal portfolio". I suggest you type the word - personal - into the Fullermoney Search facility.](#)

My personal portfolio: Leveraged long in Aberdeen New Dawn (ABD LN) increased - [Having protected my initial position with a breakeven stop, I increased it by 50% today, paying 481.7p for a March contract. This price includes spread-bet dealing costs. Here is a \[chart\]\(#\) of the cash price.](#)

The turning point in China's economic development - [My thanks to PG Bocquet for this interesting \[report\]\(#\) by Ross Garnaut and Ligang Song, and also for the inspirational feedback. PG adds:](#)

"Professor Ross Garnaut is a leading economist, former Australian ambassador to China and arguably Australia's foremost China watcher.

"The paper presented by Garnaut should be noteworthy to Fullermoney subscribers because of what it has to say about future global inflation, the resources boom, particularly in energy and industrial metals, and the international currency system.

"I'm sure that you and your subscribers will find this document interesting particularly since you, David, have been emphasising these investment themes for some years now.

"Incidentally, on page 287 there is a chart of the copper price (inflation adjusted) from 1895 to 2006 that puts the current price into perspective.

"Thanks to you and your staff for your valuable and informative service."

[The report is posted in the Subscriber's Area but here is a brief section:](#)

The theme of this year's review of recent developments in and research on the Chinese economy selects itself. China has or is fast approaching reached the turning point in its economic development, at which 'surplus' labour from agricultural employment in the countryside ceases to be available to drive the growth of the modern economy; so that labour becomes scarce and valuable; forcing large real wage increases and real exchange rate appreciation; which generate structural change towards more capital-intensive and technologically sophisticated industrial structure at the relative expense of labour-intensive manufacturing and agriculture; and changes fundamentally the character of China's interaction with the international economy.

My view - [This problem of an eventual shortage of surplus labour was always inevitable, assuming that China's economy continues to grow rapidly. However I would be surprised if it reached anything like a crunch point in the next few years. But if I am wrong in this expectation, there are plenty of other](#)

countries hoping to receive a larger share of the FDI currently flowing into China. My guess is that China's environmental problems are the greater and growing problem, and not just for the PRC.

Email of the day (2) - On the Audio volume:

"Well, it was a glorious Indian summer, communication-wise: strong, clear, sonorous David's daily audio for several weeks.

"Now, seemingly, it's truly autumn once more - volume set to maximum (remember to reset after each session, or all other sound programs will burst your eardrums!), straining to hear those faint, faded pearls of wisdom, first via the speakers, then using the top-quality earphones...

"Did Eoin reset the recording level for his broadcast the other day, one wonders? Please, please turn it up again! It was just fine, for an all-too-brief spell: I'm off to South Africa for the winter soon and as things are, it will be inaudible, as so often in the past, on the laptop."

My comment - I'm sorry to hear of this but there have been no changes at our end and all Audios sound consistently loud when we test, as I do immediately after posting each Audio on the site. I am not sure which of the downloads you are using but if convinced that the problem is not with your settings, please email Peter at - ptang@stockcube.com.

Email of the day (3) - On the PPT (from a pre-subscriber):

"I must disagree with the observation below. You seem to believe that we have free markets in the USA. We do not; we have the PPT (plunge protection team) which is run by the White House and is currently pumping up the stock markets to help the Republicans in the November elections. Pres. Bush wants to be able to say the economy is just great because the Dow has hit all time highs."

"-----the market, which is the synthesis of all views and reflects the weighting that investors are prepared to give them." [Ed note: This is from an item that I wrote on 29 September 2006]

My comment - Well, without wishing to make a partisan political comment myself, or indulging in conspiracy theories, the so-called PPT would not need to buy because the Dow has been rising along with other global stock markets. I believe this reflects liquidity and a change in sentiment, more than anything else. And a surprisingly high number of European advisors have been recommending US equities recently, presumably without any obligation or connection to the White House.

But regardless of who is buying and why, the PPT would be no more than another large and occasional participant contributing to supply and demand.

That is why many of us monitor price charts. In other words, the PPT, if it exists beyond sensible intervention during an occasional extreme plunge, would still be part of the supply and demand equation, covered by my partially reproduced quote above.

Last week's signups for the Free (Abbreviated) Comment of the Day - For the week of September 24th new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, Belgium, Canada, China, Czech Republic, Hong Kong, India, Ireland, Singapore, Switzerland, the UK and the USA - 12 in total. In descending order, which topped the list in terms of the week's new signups? It was the UK, USA and Canada. Welcome all to the Fullermoney Global Strategy Service.

Eoin is in Beijing - He returns on 18th October.

Tuesday 3rd October 2006

Wachovia Securities: The Week: Now What? - My thanks to Rod Smyth and colleagues for this latest edition of their fine [report](#), published by Wachovia Securities. The Week is posted in the Subscriber's Area but here is a section referring to the S&P's trend channel (don't miss this graph):

We think the most credible catalyst for a multi-year break to the downside would be a rise in long-term inflation expectations. We have consistently highlighted the importance of the long-term relationship between inflation and the market's PE ratio and how periods of low inflation have supported higher PEs and vice versa. Although inflation has risen, 10-year bond yields have remained relatively low suggesting that inflation expectations are still well contained, which is why we believe the S&P 500 has remained in the channel despite the higher inflation numbers. The other factor offsetting higher inflation is the exceptional strength of corporate earnings - S&P 500's reported earnings for June are 40% above their 70-year trend. In our view the most dangerous environment for stocks over the next year would be one in which inflation continued to rise, forcing the Fed to raise rates further and running the risk of a recession that would depress earnings. We currently place a low probability on such a scenario.

To break out to the upside on a multi-year basis, thereby increasing the rate of advance, we think investors would need to either believe in a new era of faster earnings growth (the trend rate since 1935 is 6.3%) or be willing to pay a higher price for the same earnings stream. Both occurred in the late-1990s stock market boom, but the subsequent bust makes it less likely to reoccur while investors' memories are fresh, in our opinion. To break out to the upside for a shorter period of time, investors simply need to become more 'exuberant', a possibility that we discussed in Pondering the Probability of Perfection (The Week, 4/24/06).

My view - Rod Smyth and colleagues' review touches on salient points and I agree with it.

Email of the day (1) - On how to benefit from Fullermoney:

"I am interested in subscribing to your newsletter, being bullish on commodities, precious metals, and emerging markets for the long term. I am looking for good entry points (market timing) to hold positions for several months and longer.

"Being relatively new to this, appreciate any suggestions on how to benefit from your newsletter.

"What trading style best describes the recommendations/suggestions made in your newsletter. Eg: % winners, average holding time of winners/losers, average profit per winning position, average loss per losing position."

My comment - Thanks for your interest. Fullermoney's theme is Empowerment Through Knowledge. I hope that I help to empower subscribers through my experience, fascination with the markets and personal journey through investment and trading. And I know subscribers help to empower me through their invaluable comments, experience, plus the quality articles and reports which they forward. Many of these are posted in Comment of the Day and/or the Subscriber's Forum. So Fullermoney is not just one man's view, or two men's views since Comment of the Day has included Eoin Treacy's excellent contributions over the last two years. Instead, this service has increasingly become a Collective, to which many subscribers contribute to our mutual benefit.

What we don't do is tell you what to do, because we certainly don't have all the answers and crucially, we address a widely diverse, in terms of specific interests and requirements, global subscriber base. So there are no recommendations because in addition to it not being my style, it would be a case of recommendations for whom? However my undertaking on behalf of subscribers and also reality check, is to list every investment and trade that I make in my personal portfolio, as these occur. Eoin, at his own instigation, has followed this example. And while we list both purchase and sale prices, we do not compile or provide any additional statistics, and I don't know of many who do, unless they are either running a fund or trying to sell something. However the information is all there, for anyone to access and vet should they wish to. What you would find is that whereas my investments seldom change, beyond the occasional increase or reduction in exposure, trades can last anywhere from a few days to months, depending on how they are doing.

I believe that the most important point in your email concerns how to benefit from Fullermoney, which is no longer a newsletter in the conventional sense, but evolved over several years into an interactive online service. The main

features are Comment of the Day, the daily Audio and last but not least, a comprehensive and steadily developing Chart Library.

In assessing Fullermoney, which is a Global Strategy Service, I suggest that before considering a subscription, you [signup](#) for the Free (Abbreviated) Comment of the Day, which is emailed to both pre-subscribers and also subscribers who wish to know when the site has been updated. Rest assured that in doing so you will not receive sales calls and your details will not be leased or swapped with any other service. The Free Comment will tell you a lot about Fullermoney and its subscribers. And in the all-important - 'what did he say back then' department, you can use the Archive and Search facility to peruse both the historic Comments of the Day and Audios. Subscriber's material is available in the public Archives four months following its initial release. Consequently you can (and I will suggest should) become very familiar with Fullermoney before deciding to subscribe.

Lastly, while the Chart Library is for subscribers only, Comment of the Day will tell you a great deal about my behavioural, factual approach to chart reading, which is an essential discipline at Fullermoney. Our price charts, which include funds and ratios, enable us to monitor the world's markets from our computer screens. Veteran subscribers frequently mention the value of this Library in planning their investment and trading decisions.

UBS Wealth Management Research's Commodity Guide: Year-end Gold outlook - My thanks to a subscriber for this useful [summary](#), including technical levels. The report is posted in the Subscriber's Area but here is a brief section:

Gold is hovering around the 600 USD/oz level as we enter the last quarter of 2006. We expect the metal to trade higher toward the end of the year as we expect a number of price drivers to apply pressure for a firmer gold price. These include a weakening USD, energy prices, seasonal demand and, not least, a favorable technical picture.

My view - This is a timely reminder at a time when [gold](#) is clearly under the psychological influence of price changes for [crude oil](#), which has breached \$60 again today.

Since everyone uses oil in its various forms, it is the most political of commodities - much more so than even gold. And having derided conspiracy theories yesterday, I'll contradict myself by asking: Do I sense the Machiavellian hand of Karl Rove in the oil price action?

I have frequently mentioned in the Audio that the Republican Party would dearly love to have the gasoline price well down, to have any chance of avoiding a massacre at the November Congressional elections. And I published this comment in an energy feature on 28th September:

And as a political aside, the Republican Party would dearly like to see subdued energy prices through at least the November Congressional

elections. It is no coincidence that an improvement in the poll ratings for President Bush and the Republican Congressional candidates has coincided with the sharp drop in gasoline prices.

Today on CNBC, I heard mention that the US Energy Department had announced that it was in no hurry to top up last year's drawdown from the Strategic Petroleum Reserve. This was confirmed by this [report](#) published yesterday on CNN Money. And [Yahoo News](#) has more today. Why the announcement unless the Energy Department was aiming to jawbone oil prices lower, or at least prevent them from rising, at a time when they had started to firm?

Anyway, yesterday's and particularly today's action challenges my recent contention that oil was bottoming out in the low \$60s. I now suspect that we have seen no more than the beginning of the bottoming out process, characterised by a loss of downside consistency and choppy action. Meanwhile both crude oil and gasoline need to rally back into last week's small trading ranges to offset near-term risk for some further weakness.

Oil's move also triggered a downward dynamic in gold today. Short of rally by crude, this opens the door for a possible test of the year's earlier lows by bullion. Looking further ahead, I maintain that we are seeing no more than a medium-term correction in oil, gold and other industrial resources and precious metals, before their long-term uptrends are reasserted.

Meanwhile, the oil price correction is good for global GDP growth and stock markets. This can only increase global demand for oil, other industrial resources and precious metals in coming months.

Email of the day (2) - On understanding charts:

"I would appreciate your advice about how to gain a basic understanding of charts."

My comment - I'm reluctant to recommend textbooks because it took me a long time to unlearn the pattern identification emphasis of these publications and also their mechanised theories, before I could start to think about what was actually occurring on a price chart. However this is a minority view and John Murphy's books are probably as good as any. You can read about them in the Stockcube [Bookshop](#) and elsewhere.

My suggestion would be to concentrate on chart facts rather than theories. For instance, is it trending or ranging; if trending, is it consistent or inconsistent; is it relatively strong or weak; does it show any evidence of the 3 primary trend-ending characteristics mentioned by TCS - acceleration, extreme reaction against the prevailing trend, or the comparatively large churning time and size patterns?

I would hope that the daily comments on charts in Fullermoney would help with your understanding of chart reading. Some people never learn to read

charts, perhaps due to not seeing the relevance of looking at prices in graphic form when considering what they might do. Others become reasonably proficient chart readers in a couple of years. Your interest augers well.

My personal portfolio: Stops for second SMI trade and gold longs triggered - Not wanting to take too many risks in what could still be a somewhat nervous market environment during October, I had placed a tight breakeven stop on my most recent December SMI long. The price opened below the stop this morning, taking me out at 8406 against my purchase at 8415 on 27th September. This reduced my position by 50% and the earlier purchase is protected with a somewhat lower stop. More importantly, my December gold long was stopped out this afternoon at \$595 against the rollover purchase at \$594.20 on 26th September. I hope to buy it back below where I was stopped out but would first like to see either a somewhat more overstretched decline or steadier action.

These prices include all spread-bet dealing costs. Here are charts of the spot prices - [SMI](#) and gold [bullion](#).

Today's interesting charts - I am currently testing the new global equity section for the Chart Library, which will probably go live shortly after Eoin's return on the 18th. The coverage is awesome.

Oil (NYME) - Resumed [decline](#) in second day of heavy and probably climactic selling, but needs move back into the low \$60s to offset current scope for a further test of the yearend 2005 and February 2006 lows.

Gasoline - [Pressuring](#) recent low; needs move above \$157 to reaffirm support between current levels and the November 2005 and February 2006 lows and to signal further recovery scope.

Gold - Downward [dynamic](#); needs countermanding rebound to offset scope for further test of this year's lows.

Silver - [Same](#) as above.

USA (Dow) - A new all-time high ([monthly](#), [weekly](#) & [daily](#) but not quite on the [p&f](#)) would require downward dynamic to check scope for some further near-term gains.

Wednesday 4th October 2006

Jim Sinclair: Black Boxes and Dead Hedge Funds - My thanks to a subscriber for this interesting and sensible [item](#) written yesterday by one of the wiser financial commentators. Here is the opening:

The action in the marketplace speaks of bankruptcies among hedge funds that are not evident to the general public or to even those professional traders that I know.

Sure those in gold and energy on margin beyond their capacity are being liquidated into the marketplace. But it is the hedge fund managers with their damn algorithms that have hit the fan hard - and you can guess what is flying all over the place.

This may well be the watershed for black boxes, along with the 32 year old wunderkinds who really believe that computer systems can trade markets. Their convictions have convinced billions of dollars to invest in them. When you read a year ago that state retirement funds were investing massive amounts into hot hedge fund operator's hands, you had to know the game was all but over. These hotshots - lacking any personal risk - entered all derivative markets to get the largest bang for their bucks - and bang is what they got.

My view - One of the more bizarre financial fashions in recent years has been the stampede into hedge funds. This was more often an act of faith rather than due diligence. After all, the hedge funds were loosely regulated, charged higher fees than anyone else and the investor had little idea as to what the manager was going to do with his money.

And in the incestuous world of finance we have seen the return of the fund of funds, a product invented by the infamous Bernie Cornfeld in the 1960s. These often consist of hedge funds that invest in other hedge funds, enabling the punter to pay an extra layer of fees. A fund of funds is an investment which is worth less than the sum total of its separate (and pricey) constituent parts.

"But look at the superior performance", believers cry. Sure, some hedge funds have achieved exceptional performance over several years and all fledgling managers aspire to emulate them. Performance is usually achieved for two reasons: not all fund managers are of equal ability and there are bull markets from time to time.

However the method for achieving really superior performance is leverage. Leverage is a splendid financial tool but it is inevitably a double-edged sword. And it is speculation, not investment. Did all those pension fund trustees and financial advisors who piled their client's money into hedge funds know that they were speculating, or did they think they were buying superior expertise?

Those of us who use leverage, and I do in my personal trading accounts, know that we can't be right all of the time. If we are bold and succeed, we look clever and when we are bold and fail, we look foolish. Hedge fund managers with their high fees and mystique are often under pressure to be bold. If a manager's career is on the line and a previously reliable trade starts to implode, he can be rendered inert, like the deer caught in a headlight.

I believe that the recent Amaranth fiasco (it takes a bit of flair to lose \$6 billion in a month) represents a peak for the hedge fund industry. Those who allocate other people's money will now think twice about the wisdom of channelling savings into potentially volatile hedge funds. They now know that there is no satisfactory explanation if a hedge fund blows up.

And in volatile markets a few hedge funds are very likely to blow up, as we have seen recently, not least because new ones have appeared at a faster rate than experienced managers have evolved to run them. A growth industry in recent years has been the recruitment of people to manage new hedge funds. This may no longer be the best of career options. So if your dentist is considering giving up the day job to become hedge fund manager, a cautionary word or two might be appropriate, but I would wait until he has stopped drilling.

Who will be the beneficiaries within the financial industry if the fashion for hedge funds has reached a peak? Managers who use little or no leverage and also trackers. They do not look as sexy in a bull market but at least investors will know what they are buying and the fees are a lot lower.

Lastly, don't miss Jim Sinclair's comments on gold in the report quoted above.

Email of the day (1) - [El Nino and Volcano Update](#):

"Against original expectations for a gradual warming of the Pacific ocean of less than 1 degree C above normal by middle of winter, weather folk have been surprised by the central Pacific seas surface temperatures already showing a greater than 1 degree C rise above normal. The trade winds of lower latitudes have weakened. This means that instead of an El Nino developing mid-winter, it is now in being and confirmed on the ground by South East Asian countries reporting drier weather. Apparently, another sign of a fully developed El Nino has been the splitting of the jet stream above North America into northerly and southerly branches. The southerly branch tends to bring heavy rains throughout the southern group of states. The occasional interaction of the two streams in the east cause quite frequent heavy storms, and tornado seasons in the South East states.

"The big imponderable now is how strong an El Nino? The effect of volcanoes in previous El Ninos is interesting. The 1982 Mexican volcanic eruption happened just before the very strong 82-3 El Nino. The Philippine Pinatubo eruption also occurred just before the very long and strong 1991-2 El Nino. These were all volcanoes within the tropics. This time we have the tropical Montserrat volcano and the Russian eruption in much higher latitudes, but the Montserrat eruption was the bigger and longer of the two. In view of this some weather folk think that a weak El Nino will have the impact of a moderate El Nino. (A severe El Nino if we are having a moderate El Nino??)

"Agriculturals have lagged in recent years; could the El Nino be the catalyst for some catching up?"

My comment - Fascinating - another example of the Fullermoney Collective's wide ranging interests and knowledge. Any subscriber interested in the agricultural commodities can follow their progress in the Chart Library. Looking at the long-term monthly charts, you will see that many have multiyear bases capable of supporting significant advances, should an El Nino or some other factor cause adverse weather conditions for crops.

Email of the day (2) - More on commodities, plus balanced versus unbalanced portfolios:

"I've attached a copy of Stephen Roach's recent write-up on the commodity market. I'm quite perplexed and am questioning my present assumptions about the commodities market (which in principle agree with your own-expected renewed strength in commodities over the near-term). I am continually amazed (I've been in the business for over 30 years now) how the market in a financial asset can be so cogently explained from both a bearish and bullish point of view. That's what makes a market, but it certainly plants the seeds of doubt in one's mind and makes life awfully difficult to stay the course. Using close stops in present markets is suicidal given present volatility, so by the time an investment thesis is proved right or wrong, investment returns can be quite successful or quite poor (I work on an absolute return basis). This sounds as if I am asking for the meaning of life (maybe I am), but would appreciate it if you once in awhile might discuss in your market coverage the continuing argument: the diversified balanced approach vs. targeting and heavily weighting specific sectors. Many thanks for the excellent coverage."

My comment - Thank you for this candid and topical email. You have raised several interesting and important themes to which I cannot do justice in one response. However I'll at least touch on each of your main points.

Fullermoney has a tradition of posting some articulate reports which take a different view from my own. This is so that subscribers can see both sides of an analytical debate, in making up their own minds, which ideally in my view, should also be guided by the price charts. Stephen Roach's views often fall into the category of disagreement, as he has generally been much more bearish than my own view over the last four years, not least regarding global stock markets, global GDP growth, industrial commodities and precious metals. And in the same spirit of debate, I have posted his latest [report](#) on commodities, mentioned in the email above.

Very briefly, I believe Stephen Roach has mistaken a predictable medium-term correction for something much more enduring. I believe that he continues to underestimate China's GDP growth and that his report is China-centric, while I have talked about 5.5bn people in the developing world who are now benefiting from capitalism, creating what I think will be the biggest industrial commodity boom of all time. But as with any trend, this was never likely to be without considerable volatility, including some significant medium-term corrections such as we are currently seeing.

I do not agree that the "US housing bubble", such as it is, is a seminal event for industrial commodities. A temporary slowdown in US house building, partially offset by an increase in industrial building, is not nearly so significant as the infrastructure development and growing consumer demand for machinery, from those 5.5bn people mentioned above, stretching from China to India, the Middle East and South America.

I do agree that the asset allocation play is significant, at least temporarily. Investors rushed into commodities last year and earlier this year, and are rushing back out just as quickly. That's crowd behaviour for you but it does not change the big picture which I have described over the last four years as: Supply Inelasticity Meets Rising Demand. *Note: for much more on this, use the Fullermoney Search facility, looking under resources and other key words.*

Regarding the next point in the email above, which I believe concerns tactics, I will differentiate between trading and investing. Speaking personally, where I have gold investments, I am in for the long term. And while profit erosion is always an uncomfortable experience, and tests our analytical views, deep into a correction I would be planning my next purchase. After all, the object of the exercise for investors is to buy low and sell high.

The real problem for any of us concerns leveraged trading. If I'm overleveraged relative to my capital, an adverse move is potentially traumatic. I sold my silver position too soon earlier this year, well before the peak. I did better in gold, selling my biggest ever leveraged long in bullion futures in May, when my \$20 trailing stop, introduced during the upward acceleration, was triggered. That marked the beginning of a predictable medium-term correction and the most sensible position would have been to avoid any leveraged longs, at least until gold and silver had fallen sharply and lost downward momentum. Lacking that restraint I came back in too soon but with much smaller positions than I had held previously, because I could see from the charts that the environment had changed. I'm nibbling once again, commencing with silver, and very cautiously as this is still falling knife territory. I suspect we will see a bottom this month, even allowing for an overshoot, and oil is likely to remain a key influence. I aim to leverage up behind trailing stops on the next major rally.

Lastly, you raise the issue of a diversified and balanced portfolio approach versus targeting and heavily overweighting specific sectors. I see this as a very personal choice, rather than an issue of the right way or wrong way to invest. Generally speaking, people who love the investment game and spend quite a bit of time researching and thinking about markets, prefer to concentrate their investments in two or three areas, which they may change from time to time. Conversely, those who lack the time to be their own investment managers often prefer a balanced portfolio.

Balanced is a comforting word but in terms of portfolios usually buys a degree of safety at the price of mediocrity. Overweighting is brilliant when we are right but a double-edged sword when we are not. As an absolute return investor myself, I would never have a balanced portfolio. Currently, the emerging Asia side of my portfolio is performing reasonably well, despite Thailand lagging

over the political situation, as stock markets gradually complete their predictable medium-term corrections and resume overall uptrends. The resources side of my investment portfolio did splendidly until this correction but I'm optimistic about the potential and in for the long-term ride. That said, my weighting has changed from approximately 55 to 45 percent in favour of resources about a year ago, to approximately 60 to 40 percent in favour of Asia today. This is mainly due to a halving of my holding in Ballarat (I should have sold it all at the time but regard it as a recovery candidate today) and the investment of that money in the Atlantis China Fortune Fund. I then sold my Inco not long ago as the bid outcome became clear. Most of those proceeds have been invested in Asia, through a top-up in the JP Morgan Indian Trust and particularly the Aberdeen New Dawn Investment Trust. I also bought a bit more Rio Tinto the other day. I will continue to increase my stock market investments in coming months.

My personal portfolio: A second Baby Steps purchase of silver - This is a risky trade, in the short term, as there is no evidence that capitulation selling in precious metals has ended. Nevertheless, having sold my last medium-sized silver position nearly \$2 higher last month, I have only repurchased 40% of it with this second nibble. I won't use a stop at this stage. For the record, I purchased December silver at \$10.995, including spread-bet dealing costs. Here is the spot [chart](#).

Ben Bernanke's statement: The predictable comment on inflation - Only it is more tactfully stated than my version of several weeks ago, in which the Fed Chairman would claim a partial victory over inflation (which he helped to create, don't forget) while promising to remain vigilant. Here is the key paragraph as reported by [Bloomberg](#):

"We do believe that inflation is going to be coming down gradually over time," Bernanke said after addressing the Economic Club of Washington. "But it is something that we have to watch very carefully to make sure that it doesn't rise or even remain where it is."

As Mandy Rice-Davies said: "He would say that, wouldn't he?"

Today's interesting charts - In addition to a huge equity section, the new Subscriber's Chart Library upgrade will enable you to customise charts, including [semi-long](#) scales, [volume](#), [moving averages](#), etc.

USA (S&P 500) - [Extending](#) upward break following brief consolidation above May high; would require break in current sequence of higher reaction lows to check momentum beyond a brief pause.

USA (Nasdaq 100) - [Same](#) as above, albeit lagging.

Brazil - This resources market has lagged recently but is now [challenging](#) lateral trading near 38,000; a close beneath 36,400 is required to indicate more than temporary resistance here.

Mexico - A [new high](#) for the year by this resources market; would require break of the recent sequence of higher reaction lows to check momentum beyond a brief pause.

Heating oil - [Holding](#) above last week's low in probable bottoming process near former lows.

Wheat - [Extending](#) upward break; needs downward dynamic to check momentum beyond a brief pause.

Eoin is in Beijing - He returns on 18th October.

Thursday 5th October 2006

Adrian Van Eck's Money-Forecast Letter - My thanks to Laura Stein for this [copy](#) of the venerable Adrian Van Eck's October letter, and particularly for requesting and receiving permission for it to be posted in Fullermoney. You will find it in the Subscriber's Area but here is a brief section:

I have never known the U.S. economy to enter a recession when money supply was growing fast and interest rates were falling!

Back on page 2 you saw a chart showing the strong, continuous growth of the fairly broad M2 money supply. You can see how since July, 2005 - a time period when Wall Street pundits solemnly declared that the Federal Reserve was "tightening money" - the actual count of M2 money being flooded into the system was PLUS FOUR HUNDRED BILLION DOLLARS. And you may remember that back when Alan Greenspan discontinued releasing info on the broader M3 money supply, I ran exhaustive studies on the relationship between M2 and M3. I learned that M3 historically runs at 150% of M2.

That tells me that right now M3 (which is still being added up in secret by the Fed and privately used by them to make policy) is actually up by some two-thirds of a TRILLION dollars since the Summer of 2005. If I carried this back to mid-2004 I am quite sure you and I would soon realize that during the entire period of so-called "money tightening" the Fed was pumping ONE TRILLION NEW DOLLARS new money into the U.S. banking system and on to American businesses and consumers.

My view - Here is Fullermoney's [chart](#) of M2 since 1995. You will note that it continued to rise during the 2001-2002 recession, when interest rates were also falling, so I do not see how Adrian Van Eck reconciles this with his opening sentence above. However I agree that the Bernanke and the Fed ought to be able to avoid a recession in 2007-2008, assuming no further rate hikes and no significant exogenous shocks.

Adrian Van Eck's contention that M3 grows at approximately 150% of M2 is supported by the additional evidence in our Chart Library. US money supply growth helps to explain the US stock market's current strength - the Fed has raised the cost of money while keeping the supply plentiful. Gold bears may be overlooking this point.

I believe subscribers will be interested in the comments on China, not least regarding its trade relationship with the USA. These are certainly controversial and worth reading for that reason alone. Adrian Van Eck has earned his reputation over decades, with independent and non-consensus economic and financial market commentary.

Email of the day (1) - [On market action](#):

"I am a young, 'very green' but independent (absolute return as they would have it) fund manager, who is fascinated by markets and their psychology. Many commentators to your site often congratulate you on your fine service, applause which I would echo. However, personally, it is when the Fullermoney Collective contribute seminal, less mainstream, trade ideas which for me really affords the value added. What really drives me is discovering ideas 'off investment piste' and trying to figure out the best risk adjusted means of translating them into a trade idea. This will become easier to implement once the model portfolio is OEIC'd in the near future rather than via managed accounts.

"I know that you place a premium on price action over indicators for instance, however personally I like to have a frame of reference in terms of indicators/observations which conflate into a rather crude market thermometer - the intention is to help me take the market's temperature/assess its personality.

"Enough with the self serving sophistry - here's my beef. On a monthly basis I put down my thoughts in a 'portfolio factsheet' and the same themes are recurring and troubling me. I completely bought into the idea of a correction earlier in the year (a little prematurely actually), followed by a recovery then a final cleansing setting the scene for a good move going into 2007. It seems on the face on it that price action looks bullish, and I appreciate you have accounted for choppy action but is there something more significant afoot?

"A number of points give me reason to be wary of a hiccup:"

"Price leadership: can a new move just yet really be underpinned by defensive positioning? Commodities, small cap stocks, middle eastern markets, the Kiwi dollar etc all spearheaded the liquidity driven bull run we have experienced. Presently though utilities, telecoms, even retailers are leading the charge - [bets being placed on a consumer who has had his pocket money docked (housing ATM) puzzles me!!!]

"Non confirmation: this is why I believe the Dow challenges new highs but leaves the NASDAQ and S&P trailing (due to its composition). A piece

recently I read put forward the very simplistic relationship between the NDX and the S&P. 'Relative NDX out performance of the S&P has led or been coincident with every major absolute price rally in the S&P since 2002 at least. And what is extremely noticeable is the fact that just recently, the NDX/SPX relationship slipped to a new three year low before attempting to recover.'

"The Transports bottomed in August and have since failed to move back above their July 3rd high. Relative to the Dow any number of 'Dow' theory non confirmations have materialised in recent months.

"Price action: at the risk of seeking out evidence to reinforce convictions, it seemed that the S&P displayed a Harami last Thursday before a bearish engulfing on Friday. Tweezer tops Wed and Thursday can be reliable formations. The lack of heavy selling in the last move down in May has not been completely discarded in my thinking either.

"While I feel there is a hiccup in the road ahead, before Bernanke reinstitutes the reflation campaign, pre emptying further commodity price inflation (with concerns over growth pacified), it is hearing your take on price leadership/sector rotation which compels my correspondence.

"I always try to remain open minded to all investment contingencies, recognising we are often dealing in probabilities. Price action is rarely the handmaiden of intellectual rationale, and I am prepared to discredit the divergences between momentum, breadth indicators and the broader US indices performance, but I find the sector rotation issue difficult to put into context.

"I would imagine your time available to reply to all enquiries is limited, however, any help would be really appreciated. Hopefully, in the spirit of quid pro quo, in the future I can contribute to the Fullermoney with trade ideas - I also look forward to meeting you and Eoin at wine and cheese evenings in due course."

My comment - Many thanks for this thoughtful account. And we certainly agree regarding the Fullermoney Collective. It is what I value most (after all, I usually know my own views) and a wonderful source of information and also inspiration.

The Fullermoney Collective is the essence of my Empowerment Through Knowledge theme. And I encourage all subscribers to enter their informative emails and reports in the Subscriber's Forum, in addition to sending them to me. I know this requires two postings on your part but you can be certain that it will generate more feedback, which may well be of interest to you.

You have identified the thinking investor's (and few of us would aspire to be any other kind of investor) dilemma. The more we ponder, the more questions and concerns we will have. We need inquiring minds but they can also lead us into cul-de-sacs due to the sheer weight of information available. And the intellect that we nurture can be a double-edged sword, lulling us into analytical

arrogance. In this mindset we become the critical parent, telling the market what to do. It may not be listening, or care.

In my own attempt to avoid this ever present trap, I try to distil information down to common denominators. And I have always described the market as a manic-depressive mob, consisting of all those nice Fullermoney subscribers, and everyone else. In mob mode, in other words, once we enter the market, we are not only extremely emotional but also opportunistic and predatory, with bouts of shrewdness followed by foolishness, and vice versa. Think about it.

Returning to common denominators, I try to observe objectively what the market is doing. This is not always easy because our heads are spinning with ideas, theories (including those colourful Japanese candlestick formations that you mention); we are also influenced by all that market chatter, and most of all, our own positions.

So objectivity in the money game is an elusive will-o'-the-wisp but the key to money-making insights when you can grasp it. From my (hopefully objective) perspective, commonality has revealed a global stock market sell off into mid June, with a majority of stock market indices successfully testing their June lows in July, followed by increasingly consistent upward moves ever since.

And precisely because renewed strength has been the dominant characteristic since July, I'm more interested in the performance of upside leaders rather than laggards, many of which I now note are beginning to follow the upside leaders. This guarantees nothing but it is a trend until it stops.

And given all above, why shouldn't market leadership change? Intellectually and analytically (a subjective assessment) this may not always seem logical but the market is a powerful, self-feeding force. It roams like a Borg Cube, assimilating all of us, and discounting our collective expectations. Resistance is futile.

Lastly, I loved your comment: "Price action is rarely the handmaiden of intellectual rationale." I've added it to my collection of quotes.

Email of the day (2) - On Amaranth and will the CRB "collapse" cause problems for emerging economies?:

"Do you think the current liquidation has much/anything to do with the Amaranth unwind? It would seem to me that the "street" had the LONG crb SHORT consumer trade on. As the Amaranth debacle started you had wholesale selling of CRB to hedge the faltering Nat Gas position. The other side of the trade (Consumer/Banking), not involved directly with Amaranth, was also forced to unwind creating a widening of that spread. Add the comments below (Jeffrey Saut) and a forced unwind seems very plausible.....

"As we understand it, back in late July Goldman Sachs decided it was going to reduce the weighting of gasoline in its widely followed commodity index (GSCI). Participants wanting to dissect the entrails of that decision may refer

to *The Financial Times* story dated August 29, 2006 titled "Market Insight: Index shifts follows oil decline." Suffice it to say, Goldman took the gasoline weighting in its commodity index from 7.3% to 2.5%, for pretty mysterious reasons, in a gasoline-centric economy (IMO). Goldman even went so far as to scale-in those reductions at intervals between August and November. Accordingly, the billions of institutional dollars that "mimic" (read: invest) the GSCI have had to periodically SELL those gasoline futures contracts to stay in-sync with the index's new weightings. Unsurprisingly, unleaded gasoline prices peaked on August 3rd at \$2.35/gallon, basis the NYMEX November future's contract, and crashed into last week's lows of \$1.46/gallon for an eight-week price decline of 38%, causing one old Wall Street wag to scream, "SPURIOUS!"

"Lastly....could the "collapse" in the CRB complex cause instability in the developing/emerging world? What if the EMs, like the developed world and its equity bubble, become CRB bust? We (developed) had the laws/infrastructure in place to pad the ill effects of a burst bubble. With globalization in full force does it negate all of the ill effects of yet another bubble bursting? Or has the infrastructure been created to overcome such shocks? Thoughts?"

My comment - I'll just comment on this subscriber's points. I maintain that the Amaranth unwind has been a big factor, in terms of selling pressure in the oil futures and gas complex, and also psychologically because investors inevitably ask: "Who's next?" And we also know that the CRB has broken its over all upward trend. But reports of a "collapse" are hyperbolic.

The CRB ([weekly](#) & [daily](#)) has seen a correction of 19.9% to date, frightening for anyone who is long but hardly a collapse. I believe it is close to an important low during what I maintain is no more than a medium-term correction. And for perspective, some in media described India's Sensex ([weekly](#) & [daily](#)) decline in May and June as a "collapse". It was a predictably big medium-term correction for one of the world's best performing markets in recent years but today the Sensex is testing its May high and should resume its overall upward trend before long. Crude oil ([weekly](#) & [daily](#)) broke its uptrend, also in a medium-term correction, which was only the third largest in percentage terms over the last five years. I believe it is now bottoming out although we have yet to see the sort of convincing upward dynamics shown by the Sensex daily chart above, following the June low.

As for emerging economies reliant on the export of commodities, they are still benefiting from what I maintain is a secular bull market and likely to be the biggest and longest of all time - see *also yesterday's comments on this subject*.

Roger Nightingale: Except perhaps the central bankers - More common sense economic analysis and wonderful knockabout [commentary](#) by Millennium's Global Economist. It is posted without further comment and here is a brief sample:

The attitude of the monetary authorities in this turbulent period was sometimes truculent, more often obstructive. They knew they had mis-analysed the cycle during 2005, and they knew that their actions in the last couple of years had made things worse rather than better. But, instead of admitting their intellectual error as a prelude to remedying the policy response, they preferred to pretend that no mistake had occurred. Like charlatan lawyers, they muddied the statistical waters and deliberately perverted logic. They seemed to be more concerned with their own reputations (such as they were) than the well-being of their fellow-citizens (such as it was).

Email of the day (3) - [On markets, housing, musings and divas:](#)

"dec copper's weak close below 325 is bearish opening the door to 260-280 anyway with 320 now imp't support, plus i think we're going to see more fund liquidation in many commodities. the new dow record btw is still about 10% below the peak in 1929 in terms of gold, courtesy of \$ debasement.

"i am wrestling with the notion of whether so much discussion about housing is some kind of bottom, or whether the chatter is too optimistic and in that sense, too bullish. having been a real estate investor for many years, these markets don't clear this quickly. 425# of copper per house is a bunch, and now with the shanghai pension scandal resolving itself in favour of hu, and along with it the emerging process of now redeveloping the interior vs. the coast, that marginal prop under commodities is gone. btw, there has never been a housing bust in which both supply and demand got so out of whack without exogenous factors at work. i'm hearing more and more of speculators being hung out to dry and people walking from contracts and builders walking from land deposits, as the flipping game is over. housing "profits" have 3x the marginal effect of equity gains on consumption, as they are perceived as permanent. that process will work in reverse, and the fed has the \$ to worry about and its so-called inflation fighting credentials. Depending on where they started from and depending on where in the country the property is located, prices are down from 5-20%, which, roughly puts them back in 2003 -04. What has happened, however is the psychology, flamed primarily by the media (think Hearst and the battleship Maine), is such that buyers are afraid to touch houses for fear of getting in and watching a further fall. This "freeze" will last until mid-late 2007 at which point it will slowly turn back to a normal 3-5% annual inflation, balanced supply/demand market, which is the best case, and a reasonable one.

"as a footnote, when i was a child, my mom hosted the after symphony parties. the soloists showed up early, and i remember chatting with roberta peters, leontyne price, joan sutherland and van cliburn, who wouldn't shake hands, only finger tips, and actually cooking omelettes side by side with Jerome hines, who had a prodigious appetite eating a dozen eggs.

"as always..., enjoy your work"

My comment - [Thanks, you are another of many subscribers who have considerable experience, interesting observations and views that you are](#)

willing to share. Again, I encourage all of you to post these missives in the Subscriber's Forum, in addition to sending them to me through the Fullermoney email facility. I receive far more than I have time to comment on personally, although I try to read every single email from subscribers. Incidentally, I am much less likely to inadvertently overlook your emails if they arrive via the Fullermoney email facility, where they are vetted and set aside for the separate attention of Eoin and myself. Emails sent directly to me can too easily become buried when I am writing, as a considerable number arrive each day.

Briefly, on resources markets, you seem closer to the Stephen Roach view than my own. I note your housing comments with particular interest, and also suspect this sector will be an underperforming asset for some time, before rising in line with real inflation once again. And lastly, you had a very interesting childhood!

Citigroup's Metals & Mining: Gold: Seeking Macro & Demand-Side Catalysts - My thanks to a subscriber for this very good [report](#) by John Hill and Graham Wark. It is posted without further comment.

Email of the day (4) - [More on Amaranth and contrarian signals](#):

"Following the setback from \$80 to \$60 in crude oil Merrill Lynch is NOW changing their sector weighting to Underweight. What a timing!

"In light of speculative futures traders (CoT report) having exited all long crude oil futures commitments (on a net basis) and a fund like Amaranth being run over in the gas market and that Bullish Sentiment reading is as low as 25% (see also attached pdf-file) does this not smell like a contrarian signal from the Merrill Lynch energy underweighting?"

My comment - I would be surprised if this is one of their better calls, but time will tell, to coin a phrase.

Here is the Merrill [report](#) that you kindly forwarded, plus your interesting [chart](#).

Email of the day (5) - [On gold and oil](#):

"I'm watching today's further declines in oil and gold with yes.. some alarm, especially as additional key support levels are breached. Accepting that October could be a difficult month, how feasible is a scenario whereby oil and gold follow a similar path to natural gas in 2006 - interminable declines for 10 consecutive months, ending up in 2004 levels?"

My comment - Theoretically, anything is possible in markets but I would be very surprised. I think this scenario would require multiple Amaranth-type failures - just possible but probably unlikely. However if it did happen, I think it

would be a rare buying opportunity. Also, I suspect that unleveraged long-term investors in gold are buying once again.

One of the problems with NG was that due to transportation and storage difficulties, it is not fungible. So once the local storage capacity is full, new supplies drive prices lower than would otherwise be the case.

Today's interesting charts - Here is another sample of the shortly to be released expanded coverage, plus customisation features requested by subscribers. The [chart](#) of Barclays contains a Stochastics indicator for which the time periods can be varied as preferred.

Hong Kong - Currently Asia's [leading](#) market and extending upward trend towards 2000 [high](#); would require a close [beneath](#) 17,300 to suggest an upside failure.

China (Shanghai A) - I would not be surprised to see a [new high](#) for the year when this reopens following the holiday break.

Australia (ASX 200) - More [evidence](#) that bulls have won the battle between supply and demand over the last three months; a close [below](#) 5140 would be required to question this hypothesis.

Thailand - Upside follow through after yesterday's small [key day](#) reversal for Asia's cheapest stock market.

Switzerland - Still [leading](#) on the upside; would require a close beneath 8350 to question uptrend consistency.

Eoin is in Beijing - He returns on 18th October.

Friday 6th October 2006

Robin Griffiths' World Investment Strategy: Rhythm and rhyme - My thanks to Robin Griffiths for the latest [edition](#) of his comprehensive World Investment Strategy, published by Rathbone Investment Management. Here is the beginning of the introduction:

› According to Mark Twain, the events of history do not repeat themselves but they often seem to rhyme. The chart patterns for the US stock market are at present very similar to those of 1987. We are cautious and risk averse.

› From a timing point of view we cannot be at the bottom of an economic cycle, it is more likely to be a top leading to a cooling of activity. Trading out of this in the stock market is much harder to do than buying at the low.

› Many stock market indices and share prices are performing exactly as we

have been expecting but the famous ones on Wall Street are not. We are wrong in part but still think our basic scenario is substantially correct.

There is a cycle in economic activity that is driven in lock step with the US presidential election cycle, mandated at four years. This points to a strong down corrective move late this year. The equally robust annual seasonal deviation, that most markets have, implies that this correction will take place from a high in May, and lead to a low in late October. The normal shape traced out on the chart is of a fall, followed by a rally, then the rest of the fall. For many market indices that shape is indeed present. The final drop often starts after Labour Day. The Canadian market index is making exactly the expected move, but the US market has moved back up to new highs. The last time this occurred in this way was in 1987. Eventually the fall back did take place and the indices made a percentage decline of 39%, more than enough to be labelled a bear move, but it all took place in a brutally short time. Markets feel the rhythm and they hear the rhyme.

My view - Robin Griffiths has long been an analytical heavyweight, which is why I take note of his views, not least when I don't agree with some of them, as is the case today.

I am with Robin all the way in terms of the influence of the US Presidential Election cycle. And in expecting a global stock market correction for 2Q and 3Q, And back in May I too thought that we might not see the lows until this month, as veteran subscribers may recall.

However I maintain that the aggressive management of inflation expectations by central banks caused investors who were likely to panic, to panic early. This is why I revised my timing view in mid-June, concluding that we had seen the worst of the selling but that a period of support building would be required before we could expect significant recoveries. This took place in late June and July, and when I returned in late August following my operation and holiday, the rallies were well underway.

Subsequently we have seen several European indices lead breaks above their May peaks, followed by Hong Kong, then Wall Street and now more of the Asian markets. The main exceptions are a few of the resources-weighted markets such as Canada, which Robin mentions. But is Canada leading or lagging? I believe it is the latter because some of the resources markets are doing very well, led by South Africa and Mexico, and both Australia and Brazil have firmed noticeably recently.

I believe that underperformance by some of the resources markets in recent months is easily explained, initially as a proportionate reaction in response to outstanding relative strength up until May, and more importantly the recent weakness of the petroleum complex, plus some very bearish commentary about metals from people who thought that the strength of copper, nickel, zinc, etc owed more to hedge funds than the supply / demand imbalance created by a 21-year bear market for metal prices, followed by a synchronised global economic recovery, led by the economies of China and India, which were barely on the radar screen less than a decade ago.

And the oil price correction is bullish for everyone other than the producers.

Lastly, I see few parallels with 1987, beyond a mild inflation scare and prior short-term rate hikes. Crucially, valuations were much higher in 1987. Japan and Germany were worried that a plunging US dollar would export inflation (sic) to their shores. And 1987 was characterised by churning near the highs, without anything like the shakeout that we saw this year from mid-May to mid-June. So unless central banks are about to shock stock markets with more hawkish talk about inflation risks and another series of leapfrogging interest rate hikes, which I seriously doubt, then equities should experience no more than a wobble or two before heading higher. They could withstand another ECB hike in December because even after yesterday's increase, the Euroland rate is still an accommodative 3.25%.

Email of the day (1) - On house sector, copper, money & deflation:

"1. JPMorgan repeated its bullish stance on the commodity markets in a conference call last week. Apparently there is quite some difference in perception in the market place and some facts. If for example, according to JPMorgan, the housing market in the US would come to a standstill, the world wide demand for copper would only be reduced by 2.6%.

"2. Doesn't the money analysis of Van Eck indicate that the Fed is still very worried about the risk of deflation - in my opinion rightly so - and that the policy of higher interest rates and the whole inflation talk is one big deception or smoking screen for this deflation risk? Bill Bonner suggested a few months ago the idea that the Fed needs some ammunition in case deflation shows up.

"Thanks for your superb analysis and accompanying research."

My comment - Many thanks. A term frequently heard several years ago and mentioned by me on a number of occasions, was that the Fed needed to 'reload the interest rate gun' as the US economy moved out of recession, so that it could lower them again when it needed to. Well, it has succeeded in raising rates and is now in a position to use this ammunition (lower rates) if/when the economy appears in danger of sliding into recession.

Fearing deflation most of all, a central bank generally tries to set a course of moderate inflation, which usually runs at a higher rate than officially reported. So central banks remain in the business of quietly inflating, while vociferously managing inflation expectations. Investors who do not understand this spend a considerable amount of time worrying about deflation while inflation continues to erode their savings.

Bernanke, in a number of high-profile speeches several years ago (*links are available in the Fullermoney Archives and can be found using the Search facility*) went to great lengths to reassure us that a destructive deflation would not occur in the USA. Since both inflation and deflation are essentially monetary problems, I believe him.

My personal portfolio: Aberdeen New Thai (ANW LN) position increased with a trade - Having pointed out Thailand's small upside key day reversal yesterday, and loving the current valuation if not the temporary political uncertainty, and seeing the strength of most other Asian markets, I conclude that this current laggard will sprint up out of the blocks one (not too distant) day. Accordingly, I paid 152.75p for a March long contract in ANW (cash price [weekly & daily](#)), including spread-bet dealing costs. It currently trades at a 4% discount to NAV, according to Bloomberg. If it performs, I'll introduce a breakeven stop and commence leveraging up, as I did with Aberdeen [New Dawn](#) not long ago. This is benefiting from the strong performance of other Asian markets.

Email of the day (2) - [On UK stock brokers](#):

"Can you help with the following problem? I am trying to build up my own portfolio of international stocks/IT's/ETF's. Your analyses and those made available by other subscribers posting on Fullermoney are very useful, as are the charts in the library. However, the online brokerage firm I use, Seftrade, are unable to execute many of the securities listed in the Library -(there is another problem here since I am not familiar with some of the 2-letter country codes, but I believe I can get these via Bloomberg) - a couple of examples:- ishares A50 China Tracker (HK), I believe because it cannot be settled through Crest, or they just don't have access to the Hong Kong Exchange, directly or through an agent - also, once again as an example, the Atlantis China Fortune Fund, because the broker aver that they do not deal with this fund management company. Yes, they do deal in a range of ETF's and Inv.Trusts, mostly UK-based, but nowhere near as many as are available in the States. I am particularly keen on ETF's for their low costs, liquidity, and in theory, the diversity they can provide. I'd be most grateful if you or any other subscribers can point me towards a broker/(s) with a strong International bias who can meet my needs. From a practical point of view and since some of my investable assets are in Isa/Pep wrappers, I guess they would have to be UK based. They do not have to be online brokers, by the way. Finally, I would like to add that I am not asking for a personal endorsement - just some information that I can then follow through on my own behalf. Empowerment Through Knowledge? Many thanks, this would be a great help.

My comment - I receive a number of emails of this nature and if any subscriber wishes to respond to this email please do so via the Forum. My own experience is that you will get less assistance with an online broker, although some investors prefer their low dealing costs. With most general enquiries, I start by Googling. For instance, there is The [Association](#) of Private Client Investment Managers and Stockbrokers.

Email of the day (3) - [On the Dow and more on the PPT](#):

"I would like to point out that, if the PPT has been active, they have been active for a very long time; I had posted this in the forum on 15 January 2006 discussing the writing on the charts:

"Checking the weekly chart I found that since 2002 the Dow has made 3 attempts to cross 10700 level: on 22-3-2002, on 20-2-2004, on 11-3-2005. The rejection of the 10700 level from onwards of 22-3-2002 was quite definite with the Dow falling more than 3500 points; on the other two occasions the fall have been much less and shows up on the charts as higher bottoms.

"The Dow now is holding above 10700 for the first time in 3 years for 7 weeks in a row. So the trading strategy for the Dow would be to go long and put a stop at around 10600.

"My target for the dow is 11500 -12000 by year end provided the stop holds. But..... can anybody justify this view from a fundamental stand point?"

My comment - Thanks for also using the Forum. Regarding fundamental justification (or is it technical?) how about our old friend liquidity, to which we can now add sentiment?

I receive some erudite, and many more pseudo-erudite, reports and articles, mentioning all manner of economic statistics, historic precedents and above all, theories. Those which are not very good usually include a dollop of conjecture, subjective biases, ego, and either paranoia or euphoria. This is the busy work of our profession - gazing at entrails and tipping small bones out of a cup. These reports churn out mental noise.

No one, and I mean no one, can assimilate, let alone make sense, of all the data available. And guess what - we would be no wiser if we could. We would only be a walking data base - a repository for conflicting information and opinions.

The interesting point concerns what happens to this sargasso of information and noise. The market mob assimilates it, in a never ending process, and blends and distils it in the manner of a giant Cuisinart processor of facts and theories. The end product is market sentiment.

Sentiment is one of the two primary drivers of market prices. The other is liquidity. Sentiment and liquidity combine to move the market and they are seldom constant. So how on earth can we monitor sentiment and liquidity?

With charts. When we look at a price chart, we see sentiment and liquidity at work. The end product is the trend. And when sentiment and liquidity change, you will see it first on a price chart. This is the rason d'être for technical analysis.

And you will see sentiment and liquidity at work most readily with plain, unadulterated price charts. Everything else - all the indicators, lines and theories are elaborations, complications and too often distractions. Rather than manifestations of sentiment and liquidity, everything else that we add to the price chart is an aspect of mental noise.

If charts are so useful, does this mean that we should ignore all the financial reports and articles that are published? I certainly don't think so, unless one

finds that they irritate and distract, confusing one's thought process. Personally, I find the better reports very interesting. They help me to think and I want some idea of what is behind the chart, particularly in terms of value. Good reports contain facts and insights, provided by the authors' diligence, experience and wisdom. And the lesser reports can be revealing in terms of conventional thinking, which is often a contrary indicator.

Email of the day (4) - On potential inflation:

"Is this [*Ed note: great chart supplied*] basically what the Van Eck article was referring to? There have been several times that M2 has gone higher (60s-70s) but that ended in soaring inflation. With the rapid rise in M2 from the SPX peak in 2000, will this most likely end in the same inflationary situation as before?

My comment - Regarding money supply, I believe Adrian Van Eck was talking mainly about the US economy and stock market in the report posted yesterday. My short answer to your inflationary question: Yes, I believe so but inflation will probably develop slowly and in a series of gradually rising waves, as I have discussed on many occasions previously.

I maintain that inflation will be more bullish for gold than the S&P 500 Index, not least because we are in generational-long period of rolling valuation contraction for the US stock market, following the burst bubble in 2000. On the [chart](#) you kindly supplied, note how the S&P traded beneath a flat ceiling during the last major valuation contraction period from 1966 until 1982, despite mostly strong growth in money supply. And when that dipped, the S&P experienced bear markets. We have the same risk going forward so keep an eye on that M2.

Lastly note how the S&P was largely impervious to the M2 contraction in the early 1990s. That is because Wall Street was in a secular bull market, characterised by a generational-long period of valuation expansion between 1982 and early 2000.

Today's interesting charts - Here is another sample of the new customisation functionality being tested before the next generation of the Subscriber's Chart Library is launched later this month - Switzerland's [UBS compared to US 10-year Treasuries](#).

Malaysia - Testing lateral and psychological [resistance](#) near 970; would require a downward dynamic to delay an upward break beyond the short term.

Indonesia - Here also a downward dynamic is required to indicate more than [temporary](#) resistance near the May peak.

UK (FTSE 100) - Challenging lateral and psychological [resistance](#) near 6000; would need downward dynamic and/or close under 5800 to indicate more than temporary resistance here.

Euro/dollar - Downward dynamic to break out of a small range today; requires countermanding move to offset prospect for test of June-July reaction lows.

Dollar/yen - Break above psychological ¥118; requires move under ¥117.40 to suggest upside failure. Note also progression of higher reaction lows since July.

Copper (3rd m LME) - Back from the brink; still topy but requires close under \$7000 to signal renewed weakness.

Nickel (3rd m LME) - Testing important lateral and psychological resistance near \$30,000; requires close under \$28,000 to reaffirm this barrier and renewed vulnerability.

Zinc (3rd m LME) - Firm and requires downward dynamic to offset current scope for further test of upper boundary.

Cultural notes: Andrew Hemingway - In my opinion, this delightful Yorkshireman is the greatest living painter of still-life pastels. Some of his mostly smaller works will be on display at Messum's Cork Street, London from 1st to 11th November. Andrew also exhibits internationally.

Quote of the week - On price action:

"Price action is rarely the handmaiden of intellectual rationale."
Matt Brittain

Eoin is in Beijing - He returns on 18th October.

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