

Fullermoney *Highlights*

Global Strategy and Investment Trends compiled by Eoin Treacy

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New Positions in Personal Account Open/Closed			
David	Gold		CL 12/11 \$824.8 Feb08
	Gold		CL 12/11 \$820 Feb08
	Gold		CL 12/11 \$815 Feb08
	Gold		CL 12/11 \$813 Feb08
	Gold		CL 12/11 \$810 Feb08
	Silver	total position stopped out	CL 12/11 \$14.75Mar08
	Gold	Long 13/11 \$814 Feb08	
	Gold	Long 13/11 \$809.5 Feb08	
	Silver	Long 13/11 \$15.105 Mar08	
	Silver	Long 13/11 \$15.055 Mar08	
	Silver	Long 13/11 \$14.75 Mar08	
	Dax		CS 13/11 7897 Mar08
	Gold	Long 14/11 \$819.4 Feb08	50% increase
	Copper	Long 14/11 317.05¢ Dec07	
	Platinum		CL 19/11 \$1453.5 Jan08
	Platinum		CL 19/11 \$1453.8 Jan08
	Platinum	50% reduction	CL 19/11 \$1450.3 Jan08
	Silver	Long 19/11 \$14.50 Mar08	25% increase
	Silver		CL 20/11 \$14.82 Mar08
	Silver	Long 20/11 \$14.74 Mar08	
	Silver	Long 20/11 \$14.725 Mar08	
	Platinum		CL 21/11 \$1468.1 Jan08
	Platinum		CL 23/11 \$1474.5 Jan08
	Silver		CL 27/11 \$14.75 Mar08
	Silver		CL 27/11 \$14.735 Mar08
	Silver	Long 27/11 \$14.715 Mar08	

	Silver	Long 27/11 \$14.665 Mar08	
	Gold		CL 27/11 \$820 Feb08
	Gold		CL 27/11 \$815 Feb08
	Gold		CL 28/11 \$811 Feb08
	Gold	Long 28/11 \$813.9 Feb08	
	Gold	Long 28/11 \$812.9 Feb08	
Eoin	Silver	Long 12/11 \$15.00 Mar08	
	Nasdaq	Long 14/11 2093.75 Mar08	
	Silver	Long 20/11 \$14.665 Mar08	

November 13th George Magnus: Is the global monetary system starting to crack?

My thanks to a subscriber for this interesting and highly informative [history](#) of the post WW1 monetary system and potential developments emanating from the current US economic problems, written by George Magnus for UBS. Here is a brief sample:

While these matters will continue to remain central to our focus as regards financial markets and economic outcomes, there is another issue that now lurks behind the current rumblings in the global economy. The structure of the global monetary system - call it Bretton Woods II or any other name - is beginning to creak, largely as America's and China's economic, and ultimately, policy interests diverge. The Minsky Moment of 2007 has almost certainly been the catalyst for this development. While it may have been academic or premature until now to question the sustainability of global monetary arrangements, the 'creak' in these arrangements may well now result in a 'crack' or something even more spectacular as this credit cycle unfolds. If you like, something akin to the breakdown of the Bretton Woods system in the early 1970s - to which current developments bear an uncanny resemblance.

In short, it may not now be 'too soon' to think about the deeper implications of the decline in the US dollar; the incompatibility of monetary policies between the US and China and other US dollar bloc emerging markets; and the political significance, as opposed to the growth rates or size, of Sovereign Wealth Funds. The upshot of these developments is likely to be a loosening of the links between the US dollar and Asian currencies, quite possibly involving more significant revaluations than generally expected. These would of course then have important implications, not just for currency-adjusted returns for investors but also for the global economy and financial markets. By and large, the prospect of a collapsing Bretton Woods II should give rise to beneficial economic effects throughout the global economy but getting from here to there is still likely to be complicated.

My view - There was some respite in the US Dollar Index's persistent decline [yesterday](#) as it rebounded sharply against many currencies. However that was most likely technical, in the form of some short covering as leveraged carry

trades were unwound in other markets. Given the fundamental background for the US economy, and the magnitude of the downward break not long ago evident on this 50-year [chart](#), it would be premature to interpret yesterday's upward dynamic by the dollar as anything more than a short-term technical rally.

George Magnus' thesis is interesting because it would presumably also address another problem - unwarranted strength in European currencies as the US dollar devalues. Subscribers may recall my feature: [Currencies: Are we approaching the end of stability?](#) - posted on 4th July, followed by [Implications if currencies are approaching the end of a period of relative stability](#) - posted on 5th July. Both are now in the public archive.

Sterling has followed through on the upside and now appears to be established above \$2.00. Moreover this pattern has the potential eventually to test previous highs evident at \$2.40 and \$2.60 on this [chart](#) dating back to 1971. However the crucial factor to monitor is the series of higher reaction lows since 2006, best seen on this weekly [chart](#). The last reaction lows are near \$1.965. Assuming that sterling will rally higher within a ranging pattern, as I do, there will be additional higher reaction lows to monitor. Once these are broken, and / or sterling accelerates dramatically higher, a more important correction is likely to follow.

The euro also shows potential for significant additional appreciation against the dollar, and will most likely outperform sterling in the process. This price [history](#) since 1971 can only be shown on our data system with the dollar declining (as with US Dollar Index above) and I have used the German mark as a euro proxy because of its back history. With this weekly [chart](#) of the euro we can also see a series of higher reaction lows since 2006, and the euro's rate of ascent has steepened so I'm not sure that the small reaction just above \$1.4 really qualifies as a higher reaction low. Meanwhile, the overall trend is clearly upward, albeit temporarily overextended and susceptible to some consolidation.

At Fullermoney, we have maintained since 2003 that Asian currencies were not only the most undervalued, but also had the best fundamentals to drive them higher. This [chart](#) of the Bloomberg JP Morgan Asia Dollar Index since 1994 would need to break its progression of higher reaction lows since 2001 to question this hypothesis. Here is the 5-year [chart](#).

Will the dollar's plight and what is arguably the overvaluation for European currencies compel Asian countries to accept a faster rate of currency appreciation? Perhaps one day but I am not currently holding my breath.

November 21st Inflation Targeting Comes to Washington DC

My thanks to a subscriber for this interesting [article](#) (PDF also [provided](#) should link be withdrawn) by Willem Buiter for the Financial Times. Here is the opening:

It has taken a while, just under two years since Ben Bernanke took over from Alan Greenspan as Chairman of the Fed, but the deed now is done: the Fed has moved to de-facto inflation targeting. It will continue to be an inflation targeting that dare not speak its name. The Fed has introduced inflation targeting inside the twin Trojan horses of improved communications and greater transparency. An indeed, these proposals are likely to improve the clarity of the Fed's communications to the market and the public at large and to enhance its transparency. But there is more that that involved. I discern a movement away from the Fed's symmetric dual mandate to a greater emphasis on price stability as the primary objective of monetary policy. This reform will not take the Fed the whole way towards the lexicographic or hierarchical inflation targeting of the ECB and the Bank of England, whose primary objectives are price stability and without prejudice to, or subject to, the price stability target being met, output, employment and all things bright and beautiful. It does, however, represent a significant step in that direction.

The Fed's modus operandi under Greenspan could be described as formally symmetric but in fact biased towards low unemployment, extremely flexible inflation targeting without a firm, let alone a numerical, inflation target. The existence of the 'Greenspan put', referring to the asymmetric reaction of the Fed's policy rate to asset price increases and asset price declines (and specifically to increases and declines in equity prices) remains a hotly disputed issue. There can be no doubt, however, about another asymmetry in the reaction function of the Greenspan Fed. With unemployment at or near the best guesstimate of the natural rate, when faced with the choice between a rate cut that would reduce the likelihood of an increase in the unemployment rate at the expense of a higher risk of excessive inflation, or tighter monetary policy that would increase the likelihood of higher unemployment but would lower the risk of excessive inflation, the Greenspan Fed would opt for lower unemployment.

This is no longer true for the Bernanke Fed. This may in part reflect differences in the interpretation of the Fed's mandate between the two Chairman, or differences in their view of the transmission mechanism of the Federal Funds target rate to inflation and unemployment. It may also reflect differences among the two Chairman in their willingness and/or ability to impose their own views on the majority of the voting members of the FOMC. I have the impression that the Regional Federal Reserve Bank Presidents have become more vocal, assertive, and influential than they were under Greenspan. While among the Regional Fed Presidents there is a range of views and objectives - there is at least one distinguished modern Keynesian among them, Janet Yellen of the Fed of San Francisco - the Regional Fed Presidents tend to give greater weight to maintaining price stability than to maintaining high levels of employment and output. While the time series of observations on the Bernanke Fed is still short for meaningful statistical analysis, I believe we will be able to identify in due course this break in Fed behaviour in the direction of putting greater weight on price stability.

My comment - [This may be the intention but I do not rate its chances of becoming a reality anytime soon. I can understand that from the outset any responsible central bank governor would like to target inflation, at least in](#)

theory. However quite apart from the fact that the Fed has a dual mandate which it is not at liberty to alter significantly, there are obvious limits to any central bank's independence.

If the US economy was strong, which it clearly is not, then the Fed could target inflation. Currently and on the one hand, the Fed faces increasing inflation from resources prices - from crude oil to foods - due to the global Supply Inelasticity Meets Rising Demand theme, plus the weak US dollar. On the other hand, it faces increasing deflationary pressures from the burst housing bubble and the US's credit crisis, which can only weigh on consumer and corporate sentiment.

Today, the Fed could only attempt to combat inflation from food, oil and other resources by raising interest rates sharply and draining liquidity to boost the US dollar. However such blunt instruments could only achieve a partial success, at best, because resources inflation is a global problem. Meanwhile, an attack on commodity inflation, which will remain largely outside the Fed's control, would tip the already weak US economy into the severest of recessions.

The public and political outcry would be deafening. Bernanke would be replaced as Chairman of the Fed at the earliest opportunity.

November 22nd Nick Train on the banking sector

My thanks to Christopher Legge of Brewin Dolphin Securities for this fine [commentary](#) by Nick Train of Lindsell Train. Here is the opening:

On the failure of Alexander Fordyce's bank, June 1771

"There has not since the year of the South Sea been, I believe, such extensive distress or so frightful an alarm. It can however be little more than a panick terrour from which when they recover, many will wonder why they were frightened."

Samuel Johnson, letter to John Taylor

There have been plenty of "panick terrours" since 1771 of course, up to and including our very own of Summer/Autumn 2007. Fordyce's investment bank was brought down by his imprudent speculation in East India Company stock - a reminder that some economies have been "emerging" for centuries. Of the collapse, the then thinking man's journal, the Gentleman's Magazine reported - "An universal bankruptcy was expected, the stoppage of almost every banker's house was looked for." Today's bear squeeze on the British banks is not unprecedented.

Panick terrours are terrifying and it takes men of commonsense - and Samuel Johnson is perhaps the most commonsensical Englishman who ever lived - to hold a steady nerve. We have no keener insights about the solvency of British banks or their future dividend paying capacity than anybody else, but we are sure it is important to stay cool. ABN-AMRO changed hands very recently at

2.9x P/B in a contested auction. That is an important strategic marker. Actual book values may be difficult to determine today, but the justification for paying a multiple of book for a well-entrenched banking franchise is confirmed.

The reasons banks can command a premium to book are, first, that they remain necessary to the workings of a modern economy and, next, they are difficult to build up from scratch, as is demonstrated by the willingness of up to ten institutions to win control of a franchise as impaired as Northern Rock. If HBOS did not exist it would be necessary to invent it.

My comment - One of the more colourful market adages has long been: "Buy when there is blood in the streets." Well, we are not quite there yet, not that every panic produces such extremes, but staying with the imagery, the queue of wounded forming outside the casualty ward is growing, with three groups particularly evident.

They are, of course, banks, property and house building companies, represented here by [Royal Bank of Scotland](#), [Land Securities](#) and [Persimmon](#). According to Bloomberg, the estimated PERs and Yields are: RBS p/e 5.66 / y 8.01%, LAND p/e 19.57 / y 4.57% and PSN p/e 5.25 / 6.79%. Of these estimated PERs, I assume only that of Land Securities has recently been adjusted in line with current economic realities. In other words, I think the other's forward PERs should be higher to reflect inevitable declines in earnings, suggested by share prices. The dividends may also be under some pressure although I would think RBS and Land Securities are in the best position to maintain payouts.

My point is not that these shares and their sectors are now screaming buys. They remain in clear downtrends, could easily fall further in overshoots and have yet to signal new floors. However, their steep declines are bringing them to buying ranges. I suspect that anyone who gradually bought into these sectors on weakness over the next few months would show excellent returns a few years later, from both price appreciation and the yields. An alternative strategy, if you agree, is to wait for the chart patterns to form at least small bases.

While I think Nick Train's opening analysis shows real perspective, I am not in full agreement with Bill Miller's points, which are extensively quoted. Briefly, although he does not quantify his prediction of a rally for the dollar, I suspect it will take more than current account deficit reduction to produce more than short to medium-term recoveries within the overall downtrend. However price charts will guide us.

Also, while the US housing and banking related slowdown is reintroducing more deflationary pressures, central banks remain the great inflators, not least in this cycle to date. I don't see evidence that this will change. Consequently, I think we have seen the best of the bond rallies and the next chart sell signals for long-dated government issues could be important.

Lastly, having opened with an old stock market adage, I will close with a less familiar one from the USA: "The bears have Thanksgiving and the bulls have Christmas." Happy Thanksgiving Day, and on to Christmas!

November 30th Bernanke Says Fed to Judge Market 'Turbulence' Impact

Here is the key comment from the Fed Chairman's speech last night, [reported by Bloomberg](#):

The outlook has been ``importantly affected over the past month by renewed turbulence in financial markets," Bernanke said in remarks at an annual meeting of the Charlotte Chamber of Commerce. The Fed is paying ``particular attention to the question of how strains in financial markets might affect the broader economy."

My view - To paraphrase Oscar Wilde's quote from *The Importance of Being Earnest*: To lose one market, Mr Bernanke, may be regarded as a misfortune; to lose both looks like carelessness.

The weak housing market is already a problem for the beleaguered US economy. If the Fed killed off Wall Street's moderate bull run since 2003, by falling too far behind the curve of events during the credit crisis of confidence, that would look like carelessness, to put it mildly.

Successful completion of a course on behavioural psychology should be a requirement for all wannabe central bank officials, particularly aspiring CB chairmen. Greenspan understood that investors would pour over every utterance; therefore as Fed Chairman his comments were often torturously obscure, except when he was trying to reassure markets.

Investors, seeing the bank sub-prime write-downs, were looking for additional assurances in October. Instead, the FOMC statement following its 25 basis points cut last month was interpreted as neutral to hawkish. A sharp sell-off followed, wiping many more billions off share prices than were forecast from sub-prime losses.

The prospect of further losses on Wall Street, in addition to the house price slump, would be doubly problematical for the US economy. Consequently, in his comments last night Ben Bernanke followed an earlier lead from his more experienced deputy, Donald Kohn, in acknowledging risks and signalling further rate cuts.

What next for stock markets?

This week's back-from-the-brink rally is encouraging but I would still like to see a 50 basis points cut to underpin it, with an unequivocal statement from the Fed that further reductions will follow if necessary. Upside risks to inflation are most definitely not roughly in balance with the downside risk to growth, as the Fed indicated a month ago.

Current inflation in the USA, as I have emphasised repeatedly, is coming mainly from energy and food prices. This is not something that the Fed should be tackling with monetary policy since it is a global problem. Meanwhile, house price weakness has obviously introduced new deflationary pressures for the US economy.

A number of stock markets, including the USA and within Europe, have established lows of at least near-term significance during the last two weeks, evidenced by upward dynamics from those lows (see *Today's interesting charts below*). Weekly key reversals for the Dow and S&P 500 Index are encouraging developments.

However, where short-term to medium-term downtrends have been established in recent months, significant rebounds are required to offset prior technical damage. After all, periodic rallies are a feature of most downtrends. The Fed should not be complacent, as it clearly was following the September and October rally.

December 4th Tim Price: Don't bank on it

My thanks to Tim Price for his latest and interesting [letter](#) published by PFP Wealth Management. Here is the opening:

"If we didn't have bonuses, we wouldn't have had anybody working for us."

- Drexel Burnham Lambert spokesperson, explaining why the company gave over \$195 million in bonuses just before it filed for bankruptcy.

Time was, any self-respecting bear had to rummage hard through the financial papers to find evidence for their base case scenario of looming financial sector implosion. Admittedly, such venal conduct is frowned on by the behaviouralists, who call it "confirmation bias", which is evidently a bad thing (even if the apparent "bias" turns out to be correct). The point being, all a self-respecting bear has to do nowadays to find evidence of imminent armageddon is simply: open the paper. Wednesday's issue of the Financial Times was a case in point. Gillian Tett published another report from her consistently excellent coverage of the credit crisis ("Draining away - four problems that could beset debt markets for years"). Any reader who survived that account only had to turn the page to read Martin Wolf's related discussion of the current financial crisis: "Why banking remains an accident waiting to happen". One can only take issue with the tense: banking as accident has already happened, although admittedly it can and probably will get worse. Equity market investors can in any case no longer use the excuse that credit market problems weren't entirely in the public domain - try and read any broadsheet without stumbling upon ever lengthening coverage.

My view - There is no doubt that the commercial / investment banks, in their time-dishonoured way, have self-destructed once again. Hailed as innovative and modern money making masters in good times, the real profits are made by the inventors and promoters of increasingly dubious and highly leveraged schemes.

The game is slightly different each time but there are common themes - find a new financial product which most people don't understand; entice a gullible public to spend way beyond their means on the basis that they too can make money just like rich people, and sell this debt-related product to naïve money managers. Lastly, and for the banking insiders - make your money and get out before the scheme goes belly up, as it always does.

On average, we see a banking crisis every ten to a dozen years, during which many of these august firms become insolvent. However governments no longer allow their banking sectors to go bust, beyond perhaps a token example. Instead, they bail them out via the yield curve, at the taxpayer's expense.

Meanwhile, there are several behavioural themes which I believe provide insights as to the outlook for stock markets.

There is a growing and I believe now widespread perception that Western central banks are behind the curve of events. This is certainly my view, as stated daily in the Audio. Consequently, to mitigate economic damage from the credit crisis of confidence and to underpin stock markets, they need to pump in more liquidity to offset that which has floated off to money heaven, via write-downs and trading losses.

They also need to slash short-term rates and reassure everyone that they will use all policy tools at their disposal to mitigate downside risks for the economy. I believe the Fed and even the BoE is now moving in this direction, albeit grudgingly. We will soon know and I recommend 50 basis point cuts this month, followed by another 25 basis points in January, and more later on if necessary.

Regarding stock markets, the situation is tricky, as we can see from the charts for many indices, although by no means all of them. However, I think forecasts emanating from banks are not always objective (*see also my [comment about "piranhas biting each other"](#)*). Tim Price also discusses the round robin sell recommendations for banks, by banks.

Clearly, the avalanche of bearish forecasts from the Financial Times and most other business pages is a contrary indicator. My point is not that these people are stupid. However they accelerate the discounting mechanism. Remember this anonymous quote: "Risk is often lowest when it is most visible."

Lastly, and also related to the discounting mechanism, a crisis has to escalate for it to affect markets negatively. Veteran subscribers may recall this point during other crises, real and imagined.

December 5th Subprime Rate Five-Year Fix Agreed by U.S. Regulators

This [announcement](#) is important and also controversial.

My view - This was rumoured earlier in the day and Bloomberg's late article this evening indicates that it is mostly a done deal. The rumours were certainly

a factor in today's stock market rally, in addition to expectations of interest rate cuts.

My initial impression is that the five-year fixed agreement will be highly controversial, not least with people who have been making their mortgage payments all along. However they will be assisted as lower short-term rates - current and pending - filter through the economy.

The question is who pays for the subsidised mortgages? The firms which enticed unsuitable borrowers, if there is any moral justice to all this. Perhaps that is why bank shares rallied only modestly today.

I would not be surprised to see US short-term rates cut further than most people currently expect - sort of a Marshall Plan for homeowners, the housing sector and lenders - and stay lower for longer than generally forecast.

If so, this would be far better for the US stock market than for bonds or the dollar over the next couple of years.

December 10th How are bank sector indices doing relative to their wider markets internationally?

We have often said that we consider bank shares to be a lead indicator for equity markets generally. This was certainly the case with the current stock market correction, as we saw banks topping out a number of months before wider market indices commenced corrections. So how are they performing now?

The [S&P 500 Banks](#) index had been in an increasingly steep downtrend relative to the overall market for much of the last two years. It recently found support at 0.19 and bounced to 0.2; having accelerated considerably in the last four months. So far this is no more than a similar sized rally within the overall downtrend. It needs to hold this rally, hopefully improve on it but more importantly it needs to move into a period of consolidation, during which support is encountered above the November lows, which will at least signal that the sector has stabilised relative to the market.

The [S&P Diversified Banks](#) haven't underperformed for as long and their decline has not been as great. They topped out relative to the market in January and have been in a relatively aggressive downtrend for most of the year. They recently found support near 0.44 and so far have posted a recovery of similar size to that between July and October. It needs to sustain a move above 0.47 to indicate that it has found a low of at least medium-term significance.

The [FTSE 350 Banks](#) remain in a relative downtrend. This move began following the breakdown from the prolonged Type-3 top (as taught at The Chart Seminar) in 2004 and remains intact today. It recently found support at 2.6 and has so far rallied in a fashion similar to other distributions in the overall trend. It needs to hold above the recent lows, consolidate the move

and push upwards once more, breaking the progression of lower highs to confirm potential for further upside.

The [Swiss Banks](#) Index had generally been a market outperformer from 2001 until it topped out relative to the Swiss Supplement Index in early 2006. They didn't really look to be a threat to the performance of the wider market until they broke down from their year-long range in June this year. Following the downward break they accelerated, with only a brief distribution near 14. They have now posted a larger rally than on that occasion and the upside can be given the benefit of the doubt as long as they can sustain the move above 12.

The [South Korean Financial](#) sector remains in a consistent downtrend relative to the market and needs to break the progression of lower highs to question scope for a further decline.

While both the [New Zealand Investment](#) Index and [S&P/ASX 200 Banks](#) are performing in line with their respective wider indices the [ASX 200 Financials](#) Index remains in a downtrend and would need to sustain a move above 1.1 to question scope for further downside.

The [Canadian Financials](#) Index performed more or less in line with the S&P/TSX Index between 2003 and early-2007. The rally from the highs near 0.155 was more consistent and faster than other retracement over the last four-years and saw the market move to the new low for that time frame. However it has since rallied above the 0.14 level and would need to sustain a move below the lows at 0.134 to question scope for some further higher to lateral ranging.

[South African Banks](#) generally remain in a downtrend relative to the market although they have been rangebound for much of the last year. They would require a sustained move below 1.2 to question scope for some further lateral ranging.

[Taiwan Banks](#) also remain in an overall downtrend relative to the market but have lost momentum and would require a sustained move below 0.11 to offset scope for an upward break.

[Singapore Financial Equities](#) have also lost downward momentum relative to the market and would require a sustained move below 2.44 to offset potential for an upward break.

The [Jakarta Financials](#) Index topped out relative to the wider market in 2005 and has generally underperformed since then. A sustained move above 0.1 would be needed to offset scope for some further downside.

The [Thai Banks](#) Index improved relative to the SET Index between late-2003 and late 2006. However it then entered a much more volatile phase which was characterised by a progression of lower highs relative to the market. The Index found support in late-October near 0.33 and rallied well. It continues to consolidate that move and would need to sustain a fall to new lows to question scope for a further rally.

The [Hang Seng Financial](#) Index has been in a relative downtrend since breaking down from the Type-3 top in early 2005. It needs to break the progression of lower highs to question scope for further downside. The [S&P/Citic 300 Financials](#) Index in China doesn't have much back history, but have generally outperformed its Index since inception and would need to sustain a move below 1.1 to question scope for this to continue.

The [Topix Banks](#) sector was in a relative downtrend for much of the last 18-months but found support in late-September and managed to hold the lows. It has now broken upwards from this consolidation and the upside can be given the benefit of the doubt as long as it can hold above the recent lows near 1.9.

The [Dow Jones Euro Banks](#) Index was in a consistent downtrend relative to the overall market until it found support in mid-November. The subsequent rally has seen the Index move higher faster and farther than at any other time in the last year. It would need to break the lows near 1.08 on a sustained basis to question scope for further upside.

The [Bombay Banks](#) Index has performed more or less in line with the wider BSE500 over the last year and would need to sustain a move below 1.28 to question scope for further higher to lateral ranging.

In conclusion, while it is not a requirement that banks lead a stock market higher, if they perform at least in line with the Index, they help to lend credence to the markets longer-term potential. We can see from the charts above that generally speaking, the worst performing banking sectors have been in the USA, the UK and Switzerland and these remain so. Importantly European and Japanese Banks rallied well from relative support, which is a positive sign that they have probably weathered the worst of the storm.

Importantly, while the New Zealand, Australian, Chinese and Indian banks indices are performing in line with their markets, given the actual performance of their wider indices, the Indian bank sector is clearly in a position of leadership, globally.

November 23rd US Dollar: A "Zimbabwe Situation" or Tomorrow's Phoenix?

The markets can seldom be accused of understatement, not least regarding the world's reserve currency right now. An increasingly vocal and somewhat wizened group, comprised mainly of roving strategists and mountain top gold bugs, sees the US dollar as tomorrow's confetti.

Providing the opposite view is a slightly younger but now prematurely wizened gaggle of chastened investment bankers and hedge fund managers, who now have an emotional attachment to born again levitation themes.

The first group thinks that America should be punished for everything from the Federal Reserve to Krispy Kreme doughnuts. They have a point, I suppose, although the world would be less fun.

The second group is not driven by such a high-minded ideal as revenge. Instead, it needs trading profits, lots of them, and it needs them now. Fearing that the dollar's momentum play may be overdone, and perhaps having lightened positions accordingly, they want a sharp rebound so that they can play the upside for at least a few months, before shorting the greenback once again.

Neither of these fundamentalist groups (a reference to religious fervour rather than disciples of Graham & Dodd) may be particularly objective, but one of them has to be right, don't they?

Yes, to one degree or another, and Fullermoney has long been in the camp maintaining that the US dollar was both fundamentally and technically weak, as the Archives will confirm. Today, however, I would like to avoid attachments, not least regarding familiar and comfortable ground, in an effort to summon objectivity in my self-declared role as a technical naturalist.

I'll start by saying that I don't know in which direction the US dollar's next big move will be, and neither does anyone else. You and I can see the trend and the US Dollar Index ([daily](#), [weekly](#) & [monthly](#)) is still weak. However that trend has steepened recently, which is a form of acceleration. Acceleration, as we say at The Chart Seminar, is an ending of unspecified duration.

Therefore it warrants close monitoring and I am now particularly interested in the Daily chart above. It failed to maintain a downward break today, which is a small warning but far from conclusive. However if the US Dollar Index were to break up out of its recent range, clearing 76.20 for more than a day or two, I would conclude that we had seen a low of at least short-term significance. Given the steepening of this year's long, ranging downtrend, I suspect that a break above the small range immediately overhead would signal the onset of a medium-term recovery for the US Dollar Index. Of course if it cannot do this, the steepening downtrend remains very much intact, with the clear possibility of an additional acceleration.

Similar levels can be identified and monitored on many of the US dollar's other cross-rates. For instance, the [euro](#) stalled beneath \$1.50 today. That is an understandable psychological resistance level, so for real deterioration we would need to see a break beneath \$1.45. [Sterling](#) fell back against the dollar following the key day reversal earlier this month. A break beneath \$2.035 would further question the ranging overall upward trend. The dollar's downtrend against the [yen](#) is much more recent and a move back above ¥112 would be required to question sideways to lower scope.

November 12th on the Wall Street leash-effect:

"In the past your mantra has been the "Wall Street Leash Effect". I have been surprised in your comments over the past few dangerous days that this effect has NOT been invoked, nay ignored, in your prognostications about the future of global markets. If the Leash were to hold we should be more worried about global markets than you seem to be, otherwise we should proclaim loudly that "this time it is different" and act accordingly.

"On what side do you sit now?"

My comment - Actually, I last wrote about the Wall Street leash-effect on [2nd November](#). However you are correct in that I have not mentioned it as often recently, mainly for two reasons.

For decades I have talked about a Wall Street leash effect - a reference to the influential US market's tendency to pull other stock markets up or down. For anyone interested in examples, there are many references to the leash effect which can be found via the Search facility (use 'leash-effect' and also 'leash effect', as I have tended to hyphenate it more recently). Here is a reference to a newer phenomenon - a [China](#) leash-effect.

Both Eoin and I have mentioned it less in recent months for two reasons:

1. There has been the fascinating and no longer illogical ability of high-growth emerging markets to uncouple somewhat from Wall Street this year, as their economies continue to grow in importance relative to the rest of the world, which is no longer unipolar.
2. Also, we have been emphasising banks as a lead indicator more frequently. The performance of Wall Street banks has definitely had a leash-effect on European and Japanese banks, but notably, less so in Asia or other regions which largely avoided the sub-prime slime.

Going forward, I suspect that Wall Street will often exert a leash-effect, particularly in Europe, but elsewhere less so than before due to an increasingly multipolar world.

November 27th Jonathan Davis: Bears and bulls' battle is finely balanced

This is certainly a topical [column](#) by veteran commentator Jonathan Davis for the Financial Times. Here is the opening:

The struggle for supremacy between stock market bulls and stock market bears is turning into a titanic battle in which both sides can still periodically claim victory, thanks to the much increased volatility of market movements. It is hard to recall a time in recent years when market sentiment was so polarised, or when convictions on either side of the fence were so strong. It is making for a fascinating but stressful period for professional investors, some of whom, noted one weary hedge fund manager of my acquaintance, "may have to earn their fees this year".

There is no question that after the last couple of weeks the bulls are on the back foot. As the credit crisis unfolds, the banking sector is in full retreat and many commodities are showing signs of weakness. To do exceptionally well this year, benchmark-driven fund managers have had to call two sectors right - short financials and long commodities. Where appropriate, it clearly helped to be short the dollar as well.

It may be no accident that in both the financial and mining sectors earnings forecasts are prone to error, in the case of the banks, because of the difficulty in forecasting the level of write-offs and losses from the credit crisis, and in the case of commodities, because of both their inherent volatility and the uncertainty about the impact that a slowing US economy will have on global economic activity.

My view - Bears have certainly had the upper hand recently - emotionally, technically and fundamentally. Animal spirits have waned as investors' fears are reflected by a bearish media. Western bank shares remain weak. Stock market rallies have mostly stalled following a number of failed upside breaks in October and there are many short-term downtrends. Global GDP growth has been slowing for months, yet central banks continued to raise interest rates against that background and have been slow to cut rates recently, putting them behind the curve of events.

This raises the question: Is this a reaction, correction or bear market? And what bull factors can we see?

The answer to the first question is frustratingly varied. For a shrinking minority of stock markets, what we have seen to date barely qualifies as a reaction. A number of others are technically in corrections, at least by my [definition](#). Unquestionably, this has been a bear market for most Western bank shares, and both house building and property companies have been similarly weak.

Bullish factors are inevitably less obvious during a market retreat. However increasing bearish sentiment and the anxiety that some of us undoubtedly feel is usually a good contrary indicator. Arguably, many stock markets are as short-term oversold today as they were overbought in mid-October. The big growth themes, represented by Chindia and resources markets such as Australia and Brazil have not shown the downside beta, at least not to date, that one might expect in a bear market.

Lastly and most importantly, look at this 5-year [chart](#) of the S&P500 Index compared to US 30-Year Treasury prices. Bonds usually lead. We saw this in 2003, again following the 2004 dip, similarly in 2005 and dramatically in mid-2006. Bond prices also led the summer correction and are probably signalling a yearend rally.

The counter argument, I should add, is that some people fear a sharp slowdown in the global economy, including deflationary pressures. This would be an overreaction in my view, not least because the global economy is still synchronised in a period of expansion, albeit at a slightly slower rate than twelve months ago. However this could change if the Fed, through an act of stupidity, refused to cut short-term rates significantly.

What about inflation, some will say. It is mostly from food and energy prices, and therefore a global problem, exacerbated by the rising cost of government services in countries such as the UK. Therefore a too tight monetary policy is a crude and ineffective club with which to tackle a problem of supply inelasticity and rising demand, not to mention the cost of government

services. Instead of wringing these price increases out of the system, it would only beat up on consumers and businesses.

Even if an expansionary monetary policy did push up inflation slightly over the next year, this would be a small price to pay for avoiding a damaging recession. A more worrying inflationary problem is unlikely to occur before global GDP growth is surging once again. Significantly weaker prices for long-dated government bonds will provide ample warning.

Lastly on stock markets, I'll feel a lot better when Western banks improve but regard their market action as climactic. The current environment is obviously not without risks, not least because one can never be certain about the timing of central bankers. Also, Asian stock markets have temporarily lost the previously bullish China leash.

Nevertheless, I would rather be a buyer than a seller today. I continue to favour the Fullermoney themes, led by Asian emerging markets and resources. These are best purchased following setbacks and have enormous long-term potential. Among newer themes, mainly but not exclusively found in Europe and especially North America, which are good for at least the medium-term, I like big-cap multinational companies that derive a significant proportion of their earnings from Asia. I also like technology, and the recent market setback has made high-yielding equities interesting once again.

For additional buy ideas, see Mike Lenhoff comments below.

November 28th James Paulsen: The Crisis is "A Mile Deep, but Only an Inch Wide"!!!?

My thanks to a subscriber for this refreshing and very interesting [report](#) by James Paulsen of Wells Capital Management. Here is the opening:

The most dominating characteristic of the contemporary crisis is not the housing industry, subprime contagion, Wall Street banking losses, Fed actions, crude oil prices or the sliding U.S. dollar. Rather, the single factor which stands out more than any other is "Fear!" The epicenter of this crisis, the housing industry, has been in decline for two years. Its collapse was obvious by the spring of 2006 and "fear" has been constant ever since. That the housing collapse would spread out and take down the entire economy was the fear in June 2006 and it remains a fear more widespread and riveting than ever today. And yet, although the housing industry has gone from bad to worse, there is still very little evidence of actual "economic damage" to other parts of the economy! As it was when housing first collapsed 18 months ago, the premise of major and broad-based economic fallout, while almost universally accepted, is still today largely a story "on the come!!"

No doubt the housing industry is a mess. Single family housing starts are off by almost 50 percent from peak levels in 2005! Throw the automobile industry in the same category. Together these two sectors comprise less than 9 percent of real GDP but have declined by about 10 percent in real terms during the last year. Nasty indeed! However, the remaining 91 percent of real

GDP has risen by 3.8 percent in the last year! Hardly crisis-like character! This crisis is 9 percent collapse and 91 percent "fear of collapse!" It is a mile deep but only an inch wide. However, if one is on the inch, for example homebuilders or subprime borrowers and lenders, it's the worst conditions seen in decades. Made to feel even worse since this 9 percent of the economy gets about 95 percent of the media coverage. Fortunately, although largely ignored, most of the economy remains at least a foot away from this epicenter inch and at this point still appears healthy.

My view - The market is a crowd in motion, so it hardly surprising that mob psychology rules, for at least the short term. The pendulum of sentiment swings in an arch between extremes of apocalyptic fear and rapacious greed. You may have noticed that the needle has been twitching in fear territory recently.

Yes, but this is the worst meltdown or fry-up since the Great Depression, some will say. Really? Well, I have heard that before and it proved to be a tad hyperbolic. However I appreciate that for debt derivative salesmen it may look like the end of capitalism, if not the world. They will reinvent themselves.

I am not implying that the credit crisis and US housing slump are not serious. Nevertheless they are containable and should have no more than a limited global impact.

Having seen innumerable reports detailing all the things that might go bump in the night, I find James Paulsen's analysis refreshingly sensible. I commend it to you.

If you are really pressed for time, just read his conclusion on page 4. Even if one does not agree with everything in this optimistic report, and I don't, it is an effective riposte to some of the extreme pessimism heard recently.

Meanwhile, some firm and positive leadership from central banks, particularly the Fed, would help prevent people from talking themselves into a recession. Also, we need lower interest rates, as I have mentioned daily.

Technically, today's stock market rebound is providing some encouraging upward dynamics from an oversold condition. This evidence is not conclusive (it never is until markets are much higher) but most good rallies commence in a similar fashion.

(See also yesterday's feature on global stock markets, plus Eoin's chart review below.)

November 28th Wall Street posts upward dynamics

Today saw upward dynamics posted on all of the main US indices. The Dow Industrials ([weekly](#), [daily](#)), S&P500 ([weekly](#), [daily](#)) and Nasdaq ([weekly](#), [daily](#)) all posted impressive moves today and the upside can be given the benefit of the doubt as long as they hold above their recent lows. Also of note will be the weekly key reversals which are developing on the Dow and S&P. If these hold

and we see follow through next week, we may have seen an important medium-term bottom. Importantly, the Nasdaq had the shallowest reaction so far, and the largest percentage rise today, which suggest that the Index should continue to outperform its peers.

5 of the Top-10 best performing companies on the S&P today were financials. Of the large brokers, [Merrill Lynch](#), [Lehman Brothers](#) and [Citigroup](#) were all up in excess of 7%. The S&P Banks index ([weekly](#), [daily](#)) found at least short-term support above 260 and would need to sustain a move below that level to question scope for some further upside in the short-term. However the Banks Index remains in a medium-term downtrend and this move is not larger than similar advances we have seen during the course of the decline. To scare the bears out of their positions and indicate to investors that it has bottomed, the Index will have to rally further than it has in previous distributions, successfully find support above the low and subsequently build support above that level.

While it is too early to state the wider markets have bottomed, we have seen lows of at least short-term significance, which would need to be taken out to indicate scope for further weakness.

November 29th on opportunities in high-yielding shares following the market shakeout:

"My Global Thematic colleague Dr Nag Bharatula has screened (see attached) this list of European stocks now trading at:

- 1 Earnings Yields of 7%+ (ie historic PERs of 14.2x or better)
- 2 Dividend yields of 3.5% or better
- 3 Market caps of USD 750mn or better

"It is implied mathematically that dividend cover must be greater than 2x (and this is detailed on the spread sheet). Some comments:

- 1 Obviously, it throws up a lot of banks and insurances and property companies.
- 2 There are crazy anomalies. Northern Rock doesn't trade at 78% earnings yield, but probably has NO earnings yield....this year!
- 3 Some dividends will be cut (though this is less probable than earnings per share being cut; a suffering bank that is Basel 2 compliant may be able to still pay out an uncovered dividend, though we have not checked this).
- 4 Even allowing for a 50% earnings cut across the board (including a "write down" that may become a "write up" in later years), banks still trade cheaply.
- 5 Small cap trades expensively relative to large cap, so -interestingly- lowering the market cap to \$500mn does not produce many more small caps.

"The point is that Nag's screening also produces Unilever, Electrolux, AstraZeneca, BT and Vivendi...not bad long-term franchises I would have thought if they are yielding more than a depositor gets in a bank, however riddled with sub prime slime it might be!"

My comment - Emails generally appear anonymously in Fullermoney although I have on occasion altered this protocol when original research has been contributed. This one is from Iain Little of Global Thematic Investors, who also works at Butterfield Asset Management in Switzerland (don't miss his outstanding [letter](#), co-written by Bruce Albrecht).

A couple of days ago, Iain and I were talking about high-yield opportunities. Since Eoin who usually does the Fullermoney searches was at TCS in Dublin, I had the bald-faced cheek to ask Iain if his team could produce a pan-European list of high yield shares. He had mentioned that his colleague, Dr Nag Bharatula, a portfolio manager and also with Butterfield in Switzerland, was a wiz at that kind of search.

Readers who have not been driven to high ground by the credit derivatives folly or taken to ark building, and who suspect that forecasts of a global financial tsunami may be not only premature but also a contrary indicator, and who would welcome some high-yield opportunities as a cyclical recovery complement to Fullermoney's secular themes, may be interested in this list, generously contributed by Iain and Nag, in the spirit of Empowerment Through Knowledge.

Here is Dr Nag Bharatula's [list](#). It arrived in an Excel spreadsheet which I had to turn into a PDF file for posting on Fullermoney. This has compressed a letter or two in the headings but their meaning is obvious and the list of shares is complete.

In the caveat emptor department, please note Iain's points above. Also, I have not had time to view the price charts for these shares. However I thought it more important to get this list to subscribers asap, knowing that most of you are very good at conducting your own due diligence and any additional research required. For the record, Earnings Yield is the earnings per share divided by price per share.

Clearly, high-yielding shares are best purchased following market corrections such as we have seen recently. Whatever happens to stock markets going forward, and I am more optimistic than the general consensus as you probably know, I think this list of shares will, on average, prove to be competitive within Europe over the next couple of years.

December 6th on my big picture outlook:

"My question relates to your big picture outlook. I remember you made the comment at the May TCS that the next global bear market would set up the "buying opportunity of a lifetime in markets such as India and China" (please forgive me if I have misquoted you). I am fully invested in the Australian stock market and intend to move to cash as the risks of next bear market increases (inflation and bond yield increases etc) and then move funds to India and China investments at this point. However, with your suggestion that the global credit crunch extending out the current bull market I am wondering whether I should move funds to India and China via the vehicles you use now. I would appreciate your thoughts regarding how long away the next bear market might

be and how far Indian and Chinese equity markets could potentially fall during this."

My comment - First, I congratulate you on having been fully invested in the Australian stock market for some time, as its performance has been outstanding.

Regarding my comment on India and China at TCS in May, I would trust your memory more than mine and what you quote does sound like me. Therefore I will only take this opportunity to expand the comment by adding that it would be the second great buying opportunity of a lifetime, since I do not expect either stock market to retest the lows seen during the first half of this decade - short of Armageddon - which I do not forecast.

As to your queries regarding an extension to the credit cycle and the bull market in equities, and I'll use this opportunity to expand my comments into a broader discussion of stock markets, I do maintain that some forecasts need to be revised following the crisis of confidence since August. Some commentators have done this by assuming that a global bear market has already commenced. I disagree, as you know, although we have certainly seen a bear market for most Western banks, property and house building companies.

Equity bull markets, I maintain, do not die of old age. Instead, they are assassinated, usually by central banks. I have not felt that we were entering a bear market for global stock market indices, as you know, because I do not see it in the leading stock markets. Also, and crucially, long-dated government bond prices - a crucial leading indicator in my view - not only stopped falling in June but have rallied strongly.

Consequently, overall inflation concerns were receding rapidly, removing the need for a central bank squeeze. The specific inflation that *does* remain is primarily from energy and food costs, plus and lamentably, government services in some countries such as the UK. These problems will not be addressed by monetary tightening, at least not without draconian consequences.

However my greatest analytical concern in recent months, which *has* worried me considerably, is that Ben Bernanke and Mervyn King have fallen behind the curve of events. King in particular seems to lack the emotional intelligence - market savvy if you prefer - to understand the speed with which confidence can unravel in a crisis. Also, he does not appear to have any senior UK contacts with Hank Paulson's market nous, with whom he is willing to confer.

The UK economy will pay a price for Mervyn King's inability to deal in timely fashion with a crisis of confidence, but this is less of a global concern. Ben Bernanke's decisions *really do* matter and although he is highly regarded as a leading academic, he remains an inexperienced and on the job trainee Governor of the Federal Reserve.

Nevertheless, the balance of technical evidence suggests to me that aside from Western banks, property and house building companies, what we are seeing is no worse than another medium-term correction for mainly northern hemisphere stock markets, and little more than a reaction for most others. We won't see a confirmed 'all clear' signal until bank shares in the West are considerably stronger. Meanwhile, I regard the three sectors mentioned above as medium to long-term recovery candidates.

Lastly, and this brings me back to the email above, I don't think we will see a global bear market until the synchronised economic expansion is clearly overheating once again, causing long-dated government bond prices to plummet, and most central banks to ratchet short-term rates higher. This is very unlikely to occur before 2009, at the earliest.

Regarding an equity switch from Australia to India and China, I do not think you would have cause to regret it a decade from now, but you would be increasing your medium-term risks as both markets trade on considerably higher valuations, particularly China. I would be in no hurry to abandon Australia, and at this stage I would only buy India and China incrementally, preferably following setbacks.

November 29th on Japan's banks:

"David: Have you been (silly question?) watching the banking shares in Japan, seem to be acting well, even before the recent rally in Western banks, seems Japan may be set for some relative strength?"

My comment - Eoin and I have been discussing the Topix Banks Index ([weekly](#) & [daily](#)) almost daily in our global market review.

It has certainly improved recently, evidenced by an increase in upward dynamics, following a significant percentage decline taking it back to the first area of psychological and lateral potential support near 300. Note also the 200-day MA, which we use entirely as a 'regression to the mean' tool. In other words, the decline was almost as overextended relative to the MA a few weeks ago, as the rally was on the upside at the peak. And while I generally eschew pattern labels, you may notice a falling wedge characteristic caused by the steep downtrend from about 415, and marginally less steep tangent connecting lows in September and November. One does not need to draw lines to see this. It indicates that demand, having been conspicuous by its absence for a while prior to late September, is now increasing relative to supply.

November 23rd on the spread between 3-mth Libor and T-Bills:

"Have a look at this 22 yr chart of 3M T-BILL/LIBOR SPREAD

"Suggest a high level of Risk Inversion ... Fed Funds at 4.75pct ... US Guys buying t-bills at 3.38pct i.e. giving money to uncle Sam at 3.38 and not willing to lend Libor Interbank at 4.98 pct ... missing out 160bp spreads!

"Also 2 yrs US Treasuries at 3.18pct now - lower then T-BILL Rate!

"Such a credit squeeze must be really tough for businesses, no?"

My comment - Thanks for this interesting [overlay](#), which shows just how risk averse money market participants have become over the last couple of weeks. I agree that this is troubling for businesses attempting to raise capital in the markets and can not be allowed to go on indefinitely. In fact what we can also see from the overlay is that every time these rates have diverged, they have always come back into balance not long afterward.

Increasingly copy released by the major banks is stating the problem in no uncertain terms, but they seem to be short on solutions. Of course this is understandable to an extent, if we show some empathy with their situations. It can't have been a pleasant experience to be sitting on a money market or STIR desk over the last six-months and this is shading their commentary.

This interesting [article](#) by Richard Berner for Morgan Stanley, kindly submitted by a subscriber, covers recent credit events in some detail. Here is a section:

The extent of this reintermediation process matters for both the cost of credit as reflected in spreads and its availability. The process for US banks probably has not pushed the median Tier I capital ratio below the 6% "well-capitalized" level, although in the past 14 weeks, that absorption resulted in a \$340 billion surge in the combination of C&I loans and other securities. In part, sensing that capital would start to be a constraint, banks over the last seven weeks sold about \$60 billion of government securities (including MBS). Moreover, several banks recently tapped the markets to raise new capital at historically wide spreads because they likely expect that they will need it and that the terms for doing so may get still worse. And Betsy Graseck and our accounting analyst Juliet Estridge point out that the increased transparency promoted by new accounting rules under FAS 157, coupled with an ongoing deterioration in lower-quality assets and reduced liquidity, will likely prompt risk managers to continue, but not accelerate, the pace of markdowns. That will further pressure balance sheets (see "FAS 157: Expect Subprime Pressure to Drive More Level 2 & 3 Markdowns in 4Q07", November 14, 2007).

Beyond the banks, other intermediaries are also in asset-reduction mode. My colleague Patrick Pinschmidt notes that Wall Street may have a significant volume of assets to sell between now and year end. To gauge the magnitude, he suggests looking at the second half of 1998 and the second half of 2001, when the Street reduced assets. In the first of these two periods, he notes that total balance sheet assets declined by about 10-20% immediately after the market break - and in that period, market valuations rose as the Fed eased monetary policy. The Fed's flow of funds data show that credit market assets at securities firms contracted by \$79 billion (32%) in the year ended in the third quarter of 1999. With the Street's balance sheets more than three times larger today than a decade ago, and shareholders' equity declining, I guess that the scale of the balance sheet contraction today could run to \$500 billion. Fed data show that Wall Street's credit-market assets had already contracted by \$84 billion in the spring quarter as the subprime meltdown moved into high

gear.

Moreover, unlike the past, when financial markets and the Street could cushion deleveraging at the banks or vice-versa, this time they are deleveraging and shrinking together, representing a constraint on the supply of credit. Both will continue to tighten financial conditions and weaken already-slowing US and perhaps global growth. In that regard, it is useful to consider whether banks abroad could play a cushioning role. My colleague David Miles notes that the Bank of England in its recent Financial Stability Report seems relatively sanguine about the pressure on UK bank capital resulting from prospective reintermediation. The Bank estimates that, if all the assets they judge cannot be funded return to balance sheets, the median Tier 1 capital ratio would fall from 8.2% to about 7.6%. But he and our colleague Neil McLeish are concerned that a broader scale of write-downs and losses will hit capital and create additional pressure in those markets. However, a word of caution is in order: Although such writedowns will impair their equity positions, one should not assume that these intermediaries will contract their assets by a multiple that reflects their capital ratios. Some of the writedowns will eventually turn into recoveries. And historically, intermediaries have raised capital in response to such writedowns, and as noted, they appear to be doing just that.

These developments are critical for money markets in particular, but because banks have become the fulcrum in the deleveraging process, they are also important for all risky asset markets. Spread widening probably will extend more broadly into credit markets as funding costs rise. In my view, the rise in money-market and credit spreads represents a tightening in financial conditions that will weigh on economic activity and require the Fed to move further to cushion downside risks to credit-sensitive areas of domestic demand.

Further near-term financial shocks and a concurrent heightening of risk aversion could drive risk-free rates lower and money-market spreads correspondingly wider as a scramble for liquidity intensifies. Market participants and policymakers alike will find it difficult to disentangle the transitory from more permanent pressures on funding, making assessments of funding needs and financial conditions less certain than in the past.

The above view is predicated on the present situation continuing, which is by no means certain. However it does a good job of describing just how far behind market events various central banks have fallen.

Looking at this [spread](#) chart of USD 3-mth Libor over US 3-mth T-Bills, we see that when it reached a peak of just under 250 basis points in August, the Fed intervened with a cut to the discount rate and followed with a rate cut a few weeks later. They should cut rates now too, as that spread continues to widen, and should follow through with additional rate cuts to help the banking sector recover. In the absence of this type of action, we risk further liquidity problems, which are not in the interests of any central bank. In fact, the longer they leave it before acting the greater the move they will subsequently be forced to make.

November 22nd ETF Securities Ltd: Investment Case for Agriculture

Thanks to colleague John Ritchie for this [presentation](#) on Agriculture which has a number of interesting charts. Here is a section:

Culmination of (i) growing demand, (ii) new sources of demand and (iii) tight supply

Supply:

Record low world inventories
Extreme weather events, climate change
Crop rotation
Rising input costs
Limited land and water availability per capita
Threats of nationalization

Demand:

Rising world population and income per capita
Robust demand from China and emerging markets
New sources of demand (biofuels)
Possible inventory building from several countries as commodity prices keep rising

My view - While one can argue about the implications of climate change there are a number of other factors which point towards a bull market in food commodities. On the supply side, it is a fact that inventories are at record lows and are not being replenished. It is also a fact that unpolluted water is becoming an increasingly scarce commodity, particularly in countries with large populations which are industrialising rapidly. Costs for energy and fertilisers are on the increase and show little sign of abating. On the demand side, the first thing people do when their incomes increase is improve their diets. When a sufficient number of people's median incomes increase this leads to a sustained jump in demand. Biofuels are also taking up an increasing portion of land which would once have been dedicated to food production.

All of these factors point toward a sustained bull market for agricultural commodities. However this sector will continue to be volatile because every country in the world produces and consumes these commodities and weather will always play a role in how they are priced. This means that they are best purchased following corrections and patience is needed for them to recover.

November 29th UBS Bubblewatch: Is Shanghai finally deflating?

My thanks to a subscriber for this informative [report](#) by Sakthi Siva for UBS Investment Research. Here is the opening:

Shanghai Composite down 20% from its high

While investor focus is largely on US sub-prime and the risk of recession, we highlight that an equally important issue for Asian investors (particularly given

most are still Overweight China) is the 20% fall in the Shanghai Composite from its 16 Oct high of 6093. The key question is whether this is the start of the Shanghai bubble finally deflating (see our AES of 3 Oct "Bubblewatch").

My view - Sakthia Siva's report makes a useful contribution to the usually dismal science of *Bubbleology*, not least because of its comparative statistics.

Unquestionably, China has been trading at significant bubble valuations this year, so let's have a look at charts for the Shanghai Composite Index ([monthly](#), [weekly](#) & [daily](#)). For the record, Fullermoney has been monitoring the loss of uptrend consistency at frequent intervals, commencing with 4 consecutive days on the downside in [October](#).

The current weekly graph above shows 4 similar-sized steps on the upside since the first higher low for this overall move in October to early December 2005. However the current correction is considerably larger, as Sakthi Siva has pointed out. Thus we have certainly seen at least a medium-term peak. Nevertheless the decline has been orderly to date, therefore less traumatic, so there is a good chance that the high will be retested.

The daily chart above shows a small upward dynamic today, near the psychological 5000 level. While hardly conclusive, upside follow through on Friday would increase prospects for a technical rally.

A potentially important difference between China's current bubble and some of the other examples cited in the UBS report is its short duration, not least relative to the size of its base. The most dangerous bubbles inflate for many years.

Lastly, and this has always been pure conjecture, I have long suspected that China would want a showcase stock market during its Olympics year. Having managed a partial deflation and decline closer to the 200-day MA, China is in a position to influence stronger action for its stock market in coming months.

December 5th China Plans 'Tight' Monetary Policy Next Year to Cool Economy

This is an interesting [article](#) by Li Yanping for Bloomberg. Here is the opening:

China plans to shift to a "tight" monetary policy in 2008, signaling the government may raise interest rates further and allow quicker currency appreciation as the economy heads for its fastest expansion in 12 years.

The central bank changed its stance from the "moderate tightening" bias of recent months and "prudent" policy of the preceding decade, in a statement released today at the end of a three-day meeting of China's top leaders and financial officials.

The change underscores the government's failure to cool the world's fastest-growing major economy after five interest rate increases this year. China's economy grew 11.5 percent in the third quarter, inflation is running at a

decade high and the benchmark stock index has more than doubled in 2007, as an export boom pumps cash into the financial system.

My view - This sounds to me like a signal to various groups and certainly not just within China. For instance, I assume that it is meant to placate US and EU critics who call for a faster rate of renminbi appreciation.

What might be the implications for China's property and stock markets?

China needs and wants a strong economy but no sensible government wants an inflationary problem. With food prices already high and difficult to control, not least because this is a global problem of supply inelasticity meets rising demand, China wants to curb asset inflation in its property and stock markets.

Property speculation is the greater concern because no government wants its less wealthy citizens to be frozen out of the housing market. At worst, this can lead to social unrest.

However the stock market is also important because all big bubbles eventually burst. Chinese officials had previously signalled an intention to create a slow cooling off period for share prices, to less overextended valuations, and the Shanghai Composite Index's [retreat](#) has been orderly to date. A PER of 46.23 shown on this [chart](#) is certainly high but probably not dangerously so given the favourable outlook for the Chinese economy and corporate profits.

My guess is that China's officials would welcome a medium-term period of ranging beneath the Composite Index's early-October peak at 6124. Meanwhile, this daily [chart](#) shows the Index steadying near the psychological 5000 level, following a decline of nearly 22%. A close beneath 4770 would now be required to signal an extension to the recent downtrend.

A contention of mine during the last two years has been that China would want a showcase stock market during the 2008 run-up to the Beijing Olympics. I should probably reassess this because at these valuations, it is unlikely that officials would wish to signal that the stock market was a one-way bet for most of next year. Given all the bubble warnings, not least from overseas, they may prefer a lengthy and orderly consolidation.

If correct, this may disappoint some investors in the Atlantis China Fortune [Fund](#) or similar instruments. I do not hold that view and it is the second largest investment in my personal long-term portfolio. I have no intention of trimming this position because I'm backing the manager, Yang Liu, in one of my top-2 stock markets for the very long term. Incidentally, she has mainly invested in Hong Kong-listed instruments, as you can see from this latest [newsletter](#), posted on Monday.

While these shares are obviously not unaffected by the Shanghai Composite, and some of them also trade on high valuations, I would not be deterred by a period of modest performance, if that is what we get, and would prefer it to more dangerous bubble conditions. In fact, I am more likely to increase than

decrease this position over the next year or more. I seldom trade my favourite investments if I feel that risks are acceptable relative to long-term potential.

December 5th Macquarie research Economics: Locking it down, Energy and food security

Thanks to a subscriber for this interesting [report](#) by Rebecca Hiscock-Croft which covers a number of issues relating to energy and food. Here is a section on the latter:

Food security is the other equally insidious security concern emerging at the moment. Just as economies need energy to fuel growth, people need to eat. And just as supply and price shocks create vulnerabilities in terms of energy, they are also sources of insecurity in this other major part of our living standards.

Looking at soaring wheat and corn prices, it isn't hard to see how ominous supply and demand dynamics are building towards a food crunch. World export prices for wheat climbed 25% during September alone. This is a widespread phenomenon. As at mid-October, prices for soybeans, coffee, cocoa and cattle feed all posted double-digit growth on the prior year. Recent rising trends look set to persist. Prices of global wheat futures have also skyrocketed, reaching levels about double what they were a year ago, and turnover has jumped.

What is propelling food prices to exorbitant heights?

Looking first at supply constraints, temporary shocks related to weather and diseases are big factors. The OECD and the United Nations Food and Agriculture Organisation (UN FAO) estimate that temporary factors, such as drought-related supply shortfalls, account for most of the current strength in world market prices for agricultural commodities. The fact that the Australian Bureau of Agricultural and Resource Economics (ABARE) slashed its winter crop production forecast by 45% for 2007-08, due to below-average winter rainfall, shows that weather patterns have a powerful impact. Current International Grains Council assessments also indicate that weather related shocks in Australia, and in other key exporting areas Canada and the EU, will hurt global grain supply over 2007/2008. Similarly, disease, such as blue-ear in Chinese pigs, can also deliver a short-term term shock on the supply side.

Sustained higher crude oil prices also affect global markets for agricultural commodities. Higher oil prices feed into higher agricultural production costs, such as fuel and fertilisers, leading to lower quantities of production and bumping up price levels. Of course, this effect depends on the share of energy in total crop production costs. But at rough estimate, the OECD/UN FAO puts this at 25% of total production costs for OECD economies, and 43% for non-OECD. Though the actual supply response to changing energy prices is comparatively small, these are nonetheless high proportions of total costs and can have a notable impact, as shown in Figure.

Longer-term influences also seem to be at work, with structural changes suppressing supply in countries historically accustomed to high levels of government support. International commitments to reduce domestic support and export subsidies were established in 1994, with the Uruguay Round Agreement on Agriculture. Government supports are now subject to value and volume restrictions, which are squeezing supply. This is particularly true for dairy and sugar. For instance, policy reforms in the EU are behind the fall in the region's dairy surpluses, and the drop in its subsidised exports. Where the EU and the US were exporting agricultural deflation, they are now exporting agricultural inflation. In driving down supply and leaving prices to the market, policy shifts have the potential to keep price levels above historical norms over the medium-to long-term.

At the same time, heavy subsidies on European and American agricultural exports over the last few decades have made investment in agriculture unprofitable in many other countries. This is now coming full circle in the form of higher food prices, with global agricultural commodity supplies now falling behind demand.

Climate change is the wild card on the supply side. With the world heating up and weather patterns becoming increasingly unpredictable, crops too will flourish or flounder unpredictably. This is likely to lead to erratic supply shortfalls and price volatility. Looking beyond the immediate outcome of short-term shocks, uncertainty also makes investment decisions increasingly risky, which could perpetuate supply shortages over the longer term.

My comment - Food inflation is something which we are all likely to get used to, as higher prices at the supermarket become a permanent feature. Generally speaking the chart action across a whole host of food commodities is looking much more positive, which indicates that this is a sector we will hear much more of in the coming years.

Wheat, in particular, made headlines this year as it posted some impressive gains and moved to new all time highs. It broke upwards from its long-term base in early June and accelerated to a high above 950¢. Since reaching that high, the grain has been consolidating and in the short-term, looks set to at least test its highs. Over the longer-term, it would need to sustain a fall back into its base to offset scope for a reassertion of its uptrend.

Corn broke upwards from its base in October 2006 and following a retest of the top of that long consolidation it is now rallying once more. Importantly, this is the first time, in the available price history, that it has sustained such high prices for more than a growing season. This points to a fundamental change in the supply/demand dynamics for the market, which most likely signal higher prices going forward. It would need to sustain a fall below 300¢ to question this long-term hypothesis.

Oats also broke upwards in October 2006 and is technically very similar to corn above, although more volatile within its consolidation.

Soybeans is only now challenging its all time highs which were set following an impressive acceleration in early 1973. A sustained move below 800¢ would be needed to question the commodity's longer-term upside potential.

Rough Rice is now also breaking upwards from a long-term consolidation. I'm afraid we do not have the same length of back history for this commodity, but this breakout is important nonetheless, and we can give the upside the benefit of the doubt as long as it can hold the break.

Barley has also been in a long-term consolidation and only broke upwards in September. It is currently consolidating and would need to sustain a move below 180¢ to question upside potential.

Canola (Rapeseed) is similar to Barley above.

Cocoa conclusively bottomed in 2000. It then rallied impressively from \$685 to over \$2400 in early 2003. Following that medium-term peak the commodity has consolidated the move, largely above the base, though occasionally straying back into it. The move above \$1800 in March signalled a return to a more bullish attitude and it would need to sustain a move below that level to question scope for further upside.

Arabica Coffee bottomed in 2001 following two impressive rallies in 1994 and 1997. It then rallied from 42¢ to a high of 139¢ in 2005. Following that historically minor acceleration it moved into a lengthy consolidation and needs to sustain a move above 140¢ to reassert the overall uptrend.

Robusta Coffee bottomed in 2002 near \$350 and ranged for almost 3-years before breaking upwards in early 2005. It had been in a consistent uptrend but is now pressuring the progression of higher lows, which have remained intact for much of the last 2 years. A sustained move below \$1600 would be needed to question potential for a reassertion of the uptrend in the medium-term.

Orange Juice was in a gradual long-term downtrend until it bottomed in 2004 and proceeded on an impressive rally which would have shaken the bears out of their complacency. It continues to consolidate that impressive rally but needs to sustain a move above 200¢ to reaffirm the overall uptrend.

Sugar broke upwards from its 7-year base in 2005 and accelerated, setting new all time highs just underneath 20¢. It then gave up almost the entire move before finding support near 10¢; a level which marks the top of the former base. A sustained move above 11¢ would be needed to indicate further recovery scope.

A couple of phrases such as 'all time new highs' and 'breaking upwards from a long-term base' are enough to attract the attention of many investors and they are likely to be increasingly heard in the soft commodity sector in the coming years.

November 12th on Rio Tinto:

"Is it time to lighten up on Rio Tinto?"

My comment - From a trading perspective, possibly, although there could easily be a higher bid and I doubt many subscribers bought [Rio Tinto](#) for a trade. From an investor perspective, anyone who sold Rio might not be able to get back in lower, if this takeover goes through, except via [BHP Billiton](#). From a long-term perspective, I think BHP Rio, or whatever they might call it, would be the most important mining company in the world, and probably one of the most profitable companies generally.

To remain objective, one should never fall in love with a share, but I continue to regard Rio and BHP as treasure troves of industrial resources, in what is now a conservatively valued growth industry. I'll put it another way, even though it is comparing apples with pears: If Rio and BHP were listed in Shanghai, I suspect they would trade at four to five times today's valuations.

Personally, I do not want to see any other bidders for Rio, even though that would boost the share price higher in the short-term. It would be a tragedy far greater than Falconbridge / Inco if a state-controlled Russian company, Chinese sovereign wealth fund or PetroChina took over Rio, as discussed in this [article](#) from Mineweb. I feel it would be very detrimental to our minority shareholder rights and I would hope that the Australian government would block any foreign takeover attempt for Rio or BHP.

Meanwhile, BHP has made its offer quite attractive, I believe, for those of us who hold both Rio and BHP in our long-term investment portfolios. From what I have heard in this latest [article](#) from Bloomberg, we would get BHP shares for our Rio and that the company would also launch a buyback programme to rival that of Microsoft. (See also [link for Donald Coxe's view below](#).)

November 14th on industrial metals

With industrial metals in the last two years, it has generally paid to sell the previously strongest on evidence of a loss of upside momentum, and buy the weakest on evidence of loss of downside momentum.

Zinc and lead are at likely price extremes, although neither has yet provided clear evidence of a turn. Zinc ([monthly](#), [weekly](#) & [daily](#)) remains on the defensive and everyone who has read a book on charting will recognise the H&S-type formation. I'll just add that in recent years these have mostly failed in metals and that zinc has already fallen a long way. Watch for an eventual upward dynamic, failed break beneath the September low and most importantly, a rally back above \$3200 to signal a pattern failure and scope for a retest of the highs within this secular bull market.

Lead ([monthly](#), [weekly](#) & [daily](#)) is at the opposite end of the spectrum, having seen a spectacular advanced. Its uptrend has not yet failed but the last two dynamics have been downwards and it is barely steady near the July high. Another downward dynamic from current levels would suggest a slide back to

at least \$3000. A break above the lower high near \$3785 is required to offset this bearish possibility.

December 5th Behavioural musings

Colleague Jackson Wong of Investors Intelligence has adopted the behavioural approach with gusto, and has a good eye for spotting front-page contrary indicators, many of which are temporarily posted beside his desk. Among the more recent, was a Chinese language magazine extolling the successes of three investors on its front cover - a 14-year old boy who turned HK\$50k into HK\$630k, a waitress and trader who was making HK\$50k every day, and a fung shui master who claimed to have made \$4m using fung shui methods in the stock market!

Rather than merely creating envy, the behavioural point is that this issue was published on 31st October, the day after the Hang Seng [Index's](#) high for the year to date.

Today, Jackson posted The Independent newspaper's apocalyptically dark front page, entirely devoted to the theme: "Is Britain's economy heading for...THE PERFECT STORM?" The FTSE 100 [Index's](#) repost - a gain of 2.83% (178.6 points).

The behavioural point, well known to veteran subscribers - when a financial story dominates the front page, the move discussed is probably over for at least the short term and one should take a contrary view. In contrast, the best investment stories are found buried in the back pages, or may not be on the radar at all.



This is not because the financial press is stupid - far from it. However it would not sell as many copies of newspapers and magazines without reflecting back the consensus view. In that roll the press can be more descriptive and emotional than analytical.

Staying with this theme:

Covered in shame

- My thanks to a subscriber for this [article](#) from The Economist, to which he

added the subtitle: "Shock 'cover stories as contrarian indicator' "revelations" from The Economist". And in case you missed their latest cover, it was supplied separately by another subscriber.

Along with this illustrious [history](#) of forecasting.

November 22nd Jan Bylov on Stop Techniques

- My thanks to Jan Bylov for his detailed and impressive Research [Paper](#): "*Stop techniques - the implications from inconsistent forecasting skills*", published by Nordea. Jan is a highly successful professional trader. I first met him over 20 years ago and was impressed by his enthusiasm, passion for research and incisive mind. I've seen him at various seminars over the years, including TCS, and can recall some very timely emails, not least when my analytical thoughts have drifted off course.

Jan was at my final Chart Seminar last week, one of a number of old friends who attended, sitting in the front row as usual, intense and sharing some very helpful insights. He sent this lovely email:

"Thank you again for two wonderful days about markets guided by the most experienced mentor I have known in my career. Participating at your last Chart Seminar was exactly the right opportunity to thank you for the direction you guided me in almost 20 years ago... when we first met in Cambridge and shortly after at your own Chart Seminar.

"By the way, there was a lot of discussion on the use of stop-techniques - in particular from the "trader group" of delegates - and it happens that just a few weeks ago I published a research report on "Stop techniques - the implications from inconsistent forecasting skills". If you find the report of any interest (attached) you are most welcome to make it available to your subscribers of FullerMoney.

"I hope to you see... somewhere around the globe in the years to come.

"Cheers, my old friend."

Well, when you read Jan's superb report on stops, you will see that it is a question of who is mentoring whom, and certainly not to the first time with the FullerMoney Collective. Incidentally, Jan mentions me in this report but don't hold that against him. Here is a brief section:

The dilettante's experience

The initial experience is with stop-loss orders

Initially, stop techniques refer to how much money we are willing to lose on an investment idea before accepting that our forecast was wrong and exiting that investment. That is, we must attempt to predetermine a connection between perceived adverse market information and a maximum money risk amount

and then transform this equation to a specific price level at which we must exit our investment (typically called stop-loss).

When the uninformed get burned...

To lots of traders and investors the stop-loss usage is the first, only and last experience they will have before abandoning this technique within their trading approach.

...they are quick to reject the idea

This sad experience typically originates from a lack of fully comprehending all elements of stop techniques, and not least the psychological pressure from the experience that *my* stop-loss level was hit only to see the market soar in the direction that *I* had forecast (it can feel very personal). Just one or a few experiences like this will generate a perception that stop techniques are detrimental to the performance and that they don't work.

The weak hands...

For example, following a price setback the market settles down into a new price range and "my" analysis states that this market is undervalued and should start to rally eventually. Accordingly, I then buy and typically traders place a stop-loss just below the latest price range low. Subsequently, however, the market briefly falls below the recent price range low and "my" stop-loss order is executed only to observe that the market almost immediately starts to rally...as "I" originally had been expecting.

Hit...and then you hesitate!

The experience may look like the example below: [*Ed: see Subscriber's Area*]

The technique is complex

Clearly, there is more to successfully operating with stop techniques in your trading approach than just the use of an all-or-nothing stop-loss order!

The various stop types

While some traders and investors never get to know anything more than stop-loss orders before abandoning the use of stop techniques, the technique actually covers other sequential stop types in combination with the more traditional fixed entry buy and sell orders at predetermined price levels. The additional sequential stop types are phased stop-loos, breakeven stop, protective stop-profit, stop-profit and trailing stop.

My view - I've often had a love-hate relationship with stops. I love them when they save my bacon and hate them when I get shaken out by what prove to be temporary and not very significant moves. I've learned a lot about stops through trial and error, lectured about them on occasion, and forgotten too much about them in terms of my own trading.

My personal ambivalence about stops often means that I don't think about where I am placing them sufficiently, rationalised as lack of time. If, for expediency, I pull them out of thin air, results are understandably chancy.

I've printed off a copy of Jan Bylov's polished, detailed 50-page paper on stops. However if you don't have a colour printer, the many illustrations and highlights are best seen online. I'm going to study it very carefully because I know it has immense practical value, and will save me money. I commend Jan Bylov's report to you.

December 7th On meeting a long-time subscriber at the recent World Money Show in London

I arrived early for my panel discussion last Saturday morning and was chatting with the other speakers when a subscriber introduced herself. She had been at David's first TCS in Hong Kong in the early '80s and has been a subscriber since. She told me a story I thought subscribers might find interesting:

Her father died 50 years ago and left her 40 shares in one of the major Hong Kong property developers. At that time, the price was around HK\$30. Today, the price is HK\$60, but because of stock splits, bonus shares etc. she now has 200,000 shares, an increase of 1000 fold. She probably predates Buffett, but shares his wit and incisive intelligence. I don't think I've ever heard a story, which better exemplifies the reasons for remaining invested in a high growth region for the long term.

December 6th World Equity Index Valuations Tables

Here is the monthly list of 96 global indices ranked in descending order by [dividend yield](#) and then in ascending order by [P/E](#).

Notably [Venezuela](#) continues to lead both lists which is interesting since the market continues to range following a decline from the highs to which it accelerated in January. Where countries such as Venezuela underperform is in governance. The defeat of Chavez's referendum on Sunday was welcomed by the stock market, although I believe his dictatorial tendencies will not be so easily defeated. While in the short-term we can give the upside the benefit of the doubt, the Index would need to sustain a move above 42,500 to indicate that the bulls have gaining the upper hand.

Western European stock market indices continue to feature highly in the both lists, indicating that they may be of interest to value investors.

(Please note: All data quoted above originates in Bloomberg. We realise that some of the data displayed is inaccurate for some indices, particularly where ADRs are included. However, I have endeavoured to remove those indices which were problematic. We continue to publish these tables because the data is generally accurate and going forward we will continue to weed-out the less reliable data sets as subscribers highlight them for us. I have also deleted the FTSE AIM Index from the list because it does not seem to have very reliable figures.)

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