Fullermoney

Global Strategy and Investment Trends by David Fuller **www.fullermoney.com**

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

Monday 17th December 2007

Commentary by Eoin Treacy

Barclays Capital Commodity Investor: Curve Cryptography - Thanks to a subscriber for this interesting report by Kevin Norrish and colleagues which raises a number of points on the spread between LME and Shanghai commodity prices I had not seen previously. Here is a section:

The interplay between SHFE and LME prices has become increasingly important as China's share of the global metals markets has expanded. This spread determines the economics of exporting and attractiveness of importing and is therefore the key driver of regional trade flows. The SHFE/LME copper spread has widened through December to the highest average since February. Effectively, this means that buying copper domestically has become increasingly more expensive than imports, thus raising the relative attractiveness of importing copper. The recent widening of the spread has been due to SHFE prices outperforming LME prices, reflecting a tightening spot market. This is also highlighted by large draws in SHFE stocks, local prices trading at a premium to the SHFE and the cash-3M SHFE spread stretching out to a large backwardation. This near-term tightness may have been created by a temporary restriction in supply of imported metal.

According to market reports, the Chinese government is restricting the issue of new import VAT invoices until 2008, and without this documentation the copper apparently can not be imported. The move of the SHFE/LME aluminium spread almost into parity is interesting given that it has developed at a time when domestic supply is increasingly rapidly; Chinese smelter production is expanding at a record pace; primary metal exports have been very low; and SHFE stocks have been falling. While we suspect that a small portion of this huge rise in domestic supply has gone into unreported Chinese stocks, we believe that most of it has been consumed. This would evidence very strong Chinese consumption, which is in line with our expectations given the tremendous expansion of semis production.

The zinc SHFE/LME price spread meanwhile has been volatile since the SHFE began trading the contract in March. In December so far, the spread has narrowed by 35% from November's average. But for the moment at least, support has been established around RMB19,000/t, with both SHFE and local prices holding around this level.

My view - I added the five contracts traded on the Shanghai Futures Exchange to the Chart Library. These are for Aluminium, Copper, Fuel Oil, Rubber and Zinc. Since these contracts are traded in Yuan and quoted in different sizes than on the LME we cannot replicate spread charts which would be relevant in the Chart Library. However I created these spreads in Bloomberg:

Aluminium traded in Shanghai got progressively cheaper relative its LME traded counterpart between mid-2002 and early 2006. The $1500 level proved to be a psychological hurdle and the price failed to rally much beyond it over the next year. Since late July, Shanghai aluminium has been getting more expensive in relative terms. The spread chart would need to sustain a move above $1000 to question scope for some further relative strength in the Shanghai traded contract.

LME traded copper remains in an overall uptrend relative to its Shanghai counterpart however it has been getting rapidly more expensive over the last two months; possibly as a result of the VAT rules referred to above. A sustained move below $1750 would break the progression of rising major reaction lows and would point to an extension of the Shanghai contract's current relative strength.

LME traded zinc remains in an overall downtrend relative to Shanghai traded zinc. Although it found support near $800 in the last couple of months, it would need to sustain a move below this level to indicate scope for further relative weakness.

Platinum Rises to Record on Demand Outlook; Palladium Gains - This article by Millie Munshi for Bloomberg covers interesting developments in the platinum and palladium markets. Here is a section:

Platinum rose to a record on speculation demand for the metal used in car parts and jewelry will remain robust. Palladium also climbed.

Platinum has surged 31 percent this year, beating gains in gold and silver, as demand outstripped supplies. Consumption by the auto industry will gain 6 percent this year as production of catalytic converters increases, Societe General said last week.

``Despite the economic shakeout in the U.S., automotive demand for platinum will remain strong,'' said James Steel, an analyst with HSBC Securities in New York. ``Platinum is an exceptionally strong market.''

Platinum futures for January delivery gained $24.40, or 1.6 percent, to $1,503.60 an ounce on the New York Mercantile Exchange. Earlier, the metal reached $1,504, the highest ever.

The United Nations climate talks in Bali this month increased investor awareness about platinum as the world tries to reduce greenhouse-gas emissions, Steel said. The metal is used in catalytic converters, which help to control pollution emitted by cars.

``The recent talks have helped to keep the attractiveness of platinum in people's minds,'' Steel said. ``As the world goes green, they will use more platinum.''

The metal will gain as demand from the auto industry rises in China, the world's fastest-growing major economy, Steel said. China's demand for the metal in vehicle-emission filters will probably jump 35 percent this year, Johnson Matthey Plc, which makes a third of all auto catalysts, said last month.

My view - Platinum is often a leader among precious metals and has certainly outperformed its counterparts this year. It broke upwards to a new high today and the upside can be given the benefit of the doubt as long as it holds the gain above $1500.

Palladium is also looking much firmer, it found support near $340 at the end of November and would need to sustain a move below $345 to question scope for further upside.

Martin Spring's On Target: Themes for Long-term Investment - Thanks to Martin Spring for his ever interesting missive which this month concentrates on the excellent report produced by a good friend of Fullermoney, Bruce Albrecht on Global Thematic Investment. This report appeared in Comment of the Day on December 3rd and I commend it to subscribers. Here is a section from Martin Spring's introduction:

One of the things you'll notice about some of the world's most successful investors is that they identify long-term areas of opportunity and buy into them long before they become fashionable, or even rate a mention in the financial press. They then stick with their holdings, even if they go through really bad patches.

There's even a handful of funds that specialize in investing in the long-term themes that they believe in. The best-known is probably the P&C Global Thematic Investors Fund run by Iain Little and Bruce Albrecht, whose balanced accounts achieved annualized dollar returns averaging nearly 21 per cent in recent years.

Here is a summary of one of their recent presentations on the eight major themes they're investing in, which are: The burgeoning global middle class, water and energy shortages, outsourcing, aging population, Japanese restructuring, the supply/demand imbalance in commodities, and China.

The Burgeoning Global Middle Class

Globalization in trade, increasing travel, migration and working abroad, and interracial marriage, are producing cultural integration, with better opportunities for global brands.

Technology is a major driver of global wealth creation, and its impact is intensifying. "As late as the 1940s, the product cycle (idea, invention, innovation, imitation) stretched to 30 or 40 years. Today, it seldom lasts 30 to 40 weeks."

80 per cent of the scientists, engineers and doctors who ever lived are alive today - and exchanging ideas in real time on the internet. It's estimated that at current rates all the technical knowledge we work with today will represent only 1 per cent of the knowledge that will be available in 2050.

Retirement of a wealthy post-World War 2 generation in the developed nations will be a "major driver" of consumption trends. In the US the "Baby Boomers" (born 1946-64), who comprise 28 per cent of the population but control 50 per cent of personal income, are entering their peak earning years as they mature, offering a lucrative market for travel, entertainment and housing.

Simultaneously, unprecedented economic growth in developing countries is causing an explosion in their middle classes. Using an annual income of $6,000, adjusted to purchasing power parities, they already number some 665 million people, of which 290 million are in China and 91 million in India.

My view - Martin Spring has also distilled Bruce Albrecht's report for all of the companies mentioned and lists them which may also be of interest to subscribers.

Email of the day (1) - on individual futures contracts:

"I am a 'pre-subscriber'.

"Does the Chart Library contain charts of individual futures contracts e.g. January Feeder Cattle, November Soybeans etc or is it just Continuation charts?"

My comment - Thank you for this topical question and your interest in the Service. The Chart Library, for the most part, contains only continuation charts. For the most popular futures, we have both the first and second month continuation charts. Generally the on-the-run contract doesn't have very much back history and, while relevant for those actively trading, are not ideal for looking at historical data.

We also carry a number of spreads so that you can track, among other things, the backwardation or contango for a given future. For example, it may be of interest that Chicago Wheat has just moved into backwardation which suggests a near-term tightness.

Email of the day (2) - on the addition of volatility indices:

"Please is it possible to put the following chart to the Library

"S&P Implied volatility
Dow Jones Implied volatility"

My comment - Thank you for these suggests. While we already have charts for the S&P Implied Volatility (VIX) and the Nasdaq Implied Volatility (VXN), I have now also added the Dow Jones Industrial Average Volatility Index (VXD) to the Chart Library.

All of these charts show a more significant increase in the perceived risks associated with their respective markets and would need to fall back into their bases to indicate that we were about to revert back to the sanguine attitude of the last 3 years.

Email of the day (3) - on wheat:

"I continue to enjoy and benefit significantly from the Fullermoney service.
I have noticed that while the March 08 Wheat contract has been quite bullish in the past few days the Dec 08 contract has been quite bearish. I wonder if someone can explain what's happening here for this novice investor. In the past year I have been fortunate to make a handsome profit by holding the Dec 07 Wheat contract for the long term.

"Thanks again."

My comment - According to the CBOT's Commodity News for Tomorrow report:

"Forecasts for more precipitation in the U.S. Plains, seen as beneficial for the developing wheat crop, were bearish for the deferred months, analysts said. CBOT"

By best guess is that most wheat for delivery in March has probably already been harvested. On the other hand, December 2008 wheat is more prone to weather related fundamentals. If subscribers know of other reasons, please let me know.

Eoin's personal portfolio: corn and wheat long positions opened - I decided that I had prevaricated enough with the grains and decided to open two long positions. I bought March corn at 444.25¢ and March wheat at 1005¢ this morning. All prices quoted include spread-bet dealing costs.

Today's interesting charts - The Chart Library has a large number of spread and ratio charts which may be of interest to subscribers.

India (Nifty) - fails at the upper side of the range, making a test of at least 5500 likely and the Index needs to sustain a move to new high ground to reaffirm the overall uptrend.

Australia - downward dynamic confirms that a high of at least near-term significance has been reached near 6800 and it would need to sustain a move to new high ground to reaffirm the overall uptrend.

Saudi Arabia - one of the only indices in the world making new recovery highs against a background of general stock market weakness. A downward dynamic would be needed to check the advance beyond a brief pause.

Robusta Coffee - remains in an overall uptrend, with an unbroken progression of rising major reaction lows, having rallied from 1700p. It would need to sustain a move below that level to question scope for further upside.

White Sugar - breaking upwards from the 5-month base and would need to sustain a move below 290¢ to question scope for further upside.

South Korean Won per 1 US Dollar - The Dollar found support at 900 won in early November and would need to sustain a move below 920 won to question scope for some further short-term upside.

Email of the day (4 & 5) - on additions to the Chart Library:

"Would it be possible to kindly include the following chart in the Library:

"JJG(NYSE) : IPath AIG Grains ETN

"Thanks and regards"

And

"Thanks for adding the following charts:

"ASD:CN
MFL:CN
GUR:SW
MPXE3:BZ (it's an IPO on Energy)
DYS:CI
FALAB:CI
CENCOSUD:CI
IAM:CI
BIOT:SP
DLEKG:IT
IVRC:IN
MWC:PM"

My comment - These have all now been added to the Chart Library.

Email of the day (6) - on an addition to the Chart Library:

"Could you please add to the chart library the following:

"1.Schroder AS Agriculture Fund
2. Yara International, the Norwegian-listed company which is the world's largest producer of mineral fertiliser "

My comment - Both of these are already in the Chart Library. You will find the Schroder Alternative Solutions Agriculture fund in the Commodity funds section and Yara International is in the Norway section of the International Equity Library.

Last week's signups for the Free (Abbreviated) Comment of the Day - For the week of December 9th new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, Germany, Hong Kong, India, Ireland, Poland, the UK and the USA - 9 in total. In descending order, which topped the list in terms of the last three week's new signups? It was the USA, Australia and the UK. Welcome all to the Fullermoney Global Strategy Service.

Thousands of people around the world receive Fullermoney's Free (Abbreviated) Comment of the Day, and their numbers steadily increase. Why do so many sign up? It is primarily due to word of mouth or word of press mention, from people who like Fullermoney's global perspective and our Empowerment Through Knowledge theme. Incidentally, on receiving our free daily email, you will not be contacted or solicited with advertisements and other marketing material. No one else will have access to your email address. We respect your privacy.

Please Note - David is on holiday and will return briefly on December 24th and a full service will continue on December 27th.

Tuesday 18th December 2007

Commentary by Eoin Treacy

Drama and tears in Bali as US finally gives in - This article by Frank McDonald which ran in yesterday's Irish Times covers some of what can be expected from the next two years of negotiations. Here is a section:

Adoption of the "Bali Roadmap" sets the agenda for two years of negotiations on ways to cut greenhouse gas emissions - though without specifying the range of reductions required to avert "dangerous" climate change.

However, it explicitly endorses the latest assessment by the Intergovernmental Panel on Climate Change (IPCC) that global warming is "unequivocal" and that delay in reducing emissions would increase the risk of more severe impacts.

Due to conclude in 2009, the negotiations will ensure that a new deal can enter into force by 2013, after the "first commitment period" of the Kyoto

Protocol expires. They will also cover adaptation to negative consequences of climate change.

Delegates decided that funding for adaptation projects in developing countries would be managed by the Global Environment Facility.
But delegates could not agree in Bali on additional practical measures such as how to integrate adaptation into national policies.

Important progress was made on the issue of technology transfer, one of the key concerns of developing countries, with a decision to kick-start a strategic programme to scale up the level of investment for concrete demonstration projects and incentives.

The Bali conference also reaffirmed the urgent need to take further meaningful action to reduce emissions from deforestation - responsible for 20 per cent of the total - and adopted a work programme for demonstration projects in this area.

Small-scale afforestation and reforestation projects are to be expanded in scope under the Kyoto Protocol's Clean Development Mechanism (CDM) and, for the first time, the CDM may also be broadened to include "carbon capture and storage" projects.

My view - Two years of tough negotiations probably mean that the final agreement will have very little of what was agreed over the weekend in it. However what seems likely is that new energy technologies should benefit from an increased willingness by governments and consumers to partake in cleaner energy generation. They should also benefit from developing country markets being opened up to them. Of course what has not been addressed is the increased cost of getting new energy projects off the ground, as a result of rising labour, raw material and transport costs, but this is an issue faced by the entire basic resources sector globally.

Finding a list of companies that are wholly dedicated to renewable energy is not an easy prospect because a great many companies produce renewable power in an effort to improve their green credentials. In the end, I looked for interesting chart patterns in the members of the Bloomberg world Alternate Energy Index. Here are my results:

Renewable Energy Corp (Est P/E 68), listed in Norway remains in an overall uptrend with an unbroken progression of rising major reaction lows. It would need to sustain a move below Kr230 to question scope for further upside.

First Solar (Est P/E 185), listed in the USA, has performed remarkably well since its IPO, at least in part because it garnered significant media attention for its thin film semiconductor technology. However it is looking overextended right now and has lost momentum near the $250 level. It needs to sustain a move above that level to reaffirm the overall uptrend.

Solarworld (Est P/E 46), listed in Germany, remains in an overall uptrend with a rivetingly consistent progression of rising major reaction lows. It reacted quite violently in November but has since found support near 35 Euro and would need to sustain a move below that level to offset scope for further higher to lateral ranging.

Covanta Holding (Est P/E 34), listed in the USA, remains in a relatively consistent uptrend although looking slightly overextended relative to past performance right now. However it would need to sustain a move below $20 to question scope for further upside.

Areva (Est. P/E 38), listed in France, remains one of the largest uranium companies with operations in both the production of concentrated uranium fuel and constructing nuclear reactors. It reacted violently during the July/August correction but has since found support near 625 Euro and would need to sustain a move below that level to question scope for further upside.

Vestas Wind Systems (Est P/E 52.9), listed in Denmark is also worthy of mention although not a member of the Bloomberg index for some reason. It broke upwards from its base in early-2005 and remains in a consistent uptrend and would need to sustain a move below Kr400 to question scope for further upside.

None of these shares are fundamentally cheap and a large amount of growth has already been priced in. However, all remain in primary uptrends and provided conventional energy markets remain at historically elevated levels, the outlook for this sector should be quite positive. If further government incentives were to flow to the sector, a number of these companies should be significant beneficiaries.

Citi Industry Focus: Gold - 'Tis The Season To Be Jolly - Thanks to a subscriber for this well reasoned report on gold by the team at Citi Smith Barney. Here is a section:

The gold price has risen ~23% in the second half of CY07 compared to the 2% rise in the first half of the year. H2 outperforming H1 is a relationship now witnessed in 21 of the last 34 years, since the collapse of the Bretton Woods fixed exchange rate that pegged gold at US$35/oz - US$40/oz.

Over the same period, the average gold price rise in the first half of the year has been ~1% compared to ~7% in the second half.

With the speculator net long positions remaining close to record levels and the seasonally weak period approaching (February through to July) the prospect of an opportunistic dip in the gold price during Q1 '08 looks a real possibility. Other short-term risks to the gold price could emanate from potentially reduced fabricator demand from India, which has experienced price sensitivity, increased scrap supply as a result of higher prices and a slowdown in producer de-hedging as the global hedge book dwindles.

However, with the prospect of ongoing pressure on the US dollar, uncertainty brought about by the ongoing credit meltdown, continual inflationary pressures, oil hovering around US$85 barrel and limited new production from mines, the underlying fundamentals remain positive. Subsequently, any potential dips in the gold price should be used as an opportunity to buy gold equities or the underlying metal through an ETF. Newcrest remains our preferred large cap gold stock and Equigold remains our preferred small cap gold stock.

Central bank sales are capped through the Central Bank Gold Agreement (CBGA II) and we maintain that a major sell down of the IMF bullion reserve remains unlikely with the US holding 16.7% of the IMF voting rights - enough to ensure the 85% required majority for any gold disposal is not achieved. We also assume that given the IMF has a systemic responsibility to avoid causing disruptions to the functioning of the gold market that if it were to dispose of any gold then it would be dealt with in conjunction with the existing CBGA.

My view - Gold (p&f, monthly, weekly, daily) rallied to a high near $850 in early November which was a more than 30% increase in less than 3 months. It has since moved into a relatively volatile consolidation, which has taken on a triangular shape.

In behavioural terms this indicates that sellers are progressively lowering the price at which they are willing to offer their supply and buyers are only incrementally raising their bids. This situation will not go on interminably because this decision making process by both buyers and sellers is thinning out supply above and demand below the market; creating vacuums. Once the weight of opinion moves enough in one direction we are likely to get an explosive move.

The Goldbugs Index is testing support from the top of the prior range, but would need to sustain a fall back below 370 to question the overall upward bias.

Platinum continues to lead the precious metals sector generally and posted a marginal follow through on yesterday's upward break today. It needs to sustain this breakout to maintain its bullish outlook.

Given the generally positive commonality across the sector I believe that the outlook remains bullish for gold but it needs to sustain a move to new high ground to reaffirm the overall uptrend.

Money Market Rates Tumble; Central Banks Inject Funds - This article by Gavin Finch for Bloomberg covers today's injection of $500 billion by the ECB into the money markets. Here is a section from the conclusion;

``Maybe this is the sign we've all been waiting for that a peak in Libor has been reached,'' said Patrick Jacq, a fixed-income strategist at BNP Paribas SA in Paris. ``It's a definite sign of an improvement in the market.''

The cost of borrowing in dollars for two weeks increased 1 basis point to 5.10 percent, the BBA said today. The Fed yesterday offered $20 billion in one-month loans. The results will be announced tomorrow.

The corresponding rate for pounds soared to a record of 6.51 percent, the BBA said. Today is the first day that pound-denominated loans cover a borrower's commitments through the end of the year.

The Bank of England held the first of two special operations today, offering 10 billion pounds ($20 billion) of three-month cash. The cost of borrowing pounds for three months dropped 4 basis points to 6.39 percent, the fourth straight decline. That's still 89 basis points higher than the central bank's benchmark interest rate.

Goldman Forecast

Central banks in the U.S., U.K., Canada, Switzerland and the euro region are responding to subprime mortgage-related losses at financial institutions including Citigroup Inc., Merrill Lynch & Co. and Bank of America Corp.

Goldman Sachs Group Inc. estimated last month losses related to record home foreclosures in the U.S. may be as high as $400 billion for financial companies. If accurate, banks, brokerages and hedge funds would need to cut lending by $2 trillion, triggering a ``substantial recession,'' the firm said.

U.S. corporate defaults probably will quadruple next year after the number of companies that lost their investment-grade credit ratings rose at the fastest pace since 2003, according to Moody's Investors Service.

My view - The ECB's injection of such a large number of Dollars signals that they are serious about thawing out the credit markets and ensuring that banks have sufficient capital to see them through the holidays. German 3-month yields fell 50 basis points but the corresponding move in Euro 3-month Libor was much more muted. This saw the spread between the two widen further and look even more overextended. This suggests that banks have not rushed to lend this liquidity to one another, but it will take time for trust to return.

The first downtick on the spread above will likely be a signal that the recent liquidity injections are having an effect on sentiment within the banking fraternity. Such a downtick would also be a positive for at least European stock markets, which rallied well on today's news but were unable to hold their gains as the session wore on.

Email of the day (1) - on wheat from a CME insider:

"I have been a trader at CME for 36 years, and I have first hand knowledge that a large speculator thought the wheat market top out and bought Dec 08 wheat and sold March 08 as a spread and today was unwinding that position. Also glad to be of help and love your service.

"Happy Holidays"

My comment - Thank you for this informative email and Merry Christmas. The detailed knowledge of the Collective never ceases to amaze me.

Email of the day (2) - on the Fullermoney highlights report:

"I have been a fan of yours for years and attended a chart seminar in NZ in the mid-eighties. I used to love reading your monthly Fullermoney report. Do you still have anything like this?"

My comment - Thank you for this email which I'm sure David will be glad to read when he comes back from holiday. We produce the Fullermoney Highlights report at least once a month, which has all of the most memorable pieces of analysis from Comment of the Day as well as all our personal portfolio trade details. The most recent report was released on December 11th but you will find a number of examples in the Archive.

Email of the day (3) - on Chart Library enhancements:

"Concerning the Chart Library are there any future plans to include a filtering system e.g. Any Chart Library component that has made a new 11 week high.

"Merry Christmas and a happy new year, thank you for a great service."

My comment - Thank you for this thoughtful email and we are delighted you are enjoying the Service. We regard filtering the increasingly large list of instruments as imperative to creating a world class service, which is something we continually strive for at Fullermoney. David has long described filtering as his man Friday project and we are intent on releasing the first iteration of it early next year.

Email of the day (4) - on TIPS spreads:

"Could you please include a spread chart of the difference between the 5 yr US Treasury Yield and the 5 yr US TIPS?

"You already do have a spread chart of the difference between the 10 yr Treasury and 10 yr TIPS in the chart library.

"These charts may be useful in determining the markets expectation of long term inflation.

"Thank you very much,"

My comment - I've added the spreads for the 5-year and the 30-year but the 10-year spread has much more long-term history.

The spread between the 10-year Treasury yield and the 10-year TIPS peaked between 2004 and early 2005 and is now in a prolonged ranging phase with a somewhat downward bias. A break below 215 basis points would signal that this relatively long-term trend is reversing.

Today's interesting charts - Did you know that you can create sections in your Favourites, allowing you to create multiple lists of instruments?

Switzerland - remains in a medium-term downtrend and would need to break the progression of lower highs to question scope for further lower to lateral ranging.

Cocoa - breaking upwards from the psychological 1000p level and would need to sustain a move below that area to question scope for further upside.

Oats - encountering resistance once more at $3 and needs to sustain a break above that level to suggest the completion of this rather prolonged ranging phase.

New Zealand Dollar per 1 Australian Dollar - the Australian Dollar surges upwards from support near $1.12 and breaks the short-term downtrend in the process. It would need to sustain a move below this level to question scope for some further strength.

Please Note - David is on holiday and will return briefly on December 24th and a full service will continue on December 27th.

Wednesday 19th December 2007

Commentary by Eoin Treacy

Morgan Stanley G10 currencies: A Retrospective on 2007: Another Weak Dollar Year - Thanks to a subscriber for this interesting report by Stephen Jen which looks at how lessons learnt in 2007 affect there views of what to expect in 2008. Here is a section:

Aside from our market calls, several themes/lessons will be important for 2008:

Lesson 1. This is more than a sub-prime crisis. The scale of the financial crisis we face goes beyond housing and sub-prime. In the past years, the extraordinarily low volatility environment, coupled with a healthy gap between the return on capital and the cost of capital, led to excess leverage in some sectors. The money markets froze up, reflecting not only the sub-prime crisis, but also a general 'bank run' on the capital markets in developed countries.

Lesson 2. Central banks are potent, but the private sector is critical, too. In our view, the co-ordinated liquidity action (as opposed to co-ordinated monetary action) by various central banks yesterday was very important, and potentially positive for the outlook for the financial markets and the global economy. The Fed effectively introduced a lower-cost, anonymous, variable-rate auction version of the discount window that is aimed at providing additional liquidity beyond the cash market.2 To the extent that this enhances general confidence (and it is still unclear whether banks would be marginally more willing to lend to each other, now that the relative demand and supply for term liquidity are altered), the term interest rates in the interbank market should start to decline. The corporate bond and money markets' initial reaction has been remarkably muted, and the reaction of the global equity markets has been outright negative so far. But it is perhaps correct to assume that, if this variable rate tender proves to be too modest in size (US$20 billion next Monday, December 17, 2007), the Fed will raise the amount auctioned and/or will introduce other tools to achieve its objective. In short, the willingness of the Fed to go to the extreme should not be in question, even though its ability to close the LIBOR-OIS spread requires a change in the behaviour/psychology of the private sector.

Lesson 3. Extraordinary powers of globalisation. The rise of the emerging powers (BRIC and other EM economies) has suddenly become blatantly evident this year. Their ability to withstand the multiple sell-offs in the global financial markets this year has been absolutely remarkable; a year ago few would propose the notion that EM could be a 'safe haven'. Further, this structural rise of the real economies of EM within a fundamentally asymmetric arrangement between capitalists in the West and labourers in the East is quickly evolving into a more symmetric arrangement: EM is now a source of capital flows, not just a destination of FDI from the West. This, in our view, is a historical watershed, and marks a turning point in the balance of economic power in the world.

Lesson 4. The rise of sovereign wealth funds. SWFs have indeed turned out to be a powerful driver of risky asset prices. At fire-sale prices, SWFs have been particularly active with financial institutions in the developed world, which they broadly consider as strategically important. In our view, this is not a fad, but the beginning of a long-term trend, as the SWF will form the single-most powerful new category of investors in the world, with Japan likely the next new member. Bottom line 2007 has been marked by powerful macro trends and crosscurrents. Many of the themes dominating 2007 will likely be at least as relevant in 2008.

My view - Given the rate at which Sovereign Wealth Funds (SWFs) are anticipated to grow over the next decade, their importance to financials markets is beyond question. While bankers in the developed world continue to consider their futures with a significant bearish bias, SWFs see value. Even today, the Chinese spent $5 billion on a part of Morgan Stanley. Not only is this strategic bottom fishing, but they see value in these shares, which are unquestionably going through a tough time. However, they will emerge from this malaise, and should be stronger for it.

The S&P 500 Banks Index is testing support near the November lows. At the very least, we can conclude that the medium-term downtrend has lost momentum, but it needs to break the progression of lower highs on a sustained basis to indicate that it has reached a meaningful bottom. We can probably expect this index to range close to this area and ideally start to put in a succession of incrementally higher lows which would act as a support building phase.

The S&P 500 Diversified Banks Index had not fallen to the same extent as the former index but it shares a similar profile and would need to fulfil the same technical conditions to restore investor confidence.

The S&P 500 Regional Banks Index moved to a marginal new low but its decline has slowed in recent days. We have seen more two-way action in the last month than at any time since September but the Index needs to sustain a rally to indicate that it has reached a low of any importance.

Looking into 2008, the financial sector is likely to continue to worry investors, as writedowns continue. As long as this is the case, we can expect developed country stock markets to mostly range. However the sector that is showing most relative strength, as we enter the New Year, is soft commodities and they are likely to increasingly make headlines as more investors come to this realisation.

Brewin Dolphin Market Tactics: Let's Lighten Up - for a While at Least! - Thanks to Brewin Dolphin for this level-headed view by Mike Lenhoff, of what to expect next year. Here is a section:

But bring down interest rates they will. Right now, the pressure on headline inflation is coming from food and energy, not demand. The latter, as the chart for the US shows, is slowing and this, in so far as the influence on core inflation is concerned, is likely to prove disinflationary.

We are not convinced a US recession is on the cards for 2008 but the bad news is that the risks to growth are on the downside and that is why we think interest rates will still come down. The rise in headline inflation is squeezing real wage growth and this, plus the slowdown in job growth, will slow the growth of disposable incomes and, in turn, the growth of consumer spending. That underlying trend in the chart will remain downward.

As demand growth continues to slow, the growth of profitability will continue to slow too, meaning the risk is of more earnings downgrades, less job creation, even slower personal income growth and spending and so on and so forth.

All this keeps up default risk, which is another reason for expecting lower interest rates. Who would lend with default risk on the rise? Opportunists maybe, like sovereign wealth funds, but the banks wouldn't. They would still hoard cash whether or not they had SIVs to bail out.

So the good news is that, given its policy mandate of achieving sustainable non-inflationary growth, the Fed has little choice but to cut rates, which is what it has been doing.

Our view is that the Fed will end up cutting the Funds rate to 3.5 percent by next summer. In the UK, where core inflation is actually falling, the MPC is likely to bring base rates down to 4.75 percent by then. That is also when the trough of the current downswing in the earnings cycle is likely to have been reached and when the downgrading of corporate earnings estimates is likely to have run its course. At that point attention is likely to focus on the prospect of an upswing in the cycle and a more promising outlook for corporate earnings. With much lower interest rates and favourable valuations, the stage should be set for equity markets to resume their upward journey.

My view - The S&P 500 remains in a range between 1400 and 1600 and is currently towards the lower side of that range. It needs to bounce from this region in a fashion similar to that in August and October to maintain this lateral pattern.

Over the last year, the worst performing sectors have been Homebuilding (-60.69%) Thrifts & Mortgages (52.45%) Real Estate Management (-37.11%), Department Stores (-34.99%), Motorcycle Manufacturers i.e. Harley Davidson (51%) and Regional Banks (-31.2%) This is no secret and real estate related worries have dominated media coverage over the last year.

However what is less well known is that of the S&P 500's 147 sector indices, 85 are positive or unchanged for the year. Of these, 7 are up in excess of 50% year-to-date. These were Fertiliser & Agricultural Chemicals (+94.42%), Construction & Engineering (94.24%), Education Services (+84.89%), Coal and Con Fuel (+76.61%) Diversified Metals (71.97%), Internet Retail (64.89%) and Healthcare Services (51.21%. A number of these indices are consolidating their gains and need to sustain moves to new high ground to reaffirm their overall uptrends.

In the coming year, we can probably expect banks to bottom out and they should perform better than they did this year. So I would be surprised to see them at the bottom of this list a year from now. However with the increase in interest in agriculture, the continued need for infrastructural improvements, not only the in the USA, but globally, and the continued secular bull market in all commodities; it is difficult to imagine that the leaders for this year will not be in the upper quartile of performers again next year.

China Tax Move May Boost Price of Soybeans, Korean Buyer Says - This article by Jae Hur for Bloomberg covers some interesting developments on the global soybean markets. Here is a section:

China, which competes with the U.S. in grain sales to Asia, may push up prices of non-genetically modified soybeans by scrapping export tax incentives, South Korean food importer Korea Agro-Fisheries Trade Corp. said.

``The Chinese move will definitely raise prices for non-GMO soybeans,'' Kang Gye Weon, general manager at the state-run company's trading team, said in an interview. China is removing export tax rebates on crops including wheat, corn and soybeans from tomorrow to secure domestic supplies and control food prices.

South Korea may turn to rival grain and oilseed suppliers, including the U.S. and Brazil, if Chinese supplies are limited, boosting world prices. Wheat futures in Chicago jumped to a record this week, soybeans rose to a 34-year high and corn reached a nine-month peak.

``We are concerned about a situation where we can't buy grains even with money,'' said Kim Chi Young, purchasing team manager at the Korea Feed Association, South Korea's biggest importer of feed grains. ``For the time being, corn importers may have to rely on supplies from the U.S.''

South Korea may import 8.8 million metric tons of corn, 3 million tons of wheat and 1.2 million tons of soybeans in the year ending September 2008, the U.S. Department of Agriculture said Dec. 11. The country is the biggest buyer of Chinese corn.

``Exporters may require buyers to help absorb the impact'' of the tax rebate removal, Li Gang, program manager at Jilin Grain Group Co., said by phone from Dalian, northeast China.

Korea Agro-Fisheries covered 50 percent of its non-GMO soybean imports from China and the rest from the U.S. in 2007, Kang said by phone yesterday.

My view - Grain prices continue to pressure their all-time-highs. This is causing a change in the export bias of some countries where it now makes more sense to hoard their crops rather than export. We saw this earlier in the year with Russian wheat and now with Chinese soybeans. All of this points to continued market tightness in the coming months.

The USDA reports on January 11th for wheat, corn, oats, soybeans and sorghum stocks will be eagerly anticipated by investors and could potentially come in below expectations. If this is the case we can expect grains to push upwards to new high ground and it could also be a catalyst for increased investment right across the sector.

British Columbia Gets C$401.1 Million From Drilling-Rights Sale - Thanks to a subscriber for this report by Ian McKinnon for Bloomberg which covers increased interest in Canadian exploration rights. Here is a section:

British Columbia collected C$401.1 Million ($392.5 million) yesterday from the sale of oil and natural-gas drilling rights, raising sales for the year to a record C$1.05 billion as companies seek new reserves to capitalize on growing demand.

Sales for the year were 62 percent higher than the previous record of C$646.7 million set in 2003, according to the provincial government's Web site. Buyers paid an average of about C$4,342 per acre, also a record and up 93 percent from last year.

Increased competition for gas prospects in Devonian shale formations in northeastern British Columbia is boosting demand for the drilling rights, said

Gregg Scott, president of Scott Land and Lease Ltd., a Calgary-based brokerage.

``The prospects of the play look so good that companies are definitely stepping up to the plate when it comes to land sales,'' Scott said in an interview prior to the release of sale results. ``The companies are positioning themselves for the gas-price rebound that may be coming'' within two years, he said.

Calgary-based Nexen Inc. last month said prospects for the Devonian shale region are similar to those for the Barnett Shale region in Texas, one of the fastest-growing exploration areas in the U.S. Nexen, EnCana Corp., Canada's largest gas producer, and Apache Corp. are among companies pursuing that play.

Saskatchewan, Alberta's eastern neighbor, last week said sales of drilling rights raised a record C$250.3 million this year, 25 percent higher than the previous record set in 1994.

My view - Natural Gas (p&f, monthly, weekly, daily) topped out near $16 in late 2005 and quickly fell back below the psychological $8 level. In fact the contract didn't bottom until it briefly reached $4 following the Amaranth scandal. It now remains in a base formation where it is ranging between $6 and $8 and needs to sustain a move above the latter level to indicate that the bulls have gained the upper hand beyond a very short-term move.

Energy companies are snapping up exploration rights because they sense that natural gas is cheap in absolute terms and relative to oil . The development of oil sands resources is also heavily natural gas intensive. These are important consideration when looking at the prospects for natural gas; which is characteristically volatile. The commodity shows little sign yet that it is about to break upwards yet, but once it does, it is likely to run quite quickly on the upside.

Fullermoney subscription increase for 2008; our policy of loyalty discounts for continuous renewals continues - Our policy at Fullermoney is to pass on fixed costs, rather than software enhancements for the Chart Library, or salaries. The latter we aim to cover with increased subscriptions as value is added to the service. There will be £20 increase on the headline annual subscription for new subscribers, which will rise to £460 for 2008, an increase of 4.5%. Monthly subscriptions will rise from £44 to £46. That's the bad news.

The good news, and the best kept secret at Fullermoney, is that no subscriber pays the headline rate on continuous renewal. While the Fullermoney subscription is never discounted for new subscribers, everyone who renews before their subscription expires receives a loyalty discount. For instance, new subscribers in 2007 paid £440 pounds for a single user (one corporate individual or private household). On renewal in 2008, they will pay only £414, due to a loyalty discount of 10%. So new annual subscribers in 2007, who renew on time in 2008, will pay less than their initial subscription rate. Monthly subscribers who joined in 2007 paid £44 per month. They will stay at that rate in 2008, but clearly the better deal is in the annual rate.

Our IT department reports that there is some multiple usage of identifiable Fullermoney logon names beyond single household (one computer) usage. This is mainly among institutional subscribers and is not in accordance with our terms and conditions, which you will see when reviewing your subscription details. Institutional subscribers are reminded that they must have a multiple-user license and a subscriber logon name for each individual user. Please contact Sarah Harrison to arrange your multiple-user subscription: sharrison@fullermoney.com, Tel: +44(0)20 7349 2129.

Anyone who is thinking of subscribing to Fullermoney can beat the price increase by doing so before the end of December.

Today's interesting charts - Did you know that point & figure box sizes are completely customisable in the Chart Library?

US Dollar per 1 British Pound - The Pound fell below the $2 level for the first time in three months today and needs to sustain a rally back above $2.01 to hinder potential for some further weakness.

Hong Kong - finds support near the November lows at 26,000 and would need to sustain a move below that level to offset scope for a further recovery in the short term.

Taiwan - sagged below the mid August lows near 8000 but has rallied back above that psychological level and would need to take out yesterday's lows to question scope for some further short-term upside.

UK 10-year Gilts - rallied from the short-term range and would need to sustain a move below 107.75 to question scope for some further upside.

Orange Juice - continues to firm above the November lows and would need to sustain a move below 130¢ to question scope for some further upside.

Please Note - David is on holiday and will return briefly on December 24th and a full service will continue on December 27th.

Thursday 20th December 2007

Commentary by Eoin Treacy

Investec Currency Views: Divergence or re-convergence? - Thanks to a subscriber for this interesting report which looks at decoupling between the USA and Europe. Here is a section:

Chart 1 shows US states renamed for countries with similar GDPs. We have omitted six major countries, namely the UK, Italy, Germany, Japan, India and

China and it is true that the latter two are the principal reason for optimism to believe in divergent growth, but it certainly puts the rest of the world into perspective.

We are extremely sceptical of this divergence notion and believe it has significant implications for G10 currencies. In fact, we believe that currency markets in November have actually been showing signs of that very theme. Indeed, we are far more likely to see a reconvergence of the higher-growth world to that of the much slower US economy. But we must first assess the true scale of the problems (or not) in the US.

The average annualised quarterly growth of the US economy in 2006 was 2.6% So far this year, the figure stands at 3.1%. Even if the US economy grows at a measly 1% rate this quarter, 2007's growth rate will match that of 2006. A key driver of this statistic will be net exports. We discussed the improving US deficits last month, but this theme is starting to gain some traction at a time when relative rate expectations between the US and rest of the world look stretched and the greenback is floundering near all-time lows

The unconditional weakness of the US dollar seen in previous months looks to have ended in November, at least for now. In fact, looking at G10 currencies in the last month, the dollar has rallied relative to six of them and fallen against three.

My view - I can well imagine that one would be sceptical of decoupling if one only looked at European economies. However to my knowledge no one was suggesting that decoupling was occurring between the USA and Europe. Rather between the USA and Asia's high growth economies; namely China and India.

In this regard, it remains unlikely that growth in these economies will slow meaningfully as a result of a US slowdown. Both the India Rupee and the Chinese Renminbi are in secular uptrends relative to the Dollar which is reflective of their robust high growth trajectories.

The Rupee had been a powerful inhibitor to investment in India, because it was in a prolonged downtrend relative to the Dollar between 1980 and 2002. However that is no longer the case. Following the Dollar's peak near R49 in 2002, the currency ranged below the high for nearly 5-years and the break below R43 earlier this year marks the beginning of a prolonged Dollar bear market against the Rupee. Of course this will not be a linear move and will be punctuated by some significant Dollar rallies. However there is a strong likelihood that the prevailing overall trend will remain downward for much of the next decade and more. This should prove to be a significant tailwind for inward investment going forward.

The Renminbi has been a much more managed currency and this is proving slow to change, although the Chinese authorities have intimated that they will gradually allow the currency to appreciate against the Dollar. They have been even slower to allow their currency to appreciate versus the Euro, which is a cause for growing distress in the Eurozone. Even so, we can take it as a given that the Chinese will allow their currency to appreciate versus a broad basket of currencies over the long-term. However they are unlikely to be hurried in this endeavour beyond a speed with which they are comfortable.

This move by two of Asia's fastest growing economies is also allowing greater flexibility across the Asia region and the Asian Dollar Index remains in a secular uptrend. Following the Asian Financial Crisis, this index fell precipitously and moved into a long base formation. From 2001, the Index displayed a progression of rising major reaction lows and the successful break above 105 in early 2006 completed the base. The upside can be given the benefit of the doubt as long it maintains the progression of rising lows and over the long-term this index is likely to head back towards its 1995 highs which will also be a significant tailwind for Asian investment.

The Dollar Index, which is largely weighted in favour of the Euro, continues to rally from all-time lows near 74.50 and a move below 76 would be needed to question scope for further upside in the short-term. Longer term, at previous important turning points, the Index has tended to range in the region of the respective top or bottom and there is no reason to suspect this case will be any different. So while the Index is rallying currently, a retest of the lows at some point next year is not beyond question.

Email of the day (1) - on defining a bear market:

"Good morning! I have been following your work for the past 2 years and I wanted to know what is the difference between a medium term correction and a bear market. To be honest, when a market is down more than 20% over at least 6 months, in my book this is a bear market. For example, base metals like zinc and nickel are down 60% + from their highs and copper is down sharply from its high in May 2006. To me, it looks like a bear market. In addition, many markets are turning into a bear market: Japan is down 18% from its high, Hong-Kong is also down 17% from its high, Shanghai is down 20%+ from its high. We also had big declines in Singapore, Canada, and some European indices. All in all, I see more markets in a bear market than in a bull market, and don't forget that we are in what is supposed to be the best quarter in the best year of the presidential cycle.

"Thank you very much."

My comment - Thank you for this email which raises some important questions. Initially I would like to refer you to Email of the day (1) in Comment of the day on September 27th where David defined our terminology with reference to the difference between a medium-term correction and a bear market.

I think that essentially yours is a question of the difference between a cyclical and secular move. The industrial metals went through a secular, as in very long-term bear market between the 1980s and 2003. As you can see from this long-term chart of copper; trading prior to 2003 looks like one long base formation. Unquestionably copper, zinc, nickel and the other industrial metals experienced accelerated moves which took them to levels well beyond the imaginations of most investors. I would argue they are consolidating those impressive gains.

If you are of the opinion that the commodity secular bull is over, then you would be justified in saying that this is a bear market. However if you believe, as I do, that this move has further to go and that what we are seeing now is nothing more than a protracted medium-term correction above their long-term bases; you would not classify this trading action as a bear market.

Looking at your stock market examples: Japan's Topix was undeniably in a secular bear market between its euphoric peak in 1989 to when it bottomed following an almost 70% decline in 2003. Since then the market more than doubled and it remains in a prolonged consolidation of that move. I agree that it is certainly not setting the world alight with relative outperformance, but its decline to date has been relatively orderly and it remains within the range which has extended for the last two years. Although it is at the lower side of that range right now and could potentially go lower, the chances remain good that this is still a large consolidation which will eventually by completed with a reassertion of the overall uptrend, rather than a return to the outright bear market.

Hong Kong has certainly accelerated recently and the move to 30,000 was quite startling in how fast it occurred. Is this market in need of some consolidation? Absolutely. Could is be potentially lengthy? That is a possibility. However is it in a bear market? I sincerely doubt it. This move, although overextended, is well underpinned by a lengthy trading range which lasted for more than 10 years. It can certainly be volatile and it could potentially come lower than it already has, but I think the odds are better than even that this market will reassert its uptrend in the medium-term.

China's stock market is a relatively new phenomenon and is still largely closed to foreign investment. It went through an impressive move in the late '90s and gave most of it up by late 2005. The move since the beginning of 2006 dwarfed the performance of the index previously and this market is displaying more bubble characteristics than any other globally today. The current reaction is larger than any we have seen in the last two years and this is a cause for concern, but the decline so far has been quite slow and since markets mostly fall faster than they rise, there is probably no need to panic right now. If this is a bubble, I suspect it has further to run. Most bubbles take a number of years to play out and the biggest ones are truly global phenomena, such as the TMT bubble. China's bubble may still be in its early stages and although the central bank is tightening, the stock market remains reasonably steady.

Singapore, similar to Hong Kong, went through a long consolidation between 1993 and 2003. It broke upwards in early-2006 and rallied impressively. It is now in a medium-term correction of that impressive gain and this could potentially be lengthy, but for it to turn into a more serious correction it would need to sustain a move below the August lows which is a considerable distance from where the Index is trading today.

Canada accelerated into the 2000 peak and gave up almost the entire move before bottoming in 2002. Since then it has been in a remarkably consistent uptrend and the present reaction is larger than the previous consolidations, but currently looks like more of a loss of momentum rather than an outright reversal. I believe a further ranging consolidation is much more likely than an extended downtrend.

The Irish, Icelandic, Swedish, and Italian stock markets have been Europe's worst performers this year. Ireland in particular has performed in line with the banking sectors of many western nations and was down 37% at the November 22nd low. So we could class the Irish market as having been in a bear market, because it has broken all of the consistency characteristics of its uptrend and has yet to show conclusive signs that it has bottomed. However, the downtrend has lost momentum and the Index has been steadier recently. It would need to sustain a move to new lows to question scope for further base building and an eventual recovery.

As a trader one might make money by shorting, although even that would be difficult given recent volatility. As an investor in the above markets, you would have enjoyed strong performance over recent years but many have now entered more corrective phases. However, I believe it is premature to call these bear markets because the technical evidence does not justify that call, although their convalescence might be quite lengthy. Once the current uncertainty passes, most of the markets above should reassert their overall uptrends and patience is likely to be rewarded.

Sugar Price Decline May Bottom Out in 2008, Czarnikow Forecasts - This article by Marianne Stigset for Bloomberg covers how interest is returning to this section of soft commodity universe. Here is a section:

Sugar, the third-worst performing commodity in the UBS Bloomberg CMCI index, may bottom out in 2008 as demand rises in Asia and the Middle East, and Brazil converts more cane into ethanol, Czarnikow Group Ltd. said.

Consumption climbed 3.5 percent in the 2006-07 season, faster than the historic trend of 2 percent, London-based Czarnikow, the world's largest sugar broker, said in an e-mailed report today. Asia and the Middle East are poised to account for 50 percent of global demand, expected to rise to 200 million tons from 156 million tons in 10 years' time, the broker said.

``While the sugar market is currently in a downward trend, we believe that prices will not fall as low as in the past,'' a team of analysts led by Toby Cohen, head of research at Czarnikow, said. ``The sugar market is now based on firmer support.''

White, or refined, sugar for March delivery, the most-actively traded contract, rose $5.50, or 1.8 percent, to $314.5 a ton as of 10:58 a.m. on Liffe. Prices have dropped 8.2 percent this year.

Raw sugar futures for March delivery rose 0.1 cent, or 0.9 percent, to 10.84

cents a pound on ICE Futures U.S., formerly known as the New York Board of Trade, as of 9:23 a.m. London time. Prices have declined 7.7 percent this year, compared with an 18 percent advance in the UBS Bloomberg Constant Maturity Commodity Index of 26 commodities.

My view - Only two years ago, sugar was viewed as the bio-fuel of the future and moved on a daily basis in line with the oil price. That was until it accelerated to an unreasonably high level and gave up the majority of its gain. In the last couple of months sugar has firmed once more and is pushing upwards. This is at least in part attributable to corn's relative strength, the new US energy bill, cuts to India's crop and Brazil's exports.

White Sugar almost halved in value between its high 18-months ago and its low in August. It found support above $250 and ranged for four months before breaking upwards. The move above $300 breaks downtrend, the progression of lower highs and complete the base. It would need to sustain a fall back below the latter level to question scope for further upside.

Sugar traded in the USA had an even greater percentage decline but bottomed two months earlier than the UK listed contract. It is has now also broken its downtrend and is moving upwards from the six-month base. It would need to sustain a move below 10.50¢ to question scope for further upside.

Eoin's personal portfolio: white sugar long opened - I opened a long position in March White Sugar contract paying $314.5 including spread-bet dealing costs.

Email of the day (2) - on moving instruments in the Favourites section of the Chart Library:

"A question regarding the chart library: I set up a few sub-categories and did not find how to move from the chart library the chart I am interested in into the relevant sub category? I did not either found how to move chart from one sub category to another one.

"Thank you for help on this."

My comment - Thank you for this interesting question which I'm sure must also be an issue for other subscribers. The first section you add to your Favourites will be appended to the top of the list but subsequent sections will appear at the bottom of the list. To move a section, hold the mouse above it until it goes yellow, then drag and drop it to the desired location. To help with placing it in the correct place, a blue line will appear to designate where the instrument will rest once you release the mouse button. In a similar fashion, all new instruments added to your Favourites will be added to the bottom of the list and you can drag and drop them to the correct sections.

Today's interesting charts - Did you know that it is possible to get 50-years of data for a wide variety of instruments in the Chart Library.

China (Shanghai A-shares) - continues to find support near the psychological 5000 and the upside can be given the benefit of the doubt as long as it holds above this level.

Oats - breaking upwards from the year-long range and would need to sustain a move back into the consolidation to question scope for some further upside.

US Dollar per 1 Euro - The Euro is breaking down from the short-term range and would need to sustain a move back above $1.45 to question scope for some further weakness.

Friday 21st December 2007

Commentary by Eoin Treacy

Citi Strategy Focus: Money Seeking "Growth" - Thanks to a subscriber for this report by Elaine Chu and colleagues which looks at money flows across Asia. Here is a section:

Net inflows to Global Emerging Market funds at new high - Of the 558 GEM funds tracked by EPFR Global, 68% took in new money and very few faced heavy redemptions. As a result, in the week ended Dec 12, net inflows surged to a record US$3.4b. This was more than double the amount flowing into Asian funds.

Month-to-date, net inflows to GEM and Asian funds total US$9.7b, almost five times the inflows to Global equity funds focused on developed market equities.

Inflows to China, Hong Kong and Singapore funds gaining momentum - While inflows to Indonesia funds are also strong, they are close to previous highs and are likely to roll over on a short-term perspective. On the other hand, inflows to Malaysia and Thailand funds are losing momentum, whereas Taiwan funds are the lone group to report outflows for five weeks in a row.

Foreigners become net buyers in emerging Asia, bar Korea and the Philippines - Net sales of Korean equities fell to a 2-month-low US$200m compared with the record US$3.3b five weeks ago. In the case of Philippines, foreign net sales rose to the highest in four weeks.

Locals are buying less - Net purchases by domestic mutual funds in India, Korea and Thailand dropped to three-week lows, while local individuals in Korea and Thailand remain net sellers.

My view - While the credit crisis is ongoing, we continue to see that investors for whom liquidity is not a problem have no inhibition with buying where they see value. Sovereign Wealth Funds have become large swing players in many markets and their influence is helping to sustain the relatively shallow reaction seen to date in a number of Asian stock markets. Since these funds are growing at an exponential rate and, at least Asian funds, are likely to invest in their home region we can expect relative strength to reside in Asia for the foreseeable future.

Morgan Stanley Downunder Daily: Priced In? - Thanks to a subscriber for this interesting report from Gerard Minack which raises some important points about the expectations priced into the bond and equity markets. Here is a section:

It remains a matter of debate how much bad news is already priced into markets. On some measures, arguably a lot is in the price:

Exhibit 1, for example, shows the much-watched prospective earnings yield/bond yield ratio for the US. This is now near a 20-year extreme, suggesting that equities are very cheap relative to Treasuries.

I don't put much weight on this ratio (or, put better, it needs to be used with extreme care), but there is one message I agree with: Treasuries and equities are pricing in weakness to a different extent.

Exhibit 2 shows Treasury yields in nominal and real terms. Real yields are low by historical standards. I think part of the reason for this is an (appropriate) flight-to safety within debt markets, rather than a large asset allocation switch from equities to debt. This, in turn, suggests that there is some scope for further yield declines if a recession unfolds. However, if there is no recession, then the earnings yield/Treasury yield ratio in Exhibit 1 will rise more due to Treasury yields rising than equity yields falling.

The outlook for short rates clearly reflects concerns about growth. The Fed funds futures now anticipate a funds target around 3¼% by end-2008. The Euro-dollar futures likewise imply declines (Exhibit 3).

As I've noted before, short-end futures typically under-estimate the extent of Fed rate cuts in an easing cycle, but clearly the expected direction of policy reflects recession concerns.

My view - Bond yields across maturities have fallen considerably this year and are pricing in a recession. This situation results from the direct experience of dealers on bond desks globally, who have seen a flight to quality as investors have scrambled out of bond derivatives and to a lesser extent equity markets.

However, equity markets are not showing such a dire emotional reaction to the credit crisis. Yes, they have been limited on the upside by threats to growth but they are also being supported by the likelihood of further rate cuts. This situation has been in play for a number of months and is likely to continue for a while longer.

Global P/E ratios have remained relatively unchanged during this crisis of confidence, signaling that lower earning growth has yet to be priced in. This marking down of expectations would seem to be inevitable at some point next year, which is a threat to how equity markets are priced as P/Es will rise. However the extent to which they fall will most likely continue to be dictated by further rate cuts at the Fed, BoE and probably at some point the ECB. These rates cuts are a signal that central banks have dedicated themselves to getting the credit markets moving once more. The other high profile action has been in massive injections of liquidity, most notably by the ECB this week, which now appear to be gaining traction as is evidenced by the firmer tone across Western markets over the last two days.

One new storm cloud I can envisage next year is a growth in corporate defaults. This is an element which has so far been absent from the list of concerns in the bond markets, but it could become more salient next year. This is a problem because of the huge market in credit default swaps; which for the want of a better simile are like insurance contracts against default. With so many writedowns, some analysts are predicting that a greater number of companies will go to the wall and the number of defaults generally has been rising. The issue for a number of the larger more liquid issuers, is that there is much more insurance outstanding than assets to cover the contracts.

This is a conundrum which will not trouble markets unless a high profile corporate goes bust. I am not predicting this, simply exploring the possibility. Considering that this is a known possibility and that the health of the already fragile economy rests on the bond market functioning; we will probably see a bailout if this does happen. However between the time of a major default and the bailout we could have a rough few of weeks.

The extent to which various purchasers of toxic waste will be affected by their bad decisions will probably be much better known next year and with knowledge should come a diminution of the anxiety racking market confidence. Assuming we do not move into a major recession, and I don't think we will, then that knowledge should act as a support to stock markets going forward.

Eoin's personal portfolio: soybeans position rolled forward - My January Soybeans position was rolled forward this afternoon into the March contract. This resulted in my January position being sold at 1159.25¢ against my purchase on December 12th at 1139.75¢ and a corresponding purchase was made in the March contract at 1180.65¢. All prices include spread-bet dealing costs.

India's Inflation Slows Before Ministers Meet on Oil - This article by Kartik Goyal for Bloomberg covers the fall in India's headline inflation. Here is a section:

India's inflation unexpectedly slowed in the first week of December as food costs declined, giving the government room to raise prices of gasoline and diesel for the first time in more than a year.

Wholesale prices rose 3.65 percent in the week ended Dec. 8 from a year earlier, slower than the previous week's 3.75 percent gain, the Ministry of Commerce and Industry said today in New Delhi. Analysts had forecast 3.77 percent.

Inflation has held below the Reserve Bank of India's 5 percent target for five months. Still, price pressures may be reignited as the government may have to increase retail fuel costs if crude oil rises further, according to the central bank.

``Inflation remains a key concern as food prices continue to exert pressure,'' said Shubhada M. Rao, chief economist at Yes Bank Ltd. in Mumbai. ``Going forward, the pressure on prices may further rise on increases in retail oil prices next week.''

A group of ministers is likely to meet next week to discuss increasing fuel prices, Oil Minister Murli Deora said last week. India hasn't increased retail fuel prices so far this year, although global oil rates have risen more than 50 percent.

The slowdown in prices will help Prime Minister Manmohan Singh to sustain the fastest pace of economic growth in 60 years and the central bank to curb prices more than the 5 percent year- end target.

The Reserve Bank is scheduled to meet in the last week of January to review interest rates. The central bank has lifted its benchmark interest rate nine times since October 2004 to fight inflation.

My comment - The Indian central bank raised interest rates aggressively and started to allow the Rupee to appreciate about a year ago; targeting inflation which had become an election issue. That inflation is now much less of a threat, allowing the Indian authorities the luxury of choice, as to how to manage the pressures of continued high oil and food prices.

Subsidies for fuel have obviously become much more of a burden and it makes sense to attempt to bring retail prices into line with international norms. Although this will have to a gradualist move, because fuel prices can also quickly become an election issue. In the meantime the central bank's focus is no longer on raising interest rates, which is a tailwind for the stock market.

Indian equities continue to outperform on a relative basis and remain within only a short distance of their highs. The Sensex continues in a tight consolidation beneath the 20,000 level as it unwinds its overbought condition and needs to sustain a move above this area to reaffirm the overall uptrend.

Today's interesting charts - Did you know that the Chart Library has in excess of 16,000 equities, bonds prices & yields, currency crosses, indices, ratios, spreads, funds, investment trusts and ETFs.

Nasdaq 100 - bounced well from the November lows near 2000 and would need to sustain a move above below that level to offset scope for some further upside.

VIX - falls back below 20 and would need to sustain a move above 25 to offset scope for a further decline.

Baltic Dry Index - remains in a short-term downtrend but it is a relatively gradual decline. It would need to break the progression of lower highs to question scope for some further weakness.

Email of the day (1) - on additions to the Chart Library:

"First of all I wish you a very Merry Christmas.

"Then would like to add the following charts:

"RG:CN
WEGE3:BZ
EZTC3:BZ
MOR:GR

"And finally attached you will find a greeting card from my company and inside the card: my granddaughter).

"Thank you for your titanic work,"

My comment - These have now all been added and I trust you won't mind me attaching your Christmas card, because you granddaughter is so cute I thought other subscribers might like to see her.

Email of the day (2 & 3) - further additions to the Chart Library.

"Could you please add the following funds to the chart library.
UBS(LUX) EQUITY FUND- GREATER CHINA B
Bloomberg UBSCHDl

"UBS(CH) EQUITY FUND-ASIA
Bloomberg UBSASPI SW

"Compliments of the season."

And

"The international equity library for the ASX doesn't include Brambles BXB which is curious as this is definitely a top 100 ASX company with globally significant businesses. It did go through a restructure about the time you were updating chart library and have noted in the past some anomalies with delisted (taken over) companies still appearing for some time. It should be in that list and was wondering…"

My comment - Thank you both for these suggestions. They have all been added to the Chart Library.

As an aside, we rely on Bloomberg to notify us of splits and mergers but extinct equities have to be deleted manually from the database. So if you notice any stocks which are no longer trading please drop us a line.

Quote of the Week - on perseverance:

"Fall seven times, stand up eight."
Proverb

Please Note - David is on holiday and will return briefly on December 24th and a full service will continue on December 27th. I will not be at my desk next week but will return on December 31st.

Merry Christmas and thank you for your support over the last year.