

Fullermoney

Global Strategy and Investment Trends by David Fuller

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

Monday 24th December 2007

Seasons Greetings! - [Just back from my travels, I have recorded an Audio today. Also, don't miss Eoin's excellent big picture, long-term outlook Audio posted on Friday. I will resume my normal updates on Thursday 27th December. Eoin will return on 31st December.](#)

[Meanwhile, Happy Christmas and best wishes for the holidays!](#)

Thursday 27th December 2007

Mark Glowrey: Commodities Daily Hotline from Investors Intelligence - [My thanks to colleague Mark Glowrey for this very interesting review of a topical sector. It is posted without further comment.](#)

Email of the day - [On gold versus gold shares and silver:](#)

"I'd like to open a debate on 2 subjects: first, silver versus gold and, second, gold physical versus gold shares.

"ONE.

On silver, this was sent to me by a fine gold and resources fund manager friend who has a number of commodity related funds, and who seems to be wary of the "silver is high beta gold" argument:

"While I am generally positive on a number of smaller silver-focused equities, I still believe gold will outperform silver. The nature of their relationship is a fairly consistent one- in a "good inflation" environment, i.e. economic growth is strong and all asset prices are inflating, then silver typically outperforms gold due to the industrial demand component. If we are in a "bad inflation" environment, i.e. economic growth is declining but the monetary policy response to that creates an acceleration in inflation, then gold typically outperforms silver due to it's ability to function as a legitimate currency (silver is far too bulky to do so).

" I know there are a number of VERY enthusiastic silver bulls out there, which is part of the reason we typically don't own a lot of the larger silver stocks (the zealot's enthusiasm gives them valuations that make even the senior gold companies blush). They often cite the low silver/gold ratio, the massive

institutional short position, the metal consumed in industrial applications, and the lack of a "monetary stockpile" like the central bank gold holdings. All of this is true, I'm just not sure one can build an investment case over the next 3-5 years on it- therefore I would think it continues to play second fiddle to gold as the primary catalysts today seem to be fiat currency/default/confidence based."

"TWO.

Is it possible that the outperformance of gold stocks versus gold physical means that for the next gold up leg we should be out of shares and into bullion? Indeed, now that the ratio has moved so dramatically in favour of shares since 2000 (moving the gold to gold bugs index ratio from a high of 7 in 2000/2001 to a range of 1.5 to 2.5 (historically a range with a strong mean-reversionary pull) since 2003, can we expect ANY out performance longer term by shares over physical? It is true that shares yield something and gold costs something, so the weight of evidence should -under normal circumstances- be in favour of gold shares. But the ratio is still daunting and the hard numbers are of concern."

My comment - Thanks for an interesting email on age old debates. The answers, I believe, are a movable feast and can be attributed to behavioural factors. And there is something even more important.

I do not consider these instruments to be mutually exclusive and their relationship often resembles the game of leapfrog, in which one periodically leaps ahead of the latter, in moves determined by sentiment. The important point: if there is going to be a big move, gold, silver and their respective mining shares will all participate.

Personally, I do not read a lot into this chart of the Gold Bugs / Bullion [Ratio](#). Yes, it has backed away from the higher side of its range for the last several years but the 2000 trough is probably a once or twice in a lifetime extreme, occurring near the end of a secular bear market for gold.

I also do not think we should try to be too fundamental about the gold / silver relationship, not least because investment / speculative demand (or the lack of it) is the key variable behind silver's high-beta performance. In a bull market, which I maintain this is, gold fever will rage hot from time to time, as you know. When it does, animal spirits will usually catapult silver even higher because it is a thin market. The same psychology works in reverse, on the downside.

Currently, [gold](#) is outperforming [silver](#) as both rise from what I believe are the low points for their respective consolidations. The prior setback has made people more cautious but this is likely to change when gold sustains a break above \$850, setting the stage for silver to catapult even higher. Meanwhile, the [Gold Bugs Index](#) is not doing that badly, although it has always been volatile.

People have been more wary of shares recently, and gold itself is not immune to this contagion. Personally, I have always regarded precious metal shares

as more speculative than bullion, because more bad things can happen to the companies, which are often wasting assets. They also tend to trade at higher valuations than industrial mining shares. Nevertheless Lihir Gold ([LGL AU](#)) and the Merrill Lynch Gold and General Fund ([MRCGLDI LN](#)) are the 6th and 7th largest positions by weighting in my personal long-term investment account. The former has taken a beating recently but should bounce back quickly if gold moves higher, as I suspect. I mostly trade gold and silver via futures and may leverage up these positions behind trailing stops, on further strength.

Morgan Stanley: The Return of the Dollar - My thanks to a subscriber for this interesting [report](#) by the Global Macro Team at Morgan Stanley. Here are some opening bullet points:

The US dollar is cheap

Our calculations show that the median fair value of the dollar is 1.18 against the EUR (latest 1.43), 1.64 against the GBP (latest 1.98), and 101 against the JPY (latest 113). The dollar is cheap against EUR, GBP and several other G10 currencies, though it is still rich against the JPY and some EM currencies.

The dollar smiles in a US recession

We believe the risk of a recession in the US, and the concomitant fear in the financial markets, will be supportive for the dollar. Further, a healthy recovery following the prospective slowdown in the US economy will also be USD supportive. This is our 'Dollar Smile' idea.

My view - Fullermoney has a long tradition of posting reports with which it does not always agree, particularly if they are well written, as in this case.

The US dollar is at one of those interesting crossroads when informed people can make a credible case for or against a recovery. I believe that subscribers should be familiar with both sides of the argument, to remain objective. Meanwhile, the chart action remains our arbiter and reality check.

For these reasons and following the US Dollar Index's steepening decline ([monthly](#), [weekly](#) & [daily](#)) to its October low, which generated extreme pessimism among many currency pundits, we have spoken of a technical rally and pointed out a number of short-term technical levels against the Index and also several other leading currencies.

More recently and both before and after my pre-Christmas holiday in Squamish, I have mentioned repeatedly in Audios that the dollar had probably seen the best of its rally, at least for the short term. However I also mentioned in my Audio on Monday that we had yet to see a downward dynamic by the US Dollar Index. That occurred yesterday and there has been some follow through today, as you can see from the daily chart above.

I do not argue with Morgan Stanley's point that the USD is cheap on a purchasing power basis, particularly against the EUR and GBP. However the USD needs to be cheap because the US economy remains a focal point of risk and will skirt very close to recession, perhaps avoided only with the help of an accommodative Fed and considerably stronger global economy led by Chindia.

As an aside, there is now a two-tier US economy, as I have mentioned before. This consists of a moribund domestic consumer sector and a comparatively robust multinational / export sector. If there was ever a time to bet against the near legendary resilience of the US consumer, it is now. All those chickens of folly - teaser mortgages, 'pay nothing until 2009' enticements for cars and other big ticket items, 'cheap rate' loan shark advertisements, soaring credit card debt arrears - are coming home to roost.

With the US economy overly dependent on consumerism, the USA faces stagflation - the stagnation portion led by banks and overstretched consumers, and the inflation coming mainly from food and energy prices. I fear this combination will feel considerably worse for middle class and blue collar Americans than the 2001-2002 recession.

The financial sector's multiple own goals will make it a most unlikely candidate to take up the economic slack and lead the next US recovery. The good news, albeit for the longer term, is that US households may increase savings. Meanwhile, the Fed will be forced to remain accommodative. This will be a headwind for the USD but it might just prevent Wall Street from slumping, with food and other resources companies to the fore, along with quality multinationals and tech.

The Wall Street leash-effect will remain a factor for all other stock markets, albeit not so powerful as it used to be. Weakness by the major US equity indices will exert a downward pull but Fullermoney themes such as Asia and resources will not necessarily be high-beta, except that they are likely to recover more quickly, as we have seen this year. Steadily ranging to rising US indices would allow the fundamentally bullish markets to extend their outperformance.

Returning to the Morgan Stanley report, I continue to regard bullish dollar commentary as a contrary indicator. However chart action usually tells the real story, far more effectively than any forecasts. Therefore, as I see it, the [DXY](#) short-covering rally is now being retraced and a move over 78 is now required to revive it. Even if the DXY is forming a significant base, which I doubt, the process would take many months and possibly years, as Eoin explained in Friday's Audio. Meanwhile, the dollar may not attract more than occasional short-term demand before the trend for US short-term rates eventually reverses to upwards.

I agree that GBP ([weekly](#) & [daily](#)) is no longer a hard currency, due to a weak UK economy and the likelihood of lower short-term rates. However it has steadied following a somewhat overstretched decline and would need to fall beneath \$1.97 to indicate renewed weakness.

The EUR ([weekly](#) & [daily](#)) also faces a somewhat weaker economic headwind but has been involuntarily upgraded in terms of reserve currency status by the USD's weakness. Moreover, the EUR has failed to maintain its break beneath \$1.45 and would need to fall under \$1.43 to indicate renewed weakness.

I agree with Morgan Stanley that Asian currencies ([monthly](#), [weekly](#) & [daily](#)) remain attractive, generally, although I would exclude the low-yielding yen, which remains a carry trade vehicle. For instance, there is no compelling evidence to buy EUR/JPY ([weekly](#) & [daily](#)), although the euro may encounter some resistance near its former highs, particularly if there is renewed political pressure within Euroland to stem its strength. However, the dollar's rally might just have peaked against the yen today, although the [key day](#) reversal is too small to be conclusive.

Resources exporting countries do not want their currencies to appreciate (Who does? This remains one of the gold bull points) but they face a headwind in the form of strong economies. AUD ([weekly](#) & [daily](#)) has not maintained its latest downward break although it needs to takeout the recent sequence of lower reaction highs to show significant improvement. This is likely, since the Australian currency continues to show extensive underlying support against the greenback.

It continues to look as if the politically induced short-covering rally in CAD ([weekly](#) & [daily](#)) has reached at least a temporary peak. Another upward dynamic is required to check the latest slide beyond a brief pause.

Lastly, if the US Dollar Index ranges at best, as I suspect, one half of Morgan Stanley's reasons behind a bearish forecast for industrial metals will have been undermined. I also think they underestimate global infrastructure and consumer demand, led by Chindia and booming resources countries. It seems a bit late to be bearish of zinc ([weekly](#) & [daily](#)), which I believe is now in a buying range, although technical evidence of a firm floor remains tentative. However it is quite overextended relative to the 200-day MA.

Donald Coxe's Basic Points - My thanks to subscriber for pointing out this [link](#) to Basic Points. Many veteran subscribers regard it as essential reading, as do I.

I found this issue particularly interesting, not least for its additional insights regarding the sub-prime fiasco and related developments of ethics and governance.

At Fullermoney we have often said: With emerging markets, governance is everything. Perhaps we should drop the reference to emerging markets, which increasingly show superior governance, and just say: Governance is everything - starting with the administration in power and throughout the entire political system, and not least the corporate boardroom.

I also maintain that ethics should be a required course for schools, not least at universities and business schools. Just think of the economic benefits.

Lastly, Donald Coxe has some interesting things to say about gold.

Extended Audio today - This includes an updated discussion of the US banking crisis.

Please note - Eoin is away but returns on Monday.

Great video of bears and salmon - This could have been my recent [holiday](#), had I been moonlighting. I certainly saw plenty of salmon and eagles.

Friday 28th December 2007

Thailand: "Let the Party Begin" - This is an interesting and informative post-election [article](#) by Thitinan Pongsudhirak for The Wall Street Journal. Here is the opening:

BANGKOK -- Last weekend, Thai voters unwittingly produced a clean winner in the elections but a murky outcome for the future of democracy in their country. In the first polls since the military coup that overthrew former Prime Minister Thaksin Shinawatra in September 2006, the People Power Party, Mr. Thaksin's proxy vehicle, won a thumping victory by capturing 233 of 480 seats in the national assembly, leaving its nearest rival, the Democrat Party, in the dust with 165 seats.

The PPP's comfortable win against all odds has vindicated Mr. Thaksin's resilient populist platform, which catered to the demands and grievances of the country's rural majority. It was also a win for performance over integrity. Mr. Thaksin is hounded by a host of corruption allegations, but his ousted administration is widely seen as strong and effective, a perception magnified by the ineptitude of the military-appointed interim government.

Despite its large margin of victory, the PPP's quest to head the incoming coalition government will have to overcome several hurdles. Most fundamentally, it would be surprising if the generals and their allies accept a PPP-led government without a tussle. While it would be rightful and legitimate, the PPP's leadership of the new government would be difficult if it reverses the last 15 months of Thai politics. The PPP could go against everything the putsch has stood for: Mr. Thaksin would be poised to return with a chance to clear his name and reclaim his vast frozen assets; the 111 leaders of his party, Thai Rak Thai, who are currently banned from politics would be given a new lease on life; and various post-coup antigraft agencies would be disbanded. A PPP-led administration could also mete out reprisals to the coup makers and their powerful backers, uproot the military's corporate interests, re-arrange the top brass, and marginalize the army's resurgent role in politics. None of these changes would be welcomed by the military leaders behind the scenes.

Yet the PPP's parliamentary strength is so formidable that it cannot be easily

suppressed or outmaneuvered. And the military is increasingly constrained by international norms. The generals' post-coup incompetence has discredited the military as an institution and failed to meet public expectations at home. Yet at the same time, unless the PPP can strike a deal that ensures the security of the generals and their allies, its coalition leadership is not a foregone conclusion.

My view - Investors with an interest in Thailand have had to be very patient in recent years, although performance has been far from a disaster with the Bangkok SET Index ([p&f](#), [monthly](#), [weekly](#) & [daily](#)) mainly rangebound but the currency firm ([monthly](#), [weekly](#) & [daily](#)). Meanwhile, the SET has a decent yield of 3.41%.

The main reason for Thailand's underperformance, as everyone knows, has been the long running political crisis. So against that background, what should we make of this election result?

I view it as progress, despite the considerable uncertainty which remains, not to mention haggling which is undoubtedly occurring right now. The important point is that a democratic election has actually occurred. The best result, I believe is that a civilian government, almost certainly formed by the People Power Party, will most likely emerge following the deal making.

A civilian government formed by either the PPP or Democrat Party will be far from ideal, under the circumstances, but should be infinitely preferable to continued rule by the military. There are few ideal governments, as we know, but what investors will want to see is some stability and particularly evidence of economic competence. This crucial latter factor was conspicuous by its absence under military rule.

Importantly, the SET encountered support near 800 and rebounded following the election. Uncertainty regarding the next government remains but provided a result is peacefully achieved and the SET remains above 800, investors in Thailand may not have to wait too much longer before their patience is rewarded.

Thailand is no BRIC but it should benefit from the current surge in many agricultural prices. It is also a popular tourist destination, not least among visitors from China. Thailand is also a leader in [medical tourism](#), as you can see from these two items.

Thailand is currently the third largest position by weighting in my long-term investment portfolio, mainly via the Aberdeen New Thai Investment Trust ([ANW LN](#)). However I would most likely reduce this position in the event of significant gains over the next year or two.

Email of the day (1) - On Japan and a gold fund:

"With Japan completing another anaemic performance one can only wonder if somehow they can get it right in 08. Any thoughts or are we just beating a

dead horse?

"Also, in your opinion how would you handle the following? I have a gold fund that performed very well for a couple of years, but has only appreciated about 10% for the year which I believe to be low compared to others. I understand that investments can range, but it does not make much sense when other similar investments are performing better. I realize there can be transaction costs (small) and possibly taxes as well."

My comment - Commencing with your latter question, you might ask the managers why they have underperformed. If the answer is unsatisfactory, you will find plenty of gold funds in the Chart Library, enabling you to compare relative performance.

The best case scenario for Japan is the possibility that it is nearing the end of another lengthy consolidation of approximately two years. It has happened before as you can see from this [chart](#) of Topix. Watch for an eventual bullish lead from the [Banks Index](#). A sustained break above 350 would increase my interest.

"Happy New Year? Don't Bank On It" - This sobering headline comes from and informative [article](#) in The Wall Street Journal today, discussing the capital raising needs of US and European banks. Here is the opening:

In the credit crisis, banks have been taking extraordinary steps to shore up their finances, selling stakes to foreign investors and snapping up loans from central banks.

Now comes the yard sale.

In a sign that they see tough times ahead, U.S. and European banks are considering sales of everything from branches to entire units. Possible sellers include Citigroup Inc., which may unload or shut several midsize units, and United Kingdom banking giant HSBC Holdings PLC, which could exit all or parts of its \$13 billion auto-finance business, say people familiar with the situation.

Talk of the potential moves comes days after Merrill Lynch & Co. announced that it would sell most of its commercial-lending business to General Electric Co. for \$1.3 billion. Morgan Stanley pocketed more than \$250 million last month by selling a slice of its MSCI Inc. investment-analysis unit in a public offering.

"I think we are going to see a real wave of these coming through in the first half of next year," says Huw van Steenis, a banking analyst at Morgan Stanley in London. Spokeswomen for HSBC and Citigroup declined to comment on any potential asset sales.

Some executives estimate that Citigroup could dispose of as much as \$12 billion in so-called noncritical assets. Among the candidates: Student Loan

Corp., a publicly traded company 80%-owned by Citigroup; the bank's North American auto-lending unit, which issued about \$9 billion in loans last year in the U.S. and Canada; Brazilian credit-card company Redecard SA, in which the bank held a 24% stake as of Sept. 30; and the bank's Japanese consumer-finance business, which lost \$312 million in the first nine months of 2007 amid rising loan defaults.

My view - I believe it was someone at Wells Fargo, possibly Richard Kovacevich, who said of the banks' current plight: "Why do we have to think up all of these complicated new ways of losing money when the old ones still work so well."

Well...they did but banking is among least sentimental of industries so in the interests of survival it will waste little time in dumping less desirable subsidiaries, shedding personnel, diluting shareholders' equity through sovereign wealth fund deals, or any other measures likely to stem the balance sheet rot and restore profitability.

What does this mean for the investor, particularly those who have traditionally looked to the banks for income?

I have little doubt that the US and European banking sectors will not only survive, but eventually emerge from the ashes of their self-destruction, as slimmed down phoenixes, minus some feathers. However it will take time.

Therefore I would rather risk missing an opportunity, than rush in prematurely. Even if banks are near their troughs, as I suspect, the convalescent base building phase is likely to be lengthy, as I have said before. If I held any of the shares for income purposes, it is probably too late to sell and the dividends, even if reduced at some point, offer some consolation.

Meanwhile, we are likely to see more write-downs before there are any write-ups. There will be more shareholder dilution in the form of SWF deals and perhaps rights issues. More divisions will be sold. This will raise capital but it usually reduces profitability as well. There may be dividend cuts. The means by which banks will restore their former profitability is not immediately apparent.

I saw Warren Buffett say during a CNN interview earlier this week that he had been approached by a number of banks recently, offering SWF-type deals in search of capital. He declined the invitation to participate. If Warren Buffett is not yet willing to invest in the banks, on favourable terms no less, perhaps we should be in no hurry.

Email of the day (2) - On the S&P 500 Thrifts & Mortgage Index:

"On the commonality / leadership principle, I recommend looking no further than the S&P500 Mortgage and Thrifts Index (down 70% off the highs!!!!) when we talk about the banking sector and the end to sub prime slime.

"It's basing out would be my personal guide for better things in financials worldwide as this is where many of the bodies are buried."

My comment - Thanks for pointing this out - I've added it to my watch list. The best that can be said today is that it has lost downward momentum following the [crash](#). Moves of this sort are usually followed by at least a medium-term (multi-month) period of base development before a sustainable recovery can occur.

My personal portfolio: Two trades rolled forward, another increased - In a delayed report, as I was away at the time, I rolled my expiring [Pacific Ethanol](#) trade forward, selling the December contract at \$7.2880 on 18th December against my purchase at \$10.639, and simultaneously purchasing March at \$7.4880. I said I would not do this if I lost money on the last position, but changed my mind following the upward dynamic off the recent low. Nevertheless this is too risky a trade in a suspect industry to be of general interest. I have already protected my new position with a stop, currently just above a breakeven level.

More sensibly, I rolled my expiring [platinum](#) trade forward today, selling a January position at \$1535 against my purchase at \$1480.5 on 7th November, and simultaneously purchased an April position at \$1540. After raising stops on some existing positions, I also increased my [silver](#) longs by 20%, paying \$\$14.915 for another March position.

Prices above include spread-bet dealing costs.

Today's interesting charts - Charts are our reality check.

Gold in USD - Testing the November [high](#); a downward dynamic would be required to indicate more than temporary resistance near the psychological 850 region.

Gold in EUR Proxy - Similarly testing November [high](#), but this 10-year chart shows more back history.

Gold in Sterling - Well into [new high](#) ground; a reaction larger than last month's would be required to suggest more than a brief pause within the medium-term upward trend.

Gold in Australian dollars - Upward [break](#); would require move beneath A\$900 to suggest upside failure.

US Dollar Index - Fallen [back](#) to this month's upside breakout point; nevertheless an upward dynamic would be necessary to suggest more than temporary support near the 76 region.

Please note - Eoin returns on Monday.

Quote of the week - [On chaos versus order:](#)

"Chaos often breeds life, when order breeds habit."

Henry Adams

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