

# 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](http://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 18th February 2008

The Debt Delusion - [My thanks to a subscriber for this excellent and informative assessment of the US economy by Thomas Palley for The Australian, reproduced by Project Syndicate. Here is a section:](#)

The differences between the new and old cycle are starkly revealed in attitudes toward the trade deficit. Previously, trade deficits were viewed as a serious problem, being a leakage of demand that undermined employment and output. Since 1980, trade deficits have been dismissed as the outcome of free-market choices. Moreover, the Federal Reserve has viewed trade deficits as a helpful brake on inflation, while politicians now view them as a way to buy off consumers afflicted by wage stagnation.

The new business cycle also embeds a monetary policy that replaces concern with real wages with a focus on asset prices. Whereas pre-1980 monetary policy tacitly aimed at putting a floor under labor markets to preserve employment and wages, it now tacitly puts a floor under asset prices. This is not a matter of the Fed bailing out investors. Rather, the economy has become so vulnerable to declines in asset prices that the Fed is obliged to intervene to prevent them from inflicting broad damage.

All these features have been present in the current economic expansion. Wages have stagnated despite strong productivity growth, while the trade deficit has set new records. Manufacturing has lost 1.8 million jobs. Prior to 1980, manufacturing employment increased during every expansion and always exceeded the previous peak level. Between 1980 and 2000, manufacturing employment continued to grow in expansions, but each time it failed to recover the previous peak. This time, manufacturing employment has actually fallen during the expansion, something unprecedented in American history.

The essential role of asset inflation has been especially visible as a result of the housing bubble, which also highlights the role of monetary policy. Despite the massive tax cuts of 2001 and the increase in military and security spending, the US experienced a prolonged jobless recovery. That compelled the Fed to keep interest rates at historic lows for an extended period, and rates were raised only gradually because of fears about the recovery's fragility.

Low interest rates eventually jump-started the expansion through a house price bubble that supported a debt-financed consumer-spending binge and triggered a construction boom. Meanwhile, prolonged low interest rates contributed to a "chase for yield" in the financial sector that resulted in disregard of credit risk.

In this way, the Fed contributed to creating the sub-prime crisis. However, in the Fed's defense, low interest rates were needed to maintain the expansion. In effect, the new cycle locks the Fed into an unstable stance whereby it must prevent asset price declines to avert recession, yet must also promote asset bubbles to sustain expansions.

My view - National wealth is not an entitlement; it is the consequence of good governance and enterprise. Paradoxically, when America's economic power appeared to be at its height, it was most vulnerable to hollowing out as a number of developing countries with large populations, led by China and India, adopted capitalism.

Today, the global economy is more dynamic and creative than ever before. It is also vastly more competitive, producing instant winners and losers. Thomas Palley provides a sobering summary of America's economic dilemma, aspects of which can be viewed as the flipside of Chindia's success.

However, just as success can prove to be ephemeral in a dynamic and therefore competitive global economy, failure can also be transitory, subject to governance. The key is often adaptability.

I do not share Thomas Palley's pessimism expressed in the third paragraph of his article (not shown in the segment above), although solutions may appear elusive at the moment.

'Needs must' is often the mother of invention, as we have seen before and as I believe we will see at an accelerated rate in future. All countries face daunting challenges - concerning energy, water, pollution, food and employment, to mention a few, but inventive capitalism and good governance are the mechanisms for resolving them.

The USA's problems, partially detailed by Thomas Palley, only seem greater because of our shock over America's decline from a higher economic pinnacle. In contrast, China's and India's stunning rates of economic development seem more impressive because up until about 20 years ago their economies remained moribund.

I do not know precisely how the USA will resolve its economic problems. However I suspect it will begin with a reduction in overseas bases and military spending. Simultaneously, I would not be surprised to see a reallocation of government funds, in partnership with industry and also university research efforts, directed towards improving the country's energy situation and overhauling America's aging infrastructure.

It will obviously take time but I would not underestimate the USA's inventive and regenerative capabilities. There will also be inward investments as Alex Seagle [detailed](#) not long ago. Meanwhile, America's multinational companies are doing very well. Consequently, I would not be surprised if we look back at some point in the next decade or two and see 2007-2008 as a nadir for the US economy.

Email of the day (1) - On a commodity fund:

"The latest scare I have read is about a potential wave of lawsuits liable to ruin many banks involved in the subprime crisis.

"You were right about Y2K. You may well be right about the outcome of the present crisis.

"My bank has proposed to me a diversified Commodity Fund. It holds no physical commodities, but only derivatives. The fund has held up well in the last 6 months, broadly tracking the CRB. As it holds only derivatives, would the fund not be risky if there were to be a major derivatives crisis? Can you comment?"

My comment - The surprise is that there have been so few lawsuits to date and I imagine US tort lawyers would like to have a go. However it may be difficult to prove malfeasance.

Your bank would not or could not effectively hold physical soft commodities and it is much more efficient to use derivatives, which I assume will be mainly futures contracts. These have been around for a long time - well before I began to trade them in the early 1970s, for instance. The complex financial derivatives that landed banks in trouble have nothing to do with commodity futures.

Mike Lenhoff: Where to for the FTSE 100 - 5000 or less or 6000 and beyond? - This is a good [letter](#) from Brewin Dolphin's Chief Strategist, kindly forwarded by Tony Smith. Here is the opening:

Japanese equities have retraced 50 percent of their bull market gain. Maybe it's time to buy Japan. On the other hand, maybe the other major equity markets will follow Japan. Thus far they have given up a third of their bull market gain and, if they retrace 50 percent of it, we would then be talking about 5000 for the FTSE 100 and 1170 for the S&P 500, about another 15 percent drop. We'll come back to this.

As the chart shows, [see Subscriber's Area] the earnings recessions of the early 1990s and of the new millennium (dotted line) were both associated with widening spreads on higher yielding corporate debt (solid line). On each occasion, the spreads widened by roughly the same amount, i.e., by between 900 and 1000 basis points.

Equity markets behaved quite differently in and around these recessions except in one important respect. This was that a bull market phase did not resume ahead of the recovery in the market for corporate debt. Furthermore, it wasn't until interest rates, in this case the Federal Funds rate, were either at or very near their respective cycle lows that equity markets picked up. While the corporate debt markets led the way, this proved to be more a necessary than a sufficient condition for a sustainable recovery in equity markets.

My view - I often like Mike Lenhoff's reports and feel this is one of the best.

I think Japan probably is in a buying range and have been nibbling at Nikkei futures ([monthly](#), [weekly](#) & [daily](#)) on setbacks. Of course many people don't want to know, having been disappointed by Japan last year. That may be why it fell by 50%.

I have some lingering concerns over Japan's [bank](#) shares, since a late disclosure of sub-prime write downs would be a big irritant, especially following months of denial. Should a bearish disclosure occur, it could produce another climactic low for Japan's stock market.

However I am now willing to take some risk in Japan, evidenced by an initial stake in futures, which I can protect with stops. Furthermore, an improvement in the Second Section Index ([monthly](#), [weekly](#) & [daily](#)) would encourage me to leverage up. This has been a fantastic lead indicator in the past and I would be greatly heartened by a sustained move above 3000. This would establish a higher high and higher low - a fledging uptrend, in other words.

The UK's FTSE 100 Index ([weekly](#) & [daily](#)) has a good chance of taking out 6000 this week, but it needs to maintain a break above that level. Meanwhile, an encouraging sign is that commencing with the climactic low on 22nd January, five out of the last seven dynamics have been on the upside.

However it now needs to hold above 5680 if we are to see bullish action anytime soon. If rumours of dividend hikes by [Barclays](#) and [Lloyds TSB](#) (reported by the Sunday Times over the weekend) are true, that would be a powerful vote of confidence on behalf of the sector. Meanwhile, these two shares remain in downtrends although both saw impressive upside key day reversals on 22nd January. (*Note: if you don't know what a key day reversal is, treat yourself to The Chart Seminar.*)

Email of the day (2) - On sitting tight:

"Thank you for your great service. I thought you might find this article interesting (in line with the Capetown posting last Friday)."

My comment - Thanks you, and also for the interesting [article](#).

Japan, Korea agree 65 percent iron ore price hike with Vale - My thanks to a subscriber for this [item](#) from Mineweb.

My view - Eoin also covers this below, so I will just add that I cannot think of another industry in the world that currently commands this degree of pricing power.

My view on the top miners remains unchanged: they are increasingly scarce gems within one's long-term investment portfolio. Meanwhile, the market in its munificence will provide volatility, and downward corrections in mining shares are buying opportunities, as we last saw only a month ago.

Additional Commentary by Eoin Treacy

JFE, Posco Agree to 65% Increase in Price of Iron Ore - [This article by Yoshifumi Takemoto and Jesse Riseborough for Bloomberg](#) covers the completion of iron-ore negotiations between CVRD and JPE and Posco. Here is a section:

Smaller Australian iron ore companies gained. Mt. Gibson Iron Ltd. rose 4.9 percent and Fortescue Metals Group Ltd. surged 5.2 percent at the 4:10 p.m. Sydney time close on the Australian Stock Exchange. Melbourne-based BHP fell 33 cents, or 0.8 percent, to A\$38.96 at Rio declined 2.2 percent to A\$134.

Soaring demand for cars and ships in China is stoking Asian appetite for steel, allowing Nippon Steel, Posco and rivals to raise product prices. China, the world's fourth-largest economy, expanded 11.4 percent last year, the fastest pace in 13 years.

``They should be able to pass through a large portion of the costs," Frederic Gits, senior director at Fitch Ratings in Tokyo, said today by telephone. ``Their end customers in shipping and automakers are still doing pretty well."

Contract prices for Rio Tinto's products, which don't include shipping and insurance costs, were set at \$51.47 a metric ton for the year starting April 1, 2007. Including freight, contracted iron ore was sold in December for \$85 a ton, Rio Tinto said in a Dec. 18 statement. The biggest gain previously was 71.5 percent in the year starting April 1, 2005.

#### Annual Talks

Iron ore producers and steel mills hold annual talks starting before the end of the year in Asia to set contract prices. Cash prices in China have surged to four times the current contract rate because of rising shipping costs and demand. Prices at Beilun here unchanged at 1,420 yuan (\$198) a metric ton last week.

Lehman Brothers Holdings Inc. said in December that contract prices could rise 50 percent this year. Goldman Sachs JBWere Pty. in November said they could increase by more than 50 percent. Any gains above 40 percent will lead to earnings revisions for mining companies, Credit Suisse said Jan. 16.

``The result is higher than the market expectation of 50 percent," said Helen Wang, Shanghai-based analyst with DBS Vickers Hong Kong Ltd., ``Although

steel prices are rising now, steelmakers will feel pressure from the higher raw-material costs late this year as prices may fall back.'

Nippon agreed a 9.5 percent gain in ore prices for the 12 months from April 1, 2007, after Baosteel Group Corp., Baoshan's parent, settled with Vale. That was the first time China had set a benchmark price increase for steelmakers worldwide.

Calls and an e-mail sent to Fernando Thompson, a Rio de Janeiro-based spokesman for Vale, weren't immediately returned.

My view - Iron-ore companies such as the CVRD, BHP Billiton and Rio Tinto continue to exemplify the potential profits to be made from the expansion of Asian economies and the massive investment infrastructure development going on across the region. Iron-ore is another example of the Supply Inelasticity Meets Rising Demand theme and these miners should continue to be able to largely dictate terms to their major customers for as long as the Asian infrastructure boom lasts. Considering the plans China and India have for their development, this could run into decades. In the meantime, competition continues amongst the majors for control of key global assets so we can expect M&A to remain active.

Mining Weekly Online: Mine costs to 'spiral out of control', Implats CEO Brown warns - [Thanks to a subscriber for this interesting article by Martin Creamer which focuses on mining costs. Here is a section:](#)

Costs would "spiral out of control" for the entire South African mining industry if the skills shortage persisted and retention bonuses became an ongoing feature, Impala Platinum CEO David Brown warned on Wednesday.

Brown said that it would be unreasonable to expect unit cost increases to be single digit and he expected increases to be "more or less" between 12% and 15% a year for the "immediate couple of years".

"Quite clearly we are in a position where, with the skills shortage aspects as well, there is an element of retention money that has to be spent to retain skills and that is over and above what can be called normal mine inflation at this particular point in time.

"I don't think that it is a position that we can continue in this country forever and a day, otherwise costs, literally, are going to continue to spiral out of control for the whole industry," Brown warned.

He said that skills were the "single biggest issue" facing South Africa and was a "major area of concern".

"We believe this issue needs to be addressed on an holistic basis rather than an individual company basis and requires engagement between both government and industry at a high level," he said.

Cooperative training initiatives through engagement with government were needed in order to drive down those particular costs and attempts made to increase the skills pool.

My view - Metals remain in secular uptrends and many mining companies are benefitting enormously from this move, which appears to have many years left to run. However, what preceded this impressive bull market was a generational long bear market so the raw materials for mining operations are in short supply. When companies are fighting for survival they are not thinking about doubling or tripling production so capacity was at cyclical lows just when demand picked up. This is the case with everything from tyres and drills to graduates with the necessary qualifications to enter the field.

Miners have concentrated on negotiating higher prices from their consumers but what we will inevitably see in coming years is an equally dedicated approach to controlling input costs and a much more aggressive management of inventory. Companies which grasp this secular change early are likely to be able to maintain their profit margins best.

World Tribune.com: Is the party over in China? Massive unemployment looms - Thanks to a subscriber for this interesting [article](#) on employment in China. The full article is posted in the Subscriber's Area but here is a section:

China watchers are predicting a drop in the GNP growth rate this year and for the foreseeable future. Most are attributing the expected fall off this year - from last year's official 11.4 percent, the fifth year in a row of double digit expansion - to the expected downturn in the U.S. and the world economy in general.

Even the 2007 growth rate wasn't that high when compared with the peaks of the 1980s and 1990s, when GDP growth in some years surpassed 15 percent, coming out of the stagnation and even losses at the end of the Maoist era.

The downturn is going to be welcomed in some Chinese leadership quarters because of the fear of runaway inflation from an overheated economy - now fed by food shortages and the impact of the worst winter in 50 years.

But a look over that horizon isn't good news either: massive unemployment is China's continuing biggest long-term problem.

The macro-statistics look good: China's official GDP reached \$3.43 trillion in 2007, the National Bureau of Statistics reported, making it the third-largest economy in the world after the United States and Japan. China is also the third-largest exporting country after the U.S. and Germany. China's foreign currency reserves are the largest in the world, driving up more than \$1.4 trillion. And China appears to have shifted from a primarily agricultural country to an industrial one.

The official urban unemployment rate has typically remained around 4

percent, but that isn't the real story. Chinese unemployment statistics do not include the laid off - and workers can be laid off for up to three years before they officially count as unemployed.

My view - Above all else, the Communist Party is concerned with maintaining its grip on power and mass unemployment would seriously threaten that ambition. If unemployment is truly as high as this article reports, and I have seen no evidence of this in my trips to China, then we can expect the Chinese government to deploy its massive reserves into growth schemes aimed at creating further employment.

Arguably they have already embarked on this path, having elected Hu Jintao to the post of President, considering his powerbase in the rural interior. The concentration of the current 5-year plan is to focus on developing the interior and narrowing the income gap between urban and rural dwellers. It remains in the interests of the government that China continue to grow aggressively and while inflation remains a concern, as does overheating, growth is likely to remain the top priority.

The [Shanghai A-Shares Index](#) remains in a corrective phase following the fall from the highs near 6500. It found support near 4500 recently and would need to sustain a move below that level to question potential for some further higher to lateral ranging.

Last week's signups for the Free (Abbreviated) Comment of the Day - For the week of February 10th new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, China, Denmark, South Africa, the UK and the USA - 6 in total. In descending order, which topped the list in terms of the last week's new signups? It was the UK, the USA and Australia.

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.

## **Tuesday 19th February 2008**

The riskier the trades, the more the brain craves them, scientists say - This is a very good [article](#) by Jenny Anderson for the International Herald Tribune. Here is a brief sample:

The findings, while preliminary, suggest, perhaps unsurprisingly, that traders who let their emotions get the best of them tend to fare poorly in the markets. But traders who rely on logic alone do not do that well either. The most successful ones use their emotions to their advantage without letting the

feelings overwhelm them.

"The best traders are the ones who have controlled emotional responses," Lo said. "Professional athletes have the same reaction - they use emotion to psych them up, but they don't let those emotions take them over."

Or, as Warren Buffett once put it, "Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing."

My view - I suggest that the most successful traders use their intuition, understanding of psychology and price charts to anticipate what the crowd is going to do next.

Every trader and most investors will identify with aspects of this article. These behavioural themes and how we deal with them are what The Chart Seminar, Fullermoney's two-day [workshop](#) on Behavioural Technical Analysis is all about.

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

"I am a subscriber and I appreciate the spirit of sharing and collaboration in your community.

"As a small contribution, here is a recent [presentation](#) I have attended at Delhi about Indian economy, some interesting take-aways."

My comment - Thanks for your comments and also for contributing in the spirit of Empowerment Through Knowledge. The Ernst & Young presentation is very informative and will be of interest to many readers. The projections for infrastructure spending on airports, roads, railroads, ports, telecommunications and utilities are breathtaking.

Mike Lenhoff: Improving tone for the UK equity market! - [My thanks to Tony Smith of Brewin Dolphin for his colleague's latest update](#), with which I concur.

Email of the day (2) - [On lawsuits against the banks](#):

"Re. lawsuits against the banks, per today's e-mail, I think the FT had an article on this on Friday 15th. In outline, the big law firms aren't taking on the business, due to not wanting to bite the hand that feeds. As a result, new law houses are popping up to do this work. Hope this helps."

My comment - [It does, thanks, but where will the new law firms bank?](#)

My personal portfolio: Longs opened in H-Shares Index; short opened in JGBs; long opened in natural gas; bund short stopped out - [For the benefit of](#)

new subscribers I should mention that I do not add cash to my equity portfolio, except on a drip-feed basis, as it is mainly in SIPPs (self-invested personal pensions), plus ISAs (a UK tax-efficient saving scheme), and a small contributory pension scheme linked to my salary at Stockcube. Fullermoney is a division of Stockcube.

These investments represent my personal long-term equity portfolio. I seldom change the constituents because they are invested in Fullermoney secular themes - Asian emerging markets, resources and gold - many of which I have held since at least 2003 and will probably hold for many more years. In other words, I take a Warren Buffet approach with my long-term equity investments.

With hindsight, I would have been better off if I had temporarily liquidated most of these positions last October or perhaps in December. I had mentioned to subscribers on a number of occasions that I hoped to be largely out of the market if a bear market of consequence beckoned. By my definition this would be a major decline similar to what we saw during 2000-2002. It would not be the 20 to 30 percent corrections which I regard as commonplace for most high-performing investments. Rather than fear those periodic shakeouts, I have regarded them as buying opportunities in favoured themes.

Clearly, many of the declines that we have seen since last July have been deeper and / or persisted longer than what I would expect during a typical medium-term correction, although none as far as I am aware are anything like the scale of what we saw during the 2000-2002 bear market. However a majority of pundits expect that this comparatively shallow bear market, where it has occurred, will persist due to the severity of the western banking crisis and US economic slowdown.

They could be right and any of us can script more of the financial write-downs that have so traumatised investors since last August. However I remain content to give last month's selling climax the benefit of the doubt provided the January lows continue to hold. Technical conditions have improved somewhat, not least for the resources sector. Valuations are attractive for many markets. A number of multinational companies continue to prosper. I maintain there is little risk of widespread recession, unlike in 2001-2002. Barclays' dividend hike today suggests that at least a partial reappraisal of the financial sector is warranted.

Consequently, I will be holding my personal long-term portfolio, for better or worse, undisturbed until I have a timely restructuring opportunity from a position of irresistible strength. However if the bears are right, and I suspect they are not, then by the time we know I will have left it too late to sell. Also, I remain confident that these investments are in secular bull markets. Therefore downdraughts should remain temporary.

Here are my top-10 personal holdings, in order of weighting: 1) JP Morgan [Indian](#) Investment Trust, 2) Atlantis [China](#) Fortune Fund, 3) Aberdeen New [Thai](#) Investment Trust, 4) [Rio](#) Tinto, 5) [BHP](#) Billiton, 6) Merrill Lynch [Gold](#) and General Fund, 7) [Lihir](#) Gold, 8) Merrill Lynch World [Mining](#) Trust, 9) Aberdeen

[New Dawn](#) Investment Trust, 10) [DRD](#) Gold (Cameco has slipped to 11th position as DRD has rallied).

The portfolio is notably short on income. However I have a not insignificant cash position, currently invested mostly in [New Zealand](#) dollars, where it has yielded between 8.2% and 7.84% to date. This is my "just in case" reserve. For instance, in the event of a big bear market I would probably invest it in equities.

Meanwhile, I continue to use my spread-bet trading accounts to run long positions in commodities, occasionally hedge my equity portfolio, short bonds and buy bombed out equities or indices. Early this morning, I added to my stock market futures longs. I bought the Hong Kong listed China [H-shares](#), paying 13879 and 13860 for February positions. However I don't like its Asian-only trading hours, and may concentrate more on the Hang Seng Index where I also have long positions.

I also opened an initial short position in JGBs ([monthly](#), [weekly](#) & [daily](#)) early this morning, paying 137.26 for a March position. This afternoon I opened a long in Natural gas ([weekly](#) & [daily](#)), paying \$8.969 for an April position. Lastly, and over cautiously, I placed a tight stop on my [Bund](#) short today, this was triggered on a temporary rally and the position was purchased at 116.25 for the March contract, against my sale at 116.28 on 24th January. My main fixed interest short position is in US 30-year T-Bonds.

Prices above include spread-bet dealing costs.

Email of the day (3) - On Japanese stocks that were outperforming their market:

"Several months ago you published a list of about 200 Japanese stocks that were outperforming other parts of their market. Do you happen to remember that group and more would there be a fund or etf that reflects much of that group? Many thanks for all your efforts."

My comment - The Search facility will locate these [items](#) and I found it using 'Jackson Wong', as he had produced it. In a matter of days you will be able to conduct your own search using the Chart Library's about-to-be-launched customisable filtering facility. Also, I suggest that a click through the Nikkei 225 constituents, shown on the weekly chart setting, will prove illuminating. Look for stocks currently showing relative strength.

Email of the day (4) - On my portfolio:

"I am a new subscriber, please where on the website do I find your "portfolio"?"

My comment - [Welcome to Fullermoney](#).

You can Search using 'portfolio', or 'personal' for all my investments and trades, of which there are inevitably many more of the latter as I do not change my personal investment portfolio very often. You will also find it under 'top-10', and by coincidence, I have listed my top-10 by weighting positions in the Subscriber's Area of today's Comment.

Today's interesting charts - If it moves, it is probably already in the Subscriber's Chart Library. If not, we will add for you.

Nickel - You may have seen what [copper](#) has done recently. Whose next? Watch the laggards and the inventories. For instance, nickel is ranging in a probable support building phase. The green line on this [spread chart](#) shows LME inventories which have lost upside momentum. When they turn down, nickel's next big upside move should be underway.

Platinum - Likely exhaustion gap today in [accelerated](#) trend, although there can be more than one of these; watch for a downward dynamic, possibly a key day reversal, to signal the onset of the next corrective phase.

Silver - Upward [dynamic](#) within step sequence trend; would require a close beneath \$17 to question current scope for higher levels.

US 30-year T-bond - Note buying [climax](#) on 22nd November. This contract is currently extending decline beneath small top and would require a close above 117.15 to check short-term downward momentum beyond a brief pause.

Additional Commentary by Eoin Treacy

Goldman Sachs JBWere, Copper: Searching For Supply - Thanks to a subscriber for this section of an interesting [report](#) by Malcolm Southwood and Paul Gray on the outlook for copper. Here is a section:

Copper remains our preferred base metal from the perspective of investment exposure.

On the demand side, copper is sensitive to the same forces as the other major base metals; the prospect of slower demand growth or even shrinkage in the major OECD countries, offset by the likelihood of continuing strong consumption growth in emerging markets.

Where copper differentiates itself is on the supply-side, where we see ongoing production difficulties at many existing mines, and an extremely challenging environment for developing new mine capacity.

In 2007, we estimate that the global copper market recorded a fifth successive year of deficit. True, the shortfall narrowed to just 57,000 tonnes, but the cumulative effect of five years' shortfall on industry stocks has been profound.

In the absence of significant inventory on which to draw, and given the supply-side difficulties, we believe that copper is being priced according to what the marginal consumer has to pay to stay in business, rather than in relation to the marginal cost of production.

In 2007, the LME cash copper price averaged 323c/lb, having dropped as low as 237c/lb in early February-07 on fears of weaker Chinese demand. A strong rebound in Chinese imports of copper drove the price to a peak of 373c/lb in mid-May, before softer Chinese imports and a weakening OECD macro-economic outlook took a toll in 2H, with LME stocks doubling to 197,000 tonnes at year-end, and the price flirting with sub-300c/lb levels in volatile trading during November and December (Chart 1).

LME stocks have fallen sharply in early 2008, mainly on fresh Chinese buying, and cash copper has traded back up to the 350c/lb level. We believe that the copper market will remain very tight through 2008 and beyond, and we remain very comfortable with our existing prices forecast profile. Chart 2 puts copper's recent price behaviour into a longer term historical context. In real terms, today's copper price is comparable with the 1950s, 60s and early 70s trading range.

My view - Copper ([p&f](#), [monthly](#), [weekly](#), [daily](#)) rallied from depressed levels in 2003 and broke upwards from its long-term base in 2004. The ensuing acceleration resulted in copper setting new all time highs and a degree of euphoria overtook the market. Following 9 successive weeks on the upside the first downward dynamic was a signal that copper was about to enter a medium-term correction, which has turned out to be quite lengthy.

However since then sentiment has reversed and has turned bearish in spite of the fact that copper remains at historically quite high levels, at least in nominal terms, and once it found support near \$5000, more than a year ago, has not retested that level. For the last year, copper has been in a relatively consistent range between \$7000 and \$8200. The failed break below \$7000 has resulted in a rally which is now retesting the highs, which follows a rule of thumb from TCS. It is no surprise that we are now starting to see bullish reports, as the potential for an upward break is appreciated and investors are attracted once more to copper. However from a technical perspective and considering its history, copper needs to sustain a move above \$8,500 to reaffirm its overall secular uptrend.

Patersons Resource Review February 2008 - Thanks to a subscriber for this [heavyweight 93-page report](#) focusing on the Australian mining sector. Here is a section:

The mid-cap resources market recovered from the August 07 crash only to see similar levels again in the past few weeks. Gold outperformed with the backdrop of global uncertainty, spot iron ore prices have recommenced their run, ahead of upcoming benchmark price agreement, nickel and copper have stabilized around US\$13/lb and US\$3/lb respectively, while the weaker zinc

price has weighed heavily on zinc stocks. The past weeks have seen the resources sector caught in the downdraft of the broader market sell off.

Looking forward we continue to see margins come under pressure, increasing capital costs for development projects and stretched timelines for construction projects. With the back drop of the largest mining corporate offer in history (BHP 3.4 for 1 bid for Rio), we see asset acquisitions and divestments as the theme for CY08. This expected shuffling of assets will have winners and losers and our preference is to stay with the high quality, high margin and high grade operations.

The extent to which the collapse of the US subprime market and sustained fears of a credit crunch impacts demand from China and therefore the earnings of Australian-listed miners remains to be seen. However we are firmly in the bullish camp and in agreement with BHP Billiton's recent commentary on the intensity of raw material demand stemming from Asian GDP growth.

With market jitters and credit becoming more expensive we are particularly alert to the gearing levels and debt distribution of miners. Companies yet to secure funding (particularly for low margin operations) will have trouble finding funding going forward. Patersons' commodity price outlook favours iron ore and inline with this increased demand we expect base metals (nickel and zinc) to follow with their uses being tied to steel output. With the recent market uncertainty we are also bullish gold due to its safe haven status.

My view - [Australia](#) is one of only a handful of developed countries, offering a politically stable environment, with respect for minority shareholder rights as well as excellent reserves in the ground. This is why we continue to consider Australian companies, with world class reserves in the ground, as collectors items from an investment perspective. The [ASX 300 Resources index](#), made up of 78 companies, accelerated to its high near 6500 in November following an impressive rally from the August lows near 4750. The subsequent retracement briefly retested those lows and the Index has again rallied impressively. In the short-term, a move below 5500 would be needed to hinder upside potential, while a sustained move below 4750 would be needed to question the integrity of the overall uptrend.

In line with the bullish environment, healthy state of the Australian economy and rising interest rate environment, government bond [yields](#) are rising and the yield would need to sustain a move below 5.75% to question scope for additional upside. Looking at the [price](#) charts, the 10yr has been in a developing top formation for much of the last decade and is now breaking down. A sustained move back above 94 would be needed to question scope for further weakness.

The [Australian Dollar](#) has been basing against the greenback for much of the last 20 years and broke upwards late last year. It continues to consolidate that gain but would need to sustain a move below [0.85¢](#) to question scope for a test of parity and potentially even further strength in the coming years.

Citi Commodity Heap: A Ferro-Chrome Crunch - [Thanks to a subscriber for this interesting chartbook by Alan Heap](#) which focuses on the impact on a number of resources of power outages in South Africa and China. Here is section:

No Power & No Chrome - Several South African ferro-chrome producers (accounting for 35% of supply) have declared force majeure on deliveries due to Eskom's power supply issues.

Demand Healthy - Stainless Steel production accounts for the majority of ferrochrome demand and we expect moderate, albeit slowing demand growth in stainless steel.

A Stainless Shift The Driver - Chrome is used in both austenitic (~18% Cr) and ferritic grades (~10-27% Cr). High nickel prices have driven a consumer shift to more cost effective nickel free ferritic grades of stainless. We are not seeing any swing back to high nickel grades stainless despite prices correcting. At present chrome only accounts for 8-9% of stainless steel production costs (compared to nickel at ~50%).

China Swings To Net Importer - Increased export duties on ferro alloys in 2006 and 2007 and other industry controls resulted in China becoming a net importer of ferro-chrome in 2H07. Additionally major ferro-alloy producing areas in China have also been impacted by heavy snow falls hindering raw material supply and power supply issues causing production shutdowns.

Cost & Power Pressures Continue - Major chrome producing regions (South Africa, China and Kazakhstan) are facing cost pressures endemic in global mining. South African power costs would increase and power supply shortfalls could persist until 2013 potentially impacting current production and limiting expansion plans. Further South African producers also face a headwind of depreciating USD.

My view - [Ferro-Chrome](#) broke upwards from its base in early 2007 and remains in an overall uptrend. A move below 1 would be needed to question scope for further upside. This [article](#) from The Times of South Africa by Sherilee Bridge may also be of interest to subscribers interested in ferro-chrome.

Bank of China Shares Jump After Subprime Report - [This article by Chia-Peck Wong for Bloomberg](#) covers how the Bank of China has dealt with its subprime liability. Here is the story in full:

Bank of China Ltd. rose the most in almost a month in Hong Kong trading after Reuters reported the lender has set aside enough money to cover its investments in securities tied to U.S. subprime mortgages.

Bank of China jumped 7.5 percent to HK\$3.29 at 11:19 a.m. local time. The company expects "marked" profit growth for this year and is considering

buying an insurance company, Reuters also said late yesterday, citing Chairman Xiao Gang. Spokesman Wang Zhaowen confirmed Xiao's comments.

The bank may have to write down the value of overseas securities by 35 billion yuan (\$4.9 billion), analysts at BNP Paribas SA have estimated. That would amount to three-quarters of profit in the nine months to Sept. 30, 2007.

Bank of China has fallen 33 percent in Hong Kong since Oct. 30, when it reported profit growth that trailed competitors because of losses on its \$7.95 billion of subprime-related investments.

My view - Chinese banks along with their compatriots in the Western world have had to pay for their dalliance with the subprime mess. However the fact remains that Bank of China and other Chinese banks are based in an economy which is leading the world in terms of GDP growth and while this crisis may have a temporary effect on their balance sheet the longer-term effects are likely to be minimal.

Mrs. Treacy and I continue to hold [Bank of China](#), [ICBC](#) and [Communications Bank](#) in our long-term investment portfolio. All of these banks have corrected from the highs posted last year, but they have all recently found support, and would need to sustain moves below their February lows to question recovery potential.

### **Wednesday 20th February 2008**

Energy Watch: Supply issues trump cyclical demand weakness - [My thanks to a subscriber for this informative report](#) by Jeffrey Currie and colleagues at Goldman Sachs. Here is the opening:

Oil decouples from equities market, closing above \$100/bbl

After trading in near lock-step with the equity markets, oil prices have decoupled and moved sharply higher over the past week as economic growth concerns have been trumped by long-term structural supply issues that recent news flow has highlighted. Oil now joins metals and agriculture in structurally driven price rallies. While most commodity prices are at or above all-time highs, forward timespreads, the cyclical component of prices, are much weaker than when last at these levels, which is consistent with the economic concerns. However, this weakness in spreads has been more than offset by stronger long-dated prices, the structural component of prices, which has generated record prices despite demand concerns.

Window of opportunity for a cyclical price pull-back is closing

While the recent short-covering and increased speculative buying raises the potential for another near-term liquidation off renewed concerns over the economy, it is important to emphasize that this window of opportunity for a cyclically driven pull-back in crude oil prices is closing quickly. Looking toward the second half of this year, the balance of risks begins to shift to the upside

both cyclically and structurally, and we continue to expect oil prices to trade above \$105/bbl in 2H08.

My view - In theory, oil producers could swamp the market with additional supplies, forcing a significant correction in the price of crude. But why would they want to do that? They want to get the best price for their product, just like any other supplier, without killing the market. If that price is in soft US dollars, they have an additional incentive to safeguard their return.

Over the longer term, suppliers of nearly all commodities will struggle to meet rising demand. This situation is summarised in one of Fullermoney's main investment themes of the last six years: Supply Inelasticity Meets Rising Demand.

Email of the day (1) - [On spread-betting info, China funds, trading and TCS:](#)

"First of all thanks again for your valuable comments.

"As a "newbie" I have a couple of questions as well as a "top tip", well I consider it a "top tip".

"OK, the "top tip" first. Being new to moving from a UK equity based investment attitude to a more global outlook, e.g. commodities, bonds, indices, etc. I had great trouble finding the opening times of all these new markets. But by simply clicking on the information button next to the instrument whilst logged into my ig index account I get all the information I need. OK, may seem like a small "top tip" to some but for me it was invaluable when I found it.

"Now, question time, sorry if they are quite long.

The Atlantis China Fortune Fund, I know is a favourite of yours. Following the recent commentary and related news I am becoming interested in possible exposure to China. Having investigated this fund it seems it is one not isa-able and two, requires a minimum 100,000 USD investment. As a UK subscriber and a not massively wealthy one this investment falls out of one, my investment limit and two, my isa-able investment pool. Can you suggest any other instruments that you are keen on or keep an eye that you would personally consider if you were in my situation? Obviously if this is just a case of an appropriate ETF that would be completely understandable. Thanks in advance.

"There is another question I have. It is in relation to your Chart seminar. I am keen to attend to extend my knowledge and add to my already quite basic long trend following entry/exit strategy. However, I follow with interest the "scalping", what I would call more trading orientated positions you seem to take now and again, e.g. most recently Silver, HSI. Can I ask, does the seminar go into in any way introducing one to this side of things as it seems quite often you get into some nice moves. Whilst I appreciate that trading in

this way is a long-term education it is still of great interest to me that it is covered during the Chart seminar.

"By the way, it would be good to see more information on the website in relation to the Chart seminar.

"Thanks once again for a superb service, I look forward to your responses."

My comment - Welcome to Fullermoney and thanks for your kind words.

Thanks also for the informative access pointer with IG Index accounts. One is not born knowing these things and it can take time to discover them.

The Atlantis China Fortune Fund has been in my personal long-term investment account for several years. I believe the minimum is US\$10,000. Technically, it is ISA eligible but here is the dirty little secret regarding fund listings, with many online discount ISA brokers and banks. They negotiate for kickbacks, such as a proportion of annual charges and / or performance fees charged by fund managers. If the managers say no, as is the case with Atlantis, their funds may not be listed. You might try Tony Smith [(0)20 7246 1024] of Brewin Dolphin Securities, which is not a discount broker.

The Chart Library lists many funds as you probably know - have a look at the dropdown menu, under "Asia & Asia Pacific - Funds, ITs and ETFs". Many of these are request listings from subscribers and generally conform to our preferred criteria of at least performing in line with their benchmark. With funds, we always advise subscribers to conduct their own due diligence, not least in terms of costs. My own view is that ETFs are hard to beat, but they are not always available for the investment coverage one seeks. Also, I regard the choice of vehicle as secondary to the selection and timing of the investment theme.

The Chart Seminar is a workshop, covering specific aspects of Behavioural Technical Analysis that I adapted and developed from 1970 onwards. Aspects of both trading and investing feature, and are tailored in line with the interests of each group of delegates, in terms of market examples. The interests of most delegates are diverse, as you would expect from subscribers to a global strategy service. The [brochure](#) provides further information. There are only a few places left at the May TCS and the early booking rate expires on 31st March.

Email of the day (2) - On my tongue-in-cheek question: ...where will the new law firms bank?

*Re. lawsuits against the banks, per today's e-mail, I think the FT had an article on this on Friday 15th. In outline, the big law firms aren't taking on the business, due to not wanting to bite the hand that feeds. As a result, new law houses are popping up to do this work. Hope this helps."*

My comment - *It does, thanks, but where will the new law firms bank?*

"A: At maybe the Northern Rock, 'government guaranteed' trust accounts' My apologies for cynicism but still can't believe that the Exchequer is that silly to go back into the 'dark ages'. Keith Joseph must be rolling in his grave!"

My comment - [Nice one!](#)

My personal portfolio: In-the-money stops triggered in NKY and HSI; NKY repurchased lower - [This is annoying as I left too much money on the table, optimistically hoping that we would not have another sharp reaction from those levels. However that often happens in ranges, as the battle between supply and demand continues. For the \[Nikkei\]\(#\), my March longs were stopped out at 13635 and 13550 this morning, against purchases at 13625 and 13450 on 31st January and 5th February, respectively. I repurchased these two equal-sized positions at 13435 and 13455 late this afternoon. With the \[Hang Seng\]\(#\), my February longs were stopped out at 23536 this morning against purchases at 23000 and 23439 on 11th and 15th February, respectively. I may have missed my opportunity to buy back lower, but I still have the H-Shares Index longs, although I rashly paid up for them yesterday. Prices above include all spread-bet dealing costs.](#)

Email of the day (3) - [On NZD interest rates:](#)

"For your information most banks in New Zealand offer call rates with interest paid monthly in excess of 8.0%p.a. Rabobank 8.25% and our own AA S&P Rated call a/c 8.0% plus depending on amount invested.

My comment - [Many thanks for this information, which I have already forwarded to RBS, telling them that I expect my rate on NZD to be back above 8% next month.](#)

Additional Commentary by Eoin Treacy

MF Global Metals Report - [Thanks to a subscriber for this interesting report concentrating on industrial metals. Here is a section on lead:](#)

Global lead mine output in 2007 was 4.1% higher than in 2006. The largest rise in absolute terms was in China where production increased by a further 9.2% to 1.45 million tonnes. European output benefited from increases in Macedonia, Russia and Sweden. Production was also higher in Bolivia, Peru and India. The main reductions were in Australia, primarily as a consequence of the suspension of output at Ivernias Magellan mine in March 2007, and Iran, due to the collapse at the Angouran mine in October 2006.

An increase in world production of refined lead metal of 2.5% was mainly driven by rises in China, India, Kazakhstan, the Republic of Korea and a

number of European countries, most notably Belgium, Bulgaria, Italy, Poland and Spain.

Despite falls in Europe (-2.9%), Japan (-7.6%) and the United States (-3.4%), overall global demand for refined lead metal grew by 2%, mainly influenced by a further rise in Chinese usage of 17.4%.

Chinese net exports of refined lead metal amounted to 214kt compared to 501kt in 2006. Net imports of lead contained in lead concentrates totalled 697kt compared to 661kt in 2006.

Inventories of lead held in LME warehouses at the end of December 2007 were 4kt higher than at end of 2006. Stocks reported by producers were 13kt lower.

Cash Settlement and Forward Three Month Prices on the LME averaged US\$2600 and US\$2571 respectively during 2007, 102% and 101% higher than during 2006. The highest Cash Settlement Price of US\$3975 was recorded on 10 October and the lowest of US\$1575 on 17 January.

My view - [Lead](#) broke upwards from its long-term base in 2004 and early 2005. It ranged above the base for most of 2006 and rallied significantly in 2007 to reach an accelerated high above \$3500. When an instrument accelerates in a Type-1 ending, it will either come straight back down in a reversionary move, or if it comes down more slowly than it rose, it will often find support and rally back towards the high, and possibly even exceed it for a short while, in a period of right-hand top formation extension. When an instrument accelerates spectacularly, (as lead did), finds support, and pushes to a new high, we are tempted to believe that it is reasserting its uptrend, but in fact the risks have increased considerably because it has lost its consistency.

Lead needed to sustain the break to maintain the bullish outlook and when it didn't, sentiment turned against it quite quickly. This type of trading behaviour happens too often to ignore. As a rule of thumb, acceleration is an ending signal of undetermined duration and can be a penultimate ending, where demand is exhausted at levels marginally above the fever pitch of the acceleration. To reassert the uptrend, a new upward break has to be sustained.

Lead has since found support near \$2500 and is rallying once more. A sustained move below that level would be needed to question scope for some further upside.

Globe and Mail: Forging hits bottlenecks getting coal to markets - [Thanks to a subscriber for this interesting article highlighting infrastructure constraints in the mining industry. Here is a section:](#)

However, "substantial" shipments in the April-June quarter and on into the third quarter will be at 2007 prices because of overhangs arising from railway

delays, he said.

Since Fording may not be poised to benefit from the higher coal prices for a while, Desjardins Securities analyst John Hughes gave Fording a "hold" rating and set a unit price target of \$36.10.

"Although we anticipate 2008 coal year contracts to be settled at \$140 [U.S.] per tonne or above, management expects this potential positive impact to be delayed until (the third quarter of 2008)," Mr. Hughes wrote, adding that his firm had been anticipating the positive effects of higher coal prices to be felt in the middle of the second quarter.

On the conference call, Mr. Bell noted that Elk Valley Coal, operated and 40 per cent owned by Teck Cominco Ltd., has asked a federal policy review panel to scrutinize the railway sector.

"We believe that our captivity to a single railway at each of our mines, and the monopoly pricing practices that result, create a significant barrier to our long-term success serving the global steel industry," he said.

Elk Valley's five mines in southeastern British Columbia are served by Canadian Pacific Railway Ltd., while Canadian National Railway Co. moves production from the partnership's southwest Alberta operations. The railways have provided "much higher throughputs" in the past than they did in 2007, Mr. Bell said. "The inherent capacity is there in the system. It's just a matter of finding ways to unlock it."

Elk Valley also faces higher West Coast port charges - already amounting to \$1 a tonne - as ships await loading.

My view - Globally, infrastructure bottlenecks are limiting the ability of companies to get their product to market. Because this area was neglected for so long it will take years to build new ports and railways to handle the increased traffic of today's activity without even considering the significantly larger production we can expect to come on line in the coming years. Right now, these bottlenecks are helping to support prices and show no sign of easing in the short-term.

Coal remains in an accelerating uptrend having found support near \$40 a year ago. The first clear downward week is likely to signal the onset of the next medium-term correction.

Palm Oil in Malaysia Rises to Record on China, Biofuels Demand - [This article](#) by Thomas Kutty Abraham and William Bi for Bloomberg covers the continued high demand for palm oil. Here is a section:

Palm oil futures in Malaysia, the global benchmark, rose to a record on increased demand from China for vegetable oils and as higher crude oil prices boosted the appeal of biofuels.

Shipments of palm oil from Malaysia to China, the world's biggest buyer of vegetable oils, jumped in the first 20 days of this month from a month ago, an independent cargo surveyor said today. Crude oil prices reached a record \$100.10 a barrel in New York yesterday, raising prospects for alternative fuel demand.

“Palm oil has been driving higher because of the increasing demand for vegetable oils, particularly from China,” Chaw Sook Ting, an analyst at SJ Securities Sdn Bhd. in Kuala Lumpur, said by phone. “Record crude oil prices provide further strength to palm because of its biofuel role.”

Palm oil for May delivery climbed as much as 32 ringgit, or 0.9 percent, to 3,657 ringgit (\$1,135) a metric ton on the Malaysia Derivatives Exchange in Kuala Lumpur. It ended the morning trading session at 3,650 ringgit, taking gains this week alone to almost 5 percent.

Soybean oil for May delivery on the Dalian Commodity Exchange jumped as much as 190 yuan, or 1.5 percent, to 12,596 yuan (\$1,762) a ton today, the highest since the contract started trading in January 2006. It stood at 12,476 yuan at the break. Palm oil for May delivery jumped as much as 1.6 percent to finish the morning session at 10,870 yuan on the Dalian exchange.

Rapeseed oil for May delivery, traded on the smaller Zhengzhou Commodity Exchange, rose as much as 1.2 percent to 13,038 yuan.

My view - [Palm Oil](#) began to rally from quite depressed levels in 2006 and quickly reached a short-term high near MYR3000 before consolidating the move. It broke upwards once more late last year and is now looking somewhat overextended. The last major consolidation had an amplitude of MYR500, which represents a 'normal' reaction within the trend and the next ranging pause would need to be larger to question the integrity of the overall move.

Email of the day - [on an addition to the Chart Library](#):

"I would be very much obliged if you can list the following fund in your Chart Library. Please let me know which section you have posted it. The fund is domiciled in Luxembourg.

["Oakmark Global Value Fund](#). The Bloomberg ticker is CDCOGVR LX Equity and ISIN number LU0 130 103 400."

My comment - [Thank you for this interesting suggestion which has been added to the Global funds, ITs and ETFs section of the Chart Library. It has a front end load of 4% and management fee of 1.3%. Regardless of what section it appears in the Chart Library you will always be able to find it via the Chart Library's dedicated search engine.](#)

**Thursday 21st February 2008**

On Behalf Of All Indians - [My thanks to a subscriber for this superb, thoughtful article](#) by Arun Maira for the Times Of India Hyderabad. Here is the opening:

The wheat fields look the same on both sides of the border as they have for centuries. However, the contrast between the two nations the border separated 60 years ago has become starker. As the time approaches for the lowering of flags at Wagah, dozens of Indian women from many parts of the country who have come to watch the show spontaneously begin to dance the bhangra. On the other side, a lone old man steps out and waves a big green flag and the crowd responds with Allah Hu Akbar. The same fields, and the same people, we are often reminded. Yet how differently the two nations have developed.

I accompanied 50 students from the Harvard Business School to a village in Haryana, a few days before my visit to Wagah. They had met Indian business leaders in Mumbai and Delhi. Now they wanted to see what life was like in India's villages. The village they visited is inhabited by poor tribals who converted to Islam centuries ago. On the way, our guide cautioned that though the women are not in purdah, it would be unwise for the male students to engage them in any conversation. The students wanted to know if they would be permitted to take pictures. When we arrived, a student asked a resident if he could take pictures. "Why not", the villager replied. "It is a free country!"

It has become customary to describe the years before 1991 as India's dark ages. India, some say, was unbound in 1991 when economic liberalisation was accelerated. Watching the Indian women dancing freely at Wagah, one is reminded that India was unbound at its birth. Our Constitution gave the right to all adults, regardless of race, religion, sex or income to vote. It was a very bold step. Blacks in America got their rights later, and women in India got the right to vote even before women in some Western European countries did.

Winston Churchill said that India would not survive even a few years: it would fall apart. Therefore, we must give thanks to those who brought us safely from independence to 1991 and built our foundations. Now Indian corporations are making a mark on the international business scene. First, it was our IT companies. Then our auto parts' producers and pharma companies. When Ratan Tata unveiled the Nano in January this year, the nation burst with pride. But where did the engineers and technicians who have enabled these companies to succeed come from? And how did these companies develop deep 'domain' knowledge in their fields? The institutions of technology and management that all these firms have drawn upon for their people were built during those so-called dark years. And the policies compelling industry to be self-sufficient in those years forced Indian firms to develop deep capabilities.

Now even Jyoti Basu admits that private capital is required for development and the Marxist model may have to change. However, Marxists not having understood India does not mean capitalists have. According to the right-wing American think tank, the Heritage Foundation, economic freedom is the real key to development and reduction of poverty. According to its ratings, Pakistan's economy has always been freer than India's and continues to be so

even after India's market reforms since the 1990s. Then how can it explain why Pakistan is worse off than India now? (Or that China, who it rates even lower than India in economic freedoms, has reduced poverty even faster?)

My view - India - so much talent...so much wisdom and energy...and the journey to restore its economic prowess of former centuries has only just begun.

Arun Maira's article also has some relevant observations regarding the Democrat Party in the USA.

Email of the day (1) - On credit market conditions:

"What do you think of credit market conditions and its possible impact on equities into early Q2? Many people now say that worst is behind as banks aggressively (especially US) wrote down subprime exposure. Think this is true, but some people do not pay attention to where credit trades in secondary market now. Most of the spread widening occurred this year rather than fall 2007. For example Commercial Mortgage Backed Securities at least doubled this year - CMBS AAA 10 year trades at 340 (+190 YTD), while BBB at 1300 (+500), iTraxx Xover at 577 (+240 YTD), banks everywhere struggle to issue bonds and pretty much corporate credit is trading heavy in any market. I imagine all leveraged loans are dead illiquid and sit on banks books. Which means if conditions do not change we will have further poor mark to market on these positions, which banks, hedge funds, dedicated money, other investors will have to write down in Q1. Some of them will probably lose more in comparison to what they have written off in subprime... Any thoughts?

"Thank you as ever for your great service."

My comment - Thanks for your kind words and informative insights.

Yes, the credit situation remains a problem, particularly regarding dodgy loans. If you take a long-term view, this is positive because an economy will not establish a platform for long-term prosperity on the basis of reckless lending. It is also why we expect a lengthy convalescence for the firms most affected.

We should assume the obvious - some weak borrowers, including under capitalised companies, overstretched hedge funds or individuals will fail, as may some lenders as we have already seen with Northern Rock, now nationalised by the Bank of England. However most financial institutions have either better business plans, stronger balance sheets and / or successful hedging policies. They are inconvenienced, to put it politely, but not fatally so given central bank liquidity infusions and SWF loans.

Additionally, while the credit difficulties were largely a made-in-America fiasco, albeit either exported to many countries or also copied by them, not least the UK, for many other countries this is merely a temporary problem rather than a crisis. As far as Fullermoney themes are concerned, I think we will look back

in two year's time and see that credit-related difficulties were not a major factor in terms of emerging Asia, resources and global infrastructure development.

Email of the day (2) - [On investing in offshore funds from Australia:](#)

"Re the posted email yesterday about investing into Atlantis Funds - I recently invested into the China and the Fortune funds from Australia via [www.investoffshoredirect.com](http://www.investoffshoredirect.com)

"Entry fee was 1%."

My comment - [Thanks for sharing this information in the spirit of Empowerment Through Knowledge.](#)

Email of the day (3) - [On US economic woes:](#)

"I'll tell ya what...I'm 36 and have worked in the hedge fund game for 10yrs. I quit last year to travel around and get closer to my roots. My friends in Florida are being hurt by the housing woes, 4 of my friends have recently gotten laid off in NY, and people out west (Utah, Colorado) are being hit by higher energy prices. While in Mexico my peers (and Spanish teachers) were all feeling the pinch. Rates might be headed lower. But, they are not going to help the people that need it most. FOOD prices are going thru the roof. OIL rallying 10% ain't helping matters either. The FED is really stuck imo. Lower rates makes more of the same...higher rates (markets are doing it anyway) will only increase the pain. Margins seem to be in big trouble.

"Seems like the trade is to be long necessity and short wants.

"I've got some thoughts going forward ....sorry if I start rambling...think RAILS. Seeing that China is going to be forced to raise rates along with curbing prices. Wages are going to have to rise. OIL is hurting margins on so many levels. Mexico...just visited and planning to go again...is one of the last bastions of cheap labor. Should OIL rise to 125...it would make sense to lay tracks running the length of the country. Tap the coasts and the cheap labor. Trains are cheaper than boats. Initial infrastructure is costly...but what else can be done? Think Marshall plan. Its a longer term theme...but its got legs.

"I'm actually going to visit Mexico to purchase a smallish hotel. Thinking about it anyway. Should the FED take the cutting rates route...a boomer with 1M in assets with a 5% yld will have 50k in disposable income...cut rates to 3% and disposable income drops 20k. How is that going to be made up? I'm going to cater to US, CAD, and EUR retirees. FX is allowing this to be very profitable in the long run. Demographics favor the thought. Borders are going to come down. Trade is going to open up but not until the blame game is over.

"I appreciate your thoughts."

My comment - Thanks for the fascinating but also sobering insights, and I strongly agree with your thoughts on railroads - also the Marshall plan, which I think will focus on infrastructure development and possibly even extend to State sponsored arts. During the Depression, my parents met in NYC while earning meagre salaries acting and also directing plays for a government sponsored theatre group. I don't think things will get that bad but perhaps you could run trading courses at your Mexican Hotel.

I also liked your point: "Seems like the trade is to be long necessity and short wants."

Email of the day (4) - On Iain Rushbrook's decision to cash up:

"You may recall towards the end of last year I sent an email entitled *Is this bearish or is this bearish?* detailing Iain Rushbrook's decision to move the £200m Personal Assets Trust (PNL.L) into 100% liquidity. Iain Rushbrook is one of the Money Makers featured in Jonathan Davis' book. I have met him and am a previous investor. He is seriously into wealth preservation. You didn't publish but gave a one liner response - Maybe he knows something which we don't.

"Well for your info I enclose his recent report, the day following which he moved back to 100% liquidity. PNL's NAV has been essentially maintained. His asset allocation is to say the least interesting!"

My comment - Thanks for [this](#).

Iain Rushbrook clearly knows what he is [doing](#), especially in terms of limiting downside risk. He obviously remains very cautious but of what he does own, the weighting of UK financials may suggest that he does not envisage too much additional downside.

My personal portfolio: US T-Bond short partially stopped out, and reinstated at a better level; silver long increased - One third of my 30-year [T-bond](#) short, and the least advantageously priced, was stopped out this afternoon, resulting in a purchase of the March position at 117.00 against my short sale at 117.12 on 15th February. I re-shorted the position at 117.37 shortly thereafter. Having raised stops, I leveraged up my [silver](#) longs, paying \$18.025 for another May position. The tighter stops are chancy but once in profit, I would rather risk profit than losses. These prices include spread-bet dealing costs.

Email of the day (5) - On China, Hong Kong and India:

"After many years avidly scanning your reports I still find them vital as a mental crutch, thank you from the bottom of my pockets.

"Your trading purchase of China H shares yesterday prompted me to ask for help. Having spent many years in Hong Kong I trust the governance of HK

stock markets more than mainland and as a result bought Baring Hong Kong and China Fund (open ended and quite heavily into H shares) several years ago in an offshore bond. After its strong performance over the year to October I sold due to vertigo set off by the charts (I held on to my Atlantis China Fortune fund as it appears to be more stable). I have looked for suitable ITs to replace it without success and so rebought Barings HK&C fund earlier this month having avoided 30% of the f\*\*\*. I sh\*\*\* be grateful if you can include this fund among FM charts and advise of any ITs covering similar markets.

"I'm also looking to add to my Indian IT when China, which seems to me to be leading India at present, shows firmer progress. Your comment from the charts regarding this perceived "lead" would also be appreciated."

My comment - Thanks for your kind words, drolly expressed.

As a veteran subscriber, you will certainly know that we can only deal with the reality that markets provide. Right now that reality is mainly in the form of a somewhat choppy battle between supply and demand, as often occurs near tops and bottoms. I see it as a time neither to be too aggressive nor to panic. In terms of the vision thing, if you hold unleveraged investments in promising long-term themes, it is sometimes best not to follow the day to day gyrations too closely.

Eoin will add the Barings HK & China Fund to the Library. My guess is that India may lead China on the next upside move, provided India does not experience a late catch up move on the downside. More relevantly, the charts will show us. Meanwhile, the important point is that both China and India have fantastic long-term potential.

Email of the day (6) - On global coverage:

"As a potential subscriber, I have a question for you if I may.

"It seems you cover many, many markets, and I rather wonder where one would begin. Do you have one section of your internet site where you basically convey all existing positions as well as new positions that you hold?"

My comment - Thank you for your interest in Fullermoney.

We live in a world of increasing economic and cultural globalisation. To tap this investment potential, Fullermoney has long been a global strategy service. We suggest that subscribers view the markets from the perspective of a judge at an international beauty contest. In other words, and assuming that you have the freedom to invest internationally, why concentrate exclusively in your local market, if there are better growth and income prospects elsewhere? A successful and growing business thinks internationally, so why not an investor?

You can access copy on the Fullermoney site by using the "Search" facility listed upper left. Single word searches are most effective and spelling must be

correct, as we are not Google. Access to copy posted within the last four months requires registration. Copy more than four months old is accessible by pre-subscribers, enabling them to evaluate the Fullermoney service at leisure, without any pressure or harassment. Pre-subscribers can also sign-up for our Free (Abbreviated) Comment of the Day and your email address will not be shared or used for any other purpose. Subscribers may wish to stay on this list as the arriving email also signals that the Subscriber's Area has been updated. Unusually for financial services, Eoin and I disclose our personal investment and trading decisions as they occur. These are easily found by the Fullermoney Search facility by typing "My personal" for my investment and trading details, or "Eoin's" for his.

Please note - I will be away tomorrow (Friday).

Quote of the day - During lunch with a veteran subscriber:

"Your service is grossly under priced. The Chart Library alone is worth more than the cost of a subscription."

My comment - I do not disagree but because Eoin and I value input from the Collective so much, we would rather have lots of subscribers at £460 per annum than perhaps only one-tenth as many, consisting of institutional investors and HNW individuals paying £4,600 per annum. Currently, Fullermoney subscribers range from SWFs, and other institutions to private investors.

Additional Commentary by Eoin Treacy

Citi Strategy Focus Asia ex Japan, Portfolios: Talking Recession but Walking Reflation - Thanks to a subscriber for this interesting [report](#) by Markus Rosgen and colleagues which argues for the possibility of another downward leg in equity markets. Here is a section:

Over the last four weeks, investors have certainly become more concerned about the state of the global economy. Complacency has to a very large degree abated, if not disappeared outright. We are now increasingly in the "concern" stage of the equity market. Once we have gone through the next and final stage - capitulation - markets will have bottomed and a good buying opportunity should present itself. Between now and then, patience is what is required and the winner is the one who loses least.

Talk without actions as the saying goes is cheap, and in this regard it is interesting to note that while the R word is now used freely, actions, or better put, portfolios, tell us that there remains a disconnect between the talk and the action part. Investors continue to speak with forked tongues. We have bearish talk on the real economy, but bullish/reflationist portfolios. This will prove the undoing of many an investor. As we highlighted in previous Asian

Investigators, for the time being it's all about cash flows and dividend yield. It may sound boring and go against the grain of "growth" investing, but buying growth into a slowdown has historically proven imprudent, to say the least.

Still long reflation and underweight cash flow or yield

Figure 1 comes out of Elaine Chu's Fun with Flows (Jan 25) and relates to the portfolio of investors as of year-end 07. Granted, over the course of the last four weeks much has changed, the region is off 7.4%, but are we really to believe that we have had a 180 degree swing in portfolios? From the conversations we have had, the answer is No. We draw the same conclusion looking at the flows from the program trading desk. At the margin, money has flowed towards banks and telecoms, but not sufficient to suggest a reversal of portfolio positions.

My view - This report is interesting to juxtapose with the Merrill Lynch Fund Manager Survey Global: When Cash is King report posted on [February 14th](#), because they are arguing from opposite positions. One holds that cash levels amongst fund managers are relatively low while the other argues that cash levels are relatively high. In this type of scenario where we are being bombarded by data which is sometimes contradictory, the one barometer we can rely on is the chart action.

The last important thing that happened in stock markets was the selling climax on January 22nd. Following that capitulation, only two markets I know of have made new lows; [Vietnam](#) and [Malta](#). The majority have so far sustained their rallies and are pressuring the upper side of their short-term trading ranges. A number have broken upwards; [Oman](#) and [Morocco](#) are making new highs with Indonesia testing its January highs. [Canada](#), [Brazil](#), [Chile](#), [Peru](#), [Denmark](#), [Russia](#), [Lithuania](#), [Norway](#), [Austria](#), [Turkey](#), [Indonesia](#), [South Korea](#), [Taiwan](#), [Sri Lanka](#), [South Africa](#), [Saudi Arabia](#) and [Jordan](#) have all rallied above their early February highs. In most cases, this posts a higher high following earlier higher lows forming the basis of an uptrend.

At the very least, if stock markets are going to embark on another wave of panicky selling, they would need to sustain moves below their recent lows and in the meantime we can continue to give the benefit of the doubt to the upside.

Macquarie Research Australian economics: Agriculture joins the global commodities price revolution - Thanks to a subscriber for this well argued [report](#) by Richard Gibbs and colleagues which concentrates on the future of Australian agriculture. Here is a section:

While the rate of population growth is slowing, per capita incomes are rising. In per capita terms, global economic growth has been vigorous in recent years. Developing economies have sustained strong GDP growth, particularly China and India, with respective average annual growth rates of 9 and 7%. This is expected to continue over the medium-term, with world growth forecast to average a buoyant 4%, despite a near-term slowdown in activity.

Developing economies are expected to keep up recent strength, with average yearly growth of around 7%. This is an important force on the demand side of agricultural commodity markets, as income growth readily translates into rising per capita food demand. People consume more, and more of certain foods, when they have more money. Typically, consumers trade up lower value foods, such as staple grains, for higher value foods as they become wealthier. This initially involves a transition from rice to an alternative staple grain, such as wheat. Consumption of meat, fish and dairy products, and other higher-value foods, namely fruit and vegetables and processed foods, also increases. Income growth in later stages of development is used for greater consumption of livestock products and processed foods, with demand for grains diminishing.

Notably, dietary change is most pronounced in the earlier stages of income growth. This is significant because emerging economies are expected to be the main drivers of global economic expansion going forward. Consequently, income and population growth will likely be concentrated in developing and emerging market economies over the next decade, shown below.

Africa, Asia and Latin America have recently achieved the largest gains in both, and this is expected to continue over the next ten years. Coming from a low income base, demand for livestock, secondary grains, such as wheat, and fruit, vegetables and processed foods can be expected to swell substantially, and sustain demand pressures over the medium term. Recent changes in Chinese consumption are evidence of this pattern. As shown below, demand for dairy products in China tripled between 1990 and 2005, and consumption of meat more than doubled. Similarly in India, consumption of oil crops near doubled, and also increased for meat, milk, fish, fruit and vegetables.

**My view** - A hungry person's first concern is getting enough food to eat, so when people move from subsistence living to having some additional disposable income, they improve their diet. Globalisation has succeeded in moving hundreds of millions out of subsistence living into a more secure standing. The demand for food for these people alone, without having to factor in the millions more joining them every year, is enough to fuel a secular bull in agriculture. When we also consider the added complications of weather related events and the growing demand for biofuels, we can quickly comprehend some of the reasons for the current buzz surrounding agriculture.

However, what has not changed is that these are volatile commodities which trade in comparatively small markets compared to other asset classes. This means that while the overall trend for many food stuffs is likely to follow a secular upward trajectory it will be punctuated by aggressive corrections which will provide good buying opportunities.

Email of the day (1) - [on a fund which tracks the ASX300 Resources Index:](#)

"Eoin's comments on the Pattersons Resource Review of 2008 was most helpful in illustrating the scope and likely attractiveness of the Australian mining industry. The ASX300 Resources Index, to which he refers, would

seem to be an ideal basis for an ETF or iShares. I was unable to find either in the chart library. Do you know if such an instrument exists?"

My comment - Thank you for this interesting email which prompted me to do a search. I found the [Storm Financial Australian Resources Index Fund](#) listed in Australia. It has a front end load of 6.6% and a management fee of 1.15%. The minimum investment is A\$5000. I'm afraid I was unable to find any funds which track the ASX300 resources Index listed outside Australia but would be happy to add them if subscribers can suggest any that are at least performing in line with their benchmark.

Email of the day (2) - on additions to the Chart Library:

"Would it be possible to add the Aberdeen Emerging Markets fund to the chart section? "

My comment - I have added the [Aberdeen Emerging Markets Fund](#) listed in the USA to the Chart Library.

## Friday 22nd February 2008

Commentary by Eoin Treacy

The New York Times: Arcane Market Is Next to Face Big Credit Test - Thanks to a subscriber for this informative [article](#) which contains two useful graphics and treats of the potential issues which may arise from risks in the credit default swap market. Here is a section:

To the uninitiated trying to understand this complex market, its size might initially seem a comfort, as if there were far more insurance covering the bonds than could ever be needed. But because each contract must be settled between buyer and seller if a default occurs, this imbalance can present a problem.

Typically, settling the agreements has required the delivery of defaulted bonds if the insurance buyer wants to be fully covered. If the insurance contracts exceed the bonds that are available for delivery, problems arise.

For example, when Delphi, the auto parts maker, filed for bankruptcy in October 2005, the credit default swaps on the company's debt exceeded the value of underlying bonds tenfold. Buyers of credit insurance scrambled to buy the bonds, driving up their price to around 70 cents on the dollar, a startlingly high value for defaulted debt.

Market participants worked out an auction system where settlements of Delphi contracts could be made even if the bonds could not be physically delivered. This arrangement was done at just over 36 cents on the dollar; so buyers of protection on Delphi who did not have the bonds received \$366.25 for every \$1,000 in coverage they had bought. Had they been valuing their Delphi insurance coverage at \$1,000 per bond, they would have had to write off that

position by \$633.75 per \$1,000 bond.

That is why the valuation of these contracts is of such concern to some participants.

As with other securities that trade privately and by appointment, assigning values to credit default swaps is highly subjective. So some on Wall Street wonder how much of the paper gains generated in these instruments by firms and hedge funds last year will turn out to be illusory when they try to cash them in.

My view - Credit default swaps were a useful innovation because they allow investors to hedge at least some of their exposure to default risk. However this remains a relatively new market and has not yet been tested to any great extent. Default rates have been unusually low for a number of years and are likely to rise in the coming years, as credits are repriced to reflect higher risk perceptions. CDS attached to CLOs could potentially be a test for this market but these risks could already be priced in.

However, what I think will be a more serious test, is if we see a default by a major debt issuer, such as GMAC; where a large portion of this type of insurance is concentrated. This would spark a rush to purchase such bonds and could result in a number of funds getting into difficulties. At present, we see no evidence that such a large company is getting into a default situation but, eventually this will become an issue and will probably be the trigger for a medium-term correction when it occurs. Given the state of global sentiment regarding the credit and equity markets there might be the perception that this type of event is just around the corner, but I do not believe this to be the case. The Fed's aggressive easing over the last month and further cuts to come should help to defer higher risks of defaults at least in the medium term.

Planetark.org: Energy Execs Debate Whether Oil Crisis Looms - Thanks to a subscriber for this interesting [article](#) by Michael Erman which contains a number of quotes from oil executives. Here is a section:

Ironically, StatoilHydro CEO Helge Lund said the shortage of industry spending is due in part to the high oil prices that have brought in that windfall to the companies.

Oil companies could be hesitant to spend money to pick up new exploration and production projects because they will have to pay for these assets based on an oil price that they believe is inflated.

"It is a question of whether you can make efficient investment decisions and be at the right cost level in the current environment," he said. Cambridge Energy Research Associates, the conference's host organization, believes that adequate oil supply should be available in the near term.

According to a study released last month, CERA estimates that the global decline rate of fields currently in production is 4.5 percent -- a lower number

than previously believed. The group says this means that the oil supply won't hit a peak and start to contract in the short term.

My comment - Oil executives have a particularly difficult challenge ahead of them because they face the threat to their balance sheets of not being able to replace reserves quickly enough. They are also hampered in their efforts by record prices for access to the increasingly small number of resources available to them.

As the tight global supply situation continues, and bearing in mind that it takes a number of years to develop any new reserves, the investment case for the Canadian oil sands continues to strengthen. Canada remains one of the only developed countries with reserves in the ground, where internationally significant companies can be assured of access rights and contracts will be respected.

Email of the day (1) - on further credit market challenges:

"What do you think of credit market conditions and its possible impact on equities into early Q2. Many people now say that worst is behind as banks aggressively (especially US) wrote down subprime exposure. Think this is true, but some people do not pay attention to where credit trades in secondary market now. Most of the spread widening occurred this year, rather than fall 2007. For example Commercial Mortgage Backed Securities at least doubled this year - CMBS AAA 10 year trades at 340 (+190 YTD), while BBB at 1300 (+500), iTraxx Xover at 577 (+240 YTD), banks everywhere struggle to issue bonds and pretty much corporate credit is trading heavy in any market. I imagine all leveraged loans are dead illiquid and sit on banks books.

"Which means if conditions do not change, we will have further poor mark to market on these positions, which banks, hedge funds, dedicated money, other investors will have to write down in Q1. Some of them will probably loose more in comparison to what they have written off in subprime... Any thoughts?

"Thank you as ever for your great service."

My comment - Thank you for an interesting and well thought through email which I'm sure will be of interest to other subscribers. We are certainly not out of the woods yet, with regard to the credit crisis and there remains the potential for some further write downs. Credit spreads and [CDS spreads](#) are widening in a move which is part of the general re-pricing of risk following the implosion of the subprime market, but [Libor spreads](#) have contracted significantly, indicating that banks are lending to one another again. I take that as a sign of confidence in the financial system. However, bank's stock prices are likely to take time to recover for precisely the reasons you enunciate above.

No one knows if stock markets have bottomed or whether we will see another wave of selling pressure in Q2, but for the medium-term downtrends to be reaffirmed, they need to sustain moves to new lows and no major market has

done this to date. I believe we can continue to give the benefit of the doubt to the upside as long as global indices can sustain their rallies above those January 22nd lows.

Email of the day (2) - on funds investing in the Australian and New Zealand dollars:

"Are you aware of any currency ETFs in the UK? Looking for NZ or Aussie dollar. Any in the chart library? I couldn't find any."

My comment - The only Australian dollar fund in the Chart Library is the [CurrencyShares Australian Dollar Trust](#) listed in the USA. I'm afraid I do not know of one listed in the UK and have been unable to find any. If subscribers know of such funds which perform in line with their benchmark, I would be happy to add them to the Chart Library.

Email of the day (3) - on access to Australian resources companies for UK investors:

"You may want to take a look at the [ACDS Oceanic Australian Natural Resources fund](#) -- a UK fund - managed from Perth by Elliott Rowton. This fund specialises in small/mid cap Aussie resource stocks -- just be aware that whilst the opportunities may be attractive they do come with high levels of volatility.

"I should say that some of the funds that I manage have notable interests in this fund."

My comment - Thank you for this suggestion and the useful caveat that such companies are volatile. We would urge subscribers to do their own due diligence before investing in any vehicle. I came across this fund while searching yesterday, but did not call it to notice because it is not performing in line with its benchmark, even when currency fluctuations are considered. However, since it is denominated in Pounds and there seem to be few other alternatives for UK investors, I have added it to the Chart Library. It has an initial fee of 4%, management fee of 1%, a 20% performance fee and appears to have a minimum initial investment of £50,000.

Today's interesting charts - The Chart Library has an extensive selection of spread and overlay charts and subscribers can create their own using the Charting tool.

S&P 500 - continues to [range](#) above the January lows and would need to sustain a move below that level to offset scope for some further higher to lateral ranging.

New Zealand Dollar per 1 US Dollar - [the New Zealand Dollar is breaking upwards](#) from the almost 5-month range and would need to sustain a move below .79¢ to question cope for further upside.

Lumber - [failed](#) downside break makes the possibility of a test of \$240 more likely and would need to sustain a move to new lows to question medium-term recovery potential.

Natural Gas - [breaking upwards](#) from the two-year base. This instrument has been subject to a number of failed upward breaks over the last couple of years, but we can give the upside the benefit of the doubt as long as it can sustain the upward impetus.

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