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Global Strategy and Investment Trends by David Fuller

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

Tuesday 25th March 2008

Commentary by Eoin Treacy

Loss of liquidity, not insolvency, caused credit crunch - [Thanks to a subscriber for this interesting account, by Anatole Kaletsky, of the ongoing liquidity problems in the credit markets. Here is a section:](#)

The probability of the American GSEs defaulting remains essentially zero, as it has always been. If anything, the willingness of the US Government to stand behind these enterprises is even higher today than it was before the financial crisis. The market value of these bonds has fallen simply because they have turned out to be less liquid assets than previously believed - and liquidity has been recognised as a much more important and valuable characteristic than investors suspected until a few weeks ago.

Until last month, it was still widely assumed that the danger of illiquidity affected only inherently risky assets, such as sub-prime mortgages, complex derivatives and leveraged loans. But this assumption completely changed when the US bond insurers started to be downgraded in January. Suddenly, ultra-safe municipal bond prices plunged to levels normally associated with the riskiest junk bonds. This was not because the Port Authority of New York or the California Water Board suddenly looked like defaulting. It was simply because municipal bonds became illiquid as investors were forced by regulations to dump them into a market with no bids.

After the municipal meltdown, forced sellers of top-quality mortgages, and even of government-backed GSE bonds, suddenly could find no buyers. It was this disappearance of liquidity - not a growing risk of default by borrowers in the non-financial economy - that caused the collapse of Bear Stearns.

By last week, the liquidity crisis had spread even to assets whose default risk was literally zero. A widely quoted story on Bloomberg read: "The risk of losses on US Treasury notes exceeded German bunds for the first time ever, amid investor concern the sub-prime mortgage crisis is sapping government reserves." The evidence cited was a sale of credit-default swap (CDS) insurance on US Treasuries, which implied a default probability of 0.16 percentage points, as against 0.15 points on German bonds. But what did these "probabilities" actually show? After all, Washington can always print the money with which it pays for its bonds - and, like all governments, invariably

does so. Moreover, in the vanishingly improbable event that the US Treasury really did decide to stop printing dollars, would the underwriters of CDS insurance still be in business and pay up? What court would enforce a private CDS deal if contracts with the US Treasury were no longer in force? And what currency would such a judgement be paid in, since US dollars would no longer exist?

My view - I believe that Credit Default Swaps (CDS) are a useful invention which can be used to hedge default risk but that's about all. The ongoing situation in the credit markets which I have described as 'Model Myopia', (Comment of the Day [March 6th](#)) where the price of insurance against default is being used to evaluate the integrity of companies, can not persist, but it is creating value. Buying opportunities for investors capable of placing competitive bids in that market are available now and I have little doubt we will hear of a number of funds who benefitted enormously from this crisis over the coming months.

European Banks Climb After HBOS Management Buys Stock - [This article by Ben Livesay for Bloomberg covers some important developments in the global banking sector. Here it is in full:](#)

European banks advanced, led by HBOS Plc, after directors including Chief Executive Officer Andy Hornby bought shares in the U.K.'s largest mortgage lender and JPMorgan Chase & Co. quadrupled its offer to rescue Bear Stearns Cos.

HBOS climbed as much as 17 percent in London, the most ever. UBS AG, Europe's largest bank by assets, advanced 7 percent in Zurich, and Commerzbank AG, Germany's second-biggest bank, added as much as 8 percent in Frankfurt, the most in almost two years.

HBOS's stock was buoyed after it said executives bought shares following its steepest ever decline last week. HSBC Holdings Plc, Europe's largest bank by market value, rose 3.6 percent.

"The fact that HBOS management has bought shares will calm a few nerves," said Colin Morton, an investment director at Rensburg Fund Management in Leeds, England. He holds shares of the U.K.'s largest banks including HBOS.

The 60-member Bloomberg Europe Banks & Financial Services Index climbed 3.7 percent. The FTSE 100 Index rose 3.3 percent as all 102 members advanced.

Barclays Plc, the U.K.'s third-biggest bank, added as much as 12 percent to 480.25 pence, the most since 1992, and Royal Bank of Scotland Group Plc advanced as much as 11 percent to 350.25 pence, the biggest gain in more than four years.

HBOS added 53.75 pence, or 11 percent, to 527.5 pence as of 9:06 a.m. in London. UBS advanced 1.64 Swiss francs to 29.56 francs. Commerzbank

climbed 1.18 euros to 18.48 euros.

Hornby and other employees bought a total of 1.4 million shares on March 20, HBOS disclosed yesterday. U.K. regulators said March 19 they are investigating "false rumors" on stocks after HBOS declined to the lowest ever price on speculation it had funding problems. The bank denied it had any such problems.

My view - In times like this one is reminded of Mark Twain's comment "rumours of my death have been greatly exaggerated". Bank shares such as those of [Citigroup](#), [UBS](#), [HBOS](#), [Anglo Irish](#), [Commerzbank](#) and a host of others have been priced as if they were about to go out of business. While the risks of such an eventuality are higher than they were a year ago, only a small minority of such banks will actually prove insolvent.

Investors are coming to this realisation and we see a number have rallied impressively over the last week as shorts are covered. However, given the extent of the decline in many of these shares, they are unlikely to be able to support more than a short covering rally at this time, They will require a lengthier base building phase, which will succeed in flushing out the more aggressive bears and probably succeed in creating a degree of apathy around this sector as the better returns, for a time, are found elsewhere.

Email of the day (1) - on credit spreads tightening:

"Listened with interest to your credit opportunity comments. One way I found (I believe) is to buy [PHK](#) (Pimco Hi Yield Fund) and buy the Bond Inverse ETF [RYJUX](#).

"One drawback is that RYJUX trades like a unit trust, settling daily, while the PHK trades intraday like a stock. But it appears it may be a way to participate when the credit spreads narrow. Perhaps the Fullermoney Brain Trust might have some other ideas."

My comment - Thank you for these interesting suggestions, which can both be found in the Chart Library. I would be happy to add any further funds that may be of interest to subscribers.

Email of the day (2) - on US Dollar volatility:

"In Bloomberg today there is an article that the implied volatility of US Dollar options is the highest since 1995. This is one of the things we should look at as traders are on "intervention watch".

"Could you please include a graph of the implied volatility of the US Dollar in the chart library? I believe that Bloomberg has this graph."

My comment - Thank you for this interesting email and I think I found the [article](#) you were referring to. Here is a section of interest:

For the first time in 13 years, people who trade currencies say confidence in the markets to determine exchange rates is dwindling.

The crisis that may bring the so-called Group of Seven nations to coordinated intervention is the result of a sinking U.S. economy, the weakest dollar since 1971 and the biggest currency fluctuations this decade.

“The risks of coordinated intervention are going to increase in the second quarter for sure as the dollar weakens further,” said Mitul Kotecha, head of foreign-exchange research in London at Calyon. The firm is the securities unit of Credit Agricole SA, France's second-biggest bank.

Even with the latest gain against the euro, strategists at Deutsche Bank AG in Frankfurt, the world's biggest currency trader, say the dollar is likely to fall to \$1.60 versus Europe's common currency, from \$1.5428 as of 7:49 a.m. in New York, because of a recession. Royal Bank of Scotland Group Plc, the fourth-largest trader, says the risk of intervention is increasing and “would become severe” if the dollar depreciates below \$1.60.

“The strength of the recent euro-dollar rally came as a surprise to many people, and such swift moves certainly raise the specter of coordinated central bank intervention,” said Hans-Guenter Redeker, global head of currency strategy in London at BNP Paribas SA, the most accurate forecaster in a 2007 Bloomberg survey. “As volatility rises, the likelihood of such an intervention increases.”

'Disorderly Movements'

After the Federal Reserve's U.S. Trade Weighted Major Currency Dollar Index declined to 69.2631 on March 18, the lowest in 37 years, Redeker said he sees parallels between now and 1995. That was last time central banks stepped in to arrest a slide in the greenback by purchasing and selling currencies to influence exchange rates.

The most obvious is implied volatility on options for the dollar, which rose to 14.5 percent last week, the same as in 1995 and up from the low this year of 9.62 percent on Feb. 26. Morgan Stanley is on “intervention watch,” Stephen Jen, the New York-based firm's head of foreign exchange research, said March 14.

The G-7, which comprises the U.S., U.K., Canada, Japan, Germany, France and Italy, said Feb. 9 that “excess volatility and disorderly movements in exchange rates are undesirable.” The group next meets April 12-13 in Washington.

[This index can now be found in the Chart Library and according to Bloomberg:](#) “The JP Morgan G7 Volatility Index is calculated based on currency 3 month ATMF vols, which are combined with a set of fixed weights to produce the daily result.”

This [overlay](#) of the G7 Volatility Index over the Dollar Index shows that since 1992, major bottoms in the Dollar index have coincided with significant spikes in the G7 Volatility index. The [G7 Volatility Index](#) is testing the 1998 and 1995 highs and is worth keeping an eye on to see if it spikes even higher. In the last week it has pulled back from its peak, but would need to sustain a move below 10 to indicate that volatility was returning to the more 'normal' level of the last 5 years.

The [Dollar Index](#) rallied well last week from an oversold position but needs to hold above the March 17th lows to offset scope for some further downside.

Today's interesting charts - There are more than 17000 instruments in the Chart Library, from every asset class, which may be of interest to subscribers.

India (Nifty 50) - [rallies well](#), having found support near the January lows. It would now need to sustain a move below 4500 to question scope for an assault on the upper side of the range.

Hong Kong - [surges](#) back above 22,000, in what increasingly looks like a failed downside break. A sustained move below 20,500 would be needed to question potential for a test of the upper side of the range near 25,000.

Eurobunds - was unable to hold the move to a new high last week and [breaks down](#) from the short-term range. It would need to sustain a move above 118 to question scope for some further downside.

Silver - finds at least [short-term](#) support near \$16.75 following last week's dramatic fall, but would need to sustain a move above \$20 to reaffirm the upward bias.

Email of the day (3) - on Morant Wright Japan Income Trust:

"One of FM subscribers asked some information about the above referenced fund +/- 2 weeks ago. MW has no web site but attached are the [2006](#) final report and the [2007](#) interim report.

"Please note that I am neither an investor in the fund nor get any form of incentive or remuneration from MW."

My comment - Thank you for this contribution which I'm sure will be appreciated.

Email of the day (4) - on an addition to the Chart Library:

"Do you have Proshares ultra short Dow ([DXD](#)) - Amex somewhere in the chart library?"

"If not, would it be possible to include it. This is an ETF whereby one can short the Dow Jones index.

"Are there any ways that you know of whereby one can be short the market within the confines of an ISA or SIPP?"

"Thanks for great service"

My comment - Thank you for this suggestion which can now be found in the Chart Library. I'm afraid I don't know enough about SIPPs or ISAs to answer your question but some other subscriber may.

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

"Pls add UNR TSX Venture [Uranium North](#)."

My comment - This has now been added to the Chart Library.

Last week's signups for the Free (Abbreviated) Comment of the Day - For the week of March 16th new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, Belgium, Brazil, Canada, Denmark, Hong Kong, India, Ireland, Italy, Japan, Kuwait, New Zealand, Poland, Qatar, Russia, Singapore, Switzerland, the UK and the USA - 19 in total. In descending order, which topped the list in terms of the last week's new signups? It was the India, the UK and the USA.

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

Please Note: David returns tomorrow and I will be away on paternity leave for the coming two weeks.

Wednesday 26th March 2008

Buffett Shows Schwarzman Berkshire's Free Money Beats LBO Model - This is a salutary [article](#) (also in [PDF](#) in case the original link is eventually dropped) by Nick Baker and Jason Kelly for Bloomberg. Here is the opening:

Credit-market gridlock has trapped Stephen Schwarzman, who relies on lenders to fund acquisitions, while leaving Warren Buffett free to pursue the debt-free deals that have helped make him the world's richest person.

Buffett, chairman of Omaha, Nebraska-based Berkshire Hathaway Inc., has \$59 billion in cost-free money from insurance premiums to invest. Schwarzman's New York-based Blackstone Group LP, manager of the biggest private-equity fund, is being forced to bypass Wall Street banks after they stopped financing most leveraged buyouts.

Buffett and Schwarzman each takes a different approach to the same goal: finding companies they consider undervalued. Investors are betting Buffett's model will prevail, at least for now. Berkshire climbed 5.4 percent since the subprime-lending crisis sent the Standard & Poor's 500 Index tumbling as much as 19.7 percent from its Oct. 9 peak. Blackstone dropped 43 percent in the same period.

“There's a massive, massive advantage for Buffett in this kind of market,” said Guy Spier, chief investment officer of New York-based hedge fund Aquamarine Capital Management LLC. “All the leveraged finance has dried up, so he's going to have a much better time finding things to buy.”

Blackstone's vulnerability was underscored March 10, when the company said fourth-quarter profit plummeted 89 percent amid what Schwarzman called a “severe financial crisis.” Banks started pulling back from most LBO lending last June after as much as \$400 billion in debt sat unsold on their books and losses from the subprime-mortgage market increased.

My view - Who do you suspect is the calmest person around at a time when it is fashionable to talk about the "worst financial crisis since World War 2"? Do we think he is awake at night, shaking in fear at the prospect of some highly leveraged financial institution going belly up? Is he hanging on every grim word from Wall Street's honourable doomsters?

I am, of course, speaking of Warren Buffett, who I suggest did not panic his way to becoming the world's richest man. After acknowledging a couple of years ago that he could not find many bargains, did Warren Buffett leverage up to the eyeballs in Wall Street's hottest new mystery derivatives? I do not think so.

Actually, Warren Buffett seems to be enjoying today's stock market environment, in which he is finding some bargains. Is he complacent or nonchalant? Does he simply not understand the severity of the situation? Again, I do not think so.

So why can't we be more like Warren Buffett, minus a few zeros in terms of today's wealth?

The answer is, you can.

1. Maintain a sense of humour. Without it, life is not worth living and you will not be able to view events in perspective.

2. Be a contrarian, buying low and selling high, or just holding onto what are arguably your best growth positions.
3. Avoid debt if you possibly can; the main exception for some being a temporary mortgage on the roof over one's head.
4. Maintain a cash reserve. It will be comforting, not to mention useful when others are panicking out of leveraged positions.
5. If you use leverage, build positions slowly within a trend, limiting your risk with trailing stops.
6. Conduct your own due diligence. Not many of us will have Buffett's brain for fundamental analysis. However you can emulate his vision and probably have the edge when reading price charts.
7. Avoid complicated financial products.
8. Whatever your specific skills and levels of experience, remember, in this business common sense is the most useful form of intelligence.

Lastly, the list above is only a beginning. There are veteran subscribers who either know a lot more about Warren Buffett than I do, or have a wealth of personal experience and wisdom. If you would like to contribute your own tried and tested maxims to the list above, in the spirit of Empowerment Through Knowledge, I am sure we would all appreciate it.

Email of the day (1) - On signs of a bottoming process:

"Happy Easter! I hope you enjoyed a relaxing break.

"As world markets sink deeper into a slough of despond and commentators on all sides are predicting much worse to come I noted some very interesting chart action on Thursday by two stocks in particular. Wal-mart, the world's biggest retailer, and GE, sometimes cited as a proxy for the NYSE, enjoyed remarkable rises on strong buying. BKX was also supportive. These look to me like straws in the wind and tend to support what you have been saying in recent weeks about the market beginning a bottoming process.. They do not, in my view, support the dire predictions of a deep, extended recession for the US and a possible world recession.

"Having Fullermoney to consult in these difficult times has been invaluable.

"PS Am enjoying the NY Met opera season broadcasts at a local cinema. With Covent Garden on your doorstep you are already spoilt for choice but the productions are wonderful with some new glorious young singers coming through who we might not otherwise see. I recommend them."

My comment - Thank you for your interesting and thoughtful comments. I have heard other favourable reviews regarding the Met's opera broadcasts, and am

glad you are enjoying them. Mrs Fuller and I spent a delightful Easter, "Travelling in Wagner's Footsteps", attending three operas and a concert, in Dresden, Eisenberg and Leipzig. It was our first trip to that part of Germany and Dresden's faithful reconstruction of cultural landmarks was especially impressive.

Regarding stock markets and their message, I agree with what you say. The performance of [Wal-Mart](#) and [General Electric](#) more recently has been most impressive. Along with other performing shares worldwide, they are timely reminders that the huge amounts of liquidity pumped in by central banks will not all flow into government securities or commodities.

However when I click through a Library 'Favourites' section each day, viewing charts of global stock market indices including financials, government bonds, commodities and currencies - an informative scan that I commend to all subscribers - it looks as if financial tornados have swept through the markets. Some have been flattened while others are barely affected. Most importantly, for every stock market chart pattern that is still deteriorating, one will also find others where the foundations for recovery appear under development.

Crucially, financial sectors show evidence of base building, although this varies considerably, as you can see from a lagging performance by the [DJ Euro Bank Index](#), a slightly better performance by the [S&P 500 Banks Index](#), at least in terms of upward dynamics since January, and the considerably more robust performance by the Taiwan Bank / Insurance Index ([weekly & daily](#)). Needless to say, European and USA banks were hit harder by sub-prime related problems than most other banking sectors around the world.

More generally, the most important point I believe, rather than being too bullish or too bearish, is to accept that the environment has changed. Clearly we are no longer in what was primarily a period of ranging uptrends from 2003-2006. The bearish, or at best, choppy trends that we have seen since last July have obviously been considerably more hazardous for investors.

However that is not all bad. Many of us have enjoyed some outstanding moves in commodities. Meanwhile, equity valuations have improved considerably in many markets. This is creating more recovery situations, including among high-yielding shares, than we have seen since 2003. It is worth recalling that most investors were extremely cautious as that year commenced.

I do not expect a repetition of the smooth uptrends that developed in 2003 anytime soon. For approximate parallels, today's environment is more similar to 2001, when the bottoming out process was commencing. I expect further choppy action in the months ahead. Nevertheless that environment does not merit the "global recession", let alone "financial Armageddon" fears that signal oversold markets.

Feeding the Dragon: China's February 2008 Commodity Trade Data - [My](#)

thanks to a subscriber for this excellent [report](#) published by Barclays Capital. Here is the introduction:

China's commodity demand is the most important driver of fluctuations in global commodity consumption. So far in 2008, despite the concerns of some macro-economists, there is little sign of any deterioration in local demand. Indeed, the latest set of trade data (for the month of February) points to very robust conditions indeed for a wide range of different commodities. In crude oil, net imports hit an all-time high, while the recent surge in diesel imports has continued and strong local demand is limiting gasoline exports. In industrial metals, nickel imports hit another all-time high, while refined copper imports stayed very strong. A combination of strong demand and supply problems has pushed aluminium, lead and zinc exports lower, contributing to tighter international markets. In agricultural markets, China's imports of soybeans and oil have continued to surge higher while net exports of corn have stayed very low, consistent with our view that China will soon switch from a net exporter to a net importer of corn.

My view - China is very likely to remain the most influential driver of commodity prices for the indefinite future. However as with any other active participant, it will aim to buy low and sell high, while also attempting to disguise its next big moves from other consumers and producers of commodities, and also speculators.

Barclay's item-by-item review provides a useful background check against the price action which subscribers can easily monitor in the Library.

Please note - Eoin is on paternity leave.

Thursday 27th March 2008

US Housing Crisis: Still in the Early Innings - My thanks to a subscriber for this highly informative [presentation](#) by T2 Partners LLC, incorporating many historic graphics prepared by Amherst Securities Group L. P. Here is a brief sample:

Causes of the Great Mortgage Bubble

Wall Street's Demand for Loan "Product" Was a Major Driver of the Decline in Lending Standards

As discussed later in this presentation, the Asset-Backed Securities (ABSs) and Collateralized Debt Obligation (CDO) businesses were enormously profitable for Wall Street firms.

To produce ABSs and CDOs, Wall Street needed a lot of loan "product".

Mortgages were a quick, easy, big source.

It is easy to generate higher and higher volumes of mortgage loans: simply lend at higher loan-to-value ratios, with ultra-low teaser rates, to uncreditworthy borrowers, and don't bother to verify their income and assets (thereby inviting fraud).

There's only one problem:

DON'T EXPECT TO BE REPAID!

My view - This is easily one of the best presentations that I have seen on the mortgage fiasco, made easier to view in perspective by the many fine graphs. In particular, note Slide 6, depicting US house price appreciation since 1975. From its 2Q 2007 peak, a 34% decline would be required for mean reversion. However veteran subscribers will know that trends usually overshoot, in both directions.

Slides 13 and 14 spell out the self-feeding risk: Homeowners with negative equity are often tempted to walk away from their properties, which are then sold at auction, further depressing the market, creating more negative equity.

Unlike some naïve homebuyers, I do not believe that financial institutions thought house prices would rise indefinitely. They just hoped they would not fall on their watch.

Slides 18 and 19 confirm that mortgage rates are not falling, despite a series of rate cuts by the Fed. Why should they? Banks have little incentive to lend in a falling market, especially when they can recapitalize by borrowing cheaply from the Discount window and leveraging up in higher-yielding long-dated Treasuries.

So how will all this play out, especially for the US stock market?

A massive deleveraging is underway in the overleveraged US economy. This started with the banks (yield curve recapitalisation mentioned above excepted), and is affecting all other borrowers, not least consumers who are now being forced to rebuild their personal balance sheets.

Judging from other credit contractions, the USA's deleveraging process will probably take several years. This is a healthy process although the journey will be painful for many, not least because of America's overdependence on the financial sector and consumer spending.

The Federal Reserve, White House and Congress will use every effort to cushion downside risk during this process. Inevitably, this is somewhat controversial since rather than allow a widespread and devastating debtors' collapse, the government is trying to mitigate a deflationary contraction, erring on the side of future inflation and additional bubbles.

I think the US government will succeed in this effort, because following a slow start last summer and early autumn, the Fed has caught up with the curve of events. Moreover, Fed Chairman Ben Bernanke is an acknowledged expert

on the Great Depression of the 1930s, so a repeat of that outcome is the least likely possibility, on his watch.

But how will Bernanke stem a vicious cycle of mortgage defaults and falling house prices, especially as short-term rate cuts have had little or no effect on mortgage rates? Not easily - I would not be surprised to see an overall price correction of approximately 40%, but the answer is nationalisation.

Arguably, this is already underway and I expect the government, one way or another, to eventually own most of the dodgy mortgages. Yes, this will bailout the banks although not before considerable financial damage has occurred, as we have already seen. More importantly for the government, it will also assist debt-strapped voters.

How will the stock market respond to the nationalisation of \$trillions in mortgages? It will love it. Historically, house prices often lag and money will chase performance. Once fears of a widespread financial collapse triggered by house prices abate, investors will gravitate increasingly towards equities in preference to additional real estate, which is the most recently burst bubble.

I maintain we are already seeing the basing process in price charts for most equity sectors. It is likely to be a long convalescence for some, not least because the US economy is likely to grow below its long-term trend for several years. However there will always be star performers.

Price charts will show us the way once again. Sectors and shares that are clearly outperforming the S&P 500 Index today, and better still three to four months from now when investor buying rather than short covering should be the main driver, will be candidates to outperform over the medium to longer term.

My guess is that the leaders will be big, cash generative, multinational companies. For instance, Wal-Mart will continue to grow but many small retailers will suffer due to insufficient consumer demand.

How will other stock markets around the world perform? The Wall Street leash-effect will remain important. It has exerted a largely negative pull since the July and October 2007 highs. However, if the Dow ([weekly](#) & [monthly](#)) and S&P 500 ([weekly](#) & [monthly](#)) continue to range above their January and March lows (this March could be similar to October 2002 in the support building process) many of the stronger GDP growth economies should eventually attract additional investor interest.

Meanwhile, long-term investors will need to remain patient more often than not, although each dip in prices now provides buying opportunities. Short to medium-term traders can harvest some of the ranging on a buy-low-sell-high basis.

Email of the day (1) - More on opera and Dresden:

"We may have crossed paths at the SemperOper in Dresden on Oster Montag. We were also impressed the presentation of Wagner's Parsifal, and my wife was especially happy to visit the SemperOper amongst the well restored buildings of the original old town.

"London next week for the West End. Please arrange to have the snow gone and a proper Spring Time awaiting!"

My comment - Almost - we attended Parsifal on Good Friday. Yes, it was a good production, particularly the orchestra and young Klaus Florian Vogt's Parsifal, we thought. I hope you also stayed at the splendid Kempinski Dresden Hotel, across the street from Augustus the Strong's wonderful Green Vault, and a five minute walk from SemperOper. What a stunning building.

Snow is most unusual for London these days but you should be prepared for some rain.

Auction-Rate Crisis Hits Stadiums for Saints, Giants - This [article](#) from Bloomberg highlights problems for borrowers in today's credit restrictive environment. Here is the opening:

The auction-rate bond crisis is raising borrowing costs on more than sewers and hospitals, forcing some states to pay three times higher interest on 65,000-seat sports arenas with moving roofs and 50-foot video displays.

Debt payments for Louisiana's Superdome, home to the National Football League's New Orleans Saints, ran the state about \$1.8 million last month -- up from roughly \$500,000 in January -- after interest rates tripled to 12 percent, said Whit Kling, director of Louisiana's bond commission. Some private borrowers are paying even more, with rates on bonds sold by owners of the NFL's New York Giants reaching 22 percent this week, according to a person familiar with the debt.

"I don't think anyone ever anticipated this," said John Kennedy, Louisiana's state treasurer. "We're paying the price."

States and cities that subsidize sports venues to stimulate the economy have often failed, and this year's credit meltdown will make it even harder to avoid raising taxes or reducing services to cover bills, said Dennis Coates, a professor at the University of Maryland in Baltimore. His studies on the effect of major league franchises on U.S. cities show stadiums hurt residents by steering public and private spending away from health, safety or other forms of entertainment, he said.

My view - In countries affected by the credit crunch, this is a tough environment for any municipality, business or individual in need of loans. Conversely, it favours those with cash, and who remain cash generative. I suspect that Warren Buffett, while wishing no one misfortune, prefers today's investment climate to that of two years ago.

My personal portfolio: Some rollovers among small recovery trades and another mini PPT transaction - In dogs of the trading account department, two small losing positions were automatically rolled forward as I was preparing to leave for Dresden. These were a March long in the [Taiwan Greater China Fund](#), sold at \$6.6168 on 18th March against my purchase at \$8.378 on 11th October, and simultaneously repurchased for June at \$6.6903. Worse, was a March [Nasdaq](#) long stubbornly retained. This was sold at 1739 on the 19th March against my purchase at 2157.5 on 8th November, and simultaneously repurchased for June at 1748.45.

Resorting to my preferred tactic for this environment as a mini PPT (plunge protection team) buyer of the [Nikkei](#) on weakness, I halved the two losses above with June Nikkei purchases at 12288 and to my surprise, a bid a 12050 on 19th March. I sold these today at 12808. Apologies for this late report; a consequence of too many loose ends as I completed copy prior to Easter weekend.

Prices above include all spread-bet dealing costs.

Email of the day (2) - [On US housing](#):

"I am surprised by the positive note of the comments following the housing figures this week. People see as a good news the decrease, in itself, in the number of unsold houses.

"We should bear in mind that housing is just another market and that it won't reach a bottom without an increase in volume and a form of capitulation. During the last years of the bubble, the housing affordability increased by 40%, not by a surge in income but thanks [to] the lower rates and the new (and arguable) practices in lending. These factors explain the bulk of the increase in price. We know that they disappeared now, and 40% should be the magnitude of the decrease in price eventually, with even more damages in the former hottest markets.

"The last national figures say that the inventory of homes is still 1 500 000 higher than "normal". Currently the net production of new homes is around 750000, and the demand is 1 200 000 (number of households formed in a year). Even if we assume that the latter figure will not be reduced by the bad economical conditions, it will take 3 years before we come back to a normal situation and a stabilization of the market...or we may see an accelerated liquidation with a sharp drop in prices (more likely). In any case we'll have further pain in the housing sector: don't forget that housing is not first a financial product, it is a tangible asset which needs to be occupied in order to have some value. When you see the level of the rents now and the level of vacancies, you forecast easily a 50% drop in price from the peak in the previously more active markets. We did less than half of the way."

My comment - [I agree, the Fed and particularly mortgage lenders created the bubble. You will see all of this detailed in the opening report above.](#)

Please note - [Eoin is on paternity leave this week and next.](#)

Friday 28th March 2008

Prieur du Plessis on Treasury Bonds - [My thanks to Prieur du Plessis of Plexus Asset Management for his latest and informative Investment Postcard. You will find it in the Subscriber's Area but here is a brief sample:](#)

But what about the outlook for US bonds, especially as yields have edged up since the recent lows of 3.314% (March 17) and 4.165% (March 20) for the 10-year and 30-year Treasury Note respectively?

The graph below shows the long-term movement of the yield on the US 10-year Treasury Note, indicating that long-dated US bonds have experienced a multi-year bull market and are trading at levels last seen more than 40 years ago as far as nominal yields are concerned and 28 years ago in real terms. Thinking of which, the only investors who first-hand experienced the last major bear market in bonds (from 1971 to 1980) are now all on the wrong side of 50!

My view - [Regarding the last comment, yes, but assuming we were paying attention and can still remember, it should also be the knowledge side of 50.](#)

[What about the outlook for US Treasury Bonds?](#)

Basically, I agree with Prieur. However the base building process for long-dated Treasuries has been greatly extended by the credit crunch and accompanying US economic slowdown. This includes an intentional steepening of the yield curve by the Fed, to help banks recapitalise. Consequently, the Fed has and will continue to support long-dated Treasury Bond prices, as deemed necessary. It is helped in this respect by the flight to bonds due to recession concerns.

All of this will change when bank balance sheets look less perilous, the US stock market is seen to be recovering, and inflation rather than recession fears are ascendant.

Soft commodities: bull market or bubble? - [My thanks to a subscriber for this balanced and informative report by Max King of Investec Asset Management. Here is the opening:](#)

The recent turbulence in financial markets has made investors fearful, but there is one area where caution has been thrown to the wind: soft commodities. The oil price has been rising for nearly 10 years and metal prices for five years but now the prices of agricultural products are following. Money is pouring into specialist funds, volume on the futures market has exploded and a slew of high-cost investment vehicles are rolling off the production line.

Underlying this growing interest are some sharp price increases. Corn has nearly tripled in price to \$5 a bushel in three years, spring wheat has quadrupled to \$24 a bushel in a year and soft wheat doubled to \$6. Overall, the Reuter/Jefferies CRB Softs index has risen less than 20% since the start of 2007, but the increase since September has been 40% and appears to be still accelerating. While grain prices have soared, other softs have been left behind: meat and sugar prices have barely budged. Bulls can take heart from Jim Rogers' prediction that agricultural commodities, including sugar, are "going to explode" in price.

My view - Fullermoney has been a vociferous advocate of the commodity supercycle hypothesis over the last six years. However, our technical discipline causes us to be very cautious following dramatic upward accelerations in prices.

These are invariably unsustainable because prices run ahead of events on a wave of frenzied, climactic and speculative buying. Even within secular bull markets, medium-term corrections follow dramatic price spikes. These can last from several months to a couple of years, and occasionally longer.

I maintain that most agricultural commodities are currently in medium-term corrections, as indicated by the [DJ Agriculture Index](#) (note the weekly key reversal at the peak), and will be joined in this process by those that are still accelerating, such as rough rice illustrated below.

Consequently, investors should expect a period of underperformance by agricultural commodities and shares, which have run ahead of their current potential. Medium-term corrections will provide renewed buying opportunities within these secular bull markets.

My personal portfolio: HSCEI rollover shows the risk of - This trade shows the risk of holding on too long when bottom fishing in depressed markets. When I allowed my expiring February long in the China H-Shares Index ([daily & weekly](#)) to be rolled forward at a small profit on the 27th of that month, I acquired the March contract at 13926, near the top of the range. Resistance held and the H-Shares Index fell to a new reaction low. I held on, feeling that we would see a downside failure, which appears to have occurred with today's rally. Nevertheless this was a poor trade as my expiring March long was sold yesterday (automatic rollover transactions by spread-bet firms are not reported until the following day) at 11923 against my purchase at 13926 on 27th February. As this was on automatic rollover, I simultaneously purchased Apr H-Shares yesterday at 11924. I hope to sell this position near the previous resistance near 14000, rather than hang around to find out if that level is taken out, as I am sure it eventually will be, although possibly not before we see additional support building.

I mention all this for the tactical lesson, which can be summarised by the saying: 'horses for courses'. If you have been observing my trades since January 21st, I have done well when buying stock market futures during the panicky moves to new lows, and trading out on the subsequent rebound.

However I have lost money when either paying up during a rally or optimistically hanging around too long. I believe that the Baby Steps buy-low-sell-high range trading strategy is appropriate for today's environment. However when support building is eventually followed by medium-term uptrends, as it will be, then there will be fewer opportunities to buy on weakness but one will be able to run profits and leverage up on upside breakouts. As always, the charts will show us when the environment next changes.

Investors wishing to take advantage of today's lower prices should also endeavour to buy on weakness during this choppy, support building phase.

Today's interesting charts - The Fullermoney Subscriber's Chart Library contains over 17,000 customisable instruments, covering global stock markets, funds and ETFs, government bonds, currencies and commodities.

Rough Rice - Food inflation is a big problem, especially for poor countries where grains such as rice are a key portion of the staple diet. The accelerating [trend](#) in recent months and proximity of the psychological \$20 level, suggest that a correction is likely before long. However the monthly [graph](#), with its sustained break above previous historic peaks in the \$12 region, suggests that a new era has commenced, in line with Fullermoney's Supply Inelasticity Meets Rising Demand theme.

China (Shanghai A and Comp) - Today's upside key day reversals for both the A-Shares ([daily](#) & [weekly](#)) and Comp ([daily](#) & [weekly](#)), in the proximity of the June-July 2007 reaction lows, should check the somewhat overstretched downtrends for at least the near term. However upside follow through is required to signal more than a brief pause. Given the overall declines, I would not be surprised to see a period of support building occur between current levels and 3000 for these two indices. In other words, they are close to sustainable floors.

Hong Kong (HSI) - Failed break [beneath](#) the January low, so a clear downward dynamic is now required to offset current scope for a further rally towards the February highs.

India (Nifty) - [Rebounding](#) from lateral trading near 4500 and the January reaction low; a sustained break beneath this level would be required to reaffirm the downtrend but current [activity](#) looks like support building.

USA (Transports) - Although [rangebound](#), this continues to show relative strength. A close beneath the last low at 4390 is now required to question current scope for sideways to higher ranging and a sustained break above 5000 would be a compelling repost to the bearish consensus.

Platinum, gold and silver - Prior accelerations - particularly for [platinum](#), somewhat less so for [silver](#) and least for [gold](#) - followed by large downward dynamics, confirmed that medium-term corrections were underway, as previously mentioned. Therefore, despite the recent bounces, it would be

premature to assume that we have seen the reaction lows, for what on past evidence is a multi-month shakeout within the long-term bull markets for precious metals. Importantly, if stock markets are bottoming out as I suspect, then precious metals and other recently performing commodities face more competition in terms of investor and speculator interest, unlike the period from last August until this month's mostly successful tests of the January lows by share indices.

Please note - Eoin is on paternity leave but will resume coverage on 7th April.

Please note - The big picture, long-term outlook Audio will be recorded on Saturday and posted by 2:00pm GMT.

Quote of the week - On fortitude:

"To buy when others are despondently selling and to sell when others are greedily buying requires the greatest fortitude and pays the greatest reward."
Sir John Templeton

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