Fullermoney

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

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

Monday 31st March 2008

Paulson Backs Regulatory Overhaul, Broader Fed Role - Here is Bloomberg's article on today's main financial news item. We can expect a broad range of opinion regarding the efficacy of these latest proposals, not least during an election year. I will leave that discussion to others. What concerns me is their likely effect on stock market sentiment, at a time when confidence is low.

I believe this will be positive because officials at both the US Federal Reserve and Treasury now recognise the need to manage expectations during a crisis. The best way to accomplish this is by being seen to be proactive. Ideally, on a daily basis with comments, often repeated, proposals and actions as required.

It is a cumulative process, which increasingly demonstrates that the problems are not only recognised but also understood, and most crucially, that they are being addressed.

During a crisis, the crowd becomes emotional and infantilized. However one is less likely to panic when leadership and reassurances are provided. This is as important for the stock market as it is with a frightened child, because both are inclined to overreact.

Here is more on the specific proposals, released over the weekend.

Email of the day (1) - On a China leash effect:

"In your Sat 29th March audio, you described how the Wall St credit crunch was having a malign influence on stock markets world wide - even the Asian and resources markets which form the backbone of the Fullermoney theme. It seems to me however, that we are forgetting, or minimising the effect the Chinese economy and stock markets are having upon the rest of Asia. The PBOC have a huge inflation problem on their hands, and that is their focus, whereas the Fed has its eye on recession and deflation. Accordingly, while the Fed is injecting liquidity into their system, China is withdrawing it from theirs. I am raising the points you have made in the past I believe - that not only do we have to watch out for the Wall Street "leash effect", but we have to be just as aware of the China "leash effect", particularly on their Asian neighbours. I wonder to what extent Asian markets taking such a hit has been influenced more by the latter than the former. By the same token, If the

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PBOC should introduce measures which have the effect of their stock markets turning positive as dramatically as they have fallen, could this not augur well for the rest of Asia (and indeed other markets), regardless of any ongoing rumbles created by the US credit crunch?"

My comment - I have indeed commented on both the Wall Street and China's leash effect on other markets in Audios and also Comment of the Day. The latter can be accessed by searching the Archives under the word leash. I agree with your points except for China "withdrawing" liquidity. Instead, I would say that while Chinese officials have responsibly increased the price of borrowing somewhat, and also bank reserve requirements, liquidity remains abundant.

I agree that China's weak stock market has been a negative influence regionally, and that if the PBOC were to target equities as they last did in 2004, it would have a very positive influence. There have been rumours that this may occur, particularly regarding the curbing of new supply, although I am not aware any actual moves to cushion downside risk. My guess is that some trial balloons are being floated and that PBOC monetary officials would like the Shanghai Composite Index to bottom between current levels and 3000. I also maintain that they would like a steadier stock market before the Olympics in August.

From and investment perspective, which would you rather own today, gold or the Chinese stock market? - The two markets are not mutually exclusive, of course, but I suspect most people would say gold. They might think again after reading this article from China Daily, kindly forwarded by a subscriber. Here are a few brief samples:

For Yuan Yuan, a 26-year-old office employee at a Japanese advertising company in Shanghai, buying gold gives her peace of mind after watching the value of her stock portfolio plunge almost 30 percent in the past two months.

"The number of people who approached us for advice on opening gold trading accounts has increased about 200 percent in the past month, compared to the monthly average last year," Fu Jing, an analyst at Qianhe Investment Co in Shanghai, said. Most of the new investors were reportedly individuals switching, at least temporarily, from stocks. "Many individual investors like to buy gold bullion in 50g or 100g pieces," Fu said.

Shanghai Yayi Jewelry is also seeing no letdown in a buying frenzy that began at the end of last year. "There is no sign of a sales decline, although gold prices in the global market have risen quite a lot," a salesman at the store said.

My view - I still like gold for the long term, but maintain that it is a crowded trade, which may have completed another medium-term upside cycle. Consequently I sold the last of my gold and silver futures earlier this month, although I still hold mining shares for the long term.

I also like China for the long term, although I missed an opportunity to take profits when the crowd was still piling in near the last peak. I'm not too troubled by that because I have an unleveraged position. However I would have liked to have been more aware of risk on behalf of subscribers.

When I look at these charts of the Shanghai Composite Index (weekly & monthly) and Gold (weekly & monthly), and ask myself: Which will be the first to double from today's levels? I would bet on the Shanghai Composite.

However since I cannot buy the Shanghai Composite, what I am also saying is that any China fund from the Library has a good chance of doubling from today's price before gold sees a similar upside move.

Meanwhile, I am sure I will be interested in gold futures once again if the price approaches $800. This may require some negative news, such as IMF selling - a story that has dropped back beneath investment radar recently.

Email of the day (2) - On creating personalised sections in the Library:

"Just wondering what is the simplest way to isolate (1)all the ETFs and (2) The Investment Trusts that are available in the chart library?"

My comment - Why not create your own customised 'Favourites' lists, to which you can easily and quickly add or subtract items? See the Library 'Help' link for specific instructions on how to do this, if required.

Not Waving But Drowning - Here is more wit and wisdom from Tim Price.

Email of the day (3) - On long-term trend lines:

"Whilst I know that you are not a fan of trend lines - if you look at the 5 year charts on MSCI Asia Pacific ex Japan, Hong Kong and the Nifty you can see that they have all moved back above their long term trendlines. I think that these are significant events particularly the Asia chart as this is now the 3rd bounce. Having sailed and used charts I remind myself that the trendline represents the direction to the desired location (rate of average growth) and the price represents where the tide is taking me. I think that these long term trendlines are important in the current uncertain environment because they enable long term investors to take positions with reasonable confidence."

My comment - For those new to technical analysis, I do feel that trend lines can overused, sometimes to the point of becoming an analytical crutch or at least clutter. However as you probably realise, I sometimes use a long-term trendline on weekly charts as a smoothing device, particularly to highlight scope for mean reversion following overextensions. I liked you nautical analogy.

An important interview with Marius Kloppers of BHP Billiton - This item by Mary Kissel for The Wall Street Journal will be of interest to many subscribers who hold BHP, Rio and other key mining shares, as do I.

Email of the day (4) - On Baby Steps range trading:

"You have said that you believe that the Baby Steps buy-low-sell-high range trading strategy is appropriate for today's environment. Can your Baby Steps tactic be used for individual stocks? I still have not got the full gist of your Baby Steps methodology. Would it be possible for you to illustrate a working example using a chart or charts? I am sure a good number of your other subscribers would like a lesson as well.

"Many thanks for a fantastic service which I think is second to none. I have just renewed my subscription for the 'umpteenth' time which I feel is great value for money."

My comment - Thank you for your generous praise and support over so many years.

Regarding Baby Steps, I imagine you have read my original article from 1992 and the follow up in 2004 which is attached. You can use Baby Steps for individual stocks and the optimum time for this tactic is when a market that you like is clearly, objectively fundamentally and technically undervalued, but ranging in a potentially lengthy Type-3 base formation.

The best Baby Steps candidates will have some volatility, providing the opportunities to buy-low-sell-high, long positions only if we are talking about a cheap market, effectively harvesting the range before the next uptrend commences.

It is not that easy to illustrate an example, not least because that would be arbitrary and artificial. However I have demonstrated Baby Steps in my own account, mainly with trading, although it is a viable tactic for investors to consider if the valuation criteria mentioned above apply.

You may recall my active Baby Steps trades in silver commencing around 2002, as I recall, and until ranging gave way to more orderly trending. Much more recently, I have done a bit of Baby Steps trading in the Hang Seng and Nikkei indices.

Please note - Eoin is on paternity leave but will be back next week.

Tuesday 1st April 2008

Stunning technical action today for stock markets in Europe and the Americas - Today's action validates bullish sentiment indicators and reaffirms support from the January and March lows for stock market indices. Increasingly, the

ranging chart patterns that we see look like base formation development prior to upside trending action. Inevitably some will recover more quickly than others and here is one of the leaders, followed by a laggard:

USA (Transportation) - Note the upward dynamics since 23rd January. There is some lateral and psychological resistance near 5000 but a close beneath 4590 would now be required to question current scope for sideways to higher ranging.

USA (S&P 500 Banks) - The January and March lows continue to hold and today's upward dynamic is consistent with support building. However, until this underperformer becomes an outperformer, upside progress on Wall Street will be characterised by more sideways than higher trending action.

USA (Nasdaq 100) - The Nasdaq is often a lead indicator and this is an impressive move. A close beneath 1760 would now be required to indicate an upside failure and further base extension before this pattern supports higher levels.

Mexico (MEXBOL) - Surged to break last two rally highs and test upper side of range where some resistance can be anticipated. However a move back below 30000 would be required to question medium-term scope for a sustained upside breakout from this ranging pattern.

Brazil (IBOV) - A close beneath 57850 would be required to offset current scope for at least a test of the upper boundary.

Europe (DJ Euro Banks) - Testing upper boundary and a close beneath 330 would be required to reaffirm significant resistance here.

Switzerland (SMI) - Upward dynamic reaffirms support near January and March lows. A close beneath 7070 would be needed to offset current scope for sideways to higher ranging.

Ireland (ISEQ) - Found support above last month's low in somewhat overstretched downtrend but still an overall underperformer and needs a move above 7000 to indicate significant improvement.

Sweden (OMX) - Impressive recovery to upper side of range following successful test of January low - would require a downward dynamic to indicate more than temporary resistance here.

Vietnam (VNINDEX) - Overextended, so some basing action near psychological 500 level likely before long.

Crude oil (WTI) - Three downward dynamics since last month's all-time high indicate some deleveraging. A close back beneath the psychological $100 would suggest a further reaction.

Gold - Resumed decline from psychological $1000 level, breaking another reaction low in the process. A close above $955 would be required to offset current scope for additional weakness towards Nov-Dec 2007 range.

US Dollar Index - Encountered support above mid-March low, and a close beneath 71.30 would be required to offset current scope for some additional sideways to higher ranging as the previous oversold condition is unwound.

Email of the day (1) - On gold, (sent 25th March):

"Your service, as usual is excellent. Your comments over the past several weeks about the risks associated with precious metals and agricultural commodities were prophetic, given what happened last week. Eoin's summary about the potential for further falls and likely long convalescent period (1 year) in precious metals suggest that, at a minimum now is not a time to buy. I consider myself a medium to long term investor, who is heavily weighted in the Fullermoney themes generally. However, I am particularly concerned about my exposure to precious metals given Eoin's comments above, which seem quite logical. His comments about waiting for sentiment to turn negative and to see evidence of support building before starting a baby steps approach to buying make a lot of sense. Would I be better selling my existing PM position on the next rally and then waiting for evidence of support building before re-accumulating via the baby steps approach?"

My comment - Thanks for your kind words.

Unfortunately, I am well behind in covering all the emails of general interest but I trust you answered your own question, given your thought process above, and on seeing our coverage before and after Eoin's sensible view quoted above.

Additionally, one's tactics should vary depending on time horizon, exposure, whether or not leverage is used and whether in bullion, shares or both.

As a basic strategy, if a position does exceptionally well, let alone accelerates, money control discipline would suggest lightening or at least introducing trailing stops to lock in most of the profit, even if one likes the long-term theme, as no one can be sure what will happen over the long term. If leveraged, this strategy is a must.

And above all, we want to avoid chasing a popular theme, no matter how promising, only to be shaken out later near the bottom of the next inevitable correction. Using sentiment as a contrary indicator, including our own feelings of elation and fear, will help us to maintain analytical perspective when others become emotional.

You probably saw how I sold the last of my gold and silver futures long positions last month. It would have been an expensive tactical blunder to lose those gains in leveraged positions. As PM futures weakened, I though about selling some of my unleveraged long-term gold shares / funds positions,

knowing that they would experience a drawdown during the next correction. However I decided against this because although they showed relative performance, they had been held back by nervous stock market conditions. Also, the long-term uptrend is intact.

What's wrong with Wall St. and how to fix it - My thanks to a subscriber for this excellent article by Shawn Tully for Fortune. Here is a brief section, reminding us of what happened:

The truth is that Wall Street's shocking reversal of fortune was inevitable. Its black box is virtually guaranteed to careen from record riches to deep losses and ensure that employees grab a fat share of the booty. "As margins shrank in traditional businesses like underwriting and brokerage, Wall Street looked for new places to make money," says Louis Pizante, a former investment banker at Goldman Sachs and Nomura who runs Mavent, a leading compliance firm that ensures that mortgages bought by Fannie Mae and other institutions comply with federal and state regulations. "In the process the firms took imprudent risks to make big profits."

Put simply, Wall Street firms used towering leverage to make lottery-like loot in a long-running bull market that blatantly underpriced risk. Now that run is over, and the price of risk is rising dramatically. That's driving down the value of everything from junk bonds to mortgage-backed securities, and Wall Street's addiction to leverage is cutting the wrong way. The Bear Stearns story is a primer on the Wall Street curse: When portfolios are built on a mountain of debt, a firm's capital can vanish overnight.

Redemption won't be easy. The firms' three big weaknesses are deeply embedded in Wall Street culture. The first is that they depend far too heavily on risky trading as opposed to solid, reliable fee businesses favored by commercial banks. Second, Wall Street embraces leverage levels so dangerous that its vaunted risk-management systems can't prevent a collapse. Third, an outsized share of the gains goes out the door to executives and traders when times are good - or rather, when the firms get lucky - leaving shareholders with far less wealth when markets go sour.

The first issue - trading - is complex. Just a few years ago Wall Street garnered most of its revenue from fee-based businesses, including M&A advisory, equity and debt underwriting, and asset management. But from 2000 to 2006 trading jumped from 41% to 54% of revenues for the Big Five, rising to $70 billion a year. That figure includes commissions earned for executing trades for customers, as well as proprietary trading - investments made by the firm with its own money. Proprietary trading has accounted for most of the increase in revenue, but it's problematic in several ways. Wall Street firms occupy a highly privileged position for viewing which investors are buying or selling which stocks and bonds. That's because they fill orders for market-moving mutual funds like Fidelity and T. Rowe Price. They also own large "prime brokerage" arms that clear trades for hedge funds. Wall Street firms have always denied using information from their clients' trades in any way. But anyone who really knows the business will tell you that the firms use

that intelligence to trade for their own accounts. Traders even have a name for it: They call it "color." "There's some truth to their having an advantage on information," says Scott Sprinzen, an analyst with Standard & Poor's. Though their fund clients complain about the practice, they put up with it - in part because Wall Street gives them lucrative allocations of initial public offerings.

We're not talking about the notorious - and illegal - activity known as front running, in which a firm takes a mutual fund's order, then buys the stocks or bonds for its own account before executing the customer's trade. Rather, Wall Street operates within the law by exploiting its intimate knowledge of the funds' trading patterns. For example, let's say a big mutual fund that owns no Oracle stock places an order for one million shares, and the broker knows that the fund typically builds a large position in several stages. The firm can profit by buying Oracle shares for its own account or by investing in a software index that will rise with Oracle's stock price.

My view - Leverage, of course, was an even bigger problem. Shawn Tully mentions the increased capital requirements for investment banks that became inevitable once the Fed felt it had to rescue Bear Stearns. He also predicts the end of independence for US investment banks, believing that more of them will be taken over and run by big diversified banks, which is basically the European model.

The trouble is, most US and European diversified financial institutions were also brought to their knees by leveraged credit-related problems.

Michael Lewitt on How To Fix It - For a much tougher view on this problem, I was impressed and heartened last night when I read Michael Lewitt's paper, reproduced by John Mauldin's "Outside The Box". Michael Lewitt is President of HCM (Hegemony Capital Management). He has written a much needed and groundbreaking report which will interest all visitors to this site. Here are a few samples, commencing with a quote on morality by Adam Smith:

> "This disposition to admire, and almost to worship, the rich and the powerful, and to despise, or, at least, to neglect, persons of poor and mean condition, though necessary both to establish and to maintain the distinction of ranks and the order of society, is, at the same time, the great and most universal cause of the corruption of our moral sentiments."
> Adam Smith, The Theory of Moral Sentiments (1759)

On financial speculation over production:

American Capitalism In Need of Repair2
We all know Adam Smith as the author of the bible of capitalism, The Wealth of Nations (1776). But he first wrote what is arguably a far more important book, The Theory of Moral Sentiments, from which the quote that heads this month's newsletter is drawn. America is rushing headlong into the 21st century without a proper understanding of what economic policies and financial tools are going to be required to prosper in a changing world. For

more than two decades, the United States economy has favored financial speculation over production. Over the past century, our legal system had developed an increasingly outmoded concept of fiduciary duty that privileges short-term, single-firm interests over the kind of long-term, society-wide interests that could lead to prolonged prosperity. The current meltdown in the financial markets is a symptom of a serious disease that is eating away at the stability of our most important institutions. What we are witnessing might well be the end of American financial hegemony, which is the result of a burgeoning global economy. The current crisis in financial markets gives us an opportunity to evaluate how we can better prepare ourselves to deal with a borderless world.

On fiduciary responsibility:

The fiduciary law that governs our business culture reaches back to the 15th century and requires those who are entrusted with managing our largest corporations or pools of money to act in the best interests of their shareholders or clients. But the evolution of fiduciary law has developed into a mode of thinking that privileges short-term, single-company results over long-term, society-wide results. Consequently, fiduciaries are driven by a logic that dictates a focus on the short term, which can be more accurately predicted than the long-term. But there is something deeper at work in this mindset. Fiduciary thought privileges form over substance, procedure over justice. Decisions that serve a single corporation's shareholders may cause significant harm to a wider array of interests. The entire concept of fiduciary duty must be rethought if capitalism is going to flourish in a borderless, digitalized world. Instead of a narrow focus on the interests of a single firm's shareholders, the fiduciaries of our large business enterprises are going to have to widen their arc of concern to a wider group of constituencies. Without such a broadening of focus, narrow interests will continue to place the entire system in jeopardy because of the networked nature of today's financial markets.

On private equity:

The private equity business has resulted in the overleveraging of American business. One result is that many businesses are short-changing capital expenditures and research and development in order to service debt. Despite the statistics promulgated by self-serving, private equity-financed industry groups, it is irrefutable that companies would have more money to contribute to the productive stock of the economy if they were devoting less money to servicing their enormous debts. We will look back at the private equity boom as a phenomenon that damaged the American economy and impaired America's competitive position in the world.

The private equity boom is the quintessential example of what the economist Hyman Minsky termed "speculative finance" and, in its most extreme form, "Ponzi finance."4 Private equity deals add little or nothing to the productive capacity or capital base of the economy. Instead, they merely create debts that have to be serviced and divert cash to the activity of servicing debt rather than creating jobs or funding new projects or research. In 50 years, it is going to be clear that the U.S. economy has paid a terrible price for this.

On financial institution leverage:

Allowing investment banks to be leveraged to the tune of 30 to 1 is the equivalent of playing Russian roulette with 5 of the 6 chambers of the gun loaded. If one adds the off-balance sheet liabilities to this leverage, you might as well fill the 6th chamber with a bullet and pull the trigger. If this continues, the odds of a systemic crisis more severe than the one we are experiencing are near 100%. An absolute leverage limit should be imposed on investment banks and other financial institutions.6 Some will argue that limiting financial institution leverage will render these businesses less profitable and less competitive with non-U.S. companies. HCM's response is - "so what?" Perhaps less profitable investment banks will result in more of America's talented students becoming scientists, engineers, doctors and teachers instead of investment bankers and mortgage traders. What would be so terrible about that?

On hedge fund leverage:

Allowing unregulated entities such as hedge funds to be leveraged 10 to 1 or 15 to 1 would be laughable if it wasn't so dangerous. Prime brokers continue to be suckers for big names and big clients (and especially for big name clients). As a result, they often extend credit to parties who are not qualified to employ it prudently. HCM has expressed its view on more than one occasion that fixed income strategies that require excessive amounts of leverage do not make sense and have never made sense. We would refer anybody who disagrees with us to the recent collapses of Sowood Capital Management, LP, Peloton Partners LLP and Carlyle Capital Corp. Each of these firms reportedly employed high amounts of leverage (reportedly more than 15x) in their strategies. An absolute leverage limitation should be placed on hedge funds immediately. Since the prime brokers don't seem to want to impose such a limitation, the Federal Reserve should do so with its new powers. If investors can't generate decent returns without employing grotesque amounts of leverage, they should find another profession.

On the downtick rule (often described as the uptick rule):

Short selling is an absolutely legitimate way to invest or hedge a portfolio. The SEC made a major error when it repealed the downtick rule last year. The repeal of this rule increased downside volatility exponentially and contributed to the ability of quantitative and other computer-driven selling to push the market lower based on technical rather than fundamental investment considerations. The SEC should reinstitute the downtick rule immediately.

My view - Well said Michael Lewitt! Some of these points will resonate with veteran subscribers and I commend the entire article to you.

It has been with sadness in recent years that I have often described the USA as the epicentre of global risk. If this report heralds the beginning of a root and branch overhaul of financial governance in the country, as I hope, then America will be on the mend.

Email of the day (2) - On UltraShort Dow30 ProShares:

"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 - Thanks for the feedback.

Yes, DXD is listed but to see it you need to click on the "International Equities" Search in the Library. Regarding your second question, I'm not sure about the ISA account, which would presumably require a UK listing, but your provider would know. You should have more freedom with the SIPP account.

Email of the day (3) - On "the legendary Finucane":

"Pls see below an interesting piece on the legendary Finucane. Like Fullermoney, he seems to be the lonely voice in this scary time. He is 67. I don't know your exact age David, but it's no secret that you are over 60. Perhaps it's the time to listen to the 60-something of wisdom.

"If you and Finucane have been right all along calling the mega lows in the last 40 or so years, why "this time is different"?"

My comment - Being only 66 myself, I yield to James Finucane on experience. I enjoyed the article - colourful, shrewd and history is on his side.

He is also right about market lows being somewhat easier to spot than tops, euphoric accelerations excepted. An important low is more emotional, with the crowd panicking; there is often a visible crisis, and central banks are galvanized into action.

US Equities: Technical Chart Outlook - My thanks to a subscriber for this very good, timely report by Mensur Pocinci for Credit Suisse, posted without further comment.

Please note - Eoin is on paternity leave but will return next week.

Wednesday 2nd April 2008

Hong Kong: Crisis or Opportunity? - My thanks to Chris Roberts of Lux-Topic Pacific Fund for his latest report. Chris is an old friend, who veteran subscribers will recall from his CLSA days when he produced the popular

'Trendlines & Breakout!' publication, now a collector's item in the Fullermoney Archives. Here is the opening from his latest report:

Looking at the recent Hong Kong stock market action one is reminded of the Asian crisis or Sars. But around Hong Kong the mood is more akin to the euphoria at the height of the 1997 bull market: the streets are busy and the shops are full of people. If you want to eat at your favourite restaurant you'd better book a day in advance.

Why the disparity? The man in the street feel-good factor is rather easy to explain: a 3.3% unemployment rate and a high demand for skilled labour puts upward pressure on salaries. Households have strong cash flow. The typical homebuyer's mortgage is linked to the prime rate, abundant liquidity in the banking system and low growth in demand for mortgages in recent years has led banks to offer deep discounts to this benchmark rate. In recent years the vast majority of new mortgages have been priced at prime minus 2.5% or more. With the prime rate now down to 5.25% at the big banks and 5.5% at the smaller ones, hardly anybody is paying more than 2.75% for their home loan. It's worth noting that the monthly mortgage payments of households have more than halved since the middle of 2006. In addition, during this period, prices for residential properties have risen and remain in a solid upward trend.

And another brief portion:

So why the slump in the stock market and huge volatility

The US sub-prime crisis is sending shock waves through financial markets worldwide. Although Hong Kong has fairly little direct exposure, the crisis in the US has struck a blow to local confidence. In a globally linked world problems in the U.S. affect other markets; investors in need of more liquidity may sell their Hong Kong equities (where they made good profits in 2007). In addition, globally active Hedge Funds and proprietary trading desks of investment banks have decreased risk capital to invest and more stringent credit control and thus positions everywhere are reduced as de-leveraging spreads.

In addition to de-leveraging in a nervous environment traders are actively short selling. On a normal day short sales may account for some 4% of trading volume. Now brokers report that this part of the market's turnover is surging to 20% of the total on certain days.

My view - I think Hong Kong's current and long-term fundamentals are attractive, although inflation is somewhat of a problem. As for the big market swings, it is all about confidence, liquidity and leverage, which increase on the upside and contracts on the downside.

Chris Robert's forecast for Hong Kong will certainly raise a few eyebrows. He expects the Hang Seng Index to exceed 65,000 in the next five years! That is a bold forecast but not outrageous, with the usual proviso that there is no disaster for currently unknown reasons. Meanwhile, GDP growth in Hong

Kong and China's could be as good over the next five years as it was during the last five.

With Chris' technical skills the Lux - Topic Pacific Fund should do very well in a bull market. One can also invest in Hong Kong via ETF and iShares trackers listed in the Library. I would not pay up, as the mainland China leash-effect is still negative, but this too is likely to improve in coming months.

Email of the day (1) - On John Hussman's quip regarding the difference between a liquidity and solvency crisis:

"Immediately below is the email permission I received from Dr. John Hussman to re-publish in your daily commentary, should you consider it worthy, a link to Dr. Hussman's weekly commentary (March 17) and an excerpt from that commentary, both found further below. I thought Fullermoney subscribers might benefit and enjoy Dr. Hussman's concise, lucid and humorous explanation of a "liquidity crisis" vs. a "solvency crisis"."

"Thank you for your request to quote John Hussman's commentary. We forwarded your request to Dr. Hussman and he said he would be fine with your use of his material as described in your inquiry."

"I'm a regular reader of you commentary, which I find very informative. I'm also a subscriber to www.fullermoney.com which publishes a daily newsletter and audio commentary that frequently includes, when permitted, links or excerpts from outside publications.

"I'm writing to ask your permission to submit to Fullermoney, for consideration of re-publication, the following link and excerpt from your March 17, commentary:

"A Liquidity Crisis is when you write a check for more than the amount in your checking account. You suddenly realize that you need to sell a big securities position to cover it, but selling everything at once might only get you "fire sale" prices. In this case, you need a loan for a few weeks to give you time to work out of your securities position. Without that short-term "liquidity", the check might bounce even though you really do have the assets to pay it off. In contrast, a Solvency Crisis is when the only asset you have to cover that check is an IOU from your Uncle Ernie, who keeps promising "I'll pay you every dime as soon as I win it back on the ponies."

"Warm regards and thanks for your regular contribution to my education."

My comment - Phew! I must be OK then because the IOU I hold is from my brother-in-law's broker.

Thanks for your kind words, informative commentary for the Collective, and for securing the ever-interesting John Hussman's permission to post his letter.

Email of the day (2) - More on vehicles for shorting the stock market:

"I am a UK based investor and have researched this same issue. In my experience ISAs have more restrictions on what instruments can be held than SIPPs. If one is interested in shorting on a leveraged basis it would be worthwhile investigating some of the derivative instruments issued by certain banks which can be traded in investment accounts including SIPPs. For instance, Soc Gen has a wide range of Covered Warrants, Trackers and other structured products that should meet most requirements for aggressive investment strategies. It is also possible to use the Baby Steps technique with these instruments."

My comment - Thanks for the informative feedback.

Other than sharing information, I suspect this is a conversation that would have been more advantageous a year ago, rather than today. For the record, my own occasional stock market shorts have occurred in index futures, via spread-bet firms. These have been reported in Comment of the Day, along with all my other trades and investments.

Email of the day (3) - On inflation:

"I was wondering what you make of the increased inflation reports on Bloomberg today [recently] of Iceland, South Africa and Russia and how you see this playing out on the markets over the months and years ahead."

My view - The Fullermoney view from early this decade, often repeated - and particularly in the Friday big picture, long-term outlook Audios - was that the world was not sliding into a widespread deflation as generally feared. Yes, there were obviously some deflationary pockets, not least in manufacturing costs due to globalisation. However central banks, and not least the Fed, had already sown the seeds for the next long-term inflationary cycle due to aggressively expansionary monetary policies. The first inflationary flash point occurred with industrial resources, in line with Fullermoney's secular theme: Supply Inelasticity Meets Rising Demand. This subsequently spread to food prices.

What next?

I believe that resources inflation will wax and wane, in line with supply and demand, but with an overall upward bias more often than not.

Supply will be determined by what is often a big effort to increase production, or at least production capability, handicapped by various factors such as costs, nationalisation, scarcity, hoarding, accidents and weather.

Demand will continue to grow, more often than not, in line with global GDP growth, which will continue to be led by the dynamic engines of Asia's bigger countries in terms of population. Economic slowdown, such as we currently

see, or even widespread recession as occurred in 1997-1998 and 2001-2002, will only slow demand for many essential commodities such as energy and foods. Substitution or investment fashions are likely to be bigger influences in terms of price cyclicality.

A consequence of resources inflation, particularly for food and energy, is that the cost of essentials rises faster than the price of most discretionary consumer items. This can put upward pressure on wages, particularly where economic growth is robust.

Recently, inflationary pressures have reached a medium-term cyclical peak, following the overextended fashion for investment in commodities. Additionally, economic slowdown will mitigate wage inflation somewhat. However, we should not expect to see much in the way of retail price reductions for energy or foods.

Central bankers will 'talk the talk', in terms of managing inflationary expectations. But remember, they are closet inflationists, particularly in countries where government debt is high.

As for how this will play out in the markets, equities often do best in a disinflationary environment, which we no longer have in terms of a secular trend. However stocks can also be a hedge against inflation provided that companies can pass on inflationary cost increases. If central banks are tightening monetary policy, or at least increasing the cost of money, this will be a headwind for equities as we saw commencing last year. That policy is gradually ending, led by US rate cuts.

Email of the day (4) - On liquidity versus solvency:

"I attach the latest article from Anatole Kaletsky which may be of interest to subscribers. It's the best analysis of the "liquidity vs. solvency" debate I have seen. It helps explain how much of the market turmoil really is about fear and uncertainly rather than anything remotely to do with fundamentals. Hopefully it should help support the move back to more rational behaviours that we all long for."

My comment - Bless the collective! This is another informative article, which I would have otherwise missed due to a hectic schedule recently, despite purchasing The Times every day. I agree with your conclusion and suspect most investors will gain valuable perspective from this article.

Email of the day (5) - More Hussman, this time on sentiment:

"Thought these comments from John Hussman were interesting. His weekly article re Bear Stearns [discussed in Email (1) above] was also interesting:

"Much has been made of the low percentage of investment advisors who are bullish - a low 31.1% according to Investors Intelligence - with some suggesting that stocks may be near a bottom on the basis of "contrary opinion." The problem , as I noted years ago (e.g. Law of Large Numbers), is that "before looking at advisory sentiment, we have to factor out the portion that is explained simply by past market movements. Once we've done this, we are left with a much more informative indicator."

"All of the forecasting usefulness of those figures is contained in the "excess" bullishness or bearishness - the extent to which sentiment figures are higher or lower than what you would expect, given recent market movements. Presently, the level of advisory bullishness is not much below where we would expect it to be, given the market decline that we've observed. That's often the case early in bull or bear markets. High bullishness in early bull markets is typically not a negative, because the initial advance is generally very powerful. Likewise, very low bullishness is typically not a negative early in bear markets, because the initial decline is often fairly deep.

In short, aside from some potential for a "clearing rally" to correct the short-term oversold condition of the market, even the low advisory bullishness figures provide little evidence for a "contrary opinion" call on the market."

My comment - In my experience, sentiment indicators work better at market bottoms than tops, as also mentioned yesterday, because a selling climax is generally more emotional than buying climaxes. The main exceptions are during accelerated bubble feeding frenzies.

There is always a theoretical possibility that markets can become even more oversold following historic extremes of bearish sentiment. However, this usually requires a new negative influence that few people have been unaware of previously, such as one of Donald Rumsfeld's "unknown unknowns".

Historically, I have been more impressed by the accuracy of extremely bearish sentiment readings, in identifying market troughs, than subjective assessments as to how low stock markets should fall.

Email of the day (6) - On Nils Taube:

"How about acknowledging Nils Taube's great contribution to investing?"

My comment - Absolutely, and thanks for attaching this item as I had not been aware of his death. I met him at least once, many years ago during a lunch at Kitkat & Aitken. He had an incisive mind and obviously a fascinating history of which I was only slightly aware. Judging from the first line of his obituary, Nils Taube was as clinical in his passing as with his analysis. I suspect most of us hope to do as well, enjoying our profession / vocation, and with all our mental faculties right until the end.

Today's interesting charts - Price charts offer empowerment. They enable you

to vet markets quickly and in perspective. Nothing else enables you to do this as efficiently and insightfully.

UK (FTSE 350 Banks) - Testing prior resistance near February highs where some hesitation may be seen. However, note the number of upward dynamics (big upside days in blue) relative to downward dynamics (big red down days). These are a characteristic of base formation development prior to a sustained recovery. Risk appears limited to an extension of the present trading range.

Japan (Topix Banks) - Upward dynamic confirms failed break beneath January low. A close beneath 238 is required to offset current scope for some additional recovery.

Australia (S&P ASX Finance) - Approaching potential resistance near 5500 but three upward dynamics recently have broken the steep downward trend and indicate that an important low was reached last month.

USA (Thrifts & Mortgage) - Possible base development but needs further improvement to signal end of housing crisis preoccupation by investors.

China (Shanghai Comp) - A negative leash-effect for Asia but becoming overstretched and approaching next area of potential support near 3000.

Hong Kong (HSI) - Approaching are of potential resistance from February highs but failed break beneath January low is a sign of base formation development.

Please note - Eoin is on paternity leave but will return next week.

Thursday 3rd April 2008

Small investors in China get a lesson in stock bubbles - My thanks to colleague Jackson Wong of Investors Intelligence for this sad but illuminating tale, reported by David Barboza for the International Herald Tribune, which will interest contrary opinion investors. Here is the opening:

A year ago, investors like Guan Ling were ebullient. The mainland Chinese stock markets had climbed about 500 percent in two years, setting off a stock buying frenzy.

When experts periodically warned about the possibility of a bubble, prices dipped temporarily, then soared even higher, breaking records and inciting another mad dash to snap up equities.

"The market was going wild," said Guan, 49, who a few years ago closed his real estate company to invest in stocks full time. "Everybody was talking about how much they had earned, how much more they would invest and which stocks had jumped 20 times, or even 30 times."

That was last year. The Shanghai composite index has plunged 45 percent

from its high, reached last October. The first quarter of this year, which ended Monday with a huge sell-off, was the worst ever for the market.

Suddenly, millions of small investors who were crowding into brokerage houses, spending the entire day there playing cards, trading stocks, eating noodles and cheering on the markets with other day traders and retirees, are feeling depressed and angry.

"These days my family quarrels a lot," says Zhang Liying, 55, a retired hotel waitress who with her husband invested all their savings in the stock market. "My husband asked me to sell; I wanted to hold for a while. Now my husband condemns me as so stupid that we lost our family's savings."

Si Dansu is even more distraught, but she blames the government.

"I devoted my whole life to the country," Si said. "I went to the countryside after graduation, and worked as an engineer in a Shanghai factory until retirement. I invested almost all my savings and retirement fund in the market 10 years ago. But now I'm totally penniless. All my stocks went down."

My view - Jackson is drawn to Fullermoney's behavioural approach and subscriber's may recall this item posted on 5th December:

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

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

Considering that the magazine feature above also coincided with the Shanghai Composite Index's (monthly, weekly & daily) peak in October, what can we conclude from today's angst expressed by private investors in Shanghai? In other words, are the two reports above comparable, albeit reflecting opposite extremes of emotion?

Almost, although the recent IHT article was not a front page item, it is certainly evidence of the despondency that veteran subscribers will recall near previous stock market lows. While the charts above have yet to signal a bottom, and it is the nature of crowd-driven markets to overshoot, I think downside risk for mainland China's share indices is now limited to, at worst, a brief and unsustainable additional acceleration.

What might trigger this? Momentum and concern over the portion of corporate profits attributed to stock market speculation, which are not repeatable, at

least until the next bull phase. For investors in mainland China, I do not believe that is a risk worth selling for. Instead, any additional weakness, should it occur, would be a buying opportunity in my opinion. The ending pattern is likely to be of the Type-2 variety as taught at The Chart Seminar - V-bottom, with right-hand extension.

Interestingly, it does look to me as if the lows for the Hang Seng and H-Shares Indices were reached last month, although we won't have confirmation until a higher low and higher high are established.

Email of the day (1) - On concern over English comprehension at TCS:

"Dear David, this mail is about the Chart Seminar. I would love to assist [attend?] but I have some doubts: my English reading is ok, but my English listening and understanding is not that good and I am afraid to miss a lot of information.

"Do you give handouts and written material in order to catch up with the items one could not follow appropriately? Do you think the dynamic of the Seminar is friendly in order to understand most of it, given my handicap in the language?

"Many thanks for your thoughts."

My comment - It is a pleasure and I should mention to all readers that this gentleman had previously asked if he could bring an interpreter. I tried that on a couple of occasions during the decades when I taught the workshop. Regrettably, it was a disaster in terms of being a distraction for other delegates and also me.

We do not use handouts of course material because the essence and success of TCS is in tailoring each workshop in line with the delegates' interests and market activity at the time. For instance, delegates provide all the working examples, which are then interpreted using Fullermoney's behavioural - factual approach.

As a subscriber, if you can understand Eoin's Audios, you should be able to absorb most of the course material, not least because it is illustrated with charts. We have had many delegates for whom English was a challenge, and my impression was that most were pleasantly surprised at how much they did understand. Also, you would be able to question Eoin during the breaks. I recall a deaf delegate who attended and said later that he could follow most of the seminar, even questions from the floor, which are usually repeated.

Email of the day (2) - On AUD-GBP Interest Rate Spread:

"Good morning David & Eoin. I am looking forward to attending your chart seminar in May. With David's NZ cash investments in mind, on a recent holiday to Australia (from the UK) I took the opportunity to to open a bank

account. I now have term deposit accounts of 3,6 & 12 months paying 7.6%, 7.7% and 7.8% respectively. I check the AUD / £ rate using your chart library and found this chart "AUD-GBP Int Rate Spread". Would you please explain what this chart shows us fundamentally. In my ignorance I expected the spread to change infrequently (or in line with changes made by the BOE or Oz bank) and not daily.

"As always thanks for your great service."

My comment - Thanks for your kind words and I hope to meet you at the reception following TCS's second day.

The chart (weekly & monthly) you refer to was probably requested by a subscriber. At the risk of embarrassing myself, I suspect it shows the compounding rate differential, working in your favour if you are long AUD or against you if short against GBP. If I'm wrong a correction will soon arrive from the Collective. Meanwhile, isn't the monthly chart aesthetically pleasing? As modern art, it beats much of what I see in the auction rooms.

Thoughts From The Emerging Markets Strategy Roadshow - My thanks to a subscriber for this interesting report by Robert Buckland and colleagues at Citigroup. Here is a brief section:

Emerging Markets have outperformed for seven consecutive years now and we think they can outperform again in 2008. Our bullish view is based on a number of drivers, including (1) relatively resilient economic and earnings growth, (2) valuations that suggest the region is not overly expensive, and (3) Emerging Markets are a likely beneficiary of much of the cheap money being pumped into the financial system right now. We discuss each of these drivers below.

For 2008, our economists forecast the slowest year of global growth (2.8%) since 2003. In comparison to the past 20 years, this would be a relatively mild downturn. Developed markets have seen the greatest downgrades to expectations. Over the last six months, 2008 GDP forecasts for the US have come down from 2.5% to 0.8%. Similar declines have been seen in Europe - the UK from 2.8% to 1.4% and the Euro zone from 2.3% to 1.3%. In comparison, the downgrades to Emerging Market GDP forecasts have been more modest. Six months ago our Emerging Market economists forecasted 2008 real GDP to grow by 6.9%. Now the forecast stands at 6.1%. This is broadly trend growth. While our economists do not subscribe to the decoupling argument, they do believe that Emerging Market economies are far better positioned to deal with a developed market slowdown than in previous cycles.

The supportive macro backdrop for Emerging Markets should ensure greater earnings resilience than elsewhere. IBES consensus expectations are for 14.8% earnings growth in 2008. While we suspect this will prove to be too high, the likely downgrades should be small compared to the earnings downgrades we forecast elsewhere.

My view - Valuations have improved in most markets - considerably in some instances. Nevertheless I favour emerging markets (which I prefer to describe as progressing markets), today and for the long-term. However their performance can vary considerably.

Which do I like the most for the next upturn? And which developed market sectors do I most favour?

Hong Kong (correctly described as the first developed market to become emerging once again due to China listings), H-Shares, Thailand (an important exporter of rice) Vietnam as a speculative recovery candidate, and Taiwan as a conservative, largely developed economy choice.

Basically, I like all Asian progressing markets and also Japan, where I suspect the government will target equities. Today, Japan is reasonably cheap and a recovery candidate. However for outstanding performance we will have to wait until the Banks and Second Section are leading. This will require a sustained move above 3000 for the latter.

And yes, India remains my favourite market for the long term.

Among developed markets, I prefer multinational exporters for earnings. These range from resources plays to tech, with the latter being more speculative. Additionally, there are good opportunities for yield but I would only buy banks on setbacks, given the probability of lengthy convalescences for many. For conservative investors, this is a good environment for high-yield equity funds.

Email of the day (3) - On US property / real estate (sent 27/3):

"Today's FM is once again 'spot on' to what I saw in U.S. property/real estate the last four months and on a recent visit from my own notes and observations.

"Here is a general synopsis I credit from www.nowandfutures.com on the property cycle (with wonderful weekly chart watches on a variety of financial instrument fundamentals and technicals including a variated Fed M3!!!) as it says it all in a rather compact form. These fellows are very astute for pensioners in their 70s, we all need to emulate iconoclastic people like them whether we agree with their web content or not.

"Our oldest customer in our business who is 83 and still trades (ex Boston broker) brought this to my attention so I pass it on to the collective as I found this link very interesting:"

Stages of a Property / Real Estate Cycle

1 Population growth and commercial growth at the early stage of the economic cycle, often supported by government encouragement/ low interest rates, creates an increase in the demand for housing and commercial

buildings in excess of current supply.

2 It takes time for construction to gear up. This construction increases demand for vacant land. Bank loans are attracted to construction and real estate sales as prices begin to rise.

3 As vacant land prices rise a boom in land develops, leading to sub-divisions and speculative resale.

4 The real estate cycle peak is characterized by a high volume of subdivision and sales.

5 Construction catches up with demand and a small surplus is created. Rents can't go up enough to support the higher property costs, making new construction and rental property investment unprofitable. Land values start to adjust downwards, the bubble/mania is broken.

6 Rising interest rates hurt confidence and profits, adding to the downwards pressure on prices. Real estate enters a 'hanging' slow phase. Asking prices stay high but there are few buyers. Building, subdivisions, and speculation drops quickly. Sometimes a panic or crash begins at this point; often the market just slowly dies. Many keep speculating during this phase as they're unaware of the market having turned.

7 Real estate starts to get marked down in price. This tends to take quite a while as owners tend to cling to mortgaged property longer than they would to other assets, like shares. Foreclosures rise but the foreclosure process is not quick.

8 Mortgage costs/interest rates are higher, rents decline, and vacancies increase. The market is dying rapidly. Foreclosures increase; speculators and investors are forced to sell as the capital value of their property decreases below lending margins and rents decrease below holding costs.

9 The bottom of the market has the following characteristics: high vacancies, low construction rates, foreclosures and no speculation. Debt must be written off and properties sell at a deep discount. Only those who entered stage 6 with little or no debt survive to buy the dramatically discounted properties.

Note that in a typical property / real estate cycle that non-residential (commercial & industrial) property / real estate follows residential trends with a time lag of about 5 quarters (the historical range is 3-8 quarters).

My comment - Age-enhanced investors are such fonts of wisdom, having seen it all. I wouldn't turn the clock back for anything - roll on 83.

Thanks for this highly informative contribution, certain to be of interest to many subscribers.

Please note - Eoin is on paternity leave but returns next week.

Friday 4th April 2008

Crossing the Rubicon - My thanks to a subscriber for this interesting report by First Pacific Advisors. Here is a sample:

We believe that one of these unintended consequences will likely lead to the Federal Reserve becoming even more politicized. With the taxpayer's purse being placed at greater risk by these governmental entities' increased financial risk, the process by which the Federal Reserve conducts monetary policy may be placed in jeopardy. Will the Fed be as willing to raise interest rates to fight economic excesses or inflation if it means it could cause losses for these governmental entities or place the American mortgage borrower at increased financial risk? Given the extreme measures that are currently being contemplated, we believe this is a serious risk consideration. If we are willing to "rescue" borrowers and financial institutions that have been reckless or unwise in their financial decision making leading up to this crisis, how can we expect a different outcome in the future? Why should individuals and financial institutions conduct themselves in a financially prudent manner, knowing that the government will likely ride to their rescue? Why shouldn't they take increased risk with the expectation of short-term gain, while laying off long-term risk to the government? The Federal Reserve's recent policy changes, federal agency enhanced risk taking and possibly new consumer mortgage "rescue" plans, all have the potential of increasing future unsound business and consumer decision making.

Ever since the government bailout of Chrysler in 1979-80, this country has been on a course of raising the safety net so that the market's discipline, in a capitalistic economic system, has been truncated. We have witnessed a growing level of decisions that are based upon expediency rather than sound long-term decision making. Each time these expedient decisions are made, the level of risk within the U.S. economy has been increased. The market's discipline is not allowed to work for fear of the potential economic fallout.

In light of the above comments, the partners of FPA came to a unanimous conclusion that the recent Federal Reserve actions and the potential new Congressional policies under consideration are likely to lead to a significantly higher level of long-term inflation in the U.S. We are more than disappointed in the substandard decision making that has taken place within the Federal Reserve and other governmental entities these last several years. The misguided monetary policies of the former Chairman of the Federal Reserve, Alan Greenspan, created an era of "too big to fail" that has led to two major asset bubbles. With each successive bubble, the policy actions available to the Federal Reserve to reduce financial system risk have been systematically reduced. The extraordinary actions taken by the Bernanke Federal Reserve reflect acts of desperation rather than long-term policy solutions. The rapidly changing events within the capital markets are forcing the Fed to adopt policies that have the potential of long-term negative consequences. These recent events, and their fundamental changes to the U.S. financial system, are forcing the leaders of FPA's product areas to reassess their present portfolio allocations. In essence, we believe we have "Crossed the Rubicon" into a new financial era.

My view - This is a widely held view among fiscal conservatives, a label that will probably feel comfortable to many subscribers. For instance, I consider myself a fiscal conservative, but I am a social liberal.

I also think the Fed would like to be fiscally conservative, at least in theory. Who wouldn't under ideal circumstances, which these are most certainly not. The Fed helped to create today's problems, so for it to suddenly metamorphose into a disciple of born-again Austrian School economics would be *some* transition, no doubt triggering another wave of righteous indignation from other groups. More importantly, it would also plunge the US economy into the severest economic slump since The 1930s Depression.

Instead, the Fed hopes to be expedient today, avoiding economic collapse, and perhaps becoming virtuous at some point well in the future. The problem is, you can't get there from here, as the local yokel said when asked for directions.

So what happens next, and what will be the implications for markets?

Welcome to the more inflationary world, long forecast by Fullermoney. Currently, inflation is coming mainly from resources prices, most notably food and energy. This cannot be blamed on the Fed or any other central bank, as I have said before. Other forms of inflation are largely dormant in the main developed economies, due to slower economic growth, but clearly evident in developing (progressing) countries. Inflation will pick up again as the global economy strengthens, although we may gain some temporary respite in food prices if crop yields improve, as early reports indicate.

Veteran subscribers have been here before and inflation is not a problem to lose sleep over, provided we know what to do about it.

Long-dated government bonds and money market funds have been temporary safe havens but most of the yields are not competitive and the investments will lose purchasing power over the long term. However high-yielding Asian and resources currencies remain attractive. There is also value in quality corporate bonds, which have been oversold in the general flight from this sector.

In stock markets, high-yield equity funds are attractive following the shakeout. High-growth progressing markets are very promising, but you can expect a roller coaster ride, so don't pay up and consider taking some profits when accelerating uptrends (yes, they will return) lose momentum. Resources stocks have held up well because they have pricing power. Any multinational company able to pass on production costs is in a strong position. I would be wary of consumer shares in developed economies, for the time being. Although arguably cheap in many instances, they will be late to blossom.

Gold and most other commodities are likely to remain in long-term uptrends but these will be subject to very large cyclical swings and the bigger setbacks can last for a year or two.

Psychological perception stages of stock markets - Delegates to The Chart Seminar over the decades know that I have often referred to three psychological perception stages of bull and bear markets. These coincide with three important structural stages, in terms of liquidity.

So where are we today?

I believe we are in the first psychological perception stage of a stock market recovery, which will be a bull market for some, including Fullermoney long-term themes. This presumes that the January - March lows hold, or thereabouts. I will continue to give this hypothesis the benefit of the doubt, unless events prove otherwise.

The first psychological perception phase of a significant recovery or new bull market is characterised by widespread disbelief. Although people see the firmer action, including upward dynamics off the lows, they have been psychologically conditioned to expect another downturn.

One reason for this disbelief is that investors have raised their cash levels significantly - the first (of three) structural phases in terms of liquidity - so they have been preparing for weaker markets. Also, there will be plenty of overconfident short sellers near lows, who will understandably 'talk their book'.

The paradox at market lows is that risk is perceived to be highest by the crowd, when it is actually lowest. Think about it - markets have already discounted plenty of bad news, monetary authorities have slashed interest rates and / or pumped in additional liquidity, and investors who are likely to sell near the bottom have already done so.

All that is missing is confidence, which is why markets often bumble along in a largely sideways support building phase at important lows, with small rallies capped by short selling and stale bull liquidation, before investors are eventually emboldened to fuel the next uptrend.

The psychological and structural phases of bull and bear markets are a feature at TCS, which Eoin will be conducting next month and again in November.

Global Infrastructure Digest Plus Commodity Corrections and Economic Cycles - My thanks to a subscriber for these two highly informative reports from Citigroup, dealing with Fullermoney secular themes. They are posted without further comment.

Dr Erwin Grandinger: German political cycle deteriorates - Inflation, not rate cut, is on the ECB's mind - No fx intervention pressure in the Eurozone - Veteran subscribers will recall Erwin Grandinger's lucid, informative reports published by EPM Financial Services, which I had missed over the last year. On enquiring about him in conversation with a comparatively new subscriber introduced to Fullermoney by Erwin, I was told: "He's too busy trading commodities!"

A good excuse, but as Erwin Grandinger is also a renaissance man, being a marathon running opera lover, he has also produced another of his interesting reports, for which I thank him. Here is a sample:

Economically Germany is currently enjoying the benefits of 'forced' globalization. The painful domestic economic adjustment process from 2000 to 2004 compelled exporters to seek new markets in greater Asia (India, China, et. al.) and eastern Europe, away from traditional markets in Japan and the US. During this period the former government of SPD Chancellor Gerhard Schröder implemented overdue domestic structural reforms (which are now in the process of being steadily unwound by the SPD, with the help of the CDU). In the 2000-2004 period, political, fiscal and economic pressures were sufficiently strong to force through reforms. At the same time the weak domestic economy and disinflationary environment produced a sustained period of wage moderation. In addition, towards the middle of the current decade, a very important change in export currency factoring took place. Many German exporters were forced by Asian trade counterparts (predominantly Chinese) to switch the preferred transaction currency from the US dollar to the Euro. German and Eurozone exporters willingly accepted this super-imposed demand and both trade counterparties now benefit from it. This is one reason why the 2006-to-date slide in the US dollar has had only a very modest impact on German exports and hence the German economy. It is an extremely important factor and one that is poorly understood abroad. It is one of the key sources of misalignment between US/UK-based investors' economic perceptions and the actual development of the German economy (possible *'incremental decoupling'*), which manifests itself in the ongoing mispricing of Euribors across the curve. The permanent and predominant

(US/UK-based) assumption is that the next rate cut by the European Central Bank is around the corner. A brief glance at current Eurozone HICP, its most likely future projectory and a full understanding of the ECB's mandate (which exclusively targets inflation, not a mix of growth and inflation) should inject a dose of reality.

My view - If the ECB is not going to cut rates, and the assumption that it will is based on the weakness of some other Euroland economies, then the euro will certainly extend its uptrend. A break in the progression of rising lows remains necessary to question this gradually steepening long-term uptrend.

Easter in Egypt - My thanks to old friend Gérard Le Roux for this highly amusing and mildly alarming travelogue. Here is the opening:

I am just back from a beautiful trip on the Nile. My 16 year old daughter Clara got her telephone stolen leaving the boat at Aswan. A tragedy? Not really! It was equal to $200 in economies in telephone bills for daddy, plus an upgrade at the hotel into a luxury suite at the Old Cataract…

I lost my credit card which could have been another blissful economy until I remembered that the head of my harem, Maya, had hers…

The last day, on the road bordering the Karnak Temple, we found ourselves on Friday between 600 angry homeowners about to be evicted and 40 soldiers with shields and machine guns and bats. Our chauffeur had the bright idea to go through the crowd and then have second thoughts about trying to go through the phalanx of heavily armed soldiers with shields… He really stopped in the middle, between the two antagonists. If the crowd was very cross with the authorities, they obviously recognized that our chauffeur was afflicted by a fit of paralytic hesitation. They rightly felt it was their duty to help him make a decision. We were therefore privileged to get the very first rocks through the back window as the second onslaught wave was probably decided. Eight year old Helen was quite scared. Dame Maya, as a good Serb, immediately covered her chickees, muttering here we go again!

My comment - Delegates at The Chart Seminar in London last November and also November 2005, may recall Gérard and his delightful, talented, composer / musician wife Maya. Gérard is an intrepid traveller, combining worldly Swiss sophistication with the spirit of an explorer. A couple of years ago, as I recall, while on a trip to Asia, he went to Mongolia to check on the Rio / Ivanhoe mining sites, and crucially, to sound out government bureaucrats on their intentions regarding these projects. I posted a report following that visit, anonymously.

Don't miss Gérard's "…answer to luxury travels: before going anywhere, try to pay a few people to start a small manifestation or even better have someone throw a few bombs here and there (it gets rid of the overload in tourists and people are more eager and polite)."

Absolutely, do I assume that it will be Kenya next month, or was that trip in January?

Please note - If BA can be relied upon (gulp), Mrs Fuller returns from a week in Moscow late this evening and we will be off to Manhattan early in the morning on mostly family matters. On arrival, I hope to avoid Homeland Security's four-point restraint, full body cavity search.

Please note - Eoin is currently on paternity leave but will be producing Fullermoney next week.

Quote of the week - On Wall Street:

"A pack of lemmings looks like a group of rugged individualists compared with Wall Street when it gets a concept in its teeth."
Warren Buffett, courtesy of Pradeep

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