

# Fullermoney *Highlights*

Global Strategy and Investment Trends compiled by Eoin Treacy

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**April 30th 2008**

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David	TFC US	Long 18/03 \$6.6903 Jun08	CL 18/03 \$\$6.6168 Mar08
	Nasdaq	Long 19/03 1748.45 Jun08	CL 19/03 1739 Mar08
	Nikkei 225		CL 27/03 12808 Jun08
	H-Shares	Long 27/03 11924 Apr08	CL 27/03 11923 Mar08
	Lumber	long 17/04 \$243.58 Jul08	CL 17/04 \$218.20 May08
	Hang Seng	Long 23/04 25210 May08	
	Nikkei 225	Long 28/04 13985 Jun08	
	Lumber		CL 28/04 \$243.65 Jul08
	H-Shares	Long 28/04 14238 May08	CL 28/04 14212 Apr08
	Hang Seng	Long 28/04 25551 May08	CL 28/04 25655 Apr08
	JGB		CS 30/04 136.10 Jun08
OMX	Long 30/04 980.13 May08		
DAX	Long 30/04 6990 Jun08		
Eoin	600030 CH	Long 25/04 ¥34.54	
	Hang Seng	Long 25/04 25518.8 Apr08	
	Hang Seng	Long 28/04 25551 May08	CL 28/04 25655 Apr08
	IBZL LN	Long 01/05 £35.5228 Sep08	

April 17<sup>th</sup> My personal portfolio: Where to invest a little spare cash in my SIPP's / ISA accounts

Judging from sentiment readings - a subject of great interest to Fullermoney and we have commented on many of these indicators in recent weeks - the conventional view is that this is a time of great risk for stock market investors.

After all, "The situation is much more serious than any other financial crisis since the end of World War II", according to George Soros recently; the USA's consumer-related portion of the economy is in deep recession; global GDP growth is slowing; resources inflation is rampant, and there are food price or scarcity riots in a number of countries.

In other words, there really is 'blood in the streets'. And let us not forget global warming. If we do not all freeze to death in the dark due to the energy shortage, or starve as the last grain of rice or any other staple food is consumed, we will all drown as the seas rise, if we have not already been

vaporised by an overdue Doom's Day rock, before our expanding sun incinerates the planet.

Does this sound like the end of the world? That would presumably be worse than an often repeated forecast over the decades: "The end of capitalism as we know it." It would even be worse than taxes in Europe.

Or perhaps there is more emotion than analysis in these views, and this is a better time to buy than sell.

Being of the generation of investors duly frightened by but who also survived oil shocks, the secondary banking crisis, a secular bear market on Wall Street from the late 1960s until 1982, food hoarding and rampant inflation during the 1970s, another banking crisis in the early 1980s linked to Latin American loans, including "too big to fail" Continental Illinois, plus record high interest rates, the Crash of '87, not to mention the Aids epidemic, the S&L crisis, followed in the 1990s by SARS, bird flu, the Asian Financial Crisis, Russia's debt default, Long-Term Capital (mis)Management's blow up, Y2K hysteria, the dot-com bubble's bursting in 2000, 9/11, not to mention several wars over the decades, recent bearish sentiment has a "déjà vu all over again" feel to it.

Yes, I know that many say, "It is worse this time", but they always do. I am more impressed by the bullish, contrary opinion sentiment indicators, which have a better track record. Problems of liquidity, solvency and profits will linger, but they have almost certainly passed their nadir and stock markets are a discounting mechanism.

As dust from the Wall Street inspired banking crisis slowly settles, the technical building blocks of base formation development become more evident. It will take time for markets to reorganise and assemble them as platforms of support, as we have seen before, but the process is underway. In fact, investors waiting to re-enter the markets are spoiled for choice by some of the best valuations in recent years, but not all opportunities appear equal.

My personal long term equity portfolio consists entirely of self-administered pensions (SIPPs) and UK tax efficient ISAs, as subscribers may recall. As these positions are sufficient for me I am not adding new cash except for a small amount of salary related revenue as I am still employed, and I also top up the family ISA accounts every April by the maximum allowed.

So my current decision is where to invest the new ISA money, and while the amount is small, a seedling well planted in stock markets can do exceedingly well, as we know. That is always my hope and the analytical exercise gives me another opportunity to update my investment thinking for subscribers.

If I wanted income, I would turn to [Neil Woodford's Invesco Perpetual High Income Fund](#), or the equivalent, because he has a proven record and will know far more about prospects for dividend increases, versus possible cuts, than I ever could. The market setbacks since last July have made equity income funds more appealing, as I have mentioned before. However I do not need income at this time, and despite inflation I am probably maintaining

purchasing power in my compounding main cash account, currently earning 8.31% in the latest 1-month rollover. This is the highest rate of return that I have received since switching from GBP to NZD four months ago. However there has been no capital appreciation against the GBP, although I remain hopeful.

Incidentally, I am required to invest my ISA account in a UK-listed vehicle offered by an ISA broker. However this is not a big constraint, given the number of foreign shares and funds listed in London. Staying with Fullermoney themes, my main choice, as I see it, is between emerging (progressing) markets and resources / global infrastructure.

In the latter category, I like Eoin's suggestion of CRH plc, which he is considering for baby Fiona's Child Trust Fund. It is in the international cement and other materials business, listed in [Dublin](#), London (also in euros) and the [USA](#), currently trading at an estimated PER of 8.91 and yielding 2.83%, according to Bloomberg.

Worthy though CRH appears, despite economic concerns over their prospects in Ireland and the USA, I will probably opt for an existing position in my portfolio, or a combination of Fullermoney themes.

Naturally I am delighted by the performance of industrial miners in my top-10 (by weighting) portfolio, led by [Rio Tinto](#) (5th), [BHP](#) (6th) and [MLW](#) (8th). [Vedanta](#) (12th) is similarly strong. I suspect they will continue to do well but my policy has always been to buy them on weakness, often in my trading account, which I last did with Rio and MLW in January.

To be continued tomorrow.

April 21<sup>st</sup> My personal portfolio: Where to invest some spare cash in my ISA accounts: Part 2

This item completes last Thursday's feature on my personal SIPP's and ISA positions.

Last week's review concluded with a look at the considerable industrial mining component in my personal portfolio. I remain very bullish of this sector but will only buy on weakness, so they are not candidates for a top up today.

For similar reasons, I will not add to my position in the Merrill Lynch [Gold & General Fund](#), which is my 4th largest equity holding by portfolio weighting. However I have no intention of reducing this stake, viewing the management's performance as outstanding, albeit somewhat flattered by its USD denomination. I could justify adding to A\$-denominated [Lihir Gold](#), which has fallen back to a previous support level, but probably won't as I am already overweight in this sector. I also hold [DRD](#), a speculative recovery candidate, which currently occupies 10th position in the portfolio. Moreover I suspect gold bullion is in another of its medium-term consolidations, albeit within a long-term upward trend.

I am more inclined to invest in developing (progressing) Asia, which remains my favourite region for long-term GDP growth. I could justify adding to the [JP Morgan Indian](#) Investment Trust following its setback and subsequent steadying, but it is already the largest holding in my portfolio. For a similar reason I will not add to the [Aberdeen New Thai](#) Investment Trust, as it holds third position by weighting.

The [Aberdeen New Dawn](#) Investment Trust is a candidate, despite testing its highs currently. This was criticised by some for underperforming last year, due to the management's conservative policy, subsequently justified by market events. I suspect it will do well from here on and as it is only in 9th position by weighting, I could easily justify increasing the position.

ABD would give me regional diversification but I am also tempted by [Vietnam](#), which has taken quite a pounding. If I am ever going to buy a Vietnam fund or tracker (see Chart Library), I would want to do it following a big setback, even though I do not know how much base building may be necessary before the next significant uptrend occurs. [China](#) is interesting for the same reason and I would not be surprised to see a bottom near 3000.

While it is difficult to invest in mainland China, I could add to my position in the [Atlantis China Fortune](#) Fund, which invests mainly through Hong Kong, not least the [H-Shares](#). Still the 2nd largest position in my long-term portfolio by weighting, this has experienced a bigger pullback than I expected. Nevertheless in my view this volatility is due to the nature of markets, not China's long-term prospects. The time to buy, I have long maintained, is following setbacks.

One caveat regarding this and too many other open ended funds: Having to make forced sales due to redemptions, Atlantis lengthened exit periods to twice monthly. I think this was a mistake and have told them so. I know why they did it, ostensibly to protect other investors in the fund, but I maintain it is a short-sighted policy. If you can invest in Atlantis China Fortune or any other fund on a daily basis, you should also be able close the position without time constraints.

Among alternatives for China would be trackers or futures. Currently, I have a spread-bet long in [China's H-Shares](#) Index. Also, I regard [Taiwan](#), following its recent election, as a very promising way to participate in China, indirectly. Taiwan's valuations are much lower than China's and it is also strong in the technology sector, which is coming back into form.

Lastly, I am also considering a [Brazil](#) tracker. While I would prefer to buy this on a setback, I may not get another chance within the current range, given the interest in resources shares. Brazil provides unique exposure to the Supply Inelasticity themes with its minerals, energy sources and foods.

Where will I invest the ISA cash that I was able to add as of 6th April? I have yet to make up my mind and feel 'spoiled for choice'.

April 25<sup>th</sup> Eoin's personal portfolio: investment position opened and trading long opened in the Hang Seng

When Mrs. Treacy and I opened a trading account in Shanghai last year we kept one third of the capital attributed to this account in reserve in the event of a pullback. All four positions opened back in October are at a loss. [ICBC](#), [Bank of China](#) and [Bank of Communications](#) have all fallen less than the broader index and remain good recovery candidates to lead the market upwards following the current correction.

[Yunnan Chihong Zinc & Germanium's](#) shares were suspended for three months on foot of an announcement they wanted to make regarding a takeover. It only returned to trading in the last few days. The industrial metals miners in China are going through a period of consolidation and Yunnan Chihong Zinc is part of that process. In any case, I believe it will either be successful or be taken over itself in due course. We will not be selling our holding at these levels and are prepared to sit out this correction. (Also see Comment of the Day on [October 30th](#)).

Today, we put our remaining cash to work in [Citic Securities](#), China's largest brokerage. The share had fallen more than 50% during this correction and found support since the beginning of April above ¥25. It surged following the cut in stamp duty and was one of the few shares to be limit up both days. If the Chinese market has [bottomed](#) and I believe it has, then increased trading volumes should see brokerages doing well.

Last night, I also opened a trading long in the April [Hang Seng](#) paying 25518.8. The Hang Seng broke above 25000 this week and as long as it can sustain the gain, the upside can be given the benefit of the doubt.

April 3<sup>rd</sup> 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 front 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.

#### April 4<sup>th</sup> 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.

March 26<sup>th</sup> 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.

March 26<sup>th</sup> 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.

March 27<sup>th</sup> 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 REPAYED!**

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 recapitalise 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.

April 14<sup>th</sup> On distinguishing between a medium-term commodity correction and a bear

"Everyday that goes by I appreciate your service even more. I was amazed by how accurate you were in your call for the medium-term correction in the commodities sector. Speaking of which, how or when do we figure out from the charts that the medium-term correction has broken on the downside and we are dealing with a pure bear market?"

"I am really looking forward to participating in the May TCS seminar and meeting you and Eoin in person. Would you recommend a play or opera that will be on at the time of the seminar as to seize the opportunity coming to England?"

"Thanks ever more for the everyday inspiration and motivation you provide in the markets and general stance in life."

My comment - Thank you so much for your thoughtful comments and enthusiastic participation in the Fullermoney service. I look forward to meeting you and other TCS delegates at the post seminar reception on Friday 16th May. This will be after I have completed Comment of the Day and the Audio for all the other subscribers who are not attending our 2-day workshop conducted by Eoin, which I am pleased to say is another sell-out.

I'll answer the easier of your two questions first. By coincidence, I have long had bookings for two cultural events: the Royal Opera's performance of [Tosca](#) on 15th May and the London Philharmonic Orchestra's [concert](#) on the 16th. I know less about the theatre but if that is your preference, you can research the many possibilities on the web with these [two sites](#) and others that you will readily find.

Your first question regarding distinguishing between corrections and bear markets for commodities or any other asset class is much more difficult. Needless to say, if the answer was easy, before it eventually became obvious after the event, every investor would be fabulously successful.

The best we can hope for is to make an educated guess. People attempt this in different ways.

For instance, some technicians will rely on chart patterns, moving averages, or percentage declines to provide the answer. These are extremely useful; particularly the first two, but they do not necessarily answer your question.

For this reason, Eoin and I will often refer to upside trend acceleration as an ending of unspecified duration. However, common sense and experience tell us that the bigger accelerations, accompanied by extremes of crowd euphoria, are much more likely to be followed by serious corrections, if not bear markets.

Fundamental filters can help considerably but they are the most subjective in my view, easily leading to excesses of emotion. For instance, someone who missed the upside move, or sold too soon, or perhaps saw their preferred asset class jeopardised by it, is likely to be more bearish than someone who participated in the run. Either can be right or wrong, but those in the latter position are more likely to hold on when the trend deteriorates.

A Fullermoney view for at least the last six years is that we are in a once-in-a-lifetime commodity supercycle, due to a dramatic increase in demand from prospering emerging (progressing) markets, many of which have extremely large populations. Supply has struggled to keep up, not least because of the prior secular bear market for resources, which reduced production capacity.

We have also said that these markets were notoriously volatile, and prone to corrections lasting for several months to a couple of years and occasionally longer. The bigger corrections will certainly feel like bear markets, even if they occur within long-term upward trends.

For these reasons, we have stated our preference for buying following setbacks and tight stops following trend acceleration. And to quote two splendid adages which subscribers probably saw in Iain Little's and Bruce Albrecht's splendid Global Thematic Investors report posted by Eoin last Monday: "If you must panic, panic early." Also: "Be a fast sheep but don't ever be a slow one."

April 22<sup>nd</sup> Is the Nasdaq moving into a period of outperformance?

Over the last year we have maintained that the US economy is two-tiered, with multinational companies remaining quite healthy while the domestic consumer discretionary part of the economy having moved into recession. In tandem with the fact that multinational operations are helping to offset slowing growth at home, the Dollar has been quite weak over the last year, helping companies who consolidate foreign earnings in Dollars.

The Nasdaq-100 [outperformed](#) the S&P from its relative lows in July 2006 to its relative peak in late 2007. This move completed the base which followed the zenith of the Nasdaq bubble in 2000. The reaction in the first quarter of this year saw the chart pull back into the base briefly, but it is rallying again, indicating that the Nasdaq-100 is outperforming once more. It would need to fall back below 1.35 to hinder current potential for additional upside.

In this earnings [season](#) 16 of a possible 87 companies in the Nasdaq 100 have reported. Of 12 positive surprises 6 have been in the Information Technology sector. Last week, [Google](#) surged upwards on an earnings report well in excess of analysts' expectations. It would now need to sustain a move below the March lows to offset scope for further upside. [Altera Corp](#), [Linear Technology](#), [Intel](#), [Ebay](#) and [Tellabs Inc](#), also all beat analysts' estimates.

Using the Chart Library filter, to look at Nasdaq-100 stocks, I saw that companies such as [Baidu.com](#), [Research in Motion](#) and [Apple](#) have been some of the best performing companies in the last year. They all rallied well having found support, are now testing their highs and need to sustain moves to new high ground to reaffirm their overall uptrends. [Activision](#) surged upwards in December and has so far maintained the upward break. A sustained move below \$25 would be needed to offset scope for further upside.

In the Healthcare sector, [Gilead Sciences](#) remains in a consistent staircase uptrend. It would need to sustain a move below \$42, breaking the progression of rising lows, to offset scope for further upside. [Stericycle](#) has had a relatively shallow reaction and found support at \$50. It would need to sustain a move below that level to hinder potential for some additional upside.

[Joy Global](#) has been in a medium-term consolidation for much of the last two-years but broke upwards last week and would need to sustain a move below \$70 to offset scope for additional upside.

While the consumer discretionary sector is looking distressed, some consumer staples such as [Costco](#) remain in quite consistent uptrends. It found support near \$60 in March, sustaining the progression of higher lows and would need to break below that level to damage the integrity of the overall uptrend.

April 8<sup>th</sup> Martin Spring's On Target: Is This Rally a Bull Trap?

Thanks to Martin Spring for his ever-interesting [letter](#) where Fullermoney is quoted on this occasion but don't hold that against him. This month he lucidly

identifies many of the problems from which the credit crunch sprang. Here is a section:

Although there is plenty of money available to solve the current crisis - trillions of dollars in pension, insurance and sovereign wealth funds - managers are largely unwilling to use it to buy credits that seem cheap, because they have a nasty feeling they could get even cheaper. "Every time you buy anything, it is worth less the next day," moaned one fund manager.

The "sovereign welfare funds," as Christopher Wood, the strategist at investment bank CLSA Asia-Pacific, calls them, have already suffered the painful experience of buying into major banks because they seemed to offer cheap, once-in-a-lifetime opportunity, only to see billions of dollars of value in their investments evaporate within weeks.

Judging by the latest estimates by financial experts, the credit crisis has a lot further to run. One study suggests that write-offs of bad debts in the US alone could reach \$600 billion and knock-on effects \$900 billion - enough to cut 1 to 1½ percentage points off economic growth.

And that's without taking into account the wider effects of falling house prices. Increasingly, borrowers who owe more than their homes are worth are just walking away from their debts. They call it "jingle mail" - the borrower posts the keys to the lender.

Eventually as many as 20 million American families could fall into "negative equity" - having mortgage liabilities greater than the value of their houses.

Nevertheless, it seems likely to me and some other analysts that the current bounce in the stock and credit markets and loss of upward momentum in commodities could be the start of something important. Not of new bull markets, but of a major rally in ongoing bear markets.

In other words, a bull trap.

My view - I found this article useful as a summary of the problems which sparked the continuing crisis of confidence in the credit markets. This graphic from the [New York Times](#), separately forwarded by a subscriber, also helps to show how exposed certain areas of the USA are to the subprime problem. This problem will not be fixed over night and I agree that it could take a number of years to successfully recapitalise the banking sector.

As more facts about the origin, nature and extent of the crisis emerge, it is easy to become more bearish. This is because we have seen the results of the credit mess, probably experienced it in our own portfolios, and fear the same may happen again. However, I believe that this would be allowing our emotions to overcome our analysis.

The technical facts are that the majority of stock markets found support following climactic selling pressure in January. Those lows were successfully tested in the last few weeks. An impressive rally, resulting in many indices

testing their range highs, has just taken place. We have held since January that for markets to reaffirm their medium-term downtrends, they would need to sustain moves below their January lows. A number of markets posted new lows for a couple of days but have since rallied significantly back into their ranges. Undeniably, medium-term downtrends have lost momentum.

Ideally we would like to see a succession of higher reaction lows or highs to confirm that demand is coming in at progressively higher levels. These are not yet evident. They will be signals that investors are increasing bets that the January/March lows will hold.

Right now, with many indices testing their range highs, downward dynamics would be a signal to traders to short the market back down for a retest of the lows. Many will also be tempted to take profits in this region. If the consolidation below the February highs is relatively shallow and indices can sustain breaks above those highs, then the potential for markets to initiate medium-term uptrends will have improved substantially.

April 2<sup>nd</sup> 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 cyclicity.

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.

April 4<sup>th</sup> Crossing the Rubicon (on liquidity)

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.

April 29<sup>th</sup> Jeremy Grantham: Immoral Hazard - Greenspan, Bernanke, and Volker: A Study in Contrasts

My thanks to a subscriber for this authoritative and educative Quarterly [Letter](#) by the distinguished founder of GMO. Here is a brief sample:

The defense of bailouts is that the alternative is ugly. But surely the penalties for excessive risk taking, issuing flaky paper, passing it on - often in its entirety - to others, and not even understanding the consequences of the low grade

paper that you yourself issue should be ugly. "Yes, of course, we would like to punish the excessive risk takers" goes the line, but we can't do it without hurting the innocent economy. But we will never know what can be absorbed if the penalties are always removed by a bailout. In more traditional times, say, from 1945 to 1985, the economy could absorb substantial punishment from recessions and still grow faster than it has done in the last 10 years. So in a crisis à la Bear Stearns we now transfer pain from risk takers to innocent tax payers. Worse, even the routine treatment for the bubble breaking disease does the same. By raising the slope of the yield curve, the Fed deliberately benefits its bankers and hedge funds that borrow short and invest long and punishes pensioners and others who are trying to make a safe but still reasonable return at the short end.

Yes, this is a real credit crisis, substantially the worst since the Depression, so it now invites unusual responses, and what we have is a series of harried and hasty responses, perhaps even panicky, but we can at least understand the urgency. The real incompetence here goes back over 20 years: the refusal to deal with investment bubbles as they form, combined with willingness, even eagerness, to rush to the rescue as they break. It's almost as if neither Greenspan nor Bernanke allows himself to see the bubbles. Greenspan was always conflicted and contradictory about whether bubbles could even exist or not. Bernanke, in contrast, has more of the typical academic's certainty that the established belief in market efficiency is correct and therefore investment bubbles must be merely the product of investors' overheated imaginations. It would be convenient to have such an important role as Fed Chairman filled by someone who actually deals with the real world, messy or not, that is given to inconvenient bursts of euphoria and riddled by considerations of career and business risk, which modify behavior far away from economic efficiency.

Back in the real world, major asset bubbles are easy to see. They are nearly impossible to miss, in fact. But we travel in a world with a systemic bias to optimism that typically chooses to avoid the topic of the impending bursting of investment bubbles. Collectively this is done for career or business reasons. As discussed many times in the investment business, pessimism or realism in the face of probable trouble is just plain bad for business and bad for careers. What I am only slowly realizing, though, is how similar the career risk appears to be for the Fed. It doesn't want to move against bubbles because Congress and business do not like it and show their dislike in unmistakable terms. Even Fed chairmen get bullied and have their faces slapped if they stick to their guns, which will, not surprisingly, be rare since everyone values his career or does not want to be replaced à la Volcker. So, be as optimistic as possible, be nice to everyone, bail everyone out, and hope for the best. If all goes well after all, you will have a lot of grateful bailees who will happily hire you for \$300,000 a pop. By the way, that such payments to prior Fed officials are in themselves a moral hazard and an obvious conflict of interest that could moderate their prior behavior, is apparently too crude an accusation even to have surfaced yet. Well it should surface. Selling services to financial interests whose fates have been in your hands should simply not be tolerated as acceptable or ethical behavior by a former Fed Chairman.

My comment - Jeremy Grantham is refreshingly old school ( as in Austrian). I endorse many of his comments, not least regarding the amorality of the CEO compensation system. Also, there is no doubt that an overabundance of liquidity in the late 1990s and earlier this decade fuelled property bubbles. During the deflation debate (remember that?), an important and frequently repeated Fullermoney investment theme maintained that the Fed and other central banks had already sown the seeds of another inflationary cycle, led by resources.

Who is learning and therefore benefiting the most from all this? Emerging (progressing) countries, for sure, because the policies of developed countries, not least the USA, continue to show them what works and what does not. Emerging countries will also have problems of their own but those that take heed will be less prone to blunders seen in the west.

For instance, consider how China has skilfully deflated its stock market bubble over the last year. Note also how India has curbed economic overheating by gradually increasing reserve requirements for its banking sector. As investors, we need to change our perceptions of earlier decades, concerning where the greatest risks lie.

Massive infusions of liquidity have put a floor under global stock markets. Additionally, it will most likely fuel significant gains in some stock markets and many individual shares. Indices that are already above their February highs, and maintain those upside breaks, will be among the more reliable performers. Many of the shares that are outperforming their indices will remain relative strength leaders throughout most of the rallies expected in coming months.

Some stock market indices, notably in Europe, are further underpinned by attractive yields. Sweden is an example, with the OMX Stockholm 30 Index ([weekly](#) & [daily](#)) currently yielding 4.33%, according to Bloomberg.

April 11<sup>th</sup> Pound Falls to Record Against Euro on Speculation of Rate Cuts

This [article](#) by Lukanyo Mnyanda for Bloomberg covers the continues weakness of the British Pound. Here is a section:

The pound fell to a record against the euro for a fourth day on bets the Bank of England will keep cutting interest rates as economic growth slows, eroding the allure of U.K.-denominated assets.

The pound headed for weekly declines versus the euro and dollar after industry reports showed house prices and consumer confidence declined. UBS AG, Europe's largest bank, revised its U.K. interest-rate forecast today, predicting four more reductions this year, after policy makers yesterday cut for the third time since December. The European Central Bank kept its main rate at a six-year high.

``The U.K. economy is clearly slowing and there are risks it could slow sharply," said Paul Robinson, a currency strategist at Barclays Plc in London

and a former Bank of England economist. ``The pound is going to remain at low levels against the euro."`

The pound dropped to 80.33 pence per euro, the lowest level since the common currency's 1999 inception, and was at 80.32 pence by 2:25 p.m. in London, from 79.87 pence yesterday. It has declined 1.7 percent this week and 9 percent this year. The pound will hold around 79 pence in the next month, Robinson forecast.

Britain's currency declined to \$1.9694, from \$1.9707, headed for a 1.2 percent weekly drop. It fell to 198.83 yen, from 200.92 yen yesterday, after slipping 1.7 percent since April 4.

The pound fell versus all but two of the 16 major currencies tracked by Bloomberg this week.

My view - Perceptions continue to grow, that the Bank of England will cut interest rates further, as it attempts to stave off the worst effects of the global credit crunch and any prolonged weakness in the housing market. This has put the Pound under pressure against a whole host of other currencies.

Most notably, the [Euro](#) has been rallying against the Pound for much of the last seven months and remains in a consistent uptrend, although it is becoming overextended. However it would need to sustain a move below 78p, breaking the progression of higher lows, to offset further upside potential.

The [Swiss Franc](#) has followed a similar trajectory to the Euro against the pound over and looks somewhat more overextended. A move below 49p would be needed to question potential for further upside. The same is true for the [Danish Krone](#) and [Swedish Krone](#) with 10.5p and 8.3p the key levels to watch.

The [US Dollar](#), a comparatively weak currency, broke its downtrend against the Pound late last year and would need to sustain a move below 48p to question scope for some further strength.

This week the [Singapore Dollar](#) broke upwards against the Pound this week. The rate had been testing the 2003 highs over the last couple of months and powered through that level yesterday. A sustained move back below 36p would be needed to offset scope for further strength.

The [Chinese Renminbi](#) broke upwards against the Pound this week with a move above 7.2p. A sustained move below 7p would be needed to question potential for additional upside.

The [Japanese Yen](#) broke its downtrend against the Pound in August and has since moved into a consistent medium-term uptrend. A sustained move below 48p would be needed question scope for some further upside.

The [Australian Dollar](#) also broke upwards from the prolonged ranging phase against the Pound in Q4 2007. This upward break has been more volatile than

other currencies, but the Australian Dollar would need to sustain a move below 45p to question scope for further upside.

The [New Zealand Dollar](#) surged upwards from the lower side of its five-year range in early September and is now testing the highs beneath 42p. A sustained move below 39p would be needed to question potential for an upward break.

The [Canadian Dollar](#) broke upwards briefly late last year and is consolidating that move to new high ground. A sustained move below 48p would be needed to question potential for a reassertion for the overall uptrend.

The [Indian Rupee](#) remains in a long-term base formation and would need to sustain a move above 1.3p to complete this consolidation.

The [Korean Won](#) weakened against just about every currency in March but found support late in the month, below 5p and rallied well. It would need to push back. A sustained move below those lows would be needed to question recovery potential.

The Pound remains in an overall uptrend against the [South African Rand](#). Although the Rand found support near 6p in late March, a move back above 7p would be needed to offset scope for some additional downside.

April 22<sup>nd</sup> Fascinating interview with the Yang Liu, Chairman of Atlantis China

My thanks to a subscriber for this informative [item](#) from the FT's video interview section.

My view - Atlantis [China Fortune](#) Fund remains the second largest position in my personal long-term investment account. My position is still substantially in profit but naturally I wish I had had the vision to take profits in October 2007. I didn't and I have absolutely no intention of selling near current levels, which I consider to be a buying range, not least now that China's main indices have fallen 50%. If I ever sell this fund, it will be on strength.

I'm not the only one who thinks this is a good time to invest in China. Yang Liu, who manages Atlantis' China funds, told me recently that she invested \$2 million of her own money in the China Fortune Fund over Easter. I think you will also find her comments interesting, not least the section on pre-IPOs which she can buy more cheaply today, and also her remarks on understanding and operating within the Chinese system.

April 24<sup>th</sup> China's Shanghai Composite Index Surges 9.3% on Trading Tax Cut

This [article](#) by Chua Kong Ho and Zhang Shidong for Bloomberg covers today's impressive rally in the Shanghai A-Shares and some of the changes in policy which have contributed to it. Here is a section:

China's stocks surged, sending the Shanghai Composite Index to its biggest gain in more than six years, after the government cut the tax on equity trading to stem a slump that erased \$1.7 trillion of market value.

The index rose 9.3 percent, the most since Oct. 23, 2001, with more than half its members climbing by the daily limit. The government stepped in to boost the world's fourth-largest equity market two days after the Shanghai measure sank to less than 50 percent of its October record amid concern earnings growth will slow and share sales will overwhelm demand.

“The government is clearly concerned about the meltdown,” said James Liu, Shanghai-based deputy chief investment officer at APS Asset Management, which oversees \$1 billion. “It's positive for the market in the short run.”

Citic Securities Co., China's biggest brokerage, gained on speculation the stock market rally will boost trading income. China Life Insurance Co., the country's largest insurer, climbed on optimism gains from equity investments will increase.

The stamp duty on stock trading was reduced to 0.1 percent from 0.3 percent effective today, the government said after the close of trading yesterday, the latest in a series of measures to revive stocks.

Regulators on April 20 required shareholders selling more than 1 percent of a stock to do so in single trades, to keep the transactions off the open market. China in December tripled to \$30 billion the amount overseas institutions can invest in yuan-denominated stocks and bonds. Two months later, regulators ended a five-month freeze on the sale of new mutual funds.

#### Televised Announcement

“In recent weeks, expectations have been mounting on the government to take decisive steps to prop up the domestic markets,” Jing Ulrich, Hong Kong-based chairwoman of China equities at JPMorgan Chase & Co., said in an e-mail. “The lowering of stamp duty is among the most aggressive steps the government could have taken to improve sentiment.”

The tax cut was announced on a daily national newscast by state-owned China Central Television last night in a country where individual investors have opened about 140 million accounts to trade stocks and mutual funds.

The government tripled the stamp duty last May in an attempt to cool a rally that was drawing more than 300,000 new investors a day to stocks. The CSI 300 Index, which tracks yuan-denominated shares in Shanghai and Shenzhen, surged almost six fold in the two years through 2007.

The three-year-old index climbed 9.3 percent to 3,774.50 at the close in Shanghai, with all of its 10 industry groups rising. The gauge tumbled as much as 39 percent this year, making it the second-worst performing benchmark in the world after Vietnam.

My view - The bottom of the last important reaction in [mid-2005](#) also coincided with the Chinese government announcing measures to support the stock market. On that occasion, a clear message was sent that the government was willing to buy shares to support the market and 1000 was seen as a floor. This was following more than a year when the A-Shares were the worst performing index in the world, an embarrassing situation for a country aspiring to become a globally significant capital market.

In 2005, the clear upward dynamic from the low near 1047 signalled the end of the bear market. This level was successfully retested in the following weeks, and after a significant short covering rally, moved in a period of consolidation where it built support for the ensuing advance.

The move upwards from the 2005 lows saw China's stock market become the best performing market in 2006 and 2007 before it peaked above [6000](#) in October. The resulting fall which had gathered pace over the last months placed China once more in the laggard's position in terms of global performance. The market began to find support over the last few days as its correction passed the 50% mark and today's [upward dynamic](#) is a clear signal that demand is returning to the market in force. It would now need to sustain a move below the recent lows to offset recovery potential. Interestingly, [ICBC](#), China's largest bank, bottomed in late March and has led the market upwards. It would need to sustain a move below ¥5.30 to offset scope for further upside.

The cut in stamp duty from 0.3% to 0.1% returns taxes to where they were before measures were taken to slow the stock market's advance last year. This has been well received by investors. Given the similarities with the situation in 2005 a similar trajectory for the A-Shares is possible. The sequence of events would run something along the lines of an initial strong rally as shorts are closed which morphs into a consolidation of gains that may last a number of months. A more orderly advance might then ensue. Of course all of this is subject to events and based on the premise that the Index can sustain its current impetus.

April 25<sup>th</sup> Japan's Notes Fall Most Since 1999; Futures Trading Suspended

This [article](#) by Theresa Barraclough and Yumi Teso for Bloomberg covers today's downward dynamics on Japanese government bonds. Here is a section:

Japanese government bonds tumbled, causing the biggest jump in five-year yields in nine years, after inflation accelerated, stocks climbed and the dollar rallied against the yen.

Ten-year bond futures plunged as much as 1.8 percent, forcing the Tokyo Stock Exchange to order a 15-minute halt in trading for the first time since September 2002. The statistics bureau said consumer prices climbed 1.2 percent from a year earlier in March, adding to speculation the Bank of Japan will increase its overnight interest rate this year.

“The market is in a bit of a panicked state,” said Masahiro Sato, joint general manager of the treasury division at Mizuho Trust & Banking Co. in Tokyo, a unit of Japan's third- biggest lender. “I can't say how far Japanese bond yields will rise, because they've already broken through my forecast levels and the selling pressure could snowball from here.”

The yield on the 0.8 percent bond due March 2013 rose 19.5 basis points, the most for five-year notes since 1999, to 1.24 percent as of 5:04 p.m. in Tokyo at Japan Bond Trading Co., the nation's largest interdealer debt broker. The price fell 0.887 yen to 98.973 yen. The yield was at the highest level since October 2007.

Ten-year bond futures for June delivery lost 1.49 to 135.59. Yields on 10-year bonds increased 12.5 basis points to 1.605 percent, the highest since Nov. 2.

U.S. Treasuries also fell today, pushing 10-year yields up 6 basis points to 3.89 percent, as traders increased bets the Federal Reserve will stop cutting interest rates. The dollar advanced 0.2 percent to 104.50 yen, bringing the week's gains to 1.1 percent.

My view - [JGBs](#) had rallied impressively over the last 9-months to test levels last seen between 2003 and 2005. They encountered resistance near 142 and have pulled back significantly from that level. They now look set to at least test the lows near 132, over the coming months, but are somewhat overextended in the short-term and potentially prone to a short-term rally. They would need to sustain a move above 138 to offset scope for some additional upside. Today's action saw that decline gather pace on the news that CPI inflation was picking up in Japan. There are two ways of interpreting this news:

The bullish case is with inflation, Japan's deflation appears to be over. This inflation will be met with higher rates, which will encourage some Japanese investors to repatriate part of their offshore investments. This cash could easily find its way into stock and property markets and help to fuel a recovery in those assets.

The bearish case stems from the fact that this inflation has not originated in consumer demand but in the rising price of commodities outside of the control of the Japanese monetary authorities. In other words, the deflation may have ended but for the wrong reasons.

Between the bullish and bearish cases outlined above, I believe chart action should be the final arbiter. [Stock markets](#) responded well to the news as did the [Topix Banks Index](#). Both are in short-term uptrends with progressions of rising lows and highs, but are now approaching areas of potential resistance. They both need to sustain moves above their February highs to challenge the integrity of the medium-term downtrends. Given the size of the [correction](#) to date, a lengthy convalescence is now likely but as long as they can hold above their March lows, the upside can be given the benefit of the doubt.

March 19<sup>th</sup> Commodities Attracting 'Enormous' Investments, JPMorgan Says

This article by Claudia Carpenter succinctly describes what has helped to push many commodities to historic highs over the last few months. Here it is in full:

Commodities are still attracting "enormous" investments from money managers seeking an alternative to equities and bonds, JPMorgan Securities Ltd. said.

"The money coming into commodities is absolutely enormous, and it's still flowing very, very rapidly," James Proudlock, commodity product head for Europe, Middle East and Asia at JPMorgan in London, said at the Sugaronline World Sugar & Ethanol Conference in Geneva today. "The equity markets don't quite look as interesting as a few years ago and the bond markets are very confusing. You never know when the Fed is coming in next."

There are 361 commodity funds that had \$98 billion in assets as of Feb. 28, compared with 345 funds with \$80 billion at the end of 2007, he said. In the soft red winter wheat market, index funds control two years of production, he said.

Gold, which breached \$1,000 an ounce last week, will probably continue higher, he said, without giving a forecast.

The commodity investments compare with \$45 trillion in equities and \$20 trillion in bonds, Proudlock said. If some of the "leading, real money managers" put 2 or 3 percent of assets into commodities, "everything that's happened in the last couple of years is going to happen again, times two."

My view - Commodities of all hues are in secular bull markets and investors are increasingly coming to this realisation. However, they have had a very good run of late and this has become a crowded trade, as we have been emphasising recently. The action seen on a number of commodities over the last two weeks suggests that at least some are likely to enter medium-term corrective phases, which we describe as lasting from a few months to seldom more than two years. Also see Comment of the Day on [March 6th](#) and [March 7th](#) and David's additional comments last [Friday](#) and this week, not least in the Audios.

As of today, [oil](#), [gasoline](#), [natural gas](#), [heating oil](#), [platinum](#), [gold](#), [silver](#), [palladium](#), [soybeans](#), [coffee](#), [wheat](#), [corn](#), [oats](#), [sugar](#) and [cotton](#) have retreated from their recent highs. The severity of this decline varies greatly between these commodities, but we notice that the leaders in the upward move are amongst those with the steepest falls.

Part of the reason commodities have accelerated higher has been because of the weaker [US Dollar](#) but also because they have been one of the only momentum plays around. Considering the downward dynamics posted in a number of agriculturals on March 7th and the break down of oil, silver, gold and platinum there is the possibility that the sector is entering a medium-term

correction. Individual commodities would need to sustain moves to new high ground to offset this possibility. Undeniably, billions have flowed into commodities over the last few months, but given recent action, at least some of that money is being taken off the table. Additionally, the US Dollar is looking quite oversold and ripe for a technical rally. This could encourage investors to go elsewhere in search of returns.

April 14<sup>th</sup> Higher Food Prices May Be Here to Stay

This is a sobering [article](#) from the front page of today's Wall Street Journal Europe, written by Patrick Barta and Wilawan Watcharasakwet. Here is the opening:

For all the economists and consumers who hope high food prices are temporary, here's one reason why they probably won't be: Farm costs are skyrocketing, making permanently higher prices essential for farmers to keep expanding production.

Inflation is biting farmers world-wide. In New Zealand, farm wages are up as much as 20% this year, and the average price of a dairy cow has jumped to more than \$1,900 -- almost double last year's average of about \$1,000. In Thailand and Indonesia, farmers are complaining about sharp increases in the price of fertilizer and diesel fuel.

In the American Midwest, land prices have jumped, along with the cost of energy and chemicals. The price of diammonium phosphate, a common fertilizer, is about \$1,200 a ton in the U.S., up from about \$450 a ton a year ago.

"Diesel, fertilizer, insecticide, grass-killing chemicals, they're all going up -- just like a shadow," says Samear Ruengrit, a 57-year-old farmer who grows rice about 45 minutes north of Bangkok. His average costs are now about 50% higher than last season, he says.

Farming costs are climbing for several reasons. Higher fuel prices make it more expensive to run tractors and other equipment, while pricier natural gas -- needed to make some fertilizers -- has also played a role. Equipment prices are rising because of strong demand for farm machinery in China and other developing countries, along with rising costs for raw materials like steel.

Wages are up in some parts of the world because many farms are expanding to meet higher demand, putting pressure on labor supplies, especially in countries like Australia where many workers are already occupied in commodity-based trades like mining.

Cost pressures have intensified over the past six months. Many farm suppliers and equipment dealers held back on price increases in 2006 and 2007, despite their own higher energy and labor costs. Now, after a year or more of strong markets for corn and other crops, those suppliers are deciding farmers can afford to pay more -- and they are passing costs along.

Many farmers were able to postpone cost increases through hedging or by buying fertilizer, chemicals and other supplies in bulk in 2006 or 2007, when they were cheaper. Now those strategies are hitting their limit as the stockpiles run down.

My view - Food price inflation is a serious concern for governments and central banks but remains largely beyond the influence of central banks. A monetary squeeze, for instance, would not increase crop yields and people still have to eat. Today's runaway food prices are further evidence of the commodity supercycle, frequently discussed on this site for a number of years.

This secular bull trend is likely to persist for decades, albeit punctuated by periodic corrections, despite what is clearly a US recession at least in terms of consumer spending, and somewhat slower global GDP growth. Even a global recession, which the IMF now rates it as a 1 in 4 possibility, but seems highly unlikely to us due to strong growth rates in many developing economies, would not have a lasting effect on food price inflation.

What are the investment implications?

This is an unsettled time for investments generally, to put it mildly. Nevertheless agricultural and resources stocks with pricing power, due to near monopoly positions in terms of supply, have continued to outperform.

Fertilizer companies such as [Potash](#), previously mentioned on this site, have been outstanding performers. However they are not cheap and POT has pulled well away from its 200-day MA recently. No matter how promising the outlook, the risk of mean reversion suggests that newcomers should regard runaway uptrends as speculative, and only consider purchases following setbacks within the trend defined by the MA, and provided there is no clear evidence of top formation development.

Seed providers such as [Monsanto](#), also previously mentioned, are no longer cheap and should also be regarded as somewhat speculative. Nevertheless this share bounced off its MA following the last reaction. Provided it can continue to do so, the primary uptrend will remain intact.

Interestingly, Monsanto's chart pattern is somewhat similar to leading miners, represented here by [Rio Tinto](#)\* which touched a new all-time high last week, albeit only in sterling terms. Miners have underperformed most food shares recently, due to what I regard as exaggerated concern over the impact on demand caused by the US-led economic slowdown. Consequently they have lower valuations. I suspect relative performance will strengthen if / when [copper](#) sustains an upward break.

Meanwhile, all of these shares would most likely experience pullbacks if the S&P 500 Index ([weekly](#) & [daily](#)) retests its January / March lows following Friday's downward dynamic, confirming additional resistance near the February highs. However they should bounce back quickly if the US Index's lows hold.

Agricultural commodities remain more speculative following this year's earlier upward accelerations. Also, they are more susceptible to downward corrections in the event of higher crop yields, which will certainly occur from time to time.

\* Note: Rio Tinto is the fifth largest position by weighting in my personal long-term investment account.

April 29<sup>th</sup> Commodity Advance Stalls as Fed Signals Pause

RiverFront's Rod Smith produced this second [report](#) and here is a brief section:

From a fundamental perspective, commodities are being driven by three concurrent forces in our view. First, developing economies have emerged as among the biggest commodity consumers for both domestic demand and value-added exports. Second, following twenty years of stagnant prices, there had been minimal investment in potential new supply until the last few years. Third, when real short-term interest rates are negative, commodity prices have historically risen at roughly an 8% annualized rate, according to Ned Davis Research. By setting policy to offset the housing downturn in the US (the weakest link) and lowering interest rates aggressively, we think the Fed has been inflating commodity prices and emerging markets (the strongest links in the global economic chain). We expect the Fed to keep real short-term interest rates low or negative as housing deflates, the credit crisis ensues and the economy weakens. We think the uptrend in commodity prices will be vulnerable once it becomes evident that the Fed is willing to tighten again and normalize real interest rates. However, given the drawn out nature of the housing correction, the workout of credit dislocations and their protracted economic impact, we believe Fed rate hikes are at least several quarters away.

My comment - Fullermoney has been a persistent advocate of the commodity supercycle since gold's initial stirrings in 2002, quickly followed by recoveries for industrial resources after historically low levels in real (inflation adjusted terms). The difference this time has been unprecedented demand, not just from China and India, but most of the developing world.

In contrast, during the 1970s the demand for industrial commodities came mainly from the west plus Japan - less than a billion people. The biggest story of this decade and no doubt beyond - far bigger than the credit crisis confined to a portion of the west - is the global infrastructure boom. And a total population of 6.5bn and rising consumes plenty of food, as we have also discovered in the last few years.

However timing is everything in markets, not least with commodities. I made my first commodity trade in 1971 and have been a participant in these markets ever since. When dealing in markets one learns a few things over the years.

For instance, commodities are particularly volatile because most of the activity occurs in leveraged futures markets. To survive, let alone thrive, in addition to money control disciplines one soon learns that it is safer to buy following setbacks than to pay up, the only exception being in the most consistent of trends, and then only gradually. One also learns that persistent price acceleration is an ending of unspecified duration, but usually in proportion to the prior move.

So what can we conclude about the commodity markets today?

I maintain that the supercycle will run for many more years. However many commodities, not least foods, accelerated higher during the depths of the credit crisis. In fact, they were really the only game in town for a number of months, as Eoin and I mentioned repeatedly. However one by one, they have been topping out in the last couple of months, led by [wheat](#) and [platinum](#).

As classic contrary indicators, consider front page stories on food riots and energy shortages. Pension funds, not particularly noted for timing, were shifting serious money into commodities. Jim Rogers had become a bigger household name than his boyhood hero, the singing cowboy Roy Rogers. When the price of gold finally exceeded the psychological \$1000 level, bullish forecasts were topped up by at least another grand. Any investor who was not long commodities felt like a plonker.

Today, the predictable correction in accelerated commodity trends continues, with gold ([historic](#), [weekly](#) & [daily](#)) the psychological bellwether. I suspect we have seen over 50% of the correction and that any move beneath \$800, if it occurs, will be short lived. More importantly, a clear upward dynamic is required to signal a steadier phase and once gold bottoms within its long-term upward trend, it will mostly likely retest its reaction low in a support building process. A successful test will be the next signal to commence buying once again.

Tactically, for long-term investors in bullion funds or gold shares, we are in that uncomfortable 'no man's land' where it may be too late to sell and too soon to buy. (*Gold and other commodities are also discussed at greater length in today's Audio.*)

April 7<sup>th</sup> World Equity Index Valuations Tables

Here is the monthly [list](#) of 96 global indices ranked in descending order by dividend yield and then in ascending order by P/E.

European indices continue to dominate the table when sorted by P/E. The Bloomberg European 500 Index now has a P/E of 4.65 and tops the list in terms of value. It is now testing the upper side of its range having found support near 210 in January and again in March. A sustained move above 240 would be needed to indicate that the Index has gathered enough of impetus to sustain more than a technical rally within the medium-term consolidation.

(Please note: All data quoted above originates in Bloomberg. We realise that some of the data displayed is inaccurate for some indices, particularly where ADRs are included. However, I have endeavoured to remove those indices which were problematic. We continue to publish these tables because the data is generally accurate and going forward we will continue to weed-out the less reliable data sets as subscribers highlight them for us. I have also deleted the FTSE AIM Index from the list because it does not seem to have very reliable figures.)

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