

Fullermoney *Highlights*

Global Strategy and Investment Trends compiled by Eoin Treacy

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May 31st 2008

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David	XVFT LN	Long 01/05 £30.74	
		Long 01/05 £35.5228	
	IBZL LN	Dec08	
	Hang Seng	Long 02/05 26345	May08
	Nikkei 225		CL 02/05 13985 Jun08
	MSCI Singapore	Long 02/05 400.4	May08
	VOF LN	Long 02/05 334.23p	Sep08
	Nikkei 225		CL 02/05 13995 Jun08
	Singapore Blue		
	Chip	Long 02/05 400.4	May08
	Hang Seng	Long 02/05 26345	May08
	VOF LN	Long 02/05 334.23p	Sep08
	Hang Seng	Long 06/05 26098	May08
	DAX	Long 06/05 7026	Jun08
	H-Shares		50% increase
	H-Shares	Long 07/05 14035	May08
	Hang Seng		50% increase
	DAX		CL 07/05 14220 May08
	Nasdaq		50% replaced
	IBZL LN		CL 07/05 25655 May08
	DAX	66% closed	CL 09/05 6995
	Nasdaq	Long 14/05 2022.13	Jun08
	IBZL LN	Long 14/05 3898.06	Dec08
	DAX	Long 15/05 7161	Jun08
	Hang Seng	Long 15/05 25674	May08
	OMX	Long 16/05 1024.85	Jun08
	Nikkei 225	Long 16/05 14300	Jun08
	Silver	Long 16/05 \$16.993	Jul08
	DAX	50% sold	
	Nasdaq		CL 19/05 7161 Jun08
	IBZL LN	33% sold	CL 19/05 2025 Jun08
	TFC US		CL 19/05 4058.54 Dec08
Nasdaq		CL 20/05 734.1 Jun08	
DAX		CL 20/05 1995.4 Jun08	
OMX		CL 20/05 7138 Jun08	
Gold	Long 21/05 \$928.4	Aug08	
Palladium	Long 21/05 \$459.3	Sep08	
Gold		CL 22/05 \$929 Aug08	
Gold	Long 22/05 \$927.8	Aug08	
	Long 22/05 3979.88p		
IBZL LN	Dec08	19/05 position repurchased	
Silver		CL 28/05 \$17.30 Jul08	
Silver	Long 29/05 \$17.158	Jul08	
	Long 29/05 \$898.40		
Gold	Aug08	50% repurchased	
Hang Seng	Long 28/05 24182	Jun08	
H-Shares	Long 28/05 13221	Jun08	
Singapore Blue		100% increase	
Chip	Long 28/05 386.02	Jun08	
		CL 28/05 24216 May08	
		CL 28/05 14320 May08	
		CL 28/05 385.4 May08	

Eoin	IBZL LN	Long 01/05 £35.5228	CL 20/05 3950p Sep08
	IBZL LN	Sep08	
	EWZ US	Long 28/05 9867.1 Sep08	CL 29/08 24535 May08
	Hang Seng	Long 29/05 24477 Jun08	
EWZ US		CL 30/05 9870 Sep08	

May 7th Market timing alert

It looks to me as if stock markets have commenced another reaction, partly in response to recent rallies, and perhaps also concern over the latest surge in energy costs and food price inflation. This may only be a consolidation within the recent uptrends, and it will not look serious provided that support is encountered above the early-April reaction lows clearly evident on most share indices. Meanwhile, closes above this week's highs will be required to reaffirm recent uptrends.

I have discussed this in greater detail in tonight's Audio.

May 1st Could oil mania be coming to an end?

My thanks to a subscriber for this interesting [column](#) by Anatole Kaletsky for The Times (UK). Here is a section:

Commodity inflation is worse than housing and bank deflation for three main reasons.

First, rising prices of food and energy hit poor people hardest and therefore provoke turmoil among groups that would otherwise be politically apathetic, as well as causing greater losses in consumer purchasing power than falling house prices. Secondly, inflation is inherently harder for governments and central banks to deal with than deflation - any politician can cut interest rates and taxes to prevent a financial collapse, but counteracting inflation requires higher interest rates or taxes, which are always more painful to implement and damaging to growth. Thirdly, the countries most exposed to the risks of commodity inflation - China, India and other large consumers of energy and food - are precisely the ones that the world economy now depends on for most of its growth.

To make matters worse, the political pressures caused by energy and food inflation in developing countries is provoking panic reactions such as trade restrictions, price controls and credit rationing schemes that now seriously threaten the progress towards global market liberalisation and will almost certainly make commodity shortages even worse in the long term.

To set against these scary features of global commodity inflation there are, however, three items of good news. The first is that the recent bout of food and energy inflation does not seem to reflect a permanent imbalance in global supply and demand any more than did the price spike of the 1970s. The recent doubling in rice prices does not mean that the world is running out of

food and this week's prediction by the chairman of Opec that oil prices may soon rise to \$200 has less to do with careful analysis than with greedy wishful thinking.

The Chinese and Indians are not eating any more rice today than they were three months ago. The doubling of rice prices cannot therefore be explained by a sudden shift in supply and demand. And the same is true of oil, since the global growth of oil output in the past two years has been substantially faster than the growth of consumption. The key factor, as in the last great commodity inflation of the 1970s, appears not to be any immediate supply shortage but panic buying by consumers, governments and financial investors, in anticipation of possible future shortages of supply.

My view - I agree that commodity inflation is worse than the housing and bank deflation that we have seen. In addition to Anatole Kaletsky's points, the former has global implications; the latter is largely a problem for the west.

Regarding his third point, Fullermoney repeatedly pointed out that while commodities were 'the only game in town' during the financial panic that largely ended in March, they would soon face competition for investors' interest from recovering stock markets, which we see today.

And as any investor who looks at price charts for perspective soon understands, accelerating upward trends are unsustainable beyond the short term. As the latest cycle in the commodity story finally became a front page news item (a powerful contrary indicator), overstretched commodity prices were peaking. [Wheat](#) was first to fall among the grains, with [soybeans](#) soon following and now [rice](#) is among the latest to peak. Logically, [palm oil](#) peaked with soybeans. Most other agricultural commodities have experienced similar price action, but there were other overstretched trends. [Platinum's](#) sharp fall from the all-time high on 4th March signalled imminent trouble for other precious metal uptrends.

How will this play out over the longer term and what are the investment implications for other asset classes?

The speculative bubble has burst; therefore we have seen important medium-term peaks for most agricultural commodities, as previously mentioned. A major effort is now underway to increase supply and this will inevitably have some success. The USA and other countries are understandably reassessing their food for biofuel policies.

However, it would take years to refill the vast and now nearly empty warehouses for surplus grains and beans, even under ideal growing conditions, which we are unlikely to see over time. Water is scarce in many regions; the price of fertilizers has soared, and inclement weather can always cause problems. Meanwhile demand for foods is rising in line with increasing populations and bigger middle classes in prospering economies.

Therefore, while I do not see the financial conditions capable of triggering another buying panic in most agricultural commodities reoccurring anytime

soon, demand will rise and there will be periodic supply problems in the years ahead. However as with industrial metals in recent years, they may affect specific commodities in rotation, rather than the entire sector at once.

I do not assume that [crude oil](#) will automatically see a similar correction to agricultural commodities, because we cannot sow new oil as if it were rice. However I maintain that the \$120 to \$125 region was always going to be a temporary psychological barrier. A bigger reaction than we have seen since the yearend setbacks and the similar sized March pullback, would indicate that a medium-term peak had been seen.

Meanwhile, the correction in commodity prices, aided by some significant short covering in the [US dollar](#), is helping to restore confidence in stock markets. This is where we should see some of the best gains in coming months.

I will continue to leverage up my long-term investment portfolio with trading longs in stock market indices and ETFs, while these recoveries persist. This strategy is obviously not for everyone, but for me it is an alternative to putting cash back to work in the stock markets. As veteran subscribers may recall, I always keep substantial cash reserves, ideally in a high-yielding and / or appreciating currency. That is my 'just in case' fund. I use my trading account to increase exposure when the prospects look most favourable.

May 9th on refiners and biotech

"Thanks for all your hard work. It's very helpful. Do have a couple of questions:

"Refiners seem to be a casualty of high oil prices. Looking at the chart of Valero I cannot tell if we are looking for much lower prices or we may be approaching a bottom. Any thoughts?

"Also, do you foresee any stirring of the Biotech Industry?. Once in motion it can be a strong dose of financial gain."

My comment - Refiners are suffering from a margin squeeze initiated by the sharp rise in crude prices. Crack spreads whether [3:2:1](#), [5:3:2](#) or [2:1:1](#) (Also see Comment of the Day on [September 18th 2007](#)) have declined sharply from the first quarter of this year. This implies that the profitability of refining is decreasing. This contention is held up by this [story](#) by Eduard Gismatullin for Bloomberg. Here is a section:

BP Plc and ConocoPhillips are among companies set to gain from widening refining margins on a forecast increase in gasoline demand and a drop in oil prices, industry analysts said.

Exxon Mobil Corp., Royal Dutch Shell Plc and BP, the world's three largest oil producers, all reported first-quarter earnings this week that were curbed by lower profits from processing crude into fuels. Refining margins fell to \$4.57 a barrel in the quarter from \$9.41 a year earlier, according to BP data.

Margins ``should be higher in the second and third quarters of 2008 compared to the first quarter," Andy Sommer, an analyst with HSH Nordbank AG in Hamburg, said today in an e-mail. ``But I don't expect margins to rise back to levels we have seen last year" because fuel demand will weaken from the third quarter and new refining capacity will come online.

Crude has risen 79 percent in the past year. Oil futures traded at \$100 a barrel for the first time on Jan. 2 and reached a record \$119.93 on April 28, outpacing gains in gasoline prices. So-called gasoline crack spreads, or refining profit margins, have dropped about 73 percent in the U.S. in a year.

``It seems that the `golden age of refining' is almost over," Ehsan UI-Haq, head of research at JBC Energy in Vienna, wrote in an e-mail today. ``Refiners in the U.S. suffered most due to their high yield of gasoline, while Asian and European refiners have a more balanced product output slate."

A number of new refineries are due to open in the coming years which should help to increase supply of refined products but the most important component for these businesses is the relative price of crude. Oil remains in a consistent uptrend, although it is now looking somewhat overextended as the trend steepens. The first clear downward dynamic is likely to be an important trend ending signal and a sustained move below \$110 is needed to question the integrity of the overall move.

[Valero Energy](#) advanced impressively to a high near \$70 in 2006 and entered a medium-term consolidation of those gains. It was unable to hold the move to a new high near \$80 a year later and is now breaking down. It has a progression of lower rally highs and needs to sustain a move above \$55 to offset scope for further weakness.

In relation to the Biotech part of your question: The [Nasdaq Biotech](#) Index, currently made up of 159 companies, accelerated to a spectacular high in 2000 near 1600 and bottomed near 400 in 2002. Following an initial rally it moved in a support building phase with a mild upward bias. This remains the case. It is now towards the lower side of that range and could potentially rally towards the upper side, but needs to sustain a move above 900 to indicate that more than occasional investor interest is returning to this Nasdaq sector.

The considerably smaller [S&P Biotech](#) Index has only 5 members and tells a different story. It also accelerated to a peak in 2000, but rallied significantly following its 2002 bottom and has been consolidating beneath the high at 1000 for the last 18 months. It needs to sustain a move above this area to reaffirm the overall bullish environment.

The divergence between these two indices tells us that the leaders in the industry are doing considerably better than more speculative plays, which is indicative of a trend which has been evident since the Nasdaq crash. Profitable companies, with marketable products, who are leaders in their particular niche are well regarded by the market, but smaller more untried companies are not performing nearly as well as a group.

May 13th On oil, in response to yesterday's leader:

"I'm a big believer in the arguments you have been making about upside potential in commodity prices for some time now and I greatly respect your preparedness to continually reiterate these views as ongoing strength in commodity prices requires more and more courage and insight in doing so. Today's piece showing the equivalent cost per "barrel" of Coca Cola, Latte etc is fascinating for sure, but does it add any real insight in telling us how far the oil price could yet advance? All the comparisons shown are with liquid goods that have all been processed to a considerable degree whereas the barrel of oil is in unprocessed form. All commodity based goods become disproportionately and progressively more expensive / valuable as they are processed, with labour and capital costs soon dominating the commodity cost element. A "barrel" of something made from processing oil as a key input would sell for big a multiple of the price of a barrel of oil by the time it has been processed and travelled from wholesale distribution to retail etc. Interesting as they may be, I would prefer to rely on something more fundamentally solid in judging whether oil prices have still got more upside.

"Thanks again to you and Eoin for a great ongoing commentary on practically everything that counts in the world of investment."

My comment - Thank you for your kind words and absolutely valid point concerning commodities becoming increasingly more expensive as they are processed. It is another way of saying that despite all the press hyperbole, oil and other commodities are still remarkably cheap. That was my main point, which I also illustrated with the inflation-adjusted charts.

In addition to the price comparisons being interesting, I also think it is ironic that we attach such a large monetary premium to the processing, packaging and marketing of goods, while all but taking the basic commodity for granted. This is bizarre, not least with crude oil, since Mother Nature is replenishing very few of the millions of barrels that are consumed every year.

The wakeup call, I believe, is that we most likely are on the cusp of a paradigm change regarding the price of crude oil and other industrial commodities which cannot be replenished. I maintain that the long-term price trends for these resources are upwards, albeit often very erratically, in what Fullermoney has long believed to be a commodity supercycle.

The speed and extent of price rises and also corrections will be determined by global GDP growth, the cost of production, scarcity and substitution. These factors have always dictated commodity price trends but the numbers are now skewed much more heavily in favour of demand, with big increases coming from developing (progressing) countries with large populations.

Coincidentally, historically low prices for many years, which arguably reached their nadir at the beginning of this decade, meant that the worldwide ability to increase the supply of resources had been compromised. Efforts to boost the production of resources in recent years have often been hampered by

spiralling costs and some shortages in terms of equipment and skilled workers.

Consequently I expect more of the same for resources prices - generally rising demand, frequent supply problems aggravated by scarcity or inaccessibility, and a rising cost of production.

This Supply Inelasticity Meets Rising Demand situation is unlikely to change significantly without a severe global recession. Some analysts suspect this is imminent, although I maintain that is too pessimistic at this time, at least in terms of known factors. We do have an economic slowdown, aggravated by inflationary problems, but I do not envisage conditions deteriorating dramatically without an exogenous event such as a much more dramatic near-term spike in the price of crude oil towards \$200.

This price has been mentioned by Goldman Sachs and others recently, although I believe as a longer-term target. I agree and would not be surprised to see considerably higher prices over the next decade. However significant price extrapolations when trends have already steepened usually prove to be short-term contrary indicators.

The short to medium-term trend for oil ([weekly](#) & [daily](#)) is now steepening at a rate which is becoming unsustainable. Nevertheless there is still a consistency in the form of rising steps, most easily seen on the daily chart above. A consistent trend is still in motion, as we say at The Chart Seminar, meaning that nothing has yet occurred to break its momentum.

Currently, a move below \$120 would be an initial indication that demand was waning, particularly if it occurred on a downward dynamic. A move beyond the mid-point of last step (\$117.5) would indicate some further loss of momentum, although from today's high at \$126.98 that would still not represent a bigger reaction than we have seen recently. This would require a decline of over \$15 and a break of the last reaction low near \$110. Should this occur, I would conclude that we had seen a peak of medium-term significance.

May 29th on crowded trades (Nomura Strategy From pockets of inflation to speculative excess (III))

Thanks to a subscriber for this well-argued [report](#) by Sean Darby covering a number of crowded trades evident in today's markets. Here is a section:

Rising inflationary pressures and a weak US dollar, along with expectations of further monetary easing, have induced fund flows from the bond and money markets into the commodity markets. Due to the existing squeeze from above-trend growth in China and India as well as supply problems, spot prices have risen above futures prices - ie, a backwardation has taken place. Ironically, this only encourages further flows of investment as there is a carry return from selling the spot price and buying a future contract month. This "free lunch" depends on spot oil supplies being restricted and demand remaining firm, notwithstanding the fact that prices may be climbing

While we remain enthusiastic about long-term energy demand and the need for substantial investment in upstream projects, we believe there have been six changes in the macro backdrop that ought to imply that oil prices will trend downwards:

The movement of a commodity market from backwardation to contango (spot price below futures price) ought to deter and flush out hot money flows, as income from rolling over spot contracts disappears.

G7 long-term bond yields have begun to climb. This is a function of intensifying inflationary pressures and expectations of future monetary tightening, as well as the fact that Asia and other emerging markets are seeing their current accounts shrink due to higher import bills and slowing exports. A contraction of saving surpluses in developing economies is forcing bond yields higher in developed economies.

A weak US dollar has encouraged investors to seek "stores of wealth" in commodities as an inflation hedge. However, an incremental change in sentiment on the interest rate outlook (ie, upward) and a bottoming out of current accounts suggest that the US dollar may be finding a floor against other G7 currencies. A rally in the greenback would undermine the above-mentioned "store of wealth" rationale and would discourage fund flows into commodities.

My view - Taking these three important points in order: Oil's contango bottomed around the same time as the oil price and the move upwards into backwardation coincided with oil's impressive advance. The [backwardation](#) topped out in mid-March but the oil price continued to move up to hit new highs and right now, the spread is flirting with moving into contango once again. In my experience, this type of activity is usually a warning that a powerfully trending move is coming to an end.

The [EU](#), [UK](#), [USA](#), [Canada](#), [Switzerland](#), [New Zealand](#), [Australia](#), [Singapore](#) and [Japan](#), among others, all show advances in government bond yields over the last month. Some such as the US are from areas of important historical significance, while Australian yields are moving into a more consistent uptrend. This is an important change, and suggests the market is pricing-in the end of the rate cutting spree enjoyed by investors over the last 6 months. While rising yields will be a headwind for stock markets they have not yet risen to a stage where they pose a significant threat.

The stronger [US Dollar](#) is also at least in part a result of this re-pricing. The Dollar Index accelerated as it approached its [March](#) lows and has been ranging with a gradual upward bias since. While the Dollar tends to bottom and top out in long ranging phases which often last for a number of years, the turning points also generate impressive short-term trends. The Dollar Index would need to sustain a move below 72 to offset scope for some further short-term upside.

May 28th On the ground in Asia: This oil thing is getting out of hand

- Thanks to a subscriber for this interesting [report](#) by Bill Belchere covering the impact of higher oil prices on Asian economies. Here is a section:

Oil prices could be a swing factor to the outlook for Asian growth, inflation and interest rates in 2008. There are three primary channels through which higher oil prices directly impact the outlook for Asia (1) higher oil import bill; (2) higher inflation; and/or (3) rising fuel subsidies. These direct impacts can in turn force policy to tighten to address increased financial instability stemming from the deterioration in the macroeconomic balances. Indeed, current account deficits need to be financed and Asian central banks that experienced the crisis in 1997-98 see the current account and capital account positions as positively correlated.

A tighter policy stance reinforces the economic slowdown by constraining domestic demand to control the current account deficit and inflation. If domestic prices are controlled, then the subsidy bill rises and has to be borne by the oil sector or the tax payer through government borrowing that crowds out the private sector. Subsidies also prevent price increases from curbing demand and could also lead to higher import bills in cases where smuggling is a problem. David Johnson, our energy guru, recently upped his forecast for oil prices through end-2008 and beyond. This year, we expect oil prices (WTI) to average US\$102/barrel before easing to an average of US\$85/barrel in 2009 vs our previous forecasts of US\$87/barrel and US\$75/barrel, respectively. At US\$100/barrel, we believe Asia would be able to manage the associated macroeconomic fallout.

Nonetheless, the updated forecast marks a US\$30/barrel increase over the average price of WTI in 2007 (ie, US\$72/barrel). However, oil prices moved up to US\$135/barrel last night and an average increase of US\$60/barrel in 2008 could severely limit Asia's policy flexibility via its impact on the BoP, inflation and fiscal positions, and of course, the undesired policy tightening mentioned above. If oil prices rise, the global slowdown could be deeper and more prolonged than we currently anticipate, heightening G-3 trade tensions with China, which appears to be relatively well insulated from dearer oil, given a current account surplus of 11% of GDP in 2007.

My view - The continued high price of oil is probably having a greater effect on Asian countries than on other regions. A number of factors compound this problem, but high on the list is the fact that many Asian governments subsidise oil. Maintaining these subsidies and dealing with the high cost of energy generally is proving increasingly difficult for economies in the region and is also affecting investor sentiment.

Doing nothing is not an option; the problems associated with higher energy prices are not going away, even in the best case scenario where the price of oil enters a medium-term correction. Measures to deal with these problems (mentioned in the report above) would have been best implemented when prices were lower, but any correction should be used as an opportunity to reform rather than delay further. The success or otherwise of countries, not

blessed with the natural resources necessary to fuel their own expansion, will be linked to how they can overcome this lack. Those that are already actively attempting to secure long-term supplies are likely to come out better than those that ignore the problem.

The successful break above \$40 completed oil's base ([p&f](#), [monthly](#), [weekly](#), [daily](#)) and it remains in an uptrend whose main consistency has been a progression of rising lows. The pullback to \$50 in January 2007 broke this consistency but the commodity rallied well and has entered by far the most consistent part of its move following the completion of the base. Consistency characteristics include a staircase step sequence uptrend, each of the steps is one above another and the reactions are relatively similar sized. In the last month, the uptrend has picked up pace, the reactions are getting smaller and their duration is getting shorter. This acceleration indicates that we are approaching an ending of undetermined duration.

Last week, oil hit a new high just above \$135, since then it pulled back \$9. Reactions of between \$10 and \$13 are not unusual for this trend so nothing has happened to shake the complacency of the bulls. A pullback below \$120 would be a larger reaction from a higher level: one major trend inconsistency. A sustained move below \$120 would be dipping back into the last reaction: a second major inconsistency. A sustained move below \$110 would break the progression of rising lows: a third major trend inconsistency.

The steepening of the uptrend was our first warning that oil's advance is becoming unsustainable beyond the short-term. Oil could still push upwards to significant new highs but if it is going to do it needs to start to rally within the next \$5 range to maintain its consistency.

That's how I wrote it about 1pm today, since then oil rallied impressively, having found support near \$126. A break below that level would now indicate the first loss of trend consistency.

May 19th Precious metals outlook review: Where are we in the cycle: Bull versus bear points

At Fullermoney, we became born-again bulls of precious metals in 2001. After all, gold had experienced a 21-year bear market; the price action resembled base development; everyone hated the yellow metal except for the much ridiculed gold bugs; Gordon Brown had [sold](#) over half the UK's reserves of bullion at the bottom; we lived in a fiat currency world and central banks had been printing money with abandon for years.

There have been plenty of other reasons to be bullish of gold, discussed by this service, but the present outlook review is mainly concerned about what happens next. However I will add that Fullermoney has remained a long-term bull of precious metals but aimed to trade the medium-term cycles, a [subject](#) frequently discussed with subscribers in Comment of the Day.

We have often pointed out that platinum ([weekly](#) & [daily](#)) was usually the [lead](#) precious metal, both up and down. Since its early March peak, platinum has

seen a sharp correction to nearly \$1800, successfully tested that low earlier this month, and rallied above some lateral resistance. Consequently, platinum would now need to fall back beneath \$2000 to reaffirm resistance from the year's earlier high.

This is an impressive performance, reasonably consistent with earlier support building phases following accelerated peaks, although they continued for much longer. This was also true for gold ([weekly](#) & [daily](#)) and silver ([weekly](#) & [daily](#))

I recently pointed [out](#) that gold had approached an area of potential support from the mid-\$800 region and the MA. It has subsequently rallied from this level and a close beneath \$845 is now required to suggest further easing rather than a period of support building at sideways to higher levels.

Silver tends to lag platinum and gold in the earlier stages of an advance, before finally attracting strong speculative support which causes it to perform like high-beta gold once again. Nevertheless, silver is now technically interesting as a recovery candidate, following its decline to nearly \$16, and would have to close beneath this price to suggest further weakness rather than the sideways to higher support building presently indicated.

Lastly among futures-traded precious metals, palladium ([weekly](#) & [daily](#)) also looks technically interesting following its fall to nearly \$400. Its subsequent rebound has also registered a failed downward break from the last trading range. In the current cycle, palladium has usually been a laggard on the upside, although its advances have been explosive, albeit brief.

In summary, technical action for precious metals indicates that they are now in accumulation zones, although historical action suggests that they are best purchased on easing during these phases, as ranging can be lengthy. This remains a real prospect, of some concern to me, not least because this is not usually a bullish period seasonally, as I have mentioned before. We are likely to see some central bank selling and perhaps also from the IMF. The traditionally bullish buying in anticipation of Christmas, the Chinese New Year and Indian wedding season occurs between 4Q and 1Q.

Could it be different this time? If precious metals have a shorter support building phase before retesting their highs and extending the overall upward trends, what would be the catalyst?

I can think of two factors - liquidity and inflationary expectations. Central banks have pumped plenty of liquidity into the system, as we know, and many investors are currently sitting on historically high levels of cash. Today, few investors remain in denial regarding inflation.

In conclusion, I think precious metals are in accumulation zones. Given the possibility of further support building, I favour the Baby Steps [tactic](#) of nibbling on easing and for traders, lightening on rallies

May 21st On gold

"You mentioned on Thursday's audio that Gold had no more than \$50 - \$75 downward possibility and many hundreds of dollars upward potential. This is a fairly 'stake in the ground' forecast, which I see you so often do, and do so very well.

"Could you elaborate your thoughts on gold a bit more? Why do you believe gold won't go below, \$800 for long, if it gets that far, and over the next 12-24 months as confidence returns to the markets, what do you believe will push the gold prices upwards past \$1,000

"I have just sent in my registration for your November chart seminar, money that will obviously be very well spent. I will have many more questions for Eoin when I arrive!"

My comment - Many thanks for your kind words and I am delighted to hear that you will be attending November's TCS in London. I encountered a very enthusiastic group of delegates when I attended the TCS reception last Friday, where I also met some old friends and made some new ones. The success of these seminars is greatly enhanced by the enthusiastic participation of subscribers, of all ages and levels of experience.

Regarding gold, the less difficult call was to say that it had seen most of its downside move, following a similar sized correction to what occurred in 2006. Also, gold had fallen to the upper-side of an area of potential support from an earlier trading range evident on the [chart](#) and was near its rising 200-day MA, which is a trend smoothing device.

However in all honesty I had no idea that I would commence buying precious metal futures once again last Friday. Previously, we had seen lengthy ranges following gold's lows, not least due to seasonal factors which I have mentioned before. This is still possible, of course, but when I saw the [US dollar's](#) rally stalling, the ongoing strength of [crude oil](#), the continued strength of [platinum](#) which usually leads, plus some upward dynamics by [gold](#), I decided to buy silver because it was also finding support at a logical area but had lagged on the upside.

Of course it is not beyond the bounds of possibilities that gold will advance to a high in perhaps the mid-\$900 range and then fall back in a further support building phase above \$850. This possibility would increase if crude oil, which is now accelerating, fell back sharply as it eventually will.

However there is also another and perhaps even greater possibility. Concern over resources inflation and renewed weakness by the US dollar could trigger a surge of investment and speculative demand for precious metals.

May 22nd Donald Coxe's recommended investment strategy

My thanks to a Subscriber for this [report](#) from Prieur du Plessis's Investment Portcards from Cape Town. This really is one not to miss, on past

performance and synergy with Fullermoney secular themes. Here are the 11 recommendations:

1. Long-term investors should remain heavily overweight commodity stocks, including the base-metal stocks. As the bear market grinds on, use days of stock market weakness to add to commodity stock exposure. They not only remain the asset class with the best earnings outlook, but also the asset class that is least understood by conventional asset allocators, who still see them as cyclical dependent on OECD growth.
2. In the near term, the golds will continue to outperform stock markets and to act as a form of hedge against two kinds of shocks - financial panics and inflation shocks.
3. Remain heavily underweight bank stocks, and financials tied to "Jurassic Park Avenue" excesses. Within the financial group, overweight high-quality fire and casualty companies, life insurers, and asset management organizations.
- 4 Retain above-average cash positions, preferably in strong currencies.
5. Where possible, borrow in dollars and invest in assets denominated in strong currencies.
6. The Canadian dollar remains the Western currency with the best fundamentals. Canada's problems arise because the Great Lakes are an insufficient barrier to the flow of bad economic and financial trends from the South.
7. Within the commodity groups, continue to emphasize investment in companies with long-duration unhedged reserves in the ground in politically secure regions.
8. The growth of sovereign control of energy assets means that the supply-side response to record-high oil prices will probably be inadequate to meet relentlessly growing global demand. Too many Third World governments with rich oil reserves have too many other demands for cash to reinvest heavily for the long term in new production. Retain exposure to the shares of producing Alberta Oil Sands companies with reserves that could outlast this century.
9. Long-term-oriented investors should use any temporary pullback in base metal producers to build their portfolios for the Final Movement of the Sonata - which will be the longest and loveliest performance of metal music in history.
10. The Treasury yield curve is now in recession mode - low yielding and upward sloping. It is of investment merit only for those who expect a long, deep recession. The Ten-Year note, with a negative real yield of 50 basis points, should appeal only to those who believe the recession will be accompanied by deep deflation. Oddly enough, credit spreads, though they have widened from their record-low levels, do not discount any recession at all.

We think bond investors should go for short- and medium-term high-quality non-Treasury paper - preferably in currencies other than greenbacks.

11. Defence stocks remain attractive, even if Democrats win it all in November. The next president may well choose to speak more softly than the incumbent, but if he or she doesn't carry a big stick, the jihadists won't listen.

My view - Taken one by one: 1. I strongly agree, although active investors may wish to consider lightening positions when crowd enthusiasm produces dramatic accelerations in commodity stocks. 2. I think gold shares will most likely spike higher over the medium term and I aim to take some profits if they do. Gold shares are a volatile, speculative sector, due to generally high valuations, often dwindling reserves, soaring production costs and other associated risks, not least from legislation from countries where the mines are located. 3. Yields are tempting but I maintain it will be a lengthy convalescence for troubled banking shares, not least because their speculative business model has gone up in flames. 4. Personally, I always favour a decent cash reserve, in relatively firm and high-yield currencies. It is my 'just in case' reserve. 5. Risky, in spite of inflation, and I never want any long-term debt although I use leverage in trading. However I suspect the USD and yen will remain carry trade currencies, at least until the Fed and BoJ raise short-term rates. 6. Generally agreed. 7. Agree strongly, from an investment perspective. I do not have the time for small-cap mines but recognise the 'lucky dip' speculative appeal, amidst high risks, which understandably make this sector a therapeutic way of life for some investors, not least because they enjoy the conferences. 'To each his own.' 8. I agree. 9. I hope so, but I am biased, having long been overweight in this sector. 10. I maintain that long-dated government bonds are in secular bear markets, meaning that yields will rise, albeit erratically, as this is often the nature of markets until the trend is obvious to everyone. My strategy is to short long-dated government debt futures following rallies in the prices for these contracts, although I have no positions at the moment. There are opportunities in corporate debt for those who can do the fundamental analysis, which I prefer to leave to specialists. 11. I do not really agree with this but would defer to the chart patterns, assessed from the perspective of a judge at an international beauty contest.

May 30th on a bubble in the FTSE 350 Miners index

"I read w/ interest Tim price's assessment of the nascent Miner's "bubble". He states:

"One can argue, as always, that "this time it's different", and that mining stocks trading on "just" approaching 20x p/e ratios and 1% dividend yields are hugely better value than internet stocks were in 2000 with p/e ratios approaching the infinite and no dividend yields, but the charts have a fairly compelling power, and anyone sitting on gains of the order of 200-300% or more is wholly justified in a spot of profit-taking."

"A quick look at the Black Rock World Mining Trust (that we hold near and dear) shows the top ten holdings and their PEs:

Alcoa 14
Bumi resources 20.5
First Quantum Minerals 5.6
Impala Platinum 16
Minas Buenaventura 30
Teck Cominco 11
Rio 11
BHP 9
Vale 18
Zinifex 5.6

"The S&P trades around 22. I can't find a complete listing of holdings, but these top ten holdings have an average PE of 14.2 (and I rounded up!). And the fund trades on a discount to NAV of 12%. I also noticed that the overlay chart comparing the bubbles (Nikkei, Saudi mkt, A-shares) show pretty healthy corrections for the FTSE Miners index on the way up. I recall buying Rio at 42(!) in Jan after it had made a high of 59 in December.

"The S&P trades around 22. Perhaps the FTSE Miners index has different constituents, but, barring that, what am I missing here?"

My view - Thank you for this interesting email and the statistics you include. The problem with overlaying charts of instruments that have had very big moves is that they all look the same if you look at enough back history. However putting each instrument's move in context is vitally important to determining where it is in its long-term cycle.

The [Nasdaq](#) was in a gradual uptrend from the early 1980s and really started to move in the early '90s before accelerating into a global mania in the late '90s. The [Nikkei](#) followed a similar trajectory. It had been gradually improving throughout the 1970s and moved into a remarkable accelerated hysterical peak in the late 1980s. [Saudi Arabia](#) is a closed market and has very little back history. It also displayed bubble characteristics but is not nearly as important in terms of global cycles and arguably will not take as long to recover its highs as the Nikkei. [China](#) has had a very big move, but also has limited back history. The accelerated move of the last two years has bubble characteristics but because it is a closed market, it has not attracted the same level of global investment as the Nasdaq or Japanese manias. It is also a managed market so I am unwilling to write off the ability of this market to recover in the coming years. Is it appropriate to compare the [FTSE 350 Mining Index](#) to these other markets?

The sector has had a big move, following a prolonged base formation. This is a feature it has in common with the other indices above. Interest began to turn towards the sector in late 2003 and continues today, almost 5-years later. Has this chart accelerated? It has certainly gone up a lot, but it has not accelerated, especially when compared with the performances of some of the indices covered above. It is much easier to argue that it recently completed a multi-month [consolidation](#) and is looking temporarily overstretched following an impressive gain, rather than showing any major topping characteristics.

Taking a step back, we know that the biggest bull markets follow the biggest bear markets. Mining shares were unloved for a generation and are only now attracting attention in the media. In terms of the psychological perception stages of a bull market we are entering the second stage which is characterised by grudging acceptance that this trend is not just a cyclical and therefore temporary move. When than grudging acceptance gives way to a fervent faith in the ability of the market to go up forever, we will be in the final stages of a bubble scenario.

Incidentally, the pseudo science of bubbleology has gained many new adherents since the bursting of the tech bubble. They all want to be the first to call a market a bubble, so they can refer back to their call, if it all goes wrong. Identifying markets that can form a bubble is one thing, identifying the ending when we, and everyone we know, is heavily long and leveraged, is quite another. I intend to be writing for the Fullermoney Collective for a good number of more decades, so hopefully I'll get an opportunity to test my own mettle in that regard, but I don't see it happening this year.

Getting back to your question, The FTSE-350 Mining Index has a P/E of 17.29 and a dividend yield of 1.41%. Its top-4 constituents make up 86.53% of the overall index. These are Rio Tinto (29.6%), Anglo American (22.07%), BHP Billiton (20.64%) and Xstrata (14.21%). The simple average of their P/Es and dividend yield is 16.97 and 1.37% respectively. So you are not missing anything. The market has gone up a lot and has the potential to go a lot more. This is assuming we are correct about the long-term potential of the Supply Inelasticity Meets Rising Demand theme. Back history and a historical context indicate that we are correct, but monitoring the charts and being aware of global sentiment will be key to determining when it ends.

May 22nd on live cattle and feeder cattle

"I am looking forward to the day when I can get from NZ to the UK to attend TCS. When that happens, it will be in no small part to the incredibly sound advice and analysis imparted by the Fullermoney service. Typically for an NZ'er, I would like your thoughts on the Live and Feeder cattle price action. It seems that with reports of US farmers increasing slaughter rates in the face of higher feed costs the script is written for higher prices.

"However, the daily and weekly charts (to a novice) don't appear to point to any potential breakout in either direction. No sexy staircase action here!

"Is that the nature of these contracts?"

My comment - I look forward to meeting you at a future TCS, whether that is in the UK or if we bring it on tour down to your part of the world. This chart of the contango for Live Cattle demonstrates that there are no short-term supply problems, which fits in with news that slaughter rates have been stepped up. Feeder Cattle's contango on the other hand has narrowed considerably since February, which may suggest that oversupply is starting to ease in that contract.

Historically both of these charts have been volatile and because of the nature of the market supply and demand dynamics have been seasonal. However, seasonal factors have not been a factor in the strength of grain prices and, we know from The Chart Seminar that, the most consistent trends develop from the greatest imbalance between supply and demand. Prices for both of these commodities remain extremely volatile but I would not dismiss the possibility that more consistent charts could develop if the difference between supply and demand increases.

I agree that the slaughtering of so many animals in recent months is a bullish fundamental in the medium-term. Looking at the long-term charts for perspective, we see that they are both in gradual uptrends. The recent contract change in [Live Cattle](#) puts it on the cusp of breaking upwards to [new highs](#) and a sustained move below \$98 would be needed to offset scope for higher trading. [Feeder Cattle](#) remains in the broad trading [range](#) of the last four years between \$100 and \$120. It needs to sustain a move above \$120 to reaffirm the overall uptrend.

The iPath [Livestock](#) ETN bottomed in early April and remains in a nascent uptrend. It would need to sustain a move below \$42 to break the progression of rising lows and question potential for some further upside.

May 19th on an addition to SIPP's portfolio:

"I was wondering could you add Enegi oil to the charting library, I am contemplating adding the JP Morgan Indian Investment Trust to my SIPP portfolio and I would value your opinion on whether or not you feel it is still an appropriate time to enter this particular fund. I would also like to congratulate both of you on a wonderful and ever informative website, keep up the fantastic service."

My comment - Many thanks for your inspirational comments. Eoin has added Enegi Oil to the Library.

Regarding the JP Morgan Indian IT (JII LN), the short answer is, yes, probably. Since you may also be interested in my reasoning, I will elaborate in an attempt to be objective.

I should remind subscribers that JII is the biggest position in my SIPP's account, mainly because most of it was purchased in 2003. I have also said for a number of years that India is my favourite stock market for the very long term.

However, none of us can do more than guess about the very long term; therefore from a practical standpoint, my personal view should always be tested against the reality of what markets are doing on the price charts. If price and my view are synonymous - no problem. On the other hand, if clearly diverging, it is my view that needs to be reappraised, at least in the short term.

At Fullermoney, we often suggest that one should try to view markets from the perspective of a judge at an international beauty. Using that approach today, I

maintain that we are spoiled for choice. In other words, there are plenty of attractive recovery candidates and also markets that are showing impressive relative strength. No one knows for how long this situation will persist, but based on what I know and can see, this remains an investment and trading opportunity, and I have increased my stock market exposure considerably as you probably realise.

So how does JII shape up today in the global beauty contest? Perceptions will vary but we should always strive for objectivity. Currently, it is neither a leader nor a laggard ([weekly](#) & [daily](#)), but one of the pack. In terms of valuations, India is still on the pricy side, although not seriously so with the Nifty Index trading at an historic PER of 20.46 and yielding 0.95%, according to Bloomberg. So other markets have more fundamental allure at the moment, in terms of valuations if not GDP growth potential.

However if you also think India is one of the best markets for the long term, it probably deserves to trade at a premium. It will also be high beta so one should try to pick it up following a correction. JII is still almost 20% off its January peak. Therefore if I had no India exposure, I would be nibbling. Since my largest investment position is in JII, and I also have the Indian mining company [Vedanta](#), I have opted for other opportunities while increasing my equity exposure recently.

May 21st Still an Appetite for Acquisitions (on Japan)

Thanks to a subscriber for this interesting [report](#) by Robert Buckland and colleagues covering the global M&A market. Here is a section on Japan:

One area that stands out in terms of M&A potential is Japan. Japanese companies make attractive M&A targets for three reasons. First, for almost a decade now there has been a positive carry opportunity between credit and equities. This carry is in excess of 500 basis points right now and has been as high as 600 basis points earlier this year. Investors can borrow in Japan at a yield of about 2% (this is the current BBB yield) and buy equities that are yielding more than 7% (the earnings yield). We illustrate the spread between the earnings yield and the credit yield in Figure 12. The rise in debt-financed M&A elsewhere was mainly based on a similar positive carry. However, it was never as lucrative as it is in Japan right now - even at its most attractive, in 2004, the US earnings yields rose only 50bp above the US BBB yield.

A second potential driver of M&A is that Japanese equities are no longer outrageously expensive relative to the rest of the world. On PEs, Japanese companies now trade at less than a 10% premium. On price-to-book multiples, Japan now trades at a 35% discount to global equities. Cheaper valuations suggest non-Japanese companies could at least entertain the possibility of issuing equity to make a potentially accretive acquisition in Japan.

A third attraction of acquiring in Japan is the possibility of restructuring. Japanese companies are currently the least profitable in the world. ROEs are less than 10%. This compares to 15% for all Developed Market companies

and 17% for Emerging Markets. The allure of raising profitability to levels approaching those in the rest of the world has kept activists interested.

However, despite the M&A opportunity, many potential predators have been effectively discouraged. Japanese Companies have achieved this through a combination of creative corporate governance, cross shareholdings, and takeover defense plans. The government and judicial system have also contributed. As a result, the M&A opportunity in Japan remains largely unexploited for the time being. But we will continue to watch it closely.

My view - As long as Japanese corporations remain more interested in maintaining control through the use of cross shareholdings and poison pills rather than maximising shareholder value, the impressive potential for a swathe of mergers and acquisitions is unlikely to be met. Former Prime Minister Koizumi went some way towards dismantling the cross shareholdings but much of that progress has been unwound since he left power. A further catalyst is needed to encourage Japanese companies to rationalise and this would seem unlikely to develop in the current moribund political situation. The market does, however, warrant close attention for such a move.

The [Nikkei's](#) downtrend lost momentum from early January and eventually found support below 12,000 in March, having completely unwound the impressive advance posted in 2005. The subsequent rally has been larger than any seen since 2005 and the market would need to sustain a move to new lows to question recovery potential.

While the Nikkei topped out gradually throughout 2006 and 2007, the [Topix Banks](#) Index reached a high near 500 in April 2006 and moved into a consistent downtrend. Following the recent rally from 225, the Index is challenging the progression of lower rally highs and needs to sustain a move above 340 to indicate that the bulls have regained the upper hand.

Also of note is the [Topix REIT](#) Index. When the Banks Index topped out, this index began an impressive uptrend before topping out near 2600 in June 2007. Since then it retraced more than the initial advance but found support near 1250 in March and has rallied well. So far this is not a larger rally than seen in late 2007 but it is from a lower level and the Index would need to sustain a move to new lows to offset scope for some further higher to lateral ranging.

May 2nd on liquidity (Fed Raises Cash-Loan Auctions by 50% to \$75 Billion)

This is today's news [story](#), reported by Scott Lanman for Bloomberg, which boosted stock markets in Europe this after noon and pushed US futures higher before the opening on Wall Street. Here is a sample:

The Federal Reserve expanded its cash- loan auctions for banks by 50 percent to \$75 billion each after higher borrowing costs blunted the impact of the four-month-old program.

The Fed also increased its currency-swap arrangement with the European Central Bank by two-thirds to \$50 billion and doubled the amount with the Swiss National Bank to \$12 billion, extending their terms through January. In a third move, the Fed will accept other AAA rated asset-backed securities as collateral for Treasury loans through another program.

Fed Chairman Ben S. Bernanke created the Term Auction Facility and two other programs to reverse a decline in liquidity that began last year with the collapse in the market for subprime mortgages. Today's move may reduce loan payments for some companies and homeowners with variable-rate mortgages.

The actions were taken "in view of the persistent liquidity pressures in some term funding markets," the Fed said in a statement.

The TAF, which provides 28-day loans to commercial banks, will sell \$75 billion per biweekly auction, starting with a sale on May 5, the Fed said in a statement. The decision will increase the amount outstanding under the auctions to \$150 billion from \$100 billion.

It's the third increase since the program started in December at \$40 billion per month.

World Awash

"The world is awash in liquidity, it just isn't reaching the right financial borrowers," said Chris Rupkey, chief financial economist at Bank of Tokyo-Mitsubishi UFJ Ltd. in New York. "Today's action from the central banks is another strong dose of medicine that will help cure what ails the credit markets."

My view - At a time when according to some pundits we are supposed to be in "the worst financial crisis since WW2", how many investors remember the maxim: "Don't fight the Fed"?

Who are the winners and losers, and where are we in the stock market cycle?

There is often a cruel efficiency to capitalism. Chris Rupkey, quoted by Bloomberg above, is absolutely right: "The world is awash in liquidity, it just isn't reaching the right financial borrowers" [despite the Fed's intentions]. Banks are in survival mode, looking after themselves. They will survive. Some of the benefits of lower short-term rates and the liquidity infusion will trickle down to distressed borrowers, and the semi-nationalisation of mortgages during an election year will help, a little.

A big chunk of that liquidity is inevitably flowing towards the best returns. And guess what - perceptions are changing, as is the nature of investment crowds. What some referred to as "the Armageddon hedge" in commodities is being scaled back, as price charts have been showing us for weeks, and the active players are moving back into stock markets - the one highly liquid and also oversold asset class available to investors today.

Consequently a review of the charts, which I commend to all over the weekend, will show that stock market indices continue to complete small bases following the big correction, mini bear market, or whatever people wish to call it. There is simply too much liquidity around, too much value in most stock markets, and too little recession for the grizzly crunch, forecast by so many pundits only a few weeks ago, to occur.

In terms of the stock market cycle, I believe we are still in the first psychological perception stage of a recovery, which I last discussed in some detail on [4th April](#). In other words, many investors who are still sitting on piles of cash in anticipation of lower markets, are variously bemused and 'gob smacked' as we say in the UK. While indices ranged above their January and March lows in a support building process, evidenced by the upward dynamics that we typically see at market bottoms, most commentators saw what they wanted to see in terms of volume and breadth, and the press had a field day producing hyperbolic scare stories. Markets are often volatile and investors traumatised at market lows, but sentiment indicators were screamingly [bullish](#).

However some of these bearish investors, notably investment managers, cannot afford to sit on the sidelines during a stock market recovery. As they re-enter, helping share indices to range higher, the cycle will slowly morph into its second psychological perception stage. I will discuss this process next week.

May 15th U.S. Investors Say It's Time to Buy Stocks; Favor Asia, Energy

Here is the opening from this topical [article](#) by Rich Miller for Bloomberg:

Close to half of affluent U.S. investors see the stock market as a buy, with energy as the industry and Asia as the region to be in.

The annual Bloomberg/Los Angeles Times poll of investors found that 44 percent of those with household incomes of \$100,000 or more viewed it as a good time to buy stocks, versus 15 percent who said it isn't. The benchmark Standard & Poor's 500 index has declined 10 percent from its record high in October.

"Any time prices come down, that's typically been the time to buy," said Phyllis Hamm, 59, a survey participant who works at a nonprofit group in Raleigh, North Carolina.

The poll results signal some Americans may be ready to shift part of the \$3.5 trillion parked in money market funds into equities. The confidence also indicates they anticipate limited spillover among stocks from the financial crisis that has led to \$335 billion of losses and writedowns in that industry.

My view - Readers will ponder whether or not this is a contrary indicator. As a behaviourist, I am usually wary of any market consensus but an agnostic on the point above, not least because it inevitably reflects a recent change in perceptions since the March lows occurred only two months ago. We know how frightened everyone was back then, when it was fashionable to talk about

financial Armageddon. I also think the Phyllis Hamms of the investment world will be right nine-tenths of the time.

Incidentally, among the most bearish in January and March were the perpetrators of the crisis - investment bankers and mortgage lenders. They knew that they had torpedoed their once cushy income vehicles, but could claw something back by shorting either their own company's shares or those of their competitors. Among the next most bearish were the 40-somethings and under within the investment community, because they had not lived through at least a couple of international banking crises. These are terrible events, particularly for the poor, but they are certainly not financial Armageddon. The last devastating banking crisis for a developed economy was in the 1930s. Today, we have it on good advice, from people like Mr Bernanke, that of all the mistakes central bankers may make, he is least likely to repeat that one.

What about all the bad news - from the credit crunch to a global economic slowdown, weaker corporate profits and rising inflation?

At the risk of sounding glib, these are widely publicised stories so most of it was discounted as stock markets fell to some of the most attractive valuations that we have seen since at least 2004. Today, there is a useful adage for investors to recall: 'Don't fight the Fed.' What interests me most in the article above is the \$3.5 trillion parked in money market funds, which I have mentioned before. Investors in most other stock markets hold quite a bit of cash as well, more than enough to fuel significant recoveries by equities, which are arguably the only undervalued asset class today.

How will we know whether or not investors intend to place those cash hordes in the stock markets? Might they not just sit tight, waiting for even better valuations?

The charts will show us. We have already seen ranging uptrends since the March lows for most stock market indices. Among shares, there are many more new highs than new lows, measured over any time period. So long as these strengthening trends persist we know that money is finding its way back into stock markets. After all, low real interest rates and rising inflation provide little incentive to hold cash, once people realise that their worst fears for the global economy are not being realised.

May 27th on the US savings rate (Financial Sense Wrap Up: Cool, Clear Water)

Thanks to a subscriber for this well-argued [report](#) by Brian Pretti, which includes a number of thought provoking charts and covers the decline in the US savings rate,. Here is a section:

This question of households and their liquidity circumstances at any point in time is quite the important issue for financial market outcomes ahead. Over the years you've seen the deterioration in the reported US savings rate numbers. A data series that has been quite the object of criticism decade to

date in that no credit in that calculation is given to rising real estate values as a theoretical method of savings. Certainly that particular criticism has died down as of late, and for very good reason. I'll spare you a long term chart of the US savings rate as I'm pretty sure you've seen it many a time. Rather, let's drill down a bit decade by decade and have a look at the US savings rate relative to equity market outcomes. After all, I believe the linkage is direct and meaningful.

First, savings vis-à-vis liquidity growth, per se, and potential investment in equities is an alternative choice for households. Save in cash, bank products or bonds, or invest in equities as a means of savings. The tradeoff is simple. To be inclusive, real estate is also an investment choice, one not wildly popular for now. Moreover, savings versus consumption likewise relates to the savings versus equity tradeoff as consumption theoretically lifts corporate earnings, and in turn equity values. Let's have a look back at the very simple relationship between the US savings rate and the performance of the S&P 500 as representing equities over time. We're largely covering the 1980 to present period. In other words, the coming of age and maturation of the very boomer generation that holds the key in large part to forward real world economic and financial market outcomes.

As we look at the 1980 through mid decade relationship, it's clear that the equity market saw its best days while the official US saving rate experienced periods of meaningful cyclical declines.

Moving on to the 1987 period through the end of the last decade, this is what we find. As you can clearly see, it is when the savings rate really started to drop from the 8-9% level all the way down to roughly 2% that the equity market really took off.

Finishing up with the decade to date period, again we see the consistency of elongated periods of decline in the official savings rate aligning with the most meaningful period of equity market gains.

My view - The [Dow Jones](#) almost doubled in the 5-years from the 2002 lows and encountered resistance near 14,000 last year. The most consistent parts of the move were in 2003 and following the break above 11,000 in 2006. The pullback from last year's highs conclusively broke the progression of rising major reaction lows and did serious damage to investor sentiment. Following the climactic ending experienced in January the argument about the overall direction of the market has come more into balance. Trading activity broadly reflects this will a considerable amount of ranging.

As long as questions about the health of the overall economy, the domestic economy, the consumer, household debt, the banking sector, deficits, the Dollar, the Presidential Election, Iraq and Afghanistan continue to deter investors from putting their liquidity to work in the markets, it will be difficult for the [Dow](#) or [S&P500](#) to sustain anything more than short-term rallies. Investors who had become used to the Goldilocks environment are now learning that it is unlikely to resume, and are wary of committing, too early, to a nascent uptrend. However, as long as the January / March lows hold we can consider

them the bottom of this correction. The bad news is that it is likely to take a considerable amount of time before sentiment improves to a stage, where they can sustain rallies strong enough to maintain breaks to new high ground.

May 29th on UBS and other bank shares

"I would like to know your thoughts regarding UBS. It has been hard hit and it is bordering the closing price of March 17.

"It seems to be that the bank wrote off several real estate assets and they will be issuing near 15BB in stocks at a 30% discount to strengthen its balance sheet. Although they will find buyers, the fact that the bank agrees to get a 30% haircut is scaring. What do they know that we don't? Thank you for your thoughts David and, as usual, my gratitude for your coaching"

My comment - The Banking sector generally, remains under pressure because of continued doubts about balance sheets and the dilution of shareholder capital from the issuance of new shares. UBS fell almost 70% from its highs near \$80 a year ago and is probably in a support building phase which could be quite lengthy. A lot of damage has been done to investor confidence over the last year and the deterioration of sentiment towards the banking sector is particularly marked.

At the recent Chart Seminar, when a delegate suggested that the banks would eventually recover, there was derisive laughter from some of the other delegates. We all reflected on this but, if nothing else it tells us how low in the estimation of investors banks have fallen. I personally take this as a signal that we are close to a bottom.

The more important question though, is what will this bottom look like? The crash type scenario which typifies the fall in banking shares means that there are probably still large long positions that would be happy to sell at slightly better prices. This means the speed of the recovery will be slowed by the liquidation of stale-bull inventory above the market. This type of recovery could be lengthy and is likely to be volatile. On the charts it should look like base building and will be viewed by the crowd as a market with 'no guts'

When we see that lows start to rise gradually within a base, this is an indication that demand is beginning to return at progressively higher levels. We are still extremely early in the recovery phase for banks and it can still be argued that they are due another down-leg, but for that to occur they would first need to sustain moves below their March lows.

Banks such as [UBS](#), [Merrill Lynch](#), [Credit Suisse](#), [Lehman Brothers](#), [Morgan Stanley](#), [Bank of America](#) and sector indices such as the [S&P500 Banks](#), [S&P500 Regional Banks](#), [S&P 500 Diversified Financials](#), [FTSE 350 Banks](#), [Dow Jones Euro Stoxx Banks](#), [Swiss Banks](#), [Australian Financials](#) and [Irish Financials](#) all share a common pattern. For the most part, they found support in March, rallied to varying degrees and have given up part of their advance. Some have moved to new lows. Across the sector, a loss of downward

momentum is evident, the most likely outcome is for the sector to move into a potentially lengthy convalescence / base building phase.

It should also be noted that [Asian](#) bank sectors have fared considerably better throughout this crisis. They suffered more from a drying up of liquidity international rather than a solvency crisis, which has plagued some of the Western banks.

By far the best performers are the [Taiwanese banks](#), partly because they had lagged on the upside and also because they have had the bonus of thawing relations between Taiwan and mainland China. Having hit a new 7-year high in April the Index has retreated from the 1200 level and needs to sustain a move above that area to reassert the bullish outlook.

The [Hang Seng Financial Index](#) also found support in March but rallied impressively and while it encountered resistance near 4000, it would need to sustain a move below 3500 to question recovery potential. [South Korean](#) and [Singaporean banks](#) share this pattern.

The [Japanese Topix Banks](#) Index was one of the first to top out and its downtrend has been losing momentum for more than 6 months. However it needs to sustain a move above 325 to break the progression of lower highs.

[Indonesian](#) banks remain in an overall uptrend and the retracement to date has been relatively slow. The sector found support in March and continues to consolidation above 200. It needs to sustain a move above the February highs to indicate the demand is returning in force.

May 20th Big Spenders Dropped \$1.56 Billion on Sport of Choice: Auctions

Here is the opening from this topical [report](#) by Lindsay Pollock for Bloomberg:

The two-week New York art auctions were a raucous party for some of the world's richest spenders, who parted with \$1.56 billion, confirming that contemporary art has become their sport of choice.

Similar sales at Christie's International and Sotheby's tallied \$1.4 billion a year ago. The sales in New York began on May 6 and ended May 15.

``There is a growing class of extraordinarily wealthy people who are interested in contemporary art," said William N. Goetzmann, a former museum director and a professor at Yale School of Management. ``This seems to be the dimension on which they are competing."

A flesh-filled Lucian Freud painting of a 280-pound nude woman sold at Christie's for \$33.6 million, smashing the record for a living artist at auction. The next night at Sotheby's, a bloody three-paneled Francis Bacon painting fetched \$86.3 million, becoming the priciest contemporary artwork ever sold at auction.

The sales came against a backdrop of anxiety over a sagging economy, yet results suggest that art buyers are insulated.

“When we look at the disparity between middle income and the wealthiest individuals, there is a huge gap,” said Goetzmann. “We are seeing art prices that seem to be running counter to the capital markets.”

Global Buyers

The auction houses, with international offices and representatives, attracted bidders from around the world.

My view - The Lucian Freud in particular would appear to be an acquired taste. However at \$33.6m the happy purchaser paid the equivalent of only \$120,000 per lbs for the model in this well fleshed-out canvas, with the couch thrown in for free.

Recent auction results have raised a few eyebrows but the same thing happened following the Crash of 1987 and the bursting of the dotcom bubble in 2000. Fashionable art is an international currency, which often benefits from financial crises, provided they are temporary.

The financial reminder provided by these auctions and other asset bubbles is that we need not fear global deflation as a consequence of the credit crisis, or any other crisis, at least not anytime soon. We continue to live in a fiat currency world, so the 'solution' of first and certainly last resort is for governments to print money.

As inflation hedges go, art is quite speculative because it is subject to fashion, which changes over time. However buyers at the internationally interesting auctions can usually count on a prevalent fashion trend lasting for at least a few decades. When buying, it is usually better to purchase a major work by a minor, albeit known, artist than a minor work by a major name. Buy only what you like, otherwise there is no inestimable yield to the spirit. There are also art funds but one can pay hedge fund-type charges, without the pleasure of hanging your investments on the walls in your home.

These same guidelines above apply to other collectables, the safest of which will have an international appeal. Top quality gemstones are both an international currency and inflation hedge, best purchased at auction unless one *really* has expert knowledge. Desirable property or farmland is also an inflation hedge, albeit with running costs which can be considerable and are not always offset by rental income.

I regard gold and other precious metals as the least complicated and arguably safest of inflation hedges. They too are subject to fashion but have the best long-term track record. Precious metals are slowly being remonetized in the eyes of investors, as I have been saying since 2001. The current leader is little known [rhodium](#). (*See also yesterday's item on gold, silver, platinum and palladium.*)

Equities generally do best during disinflationary periods, although they can also be an inflation hedge under some conditions - low interest rates, for instance, and individually if they have pricing power, as we have seen with the better resources shares. Stock markets will generally do worse when interest rates are rising in an effort to check inflationary pressures. We have seen this over the last year with some countries. Soaring commodity prices, not least crude oil, can also roil share markets, as we are seeing today.

Even when equities appear to be performing, this can be deceptive in purchasing power terms if the underlying currency is underperforming. We see the consequences with these monthly charts of the [S&P 500 Index in USD](#) and again in [EUR terms](#).

May 6th 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.

Not surprisingly, P/Es rose somewhat in the last month, in tandem with a number of stock markets moving above their February highs. However, European indices continue to dominate the table when sorted by P/E and globally very few markets have moved to new highs following the December/January correction. Most note worthy were South Africa and Brazil. Some of the Middle Eastern markets also remain at elevated levels having, so far, remained insulated from the travails of other indices. For the most part, this earnings season has not resulted in a swathe of missed estimates and stock market performance has been most responsible for increased multiples.

(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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