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

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

Tuesday 27th May 2008

Commentary by Eoin Treacy

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.

Martin Spring's On Target: Natural Gas is a High-Growth Business - Thanks to Martin Spring for this latest instalment of his ever-interesting report which, on this occasion, focuses on natural gas. Here is a section:

Pipelines. Russia, which has the world's biggest reserves of natural gas, is building a direct link between its territory and Germany beneath the Baltic Sea, and planning others to China and Italy.

These are enormous undertakings. The 3,000-kilometre Italian link, for example, is expected to cost $15 billion. The ConocoPhillips-BP pipeline to bring North Slope gas from Alaska to Canada's oil sands industry and the lower 48 US states will be the largest private-sector construction project in North America.

The pipeline China is building from Turkmenistan in Central Asia to Shanghai will stretch for 9,000 kms.

Liquefaction. An alternative means of moving gas from where it's found to where it's needed is to liquefy it by freezing, ship the liquids across oceans, then turn it back into gas.

The technology is not new, but LNG (Liquified Natural Gas) facilities are hugely expensive, with each "train" costing billions of dollars. For years this limited its use to transporting gas to countries not accessible by pipeline, mainly Japan.

But high energy prices have now made LNG viable on a large scale. And there are other advantages. European nations, for example, nervous about their increasing dependence on Russian gas, are looking to alternative sources such as North Africa, using LNG. China signed a $60 billion deal last month to buy 3 million tons of LNG a year from Qatar over 25 years from 2011.

With its volumes growing 7 per cent a year, LNG is the fastest-growing of the fossil-fuel industries. Because of the massive investments required, it is dominated by a handful of very large multinationals.

New Reserves. Oil majors are boosting efforts find and tap hydrocarbon deposits that are primarily gas, with oil as a side-product. The newly-discovered Sugar Loaf field under the Atlantic off Brazil, claimed to be one of the world's biggest, is primarily a natural gas resource. The Shtokman development in the Barents Sea off Russia's Arctic coast, and several projects off the coast of Northwest Australia, focus on production of gas, not oil.

There is also increasing interest in exploiting hard-rock resources that have been neglected in the past because it's difficult to tap their gas. On the western slopes of the US Rockies, Exxon Mobil is starting to employ an explosive fracturing technique three times more effective than conventional technology to unlock the riches of the Piceance Basin.

Coal-bed Methane. The "fire-damp" found in coal deposits and the curse of miners throughout the ages is almost pure methane and an excellent substitute for natural gas, which is about three-quarters methane.

It may be recovered from worked-out collieries or from coal deposits left unexploited because they are so gassy they are too dangerous to mine, and already accounts for a tenth of natural gas production in the US.

BG Group, the global specialist in the discovery, extraction and supply of natural gas, plans to build the world's first plant to produce LNG from coal-bed methane piped 400 kms from fields in the interior of Queensland, Australia.

Liquid fuels. Although currently used as gas to fuel central heating, industrial furnaces and power stations, natural gas can be converted into liquid fuels. In Qatar, the Mideast sheikdom that has the world's third largest gas reserves, they're building plants to do just that.

Worldwide demand for natural gas has been growing at an average rate of nearly 3 per cent a year, compared to oil's 1.7 per cent. China's gas consumption is forecast to triple over the next 12 years, India's to double. Yet between them they have less than 2 per cent of global reserves, so they will be forced to look to imports from the Mideast, Russia and Australia.

My view - Natural Gas (p&f, monthly, weekly, daily), traded on Nymex focuses on the North American market, with little input from LNG at present. However, this does not affect the fact that natural gas is the fastest growing fuel for power generation and remains comparatively cheap relative to oil.

Oil recently tested a 13-year high relative to natural gas, but has retreated from that level and would need to sustain a move above 14 to offset potential for some further outperformance of natural gas in the short to medium term.

Natural gas fell precipitously from its high near $16 in early 2006 before finding support at $4. The upside weekly key reversal from that depressed level marked the bottom for the reaction. Following an impressive rally, the commodity moved into a support building phase for much of the next 18 months. The sustained break above $8 completed the base and natural gas remains in a consistent uptrend. A sustained move below $11 would be needed to offset scope for some further upside.

Econbrowser: Oil Speculation - Thanks to a subscriber for this interesting analysis of the testimony by Michael Masters posted on Friday. Here is a section:

One notices right away that one problem with trying to compare demand from index speculators with the demand from China is that the two concepts are measured in different units-- the Chinese demand is measured in barrels per year, whereas Masters' speculation-based number is measured in barrels, with no clear time interval associated with them. But a more fundamental reason you can't add the two numbers together to get total demand is that there is an underlying physical commodity to whose spot price instruments such as the NYMEX oil contract are ultimately tied. There are individuals who use this physical commodity-- namely, consumers who use the gasoline to drive their cars-- and separate entities that produce it-- most importantly today, the national oil companies of the oil-producing countries. The key question is, How would the behavior of these two parties change as a result of a new higher price for the basic commodity they are consuming or producing?

If your answer is, neither consumers nor producers change anything they do at all in response to the price increase, then I agree you could make a case that speculators by themselves could make that price any old number. But I don't believe it is accurate to assume that both consumers and producers would do exactly the same thing, no matter how high the price goes. At a higher price of gasoline, consumers will use less of the physical commodity. Not much less, I grant you, and that's why I agree that speculators are able to have more of an influence than I might have expected. But I would insist that if you drive the price of gasoline sufficiently high, consumers will respond.

And that's a problem for any "paper oil" theory-- if consumers are buying less of the physical commodity, what's happening on the production side? If production doesn't change, then oil must be piling up somewhere in inventory, possibly some just idling in tankers in the Persian Gulf. But no one has an incentive to keep adding more and more oil to inventory forever. So ultimately, the "paper oil" theory is going to require a reduction in the production of actual physical oil.

My view - I believe it is beyond question that Commodity Index Funds are having an effect on the functioning of the futures markets, particularly in more illiquid commodities such as some of the grains. However, as is pointed by Tim Bond quoted in On Target above:

Speculation does not explain the current boom in commodities. Prices of commodities that are not accessible to investors, such as cobalt, tungsten, silicon, manganese, cobalt and cadmium, have risen as much if not more than those of widely-traded commodities.

Thanks also to colleague Jackson Wong for this report by John Mauldin which also seeks to challenge the extent to which Index funds can manipulate the market. Here is a section:

But what if index funds continue to grow? If there is an abundance of oil, it will eventually show up in the spot price, as storage will be lacking, no matter what the longer-term futures prices do. The market will soon tell us whether index funds are a major factor. I tend to think that even while index fund buying is bullish, it is not the major factor that is the driver of commodity prices. And even if it is significant in the short term, in the long term fundamentals will drive the true price.

The fundamental background for the entire commodity sector has changed considerably in the last 8 years. This new secular bull market is attracting interest in commodities unlike any seen since the 1970s. Going forward, we can assume increasing inward capital flows will be the norm. Funds building positions in the futures markets or in physical commodities are perfectly legitimate in my opinion, as long as they do not interfere with the orderly functioning of the markets they participate in. If we get to a stage where commodity tracking funds have an effect corner of a commodity then legislators will inevitably become involved. I do not believe we are anywhere near that stage right now, but it is something to be aware of longer term.

The importance of 3-billion new consumers entering the global economy is not to be underestimated both in terms of the duration and size of the impact they will have. The recent surge in food prices has focused attention on the social cost of the commodities boom, but ignores the reality that protectionism in the agricultural arena is probably more responsible for food shortages than any other factor. Bottlenecks such as these are an inevitable consequence of the Supply Inelasticity Meets Rising Demand theme. Resource nationalism on the one hand and an unwillingness to accept the secular theme on the other have stifled supply when demand has grown considerably. This will be slow to change which continues to be a bullish factor for the sector.

Email of the day (1) - on The Chart Seminar:

"Thanks a lot for a superb TCS workshop that I highly regard it as one of best ways that someone like myself in the beginning of his investment career can cut through all the technical jargon around and have a clear perspective and context on the markets from the dynamics of crowd behaviour as expressed on the charts.

Great opportunity to exchange views with Eoin (Congratulations for your first historic seminar) and the other delegates which were from every sector of the markets around the globe.

"I was very lucky also to find a ticket at the Royal Opera for Simone Berrangerro just after the end of the reception. Great Performance.
Thanks a lot again and now feel much better in line with the Daily Commentary."

My comment - Thank you for your kind words. One of the key strengths of TCS is the depth of experience of the delegates and the generous way knowledge is shared with the group. Thank you for your valuable contribution in what were some lively debates. Congratulations on picking up a ticket for the opera. Mrs. Treacy and I joined David and Mrs. Fuller at the LPO for an unforgettable evening. The piano solo by Dejan Lazic was particularly memorable as was the performance of conductor Kirill Petrenko. Witnessing such passion is truly inspiring.

The November TCS is already 33% full and I would like to take this opportunity to make potential delegates aware of the discounted rate of £875 for early booking.

Email of the day (2) - on a UK listed fund not updating:

"Apologies for troubling you but the chart for JP Morgan Natural Resources (SAVCOMI) seems to have stalled on the 23rd May. Would it be possible to update? Many thanks."

My comment - Thank you for this topical question, which may also be relevant to some other funds. May 23rd is the last data point recorded on Bloomberg, but this may be because yesterday was a holiday in the UK. It should start to update once more tomorrow, but if not I will contact Bloomberg.

Email of the day (3) - on questions about the Chart Library:

"Would you mind adding the equity code GLD (on the JSE) please?

"Also a technical question regarding the Chart Library: Using the Relative subsection - Commodities in different currencies - I can view both the RSI and Stochastics, but not the MA's of for example, Gold in ZAR terms. Something I'm missing here?

"Thank you."

My comment - Thank you for this interesting suggestion. GLD can now be found in the Chart Library. At present, it is not possible to apply more than one study to the chart area. This means that since the Chart Library has already performed one operation, i.e. to make the relative line chart, it cannot then also plot a moving average. I have added this enhancement to our list.

Today's interesting charts - The Chart Library Filter system allows you to adjust a large number of instruments into a single currency and rank them in terms of absolute and relative performance. Here is a link to the Help pages.

Silver - today's downward dynamic caps the short-term advance as it approached the upper side of the 3-month range. A retest of $16 now seems more likely.

Bombay Banks Index - Indian banks led the downside move in April and are now testing the March lows. However, a sustained move below 7250 would be needed to indicate a renewal of the medium-term downtrend.

Live Cattle - successfully holding the move above $100 and it would need to sustain a move below $97 to offset scope for some further upside.

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

"Good morning Eoin, would you please add the following to the Chart Library:
ETFS Petroleum - AIGO (UK)
ETFS Agricultural - AIGA (UK)

"Thanks"

My comment - Thank you for these interesting suggestions which have both now been added to the Chart Library.

Please note - David is away and will return on June 2nd.

Wednesday 28th May 2008

Commentary by Eoin Treacy

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 can 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.

Citi Commodities and Currencies Conference: Highlights from the Day - Thanks to a subscriber for this report containing contributions from a range of speakers. Here is a section on dry bulk freight rates by Dr Henriëtte van Niekerk:

Industry snapshot: The key index for the iron ore and coal seaborne markets is the Baltic Capesize Index (ships over 100 kdwt capacity). The cost of a new 172 kdwt ship is $80-90m with a three-year lead time compared with $155m for a prompt delivery second hand ship. Rapid growth in seaborne trade has stretched the existing fleet and pushed charter rates to record levels.

Growing fleet: Growth in the dry bulk fleet is gaining momentum and is expected to outstrip trade growth over the next four years. The current order book to 2013 accounts for 60% of the existing fleet. This is expected to ease prices in the coming years.

Declining efficiency: Congestion at Brazilian & Australian ports is reducing efficiency (higher waiting times). The key constraint on iron ore imports from Brazil will be port and rail rather than mine output. The infrastructure needed in Australia is planned for completion by the end of 2010 with no real improvement expected in the near future.

Short-term easing in rates: Brazilian iron ore exports have slowed in Q1 which could ease the freight market in the coming months.

My view - Baltic Capesize prices are just as volatile as the Baltic Freight rates and also hit new highs in the last few weeks. However the trend is not as consistent. To date, this sector's move has been characterised by extremely large moves on the upside followed by aggressive retracements. Following the break above the long-term base in 2003, the Index has found support at progressively higher levels following each successive pullback. As long as this remains the case we can continue to give the benefit of the doubt to the upside.

The recent pause in freight price advances has corresponded in a quite severe pullback for a number of shipping stocks. Downward dynamics last week for Dry Ships and Diana Shipping broke the two-month uptrends. However, both found support in the last few days and rallied impressively today. A sustained close below the most recent lows would be needed to question scope for some further upside.

The New York Sun: Gas Price Help May Be on the Way - Thanks to a subscriber for this interesting article by Dan Dorfman covering the potential for margin requirements to be raised for oil. Here is a section:

A bold and long-overdue move aimed at curbing the spread of the latest economic cancer - the seemingly unstoppable rise in oil and gas prices - may soon be on the way.

That's the sunny forecast from one of the country's leading heavyweight investment strategists, Bill Knapp, who tells me relief could be coming via a sharp increase in margin requirements for the purchases of oil futures, an event he sees occurring in the next two to three months.

Speculative trading fueled by low margin requirements, where buyers can acquire a barrel of oil (now around $132.40) for about $6 or $7, or at a leveraged ratio of roughly 20 to 1, has been the major driver of the skyrocketing price.

Congress has been pushing the Commodity Futures Trading Commission, which regulates commodity futures and options markets in America, to hike margin requirements on crude purchases in an effort to temper the rise in oil prices and give consumers some relief at the gas pump.

Given the impending presidential election and the national uproar over swelling gas prices, Mr. Knapp, who helps guide strategy at a $37 billion money management subsidiary of New York Life, MainStay Investments, gives Congress a 50-50 chance of bringing about higher margin requirements and increasing the leveraged ratio to possibly 4:1.

My view - Margin hikes following accelerated moves have often been associated with trend reversal. The size of the margin increase has a direct influence on the reaction of investors. For example the margin increase on May 6th, announced by NYMEX had little effect, but that will not necessarily be true for any future move particularly if it is large and is accompanied by widespread publicity by the media.

Email of the day (1) - on the inflation-adjusted price of oil:

"The price of oil in 1971 was around USD 13/bbl. Using the inflation factor given by Shadow Statistics and correcting for today the price would be USD 124/bbl, so apparently in real terms the price of oil didn't go up at all.
It wasn't OPEC which raised the price. It was the Fed !!!!"

My comment - Thank you for this interesting statistic. The inflation-adjusted figure may help to explain the resilience of the global economy to high oil prices over the last few years, but also points to the fact that we are now at historically high levels. It also puts into the perspective the depth of the bear market for so many commodities and also suggests that the secular bull has significant room to appreciate over the long term.

Email of the day (2) - on India from a new Indian subscriber:

"I am a keen reader of your site and a recent subscriber...

"Having spent 17 years in the investment industry since the first reforms I have been privileged to witness all the key cycles in the markets.

"I need to pick your brain on the mid-term outlook on India - where the key economic constituents are witnessing an extended phase of indecision. This "pause of uncertainty" is also coinciding with an election year saddled with imported global inflationary pressures from all commodities. For the first time in last 5-years man, money, material and efficiency stand on a diagonally opposite trajectory to put a question mark on earnings....

"Is it a time to say good-bye to India and return later once there is more clarity on the policy issues (not to forget the Fiscal deficit which is expected to cross double digit by the end-year)"

My comment - Thank you for this well considered email. The Indian market has been ranging for much of the last 4-months. If nothing else this tells us that supply and demand have come back into balance. This also means that the arguments both for and against the market are being given equal weight in the short term.

Looking at some back history, the Nifty remains in an overall uptrend with a progression of rising major reaction lows. In percentage terms, this is not a larger reaction than seen previously although it has spent more time below Its 200-day moving average than at any time since 2004.

In terms of commonality, the only markets which have made new highs are heavily weighted to resources. Most others remain in ranging phases and while India is not among the best performers neither is it the worst. India is unlikely to be able to sustain a meaningful rally on its own, but it is also unlikely that it will sustain a move below the January / March lows without a number of other markets doing the same.

The prognosis is for further ranging. The problem with walking away from a market that is in a secular uptrend when there is uncertainty about policy is that when those issues have been resolved it could be considerably higher before an opportunity presents itself to re-enter the market. A sustained move below the January / March lows would be needed to question potential for this, and other markets, to continue ranging as they build support in the current region.

Today's interesting charts - Did you know that the Chart Library has a wide rage of fixed income prices, yields, funds and rates?

US 30-yr Treasuries - breaking down from the short-term distribution and would need to rally above 116 to question scope for further downside.

UK 10-yr gilts - remain in the short-term downtrend and would need to sustain a rally above 108 to question potential for some further downside.

Australian 10-yr - remains in a short-term downtrend and breaking down once more. A sustained move above 93 would be needed to question further downside potential.

Email of the day (3) - on The Chart Seminar and listening to the Audio:

"You and David often refer to charts relative to your commentary during the daily audio and it would be great if we listeners could pull charts too, the commentary stops as soon as I click anything whilst in 'play' mode!!

"Also, my fwd/rewind/pause facility does not work, is this normal?

"The first thing I remember you talking about during the chart seminar was that "arrogance" sometimes tripped you up in trading / investments, well, I didn't notice any all day, not even when I asked my 1st grade questions, so thanks for that, and thanks too, for packing so much into the two days at a steady pace that even I could keep up with, money well spent without question.

"Thanks to you and David for sharing tools developed over such a long period of time, and for using your experience to explain what's going on in your view. Experience is the key in all area's of life, thanks for fast tracking me by sharing yours.

"Finally, thanks to all your contributors for taking the time to share stuff, invaluable, one day I hope to have something worthwhile to contribute, until then...have fun."

My comment - Thank you for your praise and I thoroughly enjoyed hearing about life in Monaco during one of the breaks. There are three ways to listen to the audio via the site. If you click on the 'play' button, it plays the audio in the browser which means you cannot use it for anything else while the audio is playing. The pause / play button should work, while fast forward and rewind do not in this player.

The Real Audio player is probably a better method. You can access the audio via the Real Audio Player but clicking on the date of the audio in the left hand column. This will allow you to use the site to look at charts and you can if you click on the date link to the left it will open Real Player which allows you use the site while the audio is playing and move to the any part of the audio you wish.

Eoin's personal portfolio: Brazil long re-opened - I re-opened the long that was stopped out last week in the Brazilian market. On this occasion I opened a similar sized position in the US listed iShares Brazil fund because of the more favourable trading hours. I bought the September contract at 9867.1 including spread-bet dealing costs.

Please note - David is away and will return on June 2nd.

Thursday 29th May 2008

Commentary by Eoin Treacy

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.

PFP wealth Management: Power failure on Wall Street - Thanks to Tim Price for his always well-written and interesting report. It is posted without further comment but here is a section from the conclusion:

What makes markets so intriguing today is that equities seem largely immune to a combination of $120+ oil, softening housing markets and a likely collapse in western consumer spending. Arguing that several trillion currently either sheltering in money market funds or rapidly accumulating thanks to petrodollar wealth in sovereign wealth funds will ride in to support stock markets (a.k.a. greater fool theory) only logically goes so far in the face of such sizeable challenges. But some confusing short-term resilience on the part of stock markets does not invalidate the need for caution, it rather reinforces the need for patience. On a separate note, James Ferguson of Pali asks whether it might be time to commit heresy and talk, not of $200 oil (or $1000 oil, has anyone on Wall Street tried that yet ?), but merely $100 oil ? "The last three times, in the 7-year bull run that West Texas Intermediate (crude) has enjoyed, that the oil price got more than two standard deviations above trend, it precipitated an almost immediate profit-taking that resulted in an average -28% drop." Wall Street?s venal salesmanship and management of subprime goes some way to underpinning its credibility in other markets, so its bandwagon-chasing on oil can be largely discounted on fundamental trustworthiness. The bigger question is how long equity markets can hold their poise in the face of the world?s mounting unbalances, and that question touches on government bond valuations too in the face of the smoke of the battle around inflation. Sir Francis Bacon once wrote:

"If a man will begin with certainties, he shall end in doubts; but if he will be content to begin with doubts he shall end in certainties."

In the face of almost insurmountable doubts (over likely economic slowdown, the impact on consumer confidence of softening residential property prices, the robustness of Asian fundamentals in the face of the ongoing commodity rally, the impact of $130+ oil, and the health of government bond markets given growing doubts over the under-reporting of inflationary pressures) it makes absolute sense to assume ongoing and substantial macro uncertainties. That argues, in turn, for nuanced and highly selective exposure to equity market risk, to capital preservation strategies in bond market terms, and to a healthy degree of "absolute return? (quality hedge fund) as opposed to long-only market positioning, not to mention further asset diversification. Markets may not yet be flashing red, but there seem to be more than usually strong headwinds about. Unfortunately, an especially discredited Wall Street establishment now has peculiarly weak authority in either recommending appropriate strategies or taking advantage of the resultant dislocations in markets. Happily, evolutions in financial products and the rapid democratisation of more sophisticated investment vehicles make it easier for independent asset managers and private individuals to try and resolve these questions for themselves, rather than simply overpaying to engage with a mountain of conflicted interests.

Email of the day (1) - 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 strenghten 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 dont? 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 Sf80 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 particular 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 is 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 internationall 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.

Email of the day (2) - on how banks will come up with a new business model:

"I hold an investment ISA with barclays stockbrokers and recently got an interesting phone call from a rather forceful sales person of theirs selling a new Diversified Commodities Investment Note. This is a structure product whose price is linked to a large basket of commodities, the highest weighting being crude oil making up nearly 40% of the basket. A range of other commodities is included in the basket including precious metals, base metals, natural gas and soft commondities. This structured product has a maturity of 5 years after which your initial investment is guaranteed (i,e. no down-side risk if the contract is held to maturity) while your up side potential is capped after 130% rise in your initial investment. This got me thinking about your comments relating to how the business model of banks had collapsed in the wake of the credit crunch and full recovery will not ensue until they find another route for revenue growth, and maybe selling commodities linked structured products to clients looking to cash in as we move into an era of high commodity prices and rising inflation could be the way forward for many institutions. If this does become the case, is there a risk this speculation could drive up prices into bubble territory and a subsequent crash bringing the banks full circle?"

My comment - Thank you for this informative email and interesting question. Banks are being recapitalised via the yield curve where short-term rates are low and long dated yields are relatively higher making it easy to borrow cheaply and lend more expensively. This will help them in survival mode, but they also need a big trend to profit from, if they are to recover significantly. Right now commodities and emerging markets are where the action is. Both have outperformed during the current correction and have a large degree of separation from the mess that is subprime.

I think that structured products limiting the upside are indicative of the early stages of a bull market where investors are keen to preserve their principal. We won't be in the final bubble stage, until investors believe there is no need to preserve their principal and will be opting for much more leveraged products. Inevitably, when that happens, some participants will have become hopelessly overstretched and it could well spark a fresh banking crisis. Let's not forget however that we are probably a decade away from such an event.

Liquidity crises which hark the end of the world when they are in full swing, seem to occur about once a decade. 1987, 1997 and 2007 have a familiar ring. This is no guarantee that the next one will occur in 2017 but it does indicate that it takes time for excesses to develop. Following one of these crises, investors are chastened enough that they will not immediately fall foul of the same mistake right away so another crisis immediately following the last one is unlikely.

The biggest investment story in the world today is the emergence of billions of new consumers. The greatest investment issue is how the world is going to change to accommodate so much more demand for goods and services and how can we can profit from it? Increasingly, this is leading investors to invest in commodities directly and in commodity producing companies. It is also leading to increased interest in the stock markets of countries who either produce commodities or who harbour large populations of new middle class consumers. I believe it is in this connected arena we will see the next big bubble developing.

Eoin's personal portfolio: Hang Seng long rolled forward - My long in the Hang Seng which was rolled forward on April 30th at 25,551 was sold last night at 24,535. A corresponding June position was opened at 24,477. The Hang Seng remains in a ranging phase and has been costing me money over the last month, although this is a small position. I remain of the opinion that it has the potential to sustain a move above 26,000 but this may take longer as the current uncertainty in global stock markets continues.

Japan's Stocks Rise Most in Two Months on Earnings Outlook, Yen - This article by Masaki Kondo and Toshiro Hasegawa for Bloomberg covers today's impressive move by Japanese stocks. Here is a section:

Japan's stocks jumped the most in almost two months after orders for durable goods in the U.S. unexpectedly rose in April, easing concern an economic slowdown will curb spending in Japan's biggest export market.

Sony Corp., which gets a quarter of its sales from the U.S., sent electronics makers higher, while Canon Inc. jumped the most in a month. Mazda Motor Corp., which exports 80 percent of domestic production, led a gain by carmakers after the yen weakened against the dollar. Wigmaker Aderans Holdings Co. surged after its shareholders rejected the reappointment of executives.

The Nikkei 225 Stock Average climbed 415.03, or 3 percent, to close at 14,124.47, the sharpest gain since April 2. The broader Topix index jumped 31.94, or 2.4 percent, to 1,380.63. All but one of 33 industry groups on the index advanced.

``More and more investors, particularly those overseas, are wanting to increase their weighting in Japanese stocks, and the report on U.S. durable goods spurred buying,'' said Yoji Takeda, who helps manage the equivalent of $1.1 billion in Asian funds at RBC Investment (Asia) Ltd. in Hong Kong.

Orders for goods, excluding cars and planes, rose 2.5 percent in the U.S., the most since July, the Commerce Department said yesterday, while economists had estimated a 0.5 percent decline. The yen weakened against the dollar to as much as 105.31 in New York, a level not seen since May 14, from 103.97 at the close of stock trading in Tokyo yesterday.

'No Recession'

Sony added 3.7 percent to 5,080 yen, while Canon, the world's largest digital-camera maker, rose 3.9 percent to 5,540 yen, the biggest advance since April 25. Mazda, the world's only mass producer of rotary engines, gained 7.3 percent to 513 yen, the highest since Jan. 7, while larger rival Honda Motor Co. climbed 3.1 percent to 3,360 yen. Makers of electronics and cars accounted for a third of the Topix's gain.

``With the report on durable goods, investors concluded there will be no recession in the U.S.,'' said Takanori Shimizu, president of 21st Century Asset Management Co. in Tokyo. ``The U.S. will likely raise interest rates next year, and that will put an end to a stronger yen, giving a tailwind to exporters.''

A 1 yen change against the dollar alters Sony's annual profit by 4 billion yen ($38 million), Canon's by 9.9 billion yen and Honda's by 20 billion yen, according to the companies.

My view - The Dollar was in a consistent downtrend against the Yen from late-June 2007 and accelerated into the March lows. Since then, the rate rallied significantly and has been consolidating beneath the 105 level for much of the last 6 weeks. A sustained move below 102.5 would be needed to question scope for the Dollar to strengthen further. For an export driven economy, such as Japan's, investors pay particular attention to the strength or otherwise of the currency.

The Nikkei found support around the same time as the Dollar and the two charts share a number of similarities. Of course, this is not a hard and fast correlation, but nor is the movement of the currency unimportant to the direction of the stock market. The Nikkei rallied well today from the lower side of its short-term range, finding support where it needed to, in order to maintain a near-term bullish outlook. A sustained move below 13,500 would be needed to question potential for a break above 14,300.

Today's interesting charts - Did you know you can find backwardation / contango charts for a range of commodities in the Chart Library?

Platinum - encountered resistance near $2200 and reacted violently. It paused today near the psychological $2000 but an upward dynamic would be needed to question potential for a test of the lower side of the range near $1800.

Zinc - breaking down from the 6-month range and needs to sustain a move above $2100 to offset scope for some further downside.

Austria - recovering better than most other European markets and would need to sustain a move below 4200 to question potential for some further upside.

Rough Rice - fallen more than 25% from the April highs and would need to break the short-term progression of lower highs to indicate a low of importance has been reached.

Jordan - consolidating gains in what is a consistent uptrend. A break of the rising lows would be needed to offset scope for further upside.

Please note - David is away and will return on June 2nd.

Friday 30th May 2008

Commentary by Eoin Treacy

Email of the day (1) - 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.

Email of the day (2) - on the reaction of resources companies to any pullback in oil:

"Thanks for your missive yesterday (thurs). This must be one of your best yet- very succinct and full of insight in to a possible new stage in time of - temporarily - declining oil prices.

"My question is; should oil choose to decline from here, and equities become more attractive to investors, what is the expectation for resource stocks over this time? Will say Rio Tinto rally since it is a stock, or decline as its pricing power stems from strong commodity prices"

My comment - Thank you and I'm delighted you're enjoying the Service. Resources shares have been some of the best performers within individual indices from the beginning of the year. And countries with heavy weightings in resources shares have been some of the only indices to make new highs following the January correction.

There are a number of reasons for owning resources shares. They offer remarkable access to the Supply Inelasticity Meets Rising Demand theme. They have posted incredible profit growth and this looks likely to continue. They represent one of the few industries with significant pricing power. They have access to irreplaceable reserves in the ground which have an intrinsic value. They offer a quasi hedge against inflation. I'm sure subscribers can come up with many more reasons.

Oil's advance is important to investor sentiment regarding the resources complex generally. If oil peaked in the medium-term at $135, (and let's not forget that this could still be a consolidation within this consistent uptrend, although for this to be the case it needs to sustain a move above $130.), then sentiment towards the entire sector is likely to sour somewhat. Companies directly exposed to oil should be most at risk of a pullback but there is likely to be a knock-on effect for other shares in the commodities sector. Energy shares have already pulled back in what has been a larger reaction than anything seen in the last months.

Mining companies such as Rio Tinto and BHP Billiton should recover relatively quickly following any shake out, because oil is less important to their revenue streams. Energy is the fourth largest business unit for both Rio Tinto and BHP Billiton. Aluminium is also important. These shares have been quite volatile over the last year and major sell-offs have been good buying opportunities. A sell-off in oil might also present such an opportunity, but the relative outperformance of the sector might take longer to reassert itself as other sectors which have suffered more from high oil prices rally.

Tin Heads for Steepest Drop in 9 Months on Stockpiles, Record - Thanks to a subscriber for this article by Channahon Channahon for Bloomberg covering the steep decline in tin prices. Here it is in full:

Tin headed for its steepest weekly drop since August in London after stockpiles expanded and investors judged that a record reached this month didn't reflect the outlook for demand. Copper and aluminum advanced.

Open interest in tin futures, or contracts that have not been closed or liquidated, has slumped 12 percent in a month, indicating investors withdrew from the market as prices rose to an all-time high. Tin is the least-traded metal on the London Metal Exchange, increasing the likelihood of price swings.

``Tin is such a thin market that, when sentiment turned, there is no depth,'' Stephen Briggs, an analyst at Societe Generale in London, said today by phone.

Tin for delivery in three months fell $350, or 1.7 percent, to $20,700 a metric ton as of 12:08 p.m. in London. The contract has dropped 13 percent this week, the worst performance since the week ended Aug. 17. It fell by a record 11 percent yesterday and is 19 percent below the record $25,500 reached May 15.

PT Timah, the world's second-biggest tin miner, declined as much as 5.7 percent in Jakarta trading today. The Indonesian miner has sought to diversify into coal and other commodities to reduce its exposure to tin prices.

Stockpiles of the metal monitored by the LME jumped 115 tons, or 1.6 percent, to 7,550 tons, the highest since May 20, according to LME data. That's equal to 7.5 days of world usage, estimated at 370,000 tons for this year by Societe Generale.

Copper rose $60, or 0.8 percent, to $7,950 a ton, rebounding from yesterday's two-month low. Stockpiles of the metal dropped 1,450 tons, or 1.2 percent, to 124,950 tons, at warehouses registered with the LME. Those reported by the Shanghai Futures Exchange also fell 2 percent to 44,554 tons this week.

Copper Prices
``Our expectation for softness in copper prices has been realized and we view dips below $8,000 a ton as a buying opportunity given tightening concentrate supply,'' Barclays Capital analysts led by London-based Kevin Norrish wrote in an e-mailed report dated yesterday. Concentrate is an intermediate product smelted into metal.

Near-record oil prices have boosted production costs for metal miners and refiners, the Barclays analysts said.

Among other LME-traded metals, nickel added $100, or 0.5 percent, to $22,300 a ton and zinc dropped $10 to $1,975. Lead fell $32 to $1,920. Aluminum rose $30, or 1 percent, to $2,910.

My view - The massive downward dynamic posted by tin yesterday completes the developing Type-2 top formation as taught at The Chart Seminar. (See Comment of the Day on May 21st). This activity is characterised by a loss of momentum, often with failed upside breaks, followed by a massive reaction against the prevailing trend. Given the size of the correction, the commodity has become temporarily overextended so some steadying in the current region would not be unexpected. However, this is the beginning of a medium-term correction which could involve a long convalescence, in common with similar moves in other industrial metals.

Nickel broke down from the 9-month range two weeks ago and is approaching an area of potential support at $20,000. An upward dynamic is needed to check downward momentum.

Zinc broke below $2200 last week and is currently pausing near $2000, but a sustained push back above $2200 is needed to offset scope for some further downside

Lead is looking somewhat overextended in the short-term but needs to sustain a move back above $2250 to offset scope for some further weakness.

Copper posted a new high in April but was unable to hold it and is now backing away from that area, albeit slowly. However it needs to sustain a move back above $8500 to reassert the overall uptrend and hinder a continuation of the ongoing ranging consolidation.

Aluminium rallied impressively from the lower side of its two-year consolidation and tested the 2006 highs, before consolidating that move. It remains in this ranging phase and needs to sustain a move above $3000 to reassert the overall uptrend.

Canada first-quarter GDP declines for first time since 2003 - Thanks to a subscriber for this interesting article by Randall Palmer for Reuters. Here it is in full:

Canada's economy shrank unexpectedly in the first quarter for the first time in five years, with gross domestic product falling an annualized 0.3 percent, Statistics Canada said on Friday.

Analysts surveyed by Reuters had, on average, expected annualized first-quarter real growth of 0.3 percent.

In nominal terms, GDP grew an annualized rate of 4.6 percent, reflecting higher energy prices.

GDP declined 0.2 percent in March, after a revised decline of 0.3 percent in

February. Statscan originally reported the February decline as 0.2 percent.

The numbers disappointed the market and led to a sell-off in the Canadian dollar.

"As far as monetary policy is concerned, it leaves the door wide open for at least one more (interest rate) cut by the Bank of Canada.

Whether it is in June or July remains to be seen," said Matthew Strauss, senior currency strategist for RBC Capital Markets.

Statistics Canada said the economy had started to lose momentum in the second half of 2007 as exports declined. It "stalled in the first quarter due to widespread cutbacks in manufacturing, most notably in motor vehicles."

My view - The key day reversal posted on May 21st capped the impressive advance from 14,000. Since then the market has fallen to test the October highs and it would need to sustain a move below 14,500 to damage the integrity of the uptrend from the March lows.

Email of the day (3) - on inverse bond funds as a hedge:

"Thank you for your chart update/review of the major countries' long bond yield. Proshares recently launched 2 ETFs-TBT/PST which perform two times the inverse of the respective Lehman US Treasury bond index.

"Would like to have your thoughts on the effectiveness and efficiency as a hedge against equities in general and in Asian equities in particular. Are central banks' holding mainly in the short end of the Treasury curve? Given the turmoil in the asset-backed credit markets, will institutional investors' refrain from corporate actions as a cap to the rise in yield?

"Again, thanks for the excellent service you and David provide; learn a lot in the past one and half year as a subscriber to the Fullermoney collective.

"Please keep up the good work."

My comment - Thank you for your kind words and we'll do our best. The instruments you mention have a short back history but are performing well in the current climate and the upside can probably be given the benefit of the doubt as long they hold above 72 and 71 respectively.

We have often spoken of the fact that rising government bond yields are a headwind for stock markets. However, this would be more appropriate to speak of when yields have been rising for a while, and are challenging equities as an investment destination. Right now yields are rallying from extremely low levels in the US and probably have a way to go before they are at a stage which worries investors. In fact, there is the possibility that the current surge in yields could benefit equities as they may attract investment flows as investors sell bonds.

In an environment where bond yields are surging these could be potentially viable hedges, until of course yields start to falter, in which case they would be a double liability because of the leverage.

Today's interesting charts - The Chart Library has two Search Engines. One searches the more than 16,000 equities, funds and ETFs in the International Equity Library and the other searches through the rest of the Chart Library for indices, commodities, currencies, bond prices and yields, ratios, spreads and overlays.

Brazilian Real per 1 US Dollar - the Dollar breaks down to new low and would need to sustain a rally above 1.7 to offset scope for some further downside.

New Zealand - rallies well within the 4-month range and would need to sustain a move below 3550 to hinder potential for at least a test of the upper side of the consolidation. .

Japan (Topix) - rallies to test the upper side of the month-long range and would need to sustain a move below 1350 to question potential for an upward break.

Eoin's personal portfolio: iShares Brazil break even stop triggered - I was stopped out of my long in the iShares Brazil fund last night, when a break-even stop was triggered. This took me out at 9870 against my purchase at 9864 on Wednesday.

Email of the day (4) - on GaveKal funds:

"Given that you sometimes feature some of the interesting research output from GaveKal, I wonder it you might add some of their funds to the Chart Library? I believe that GaveKal offer access to research for clients investing above a certain level, but don't know the details.

"The web link gives details and codes for all 5 of their funds. Personally, I would find the Asian Absolute Return and the Platform Company Fund the most interesting."

My comment - Thanks for these interesting suggestions which have now been added to the Chart Library.

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

"FDL (in the Chart Library under Australian Resources) had a name change to FMS on 29/05. It seems Bloomberg does not automatically incorporate name changes. Would it be possible to carry out the name change from FDL to FMS. Thanks."

My comment - Thanks for the head's up. I have made the relevant adjustments.

Please note - David is away and will return on June 2nd.