

Fullermoney

Global Strategy and Investment Trends by David Fuller

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

Monday 30th June 2008

Lawrence Summers: What we can do in this dangerous moment - [This is certainly a topical article from the Financial Times, by the former Secretary of the Treasury during the last year and a half of the Clinton administration. Here is his four-point proposal:](#)

First, the much debated housing bill should be passed immediately by Congress and signed into law. It provides some support for mortgage debt reduction and strengthens the government's hand in its troubled relationship with the government-sponsored enterprises - Fannie Mae and Freddie Mac. While it is an imperfect vehicle - too limited in the scope it provides for debt reduction, insufficiently aggressive in strengthening GSE regulation and failing to increase the leverage of homeowners in their negotiations with creditors through bankruptcy reform - it would contribute to the repair of the nation's housing finance system. Failure to pass even this minimal measure would undermine confidence.

Second, Congress should move promptly to pass further fiscal measures to respond to our economic difficulties. The economy would be in a far worse state if fiscal stimulus had not come on line two months ago. The forecasting community is having increasing doubts about the fourth quarter of this year and beginning of the next as the impact of the current round of stimulus fades. With long-term unemployment at recession levels, there is a clear case for extending the duration of unemployment insurance benefits. There is now also a case for carefully designed support for infrastructure investment, as financial strains have distorted the municipal credit markets to the point where even the highest-quality municipal borrowers are, despite their tax advantage, paying more than the federal government to borrow. There are legitimate questions about how rapidly the impact of infrastructure spending will be felt. But with construction employment in free fall, there will be a need for stimulus tied to the needs of less educated male workers for quite some time. Fiscal stimulus measures must be coupled to budget process reform that provides reassurance that, once the crisis passes, the fiscal policy discipline of the 1990s will be re-established.

Third, policymakers need to make a clear commitment to addressing the non-monetary factors causing inflation concerns. Though this could change rapidly and vigilance is necessary, it does not now appear that there are embedded expectations of a continuing wage price spiral. Rather, the primary source of

inflation concern is increases in the price of oil, food and other commodities. Even if structural measures to address these issues do not have an immediate impact on commodity prices, they may serve to address medium-term inflation expectations. Appropriate steps include reform of misguided ethanol subsidies that distort grain markets to minimal environmental benefit, allowing farm land now being conserved to be planted; measures to promote the use of natural gas; and reform of Strategic Petroleum Reserve Policy to encourage swaps at times when the market is indicating short supply. Major importance should be attached to encouraging the reduction or elimination of energy subsidies in the developing world.

Fourth, it needs to be recognised that in the months ahead there is the real possibility that significant financial institutions will encounter not just liquidity but solvency problems as the economy deteriorates and further writedowns prove necessary. Markets are anticipating further cuts in financial institution dividends; regulators should encourage this to happen sooner rather than later and more broadly to reduce stigma. They should also recognise that no one can afford to be too picky about the timing or source of capital infusions and rapidly complete the review of regulations that limit the ability of private equity capital to come into the banking system. Most important, regulators should do what is necessary, including possibly seeking new legislative authority, to assure that in the event of an institution becoming insolvent they can manage the resolution in a way that protects the system while also protecting taxpayers. It was fortunate that a natural merger partner was available when Bear Stearns failed - we may not be so lucky next time.

My view - Sentiment has deteriorated significantly in the last month so this is probably not a time for masterly inactivity by government officials responsible for economic policy. In his conclusion, Lawrence Summers also says: "Unfortunately we are in an economic environment where we have more to fear than fear itself."

This seems irrefutable so the US government needs to be proactive, ideally with some bipartisan policies to stimulate the economy. I have long assumed that a government led programme of infrastructure improvement, which the US certainly needs for its long-term development, will be required. Major projects of this type will take time to organise and implement, as Lawrence Summers points out, not least during an election year.

Meanwhile, what the global economy needs most right now is some respite in the uptrend for [crude oil](#), which hit another new high this morning before backing off. This would also be significant for stock markets which are behaving as if they are on an oil standard.

How might this develop?

Currently, Wall Street and indeed most of the world's stock market indices are behaving as if they are on one end of a playground seesaw, with crude oil on the other end. When the price of oil dips, stock markets steady. However when oil rises ([p&f](#) & [weekly](#)), extending its staircase upward trend, most stock markets sag.

Of course stock markets face other headwinds, from the west's ongoing credit crisis to the burst housing bubble, soaring food prices, global deleveraging, higher interest rates in many countries, slower GDP growth and corporate profit downgrades. Nevertheless, crude oil's rise is the biggest problem currently affecting economic growth in oil importing countries.

Currently, WTI crude has paused near the top of its recent range between \$140 and \$130, following new intraday highs on Friday and again today. So crude is not extending its latest upward break as it often did in the past (this is best seen on the p&f chart above which uses closing prices), indicating that supply and demand are in balance at the moment. The weekly chart also shows that the medium-term advance is quite overextended relative to its 200-day MA.

However the overall trend is otherwise consistent and crude will need to fall back into the range below \$140 to suggest an upside failure. A close beneath \$135 would be a mid-point danger line (MDL) violation, as taught at The Chart Seminar ([TCS](#)). Thereafter, a close beneath \$130 would affect bullish sentiment among oil traders and represent a break in the progression of higher reaction lows. Below \$120 we would have clear evidence of a medium-term peak in the price of oil.

Of course if none of this happens and crude extends its advance following a brief pause above \$140, the uptrend consistency will be maintained. A consistent trend is a trend in motion, as we say at TCS, meaning that it has further to go because nothing has occurred to alter the prevailing psychology.

Does commonality in terms of other oil contracts provide any confirming or non confirming evidence?

Yes, [heating oil](#) has yet to confirm crude's upward break and this would require a close above the psychological \$400 level. Conversely, a close beneath \$370 would reaffirm resistance near that level and below \$350 we would have evidence of a medium-term top. Similarly, [gasoline](#) has not confirmed crude's latest breakout. Its technical levels currently of interest are \$360, \$330 and \$315. [Natural gas](#) currently has the most consistent uptrend of all and would require a close beneath \$12.60 to question medium-term consistency.

In conclusion, the four oil futures contracts remain in overall upward trends, which although somewhat overstretched, have yet to lose consistency. As with most market trends, the higher they go in the short term, the more they will eventually fall back. Meanwhile further strength in petroleum futures would continue to weigh on stock markets, particularly if gains were rapid. Conversely, evidence of medium-term peaks would probably be accompanied by technical rallies for most share indices.

Over the longer term, there is no change in Fullermoney's view that oil is in a secular bull market.

Emerging markets infrastructure spending to surge - [My thanks to a subscriber for this informative item by Rita Raagas De Ramos for Asian Investor. Here is the opening:](#)

Merrill Lynch has raised its annual infrastructure spending forecast for emerging markets by 80% on the back of increased government spending, especially in China, the Middle East and Russia.

Merrill Lynch has raised its emerging markets infrastructure forecast to \$2.25 trillion annually, or 5% of GDP, from \$1.25 trillion over the next three years, due to more aggressive government spending programmes and higher analyst estimates.

Infrastructure spending – which Merrill Lynch calls a long-term solution to inflation – is expected to be fuelled by decades of under-investment in power, transportation, and water. Merrill Lynch expects 70% of infrastructure spending to be concentrated in China, the Middle East and Russia.

“The higher forecast is due to more aggressive government spending and higher analyst estimates,” Merrill Lynch says in a report.

To give an example of the infrastructure spending in the pipeline, Merrill Lynch notes that Xstrata recently estimated \$22 trillion in emerging markets infrastructure spending in the next 10 years. Xstrata is a global diversified mining group, listed on the London and Swiss stock exchanges. “That estimate is among the highest that we have seen, with an implied run rate of \$6.6 trillion over the next three years,” the report says.

Merrill Lynch breaks down its upward revisions in emerging markets infrastructure spending over next three years (new versus old estimates):

China - \$725 billion vs \$400 billion
Gulf - \$400 billion vs \$225 billion
Russia - \$325 billion vs \$195 billion
India - \$240 billion vs \$110 billion
Brazil - 225 billion vs \$100 billion
Mexico - \$120 billion vs \$60 billion
Turkey - \$65 billion vs \$50 billion
South Africa - \$60 billion vs \$60 billion
Central and Eastern Europe (CEE) - \$45 billion vs \$45 billion

[My view - Global infrastructure development has been one of Fullermoney's key secular themes since 2003 and we remain long-term bulls. Xstrata's estimate of \\$22 trillion in emerging market infrastructure spending over the next ten years is staggering, as are the upward revisions for individual countries.](#)

[However, while Xstrata is a great mining company, I am not sure that it is the most objective source for these forecasts, and any 10-year projection needs](#)

to be taken with a grain of salt. The individual country forecasts sound more like wish lists to me.

I do not doubt that infrastructure spending plans are both enormous and necessary for these countries if they are to fulfil their development potential. However, I suspect few of the estimates have been based on today's higher costs for energy, most raw materials and labour, all of which are still rising.

I do not think these problems will end the infrastructure spending cycle - far from it - but they may slow and lengthen it from time to time, in line with GDP growth. Nevertheless this should remain a very attractive investment sector more often than not.

Email of the day - [On Midwest topsoil damage and potash](#):

"Just for your info, the levee breaks have totally destroyed and washed away topsoil for growing that may take decades to repair. If you understand how critical topsoil is in the Midwest, think the dust bowl challenges there in the 1930s.

"Technology and rehabilitation is really going to be tested here so prepare for higher food costs from this region for awhile that stakeholders have not prepared for.

"Again, I think a lot of the U.S. Midwest will be looking to of all places Saskatchewan to provide the needed potash base to rework the topsoil base and repair this damage.

"When you understand the composition of what makes great topsoil the mineral and organic matter mix needs to be just right. I would think that peat and deciduous areas on what was once considered marginal property lands for any commercial use may be in demands where permits or legislation allows for organic matter or peat production. Much of Northern Minnesota, Manitoba, Saskatchewan and NW Ontario could see future possibilities for new growth industries if not a resurgence in areas of the horticultural industry within the U.S supporting the U.S. farmer over the consumer.

"Again, potash is not just for Chindia, it will be needed to rehabilitate fast the U.S. Midwest after these rainfalls and levee breaks and will be a test as to the resilience of the U.S. agricultural industry."

My comment - [Thanks for some interesting and informative observations.](#)

What you say certainly makes sense to me and [Canada](#) is spectacularly well positioned for this cycle in which the demand for resources is unlikely to be more than temporarily interrupted, if even that, by the current global economic slowdown. Arguably, in terms of resources Canada is only rivalled by [Brazil](#). However being a developed country with a small population, Canada probably faces fewer risks.

[Potash](#) remains a spectacular performer and subscribers clever enough to be holding this share will know that they need to monitor the trend consistency.

In contrast, [uranium's](#) performance has been weak ever since the metal peaked last year. We expected a significant correction but I am surprised that it has fallen this far and has yet to signal a low. Surely uranium funds now have long-term investment appeal. Canada has the largest producer in Cameco ([weekly](#) & [daily](#)) and the share is beginning to perform once again. I hold Cameco in my personal long-term investment account and the pattern will remain promising so long as the reaction lows continue to rise.

Mittal eyes Rio Tinto move to ensure ore supply - This was a front page [item](#) in the FT today, written by Peter Marsh. Here is the opening:

Lakshmi Mittal is looking at entering the takeover battle for Rio Tinto, the mining group, according to people familiar with the matter.

Mr Mittal, the main shareholder in steelmaker Arcelor-Mittal as well as its chairman and chief executive, is keen to secure larger supplies of iron ore.

Rio, one of the world's biggest producers, is the subject of a contested bid by Australian mining group BHP Billiton, valued at \$160bn (£80bn) at current share prices.

Mr Mittal's thinking emerged as Goldman Sachs, his adviser, announced that he had joined the board of the Wall Street bank.

The BHP-Rio deal is being scrutinised by antitrust regulators, who fear that, should the bid be allowed to proceed, a combined group would dominate the global supply of materials such as iron ore and aluminium.

"Mr Mittal has considered some involvement in the takeover, such as the idea of taking a stake in Rio through buying from existing shareholders," said a banker. "On the other hand, he could wait until later, when quite possibly some of the iron ore assets [of Rio] go on sale as a result of demands by antitrust regulators."

Bankers believe Rio's iron ore assets are worth about \$50bn. But this could fall if the boom in steelmaking starts to peter out.

My view - Fullermoney has long maintained that leading miners, with substantial resources in the ground and in politically stable countries, were collectors' items. If any economic scenario can test this hypothesis, it might well be the present one. However I am encouraged by the overall performance.

Holding both [Rio Tinto](#) and [BHP Billiton](#) in my personal investment account, directly and also via my holding in [BlackRock](#) World Mining Trust, I do not favour any merger that would require either firm to divest itself of resources due to antitrust legislation. And while I have studied BHP's case for merger

synergies, I am sceptical that any two great companies can achieve even better long-term results by merging rather than remaining single entities.

Additional Commentary by Eoin Treacy

Email of the day (1) - on house prices:

"Could you please add the Halifax House Price Index to your Chart Library and send me an email confirmation once it has been done?"

My comment - We have a number of HBOS indices in the Chart Library but having just checked with Bloomberg, they have not been updated in a number of years. The UK Nationwide House Prices All Houses Index is the most up to date index I could find.

This 18-year [chart](#) tells a powerful story. The bull market which unfolded from 1995 has been unprecedented and has lifted a large number of people up the middle class ladder via the property market. However, the most recent reaction is the largest in the last 18 years and from a significantly higher level than at any time in the past. This is probably a secular change in direction for the UK housing market and will have significant repercussions for the wider economy.

The [Case / Shiller Index of 20 US cities](#) does not have as much back history, but it also turned down significantly in the last year. The US housing market's distress has been widely reported and also signals a secular change in direction.

The [Irish Permanent TSB & ESRI New House Price Index](#) has been in an uptrend since 1996 which is now also undergoing its largest reaction yet. This is probably also a key turning point in the course of this move.

The [New Zealand Index's](#) uptrend picked up pace in 2002 and encountered resistance early last year near 350. So far this is a loss of momentum following a spectacular advance. A move below 335 would form a lower high and would indicate a similar climax had been reached to those profiled above.

The [Australian Index](#) was reconstituted in 2002 but remains in an overall uptrend. More back history can be viewed [here](#). A reversal similar to the UK, USA or Ireland above would be needed to question upside potential.

The [Canadian](#) market also remains in an overall uptrend. It spent more than a decade ranging before breaking upwards in 2002. A downward reaction would be needed to question scope for further upside. Alone in the Anglo/Franco sphere, Canada has not experienced a secular bull market, this move is still comparatively short by comparison to those above and probably has the best potential to continue upwards.

Real estate as an asset class was, until quite recently, a safe bet and

provided large numbers of investors with a reliable investment vehicle. However, in terms of relative performance, house prices only seriously outperformed [equities](#) from 1999 onwards and reached a peak in 2004. Since then they have held their own, but would need to sustain a move above 0.07 to reaffirm upward potential.

UK House prices peaked against the [Continuous Commodity Index](#) in 2004 following an 8-year period of outperformance. Since then the CCI has retraced most of the uptrend in a far shorter time.

We can draw two broad conclusions from these charts, the first is that many housing markets are turning down in absolute terms. This is probably a secular move and it will take time before they can rally to exceed their highs.

The second is that in relative terms, house prices in the UK and a number of other markets peaked in the last two years and are unlikely to outperform other asset classes in the next few years. In terms of how one structures one's portfolio, consideration should be taken of this relative change of leadership.

Giant Saudi field is key to boosting oil output - Thanks to a subscriber for this interesting [article](#) by Sebastian Abbot for the Associated Press which appeared in Yahoo Finance. Here is a section:

This massive oil field surrounded by the desolate sands of Saudi Arabia's vast eastern desert feels like the middle of nowhere.

But what happens over the next year at Khurais, one of Saudi Arabia's last undeveloped giant oil fields, could hold the key to what drivers will pay at the pump for years to come.

Under way at Khurais and two other smaller fields nearby is what Saudi Arabia calls the single largest expansion of oil production capacity in history.

With consumers howling over record fuel prices and the United States pushing Saudi Arabia to produce more oil, this patch of sand 100 miles west of the Saudi capital of Riyadh has become one of the most important places in the world economy.

Saudi Arabia's state-owned oil company, Aramco, is spending \$10 billion to build the infrastructure to pump 1.2 million barrels of oil per day by next June from the Khurais field and its two smaller neighbors. That alone would be more than the total individual production of OPEC members Qatar, Indonesia and Ecuador.

The project forms the centerpiece of the Saudi plan to increase the total amount of oil it can produce to 12.5 million barrels per day by the end of 2009 -- up from a little more than 11 million barrels per day now.

Consuming nations have pushed Saudi Arabia to boost production capacity even further and also want the world's top oil exporter to begin pumping more

crude immediately to bring down record oil prices hovering near \$140 a barrel. They say oil production has not kept up with increased demand, especially from China, India and the Middle East.

Saudi Arabia plans to produce 9.7 million barrels of oil per day, or 11 percent of the world's total, in July. It is the only nation with significant excess capacity that it could put on the market quickly.

But the kingdom has resisted calls to increase production further, saying financial speculators and the falling dollar are to blame for high oil prices, not a shortage of supply.

These disagreements came to a head June 22 at a rare meeting of oil producing and consuming nations hosted by Saudi Arabia. In the end, Saudi Arabia said it could increase oil production capacity to 15 million barrels per day if needed in future years. But it gave no indication that step, or an immediate increase in output, was necessary or planned.

My view - This [article](#) by Ayesha Daya and Shaji Mathew for Bloomberg also covers details of other Saudi oil fields being brought online in the coming years.

Saudi Arabia is blessed with one of the most valuable commodity reserves in the world. Giant fields such as Ghawar have been producing for decades and a large number of lesser fields remain untapped. However, the cost of bringing these reserves to market is getting more expensive as global competition continues to be heated for talent, machinery and drilling equipment. The fact that Saudi Arabia has to compete with a host of other countries, OPEC and non-OPEC alike for the resources needed to bring their oil products to market is putting a floor under prices for the long term.

This is quite apart from the consideration that they are tight lipped about even the possibility that their total production could ever go into decline. It is also well documented that a number of the untapped fields contain much heavier blends of crude and as such are even more expensive to bring to market. Sustaining production in aging fields also becomes increasingly expensive.

At present, the Saudis assure their customers that they could expand production to 15mbd but there have been no plans released to indicate that they are actually going to build the infrastructure needed to do it. What we do know is that even with a large budget, it takes years to bring new capacity on line and we have no idea whether this is to replace declining production in other areas or whether it is new potential supply. This uncertainty also supports prices in the long term.

Over the short to medium-term, one certainty is that the higher oil moves now, the farther it can fall in the next medium-term correction.

Canada Oil Sands Need Minimum Price \$70 a Barrel, Statoil Says - [This](#)

article by Stephen Voss for Bloomberg covers another important supplier of oil to the global market. Here it is in full:

Canadian oil sand deposits require crude prices of at least \$70 a barrel to cover capital and operating expenses and provide an acceptable rate of return, a StatoilHydro ASA executive said.

"You cannot produce at \$50 a barrel," Robert Skinner, StatoilHydro's senior vice president for commercial and business development in Canada, said in Madrid today. Rising costs mean New York oil prices need to be at least about \$70 or \$80 a barrel to make Canadian oil sands worthwhile, he said.

Oil sands, biofuels and exploration in harsh, untapped environments such as the Arctic, are among the possibilities for finding the "third trillion barrels" of oil resources, Saudi Aramco Chief Petroleum Engineer Khaled Buraik told a round-table panel today at the World Petroleum Congress in Madrid.

About a trillion barrels of oil has already been produced and the world has another trillion of proven oil reserves, leaving the question of where the third trillion will be found.

StatoilHydro is Norway's largest oil company.

My view - The Canadian oil sands had long been considered a marginal, although large, resource at best. All of this changed with higher oil prices. Suddenly vast resources are economic and while challenges remain as to how to extract and process the bitumen, the future for the Canadian industry looks promising. The trend towards resource nationalisation, globally, also makes operations already in place and turning a profit, potential takeover targets in the medium term.

Eoin's personal portfolio: arabica coffee, corn and soybeans stopped out at profits - I was running relatively tight stops on all three of my commodity positions and they were all hit today following some volatility in the commodity markets. September [Arabica coffee](#) was sold at \$151 against my purchase at \$147. September [corn](#) was sold at 754.5¢ against my purchase at 753.5¢ and November [soybeans](#) were sold at 1545¢ against my purchase at 1529.25¢. All these prices include spread-bet dealing costs.

Today's interesting charts - It is possible to create your own relative charts for any instruments in the Chart Library using the Charting tool.

UK FTSE-100 - finds short-term [support](#) near the January / March lows but needs to rally further to break the downtrend from near 6400 and continues to have a negative leash from the [FTSE 350 Banks](#). However a sustained move below 5400 would be needed to offset scope for some further ranging.

Amex Goldbugs - testing the upper side of the short-term range and the progression of lower highs from near 500. It needs to sustain a move above 450 to offset scope for some further lateral ranging.

Egypt - breaking down from the overhead top formation and would need to sustain a move back above 90,000 to offset scope for some further downside.

Email of the day (2) - on electricity prices:

"Hi, hope you are well.

"I was wondering if it would be possible to track global wholesale electricity prices or if not if you know where this type of information could be found."

My comment - I'm afraid, that a global electricity price does not exist because of the fragmented nature of the market. Getting charts that will reliably update in this sector is challenge and I would welcome any feedback on what the best instruments to us would be in order to reflect this developing market.

Email of the day (3) - on an addition to the Chart Library:

"Pls. add =ARU AU = Arafura Resources Ltd to the chart library.

"Thanks,"

My comment - Thank your for the suggestion which has been added to the Chart Library.

Last week's signups for the Free (Abbreviated) Comment of the Day - For the week of June 22nd new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, Bahrain, Canada, India, Ireland, Italy, Singapore, South Africa, Switzerland, the UK and USA - 11 in total. In descending order, which topped the list in terms of the last week's new signups? It was the UK, the USA and Australia.

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

Tuesday 1st July 2008

U.S. Dismisses Report Israel Likely to Attack Iran - This is Bloomberg's latest update on the story that roiled financial markets today. As if they did not have

enough problems! The earlier headline was more alarming: "Israel May Attack, Iran, Pentagon Official Tells ABC". Here is the opening from the [article](#) containing the dismissal:

The U.S. State Department dismissed an ABC News report that Israel is increasingly likely to attack Iranian nuclear facilities this year.

"I have no information that would substantiate that," spokesman Tom Casey said.

ABC cited an unnamed Pentagon official as saying an Israeli strike might be triggered by the production of enough enriched uranium at Iran's Natanz nuclear plant to make a bomb. A second possible trigger would be the delivery of a Russian SA-20 air-defense system, the installation of which would make an Israeli attack more difficult, the official told ABC.

Some Pentagon military analysts believe the possibility that Israel could strike Iran by year's end has increased and the ABC report reflects that assessment, two Defense Department officials told Bloomberg News on condition of anonymity.

Crude oil rose above \$142 a barrel on concern any conflict would cut supplies from OPEC's second-largest producer.

Spokesmen for the Central Intelligence Agency and the White House declined comment on the report as did Israeli government officials. Iran's government dismissed it as propaganda.

'Prepared' for Attack

Former Israeli Air Force General Isaac Ben-Israel, now a lawmaker in Israel's ruling Kadima party, told Germany's Spiegel that his nation is "prepared" for an attack if diplomacy and United Nations sanctions fail to stop Iran from making a nuclear weapon. Ben-Israel helped plan Israel's 1981 strike on an Iraqi nuclear reactor, the magazine said.

A strike on Natanz would only temporarily damage Iran's nuclear program and could spark a wave of attacks on U.S. interests, ABC said in yesterday's report, citing unidentified Pentagon officials. The U.S. and many of its allies have accused Iran of trying to develop nuclear weapons. Iran insists its production of enriched uranium is intended to produce electricity and is legal under the nuclear Non-Proliferation Treaty.

The Israeli government may want an attack to take place before President George W. Bush leaves office, Ephraim Kam, deputy director of the Institute for National Security Studies in Tel Aviv, said today in a telephone interview.

"There is no doubt that such an operation is being considered, but it's not going to happen tomorrow," Kam said. "We still have some time. The Bush administration may be more sympathetic to an Israeli operation against Iran than whoever the next president may be, so it could happen before the end of

the year."

My view - Similar stories concerning the imminent bombing of Iran's nuclear installations have been around for at least a year, so why the fuss today, attributed to an "unnamed Pentagon official"?

Could he / she be a whistleblower? Was this an unofficial, official bluff? Might it have been propaganda or a sadistic joke? Was someone short equities, long commodities and in a hurry?

I don't know but we cannot entirely dismiss the possibility of an eventual attack. However given the enormous risks involved, no planning for a military strike would take place without funding considerations.

There are precedents for this and forensic strategists should spot the clues.

To work this out, put yourself in the position of those who might be planning an attack. Would you fund it out of tax receipts or borrowings? No way. How about with printed money? The USA has done that but Israel could not because the shekel is not an international currency. Consequently the price in terms of domestic inflation would be immediate and very high.

The obvious solution is to use the markets. The most veteran of subscribers will recall that the former Soviet Union used to buy gold before its invasions. As I recall, the price of bullion rose before each surprise but also major Soviet military incursion, the last being the seizure of Afghanistan. The gold price fell back shortly thereafter as profits were taken.

In addition to gold, oil futures would be candidates, as would short positions in stock market futures. However stock market futures or put options would be less difficult to trace than oil or gold purchases.

On a lighter note - Here are two amusing spoofs by Bloomberg columnist David Pauly, posted without further comment:

Confessions of a Money [Manager](#) With Nowhere to Go

Dazzling Dandelions [Foment](#) New Commodities Craze

Email of the day (1) - **On gold and central banks:**

"Sorry, recently new subscriber, some questions in relation to your comments and audio... Still trying fill in parts of the jigsaw..."

"You mentioned on Friday's audio that governments don't want the price of gold going up too high. Can explain why this is."

"Also, how will we know when the IMF sells their gold into the market. Would it not be prudent for them to hold off as gold is on a long term uptrend?"

"You have also referred recently to banks re-capitalising via the yield curve. Can the European banks do the same thing?"

"When the economy returns to "normal" in the future, how will the FED/ECB put an end to this?"

My comment - Today's generation of central bankers (CBs) do not like gold because it is a monetary metal and they manage fiat (paper money) currencies. Therefore when gold rises strongly or persistently against a currency, it is usually signalling that CBs are printing too much of it.

Remember, CBs are closet inflationists in the business of managing inflationary expectations. They only apply tight monetary policies when inflation risks spiralling out of control.

Regarding IMF gold sales, we will probably hear about it after the event. I agree that they should hold off - actually I don't think they should sell at all. However this is a political decision so timing would most likely be a secondary consideration.

The short answer to your question regarding recapitalising via the yield curve is, yes, but the ECB has not slashed rates, unlike the Fed, so the terms are not as attractive for banks. Thereafter, CBs would raise rates to at least neutral on an inflation-adjusted basis to normalise the situation.

For more on these or any other financial topics, you might use the Search facility shown upper-left to access Archival material. As we are not Google, the Fullermoney Search must contain the correct spelling and I suggest using only one or two key words for the best results.

Email of the day (2) - Questions on oil, etc (note, English is not always the first language of subscribers):

"Given current global inflation set up, how high oil can go up on speculation as well as on dollar decline. If starts correcting after hitting high of 150\$, how much fundamentally & technically it should correct %? What steps Fed or ECB can take to strengthen dollar? Would you advise to stay away from equities until year end?"

"Hope you'll try to share as much inputs as possible."

My comment - Until we see evidence of technical deterioration (see yesterday's comment on crude), oil can temporarily spike on supply fears, as we have already seen. The higher it goes, the more it will eventually correct, for fundamental, technical and behavioural reasons.

The Fed and ECB can intervene to support the US dollar but this is a rare event and unlikely, I suspect, without at least a further slide to new lows.

Stock market [performance](#) has been dreadful, and with [crude oil](#) currently dominating sentiment and still in an uptrend, many investors are understandably opting to retain cash. So if you are out of the market, as your question implies, there is no compelling reason to rush back in.

However sentiment is so gloomy and with some interesting markets well off their highs, other investors can justify nibbling in areas which they like for the long term. It is a personal choice. On looking at the charts and speaking for myself, I do not think that many charts currently show the potential for more than a technical rally in response to the hammering that occurred last month. The exceptions are mainly in resources.

Email of the day (3) - [On bonds](#):

"Thanks for your continued insight into the markets. I would like get more insight into bonds. With many balanced portfolios holding a blend of cash, equities, bonds, and alternative instruments, it seems that misunderstanding the bond segment can have serious consequences if the objective was to attain a risk minimized investment. This is probably the case with my understanding (or lack thereof). When you refer to bonds as being in a bear market (ie. rising bond prices, decreasing yields, depreciating underlying currency), is this strictly related to US bonds and treasuries? What is a sensible alternative to bonds? Where are the "safe" fixed income investments these days?"

My comment - Thanks for your comments and for providing me with the opportunity to correct a perception regarding my view on long-dated government bonds. Since June 2003, I have maintained that the last secular bull market in government bonds had not only ended, but that we were in the early stages of a secular bear market, meaning falling bond prices and rising yields. In other words, the opposite of what you describe above. I have written about this on many occasions as you will see from the Archives, if you Search under 'secular bear market'.

So I do remain bearish of long-dated government bonds but secular trends usually begin slowly. As I see it, all long-dated government yields are in base building phases. Correspondingly, this means that bond prices are developing large top formations (Type-3, as taught at The Chart Seminar). Here is an [example](#).

For yield, investors have four choices to consider: short-term government paper, high-yielding currencies, corporate bonds and equity income funds. The first two are safer, particularly in today's turbulent economic environment, although there will be some currency movement which could work for or against you. Corporate bonds and particularly equity income funds should produce more capital appreciation once today's economic problems subside.

My personal portfolio: Coffee partially stopped out; silver bought and sold - Yesterday afternoon I overcautiously placed a very tight breakeven on my

latest [coffee](#) purchase. This was stopped out at \$150.70 against my purchase at \$150.20 on 24th June, reducing my position by a third. On seeing [crude oil](#) up over \$2 early this afternoon and precious metals breaking upwards, I bought some [silver](#), paying \$17.975 for a September position. When oil fell back I sold this at \$18.19. I am probably too cautious in precious metals at the moment, at least while oil is firm, and may open more longs on any setback.

Prices above include all spread-bet dealing costs.

Additional Commentary by Eoin Treacy

How are banks performing relative to their overall indices? - Banks have been a lead indicator during the financial crisis to date. The [S&P 500 Banks Index](#) lost 58.68% of its value since early 2007 and remains in an accelerating downtrend. Relative to the [S&P500](#) it is now at levels not seen since the Savings and Loan crisis in 1990. However, while it is overstretched, an upward dynamic is needed to check downward momentum beyond a brief pause.

In the UK, the [FTSE 350 Banks](#) Index has fallen 43% and is in the region of prior areas of support near 6000. However, an upward dynamic is needed to check downward momentum beyond a brief pause. Relative to the [FTSE 350](#), the sector has already fallen through the lows posted in 1999 and 2000 and needs to sustain a rally back above 2.5 to offset scope for further downside.

[European Banks](#) topped out a number of months later than in the US and UK. So far they have lost 42.9% of their value and also remain in an accelerating downtrend. Relative to the [Stoxx 600](#), European Banks remain in an accelerating downtrend and while 0.9 marks a potential area of support, they would need to post an upward dynamic to call further downside scope into question.

The [Australian Financials](#) Index has lost 41.06% of its value from its high in November. It continues to accelerate downwards and while 4000 may offer an area of support, an upward dynamic is needed to check momentum. Against the [ASX200](#), the Financials Index has recently broken to a new low and needs to rally back above 0.9 to question scope for further downside.

[Canadian Financials](#) have lost 22.1% of their value since May 2007 and are pressuring their March lows. They need to hold above 1500 to offset potential for a downside break, in common with the financial sectors of many other countries. Relative to the [TSX](#), the S&P TSX Financials broke down from the prolonged ranging phase in March 2007 and remain in an accelerating downtrend. They need to break the progression of lower highs to question further downside scope.

[Indian Banks](#) shares topped out earlier this year and have also led the wider market downward, losing 53.34% of their value to date. An upward dynamic is needed to check downward momentum beyond a brief pause. Against the

[BSE500](#), the Bombay Banks Index topped out around the same time and accelerated lower. It is approaching a potential area of relative support near 1 but would need to post an upward dynamic to check momentum beyond a brief pause.

The S&P Banks Index was the first to turn over and it has had one of the biggest moves. Since it is leading other Bank indices and its broader index, it is worth watching for signs that it may be finding support, in attempting to time the next bounce. The fact that so many bank indices, globally, are accelerating downwards is unsustainable beyond the short term.

Sentiment relating to the Banks is becoming increasingly bearish but unless one believes we will see large numbers of banks going out of business, we are quickly approaching the next important low.

UBS reckons global aluminium market heading for deficit this year and next - This article by Reuters appeared in today's Mineweb.com and looks at the prospects for aluminium. Here it is in full:

The world aluminium market was heading for a 200,000-tonne deficit this year and in 2009 as coal supplies turn scarce and producers are forced to cut output, banking group UBS said on Monday.

"We expect market fundamentals to continue to tighten as global constraints on energy supply grow and impinge on the aluminium industry," UBS said in a report on the sector.

Prices for the metal should respond on the upside to the deficits, averaging \$3,150 a tonne, or \$1.43 a pound, this year and \$3,525 a tonne, or \$1.60 a pound, in 2009, it said.

Aluminium averaged \$2,640 a tonne, or \$1.20 a pound, in 2007.

Three-month London Metal Exchange-traded aluminium stood at \$3,115 a tonne early on Monday. The contract hit a record \$3,310 a tonne in May 2006.

Western world unwrought aluminium stocks rose to 1.67 million tonnes at the end of May 2008 versus 1.58 million in April, International Aluminium Institute data released last week showed.

Due to higher coal prices the production cost of aluminium has increased, forcing smaller smelters operating at close to marginal costs to close, according to UBS.

As a measure to provide more power for civilian use, authorities in some countries have curtailed power to energy-intensive industrial users like aluminium smelters, making less aluminium available to the market.

BHP Billiton Ltd announced it was reducing its aluminium production at three African smelters by 10 percent, putting the total annual output loss at just over

120,000 tonnes.

Rio Tinto Ltd/Plc has also cut output 10 percent, or 35,000 tonnes, at its Tiwai Point smelter in New Zealand to reduce demand on the national electricity grid.

Thermal coal contract prices are up more than 100 percent to \$125 a tonne, while spot prices at Newcastle port in Australia and Richards Bay in South Africa remain volatile with prices at \$163 a tonne and \$146 a tonne FOB respectively for the week ending June 20, UBS noted.

World production of 37.85 million tonnes of primary aluminium in 2007, compared with 37.23 tonnes consumed, according to the Australian Bureau of Agricultural and Resource Economics.

My view - One of the main characteristics of the industrial metals complex, over the last 7 years, is that they have seldom all rallied at the same time. At present, past leaders such as nickel and zinc are some of the laggards, while aluminium and copper are outperforming.

Aluminium accelerated to a high near \$3300 in mid-2006 in a Type-1 ending (as taught at The Chart Seminar). This augured the beginning of a medium-term correction which bottomed near 2500 and continues today. The metal rallied sharply earlier this year to test the highs and continues to consolidate that gain. A sustained move below \$2800 would be needed to question potential for an upside break.

Copper posted an even greater acceleration in 2006 and also remains in the ensuing medium-term consolidation of those impressive gains. The metal has gradually moved back towards the 2006 highs in the last few months and would need to sustain a move below \$8000 to question potential for an upside break.

Email of the day (1) - on live cattle:

"I notice you never mention live cattle in your commodity review. They should be a laggard in the agricultural chain and surely enough they seem, now, to be entering the joy ride. What do you think? A current bright spot? I am not invested in them."

My comment - Thank you for this interesting mail, although we write about cattle prices reasonably often considering they are a relatively illiquid market. If you put 'cattle' into the search engine, you'll find a number of instances in the last month where we have commented on live cattle. The most recent of these was on June 17th when it broke upwards. This breakout completes a long consolidation and the upside can be given the benefit of the doubt as long as it sustains the move above \$100.

Orange Juice Has Biggest Gain Since Late 2006 on Storm Threats - [This](#)

[article by Ron Day for Bloomberg covers renewed interest in the orange juice market. Here it is in full:](#)

Orange juice rose the most since October 2006 on renewed concern that citrus groves in Florida, the world's second-largest orange grower, may be damaged during the hurricane season that began this month.

Developing storms off Mexico's Pacific Ocean coast, which pose no current threat to Florida, created a knee-jerk reaction among investors, said Fain Shaffer, president of commodity broker Infinity Trading Corp. in Medford, Oregon. Orange-juice futures fell as much as 28 percent this year to a two-year low on May 30 on expectations Florida's citrus crop would increase.

“Any kind of tropical activity” boosts orange-juice prices, Shaffer said. “This market has been waiting for this storm season to start.” The most-active period for Florida's hurricane season is in August, and citrus groves are at risk through November.

Orange-juice futures for September delivery rose 8.95 cents, or 7.9 percent, to \$1.226 a pound on ICE Futures U.S., formerly the New York Board of Trade. The gain was the biggest for a most-active contract since Oct. 12, 2006, when the price reached a 13-year high. The contract earlier reached \$1.2365, the highest since May 12.

Colorado State University meteorologists have projected eight Atlantic hurricanes in the storm season that ends in November. No hurricanes hit Florida last year. Storms in 2004 and 2005 damaged citrus groves in the state and reduced output, sending orange-juice futures to \$2.094 a pound on Dec. 7, 2006, the highest since at least 1986.

Pacific Ocean, Africa

While storms in the Pacific don't pose an immediate hazard to Florida, they can pass across Mexico and head toward Florida, said Paul Markert, a meteorologist at Cropcast Services Inc.

Clouds and westerly winds from Africa, approaching northeastern South America, may develop into storms, Stephanie Kinard, a broker with JKV Global in Chicago, wrote in an e-mail.

She said her firm is “keeping a close eye” on those winds and clouds.

Computer models of the winds show that conditions off of Africa may develop into a storm that could be a threat to the Gulf of Mexico in the next six to 10 days, said Cropcast's Markert.

Forecasts for a rebound in Florida's orange production, second only to Brazil's, helped send orange-juice futures on May 30 to their lowest price since October 2005. The state's harvest this year, which is almost complete, will climb to 168.5 million boxes, the USDA estimates. A box of oranges weighs 90 pounds (40.8 kilograms).

My view - [Orange Juice](#) bottomed in early 2004 at a time when farmers in Florida were giving up on maintaining orchards and were selling their land to property developers. The break above \$100 in late 2005 completed the base and the commodity surged to highs above \$200 as hurricane Katrina threatened the growing region in 2006.

Orange Juice broke down in early 2007 and gave up almost the entire advance. It recently found support above the prior base and yesterday's upward dynamic breaks the progression of lower highs from October. It would need to sustain a move below \$110 to question scope for some further upside.

Orange Juice is one of the few comparatively cheap commodities and may be beginning to attract attention for that reason. While an active storm season is forecast this year, one was also forecast for last year and did not materialize. Weather is hard to predict beyond a few days and even that is difficult. I wonder if there is more to this trading activity than simple hedging relating to expected weather patterns that might not develop.

Today's interesting charts - Commodities are the leading sector at present and the Chart Library has a large number of investment vehicles in this sector.

Gold - [rallying](#) to test the top of the medium-term range and needs to sustain a move above \$950 to question scope for some further ranging.

White Sugar - [testing](#) the March highs near \$400 and would need to sustain a move below \$370 to question potential for an upside break.

Robusta Coffee - broke [upwards](#) from the medium-term range last week and would need to sustain a move back below \$2400 to question potential for some further upside.

Email of the day (2) - on finding instruments in the Chart Library:

"Please assist me with locating charts for the following (I could not find them):

["Blackrock World Mining Fund
Blackrock World Gold Fund"](#)

My comment - You can find all the Blackrock Funds in the Chart Library by simply putting 'Blackrock' into the search facility, or any other key word in the name. You can also search via the Bloomberg code, if you know it. I suspect the two you are looking for are the Blackrock World Mining Investment Trust and the Blackrock Gold and General Fund.

Wednesday 2nd July 2008

Anatole Kaletsky: Forget the crunch, oil is the key to world recovery - [This is an interesting, lively and somewhat controversial article](#) by The Times columnist. [Here is the opening:](#)

After the stock market's worst half-year since the early 1990s, nobody - not even I - can deny any longer that financial assets around the world are in a severe bear market. But with so many of the world's most important markets last week retesting their post-credit crunch extremes - the FTSE at 5,500, the S&P 500 at 1,280, oil at \$140 and the euro at \$1.60 - it seems worth asking the defiant Churchillian question: Is this the end of the beginning or the beginning of the end? Is the bear market only just starting and about to break down to much lower levels? Or is it possible that last week was a test of the lows hit by equities and the dollar in the credit crisis and the high hit by oil two weeks ago?

You might say that this hardly matters. The financial markets are a casino and therefore of interest only to gamblers, clairvoyants and cheats. Politicians, businessmen, homeowners and consumers should focus instead on the economic fundamentals and an article such as this should try to explain whether these are really better or worse than suggested by the media headlines and the stock market talking heads. The trouble with trying to focus on fundamentals, however, is that these fundamentals are themselves enormously affected by financial behaviour. In a world in which politicians and investors believe that the market price of oil tells us more about supply and demand than any amount of statistical analysis, the doubling of oil prices in the past 12 months appears to have rendered irrelevant all the fundamental analysis which has been pointing to lower oil prices for the past 12 months - even though demand for oil is falling and supply is gradually rising, in precisely the way that economists would predict when the price of a commodity goes up.

The sensible economist's response to the paradox of rising prices at a time of falling demand and increasing supply would be to try to understand the reasons for this market failure - in this case, most probably herd-like behaviour of momentum-driven investors, of the type we saw in the credit bubble, the housing bubble, the internet bubble, the Japanese bubble and so on.

We live, however, in a world of naive market fundamentalism, where politicians and media commentators assume that the market is always right, despite the copious evidence that markets are often very wrong indeed. In these conditions, financial market movements can sometimes become self-fulfilling prophecies - if bank shares keep falling they can cause financial crises and recessions, simply because the world starts to believe that investors must "know something" about banking solvency that is not apparent to the naked eye. Similarly, if oil and commodity prices keep rising, they can create a permanent inflationary psychology, if consumers and producers conclude that the market must "know something" about the world running out of energy and food.

My view - For these reasons, some of us believe that before investing, let alone trading, we should look at a price chart.

I agree with Anatole Kaletsky's conclusion, which you can see via the link above.

Email of the day (1) - [On markets and oil in particular:](#)

"Hope all is well. It seems as though these markets are going to get a whole lot worse. If you take a look at weekly 5 year charts, most stock markets (except resource rich nations) have broken below the uptrends and some have broken below their prior support levels as well. Not a pretty picture especially when you factor in the fact that the Fed Funds rate is already so low and there is nothing more any central bank can do. With "Peak Oil" here and a possible conflict in Iran looming, I suspect fuel, food and gold are the only safe options. By the way, apart from Greater China and Vietnam (both of which I bought recently), currently I don't have any more positions in equities. As you may remember, I sold out of India and Asia infrastructure 2 months ago and now have a hug position in commodities via producing co's. "Peak Oil" scares the hell out of me; there is no Plan B and we have left it too late. The chances of increasing production are slim at best due to geology, rusty infrastructure, shortage of equipment and scarcity of skilled workers. In my estimate, global supply of oil will drop by 7-10 m barrels per day by 2012 and this is after taking into account new supply over the same period. Not a happy thought and all we can do now is to load up on commodities, pray and hope for the best. "

My comment - [Thanks for an articulate summary and for sharing your market views. Many other subscribers will agree with you.](#)

[I will mention for new viewers to this site that these themes are among those most frequently discussed and debated in Fullermoney.](#)

Email of the day (2) - [More on the stories concerning an attack on Iran:](#)

"In relation to the posting today regarding a rumor of attack on Iran by Israel, here is a much more serious [article](#) on the subject in a recent edition of the New Yorker. Seymour M. Hersh as no lightweight of investigative reporting, as many familiar with his articles will recognize. While the Israel rumor may be just that, this article discusses funding that is already in place in the US for covert operations, and the willingness of the US Administration to consider a strike, or more. Could the US government do something like that? We can look at recent history and judge for ourselves."

My comment - [Many thanks for a good article. Other than saying that I agree with the comments attributed to Secretary of Defense Gates before the Democratic caucus in the Senate \(8th paragraph\), I'll limit my comments on this subject to yesterday's market-related thoughts and another update from \[Bloomberg\]\(#\): "Bush Says Diplomacy Is First Choice to Deal With Iran".](#)

Email of the day (3) - On Fullermoney themes:

"David...I'm here in the epicenter (USA) and ok , I admit it ...I'm scared. Long time market experts are very negative.

"QUESTION: I'm heavily invested in Fuller Money themes. The areas of most concern are Emerging Stock Markets. What is the best way to play these markets if the USA enters a more serious recession than currently discounted?"

My comment - Being scared during what is a very difficult period for investors is a normal and necessary reaction, provided we do not let our emotions nullify the analytical portion of our brain.

We know that emerging markets are high-beta but this decline has really been savage - possibly the worst that I have experienced since 1973-1974. I can only speak for myself, and I wish that I had sold my emerging market positions last year, but I did not as you know. I am certainly not going to sell the [JP Morgan Indian Trust](#) or the [Atlantis China Fortune Fund](#) here, even though there is a real possibility that they will move somewhat lower before this rout ends.

I do not watch them every day, because it would be stressful, and I can see that the stock market perfect storm, with crude oil at the centre, has yet to blow out. Moreover, I do not know whether this storm will end relatively soon or sometime next year, but the charts will show us. When it does end, I would not be surprised to see [India](#) and [China](#) eventually resume their leadership, evidenced by moves well above their previous stock market highs.

Why the long-term optimism when so many are so gloomy? Pessimism goes hand in hand with lengthy market slumps, which inevitably have worrying fundamental components to which equities are re-priced. The worst declines do not end until the economic problems have been over-discounted by capitulation selling.

A few charts may help our perspective. Not all of our emerging market data goes back to the 1970s but Japan was still an emerging market then. This [chart](#) shows the Nikkei from 1970 with an S&P overlay. You can see that the Nikkei fell less during the 1973-1974 bear and afterwards resumed its advance much more quickly, demonstrating vastly superior relative performance.

Usually emerging markets are much more volatile in both directions and you can see this with the long-term Hang Seng [chart](#). Here also the time span I wish to emphasise is the 1970s, due to the severity of that bear market and because back then we also had oil spikes and an inflation problem. All equity indices had rollercoaster rides but emerging markets generally produced the better gains both before and after the specific crises.

In answer to your last question, I can tell you what I will most likely do.

In a best case scenario, conditions for stock markets clearly improve before yearend, resulting in few if any changes to my long-term investment portfolio. I will not sell under duress although I might lighten in the event of another good run in gold shares.

In a worst case scenario, stock markets move significantly lower over the next year or two, creating the best valuations in decades. Should this happen, I will reduce my 'just in case' cash position, which is currently about the same size as my equity portfolio, by increasing my stock market investments.

I have not raised cash in my personal long-term equity portfolio, although I should have taken profits in emerging market positions last year. In recent years I have not added capital to my equity account, as veteran subscribers may recall, except for the UK's small annual ISA allocation and a matched 5% of my modest salary in a SIPP's account.

However I have used capital generated from futures trading to steadily increase investments in collectables.

My personal portfolio: Some gold longs reopened - I did not buy during this morning's pullback, because [crude oil](#) was hovering near \$140. That strategy proved to be too cautious but when oil reached a new high in late trading, I opened some [gold](#) longs, paying \$946.55 and \$946.90 for August positions, including spread-bet dealing costs. I maintain that gold is on the same side of the current seesaw as oil, and stock markets are on the other side.

Latest Advisor's Sentiment reading from Investors Intelligence - Here is the this week's update of an important [indicator](#) devised by Mike Burke and John Gray of Investors Intelligence, which is part of the Stockcube stable. The reading is certainly registering oversold but I am less optimistic today than I was in March because the oil spike continues. Consequently this or any other sentiment indicator can become even more oversold before we see a meaningful bounce.

Terrific Site: The Oil Drum: Europe - The Fullermoney Collective of Subscribers' sources, contacts, experience, perspective and wisdom never cease to amaze me, and I have been a fan for many years. My thanks to a member of the Collective for introducing this [site](#) to us, in the spirit of Empowerment Through Knowledge.

My view - This is clearly a very good site, which I have only just begun to explore. I have added it to my favourites.

Most of the points and graphs in Countdown to \$200 are familiar to veteran subscribers but it is nice to have so much information on one handy site. As veteran subscribers may recall, Fullermoney has maintained since the early years of this decade that all commodities were entering a supercycle, which we later summarised as Supply Inelasticity Meets Rising Demand.

However, we have also maintained that there will be big, cyclical rotations in terms of performance, more often on a sector by sector basis, rather than for commodities in general. A global recession, which \$200 oil could certainly trigger if reached sooner rather than later (I'm hypothesising rather than forecasting) would test the individual commodity or sector rotation premise, rather than a deflation for all commodities as many analysts have forecast.

For instance, a recession could reduce oil consumption, as could substitution, although this did not happen in 2000-2002. A recession might well reduce demand for industrial metals, but not necessarily for precious metals if they are increasingly seen as hard money. As for agricultural commodities, people will always need to eat, although supply is the key variable.

Meanwhile, we should expect a correction in the price of crude oil ([p&f](#), [monthly](#), [weekly](#) & [daily](#)), when the medium-term uptrend loses its consistency. For review, I repeat that the important downside levels to be breached, if we are to see a medium-term correction any time soon, are \$135 (MDL), \$130 (last reaction low) and \$120 (important support). Today, oil has reaffirmed its uptrend once again.

Additional Commentary by Eoin Treacy

Barron's: This Bear Has Sharp Claws - Thanks to a subscriber for this interesting [article](#) by Jacqueline Doherty which mentions a number of companies with high dividend yields. Here is a section:

ONE GOOD THING about the selloff: Some stocks are now sporting much higher dividend yields. "You can structure a very well diversified portfolio" that also offers a nice yield, observes Ed Shill, chief investment officer of QCI Asset Management in Rochester, N.Y.

Oil and gas limited partnerships are paying out notably high dividends. Legacy Reserves (ticker: LGCY), which yields 8.2%, and Atlas Energy Resources (ATN), which yields 6.3%, are two favorites of Wayne Nordberg, chairman of investment manager Hollow Brook Associates. "They're smaller, well positioned and are in the early stage of development," he says.

To maintain their high dividends, these companies need to replace their reserves. That often means raising new capital. So investors need to bet that the companies can continue to raise capital and find new oil and gas. Investors also must be ready to fill out special tax forms, because these investments are limited partnerships.

Some of the small regional telephone companies might not be glamorous, but they're generating nice cash flows. Citizen Communications (CZN) offers investors an 8.9% yield while Qwest Communications (Q) has a 7.9% yield. Of course, competition from cable companies and wireless providers is the threat that can't be ignored in this sector.

Everyone hates the drug companies, because their drugs have lost patent protection and few new offerings have filled the void. But some still throw off good cash flow, and buying them is a bet that their research crews will eventually hit gold. Among the highest yields: Pfizer (PFE), at 7.2%, and Bristol-Myers Squibb (BMY), at 6.1%.

My view - We have long maintained that Wall Street is in a secular bear market, which we define as a generational long period of P/E ratio contraction and rising dividend yields. (Also See Comment of the Day particularly on [September 15th 2006](#), [July 25th 2006](#). and [July 12th 2006](#)).

The shape of any bear market will be largely dependent on the availability of liquidity. Japan's central bank tightened monetary policy for long after the stock and property markets had burst and threw the economy into a deflationary spiral which it is only now recovering from. The Fed, following the busting of the Nasdaq bubble, was eager to avoid the same mistake. Their answer was to cut rates aggressively and expand the monetary base as much as was needed, and then some. This effectively limited the worst effects of the Telecom / Tech bust to those sectors and in the process sowed the seeds of the housing bubble and the secular inflationary cycle we are now starting to feel the effects of.

In the last 6-years governments and commercial banks have been expanding their monetary base and extending credit, and in the process fuelled the advance of a number of markets and asset classes. Wall Street rallied to post new highs on the Dow and the S&P tested the 2000 highs in this timeframe. While central bank liquidity remains abundant, commercial bank liquidity has collapsed with the bursting of the US housing bubbles and subsequently others housing markets across the globe. In tandem with the problem of surging oil prices, this is contributing to lower valuations and higher yields for a large number of companies.

The [P/E](#) chart of the Dow Jones remains in an overall downtrend. It expanded rapidly in the late '90s to 28 but has been gradually contracting since early 2002 and would need to break the progression of lower highs to question scope for some further contraction.

The [Dividend yield](#) chart for the Dow Jones bottomed at the end of 1999 and remains in a ranging uptrend. It recently spiked higher, at least in part due to falling equity prices. However, this does not mask the fact that investors are now demanding a greater return for holding equities, than at anytime in the last 15 years. A break of the rising lows, with a move below 2% would be needed to question the secular nature of this move.

Wall Street continues to exert a powerful leash effect on the rest of the world and as long as it remains negative, other markets will have difficulty rallying significantly. Commodity related stock markets, and those least correlated with the USA, have performed best in the current climate. Those with an outstanding fundamental story, such as many Asian markets are also likely to be some of the best performers when the current crisis abates.

Tempo Indonesia's Weekly News Magazine: Overtaking Oil? - [Thanks to a subscriber for this interesting article covering the global coal market. Here is a section:](#)

China has confirmed that it will reduce its exports within the next three years. With projected growth of 10 percent, the energy demands of this country will increase at the same rate. Jim Lennon, an analyst at Macquarie Group Ltd, however believes that, based on its economic strength, China's demand for coal will grow more quickly than its growth in production. "This will result in a limited supply of coal in markets and prices will continue to jump," said Jim Lennon.

India is also currently constructing power plants with a total capacity of 50,000 megawatts. As a result of this additional capacity, according to Jeffrey, India will need an extra supply of between 175 and 200 million tons of coal per year. Indonesia itself will need an additional supply of between 35 and 47 million tons per year if the 10,000 megawatt power plant program goes into operation within the next two years.

However, this global increase in demand for coal is not equaled by current supply. Last year, out of the total global production of almost 6 billion tons, only 525 million tons of thermal coal was traded on the international market- and 375 tons in the Asia Pacific region. The remainder was used for domestic needs but this was still not enough. If only 1 percent less than this total was traded internationally, then the coal market would be really shaken.

It is because of this that, in order to secure supply, consumers are now competing to sign long-term contracts and, rather than the normal contracts to meet 60 percent of demand, these are now to meet 80 percent. Purchases at spot prices have also reduced. "Because panic is infecting supplies everywhere," said Jeffrey. In addition, the speed of production has not kept up with increased consumption. This has resulted in false demand.

It is not surprising that from now on, coal contracts are being signed for shipments in 2010. "This is despite the fact that the coal is still in the ground," said Singgih Widagdo, Director of the Indonesian Coal Society. The situation has become worse because of coal being targeted by speculators. "It is coal traded on paper that has resulted in business deviations and prices rising sharply in the second quarter," said Singgih. The value of coal-shipping contracts for the third quarter of this year, for example, has already reached US\$170.44 per ton.

The panic that supply will cause prices to jump even more has also been affected by the flooding that hit Queensland and the heavy rain in New South Wales from the beginning of the year until February. According to Singgih, these resulted in disruptions to coal shipments globally in the first quarter of the year. Due to this, the coal exports of Australia dropped by some 700,000 tons to 1 million tons per month. Thus Australia lost export potential of some 15 million tons this year.

The reduced supply in the worldwide market was also because the Government of South Africa moved coal intended for export over to meet domestic demand. A similar measure was carried out by China. Because of the storms that occurred between February and March this year, China shifted 9 million tons to cover domestic needs.

My view - Coal accounts for a huge percentage of the globe's energy needs and as such is worthy of notice. However, it is a misperception to assume that because coal prices are rising due to short supply, that there is a long-term shortage. Even with ambitious extraction targets, coal reserves are expected to last considerably longer than oil; with the USA holding the largest reserves.

While coal is an important energy resource is not far from a panacea. A ton of coal only provides approximately one fifth as much energy as oil, so we need five times more of it to fulfil the same function. It is bulky and its high carbon content makes coal a pariah for the environmentally minded. Even so, growth in the use of coal remains strong, particularly in the developing world.

Today, the explosion in global steel production and the continued growth in coal fired energy generation mean that demand is rising impressively. This is being met by a supply side still struggling with inadequate infrastructure; a legacy of the secular bear market. The lead time to build new mines, railroads and ports runs into years and costs continue to escalate.

Coal broke upwards from its long base in late 2007 and has surged to over \$140. In percentage terms, this is a larger move than oil's, but it is occurring concurrently and they are closely related. A downward dynamic on the coal price would be needed to check momentum beyond a brief pause.

Bumi Resources Increases Bid for Australia's Herald - This article by Jason Scott covers the expansionary ambitions of an increasing number of coal mines. Here it is in full:

PT Bumi Resources, Indonesia's biggest coal producer, increased its bid for Herald Resources Ltd. 1.8 percent to A\$563 million (\$541 million), edging an offer led by PT Aneka Tambang.

Bumi will offer A\$2.85 cash for every Herald share, up from A\$2.80, it said in a statement sent today to the Australian stock exchange. The offer is less than the Perth-based company's closing price of A\$2.89 in Sydney trading today and more than the A\$2.80 a share joint offer by Aneka Tambang, Indonesia's second-largest nickel producer, also known as Antam, and partner Shenzhen Zhongjin Lingnan Nonfemet Co.

The offer extends the seven-month contest for control of Herald's Dairi lead and zinc mine in Indonesia as demand from China rises. The mine is forecast to produce 220,000 metric tons of zinc concentrate and 100,000 tons of lead concentrate a year.

Herald told shareholders on June 27 to accept either cash offers for the company. Antam and Shenzhen Zhongjin today asked Herald to pay a A\$5 million break fee that they say was triggered by its recommendation of the Bumi bid, Herald said in a separate statement.

Antam is trying to reduce its dependence on nickel, which provided more than four-fifths of its sales in 2007.

My view - Coal miners, now flush with cash are understandably starting to take a look at their long-term viability and access to world class reserves in much the same way industrial metals miners were doing a few years ago. This may indicate that further M&A is to be expected in the industry.

Bumi Resources now makes up the largest weighting in the Indonesian market and contributes to that country's relative outperformance. It accelerated to a high near 8000 in March before reacting sharply to 5000. It has since rallied impressively back up to the high and is presently consolidating in that region. A sustained move below 7000 would be needed to question potential for some further upside.

Today's interesting charts - A large number of currency crosses can be found in the Chart Library.

Dollar Index - testing the progression of higher reaction lows from mid-March and needs to rally from these levels to offset scope for a retest of the lows near 71.

Vietnam - finds at least short-term support below 400 in a downtrend that has been losing momentum. It would need to sustain a move below that level to offset scope for some further upside.

Copper - testing the highs near 400¢ and needs to sustain a move above that area to reaffirm the overall secular uptrend.

Email of the day - on the whereabouts of Resources Investment Trust:

"I'm not sure what happened to Resources Investment trust but it seems to have disappeared from the library-could we have it returned please.

"Thanks"

My comment - This trust was delisted in April. Their website address is for possibly sale and being used as marketing. When I called the contact number, the woman who answered said they hadn't been at that address in 4 years. It is possible that the fund has been reconstituted under another name, but I find no evidence of this.

Thursday 3rd July 2008

Richard Karn: *Gas Panic* - My thanks to Richard Karn for his abbreviated [report](#) on the natural gas industry, contributed in the spirit of Empowerment Through Knowledge. Veteran subscribers will recall his earlier, outstanding contributions which are still available in this site's Archives. Fullermoney has a very high regard for Richard Karn's analysis, which is independent, always diligently researched, and has proved to be prescient in its conclusions and recommendations. Here is the executive summary:

Much the way the United States consumes more than 24% of the world's crude oil, it also consumes more than 22% of the world's natural gas. The critical distinction between the two, however, is that at least for the time being domestic production is capable of meeting the vast majority (84%) of our natural gas needs.¹

US reserves, which were long static despite increasing demand, have been experiencing healthy growth this decade thanks to the price of natural gas transitioning to a higher trading range. At this higher threshold, price converts previously uneconomic gas fields into exploitable reserves, as is being manifested in the rapid development of, and growing reliance on, so-called unconventional sources—those derived from tight sand and shale formations as well as from coal-bed methane. Today, these unconventional sources have supplanted conventional wells as the primary source of North American natural gas.

From the US perspective, the price of natural gas seems high, and many are wont to dismiss it as an anomaly attendant to the relentless surge in oil prices. But when considered on either an energy-content or a global price basis, North American natural gas is actually extraordinarily cheap. *This discrepancy will afford American industry a competitive advantage that appears to be signaling a resurgence in manufacturing.* Decreased liquid natural gas (LNG) imports combined with increased domestic natural gas production are driving the boom Texans have longed for, albeit all over North America and in natural gas rather than oil.

However, the boom comes at the cost of a permanent step-up in price as a confluence of trends can only serve to support, if not increase, the price of natural gas going forward. Foremost amongst these drivers are:

1 the ongoing, albeit slower than anticipated, shift from regional to international natural gas markets made possible by long distance pipeline networks as well as delivery in the form of LNG will eventually lead to something approaching parity in global prices, which can only translate into higher North American prices;

2 globally, but especially in the US, monetary inflation-driven cost over runs, project delays and shortages of material as well as skilled personnel will continue to exert an upward pressure on the price of energy, especially natural gas;

3 the production costs of unconventional sources of natural gas cannot tolerate a reversion to the trading range of but a few years ago-there is simply no going back in terms of US prices as reserves become progressively more difficult and expensive to produce;

4 the cost of new infrastructure to develop these unconventional sources, as well as the cost of restoring the structural integrity of existing infrastructure long neglected by the last post-boom cyclical downturn, will also be reflected in domestic prices;

5 in both the US and the majority of the Organization for Economic Co-operation and Development (OECD) member states, climate change has become the *cause ce`le`bre* and natural gas-fired electrical generation has become the default choice espoused by an unlikely coalition of environmentalists, politicians, and industry lobbies, thereby spurring specious demand that will compete with that of emerging nations for limited supply; and

6 sovereign risk and the threat to free market operations posed by mercantilist intra-national supply agreements is intensifying and will further constrict global supply.

Combined, this portends well for the natural gas industry in North America and Australia for at least the next decade. But as large and variegated as the natural gas industry is, in an era of escalating inflation, political uncertainty compounded by policy blunders, and the reduced availability of credit, certain sectors stand to outperform disproportionately while others will fall victim to the transformations reshaping the industry. To help readers profit from the unfolding gas panic, we have compiled a portfolio of 27 stocks we believe to be positioned both to navigate the financial turbulence we see stretching to the horizon and to profit handsomely in the unstable environment; and as is our practice, none of our recommendations bear significant sovereign risk.

My view - Natural gas has become a vitally important component of the energy sector over the last decade and this trend will inevitably increase. However price action is notoriously volatile so investors should always pay attention to the trend action ([p&f](#), [monthly](#), [weekly](#) & [daily](#)), which is currently very consistent as the Hurricane Katrina highs are approached.

The full version of Gas Panic, containing the all-important share recommendations, is available from emergingtrends.com. At a cost US\$300, I think it is a bargain for any investor with an energy portfolio.

As always, neither Fullermoney nor I have any financial incentive whatsoever in recommending any outside reports, services, funds or other products in this service.

Email of the day (1) - [On secular trends and the "apocalyptic"](#):

"When I started to subscribe to Fullermoney in 2004 you frequently referred to your prognosis that the stock markets would return to bottom out at lower than 2003 lows at some point. Roll on some years to end 2006 I think, you alerted us all to a presentation with Jeremy Grantham forecasting a reversal to the mean of all asset classes.

"In recent years you have made infrequent references to these previous views. However events of late and the breaking of the March lows, may indicate that the game has changed- perhaps in line with Grantham and your previous opinion.

"Whilst every view is in with a chance, do you consider than the current situation could become something far more apocalyptic - along the lines of these other views?

Many many thanks for your service- I have learnt so much since becoming a subscriber.

My comment - Thanks for your kind words and for providing the opportunity for me to clarify an impression.

What you are referring to in your first paragraph, I believe, are remarks in Comment of the Day and more frequently in the Friday big picture, long-term outlook Audios, stating that Wall Street was in a secular bear market, which we always defined as a generational long process of valuation contraction, meaning lower PERs and higher yields. It was not a comment on the actual price trend for either the Dow or S&P.

This important clarification did not always register with newer subscribers less familiar with our terminology, leading to some misimpressions. This was the main reason why we stopped referring to it so often, although Eoin posted an interesting, chart-illustrated item on this subject yesterday, including reference links, which may have prompted your email.

With hindsight, it would have been less confusing if all along we had simply referred to a secular downtrend in Wall Street's valuations. If you search the Archive under 'Jeremy Grantham', and scroll back to the earlier references, you will find his report on this subject (requires subscriber logon), which was contributed to the Forum by a subscriber who also added: "Report by Jeremy Grantham. Good quote on the last page which emphasises David Fuller's Friday Big Picture audio caveat on the PE contraction scenario."

Regarding your important question on the possibility of "something far more apocalyptic", you may have observed that the vast majority of extreme forecasts - both bullish and bearish - seldom prove to be accurate. Similarly, the most widespread euphoria or pessimism in markets occurs at tops and bottoms.

I do not wish to minimise the fundamental problems, which I have described as a 'perfect storm' recently. Nevertheless, we are seeing capitulation selling, resulting in downward accelerations. These invariably prove to be climactic.

Therefore we should see at least a technical rebound before long. For a significant recovery, we probably need to see evidence of a medium-term correction in the price of crude oil (*see also earlier Comments of the Day on this subject*).

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

"Vietnam stock market recent performance. I am intrigued by the recent apparent bottoming and beginnings of a recovery in the Vietnam stock market in the face of collapsing equity indices elsewhere. For the past couple of months Vietnam has been falling relentlessly day on day irrespective of global stock market movements. I wonder what your thoughts are about the recent turnaround in Vietnam's fortunes? What factors are at work which caused it to fall when others were not falling and now allows it to rise when others are falling? Is this the beginning of a recovery for this long favoured frontier market which we as investors should consider jumping on now or will the global bear market sentiment if it continues crush this uptrend?"

My comment - Vietnam is a thinly traded market which investors chased higher in 2006 and early 2007 ([weekly](#) & [daily](#)). A weekly key reversal can be seen at the peak, followed by Type-3 top formation development and a precipitous decline. The latter stages of the downward move were aggravated by Vietnam's monetary authorities' mistaken decision to limit daily percentage moves, as you can see on the daily chart above. This locked in investors who wanted to sell and probably convinced others that they should get out as well, leading to a classic overshoot.

Vietnam has a whopping inflation problem, currently 26% per annum and the Vietnamese dong, shown here as [dong per 1 US dollar](#), was recently devalued. This makes Vietnam super competitive and if we look beyond the current inflation, I think it is one of the most promising Asian emerging markets for long-term investors.

Governance is always a crucial issue with any market and Vietnam's seems pragmatic so far, albeit inexperienced. It is probably emulating China, although I am told with a less authoritarian leaning. Vietnam is open for business and should continue to benefit from foreign investment. With abundant natural resources, it is currently an exporter of crude oil and a number of foods, including coffee and rice. It is an increasingly popular tourist destination, with a long and beautiful coast.

I opened small long positions in both my personal investment and trading accounts back in April, which was too soon, although the recent recovery has been just as swift to date. My preferred position is the db x-Trackers FTSE Vietnam ETF ([XFVT LN](#)), which is also listed in Germany. I do not expect Vietnam to uncouple from the trends on Wall Street and in China for long, but regard it as being in a buying range. I will probably be adding to my position at some stage.

Today's interesting charts - [The Fullermoney Library](#) contains many funds and trackers, a number of which have been included following subscribers' requests.

US Dollar Index - Upward dynamic [checks](#) slide near May-June reaction lows; a break beneath 72 is required to indicate renewed weakness rather than current scope for sideways to slightly higher trading within the present range.

EUR/USD - Downward key day reversal has [checked](#) rally near upper side of current range; a break above \$1.6 is necessary to reaffirm the overall upward trend and the short-term outlook is for sideways to slightly lower trading within the current band.

DJ World Stock Index and crude - This is a reasonable composite ([weekly & daily](#)) for most individual market trends which look at least temporarily overextended, especially where they have accelerated. However, upside scope is probably limited and downward risks will remain until crude oil ([weekly & daily](#)) loses upside momentum. There is no sign of this currently, although the medium-term trend is overstretched.

Additional Commentary by Eoin Treacy

Newcrest Completes A\$1.7 Billion Hedge Book Closure - [This article by Jesse Riseborough for Bloomberg](#) covers what has been a fundamental support for the gold market over the last number of years. Here it is in full:

Newcrest Mining Ltd., the largest Australian gold mining company, completed the closure of its gold hedge book for A\$1.7 billion (\$1.6 billion), 11 percent higher than estimated.

The increased cost was offset by the higher price of gold the company received from bullion sales, Melbourne-based Newcrest said today in a statement. The company closed out forward sales contracts for 4 million ounces at an average price of A\$868 an ounce, it said.

Chief Executive Officer Ian Smith last year completed a A\$2 billion share sale to help fund a buyout of the forward sales contracts. Global gold mining companies such as Newmont Mining Corp. have been closing hedge books to take advantage of record prices for the precious metal.

Higher prices from its gold sales meant the company did not need to use any debt to fund the closure as initially forecast, it said.

Newcrest fell A\$1.01, or 3.3 percent, to A\$30 at the 4:10 p.m. Sydney time close on the Australian stock exchange, giving it a market value of A\$14 billion.

Mining companies can agree to sell future production at current prices to

protect against losses caused by sudden declines, a strategy known as hedging.

My view - Gold miners have been incrementally closing their hedge books as they have turned from being a lifeline, while bullion was weak, to a liability during the course of the current bull market. This short covering which has been taking place over a number of years and continues for other gold miners is a strong technical support for the market. When choosing a gold mine as an investment, whether that mine's production is hedged or not should be among some key considerations. (This type of information is best found from the investor relations departments of mines themselves.) Other factors are how well it is performing relative to gold and its peer group and how consistent its chart pattern is.

Gold bottomed out between 1999 and 2001 before moving into a gradual uptrend which encountered resistance as the metal tested the top of the base near \$400. The price consolidated in the region of \$400 until late 2005, when it broke upwards and surged to more than \$700. The resulting pullback was sharp but swift and the metal found support quickly. Over the next 16-months it progressed back to test its highs. Gold broke upwards once more in September 2007 and surged to more than \$1000. The reaction on this occasion was also quite sharp and swift, but the market found support again relatively quickly.

Past experience suggests that it may be difficult for gold to rally directly back up and post significant new highs less than four months after the last peak. However, the upside can be given the benefit of the doubt as long as it sustains the move above \$850 and given the volatility of the move, it is best bought following inevitable reactions.

Barrick Gold also broke upwards in September and encountered resistance near C\$55. A sustained move below C\$40 would be needed to question potential for some further upside.

GoldCorp, the clear leader in this group, accelerated to a high near C45 in 2006 and spent much of the next two-years consolidating that move. From the July lows last year, the share's has been progressing steadily back to its highs and broke upwards once more last week. A sustained move below C\$40 would be needed to question scope for further upside.

Newmont remains in an overall ranging formation where demand is returning at gradually higher levels. It needs to sustain a move above \$60 to indicate the demand has returned on a more prolonged basis.

Zijin Mining accelerated from HK\$4 in mid-August to more than HK\$14 in late September. Since then it has given up almost the entire advance. The downtrend found at least short-term support near HK\$6 in March but it needs to sustain a move above HK\$8 to break the progression of lower highs and offset scope for some further downside.

[Kinross](#) also surged from its August lows to a high near C\$27. The ensuing reaction coincided with those of most other mines but it found support faster and is now testing the highs once more. A sustained move below C\$20 would be needed to question potential for the share to post new highs.

[Newcrest Mining](#) broke upwards from an 18-month consolidation last September and surged to near AU\$40. It has since given up the entire advance but found support at the top of the previous range near AU\$25. A sustained move above AU\$32 would break the progression of lower highs and indicate that the bulls have regained dominance.

Mineweb.com: Is First Quantum a screaming buy? - [This article](#) by Barry Sergeant covers the prospects for copper and don't miss the extensive list of stocks towards the end of the piece. Here is a section:

There are inevitably bulls and bears in most pockets of the market; copper is no exception. But while the metal has been hovering around within reach of its all time record level, investors have effectively demoted listed copper producers to among the poorest performing resources sub-sectors.

On the physical metal side, bears have outlined a plethora of reasons for why copper metal should fall, but bulls have been talking the metal up to \$10,000 a ton. At the moment copper is looking to test its all time record levels of \$8,880 a ton, supported by technical buying, continued supply disruptions in South America and surging oil and gold prices, along with continued heavy buying of broad commodity indices.

Dealers in the commodity pits say softer physical premiums and a lagging performance by Shanghai copper prices in response to gains on the London Metals Exchange suggest that the (Northern Hemisphere) summer slowdown is taking bite.

There are also negative fundamental factors at play, not least US light vehicle sales falling 8.5% year-on-year in June and the JPM Global Manufacturing PMI falling below 50 for the first time in five years. Dealers say, however, that there are a number of significant shorts across the base metals complex, and that the copper metal price may indeed be taken yet higher. Overall, copper metal prices are saying that supply demand remains tight.

So far as listed copper stocks are concerned, however, investors appear to have taken the view that the slowing global economy is going to take its toll on economically-sensitive copper metal prices, be it sooner or later. With the exception of a few listed stocks - such as Freeport-McMoRan - that are trading up on perceived or actual corporate action, the average copper name out there is trading nearly a third off its 12-month high.

Copper stocks have been heavily outperformed by a number of other resources subsectors, not least potash, iron ore, coal, platinum, tin, gold and oil. With the exception of tin, however, copper stocks have outperformed their

peers in the base metals complex. This may be surprising in the case of aluminium, which, like copper, is looking to test new highs.

My view - [Copper](#) is in the latter stages of a more than two-year consolidation which many touted as a prolonged topping formation. Could they still be right? The short answer is yes. However, a sustained move below 350c would be needed to give this argument technical weight. Right now, the upside can be given the benefit of the doubt following yesterday's upward break.

Although copper has been consolidating in the region of its highs for a number of months, this activity which is bullish in and of itself was greeted with a surprising degree of scepticism by analysts. This may in part be due to expectations that global growth will slow further. Another reason may be because other industrial metals such as nickel, zinc and lead were underperforming. The temptation is to assume that the copper should do the same. This resulted in most copper related equities being neglected by investors and there were certainly more interesting fundamental stories going on in the potash and iron-ore sectors. If copper sustains the breakout, and improves on that performance, a re-rating of copper related equities may occur.

[Freeport McMoRan](#) has been one of the better performers. It rallied to a new high in line with the copper price, in May, and appeared to be consolidating in the region of \$120. Yesterday's downward dynamic questions that hypothesis. It now needs to sustain a move back into the short-term range to offset scope for some further downside.

[Southern Copper](#) accelerated to a high near \$140 in late 2007. The ensuing correction saw it halve in value before rallying back to \$120. It needs to sustain a move above the latter level to question potential for some further lower to lateral ranging.

[Antofagasta](#) also accelerated to a peak late last year and is currently pressuring the lower side of the 9-month range. A sustained move above 675p is needed to question potential for some further downside.

[Kazakhmys](#) rallied well from the January but had been losing momentum from mid-March. The failed upside break which peaked below 2000p was a first indication that bullish sentiment was not strong enough to sustain the upward impetus. The reaction from the high is now looking somewhat overextended, but an upward dynamic is needed to check momentum beyond a brief pause.

[Vedanta](#) is also retracing its advance from earlier in the year and a sustained move above 2250p is needed to offset scope for some further downside.

[Jiangxi Copper](#) accelerated to a high near ¥30 in October before giving up a large portion of the advance. It has since found support near ¥15 but needs to sustain a move above ¥20 to question potential for some further lower to lateral ranging.

[First Quantum](#) is currently testing the lower side of the 9-month range and needs to sustain a move above C\$74 to break the progression of lower highs and indicate that demand is returning in this area.

Friday 4th July 2008

Iran Gives 'Constructive' Reply to Incentives Package - [This is the latest update](#) from Bloomberg on what has been a tense situation in recent weeks. Here is the opening:

Iran has given a "constructive" response to an incentives package from world powers intended to persuade the Persian Gulf nation to suspend uranium enrichment, the country's chief nuclear negotiator said.

The government in Tehran has prepared and presented its reply "with a focus on common ground and a constructive view," state television cited Saeed Jalili, secretary of Iran's Supreme National Security Council, as saying today in a telephone call with European Union foreign policy chief, Javier Solana.

Jalili didn't elaborate on the terms of the response nor say whether Iran might be prepared to call a halt to its atomic work. The U.S. and many of its allies accuse Iran of trying to develop nuclear weapons. Iran, under three sets of United Nations sanctions for refusing to stop the program, insists the work is aimed at producing electricity.

Crude oil fell from near a record after Jalili said the Iranian response would be delivered today. A compromise may allay concern that Israel is ready to attack Iran's nuclear installations, starting a conflict likely to cut supply from OPEC's second-largest oil producer.

Crude oil for August delivery fell as much as \$1.41, or 1 percent, to \$143.88 a barrel in electronic trading on the New York Mercantile Exchange, trading for \$144.14 at 2:03 p.m. London time.

Economic, Technology Incentives

Solana presented the package of economic and technology incentives to the government in Tehran on June 14 on behalf of the five permanent members of the United Nations Security Council plus Germany. Enriched uranium, the material the UN partners want Iran to stop producing, can fuel a power station or arm a nuclear weapon.

The plan includes an offer to recognize Iran's right to develop nuclear energy for peaceful purposes and to support the construction of a light-water reactor. The world powers have also proposed steps toward the normalization of trade and economic relations, greater Iranian access to international markets, and support for its admission to the World Trade Organization.

"We can confirm that there was a phone conversation this morning. Mr. Jalili called Mr. Solana. They had a good conversation and it was decided that they would remain in contact in the coming hours," Solana's office in Brussels said

in a statement.

Iran's response to the incentives package was delivered by the country's ambassador in Brussels, the state-run Islamic Republic News Agency said, citing an unidentified official at the Supreme National Security Council. Iranian Foreign Minister Manouchehr Mottaki signed a response letter, the news agency said, adding that Jalili and Solana are scheduled to hold talks later this month.

My view - Stemming what has had the appearance of a collision course would be a rare and major achievement for the United Nations Security Council. Anything else would risk becoming a lose-lose situation.

Inevitably, there is a war risk premium in today's price of crude oil ([p&f](#), [monthly](#), [weekly](#) & [daily](#)). Meanwhile the uptrend remains consistent, albeit somewhat overstretched.

Email of the day (1) - [On central banks being closet inflationists](#):

"David, I find your service invaluable for learning. I'm glad I found this super informational service at a young age. This has got to be the best value-for-money educational service I have ever spent & I am only a subscriber a few months.

"Currently I am researching some of your archive material. Considering the current environment we find ourselves I was researching inflation and your comments around central banks being "closet inflationist's".

You commented previously:

"Central banks almost always have a vested interest in some inflation, and more so in this long-term cycle. They understandably want to maintain GDP growth and they wish to inflate away some of their national debt burden. And they will also inflate away some of the higher cost of essential resources, not least crude oil imports, where they have little control over the price. And the US also has its war against terrorists."

"I hope I don't sound dumb here, but I don't understand what you are saying. Can you explain how a countries national debt can be reduced using inflation as an implicit tool OR how a central bank could inflate away the higher cost of crude oil imports as you discussed above.

"Also not sure what you meant by your comment on the US's war on terror.

"You don't have to publish this, as I'm sure you have other intelligent subscribers with clever questions. But if you could even email a brief answer, or point me to where I can find it.

"Thanks in advance. See you at the chart seminar in Nov."

My comment - Welcome to Fullermoney and thank you for your kind words. Subscribers' quest for insights and knowledge is motivational for us, and something that we all share in this ever fascinating business.

The USA and other countries have often been able to inflate away a portion of their debt burden by borrowing today and paying the loan back over time with a currency that has had its purchasing power reduced by inflation.

For instance, if I purchase crude oil or a widget from you today, and give you an IOU repayable in 3 months, or a year or longer, and pay an interest rate that is lower than the real rate of inflation, I am inflating away a portion of my debt to you. I will go on doing that if I can persuade you to roll that debt forward, rather than demanding that it be repaid on expiry.

However this will only work if you are willing to accept a slow devaluation of your capital invested in my debt, as a tradeoff for selling me more oil, widgets or whatever. If not, you may withdraw your capital, or demand higher rates, or some assurances that the loan devaluation will be addressed.

Alternatively, if this feels too confrontational, you may stealthily raise the price of your oil (fan a supply shock rumour) or reduce the supply of your widgets to drive up the price. Another possibility is that you might barter for something else in addition to the interest received on your loan.

As a debtor nation, and with creditors unhappy about the devaluation of their loans, the US has to 'talk the talk' which is why Bernanke and Paulson have jawboned the US dollar up a bit recently.

In referring to the war against terrorists, which you quote above, my point was that all these programmes have to be funded. Even with a booming economy, which the USA certainly does not have currently, taxpayers can only provide so much. Consequently the Fed prints more money, further devaluing its purchasing power. I should also add that all countries do this, but some more than others, depending on their fiscal circumstances.

I look forward to meeting you at the TCS reception in November.

My personal portfolio: Profit taken as stop on copper futures ETFs triggered - [US copper](#) did not maintain Wednesday's upward break and the price gapped down through my trailing stop today. Consequently I sold [ETFs Copper](#) for September at 4698.603, against my purchase at 4434.7325 on 17th June.

Gold bugs think fed, other central banks making it available - My thanks to a subscriber for this interesting [item](#) by Peter Brimelow for Market Watch. Here is a section:

The lease rate for gold. This is the cost of borrowing gold. Thirty years ago, this was a detail, but with the huge expansion of lending to gold mining companies in the 1980s it became a big deal. In particular it was an important

part of the argument of outfits like Gold Anti-Trust Association GATA which argued that secretive activity in the gold market by central banks was crucial to understanding what was happening with gold.

In the past few days a strange thing has happened. Australia's Privateer says, "the shorter term (one and two-month) rates have actually gone into negative territory this week."

In other words, gold is being supplied to the market by the central banks. Privateer goes on: "We do not recall a previous instance of this, and there certainly has not been one since the cold bull market began in 2001-02 ...

"We have not -- until now -- seen a situation in which the central banks are actually paying the bullion banks, hedge funds, gold miners et al to borrow the stuff. And please don't forget that, in this context, leasing gold is actually "shorting" gold. Gold is not "leased" to be hoarded, it is "leased" to be sold for something that pays a far higher rate of interest ... the practice of 'leasing gold -- and silver' by the central banks has been one of their best means of suppressing the prices of these precious metals for a long time."

Goldbug conclusion: Central banks, led surreptitiously by the Fed, are supplying physical gold to the market. And wise heads like the Indians are buying it.

My view - It is hard to know what to make of this report so I will continue to be guided mainly by gold's technical action ([historic](#), [p&f](#), [monthly](#), [weekly](#), [daily](#), [inflation-adjusted in CPI terms](#), [gold in euro proxy](#)).

I can be brief, as we comment on gold so frequently. Obviously bullion remains very much within its overall upward trend. Moreover, it shows support building since its early May low. However this is not a period of seasonal strength for gold, unlike 4Q and 1Q, due to demand before Christmas, the Chinese New Year and Indian wedding season.

Gold in other viable currencies has only broken upwards against the [Chilean peso](#), although it is near its highs against several others, including the [Thai baht](#) and [Indian rupee](#), [New Zealand dollar](#) and to a lesser extent [Japanese yen](#).

In US\$ terms, \$950 is a temporary psychological barrier and gold appears to be consolidating recent gains beneath that level. I favour accumulation on easing within the current range for a possible upward break before yearend or the end of 1Q 2009. I say possible because that would require a shortening of the consolidation cycle that gold has previously shown within this overall upward trend.

On a day to day basis, the USD and oil are clearly influences on bullion's price. Lastly, as Eoin said yesterday, gold would have to break beneath \$850 to significantly delay medium to longer-term upward scope.

Email of the day (2) - [On Japan's energy efficiency](#):

"Sending along a link to great story in today's NY Times about Japan promoting its "energy-frugal ways" to the rest of the world. I believe you've highlighted this reason previously as a factor in why Japan is likely to outperform other developed markets."

My comment - [Thank you so much for contributing this informative article in the spirit of Empowerment Through Knowledge. Here is the opening:](#)

KUMAGAYA, Japan - With its towering furnaces and clanging conveyer belts carrying crushed rock, Taiheiyo Cement's factory looks like an Industrial Revolution relic. But it is actually a model of modern energy efficiency, harnessing its waste heat to generate much of its own electricity.

Engineers from China and elsewhere in Asia come to study its design, which has allowed the company to slash the amount of power it buys from the grid.

The plant is just one example of Japan's single-minded dedication to reducing energy use, a commitment that dates back to the oil shocks of the 1970s that shook this resource-poor nation.

Now, with oil prices hitting dizzying levels and the world struggling with global warming, the country is hoping to use its conservation record to take a rare leadership role on a pressing global issue. It will showcase its efforts to export its conservation ethic - and its expensive power-saving technology - at next week's meeting in Japan of the Group of 8 industrial leaders.

"Superior technology and a national spirit of avoiding waste give Japan the world's most energy-efficient structure," Prime Minister Yasuo Fukuda said in a speech outlining his agenda for the meeting. Japan "wants to contribute to the world," he said.

Mr. Fukuda has already urged the leaders of the Group of 8 nations to adopt numerical targets as they discuss new ways to curb carbon dioxide emissions, a focus of treaty talks aimed at a new global agreement by the end of 2009. The existing pacts, the original climate treaty from 1992 and the Kyoto Protocol, which expires in 2012, have been called failures by energy and climate experts.

[I do think that energy efficiency is one reason why Japan's stock market will outperform most industrialised developed nations. Another is demographics, which are usually cited as a serious weakness for Japan. They can be but it is easier to allow in productive immigrants than it is to feed the teeming masses of poor and uneducated people. Meanwhile, Japan remains at the cutting edge of technological developments in many industries.](#)

[So I remain a long-term bull of Japan's stock market \(p&f, monthly, weekly & daily\), but have emphasised that it will not perform on its own. Therefore](#)

people who agree with me can afford to be patient, nibbling at Japanese shares funds or ETFs on weakness.

Once we see evidence that a potentially significant stock market rally is commencing, we will produce a list of Japanese shares showing the technical potential to outperform.

Please note - Eoin is away today.

Quote of the week - On the art of finance:

"Finance is the art of passing money from hand to hand until it finally disappears."

Robert W Sarnoff

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