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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 7th July 2008

BRIC outlook: Structural growth drivers favour China and India over Brazil and Russia - [This is an interesting, if somewhat fundamentally complex report by Markus Jaeger for Deutsche Bank Group. Here is the opening:](#)

The resilience of economic growth in emerging markets has increased. The resilience emerging markets have exhibited in the face of the US credit turmoil and growth slowdown so far is due to the much reduced vulnerability of emerging markets to global financial market conditions and due to the greater reliance on demand from domestic and emerging markets rather than developed markets. (Some slowdown in EM growth seems inevitable, but growth figures will remain solid.) If anything, most if not all BRIC countries currently seem to be at risk of overheating. There is of course a cyclical component to strong domestic demand growth, but there are also structural factors at work that bode well for the medium-term growth prospects of the BRICs. These factors can be captured in a simple growth accounting framework. Economic growth can be broken down into several components, namely changes in labour and capital inputs, and total factor productivity. (Total factor productivity captures technological progress and/ or efficiency gains and is the residual that is not explained by changes in labour and capital inputs.) Growth accounting provides an analytical framework to assess medium-term economic growth dynamics. The BRIC economies differ greatly in terms of their growth prospects.

Labour supply dynamics will remain favourable in Brazil and India thanks to demographic trends and/or low urbanisation ratios. In Brazil and India the working age population will continue to expand until the middle of the current century, while in China it will decline after 2015 and in Russia it is at risk of collapsing. (The UN projects Russia's working age population to decline from 97 m in 2005 to 47 m by 2050!) A low urbanisation ratio of 40% in the case of China may help counteract the projected decline in the working age population by allowing for the transfer of labour from the countryside into the more productive urban economy. In Brazil, not much should be expected from further urbanisation, as the country is already more highly urbanised than many of the developed countries in the world. But thanks to a relatively favourable demographic profile, Brazil will benefit from a 20% increase in the population of working age between 2005 and 2025. This should help support economic growth. The Russian population of working age is already in decline and little help will come from "surplus rural labour" due to a high urbanisation

ratio. From a purely demographic point of view, India faces the most promising prospects, combining solid population growth and a low degree of urbanisation. While this may pose challenges of its own (in terms of urban development and infrastructure), it will be supportive of growth dynamics.

Recent capital accumulation trends favour China and India. Assuming that investment ratios do not change dramatically over the next few years, China and India will face much brighter prospects than Brazil or Russia. Currently domestic investment ratios amount to around 40% and 30% of GDP in China and India, respectively, versus an investment ratio of 20% of GDP (or less) in Brazil and Russia (see chart). Although it is difficult to project future investment (and savings) ratios, any changes will probably be gradual. Russia will probably increase its investment ratio thanks to large savings generated by the commodity boom. Brazil, having experienced a more modest increase in domestic savings, will likely see a moderate uptick in investment ratios (despite the PAC). In China both investment and savings ratios will decline over the medium term, but are likely to stay at very high levels over the next few years. What seems certain is that Chinese and Indian capital accumulation will proceed at a much faster pace than in Brazil and Russia. If one adds the fact that China and India are growing faster than Russia and Brazil, it becomes clear that investment growth is faster still than suggested by the difference in investment-to-GDP ratios. (We are assuming for simplicity's sake that the higher gross investment ratio leads to a faster increase in the net capital stock.)

My view - Fullermoney has maintained for a number of years that while [China](#) and [India](#) were certainly high-beta markets, not least because of growth rates and swings in valuations, their economies would also remain generally more resilient than what we saw in the west. This was not a prediction of actual decoupling, which ought to be less likely due to globalisation, but for better overall GDP growth in fundamentally stronger economies.

If this theory is ever going to be tested, it is likely to be now and over the next couple of years. Therefore while I am very interested in Markus Jaeger's opening paragraph, a number of caveats remain, in my view.

Governance will remain crucial, as always. For instance, China and India are experiencing higher inflation than in the west, albeit also primarily in the form of food and energy prices. I believe Chindia's central banks have reaffirmed their credibility in attempting to curb a wider outbreak of inflation but they still face a difficult balancing act. On the one hand, a too stimulatory monetary policy, not least in India during an election year, could compound inflationary problems necessitating more draconian measures later on. On the other hand, too much tightening now could setback growth prospects for at least a year.

External factors are also crucial, not least concerning the price of crude oil ([weekly](#) & [daily](#)). If this continues to rise, as some 'Peak Oil' advocates maintain, then India would certainly be vulnerable to a sharp decline in GDP. Moreover, India's much needed infrastructure development programmes would be significantly delayed. Conversely, if the price of crude oil spills over into a medium-term correction following its somewhat overextended advance -

the key downside levels required to first indicate and finally confirm this remain £135 (MDL), \$130 (lower low) and \$120 (trend breakdown) - then we would mostly likely see a major shakeout of commodity investment and speculative positions. This would give the global economy some much needed breathing space.

For Markus Jaeger's headline above to be correct in terms of stock market performance, I think we will need to see a commodity shakeout, enabling the world's central banks to declare that the inflation genie has at least been tamed, if not put back into the bottle, enabling them to switch their focus back to GDP growth. However if the price of crude oil continues to move higher, Russia and other energy exporters are the obvious beneficiaries.

Of the four BRIC indices, China ([weekly](#) & [daily](#)) and India ([weekly](#) & [daily](#)) are clearly the most oversold but need some clear upward dynamics to suggest that base building is underway. This is often a lengthy process, not least following a series of fundamental problems that have resembled a perfect storm for investors in recent months. Russia ([weekly](#) & [daily](#)) and particularly Brazil ([weekly](#) & [daily](#)) have experienced some technical deterioration recently, following the phenomenal earlier relative strength of these commodity exporters. However rebounds are now required to maintain the technical integrity of their overall trends, characterised by lengthy progressions of higher reaction lows.

The good news is that a considerable portion of these economic difficulties have been well aired - just look at the financial pages of newspapers - and therefore increasingly discounted by stock markets. Nevertheless, this remains a time for caution. A technical rally aside, it is still too easy to lose money in stock markets.

Jonathan Davis: A year when sentiment ruled reason - This is a good [item](#) by veteran columnist Jonathan Davis, writing for the Financial Times today. Here is the opening, posted without further comment as my views on this subject are in the preceding item:

A year on from the onset of the credit crunch seems a good moment to reflect on the way that markets have behaved since that point.

One lesson learnt over many years is that in times of crisis an understanding of market dynamics is a far more useful guide to short-term action than detailed or sophisticated analysis of valuation metrics. You can't fight a market trend with reason alone when sentiment is running so strongly the other way.

After a bad month in June, and one of the worst first six months of the year since the 1930s, many markets now look oversold. But at the same time many leading market indices, including the S&P 500 and the FTSE 100, are either bumping up against or already pushing through the lows set in March at the time of the Bear Stearns rescue. If those lows are decisively broken, then even after the inevitable rally you can be sure of a further downward leg to this bear market.

Email of the day (1) - [On non confirmation of sentiment indicators](#):

"There is some thing about the current sentiment that I do not understand. It is true that the long term sentiment indicators like Investors Intelligence show extreme pessimism. However the shorter term sentiment indicators mainly the VIX have still not spiked up even though the market has been going down with no apparent end in sight. Even more interesting is the fact that now options are available on the VIX. The implied volatility on these VIX options is very low. (About 70%). At times of stress the implied volatility on VIX options goes over 100%.

"It seems that Hedge Funds are not buying put options on the S&P in great amounts (VIX has still not spiked up) and they are not buying VIX futures or VIX options in great amounts (implied 30 day volatility on the VIX options is about only 70% now) It seems that they are just not hedging much. This complacency seems to suggest that the market still has further downward potential.

"Could you kindly give us your opinion on the great divergence between the sentiment surveys (showing extreme pessimism) and the volatility indicators (showing complacency)?

"I would appreciate your comments as I am very confused by this situation."

My comment - [The difference, I believe, is due to the fact that although many stock market indices have fallen significantly since their mid-May rally highs, we have not seen the dramatic form of capitulation that occurred last August, this January and also in March.](#)

[There could be two different explanations for this.](#)

[One could be that investors are complacent, in denial or simply do not understand the gravity of the situation. This view is popular with many of the more bearish commentators, not surprisingly, who are looking for another major panic.](#)

[A less dramatic view is that people can only panic so many times in a bearish cycle, and have already done so on the three occasions mentioned above. Consequently this catharsis may have been largely completed, although that would not necessarily prevent stock markets from moving lower, as we have seen in recent weeks.](#)

[To repeat a central theme in my own view, I have described stock markets and crude oil as being on the opposite ends of a playground seesaw. In other words, I would be surprised if we saw a big rally in equities without some corresponding weakness in crude oil. Also, another spike in oil could trigger the downward acceleration in stock markets that would soon lift the \[VIX Index\]\(#\). Meanwhile, the clearest technical evidence is an oversold condition for stock markets of at least near-term significance.](#)

Readers may find these two articles on capitulation and short selling interesting:

[IHT](#): Is capitulation on the cards?

[BBG](#): Record Shorting of U.S. Stocks may Fuel Rebound, JPMorgan Says

(See also Eoin's lead item on this subject below.)

My personal portfolio: Trailing stop triggered on coffee futures long - [My Arabica coffee](#) long was sold today at \$149.00 for the September contract versus my purchase at \$141.90 on 20th June. These prices include spread-bet dealing costs.

Additional Commentary by Eoin Treacy

Asia Quantitative Strategy: Tactical indicators call for a rebound in July - Thanks to a subscriber for this interesting [report](#) by Sophie Biro of Credit Suisse covering improving readings from a number of indicators. Here is a section

This month, we have as many as six indicators with positive signals. This is a massive increase compared to last month, where only one indicator scored with a positive signal. (breadth of EPS revisions). These are:

MSCI NJA is oversold on the price technical indicator. We look at the percentage deviation of the MSCI Asia ex. Japan index from its six-month average.

The percentage of stocks trading above their 10-week average is 7.2%. This is an extreme case of oversold stocks and is usually followed by a market rebound.

There are still more earnings downgrades than upgrades for the asset class, but less so as there are signs of reversion.

The index is 11% undervalued on our three-factor model, suggesting a "buy" signal.

The yield ratio, which is the ratio between the Asia ex. Japan dividend yield and the 10-year US bond yield gives a "buy" signal this month.

There have been only two weeks of inflow out of the past 10 weeks and history suggests that we should get a reversal trend in flow and market performance.

On the other hand, there are two signals with negative signals and these are: 1) the OECD lead indicators, which have headed south for the past year, and

2) the volatility of Asia ex. Japan that is still rising despite our expectations for it to be close to its peak.

This is the same number of positive signals as last April, where the market subsequently rebounded by 7.9% that month. Similarities between then and now include price technical and valuations (three-factor model and yield ratio). On the other hand, the differences are: 1) volatility of the market was a positive and 2) Credit Suisse risk appetite was in panic zone. This time around, we have liquidity pattern and earnings revisions in our favour.

My view - Another sign that we are approaching a low in the market is that leading investment instruments such as commodities and commodity related stock markets have turned down. One of the reasons for this may be because they are catching some contagion from the wider stock market and profitable positions are being sold to plug holes in other parts of a portfolio.

In the last few days, downward dynamics have been posted in [Arabica coffee](#), [Robusta coffee](#), [white sugar](#), [cocoa](#), [soybeans](#), [corn](#), [wheat](#) and [oats](#). The [Brazilian](#) market has pushed back into its previous trading range, [Canada's](#) stock market has also weakened. [Russia's](#) market is not confirming oil's continued move on the upside.

If profitable positions are being sold along with losing positions, then this is another indication that sentiment is deteriorating. We have no technical evidence that the market has found a low just yet, but it is unwise to become increasingly bearish in line with sentiment.

JP Morgan: China Insights and Strategy - Thanks to a subscriber for this blockbuster heavyweight [report](#) by Frank Gong covering the macro economic outlook for China as well as a run down of a large number of sectors. Here is a section:

Meanwhile, as the absolute level of inflation remains high, policy risks remain in the near term. The government has been pushing out contradictory policies: on one hand, it increased gasoline/diesel and electricity prices earlier than expected, but on the other hand it launched a "temporary" price cap on thermal coal (with questionable feasibility at implementation). Such contradictory policy moves have left the market doubtful about China's determination to fully liberalize gasoline/diesel and other controlled resources prices. Such policy risks/uncertainties have been a big factor in the de-rating of Chinese equities.

The good news is that CPI inflation has now topped out and is finally trending downward on a Y/Y basis as we have long expected. The consensus view is moving in the same direction and China's CPI inflation is expected to moderate further. This is likely to be true even after the recent substantial increases in gasoline and diesel prices and electricity prices, due to the softening food prices and moderating food inflation on increased supply and good harvests in China. If CPI inflation moderates further in 2H08, we expect the authorities to continue on the path of price liberalization for gasoline/diesel

and other resource prices, and to raise electricity prices. We expect full price "normalization" (as the authorities would call it) or liberalization (convergence with international prices) for gasoline/diesel prices in the next 6-9 months.

Once CPI inflation moderates further, much of the policy risk should fade away. The authorities may even loosen some of the credit and macro control programs by the end of this year. With declining CPI inflation in China, the risk of a near-term PBoC interest rate hike is very low without the Fed increasing the US dollar rate first. China has suffered from hot money inflows to catch the "risk free" gain on Rmb-US\$ interest rate spread and Rmb appreciation. To manage the excess liquidity created by the hot money inflow and current account surpluses, the PBoC may need to continue to increase the RRR and use the conventional way of open market operations to sterilize the liquidity.

Based on such moderating inflation outlook, and the expectation of fading policy risks and price liberalization/reforms, we recently upgraded China to overweight in our regional and GEM asset allocation. The risks to our "investing in China thesis" continue to be on the crude side if crude oil prices continue to hit record highs. However, even in the face of skyrocketing oil prices, China should not underperform given its unique cushion of "twin surpluses", and the potential for the Rmb to appreciate further to fend off the externally caused inflation pressure.

On an earnings-adjusted basis (based on consensus estimates), China has never been cheaper, with MSCI China's FY08E and FY09E P/E at 13.9x and 11.8x, respectively, and expected earnings growth of 21% for FY08E and 18% for FY09E. Even for the A-shares (CSI 300), it is trading at an FY08E and FY09E P/E of 16.8x and 13.8x, respectively, with expected earnings growth at 21% for FY08 and 22% for FY09. The A-shares (CSI 300) have experienced a material earnings slowdown whenever its earnings growth was more than 40% in the past two years. Valuations, however, now appear to have discounted the expected earnings slowdown (again most of the earnings slowdown came from two sectors distorted by government price controls: refining and IPP).

My view - To use an old adage, there have been a number of 'straws in the wind' with regard to a change of tone towards the Chinese stock market. Put another way, signs are becoming more pronounced that interest is gradually returning to a market which has been unloved most of the year.

Inflation is a major threat to the survival of the world's poorest people, so countries such as China and India have had to act quickly and hopefully effectively to contain it. The measures enacted by China have included raising the lending rate, raising reserve requirements for banks and allowing the Yuan to appreciate. If CPI inflation has peaked then some of these measures may be unwound. This would be a bonus for a stock market which has seen investor interest plummet.

The [Shanghai A-Share Index](#) remains in a medium-term [downtrend](#) which is losing momentum. While policy changes have contributed a number of sizeable upward dynamics in the last few months, the Index needs to sustain

a move above 4000 to break the progression of lower highs. Given the pace and size of the decline to date, a V-shaped recovery remains unlikely under the current set of market regulations. A period of support building is probably needed to allow investor confidence to be rebuilt following the trauma of the last 9 months.

World Equity Index Valuations Tables - Here is the monthly [list](#) of 95 global indices ranked in descending order by dividend yield and then in ascending order by P/E.

I removed Egypt from the list this month because the data provided by Bloomberg is no longer accurate.

We continue to see that REIT indices in Japan and the USA continue to yield higher than most equity indices. When the list is sorted in ascending order by P/E, the list continues to be dominated by European indices.

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

Last week's signups for the Free (Abbreviated) Comment of the Day - For the week of June 29th new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, Canada, France, Ireland, Japan, Netherlands, Panama, Spain, the UK and USA - 10 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 8th July 2008

G-8 Says Oil, Food Prices Pose Risk to World Economy - Here is the opening from this [report](#) by Bloomberg today:

Group of Eight leaders said rising oil and food costs pose a "serious challenge" to the global economy, indicating inflation has become their

primary concern.

“We have strong concerns about the sharp rise in oil prices,” the group said in a statement today in Toyako, Japan, where the leaders are holding their annual summit. “The world economy is now facing uncertainty and downside risks persist.”

The impact of rising oil prices, which reached an unprecedented \$145.85 a barrel on July 3, are rippling through the global economy by sapping household budgets and boosting production costs. The MSCI World Index of stocks fell today to the lowest in almost two years on concern global inflation will slow economic growth.

“The global outlook is definitely more cloudy with oil prices where they are,” said David Cohen, director of Asian economic forecasting at Action Economics in Singapore. “Inflation is a strain on household budgets for everybody.”

My view - Yes, energy price inflation has rightly become the primary concern, because oil-importing countries are increasingly aware of the deflationary blow that the current price of crude oil represents, not to mention what would happen to GDP growth in the event of an even higher spike as many have forecast.

Consequently what we are now seeing is an attempt to jawbone down the price of crude, in addition to efforts to persuade producers to increase output. The latter effort should meet with some modest success. However the best hope for at least temporary respite from rising energy costs is to change the prevailing psychology among speculators and particularly long-term investors in oil futures tracker funds.

This is a controversial subject but I maintain that it is ludicrous to claim that the investment of several hundred billion dollars in oil futures has no effect on the price. Think of house prices, art at auction or any other asset where there is an element of supply inelasticity. If lots of people with substantial amounts of cash want to buy, prices inevitably go up. If they decide not to buy, prices go down. Petroleum futures are no different.

The biggest investors in oil futures range from university endowment funds to sovereign wealth funds, and millions of private individuals have invested in the much publicised commodity tracker funds, launched by Jim Rogers, Barclays Capital and others.

Democratically elected governments are understandably reluctant to use the heavy hand of legislation to deter investment in commodity futures, even though these were never intended to be asset classes - gold and other monetary metals aside, as they have been regarded as hard money for centuries longer than the existence of modern futures contracts.

The all-important question is: How do governments deter price-distorting investment and speculation in energy and food futures, without impinging on peoples' freedom of choice? I think moral suasion would be as dubious a

route as legislation. However governments can point out the economic risks easily enough, without pointing a finger at anyone.

Thereafter it should be a matter of common sense. After all, if energy and food prices continued to spiral higher with the help of tracker funds over the next few months, the gains in those investments would soon be more than offset by the deflationary impact of a severe global recession on most of one's non commodity assets. In other words, it would be a Pyrrhic victory.

The biggest tranche of money in commodity futures, by far, is in crude oil. In contrast, most of the medium to longer-term investment in gold is in bullion. I maintain that a decline in crude oil would weigh on a number of other commodities that arguably look overextended on their price charts, genuine supply shortages excepted.

There is now some preliminary evidence that these reactions have commenced. If [crude oil](#) now breaks its medium-term uptrend - the key levels to look for are \$135 (MDL), below \$130 (a lower low) and below \$120 (clear evidence of a breakdown) - central banks would have won an important round against inflation and could focus on GDP growth, which has deteriorated significantly in the west.

This switch in emphasis by central banks is only a matter of time and would be a tonic for stock markets, where short interest is near record highs and many investors hold substantial cash reserves.

Oil Falls as Economic Slowdown Concern Sparks Commodity Selling - Here is a related [article](#) as crude oil fails to maintain its break above \$140 achieved on 27th June.

Iran Says It Will Hit U.S. Ships, Israel, If Attacked - Here is the opening from this morning's [update](#) in this ongoing sabre rattling saga:

Iran would strike Israel and the U.S. Navy in the Persian Gulf as a first response to any American attack on its nuclear program, an aide to Supreme Leader Ayataollah Ali Khamenei said.

Israel wants the U.S. "to prepare a military aggression against Iran," the state-run Fars News agency today cited Ali Shirazi, Khamenei's representative in the Revolutionary Guards' naval division, as telling military personnel. "If they resort to such a silly undertaking, Tel Aviv and the U.S. fleet in the Persian Gulf will be the first targets" of Iran's response.

Tensions over Iran increased, helping push the price of oil to a record, after a New York Times report that Israeli military maneuvers in the eastern Mediterranean last month were in preparation for a possible strike on Iran's nuclear facilities. Shirazi's comments came as Iran conducted military exercises designed to strengthen the combat capacity of its missile and Navy units, Fars said in a separate report.

Fars didn't give details of the maneuvers. Shirazi, though, said Iran and its forces were now at the peak of their ``capability, power and readiness."

My comment - To ask the rhetorical question: Do you suspect that some countries have a vested interest in publicising tensions, which have often boosted oil prices over the last year?

However there are limits, especially when some of your allies see themselves caught in the crossfire that lifts oil prices - "Ahmadinejad [Says](#) 'There Won't Be War,' Pledges Peace."

Without action to back it up, any repeated threat eventually has a diminishing impact on sentiment. Today's price action suggests that oil traders are at least somewhat less concerned about the prospect of a war in the Persian Gulf region.

We have been illustrating and commenting on oil virtually on a daily basis, and you will not want to miss today's action for the three major contracts. The first real inconsistencies for these medium-term trends are now evident. [Crude oil](#) has failed to maintain its break above \$140 and is not far from the mid-point danger line (MDL) at \$135. Similarly, [heating oil](#) has failed to maintain last week's upward break. [Gasoline](#) has lagged recently and shows a loss of upside momentum in the form of a rising wedge pattern discussed at The Chart Seminar.

Today's small downward dynamics, also evident for natural gas covered by Eoin below, indicate that the uptrends are faltering. However sustained breaks in the progressions of rising lows are required to show more clearly that demand no longer has the upper hand.

Talk of bogeyman coming may have dramatic impact but this is not the Seventies revisited - [This is a good article](#) by Gary Duncan for The Times. It is also supplied in [PDF](#) format, in case The Times' link is dropped. Here is a section:

The crucial question is whether this present, mild form of the malady proves just a temporary affliction, or becomes chronic. There are at least three good reasons to think that it will prove to be merely a passing symptom, rather than a lasting sickness.

The first is arithmetic. In the very short term, recent sharp rises in fuel and food prices will continue to propel inflation upwards. Yet for overall inflation to keep rising, rather than begin to fall back by later this year, oil and food prices will need not only to keep rising but to rise even faster. This seems very unlikely indeed, since a series of rogue factors conspired this year to stoke food and energy costs.

ING, the investment bank, calculates that even if oil prices rose to \$200 a barrel, and stay there, headline US inflation would plunge next year simply due to the maths. Even more strikingly, if oil fell to \$100 a barrel by the end of next year, which seems much more likely, US headline inflation would actually turn negative. These sums work much the same for Britain.

The second, compelling reason to expect stagflation to be only a temporary scare is rapidly deteriorating economic activity.

In every downturn there is a marked time lag before slowing growth pushes inflation lower.

As conditions weaken, and families and businesses cut spending, there is less demand chasing the supply of goods and services.

Companies then have to compete harder, and prices slide as extra slack is created in the economy. The sharper the downturn, the greater the slack that is opened up and the more potent the downward pressure on prices.

The time lag can be both long and variable but Britain must surely now be approaching this critical tipping point. Goldman Sachs research estimates that across advanced economies the delay averages between four and six quarters in most economic cycles.

So, based on the world upswing having peaked sometime last autumn, the moment of truth when inflationary pressures start to ease should arrive shortly. Given the severity of the slump in activity implied by the latest bleak economic news, a truly icy blast should soon be helping to extinguish Britain's inflationary fires.

The third, and final, reason to think that the stagflation bogey will soon cease to be a reality is pay.

For inflation to become truly entrenched in the economy and full-blown stagflation to take real hold, the present steep increases in living costs would need to stoke an outbreak of inflationary pay deals, leading to the return of that other Seventies bane, the wage-price spiral.

Yet there is scant sign of this happening. Far from taking off as inflation has climbed, pay settlements have remained muted. As Goldman Sachs notes, the data indicates that wage growth is actually falling, rather than accelerating.

These favourable trends are underpinned by far fewer pay deals now being pegged to inflation than in the Seventies - only about 10 per cent of settlements are now explicitly linked in this way.

With unemployment rising, and workforces now likely to be more anxious about keeping their jobs than raising their pay, it seems probable that the trend in earnings will remain tame.

Taken together, all of this implies that by next year slump and stagnation, not stagflation, will dominate the headlines.

The lasting danger to the economy will prove to be from the icy chill of recession, rather than the flames of inflation.

My view - I agree regarding the statistics of inflation (Gary Duncan's first point) and have discussed this before. I am less certain about his second point because the inflation we most experience is not in discretionary items where prices will be kept comparatively low by the competitive pressures of globalisation and also economic weakness in the west. However most people are already acutely aware of the increasing costs food and energy - necessities - the impact of which they feel all the more because wages are constrained.

I agree that inflationary pressures will be less severe than in the '70s, not least because back then they had been building since the early '60s. However investors need to be aware of some risks that are likely to be greater this time.

Today, the demand on resources is vastly greater, due to a much larger global population, especially in terms of aspiring middleclass consumers. Also, there is some supply inelasticity, which certainly did not exist in the '70s. For these reasons and looking beyond the current stock market slump, resources shares will remain a long-term overweight in my personal investment portfolio.

The process of deleveraging in this cycle is likely to be worse, due to a more reckless financial industry in the west. Also, many individuals and also governments in the west have considerably higher real levels of debt than in the '70s. For these reasons, my personal portfolio will also remain overweight emerging (progressing) markets, which will storm back, just as we saw from 2003 through 2006.

Meanwhile, we are due for at least a technical rally, which will gather participants if medium-term uptrends for petroleum futures break, as seems quite likely. I will be able to say more on all this in tonight's Audio.

Please note - The link to yesterday's lead article by Markus Jaeger for Deutsche Bank Group has been removed from their website. I sent an email this afternoon, asking why, but have heard nothing to date.

Additional Commentary by Eoin Treacy

Aluminum Falls From Record After Surge on China Supply Concern - [This article by Li Xiaowei for Bloomberg covers yesterday's upward break in aluminium prices. Here it is in full:](#)

Aluminum declined from a record in Asian trade after it jumped yesterday on reduced output from China, the world's largest producer, because of power shortages.

The metal, used in construction and cars, advanced as much as 5.3 percent to a record of \$3,327 a metric ton in London yesterday as Aluminum Corp. of China Ltd. halted output at a venture in Shanxi province because of an electricity shortfall.

“Investors are becoming increasingly bullish on aluminium because of expected power issues around the world,” Yang Bo, a trader at Minmetals Starfutures Co., said today by phone from Shenzhen. Still, “Shanghai prices are quite reluctant to chase the London gains due to lackluster demand, and this may curb further gains in London.”

Aluminum for delivery in three months on the London Metal Exchange declined as much as 0.5 percent to \$3,290 a metric ton and traded at \$3,290.75 at 9:13 a.m. in Shanghai.

The contract has rallied 37 percent this year after power shortages in China and South Africa curbed output. Power accounts for between 30 and 40 percent of operating costs for aluminum smelters.

September-delivery aluminum on the Shanghai Futures Exchange rose as much as 1.1 percent to 19,920 yuan (\$2,903) a ton, and traded at 19,845 yuan. The metal has gained 11 percent since the start of the year.

The government in northern Shanxi ordered smelters to pare capacity to ensure power supply for farming, Wang Suomin, a manager at the Shanxi Huaze Aluminum & Power Co., said yesterday.

The venture has an annual capacity of 280,000 metric tons.

Among other LME-traded metals, copper rose 0.6 percent to \$8,460.25 a ton, zinc fell 0.5 percent to \$1,825 and lead was down 0.6 percent at \$1,620. Nickel and tin were untraded in Asia after settling at \$20,925 and \$22,750 yesterday.

My view - Aluminium is not an industrial metal in the classic sense because, technically, it is created through refining bauxite. This refining process is enormously energy intensive so aluminium prices will always have an energy component factored into their valuation.

Aluminium prices on the LME accelerated to a high near \$3300 in May 2006 from a low less than a year earlier below \$1900. The resulting consolidation of gains quickly found support near \$2350, but it took almost two-years before aluminium could support a rally that would take it reasonably close to the 2006 highs. Aluminium posted a new high yesterday. If it has further to go now, it needs to sustain the break and consolidate a move above the previous high. If it fails here, then a retest of the lower side of the most recent range near \$2850 appears likely.

In Shanghai, [Aluminium](#) remains towards the lower side of the two-year consolidation. It needs to sustain a move above ¥22,000 to offset potential for sideways trading activity to continue.

Toxic CDOs Given Up for Dead Coming to Life With Pension Funds - [This article](#) by Jody Shenn for Bloomberg covers one of the ways investment banks are looking to clear their rather large inventory of mortgage related debt. Here is a section:

CDOs are back.

Collateralized debt obligations that helped drive banks to \$400 billion of writedowns and credit losses are finding buyers under a different name: Re-Remics.

Goldman Sachs Group Inc., JPMorgan Chase & Co. and at least six other firms are repackaging unwanted mortgage bonds as sales of CDOs composed of asset-backed securities fall to less than \$1 billion this year from \$227 billion in 2007 because of the global credit crunch. Re-Remics contain parts that are structured to guard against higher losses on underlying loans than most CDOs, allowing holders to sell or retain other sections at lower prices that can translate to potential yields of more than 20 percent.

“It's just the reincarnation of the CDO,” said Paul Colonna, who manages more than \$100 billion as chief investment officer for fixed income at GE Asset Management in Stamford, Connecticut. “The mechanics are the same, but you're getting in at a much different level of valuation.”

GE Asset Management has considered buying the debt, Colonna said. The General Electric Co. unit may also have Re-Remics made out of bonds it owns if disposing of the riskier pieces boosts the securities' overall value.

Re-Remic stands for “resecuritizations of real estate mortgage investment conduits,” the formal name of mortgage bonds. Sales of the securities may help revive the market for new home-loan debt, according to Bernard Maas, an analyst in New York at credit-rating firm DBRS Ltd.

My view - I found this to be an interesting story which illustrates that the Collateralised Debt market is not going to disappear but neither will it regain the heady heights reached in 2007 anytime soon. Banks are now offering some of their debt at much more attractive rates more accurately reflecting the level to risk being undertaken. They are likely to find at least some buyers for this inventory and should gradually be able to mend their balance sheets. However given the considerable damage done to their own financial stability over the past year, the recovery for the banking sector is likely to take years as new business models are adopted.

Banks have led stock markets downwards in the majority of cases and most especially those with a heavy weighting of financial shares. Major global

indices are unlikely to be able to stage meaningful recoveries until bank shares at least stop going down.

Presently, the [S&P500 Banks](#) Index remains in an overall downtrend which is unrelentingly consistent. It is certainly overstretched, but not unlike the first down leg, prior to the ranging pattern centred on 250. This is unsustainable and therefore an ending. We don't know where the bottom is; only that it is getting closer. An upward dynamic which is clearly larger than any seen in the last two months is needed to check the slide.

www.Canada.com: India ready to make multi-billion-dollar oilsands deal in Alberta - Thanks to a subscriber for this interesting [article](#) by Shaun Polczer, covering the ambitions of Indian companies to increase their exposure to Canadian energy resources. Here is a section:

After two years of hunting the oilsands for acquisitions, India plans to pull the trigger on a multibillion-dollar deal this year, government officials told the World Petroleum Congress on Thursday.

"Indeed, we are going to get more actively engaged in the Canadian tar sands in the next six months, we are looking at opportunities," said M. S. Srinivasan, India's Petroleum Secretary.

He said India would prefer to acquire assets over producing companies on a magnitude of at least \$2 billion to \$2.5 billion.

"Size does matter," he continued. "We would like to be going for an economically viable size; too small an acreage may not be a commercially viable proposition."

India is currently the world's fifth-largest consumer of energy and accounts for almost four per cent of the world's energy consumption. Like other emerging economies, it has been scouring the globe for oil and gas supplies to fuel its growth.

In a speech to the congress - which wrapped up Thursday - Oil Minister Murli Deora said India needs ever-increasing oil and gas reserves at home and abroad to sustain economic growth of nine to 10 per cent per year.

"India's energy needs are growing as income levels and population are both rising. Our main focus is to enhance energy security for the country," he said.

Although its domestic production is expected to jump 30 per cent over the next five years, it still won't be enough to feed its economic development.

The country has been looking for an entry into the oilsands for more than two years.

My view - Oil executives are still coming to grips with the potential for a generational long expansion in energy demand; medium-term corrections notwithstanding. This can be seen from the continued reluctance to make the investment needed to rapidly expand oil sands production, whether that is

through the provision of more power plants or the construction of basic infrastructure to facilitate the growth of the industry.

In the meantime, governments in India and China are losing no time securing long-term reserves, which they anticipate needing to fuel their rapidly expanding economies in the coming decades. If they are so positive about their future needs and are literally staking the financial wellbeing of their countries on this growth, why do investors still doubt the extent of growth in energy needs and not build today rather than waiting paying even higher construction costs later?

Email of the day (1) - on draw-downs in commodity related instruments:

"If you can please comment on the sudden, sharp down moves in mining & metals, basic materials and coal as typified by [IYM](#), [XME](#), and [FDG](#) (NYSE) respective charts. Thanks, as always for your calm analysis."

My comment - Commodity related investment vehicles have been some of the best performers in relative and absolute terms over the last few months. Those you mention, as well as a number of commodity related country indices and also a number of actual commodities have come under some selling pressure in the last few days. This is at least in part due to contagion selling, where winning positions are sold to plug holes left by losing positions being closed. (See yesterday's [Comment of the Day](#) for a more detailed explanation) This only tends to happen towards market bottoms and while we have yet to see the upward dynamics that would characterise a short covering rally - we shouldn't be surprised when they appear.

Email of the day (2) - on meditation:

"Just a quick one on meditating, I read before how Ed Seykota used meditation to help clear his thoughts on investing. I'm wondering did you (or any of the collective) ever do likewise and if so was it useful? I have an opportunity to study it a bit and would some feedback.

"P.S. could you update the iShares Asia Trust - MSCI China Tracker (HK)."

My comment - Thank you for this interesting email. I wrote my undergraduate thesis on whether thought was possible without language. Part of the research surrounding this question was whether hypnosis could be used as a practical application to make someone forget language. Unfortunately, I wasn't much of a test subject because I couldn't enter a deep trance. However, the self-hypnosis techniques I learned are akin to meditation and useful in times of stress. I believe spending some time to relax and reflect would be a worthwhile investment.

Anything that helps us to distinguish between what is an emotionally motivated conclusion rather than an analytical one is to be valued. We tend to be at our most emotional and therefore least analytical at major tops and

bottoms. The challenge at these emotional extremes is to recognize them for what they are and act accordingly.

The [iShares Asia Trust - MSCI China Tracker](#) has now been updated correctly.

Today's interesting charts - The Chart Library contains a large number of sector indices which can also be viewed relative to hundreds of different benchmarks.

Natural Gas - breaks the [progression](#) of rising lows which has been the hallmark of the move to date. A sustained move to new high ground is needed to offset scope for some further downside.

Irish Financial Index - remains in an orderly [downtrend](#) but is now accelerating. This is probably climactic but an upward dynamic would be needed to check momentum beyond a brief pause.

Taiwan - fifth straight week on the [downside](#) and looking overextended. However an upward dynamic is needed to signal that demand is returning.

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

"Please add European Goldfields [EGU](#) to Toronto"

My comment - This has been added to the Chart Library.

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

"Please can you add the S&P ETF which is a short interest fund to the library? The ticker is [SH](#)."

My comment - This was already in the Chart Library. In fact, if you put 'Proshares' into the international Equity Library's [search](#) engine it will give you a full list of their funds.

Wednesday 9th July 2008

Alex Seagle's the Contrary Investor: Is This a Stag Party? - This is always a thoughtful, informative [letter](#), written by Alex Seagle of Fraser Management Associates. Here is a brief sample:

So if an investor believes stagflation is a very real possibility, the question becomes what will profit from stagflation. One amusing, and perhaps correct answer the Contrary Investor heard at an investment conference last month was "anything you can touch, feel, burn, eat or hurts your foot if you drop it." This definition essentially boils down to hard assets like gold or commodities, both of which have seen substantial, if not historic, run-ups in price. In fact,

there is robust debate on whether these asset classes are experiencing a speculative bubble.

A very interesting exercise the Contrary Investor witnessed recently was designed to show some institutional investors how speculative bubbles form, why intelligent does not equate to rational, and why market prices can far exceed intrinsic value. The speaker auctioned a \$100 note, offering it to the best bid with the binding covenant that the 2nd and 3rd highest bidders MUST also pay but receive nothing. Sure enough \$5, then \$10 bids started things off, but it was not long before the bids went far above \$300! This despite those bidding were financial professionals with an alphabet soup of qualifications after their names and knowing, with certainty, that the value of the asset was just \$100. With the value uncertain, the behavior becomes more extreme. The actions of those who bid \$90 and \$95 when someone else bids \$100 are fascinating. In many parts of the world there are still \$300 bids for \$100 securities going on right now.

My comment - [This issue talks about stagflation investments, contains a major section on medical Real Estate Investment Trusts \(interested parties may wish to vet the individual REITs mentioned on the basis of relative chart performance\). There is also some more information on Fraser's 46th Annual Contrary Opinion Forum at Basin Harbor, Vermont, from October 8th - 10th, where I look forward to speaking this year.](#)

Email of the day (1) - [Contrarian event, G8 and precious metals:](#)

"We will likely be in Maine again this year and perhaps run over to Vermont for the Contrarian event -- in which case we hope to see you.

"David, I would appreciate any response from you on this aggravating subject. Memory serves me, on contemplation, that my positions take an ugly, though usually short term, hit in and around G7 (now G8), meeting times. Is it an EFFECT that you have noticed or in which your concurrence can be researched easily or is it that, generally, I am in precious metals, currencies or indexes that those people don't like! Maybe the " Effect" is as consistent as "Seasonality" or other predictables. What say you?

"Since re-subscribing I have appreciated your perspective in this hard year for equities."

My comment - [Welcome back to Fullermoney and many thanks for your kind words.](#)

[I am delighted to hear that you are considering attending the Contrary Opinion Forum \(see further details in the letter above\), as it would be great fun to see you both. The more I talk to Alex Seagle about this event, the better I feel about it. Clearly, it is nothing like the many aggressively commercial conferences that I stopped attending long ago. I have also heard favourable comments from a subscriber-friend in London who is attending once again this year.](#)

G8 does have a low key agenda for supporting the [USD](#), mainly by jawboning. This does weigh on gold temporarily but it also tells us that the greenback is on the financial equivalent of emergency life support. Seasonally, this is usually a period of consolidation for gold, as you may realise. However I am encouraged by the overall performance ([weekly](#) & [daily](#)), and would not be surprised to see renewed strength in 4Q 2008 and 1Q 2009.

Iran Test-Fires Missile Capable of Reaching Israel - [Here is the opening from this report by Bloomberg](#):

Iran test-fired its long-range Shahab 3 missile, capable of reaching Israel, as part of war games today, Iran's Arabic state television Al-Alam reported.

Iran ``test-fired successfully the Shahab 3 missile with a 2,000-kilometer (1,240-mile) range and a one-ton weight at 8 a.m. local time," the channel said in a report on its Web site.

The test is part of war games being held by the Revolutionary Guards Corps in the Persian Gulf, it said. Nine missiles ``with improved accuracy" were tested during the exercises, including the Zelzal and the Fateh with a range of 400 kilometers and 170 kilometers respectively, Iran's English- language Press TV reported on its Web site.

My view - [The oil price](#) now shows a diminishing return in response to these missiles, actual and verbal. Veteran subscribers may recall that a perceived 'crisis' has to be visibly worsening, to remain an important influence on market sentiment.

Tim Price: The perils of market timing - [Published by PFP Wealth Management](#), these [reports](#) are always controversial, refreshingly candid and witty. This latest edition is no exception. Here is a section:

Dan Gross of Slate Magazine wrote about the hurdles facing any very large fund in 2005, when the then manager of Magellan, Robert Stansky, resigned:

"When you have to buy as much as they do, it?s difficult to open and close positions quietly. Hedge funds and other quick-fire traders are constantly trying to suss out which stocks the big dogs are buying and selling and how they can profit by jumping in and out ahead of them. And unless you want to buy hundreds upon hundreds of positions - in which case you?re essentially mimicking the broader market - a huge mutual-fund manager has to confine himself to huge stocks. Magellan has 207 positions, and its top 10 holdings are the same giant stocks that everybody owns.."

As we said at the time, beyond certain levels, size is an insurmountable barrier to ongoing investment success. (Buy the products of entrepreneurial boutiques.) This facet of the business will continue to haunt the major players in both traditional assets and hedge funds and funds of hedge funds for years (those that survive this bear market, that is).

Now that all asset markets are facing more challenging times, it makes sense to revisit some comments made by Yale endowment CIO David Swensen, in an op-ed piece for the New York Times, again in 2005:

"Unfortunately, the track record of individual investors with plain-vanilla mutual funds fails to inspire confidence. Actively managed mutual funds overwhelmingly fail to beat the market. In a well-structured study published in 2000, an investment manager, Robert Arnott, showed that over a two-decade period, excessive management fees and frantic portfolio trading reduce the chance that a mutual fund investor will beat the market to less than one in seven."

"Most mutual funds do not produce even minimally acceptable results because of the conflict between the mutual fund company's profit motive and the mutual fund manager's fiduciary responsibility. Mutual fund companies profit by gathering assets, charging high fees and churning portfolios. Mutual fund managers produce superior investment returns by limiting assets, assessing low fees and trading infrequently. In case after case, profits trump returns. The mutual fund manager abrogates fiduciary responsibility for personal gain."

Not that every fund manager is a greedy incompetent, just most of them. But in such an acutely difficult market environment, if you have to own third party funds, you will probably do significantly better not by buying the biggest, but by thinking small.

The key challenge today is not in accessing the market: plenty of low cost ETFs will enable you to do that at a stroke, with the likelihood of superior performance compared to the average asset manager. The critical challenge now lies in asset allocation, and particularly in moving money away from those areas where it is most vulnerable.

My view - The key question every investor needs to ask concerning any fund is: Does the manager add value? With long-only, unleveraged funds, one can increasingly measure performance against an ETF or other form of tracker.

If the answer is yes, the fund is a viable candidate for consideration, assuming one also likes the market in which it concentrates. If the answer is no, an ETF or other similar tracker is obviously preferable for the reasons stated above.

With leveraged funds, it is a good idea to be aware of how much leverage the manager can use in pursuit of performance. I would also expect a rollercoaster ride from time to time, as with most speculations.

Email of the day (2) - On commodity stocks:

"David...the commodity stocks are down 20% plus in most cases....at this point would you buy ...sell...or... hold?"

My comment - My guess is that you are referring to the big industrial miners, such as [BHP Billiton](#) and [Rio Tinto](#). After a period of phenomenal relative performance, they encountered some capitulation selling recently. I am definitely holding my positions, and I have often said that they were best purchased following setbacks.

Meanwhile, the global equity environment remains difficult, for all the reasons previously mentioned. However we currently have an oversold condition. The price of crude oil - remember my seesaw description, with crude on one side and stock markets on the other - will have a big influence on whether we see no more than a dead cat bounce for stock markets in an ongoing downtrend, or something considerably stronger over the next few weeks.

My personal portfolio: Long positions opened in DAX and S&P stock market futures - The [German DAX Index](#) purchase occurred late yesterday evening, after I had posted Comment of the Day, although I was able to mention it in the Audio. I bought a September position at 6439. Early this afternoon, I bought the [S&P 500 Index](#), paying 1269.88 for a September position. These prices include spread-bet dealing costs.

I am obviously expecting (hoping for) a technical rally, in response to the oversold conditions discussed recently. I could have purchased both indices more cheaply this evening but probably have to expect a bit of choppy action as we so often see at market lows. Nevertheless today's late weakness on Wall Street is disappointing and I will have to reassess if the lows are taken out for more than a day or two.

Today's interesting charts - Fullermoney has one of the biggest, customisable chart libraries available, with over 17,000 instruments.

USA (S&P 500) - Yesterday saw the biggest [up day](#) in over a month, in the region of the January and March lows. However those gains were more than retraced today and a move above 1300 is required to break the short-term downward trend.

Vietnam - Leading the recent [rally](#) such as it is, and still very overextended relative to its [200-day MA](#); a new closing low would be required to offset current scope for sideways to higher ranging.

China (Shanghai A) - Back above the psychological 3000 [level](#) and similarly overextended against its [MA](#); here also a new closing low is required to offset sideways to higher trading.

Please note - I will be away tomorrow but back on Friday.

Additional Commentary by Eoin Treacy

Copper - Carpe Diem - Thanks to a subscriber for this interesting [report](#) by Alan Heap and Alex Tonks for Citigroup, which includes a wide array of charts. Here is a section:

Cost Imposts - Electricity

The looming global power crunch has implications for copper production, especially in Chile.

Chile produces 35% of world copper supply.

There are two power challenges: gas, and water (for hydro).

The northern Sing grid supplies 85% of Chile's copper produces and is gas powered.

Gas supplies from Bolivia and Argentina have been curtailed forcing Gas Atacama (the utility) to use diesel.

In April the copper companies provided US\$650m to keep diesel supplies available until 2011.

Longer term solutions entail onshore LNG regasification and new coal fired power stations (planned by the copper companies).

Copper production in Chile is becoming more power intensive, especially through increased requirements for desalination and pumping.

Cost Imports - Power in Central Africa

Power supply problems in Central Africa revolve around their dependence on imported supply, as well as problems in supply from local utilities.

In the Zambia, Copperbelt Energy Corp. has enforced some load shedding, but so far most problems have affected cobalt production , rather than copper.

Power rationing was increased following supply issues from the DRC due to a line outage. The DRC is a power exporter to Zambia and Zimbabwe. The national power utility SNEL producing all power supplies from Hydro on the Congo River. While DRC has excess power access to the grid can involve substantial capex.

Cost Imports - Water

After shortages threaten production - in China and Latin America in particular.

And in different ways - power supply (hydro power) and processing water.

Water is required for both hydro power and for mineral processing.

My view - The supply of copper and indeed most other metals are hostage to the lack of investment, over decades, which led to necessary infrastructure projects being neglected. This lack is being felt by the now flourishing mining industry. Copper's advance has been written off as a cyclical rather than

secular move by a range of analysts. However, this does not take into account that the nominal cost of production continues to rise due to infrastructure, materials and labour bottlenecks. These issues will not be resolved quickly and have helped to support prices over the last two years and continue to do so now.

[Copper](#) has been in a ranging phase for much of the last two years following the impressive acceleration in 2006. Some commentators prefer to describe this as a lengthy topping out process and, while we are not in that camp, they will not be proved wrong unless copper sustains a move to new high ground.

In the last 6-months, copper has been in a tight consolidation beneath the \$4 level and has broken upwards on two occasions; only for the gain to be immediately countermanded. The most recent upward break was in the last week. Volatility has increased considerably due to this whipsaw trading, but a sustained move below \$350 would be needed to suggest that this anything other than a consolidation beneath the highs.

Sugar May Rise on Less Supply From India, EU, ISO's Rocha Says - [This article](#) by Feiwen Rong and Claire Leow for Bloomberg covers the recent strength in sugar prices and examines some of the main supply / demand dynamics. Here is a section:

Sugar may extend gains on expectation that farmers in India and the European Union may switch to other crops, paring global supply and helping narrow a surplus which depressed prices for the past two years.

India, the world's second largest producer, may cut output by up to 4 million metric tons to 22 million tons next season ``as a result of less cane availability," Leonardo Rocha, an economist at the International Sugar Organization, said in an interview yesterday in Singapore. The European Union may reduce output by about 2 million tons next year, he said.

Raw sugar futures traded in New York were the worst performer after zinc in the past two years on the UBS Bloomberg Constant Maturity Commodity Index as growers from Brazil to India boosted output after prices rose to a 25-year high. The sweetener gained 41 percent in the past month.

``I see sugar prices going up," Rocha said. ``The surplus being talked about in the sugar market is estimated at 8 million tons now, and that surplus could disappear next year if you remove up to 6 million tons from the supply while consumption is growing at a rate of 3 million tons every year," he said.

Raw sugar futures traded on ICE Futures U.S., the former New York Board of Trade, rose 1.7 percent to 13.75 cents a pound yesterday. The most-active contract closed at a 25-year high of 19.3 cents a pound on Feb. 3, 2006.

India may grow less sugar cane this year, farm secretary P.K. Mishra said yesterday in New Delhi. The crop was planted on 4.3 million hectares (10.6

million acres) by July 4, 17 percent less than a year earlier, the ministry has said.

My view - Brazilian sugar supply, and the comparative benefits to cane producers of either selling their product on the open market or creating ethanol, is a key determinant in how high the price of sugar can rise.

The [Brazilian](#) ethanol contract broke upwards from an eight-month range in June and rallied to \$585. It has since encountered some resistance and appears to be consolidating its gain. A sustained move below \$500 would be needed to question this proposition.

[Sugar](#) traded on the ICE, accelerated to a high near 20¢ in early 2006 before more than halving and bottoming near 8.6¢ in mid-2007. Sugar rallied significantly from the beginning of the year and topped out in early March with a number of other soft commodities. It found support near 10¢ and remains in a short-term uptrend which is testing the 15¢ level once again. A sustained move below 13¢ would be needed to question the integrity of this consistent uptrend.

The relative comparison of sugar to ethanol is hampered by the lack of longer-term data for the Brazilian ethanol contract. However, the US traded [contract](#) has performed [similarly](#) to the Brazilian contract and is a suitable substitute for relative analysis in my opinion.

Sugar has been trading in a range [relative](#) to ethanol for much of the last two years but has encountered resistance at marginally lower levels over the last couple of years. The region of 6.6 has been important on three separate occasions. The latest high was at 6.48 in late February. At the lower side of the range, sugar found support near 4 on a number of occasions since 2005.

The commodity is currently rallying, having recently found support near the lower side of the range and would need to sustain a move below 4 to question scope for an eventual test of the upper side of the range.

Today's interesting charts - A number of significant global indices are in the region of their January / March lows. They can all be found in the Chart Library.

FTSE-100 - finding [support](#) near the January and March lows but needs to sustain a move above 5600 to break the 6-week downtrend and progression of lower highs.

India - [rallied](#) to break the short-term downtrend but needs to sustain a move above 15,000, pushing back into the prior range, to indicate that the bulls have regained the upper hand.

Dollar Index - [continues](#) within the three-month trading range and would need to sustain a break below 72 to suggest further Dollar weakness.

Email of the day (1) - [on an addition to the Chart Library](#):

"Would you please add the Australian Listed Property Index (XPJ) to the chart library? This sector has fallen a quite remarkable 50% in 9 months, sits on a current yield of about 11% and a price to book of about 0.6. The chart still looks dismal but some remarkable value must be accruing."

My comment - Thank you for this interesting suggestion. I couldn't find any instrument on Bloomberg with XPJ as a ticker, but I added the [S&P/ASX 200 Property Trust Index](#) and the [SPDR S&P/ASX 200 Listed Property ETF](#).

The Index has a P/E of 5.17 and yields 9.4%. I don't have a figure for the average P/E for the fund but its net yield, according to Bloomberg, is 12.52%. Of course, the yield is increasing as the price of the fund falls - assuming that cashflows are a constant.

Perceptions of value are relative and would depend on your view on how well the individual trusts will be able to maintain their dividends in the coming years. A major problem for similar vehicles in the UK has been leverage

The Index remains in a consistent downtrend which although overextended and looking potentially climactic, would need an upward dynamic to check momentum beyond a brief pause.

Email of the day (2) - [on an addition to the Chart Library](#):

"Can you please add charts for New Gold, ([NGD](#)) listed on TSE exchange?"

"Many Thanks"

My comment - Thank you for this suggestion which has now been added to the Chart Library.

Thursday 10th July 2008

Commentary by Eoin Treacy

Fannie, Freddie Tumble on Bailout Concern, UBS Cut - [This article](#) by Dawn Kopecki and Shannon D. Harrington for Bloomberg covers the recent weakness in Fannie Mae and Freddie Mac. Here is a section:

Fannie Mae and Freddie Mac, the two biggest providers of financing for U.S. home loans, fell to the lowest levels in 17 years in New York trading after a former Federal Reserve president said the companies may need a government rescue.

Fannie Mae tumbled as much as 24 percent and Freddie Mac slumped as much as 34 percent in New York Stock Exchange composite trading after UBS AG analysts said in a report today that Freddie Mac's decline creates

``challenges" for the company's plan to raise \$5.5 billion.

Chances are increasing that the U.S. will bail out Fannie Mae and Freddie Mac because they don't have enough capital to weather the worst housing slump since the Great Depression, former St. Louis Federal Reserve President William Poole said in an interview. Freddie Mac owed \$5.2 billion more than its assets were worth in the first quarter, making it insolvent under fair value accounting rules. The fair value of Fannie Mae assets fell 66 percent to \$12.2 billion, data provided by the Washington-based company show, and may be negative next quarter, Poole said.

``Congress ought to recognize that these firms are insolvent, that it is allowing these firms to continue to exist as bastions of privilege, financed by the taxpayer," Poole, 71, who left the Fed in March, said in the interview yesterday.

Poole roiled markets in 2003 when he said the government should consider severing its implied backing of Fannie Mae and Freddie Mac and the companies lack the capital to weather financial market disruptions. In 2006 and 2007 he called for lawmakers to strip Fannie Mae and Freddie Mac of their charters.

My view - [Fannie Mae](#) and [Freddie Mac](#) are being priced as if they are going to go out of business. As rational investors, we have to ask ourselves if the Fed and Treasury will allow this to happen, when they rescued Bear Stearns; a minnow in comparison to these behemoths.

We are drawing closer to a time when a decision will have to be made about the future of these companies, but one way or the other it will require a massive injection of liquidity to avert a further deterioration of the current crisis. This may be a catalyst to signal at least a technical rally in stock markets, whenever it occurs.

My Plan to Escape the Grip of Foreign Oil - Thanks to a subscriber for this interesting [article](#) by T. Boone Pickens which appeared in the Wall Street Journal and outlines his plan to curb America's reliance on imported oil. Here is a section:

Consider this: The world produces about 85 million barrels of oil a day, but global demand now tops 86 million barrels a day. And despite three years of record price increases, world oil production has declined every year since 2005. Meanwhile, the demand for oil will only increase as growing economies in countries like India and China gear up for enhanced oil consumption.

Add to this the fact that in many countries, including China, the government has a great deal of influence over its energy industry, allowing these countries to set strategic direction easily and pay whatever price is needed to secure oil. The U.S. has no similar policy, because we thankfully don't have state-controlled energy companies. But that doesn't mean we can't set goals and develop an energy policy that will overcome our addiction to foreign oil. I have

a clear goal in mind with my plan. I want to reduce America's foreign oil imports by more than one-third in the next five to 10 years.

How will we do it? We'll start with wind power. Wind is 100% domestic, it is 100% renewable and it is 100% clean. Did you know that the midsection of this country, that stretch of land that starts in West Texas and reaches all the way up to the border with Canada, is called the "Saudi Arabia of the Wind"? It gets that name because we have the greatest wind reserves in the world. In 2008, the Department of Energy issued a study that stated that the U.S. has the capacity to generate 20% of its electricity supply from wind by 2030. I think we can do this or even more, but we must do it quicker.

My plan calls for taking the energy generated by wind and using it to replace a significant percentage of the natural gas that is now being used to fuel our power plants. Today, natural gas accounts for about 22% of our electricity generation in the U.S. We can use new wind capacity to free up the natural gas for use as a transportation fuel. That would displace more than one-third of our foreign oil imports. Natural gas is the only domestic energy of size that can be used to replace oil used for transportation, and it is abundant in the U.S. It is cheap and it is clean. With eight million natural-gas-powered vehicles on the road world-wide, the technology already exists to rapidly build out fleets of trucks, buses and even cars using natural gas as a fuel. Of these eight million vehicles, the U.S. has a paltry 150,000 right now. We can and should do so much more to build our fleet of natural-gas-powered vehicles.

I believe this plan will be the perfect bridge to the future, affording us the time to develop new technologies and a new perspective on our energy use. In addition to the plan I have proposed, I also want to see us explore all avenues and every energy alternative, from more R&D into batteries and fuel cells to development of solar, ethanol and biomass to more conservation. Drilling in the outer continental shelf should be considered as well, as we need to look at all options, recognizing that there is no silver bullet.

I believe my plan can be accomplished within 10 years if this country takes decisive and bold steps immediately. This plan dramatically reduces our dependence on foreign oil and lowers the cost of transportation. It invests in the heartland, creating thousands of new jobs. It substantially reduces America's carbon footprint and uses existing, proven technology. It will be accomplished solely through private investment with no new consumer or corporate taxes or government regulation. It will build a bridge to the future, giving us the time to develop new technologies.

My view - [With the price of oil well in excess of where the majority of people ever expected to see it, the debate about substitution is growing more heated. Against this background, Boone Pickens has a good chance of making energy independence a central issue in the upcoming election.](#)

[Wind energy remains expensive to set up but, in relative terms, is getting cheaper as oil prices climb and technology improves. Vestas Wind Systems and other windmill companies are benefiting from the increased interest in the](#)

sector and are priced for growth. Vestas remains in an overall uptrend, and while it is currently pulling back from Kr700, a sustained move below Kr500 would be needed to question the integrity of the overall uptrend.

[First Solar](#) surged to a high near \$280 in late 2007 and continues to consolidate its move. It is also priced for growth, but the [P/E](#) has been coming down from its stratospheric heights over the last few years. It needs to sustain a move above \$300 to reassert the overall uptrend.

On the demand side, natural gas powered cars remain a novelty, but the cost of gasoline is a powerful motivation for consumers to consider alternatives. This [article](#) from gas2.org covers the growth of the CNG fuel market in Utah. Here is a section:

There are about 1500 CNG refueling stations in the US, which is about the same number of commercial stations offering E85 ethanol blends. Utah has a total of 91 CNG filling stations, most of which are reserved for commercial fleet use, but there are 20 open to the public. According to an article by the Associated Press, you could drive Utah from top to bottom and hit 22 different stations offering compressed natural gas.

The NGVA also says there are 50 different manufacturers producing 150 models of light, medium and heavy-duty vehicles and engines that run on compressed natural gas. Unfortunately, there's only one for sale to individuals, Honda's Civic GX, and it's only offered in California and New York (although Utah could be next on the list). California ranks highest in number of CNG refueling stations, but fuel prices are also higher-more like \$2.50 per gallon.

There's so much demand now in Utah for CNG-ready vehicles that Honda can't make them fast enough. Savvy customers are buying the vehicles from other states and shipping them back for sale. But waiting for a new Honda Civic GX to roll off the assembly line isn't the only option. It's also possible to convert a used vehicle to run on natural gas, like Utah Gov. Jon Huntsman, who converted his state-owned Chevy Suburban. And for either used or new vehicles, the tax incentives are substantial. Combining state and federal tax credits in Utah can almost completely offset the approximately \$7,000 difference in price between regular and CNG-ready vehicles.

It makes sense, to generate as much renewable energy as possible to cut the cost of importing vast quantities of foreign oil. Increasing the variety of the energy mix in favour of what can be developed domestically is sensible for any country, as long as oil remains in a secular bull market. The obvious conclusion is that the wind, solar, biomass, geothermal, nuclear, ethanol, coal-bed methane, oil sands etc. can all be considered growth industries over the long term.

Buy Petrobras Preferred, Sell Common a Top Trade - Thanks to a subscriber for this interesting [article](#) by Alexander Ragir for Bloomberg, covering the

arbitrage between Petroleo Brasileiro SA common and preferred shares. Here is a section:

The best trade in Brazil may be buying preferred shares of Petroleo Brasileiro SA, the nation's biggest company, and betting its common stock will fall after international investors pushed up prices 19 percent since March.

Common shares of the Rio de Janeiro-based company, the world's fourth-largest oil producer by market value, cost 22 percent more than its preferred, the biggest price difference since at least 1994, according to data compiled by Bloomberg.

Petrobras, as the company is known, rose to a record in May after announcing the largest oil discovery in the Western hemisphere in three decades.

The expanding gap prompted hedge funds Ciano Investimentos Gestao, Mercatto Gestao de Recursos and Neo Gestao de Recursos to bet in the past three weeks that prices will converge. Petrobras, the most heavily traded Latin American company on the New York Stock Exchange, is controlled by the government, so common shareholders get no say in company decisions and a sale is prohibited by Brazil's constitution.

“The premium for common shares isn't justified and we can't find any good reason that it widened so much,” Felipe Taylor, a portfolio manager at Ciano Investimentos Gestao, the \$142 million Sao Paulo hedge fund managed by former central bank chief economist Ilan Goldfajn. “It's a good opportunity to short the common and buy the preferred.”

Short sellers borrow shares and sell them, hoping to replace the stock at a lower price and pocket the difference.

Petrobras preferred shares fell 2.9 percent to 39.44 reais in Sao Paulo trading at 9:26 a.m. New York time. The common shares declined 2.7 percent to 48.40 reais.

Virtually Identical

Investors outside Brazil mistakenly assume common shares of Petrobras are worth more than the preferred, even though the securities are virtually identical, according to Credit Suisse Group AG analyst Emerson Leite.

American depositary receipts on Petrobras common stock surged 81 percent in the past year, surpassing the 68 percent gain in the preferred ADRs. An average of 17.9 million common ADRs trade daily on the NYSE, more than double the preferred shares. That's the most of any Latin American company, according to data compiled by Deutsche Bank AG.

Petrobras's market value of \$249.6 billion makes it the sixth-largest company in the world, according to data compiled by Bloomberg. The only bigger oil producers are Exxon Mobil Corp., based in Irvine, Texas, PetroChina Co., based in Beijing, and Moscow's OAO Gazprom.

My view - The spreads between the common and preference shares quoted in [Brazil](#) and the [USA](#) show the same widening pattern. While investors are now betting that this trend is about to reverse, there is no chart evidence, just yet, to support that view. The downtrend remains relatively consistent, with a progression of lower highs and this sequence would need to be broken to offset scope for the differential to become even wider. In the absence of a compelling fundamental reason for this disparity arising, it would appear to be only a matter of time before investors begin to close this arbitrage.

Email of the day - [on meditation](#):

"I thought I'd weigh in on the subject of meditating. I practice transcendental meditate (TM) twice daily and can report that it does help to keep the analytical cool in times of uncertainty and stress. When combined with years of experience in watching the markets go through the ups and downs it is especially valuable."

My comment - [Thank you for this thoughtful contribution](#).

Technical Speculator: Tax on commodity-based ETFs - [Thanks to a subscriber for this informative article covering the tax implications for US citizens of exchange traded funds that invest in futures. Here is a section:](#)

It appears that commodity ETFs that use futures contracts are generating thousands of dollars of "phantom income" by incurring a tax liability without producing income. So far, I have identified a number of ETFs that fall into this tax trap situation. They include PowerShares DB Agriculture (DBA) and PowerShares DB Commodity Index Tracking Fund (DBC).

"Years ago, commodities generally were for hedgers and speculators," said Kevin Rich, a managing director at Deutsche Bank who directs its PowerShares DB commodity ETFs.

Unlike investing in equities, in which you own the stock until you decide to sell it, for individual investors, it is impractical to own the commodity if you invest in futures contracts, Rich explained. To stay invested in futures contracts, an investor would need to buy new ones to replace expiring contracts, he added.

The Internal Revenue Service (IRS) taxes futures investments differently than equity investments. In contrast to equities that remain unsold, holdings in futures contracts and T-bills are marked-to-market at the end of each year. As a result, there is a tax consequence on commodity ETF investments even if they have not been sold yet. This leads to the cost basis of these investments being adjusted at the end of each year, Rich explained.

One way to avoid these tax issues is to use an IRA or other tax-deferred accounts for commodity ETFs, rather than putting them into taxable accounts, Rich said.

Deutsche Bank had more than 380,000 different investors who owned its commodity ETFs in 2007, and each of them received a K-1 to complete their tax returns, Rich said. To assist those investors, Deutsche Bank provides a toll-free phone number, 1-800-578-8755, for them to call with any questions. The investment firm also tries to send out all of the K-1 forms it needs to distribute no later than the second half of February to help its investors ready their tax returns in time.

High returns for commodity ETFs since last year are helping to draw a significant amount of additional investment dollars into commodity ETFs. Institutional money also has moved into commodities in recent times because generally speaking, commodity investments do not exhibit a high correlation with overall market returns.

For commodity investors who do not want to receive K-1 forms that could surprise them with unexpectedly high tax liabilities, DB recently has begun to offer exchange-traded notes (ETNs) that invest in commodities. The returns of ETNs are reported on 1099 forms. The ETNs have the transparency of ETFs but the notes guarantee the investors a return that matches the index that they follow, Rich said.

Three gold notes were introduced by Deutsche Bank during February. Four agricultural notes were launched during the first half of April, while four diversified commodity notes were unveiled on April 29.

For investors who are concerned that commodities will not go up forever, Deutsche Bank recently began offering funds that allow investors to go short on these investments. These so-called inverse funds include leveraged products that give twice the exposure to losses or gains than the amount that is invested.

For investors who want to diversify into commodities, beware of the tax trap with funds that use futures contracts. If you want to steer clear of the year-end tax uncertainty, those who seek commodity exposure may want to consider using tax-deferred accounts for such ETFs or just buying ETNs.

My view - [Subscribers may also be interested in a Fortune magazine article that appeared in Comment of the Day on January 3rd.](#)

Today's interesting charts - [The Charting tool allows you to save Preset templates so they can be applied to any instrument at a later date with a minimum of hassle.](#)

S&P500 Diversified Financials - remains in an overall [downtrend](#) which has been rivetingly consistent. An upward dynamic, breaking the short-term trend, would be needed to check momentum beyond a brief pause.

Lead - [breaks](#) the four-month downtrend and would need to sustain a move below \$1500 to question scope for further upside.

Hang Seng - [testing](#) the lower side of the six-month [range](#) and would need to sustain a move below 20,000 to question scope for further lateral ranging.

Email of the day (2) - [on an addition to the Chart Library](#):

"Would you do me the favour of adding China National Building Materials, [3323](#) HK,

"Thanks."

My comment - [Thank you for this suggestion, which has now been added to the Chart Library.](#)

Please note - [David is away today and returns tomorrow.](#)

Friday 11th July 2008

"Shock as China export growth falls" - [My thanks to a subscriber for this article by John Garnaut for the Sydney Morning Herald. Here is the opening:](#)

CHINESE export growth has slowed to its lowest rate in at least five years, raising new risks for the world economy.

China's export volumes grew just 7 per cent in the year to June - down from sustained growth rates above 20 per cent before the middle of last year - and they are likely to fall further as key markets in the United States and Europe continue to deteriorate.

"It's signalling that by the end of the year we'll have zero export growth," said Stephen Green, an economist with Standard Chartered Bank in Shanghai.

China's gross domestic product grew 11.9 per cent last year, of which net exports made up 2.6 percentage points.

Yesterday's figures show the volume of Chinese imports rose 9 per cent from a year earlier.

But the "real" trade figures mask a larger income shock caused by China's rapidly deteriorating terms of trade.

Exports for the year to June rose 17.6 per cent in US dollar values while imports soared 31 per cent, as China begins to cover huge new price rises for iron ore as well as other imported commodities, like oil.

"China's terms of trade is deteriorating quite rapidly; it's quite the opposite of Australia," said the chief Asia economist for Citigroup, Huang Yiping. "You just shift the denominator and the numerator for Australia."

Li Jian, an economist with the Academy of International Trade and Economic

Co-operation under the Ministry of Commerce, said China's small and middle-sized enterprises were hurting.

"The accelerated appreciation of the yuan, a funds shortage, continued price rises of raw materials and labour cost increases have forced more and more enterprises into financial loss or bankruptcy," he told Xinhua news agency.

But investment is strong, consumer spending rising and many experts say the export slowdown is helping to rebalance the economy for more sustainable growth.

"The trade surplus reached about 11 per cent of GDP last year - it had to adjust," said Song Guoqing, of Peking University, one of China's most respected economists.

"There is some probability that the economy will slow too quickly, but also that inflation will persist for some time," said Professor Song. "That suggests to me that policy is just about right."

China's huge monthly trade surplus fell to \$US21.4 billion (\$22.3 billion) in the month and \$US58.1 billion for the June quarter - down 11.9 per cent from a year earlier.

Leaked inflation numbers suggest consumer prices rose 7.1 per cent in the year to June, down from a peak of 8.7 per cent earlier in the year.

Food prices appear to have peaked and the Government is able to dampen rising import prices with subsidies and price controls on energy and grain.

Next week's GDP figures are likely to show reported growth has slowed to about 10 per cent.

"A little bit of a slowdown is a good thing," said Dr Huang. "The question is how much."

My view - We could summarise this as: China has a problem - the western economies are in trouble!

I recall reading that there were over 600 manufacturing companies in the US automotive industry in the late 1920s. In a much more recent example, there were hundreds of little technology start-ups just before the dotcom bubble burst, and many have not survived.

Similarly, I do not think anyone expected thousands of small family run and often one product engineering companies, toy manufacturers or small assembly firms to all survive in China, despite its impressive GDP growth.

The test for China's economy will be to see how successfully companies consolidates within industries, move up the manufacturing ladder and develop global brand names of their own.

I would not underrate its potential, although I think GDP growth will dip under 10%. We should have problems like that in the UK!

Meanwhile, China is an increasingly powerful creditor nation, with a firm currency, much improved banking sector and an exemplary work ethic.

[China](#) and its resources suppliers, obviously including [Australia](#), are key players in Fullermoney's two most important long-term investment themes - emerging markets and the commodity supercycle. As emerging markets thrive because they have embraced capitalism and also benefit from globalisation, they consume many more commodities. This creates unprecedented wealth in the resources exporting nations, many of which are also emerging markets, which then develop their own infrastructure.

The west's financial and economic problems, on their own, are not a major difficulty for this emerging market and resources supercycle, although they are likely to slow it slightly. However they do have a disproportionate medium-term influence on stock market performance, not least due to crowd psychology. The main current and future economic threats are in the form of energy costs, shortages and environmental problems. However these issues are as important for weak economies as they are for strong ones

My personal portfolio will remain overweight in emerging markets and resources companies. Meanwhile, China's stock market index shown above may have commenced base formation development. Australia's main index looks overstretched following the latest decline of eight consecutive weeks, but a clear upward dynamic is required to check momentum.

Email of the day (1) - On sentiment comparison with early 2003:

"On our Asian side, if I place myself back into early 2003 (the previous bottom), I would have found it equally hard to be positive about anything. The dotcom bubble had burst. US was in a recession. Real estate was in the dumps. SARS was destroying the credibility of Singapore, HK and China.

"And yet, it was a very major bottom. Are we in similar circumstance 5 years later?

"Keeping an open mind. Have closed out all my shorts."

My comment - Thanks for your perspective.

As you know, sentiment regarding various crises is usually worst at market bottoms and most optimistic at tops, due to events that do not fulfil either our apocalyptic fears or avaricious hopes.

Of course naysayers will claim that it is different this time, as it always is in one form or another. They can point to a [Hogarthian](#) Rake's Progress of fiscal and financial excesses in the USA which is arguably more serious than the

dotcom bubble. We also know that the SARS outbreak, while terrifying at the time, mercifully never morphed into the pandemic feared.

From my perspective, the USA remains the epicentre of financial risk. This does not negate the point that there are some superb American companies, particularly among the multinationals, and that valuations have improved somewhat. Until the [US bank indices](#) bottom out, I will remain wary, oversold and short covering induced technical rallies aside. I fear that the potential for US economic growth has been impaired, and although I will be guided by the price charts, I do not see why the [USD](#) should recover against this background, which will almost certainly include at least a [semi-nationalisation](#) of Fannie Mae and Freddie Mac.

Meanwhile, the biggest improvement in valuations is occurring in Asia's high-bet markets. They too have problems (doesn't everyone, perpetually, to a greater or lesser degree?) but these pale compared to what we are seeing in the west, in my view.

I know where I would rather invest, and 50% plus declines by Asian indices look to me like an invitation for investors. Tactically, I would nibble on weakness in anticipation of medium to longer-term recoveries.

Meanwhile, concern over the US dollar's problems, and those of many other fiat currencies, continue to underpin the investment appeal of [gold](#).

My personal portfolio: Silver long trade reopened - With breakeven stops now protecting my gold longs, which I did not buy particularly well, I have participated in the upward breaks from trading ranges today by repurchasing some [silver](#). I paid \$18.71 for an August position, including spread-bet dealing costs, and this is now protected by a tight breakeven stop. While I remain a long-term bull of precious metals, one cannot be too careful in this market environment. Stop Press: the silver was stopped out at \$18.72, including spread-bet dealing costs, as [crude oil](#) fell back from its latest new [high](#).

Email of the day (2) - On holiday time:

"I think this is the time of year that you and your wife will have a cycling trip. I have been a subscriber for 5 or 6 years and now based in Shanghai.

"We are going to Scotland for a week next Monday and in south England for the following week. I remember you did a cycling trip in Scotland about two or three years ago and am wondering where you will be heading this time. We plan to camp around UK so would be good to have tea or coffee with you and your wife if we happen to cross each other.

"I was introduced to your service by an old subscriber Mr. Graham Wilde and have been enjoying the Fullermoney show ever since. I am using the word "show" not in any derogatory sense (why would I pay for such a privilege?), but aren't we in the financial drama all the time? We are small players too, but

with your guidance and your show, we can sometimes take a backseat and a calm look.

"Sorry, not any intriguing question on the markets in this email. Not that I don't have any but, hey, this is a holiday time!"

My comment - That would be great fun and I thank you for your enquiry. We have cycled around the UK and usually well into Scotland for many years and have loved it, including the drama of some challenging weather. However we will not be cycling this August as our eldest daughter will be giving birth to her first child that month - a keenly awaited event!

We certainly are in a financial drama, and I am sure the Fullermoney Collective would welcome your perspective from Shanghai, should you ever wish to comment.

Quote of the week - On inflation:

"Some idea of inflation comes from seeing a youngster get his first job at a salary you dreamed of as the culmination of your career."
Bill Vaughn, courtesy of Alex

Additional Commentary by Eoin Treacy

The most unloved of commodity sectors - While oil, grains, beans, fibres, coal, potash, rubber, precious metals and others were all making headlines as they set new highs or in some cases all-time highs, one sector has been particularly unloved. If anything the most active participants have been short of this sector, however bullish interest appears to be returning now.

The industrial metals were the leading sector in the commodity complex from the beginning of the secular bull market, but have been particularly unloved for more than a year. Zinc, Nickel and Lead have more than halved while aluminium and copper have been going sideways for more than two-years. Tin was the only industrial metal still setting new highs, but even that has now moved into a corrective phase. Over the last five years, I have noticed that the industrial metals seldom advance together. One or two metals, taking clear leadership is much more common. At present, this is aluminium, with copper in close second.

Aluminium broke upwards from its two-year consolidation this week. Trading has been volatile with some rather whipsaw-like activity but, the upside can be given the benefit of the doubt as long as it sustains the move. This is a reassertion of the secular bull move and aluminium now shows the greatest potential, to go on and set significant new highs.

Copper also appears to be in the latter stages of a two-year consolidation, but it needs to sustain a move above \$9000 to reassert the overall uptrend.

Trading of late has also been volatile, exemplifying a battle between supply and demand, making this a difficult commodity to trade. However, in the absence of a break below \$7800, the risks are to the upside.

Tin was the best performer in the sector until mid-May, when it encountered resistance near \$25000 following an impressive advance from its 2005 lows. It quickly found support near \$20000, but needs to sustain a move to new high ground to reassert the overall uptrend.

Lead accelerated to a high near \$3500 in July, consolidated briefly and pushed to a new high below \$4000, where it failed. The downtrend has been relatively consistent from January, but this week's upward dynamic from near \$1500 is the largest upward move all year and has broken the short-term downtrend. A sustained move below \$1500 would be needed to question scope for a further recovery.

Zinc has also been in a consistent downtrend having topped out in late 2006 near \$4550. This week, zinc posted the largest upward dynamic since February and the upside can be given the benefit of the doubt as long as it sustains the move above \$1775.

Nickel remains the laggard of the group. It topped out near \$50000 in May 2007 following a phenomenally strong period of outperformance. It broke down from the 9-month range in May 2008 and found at least short-term support near \$20,000. A sustained move below that level would be needed to question potential for some further upside, but a sustained move back above \$25000 would be needed to indicate that the bulls are returning in force.

Fortune Magazine: The Southwest desert's real estate boom - Thanks to colleague Jackson Wong for this interesting [article](#) by Todd Woody covering the race to build solar power plants in the USA. Here is a section:

The race has barely begun - finished plants are years away - but it's blazing fastest in the Mojave, where the federal government controls immense stretches of some of the world's best solar real estate right next to the nation's biggest electricity markets. Just 20 months ago only five applications for solar sites had been filed with the BLM in the California Mojave. Today 104 claims have been received for nearly a million acres of land, representing a theoretical 60 gigawatts of electricity. (The entire state of California currently consumes 33 gigawatts annually.)

It's not just a federal-land grab either. Buyers are also vying for private property. Some are paying upwards of \$10,000 an acre for desert dirt that a few years ago would have sold for \$500.

No doubt the prospect of potential riches is overheating expectations. But California and surrounding states have mandated massive increases in renewable energy in the next few years. That has led some experts at Emerging Energy Research of Cambridge, Mass., to predict that Big Solar could be a \$45 billion market by 2020.

Meanwhile, the land rush is setting the stage for a showdown between solar investors and those who want to protect a fragile environment that is home to the desert tortoise and other rare critters. The Southwest is on the cusp of what could be a green revolution. And the biggest obstacle of all may be ... environmentalists.

My view - High oil prices have increased interest considerably in alternative sources of energy. The cost per kilowatt hour of solar power is relatively constant once the necessary infrastructure has been put in place. That is not the case for the carbon based power generation as householders continue to see in their electricity bills.

Solar power technology has come a long way in the last decade, and we can expect further efficiencies as research is concentrated on this area. Going forward, it seems inevitable that we will see a much higher proportion of solar and other alternative sources in the energy mix.

Email of the day (1) - on the potential for a short-term bounce:

"A good brief piece on the high levels of short interest in the US market covering over a third of stocks.

Encouraging. The worry, perhaps, is how frequently market commentary is grim on fundamentals but fantastically positive on the potential for a short-term bounce. If we all take the 'contrarian' stance (I am too!), who is the genuine contrarian?"

My comment - Thank you for this interesting [article](#) by Elizabeth Stanton for Bloomberg. Here is a section relevant to your comment above:

Record bets against U.S. stocks may mean the market is on the verge of a rebound fueled by purchases of shares that were sold short, according to JPMorgan Chase & Co.

So-called short interest on the New York Stock Exchange has risen 55 percent this year to a record 3.6 percent of listed shares, JPMorgan Chief Equity Strategist Thomas J. Lee wrote in a report today. In a short sale, an investor sells borrowed shares in anticipation of being able to buy them back later, or "cover," at a lower price.

Given the "extreme levels" of short interest, positive catalysts for the market "could trigger a substantial short-covering rally," New York-based Lee wrote.

The Standard & Poor's 500 Index of large U.S. companies declined 14 percent this year, led by financial and telephone shares. Short-sellers have benefited from crude oil's 49 percent advance to more than \$140 a barrel, falling home prices and resulting bank losses on mortgages, and "wariness" about second-quarter earnings following three straight quarters of profit declines, Lee wrote.

You will have seen on this site as well as from other sources that the potential for a short-covering rally is increasing. What we don't know is when that rally is going to occur or how strong it will be when it happens. A large number of stock market indices look [overextended](#) at present. However, when a market gets oversold, it can stay oversold for a significant period of time. Today saw the first signs that they are beginning to accelerate lower which is an indication that bearish sentiment may be reaching a crescendo. The [VIX](#) index is also pushing back up towards the August, January and March highs near 35. This is also a signal of increased bearish sentiment.

We have not yet seen the upward dynamics that would mark at least a short-term bottom and a catalyst has yet to emerge which would effect a change of sentiment. A medium-term correction in oil or a rebound in US bank indices are candidates, but no more than that, at this stage.

Email of the day (2) - on airlines:

"Jim Rogers recently commented that he was investing in airlines. His comments implied that he considered the bad news to be fully discounted in current share prices. "Buy at times of maximum pessimism" and "twenty four airlines have already gone bust - how much more pessimism do you want?" give you a flavour of the comments. Given that this is a sector with a long history of disappointing investors, I wanted to get your take on the sector and also what the charts currently imply (especially for the US airlines)?"

My comment - Thank you for this interesting question. Airlines, as you say, have a history of disappointing investors. Air travel is a ruthlessly competitive business; where airlines have to compete with state owned subsidized companies as well as dealing with the high cost of fuel. The most successful have been those efficient in cutting costs to the bone and hedging the price of fuel. One of the reasons [Southwest Airlines](#) has been a better relative outperformer is because it has hedged its fuel consumption so effectively.

Airlines such as [AMR Corp](#), [Northwest Airlines](#), [Delta Air Lines](#), [Continental Airlines](#) and [JetBlue Airways](#) are all in consistent downtrends. Buying these airline stocks now, is a bet that they will survive the current high oil price and will stage short covering rallies when oil eventually hits its medium-term peak. However, if one is a believer in oil's secular, as in long-term, bull market, then these shares are going to be trading against a significant headwind for the foreseeable future. In the international beauty contest, there are going to be better long-term investments.

Email of the day (3) - on an overlay of [FXI](#) with [SSO](#):

"A couple of points: 1. Please refer to the [url](#) which I believe is a free public service. In that commentary they refer to the FTSE/Xinhua China 25 Index which I seem unable to locate in your chart library. I have compared the last twelve months to the China 50 Index available and there does appear to be some correlation.

"2. In regard to this study I'm wondering if they are using an apples to apples comparison as they present a US index vs a two times leveraged ETF. As David has in the past referred to an eventual decoupling between the China and the US markets I'd appreciate your latest thoughts on this matter."

My comment - Thank you for this interesting [overlay](#) chart which I cloned in the Chart Library using the same two funds. [Here](#) it is again over the last [5 years](#). I also added the [FTSE/Xinhua China 25 Index](#) to the Chart Library. I agree that it is not really to compare a leveraged fund to an unleveraged one, but I think the point they are making is that the corrections have had remarkably similar patterns to date. The [overlay](#) of the S&P500 Index and the H-Share Index shows the same correlation since October. Another argument centres on whether the H-Shares are a good reflection of what is going on in the Chinese economy. This [overlay](#) of the Shanghai A-Shares with the S&P500 illustrates a number of differences between the markets.

Economic and stock market decoupling are very different phenomenon. Emerging economies are not as focused on what happens in the USA as they once were. The evolution of the BRIC countries and the growth in trade between emerging economies is creating new centres of gravity from an economic perspective. This development is still in its infancy but is only likely to increase over the long term.

From an investment perspective, the climate is now more global than it ever was before, and while capital markets in countries such as China are developing quickly, they are still relatively small when compared to Wall Street. As can be seen from this longer-term overlay, when Wall Street does well, other markets can outperform considerably. However when liquidity on Wall Street is contracting, it has a knock-on effect for most other markets. The depth and severity of the current liquidity crisis continues to affect stock markets globally, but international markets, with sound fundamental stories, will in all likelihood outperform when this crisis passes.

Email of the day (4) - on Boone Pickens:

"What is not mentioned in the article on Boone Pickens is that Pickens' patriotic wind power plan has another part to it that very much involves Pickens himself and whose goal is no less than to control the water supply of no less than Dallas, Texas via a pipeline through northern Texas. Those who are aware of it can decide for themselves whether Pickens' intentions are for his country or his company. Never underestimate Boone Pickens. As can be seen by the following report, he has used questionable methods to achieve his goal. Here is a short report on this item. "

My comment - Thank you for this informative [email](#).

Today's interesting charts - The Chart Library has two Search Engines. One searches the more than 16,000 equities, funds and ETFs in the International Equity Library and the other searches through the rest of the Chart Library for

indices, commodities, currencies, bond prices and yields, ratios, spreads and overlays.

FTSE-100 - breaking [below](#) the January / March lows and needs to push quickly back into the range to offset scope for some further downside.

France - starting to accelerate [lower](#) which is an ending signal but an upward dynamic is needed to check momentum beyond a brief pause.

South Korea - finds at least [short-term](#) support near 1500 and would need to sustain a move below that level to question scope for a further rally.

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

"Is it possible to add the [Coxe commodity strategy fund](#) to the chart library?"

My comment - Thank you for the suggestion and the link to the [prospectus](#). This fund can now be found in the Chart Library.

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