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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 15th September 2008

Quote of the day, from Hank Paulson - [Reported by Bloomberg, and destined to be cited whenever this crisis is referred to in future decades?](#):

``We are working through a difficult time in our financial markets right now," Paulson said. ``The American people can remain confident in the soundness and resilience of our financial system. Our banking system is a safe and sound one."

'Tectonic' Market Shift as Lehman Fails, Merrill Sold - [For anyone who missed it, here is the sobering news which rocked stock markets today, also reported by Bloomberg](#):

In the biggest reshaping of the financial industry since the Great Depression, two of Wall Street's most storied firms, Merrill Lynch & Co. and Lehman Brothers Holdings Inc., headed toward extinction.

New York-based Lehman, founded 158 years ago, said early today that it filed for bankruptcy protection after failing to find a buyer. Merrill Lynch, 94 years old and also based in New York, agreed to sell itself to Bank of America Corp. for \$50 billion in an emergency deal hashed out yesterday.

``The tectonic plates beneath the world financial system are shifting, and there is going to be a new financial world order that will be born of this," said Peter Kenny, managing director at Knight Capital Group Inc., the Jersey City, New Jersey-based brokerage that handles about \$1 trillion worth of stock transactions a quarter. ``It's an ugly and painful process."

The engines that powered record growth in the financial industry over the past decade -- cheap credit and surging property values -- have been thrust into reverse. Companies that once thrived on making real estate loans and holding assets bought with borrowed money are now under siege, giving the upper hand to those less reliant on leverage and holding the fewest assets tied to property.

My view - [Rather than add to these assessments, I think it will be more useful if I begin by reviewing some important charts.](#)

USA (10-Year Treasury futures) - Approaching January and March [highs](#), and a downward dynamic is required to reaffirm resistance in this region.

USA (S&P 500) - New low [reaffirms](#) overall downward trend and a close above 1250 is required to question lower scope, but a sustained push above 1300 remains necessary to indicate a significant technical improvement.

USA (DOW) - [Similar](#) to above.

UK (FTSE 100) - [Similar](#) to above and needs a close above 5660 to question overall downward bias.

Germany (DAX) - [Pressuring](#) July low and needs close above 6650 to offset lower scope and to reaffirm support near 6000.

Conclusion - Stock markets are resuming their bear trends against a background of renewed financial sector turmoil on Wall Street. Further deterioration brings us closer to the coordinated policy response that I frequently discuss in Audios, in which more central banks switch their monetary emphasis from fighting inflation to stimulating GDP growth, as we saw with China today (see *Eoin's item on this below*).

Email of the day (1) - [On the US housing market](#):

"To quote from the linked paper issued a few days ago, "all eyes are on the housing market". Which way is it likely to go in the coming months, and how will it continue to impact the economy?

"The case is made for the pessimistic view that stability will not return to the housing market until well into 2010 or later. A more optimistic stance concentrates on the July 2008 reported decrease in inventories and new home sales increases, as well as an upturn in the Case Schiller index, (page 28, the Final Words).

"It is a fascinating and most readable study, using historic data, and we might hear it cited to make the psychological point that many homeowners have not been shaken in the belief that given enough time, price levels will be on an upward trajectory again.

"What is not part of the study is the Sword of Damocles overhanging the housing market in form of baby boomers retiring in waves from 2010 onward, and the smaller number of Generation Y and X'ers able to absorb older housing stock potentially put up for sale.

"Projections into the future are difficult and I will leave it to the passage of time and people a lot more adept at reading the tealeaves.

"In the meantime, here is the [link](#) to the paper and many thanks for your comments and help in the "divination process"!

My comment - Many thanks for this detailed study. No one knows how long the US housing slump or similar situations in a number of other countries will persist. However, we do know that once the biggest bubbles burst, it can take many years and often a considerable amount of inflation, before their nominal peaks are exceeded.

Damien Hirst goes for broke at Sotheby's - [This article](#) by Carol Vogel for The New York Times covers the Damien Hirst / Sotheby's gamble in London this evening and also tomorrow night. Here is a section:

Damien Hirst has a recurring nightmare. His big auction here is about to begin and the Sotheby's salesroom is overflowing with collectors and dealers. Oliver Barker, the auctioneer, opens the bidding on 223 works that Hirst has produced over the past two years. Suddenly the place goes quiet. Not a paddle is raised.

"The galleries have convinced everyone not to bid," Hirst said last month, recounting the dream while overseeing the installation of "Beautiful Inside My Head Forever," his one-artist, two-day auction that begins Monday night. "It's risky I know," he added. "But it's too late to worry about it now."

For sale will be variations on familiar themes. There will be dead animals galore: black sheep, tiger sharks, a dove, a zebra. There will also be glass cabinets filled with everything from diamonds to cigarette butts. Paintings and works on paper decorated with his signature skulls and dots, swirls and butterflies are available in all sizes. As part of his sales pitch, Hirst said he would no longer be making any more spin or butterfly paintings, far fewer dead animals and almost no dot paintings.

Estimates range from a high of \$15.8 million to \$23.6 million for a calf submerged in formaldehyde to about \$60,000 for a colored pencil drawing of dots. Sotheby's expects the two-day sale to total about \$200 million. That figure does not include the buyer's premium, the fee buyers pay Sotheby's: 25 percent of the first \$20,000, 20 percent of the next \$20,000 to \$500,000 and 12 percent of the rest.

Sotheby's and Hirst will not reveal the details of any financial package except to say that no guarantee has been paid to him. It is safe to say that if the sale follows his recurring dream and falls flat, the unsold work will be returned to him and Sotheby's will have to write off its expenses.

Hirst has help in his marketing efforts. Sotheby's has devoted every inch of its London gallery space to Hirst. About 30 guards have been employed to watch over the installation during the 11-day public viewing, which was open until midnight Saturday and drew crowds of thousands.

The auction house also reinforced its floors to show Hirst's dead animal kingdom. The calf weighs 10 tons. And it hired the New York architect Peter Marino to transform a rabbit warren of tiny back offices into a suite of rooms with polished mahogany doors and walls lined with Hirst's butterfly paintings.

Resembling a five-star hotel, several rooms have fireplaces and all are equipped with flat-screen televisions to allow VIPs to watch the sale live and bid by telephone.

To make sure the works reach as wide an audience as possible Sotheby's experts have taken highlights of the sale everywhere from the Hamptons to New Delhi. The catalog, which Sotheby's said cost about \$240,000 to produce, is meant to be a collector's item, too. The three-volume tome has a special slipcovered case and costs \$130.

The artist, who employs 120 people to help him with his work, had a hand in its design as he has the Sotheby's installation, spending every day for six weeks at the auction house.

My view - Will there be a sufficient number of solvent hedge fund managers, pop stars and rich Russians such as Roman Abramovich's new squeeze Daria Zhukova on hand for this sale to reach Sotheby's target of \$200 million? That is quite a challenge despite the cleverness of both Hirst and Sotheby's at marketing.

The timing could be questionable, unless the super-rich conclude that with other markets doing so badly, they might as well buy the dead fish. That happened with impressionist pictures after the Crash of '87. However I wonder when *The Shock of the New* will wear off for Hirst, considering that 120 people created these 223 items over the last two years - not much supply inelasticity in that.

Fashionable modern art does become a trendy form of currency, but it has to be good and in short supply for the value to endure. Personally, I find the stuffed animals in formaldehyde grotesque.

Stop press - The [auction](#) seems to be going rather well.

Emerging market sell-off in historic context - [Bloomberg had an interesting article](#) on this subject today: Emerging-Market 'Panic' May End With 20% Stock Rally. Here is the opening:

Emerging-market companies, earning more for shareholders than ever before, are getting no respect just as their stocks drop to levels that preceded rallies.

More than \$500 billion in credit-market losses and falling prices of oil, nickel and soybeans pushed the MSCI Emerging Markets Index down more than a third since October, leaving it 24.7 percent below its 200-day moving average. In the past two decades, the difference grew that wide only in the aftermath of Sept. 11, the 1998 Russian debt default and Mexico's 1994 peso devaluation, data compiled by Bloomberg show. In every case, the index gained 20 percent or more in the next three months.

This time, prospects for a rebound are even greater as developing-nation economies grow twice as fast as a decade ago, says Uri Landesman, head of

global growth and international equities at ING Groep NV's asset management unit in New York. Return on equity, or a company's profit made with money invested by shareholders, rose to 16.8 percent this quarter, the highest for emerging markets since Bloomberg began tracking MSCI Inc. data in 2003 and a level Morgan Stanley says may be a record.

"You're more than getting paid for your risk," said Landesman, who oversees \$5 billion. "When you have a panic like this, the baby gets thrown out with the bathwater."

Equity prices in the MSCI index average 9.8 times forecast earnings over the next 12 months, the cheapest in a decade versus reported profits. Valuations have fallen even as developing economies are projected to expand 6.7 percent next year, double the average rate during the 1990s, with one-tenth the inflation, according to the Washington-based International Monetary Fund.

My view - [Let's start with charts for the MSCI Emerging Markets Index \(monthly semi-log, monthly arithmetic, weekly & daily\)](#). This high-beta sector has certainly plunged and is becoming increasingly overextended relative to its 200-day MA, as the BBG article points out. So a bounce, possibly from near the 800 region, would not be surprising. However the Index also completed a top formation above 1000 and a sustained rally above that level would be required to indicate that a significant low had been seen.

My concern is not with emerging market valuations and GDP growth potential over the next decade or more. Currently, however, the sector is being dragged down by the USA's financial meltdown and related concerns for global GDP growth. Therefore the MSCI Emerging Markets Index may not perform until Wall Street's problems become more manageable. That should present the next good buying opportunity for emerging markets.

Email of the day (2) - [On EUR/USD:](#)

"Many thanks for your detailed comments on currencies in today's audio.

"You mentioned the rebound currently taking place in the euro having tested a low of 1.3880 against the dollar on Thursday and closing at 1.4220 Friday evening.

"In terms of this rebound do you feel we can get back to the 1.5200 level again? I know anything is possible in these markets given the volatility we have seen over the last few weeks, however, has too much technical damage been inflicted on the Euro since we broke below 1.5200 and will the market use any rebound in the Euro as a selling opportunity?

"I have read a number of forecasts from banks and they are calling for EUR/USD to test the 1.3500 level Q1 2009."

My comment - The [EUR](#) has indeed experienced considerable technical damage against the USD, but its decline also became overextended, which was my timing message that you refer to.

I do expect the EUR to get back to at least \$1.52 at some stage but it may require prior support building. Meanwhile, I would take my cue from the chart action, which is generally the best policy in currencies.

On a fundamental basis I regard the EUR as expensive but as the second most liquid currency, it has become the alternative reserve unit of choice, by default. The USD is cheap on a PPP basis and has been for years, so that is seldom a timing indicator. However the USA's self-inflicted financial mess strikes me as very bearish for the USD over the longer term. I assume that the USA will inflate away much of its long-term debt.

Is the United States Bankrupt? - My thanks to a subscriber for this interesting, somewhat academic [report](#) by Laurence Kotlikoff for the Federal Reserve Bank of St. Louis. Here is the opening:

Is the U.S. bankrupt? Or to paraphrase the Oxford English Dictionary, is the United States at the end of its resources, exhausted, stripped bare, destitute, bereft, wanting in property, or wrecked in consequence of failure to pay its creditors?

Many would scoff at this notion. They'd point out that the country has never defaulted on its debt; that its debt-to-GDP (gross domestic product) ratio is substantially lower than that of Japan and other developed countries; that its long-term nominal interest rates are historically low; that the dollar is the world's reserve currency; and that China, Japan, and other countries have an insatiable demand for U.S. Treasuries.

Others would argue that the official debt reflects nomenclature, not fiscal fundamentals; that the sum total of official and unofficial liabilities is massive; that federal discretionary spending and medical expenditures are exploding; that the United States has a history of defaulting on its official debt via inflation; that the government has cut taxes well below the bone; that countries holding U.S. bonds can sell them in a nanosecond; that the financial markets have a long and impressive record of mispricing securities; and that financial implosion is just around the corner.

This paper explores these views from both partial and general equilibrium perspectives. The second section begins with a simple two-period life-cycle model to explicate the economic meaning of national bankruptcy and to clarify why government debt per se bears no connection to a country's fiscal condition. The third section turns to economic measures of national insolvency, namely, measures of the fiscal gap and generational imbalance. This partial-equilibrium analysis strongly suggests that the U.S. government is, indeed, bankrupt, insofar as it will be unable to pay its creditors, who, in this context, are current and future generations to whom it has explicitly or implicitly promised future net payments of various kinds.

My view - Some argue that the USA cannot be bankrupt because it can just print more money. That is a short-sighted view because I am not aware of any country printing its way back to prosperity. I think the USA government is technically bankrupt. And considering fixed expenditures and campaign promises from both Republicans and Democrats, I fear that this situation will become worse before policies to reverse the decline are agreed on a bipartisan basis, and implemented.

My personal portfolio: Corn and silver stops triggered - Reluctant to take more risks and following last Friday's purchases, I had placed an in-the-money stop on [corn](#) on Friday evening and added a breakeven stop in [silver](#) this morning. Both were triggered with December corn sold at 555¢ this morning against my purchase at 542.5¢ on 12th September. Similarly, my long in December silver was sold late this morning at \$10.88 against Friday's purchase at \$10.87. These prices include all spread-bet dealing costs. Tactically, I think corn, soybeans and precious metals are buys on weakness but may be deterred myself by a holiday coming up next week, when I will not want to be thinking about trades.

Additional Commentary by Eoin Treacy

What Happens During Recessions, Crunches and Busts? - Thanks to colleague Michele Affortunati for this academic [report](#) by Stijn Claessens, M. Ayhan Kose and Marco E. Terrones for the IMF dated August 5, 2008. Here is a section from the conclusion:

Our analysis of the interactions between macroeconomic and financial variables around various episodes of business and financial cycles suggests that these linkages play key roles in determining the severity and duration of recessions. In particular, recessions associated with credit crunches and house price busts are deeper and last longer than other recessions do. The durations of credit crunches and house price busts tend to be longer than those of typical recessions, while the dynamics of the main components of domestic absorption around these events are similar to those observed during recessions. Credit crunches and house price busts are more costly than equity price busts are, and equity price busts appear to be less consistently associated with real sector outcomes.

In light of these findings, we examine the prospective implications of recent macroeconomic and financial developments in the United States and conclude that there are indications that the current slowdown in U.S. output is not atypical of the onset of previous recession episodes. Yet at the same time, the sharp decline in total investment (mainly driven by a large drop in residential investment), the drop in house prices and, to lesser extent, the credit contraction suggest that the slow down is more severe than in a typical onset of a recession. This suggests that, if a recession were to occur in the United States, its amplitude might be deeper and its duration longer than that of a typical recession.

However, the hefty combination of expansionary monetary and fiscal policies already employed could mitigate the risk of an adverse outcome. Nevertheless, the persistent difficulties in credit and housing markets combined with rising inflationary pressures due to the oil and other commodity price shocks can further weaken economic activity while limiting policy options. As such, the current slowdown in the United States is an evolving case affected by a multitude of factors, and it is not clear whether this will eventually be a mid-cycle slowdown, or if a recession, how severe it will be.

While our broad cross-country study sheds much new light on the implications of recessions, crunches, and busts, it does come with its caveats. Being an event study, no causal inferences are made (or intended) as to how recessions come about, whether financial variables affect macroeconomic outcomes or vice-versa, and how policies affect economic and financial outcomes. Moreover, an important caveat to our prospective analysis for the United States is that initial conditions, external developments in terms of both demand and supply, and policy responses will affect the path the economy may follow. Furthermore, while business cycles have not disappeared, due to a number of factors they have changed over time. As such, the future path of the U.S. economy can well differ from that typically followed in past U.S and other recessions.

Our analysis also made clear that more work is needed to get a better grasp of the important macroeconomic and financial linkages so as to be better informed on how to adjust policies and institutional environments, and to make better forecasts on the shape of economic outcomes. For instance, our analysis did not yet explore the channels through which financial and real variables interact. As noted by a diverse set of theoretical studies, besides general wealth and substitution effects, financial variables will impact the balance sheets of financial institutions, firms and households, and thereby affect the extension of credit and thus the real economy. While there has been some empirical work documenting the importance of these channels in normal times, little is known about how they operate in a recession, which could include Fisherian deflations.

My view - How severe or long lasting any recession is likely to be is a question of perspective or personal circumstances. For employees of Lehman Brothers this is already a recession to equal their worst nightmares. Sentiment surrounding the banking sector remains conspicuously bearish and not without reason, since high profile bankruptcies continue to dominate headlines. However, shorting banks is no longer a one way bet. Not all banks are in the same situation and some are exhibiting quite healthy recovery prospects. Since it was the banking sector which led the market into this downturn, banks are likely to be one of the leading sectors on the upside, so they merit close attention.

Today's headlines have focused on the [S&P500 Diversified Financials](#). This Index rallied well from its July lows and although it is now at the lower side of its short-term range, it would need to sustain a move to new lows to question scope for some further ranging around current levels. The [S&P500 Banks Index](#) has a relatively similar pattern. It has not suffered to the same extent as

a result of today's news and a sustained break above 200 would indicate the bulls are regaining the upper hand. The [S&P500 Regional Banks Index](#) broke upwards from the short-term range last week and has held the gain. A sustained move below 65 would be needed to question scope for some additional upside. The [S&P500 Thrifts & Mortgage Index](#) remain in a consistent downtrend and would need to break the progression of lower highs to question scope for additional downside.

Seeing the Banks and Regional Banks indices were relatively steady, I put all of the companies in the four above mentioned sectors into a section in my Favourites and put it through both the [Performance](#) and [High / Low](#) chart Library Filters. For instructions on how to create these filters please see Comment of the Day on [September 10th](#).

While some financial shares are quite firm, (see below), others remain weak. Shorting banks that failed to rally from their July lows has been a profitable exercise, especially for those who bet against Lehman Brothers and Merrill Lynch. Considering the success of this strategy, it seems likely that traders might now also consider shorting other high profile members in the same sector.

Companies such as [Washington Mutual](#), [SLM Corp](#), [National City Corp](#), [MGIC Investment Corp](#) and [E*Trade](#) are all at risk of declaring bankruptcy evidenced by the deterioration of their price charts. [Wachovia](#), [Citigroup](#), [Morgan Stanley](#), [Legg Mason](#), [CIT Group](#), [Janus Capital Group](#) and [American Express](#) all broke downwards from short-term ranges today and are testing their July lows. Breaks to new reaction lows would be powerful bearish signals for any financial stock in this environment. They need to find support around current levels to offset further downside potential.

However, not all banks are as weak as those cited above. [Northern Trust Corp](#) is making new highs. It broke upwards last week and has so far maintained the gain. A sustained move below \$80 would be needed to question scope for additional upside.

[PNC Financial](#) broke upwards to new high ground last week but was unable to hold the move. It fell back to near \$70 this morning but has since rallied. A sustained move below that level would be needed to question scope for an upward break in the coming months.

[Hudson City Bancorp](#) has not fallen to anywhere near the same extent as other banks and remains in an overall uptrend. A sustained move below \$17 would be needed to question scope for additional upside.

[Wells Fargo](#) is now the largest share in the S&P 500 Banks Index. While it fell precipitously to the July lows, it has since surged upwards and is within striking distance of its highs. A sustained move below \$28 would now be needed to question scope for further upside.

[BB&T Corp](#) also rallied extremely well from the July lows and would need to sustain a move below \$27 to question scope for some additional upside.

[US Bancorp](#) broke down from the medium-term range in early July and following a severe, but short-lived dive, rallied impressively and is now testing the highs near \$36. A sustained move above that level is needed to reassert the overall uptrend.

[Charles Schwab](#) found support near the October lows in April and again in July. It has since rallied well and is testing its highs near \$26. A sustained move below \$18 would be needed to question scope for some additional higher to lateral ranging.

[JP Morgan](#) rallied well from the July lows and continues to consolidate that move. A sustained move below \$35 would be needed to question potential for further higher to lateral ranging.

[Bank of America](#) surged upwards from its July lows and, prior to today, looked like it was going to break upwards from its short-term range. It is taking a risk in buying Merrill Lynch and is now testing the lower side of its short-term range. A sustained move below \$20 would indicate that the bears have regained the upper hand.

[Leucadia National Corp](#) broke upwards to new high ground in May but was unable to sustain the move and fell to test the January lows. It found support this week and would need to sustain a move below \$40 to question scope for some additional upside.

China Cuts Rates as U.S. Turmoil Adds to Global Risks - [This article](#) by Li Yanping and Kevin Hamlin for Bloomberg covers today's rate cut in China. Here is a section:

China cut interest rates for the first time in six years and allowed most banks to set aside smaller reserves as worsening credit-market turmoil and weakening export demand dim the outlook for economic growth.

The People's Bank of China reduced the one-year lending rate to 7.20 percent from 7.47 percent, effective tomorrow, and lowered the reserve ratio at the nation's smaller banks by 1 percentage point. The changes were in a statement on the central bank's Web site today.

Lehman Brothers Holdings Inc. filed for bankruptcy today and Merrill Lynch & Co. agreed to be sold, adding to evidence that the credit crisis is deepening and threatening the global economy. Cooling inflation has given China room to cut borrowing costs and protect jobs in the world's fourth-largest economy.

``Policy makers see the probability of a recession in the U.S. is higher now, so the outlook for Chinese exports has deteriorated," said Darius Kowalczyk, chief investment strategist at CFC Seymour Ltd. in Hong Kong. ``Policy makers have concluded that inflation is easing permanently." He was the only one of seven economists in a Sept. 13 Bloomberg survey to predict a rate cut this year or in the first quarter of 2009.

China's inflation was the weakest in 14 months in August, slowing to 4.9 percent, export growth cooled and industrial production grew by the least in six years, according to data released last week.

Important Problems'

The rate cut is ``to help solve important problems in our economy for its continued stable and fast development," the central bank said in the statement.

China's economy expanded 10.1 percent in the three months to June 30 from a year earlier, the fourth straight quarter of slower growth. From July, policy makers dropped references to a ``tight" monetary policy and put extra emphasis on sustaining the economic expansion.

``The economic slowdown in the U.S. could be more serious than previously anticipated," said Zhao Qingming, senior economist at China Construction Bank Corp. in Beijing. ``The impact on China could be harsher, making it harder to maintain the pace of economic growth."

My view - China used the mid-Autumn festival holiday, when the market was closed, to make its rate cut announcement, so it will be interesting to see how it is greeted in tomorrow's trading. This should be a net positive for the stock market, as it is a clear indication that the central bank has turned from targeting inflation to growth. The Chinese have been successful in pricking housing and stock market bubbles without conceded too much in terms of economic growth. In turning their attention to supporting the economy and considering the myriad tools and reserves available to them, they have a good chance of preserving their economic expansion albeit at a somewhat slower pace.

Email of the day (1) - on potential value in fixed income:

"I have been subscribing to your service for 2 months and find the information very useful and informative. Can you comment on the attached [bond](#) and its [price](#) performance Issued by BNP Paribas at â,100(par) with coupon of 4.85% Now trading at â,65 and effective coupon almost 8%. What is the downside risk on BNP? It has a AA rating"

My comment - Thank you for this interesting question. The bond in question is a subordinated tranche so if the company goes bust, investors will have little chance of getting all of their principal back. In the current environment, it would be rash to say that [BNP Paribas](#) is free from default risk, but it is probably more likely to survive, after all, most banks will. Looking at the share price, it has fallen approximately 31% from the 2007 high and in the process given up half of its advance from the 2002 lows. The support found above €50 in March and July has so far held and it would need to sustain a move below that level to question scope for further support building around the current area.

The [yield](#) has appreciated considerably over the last few months, but there is no guarantee that it will not go higher, particularly in the current environment as uncertainty about counterparty risk continues. However, I believe your instincts are correct, because we know for a certainty that some banks are being unfairly valued because of the credit crisis. What is more difficult to ascertain are which ones.

Today's interesting charts - Interesting chart patterns can be found in every asset class and they are all well represented in the Chart Library.

Dollar Index - proving to be enormously [volatile](#) and failing to follow through on Friday's downward dynamic. This suggests that further choppy action is likely and the Index would need to sustain a move above 80 to offset scope for some further weakness over the coming weeks.

US Treasuries - soared [upwards](#) to test the January highs near 122 and looking increasingly overextended. However, a downward dynamic is now needed to check momentum beyond a brief pause.

Gold - showing considerably less volatility than other asset classes. A sustained move below \$750 would now be needed to question scope for some additional [upside](#).

Oil - breaks below the [psychological](#) \$100 and would need to sustain a move back above that area to question scope for some further downside.

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

"Could you please include the following company in the Chart Library. Societe des Bains de Mer its full name is: Societe des Bains de Mer et du Cercle des Etrangers a Monaco. I think it is normally known by the first 5 words, or [SBM](#) which is even easier. It is quoted on the French Stock Exchange. I have checked the library but can't find it."

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

Last week's signups for the Free (Abbreviated) Comment of the Day - For the week of September 7th new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, Canada, Hong Kong, India, Ireland, Slovakia, South Africa, the UK and the USA - 9 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 16th September 2008

Fed Adds \$50 Billion to the Banking System; Funds Rate Declines - [This report from Bloomberg highlights not only the Fed's actions, but also those of some other central banks:](#)

The Federal Reserve added \$50 billion in temporary reserves to the banking system when it arranged overnight repurchase agreements, or repos.

The rate for overnight loans between banks had opened at 3.75 percent, above the Federal Reserve's target rate, as American International Group Inc.'s credit rating cut increased banks' reluctance to lend. The rate dropped to the central bank's target of 2 percent after the cash injection.

The Fed added \$70 billion in reserves to the banking system yesterday, the most since the September 2001 terrorist attacks, to bring borrowing costs down after the bankruptcy of Lehman Brothers Holdings Inc. triggered a hoarding of cash. Funds opened at 3.5 percent yesterday.

“From a pure reserve perspective, the desk might not need to arrange any repos at all today,” Wrightson ICAP analysts wrote in a note. “From a dealer-funding perspective, another round of large morning repos may have a calming effect.”

Funds traded to as high as 6 percent yesterday, or 4 percentage points above the central bank's target rate for overnight loans between banks, according to ICAP Plc, the world's largest inter-dealer broker. That margin was the greatest at least since Bloomberg began tracking the data in 1998. The rate closed at 0.25 percent yesterday, and reached as low as 0.01 percent.

The Fed will lower its target rate by a quarter percentage point to 1.75 percent, futures trading showed. Contracts on the Chicago Board of Trade put the odds on a cut at 96 percent, compared with 2 percent a week ago. Of the 105 economists surveyed by Bloomberg News, 100 expect the Fed to leave rates unchanged today.

Foreign Central Banks

Central banks from Tokyo to Frankfurt injected cash into their financial systems in a bid to calm markets.

The European Central Bank awarded 70 billion euros (\$99.8 billion) in a one-day money-market auction today. The Bank of Japan added a total of 2.5 trillion yen (\$24 billion) and the Bank of England pumped in 20 billion pounds (\$36 billion). Counterparts in Australia and Switzerland took similar steps.

Banks' demand for the security of cash rose again after AIG had its credit ratings cut by Standard & Poor's and Moody's Investors Service yesterday, threatening efforts to raise funds to keep the company afloat and roiling global financial markets.

The so-called effective funds rate was 2.93 percent yesterday, according to ICAP. The rate was from 2.1 percent on Sept. 12, according to The Federal Reserve Bank of New York reports daily the official effective funds rate, for the previous trading session. It is a weighted average rate of unsecured overnight lending transactions. A basis point is 0.01 percentage point.

My comment - \$50 billion here, \$70 billion there, and soon we are talking real money. And that's just from the Fed. Other central banks around the globe are also pumping in huge amounts of liquidity, all in an effort to stem the latest and rapidly developing chapter of the banking crisis. China cut rates and also reserve requirements [yesterday](#) and will shortly do so again.

A good thing too, since every newspaper that I have seen today features - "Crisis" - on the front page headline and stock markets are in turmoil.

We are now seeing the beginning of a coordinated policy response from central banks, which I have been discussing recently. This is much more likely to cushion rather than draw a line under stock market declines because the west's banking debacle is of unprecedented severity, at least in my lifetime. Inevitably it has global repercussions, as we are also seeing.

It is impossible to know how and when all this will play out, because the final chapters have yet to be written by central banks and their respective treasuries. However, I assume that they have begun the process of shifting their main focus from fighting inflation to reviving growth.

Central banks need to stimulate economic growth because the current trends are very disinflationary. They will want to ensure that welcome disinflation does not slip into a Japanese-style deflation of the 1990s, let alone a sustained global deflation which would be far worse.

Meanwhile, the disinflation is certainly not all bad because property and other asset bubbles are inflationary, and will always burst at some point. However it is not easy to be philosophical about this process when one's own asset bubbles, in terms of participation, happen to burst.

Global deleveraging continues, which is why [crude oil](#) traded near \$91 today, well down from its peak at \$147.27 on July 11th. It is also a partial explanation for the strength of the [US Dollar Index](#) and yen, the latter shown here in terms of the [euro's fall](#) against the Japanese currency.

Is this *Back to the Future*, to use the title of Steven Spielberg's film in another context? I believe so, in that we will be able to participate in a renewed bull cycle for Fullermoney themes which served us so well earlier in the decade - precious metals and other resources, Asian-led emerging markets and global infrastructure development - all of which should be among the leaders of the

next up cycle. However we will have to be patient for a while longer, awaiting evidence that the down cycle has ended.

Email of the day (1) - On numerous points:

"Reading your morning summary is an integral part of my daily rituals - something similar and close to soul like morning prayers we Hindus offer to our gods....

"I had a very critical issue for discussion with you -

"You have recently uploaded two insightful articles one from citi and another by stephan roach which identified the patterns that we might witness in the current financial turmoil...

"What is your take on -

- a. The impact of the fact that the global wealth is shrinking by the day
- b. The financial behemoths are waiting in queue to get recapitalised or throw belly up
- c. Assets are witnessing a slide that is reflecting on the sentiments
- d. Money available in the system has evaporated - bringing the cost of capital to its near historic high
- e. While businesses remain de-coupled the financial markets have exhibited strong correlation between developed and emerging markets
- f. The first bout of corporate defaults is yet to begin
- g. The extent of promoter fundings to buy their stocks (particularly in India) is at its peak...risking a strong slide in a wind down cascade

"Do we stay away from equities for next 18-months....given the fact that an impending election adds further complexity to the equation...

"Looking forward to your words of wisdom..."

My comment - Thank you for the charming introduction and formidable tally of market problems. I think we all enjoy the multicultural aspects and insights that subscribers contribute to the Collective, and I certainly appreciate them.

You will of course recognise that wisdom is a will-o'-the-wisp in its elusive meaning, but nevertheless worth pursuing.

The problems or risks that you sight remind us to be careful, but price charts also show us that stock markets have discounted much of what rightly concerns us. For additional perspective, we should also balance your points with any developments likely to facilitate the next upturn. We should trust that the charts will also show us positive change, provided that we remain receptive to that eventuality.

Lehman Brothers: China's Great Transition - My thanks to colleague Jackson

Wong for this informative, blockbuster (103-page) [report](#), possibly the last produced by Lehman Brothers and therefore a collectors' item. Here is the poignant forward from Hua He, Head of Equity and Fixed Income Research, Asia Pacific:

We are proud to launch this special report, which outlines a roadmap for China's transition from a low-end manufacturing center to a higher value-added economic force. We see a China which has much overcapacity in low-end textiles, toys, garments and other manufactured goods. But, more importantly, we see a China that is engaging in currency appreciation in order to tame inflation brought on by shortages in many parts of the economy. The price exacted by China's success in currency management is that many low-end manufacturing companies will be forced to leave places such as Guangdong or Eastern China and seek cheaper locales. Eastern China is being challenged as never before to move up the value-added curve and produce high-quality, higher-value goods.

As this transition takes place, we see a government poised to balance the need to move into higher value-added goods and services with the need to maintain employment. Ensuring the creation of millions of jobs a year while undergoing this transition will be a great economic and political challenge for China. The country is also trying to deal with the side effects of economic success: soil, water and air pollution. We see the efforts to force the closure of many industrial facilities as a way to help clean China's rivers and soil, and to alleviate air pollution, which has become problematic.

The main focus of this report is the pressing need to upgrade China's infrastructure to head off inflationary problems owing to shortages. Doing this will require massive spending over 2009 and 2010 - estimated in the order of US\$400 billion. It will also require deregulating prices so that the private sector can receive a fair return on capital. Finally, spending on infrastructure will require a long-term source of financing independent of bank credit, i.e., direct access to capital markets.

We thank you for your ongoing support during this difficult time in the financial markets. We are committed to continue to offer you value through our economics, equity and fixed income research. We understand the challenges as we navigate through challenging times, and we are making every effort to ensure our research remains relevant and timely. We need your feedback. Please let us know how we can make our research better.

My view - [Anyone interested in China should at least read the Executive Summary by Paul Schulte.](#)

[A key theme emphasised for China's industrial modernisation is infrastructure spending of US\\$420 billion for 2009 and 2010. This will lend support to the shares of top miners and should also help firm prices of most industrial metals next year. China needs economic growth so I expect the transition from fighting inflation to stimulating GDP, commencing yesterday, to continue.](#)

Email of the day (2) - [On government bond yields:](#)

"Many thanks for maintaining a consistently excellent service during these stressful times.

"Using the high/low filter, I noticed that US and Canadian 30 year bond yields have recently hit multi-decade lows. Does this challenge the Fullermoney view that long dated government bond prices are in the early stages of a secular bear market? Or can we put it down to a temporary blip caused by an exceptional period of panic?

"I personally have no reason to doubt the Fullermoney view (inflation is obviously alive and well), but if there is one thing I've learned from Fullermoney, it's that we should pay close attention to the charts."

My comment - [Many thanks for your generous comment.](#)

Regarding government bond yields or any other market, you rightly emphasise the importance of charts. They are our reality check. My earlier comments were based on the historic lows for US ([long-term](#) & [weekly](#)) and many other treasury yields around June 2003. I felt these were achieved due to exaggerated inflation fears when money supply showed that central banks were stoking another inflationary cycle.

We have seen the inflation, as you point out, but we have also experienced a perfect storm of disinflationary pressures this year, caused by the west's ongoing credit crisis and banking insolvency problems, to burst housing bubbles and the oil price shock. Global deleveraging continues. We have also seen a flight to government bonds.

This certainly challenges the lengthy bottoming out hypothesis for government bond yields (topping out for bond prices) that I have advocated. Quite simply, the game has changed and some people think US 10-Year Yields will fall to 2%.

I doubt this because I do not expect the crunching global recession that it would imply. I think government bond yields will start to rise as the stock market begins to anticipate the next economic recovery. However we should let the charts illuminate us.

Today's interesting charts - [You can create your own relative charts for any two instruments by first selecting one of them, and then using the "Charting" link shown upper left in the Library.](#)

OEX Volatility Index (VIX) - [Spiked](#) above the level seen at the July low and not far off peaks pinpointing the January and March lows.

USA (S&P 500) - Did not [maintain](#) additional downward break but a sustained move above 1300 remains necessary to indicate a significant technical improvement.

Platinum - Today's additional [slide](#) by what is often the lead indicator warns of additional short-term risk for other precious metals. However, platinum looks increasingly overstretched on this weekly [chart](#) and is approaching potentially important psychological support from the \$1000 region. An upward dynamic on this chart, when it occurs, is likely to signal an important low.

Additional Commentary by Eoin Treacy

Wall Street Journal: The Resilience of American Finance - [This article](#) by Jeremy Siegel covers some important points about what to expect from the financial sector in the coming years. Here is a section:

There is no doubt in my mind that if we didn't have a proactive Federal Reserve and deposit insurance, we would have been following the same course as we did in the 1930s, when the bursting of the stock bubble and fear of loan defaults led to thousands of bank failures and ushered in the Great Depression.

That will not happen this time. The rapid provisions of liquidity by the Fed will prevent any full scale downturn. In fact, I take it as a mark of confidence in our financial system that the Fed did not feel compelled to bail out Lehman Brothers as they did last March when they folded Bear Stearns into J.P. Morgan. Certainly politics played a role in this election year, as critics (and some Congressmen) criticized the government for bailing out the big boys, while letting homeowners twist in the wind.

Despite the recent turmoil, there is good evidence that the worst is over, especially for the commercial banks with access to Federal Reserve credit. Despite yesterday's severe sell-off, most are significantly higher than their July 15 low, and some such as Wells Fargo and UBS are up over 50%.

Nevertheless, the current crisis will change the financial landscape. Certainly Bear, Merrill, Lehman and others will disappear as separate corporate entities. But other institutions, specifically the commercial banks that absorb these firms, and who have direct access to Federal Reserve credit, will become larger.

The demand for financial services will in no way disappear as the automobile pushed out the horse and buggy a century ago. Although unemployment on Wall Street will undoubtedly rise, many workers will be reabsorbed elsewhere in the industry. The current financial crisis calls out for new products and services as well as more, not less, information about what is safe and profitable in the future environment.

It is easy to be pessimistic about the future of financial services in the current

climate. But objective facts indicate that the future demand for these services will be high. Looking beyond past losses, the demand for financial services, especially internationally, has been strong. The growth of the developing countries, combined with the aging in the developed countries, will lead to huge international capital flows that will be facilitated by new and existing financial intermediaries.

It is shocking that firms that withstood the Great Depression are now failing in what economists might not even call a recession. But their failure was not caused by lack of demand for their services. It was caused by management's unwillingness to understand and face the risks of the investments they made. The names of the players will change, but the future growth of the financial services industry is assured.

My view - Considering the dire situation a number of household name financial institutions find themselves in, it is hard to envisage a scenario where they are going to lead the next upside move for the sector and stock market generally. What seems far more likely is that commercial banks with relatively healthy balance sheets can now afford to purchase investment banking divisions and some have already done so. It might be a truism but firms currently at risk of bankruptcy are either going to go bust or not. If they survive they will have to go through a lengthy period of convalescence or they will be taken over by stronger organisations. For Merrill Lynch this will be as part of Bank of America and the question as to whether AIG will survive in its current form looks likely to be resolved in the coming week.

However, when thinking about which financial companies are best placed to outperform going forward, those leading the sector right now are probably a good place to start looking. These companies have far less to worry about from the liquidity and solvency crisis affecting many of their peers. They are in a prime position to make purchases as troubled firms divest themselves of choice assets. They also should hold a competitive advantage when any recovery takes place. (For a technical review of the best and worst performers in this sector, see my piece on banks in yesterday's [Comment of the Day](#).)

This is a challenging environment in which to make money and prudent investors would do well to hold cash in reserve. Considering that the majority of stock markets globally are in downtrends, sustained breaks of the sequence of lower highs would be needed to question scope for further weakness while upward dynamics in the region of current levels would help to put at least a short-term floor under markets.

Looking longer term, the business model based on securitization of dodgy credits is broken, but the need for sophisticated and deep capital markets remains and the banking sector will eventually recover. However, it will be years before some of the more troubled institutions regain their highs.

Taiwan Government Funds to Support Market After Slump - This article by Tim Culpan and Janet Ong for Bloomberg covers some potentially important developments in the Taiwanese stock market. Here it is in full.

Taiwan's government instructed its four major funds and state-owned banks to buy shares to help reverse the stock market's 9 percent slump following Lehman Brothers Holdings Inc.'s bankruptcy filing yesterday.

Taiwan's National Stabilization Fund is also monitoring the situation and may enter the market if there are any "non-economic influences," the Cabinet said in a statement. Banks have ample liquidity and capital, the Central Bank said in a separate release.

Government efforts to support the stock market came after Taiwan's benchmark Taiex index fell to a three-year low. Lehman's bankruptcy filing left Taiwanese companies with NT\$80 billion (\$2.5 billion) at risk, the financial regulator said yesterday.

"The Lehman crisis has some real impact on Taiwan's financial institutions, as its structured notes may become worthless," said Michael On, president of Beyond Asset Management Co. in Taipei, declining to disclose his holdings.

"The panic selling, and government attempts to rescue the market, are signs that the stock market may be near its bottom."

Massive selling of shares to meet margin calls are unlikely as the share-price-to-margin loan ratio in Taiwan stands at an average 137 percent, more than the required minimum of 120 percent, the Financial Supervisory Commission said in a statement.

The government controls the Civil Service Pension Fund, the Labor Pension Fund, the Labor Insurance Fund and the Postal Savings Fund, as well as a special National Stabilization Fund used when the market is threatened by so-called non-economic forces.

Taiwan Lenders

Taiwan lenders have total liquidity of NT\$5.65 trillion, of which NT\$2.06 trillion are deposits with the central bank and NT\$3.59 trillion are certificates of deposit issued by the central bank, according to a statement by the central bank of the Republic of China (Taiwan) today.

The Taiex index lost 4.5 percent to 5,778.08 as of 1:09 p.m., the lowest since Oct. 31, 2005, as the Banking and Insurance sub-index fell to a five-year low.

Cathay Financial Holdings Co., the largest financial-services company, fell by its 7 percent limit to NT\$51.30, a three-year low, after saying it holds NT\$1.5 billion of Lehman-related securities. Shin Kong Financial Holding Co., owner of Taiwan's third-largest life insurer, lost 6.8 percent to NT\$13.80.

The company said it expects losses of NT\$2.5 billion from investments in Lehman bonds made by its insurance and banking units.

My view - [The Taiwanese stock market](#) is being led on the downside by the [Banks and Insurance Index](#) which is looking even more overextended. If the

government is prepared to buy stocks then this is a strong potential support and is not to be dismissed. In past instances governments have always been successful when they intervene to support their market because they can change the rules to manufacture the result they want. In the current environment this may seem like an unlikely scenario and I am certainly not advocating jumping in with both feet but the first upward dynamic will help put a short-term floor under the market. A sustained break above the 7000 would suggest the bulls have regained the upper hand.

China May Cut Rates Again, Boost Spending for Growth - This [article](#) by Li Yanping and Kevin Hamlin for Bloomberg covers the change in focus at the Chinese central bank from inflation fighting to promoting growth. Here is a section:

China may cut interest rates again, ease limits on bank lending and boost spending to spur economic growth after lowering borrowing costs for the first time in six years.

“Policy makers will consider further interest-rate cuts in the coming month, in conjunction with a more proactive fiscal policy,” said Jing Ulrich, chairwoman of China equities at JPMorgan Chase & Co. in Hong Kong. The central bank yesterday reduced the one-year lending rate and lowered the proportion of deposits that the nation's smaller banks must set aside.

The slowest inflation in 14 months gave China room to lower borrowing costs and protect jobs as the outlook for exports dims and the credit crisis deepens. China's stocks tumbled today after Lehman Brothers Holdings Inc. filed for bankruptcy and Bank of America Corp. agreed to buy Merrill Lynch & Co.

“A gradual easing cycle has probably begun,” said Alec Young, an international equity strategist at Standard & Poor's in New York. “The focus is no longer on inflation and is more on China's growth. The rest of the world is flirting with a recession and China's growth is slowing too.”

The People's Bank of China reduced the one-year lending rate to 7.20 percent from 7.47 percent, effective today. It lowered the reserve-requirement ratio for smaller banks to 16.5 percent from 17.5 percent.

'Important Problems'

The CSI 300 Index of stocks fell 2.6 percent as of the 11:30 a.m. trading break in Shanghai today as banks declined. The yuan climbed 0.2 percent to 6.8324 against the dollar as of 12:02 p.m., the biggest gain in six weeks, as the U.S. currency slumped.

The rate cut is “to help solve important problems in our economy for its continued stable and fast development,” the central bank said in a statement on its Web site yesterday, when markets were closed for a holiday.

In July, the central bank reduced restrictions on how much banks can lend by raising 2008 loan quotas for national banks by 5 percent and regional lenders

by 10 percent, according to reports by Goldman Sachs Group Inc., BNP Paribas SA, and China Merchants Bank Co.

It's likely those quotas, the main constraint on borrowers, will be eased again, said Mark Williams, a London-based economist with Capital Economics Ltd. The rate cut will have a limited impact on the economy because bank lending financed just 15 percent of fixed investment last year, Williams said.

Shanghai Stocks Fall

The Shanghai Composite Index of stocks fell 3.2 percent to 2,013.91 as of 11:30 a.m. after earlier dropping below 2,000.

It was "suspicious" that the central bank acted when the index was near 2,000, Williams said, adding that some people thought that level "was a floor at which the government would intervene to shore up the market."

China last week released data indicating the economy slowed. Inflation cooled to 4.9 percent in August, export growth slowed and industrial production expanded by the least in six years. China's economy expanded 10.1 percent in the three months to June 30 from a year earlier, the fourth straight quarter of slower growth.

Asset-market weakness is not limited to stocks. Property could be headed for a "meltdown" as home prices and sales decline, Morgan Stanley said Sept. 12. In August, prices rose at the slowest pace in 18 months, the government said today. Property companies' shares rose today on the cut to borrowing costs.

My view - The Chinese authorities have slowly introduced measures to support the market over the last year. So far these have been failed to gain [traction](#). Cutting interest rates for the first time in six years is a powerful signal focus has shifted back to promoting growth from fighting inflation. If a series of further rate cuts follows, it will lend an important tailwind to markets generally but an upward dynamic is needed to suggest that investors are taking this change of emphasis on board.

Email of the day - [on the ETF Securities exposure to AIG](#):

"The [link](#) above gives some information on ETFs with links to AIG, in particular ETCs issued by Commodity Securities Ltd."

My comment - [Thank you for this informative link which might also be of interest to other subscribers.](#)

Wednesday 17th September 2008

U.S. Stocks Plunge as Lending Freezes Up Following AIG Takeover - [Here is the opening from today's big story, reported by Bloomberg](#):

U.S. stocks tumbled as bank lending seized up in the wake of the

government's takeover of American International Group Inc., raising concern that more of the nation's biggest financial companies will fail.

The Standard & Poor's 500 Index lost 4.7 percent, extending its decline from an October record to 26 percent and erasing half its gain from the five-year bull market that began in 2002.

Goldman Sachs Group Inc. and Morgan Stanley, the only remaining independent brokerages on Wall Street, plunged the most ever. General Electric Co., the world's third-biggest company, fell 6.7 percent and U.S. Steel Corp. slid 11 percent. Yields on three-month Treasury bills sank to the lowest since World War II as investors sought the relative safety of government debt, and a measure of corporate borrowing costs surged above the level seen during the crash of 1987.

``It's ugly," said Michael Mullaney, a Boston-based money manager for Fiduciary Trust Co., which oversees \$10 billion in stocks and bonds. ``It's about the worst I've seen it in 25 years. You have to have free-flowing credit to lubricate the system. That's not happening right now."

[And a paragraph on short selling:](#)

Naked Shorts

The Securities and Exchange Commission stiffened regulations against manipulative short-selling after the routs in AIG and Lehman. The new rules force traders to borrow shares before selling them short and make it a fraud for investors to lie to their broker about locating stock to close positions.

My view - [This is a small step in the right direction by the SEC...at last, but they need to do more \(see also my comments related to emails 1 & 2 below\).](#)

Russian bourses halt trading for second day - [This report from the Financial Times covers the latest developments in Russia's market meltdown. Here is the opening:](#)

Russia's two main bourses, RTS and MICEX, said on Wednesday they were suspending trade until further notice from the state's main market regulator as shares continued to tumble one day after their steepest decline in more than a decade.

Russian stocks had continued to slide on Wednesday morning even as the government unveiled new anticrisis measures to pump up to \$29.5bn in extra budget funds into the three main state-controlled banks.

Traders at Micex, where early trading was suspended temporarily as investors ignored assurances by Russian officials

The dollar-denominated RTS was down 6.4 per cent and the rouble denominated MICEX was down 3.1 per cent when the suspension was

enforced with the two main state-controlled banks, Sberbank and VTB leading the slide.

Analysts said state cash being pumped into state banks was not being filtered into the rest of the system, which is being hammered by a liquidity squeeze as domestic investors faced margin calls on loans collateralised by shares.

"Russia doesn't have a liquidity problem. It has an intermediation problem," said Roland Nash, head of research at Moscow investment bank, Renaissance Capital.

"You can't borrow on the interbank market," he said.

Brokers have been pulling credit lines amid widespread fears of defaults as local clients saw leveraged shareholdings wiped out by the market slide. One Moscow investment bank, KIT Finance, said on Tuesday night it had failed to meet payments on several financial obligations because clients had failed to meet payments to it. The bank said on Wednesday that it was in talks with a strategic investor on stake sale. One potential suitor, VTB, however declined to comment.

My view - Surging commodity prices in 3Q 2007 and 4Q 2008 ensured that resources markets were among the last to peak. Russia ([weekly](#) & [daily](#)) had lost some of its uptrend consistency in January, with the sharp downward break. However that setback did not halt the sequence of higher reaction lows, which are the hallmark of most strong upward trends.

With the price of crude oil surging, Russia managed one more push to a new high before peaking on 19th May and spectacularly failing to maintain that last upward break. The RTSI\$ Index went into freefall as crude oil weakened. Russia's stock market is another casualty of global race to deleverage, which continues to sweep through many asset classes.

Where do we go from here?

The RTSI\$ Index has now fallen over 57%. The trend has accelerated recently and this is a Type-1 ending characteristic as taught at The Chart Seminar. Normally, the psychological 1000 level could be expected to provide some support but these are not normal times, so we may see an additional slide towards the platform of support evident below 800, which launched the last huge advance.

That would represent a considerable overshoot in my view because RTSI\$ Index is underpinned by some of the lowest valuations, currently shown as an historic PER of 5.63 and dividend yield of 3.23%. It also has one of the better growth rates among emerging markets, 7.5% for 2Q, although this will decline with the slide in oil and gas prices.

Yes, recent politics have not helped and the government is not shy about dipping into profits from the energy giants. It is cavalier regarding the rights of minority shareholders. Nevertheless, Russia has a stable, albeit authoritarian

government, vast energy and mineral resources, and a strongly growing economy, ensuring a flourishing consumer sector.

In another example of *Back to the Future*, which I mentioned yesterday, subscribers are gaining a chance to buy Russia cheaply once again. You may prefer to wait until the dust settles and a new base forms.

Emails of the day (1 & 2) - On how to protect one's cash:

"Although I agree wholeheartedly with your long-term themes, when one has to wonder about the viability of banks where we keep our cash, then that makes me sit up and ask a few more questions."

And:

"With the current market situation when it seems that any bank is at risk of going belly up, have you any thoughts as to protect cash holdings? You have stated from time to time that you like to hold a relative amount of cash and most would probably have some at this juncture. I am sure that the subject is exercising a number of minds at present"

My comment - I have received several emails on this subject, which is likely to be of concern to many of us. The spectre of financial shares reeling once again is alarming and testimony to the severity of this ongoing crisis. The banks in trouble created their own problems, due to excessive greed, leading to reckless leverage, appalling governance and management mendacity as it all went wrong. The official regulators were useless.

Unfortunately, these serious problems are being compounded by a roaming cabal of bear traders who single out financial targets, pyramid their short sales and even spread rumours to help their cause. This is laissez-faire capitalism at its worst because it is very destructive and serves no common good.

Some will argue that this is the unintended genius of creative destruction. Companies that deserve to fail are quickly forced into bankruptcy, in the best Darwinian fashion. Only the strong survive, ensuring a healthier and more dynamic economy in future. This is not without some merit and I agree that weak companies should be allowed to fail, rather than be rescued at taxpayers' expense.

Short sellers should not be vilified but they too have ethical responsibilities beyond the performance of their funds. Short selling is a legitimate tactic in pursuit of profit and to enable hedging. It can also improve market efficiency by increasing liquidity. However it needs to be regulated, as I have said before. Our economies are ill-served if bear raids are used to create panics and runs on banks, as we are currently seeing. Daily price swings of up to 30 or 50 percent by large-cap financial shares also undermine the orderly functioning of markets.

If you agree, what should regulators do and how can we help?

1. Demand that the SEC bring back the Uptick Rule
2. Ban naked short selling
3. Institutional investors can ensure that their shares are not lent to short sellers
4. As with long positions, require the disclosure of large short positions

As traders and investors, I believe that we also have communitarian responsibilities. I made a similar point earlier in the year, concerning the stampede into commodity futures trackers. This was driving up food and oil prices, as it would any other market similarly affected by a one-way surge of capital. Staple commodities were never intended to be long-term asset markets. Had investors and traders thought through the consequences of those strategies, they would have realised that their 'success' in terms of seeing crude oil surge to \$200 or more as hoped, would ensure the severest of global recessions and immense hardship for billions of people.

Returning to the concerns expressed in the two emails above, how do we protect our savings against bank failures?

I assume that most banks will survive. Nevertheless, the solvency crises that we see today are unprecedented in most people's living memory. Therefore we need to monitor the performance of bank shares closely, which subscribers can do in the Library (*see also Eoin's latest and highly informative bank review below*).

Deposit insurance varies from country to country but most of us hold savings in excess of that coverage. Unfortunately, the previously unthinkable is now a possibility; theoretically, those uncovered funds may be at risk. To eliminate that risk, you can temporarily remove the excess cash, place it under the mattress or in a secure safe, or put it in other banks. That last option becomes tedious in many countries, including the UK where deposit insurance is very low.

Fortunately, many of these banks also have stockbrokers, or if not you already have brokerage accounts elsewhere. You can place that cash in a "nominee's" account, which removes it from the bank's balance sheet, so it can no longer be lent. Therefore, in the unlikely event that the bank did go under, your funds should be safe, provided they were not fraudulently used by the bank. This latter risk should be very low.

Lastly, we have seen a small diversification away from cash this week. People hoovered up Damien Hirst's confections at Sotheby's on Monday and Tuesday, and today they piled back into gold and silver.

Resurrect the Resolution Trust Corp - My thanks to a subscriber for this item by Nicholas Brady, Eugene Ludwig and Paul Volker, posted on The Wall Street Journal Opinion site. Here is a brief sample:

The fact is that the financial system needs basic, long-term reform, but right now the system is clogged with enormous amounts of toxic real-estate paper

that will not repay according to its terms. This paper, in turn, is unable to support huge quantities of structured financial instruments, levered as much as 30 times.

Until there is a new mechanism in place to remove this decaying tissue from the system, the infection will spread, confidence will deteriorate further, and we will have to live through the mother of all credit contractions. This contraction will undercut the financial system, and with it, the broader economy that so far has held up reasonably well.

There is something we can do to resolve the problem. We should move decisively to create a new, temporary resolution mechanism. There are precedents -- such as the Resolution Trust Corporation of the late 1980s and early 1990s, as well as the Home Owners Loan Corporation of the 1930s. This new governmental body would be able to buy up the troubled paper at fair market values, where possible keeping people in their homes and businesses operating. Like the RTC, this mechanism should have a limited life and be run by nonpartisan professional management.

My view - [Sounds like a good idea.](#)

Today's interesting charts - [Subscribers can send interesting charts to colleagues, clients and friends, simply by clicking on the icon in the top right of the chart window.](#)

USA (S&P 500) - [Resumed downtrend and a close above 1215 is now required to question lower scope, while a sustained push above 1300 is still necessary to indicate potentially significant improvement.](#)

USA (VIX) - [Rallies have followed previous spikes by VIX \(daily with overlay, weekly & monthly\) but it has been higher in the past.](#)

Silver - [Big upward dynamic confirms support near \\$10 and a close beneath this level would be required to offset current scope for sideways to higher ranging.](#)

EUR/USD - [Appears to be building support and a new reaction low would be required to offset continuing scope for sideways to higher ranging.](#)

Crude oil - [Upward dynamic following accelerated decline suggests that a technical rally has commenced. A close beneath \\$90 is now required to offset scope for sideways to somewhat higher trading.](#)

Additional Commentary by Eoin Treacy

[How are European Financials performing relative to the Europe STOXX? - On Monday, I filtered the members of the S&P 500 Banks, Diversified Financials, Regional Banks and Thrifts & Mortgages Sectors to find the best and worst](#)

performers. This morning, the news was awash with financial stories such as HBOS being taken over by Lloyds TSB and Bank of Ireland halving its dividend, I was curious to see how the European Financial sector is performing.

The [DJ Stoxx 600](#) which includes shares outside the Eurozone completed a Type-3 top in early January as it broke below 350 and remains in a consistent downtrend. The Index has yet to show a conclusive sign that it has bottomed and an upward dynamic is needed to suggest that it has found at least a short-term floor. A sustained move above 300 would be needed to break the sequence of lower rally highs and indicate that the bulls may be regaining the upper hand.

The [DJ Stoxx Banks Index](#) remains in an overall [downtrend](#) against the wider Index and needs to sustain a move above 1.06 in order to suggest that it is capable of reversing its 18-month pattern of underperformance. The [DJ Stoxx 600 Financial Services Index](#) also remains in a downtrend against the wider index and would need to sustain a move above 1.1 to offset scope for some further downside. The [DJ Stoxx 600 Insurance Index](#) continues to range above 0.66 and would need to sustain a move below that level to question scope for some further ranging.

What surprised me about the above ratios is the fact that there is a distinct divergence between the performance of the European Banks relative to their Index compared to how the [S&P Banks Index](#) is performing relative to the [S&P 500](#). European banks bounced against their Index in mid-July but have given up almost the entire advance. US Banks topped out nearly two months before their European counterparts and continue to lead. If US Banks continue to outperform the S&P and this is still early days, then perhaps they will lend a positive leash to their European counterparts.

I put the members of the DJ Stoxx Banks, Financial Services and Insurance sectors into a section of my Favourites and filtered the list to find the best and worst performers. This was done using the [Performance Filter](#) and the [High Low filter](#). For instructions on how to create these filters please see Comment of the Day on [September 10th](#).

What becomes immediately obvious from the results of the High Low filter is that there are a lot more European companies making new lows than new highs. Compared to the results for the [S&P 500 Financials filter](#), this is a stark divergence.

The top two performing companies are listed in Switzerland with [PSP Swiss Property](#) and [Valiant Holding](#) making new highs and close to new highs respectively. PSP Swiss Property topped out following an impressive advance in May 2007 and fell by about 25%. It found support above chf50 and rallied well from January onwards. It broke upwards from the most recent short-term range last week and would need to sustain a move below chf65 to question potential for a successful upside break. Valiant Holding remains in a consistent uptrend and would need to sustain a move below chf190 to question the integrity of the overall move.

A number of other companies are relative outperformers but remain in ranging phases. Examples are [Admiral Group](#), [CNP Natle A Portfeuille](#), [IG Index Holdings](#), [HSBC](#) and [Royal & Sun Alliance](#). [Liberty International](#) is also of interest in this group because of its impressive rally over the last month. It has broken the medium-term downtrend and a sustained move to new lows would be needed to question scope for some further higher to lateral ranging.

[Banco de Valencia](#) is also interesting. It rallied significantly this week and for a brief time was forming an impressive upside weekly key reversal. The share was in a consistent downtrend which had been gathering pace and the recent action puts at least a near-term floor under the price. A sustained move below €6 would be needed to question scope for some additional higher to lateral ranging.

However, what truly stands out from the charts on a bottom-up basis is how many of these shares remain under pressure. [Group Bruxelles Lambert](#), [Allied Irish Bank](#), [Alpha Bank](#), [Assicurazioni Generali](#), [Baloise Holding](#), [Banco Espirito Santo](#), [Bank of Greece](#), [Bank of Ireland](#), [Bradford & Bingley](#), [Commerzbank](#), [Deutsche Postbank](#), [DNB Nor Asa](#), [EFG EuroBank Ergasias](#), [Fondiaria](#), [Fortis](#), [Glithnir Banki](#), [Immofinaz Immobilien Anlagen](#), [Industrivarden](#), [Intermediate Capital Group](#), [IVG Immobilien](#), [Jyske Bank](#), [KBC Ancora](#), [Kinnevik Investment](#), [Muenchener Rueckver](#), [Natexis Banques Populaires](#), [Pargesa Holdings](#), [Pireaus Bank](#), [Raiffeisen International Bank Holding](#), [Swedbank](#), [Swiss Life Holding](#), [Swiss Re](#), [Sydbank](#), [Unicredito Italiano](#), [UBS](#), [Unipol](#) and [Vienna Insurance](#) among others all made new reaction lows this week and remain close to those levels.

We cannot rule out the possibility that these shares will continue to move lower and given the commonality across European countries this would seem likely; at least in the short term. In order to demonstrate that they have found near-term support, they need to sustain moves back above their July lows. To suggest that they have reached more long-term lows, they need to break their sequences of lower rally highs. Considering the technical damage done, it will take time before these shares can garner enough of support to sustain anything more than technical rallies.

Macquarie Slumps; Denies Reported Refinancing Problem - This [article](#) by Laura Cochrane and Shani Raja for Bloomberg covers the difficulties currently being experienced by Macquarie Bank, here is a section:

Macquarie Group Ltd., Australia's biggest investment bank, fell to its lowest in more than four years in Sydney trading as it sought to defuse speculation of a potential funding shortfall.

The stock slumped 7.8 percent while the cost to protect Macquarie's debt jumped to a record high. The company said a report in the Australian newspaper that it may face difficulties refinancing A\$5 billion (\$4 billion) of debt was misleading.

The global credit crisis that's sent Lehman Brothers Holdings Inc. bankrupt

and forced American International Group Inc. into the hands of the U.S. government is raising doubts about Macquarie's debt-driven funding model. Babcock & Brown Ltd., another Sydney-based firm that also borrows to buy assets to bundle into funds, lost 97 percent of its market value this year.

“Questions were raised as to whether Macquarie would be able to meet its funding requirements,” said Angus Gluskie, who helps oversee \$500 million at White Funds Management in Sydney. “In the current conditions, people are skeptical.”

Macquarie is confident it can refinance debt even as the global credit squeeze worsens, spokeswoman Paula Hannaford said in an interview today.

The outlook on Macquarie's credit rating was today lowered to negative from stable by Standard & Poor's, implying a one-in-three chance of a cut to the bank's rating.

The negative outlook reflects a potential weakening in Macquarie's business due to the increasing dislocation of global financial markets, S&P said in an e-mailed statement.

Value Cut

Macquarie's shares fell A\$2.87 to A\$33.93 at the close of trading in Sydney, the lowest since August 2004. The stock's lost 26 percent this month alone amid the global credit squeeze that's wiped A\$12 billion from the company's market value this year.

The company can borrow A\$3.8 billion through an unused credit facility and doubled its so-called “liquid assets” to A\$20 billion at June 30 from a year earlier, it said today in a statement to the Australian stock exchange.

“The fundamental story at Macquarie is very different from anything you've seen in the U.S.,” said Patrick Winsbury, an analyst at Moody's Investors Service in Sydney. “They have done an extremely good job avoiding all the pitfalls so far.”

Winsbury said Macquarie has “a good buffer of capital,” which is 40 percent more than regulatory requirements.

My view - At The Chart Seminar (TCS) we talk about the various attributes of any market and one of the most important is that they are predatory. Even the best intentioned company with a relatively healthy balance sheet will have great difficulty dispelling rumours about its financial health once they begin. Given the precedents set over the last 18-months, some cynics even short the shares as soon as they hear such a proclamation because they immediately think what is the bank hiding? The extent to which many banks have fallen is probably not a fair reflection of their financial health but is more about the crowd being opportunistic in attacking weakened companies. Another saying from TCS is that in a bear market they take them out one at a time and shoot them. This is evident today in the action seen in [Goldman Sachs](#) and [Morgan Stanley](#).

[Macquarie](#) reasserted its overall downtrend today with the drop below AU\$41.50. A sustained move back above that area would be needed to question scope for additional downside. A sustained move back above AU\$55 would be needed to suggest a medium-term floor has been reached.

Buy Exotic, Not Vanilla, Options for Rupee Risk, Barclays Says - [This article](#) by Anil Varma for Bloomberg covers the recent weakness of the Indian Rupee. Here is a section:

Overseas investors should buy so-called exotic rupee options that offer limited protection at a lower price to guard against the Indian currency's steepest slide in 17 years, according to Barclays Plc.

Traders should avoid the costlier and more common "vanilla" options because the rupee's rising volatility is raising derivative prices, said Peter Redward, head of research for emerging Asia at the U.K.'s third-biggest bank. Money managers should buy partial defense against rupee weakness as India stems the currency's slide, he said. The currency plunged 1.9 percent yesterday, the most in a decade, and jumped as much as 1.4 percent today.

"The balance of risks tilts toward more rupee losses," Singapore-based Redward said in an interview. "It's much better to use structured options to hedge than simple vanilla contracts, which are too expensive."

India's rupee is headed for its biggest slide since 1991, when a balance-of-payments crisis forced the nation to pawn its gold with the International Monetary Fund to pay for imports. It is poised for the first annual loss since 2005 as overseas investors pulled out a record \$8.1 billion from local stocks this year.

The rupee has slumped 15 percent this year, the second-worst among Asia's 10 most-active currencies outside Japan. It traded at 46.3325 at 12:19 p.m. in Mumbai, after falling to a two-year low of 46.975 yesterday, according to data compiled by Bloomberg.

My view - The Dollar topped out against the [Rupee](#) in 2002 following a generational long advance and declined considerably in the following years. The Dollar found support near R40 at the end of last year and the break above R41.20 broke the medium-term downtrend. The greenback remains in an aggressive advance which is looking overextended and it encountered resistance near R47 today. R47 also marked areas of resistance in 2004 and 2006. A sustained move above this area would be needed to suggest a test of the highs near R49 and a sustained move above that area would be needed to question the long-term bullish hypothesis for the Rupee.

Today's interesting charts - The Chart Library has two Search Engines. One searches the more than 17,000 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.

Gold - surges [upwards](#) having found support near \$750. A sustained move below that level would now be needed to question scope for some further higher to lateral ranging.

Natural Gas - finds [support](#) above \$7 and would need to sustain a move below that level to question scope for some additional upside.

UK (FTSE-100) - breaks [below](#) the July lows and needs to rally swiftly back above 5000 to offset scope for further downside.

Indonesia - rallying from deeply [oversold](#) territory and a sustained move below 1600 would be needed to question scope for some further upside.

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

"Just for info IPL listed on ASX has today started trading after 20 for 1 split. Interim code is [iplda](#).

"Also, could you please add [cfu.ax](#) - the parent is Australian and you already have aim security in library.

"Keep up the good work."

My comment - [Thank you for the head's up and both of these shares have been added to the Chart Library](#).

Thursday 18th September 2008

Central Banks Offer Extra Funds to Calm Money Markets - [This is today's main story, reported by Bloomberg](#). [Here is the opening](#):

The Federal Reserve almost quadrupled the amount of dollars central banks can auction around the world to \$247 billion in a coordinated bid to ease the worst crisis facing financial markets since the aftermath of the 1929 Wall Street crash.

The Fed increased the amount of dollars that the European Central Bank, the Bank of Japan and other counterparts can offer from \$67 billion ``to address the continued elevated pressures in U.S. dollar short-term funding markets." The Bank of England, the Bank of Canada and the Swiss National Bank also participated. Several of them lent funds in their own currencies as well with the Fed adding a record \$105 billion in temporary reserves.

Policy makers have struggled to revive confidence in markets this week as investors stockpiled money on concern more financial institutions would fail after the bankruptcy of Lehman Brothers Holdings Inc. and the U.S. government bailout of American International Group Inc. The cost to hedge against losses on U.S. government debt climbed to a record yesterday.

“There's a complete lack of faith in the markets," said Jim O'Neill, chief economist at Goldman Sachs Group Inc. in London. “There's a lot of cash hoarding and people losing trust in banks, so the central banks are acting to relieve that. This might not be the last time they have to act.”

My view - This is the beginning of the coordinated central bank policies that I have been discussing. I agree with Jim O'Neill, we will need to see more of this but it is an important development, discussed extensively in today's Audio.

Email of the day (1) - On gold:

"Hi David, I went to my gold dealer today [*Wednesday*] to buy some gold coins. He told me that he had had a tremendous run on gold the last few days, and that he only had a handful left. Also the premium which had been between \$15 to \$25 is now \$40 per ounce. Needless to say, I cleaned him out."

My comment - Well done. As you know, Gold's price is subject to supply and demand, with the latter heavily influenced by sentiment, just like other investments. However unlike other reserve assets gold is in the reassuring position of being no one's liability.

UK Regulator Stops Short Selling of Bank Shares - I believe this announcement, [reported](#) by Bloomberg, came after the close, and can only have a bullish influence tomorrow. I agree with this section:

“This was the right thing for the FSA to do," said Mamoun Tazi, a London-based analyst at MF Global Securities Ltd., who has a “neutral” rating on HBOS and a “buy” recommendation on Lloyds. “I'm generally in favor of short-selling as an investment strategy and don't think it's wrong. But the market has gone too far and something needed to happen.”

“While we still regard short-selling as a legitimate investment technique in normal market conditions, the current extreme circumstances have given rise to disorderly markets," said Hector Sants, the FSA's chief executive officer, in an e- mailed statement. “We have taken this decisive action, after careful consideration, to protect the fundamental integrity and quality of markets and to guard against further instability.”

Email of the day (2) - On My personal investment positions:

"First of all thank you for your superb coaching. Your views are very well regarded and appreciated in this side of the globe [*Ed: South America*]. I want to know your thoughts about your top 10 investments. Have you kept them without reallocating risks? Which could be the triggers that would make you change your views?

My comment - Thank you for your thoughtful remarks.

Investor psychology has been dominated primarily by fear during the last fifteen months, and not without good reason, as we have increasingly discovered. The experience has been traumatic and in the west we have seen financial developments that go beyond our personal experience.

However we also know that the world does not end, at least not for manmade financial reasons. Bear markets are temporary because there are limits to deleveraging and asset liquidation. Recent action represents the fifth wave of capitulation selling that we have seen. Cash is an appealing haven in times of crisis, but it is also a wasting asset over the long term.

With bank shares still reeling, we obviously cannot say that the problems are over. Consequently the risk of additional selling remains. Stock market indices are in downtrends. Financial sector problems inevitably weigh on the broader economy, although the latter will remain in better overall shape.

The really good news - inflation is now a rapidly waning problem, although it will take longer for official statistics to reflect this. If the appropriate analogy is to think in terms of inflationary fire and deflationary ice, we have gone from ice over fire at the beginning of this decade, to fire over ice as central banks stoked up money supply, to ice over fire once again, in response to higher rates and asset price disinflation.

Consequently central banks are now in a position to switch their policy emphasis from fighting inflation to stimulating GDP growth. They may remain crisis oriented, but at least we are beginning to see the coordinated intervention that I have been discussing and expecting.

My personal long-term investment portfolio has suffered plenty of profit erosion over the last year. Having said that I would ride it out, I will certainly not be selling during what I expect is the beginning of the end of this bear market. However, as conditions improve I am likely to shift some of my 'just in case' cash holding into equities over the next few months. This will almost certainly be in Fullermoney themes, but I will also broaden the portfolio's coverage. Meanwhile, I'm just watching the charts, reading the articles and reports, and commenting.

Bright Side of a Total Financial Market Collapse - A bit of hyperbole in the title, one hopes, but this is an interesting [column](#) by Michael Lewis for Bloomberg.

Email of the day (3) - On protecting your cash:

"Re: the email from yesterday's letter about the above. I had a similar problem and did not wish to open numerous accounts. What I did was open an e-savings account with Northern Rock that pays 6%. The limit is £250000 per investor and the risk is on the UK Treasury so should be OK !!!?? Obviously

6% may not be a good enough return to someone wanting to invest for a long time.

"I thought this may be useful to some readers."

My comment - Well done and thank you so much for this useful information, contributed in the spirit of Empowerment Through Knowledge.

Let's get to the bottom line - My thanks to a subscriber for this informative conclusion by Russell Napier of CLSA:

Let's get to the bottom line. A deleveraging process is under way. It can happen against a background of bankruptcy, deflation, declining cash flows and bank bankruptcy or in a slower way against a background of inflation. Both reduce the debt burden, but one is socially jarring and led in the past to mass unemployment and arguably WWII. Democracies will choose the inflationary approach. This is not evident today, but it will be more evident soon enough as the BoJ, ECB, BoE and others realise that their current monetary policy is driving them not to slower growth and lower inflation but to deflationary calamity. Today, you can see the calamity of the deflationary disease but what will you see tomorrow, or the day after, if the monetary cure pours from the medicine jars of the global central banks?

It's your call. Nobody is asking you to be brave as most of us are in the business of buying equities somewhere in the world. This is a business we still hope to be in next year. Now, as a fiduciary do you want to commit your funds to equities in economies where deleveraging, albeit against a background of inflation, is almost inevitable over the long term? Or perhaps if you are in the business of owning equities, perhaps you should consider committing your funds to equities in economies where loan-to deposit ratios are low, consumer and corporate gearing is low, savings are high and many external accounts are in significant surplus? It is that time when anybody who still wishes to be an investor in equities next year has to make the choice between these two conflicting systems. It's your call.

My view - There is a hint of anxiety and self-interest to this. As Asian brokers with many clients in the west, CLSA may be at the sharp end of global deleveraging. Nevertheless it is a class outfit, renowned for its research, and I personally cannot fault Russell Napier's conclusion above, diplomatically presented as a question. When has it not paid to buy into Asia's emerging markets following a terrifying bear trend?

Email of the day (4) - On deflation:

"I've attached an [article](#) I came across from Adam Posen of The Institute for International Economics. Although written in 2006, it discusses the Japanese deflationary period of the 90s and seems to be quite pertinent to the present economic environment. Given the tremendous amount of liquidity being added by Central Banks presently, until inflation spirals out of control, which is a

necessary consequence, we may have to face a period of deflation first. Two items to note: Point 11-financial supervisory agencies must make banks write off bad loans and recapitalise. Just providing liquidity doesn't improve bank behaviour. And in the summary, central banks must commit to being accommodative and move expectations. Moving expectations will move outcomes (confidence must be restored)."

My comment - [Many thanks, this is certainly an informative report.](#)

[If anyone understands the dangers of a destructive deflation, which I will define as shrinking sales, output and profits - it is Ben Bernanke. That is fortunate because he is at the epicentre of the credit crisis and financial solvency problems.](#)

[McCain Says He Would Fire SEC's Cox If President - Here is the opening from Bloomberg's report:](#)

Republican presidential nominee John McCain said he would fire Securities and Exchange Commission Chairman Christopher Cox if he were president.

"The chairman of the SEC serves at the appointment of the president and in my view has betrayed the public's trust," McCain said at a rally in Iowa. "If I were president today, I would fire him."

SEC spokesman John Nester declined to comment. President George W. Bush's spokeswoman, Dana Perino, said in response that Cox "has the president's confidence."

Turmoil in the financial markets has shaken public confidence. Lehman Brothers Holdings Inc. filed for bankruptcy this week and Merrill Lynch & Co. was sold to Bank of America Corp. To stem the crisis, the Bush administration has approved the takeover of American International Group Inc. and ordered the rescue of mortgage giants Fannie Mae and Freddie Mac.

The SEC "kept in place trading rules that let speculators and hedge funds turn our markets into a casino," the Arizona senator, 72, said. "We cannot wait any longer for more failures in our financial system."

[My view - Christopher Cox is the worst Chairman of the SEC in my lifetime, and McCain is wrong in saying that he "kept in place trading rules that let speculators and hedge funds turn our markets into a casino." Cox created the problems by removing the Uptick Rule on short selling in June 2007 - talk about timing! He also allowed short sellers to slide around the borrowing of stock requirement. Naked short selling is supposed to be illegal.](#)

[This disastrous decision and failure to enforce policy has contributed to financial anarchy. Cox is now backtracking somewhat but only because he is being pushed.](#)

Email of the day (5) - [On the next big calls](#):

"David.... at this juncture the two most important services you and Eoin can provide IMO are:

- 1) to call a high probability bottom in stock markets.
- 2) to recommend what to buy in the next bull market including a re-evaluation of Fuller Money themes."

My comment - I agree - watch this space, and keep listening to the Audios because it is more of a journey than a eureka moment.

However, there is growing evidence that we are near another climactic low. It is too soon to say whether this is *THE* low rather than just *A* low within the overall downtrends. Nevertheless markets are closer to their eventual trough by virtue of the additional declines. Also, I am encouraged by the coordinated central bank action. This is a new development, and predicted by Fullermoney.

SEC May Require Hedge Funds to Reveal Short Positions - [Belated action by the SEC, reported by Bloomberg](#). Here is the opening:

The U.S. Securities and Exchange Commission may require hedge funds to disclose their short-sale positions and plans to subpoena the funds' communication records in an effort to stem turmoil in stock markets.

Hedge funds and investors managing more than \$100 million in securities would be "required to promptly begin public reporting of their daily short positions," Chairman Christopher Cox said in a statement yesterday. The proposed disclosure is in addition to three SEC rules that took effect today aimed at reducing manipulative trades betting on a drop in share prices.

Lawmakers including U.S. Senate Banking Committee Chairman Christopher Dodd and executives such as Morgan Stanley Chief Executive Officer John Mack say short sellers may be spreading false information and using abusive tactics to attack companies. Hedge funds say poor business strategies are to blame and an industry spokesman said the SEC announcement was "abrupt."

My view - Obviously hedge funds did not create the banking problems, but some have aggravated a difficult, dangerous and costly situation. This is an ethical issue and markets will function better if participants rediscover the communitarian values of responsibility. (See also yesterday's item on this subject.)

Please note - I will be away until Monday 29th September.

Additional Commentary by Eoin Treacy

Buffett, Greenberg May Find AIG Rummage Sale Bargains - [This article by Andrew Frye for Bloomberg covers the opportunities arising from the liquidation of insurance and financial businesses. Here is a section:](#)

Billionaire Warren Buffett and Maurice "Hank" Greenberg may find bargains as the U.S. government opens up American International Group Inc., the biggest U.S. insurer, for a rummage sale.

AIG will probably sell assets to raise cash and repay the \$85 billion loan it secured Sept. 16 from the Federal Reserve to stay in business. The insurance units are solvent, regulators said, because New York-based AIG was barred from tapping reserves at the subsidiaries even as \$18 billion of losses tied to home loans drained capital from the holding company.

Buffett, chairman of Berkshire Hathaway Inc., and Greenberg, who ran AIG for almost 40 years until 2005, may bump elbows with Allianz SE Chief Executive Officer Michael Diekmann and Munich Re's Nikolaus von Bomhard. Both told reporters this week they would consider bids for parts of AIG.

"There's going to be widespread international interest in some of the areas where AIG has accumulated a dominant presence," said Frank Betz a partner at Warren, New Jersey-based Carret Zane Capital Management, which holds Berkshire shares. Buffett is probably "lurking in the shadows," looking for a deal, Betz said.

Insurers are buying U.S. property and casualty companies at the fastest rate in 10 years, announcing 33 deals worth \$13.5 billion since Dec. 31, after profits rose in 2006 and 2007 on sales outside the U.S. and lower-than-average losses from Atlantic hurricanes. Buffett and CEOs including Prudential Financial Inc.'s John Strangfeld have said they'll be ready to make purchases when the credit crunch pushes rivals to sell assets at distressed prices.

New CEO

The government tapped former Allstate Corp. chief Edward Liddy to oversee the divestitures. Liddy replaces AIG CEO Robert Willumstad who took over in June and saw the company collapse before he could present a reorganization strategy, which was set to be unveiled Sept. 25. Liddy arrived yesterday and hadn't yet presented a plan, said spokesman Nicholas Ashooh.

AIG may sell assets including the biggest commercial insurance business in the U.S. and "the best Asian insurance franchise in life and general insurance of any Western company," said David Havens, a credit analyst at UBS AG.

Investors led by Greenberg said hours before the federal loan announcement they might want to buy the insurer's subsidiaries. Greenberg, who controlled 11 percent of AIG's shares before the takeover, the largest block, has the

ability to assemble "huge pools of capital" and will likely seek to bid for assets, Betz said.

My view - The trouble AIG got itself into was of its own making and its management bears full responsibility. However its competitors must now be rubbing their hands with glee as they have the opportunity to acquire some of its units at fire sale prices. This further stresses the point that companies with strong balance sheets are best placed to weather this storm and will come out the other side with a competitive advantage.

Asian Currencies Retreat After Interventions Falter - This [article](#) by Patricia Lui and Wes Goodman for Bloomberg covers the continued weakness of Asian currencies against the Dollar. Here is a section:

Asian central banks are giving up efforts to stop their currencies falling after an investor exodus overwhelmed the largest intervention in a decade.

Policy makers are reducing their support for South Korean won and the Philippine Peso, allowing faster depreciation across Asia, according to HSBC Holdings Plc estimates and data compiled by Bloomberg. That's a change from two months ago, when the Bank of Korea sold a record \$20.9 billion and the Reserve Bank of India reduced foreign exchange reserves by \$7.9 billion, London-based HSBC said.

The shift prompted ING Investment Management and Daiwa SB Investments Ltd. to bet on declines even after the won slumped 16 percent this year and the rupee slid 15 percent. A slowdown in the region's economies is causing investors to flee and putting Asian stocks on course for their worst year since 1990.

Foreigners sold \$32 billion more shares than they bought in South Korea and \$8.6 billion in India.

"The willingness to intervene and burn reserves to maintain a specific level versus the dollar is a lot less," said Joel Kim, head of Asian debt in Hong Kong for ING Investment, which oversees \$12 billion in assets and is part of the largest Dutch financial services company. "We've been selling across the board."

Shifting Strategy

Central bankers say they will accept weaker currencies.

South Korea's Vice Finance Minister Bae Kook Hwan said on Sept. 11 that authorities will only buy or sell to influence exchange rates when won moves are "volatile." Two months ago, when the won was 7 percent stronger, the Finance Ministry pledged "stern action" to prevent excessive price swings.

The Bank of Thailand isn't planning to use its more than \$100 billion in reserves to hold back the baht's slide, Bank of Thailand Governor Tarisa Watanagase said today in Bangkok. "We will just move with the market," Tarisa said in a Bloomberg Television interview when asked about the baht.

Reserve Bank of India Governor Duvvuri Subbarao said on Sept. 9 in Mumbai that the central bank will be "flexible" and focus on managing price swings.

South Korea's reserves slid 8 percent in five months to \$243.2 billion, heading for the first annual decline in a decade. Last month, they dropped 1.8 percent, less than half the pace in August, a sign the central bank was spending less to prop up the won. India's cash reserves dropped 7.4 percent this quarter to \$280 billion and Thailand's fell 5 percent to \$101 billion.

My view - The [Asian Dollar Index](#) rallied impressively from its 2001 lows to a high over 115 in February. The current [correction](#) is larger than anything seen in the life of the move to date and is looking overextended. A sustained move above 111.5 would be needed to offset scope for some additional downside. Time will be needed before the Index can reassert the overall uptrend.

Considering that the Dollar appears to be weakening against the [Euro](#) and other major currencies, it may also be close to a peak when compared to some Asian currencies.

The Chinese [Renminbi](#) has paused, over the last month, in its managed advance and a sustained move below ¥6.8 would be needed to reaffirm the overall move.

The US Dollar is losing momentum against the [Singapore Dollar](#) and needs to sustain a move above [S\\$1.44](#) to offset scope for some further downside.

The Koreans made a conscious decision to allow their currency to weaken from last year and recent Dollar strength has seen the [Won](#) fall to more than W1150. The advance is looking overextended and is becoming increasingly volatile. A sustained move above 1150 would be needed to question potential for at least a partial retracement of recent Dollar gains.

The Thai authorities introduced sweeping measures to weaken their currency last year but were largely unsuccessful until quite recently. The recent move probably has more to do with Dollar strength than Baht weakness. The Dollar is now losing momentum and would need to sustain a move above [THB34.75](#) to question scope for some additional downside.

The Dollar completed a Type-2 [base](#) against the [Philippine Peso](#) in March and remains in a medium-term uptrend. A reaction larger than 2 pesos would be needed to question the integrity of the move.

The US Dollar found support against the [Taiwan Dollar](#) in March and broke [upwards](#) from the medium-term consolidation in August. The move remains quite consistent and a sustained move below TW\$31.8 would be needed to question scope for some additional Dollar strength.

Looking all of these currency pairs, the Dollar has had a spectacular move but is in many cases looking overstretched. It needs to sustain moves to new highs to offset scope for at least a partial retracement of recent gains.

Email of the day (1) - [on ownership of the Federal Reserve:](#)

"I'm intrigued.....who owns the Federal Reserve? Why do bankrupts like Fannie and Freddie end up with the Treasury and the taxpayer (socialising of losses as they say), while a solvent (by most accounts) but illiquid AIG is taken over by the Fed? The shareholders of the Federal Reserve must be smiling at the thought of 13.5% interest charged on \$85 billion...whoever they are..:-)"

My comment - [The citizens of the United States of America own the Federal Reserve according to the Federal Reserve's website.](#) Here is a section:

The Federal Reserve System is not "owned" by anyone and is not a private, profit-making institution. Instead, it is an independent entity within the government, having both public purposes and private aspects. As the nation's central bank, the Federal Reserve derives its authority from the U.S. Congress. It is considered an independent central bank because its decisions do not have to be ratified by the President or anyone else in the executive or legislative branch of government, it does not receive funding appropriated by Congress, and the terms of the members of the Board of Governors span multiple presidential and congressional terms. However, the Federal Reserve is subject to oversight by Congress, which periodically reviews its activities and can alter its responsibilities by statute. Also, the Federal Reserve must work within the framework of the overall objectives of economic and financial policy established by the government. Therefore, the Federal Reserve can be more accurately described as "independent within the government."

The twelve regional Federal Reserve Banks, which were established by Congress as the operating arms of the nation's central banking system, are organized much like private corporations--possibly leading to some confusion about "ownership." For example, the Reserve Banks issue shares of stock to member banks. However, owning Reserve Bank stock is quite different from owning stock in a private company. The Reserve Banks are not operated for profit, and ownership of a certain amount of stock is, by law, a condition of membership in the System. The stock may not be sold, traded, or pledged as security for a loan; dividends are, by law, 6 percent per year.

[The Fed and the Treasury have acted as lenders of last resort with both AIG and Fannie and Freddie. These investments on behalf of US citizens will hopefully pay of over time and any potential profit made will be on behalf of US taxpayers and no one else.](#)

Email of the day (2) - [on the cost of a subscription:](#)

"How much to get back in the game to subscribe? Maybe I have just enough after this week!"

My comment - [Thank you for your renewed interest in the Service. Every crisis begets an opportunity and this occasion will be no different. I was talking](#)

about the current market situation with Mrs. Treacy last night and she reminded me that the Chinese word for crisis 'wei ji' means dangerous opportunity. Today 64 stocks in the S&P 500 and 107 in the DJ Stoxx 600 have Price to Book ratios of less than 1. This is an unusually high number and is a further indication of how oversold the market is. That is not to say indices cannot become briefly more overextended because markets often overshoot as emotional responses replace rational analysis. One thing we can be sure of is that value is quickly returning. Many sectors are in need of some support building before they can justify anything more than a technical rally, but we are getting increasingly close to the next good buying opportunity.

As to the cost of a [subscription](#): You can take a one month trial for £46.00, a monthly subscription (with automatic renewal) for £46.00 or an annual subscription for £460.00. And don't forget, no subscriber pays the headline rate on continuous renewal. While the Fullermoney subscription is never discounted for new subscribers, everyone who renews before their subscription expires receives a loyalty discount.

The Chart Seminar 2008 - The November 13th & 14th [Chart Seminar](#) is filling steadily, so if you are thinking of attending, booking is advisable sooner rather than later to avoid disappointment. Remember delegates who pay before September 30th can take advantage of our early booking rate of £875 + VAT, thereafter the rate will be £950 + VAT.

Today' interesting charts - The Chart Library has a wide array of volatility indicators which may be of interest in the current environment.

Silver - holds yesterday's gain having found [support](#) near \$10. The upside can be given the benefit of the doubt as long as it holds above that level but it is likely to remain volatile.

US Dollar per 1 New Zealand Dollar - The [New Zealand Dollar](#) finds support near US\$0.65 and would need to sustain a move below that level to question scope for some additional upside.

VIX Index - falling back from the [highs](#) which suggests we may be at a climactic bottom. The Index would now need to sustain a move above 40 to offset scope for further downside.

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

"May I request you to kindly add the following two charts to the library?"

"[XLB](#) - spider materials select sector fund"

"[XLI](#) - spider industrial select sector"

My comment - These ETFs can now be found in the Chart Library.

Friday 19th September 2008

Commentary by Eoin Treacy

An update on bank shares - This week has seen tumultuous moves by the majority of financial shares. The long list of shares which were breaking down, posted on Wednesday, is probably worthy of review today considering the rebound seen in the UK and US financial sectors. They can all be found in the International Equity section of the Chart Library in the Europe DJ Stoxx 600 section.

Today I would rather concentrate on the performance of financial sector indices relative to their parent indices. Financial shares are a lead indicator for the stock market and their outperformance is something of a prerequisite for any recovery in the current environment.

In the USA, the [S&P Banks](#) Index found support above the July lows and broke upwards yesterday from a 6-week consolidation. It would need to sustain a move below 200 to damage the integrity of this nascent uptrend. Against the S&P 500, the [Banks](#) sector broke upwards on the 17th and would need to sustain a move below 0.16 to question scope for some further outperformance. The [S&P Diversified Financials](#) Index rallied strongly in both absolute and [relative](#) terms over the last few days but has yet to break upwards.

The banning of new short positions in financial shares until January led to a spectacular rally in the [FTSE-350 Banks](#). Relative to the wider Index, it found support in mid-August above the July lows and rallied from 2.25 once more this week. A sustained move below that level would be needed to question potential for an upside break.

The [DJ Stoxx Banks](#) Index found support near the July lows this week and is rallying strongly relative to the Stoxx 600. A sustained move above 1.075 would be needed to suggest a lengthier period of outperformance is likely.

The [S&P TSX Banks](#) found support in July and formed a consistent uptrend relative to the wider index. The sector found support at the top of the prior range this week and would need to sustain a move below 1.275 to offset scope for further upside.

The [Topix Banks](#) Index also broke upwards relative to the wider Index this week and would need to sustain a move below 0.205 to question scope for some additional upside.

The [Swiss Banks](#) Index briefly broke downwards against the SWX Supplement Index this week, but has since rallied significantly. A sustained move below 8 would be needed to question scope for some further upside.

The [ASX 200 Financials](#) Index lost downward momentum against the ASX 200 from March and bottomed in July. It continues to exhibit a progression of

higher reaction lows and would need to sustain a move below 0.925 to question scope for further upside.

The [Bombay Banks](#) Index also found support in July and continues to outperform the BSE500 Index. A sustained move below 1.3 would be needed to question scope for further upside.

The [Jakarta Finance](#) Index found support [relative](#) to the JCI in June and continues to rally strongly. The uptrend has lost momentum somewhat over the last month but a sustained move below 0.105 would be needed to offset potential for some further upside.

The [Hang Seng Financials](#) Index found support in [January](#) and began to rally against the Hong Kong Composite in February. It remains in a consistent uptrend and would need to sustain a move below 1.22 to question scope for additional upside.

The [FTSE/JSE Africa Banks](#) Index found support against the FTSE/JSE Africa All Share in [June](#) and continues to rally strongly. A sustained move below 1.2 would be needed to question scope for further upside.

Banks in [China](#), [Thailand](#), [New Zealand](#), [Korea](#), [Taiwan](#) and [Singapore](#) are still lagging their wider indices and have some work to do before they can demonstrate meaningful outperformance.

Interestingly, banks where the credit scare has been focused are doing best relative to their indices and are most likely to continue to benefit from any short covering rally. The fact that bank shares are now beginning to outperform will not be lost on investors, as solutions are found to help banks improve their balance sheets.

Nordea Markets Contrarian opportunities: financial valuations positioned for an end-2008 recovery - Thanks to Jan Bylov for his informative and consensus challenging [report](#) which looks at the potential for a year-end recovery. Here is a section on the savings & loan era RTC:

(Slide 24) Resolution Trust Corporation (RTC)

Corporation set up by the US government in 1989 to collect assets from bankrupt savings & loans (S&Ls) at the end of the 1980s.

Assets were typically homes and mortgage loans.

Dissolved in 1995.

Managed to take over assets from 747 institutions totalling USD 520bn.

Assets were sold for USD 394bn - a loss to taxpayers of around USD 125bn.

(Slide 26) Solution?

An RTC-style solution is increasingly being discussed in the US. Obviously, that does not address the "moral Hazard" problem. But that is clearly not the most important to politicians (which the takeover of Fannie Mae, Freddie Mac and AIG shows.)

Everything suggests that Democrats and Republicans can agree on such a

solution.

As such a solution is still only rumoured, the assets that the trust would buy are unknown (also equities?).

My view - This weekend is likely to prove pivotal to how financial shares are likely to form a recovery. The decisions made about how any new institution will acquire and divest itself of illiquid credits will be important for confidence. The shape of any recovery for financials will also be impacted. I believe the current talk of moral hazard and the cost of bailouts is beside the point. When markets become disorderly and panic is allowed to set in, it is the responsibility of the authorities to intervene and help restore confidence. Suspect companies should be allowed to go to the wall, but not at the cost of the rest of the financial system.

Fed to Help Meet Fund Redemptions, Buy Agency Debt - [This article by Scott Lanman for Bloomberg covers measures being put in place to protect deposits at money market funds. Here it is in full:](#)

The Federal Reserve said it will lend to banks to meet demands for redemptions from money-market mutual funds and plans to buy agency debt from primary dealers to aid financial-market liquidity.

The Fed will extend loans to banks to purchase "high-quality" asset-backed commercial paper from money market funds, the Fed said in a statement in Washington. The loans will be at the discount rate, the Fed said. The rate is currently 2.25 percent. The Fed didn't provide a size for either initiative.

Investors pulled a record \$89.2 billion from money-market funds on Sept. 17, according to data compiled by the Money Fund Report, a newsletter based in Westborough, Massachusetts. The U.S. Treasury separately said today it will use as much as \$50 billion from the government's Exchange Stabilization Fund to temporarily protect investors from losses on money-market funds.

The central bank said it will buy short-term discount notes issued by Fannie Mae, Freddie Mac and the Federal Home Loan Banks "to further support market functioning." The New York Fed will conduct the purchases of debt through "competitive auctions" over the "next several weeks," the district bank said in a statement.

The actions came a day after Treasury Secretary Henry Paulson and Fed Chairman Ben S. Bernanke proposed moving troubled assets from the balance sheets of U.S. financial companies into a new institution, the most sweeping action aimed at ending the crisis.

Paulson, Bernanke Push New Plan to Cleanse Books - [This story by Alison Vekshin and Dawn Kopecki covers the potential for a new agency to deal with bad debts being formed. It is posted without further comment but here is a section:](#)

Options that U.S. officials are considering include establishing an \$800 billion fund to purchase so-called failed assets and a separate \$400 billion pool at the Federal Deposit Insurance Corp. to insure investors in money-market funds, said two people briefed by congressional staff. They spoke on condition of anonymity because the plans may change.

Another possibility is using Fannie and Freddie, the federally chartered mortgage-finance companies seized by the government last week, to buy assets, one of the people said.

“We will try to put a bill together and do it fairly quickly,” House Financial Services Committee Chairman Barney Frank, a Massachusetts Democrat, said after the meeting. “We are not in a position to give you any specifics right now” on the proposals, he said when asked about the potential cost.

The likelihood of the government taking on yet more devalued assets, after the seizures of Fannie, Freddie and AIG and the earlier assumption by the Fed of \$29 billion of Bear Stearns Cos. investments, may spur concern about its own balance sheet.

Debt Concern

The Treasury has pledged to buy up to \$200 billion of Fannie and Freddie stock to keep them solvent, while the Fed agreed Sept. 16 to an \$85 billion bridge loan to AIG. The Treasury also plans to buy \$5 billion of mortgage-backed debt this month under an emergency program.

“It sounds like there's going to be a giant dumpster for illiquid assets,” said Mirko Mikelic, senior portfolio manager at Fifth Third Asset Management in Grand Rapids, Michigan, which oversees \$22 billion in assets. “It brings up the more troubling question of whether the U.S. government is big enough to take on this whole problem, relative” to the size of the American economy, he said.

Senator Richard Shelby of Alabama and some other Republicans have criticized the takeovers of AIG, Fannie and Freddie for imposing a potentially high cost on taxpayers.

SwissTrust (A subsidiary of Interhold): How I spent my evening - [Thanks to a subscriber for acquiring permission to post this well-balanced report by Dan Kohler covering the climactic pace of this week's sell off and the potential ramifications. Here is a section from the conclusion:](#)

It is normal that when counterparts in financial markets no longer trust each other, and especially when investors no longer trust the financial intermediaries, the system freezes up. All note and bond issues, even those who are not contaminated, are met with suspicion. In the absence of trust there are no trades, and thus no market. In this situation the rules forcing banks to “mark their portfolio to market” become insidious time bombs. The rules demand that if there is no market price for assets, these assets have to

be written off or at least provisioned against. In other words, if there is no market now, the asset is "worthless".

If one contrasts the enormous write-offs banks had to take in the application of this rule with the essentially health condition of the debt and mortgage markets, where the problems forcing these write-offs are supposed to lie, one quickly notices a disconnect. It is simply not possible that all these write-offs are economically justified in a generally healthy credit environment where most loans are still serviced normally and default rates are no higher than average.

The write-offs are necessary, however, to comply with the rule that an asset which cannot be traded right now has to be considered "worthless". That the underlying credit may still be healthy, may still be serviced normally is almost irrelevant. The accounting and audit profession is dancing around the golden calf of "marking to market" and loses sight of true value. I am pleading here for a "fair value" approach that allows establishing a fair value for an asset, even if it is not traded right now. The distinction is at least as important as the distinction between valuing a company as an ongoing concern or at liquidation prices. Why an otherwise healthy financial company should be forced to value its portfolio at liquidation prices is beyond me.

If you surmise from this that I see value in the beaten down stocks of financial companies, you are right. I am of the contrarian belief that in the short- to midterm financial stocks are a good buy. In the long run, however, I am seriously concerned about the nationalization trend which distorts the financial sector, as I explained above.

I am convinced that in not too long a time we will look back to this current period as the buying opportunity of the decade. Remember that Prince Waleed of Saudi Arabia purchased a solid junk of Citibank at the last major financial crisis and that his adjusted acquisition price is today somewhere between USD 1.00 and 1.50. This, by the way, is something that could happen again. Investors from the oil exporting countries could seize the opportunity of putting some of their oil money to work.

In the medium to long term, however, I see more value in the natural resource sector than in Financials. The shares of commodity producers have been battered by the double whammy of an extremely unfriendly stock market environment and falling commodity prices. This trend, however, is being reversed. Oil is off its low and approaching USD 100 again and in the general flight to safety gold posted its biggest one day gain ever yesterday. In the stock market 21 out of the 43 companies in the S&P 500 index that did post a gain yesterday 21, i.e. almost half, were natural resource companies.

My view - I found this to be an enlightening report but I'm not as a worried about the nationalisation of the banking sector over the long-terms the author. Governments are not as well equipped to manage banks as the private sector, although this is necessary in some cases at present. They will eventually allow these banks back onto the open market; having had their wings clipped somewhat.

We have discussed on a number of occasions that the current crisis was resulting in some companies being priced at ridiculous levels and that credit markets were producing bargains not seen in years. One of the most interesting moves today has been in the resources sector, which was one of the most overextended.

Rules have been introduced to stop short selling of financial shares in the UK, USA and Ireland, but the short covering rally has also fed through to the commodity markets. The FTSE-350 Banks Index was the biggest mover today, advancing 39% but it was followed by the Mining Index up 12.47% and Oil & Gas Producers up 10.64%. These latter two indices have been some of the most heavily shorted and were looking particularly overextended. They would now need to sustain moves to new lows to offset scope for some further upside.

Considering the extent of the decline, a 'V' shaped recovery is probably too much to hope for. Once the short-covering rally runs its course, which may take a number of weeks, support building is needed before they can sustain a moves to test and exceed their highs.

ICBC, China Banks Rise By Limit on Government Support - [This article](#) by Luo Jun for Bloomberg covers today's surge in Chinese shares. Here is a section:

China's banks surged by the most in almost 12 months after the government said it will buy shares of the three largest lenders on the open market to shore up investor confidence in the world's second-worst-performing stock market this year.

China Investment Corp., the nation's \$200 billion sovereign wealth fund, will buy stakes in Industrial & Commercial Bank of China Ltd., Bank of China Ltd. and China Construction Bank Corp., through unit Central Huijin Investment Co. starting today, according to the official Xinhua News Agency. The nation's 14 publicly-traded banks all rose by the 10 percent daily limit in Shanghai and Shenzhen.

The CSI 300 Index has slumped more than 60 percent this year as an equity bubble deflated and the economy slowed, undermining earnings growth and threatening to spark a rebound in bad loans. Industrial & Commercial Bank of China on Sept. 17 ceded its position as the world's most valuable bank to HSBC Holdings Plc after shrinking by \$241 billion in less than a year.

“This is a shot in the arm to stem the hemorrhage and may lead to a 10 to 20 percent rebound of share prices,” said David Liao, a Shanghai-based bank analyst at HSBC Jintrust Fund Management Co., which manages \$975 million. “But it won't be a turning point -- the concern over an economic slowdown and rising corporate defaults is materializing.”

Banking stocks across Asia-Pacific are climbing today after the U.S. government said it was considering a plan to shore up the financial system

after Lehman Brothers Holdings Inc. collapsed and the government stepped in to rescue the country's biggest insurer, American International Group Inc.

My view - This is the latest of a number of measures to stimulate bullish interest in the stock market and resulted in 488 of the 807 Shanghai [A-Shares](#) rising the daily limit of 10%. This is one of the Index's largest rallies and it would need to sustain a move to new lows to offset scope for further upside. It remains likely that the low will be tested as the extent of the government's intent to support markets is probed. However, it should not be forgotten that the advance from the 2005 lows was also sparked by a government support program and it may not pay over time to bet against the CIC's deep pockets.

Email of the day (1) - on panic:

"I am really scared. This morning I saw my company stock dropped from \$68 to \$54 even the Dow was rallying at that time. I felt there were something wrong and immediately tried to unload my shares but the web site to trade my stock grants crashed apparently due to extremely heavy volume. In the next one hour, the stock plunged to \$23! This is a 20 billion dollar world wide financial service company!! Unbelievable!

"But if the market can manage to close up, I think this has to be the bottom as the fear just became hysteric!"

My comment - Thank you for this highly personal email which shares the feelings associated with profit erosion shared by most investors. I'm sure it will be appreciated by the Collective. With no knowledge of which share you are referring to, I presume it will also be covered by the ban on shorting of financials, so a bounce may be at hand.

Panic is seldom a good condition from which to make financial decisions, although when hysterical fear is rising, it is hard not to act. However, these extremes of sentiment are transient and we are now in a position where shorts are being covered following intervention by the US and UK authorities. Confidence is built slowly, but is easily destroyed and it will take time before faith is restored in the banking industry.

Email of the day (2) - on avoiding financial news channels while trading:

"A few words to tell you how I lived the reversal of September, 18th. I was trading, my son who was watching Bloomberg in another room came at 12:15 saying "they say that gold is going to soar, everybody is rushing to gold and flying from equities!"

"At this moment, I could see gold going through the roof, and I was short gold, long equity. Fifteen minutes later, gold collapsed and equities made a huge bounce.

"morale de l'histoire": never watch a financial media while trading, only to unwind at night.

"Good trading to all the subscribers."

My comment - Thank you for this insight which I'm sure many of us have experienced at one time or another..

Today's interesting charts - The Chart Library is bursting with interesting chart patterns after an exciting, if nerve wracking week. A click through of one's favourite sectors would be time well spent.

Switzerland - finds support above the July lows and rallies strongly. A sustained move below 6500 would be needed to hinder scope for additional upside.

Spain - failed downside break as it rallies firmly back above 11,000. A sustained move below that level would be needed to question scope for at least a test of 12,000.

Ireland - looking like a failed downside break which makes a retest of the 4600 level more likely. A sustained move to new lows would be needed to question potential for some additional upside.

Russia - rallies spectacularly from deeply oversold territory. A sustained move to new lows would be needed to question scope for further upside.

US Treasuries - falling back abruptly from the highs near 124 and would need to sustain a move above that level to question scope for some additional downside.

Gold - continues to hold Wednesday's phenomenal advance and, while it is likely to remain volatile, a sustained move below \$750 would be needed to offset scope for further higher to lateral ranging.

Dollar Index - continues to range lower and would need to sustain a move above 80 to hinder potential for some further downside.

Please note - David will be away until Monday 29th September.

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