

Fullermoney

Global Strategy and Investment Trends by David Fuller

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

Monday 13th October 2008

Après Gotterdammerung (twilight of the Gods) - This was the title of my keynote presentation last Wednesday evening, at the 46th Annual Contrary Opinion Forum, held in the beautiful Basin Harbor Club on the shores of Lake Champlain, in Vergennes, Vermont USA. The tranquil, sylvan setting in one of the most unspoilt regions of the country seemed surreal against the background of crashing stock markets and financial rescue packages. However the remoteness of location undoubtedly contributed to a more objective assessment of financial developments during this event hosted by Fraser Management Associates. Mercifully free of commercial hype and with a number of subscribers attending from across the USA, it was one of the most interesting and enjoyable conferences that Mrs Fuller and I have attended, your correspondent's somewhat jet-lagged delivery aside.

The title of my speech may require some explanation, although the fourth and concluding opera in Richard Wagner's magnificent Ring Cycle will be familiar to many of you. The Ring Cycle's operas concern epic and allegorical myths, which we live. I felt its parallels with both our current state of financial turmoil and the USA's presidential election was particularly apt.

Very briefly and in sequence, Das Rheingold is reminiscent of our fondness for gold, which has been a key component of successful portfolios in this decade. The highlight of the second opera, Die Walküre, is the 'Ride of the Valkyries', featuring Wotan's warlike daughters. The USA has been fighting two controversial wars in recent years. Third in the Ring Cycle series is Siegfried, the story of a fearless and naïve hero. Voters in the USA hope to elect a president on 4th November capable of leading the nation's recovery. Finally, in Gotterdammerung the Gods are destroyed along with Valhalla, their real estate in the sky. Many of Wall Street's Masters of the Universe have self-destructed and dubious real estate transactions have been at the centre of these problems. If all this sounds rather gloomy, we should recall that the age of (reasonable?) men follows Valhalla's destruction and Gotterdammerung's final orchestral theme is [Redemption by Love](#).

My presentation discussed governance, ethics, regulation, consequences of the USA's credit crisis, what is next for the markets, crude oil's influence, global concerns in retreat, fire (inflation) versus ice (deflation), global deleveraging, and concluded with both short and long-term forecasts for stock markets, gold, agricultural commodities and Fullermoney themes for the next

up cycle. Here is my [PowerPoint](#) outline and the market themes are discussed in more detail in today's Audio.

In last Friday's concluding Panel Session at Basin Harbor, I said that we might have seen the actual low on that day (October 10th). My view was based on one of the biggest weekly declines in history last week, plus the frenzied and coordinated political activity which it inspired. Today's market action supports that view.

Email of the day (1) - [On emotional Armageddons and house rental rates stabilizing in the USA:](#)

"I am embarrassed to say that I have been a loyal reader of your free comment of the day for four years and I have only now taken a 1 month trial subscription. I see now that I have postponed this far too long and I will certainly be converting to a 1 year subscription upon this month's expiration.

"As I am fairly young, I have no memory of any previous financial panics and must rely on historians. (I had been relying on Marc Faber and James Grant). Although I appreciate that every new Armageddon must necessarily seem to be "the" Armageddon to end all armageddons (humor intended), I wonder how you feel the current panic is measuring up emotionally to previous ones, such as the late 1970's.

"I would also like to share some interesting first-hand impressions. I sold my primary residence in 2005 (I reside in the USA) and began renting in anticipation of current residential real estate problems. The data regarding ARM resets suggests to me that a durable real-estate bottom may not be due until at least after 2009 and so I plan to rent until at least then. However, an interesting side-effect of the foreclosure trend is that the rental market in my area is now also drying up, causing rental rates to stabilize. After all, a foreclosed house is not available for ownership nor for rental. I find this dynamic interesting and wonder if this might begin to put a bid under real estate via stabilization of rent-to-value ratio."

My comment - [Welcome to Fullermoney and there is no need to feel embarrassed. We do not chase potential subscribers, as you know. We prefer to have them choose us, after a good look at Fullermoney's free content and in their own due time.](#)

Thanks for your interesting observations and questions.

In terms of emotional trauma, I regard what we have seen this year as much greater than the dotcom crash and subsequent declines from 2000-2002. It certainly ranks with the post 1987 crash, when many people feared a depression, although in economic terms the current circumstances are obviously much more worrying. However I can thank fellow Basin Harbor speaker Jeffrey deGraaf of ISI for pointing out that the [VIX](#) briefly reached 110 in 1987, whereas we only saw its second highest level at 76.94 last Friday. Emotionally, 1974 takes some beating, as many people vowed never to invest

in the stock market again. I have not heard that this time, but perhaps it will follow.

Your point on US property rentals is interesting, and given earlier success in this field, your guess is probably as good as anyone's. I do not know the answer but presumably location would be a factor. It is not unprecedented for desirable rentals to steady, due to scarcity, while an index of house prices is still falling. Certainly firm rents over a period might tempt more buy-to-let purchasers back into the market, but I would be in no hurry to buy, unless your dream property became available at what you considered to be a good price.

Stock market technical view - Last week's near record plunge by many indices, not least on Wall Street, was even more climactic than the other sell offs since August 2007. It also took indices to much lower levels and therefore closer to their eventual bottoms. Today's upward dynamics, which were over 11% on Wall Street and a number of European indices, suggest that stock markets have reached important lows of at least medium-term significance.

If this technical action is now followed by a significant retracement in the [Ted-Spread](#), stock markets will be capable of technical rallies which extend into the New Year. Monday 13th October is also an "all change" signal for many different markets, as discussed at The Chart Seminar. In other words, all persistent trends suddenly reverse for at least the short term.

Listen to the Audio for additional details. Here are two related articles from Bloomberg:

U.S. Stocks [Rally](#) Most Since 1930s on Bank Plan; Dow Gains 936

Fed Releases [Flood](#) of Dollars, Market Rates Fall

Email of the day (2) - On contrarian viewpoint and central bank gold sales:

"I look forward to hearing the contrarian viewpoint from last week....."

"Meanwhile do you think that governments or central banks may sell gold to help pay for their various bailouts?"

My comment - My PowerPoint for last Wednesday's speech is posted above.

Yes, I assume some central banks will continue to sell gold, as may the IMF. However some countries with big current account surpluses may increase their gold reserves.

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. The other searches through the rest of the Chart Library for

indices, commodities, currencies bond prices and yields, ratios, spreads and overlays. You can also customise these charts and save any of them in your Favourites section. Check the Library's Help section for further details.

USA (S&P 500) - Upward [dynamic](#) following accelerated decline indicates low of at least near-term significance; a close beneath 840 would be required to offset current scope for sideways to higher ranging.

Germany (DAX) - [Same](#) as above - sideways to higher ranging provided there is no close beneath 4300.

China (SHCOMP) - Held above September low during recent drift and today's upside [key day reversal](#) indicates renewed support near 2000. A close beneath 1800 is required to offset current scope for a further ranging recovery.

AUD/USD - Upward [dynamic](#) following overstretched decline; a close beneath US\$0.6330 would be required to offset current scope for somewhat higher ranging.

Additional Commentary by Eoin Treacy

GSI Investment Notes October 2008 - Thanks to subscriber for this [report](#) from GSI covering the credit crisis and its impact on Asian markets. Here is a section from the conclusion:

Citibank estimates that US\$300 billion has been parked in cash by hedge funds (most probably to prepare for redemptions), an industry once over US\$2 trillion in size. We do not know how much the industry has already downsized, given the lack of data. Chances are more is still to come, as the recent collapse of AIG and Lehman came as shocks to most, including some of the biggest funds. In addition, the prospects of a deep and long, drawn-out U-shaped recession have yet to be discounted by Wall Street. Chances are that markets will retest the early September lows for the final formation of a major bottom.

We knew early on about the emerging market balloon, China being a leader. But, in retrospect and belatedly we realized, Asia ex Japan funds marketed in the U.S. and Europe were also embroiled in that theme-e.g. Franklin Templeton Pacific Growth and T Rowe Price Asia Pacific funds surged 5 to 6 times in size from Mar 05 to the Oct 07 peak.

The China bubble burst at the end of 2007. Investors unseasoned by high betas of market turbulence bailed out en masse. The outflow was massive and unprecedented. As China plunged, selling by fund managers spread to other areas to raise cash to meet redemptions. The HSBC survey on the 10 largest global fund managers showed US\$50 billion left Asia Pacific ex Japan in 2Q08. Since June, Asia Pacific ex Japan EMFs have had US\$14 billion of outflow, according to Merrill Lynch. Massive outflows over such a short period

have sent Asian Pacific ex Japan markets into deep bear territory-over two-thirds of all listed stocks in key markets have collapsed 40 to 50%, or more, since June 2008.

By now, foreign ownerships in Korea and Taiwan have returned to pre-EMF bubble 2004-05 levels. The selling in these bourses from the current wave of fund downsizings should therefore be near the end. In terms of fundamentals, we now see glimpse of light at the end of the tunnel for the global systemic credit crunch. Asian economies and companies are in good shape, and their shares are very oversold. Insider buying and company share buybacks are now rising in Asia. Our portfolios are 60% to 65% liquid. Market corrections over the coming weeks/months should thus present an excellent time to begin rebuilding our long-term investment positions in Asia. What's the outstanding major risk remaining? Policy mistakes and governments losing control of the situation. The odds? We are hopeful but fingers crossed.

My view - Liquidation of positions in Asian securities at an institutional level have been more as a result of losses in other areas rather than any systemic threat to the Asian banking structure. In fact the financial system in the region is in ruddy health compared with that in the Western world and stands ready to benefit from any loosening of credit controls once this crisis fades.

Asia remains the centre for GDP growth and will continue to lead the world in that regard throughout the next cycle. When investors begin to regain their confidence and look around the world for the assets they wish to purchase, I anticipate that Asian equities will be towards the top of any list.

Astaire Research: The India Report - Thanks to Deepak Lalwani for his interesting [report](#) focusing on the Indian market. Here is a section:

So, how has this affected India and what will its impact be in the future? Perversely, the very bureaucratic and regulatory controls that have frustrated many international investors have now actually proved to be a good firewall for India's banking system against the credit virus from the West. Despite this, the SENSEX had the worst week this week in 18 years as global markets collapsed and fear overwhelmed investors. Foreign investors sold heavily (US\$10 bn YTD) as they face redemptions back home and in the face of a slowing Indian economy and a depreciating currency. The SENSEX is at its 2008 low today and the index is down 48% YTD, after having risen for 6 consecutive years to 31 December 2007, during which it gained 622%. The economy will slow down to about 7-7.5% this year and to about 6.8% next year as tight credit domestically and abroad cut project finance availability. Although a bounce in share prices is expected next week after such precipitous falls, it is safer for traders to wait for Q2 results to give guidance on possible downgrades. Long term investors, however, may wish to start slowly accumulating blue chip shares around these levels.

My comment - Even though the Indian markets have fallen almost [50%](#) from their peak, they have been relative outperformers during the most recent episode of selling. Even so, the Nifty broke below the July lows last week and

fell to a near-term trough near 3200. The Index [rallied](#) well today and a sustained move below that level would be needed to question scope for further upside. Importantly, the Bombay [Banks](#) Index continues to outperform the wider market and tested the July lows on Friday. It rebounded today and would need to sustain a move below 5000 to question potential for some further upside.

Email of the day (1) - on when to invest in high yield bonds:

"Assuming economic renewal, if I am looking to invest in high yield US bonds at some hopeful future time, what spreads should I be looking at and at what historic levels should I be watching for? Thank you."

My comment - Thank you for an interesting and engaging question. The last year has seen unprecedented turmoil in credit markets. Up until 2007, investors had competed with one another to find yield. Record low defaults, low volatility, low inflation, synchronized global economic expansion and a twenty-year bull market for Treasury prices all contributed to the perception that risk was being squeezed out of the system. This meant that yields were being compressed and investors have to move into increasingly less credit worthy instruments to achieve their desired return. This competitive drive towards lower yields is over in the credit markets.

Right now, few investors are buying credits because everyone is hoarding cash. The continued high levels on the [TED](#) and [OIS](#) spreads indicate that liquidity fears remain the dominant emotion in the market. The NASD Bloomberg Active High Yield US Corporate Bond Average [Yield to Maturity](#), NASD Bloomberg Active High Yield US Corporate Bond [Price](#) and the [iBoxx](#) \$ Liquid High Yield Index (price) all have accelerating trends. High yield instruments have gone from having an historically low relative risk premium to one of the highest in decades. The low levels seen from 2003 to 2007 were an aberration but what we are seeing right now is also an overreaction.

We are not going back to the perceived risk free environment that prevailed before the credit crisis. What seems more likely is that credits will be judged in future more on their individual merits, with closer attention paid to balance sheets and the ability to repay the principle.

[High yield](#) traditionally trades much more in line with the equity markets than other credits. Over the last month, the Dow and S&P accelerated to today's lows. At the same time the average yield on US Corporate High Yield Bonds rises from 12.4% to 22%. If one is assuming economic recovery then an argument could be made for cost averaging into this market on a gradual basis.

The Bond Yield section of the Chart Library has a wide selection of credit indices including US US\$ Finance AAA to BBB-, GMAC, Utilities US US\$ BBB+ to BB, among indices for the Eurozone, UK, Japan, Canada, Switzerland, Australia, the Eurobond market, Korea and Singapore. Keeping

an eye on the indices and spreads listed above should help to keep one acquainted with how the market is pricing risk.

Email of the day (2) - on swap spreads:

"Is it possible to get graphs of the 1yr, [2yr](#) and [5yr](#) US interest rate Swap Spread?"

"The chart library already has the [10yr](#) interest rate Swap Spread however this does not reflect the extreme stress in the short end of the curve and the money markets."

My comment - Thank you for this interesting suggestions and they have now been added to the Chart Library. You are correct to point out that the short end of the curve has been under more stress than the longer side. The 2yr spread rallied to 160bps from mid-September to early October but has since pulled back somewhat. However, a sustained move below 130bps would be needed to question scope for some additional upside.

In contrast, the 10yr swap spread broke down last week from a well defined range and would need to sustain a move above 65bps to question scope for further downside.

Email of the day (3) - on UK house prices:

"Could you please update the UK Nationwide [Avg. house](#) price index? No update since June 06."

My comment - Thank you for pointing out this inconsistency, it has now been updated with the most recent prices but the last one was on June 30th. The UK Nationwide [All House](#) Prices Index was last updated on September 30th. It indicates that house prices peaked in October 2007 in a secular change of trend. They now need to break the progression of lower highs to question scope for additional downside.

Email of the day (4) - on gold and uranium funds it is possible to put in an ISA:

"Hope all is well with you two, it's sure tricky business at the moment and although I am only 37 and been in the markets for only 15 years I ain't ever seen nothing like this. I wanted to ask, with Gold shares appearing cheap and I believe Uranium companies looking cheap too do you know any UK isa-able (is that a word?) funds providing good exposure to these areas.

"Appreciate any suggestions you or the collective may have and look forward to investigating further."

My comment - Thank you for this interesting email and I think we can all empathise with having seen nothing like last week's activity. It is possible to

put the Blackrock [Gold & General](#) Fund in an ISA, but subscribers may have further input.

[Geiger Counter](#) and [Nufcor Energy](#) are both UK listed uranium investment vehicles. Subscribers may know of others.

Eoin's personal portfolio: Dow Jones Industrials long opened - I reopened my long in the December Dow Jones this afternoon, paying 8955 including spread-bet dealing costs.

Atlantis China Fortune Fund - James Alexander called me back on Thursday about the activity in the Fortune Fund. He was kind enough to add some colour to the statement released last week. The fund has a limit on redemptions of 10% per dealing day. The fund deals twice a month. They now have redemption orders equal to another two days trading.

The focus of the current problem is in illiquid P-shares positions. They cannot realize cash from these positions without selling them for substantially less than they are worth and redemptions are forcing the sale of other assets which is damaging the value of the fund. They are making every effort to deal with their problems and will restart the fund as soon as is practicable.

Interestingly, the Atlantis China Fund has not suffered any redemptions, perhaps because it does not hold private company shares.

Today's interesting charts - The majority of stock markets have become deeply oversold and many had upward dynamics today. They can all be found in the Chart Library.

Germany - rallies [strongly](#) from its very oversold position and would need to sustain a move below 4300 to question scope for some further upside.

Australian 10yr bonds - [peaked](#) near 95 and Friday's downward dynamic broke the short-term uptrend. A sustained move above that level would now be needed to question scope for further downside.

Hong Kong - rallied well from deeply [oversold](#) territory and would need to sustain a move below 14,000 to question scope for some further upside.

Last week's signups for the Free (Abbreviated) Comment of the Day - For the week of October 5th new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, Canada, Chile, Hong Kong, India, Ireland, Netherlands, New Zealand, South Africa, the UK and the USA - 12 in total. In descending order, which topped the list in terms of the last week's new signups? It was the USA, the UK and Canada.

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 14th October 2008

Tim Price: Apocalypse Dow - [There is much to ponder in this balanced letter](#) from Tim Price, published by PFP Wealth Management. Here is an opening quote from John Kenneth Galbraith:

"This notion that great misadventures are the work of great and devious adventurers, and the latter can and must be found if we are to be saved, is a popular one of our time. Since the search for the architect of the Wall Street debacle, we have had a hue and cry for the man who let the Russians into Western Europe, the man who lost China, and the man who thwarted MacArthur in Korea. While this may be a harmless avocation, it does not suggest an especially good view of historical processes. No one was responsible for the great Wall Street Crash. No one engineered the speculation that preceded it. Both were the product of the free choice and decisions of thousands of individuals. The latter were not led to the slaughter. They were impelled to it by the seminal lunacy which has always seized people who are seized in turn with the notion that they can become very rich. There were many Wall Streeters who helped foster this insanity, and some of them will appear among the heroes of these pages. There was none who caused it."

- From 'The Great Crash: 1929' by John Kenneth Galbraith.

China Loss Is Alabama Gain as Sleeping-Bag Firm Adds U.S. Jobs - [This article](#) from Bloomberg describes another small step as the USA begins to regain competitiveness in manufacturing. Here is the opening:

Wal-Mart Stores Inc.'s worldwide quest for a lower-cost sleeping bag has led to a one-story factory in northwest Alabama, where Chris Defoor has a new job.

The same forces that have sent thousands of American jobs overseas are now giving a lift to places like Haleyville, a town of 4,200 where Defoor is in his fourth month working at Exxel Outdoors Inc.

With costs in Alabama running 3 percent below those in China, Exxel is cutting production at a joint venture in Shanghai while hiring workers, adding machines and increasing output at the 250,000 square-foot plant. This year, for the first time, the company will make more bags in the U.S. than abroad.

"We'd been losing the battle to China but had a feeling things were going to change," founder and chief executive officer Harry Kazazian said. "Call it a

calculated gamble or hindsight, it's working for us."

The increase in production at Haleyville comes as manufacturing in the U.S. contracts at the fastest pace since 2001, during the last recession. Record exports that had supported output now are slowing as a growing number of countries grapple with the credit crisis.

Meanwhile, Wal-Mart, the world's largest retailer, saw its sales rise in September and is forecasting a third-quarter profit. The Bentonville, Arkansas-based company is "gaining more people who are looking to save money by shopping there," Exxel's Kazazian said. "That's one of the reasons why we think we'll do well" as a supplier.

Rising Revenue

Kazazian's strategy is a result of the dollar's 17 percent drop against the yuan since 2005, rising wages in China and a jump in freight rates. He projects his company's revenue will rise as much as 20 percent this year to \$42 million from \$35 million in 2007, helped by the Wal-Mart order last December for Disney-themed kids' sleeping bags.

The need to cut costs means manufacturers large and small "are revisiting their outsourcing policy," said Norbert Ore, chairman of the manufacturing-survey committee at the Institute for Supply Management in Tempe, Arizona.

Ikea, the world's largest home-furnishings company, opened its first U.S. factory in May. Caterpillar Inc., the world's largest maker of earth-moving equipment, and Home Depot Inc., the biggest home-improvement retailer, plan to produce or buy more goods in the U.S.

My view - At least three factors are critical for a fledgling recovery in US manufacturing to occur following the current recession. The next government elected on 4th November and inaugurated in January will need to avoid populist trade barriers and globally uncompetitive increases in the minimum wage. Additionally, a resumption in the USD's slide against the [CNY](#) needs to occur sooner rather than later.

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

"Regarding the current meltdown; This had been predicted by quite a few and conversely others considered it unlikely; Nonetheless, the risk was clearly identified. So, regardless of what one believed on the likelihood of the meltdown occurring the consequences of it happening were always going to be catastrophic.

"To talk of entry points, current low values/opportunities or how bearish sentiment is in the extreme (only for it to get worse!) is fine but perhaps we (the collective) in the empowerment through knowledge theme could try and learn something from this?

"More specifically I would be interested to know your thoughts on managing the (downside) risks and financial consequences of a long term buy and hold strategy in FM themes?"

My comment - Events of the last year or more have certainly been traumatic, especially the persistent decline since late May. Yes, some did forecast these events, so full credit to them. However most also forecast a crisis well before it occurred, and consequently missed plenty of upside. It is little consolation but many of the supposedly brightest and best, and certainly highest paid, have struggled in these markets as you can see from this hedge fund [report](#). Therefore I see this as a time for reflection, rather than point scoring or apportioning blame, since only the former will increase our knowledge.

Therefore I agree that all of us need to learn from this experience, including how not to be paralysed by it during the next recovery. For instance, many investors were either afraid to re-enter stock markets or sold too soon as recoveries commenced, following 1973/4, 1987 and 2000/2. Market collapses are invariably followed by significant recoveries, although these can take time where significant economic damage has occurred.

Also, while the Collective contributes enormously to the sum total of our individual knowledge, each of us should also have a plan and take responsibility for our individual investment and trading decisions. My investment plan since 2003, as you may recall, was to take a long-term 'Warren Buffett view' on my unleveraged SIPPs and ISA holdings in Fullermoney themes, while hedging in my trading account during downturns. I also maintained a substantial cash reserve, as mentioned on many occasions.

The investment portion of this plan worked well up until the beginning of this year, although it would have done even better if I had invested the cash in the same themes. However I never want to have all of my eggs in the same basket, and a good thing too given what has happened to stock markets. My long-term investment plan has proved very costly this year because I certainly did not anticipate the extent of the perfect storm that has occurred, which included the energy and food price shock, in addition to the credit freeze. Consequently, my hedges proved to be too few and too infrequent.

I will learn from that, as will others from their own experiences. I can also offer a template in terms of technical monitoring and discipline, for you to consider during the next bull market in equities, which will surely follow this bear trend. Some of it will be familiar to veteran subscribers who have attended The Chart Seminar.

Assuming one has invested in promising themes, the first challenge for unleveraged investors in the next bull market, which commences with the final low for the bear, will be to ride out short-term setbacks. There will be many of these but most will last for only a few weeks or occasionally several months. How can we be sure these will only be short-term setbacks? We can never be certain but fundamental valuations and price trend consistency will be important guides.

Fundamentals will be generally attractive during the early years of a bull market, although investors' recollection of the last bear will make many of them skittish. Consequently there will be frequent reactions and a small number of somewhat larger corrections for leading indices. However as uptrends develop, their consistency characteristics will become apparent to those who have taken the time to understand factual, behavioural chart reading.

A very useful guide, I maintain, will be the 200-day (40-week) moving average (MA), which I prefer to use with weekly charts. I regard this as the approximate mean for the trend. Consequently the market's more euphoric periods will be followed by reversions to the mean, as you can see on most uptrends. The trend will remain generally healthy provided its MA continues to rise and is not breached significantly.

The key danger signs to look for, will be loss of pattern consistency, parabolic acceleration (very profitable but unsustainable and most likely accompanied by pricy valuations), and an eventual downturn by the MA which usually becomes a resistance level in the next downtrend. To familiarise yourself with these danger signs, dip into the Library and scroll a number of weekly charts with 200-day MAs.

I do not want the David Fuller investment plan to ignore these common sense signals in the next bull market. You will be a better investor for evolving your own plan, which may have a similar approach or other refinements that you prefer. The important point is not to default responsibility for your plan to me or anyone else. It also helps if we discuss these developments, as they occur. The Collective's input always contributes to Empowerment Through Knowledge.

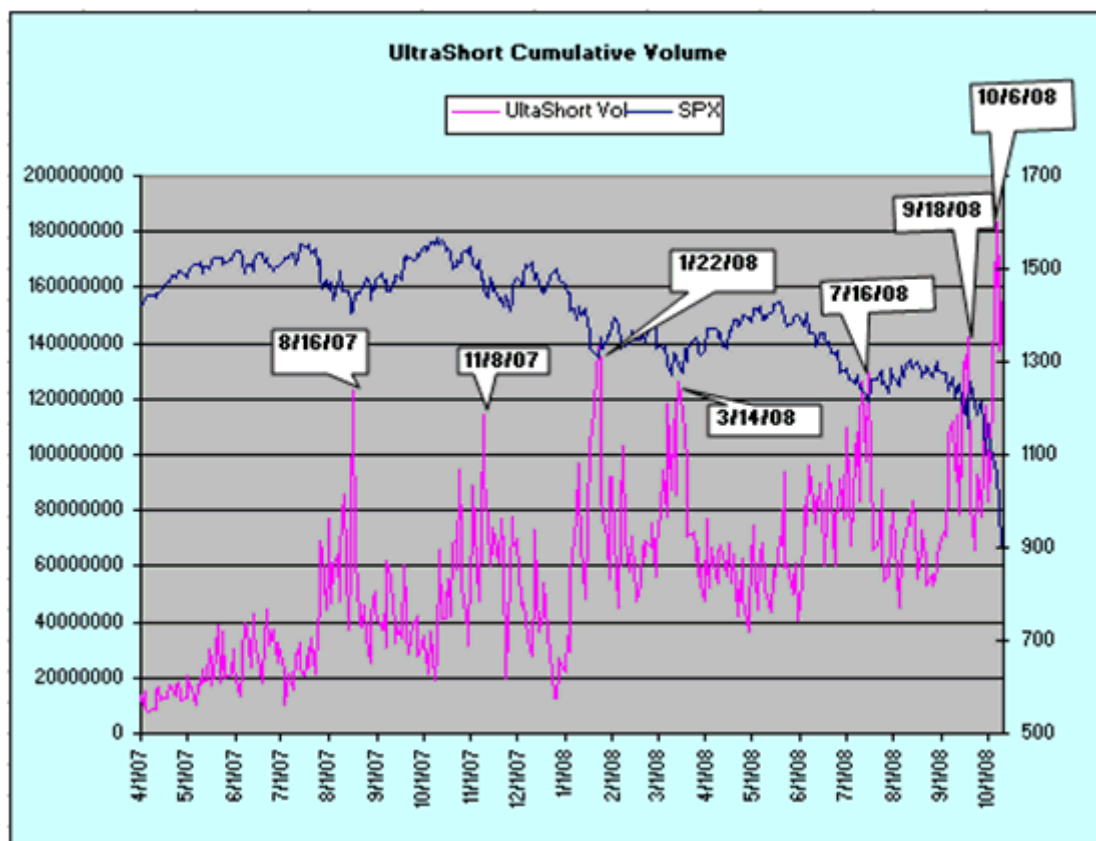
ProShares UltraShort ETFs Pointing to Bottom? - My thanks to a subscriber for this fascinating item by Joseph Sunderman, posted on SchaeffersResearch.com:

In this age of exchange-traded funds (ETF), we have seen a myriad of new and exciting instruments introduced for investors to diversify their individual portfolios. During the past few years, ProShares has developed several ETFs that allow individual investors to gain exposure to the major market indexes. Additionally, ProShares has created ETFs that allow investors to hedge their portfolio with Short Proshares and UltraShort ProShares. The Short Proshares are designed to go up when their underlying indexes go down (and vice versa). Furthermore, the UltraShort ProShares are ETFs designed to double the daily performance of their underlying indexes.

These instruments are not only useful for individual investors to hedge against a bear market, but these ETFs can be useful from a sentiment perspective. By measuring the volume of the UltraShort ProShares, we can gauge the current temperament of investors through these hedging vehicles.

In the accompanying graphic, we have cumulative volume (in pink) for the 6

UltraShort ETFs - UltraShort QQQQ (QID), UltraShort Dow30 (DXD), UltraShort S&P500 (SDS), UltraShort MidCap400 (MZZ), UltraShort SmallCap600 (SDD), and UltraShort Russell2000 (TWM). Also included in the graph is the price action for the S&P 500 Index (SPX).



During the past couple of years, we have seen significant spikes in the UltraShort cumulative volume associated with market bottoms (per each date). In light of the recent decline, the UltraShort cumulative volume on October 6th was approximately 30% higher than any previous peak for the past 2 years. Thus, we are seeing signs of capitulation, as investors look for any instrument to hedge (or speculate) in this market downturn.

My view - This is certainly interesting but there is little back history because short ETFs are a recent, albeit welcome innovation. The spike in volume shown on the UltraShort Cumulative Volume chart provides additional evidence that we saw an important low last week.

Given all the other extremes of sentiment and price action, plus last week's internationally coordinated financial rescue packages, which I have often stated were a precondition for an important bottom, I maintain that we have seen stock market lows of at least medium-term significance.

My personal portfolio: Long trade opened in BRWM - The BlackRock World Mining Trust ([weekly](#) & [daily](#)) has been hammered since May by concern over a global economic recession. We have certainly seen capitulation selling recently, evidenced by downward acceleration. I feel a chump for having

ridden it down but this world-class investment trust now looks absurdly oversold. It also sells at a discount to NAV of 17.5%, according to Bloomberg. BRWM is still underperforming and we certainly are seeing a big economic slowdown, so some near-term risks may persist. Nevertheless, global infrastructure development will remain an important theme in the developing world as confidence recovers. I also maintain that a 'Marshall Plan' in terms of much needed infrastructure redevelopment in the USA will be a cornerstone of the next administration's economic policy. I paid 321.9p, including spread-bet dealing costs, for a December contract.

Additional Commentary by Eoin Treacy

Why The Worst Will Soon Be Over - This interesting [article](#) from Bedlam Asset Management appeared in today's Outside the Box eletter from John Mauldin. It covers the responses to the credit crisis to date and what we can expect from the coming weeks and months. Here is a section:

For all these imponderables and uncertainties, investors can start to do that 'light at the end of the tunnel' thing. If the hurricane had hit in 2005 or 6, the damage would have been less; but this is spilt milk, move on. The light is that correct actions are now in train. Many savers will still lose money in those weaker institutions which the governments have rightly decided to sacrifice, to preserve the core of the system. It will be unfair and unpleasant, but the right action. More important is that just as banks in each country will consolidate down to a core handful, so the same will apply in many other sectors. Consolidation is the new trend. Normally the advice would be to buy small bombed-out niche companies with good businesses, knowing that giant multi-nationals, most of whom have surprisingly strong balance sheets, will be buyers. However, the number of already wounded, as their banks reduce or refuse to roll over their loans at all, mean these multi-nationals can be very picky, and wait. Just as government-induced bank consolidation ensures their balance sheets should recover far faster than had there been no intervention, so more voluntary consolidation in other sectors will have a similar result. Consider the semi-conductor industry (if only for a moment). It is about to be obliterated. Huge over-capacity and rapidly tumbling demand. By as soon as end 2009, it is a good bet the number of manufacturers will have halved. Their profit cycle will then boom. Consolidation in pharmaceuticals has already started, one of the few sectors with very strong free cash flow and growth. In telephony, the parasitic companies are about to be sprayed with DDT. These lived off the incompetence of once state owned incumbents to move into the mobile market and almost universally, are highly borrowed, rely on ever-available bank credit and ever-rising sales. The consumer always foregoes trips to the cinema or theatre in a recession. This time he will hunker down in front of his broadband-fed, all singing and all dancing pc/TV/call-centre/work station. Only the ex-national monopolies can provide this service, the rest blow away like chaff.

Despite consensus forecasts for corporate profits in 2009 being still way too happy -- we are pencilling profits ex the banks for the MSCI World Index in

2009 of minus 9% - the return to an almost forgotten world of national and international cartels to reboot the economic cycle may well ensure that after a steep recession, a return to mild profit growth may be none too far away. The 'death' of free markets is sad: for a while we were all rich, it was fun and you didn't have to work much either; just own a house and a lot of debt. The imminent brave new world of state directed banks and cartelisation of sectors is inherently corrupt and less efficient, but should work. It is certainly the least bad solution for us all; yet this very different and cartelised world could be rather interesting, and profitable. Although indices have every chance of a roaring bounce soon, in 2009 many will sink again. Even so, too many large company valuations are already forecasting a Depression. We think state owned banks are temporarily rather a good idea, and many company valuations look pretty interesting, especially versus bonds, property or even cash. Growing huge ears or sticking a white feather up your nose is another option, but not advised.

My view - The credit crisis is not over but we have certainly passed an important juncture. With central banks and governments all over the world now in overdrive attempting to fix the problems in their economies, some of the tightness in the credit markets is beginning to ease. The [OIS](#) spread fell for the first time since mid-September today which is a positive sign. The [TED](#) Spread also contracted but remains in its consistent uptrend. Significant further contractions of both these important spreads are needed to suggest that banks are beginning to lend to one another once more.

Another important indicator is the [VIX](#) Index which fell back from its accelerated highs yesterday. A sustained move to new highs would be needed to offset scope for some further contraction. The majority of stock markets experienced historic levels of capitulation selling last week and those extremely oversold conditions are now being unwound. Considering the size of the downward reactions, many markets have significant room to advance further over the coming weeks but action is likely to remain volatile.

Email of the day (1) - on industrial metals:

"I noticed that zinc, nickel and lead had strong upside moves today. When looked at on their long term price charts and long term inflation adjusted they are looking interesting - Have you any particular views on this area."

My comment - Industrial metals are an unloved sector right now. The prospects for various metals have been discounted by fears for a global recession. At the same time that global economies began to slow, supply of many key metals increased, putting pressure on prices. However, now that prices have fallen, operations which were marginally profitable are being squeezed, helping to reduce supply. Once the global economy begins to recover demand for some of these key industrial resources should increase.

[Copper](#) had been in a volatile range from the 2006 peak and by mid-2008 had edged its way back up to test the highs. It failed to make new highs and the break below 350¢ opened the way for some further downside. The metal has

since accelerated lower. It found support near 200¢ on Friday and would need to sustain a move below that level to question potential for some further upside. Over the medium-term, a move back above 300¢ is needed to suggest demand has returned on a sustainable basis.

Aluminium broke upwards to a new high in July, but was unable to hold it. It has since accelerated lower but found support near \$2200 late last week. A sustained move below that level would now be needed to question potential for an unwinding of the oversold condition. However, a sustained move back above \$2500 is needed to indicate something more than a technical rally is occurring.

Tin peaked in May near \$25,000 and remains in a consistent steep downtrend. It found support above \$12,500 last week and is currently rallying. However, it needs to sustain a move above \$18,000 to break the progression of lower rally highs.

Lead accelerated to a high in late 2007 and remains in a relatively consistent downtrend. It found support near \$1500 in July and retested that level last week. A sustained move below \$1500 would be needed to offset scope for further upside and reaffirm the medium-term downtrend.

Nickel accelerated to a high near \$50,000 in May 2007 and following the peak, quickly fell to \$30000 where it distributed. It also accelerated to current levels and nickel is now testing the upper side of the long-term base near \$10,000. A sustained move below that level would be needed to hinder potential for some additional upside. Over the medium-term a sustained move above \$20,000 is needed to suggest the bulls are regaining the upper hand.

Zinc peaked in late 2006 and broke down from the extended Type-3 top in August 2007. It remains in a consistent downtrend and would need to sustain a move above \$2000 to break the progression of lower rally highs. In the short-term it found support near \$1250 last week and would need to sustain a move below that level to offset potential for some additional upside.

In inflation-adjusted terms, aluminium, lead, nickel and zinc have all returned to interesting levels. The conclusions we can draw from these charts are limited by the lack of enough available back data. This precludes us from comparing today's prices to their 1970's peaks.

Email of the day (2) - on updates of macro data in the Chart Library:

"Just wanted to let you know that many of the money supply charts have not been updated for some time. For example, Switzerland YOY M3 hasn't been updated since June-2006 and the Japan money supply charts haven't been updated since April-2008."

My comment - Thank you for pointing this out and the Monetary Measures section of the Chart Library has now been updated with the most recent data.

Email of the day (3) - [on gold funds](#):

"on (UK) gold and uranium funds it is possible to put in an ISA:"

"An alternative to the Blackrock Gold and General Gold fund is the [CF Ruffer Baker Steel Gold fund](#). I hold both. It is eligible for inclusion in a UK ISA or SIPP and can be purchased with no upfront charge from a fund supermarket such a Hargreaves Lansdowne. On the plus side unlike the Gold and General fund it has no bid offer spread as it is an OIEC so cheaper to dip in and out. On the minus it is more volatile and invested in some smaller companies.

"For more info: <http://www.ruffer.co.uk/funds/bsg.aspx>
<http://www.morningstar.co.uk/uk/snapshot/snapshot.aspx?id=F0GBR04H9S>"

My comment - [Thank you for this information, contributed in the spirit of Empowerment Through Knowledge.](#)

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

Korean Won per 1 US Dollar - [the Dollar](#) is falling back from its accelerated peak relative to the Won and would need to sustain a move to new highs to question scope for some additional downside.

Switzerland - continues to [rally](#) strongly from its deeply oversold condition. A sustained move below 5200 would be needed to question potential for further upside,

Nikkei 225 - upward [dynamic](#) puts at least a short-term floor under the market and would need to sustain a move below 8000 to question scope for some further upside.

Wednesday 15th October 2008

Deciphering the 2007-0? Liquidity and Credit Crunch - [My thanks to colleague Will Chawner for this interesting analysis](#) by Markus Brunnermeier of Princeton University. It is posted without further comment.

John Husselbee: Are we there yet? - [My thanks to John Husselbee of North Investment Partners Ltd for his latest thoughts](#) on stock markets. They arrived this afternoon in email format which I have converted to a PDF, so that it can be posted on the site. Here is the opening:

I have put pen to paper so many times in the last week but each time find myself tearing up copy as events unfold by the hour. The fact is that the world is still sobering up to the financial mess left behind after a global synchronized boom party fuelled by cheap western debt. Rather than join the blame game

or the witch hunt I think it more productive to look forward with a steady hand on the wheel, although the occasional glance in the rear view mirror is always advisable.

Too little, too late was the initial reaction to the US bailout and the joined up concerted effort of central banks in cutting interest rates. I am not sure about the scale of the rescue package as this is surely just the beginning of their efforts to get a grip of the situation. Too late? Until last week the approach of central banks and policy makers to this financial crisis was vinegar and brown paper to bandage what was becoming a very large wound. This is intensive care now, a full scale operation with everyone working at pace to catch up with events but it does show how policy makers and central banks are reactive rather than proactive. They have now abandoned their fight against inflation but can do so on the basis that energy and food prices have fallen sharply - the triangular shape of the oil price that saw it rise from \$80 in September 2007 to \$147 in July 2008 and back again provides good evidence.

My view - I am in general agreement with John Husselbee's comments, which I commend to you.

The current environment remains highly nervous and emotional. Against this background, the easy forecast is to say that we will see further volatility, which adds to the general uncertainty and anxiety. Understandably, a major concern for most equity investors is the outlook for corporate profits in what is still a deteriorating economic environment. There is little doubt that reactive central banks prevaricated for too long before introducing their sweeping rescue packages, as Warren Buffett was pointing out a few weeks ago.

As a consequence, my guess is that we will have a longer economic slowdown in the USA and parts of Europe than might have otherwise occurred. However the world's stronger developing economies should recover more quickly, buttressed by their fundamentally sound financial sectors, higher personal savings rates and government surpluses in many instances.

Technically, most eyes are still focussed on Wall Street, ensuring that its leash-effect remains influential for other stock market trends. Last week's plunge was certainly climactic and Monday's relief rebound impressive. Also, the recent relative strength shown by US [financial indices](#) is encouraging. However, the [Dow](#), [S&P 500](#), and [Nasdaq](#) need to undergo successful tests of last Friday's lows, followed by moves above yesterday's highs, to reaffirm scope for the yearend rallies that I expect.

The [Ted-Spread](#) remains my greatest immediate concern. If this does not fall more quickly and significantly, it will be difficult for the recent stock market lows to hold, delaying scope for a yearend rebound. (*Please note: charts above were downloaded before Wall Street's close.*)

Eoin expands on these themes below.

Please note - Thanks for the constructive feedback on the Email of the Day that I posted and discussed yesterday. I will comment on them tomorrow.

Additional Commentary by Eoin Treacy

Global Equity Strategy - Thanks to a subscriber for this in depth [chartbook](#) by Andrew Garthwaite for Credit Suisse covering a wide number of statistics and ratios. Here is a section from some of the commentary

Credit offers deep value- Implied default rates, at 50%, are well above previous recession peaks (of c 36%). But we note that US non-financials entered this downturn with better cash positions, lower leverage and less over-investment than previous recessions!

And

Equities offer deep value: the actual equity risk premium is 5.8%. The warranted equity risk premium (which depends on credit spreads, VIX and lead indicators) is 5.8%. Over the next 6 months, we think that the warranted ERP can fall to 4.5%. Deep value is ERP above 5%.

And

The current PE on trend earnings is 11.7x, below 15.7x in Oct 2002 and 14.2x in Oct 1990. (Critically, we assume trend real EPS growth of 4.2% since 1988.) As long as we avoid outright deflation, valuations are clearly attractive. Into periods of deflation - 1930s, 1949, 1954 - the PE averaged 11x

My view - There is no denying that equities are considerably cheaper now than they were more than a year ago but the concept of value is relative. For those of us who look at last week's activity as climactic, value is quite evident in many markets that had accelerated lower. However for those who still believe markets will sustain moves significantly below the recent lows, any talk of gradually easing into long positions is premature. We have to take a step back and address the chart facts as they stand today.

Never have we seen so many indices become so divergent from their moving averages. This is a clear indication that we are in deeply oversold territory. The bounce seen on Monday and Tuesday was also historic in scale. However, the vast majority of stock markets remain in downtrends. Acceleration is an ending of unknown duration. We will not be able to say with any certainty that these downtrends have ended until they either break their progression of lower rally highs or extend base formations which will gradually build support. I believe the latter is the more likely scenario today. Right now, we are at an interesting juncture.

In the early part of this downtrend, bear rallies on the [S&P 500](#) succeeded in taking the Index marginally back above the lows of the previous range. This occurred in May and August. Following the break below 1200, less than a month ago, prices accelerated lower. This is a typical Type-1 ending from The

Chart Seminar. We are now in the counter trend rally which has retraced at least part of the decline. From here, either the market is going to retest the lows, in which case the October 10th low may be a penultimate low, or it will find support above those levels. For the bear case to be further realised, a sustained move below 850 is needed.

The shape of any recovery when it occurs will be heavily influenced by the health of the financial sector and the confidence investors have in the solutions provided by central banks and governments working together. The extent to which the [TED](#) and [OIS](#) spreads contract as well as the size of the fall in the [VIX](#) Index are likely to continue to have a significant bearing on the performance of the stock market and investor attitudes to it. Considering the extent of the fall, technical damage incurred and loss of faith in the system, major indices such as the S&P are likely to need time before they can support meaningful, trend changing rallies.

Wells Fargo Profit Tops Analyst Estimates on Market-Share Gains - This article by Ari Levy for Bloomberg covers the competitive advantage being accrued by some banks as other continue to languish. Here it is in full:

Wells Fargo & Co., the California bank that's buying Wachovia Corp., said third-quarter profit topped analysts' estimates as the company picked up market share from collapsing rivals.

Net income fell 24 percent to \$1.64 billion, or 49 cents a share, from \$2.17 billion, or 64 cents, a year earlier, the San Francisco-based company said today in a Business Wire statement. Analysts expected profit of 43 cents, the average estimate in a Bloomberg survey. The bank's allowance for credit losses doubled to \$8 billion from a year earlier.

The failure of IndyMac Bancorp in July and Seattle-based Washington Mutual Inc. last month allowed Wells Fargo, the biggest bank on the U.S. West Coast, to win deposits and borrowers. Chief Executive Officer John Stumpf kept Wells Fargo profitable amid record U.S. mortgage defaults, allowing him to snap up Wachovia after the Charlotte, North Carolina-based bank lost 90 percent of its value in a year.

"If you can look out 24 months into the horizon, the deal makes a great deal of sense for Wells Fargo," said Peter Sorrentino, who helps manage \$16.7 billion at Huntington Asset Advisors in Cincinnati. "Both the product mix and the geographic footprints are very complimentary,"

Wells Fargo shares rose \$3.12, or 10 percent, to \$33.52 yesterday on the New York Stock Exchange. The stock has gained 11 percent this year, the second-biggest advance, behind BB&T Corp., in the 24-company KBW Bank Index, which has tumbled 30 percent.

Mortgage-Related Losses

Losses are likely to increase after the \$14.4 billion acquisition of Wachovia, which has been approved by the Federal Reserve. Wachovia was the biggest

provider of option adjustable- rate mortgages, loans that are prone to default. While Wachovia brings branches along the East Coast, its loan portfolio includes option ARMs in California.

“With Wachovia they're going to double down on their California exposure and their mortgage portfolio,” said Blake Howells, an analyst at Becker Capital Management, which oversees about \$2 billion in Portland, Oregon. The company faces risks “given their geographic profile and their product profile.”

The Bush administration said this week it will pay about \$125 billion for stakes in nine major banks, including \$25 billion in Wells Fargo. The investments are part of the U.S. Treasury's plan to spend \$700 billion to unfreeze credit markets amid the worst financial crisis since the Great Depression.

California home prices tumbled a record 41 percent in August from a year earlier to the lowest since 2003, according to the Los Angeles-based California Association of Realtors. More than 101,000 households in the state received a default notice, were warned of a pending auction or foreclosed in August, RealtyTrac Inc. said on Sept. 12. That was a third of the nation's total.

California Loans

Still, Wells Fargo has grown while California lender Countrywide Financial Corp. was bailed out by Bank of America Corp. and IndyMac failed, as did WaMu, which did half its lending in the state.

Wells Fargo, whose biggest stakeholder is Warren Buffett's Berkshire Hathaway Inc., avoided most of the riskiest loans, including option-ARMs that plagued Wachovia and WaMu.

“Wells has never been seduced by the vagaries of the credit market,” said Anat Bird, a former executive at the bank who now runs SCB Forums Ltd., a Granite Bay, California-based company that conducts peer group conferences for bankers. “The company has always been incredibly disciplined.”

My view - [Wells Fargo is clearly one of the winners in the current crisis. It is likely to come out the other side a much more influential institution and is already the industry leader in terms of relative and absolute performance. This story by Elizabeth Hester for Bloomberg covers the similar outperformance of JP Morgan.](#)

[Wells Fargo's](#) share price has been enormously volatile as it hoovers up distressed competitors. It is currently rallying, having found support near \$25 and would need to sustain a move below that level to question scope for further upside.

[JP Morgan Chase](#) has also been extremely volatile but found support near \$35 for the third time in two-months and would need to sustain a move below that level to question scope for some additional upside.

The S&P [Banks](#) Index did not break its July low last week and is now rallying well having found support in the region of 125. A sustained move to new lows would be needed to question potential for some higher to lateral ranging.

The S&P [Diversified Financials](#) Index broke down from the three-month range last week but rallied back in the consolidation this week. A sustained move below 300 would be needed to offset potential for some higher to lateral ranging.

The S&P [Regional Banks](#) Index remains a relative outperformer and found support near 50 last week. Here also, a sustained move below that level would be needed to offset potential for some higher to lateral ranging.

The Banks continue to [outperform](#) the wider index in a sign that governments are succeeding in supporting this sector. It would seem only a matter of time before this change of leadership is accepted by investors as a significant signal that the worst of the crisis is past.

Email of the day (1) - on the TARP:

"Looking at the rather weak market reaction outside the hit banking sector, do you think TARP is a TRAP: TROUBLED PROGRAM for ASSET RELIEF?"

My comment - Thank you for your email and I agree that this environment lends itself to black humour. Let's not forget though, that the majority of the TARP money has yet to be spent and will take time to filter down. In fact decisions continue to be made as to how it will be applied. The TARP is only the most public of many measures already in place to support markets and we can be assured that more will be forthcoming if needed.

Mineweb.com: Rio Tinto predicts early winter in Shanghai - This [article](#) by Barry Sergeant covers the statement made by Tom Albanese this morning surrounding Rio Tinto's forecast for Chinese growth. Here is a section:

In a statement accompanying the Rio Tinto third quarter 2008 operating review, CEO Tom Albanese has reassured investors by stating that the long term outlook for Rio Tinto remains positive "despite the upheavals in global markets. In the third quarter, our business continued to perform extremely well, breaking yet more production records in iron ore, bauxite, hard coking coal and US coal".

The CEO, who steers one of the world's three biggest mining companies, warned, however, in several respects over developments in China, the world's biggest consumer of raw materials: "In the near term, the Chinese economy is pausing for breath. China is not completely insulated from an OECD recession and we will see an impact on Chinese exports. However, the near term slowdown of growth is substantially due to tightening of monetary policy introduced by the Chinese government last year in order to tackle inflation" Albanese said Rio Tinto expects that China's third quarter economic data will

show "an exaggerated slowdown", reflecting the postponement of projects during the Olympics. Looking further out, said Albanese, Chinese GDP will remain largely driven by the domestic economy "and we expect industrialisation and urbanisation to continue apace with strengthening demand across a range of Rio Tinto products".

In a statement expanding on Albanese's observations, Rio Tinto said that there had been a deceleration in Chinese growth, which is expected to fall from nearly 12% in 2007 to less than 10% this year. The slowdown, Rio Tinto says, "is a product of tight credit policies in China that were introduced late last year to address inflationary concerns. These are only now being relaxed.

"We expect to see Chinese economic data in the third quarter of this year showing an exaggerated economic slowdown because of the 'Olympics effect', with the negative impact falling away in later months. Over time, as economy-wide inventories are dissipated, industrial production and commodity demand can be expected to accelerate. Nevertheless, it now seems clear that any bounce in net demand will be delayed until next year".

My view - Regardless of any slowdown in the Chinese economy it will continue to be one of the largest, if not the largest, consumer of commodities in the world. In the last week, we have seen the Chinese Premier telling the Australian government that they will remain strong consumers of commodities for years to come and now we see that companies such as Rio Tinto are seeing orders fall back. The Chinese are likely to use any opportunity presented by the global slowdown to negotiate the prices of key commodities, such as iron-ore, lower. However, prices for such bulk commodities are likely to remain well in excess of historic averages.

The shares of [Rio Tinto](#), [BHP Billiton](#) and others are in deeply oversold territory and would suggest that much more than a Chinese slowdown in demand is being priced in. However, the shares need to break their progression of lower rally highs, with moves above 3000p and 1200p respectively, to question the integrity of their downtrends.

Email of the day (2) - on JP Morgan India Trust's bonus share offer:

"Good day gentlemen, thank you for your continued calm and rational service during these very volatile times. As a fellow investor in JP Morgan Indian Investment Trust I received notice they are proposing to issue new subscription shares (1 subscription share for 5 Ordinary) in a Bonus Issue on 5 November 2008, with Percentage Premiums on conversion, varying on how long one holds before converting. Please excuse my ignorance and before I phone JPM, I would be appreciative of your take on why you think they are doing this (or why generally any Investment vehicle makes this kind of offer), is it to encourage share holders to hang on to their shares longer, is it dilutive when converted, what does it tell us about the trust? I look forward to hearing from you."

My comment - The JP Morgan India fund is doing two things. First the current holders will receive one subscription share for every 5 ordinary shares held. Here are the details:

JP Morgan Indian Investment Trust is proposing to effect a bonus issue of subscription shares on the basis of 1 subscription share for every 5 existing ordinary shares held.

The expected ex-entitlement date of the bonus issue is 5th November 2008.

Each subscription share will entitle the holder to subscribe for one ordinary share from 2nd January 2009 until 2nd January 2014.

The conversion price will be equal to the unaudited net asset value (NAV) per ordinary share as at 5.00 p.m. on 29th October 2008, plus a percentage premium, rounded up to the nearest whole penny as follows:

(a) if exercised on any day between and including 2 January 2009 and 2 January 2010, a 1% premium to such NAV per ordinary share;

(b) if exercised on any day between and including 3 January 2010 and 2 January 2012, a 10% premium to such NAV per ordinary share; and

(c) if exercised on any day between and including 3 January 2012 and 2 January 2014, a 30% premium to such NAV per ordinary share.

Should you wish to convert your subscription shares into ordinary shares, please ensure your request is with this office 10 business days before the end of the conversion price period.

They are also offering new shares which can be bought by anyone. Here are the details:

JP Morgan Indian Investment Trust is seeking to effect an offer for subscription, whereby holders may apply for any number of new shares.

The new ordinary shares will be issued at a price equal to the unaudited NAV per ordinary share as at 29th October 2008 plus a premium of 1%, rounded up to the nearest pence per share.

Subscription shares will be attached to the new ordinary shares on the basis of one subscription share for every five new ordinary shares subscribed. Each subscription share will entitle the holder to subscribe for one ordinary share from 2nd January 2009 until 2nd January 2014.

As the issue price of the new shares is currently unknown, applications for new shares should be made in GBP, with a minimum subscription level of GBP500.00 and thereafter in multiples of GBP1.00. If subscribing please use the GBP total you wish to invest.

It is expected that the new ordinary and subscription shares will be issued on or around 5 November 2008.

In answer to some of your questions, yes, this does dilute shareholder capital. The person I talked to said they were looking to raise an additional 20% of the fund's capital to make acquisitions. I sent an email to the fund manager this afternoon asking for further details of the new investments they wish to make and will post the reply when I receive it.

Eoin's personal portfolio: Dow Jones long stopped out at a profit - I had an in-the-money-stop on my Dow Jones long which covered the loss I made in the same instrument last week. This was triggered this afternoon at 9160 against my purchase at 8955. These prices include spread-bet dealing costs.

Today's interesting charts - The Chart Library has a large number of currency crosses which may be of interest to subscribers.

US Dollar per 1 Swedish Krona - The Dollar is breaking upwards from the short-term consolidation and would need to sustain a move below KR7.2 to question scope for further upside.

UK FTSE-100 - encounters resistance having retraced approximately half of the downward acceleration. A sustained move above 4500 is now needed to suggest that demand has regained the upper hand.

Japan (Topix 2nd Section) - largest upward dynamic in more than a year and a sustained move below 1850 would be needed to question scope for some additional upside.

Thursday 16th October 2008

Putin May Use Credit Crisis to Finish Reining in Oligarchs - This is an interesting article by Torrey Clark and Henry Meyer of Bloomberg. Here is the opening:

Vladimir Putin came to power in 2000 vowing to destroy Russia's oligarchs ``as a class." Within two years, he'd driven two into exile and imprisoned another.

Now, he may use the global markets meltdown to finish the job.

The \$50 billion that the prime minister and President Dmitry Medvedev have pledged to lend cash-strapped companies will extend state control over business leaders. Billionaires seeking bailouts -- including Oleg Deripaska, Russia's richest man, and Mikhail Fridman -- will have to give authorities veto power over their companies' financing decisions.

``This will give the state more leverage over the country's biggest companies and main industries," said Chris Weafer, chief strategist at UralSib Financial

Corp. "In 2008, there is only one real oligarch: the state."

All this marks a reversal from a decade ago, when oligarchs bankrolled Boris Yeltsin's almost-insolvent government. As recently as April, Russia's 100 wealthiest citizens had a combined fortune equivalent to about a third of the economy, Forbes magazine estimated.

The nation's 25 wealthiest businessmen have seen their worth shrink by \$230 billion, or 62 percent, according to Bloomberg calculations. And Putin controls the strings on the biggest remaining purse -- \$531 billion in government reserves, which he is doling out through state-run Vnesheconombank, or VEB, where he presides as chairman of the supervisory board.

My view - This intrigue may have more to do with Russia's extreme 71% stock market [slide](#) than the military incursion into Georgia. (See also Eoin's [comments below](#).)

Email of the day (1) - [On long-term holdings in my personal investment account](#):

"I have been reading the daily email for about 5 years and have been a subscriber for around 8 months now. I have always valued your service as being one of the best around. One of the issues that I struggled mightily with this past year was your bullish long term stance, given that I was very negative on the markets. In particular, I recall one of your comments on your long term portfolio when you said "I am never selling this". Sadly, I identified exactly with this statement as I had said almost the same thing in watching a favourite stock holding falling 90% from my entry point in 2004/05 and kicking myself for being in love with the position.

"I must admit that I could not sell the market when I wanted to this year because of your bullish stance. I was angry at missing the downside and wanted to write you a stinging email about lack of risk control and admitting when you are wrong. Instead, I held off and today's newsletter is the reason why. Your comment to the writer "The important point is not to default responsibility for your plan to me or anyone else" is exactly what I had been doing. In fact, I have been doing this to my own detriment for much of my adult investing life. If there is one thing that I could take away from the past 5 years of reading your letters, it is this one sentence above. I am hoping that this lesson will stay with me for the rest of my investing life."

My comment - [Many thanks for this thoughtful and constructive email in response to my comments following 'Email of day' on Tuesday 14th October. I suspect many readers will both identify with and benefit from your conclusions.](#)

[As social critters, we are all subject to the influence of others, for better or worse. As adults, if we choose our main sources of information, analysis and influence wisely, we will benefit more often than not. However if we idealise these people, as it is easy for any of us to do, we will lose some of our](#)

objectivity and analytical acumen. In the process, we will also be disappointed by those who can help our development, on discovering that they too are fallible.

The balance to strive for, I suggest, is to establish good, original and trustworthy sources. Over time, we develop a greater understanding of their strengths and weaknesses, although these can also change in line with the human condition. This input should help us to evolve our own investment plan - tailored to our specific requirements and interests - for which we take full responsibility.

Our individual investment plan needs to be flexible because markets move in cycles, as we know. Therefore we need to adjust our plan as fundamental and technical data signal that risks are increasing or decreasing, prior to important trend changes. This takes some time, but most of us find the process fascinating. Also, no one will ever have a greater interest in preserving and growing our capital, than we ourselves.

(See also technical example in the next item below.)

Are We Targeting the Wrong Monetary Aggregates - My thanks to a subscriber for this interesting [article](#) by John Slater for Seeking Alpha. Here is the opening:

From 2003 through summer of 2007, a significant portion of the credit boom was funded through what Nouriel Roubini has described as the Shadow Banking System. By Prof. Roubini's definition, the Shadow Banking System comprised approximately \$10.5 Trillion in 2007, including \$2.2 Trillion of commercial paper conduits, \$2.5 Trillion in the repo/reverse repo market, \$4 Trillion of brokerage assets and \$1.8 Trillion in hedge funds.

For analytical purposes I believe it makes sense to define Shadow Credit more broadly to include various other financial institutions, conduits and debt markets not regulated as banks. These sources of credit include private equity groups (PEGs), mortgage backed securities (MBS), structured investment vehicles (SIVs), collateralized loan obligations (CLOs), collateralized debt obligations (CDOs), Fannie Mae, Freddie Mac, etc., etc. Many of these vehicles have been supported by credit default swaps (CDS), further leveraging their impact on the monetary system.

The growth of these alternative credit and liquidity sources during the current decade has been so significant that they can no longer be ignored in formulating monetary policy. At a minimum, using Prof. Roubini's definition, Shadow Banking is 40% larger than M2 and more broadly defined Shadow Credit may be as much as three times M2 (i.e. well in excess of \$20 Trillion). To date there is no recognized monetary aggregate that adequately measures the impact of this Shadow Credit on the Effective Money Supply and as a result policymakers have utilized the traditional tools at hand such as M2. In retrospect this may have contributed significantly to the recent credit collapse.

My view - I suspect we will be hearing more about this in future. For investors bewildered by the complexity of it all (welcome to the club), I do not think you will find a better single guide for timing your medium to longer-term investments than a weekly chart and its accompanying 200-day (40-week) moving average.

Examples are frequently posted in Fullermoney. More importantly, subscribers can view them in the Chart Library, choosing items of interest from over 17,000 instruments, to review at their leisure. Here is a sample:

Germany's [DAX Index](#) - Note how during the last bull market, that the more DAX rallied above its trend mean represented by the 200-day moving average (MA), the more prone it became to a reversion back to the MA. Note also that commencement of these reversions was usually signalled by downward dynamics (the somewhat larger red candlesticks coming off those highs. As DAX broke downwards from its eventual top, the MA also turned downwards for the first time. Note how overextended it now is against that declining MA. The next significant development on this chart should be lateral to higher reversion towards its declining mean. This [10-year](#) monthly chart for DAX, plus the same MA, shows how it performed relative to its mean in the earlier cycle.

You can learn more about factual chart reading at [The Chart Seminar](#).

Interim Assistant Secretary for Financial Stability Neel Kashkari's Remarks Before the Institute of International Bankers - [My thanks to a subscriber for this press release](#) from the US Treasury. Here is the opening:

I am here today to provide a comprehensive update on the Treasury Department's progress in implementing the Troubled Asset Relief Program (TARP).

As you know, our credit markets are frozen and lending has become extremely impaired. In recent months our government has taken strong and decisive actions, but a more systemic approach was needed. Secretary Paulson and Chairman Bernanke asked Congress for extraordinary authorities to address the extraordinary challenges in our financial markets. Every American depends on the flow of money through our financial system. They depend on it for car loans, home loans, student loans and their individual family needs. Congress recognized the threat frozen credit markets posed to Americans and to our economy as a whole. On Friday October 3, Congress passed and President Bush signed into law the bipartisan Emergency Economic Stabilization Act of 2008.

The law gives the Treasury Secretary broad and flexible authority to purchase and insure mortgage assets, and to purchase any other financial instrument that the Secretary, in consultation with the Federal Reserve Chairman, deems necessary to stabilize our financial markets -- including equity securities.

Treasury worked hard with Congress to build in this flexibility because the one constant throughout the credit crisis has been its unpredictability.

The law empowers Treasury to design and deploy numerous tools to attack the root cause of the current turmoil: the capital hole created by illiquid troubled assets. Addressing this problem should enable our banks to begin lending again. Our nation has successfully worked through every economic challenge we have faced and we are confident this new program will help us overcome these challenges as well.

Today, I will brief you about three areas. First, I will discuss Treasury's strategy to develop multiple tools under the Troubled Asset Relief Program. Second, I will give you a detailed update on the many steps we have already taken to begin to implement the program. And finally, I will briefly discuss our next steps.

My view - There is little doubt that crisis oriented governments are finally recognising the enormity of economic problems which their policies helped to create. In other words, our economic crises are manmade, which means that effective governance can also find the solutions. I would not be too cynical or defeatist about the likely outcome, because 'needs must' is a powerful motivator.

Email of the day (2) - On Iceland:

"Good to have you back - not that Eoin does anything other than a fantastic job while you are away!

'Just to brighten up your day - I heard some this morning describe Iceland as "a hedge fund the size of Coventry".'

My comment - Thanks, including for the good quip.

I have yet to visit their country but feel sympathy for most Icelanders, who seem to be hard working, non whinging types.

Email of the day (3) - On lessons that can be drawn:

"David, following on from yesterday's [*Ed: Tuesday's*] email regarding lessons that can be drawn may I add my following observations. Firstly there are always forces that work in the background counter to the existing trends and the art is identifying these forces and deciding at what stage they become a threat to the existing trend. If the art of investment is assessment then technical analysis can only be part of that. Value must always be considered, the emotional state of market participants, how stable the market is and to what degree of precariousness is the market supported. Bubbles exist both cyclical and secular. We must be aware that both types burst and the fact that bubbles of any type exist should give us cause for concern. The charts of

China, Zinc, Platinum serve to remind us that the long term fundamentals may be sound but short term overexuberance will still cause their bubbles to pop."

My comment - [Very well said - I agree with all of this.](#)

Email of the (4) - [On the meltdown:](#)

"Some other suggestions for this subscriber, who appears to have lost money by being invested in the "Fullermoney themes."

1. Don't believe everything the guru says. They are capable of mistakes.
2. If you always follow the guru, spread risk by following at least three.

"May I suggest a couple of ideas for the "Fullermoney themes"?"

1. Buy stuff that's going up in price.
2. If nothing is going up, don't buy anything!

My comment - [It may also help to consider that the original definition of a guru is: An Indian mystic. Adding on to your last point, if everything is going down, it must be a late stage in the bear's time cycle, and vice versa.](#)

Email of the day (5) - [More on meltdown:](#)

"I really enjoyed your 'On the Meltdown' comment last night and could not agree more. New to the markets I have made a great many mistakes (fewer thanks to the Fullermoney collective), but I own them all and it's much easier that way. We must all have our own plans and trade accordingly, remembering the only difference between a 'Champ' and a 'Chump' is 'u'.

"Question; (BRWM) trading at a discount to NAV of 17.5% what is NAV? If you have time and space sometime in the future, please can you give a short explanation on what OIS/TED/VIX represent. Many thanks for a great service."

My comment - [Thanks for the feedback. NAV stands for net asset value. For other definitions, may I suggest that you Google them? You will find more comprehensive definitions than I can produce.](#)

Additional Commentary by Eoin Treacy

India Joins Brazil, Russia in Injecting Cash in Banks - [This article by Cherian Thomas and Archana Chaudhary for Bloomberg covers the challenges faced by the biggest emerging economies. Here is a section:](#)

India joined Brazil and Russia in injecting funds into commercial banks to tackle the global credit crunch without risking interest rate-cuts that may fan

inflation.

The Reserve Bank of India yesterday cut its cash reserve ratio to 6.5 percent from 7.5 percent to ease the worst cash crisis in the economy since 2000. Russia lowered its reserve requirement for the second time in a month, while Brazil reduced the measure Oct. 13 for the fourth time in three weeks.

Only China among the so-called BRIC economies has cut interest rates after the nation's inflation rate almost halved since April. Prices are still at elevated levels in India, Russia and Brazil, and the decline in their currencies this year may stoke inflation from higher import costs.

“There are a number of countries that haven't cut rates and the common feature for all of them is that their domestic inflation numbers are still quite high,” said Subir Gokarn, Asia-Pacific chief economist at Standard & Poor's. “That is really what is holding back the Reserve Bank of India.”

Brazil's real has slumped 30 percent from a nine-year high on Aug. 1 and India's rupee fell to a record low this month as investors spooked by the global credit crisis have sold emerging market assets. Stocks tumbled in all three markets on concern a U.S. recession will depress corporate earnings worldwide and deepen financial turmoil.

“It's unacceptable that we will pay for the irresponsibility of speculators that transformed the world into a gigantic casino and at the same time they give us lessons on how we should govern our countries,” Brazilian President Luiz Inacio Lula da Silva said in New Delhi yesterday. “We are the victims of a financial crisis generated by the rich countries.”

Stocks, Rupee

India's Sensitive index fell as much as 6 percent to 10,238.52, extending its decline for this year to a record 49 percent. Ten-year bond yields declined to 7.7 percent from 7.91 percent yesterday, while the rupee, Asia's second-worst performer this year, dropped as much 1.1 percent to 49.05 a dollar before trading at 48.95 at 9:45 a.m. local time.

Brazil's inflation rate will end this year at 6.20 percent, according to a weekly central bank survey of economists on Oct.

13, more than the 6.14 percent forecast last week. The forecast for Brazil's benchmark interest rate remained at 14.75 percent by year end, according to the survey.

Brazilian companies may report as much as \$28 billion of write-offs because of currency bets gone wrong, according to Paulo Vieira da Cunha, a hedge fund manager and former Brazilian central bank deputy governor.

On Oct. 13, Brazil's central bank eased reserve requirements to inject as much as 100 billion reais (\$45.5 billion) of cash into the financial system and unfreeze lending. The three earlier cuts had freed up 60 billion reais.

Pumping Cash

Inflation in Russia may exceed an annual 12 percent by the end of December, more than the government's 11.8 percent forecast, as the country pumps more cash into the economy, according to Arkady Dvorkovich, an adviser to President Dmitry Medvedev.

Inflation, which was an annual 15 percent in September, could be spurred after the ruble declined 13 percent in the past three months against the dollar.

Russia's central bank yesterday cut the reserve requirements to 0.5 percent for all liabilities. Earlier, Russia's State Duma on Oct. 10 approved a banking liquidity package worth about \$86 billion, which Medvedev signed on Oct. 13.

My view - The so-called BRIC economies were star performers until risks often associated with emerging markets were amplified by the credit crisis. However, while they share the characteristics of large populations and strong growth, they vary widely in other important aspects. The fact that they have not moved in unison during this crisis is testament to the fact that they need to be treated as individual markets rather than as a whole.

Russia has been able to pay off USSR era debts and build a sizeable reserve through oil revenues. Continuing concerns about governance, oil's decline and fears of further hostilities in the Caucuses are all headwinds for the RTSI. Its uptrend was volatile between 2006 and May this year, characterised by a progression of rising lows and succession of failed upside breaks. It broke its rising lows in August and has, to date, given up 71% of its peak value as it accelerates lower. It is looking remarkably oversold and the Russian government is becoming involved to support the market, however, an upward dynamic is needed to suggest that this liquidation is coming to a close.

Although the RTSI is quoted in US Dollars, it is no coincidence that the same week that the Index broke its progression of rising lows; the Dollar broke upwards against the Ruble. It remains in a relatively consistent uptrend and a sustained move below R25 would be needed to question scope for further upside.

Brazil has also benefitted enormously from being a major producer of many globally important commodities and is suffering as they retreat. An unbroken progression of rising major reaction lows was the hallmark of the Bovespa Index's uptrend from the 2002 lows. It violated that sequence as it fell through 60,000 in late July and has accelerated lower. The Index found support near 33,000 last week but is retesting the lows today. It needs to hold above that level to offset potential for some additional downside.

The US Dollar bottomed out against the Real the same week the Bovespa hit its high. The subsequent Dollar rally has been almost a mirror image of the decline in the stock market. The Dollar hit an accelerated peak near BR2.55 last week and would need to sustain a move above that level to question scope for some further weakness.

The [Indian](#) market was also one of the best global performers from its 2003 lows. Throughout that time it was extremely volatile and corrections of 30% were not uncommon. However, it continued to find support at progressively higher levels before accelerating to its peak above 20,000. It broke the progression of rising lows with the fall below 15,000 in June. Right now, the Index is looking overextended relative to its 200-day moving average but an upward dynamic is needed to check momentum beyond a brief pause. A sustained move above 15,000 would be needed to break the progression of lower rally highs.

The Dollar bottomed against the [Rupee](#) following a relatively large decline in January around the same time as the Sensex topped out. It has since accelerated higher and is looking extremely overbought as it tests its 2002 highs. However a downward dynamic is needed to check momentum beyond a brief pause.

In the case of these three markets, massive repatriation of foreign investments has resulted in steep declines for both the equity indices concerned and domestic currencies. The weakness of the Dollar against these currencies was a bellwether for the prospects of these stock markets from 2003 to their respective peaks. The fact that the Dollar bottomed at the same time as the equity indices peaked was an indication that serious money was being removed from these emerging markets. Going forward, the Dollar is much more overstretched against the currencies that at any time in the last few years. I believe we will have a strong indication that money is ready to flow back into these markets when the Dollar tops out against the respective currencies. For now, the only one where this is looking possible is in Brazil but the situation remains extremely volatile so any inflow of capital will take time to develop.

[China](#) is the exception to this rule. The A-share market has negligible foreign direct investment and in Hong Kong the local currency is pegged to the US Dollar. China has vast reserves available to support its economy should it need to. The slowdown in the Chinese economy was largely manufactured by raising interest rates and reserve requirements continually over the last few years. The fact that the Chinese have cut interest rates twice in the last month, delayed the appreciation of the [currency](#), cut reserve requirements and ordered the CIC to start buying domestic bank shares all point to a change in policy.

The Shanghai A-Shares Index began to advance from mid-2005 and quickly picked up pace as it accelerated to its high near 6500. The break below 5000 broke the progression of rising lows and the Index has since given up 68% of its peak value and remains in an overall downtrend. It found support near 2000 in the last month but a sustained move above 2400 is needed to break the progression of lower rally highs and signal that demand has regained the upper hand.

Bernanke Foreshadows End to Fed's Hands-Off Approach to Bubbles - This

[article](#) by Craig Torres for Bloomberg covers Ben Bernanke's speech yesterday and some of the points that arose from it. Here is a section:

Federal Reserve Chairman Ben S. Bernanke signaled an end to the Fed's decades-old aversion to interfering with asset-price bubbles as the financial crisis reshapes some of the central bank's most firmly held views on regulation and monetary policy.

Officials should review how supervision and interest rates can tackle the "dangerous phenomenon" of bubbles in housing, stocks and other assets that risk bringing the entire economy down, Bernanke said yesterday. He also warned that banking may be concentrated in too few hands even as mounting losses and corporate failures push lenders into mergers.

"There is no doubt that as we emerge from the current crisis that we are all going to look very hard at that issue and what can be done about it," he told the Economic Club of New York in response to a question after a speech.

"It's a big change," said Ross Levine, a professor of economics at Brown University in Providence, Rhode Island. "It brings up one of the major failures underlying the crisis."

Bernanke, a scholar of the Great Depression, is contending with an increasingly fragile economy. Hours before he spoke, the Commerce Department reported that retail sales fell the most in three years last month. The decline was the third in a row, a retrenchment unseen since 1992, and contributed to the biggest slide in U.S. stocks since the 1987 crash. The Fed's Beige Book regional survey showed activity deteriorated in September.

Anticipating More Cuts

The data led traders to bet the Fed will reduce rates again after last week's cut in tandem with the European Central Bank, Bank of England and three other central banks.

"It is a good thing the nation's chief economist is an avid student of the causes and roots of the Great Depression because it will take all the Fed's skills and tools and imagination to get us out of this financial mess," said Chris Rupkey, chief economist at Bank of Tokyo-Mitsubishi UFJ Ltd. in New York.

Government efforts to calm financial markets and stem the credit crisis probably won't result in an immediate economic rebound, Bernanke said. Bernanke and Treasury Secretary Henry Paulson announced a day earlier that the government could inject \$250 billion into thousands of banks.

"Stabilization of the financial markets is a critical first step, but even if they stabilize as we hope they will, broader economic recovery will not happen right away," Bernanke said in his speech. "Economic activity will fall short of potential for a time."

My view - [The credit crisis is challenging the ability of central bankers to efficiently deal with the problem, so it is not too surprising that they are](#)

beginning to talk about never letting bubbles develop again. I am inclined to take this talk with a pinch of salt until we see the next bubble inflate. This is likely to be a good many years away considering the current deflationary environment. It is much harder to tighten when an idea captures the imagination of every investor and they begin to make money easily, than it is to talk about it when the market is focused on how to avert losses. It will be interesting to see how the Fed reacts when that next bubble begins to expand.

Focusing on the current issues. The [TED](#) and [OIS](#) spreads contracted further today but this retreat continues at a snail's pace. These spreads need to move significantly lower to help restore investor confidence. Following today's early sell-off on Wall Street, the [VIX](#) index hit a new high and also needs to reverse significantly before some calm returns.

As long as the TED and OIS spreads continue to contract, although slowly, central bankers may be under less pressure to implement any further radical supports for the money markets. However, if these spreads spike upwards once more, we can expect even more drastic intervention to help restore order.

Email of the day - on the possibility of a long recession:

"If there is some room for another view please watch [Bloomberg.com's video](#) "Roubini Predicts a recession that may last 24 months" of today. In any case impressive!"

My comment - Thank you for this interesting interview, which makes a cogent argument for further deterioration of economic conditions. I agree that it will take time for the current deflationary pressures to be excised from the system and that \$250 billion is unlikely to be enough to recapitalise the banks. This is the reason I believe it would be more efficient to guarantee at least some interbank lending in order to get markets moving once more in conjunction with recapitalisation. Something is also clearly needed to help shore up the housing market because continued defaults remain a drag on the possibility of any recovery.

However, the correlation with the length of any recession, global or otherwise, and the recovery of the stock market is weak at best. Stock markets usually bottom well in advance of the wider economy and this occasion is unlikely to be any different. The most important thing that happened recently in the stock markets was the accelerated lows posted a week ago. Indices would need to sustain moves to new lows to reassert their downtrends, while moves above the Tuesday highs would be needed to suggest demand is regaining the upper hand.

Today's interesting charts - The Chart Library has a large number of pre-arranged ratios and spreads. However you can make your own, with the instruments of your choice, using the Charting tool.

Platinum - extends the [downtrend](#) as it breaks below \$950. It needs to sustain a move above \$1050 to break the progression of lower highs.

South African Rand per 1 US Dollar - The Dollar broke [upwards](#) from its base in September and while it is overextended, a sustained move below ZAR8 would be needed to question scope for some further upside.

Oil - remains in a consistent medium-term [downtrend](#). An upward dynamic would be needed to check momentum beyond a brief pause.

Friday 17th October 2008

Asian Money Rates Head for Weekly Decline on Bank Guarantees - [My thanks to a Subscriber for this item from Bloomberg](#); it comments on the focal point of my recent concerns - interbank rates:

Asian money market rates fell this week as governments pledged to guarantee bank deposits and shore up lenders as the financial system faced gridlock.

The rate Australian banks charge each other for three-month loans fell to 5.66 percent as of 10:08 a.m. in Sydney, compared with 6.20 percent a week ago. The London interbank offered rate for three-month dollar loans, or Libor, may fall today to 4.45 percent and round out the biggest weekly decline since January, according to ICAP, the world's largest inter-bank broker.

Funding rates remain close to record highs, threatening to tip the global economy into the steepest recession in 70 years. Australia, Hong Kong and Japan are among the Asian countries that saw interbank rates drop this week. South Korean officials are meeting today to compile steps to restore investor confidence as the currency and stocks slumped to levels not seen since the Asian financial crisis.

“Money market rates are slowly improving, though the glacial pace is a bit of a concern,” said Adam Carr, senior economist in Sydney at ICAP Australia Ltd. “We've had hundreds of billions of dollars pumped in and Libor is still at about 4.5 percent when the Federal Reserve is expected to cut the benchmark rate to 1 percent. That's a ridiculous gap.”

Interbank lending rates jumped this year after Lehman Brothers Holdings Inc. went bankrupt Sept. 15. The Libor-OIS spread, which measures the difference between the three-month dollar rate and the overnight indexed swap rate, narrowed 4 basis points to 339 basis points yesterday compared with 365 points a week ago. The spread was 31 basis points on Jan. 25. A basis point is 0.01 percentage point.

Libor Decline

The Libor rate may decline for a fifth day at today's 11 a.m. fixing in London, ICAP's Carr said. Libor fell 5 basis points yesterday to 4.50 percent.

Funding costs eased this week in Asia after Australian Prime Minister Kevin Rudd kicked off a round of regional bank guarantees on Oct. 12. The Reserve Bank of Australia poured A\$2.9 billion (\$2 billion) a day into the country's financial system this week, about three times the daily average in the first seven months of 2008.

Australian banks' borrowing costs fell today, according to a gauge that measures the availability of funds. The difference between the rate banks charge each other for three-month loans and the overnight indexed swap rate stood at 73.08 basis points, heading for the narrowest closing level since Oct. 2, from 78.50 yesterday. The gap has averaged 47 points this year.

South Korea

The Bank of Korea is changing rules governing the foreign- exchange swap market to make it easier for banks to trade and to help bolster liquidity.

``We expect this new trading system to help ease the recent market jitters in the foreign-currency money market," the Seoul- based central bank said today in a statement.

South Korea's won has plunged 30 percent this year, the worst performance among Asia's 10 most-traded currencies, as companies and banks sought dollars to service debt and foreign investors pulled a record \$24 billion out of local stocks. The central bank will keep providing U.S. currency in the local won- dollar swap market until the market stabilizes, an official said yesterday.

The country's benchmark 91-day certificate of deposit rate rose 3 basis points yesterday to 6.08 percent, the highest since January 2001.

Japan's one-month deposit rates dropped 35 basis points to 1.1 percent, the biggest decline since 2000. The Bank of Japan injected about 30 trillion yen (\$295 billion) into the system over the past seven weeks.

My view - Unfortunately, governments have almost always been reactive rather than proactive. I have also described them as being crisis oriented. We have certainly seen this during the current financial crisis.

For a number of weeks I have mentioned that a coordinated move by central banks, away from fighting inflation to increasing liquidity and stimulating GDP growth, was essential to stem the accelerating bear market trends for most stock markets.

In this instance, the central banks' Rubicon is wide and they have yet to cross it. Nevertheless, their motley armada has been launched, although for long-suffering investors it may look and feel more like the [Dunkirk](#) evacuation.

On 3rd October, I wrote an [item](#) under the headline: *Ted-Spread: Don't take your eye off it*. In my recent PowerPoint [presentation](#): *Après Gotterdammerung*, I asked if the "Ted-Spread was the most important chart today?" Subsequently, Eoin and I have posted this chart and often OIS on a

daily basis. In line with the article above, I think we should look at the current evidence from these and related charts, plus their performance during a previous crisis.

Both the [Ted-Spread](#) and [OIS](#) commenced their upward spikes on 15th September, when the US Government shocked the global financial system by saying that it would allow Lehman Brothers to go bankrupt. I agree with those who have said this was a colossal, inconsistent and arbitrary blunder following the rescue of Bear Stearns and AIG.

I do not know if this was Hank Paulson's decision or if he was operating on instructions from the economically clueless White House. However we have seen the tragic consequences, including trillions in savings lost during the stock market meltdown, an economically devastating credit freeze, and countless more unemployed across the globe.

This brings me back to the motley armada, crossing their monetary policy Rubicon. There are encouraging signs. The Ted-Spread fell more rapidly today, failing to maintain its last upward break, and we have now seen the biggest downside move since this spike occurred. It seems inconceivable to me that we are witnessing anything other than the retreat from last Friday's peak. However the speed and extent of this now inevitable decline is crucial for both the global economy and stock markets. Bear in mind that the previous peak for the Ted-Spread was 300 basis points following the 1987 crash.

I was curious to see how quickly the Ted-Spread declined following its 1987 peak, and highlighted the relevant section in the Chart Library to produce this [daily graph for the period](#). I believe it took about 11 days for the lower low to occur in 1987, whereas on the current chart above this could take place on Monday, which would be the 6th day.

In any event, the faster the Ted-Spread and OIS (overnight index swap) come down, the sooner we will see sustainable lows for global stock markets. By the time the Ted-Spread is safely beneath 100 basis points once again, I expect the next bull market in equities to be well underway. The global economy should be recovering as well.

Our thanks to a subscriber who also provided these two charts of the Ted-Spread components' recent separate trajectories ([weekly](#) & [daily](#))

Warren Buffett: Buy American. I Am. - My thanks to colleague Jackson Wong for this [article](#) by the Oracle of Omaha, published in The New York Times. Here is the second half:

A little history here: During the Depression, the Dow hit its low, 41, on July 8, 1932. Economic conditions, though, kept deteriorating until Franklin D. Roosevelt took office in March 1933. By that time, the market had already advanced 30 percent. Or think back to the early days of World War II, when things were going badly for the United States in Europe and the Pacific. The market hit bottom in April 1942, well before Allied fortunes turned. Again, in

the early 1980s, the time to buy stocks was when inflation raged and the economy was in the tank. In short, bad news is an investor's best friend. It lets you buy a slice of America's future at a marked-down price.

Over the long term, the stock market news will be good. In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a flu epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to 11,497.

You might think it would have been impossible for an investor to lose money during a century marked by such an extraordinary gain. But some investors did. The hapless ones bought stocks only when they felt comfort in doing so and then proceeded to sell when the headlines made them queasy.

Today people who hold cash equivalents feel comfortable. They shouldn't. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate in value. Indeed, the policies that government will follow in its efforts to alleviate the current crisis will probably prove inflationary and therefore accelerate declines in the real value of cash accounts.

Equities will almost certainly outperform cash over the next decade, probably by a substantial degree. Those investors who cling now to cash are betting they can efficiently time their move away from it later. In waiting for the comfort of good news, they are ignoring Wayne Gretzky's advice: "I skate to where the puck is going to be, not to where it has been."

I don't like to opine on the stock market, and again I emphasize that I have no idea what the market will do in the short term. Nevertheless, I'll follow the lead of a restaurant that opened in an empty bank building and then advertised: "Put your mouth where your money was." Today my money and my mouth both say equities.

My view - [This article helped to reverse Wall Street's opening decline](#), although it slipped back into the red shortly before the close. Recently, Warren Buffett was negotiating deals for Berkshire's billions that are unavailable to the rest of us. He does not say what he is buying for his personal account, but presumably it includes widely traded shares in big cap sector leaders, as is his usual policy.

Quote of the week - [On honesty](#):

"Being entirely honest with oneself is a good exercise."
Sigmund Freud

Additional Commentary by Eoin Treacy

Natixis Commodity Markets Metal Review 4th Quarter 2008 - [Thanks to Natixis for the latest edition of their informative industrial metals review. Here is a section on the prospects for steel:](#)

Demand is likely to get worse before it gets better

The whole economic picture in late September has been clouded by the financial crisis associated with the credit crunch. Irrespective of the success or otherwise of the US government's attempts to ring fence the "toxic assets" held by financial institutions, the recovery of demand from the key construction sector is going to be a slow process. A concern for the producers of steel long products is that the weakness in the housing market that has been in place for over a year has now spread to the non-residential construction market which is a larger end use market than housing.

In the US, sales of existing homes in August fell by 2.2% month-on-month (m-o-m), according to the National Association of Realtors. At an annualised rate of 4.91m units sales remain in the 4.8-5.0m band that has characterised most of the last 12 months. This implies that the housing market may be close to the bottom, however any rebound is likely to be modest. There remains a large overhang of unsold housing and prices continue to fall with the median price declining by 9.5% y-o-y.

The housing start data remains bearish with the August figure at 895,000 units, which was 6.2% down m-o-m and 33.1% lower y-o-y. New permits were also well down suggesting on-going weakness. Residential construction is now at lowest level since the 1990 recession.

Overall construction spending fell in July by 0.6%. Importantly private non-residential construction registered its first m-o-m decline this year. Inevitably lead times for these projects are much longer than for the housing market. We believe that July will mark the beginning a period of extended weakness in the non-residential sector.

Much of the data relating to construction activity in the Eurozone is less up-to-date than for the US. However figures on housing starts point to weakness in the French, Spanish and German markets. Certainly the exceptionally low levels of business and consumer confidence suggest sluggish demand from the construction sector going into 2009. In Asia, the Japanese housing market remains weak reflecting the poor economic climate and the change in the government's building regulations that curbed activity in the sector. Conditions are obviously more robust in China with fixed asset investment still posting gains of around 25% y-o-y. This combined with a post Olympics return to normal activity should boost domestic demand.

[My view - Fears that economies, globally, will slow more than forecast are having a detrimental effect on sentiment towards industrial commodities. A number of metals are down in excess of 50% and none of the 6 main industrial metals appear currently capable of sustaining more than a technical rally from current levels. It will take time for support to be rebuilt and speculative interest to return. Since this sector is suffering more than most](#)

due to recessionary fears, there is a possibility it will also be one of the better performers when those concerns ease.

Global infrastructure development remains a powerful secular theme. Important projects have been stalled because of high commodity prices and more recently due to withdrawal of credit by financial institutions. However, now that commodity price inflation is unlikely to be a problem for the time being, the availability of credit is one of the key concerns for those interested in initiating major construction projects. The credit crisis continues to ravage investor confidence and only governments, sovereign wealth funds and a few cash rich investors currently have the ability to make significant investments in development projects. This will not always be the case. Demand for inward investment remains high.

High commodity prices led to demand destruction but that is now giving way to supply destruction. This will gradually provide price supports for the sector. Once the credit crisis has been resolved, and I accept this will take time, the most credit worthy borrowers are likely to be in Asia and they should not have too much trouble raising the capital needed to help expand their economies.

Email of the day (1) - on extreme divergences from 200-day moving averages:

"In relation to studying pullbacks to the MA [200 or whatever] would it be interesting to compare this plunge with 1973/4 or even 1929? I have a hunch that there were no pullbacks in those episodes."

My comment - Thank you for your email which raises some interesting points. By definition an instrument can only stay away from its mean value for so long before reverting. Analysis of a statistical bell curve bears this out.

In [1973/74](#) both the Dow and S&P diverged significantly from the mean but following the downward acceleration gradually built support and returned to the moving average. In [1929](#), following the initial decline, the subsequent rally encountered resistance near the 200-day moving average. From then until the market bottomed in 1932, any rallies from oversold territory were capped by the moving average.

The Dow's [divergence](#) from its 200-day moving average hit a low not seen since 1938 last Friday. The indicator improved somewhat this week, rallying from .69 to .75, but needs to advance further to lend support to the hypothesis that we are close to an important medium-term low. (Also see Comment of the Day on [October 10th](#))

Gold Set for Biggest Weekly Loss in Two Months on Stocks, Oil - This article by Rachel Graham for Bloomberg covers the activity in the gold market this week. Here it is in full:

Gold headed for the biggest weekly loss in two months in London as global equity markets rose and crude-oil prices declined, reducing demand for the

metal as a haven and an inflation hedge. Palladium fell to a five-year low.

The Dow Jones Stoxx 600 index of European shares headed for its first weekly advance in five. Crude oil has dropped 9.3 percent this week, trading at less than \$70 a barrel.

“We are seeing a cut in inflation expectations; this is pushing the gold market lower,” Sagiv Peretz, a senior dealer at trading-system operator Finotec Trading U.K. Ltd., said by telephone from London. Stock-market gains are also supporting the metal, he said.

Gold for immediate delivery fell \$16.43, or 2 percent, to \$788.17 an ounce as of 1:55 p.m. in London. The decline for the week is 7.3 percent, the most since the five days through Aug. 15.

Gold in the SPDR Gold Trust, the largest exchange-traded fund backed by bullion, dropped 1.4 percent. The holdings fell 10.72 metric tons to 756.86 tons on Oct. 16, according to figures posted on the company's Web site.

The fund was at a record 770.64 tons on Oct. 13, overtaking Japan as the world's seventh-largest gold holding.

Gold has fallen 24 percent since March 17 when it traded at a record \$1,032.70 an ounce in London.

Joe Conway, chief executive officer of Toronto-based mining company lamgold Corp., said he expects the metal to trade at more than \$1,000 by the end of the year.

“What we're seeing now is massive financial market turmoil and, I would think, significant monetary inflation,” Conway said today in a Bloomberg Television interview. “As a store of value, you're going to see more people rush to gold.”

Palladium for immediate delivery fell as much as \$11.50, or 6.5 percent, to \$165.50 an ounce. That's the lowest since July 25, 2003. The metal, used in car exhaust systems, last traded at \$175.25 an ounce.

Among other metals for immediate delivery, silver fell 32 cents, or 3.3 percent, to \$9.35 an ounce and platinum slid \$40.30, or 4.5 percent, to \$855.70 an ounce.

My view - [Gold](#) has been an excellent relative performer during the most recent part of the stock market sell-off. It hit new highs in currencies such as the [Australian Dollar](#), [British Pound](#), [Euro](#) and [South African Rand](#) this month, helping to reinforce investor opinions that gold is a safe haven. However, it has since fallen back from those highs and in US Dollar terms is pulling back having tested its 200-day moving average.

The [moving average](#) is a salient indicator because it provided support throughout the relatively consistent uptrend and gold has just encountered

resistance at the moving average following its March peak above \$1000. Gold's advance was capped with a large weekly key reversal and trading has been quite volatile since. However, the recent failure to sustain a move above \$900 poses a problem for those who continue to see gold as a shelter for their assets in the current environment.

There is little doubt that gold has benefitted from investor flows seeking a hard asset as central bank printing presses work over time. However, caution is warranted because gold is characteristically volatile. It is also conspicuous as the only instrument, I can think of, which has not had an accelerated move. Gold had found support near \$825 but violated that level yesterday. The next area of potential support is near \$750, but this may only be token, in the absence of an impressive upward dynamic.

[Platinum](#), [Silver](#) and [Palladium](#) have all led on the downside. Platinum remains in a consistent, orderly downtrend which has been losing momentum recently. It needs to push back above \$1000 to suggest demand is returning. Palladium has also fallen considerably and is approaching the 2003 lows. However, a sustained move above \$220 is needed to break the progression of lower rally highs. Silver is in a much more inconsistent downtrend. It broke down from the most recent distribution yesterday and needs an upward dynamic of limit scope for some additional downside.

Gold shares continue to weaken against the gold price. The Gold / Philadelphia Gold & Silver Index [ratio](#) hit another new high today. It now needs to sustain a move below 7.8 to question scope for additional upside. The possibility remains that gold's massive outperformance relative to other precious metals and gold shares could be unwound by a significant rally in these instruments. However, the possibility that gold could sustain a fall below \$750 and in the process reverse its relative uptrends against platinum, silver, palladium and gold shares is now gaining strength. What seems a certainty is that it will remain volatile.

Email of the day (2) - on Chart Library defaults:

"Need some help; I placed the chart of LME total open stock at my favorites. Now every chart shows this as an overlay.
"What did I do and how can I remedy it "

My comment - Thank you for this email which highlights a question some other subscribers might also be asking. The Chart Library is attempting to provide you with the chart you want. If, as on this occasion, it is in error, simply click on the Reset tab at the top of the chart. This will restore the default setting and you shouldn't have any other problems.

Today's interesting charts - The US Dollar's ascent against a host of currencies has coincided with the decline of a number of emerging markets. All of these charts can be found in the Chart Library.

Hong Kong Hang Seng - remains in a consistent downtrend and needs to sustain a move above 17500 to break the progression of lower rally highs.

India Sensex - closes below 10,000 for the first time since 2006. It needs to sustain a move above 12000 to break the progression of lower highs and offset scope for some additional downside.

US 10yr bonds - steadying somewhat in the region of 112 but needs to sustain a move above 113 to question scope for some additional downside.

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