

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 3rd November 2008

Commentary by Eoin Treacy

Astaire Research: The India Report - [Thanks to Deepak Lalwani for his ever topical report which this week leads with a comment on the Indian banking sector. Here is a section:](#)

India's banking sector largely escaped the toxic financial virus emanating from America because of regulatory and bureaucratic controls. In our view these same controls, which have frustrated foreign investors, have proved to be an effective firewall against the current virus. Whilst this is a positive point for India there are fears that policymakers there may feel vindicated and hence have no need to relax controls and continue with financial reforms that would also allow foreign participation in the economy. These fears were put to rest by the new RBI Governor, Mr Duvvuri Subbarao, in his interview last week in Mumbai with Financial Times South Asia bureau chief, Mr James Lamont (www.ft.com/subbarao). "We have been prudent, which has often been described as conservative. That has stood us in good stead. But not to move on with reforms would be the wrong lesson to take from this (crisis)" said Mr Subbarao. Progressive and heartening words for investors in our view.

My view - [Indian equities](#), as well as whole swathes of the Asian markets, have been severely affected by the drying up of liquidity in global markets. However, they have little relative exposure to subprime when compared to the woes being experienced by western financials. This leaves them in a favourable position to perform in any recovery scenario.

The [Bombay Banks Index](#) bounced well last week and rallied back above the July and mid-October lows today. A sustained move back below 4000 would now be needed to question scope for some additional upside. Against the [Bombay 500 Index](#), the Banks Index continues to trade in a wide range. It found support near the lower side in July and continues to rally towards the upper side near 1.5. A sustained move below 1.4 would be needed to question scope for some additional upside.

Financial Times Transcript: Duvvuri Subbarao - [This interview](#), mentioned in the above report, was conducted on October 26th and contains a number of interesting points. Here is a section:

FT: Is bringing inflation down from 12 per cent last month to 7 per cent in March too ambitious a target?

Subbarao: It's a difficult call because, even as prices are coming down with some softening, there are pressures from the other side. Agricultural prices, prices of commodities in the consumer basket, which are sensitive; they should soften too. We still believe that 7 per cent is possible.

Inflation is a daily life issue for a large majority of people so both the government and central bank have to be sensitive to that concern. We have to go beyond the numbers. One thing that the Prime Minister told me before I came here was 'You have been long a civil servant, but when you get to RBI there will be a tendency to lose touch with reality. So just remember whatever you do always think of the impact it will have on the real economy.' That stuck in my mind. Because it's not just about chasing numbers. Even if inflation comes to 7 per cent, a lot of people must still be unprotected. That concern is there even for the RBI.

FT: How can you make this bold prediction when the markets are so volatile?

Subbarao: We have acknowledged the uncertainty. Commodity prices may go up, softening of food prices may not be as much as expected. It is our best judgement at this time that inflation can go down to 7 per cent.

FT: Did the RBI act in a timely fashion to the financial crisis in the US and Europe?

Subbarao: We've tried to be. I cannot make a judgement of our own action. Time will tell you. We've tried to be proactive and we will continue to be proactive.

I'm a bit wary of all the books coming out on the crisis. We should wait for it to settle and for some calm and confidence to be restored.

FT: How worried are you about a global recession's impact on India?

Subbarao: There has been a moderation in certain sectors of the economy even independently of the crisis. This is part of the cyclical downturn and the impact of the global crisis has come on top of that. The most direct impact will be on the adverse effect on our exports particularly our software exports. Second, our ability to raise money overseas for investment purposes for infrastructure could be constrained. Third, if the recession is longer and deeper and if recovery is protracted, I'm concerned about protectionist pressures arising. And then there are second round effects like trade losses.

But look at the positive side too. This is not like the 1990s for India. It's changed. In the 1990s our growth resilience arose from debt financed growth. Today it is private sector driven productively financed growth and there is resilience and even in the rural sector, I'm told there is a vibrant economy growing there. There's improvement in the social sector, education, health. So

there is a spin off effect of all this.

My view - A commitment to continued reform is essential for India to continue to attract inward investment. While, it has at times, been portrayed as stagnant when compared to the ability of China's communist rulers to bypass red tape; the growth prospects for India under a democratic system remain excellent over the long-term. Fears about the negative impact of high inflation forced the central bank to act aggressively over the last year, but these pressures are waning. As inflation becomes less of an issue and the need for action to support the economy grows, the RBI has significant leeway to act.

The [Rupee](#) has fallen victim to the global liquidity crisis and hit new 20-year lows last week. However, considering the economy's distance from the nexus of this crisis and that India is likely to remain one of the world's growth centres; liquidity flows should increase as investor panic recedes. The Rupee has rallied relatively well over the last week in a similar sized move to others posted in the last few months. However, considering the commonality of the Dollar's move against so many other emerging market currencies, the odds are improving that the Rupee has hit its low. The US Dollar would now need to sustain a move above R50 to question potential for Rupee recovery over the medium term.

Templeton, Sydbank See Won, Rupiah, Rupee Bottoming - [This article](#) by Lilian Karunungan and Kim Kyoungwha for Bloomberg covers the important moves occurring presently in the Asian currency markets. Here is a section:

The biggest rout in Asian currencies since the crisis in 1997 is tempting investors to buy in the region that still enjoys the world's fastest economic growth and \$4 trillion of reserves.

Franklin Templeton Investments, which manages about \$500 billion, favors the Malaysian ringgit and China's yuan. Sydbank A/S, Denmark's third-largest bank, is buying South Korean won, Indonesian rupiah and Indian rupee. Goldman Sachs Group Inc. said last week that the won, Asia's worst-performer this year after falling 26 percent against the dollar, may gain 10 percent the next six months.

“We have taken advantage of the recent broad-based weakness to increase our exposure to some Asian currencies,” said Michael Hasenstab, manager of the \$9.6 billion Templeton Global Bond Fund in San Mateo, California. “The differential in growth between Asia and other regions should continue to attract capital, and growth may further benefit from initiatives of local governments that have significant resources to bolster domestic demand.”

While stocks and foreign exchange rates in emerging markets tumbled since the collapse of Lehman Brothers Holdings Inc. in September, Templeton, Sydbank and Mirae Asset Global Investments Ltd., which oversee a combined \$563 billion, say Asian economies are safer because banks and governments spent a decade amassing reserves, laying the foundation for sustained growth.

Reserve Pools

China, India and Southeast Asia's five other largest economies will grow 8.4 percent this year and 7.7 percent in 2009, according to the International Monetary Fund in Washington. In the U.S., where financial companies have been battered by about \$430 billion of subprime-related losses, gross domestic product will expand 0.1 percent next year. The forecast for the 15 European nations sharing the euro is 0.2 percent.

Asian nations have seven of the 10 biggest pools of foreign-exchange reserves, according to data compiled by Bloomberg. China's \$1.9 trillion holdings account for 28 percent of the worldwide total. Japan has the second-highest tally at \$969 billion. India, Taiwan, South Korea, Singapore, Hong Kong and Malaysia each have more than \$100 billion, the data show.

“For a longer-term picture, Asian currencies should perform better,” said Wilfred Sit, who helps oversee \$10 billion as chief investment officer in Hong Kong for Mirae, South Korea's biggest asset manager. “We are not the center of this turmoil and, in general, governments and people have their savings.”

My view - Asian currencies have been a very obvious victim of the deleveraging process which has played havoc with markets the world over. However, this appears to be changing as the Yen and US Dollar encounter resistance following remarkable moves to the upside. We have often relied on the [Asian Dollar Index](#) as a proxy for the performance of currencies in the region. It is made up of Chinese Renminbi, Korean Won, Singapore Dollars, Hong Kong Dollars, Taiwan Dollars, Malaysia Ringgit, Indian Rupee, Thai Baht, Indonesian Rupiah and Philippine Peso and has returned to an interesting level. (Also see Comment of the Day on [August 26th](#))

The [Index](#) experienced a cataclysmic fall in 1997 as a result of the Asian Financial Crisis, but found support in early in 2008 and began to build a base. A progression of rising lows was evident from late 1999 until August this year when the sequence was broken with a move below 112.5. The Index found support last week near 105, which had been an important area of resistance in 2000 and 2005.

[Last week](#) was the first significant week on the upside in 14 weeks and the Index would now need to sustain a move below 103.50 to question scope for further upside. Since the Asian Dollar Index led the Dollar Index's move by a couple of weeks on the way down, it is possible that it may also lead on any reversal.

Email of the day (1) - on Xstrata:

"From banks to miners!!

"Xstrata's short interest stands at 19.26% of market cap, equating to 11.88 days to cover. The stock has seen some aggressive movements in its short interest recently, with an increase from 12.5% in the last week!

"Please see the attached chart comparing the short interest with the underlying..."

My comment - Thanks to a subscriber for this note and chart from Schroders, highlighting the extent of short interest in Xstrata shares. [Xstrata](#) has been in an unremitting downtrend since peaking with a weekly key reversal in May. It has failed to post two consecutive weeks on the upside since August and fell 8 weeks in a row before finding at least short-term support last week. The number of shares on loan, coupled with the consistency of the downward reaction are helping to fuel potential for a sharp short covering rally. The shares would now need to sustain a move below 750p to question scope for some additional upside.

Email of the day (2) - on [Russell Napier's Anatomy of the Bear](#):

"We are all looking for that elusive bottom and the charts which Eoin incorporated in his lead article on Friday evening do appear to strengthen the case for those who believe we have now seen the bottom. However in his excellent study of bear markets (Anatomy of the Bear) author and former number one Asian strategist Russell Napier found that the best indicators had been the cyclically adjusted PE ratio and the Q ratio.

"At all four major stock market bottoms he noted that the Q ratio fell below 0.3 and while the bottom range for the cyclically adjusted PE was rather wide it bottomed at 4.7 in 1932. (27.6 end of June 2005 and 29.4 June 2007)

"I looked for cyclically adjusted PE for the S&P Composite and the Q ratio in the Chart Library but couldn't find them - are they there and if so how do I find them - if they are not could you add them please if possible as they may be of interest to the wider Fuller collective as well as myself.

"Two other points of interest from Russell's book are worth mentioning in the context of pointers for bear market bottoms namely:

"1. Of all the commodities a change in the trend in the price of copper was a pretty good signal for higher equity values.

"2 An increasing amount of good economic news is ignored by the market at major bottoms.

"For me a feature of Fullermoney has always been the willingness you have shown to display views which may not be in accordance with your own but you nevertheless deem worthy of inclusion because they stimulate thought and help members of the "Fuller Collective" in reaching balanced, unbiased decisions.

"I hope this email contributes something useful in that respect because I have over the years personally gained much knowledge and wisdom from what has been posted by everyone but particularly yourself and Eoin - many thanks for that."

My comment - Thank you for an informative email, contributed in the spirit of Empowerment Through Knowledge. It is not possible to graph an index's Quick Ratio (Q ratio) using Bloomberg, so we have no data with which to draw a chart. It is possible for an equity, so, I created this chart of [General Electric's Q ratio](#) since 1990 as a proxy.

I'm afraid I don't know what cyclically adjusted P/E is, so I can't recreate the data used in the book. This chart of the P/E for the [S&P500](#) since 1960 indicates that the ratio is approaching the historic mean, however, this chart's levels do not equate with the figures you quote above.

Email of the day (3) - on the P/E and Dividend yield for the Russell 2000:

"I have been trying for days to locate reliable information on the dividend yield and payout ratio for the US Russell 2000 Index as of 6/30/07, 12/31/07, and 9/30/08.

"Based on a November 2007 study by Fullermoney that reflected a 1.56% yield for the Russell 2000, I subscribed to your service in hopes of locating the data I sought.

"So far I have been unable to locate the data I sought. Can you help?"

My comment - Welcome to the Service and thank you for an interesting question. Here is a chart of the [dividend yield](#) for the [Russell 2000](#). We do not get fundamental data in our feed from Bloomberg so we cannot plot these types of charts in the Chart Library. However, we occasionally display them for educative purposes, as is the case for this and the preceding email.

It is not possible to find the payout ratio for a whole index on Bloomberg so I'm afraid I do not have access to this information. If other subscribers know what it is, I would be happy to publish the data because I believe it is of general interest.

For the record, the dividend yields on 6/30/07, 12/31/07 and 9/30/08 were 1.4172% 1.6310% and 1.8221% respectively.

Email of the day (4) - on charts of the Dow and S&P relative to their 200-day MA:

"The chart showing the DJIA to its 200 MA is excellent. Is that in the library or if not can it be added?"

My comment - Thank you for this question which I'm sure others are asking. It is not possible to produce this indicator in the Chart Library at present. However, we hope to have it at some point. This is why I will continue to produce it using Excel, every Friday, until it is clear that the market has bottomed.

Today's interesting charts - The Chart Library has a wide number of important spreads and overlays which may be of interest to subscribers.

[TED](#) & [OIS](#) spreads - these important spreads continue to contract; further indicating that conditions in the credit markets are easing. They both need to fall back to their pre-Lehman Brothers bankruptcy levels (mid-August) to suggest a semblance of normality has returned.

Australia - breaks back above [4000](#) and would need to sustain a move below 3500 to question potential for some additional upside.

Swiss Franc per 1 US Dollar - the Dollar is testing its highs against the [Swiss Franc](#) and would need to sustain a move below CHF1.12 to question scope for an upside break.

Mexican Peso per 1 US Dollar - the [Dollar](#) encountered resistance at MXN14 throughout October and would now need to sustain a move above MXN13 to question potential for a retracement of at least part of the recent gain.

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

"Would you please add the following UK authorised funds to the chart library:

"Fidelity [European](#) (FIEU) - last price 895.20 JPM [Europe Smaller Companies A](#) (SPESCG) - last price 199.30 Fidelity [European Growth A Inc EUR](#) (FIEMM) (LUX) - last price 7.94"

My comment - Thank you for these interesting suggestions, all of which can now be found in the Chart Library.

Please note - David is well, but away from the office, probably until next Tuesday or Wednesday due to family medical reasons.

Last week's signups for the Free (Abbreviated) Comment of the Day - For the week of October 26th new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, Bahamas, Greece, Hungary, India, Malaysia, Philippines, Poland, Singapore, South Africa, Spain, the UK and the USA - 13 in total. In descending order, which topped the list in terms of the last week's new signups? It was the USA, Singapore with India and the Philippines tied for third.

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 4th November 2008

Commentary by Eoin Treacy

The credit crunch - What led to it and what is the likely policy response? - Thanks to Iain Little of P&C Global Wealth Managers for gaining permission from John Wisbey of Lombard Risk Management to republish his concise, insightful [report](#) on the origins of the credit crisis and possible repercussions. Here is a section:

6. Far from becoming extinct, credit derivatives will eventually become widely publicly traded and quoted on exchanges. Why should it only be the financial elite who use this valuable market?

7. There will be some re-evaluation of what the Authorities should share with the public and when. The natural inclination is to avoid creating instability as no one wants to start a run on a bank, but in this case minor instability earlier would have been preferable. This issue is at the heart of the matter.

8. There will be a complete re-evaluation of the role of Rating Agencies. Should there be legislation to make clear that they have a duty of care to investors? Should they perhaps also revise the rating system to include not just present rating but some estimate of the sensitivity of rating to changes in market conditions. AAA-S1 meaning AAA and stable might be obviously less risky than AAA-V3 meaning AAA but very volatile.

9. Many hedge funds that rely on leverage will face a lethal combination of investor withdrawals and having to reduce their leverage. Many will close or merge - even good ones run by highly capable people.

10. Smaller banks and others like credit card companies will face a tough time and will have to redefine their business models to survive successfully. Many will merge and others will disappear.

11. The UK Government will become by far the biggest hedge fund in the UK with its stakes in several banks funded by massive issue of bonds. The Government will have a structurally huge incentive to try to keep interest rates low.

12. The overall effect on the UK could be massively negative. The City is by far the UK's most successful international industry and any significant weakening of the City by this crisis will be extremely serious for both the UK's foreign currency revenues and the UK Government's tax take both from City firms and high earners in the City. Expect an even weaker pound and UK tax rises. Let's hope that UK policy makers fully recognize this because acquiescence in a new world banking order of back to basics without financial innovation will hurt the UK greatly (and the New York tri-state area by the

way) and benefit countries like Germany and Japan with a very strong industrial base. I suspect our policymakers do recognize it, but they will need to be very tough in withstanding pressure from other countries with less to lose.

My view - The credit crisis is going to have far reaching effects that are going to be with us for a long time to come. I was asked after a talk I gave at the Society of Technical Analysts two years ago when I thought the housing market in London would turn downwards. My answer was that it would probably be ok until we had our next banking crisis. There was no great prescience in this forecast because anyone can see that London's economy is dependent on the relative health of the City. The current environment, where investors shun any kind of financial opacity, isn't good for investment banks' bottom line. Profits and bonuses will be lower going forward.

London has been reinvented many times in the past and I have no doubt it will be again; but it won't happen over night. We can expect interest rates to be cut significantly and the value of the Pound is likely to fall against a range of currencies. The extent that interest rate differentials narrow will be a key determinant of the Pound's performance.

The Pound has fallen aggressively against the [US Dollar](#) and [Japanese Yen](#) over the last three months. It bounced last week and would need to sustain moves below \$1.53 and ¥140 to reaffirm its downtrend. Both the Dollar and the Yen have weakened considerably against a large basket of currencies, so the potential for a significant extension of their relative outperformance has declined in the last couple of weeks.

The Pound has been trading in a relatively tight range against the [Euro](#) for much of the last 7 months. The rate has become much more volatile since the end of September and it is currently testing its lows. An upward dynamic from near current levels would be needed to check momentum beyond a brief pause.

The Pound broke down against the [Swiss Franc](#) in early September and while it rallied well last week, needs to sustain a move above CHF1.90 to question the integrity of the downtrend.

The Pound accelerated higher against the [South African Rand](#) from early October but encountered resistance above ZAR19 and pulled back sharply. It has fallen back into the previous range and would need to sustain a move above ZAR16.6 to offset scope for some additional downside.

The Pound broke downwards against the [Swedish Krona](#) late last year and remained consistent until it lost momentum near SEK11.5. From mid-September the Pound rallied impressively to test the lower side of the 2005-07 range but failed near SEK13. A sustained move above that level would now be needed to hinder scope for further downside.

The Pound remains in a choppy downtrend against the [Canadian Dollar](#). It found support in the region of C\$2 in 2006 and again throughout 2008 but is

currently breaking downwards. It needs to sustain a move back above C\$2 to question scope for some additional downside.

The Pound rallied remarkably quickly against the [Australian Dollar](#) in October but encountered resistance near AU\$2.7 and is now correcting its severely overbought condition. A sustained move back above AU\$2.4 would be needed to question potential for some further weakness.

The Pound continues to trade in a volatile range against the [New Zealand Dollar](#). It recently tested the upper side of the range near NZ\$3 and is quickly moving back towards the lower side. A sustained breakout in either direction would be needed to question the longevity of this relative equilibrium.

The Pound continues to extend its downtrend against the [Singapore Dollar](#) and [Chinese Renminbi](#). Upward dynamics which are sustained beyond a few days are needed to check momentum beyond a brief pause.

The Pound remains in a range against the [Indian Rupee](#) but has weakened significantly of late. An upward dynamic would now be needed to question potential for a downward break.

Against the [Brazilian Real](#), the Pound remains in an overall downtrend. The significant rally from BR3 to BR4.3 has now been more than 50% retraced and a sustained move above BR3.6 would be needed to question scope for some further downside.

The Pound's downtrend against the [Russian Ruble](#) accelerated lower from mid-October and a sustained move above R44 would be needed to question scope for further weakness.

The Pound surged against the [Mexican Peso](#) from late September but has since given up most of the advance and would need to sustain a move above MXN21.70 to question potential for further weakness.

In conclusion, the Pound is getting weaker against a whole basket of currencies as the ill effects of the credit crisis, burst housing bubble and contracting consumer economy take their toll on the outlook for the economy. The only currencies it is firming against are the US Dollar and Japanese Yen which are losing the support of the capitulation trade. The Pound's performance against this basket of currencies will be worth watching for when they turn decisively because it will be an indication that investors are beginning to re-evaluate the prospects for the UK economy.

Developing Nation Debt Costs Drop Most Since '01 as Bonds Rally - This article by Laura Cochrane for Bloomberg covers the easing of the extreme risk premium that had been put on emerging market debt. Here it is in full:

Emerging-market bonds rallied for a seventh day, reducing borrowing costs for developing nations by the most since 2001, as lower money-market rates eased investor concern of a squeeze in credit to the most vulnerable

economies.

The extra yield investors demand to own developing nations' bonds instead of U.S. Treasuries fell 28 basis points to 5.85 percentage points, according to JPMorgan Chase & Co.'s EMBI+ Index. The yield spread has dropped by 2.8 percentage points since Oct. 24.

Emerging-market assets are rebounding from a record plunge last month after interest-rate cuts and as much as \$3 trillion of emergency credit helped send the London interbank offered rate to its lowest since the collapse of Lehman Brothers Holdings Inc. and Japan's interbank rate down by the most in almost a decade. The seizure in debt markets drove Hungary, Ukraine and Pakistan to seek bailouts last month.

“The hope is that this will in part prevent an escalation of concerns about external funding for emerging markets,” said Ralph Sueppel, chief economist at BlueCrest Capital Management Ltd. in London, which manages \$2 billion in emerging-market assets. “These concerns dominate over fears of economic slowdown.”

Hungarian stocks climbed 23 percent in the past week, after losing 28 percent in October. The nation has a wider budget deficit and higher government debt than elsewhere in Eastern Europe. Most household borrowing is in foreign currencies, increasing the risk of loan defaults from a slump in the forint.

Ukrainian assets have been battered by concerns the nation will be unable to meet its dollar-denominated debt as declines in the hryvnia push up borrowing costs. Shares advanced 15 percent in Kiev in the past week, paring a 32 percent slide in October.

Fed Rescue

Investors began returning to emerging markets last week after the IMF almost doubled its limit on loans to developing nations and the Federal Reserve provided \$90 billion in currency swap agreements to Mexico, Brazil and Korea. The MSCI Emerging Markets Index of stocks rose for a sixth day, climbing 0.4 percent to 586.76 at 9.46 a.m. in London. The index is almost 29 percent higher from a four-year low on Oct. 27.

“This rally may have legs yet, although a pause before long is inevitable,” Deutsche Bank AG analysts led by Marc Balston in London, wrote in a research note today. “Such an unbroken rally is rare in the history of emerging markets.”

Emerging-market bond yields are the lowest since Oct. 15, after reaching a six-year high last month compared with U.S. Treasuries.

The extra yield investors demand to own Ukrainian government bonds instead of U.S. notes fell 205 basis points today to 16.5 percent, according to JPMorgan.

Default Swaps

Kazakhstan led a decline in the cost of protecting emerging-market bonds against default. Five-year credit-default swaps based on Kazakhstan's debt dropped 2.8 percentage points to 4.92 percent today, according to CMA Datavision in London. The contracts reached a record-high of more than 12 percent, or 1200 basis points, on Oct. 24, Bloomberg data shows.

Credit-default swaps protect bondholders against default by paying the buyer face value in exchange for the underlying securities or the cash equivalent should a borrower fail to adhere to its debt agreements. An increase indicates a deterioration in the perception of credit quality; a decline signals the opposite.

Contracts tied to Russian government debt declined 147 basis points to 4 percent and Turkey fell 60 basis points to 3.48 percent.

My view - Government Bond yields spiked in a number of countries from late-October, but the majority have since seen a significant easing of this risk premium. Some of the most extreme moves have taken place in [Brazilian](#), [Indonesian](#), [Mexican](#), [South African](#) and [Russian](#) debt. All of these yields surged on the upside as concerns about the risks attached to emerging markets soared, but all have since pulled back sharply as bargains were perceived with yields at such elevated levels.

The highs posted for these yields coincide with lows for a number of the respective currencies against the US Dollar and Japanese Yen. Stock markets have rallied reasonably well over the same time frame but the moves in the currency and bond markets are providing a clearer signal that investors are willing to tolerate some risk when the potential return is so appetising.

Email of the day (1) - on price to book ratios:

"Thank you very much for the addition of price to book charts to the chart library. Would it be possible for you to also add price to book charts for the FTSE Xinhua China A50 Index, the Brazil Bovespa Index, Russia RTSI Index and the MSCI Asia ex. Japan index please."

My comment - Thank you for an interesting suggestion. I added Price to Book charts for the Japanese, Indian and Mexican markets to the Chart Library on [October 28th](#). The reason I did not add more was because these were the only ones which were listed as individual indices on Bloomberg. Today, I created Price to Book charts for the [Xinhua China A50 Index](#), the [Brazil Bovespa Index](#), [Russia RTSI Index](#) and the [MSCI Asia ex. Japan index](#) but you will not be able to find these in the Chart Library because we do not get this type of data in our feed from Bloomberg.

Email of the day (2) - on petroleum products:

"In today's Financial Times (Nov 3) there is a very nice article on how the prices of Naptha, PVC and other petroleum products have crashed out of proportion to the fall in the WTIC.

"Is it possible to get a graph of Naphtha or any of the other petroleum products mentioned in the article? I do not know if they are traded in the futures market, how ever their prices could help identify the bottom of the current economic cycle."

My comment - Thank you for highlighting this interesting [story](#) by Javier Blas. Here is a section:

The cost of naphtha - the cornerstone of the petrochemical industry - fell last week to a five-year low of \$284 a tonne in the far-east Asia market, down 76 per cent from July's record high of \$1,200 a tonne, according to Platts, the pricing agency.

At current levels, naphtha, a by-product of crude oil, is trading well below the cost of crude, a highly unusual phenomenon. While naphtha prices have tumbled more than 70 per cent in three months, oil prices had fallen 45 per cent - a gap traders described as "unprecedented".

"It is a bloodbath," said Shahrin Ismaiyatim, head of petrochemicals at Platts. "There is a steep decline in demand in the US and Europe and that is also affecting China . . . But this is not yet the bottom of the market."

Analysts said some of the price movements were unheard of in at least 20 years. They pointed out that the price of benzene, a -petrochemical derived from naphtha used for plastics and dyes, fell last week below the cost of - naphtha for the first time since the 1980s, as demand vanished.

In response, the petrochemical industry, from Sumitomo in Japan to Lyondell in the US, has reduced processing rates as producers forecast that demand will remain weak for the rest of the year and probably in the first half of next year.

The cuts during petrochemical plants' troughs are likely to trigger a further drop in oil consumption on top of current weakness in gasoline, diesel and jet fuel demand, resulting in a further drop in energy prices, analysts said.

I've added charts for naphtha ([North Europe](#), [Singapore](#), [Japan](#)) , [ethylene](#) and [PVC](#) to the Chart Library. As with other thinly traded markets these instruments surged upwards as oil hit new highs. As the panic surrounding supply gave way to a correction, speculative interest deserted these markets and they collapsed. There is no evidence that these oil products have bottomed, as they continue to accelerate lower. However, I am wary about projecting significant new lows for a market that has already fallen so drastically. The first upward dynamics when they arrive are likely to signal lows of at least medium-term significance.

Today's interesting charts - Moves in the currency and bond markets may be a clue to how equity markets are likely to perform and the Chart Library is full of relevant instruments for those interested in monitoring them.

Oil - [rallies](#) well from close to \$60 and would need to sustain a move below that level to question scope for some further upside.

Nikkei 225 - [testing](#) the mid-October highs but a downward dynamic would be needed to question potential for some further short-term upside.

Dollar Index - encounters [resistance](#) below the late-October highs and would need to sustain a move above 88 to question potential for further downside.

Silver - first successful [close](#) above \$10 in three weeks. A sustained move below \$9 would now be needed to offset potential for some further higher to lateral ranging.

Please note - David is well, but away from the office due to family medical reasons. He may be back in tomorrow.

Wednesday 5th November 2008

Commentary by Eoin Treacy

Davis Advisers: The Wisdom of Great Investors - Thanks to a subscriber for this highly relevant [report](#) which compiles snippets of advice from a number of legendary investors. Here is a section:

Avoid Self-Destructive Investor Behavior

Chasing the hot-performing investment category or making major tweaks to your long-term investment plan can sabotage your ability to build wealth. Instead, work closely with your financial advisor to outline your long-term goals, develop a plan to achieve them and set the expectation that you will stick with that plan when faced with difficult periods for the market.

Understand That Crises Are Inevitable

Crises are painful and difficult, but they are also an inevitable part of any long-term investor's journey. Investors who bear this in mind may be less likely to react emotionally, more likely to stay the course, and be better positioned to benefit from the long-term growth potential of stocks.

Don't Attempt to Time the Market

Investors who understand that timing the market is a loser's game will be less prone to reacting to short-term extremes in the market and more likely to adhere to their long-term investment plan.

Be Patient

Though periods of short-term volatility for stocks are to be expected, it is

crucial to bear in mind that historically stocks have rewarded patient, long-term investors.

Don't Let Emotions Guide Your Investment Decisions

Great investors throughout history have recognized the value of making decisions that may not feel good at the time but that will bear fruit over the long term—such as investing in areas of the market that investors are avoiding and avoiding areas of the market that investors are embracing.

Recognize That Short-Term Underperformance Is Inevitable

Almost all great investment managers go through periods of underperformance. Build this expectation into your hiring decisions and also remember it when contemplating a manager change.

Disregard Short-Term Forecasts and Predictions

Don't make decisions based on variables that are impossible to predict or control over the short term. Instead, focus your energy toward creating a diversified portfolio, developing a proper time horizon and setting realistic return expectations.

My view - [All of these are useful pieces of advice which are helpful to review when one is feeling under pressure to liquidate long-term holdings in a market panic.](#)

Obama May Spend on Highways, Bridges to Stimulate U.S. Economy - [This article by Angela Greiling Keane for Bloomberg covers one of many projects vying for attention from the new President-elect. Here is a section:](#)

President-elect Barack Obama may put spending on roads and bridges at the top of his agenda for stimulating U.S. economic growth.

“He's identified infrastructure as one of the ways to strengthen the American economy,” Janet Kavinoky, transportation infrastructure director for the U.S. Chamber of Commerce, said in an interview. “So we would expect it to be on his list of actions both for the stimulus and longer term.”

Obama was elected yesterday amid a global credit crisis and with the U.S. in or heading into a recession that may be the deepest in more than 20 years. He promised during his campaign he would use infrastructure spending to create jobs.

“We'll create 2 million jobs by rebuilding our crumbling roads, schools and bridges,” Obama said in an Oct. 13 speech in Toledo, Ohio, where he outlined his plan for reviving the economy.

Obama, 47, has urged Congress to pass an economic stimulus bill immediately after the election. House Speaker Nancy Pelosi, a California Democrat, has said she wants spending on highways and other transportation infrastructure included in the next stimulus package.

“Transportation's always something that everyone takes for granted, and then it gets a lot of attention as a result of a tragedy like 9/11 or I-35W in Minnesota,” former Transportation Secretary Norman Mineta said in an interview. An Interstate 35W highway bridge collapsed in downtown Minneapolis last year, bringing attention to decaying infrastructure.

My view - Congratulations are in order for Barack Obama following a gruelling campaign in which he showed his intelligence and political nous. From a personal perspective, the degree to which he was able to utilise the internet to spread his message is a testament to the role of the internet in our daily lives. His success holds lessons for those of us seeking to publicise a service via the online community.

A number of urgent challenges will face Mr Obama from the onset of his presidency. The credit crisis, burst housing bubble, global recession, deficits, the wars in Iraq and Afghanistan will all be at the top of the priority list. I also believe that regardless of who won, investment in the USA's infrastructure from roads and bridges to pipelines and power plants is inevitable. This is both necessary and a way of creating jobs in the heartland. Depending on the size of any investment project, the potential demand for commodities could increase considerably during this four-year term.

Mineweb.com Canadian analysts pick likely junior mining acquisition targets - This [article](#) from Reuters which appeared in yesterday's Mineweb.com covers an important topic, which is likely to garner increased interest over the coming year. Here it is in full:

Merger and acquisition activity in Canada's mining patch will heat up again, but it is tough to predict when big miners will decide the time is right.

"The increasing valuation gap between the senior and intermediate producers and the junior explorers/developers suggests to us that M&A activity will likely heat up going into 2009," Dundee Securities said in a note to clients. Analysts have fingered a handful of juniors that are likely takeover candidates. Here is a list of some potential targets:

* Aquiline Resources ([AQI.TO](#)) - The owner of Navidad silver project in Argentina needs to raise funds to finance immediate capital needs, analysts say. "If the company can continue to move toward development, potential acquirers may take an interest in its large, world-class silver project," Dundee Securities said in a note.

* Corriente Resources ([CTQ.TO](#)) - Developing the big Panantza-San Carlos copper project in Ecuador, Corriente is looking for partners. The owner of the Mirador and Mirador Norte projects, has a "good probability of being taken over," Wellington West Capital Markets said in a report.

* Candente Resource ([DNT.TO](#)) - Said in late September it was looking for a joint venture partner for its Canariaco copper, gold and silver project in Peru.

* Detour Gold ([DGC.TO](#)) - The past-producing Detour Lake project has a good chance of being acquired by a senior producer in the coming year, Wellington West said. Buyers may have to go through PDX Resources ([PLG.TO](#)) which holds a 42 percent stake in Detour.

* South American Silver ([SAC.TO](#)) - "The size and scope of the Malku Khota project makes South American Silver Corp a takeover candidate by a major with cash or cash flow," said Wellington West.

Noront Resources ([NOT.V](#)) - Owns a promising nickel, copper and platinum property at its Double Eagle property in northern Ontario. Complicated by a recently settled proxy battle.

* Osisko Mining ([OSK.TO](#)) - Developing the Malartic gold project in Quebec with an estimated 8.4 million ounces. (Reporting by Susan Taylor; editing by Rob Wilson)

My view - Companies with access to world class assets in politically secure parts of the world offer investors' privileged access to the resources sector. There is no denying that bulk and industrial commodities are in corrective phases right now. Industrial resources companies have fallen aggressively from their May highs. Many of these shares are now trading at levels not seen since 2005.

To my eye, there are two main reasons for this sell-off. The first is that investors have become spooked by the credit crisis' impact on the wider global economy. The prospects for a global recession have been priced in as well as a wide margin for a potential depression. However, risk premiums are now contracting from the TED and OIS spreads to the Yen and emerging government bond yields. This is an indication that the depression scenario is getting less attention and that central bank and government interventions are beginning to gain traction.

The second reason for the big sell-off in resources shares was the fact that they held on to their position of relative outperformance for much longer than any other sector. As oil started to correct, the resources sector came under panicked selling pressure as long positions were liquidated. The banning of short positions in financial stocks saw the cabal of short sellers migrate to the under pressure resources sector. This was accentuated by the open secret that some high profile funds were heavily long of junior miners and relatively illiquid metals. Short selling of resources shares has put some funds under intense pressure and seen short interest in a number of household name companies hit historic highs.

Short sellers of [Volkswagen](#) shares learned that becoming heavily leveraged in a share where there is the probability of merger activity is a high risk strategy. Short interest in many mining companies is now decreasing, as this risk is taken onboard.

Sovereign wealth funds have made no secret of their intention to acquire resources, to fuel the economic growth of their respective countries. To date

they have been relatively quiet but as this market begins to find support and large short positions are unwound, the time to pick up bargains is quickly narrowing.

All of the shares mentioned in the above article are in the Canada section of the International Equity Library. All have fallen substantially from their highs and some are beginning to build support. However, judging from the chart patterns, none are currently receiving much investor interest as potential takeover candidates.

Of greater interest are some of the larger companies. [BHP Billiton](#) fell by 65% from its highs before finding support near 750p. It rallied impressively last week and improved on that performance this week. A sustained move below 800p would now be needed to question scope for some additional higher to lateral ranging.

[Rio Tinto](#) fell by even an even greater percentage before finding support near 2000p. A sustained move below that level would now be needed to question potential for some additional upside.

[CVRD](#) is also rallying having found support near BRL20. It would need to sustain a move below that level to question scope for some additional upside.

[Xstrata](#) had one of the largest short positions and is currently rallying strongly. A sustained move below 800p would be needed to offset potential for some additional upside.

It certainly appears that shorts are being covered as the worst of the panic selling subsides. All of these shares have been sold indiscriminately, irrespective of their balance sheets and value can certainly be found near current levels. However, volatility is likely to remain high as fears of depression wax and wane over the coming months. The mantra that these shares are best bought following corrections is as true now as at any time over the last 6-years.

Uranium stocks back in fashion - This [article](#) by Barry Sargeant for Mineweb covers increased interest in the uranium sector. Here it section:

Listed uranium stocks may have surrendered some USD 31bn in market value since the price of uranium oxide - "yellow cake" peaked out in June 2007, but very recent investor portfolio flows indicate a resurgent interest in the sector. Not only have prices for uranium oxide fallen continuously from USD 136/lb in June 2007, to current levels around USD 45/lb, but like all listed stocks, and in particular mining stocks, uranium names have been singled out for special punishment.

Analysis of listed uranium names indicates that enthusiasm for the sector is back. Stock prices for uranium developers, or juniors, are now on average 51% above low points, and for listed producers of uranium oxide, 46% higher than recorded lows.

In value terms, the aggregate gains amount to USD 4bn in market value, driven by heavily capitalised stocks such as Cameco, the world's leading producer, ERA, the listed uranium producer inside the Rio Tinto stable, now 63% above its low stock price, and Uranium One, which has risen recently on news that it has placed its cash burning Dominion mine in South Africa on care-and-maintenance.

Investors appear unperturbed by further recent confirmation that BHP Billiton, owner and operator of Olympic Dam, by far the world's biggest uranium deposit, is to expand the Australian mine, which also ranks as the fourth largest copper deposit in the world, and the world's fourth largest gold deposit. Beyond Olympic Dam, the majority of the world's biggest uranium oxide deposits are either expanding or yet to come into production.

My view - Uranium shares topped out with the uranium price in 2007 and for the most part did not participate in the advance for the resources sector which peaked in May. However, they did come under the same selling pressure as short positions were leveraged up from July onwards. [Uranium](#) prices remain in a downtrend and need to sustain a move above \$64 to break the progression of lower highs.

[Cameco](#) broke its short-term progression of higher lows in July and accelerated lower before finding support near C\$15. A sustained move below that level would now be needed to question potential for at least some further upside in the short-term. Over the medium-term some higher to lateral ranging appears to be the most likely prospect.

[Energy Resources of Australia](#) was one of the best performing uranium shares over the last year, but it broke downwards in early September and accelerated lower before finding support near AU\$10. It has since rallied impressively and would need to sustain a move below the lows to question scope for some additional upside.

As long as the uranium price remains in a downtrend, companies with less steady balance sheets are likely to remain under pressure. The better performers right now have the commonality that they are well established producers with steady cashflows.

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.

UK FTSE-100 - [breaks](#) above the mid-October highs and the upside can probably be given the benefit of the doubt in the absence of a sustained move below 4000.

US 10yr - [testing](#) the short-term downtrend and a sustained move below 113 would be needed to question scope for some additional upside.

Topix Banks - [rallies](#) well and a sustained move below 150 would be needed to question potential for some further higher to lateral ranging. However, the Index will need to break the progression of lower highs to indicate that the bulls have regained the upper hand beyond the short-term.

Please note - David is well, but away from the office due to family medical reasons.

Thursday 6th November 2008

Commentary by Eoin Treacy

Bank of England Slashes Key Lending Rate to Lowest Since 1955 - [This article](#) by Jennifer Ryan covers today's surprisingly large interest rate cut by the Bank of England. Here is a section:

The Bank of England unexpectedly cut the benchmark interest rate by 1.5 percentage points to the lowest since 1955 as U.K. policy makers tried to limit damage caused by the worst banking crisis in almost a century.

The nine-member Monetary Policy Committee, led by Governor Mervyn King, reduced the bank rate to 3 percent, the biggest single step in 16 years. None of the 60 economists in a Bloomberg News survey predicted the move.

“It's absolutely staggering and deeply impressive,” said Brian Hilliard, director of economic research at Societe Generale in London. “They are clearly grasping the nettle and taking deep action. Boy, this is going to have an impact.”

The seizure in credit markets has left Britain on the edge of its first recession since 1991, prompting a 50 billion-pound (\$80 billion) bank rescue package from the government and a half-point emergency rate cut on Oct. 8.

Prime Minister Gordon Brown's administration stepped up pressure on commercial banks to pass on rate reductions to businesses and consumers struggling with higher food and fuel costs. Lloyds TSB Group Plc said its customers would feel the full impact of the central bank's reduction. Barclays Plc and HSBC Bank Plc said they had the matter under review.

“We really do expect them to pass cuts on now to customers,” Yvette Cooper, a junior Treasury minister, said on Sky News. “People around the country would expect that. They now need to see the benefits from the Bank of England today.”

Pound's Decline

The pound dropped immediately after the decision before rebounding. It traded at \$1.6011 at 12:30 p.m. in London compared with \$1.5868 before the

decision.

Economists said policy makers may lower the key rate again in coming months, and opposition politicians said the size of today's move suggested the economy is in bigger trouble than most people think.

``The cut today from the Bank of England is an indication of the seriousness of the crisis we're facing," George Osborne, who speaks for the Conservative opposition on finance, told broadcasters. ``It is a confirmation we are in a very deep economic hole."

Unions that fund Brown's ruling Labour Party said not enough is being done to ensure that banks step up lending. They praised the central bank's decision.

My view - Today's action is a clear signal that the Bank of England is serious about getting back ahead of the curve in how they manage the credit crisis. The City of London and national housing boom supported the economy for the last decade and more. Now that they are in trouble, the administration has no choice but to act decisively to support markets. 150 basis points cut off the [Base Rate](#), with potentially more to come, sends a signal that they are willing to do what is necessary to help the economy through this crisis.

The [Pound](#) strengthened against most currencies following the news; indicating that at least some of the weakness over the last week had been pricing in this move as a possibility. Interest rates are set to continue to fall in other economies, so an acceleration of the Pound's downtrend is likely to be avoided. However, interest rate differentials as the only hard fundamental in currency markets continue to be a headwind for the Pound. Investors will be watching the currency intently for signs that it may reassert its downtrend.

Email of the day (1) - on yield for a UK Pound denominated investor:

"As a long term investor in most of the Fuller Themes, I am looking to generate £s income over the next 2-3 years from accumulated cash.

"With bank interest on deposits falling and many corporate/bank bonds being marked sharply down, have you any thoughts on possible "safe" income producing opportunities, other than government bonds, that might be considered? I must congratulate you both once again for continuing to provide objective help & guidance through this current turmoil. Though recognized by most subscribers, these "home truths "can't be emphasized too often."

My comment - Thank you for your kind words and I agree that the yield on government bonds is unlikely to be satisfactory considering the trajectory of UK interest rates.

'Safe' isn't a word many people would associate with the credit markets right now, but there are bargains available for those willing to search for them. Fixed Income is an over-the-counter (OTC) market and liquidity has dried up considerably. This means that actually being able to purchase your chosen

bonds might be challenging. However, assuming you have a well diversified portfolio and are prepared to do some in-depth due diligence, opportunities do exist.

Here is a section from a piece by resident bond guru, Mark Glowrey, for the [Fixed Income Investor](#) where he explains the credit market's present illiquidity:

The bond market is a curious thing. Unlike a stock exchange, which acts as centralised point for the vast majority of stock transactions to flow through, the bond market comprises of numerous participants trading on a peer-to-peer basis. These participants are generally investment banks and similar organisations who will carry an inventory of bonds, buying, hedging, selling and swapping as they see fit. Dealing in secondary market bonds is often a profitable activity in its own right, but is also part of the "big picture" of running a full-service investment bank, supporting the fee-generating new issue business.

This is all well and good in normal circumstances, but in the current market the banks are squeezed for capital. Taking positions in bonds now exposes them high mark-to-market volatility and at least some risk of default. As a result, the players have pulled in their horns considerably.

This has been reflected in lower inventories on dealer's books, a much reduced picture on the IBD (the wholesale inter-dealer brokers) screens and a general unwillingness for dealers, large and small, to bid for, offer or take positions in bonds.

Thus, as a rule of thumb, the average corporate bond is now trading on a 2.5 point bid-offer spread, although feedback from readers of this site suggests that 5 point spreads are not uncommon. The better quality names have retained at least some of their marketability. The AAA-rated European Investment Bank bonds can generally be dealt in on a 1-point bid-offer spreads whilst the more defensive issuers such as utilities, food retailers, tobaccos etc tend to be easier to deal in than more dubious credits.

The UK government has given substantial backing to the financial sector so the risk of default is much reduced for senior debt. Subordinated issues are significantly more risky because they often have clauses in the fine print which allow the issuer to skip coupon payments when times are tough. Companies with high cashflows, such as food retailers, utilities and tobacco companies might be less likely to default than those which depend on credit to support their business model.

Here is a [link](#) to the list of GBP bonds from the Fixed Income investor which may be an interesting point to start with, if you are interested in buying individual bonds. One might also be attracted by income funds, a number of which can be found in the Chart Library by searching using the keyword 'income'. Many of these funds have fallen significantly of late, but one would be well advised to find out what they hold before making an investment.

Asia Pacific Strategy 2009: Déjà vu 1998? - [Thanks to subscriber for this interesting, well argued report by Malcolm Wood, Ryan Tsai Corey Ng for Morgan Stanley. Here is a section:](#)

If Asia's So Good, Why Has It Been So Bad?

The obvious response to this analysis is that it has been a lousy indicator of market performance over the past year. We attribute Asia's poor performance to three key factors: rapid financial institution deleveraging, depressed risk appetite, and a deteriorating earnings outlook. On financial institution deleveraging, qualified foreign institutional investors (QFIIs) have been heavy sellers in Asia since the credit crunch began. Indeed, net selling in six Asian emerging markets totalled US\$93.2 billion, or 69.2% of the preceding inflows of the 2003-07 bull market (Exhibit 27). Consistent with this, foreign ownership has fallen to at least a seven-year low of 29.4% in Korea, a five-year low of 18.6% in India, and a three-year low of 27.0% in Taiwan. Furthermore, anecdotally, the gross and net investment weighting of hedge funds in Asia has never been lower.

That said, margin lending is still high in Australia at 2.5% of market cap, or 3.1% of GDP, well above the 10-year averages of 1.6% and 1.7%, respectively. Inflows into mutual funds in India (inflow of Rs300bn year to date) and Korea (fund balance up W26.5tr year to date) have remained positive. Margin lending in Taiwan, however, is at a record low 1.1% of market cap (versus an average 2.3%).

Second, global risk appetite appears to be very significant in Asia, and the collapse in the MS Global Risk Demand Index has coincided with weakness in Asia equities (Exhibit 28).

Third, reflecting past cycles, the market has been anticipating the economic downturn and earnings downgrades. Indeed, the index has declined far ahead of analyst earnings revisions. With consensus earnings still at 13.8% for 2009, we too see material downside toward our base-case forecast of -1% and bear-case forecast of -21% YoY.

Morgan Stanley economists foresee a material slowdown in Asian GDP growth, but do not see a recurrence of 1997-98 (Exhibit 30). That said, Chetan Ahya is emphasising downside risks, pointing to the risks to exports from an EM downturn, the impact on cost of capital from capital outflow and FX weakness, and the hit from financial market instability. Against this, the support from monetary and fiscal easing and lower commodity prices will need to be balanced.

My view - [The credit crisis has forced investors to sell just about anything they could raise liquidity from. Regardless of Asia's status as the growth centre of the world, equity markets in the region were hit hard by redemptions. The risk premium ascribed to stock markets has soared in the last few months but is gradually starting to contract. Asia would now appear to be in an excellent position to attract money flows since, for the most part, it does not have the credit problems which are plaguing Western economies. However, this](#)

process will unfold gradually as investors get their confidence back. The process of deleveraging is too fresh an experience for investors to rush back into markets and it will take for support to be built.

The [MSCI Asia ex-Japan Index](#) fell from close to 600 to 200 in just less than a year. The current rally is the largest upside move since March and follows an extreme downward acceleration. We can probably give the upside the benefit of the doubt provided the Index does not sustain a move to new lows.

Email of the day (2) - on long-term data charts

"Is it possible to get charts with DAILY prices going back 50 -100 years on some of the major world indices ie FTSE, DAX, NIKK etc.? Sometimes it is nice to study in daily detail how bear markets in the past have behaved.

"If any one in the Fullermoney collective is aware of vendor who can provide printed chart books of this sort I would appreciate information about the name and web address of the vendor."

My comment - Thank you for an interesting question. There are a number of limitations which need to be taken into account before we can draw such long-term charts. The first is we can only display as much historical data as we receive from Bloomberg and they are limited in this regard. The Chart Library, at present, can only display 50-years of data. Another consideration is the width of the screen. There are only so many pixels to the width of one chart and each candle requires at least three.

To draw 50-year charts follow these instructions:

Select the instrument from the search of Chart Library menu.

Click on the Charting tab in the top left of the chart area.

Click on daily from the Sample dropdown menu

Click on 50 years (Max) from the Period Dropdown menu

Hit Apply.

If you want to examine what happened over a particular period of time you can use the zoom feature to highlight your chosen timeframe. The Chart Library will then automatically define the optimal Sample (daily, weekly or month) to view the data.

For The Chart Seminar's custom chartbook, we include long-term monthly charts for every instrument. Our sister service Investors intelligence is the only firm I know of that prints chartbooks.

World Equity Index Valuations Tables - Here is the monthly [list](#) of 100 global indices ranked in descending order by dividend yield and then in ascending order by P/E.

What immediately sticks out from this month's lists is how many indices trade at P/Es of less than 10. The number has increased substantially since this time last month with 61% now less than 10. Even accepting that P/Es may rise as earnings are revised downwards, this is still an impressive number.

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

Please note - David is well but away because of Mrs. Fuller's illness. Mrs. Fuller endured an aortic valve replacement operation on Monday and as of writing remains in intensive care.

Friday 7th November 2008

Commentary by Eoin Treacy

S&P 500 and Dow Jones Industrials Average divergence from 200-day moving average - A subscriber first sent me the spreadsheet for this indicator on October 10th. It registered with me immediately because from a purely statistical point of view, the more an instrument diverges from its long-term average, the greater the chances are that it will revert to its mean.

The extremes posted in October have not been seen since the 1930s, but I do not want to exaggerate the power of this indicator. Looking at its predicative power historically, extremes usually mark the end of an accelerating move, but not necessarily the absolute bottom. However, good medium-term rallies have followed extremes such as we have just seen in the vast majority of cases.

For both the [Dow](#) and [S&P](#), the indicator remains above its lowest levels but has yet to sustain a meaningful rally. This mirrors the performance of the indices themselves. Both had rallied well over the last week but encountered resistance at the top of their short-term ranges. Sustained moves above 10,000 and 1000 are needed for the Dow and S&P respectively to suggest confidence is returning.

GSI: The Issues November 2008 - Thanks to a subscriber for this excellent [report](#) which details the apparatus of forced selling in Asian markets. Here is a section on the performance of stock markets:

Key Characteristic of the 2008 Bear Market: Performance and Our Use of Cash -The real drivers of the 2008 bear market were not U.S. housing problems, subprime lending or the use of too much debt but the global

blowout of exotic derivatives (in which ABS and CDS are components) plus unexpected major policy mistakes.

1. Historical bear markets were driven by one or two major economic dislocations. Other places were available to re-position funds, e.g., old-economy sectors in the IT bubble and exporters during the Asian financial crisis. The financial meltdown of 2008 is unique. All global markets and sectors have plunged. The key decision for long-biased funds is the cash level. The more pervasive the presence of derivative instruments, the bigger the fall of that stock market.

We were wary quite early on about the bubbles in China and emerging markets, and the ABS issue. On average, our funds were on average ~30% in cash over 1H08. In retrospect, that was not enough. As we realized belatedly by July/August this year, on unrelenting redemption-driven selling, there was also an ownership bubble in mainstream Asia Pacific x Japan funds sold to European and U.S. retail investors with no experience, thus no appetite for the high beta feature of Asian bourses. By August we were over 40% in cash, over 50% in September (on the unexpected fall of Lehman). Our highest cash position was 70% to 75% by early October at time of the blow-out of yen-carried trades.

2. An inverse relationship exists between the degree of price collapse of a share and its investment fundamentals. The better the investment case, the bigger the hammering. In Asia, Malaysia felt the least, despite political uncertainties and risks of racial tension. Japan, with US\$15 trillion of savings, suffered a 10% daily plunge as if it were a third-world, heavily indebted economy. The U.S., the epicenter of the ABS crisis that precipitated global bank runs, has vulnerable, heavily indebted consumers. Yet not until October did Wall Street fall by more than the 20% bear market threshold, while all other major bourses elsewhere had already plunged well into bear territory.

The inverse relationship arose because the best investment ideas were exactly the same ones that attracted hedge funds. Forced selling from deleveraging drove share prices to collapse, and our funds' sector and specific stock exposures suffered as a result. However, overall portfolio damage was cushioned by our move into cash. YTD (to the sell-off in 3rd week in Oct), our funds have fallen by approximately an absolute ten percentage points less than the MSCE FE x J Index.

3. Governments were behind the curve as the financial turmoil unfolded. Policy mistakes were made, the major one being letting Lehman go, without any backup plan for the CDS market in which Lehman was a key player. When that link snapped, the whole derivatives market imploded. Not until authorities get ahead of the curve will this bear market be over.

My view - I heartily recommend the early part of this report for a concise but thorough overview of the impact on Asian stock markets of derivative positions being liquidated. Asian economies are in a far healthier condition now than they were a decade ago. Their relative fiscal position also outstrips that of the majority of western economies. It makes much more sense to view

the drawdown in Asian markets as a contraction of global liquidity rather than as the direct impact of subprime related exposure.

I accept that Asian markets will not come through the current crisis and resulting recession unscathed. No market will. However, the competitive advantage of economies with budget surpluses, plenty of cash in reserve and little exposure to the CDO mess should not be underestimated when we come to think about which markets will outperform in any future recovery.

While still elevated, the premia attached to [currency](#), [credit](#) and [emerging government bonds](#) have contracted considerably from their accelerated highs in mid-October. However, the longer these indicators remain below their highs, the greater the chances are that they have peaked. It will take time for investors to regain confidence and many will not dare to re-enter the market before new uptrends are well in place, but that does not negate the possibility that we are already close to the lows for this correction.

Custom Chartbook for The Chart Seminar - While proof reading the chartbook for next week's TCS I noticed some charts which may be of interest to subscribers. I click through a large number of instruments every day in order to get a feel for where markets are trading, but the exercise of looking at some longer-term charts and additional p&f charts threw up some developments I had overlooked.

[Uranium Participation Corp](#) has fallen by almost [75%](#) but steadied near \$5. This p&f chart clearly illustrates the failed break below \$5 which marked a low of at least short-term significance. The share has rallied impressively since and broke the short-term progression of lower rally highs. While the overall downtrend remains in place, a sustained move to new lows would be needed to question scope for some higher to lateral ranging.

[Bloomberg World Utilities Index](#) found [support](#) near 150 in early October and rallied more than at any time since March. It encountered resistance this week near 180 but would need to sustain a move below 150 to question potential for some additional higher to lateral ranging.

The [Norway Index's](#) downtrend has been losing [momentum](#) since mid-October. The rally from early last week, broke the short-term progression of lower highs and while the Index pulled back sharply yesterday, a sustained move below 175 would be needed to question scope for some additional higher to lateral ranging.

[Ireland](#) broke its short-term [progression](#) of lower rally highs this week and while it was unable to hold the move above 3000, a sustained push back below 2500 would be needed to question potential for some additional higher to lateral ranging.

Email of the day (1) - on buying residential property:

"Firstly may I wish Mrs. Fuller a speedy recovery and also my prays for all the fuller family at this difficult time. I am hoping to attend the TCS in May'09 and was wondering is there a book containing the course content or is it just a case of taking notes.

"Also I am seeking your opinion on whether or not you think it is a good time to start buying residential property as it looks like rates are on the way down and people are very fearful, I would look to hold the properties for a 7 to 10 year period.

"I have been a subscriber for a relatively short period but I must say I have been hugely impressed with both yourself and David and must congratulate and thank you for all your efforts and the sterling service that you both provide."

My comment - Thank you for your kind email. We are all much relieved that Mrs. Fuller has come through her operation successfully and is on the road to recovery. I look forward to meeting you at The Chart Seminar. At present there is no book to accompany the course, although it is an ambition of mine to write one; if I can garner the time.

Buying property is a tricky business in the current environment, so I would be wary and do considerable research on the market in your chosen area. However, one should also be aware of the secular trend. Real Estate outperformed most other asset classes for a considerable period of time but its secular uptrend has peaked.

In absolute terms, [UK house prices](#) peaked in September 2007 and have since posted their largest reaction in more than 20-years. Following the last bubble, which peaked in 1989, prices bottomed in 1992, but did not post new highs until 1998. The bull market over the last 10 years was truly impressive in absolute as well as [inflation-adjusted](#) terms but has categorically ended.

The [FTSE-100](#) outperformed house prices between 1989 and 1998 and underperformed quite considerably between 1999 and 2003. The last 5-years have been characterised by a relative equilibrium. 2008 has seen house prices outperform even as they fall in absolute terms. A sustained move back above 8.6 is needed to question scope for some additional underperformance by the FTSE in the medium-term.

From 1983, [gold](#) was in a secular bear against the price of property. It appears to have bottomed in 2004. Gold outperformed until July before posting its largest reaction in more than four years. It needs to sustain a move above the July highs to offset scope for further downside.

House prices are considerably less volatile than either the commodity or stock markets and the Index updates less frequently. Although, house prices are outperforming right now, this may be because of that market's more staid nature. As long as house prices are falling in absolute terms, their long-term potential as an investment is likely to be limited.

Email of the day (2) - [on the bearish case](#):

"I paid my subscription and therefore feel obliged to continue listening to your audios, but my god, when are you guys going to do some homework? This is a balance sheet recession much like experienced in Japan. Lowering interest rates around the world will have little effect. This will be a long and painful recession! S&P earnings estimates for next year of \$90 are ridiculous and we will not see a final bottom in the market until analysts panic and reduce those estimates. So go ahead and reassure everyone that markets have discounted all the bad news to their financial detriment."

My comment - Thank you for your strongly held opinion and continued support, even when there is a difference between our positions. I agree with you that this could be a potentially lengthy recession. As we have mentioned on numerous occasions, not least in last night's audio, we expect analysts to revise their earnings estimates lower and this will result in rising P/Es. However, so many indices sport P/Es in single digits that it is worth taking notice of. From past cycles, we can also expect stock markets to bottom well in advance of the end of a recession.

US consumers are going to save more and buy less. Earnings will fall. However, the government's response will be to step in and spend more on the domestic economy in an effort to stimulate growth. I believe infrastructure projects will be high on that list of spending programs.

Interest rates are not everything, but they are no longer a headwind to growth. Unlike [Japan](#) in 1989, interest rates were cut [quickly](#) and aggressively as this crisis began to unfold. Even in a worst case scenario where Wall Street takes years to find a well defined bottom, other markets should outperform considerably.

It will not be apparent until well after the event, that the deleveraging process has ended, but once it does, individual stock markets will be judged on their merits. This should favour high growth markets more than Wall Street. .

The majority of stock markets found some level of support in the latter half of October and rallied smartly to test the highs posted earlier in the month. In the last few days, we have seen most fall back from those levels. If the yearend rally hypothesis is to be maintained, indices need to find support above their recent lows and sustain moves above this week's highs. Subsequent to any rally that takes place as this process unfolds, we will be in a much better position to judge the direction of markets beyond the coming couple of months.

Please note - Mrs. Fuller was moved out of the ICU last night and while groggy, is in good spirits. David expects to be back in the office on Monday, helped by the arrival of family from the USA to help him care for his patient.

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