

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 17th November 2008

Tim Price: What's the colour of money? - [Published by PFP Wealth Management, topics discussed in this interesting issue include the US automobile industry, credit default swaps, currencies and gold. It is posted in the Subscriber's Area but here is a sample:](#)

Economist John Tamny is similarly sceptical, recalling the words of Ludwig Von Mises that the entrepreneur who fails to use his capital to the best possible satisfaction of consumers is "relegated to a place in which his ineptitude no longer hurts people's well-being". Detroit's so-called Big Three are curiously vestigial entities - embarrassing, mismanaged throwbacks to the dawn of car-making. And there can be little doubt that any business (such as General Motors) that has posted \$70 billion in losses over the past four years - versus a current market capitalisation of just \$1.8 billion - is hardly a success story. President-elect Barack Obama has described US carmakers as "the backbone of American manufacturing". This particular backbone has advanced osteoporosis.

Citigroup's Hans Kullberg ("Reconstructing America: Why the US Government should turn a blind eye to US automakers.. and invest in the future") has written an interesting piece in which he details the extent of the problems facing the US auto sector, but also puts forward a strategic alternative simply to shovelling money at them (in the form of investing into energy and alternative energy infrastructure):

"Every time I see a commercial on television advertising a "0% APR No-Fees, No-Money Down" loan for a car, I cringe. The average American household currently owns 2.28 cars - how many of these are idle? The days of "buy now and pay later" are over, meaning there's no money left to buy cars, meaning there's no money left to support the auto industry, meaning there's no sales revenues to pay absurd pension plans, meaning there's no reason for the US Government to extend a lifeline simply to postpone the inevitable future of a futile auto industry. Although politically appeasing, to do so would be a disservice to the American taxpayer, which is a much larger contingent than the 2 million or so odd jobs that would be saved. It's readily apparent the "modest" loan would be used simply to renegotiate debt terms which are now trading at 25 cents on the dollar and yielding over 30% a year. To put off the day of reckoning will make the downfall worse when it finally comes."

But then, let he who doesn't need government money cast the first stone. And the problem with government money is that in most jurisdictions the very term is a misnomer, because governments too are already heavily indebted, so it's taxpayers' money we're really talking about. And this gets us to the heart of the debate: at what tipping point do effectively unlimited guarantees and capital support by governments start to become self-defeating, inasmuch as they start to erode belief in the very instruments (specifically, government bonds, and in due course fiat currency) from which they are constructed ? Or to put it another way, when does money start to eat itself?

My view - Whether GM, Ford and Chrysler are bailed out, nationalised or reconstructed under Chapter 11, this is going to be messy, expensive and generally damaging in terms of corporate and consumer sentiment. These recent items from [Condé Nast](#), [Freep.com](#) and [The Wall Street Journal](#) help to explain why.

What about other ramifications?

This saga gives equity investors another reason to stay on the sidelines for a while longer. Speaking for myself, as one who holds a reasonable amount of cash potentially earmarked for stock markets, I am content to wait for at least some evidence of base formations, such as we last saw in 2003, rather than attempt to pick the bottom. Meanwhile, [China](#) interests me more than [Wall Street](#). I would not be surprised to see China lead the eventual recovery, or at least outperform on the upside if stock market indices eventually turn upwards more or less simultaneously.

I also maintain that technicalities behind the [US Dollar Index's](#) current levitation - from global deleveraging to momentum trading - will not be sustainable beyond the medium term. However I will wait for the charts to confirm that this trend has run its course. Currently, it needs to sustain a break above 88 to reaffirm the medium-term uptrend.

Email of the day - On a request for a free trial subscription:

"Hope you are well. I am enquiring into the possibility of obtaining a free trial of your website. We are a wealth management firm and are looking into the possibility of expanding our subscriptions to economic research.

"I look forward to hearing from you."

My comment - Thank you for your interest in Fullermoney. We do not offer free trials to the service. However on the Fullermoney.com website, you can register for our Free (Abbreviated) Comment of the Day, which will be sent to you by email. This will give you a good idea as to the style and content of the service. You will not receive any sales calls and no one else will have access to your email address. (Note: subscribers may wish to remain on the (Abbreviated) Comment email list as its arrival informs that the Subscriber's Area has also been updated.)

Additionally, you can click on the "Previous Item" link (just above the date for each comment) or search the "Archive" (centre link above Comment of the Day) which will enable you to read copy dating back to May 2002, when Fullermoney evolved into an online service. You will also be able to review earlier Subscriber's Area sections, including Audios (see orange link, upper left), which enter the public domain four months after they are released for fully paid-up subscribers.

There is a great deal of content on the Fullermoney site. However if you want to assess the service quickly, I suggest that you listen to some Audios. They are the most efficient means by which Eoin and I can convey our views to subscribers.

Lastly, many firms in your industry take out multiple subscriptions for their managers. You will find details in our Subscription pages.

Gold Producers Quarterly - [My thanks to a subscriber for this informative report](#), published by National Bank Financial. Here is a brief sample:

Gold correlation statistics from Q3 continued to show that the U.S. dollar is the primary driver of the gold price. The greenback had a negative 90% correlation with bullion up from a negative 72% correlation in Q2, as gold started to decline after the seizures of Fannie Mae and Freddie Mac were announced and the unwinding of the long gold / short U.S. dollar trade began. In addition to the greenback, gold and oil were re-acquainted as strong positive correlates sharing a positive 76% correlation in Q3, as both were victims of a global commodity sell-off after oil outperformed gold in Q2, resulting in a negative 17% correlation in the quarter. The euro maintained its strong positive correlation to bullion at 86% as it suffered from weakening economies in Europe and investor flight into the U.S. dollar. In other currencies, gold strongly outperformed in the Australian dollar (+15%) as the Aussie currency was hit hard by falling commodity prices. Gold also outperformed in the British pound (+6%), the Swiss franc (+4%) and the South African rand (+1%). Both the U.S. dollar and the Japanese yen outperformed gold (-5%), while the loonie was relatively flat in gold performance at -1% (small out-performance by the loonie). On the commodity front, base metals were mildly positively correlated with bullion - copper and gold had a positive 66% correlation while zinc and bullion shared a positive 52% correlation. This was to be expected as the quarter was marked by a global commodity sell-off with the financial crisis and speculation that development in regions like China and India was slowing down. Gold was caught in the sell-off by commodity funds liquidating positions.

My view - [Subscriber's can access charts of the gold price in other currencies in the "Relative Charts - Commodities & Indices in Currencies", section of the Library. Here is a sample: gold in euro proxy \(monthly, weekly and daily\).](#)

Technically, gold needs to hold near the bottom of its ranges against various currencies, to indicate that the overall upward trend is intact. Against the euro, this level is at €533.

In US dollars, [gold](#) peaked in March, with its dramatic weekly key reversal, and well before the US currency's strong rebound commenced in July. Over the last four weeks and counting, it has been finding support near \$700 - the upper side of a previous and important trading range, but the MA has turned downwards and lower highs are evident.

In a fiat currency world and with talk of Bretton Woods II premature, I assume that gold will remain a safe long-term store of value, albeit volatile. As such, it is best purchased on weakness and the next significant rally will probably require a weaker US currency.

Additional Commentary by Eoin Treacy

The Chart Seminar (TCS) Highlights - All examples at The Chart Seminar are provided by the delegates. This ensures that The Seminar is relevant to the group but is also instructive from a behavioural perspective. At the May seminar the accepted reality was that commodities had come into their own, inflation was to the forefront of investors minds and the Dollar's decline was taken as a given. Delegates were most interested in Asia's big population centres, commodities, commodity shares and commodity related markets. We didn't look at a single bond price or yield.

Right now, the accepted reality is that the deleveraging process remains a powerful force. The Dollar's uptrend remains intact and has further to go. That almost every developed market is in, or about to begin, a potentially deep recession is taken for granted. Banks are considered an extremely risky investment.

On Thursday and Friday, the discussion of this highly experienced group related to the Dollar's uptrend and the ramifications of its strength on other markets such as stock markets and commodities. We also discussed the prospects for major indices such as the Dow Jones and S&P500 and agreed that while downtrends remain in place, the extent of the acceleration makes increasing short positions risky at this time. In behavioural terms, what was evident from the debate was that demand has become inert. This is due to the extent of the downdraft and large number of false dawns, meaning it will take time for confidence to be rebuilt.

No one is in any doubt that the Dollar's tipping point, whenever that occurs will be a seminal moment for a number of markets. However, what is also interesting is what was not covered in the examples mentioned at the seminar.

We did not look at a single emerging market country index, emerging market equity or emerging market bond. Other than oil, the only commodities we looked at were gold, silver and copper and this was mostly in relation to their inverse correlation to the Dollar. Resources shares didn't feature at all in the discussion. This is partly because the only places investors have made money over the last six months have been in either being long the US Dollar, Yen and/or Treasuries and short stock markets and commodities.

The behavioural conditioning of making money leads us to question our methods less and to expect the situation to continue. When we lose money, self doubt leads us to question our methods but we have the same expectation that conditions will persist.

We do not yet have convincing evidence that most stock and commodity markets have bottomed. However, I am cautious of becoming increasingly bearish when the accepted reality is that things will get considerably worse before they get better. Since interest has declined so much in resources and emerging stock markets, these may be due a rally in the coming six months.

Next [The Chart Seminar](#) date - The next TCS will take place in the Westin Hotel Dublin on February 19th and 20th. The early booking rate of £875 + VAT will be available until January 15th with the full rate of £950 + VAT applicable subsequently.

Email of the day (1) - on a book mentioned at The Chart Seminar:

"Can you please provide me with the full title to Sigmund Freud's book on Crowd Psychology that Eoin recommended?"

My comment - The only book I recommend as providing a foundation in a behavioural approach to markets is Freud's Essay on Crowd Psychology. Here is a link to the [Amazon](#) page.

S&P 500 and Dow Jones Industrials Average divergence from 200-day moving average - A subscriber was kind enough to send me the spreadsheet for this indicator in early [October](#) and we plan to add it to the Chart Library at some future date. The importance of the indicator 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. 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.

The path the indicator is taking is for the moment tracking the performance of the [Dow](#) and [S&P](#). This means that it hit an important low in mid-October but has so far failed to rally significantly.

Email of the day (2) - on UK Gilts:

"I wonder whether today the potential for UK Gilts to have more upside in the near-term is worth considering?"

"The counter arguments are strong: I have no doubt the unprecedented reflationary stimulus will prove inflationary, potentially substantially so, eventually. Also, the UK Government's borrowing requirements ensure there will be a substantial new supply of Gilts for some time to come.

"However, in the near term, I think there is every possibility these headwinds will be outweighed. Mervyn King yesterday flagged the scope for the Bank Rate set to be cut much further (I expect to see this down to 2%, probably 1%), which will make today's Gilt yields look very attractive in the nearer term.

"So I am interested in your views on the scope for Gilts to move towards the top of the 15 year range, i.e. towards early 2003 levels."

My comment - Thank you for a relevant question, which I'm sure others will be asking as Gilt prices remain in a persistent advance. The reason bond investors look at yields instead of prices, especially for longer-term fixed income charts, is because historical levels can be distorted by coupon changes.

Taking the example above; price levels are currently significantly below their 2003 highs, but yields are testing their 2003 and 2006 lows near 4%. Yields would fall to 2.06% if prices rise to the 2003 high of 124.77 using the current on-the-run UK Gilt.

Prices broke upwards to a new short-term high last week and so far have sustained the gain. The most consistent thing about the advance to date has been the progression of rising lows and these would need to be taken out, with a sustained move below 111, before investors question the bullish hypothesis. Both prices and yields are within striking distance of their 2006 levels. On a yield basis, a sustained break below 4% would be needed to signal a move to lower trading levels and would likely mark a significant deterioration in expectations for the economy.

Email of the day (3) - on corporate bond indices:

"Is there a corporate bond index available which averages all corporate bonds and if so could we have it in the Library?"

My comment - We have composite corporate bonds indices sorted by credit rating for US Dollars, Euros and Japanese Yen in the Chart Library. You will find them along with a large number of Bank and Financial indices in a number of currencies in the Bond Yields section. The composite indices can be found using the keyword 'comp' in the search engine or by using the credit rating as a search parameter. I don't know of a bond index that does not segregate bonds by credit rating.

Yields have risen for all of these US Dollar indices (AAA, AA, A, BBB, BB, B). However, the advance in the spread between AAA and B, since the Lehman Brothers bankruptcy, has been unprecedented in the 13 years of available

history. The uptrend remains consistent and a downward dynamic is needed to question momentum beyond a brief pause

Email of the day (4) - on customizing p&f charts:

"I still have a few problems with my P&F charts. Why am I getting a sort of 'ghost' P&F chart? Also, can I choose my own box and reversal figures?"

My comment - Thank you for this interesting question which may be of interest to other subscribers looking at p&f charts. The reason the data points are so small is because your zoom factor has been set to Tiny. You can change this by selecting 60% (standard) from the rightmost dropdown menu at the top of the page. You can change all of your p&f options, including box size and reversal by clicking on the Charting tab at the top of the chart.

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.

China Shanghai A-Shares - continues to rally having found support near 1750 in what is a failed break below the late September lows. A sustained move below the former level would be needed to question scope for base development in the current area.

Eurobunds - remains in a volatile uptrend and would need to sustain a move below 116 to question scope for further upside.

US Dollars per 1 British Pound - finds at least short-term support near \$1.45, but would need to sustain a move above \$1.60 to question the integrity of the downtrend.

Last week's signups for the Free (Abbreviated) Comment of the Day - For the week of November 9th new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, Canada, Croatia, France, Hong Kong, India, Ireland, Israel, New Zealand, Singapore, Slovenia, South Africa, the UK and the USA - 14 in total. In descending order, which topped the list in terms of the last week's new signups? It was the USA, UK with Canada and Australia in third position.

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 18th November 2008

Is China the Next Shoe or the Final Capitulation? - [My thanks to a subscriber for this topical item by Cam Hui for Seeking Alpha. Here is the opening:](#)

China, with its enormous reserves, had long been regarded by many investors as the last bulwark against the financial conflagration sweeping the globe. Now comes this story indicating that China itself could be a source of deflation:

After a recent visit to China, Nobuyuki Saji, chief economist and equity strategist for Japanese investment bank Mitsubishi UFJ Securities (MTU), issued a report warning that China could be on the verge of pushing the world into a deflationary spiral. The problem? Swelling industrial overcapacity, which threatens to undermine prices both for China's exported goods and its imports of raw materials.

He estimated that China's production is running as much as 50 per cent below capacity, as many industries that have been expanding rapidly are now being hit by slowing demand both domestically and abroad. Based on his estimates, China alone represents 7 per cent of the global supply/demand gap.

Excess Chinese capacity would crater capital investment

News of the Chinese economy slowdown is not new. What is new is the amount of excess manufacturing capacity in the country. (Remember those stories of all that dark fiber networks after the NASDAQ crash of 2000?)

I had called for a rally into year-end and then another leg down in the stock market. This Chinese overcapacity story, if it becomes widespread, could be the catalyst for the next downleg. It would serve to take US and European stocks down further. It would also be extremely negative for commodities of all types, as the hopes of commodity demand from future Chinese infrastructure investment would evaporate.

China slowdown: The final capitulation?

One ray of hope, however, comes from the analysis from Marty Chenard of stocktiming.com. He recently wrote a piece [*] indicating that the Chinese stock markets may be in the process of forming a bottom. He highlights the point and figure chart of Shanghai Composite as an example. The Shanghai market recently broke out of a downtrend, indicating that it is in a bottoming process.

[My view - I think China's economy is slowing more than officials suggest, not least because the global economy continues to weaken. However the stock market will be a leading indicator more often than not, although this was not the case a few years ago, due to the supply of new issues. That problem is](#)

unlikely to be repeated anytime soon and authorities are introducing increasingly market friendly monetary and fiscal policies on an incremental basis.

Consequently, I maintain that China will be one of the leaders of the next stock market recovery. However as today's downside key day reversal [suggests](#), further base building is likely before a sustainable uptrend is established.

Here is a related [article](#) from Bloomberg.

Email of the day (1) - On commodity shares as part of the Fullermoney themes:

"Many thanks for the excellent service and thought process provided by you and the Fullermoney collective. I have been a subscriber for about a year and am now planning to return to stocks (lucky of me to be totally out, but have lost some money in real estate). My focus is on commodity as part of the Fullermoney themes.

"Could you be so kind to put your portfolio on the website so we can access it anytime and also have a look at the entire book in one go? I tried searching for "portfolio" but it simply refers me to sporadic mentions in various comments of the day, but does not give me a full picture of all your holdings.

"p.s. My son is 15 and I intend sending him to TCS in a few years."

My comment - Many thanks for your thoughtful comments. Reports and emails from the Collective have always been a valuable feature of the interactive online service, and never more so than during the last two years. Also, congratulations on having been out of the equity markets during this severe bear market and economic downturn.

You can see my personal long-term equity portfolio by using Comment of the Day's 'Search' facility shown upper left. Just type in 'top-10' and click on the Search button. Having decided long ago to ride out this downturn with my own unleveraged portfolio - a big mistake but also an incentive to do better going forward - rather than fret about it I have focussed on monitoring the broader markets' downtrends, while thinking about how I might eventually invest my cash holding. For this latter reason your email is timely.

Resources (commodity) shares will definitely be among my eventual purchases. However small-cap shares will not be on my buy list, although I appreciate that they can do spectacularly well when a sector is hot. Subscribers could monitor their relative performance in the Library, for that next opportunity, but my purchases will be confined to big-cap leaders.

Among those in my personal top-10 portfolio by weighting, BHP Billiton ([weekly](#) & [daily](#)), Rio Tinto ([weekly](#) & [daily](#)) and BlackRock World Mining Trust ([weekly](#) & [daily](#)) will certainly be candidates. However I personally am in no

hurry, as I have said before, and may opt for the cautious strategy of waiting for additional evidence of base formation development. That is a personal choice, as is any investment decision. More importantly, I believe these candidates offer outstanding long-term value today, and I maintain that global infrastructure development will be a key theme during the next economic upturn.

Meanwhile, agricultural shares are a glaring omission in my current portfolio. This will be corrected in the months ahead. [Potash](#) Corporation of Saskatchewan is a leading candidate, although given its extreme surge and late peak on 18th June, I hope to buy it a little more cheaply. The [potash commodity](#) chart looks vulnerable to a downturn, in line with every other commodity popular with investors over the last few years. A seed company such as [Monsanto](#) could be a candidate, although not at today's price and valuations. For general commodity exposure, I may invest in a [Brazil](#) tracker, but preferably at a lower level.

I know that Eoin will look forward to seeing your son at a future TCS. We have had many second generation and even some third generation delegates.

Email of the day (2) - On technical views of the US market:

"It would be interesting to have your appraisal of the technical view given on Bloomberg;

After rebounding 11 percent Nov. 13, the benchmark index for American equities slipped 6.6 percent during the last two days and will probably keep falling past 818.69, its lowest level since 2003, according to three top-ranked technical analysts. The S&P 500 declined below its Oct. 10 low of 839.8 before rallying last week, making it a "retest" to chart readers.

"Historically you would've had a better charge from the bulls at this point, and it hasn't developed," said Jeffrey de Graaf, a senior managing director at ISI Group Inc. in New York, in a telephone interview. "The buyers haven't presented themselves in a meaningful way to show that there's a sustained move to the upside, so the concern is that you just drift here."

"The 11 percent trough-to-peak gain in the S&P 500 on Nov. 13 was one of six "key reversals" in the past 40 years, according to de Graaf, who defines the term using intraday levels and moving averages. Its 4.2 percent retreat a day later was the worst showing after such a turnaround by a factor of seven, he said.

"De Graaf, the highest-rated technical analyst in Institutional Investor magazine's survey the past four years, said other indicators suggest stocks will keep falling. They include declining stocks outnumbering rising ones; higher trading volume when the market is falling than when it's rising; and two-year Treasury note yields near record lows at 1.17 percent, an indication investors are seeking to avoid risk."

My comment - I met Jeffrey de Graaf at the 46th Annual Contrary Opinion Forum hosted by Fraser Management Associates last month. He was also speaking and gave a good presentation, posing the key question for all of us: Will the stimulus that has revived all stock markets following bear trends since WWII work again this time, or are we in a new and different environment?

None of us know the answer to this question because, I suggest, there is no historic precedent for the global debt mountain and deleveraging that we are experiencing. However I do not see the world trapped in deflation, as some fear, because we have fiat currencies. Moreover, both monetary and fiscal policy authorities are belatedly committed to doing everything in their considerable power to limit the worst risks of a lengthy debt deflation.

My guess is that we face an L or U-shaped recessionary trough which carries well into 2009, followed by a moderate global recovery that reignites commodity inflation, leading to more stop-go cycles of approximately 4 years duration. For Wall Street and a number of other stock markets, this would include a further and somewhat erratic valuation contraction, similar to what we last experienced between the late 1960s and 1982, when the Dow had a glass ceiling near 1025 but some emerging markets, notably Japan at the time, were much stronger. I have been discussing the possibility of this generational long valuation contraction, in terms falling of PERs and rising yields for Wall Street, since the dotcom bubble burst in 2000.

Regarding the key day reversal referred to above, at Fullermoney we often say that such signals are more reliable if they attract immediate follow through. This has not occurred, as Jeffrey de Graaf mentions above, although the low for last Thursday's upside key for the [S&P 500 Index](#) has not been taken out either.

Meanwhile, the upward dynamics since 10th October indicate that the market is attempting to bottom. However bears still have the upper hand and bullish sentiment is tentative. There is indeed a risk that stock markets continue to drift due to economic concerns but I would not rule out the possibility of a yearend rally.

Email of the day (3) - On an absence of pa trading:

"I have not seen any portfolio updates from either of you lately. Does that mean you haven't been trading at all? I listen to the audios and read your columns daily with great interest and realize you were "cutting back" on your trading but have you ceased altogether? Best wishes from the windy city!"

My comment - Thank you. Eoin and I are inclined to take breaks from trading if the environment feels tricky and / or there are personal distractions. Both of us feel that the combination of thin markets and high volatility in recent months increase the risks in trading relative to potential rewards.

Additional Commentary by Eoin Treacy

Email of the day (1) - [on the views of Marc Faber and Hugh Hendry](#):

"To my chagrin the chief economist of a major bank here has predicted that the markets have bottomed; for the record every single one of his many predictions has turned out to be wrong.

"While one may fault [Marc Faber](#) on his market timing, his analytical analysis of macro economic trends is always superb. The Fullermoney collective might find this recent presentation to be interesting. In light of the view that shoving trillions of dollars into the economy might eventually save the day I point you to chart 41 which shows the starkly descending trendline of diminishing returns to the economy as more money is pumped into it.

"Outspoken hedge fund manager [Hugh Hendry](#) also does not believe () that adding liquidity to the economy will make any difference. Hendry has placed his personal money into long government bonds in the expectation that interest rates are going to go significantly lower. When the interest rate cycle is over he will then shift his money to gold which he expects will see \$550 or less

"While I'm still fully invested in the Fullermoney themes it is still difficult to hold on to them, given these alternative perspectives."

My comment - Thank you for an interesting email which highlights a number of important views. Marc Faber has been known to Fullermoney since the 1980s and we have the deepest respect for his ability to reason through long-term problems in the market. Looking at the attached report which is a presentation given to Enam Securities on September 30th; I see a lot that rhymes with Fullermoney's themes.

Both of these commentators point out the problems facing the market and identify the fact that downtrends remain in place for the majority of stock markets. The deleveraging process also remains intact as the continued strength of the [US Dollar](#) illustrates. No one knows how much more deleveraging is due to take place, but one would be well advised to pay close attention to how these two currencies perform as an indicator of how the process is developing. Being bullish of long-dated [government bonds](#) serves the same function as being long carry trade currencies. They are all likely to come under pressure when deleveraging has run its course. In the meantime, there is no conclusive evidence that their upward trajectory has peaked.

Economies in the western world continue to bear the brunt of the global slowdown. Asian economies and commodity related markets have also been hit hard but this is more due to deleveraging and liquidity contraction rather than exposure to the bearish themes driving the contraction in the USA and Europe. In any recovery situation Asian markets should have a competitive advantage.

Given the extent of the fall to date, base formation development is needed before currently inert demand is tempted back into the market. Risk is always perceived as lowest at the top and the greatest near the bottom. However,

while volatility remains at such elevated levels few investors will be encouraged. Current trading conditions mean that one cannot wait for upward dynamics, but needs to anticipate the market, and any sensible stop needs to be placed well away from the current price.

A number of markets remain near their October [lows](#) and some have already broken [downwards](#). The performance of bank shares remain a [headwind](#) and while potential remains for shares to rally towards their 200-day moving averages, it is all for the bulls to prove.

Email of the day (2) - on municipal bond indices:

"Would it be possible to add charts for US municipal bonds to the chart library? It would be enormously valuable to have both charts for yield curves as well as state-level municipal yields. Recent dramatic moves in municipal bond yields here in the US have created some historic shifts in these bond prices.

"I have been using municipal bond closed-end funds as a proxy for these charts, but the correlations are far less than ideal, as you would expect, especially given the wide range of maturities and credit qualities in each fund.

"Thanks for providing a great service and analyses."

My comment - Thank you for an excellent suggestion. Municipal bond indices have been a significant omission in our fixed income coverage. To amend this situation, I added 10-year indices for municipal bonds for ratings [AAA](#) to [BBB](#). I also added indices of various ratings for [Education](#), [Healthcare](#), [Power](#), [Utilities](#), [Transportation](#), and also for a large number of individual [states](#). All of these charts can be found in the Bond Yields section of the Chart Library.

The majority of these indices have been ranging for much of the last 6 years. They all broke upwards in late July or early August and accelerated to near-term peaks by mid October. Most of the investment grade indices have fallen back from those elevated levels in the last month, but are now testing the upper side of the 6-year ranges. Sustained moves back into those congestion areas would be needed to suggest that the risk premium attached to this market has returned to pre-crisis levels.

The [spread](#) of AA+ Transportation Index over Treasuries hit an accelerated peak above 1.4% in mid-October and has fallen back considerably. A sustained move above 1.25% would now be needed to question potential for some additional compression.

FT.com: Refinery plans to be scrapped as profit slides - This [article](#) by Carola Hoyos for the Financial Times covers the increasing trend of cancelled oil infrastructure construction projects. Here is a section:

More than four out of five refinery construction projects face cancellation as

the worldwide collapse in fuel demand wipes out all but those developments with strong government backing.

In a report, Wood Mackenzie, the industry consultant, concluded that only 30 of the 160 refining projects announced since 2005, which should be completed in the next two to seven years, would now go ahead.

The sharp drop in the number of new refineries is related to the collapse in the refiner's profit margins, which are known in the industry as "crack spreads".

The scale of the cutback is the starkest illustration yet of the severity of the collapse in fuel demand and the effect on the refining industry.

Until a few months ago profit margins were strong and refiners were struggling to meet high demand.

A widely touted supply bottleneck had been caused by the lack of investment in refining in the lean years of the 1990s.

Only one in five refinery construction projects planned to be completed in the next two to seven years will go ahead. Of the 30 refineries that are still on track, almost all have the backing of large national oil companies, which are set to provide 11m of the 12m barrels of new refining capacity expected to come on stream.

Saudi Arabia's Saudi Aramco and China's Sinopec will in aggregate account for 2m of those barrels, according to Wood Mackenzie.

This will significantly shift the balance of power in refining away from the west, whose integrated oil companies and independent refiners have dominated the sector from the start more than a century ago.

My view - The fall in the oil price is raising questions about the viability of new refining projects. This is a very short-term view. The pace of cancelations means that the next time economies are expanding and demand for distillates increases; the same bottlenecks that made the market inelastic during the last bull-run, will still be present the next time.

Email of the day (3) - [on uranium and uranium shares](#):

"Take a look at Nufcor. It is trading at half asset value and the Uranium price is rising again"

My comment - Thank you for this piece of information. [Uranium](#) remains in an overall downtrend but found support at \$45 in late October and has since improved somewhat. However, it needs to break the progression of lower highs to suggest that support is returning in force to this depressed market.

[Nufcor](#) rallied well in the last week, following an accelerated decline from late September. A sustained move below 100p would now be needed to question

scope for some additional higher to lateral ranging. Of course, since this vehicle holds physical uranium, how the commodity performs will be a key determinant in the share's recovery.

Email of the day (4 & 5) - on additions to the Chart Library:

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

"Threadneedle Absolute Return Bond Fund (BOL4TF8)"

And

"Could you please add the following corporate bonds to the library? Standard Life AAA income, M&G corporate bond, Rensburg corporate bond, Prudential corporate bond, Old Mutual corporate bond, New Star sterling bond, Jupiter corporate bond?"

My comment - Thank you for some interesting suggestions, all of which have been added to the Chart Library.

Email of the day (6) - on charting the spread of credit default swaps (CDS) over Treasuries:

"This week's Barrons has a very nice article about the US yield curve and credit default swaps on US Treasury Bonds. I did not know that CDSs were traded on US Treasury Bonds.

"Is it possible to get a graph of the yield spread for the CDSs on US Treasury?"

My comment - Thank you for an intriguing request. I had heard about these being traded but do not know of a way to chart the spread at present. If subscribers know of a way to get CDS prices on Bloomberg for US Treasuries, I would be glad to reproduce them in the Chart Library.

Email of the day (7) - on Peter Schiff:

"I thought you might like to share this intelligent and amusing series of interviews with Peter Schiff, the one person I know who called the recent moves successfully, with the collective.

Click on this:

My comment - Thank you for this interesting compilation, contributed in the spirit of Empowerment Through Knowledge.

Email of the day (8) - on the UK equivalent of the TED spread not updating:

"Just checking a few graphs and noticed that the UK equivalent of the TED spread (GBP LIBOR 3mth - UK 3mth T-Bill) appears to have stopped updating on 17th October - could you see if you can get it updated. I don't think there should be a lag in the index."

My comment - Thank you for highlighting this problem but the issue lies with Bloomberg who no longer have a supplier for UK 3-month T-Bill rates. They say they are looking for a new supplier, but as of yet do not appear to have found one. Also see Comment of the Day on [October 24th](#).

Wednesday 19th November 2008

The Message from Financial Sectors Relative to Broader Indices - Fullermoney has long regarded a country's financial sector as a lead indicator for its overall stock market. There is logic to this contention, and we maintain that what is good for financial shares is usually good for the economy, and vice versa.

Among many resources in the expanding Subscriber's Chart Library is an extensive "Relative Charts" [section](#), highlighting some of the key comparisons. Subscribers can also customise their own relative charts, comparing any two instruments of interest, selected from many thousands. These can also be stored in Personal Portfolios, where they update automatically, for review as required. Please note: relative charts that you create need to be saved as Presets; they cannot be saved as individual charts as you may have done with those in the Relative chart section.

Charts for financial sectors relative to broader indices have been in the Library for over a year. They should help us to assess upside potential relative to downside risk for global stock markets. For instance, this 10-year [chart](#) of the S&P 500 Banks Index divided by the S&P 500 Index, shows banks deteriorating in the late 1990s, prior to the bear market commencing in 2000. We also see the recovery in the S&P 500 Banks Index commencing during the base building process for the broader index. While the Banks Index relative peaked in the second half of 2002, it mostly ranged sideways thereafter, before weakening significantly from February 2007.

Looking at this 5-year [chart](#) for additional detail, the ratio improved following rescues in July, but has retraced some of these gains more recently. A bullish signal for Wall Street would be a sustained break above the September high. Conversely, a new low would be consistent with an ongoing bear market. To avoid distortions due to takeovers or bankruptcies, we should also look at other financial relatives, such as this [chart](#) of the S&P 500 Diversified Financials divided by the S&P 500 Index. It has resumed its decline recently, indicating that Wall Street still has risks to the downside.

What about relative comparisons for other stock markets?

[Canada's](#) financial relative is much stronger, although it has begun to weaken recently. I should also point out that both the Canadian [Financials](#) and [S&PTSX](#) are still in downtrends. Nevertheless if Canada's banks continue to

outperform this should bode well for the broader market during the next recovery. The same may be true for [Australia](#), although the volatility of this relative index has introduced another element of uncertainty. The [UK's](#) relative performance by banks has deteriorated sharply recently. [Hong Kong's](#) relative is more encouraging, as is [India's](#), but [Japan's](#) is deteriorating once again. There are more of these charts for different countries in the Library.

In conclusion, it is a mixed picture but continued relative strength by financials, where it occurs, is likely to be a clue to leadership in the overall bottoming process and next recovery by stock markets. Meanwhile, most indices remain in overall downward trends and oversold conditions have produced no more than temporary steadying to date. We know that valuations are much improved but base formation development is not that apparent. Consequently I remain cautious. What we need to see, before turning unequivocally bullish, is clear evidence of base formation development for a number of stock markets and upside leadership from financials.

Silver Linings and Lessons Learned - My thanks to a subscriber for this highly educative additional [report](#) from the venerable Jeremy Grantham of GMO. I had meant to post it earlier, before family events previously mentioned took me away from the office for a while. It is no less valuable today and here are two brief samples:

The Gold Lining

Topping off all of the offsetting virtues of this ugly last year is the arrival of cheap assets. All too easily we forget that you can compound wealth rapidly only by having cheap assets. For those with a long horizon, it is always better to have assets fall in price so that the compounding returns are higher. For an unparalleled 20 years, global equities, especially U.S. equities, have been overpriced. Now, finally, they are cheap and likely to get cheaper. Likely, I believe, to set up a once-in-a-lifetime investing opportunity (or maybe twice in a long career).

Finally, a Single Piece of Advice for the Government

I have never been a fan of the hysteria that has surfaced on all sides in recent years at a hint of recession, and the panic to throw public money at the economy. Mild recessions have several long-term advantages discussed in earlier Letters, but in recent years we seem to have lost interest in the long term.

However, this time it's different. This is the Real McCoy crisis, and we must welcome all the stimulus we can get. It is easy, though, to end up employing people to build mildly useful parks or, in the Japanese style, nearly useless bridges to nowhere. Government stimulus can have a decent (even high) return in the long run. It absolutely doesn't have to be a series of boondoggles. Let me suggest that the magic word this time is not "plastics" but "alternatives." Massive spending on energy and, better yet, energy savings will create jobs, stimulate the economy, produce a good long-term

economic return, reduce dependence on depleting Middle Eastern oil, curtail carbon dioxide emissions, and set, for once, a real example for other countries. From the simplest - better insulation and more efficient machines - through the new alternatives - solar, wind power, and second generation biomass - to the potentially massive investments in new nuclear plants and efficient energy transmission, this could be in total a long range bonanza for the U.S. in economic and broader respects. Such a program could offset the risks of a Japanese-style drawn-out recession. It would be potentially an epoch-defining change, and one of which, like the Marshall Plan, future generations might be proud.

My view - I commend Jeremy Grantham's letter to all subscribers. The section you may not have seen yet commences on page 9.

Today, we still see evidence of further global deleveraging, which is alarming because all of us are affected in one way or another. At such times we need to remember that cheap assets are the essential ingredients for sustainable bull markets. Fullermoney's challenge and quest is to identify the better opportunities in a timely fashion.

Jeremy Grantham's point regarding alternative energy, ideally leading to a significant degree of self-sufficiency, could not be more important. Another silver lining for this crisis is the window of opportunity granted, in which to prevent a much bigger catastrophe in terms of energy prices and shortages. Success in this endeavour will require good governance, another resource that is too often in short supply.

Energy investments will be among my next purchases, including an alternative energy fund. The candidates are already in the Chart Library, within this [section](#) - Commodity Indices - Funds, ITs & ETFs.

Another China Bailout? 800 Billion Yuan Stabilization Fund Being Reviewed - This [item](#) from EEO may interest readers who invest in China. Here is the opening:

An anonymous policy recommendation calling for an RMB 600-800 billion fund to buy up mainland stocks in the event of a market crash has made its way onto the desk of top banking officials.

The report, which included three pages of discussion and a two-page list of target shares, was first sent using an anonymous internal email account to a mailing list at the Research Center of International Finance (RCIF), under the Chinese Academy of Social Sciences, on October 30. It was later submitted to top banking officials as policy advice, the EO learned.

It suggested the government use such a fund to unconditionally buy shares in 50 heavyweight firms listed on the Shenzhen and Shanghai exchanges if the Shanghai index hit 1,500 points.

The RCIF's director Yu Yongding confirmed the authenticity of the report. According to a researcher at the Center, the report was well received by the financial industry, and the Center had so far received much feedback. Banking officials had long considered establishing such a fund, he added.

My view - This would not be the first time a government has considered investing in its stock market. It makes financial sense if valuations are depressed, and the government can also take profits on an incremental basis during the next bull trend, to help prevent bubbles from forming. Additionally, the mere mention of possible intervention can stabilise the market as we have seen in [China](#) recently.

Additional Commentary by Eoin Treacy

Iron Ore Supply Demand Update: the Race for Cut Backs - Thanks to a subscriber for this interesting [report](#) by Alan Heap and Alex Tonks for Citigroup covering the iron-ore market. Here is a section on forecast prices for the coming year:

Iron Ore to Settle -20%

We maintain our current forecasts for a -20% fall in JFY2009 iron ore contracts. We believe trough cycle pricing outcome would be unlikely in this round of negotiations as:

The cost curve is steep with high cost Indian and Chinese production providing a buffer (price elastic production). This can already be seen with domestic Chinese iron ore production has lost market share this year and Indian exports have slowed. However further curtailments will be required.

~80% of new production growth is controlled by the majors. The majors are at the bottom of the cost curve and may use price weakness to drive out high cost players. Yet if price are excessive then a lack of incentive for expansions will see a dramatic change in mine supply outlook.

If Chinese steel production growth recovers more rapidly than we expected then the projected surpluses will not eventuate and prices could recover. A return to recent growth rates of around 20% would be sufficient to push the market back into deficit.

Contract prices are less volatile than spot and never achieved the highs of the spot market, and will be unlikely to reach the lows as has been the case in other markets where spot sales and contracts are used in parallel (e.g. thermal coal). We would expect some relief in the spot market as inventories are worked off and freight rates pick up. However the iron ore market will remain under pressure in the outer years and we have trough pricing achieved by 2012.

My view - The illiquid iron-ore market has been much slower to react to the slowing global economy than the share prices of the major producers. As long

as a global recession is being considered, no one expects these companies to continue to be able to charge the high prices for iron-ore they have gained in the last few years.

Collapsing prices for many commodities have led investors to question the supercycle hypothesis with good reason. The demand destruction taking place will take time to rebuild and a synchronised global economic expansion is probably needed to improve sentiment towards this sector.

However, we also know that demand for bulk commodities will not disappear. The need for infrastructure development is as strong now as it was a year ago; cash to pay for it is now the problem. Countries with current account surpluses, such as China, have the money to fund their development projects. Increasingly, the solutions being mooted to combat growing unemployment are centring on big infrastructure projects in many countries. It has long been identified that the USA is badly in need of an infrastructure overhaul and the incumbent administration has made positive noises about taking on this challenge.

Right now, the main iron-ore producers are reflecting the pessimism surrounding the commodity sector generally. [BHP Billiton](#) (P/E 4.68 DY 4.41%), [Rio Tinto](#) (P/E 4.18 DY 3.34%) [CVRD](#) (P/E 5.46 DY 1.08%) remain in overall downtrends. All of these shares accelerated lower and are now in broadening ranges, having found at least short-term support. Could they still go lower? The short answer is yes. However, the broadening pattern is an inconsistency in relation to the trading that has gone before it and makes a bearish view risky.

Throughout the bull market from 2003, investors were conditioned to buy on weakness because upside breaks were not sustained beyond the short-term. This means that a number of investors will have been tempted back into the market on the decline from the recent highs and have been punished for using a strategy that was profitable for a number of years. While the current downtrends have been surprising in their ferocity, this does not negate the potential for purchases on weakness to be a winning strategy in future. Regardless of the amount of time resources shares spend building support, they are likely to remain volatile. This makes paying up for them an equally risky strategy.

The extent to which this sector has fallen and the shaking of faith in the long-term story suggest that investors will now be slower to invest and are likely to wait for more of a bullish confirmation before committing additional capital. Base formation development is needed before large numbers of investors are attracted back into this market; probably limiting the extent of rallies, in the short-term, to bouts of short covering.

The most prudent approach will require patience to wait for support to be built, for at least part of any potential breakout to be retraced and find support above any low that is formed.

Astaire Research: The India Report - Thanks to Deepak Lalwani for his ever interesting [report](#) which this week leads with commentary on India's falling inflation. Here is a section:

YoY wholesale inflation fell sharply to 8.98% for the year to 1 November, after touching a peak of 12.91% in early August. This is the lowest reading in five months, helped by strong agricultural output lowering food prices, the prices of metals and fuel falling and the slowing economy experiencing a drop in demand. The annual inflation rate was 3.35% during the corresponding period a year ago. The wholesale price index is more closely watched than the consumer price index, which is published monthly, because it covers more items and is published weekly. We expect the inflation rate to fall sharply from January because of the high base effect and we see the rate at around 5% by March 2009.

The downward trend in inflation is a great relief to policymakers at a time when consumer demand needs to be increased to stimulate economic growth, especially ahead of general elections. The falling inflation rate gives some room for the RBI to further reduce interest rates by 150-200bp by end January 2009, after cutting it aggressively by 150bp in October and November.

My view - Indian policy makers will indeed be happy to see that the rate of inflation is falling because it allows them greater leeway to act in support of the economy. Inflation is always going to be a worry for a country where a vast rural population has voting power. The government has to be seen to do something about rising prices as they directly impact the poor in society most quickly. This was part of the reason for India's aggressive raising of rates last year.

The prospect of lower interest rates would normally be a boon to stock markets but the weakness of the [Rupee](#) has made many investors cautious about investing in the country. This is a theme common to a large number of markets. Until the Dollar's medium-term uptrend conclusively tops out, the prospects for a sustained rally remain difficult to justify. However considering the extent of the currency's move to date, it is becoming increasingly likely that the Dollar is in the latter stages of its advance.

The [Sensex](#) remains in an overall downtrend. It found at least short-term support near 8000 following an accelerated decline and needs to spend some time above that area to suggest base development is underway.

Email of the day (1) - on a lecture given in India titled Global Imbalance - An imminent Dollar Crisis:

"This lecture from India could be worth your time listening to."

My comment - Thank you for this interesting [lecture](#) (57mins) by M.R Venkatesh. It covers, among a range of topics, the imbalances evident in the global economy from an Indian perspective.

Email of the day (2) - on a New Zealand tracker:

"I was wondering whether there was an investment vehicle which gives exposure to New Zealand in general, rather than just individual shares in its 50 index?"

My comment - From searching on Bloomberg, it appears that New Zealand tracker funds are a rare entity. Most of the funds I found offer exposure to the currency rather than the equity market.

I added the [Fisher](#) New Zealand Growth Fund listed in New Zealand and in New Zealand Dollars to the Chart Library. It invests in small growth stocks but has performed more or less in line with the NZSE 50 over the last year. According to Bloomberg it has a front-end load of 1%, management fee of 0.85% and performance fee of 10%.

If subscribers know of any more suitable funds please let us know and we will be happy to add them to the Chart Library.

Congratulations to the All Blacks following their narrow victory over Munster last night. It was a thrilling spectacle and tight game right up until the end. Although it wasn't to be our night, I think any supporter watching the game will have gone away proud of their team.

Today's interesting charts - The Chart Library has a large number of fixed income prices and yields which may be of interest to subscribers.

US Treasuries - surging [upwards](#) to test the September highs near 124 and a downward dynamic is needed to check momentum beyond a brief pause.

S&P500 Diversified Financials - extends its [downtrend](#) and a sustained move above 300 would be needed to hinder scope for further downside.

Swiss Franc per 1 US Dollar - the [US Dollar](#) continues to [advance](#) in a steep though consistent uptrend. A downward dynamic is needed to check momentum beyond a brief pause.

Email of the day (3, 4, 5 & 6) - on additions to the Chart Library:

"Could you please add [Jupiter](#) Financial Opportunities Fund to the library? The manager Phillip Gibbs is first rate and has managed only 3% decline over the last year massively outperforming the sector. He has the majority of his money currently in bonds and is sitting on 27% cash. Once he feels the time is right a lot of this is going to equities and the fund will get a great lift."

And

"Would you please add the following emerging market corporate bonds to the library M&G Emerging Market bond, [Threadneedle](#) Emerging Market bond."

And

"Could you please add the [Invesco](#) Leveraged High Yield Investment Trust to the library?"

And

"Would you please add [Unicorn](#) UK Income A Fund to the library?"

My comment - Thank you all for these interesting suggestions which have now been added to the Chart Library.

Thursday 20th November 2008

Iran switches reserves to gold - My thanks to a subscriber for this short item from Reuters, via the Guardian:

TEHRAN, Nov 15 (Reuters) - Iran has converted financial reserves into gold to avoid future problems, an adviser to President Mahmoud Ahmadinejad said in comments published on Saturday, after the price of oil fell more than 60 percent from a peak in July.

Iran, the world's fourth-largest oil producer, is under U.N. and U.S. sanctions over its disputed nuclear programme and is now also facing declining revenue from its oil exports after crude prices tumbled.

"With the plans of the presidency...the country's money reserves were changed into gold so that we wouldn't be faced with many problems in the future," presidential adviser Mojtaba Samareh-Hashemi was quoted as saying by business daily Poul.

He gave no figures or other details.

Before oil prices plunged by more than 60 percent from a peak of \$147 per barrel in July, Iran made windfall gains from its crude exports and in April estimated its foreign exchange reserves at about \$80 billion.

Iranian officials in July denied reports Iranian banks were moving funds from Europe, with one report suggesting as much as \$75 billion had been withdrawn and converted into gold or placed in Asian banks, because of a threat of tightening sanctions.

The International Monetary Fund said in August that if the price of Iranian crude fell to \$75 a barrel, Iran would face a current account deficit in the medium term that would be tough to sustain due to Tehran's financial isolation.

(Reporting by Zahra Hosseinian; Writing Fredrik Dahl; Editing by Jan Dahinten)

My view - I would not count on Iran having all that much left in terms of foreign reserves, if Professor Hossein Askari from George Washington University is correct. He says approximately \$250 billion has been moved out of Iran over the past six years, according to this [article](#) by Huda al Hussein for Asharq Alawsat. Here is another [article](#) by Askari himself, commenting on Iran's economic problems.

Looking at this 5-year [chart](#) of the rial per 1 US dollar, we see that the Iranian government adopted a soft, slowly devaluing peg until the beginning of this year. Perhaps they thought oil prices would continue to rise. In any event, the rial has fallen more rapidly since July, when crude peaked.

[Gold in rials](#) has fallen since March, although this should be temporary given Iran's high inflation rate. Also Iran will receive dollars for most of its exports, of which crude oil is by far the biggest component. Perhaps the Iranian government believes that the dollar's rally will not last, in which case the switch to gold is a logical alternative.

How has bullion performed against other currencies? You can observe its performance in the "Relative Charts" [section](#) of the Subscriber's Library at any time and I have posted some of them below.

Since July, gold has weakened against carry trade currencies such as the [yen](#), [Swiss franc](#) and [US dollar](#), and also currencies mainly pegged to the US dollar, such as the [Chinese Renminbi](#) and [Saudi Riyal](#). It has also weakened against the [Singapore dollar](#) since March. However gold has fallen back to areas of potential support against these currencies, which at least has the potential to cushion downside risk. Gold remains firm within its overall upward trends against most other currencies, as you can see from these samples: [euro proxy](#), [sterling](#), [Norwegian krone](#), [Swedish krona](#), [Australian dollar](#), [New Zealand dollar](#), [Canadian dollar](#), [Brazilian real](#), [Korean won](#) and [Indian rupee](#).

In conclusion, gold can be volatile, but generally less so than most other freely traded assets in the current environment. Bullion has shown defensive qualities during the global financial meltdown, in which people fear deflation. However, many governments have recently thrown caution to the wind in terms of boosting their money supply, not least the [USA \(M1\)](#), while [Euroland \(M3\)](#) and [UK \(M4\)](#) continue to print, although not [Switzerland \(M1\)](#) and not [Japan \(M1\)](#)...yet.

In other words, most will err on the side of future inflation in their efforts to stem economic slump. For this reason, gold continues to merit a position in diversified investment portfolios, although we maintain that it is best purchased following setbacks. I would not be surprised to see the \$ price for gold rally sharply when this somewhat overstretched rally by the [US Dollar Index](#) peaks.

Email of the day (1) - More on reducing oil dependence, from a pre-subscriber:

"The notion that we are going to seriously attempt to get off foreign oil is a cheery one but highly unrealistic imo: the military and oil industry would be undermined and neither will allow their power to be usurped."

My comment - It's "the vision thing", as former president George Herbert Walker Bush said, in a different context. For instance, France is much less dependent on oil and gas imports than the USA or UK because it has a well developed nuclear industry. Surely the military would benefit from less need to import oil, just like the rest of us. If the West's big oil companies are smart, they will be participating in the development of alternative and renewable fuels because they cannot replenish their dwindling reserves of crude oil at the rate they are being consumed.

The Speculator Super Cycle - My thanks to a subscriber for this interesting [study](#) by Steven Wieting of Citigroup. Here is the opening:

In 2008, suddenly, all risk looked undesirable once again - of course to different degrees - but directionally it's all the same (see figure 1).

No one confused the modest, relatively disappointing U.S. expansion of 2002-2007 with boom times. Yet housing managed to bubble, and larger asset classes got frothy, particularly credit. Elsewhere, solid fundamentals and financial bubbles went hand in hand (see figure 2). The unwinding of virtually all asset prices globally appears to be a symptom of the pending global recession.

What helped facilitate the excesses? - Financial (portfolio) leverage, either actual or synthetic. Over the past decade, it increasingly felt to us as though the real economy became a side show for financial speculation. Speculation not detached from reality, but an exaggeration of it.

As figure 3 shows, the heights of the crude oil price at \$147 a barrel this summer coincided with booming futures trading volumes relative to growing global demand. That's right. As you read so often, global demand for crude oil boomed in emerging market countries in recent years. But crude oil paper contract trading volumes (with limited capital commitments) boomed even more. With it, some correlations between commodities and other financial variables rose to record highs, with outsized absolute moves (see figures 4-5).

Commodities were far from the only leveraged market. Margin debt rose to record highs in equities markets While not positioned so "bullishly," put and call options volumes rose to 5.7X the level reached at the 2000 equity market high within the past year (see figure 6-8). That's not even mentioning the speculative use of credit default swaps beyond "hedging" purposes.

My view - Leverage is a problem in every boom to bust cycle, but arguably more so for this one, with worldwide borrowing of low-yielding yen and US dollars for leveraged trading, from Moscow to Dubai and not least on Wall Street and in the UK.

The fashion for investment in commodity tracker funds, particularly crude oil and food futures contracts, which were never meant to be an asset class, has contributed significantly to the global economic downturn. Spikes in crude oil have always led to recessions; central banks responded by raising interest rates and tightening money supply, and we are still experiencing the consequences.

The good news: there is an element of back to the future in all this. Asset valuations are much lower, inflation is falling rapidly, interest rates are much lower, and governments are increasingly fighting disinflation in an effort to check deflationary risks. Unfortunately, confidence is at rock bottom levels, compounding the global economic slump and rendering stimulative measures largely ineffectual to date.

Where will this lead, and how will it change?

Sometimes, problems such as debt deleveraging just have to run their course. There is little that monetary and fiscal policies can do, or should do, to prevent this corrective process, although it can address the worst consequences for people and help to facilitate the next recovery.

Meanwhile, value investors such as Jeremy Grantham and John Hussman now see enough bargains to nibble at depressed corporate bonds and equities. However, alarming volatility gives most of us an understandable excuse to sit on what remaining cash we have. Who wants to catch a falling knife?

I think we will need to see normal to low volatility before confidence starts to return. Without a dramatic catalyst, this may not occur until the selling is played out and market action changes from too exciting to reassuringly boring. Also, because everyone now knows that surges in the yen and dollar are in no small part a sign of ongoing deleveraging, these two low-yielding currencies will have to break their uptrends, as I have often mentioned, before people conclude that forced selling is subsiding. Some of us will want to see technical evidence of base formation development and the beginning of uptrends before we increase our participation.

Email of the day (2) - On a reallocation of bailout resources:

"A Modest Proposal: The US has by some estimates thrown some \$2-3Tr. Into the financial system and economy. We have little to show for it, so far, and the Fed and Treasury are scratching their heads trying to figure out how to get money flowing. Here's another idea: \$1Tr. amounts to about \$3,333 per person in the US. Just pay it to every citizen. They know what to do with it! And, you don't have to manage any complex formulas to pay it back...we're borrowing from ourselves. (I'm really not kidding)."

My comment - Isn't that what Sarah Palin did in Alaska? Does a career as a populist politician beckon? (I am kidding.)

Seriously, on the next government expenditure, would a short-term boost to consumption be better for the economy over the longer term than investment in infrastructure and renewable energy? I doubt it.

Email of the day (3) - On to nibble or to wait, BRWM warrants and JII subscription shares:

"A question or two for you which may be of interest to others. Thanks in advance for your responses.

1. Not sure how to word this but it is meant in good faith, it's sometimes not easy to convey questions by email. If you are saying to people it is possible to nibble at these levels, I am not sure I understand. OK, there are enough reasons for this market to bounce as you continue to outline, Government support, CB support, inflation no longer an issue, record amounts of cash on the sidelines, divergence from 200MA, bearish sentiment, etc. etc. However, on the other hand there are the redundancies still to come through, further house price declines and foreclosures, earnings revisions, economies still getting worse, deleveraging still not over, etc. Surely the reasons not to invest are still much greater than those to invest, there will certainly be better levels at which to recommend nibbling. OK, the worst is over in terms of surprises, but surely the knowns (that are to come, writedowns, redundancies, etc.) now mean something too, e.g. there is worse to come, and we know it. Perhaps it is time for Fullermoney to be bearish for a while, at least in the short/medium term, especially following any significant bounce. Once again I stress this is not a moan or a complaint, it may just seem aggressive because of the delivery medium (email).

2. BlackRock World Mining Trust has fallen considerably, let's say, 70% off its highs. However, the warrant has fallen from a whopping level of 240 to 8. I do not understand the latter instrument and wondered whether you could shed some light on this. Is it a much better investment opportunity with considerably more upside potential than the fund itself or it is so priced because its almost a dead duck! Sorry for my ignorance in this it's just something I found of interest whilst having a flick through the charts.

3. Below is a message from my broker in relation to JII. I know you are not in the business of offering advice but could you please provide some sort of direction on appropriate action, possibly even outlining your own in this matter. Again, my ignorance is shameful!"

My comment - Thank you for these questions and points, and no need to berate yourself.

Yes, one could nibble in stock markets on an incremental basis, without paying up, as value investors such as Jeremy Grantham and John Hussman and now doing. However I personally am waiting, as you know. The BRWM warrants are way down because they are out of the money and expire on 27th February 2009. I discussed the JII offer in the Audio on Friday 17th October, following my conversation with a representative from the fund. As

shareholders, we have the right to buy 1 subscription share for every 5 shares held, on the following terms:

EXERCISED BETWEEN 02/01/09 AND 02/01/10 - AT 227P, A 1% PREMIUM.

EXERCISED BETWEEN 03/01/10 AND 02/01/12 - AT 247P, A 10% PREMIUM.

EXERCISED BETWEEN 03/01/12 AND 02/01/14 - AT 291P, A 30% PREMIUM.

As I understand it, this is a creative sweetener to encourage us to stay with the fund, as I have every intention of doing. If we see a significant recovery between now and 2014, as I expect, we will receive a nice bonus by purchasing the subscription shares at what would then be the discounted prices cited above, between one of the time intervals specified.

Additional Commentary by Eoin Treacy

Record Options Trading Slows as Hedge Funds Fold, Prices Surge - [This article](#) by Jeff Kearns for Bloomberg covers some important points relating to the VIX index which continues to trade at historically high levels. Here is a section:

The S&P 500 rose or fell at least 1 percent in 86 percent of October's trading days, making it the second-most volatile month in its 80-year history, according to S&P analyst Howard Silverblatt. Only November 1929 produced bigger swings, he said.

The CBOE Volatility Index, which averaged 17.54 last year, jumped to 89.53, its highest intraday level, on Oct. 24 and a record close of 80.06 three days later. It increased 91 percent in September and 52 percent in October. The measure, known as the VIX, tracks the cost of options linked to the S&P 500, which fell 17 percent last month.

U.S. options volume was fewer than 10 million contracts on three days in November. That's below the total trading during the holiday-shortened session of July 3, when exchanges closed early before Independence Day.

"We're going to see a pullback to more normal volumes," said Ed Boyle, senior vice president for U.S. options at NYSE Euronext, the world's largest operator of stock exchanges. "It's a big deal because it can hurt the revenue of exchanges and the ability of trading firms to profit."

Shifting to Cash

One reason for the decline is that investors have sold assets to protect against losses by moving money into cash, which reduces the need to use options to protect against drops in the underlying assets, said Jeremy Wien,

who trades VIX options at Societe Generale SA in New York.

"People have fewer underlying positions to hedge," Wien said. "There are fewer and fewer people taking positions because they're saying, 'I just want to make it to next year.'"

An estimated 700 hedge funds may go out of business by the end of the year, an increase of 24 percent from 2007, according to Hedge Fund Research. The Chicago-based firm's Fund Weighted Composite Index fell 6 percent in September and another 6 percent in October.

"Over the last 10 years, the amount of volume that was because of hedge funds really went up as they were getting bigger and bigger and trading more and more," said George Ruhana, chief executive officer of Chicago-based OptionsHouse LLC, the online brokerage unit of PEAK6 Investments LP. "Now their capital base isn't going to allow them to trade as much."

My view - There is a certain amount of schadenfreude permeating the media with relation to the difficulties being experienced by some hedge funds. However, while one may have reservations about the fees they charge, no one is coerced into investing in a hedge fund. One of the oft overlooked roles filled by hedge funds has been to add vital liquidity to markets where it was needed.

While some are trumpeting the end of the hedge fund industry, this is premature. In any group, a bell curve can be applied with most performing around the median while some will outperform considerably and others will underperform. Some funds will be doing very well; rewarding investors and managers alike. Others will inevitably be forced to close.

The continuing stress in the financial industry is testing the mettle of all money managers and investors are likely to be more cautious going forward. Although volume on the [VIX](#) is contracting, the Index remains historically high as anxiety about the health of the economy continues. In normal circumstances one would associate peaks in the VIX with important market lows. However the current situation requires a somewhat different interpretation.

The extremely elevated volatility of the last two-months, not only in equity markets but across asset classes, makes investments difficult to manage on a short-term basis. The very fact that volatility remains so high is staying the hand of potential investors and forcing them to wait until volatility contracts. On a closing basis, the VIX is testing its highs and a downward dynamic is needed to check momentum beyond a brief pause. The low near 45 will now hold some psychological importance for investors monitoring this Index and it will need to sustain a move below that level before confidence begins to return. A sustained move back below 30 will be needed to suggest that a degree of 'normality' is returning. However, by the time that occurs, stock markets are likely to be well off of any lows they post.

For the moment, the continuing strength of the VIX is a headwind to stock markets as is the negative leash exerted by the financial sector in many countries and uncertainty as to the future of the US automotive industry. . Some improvement in these areas is probably needed for sentiment to improve.

Email of the day (1) - on fixed income funds:

"Hi, sorry to trouble you yet again, but these corporate bond funds are very attractive and Paul Read of Invesco seems to have a good handle on things.

"Could you also add the following to the library: Invesco [Corporate Bond Fund](#), Invesco European [High Yield](#) and Invesco [Global Bond Fund](#)? Take a look at his recent [webcasts](#) via Invesco's webcast site. "

My comment - Thank you for these interesting suggestions for the Chart Library and the informed commentary from the managers at Invesco. It seems clear from the number of requests we have received for additions of corporate bond funds, not only from you, that investors are beginning to look seriously at this sector. In the media, we notice that the debate as to whether credit is preferable to equity is growing.

High yield debt has always traded in a fashion more akin to equities. However, the market conditions and the drying up of liquidity are leading even senior debt for highly rated companies to trade with a high degree of volatility. (Also see Comment of the Day on [November 6th](#) for more on this issue.)

Investors willing to take a medium to longer-term view are beginning to look at credits as a way of locking in yields well in excess of Treasuries. If you click through the now large number of corporate bond funds in the Chart Library, you will see that some are in accelerating downtrends. Any one considering buying such funds would be well advised to do some in-depth due diligence and contact the managers to find out exactly what they are holding. Monitoring the price charts should indicate when any funds one might then be interested in begin to find support.

If one is considering buying straight bonds, then companies who depended on access to cheap funding to support their business models are obviously at higher risk of default. Senior debt, from companies with a high credit rating and strong cashflows would be somewhat safer in this environment. Institutional investors with the ability to bargain may be able to take advantage of the lack of liquidity.

Email of the day (2) - on New Zealand tracker funds:

"Your subscriber query about NZ Tracker Funds could look at the NZ Stock Exchange [products](#) which replicate a tracker fund"

My comment - Thank you for this useful contribution and to the numerous other people who responded to this call for more information.

Email of the day (3) - [more on New Zealand tracker funds](#):

"With regards to today's query about New Zealand index funds, a subsidiary of the NZ Stock Exchange called Smartshares has 3 listed NZ index funds on offer :

"FNZ.NZX (top 50 by market cap)
TNZ NZX (top 10 by market cap)
MDZ.NZX (NZ mid-caps, excluding top 10)

"I hope that helps.

"Thanks for one of the world's great investment sites."

My comment - Thank you for your kind words and for this useful information contributed in the spirit of Empowerment Through Knowledge.

The [SmartFONZ Fund](#), which tracks the NZSX 50 Portfolio Index, remains in a consistent downtrend and would need to sustain a move above 1.3 to question the integrity of the move.

The [Smart TENZ Fund](#), which tracks the NZSX 10 Index, broke downwards from a lengthy ranging phase at the beginning of the year and remains in an overall downtrend. It found support this month near 0.8 but so far, this is no more than a similar sized reaction relative to those which have taken place previously. A sustained move back above 0.9 would be needed to question the integrity of this consistent move.

The [SmartMIDZ](#), which tracks the NZSX Mid Cap Index, broke down from a ranging distribution in early October and remains in an overall downtrend. A period of base formation development is probably needed before the market can sustain anything more than a technical rally.

Email of the day (4) - [on New Zealand tracker funds](#):

"I love your daily free comment, thank you, I haven't subscribed to your full service as I would not have time to follow the wealth of information that was there. I will subscribe one day, as I feel I owe you some 'payback' for your insights which have educated & helped me.

"I'm from NZ, & with my small investment fund have been short kiwi dollar to AUD, USD & UKPDS which have gone, and will continue to go, well. The kiwi dollar is on its way down for the next few months. I have not been invested in equities for the last 2 years, so have escaped the fall out. Since May, probably a little early but when one has been on the sidelines for 2 years one wants to be in, I have invested in JP Morgan Indian (down 20%) and a NZ

infrastructure firm 'Infratil Ltd' (who also own airports in UK & Europe). I have invested 30% of my funds since May (trying to pick bottoms??? and following a couple of the Fullermoney Themes) and will invest the remaining 70% into equities over the next 6-9 months as 'others are fearful'.

"To help the member of the collective who was asking about NZ tracker funds in daily letter of 20/11 email of the day 2.

"While I don't know these funds I below post a links to them, which will give him a start.

"AMP: you will be familiar with the [AMP](#) brand.

"[Tower](#) also do a number of funds, one of which is a NZ equity tracker fund this [link](#) is a pdf download. Tower have had to stop redemption of their property fund as in NZ we are experiencing a property price decline similar to you in the UK.

"If he wishes to look at the NZ equities exchange I post that link here <<http://www.nzx.com/home>>

"Keep up your brilliant work."

My comment - Thank you for this detailed email and congratulations on your avoidance of the equity markets and short New Zealand Dollar positions. We are delighted to hear you are enjoying the free daily email and look forward to welcoming you into the Fullermoney family in your own good time.

For anyone worried about not having the time to utilize the site, I personally believe that the Subscriber's Audio, which is seldom more than 15 minutes long, is the most efficient way of getting to the crux of our market view. Many subscribers in your part of the world listen to it with their breakfasts or download the file onto their iPods to listen to on the way to work. Pre-subscribers can access all of our archived material, including the subscriber's audios, that is more than 4-months old via the website.

Thank you also for alerting us to these interesting vehicles. Unfortunately, I can't find the AMP fund on Bloomberg. The Tower New Zealand Equity Trust is an interesting fund, but can also hold Australian shares so is not exactly a New Zealand tracker.

The [New Zealand Dollar](#), as with so many other currencies, continues to hit new lows against the US Dollar. However, while this trend shows little sign that it has ended, it is becoming increasingly overextended and a break of the lower highs would suggest that at least a medium-term low has been reached.

Against the [Australian Dollar](#) it rallied impressively before peaking in mid-October and has spent much of the last month retracing the gain. A break of the succession of lower highs would be needed to question scope for further downside.

The [British Pound](#) per 1 New Zealand Dollar rate has become much more volatile of late. The New Zealand Dollar fell sharply to a low near 33p in early October and rallied to test the progression of lower highs until this week. It encountered resistance near 39p and would need to sustain a move above that level to question potential for some further downside.

Today's interesting charts - The Chart Library has a wide range of fixed income spreads, ratios and overlays which may be of interest to subscribers.

US 10yr Yield - testing the 2003 [lows](#) and an upward dynamic is needed to question scope for some additional downside.

UK Gilts - breaks above the [psychological](#) 115 and looking increasingly overextended. However, a downward dynamic is needed to check momentum beyond a brief pause.

Canada - breaks to a new reaction [low](#) and needs to push quickly back up into the range to offset scope for further downside.

Friday 21st November 2008

Global Thematic Investors: After The Bomb - I always look forward to this [letter](#), written by Iain Little and Bruce Albrecht, and I am pleased to note that it is now a monthly rather than quarterly publication. Here is a sample:

We have clear advice for our readers. If you're a long term investor, it's far too late to sell. If you're a long term investor, it is almost certain you will make good money in the years ahead (we give estimated return numbers later on).

Economically, there is a race against time to prevent the contagion spreading into the real economy. It's already five minutes to midnight. People and firms (though not governments) start by delaying and then go on to cancel new purchases, laying off workers and planning for lower growth. At the point of cancellation, there is little chance of reversing the process and it becomes self-feeding.

We have no doubt that our 8 global themes will fare well once the world's financial confidence returns. But we must also acknowledge that it is - perversely- events on Wall Street that have driven our themes' investments into bargain basement territory. So understanding Wall Street is extremely important. Observing the wreckage, these are the key points:

A fast market fall beats a slow fall. The crashing bear of 1987 beats the grinding bear of 1973.

On valuation grounds, it's possible -even probable- that we've seen the bottom in October, or close to it.

But we need an injection of greed to reverse the negative psychology. And the best way of spotting emerging greed is bottoming out on major stock market charts.

We cannot find a period in the last century of US data when a volatile period of this magnitude was NOT followed by a change in primary trend within a few months. In case your name is Rip Van Winkel, the primary trend has been down these last 12 months. If past history is any guide, it's about to change.

My view - We know that economic data for many countries, not least within the OECD, continues to deteriorate at an alarming rate. Fullermoney remains cautious regarding the outlook for global GDP growth, because we can see the trend. However we also agree with GTI that much of this has been discounted by stock markets in recent months.

Unfortunately, with financial sectors having resumed their declines recently and many broader market indices now below their October lows, we have yet to see evidence of bottoming out on many major stock market charts (GTI's penultimate point mentioned above, with which we agree).

While this is worrying, to put it mildly, and sentiment is diabolical, investors should recall an extremely important behavioural conditioning process. The crowd has always turned progressively more bearish with each additional decline towards the eventual low for every bear market. This is inevitable as more people sell, and unfortunately, few are more bearish than a battered holdout who finally capitulates. Think back to every bear market that you can recall: the crowd was most bearish at the low. This psychological process also works in reverse, causing the crowd to be most bullish at the top of bull markets because practically everyone is playing the game.

We have seen fundamental selling, technical selling, forced (deleveraging) selling, short selling capitulation selling and selling due to ennui. Fourteen and a half more days like yesterday, and the S&P 500 Index would be at zero, which somehow I doubt we will see. A key reason for the big percentage declines is that we are also seeing a buyers' strike, other than occasional bouts of short covering.

If global stock markets are not close to a major buying opportunity, then I suggest we should all head to sea and become Somali pirates.

(See also yesterday's additional pre-conditions for a market turn, discussed in the final paragraph of "My view" in "The Speculator Super Cycle" feature.)

Here is another juicy item from GTI:

Bruce's Hamburger List

"To refer to a personal taste of mine, I am going to buy hamburgers for the rest of my life. When hamburgers go down in price, we sing a "Hallelujah Chorus" in (our) household. When hamburgers go up, we weep. For most people, it's the same way with everything they will be buying - except stocks.

When stocks go down and you can get more for your money, people don't like them anymore".

OK, it's Buffet talking and not us, and we all know he's developed an attachment to stocks for the long run. But consider what it means for returns if you can prise yourself way from prevailing negative sentiment.

Bruce has just put together a Hamburger List.

To get on Bruce's list, you've got to elbow aside a lot of competition. You've got to be a major blue chip international stock with an established global franchise and a consistent track record of maintaining dividends through thick and thin. Preferably, your dividend yield is twice or three times the cash deposit yield in your own country.

And, whilst the financials will certainly power ahead if the stock market bottomed in October, we're not going to try and be clever. Financials are off-limits for now.

Here is Bruce's first hamburger, Royal Dutch, our Energy and Alternative Energy theme adviser's biggest holding by far (10%).

A large blue chip stock the size of a small country with a fat 5% dividend yield that hasn't been cut since WWII. Royal Dutch, and others on Bruce's list, are stocks that now trade on the valuations of bonds (on account of their high dividend yields). The difference is that stock yields increase, whilst bond yields stay the same. In fact, many bonds have features that allow borrowers to take the yield away by calling them early.

In this market no one would rule out the possibility of [Royal Dutch](#) becoming even cheaper before it rallies, mainly due to forced selling, but that yield has now risen to 5.74% and the estimated PER is 4.56, according to Bloomberg. Also, its debt to assets is only 6.72%, providing a low gearing of 14.60%.

Browning Newsletter, covering climate, behaviour and commodities - [My thanks to Alex Seagle for this fascinating publication](#), written by Evelyn Browning Garriss and published by Fraser Management Associates. Here is the opening:

Cooling Weather

It took a long time for the Phillies to win the World Series. For the first time in history, a World Series game was suspended while in progress. During the 5th game of the classic, heavy rain had turned the field into a swamp, home plate into a puddle and every ball became an adventure. Finally, when the foul lines were completely washed out, the Commissioner of Baseball suspended the game.

It rained for two days. Finally, 50 hours later, the game resumed. As fans in their parkas shivered in the stands, the Phillies finally won. The strangest

World Series game in history was over.

The very strange game was shaped by very strange weather. A rare October Nor'easter roared up the East Coast, dumping rain and snow from Florida to Canada. Hard winds, some reaching 50 mph created near-blizzard conditions. North Carolina had up to 2 inches of snow and parts of Pennsylvania received over a foot. Lake-effect snows buried regions from the Great Lakes to Virginia. Freezing temperatures swept deep into the South. Tens of thousands of people were left without electricity and travel was disrupted.

This was certainly not the only storm or unexpected cold this season. Over 200 cold temperature records have been broken, from California to Maine and the Carolinas. Storms brought early deep freezes into the Southern Plains and snow into the Central Plains and Rocky Mountains. Even your author, living 300 miles from the Mexican border awoke to find mid-October snow in her front yard.

Unfortunately, these unusually cold temperatures were not a one-time event. It is shaping up to be a cold late fall and an even colder winter.

The factors that shaped the extreme storminess of this summer still remain.

My view - [Don't miss the section on ice packs, including satellite photos - it is different from what you may have been led to expect, and it is likely to affect energy contracts. There is also a fascinating feature on sun spots.](#)

Email of the day - [On holding on and a possible US depression:](#)

"Here's a comment by Richard Russell on the coming depression, as quoted by Prieur du Plessis today. Given this perspective and the continued prospects for unknown but potentially large amounts of further deleveraging and given the beginning of yet another down-leg on the markets, I wonder if you could you could further rationalise continuing to hold on to all Fullermoney investments. You talked about Oct 10 being a penultimate level, how might this level relate to ultimate level? I wonder if I am going to once again regret holding on, noting that a 50% drop in value requires a 100% appreciation just to catch up.

"Here is what Richard Russell (Dow Theory Letters) - one of the few market commentators with first-hand experience of the Great Depression - has to say: "The market is warning of a coming depression. Next year there'll be a huge problem of unemployment, job openings will have disappeared, and every business will be going over its personal thinking in terms of who the business can do without.

" "The sentiment in the country will be dark grey to jet black. Fortunes will have been wiped out. Thousands of savings plans and 401Ks will have been shattered. Americans who have never experienced true hard times will be living hard times. Confusion and fear will be rampant. How do I know all this? I've been here before, I know the signs." "

My comment - I have received a number of emails of a similar nature. These are painful times for investors. Everyone loses in an economic contraction and asset disinflation, one way or another. Stocks, corporate bonds, property and collectibles all fall in value.

Every one of us has to decide for ourselves how we handle this, in terms of our own portfolios. I do not know if you will have further cause to regret holding on to your positions. You might, because most markets remain under pressure. However we also know that it seldom pays to sell good, unleveraged assets a year or more into a slump, which monetary authorities are actively and increasingly trying to mitigate.

Richard Russell is a venerable and much respected commentator, not least by me. In my view, the US economy is certainly warning of very difficult times ahead. This will come as no surprise to veteran Fullermoney subscribers, since this service has often stated, with considerable sadness I should add, that the USA has been at the epicentre of global economic risk for a number of years.

This downturn may feel like a depression for many Americans, although it will not be comparable to the Great Depression in which depositors were wiped out by bank failures and there was virtually no welfare to cushion hardship. I am not aware of depositors in US banks losing their savings, and neither have any of us in the UK or Euroland, to my knowledge.

More importantly for investors with globally diversified portfolios, will it feel like a depression in Shanghai, or in the financial centres of other countries with high savings rates, surpluses, viable banking sectors, and which are not in recession? I doubt it. Stock markets of all countries have been dragged down by the 'perfect storm' frequently discussed by this service, not least in our Audios during the first half of this year. The worst problems of commodity inflation have already passed for many of these countries, and they are more than capable of adapting to weaker OECD countries in terms of exports.

Bond Market: Unsafe at Any Yield? - My thanks to a subscriber for this topical [article](#) from Seeking Alpha. Here is the opening:

This year will be remembered for many things, most of them negative, brutish and just plain ugly. But 2008 will likely go into the history books for other reasons, including a year that extended extraordinary gifts to strategic-minded investors. No less extraordinary will be the dearth of investors willing or able to accept the gifts from the financial gods.

So it goes in the money game. When prospective returns --long-run prospective returns -- are thin, the crowd can't get enough. At the other extreme, when risk premia is soaring, Mr. Market finds few takers. All the more so when fears of depression are swirling about.

Consider the chart below, which is but one example of the astonishing repricing of risk now underway in the bond market. The recent spread in junk

bonds over Treasuries is currently at levels last seen, well, almost never, at least since the modern notion of high yield bonds as an asset class was minted in the 1980s. Today, the asset class can be had at a yield spread of nearly 1,700 basis points over a 10-year Treasury yield. For reasons that need no explanation, there are few takers, which is one factor for why the spread's so high. By comparison, in June 2007, the spread was compressed at one point to less than 260 basis points, to which investors were happily accepting.

My view - During a panicky deleveraging, I do not assume that all assets are priced rationally. Subscribers have been helping us to boost the corporate bond fund sector of the Chart Library and I think you are right to be interested in this sector. However one needs to do a certain amount of due diligence in terms of the contents of these portfolios and the calibre of the managers, as Eoin has pointed out previously. Obviously we should monitor the price performance because distressed bonds will eventually bottom out with the same characteristics as any other market. Feedback from subscribers with specialist knowledge in this sector is always appreciated.

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

"To love the free market is to loathe the scandalous behavior of those who have betrayed the values of openness that lie at the heart of a healthy and prosperous capitalist system."

Senator John McCain

Additional Commentary by Eoin Treacy

Email of the day - [on the S&P 500's technical action:](#)

"I've been paying very close attention to your narratives on the markets and your comments that, "...the charts will provide guidance for necessary actions..." I must admit however, that at this point I am very concerned, particularly since I am invested in the Fullermoney asset classes.

"I just heard Louise Yamada (technical market analyst) calling for the S&P 500 to trade in the area of 600 to 400 given the supports recently broken. Unfortunately, she has been very accurate so far in her forecasts.

"Aside from your decision to hold steady with the Fullermoney themes, what do the charts tell you? At some point we all need to reassess our position in light of new circumstances. Notwithstanding the secular rationale for commodities & emerging markets, if the technical signals corroborate Ms. Yamada's forecasts, would you not abandon your long supported theme for a more appropriate entry point at a later date?

"Thanks in advance for your response."

My comment - Thank you for a thoughtful email which enunciates emotional responses I believe many investors are currently experiencing. You correctly point out that the S&P 500's chart action deteriorated significantly yesterday. I believe it is useful at this point to review the chart facts:

The [S&P 500](#) completed a Type-2 top formation in mid-January as it fell below 1400. It rallied from mid-March to mid-May but failed to sustain a move back above 1400 and quickly fell through the lower side of the three-month range. Support was found between 1150 and 1200, and the market rallied once more to test the lower side of the previous range near 1300. As the Index fell through 1200, it accelerated lower, before finding support near 850 by mid-October. The resulting range was the third congestion area of approximately 150 points. The market broke down again on Wednesday.

In terms of [consistency](#), the downtrend has formed three relatively equal-sized ranges one below another. Each of the ranges has spent less time distributing; the first took five-months, second two-months and third one-month. While the first two ranges were quite close together, the third is significantly below the others. We will often see that the most consistent thing about a trend is the size of the reactions while the distance between them is often the least consistent. The fact that these ranges are taking less time to form is explained by the deterioration of sentiment and desire of investors to be rid of a heavy emotional and financial burden.

The most recent range was far more volatile than the others and took much less time to form. This further suggests that not only is the price deterioration accelerating but that investors are reaching their pressure point in greater numbers. The Index broke downwards again two days ago, reaffirming the downtrend. A sustained move back into the previous range would be the first major inconsistency to challenge the integrity of the move, but as of writing there was no evidence that this is about to occur. The downtrend has just been extended and short traders will be emboldened to increase positions; if prudent, behind a trailing stop.

Not surprisingly, the first question people ask as a market breaks down is how far will it fall? No one can answer that question with any degree of certainty, although many will attempt to. As we identified in the consistency characteristics above, the distance between ranges is the least consistent thing about this downtrend, making predictions about the extent of any fall even more difficult to formulate.

The temptation, if one wants to make a prediction, is to extrapolate the downward trend lower. An example of this would be to assume that if it fell from 1300 to 850 in September, it might fall from 1000 to 550 in November and December. In any situation where sentiment is trending towards an extreme, an internal argument develops between the realisation that the trend cannot continue at the same pace indefinitely and the wish for a winning strategy not to end.

In the current situation, if the bears thought the market was only going to fall another 5%, they would be closing positions and long side investors would be

buying. However, the bears have the trend and sentiment on their side, regardless of the fact that the market has already deteriorated considerably. However, ever greater numbers of sellers need to increase shorts or liquidate long positions, in order to extend the trend. To bolster the belief that this situation will continue, more and more extreme forecasts of potential losses are required by the bears. If one wants to make a name in this market, the easiest way is to come out with the most bearish forecast.

When gold was at \$1000, we saw forecasts for \$2000 and \$3000. When oil was \$145, we saw forecasts of \$200 and \$250. These guesses were made because of the wish that the good times would not end. Even though many investors now fervently wish that this situation would end, the emotional response among the bears is the same as it was for the bulls at the top.

The problem is that in the short to medium-term these bearish forecasts could be right. The trend remains relatively consistent so the benefit of the doubt can be given to the downside. However, the acceleration and increasingly bearish forecasts are signals that caution is warranted. The temptation to sell everything and just get away from the market, only to come back in at a later date, hopefully lower, is a powerful emotional response but is not without risks of its own. This is a decision we all face as individuals, but I for one will not be selling investments, which I intended for the long-term, following such an exaggerated downward acceleration and during a cacophony of bearish extremes.

'Unprecedented' Biotech Bankruptcies Erupt Amid Finance Crisis - This [article](#) by David Olmos and Rob Waters for Bloomberg highlights a sector which has been a relative performer until quite recently. Here is a section:

The global economic crisis has cut funding for biotechnology companies to the lowest level in a decade, triggering bankruptcies and threatening development of drugs based on biomedical breakthroughs.

In the past month, at least five biotechnology businesses have sought bankruptcy protection, according to company news releases, and others may be heading toward a similar fate. Those at highest risk have experimental compounds moving into costly human research. Peptimmune Inc., a 6-year-old closely held firm, says it's struggling to pay for clinical trials of its promising multiple sclerosis drug.

The amount raised this year by biotechnology companies fell by \$9.7 billion through September, or 54 percent, compared with the same period in 2007, according to Burrill & Co., a life sciences investment bank in San Francisco. That may mean work on dozens of potential treatments will stall or die as companies fire workers and shelve early research projects, industry executives and investors said.

"I'm looking down the barrel of a gun," said Peptimmune's Chief Executive Officer Thomas Mathers in an interview. The Cambridge, Massachusetts-based company's cut staff by more than half to 22 people, moved to smaller

offices to conserve the \$6.5 million on hand and is delaying research on new drugs for Alzheimer's disease and Parkinson's, Mathers said.

Biotechnology companies in the U.S. are raising less cash than they have in a decade, according to Burrill, which tracks investment in the life-sciences industry. Financing fell to \$8.2 billion through September, from \$17.9 billion last year. Venture capital funding fell 16 percent, to \$2.9 billion.

Bankruptcies Rare

"For the first time in the history of the biotech industry, you're going to see unprecedented levels of bankruptcies and dissolutions," said David Strupp, managing director in the life sciences group at Canaccord Adams, a research and investment bank in New York. "This all will play out in the next six to nine months."

Bankruptcies in biotechnology have been rare because struggling companies often dodged trouble through mergers, licensing or development deals, or through investors willing to make cash infusions, Strupp said in an interview.

Now, a large number of companies are "not cycling out of this queue," Strupp said. "Wall Street won't finance them, and the pharmaceutical industry can't buy all of them. They keep marching forward without the ability to get saved."

My view - Biotech is the 7th best performing sector in the S&P500 year-to-date; down 14.6% as of last night's close. As with all industries affected by the credit crisis, the companies most likely to survive are those with access to steady cashflows. In the case of the Biotech industry, this means companies with products already on the market and earning an income.

The [S&P 500 Biotechnology](#) sector was in a broad trading range with an upward bias from mid 2005. It [broke](#) upwards from mid-July before encountering resistance near 1200 in August. It then quickly followed the wider market lower before finding at least short-term support near 800. The sector again outperformed the market from the October lows but began to pull back more aggressively this week. A sustained move back above 1050 would now be needed to question scope for some further downside in absolute terms. [Relative](#) to the S&P, it continues to outperform and would need to sustain a move back below 1.1 to question scope for further upside.

The [Nasdaq Biotechnology Index](#) also continues to outperform the wider market and a downward dynamic would be needed to check momentum beyond a brief pause. In absolute terms, the Index rallied well from the [2002](#) lows, but ranged within a gradual uptrend for the next five years. It broke downwards in early October and posted a new closing low yesterday. A sustained move back above [750](#) would be needed to question scope for further downside.

China Cosco, Container Lines to Cut Asia-Europe Capacity 30% - This short article by Wendy Leung for Bloomberg covers the drop-off in shipping inventory following the price collapse over the last months. Here it is in full:

China Cosco Holdings Co., the nation's largest container line, and three partners will cut capacity on Asia-Europe routes by 30 percent from early December as a European recession damps demand for Asian-made goods.

The four lines will reduce existing capacity by around 16,000 twenty-foot-equivalent units during the traditionally slow season that lasts until the end of March, Yang Ming Marine Transport Corp. said in a statement on its Web site today.

Hanjin Shipping Co. and Kawasaki Kisen Kaisha Ltd. are also members of the grouping, called the CKYH Alliance.

The lines also announced last week cuts on Asia-Europe routes starting in January as Europeans pare spending on toys and consumer goods amid the global recession. Neptune Orient Lines Ltd., Southeast Asia's largest container line, said this week that it was cutting 1,000 jobs because of weaker demand.

The CKYH Alliance will combine some routes and suspend others under the capacity reduction plan, Yang Ming said.

My view - The [Baltic Dry Index](#) collapsed from historic highs earlier this year to historically low levels where the supply of shipping inventory is being curtailed. At current [prices](#), the cost of shipping will no longer be an issue for commodity exporters and consumers. The fact that prices have stabilised around current levels is an indication that the bottoming out process has begun.

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

"Still on the theme of high yield could you add [New Clty](#) High Yield Investment Trust to the Library. It is run by Richard Lockwood."

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

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.](#)

Gold - [breaking upwards](#) from the consolidation above [\\$700](#) and would need to push back below [\\$750](#) to question scope for some additional short-term upside.

Natural gas - found [support](#) near [\\$6](#) over the last [month](#) and would need to sustain a move below that level to hinder potential for base development in the current region prior to a recovery.

Germany - testing the mid-October [lows](#) near 4000 and needs an upward dynamic to question scope for some further downside.

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