

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 1st December 2008

Commentary by Eoin Treacy

On Target: Gold's Sparkling Performance - [Thanks to Martin Spring for his wide ranging letter which this month leads with a piece on gold. However, here is a section on when to begin to re-enter the stock markets:](#)

Don't Reinvest Yet!

This isn't the time to buy back into the US stock market - wait until February, advises former hedge fund manager Andy Kessler, in The Wall Street Journal. His reasons?

Selling before year-end to capture tax-deductible losses will weigh on the market. "The December effect will be huge this year."

For a similar reason, mutual funds will be forced to dump stocks as investors cash in their units.

Ironically, funds that bought into the market many years ago but now need cash to meet customers' redemptions will be forced to sell at prices which, even at current low levels, will produce capital gains, generating unexpected tax bills for those customers. That will add to the pressure to sell units, raise cash.

Hedge funds will continue to be forced to sell securities to raise cash, especially as they have billions of dollars of assets inaccessible because they are locked up in the Lehman Brothers' bankruptcy.

Funds that bought on margin are being forced to sell to meet "spectacular" margin calls requiring them to raise capital to cover share losses.

After year's end comes "the January effect," which is normally "supposed to be positive." This time, however, Kessler suggests, lots of fund managers will be fired after a disastrous year. Their replacements will probably re-shape portfolios to their liking, initially by dumping stocks they don't favour. That will produce a negative January.

Wait till February to invest, he advises.

Tim Price, a British analyst, says he sees "climactic action in many charts - but not the base formations to support sustained recoveries."

Citi Research calculates that the fall in the S&P 500 index had already, in early November, exceeded the average of the 18 preceding bear markets since 1929. Interestingly the worst of those, the one that began in 1929, saw a peak-to-trough plunge of 86 per cent followed by a 12-month bounce back of 121 per cent. (Of course, that still left prices far below the previous peak).

My view - Right now, bearish sentiment is growing increasingly more pessimistic and pundits are competing with each other to come up with ever more intense adjectives to describe the action. In such an environment it is easy to rationalise why markets cannot rally for at least another few months. For those short or who have just sold, this also helps to reinforce the righteousness of their recent decisions.

However, in former more bullish periods, investors looked for a Santa Claus rally as December approached rather than worrying about redemptions into the end of the year. Part of the logic was that investors would buy shares before the New Year, attempting to embellish their annual performance. A subscriber's email today also points out that hedge funds redemption notices have already passed:

"December is a seasonally favorable month for many commodities, including the precious metals. Also, with 30, 45, and 60 day notices for hedge funds out of the way for 2008, there should be some cleaner trends in December."

Setting aside these arguments; is there conclusive evidence that the stock market has bottomed? No. Looking at the chart facts, the [S&P 500](#) remains in a consistent downtrend, and while the current range is more volatile than that which occurred previously, it is no larger. The Index broke downwards eight days ago but quickly found support and rallied back into the range. In less volatile trading activity, we could have greater confidence in calling this a failed downside break, which would make a retest of the upper side of the range more likely. However, in the current environment, the relationships between different asset classes are a more reliable indicator.

The [Dollar Index](#) broke upwards from the consolidation above 70 in August and over the coming months soared to 88. To date, the current consolidation is no larger than the congestion area between 75 and 80. They have also gone on for approximately the same amount of the time. The current range is different in that it has posted three failed upside breaks and continues to form a wedging characteristic. It is currently rallying having posted another higher low and needs to sustain a move above 88 to reaffirm the uptrend.

Government bond [prices](#) in a host of different countries continue to hit new highs. US Treasuries rallied spectacularly in November and hit a new high today near 130. The trend is looking overextended but a sustained move below 125 is needed to question potential for some additional upside.

While the potential for the S&P to sustain a rally towards 1000 exists, it faces

the short-term headwinds of strong government bond prices and a firm dollar. Nothing other than volatility has occurred to the price to shake the bears out of their positions and it remains for the bulls to prove their case.

Astaire Research: The India Report - Thanks to Deepak Lalwani for his ever interesting [report](#) which this week focuses on the terror attacks in Mumbai. Here is a section:

So, what is the impact of the latest terrorist atrocity? In the short term it will rock sentiment. The physical fear aspect is more relevant than the investment fear. Foreigners travelling to India as tourists or businessman may wish to postpone trips. Tourism, already facing a sharp slowdown due to the credit crunch, will be an obvious victim. S&P yesterday stated it does not plan to downgrade India's credit rating if this attack is seen as an isolated case.

Economically, it will revert quickly to business as normal and re-focus on economic fundamentals. India was already facing a clear economic slowdown. The timing of the attack is abysmal. The stock market was already over 50% down YTD on heavy selling by FII facing redemptions at home. The Rupee as a result has fallen over 20% YTD. The Rupee may well fall to Rs 52 vs the US\$ on more selling by foreigners. We expect the RBI to cut interest rates by up to 100 bp within 4 weeks. The SENSEX will probably close 2008 the worst in %age terms since 1991 (the record so far is -21.4% in 2000). 2008 will be remembered as a year to be forgotten. But, on a 2-year view India is a BUY.

My view - The terror attacks in Mumbai and others which have taken place over the years are to be abhorred. In other countries where Westerners have been targets, security measures have subsequently been put in place, making it much safer for visitors and India should be no different.

The [stock](#) market rallied in the immediate aftermath of the attacks but continues to test the lows near 8000. Overall, the Sensex remains in a consistent although overextended downtrend. A sustained move above 10,000 is needed to indicate that the bulls are regaining the upper hand.

Investment Postcards from Capetown: Credit Crisis Watch - Thanks to Prieur du Plessis for forwarding this [posting](#) from his website which lists a number of indicators of liquidity in the credit markets. Here is a section:

For the world's financial system to start functioning normally again, it is imperative that confidence in the credit markets be restored. In order to gauge the progress being made to unclog credit markets, I regularly monitor a range of financial sector spreads and other measures. By perusing these one can ascertain to what extent the various central bank liquidity facilities and capital injections are having the desired effect.

I am planning on updating this "Credit Crisis Watch" regularly as I believe a grip on the credit situation will be key to determining the appropriate investment strategy.

First up is the three-month dollar LIBOR rate. After having peaked on October 10 at 4.82%, the rate declined sharply to 2.13% on November 12, but the healing process has since experienced a setback with the rate edging up to 2.18%. LIBOR trades at 118 basis points above the Fed's target rate of 1.0%, compared with 43 basis points at the start of the year.

The TED spread (i.e. three-month dollar LIBOR less three-month Treasury Bills) is a measure of perceived credit risk in the economy. This is because T-bills are considered risk-free while LIBOR reflects the credit risk of lending to commercial banks. An increase in the

TED spread is a sign that lenders believe the risk of default on interbank loans (also known as counterparty risk) is increasing. On the other hand, when the risk of bank defaults is considered to be decreasing, the TED spread narrows.

Since the TED spread's peak of 4.65% on October 10, the measure eased to 1.75%, but has since worsened to 2.10%.

My view - Even though some important spreads have contracted considerably over the last month, credit conditions remain tight and distrust in the banking sector remains high. Banks are not lending to one another and as long as this continues, markets will remain under pressure. The [TED](#) and [OIS](#) spreads both need to contract further to indicate that liquidity is beginning to move more freely.

Mineweb.com: Iron ore miner Fortescue stock surges on bid rumours - [This article](#) from Reuters which appeared in today's Mineweb.com newsletter covers the rebound in Fortescue shares. Here it is in full:

Shares in Australian iron ore miner Fortescue Metals Group (FMG.AX) soared as much as 42 percent on Monday, forcing Fortescue to issue a statement that failed to extinguish rumours of takeover interest in the firm.

Fortescue shares hit a high of A\$2.93 on rumours that BHP Billiton Ltd (BHP.AX) (BLT.L) might make a takeover bid for the company or that Chinese firms might seek to take a stake.

The company, responding to a stock-exchange query, said it knew of no reason for the sudden rise, but left open the door to speculation it might be in talks with BHP or a Chinese suitor.

"The company does from time to time hold discussions with industry entities regarding product supply and investment opportunities which are confidential in nature and there are none that are progressed to a level that could be considered complete," Fortescue said in its short statement.

Fortescue's statement cooled the share price, which closed up 21.4 percent at A\$2.50.

But fund manager Tim Schroeders, of Pengana Capital, doubted the rumours and said the day's gains had been magnified by short-covering after a recent steep fall in Fortescue shares.

"I think it's people grasping at straws," he said.

"The BHP one can be ruled out plain and simple," he added, noting that Fortescue was saddled with debt and that BHP had dropped its \$66 billion bid for rival Rio Tinto (RIO.AX) (RIO.L) last week partly because of Rio's indebtedness.

Both Fortescue and BHP declined to comment.

"We don't comment on market speculation," BHP spokesman Peter Ogden said.

Fortescue's volatile shares stood as high as A\$13.15 in June, before falling to a low for the year of A\$1.16 on Nov. 20. The company sells iron ore to 27 Chinese steel companies, its largest customer being Baoshan Iron and Steel Co (Baosteel) (600019.SS), China's top steel maker.

My view - [Fortescue](#) has yet to turn a profit which might help to explain the extent of the fall following the remarkable advance from 2005 to the June highs. If one believes the company is not going to go bankrupt, and at current levels this could not be ruled out. The general mood at The Chart Seminar in November 2007, when Fortescue was discussed, was that it was a viable prospect but this may have changed since. If the reserves are all that they were hyped up to be, then the company could be a potential takeover candidate at these levels for a cash rich or government backed entity.

Just as the accelerating trend was a warning that things were getting overdone at the top, the accelerated move from AU\$7 to less than AU\$2 was also a sign that the share was overextended. It would now need to sustain a move to new lows to question potential for base formation development around current levels.

China's Yunnan Government Purchases Metals to Help Smelters - [This article by Xiao Yu for Bloomberg](#) covers the announcement by Yunnan's government that they are implementing plans to support the resources industry. Here it is in full:

China's Yunnan province, home to the world's largest tin producer, will buy 1 million metric tons of base metals from local producers and traders to provide capital for operations and acquisitions during the global credit crunch.

Companies including Yunnan Copper Industry Co., Yunnan Tin Co. and Yunnan Metallurgical Group Corp. will benefit, according to a newsletter report on the Web site of the land ministry today. The government will stockpile the metals for a year.

Industrial metal prices have tumbled from records this year as the global economy tips into a recession, forcing producers to slash output. The Yunnan government will also increase its loan quota to smaller mining and smelting companies by 5 billion yuan (\$723 million), it said.

"The government will raise funds for the purchase, which is intended to encourage companies to make acquisitions at low prices in China and overseas," the statement said.

The Yunnan government will purchase 150,000 metric tons of copper and lead each, 300,000 tons of aluminum and a similar amount of zinc, and 100,000 tons of tin, according to the China Land and Resources News, a newsletter of the land ministry. It didn't say how much the metals will cost.

Yunnan Tin, the world's largest producer of the metal, surged 10 percent to 11.54 yuan in Shenzhen trading. The stock is down 79 percent this year.

Yunnan Copper, China's third-largest smelter of the metal, has dropped 84 percent this year in Shenzhen trading. The stock was suspended on Nov. 27.

The increased loan quota will help companies close obsolete capacity and improve their technology, the newsletter said, without giving details on the previous loan amount.

My view - On paper this sounds like a spectacular effort to support the local basic resources sector, but it remains to be seen as to whether this effort will have any effect on the prices of industrial metals.

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

Chinese Renminbi per 1 US Dollar - The US Dollar [breaks](#) upwards from the 6-month range against the Yuan in one of the largest moves since the end of the hard peg. A sustained move back below ¥6.82 would be needed to question scope for further upside.

Yen per 1 Euro - the current range has marked a loss of [downward](#) momentum but the Euro needs to rally from near current levels to question potential for some additional downside.

Natural Gas - [belies](#) weakness in the oil complex as it finds support above Friday's lows. A sustained move below \$6 would be needed to question scope for further [base](#) formation development around current levels.

[S&P 500](#) and [Dow Jones](#) Industrials Average divergence from 200-day moving average - We first posted this indicator on October 10th when the relevant spreadsheet was created for us by a subscriber. We intend to add it as a permanent feature to the Chart Library at some future date, but I will continue to update these charts on a weekly basis until then.

Over the last month, these indicators have remained in the region of their historic lows; more or less mimicking what the stock market has done. Mean reversion is not yet taking place to any significant degree but the extent.

Last week's signups for the Free (Abbreviated) Comment of the Day - For the week of November 23rd new signups, including subscribers and pre-subscribers, live in the following countries or regions: Brazil, Canada, France, Germany, Ireland, Malaysia, New Zealand, South Africa, Switzerland, the UK, the USA and Vietnam - 12 in total. In descending order, which topped the list in terms of the last week's new signups? It was the USA, UK and Canada.

Thousands of people around the world receive Fullermoney's Free (Abbreviated) Comment of the Day, and their numbers steadily increase. Why do so many sign up? It is primarily due to word of mouth or word of press mention, from people who like Fullermoney's global perspective and our Empowerment Through Knowledge theme. Incidentally, on receiving our free daily email, you will not be contacted or solicited with advertisements and other marketing material. No one else will have access to your email address. We respect your privacy.

Please note - David is away today but will be back tomorrow.

Tuesday 2nd December 2008

The Paradox of Panic - Less Bad is Good - This is an interesting [issue](#) of The Weekly View from Rod Smyth, Bill Ryder and Ken Liu of the USA-based RiverFront Investment Group. The discussion of psychology will resonate with veteran subscribers and attendees at The Chart Seminar. Here is the opening:

Consumer and investor confidence are at bearish extremes, reflecting a high degree of certainty that the economy is in bad shape and likely to deteriorate. Markets are discounting mechanisms - prices incorporate investors' aggregate view of the future. Thus, the more certain investors are that the future will be awful, the more bad news will be discounted in current market prices. The stock market's 40% decline since September, along with feedback loops (from the markets to the economy and back) and margin calls for individual and institutional investors, has discounted in three months what in most bear markets take several years. The paradox of panic is that it is possible that the economy will be every bit as bad as we are expecting in 2009 and yet the worst of the stock market declines may be over. By way of reference, 1933 was just such a year. The Dow Jones Industrials rose 64% in the face of some of the worst economic news in US history.

As discounting mechanisms, markets will tend to react to news at the margin. Bad news can be taken in stride if it is not as bad as investors had expected. Good news can disappoint if investors were expecting better. This is the basis for one of our three investing rules 'Beware the crowd at extremes.' Thus the issue is how accurate will expectations for 2009 turn out to be. If the economy

is only as bad as investors currently expect, then stocks should begin to stabilize in our view. If the laggard effect of past monetary and fiscal policy, combined with low commodity prices cause the economic news to be less bad than investors' current fears, then we think stocks will rise. Only if the economy is worse than expected, despite policymakers' efforts, do we see a break below the 2002 lows.

My view - I agree with the market psychology above, although in reference to the 1933 stock market rally, we should remember that President Roosevelt confiscated the gold of private citizens and devalued the US dollar by 40 percent against bullion that [year](#).

The US stock market has certainly discounted a great deal of bad economic news this year. Nevertheless extremely bearish members of the commentariat increasingly refer to a 'depression' in the USA, adding that 'monetary policy is not working' and that various 'bailouts will make matters worse'.

Those of us whose parents and grand parents suffered during the Great Depression, or who have read about it in detail, may recall that there was no protection for depositors during bank failures, virtually no welfare safety net and the US dollar was on a gold standard until March 1933.

Today, there are few constraints in terms of what the Federal Reserve can print. Additionally, the central bank has many more options, as we are about to see, including the possibility of devaluation. This [item](#) from the Financial Times: "*If all else fails, devalue the dollar*", discusses some of the monetary options (*also in [PDF](#), in case the link is dropped*).

A weaker US dollar remains one of the key factors that Fullermoney looks for, to signal a stronger phase for the stock market. For evidence that stock market indices are base building and demand regaining the upper hand, we need to see higher reaction lows within the trading ranges. Conversely, breaks beneath the November and particularly the October reaction lows, would reaffirm the overall downtrends.

Roger Bootle: How on earth did we get ourselves into this mess? - Turning to the UK economy, this is an excellent [article](#) by Roger Bootle for The Telegraph, posted without further comment.

Attempting to analyse what we have not experienced before - I had an interesting lunch in [Smithfield](#) today, discussing markets with two very experienced gents, known to me since the 1970s and 1980s.

One referred to a breakfast meeting this morning, during which the stock market was described as at a very interesting level in terms of historical comparisons, psychology and valuations. Few would disagree but we know that an important difference this time is the degree of leverage currently being unwound.

I was somewhat surprised when the economist present mentioned that he was more interested in price chart action than fundamental forecasts at this time. He was looking for an improvement in the corporate bond market as a bullish signal. The logic is sound - until investors regain confidence in the corporate bond market, why should they trust equities?

A weaker dollar was seen as an important signal that global deleveraging was winding down - a point often mentioned on this site. Our host had adapted to the extreme volatility by forsaking long-term investing at this time. Instead, he was buying on the plunges and selling quickly on the rebounds, in a manner not dissimilar to Fullermoney's Baby Steps tactic. Cyclical / reflation trades were preferred to defensive sectors.

We all said that we had been too optimistic on the way down but that the consensus was too bearish today, not least regarding policy. Capitalism is a robust system and governments will continue to stimulate, until they succeed.

I have undoubtedly forgotten more than I have recalled from this excellent lunch, but we also agreed that England's Cricketers should have completed the series in India.

Additional Commentary by Eoin Treacy

GSI The Issues: Public Confidence - [Thanks to a subscriber for the latest issue of this ever interesting and well written report](#) which this week focuses on investor confidence. Here is a section:

U.S. Banking System Still Very Tight

The September and October 2008 pickup in loans (Chart 2, source: U.S. Fed) reflects the reclassification of Merrill Lynch into a commercial bank which pushed total assets of the commercial banking system up by over 8%, +US\$900 billion (rise in loans and securities' holdings up US\$600 billion). There is no net growth in loans, i.e., the system is not lending. Note that the industry's total loans-to-deposit ratio has jumped up to just under 102%. The system is still very tight.

The quickest way to reliquefy the banking system is by swapping mortgage backed ABS for U.S. Treasuries (which can be sold for cash), i.e., the original aim of TARP. Government capital injection of tens of billions each into bank capital and public guarantees of bank debt can provide only temporary relief. As long as sizable, hard-to-value ABS assets remain on bank books, as the recession deepens, market forces will continue to push for greater markdowns and punish bank share prices down to levels difficult for banks to raise capital. Aside from ABS, other assets such as LBO loans, commercial mortgages and recession-driven loan defaults will take their toll on banks' equity base. The credit crunch will stay very much alive while bank balance sheets are stuck with hard-to-sell assets.

Unfortunately, Secretary Paulson's actions remain ad hoc and reactive. For a short while, he appeared to be finally getting ahead of the curve with the creation of TARP. But then came a surprise flip-flop ? TARP would no longer buy mortgage backed securities off banks. This is another policy mistake. Sure enough, after Paulson's U-turn, the market bashed bank shares hard, sending them into bankruptcy-like valuations.

My view - The collapse of the shadow banking system has called into the question the entire financial system. Investors are now asking themselves how such excesses can be prevented and how we can avoid making the same mistakes next time around. The role of financial shares in this crisis continues to be monitored closely, and the Bank and Diversified Financials sectors remain important bellwethers for the wider market.

The [Banks](#) index broke downwards from the lengthy range last week and needs to sustain a move above 150 to question scope for some additional lower to lateral ranging.

The S&P 500 [Diversified Financials](#) Index remain in a consistent although increasingly overextended downtrend and need to break the progression of lower highs to question the integrity of the move.

Email of the day (1) - on US Foreign Net Transactions:

"Can you provide information on the US Foreign Net Transactions that is in the chart library?"

"Thank you very much for your help."

My comment - Thank you for this interesting question which is relevant in the current market environment. I updated the data in the Chart Library to the most recent reading. Here is the explanation from Bloomberg of what the Index composes:

This is the sum of gross purchases by foreigners from US residents minus gross sales by foreigners to US residents. The categories are as follows: US Treasury Bonds & Notes, US Govt Agency Bonds, US Corp Bonds, US Corp Stocks, foreign Bonds, and Foreign Stocks. This data is for long-term securities, for example US Treasury Bills are not included.

This [chart](#) of Foreign Net transactions since 1977 shows that while the peak to trough swings increased from 1993, foreigners were net buyers of US investment vehicles until 2007. The Index posted an unbroken progression of rising lows until the big downward reaction in July 2007. Since then it has posted three lower highs and a succession of lower lows, indicating that foreigners are now buying fewer US assets. The progression of lower highs would need to be broken to question this new emerging trend.

While the pace at which the USA is attracting foreign investment is slowing it is still in net positive territory. A considerable further deterioration would likely

be necessary before this nascent trend turns into a problem large enough to require significantly higher interest rates.

Alstom CEO Awaits Keynesian Stimulus to Chase Gloom - [This article by Anne-Sylvaine Chassany for Bloomberg covers the continued global focus on infrastructure development. Here it is in full:](#)

Alstom SA Chief Executive Officer Patrick Kron is having a hard time feeling the gloom and doom.

The French maker of power plants, turbines and trains is hiring 1,000 people a month worldwide to work through a 47 billion-euro (\$59.2 billion) backlog and the CEO anticipates a further boost as governments from the U.S. to France increase infrastructure investment to weather the global economic decline.

"The world is rediscovering the Keynesian approach to the economy, and that will benefit infrastructure projects," Kron said yesterday in an interview at the company's headquarters near Paris. "I cannot convince myself that the infrastructure needs of a year ago aren't still true today."

Alstom, the world's third-biggest power-plant builder, has fallen 47 percent this year in Paris trading on concern the world financial crisis may hurt large energy projects. While the credit crunch may prompt some clients to delay jobs in the short term, Kron predicted that the need for new power generation and environmentally friendly rail links will spur longer-term orders in both developed and emerging markets.

"Capital goods-related stocks have suffered from the perception that demand for heavy equipment will decrease. It may be true for cement plants or steel factories, but I think it's unfairly applied to us," Kron said. "We're in growing markets and where there's a government plan to support the economy, there's an element to sustain investment in infrastructure. I believe this will boost demand if there's a slowdown here or there."

More Stimulants

Early next year, Barack Obama will propose an economic-stimulus package three times larger than one he was discussing only weeks ago, with the main focus on infrastructure, according to lawmakers and aides to the president-elect. French President Nicolas Sarkozy has pledged measures that include "massive" investment in infrastructure and said he wants to see similar measures across Europe.

Such moves are in keeping with the economic philosophy of British economist John Maynard Keynes, who advocated government intervention in areas such as taxes, interest rates and public projects to stimulate growth.

Alstom rose 0.2 percent to 39.06 euros as of 10:23 a.m. today while the CAC 40 Index fell 1.1 percent in Paris trading.

Kron isn't convinced that the current financial crisis significantly changes long-

term demand. Global power capacity will double in about 20 years and it makes little difference whether that mark is reached in 2032 or 2030, he said.

Today? Tomorrow?

The CEO was also unconcerned about short-term delays at Alstom's transport unit, which makes the world's fastest train and competes head-to-head with Montreal-based Bombardier Inc. The possible suspension of a 1.1 billion-euro order to build and equip a high-speed link Buenos Aires to Cordoba in Argentina "makes no difference," he said. The project isn't part of Alstom's backlog, which only includes fully funded orders, he said.

"It's an interesting project for us, but we're not financing it," Kron said. "If the financing is not available today, it will be tomorrow."

Alstom, rescued from near-bankruptcy by the government in 2003, said on Nov. 6 that first-half net income rose 36 percent to 520 million euros. The order backlog, equal to more than two years of work, will help the company meet a 2010 operating margin target of about 9 percent of sales, it said. New bookings climbed 20 percent to a record 15.4 billion euros in the first six months and sales rose 12 percent to 8.96 billion euros.

The company, which also manufactures turbines, remains interested in a possible tie-up with French state-owned nuclear reactor maker Areva SA, though the government hasn't made a decision, he said. The government, which wants to raise cash for Areva's expansion, may also sell shares to the public.

"If we don't go into a long and depressed economic downturn, we'll be able to adapt smoothly," he said.

My view - Reading upbeat upbeat comments from a CEO among so much gloom grabbed my attention. Infrastructure development is likely to play a key role in the any stimulus package announced whether that is in the USA, France or anywhere else. Demand for power is set to rise considerably over the coming decades, especially in the big population centres of the world and that means power stations and transmission networks need to be built. This ignores the need to simply maintain the current infrastructure.

Even though many of the [companies](#) which stand to benefit from this growth have sold off heavily, over the last few months; they remain prime candidates to lead in the next recovery.

China's Yuan Trades at 5-Month Low on Policy Shift Speculation - [This article](#) by Judy Chen for Bloomberg covers yesterday's weakness of the Chinese Renminbi against the US Dollar. Here is a section:

China's yuan traded at a five-month low on speculation the central bank favors a weaker currency to support exporters two days before U.S. Treasury Secretary Henry Paulson visits Beijing to push for further appreciation.

The People's Bank of China set the reference rate at 6.8527 per dollar in Shanghai, compared with yesterday's fixing of 6.8505. The yuan fell as much as 0.5 percent from the central parity rate to 6.8870 per dollar, touching the daily trading limit, after it slid 0.7 percent yesterday, the biggest loss since the central bank ended a fixed exchange rate in 2005.

China slowed the yuan's appreciation in July as the world's fourth-largest economy grew at the slowest pace in five years in the third quarter, prompting Premier Wen Jiabao to pledge "forceful and fast" measures to sustain growth. President-elect Barack Obama said China must stop manipulating the currency in a letter to the National Council of Textile Organizations released on Oct. 24.

"The central bank has the intention of weakening the currency but is also worried about excessive reactions in the market," said Yang Shengkun, a currency analyst in Beijing at China Citic Bank Co., a unit of China's biggest state investment company. "The reference rate today signals it doesn't want to see a big drop in the yuan's value."

The yuan traded at 6.8867 a dollar as of 2:27 p.m. in Shanghai, from 6.8848 yesterday, according to the China Foreign Exchange Trade System. The currency is allowed to trade by up to 0.5 percent against the dollar either side of the parity rate.

My view - [The Chinese Yuan](#) fell by the most against the US Dollar, since the end of the hard peg yesterday and sustained the move today. The Chinese have said on a number of occasions that they will use whatever policy measures are necessary to protect their economy. The pausing of Yuan appreciation over the last four-months was a step in that direction and yesterday's move was a further declaration that they are willing to flout international pressure in order to protect their growth rate.

Email of the day (2) - [on trading interest rates](#):

"I'm wanting to trade US interest rate Futures once they start to rise. Do I assume the best vehicles are Treasury Notes and Treasury Bonds? If this is true, how does one relate a figure of 127 in the T-Bonds 30 Yr to interest rates. Unable to make sense of CBOT information. Hope this is not outside your scope otherwise a pointer."

My comment - [Thank you for this relevant question which I'm sure will also be of interest to other subscribers. Treasury notes and bonds are vehicles which allow you to play the long side of the yield curve. The short end of the curve will be much more responsive to interest rate changes so you might be better off examining opportunities in the Eurodollar, Short Sterling, Euro Euribor or EuroYen markets. All of these markets allow you to take a view on interest rates in the USA, UK, Eurozone and Japan respectively. Here is a link to a helpful article in the \[Fixed Income Investor\]\(#\) which explains how prices and yields are calculated.](#)

[EuroDollar](#) futures have posted successively higher major reaction lows over the last 20-years and are currently rallying towards the 2003 highs. A sustained move below [97.8](#) would be needed to question scope for some additional upside.

[Short Sterling](#) continues to accelerate higher having found support near [93.5](#) in June. A downward dynamic would be needed to check momentum beyond a brief pause.

[Euro Euribor](#) futures tested the 2000 lows in June, but broke upwards strongly in September as expectations of Eurozone rate cuts increased. While the rate has lost momentum somewhat over the last month, a sustained move below [97](#) would be needed to question scope for some additional upside.

[3-month Euroyen](#) futures have been trading in a tight range between 98.5 and 100 for much of the last 13 years, in line with Japan's ultra-low interest rates. A sustained move below [98.5](#) would be needed to indicate that this long top formation has been completed.

All of these markets are pricing in lower interest rates and would need to exhibit some significant technical deterioration to question potential for some additional upside.

Email of the day (3) - on creating inflation-adjusted charts:

"Friday's email to Eoin about US housing and subsequent graph of Case-Schiller looking like it still has a long way to fall. The chart library is such a great tool - look at the same graph with a US CPI overlay and it looks like it's already over shooting. Keep up the great work and wishing a speedy recovery to Mrs. Fuller."

My comment - Thank you for this interesting email. However, to look at only [seven years](#) of history on an inflation adjusted basis might distort the image. If one wants to get a better idea of the effects of inflation on a market, it's better to look at longer term charts such as this one of the [UK HBOS](#) house prices index adjusted by the CPI for the UK.

Today's interesting charts - The Chart Library has interest rate charts for a host of different countries which one might not easily find elsewhere.

India - [rallies](#), having opened down on the day and would need to sustain a move below 8000 to question scope for some additional higher to lateral ranging.

Eurobunds - continues to [accelerate](#) higher and are approaching an area of potential resistance near 124. However, a downward dynamic would be needed to check momentum beyond a brief pause.

US Dollar per 1 British Pound - [the Pound](#) remains in a consistent downtrend and would need to sustain a move above \$1.55 to question the integrity of the move.

Email of the day (4) - [on bond fund additions to the Chart Library](#):

"iShares has a number of bond funds that track well known indices. Their quotes are very easily available on an intra day basis. Some of these funds are in the chart library eg HYG (high yield) LQD (Investment grade).

"Could you include some of the other funds that are not yet in the chart library. I am specially looking for: [AGZ](#) (agency bonds), [MBB](#) (mortgage backed), [MUB](#) (Municipal bonds), and [NYF](#) (New York municipal bonds)."

My comment - [Thank you for these suggestions which have now all been added to the Chart Library.](#)

Wednesday 3rd December 2008

Tim Price: Considering the snow - [This issue](#) from PFP Wealth Management discusses 'The Snowball: Warren Buffett and the business of life', by Alice Schroeder. Here is a section:

Aspirant financiers and entrepreneurs seeking the Value Way to Riches will be well served by the shareholders? letters alone. "The Snowball? fills in both the private and public history of America's greatest investor. What strikes the reader of today is the extent to which the current deep crisis has its roots in the behaviour of bankers ten and twenty years ago - the Credit Crunch and Banking Fiasco of 2008 did not come out of a clear blue sky. The full dress rehearsal for the bankruptcy of Lehman Brothers in 2008 - probably the worst decision made by the US Treasury and Federal Reserve so far, in an environment where the swirl of poor decisions has been as thick as autumn leaves - came in 1991 when Salomon Brothers was hours away from bankruptcy following a hushed-up fraud involving rigged auctions for US Treasury bonds. Buffett was parachuted in as chairman to save the firm, and perhaps even the integrity of the US financial system. So "too big to fail" is hardly a contemporary coinage. And the festival of moral hazard that is the current Anglo-Saxon banking culture has its origins in the 1998 collapse of Long-Term Capital Management and its vilely hubristic executives. Buffett was invited to rescue the fund. But its management, in what might be seen as an eerie presentiment of the downfall of Lehman's CEO Dick Fuld, were determined to retain ownership and control of the business. Alice Schroeder asks the pertinent question of the Fed-orchestrated LTCM bailout:

"It is hard to overstate the significance of a central-bank-led rescue of a private money manager. If a hedge fund, however large, was too big to fail, then what large financial institution would ever be allowed to collapse? The government risked becoming the margin of safety. No serious consequences had come about in the end from the derivatives near-meltdown. The market

afterward seemed to behave as if no serious consequences ever could. This threat, the so-called "moral hazard," was a chronic worry of regulators."

Buffett himself candidly explained the second- and third-order impact of failing derivative structures, which again carries huge resonance in our dislocated modern financial arena:

"Derivatives are like sex. It's not who we're sleeping with, it's who they're sleeping with that's the problem."

Much of "The Snowball?" has a grim relevance to current events:

"Terrorists have a huge advantage. They pick the time, the place, and the means. It's very difficult to defend against fanatics.. This [the terrorist attacks of September 11, 2001] is just the start of things. We don't know who our enemy is. Now, it's us versus a shadow. There could be many shadows."

And like the shareholders' letters, "The Snowball?" is a repository of fine quotations, about business and investment success, and much else. But as we crouch in the aftermath of the Crash of 2008, amidst the rubble of the equity and credit markets, there is specific cause to see optimism and a sense of opportunity in Warren Buffett's words describing a previous panic (in this case, the crisis of confidence in the financial markets post-Enron). As Alice Schroeder puts it,

"Berkshire's best opportunities always came at times of uncertainty, when others lacked the insight, resources, and fortitude to make the right judgments and commit."

But Buffett tells it best, and the advice resonates for our time as well as in relation to his previous market coups:

"Cash combined with courage in a crisis is priceless."

My view - This quote immediately above, selected by Tim Price, is particularly apt. When a crisis appears all but insurmountable, it is usually well discounted.

'The Snowball' should make a good present for the forthcoming holiday season.

Email of the day (1) - [On our site and equity outlook](#):

"It is always pleasure to get to read insightful independent thoughts from our community on our site. Pl note I call it as our site..."

"I am from India and have spent close to 17 years in equities. I just want to bring to notice two crucial facts:

- a. all bear markets bottom with a mishap
- b. all bull markets start amidst a war...

"I am sensing that the current situation in Mumbai is giving us similar signals and we might just be fishing the bottom at this stage..."

"I am attaching herewith a good piece from [Stratfor](#) which highlights possibilities of the scenario as it sets to develop over the next few days, weeks or months..."

"What is your take on the situation...as always would keen to get your words of wisdom..."

My comment - Absolutely we think of Fullermoney as your site (as in the Collectives'). Eoin and I know that the service would be much diminished without the insightful comments, articles and reports that we receive from Subscriber's. Long may this last.

On your point (a), I do think some economic situations become sufficiently worrying to provoke an even more dramatic policy response, and expect it to happen this time.

On point (b), there are precedents, but I suggest that the 2003-2006 bull-run was delayed until the invasion of Iraq had commenced and met minimal opposition, initially. I have great sympathy with the citizens of Mumbai and obviously emotions there run high. However as you will know, the president of Pakistan, Asif Ali Zardari, is also a victim of terrorism following the assassination of his wife, Benazir Bhutto, last December. Even though his ability to control the terrorists and eliminate their bases must be limited, India may have more success if the current government is on their side. I sincerely hope there is no likelihood of another war, although the problem of Kashmir is far from resolved. Assuming there is no serious conflict between India and Pakistan, I expect your country to be among the leaders of the next upturn.

Richard Lambert: Media help deepen crisis, says CBI chief - Fewer people might take this [item](#) seriously if the comments had not come from a former editor of the Financial Times, and appeared in the same paper today. Here is the opening:

Richard Lambert, director general of the CBI employers' body, yesterday launched an attack on the press watchdog for failing to crack down on reporting that had served to deepen the financial crisis.

He said unsubstantiated rumours had been spread about institutions in trouble and that the Press Complaints Commission should have issued guidelines to business journalists on the importance of accurate information in such uncertain times.

Instead, there had been stories that had alarmed savers with melodramatic language, unsourced quotes and suggestions that problems in one institution

were spreading to others.

"At a time when careless headlines or injudicious reporting risk becoming self-fulfilling prophecies of a very serious nature, you might have thought that the industry's self-regulatory body . . . would have had some guidance to offer about the special responsibilities of business journalists as they pick their way through the dangerous minefields of the credit crunch.

"But of course the PCC is nowhere to be seen in this drama."

Mr Lambert, a former editor of the Financial Times, said crisis management had become more difficult because of changes in the way the City worked and in the culture of the business media that reported it.

My view - This is a delicate subject. We have a free press, which is essential for any open and vibrant society, but freedom is best assured when it is accompanied by responsibility.

No one is calling for Pollyannaish stories in an economic crisis or cheerleading from those with vested interests. However there is an old adage: 'Fear sells.' Readers will have their own views as to whether there is sometimes an element of gratuitous gloom in headlines or a surfeit of articles focusing on everything that might possibly go bump in the night.

Journalists can be as emotional as the rest of us, and one of their functions is to be a mirror of our fears and expectations. My own view is that the serious press is responsible and that we are generally well served.

My personal portfolio: BRWM trading long partially stopped out, silver long increased - Half of my trading long in the [BlackRock World Mining Trust](#) was stopped out yesterday. Consequently a March position was sold at 219.7p against my purchase at 221.8p on 24th November. Using the Baby Steps approach, I doubled my small long position in [silver](#) today, paying \$9.705 for another March position. These prices include spread-bet dealing costs.

Bill Gross: Dow 5,000 Redux - [My thanks to a subscriber for this interesting report](#) published by PIMCO. Here is the refreshingly self-deprecatory opening:

Here I go again! Gosh it was only six years ago that I cemented my place in stock market history by predicting that the Dow would fall from 8,500 to 5,000, instead of going up to 14,000 where it peaked in October of 2007. Well, I could use the standard set of excuses: 1) No one else saw it coming, 2) I was misinterpreted, and taken out of context, 3) I was tired, overworked, and had family problems, or 4) I had just come out of rehab. But these days what really works is a full confession. I mean, like, uh, it was totally my fault and I take full responsibility. The fact is I was only off by 9,000 points. That's my story, and I'm stickin' to it.

Well, fools rush in. This time though I'm definitely older and maybe a little bit

wiser. No magic number, nor a specific target date from the Swami of the Dow. This one will be more conceptual, but still present a "take" that you can criticize or damn with faint praise. And no, despite the title, it doesn't imply that the stock market is headed to 5,000 and that I was always right or just a little bit early. It only suggests that I'm readdressing the critical topic of equity valuation - that mysterious fragile flower where price is part perception, part valuation, and part hope or lack thereof. Press on, Swami.

Let me first announce a fundamental premise with which I think all rational investors would agree: I believe in stocks for the long run - but only if purchased at the right price. That statement packs a real punch. It says that capitalism is and will remain a going concern, that risk-taking - over the long run - will be rewarded, but only from a starting price that correctly anticipates the economy's growth and its share of after-tax corporate profits within it. Acknowledging the above, let's look at a few basic standards of valuation that historically have stood the test of time, to see if at least the price is right.

One of them is what is known as the "Q" ratio, or the value of the stock market relative to the replacement cost of net assets. The basic logic behind "Q" is that capitalism works. If the "Q" is above 1.0, then the market is valuing a company at more than it costs to reproduce it; stock prices should fall. If it is below 1.0, then stocks are undervalued because new businesses can't be created at as cheap a price as they can be bought in the open market. In the short run, this ratio is volatile as shown below but it tends to be mean reverting, which is critical. As long as capitalism is a going concern, "Q" should mean revert to 1.0. If so, then oh, oh what a "Q"! Today's Q ratio has almost never been lower and certainly not since WWII, implying extreme undervaluation, as seen in Chart 1.



My view - The Q Ratio is certainly at an interesting level but what of Bill Gross' concluding four points?

Corporate profits - I assume that the outlook is diabolical through at least 2Q 2009, and that a great deal of this is factored into today's share prices. The longer-term points cited by Bill Gross are a concern for US equities but

policies in a Democratically-dominated Washington will not necessarily be repeated in Asian-led emerging markets.

Globalization's salutary growth rate - These are interesting points and we can only guess as to how it will play out. Protectionism is always a risk, especially in an economic downturn, but I think the attractions of globalisation are well understood by most governments. I have often wondered if Asia would be less willing to fund the USA's deficits, but their holdings in US Treasuries have done extremely well recently, due to falling yields and a stronger dollar.

Animal spirits - These are part of human nature and I am optimistic that they will return, although hopefully on a healthier basis, meaning less cowboy capitalism.

The benevolent fist of government - Usually, this is less onerous in developing economies, which I expect to outperform OECD countries once again.

Email of the day (2) - On compensation regarding spread-betting accounts:

"I refer to the e-mail of the day on 27 November on the above subject. I trust you will advise us further, once you are able to ascertain the compensation available, if the spread betting company was to go bust."

My comment - I promised that I would follow up, particularly regarding IG Index, which has recently reported potential bad debts of £15 million due to clients unable to meet margin calls.

I spoke to Chris De La Vega (christopher.delavega@igindex.co.uk) of IG, who is my account manager, although I deal online. He has always been helpful and provided two links to their website. This first [link](#) will tell you about the firm. This second [link](#) confirms compensation limits.

[IG Group](#) is a listed company in the UK, pays a 5.58% [dividend](#) at current prices and with [no debt](#) has an infinitely stronger balance sheet than all those banks which have so concerned us.

Incidentally, I was offered 10% of all commissions generated by any clients whom I introduced to the firm. I thanked them for the offer but explained that by longstanding policy agreement, neither Fullermoney nor any of our associates ever receives any commissions or other forms of remuneration for services mentioned on this site. To do so, would in our view, compromise our objectivity and potentially create a conflict of interests in terms of our relationships with our subscribers.

However, subscribers should be aware that revenue sharing has always been commonplace in the financial sector. Therefore, when any financial service is recommended to you, it may not be a bad idea to enquire if that person or their firm has a financial incentive in making the recommendation.

Additional Commentary by Eoin Treacy

Asia ex Japan: The Valuation Inquisition - Thanks to a subscriber for this excellent, measured [report](#) by Markus Rosgen and Elaine Chu making the case for Price to Book as a highly relevant ratio to finding value in today's market. Here is a section from the conclusion:

So, will it help us make money?

Yes. People like to believe that whatever is happening to them is unique and has never happened before. What's more, recent memories tend to be stronger than distant memories. The fact though is that what may be unique to us has happened before, be it recession, runs on banks, financial crises and, sadly, wars. Investors in the past have had to deal with these events and it is very doubtful that this time around their behaviour will be any different.

So, be it on current P/BV for Asia ex, the risk reward is getting increasingly attractive and Asia is no longer a riskless short at these levels. Based on the "short" 33-year history of Asia ex from these levels of P/BV, returns over the next 12 months have been 26%, 45% and 77.6%. The same is true using the deviation from the 10-year moving average of current earnings yield, the current dividend yield or the Graham and Dodd earnings yield or P/E. The average 12-month returns from those strategies based on the 100-plus years of the USA has been 10.1%, on a 24-month basis it has been 29% and on a 36-month view it has been 22.3%. And all of this even if we compare the valuations to the trading history of the US market over the course of the last 100-plus years.

S**t has happened over those 100-plus years and yet, it continues to be the case that cheap stocks go up and expensive stocks go down. Selling expensive markets has worked very well over the past 100 plus years and especially so over the past 12 months. At these levels we doubt greatly that the strategy of selling will work for the next 12 months. As such, we need to begin to retune our investment thinking from that of selling due to lack of opportunities to seeking opportunities. We still have time on our side, but there is plenty of homework to do to find the right stocks and it takes time to reset the mind. We see more opportunities to make money around today than there were 12 months ago and believe that these opportunities carry with them substantially less downside risk.

My view - The [MSCI Asia Pacific ex-Japan Index](#) soared from its 2001 lows to the highs posted late last year, in what had been a very consistent uptrend that accelerated towards the peak. The Index lost 67% of its peak value before finding at least short-term support near 200 in late October. When we compare the Index's Price / Book [ratio](#) with the price chart, we see that extreme lows for the ratio correspond with important market lows.

In the past, periods which have seen such enormous sell-offs are generally good buying opportunities if one is willing to look past the short term. Given the size and speed of the decline, [base](#) formation development is needed before the market can sustain more than a technical rally. The question now is

whether this already taking place; with the downtrend having lost momentum and a sustained move below 200 needed to question scope for further higher to lateral ranging.

Fixed Income Investor: Bond of the Week - Thanks to colleague Mark Glowrey for forwarding his latest fixed income [comment](#), which this week focuses on Gilts. Here is a section:

This year, the majority of the action in the Gilt market has been in the shorter-dated end. Investors have flocked to the security of government-guaranteed debt to protect their capital, egged on by the prospect of even lower interest rates.

The impact on the shorter end of the curve* has been dramatic. The flood of money into 1 to 5 year maturity gilts has bid up prices, forcing down the yields on these fixed coupon securities. The benchmark 5.75% Dec 2009 issue, which has just one year to run to maturity, has gained over 4 points in price terms from its lows back in June, and now yields a less-than-generous 1.3% to maturity.

The longer dated end of the curve, however, has been somewhat of a Cinderella. Investors have preferred the security of shorter dated maturities, which ensure a relatively quick return of capital, rather than risk locking up their funds for ten years or more. There is also the nagging uncertainty of inflation coming back to haunt us in the future, which would severely impact longer dated bonds.

The last few days have seen longer dated Gilts start to play catch-up. Prices for 10 and 30 year US Treasuries and the 30yr German BUXL have soared, and well-known (and top performing) hedge fund manager Hugh Hendry has been widely quoted in the press stating that he is buying the undated 3.5% War Loan bond for his own personal portfolio.

We would be inclined to agree with Mr Hendry. A study of the chart of War Loan (see right) shows that this instrument displays clear range-trading characteristics. This year's range has until recently been constrained between 71 and 80, but the last few days have seen the resistance taken out, opening the door for a potential rally up to the 2006 highs above 90.

At this morning's mid price of 86.5, the running yield on War Loan can be calculated as $3.5\% \times 100 / 86.5 = 4.0\%$. This does not seem unreasonable given that base rates now stand at 3.5%, and are set to go lower.

My view - Government bonds of all maturities are receiving considerable inflows as investors shun other asset classes and move increasingly large amounts of cash into the security of government backed instruments. With yields on three-month US Treasuries yielding almost nothing and low readings also being posted by a number of other countries' short-term debt; investors are increasingly looking to longer maturities in order to get some return on their investment.

There are two ways of looking at the market for [30-year Gilts](#), mentioned in another part of the above piece: One can't but identify the obvious acceleration and be wary that this trend is quite overextended. The flight to quality has been remarkably swift and investors are experiencing unusually high levels of fear. Being objective about the chart action, the accelerations are eyebrow raising but there is no sign yet that they are over. However, considering the extent of the move, a trailing stop might be advisable. .

The other view is that UK interest rates are expected to come significantly lower over the coming months and on a commonality basis [US](#), [European](#) and [Canadian 30yr](#) yields have all already broken to new lows. The UK 30yr yield has been relatively steady by comparison, but could now be partaking in a catch-up move. An upward dynamic would be needed to check downward momentum beyond a brief pause.

Email of the day (1) - on the medium to longer-term outlook for bonds:

"I see, interestingly, bonds yields continue to decline due I suppose to huge risk aversion, safe haven flows, a guarantee that you will get your money back, deflationary fears, de-leveraging, capital flight from emerging markets, CDS levels on corporate debt and now the prospect that the fed will buy the Treasuries own bonds.

"However one would have thought yields would rise with the excessive supply coming on the market in 2009. Not so obviously looking at the charts.. What gives...

"What will China and other emerging countries with current account surpluses make of this game? Will they look for higher yields on new bonds or be happy the value of the existing bonds they are holding is appreciating."

My comment - Thank you for these interesting questions which I'm sure other subscribers are also asking. Of all the valid reasons you mention above we can also add the prospect of lower interest rates, not least in the UK and Europe.

The fear for fixed income investors is that the current recession turns into a damaging deflationary spiral such as that experienced by Japan in the 1990s. Japanese 10yr [yields](#) fell to a low near 0.77% in 1998 and while they posted even more extreme levels in 2003, they have ranged between 1 and 2% for a decade. Japan continues to experience anaemic growth and little or no inflation. Could the USA, UK and Europe follow a similar pattern?

Bond markets are certainly being re-priced to allow for this possibility and the word 'depression' is being thrown around willy nilly as if it were a certainty. The power of this contention is that its proponents can point to Japan as an example and rationalise that government bonds are cheap even at these elevated levels.

They might be right in predicting that government bond prices can still go higher in the short to medium-term. However, the Japanese example is different from the current situation because the policy response has been implemented much quicker and is far more wide ranging than any initial move to prevent the Japanese deflation. Policy makers can also look to the Japanese example and learn from past mistakes. However, there is no short-term solution. It could be a number of years before Western central banks can declare victory in their efforts to stem the deflationary threat. Considering, the quantity of cash been printed, it is hard to imagine that the seeds of the next inflationary cycle, which is some years away, are not now being sown.

Asian governments have been buying Treasuries over the last decade as a safe haven for their national savings and in the process, have helped to fund consumption in the USA. Net Foreign Transactions into the USA are still considerable but are declining; suggesting foreigners are buying less US securities. It is too early to say whether this will turn into a more prolonged trend but anecdotally, we also hear that China and other Asian economies are spending more money at home in order to support their domestic economies. There will still be a need for AAA rated government securities but at such low yields, better long-term returns are likely to be found in other assets.

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.

Shanghai A-Share Index - this market continues to show more evidence of base development than others and would need to sustain a move below 1750 to question potential for some additional support building around current levels.

South Africa - continues to range above 18,000 and would need to sustain a move below that level to reaffirm the downtrend.

Oil - remains in a consistent, albeit increasingly overextended downtrend and a clear upward dynamic is needed to question scope for some additional downside.

Email of the day (2, 3 & 4) - on additions to the Chart Library:

"At your earliest convenience, please add the following to the chart library: CGM Focus (CGMFX). This fund is managed by Capital Growth Management in the USA."

And

"Please add Impax Environmental Markets plc ([IEM](#)) to your chart library (it is a "fund", actually a closed end investment company), thanks."

And

"Could you please add the Mortgage Finance index ([MFX](#)) to the library?"

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

Thursday 4th December 2008

Commentary by Eoin Treacy

Global Recession and Response: Market Implications for 2009 and Beyond - Thanks to a subscriber for this blockbuster 92-page [report](#) by Lewis Alexander and colleagues for Citigroup covering the outlook for next year. Here is a section:

We are in the midst of a major global recession. The economic outlook has deteriorated sharply in the wake of almost unprecedented stress in the core of the global financial system.

Plunging asset prices have sharply reduced global wealth and continue to generate new losses for major financial institutions. The weakened condition of major intermediaries is limiting their ability to support the economy. Financial disruptions of recent months have diminished both consumer and business confidence. All of these factors are generating a sharp deceleration of economic activity.

Investors face a complicated set of questions. Many asset prices are already quite depressed and seem to anticipate very negative economic outcomes. Given the forces at work in the global economy, however, any forecast must entail an unusually large margin for error. Moreover, the pace of adjustment at present suggests that it will be some time before it will be possible to better gauge both upside and downside risks.

That said some tentative observations are noteworthy. Major industrial economies likely will contract well into next year (see Figure 7). The adjustment that is under way appears to entail a substantial increase in desired levels of savings in many industrial economies. The underperformance of the global economy should further depress inflation in coming quarters.

Deflationary forces are likely to be met with a substantial policy response. In early October, the G7 countries committed to preventing the failure of any systemically significant financial institution. To meet that objective, they established substantial new support mechanisms designed to stabilize the core of the global financial system.

Many central banks have eased policy significantly, and we expect them to ease further. Monetary policy should provide a boost to economic activity in many countries even where short-term interest rates are already very low. Finally, many countries have already announced their intention to implement significant programs of fiscal expansion.

Despite a robust policy response, the recovery, when it comes, is likely to be tepid. We expect global growth to remain below trend in 2010. The long-term adjustment of consumers to their reduced wealth should limit the dynamism of the recovery. Finally, recovery will hinge on a general improvement in financial conditions. Recent efforts by major industrial countries to stabilize core financial institutions appear to have been successful thus far. But the financial system remains dysfunctional in key ways. The depth, scope, and pace of adjustment and recovery in the financial sector remains the most important source of uncertainty in the outlook.

My view - Today's rate cuts of 100 and 75 basis points by the Bank of England and ECB respectively are a signal that central banks have abandoned any pretence of combating inflation and are giving this crisis their full attention. We are rapidly entering a period of very low interest rates across a large swathe of the global economy. The [USA](#) (1%), [Europe](#) (2.5%), [UK](#) (2%) and [Japan](#) (0.3%) are making lots of cheap money available to financial institutions as well as easing the burden on retail borrowers, particularly in the variable rate mortgage sector.

Of course, these are not the only countries lowering interest rates. In fact, this is one of the only times in history where we have a concerted global response to such a crisis. It will take time for the global economy to recover but yield curves are no longer inverted and are turning to being broadly supportive of growth. (Also see Comment of the Day on [August 12th 2008](#).)

The proxy for the [US](#) yield found in the Chart Library i.e. 10yr yield - the Fed Funds rate was inverted from mid-2006 until a year ago. In previous cycles, an inverted yield curve has been a precursor to recessions and has always bottomed in advance of GDP growth. The spread rallied to almost 3% by October and is now pulling back. As long as the ratio remains above 0%, it acts as more of a tailwind than headwind.

In the [UK](#), the yield curve was inverted from 2005 and only broke upwards in October as more strident action was taken to combat the repercussions of the credit crunch on the UK economy. The ratio is now close to 1.5% but needs to rally further to act as a significant support to growth.

In the [Eurozone](#), the yield curve was briefly inverted this year and the recent policy response has helped to push the ratio upwards. However, it needs to rally further to add support to growth.

All of these indicators lag GDP growth by approximately 12 - 18 months so they are not useful to predict where the stock market bottom will occur. However, as these measures improve, we will have a greater degree of

confidence that we are closer to the next recovery. Stock markets should bottom in advance of GDP growth picking up.

Email of the day (1 & 2) - on oil:

"I hope the family is well.

"I am not sure if you get any shipping reports but occasionally I get this report from a friend. It's a bit confidential so please do not post it on Fullermoney.

"The report seems to suggest that China is buying crude at quiet a rate. On the schedule

"1st column is the ships name
2nd its tonnage in 1000 ton units
3rd is the date the ship will be filled with oil 4th indicates where the ship will depart and arrive e.g. MEG = Middle East Gulf, USG = US Gulf 5th is the charter rate and there are 2 different pricing models but ignore this 6th indicates whose chartering.

"Going down the list it appears that on 3 Dec China ordered 5 ships:

Ship A 265,000 tons
Ship A 260,000 tons
Ship A 260,000 tons
Ship A 130,000 tons
Ship A 275,000 tons

"Total tonnage of those ships is 1,190,000. Looking at the schedule the Spartan Warrior item has FLD which may mean that the order was not completed so let's take that off the total tonnage and we are left with 930,000 tons. There are 8 barrels to the ton. So on this day China placed shipping order from this one, but big shipping charter company of 7.44 million barrels of Crude Oil! That is a significant number.

"This charter company issues schedules like this each and every day... the numbers, names and dates change but this list is not much different to a similar list I saw on Monday. I am sure China uses other charter companies not just this one.

"There are a few other interesting items. Ship F (275,000 tons, that's 2.2m barrels or \$103m worth of oil) from HPoint (Shetland Island I think) to US Gulf + Storage. BP has a big storage facility in Mexico. Why would BP be putting \$103m of oil in storage? Maybe they think \$47 oil is cheap, maybe there is another reason.

"To me there seems to be something of a disconnect from what we read and hear and what is actually going on in the real world. Maybe I am trying to read too much into this but the herd appears to me to be looking in the wrong direction."

And

"Today's numbers shipping numbers from the same source...

"China 5.5mb but India 6.8mb. I am told that shipping to China started to pick up about 6wks ago and India more latterly."

My comment - Thank you for these informative emails, contributed in the spirit of Empowerment Through Knowledge. Our family is thriving. Little Fiona (8-months) has gotten four teeth in the last two weeks and appears to be getting more imminently. Aisling (2 years eight months) is starting to get very excited about Santa Claus and is looking forward to visiting the Christmas markets in Germany next week.

According to this [EIA](#) report, China consumes between 5.6 and 8.7 million barrels of oil per day, so 7.44 million barrels from just one charter company is significant. Perhaps oil's future contracts curve might shed some light on this question. In [May](#), almost the entire oil curve was in backwardation, meaning that for all maturities, investors were willing to pay more to receive the commodity sooner rather than later. [Now](#), however, the situation is reversed. The entire curve is in contango.

Oil in 2016 remains close to \$87 and there are a number of maturities between now and then. If one was buying for a reserve, this would appear to be a good time to add to it on an incremental basis, since expectations are that future prices will be higher. This may also help to explain BP's actions, although there are also likely be other reasons.

Email of the day (3) - more on oil:

"I see that Merrill are warning that oil prices could fall to [\\$25](#). Is this an early buy signal for oil in 3 months time? I seem to remember that the headlines about oil going to \$200 shortly preceded the final top.

"Perhaps, a cold winter, some trouble in the Middle East and a massive Obama reflation package will see oil prices rising again by February."

My comment - Thank you for this interesting article. I agree that we need to be cautious of extreme forecasts following what has already been, by any standard, a spectacular decline. When we see forecasts for something to halve in three-months, this tells us more about the open positions a pundit has rather than where the price is going.

[Oil](#)'s decline has been remarkably consistent and remains so. I have been cautious of being too bearish of oil from about \$60 and am increasingly vigilant for a clear upward dynamic. Considering the extent of the fall and size of the reactions within the downtrend, a sustained rally of more than \$10 is needed to question the integrity of the move. When this occurs, we should have a clear signal that oil has begun its bottoming out process.

Email of the day (4) - on US Treasury auctions:

"Can you find / post the volumes of US Treasury auctions?"

"If it has any sense, the UST must be issuing bonds like crazy at these levels of yields, and as long dated as possible. I would presume that they will want to keep the USD from collapsing for now until they've satisfied the demand.

"When the UST demand is satisfied, they can let the USD go through the floor to reflate the economy. The cynic in me wonders if they'll also officially target USD 1500 gold to stoke up inflationary expectations and get the economy show on the road.....

"Is that too cynical?"

My comment - Here is a chart of US [Auction](#) Results 10yr Total Public Sold which hit a 17-year high of \$20 billion at the last auction. This would indicate that the US government is definitely raising more money by selling longer dated bonds at these yields. I could not find an index of totals sold for 30yr bonds that had significant back history. I can't but think that if they need the money so badly, do we want to give it to them for such a paltry yield?

It may take time before the US Treasury has borrowed as much as it requires in the bond markets because they have some sizeable liabilities outstanding as well as in the pipeline. Supply of bonds is not going to be a problem. Demand on the other hand should run out before supply does.

10yr Treasury [prices](#) continue to [accelerate](#) higher and while this is an ending signal, they have yet to peak. A clear downward dynamic that is sustained for more than a few days is needed to check momentum beyond a brief pause.

However, when Treasuries do top out, it is likely to coincide with a peak in the US Dollar which should be broadly supportive of stock and commodity markets. Gold should be a beneficiary in that event, but I think it unlikely the Treasury are targeting gold at all given the other problems they have right now.

Email of the day (5) - on Type-2 tops and TCS over the web:

"Eoin has mentioned a type-2 top formation for the dollar index a few times in the recent audios. Can you expound on what this formation means and how to identify it?"

"Also, any chance of allowing participation in the Chart Seminar via WebEx? I'm in New York and it's unlikely that I'll be able to attend a seminar in London in person in the near future. 7city (7city.com) does a good job of WebEx classes, I've taken some of the Paul Wilmott classes via 7city (Paul is based in London). They work great and there should be no piracy concerns since it's streaming media (not a download)."

My comment - Thank you for this interesting email. Here is a definition of a Type-2 ending from Comment of the Day [November 16th 2004](#):

TYPE-2: EXTREME REACTION AGAINST THE PREVAILING TREND - This dynamic usually follows Type-1 endings and can therefore be anticipated - what goes up in a vacuum of supply will eventually fall in a vacuum of demand, and vice versa. However the less predictable Type-2 endings are not preceded by acceleration. Instead, there is often a warning as momentum wanes, followed by a more significant warning in the form of a failed break to a new high in the case of tops, such as we saw on this chart of the Dow Jones Utilities Average in early 2001. The Type-2 extreme reaction against the prevailing uptrend was followed by several months of choppy right-hand extension, which eventually turned it into a Type-2/3 hybrid. The Utilities Average commenced its bottoming out process in mid 2002 with the Type-1 acceleration, quickly followed by the Type-2 extreme reaction, which was reversed by a fall to a new low, then another rebound and a reaction, which were all part of the eventual Type-1/2/3 base.

I am sceptical as to whether TCS would work over the web, because part of the essence of the seminar is the interaction that goes on during the course and the sharing of experience between delegates. No two Chart Seminars are the same. I fully intend to take The Chart Seminar to the USA when the economic climate improves.

Today's interesting charts - Subscribers can monitor charts for the base rates of a host of counties in the Chart Library.

Dollar Index - encounters [resistance](#) near the top of the range and would need to sustain a move above [88](#) to question potential for continued top formation development.

UK FTSE-100 - continues to [range](#) above 3500 and would need to reassert the downtrend.

Platinum - continues in a tight [range](#) between \$750 and \$900, in what has been a significant loss of momentum following the decline from above \$2000. A sustained move below \$750 would be needed to question scope for some further base formation development.

Please note - David is away today but will be back tomorrow.

Friday 5th December 2008

James Grant: Little logic to bond world amid current risk phobias - This is an excellent and timely [article](#) (also in [PDF](#)) from an authoritative source, published by the Financial Times. Here is the opening:

US Treasuries are the investment asset of the year. The less they yield, the more their fans adore them. Then, again, these fearful days, yield seems to

have nothing to do with investment calculation. Purported safety is all in all.

"Super-safe Treasuries", the papers call these emissions of a government that, this year, will take in \$2,500bn but spend \$3,500bn. "Toxic assets" is how the same papers characterise orphaned mortgage-backed securities-or, for that matter, secured bank loans, convertible bonds, junk bonds or almost any other kind of debt obligation not bearing the US imprimatur.

"There are no bad bonds, only bad prices," the traders used to say. They should say it again, only louder. In the spring of 1984, long-dated Treasuries went begging at yields of nearly 14 per cent in the context of an inflation rate of just 4 per cent. Those, too, were fearful times, the recollected horror being the great inflation of the 1970s. Inflation was ineradicable, the bondphobes said. Now a new generation of creditors espouses the opposite proposition. Deflation is baked in the cake, they say.

The truth is that no investment asset is inherently safe. Risk or safety is an attribute of price. At the right price, a lowly convertible bond is a safer proposition than an exalted Treasury. Watching the government securities market zoom, many mistake price action for price.

Yes, Treasuries might conceivably redeem the hopes of their besotted admirers. Maybe a deflationary chasm is about to swallow us all. Never before has the US been so leveraged. And - just possibly - never before were lending standards so reckless as the ones that brought joy to so many astonished mortgage applicants in 2005 and 2006.

In their magnum opus, *Security Analysis*, Benjamin Graham and David L. Dodd advise that "bonds should be bought on their ability to withstand depression". They wrote that in 1934. So far is that rule from being honoured by today's financiers that not a few bonds - and boxcars full of mortgages - could hardly withstand prosperity. Two urgent questions present themselves. One: does something far worse than recession loom? Two: does that certain something definitely spell much lower interest rates?

We can't know but we can at least observe. What I observe is a monumental push to reflate. The Federal Reserve is creating more credit in less time than it has ever done before - in the past three months the sum of its earning assets, known in the trade as Reserve Bank credit, has grown at the astounding annual rate of 2,922 per cent. Are the bond bulls quite sure that these exertions will raise no inflationary sweat?

Evidently, they are - at least, forward swap rates betray no such concern. The market's best guess as to what the 10-year Treasury will yield in 10 years' time is 2.78 per cent, never mind the famous (and now, as it seems, prophetic) remark of Fed chairman Ben Bernanke that the Fed could drop dollars out of a helicopter in a deflationary pinch.

My view - [Markets have always been manic-depressive. They are also momentum driven, which reinforces perceptions behind whatever manic or depressive theme is prevalent at any given time. Every investor knows where](#)

the most depressive trends are today - [stock markets](#), [corporate bonds](#) and [commodities](#). We also know the most recent manic trend - [government bonds](#), but only since the beginning of June, with the biggest gains occurring from early November onwards.

There are good fundamental reasons behind every big trend, at least at the beginning, and they usually overshoot. Consider commodities - the must-have investment for endowment funds and many others at the beginning of the year. Soaring prices created an inflationary crisis and one high-profile former investment bank forecast \$200 for a barrel of [crude oil](#) by the end of this year. Yesterday, another former investment bank announced that crude could soon reach \$25.

Today, we read about a "deflationary depression", while Ben Bernanke's monetary helicopter is much in [evidence](#). If he succeeds in reflation the US economy out of its vicious contraction, with the help of expansionary fiscal policies from the Obama administration, then people chasing accelerating government bond prices (plunging yields), really should consider a trailing stop to limit eventual profit erosion. I believe Bernanke will succeed, but it can often take a year or more for significant changes in monetary policy to kick in.

Success for Bernanke, I suspect, will be apparant at some point next year when the US economy slowly emerges from a deep and disinflationary recession. That may sound like a modest achievement. Yes, but it would be infinitely preferable to the deflationary depression that some investors in long-dated government bonds forecast.

Anything short of a depression should ensure that corporate bonds are now a much better medium to longer-term investment prospect than long-dated government issues, which as James Grant observes, are rapidly becoming a "return-free risk" rather than a "risk-free return".

Personally, I am considering the [iShares GBP Corporate Bond \(SLXX LN\)](#) instrument as a future investment. However the Chart Library now contains several corporate bond funds, often thanks to suggestions from subscribers, which I will also consider. A few months ago I was wary of [SLXX](#) because of the number of bank issues in this index tracker. However, I am assuming that bond holder risk is now much reduced in what are now semi-nationalised financial concerns, and that there will be no more Lehman Brothers type failures among big financial institutions. Conservative investors interested in corporate bonds should favour Senior rather than Subordinated instruments. *(See also Eoin's comments on corporate bond funds below.)*

Lastly, we maintain that a crack in the USD is required to change many of the other market trends evident. Currently, the [US Dollar Index](#) is testing the upper side of its range and a break beneath last month's reaction low just beneath 85 is required to provide clearer evidence that a top is forming. Meanwhile, the USD is still firm against all currencies except for the [yen](#).

Email of the day (1) - On bonds, starting with a quote from Bill Gross:

" *My transgenerational stock market outlook is this: stocks are cheap when valued within the context of a financed-based economy once dominated by leverage, cheap financing, and even lower corporate tax rates. That world, however, is in our past not our future. More regulation, lower leverage, higher taxes, and a lack of entrepreneurial testosterone are what we must get used to - that and a government checkbook that allows for healing, but crowds the private sector into an awkward and less productive corner. Dow 5,000? We don't have to go there if current domestic and global policies are focused on asset price support and eventual recapitalization of lending institutions. But 14,000 is a stretch as well. One only has to recognize that roughly 20% of bank capital is now owned by the U.S. government and that a near proportionate share of profits will flow in that direction as well. Better to own corporate bonds than corporate stocks, but that's a story for another Investment Outlook"*

"Bill Gross's December Investment Outlook is certainly worth pondering over. True, Mr. Gross is a bond guru, but I have found him to be very objective about the investment merits of the various bond markets. The same might be said about Jim Grant (albeit more bearish) who has now devoted 2 issues of his "Interest Rate Observer" to how mispriced many corporate issues are and that equity like returns are there for those who can find the ripe fruit. Grant gives many specific examples of companies paying close to double digit returns, showing the balance sheet strength (cash flow/interest payment and projected EBITDA/interest payment ratios) and what would have to happen for a company to default.

"This goes to the point of the differing opinions of many respected market analysts as to when it is ok to get back in the water. It seems as if each has their own favorite tool to make that judgement. For instance, Jeremy Grantham discounted current earning expectations, profit margins and market p/e ratios to get to 575 S&P but then noted that bottoms are impossible to pick so he used 600-800 as a buying range to gradually move back in. I strongly believe that we will see serious inflation, rising interest rates, falling bond prices and another commodity bull market. BUT WHEN? What we now have is continued hurricane strength deflationary forces caused by forced selling going head to head against the greatest global money printing effort ever. The result is that the deflationary forces will not allow the usual inflation results to take place. It is a stand off until we have squeezed out all of the forced selling. In this environment, I tend to think that the strategy of owning cherry picked corporate bonds for a length of time until the inflationary forces have their way is an intriguing idea. I do not see what is being called a multigenerational change in the way the investment world will play out as being very inducive for anything but some bear market rallies (which can be fruitful if timed right). Why not have high yielding bonds until we get further along and see which way the winds are blowing? I am curious about your opinion as I know you are bearish on long term treasuries, as I am. But is this not an interesting interim way to invest, though I have never followed the corporate bond market?"

My comment - Many thanks for an excellent summary, and in a carefully prepared email. This latter, perhaps seemingly small consideration to some, is

very important as it means we can cut and paste emails without wasting time on tidying them up for publication.

I have not seen Jim Grant's report for some time, but by coincidence I have seen and posted his excellent article in the FT today. Presumably, it lists one of the corporate bonds to which you refer.

We definitely think corporate bond funds are interesting today. I also assume that clear evidence of recovery in this sector would be a positive indicator for the stock markets.

Fullermoney would welcome good articles and reports on corporate bonds from the Collective.

Email of the day (2) - [More on compensation](#):

"The link relating to compensation covers 'Deposits' and 'Investments', which are CAPITAL in nature. It is not clear whether trading profits (running profits not realised), are covered!

"Under the chapter, 'Limitations of the scheme', it says that compensation will only be paid for financial loss - would that mean that 'trading profits' are excluded?

"I am sure we will all benefit from a clarification on this aspect of the compensation scheme."

My comment - [Our understanding is that you are correct - trading profits on a spread-bet would not necessarily be recovered if the firm went into liquidation. However the bigger, longer established and better managed firms should be able to weather this difficult period. Unlike some banks that we could all mention, they are neither leveraged to the eyeballs, nor do they have off balance sheet liabilities. Instead, they are financial bookmakers.](#)

Email of the day (3) - [On the Q Ratio](#):

"Regarding your post from Bill Gross and the Q ratio I would say that it has got quite a bit further to go to get to what I would call a Q ratio low equal or similar to major bear market bottom which I would expect to be in the region of 0.35 - 0.33. I have done a lot of work on this ratio recently so for me the Q ratio is the best indicator by far for a major bottom. I have attached my [work](#) which has been downloaded from the Z1 funds data at the Federal reserve with quarterly figures going back to 1952. The other figures before 1952 were taken from a report of Andrew Smithers who wrote 'valuing Wall Street'. Incidentally you often get a Q ratio low in advance of a stock market bottom. Hope you find the info useful."

My comment - [The Collective brain trust remains a great source of information and considered research. Thanks for sharing your work in the spirit of](#)

Empowerment Through Knowledge. I am sure we would all be pleased to receive further updates, if possible, during this challenging period for investors.

Email of the day (4) - [More from Evy Hambro in Australia](#):

"Another [article](#) with some interesting comments from Evy Hambro in Australia."

My comment - [Thank you so much for this highly informative interview from Business Speculator](#).

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

"The beginning of knowledge is the discovery of something we do not understand."

Frank Herbert

Additional Commentary by Eoin Treacy

The Institutional Risk Analyst: Bank Stress Index Up in Q3; Will the Final Solution for CDS Start in EU? - [Thanks to a subscriber for this interesting article from The Institutional Risk Analyst covering the problems inherent to the CDS market. Here is a section from the conclusion](#):

We hear from a very well placed Buy Side investor with extensive business interests in the US and EU that three primary banking institutions in Europe, two French and one German, have such significant CDS exposure and other problems that they cannot even begin to fund the payouts anticipated over the next quarter.

The funding squeeze reportedly is exacerbated by a near-collapse among weaker players in the hedge fund market, who were accustomed to receiving loans from one large French institution, which then stupidly converted the loans into equity. That's right. This past summer, when the bank put out a call for redemptions of \$4 billion in hedge fund investments, says the source, only \$400 million was returned. And the French bank also used these same hedge funds and others to reinsure some of its own CDS exposure. Sound familiar? Yup, just like AIG.

Unlike the approach taken by Paulson and Geithner to bailout AIG and JPM (via the Bear Stearns rescue), however, the investor claims that EU officials are considering a moratorium on CDS payments by the three Euroland banks in question. The banks would be given ten years to write down their CDS and hedge fund exposures and would receive additional infusions of capital by their respective governments. The source claims that French banks have such huge exposure to both hedge funds and CDS, sometimes linked together, that

the positions are beyond the ability of the EU governments to bail them out without a cessation of CDS payments.

The IRA was not able to obtain a comment from EU officials over the weekend about these allegations. We'll be making some calls Sunday night and Monday.

But if this unconfirmed report turns out to be true, then the beginning of the end of the CDS market as we have known it will be at hand. And ironically, the catalyst for the final solution will come not from the failure of a US dealer, but instead by a moratorium on CDS payments by an EU bank.

In the event, as other governments around the world follow the very reasonable example of the EU, the OTC derivatives market will implode and these unfunded liabilities may very well force the nationalization/liquidation of C, JPM and AIG, among others. And in the event, Hank Paulson, Tim Geithner, Alan Greenspan, Ben Bernanke and other senior officials at the Fed in Washington are going to have a lot of explaining to do to the Congress, to a new President and the global financial community.

My view - This is a worrying prospect for markets generally, since so much leverage has been built up in the credit default swaps (CDS) market over the last few years. One can imagine that a sovereign faced with banks that have more outstanding debt than the total GDP of the country, would have little choice but to take drastic measures to ensure that the domestic financial sector survives. Banning CDS repayments is one of many possible solutions. The current crisis will likely lead to CDS eventually being regulated, but it's going to be a tough period for many financial institutions as long as this leverage is being unwound.

Which markets are performing best in the current environment? - I asked myself this question this morning after I completed my 'click through' of global markets. To do this, I went to the Chart Library and put 96 country indices into a section in My Favourites. I then filtered this section by [local currencies](#), [US Dollars](#), [British Pounds](#), [Euros](#), [Japanese Yen](#), [Swiss Francs](#) and [Australian Dollars](#).

From a perusal of global markets we can quickly identify that the majority of stock markets remain in downtrends and evidence of base formation development is still tentative in the majority of cases. We also see that these downtrends are already well developed so becoming increasing bearish as sentiment deteriorates is probably not the best course of action.

Indices posting positive returns this year, such as [Ghana](#), [Tunisia](#) and [Ecuador](#), are insignificant in terms of global market cap and relatively uncorrelated to global markets. In fact every other index, in this sample space, has posted a negative performance this year.

When we sort the list in local currencies by three-month performance, the first globally significant market on the list is the Shanghai [Composite](#) Index. It also

figures highly when we look at the list adjusted for other currencies. This is significant because China was one of the worst performing markets in the world during the first half of the year and has since improved quite considerably in relative terms.

In absolute terms, the Chinese stock market continues to have the best base formation characteristics of any equity market and would need to sustain a move below 1660 to question potential for further support building and gradual mean reversion.

Also of interest is the relative performance of the [Topix 2nd Section Index](#). The 2nd Section peaked 18-months and 13-months before the Nikkei 225 and Topix respectively. It remains in an overall downtrend and accelerated lower in the first week of October. However, it found support above 1850 and continues to range above that level. It is currently testing the lower side of the range and needs to hold above the October lows to offset scope for base formation development to continue at somewhat lower levels.

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

I included the third table sorted by Price / Book because 33% of the indices are now trading at or below their book values. I understand that some investors might have reservations about the validity of such measures, but this is still a significant number of markets trading at historically low levels. This does not mean that the number cannot increase but it does suggest that many indices have returned to levels which should begin to interest value investors.

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

Email of the day (1) - on corporate bonds:

"Thank you for the wonderful informative website, I note in the last few weeks some emails have arisen asking about the corporate bond sector and I was wondering could you post what you think might be the best performers in this sector. I look forward to contributing more to the Collective once I have educated myself further with your chart seminar. Thanks again and warm wishes to Mrs. Fuller."

My comment - Thank you for your kind words and David passes on his thanks on behalf of Mrs. Fuller. We have been highlighting the potential opportunities

in the corporate bond markets over the last few weeks in particular and indeed over the last few months in Comment of the Day because of the panic that has sent these vehicles to record wide spreads over the last couple of months.

The [Dow Jones Corporate Bond Index](#) peaked in 2003 and accelerated lower from August to a low near 85. It is now rebounding and would need to sustain a move to new lows to question scope for further upside.

Yields on the [AA](#), [A](#) and [BBB](#) US Dollar Composite indices all fell sharply in the last few weeks having accelerated higher from September to late October. The correction in Euro Composite indices is more pronounced with [AA](#), [A](#) and [BBB](#) falling more sharply than their US Dollar equivalents. Swiss Franc [AA](#) and [A](#) bond indices yields have fallen even faster. These moves are significant enough to signal trend reversals and yields would now be to push to new highs to offset potential for contraction over the medium term.

Interestingly, Japanese Yen [A](#) and [BBB](#) Composite indices continue to hit new highs. Downward dynamics are needed to suggest they have reached peaks of short to medium-term significance.

I do not feel I am knowledgeable enough to make confident statements about the merits of individual bonds, beyond favouring senior debt, from highly rated companies, with businesses that provide strong cash flows. I believe a good place to start such a search is the [Fixed Income Investor](#) site, run by colleague Mark Glowrey. Bonds from British Telecom, Allied Domecq, Lloyds TSB, Imperial Tobacco and Rabobank have all featured in his Bond of the Week since late October.

We have added a large number of bond funds to the Chart Library over the last month. Of these a number of the ETFs are noteworthy:

The iShares [\\$](#), [Euro](#) and [Pound](#) Corporate bond funds all look interesting and are in varying degrees stages of rebounds from deeply oversold territory. (Also see Comment of the Day on [November 28th](#))

The iShares [iBoxx](#) Investment Grade Bond Fund hit an important low in late September and would need to sustain a move below 80 to question recovery potential.

The iShares Lehman US [TIPS](#) Fund lost downward momentum from mid-October and this week's rally broke the progression of lower highs. A sustained move to new lows would be needed to question scope for further upside.

While I'm sure MBS are anathema to most investors; the iShares Lehman [MBS](#) Fixed Rate Bond Fund hit a new high this week, breaking upwards from a yearlong range. It remains enormously volatile and is probably best bought following corrections but this is certainly an example of interest returning to the sector.

There are also a number of other funds which have performed relatively well over the last month and could be in the early stages of recovery. Examples such as [M&G European High Yield A Income Fund](#), [Invesco Sterling Bond Fund](#), [Rensburg Corporate Bond Fund](#) fall into this category.

I should add that I would highly recommend doing ones own due diligence before making any investment.

Email of the day (1) - on platinum:

"Saw your mention about the potential for platinum and other precious metals to do well. Then I saw the following note from Bill Bonner (the Daily Reckoning) that also mentioned platinum, chrome, as well as the company you spoke of, Impala. I like "personal" quotes, even if sometimes they may be made up and in the category of "send three and fourpence, we're going to a dance" [category](#). But I think this one may be more genuine than others.

"All good wishes for the season. You are a beacon of reassurance at times like this."

My comment - Thank you for your kind words and [link](#) to Bill Bonner's piece; he is known and liked by Fullermoney. Here is the relevant section on platinum:

"South Africa is a special place," began an old friend. "We've had the same sorts of things that you've had in America. People got 100% mortgages. House prices soared; they went up more than 50% in a single year. And now the bubble has popped.

"We're largely a resource economy. Mining is very big here. So our bubble didn't pop as soon as the bubble in the US and the UK. We kept going as long as commodity prices were going up. But that fell apart last June and it's been down ever since.

"And now there are some good deals in South Africa. The boom didn't go on long enough to allow the mining companies to increase production very much, so the world is still running out of these industrial or semi-precious metals - such as platinum and chrome. We're going to see a huge squeeze on supplies in the years ahead. So, we have a potentially very interesting situation, in which the mining companies have sold off so much that you can get a 10% dividend from some of them....such as Impala, I believe...you get paid very well to wait for the next boom. And when it comes, it could be very big. Very big."

[Platinum](#) has lost downside momentum and continues to [range](#) between \$750 and \$900, in a potential support building phase. Having underperformed gold for a number of months, platinum is now also losing downside momentum on a relative basis as it approaches [parity](#). A sustained move below 1 would be needed to question recovery potential.

[Impala Platinum](#) fell [precipitously](#) from the high near ZAR35,000 before finding support near ZAR10,000 where it is currently building support. A sustained move below the October lows would be needed to question potential for further base formation development around current levels.

Today's interesting charts - charts for gold in more than 30 currencies can be found in the [Chart Library](#).

Gold - backing [away](#) from the short-term [peak](#) near \$825 and pushes back into the previous range. A sustained move above the November peak near \$830 is required to reaffirm support from the lows near \$700

Natural Gas - the [downtrend](#) has lost considerable [momentum](#) over the last three-months, but continues to post lower highs. A sustained break above \$7 is needed to indicate the bulls have regained the upper hand.

Corn - reasserts the medium-term [downtrend](#) and needs to sustain a move above [375¢](#) to check downward drift beyond a brief pause and break the progression of lower highs.

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