

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 29th December 2008

A Relentless Push to Approve Loans - [This is an informative, salutary, must-read article](#) by Peter Goodman and Gretchen Morgenson for the International Herald Tribune, via the NYT (also provided in [PDF](#) format, in case the access link is eventually removed). Here is the opening:

As a supervisor at a Washington Mutual mortgage processing center, John Parsons was accustomed to seeing baby sitters claiming salaries worthy of college presidents, and schoolteachers with incomes rivaling those of stockbrokers. He rarely questioned them. A real estate frenzy was under way and WaMu, as his bank was known, was all about saying yes.

Yet even by WaMu's relaxed standards, the mortgage on one home four years ago raised eyebrows. The borrower was claiming a six-figure income and an unusual profession: mariachi singer.

Parsons could not verify the singer's income, so he had the applicant photographed in front of the home, dressed in his mariachi outfit. The photo went into a WaMu file. Approved.

"I'd lie if I said every piece of documentation was properly signed and dated," said Parsons, speaking through wire-reinforced glass at a California prison near here, where he is serving 16 months for theft after his fourth arrest - all involving drugs.

While Parsons, whose incarceration is not related to his work for WaMu, oversaw a team screening mortgage applications, he was snorting methamphetamine daily, he said.

"In our world, it was tolerated," said Sherri Zaback, who worked for Parsons and recalls seeing drug paraphernalia on his desk. "Everybody said, 'He gets the job done.'"

At WaMu, getting the job done meant lending money to nearly anyone who asked for it - the force behind the bank's meteoric rise and its precipitous collapse this year in the biggest bank failure in American history.

In a financial landscape littered with wreckage, WaMu, a Seattle-based bank that opened branches at a clip worthy of a fast-food chain, stands out as a

singularly brazen case of lax lending. By the first half of this year, the value of its bad loans had reached \$11.5 billion, having nearly tripled from \$4.2 billion a year earlier.

Interviews with two dozen former employees, mortgage brokers, real estate agents and appraisers show the relentless pressure to churn out loans that produced such results. While that sample may not fully represent a bank with tens of thousands of people, it does reflect the views of employees in WaMu mortgage operations in California, Florida, Illinois and Texas.

Their accounts are consistent with those of 89 other former employees who are confidential witnesses in a class action filed against WaMu in U.S. court in Seattle by former shareholders.

According to these accounts, pressure to keep lending emanated from the top, where executives profited from the swift expansion - not least, Kerry Killinger, who was WaMu's chief executive from 1990 until he was forced out in September.

Between 2001 and 2007, Killinger received compensation of \$88 million, according to the Corporate Library, a research firm. He declined to respond to a list of questions, and his spokesman said he was unavailable for an interview.

During Killinger's tenure, WaMu pressed sales agents to pump out loans while disregarding borrowers' incomes and assets, according to former employees. The bank set up what insiders described as a system of dubious legality that enabled real estate agents to collect fees of more than \$10,000 for bringing in borrowers, sometimes making the agents more beholden to WaMu than they were to their clients.

WaMu gave mortgage brokers handsome commissions for selling the riskiest loans, which carried higher fees, bolstering profits and ultimately the compensation of the bank's executives. WaMu pressed appraisers to provide inflated property values that made loans appear less risky, enabling Wall Street to bundle them more easily for sale to investors.

"It was the Wild West," said Steven Knobel, a founder of an appraisal company - Mitchell, Maxwell & Jackson - that did business with WaMu until 2007. "If you were alive, they would give you a loan. Actually, I think if you were dead, they would still give you a loan."

My view - Despite all that we have learned about dodgy financial transactions over the last two years as one sordid saga after another has become known, and despite all that we knew about financial insanities from earlier eras, I still find the Washington Mutual (WaMu) story shocking. Historically, boiler room scams have been small operations. WaMu was huge and had a \$40 billion stock market valuation at its peak.

Corruption always starts at the top. Before he was replaced, the aptly named Kerry Killinger rewarded himself with at least \$88 million, which he has so far

been able to keep. Employees who questioned the efficacy of company policies were sent away for attitude restructuring:

Employees in Tampa who fell short were ordered to drive to a WaMu office in Sarasota, an hour away. There, they sat in a phone bank with 20 other people, calling customers to push home equity loans.

"The regional manager would be over your shoulder, listening to every word," Zweibel recalled. "They treated us like we were in a sweatshop."

Where was any sense of shame? Where was the regulation? Regulation appears to have been either compromised or absent. An ongoing problem is that while effective regulation will introduce fear among the culpable and more 'red tape' for the honest, it will not improve ethics.

In fact, one could argue that tighter regulation, while necessary under the circumstances, is an admission of ethical failure. An industry, let alone an economy with low ethical standards will inevitably be remembered more for its notoriety than long-term success.

Email of the day - On learning:

"Thank you for helping me get through this year financially and with a level head. I spent the first 9yrs of my financial career at Bernard Madoff Investments (proprietary side) so this Holiday season has a different meaning than most. I've learned a lot and have a lot to be thankful for. You have taught me plenty over the years and I just wanted to express my gratitude.

"Keep up the insight. It is greatly appreciated. Happy New Year and everything associated with the good things."

My comment - Thank you for these thoughtful comments and also for contributing a great deal to the site in recent years.

Also, and at the risk of sounding frivolous, well done on the career change!

My personal portfolio: Platinum futures rolled forward and increased; gold long increased - I had three separate [platinum](#) purchases over the last month. On 24th November I made a Baby Steps purchase in the January contract at \$864.6; on the 28th I rashly doubled it near the top of the range, paying \$888.2; on 10th December I increased the earlier positions by 120%, paying \$837.1, also for the January contract which is expiring today at the spread-bet firm involved. Requesting a rollover, these positions were sold this afternoon at \$915.2 and I simultaneously purchased an equivalent amount of April platinum at \$918.2. I made an additional Baby Steps purchase at \$918.5. Later on, I increased my [gold](#) longs by a third, paying \$879.8 for another April position.

These prices include all spread-bet dealing costs.

Excited About the Prospects for GOLD in 2009 - My thanks to a subscriber for this [report](#) on gold and gold shares, by Craig West and Stefan Axell of GMP. Here are some opening bullet points:

We continue to believe that Q1'09 and first part of Q2'09 will be supportive of higher precious metal commodity and equity prices. We expect that:

1) continuing government intervention and investment in various sectors of the economy (just starting with the automobile industry) will slowly start to alleviate fears of a worst case deflationary depression,

2) acceleration of this government/central bank intervention and details of the U.S. Economic Recovery Plan revealed as the new presidential administration takes power will swing concern from deflation to inflation - prompting increased investment demand for gold,

3) the flow of investment funds into the U.S. dollar that we've witnessed over the past few months, which has temporarily driven the dollar to highs, will slow (and possibly reverse to some extent?) in the new year as investors look to re-deploy cash holdings - thus we expect the U.S. dollar will correct downwards in Q1'09 positive for USD denominated gold prices,

4) U.S. government bailouts (largely direct investment in financial institutions) have resulted in a material increase in monetary supply, but because this has not yet stimulated increased lending, the inflationary impacts have not been felt. Expect a new U.S. Administration to lean heavily on banks, pushing them to start lending.

5) Continuing stability and upward trend in gold price will go a long way to restore confidence in the sector as a whole. Precious metal equities should continue to regain premium valuations that they once enjoyed (they've already started - see below).

My view - Fullermoney remains bullish of gold and other precious metals, relative to most other assets, and these ratio charts of the AMEX Gold Bugs Index divided by gold bullion ([monthly](#) & [daily](#)) show that the shares remain in recovery mode since their climactic October low.

How long might this recent performance continue?

The answer, I suspect, depends on the performance of stock markets generally. For instance, if they continue to range sideways to higher, this would be favourable for gold shares, particularly if bullion remains generally firm, as I expect. Conversely, a resumption of the overall downtrends by broad stock market indices would probably weigh heavily on gold shares.

Meanwhile, as a bad year for equity performance comes to an end, gold shares are the recovery leaders in my personal long-term equity portfolio. Here are the two with the biggest weighting: BlackRock Gold & General Fund ([MRCGLDI LN](#)) and Lihir Gold ([LGL AU](#)).

Please note - Eoin is away today.

Tuesday 30th December 2008

Good News: The End of the World Has Been Postponed - You may have to pinch yourself or read this headline once again to be sure that I have actually said what you think it says. I have, but I did not have the global economy in mind. Unfortunately, it continues to deteriorate, which will surprise no one.

I do not mean to sound frivolous at dire times. For anyone who has lost their job or who finds it under threat, this is a grim period. Along with so many others, I know from first hand experience because my extended family has been affected. Moreover, everyone loses, one way or another, in a period of widespread asset price depreciation. This can be extremely stressful.

My headline above refers to stock markets, which do not necessarily move in tandem with their underlying economies. There are leads and lags, and occasionally disconnects, both up and down, which can be significant. These overshoots are caused by sentiment and liquidity.

"Yes", I have heard people say, not least in recent months, "but surely you are complacent", or "too sanguine" or "you don't get it" - you don't understand that this is a depression." Others have pointed out that "this is a once in a 100 years event."

A credit implosion and insolvency crisis of this magnitude is certainly not analogous to anything that most of us have ever experienced before, so there are no grounds for complacency. Also, the year's earlier surge in commodity prices was even more damaging for emerging market economies, as I have mentioned before. Spikes in the price of crude oil have always caused recessions and this time we had food shortages as well.

Nevertheless talk of a depression is premature to say the least. It is a widespread fear, not a reality, except in Zimbabwe and a few other grossly misgoverned economies. I maintain that a depression in the OECD countries and most emerging economies is unlikely, given the monetary and fiscal policy response.

Interestingly, Nouriel Roubini, who saw the downturn more clearly than most, does not expect a depression. However he recently forecast an additional 15 to 20 percent decline for global stock markets (see [Comment of the Day for 24th December](#)). One cannot rule this out, but there is no technical evidence of it at present. There are also far more reasons why the next significant move for stock markets is likely to be upwards than downwards.

I have listed and illustrated 10 tangible reasons for a rally (no cheerleading here), and also discussed a crucial missing ingredient. Most have been mentioned previously, so I will cover them briefly, illustrated where possible

mostly with US examples (*note: US charts have been drawn down before today's close*).

1. Governments have flooded the system with [liquidity](#). It takes time for this to filter through to the economy but it will reach the stock market more quickly.
2. Interest rates are at record lows for the USA and UK, both [short-term](#) and [long-term](#), and heading lower elsewhere. This is an ideal background for stock market recoveries.
3. Valuations are much improved, despite legitimate concerns over the earnings outlook for at least the first half of 2009. Equity yields are competitive with government bond yields, despite the near certainty of more dividend cuts than increases over the next six months.
4. [Corporate bond yields](#) peaked in October and November and have fallen significantly. They have also begun to improve their performance [relative](#) to government bonds.
5. Various measures of investor / [advisor sentiment](#) reached extreme lows in October.
6. The [VIX Index](#) peaked in October and is trending lower.
7. Commodity [indices](#) have fallen significantly, lowering inflationary pressures. Historically, equities have done best in disinflationary environments.
8. In many countries, the [financial sector](#) is showing strength relative to the broader [indices](#). This is a key lead indicator.
9. Levels of cash are at record highs (*see also Eoin's lead item below*).
10. Most broad stock market indices show some evidence of base formation development. This is less clear for the [DOW](#), but can be seen for the [FTSE 100](#), [DAX](#), [SX5E](#), [FSSTI](#) and [NKY](#), to show a few of many.

In conclusion, technical evidence remains more conducive to a stock market rally rather than another slump. However, at Fullermoney we want our views to be factually rather than faith based. Over the last three weeks we have repeatedly mentioned the December reaction lows. They need to hold to remain consistent with our expectations for a ranging stock market recovery extending well into 1Q 2009. Violation of those levels by major stock market indices would not confirm a downward break to follow, but it would increase the risk of an additional bear market decline.

The crucial missing ingredient for stock markets to date has been confidence. This is certainly understandable. Nevertheless that could change in January, given the high levels of cash held by most institutional investors. If stock markets languish in the New Year, as many expect, there will be little reason for investors to reinvest in the stock market. However, if stock market indices surprise the bearish consensus and start to break upwards rather than

downwards from their trading ranges, institutional investors will be under increasing pressure to participate. Failure to do so would put them at a competitive disadvantage in terms of 2009's performance.

Lastly, if the global economy does not show evidence that the recession is ending by 3Q 2009, in response to the stimulus programmes, stock markets will be susceptible to a significant retracement of gains achieved during the first half of the year.

My personal portfolio: Singapore Blue Chip Index long trade rolled forward; platinum long increased - I do not like monthly contracts but Singapore's Blue Chip Index, as it is called by some spread-bet firms but better known and listed in the Library as the MSCI Singapore Index ([SGY](#)), has one of the better chart patterns. I bought it too soon this month but had little hesitation in allowing it to be rolled forward. Consequently, my expiring December SGY long purchased on 18th December at 219.80 was sold at yesterday's price of 213.4 and I simultaneously purchased the January contract at 213.82. Continuing to build my [platinum](#) position, I increased it by approximately 5% today, paying \$906.6 for another April position.

Thomas L Friedman: Win, win, win, win, win... - This is a timely [message](#) from a top columnist for the IHT and NYT.

How many times do we have to see this play before we admit that it always ends the same way?

Which play? The one where gasoline prices go up, pressure rises for more fuel-efficient cars, then gasoline prices fall and the pressure for low-mileage vehicles vanishes, consumers stop buying those cars, the oil producers celebrate, we remain addicted to oil and prices gradually go up again, petrodictators get rich, we lose. I've already seen this play three times in my life. Trust me: It always ends the same way - badly.

So I could only cringe when reading this article from CNNMoney.com on Dec. 22: "After nearly a year of flagging sales, low gas prices and fat incentives are re-igniting America's taste for big vehicles. Trucks and SUVs will outsell cars in December ... something that hasn't happened since February. Meanwhile, the forecast finds that sales of hybrid vehicles are expected to be way down."

Have a nice day. It's morning again - in Saudi Arabia.

Of course, it's a blessing that people who have been hammered by the economy are getting a break at the pump. But for America's long-term health, getting re-addicted to oil and gas guzzlers is one of the dumbest things we could do.

That is why I believe the second biggest decision Barack Obama has to make - the first is deciding the size of the stimulus - is whether to increase the federal gasoline tax or impose an economy-wide carbon tax. Best I can tell,

the Obama team has no intention of doing either at this time. I understand why. Raising taxes in a recession is a no-no. But I've racked my brain trying to think of ways to retool America around clean-power technologies without a price signal - i.e., a tax - and there are no effective ones. Without a higher gas tax or carbon tax, Obama will lack the leverage to drive critical pieces of his foreign and domestic agendas.

How so? According to AAA, U.S. gasoline prices now average about \$1.67 a gallon. Funny, that's almost exactly what gas cost on the morning of Sept. 11, 2001. In the wake of 9/11, President Bush had the political space to impose a gasoline tax, a "Patriot Tax," to weaken the very people who had funded 9/11 and to stimulate a U.S. renewable-energy industry. But Bush wimped out and would not impose a tax when prices were low or a floor price when they got high.

Today's financial crisis is Obama's 9/11. The public is ready to be mobilized. Obama is coming in with enormous popularity. This is his best window of opportunity to impose a gas tax. And he could make it painless: Offset the gas tax by lowering payroll taxes, or phase it in over two years at 10 cents a month. But if Obama, like Bush, wills the ends and not the means - wills a green economy without the price signals needed to change consumer behavior and drive innovation - he will fail.

The two most important rules about energy innovation are: 1.) Price matters - when prices go up people change their habits. 2.) You need a systemic approach. It makes no sense for Congress to pump \$13.4 billion into bailing out Detroit - and demand that the auto companies use this cash to make more fuel-efficient cars - and then do nothing to shape consumer behavior with a gas tax so more Americans will want to buy those cars. .

There has to be a system that permanently changes consumer demand, which would permanently change what Detroit makes, which would attract more investment in battery technology to make electric cars, which would hugely help the expansion of the wind and solar industries - where the biggest drawback is the lack of batteries to store electrons when the wind isn't blowing or the sun isn't shining. A higher gas tax would drive all these systemic benefits.

The same is true in geopolitics. A gas tax reduces gasoline demand and keeps dollars in America, dries up funding for terrorists and reduces the clout of Iran and Russia at a time when Obama will be looking for greater leverage against petro-dictatorships. It reduces our current account deficit, which strengthens the dollar. It reduces U.S. carbon emissions driving climate change. And it increases the incentives for U.S. innovation on clean cars and clean-tech.

Which one of these things wouldn't we want? A gasoline tax "is not just win-win; it's win, win, win, win, win," says the foreign policy specialist Michael Mandelbaum. "A gasoline tax would do more for American prosperity and strength than any other measure Obama could propose."

I know it's hard, but we have got to stop "taking off the table" the tool that would add leverage to everything we want to do at home and abroad. We've done that for three decades, and we know with absolute certainty how the play ends - with an America that is less innovative, less wealthy, less respected and less powerful.

My view - I have previously described the current recession and related plunge in oil prices as a window of opportunity in the long-term effort to become less dependent on imported fossil fuels. This requires good governance at both national and corporate levels. Yes, the effort will be expensive, but not nearly as costly over the long term as inaction. Countries that do not work to achieve their own sustainable energy will diminish their potential for future prosperity, in my opinion.

Additional Commentary by Eoin Treacy

Cash at 18-Year High Makes Stocks a Buy at Leuthold - [This article](#) by Eric Martin and Michael Tsang for Bloomberg covers the huge amount of cash currently sitting on the sidelines which will fuel the next stock market rally. Here is a section:

Analysts estimate profits at S&P 500 companies will shrink 10.3 percent in the first three months of 2009 and 5.8 percent in the second quarter, bringing the stretch of earnings declines to a record eight quarters, Bloomberg data show. Gross domestic product will contract in the first half of the year before growth resumes in the third quarter, according to a Bloomberg survey of economists.

"The fuel supply is there, but people have to have a reason to use it," said Dickson, who helps oversee about \$19 billion. "The Fed fired the shot out of the biggest cannon they know. Now the question is, will it hit the right mark?"

This year's slump has left S&P 500 companies valued at an average of 12.6 times operating profit, the cheapest since at least 1998, monthly data compiled by Bloomberg show.

Cash in interest-bearing checking accounts at U.S. banks earns less than 0.1 percent annually, minus inflation, according to national data compiled by Bankrate.com. Ten-year Treasury notes yield 1.03 percent after adjusting for the cost of living, and yields fell to the lowest level on record this month.

Benjamin Graham

Seth Klarman's Baupost Group LLC, which held 40 percent to 50 percent of the Boston-based hedge-fund firm's more than \$14 billion in cash, reduced its hoard by half to take advantage of falling asset prices, according to the December issue of Harvard Business School's Alumni Bulletin.

The 51-year-old investor who seeks shares of companies trading at discounts to measures such as assets and cash flow was the lead editor for the sixth edition of Benjamin Graham and David L. Dodd's "Security Analysis," which

laid out the principles of value investing followed by billionaire Warren Buffett.

Klarman has generated an annual compound return of 20 percent in the past 26 years, the Bulletin said. He declined to comment in an e-mailed response to Bloomberg News.

'Same Scenario'

Cash holdings peaked one month before equities began to recover during the two longest recessions since World War II. In July 1982, money of zero maturity as a percentage of the U.S. stock market's value rose to 95 percent before a 20-month bear market ended and the S&P 500 began a six-month, 36 percent advance, data compiled by Bloomberg show.

Cash on hand reached \$604.5 billion in September 1974, representing a record 1.21 times U.S. stock capitalization. That preceded a 31 percent gain in equities between October 1974 and March 1975, Bloomberg data show.

"If history tends to repeat itself, we're in the exact same scenario," said Neil Hennessy, who oversees \$650 million as president of Hennessy Advisors in Novato, California. "Once the money starts to come back into the market, buying is going to beget more buying. People don't want to be left behind." Hennessy's Focus 30 Fund beat 96 percent of its peers this year.

Lighting the Match

The last time cash accounted for a larger proportion of market value was 1990. The ratio peaked at 75 percent in October of that year, after the savings and loan industry collapsed, Drexel Burnham Lambert Inc. was forced into bankruptcy and the U.S. fell into a recession. The S&P 500 rallied 23 percent in six months and almost 30 percent in a year.

Robert Doll, the chief investment officer of global equities at BlackRock, has been buying stocks anticipating the S&P 500 may rise as much as 20 percent next year. The firm oversees \$1.3 trillion.

"It's a mountain of cash," Doll, who is based in Plainsboro, New Jersey, said on Bloomberg Radio. "Somebody's just got to find the match and light it."

My view - Cash has been king for a number of months. The [yield](#) on 3-month Treasuries continues to flirt with 0% indicating that demand for these instruments remains high. As losing positions have been closed and leverage unwound commentators have struggled to come up with adjectives abysmal enough to describe sentiment. However, one surety is that all this cash will eventually find its way back into the markets in one form or another.

The most likely scenario, in my view, is that investors see enough value in company balance sheets that they are willing to start committing cash to the market around current levels. They will not be taking big positions, but may come in with enough size to pressure some of the shorts and spark a rally large enough to force other investors to reassess their bearish stance.

[S&P 500](#) and [Dow Jones](#) Industrials Average divergence from their 200-day

moving averages - The [S&P 500](#) and [Dow Jones Industrials](#) continue to range in the region of their October lows. While these markets have moved laterally for a number of months sentiment has deteriorated significantly. Forecasts of 20% further losses are commonplace but the majority of global indices, and Wall Street is no exception, would need to take out their December lows to question potential for base formation development.

Australian Dollar Gains on Gold Prices; N.Z. Currency Advances - This [article](#) by Candice Zachariahs for Bloomberg covers the recent positive action for the Australian Dollar. Here is a section:

The Australian dollar rose as the price of gold, the nation's third most-valuable raw material export, gained to an 11-week high as political tensions mounted in the Middle East. New Zealand's currency advanced.

The currencies also strengthened before reports this week that economists expect will show U.S. manufacturing shrank at the fastest pace since 1980. Prices of gold and crude oil rose for a second day after Israeli air strikes in the Gaza strip killed at least 285 people.

"The Aussie is benefiting from the improved tone in gold," said Robert Rennie, chief currency strategist in Sydney at Westpac Banking Corp. "The Aussie will remain within a 67.50 and 70 range for the remainder of this year," he said referring to the currency by its nickname.

Australia's currency rose 0.4 percent to 68.69 U.S. cents as of 3:14 p.m. in Sydney from 68.40 cents late in New York on Dec. 26. The currency advanced 0.1 percent to 62.17 yen.

New Zealand's dollar gained 0.4 percent to 57.77 U.S. cents from 57.55 in New York late last week. It bought 52.22 yen from 52.35.

The Institute for Supply Management's December factory index dropped to 35.4, the lowest reading in almost three decades, according to the median estimate of economists surveyed by Bloomberg News. A separate report may show a record drop in U.S. home prices accelerated in October.

Gold rose as much as 2.4 percent to \$890.49 an ounce, the highest since Oct. 10, after Israel called up reservists following two days of air attacks against the Hamas-led Gaza strip. Crude oil gained as much as 5.6 percent. The Middle East produces almost a third of the world's oil.

My view - The Australian Dollar has strengthened most against the [British Pound](#) over the last few months and is now testing the highs seen in the summer. Further upside will be more difficult from here. This move is an exception when compared to how the Australian Dollar has performed compared to other currencies.

It fell precipitously against the [US Dollar](#) from July before finding support near 60¢ in October. A sustained move below that level would be needed to

question scope for some additional higher to lateral ranging. In the short-term, the currency is testing the upper side of its three-month range and a downward dynamic would be needed for this area to provide anything more than a brief pause.

The Australian Dollar also found support in October against the [Euro](#), [Japanese Yen](#), [Swedish Krone](#), [Canadian Dollar](#), [Chinese Renminbi](#), [Indian Rupee](#), and [Singapore Dollar](#) and would need to take out those lows on a sustained basis to question scope for some further higher to lateral ranging.

Last week's signups for the Free (Abbreviated) Comment of the Day - For the week of December 21st new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, Canada, France, India, Malaysia, Poland, the UK and the USA - 8 in total. In descending order, which topped the list in terms of the last week's new signups? It was the USA, Australia and India.

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.

Wednesday 31st December 2008

Stock Markets: Yearend Technical Review - It has been a year that most investors are relieved to leave behind but looking ahead we can take some comfort from two historical facts:

1. Bear markets do not last forever.
2. The biggest bear markets are followed by the best recoveries.

The long-term foundation for the next recovery will be laid down by fundamental economic factors. However, since sentiment is such a crucial influence on markets, the evidence of recovery will not appear first in fundamental data, which is reported some months after the event. The stock market is a discounting mechanism. Consequently evidence of significant recovery potential will appear on the price charts before anywhere else.

An update and reassessment of developments may help investors as they consider opportunities and strategies for the New Year.

Singapore (FSSTI - [data](#) - charts shown on [p&f](#), [weekly with MA](#) & [daily](#)) - One of the most stable economies and best value markets, Singapore's May-October slide appeared climactic and commencing with the low on 28th October, the big days (dynamics) have been on the upside (note blue candles

on the daily chart). The current ranging pattern shows base formation characteristics from upward dynamics to rising lows. A move beneath the early-December low would suggest at least a retest of the lows, and offset current scope for sideways to higher ranging.

China (SHCOMP - [data](#), [p&f](#), [weekly](#) & [daily](#)) - Drifting beneath early-December low, questioning role as a possible leader of eventual recovery; needs push back above 2000 and a higher high on the p&f to remain consistent with base formation development.

Australia (AS51 - [data](#), [p&f](#), [weekly](#) & [daily](#)) - Australia had lagged until this week but would show further evidence of base development on a sustained break above 3750. Conversely, a close beneath 3500 for more than a day or two would be a concern. Australia's stock market could improve quickly given a stronger performance by oversold industrial commodities, notably base metals.

India (SENSEX - [data](#), [p&f](#), [weekly](#) & [daily](#)) - Here also a higher high on the p&f is needed to increase evidence of base development and the early-December low is probably important since the current range is little different from earlier pauses, other than occurring at a lower level and against the background of rate cuts.

UK (FTSE 100 - [data](#), [p&f](#), [weekly](#) & [daily](#)) - Interestingly, the p&f shows both a higher high and a higher low (previously it showed only one or the other but not both) for the first time since the bear market commenced. Upward dynamics within the current range are encouraging but a close beneath 4200 would provide the first evidence of a lower phase of base development.

Germany (DAX - [data](#), [p&f](#), [weekly](#) & [daily](#)) - Here also the p&f shows a higher high and higher low for the first time since the top was completed. This is an interesting clue in terms of base development but not conclusive - nothing is except with hindsight when the next uptrend is well underway. Note the encouraging upward dynamics; a close beneath 4500 is required to indicate a lower phase of base extension, and below 4300 to question the base building hypothesis.

Switzerland (SMI - [data](#), [p&f](#), [weekly](#) & [daily](#)) - Underperforming within range and needs a higher high on the p&f to reaffirm support from the November low. The valuation data is uncompetitive relative to others shown.

(Note: Charts shown below include some of today's action, where open, but not the closes.)

USA (S&P 500 - [data](#), [p&f](#), [weekly](#) & [daily](#)) - Upward dynamics offer some hope that the current range is a base formation but it is important that the early-December lows hold. Meanwhile, a retest of 1000 would be an extremely positive development. Here also valuation data is uncompetitive.

Canada (SPTSX - [data](#), [p&f](#), [weekly](#) & [daily](#)) - Canada's p&f shows a higher high and higher low for the first time since the last bull market's peak. An

extension in the sequence of rising lows evident on the daily and weekly charts would be extremely positive.

Subscribers can vet any other indices in the Library, and if you are comparatively new to factual chart reading, the examples above at least provide a template for additional assessments. It is never too late for any of us to learn.

(See also yesterday's 10-point feature on stock markets, including some leading indicators.)

Jim O'Neill Says Government Will Lead the Way: Year in Review - [Here is the opening for this item](#) from Bloomberg:

This year was easily the most tumultuous of my 27 years in international finance. A number of never-in-our-lifetime events occurred, all of which individually had the power to impact the world, but together have left us with a profound sense of uncertainty as we turn the year.

One thing for sure: The advanced economies have entered the largest synchronized recession that many of us have ever seen. The measures to get out of this -- to ensure medium- to long-term sustainability of growth, low inflation, a healthier environment, and a world in which the most-needy can advance -- are going to require our policy makers to be bold and ambitious.

For 2009, I look forward to the inauguration of President- elect Barack Obama, as he appears to be up to the challenge. The difficult times we have entered require governments to take strong actions, using their own direct involvement in the economy in a manner the world hasn't witnessed since perhaps the aftermath of World War II.

Luckily, along with the strength and speed of reaction from the all-important Chinese, the new U.S. leadership might just be what we need. I look forward to bold fiscal expansion in both nations, helping to lead the world to recovery from the terrible turmoil of this year.

As the year closes, the depth of the crisis facing the world might allow policy makers to marry the cyclical challenge with a shared commitment to improving the environment and meeting the energy and climate challenge. I suspect we will get considerable initiatives in these areas.

My view - [A reasonable summary, albeit on the optimistic side of most economic forecasts. However that does not make it wrong.](#)

Gold Heads for Record Eighth Annual Gain on Dollar, Recession - [Here is the opening for this report](#) from Bloomberg:

Gold headed for a record eighth annual gain in London on expectations that the dollar and global economies will weaken, bolstering demand for the metal

as a hedge against further declines in the currency and as a haven.

Gold rose 3 percent this year, preserving investors' money as \$30 trillion was wiped off equities and the Reuters/Jefferies CRB Index of 19 raw materials headed for its worst year in a half-century. The dollar index, measuring the currency against six counterparts, fell this month after the Federal Reserve cut its benchmark interest rate to a range of zero to 0.25 percent.

"What's really driving gold at the moment is pressure on the dollar from the Fed lowering interest rates relative to other foreign currencies and other central banks," David Meger, a senior analyst at Alaron Trading Corp., said from Chicago, predicting that bullion will trade at \$840 to \$880 an ounce in the first quarter of 2009.

My view - [Gold \(p&f, monthly, weekly, daily and inflation adjusted\)](#) continues to merit investor interest but it is not the best-value metal today. Platinum ([p&f, monthly, weekly, daily, inflation adjusted](#) & relative to gold [monthly & daily](#)) is cheaper and just beginning to recover.

[Nickel \(p&f, monthly, weekly, daily, relative to gold & inflation adjusted\)](#) is also far cheaper today and while it is not a monetary metal, will be critical for global infrastructure development. Other industrial metals are also cheap but show less evidence of base formation development to date, possibly because they topped out later than nickel.

Happy New Year to all our subscribers - [and a healthy, peaceful and prosperous 2009.](#)

Additional Commentary by Eoin Treacy

Dollar Heads for Biggest Annual Drop Against Yen in Two Decades - [This article](#) by Ron Harui and Andrew MacAskill for Bloomberg covers the performance of the Yen, particularly against the Dollar over the last year. Here is a section:

The yen was the best performer of 2008 among the world's 16 most-active currencies against the dollar, while the pound was the worst, sliding 27 percent.

Near-Zero Rates

The U.S. Dollar Index traded on ICE futures in New York, which tracks the greenback against the currencies of six trading partners, fell this month after the Federal Reserve cut its benchmark interest rate to a range of zero to 0.25 percent for the first time and shifted its focus to debt purchases to revive the economy. Consumer confidence is the lowest in at least 41 years and a slide in property prices gathered pace in October, according to U.S. reports published yesterday.

"The U.S. reducing rates to near zero is having an impact," said Gerrard Katz, head of foreign-exchange trading in Hong Kong at Standard Chartered Plc, a U.K. bank that gets most of its profit from Asia, in an interview with Bloomberg Television. "In the second half of 2009, we should see the dollar weaken."

Bailouts

The U.S. government this year enacted a \$700 billion Troubled Asset Relief Program and used half of those funds to help banks. The Treasury this week committed \$6 billion to support GMAC LLC, the financing arm of General Motors Corp., widening the government's effort to keep the largest U.S. automaker out of bankruptcy.

The Institute for Supply Management's December factory index probably dropped to 35.4, the lowest reading in almost three decades, according to a Bloomberg News survey of economists. The report is due on Jan. 2.

The Standard & Poor's 500 Index plunged 39 percent in 2008 as the economy deteriorated, poised for its worst year since 1931. U.S. Treasuries returned 14.9 percent, the most since 1995, according to Merrill Lynch & Co.'s U.S. Treasury Master index. The Dollar Index is set for a 5.1 percent advance.

"The data is still going to look quite poor," said Besa Deda, chief economist at St. George Bank Ltd. in Sydney. "It's negative for the dollar."

My view - The Yen strengthened considerably as panic hit international markets from the late summer and carry trades were closed. This turned into a self-feeding trend as increasingly large numbers of investors came under pressure and were forced to close more positions and buy back their Yen shorts. This saw the Yen go from being one of the weakest currencies in the world to one of the strongest.

The [US Dollar](#) remains in a downtrend against the Yen with an unbroken progression of lower highs. A sustained move back above ¥92.5 would be needed to question this consistency and hinder scope for some further weakness. However, this is not the whole story. The Yen continues to strengthen against the US Dollar more because of the Dollar's recent weakness against a wide basket of currencies rather than any broad based strength. The Yen is also strong against the [Ruble](#) and the [British Pound](#); two fundamentally weak currencies right now.

The Yen hit a peak near 8.8¢ in October against the [Euro](#) and has failed to revisit that level since. One of the points we stress at The Chart Seminar is that a broadening formation following such an accelerated advance is seldom a reliable continuation pattern. A sustained move above 8.5¢ would be needed to question top formation development. This is also an indication that the pace at which carry trades were being closed has slowed considerably and may even be reversing.

The Yen has fallen even further and more abruptly against the [Swiss Franc](#) and while it is probably somewhat overstretched in the short-term, it would

need to sustain a move back above CHF1.3 to question further downside potential over the medium term.

The Yen has also lost momentum against the [South African Rand](#), [Swedish Krone](#), [Canadian Dollar](#), [Australian Dollar](#), [New Zealand Dollar](#), [Singapore Dollar](#), [Indian Rupee](#), [Brazilian Real](#) and [South Korean Won](#). It would need to sustain moves to new highs against all of these currencies to question potential for some further retracement of 2008's gains.

Maple Leaf Memo: Higher Ground - Thanks to Roger Conrad for his informative [ezine](#), which this week discusses distribution cuts and how to spot good balance sheets. Here is a section:

Some businesses face more difficult roads than others. You can see that variation in the microcosm that is the Canadian Edge Portfolio, but in the main our recommendations have used cash flows made possible by strong operating conditions to position themselves to withstand the further stress the global financial crisis and corresponding economic downturn better than most companies. Companies saddled with disproportionate amounts of debt before the global financial system buckled face rocky rides.

What can be said generally about CE Portfolio trusts is that they entered this tumultuous period in positions of relative strength. Oil and gas trusts, in particular, used significant second quarter windfalls to pay down existing debt and fund capital expenditures.

Some, such as ARC Energy Trust (TSX: AET-U, OTC: AETUF) and Enerplus Resources (TSX: ERF-U, NYSE: ERF) have already taken prudent steps to ensure long-term sustainability of their distributions.

The quickest way to understand a trust's ability to cope is to look at its payout ratio; lower rates correspond to greater financial flexibility because excess funds from operations can be invested in capital expenditures for the long term or be utilized to repay debt and reduce leverage.

Declines in commodity prices will directly impact cash flows, payout ratios and use of debt to fund development projects going forward. Banks are faced with reduced capacity to lend, which limits trusts' access to capital and will push borrowing costs higher.

The current environment is challenging for all, but relatively conservative balance sheets and capital structures put solid oil and gas trusts in position to weather the storm better than most.

My view - Distributions are being cut right across the income trust sector and most especially where they have been boosted because of higher revenues taken in while energy prices were close to historic peaks. However, much of this bad news has already been priced into the sector, seeing many trusts fall precipitously over the last year.

The [S&P/TSX Capped Income Trust Index](#) is losing downside momentum. A sustained move below 80 would now be needed to question scope for some further higher to lateral ranging, while a move above 110 would suggest the bulls have regained the upper hand. Here is a list of [75 trusts](#) ranked in ascending order by their dividend payout ratio which might be of interest to those researching this sector. We would strongly recommend doing one's own due diligence before considering any investment.

[ARC Energy Trust](#) found support near C\$15 in October and remains within a range. A sustained move to new lows would be needed to question scope for some further higher to lateral trading.

[Enerplus](#) remains in a downtrend but has lost substantial momentum. A sustained move below C\$21 would be needed to question scope for higher to lateral ranging.

Friday 2nd January 2009

Happy New Year! - In market terms, 2009 would have to try very hard to be worse than 2008 and it is much more likely to be a lot better. Those of you returning from holiday may be interested in Fullermoney's two features on stock markets, posted on 30th and 31st December - just click on the 'Previous Item' link, above left.

One of December's great pleasures for the Fuller household was the BBC's splendid adaptations of several novels by Charles Dickens. My favourite was Little Dorrit, an entertaining morality tale, published in 1857, but just as relevant today.

Among the book's secondary characters was Mr Merdle, a much admired and sought after banker, who was later revealed to be running a 'Ponzi scheme', long before the infamous Charles Ponzi, not to mention Bernard Madoff, were born.

There was also Mr Plornish, a kindly, simple philosopher: "There was ups, you see, and there was downs." How true, and in markets one follows the other. This obvious point is worth remembering as we embark on 2009's investment and trading adventures.

Clive Hale's View from the Bridge: Poll of polls - We can expect many interesting letters from Clive Hale in 2009 and I believe the next one will contain his observations on Thailand. This [issue](#) of View from the Bridge mentions me but do not hold that against him. Here is the opening:

The voting is over, the result is in and by an overwhelming majority no one has the foggiest idea about what actually comes next, which is a small vote for sanity as those who profess to "know" are due a good "shipwrecking on the laughter of the gods".

There have however been some excellent ruminations. In the red corner the supporters of the end of the world include Robert Prechter of Elliott Wave fame (www.elliottwave.com) whose targets I won't trouble you with for fear of apoplexy (at best!). He is also one of the founders of the study of Socionomics of which more anon. For the rabidly bearish I can also recommend the Daily Reckoning (www.dailyreckoning.com) writ large by Bill Bonner who is both plausible and terrifying at the same time.

In the blue corner the doyen of value investors and sometime Yorkshire man Jeremy Grantham at GMO (www.gmo.com) is a steady buyer of equities, but admits that the curse of the value manager is to be too early. My good friend David Fuller (www.fullermoney.com) is also siding with the bulls but would be a lot happier if a touch of confidence returned to the market; after all, as he points out to the battered and bruised investors of the class of 2008, "bear markets don't last forever".

My comment - [Don't miss Clive Hale's last paragraph.](#)

My personal account: ArcelorMittal long position opened; copper futures long opened - [Having mentioned on 24th December](#) that I would most likely add [ArcelorMittal](#) (MT NA, and also traded on many other exchanges) to my portfolio, I opened a long position in the share this afternoon. Preferring to allow my cash position to compound interest in New Zealand dollars, I have financed this purchase with excess credit margin in a spread-bet account. Nevertheless, I regard ArcelorMittal as a long-term investment position. I paid €17.94 for a June contract, including spread-bet dealing costs. This evening I also opened a long in [copper](#) (CMX), paying 146.55¢, including spread-bet dealing costs, for a March position.

More on investor psychology as the New Year commences - [The market crowd loves heroes. After selecting a new hero on the basis of a great call or performance, the crowd of investors hangs on their every utterance, until they eventually stumble, causing the crowd to search for a new hero.](#)

Among economists, Nouriel Roubini is the hero of the last two years and counting. In a recent interview with the [Financial Times](#), which I posted on 24th December, Roubini said: "We are going to avoid the Great Depression and a severe recession even if there is a risk of protracted slow economic growth." However he did expect another 15 to 20 percent downside risk for stock markets because "macro news is going to be much worse than expected."

Worse than expected by whom? Most of us think the news will be dire for at least the first half of 2009 and many pundits are talking about a depression, although Fullermoney is not among them and more importantly, neither is Roubini according to the FT.

So where does this leave investment managers as they return from holiday?

Nervous, I would say, only this time the fear will be of being left behind in a rally, if stock markets extend their yearend gains in early January. After all, shares have steadied and show some evidence of base development, provided those December reaction lows continue to hold.

Also, stock markets have been edging higher despite bad economic news recently. Consequently one does not require a degree in psychoanalysis to conclude that much of the bad news has been discounted. If Roubini, who forecast the economic crisis does not expect a depression, why should we?

Might some investment managers, flush with cash, feel that Roubini's 15 to 20 percent downside risk is worth taking if stock markets are moving away from them on the upside? I think so. Arguably, the only thing worse than losing money in a downturn, is missing out on a good rally when so many feel that valuations are cheap.

Today's interesting charts - Price charts show you the current facts, in terms of market supply and demand.

Ireland (ISEQ) - Steadied near November low, and a new closing low is now required to offset current scope for sideways to higher ranging.

Sweden (OMX) - Another upward dynamic within this potential base characterised by rising lows; a close beneath 645 is now required to offset current scope for sideways to higher trading.

France (CAC) - Similar to above, with a close beneath 3100 now being required to question sideways to higher trading.

Netherlands (AEX) - Rising lows and testing recent highs in potential base formation; would need close beneath 240 to question sideways to higher trading.

Hong Kong (HSI) - Steadied in upper region of potential base, and would need a close beneath 13800 to offset current scope for lateral to higher ranging.

Nickel (LME 3M) - Rebounded from \$10000 region once again to test November high and a downward dynamic is required to indicate more than temporary resistance here. Interestingly, the last three days comprise the best weekly gain since the \$30000 region.

Zinc (LME 3M) - Same as above.

Note: charts below include today's action but not the close.

Crude Oil (NYME) - Upward dynamics have checked downtrend consistency by breaking the long sequence of lower trading range steps. A new closing low is now required to question sideways to higher trading.

Brazil (IBOV) - Another upward [dynamic](#) to test lateral resistance near 40000 once again in potential base formation; a close beneath 36350 is required to reaffirm resistance here and offset scope for an upward break.

USA (Dow) - Testing lateral [resistance](#) near 9000 once again against a background of rising lows, and a close beneath 8350 is now required to reaffirm more than short-term resistance near current levels.

Keynes offers us the best way to think about the crisis - This is an excellent [column](#) by Martin Wolf for the Financial Times, posted without further comment. Here is the opening:

We are all Keynesians now. When Barack Obama takes office he will propose a gigantic fiscal stimulus package. Such packages are being offered by many other governments. Even Germany is being dragged, kicking and screaming, into this race.

The ghost of John Maynard Keynes, the father of macroeconomics, has returned to haunt us. With it has come that of his most interesting disciple, Hyman Minsky. We all now know of the "Minsky moment" - the point at which a financial mania turns into panic.

Like all prophets, Keynes offered ambiguous lessons to his followers. Few still believe in the fiscal fine-tuning that his disciples propounded in the decades after the second world war. But nobody believes in the monetary targeting proposed by his celebrated intellectual adversary, Milton Friedman, either. Now, 62 years after Keynes' death, in another era of financial crisis and threatened economic slump, it is easier for us to understand what remains relevant in his teaching.

I see three broad lessons.

The first, which was taken forward by Minsky, is that we should not take the pretensions of financiers seriously. "A sound banker, alas, is not one who foresees danger and avoids it, but one who, when he is ruined, is ruined in a conventional way along with his fellows, so that no one can really blame him." Not for him, then, was the notion of "efficient markets".

The second lesson is that the economy cannot be analysed in the same way as an individual business. For an individual company, it makes sense to cut costs. If the world tries to do so, it will merely shrink demand. An individual may not spend all his income. But the world must do so.

The third and most important lesson is that one should not treat the economy as a morality tale. In the 1930s, two opposing ideological visions were on offer: the Austrian; and the socialist. The Austrians - Ludwig von Mises and Friedrich von Hayek - argued that a purging of the excesses of the 1920s was required. Socialists argued that socialism needed to replace failed capitalism, outright. These views were grounded in alternative secular religions: the former in the view that individual self-seeking behaviour guaranteed a stable

economic order; the latter in the idea that the identical motivation could lead only to exploitation, instability and crisis.

Keynes's genius - a very English one - was to insist we should approach an economic system not as a morality play but as a technical challenge. He wished to preserve as much liberty as possible, while recognising that the minimum state was unacceptable to a democratic society with an urbanised economy. He wished to preserve a market economy, without believing that *laissez faire* makes everything for the best in the best of all possible worlds.

This same moralistic debate is with us, once again. Contemporary "liquidationists" insist that a collapse would lead to rebirth of a purified economy. Their leftwing opponents argue that the era of markets is over. And even I wish to see the punishment of financial alchemists who claimed that ever more debt turns economic lead into gold.

Yet Keynes would have insisted that such approaches are foolish. Markets are neither infallible nor dispensable. They are indeed the underpinnings of a productive economy and individual freedom. But they can also go seriously awry and so must be managed with care. The election of Mr Obama surely reflects a desire for just such pragmatism. Neither Ron Paul, the libertarian, nor Ralph Nader, on the left, got anywhere. So the task for this new administration is to lead the US and the world towards a pragmatic resolution of the global economic crisis we all now confront.

Please note - [Eoin is away today](#).

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

"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair, we had everything before us, we had nothing before us, we were all going direct to heaven, we were all going direct the other way - in short, the period was so far like the present period, that some of its noisiest authorities insisted on its being received, for good or for evil, in the superlative degree of comparison only."

Charles Dickens (1812-1870), *A Tale of Two Cities*

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