

# 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 5th January 2009

Tim Price: Farewell to all that - [Subscribers who have enjoyed Tim Prices' reports over the last year will recall that he has variously entertained us with inspired wit and also provided some very sagacious thoughts on investment strategy and timing. This New Year issue, published by PFP Wealth Management, is packed with the latter. Here is a brief sample:](#)

Investors betting on deflation are betting against the historic success of western governments at fostering inflation. While the timing will inevitably be a matter for debate, hence Sean Corrigan's reference to the "far side" of our present "deep valley", deflationists are also underestimating the historic scale of the current intervention. Jim Bianco of Bianco Research recently tried to put just the US figures into context. He concluded that the extent of the US bailout to date is currently bigger than all of the following US government expenditures combined:

- The Marshall Plan. Cost: \$12.7 billion. Inflation-adjusted cost: \$115.3 billion.
- The Louisiana Purchase. Cost: \$15 million. Inflation-adjusted cost: \$217 billion.
- Race to the moon. Cost: \$36.4 billion. Inflation-adjusted cost: \$237 billion.
- Savings and Loan crisis. Cost: \$153 billion. Inflation-adjusted cost: \$256 billion.
- Korean War. Cost: \$54 billion. Inflation-adjusted cost: \$454 billion.
- The New Deal. Cost: \$32 billion (est.). Inflation-adjusted cost: \$500 billion (est.)
- Invasion of Iraq. Cost: \$551 billion. Inflation-adjusted cost: \$597 billion.
- Vietnam War. Cost: \$111 billion. Inflation-adjusted cost: \$698 billion.
- NASA. Cost: \$416.7 billion. Inflation-adjusted cost: \$851.2 billion.

That aggregate total of \$3.9 trillion is \$686 billion less than the cost of the credit crisis in the US thus far. And as commentator Barry Ritholtz points out, the only event that comes close to the cost of the current financial crisis is World War II, with the inflation-adjusted cost borne by the United States summing to some \$3.6 trillion. Bloomberg calculates that the US taxpayer is on the hook for a total of \$7.76 trillion of liabilities, which equates to \$24,000 for every man, woman and child in the country.

My view - [This helps to put the combined US Federal Reserve and Treasury reflation / bailout effort - recent and pending - in perspective although I will](#)

quibble with one statistic. The figure cited above for Iraq may cover the invasion and regime change, but the true cost of the entire campaign to date is probably much closer the \$3 trillion [cited](#) by Joseph Stiglitz. And this is before the ongoing cost of caring for injured veterans, which will continue for decades.

However I digress - the key investment point here is that investors should recall the time-honoured adage: 'Don't fight the Fed.'

I commend to readers the rest of Tim Prices' interesting and informative points, not least concerning the Altman Z Score, plus commodities viewed in an historic context.

For Fullermoney's outlook on stock markets, see also Comment of the Day and Audios for last week, posted every day except 1st January.

Although I have not done the Altman Z Score calculation for ArcelorMittal, I did post Bloomberg's Ratios page for this top steel company on [24th December](#), before purchasing it myself on 2nd January. I doubt many companies will score more highly and also benefit from the global infrastructure programmes promised by governments, from China to the USA.

At this early stage of the recovery cycle for global stock markets, among individual shares I favour industry leaders with strong balance sheets, which are also beginning to show relative strength on price charts. I also like indices, ETFs and funds which reflect Fullermoney themes such as Asia, resources and global infrastructure.

Accordingly, here are the equity positions that I have opened in the last three months and continue to hold today: Blackrock World Mining Trust ([BRWM LN](#)), Singapore Blue Chip Index (also known as [MSCI Singapore SGY](#)), the Nikkei 225 Index ([NKY](#)) and ArcelorMittal ([MT NA](#)). I may increase these positions and am likely to add more while stock markets maintain an upward bias.

Email of the day (1) - For pre-subscribers:

"Hi David. I have been a daily reader of your free daily blog, and I must say I am very impressed with your daily take on the market. Would you kindly email me with a yearly subscription fee?"

My comment - Thank you for the feedback and welcome to Fullermoney. Sarah Harrison ([sharrison@fullermoney.com](mailto:sharrison@fullermoney.com)) has contacted you separately, regarding your subscription. Interested parties can also access subscription data on the site by clicking on the link shown centre above. Annual subscriptions offer the best terms because on renewal you will always receive a loyalty discount for continuous renewal.

Email of the day (2) - On banking shares:

"You have often said unless the banking shares go up in prices, the overall mkt is not going up - i.e what is good for bank shares - is good for the mkt.

"Under the current scenario, bank shares (with govt as a shareholder) are unlikely to go up. Does it mean that the upside in overall mkt is limited?"

My comment - Fullermoney regards bank shares as a lead indicator and therefore we favour stock markets with sound banking sectors.

My personal portfolio: Profits taken in platinum futures longs - On seeing a stronger [US Dollar Index](#) this morning and weaker prices for [gold](#) and [silver](#), I took the precaution of booking profits in the comparatively steady [platinum](#) market. Accordingly, I sold approximately 90% of my April platinum longs at \$938.9 today, against the rollover purchases at \$918.2 on 29th December. The remaining 10% platinum position in another account was sold at \$938.1 against equal-sized purchases at \$918.5 and \$906.6 on 29th and 30th December, respectively. These prices include all spread-bet dealing costs. I should add that I remain very bullish of platinum's medium and longer-term upside prospects and will almost certainly buy it once again, ideally during a pullback. Judging by today's performance, I may have to pay up for it.

Email of the day (3) - On Mark Faber, printing money and commodities:

"I came across this YouTube [video](#) of Mark Faber who apparently appeared on CNBC a few days ago. It seems Mr. Faber's recent bearishness towards commodities and natural resources has been quite short-lived and he now believes the global money printing machine will soon begin to spill over into precious metals, oil, and interestingly enough, industrial metals. He makes the point that the sell off in oil and industrial metals is even greater than in equities. It will be interesting to see whether base metal commodities could enjoy any significant bear market rally without any positive economic news or reports. I have been reading consistent reports of discontinued projects or new projects put on hold recently and a bet on copper and its ilk certainly would give one an interesting contrarian play. I noticed that you have just taken that step. I suppose we need to tweak the theme to "rapidly expanding paper money meets inelastic supply"."

My comment - Thanks for the link - it is a good interview, which I have posted in the Subscriber's Area. Also, I like your "tweak" to the theme - Supply Inelasticity Meets Rising Demand - which has taken a recession breather.

Initially, fundamentals of producer supply and consumer demand drove commodity prices higher for several years, before speculation took over, leading to accelerated peaks. The speculators were subsequently blown out, as we know, and demand inevitably plummeted in line with the global recession.

Producers have sensibly responded by reducing output. As reflationary efforts eventually revive the global economy, demand for industrial commodities will

pick up once again. Meanwhile China and some other countries, knowing that they will need these metals in coming months, may decide to stockpile while prices are incredibly cheap.

I did not expect industrial metals to fall this far, but I believe that all of them are now very oversold. Price charts have recently indicated that a new base building process has commenced. I bought [nickel](#) last month, before I bought [copper](#), and I am likely to add to my longs in industrial metals.

Email of the day (4) - [On financing the US debt](#):

"With: 1) the government now guaranteeing everything; 2) M1 & M2 money supply on a 13 week annualized basis now growing at 50 & 20 % respectively; 3) government yields now lower than the rest of the world, and guaranteed by the FED & Treasury to stay that way (extra printing presses now installed in the basement); and 4) our debt now growing at a monstrous pace;

"When do you think the rest of the world will stop financing our debt or demand rates to compensate for the above?"

My comment - [Good question](#). I do not know the answer but we can be certain that they are not motivated by charity. Creditor countries will be influenced by currency action, yield and most of all, the USA's ability and propensity to import goods manufactured by other countries. Meanwhile, this marriage of convenience has seldom looked more compromised.

Email of the day (5) - [On timing](#):

"A quick note to wish you well for the new year and good health to your family most importantly.

"I will add a question too which I hope will benefit all in the new year too. It appears the coming year may present some great investing opportunities and I personally have my eye on a number of stocks and ETFs I favour. My question is, well, I will make an assumption first .... when you favour a particular instrument and the fundamentals are sound you must have a reason to then get yourself into this investment. Now this assumption may be wrong, you may just wake up one morning and find that last bit of fundamental news and bingo, you invest. However, it leads to my question, as you are, like me, quite technically orientated, what do you look at (technically) to get into a specific instrument once you are happy with the fundamentals? A 12 week breakout, a crossing MA, support holding, a rising 200MA? The answer to this would be of great benefit to me on establishing entry points on some of the instruments (on which the fundamentals are getting better) and I feel would also benefit the collective. I hope the question and the answer is not too (down to ones own preference) and that you can give some direction on what you guys personally like to see technically.

"Once again, best wishes for the new year and long may it be better than this (market) wise."

My comment - Thank you for your best wishes, which we return in kind. Thanks also for some important timing questions, relevant to us all.

I like the fact that you are combining both fundamental and technical factors. Thereafter, I doubt that a specific news item will be the determining factor, particularly on entry. For instance, when did you last hear any important news regarding gold, although most of us will have a fundamental and technical view of the yellow metal?

You will appreciate that answers to the technical questions you raise will vary depending on where we are in the cycle. However I assume that you are concerned today with entry points in what we believe are depressed asset values.

Inevitably, the answers do depend partly on your preferences, which I assume are based on experience. It would be absurd for me to say: No, what you suggest is wrong and this is right. There is certainly nothing wrong, in my view, with the technical screening that you suggest. After all, it is based on market action rather than technical theory.

However, the technical factors you mentioned: "A 12-week breakout, a crossing MA, support holding, a rising 200MA", will often occur well after the market bottom. You may wish to wait for that much evidence, or not. To me, they sound like useful screening tools, to ensure that you do not miss potential trend opportunities. But for every rising 200-day MA, I am certain you will see lots of prior bottoming signals.

We need some rules, and certainly discipline, but if we are too rules based we may be inhibiting intuition. My point is that we need to combine both. And we need to observe lots of charts, looking for relative strength when buying, whether that is a sudden upward dynamic in an overstretched downtrend which has been losing momentum, or the more obvious example of a breakout from a lengthy base formation. We also use commonality, as you know.

That is about as far as I can take your questions at this time. Going forward, all of us have the exciting and shared challenge of spotting opportunities and profiting from them more often than not.

Email of the day (6) - On sterling:

"What is your view on the GBP?? Do u think there is a buying opportunity to be had at current levels. Everyone hates it and no one wants it. It appears to be making some nice bullish divergences against various momentum indicators. Would appreciate your view on it."

My comment - [Competitive devaluation is a game of leapfrog, aided by momentum trading](#). You have identified that many people have been short sterling and that its declines against some currencies appear variously to be overstretched and / or losing momentum, at least for the short term.

Additional Commentary by Eoin Treacy

Stocks to Benefit from a 'New Energy Economy' - [Thanks to a subscriber for this interesting article from Seeking Alpha covering a number of shares which may benefit from increased interest in renewable energy](#). Here is a section:

Is there anyone who doesn't think that with Barack Obama in the White House, clean and green won't be hot in 2009, no matter what the state of the economy? Here are 10 publicly-traded companies that we think investors should look at carefully before the calendar turns and the new U.S. President details his plans for a green, efficient "new energy economy":

#10 centrotherm photovoltaics ag [FRA:CTN]: Shares of solar energy firms have been hammered, including for this German solar equipment manufacturer. But countries including the U.S. continue to pursue aggressive renewable energy standards despite the recession, and experts say solar power should be cost competitive with conventional electricity within two to four years. Thus centrotherm's strategy "to establish ourselves globally as a provider of production plants for solar silicon and turnkey production lines for the manufacturing of solar cells and thin-film modules" appears to have a lot of potential. It doesn't hurt that, in these trying economic times, centrotherm can pitch would-be customers that its equipment can cut their costs.

More immediately, the company, whose shares trade in Frankfurt, reported that its net income tripled in the first nine months of 2008. In a November 12 press release, the company forecast a strong fourth quarter and indicated that it expects to keep growing despite the global financial crisis.

#9 New Flyer Industries Inc. (NFYIF.PK): A favorite of Tom Konrad at [AltEnergyStocks.com](#), this Canadian company is the self-described leading manufacturer of heavy-duty transit buses in the U.S. and Canada, as well as a leading provider of aftermarket services.

Thanks to the push for greater energy efficiency in transportation, New Flyer, whose shares trade on the Toronto exchange, looks positioned to keep reporting strong growth. Among other recent developments, the company just delivered the first 22 of 150 new plug-in hybrid transit buses to the Chicago Transit Authority.

The company most recently reported third-quarter earnings and revenue roughly the same as the year-ago period. It said its order backlog is up 20% compared with December 30, 2007, and that it continues to experience near double-digit growth in aftermarket services.

While municipalities will be hard up for cash in 2009, as Konrad recently noted, Obama's fiscal stimulus should contain significant money for green, energy-efficiency related jobs. While new orders have slowed some, New Flyer's order backlog is still at record levels.

**#8 Waterfurnace Renewable Energy Inc. (WFIFF.PK):** This Indiana-based company makes and installs residential geothermal heat pumps. While its shares have fallen with the market, percentage-wise they have held up much better than many other clean, efficient energy providers, no doubt thanks to sales and earnings that keep rising in the teeth of, first, the housing crisis, and now, the deep overall recession.

Waterfurnace, whose product taps the earth's constant 55 degree temperature to heat and cool a house or other building by heating and cooling water depending on the season, most recently reported a 56% increase in third quarter net income over the year-earlier period on a 41% increase in sales. The company said it continues to benefit from consumers' penchant for wanting to save money and go green at the same time.

The company likely should continue benefiting in 2009, given that the recent Wall Street bailout bill passed by the US Congress provides significant tax credits for both homeowners and businesses that install geothermal heat pumps.

**My view -** This article relies heavily on the assumption that the incoming Obama administration will favour green technologies. President-elect Obama has certainly stated that he wants to spend serious amounts of cash on infrastructure projects, but it remains to be seen if those funds will be steered towards green energy technology. All of the shares mentioned in this article can be found in the Chart Library.

Government incentives are important for infrastructure development but the relative cost of energy is a more vital consideration for the long-term viability of most renewable energy sources such as wind, solar or geothermal. If, as seems likely, oil prices have begun a bottoming out process, then the allure of renewable energy may increase as the potential for growth is factored in. Oil would now need to sustain a move below \$40 to question the base building hypothesis.

Engineering companies such as [Fluor](#) and [Jacobs](#) have rallied well from their October lows and would need to sustain a move below \$42.50 and \$43 respectively to question further upside potential (Also see Comment of the Day on [November 27th](#)).

[Itron](#) found support near \$35 in late November and has since rallied impressively. It broke upwards once more last week and would need to sustain a move below \$57 to further upside potential.

[Ormat Technologies](#) found support near \$22 from early October and is currently testing the upper side of the range near \$32.50. A sustained move below \$28.50 would be needed to question potential for an upside break.

Both [Halliburton](#) and [Schlumberger](#) appear to be in base building phases having lost downward momentum from early October. Sustained moves below \$13.40 and \$37.40 would be needed to question scope for some further higher to lateral ranging.

Email of the day (1) - [on Asian growth](#):

"Let me on the first place wish you, your family and all at Fullermoney a healthy, happy and prosperous 2009. I have to admit that 2008 has been a financial disaster for me. In spite of all the signs written on the wall, I have kept hanging on to my investments (mainly in Asia) on the belief that subprime has nothing to do with water purification, infrastructure and consumer spending in Asia. How wrong have I been! There is no need to cry over spilled milk as the saying goes, so let's move on.

"But on a personal note, I spent from half October to half December visiting Laos, Cambodia, Vietnam, Thailand Malaysia and Singapore. Except for Thailand my personal feeling was that the growth in economical activity is mind blowing, yes there are issues, property markets etc. but I can not see that economic development in Asia is going to stop or reverse.

"A very interesting point was the massive growth of tourist from China in the last few years. In Borneo a guide told me that Chinese tourists were the majority these days, I think that looked a strong statement but there were certainly many in Borneo! My trip and the one last year to China only reconfirm that it will take (maybe) some time but the real future economic growth story comes from Asia. This is obviously only a personal experience but the local people I met and the discussions I had was mainly about aspirations to grow the business or to setup a business.

"This year I will go back to China I have to admit that I have fallen in love with Asia and especially with China!

"Back to Fullermoney: I could not find a chart showing the Global Corporate bond market, an indicator mentioned by Don Coxe, based on the fact that as long as the corporate bond market doesn't recover a real recovery of the economy is long away."

My comment - [Thank you for your insightful email and valuable firsthand feedback on economic life in Asia. Markets across of the Asian region have been hit hard by the credit crunch as liquidity contracted and investors were forced to sell profitable positions. This turned into a momentum play for those looking to pressure those caught on the wrong side of the liquidation trade. However, many markets have lost downside momentum and today saw a number post impressive upward dynamics.](#)

[Japan](#), [Hong Kong](#), [Singapore](#), [Indonesia](#), [Thailand](#), [South Korea](#), the [Philippines](#) and [Malaysia](#) all posted impressive upside moves today and most are either testing the upper side of two-month ranges or have already broken

upwards. The upside can be given the benefit of the doubt, in the short-term, provided they can sustain the moves above their respective December lows.

Valuations and prices have also returned to interesting levels for most of these markets. A number of fundamental conditions are now in place, such as lower energy prices, lower inflation, and low long-term yields for value investors to begin to think about where they want to have their cash in any recovery scenario. Asia is a leading candidate.

The closest I can find to an index of global bond prices is the [US\\$ Global Industrials BBB 10yr Index](#). Yields broke upwards in mid-September and surged to a high of 9.6%. The Index has since fallen to 7.5% and would need to sustain a move to new highs to question the view that this index has topped out for at least the medium-term.

The [spread](#) of Global BBB Industrials over Treasuries remains close to its highs of 550 basis points but would need to sustain a move above that level to question scope for further contraction. It remains likely that the corporate bond market bottomed in October and now represents a diminishing headwind for the wider economy.

Email of the day (3) - on corporate bonds:

"Can you please provide more of an analysis of opportunities and risks in corporate bonds? Given the focus of Fullermoney on Commodities and Emerging Markets, maybe you could focus your comments in these areas of expertise.

"The extraordinarily high yields on investment grade corporate bonds indicates that the market is discounting a high level of default: Yet on the basis that 'a sinking tide lowers all ships' there must be many good quality commodity companies that currently offer an excellent risk/reward ratio both in bond yields and future capital gain. Any guidance you can offer would be much appreciated."

My comment - Thank you for an interesting email and I agree that good value can be found in the corporate bond market. However, the best bargains in absolute terms have probably already been realised. In terms of the spread over Treasuries, relative value is still available since many [spreads](#) remain close to historic highs. I added, and commented on a large number of corporate bond yield and spread charts from early November. (Also see Comment of the Day on [November 26th](#))

The [iShares IBOXX Investment Grade Bond Fund](#) has retraced its entire accelerated decline and is currently testing the 5-yr downtrend. Further upside will be more difficult to achieve from here, but a sustained move below 98 would be needed to question scope for some further higher to lateral ranging. (Also see Comment of the Day on [December 19th](#))

Email of the day (4) - [on shorting Treasuries](#)

"May I kindly request you to add the following NYSE stock to our library:

-ULTRASHORT LEHMAN 20+ TREASURY PROSHARES ([TBT](#))"

My comment - [Thank you for this suggestion which can already be found in the Chart Library. To locate it, simply type TBT into the Chart Library's search engine.](#)

Email of the day (5) - [on shorting Treasuries and gilts](#)

"I am interested in obtaining exposure to a decline in US and UK bond prices at some stage within the next few weeks and I was wondering whether you are aware of any ETFs that give you such exposure?"

"Any help would be most welcome"

My comment - [It is possible to short the US Treasury market using the fund mentioned in the above email which will give you 200% leverage to the price. I'm afraid I don't know of an unleveraged alternative or of a fund that offers the ability to short Gilts. If subscribers can suggest relevant vehicles, I would be happy to add them to the Chart Library.](#)

Email of the day (6) - [on freight rates:](#)

"Could you include the Baltic Exchange sea Freight Index in the chart library? It is possibly one of the main indicators of global GDP recovery"

My comment - [The Chart Library has a section dedicated to Freight rates. The benchmark for this sector is the Baltic Dry Index. I'm afraid I could not find an index names the Sea Freight Index.](#)

Email of the day (7) - [on oil futures funds:](#)

"This week I bought USO (US Oil) expecting a technical bounce given its historical oversold condition. According to the info I found it is an ETF that only holds crude futures. The fact is that today crude futures are near 3% up while USO is 3% down. Am I missing something? There should be a correlation between them, I guess. Could you please help me understand it?"

·  
"Many thanks for your help and your constant coaching. Best wishes for 2009."

My comment - [Thank you for your kind words. USO is performing more or less in line with the oil price. However, because it holds futures contracts, any](#)

contango costs that may be incurred will be reflected in the price. This might help to explain the difference.

Email of the day (8 - 14) - on additions to the Chart Library:

"Please kindly add the Phaunos Timber Fund ([PTF](#) listed on AIM)."

And

"Could you please add Dalian Port Company Limited ([2880.hk](#)) and BYD Company Limited ([1211.hk](#)) to the Chart Library? Thanks very much."

And

"Could you please add the following Australian resources share to the chart library? Giralia - [GIR](#)

And

"Happy New Year to you and your family. Please can you add to the chart library...ETF Securities LTD ETFS's (1) Leveraged Nickel ([LNIK](#)) (2) Nickel ([NICK](#)) (3) Leveraged Lead ([LLEA](#)) they do not appear to have unleveraged Lead? I'm on holiday in Mauritius, so I'll call them on Monday to enquire. Many thanks,

And

"Good day and a happy, healthy & prosperous new year to you both. Thank you for your service during this last year. I look forward to another interesting year in all markets and a more profitable year than last year.

"Would you please add the following ETC to the chart library:

"Leveraged Crude Oil (London Code - [LOIL](#)) - last price \$6.60"

And

"Good morning gentlemen. Would you please add the following UK registered fund to the chart library?

"Lazard Emerging Markets Inc. ([LZEMG](#)) - last price 136.60"

And

" A very happy new year to you all. Could you please add ETF's: [OILS](#) and [OILG](#) to the library?"

My comment - Thank you all for your well wishes. All of these suggestions have been added to the Chart Library.

Email of the day (15) - on Australian fertiliser prices:

"Greetings from Southern NSW, Australia, harvest almost done, disappointing yields in our region, however better than last season. Really enjoy your commentary on all markets. Just referring to the chart library it does not appear that fertilizer (DAP, urea) prices are current in the 'soft commodities' section. This is of particular interest in our region where growers are budgeting for next season's planting with fertilizer costs still very high in \$A terms, a number of suppliers caught with large inventories of high cost product, already one senate inquiry, and rising anger in the bush. Merry Christmas, wishing you all a happy and safe festive season. The Australian cricketers coming back to the field."

My comment - Thank you for this informative email. You will find a number of DAP and urea prices in the Soft Commodities section but I'm afraid I could not locate any that are specific to Australia. If you could suggest a relevant benchmark, which I might find on Bloomberg, I would be happy to add it to the Chart Library.

## Tuesday 6th January 2009

How frightened were investors recently? - Judging from this 50-year yield [chart](#) of US 3m T-Bills, many US\$ holders were more frightened about their financial security than for well over 50 years. Now let us look a little more closely and consider the implications, which may not be what you expect.

To see the recent trends more closely, have a look at these charts of T-Bill yields ([monthly 10-year](#), [weekly 5-year](#) & [daily 1-year](#)). As you can see, T-Bill yields briefly moved marginally beneath zero last month.

People were so afraid that they were not asking for any return on their money. That level of fear cannot be sustained beyond the short term. Consequently, T-Bill rates are now edging higher, signalling that some investors are moving out of these positions.

Where is that money going? A chunk of it is flowing into equities and commodities, judging from the current rallies.

How high will T-Bill yields go and how choppy might the action be? I do not know, and neither does anyone else, but have a look at the 10-year chart once again. The trends have been good indicators, albeit somewhat lagging, of bull and bear market moves in equities.

My conclusion: For as long as T-Bill yields trade sideways to higher in an orderly fashion above zero, it would seem a good idea to have some investments in other assets, although not long-dated government bonds. My current preference is for quality equities, plus precious and industrial metals. I may also short government bond futures.

Email of the day (1) - [On an excellent contrary indicator:](#)

"  
I failed to catch this in real time, but thought I would pass it along anyway. I have found closures and re-openings of mutual funds with good long-term performance records to be excellent contrary indicators. Vanguard Precious Metals and Mining (VGPMX) in the US pursues many Fullermoney themes, including platinum, gold, copper, steel, and even coal. It closed to new investors in February 2006 and reopened October 31 2008. In retrospect, the re-opening date was within 5 days of the XAU October low and within 20 days of the fund's own low in November. We'll see if this holds as an ultimate low, but I have rarely incurred intermediate-term losses using this contrary indicator. Disclosure: I own shares."

My comment - Thank you so much for sharing a logical and educative indicator in the spirit of Empowerment Through Knowledge. Behaviourally, this indicator is very sound. A trend-chasing influx of funds cause manoeuvrability problems at a time when the manager is becoming concerned over valuations. The prudent decision, which the more responsible organisations may opt for, is to close the fund to additional participants and not reopen it until the manager is bullish of valuations once again.

So how do we play it?

If a fund you hold is doing very well and the managers close it to new money from investors, that is probably good news in the short term because a bubble is forming, but bad news over the intermediate to longer term because it will eventually burst. The strategy, I suggest, would be to monitor charts of the main constituents, and either lighten on evidence of trend acceleration or at least introduce a trailing stop. If that sounds like too much busy work, just consider a 10 or 15 percent trailing stop.

Conversely, if a formerly successful fund reopens for new investment money, it may be a good idea to check the constituents for loss of downside momentum. If so, that could be a signal that it is bottoming out prior to the next recovery.

Obviously fund closures in terms of additional investment capital and eventual reopenings are only part of the story, and each investor should do their own due diligence. However, the data is an obvious contrary indicator and therefore worth noting.

The problem: I am not aware of any single source providing this information, which presumably is not that easy to obtain. However we are a Collective and your editors would welcome additional input on this subject, similar to the email above, so that we can share more of the info and monitor its effectiveness.

Lastly, the [Vanguard Precious Metals and Mining Fund](#) looks like a recovery candidate to me.

Global Thematic Investors: Staying Awake - [We have just received the late-December issue of this interesting publication from Iain Little and Bruce Albrecht of GTI. Here is the opening:](#)

*"So if you wait for the robins, spring will be over."*  
Warren Buffett

Waiting is always hard. Waiting for recovery in global stock markets is excruciating. Emotions run riot. Hope. Disappointment. More hope. More disappointment. It's important not to forget why we're invested in the 8 long term global themes.

Remember that the emerging markets, where GTI has placed most of its bets, are *the* place to invest for the next 20 years. There are times when "long term" feels, well, rather too long. For many people there have been too many "King Lear on the heath" moments lately.

GTI is a bet on the urbanization of China (one new Houston, Texas per month), the emergence of a middle class of 400 million Indians, the inevitable greying of the population, the West to East power shift etc. None of this changed in the last year.

My view - [Fullermoney remains very interested in GTI's long-term investment themes.](#)

Also, do not miss [Bruce Albrecht's Hamburger List, which contains two stocks this month. On technical grounds, I prefer the second one.](#)

Email of the day (2) - [On Crook und Schwein:](#)

"First of all, Happy New Year!

"Second, your friend Jim Bianco has omitted two very important historical costs. Perhaps even four if he goes back to the Louisiana Purchase. One would have to include at least the cost of World War I and II above all. Then, if he wishes to go back a century, the cost of the Civil war and perhaps the purchase of Alaska. What is interesting is his inflation adjusted calculations, i.e. Marshall plan which works out to 9.1x, Korean war 8.4x, race to the moon 6.5x, New Deal 15.6x and Vietnam 6.28x.

"In reality, the devaluation of the US dollar since the end of the Vietnam war seems to be a bit higher, i.e. from 1973 to today the \$ has lost 3.9x (from CHF 4.30 to 1.10) the Swiss franc, and the Swiss franc has lost in purchasing power easily 50%.

"My Master, Franz Pick, always started his conferences in saying "First, never forget all governments are Crook and Schwein. The debasement of currency will inevitably lead to corruption in all stratuses of a society and economy". He pointed a finger as far back as 1968 at Russia as a prime example of a

thriving mafia and corruption due to its monetary policies. We couldn't believe him because we thought that the KGB would never have allowed such a phenomenon.

"Today, we believed that the government of the USA, the Standard & Poor's and Moodys and, above all, the SEC were our KGB, our watchdogs. But it seems that the debasement of the currency gives way to a current of corruption, far more powerful than any law or its capacities to be enforced. We have in essence a colossal Madoff economy where we are just realising that government receipts stemming from productive work are far inferior to government distribution, and the only difference with Madoff is the power of the printing press and the intellectual aberration of our so-called Keysian economists that have hired to glorify a rubber stamp the debasement of currencies as a miracle potion that should be administered to any economy...

"Albert Wojnilower described gold as a simple plaything that no longer has any importance. Unfortunately, this conception has brought ruin and is quite untrue. Since 1973 to this date, gold has fared far much better than the Dow Jones. Just like the story of the Golden Calf is a monumental disinformation, it's not the gold bug that is dangerous, it is the fanaticism of the anti-gold bug that has brought us to a very dangerous situation."

My comment - Thanks for your observations. For the record, I do not know Jim Bianco. However Tim Price, who quoted him, is a friend.

I agree with you regarding the inflation data, which may have been based on the CPI, which has often been altered to understate inflation. How fortunate to have known Franz Pick! I remember some of his comments, including this quote: "It is the greenback which is unstable, and not bullion."

Your last two paragraphs are a very forceful statement, which will resonate with many of us.

Email of the day (3) - [On the GBP/EUR rate](#):

"Long time blog lurker and occasional trial subscriber. 'Nibbling' on value, if you like, to coin one your own terms David! I've been playing chicken with the GBP/EUR rate in the past few weeks (I'm in Ireland) telling myself that when it got close to parity I was going to sign up for an annual subscription. I know it will be one of the best investments I will ever make. As a complete beginner I can't think of a better guide through the fascinating world of market investments.

"Keep up the very fine work."

My comment - [Welcome to Fullermoney](#), to which a euro-zone subscription, as you point out, has until recently never been cheaper. It is also a timely purchase in USD. And for those who know how to trade gold and its proxies, a subscription to Fullermoney will always be a negligible expense. Euro-zone residents will also find Eoin's next [Chart Seminar](#) - in Dublin on 19th and 20th

February - to be good value. I believe the timing will also be good in terms of market opportunities. (Please note: The early booking of £875 expires in 15th January.)

Thanks also for your enthusiasm, which I trust will be rewarded. Also, forgive me for offering some advice to a self-described "complete beginner": Read, listen, look at the price charts and think, but most of all, with investments and trades always make up your own mind.

Email of the day (4) - On the volume pattern for crude oil:

"Merry Christmas and a successful and healthy 2009 to you, your family, staff and all fellow subscribers.

"I have a small question re chart reading that may not mean anything, but I would be interested in your comments. On looking at Crude Oil NYME (cont) chart I am struck by the remarkably consistent volume pattern. Presumably this is because of contract rollovers or some similar event that occurs each month as it does not seem to correlate to any particular price movement."

My comment - Thanks for your good wishes.

We confess to not looking at the [volume](#) for crude oil very often but your conclusion makes sense.

My personal portfolio: HSI futures long trade opened, NKY futures long increased - Now that my other equity trades are protected with at least breakeven stops, I have opened an initial stake in the [Hong Kong Hang Seng Index](#), paying 15675 for a January contract. I also increased my [Nikkei 225 Index](#) long by 40%, paying 9338 for another March position. These prices include spread-bet dealing costs.

Email of the day (5) - On reducing gasoline consumption:

"I think a better way to reduce our consumption of gasoline would be to tax cars based upon their fuel efficiency. The higher the gas mileage the less the tax. That way you are directly affecting behavior and not penalizing those that have been prudent in buying fuel efficient cars and those lower income households that usually buy a used car. A graduated sales tax that is inversely correlated to fuel efficiency would do the trick. That would be too simple though."

My comment - That makes sense to me. I also think that the US government will commence graduated hikes in gasoline taxes once the economy shows clear evidence of recovery.

## Additional Commentary by Eoin Treacy

FT.com Alphaville: Beware, commodity index rebalancing ahead - [Thanks to a subscriber for this interesting piece](#) posted by Izabella Kaminska yesterday. It covers the potential for commodity index fund rebalancing to impact commodity prices. Here is a section:

The major commodity indices rebalance their respective asset weightings once a year (or occasionally more) - and with that comes a mass dose of buying and selling. The 2009 rebalancing is expected to start sometime this week.

Luckily, JP Morgan has produced its best guess of how the 2009 reweightings of the DJ AIGCI and the S&P GSCI indices will impact the market.

The weightings for both indices are released ahead of time, but begin to kick in the first few working days of the new year. In the case of the DJ-AIGCI - which JP Morgan estimates has \$25bn in funds tracking it - the new weightings come into force during the roll period that begins January 9th. The S&P GSCI index weightings kick-in after its January roll which commences January 8th. JP Morgan estimates about \$50 bn of investment into that index.

As the DJ weighting multipliers account for changes in US dollar-denominated values there is generally more potential for large changes there than in the GSCI, whose weightings are set in terms of ounces/tonnes (on the basis of liquidity and are weighted by their respective world production quantities).

Accordingly, JP Morgan see the most significant change coming in the DJ-AIGCI rebalance. Here the market weight of crude oil is expected to increase from 9.6 per cent to 13.8 per cent, gold from 10.8 per cent to 7.9 per cent, copper (COMEX) from 4.5 per cent to 7.3 per cent, live cattle from 6.4 per cent to 4.3 per cent and sugar from 4.7 per cent to 3.0 per cent. Meanwhile, S&P GSCI crude oil weight will go from 32 per cent to 33.8 per cent.

My view - [The reweighting](#) of commodity tracking indices could have a short-term impact on the direction of commodity prices and may have contributed to the recent positive performance of the industrial metals complex. However, grains have also done well over the last few weeks, with [soybeans](#) in particular leading, and they are not set for any particular benefit in the reweighting. The reweighting is unlikely to have a lasting effect on the trading characteristics of individual commodities. However, what is now clearly noticeable is that commodities which have been most heavily sold i.e. industrial metals and energy are rebounding while relative outperformers such as gold are coming under some short-term pressure.

[Oil](#) prices found support in the region of the top of the long-term base near \$40 and have since rallied impressively to break the medium-term downtrend. This rally, in all probability, marks the beginning of oil's bottoming process. In the last week, oil has posted a higher low, broken the progression of lower highs and posted a new higher high. At the very least, this is enough for bears to reconsider their positions and a sustained move back below \$35 would be

needed to question scope for some further higher to lateral ranging.

[Gold](#) rallied impressively, having found support near \$700 in October and is now testing the medium-term progression of lower highs and the [moving average](#). The yellow metal has been a relative outperformer over the course of the credit / solvency crisis when compared to both equities and commodities. Now that these other instruments are receiving more investor attention, gold has to compete more strongly for attention. Prices have spent a good deal of time around \$800 since August and it looks unlikely that the lows will be retested in the short-term. However, a sustained move above \$900 is needed to break the medium-term progression of lower highs and confirm that the bulls have regained the upper hand.

The Dow Jones [Industrial Metals](#) Index broke downwards from its ranging top formation in August and quickly fell to near 90 where it found support. It rallied well last week and would need to sustain a move to new lows to question scope for further base formation development.

China faces wave of unrest in 2009 -official report - Thanks to a subscriber for this interesting [article](#) by Chris Buckley for Reuters which appears in Forbes.com. Here is a section:

China faces surging protests and riots in 2009 as rising unemployment stokes discontent, a state-run magazine said in a blunt warning of the hazards to Communist Party control from a sharp economic downturn.

The unusually stark report in this week's Outlook (Liaowang) Magazine, issued by the official Xinhua news agency, said faltering growth could spark anger among millions of migrant workers and university graduates left jobless.

'Without doubt, now we're entering a peak period for mass incidents,' a senior Xinhua reporter, Huang Huo, told the magazine, using the official euphemism for riots and protests.

'In 2009, Chinese society may face even more conflicts and clashes that will test even more the governing abilities of all levels of the Party and government.'

President Hu Jintao has vowed to make China a 'harmonious society', but his promise is being tested by rising tension over shrinking jobs and incomes, as well as long-standing anger over corruption and land seizures. (For a related factbox click on )

China also faces a year of politically tense anniversaries, especially the 20th year since the June 1989 crackdown on pro-democracy protesters in Tiananmen Square. That date has already galvanised the 'Charter 08' campaign by dissidents and advocates demanding deep democratic reforms.

While foreign commentary about risks to China's recipe of fast economic growth and one-party control are common, the nation's leaders are usually

reticent about such threats.

This report and other recent open warnings may be intended to help snap officials to attention, said one Chinese expert.

'The candour about these problems reflects the severity of the unemployment problem. It's meant to attract the attention of all levels of government,' said Mao Shoulong, a professor of public policy at Renmin University in Beijing.

'The government wants to show that stability is at the top of its agenda.'

**My view** - The Communist Party's mandate to retain power is based on providing security for all China's citizens. This manifests itself in promoting strong economic growth; allowing high employment and giving people the ability to work towards a better standard of living. High unemployment puts that process in jeopardy so we can expect the government to do everything possible to counter the slowing economy, which it at least in part helped to engender through choking off growth in the stock and housing markets more than 18-months ago.

It remains unlikely that the government will lose control to an extent that would allow protests to become cohesive across cities and regions. The internal security forces have much too tight a grip to allow that to occur. However, in the unlikely event that economic growth were to actually turn negative resulting in millions of layoffs, an internal party 'champion of the worker' emerging could not be ruled out.

In the meantime, signs remain positive that China can sustain growth in the 6-8% range and the [stock market](#) continues to show base formation development characteristics.

Email of the day (1) - on Ruble crosses:

"I don't find the rate Ruble per Euro. Am I overlooking it? If not could you please add it. Could you also add the AMX-index (Dutch index for midcap funds) to the chart library? Thank you."

**My comment** - Thank you for pointing out this omission. I added a large number of Ruble crosses to the Chart Library today so you will now be able to see the Ruble quoted both ways around against the US Dollar, Euro, Japanese Yen, Swiss Franc, South African Rand, Swedish Krona, Canadian Dollar, Australian Dollar, New Zealand Dollar, Singapore Dollar, Hong Kong Dollar, Chinese Renminbi, Indian Rupee and Brazilian Real. I also added the same list of crosses for the Brazilian Real.

These can all be found in the Chart Library's Major Currency Cross Rates section or by putting the currency code into the Chart Library's dedicated search engine.

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 Price / Book.

Within the last month the number of markets trading at their Book value or less has shrank from 31 to 21. This is clear evidence that value is being seen in stock markets by investors willing to look beyond short-term volatility. The fact that the majority of stock markets are testing the upper side of three-month ranges will also be helping to bolster confidence that the risks are to the upside. On a P/E basis, Ireland (4.61) has moved up the rankings quite considerably and on a dividend yield basis markets such as New Zealand (9.08%), Italy (8.81%), Taiwan (8%) and Norway (7.03%) among others are worthy of mention because of their high yield and potential for base formation development.

(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 most 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.)

[S&P 500](#) and [Dow Jones Industrials Average](#) divergence from their 200-day moving averages - It is now clear from the indicator that mean reversion is taking place so I see no further need to continue to reproduce this indicator on such a regular basis. Both the S&P 500 and Dow Jones Industrials are testing the upper side of their three-month ranges and would need to sustain moves below 850 and 8500 respectively to question potential for some additional upside.

From its October nadir, the divergence with the 200-day moving average has narrowed considerably, as the mean level continues to fall towards the price. New uptrends can be deemed to be underway, when moves are sustained above the 200-day moving average, which also turns upwards; although this is likely to occur well after indices have bottomed in absolute terms.

Today's interesting charts - Upward dynamics can be seen across a whole swathe of investment vehicles and they can all be found in the Chart Library.

Singapore - [testing](#) the upper side of the 10-week range and would need to sustain a move below 1700 to question scope for some additional upside.

Natural Gas - [rallying](#), having found support near \$5.25. A sustained move below \$5.50 would now be needed to question potential for some further higher to lateral ranging.

Copper - [rallying](#) to break the medium-term downtrend and would need to sustain a move below 125¢ to question scope for some further upside.

Email of the day (2) - [on additions to the Chart Library](#):

"Would you please add the following Sterling Investment Grade Corporate [Bond](#) index to the chart library if possible: iBoxx £ Non-Gilts (ex-BBB) 15 Year Index. Many thanks."

My comment - [Thank you for this interesting suggestion](#). I added some investment grade indices but could not find one that specifically excludes BBB. If anyone knows of a suitable Bloomberg ticker, I would be happy to add it to the Chart Library.

Last week's signups for the Free (Abbreviated) Comment of the Day - [For the week of December 28th new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, Canada, Hong Kong, India, Ireland, Italy, South Korea, Portugal, Sweden, 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, the UK with Australia and India tied for third.](#)

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

### **Wednesday 7th January 2009**

Feel Like a Trillion Bucks - [This editorial](#) from The Wall Street Journal discusses the next US President's stimulus package. Here is a section:

Barack Obama will soon request an economic stimulus package of some \$775 billion over a mere two years and optimistically hopes to hold the final figure under \$1 trillion. The latest leaks say this will include targeted tax cuts of perhaps \$300 billion, though when Congress gets involved both numbers are likely to grow given the political imperative for everyone to get as much as possible into law while the honeymoon aura lingers. But before we get lost in the policy details, let's pause to consider that number of \$1 trillion.

The human mind is not well equipped to fathom a number that large. A check for \$1 trillion -- a million million dollars -- would have 12 zeros to the left of the decimal point. Homo sapiens hadn't evolved a trillion seconds ago: 31,546 years in the past, Neanderthals were still trying to make fire.

More immediately, \$1 trillion is about one-third of annual U.S. government spending and 13% of the U.S. economy. It is more than the GDP of all but 12 countries in 2007 (America, Japan, Germany, China, the U.K., France, Italy,

Spain, Canada, Brazil, Russia and India, in that order). A trillion dollars is also:

- The difference between President Bush's proposed budgets of 2002 and 2008 -- the former being the first in U.S. history to exceed \$2 trillion, the latter being the first to exceed \$3 trillion.
- The all-but-certain minimum deficit in the federal fisc in 2009. A trillion-and-a-half isn't out of the question.
- Roughly one-sixth of the entire outstanding U.S. federal debt held by the public, one-tenth if you include intragovernmental debt (such as Social Security IOUs).
- The drop in market capitalization of the American financial industry since last October.
- The cost that Al Gore attaches to his plan to liberate the U.S. of carbon-based energy.
- Not even close to the unfunded liability of Medicare, which is \$36 trillion over the next 75 years, give or take a few trillion.

My view - A question many investors may wish to ask themselves: Over the next decade, would you rather hold US 10-year Treasuries yielding 2.5%, gold or its proxies, or an internationally diversified portfolio of leading equities?

Today, I would much rather hold a combination of the latter two but the stampede during the second half of 2008 was into Treasuries and their international equivalents. Those gains will prove difficult to sustain, unless the world really is repeating the Japanese experience of the 1990s and beyond, or worse.

Email of the day - [More on Crook und Schwein:](#)

"On Crook und Schwein: Let's get real here. For the efficient functioning of the very complex machine that the global economy has become, there is no known monetary system more appropriate to the task than the paper (fiat) money system. It is far from perfect in a far from perfect world but if there is a better alternative, it has not yet been discovered / developed and any study of economic history over the centuries strongly suggests that it is certainly not the gold standard. Corrupt regimes will find a way to corrupt any monetary system. It is always wise to watch for signs that inflation is being let run beyond an acceptable / normal level and it is always wise to consider gold as a potential investment on its merits at any given price at any point in time. However, it makes no sense to cross the line into the obsessive and one-dimensional world inhabited by conspiracy theorists who judge everything from the perspective of whether it vindicates their view that gold is always and everywhere superior to cash and / or equities. This is the world of the stopped clock that gets to look accurate from time to time. The danger is that in times of trauma and disorientation, such as currently, we are more vulnerable to

being deluded by these spurious dogmatic views. It would be very misleading to attribute the credit excesses in the global economy, that have triggered the recent crisis, to a build-up of inflationary pressures through central banks printing money. Look at the facts. Where is the evidence of runaway inflation over the past ten years and where is it now? Also, remember that cash usually pays an interest rate sufficient to compensate for inflation while providing a real return. Gold does not. The Dow pays a dividend yield. Gold does not. Long term return comparisons between gold, cash and equities that do not incorporate the income factor are utter nonsense. It is inaccurate to see the leading global central banks as "closet inflationists". Most are openly flaunting their monetary preferences with explicit or implicit inflation targets and for good reason since inflation running at a moderate positive level affords them a bigger "firebreak" from the liquidity trap problem in times of deflationary shock, such as currently. To paraphrase an out of the closet Tom Robinson; Sing if your glad to inflate. Sing if you're happy that way."

My comment - Many thanks for a robust, articulate and finished email (the latter allows us to copy and paste without wasting time tidying up). We receive many fine and varied emails and their contribution to the market debate is greatly appreciated.

Speaking as one who has regarded gold as hard money throughout his career, I have also argued from time to time that there could be no sensible return to a gold standard in the present era, mainly because it would be too easy for extremely wealthy speculators, not to mention rogue states, to manipulate the price of bullion. That is, I will add, unless all governments followed the highly undemocratic and hopefully unlikely path of forming a single currency, while simultaneously confiscating private holdings of gold and banning all but state ownership of bullion.

Therefore, although I regard the recorded history of gold standards over centuries more favourably than the view above, I reluctantly believe that they would be impractical today. This leaves us with an entirely fiat currency world - a system that has a long sad history, in terms of purchasing power erosion, relative to gold. The problem, I believe, is that over time fiat currencies mirror the competence and ethical standards of those who control their supply on our behalf. These standards have been found wanting more often than not.

I do regard most central banks as closet inflationists, not least because they are not fully independent from state influence. Consequently, in a fiat currency world they seek to inflate away debt by stealth over time. This occurs at the expense of savers. The process encourages more debt, leading to the creation of fiat currency in excess of GDP growth, causing more stealth inflation, partially disguised by hedonic changes in official CPI and PPI calculations.

Fortunately, prices do not always rise, thanks mainly to technology, competition, the market mechanism and periodic economic slumps. Nevertheless fiat currencies are no recipe for the preservation of purchasing power - just consider what you paid for most goods and services in any earlier decade.

As investors and traders with a reasonable understanding of market history, most of us would agree that there are times for buying and selling any asset class. In the current environment, gold and its proxies look interesting to me. So do stock markets following their big blow out last year, despite all the remaining and justifiable concerns over corporate profits in 2009.

Willem Buiter warns of massive dollar collapse - My thanks to a subscriber for this [item](#) by Edmund Conway for The Telegraph:

The long-held assumption that US assets - particularly government bonds - are a safe haven will soon be overturned as investors lose their patience with the world's biggest economy, according to Willem Buiter.

Professor Buiter, a former Monetary Policy Committee member who is now at the London School of Economics, said this increasing disenchantment would result in an exodus of foreign cash from the US.

The warning comes despite the dollar having strengthened significantly against other major currencies, including sterling and the euro, after hitting historic lows last year. It will reignite fears about the currency's prospects, as well as sparking fears about the sustainability of President-Elect Barack Obama's mooted plans for a Keynesian-style increase in public spending to pull the US out of recession.

Writing on his blog, Prof Buiter said: "There will, before long (my best guess is between two and five years from now) be a global dumping of US dollar assets, including US government assets. Old habits die hard. The US dollar and US Treasury bills and bonds are still viewed as a safe haven by many. But learning takes place."

He said that the dollar had been kept elevated in recent years by what some called "dark matter" or "American alpha" - an assumption that the US could earn more on its overseas investments than foreign investors could make on their American assets. However, this notion had been gradually dismantled in recent years, before being dealt a fatal blow by the current financial crisis, he said.

"The past eight years of imperial overstretch, hubris and domestic and international abuse of power on the part of the Bush administration has left the US materially weakened financially, economically, politically and morally," he said. "Even the most hard-nosed, Guantanamo Bay-indifferent potential foreign investor in the US must recognise that its financial system has collapsed."

He said investors would, rightly, suspect that the US would have to generate major inflation to whittle away its debt and this dollar collapse means that the US has less leeway for major spending plans than politicians realise.

My view - I maintain that the US dollar is a fundamentally flawed currency, for all the reasons previously discussed on this site. The USA's creditors are

unlikely to view their large dollar holdings with equanimity. However, no other country wants a strong currency, particularly when deflationary concerns are paramount. The greenback remains the world's reserve currency and there are no volunteers for this role in the foreseeable future.

Additionally, while some of the USA's creditors will inevitably be tempted to reduce their dollar exposure, they also have an ongoing interest in supporting the currency while America remains the primary market for their exports. The USA is still a big importer, albeit less so due to the economic slump.

The Browning Newsletter: The Return of La Niña Weather - My thanks to Alex Seagle for this fascinating [publication](#) covering climate, behaviour and commodities, written by Evelyn Browning Garriss and published by Fraser Management Associates. It is posted without further comment but here is the opening:

2008 - the year began with millions of Chinese workers unable to get home for Chinese New Year. It ended with millions of Americans unable to get home for Christmas. For the first time in decades, the Arctic ice cap grew. As headlines warned of global warming, 2008 evolved into a cold, wet, miserable year.

The year has ended. 2009 has begun. What can we expect? Was 2008 an anomaly or the beginning of a cooling trend?

Basically, 2009 will have a chilly beginning. The conditions that have shaped this winter are continuing. Volcanic activity remains unusually high. A neutral Pacific is evolving into a La Niña. The Atlantic is developing a strongly negative North Atlantic Oscillation. These factors will shape a cool mid-winter. At the same time, they may allow a warmer late winter and early spring.

Additional Commentary by Eoin Treacy

GSI's The Issues January 2009; The Credit Crunch: Cause and Outlook - Thanks to a subscriber for this excellent [summary](#) of the issues which led to the credit crunch. I strongly recommend taking the time to read this report for its common sense approach to a thorny subject. Here is a section:

Why the Wild Price Volatility?

Not only investment banks use exposure leverage to gain a multiple of the cash deployed. Many investors do as well, via derivatives such as options, warrants and futures on stocks, indexes and commodities. This exposure leverage has led to the size of speculative financial positions being many, many times greater than the fundamental supply/demand of real industry suppliers and end-users. As illustrated below, the derivatives accentuate price volatility.

Derivatives drive the same directional buying (or selling) from both long and short positions, which accentuates the rise or fall of the underlying security.

Take the example of a structured product designed to deliver twice the returns when the underlying stocks move higher. The base value is \$100; hence, the holder has an effective exposure of \$200. Let's assume the broker-creator of that derivative is fully hedged and holds \$200 worth of the underlying stocks. Let's also assume the market then declines 10% the next day. The value of the derivative is now \$80. The broker holds \$180 of stocks so he is over-hedged by \$20, the amount he has to sell the same day to square out his position.

Let's assume another investor holds a short position of \$100 in a similarly structured bear product. With the 10% fall of stocks, the value of this derivative is now \$120. The short exposure in the underlying stocks rises to \$240, up from the initial \$200. The broker-creator of the bear product has to sell \$40 of stocks the same day to stay fully hedged. In the above example, a 10% fall leads to an extra \$60 selling of the same stocks on the same day by both the long and short positions, equivalent to 15% of the value of the underlying contracts. Hence, falls in stock prices drive extra selling and vice versa if stocks rise. When big positions are outstanding, proprietary traders and others jump in, knowing that hedging adjustment-related buying or selling is on the way, further accentuating the rise or fall of prices.

#### Wild Volatility Increases the Fear Factor

This was how the euro surged 16% against the dollar (the world's two major currencies) in two weeks in mid-December 2009. And oil doubled to \$147 from mid-2007 to 1H08 and then collapsed to below \$40 in the following six months. Markets may still be too numbed by the volatility to ask "Are such wild price swings normal?" and "How can real buyers and sellers conduct business given such volatility and the resulting pricing risk?" Modern day finance is supposed to foster trade.

For decades the course of financial markets was led by economic fundamentals such as business cycles, inflation, and fiscal and monetary policies. But today, the tail is wagging the dog-financial market actions led the direction of the real economy. The swing in the price of oil drove the entire Russian economy first into a boom, then a bust. Many listed Asian firms such as airlines, petrochemicals, steel makers, coal miners and shipping entered into derivatives to hedge currencies, commodities and freight rates during the boom. Now with the collapse, they are facing aggregate losses in tens of billions of dollars. Although these are book losses, they are taking an economic toll right now as firms are laying off workers, reducing pay and postponing capital expenditures.

Wild financial volatility has contributed to the credit crunch and curtailed normal trade flow and business activities globally. Ad hoc evidence from our company visits reveal a number of cases where firms had to suddenly stop trading with emerging economies in October and November 2008 because of heightened pricing and credit risks due to volatile forex fluctuations. Banks saw rising risk and curbed trade financing. The rise in the fear factor also accentuated the plunge in stocks.

**My view** - It has long been a contention at Fullermoney that derivative contracts do not overly influence the direction of a market but that they are often responsible for exaggerating moves. The deleveraging process hit an important climax in October and the market action suggests it has been waning since. The argument as to whether we will yet see another down-leg continues; as one would expect in a ranging phase so close to the lows. However other measures such as the TED spread and the VIX suggest that the October / November lows are more important than others posted during the downtrend.

The [TED](#) spread has fallen consistently from the highs near 4.65% hit in October and is now testing the lower side of the Q32007 - Q32008 range. The spread fell below 2% on December 11th and continues to contract, indicating that the panic surrounding the banking sector has been reassessed.

The [VIX](#) Index has also fallen considerably from the highs, near 80, posted in late November. It remains at historically elevated levels near 40, but is heading in the right direction for those looking for stock markets to stabilise. It needs to push back below 25 before a degree of normality can be attributed to trading conditions.

**The Aftermath of Financial Crises** - Thanks to a subscriber for this thoughtful [report](#) by Carmen M. Reinhart at the University of Maryland and Kenneth S. Rogoff at Harvard University. It contains a number of interesting comparison charts which may be of interest to subscribers. Here is a section from the conclusion:

An examination of the aftermath of severe financial crises shows deep and lasting effects on asset prices, output and employment. Unemployment rises and housing price declines extend out for five and six years, respectively. On the encouraging side, output declines last only two years on average. Even recessions sparked by financial crises do eventually end, albeit almost invariably accompanied by massive increases in government debt.

How relevant are historical benchmarks for assessing the trajectory of the current global financial crisis? On the one hand, the authorities today have arguably more flexible monetary policy frameworks, thanks particularly to a less rigid global exchange rate regime. Some central banks have already shown an aggressiveness to act that was notably absent in the 1930s, or in the latter-day Japanese experience. On the other hand, one would be wise not to push too far the conceit that we are smarter than our predecessors. A few years back many people would have said that improvements in financial engineering had done much to tame the business cycle and limit the risk of financial contagion.

Since the onset of the current crisis, asset prices have tumbled in the United States and elsewhere along the tracks lain down by historical precedent. The analysis of the post-crisis outcomes in this paper for unemployment, output and government debt provide sobering benchmark numbers for how the crisis

will continue to unfold. Indeed, these historical comparisons were based on episodes that, with the notable exception of the Great Depression in the United States, were individual or regional in nature. The global nature of the crisis will make it far more difficult for many countries to grow their way out through higher exports, or to smooth the consumption effects through foreign borrowing. In such circumstances, the recent lull in sovereign defaults is likely to come to an end. As Reinhart and Rogoff (2008b) highlight, defaults in emerging market economies tend to rise sharply when many countries are simultaneously experiencing domestic banking crises.

My view - For those who may be interested, this report was also dealt with by John Mauldin in his Thoughts from the [Frontline](#) on January 2nd. The figures quoted in this report make sobering reading. We can see that a large number of stock markets have already posted larger than average corrections for similar type banking crises. Average house prices have fallen further during banking crises than has already occurred.

We would expect stock [markets](#) to bottom ahead of the wider economy. It remains to be seen whether the present 10-week range in the region of the October lows is the bottom but signs are good that this process has begun. A sustained move to new lows would be needed to indicate that base formation development will continue at somewhat lower levels.

Housing markets around the world continue to fall. We have the longest price history for the [UK](#) market, which shows definitive topping characteristics. The same pattern is evident in the [USA](#). The one ray of hope in housing data has been that the pace of US foreclosures declined in October and November. The index has not yet been updated for December so we do not know if this trend is continuing. However, if the pace of US foreclosures continues to slow, we will have an indication that we are approaching a bottom in real estate prices.

Shortage of lead sees 40 percent metal price rise in China in past month - This [article](#) by Polly Yam for Reuters appeared in today's Mineweb newsletter and covers the improvement in lead prices over the last month.

Chinese prices of spot lead, used in batteries, have risen 40 percent in the past month, buoyed by reduced supply and stronger winter demand for automobile batteries, industry officials and traders said on Tuesday.

The rise in China, which consumes a third of the world's lead, exceeded a 16 percent rise the same month on the London Metal Exchange MPB3, where the metal price was \$1,122 on Tuesday.

It marks a turnaround after Chinese prices lost nearly half their value between last September and early December on reduced demand triggered by the global financial crisis that spurred Chinese lead smelters to cut production.

"Many small smelters have shut down," said a sales manager at Yuguang Gold and Lead (600531.SS), the country's top producer of lead. "And battery

makers are buying more lead."

Battery makers had cut lead purchases in the fourth quarter of last year because of volatile prices and had used up their stocks of the metal, he added.

"Demand for batteries is improving," said a purchasing manager at a large battery manufacturing plant in Hubei province that consumed about 140,000 tonnes of lead last year.

He said many car owners in China fixed their vehicles and changed batteries before the Lunar New Year, boosting battery consumption ahead of the festival, which falls on Jan. 26 this year.

Spot lead traded at about 12,000 yuan (\$1,757) per tonne in Shanghai on Tuesday, up from 8,600 yuan on Dec. 5 but down from 17,600 yuan in mid-September last year.

My view - [Lead's](#) decline from the highs, near \$3900, posted in October 2007 to the lows, near \$850, reached in December was quite volatile. It posted a number of impressive rallies on the way down which it was unable to sustain beyond the short term.

It would be easy to dismiss the current rally as nothing more than another short-term bounce, prior to a further decline. However, while this cannot be ruled out; prices have fallen back to the upper side of the long-term [base](#). This is an obvious potential area where demand may begin to reassert itself and a sustained move below \$850 would be needed to suggest that support building will take place at somewhat lower levels. The current rally has broken the short-term downtrend and would need to pull back below \$1000 to question scope for some additional upside.

Email of the day (1) - [on shorting Treasury bonds](#):

"Re Shorting Treasuries in yesterday's "Comment of the Day", subscribers may be interested in:

"Rydex Inverse Government Long Bond Fund - US Ticker [RYJUX](#)."

My comment - [Thank you for pointing out this fund which can be found in the Income, REITs & Fixed Income funds section of the Chart Library.](#)

Email of the day (2 & 3) - [on additions to the Chart Library](#).

"Thank you for adding the ETF's I requested to the chart library so promptly, very helpful. I enquired if an unleveraged Lead ETF was available with ETF Securities Ltd, they do not have one. Please can you add ETFS Leveraged Copper ([LCOP](#)) and Copper Long ([COPA](#)) to the chart library? Many thanks"

And

"I wonder if you could kindly have [Echostar Corporation](#) included in our chart library! Many thanks."

My comment - [Thank you for these suggestions which can now all be found in the Chart Library.](#)

**Thursday 8th January 2009**

What is Russia's end-game in gas row? - [My thanks to a subscriber for this interesting article by Christian Lowe for Reuters. Here is the opening:](#)

MOSCOW (Reuters) - Russian Prime Minister Vladimir Putin raised the stakes in his gas conflict with Ukraine by slashing supplies to Europe, a measure that has left some EU states struggling to heat homes in sub-zero temperatures.

Russian gas export monopoly Gazprom said it was forced to take that step because Ukraine -- locked in a dispute with Moscow over gas pricing -- was stealing gas being pumped across its territory for customers in Europe.

What was Putin seeking to achieve by reacting in this way? There is so far no consensus among diplomats and analysts about what Russia's end-game is. The following are the main theories:

#### RUSSIA HAS NO END-GAME

The Kremlin started out with the modest aim of persuading Ukraine to pay closer to market prices for its gas, but has now been out-manoeuvred by Kiev.

"Russia and Gazprom have walked into a trap," said Fyodr Lukyanov, editor of the journal Russia in Global Affairs.

He said Ukraine -- desperate not to pay more for its gas because of the fragile state of its economy -- seized the initiative from Moscow by endangering exports to Europe.

"They are calculating, and I think not without basis, that the longer this drags on the more the blame will be laid at Moscow's door," said Lukyanov.

He said Gazprom, under pressure from a Europe angry its supplies are being disrupted and fearful for its reputation as an energy supplier, will now be forced to cut the price it is demanding Ukraine pay for its gas.

"Ukraine wants to go back to the negotiations from a position of strength ... And it is working," he said.

#### KREMLIN PUSHING NEW PIPELINE PROJECTS

The disruption of gas flows to Europe has highlighted the fragility of transit routes -- playing into the Kremlin's hands as it tries to persuade Europe to

back alternative pipelines.

Russia has been struggling to win European approval for the Nord Stream pipeline, which will ship gas under the Baltic Sea to Germany, bypassing potential troublesome transit states.

Nord Stream, a joint venture between Gazprom, Germany's BASF and E.ON and Dutch firm Gasunie, has encountered resistance, on political and environmental grounds, from several European Union states.

Moscow is also pushing the South Stream pipeline, which will ship Russian gas under the Black Sea and direct to the EU. Russia is seeking to sign up more European states to the project.

In that context, the gas row with Ukraine is "all opportune, from the Russian side," said a European diplomat in Moscow.

"Russia might find an interest in promoting Nord Stream and it will be clear to many Europeans there should be an alternative route."

Asked if the dispute would bolster the Nordstream and South Stream projects, Julian Lee of the Centre for Global Energy Studies said: "That's certainly what Gazprom is hoping for."

## DRIVING UP THE OIL PRICE

A shortage of gas in Europe could help Russia by boosting prices for its other big export, oil.

Traditionally, any problems with gas supply drive up demand for crude as energy firms and industries switch to oil products for power and heating.

The fall in world oil prices, from a high of \$147 in July, to about \$48 now, has been painful for Moscow. The world's second biggest exporter of crude after Saudi Arabia, Russia receives about half of its budget revenues from oil exports.

Russia's budget needs oil to be at least \$70 to keep out of deficit, so the fall in price threatens the lavish spending on public sector wages and pensions that have helped Putin underpin his grip on power for nearly a decade.

My view - Call me cynical but based on the evidence to date from Russia's current regime, there are plenty of reasons to suspect that political calculations in Moscow are a major factor in this dispute. This is another reason why energy-importing countries need to develop alternative and renewable sources of supply. It will be expensive, and a long march, but vital to long-term economic prospects.

Email of the day (1) - [On is the S&P cheap](#):

"John Mauldin doesn't seem to think the S&P is cheap. Is he correct?"

"Let's look at their estimates for earnings in 2008. They started at \$92 in early 2007 and are now down to \$48. On a trailing one-year basis, that puts the Price to Earnings Ratio (P/E) at over 19 as of today's close at 925, which does not make the market cheap. The current projections are for \$42.26 for 2009. That makes the forward P/E 22. That doesn't look like value at all, when the historical average is closer to 15"

My view - On those estimates, the S&P 500 Index is not cheap. Therefore, unless there are dramatic earnings surprises, raising the 2009 projection of \$42.26 significantly, most other stock markets trade at considerably more attractive valuations.

My personal portfolio: Copper long and most of NKY long stopped out; ArcelorMittal long increased; platinum long reopened - Once a leveraged trading position moves into reasonable profit, I often introduce at least a breakeven stop, usually for money control purposes rather than anything that can be gleaned from the price chart. Inevitably, this increases the risk that a position will be stopped out by a reaction that may not prove to be technically significant. However, psychologically, I do not like to see paper profits turn into paper losses and the tactic does protect one against a significantly adverse move.

Today, my [copper](#) long was stopped out at 147¢ in the March contract against my purchase at 146.55¢ on 2nd January. Sixty percent of my [Nikkei 225 Index](#) long was stopped out at 8950 for the March contract against my purchase at 8880 on 18th December. This provides further evidence, as if it were needed, that market conditions remain rangy to choppy, with few trends of more than very short-term duration. There is a high possibility that I will be stopped out of further positions and with hindsight, I would have done considerably better to grab the profits on offer a couple of days ago.

This afternoon I increased my [ArcelorMittal](#) (MT NA and listed on other exchanges) long by 50%, paying €20.13 for another June position. Although purchased in my trading account for personal reasons, I regard this as an investment grade share, inexpensive and with good prospects as governments from China to the USA focus on infrastructure development as a major portion of their economic stimulus packages. Here are the updated [Description](#) and [Ratio](#) pages from Bloomberg, which I first posted on 24th December.

I also reopened my [platinum](#) position, buying equal-sized stakes in the April contract at \$1000.5 and \$985.6.

Prices above include all spread-bet dealing costs.

Commodities: From demand weakness to supply destruction - My thanks to a subscriber for this interesting and informative [report](#) from Danske Markets. Here is the opening paragraph:

After the collapse in commodity prices during the second half of 2008, we have seen a number of commodity prices move higher over the last two weeks. Oil has once again taken the limelight, rising from a year low of USD 34 a barrel to just below USD 50. But commodities like nickel and wheat have also jumped significantly. Prices have in general been moving higher in line with equities and improved risk appetite in financial markets. But we note that prices tend to be extra volatile round Christmas and New Year due to thin liquidity. An expected reweighting of commodity investment indices in favour of base metals like nickel, zinc and copper might also have pushed these base metals higher over the last couple of days. Looking into 2009, the big question is, of course, whether we are finally seeing an end to the six month long bear market in commodities, or are we just seeing a "dead cat bounce"?

My view - The Danske report is very good. I will also add my own brief thoughts on precious metals, industrial metals and soft commodities.

I maintain that precious metals make the most sense in today's environment. However, putting aside the sky-high targets of some gold bugs, on the basis that most extreme upside targets are unrealistic, bombed out industrial metals may have more potential over the next few years. Personally, I would have some of both, but am weighted more heavily in precious, suspecting that industrials have only just commenced the bottoming out phase. Platinum remains a great precious / industrial combination.

As a sector, agricultural commodities are a weather punt and have been overhyped on the 'everyone must eat' basis. Yes, but they can eat less or more cheaply. Also, supply can catch up much more quickly in the event of a good crop cycle or two. I would be more bullish of agricultural commodities if they had seen bigger reactions, as occurred with industrial metals, which also peaked earlier. Inevitably, there will be individual exceptions, revealed by the charts.

Email of the day (2) - [More on the Vanguard Precious Metals and Mining Fund](#):

"In regard to yesterday's mention of the Vanguard Precious Metals and Mining Fund (VGPMX) I thought I'd point out that this is a very interesting fund, and is not a typical gold-oriented fund. Anyone interested in venturing into the supply inelasticity arena might benefit from taking a close look here.

"While relatively concentrated, with fewer than 40 shares, it is broadly diversified across many of the FM themes. In the past, in addition to gold and silver miners, it has held shares in coal miners, diamond producers, platinum, nickel, and steel companies, etc. In fact, as much as 50% might be in companies not associated with gold or silver.

"I discovered this fund a few years ago after noticing that it's performance was not tracking the more typical gold-oriented funds (it was better). After lightening my position earlier in the year, I plan to ease back in gradually sometime soon."

My comment - Thanks for sharing your insights, and congratulations on having the wits to take profits earlier in the year. [VGPMX](#) continues to look like a promising recovery candidate.

Email of the day (3) - On the effect of currency moves:

"I wanted to share my thoughts on the potentially very significant effect of FX movements on one's investments for the benefit of the wider audience. I know this concept may be pretty obvious to many but the recent fall in GBP has brought home to me as a UK based investor the importance of the investment vehicle chosen. As an example I have been building a position in the Japanese stock market through a GBP based index fund over the course of several months. Whilst the Nikkei has fallen over that period I see a healthy gain on my investment due to the greater fall in the currency (GBP versus JPY) than the fall in the underlying stock market. Had I invested in the ETF IJPN a similar result would have ensued. Contrast these however with an alternative investment vehicle I was considering, a spreadbet on the Nikkei, which would be FX neutral (and is therefore I suppose a purer investment in the underlying asset) and where I would have suffered a mark to market loss in line with the fall in the market (but which would also be settled in GBP). This has caused me to consider much more seriously the FX consequences of my investments and the different investment vehicles, whereas previously I have only really thought about the prospects for the market or asset class I am considering investing in. Lucky me this time, you live and learn."

My comment - Thank you for sharing your educative experience. May you live well and continue to learn.

Please note - I will be away tomorrow for family medical reasons.

Additional Commentary by Eoin Treacy

AEI: Everything You Wanted to Know about Credit Default Swaps-but Were Never Told - Thanks to a subscriber for this robust [defence](#) of the Credit Default Swap (CDS) market by Peter J. Wallison for the American Enterprise Institute for Public Policy Research. Here is a section:

It may be objected, however, that in hedging or speculation transactions, real things like wheat or loan exposure are involved, while buying or selling CDSs without any connection to the reference entity is different. Consider then puts and calls-options to sell or buy stocks-that are traded regularly on the Chicago Board Options Exchange. These are an accepted part of equity markets and are known as equity derivatives. They can be used for hedging a stock position without selling or buying the stock, or they can be used-without owning the stock-simply to speculate that a stock's price will go up or down. The function of puts and calls is exactly the same as the role played by those

who buy or sell CDSs without any connection to a reference entity. The transaction adds to the liquidity and the total information in the market. That is in part why the buying and selling of CDSs provides a continuous, marketbased assessment of the credit of a large number of commercial or industrial companies and financial institutions. Some people consider speculation in a security or a commodity to be betting, but economists recognize that this activity provides benefits to a market through added market liquidity and mitigation of bubbles. In the case of CDSs, however, the exogenous benefits of speculation are particularly strong because it provides a market-based credit judgment about the financial position of individual issuers that is not available anywhere else.

**My view** - This is a useful report for anyone interested in how the CDS market functions and I commend it to subscribers. CDS are used to make judgements about the credit quality of debt issuers but the question is whether this is a reliable course of action.

In a micro example - if the price of a CDS rises, it is taken as a reflection of the market's view that the issuer's credit quality has deteriorated. This is accepted practice in the credit markets and allowed investors to value bonds when liquidity dried up following the Lehman Brothers bankruptcy. As such the CDS market has proved invaluable over the last few months.

Prior to the introduction of CDS, an instrument's credit rating was one of the only ways for someone not intimately knowledgeable with the company's balance sheet to make a credit assessment. The credit / solvency crisis has thrown into sharp contrast the conflicts of interest in the credit rating process. It is in this area where the greatest need for reform lies, because investors now have serious unanswered questions about the quality of credit information provided by the ratings agencies. This has led to the CDS market being relied on ever more heavily. However, it is also possible to subject this process to abuse.

It was quite evident as the credit / solvency crisis unfolded, that a sort of 'model myopia' developed where the price of CDS' were the only arbiter of a bonds value rather than its underlying entity's balance sheet. It is possible for speculators to push up the price of CDS, causing a panic as to the possibility of default, while simultaneously shorting the individual shares. No one will argue that the companies which came under the most shorting pressure have serious financial issues, but the activity which went on early October was not healthy for financial stability. The CDS market was used as a means to foment panic. This was something akin to financial insurance arson and is a loophole which needs to be dealt with through regulation. CDS are an excellent proxy for valuing credits but I do not believe it can be totally relied on in times of stress.

**Fed Focuses on Consumer, Corporate Rate Spreads Over Treasuries** - This [article](#) by Craig Torres for Bloomberg covers the continued efforts to reduce borrowing costs for homeowners and potential house buyers. Here is a section:

The Fed yesterday began a frontal attack to drive down home-loan costs, buying mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae. The effort was part of a \$600 billion plan, which also includes purchases of Fannie and Freddie bonds.

Mortgage rates "should be in the low 4s right now based on Fed rates," said Ben Fox, executive vice president of Premier Mortgage Co. in Fairfax, Virginia. "They are not even close."

Even after a \$1.34 trillion increase in assets on the Fed's balance sheet last year, private borrowing costs remain at unusually high spreads over U.S. Treasury benchmarks.

Gauges of corporate borrowing costs, which reached record levels in the fourth quarter of 2008, remain three to five times their long-run averages.

The spread on investment-grade corporate bonds is 6.03 percentage points, down from a record 6.56 percentage points on Dec. 5, Merrill Lynch & Co. data show. That compares with an average of 1.23 percentage points in the previous decade.

My view - As long as the spread between what banks can borrow at and what they lend at remains high, they are making more of a return than would normally be the case. This is at least part of the reason they are reluctant to lower their lending charges. Of course they are also nervous about extending loans to under pressure consumers and SMEs; and of further damaging their balance sheets. However, it is increasingly been seen as essential that credit be made available, at relatively low rates, to those most in need of it. This means that some further government intervention is likely to ensure that the credit markets return to their role of providing liquidity.

There is also a degree of urgency to this move because of the high number of mortgage resets are due in 2009 in the USA. [Mortgage](#) and [FHA mortgage](#) rates have fallen to the lower side of their 6yr ranges but need to contract further to shield vulnerable homeowners from further pressure. This is because many homeowners came in on extremely low 'teaser rates' and these will not be available now, regardless of how far refinance rates fall. President-elect Obama's speech today on how he intends to deal with the economy may offer some clues as the forthcoming policy response. What we can be reasonably sure of is there is going to be a response and it will be large.

Platinum or gold - which will be the better performer in 2009? - Thanks to a subscriber for this interesting [article](#) by Rhona O'Connell for Mineweb.com covering the relative performance of platinum to gold. Here is a section:

What this all means in terms of market dynamics is that the shift away from platinum jewellery towards gold (and palladium), especially in China, as a result of the price differential between the two metals has a far more deleterious effect on the platinum sector than its equivalent benefit to the gold

market. This is pretty obvious, but of course it also suggests that the converse is true and that the massive contraction in the price differential between platinum and gold over the past nine months has set the scene for a revitalisation of the platinum jewellery market - at least in relative terms, given the state of the world's economy - and this should give platinum prices something of a boost.

It looks at first pass as if this has already happened, but nothing is ever that simple and this is where the automotive industry comes in. Platinum, whose demand is, along with that of palladium dominated by the auto sector with 55-57% of market share in each metal, has been suffering under the persistent deterioration in the auto market and the way in which this has spread around the globe. Given that environmental restrictions continue to tighten and the fact that the market for fitments is not fully mature, platinum demand in this sector is holding up better than auto production and sales figures themselves, but the frequency with which auto numbers are released has meant that the fate of the sector has been seen as hanging over platinum like something of a Damocletian sword.

Until now, that is. Or at least, for the time being. The market's anticipation of a stabilisation, if not a recovery, in the condition of Detroit's Big Three has combined with a growing optimism over implementation of the tax incentive scheme planned by the incoming Administration of President-elect Obama and these two factors between them have been helping to support platinum; the fact that the latest figures showed a 36% year-on-year drop in US light vehicle sales in December did not actually do much to stifle platinum's recovery and the price has since then flirted with \$1,000/ounce.

My view - Platinum fell precipitously both in absolute terms and [relative to gold](#) over the last 8 months. Against gold, it tested parity in early [December](#), having fallen from a high near 2.4 in May and is now rebounding. Platinum now looks to be in an excellent position to outperform the yellow metal. A sustained move below 1 would be needed to question potential for some further upside in the short term

In absolute terms, [platinum's](#) rally from mid-December has been impressive. The metal hit a low of \$752 in late October, consolidated around \$800 and broke upwards on December 26th. It has since rallied to test \$1000 and a sustained move back below \$900 would be needed to question potential for some further upside. (Also see David's section on platinum in [Comment of the Day on December 24th.](#))

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.

British Pound per 1 Euro - the [Euro](#) rallied today from near 90p following an abrupt decline over the last week. However, a sustained move to new high ground would be needed for this area to provide anything other than a temporary area of support.

Dollar Index - The [Dollar](#) encountered resistance at the lower side of the Type-2 top, as taught at TCS, and would now need to sustain a move above 84 to question scope for some further downside.

Japan - pulls [back](#) from the higher side of the three-month range and needs to sustain a move above 9500 to indicate that the bulls have regained the upper hand.

Robusta Coffee - [rallying](#) towards the upper side of the three-month range and would need to sustain a move below \$1700 to hinder scope for an upward break.

Saudi Arabia - the [Index](#) has posted a higher low and the current rally broke the medium-term downtrend. It would need to sustain a move below 4500 to question scope for further higher to lateral ranging.

Italy - broke [upwards](#) from its short-term consolidation late last week and would need to sustain a move below 18500 to question potential for some further higher to lateral ranging.

Email of the day - on additions to the Chart Library:

"Hi, could you please add the [DJ STOXX Oil and Gas](#) index to the library?"

My comment - Thank you for this interesting suggestion which has been added to the Chart Library.

## Friday 9th January 2009

Commentary by Eoin Treacy

Deutsche Bank FX Blueprint for 2009: Overcooked - Thanks to a subscriber for this useful [report](#) from the FX team at Deutsche Bank covering a wide number of currency pairs. Here is a section on US Treasuries and the Dollar:

Foreign inflows disappearing: Treasuries next to fall? In the absence of a stronger improvement in the current account, financing issues and thus capital flows will become even more important for the dollar. 2008 saw credit (and equity) inflows collapse to levels last seen in the late 1990s, but Treasury inflows surged to their highest levels on record (see Figure 7). Much of the demand for Treasuries was a flight to liquidity or safety and even more so in the case of the shorter-maturity T-bills, which saw their largest inflows in history following the acceleration of concerns around the banking system.

Now that the risks of a full blown banking system collapse have receded "safe-haven" demand for Treasuries is not likely to be as forthcoming. Aside from deflation fears deepening, the main motive for buying bonds will be to follow the Fed as it engages in quantitative easing. However, bond yields have collapsed to their lowest levels in over 50 years and a bond rally has already been in place for over 25 years. Foreign ownership of US bonds has also surged (see Figure 8). Given the recent bursting in real estate, credit and equity "bubbles" and the associated declines in inflows, the chances of a similar bursting in government bond markets cannot be ruled out, especially if investors increasingly rely on "nonfundamental" factors such as the Fed being a buyer-of-last-resort to buy bonds.

That leaves a return of credit or equity inflows as the only viable alternative to Treasuries as a source of funding for the current account deficit. Valuations appear cheap and the government is underwriting much of the credit market. However, just one year of weak credit inflows will not be enough to unwind the excesses of the earlier period. More generally, after the dot-com equity crash of 2000, foreign investors required two years of a subsequent equity rally to attract them back in reasonable size. (see Figure 9). So not only is a recovery in credit or equity returns required, but also time, which does not augur well for the dollar in 2009 in our view.

#### Euro-area repatriation to catch up to US

The final source of support for the dollar has been US investor repatriation - the largest and most rapid in history. Though difficult to predict, such flows may well continue. The bigger question, however, concerns Euroarea repatriation. Euro-area investors invested significantly more abroad than US investors (three times as much from 2002-2007:H1), and the most recent data show repatriation picking up sharply (see Figure 10). If this continues, the positive effects on the dollar of US repatriation will be swamped.

A related factor has been the widening in cross-currency basis swap spreads - a measure of hedging currency risk for investors in foreign markets. The spread for the EUR/USD market has widening significantly and a return to pre-crisis levels appears unlikely. What the new "equilibrium" will be is yet to be known, but the consequence of the wider levels may well be increased reluctance by Euro-area investors to invest in US markets.

My view - Treasury [yields](#) topped out in 1981 and have been falling since, in one of the biggest bond price bull markets in history. The low posted in 2003 displayed many of the signs for an end to this secular move, but the credit / solvency crisis has lengthened the credit cycle and 10-year yields appear to have now hit at least a medium-term low near 2%. Even if one does not accept the contention that the government bond price bull market (yield bear market) is over, prices are overextended and reversion is likely.

[US Treasuries](#) rallied impressively to hit a high near [141](#) in December and have since pulled back just as sharply. In the short-term, potential exists for some steadying around current levels but a sustained move to new highs would be needed to question scope for some further retracement of last quarter's gains.

Sentiment towards the bond market remains positive as medium-term traders have profited from momentum and investors remain reluctant to venture back into other asset classes. However, the fall in prices since the New Year indicates demand for government securities is waning. This also suggests that one of the most substantial props for the US Dollar is being removed.

The US Dollar Index completed its [Type-2](#) top, as taught at The Chart Seminar, in early December and fell to 78 before finding at least short-term support. It then proceeded to rally towards the lower side of the top formation and encountered resistance near 84 this week. It is likely to remain volatile but it would need to sustain a move above 84 to question potential for further Dollar weakness in the short to medium term.

Taking a [longer-term](#) view, the impressive rally from 74 to 88 broke the three-year downtrend. Potential still exists for the Dollar to post new lows but the size of the August - December rally suggests that the most likely course of action would be a broad ranging pattern between approximately 70 and 90 which could play out over a number of years. In such an environment, we can expect sentiment to become quite positive as the Dollar rallies and bearish in the extreme as the Dollar approaches its lows.

At Fullermoney, we are not in the Dollar collapse camp but believe the Greenback is a congenitally weak currency. However, due to the competitive forces of globalisation, no country wants a strong currency which means a period of prolonged ranging could remain a viable option for some time.

Email of the day (1) - on model myopia:

"The article by Peter Wallison from the American Enterprise Institute on credit default swaps may be correct in every respect, but it is largely irrelevant because of the strange definition of risk. For many years, psychology went through a phase of mathematical models which it has now largely abandoned. The mathematical models could not answer the question of how the models predicted for a particular person sitting across the desk.

"Risk is a continuum ranging from remote risk through to proximate risk. A remote risk can be calculated by mathematical formulae in which any number of assumptions can be used. CDS and other financial derivatives are an example of this. A proximate or near risk in finance is a loan to build a factory. If the loan defaults, there is still a factory or part thereof in existence. The factory does not disappear in a haze of mathematical formulae. The factory only disappears in a catastrophic event. The financial sector is guilty of confusing reality with mathematical formulae."

My comment - Thank you for this insightful contribution, made in the spirit of Empowerment Through Knowledge. I share your reticence in accepting as a given everything suggested as fact by financial models. The shadow banking system contributed so much to the bottom lines of financial institutions over the last decade, that there was a tendency to rely heavily on new methods of valuation rather than doing the hard work of examining the balance sheets of

the respective reference entities. Too much trust was put in the ratings agencies integrity and not enough attention was paid to the fundamental characteristics of exactly what people were buying. Investors now need to be more discerning about the types of credits they buy because reliance on ineffective models is creating opportunities. Banks need to be encouraged to go back to basics and not be afraid of extending credit to borrowers with realistic chances of servicing the loan. From an investment as well as a lending stance, each credit needs to be assessed on its individual merits. It is only through this process that we can [winnow](#) the wheat from the chaff. This is a process we can all contribute to and together boost our awareness of the market.

Pimco Investment Outlook: Andrew Mellon vs. Bailout Nation - Thanks to a subscriber for this interesting [article](#) by Bill Gross covering the outstanding problems in the fixed income markets and how to profit from government intervention. Here is a section from the conclusion:

Still, future policymakers must confront the reality that is, not the one that should have been. And investors must do likewise, casting aside personal philosophies for a clear-headed view of the future horizon. PIMCO's view is simple: shake hands with the government; make them your partner by acknowledging that their checkbook represents the largest and most potent source of buying power in 2009 and beyond. Anticipate, then buy what they buy, only do it first: agency-backed mortgages, bank preferred stocks, and senior bank debt; Aaa asset-backed securities such as credit card, student loan, and auto receivables. These have been well-advertised PIMCO strategies over the past 6 months but there are others in clear sight. An Obama administration will quickly be confronted by the need to provide those hundreds of billions of dollars to states and large municipalities. Their requests total nearly a trillion dollars and to think California or NYC would be allowed to fail is, well - unthinkable. Municipal bonds then, selling at historically high ratios relative to U.S. Treasuries, offer attractive price appreciation potential, or at the very least a defensiveness with high carry that a 2½% 10-year Treasury cannot.

Here's another thought. While TIPS or inflation-protected securities cannot logically be a recipient of Uncle Sam's checkbook over the next 12 months, they can benefit if and when the government's efforts to reflate begin to take hold. 2½% real yields cannot possibly be maintained unless deflation as opposed to inflation becomes the odds-on favorite. What bond investors know as "breakeven inflation rates" are currently signaling a future where the U.S. CPI averages -1% for the next 10 years. Possible, but not likely. As an additional strategy, global bond investors should recognize the value in high-quality investment-grade corporate bonds in many markets. Yields of 6%+ for intermediate maturities are still common and readily available.

There is legitimate concern as to the ultimate destination and outcome of our "bailout nation." Realistically, quantitative easing, a two-trillion-dollar expansion of the Fed's balance sheet, and the near certainty of future budget deficits approaching 6-7% of GDP should alert bond investors to once again

become vigilant as was the case in the 1980s and 90s. Vigilantes we should be, but that is a battle to be fought in the Treasury market where low yields offer little reward and increasing risk. For now, our Ponzi-style economy and its policy remedies encourage bond investors to mimic Uncle Sam and its global compatriots. Buy what they buy, but get there first. Andrew Mellon would surely have disapproved. Liquidation was his game. Wimpy? Well, he's gonna have to start paying for those burgers on Monday, even in a bailout nation.

My view - If we are correct in assuming that the Treasury market is going to come under increased pressure this year, then other fixed income investments may attract more attention. One of the primary beneficiaries could be the inflation-linked sector which experienced a tremendous sell off in the latter half of 2008, having been one of the best performers in the first half of the year.

The spread of 10-yr TIPS contracted to 0 from more than 2.5% in July. This is by the far the tightest they have traded relative to Treasuries in more than a decade and one would have to be certain of deflationary pressures continuing indefinitely to justify such a spread. Even if deflation is a threat in the short to medium-term, TIPS are often very long-dated bonds and represent value at these levels relative to Treasuries; if one assumes inflationary pressures will pick up at any point in the future.

In absolute terms, the TIPS with a 2% coupon and maturing in 2026 found support in November near 81.5 and rallied well. It encountered resistance near 100 and pulled back before finding support again this week near 88. A sustained move below this level would be needed to question scope for some additional upside.

In the Municipal market, the 10yr California and New York bond spreads accelerated to highs of 320 and 240 basis points respectively in late December. Both have contracted since and would need to move to new highs to question scope for some further contraction.

The Pimco California Income Fund trades at a premium of 5.31% and yields 10.49%. It collapsed from \$14 in September to \$4 in December where it found at least short to medium-term support. A sustained move below \$6 would now be needed to question scope for further upside.

The Blackrock California Muniyield Fund trades at a discount of 17.03% and yields 6.13%. It found support in October near \$7, following an accelerated decline and retraced almost the entire decline before retesting the lows in December. It has since rallied back to \$11 and would need to sustain a move below \$10 to question potential for some additional upside.

The Blackrock Muniholdings New York Insured Fund trades at a discount of 18.77% to NAV and yields 6.49%. The fund fell from 12 to 6.5 before finding support. It rallied well in October but gave up almost the entire advance in November before posting a higher low in December. While it is looking

somewhat overextended in the short-term, a sustained move below \$7 would be needed to question scope for some additional upside.

Email of the day (2) - [on the Chart Library](#):

"A bouquet for your charting service which, to my mind is worth the cost of the subscription on its own. Would it be possible to add charts of the new highs/new lows data for the major stock markets? This would fit in well with the volatility and advance/decline charts and be a boon to myself and, I am sure other, traders."

My comment - Thank you for your kind words and we are delighted you value the Chart Library, which will always be a work in progress. We currently show the [NYSE High-Low](#) Index but this is the only such index currently listed on Bloomberg. Unfortunately, we do not have ability to create these indices ourselves, so it is not possible to post any further high-low indicators in the Chart Library at this time.

Quote of the week - [on life](#):

"Life ought to be a struggle of desire toward adventures whose nobility will fertilize the soul."  
Rebecca West

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

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