

# 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 26th January 2009**

Roger Lowenstein: Thain's Original Sin Rooted in Executive Pay - [This is a superb column](#) by Roger Lowenstein for Bloomberg (*also provided in [PDF format](#), in case the BBG link is eventually dropped*).

As President Barack Obama moves to re-regulate the financial system, he shouldn't forget the most glaring abuse of all: the executive larceny otherwise known as compensation.

Last week's shotgun firing of John Thain provided a reminder of Wall Street's singular lack of proportion. When he was hired as chief executive officer of Merrill Lynch & Co. in 2007, Thain collected a signing bonus in cash and stock worth \$43 million, in addition to lucrative stock options.

A year later, Thain was hungry for more. Even though Merrill was hemorrhaging money and even though its eventual acquirer, Bank of America Corp., was seeking a second dose of government aid, Thain accelerated billions of dollars of bonus payments for his troops. Reportedly, he considered, before changing his mind, seeking \$10 million for himself.

At least Thain managed to preserve some value for Merrill's shareholders. His predecessor, Stan O'Neal, all but destroyed the firm, and still collected an exit package worth \$161 million.

Such payouts always seemed obscene. Now, with the banking system in ruins, their true cost is exposed. Poorly designed incentives stimulated ill-considered risks. It isn't too much to say that executive over-pay was the original sin that fostered the culture of corporate bubbles.

Not just today's credit meltdown, but all of the stock market booms and busts of the past 20 years -- from junk bonds to high tech to Enron Corp. to, finally, the subprime mortgage fiasco. It is time for it to stop. In any other country, people who bankrupted companies, much less triggered national depressions, would be lucky to escape the big house, let alone be rewarded with eight-figure paychecks.

Pay Soars

The short story of executive pay over the past few decades goes like this.

Stocks did poorly in the 1970s. Academics such as Harvard University's Michael Jensen noticed that CEOs owned relatively little stock; they urged boards to give them more.

Pay levels skyrocketed, foremost on Wall Street, but also throughout America. Where once the CEO stood to take home 20 or 30 times as much as the employee on the bottom, by the late 1990s the ratio had soared to 300, even 400 times. It was said that pay couldn't possibly be excessive, for it was set in the market -- and the market, good heavens, was never wrong.

True, boards lavishly rewarded success. They also rewarded failure. They doled out stock options and if the stock collapsed, they larded out more options at the lower share price. Set the bar low enough, and any CEO, no matter how incompetent, will sooner or later tumble across it.

My view - Well said Roger Lowenstein, and well done Bloomberg for publishing this column. The financial community has too often turned the other way, in my opinion, when faced with corporate excesses.

Governance is everything, as we have often said at Fullermoney. Mankind is a clever species, albeit deeply flawed. Consequently, developed countries are usually responsible for their own success or failure. Our ethical codes are established at the top - whether talking about government, corporations, schools and all other social institutions. Our collective sense of morality, which often fluctuates over the longer term, will inevitably be instrumental to our success or failure as a nation.

Will the Obama administration be able to improve America's standards of governance? Hopefully, and an increased awareness of the problem is one positive factor in the current economic crisis. The breakdown in ethical standards should be obvious to many. It led to the current credit and insolvency crises. Economic prospects for the future are likely to be influenced by standards of governance more than any other factor.

Email of the day (1) - On who gains most from the bubbles and bailouts:

"I have much appreciation for your stabilizing influence most needed in these days. Helps me walk without crutches.

"Read Jeremy Grantham with much interest. He is an intellectual but still in the box.

"Let us go outside the box for a sobering moment and ask WHO stood and WHO stands to gain the most from the bubbles and "bailout"? The short answer is the money creators. They are presiding over and benefiting from the greatest transfer of wealth in history, with the almost certain guarantee that they will never be found out, since they are operating above the threshold of perceived reality.

"You of course know that every new dollar that they create dilutes every dollar already created. They are using non-substance fiat that cost them nothing and exchanging it for substance in the form of capital assets. This is a transfer of wealth by any definition. This depreciating fiat is impoverishing all who hold dollar assets. All fiat paper assets will follow in time.

"Of course you already know this and I know that you cannot and will not share this with your readers and you may not even let yourself believe it. THE "BAIL OUT" IS A TRANSFER OF WEALTH to the money creators whom the public does not know."

My comment - Thank you for your kind words. And thanks especially for sharing your thoughts on what I regard as a basic truth, concerning the printing of fiat currency in excess of GDP growth.

Also, Eoin and I had no hesitation in posting your email, because we are free press.

However humane the bailout may appear to be, in terms of cushioning a severe recession and preserving some jobs, I have little doubt that it will further erode the US dollar's purchasing power over time.

Your comments are also germane to the lead article above. More people will understand what is going on if these problems and developments are increasingly discussed. For certain, your children and grandchildren know, because you have taught them. The Collective of subscribers knows, and while markets can seem capricious and our vision challenged, we are not without the wherewithal to protect our wealth in most circumstances.

Tim Price: Lessons from the 1930s - This ever-interesting [letter](#) is published by PFP Wealth Management. Here is a portion of the opening:

Bush - or at least his reputation - is dead. Long live Obama. The Economist magazine makes a decent fist of providing a not entirely partisan assessment of the achievements of George Walker Bush (in a special article entitled "The frat boy ships out", and to be fair they endorsed him the first time around) but it is plain where the journalistic, if not editorial, sympathies broadly lie now. Princeton historian Sean Wilentz is cited: "Many historians are now wondering whether Bush, in fact, will be remembered as the very worst president in all of American history."

Americans, of course, do not follow the strict Anglo-Saxon "King is dead" protocol that venerates the role, if not necessarily the incumbent, following a change-over in the administrative hierarchy. But then they claim to be republicans, with that small 'r'. In any case, Barack Obama has inherited a right royal mess of pottage.

Perhaps the biggest danger is to assume, in a crisis, that politicians are in much of a position to help anybody, other than themselves. From what I remember of my pre-O level days, my school didn't commit the biggest

resources to the study of the Great Depression. But I distinctly remember a half hour devoted to the topic, and the general implication was: Franklin Roosevelt helped end it. After reading Murray Rothbard's "America's Great Depression" (Fifth edition 2008, by the Ludwig von Mises Institute), I am no longer so sure. In fact, after reading Rothbard's study of the economic disaster of 1930s North America / rest of the world, I am left wondering whether pretty much everything I had been led to believe about that time is wrong. Since we are poised on the precipice of our very own 1930s, the question bears repeating.

Rothbard died in 1995. He was therefore unable to comment about the colossal bonfire of vanities stoked by Wall Street and the mortgage banking system over the past decade. It is unlikely, however, that he would have approved. He was not exactly a fan of the role of banks, nor of the perhaps fundamentally flawed model known as fractional reserve banking.

If it were a more perfect world, schoolchildren would at least be taught the bare minimum about the real economy, and not least about the way banks work. (One of the statutory objectives of the UK's Financial Services Authority is to "promote public understanding of the financial system". If the UK financial regulator can't pull that trick off now, it will never get a better opportunity in the history of the world.) What we know as fractional reserve banking equates to letting banks keep a tiny fraction of their deposits (their depositors' money, one should perhaps add) in order to lend out the remainder for profit (theirs, not the depositors', one should perhaps add). Simultaneously, they retain the obligation to redeem all depositors immediately upon demand. More astute readers, or anyone who has maintained a bank deposit account over the last two years, will see the subtle flaw in this system. In the words of Murray Rothbard,

"Banks are "inherently bankrupt" because they issue far more warehouse receipts to cash (nowadays in the form of "deposits" redeemable in cash on demand) than they have cash available. Hence, they are always vulnerable to bank runs. These runs are not like any other business failures, because they simply consist of depositors claiming their own rightful property, which the banks do not have. "Inherent bankruptcy," then, is an essential feature of any "fractional reserve" banking system."

My view - I think readers will find Murray Rothbard's points interesting and informative. Rightly or wrongly, we are going to experience Obama's economic programme, not that of a fervent free marketeer. Moreover, variations of the US approach are being adopted by many other countries.

From a practical investment perspective, I want to know how this will play out in the markets, so that Fullermoney can be of value to subscribers, helping us to protect our assets during what lies ahead.

I assume that the USD and most other fiat currencies will be further debased. The excess liquidity is likely to cushion the recession somewhat, preventing a depression, but probably leading to lower GDP growth in years ahead than would occur following a more significant purge of prior excesses. The

additional liquidity should be good for gold and many other commodities, but very bearish for long-dated government bonds over the next decade or two. Equities and corporate bonds should also recover more quickly than would occur following a depression, at least until inflationary pressures re-emerge, as they surely will at some point.

Email of the day (2) - On market and economic trends, not least in Asia:

"I hope all is well. This is the second email from me and my how things have changed in less than 9 months. During the previous email, I expressed a view for a strong dollar, weaker commodities (for a trade) and largely sideways to lower bias on equity markets. What a champ! Only, trading and having a view is very different and while I did get out of my silver and gold at the highs, I bought back way too early and have since suffered in silence for the past 4 months!

"As it stands, this may be of interest to you. I am not sure if you recall but our company is an importer of automotive components and as such we have extensive dealing with a lot of the Asian and European countries. Well, things couldn't be more different now. 8 months ago, we were seeing a rampant pass through of higher prices because of higher commodity prices, very high shipping rates, higher labour costs (especially in the coastal cities in China) and strong demand. Fast forward to today and well, we know what has happened to commodity prices. Shipping rates have dropped from over 4000 USD for one 40ft container from China to South Africa to around 800 USD. Labour costs have reversed and most factories that we deal with are cutting salaries, head count and hours worked. A majority of the factories that we deal with are now working 4 days weeks instead of the 7 day week which we are used to seeing.

"A lot of these problems are well documented by now, however, seeing them first hand certainly hits home hard. I want to be an optimist but I can't help but feel that these problems will extend and any solution will be a function of both a lot more time and price. As I mentioned, I am long gold and silver which has recently started to perform and fundamentally, this is the only trade that makes sense to me, especially gold which has evolved in sentiment from a barbaric relic, to a hedge against inflation and now currently to a store of value over the past years. I think a shift in sentiment to the mainstream is close to complete in the precious metals sector and we are getting ready for the next leg up especially given the state of G-7 currencies which seems like a race to see which one can be the worst. I suspect that the USD has probably topped vs the Euro however, I don't think we see too much Euro strength in the near future. The whole Euro 'project' is extremely strained right now as evidenced by bonds spreads for Greece, Italy, Spain etc etc blowing out vs German bunds. It's actually quite scary and the implications are far reaching as confidence in governments around the world are being tested like never before in RECENT history. The strength in gold has also been another tell in the past week given the USD rally. As for equities, the only sector that I am invested in is precious metals which have held up very well, even during the brief correction of gold to the 800 level in the past two weeks. I have no real

view on equity markets right now except to say that I do participate in the dow and nikkei quite frequently and I have lost money every time I have tried to buy it for the past 6 months. C'est La Vie. The only other market that I am keen to buy is Vietnam and that's purely because I just don't think that can go down too much more. I hate sounding like one of those crazed gold bugs however, given the state of interest rates around the world, the breakdown of trust in both government and our financial institutions and the likely increase in social strife (witness Iceland) I would be very surprised if we don't see 1200 on gold this year. Timing however is everything.

"I did want to ask you something. I see that you have invested in Vietnam in the past and I want to know what vehicle you invested through. I am currently long the Vietnam Opportunity Fund on IG index however, the bid / offer sometimes can be in excess of 10% on the price. This spread is obviously ridiculous. If you can suggest another method of getting exposure to Vietnam, I would appreciate it."

My comment - Thanks for the update. In terms of trading, you described a profitable beginning to 2008, an expensive midyear, followed by a partial recovery. Many of us have traversed a similar path, including myself.

That is a modest triumph under circumstances which included the biggest market meltdown since at least 1974, plus record volatility. Looking back, of course we could have and perhaps should have done better, which is always our aim, provided it can be achieved at an acceptable risk. Some very big names failed in this respect, as you know. To have survived 2008, financially and psychologically, is a triumph which all investors and traders can build upon.

While one is always predisposed to looking backwards at what we know, not least because any view of the future is inevitably murky, I believe 2009 will be a very different year.

For instance, I think volatility will gradually return to more normal levels, particularly if most stock market indices range more than they trend. The former would be consistent with base formation development. Obviously, however, the possibility of another down leg cannot be ruled out while economic news continues to deteriorate. This is a hard landing for the global economy, so when buying equities, it is better to do so on weakness than during technical rallies, at least until the next uptrends are established, confirmed by indices rising above upturned 200-day moving averages. This is certainly not imminent.

The economic conditions you describe are scary but will eventually form part of the preconditions for a recovery. Precious metals do look interesting but we need to maintain our monetary disciplines, particularly with leveraged trading.

Regarding [Vietnam](#), which is an interesting long-term recovery candidate, we have a small investment in the dbx-trackers FTSE Vietnam ETF ([XFVT UK](#)), via Mrs Fuller's last ISA. I will probably add to this position at some point but. It is not very liquid at £43 million, but this is not a problem with small positions.

Unfortunately it is still too illiquid for IG Index and I too had an unfavourable experience with spread-bets in the Vietnam Opportunity Fund ([VOD LN](#)), mainly due to spreads.

My personal portfolio: A silver long reopened - After a breakeven stop was triggered earlier this month, I had not wanted to pay up. However with [silver](#) ranging higher and the [US Dollar Index](#) looking vulnerable to a downside correction, I reopened half of my previous position, paying \$12.125 for the March contract, including spread-bet dealing costs.

Email of the day (3) - On protectionism:

"If we see a resurgence in "protectionism" around the world, as perhaps indicated by Obama's spat with China over the yuan, what could be the possible consequences in world stock/commodity/currency markets?"

My comment - I thought the recent comment by new Treasury Secretary Timothy Geithner, that China is "manipulating" its currency, was ill-timed and unnecessarily provocative. Everyone knows that a resurgence in protectionism would be extremely bad for global GDP growth.

Additional Commentary by Eoin Treacy

Deutsche Bank China Macro Strategy: Heading towards a qoq recovery - Thanks to a subscriber for this interesting [report](#) by Jun Ma and Wenjie Lu covering the release of the latest Chinese economic figures. Here is a section:

For medium-term, we stick to our outlook of a W-shape recovery. Although in this note we highlight the near-term upside in economic activities, it does not alter our medium-term outlook of a double-dip scenario or a W-shape recovery. Figures 1-2 show that we expect qoq GDP growth to trend down again from H2 this year, until hitting the second trough in H1 2010. This is partly because the 150% monthly lending growth is simply not sustainable from the second half of the year. Given that the annual loan growth is likely to be consistent with the M2 growth target of 17% (i.e., annual new loans in 2009 at RMB5.3tn), it implies that the average monthly new lending from April to December this year will likely be only RMB300bn. This will represent a 60% drop from the monthly level seen in Dec 08-Feb 09. As for fiscal stimulus, we expect this year's total fiscal deficit/GDP ratio (including that officially included in the central government budget and the off-budget onlending of state construction bonds to local governments) to reach 2.6% of GDP. This magnitude of stimulus is unlikely to repeat in 2010 (i.e. the broadly defined deficit/GDP ratio is unlikely to reach 5.2% of GDP in 2010), as many in the government still believe that the 3% deficit/GDP ratio is the threshold beyond which fiscal sustainability becomes an issue.

Therefore, on a yoy basis, fiscal stimulus will likely decline in 2010. The lack of sustainability (or the one-off nature) of policy stimulus, combined with the deinvestment process of the corporate sector shown by the intention to sharply slow down investments by real estate, manufacturing and mining companies, will result in a W shape recovery of the Chinese economy in the next 1.5 years. The double-dip scenario happened in 1998-99 in China, and has been a norm (rather than exception) during major economic recessions experienced by developed countries' (e.g., the US).

My view - This sounds like a plausible view based on the size and potential longevity of the stimulus package. The government has invested a lot of political as well as monetary capital in boosting economic growth, so they will welcome and promote this good news. If they are successful in raising the public mood, negative sentiment towards the stock market may be checked. It remains an open question, as to how long the government is willing to keep promoting such rampant loan growth and the potential for slower economic growth remains a risk when it ends. The extent of any additional slowdown is likely to rest not so much on domestic concerns but on demand for China's exports from the rest of the world.

Chinese demand growth for commodities has fallen considerably over the past year in conjunction with the global slowdown. Commodity prices have contracted severely as a result. If Chinese metal and energy consumers return to the market in force, we could see prices improve substantially in a short period of time. Their return is not a surety, but the potential is enough to check overly bearish sentiment of the sector.

China's [stock market](#) continues to show the best base formation development characteristics of any globally important market and would need to sustain a move to new lows, beyond a few days, to question scope for further higher to lateral ranging. (Please note - China is closed this week for New Year)

Email of the day (1) - on Chinese education company ADRs:

"Combining the education theme with China starting to hold up well, you might want to look at these two ADRS, tickers [CEDU](#) and [DL](#).

"I'm starting to look at things in terms of whether they have based and long term moving averages have flattened and are starting to turn up. Out of over 60 Chinese ADRs, these two are about all there is with that sort of potential (DL has quite a short history). None of the Chinese resource ADRs have done this.

"Of the US sectors, the airlines index is the most advanced in this basing process. That is no doubt helped by oil falling but there is also the prospect of industry consolidation. The basing is not replicated for the Chinese airlines yet."

My comment - Thank you for this follow-up to Email of the Day (4) in my section on [January 20th](#). Education shares are outperforming in the USA and

while a niche market, they are worth keeping an eye on to gauge whether they can maintain this relative performance.

Neither of these companies is listed on a Chinese exchange and are relatively new listings in the USA, which makes me a little suspicious. However, both have found support recently and show relative strength compared to the wider market. They may partake in the move taking place in other education shares, but doing one's due diligence would be essential if considering a purchase.

The Los Angeles Times: Asian psyllid threatens California citrus - Thanks to a subscriber for this important [story](#) by Jerry Hirsch which could have far reaching effects for orange juice prices. Here is a section:

State agriculture inspectors are stepping up their efforts to battle what they believe is an agricultural time bomb.

After discovering what's known as the Asian citrus psyllid in the Hillcrest neighborhood of San Diego last week, the farthest north the bug has been found in the city, agriculture officials warned that the bug was rapidly moving north since crossing the Mexican border at Tijuana in July.

The pest is responsible for spreading citrus greening disease and causing catastrophic damage to orange farms in Florida and Brazil. Agricultural officials warn that the same disease could be a catastrophe for California's \$1.2-billion citrus industry.

To slow the pest's advance, officials have established quarantines in parts of San Diego and Imperial counties, prohibiting the movement of citrus plant material out of those areas. Fruit can still be shipped, but it has to be cleaned first.

For now, officials believe the state's orange groves are still free of the disease. The danger is that the psyllid, a durable insect that can withstand freezing temperatures and hurricane-force winds, will find trees infected with greening and spread it across the state.

"We have never been threatened with a disease like this before," said John Gless, a third-generation farmer from Riverside who wonders whether there will be anything left of his 6,000 acres of California citrus groves to pass on to his children and grandchildren who farm with him.

Southern California residents are unknowingly the first line of defense, because only their vigilance can provide the early warning agriculture officials need to save the industry, said Ted Batkin, president of the Citrus Research Board.

My view - Agricultural commodity prices can move incredibly quickly if new data is priced-in such as frost or disease. The greening disease has not been found in California and they are vigilant for any sign it may be appearing. However, this is enough of a threat for investors to watch orange juice prices

for signs that demand is overpowering supply. The chart action will likely lead the news flow, as those in-the-know take positions if an outbreak occurs.

Orange Juice hit a [20yr low](#) in 2004, near 54.5¢, before rallying towards the upper side of the decade-long range by early 2005. It broke upwards in September 2005 and rallied consistently to test the long-term highs near 200¢. It completed a Type-2 top in early 2007 and has collapsed back into the long-term base and is currently testing the lower side.

The medium-term downtrend lost [momentum](#) from October and while a progression of lower highs remains in place, orange juice has firmed of [late](#). A sustained move below 67.5¢ would now be needed to question scope for some additional upside.

Email of the day (2 & 3) - on accessing platinum ETFs from Australia:

"Here it is Australia Day and I'm worrying about markets!

"Interesting gold move on Friday leads me to platinum.

"Am long bullion (Perth Mint) and Oz and US listed gold miners and also silver via iShares Silver Trust (US). (1) How do I 'easily' get exposure to platinum? I don't think I want a single company like AQP listed in Oz. I see there is [ETFS](#) physical platinum (UK) and [ZKB](#) Platinum ETF (SW). (2) I can't find in the Chart Library what 'SW' stands for. If it's an obscure market it's still not much use.

"Perhaps the Collective is wrestling with the same questions?"

And

"Re my previous email I have just this minute discovered that the ASX is listing (has listed?) a new ETF Securities product ETFS Physical Platinum (ETPMPT). Also palladium (ETPMPD) and silver (ETPMAG). Cheers"

My comment - Thank you this interesting question and I hope your precious metal longs give you some peace of mind during the national holiday. As you point out there are currently two Platinum ETFs. One listed in the UK, the other in Switzerland. You can get the full list of country codes, we append to every listing in the Chart Library, by typing 'country codes' into the main Fullermoney search engine. The first result should take you a forum thread, where you can download the [spreadsheet](#).

As you mention in your second email. ETFS Physical Platinum is currently being listed on the ASX. However, it is not trading so; we cannot add it to the Chart Library yet. Here is a link to the ETF Securities press [release](#) from December 20th.

Email of the day (4) - on saving settings in the Chart Library:

"I seem to be having difficulty installing 3 moving averages on my daily and weekly charts i.e. 8, 20 and 200. I tried following your 'Help' section but to no avail. Your guidance will be much appreciated."

My comment - To add moving averages to any chart: First select you instrument from the search or menus. Click on the Charting tab in the charcoal bar above the chart. Select Moving Average from the Analysis dropdown menu. Three boxes will appear. Enter your chosen values in the boxes e.g. 8, 20 & 200. Hit Apply. Your chart should look something like [this](#).

Please note - I chose a line chart for illustrative purposes, if you are looking at candles, the orange 8-period moving average may be more difficult to see because it tracks the price so closely.

You can also save these parameters as a default by clicking on Charting again. Click on the 'Save' tab in the aquamarine bar at the top of the dropdown menu. Give the Preset parameters a name and hit Apply. Refresh the page. Your new Preset defaults will have been added to the Chart menu at the top right of the page.

Email of the day (5) - on the repercussions of the financial crisis:

"The following article was discussed in this week's [Barron's](#)

"It is an interesting study of the possible aftermath of this financial crisis.

My comment - Thank you for this link which also appeared, along with my view in Comment of the Day on [January 7th](#).

Email of the day (6) - on an interesting BBC documentary:

"I thought readers of Fullermoney may be interested in this [BBC](#) documentary on the 1929 Great Crash. The documentary draws parallels with the current crash such as the global economy, deregulation and easy credit."

My comment - Thank you for this link which is available to subscribers based in the UK.

Email of the day (7) - on the New Zealand Fully Gross 50 Index:

"Can you point me to the chart of the NZX50? I can see the NZX sub sectors like Forestry etc but not the lead index. Thanks"

My comment - Previously, if you searched the Chart Library for 'NZX' you would only have found the New Zealand sectors. This was because we have two New Zealand stock indices in the Chart Library. One is the New Zealand All Share (NZSE) and the other is the New Zealand 50 Fully Gross Index

[\(NZSE50FG\)](#). To make it easier to find using the Chart Library's search engine, I've added NSX50 to the end of the latter's title. .

Email of the day (8) - on new listings for some Euronext shares:

"Just to let you know that the chart for ArcelorMittal in the CAC40 hasn't updated in the chart library since 13th Jan.

"Since David is trading this stock I thought I'd have a look at the chart but no joy."

My comment - Thank you for alerting us to this issue. We have four separate listings for ArcelorMittal in the Chart Library. The reason the French version is not updating is because Euronext launched a single order book for [50 stocks](#) on January 14th. Here is the notification on Bloomberg:

Eff 01/14/09 Euronext to launch Single Order Book (SOB). Trading data for this company will only be displayed on the Market of Reference (MoR) line MT NA.

This means that the MTP FP Equity (Paris) ticker for ArcelorMittal is no longer applicable. The MT NA Equity ([Amsterdam](#)) is updating correctly and is now the Market of Reference for the share. We are working to make all the relevant changes to the various lists in the Chart Library.

Email of the day (9) - on adding JP Morgan Emerging Bond Indices to the Chart Library:

"The article by J Grantham was insightful and the NYT article helpful. Thanks. May I request on the Chart Lib for JP Morgan Emerging Markets Bond Index Plus ([EMBI+](#))?"

My comment - This index can already be found in the Chart Library. Simply type EMBI into the Chart Library's search engine. .

Last 2-week's signups for the Free (Abbreviated) Comment of the Day - For the week of January 11th new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, France, Hong Kong, Singapore, Switzerland, the UK and the USA - 7 in total. In descending order, which topped the list in terms of the last week's new signups? It was the UK, the USA and Australia.

For the week of January 18th new signups, including subscribers and pre-subscribers, live in the following countries or regions: Canada, India, Sweden, Switzerland, the UAE, the UK and the USA - 7 in total. In descending order, which topped the list in terms of the last week's new signups? It was the UK, the USA and Canada.

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

## Tuesday 27th January 2009

Tim Price: Seems to be the hardest word - [Here is the latest, interesting letter from Tim Price, published by PFP Wealth Management.](#) Here is the opening, commencing with two apt quotes:

"..banks have done more injury to the religion, morality, tranquility, prosperity and even wealth of the nation, than they.. ever will do good. Our whole banking system, I ever abhorred, I continue to abhor, and shall die abhorring.. every bank of discount, every bank by which interest is to be paid or profit of any kind made by the deponent, is downright corruption."  
- US President John Adams, 1799.

"It is well enough that people of the nation do not understand our banking and monetary system, for if they did, I believe there would be a revolution before tomorrow morning."  
- Henry Ford.

A moment comes while you're watching the gripping new film 'Frost / Nixon' when you suddenly realise that director Ron Howard has crafted pure entertainment gold out of some ostensibly unpromising material. A televisual battle of wills between a glib showman and a disgraced politician ? But 'Frost / Nixon', boiled down to its essentials, is about just one thing: a bilked nation craving an apology.

So its relevance to the current financial débacle speaks for itself. The scale of the banking crisis is so huge, and the dislocating damage wrought across all financial assets so extensive, it challenges language and thought just to try and articulate it. But one response has been almost universal: having been monumentally cheated, we demand an apology. Yet answer comes there none.

The lack of contrition may have something to do with the breadth and diffusion of the guilt.

We can justifiably start with the politicians. The Gramm-Leach-Bliley Act of November 1999 repealed enough of 1933's Glass-Steagall Act to allow commercial and investment banks to play in the same sandpit. (At the risk of appearing parochial or partisan, all of the proponents of Gramm-Leach-Bliley happened to be Republicans.) The regulators played their part, not least the SEC in its decision to outsource its regulatory function in overseeing the credit markets in the 1970s to three for-profit companies, the ratings agencies

Standard & Poor's, Moody's and Fitch. The decision to require issuers of debt to pay for their own ratings, leaving credit ratings as a "freely provided" public good, it no longer requires noting, created monstrous conflicts of interest for the ratings agencies. And the role in the crisis played by fraudulent mortgage originators, and the ethical vacuum of the "originate to distribute" model, and deal-hungry bankers divorced from true accountability, has been widely discussed. But since a housing and credit bubble also requires the willing participation of a greedy and credulous public, there are really few people who emerge entirely untainted from the wreckage. By and large, we are all complicit. What matters is how we reach resolution.

My view - The quotes show that some things seldom change. Regarding Tim Price's conclusion in sentences immediately above, some people are obviously much more complicit than others. I suspect and hope that the public discussion and debate regarding all this will be thorough.

How we reach resolution certainly does matter, not least in terms of how we manage our investments. The stakes are high. Fullermoney's strategy will be to both monitor and participate in the analytical debate, with considerable help from the Collective, and to be guided by market trends revealed by our vast Chart Library, accessible to all subscribers.

Clive Hale's View from the Bridge (over the River Kwae): Another day - another scandal - [This issue](#) contains Clive's impressions while in Thailand. [Here is the opening:](#)

This is how politics works in Thailand. Whether it is a general accused of taking bribes for re-equipping the air force with Saab Gripens (although compared with the Al-Yamamah contract - loose change in a bucket) or a lowly official who bought air conditioning units that didn't work there is always something for the Thai's to chew on. The opposition party is the PAD (the pro-Thaksin red shirts) - Peoples Alliance for Democracy - but not democracy as we know it. In Thailand the military and the royal family have ruled the country up until about 25 years ago when the first "democratic" elections were held. So trying to compare Thailand or in fact any "new" democracy (pretty much most of the world!) with our ideas of democracy in Western society isn't going to work! Churchill would have understood - "democracy is the worst form of government apart from all the others" as he was wont to say.

Bribery, corruption and democracy are synonymous in much of the region. In Korea 67% of people polled were happy for politicians to take bribes as long as it didn't affect them! Maybe there isn't a phrase for "vested interests" in Korean? Unfortunately for Thaksin he was convicted, in absentia, by a military court for "abusing power", sentenced to two years in prison and banned from all political activity for five years. The PAD have stepped up their campaign to have the sentence revoked which culminated in a series of demonstrations which shut the two main international airports in Bangkok; Suvarnabhumi and Don Muang.

The repercussions on Thailand's tourist industry had not been thought through by the PAD and a second series of demonstrations barricaded the Parliament buildings and left the airports alone. The Government are now considering whether to charge the leaders of the PAD with international terrorism for their earlier actions. Always something controversial going on in Thai politics!

My view - Governance is everything, as we say at Fullermoney, and Thailand's governance has been challenged, to put it mildly. However this is priced into the stock market as we can see from the [Bankok SET Index's Yield](#) of 7.35%, which is higher than its current PER of 6.48.

I regard Thailand as an undated warrant on China's growth potential, and participate for that reason. I do this specifically via the Aberdeen New Thai Investment Trust ([ANW LN](#)), which is held in my personal long-term pension accounts. For broader regional coverage, including Thailand, I also have a position in the Aberdeen New Dawn Investment Trust ([ABD LN](#)). I will probably hold these until the next cycle of higher short-term interest rates in Asia is well underway.

Madoff Enablers Winked at Suspected Front-Running - [This is an informative feature](#) from Bloomberg. Here is the opening:

For Swiss banker Werner Wolfer, the memory of his first encounter with one of Bernard Madoff's emissaries nine years ago is as clear as the waters of Lake Geneva.

To hear Patrick Littaye talk, the Wall Street money manager could walk on those waters. "It was like a religion," Wolfer, 57, says of the promise of steady returns, which would be echoed by other acolytes. "These people firmly believed in the story."

Littaye, 69, was co-founder of New York-based Access International Advisors LLC, one of more than a dozen feeder funds that acted as middlemen between investors and Madoff. Wolfer visited Littaye at his office near the Champs Elysees in Paris in 2000, after becoming chief investment officer at Banque Marcuard Cook & Co. in Geneva, to learn more about how Madoff made his money.

Banque Marcuard, a private bank catering to the wealthy and now part of Swiss lender St. Galler Kantonalbank, had invested about \$50 million of its clients' money directly with Madoff in the mid-1990s on Littaye's recommendation.

Banque Marcuard made money with Madoff along with its clients. They paid fees based on the profits Madoff reported, which averaged a net of 11 percent a year. There was never a losing year, regardless of whether markets went up or down. The proof was in the trading statements sent to clients every month.

'It All Looked So Good'

"It all looked so good," says Wolfer, who has a master's degree in economics from the University of St. Gallen.

The truth turned out to be something else -- and far more complex than a criminal masterminding a \$50 billion Ponzi scheme that bilked investors from Palm Beach to Paris, as Madoff allegedly confessed to doing on Dec. 11.

If the 70-year-old money manager was running a con, then his marketers like Access International, wittingly or not, were part of the scam.

The purported mission of such feeder funds was to vet hedge funds for wealthy clients. Instead, the line between victim and perpetrator was blurred. Middlemen like Littaye funneled billions of dollars to Madoff, even, in some cases, when they suspected he was engaged in questionable trading practices. In return, they reaped hundreds of millions of dollars in client fees.

My view - When a suave banker, financier type, accountant or lawyer with all the ostentatious signs of wealth recommends that you invest in funds or various other financial products, ask him outright how he will be remunerated if you decide to follow his advice.

Commission arrangements are the accepted norm and do not imply impropriety, but they may compromise objectivity. Also, if you are financing a feeder fund, in addition to the primary investment vehicles own fees - double charges in other words - it will require either genius or high leverage to outperform the benchmark. Anyone can use leverage and financial genius is a will-o'-the-wisp.

Caveat emptor! If you read this article from Bloomberg, it is less likely that you will ever be seriously scammed.

Additional Commentary by Eoin Treacy

Deutsche Bank, The Asia Economist: How low can rates go? - Thanks to a subscriber for this interesting [report](#) by Michael Spencer covering the potential for ultra low rates in Asia. Here is a section:

Bank Negara Malaysia cut its intervention rate by 75bps this week, the latest in decisions by central banks that have surprised us with the haste with which interest rates are being cut. Being bearish with regards to the growth outlook and expecting deflation in many Asian economies this year we had expected central banks would become aggressive in easing, but still we find we have had to adjust our interest rate forecasts frequently and by large magnitudes.

Since the peak - -which was in Q3 last year for most central banks - official interest rates have fallen about 3.6% to the lowest average level of interest rates in at least four years. We expect rates to fall about another 100bps over the next six months. But could they go lower?

If we look at the history of policy rates in Asia, we find that in most economies we expect rates to fall below their previous all-time lows (see table below). In China, Malaysia, the Philippines, South Korea and Taiwan, we forecast that central bank rates will fall 100bps or more below their previous all-time lows. In India, we forecast the repo rate will essentially be reduced to its previous low, and in India and Thailand our forecasts are within 25bps and 50bps of the all-time lows respectively.

But since this is quite possibly the worst recession - in nominal GDP terms - these economies will have experienced it is reasonable for interest rates to be brought down to or below their previous all-time lows.

...but deflation means real interest rates are rising and will continue to do so

But with deflation taking hold in the region, even these low interest rates may not provide any effective monetary stimulus. Broadly, across the region, we expect inflation to fall faster than interest rates. Hence, real interest rates will rise, in our view, everywhere over the next few months. Measured in terms of real interest rates, monetary policy isn't getting easier.

My view - Some Asian countries look likely to drop rates to zero. Hong Kong is there already, due to its US Dollar peg. [Singapore](#) is also close to that level. As efforts intensify to combat nascent deflationary expectations potential exists for rate further rate cuts in a number of other Asian countries, The challenge for central bankers is to provide easy monetary conditions to combat the effects of the global recession. However, the reversal of inflationary expectations leaves real interest rates in positive territory for some countries, despite the best efforts of policy makers and already very low interest rates. In these countries quantitative easing remains a distinct possibility and inflation could easily become a problem if monetary conditions are not tightened quickly when growth picks up once more.

Many developed countries are now in a very low interest rate [environment](#). This has seen yields in countries such as the [USA](#), [UK](#), [Germany](#), [Canada](#) and [Australia](#), among others, fall to historically low levels. In the process, this is giving the respective governments an opportunity to borrow at incredibly low levels. The situation will only persist if investors' worst fears of deflation are realised. However, even in that worst case scenario, investors will continue to search for yield.

In the much cited Japanese example; the proverbial Mrs. Watanabe invested abroad to harvest higher yields which could be repatriated at a profit and converted back into a weak Yen. The Yen is now a strong currency, at least temporarily, as these carry trades are unwound. Could another globally utilised carry trade evolve in such an environment?

It could, but not until the excesses of the last cycle are largely unwound. The Dollar and Yen are still comparatively strong against most emerging market currencies. This might, at least in part, be attributed to 'flight to safety' and fund redemption trades. However, when this process eventually runs its course, the yield available in emerging markets will again attract investors in

greater numbers. This means that monitoring the relative performance of emerging market currencies relative to the Dollar and the Yen might give us an important lead indicator for when investors begin to move back into these markets. Also looking at the cross rates against the Pound, might give us an idea of how the currency may be used a new carry vehicle.

A number of Latin American countries have not cut interest rates by nearly as much as countries in other regions. [Brazil's](#) interest rate was at 11.25% a year ago and is 12.75% today. [Chile](#) was 6.25% a year ago and is 8.25% today. [Colombia](#) was at 9.5% a year and having moved up and down in the last year is the same today. [Mexico](#) was at 7.5% a year ago and is 7.75% today. [Argentina](#) 9.75% a year ago and 13% today.

The Dollar surged against the [Brazilian Real](#) from August, lost momentum from October and hit a high near BR2.6 in December. A sustained move above BR2.4 would now be needed to question scope for some further weakness. The [Chilean](#) Peso has a similar pattern against the Dollar and a sustained move above CLP650 would be needed to signal a return to US Dollar outperformance. The Dollar hit a high against the [Colombian](#) Peso near COL2400 in October and fell to COP2150 in December. The Dollar has since firmed but needs to sustain a move above COP2400 to reassert its uptrend and question the top formation hypothesis. The greenback also surged against the [Mexican](#) Peso and while it lost momentum from October, is now pressuring the highs. A downward dynamic is needed to hinder potential for an upside break. The Dollar has lost momentum against the [Argentine](#) Peso but continues to hit new highs. A sustained move below ARS3.4 would be needed to question scope for further upside.

The Brazilian Real and Chilean Peso look the strongest of these four currencies. [Brazil's 3yr](#) (Brazilian Real) Yields rallied to more than 18% in October but have since fallen back and look somewhat overextended as they find support near 11.3%. Yields firmed in the last week and a sustained move to new lows would be needed to question scope for a relief rally. I do not have access to pricing for Chilean bonds and Bloomberg do not have a generic for this relatively illiquid market.

The risk premium attached to most markets not directly associated with the credit crisis has been contracting steadily since October. If economic growth remains sluggish and rates and yields in the G7 stay lower for longer, further compression of yields in higher yielding markets is a possibility.

U.S., Europe, Japan Sell 'Bucket' of Bonds as Borrowing Soars - This article by Anchalee Worrachate for Bloomberg covering today's activity in the government bond markets. Here it is in full:

The U.S., Europe and Japan are selling at least \$87 billion of debt today as governments around the world raise record amounts of cash to bail out troubled banks and plug holes in their public finances.

The U.S. will lead the sales with auctions of \$32 billion of Treasury bills and

\$40 billion of two-year notes. The combined amount offered by the major economies today is likely to exceed the 58.4 billion pounds (\$81.7 billion) that the U.K. alone raised in the whole of the 2007-2008 fiscal year.

"There's a load of supply everywhere, a bucket of it," said David Keeble, head of fixed-income strategy at Calyon, the investment-banking arm of France's Credit Agricole SA. "They'll have to keep things very cheap in order to sell these bonds. The risk is there could be a few failed auctions, which will force governments to pay a lot more to get their debt sold."

Governments are boosting borrowing to unprecedented levels to finance measures to rescue financial institutions and revive their shrinking economies. U.S. borrowing is likely to be \$2.5 trillion in the fiscal year that started Oct. 1, Goldman Sachs Group Inc. said last week, compared with the \$892 billion in notes and bonds sold during the prior 12 months.

Euro-region governments including the Netherlands and Italy are scheduled to sell as much as 4 billion euros (\$5.3 billion) of securities today. The U.K. auctioned 750 million pounds (\$1.05 billion) of inflation-protected securities and Japan auctioned 818 billion yen (\$9.1 billion) of 20-year bonds.

My comment - [US 30yr Treasuries](#) have been weak over the last month as investors have remained reticent about paying up for paper where supply is about to increase markedly. It is of course in the Treasury's interests to borrow as much as possible when yields are at historically low levels and this appears to be just what they are doing. The 30yr hit a peak near 142 in December and remain in a downtrend. They would now need to sustain a move above 138 to question scope for some additional weakness. Importantly, Treasuries have been a lead indicator for other government bond markets over the last 2 years and may now be peaking early as well.

UK Gilts continued to rally in December but hit a peak near 123.8 in early January and have fallen sharply since. An upward dynamic would now be needed to check the decline beyond a brief pause while a sustained move above 123 is needed to offset scope for further downside.

[Euro Bunds](#) have been losing momentum since early December and the move below 123 yesterday broke the progression of higher lows. A sustained move to new highs is now needed to question potential for some additional downside.

The [Australian 10yr](#) has been losing momentum since early December and is pressuring the progression of higher lows. A sustained move to new high ground is needed to offset potential for some additional downside.

[JGBs](#) continue to encounter resistance near 140 and would need to sustain a move above that level to question potential for some lower to lateral trading.

The [Swiss 10yr](#) accelerated to a high near 134 in early December and has been gradually losing ground since. A sustained move above 132 would now be needed to question scope for further lower to lateral trading.

Today's interesting charts - The Chart Library has an extensive range of fixed income prices, yields and spreads which may be of interest to subscribers.

Robusta Coffee - paused [today](#) following a remarkably strong advance last week. I have been unable to find a story to help explain this impressive action and would be happy if someone could suggest one. While it is becoming overextended and in a region of prior resistance, a sustained move below 2000 would now be needed to question scope for further upside.

Arabica Coffee - continues to [lag](#) Robusta but broke upwards from the 4-month range on Friday and would need to sustain a move back below 115¢ to question scope for additional upside.

White Sugar - broke [upwards](#) to a new recovery high on Friday and sustained the move today. A move, below 350¢ is now needed to check the advance beyond a brief pause.

Email of the day (1&2) - on additions to the Chart Library:

"Could you please add the Indian Government 2 year bond yield ([GIND2YR](#) Index) to the chart library? Thank you."

And

"Would it be possible to add [RDXUSD](#) Index, OGZD LI Equity and [MBFOFO01](#) (Iron Ore)? Thank you."

My comment - Thank you for these interesting suggestions which have now all been added to the Chart Library. However, the Gazprom ADR is not currently updating correctly and I have asked our IT people to look into it.

### **Wednesday 28th January 2009**

Mike Lenhoff: On the Bank of England's authorized asset purchase facility - My thanks to Tony Smith of Brewin Dolphin Securities for his colleague's interesting [report](#) on the latest stimulus used by the BoE, BoJ and Fed, among others. Here is the opening:

Last week the UK government introduced a number of measures intended to 'reinforce the stability of the financial system'. One of these, the Bank of England's authorized asset purchase facility, was something I received some inquiries on. This note sets out my understanding of the broad outline of the scheme, which will come into effect from 2 February. The details have yet to be released but these will be discussed shortly, probably this week, in an exchange of letters between the Chancellor and the Governor of the Bank of England.

A special purpose vehicle will be set up to buy various assets including corporate bonds, commercial paper, syndicated loans, a range of asset-

backed securities as well as paper issued under the Government's existing guarantee scheme, which was introduced last year. The asset purchases will be restricted to high grade instruments and initially a sum of £50 billion is to be made available.

The funding for the special purpose vehicle will come from the sale of Treasury bills, presumably to the banks, so in this sense the purchases will not derive from the 'printing of money'. However, if the banks buy up the Treasury bills then there will be a redistribution of money away from the banks, who are not lending, to the non-bank corporate sector, where borrowing has been stymied.

Whether the asset purchase scheme constitutes quantitative easing is debatable but it doesn't matter because policy is aiming to 'force feed' money into the non-bank corporate sector. Also the MPC has the authority to use asset purchases for monetary policy should it judge that it would assist in meeting the inflation target. There is scope to expand the facility.

Depending on how you look at it, the £50 billion may or may not sound like a lot of money. Compared to institutional cash inflows, it represents about 60 percent of the net inflow into insurance companies and pension funds in 2007, which was a good year for cash inflows. Last year was bad. Although the fourth quarter figures are not yet available, we know that institutional cash flow will most likely come in well below £50 billion. Thus, the initial sum seems decent enough to start with.

As stated by the government itself, the intention is '... to increase the availability of corporate credit, by reducing the illiquidity of the underlying instruments'. So what might come of the Bank of England's initiative to step into the market to buy up assets directly? Here is my spin.

First, with the purchases restricted to the quality end of the investment grade market, any reduction in yields is likely to be limited but if the credit markets begin to take the view, which they may be doing, that policy makers are determined to restore the 'functionality' of the financial system, we could find that the spreads across the credit markets also begin to narrow. Don't forget, the Bank of England will not be alone in buying up assets. The Fed and the Bank of Japan are already doing much the same thing.

Second, with funding costs coming down, it will be easier for the corporate sector to issue debt, which is what is intended. But demand for that debt might also be encouraged because the expectation of lower yields and also the prospect of narrowing spreads will give rise to the expectation of a boost to capital values across the board.

Third, with the flow of credit going, or at least starting to flow, balance sheet strength might improve by virtue of the stability and, indeed, improvement in asset values in the credit markets.

Fourth, if balance sheet strength improves, then credit worthiness improves, thus bringing risk premiums down more and further opening the lending channels.

Fifth, if as a result of all this, the expectation is that the functionality of the financial system will be restored, this in turn will nurture the expectation of economic recovery, which could then set in motion a virtuous positive feedback loop.

This is a lot to expect from one measure but it is one among many measures and something along the lines described is not beyond the realms of possibilities. What makes this cycle very different is that the recession has been preceded by asset price deflation and not inflation and higher interest rates as in past cycles. Asset price deflation has wrecked balance sheets. It has prevented the banks from lending. Even if they could lend, some companies would still find it difficult to borrow because yield premiums in the corporate bond market depend on credit worthiness and that depends on balance sheet strength which, in turn, depends on the economy. With the economy in recession, yield premiums and the cost of funding have been driven up. There is duress all round.

So what should we be looking for to see if anything remotely resembling the outcome described above eventually takes shape?

My view - It has been fashionable in some quarters to say variously that, "central banks have lost control", or "are out of ammunition", and that "they can only make matters worse".

It may seem that way on days darkened by bad economic news and roiled markets. Governments, including their central banks and treasury departments, are reactive and crisis oriented, as we have often said. Every warm body now knows this is a serious financial crisis, beyond anything that most of us have ever experienced. Nevertheless, such pessimism as I have quoted above borders on gratuitous gloom.

Ever since governments around the world recognised the magnitude of this economic crisis, albeit belatedly in the second half of 2008, they embarked on reflationary courses that will continue until sometime after this severe recession ends.

The debate, I suggest, is not about whether or not policies will succeed, because they will be altered, amended and expanded until they have succeeded to some degree. Therefore the debate should be about the additional consequences of these measures, not least in terms of inflation.

The verdict of investors will be revealed by financial markets. For instance, stock markets stopped discounting a possible depression in October and early November. Currently, we have a standoff in terms of expectations, evidenced by the number of ranging chart patterns for stock market indices, represented here by the [DJ World Stock Index](#).

Eventually, they will either break decisively up or down out of their current trading ranges. For the Index shown immediately above, this would be either a sustained push above 180 or below 140. I think that governments will avoid the depression feared, therefore I do not expect a sustained break beneath 140, or the equivalent November lows for most individual country indices, although those levels may be further tested in coming months. I think the next really significant move will be upwards, although we may have to remain patient for a while longer.

Far more important than what I or anyone else thinks - the charts will show us.

Email of the day (1) - On Banks as a lead indicator:

"The S&P500 Banks Index has closed at a new low. Given that this seems to have been a lead indicator for markets, are the odds now in favour of markets breaking to new lows? Thanks once again to you and the collective for the always interesting and useful contributions."

My comment - Eoin and I have frequently commented on banks as a lead indicator, not least in the Audio. The recent downward break for the [S&P 500 Banks Index](#) certainly forewarned of a test of the November lows by the [S&P 500 Index](#) and the [DJIA](#). While the latter have subsequently firmed within their ranges, the recent weakness of financials remains a concern, not least because economies need viable banking systems.

However, while most of us would regard a quasi-nationalised banking system as far from ideal, and therefore of less interest to investors, it is better for the economy than a serially dysfunctional Zombie Bank sector swamped by its own bad debts. Therefore, the S&P 500 Banks Index may now be less of a lead indicator than it has been in the past.

Technical evidence to support this hypothesis would be further rallies towards the current range highs by the S&P 500 Index and the DJIA. Conversely, breaks beneath last week's lows, let alone the November troughs, would obviously favour the more bearish arguments. Lastly, The Banks Index show above has stopped falling, evidenced by today's upward dynamic, following an accelerated run on the downside which looks climactic for at least the near term.

Email of the day (2) - On differing performances of BlackRock World Mining and BlackRock Gold and General:

"I am puzzled as to why the fall of Blackrock World Mining from its 2008 high is in percentage terms almost twice the fall of Blackrock Gold and General over the same time. Although the former is an Investment Trust and trading at a discount, and the other is a Unit Trust, they both operate in the same field and I understand have generally similar holdings. As I believe you have holdings in one or possibly both funds I would be grateful for any thoughts you may have."

My comment - Given gold's safe-haven status in a financial crisis, gold mining shares have been among the performance leaders following climactic lows for stock markets in October and early November. Shares in BRWM ([weekly](#) & [daily](#)) are primarily producers of industrial metals, and have recovered more slowly to date.

The Gold and General Fund ([weekly](#) & [daily](#)) tracked [bullion](#). Industrial mining shares peaked later last year. Today, they lack the same safe-haven appeal of gold mines but represent the better value in my view, unless the price of bullion really is going to soar. This is possible, although I never count on it, while remaining optimistic that gold is in a long-term bull market.

I hold both of these BlackRock funds in my personal long-term account, and rate the management teams highly. I also have a long position in BRWM in my trading account, purchased in 4Q 2008. I should probably Baby Steps trade this on a buy-low-sell-high basis, as it is still in a base development stage, switching to trend running when the 200-day MA eventually turns upwards. I will not trade the Gold & General Fund, because of spreads, but should probably take at least a partial profit when bullion experiences its next upward acceleration.

Email of the day (3) - [On a broker to operate a trust](#):

"I am looking for an independent broker, to operate for a trust. Lloyds TSB (which as we all know has a large brokerage) will not operate for a Trust. I'm not averse to doing my own leg work on this, but if anyone has a broker that already acts for a Trust, I'd be interested in their details."

My comment - I'm surprised, although I assume you mean that they will not provide brokerage for a Trust managed by you and / or your chosen associates. Assuming that your requirement is for a UK broker, you might contact Tony Smith of Brewin Dolphin Securities 0845 213 3523. Subscribers may have additional suggestions.

Email of the day (4) - [More on Thailand](#):

"I have to correct the numerous errors of the person who wrote about Thailand in your Tuesday night report.

1. The PAD is not a party but a loose collection of various bureaucrats, royalists, professionals, and military.
2. The PAD are the yellow shirts (not red)--yellow is the colour associated with the King.
3. The PAD is not trying to get Thaksin's sentence revoked--they are virulently anti-Thaksin.
4. The red-shirts are the UDD (United Front for Democracy against Dictatorship) -- and they are the pro-Thaksin camp.
5. The PAD occupied Government House and later Suvarnabhumi airport in an attempt, ruled illegal by the courts, to prevent the government functioning

because they believed (almost certainly correctly) that the PM was taking its orders from Thaksin.

"Thai politics are complex--but let's not get the facts hopelessly wrong. I am happy to describe and explain the situation in more detail if you or your readers wish."

My comments - Many thanks for this clarification. While Fullermoney cannot verify let alone guarantee the accuracy of all that is said in outside reports contributed and posted on this site, we obviously have an interest in accuracy. Therefore any corrections, not least regarding my own comments or Eoin's, are gratefully received.

I confined my own comments to the Thai stock market but noting your last sentence, and given your considerable experience regarding Thailand, I am certain that we would all appreciate any insights which you think could be timely. The Fullermoney Collective is a knowledge resource and input from subscribers greatly enhances this site.

My personal portfolio: Nikkei Index futures long trade increased - Today, I doubled my small [Nikkei 225](#) long, paying 8368, including spread-bet dealing costs, for another March position.

Email of the day (5) - On John Adams quote and drama:

"The quote from Adams is brilliant, I hope you saw the recent TV drama - Kong Hey Fay Choy,"

My comment - I agree (quote from Tim Price and posted yesterday), and yes, Mrs Fuller and I greatly enjoyed the [HBO](#) production. In fact, I have ordered DVD copies for the family and recommend it. Happy Chinese New Year and good fortune to you, as well.

Additional Commentary by Eoin Treacy

Balancing Act Redux: Reward vs. Risk - Thanks to a subscriber for this [report](#) by Jim Caron for Morgan Stanley which includes a large number of illustrations to substantiate his points. Here are sections from two slides on the mortgage market:

Lower Rates Will Boost Housing Affordability by 20%  
Home price declines have increased housing affordability to multi-decade highs.

Lower mortgage rates at 4.5% will increase affordability further by 20%.  
Higher affordability could spur as much as 2.4 million new home purchases in

2009.

Increased affordability could help home prices stabilize.

How Much Will Lower Rates Help Mortgage Refinancings?

Consumer discretionary income could rise by \$22 billion/year on lower mortgage payments.

Monthly savings from lower mortgage payments more likely to be spent than a one time tax rebate.

Consumer confidence and credit will also gain on lower mortgage payments.

Benefit to consumer depends on level of home prices now versus where purchased.

Mortgage originations could rise to between \$2.5 and \$2.9 trillion in 2009

My view - [Affordability](#) is now close to the highs seen throughout the '90s as prices have fallen relative to income and mortgage rates are all historically low levels. However, while affordability is important to buyers, they are unlikely to be attracted back into the markets, in numbers, until the pace of foreclosures turns down decisively and prices stabilise.

[Foreclosures](#) posted a lower low in November and was the one positive housing statistics. However, the Index surged again on the December reading and hit a new high. A move below 250,000, sustained beyond a couple of months is needed to indicate that a peak in Foreclosures has been reached.

The [S&P/Case Shiller Composite-10 Index](#) peaked near 230 in July 2006 and remains in a consistent downtrend. The first upward dynamic is likely to signal a low of at least medium-term significance and could potentially give a substantial boost to financial markets, across asset classes. One of the most debilitating issues facing banks is the inability to ascertain accurate prices for the assets on their books. This process would be made considerably easier if house prices stabilise, making this Index worth watching.

The [spread](#) between Freddie Mac 30yr mortgage rates and the 30yr Treasury accelerated to more than 250 basis points in December but encountered resistance near the 2000 highs and has since fallen sharply. It is now testing the progression of higher lows and a sustained move above 210 basis points would be needed to question scope for further downside. The Freddie Mac 30yr [spread](#) over the 10yr Treasury has also hit an important high and has fallen to test the progression of higher lows. Both spreads need to compress further to ensure that the ultra low rates currently on offer from the Fed are passed on to home buyers and those refinancing.

Brazil Kisses High Interest Rates Farewell - This [article](#) by Alexandre Marinis for Bloomberg covers some interesting points about the potential direction of Brazilian rates. Here is a section from the opening:

Brazil's record high interest rates, a bonanza for fixed-income investors, are about to become a thing of the past.

Last week Brazil's central bank lowered the country's benchmark interest rate

for the first time since September 2008. The move is more than a simple response to the global recession. It means Brazil has finally begun to rid itself of the highest real interest rate in the world.

On Dec. 21, the central bank's monetary policy committee voted to lower the primary interest rate, known as Selic, to 12.75 percent from 13.75 percent. The 100 basis-point reduction exceeded the median forecast of 49 economists surveyed by Bloomberg and was the largest rate cut in five years.

Even after last week's aggressive move, Brazil continues to have the highest interest rate of any country after accounting for inflation. While the central bankers of at least five countries tracked by Bloomberg set nominal interest rates higher than Brazil's current 12.75 percent, none of them have an annual inflation rate as low as Brazil's 5.9 percent.

Venezuela, for example, sets its nominal interest rate at 22.52 percent but its inflation rate last year was 31.9 percent, meaning the country has a negative real interest rate. Russia and Turkey have nominal interest rates of 13 percent and inflation of 13.3 percent and 10.1 percent, respectively.

#### Controlling Inflation

About 100 analysts surveyed by the Brazilian central bank on Jan. 23 said the Selic rate will drop to 11 percent by the end of this year. Their reasons include the following:

- The worldwide economic slowdown will reduce consumption in Brazil, easing inflation worries. During the next 12 months, Brazil's IPCA, the consumer price index targeted by the central bank, is forecast to reach 4.67 percent, a significant drop from the peak of 5.48 percent forecast only two months ago.
- Although the Brazilian real has declined 48 percent against the U.S. dollar since early August, the impact on prices has been less than anticipated.
- Brazil has \$202 billion in international reserves, enough to prevent its currency from spiraling out of control and igniting inflation.
- Food and commodity prices have plunged, reducing inflationary pressures even further.
- Although international oil prices have dropped about 70 percent since July, Brazil's government, which effectively controls local fuel prices, hasn't yet lowered retail gasoline price and may use this wild card if inflation picks up.

**My view** - The potential for further rate cuts remains high, particularly now that inflationary fears are quickly reversing. Brazilian [rates](#) have come down from more than 40% in 1999 to 12.75% today. This is a remarkable achievement for the country and the comparative stability of the last decade is a credit to the monetary and fiscal authorities. The commodity bull market has helped to improve Brazil's financial position considerably in the same timeframe.

Lower prices for many commodity exports will make sustaining the country's financial health more challenging in the medium-term. Personally, I was alarmed to read of the suggestion, that a new administration would be keen to appoint central bankers who would be lax on controlling inflationary pressures.

It is precisely because the central bank kept rates relatively high, combating inflation, that Brazil was able to avoid the pitfalls experienced by Argentina in the last decade. Lowering interest rates aggressively and ignoring sound monetary policies would be disastrous for Brazil's economy over the long-term. This will be worth watching as a new government is formed in 2010.

The [Bovespa](#) stock index bottomed in 2002 near 10,000 and over the course of the next 7-years rallied consistently to a high above 70,000. The consolidation mostly above 60,000 from late 2007 was slightly longer than others in the move and the progression of higher lows remained intact. The Index broke upwards emphatically in April 2008 but was unable to sustain the move and fell back into the range, breaking below 60,000 in July and below the January low at 53,000 in September. It found support in October near 30,000 and has sustained a progression of higher lows since. A sustained move below 36,850 is now needed to question scope for further higher to lateral ranging.

The Brazilian [US\\$ 10yr](#) bond yield hit a peak near 27% in 2003 before falling dramatically to the lows near 5%. Yields spiked higher in September to hit a high above 10% but have since returned to the 3-year mean near 6%. A sustained move above 7% would be needed to suggest that a new bout of uncertainty is unfolding. (For my comments on the Brazilian Real and Brazilian Real Bonds please see yesterday's [Comment of the Day](#).)

Email of the day (1) - on the reason for Robusta Coffee's rally:

"The reason for strong performance on Jan rob coffee I believe is due to the fact that it is the last month of the old 5 tonnes contracts before they switch to the new 10 tonnes contract in March. The grade of coffee is different between the two contracts. There has been a 50% rejection rate on coffee delivered against Jan causing a shortage of that grade of coffee. To ship it from Vietnam would have taken too long. Some wise owls anticipated this and have applied a fine old fashion squeeze.....well done them!"

My comment - Thank you for this useful insight contributed in the spirit of Empowerment Through Knowledge. Here is a link to the original [press release](#) from NYSE Euronext in January 2008. I have added the new [Revised Robusta Coffee](#) contracts to the Chart Library. These new contracts have not experienced the same upside move. The contract posted a failed break below \$1600 in December but quickly rallied and is now testing \$1800. A sustained move above that level is needed confirm that demand has regained the upper hand.

Email of the day (2) - on the psychology of trading:

"How are you? Hope all is well in London. Will be visiting in a few weeks to see a friend off on a round-the-world trip. Always look forward to visiting that great city.

"Have you been following 'Million Dollar Traders' on BBC2? Tonight was the last episode and while the show was maybe just a level or three above your average reality TV show (tears? check! tantrums? check! shouting match? check!) it did highlight quite well the part emotions played in trading.

"Perhaps the show should have been titled 'How To Blow Bags of Money Trading On Your Emotions' as the majority of the participants simply got too involved in the process of buying and selling; extreme highs when trades went their way, anger and despondency when they moved against them. The most successful traders proved to be those who had control of their emotions throughout the experiment and I would assume the presence of mind to run their profits while cutting their losses early. Nothing really that's news to the majority of people who frequent this site but still an interesting study of the importance of checking your demons at the door when you enter the trading room. Episodes can be picked up on the BBC iPlayer for those living in the UK."

My comment - Thank you for this insightful email. I was only vaguely aware of this show, but don't find your description too surprising. We pay for our lessons in trading and many of us get carried away with the excitement of markets before learning that discipline is needed.

There can be a tendency to treat trading as if it is a competitive sport, but that is a mistake. However, the only person we should compete against is ourselves. Some people will trade because of the self reaffirming positive mood they get from success. However, this is a dangerous course of action because it makes the occasional failures more difficult to deal with.

I am unabashed in saying that while I love the intellectual challenge of the markets, the only reason I trade is because I want to make money, and making money is hard work. Personally, I can attest to making my best profits when I am most disciplined and I have made my biggest losses when I let me ego take control. This subject is covered in much greater detail at [The Chart Seminar](#). Here is a link to the [brochure](#) for the Dublin seminar on February 19th & 20th and the London seminars on May 21st & 22nd and November 12th & 13th.

#### **Thursday 29th January 2009**

David Brooks: What life asks of us - This is a good [article](#) by David Brooks for The New York Times and International Herald Tribune, relevant to the governance issues that are sometimes discussed on this site. Also provided in [PDF](#) format, here is the opening:

A few years ago, a faculty committee at Harvard produced a report on the purpose of education. "The aim of a liberal education" the report declared, "is to unsettle presumptions, to defamiliarize the familiar, to reveal what is going on beneath and behind appearances, to disorient young people and to help them to find ways to reorient themselves."

The report implied an entire way of living. Individuals should learn to think for

themselves. They should be skeptical of pre-existing arrangements. They should break free from the way they were raised, examine life from the outside and discover their own values.

This approach is deeply consistent with the individualism of modern culture, with its emphasis on personal inquiry, personal self-discovery and personal happiness. But there is another, older way of living, and it was discussed in a neglected book that came out last summer called "On Thinking Institutionally" by the political scientist Hugh Heclo.

In this way of living, to borrow an old phrase, we are not defined by what we ask of life. We are defined by what life asks of us. As we go through life, we travel through institutions - first family and school, then the institutions of a profession or a craft.

Each of these institutions comes with certain rules and obligations that tell us how to do what we're supposed to do. Journalism imposes habits that help reporters keep a mental distance from those they cover. Scientists have obligations to the community of researchers. In the process of absorbing the rules of the institutions we inhabit, we become who we are.

New generations don't invent institutional practices. These practices are passed down and evolve. So the institutionalist has a deep reverence for those who came before and built up the rules that he has temporarily taken delivery of. "In taking delivery," Heclo writes, "institutionalists see themselves as debtors who owe something, not creditors to whom something is owed."

My view - It should be self-evident that until the values mentioned by Hugh Heclo are rediscovered and encouraged by our institutions, by example from the top and replacing the all too prevalent - me first entitlement mentality - no country can fulfil its potential.

Here is a related [column](#) by David Pauly for Bloomberg: Lewis, Thain, CEO Cult Torched in Crisis Bonfire.

Barron's Roundtable (Part 2): Rocky Road - I published the first part of the Barron's Roundtable on 13th January. This second [section](#) ([PDF version](#)) also makes interesting reading and contains plenty of investment recommendations, most of which can be monitored in the Chart Library. Here is a brief sample, featuring Bill Gross of Pimco:

Barron's: *What grabs you in the bond market, Bill?*

Gross: The government has issued hundreds of billions of dollars of Treasuries, but with yields of 2.5% on 10-year bonds and 0.8% on two-years, who wants to buy them? The market is beginning to address that question. Treasuries don't make sense at these levels. It will be at least 2010 before we see a hint of the Fed moving interest rates higher, simply because they are aware of the Japanese experience. They know the Japanese raised rates prematurely [after Japan's economy went into a tailspin in the 1990s].

Because of their low yields, government bonds are a trap. First the government lowers interest rates to the point where the investor receives a negative real return. That's where we are now. Second, the principal is depreciated through inflation. That's a hidden tax. The combination takes away any advantage Treasury bonds have, except under a deflationary scenario.

*This crowd seems a lot more worried about inflation.*

Gross: There is a 10% possibility that government policy won't work and the U.S. will experience deflation à la the 1930s. That's not our prediction but it's more than a thin tail [low probability]. In that circumstance, long-term Treasuries yielding 3%-plus might make some sense.

Schafer: Doesn't a little inflation help us out of the current mess?

Gross: The entire capitalist system is based on a little inflation. A little, but not a lot.

Zulauf : How do German government bonds compare with Treasuries?

Gross: They are monitored by the ECB [European Central Bank], and inflation in Euro -land looks to be lower. If you had to buy government bonds, you'd want German bunds over U.S. Treasuries.

My comment - [I will post part three of the Barron's Roundtable tomorrow.](#)

My personal portfolio: Gold futures long reduced as stop triggered - [Even those of us who have long felt comfortable with gold in our portfolios, find that it has a mercurial nature. Sometimes it responds to inflationary expectations, or perhaps deflationary fears. It can move in the opposite direction of the US dollar, or not. Gold has trended with the stock market but moved in the opposite direction at other times. We view it as a safe haven in moments of fear but gold can be as volatile as any other commodity. Just when we think that we understand gold, we realise that we do not. We certainly cannot tell it what to do.](#)

[Of course gold does not have any nature, at least not in a living sense. It is just a pretty metal with some unique properties, and it is comparatively scarce. For these reasons ancients used gold as actual money. Those of us with a sense of monetary history, particularly regarding fiat currency, trust gold as a long-term store of wealth second to none. As for gold's short-term price moves, they can only mirror our own mercurial natures.](#)

[For reasons of monetary discipline, I had a breakeven stop on the more expensive of my two latest gold futures long positions. This was triggered this morning at \\$880 against my purchase at \\$879.8 on 29th December. These prices include all spread-bet dealing costs.](#)

Tactically, I maintain that the best strategy is to buy gold, [silver](#) and [platinum](#) on easing and lighten positions somewhat on strength, since price action will be choppy more often than not. Whether in response to poor economic data in the USA and a weaker performance in Western stock markets, today's action in precious metals is bullish and looks like a consolidation prior to further gains.

UK Trusts - Following Email of the day (3) yesterday, we have had another item on this subject which is [posted](#) in the Forum.

Correction - Per Email of the day (3) yesterday, the correct telephone number of Tony Smith of Brewin Dolphin Securities is 0845 213 3523. Wednesday's copy has been corrected.

Additional Commentary by Eoin Treacy

FDIC May Run 'Bad Bank' in Obama Plan to Remove Toxic Assets - [This article](#) by Robert Schmidt and Alison Vekshin for Bloomberg covers the proposals currently circulating for the creation of a bad bank. Here is a section:

The Federal Deposit Insurance Corp. may manage the so-called bad bank that the Obama administration is likely to set up as it tries to break the back of the credit crisis, two people familiar with the matter said.

FDIC Chairman Sheila Bair is pushing to run the operation, which would buy the toxic assets clogging banks' balance sheets, one of the people said. Bair is arguing that her agency has expertise and could help finance the effort by issuing bonds guaranteed by the FDIC, a second person said. President Barack Obama's team may announce the outlines of its financial-rescue plan as early as next week, an administration official said.

"It doesn't make sense to give the authority to anybody else but the FDIC," said John Douglas, a former general counsel at the agency who now is a partner at Paul, Hastings, Janofsky & Walker, a law firm in Atlanta. "That's what the FDIC does, it takes bad assets out of banks and manages and sells them."

The bad-bank initiative may allow the government to rewrite some of the mortgages that underpin banks' bad debt, in the hopes of stemming a crisis that has stripped more than 1.3 million Americans of their homes. Some lenders may be taken over by regulators as the government seeks to provide a shield to taxpayers.

Bank seizures are "going to happen," Senator Bob Corker, a Tennessee Republican, said in an interview after a meeting between Obama and

Republican lawmakers in Washington yesterday. "I know it. They know it. The banks know it."

#### Nationalization Question

Still, nationalization of a swath of the banking industry is unlikely. House Financial Services Chairman Barney Frank said yesterday "the government should not take over all the banks." Bair said earlier this month she would be "very surprised if that happened."

Obama is under increasing pressure to drastically revamp the \$700 billion Troubled Asset Relief Program for the ailing industry. While setting up a bank to buy underwater assets is emerging as a favored approach, it could drive up the cost of the rescue in excess of \$1 trillion.

Frank told reporters that he would be open to expanding the size of the bailout if the Obama administration "can demonstrate the need for it."

Senate Banking Committee Chairman Christopher Dodd said yesterday he wants to hear more about the bad-bank idea when he meets in coming days with newly installed Treasury Secretary Timothy Geithner.

**My view** - The question of what to do about the bad assets on bank balance sheets has been circulating for some time. No one has yet come up with a sound method of valuing these assets and until they do, the uncertainty surrounding the situation will remain acute. US [Aggregate Reserves for Depository Institutions in Excess of Required Reserves](#) continue to climb to levels massively in excess of what is needed. Banks are doing everything they can to shore up their balance sheets because they do not know how they will be called upon to meet their outstanding obligations. The inability to value their assets is at the root of this problem.

The de facto guarantees that have been put behind the major players in the banking system have helped to bring the [TED](#) spread down to much more reasonable levels. However, the difference between [AA Bank](#) spreads and [BBB Bank](#) spreads imply that investors continue to bet that high numbers of lower rated banks will default at some stage. This would seem to be common sense. A less leveraged, slimmed down banking sector will have less members and those either 'too big to fail' or with the healthiest balance sheets are most likely to survive.

Personally, I am in favour of a form of the 'bad bank' solution. However, I see recapitalisation and the valuing of suspect assets as separate issues. If a 'bad bank' takes possession of illiquid, hard-to-value assets, it should do so at prices well below what banks would deem as breakeven. This is the only fair way to make sure that the taxpayer is not paying up for duff assets. Recapitalisation should subsequently be considered only where any opacity in a firm's balance sheet has been cleared out; so that taxpayers know exactly what they are putting their money into.

We know that a large number of hard-to-value assets have deep intrinsic value, which is not readily available to assess in today's conditions. Price

discovery will only become apparent when an active secondary market for such assets is created. The 'bad bank' will be key to creating and managing such a pool of liquidity. If the value of the bad assets turns out to be more than a bank received in bailout funds, they would have a justifiable cause to seek redress but that would be an issue for the courts subsequent to the financial crisis and not for now.

In practical terms, the need for a solution which deals with the inability of the banking sector to conduct business is a necessity. A comprehensive solution that helps us put this crisis behind us is to be favoured rather than letting the process drag out over a number of years. It remains a high risk environment for bank shareholders because the potential for being wiped out is high. This does not apply to other sectors of the economy and companies with high covered yields are likely to outperform.

There's a Bear in There.... - Thanks to a subscriber for this bearish [report](#) by Clarke Williams for Citigroup which predicts further falls for most industrial commodities. Here is a section on BHP Billiton:

Downgraded to Hold - Recommendation downgraded to Hold, previously Buy, driven by the strong relative outperformance to the market and further risk to earnings from lower oil prices. With a strong balance sheet and plenty of options, it is the defensive diversified exposure, just a bit too expensive to buy at current levels.

Balance Sheet - Net debt is expected to fall to ~US\$5b by the end of FY09, putting BHPB in the ideal positioned to pick up any assets sales from Rio Tinto as they seek to reduce the US\$40+b Alcan debt burden. In order to not sell assets at fire sale prices, Rio Tinto would be looking to sell assets where there could be bidding tension like in thermal coal. No doubt BHPB would be interested in increasing its stake in Escondida at the right price.

Investment Catalysts - BHP Billiton is well placed to ride out the economic downturn. The company's cost of production is on average towards the bottom quartile of production. With equity prices having collapsed and projects struggling to be financed, BHPB is in an ideal position to pick up assets at low prices, with limited competitors.

Dividend Yield - It has been a long time since the dividend yield for BHPB was ~5%, and combined with the potential for capital management initiatives are supporting factors. However, we do not expect a large Buyback to be announced at the upcoming result, and instead expect the powder to be kept dry for distressed asset sale opportunities.

Risks - The closure of Ravensthorpe and pulling of the RIO bid have placed some concerns over the capital allocation process. While in both cases BHPB has made the prudent decision to act quickly, it does raise questions on how the capital process is being conducted. If the economic downturn had occurred in 12 months time, and BHPB had completed on Rio Tinto, then BHPB may have found itself in a completely different financial position.

Target price - We have lowered our target price on reduced earnings, based on commodity price downgrades, and the resultant reduction in cash flows that results in a lower NPV.

My view - 2009 is likely to be a challenging year for many commodity producers as earnings expectations are pegged back. The crux of any discussion will be the degree to which this has already been priced in.

[BHP Billiton](#) accelerated to its high near AU\$48 in late 2007 and lost much of its uptrend consistency characteristics from then. It made an incrementally higher high in May 2008, but was unable to sustain it and fell back towards its lows near AU\$35. The break below that level led to an accelerated selloff to AU\$20 by the end of November, and the share has consolidated above that level since. A sustained move below AU\$27 is now needed to question scope for some further higher to lateral ranging.

FT.com: Rio Tinto - Thanks to a subscriber for today's Lex column from the Financial Times, which focuses on Rio Tinto. Here it is in full:

Rio Tinto's resistance is weakening. A terse notice to the Australian exchange on Wednesday, in response to persistent talk that it needs to raise capital, might have given the impression that the world's third largest miner was leisurely picking over options to cut net debt by \$10bn, almost a quarter, by year-end. That impression would be wrong.

Many of the measures Rio outlined - shrinking production to meet demand, pausing capex and laying off staff - have already been taken. The company's next best hope remains selling non-core assets. But, as the yard sale has apparently failed to elicit firm bids, Rio may have to offer more cherished assets - an action few shareholders would welcome. Thus the possibility of a rights issue looms nearer, as Rio now acknowledges. It may not be alone: Xstrata could also make a cash call.

Rio is overleveraged - net debt was 133 per cent of shareholders' equity at the half-year - but there is no real danger of a covenant breach. The \$40bn in debt Rio took on to buy Alcan in 2007 is governed by the covenant that net debt to earnings before interest, tax, depreciation and amortisation should be no greater than 4.5 times. Ebitda, forecast at about \$15bn for 2009, would virtually have to halve to break it.

The problem is the \$8.9bn of debt falling due in October, as all potential buyers of Rio's assets know. Free cash flow of about \$7bn in 2009, along with undrawn facilities, may tide Rio over. But it will be living hand to mouth while better-capitalised rivals keep spending through the trough. As a big investment-grade company with a proved record in previous downturns, Rio should have few problems raising the \$4bn or so it is rumoured to seek. A new chairman, Jim Leng, will be in situ in April. Paul Skinner, the incumbent, should give him the capital cushion he needs.

My view - [Rio Tinto's debt burden continues to weigh on the share's](#)

performance and is at least in part responsible for the larger decline than that seen by BHP Billiton.

[Rio Tinto](#) accelerated to its high below 6000p in late 2007 and consolidated for 6-months before breaking upwards once more. It encountered resistance near 7000p shortly afterwards and fell consistently to the December low of 1000p. The downtrend has now lost its consistency and momentum. It would need to sustain a move to new lows to question scope for further base formation development.

DJ Asia Fund Poll: Funds Turn To Asian Stocks, Favour China - [Thanks to a subscriber for this interesting article](#) by Nisha Gopalan for Dow Jones Newswires covering the move back into equities among Asian fund managers. Here is a section:

But cash is now coming out of favor among investors, although funds were still overweight on cash in January. Bond preference stayed strong, and for the first time since December 2007, funds were overweight on stocks, according to Dow Jones' monthly poll of portfolio managers active in Asia for January.

Weightings reflect managers' portfolio composition compared with benchmark indexes. Fund managers said that low interest rates make cash attractive, but falling inflation and weak growth support bonds. J.P. Morgan Asset Management said that within bonds, it preferred those with a "modest long duration position", such as Japanese bonds.

Equities had the prospect of dismal corporate earnings hanging over them, but fund managers were increasingly optimistic. "For equities, we're anticipating further volatility, but it is a stockpicker's market and economic growth in Asia will slow but not slump," said Douglas Cairns, Asia & Emerging Market equities investment specialist at Threadneedle.

Asian stocks, excluding Japan, are trading at prospective price-earnings ratios of 9 times, and dividend yield ratios of 4.5% , according to fund manager Invesco.

Topping the list of favorites is China, turning overweight in average portfolios for the first time in more than two years.

"China is our single largest overweight position," said Threadneedle's Cairns. "Domestic consumption remains resilient, and while there's a cyclical slowdown, infrastructure spending, boosted by the stimulus package, should grow."

In November, China said it planned to spend four trillion yuan (\$581 billion) on a stimulus package that focuses on railways, airports and other hard assets. Fund managers said that the huge package will, hopefully, offset some of the decline in the country's export growth.

Last year, China's benchmark Shanghai Composite Index, which covers both A and B shares listed on the Shanghai Stock Exchange, fell 65% ; In comparison, the Dow Jones Industrial Average fell 30%.

My view - Asian equities have fallen considerably over the last year, more because of the secondary effects of the credit / solvency crisis such as fund redemptions and flight to safety, rather than any significant exposure to subprime or dodgy CDOs. Growth will be slower this year, but Asia remains home to some of the most dynamic economies in the world and investors are beginning to appreciate this fact. Valuations have fallen to levels which are of interest to long-term investors and the current dividend yield on many markets compares favourably with what is available elsewhere.

China's [Shanghai Composite](#) broke its progression of higher lows in January and fell consistently before finding at least medium-term support between 1700 and 1800 from September. The subsequent tight ranging phase has broken the downtrend and marks a clear loss of momentum as supply and demand come more into balance. The market continues to show the best [base formation](#) characteristics of any major country index and would need to sustain a move below 1700, for more a few days, to question this hypothesis.

The Index is currently testing the three-month highs and it will be interesting to see how it performs when trading resumes on Monday. A sustained push above 2000 would begin to signal that demand is regaining the upper hand.

Email of the day - on saving charts:

"I have created a chart which shows the spread between 10 year and 2 year Indian government bond yields but I am unable to save it to my Chart Library. Could you tell me how I can do this? Thank you."

My comment - Thank you for raising this relevant issue. I'm afraid it is only possible to add charts to your Favourites which already appear in the menus. At present, we do not have the required bandwidth needed to offer the ability to save individual custom charts to your Favourites. In the meantime, I have added the [spread](#) to the menus and it can be located in the Spreads and Overlays section of the Chart Library.

In future, if you wish to look at a number of spreads over a common instrument, it may be more efficient to create a preset default. To create a Preset parameter, First select you instrument from the search or menus. Click on the Charting tab in the charcoal bar above the chart. Customise the defaults to your personal settings. Click on the 'Save' tab in the aquamarine bar at the top of the dropdown menu. Give the Preset parameters a name and hit Apply. Refresh the page. Your new Preset defaults will have been added to the Chart menu at the top right of the page.

**Friday 30th January 2009**

George Soros: The game changer - [This is an interesting article](#) by George Soros for the Financial Times. Here is a fascinating section:

First, there is an asymmetry in the risk/reward ratio between being long or short in the stock market. (Being long means owning a stock, being short means selling a stock one does not own.) Being long has unlimited potential on the upside but limited exposure on the downside. Being short is the reverse. The asymmetry manifests itself in the following way: losing on a long position reduces one's risk exposure while losing on a short position increases it. As a result, one can be more patient being long and wrong than being short and wrong. The asymmetry serves to discourage the short-selling of stocks.

The second step is to understand credit default swaps and to recognise that the CDS market offers a convenient way of shorting bonds. In that market the asymmetry in risk/reward works in the opposite way to stocks. Going short on bonds by buying a CDS contract carries limited risk but unlimited profit potential; by contrast, selling credit default swaps offers limited profits but practically unlimited risks.

The asymmetry encourages speculating on the short side, which in turn exerts a downward pressure on the underlying bonds. When an adverse development is expected, the negative effect can become overwhelming because CDS tend to be priced as warrants, not as options: people buy them not because they expect an eventual default but because they expect the CDS to appreciate during the lifetime of the contract.

No arbitrage can correct the mispricing. That can be clearly seen in US and UK government bonds, whose actual price is much higher than that implied by CDS. These asymmetries are difficult to reconcile with the efficient market hypothesis, the notion that securities prices accurately reflect all known information.

The third step is to recognise reflexivity - that is to say, the mispricing of financial instruments can affect the fundamentals that market prices are supposed to reflect. Nowhere is this phenomenon more pronounced than in the case of financial institutions, whose ability to do business is dependent on confidence and trust. That means that "bear raids" to drive down the share prices of these institutions can be self-validating. That is in direct contradiction to the efficient market hypothesis.

Putting these three considerations together leads to the conclusion that Lehman, AIG and other financial institutions were destroyed by bear raids in which the shorting of stocks and buying of CDS amplified and reinforced each other. Unlimited shorting was made possible by the 2007 abolition of the uptick rule (which hindered bear raids by allowing short-selling only when prices were rising). The unlimited selling of bonds was facilitated by the CDS market. Together, the two made a lethal combination.

That is what AIG, one of the most successful insurance companies in the

world, failed to understand. Its business was selling insurance and, when it saw a seriously mispriced risk, it went to town insuring it, in the belief that diversifying risk reduces it. It expected to make a fortune in the long run but it was destroyed in short order.

My argument raises some interesting questions. What would have happened if the uptick rule on shorting shares had been kept, in effect, but "naked" short-selling (where the vendor has not borrowed the stock in advance) and speculating in CDS had both been outlawed? The bankruptcy of Lehman might have been avoided but what would have happened to the asset super-bubble? One can only conjecture. My guess is that the bubble would have been deflated more slowly, with less catastrophic results, but that the after-effects would have lingered longer. It would have resembled more the Japanese experience than what is happening now.

What is the proper role of shortselling? Undoubtedly it gives markets greater depth and continuity, making them more resilient, but it is not without dangers. As bear raids can be self-validating, they ought to be kept under control. If the efficient market hypothesis were valid, there would be an a priori reason for imposing no constraints. As it is, both the uptick rule and allowing short-selling only when it is covered by borrowed stock are useful pragmatic measures that seem to work well without any clear-cut theoretical justification.

What about credit default swaps? Here I take a more radical view than most people. The prevailing view is that they ought to be traded on regulated exchanges. I believe they are toxic and should be used only by prescription. They could be used to insure actual bonds but - in light of their asymmetric character - not to speculate against countries or companies.

CDS are not, however, the only synthetic financial instruments that have proved toxic. The same applies to the slicing and dicing of collateralised debt obligations and to the portfolio insurance contracts that caused the stock market crash of 1987, to mention only two that have done a lot of damage. The issuance of stock is closely regulated by authorities such as the Securities and Exchange Commission; why not the issuance of derivatives and other synthetic instruments? The role of reflexivity and the asymmetries identified earlier ought to prompt a rejection of the efficient market hypothesis and a thorough reconsideration of the regulatory regime.

My view - If you agree with George Soros, and I mostly do, then the investment banks were not only responsible for some of the worst excess on the way up, but also created havoc on the way down, with extremely destructive consequences. Also, allowing Lehman to fail was obviously a disaster.

Soros' comments on his trading year in 2008 are also interesting.

Barron's Roundtable (Part 3): Good Thoughts - [Here is the third and final instalment](#) of Barron's Roundtable (*also in [PDF version](#)*). It is very US centric, with the exception of Marc Faber's contribution, but interesting and with lots of

[recommendations. The Roundtable is posted in the Subscriber's area but here is the opening:](#)

MUCH HAS CHANGED, AND NOT FOR THE BETTER, since Barron's 2009 Roundtable was called to order Jan. 5. That lovely little rally that ushered in the new year? Kaput. Merrill Lynch's marriage to Bank of America? Going great, if you ignore the fact that the government had to climb into bed with the newlyweds. Corporate earnings? Feh. The job market? What job market?

Yet even amid growing evidence that the economy's travails, and the stock market's, are far from over, one thing is constant: Our panelists -- money managers and market mavens extraordinaire -- remain convinced that savvy stock-pickers can prosper by doing their homework and going against the crowd. In this week's issue, the final four get their say on the stocks and sectors that may reward investors in the year ahead, even if the big picture doesn't brighten.

A noted art collector, Scott Black of Delphi Management has turned Graham-and-Dodd-style investing into a science. Scott looks behind the numbers -- all of them -- to find mispriced companies that offer super-high returns on equity, discounts to book or break-up value, and other attractions not apparent in their shares. This year he's bullish on Oracle, General Dynamics and an infrastructure play, among others.

What's the difference between a bear and a realist? If there is one these days, Marc Faber doesn't know it. A man of the world -- after all, he's seen most of it -- the Swissborn, Hong Kong-based investor and provocateur thinks Uncle Sam's penchant for printing money will lead to disaster. En route, however, certain Asian stocks, bluechip techs and bombed-out resources shares just might double or triple. As for Treasuries, short 'em.

My comment - [Of the various recommendations, Marc Faber's are much more to my tastes.](#)

Email of the day - [On T-Bonds:](#)

"Following article may be of interest, in case you have not seen it - message is surely don't be in too big a hurry to short T-Bonds:"

By Alister Bull

WASHINGTON, Jan 28 (Reuters) - The Federal Reserve will resume a key meeting on Wednesday to review options of how to restore U.S. growth, with its traditional interest rate policy tool already lowered almost to zero.

Policy-makers are expected to focus on credit-easing measures that have already doubled the size of the Fed's balance sheet to over \$2 trillion, while assuring investors they can keep Fed borrowing costs very low for a long time.

The Fed is battling a vicious credit crunch sparked by bank losses after the collapse of the U.S. housing market, which toppled the country into a year-long recession.

Economists say the Fed will hold the target for official borrowing costs in a range of zero to 0.25 percent and repeat a commitment made last month to maintain "exceptionally low levels of the federal funds rate for some time."

More important, the Fed is expected to discuss unconventional measures to improve financial market operations, having already said it is weighing the benefits of major purchases of long-dated U.S. government securities.

Bond markets had rallied strongly on this news, and investors will be watching closely for hints on the scale of any such purchase program or suggestions that one is imminent, as well as other possible initiatives.

The Fed explicitly promised last month that it would explore other options of using its balance sheet to support credit markets and growth.

Not all Fed policy-makers have been comfortable with the aggressive manner in which the balance sheet has grown as the Fed expanded lending to banks, supported the commercial paper market and bailed out Bear Stearns and American International Group.

A split among the policy committee could give rise to dissents in the voting on the statement and policy decision, which is conducted every meeting before they are announced.

My comment - Thanks for this; I have posted the relevant section of Reuters' article above. The promise (threat?) by the Fed to purchase US long-dated securities has deterred me from shorting them to date, despite some very good sell signals which Eoin was quick to point out with that first downward dynamic off the highs on 31st December.

However I have also described the Fed's frequent hints of its apparent willingness to buy US debt as akin to a con artist's shell game. However in the Fed's version, instead of trying to guess under which of three rapidly moving cups the pea lurks, we are guessing how and when we might see their bond purchases.

I do not question the Fed's word that it would be prepared to buy Treasuries to keep long-term rates low, if necessary. Instead, my point is that they may hope to avoid purchases if they persuade the market to do their work for them. In other words, I wonder how many people, from hedge fund managers to foreign governments, have bought or at least retained their Treasuries, despite historically low yields and rapidly increasing supply.

This is a dangerous game. Financial history is full of instances where investors have been persuaded to pay record high valuations for assets, usually because: "It is different this time." Perhaps...for a while, but the bubble

always bursts in a mean reversion process which usually ends in an overshoot of its own.

The only way I can envisage significantly lower long-term yields for US Treasury Bonds, would be if the economy slid into a lengthy deflation, as we saw with Japan in the late 1990s and earlier this decade, causing real interest rates to rise. This is a risk, but one that the Bernanke Fed has vowed to avoid. It has the means to do so.

At Fullermoney, we think gold is replacing US Treasuries as the safe haven investment (*see Eoin's comments on gold below*).

U.S. Economy: Unconventional Monetary Policy Measures and Massive Fiscal Deficits: Will the Outcome be Inflation or Deflation? - My thanks to a subscriber for this authoritative [report](#) by Frank Veneroso of RCM. Here is a brief sample:

It is generally agreed that the current economic contraction is the most severe of the post-war period and will probably continue through the second quarter of this year. However, it is not agreed that there will be price deflation. The core CPI inflation rate has been zero on average over the last four months. Most people regard this as a fluke, resulting from aggressive discounting of goods prices to clear the shelves during the holiday season. This "special factor" may have depressed core CPI inflation somewhat, but many believe that core CPI inflation is still running at 2% and I doubt that transitory goods price discounting has reduced core CPI inflation by a full two percentage points.

There are other special factors that may depress core CPI inflation in the months to come. First we have had a historically unprecedented collapse in commodity prices. Commodity prices impact core CPI inflation indirectly and with a lag. A collapse in commodity prices in the second half of last year may depress core CPI deflation somewhat in the coming months. Second, industrial production in Asia appears to have fallen at an historically unprecedented rate in the final months of 2008. This should bring with it very weak pricing in tradable manufactured goods, especially those imported from Asia. Therefore, an abatement of holiday price discounting may be offset by these two factors and core CPI inflation may remain in the zero percent to one percent range in the months to come.

Of overriding importance is compensation inflation in the United States. Wage inflation is the backbone of core inflation. Under traditional Phillips curve theory, once the unemployment rate rises significantly above the NAIKU the rate of inflation falls, and in a progressive fashion There are lags between slack in the labor force (as measured by the difference between the unemployment rate and the NAIKU), on the one hand, and inflation in worker compensation, on the other. Given these lags, the zero core CPI inflation of the fourth quarter of 2008 reflects the unemployment rate of 6% or less that prevailed prior to last year's fourth quarter. By December the unemployment rate had risen to 7.2%. Based on the proliferation of layoff announcements,

we can expect the unemployment rate to rise significantly in this year's first quarter. Labor slack will then be very considerable. The meaningful increase in labor slack in the fourth quarter should be depressing wage inflation in this year's first quarter. A significant rise in labor slack in this year's first quarter should be depressing wage inflation more strongly by mid-year and afterward.

My view - With global GDP growth still contracting, unemployment rising and most commodity prices well beneath their 2007-2008 highs, I assume that inflationary pressures will continue to subside this year and stay low for at least well into 2009. However commodity-led inflation will make a strong comeback when the next synchronised global economic expansion occurs at some point in the next decade.

What are the implications for various markets?

It might just lead to a lengthy bottoming out process for long-dated US Treasury yields, although I would not count on this.

My guess is that the Fed has tolerated a stronger USD, a trend which it helped to initiate last July, because a dollar collapse would have been a much bigger problem in terms of its economic stimulus programmes. A firm currency has helped to push earlier inflationary pressures downwards. However, the Fed would probably seek to weaken the USD if deflationary fears increase, as Frank Veneroso expects.

Low interest rates are a tailwind for commodity prices, not least precious metals. While Veneroso is bullish of gold, I think he is too bearish of other commodities. Industrial resources should benefit from infrastructure development programmes and curtailed supply at current prices.

Low interest rates should cushion downside risk for stock markets. Shares with attractive and secure dividends should do well in a prolonged low interest rate environment.

In general, when governments print lots of money, it creates weight of money bull markets which will be revealed to us by price charts.

My personal portfolio: A silver futures long trade increased - With a breakeven stop now protecting my recent [silver](#) purchase, I increased my stake by 40% this afternoon, paying \$12.375 for another March position. When the market firmed again, I introduced a breakeven stop for this latest trade as well. Inevitably, there is a probability that I will be stopped out of this latest purchase, not least because the buy-sell silver spread (in lieu of a commission for this spread-bet trade on which no UK CGT is paid) is currently 3.5¢. However, I now have a virtually risk-free leveraged trade in volatile market conditions.

Additional Commentary by Eoin Treacy

ConocoPhillips, Valero, Slash Refinery Production - [This article by Aaron Clark and Margot Habiby for Bloomberg](#) covers the improved profitability of the oil refining sector. [Here it is in full:](#)

ConocoPhillips, the second-largest U.S. refiner, expects refinery operating rates near 80 percent during the first quarter due to planned turnarounds and hydro- skimming economics.

Valero Energy Corp., the largest U.S. refiner, said yesterday that average utilization rates for its fluid catalytic cracking units, which help make gasoline, are between 70 and 75 percent of capacity.

"I think they are smart business people," said Peyton Feltus, president of Randolph Risk Management Inc. in Dallas.

"Demand is down. Refiners have gotten a profitable crack spread back by reducing capacity, so why ramp up and ruin the market that they have worked hard to improve?"

The crack spread, or margin for turning three barrels of crude into two of gasoline and one of heating oil, rose \$2.18 to \$11.58 a barrel today, based on New York Mercantile Exchange futures prices for March delivery. It reached a six-month high of \$18.30 Jan. 15 and averaged \$4.542 in the fourth quarter.

ConocoPhillips made an average \$6.96 for each barrel of oil it refined in the U.S., \$2.07 a barrel less than in the third quarter. Internationally, it made \$8.31 a barrel, \$2.93 a barrel less than in the third quarter.

The U.S. margin would have been smaller without stronger profits from using high-sulfur oils and from the sale of fuels made from reprocessed refined products, Chief Executive Officer Jim Mulva said on a conference call with investors and analysts.

U.S. refineries operated at 82.5 percent of capacity last week, down 0.8 percentage point from the week before, the U.S. Energy Department reported today. It was the lowest since the week ended Dec. 26.

My view - [Refineries make their money based on how much they can make from splitting a barrel of oil into products such as gasoline and heating oil. This is known as the Crack Spread. For a description of how it is calculated see Comment of the Day on \[September 17th 2007\]\(#\).](#)

Until now, I have relied on proxy indices I created in Bloomberg to monitor these spreads but since crack spread futures contracts are now traded on Nymex ([2:1:1](#), [3:2:1](#), [5:3:2](#)), I have added them to the Chart Library so that subscribers can monitor them as they wish.

Crack spreads have a degree of cyclicity because of end user demand for the products concerned. For example, Gasoline demand peaks in the summer and Heating Oil in the winter, Longer-term crack spread charts show us that while spikes in both directions are not uncommon, the amount of time the spread spent below \$5 in late 2008 was extraordinary compared to previous

gyrations. This dealt a severe blow to refining profitability and the S&P500 Oil & Gas Refining & Marketing Index sold off heavily in the latter half of 2008.

Looking at the Chart Library's Performance [Filter](#) this morning, for the S&P 500 constituents, I noted that the S&P500 Gold Index is the best performer over the last three months in absolute terms. The S&P 500 Oil & Gas Refining & Marketing Index is the second best absolute performer over the same timeframe.

The [Index](#) performed well as the oil price began to appreciate from 2002 and peaked near 600 by early 2006. This followed a loss of momentum over the previous year. It broke upwards once more in mid-2007, but was unable to sustain the upward break and fell back into the range. The progression of lower highs remains intact. However, the Index accelerated lower in October and found support near 140. It has since rallied further than at any time in the downtrend and a sustained move to new lows would be needed to question recovery potential.

[Tesoro Corp](#) was unable to sustain the move to a new high in late 2007 and has fallen consistently since that failed upside break. It found support near \$7 between October and November and has since rallied well to test the progression of lower highs and the moving average. The move from the November lows has been remarkably consistent and is looking a little overstretched in the short-term. However, a sustained move to new lows would be needed to question recovery potential.

[Valero Energy Corp](#) has tracked the Index reasonably well. It found support near \$14.50 in October and November and would need to break the progression of higher lows, with a move below \$21.50 to question the integrity of the short-term uptrend. A sustained move to new lows would be needed to question recovery potential.

[Sunoco Corp](#) peaked with a clear weekly key reversal in early 2006 and ranged for more than year before breaking downwards early in 2008. It bottomed near \$20 in October and has since more than doubled. It has sustained a move above the 200-day moving average for a month and is testing the progression of lower highs near \$50. A sustained move below \$40 would now be needed to question upside potential.

[ConocoPhillips](#) broke upwards from an orderly ranging phase in May 2008 but was unable to sustain the move and fell steadily from late June. The accelerating downtrend lost momentum from October and continues to consolidate. A sustained move to new lows would be needed to question the base formation development hypothesis.

Barrick Sees 'Frightening' Trend Driving Gold Higher - This article by Stewart Bailey and Erik Schatzker for Bloomberg covers some interesting points regarding the gold market. Here it is in full:

Barrick Gold Corp. Chairman Peter Munk said an "unpleasant and frightening" trend of investors buying gold as protection against uncertainty in world markets may help push the metal over \$1,000 an ounce.

Munk, founder of Toronto-based Barrick, the world's largest gold producer, said he has received an increasing number of calls from wealthy investors looking for ways to buy bullion. While that is positive for the metal market, it is a "sad part of a civilized society," Munk said.

"That's not where you want to be, it's alarming," he said today in an interview from Davos, Switzerland, where he is attending the World Economic Forum. "Do I personally believe gold will break through \$1,000? It's not a question of if, it's a question of how soon."

The strong demand is being mirrored among professional investors whose funds are buying gold and shares of the companies that produce it. That helped the metal to its eighth straight annual gain last year and has driven a rally in gold stocks in recent months. Gold miners including Newmont Mining Corp. and Yamana Gold Inc. are taking advantage of the trend to raise cash, with new equity worth more than \$2 billion sold since November.

Barrick Gold rose C\$3.16, or 7.2 percent, to C\$47.14 at 4:26 p.m. in Toronto Stock Exchange trading. The shares climbed 7 percent last year, outperforming a 29 percent decline in the 16-company Philadelphia Gold & Silver Index.

#### 'Counterweight' to Currencies

Gold is a "the obvious counterweight" to currencies, Munk said. The metal has reached record levels in Indian rupees and Russian rubles, among others, as investors outside the U.S. demonstrate a greater affinity to buy the metal as a hedge against currency declines, he said.

"Americans were brought up to believe in the dollar, with some justification, and it is the Germans and Russians and Indians that never trusted their currency," Munk said. "Today, it's a situation where people also have concerns about the dollar paper currency."

Gold futures jumped to a record \$1,033.90 an ounce in New York on March 17 as the dollar slid toward a record low against the euro and bank losses increased. Some investors buy the precious metal as a hedge against inflation and a haven from financial turmoil.

#### Greenlight Buying

Greenlight Capital Inc., the \$5.1 billion hedge fund based in New York, said earlier this month it was buying gold and gold- mining stocks for the first time as protection against the Federal Reserve's attempts to revive the U.S. economy by devaluing the dollar.

"Our guess is that if the chairman of the Fed is determined to debase the currency, he will succeed," Greenlight said in a Jan. 20 letter to clients. "Our instinct is that gold will do well either way: deflation will lead to further steps to

debase the currency, while inflation speaks for itself."

Eight years of gains for the metal is the longest winning stretch of the 19 commodities tracked by the Reuters/Jefferies CRB Index.

Gold futures for April delivery rose \$16.50, or 1.9 percent, to \$906.50 an ounce today on the New York Mercantile Exchange.

My view - [Gold](#) peaked in March with a massive downward dynamic which formed a weekly key reversal. This signalled the onset of a medium-term correction which now appears to have bottomed near \$700. The rally from the October lows has been impressive in both absolute and relative terms and the yellow metal is now testing the progression of lower highs from the peak; having already sustained a move above the 200-day moving average for most of January. Gold would now need to break the three-month progression of higher lows, with a move below \$800, to question scope for further upside.

In relative terms, gold topped out against gold shares in October, following a spectacular acceleration, and has given up more than half of the advance to date. Against the [Philadelphia Gold & Silver Index](#), it found support near 7 this month and a sustained move below that level is needed to reaffirm the relative downtrend. Against the [AMEX Goldbugs](#) Index, the relevant level is 2.9. Considering the extent of the relative decline to date, there is a possibility that gold shares outperformance relative to gold will slow from the breakneck speed of the last few months.

[Barrick Gold](#) rallied consistently from its lows near C\$22 to test the high near C\$50. While this area has offered resistance in the past a sustained move below C\$43 would be needed to question the integrity of the three-month uptrend.

[Newmont Mining](#) broke downwards from its prolonged ranging phase in October and fell to \$21. It rallied quickly, however, and pushed back above \$40 last week. A sustained move below \$35 would now be needed to question the integrity of the three-month uptrend.

[GoldCorp](#) found support in the region of the 2006 & 2007 lows and has since retraced more than half its decline. A sustained move below C\$30 would now be needed to question upside potential.

[Gold Fields](#) peaked in July 2007 and the downtrend gathered pace from July last year. It bottomed in late October, broke the progression of lower highs in December and broke upwards once more this week. A sustained move back below ZAR9000 would be needed to check scope for some additional upside.

[Harmony Gold](#) is looking somewhat overstretched as it tests the highs near ZAR12,000 but a downward dynamic would be needed to check momentum beyond a brief pause.

[Silver Standard Resources](#), which owns mainly undeveloped silver resources, found support near \$7 and ranged around \$10 before breaking upwards in

mid-December. A sustained move below \$20 would now be needed to question the consistency of the move.

Gold shares have done extremely well in relative as well as absolute terms from the October lows. However, two points are worth mentioning. The first is that currency differentials flatter the performance of non-USA domiciled companies. The US listings of [Barrick](#), [GoldCorp](#), [Gold Fields](#) and [Harmony Gold](#) are not performing as well as their respective Canadian and South African listings. The second is that gold shares' underperformance relative to gold shares has slowed considerably, suggesting that gold shares as a sector may have already seen the best part of their advance relative to the yellow metal.

Relative to the [S&P 500](#) the Philadelphia Gold & Silver Index is currently testing its 2008 highs and is looking overstretched. Some consolidation would appear likely and a sustained move above 0.16 is needed to reaffirm the uptrend.

Email of the day - on Nintendo:

"Here's a quarter. Go downtown and have a rat gnaw that thing off your face." With all that's come since the first Nintendo shock last summer (the end of Anglo finance, 5,000 NKY points, and Paul Newman) it's easy to forget what a thorny investment problem that stock presents to Japan specialists. In addition to not being in the 225, the name became such an alpha trap (you had to own it because nothing else domiciled in the Empire ever went up) that the market cap was once 2nd only to Toyota, leading to all sorts of crude 'what kind of economy makes only games' jokes around the multi-strat locker room. In short, an irritation on the way up, a problem when the #s stopped rising, and a disaster on the way down. Now it trades just like a Smith's song title...depressing but you'll never forget."

My comment - Thanks to John Clappier for his daily market brief and memorable quote from John Candy's timeless movie Uncle Buck. Today, the missive included an interesting Bloomberg graphic depicting Analyst Earnings Estimates overlaid with the price chart for [Nintendo](#). Earnings expectations continued to push higher even after the chart action had deteriorated significantly. This is not an isolated case as can also be seen for this chart for [Potash Corp](#). Analysts, just like any other group of people, will have some stellar performers but most will follow the consensus. These charts tell me that the best arbiter of sentiment is price action. This is a point covered in detail at [The Chart Seminar](#).

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