

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 2nd February 2009

Forbes Interview: Jeremy Grantham - the bear buys stocks - [My thanks to a subscriber for this very interesting interview of Jeremy Grantham, conducted by Steve Forbes. Here is a brief sample:](#)

STEVE FORBES: And so, in terms of the markets today, even though they're cheap, you're going in gingerly or since it could theoretically go down to 600 and given the emotions you get in these things.

JEREMY GRANTHAM: Yes, I would say two-to-one, by the way, my instinct plus looking at the history books that it will go to a new low [in 2009]. So, this is the problem. We're underweighted still, in an ordinary asset allocation account that has 65 percent in equities, we have moved up to 55. So, we're still underweight, even though they're cheaper than they've been and they're reasonably cheap.

Now what happens? If we throw in the client's money and it goes down, indeed, as I think it will [in 2009], they will complain quite bitterly that we weren't very smart. We thought it was going down, and yet we threw their money in. So, that's one kind of regret. And the other kind of regret is that we hang back and the market runs away, the one-in-three comes up and they say, "You told us the market was cheap. You told us that you had these nine or ten percent real return opportunities and you're still underweight and the market's back up 200 points. You're an idiot."

So, there's no way you can avoid some regret. You have to look at your own personal balance sheet, how much pain can you stand? If you absolutely can't stand a 20 percent hit, you'd better carry quite a lot of cash, because you're quite likely to get it. If on the other hand, you're made of steel, you can concentrate on the seven-year horizon and filter money in and having a lot of cash here is probably a bit dangerous from the other point of view.

But in any case, it's a very personal judgment of risk avoidance and how tough you are under stress. The worst situation that will befall probably quite a lot of people is that they exaggerate their toughness. The market goes down 30 percent from here to 600 and they panic, dump their stocks and never get back. And that's the worst outcome.

My view - To buy, or not to buy: that is the question (*with apologies to Hamlet and William Shakespeare*). As investors, how should we handle this question?

I will share my thoughts with subscribers but first, do not miss this interview with one of the most experienced and independent-thinking investors. He is strong on market history and has some interesting things to say about emerging markets, Japan and US equities.

As to whether one should buy stocks at this time, or not, I think Jeremy pointed out the risks, including psychological factors, in his comments above. Expanding on what he said, I will assume that most subscribers have at least a somewhat diversified portfolio. In other words, they do not have all of their life's savings in one asset class. For instance, a reasonably diversified investor of mature years might have a significant portion of their net worth in at least three of these six categories: a business, property such as a home, equities, bonds, collectibles and cash. For the purposes of this discussion, I will focus on equities and cash.

If entirely in equities and holding no cash, which I would regard as an overweight position, one needs to be psychologically prepared to ride out a possible downside overshoot. If not, it might be better to cut back to one's comfort level if the prospect of an overshoot is sufficiently worrying to cause an unhealthy level of stress.

If one is in cash and entirely out of the stock market, some incremental buying on easing is justifiable, as Jeremy Grantham is doing, provided a downside overshoot would not cause too much stress. One way to reduce stress would be to concentrate on nibbling at equities that provided a decent and well-covered dividend, or funds that would benefit from the same. In other words, this is probably not the time to buy a small tech firm or uranium exploration company with prospects but no earnings.

If one has a mix of equities and cash, with the latter earmarked for eventual investment, temperament may be a major factor in determining how you should proceed. For instance, a prudent risk taker may enjoy the challenge of buying low and possibly lightening on rallies in what has often been a ranging (trading) environment. Conversely, others may prefer to join the next bull trend once it is clearly established.

Today, stock markets are still in overall downtrends, as identified by their 200-day moving averages, and the lows are being tested in many instances. Risks are probably higher where financials are underperforming. The best case scenario, from my perspective, is that share indices are in the early stages of a bottoming out and base building process which may be lengthy, as I have said before. The worst case scenario is that we get an historic overshoot to the downside, which would probably lead to a V-shaped bottom, followed by some right-hand extension. Either way the worst of the bear market, by far, is already behind us.

John Macintosh: The Demolition Derby of Grain Demand - My thanks to John

Macintosh for this [report](#). John certainly knows the grain markets and his breezy, irreverent style makes this an additionally good read. Here is the opening:

Have you seen the latest Monty Python skit, where a bunch of financial experts shout out "Stocks are always good in the long run". "Commodities are as safe as houses". "Crude is going over \$200". A short time later they reappear, bearish crude at \$40, but bullish the grains because they are "recession proof". "A man's gotta eat!". "Today there are more people on the planet than ever in history". The scene ends with them singing "Soybeans are Cheap Today" to the strain of Verdi's La Donna e Mobile. If you missed this skit don't worry, you can witness the same scenes on Bloomberg any day and read dozens of similar reports written by the leading disinvestment houses and once large banks, the founding members of the paradigm-a-dozen-club. A new day a new paradigm.

To pretend that demand for grain would be unaffected during the world's biggest economic collapse in 75 years is disingenuous at best. Roughly 70% of all the world production of corn, wheat and soybeans, via soymeal, end up as animal feed. A cursory glance at the cattle, hog and chicken business reveals an industry truly gutted with disastrous margins. Despite the smallest cattle herd in N. America in over thirty years, cattle prices are in the slammer. Not only is domestic consumption down, but exports are off sharply, and to make matters worse, the hides which generally represent 10% of the value of the carcass, are going unsold because of the implosion of the auto industry. With milk prices collapsing, the dairy industry is in extreme dire straits. Hog prices are very weak and cash hogs recently traded at a record discount to futures. The chicken industry is literally headless, having lost it's biggest producer, Pilgrim's Pride. Vultures are the only birds with a future

My view - Veteran subscribers may recall that I have long been interested in the commodity markets and have traded them from time to time since the early 1970s. While most of these trades have been in the precious metals sector during the current decade, agricultural commodities are often discussed in Fullermoney, and never more so than a year ago during the raging fashion for commodity trackers.

Our contention was that the tracker funds contributed to dramatically higher prices for staple commodities, adding to inflation and resulting in food riots in some countries. Among industrial commodities, crude oil particularly appealed to investors in trackers, due to 'Peak Oil' concerns. This flood of money into commodities, which were never meant to be asset classes, was highly inflationary and helped to tip economies into recession as central banks raised interest rates to prevent overheating.

What a different world we have today!

Many investors piled out of those commodity trackers just as quickly as they had chased them higher. Nevertheless, agricultural commodity trackers have experienced a partial revival, due to some active promotion which John Mackintosh parodies in his opening paragraph. This may have delayed the full

correction in prices for [corn](#) and [soybeans](#) in particular. He points out that they have not yet matched previous corrections following price spikes, and that contangos remain high. This is in spite of near record short-term interest rates. My guess is that a retreat towards last year's lows is underway.

Here is a counter argument from Chatham House, [quoted](#) by the Financial Times today: *Forecast signals end of cheap food.*

Personally, I would back John Mackintosh on timing, for the reasons he cites and because soybean and corn were among the last bubbles to burst. Consequently it would probably require a spectacular supply disruption to lift prices significantly during a global recession. The Chatham House outlook will become more likely when the global economy is next synchronised in a phase of GDP expansion.

My personal portfolio: Silver futures long partially stopped out and reopened at a slightly better level - My breakeven stop for last Friday's additional [silver](#) trade was triggered this morning. Consequently a March position was sold at \$12.40 against last Friday's purchase at \$13.375, and I repurchased it this afternoon at \$12.31. These prices include all spread-bet dealing costs.

Additional Commentary by Eoin Treacy

The Bond Issuers Are Turning Buyers - Thanks to a subscriber for this interesting [report](#) by Viktor Hunt and Kelvin Pang covering the trend towards debt buybacks at more credit worthy Asian corporates. It also contains a list of issuers who may be engaged in such activities as well as a list of individual bonds. Here is a section:

Debt Buyback Economics: Why We Should See More of Them

For corporates, the economic incentive of buying back bonds should be a matter of comparing the returns (or savings) in IRR terms against the opportunity cost of using capital elsewhere, e.g., through investing in their business. Clearly, over the past twelve months the former has gone up - just a quick look at bond prices will confirm that - but importantly the latter has gone down as company ROEs have begun trending down and likely have significant downside still as the business cycle weakens. The corporate finance argument for buying back debt has not been this strong in a long while.

There is a second argument supporting debt buybacks: at this point both the credit and equity markets like it. In fact, for the universe of companies that bought back bonds in the past twelve months, the share price had been underperforming the market materially prior to the buyback, but then stabilised after (see Exhibit 5). This confirms that equity markets are also increasingly driven by concerns over corporate liquidity, and hence, for a company to buy back its debt, especially short-term debt (which often makes the best buyback-returns anyway), signals balance sheet strength.

Who in Asia Has the Highest Incentive to Buy Back Bonds?

Two factors need to come together for bond buybacks to happen: an economic incentive (willingness) and the liquidity profile to pursue it (ability). A typical feature of the buybacks so far is the stronger-than-average liquidity profile of the companies (1.95x cash/ST Debt vs. 1.50x for the broader universe), which means that buying back debt is actually liquidity enhancing.

In Exhibit 6, we have screened the AXJ bond universe on the basis of (i) willingness - bonds that give a potential corporate buyer higher IRR than its forward ROE, and (ii) ability - corporates that score high on our favourite liquidity metric, the liquidity position (i.e., Cash + FCF - ST Debt). Interestingly, some of last year's debt buyers appear on the screen, supporting its validity, but the key point is that this is an approach that credit investors (whose primary job really is exactly that) should like as well, regardless of the supportive technicals buyback potential creates.

My view - The current global economic environment is deterring vast numbers of people from taking on more debt and encouraging them to pay down some of their existing liabilities. This is of course only an option for people with sound finances and the cash available to fund such outlays. The same is true of corporations.

Investors are slow to lend to corporations and credit spreads remain at extremely high levels. This makes issuing new corporate bonds less appealing, even in this low interest rate environment, because companies have to pay over the odds for funding. On the other hand, buying back debt that redeems at par for half its nominal value makes sense in this environment.

Only companies with comparatively strong balance sheets will attempt this feat. I looked at a number of the relevant bond price charts this morning but they are mostly illiquid and do not add a great deal of value. However, here is a selection of the equities concerned:

Mahindra & Mahindra peaked in early 2007 and broke downwards from a lengthy ranging phase in January 2008. It found support in October near R250 and continues to show base formation characteristics. A sustained move below R230 would now be needed to question this hypothesis while a sustained move above R400 would suggest that the bulls have regained the upper hand.

Reliance Communications completed a Type-2 top, as taught at The Chart Seminar, in January 2008 and remains in an overall downtrend. The share found support near R150 in late October and is currently retesting that level. An upward dynamic is needed to indicate that demand is returning at this level and to question scope for some lower to lateral trading.

Hutchison Whampoa broke downwards from a lengthy ranging phase in September and fell to HK\$33.5 before finding support. A sustained move to new lows would be needed to question scope for some further higher to lateral ranging.

[New World China Land](#) peaked with the A-Share market in 2007 and found support near HK\$1 in October. A move to new lows, sustained for more than a couple of days would be needed to question scope for some additional higher to lateral ranging.

[KCC Corp](#) accelerated to a high near KRW700,000 in late 2007 and has since given up the entire advance. It found support nears KRW150,000 in October and continues to range gradually higher. A sustained break of the short-term progression of higher lows would be needed to question scope for some additional upside.

[Olam International](#) found support near SG\$1 in October and continues to range above that level. While this rally is no larger than any in the course of the downtrend, it is occurring at a significantly lower level and a sustained move to new lows would be needed to question the base formation hypothesis.

[Noble Group](#) fell abruptly from its May peak before finding support near SG\$0.50 It has since more than doubled and sustained move below SG\$0.90 would be needed to question potential for some higher to lateral trading.

[Bangkok Dusit Medical Service Pcl's](#) consistent uptrend peaked in July 2007 and it accelerated lower from September 2008. It found support near THB13.7 in December and continues to range above that level, A sustained move to new lows would be needed to question scope for some additional lateral ranging.

[Thoresen Thai Agencies](#) found support near THB10 in October and continues to range gradually higher. A sustained move below THB15.7 would break the progression of higher lows and question potential for higher to lateral ranging.

[Western Areas](#) has mirrored the performance of nickel and shows similar base formation characteristics. A break of the short-term progression of higher lows would be needed to question scope for higher to lateral ranging.

[Macquarie Communications](#) fell from near AU\$7 in mid-2007 to AU\$0.75 in November. It is now considerably less volatile as question about the firm's survival are less poignant. A break of the short-term progression of higher lows would now be needed to question scope for some further higher to lateral trading.

[IOI Corp](#) found support near MYR2 in October and has almost doubled since. A sustained move below MYR3.6 would be needed to break the short-term progression of higher lows and question scope for further upside.

Most of these shares are not performing as if they have appreciably healthier balance sheets than other companies in their respective countries or sectors. KCC, IOI and Noble Group have the best chart patterns but need to continue to perform to suggest that demand is regaining the upper hand beyond the short-term. Buying back debt is a wise choice for these companies in this environment and it may take time for the equity markets to take notice of

these moves. Signs that they are outperforming their country indices may suggest that equity investors are beginning to take notice.

Treasury Real Yield at 16-Month High on Inflation Bet - [This article](#) by Dakin Campbell for Bloomberg covers the divergence between the continued fears of a Japan-type deflation and the threat of renewed inflation as viewed in the TIPS market. Here is a section:

For the first time since 2007, Treasury investors are betting that inflation will accelerate.

The yield on 10-year notes exceeds the consumer price index by 2.72 percentage points, the most since December 2006. The gap between two- and 10-year rates widened at the fastest pace in a year last month as traders demanded more compensation for longer-term debt. Treasury Inflation Protected Securities that signaled falling prices as recently as Nov. 20 show they will increase in the U.S. this year.

Deflation was the growing concern for investors in 2008 as government bond yields fell to historic lows in December, the Reuters/Jefferies CRB Index of commodities tumbled 53 percent since July and home prices plunged 18 percent amid a deepening recession. Now, the bond market is saying Federal Reserve interest rates at zero percent, President Barack Obama's \$819 billion planned stimulus package and \$8.5 trillion of U.S. initiatives to revive credit markets will reignite inflation.

"When the Fed gets finished here they will have an inflation nightmare on their hands," said Mark MacQueen, who helps oversee \$7 billion as co-founder of Sage Advisor Services Ltd. in Austin, Texas. "There is a lot of downside in conservative government bonds."

MacQueen is selling 30-year Treasuries, which are more sensitive to inflation expectations than shorter-maturity debt.

Rising Yields

The yield on 30-year Treasury bonds climbed 29 basis points, or 0.29 percentage point, to 3.61 percent last week, according to BGCantor Market Data. The price of the 4.5 percent security due in May 2038 declined 5 29/32, or \$59.06 per \$1,000 face amount, to 116 2/32. For the month, the yield rose 93 basis points, the most since climbing 100 basis points in April 1981.

The yield fell three basis points to 3.57 percent at 8:08 a.m. in New York.

Yields are rising so fast they are already higher than where economists just three weeks ago expected they'd be at year-end. The median estimate of 44 economists, investors and strategists surveyed by Bloomberg News from Jan. 5 to Jan. 12 was for 3.45 percent by 2010.

Investors in 30-year bonds lost 14.6 percent last month, according to Merrill Lynch & Co. index data. January was the worst month for government

securities since Merrill Lynch began tracking returns on the securities in 1988.

Yields on 10-year notes fell to the lowest on record in December as the cost of living dropped 0.7 percent, trimming the annual advance to 0.1 percent, the smallest rise in half a century, according to the Labor Department in Washington.

My view - Fears of a Japan-type deflation continue to permeate Wall Street as indices test their lows and investor anxiety remains high. We all have a tendency to imagine the worst case scenario when we have already sustained a heavy hit to our net worth. We hear nothing but the worst possible economic news in the media and the temptation is to assume that the worst is to come. The potential for a Japanese no growth, decade-long deflationary spiral must seem all too real for many investors.

However, Treasury Inflation Protected Securities ([TIPS](#)) have been rallying since November. This suggests that investors are assuming inflation will be a concern again before these bonds mature. Both of these views can't be right.

The [spread](#) between the US 10yr and 2yr tested its 20yr highs near 250 basis points in November and pulled back. It would need to sustain a move to new highs to suggest that short-term deflationary fears are being given credence by fixed income investors.

The [spread](#) of the US 10yr over US 10yr TIPS hit a low of 4.5 basis points in November and ranged above that level for two-months. It broke upwards in late January and continues to push higher. A sustained move below 50 basis points would now be needed to question scope for further upside. The [30yr](#) spread looks similar.

The [TIPS 2% 2016](#) topped out near 110 in mid-March and declined steadily before accelerating lower from September. Prices hit a low of 86.76 by late November as the belief that the economic crisis would lead to a depression gained ground. However, the bond bottomed with a key reversal on November 25th and rallied impressively to test the downtrend and parity. Further upside will be more difficult from here, but a sustained move below 97.75 would be needed to question the integrity of the two-month move.

All of these charts indicate that inflationary expectations have been radically reassessed in the last two-months. This fact is not currently being reflected in the stock market. If deflation is more likely to be transient rather than enduring, then assuming that stock markets will have another 'Octoberesque' fall becomes a less likely proposition.

Email of the day (1) - on salt prices:

"Is there any way to get the evolution of the salt price? I couldn't find it in the Library and, actually, I don't know if it is traded publicly through an open market.

"Thank for your outstanding coaching and support to us, battered investors."

My comment - Thank you for your kind words. I found intermittent prices for salt quoted in Kolcutta. Unfortunately, it is irregular and I suspect somewhat unreliable so I have not added it to the Chart Library.

Email of the day (2) - on Friday's quote of the week:

"Your referenced Karl Marx quote on commentary of the day 30th January 2009 seems to be a hoax that is currently doing the rounds on Wall Street. Another hoax on Wall Street, yet this one hasn't cost anyone their life savings that we know of. For more detail please refer to:

<http://www.popmatters.com/pm/post/made-up-marx/> "

My comment - Thanks to a number of subscribers who pointed out that the Quote of the Week, posted on Friday, was not in fact by Karl Marx. We received it from a normally highly reliable source and I did not think to question it. I deleted the quote on Saturday morning.

Last week's signups for the Free (Abbreviated) Comment of the Day - For the week of January 25th new signups, including subscribers and pre-subscribers, live in the following countries or regions: Australia, Belgium, Canada, Cayman Islands, Hong Kong, Ireland, Israel, Netherlands, Singapore, South Africa, Switzerland, Thailand, the UK and the USA - 14 in total. In descending order, which topped the list in terms of the last week's new signups? It was the 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 3rd February 2009

The Weekly View: Reconciling Value and Risk Management - My thanks to Rod Smyth, Bill Ryder and Ken Liu for the latest [edition](#) of their timely letter. Here are two samples:

On economists:

The gloom was palpable at last weekend's University of Richmond economic forum of 17 economists, including two Nobel laureates, who met to discuss the crisis. By all accounts, the same pessimism pervaded the World Economic Forum in Davos, Switzerland last week. We see the world's economic problems as both cyclical and structural but believe that universal pessimism

almost assures that there is value in a broad range of risky assets. A cyclical reversal in both the economy and stocks is likely before the end of 2010 in our view but for now we see little evidence that the downward momentum of economic news is abating. Our strategy is to remain in risk management mode (underweight stocks and neutral credit) while the technical picture looks poor. This makes it unlikely that we will increase stock exposure significantly until the S&P 500 breaks above critical technical resistance, which we currently judge to be at 1010.

On GDP and behaviour in a deflationary environment:

One striking feature of fourth quarter GDP was the role of prices. While "real" GDP attempts to remove the effect of pricing when measuring economic activity, when we consider the economy with prices (i.e. the world we live in), so-called 'nominal' GDP, fell a greater 4.1%. This is because prices for the goods and services measured in GDP declined at a 4.6% annual rate in the fourth quarter. In the third quarter the GDP price measure rose 4.5%. We find this notable for two main reasons. First, in a declining price environment - also known as deflation - households, businesses and government behave differently than in a more usual inflationary environment. Most prominently, households are incentivised to save - indeed the personal savings rate rose to 2.9% from 1.2% - while businesses are encouraged to curtail expansion and defer hiring. Government meanwhile can be expected to run loose monetary and fiscal policy, as evidenced. Second, even though disposable personal income fell at a 2.4% rate in the fourth quarter, in real terms it actually increased 3.3%. Falling prices raise household purchasing power.

My view - Re consensus views: In markets, any clear consensus is ultimately a contrary indicator. However, the crowd will be right for a while, which validates the consensus view in people's minds, leading to an extrapolation of forecasts. In other words, because it has gone down, people believe that it will go down further, and vice versa, until they are eventually proved wrong by the subsequent reversal. For this reason the trend very seldom reaches the more extreme forecasts.

Re consumer behaviour: In the transition from an inflationary bubble environment to one of disinflation and deflation, we all feel worse off because the froth is blown off our asset valuations. This is stressful, as is the spectre of rising unemployment, not least for those who have lost their jobs. However, even if unemployment reaches the frightening level of 10%, the 90% who are still employed may actually be better off as a consequence of their different behaviour in the disinflationary and deflationary environment. For instance, households are now saving more and reducing debt. Since they are also consuming less, the prices of many goods are declining. Houses are cheaper than a year ago, mortgage rates are lower, petrol costs less, and shop sales or discounts at supermarkets are more frequent.

Don't miss the interesting graphic on housing in The Weekly View - it may surprise.

Tim Price: An open letter to the Western banking establishment - [Tim takes another swipe at the banking establishment in this issue](#), published by PFP Wealth Management. Here is a section:

Re. your unauthorised overdraft Dear Western banking establishment, I notice that your unauthorised credit facility from international lenders of last resort now totals approximately \$10 trillion. As a taxpayer and therefore your largest shareholder I would be grateful if you could repay this facility at your earliest convenience. I have charged you an additional £30 for this letter and a monthly unauthorised overdraft fee of £28. If you do not repay this facility shortly I will have no choice but to become further massively impoverished along with legions of fellow taxpayers for multiple generations to come.

I would also be grateful if the strategists and economists who work for you could abstain from publishing their unsolicited opinions about resolving the banking crisis within the financial media. I am sure you will agree that hearing from the same strategists who worked for the architects of such widespread financial destruction is likely to irritate those of us who were not actually complicit in the extraordinary and venal credit boom of the last several decades. There is an expression that if you're not part of the solution, you're part of the problem. Those of your employees who were the public face of the problem are, I think you will agree, unlikely to represent the solution, unless perhaps they are fired - en masse, from a giant howitzer, into an area where they can do no further harm. Alaska, perhaps. I would further suggest that the high profile commentators who work for you and who have implicitly played their part in marketing and then amplifying this catastrophe might consider quietly entering another field with superior ethics and enhanced value to society at large: perhaps as piano players in brothels.

My personal portfolio: EUR/USD long trade opened - [One of the calls of the year](#), I suspect, will be to spot the trend change indicating a weaker USD. I do not know if we are there yet, but the dollar looks sufficiently overextended for me to open an initial short, which I have done by purchasing [EUR](#). This afternoon I bought March EUR/USD futures at \$1.2972, including spread-bet dealing costs. I will most likely add to this position, either buying it lower on a [Baby Steps](#) basis or higher behind a trailing stop on my initial position.

Today's interesting charts - [To adjust the size of Fullermoney charts for your own publications](#), first create the chart that you want, then use the 'Options' feature upper left to change the size.

China (SHCOMP) - [Testing Nov-Dec highs in range](#) that continues to show base formation [characteristics](#); a decline beneath 1950 would now be required to reaffirm resistance in this region and suggest a lower phase of ranging.

New Zealand (NZSE50FG) - [Testing lateral resistance near 2800](#); would require a break in the last and rising low near 2690 to reaffirm significant resistance at the upper boundary.

United Kingdom (FTSE 100) - [Steadied](#) near 4000 but needs move above late-Jan high near 4325 to further remove pressure from this region and to reaffirm support above the range lows.

Germany (DAX) - [Steadied](#) above Oct-Nov lows but needs 4540 to reaffirm more than temporary support at 4000.

Note: Stock market index charts below this level were base on prices prior to today's close.

Brazil (IBOV) - [Firm](#) in upper side of range; would require close beneath 36730 to halt sequence of higher reaction lows and suggest further test of underlying support.

United States (S&P 500) - Slightly [firmer](#) near 800 but needs move above 880 to reaffirm support in this region.

Nickel (LME 3m) - Slight [upward](#) bias within range dominated by upward dynamics which are a sign of base formation development. A close above 12250 would reaffirm underlying support and suggest test of Nov and Jan highs.

US Dollar Index (DXY) - Another [downward](#) dynamic as rally loses momentum in small Oct-Dec top area; a break above 86.90 is required to offset scope for sideways to lower trading.

Additional Commentary by Eoin Treacy

GSI: The Issues, How Fast is China Slowing? - [Thanks to a subscriber for this edition](#) of the ever interesting report by GSI, which this month offers an iconoclastic view on China. Here is a section:

The Shape of Things to Come

Economic activities were slowing in China by 2H08 due to its domestic credit cycle. But the above-discussed factors of inventory run-downs and disruptions to global trade resulting from the global financial meltdown were the main causes of industrial production falling off a cliff in 4Q08. Analysts have extrapolated the 4Q08 plunge as indicator of trends in 2009, which we believe is inappropriate. The credit cycle in China has reversed, and the impetus to 2009 GDP growth will come from 1) public sector fixed investments, and 2) private consumption. Trends in both support overall GDP growth of 7% to 8%.

Chart 5 shows the ratio of bank loans needed to drive a dollar gain in China's GDP. In earlier years, the ratio was 2x (GDP was probably understated then). A big, official revision upwards by ~30% of China's GDP was made in 2005 (but prior year data were not restated), hence the plunge in the ratio then. Aside from these anomalies, it appears the ratio is rather stable at about 1x, i.e., it takes a dollar of loan for each dollar gain in China's GDP. Most loans in China are investment driven, e.g., housing, plant facilities and infrastructure,

which have a higher GDP multiplier than loans for consumption (as in the U.S.).

China's 2008 GDP was ~Rmb28 trillion (US\$4.1 trillion). Nominal GDP growth of 10% in 2009 (8% real and 2% inflation, say) means a GDP gain of ~Rmb3,000 billion, which implies loan growth of 12% to 13% on the end-2008 base over the course of 2009, a magnitude easily achievable. Under government directives, banks in China extended over Rmb800 billion in loans (mostly for public infrastructure) in December 2008 alone. Stimulus is already in the works.

Private Consumption - A Function of Confidence

What drives the feel good factor that motivates consumers to consume? Real income growth and the wealth effect. Charts 6 and 7 show the positive correlation of real wages in China's urban and rural sectors and retail consumption in 2005-08. The surge in inflation in 1H08 temporarily zapped the purchasing power of urban citizens, but a recovery has since taken place (real wages up +10% YOY by end 2008) as CPI subsided. Rural residents are doing fine (real wages+ over 17% YOY).

As for the wealth effect, China's rich have suffered disproportionately from losses in property and stocks, causing a slowdown in sales of luxury goods and high-end cars. But the average household has limited exposure to stocks-witness the uptrend in consumption (Chart 7) as A-shares collapsed during 2008. And average home values have given up only one-third of what they gained over the last five years. Supported by consecutive years of good increases in real wages and high savings, their feel good factor remains solid. High single-digit gains in retail consumption should be sustainable for 2009.

My view - I find it interesting that the more sentiment deteriorates with regard to the future prospects for growth in the USA and Europe and as stock markets continue to disappoint; the same dire conclusions are rolled out to Asia and especially to China. There is no denying that the slowing global economy is having a knock-on effect in almost every country and China is no exception. Major job losses in Guangdong, slowing economic output, massive declines in the stock market and a peak in the housing market are seen as justifications to support this view. In addition, a communist system is by definition corrupt because it is unaccountable and concentrates power in the hands of too few people, media is heavily censored and citizens are indoctrinated to accept the status quo from an early age. However, with China, everything is seldom as it seems.

The decline in the wealth effect in the West has been led by the fall in house prices. It is exaggerated by the home equity withdrawals which allowed home owners to leverage up their debt on the back of house price appreciation. To the best of my knowledge this option is simply not available to Chinese residents. 100% mortgages do not exist and the norm is for large down payments. The automotive loan industry is still in its infancy and credit / debit cards are used to far less an extent than in the West. It is still not surprising for large transactions to take place in cash rather than any other means.

China does not have a futures market, although one is promised, and financial leverage available to retail investors is limited.

Yes, large numbers of consumers were trading shares in the bull market which peaked in 2007. However, one of the justifications, at the time, for why shares could continue to rise was that there was still a vast pool of savings which had not yet been allocated to the stock market. Since the stock market peak, these savings probably remain relatively untouched.

I remember sitting next to a Chinese head of logistics, for a leading US chipmaker, on the plane to Shanghai in 2007. (Also see Comment of the Day on [October 2nd 2007](#)). He told me that he owned, if my memory serves me, 12 properties and had much of his investments tied up in property. At the time, he said he was thinking of selling some in order to diversify. If he did not sell, his story would seem to corroborate the contention in the report above that the biggest effect of the slowdown is being felt by the upper middle class.

Not surprisingly, sentiment towards the stock market is bearish. Following a massive decline and 4-months of ranging, there has been little to encourage new money into the market. Ranging suggests supply and demand have come back into balance, but the [Shanghai A-Share](#) market needs to sustain a move above 2200 and ideally [2500](#) to indicate the bulls are back in control. In the short-term, the progression of higher or equal lows from the October nadir indicates that demand is returning at incrementally higher levels. The argument about the pace, course and impact of China's re-emergence has been going on for a number of years and will continue to spark powerful emotions on both sides. At Fullermoney, we will continue to give the greatest weight to the charts, and right now, China shows the best base formation development characteristics of any globally significant market.

China looks to African metals and minerals for the long term - This [article](#) by Alistair Thomson for Reuters appeared in today's Mineweb.com newsletter and contains a number of interesting points on Chinese investment in Africa. Here is a section:

Chinese businessmen are taking a long-term view and pursuing strategic expansion in Africa even though China's multiplying investments on the continent have lost some luster in the global downturn.

Beijing and Chinese companies have pledged tens of billions of dollars to Africa in loans and investments mostly to secure raw materials for the world's fastest-growing large economy.

That long-term interest remains intact, despite a worldwide economic slump that has hit China's exports to the rich world and a sharp decline in Africa's mineral shipments to China.

China-Africa trade has surged by an average 30 percent a year this decade, soaring to nearly \$107 billion in 2008.

"China is in Africa for the long term, and strategically," said David Shinn, a former U.S. ambassador to Ethiopia and Burkina Faso who teaches at George Washington University's Elliott School of International Affairs.

"They will not veer from this, in my view," he said.

Far from retreating, many Chinese businessmen are hunting for bargains.

Chinese and Indian firms have expressed interest in taking over Zambia's top cobalt producer Luanshya Copper Mines since it halted operations in December, Zambian state media reported.

South Africa's Standard Bank, itself 20 percent owned by the Industrial and Commercial Bank of China (ICBC), said last month it was advising Chinese mining clients on buying opportunities in Africa and elsewhere.

"They are looking at 2009 and saying 'This is a time we see as a very big buying opportunity. We've got the backing from government, we've got the financial means'," Thys Terblanche, the bank's head of mining and metals investment banking, told Reuters.

Beyond mining, Chinese state companies are pushing ahead with strategic energy sector investments and infrastructure; private outfits are continuing to expand in technology areas.

"Some developed Western countries hit by the financial crisis are reducing their investment in Africa. Objectively, this is a powerful opportunity for Chinese businesses to expand their investment and market share in Africa," Cui Yongqian, a former Chinese ambassador to the Republic of Congo and Central African Republic, told a China-Africa trade forum this month.

Trade with Angola, China's biggest source of African crude oil, reached \$25.3 billion in 2007 and Beijing has offered Luanda \$5 billion in oil-backed loans.

Shenzhen-based Huawei Technologies, China's biggest telecoms equipment maker, is pushing south from its established stamping ground in North Africa.

"I see no reason why they would want to decrease their investments in the telecommunications sector, because that's profitable for them," said George Washington University's Shinn.

"It will vary according to sector and country ... It's very dangerous to generalize about the China-Africa relationship," he said. "They will certainly make tactical retreats where the economy requires it."

My view - China, India and a number of other Asian and Middle Eastern countries have vast young populations which will reach maturity in the coming decade. This is occurring in tandem with an urbanisation unprecedented in the history of the world. New cities, sewage, water, power, schools and jobs need

to be created to cater for this massive population bubble. These countries have no choice but to take the long view.

The global economic slowdown is having an effect on every country but where some see disaster, others will inevitably see opportunity, according to their financial ability. Competition for scarce global resources is now much less intense than it was a year ago. Many large Western companies have funding problems and are ultimately responsible to shareholders who are demanding they strengthen their balance sheets. Companies that were less leveraged, those supported by their respective governments or sovereign wealth funds are now in a position to do deals with cash strapped, resource rich governments on terms which would have been unthinkable less than a year ago. If one is willing to look beyond the medium-term morass of the credit-solvency crisis; world class reserves in the ground, in politically stable parts of the world will continue to be collector's items.

Geneva report on the World Economy - The Fundamental Principles of Financial Regulation - Thanks to a subscriber for this thoughtful [report](#) by Markus Brunnermeier, Andrew Crockett, Charles Goodhart, Avinash D. Persaud and Hyun Shin. It contains a large number of very sensible points and I strongly recommend it to subscribers. It is posted without further comment but here is a section from the forward:

Financial crashes do not occur randomly, but generally follow booms. Through a number of avenues, some regulatory, some not, though often in the name of risk-sensitivity, sophistication and modernity, the role of current market prices on behaviour has intensified. These avenues include mark-to-market valuation of assets; regulatory approved market-based measures of risk, such as credit default swap spreads in internal credit models or price volatility in market risk models; and the increasing use of credit ratings, which tend to be correlated, directionally at least, with market prices.

In the up-phase of the economic cycle, price-based measures of asset values rise, price-based measures of risk fall and competition to grow bank profits increases. Market discipline encourages financial institutions to respond to these three related developments by some combination of (i) expanding their balance sheets to take advantage of the fixed costs of banking franchises and regulation (ii) trying to lower the cost of funding by using short-term funding from the money markets and (iii) increasing leverage. Those that do not do so are seen as underutilizing their equity and are punished by the stock markets. When the boom ends, and asset prices fall and short-term funding to institutions with impaired and uncertain assets or high leverage dries up, leading to forced sales of assets which drives up their measured risk, the boom turns to bust.

In Chapter 3, we distinguish between micro and macro-prudential regulation. Micro prudential regulation concerns itself with factors that affect the stability of individual institutions. Macro-prudential regulation concerns itself with factors that affect the stability of the financial system as a whole. As we will attempt to show, the nature of the regulation applied to an individual financial

institution depends crucially on how . systemic. its activities are. This in turn is related, inter alia, to its size, degree of leverage and interconnectedness with the rest of the system.

Obama Foreclosure-Relief Plan May Guarantee Rewritten Loans - [This article by Alison Vekshin for Bloomberg covers the proposed initiative to stem the rising number of foreclosures. Here is a section:](#)

The Obama administration is considering government guarantees for home loans modified by their servicers, seeking to stem the record surge of foreclosures that's hammering U.S. property values.

The proposal, which may also have the taxpayer share in the cost of reducing mortgage payments, is aimed at shielding lenders from default after they loosen loan terms for struggling borrowers. Comptroller of the Currency John Dugan, who regulates national banks, said yesterday that "working out the details of it is still something that's ongoing."

"We need to help more people stay in their homes" through helping mortgage lenders make more loan modifications, James Lockhart, director of the Federal Housing Finance Agency, said in an interview with Bloomberg Television yesterday. "I'm pleased that the new administration is starting to work on that area."

President Barack Obama's team is preparing the biggest effort yet to arrest foreclosures, part of a three-pronged attack on the financial crisis that also aims at restarting business and consumer lending and overhauling regulation. As banks dump on the market the properties acquired through borrower defaults, they are contributing to the biggest slide in property values since the Great Depression.

Bailout Plan

Top officials continued their series of meetings yesterday as they examine options for the next phase of the government's financial-industry bailout. The biggest challenge is finding a way to value banks' toxic assets so that the government can buy or insure them while providing some limit to taxpayer losses, Dugan said. An announcement on the strategy may come early next week, an administration aide said.

Treasury Secretary Timothy Geithner gathered with Dugan, Federal Reserve Chairman Ben S. Bernanke and Federal Deposit Insurance Corp. Chairman Sheila Bair. Geithner and White House economics director Lawrence Summers also met with House Financial Services Committee Chairman Barney Frank.

The proposal to guarantee modified mortgages is a variation of an idea backed by the FDIC. The administration plans to spend as much as \$100 billion of the second \$350 billion instalment of the Treasury's financial-bailout fund on home-loan initiatives.

Some 1.5 million foreclosures might be prevented this year in a program that would pay servicers \$1,000 to modify a troubled loan by reducing the interest rate, forgiving a portion of the principal or extending the repayment plan, Bair has estimated. The government would then absorb as much as 50 percent of any loss if the rewritten loan defaults again.

My view - [House Prices](#) are unlikely to bottom before the pace of [Foreclosures](#) declines. This makes attempting to ease the pressure on vulnerable homeowners a priority for the new administration. Any measure is likely to put further pressure on government finances but is also likely to be money well spent in mitigating the worst effects of the housing crash.

Today's interesting charts - The Chart Library has two Search Engines. One searches the more than 17,000 equities, funds and ETFs in the International Equity Library. The other searches through the rest of the Chart Library for indices, commodities, currencies bond prices and yields, ratios, spreads and overlays. You can also customise these charts and save any of them in your Favourites section. Check the Library's Help section for further details.

Lumber - [bouncing](#) from historically [low](#) levels and would need to sustain a move below \$150 to question scope for some further upside.

White Sugar - [remains](#) in a consistent short-term uptrend and would need to sustain a move below \$360 to question the integrity of the move.

US 30 Treasuries - [remain](#) in a short-term downtrend and would need to sustain a move above 132 to question potential for some additional downside.

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

"Could you please add the [Baring Global Bond Trust](#) to the library? I understand it is one of the more conservatively run global bond funds."

And

"Please add the [Franklin India Fund Class A \(acc.\)](#) to the Chart Library - ISIN Number - LU0231203729"

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

Wednesday 4th February 2009

Bill Gross' Investment Outlook: Beep Beep! - This is an interesting [letter](#) from someone who is not without influence in Washington. Here is the opening:

The current financial and economic crisis is difficult to appreciate, not only for the drop in elevation, but because of the swiftness of the declines. It's been a Wile E. Coyote 12 months - straight down like a dead weight. A year ago,

global equity prices were nearly twice today's levels and recession was only a whisper on the lips of the gloomiest of economists. Today, descriptions drawing parallels to the Great Depression make it obvious that a major shift in economic growth and its historic financial model, as well as policy prescriptions for its revival, are underway. Most of the world's connected economies and its citizens are in shock, conscious but not fully aware of the seismic shifts that will unfold in future years.

PIMCO's thesis for several years has held that the levered global economy long ago morphed from a banking-dominated regime to one that hid behind securitized lending and structures resembling a "shadow banking" system. SIVs, hedge funds, CDOs and increasingly levered mortgage and investment banks fueled asset appreciation in all investment markets, which in turn propelled real economic growth and employment to unsustainable levels. But, with the U.S. housing prices as its trigger, the deleveraging process did a Wile E. Coyote and headed over the cliff in mid-year 2007, dragging down almost all asset prices except government bonds. The real economy followed shortly thereafter, not just in the U.S., but globally, proving that linkages work on the "down" as well as the upside. *To PIMCO, the remedy for this deflationary deleveraging and mini-depression is simple and almost axiomatic: stop the decline in asset prices.* If that can be done, the real economy will level out as well. When home prices stop going down, newly created households will be more willing to take a chance on ownership as opposed to renting. If stock prices consolidate, recently burned investors will be more willing to invest, as opposed to stuffing their 401(k) mattresses with Treasury bills. Business investment, jobs, and profits should follow quickly behind.

My view - I think that Bill Gross is right, in that confidence is the most important missing ingredient today. Can the Obama administration restore confidence sufficiently in 2009 to stem the recession / mini-depression? Probably. Are the bailouts required to achieve this the best course of action in terms of the USA's long-term outlook? Possibly not, judging from history, but bailouts are what we are going to see.

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

"Poignant Quote, from Davos:

"Montek Ahluwalia, the deputy chairman of the Planning Commission in India, told a panel on the world economy:

"Confidence grows at the rate a coconut tree grows. It falls at the rate a coconut falls."

My comment - [Thanks for sharing this wise quote. We frequently see evidence of this in market trends, from one cycle to another.](#)

Digging into Construction Cost Deflation - [My thanks to a subscriber for this superb report from Wellington West. Here is a sample:](#)

The perfect storm that precipitated higher capital costs has passed, leaving in its wake a favorable development window. From 2002 to 2008, the combined effect of rising steel prices, tight markets for equipment, consultants, and labour, coupled with hurried development timelines delivered the ingredients for a perfect capital cost storm, where year-over-year increases in mine development costs approximated 10%-15%. Today's environment is materially different. In a few short months we have gone from a seller's market to a buyer's (i.e. developers) market. With few exceptions, prices for key mine inputs are down substantially from the peak levels of mid-2008 and are tracking levels last seen in late 2006/early 2007.

Major mechanical equipment prices are down 20% to 25% and lead times on large capital items have collapsed from three years to two years. Our channel checks with industry consultants and equipment vendors have provided strong evidence to suggest that since peaking in mid-2008, prices for major mechanical equipment are down some 20% to 25% and could move lower still. For large capital items, such as SAG mills and gyratory crushers, steel generally makes up about 40% of the manufacturing costs. With specialty steel down nearly 50% from the peak, it becomes quite easy to see the potential for a 20% reduction in manufacturing costs - a benefit that can and is being passed along to new buyers. In fact, we believe there is potential for the savings to be greater as vendors offer more competitive pricing to counter an unprecedented number of mine closures and project cancellations. Pricing is largely unchanged for orders that are already in the queue since quotations were based on higher costs for steel. In these instances, we are hearing of concessions being made to the payment schedule in favour of the buyer, specifically allowing for more back-end loaded payments. The recent weakening in used equipment prices and shorter lead times for new equipment provide further evidence that it is a buyer's market.

Price breaks are also in the hopper for secondary equipment, infrastructure build-out materials and labour. Prices for pumps, pipes, steel vessels, structural steel, as well as cement and labour are tracking lower and typically account for some 30%-50% of mine development costs. While the secondary equipment market is more competitive (i.e. more suppliers) and the markups were not as exaggerated in recent years, we foresee the potential for 20% savings here as well, as lower steel costs provide scope for lower prices and as vendors look to maintain market share. An informal telephone survey of Caterpillar, Hitachi, John Deere, Komatsu, Euclid, Tamrock, JCB, Getman, Case, Volvo, Liebherr, BBA, Terex O&K and Demag shows that back orders have been decreasing and a large number of cancellations have occurred.

The devaluation of currencies relative to the US dollar should provide scope for construction labour savings for mines built outside the United States. Construction labour is one of the few major line items in a feasibility study where the initial quotation is provided in local currency terms. Thus, it represents one of the few major construction cost centres that is materially impacted by currency fluctuations. Labour generally accounts for ~40% of mine construction costs. With currencies in major gold producing jurisdictions down on average 15% since Q3/08, we believe there is potential for an

additional 4% to 6% savings in project capex, depending on the country and depending on what exchange rate was employed in the feasibility study.

My view - On contemplating deflation most of us envisage falling asset prices, bankruptcies and rising unemployment. These are part of the story but deflation also leads to higher savings, debt reduction and lower input costs. In other words, it is not all bad.

In reality, what we have mainly experienced is rapid disinflation, which has the same effects mentioned immediately above. This has produced recession and perhaps even a mini-depression. Many people fear a full on deflationary depression, which could develop from a disinflationary credit / balance sheet recession. However recessions occur much more frequently than depressions. There is no certainty that we will experience widespread depression. However it is an outside possibility, which governments are trying to head off.

Meanwhile Wellington West focuses on one industry that is an obvious beneficiary of disinflation and deflationary fears - gold mining companies. Currently, these appear to have the best of both worlds - a rising price for their product, particularly in non USD and USD-linked currencies, and falling input costs. Wellington West spells out the latter in some detail and I commend their report to you.

Technical evidence to support their contention is provided by the AMEX Gold Bugs Index (HUI) ([weekly](#) & [daily](#)) which has doubled since its yearend low. There is some psychological and lateral resistance near 300 but if broader stock market indices hold within their current ranges, then I would expect (HUI) to eventually follow bullion higher. My main participation in this sector is via the [BlackRock Gold & General Fund](#) and Australia's [Lihir Gold](#). Subscribers can see charts for a broad range of gold funds and individual gold mines in the Chart Library.

Industrial mining shares are also benefiting from lower input costs although these have been more than offset by falling metal prices and weaker demand. Nevertheless the industrial metal prices are now below their marginal cost of production so it is not surprising that they show some tentative evidence of base building. I expect them to be among the leaders of the next economic recovery cycle, just as they did earlier in this decade. The drivers will be reduced supply and increased demand due to global infrastructure development projects, from China to the USA.

Additional Commentary by Eoin Treacy

Which country indices have performed best over the last month? - Every day I click through a long list of indices, bonds, currencies and commodities in an attempt to develop a view of what is happening in global markets. Over the last few weeks, the relative strength of China and some Latin American indices has made me pay closer attention to these markets. Today, I put 97

country indices as well as some others I deem important to the global outlook into a section in my Favourites and filtered the list using the Performance Filter. Here are the results in [local currencies](#) and [US Dollars](#).

[Gold shares](#) outperformed every country index over the last 3-months but have lost that position of relative performance in the last month. The [Shanghai Composite](#) has moved to top position as it pushes back up to test the upper side of the 4-month range and is one of only a handful of countries exhibiting this trait. Chinese shares peaked before a number of Western markets and now appear to be in a more pronounced period of base formation development. A sustained move to new lows would be needed to negate this hypothesis.

[South Korea](#) is also testing the upper side of its 3-month range and would need to sustain a move below 1100 to question potential for an upside break. The [Japanese Yen](#) has rallied considerably against the South Korean Won over the last 6-months; offering a competitive advantage to Korean exporters. However, while the Yen is testing its highs, this trend has lost momentum. A failure near KRW16 would be a warning that demand is becoming exhausted while a sustained move below KRW14 would complete the top formation. If the Yen is topping out against the Won, it would offer a headwind for Korean stock market performance, making this rate worth watching for subscribers interested in the market.

In Latin America, [Chile](#) bounced well from its accelerated nadir in October to more than 12,000. It found support above the lows and is now testing the November highs. A sustained move below 11,750 would be needed to question scope for some further higher to lateral ranging. [Colombia](#) also bounced well once it found support at the end of October. It consolidated the move and pushed upwards again in December. The Index has been ranging in a 'step' above 7400 for most of January and would need to sustain a move below that level to question the integrity of the short-term trend. [Brazil](#) hit a low near 30,000 in late October and has sustained a progression of higher lows since. It is now testing the upper side of the 3-month range and would need to sustain a move below 37,000 to question the integrity of the short-term trend.

[Israel](#) is also of interest. The market remains on a comparatively high multiple but found support above 500 in November and rallied to 600 where it continues to consolidate. A sustained move to new lows would be needed to question scope for some further higher to lateral ranging.

These markets are leading at present; it remains to be seen if they can maintain this position in a recovery scenario. If they can sustain their absolute and relative gains, we can look to these markets for leadership when the wider stock market universe begins to improve.

Investment Postcards from Cape Town: Credit Crisis Watch: Some Positive Developments - Thanks to Prieur du Plessis for this [update](#) of his useful list of ratios and spreads (many of which originate in the Fullermoney Chart Library) which helps to monitor the progress of the credit / solvency crisis. Here is a

section:

The Fed's Senior Loan Officer Opinion Survey of January 2009 contained indications of better tidings. Asha Bangalore (Northern Trust) said: "There were fewer bank officers reporting they had tightened loan underwriting standards for commercial and industrial loans for both small and large firms in January compared with December (see two charts below). In the case of both large and small firms, the demand for loans was weaker in January compared with December. Although the history of these data is short, in 2001, the demand for loans turned around only after the recession had reached its last leg, whereas the peak for the number of banks reporting tightening standards peaked slightly ahead."

As far as commercial paper is concerned, the A2/P2 spread measures the difference between A2/P2 (low-quality) and AA (high-quality) 30-day non-financial commercial paper. The spread has declined markedly to 1.79% from almost 5% at the end of December.

Similarly, junk bond yields have also declined, as shown by the Merrill Lynch US High Yield Index. The Index dropped by 25.3% to 1,630 from its record high of 2,182 on December 15. This means the spread between high-yield debt and comparable US Treasuries was 1,630 basis points by the close of business on Tuesday. With the US 10-year Treasury Note yield at 2.89%, high-yield borrowers have to pay 19.19% per year to borrow money for a ten-year period. At these rates it is practically impossible for companies with a less-than-perfect credit status to conduct business profitably.

My view - As credit conditions improved somewhat, over the last few months, the focus of investor anxiety has shifted from the fear that the banking sector would collapse, to the fear that recovery is years away, economic activity is in outright decline and corporate earnings are going to be abysmal in 2009. The question for us as investors is to gauge the extent to which this is already in the price.

The [Dow Jones Industrials](#) continues to range above the October lows and sentiment remains extremely bearish which is out of character with the actual trading activity. The extent of the financial crisis continues to push further into the real economy and recovery could be slow to take hold. However, the stock market is a lead indicator and should bottom well before the economic data gets better. Being objective, we cannot rule out the possibility of a further break to the downside, but because markets are ranging, a retest of the upper side of the range is also a possibility. The longer the Index continues in this congestion phase, the better the chance that the diabolical expectations of some pundits are an overreaction.

Russia, East Europe Stocks Face 'Massive' Drop, Roubini Say - [This article by William Mauldin for Bloomberg](#) includes some interesting quotes from Nouriel Roubini. Here it is in full:

Russian and eastern European equities may fall further because earnings and other fundamental measures mean little in the current economic turmoil, said Nouriel Roubini, the New York University professor who forecast a U.S. recession two years ago.

"In market dynamics, prices can move far below what fundamentals justify," Roubini said in an interview in Moscow.

"There is still a massive downside for equities in the region."

Russia's RTS Index plunged 72 percent last year, its first decline since 2000, as commodity prices fell and capital fled the country amid the country's worst financial crisis in a decade.

The NTX Index of central and eastern European stocks dropped 57 percent in 2008.

"They may stagnate there for a while, and there's not going to be any recovery," Roubini said. "For the time being, it's going to get ugly."

The RTS is trading at 0.5 times book value, or the net asset value of its 50 companies, lower than the 1.4 times book value for the MSCI Emerging Markets Index, a global benchmark index for developing economies, according to weekly data compiled by Bloomberg.

My view - The Russian market broke its progression of higher reaction lows in August and collapsed before finding support near 500. The technical action remains weak but predicting further massive losses following an already incredibly large decline would seem to be overstating the potential downside.

The [RTS Index](#) has been ranging for much of the last four months. While further lower to lateral ranging appear likely at this stage, a further downward acceleration would appear unlikely and would probably be a medium-term buying opportunity if it were to occur. A sustained move above 715 is needed to break the progression of lower highs and suggest that demand is regaining the upper hand.

The [New Europe Index](#) (East European Blue Chips) peaked earlier than the Russian market but has mirrored the decline from September and the subsequent ranging phase. A sustained move above 915 is needed to indicate the bulls are returning to this market in force.

Email of the day (1) - [on putting charts in a Word document](#):

"My children are interested in understanding what I do and why in the markets. However, as they are spread all over the place - from New York, to the deserts of Iraq, and down to Melbourne - I cannot sit quietly with them at the computer and explain certain features using the chart library.

"I am toying with the idea of writing to them each fortnight incorporating a couple of the charts from my favourites section. I understand that Fullermoney

does not object to the use of charts for that purpose provided the source is acknowledged. Unfortunately I cannot work out how to copy a chart into, say, a Word document. Can you tell me how to accomplish that?"

My comment - Thank you for an interesting email. It was a pleasure to meet you at the Chart Seminar a couple of years ago and we hope you and your family are safe and prospering in your different parts of the world. I can confirm that we are happy for subscribers to use our charts in their own publications as long as the source is referenced. It is relatively easy to save charts and put them in a Word document.

Go to the Chart Library, choose whichever chart you're interested in. Right Click and choose the 'Save Picture As' option from the menu. Select the folder on your desktop you wish to save it into and give the file a name.

To insert it into Word, open a new document and click on the 'Insert' tab at the top of the screen, select Picture and from File in the menu. This will allow you to browse for your chart. Select your chart and hit Insert. The chart should now appear as a picture in your document.

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

"Could you please add the Dow Jones short ETF [DOG](#) to the chart library please?"

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

Thursday 5th February 2009

Volker Chafes at Obama Panel Delay, Strains With Summers Rise - [This is an informative article](#) from Bloomberg today. Here is the opening:

Paul Volcker has grown increasingly frustrated over delays in setting up the economic advisory group President Barack Obama picked the former Federal Reserve chairman to lead, people familiar with the matter said.

Volcker, 81, blames Obama's National Economic Council Director Lawrence Summers for slowing down the effort to organize the panel of outside advisers, the people said. Summers isn't regularly inviting Volcker to White House meetings and hasn't shown interest in collaborating on policy or sharing potential solutions to the economic crisis, they said.

While Summers, a former Treasury secretary, oversees the official White House economic policy apparatus, Obama tapped Volcker for a new Economic Recovery Advisory Board charged with injecting fresh, outside ideas into policy debates.

"When you have two strong, highly accomplished, driven people, it's not unusual that there is going to be a battle over turf," said James Cox, a professor at Duke University Law School in Durham, North Carolina. "I would

hope that Obama doesn't lose Volcker's counsel. They need someone to help them think outside the box."

The contretemps shows the difficulties Volcker, perhaps the world's most respected economist, may encounter as an outside adviser charged with providing policy alternatives to the president, said William Silber, a finance professor at New York University's business school.

Outsider's Disadvantage

Volcker "is not in the White House and he doesn't have a bureaucracy to command," Silber said. "It puts him at a disadvantage."

After testifying at a congressional hearing yesterday, Volcker declined to respond to questions. His office said he doesn't grant interviews.

Summers, in an interview, played down any conflict.

"Paul's got a kind of experience that no one else has, and the president enormously values his advice," said Summers, 54. "I think this board is going to be very useful, because it's very easy sitting here to kind of lose sight of what's happening on the front lines of the economy."

Obama named Volcker on Nov. 26 to head the new panel, saying he wanted an outside voice to keep administration policy planning from becoming "too insular."

My view - All but the USA's most ardent enemies want President Obama to succeed in this dangerous economic climate. To do so, he will need phenomenal leadership skills and plenty of common sense.

Turf battles will be an unwelcome distraction. Hopefully, this one, if it exists, will be minor and quickly resolved. To lose the towering (in every respect) Paul Volcker would be a major blow to confidence in the Obama administration. The President needs him for the reasons he has stated, and also to counter the ex Goldman Sachs influence among economic advisors. I believe every one of them is either ex Goldman or an appointee of someone from that firm, dating back to Robert Rubin's position as Treasury Secretary during the Clinton Administration.

Back to the future - My thanks to a subscriber for this interesting [report](#) from BoA-ML. Here is a brief sample:

The four phases of a crisis

In our opinion, we are probably through Phase I (sharp fall, panic) and Phase II (short but sharp rally, hopeful on stimulus packages) and at the beginning of Phase III (range trading, a tussle between hope of a recovery and ugly earnings reality). The question is how painful Phase III can be and when Phase IV (sustained recovery) will come around (Chart 5).

So far, on both occasions, Phase I lasted for about a year and Phase II, about two months. Phase III during the Asian Financial Crisis carried on for almost four years (Nov 1998 to end of 2002) albeit on a gentle upward slope, i.e. each low was higher than the previous low. At this stage, we expect Phase III of this crisis to be longer and perhaps more likely on a downward slope for at least a few months/quarters, i.e. each low may be lower than the previous one.

Fundamentally, share market performance is driven by earnings outlook. Our experience is that the equity market tends to lead a turnaround in earnings by about 8-12 months (10 months on average on the previous 8 occasions). From a top down perspective, we expect earnings of Chinese companies to potentially suffer a great deal more this round because:

1) Nominal GDP growth, which impacts companies' top lines, is suffering from a much sharper contraction: Our economists Ting Lu and TJ Bond expect nominal GDP growth to decelerate from 16.9% in 2008 to around 10% in 2009, i.e. a drop of some 7% vs. - 4.1% and -0.6% in 1998 and 1999 respectively.

2) Cost structure is more rigid this time: the new labor laws introduced at the beginning of 2008 have made firing a lot more cumbersome (for details, please refer to our report "China's new labor laws, the death knell of corp. margins?" published on 1 April 2008). After the latest crisis broke out, the government has been encouraging companies to keep people on their payrolls. As you remember, under the leadership of Premier Zhu, China underwent painful SOE reforms between 1999 and 2001 when millions of SOE workers were let go. In addition, energy prices and environmental related charges may keep surprising people on the upside. Take oil prices for example; despite global crude prices having come off from US\$150/barrel to less than US\$40/barrel, domestic fuel prices only declined moderately because of an implementation of long overdue tax reforms.

3) Largely related to the first issue, a key thing for us this time is that the external environment is much worse. The Asian Financial Crisis was an emerging market over-stretched balance sheet problem which was easier to solve in the overall scheme of things. The subprime crisis was caused by a similar balance sheet issue but in the developed world, whose consumption is still the ultimate driver of global growth at this stage. It's true that China's contribution to global growth has picked up sharply in recent quarters but it's more due to a slowdown in other major global economies.

My view - This report is a scholarly attempt to fathom the Hong Kong China Enterprises' (H-Shares) (HSCEI) ([monthly](#), [weekly](#) & [daily](#)) next significant move. While lacking the authors' insights for the region and its shares, I find the forecast of 4200 extreme, given the decline already seen.

Unlike some Western countries with massive deficits, solvency crises and begging-bowl currencies, Hong Kong / China has not yet proved to be a basket-case economy.

Are we paying too much homage to the global depression talk? I do not know, but suspect so and certainly hope so. Meanwhile, the HSCEI chart action shows some early evidence of base formation development. Doubters might say that it looks very similar to the distribution which occurred in the first half of last year. Yes, but it is at a much lower level this time and we also have the stimulus packages which were not a feature earlier, and commodity prices are much lower.

I will close with some technical facts. The HSCEI cannot fall to 4200 without first breaking the January low near 6600. That would open the door to the possibility of further weakness but the Index would also have to break its November and October lows. Meanwhile, the longer it ranges within the current trading band, the more this activity will resemble a developing base formation, prior to the next significant recovery.

Christopher Wood of CLSA and *GREED* & fear fame, along with his colleagues, know more about China than anyone else I know. Here is what he says:

There is growing, albeit still initial, evidence that the Chinese steroid stimulus is gaining some traction. The most important measure taken by Beijing in recent months was the abolition of credit quotas announced in November. China is still in significant degree a command economy, most particularly its banking system.

The domestic A-share market has been outperforming the Hong Kong-quoted China shares so far this year. This suggests that local investors are gaining some confidence in the government's stimulus efforts. Still, the Chinese steroid stimulus can only work for so long if the global economy does not recover and if the export sector remains devastated. For the stimulus only works directly on the command economy side of the economy which is primarily the infrastructure sector and the banking system.

There is a risk that China will face a W-shaped outcome in terms of its economic fortunes when the stimulus from the command economy measures runs out. At that point there will be reason to worry about rising social strife and the growing risk of the authorities panicking and pushing through renminbi devaluation. But for *GREED* & fear that is not the way to bet right now.

Chinese and Indian economic growth rates are still expected to remain in respectable positive territory in stark contrast to most of the rest of Asia. These remain the two stock markets investors should focus on if they want to invest new money into the Asian equity universe.

India and China remain my favourite stock markets for the very long term.

My personal portfolio: EUR/USD long trade increased - I increased my [EUR/USD](#) position by 40% today, paying \$1.2774 for another March stake. Since currencies mostly range, I will be using my Baby Steps buy-low-sell-

high trading system, in an effort to harvest some of the ranging.

Additional Commentary by Eoin Treacy

Maple Leaf Memo: How Harper Rates - Thanks to Roger S. Conrad and David Dittman for their informative [newsletter](#) which, this week focuses on the effects the Canadian economic stimulus package will have on Income Trusts. Here is a section:

Last week, Prime Minister Stephen Harper introduced new spending and tax breaks worth CAD40 billion (USD33 billion) over the next two years. Much of the money will go to maintaining roads, railways and ports and in encouraging home improvements.

The government is also adding CAD50 billion to its CAD75 billion fund to buy mortgage-backed securities from banks, to encourage them to lend.

For the first time since 1996 the federal budget will move into deficit, with a shortfall of CAD34 billion in the fiscal year starting in April. Deficits will total some CAD85 billion before the federal finances return to the black in four years.

At the end of the day, the goal of any stimulus plan is to excite economic activity--to boost aggregate demand. Although the direct impact of Canada's budget on any particular sector is limited from an investor's perspective, there are important implications for the trusts included in the Canadian Edge How They Rate coverage universe. Here's a section-by-section take on the budget's impact and the current outlook; bear in mind, some segments and companies will feel the stimulus more than others.

Oil and Gas. After the washout of the past several months, energy trusts aren't just pricing in oil at USD40 or even USD30 but sell at basically the same prices they did when oil sold for less than USD20. Recent dividend cuts have had progressively less impact on prices. In fact, some trusts have actually rallied afterward.

Second, producer trusts have proven their ability to survive on their own resources. Debt levels are low and with a few exceptions there's no danger of bankruptcy, even if energy prices continue to sag.

Finally, the violence of energy prices' fall has guaranteed another upward spike, once the global economy stabilizes. And when that happens, energy trust share prices will return to last summer's heights, and quite possibly well beyond them.

Global economic weakness means we're going to have to be patient and possibly suffer some near-term downside. But this is no time to abandon trusts that have proven their ability to weather rough times and profit when conditions improve.

Electric Power. The Conservative budget was light on spending that would have directly impacted so-called green energy initiatives. But the nature of the business means cash flows and distributions are essentially bullet-proof.

My view - Canadian Income Trusts as a group have not been immune from the travails of the last year, far from it. However, as prices have fallen yields have soared for a large number of these instruments. Distributions have been cut and some will be cut further, but much of this would appear to already be priced in.

The [S&P/TSX Capped Income Trust Index](#) broke downwards from a prolonged ranging phase in early October and remains in a medium-term downtrend that is losing momentum. The Index found support in the region of 90 in November and continues to range in that general area. Demand has been returning at incrementally higher levels since early December and a sustained move below 85 would be needed to negate the hypothesis that base formation is underway. All of the trusts mentioned in the piece above can be found in the Chart Library.

[Great Lakes Hydro Electric](#) is currently testing the lower side of the 5-year range and a close beneath C\$15 would indicate somewhat lower scope, unless quickly reversed

[Energy Savings Income Trust](#) topped out in 2005 and broke downwards in 2006. IT accelerated lower again in November but found support near C\$6.50 and would need to sustain a move below that level to question current scope for further higher to lateral ranging. A sustained move above C\$15 is needed to break the 4-year progression of lower highs.

[Bird Construction](#) appears to have entered a base building phase from early December and would need to sustain a move to new lows to question scope for further higher to lateral ranging.

[IBI Income Fund](#) accelerated lower from September and found support near C\$10 in December. It has since rallied impressively and broke to a new 4-month high this week. A sustained move below C\$14 would be needed to question recovery potential.

[Canadian Apartment Properties](#) has rallied from under C\$12 three times since October and would need to sustain a move below that level to question scope for further higher to lateral ranging.

[Pembina Pipeline Income Fund](#) collapsed to C\$12 in October, but rallied well immediately afterward and continues to find support at incrementally higher levels. A sustained move below C\$13 would now be needed to question scope for further higher to lateral ranging.

[Bell Aliant Regional Communications Income Trust](#) remains in a medium-term downtrend but found support near C\$20 and is now testing the progression of lower highs. A sustained move below C\$23 is needed to question scope for some additional higher to lateral ranging.

[Cineplex Galaxy Income Fund](#) remains in a medium-term downtrend but found support near C\$11 in October and continues to range above C12. A sustained move below C\$13 is now needed to question scope for some further higher to lateral ranging.

[CML Healthcare Income Fund](#) also remains in a medium-term downtrend. While it rallied well from the October lows, it has failed to sustain the gain and is currently ranging below C\$13. A sustained move above C\$13.50 is needed to suggest that meaningful demand is returning.

[Contrans Income Fund](#) peaked in early 2005 and remains in an overall downtrend. It is currently pulling back to test the lows and a sustained move above C\$6.30 is needed to question scope for further lower to lateral ranging.

[Transforce Inc.](#) remains in a consistent downtrend and has retraced almost the entire advance from the 2001 lows. A sustained move above C\$5 would break the progression of lower highs and indicate that demand is regaining the upper hand.

[New Flyer Industries](#) rallied exceptionally well from the November lows near C\$5.70 but yesterday's downward dynamic capped the advance. Some further downside would appear likely and a sustained move above Tuesday's high near C\$10.50 is needed to reaffirm the bullish stance.

Subscribers may also be interested in the Globe and Mail's [Income Trust Centre](#).

Agora Financial The Rude Awakening: Investing for Comrades, 101 - Thanks to the team at Agora Financial for this interesting [article](#) by Dan Amoss covering the potential of natural gas related investments. Here is a section:

The federal government's attempts to reshape the U.S. economy will provide numerous profit opportunities. Take, for instance, the inevitable move toward taxing carbon emissions. Attaching a price to carbon dioxide would, obviously, increase utility bills (and the price of anything made with electricity). As a result, consumers of energy would try to avoid this taxation by utilizing cleaner sources of energy.

Right now, many natural gas-fired power plants are brought online only at times of peak demand, while coal is considered a "base load" fuel since it's cheaper. But a carbon tax would raise the price of coal (and the extra carbon it emits) closer to the price of natural gas. So it seems likely that carbon taxes or any other "climate change" legislation that comes from the Obama Administration will favor natural gas-fired electricity at the expense of coal.

Assuming the political popularity of natural gas will keep growing, and that solar and wind power production cannot increase fast enough to be meaningful (even with heavy subsidies), it makes sense that natural gas-focused exploration and production (E&P) companies and their critical suppliers like National-Oilwell Varco (NYSE: NOV) will enjoy years of

attractive growth opportunities. NOV has an attractive business selling brand-new, highly efficient rigs built for shale gas drilling.

At the moment, a glut of natural gas has produced a drop in number of drilling rigs operating in the U.S. This drop was already discounted by the crash in the oil service stocks last fall. But the faster the rig count falls, the faster the gas glut will dissipate as 2009 wears on. If demand for natural gas rebounds later in 2009, while supply is falling, then prices could move much higher in a short period of time. I'm going to keep monitoring the supply situation closely because I think it will yield several good trading opportunities this year. And the best way to get a handle on supply is to follow where and how the smartest companies are investing.

I recently tuned in to several Webcast presentations made at the BMO Capital Markets North American Unconventional Gas Conference. The larger presenters included Talisman Energy, Comstock Resources, Southwestern Energy, Ultra Petroleum, and Range Resources -- several of the visionary early movers into shale gas drilling.

These companies employ cutting-edge technology in the natural gas industry. As a group, they delivered much of the production growth the U.S. has enjoyed in recent years. We can't do without this shale growth. Keep in mind that virtually all new electric power plants brought online in recent years have been gas-fired plants.

Most of the premier shale gas plays (Barnett, Marcellus, Fayetteville, Haynesville, etc.) can be booked into reserves and brought online at cash costs between \$2-4 per million cubic feet of gas. With natural gas prices currently at \$5.50, the economics of adding to shale gas reserves and production makes sense. Even if they don't immediately hook up newly drilled wells to gathering pipelines, most of these exploration-and-production companies will still want to drill at a fairly rapid clip to book new proved reserves in 2009.

My view - [\\$4](#) was a boundary for natural gas from at least 1990 to 2000, when it broke upwards. Since then it has often been an area of support. Natural gas fell back below \$4 in 2001, but has sustained the move above that level since 2002. This area was tested in 2003, 2004, 2006 and now. On the last three occasions, impressive rebounds have occurred which saw the price almost double in a short-term period of time. Will the same occur on this occasion?

The short answer is that it could but we don't have the evidence that it is about to occur just yet. In [2003](#), natural gas ranged for 4-months above \$4. Consecutive upward dynamics from early December saw prices surge to \$7.50 in a very short period of time.

In [2004](#), \$4.50 was tested in September. An upward dynamic on the 17th broke the short-term downtrend, follow through the next day confirmed the short-term trend change and prices quickly rallied to \$9.

In [2006](#), as prices fell from the peak near \$16 and as the Amaranth hedge fund imploded, prices briefly tested \$4. An upside weekly [key reversal](#) stemmed the decline and broke the short-term downtrend. Follow through the next week confirmed the change of trend and prices quickly rallied to \$9.

[Right now](#), natural gas remains in a medium-term downtrend from the high near \$14, but at least short-term support has been found above \$4. However, an upward dynamic is needed to suggest that demand is returning in a meaningful way. A sustained move above \$4.70 this week would create a weekly key reversal, follow through next week but add weight to such a signal.

If a carbon tax is introduced, as seems likely, natural gas as a relatively clean energy source stands to be a beneficiary. This could be a fundamental driver to help drive prices higher. [National Oilwell Varco](#) peaked near \$90 in July and found support near \$20 in October. It has been ranging near this level since then and would need to sustain a move below \$18 to question scope for further base formation development.

[Ultra Petroleum Corp](#) found support near \$30 in December and would need to sustain a move below that level to question scope for further higher to lateral ranging. .

[Range Resources](#) found support in October near \$24 and has since ranged above \$30. A sustained move below that level would now be needed to question scope for further higher to lateral ranging.

On the UK equivalent of the TED spread - Bloomberg stopped issuing yields for the UK 3-month Treasury Bill in October, making it impossible to calculate the UK equivalent of the commonly watched TED spread. A new index is now available to track this rate but the history only goes back to December 22nd. This means we can't plot a chart of the UK Ted spread because between October 17th and December 22nd because the data is simply not available.

Before October 17th, the UK [spread](#) had not ballooned in the same way as its [US](#) and [EU](#) equivalents. At today's 126 basis points, the [spread](#) is marginally higher than its equivalents but not markedly so and has fallen in conjunction with the other spreads over the last month.

Email of the day (1) - on copying charts into Word:

"I hope everything is well with you and your family.

"I was interested in the email regarding copying charts into word. I use a more direct approach as follows:

"Go to the Chart Library, choose whichever chart you're interested in. Right Click and choose the "Copy" option from the menu. To insert it into Word, open a new document (go to File Page Setup Landscape Ok which gives

more room for the chart) and click on the 'Paste' tab at the top of the screen. The charts fit nicely on the page.

"I use that all the time to build up my own library of great examples of trend endings etc.

"Also on another matter, would it be possible to have the following in the chart library if available please: NAHB Housing Sentiment Index; the Indian Iron Ore Spot Price for import into China; an update of the fertiliser prices beyond October 24; and an update of Rock Phosphate. Thank you and again thanks for a great service.

"P.S. as someone who spent some time here in Melbourne I live down on the Mornington Peninsula at Frankston."

My comment - Thank you for this useful contribution which I was not previously aware of. I would only add that the best results will be attained if you set the size of your charts in the Chart Library to medium. To do this, select any chart, click on the Options tab and select Medium from the dropdown menu. Hit Apply and Save. Then Close.

I have added and updated the charts you refer to. In the case of the fertilizer prices the supplier has changed which accounts for why they all stopped updating on October 24th. The new tickers do not have as much back history but will update from now on.

The ([NAHB](#)) National Housing Market Index is already in the Chart Library, you will find it by searching for NAHB. According to Bloomberg, a reading of more than 50 indicates a bullish attitude to the economic outlook. Here is the explanation of how the Index is calculated from Bloomberg:

The NAHB Market Index is a seasonally-adjusted index based on a monthly survey of home builders of single-family detached homes and is comprised of three survey components: Present Sales, six month sales expectations and traffic of prospective buyers. The index results range between 1 and 100, with 1 being the worst and 100 the best. a reading of over 50 suggests more survey participants are seeing "good" economic conditions than "poor" ones for home sales.

The price of [iron-ore](#) imported from India by China has given up its entire advance of the last few years. It has fallen considerably over the last few months, but found support near \$65 in November and would need to sustain a move below that level to question scope for further base formation development.

The vast majority of fertilizer prices have given up their entire bull market advances. The exceptions are [MOP](#) Potash and Moroccan [Phosphate Rock](#) (December 31st is the most recent data for this commodity). Potash prices have been static near their highs for a few months, which is suspicious looking and does not reflect how the market has treated companies such as Potash Corp. I have my doubts about how accurate the pricing for this index is. As for

the others in the fertilizers group, the majority found support near their long-term trends and have most likely entered base building phases.

[Potash Corp](#) broke back above the psychological C\$100 today and would need to sustain a move below C\$90 to question potential for some additional upside.

I have happy memories of the time I spent in Melbourne swimming in the beach at Frankston and heading down to the waves at Sorrento on the weekends. You live in a lovely part of the world.

Email of the day (2) - on the Chart Library High/Low filter:

"Could you check if the high/low filter is working as it is not for me as it is not showing any stocks on a wide range of markets. The Performance filter is fine."

My comment - Thank you for pointing this out. The error has now been fixed.

Friday 6th February 2009

Platinum, Palladium Climb on Investment Demand as Economy Slows - Gold normally corners at least 80 percent of precious metals copy, in my view, which does a disservice to the other precious metals. Here is the opening from Bloomberg's [item](#) posted today:

Platinum jumped to the highest close in almost a month in New York on investment demand for the precious metal as a store of value amid a global economic slowdown. Palladium also soared.

The jobless rate in the U.S. climbed to a 16-year high last month and payrolls shrank as the recession showed no signs of abating. Unemployment surged to 7.6 percent from 7.2 percent in December, the Labor Department said today in Washington. Some investors buy platinum and palladium, used mostly in jewelry and auto parts, to hedge against declines in other markets.

"The precious metals markets continue to rally on the negative news," Miguel Perez-Santalla, a sales vice president at Heraeus Precious Metals Management in New York, said in an e- mailed note. "With nowhere else to go, the money keeps flowing into metals."

My view - When central banks slashed interest rates and pumped up money supply to combat the 2001-2002 recession, precious metals led the recovery. There is no reason why they should not do well this time, given that far more people regard them as monetary metals today. In other words, precious metals are money that central banks cannot devalue by printing more.

Platinum ([monthly](#), [weekly](#) & [daily](#)) and palladium ([monthly](#), [weekly](#) & [daily](#)) have many industrial uses, particularly in automobile catalytic converters. In my view the markets have overemphasised this vulnerability during the

current recession. It has certainly been discounted by today's low prices. What we seldom hear about is supply vulnerability. Most platinum comes from South Africa, where strikes and power outages have caused prices to spike in recent years. Most palladium comes from Russia, which has withheld supplies of resources in the past, to increase its political influence and also to boost prices.

I am reluctant to trade palladium because the spread-bet quotes are particularly wide. However I own platinum futures and there are also ETFs available (see Library). I would not be surprised if these two metals at least doubled in price over the next few years. Both would have to fall back beneath last month's reaction lows to significantly delay near-term upside scope.

As for gold ([monthly](#), [weekly](#) & [daily](#)) and silver ([monthly](#), [weekly](#) & [daily](#)), the yellow metal appears to be consolidating gains near its September-October peak. A clear downward dynamic would be required to indicate more than temporary resistance here. Silver has embarked on a more orderly trending phase recently as it heads towards the next area of potential resistance at \$14. A close beneath \$12 would be required to check momentum beyond a brief pause. I have long positions in both gold and silver futures, and maintain that precious metals are best purchased on easing.

Email of the day (1) - On base formations:

"You and David have always taught/emphasised regarding lengthy base formations following steep corrections, of the kind we have witnessed recently in almost all the markets.

"With regard to the Fullermoney themes, I was just wondering if it would be possible for you to explain for the benefit of the subscribers, the stage we may be in with regard to base formation for some of the major markets/important stocks and if at all possible, a forecast of the approximate duration of the respective 'bases'.

"In particular, an explanation for the following charts would be useful: S&P/China/India/Brazil and BHP/Rio."

My comment - You remember well. For a quick review of some of those premises from The Chart Seminar, a crash from a high is usually followed by a lengthy convalescence in terms of ranging base formation development (Type-3, represented by ranging over time, creating a large pattern). The reasons: stale bull inventory caps rally attempts as few would have sold prior to the sudden crash, inevitable shock and bewilderment, and fear of a second leg decline.

In contrast, during a lengthy, grinding bear market everyone gets the message sooner or later. Consequently most selling of long positions will have already occurred as the final low is approached and selling pressure will be dominated by short positions. In this situation, the market may form the Type-1 spike ending if there is some downward acceleration near the end. Alternatively,

without acceleration it may lose momentum, followed by a sudden sharp rebound - the Type-2 characteristic. In terms of supply and demand, the market moves from a comparative vacuum of demand on the final decline to a vacuum of supply during the initial rebound. The sudden and sharp recovery from Type-1 and Type-2 bottoms is usually followed by a pullback and right-hand extension base development phase.

These are templates, to which most bear endings will conform, even though every one of them will be slightly different, having some unique characteristics of their own. In this respect, chart patterns are like people, because they are created by people participating in manic-depressive crowds.

Today's environment introduces an additional feature, at least for some markets, which we have seen much less frequently over the decades but is likely to influence the shape of bases. For Western countries in particular, what we are experiencing has been referred to as a balance sheet or credit related recession, including higher levels of insolvency than we experience in more typical stop-go recessions created by changes in monetary policy.

For this reason, Eoin and I have frequently mentioned the probability of a lengthy convalescence, in terms of base formation development, creating more of the larger, ranging Type-3 patterns.

Additionally, and because every trend seemingly has its own genetic identity, most stock markets experienced choppy ranging declines before the accelerated slump between May and October 2008. In other words, aspects of both the long, grinding decline and also the crash mentioned at the beginning of my response.

So how will this play out as we look ahead? The charts will show us, of course, but my guess is that we will see a number of Type-3 bases, some of which may be quite lengthy. That is what we saw following the dotcom crash at the beginning of the decade. Meanwhile, if Wall Street's main indices mostly hold within their ranges seen since mid-October, thus creating a neutral leash effect, some of the markets with better fundamentals should recover much more quickly. Fortunately, preliminary evidence suggests that Fullermoney themes will be well represented among the leaders.

OK, let's look at charts for the instruments mentioned in the email above. I maintain that the USA is still at the epicentre of global economic risk and the [S&P 500](#) has struggled to remain within its range recently. It is certainly a candidate for lengthy base development and Wall Street's leash effect would tighten on other stock markets if the S&P were to slide beneath 800 for more than a few days. I think a weaker US Dollar Index would help it to maintain its present range, provided the currency declined in an orderly fashion. While the S&P's pattern remains a concern today, the [Nasdaq 100](#) is clearly firmer and it often leads.

Among the bigger stock markets, [China](#) remains our candidate to lead the recovery. This week's action is impressive, with its breakout from a small Type-3 base. For the record, China managed its bubble deflation and is also

managing its recovery from a position of fiscal strength. In contrast, the USA and UK governments bragged about their bubbles, before the inevitable consequences swept over the two countries like a tsunami. From a position of fiscal weakness, the USA and UK are attempting to print their way out of trouble.

China is now exerting a positive leash effect, particularly on the Asian region. However, with its economy approximately a fifth the size of the USA's, the Wall Street leash effect is inevitably much stronger. Consequently, in the event of no worse than a neutral (ranging) performance by US stock market indices, China could maintain its break above 2000 and form a step sequence uptrend. This is a best case scenario but by no means impossible. Conversely, if the US stock market takes another plunge, which a majority of pundits appear to expect (contrary indicator?) then I would expect China to pull back and extend its base formation.

[India](#) peaked late in January 2008, so we should expect further base development and any renewed weakness on Wall Street could result in a test of the November low. [Brazil's](#) performance is outstanding but the same Wall Street leash conditions apply here, as mentioned above for China. This is also true for [BHP](#), which has a similar pattern to that of Brazil. [Rio](#), with its large debt following the Alcan takeover, clearly suffered as metal prices slumped. Debt problems may be partially resolved by the Chinalco discussions, albeit at a price. Personally, I would rather see Rio restrict participation to preference shares, while waiting for the recovery in metals which I believe is commencing (*see also Eoin's item on Rio below*).

Lastly, there is a scenario which few other people are taking about. As part of our often mentioned forecast for a ranging, reversion to the mean recovery rally first hypothesised in late October, there is a possibility that stock markets do surprisingly well in the next few weeks. Strong rallies would eventually leave markets susceptible to partial pullbacks, including some right-hand base formation extension.

How could strong rallies possibly occur when everyone is talking about depression? The answers can be found in sentiment and liquidity. Today, most people are either incredibly bearish or despondent, but extreme forecasts are seldom accurate, as I have mentioned before. However there is plenty of liquidity in many portfolios and governments have significantly increased money supply in recent months. A rising stock market would force a reappraisal by bears, leading to a reversal of short positions, while long-only investors put more of their cash back into the stock market.

Email of the day (2) - On, "are we at a key point":

"Are we at a key point for the markets? And if so, could you please summarise the resulting opportunities? I note the following factors that you have pointed out as vital over the past few weeks now seem to be happening:

T-bill yields have risen from 0% to nigh on 30bp since December; no where near where they were but the trend now looks set for rising yields?
Government bond prices peaked? And now \$/Yen turning?

"On the \$, I am a bit bemused by your recent purchase of Euro, though heard your reasoning on the audio. Why not short the US\$ against some of the commodity linked currencies like C\$, Aud\$? Surely a double play on your key themes? Euro looking like its weakening even against £.

"Interesting times indeed, but an overall summary of key triggers and then what to do would be great!"

My comment - I think you have partially answered your opening question with your observations cited in your first two paragraphs above. In terms of evidence (what I have often referred to as building blocks for a recovery), this has been and remains a journey rather than an epiphany.

I believe that at least some of the additional summary you seek is in my detailed response to Email (1) above, but there may also be an additional short-term factor.

As I see it, plenty of traders returned from their yearend and New Year holidays to see stock markets near the top of their ranges, where they had previously failed. Emboldened by that experience, not to mention forecasts of depression, they shorted equities and index futures looking for at least a retest the lows. Those lows have held in the major markets, so far. Consequently, some traders may be saying: if the market won't go down, it will go back up to at least the range highs.

Regarding my USD short against EUR, I could have done what you suggest but the euro looked oversold to me and it is the main alternative reserve currency, as I mentioned at the time.

My personal portfolio: Profits taken near range highs in ArcelorMittal; Baby Steps profit taken in EUR/USD long - You and I can only deal with the reality that markets provide. Stock markets have ranged in recent months and I think there are plenty of bargains out there following all the asset liquidation that has occurred. However confidence is low, as we see in the latter stages of all bear markets. Therefore we have a trading rather than trend running environment.

My preferred strategy for this phase of the market cycle, in which I think ranging base formations (Type-3 as taught at The Chart Seminar) are developing for a number of investment-grade shares, is to buy lightly on easing and take profits on rallies. In other words, the Baby Steps buy-low-sell-high tactic is appropriate provided markets continue to range. I have often mentioned this, although I have not always done it, to my chagrin. When I have paid up in the current rallies (the triumph of hope over experience), the result has usually been at least a temporary trading loss on the position.

We see this with my leveraged trades in [ArcelorMittal](#) (MT NA), which I maintain is an investment-grade position. I bought well on 2nd January and soon had a good paper profit, which I mistakenly chose to protect with a breakeven stop rather than take at least a partial profit. Consequently I was [stopped out](#) for a small gain. I also paid an unnecessarily high price for a second position. This was sold today, when my limit order at €21.20 for a June contract was reached, against my purchase €20.13 on 14th January. This afternoon I decided to sell my remaining position at €21.41 against my better purchase at €17.79, which was also a June contract. Ideally, I would have had a third equal-sized unit of MT, which I might have protected with a reasonably tight trailing stop.

These prices include all spread-bet dealing costs of currently 20 points each way.

Incidentally, I remain very bullish of ArcelorMittal. However I am not sure that it can complete its base formation in the current environment. Therefore I am range trading and hoping for another pullback. My Baby Steps limit bids are already in the market. Assuming that ArcelorMittal is actually forming a base, a risk that I remain willing to take, there will come a time when it eventually maintains a break up out of the current range. If I have not anticipated that move, I will have to pay up to participate in the anticipated uptrend that follows.

Lastly, if ArcelorMittal was in my personal long-term pensions / ISA accounts, which it probably will be when I make a switch or add some new cash, my tactic would probably be to just buy and hold it until the price is much higher.

Having mentioned that I would use the Baby Steps trading tactic with my [EUR/USD](#) trade, 40% of my position was sold today as a limit was reached at \$1.2950 for the March contract, against yesterday's purchase at \$1.2774. Here also prices include spread-bet dealing costs.

Quote of the week - On limits:

"Every person takes the limits of their own field or vision for the limits of the world."

Arthur Schopenhauer

Additional Commentary by Eoin Treacy

Temasek CEO Ho Ching to Leave; Goodyear to Take Over - [This article](#) by Bei Hu and Yoolim Lee for Bloomberg covers the interesting appointment of Chip Goodyear as CEO of Temasek. Here is a section:

Temasek Holdings Pte said Chief Executive Officer Ho Ching will step down after almost seven years at the helm of Singapore's \$130 billion state-owned investment company.

Chip Goodyear, 51, a former CEO of BHP Billiton Ltd., will succeed Ho, wife of Singapore's Prime Minister Lee Hsien Loong, effective Oct. 1, Temasek Chairman S. Dhanabalan said at a press conference today. Goodyear will be the first foreigner to run the sovereign wealth fund.

Ho drove Temasek's expansion outside Singapore with acquisitions in China, Europe and the U.S., increasing financial assets to 40 percent of the fund's portfolio. Goodyear takes over as the credit crisis ravages the value of Temasek's investments in Barclays Plc, Merrill Lynch & Co. and Bank of China Ltd. The MSCI World/Financials Index slumped 60 percent in the past year.

"In hindsight, Temasek came in too early but it would be unfair to say Temasek made the wrong call to invest in American banks," Francis Lun, general manager at Fulbright Securities in Hong Kong, said. "At that time it was seen as a good opportunity to invest in U.S. banks on the cheap so it would be unfair to criticize the investment officers for the decision."

Ho, 55, joined Temasek as a director in 2002. She became executive director that year and CEO in January 2004, according to information posted on Temasek's Web site. Ho, who said she won't remain on Temasek's board, told reporters today she will decide on her next career move after she resigns in October.

Sovereign Funds

Losses at Temasek and Government of Singapore Investment Corp., the nation's other key investment company that manages more than \$100 billion of reserves, were smaller than the decline in global markets last year, Finance Minister Tharman Shanmugaratnam said last month. Temasek generated annual returns of 17 percent between its inception in 1974 and the end of March.

Sovereign wealth funds in Asia and the Middle East have pumped money into global financial institutions to help replenish capital eroded by writedowns and losses. Barclays raised 5.3 billion pounds (\$7.8 billion) in October by selling securities to a group of Middle Eastern investors including Qatar Holding LLC.

Under Ho's watch, Temasek bought stakes in China Construction Bank Corp. and Bank of China, and became the largest shareholder in Merrill Lynch before its takeover by Bank of America Corp.

My view - One can only assume that Chip Goodyear has not been hired for his experience in dealing with banks. On the other hand, if one is taking the long view, and Temasek has a reputation for doing just that, then this is an interesting time to look at commodities and commodity producers.

The Singaporeans could be wrong in choosing to focus on this sector, but they are doing so following a massive correction, rather than at the top. Base formations for many instruments are likely to take time to develop but the risk

of massive percentage losses, ala the banks from their highs, is now considerably less than it was in the summer.

Of the six industrial metals, [aluminium](#) and [copper](#) have similar patterns, while zinc, nickel, lead and tin share similarities. Aluminium and copper accelerated to important highs in May 2006 and entered prolonged ranging phases. Both were unable to sustain breakouts to new highs in July and May 2008 respectively and both have fallen considerably since then. [Aluminium](#) remains the weakest of the industrial metals. The downtrend lost momentum from December, but broke to a new low in late January and needs to sustain a move above \$1640 to break the progression of lower highs.

[Copper](#) lost downward momentum from October before finding support near 125¢ in December. The two-month ranging phase has broken the progression of lower highs and is in marked contrast to the speed of the decline. A move to new lows, sustained beyond a few days would be needed to negate the base formation hypothesis.

Zinc peaked in [November](#) 2006, nickel in [May](#) 2007, lead in [October](#) 2007 and tin in [May](#) 2008. All have since fallen considerably. [Zinc](#) and [nickel](#) found support in October and trading volatility has decreased in the last few months. Sustained moves below \$1000 and \$9000 respectively would be needed to negate the base building hypothesis.

[Tin](#) also found support in October. However, trading has been considerably more volatile, perhaps because this was the last of the industrial metals to top. The metal tested \$10,000 again in late December and would need to sustain a move below that level to offset potential for some further base formation development.

[Lead](#) was last to find support and rallied back above \$1000 in early January. A sustained move below \$850 would be needed to negate potential for some further higher to lateral ranging.

Metals & Mining Monthly - Thanks to a subscriber for this interesting [report](#) by Peter Ward and colleagues at Barclays Capital. Here is a section on Rio Tinto:

Rio Tinto confirmed that it is in talks with Chinalco regarding a possible capital injection. This capital injection could be as much as \$15 billion, for which Chinalco may receive convertible Rio securities and stakes in specific Rio Tinto operating assets. In our view, this would be more than enough to adequately deleverage Rio's geared balance sheet and should result in a re-rating of Rio's depressed equity valuation. However, we would be concerned about the longer-term implications of Chinalco taking stakes in Rio's crown jewel assets. In the short term, however, we expect Rio shares to outperform on the potential of a direct investment in the company by Chinalco.

My comment - Rio Tinto's share price is reacting well to the news that it may be about to receive a sizeable cash injection. Over the long-term, one has to question whether this will impact Rio Tinto's ability to deal effectively with

Chinese consumers. If it loses control of some of its prized assets this could turn into something of a Faustian pact for the company in the long term.

The [share](#) found support near 1000p in early December and has doubled since then. It is now testing [2000p](#) and would need to sustain a move below 1500p to question scope for further higher to lateral ranging.

Is Oil's Future Sustainable? If Not, What Are The Consequences? - Thanks to a subscriber for this bullish [presentation](#) given by Matthew Simmons to the Dallas Committee on Foreign Relations on January 14th. Here is a section:

Two "issues" threaten oil industry's sustainability.
Both took decades to develop into twin cancers.
Neither has any clear way to quickly resolve.
Both could take decades to re-dress.

The "Issues"
People Crisis
Rust

My view - Oil prices above \$100 returned massive profits to producing countries and companies alike. Development and exploration budgets swelled as new technology was employed to access hard to reach reserves, but the subsequent fall in oil prices makes many alternative reserves uneconomic and budgets are being cut as access to credit dries up. At Fullermoney, we define peak oil as a rise in the marginal cost of production and this has declined of late. In the short to medium term liquidity and sentiment are far more important.

[Oil](#) fell consistently to its lows near [\\$33](#) and continues to range above that level. The loss of momentum and longer ranging phase, as well as the largest rally in a number of months all suggest that oil is in a bottoming process. We cannot say how long this will take but a sustained move below \$33 would be needed to question the hypothesis.

Clean-Coal Debate Pits Al Gore's Group Against Obama, Peabody - [This article](#) by Daniel Whitten for Bloomberg covers some interesting points surrounding the potential for employing clean coal technology. Here is a section:

Former U.S. Vice President Al Gore and his Alliance for Climate Protection say clean-coal technology is a fantasy.

Peabody Energy Corp., the biggest U.S. coal producer, says another prominent Democrat has pledged to make the technology a reality: President Barack Obama.

The Gore-Obama split illustrates a growing debate in the U.S. as the new president attempts to deliver on his promise to reduce carbon dioxide

emissions in the country 80 percent by 2050. Depending on who's speaking, coal is either the villain or part of the solution.

"The coal groups are saying we need clean coal," said Mark Maddox, the former head of the Energy Department's fossil energy office under former President George W. Bush, in an interview. "Environmentalists are saying there is no clean coal, and we aren't going to help you get it."

Coal is at the center of the discussion about so-called green energy because the fuel provides half of U.S. electricity -- and 30 percent of the greenhouse-gas emissions that contribute to global warming.

The issue, framed in dueling television campaigns, is whether U.S. energy policy should be based on what is still largely an assumption: that technology can capture carbon emissions before they go into the air and store them permanently underground.

My view - In past cycles, oil's fall from bull market heights has served to contain investment in alternative energy research. President Obama is adamant he is not going to let that happen again; now that oil has returned to much more economic terms for many consumers.

No technology currently exists that can compete with fossil fuels for energy production in terms of cost. High oil prices changed this dynamic briefly but the cost effectiveness of wind, solar, biomass or geothermal is challenged at today's prices. This means action need to be taken to make sure investment flows to building the necessary clean energy infrastructure and promoting technological development, in order to make sure an alternative exists the next time oil prices surge.

Carbon capture is an alluring possibility; because coal fired power stations already dominate power generation in many countries. If it can be made to work efficiently and cheaply, the technology has a great deal of potential. However, the same argument can be made about a large number of green energy initiatives and it is probably still too early to make a call on which is going to survive over the long term.

Congressional Research Service: Causes of the Financial Crisis - Thanks to a subscriber for this interesting [report](#) by Mark Jickling which attempts to lay out the various reasons for the financial crisis. It is posted without further comment.

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

"Could you please add the Lyxor China ETF ([LCHU](#)) to the library? Thanks."

My comment - This fund has now been added to the Asian funds section of the Chart Library.

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