The Barmac *Journal*

The art of Finance Bartles & McCarthy

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REASONS TO BE CHEERFUL IN GLOBAL EQUITY MARKETS -- IRAN, IRAQ, AFGHANISTAN, N. KOREA, LEBANON, etc., etc!!

BARMAC MARKET DIRECTIONAL INDICATOR:-
SELL SIGNAL -issued on 12th May
Market down 7% since signal.

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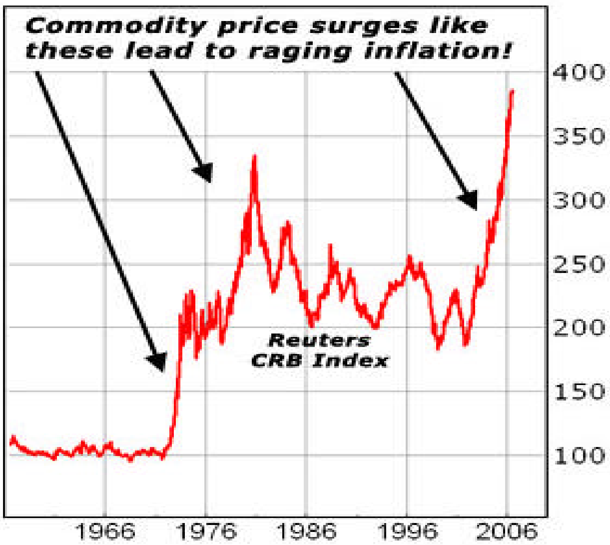
Short sugar

Raging inflation is Ben Bernanke's doorstep, but he can't see it. The numbers are staring him in the face, but he refuses to acknowledge the dangers. This is not a new phenomenon. We saw the same blindness afflict Fed Chairman Arthur F. Burns in the early 1970s. And we saw it again in Fed Chairman G. William Miller in the late 1970s.
Both men presided over massive increases in money supply and big declines in the U.S. dollar. Both ignored the obvious signs of inflation until it was too late. Now, Fed Chairman Bernanke is doing the same, paying no attention to history.
Perhaps no one has shown him this chart of surging commodity prices.



The chart demonstrates — unambiguously and without bias — which the next wave of inflation could be among the biggest of all. In particular, three waves of price surges stand out vividly:

1. In the early 1970s, the Reuters CRB Index, representing a broad range of commodities, doubled — from an index of 100 to around 200.
The primary cause: Energy prices going through the roof.
The consequence: Soaring inflation.

2. In the late 1970s, commodity prices jumped again, this time from the 200 level to about 330.
The primary cause: Energy prices going through the roof.
The consequence: Soaring inflation.

3. Now it's happening all over again, but much worse. The latest rise in commodity prices is even greater than the two surges of the 1970s: The Reuters CRB Index has *more than doubled*, from 186 at the end of October of 2001 to 386 at the end of last month.
The primary cause: *Energy prices going through the roof!*
The likely consequence: *Soaring inflation!*
And that's based exclusively on the commodity price rises we've witness *so far*.

It does not take into consideration the new surges that are still in the making, driven by the rampant demand from China and India.
Nor does it consider the elephant in the room ...

The Next Big Wave of War

Just five years ago, there were no wars in the oil-rich Persian Gulf or the Middle East. Nor were there any wars in nearby regions that could impact them.
Now, there are four:
War #1. **Afghanistan**, heating up dramatically in recent months, with a major resurgence of the Taliban.
War #2. **Iraq**, sinking rapidly into a full-scale civil war, now claiming at least 100 lives each day.
War #3. **Gaza and West Bank**, suddenly transformed from a low-level rebellion into an all-out conflict.
War #4. **Lebanon**, just starting to explode, with shocking new surprises on the near horizon.

All the above threatens to bring about great instability and potentially much higher levels of commodity led price inflation.

So our question is;--Does Helicopter Ben have the nerve to fight inflation?

After listening to the greater part of his testimony to congress last week we somewhat doubt it**.** The Fed is desperate to avoid raising interest rates as it fears destroying the already cratering US housing (*US speak – real estate)* market. Ben Bernanke's fear is that a wrecked real estate market will destroy an already pressurised and heavily indebted US consumer and thereby collapsing retail demand and causing a recession. If this was the Fed's only fear then we would anticipate that rates would fall by early next year and rescue the housing market, the US consumer and prevent recession in one simple action.
BUT…
The Fed does have another even more pressing need. This need is even more important than the prevention a major recession. That need is for money. The US has to constantly sell Treasuries and rely upon the "kindness of strangers" to keep the Government working and to prevent the economy from declining.
That pressing need is driven by the fact that the US is the world's largest debtor nation. And as anyone who is in hock knows keeping ones creditors happy is the number one priority.
So what are the policy restrictions facing the Fed caused by the US's huge debts?
Well to put it simply the US has to ensure that its creditors will continue to buy US paper and to do that it cannot appear to be soft on inflation. Global investors would drop US treasuries like a shot if they perceived the Fed was going weak and was to allow inflation to erode their value. This would knock the Dollar causing a double whammy to the value of foreign held US debt.
This is a scenario the Fed cannot contemplate as the US Government is addicted to living way beyond its means. Consequently the Fed will do anything to avoid losing the support of foreign buyers of Treasuries. It has to avoid the political suicide that the much-needed drastic and painful spending cuts would bring. The US cannot simply function if foreign lending was curtailed.
Thus the Fed is between a rock and a hard place and can only hope that inflationary pressures subside. But despite much hand wringing "Helicopter Ben" will reluctantly raise rates again to stabilise treasuries but

only if he is forced to do so by poor inflation data, despite the real risk of throwing the US into recession. The great danger is this reluctance will lead to the Fed being constantly behind the curve and a nasty "catch-up" may be forced upon the US by some outside inflationary shock or …war!.

IS THE US BANKRUPT? –

A very interesting and comprehensive report by Professor Laurence Kotlikoff of Boston University and the National Bureau of Economic Research, which was published by the Federal Reserve Bank of St. Louis posed this question. Here is part of the introduction:

Is the U.S. bankrupt? Or to paraphrase the Oxford English Dictionary, is the United States at the end of its resources, exhausted, stripped bear, destitute, bereft, wanting in property, or wrecked in consequence of failure to pay its creditors?

Many would scoff at this notion. They'd point out that the country has never defaulted on its debt; that its debt-to-GDP (gross domestic product) ratio is substantially lower than that of Japan and other developed countries; that its long-term nominal interest rates are historically low; that the dollar is the world's reserve currency; and that China, Japan, and other countries have an insatiable demand for U.S. Treasuries.

Others would argue that the official debt reflects nomenclature, not fiscal fundamentals; that the sum total of official and unofficial liabilities is massive; that federal discretionary spending and medical expenditures are exploding; that the United States has a history of defaulting on its official debt via inflation; that the government has cut taxes well below the bone; that countries holding U.S. bonds can sell them in a nanosecond; that the financial markets have a long and impressive record of mispricing securities; and that financial implosion is just around the corner.

This paper explores these views from both partial and general equilibrium perspectives. The second section begins with a simple two-period life-cycle model to explicate the economic meaning of national bankruptcy and to clarify why government debt per se bears no connection to a country's fiscal condition. The third section turns to economic measures of national insolvency, namely, measures of the fiscal gap and generational imbalance. This partial-equilibrium analysis strongly suggests that the U.S. government is, indeed, bankrupt, insofar as it will be unable to pay its creditors, who, in this context, are current and future generations to whom it has explicitly or implicitly promised future net payments of various kinds.

The world, of course, is full of uncertainty. The fourth section considers how uncertainty changes one's perspective on national insolvency and methods of measuring a country's long-term fiscal condition. The fifth section asks whether immigration or productivity improvements arising either from technological progress or capital deepening can ameliorate the U.S. fiscal condition. While immigration shows little promise, productivity improvements can help, provided the government uses higher productivity growth as an opportunity to outgrow its fiscal problems rather than perpetuate them by effectively indexing expenditure levels to the level of productivity.

Our view - The fact that a report of this nature was recently published not by a hard money / gold bug site but the Federal Reserve Bank of St. Louis, should indicate to even the most diehard sceptics and anyone else in denial, that there is a problem. And while there may be some consolation in knowing that the US's current fiscal problems are neither unique to America nor currently causing pandemonium in the markets, sentiment can change quickly.

Laurence Kotlikoff proposes three policies to address the US's fiscal gap and avert bankruptcy: a retail sales tax, personalised Social Security and a globally budgeted universal health system. While interesting, our guess is that these are sufficiently controversial and redistributive to attract little cross-party support in the House of Representatives.

And a change of administration is unlikely to help, as Laurence Kotlikoff indicates in this additional paragraph:

The Democrats, of course, had eight long years under President Clinton to reform our nation's most expensive social insurance programs. Their failure to do so and the Clinton administration's censorship of an Office of Management and Budget generational accounting study, which was slated to appear in the president's 1994 budget, speaks volumes about the

Democrats' priorities and their likely future leadership in dealing with our nation's fiscal fiasco.
So what will happen?
It is unlikely that a problem developing over many years will be tackled by any administration elected to the White House for four years. Instead, successive governments will hope to grow their way out of trouble. While theoretically possible, that is not easy and Laurence Kotlikoff referred to a past policy in his third paragraph above:
"…the United States has a history of defaulting on its official debt via inflation."
Investors know this and the markets are slowly providing their own verdict. Frequent contra-trend reactions aside, long-dated US government bond yields have completed a base (see chart in bon section on page 7) and are gradually rising; the US Dollar index has once again firmed on global tensions but this is probably no more than a technical rally prior to a retest of the historic lows; gold is encountering profit-taking at present but is in a secular uptrend; lastly and not least, the Dow continues to weaken against gold, in a probable return to its historic mean near 5 as inflation slowly erodes the Dows real value.

Dow / gold ratio

The above chart is interesting in another respect in that it illustrates the severity of the current bear market in *"real money."* The rally since 2003 has also seen the Dow continue to fall when measured against gold!

Decadent Western Capitalism

And here's an interesting little item. The 26 top executives at Toyota Motor Company earn an average of $320,000. Good money, but hardly obscene.

Toyota is a growing, profitable concern. And Japan is a country with a positive trade balance.

Across the wide Pacific, the U.S. trade deficit went further negative in the month of April, to $63.4 billion. But America's top dogs aren't complaining. The heads of America's 500 biggest companies received an aggregate 54% pay raise last year. As a group, their total compensation amounted to $5.1 billion, versus $3.3 billion in fiscal 2003. G. Richard Wagoner, Jr, heading up Toyota's rival, General Motors, received total compensation of $8.5 million. That's what you get when capitalism enters its degenerate phase. The parasites make sure they get their money...even as the company sinks.

Incompetence at the top?

We will first warn all our readers that we about to climb back onto our favourite soap box as we would like to make the following observations about Her Majesty's Government.
Just as you wouldn't choose a public relations officer to run a major industrial corporation, it makes no sense to make a superb propagandist the chief executive of a major nation.
After Labour came to power in the UK in 1997, we told our readers to expect a creeping breakdown in the administration of the British state as Tony Blair's takeover team, expert at the business of destructive criticism and marketing themselves, seriously lacked experience in managing large, complex enterprises.
And so it has come to pass…
"Now we know the Blair legacy: incompetence," is the headline on a devastating commentary in *The Business*. Among the points it makes are these:

Britain today is in crisis. "Nothing seems to work anymore. The economy is losing its competitive edge; educational standards are slumping; violent criminals are on the loose; the underclass continues to grow; immigration is out of control; and the culture is coarsened by a prevailing yobbery. Yet the most well-resourced government in British history – in terms of manpower and treasury funding – has proved to be useless in the face of such challenges".

Incompetence has become the hallmark of everything the Blair government touches. The Department of Health faces a £13 billion overrun on an IT project supposed to cost £6.5 billion; bureaucrats give social security numbers to illegal immigrants while giving instructions on how to defraud their own system; disastrous over-payments by the tax credit system for the third successive year have impacted on the poor; more than half pupils are leaving school without basic competence in maths and English despite a doubling of spending on state schools.

After nine years in power, Britain has a Home Office which, admits the new minister John Reid, is "inadequate in terms of its information technology, leadership, management systems and processes." It released on to the streets more than a thousand criminals, included convicted murderers and rapists, who were supposed to have been deported. Its officials have been caught demanding sexual favours and cash for giving help to asylum seekers and immigrants – "the sort of corrupt madness usually associated with the bureaucracy of a collapsed former Soviet state rather than one of the richest countries in the world."

"An obsession with presentation and scoring political points" has meant "presenting a good story has taken precedence over good government." Senior civil servants' focus on political initiatives to keep their ministers happy has meant that "entire departments have been allowed to slide from the usual mediocrity, characteristic of all government bureaucracies, into outright shambles." The mandarin who "should be held responsible for the mess" at the Home Office, including a financial system denounced by the National Audit Office as "fundamentally flawed," has been rewarded by appointment to one of the most prestigious and influential financial positions in the land – deputy governor of the Bank of England

.

The government has become addicted to legislative initiatives as a substitute for effective management. "The Home Office alone, for example, has since 1997 introduced 43 bills, 220 initiatives and 350 new regulations; none of them has prevented an explosion in violent crime (including the current epidemic of knife crime), disorder and loutishness."

There has been "an unprecedented squandering of public money." "The iron Chancellor" Brown has been allowed "to fatten an already-overweight public sector, much as a mad doctor would recommend force-feeding for the obese."

Unfortunately there is nothing to suggest the Tories under the bland, seemingly gormless, neo socialist Cameron would be any more competent.
There is now a most short sighted and unfortunate consensus in favour of big government. We the British people will long rue and regret the ghastly waste, profligacy and incompetence displayed by the Government and the opposition.

Five Timeless Rules of Investing

It's the perfect time to do some summer reading, and our very favourite book about investment is about the story of Jesse Livermore, the "boy plunger" of the early 20th century whose story is told in the classic biography, *Reminiscences of a Stock Operator* . This is a book that we at Barmac have read time after time.
Under the pseudonym Larry Livingstone, the first-person account reveals in story after story the thrill of victory and the agony of defeat as a speculator extraordinaire. Livermore made and lost a million-dollar fortune three times, and died tragically of suicide in 1940. He lived through the Panic of 1907, the First World War, the Roaring Twenties, the 1929 Crash and the Great Depression.
Throughout it all, he learned many lessons that we can apply today…

1"My greatest discovery was that a man must study general conditions, to size them up so as to be able to anticipate probabilities." What did Livermore mean by "general conditions"? He meant the macroeconomic environment and geopolitics. Are they favourable or not favourable to buying stocks? Today, for instance, the Fed is raising rates and squeezing the money supply (the monetary base declined last month for the first time in years; a year ago, it was going up 10%.) The war in the Middle

East is heating up. These general conditions are not conducive to a bull market, except for gold!

2. Learn from wise old men who have experience in the markets. In *Reminiscences of a Stock Operator* , the author talks about "the Old Turkey," a "very wise old codger" who counselled Livermore on making good investment decisions and avoiding mistakes. How can you do this? The best way is to read histories of the great investors such as Warren Buffett, Peter Lynch, John Templeton and J. Paul Getty.

3. Learn your strengths and weaknesses. "We've all got a weak spot. What's yours?" asks the Old Turkey. A good question that we must all answer. "Study mistakes," he counsels. You don't learn from your successes, only from your mistakes!

4.Always save some of your gains. "I was again living pretty well, but always saving something, to increase the stake that I was to take back to Wall Street." Unfortunately, Livermore made the mistake of not living up to his own advice. He leveraged himself too much, and often went bankrupt. By taking some of your gains and investing the funds in alternative investments, such as property, cash, or gold, you protect yourself in case you are wrong.

5.Beware the charismatic financial guru! "It cost me millions to learn that another dangerous enemy to a trader is his susceptibility to the urgings of a magnetic personality when plausibly expressed by a brilliant mind. In other words do not be distracted from a successful investment approach by the urgings of others.
In our experience this is easier said than done as we are all vulnerable to the influence of others.

Get a copy of the book *Reminiscences of a Stock Operator* if you can and enjoy! It is full of sage advice entertainingly written and definitely a book you can read over and over again and still learn something new each time.

INTEREST RATES & BONDS

- **US & UK rates at or near highs as EU and Japan tighten further.**
- **US bond yields have turned up in a major generational inflation warning**
- **Gilts and US bonds bounce after 6-month decline.**
- **Credit spreads are starting to widen as risk appetite declines.**

It currently appears that as far as the Fed and the B of E are concerned the current round of rate tightening is almost over. Assuming that we witness no further shocks a relieved Bernanke will be looking to hopefully march rates lower sometime next year and give the US economy a much-needed fillip. Same goes for the B.of E.
The only danger to this cosy assumption are the inflation numbers, which could derail this scenario. Unless inflation refuses to moderate over the next 6 months then the consensus will probably be correct and Helicopter Ben will be a much-relieved man. BUT this scenario is far from secure and all investors need to keep a very close watch on US price data as any shocks could set rates climbing even higher!

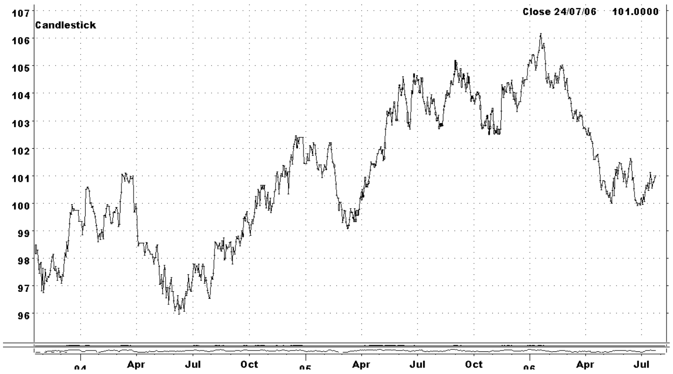
US 10yr BOND YIELD since 1962.

The above long-term chart illustrates the point we have been making for two years now that the great bond bull market has ended and with a background of rising inflation yields are set to slowly climb for many years to come.
The downtrend has been broken and a considerable base has been built which looks more than capable of

supporting an advance in yields to over 6% in the coming year or so.

The UK Gilt (shown below) appears to have found support near the March ’05 lows and looks capable of retracing maybe half of this years falls with a target of 103 on the typical issue shown below. The US Treasury market sports a very similar pattern and a relief rally also looks set to unfold over the next month or so.

UK Gilt 4.75 2015



CREDIT SPREAD of US 10yr T note vs BBB

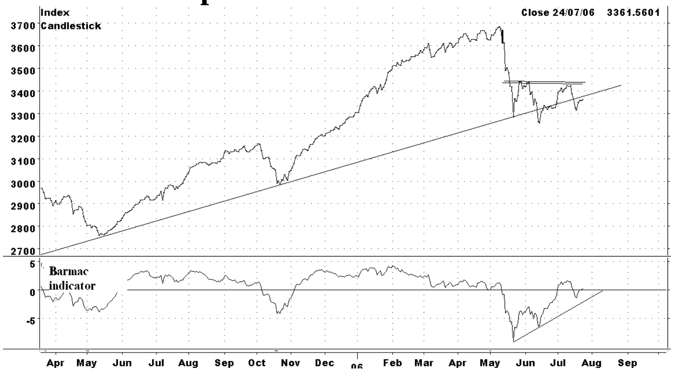
For those who do not invest in bonds, AAA most commonly refers to governments while BBB are the lowest investment grade bonds and are made up of corporates (companies bonds).
This chart shows that the spread between BBB and AAA is widening. This means that BBB prices are falling faster than Treasuries. The early part of this chart shows a period when spreads were very tight. This coincided with a time of economic expansion where the perception of risk was low. In this environment bond traders seek returns, and demand for higher yielding securities causes the spread over Treasuries to contract.
The spike in 1998 corresponds with the Russian debt default, when investors were quickly roused from their torpor of risk ignorance. The technology collapse in 2000/01 sent spreads out even further. However as the Nasdaq bottomed the search for yield again started to make spreads contract. The oft-mentioned synchronized global recovery caused the perception of risk to decline and this further tightened spreads. The last two years have been economically buoyant and the perception of risk very low.
That was, of course, until May when stock markets started to correct and inflation became more of a worry. The spread currently looks like a developing base and the surprises are almost certain to be on the upside.
Again the portents this chart seems to hold is of rising inflation pressures in the years to come.

EQUITIES

- **Barmac Indicator is neutral below key chart levels**
- **All major indices “whipsaw” below key June retracement high but no clear sign of a recovery as yet.**

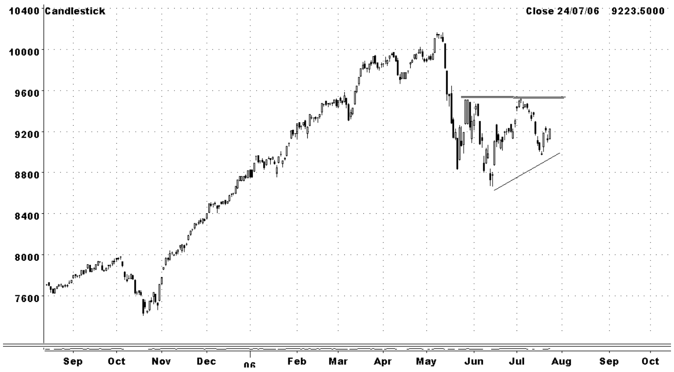
Virtually all global equity markets currently display broadly similar patterns since the massive increase in volatility accompanied the global sell-off that began in May. Typically, most indices are still below both the end May and June post decline highs and are carving out a broadly sideways consolidation. The Smallcap (below) illustrates beautifully the global consolidation patterns and highlights that the jury is still out on whether the lows have been set as yet.
The Barmac Indicator in the lower panel is just moving to “buy” but we would stand aside until the 3430 level is surpassed.

FTSE Smallcap with Barmac indicator



The Mid 250 (below) sports a very similar pattern and we would again suggest that traders stand aside until and unless 9500 is exceeded**.**

Ftse Mid 250



We tend to examine the above two smaller indices because they are a broader reflection of market sentiment and display *"beta*". Thus if they are lagging the blue chips it implies risk aversion and a lack of "animal spirits". At present markets still appear to only have a limited appetite for risk.

Ftse 100

Despite this the chart for the **Ftse 100** (above) is remarkably similar to its smaller counterparts with 5900 being key.
New highs would signal an unequivocal resumption of the bull but we will await developments.

The two US indices shown (S &P and NASDAQ) display quite clearly the current global aversion to the riskier market segment. Whilst the S & P has declined only about 100 points (8%) high to low the racier NASDAQ has continued to decline over the past couple of months losing 15% high to low.
Until and unless we see relative strength from the NASDAQ we would again question the sustainability of any rally.
Equally important the S & P has remained above its long-term trend whilst the NASDAQ has not.
So a break above 1281(S & P) is needed with some out performance from the NASDAQ before we can begin to confidently expect higher prices.

S & P 500

NASDAQ (weekly)

Japanese 2nd Section

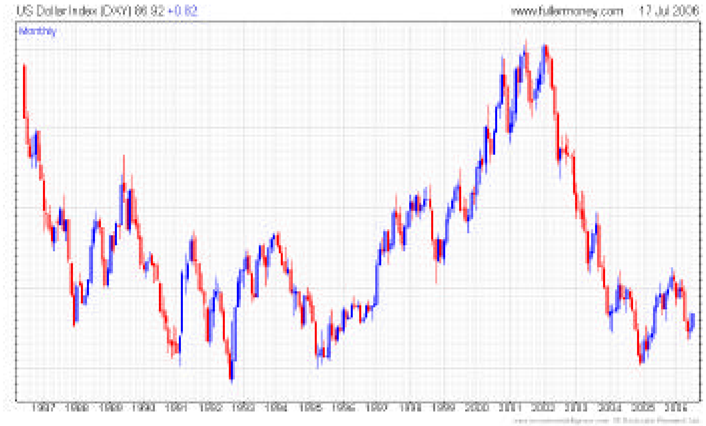
The Japanese market has been constantly led by the 2nd Section that topped out with the "Livedoor" debacle in January over four months before the Nikkei. As the chart above shows the index has consistently declined posting a series of lower lows. The least the index can do to signal and end to this trend is to rally above 4500. One positive is that the decline is losing momentum with a non-confirmation arising on the 21 day ROC in the lower panel. Whilst this is hardly conclusive it may herald a reversal in the next week or so but if the index remains below 4500 any rally by the blue chips will remain suspect because of the lack of confirmation from the high beta 2nd Section.

FOREX

- **Dollar index ranging near historic lows but a break above 90 could herald a decent rally.**
- **Euro/pound still locked in a trading range that will one day break in a spectacular fashion!**

Since late 2003 the Dollar index has ranged in what could be called a reversal pattern – "reverse head and shoulders" – with a neckline at 90. If the dollar was able to muster an advance beyond 90 then we could see a dollar rally toward the 100 "roundaphobia" levels. In the meantime the ranging could continue for weeks.

US DOLLAR INDEX

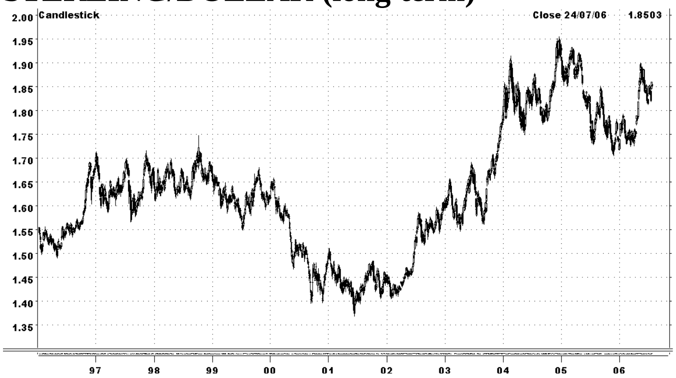


The long-term chart of pound/buck has also been stuck in a trading range between $1.75 and $1.90 for three years and the pattern also looks more like a reversal than a consolidation. Obviously, with such a broad range the two currencies could remain trapped for a further few years but a break-out looks a certainty at some stage and traders should go with the break. Meanwhile careful traders could try and trade the range – but that is not a game for us at Barmac.

It is quite possible that any move below $1.75 could lead to a test of the 2001 lows of $1.40.

The one thing that is certain the current relative stability will not last forever in the forex markets. Beware; this market will move back to centre stage one day!

STERLING/DOLLAR (long term)



The same comments made about "cable" could also be made about the pound/euro cross. The above chart highlights the extraordinary stable conditions that have existed during the past few years. So quiet that stupid politicians try to claim credit for producing a "stable" pound and that "convergence" is being managed and recognised by the market.

Well we have one phrase to describe the above claims---Balderdash (we could have used other words but decided against it).

This beast will raise its ugly head again at some stage and when it does we are in for an enormous profit opportunity and with any luck preening politicians will look the fools they clearly are!

The key levels to keep an eye on are £1.50 and £1.40 – any move beyond these levels should be pounced upon!

STERLING/EURO

COMMODITIES

- **Oil remains in a consistent uptrend. Beware the consensus. Watch out for signs of a reversal.**
- **Gold looks set to work lower for several months**
- **The commodity rally has only just begun according to Jim Rogers**

The world has been worrying constantly about the price of oil since the "war on terror" began 5 years ago and the oil chart below illustrates the consistent nature of the advance over the past two years.

Each correction has been in equal proportion to each other and we have seen a steady procession of higher highs and higher lows.

However, there exists an amazingly consistent consensus that prices can only go higher due to "peak oil" and /or war etc. that makes the contrarianism at Barmac feel somewhat queasy. There is no God given right to higher oil prices and although the advance shows no sign of faltering, the Israeli attacks upon southern Lebanon resulted in only a marginal new high. The market looks like it is losing steam and although a major dislocation could easily drive prices toward the much-vaunted target of $100 we suspect that a major reversal is around the corner.

At present all we can do is watch for a breakdown in trend consistency or a break of the bull trend line to herald a reversal. If this does happen then we could witness a major reversal that will unwind the current bullish consensus as has happened in gold.

This reversal could last many months and drive prices back below $50 as the bulls are punished. This is not a firm conviction but merely a suspicion brought about by the one-way traffic of bullishness regarding the old "Texas tea".

Action; A watching brief with a short if the trend is broken and a correction occurs that is out of character to all previous corrections.

OIL (Nymex weekly)

GOLD (weekly)

SILVER (weekly)

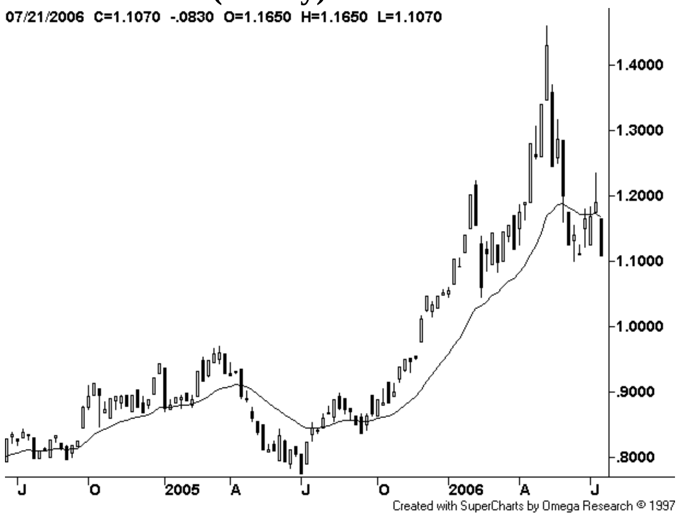
The two above charts for gold and silver are remarkably similar and this is due to the fact that recent price action has been driven by financial speculation rather than supply and demand fundamentals. We suspect that the recent lows will be at least challenged before the summer is over as the speculative excess is unwound. As mentioned last month near vertical advances always reverse hard!

We remain bullish gold with a very long-term view but remain very cautious for the rest of the year.

The industrial metals including "Dr Copper" have also witnessed a major reversal following a speculative frenzy. We now have a lower high in place and copper must hold above $3.000 in order not to set a declining trend in motion. With aluminium a key "neckline" level is evident near $1.100 and a break of this point would open the way for more sustained weakness.

COPPER (weekly)

ALUMINIUM (weekly)



COFFEE (weekly)

The coffee chart is finally coming to a head with the six-month downtrend homing in on support near $90.00. Something has to give and we would trade with the break of either boundary. Obviously we have long been bulls of coffee and a downward break we would treat with caution but the trend would point down and there is little point ignoring the evidence if this circumstance were to unfold.

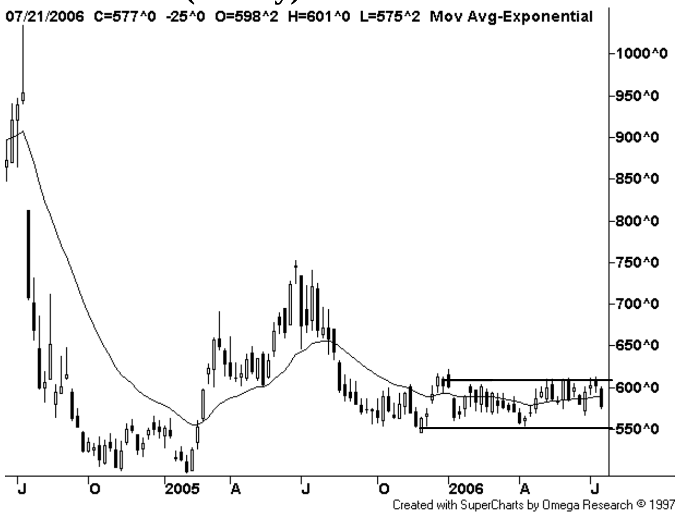
WHY STOPS ARE IMPORTANT!!

COCOA (daily)

What a chart cocoa presents. Last moth we said, "buy" at $1600. Good advice for a few days as the price soared to $17.50. But wow look what happened next.

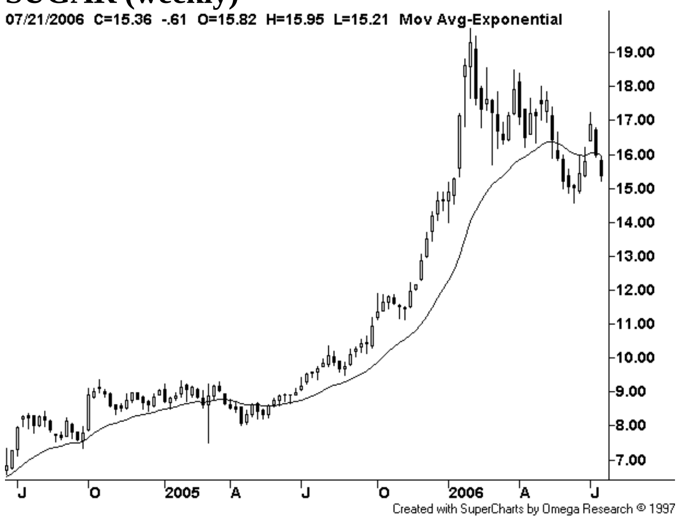
This action highlights the need for market stops, which we would have placed behind a rising market at $16.50. If you did not use a stop a "wipe out" may easily result. In the meantime we will watch for a chance to short cocoa upon a potential break below $14.00 following the dramatic failed upside move. We suspect that prices will fall further due to the dramatic shock to sentiment the failed upside spike will have to active traders.

SOYBEANS (weekly)



Soybeans continue quietly in tight trading range – a case for keeping on the radar for any price action outside marked trading range**.**

SUGAR (weekly)



Last issue we advised shorting sugar @ $15.50 which would have been subsequently stopped out at our advised level of $16. Now however the pattern has become clearer and we would again stay short with a stop at $17.00. If this level is breached then we may well see prices ping much higher.

Much hot air has been expended upon the recent Bull Run in commodity markets but the following chart of the CRB Index (Commodity Research Bureau) highlights that in inflation adjusted terms the bull has barely started.

CRB (inflation adjusted)

Jim Rogers Predicts Another Raging Bull Market in Commodities

An interview

By Dr. Mark Skousen *Chairman, Investment U*

Skousen: You've written a book called *Hot Commodities: How Anyone Can Invest Profitably In the World's Best Market*. Given that commodities have gone through a major correction of late, are they going to make a comeback? Is this the top of a market, or just a correction?

Rogers: First, we're in a secular bull market in commodities, which started early in 1999... I went back and looked, and the shortest bull market in commodities I could find lasted 15 years, and the longest lasted 23 years. So, if history is any guide, this bull market will last sometime until 2014 and 2022. That's not a prediction; I'm just telling you what history would indicate. Yes, some commodities are up, but if you look at the commodities market, there are only five or six commodities that have made all-time highs. And they're not even - most of them - above the old all-time highs. Zinc is, copper is, and oil is, but the rest of them, even aluminium, which got near its all-time high, or lead, or tin... they're not far above their old all-time highs, for the most part.

MS: Gold and silver... they haven't hit their all-time highs.

JR: Silver is 75% below its all-time high... gold is 30% below its all-time high. Sugar is 80% below its all-time high. Corn is 50% below its all-time high. Cotton is 60% below its all-time high. I could go on and on... and those aren't adjusted for inflation. So, most commodities now are somewhere between 80% and 90% below their all-time high, especially adjusted for inflation.

So is this over? No. Copper and zinc may slow down for a while. We haven't even really gotten started. Commodities have... my index has tripled... more than tripled.

MS: So easy money has been made, in your opinion?

JR: In zinc and copper. But not in coffee. Coffee is 75% below its all-time high. I don't want to use the term "easy money," but there's still plenty of money to be made. Because in bull markets - in every asset class - eventually everything makes a new all- time high.

You buy land in Los Angeles, and if there's a real estate boom, everything goes to an all-time high, eventually. Even the slums. And usually they go well above the old all-time highs, so we have a long, long, long way to go. There are always corrections. In '87, stocks went down 40% in five months. Stocks went down in 1994, they went down in 1990, they went down in 1989... we had some big corrections.

But the smart people bought more... they didn't panic and sell out. In the 1970s, gold at one time, during a two-year period, went down 50%, and a lot of people panicked and gave up, because it was a big two-year draw-down. Well, gold did a turnaround, and went up 850%. Between 1974 and 1976, gold went from $200 to $100, and then it went to $875. This is the way markets work, and if people don't understand this about markets, you probably shouldn't be investing in the first place.

MS: But aren't commodities more ideal for a speculator, rather than a long-term investor? Does buy-and-hold really make sense?

JR: Yale University recently did a study, and the Wharton School at the University of Pennsylvania determined that in the past 45 years, you'd have made more money in commodities than in stocks, with less volatility and a better inflation hedge.

MS: That's a broad-based index, that's not true of gold

JR: Your question was about commodities, not gold, but we can go back to gold if you want to. Commodities have been better investments. And the study also showed that you would have made 300% more investing in commodities themselves, rather than in commodities stocks.

If you want to buy a stock, you have to invest in the right company, you've got to worry about management, balance sheets, environmentalist unions, politicians, and 100 other things... But when you invest in commodities, there's too much that's going to go up, and too little that's going to go down, and vice-versa.

Natural gas does not know who the Fed chairman is, and it doesn't give a darn who he is. If you invest in natural gas stocks, you have to worry about a lot of stuff. Natural gas has tripled in the last five to six years. Enron was a natural gas company. Enron went to zero. Natural gas can go down, but it can't go to zero.

Your odds are a lot more risky... a lot riskier than commodities, because sure, they'll fluctuate and go down, but they can't go to zero.

MS: But you can't just blindly buy commodities because you say there's going to be a 15-year cycle. No one knows how long this cycle is going to be. And so you have to look at the fundamentals - and what are the fundamental economic reasons for this, and are those still in place? What are the things that you look at?

JR: The main reason we've always had bull markets in commodities is supply and demand. In the '80s and '90s, we had a bull market in stocks, but nobody called you up and said 'let's invest in a sugar plantation' or 'let's invest in a lead mine.' There was a bear market in commodities so no one invested in productive capacity.

All the great oil fields in the world were discovered more than 35 years ago. There's been no major oil discovery anywhere in the world since 1970. Alaska's in decline... The Mexican fields are in decline... The North Sea is in decline... The U.K. has been exporting oil for 25 years - but within the decade, they will be importing oil. Malaysia has been exporting oil for decades - they will soon be importing oil. Indonesia's a member of OPEC, and about to get thrown out because they now import oil...

You know, oil fields deplete. Ten years ago, China exported oil. Now they're the largest importer of oil in the world... the second-largest consumer of oil in the world

MS: Speaking of oil... We haven't built any refineries in this country since 1976. I can understand why that would keep gasoline prices up. But couldn't you develop a glut outside the United States. Couldn't oil prices drop like natural gas did recently?

JR: I'm glad you understand that - I read in the press that there are no refineries and that's why oil is going up, and that's wrong. The fact that there are no refineries would keep oil down. But be that as it may, we've got to have the energy somewhere in the world... In China, they are building refineries. In Asia, they're building refineries as fast as they can.

MS: Now, one of the criticisms of your book was that you only recommended the commodities themselves, rather than the stocks. Have you changed your mind? Do you like the ETFs or do you like the real asset funds that are out there, like the **Oppenheimer Real Asset Fund**... These are ways of buying commodities through the stock market.

JR: I remember in the 1970s when oil went up 10 times. A lot of oil companies did not go up. If you don't have reserves, or if you have a bad balance sheet, or 100 other things, just because you're an oil stock does not mean you will go up in the '70s. And the Yale and the Wharton studies show you would have made 300% more investing in commodities themselves, rather than in commodities stocks.

MS: You would think of gold stocks as being the leveraged way to buy gold. Maybe that's an exception to your rule.

JR: Well, more money has been lost in gold mining stocks than in any other industry - including railroad stocks...

MS: Well, if you stick with the blue chips that are actually producing them, you triple your money. If you want to leverage your return, you buy the gold stocks rather than the gold itself. Do you go along with that?

JR: Well, yes. If you buy the right natural gas company (I'm going to use natural gas instead of gold for a moment), if you find a natural gas company that's going to discover gas in Berlin, fine, because you're going to make a gigantic amount of money. But there are 500 natural gas companies in the world, and chances of your getting the right ones are not very high.

Even with gold, the chances you'd get the right gold company are not very high.

MS: Uranium just hit its all-time high. Are you bullish on uranium at this point?

JR: I certainly am. There's no futures market in uranium, so there's no way to participate except through stocks. You could buy uranium and put it in your vault if you want to. I'm not going to put uranium in my cellar, but yes, I'm very bullish on uranium. China's building 25 nuclear power plants, and that's just the beginning.

Even in America we're starting to talk about having nuclear power.

MS: Tony Blair changed his mind on that. And the anti-nukes... even they're reversing their views. It's interesting...

JR: But also, they're coming to the view that if you can control nuclear power - whatever that means - it is cleaner than coal. It is cleaner than oil. It's cleaner than a lot of things...

MS: Jim, you were a money manager for many years. Do you manage money now?

JR: Only my own. Well, I have these index funds, but nobody manages an index fund, as you know. But the basic point, Mark, is that if you find the right company, yes, it's a good investment. But otherwise, you're better off buying gold. You're better off buying natural gas. You're better of buying wheat...

We suspect that Jim is correct and there remains plenty of juice in all commodity markets.

FINALLY

UK dottiness diary:

Police, presumably with nothing better to do in a country plagued by an outbreak of knife crime, spent two hours interviewing a pub landlady on suspicion of inciting racial hatred. Her offence was using a dragon on a Welsh flag as a target in a St George's Day archery competition.

In another example of the Brits' absurd obsession with symbols, parents of a two-year-old wearing an England supporter's football shirt were told to leave a pub, part of a national chain, because it might provoke violent behavior among the customers.

Now that senior positions in police forces are dominated by those with social science and law degrees rather than proven success in crime-fighting, all kinds of idiocies have crept into policing.

In Gloucester police used a "cherry picker" crane to provide a Kentucky Fried Chicken meal, with Pepsi and a pack of cigarettes, to a suspected car thief who bombarded them with bricks and tiles from a roof-top eerie, to ensure his "wellbeing and human rights."

Legal madness: Britain's taxpayer-funded legal aid service, which refuses to provide money for obvious good causes such as victims of the painkiller Vioxx, is providing state funds (one estimate is "at least £100,000") to finance a legal challenge by animal rights militants seeking to overturn a court injunction preventing them from harassing Oxford university staff, students and contractors at work and at home. Hardly a cause warranting public financing, we would have thought.

The naked truth: One of Britain's ongoing scandals is the failure of the Rural Payments Agency to pay out £1½ billion in European Union subsidies owed to English farmers and landowners, a delay so serious that it has pushed many farmers to the brink of bankruptcy.

Now we know why the bureaucrats were so tardy. They were far too busy having fun. An investigation at the agency's Newcastle office has revealed that staff occupied their working time with pranks such as leaping naked from filing cabinets, having sex in the lavatories, leaving vomit in cups hidden in cupboards to brew up a disgusting smell, brawling in the reception area, and holding break-dancing contests.

Regards

Andy McCarthy
Andrew Bartles