Monday 22nd August 2011

**No to a higher frequency flash crash –** This is a good column (*may require subscription registration*) by John Plender of the Financial Times on a subject often mentioned by Fullermoney. Here is the opening:
http://www.ft.com/cms/s/0/6296f160-c8e1-11e0-aed8-00144feabdc0.html#axzz1VmrvPWjv

The good news about the extreme market volatility of the past month is that there has been no repeat so far of last year's notorious Flash Crash, in which $1,000bn was wiped off share values in half an hour. Yet that is no reason to be complacent about the activities of high frequency traders who are engaged in a high-tech arms race to reduce trade execution times to millionths of a second.

For conventional investors there is a long-standing concern about the uneven playing field on which they compete with traders who can afford to co-locate their high-tech kit expensively beside exchanges to reap a time advantage. While it is true that the bigger fry have always had a natural advantage in capital markets against the small, it is a legitimate goal of regulation to try to level the playing field as far as possible. And it would be good to have a regulatory verdict on whether predatory algorithmic traders are artificially manipulating prices at the expense of slower or less sophisticated market participants.

I am also profoundly suspicious of the practice of "pinging", whereby traders send out and cancel a multiplicity of orders until they manage to identify hidden pools of liquidity from which they can extract a predatory profit. The orders entered by such traders are now a huge multiple – even hundreds of thousands – of the trades actually effected.

Small wonder Lord Myners, the UK's former City minister, expressed concern last week that high frequency trading was so remote from the true function of the capital markets. It is high time we had a definitive verdict from the securities watchdogs on whether the unholy alliance between these traders and the managers of exchanges and trading platforms acts as a stealth tax on ordinary institutional and retail investors. For the formal exchanges in particular, which have seen their market share collapse as a result of liberalisation and the arrival of new trading platforms such as dark pools, the increased volumes generated by high frequency trading have been a boon. Note, in passing, that the New York Stock Exchange's share of the trade in NYSE-listed securities fell from 80 per cent in 2005 to just 24 per cent in early 2011.

**Email of the day (1) –** On “Nuke versus Nat Gas”:

**I hope you are well. I want to run something by you that has been on my mind regarding the “long term” nuclear investment stance. Anyone invested in this sector has been rather blindsided by this year’s twin “Black Swans” – Fukushima and Germany’s decision (not yet actualized) to eliminate its nuclear plants. This double whammy was all the more unfortunate as the nuclear sector had begun a long ascent from the depths visited post the uranium price collapse and the 2008-9 debt debacle. The prospects for a significant cultural shift towards the building of new plants (with the notable exceptions of China and India) has become rather sobering.**

**On the other side of the equation we have natural gas. As I have mentioned to you previously, I sit atop one of the largest shale gas deposits in the world –the Marcellus formation – where estimates are as high as 500 trillion (!) cubic feet. Because of the rather large price discrepancies between Henry Hub and EU gas prices there are now plans for at least five EXPORT LNG terminals in the US. (ironically at least two of them I believe were built at considerable cost for the IMPORT of product). With such abundant supply existent and on the horizon (shale deposits are known to exist in China, Europe, the middle east, etc), I have asked myself whether or not my current stance (I’m sure replicated by many subscribers) of owning both natgas and nuke equities somewhat equally (or indeed as a hedge!) was still realistic. Could it be the case that the expected huge long term supply in natgas that is envisioned could be the FINAL nail in the coffin for a serious resurgence of the nuclear industry? Could it be that this vast energy source (I have read estimates of 100 years of global consumption) could tide the world over until a fusion solution is found, thereby bypassing any incipient fission resurgence?**

**A bit speculative I guess, but it has profound implications for energy portfolio construction.**

**My comment –** I am well and I thank you for an absorbing email, certain to be of interest to many subscribers.

You are certainly right about natural gas, both conventional and from shale deposits. It was the superb analyst Ronald-Peter Stöferle of Erste Group who convinced us in March 2010 that shale gas was a game changer for the USA and many other countries. Subsequent, Eoin and I have often commented on shale gas and shale oil, as you probably recall.
http://www.fullermoney.com/x/default.html?mc=y&id=1852&schtxt=stoferle

The USA’s reserves of shale gas are indeed massive and their horizontal drilling and fracking technology is able to release it. The USA’s pioneering methodology is increasingly being imported by other countries, not least China, which has even more shale gas than the USA. (See slide 21 from my presentation: Bubbles, Supercycles and the Next Three Big Energy Stories.)
http://www.fullermoney.com/x/default.html?mc=y&id=2157&schtxt=three%20big%20energy%20stories

Both shale oil and shale gas are huge, and the main reasons why Fullermoney projects that energy costs should be lower in real (inflation adjusted) terms in twelve to fifteen years than we see today and will see for the rest of this decade. However, they are still fossil fuels.

This item continues in the Subscriber's Area.

**Bernard Tan: Germany Is Hardly A Paragon Of Fiscal Virtue –** My thanks to the author for latest of his independent reports. It is posted in the Subscriber's Area but here is a brief sample:

Germany is a country with a great industrial base. Unfortunately, it is also a country that has one of the most bloated and overpaid public sectors in the developed world. In addition, the massive pool of savings and surpluses generated by its industrial base has been very poorly deployed by its large and very incompetent banking sector.

**My comment –** This view from Asia is interesting, albeit unsettling. I would welcome some feedback from those who are more familiar with Germany than I am.

**Interesting interview on gold and silver's likely future performance relative to the miners –** This item is posted in the Subscriber's Area.

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Email 1 continued
As an advocate of nuclear power and one who had also invested in uranium shares, my worst fear was a major leak at one of antiquated stations built in the 1960s or 1970s. I mentioned that it could set the industry back a decade, as we saw with Chernobyl. Unfortunately, Fukushima represents a massive setback for the industry and all talk of a nuclear renaissance has ceased.

The real fallout is that we are all paying considerably higher energy costs as a consequence. The change in attitudes towards nuclear power, which is efficient, green and responsible for fewer deaths than even wind farms or solar (Search the Archive for deaths), also accelerated the building of vastly expensive, inefficient and noisy wind farms.
http://www.fullermoney.com/x/search.html?op=sch&txt=deaths&c=on&a=on&f=on&m=on&phrase=on

What irony for the eco warriors that wind and solar are such unreliable sources of fuel that they have to be backed up by additional and fully operable coal or gas power stations. This alone should revive interest in nuclear power throughout the west, but perhaps not until we see what China achieves with the many reactors it is building.

Meanwhile, I fear that investors in nuclear will have to be very patient over the next few years and many of the primarily uranium miners are likely to require additional capital.

**Rob McEwen interviewed by The Gold Report –** My thanks to a subscriber for this interesting interview. Here is a sample: http://www.theaureport.com/pub/na/10635

**TGR:** Are there any other topics you've been thinking about that might interests our readers?

**RM:** Right now we are looking at debt: the U.S. debt ceiling debate and the debt of sovereign states in Europe. I think any correction should be used as a time to accumulate.

The quiet summer is a good time to stake out the juniors and intermediates and take positions. We've seen periods like this where physical gold and the gold shares separate in terms of performance. In September 1979, which was just before the top in the gold price, gold went from $200 to $400/oz. in the space of a little over four months, but the gold stocks didn't follow. It was as if the market didn't believe the price of gold would hold up there. It wasn't until September 1980 that gold stocks reached their highs. I believe that the market had to see the impact of the higher gold price on the cash flow and earnings before they would buy the stocks.

I think we're in that period right now. I would argue that we are starting to see the seniors move—Barrick has been moving today with the gold price. These are incredible cash-flow generators right now. They are going to have to do something with their earnings, dividend them out or up their yields.

They also are going to look for growth. Barrick surprised everyone by buying a copper project, with cash. That was a curveball. I think they went into copper believing it was a better cash flow and cheaper than buying a gold property. Barrick is diversifying because they see opportunities. The seniors are doing deals to build the size of their companies, and that's positive for the intermediates and the juniors. The seniors have been reaching right over the intermediates into the junior–producer/junior–explorer side. The longer this gap exists, the more attractive the juniors and intermediates will become.

**My view –** This is an informative interview because Rob McEwen is certainly an experienced and very successful player in the gold and silver mining industry. Much more important than the headline and opening targets, which are obviously conjecture, are his recollections on the relative performance of miners compared to bullion.

I remember being pleasantly surprised in seeing leading gold miners move to new highs following bullion's climactic peak in January 1980, and I would not be surprised to see it happen again in this cycle.

Meanwhile, the NYSE Arca Gold Bugs Index (monthly, weekly & daily) remains very steady in its range relative despite the recent and fierce headwind from global stock markets.