Gartman

The Gartman Letter

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SEARS? SUDDENLY A HIGH-FLYER? Sears... the most prosaic of the prosaic... had a "melt-up" last week! Why?!

CREDIT SUISSE ASSET MGT (CIK): As in so many of the bond funds disaster has struck in the past several days. Something is amiss and attention must be paid.

OVERNIGHT NEWS:

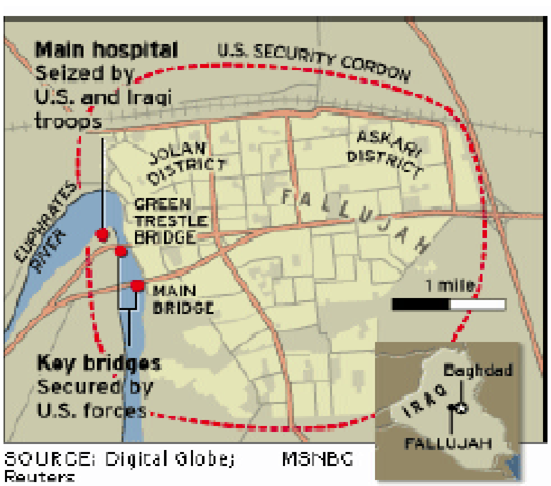
☑**THE DOLLAR IS A BIT LESS "BRUTAL"** than it was yesterday and on Friday, following rather overt rhetorical intervention by ECB President Trichet yesterday. In the past several days, Mr. Trichet has consistently ramped up his language to protest the dollar's weakness. Last Thursday he said that "excess volatility and disorderly moves in exchange markets are not desirable." The dollar paid little heed to his statement then, and so he was quite literally forced to increase the level of his rhetoric. Yesterday he said that *"the recent moves, which tend to be brutal on the exchange markets between the EUR and the U.S. dollar, are not welcome from the stand point of the ECB, full stop."* The EUR "fully stopped" just beneath 1.3000 following Trichet's vocal stand. No one should be too surprised by that circumstance, nor should we be surprised by Trichet's verbal intervention efforts. It is the duty of a central banker to try to stem what he and other perceive to be "excessive" or untoward movements on the forex markets, and if that excessive one-way movement can be stemmed for a day or two merely through the expenditure of words, not real capital, then all the better.

Mr. Trichet has been joined in his "verbal intervention" efforts by Japan's Finance Minister, Mr. Sadakazu Tanigaki, who said earlier today in Japan that "when the markets do not reflect fundamentals, we will act resolutely." Thus far, the MOF has not asked the BOJ to intervene in the dollar's favour, nor have there been any reports of the MOF "checking" rates in preparation for overt intervention, but clearly the authorities are warning market participants that a too-aggressive stance will warrant punishment:.

Mkt	**11/09 Current**	**11/08 Prev**	**US$Change**	
¥	105.85	105.45	+ .40	Yen
Euro	1.2900	1.2955	+ .55	Cents
SFr	1.1835	1.1785	+ .50	Centimes
£	1.8555	1.8565	+ .10	Dollars
C $	1.1945	1.1955	- .10	Cents
A $	.7565	.7610	+ .45	Cents
NZ$	.6925	.6950	+ .25	Cents
Peso	11.420	11.365	+ .55	Centavos
Braz Rl	2.8350	2.8180	+ 1.70	Reais
Ruble	28.64	28.68	- .04	Rubles
]Yuan	8.2764	8.2765	- .01	Renminbi

As of 10:00 GMT

As the US dollar has weakened, it has fallen perhaps most dramatically relative to the Canadian dollar. We can recall two and three years ago when we said in speech after speech to Canadian, European and American audiences that the C$/US$ rate would trade to parity again in our lifetime and our statement was met with abject disdain and derision. That is no longer true. No one is now laughing. However, at 1.1935, the trade has come far too far and done so far too quickly.



A MAP OF FALLUJAH:

US Army and Marine Units, along with Iraqi Army units, have cordoned off Fallujah on all sides. The Marines and Army are advancing from the north to the south in the city. Iraqi nationals have taken control of the railway station, and all the brides and roads into and out of the city have been secured. One by one the houses in the city will be searched and the terrorists fighting there will eventually either surrender or will be killed. It is brutal of course, but so was the "rebels" terrorising of the cities civilian population.

The Bank of Canada has created its own problems with its too-swiftly-strong dollar, following the comments by Mr. Dodge, the Governor of the Bank of Canada, last week. He said, when queried of the C$'s ascent at a meeting of the BIS last week in Basel, Switzerland that "*We have no target for the dollar... Exports have strengthened,,,even though domestic demand was strong, net exports have made a major contribution to growth.*" This was tacit approval from the BOC to Canadian businessmen and speculators to fear (on the part of the former) and to enjoy (on the part of the latter) the continued trend in the C$'s favour. We'll watch.

☑**COMMODITY PRICES HAVE FALLEN A BIT** and as is so often the case given the sizeable weighting of the energy markets into the various indices, it was weakness in nat-gas and crude that has taken the DJ-AIG Index 0.7% lower. The index is now down a rather material 2.8% for the month-to-date, with "natty" down 13.7% and crude down 4.7%. Again, given energy's weighting, it is difficult, if not wholly impossible, for the Index to be anything other than materially lower.

The corn and soyabean harvests are almost done, with perhaps 75-80% of the corn harvest finished. However, the crop here in the US is so large this year that with 20-25% of the crop still in the field that leaves something on the order of 2.6-2.8 billion bushels. This has been an extra-ordinary year for grain production, and the USDA is going to inform us just how extra-ordinary it has been with another crop report later this week... on Friday, the 12th.. We've no doubt, however, but that both the corn and soyabean crops have gotten larger, not smaller, and that the demand for storage will be enormous, pushing the carrying charges out continuously. Remember that in the October crop report the USDA said that US farmers were going to produce 11.6 billion bushels of corn. We shall not be surprised to see that edge toward 11.7 billion bushels. This shall compared to last year's 10.114 billion bushel crop. The corn carry-out was expected to be 1.69 billion bushels, up from the previous 1.21 billion, and we fully expect that to rise to 1.7 billion:

	11/09	11/08		
Gold	432.20	433.10	-	.90
Silver	7.41	7.47	-	.06
Palladium	211.00	211.00	unch	
Platinum	845.00	847.00	-	2.00
Gld/Slvr Ratio .	58.32	57.98	+	.34
DJ-AIG Comm Index	151.13	152.27	-	.7%

Regarding the precious metals, with the US dollar stabilising and with energy prices weak, it is of little wonder that gold prices are stable too. We remain bullish of gold, via gold shares, as we have for quite some while, but we shall admit that we are a bit dismayed or concerned that gold shares have tended on balance to lag bullion. Normally we expect shares to out-perform bullion in a bull market, so this "divergence" is some reason for modest concern on our part. We are not concerned enough to warrant moving to the sidelines, but we are concerned enough to suggest selling a call or two against our gold shares. Certainly we'd not argue with those who do so... even those who do so aggressively.

Perhaps the recent relative weakness of gold shares vs. bullion reflects the growing importance of the bullion ETFs. Investors in Australia and the UK have accumulated 58 tonnes of gold in the trusts traded there respectively. That is an increase of 25% in the last two months, and that we think is material. Investors now hold the largest amount of gold held in trust since the listing of Gold Bullion Securities on the Australian Stock Exchange in March 2003 and the London Stock Exchange in December 2003. That may be indicative of strong demand, but we are also cognisant of the fact that both of those times were previous market highs for bullion. The public's propensity to buy the highs is always a major concern for us, and it is here again.

Further, we note that several of the better gold mining companies are entering the capital markets to take advantage of the public's demand for gold related securities. Placer Dome and Barrick were "in" the market yesterday, and smaller mines are preparing to follow. The trend for gold remains upward, but when the public wants in aggressively, we are usually best served to "allow" them entrance by selling a bit to them. Call writing may be sufficient.

☑**ENERGY PRICES ARE AGAIN WEAK** and we note that the WTI has gone to a contango Dec vs. Jan and that December seems to be heading toward a contango vs. February too, as supplies of crude here in the US are suddenly quite large and crude is now "bidding for storage." Last week, crude inventories in the US rose 6.3 million barrels, and the SPR continued toward finally being topped off. When this weeks' crude inventories are reported tomorrow, we suspect that another 2-3 million barrels of crude will be added to the nation's inventories. Further, given the relatively mild temperatures prevailing in the east and the midwest, demand for heating oil has been a bit below the historical trend, adding to the current bearishness.

We note that the Indian government, which still tends to purchase its national requirements in socialist, central planning style, is making a very large "bet" that crude oil prices are going to weaken materially. It has done so by "freezing" the retail price of petroleum products while remaining exposed to prices of the crude it shall need for refining. The Congress Party has made it clear that it will do what it must and what it can to avoid increasing the price of crude products (gasoline and kerosene) to its constituents. As one economist there in Delhi said in an interview last week with The Financial Times of London, *the government's oil price strategy consists of praying that oil prices fall after the US presidential election. This may not be a very sensible bet.*

We have always admired Indian understatement; we admire this statement most of all.

Dec WTI	**down**	**20**	**49.12-17**
Jan WTI	**down**	**13**	**49.20-25**
Feb WTI	**down**	**7**	**49.12-17**
Mar WTI	**down**	**4**	**48.78-83**

OPEC's Crude basket (11/04) $40.53
Henry Hub Nat Gas $6.74/MMBtu
NYMEX Coal (ton) $59.50

Finally, and we have heard very little in the capital markets discuss this situation, a large tanker (the Tropic Brilliance) ran aground in the Suez Canal near Islamaiiya, to the northwest of Cairo, over this past weekend The tanker, a rather large double hulled tanker, carrying we are told approximately 84,000 tonnes of crude oil [Ed. Note: We use the ratio of 7.34 barrels of Gulf crude/tonne, so in this case we are taking about 616,000 barrels of crude oil.] has backed up traffic in the Suez for at least seven days, creating a shortage of crude in the very near term. According to the reports we've gotten, there are 135 ships now in the Suez that will be put on hold, awaiting the "un-grounding" of the Tropic Brilliance. More ships, that might have headed for the Suez, shall have to make the decision to wait in the Red Sea if they were there heading north or to wait in the Mediterranean if they were in transit there to the south and on to the Persian Gulf.

At last report the shipowners have emptied the ship's cargo into the tanks of another ship sufficiently to float the tanker. It is to be towed later today to a port at the south end of the Canal. Once the ship is towed, it shall take a day or two to make certain that the Canal is clear and capable of carrying new traffic. Then the process of clearing the vessel back-up shall begin.

☑**SHARES PRICES ARE VERY LITTLE CHANGED** in broad, global terms, and considering the strength in recent sessions, a day or two of consolidation is much needed, and much appreciated. Certainly we are glad not to be net short of US shares. The question before us is how to become long of them instead, for the market is clearly aware that the FOMC will move to raise rates tomorrow when it meets, and the market cares bearishly not a whit. What then if the FOMC should surprise us all and chose to do nothing (a circumstance we think utterly unlikely, but at least worth mentioning in passing)?:

Dow Indus	up	3	US$	10,391
CanSP/TSX	down	43	C$	8,826
FTSE	down	23	Stlg	4,717
CAC	down	4	Ffr	3,777
DAX	up	5	Dmk	4,069
Nikkei	down	19	Yen	10,965
HKong	down	11	HK$	13,513
Aus SP/ASX	up	14	A$	3,836
Taiwan	up	8	NT$	5,945
NZ 40	up	8	NZ$	2,889
TGL INDEX	**down**	**4**	**-.1%**	**5,906**

We have been actively involved in the "Long Asia" short Europe and N. America trade for a year. Comparing prices today vs. those of July 9th, we note that Aussie and "Kiwi" shares are up, on average, 7.5%, while shares in N. America and continental Europe are up on average 3.3%. For a "pairs" trade, this is not immaterial. Further, using the various i-shares available, we are paid a higher return in the form of dividends on what we are long than we are to pay out in the form of dividends on what we are short. Rarely are we paid to trade; in this instance clearly we are.

Finally, it is more than merely passing strange that some of the most prosaic of prosaic shares here in the US exploded to the upside late last week. Why, we wonder, did Sears explode to the upside. What has changed so dramatically in the way of Sear's business model that would account for a massive rally such as seen on Friday? Too, we understand that US Steel has been, on balance, one of the stronger shares traded, but why the explosion to the upside on Friday also? And perhaps even more importantly, what has happened to the shares of the various bond funds, all of which have fallen materially in the course of the past week. One after another of the corporate or government or international bond funds have broken very well defined up trends. Not to pay attention and wonder why this is happening is folly of the first order. Are the hedge funds so short of various shares and so long of the bond funds that the former may virtually "melt up" while the latter "melt down?" Have prosaic equities fully discounted the Fed's move tomorrow to raise rates, while the bond funds have not?

☑**ON THE POLITICAL FRONT** before we go on to discuss other concerns, we want to make certain that everyone understands our position on **French actions in the Cote d'Ivoire** over the past several days. We believe France has acted quite properly, moving swiftly to try to secure its citizens and doing what it must to destroy the military capabilities of both the rebels and the government there. Whether the UN approves of the actions, or disapproves, French life and property were at risk and it is France's right to defend both... pre-emptively if it must.

Turning then to **Fallujah** and **the US/Iraqi offensive** against the Islamic fundamentalists there, we note that Prime Minister Allawi minced no words when he gave the order to begin the assault. He said simply and forcefully that

I gave my authority to the multinational forces [and] Iraqi forces. We are determined to clean Fallujah of the Terrorists. I have no other choice but to restore to extreme measures to protect the Iraqi people from these killers and to liberate the residents of Fallujah so they can return to their homes.

This will send a very powerful message that we are serious. We want to secure the country so elections can be done in a peaceful way and the Iraqi people can participate in the elections freely, without the intimidation by terrorists and forces who are trying to wreck the political process in Iraq.

As the map at the bottom of p.1 shows, the "rebels" have been cordoned off, and their escape routes out of Fallujah have been closed. They've no choice other than to surrender or be killed. The situation has become that simple.

GENERAL COMMENTS ON THE CAPITAL MARKETS

☑**ON REDUCED GULF CRUDE OIL DEPENDENCE:** We are constantly amused by the fact that if one thousand US citizens were asked to name the largest supplier of crude to the US, 950 or more would say, without hesitation, Saudi Arabia. These 950 would be very, very wrong. This is, of course, a bit of a trick question, for the answer that the US is the US' largest supplier of crude; it always has been, and during our lifetime it likely shall continue to be.

This trick question then having been answered, if asked which country other than the US is the largest supplier of crude to the US, 990 would now answer, readily, "Saudi Arabia." They would again be wrong, for Saudi Arabia is but the 4th largest supplier of crude to the US, presently sending approximately 1.3 million barrels of crude/day here. According to Intertanko, the International Association of Independent Tanker Owners, for the first half of this year, Mexico was the largest exporter of crude to the US, sending us approximately 1.5 million bpd. Canada was 2nd, sending 1.44 million bpd, and Venezuela was 3rd, sending us 1.34 million bpd. Gulf dependence is a thing of the past, and likely never to be a problem again for the US. The question shall be whether it is Mexico or Canada that is the largest consistent supplier of crude. S, Arabia's time has passed.

☑**ON LAWYERS, COCKROACHES AND ADVERTISING:** There is, as we all know all too well, never one cockroach. Where we see one, we know there are hundreds. As we have applied the rule to trading, whenever there is a problem reported by a company, we can rest reasonably assured that there are more to follow. For example, when Jeff Skilling resigned his post at Enron "for family reasons" only six months after being elevated to the role of CEO, it was reasonable to assume that the real reasons were obviously not familial.

This brings us to Merck and the stunning abundance of advertisements by attorneys now advertising everywhere here in the US for plaintiffs to take the company to task for its drug VIOXX. We have no idea how large shall be Merck's eventual losses when the lawyers of the US are done with the company, but we can rest reasonably assured that the losses will be in the billions.... if not tens of billions. Already we've seen Sanford Bernstein & Company estimate that the losses will be $12 billion. Merril Lynch is now forecasting that the losses could be $17.6 billion. We fear that when the smoke has cleared several years...many, many years into the future... adding both together will be too small. We have seen this sort of thing before, and once the ball begins rolling it is a gravely train too large to avoid.

In the past three weeks we have noticed one attorney's office after another here in Tidewater, Virginia advertising for plaintiffs against Merck and VIOXX. They populate the late night television; they populate the signs along the highways; they are appearing on mailers and they are just beginning. There is never just one cockroach. Remember that when the urge to buy Merck shall tempt you in the future.

RECOMMENDATIONS:

1. Long of Five Units of Asian Shares; Short of Five Units of European or N. American shares: The last "unit" of the trade we put on is against us a bit following the sharp rally in US shares last week; however, the entire trade is still immensely profitable and so we shall sit tight a while longer.

2. Long of Three Units of Gold via shares: We've said we'll add to the position when the EUR traded through 1.2850 and spot gold took out resistance at $430-432. Both have come to fruition but "*the room is a bit crowded*" and **calls can be sold against the shares we own to reduce our exposure modestly**.

3. Long of Two Units of Silver/short of Two Units of Gold (short of the Gold/Silver Ratio): We have this on at 60:1 and we see it making its way into the low 50's over the next several months. Our stop is at 62.00:1. and should it close above that we will exit the position without hesitation.

4. Long of Two Units of the EUR and One Unit of the Yen vs. the US dollar: This is a rather sizeable net short position in the US dollar and it is now rather nicely profitable, but **cutting the EUR position by half seems reasonable... upon receipt.**.

5. Long of One Unit of Gold/short of One Unit of Crude oil: A short while ago, we bought gold and sold crude short. This morning, as the ratio trades 8.8:1, we are nicely ahead on this initial trade. We look to add to it; we just don't know when.

6. Long of One Unit of nearby WTI crude: As noted here on Friday, we "punted" crude, buying it into weakness at or near to $48.75. We've placed stops (on a closing basis) at $47.90, and we'll not likely add to the position until $51.00 is broken to the upside.

Good Luck and Good Trading, Dennis Gartman