BUT THE OPERATION WAS A SUCCESS, DOCTOR ! HOWEVER, THE PATIENT IS NO LONGER WITH US

The lack of adequate corporate profits – in many cases, it is the complete lack of corporate profits – is preventing, and will continue to prevent, a rebound in the price of equities.

The US leads the way, as always; Asia follows.

The Interim Report of The Bank of East Asia Ltd (Code: 23, Main Board, The Stock Exchange of Hongkong Ltd) is a just one small example of what one may expect in the weeks and months ahead.

The Bank of East Asia announced, last week, that its first half Net Profits Attributable to Shareholders, to June 30, 2002, were off by about 22.30 percent, Year-on-Year, to about $HK786.60 million.

That result compared unfavourably with the like period in 2001 when the Net Profits Attributable to Shareholders were about $HK1.01 billion.

Provisions for Bad and Doubtful Debts and Write-Off of some non-performing loans was, of course, the reason for the poor results of Chairman David Li Kwok Po's bank, which happens to be the largest solely, Hongkong Special Administrative Region (HKSAR) bank.

Other banks of the HKSAR are quite likely to follow the lead of The Bank of East Asia.

The quality of corporate credit among companies of any material size is poor due, in part, to the size of debt loads, with little to no chance of servicing the debt, let alone repayment of principal.

Such companies have to refinance, periodically, creating various debt instruments in order to roll over financial commitments in the hope that, at the end of the day, things will come right.

In many cases, as managements of such enterprises will discover in the fullness of time, things will not come right; and, the pigeons will come home to roost.

The health of the US economy is waning; many domestic corporations' foundations are shaky: Progressive collapse is quite possible in a number of cases.

One has seen, over the past few months, one multinational after another fall from grace.

Others, yet unnamed, are bound to follow.

Under such conditions, how can one expect a return of the investor to equity markets?

In which company can one know, with any degree of certainty, that the public company into which one buys shares is one which one may reasonably expect its profit and loss account to reflect a true and fair view of the state of the company?

At the same time, in which company may one have faith in management?

It would appear that any and all companies, today, might be held as being very highly suspect, be they multi-billion-dollar companies or the clock, watch and leather trading company.

Last week saw the US-based telecommunications company, Qwest Communications International Incorporated, make history when its Management announced that it was guilty of padding the books.

Qwest is a dominant telephone operator in 14 states of the US; it is, now, under investigation by the US Department of Justice.

The Denver, Colorado, company said that it improperly accounted for about $US1.16 billion in sales of optical capacity on its network. The company will, now, restate its Bottom Lines for the Financial Years, 1999, 2000, and 2001.

Qwest has debts of about $US26.50 billion.

Investors must be concerned about their investments; and, they will refrain from making any further major commitments, at this point.

In the HKSAR, recently, one saw the flotation of CK Life Sciences International (Holdings) Incorporated (Code: 8222, The Growth Enterprise Market of The Stock Exchange of Hongkong Ltd).

That flotation was a failure from the standpoint of nearly all prospective investors of the HKSAR since, after all the hullabaloo and hype, the only people/entities that made a profit from the flotation were the promoters, the brokers, the bankers, the accountants, the underwriters, the advisors and, of course, Mr Li Ka Shing, who was able to float off his loss-maker.

Those investors, who applied for shares in this company, lost money, as the share price of CK Life Sciences never rose to a point that they could come out with a profit.

And, today, the share price has fallen way below the Offer Price of $HK2 per share.

Looking At The Larger Picture

One of the problems in the US, today, is that the depreciating value of the US dollar is having a mixed effect on the country's industries.

Certain segments of the US economy will, undoubtedly, benefit from a US dollar that is worth less than it was a year ago in terms of the Japanese yen, the euro, and other currencies of the country's major trading partners.

When the US dollar was fetching more yen, more euros, etc, it caused distortions in the economy of the strongest nation of the world.

US exports were restrained because US-made goods and services were just not sufficiently competitive on the world's stage; and, that, in itself, fanned global competition, exacerbating an already difficult situation within the US.

A strong US dollar meant that many US multinationals had to pack up shop in Continental US and move operations, offshore, or cease operations, completely.

The resultant effect of all this, of course, was to see under-investment in certain, US-based industries.

However, with a depreciating US dollar vis-à-vis other *'hard'* currencies, it should come to mean that US multinationals would be able to bag higher profits due to their cheaper manufacturing bases, being outside Continental US, because the quality of their products is, still, of a quite high standard, relative, let us say, to similarly made goods, produced in Viet Nam, Cambodia, or such underdeveloped countries.

In any event, US multinationals earn a large proportion of their profits from foreign sales, not domestic consumption of their goods and services.

The US Department of Labour's statistics, released last week, paint a picture of economic stagnation.

The economy, one could say, has stalled.

The job growth for the month of June rose by 6,000 vacancies, having been filled, while, at the same time, the total number of hours worked, dropped by about 0.60 percent, during that month.

The unemployment rate in the US remains at about 5.90 percent.

The average workweek fell to about 34 hours, which is the lowest level since October 2001.

Since May, this year, the number of new jobs that were created in the US was about 94,000.

In the like period in 2001, about 1.60 million jobs had been lost.

That means that a large number of people are still, pounding pavements in the US, looking for employment.

In the month of July, manufacturers in the US continued to reduce workforces, sacking about 7,000 workers.

Construction companies cut 30,000 workers in July, The Labour Department said.

There is an old adage that states that a market that cannot rise must fall.

That adage could well be extended to include an economy, even a large one such as that of the US.

On the US home front, the housing market, which had been the one saving graces of the economy, is showing signs of being very tired.

However, favourable interest rates and low inflation continue to support the building of new houses because there are, still, ready buyers for the completed units.

The housing market in the US continues to provide strong support for the economy.

While existing home sales continue at near record levels, with price gains of completed units, continuing to be attractive, there is some question as to how long such a boomlet can continue.

The 30-year, fixed mortgage rate is at a near record low, but such a situation cannot continue, indefinitely.

If there should be a rapid deterioration in this industry, it will not just be the builders who will get hurt, but, also, the mortgage bankers, the secondary lenders, the building materials suppliers, the home-furnishing suppliers … and right down the line to the manufacturers of paint to the manufacturers of toilet bowls.

The low housing inventory levels of today are encouraging many builders to start up new projects, some projects, being extremely large.

But the morrow will come.

According to TARGET's information, many HKSAR companies, engaged in the manufacture of such items as fire-resistant door sets, kitchen cabinets and the like, are looking at full order books and are unable to increase production fast enough to meet demand from US importers.

In some cases, TARGET has noted that a handful of customers has accounted for a large proportion of orders at certain factories, operating in the People's Republic of China (PRC), but whose beneficial ownership are multi-faceted corporations, operating out of the HKSAR.

If just one of these US customers should cancel some of its orders, orders of materiality, that is, it could result in losses for some of these factories, which would be left with inventories that cannot be moved in a hurry.

Cash-flow squeezes will ensue.

It is known that the US Federal Reserve Board is, now, studying risk scenarios, studying countermeasures in detail.

Antideflation steps could well include an expansion of fiscal spending and a further easing of credit … and encouraging the US dollar to sink even lower against other *'hard'* currencies.

Earlier this year, many international banks thought that the second half of this year would see a return of the investor to stock-market trading floors as the economy picked up.

That scenario, now, looks unlikely to materialise.

In spite of some sporadic good economic news, emanating from US economic departments, such as the US Bureau of Economic Analysis, the Commerce Department, The Labour Department, etc, there are just too many negatives to make one think that the situation can be turned in a short space of time.

Meanwhile, the US patient continues to feel the pain – and there is no known economic operative procedure, available to him.

-- E N D --