YOU AND YOUR MONEY : STRAIGHT TALKING

Soon after the current bear market took hold in 2000, it was common to turn on one's television set and to see a New York stockbroker, talking from the trading floor, state with a great deal of conviction:

> *'Yes, now is the time to buy stocks and shares because prices have fallen more than 20 percent from their highs; and, the prospects of* (this company or that company) *are excellent. PEs* (Price-Earnings Ratios) *have fallen to very tempting levels, and dividend yields suggest that it is time to reinvest. The charts indicate that there will be no double-dip scenario; and, the US economy will turn on a dime – it, always, does. Yes, I would say to my clients: Buy now, and benefit in the next 6 months.'*

Well, Qwest Communications International Incorporated, Nortel Networks Incorporated, Enron Corporation and WorldCom Incorporated later, and with hundreds of billions of investors' money, flushed down the plughole, and that same stock-market guru looked a little peaked around the gills.

Because he, and his ilk, was, totally and completely, wrong, as were all of the other purveyors of such inane rubbish.

The above comments of TARGET are not a matter of sour grapes, although they might, at first, smack of such: It is, simply put, that such utterances represent misleading statements, aimed at the investing public in the hope of seducing them to buy into equities.

All that those stock-market jockeys wanted to do – and, still, want to do – was to churn accounts: Yours and anybody else's.

That is the way that these people can make a buck – from your losses.

Mental orgasms were all that they were selling.

And many investors, sadly, listened to these legal confidence tricksters … and rued the day that they did.

But, today, would it be correct for one to look at the price of this company, or that company, and try to ascertain whether or not it is the correct time to buy their shares?

The fact, that the chairman of a public company and/or his key men in Management make a display of the fact that they are buying up more shares in the company that they control, does not mean that the share price of that company will not fall lower, or that the company's profits will rise in the near future.

After all, the share price of Cheung Kong (Holdings) Ltd (Code: 1, Main Board, The Stock Exchange of Hongkong Ltd) has fallen from its February 2000 high of $HK120 to today's price of about $HK50.

The share price of Nortel Networks Incorporated of Canada (New York Stock Exchange, Code: NT), during that same time period, has fallen from its 2000 high of about $US136 to its present level of about $US1.

And, in the case of this manufacturer of telecommunication networking equipment, there have been suggestions that it might consider seeking the protection of the Court in order to keep its creditors at bay.

The price of the shares of Citigroup Incorporated (New York Stock Exchange Code: CI) is, now, standing at about $US23, down from its 2002 high of $US49 – which is a 53-percent fall in a period of less than 10 months.

Tempting?

Another tragic example of a company, which is a competitor of Nortel Networks and which is still trading on The New York Stock Exchange, as opposed to Nortel Networks's NASDAQ listing, is Lucent Technologies Incorporated (New York Stock Exchange Code: LU).

Its share price has fallen from a 1999 high of about $US68 to today's price of about $US1.

Tempting?

The credit worthiness of Nortel Networks and Lucent Technologies was, just last Friday, called into question by Moody's Investors Service, which rated the 2 companies' debts – $US7 billion for Lucent Technologies and about $US5 billion for Nortel Networks – as being nothing better than *'junk'*.

Moody's suggested that the companies could be running out of cash.

Moody's, also, said that the outlook for these companies remains *'negative'*.

Even those corporations, which have not yet been found to have indulged in any skullduggery, at all, such as Cisco Systems Incorporated (New York Stock Exchange Code: CSCO), are hurting.

Cisco Systems's share price has fallen from $US80, its May 2000 level, to about $US10, today.

Tempting?

The suggestions that some stockbrokers may try to employ in order to promulgate their type of logic in trying to persuade prospective investors to get their feet wet, by buying stocks and shares on The New York Stock Exchange, The Toronto Stock Exchange, The Tokyo Stock Exchange or The Stock Exchange of Hongkong Ltd is that, in view of the falls in equity prices, today is the best time to pick the ripe fruit off the trees, those trees, growing in Manhattan, New York, Bay Street, Toronto, Downtown Tokyo, or Exchange Square, the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC).

But TARGET states, categorically, that it does not follow that, just because a company's stock/share price has fallen from one, very high level to today's seemingly low level that it is within buying range.

Because it could well fall another 50 percent, or more, before it is really worthy of one's attention.

Just look at what has happened to Citigroup in the past 10 months or so.

As TARGET has written, many times before, timing is everything in life, while averaging out is a good way to go broke.

<u>Concepts and Conceptualisations</u>

The prolonged bear market, which started in the year 2000, has seen the Standards and Poors in the US fall by about 46 percent, while the world's largest trading nation, Germany, has seen its Frankfurt DAX Index shed more than 66 percent.

However, huge share-price *'corrections'* are no guarantee that the present levels represent fair or reasonable valuations.

Prior to 2000, many companies appeared to be proud to announce that they would not be in a position to recommend dividends in the foreseeable future because the companies needed a great deal of money for expansion.

The Chairman of City Telecom (Hongkong) Ltd (Code: 1137, Main Board, The Stock Exchange of Hongkong Ltd), Mr Ricky Wong Wai Kay, told TARGET, in the latter part of 2000, that his company would, definitely, not make any increase in its profits for the next year or so, and that there was no chance of investors, getting any dividends in the foreseeable future.

He appeared to be proud of his company's negative prospects.

He told TARGET of the $HK50 million that City Telecom would be spending on establishing a competitor to CNN.

Chairman Wong was correct insofar as his company has never paid a dividend since the 1999 Financial Year, and the company's Results, in real terms, that is from continuing operations, fell, in 2000, to a negative $HK130 million – as predicted by the Chairman.

Today, yields have become important to prospective shareholders, unlike days of yore when such considerations were not thought to be a determinant in considering a foray into a company's shares.

UBS Private Banking, in one of its recent publications, deals briefly with the valuation of equity markets and dividend yields.

UBS makes these statements:

> *'A comparison of the yield on stocks – corporate earnings as a percent of market prices – with bond yields provides a first indication of valuation. In the US as well as in Europe the average earnings yield has increased to about 6%, whereas government bond yields have fallen far below these levels. The ratio of bond yields to earnings yields is now significantly below the 10 year average, indicating attractive equity market valuations relative to bonds.*
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> *'A more nuanced answer is provided by a dividend discount model (DDM). Here we calculate a fair price for equities as the present value of expected future dividends. The result of the model depends on the assumptions regarding future earnings growth and the discount rate. Essentially, the higher the future earnings to finance dividends, the more attractive the equity market, the higher the discount rate, the less attractive the market. The discount rate typically includes a risk premium, the extra return investors demand from stocks over bonds.*
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> *'If we use our base case assumptions, the DDM results are in line with the simple yield comparison: the US equity market is undervalued by about 14% assuming average earnings growth of 5% in the next 2 years and a 3.5% risk premium. Even without earnings growth, the market remains undervalued. However, if a recession were accompanied by falling earnings and a sustained rise in the risk premium – as investors become more risk-averse due to dire economic circumstances – the DDM would indicate overvaluation. It is our view, however, that neither the US nor the world economy will slide back into recession. Equity markets thus appear undervalued and offer attractive long term returns.*
> *'This does not imply an immediate recovery in equity markets. If fears over the global economy and security become more virulent, the risk premium demanded on stocks could temporarily rise further, adding to pressure on equity markets. Just as markets overshot in the late 1990s they may continue to undershoot their fair value in the next months. However, once the economy normalizes, the risk premium will decline and lead equity markets higher.'*

While TARGET may not subscribe to all that UBS states, the bank does make some interesting points, and those statements are, after all, an attempt to ascertain when one should dive back into equity markets.

The War With Iraq

TARGET maintains that war between Iraq and US – and/or with a coalition, under the auspices of the United Nations – is an odds-on favourite.

When the fighting starts, all bets are off, of course.

Then, the question will be:

1. How long will the fighting last?

2. How much will the war cost?

3. How much will be the cost of reconstruction of the country?

There is the story of a very elderly Jewish member of the Knesset – the unicameral parliament of Israel – who, on hearing a proposal in the Knesset to issue a Declaration of War against the US in order to lose the war and, then, to have the victor (the US) rebuild the Israeli economic infrastructure with American money, thus resurrecting the sick economy of this Jewish State – asked the pointed question: *'But, Mr Speaker, vat happens if ve should vin the var?'*

In order to stabilise the situation in the Middle East after beating the pants off the Regime of Saddam Hussein of Iraq, the US Government is going to have to spend tens of billions of US dollars in re-establishing a government of that rogue State, one that will be able to operate in an environment, free from jingoism, dictatorship, and free from the requirement to create weapons of mass destruction.

Saddam Hussein, the current President of Iraq, will either be assassinated or will be deposed and sent to the International Court at The Hague to stand trial for his past misdeeds, he, being largely responsible for numerous crimes against humanity.

For equity markets, war is never good: It tends to disrupt the flow of goods from one part of the world to another.

Nobody wins in a war.

How taxing will be the Iraqi conflict on the economy of the US remains to be seen, but it is a sure bet that it will be high.

Companies in the US that produce aircraft, battleships, guns, tanks, personnel carriers, research and development, etc for the military, will benefit, short-term and, perhaps, in the intermediate term, but such economic activity is unlikely that panacea for what ails the US economy.

That Federal defence spending will hot up in the coming few years, up to the year 2007, at least, has, already been published by the US Government.

What needs to be done in the US, however, is for workers to be rehired and for the factories to start, rolling out consumer products, with consumers, ready willing and able to purchase those products.

And that is not the case, today.

Utilisation of Plant Capacity

The US Government's Census Bureau reported, recently, that US domestic manufacturers used an estimated 64 percent of their full production capacity, during the fourth quarter of 2001.

For the like period in 2000, US domestic manufacturers used about 71 percent of their full production capacity.

For durable goods, companies, producing such goods, operated at a 9-percent lower rate than non-durable goods industries.

The full production utilisation rate for durable goods was about 61 percent, compared with 70 percent for non-durable goods industries.

The general definition of durable goods is those manufactured goods with a life expectancy of at least 3 years.

Industries with the lowest utilisation rates, the Census Bureau reported, were machinery manufacturing, at 54 percent, and leather and allied products manufacturing, at about 56 percent.

Among the industries with the highest utilisation rates were petroleum and coal products, at 80 percent, and paper manufacturers, at 76 percent.

The Census Bureau can be well believed because the Department's conclusions are based on information that has been collected from about 17,000 US manufacturing establishments.

Estimates are based on a response factor of about 75 percent of the survey.

The US economy is growing by about 3 percent per annum, but it is hardly holding onto those levels of growth.

Confidence is at a 9-year low (Please see last Wednesday's TARGET Intelligence Report, Volume IV, Number 205 – Second Story) and investors are not happy: They are driving stock and share prices to new lows.

Treasury bond sales are rising, even with yields of 4 percent per annum and below: Investors feel safe with bonds, which are viewed as being risk-free.

Corporate scandals continue to be unearthed and companies, such as Qwest Communications, continue to shake up markets as more and more worms crawl from under Management's rug.

The US Government's Bureau of Labour, just last Thursday, said that 5,000 more jobs were lost in the month of October, with the number of people, without any work, now standing at about 5.70 percent of the working population, up from the September figure of about 5.60 percent.

The number of registered, unemployed people in The Land of The Free and The Home of The Brave stands at about 8.21 million, the Bureau said.

Of course, that statistic does not include those people that did not register for unemployment insurance, for one reason or another.

From the Bureau of Economic Analysis, last Thursday, came the report with regard to motor-vehicle sales for the month of October.

And those statistics were frightening because of the importance that sales of this big-ticket item plays in the overall economy of the US.

According to this US Government department, sales of motor vehicles for the month to October 2 were about 15.40 million units, seasonally adjusted.

That represented a Month-on-Month reduction of about 5.52 percent.

Motor-car sales fell from the September figure of 7.90 million units to 7.30 million units, while light lorry sales dropped to 8.20 million units, down from the September figure of about 8.40 million units.

The party is over, to be sure.

Meanwhile, more and more international companies are firing staff in order to stay in the game.

Japan's giant electronics company, Hitachi Ltd, plans to axe one third of its subsidiaries, or about 300 companies, worldwide, in order to stay profitable.

That is going to mean that thousands of Hitachi workers will hit the streets, looking for alternate employment.

Japan's largest producer of personal computers has already said that thousands of its workers will be sacked in the course of next year, following that company's multi-billion dollar losses of the past few years.

Just last week, American Express sacked one in 8 of its Establishment in the HKSAR.

It is clear that financial services are under stress from weak business, and even weaker business prospects.

Poor consumer credit conditions do not augur well.

Inventory levels are building up, indicating that there are insufficient takers for the goods, which are, now, being warehoused, gathering rust and dust.

Continual erosion in business confidence has been seen over the past 6 months or so.

And, it is getting worse, not better.

Going forward, consumer spending cannot be expected to propel the US economy to higher levels, or even to maintain present levels.

And an economy that cannot move forward must slip backwards.

In short, there is little upside for the US economy, only downside.

And, if that is true for the US, it is doubly true for Asia.

Anybody want to buy stocks and shares, now?

However, as TARGET has stated, so many times, investors must act as the chameleon, crawling over a tartan rug: As the colours of the rug change, so does the skin colour of the reptile.

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