THE GAME'S NOT OVER, YET : HOLD ON TO YOUR UNDERPANTS !

It is very easy to say:

> *'Well, things are looking up on Wall Street so the worst must be over in the US economy.*
>
> *'Look at how the key indices on The New York Stock Exchange and the NASDAQ are moving to higher ground!'*

In fact, out of either fear or greed, one may start to think that, if one does not run, smartly, one may miss the investment bus on American equity markets.

The figures do look imposing, with the Dow Jones Industrial Average, having gained about 10.19 percent between October 4 and November 22, while NASDAQ's Composite Index has improved by 16.22 percent, during the same period of time.

TARGET's financial analyst says, however:

> *'Wait a little longer! There are many investment busses; and, another one will come along, in the fullness of time. That money will not burn a hole in your pocket.'*

What one has to remember, always, is that Wall Street, Bay Street, Thread Needle Street, and all the other streets, known internationally to be the centres of commerce and industry, enjoy a wolf-pack mentality: When one wolf yelps, all the other wolves yelp – without thinking.

William Somerset Maugham, an English novelist and playwright, always maintained that the crowd is, nearly always, wrong.

Porgy and Bess, a 1935 opera, written by Ira Gershwin, failed miserably at its debut in New York City, costing its promoters about $US70,000 in losses – which was a fortune, in those days.

The best 1935 critics claimed that Porgy and Bess was a hopeless piece of nonsense.

It was not until 1975 when the score of Porgy and Bess was rediscovered and the dust was blown off the historic manuscript, that the world came to know and appreciate the genius of this man, and of the beauty of this truly American opera.

But Ira Gershwin, throughout, stood steadfast, claiming that Porgy and Bess was among his best works.

Of course, he was correct.

If nothing else, the lesson to be learned from William Somerset Maugham and Ira Gershwin is that one should be resolute and unflappable.

Housing Starts

While The New York Stock Exchange continues its run-up, number crunchers in the US came to learn that one of the *'engines'* of the US economy was beginning to look a little tired.

Housing Starts, as they are known in the US Government, are the measure of residential construction in The Land of The Free and The Home of The Brave.

For some time, now, Housing Starts have been adding fuel to the rather sick US economy, keeping it motoring apace.

Last week, however, the US Bureau of Census, a branch of the US Government, announced that there had been an 11.44-percent drop in the number of new homes, having been built, during the month of October, compared with September's figures.

Seasonally adjusted, the October numbers came in at about 1.60 million units, down from the September figure of 1.81 million units.

In fact, the October figures were the lowest in the previous 6 months.

And the drop came in the wake of the lowest mortgage rates in the past 41 years.

The November figures will be very interesting to analyse because mortgage interest rates have been lowered even further, below the 6-percent level.

As interest rates fall, of course, there is a greater number of people, chasing a limited number of new houses, thus resulting in new house prices, rising even further.

Many new home-owners, seeing a quick buck, cash in if they have signed a Sales and Purchase Agreement, but have yet to take delivery.

Other home-owners, having, already, moved into their new home, cash in at the first available opportunity.

After all, a dollar is a dollar, isn't it?

These quick profits, have, in past months, been recycled, back into the economy, adding more fuel to it and providing disposable income to the lucky few, who were fortunate to earn a profit on the new housing boom.

Which is good, short-term, of course, but it is a vicious cycle that, eventually, has to be curtailed … and will be curtailed by natural market forces.

It is like the game of musical chairs: When the music stops, there must be somebody with no chair on which to sit.

For the past 8 months, prices of new homes have topped levels that were considered unimaginable just a few short years ago.

Today, it is said that inventories of new houses are equal to about 4 months – only.

This is continuing to encourage many builders to scurry down to their local bankers in order to get more cash: They want to finance more Housing Starts in the hope of making an even bigger killing.

The demand for single-family homes continues to be strong – 1.35 million units in October versus 1.45 million units in September, a 6.90-percentile point drop, Month-on-Month – and, in the past, the seeming strength in this sector of this industry had been one of the driving factors in the construction market.

It may be somewhat surprising to some people to see that the new house market in the US is as strong as it is, today.

Year-on-Year, the October figures are, still, a 4.70-percent increase, one must bear in mind, so that things are not yet, coming to an end.

The icing may have become a little thin on the new house *'cake'*, but families, who can see their way clear to keeping up the mortgage payments over the next 25 years or so, will continue to buy, or to trade up, whatever the case may be.

What is evident by the Census Bureau's statistics, however, is that residential construction has moderated and, in the second half of the year, its impact on the overall economy must have weakened.

As a direct consequence, the impact on the US economy from residential construction is likely to have waned, considerably.

There will, no doubt, be a knock-on effect, cascading right down the economic line.

As soon as interest rates start to reverse, and that must come, also, in the fullness of time, there is likely to be a veritable ocean of new homes – with few takers in sight.

When that time comes, home sales will fall out of bed, and new house prices will drop, smartly.

<u>The Conference Board</u>

The Conference Board describes itself as creating and disseminating knowledge about management and the marketplace in an effort to help businesses strengthen their performance and better serve society.

Working as a global, independent membership organisation in the public interest, The Conference Board conducts research, convenes conferences, makes forecasts, assesses trends, publishes information and analyses, and brings executives together in order to learn from one another.

Last Thursday, The Conference Board announced that the US leading Coincident Index and The Lagging Index held steady in October:

- Strong real money growth and lower unemployment claims in October offset weak consumer expectations and faster deliveries, as measured by vendor performance;
- The Coincident Index performance continues to suggest a recovering, yet fragile, economy. Industrial production has shed some of its gains from the first half of the year, and non-agricultural employment has, essentially, remained unchanged. Moderate growth in personal income and manufacturing and trade sales continue to sustain economic growth; and,
- Although the leading index has been flat, or declining, over the past 5 months, it is only 0.20 percent below its level of April this year.

Six indicators out of the 10 indicators that make up The Leading Index increased in October.

The positive contributors to The Index – beginning with the largest positive contributor – were real money supply, average weekly initial claims for unemployment insurance (inverted), manufacturers' new orders for non-defense capital goods, building permits, interest-rate spread, and manufacturers' new orders for consumer goods and materials.

The 4 negative contributors – from the largest negative contributor to the smallest negative contributor – were the index of consumer expectations, vendor performance, average weekly manufacturing hours, and stock prices.

The Leading Index now stands at 111.40 (1996=100).

Based on revised data, this Index decreased 0.40 percent in September and decreased 0.20 percent in August.

During the 6-month span through October, The Leading Index decreased 0.20 percent, with 6 components out of the 10 components, advancing (Diffusion Index, 6-month span equals 40 percent).

Two indicators out of the 4 indicators that make up The Coincident Index increased in October.

The larger contributor to The Index was personal income less transfer payments, followed by manufacturing and trade sales.

Industrial production decreased in October while employees on non-agricultural payrolls held steady.

The Coincident Index
Holding steady, The Coincident Index now stands at 115.10 (1996=100).

Based on revised data, this Index held steady in September and increased 0.10 percent in August.

During the 6-month period through October, The Coincident Index increased 0.60 percent.

The Lagging Index held steady at 100.00 (1996=100) in October.

Two components of the 7 components declined in October.

The negative contributors to The Index – beginning with the larger negative contributor –- were commercial and industrial loans outstanding and change in Consumer Price Index for services.

The positive contributors to The Index were average duration of unemployment, change in labour cost per unit of output, ratio of consumer instalment credit to personal income, and the ratio of manufacturing and trade inventories to sales.

The average prime rate charged by banks held steady in October.

Based on revised data, The Lagging Index decreased 0.50 percent in September and decreased 0.20 percent in August.

What The Conference Board Data Means

In short, the US economy is not moving … or not moving, very much.

The Conference Board's determinations – which must have been known to the US Federal Reserve Board, prior to its last meeting – probably prompted The Fed to lower interest rates to the present 41-year low.

What must, still, be worrying economists are:

1. The weak labour market;
2. The lack of new job creation;
3. The clear reluctance of industry to upgrade and/or expand production;
4. The faltering pace of manufacturing activity; and,
5. The obvious lack of consumer confidence.

And, lingering in the background, of course, is the distinct probability of the United Nations/United States, going to war with Iraq.

The chances are that the UN's weapons inspectors will discover either very little in the way of weapons of mass destruction, or nothing, at all, during their investigations of that Middle Eastern country.

After all, if Iraq thought that there was one chance in a zillion that the weapons inspectors would be able to find anything, they would never have been allowed into the country in the first place.

President Saddam Hussein of Iraq will state, categorically, that Iraq has no weapons of mass destruction.

Of course, that will be his stand, the same one that he held when his troops were gassing to death the Kurds in the north of the country.

President Saddam Hussein's attestations of innocence will not please US President George W. Bush, whose Administration is likely to have conclusive proof to the contrary.

It is hoped, of course, that war can be averted.

But, it is more than likely that, like a cornered snake, President Saddam Hussein will lash out at whoever or whatever crosses his path in a last-ditch attempt to keep his power base in the oil-rich country of Iraq.

The only question, should a shooting war start, is: How long will it last?

If it is to be a protracted war – unlikely – then, it will cost the US Government dearly and could throw off all economic projections for the short-term and intermediate term.

If it is to be a short war – a couple of months or so – then, its impact will be minimal.

However, at the outset of the shooting in Iraq, there will be a number of very squeamish investors, who will run for cover.

Uncertainty is never good for equity markets: It tends to make for negative growth.

In view of the findings of The Conference Board, coupled with other leading indicators, compiled by departments of the US Government, it would not take very much to push the US economy down a couple of more notches, skirting or sinking into another recession.

It is said that 3 consecutive quarters of negative growth – falling Gross National Product -- in an economy is usually defined as being an economy in recession.

Thus far, there is no evidence of that, but one has to ask just 2 questions:

1. What would it take to send the Gross National Product into negative territory?

2. When it is in negative territory, how long is it likely to stay there?

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