EQUITY MARKETS: SOMETHING ON WHICH TO CHEW

While the US economy powers ahead, while major European economies are, clearly, improving, equity markets, around the world, are in the doldrums.

Equity markets do not appear to be responding, positively, to encouraging economic news, emanating from developed and developing countries.

Many investors are, to a great extent, concerned about the slow but sure erosion of their capital, tied up in stocks and shares or in other investments, such as mutual funds; they are indecisive as to whether or not to invest more in stocks and shares, listed on stock markets, in the US, Europe and/or Asia, or to hang onto their cash.

The US Federal Reserve Board, at the end of this month, is widely expected to raise the Fed Fund's rate by 25 basis points, at least.

This is said to be one of the main reasons that investors are hesitant in making any fresh commitments, at this point in time.

At the beginning of June, the al Qaeda raid on a commercial-cum-residential community at Khobar, Saudi Arabia, where 22 people were killed, was given as a chief reason for a quite large sell-off of stocks and shares, around the world.

Following that raid, oil prices headed straight up, hitting a 21-year, record high before coming off again.

If it is not one thing, then, it is another thing, used as an excuse for investors to shun equity markets.

But, to **TARGET**'s way of thinking – and it has never changed, over the years – fundamentals will out in the fullness of time.

There has, always, been terrorism in the world, history records, but the attacks by al Qaeda on New York and Washington D.C., on September 11, 2001, popularised the world to the horrors of it, with US President George W. Bush, calling for a war on terrorism.

The Roman Empire had huge problems, with which to contend, also, as its armies, the best-equipped and best-trained in its day, conquered the, then, known world, dealing, very harshly, with what the Romans, considered to be terrorists.

One of the most widely known of the terroristic problems, which plagued the Roman Empire, was the revolt of the slaves, which, in history, is known as *'The Third Servile War'* (73 BC to 71 BC).

It was made into the film, called Spartacus, the name of the Thracian gladiator, who was the chief instigator of the revolt.

The Third Servile War threatened the entire Roman Empire, not just some little outpost in the Middle East.

Religious wars, in nearly every part of Europe and Asia, have spawned terrorism, throughout the centuries, with the Catholics, fighting the Protestants, the Christians, fighting the Moslems, the Sikhs, fighting the Brahmans, etc, etc, etc.

But somehow, despite the massive killings, over the centuries, the world survived.

And, it will survive the next 100 centuries, too.

Equity markets will continue to operate as an organised venue in which to trade stocks and shares, debt instruments, and other pieces of paper, and indices of equity markets will, in due course, rise to new highs.

This is inevitable.

And the current economic climate, in both the US and Europe, appears to indicate that, today, is the time to get invested – in spite of al Qaeda, in spite of Afghanistan, in spite of Iraq, in spite of increases in interest rates, in spite of the arrogance of President George W. Bush, and in spite of the stupidity and incompetence of the Chief Executive of the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC).

The Shift

It becomes more and more apparent that, in the US, today, there is a decided shift, as corporations determine to readjust Management policies, moving away from traditional manufacturing into high-technology manufacturing and/or into high-growth industries.

There is little that is new about this, but it is becoming more and more apparent.

It has been brought about by the quiet revolution: The age of IT – **I**nformation **T**echnology – which is here to stay.

In today's world, if the Internet should, suddenly, stop, tens of millions of people would starve.

In today's world, if international communications should, suddenly, stop, tens of millions of people would starve.

The world has, over the past 3 decades, become more and more dependent on IT.

There is every reason to believe that this dependence will continue, with faster and faster communication systems, being introduced, annually, and more and more applications in the world of fast-moving technology, becoming commonplace in many spheres of endeavour.

For US and European multinationals, especially, they, of course, want to catch the IT *'bus'* as it moves from one station to another, and, to this end, they are forsaking tradition in order to jump aboard it.

Management must either catch this bus … or be run over by it.

From non-technology manufacturing, many corporations are looking at technology manufacturing.

They have little choice in the matter.

Statistics, compiled by various organisations of the US Government point to the following:

1. Assets, owned by US corporations in the Financial Services Sector of the US economy, grew by 353 percent in the decade, ended March 31, 2002;

2. Assets, owned by US corporation in the Information and Media Services Sector of the US economy, grew by 312 percent in the decade, ended March 31, 2002;

3. Assets, owned by US corporations in the IT Sector of the US economy, grew by about 246 percent in the decade, ended March 31, 2002; and,

4. Assets, owned by US corporations in the Education and Health Services Sector of the US economy, grew by about 367 percent in the decade, ended March 31, 2002.

Pretty astounding stuff!

Because of the fast-moving IT and communications world, the shift by Management is essential if US and European corporations are desirous of staying in the game.

It is critical that restructuring continues apace.

The alternative is completely unacceptable.

Traditional manufacturing of soaps and pencils, etc, are finding it more and more difficult to achieve a growth rate, Year-on-Year, of more than 6 percent, in most cases.

Not enough to satisfy the needs of today's world.

It is not due to an oversupply of soaps and pencils and what-have-you, but due to the rapid expansion in the IT sector of the economies of the developed and developing world, where the sourcing of products can achieved, from any part of the world, faster than any time of the past.

The cost of sales, marketing, research and development, and general and other administrative costs determine the Bottom Line, to a large extent, and, to many manufacturers, the costs, associated with the manufacture of soaps and pencils and what-have-you, are growing faster and faster, cutting deeper and deeper into the margins of profit.

Traditional manufacturers of the old school are, today, looking at vertical integration, up and down the supply chain, and/or outsourcing certain segments in the production of goods, as a means to cut operational costs.

Ancillary services are another offshoot of this manufacturing *'revolution'*, with conglomerates, making use of cash-flows in order to offer loyal customers, financial services, something that was never considered, just a few short decades ago.

Even certain supermarket chains are getting into the act, offering a variety of services to customers, in addition to supplying traditional consumer goods.

In the next few years, dynamic Managements, which apply these relatively new concepts, will find profits, taking off as never before.

This will be reflected in the market price of stocks and shares, eventually – in spite of any action by al Qaeda operatives, remnants of the Taliban, increases in interest rates, etc, etc, etc.

People will, always, eat, wash their bodies, write, using some form of instrument, and continue to fly to various parts of the world on aeroplanes.

The reallocation of available resources – as well as labour and capital – will be seen as being essential for companies, wanting to compete, internationally.

Customer loyalty will depend, simply, on the fittest corporations, maintaining their premier positions, as is the case in the animal kingdom, where the fittest male drives away the weaker ones in order to be master of all that he surveys, which, of course, includes all of the females.

The cost to manufacturers of technology, alone, just 2 decades ago, was estimated to account for about 8 percent of gross revenue.

Today, technology costs to many manufacturers are estimated to be gobbling up more like 20 percent of gross revenue.

While it may seem extravagant that IT costs have escalated in such a fashion, during the past few decades, for most corporations, headed by competent Management, such costs will pay dividends, down the road.

The cash flows of many US corporations far exceeded the capital spending, during the first quarter of this year, according to US Government statistics.

The US Federal Reserve's Flow of Funds, the difference between the corporate cash flow and the capital spending level, stood at about $US62.80 billion, on an annualised basis.

What this appears to indicate is that corporate balance sheet are healthy, and getting healthier, in spite of the high cost of technology.

Turning to the buying power of the US consumer, the net worth of US households, during the first quarter of this year, to March 31, 2004, hit a record level of about $US45.15 trillion, according to the US Federal Reserve Board.

That was an increase of about $US665 billion, compared with the quarter, ended December 31, 2003.

While household debt, also, rose during the first quarter of this year, the value of household assets well outstripped the rising costs of household liabilities.

The figures were:

Household Debt	$US9.80 trillion
Household Assets	$US54.99 trillion

Household assets comprised, in the main:

1. Real estate;

2. Mutual funds; and,

3. Cash in banks and with other financial institutions.

In respect of real-estate holdings, the appreciation in the value of bricks and mortar in the US, due in large part to the low cost of money, has pushed up the value of household real estate to about $US15.20 trillion, up about 10 percent, Year-on-Year.

In respect of holdings in equities, households in the US increased holdings by about 28 percent in the past year.

However, there was a bit of a sell-off in the first quarter of this year – the fear factor, being partially, if not fully, responsible, no doubt.

But there would appear to be huge pool of money, still undecided, and still not allocated, in the hands of US households.

This amount of money is estimated, by the US Federal Reserve, to be about $US212 billion.

This amount of money, which is growing at a near record pace, will, eventually, be used where it can do the best good for US households.

And certain equities will, without question, be snapped up before the year is out, using some or all of this cash.

As Wall Street reaps the benefits from the growth of the largest economy of the world, so other equity markets, around the world, will have a share of the spoils.

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