VOLUME VI No. 189 W E D N E S D A Y October 6, 2004

EQUITY MARKETS, AROUND THE WORLD, ARE LIKELY TO GO NOWHERE, VERY FAST

Defying the odds, share prices on US and European equity markets moved up smartly, last Friday, in spite of the fact that the price of light sweet crude oil ended the week of October 1 at a record level for a closure of the New York Mercantile Exchange: $US50.12 per barrel for November delivery.

And the equity markets of the US and Europe closed on such a high note in spite of the prospects of a bloody civil war in Nigeria: Nigeria is the second-largest exporter of crude oil within the cartel, known as The **O**rganisation of **P**etroleum **E**xporting **C**ountries (OPEC), with a daily output of about 2.30 million barrels.

The key gauge of the movement of blue chips, listed on The New York Stock Exchange, the Dow Jones Industrial Average, tacked on a gain of about 1.12 percent, last Friday, while The NASDAQ's Composite Index, which plots the course of hi-tech counters, mainly, shot up to 1,942.04 points, a one-day gain of about 2.38 percent.

As **TARGET** mentioned in reporting last Friday's seemingly bullish session on the world's 2 largest equity markets:

> *'The reasons for the gains on the largest equity markets of the world were varied and, for the most part, somewhat illogical, but who cared: Equity prices were rising; the wealth factor had kicked in; the smoke was clearing; everybody was happy.'*

Toffy economists, working at international banking conglomerates and large stockbrokerage houses, could over-generalise last Friday's situation on international equity markets and make a good argument for suggesting that the US equity markets are undervalued, in any event, and, as such, it was only reasonable for there to have been those gains on Wall Street, last Friday.

However, the high, international price of fossil fuels is, still, the Sword of Damocles, hanging over the heads of the largest economies of the world.

As **TARGET** stated last August 4 (Please see TARGET Intelligence Report, Volume VI, Number 146), if the price of crude oil is maintained, for any appreciable length of time, at $US50 per barrel and higher, it is quite likely to stoke up the fires of inflation, eventually leading to an international recession.

The US Federal Reserve Board has stated that it is keeping a careful watch on the likely prospects of higher levels of inflation in the US; and, The Fed's stance in respect of further interest-rate increases depends on its assessment of the situation at the time.

The September 21 Open Market Committee Meeting of The Fed concluded with the following statement:

> *'The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 1-3/4 percent.*
>
> '*The Committee believes that, even after this action, the stance of monetary policy remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing*

support to economic activity. After moderating earlier this year partly in response to the substantial rise in energy prices, output growth appears to have regained some traction, and labor market conditions have improved modestly. Despite the rise in energy prices, inflation and inflation expectations have eased in recent months.

'The Committee perceives the upside and downside risks to the attainment of both sustainable growth and price stability for the next few quarters to be roughly equal. With underlying inflation expected to be relatively low, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability.'

The Fed is scheduled to meet again on November 10, 2004, but that does not mean that it could not schedule a meeting before that date if it determines that needs be such.

Oil Prices Versus Share Prices

Since the beginning of 2004, for the most part, share prices in the US have been kept within a very narrow trading range.

The ever-increasing price of fossil fuels sucked the stock markets of much of its speculative cash.

Every equity market in the world depends on speculation.

A stock-market speculator is not a dirty word, contrary to that which some grey-haired, US television presenters claim.

There are very valid reasons for equity prices to lose a great deal of their steam when oil prices rise to very high levels, as has been the case since the beginning of this year.

To begin with, as **TARGET** has already mentioned in the past, margins of profits on the corporate front are cut when oil prices rise too quickly; this is reflected in lower earnings, down the line.

Consumer spending, also, is reduced as oil prices rise, for obvious reasons: Companies have to try to pass on their increased operating costs, down the line to the housewife at the local supermarket cash register.

In real terms, incomes in the US and, for the most part, in Europe, also, have hardly moved since January 1, 2004.

Yet, prices of most commodities, most consumer products and the cost of travelling, have all risen, some quite spectacularly.

In fact, for the many employees of US airlines, they are happy that they are still gainfully employed – because so many of their counterparts, in many other parts of the world, have been given their pink slips.

Last Thursday, this medium reported that the German, publicly listed travel conglomerate, TUI AG, had announced that it would be sacking some 800 of its workers, including tour operator, Thomson Holidays, a division of TUI UK Ltd, travel agency, Lunn Poly Travel Agents, and TUI's charter airliner, Britannia Airways Ltd.

The jobs would all be lost in the **U**nited **K**ingdom (UK) where Lunn Poly is the largest travel agency, having not fewer than 800 offices, throughout the country.

The previous Tuesday, **TARGET** reported **P**eninsular and **O**riental Steam Navigation Company (P and O), the European shipping giant, would be closing down 4 of its ferry routes, all being its Western Channel Routes, with the lone exception of the Portsmouth-Bilbao route.

The routes had, all, been losing money for P and O: Travellers were cutting down unnecessary expenses.

More jobs lost.

Sooner or later – and **TARGET** is betting that it will be sooner rather than later – the present high price of crude oil will eat into the growth of industry in the US and this will cascade to the eurozone.

Few will be spared.

Asia will get hurt, also.

The fact is that increased production/operating costs can only be passed down the line to the consumer to a certain extent.

At a critical stage, where-ever it is, depending on the industry, customers will baulk when they cannot see their way clear of continuing to tolerate the higher costs.

This scenario would suggest that The Fed would seek not to raise interest rates further this year.

At the same time, however, The Fed has to keep inflation in the US in check.

The balancing game may not be an easy one for Dr Alan Greenspan, the Chairman of The Fed.

Share prices on US equity markets have not yet been adjusted to take into consideration the lower levels of consumer spending, combined with the rising costs of basic commodities and imports.

Because corporate America is, definitely, feeling the pinch as earnings decline, brought about, in part at least, by the increased cost of energy.

It is maintained by some that the prices of many stocks and shares, listed on major equity markets in Europe and the US, are, relatively, cheap on current valuations, which are based on historical earnings.

But, perhaps, share prices are not cheap, based on valuations on a prospective basis, assuming that the price of crude oil maintains its present high levels.

In the first week of next month, the Presidential Elections will be held in the US: Either President George W. Bush will be re-elected for a second term; or, Senator John Kerry will become the 44^{th} President of the only super power in the world, today.

It is believed that, if President George W. Bush is re-elected, it will be good for corporate America.

If, on the other hand, Senator John Kerry is elected to be the next President of the US, it will not be good for corporation America.

So, equity markets in the US, no doubt, will start to react to the results of various polls as to which Presidential candidate appears to be in the lead.

This is likely to be a weekly affair if not a daily one.

But, regardless of who is to lead the US for the next 4 years, it will not change the price of fish.

Again, sooner or later, the penny will drop and fundamentals will play their role in determinations of stock and share prices.

Low, long-term interest rates have not stimulated economic growth, internationally, to any great extent, because of the many uncertainties, surrounding a number of very basic economic fundamentals.

The prices of equities are torn between declining earnings' prospects and seemingly low current valuations of constituent stocks of leading indicators on equity markets.

For Asia, which *'feeds'* the US with just about everything, from condoms to diesel engines, from consumer electronics to garments, from telecommunication devices to pots and pans, this area of the world will feel the material downturn of any persistent US consumer spending, first.

Japan is, already, experiencing that phenomenon as orders for consumer goods are running behind expectations and below last year's levels.

The prices of stocks and shares move up on expectations of higher profits in the future: They do not move up on historical factors.

Share prices in the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC), for the most part, have been in the doldrums since January even though, in many cases, companies have improved on their financial positions vis-à-vis the previous year.

Uncertainty in any market is not appreciated by investors and speculators alike.

As long as there is no stability in the price of fossil fuels, it bodes ill for the investment communities, internationally.

And that is the main reason that equity prices are in a rut – and they will stay there for the time being, unless crude-oil prices start to retreat to between $US28 per barrel and $US32 per barrel.

-- E N D --

guarantee to publish readers' views, but reserves the right so to do subject to the laws of libel.