INFLATION ? YES ! WITHOUT QUESTION !
ARE EQUITY MARKETS AT RISK ? UNLIKELY !

The US is set to experience much higher levels of inflation during the first half of 2006.

The US Federal Reserve intimated this, just last Tuesday (November 1, 2005), when it announced that the Federal Funds Rate would be raised another notch – 25 basis points – to 4 percent, which represents the highest level of the past 4 years.

The announcement said, inter alia:

> *'Elevated energy prices and hurricane-related disruptions in economic activity have temporarily depressed output and employment. However, monetary policy accommodation, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity that will likely be augmented by planned rebuilding in the hurricane-affected areas. The cumulative rise in energy and other costs has the potential to add to inflation pressures; however, core inflation has been relatively low in recent months and longer-term inflation expectations remain contained.'*

The next Open Market Committee Meeting of The Fed is scheduled for December 13, 2005, at which time, no doubt, interest rates will be raised again.

This meeting will be the last one for Dr Alan Greenspan, who will be replaced as Chairman of The Fed by the very well-respected, Dr Ben Bernanke.

Dr Ben Bernanke is something of a wild card, to many people at this point, but it is generally expected that he will follow the line, adopted by Dr Alan Greenspan over the years.

Europe has felt the heat from higher energy prices over the past year or so and, without question, investors in this part of the world have been well aware of the situation that has persisted for such a long period of time.

For the most part, European investors have factored into their calculations the probability of higher levels of inflation in the first half of 2006, coupled with even higher interest rates.

While the West is more than likely going to see interest rates continue to rise, during the first half of next year, and while inflation will cut into corporate profits, equity prices are unlikely to be adversely affected, the way that things stand, today.

Crude oil prices have receded of late and The **O**rganisation of **P**etroleum **E**xporting **C**ountries (OPEC) has stated that it expects crude-oil prices to stabilise at between $US45 per barrel and $US55 per barrel, according to Acting Secretary-General Adnan Shihab-Eldin.

However, for many companies, the high price of energy over the past year has cut deeply into their coffers, and this is especially true of General Motors Corporation and Ford Motor Company where these giants of the international motor industry have been hit by (a) increased competition from Asia – Honda, Nissan, Toyota, Hyundai, etc – and US consumers' refusal to purchase what are referred to as *'gas guzzlers'* – the Hummer H2 of General Motors, the SUVs (**S**ports **U**tility **V**ehicles) of Ford Motor Company and General Motors, and the mini-lorry (the US call this, a pickup).

The price of petrol at the pump in the US has gone from one record level to another, making the operating costs of the above-mentioned gas guzzlers too much of a cross for many US consumers to bear.

Financial markets have responded to the problems of the US automotive industry: The prices of the shares of General Motors and Ford, having been hit with one selling wave after another.

Whether or not these 2 icons of US industry will ever recover is questionable because their international counterparts seem to be able to produce better and more reliable vehicles than they – at cheaper costs with much more appeal to the US, and international, consumer.

The high price of energy has translated into considerably waning sales in the high street, and only the low-end retailers are experiencing material increases in business activity.

This would appear to be logical, all things considered, because US housewives, seeing prices rise, month after month, cull their shopping list to bare essentials, taking into consideration such factors as higher petrol prices, natural gas prices, etc, etc, etc.

Because inflation is on the rise to higher levels, there is almost a guarantee that prices of goods and services will continue to rise, sooner rather than later.

The one factor, which has the ability to throw off all statistics and economic forecasts, is the possibility of H5N1 Avian Influenza, becoming a pandemic.

While it is **TARGET**'s view that this is unlikely to materialise due to the fact that the world is well prepared for such an eventuality and steps have been taken to contain the first glimpse of a suggestion of a pandemic of the Bird Flu, as it is popularly known, nevertheless, fear and greed are, always, considerations with which to reckon in trying to plan a strategy for an equity market.

Further, one can never be complacent about such matters as a deathly worldwide disease, with the possibility of such a disease mutating at an alarming rate.

With no cure for Bird Flu, at this time, there is bound to be some consternation in the minds of many investors, especially the smallish ones.

However, not withstanding such a possibility, the first half of 2006 is quite likely to be a busy time on equity markets, from New York to Tokyo.

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