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THE WORLD'S STOCK MARKETS:
FEAR CLOUDING FUNDAMENTALS

The logical fallacy, usually written in Latin – Post Hoc Ergo Proctor Hoc (After This, Therefore, Because of This) – appears to be the raison d'être for the current global paring of key indices on major stock markets.

Economic fundaments, internationally, are such that they, really, do not justify the way in which investors, from one corner of the world to the other, are bailing out of stocks and shares.

Yet, major equity markets are in turmoil and investors are increasingly looking for open doors in order to allow them to scurry away with what is left of their investment capital.

Until those fears are overcome, equity markets' key indices could well continue to fall to lower levels.

There will, of course, be trading days when key indices of certain equity markets will rise, some even spectacularly, but, on net, they will continue to drift to lower levels until the fears of investors are brushed aside and replaced by attention to fundamentals.

Record-high crude oil prices, the Middle East crisis (Iraq, being on the verge of a civil war, and the invasion of Lebanon by Israel in order to root out and destroy the Iran-backed Hezbollah guerrillas), the North Korea missile and nuclear threat, and the prospects of more interest-rate increases in the US are all stoking the fears of investors.

But, for every 100 potential problems, perceived to be on the horizon, the prospects are that, perhaps, one may eventuate.

The price of crude oil hit has hit one record level after another; the stage appears to be set for it to test the $US80 per-barrel level.

That may be all she wrote, however, as the American expression goes, because the higher the price of crude oil rises, the more emphasis will be placed on:

a) Finding alternatives to fossil fuels as a means of powering industry;

b) The automotive industry, being coerced, in some cases by the force of law, to manufacture more fuel-efficient vehicles; and,

c) Spudding new oil wells and the desperate search for independence on crude-oil supplies from the members of The Organisation of Petroleum Exporting Countries.

The higher that the price of crude oil rises, the more emphasis will be placed by the West to limit its effect on the largest economies of the world, either by hook or by crook.

Exploratory drilling in Alaska has, already, begun, and in many US states, smaller oil wells have been reactivated as it becomes economically worthwhile, today, to start pumping their oil, once again.

Formerly, these wells were considered not commercially viable.

In addition, consumers in the US and in Europe, seeing the price of petrol at record levels – it has hit $US3.00-plus per (US) gallon in the US – and fearing that it could rise to even higher levels, will seek ways to limit its impact on the family budget by various means, such as pooling transportation requirements, driving less, taking public transport where possible, etc, etc, etc.

This will, eventually, lead to a reduction in the requirements in respect of the quantity of the importation of foreign-produced crude oil.

In the meantime, however, the fear of what may be just over the economic horizon, out of immediate sight, is more overpowering than fundamentals.

The *'wild card'*, so to speak, is the trouble in the Middle East and the probability that it could be exacerbated in the near future.

Iraq is in turmoil, to be sure, and there appears to be no immediate solution in sight.

Iraq is a major exporter of crude oil, but its exports are being curtailed by insurgency within the country.

Iran is a potential danger spot because its government is determined to make the country a nuclear power, come what may, and it will, without thinking clearly and objectively of the consequences, use its crude oil exports as its weapon of choice should push come to shove.

In Lebanon, there is the Hezbollah problem, with the Israeli Defence Force, continuing to seek out and destroy these guerrillas and their arsenal of more than 12,000 missiles in order to stop attacks on the Jewish State.

The Hezbollah is funded and motivated by Iran, the government of which fans the flames of its *'children of Lebanon'* at every opportunity.

Iran's motive is well known and has been stated on many occasions, publicly: The State of Israel must be erased from the map of the world; and, the Jews of Israel must be killed, in total.

Iran is not going to win because the sovereign State of Israel is here to stay.

Iran will, also, not win in its ambitions to become a full member of the nuclear-power club – because the West does not trust its government, with good and valid reasons.

The Hezbollah guerrillas of Lebanon are not going to win, also, because the Israel Defence Force will kill them, all, or drive them out of Lebanon unless stopped by a United Nations peacekeeping force.

As for the Iraq insurgency, a solution will have to be found and the US Government may well hold the key to that solution: Its departure from Iraq may help to speed up a resolution, permitting discord to pass into concord.

There is, however, one nagging fear that is plaguing the world: The possibility of a major escalation of hatred between the forces of Islam and the forces of the Jewish-Christian bloc.

The fundamentalist government of Iran has suggested the possibility of a worldwide Jihad.

Iran continues to suggest this terrible nightmare as it ferments hatred of both the US government and the governments of Israel and its supporters.

Left unchecked, it is feared that this situation could lead to an international conflict, the likes of which the world has never witnessed.

If this should come to pass, all bets are off, of course.

North Korea

While North Korea pulls the chains of the West by launching some missiles, all of which landed harmlessly in The Sea of Japan, with one, long-range missile, failing to perform, at all, and with the government of Kim Jong Il, talking, jingoistically, of the country's military might, actually, North Korea is *'for sale'* to the highest bidder.

The West is well aware of this situation, but the price has yet to be determined.

Time, however, is on the side of the West as the situation in North Korea worsens and the 23 million-plus peasants of the country start to ponder the likelihood of rebelling against its government due to the pitiful state of the country, especially in respect of the abject poverty that most of the citizens are forced to endure while the country's leaders live in luxury, and spending on military hardware continues to escalate to the detriment of the plebeian.

Although reliable statistics are difficult to obtain and/or substantiate, it is generally held that about 45 percent of the National Budget of North Korea is spent on building up the military might of the country.

The country is known to have a permanent military force of about one million men and women under arms and another 5 million men and women in reserve.

Regimes of the ilk of North Korea have never lasted for very long in the history of the world and there is every likelihood that this repressive, Stalinist regime will, in the fullness of time, destroy itself as its citizens learn what life is like in the households of the country's neighbours.

Until that time comes, however, there will be a rattling of chains as the ghosts of the Korean War, which started in June 1950 and lasted until July 1953, continue to be heard and recalled.

One thing is certain: North Korea is highly unlikely to brave an all-out war with the West, as Mr Kim Jong Il has threatened if sanctions are imposed by the United Nations due to the missile crisis, because the country is certain to lose.

The North Korean situation should hardly be of major concern to investors, internationally, because it is no more than a pesky Asian *'mosquito'*, looking to suck a little blood.

The US Federal Reserve

There are very strong indications that the US economy is slowing, due in part to the higher cost of crude oil.

This has caused there to be a bit of inflation in the world's largest economy, but The Federal Reserve is unlikely to raise interest rates much higher as **TARGET** stated on May 10, 2006 (Please see **TARGET** Intelligence Report, Volume VIII, Number 85, headlined: **'*REST EASILY: INTEREST RATES WON'T RISE MUCH MORE*'**).

Even if there should be another 25, basis-point increase on August 8, 2006, at the next Open Market Committee Meeting of The Fed, it is likely to be the last for the time being, all things being equal, due in large part to the matters, stated above, with the underlying rationale, being that one learns to curb one's appetite in accordance to the loudness of the jingle of the guinea.

Outsourcing has meant that the US and many European conglomerates have been able to maintain more than a reasonable level of profit.

Industry's successful outsourcing in countries, such as India, Thailand, Vietnam, Taiwan, The Philippines and the People's Republic of China, to name but 6 countries which are supplying the US and Europe with goods and services, has, also, cuts the legs from under labour's bargaining power in both the US and, to a lesser extent, in Europe.

Outsourcing has helped to put a cap on inflation in these 2 areas of the world and has put goods in the shops of the High Streets of the US and Europe at cheaper prices than similar goods could be manufactured at home.

This permits the consumer of the US and Europe to have more disposable income at hand to spend on other goods and services.

Just last Monday-week, in Washington, D.C., the US Federal Reserve published its Statistical Release in respect of industrial production and capacity utilisation in the US for the month of June.

What that report stated was, inter alia:

1. Industrial production in the US rose by 0.80 percent in June and was, Year-On-Year, 4.50 percent higher;

2. The production of consumer goods in the US rose by about 0.90 percent in June, Year-On-Year;

3. Manufacturing output in the US rose by about 0.70 percent in June, Year-On-Year; and,

4. Factory output in June was about 81.10 percent.

So, without putting any undue strain on labour, *'USA Incorporated'* is producing more goods, but is far from operating at full capacity.

Investors in many parts of the world are concerned because they see a tightening of monetary policies and, as countries' purse-strings are tightened, it follows that corporate profits should be squeezed.

This need not necessarily be true, but, in the case of the PRC, it is probably true to a greater extent than in the US.

It is fear, however, that is determining the direction of financial markets, more so than fundamentals.

Internationally, the world is far from experiencing an economic slump; at most, there are indications of a mild slowdown in the US.

Fear, however, justifies its own existence and tends to undermine good economic fundamentals.

There is every reason to believe that the economic situation, today, both in the US and in Europe, lends itself to justifying purchases of equities.

The strong economic growth in the developing countries of the world will not be thwarted by investor fear although in India, there must be a great deal of apprehension, following the recent terrorist attacks on Mumbai's train system, which killed upwards of 200 commuters.

Conclusion: **TARGET** continues to maintain its stance that the equity markets of the US and Europe and many parts of Asia still have a way to go, reflecting, in advance, the growth of companies' profits.

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