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IS THERE A FLY IN THE PICKLE BARREL ?

So, the equity markets of North America appear to be defying logic, with key indices, hitting close to, or rising above, former record levels.

Does it mean anything?

It means, exactly, nothing!

A fly in a pickle barrel may be more noteworthy than the present situation on the very volatile equity markets of North America.

And this raises the next question: Should one hold, sell, or buy US equities?

TARGET's answer: Buy very selectively, only, if you must.

TARGET's opinion may seem contradictory, but it is all very logical.

Here is the reasoning of this medium.

The US Federal Reserve

It is an odds-on favourite that the US Federal Reserve will try to ameliorate the situation in the US economy which, today, is dragging its tail.

At the next Open Market Committee Meeting of The Fed, scheduled to begin on October 25, 2006, there is a strong probability that there will be a 25-basis point, interest-rate reduction – at least.

If it does not come to pass at the 2-day, Open Market Committee Meeting in October, one may look for it at the November Open Market Committee Meeting.

Regardless of the timing of an interest-rate reduction in the US, the market will react to those prospects long in advance of the actual development.

An interest-rate cut of 25 basis points will, most likely, cause the US dollar to weaken against other *'hard'* currencies, at least in the short term.

This will cause, or be perceived to cause, US-manufactured goods and services to be seen to be more competitive on the world stage.

More important, perhaps, will be investors' perception of the move by The Fed as it lowers interest rates, barring the US economy, slipping into recession: Two or more quarters of negative growth in the economic activity.

Outsourcing

Due to the perspicaciousness of many managements of big business in the US, having determined to outsource to low-cost countries, such as India, the People's Republic of China (PRC), Thailand, The Philippines, etc, many of these multinationals, today, continue to enjoy reasonable margins of profits.

Without naming names, one only has to look at US industrials which have moved a large percentage of their industrial bases to Asia and are still able to pay handsome dividends to shareholders in order to realise how effective were their decisions to move out of the Continental America, some years ago.

The partial move out of the North America and into lower, labour-and-land cost regions of the world has permitted profit margins to be maintained at healthy levels.

That is one of the reasons that many US-based companies, listed on equity markets in The Land of The Free and The Home of The Brave, are able to surprise investors with continued, very reasonable profits.

The internationalisation of production, as it is called in the toffee-nosed language of some economists, today, tends to increase the attractiveness of (another new buzzword here) Mobile Capital (definition not required since the term is self-explanatory).

Some of the effects of Mobile Capital are that it permits multinationals to move part or their entire industrial bases to low-wage areas of the world and, by so doing, increase the labour pool in the US.

With more skilled labour, available in the US market, wage bargaining power wanes, appreciably.

Which, of course, is good for the US consumer, down the line.

The labour factor cost in the production of goods and services in the US has been on the decline for some 2 decades, now, and it is highly unlikely that this trend will be reversed in the near future.

In addition, technological advances in production, communications, transportation, etc, are going to mean that there will be, and continue to be, higher efficiency, leading to reasonable productivity growth.

This will, most likely, continue in the US even though, overall, the US economy may continue to weaken in the months, leading up to Christmas ... and, perhaps, into the middle of 2007 if not longer.

But not every US-based, multinational company has been successful in outsourcing, however.

The US, motor-vehicle industry is in trouble; it is unlikely to recover in our lifetime.

The fact is that the Japanese, the Germans, the Italians, the South Koreans and even the Brits, on average, are making better motor vehicles than the Americans.

Unlike the Americans, for instance, the Brits, the Japanese, the Germans, the Italians and the South Koreans do not recognise the term, Rejection Factor, as their motor vehicles roll off the assembly line.

The US motor-vehicle giants of yesteryear were slow off the mark and did not see the fast approach of the Japanese, motor-vehicle industry, which not only started to encroach on the hallowed ground of Detroit, Michigan, but started to outclass the vehicles, coming off the assembly line at the home of birth of the mass-produced, motor car.

Further, Detroit did not see, some years ago, the importance of outsourcing manufacturing facilities to lower-cost areas, leaving the field to competitors, such as Volkswagen, Citroën, Mercedes Benz, Nissan, Honda, etc, etc, etc.

General Motors Incorporated and Ford Motor Company, especially, are suffering, today, very badly as these giants, which used to be a dominant force in the world, continue to haemorrhage.

With the exception of companies, such as General Motors and Ford, one may expect to see corporate America continue to be profitable, albeit not to the extent as in the past few years.

But, nevertheless, profitable.

US companies, which produce airframes, jet engines, sophisticated electronics, etc, will continue to keep their investors happy because they have the product and a track record which the Europeans have a great deal of trouble in trumping.

At least, for the time being.

While, since about 2003, the average price of equities, internationally, has risen by about 80-odd percent, according to the database of **TOLFIN** () (The Computerised, Online Financial Intelligence Service and Web-Based, Credit-Checking Provider), equivalent to a growth rate of about 19 percent per annum, compound, one would be foolish to expect to see such a growth in the next few years.

The US Housing Market

As **TARGET** () has stated, on numerous occasions, the US economy is facing a difficult time as the housing market continues to weaken.

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The shakeout in this industry is unlikely to be short-lived and, during this difficult period, a great number of individuals and companies may well be hurt, some permanently.

Earnings in the home-building industry are likely to be considerably deflated.

There is quite likely to be a ripple effect throughout the entire US economy.

It is all a matter of time.

The immediate effect of this situation is that consumer spending will start to dry up; the first industry to feel the brunt will be retailing, no doubt.

The volume of activity on equity markets will, most likely, decrease as the housing markets' problems accelerate and become painfully aware.

One may live to regret thinking that the housing market problem will just disappear because, in **TARGET**'s opinion, its problems are just starting to materialise: There is a great deal more downside to go.

This problem has the potential to be a real doozie; and, one should never underestimate its potential to help to push the US economy into recession.

That is not to say that **TARGET** is strongly suggesting that a recession is on the cards, but it should not be ruled out, entirely.

And this is where The Fed could come to the party, bringing along a little healthy libation in order to appease the gods of industry.

However, more to the point, as far as investors are concerned, the US equity markets are likely to witness sudden and dramatic corrections, not seen for some time in the near future.

The rabbits of the equity markets will, definitely, run to ground.

Also, there may be many people who will start to consider – if they have not done so, already – whether or not recession is a real possibility in the US and, until this is ruled out, completely, one would be wise to be circumspect in making material new commitments, at least, at this juncture.

Having said that, however, unlike many stock markets of Asia, on US equity markets, when certain key indices start to fall, materially, it does not follow that the price of the shares of all of the listed counters will fall, also.

One has to consider whether or not a fly in the pickle barrel looks very attractive to a pickle-eater.

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