WHAT THE TEA LEAVES SEEM TO SAY ABOUT 2008

It is obvious that quite a number of US consumers are very concerned about the near-term future of their economy.

There is good reason for their concern, in **TARGET**'s opinion, and last Friday report from the US Labour Department reinforced some of their worst fears.

The Bureau of Labour Statistics reported, inter alia*: 'The unemployment rate rose to 5.0 percent in December, and payroll employment was essentially unchanged (+18,000) at 138.5 million …'.*

The Bureau, also, reported:

> *'Employment in manufacturing fell by 31,000 in December. Over the year, job losses in manufacturing totaled 212,000; motor vehicles and parts led the declines (-74,000). Wood products, furniture, and nonmetallic minerals – manufacturing industries associated with home building – combined to account for 3 in 10 lost manufacturing jobs in 2007. In December, employment in motor vehicles and parts fell by 6,000, and there were smaller declines throughout both durable and nondurable goods manufacturing. Average weekly hours of production workers in manufacturing fell by 0.2 hour to 41.1 hours, and average overtime was down by 0.2 hour to 3.9 hours …'.*

The 5-percent unemployment rate was the highest score in the previous 2 years.

It was not good news and the disappointment of US investors was noted on Wall Street where the key indices went into reverse gear – the Dow Jones Industrial Average shed about 1.96 percent and The Composite Index of The NASDAQ gave up 3.77 percent.

The announcement from the US Labour Department followed US Government reports and industry records in respect of Christmas sales.

It was reported that sales of consumer goods at major, US retail outlets, during the 2007 holiday season, adjusted for inflation but not annualised, were, in a word, appalling.

The reported statistics reflected, if anything, a contraction in consumer spending, relative to the like, 2006 holiday season.

Various organisations/institutions have put the increase in consumer spending, during the 2007 holiday season, at between 2.40 percent and 3.60 percent, Year-On-Year.

Which, to this medium's thinking, is a very definite negative, regardless of which figure one chooses.

For specialty apparel chain stores, such as Gap Incorporated, Urban Outfitters Incorporated and their ilk, sales were up about 1.40 percent, Year-On-Year.

Against this, sales of women's apparel fell by about 2.40 percent, Year-On-Year.

Sales of men's clothing, on the other hand, rose about 2.30 percent, Year-On-Year.

Footwear sales were up about 6 percent, Year-On-Year.

As for sales of consumer electronics, sales were up about 2.70 percent, Year-On-Year.

Sales of luxury items were down about 1.90 percent, Year-On-Year.

The reasons for restrained consumer spending are many and varied, but come down to tight family budgets, brought about by the higher costs of energy and petrol, and, perhaps, more importantly, US families are unsure as to when their monthly pay-cheques will cease as unemployment levels continue to rise.

One must bear in mind, when trying to get a handle on the statistics with regard to consumer spending, during the Christmas shopping period, that in order to bolster sales at many chain stores and some of the largest departmental stores, prices were marked down, sometimes very dramatically, thus profit margins were slashed, mercilessly, while some of the biggest stores in New York had to stay open 24 hours per day just to tread water, so to speak.

The attendant costs, involved in a store, staying open 24 hours per day – additional labour costs, energy costs, etc – cuts into the Bottom Line, also.

Unemployment In The US

The deleterious effects of the 2-year high unemployment levels in The Land of The Free and The Home of The Brave have yet to be factored, totally, into the equation in respect of the world's largest and most-important economy.

But the penny will drop as sure as ripe apples fall off trees.

Again, according to the US Labour Department, Initial Claims for Unemployment Insurance for the week, ended December 22, 2007, were 349,000, seasonally adjusted.

That figure was an increase of 1,000 Claims, compared with the figures for the week, ended December 15, 2007.

The 4-week moving average was, as at December 22, 2007, 343,000 Claims – which was the second-highest level for the 2007-year.

The trend had been established: Claims for unemployment insurance are continuing to rise and, all things being equal, this trend will continue.

As **TARGET** () has reported on numerous occasions over the past year or so, US companies are laying off staff where-ever possible in order to cut costs and, in some cases, just to stay in business.

The labour market in the US is continuing to weaken and this situation will be exacerbated in the months to come, no doubt.

The number of mass layoffs in the US – defined as being 50 or more workers, sacked from a single establishment – has been steadily rising and the December figures, still to be released by the US Labour Department, will be telling.

For the month, ended November 7, 2007, the number of mass layoff events came in at 1,799, not seasonally adjusted.

That was an increase, Month-On-Month, of about 716 events, and, once again, it was the highest level for the entire 2007-year.

In terms of the number of new US workers, who had to hit the streets of the US, looking for alternative employment, it came in at 136,924 workers, which compared with the October statistic of 131,780 workers.

It would appear that the number of workers, laid off by US companies and firms, will continue to increase in the first half of 2008 for obvious reasons – the subprime, mortgage-lending industry's woes, the credit squeeze in the US, which has been exported to most parts of the world, and the continued falling off of housing starts in the US as well as home prices, continuing to fall to 20-year lows.

Looking At Mortgages

According to The **M**ortgage **B**ankers **A**ssociation of America (MBA), the demand for new mortgages decreased by about 11.60 percent for the week, ended December 28, 2007, compared with the week, ended December 21, 2007.

As for the number of applications for purchases of real property, during the same week, they decreased by about 8.50 percent, Week-On-Week.

In respect of number of applications for refinancing, they fell by about 15.40 percent for the week, ended December 28, 2007, Week-On-Week.

As the downturn in the US housing market accelerates, so it has a knock-on effect, right down the line.

And there is no light at the end of this tunnel, at least, not at this juncture.

The fall-off in the number of applications for mortgages, one must, also, bear in mind, is on the back of falling mortgage rates, nationally.

The translation value of the US dollar, vis-à-vis the euro, the Japanese yen, the Canadian dollar and most other *'hard'* currencies, has depreciated, markedly, over the past year or so, and there is every likelihood that the translation value of the US dollar will continue to weaken.

This might, at first, suggest that purchases of US real estate should be somewhat more appealing to foreign investors with hot cash in their pockets, but, thus far, due to a number of imponderables, the relatively cheap real estate of the US has not drawn the attention of great numbers of foreign buyers, flocking to the shores of the country.

US equity markets appear to offer more attractive investment opportunities than US real estate, it appears, in spite of the recent fall-off in share prices: The Dow Jones Industrial Average lost about 4.23 percent for the 4-day working week, ended January 4, 2008; and, the Composite Index of The NASDAQ shed about 6.35 percent for the like period.

The US Federal Reserve, at its last Open Market Committee Meeting of December 11, 2007, cut interest rates by 25 basis points and the consensus, today, is that The Fed will, more than likely, reduce interest rates by at least another 25 basis points at its next Open Market Committee Meeting, scheduled for January 29-30, 2008.

For corporate America, another cut in interest rates will be good news since it will lessen the burden of debt service, thus increasing profit margins, at least, somewhat.

If, however, The Fed was to cut interest rates, aggressively, say by 50 basis points or more, it may well put the willies in US investors because such a move would mean that things are truly bad in The Land of The Free and The Home of The Brave – and The Fed has constructively acknowledged the fact.

In which case, such a move as aggressively reducing interest rates is unlikely to ameliorate the overall situation very much.

Turning one's attention to luxury items, produced in the US, for the Irish, the English, the Canadians, the Europeans, etc, such goods are, now, relatively cheaper than they were just one year ago due to today's translation value of the US dollar vis-à-vis other *'hard'* currencies.

For many a US company, especially those companies, producing high-technology or specialised products and services, the depreciating value of the greenback is good news.

Against this scenario, however, imported goods are becoming more and more expensive for US households.

One cannot, however, rule out further massive losses at US banking institutions as became patently obvious in December 2007 when Merrill Lynch and Company went cap in hand to the Government of Singapore, raising about $US5 billion in a share sale to Temasek Holdings Pte Ltd, one of the Singapore Government's official investment vehicles.

At the tail end of October 2007, Merrill Lynch and Company posted a write-down of

$US8.40 billion in recognition in the decline in value of some high-risk, (supposedly) high-return securities, backed by subprime home mortgages.

In addition to having to ask the Government of Singapore for financial help, senior management of Merrill Lynch and Company went to Davis Selected Advisors, raising a further $US1.20 billion – in cash.

Logic dictates that these cash-raising exercises were force-majeure situations.

Merrill Lynch and Company followed the footsteps of Morgan Stanley which sold a $US5-billion stake in this internationally renowned merchant bank to the Government of the People's Republic of China.

On November 26, 2007, it was announced, officially, that Citigroup Incorporated had reached an agreement to sell equity units, with mandatory conversion into Common Shares of Citigroup Incorporated, in a private placement to the Abu Dhabi Investment Authority.

Citigroup Incorporated raised about $US7.50 billion at that time.

Abu Dhabi Investment Authority is, now, the largest single investor in Citigroup Incorporated.

One must not forget, also, of course, Europe's largest bank, UBS AG, which has, thus far, announced write-downs with regard to its investments in the subprime, mortgage-lending industry.

UBS AG was forced to write off, completely, more than $US14 billion for its past miscalculations.

Management of this huge bank, which is the world's largest wealth manager, sold a 9-percent stake to Singapore Investment Corporation, another corporate entity of the Government of Singapore.

TARGET could mention quite a number of other examples of previously, thought-to-be, cast-iron, US investment banks, all of which have had to bite the bullet in the past year or so, admitting, openly, massive prior mistakes and massive errors of judgment, and seeking additional, window-dressing finance, but listing the above-mentioned, force-majeure actions and equity write-offs would appear to be sufficient to prove the point that this medium is making.

How many other paragons of the international investment world will have to make official announcements about their managements' past, financial faux pas is anybody's guess, but one can readily understand the concern of investors, from Wall Street to Zanzibar, when it comes to making fresh commitments in just about any bank or financial institution of the Western World.

TARGET is not forgetting, of course, Northern Rock plc, which is a complete goner, following a run on this bank, its Management, in desperation, turning to The Bank of England for emergency funding.

Thousands of Northern Rock customers queued up to withdraw all of their savings in the largest run on a United Kingdom bank for more than 100 years.

The run on this bank sparked broader questions about Great Britain's financial health.

Ruling out investments in US real estate and the banking industry, at this time, leaves equity investors with select industrials from which to choose – manufacturers of fixed-wing aeroplanes, helicopters, US defense contractors, producers of fertilizers, etc – and high-technology, service companies, such as producers of computer software, mobile telephones, etc.

For the Hongkong Special Administrative Region (HKSAR) of the PRC, its fortunes are linked directly to the performance of the *'motherland'* and, as Beijing moves from one plateau of strength to the next, so these 416 square miles will stand to benefit.

But there is bound to be bumps and grinds in the months ahead.

So, while the economic prospects for the US for 2008 are clouded in the financial fog of yesterday, and Europe is quite likely to feel a great deal, if not all, of the impact of a continued downturn in the US economy, to a great extent, the HKSAR will be immune to such problems since the ability of the PRC, proper – being distinct from the HKSAR of the PRC – to diversify its markets and, at the same time, continue to encourage a thriving consumer market within the Middle Kingdom, it will result in only a minimum amount of time to stop a temporary financial hiccough in these 416 square miles.

And so, as **TARGET** has stated, many times in the past year: Stick with Asia.

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