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THE LEMMING FACTOR: DON'T FALL OVER THE CLIFF

Just about every day, as soon as one tunes the television set to nearly any international station, one is bombarded by statements to the effect that this is *'reporting season'* and investors are watching their *'darlings'* in order to obtain a positive inkling of the direction of the US or the European economies.

Then, there are those wonderful interviews with some of the so-called experts of Wall Street.

Here are some of the classic prognostications:

About 8 months ago, a Wall Street guru stated: *'If you are not fully invested, you are too late …'*.

An investment manager of a large US investment bank, one of the largest in the world, in fact, stated about a fortnight ago: *'On a dip* (in the Dow Jones Industrial Average, the benchmark of The New York Stock Exchange)*, it would be a good opportunity to start accumulating stocks in such companies as …'*.

And, just last week, one was told by another US merchant bank expert: *'It looks as though the market is bottoming out. Yes, risk aversion is over …'*.

Fiddlesticks!

Last Monday, **I**nternational **B**usiness **M**achines Corporation (**IBM**), the world's largest technology services company, announced that its second-quarter revenue had risen by about 2 percent to $US23.70 billion, Year-On-Year.

Management stated that revenue had been reduced due to foreign-exchange translation paring of about $US500 million.

The Net Profit Attributable to Shareholders had risen, Year-On-Year, by about 9.68 percent to about $US3.40 billion.

IMB's share price fell by about 3 percent after trading hours on The New York Stock Exchange.

That which hurt IBM was, in fact, the fall in the translation value of the euro vis-à-vis the US dollar.

Wall Street gurus, it appeared, had forgotten about such a probability.

Pundits of Wall Street often tell investors to look to the past in order to learn about the future.

What the pundits fail to state, however, is that nothing permanent except change.

However, let us look at some statistics of the more recent past:

For the week, ended July 16, 2010:

The Dow Jones Industrial Average lost 0.98 percent
The Composite Index of The NASDAQ shed 0.79 percent

The Hang Seng Index gave up 0.62 percent
The TOPIX Index surrendered 2.40 percent
The Nikkei-225 Stock Average lost 1.85 percent

The above compared with the week, ended July 9, 2010:

The Dow Jones Industrial Average gained 5.28 percent
The Composite Index of The NASDAQ put on 5.00 percent
The Hang Seng Index rose 2.38 percent
The TOPIX Index racked up a gain of 3.64 percent
The Nikkei-225 Stock Average put on 4.15 percent

What do the above statistics prove?

Nothing.

Nothing at all!

Investors who went, charging into stocks and shares, during the week, ended July 9, 2010, today, might well be ruing their decisions because, in all likelihood, today, they are staring at losses.

Rather than be led by a lemming to the cliff's edge, investors would do well to look at the entire picture of developed world's economic health (or lack of it) and embark on an investment policy, based on facts, not on prognostications by people whose job it is to try to churn the market(s) … and clients' discretionary funds under their care.

Some Salient Facts about Life and Living

Many people tend to forget some very basic points about life, generally:

1. If people don't have work, they cannot spend money;
2. Nothing could be more disconcerting for the former, successful bread-winner of a family than to find himself/herself, being unable to meet monthly expenses through no fault of his/her own;
3. If the market price of homes continues to drop, markedly, over an extended period of time, families, which have invested their life savings in their homes when prices were materially higher, lose heart, and the chances are that they will act irrationally;
4. Crime increases rapidly in times of dire financial stress in an economy; and,
5. Like it or not, people put a lot of store in their nest-eggs and do not like to have them put in jeopardy and, definitely, will not tolerate a situation, not of their making, whereby the nest-eggs have the ability to be eroded, substantially.

The above list, of course, is not a complete list, but it covers a wide spectrum, nevertheless.

Looking first at the matter of the most-cherished asset of most families, not just in the US, but around the world.

New, single-family homes sales in the US in respect of the month of May came in at about 300,000 units, down about 32.70 percent, compared with April's revised statistic of 446,000 units.

New single-family home sales for May 2010 were off by about 18.30 percent, compared with the like month in 2009.

The US Government's incentive plan to get people to put money into bricks and mortar came to an end on April 30, 2010, and, with no tax-credit help from the US Government, it was well expected that there would be somewhat of a disincentive by families to make a whopping investment in a new home.

Certainly, not in an environment of insecurity as is prevalent in The Land of The Free and The Home of The Brave, today.

The immediate effect of the cessation of the tax credit is going to be an increase in inventory levels of new homes in the US, resulting, most likely, in declining prices, again, resulting in home-owners, wondering how in the world they got into their present, near-crisis financial situation.

What is, or should be, worrying about the May statistics is the extent of the decline in new home sales.

According to The National Association of Home Builders (of the US), its Housing Market Index is standing at a decade low.

Clearly, the US housing market is highly unlikely to recover in 2010 and it may not even start to recover before the middle of 2011.

Meanwhile, it is clear that the economic recovery in the US is not on the course, claimed by President Barack Hussein Obama: It has slowed, appreciably.

This must be the case because the backbone of any economy is exemplifies, clearly, by the price of real property.

Meanwhile, it is obvious that the unemployment level in the US is touching the 10-percent level, once again, if truth be known.

Every week, now, Wall Street watches, anxiously, for the latest figures with regard to claims for unemployment benefits and the latest figures from The Bureau of Labour Statistics as to the percentage of US workers, pounding the streets of cities, looking for employment.

Even after the figures with regard to the labour situation in the largest, single economy of the world are released, statisticians try to ascertain how many unemployed people in the US have become so disheartened that they have given up, trying to obtain jobs, awaiting a miracle … or are earning money through various devious and/or circuitous means.

This group of workers is not factored into the statistics of The Bureau of Labour Statistics, which is a branch of the US Labour Department.

The US Federal Reserve

At its Open Market Committee Meeting for the month of June, The Federal Reserve stated that it was concerned about the pace of recovery of the US economy.

In short, economic recovery is beginning to stall, in laymen's language, although The Fed would be reluctant to make such a statement, definitively, for political reasons.

Deflation is not, yet, a major concern for The Fed, but the risk of deflation is unlikely to recede until growth in employment in the US starts to rise, appreciably.

It goes back to the simplistic statement that if people do not have money, they cannot go to the High Street to spend it.

Deflation is defined in economics as being reduced economic activity: The reduction of general economic activity, including lower prices and a reduced supply of money and credit.

On July 2, 2010, Mr Keith Hall, The Commissioner of The Bureau of Labour Statistics, said, in giving testimony to The Joint Economic Committee of The Congress of the US:

> *'Nonfarm payroll employment fell by 125,000 in June, and the unemployment rate edged down to 9.5 percent. The decline in employment reflects a large drop in the number of temporary workers for Census 2010 ...*
>
> *'Over the month, federal government employment declined sharply. The number of temporary Census 2010 workers dropped by 225,000, leaving 339,000 temporary workers on the Census payroll ...*
>
> *'The manufacturing workweek declined by half an hour in June, more than offsetting an increase in May ...*
>
> *'Construction employment fell by 22,000; specialty trade contractors accounted for most of the decline. On net, construction employment has shown little change over the last 4 months ....*
>
> *'Turning to measures from the survey of households, the unemployment rate edged down by 0.2 percentage point to 9.5 percent in June. Of the 14.6 million unemployed individuals, about 6.8 million had been jobless for 27 weeks or more. In comparison, 1.3 million persons were unemployed for 27 weeks or longer when the recession began ...*
>
> *The employment-population ratio edged down to 58.5 percent in June. Among the employed, there were 8.6 million individuals working part time who preferred full-time work. The number of such workers has fallen by 525,000 over the past 2 months.*
>
> *'In summary, payroll employment fell by 125,000 in June, as modest growth in the private sector (+83,000) was more than offset by a large decline in temporary census workers (-225,000). The unemployment rate edged down to 9.5 percent ...'.*

Not very encouraging stuff, is it?

The Matter of Credit

More and more mortgage defaults are cutting a large swath through banks' balance sheets.

As a result, banks continue to be very reluctant to extend credit.

Consumer credit is weak; and, is weakening.

The bugbear is, of course, high unemployment in the US which, in turn, means a lack of cash-flow for families.

US banks put a lot of store in cash-flow, more so than European banks, which look more at a prospective borrower's collateral to cover any credit, being requested.

The delinquency rate in June was about 7.16 percent, up about 1.27 percentile points, compared with the delinquency rate for May.

Defaults in June were at their highest levels since March.

Household credit conditions border on the desperate.

Since the end of the first quarter of 2010, the pace of any appreciable improvement in the lot of most families' income has slowed.

This is very apparent when one notes the sales of chain stores.

For the week, ended July 10, 2010, sales at chain stores fell by about 1.50 percent, completely reversing the trend of the gains of the previous fortnight, according to the statistics, produced by The International Council of Shopping Centres.

With weak consumer fundamentals, one would expect that chain-store sales would wane.

Add to that, the matter of the gyrations in equity markets and the continued high unemployment level in the US, and one can see the writing on the wall, only too clearly.

What is apparent is that, in the US, growth in income, employment, wealth creation (or the lack of it), borrowing, and consumer confidence remains pitifully weak.

The Fed is restrained from raising interest rates, now or even toward the end of this year, because the already weak economy is unlikely to be able to withstand any increase in outgoings.

And, Then, There is Europe

The exact economic situation in Europe is unknown.

The most-recent hiccough was when the **I**nternational **M**onetary **F**und (**IMF**) and the **E**uropean **U**nion (**EU**) suspended its review of Hungary's funding programme, that programme, having been established to try to save Hungary from going the way of Greece.

In other words, the IMF and the EU have been trying to save Hungary from a financial meltdown.

Moody's Corporation, after studying the finances of the Irish Republic, determined that its sovereign bonds rated Aa1, down a notch from Aa2.

Moody's questioned the country's economic growth potential and said it expected growth to continue to wane for between 3 years and 5 years.

It is fact that Greece, Portugal, Spain, Ireland, Hungary and even the mighty United Kingdom are not financially healthy, with Greece, being technically, potentially on the balls of its proverbial arse; Portugal and Spain, not that far behind Greece.

How many other European countries share a similar fate as Greece is yet to be admitted.

Europe is the largest single economy for Chinese-made goods, at this time, the US, being the second largest market.

If the situation in Europe continues along its present course, it will have a knock-on effect, around the world.

The worst is still to come, it appears.

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