# Weekly Perspectives

Website: www.lomam.com

Email: info@lomam.com

iraj.pouyandeh@lom.com

## A Weekly View of Global Economies

14 June 2005

**North America**
The stock-market rally that started in April has stalled in the US but has continued to forge ahead in Europe, with the DJ Stoxx 600 hitting a 52-week high. At first sight, this does not appear to be in sync with relative economic growth rates, because the consensus expectation is that the United States will handily outperform Europe on that score. But there are other factors to consider, including comparative valuation and the interest rate cycle.

Interest rates are obviously on the rise, Stateside. So there is a good deal of concentrated attention in divining the Fed chairman's thoughts. Unfortunately, through decades of practice he has perfected the skill of expressing himself in a way that allows him plenty of room for manoeuvre.

The market is currently foreseeing two more rate hikes totalling 50 basis points - - probably in succession. But there is divided opinion about what happens after that. The primary reason is that the data has not been consistently weak or strong but somewhat erratic. So, unless a clearer trend develops, policymakers will opt for being slow rather than fast in reacting to short-term signals. There is too much risk in being overly proactive and making a mistake.

The overall backdrop of the global economy is still broadly a deflationary one. In addition, corporate margins and labour market conditions in the United States don't point to accelerating inflation. So, these factors tend to argue for a cap on interest-rate increases.

But the US stock market has been rather too quick to anticipate an end to monetary tightening and another bull run in equities. It is not assured that this will occur right on cue, after the Fed stops hiking. Right now, there is scepticism among some investors about the recent rally. In particular, the technology sector that has been at the forefront of the market's upward movement since April is showing some hesitation in making further gains.

**Europe**
In contrast with the United States, Eurozone monetary policy is on hold and there is increasing speculation that a bit of easing may be in the offing during the second half of the year. The Monetary Policy Committee of the Bank of England may also be mulling over interest rate cuts, which explains why investors are taking a second look at previously shunned sectors such as banks and homebuilders.

Equity valuations are, in general, more attractive in Europe than in the States. We say "in general" because there are sectors where the reverse is true, such as pharmaceuticals. But the market as a whole is relatively cheaper in Europe. As an asset class too, European equities look good when compared with expensive bonds. The dividend yield often compares very favourably with low-yielding government bonds - - and there is the added potential of capital gains.

Meanwhile, the euro has fallen substantially against the dollar over the past few months, potentially boosting the bottom line of many exporters. Investors have been quick to identify those stocks that stand to benefit most from further euro weakness.

These are all positive factors that have combined to offset the impact of weak economic momentum and downbeat sentiment. Consumer confidence remains fragile in the face of substantial unemployment. In addition, leading indicators haven't bottomed out yet. But as long as monetary policy remains easy, global growth continues at a steady pace and the domestic macro environment stabilises, European equity markets should hold up well.

Be it noted that we are talking about the aggregate behaviour of the Eurozone economy, which hides many disparities. There is considerable diversity within the region between stronger and weaker economies, and this poses major problems for conducting monetary policy, resulting in growing tensions about the benefits of monetary union in those countries that have been lagging in the growth and competitiveness rankings.

Domestic retail investors (as opposed to foreign and institutional ones) are notoriously risk averse, and have yet to show much interest in equities. They are usually the last to participate. But when they do, there should be further support for the stock market.

**Asia/Pacific**
Analysts are becoming more optimistic that the Chinese government will broadly succeed in reining in the pace of capital expenditure growth. Also, construction activity appears to have slowed down in response to measures taken by the authorities to restrict speculation. However, the outlook for the property sector remains uncertain and a hard landing could lead to a sharper slowdown in the overall economy than intended by policymakers. Furthermore, it could have a negative impact on the banking sector, which is none too robust.

**Bonds**
The yield on the benchmark Treasury 10-year note has breached the 4 per cent level and is edging higher, from overbought conditions earlier in the month. This has happened despite evidence of moderating growth and non-threatening inflation. Observers have attributed some of the correction to profit-taking by those who had put on curve-flattening trades. Undoing the trades would involve selling long positions in 10-year paper.

**Currencies**
Sentiment is still bullish towards the US dollar, which has made further gains against the euro. Meanwhile, higher-than-expected consumer prices in the UK and inflation-fighting words from the governor of the Bank of England dashed hopes of a cut in interest rates during the summer months. Sterling found a bit of support versus the greenback, as a result.

***Iraj Pouyandeh***
***Strategist / Senior Portfolio Manager***

*Prior to joining LOM Asset Management, Iraj Pouyandeh worked for Sun Life Financial in Toronto, advising on the global economic and financial outlook and strategy for the company. Mr. Pouyandeh manages the LOM Equity Growth Fund.*

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LOM Asset Management Limited
27 Reid Street
Hamilton, HM 11
Bermuda
441-295-6999

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