

# Weekly Perspectives

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## A Weekly View of Global Economies

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### North America

Stock markets suffered a sharp correction, last week, after the release of soft economic data and some disappointing earning reports. The US retail sales report came in weaker than expected, and this was later followed by the release of the Michigan survey of consumer sentiment that was anything but encouraging. Needless to say, the state of the household sector is important because they accounts for the largest portion of GDP and -- up to now -- most of the growth in the economy.

Oil prices have fallen sharply, recently, but the pass-through of previous high energy costs is still hurting consumers. Combined with rising interest rates, this is likely to constrain their willingness and ability to spend. Meanwhile, a falling stock market is decidedly unhelpful, because it has a negative impact on household net worth.

The earnings season is underway and, thus far, the results have largely failed to impress investors. Last Thursday, equity markets were already heading south and were distinctly vulnerable to further bad news. So when IBM came out with disappointing earnings and a profit warning nothing could prevent a serious sell-off.

IBM is something of a bellwether -- as a gauge of corporate spending -- and, unfortunately, it reported weakness in all its business areas: hardware, software and services. It was enough to set off a selling frenzy that hit tech stocks really hard, but was also quite broadly based. A good result from General Electric, combined with an upbeat forward guidance, was not enough to stop the rot.

The market is trying to come to terms with a slowdown in earnings growth, not just for the first quarter but for the even more challenging period ahead. Stocks that don't meet expectations are punished severely, none more so than in the technology sector,

Many investors have rotated out of cyclical into defensives. Apart from the tech sector, industrials and basic materials have also been beaten down. Refuge is being sought in sectors that have steady earnings and decent cash flows, such as healthcare and consumer staples. Yesterday's Cinderellas are being courted once again, with the cyclical looking rather like the ugly sisters after the make-up has come off.

Still, whenever there is a sharp sell-off one expects a degree of rebound, and it is more than likely that the cyclical may show a bit of life as a result. Also, hedge funds are adept at engaging in rapid rotation in and out of sectors that are overbought or oversold in the short term.

The US economic outlook is far from bleak, but remains challenging. Interest rates are on the rise, consumers are feeling the pinch and corporate profits will slow as the economy cools. Equity markets, which are supposed to be forward looking, may finally have smelt some trouble on the horizon.

Metal prices are generally softer, and the CRB index is down sharply. This sort of price action is usually the result of downwardly-revised expectations about global growth and an unwinding of speculative positions. As for China, the data is fudgy but there is little evidence of deceleration in the economy, yet. In the past, Chinese economic growth has often surprised on the upside by re-accelerating. Any sign of this happening will help stabilise commodity prices.

At this point in time it is important that a broad index, such as the S&P 500 should show some firmness, and resistance to further downward moves. Some observers are counting on the high degree of bearishness shown by individual investors as a contrarian indicator.

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In other words, after bearish sentiment has reached a point of exhaustion, buyers may be willing to step in. But for this to be anything other than a dead-cat bounce, it is necessary to have a positive piece of earnings or economic news that can fuel a rally, at least in the short run.

### Europe

In Germany, the ZEW index of investor sentiment fell sharply, indicating quite a bit of gloom among institutional investors. It appears that because of weak growth firms have limited pricing power and may be absorbing a good proportion of cost increases. High unemployment and energy prices are also hurting consumer confidence in the Eurozone's largest economy.

### Asia/Pacific

There has been more soft economic data out of Japan. Industrial production was revised down and consumer confidence has declined as well. The Nikkei 225 index, which was already heading south, was given a further push downward by investor worries about anti-Japan protests in China. However, it appears unlikely that the current troubles will be allowed to get out of hand because both countries have economic interests at stake. Currently, the sell-off in the Nikkei has been so precipitous that a short-term rebound is likely.

At the same time, a longer-term game of geopolitical strategy is underway, in which China is intent on preserving its predominance in Asia. And this brings it into rivalry with Japan, as well as the United States. The latter two powers have been surprised at the speed with which China has grown and spread its influence abroad. If Chinese growth proceeds at the pace we have seen in recent years, then it won't be hard to guess where to place bets on the likely winner of the strategy game.

### Bonds

Slumping stock markets, last week, sent corporate bonds lower and Treasuries higher. Evidently, there was safe-haven buying of government bonds and a flight to quality. Recovering equity markets reduced the attraction of bonds, but producer price inflation was in line and this put a cap on any upward move in yields. However, stronger-than-expected consumer inflation could renew rate hike fears and rattle the bond market.

### Currencies

Escalating interest rate expectations have been scaled back recently and the US dollar has lost ground versus the euro. However, the greenback could find some support if the CPI numbers surprise on the upside. Lurking in the background are the issues of global imbalances and lack of flexibility in Asian currencies, which have the potential to cause greater forex volatility in the future. Meanwhile, there was another call from the US Treasury secretary on China to loosen the renminbi/dollar exchange rate. But, normally the Chinese government does not respond positively to strong pressure from the United States.

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