

# Weekly Perspectives

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## A Weekly View of Global Economies

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### North America

Bullish sentiment has yet to wane on Wall Street, and this is reason enough to make contrarians a little edgy. Going forward, economic data releases have to be good enough to support the current optimism, and a slip-up in an important number such as the upcoming payroll report could be enough to give the market a bit of indigestion, even though investors would like to delay this until after the seasonal festivities.

Post-Thanksgiving sales reports have been generally OK and, as expected, the higher-end retailers have done better than the downmarket ones. The biggest one of all, Wal-Mart, had disappointing November sales. It was a result of the retail giant trying for a bit more margin instead of "everyday low prices" and customers being pinched in the wallet.

As for richer folk, they filled up their gas-guzzlers to the brim and celebrated their good fortune by spending at posh shops, where discounting isn't the norm. However, their valiant effort didn't do much to lift the stocks of fancier retailers. Valuations are topy and investors may have been prompted to reduce their exposure and put money into other sectors. Smarter people cashed in their chips before the Thanksgiving holiday - - and there was profit to be had, as many of these stocks experienced a very good run in the past few months.

In Europe, luxury names such as Christian Dior and LVMH have also been struggling. However, among some analysts, there is residual hope that oil sheiks may splurge more than usual on deluxe items, spending some of the depreciating dollars that have been flowing into their treasuries - - a nice thought, but don't count on this to support the stock prices.

Generally speaking, the absorption capacity of many OPEC oil producers is not high, which means that they will save, rather than spend, a large portion of their receipts. This tends to act as a dampening factor on global activity. The other issue is that oil is priced in dollars, so that oil exporters' revenue flows are in the form of a depreciating currency.

Buying goods and services ticketed in dollars won't hurt their books, but purchasing goodies denominated in other currencies is becoming ever more expensive. Even worse is the practice of keeping large dollar balances in reserves that have further room to diminish in value.

Post-Thanksgiving rumours are continually popping up that Asians are losing their appetite for dollar assets and it has dawned on them that only turkeys gobble them up in such large quantities. Officials are probably already mulling over the issue of shifting their asset allocation among reserve currencies.

Given the huge balances held in dollar reserves, any sudden move can be highly destabilising. We shouldn't expect a run for the door, but the fact remains that those who act fast, leaving slowly and quietly, have first-mover advantage.

The twin deficits in the United States - - the budget shortfall and the current account gap - - will continue to weigh on the greenback's fortunes.

But the imbalances are so big that not all the adjustments can be effected via currency depreciation. It would require a big fall in the trade-weighted value of the dollar to bring about some semblance of balance. So to get things back into some sort of order, we would, ideally, need a faster rate of growth abroad relative to the US.

With all the chatter about possible portfolio shifts by foreign official bodies out of dollar assets, interest rates are heading higher, Stateside. It is not surprising, then, that the fear of financing the US deficits has increased. Treasury yields have risen, as investors begin to price in a bigger risk premium. Meanwhile, gold has breached the \$450 level, signifying concern about the dollar's slide and a possible upside to inflationary pressures.

An upward move in interest rates is an unwelcome event for the US equity market. The earnings yield gap between stocks and bonds has favoured equities because fixed-income instruments have been yielding so little. If interest rates continue to rise, this will pose another challenge for equity valuations.

### Europe

With the euro continuing to trend upwards versus the dollar, investors are focussing more closely on sector and corporate exposure to USD earnings. One of the least exposed is the telecoms sector and one of the most threatened is the pharmaceutical category. It is not hard to guess which one has been the better performer.

### Asia/Pacific

Risk appetite remains high and non-Japan Asian markets have generally been doing well. Valuations are fairly reasonable and economic structures sounder than they were in the late nineties. An edging down of oil prices is also helpful. Still, there are risks if global interest rates rise faster than expected and the world economy falters.

### Bonds

Jitters about foreign willingness to fund the US deficits have been haunting the Treasury market. Bearishness is on the rise and it will take some strong deflationary data to reverse the current negative sentiment.

### Currencies

The dollar has been staging a short-term rally against the euro, but it doesn't look very convincing and the longer-term prospects for the greenback remain fragile.

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