

Weekly Perspectives

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A Weekly View of Global Economies

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North America

Oil prices have risen from their mid-May lows, but the trend is still broadly downwards and this should help household disposable income. The overall rise in oil prices over the past year has prompted people to switch to more fuel efficient vehicles, but apart from that there hasn't been much change in driving habits. However, lower-income households have obviously been hurt most because of high gas/petrol prices.

One of the problems faced by big US vehicle manufacturers, such as General Motors, is that they have been caught with an unsuitable product mix. They were geared to producing too many gas-guzzling SUVs that were highly profitable in years past but are no longer the top choice among an increasing proportion of buyers. Of course, GM has a litany of other problems, including hefty healthcare and pension costs.

The stock looked like an easy short for hedge fund managers a couple of weeks ago. Unfortunately, they were badly burned when Kirk Kerkorian declared a stake in the company, resulting in a spike in the stock price. Presumably, Kerkorian's intention is to eventually force a significant restructuring of the firm.

However, effecting change at GM isn't going to be easy. The global auto industry faces challenging times and intense international competition. But it can be done, as Carlos Ghosn demonstrated when he turned around Nissan's fortunes.

Metals prices have picked up a bit lately on renewed hopes for Chinese growth. Even so, the London Metal Exchange index is well down from its March highs and it will take a lot of positive news about accelerating global growth for a major trend reversal.

Europe

French voters have decisively rejected the proposed European Union constitution. They were in a rebellious mood and took the opportunity to hit out at the political establishment. Many observers have questioned the wisdom of submitting a 400 page document to the popular vote. Are the elite so removed from the masses that they forgot about the virtues of brevity, clarity and simplicity? Maybe the agenda for political integration in the Union is too ambitious?

Mediocre economic growth and high unemployment is prompting voters to punish their leaders. Not just in France but in Germany too voters went out of their way to send a message of rejection to those in power. The momentum of the French vote will be carried over into other countries, which means that the present formulation of the EU constitution will have to be shelved.

There is little doubt that we are witnessing an anti-liberalisation backlash in many core countries. Old Europe cannot stand the pain of too much restructuring and open competition. The political and business elite tout the benefits of competitiveness to a sceptical audience. The majority of the population fear uncertainty and unemployment.

It is very likely that the pace of reform in Europe will slow down further. Liberalisation will suffer a setback. Governments will seek to placate

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angry electorates and this will mean easier fiscal policy. We should also expect a tendency towards protectionism and more strident talk on trade issues.

Countries that were already running high budget deficits because they did not have the will to institute structural reforms are likely to backslide even more. Meanwhile, the lack of labour market reform means that mobility will remain poor and prevent markets from adjusting to economic signals.

The Eurozone economy remains weak but the European Central Bank is holding out from cutting rates, although many observers have been calling for the need to stimulate growth. Longer term, the ECB is likely to adopt a tighter monetary policy to counter an expected loosening of fiscal policies, despite overall lacklustre growth. The reserve currency status of the euro relative to the US dollar is shakier now than it was previously.

Asia/Pacific

Most East-Asian countries, ex China and Japan, are still dependent on the global growth leaders as the primary engines to drive local economies. In years past the US did most of the pulling, and now China plays a big role too. Exports are decidedly more important than domestic consumption. Saving rates are high and locals haven't shown much appetite for equity investments, preferring low-yielding bank deposits instead.

Bonds

As usual, the US payroll report at the end of the week will provide excitement for bond investors. Currently, the market does not appear to be worried about higher inflation. We are seeing more yield-curve flattening, with the two-year Treasury note holding up and the ten-year trending lower.

Currencies

The euro, which was already moving lower against the US dollar, fell again after the French referendum. It is unlikely that its fortunes will improve in the short term, as relative growth rates, interest rate spreads and sentiment continue to favour the greenback.

Longer run, it is a tougher call. A mix of loose fiscal and tight monetary policies, under conditions of high capital mobility and a freely floating exchange rate, is usually conducive to an appreciating currency. But it is too early to make such a call. We should also be watching relative productivity growth rates, purchasing power parities and political developments. Right now, none of the above factors is supportive of the euro.

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