Economic Views for Investors

by Roger Nightingale

Pointon York SIPPsolutions

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Security prices are plunging . . .

When asset prices fall steeply and broadly, it's nearly always because monetary conditions are being tightened. Is that what's happening now? Almost certainly. The Australians may have begun the process at the end of 2009, but it's been the Chinese who've made the big difference in recent weeks.

. . . in response to China's credit squeeze.

All round the world, stock markets have felt the consequences. Where previously there'd been an excess of cash, there's now a deficiency. Towards the end of 2009, investors had been impelled, almost against their better judgment, to buy assets to absorb liquidity. Today, they're being pressured, almost against their better judgment, to sell them to restore it.

It'll probably get worse before it gets better.

In the weeks ahead, it's possible that the squeeze will be intensified. The Americans, conscious of the strength of GDP in the final quarter of 2009, will feel that the threat of inflation has risen, while that of recession has receded. The Fed is bound to moderate the stimulus; it may reverse it.

The US will also tighten. India and Brazil likewise.

The Brazilians and Indians will probably follow suit. They've reported brisk real growth in the recent past, and quickening rates of inflation. That poses risks, they'll say. Better that demand burns slowly for longer than that it flares brilliantly for an instant.

Europe and Japan will fiddle, ineffectively.

The only sizeable economics blocs that might feel inclined to pull in the opposite direction are Europe and Japan. Both are experiencing negligible growth and decelerating inflation. Both would benefit from an ongoing stimulus, but it's doubtful that either will be prepared to take the initiative. Both, instead, are stoically predisposed to failure.

Asset prices continuing to slide.

Accordingly, it looks as if financial austerity will continue for some while. It may not be until economics debility returns that there'll be any respite. Arguably, that'll not be until late spring.

Not until the spring . . .

US developments will be critical. The fourth quarter's GDP estimate was strong in aggregate, but unimpressive in composition. It owed a great deal to inventory accumulation. That could turn on a sixpence. If it should do so, if jobs were to start to disappear again, assessments of the outlook would change for the worse. The Fed would start to ease again.

. . .is there likely to be any respite.

Between now and then, markets are likely to disappoint; equity indices retreating significantly. Corporate profits will rise satisfactorily and balance sheets will improve steadily, but that'll be ignored until liquidity starts to relent. Perhaps the profile of 2010's price action will replicate 2009's: weakness in the first three months; recovery in the subsequent nine.

London's equities will be shunned.

It's unlikely that the London market will be favoured in either period. Economics activity is proving slow to respond to the stimulus and the authorities no faster to respond to the need to cut public spending. Tweddledum is hopeless and Tweddledee just as bad. Not content with reneging on the promise to hold a referendum on Europe, the latter's become an enthusiastic spender of taxpayer funds. Greece, apparently, is the model to which he aspires!

Economics being bad; politics worse.

Voters no longer see any difference between the major parties: both having demonstrated moral degeneracy in relation to Middle Eastern wars and financial degeneracy in relation to expenses. It's not been a case of an occasional bad apple, but of wholesale rottenness. Like their chums in banking, MPs on both sides of the aisle seem no longer to understand right from wrong. They're spongers: they demand, however bad their performance, to be bailed out by the poor taxpayer.

Remedies were more salutary in 1648.

It can't go on indefinitely. At some stage, the flood tide of anger will inundate Westminster and Whitehall. It'll leave the reprobates stranded and starving; banks' board members cowering piteously on their roof tops waiting for the rescue that, this time, won't come. Who'll divert the rivers to cleanse the Augean Stables? Who'll be the latter day Thomas Pride? Who'll purge Parliament of its festering sores?

In the near term, short the euro!

It may be a long wait. In the meantime, there'll be fun and games in the currency markets. The dollar will be strong, the yen moderate, sterling indeterminate and the euro weak. The EZ's economy is a patchy mess, and Trichet is clueless to resolve the issues. Whatever he does, whether he eases money or not, the international community will avoid the euro like the plague.

Contact us… Visit our website www.sippsolutions.com for further information on our SIPP products and services. Alternatively, contact Roger Nightingale on 01858 419300 or email rnightingale@sippsolutions.com or visit www.rogernightingale.com .