

Economic Views for Investors

by Roger Nightingale

17th July 2009

Corporate profits are growing strongly.

The corporate earnings season kicked off briskly last week. A raft of companies reported their second (calendar) quarter results, and most were well ahead of analysts' cautious estimates. But it looked as if the advances were driven more by cost containment than sales progression. Indeed, real activity (nearly everywhere in the world) continued to be subdued.

It's because costs are falling faster than prices.

The reduction in costs had been most obvious in interest rates and commodity prices. But there were significant parallels also on the labour front: pay settlements slowing and employment numbers falling. Each of these softening trends, moreover—labour on the one hand, raw materials on the other—looked set to continue for several more months.

The trend will continue for some time.

Much, of course, would depend on the shape of the economy's cyclical recovery. If activity were to disappoint, if lower interest rates and higher public spending were to fail to fire up private sector enthusiasm, speculators' bull positions in metals and energy would be unwound. Prices then might slide another 25%.

Driven by speculators on the one hand, unemployment on the other.

Labour costs would be subject to similar forces. Currently, there was huge over-manning in most parts of the world. Employers were gambling on a resurgence that would be both powerful and immediate. If, instead, it turned out to be anaemic and delayed, layoffs would start in earnest. Employment would be cut at anything up to ½% a month, and real wages would be squeezed correspondingly.

Do higher profits imply economics recovery?

Many investors (and most politicians) were quick to cite the profits improvements as evidence of economics recovery. Whether their error in doing so was deliberate or accidental is not known. It's possible, though, they'll regret their intervention. The general public is already rather suspicious of government and big business. It's widely thought that they're more concerned with their own interests than those of the community.

No. But they add to popular disenchantment.

That impression was strengthened in the aftermath last week of profits announcements from two large US banks. Both produced sparkling results and both now want to pay their senior executives huge bonuses. Will they be allowed to do so?

Bankers are thoroughly dis-trusted.

Weren't these the organisations which, only a few months ago, were said to be teetering on the edge of the abyss? Weren't these the ones that had in consequence to be supported by public funds? Weren't industrialists and retailers driven into bankruptcy, workers and pensioners into penury, to save these same rascals?

But they seem not to appreciate it.

Do the bankers feel any shame? The government officials any guilt? Apparently not. The newspapers covered the numbers fully. But didn't have to interpose a single *mea culpa*.

Government officials simi-larly.

Understandably, the taxpayer in the US feels conned. Likewise his opposite number in the UK. In both countries, bankers, though not clever enough to spot the investment scams that lost their shareholders countless billions, were sufficiently skilled to persuade politicians that economics recovery depended upon a prosperous banking sector. To this end, non-bankers had to give money to bankers in order that the latter might lend it back to the former!!!

. Are they fools or knaves?

Did nobody in government comment on the absurdity of the proposal? If the objective had been to help the non-bankers, why not leave the money with them? Was the objective then not to help the good guys, but the bad? Very possibly. When the bankers got hold of the money, they didn't lend it. Too risky, they said. They kept it for themselves.

They show no remorse, no contrition.

And was there any criticism from the authorities? Did central banks acknowledge that the policy had been ill-conceived? Did ministers or regulators? No. They all looked the other way. They all hoped that economics resurgence would moderate the anger of the people and allow official incompetence to continue unchecked.

Electorates will eventually have their say.

That's an unlikely scenario. There'll be lots of changes. Incumbent governments will be replaced by their alternates (good) and regulation will be stepped up (bad). It's unlikely, of course, that *Tweedledum* will be any better or worse than *Tweedledee*. But increased regulation is always harmful—employing potentially valuable members of society in pointless activity prevents their doing something worthwhile.

But security prices are set to rise!

The good news, and there's not much of it, is that asset valuations will rise. Bonds will appreciate because inflation is headed into negative territory virtually everywhere. And equities will follow suit because profits are going to be quite strong. There may be a rise of 15% left in the indices in the remainder of 2009; as much as 25% in 2010.

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

Disclaimer

This document is the opinion of Roger Nightingale and does not represent the opinions of Pointon York SIPP Solutions and is for your private information only. We are not soliciting any action based upon it and whilst information contained herein is based on sources we believe to be reliable, its accuracy is not guaranteed and may be incomplete. Any opinions expressed are Roger Nightingale's current opinions as of the date appearing on this material only and are subject to change without notice and might not be followed up on a specific ad-hoc document. This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of clients of Pointon York SIPP Solutions. Investment professional use only. Not for public distribution.