View from the Bridge: Friday, September 16, 2005

The equity bull market of "2000 & x" just can't get out of the blocks - first look at the post 26/8 world

The unquantifiable disruption to regional & nationwide growth has started to take its toll after 10 sessions which took us back to the top of increasingly well established trading ranges. The first pieces of hard data which include the effects of Katrina are starting to roll in. Factory measures, pre Katrina, were already soft as input costs started to work their way through the supply chain. The manufacturing boom for now looks over. The latest new jobless figure, albeit skewed by hurricane damage, is also a concern, and makes the call on growth versus inflation extremely hard. On the plus side, the construction industry, which employs over 7 million & is valued at $1.1tn, or 8% of GDP, will be busy for years to come to rebuild the estimated $100bn in infrastructure destroyed in 100 hours.

Japan stirs

Reading the ECB president's remarks this week served as a reminder of why we reside in the pro growth camp, for want of a better description. Do these people not have any interest - or a life indeed - beyond inflation? You have to wonder whether wealth creation is something that Jean-Claude Trichet has ever truly thought about, or even *brought* about. Consider Japan where inflation has been, how can we put it, pretty low for a decade and a half. The stats now tell us we can be sure their economy is indeed emerging from this extended slump. We'll applaud when they put together a few back to back years of decent growth. Nominal growth over there is still negative, so let's keep things in perspective. Granted, the several trillion dollars of postal savings that will shortly be freed up might, just might, find their way into higher return asset classes, such as US Treasuries, thus finally providing incremental spending power for domestic consumption. There are plenty of ifs and buts there, but where there's genuine light at the end of a dark, damp tunnel, we should probably pay attention.

US shaken

As regards the US, we are split down the middle regarding what the Fed should do on Sep 20th. And so is the rest of the market, and you can guaranteee so will the FOMC be. The US economy is one complex beast, a microcosm of the global economy, a myriad of dozens of interlinked dynamic economic groupings. The Gulf Coast trauma will ripple out to all these different worlds, but ultimately the growth dynamic deeply embedded in America's DNA remains unchanging & unyielding. Since Aug 26, we have seen several massive names, that dominate their respective economies, emerge through the one indicator – market action - that has the potential to sift through the confusion and chaos of these periods of dislocation. Amgen, along with Genentech and other majors, have broken out to new highs. Google, increasingly acknowledged as one of the most advanced IT organisations ever to emerge from the Silicon Valley hothouse of innovation, moves further and further into Seattle owned territory. These companies are the tip of the iceberg that is US innovation & enterprise, the bit that we can see and & understand. Amgen ($37bn), Google ($83bn), Qualcomm ($69bn), even Microsoft at a shade over a quarter of a trillion market value. They are the extreme versions of hundreds upon hundreds of brilliantly innovative companies that repeatedly spawn & grow in this huge & fertile continent. They're a big part of the reason why US equities did not fold in the face of such stiff headwinds: a massive hit to the supply side of the US economy just as we had started to see mounting evidence of a cyclical slowdown in activity across a number of cyclically sensitive industries. So this economy can probably live with another rate hike or two, just to satisfy the FOMC, and perhaps a few million Japanese pensioners as well. We should get used to this fact, and accept that the inflation balance has shifted somewhat. At the same time we should not ignore the bigger, pro growth, picture. Monetary stability is vital, yes, but equally vital is the continuing expansion of the US economy & our understanding of its unique & subtle characteristics.

The call right now

We will have to learn to live with heightened inflation fears for some months to come and well into 2006. Technically the 10 year note broke back through its 50 day moving average. It looks to have further to go on this move, but we would note there is plenty of evidence of a key barrier at 4.30, so we may be 2/3 of the way through the move. Much will depend on the next series of data. We didn't start with a blank sheet of paper post - 8/26, but a lot of the writing on the said sheet became very blurred. We're probably looking at Q1 2006 for a decent read on the bigger inflationary picture. So get used to volatility driven by half truths for now.

On gold, they tell me charts don't lie. So let's follow over the next few weeks something in the chart below that might provide a few clues about this asset class. Once we scope out the supply shock effects of Katrina, the question we have to ask is 'has the world changed out of all proportion in the last couple of years?'. Wasn't China this time last year the biggest demand shock to hit the global trade system ever? How good has gold been as a predictive tool for looking out 6 -12 months at demand, inflation, supply? Or is it a reactive tool at best. We lean to the latter. There's a trade in there we think, perhaps the next trade.