

The Death of Wealth

by Clem Chambers

SAMPLE:

JANUARY 2012: MARKETS START TO RECOVER – BUT IS THERE TROUBLE AHEAD?

There are conflicting signals in the market.

The stock market slump of 2011 was meant to have been caused by European economic uncertainty and the possibility of the eurozone's violent implosion.

The euro crisis still seems far from being resolved. However, the markets – at least outside of the 'euro core' – have recovered much of the lost ground.

Does this mean the euro crisis is over, or does this mean the fall was not about the euro crisis at all?

I think it's likely the worst of the euro crisis is over. Yet it remains hard to believe (even as a controversial optimist) that a fail-proof solution is secured. It seems that an unconsummated deal is done, yet there is plenty of room for trouble ahead.

The US and British stock markets seems to suggest otherwise – you'd think looking at the recovery of the DOW and FTSE that everything has got back to normal.

A few short weeks ago the markets looked on the brink of meltdown. You'd have been forgiven for thinking that the world had recovered from the accident of Euro vulnerability and was almost on the point of convalescence.

To get to the bottom of these conflicting signals it is necessary to ask some fundamental questions:

1) What exactly is going on?

First, the US economy at last looks like it has passed its low point. Unemployment is falling and the housing market seems set for bottoming out. The Fed has promised no interest rate rises for the foreseeable future.

Second, an American recovery will see a global recovery – even if the developing world has a rough time for a year or two. While many worry about a Greek default, it is worth recalling that the economies of the PIIGS countries of Europe are equivalent to little more than economy of small US states.

2) Have Europe's problems been blown out of proportion?

It could be that we have just enjoyed a 'suckers rally' – a reaction against the slump of the summer. Anyone who believes the market is pretty good at pricing assets will know that a strong rally is not created from stupidity, it is a result of millions of separate, carefully calculated transactions. The market being this wrong is highly unlikely.

3) Is 2012 set to be a bull market and will stock markets climb up the 'wall of worry'?

Something to recall is that stock markets are very resilient. Companies are numerous and robust; while a few might fall into bankruptcy most manage to muddle through the toughest scenarios. Companies even survive World Wars, with the biggest surviving their nation's defeat.

Accordingly, companies fair reasonably well in bad times in comparison to many other institutions – toughened by constant, hard competition they are a good bet in tough times.

4) If 2012 is going to be a strong year, how will it pan out?

The last two years have been harshly locked into the 'Sell in May and Go Away' period.

If anything, this is linked to a global rebalancing period when large capital balances are moved and hedged. This readjustment creates volatility and hurts prices. We will be fortunate if there isn't another correction in this period.

After any such correction there will be a rally and this will play to an Obama re-election market surge in the late summer and early autumn.

January markets have already predicted Obama's re-election, and none of the Republican contenders make that seem unlikely. As such, the next market strength comes in the run up to the poll. Market down – Republicans can hope for an Obama defeat. Market up – Obama wins.

In these market times, politics constantly trump economics. Unless you see a Republican as the next president we should get a strong stock market leading up to a late spring/early summer correction, followed by a recovery up to the year end.

There are plenty of things to tip this house of cards onto the floor – Iran, Europe or another debt skeleton could come tipping out of the closet; there is always a decent excuse waiting in the wings for a failed politician to blame.

Crucially, it is time to be a little less pessimistic. Recovery will come and perhaps it has already begun for the world's economic superpower.

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