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Watching the Dogs of Summer

Usually when we hit the lazy, dog days of summer, there isn't much happening in the market, and what does happen is of little consequence. This year it's playing a little differently. The market has been strong since it reversed course at the beginning of June; it looks as if it may continue for a while. We can see some positives in the current situation and as always a few warning signs as well. On the positive side we have a good economy, good corporate earnings and personal incomes, and some helpful movement from China in the currency area. The warning signs come from the housing market, the London bombings, and historical market activity.

Our economy continues to do well and even gather strength. Corporate earnings prompt the euphoria. A high percentage of companies not only met earnings expectations but exceeded them. I believe that both analysts and management are being conservative with their estimates. This follows years when both parties tended to exaggerate corporate prospects. That to one side, current earnings are good. Companies are doing well and the rising tide of a strong economy adds to their prosperity.

Personal incomes have outpaced reported growth in the economy. We expect this gap may be reduced as the figures go through their periodic revision at the end of July. Again, regardless of the revisions, income numbers are positive and this translates as strength for the economy.

China contributed some encouragement by changing the way it values its currency. Previously, the yuan was pegged to the US dollar. Thus, no matter what happened to the US dollar there was no effect on our giant trade imbalance with China. (The current deficit is some \$180 billion per year.) China has now pegged its currency to a basket of currencies including the dollar, so there will be some movement as commercial realities respond. The devaluation was in the range of 2%, a good start, but some are looking for a much larger adjustment.

The warning signs are most prominent in the housing market and the overall level of the stock market. The London bombings are a reminder that the terrorists are still out there; yet the recent events had little effect on the markets or on economies worldwide. The housing market has a host of problems primarily linked to aggressive financing structures. I have a page of statistics on this one but the bottom line is: many people are buying houses with no money down and getting mortgages where they pay interest only. When pundits speak of a "bubble" in housing, that's what they're looking at.

The overall level of the stock market gives me pause. The trend is upward, good things are happening, but history teaches us to ride the wave with caution. Many sectors are at the upper end of the demand/supply calculations. The market can maintain these levels but will at some point back off. Since we can't know definitively how this will play out, we will stick with what is, and study the details every day. Call it: Keeping an eye on those dogs.