Bill Gary's
Price Perceptions
Technical Update

 Issue #1367A • August 16, 2008

Pessimism Grows…

This week, Merrill Lynch released a survey of 193 fund managers with $611 billion in capital. The survey revealed some profound changes in manager's investment attitudes. The survey found managers…

> ...believe the credit crunch is mutating. The report's chief consultant said: "What started as a US financial crisis is morphing into a global economic crisis. Investors now expect a downturn of such intensity that it will prevent inflation from continuing."

> ...believe the world economy cannot decouple from the US. The indicated slowing in economies of Europe, Japan, Canada, and Australia have shattered the assumption foreign economies would not fall if the US slowed.

> ...view inflation as yesterday's story. Eighteen percent of the managers now think inflation will fall over the coming year. This was the largest percentage expecting deflationary price trends since 2002.

> ...now believe the dollar is undervalued. Fifty-eight percent of the managers now view the dollar as undervalued. One manager said: "The seven year dollar slide that called into question its viability as the world's reserve currency has ended. It is now apparent other economies are deteriorating fast and the whole decoupling thesis is starting to come apart at the seams."

This week, Japan reported gross domestic product (GDP) had shrunk at an annual rate of 2.4% during the quarter ending June 30. The EU reported late this week that GDP declined 0.2% in the same quarter. This compared to the US economy expanding 1.9%. However, the US expansion was viewed disappointing as billions of dollars in tax rebate checks went to consumers during the quarter. With two of the world's three largest economies shrinking, many economists now believe a global slowdown may be ahead.

The traditional method of jump-starting economies is to reduce interest rates. However, The Bank of Japan has held interest rates at 0.5% since 1995. The Federal Reserve reduced US interest rates from 5.25% to 2.0% in the past year. Therefore, there is little room left for economic stimulus through lower interest rates in these two large economies. The EU's central bank has only one mandate, to control inflation. They are not authorized to reduce interest rates to stimulate economic growth. Therefore, unless inflation subsides in months ahead, it is doubtful the EU will become a major contributor to resurrecting the global economy.

Commodity markets are having a difficult time deciding whether inflation or deflation will be the underlying force in coming months. However, with speculative money reportedly moving out of commodities and prospects increasing for a global slowdown, commodity market pessimism is growing.

Bill Gary