Perspective

Comparing Bull Markets

The first time Communist China enjoyed rising stock markets was an occurrence of the late Twentieth Century, a fortuitous time in China's history. Communist doctrines were being superceded with commercial concepts. Government adoption of western industrial practices changed everything and spurred industrial growth. Mao policies were rejected; rampant capitalism took over. The new government welcomed technological advances. Internet applications were implemented faster than they were in many western nations. China participated fully in the bull market ending the 20th Century.

The second industrial revolution was in full swing, and, to the surprise of everyone, China was leading the way.

Even more surprising, India did not participate.

During this period, global investors enjoyed prosperity as a new wave of optimism impacted the financial markets. Forecasts for rising earnings were derived from the dot com experience, which served to drive investor confidence.

After three years of industrial growth, overconfidence gave way to slower moving reality. Global enrichment did not arrive as fast as speculators had hoped. Rising markets fell as this all-pervasive attitude of fast earnings growth was questioned.

The assumption of earnings growth and productivity improvement was not a false assumption, merely a few years late in arriving, a bit slower in coming. Five years later, global markets recovered.

By 2002, earnings were indeed on the rise again led largely by technology's advances. Business opportunities, spawned by the Internet, generated rising profits on a global basis, just as had been predicted. Moreover, all of the Asian economies participated, even India's. That was a big difference. Another billion people had joined the Second Industrial Revolution.

The second bull market, which is currently in full swing, is more all encompassing than the first. It is an extension of the first, much larger. But it may be viewed differently than the one previously experienced.

The economic 'Era of Good Feeling" has given way to hesitancy, based primarily on the 9/11 attack on the World Trade Center. For everyone, not only Americans, mental attitudes have changed a little. Economic optimism is now overcast with a pall of doubt based upon fear of global conflict. This mother of bull markets seems less exuberant than its predecessors.

Today’s earnings estimates tend to be lower than published results; not higher, as was the case previously. Except for a few wonder stocks like Google, most P/Es are modest.

The difference is the degree of optimism prevailing.

The threat of terrorist attack subtly pervades investor attitudes. Most optimistic forecasts are hedged by caveats. Rising oil prices, falling real estate values, volatile interest rates and recurring inflation fears, influence, otherwise positive, views.

Fear of another world war may be keeping a lid on optimism.

While the fear of world conflict, in nuclear terms, is unimaginable, prosperity’s prospects may also be unimaginable, outdistancing all forecasts and dwarfing earlier projections of global economic growth. This time, more than one third of the world’s population has only recently become partners in global capitalism. Economic progress, as expressed by Federal Reserve officials and other respected sources, may have overlooked this phenomenon, measuring future growth through the rear view mirror. Productivity gains in Asia are phenomenal. Chairman Bernanke reflects the American view appearing to question our progress because it is slower than the nations of the Far East. He sounds a bit like the proverbial doctor reporting to his nervous patient after a medical examination;

“ I can now confirm your direst forecasts, sir. You are in perfect health.”

Indeed the world’s economies are in remarkably good shape.

Yet we are still listening to every authoritative commentary that casts doubt on our rollicking progress. Investors still look back on the sad experience of the American involvement in Vietnam and wonder if the same judgmental error may have taken place again. The American response to 9/11 in Iraq may have ignited another threat to world peace.

From these limited observations, I draw the following conclusions, believing things are better than they seem:

1) There is no serious evidence of ‘irrational exuberance’ despite the fact that the Dow is twice the level it was when that famous phrase was uttered.

2) The impact of technology has just begun to reach its outer limits, the Asian Continent. High-speed computer usage on an international basis is nowhere near saturation.

3) The rise in global worker productivity has much further to go.

4) Global markets are seldom, if ever, impacted for long, by terrorists’ acts.

Remain positive in you investment views; and stay bullish

Happy New Year.

Richard E. McConnell

December 31, 2006