

More than a War to Think About

The President made his case for war this past week and sometime this month it will begin or if not some truly unexpected event will have taken place. Everyone has their own version of what takes place next. However, the behavior of the markets suggest to me that most traders have not made any big bets about the outcome. How else do you explain the benign behavior of the financial markets this past week given the big negative surprises on employment, further disappointments on future business from Intel and the drum beat of war.

Commentators on the stock market have discovered there may be more to worry about than the possibility of a war with Iraq. Now, saying the obvious doesn't mean that anyone should panic. But a sure sign that a stock market is not sold out is when the headlines yell out something negative that everyone should have known and the stock market still goes down. By and large that didn't happen last week. I'm encouraged.

There are, however plenty of issues to worry about.

On my list would be:

- Europe's economies are looking worse, especially Spain, France, and Germany. This is not good for U.S. multinational company earnings. What they gain in currency they may lose in local business trends, never a good tradeoff.
- The hoped for U.S. recovery appears stalled, despite some good news on manufacturing orders and durable goods orders as the weak labor markets, slower growth of mortgage refinancing projected by the Fed Chairman, and higher energy costs are slowing consumer spending.
- War or no war if higher energy costs continue through the summer, the world economy could become mired in stagflation.

These issues could be viewed much more hopefully from the other side of a successful military action by the U.S. and its allies. These other issues will either not go away or return to become worrisome again before the year is out but I still believe there could be an explosive rally first.

The positive case as I see it has to include the U.S. having a quick military success in Iraq. Success will be defined as limited losses of American lives, sharply lower oil prices, and no spectacular terrorist attacks in the U.S.

The military action, based on the technological advantage the U.S. has demonstrated in the past dozen years, is a good reason to be optimistic about the military success. The risk of diehard use of chemical or other mass destruction weapons is a reason to be pessimistic. That Iraq might use such weapons is not a closely guarded secret so I am assuming we are at least prepared for the most likely uses and types. But this is war and there are no guarantees.

There are some war premiums in oil and oil product prices and there are some other reasons that product prices are up so much here at home including a harsh winter and the cut backs in Venezuela. The winter will end, at least I think so, but Venezuela will linger as a problem. However, military success would do a lot to help especially in the low energy consumption spring time.

There is and will be constant risk of terrorist activity, probably for years to come. In the immediate aftermath of the 9/11 events, it was popular to compare 9/11, for stock market forecasting purposes to Pearl Harbor and the Kuwait military actions. I was never a fan of those points in history to describe what we were about to experience.



Pearl Harbor represented the culmination of many years of world geopolitical issues that finally reached America in a very visible way. It wasn't the start of a major confrontation of two very different ways of living that may not be able to coexist. The age that we entered on 9/11 has more analogy value to the post World War II period than any other in my mind. A period of geopolitical uncertainty that does affect business and consumer confidence about the future and makes us all less willing to take risk including financial.

But as to the risk of major terrorist attacks because of any military action we might take in Iraq reaching the U.S. I believe the fears may be exaggerated. No, I don't have any special information and no I'm not saying that nothing can happen. But it does seem to me, given the avowed goal of hurting the great evil America, that if they could they would have already. There have been terrorist attacks around the world since 9/11 but thankfully, not here. I believe if they could they would have.

So where does this leave us? Waiting and waiting. I still expect a big rally in stocks if there is a successful military action in Iraq. Until then, the stock market will be whipped by day-to-day rumors and re-evaluations of the issues surrounding the standoff about Iraq. Some rallies, however brief, indicate there could be a rally if both sides somehow put off any military action. It seems to me that road is a tough one. If Saddam is still in power, terrorist groups are likely to see this as a sign of American weakness, bidding their time for better networks and weapons. The rally could be good but the painful uncertainty would soon return.

Beyond the war issues, the combination of uncertainty, weather and higher energy costs are causing consumers to be more cautious about spending their money. The tough job market isn't helping either. As I said before,

Spring will come, but with economies slowing outside the U.S. business may not resume growing very fast even with some help from Iraq. Lower heating bills and gasoline prices, could allow consumers to feel a little better and spend a little, more causing investors to feel better about the economic momentum. That's enough absent bad news out of the Middle East, for a rally sometime in the second quarter.

Now none of this solves any of the longer term issues that have investors unexcited about the future, but it's a lot better than what we have been through for months. While I remain worried about the long term I think the chance of a rally in the next 60 days are good.

The story about the falling birth rate I discussed in the previous comments, is getting a boost from the U.N. According to a NY Times article by Ben J. Wattenberg, the U.N. is changing their standard forecast that countries never experience birth rates below replacement of 2.1 to 1.85 to reflect the reality that birth rates are declining widely. Developed countries are averaging about 1.4 and developing countries are averaging 2.9, down from 6.0 in the 1960's. These trends may explain some of the current geopolitical issues between the U.S. and Europe. As we move through the next decade it will become clear that Europe will start to experiencing not only an aging population but also a shrinking one. Not exactly a script for a region of rising political power.