

# One swallow doesn't make a summer.

Certainly not in economics; nor, probably, in securities markets!

Data are sometimes viewed through rose-coloured spectacles.

Stock market reactions depending more on investor psychology than fundamental logic.

Recession is still possible, probable even—but not until end 2011.

Public spending austerity is about to begin.

There'll be lots of dissention.

But, eventually, a more balanced economy.

Last week's economics news wasn't good, just less bad as it had been during the summer. A fine distinction! But one that most investors were not minded to make. They had become accustomed to downgrades and disappointments. They'd begun to think recession was imminent. Suddenly, realising it wasn't, they reacted jubilantly. They went on a buying spree, bidding equity valuations sharply higher.

Investors shouldn't have been surprised by the statistics. The current business cycle wasn't due to peak until autumn 2011. Until then, it was to be expected that activity would advance, albeit at a decelerating pace. There was nothing in last week's numbers to necessitate a change of perspective.

The dangerous period lay, not immediately ahead, but in 2012 and 2013. That was when recession was most likely. That was when the risk of financial default and political bloodletting was highest. By comparison, the near term was going to be almost serene. Economies would advance modestly, inflation fall sharply, interest rates stay low and asset valuations rise significantly.

The big change in Britain in the next twelve months concerned the social environment rather than the economics one. Spending in the public sector was going to be cut sharply and employment in it fall accordingly. It'd not be a painless process. Where it had already begun, in Europe for instance, there'd been strikes and demonstrations. Similar disturbances were likely here.

They'd not change the fundamentals, though. Economics logic is usually on the side of the big guns: it favours those who *create* wealth rather than those who *consume* it. Accordingly, there might be twelve months or more of labour market contention, but the process would end with large numbers of public sector employees having been dismissed, and lower rates of increase of pay being offered to those who were retained.

If the authorities were to be sensible, they'd use the endgame negotiations to bring sanity to public sector pensions. Either defined benefits would be abandoned, or the retirement age at which they started to accrue would be raised. As currently structured, public pensions were insupportable. Politicians had ignored the problem for too long. An immediate increase in the retirement age for civil servants and local authority workers was the obvious first step.

One not burdened by senseless wars.

An equally obvious second step would be the cessation of military hostilities in the Middle East. If the authorities were honest, they'd recognise that the wars in Iraq and Afghanistan had been unmitigated disasters. Their cost in lives and finance sizeable; their effectiveness in containing terrorism negative.

It'd be helpful if political leaders knew something of history.

Thankfully, the one seems almost to be over, the other beginning to wind down. The Americans are marvellous. With a fine disregard for battlefield reality, they declare victory and withdraw. It's devoutly to be hoped that the current administration doesn't make the same mistake with Iran and North Korea that the previous one made with Iraq and Afghanistan.

Bush and Blair didn't, and consequently made appalling errors of judgment.

It's even more devoutly to be hoped that Britain's current Prime Minister should behave more sensibly than his predecessor. The latter, of course, was a wrong 'un. That he got elected in the first place was regrettable, a serious indictment of Britain's psephological perceptiveness (excusable only by reference to the difficult aftermath of the shambles that characterised Major's time in office). That he got re-elected twice subsequently is inexcusable. It's a stain on their reputation with which the Brits will have to learn to live!

We're still in a bull market. The best may yet be ahead.

Where should we be putting our money? Most asset classes will appreciate during the next nine months. Bonds will be buoyed by lower inflation and governmental determination to contain public spending. Expansive credit will provide the cherry that tops the icing. Equities, though, will fret about labour disputes and their possible negative impact on profits. It's only as these fears are seen to be groundless that investors will become positive.

Only property looking set to be dull in the next few quarters.

Property may be the spanner in the ointment. Commercial demand seems likely to be scaled back as private companies (and public authorities) downsize. And residential demand will be restrained by job losses and smaller pay deals. Outside London and its catchment area, therefore, despite surging quantities of liquidity, the property scene may be dull.

Valuations generally being firm unless the Bank messes up again.

The threat to general valuations comes from the Central Bank. It's only if the *Old Lady* should take it into her head to tighten money that prices would crash. Might she do so? Sadly, yes. She's done it before—in 2007, for instance. Her misanalysis then was shocking; let's hope it won't be again.

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