

ROHR REPORT

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Overview, Reports & Events,...

...Reporting Cycle Oscillation, US Bi-Election, Miscellany

Overview

Today's overview is once again brief, as we explore the extensive reasons for the whys and wherefores of the US political decision at length in extended sections of this week's analysis. Our guess is the election will not be good for fixed income, and be problematic elsewhere. This is due in part to the existing circumstance of the need for some real inflation vigilance from a Fed relying on previous disinflation assumptions while the CRB Index and Gold rise on non-energy commodity inflation. Things that are taken for granted is a recurring theme which we explore below. For now suffice to say that other developed country central banks not only expressing their concerns but actually raising base rates speaks volumes.

Any actual Washington legislative gridlock will also preclude constructive address of the fiscal problems which are troubling not just for near term government deficits, yet even moreso the case for vastly under funded medical and retirement programs. If even a bit of sense breaks through the rhetoric, a modest tax increase and strong capital investment programs may underpin the equity markets in the near term, as negative aspects of higher prices impacting those markets are quite a bit less pernicious than for the fixed income. On historic form, and even to some degree based upon their recent ability to maintain their up trends in the face of higher yields earlier this year, the equities actually like a bit of inflation. They may not find any reason for a broad correction until competition from yields becomes extreme.

The impact on foreign exchange markets is problematic as well. Competing influences from a potentially less attractive investment environment in the US may be at least partially (and possibly completely in the near term) offset by the unexpected lack of easing (and even possible return to firming) by the Fed. Exactly how that impacts the US dollar is yet to be seen. What does seem clear is that in spite of another bout of geopolitical concerns late last week, energy markets remain weak in spite of also seeing unseasonably cool upper tier weather so far this fall. That can only mean that supplies are available to meet demand. However, as constructive as that may become in the intermediate term, its near term impact is stimulative, and therefore not very good for the fixed income market.

The other, more immediate problem for fixed income bulls (and possibly their brethren in the equities if yields push up sharply) is the reporting cycle shift back to strong news. We will expand on various aspects of that below. Yet, at the very least until Thursday's return to somewhat more extensive US economic releases, after last week's strong US wage and employment data the US is in the mid-month reporting vacuum. This leaves much influence with other developed country economic releases, a surfeit of financial luminaries' opinion, and central bank activity, so closely scrutinize Reports & Events below. ECB vigilance seems that much more rightful in the wake of recent German inflation numbers, and that does not even begin to address the likelihood that both RBA and BoE will hike this week; while the BoE rarely comments, the RBA sometimes accompanies rate changes with discussion.

Yet, whatever the mood in Europe and elsewhere, the fact that the US fixed income upside leadership of improvements in the other long ends since the **T-note** first recovered back above the 107-00/106-24 range two week's ago has now lapsed once again into weakness on the failure from the 108-11/-16 resistance. Those remain the critical parameters which will set the tone, along with the lower **Bund** support in the 117.00-116.80 area, and split Gilt support at 108.80 and the 108.50-.31 range. The already weak European short money forwards will also only do that much worse if the September 2007 **Eurodollar** fails more convincingly below the 94.94-.92 support than two weeks ago as well.

The equities also suffered at the end of last week, although whether that was due to higher yields which they had already seen previous is dubious. More likely any uncertainty over maintaining the accommodative tax regime, especially the capital gains portion of it, was moreso the culprit. In the event, we do not wish to draw any major conclusions until the markets reflect the election results on Wednesday. Yet, the **DJIA** not respecting important support at 12,000 and the December **S&P 500** falling back below an important weekly oscillator level in the 1,375 area is troubling. Even when it was maintaining an overall upward push, the slippage back below that zone by the S&P normally called for a revisit to levels which are now equivalent to the 1,340 area; that also happens to be the major daily up channel and weekly MA 13 support.

The US dollar was a bit more subdued in both directions last week, holding without quite reaching its next supports at **EUR/USD** 1.2830, **US Dollar Index** .8500, and **USD/JPY** 116.00, yet not very energetic in the wake of the sharp improvement in US yields after the Employment report on Friday. We attribute this to the market wanting to see a bit more confirmation on the trend of the fixed income (which has been lacking of late), as well as any election impact. As noted above, the energy markets remain weak in their own right as the **Crude Oil** continues to have trouble pushing back through the 60.00-59.00 area, with next supports in the 55.00 and 53.00 areas.

Reports & Events

At some point during the week, as it suits their fancy, HBOS Plc's UK House Prices (Monthly and Annualized Quarterly) will be released. What we do know for certain is early today the Australian TD Securities Inflation and CashCard Retail Indices (both OCT) will be released. This will be followed by all of the Euro-zone Purchasing Managers Services Indices (OCT) and Euro-zone PPI (SEP), as well as UK Industrial and Manufacturing Production (SEP.) The EU Commission will also publish its autumn economic forecasts, German Factory Orders (SEP), and the UK NIESR GDP Estimate (OCT.) Chicago Fed President Michael Moskow speaks on the US Economic Outlook in Chicago early in the session, and is followed by Cleveland Fed President Sandra Pianalto on the same topic late afternoon; very interesting.

Tuesday starts with the Australian AiG Performance of Construction Index, followed by a series of financial luminaries' views. The Fed's Yellen Speaks on economics at the University of California, and then Japanese exposition becomes more prominent, with speeches by BOJ Governor Fukui and Vice Finance Minister Watanabe. From there it's on to Europe, with French Central Government Balances and Euro-Zone Retail Sales (both SEP), the UK BRC Retail Sales Monitor (OCT), and German Industrial Production (SEP.) As noted previous, the US reports are rather muted until late in the week, and there is not much chance that either US Consumer Credit (SEP) or ABC Consumer Confidence (NOV 5) will have much impact.

However, not to be outdone by the Fed's economic outlook tag-team effort from Monday, ECB President Trichet speaks on monetary policy and asset markets early in the European trading day, and Herr Weber speaks late in the day, on the very same topic. Once again, very interesting. And, oh yes, there's that little "election" thing in the States.

In addition to any immediate US election impact, Wednesday starts with a bang, as the Reserve Bank of Australia rate decision is likely to be a 25 basis point hike to 6.25 percent. In some previous cases when they have moved the base rate, they also issue a somewhat extensive statement, and we will be on the lookout for that as well. This is followed by UK Consumer Confidence (OCT), their Land Registry House Price figures (Annualized Q3), and Australian Home Loans and Investment Lending (both SEP), with a coda from Australian Treasury macroeconomics head Parkinson speaking in Sidney. Yet again, very interesting.

Still in the Far East Wednesday morning, the Japanese Leading and Coincident Economic Indices (SEP) are released prior to a brief shift to Europe for the German Trade Balance and Current Account (SEP), as well as the UK BRC October Shop Price Index (OCT), and the ECB's Hurley speaking at a news Conference in Dublin. While the major news remains on hold in the US, the MBA Mortgage Applications have taken on a bit more importance in the current housing focused economic situation, and the EIA Crude Oil Stocks report (11/3) is book-ended by early morning and midday speeches on the US economic outlook, both by the Fed's Dr. Moskow. Now there's something new: a one man tag-team.

Thursday sees Japanese Bank Lending, the Economy Watchers Survey and Machine Tool Orders (all OCT), followed by the Australian Employment numbers (also OCT.) Then the real fun begins. In conjunction with this month's release of the ECB Monthly Report (NOV), the bank also hosts a two day conference on monetarism, with speakers from their institution dominating the proceedings, reserving international comment and the views of President Trichet until Friday. Thursday's speeches from ECB's Bini-Smaghi, Stark, Tumpel-Gugerell, Gonzalez-Paramo, and Papademos should be very interesting. Along the way there will be further data on the UK Visible Trade Balance (SEP), and, lo and behold, the BoE Monetary Policy Committee rate decision, broadly anticipated to be a hike to 5.00 percent. After that it's back to the US, where things pick up a bit with the Trade Balance (SEP), Import Price Index (OCT), usual Weekly Initial Jobless Claims, Wholesale Inventories (SEP), and Michigan Sentiment Index (NOV), prior to another stage of the reporting vacuum on Friday. That is followed by a trip back to the UK for Leading and Coincident Indicator Indices (SEP.)

Friday is dominated by Europe after the Japanese Machine Orders (SEP) lead into the German Wholesale Price Index (OCT), French Gross Domestic Product (Q3), Trade Balance (SEP) and Consumer Price Index (OCT), along with the French and Italian Industrial and Manufacturing Production (SEP), followed by one of our favorite macro-economic indications: the OECD Composite Leading Indicators (SEP.) Of course, in the background will be the balance of influences which flow from the ECB conference on monetarism. These include speeches by ECB President Trichet, Fed Chairman Bernanke, the BoJ's Iwata and ("now for something completely different") People's Bank of China's Xiaochuan. Two considerations come to mind: Will the good Fed Chairman once again don his more vigilant garb under the sartorial influence of Monsieur Trichet? And is there possibly a need for additional passenger safety mechanisms in foreign exchange vehicles when Governor Xiaochuan shares his thoughts at a monetarism conference? Interestinger and interestinger. We shall see.

Reporting Cycle Oscillation

As we have long believed, and duly noted when we highlighted this topic several weeks ago during the fixed income selloff after the major BLS CES revision, as strong adherents to the technical approach to risk management, we have no illusions sustained trends occur because of folks drawing lines on paper or running statistical studies. They can only occur because events and the psychology which surrounds them create shifts in the supply demand balance for physical commodities, and adjustments to the risk/reward perceptions for more ethereal items such as financial instruments and equity investments. Therefore, it is not news that the news cycle is very important in setting those perceptions.

Of course, this does not just refer to the rote calendar for reports and events. It is more so a phenomenon which most experienced market observers have noted at some point that the news tends to run in cycles of alternating bullish and bearish bias. Especially when markets are stuck in trading ranges, the oscillations in this cycle can be quite short lived. Even as we were fortunate enough to anticipate the latitude for reversal of the recent short term trends into the key technical levels at the end of last week, one client remarked, "Haven't we had about enough of this?" As analysts who feel more in tune with strongly trending markets, and know that for the most part our clients benefit more markedly from them as well, we certainly second the sentiment.

Considering that we had hoped the fixed income and foreign exchange market sustained corrections throughout the summer would return to trend activity shortly after the late summer bank holidays, the extended consolidation is getting a bit tedious. However, as we always counsel, the market is what it is, and to try and make more of it is folly. In an interview after a successful game a very talented American football quarterback was asked why he and his team had struggled to score the previous week. He noted that he had been too fixated on executing his long pass play specialty, and scoring all in one gulp. Regarding his outstanding more recent performance he noted that the opposition fearing his "long ball" was leaving a lot of pass receivers in the shorter ranges open: "I just started taking what the defense was giving me." This is a constructive perspective for dealers and portfolio managers as well.

Now that it seems the fixed income is back into a potentially more bearish trend, can the news sustain a major drop, or is this just the next oscillation in the cycle? After this morning's return to somewhat weaker than expected European news, the key factor this week would seem to be whether the influence from significantly hawkish central bank activity and opinion will be enough to knock the T-note below the 107-00/106-24 support for the weekly Close. Bearish sentiment should flow to the rest of the fixed income if there is that sort of failure by the recent upside leader. If not, then these markets can remain broad trading range affairs, as the daily MACDs turning back DOWN also requires that sort of failure.

Therefore, the pointed question this week is whether psychological pressure from the more hawkish central banks will indeed be enough, or if the markets will feel the need to wait for next week's actual inflation data in the middle of the typical US mid-month reporting vacuum? Another key factor may also be the real world 'facts on the ground.' Will OPEC demonstrate any real willingness to cut production with Crude Oil prices still struggling just below \$60.00, which could become more of a burden for the equities and supportive of the fixed income? And will the non-energy commodity inflation harbingers continue their rise, with the CRB Index setting a new high above the 400 area, and the Gold sustaining its recent success in overrunning the 608-618 resistance with a move to the 660 area? We shall see.

US Bi-Election

The bad news is that the Democratic Party might actually gain control of both houses of the US Congress. Of course, then there is always the worse news that they might only capture the House of Representatives. If they were to gain control of both houses, it might actually sober them up, and get them to abandon their pernicious plans for seeking retribution from George Bush, who they actually do despise. After all, if one party controls both houses they are going to be hard pressed to explain why nothing was accomplished by the 2008 election. However, control of only one house is grounds to use it as a stalking horse for uncovering any reprobate behavior on the part of the morons on the other side of the aisle.

Any humiliation of the Republican regime in the wake of Democratic electoral victory may come to metaphorically resemble nothing quite so much as the degeneration of the French Revolution into The Terror. While the Democrats speak of lofty goals which restore America to the average Joe and Jane, and rescuing the national purse from the depredations of tax breaks provided to greedy capitalist pigs, one senses the animosity toward President Bush and his minions will spill over into dominating their agenda. Unlikely to control both houses of Congress, they will only be able to block the renewal of tax breaks to the upper class without being able to necessarily pass more progressive tax legislation.

That will allow the Republicans to portray them as the tax hike party which the Democrats adamantly deny due to the balancing act which they managed to pull off during the hot economy of the Clinton regime. However that bit of legerdemain was accomplished by sharp military cutbacks which needed to be reversed in Mr. Clinton's final budget (the bill for which was footed by the Bush administration), and extensive increase in tax revenues engendered by the chimera of the Dot.Com Boom. Truth to tell, a strategically shaved monkey from either party could have balanced a "peace time" budget in the late 1990's.

Now the Democratic Party, and especially its left wing, dreams of a return to the 'good olde days' prior to the office being stolen by the 'hanging chads' of November 2000. Of course, the fact that the whole world has changed beyond any hope of that is apparent even to them. Therefore, they prefer partisan punishment of the culprits, including the Offender-in-Chief, regardless of whether that is what the broader body politic actually wants. The average Joe and Jane would probably appreciate it if their representatives actually accomplished something instead of exerting all of their energy attacking each other for the gratification of their hard core base; but the party orthodoxy does not allow for that.

Mindless partisan orthodoxy; the sort of thing that one expected from the right wing of the Republican Party at times, especially during the Nixon years. Yet, that there is a Liberal orthodoxy is a bit shocking to those who always thought that the Left was much more open to a cross pollination of ideas than the Right. That was indeed true in large measure in the 1960's, as Free Speech, Free Love, Free Just About Everything were a relevant counterpoint to the support of both party's political leaders for the military establishment's determined attempt to keep everyone as reasonably paranoiac as necessary to fight the good fight against Communist domination of the planet.

Of course, as cracks began to appear in that monolithic juggernaut, it seemed to warrant some relief from an oppressively narrow definition of freedom of speech and expression. However, the evolution of Liberal counterpoint into the consensus view in the wake of the Vietnam War left it as heavily populated and forceful a political bloc as the conservatives had been at one point. Now the conservatives, back on more solid footing since the Reagan administration, are more interested in open and free (if indeed contentious) debate.

Unfortunately, it is now the Left which more regularly shouts down alternative voices on campuses and in other public forums. And that is the base to which the Democratic Party must play. This leaves no room for reasonable discussion of the issues; it's a love 'em or hate 'em environment, which brooks no quarter for the wishy-washy middle that would just like to see things get done. The entire output of the mid-late phase election advertisements in the US has been negative attack ads lacking any semblance of discussion of the issues, or the subtle answers to address the real problems which the nation faces. And if that approach is carried over into Democratic control of the House, it is more likely to create committee subpoenas and mindless investigations (who knew what and when), which bog government down even moreso than the lack of ability to compromise on legislation.

This is not partisan opinion on our part; even some of the senior Democratic leaders who would assume House of Representatives leadership positions if they capture a majority in that chamber have openly allied their views with Venezuelan President Chavez. Mr. Bush *is* the Devil. The US has been transformed into America the Horrible, and it's all Bush's fault because he lied, and the new sheriff is going to run him to ground. Forget about People's Republic of San Francisco Supreme Leader Nancy Pelosi ascending to the role of Speaker of the House. Other senior candidates for the committee chairmanships in areas where they can implement such an agenda have already said they will do it. We tend to believe they will.

Miscellany

Why Politics Has Degenerated Into Farce

If the previous review of the nature of the electoral beast in the US Bi-Election seems a bit depressing, there are indeed good reasons for this which go beyond sheer partisanship. Georges Santayana noted, "Those who cannot learn from history are doomed to repeat it." Many also paraphrase and combine that with what is actually another often invoked classic bit of paraphrase: Marx's (Karl, not Groucho) extension of Hegel's observations, "History repeats itself, first as tragedy, second as farce." It is open to debate whether recent US electoral tendencies are moreso tragic or farcical, and we further suggest it is problematic whether those two categories are necessarily mutually exclusive. Yet, there are additional observations from another contemporary critic of modern political systems (of both the Left and Right) and processes which are likely relevant here.

Aldous Huxley variously noted, "That men do not learn very much from the lessons of history is the most important of all the lessons that History has to teach," and, "Most human beings have an absolute and infinite capacity for taking things for granted." Association with many different types of individuals and the experience of many markets over the years has left us with a profound respect for the lessons from those combined observations. Yet, the markets' quick reward or retribution is much easier to learn from and address in its way than the gradual shifts in perception across an entire society or political culture.

Much of the crux of why empires and great societies rise and ultimately fall is embodied in these observations. This has less to do with the specific actions of national and international leadership, and much more to do with human nature. In times of relative ease the collective mind is significantly occupied with narrowly defined, self-serving goals, forgetting the efforts taken to achieve that ease which are the foundation for achievement of individual success. No less than the citizen of Rome has the citizen of the developed world become accustomed to political and commercial institutions which always seemed to be in place.

Unfortunately, the implication of what Huxley and other philosophers seem to be saying is that it classically takes an extreme threat to benefits from those institutions to refocus the population at large on defending them. The lessons of history are too tedious, restrictive and hard to digest in the easy going ages which follow great military and commercial success. Each major epoch's societies (in the broad sense of 50-80 years) must relearn them, in much the same way each of us likely touched something hot as a child to make sure the folks were right about the potential for pain. (Even those of you who were not that single-mindedly stupid likely had your own equally naïve variation of testing the real world.)

In the USA, as in quite a few other corners of the developed world, it has just become too hard to interest the next and next and next generations in the important lessons that underpin the success of liberal democratic capitalist cultures. I doubt many middle school students today have any idea who fought on which side in World War II, and why, or even the issues which made the Nazis and Imperial Japan so abhorrent to free societies; most of them would likely be hard pressed to find Poland or Manchuria or, for that matter, Iraq on a map. And in the West they are most certainly not learning about the history of the Islamic Empire, which spanned more territory and lasted longer even than Rome.

Yet, some deficiencies in the education systems notwithstanding, this is moreso due to the inability to hold their attention. History and its lessons begin to seem tedious and pointless compared to the rich distractions from consumerism. The merchant class also prefers to see the kiddies in the shops instead of sitting at home pounding away on their history lessons. There is neither anything new nor intrinsically evil about it. It is just human nature. This is no different now than when the weekend fairs in rapidly developing towns, and the invention of gunpowder weapons and the crossbow in the fifteenth century eliminated interest in the rigorous training required to become a highly respected English longbow archer.

Why Only a Crisis Will Likely Change That

Last Wednesday the Financial Times published a comment from their previous editor-in-chief Richard Lambert (who now heads the Confederation of British Industry.) He exhibited one of those traits which make the British a great people: aggressive defense of one's perspective. However, sometimes one's perspective is a bit distorted by need to believe that their industry (or former one) is either currently, or indeed capable of, making an impact on critical fronts.

His dogged belief in the existence of an 'informed citizenry' which will somehow soon be lost is refreshingly naïve. There has not been an informed citizenry since The Great Class War ended. After the left went pacifist in the late 1970's, and the patriotic working class performed a noble act of self-immolation by repeatedly voting for Mr. Reagan and Mrs. Thatcher (who rewarded them by eviscerating their leverage over the US and UK economies), nobody cares about the values and success of society at large. It is now all about issues that are driven by parochial interests.

This is as equally true of illegal immigrants singing a socially progressive version (with some significant amendments) of the '*Star Spangled Banner*' in Spanish as it is of the corporate executives caught up in the stock options back-dating scandal due to their attempt to squeeze extra advantage from already lucrative compensation packages. The bottom line is that globalization only reinforces labor's sense they will remain under negative compensation pressure, the underclass never did care, and Mr. Lambert's assertion that what remains of balanced and broad-based reportage is devolving into partisan twaddle (with an emphasis on sound bite journalism) is accurate. For the most part, it is the level of information that the public wants.

The basic view of most denizens of the developed world which sees crime in the US matched by organized street actions in Paris suburbs is the same as any reasonably intelligent citizen of Rome living through the empire's decline. This is aptly summed up by Governor Anthony Cloyd Hayes (Peter O'Toole) in the wonderfully obscure flick "*Club Paradise*" (amazingly enough co-starring Robin Williams and Jimmy Cliff): "Dear lady, I frankly do not care if the world is going to Hell in a hand basket; as long as I am one of the people holding the handle."

Not that it excuses the population at large for being so politically unaware that they deserve highly partisan sound bite election messages from a political class who rightfully feels that they do not want to bore the *lumpen proletariat* with the facts. Yet, that explains a lot of the excessive executive compensation packages, and financial business shenanigans as well now, doesn't it? Leaders often lead from the rear. When *vox populi* has little more to say than, "Where's mine; How about me", is it any surprise that they get the political class they richly deserve until their own ethic requires higher standards?

Our only question now is just how much of a tragedy (or scary narrowly avoided one) it takes to constructively redirect the situation? A terrorist nuke in a developed world metropolis? Some natural or man-made plague? The last one was World War II. Some sixty years on there are not likely many more than ten or fifteen years left in the cycle until something horrid reunites the enlightened populations. Unfortunately, there is not much to do about it until then, and the US government going into a partisan death-grip deadlock if the Democrats (as is likely) snatch control of the House means that no meaningful address of anything is likely anytime soon from the strongest economic and military power on the planet.

Remember, that's just our opinion; we could be wrong. Yet, in the wake of the rhetorical vitriol each party generated to mobilize sentiment in its extreme wing during an off-year election, that's not likely. Set your market perspective autopilot to "dysfunctional US political environment" unless the Republicans pull off a significant surprise on Tuesday. Of course, in and of itself, that doesn't really solve many of the problems either. Yet, any continued lack of progress on important issues like resolving the US entanglement in Iraq, or addressing the funding problems of the social safety net will leave them and the country in even worse shape into the 2008 presidential.

The Republicans will either clean house (ala the overdue Foley expulsion) and clean up their legislative act (find a way to compromise a bit with the Dems), or they will likely be turfed out by the Hillarynaut in 2008. And if they've failed to provide value, possibly some new creation will dominate the marketplace for ideas that is the political culture. (Whether you love or hate the Clinton's, have no doubt they will prevail if the Republicans fail to get back on track; more on that as the process progresses.)

Whichever part of the political spectrum people inhabit, they likely realize that the absolute worst case scenario for 2007-2008 is a US government so split that it will be more than totally ineffectual; it will literally seek to devour itself in a way that leaves some significantly critical business trampled underfoot on the battle field.

We look forward to providing further comments as the situation warrants, and hope you have found these perspectives helpful.

-Rohr
(www.rohrintl.com)

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