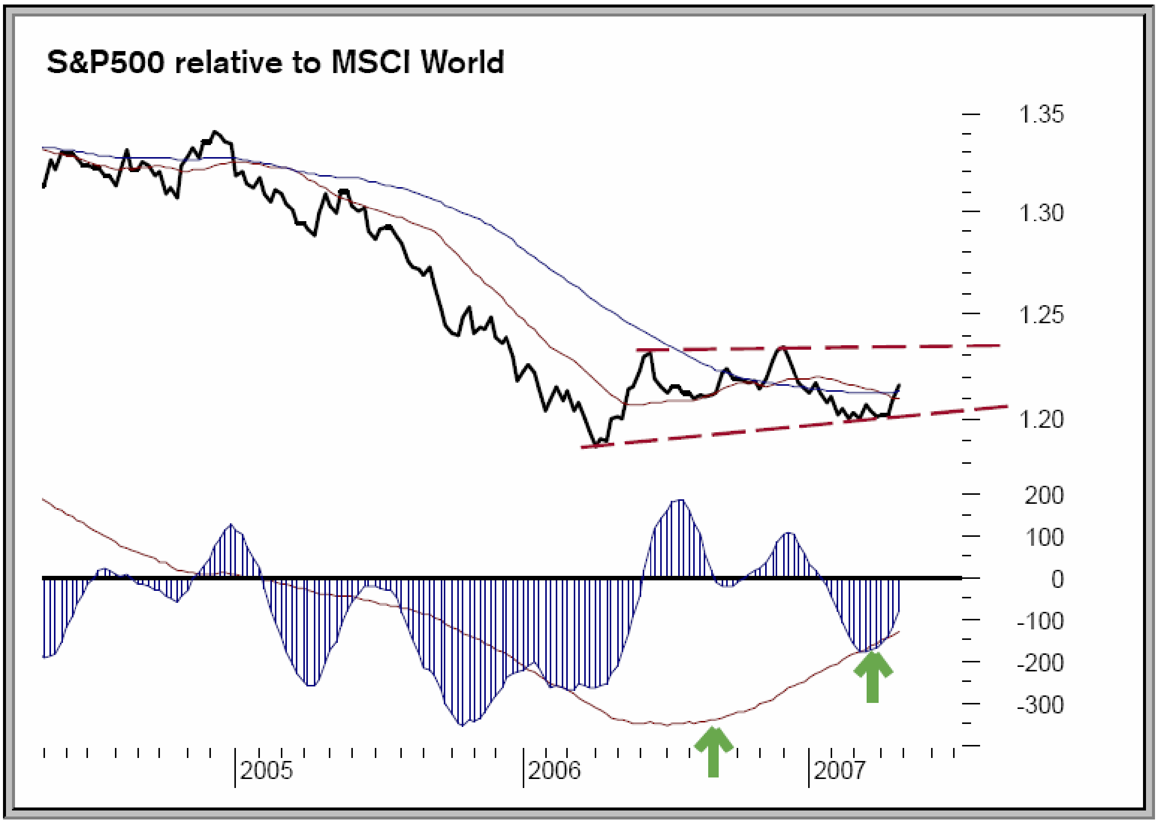
Will US Equities out-perform Foreign Stocks??

For the last few years, my view has been that to invest in US equities and especially US bonds would be a losing proposition (see Figure 1). Either US stocks or the US dollar would go down and, therefore, my preference has been to invest in commodities, and in Asian stocks and properties.

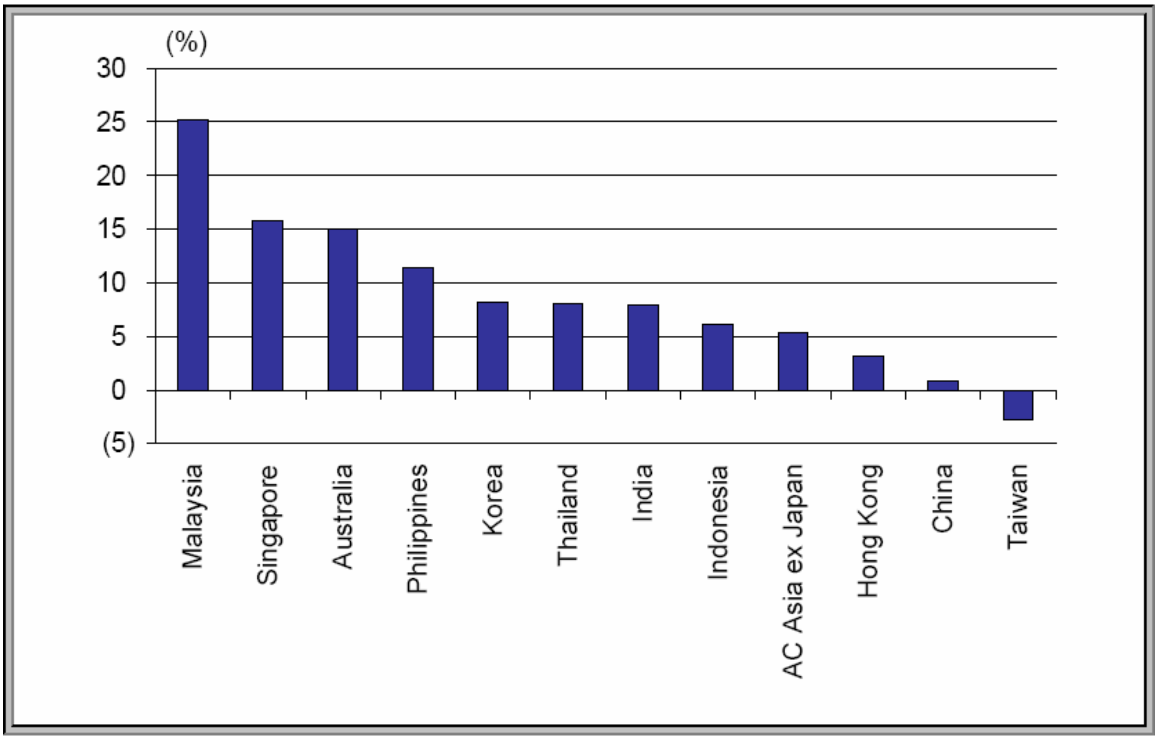
Figure 1: S&P 500 compared to the MXCI World Index



Source: Credit-Suisse

The significant under-performance of US assets compared to foreign assets has continued this year. So, whereas the S&P 500 is up in US dollar by 6% so far this year, in Euro terms it is up just 3%. Moreover, in Asia we had several stock markets that have performed superbly this year (see Figure 2). The Shenzhen and Shanghai stock markets have risen by between 50% and 100% and for gamblers they have become a major competitor to Macao where growth is now slowing down.

Figure 2: Regional Performance based on MSCI Indices, Year-to-Date



Source: MSCI, Citigroup

But not only have, since 2001, stock markets in Asia and elsewhere around the world done much better than the US stock market but also the currencies of most emerging economies have also appreciated against the US dollar and for that matter also against the HK dollar. Particularly strong were of course currencies of resource producing countries such as New Zealand, Australia, Brazil and Russia, which also had high interest rates compared to US or to Japanese interest rates. In fact, how weak the US dollar has been is evident from currencies such as the Philippine Peso and Indonesian Rupiah, which have rallied over the last twelve months against the US and also HK dollar (see Figure 3).

Figure 3: Indonesian Rupiah Rising against US dollar, Year-to-Date

Source: Mizuho Bank

I may add that the Indonesian Rupiah has more than doubled in value from its low in 1998 and is at present probably somewhat vulnerable to a setback.

So, whereas it has been a perfect strategy to avoid the US dollar and US financial assets since 2001 and to invest in commodities and stock markets and currencies outside the US, the question is whether this strategy will continue to yield superior returns in the foreseeable future. And there I have a somewhat different view. First, it would seem that some stock markets such as China, Vietnam, Malaysia and Singapore have become extremely over-bought and speculative. I do not want to go into all the details but the current bull market in Chinese shares reminds me somewhat of the big Taiwanese stock market bubble in 1989/1990 when volume on the Taiwan stock exchange regularly exceeded the volume on the New York Stock Exchange! We know what happened thereafter. The Taiwan Stock market dropped more than 80% and has never bettered its 1990 high up to this very day! Similarly, investors around the world are shifting assets into high yielding currencies and by doing so they drive up the value of these currencies. It would seem that the US dollar has no friends left….. So, as a contrarian, I am tempted to think that for a while at least US dollar bonds and stocks could out-perform the more speculative emerging financial markets. However, this is not to say that US stocks will go up (see Figure 4).

Figure 4: NYSE Composite Index, 2004 - 2007

Source: Michael Kahn, Barron's

As can be seen US equities are now also very over-bought and, as I pointed out before, they have not even experienced a 10% correction since March 2003. Therefore, I believe that all stock markets will shortly undergo a **substantial correction or a crash** during which US stocks and the US dollar could offer some relative out-performance. My favorite investment currently is to park some money in two years US Treasury Notes and to avoid all equity markets.