

BEACON INVESTMENT MANAGEMENT

THE FRIDAY BRIEF

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Plenty of Global Growth Ahead

Globalization and productivity have all but neutralized inflation. Profits in the US continue to surge while analysts play catch-up. Global economic growth looks healthy as well among the G6 countries. Earnings in Japan and Europe outpace analysts' expectations just as they do here. And the developing 'BRIC' countries; Brazil, Russia, India, and China are ablaze with growth rates as high as 10%.

The growth defies the logic of many as energy prices remain at historic highs. Industrial metals prices continue to soar as the global boom boosts demand with supplies vulnerable to disruptions. As more people around the world prosper, more commodities are required to produce they demand. Precious metals prices are also reaching new highs, with platinum at record high, and silver and gold at their highest levels in over two decades. You may have noticed that we have added to our gold position as we favor it as a good play on the general uptrend in commodity prices. Our investments in US Industrials such as Caterpillar and 3M and our country investments in Latin America, Australia, and South Korea also richly benefit from the powerful commodity trends.

Commodity prices will likely slow from their meteoric rise, but the strength and sustainability of the global expansion looks like a very long term trend. Profits are rising and the productivity miracle is global in nature, not just a US phenomenon. Rising profits and productivity cause standards of living to rise, creating more consumers throughout the world.

The Federal Reserve still has the power to bring the boom to an end in the US as do Central Banks globally. Will they do it? Ed Yardeni thinks they will stop short of crushing the expansion. He points out that central bank rates in the US, UK, EU, Canada, and Japan averaged 3.2% in May. That's only 140 bps higher than the recent low of 1.8% in April 2004, and well below the 4.6% peak during the fall of 2000. While he says that rates will likely rise from here, the upside is likely limited. The Fed may not be finished, but it is likely nearing the end of its tightening cycle. Strong currencies in other major economies might curb their central banks' enthusiasm for raising their official rates too aggressively.

Growing economies have left central banks with hoards of cash. Non-gold international reserves held by central banks rose to a record \$4.3 trillion during February, up 10.9% year over year. Emerging nations held a record \$3 trillion, up 18.8% annually. All this liquidity provides a big cushion against a global financial crisis (such as a rapid commodity price decline), and is fueling global stock and commodity rallies.

The list of worries that threaten to destabilize the world's economies is all too familiar and requires no reminders. But there is at least one development that should be mentioned. Recent moves in Bolivia and Venezuela to nationalize oil production and to

promises to take land from large landowners have threatened foreign investment in that region. The extremist policies of these dictators are being criticized by world leaders, but more importantly by global investors. The Latin American 40 Index is down 6% in the last three days.

Foreign investment in those countries will drop to a trickle if investors believe their efforts and investments could be seized at any moment on the whims of a greedy dictator. Further, it is very rare that state-run industry does well. They are usually dismal performers compared to their for-profit competitors. What is most troubling is that Venezuela is the world's fifth largest oil exporter. Add one more supply worry to the mix.

Will high energy, commodity, and metals prices eventually drag down the world's expanding economy? Possibly, but they haven't so far. As mentioned earlier, rising productivity and profitability have been sufficient to meet their rising costs without creating significant inflationary pressures. Businesses are paying more for just about everything that goes into their products, but their global competitors prevent them from raising prices. Despite all, they continue to generate profits and stock prices continue to rise.

While the US may be in the late cycles of its expansion, Japan and Europe are showing signs of new and sustainable growth. The BRIC countries are not about to return to the past. Their governments seem eager to do all they can to foster and sustain their growth. Given all the troubles in the world, there remains plenty of reason to be optimistic for our investing future. There are unlimited opportunities out there. The challenge is to avoid the myopic view that the US remains the sole engine for the global economy. That is no longer the case.