The Bear is Here to Stay

Resources and banks look set to keep the Australian share market in bear territory Another week, another dead cat bounce. After Monday's 177-point relief rally, the benchmark All Ordinaries Index fell 84 points yesterday and is well on its way to erasing the remainder of the gain today. The US Government bailout of Fannie Mae and Freddie Mac isn't going to end the credit crisis. In the words of Michael Lewitt from Hedgemony Capital Management, it might, in fact, be more like the 'end of the beginning of the end'.

There's plenty that can go wrong from here. Lewitt anticipates the second phase of the credit cycle being 'long and protracted' as sources of new capital dry up. Sovereign wealth funds, scarred by their lost billions from round one, won't be coming back for round two. As he puts it:

> *'In the second phase, which is just beginning, such capital is no longer available due to the realization that the potential losses facing these institutions are much larger than originally envisioned … The second phase of the credit crisis will claim many victims. Some of these unfortunates will not be surprises (ie regional banks that fail); others will be more unexpected (ie one or more large financial institutions). Certain investment strategies will come under a great deal of pressure, particularly those that have been most highly regarded in recent years – private equity and distressed investing.'*

Australia's banks are not immune. The lending practices of Australia's banks may have been more restrained than their US and European peers but they've hardly been conservative. Margin lending fiascos, a leveraged infrastructure meltdown and the collapse of Centro and ABC Learning Centres represent the beginning of Australia's own credit crisis. And we may have the unwinding of our own highly regarded investment strategy to contend with. Our big diversified miners are priced for perfection, but while the world may unfold as the bulls expect, that's only one of a range of possible outcomes – and you're paying dearly for it. BHP trades on 12 times last year's record profits and 116 times the 31 cents per share it made in 2003. Believe it or not, China existed in 2003 and its economy had been growing at an average of 10% pa for the previous 25 years. Investing in commodity producers isn't a risk-free game. At current prices for BHP and Rio, it's quite the opposite. Predicting markets is futile but, with resources and banks making up such a large portion of the Australian market, there are enough unresolved issues out there to suggest the bear won't be leaving us just yet.