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"War Fever" Spooks Nervous Investors

By Louis Navellier

The S&P 500 fell 1.84% last week and 3.13% in August. The Dow fell 4.45% in August. On Friday, Blackrock reported that August was its biggest month for ETF withdrawals in more than three years (since January 2010), with \$16.1 billion in redemptions through last Thursday. The S&P 500 SPDR alone had \$13 billion in outflows. These withdrawals will likely cause the strength and breadth of the market to deteriorate, but it could also increase demand for many higher-quality stocks.

False Alarms about War in Syria Spooked the Market

The stock market is nervous about reports that U.S. destroyers are off the coast of Syria, giving rise to fears of an attack that President Obama calls "a shot across the bow." But the President stands almost alone in his call for war. China and Russia would almost certainly block any United Nations approval. The British House of Commons voted 285 to 272 not to intervene in Syria – the first time since 1782 that the House of Commons rejected a Prime Minister's request for war – and Congress wants to veto or limit any military action. The President now realizes that all this complicates and delays any military action.

The fact that Iran and Russia remain staunch allies of Syria complicates any U.S. response. A "shot across the bow" might sound surgical and quick, but what if the war then escalates? There is no aircraft carrier currently with the U.S. destroyers, so any talk of an extended bombing campaign is irresponsible.

There will be serious retaliation to any "shot across the bow" or extended bombing campaign. Since Iran has threatened to retaliate by raining missiles on Israel, gas masks have been issued to all Israeli citizens, and its military reserves have been called up. I suspect that President Obama will not do anything to harm Israel and will consult Israel first. That means any military action against Syria would likely be delayed.

One other interesting aspect to this drama is that President Obama did not call Congress back during the Labor Day weekend, but instead will wait for them to return from their summer recess on September 9th. Also, President Obama will not cancel his trip to Europe and a G-20 summit in Russia, so he obviously does not believe an attack on Syria is as important enough to interrupt his trips or Congress' recess.

Syria is a close ally of Iran, so Israel and some other opponents of Iran's influence in the Middle East (including Bahrain, Kuwait, Qatar, Saudi Arabia, and United Arab Emirates) may encourage President Obama to act, but I suspect the President will wait for Congressional approval before taking any action.

The Impact of "War Fever" on Other Markets

Due to the uncertainty surrounding an imminent attack on Syria, a flight to safety began last week: Bond yields suddenly declined and high-dividend stocks reemerged as an oasis of safety while gold and silver escalated in price. Crude oil prices are now at two-year highs. Any rise in crude oil prices tends to hurt emerging market economies the most, since crude oil accounts for a higher proportion of their income.

On the brighter side, the latest rise in oil prices looks like an artificial high, based on war fears. In reality, we enjoy high oil inventories and rising domestic production, so we shouldn't fear chronically high oil prices after war fever dies down. Furthermore, the U.S. dollar is also temporarily high, since a flight to safety generally involves swapping riskier currencies for U.S. dollars. For example, the Indian rupee, Turkish lira, and other emerging market currencies were hit hard last week. As a result of the rise in gold and the fall in the Indian rupee, gold actually reached an all-time high in Indian rupee terms last

week.

Until crude oil prices come down, emerging markets will continue to be characterized by slower GDP growth, falling markets, and weaker currencies. Even oil-producing countries, like Mexico and Russia, have suffered currency erosion, despite these countries benefitting from higher crude oil prices.

For example, on Friday, India announced that its GDP decelerated to a 4.4% annual pace in the second quarter (i.e., India's fiscal third quarter), down from 4.8% annual growth in the previous quarter. This is the third quarter in a row of sub 5% GDP growth, marking India's slowest GDP growth in a decade.

Back home, Treasury Secretary Jacob Lew admitted last week that the federal government will hit its debt ceiling in mid-October and will be unable to borrow money to pay its bills. This is a bit of a surprise, since most budget experts believed that the "extraordinary accounting measures" Lew implemented last May would allow the federal government to operate through mid-November. When Congress returns next week, I suspect they will raise the debt ceiling – if they can attach some taxing and spending limits.

Stat of the Week: GDP Revised to 2.5% (from 1.7%)

Amidst all the chaos and war distractions last week, the economic news was largely positive. On Thursday, the Commerce Department revised second quarter GDP growth up to an annual pace of 2.5%, up substantially from its preliminary estimate of 1.7%. Exports rose at a sizzling 8.6% annual rate. High business investment and higher inventory growth were also responsible for the upward GDP revision, as were final retail sales, which were revised up to 1.9% growth from a preliminary estimate of 1.3%.

On Thursday, *The Wall Street Journal* reported that its Small Business CEO Survey's confidence index rose to a high of 104.2 in August, up from 102.2 in July and 93.7 a year ago, in August 2012. Of the 678 business owners polled, 73% expect revenues to grow next year and 54% expect profitability to increase.

Previously, on Tuesday, the Conference Board announced that its consumer confidence index rose to 81.5 in August, up from 80 in July, which bodes well for consumer spending. Real estate prices also continue to recover, as the Case-Shiller index of home prices rose 2.2% in June and 12.1% in the past 12 months.

The only "mixed" news last week was that the Commerce Department announced that durable goods orders declined 7.3% in July, due largely to a 52.3% decline in civilian aircraft orders. (Boeing only received 90 new orders, compared with 287 in June.) But excluding volatile transportation orders, durable goods orders fell just 0.6% in July. Orders for vehicle parts rose 0.5% in July, so the auto industry remains a bright spot. Vehicle sales rose 14% in July and are forecasted to rise 12% in August.

Speaking of the auto industry, the global growth in vehicle sales is helping boost business confidence in mighty Germany. On Tuesday, Germany's Ifo business confidence rose to 107.5 in August, up from 106.2 in July, the fourth straight monthly rise. Meanwhile, consumer sentiment fell in the U.S. On Friday, the University of Michigan/Reuters consumer sentiment index declined to 82.1 in August, down from 85.1 in July. However, the good news is that economists expected 80.5, so 82.1 was significantly better than they expected. (Bear in mind that some of these summertime economic surveys can be unreliable.)

This week, all eyes will be on Friday's jobs report, which I will cover for you in next week's MarketMail.

Marketmail gets updated on Fridays and whenever the DOW closes up or down 300 points or more.

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