"We have two classes of forecasters: Those who don't know – and those who don't know they don't know."

J.K.Galbraith

The most pressing question currently facing global markets is, "Will the US economy enter a recession?"

Over recent years the US economy had been driven hard by a housing boom made possible by easy credit – often in the form of loans with attractive "honeymoon" rates. As the boom fuelled property prices and people felt wealthier they re-borrowed against their homes to buy plasma screen TVs and new cars. Consequently household debt levels grew. When the loans started to roll out of their honeymoon phase and higher rates began to apply, borrowers began to default, lenders re-possessed properties and sold (or tried to sell) them to recover their losses, and property prices were pushed down. The excess housing stock in the US is likely to lead to falling property prices for another 12 months. The rolling over of loans is set to peak in March 2008 so defaults and re-possessions are bound to continue for some time.

Not ignoring the human cost to this (which is immense) the critical thing for the global economy is the extent to which this will carry over to the spending of the US consumer, who has traditionally driven global economic activity. Mitigating this is the greater role played by developing countries such as China and India in driving global economic demand. Locally, the effect of the fiscal stimulus unleashed in the federal election and the recovery of the non-resource states should insulate many businesses from a US recession.

Nevertheless an investor in 1950, asking themselves whether it was a good time to invest, would be oblivious to a host of truly unimaginable external events, the least of which were numerous recessions. Nevertheless they would still have been immeasurably better off investing in good businesses at that time than if they had chosen to not invest. We believe the same can be said of the prospective investor today contemplating the risk of a US recession.

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