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Bad tidings

Nervous investors push stocks to a January loss

January 30, 2009 – As expected, the bad tidings came in waves of gloom last week, topped by year-end gross domestic product (GDP) data. Canadian GDP shrank at twice the rate many economists had expected, contracting 0.7% in November. Some estimates now show Canada's GDP shrinking at a 3% annual rate for the entire fourth quarter, as the goods-producing sectors showed the largest declines in output. Manufacturing, mining, utilities, and construction are all under intense pressure. Industrial production fell for the fourth straight month as consumers shunned the big-ticket items that generally lead sales in the sector.

In the US, about the only positive spin you could put on the fourth-quarter GDP report was that it wasn't quite as bad as expected. The annualized quarter-over-quarter 3.8% contraction was better than the consensus estimate of -5.5%. But much of the disparity can be chalked up simply to the way things are counted. An unexpected fourth-quarter \$6.2 billion jump in inventories skewed the output data, which is very likely to be revised for the worse in coming weeks. Shrinking inventories are more the norm in an environment characterized by plant closures, staff cuts, dimming sales forecasts, and shrinking business investment – all of which continue to manifest in a torrent of daily bad news.

Confirmation of an industrial recession, as if more were needed, came in durable goods orders for December, which fell 2.6% in the month, the fifth consecutive monthly decline. And new home sales plummeted to new depths in the month, falling 14.7%, the lowest pace ever recorded, as a year's worth of unsold inventory remained on the books. The median price of new homes also dropped 9.3% on the year.

For all of 2008, the US economy grew just 1.3%, down from 2% in 2007, and the slowest rate of growth since 2001.

Overseas, the picture is just as gloomy, as the International Monetary Fund predicts that the global economy will expand a mere 0.5% this year. The United Kingdom plunged into recession with a fourth-quarter 1.5% (1.8% annual) contraction in GDP. Japan's economy has already been in recession for 14 months, according to the government, and fourth-quarter 2008 GDP is expected to have fallen at a double-digit rate. And as the eurozone economy continues to shrink, inflation fell to a 10-year low of 1.1% in December, setting the stage for another rate cut by the European Central Bank.

Meanwhile, the next phase of the US economic and financial rescue plan began taking shape as the Obama administration let the Democratic majority in the House of Representatives set the agenda for a near-US\$900 billion economic stimulus package that includes infrastructure spending, jobless and Medicaid benefits, and tax relief. The spending bill passed through the House with no Republican support, as House Speaker Nancy Pelosi and majority leader Steny Hoyer shut out any Republican amendments to the bill, pretty much putting paid to President Obama's pre-election promises of a new spirit of bipartisanship in government. Of course, the bill still has to pass through the Senate, where the real horse-trading will take place. If anything, it highlights Obama's strengths as a master political manipulator, much along the lines of Canada's own Prime Minister Stephen Harper.

And speaking of which, the Conservative government tabled its \$64 billion deficit budget, which also focused on direct infrastructure spending and tax cuts, rather than direct handouts. The opposition Liberals under new leader Michael Ignatieff kept a relatively low profile and supported the budget in the hopes that the Conservatives will eventually carry the can for whole ugly mess.

Of more critical importance than the usual political posturing over pork-barrel budgets, are US administration plans to shore up the banking system to the tune of another US\$1 trillion to US\$2 trillion. This is expected to involve buying up some of the banks' unmarketable assets through a so-called "bad bank." In addition, the government would also offer guarantees against future losses and purchase direct equity interest in weaker banks through common or preferred shares.

The US Federal Reserve Board also seemed to inch closer towards a plan to purchase long-term US Treasury securities in an effort to ease longer-term mortgage and other rates. However, the Fed hasn't taken this particular bull fully by the horns yet. Added to concerns about the developing glut of government debt issues needed to finance the stimulus packages, the Fed's reluctance to purchase US bonds helped push US Treasuries down last week, keeping the bond market, in general, under pressure.

Gold, that barometer of crisis and anxiety, ended last week at its highest level in six months, as rising demand pushed holdings of the SPDR Gold Trust to a record high. The safe-haven factor kicked in on the really crummy GDP reports and the continuing near-death fragility of the global banking system. Spot gold stood at US\$919.50 an ounce at Friday's London afternoon fix, while February gold futures closed at US\$927.30. Just a little over two months ago, gold traded at US\$712. There's definitely a whiff of anxiety in the air.

Not surprisingly, then, stock markets continued their trek down, to close January with year-to-date losses, retracing most of their gains through December. While closing last week just about even on the week, the S&P/TSX Composite Index has posted a 3.3% year-to-date loss from last year's closing mark. The Dow Jones Industrial Average also remained flat on the week, but ended the month down 8.8%. The broader-based S&P 500

Composite Index broke even on the week, but closed the month with its worst performance ever, down 8.6%.

There's an old market adage that says, "as goes January, so goes the year." But take heart. Historically, it's literally a toss-up. Since the creation of the Dow Industrial Average in 1896, it has actually risen through the rest of the year 50% of the time after a down January. ■

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