



**CROFT**  
**FINANCIAL**  
**GROUP**

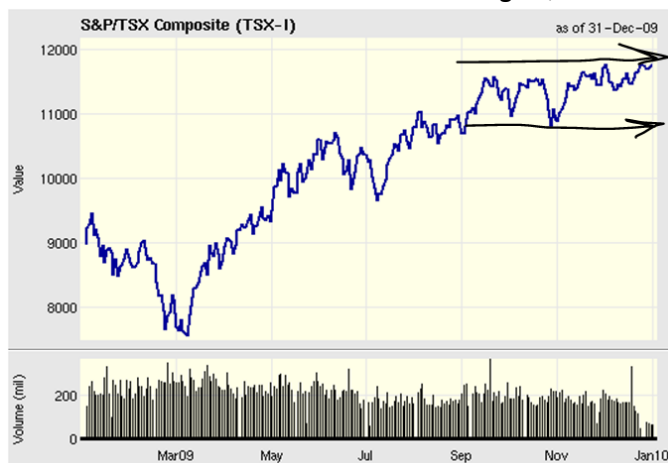
INVESTMENT COUNSELLORS-PORTFOLIO MANAGERS

## **A narrower trading range caps year of gains** *Three trends to watch in 2010*

*December 31, 2009* – Stock markets around the world rallied to new highs in December, but closed New Year’s Eve without extending their gains. Apparently Santa Claus finished his business on Christmas Eve and handed investors a gift-wrapped gain for the previous week. But he returned to the North Pole without leaving a much-anticipated rally for the final week of the year.

That pretty well paints the picture for the entire fourth quarter – three months without any big economic surprises and no trend-setting or trend-breaking market moves in either direction. Volatility abated in the fourth quarter oscillating in a fairly narrow band. At the same time, the US dollar showed a little strength against the major currencies and commodity prices eased somewhat.

### **Stock markets oscillate in narrow band through Q4**



Courtesy CTVGlobemedia

Although Canadian inflation crept upwards in the fourth quarter, the Bank of Canada left the target for its key overnight rate unchanged at 0.25%, and reiterated its views from the October *Monetary Policy Report* that a recovery in economic activity in Canada is underway, boosted by both fiscal and monetary stimulus. However, it said that both heightened volatility and the strong Canadian dollar are weighing on growth and subduing inflationary pressure.

The fourth quarter saw a slow return to growth as gross domestic product grew 0.2% month over month in October, the second consecutive month of GDP growth. The employment picture also improved somewhat in the fourth quarter, as November's 80,000 gain in jobs provided some indication that the labor market is stabilizing.

Canadian equities consolidated somewhat in the fourth quarter, following a strong advance since bottoming in March. The Canadian dollar's advance towards parity with the greenback lost some steam, while the S&P/TSX Composite Index, which is heavily weighted to resource issues, experienced more volatility than it did in the second and third quarters, even while touching a new 12-month high in December.

The S&P/TSX Composite Index ended the final week of the year down less than 1% on the week, on low volume ahead of the New Year's Day long weekend. However, the index advanced 2.6% on the month, 3.1% in the fourth quarter, and closed the year with a 30.6% annual gain.

The US economy also grew 2.2% in the third quarter but was restrained because of subdued consumer spending and slower business investment.

Inflation concerns arose in the quarter, as a 1.8% jump in the US producer price index in November and a 1.8% jump in the all-items consumer price index for November led to speculation about the "when" and the "how much" of the Fed's next rate move. But as in Canada, the Fed maintained the status quo, keeping its target benchmark overnight rate at 0% to 0.25%.

The trend to ever-smaller monthly job losses that's prevailed since July got a major boost with a much stronger than expected nonfarm payroll report for November. The unemployment rate ticked down to 10% from 10.2% in October. That, in turn, was underpinned by positive manufacturing surveys that detailed a slow but steady increase in new orders and manufacturing activity over the past four months.

The Dow Jones Industrial Average faltered in the final week of the year, giving up 0.9% on the week. However, the venerable 30-stock blue chip index advanced 0.8% on the month, 7.4% in the quarter, and finished the year with an annual gain of 18.8%. Likewise, the broad-based S&P 500 Composite Index slipped 1% week over week, but gained 1.8% on the month, 5.5% in the quarter, and closed 2009 with an overall gain of 23.5% on the year. All these gains are in US dollars.

Eurozone markets were rattled late in the fourth quarter by Dubai's debt payment delay and by the downgrade of the creditworthiness of Greece's sovereign debt. The events sent year-end jitters through the European bourses as fears spread that fiscal troubles in Portugal, Ireland, Italy, and Spain might prompt similar sovereign debt downgrades in those countries. The euro fell against the US dollar, giving up most of its advance over the fourth quarter.

Although the eurozone emerged from recession in the third quarter, the recovery remained fragile through the fourth quarter. Inflationary pressures remained subdued, advancing at an annual rate of only 0.8% in December, up from 0.3% in November. The European Central Bank left its key rate unchanged at 1%.

Despite solid third-quarter growth, Japan continued to wrestle with deflationary pressures. In an attempt to prevent a double-dip recession, Japan's new government announced an US\$80 billion stimulus package, while the Bank of Japan planned to inject a further ¥10 trillion in the financial system through low-interest loans.

In Australia, a booming resource sector fuelled by Asian demand and climbing household income have underpinned a rebound in business confidence and resulted in surging employment growth. As inflation concerns make a comeback, the Reserve Bank of Australia raised interest rates by 25 basis points for the third consecutive month in December, to 3.75%.

The MSCI Europe, Australasia & Far East Index of developed markets advanced 1.8% in the fourth quarter, and gained 27.8% for the year overall. Again all values are in US dollars.

It became clear as the year progressed that emerging markets were leading the global economic recovery. The trend continued in the fourth quarter as emerging economies responded to aggressive fiscal and monetary stimulus programs with robust revivals in consumer spending and industrial output. In general, emerging economies, particularly in Asia, showed falling unemployment rates. Consumers have lower debt levels and even more significantly, bank credit is expanding in contrast to most developed economies, where it is largely still shrinking.

China's recovery continues to lead the Asia-Pacific region, as industrial output surged 19.2% year-over-year in November, with heavy industry leading the way. India's third-quarter gross domestic product grew 7.9% year-over-year in the third quarter, fed by robust government stimulus programs and low interest rates over the past year. However, October's inflation rate jumped to 1.34%, raising concerns of an interest rate hike early in 2010.

MSCI Emerging Markets Index gained 8.3% in the fourth quarter, and closed the year with an annual gain of 74.5%.

Of course, this is the season to make predictions and attempt to assess the outlook for the coming year with a view to setting general investment policy. So here are a few trends we believe are worth watching for 2010.

**Bank credit.** With very few notable exceptions, such as Australia, bank credit is still plugged up in the developed economies. That is unlikely to change until banks get a handle on their exposure to impaired assets. Much of European and US central bank monetary largesse has gone to bail out banking institutions that have failed to pass on

their increased deposits to private-sector lenders. Instead, the money has gone to prop up the banks' off-balance sheet entities (such as structured investment vehicles, or SIVs), which led to the crisis in the first place. The bank credit story is the seven eighths of the financial crisis iceberg that remains to be resolved. It's esoteric. It's hidden. And yet it will decide the fate of the global economy in 2010.

**State intervention.** That massive government intervention in the private economies of countries is still considered, somehow, to fall in the "free market" model will be a major theme in 2010. Developed-world governments faced with unmanageable debt, black-hole fiscal deficits, and wholesale Keynesian intrusion in the economy will face a taxpayer tipping point, as stimulus is removed. At some point, central banks will begin tightening, consumer spending will tighten, and taxes will go up. The kind of restiveness lately seen in Greece may be simply the tale told in miniature for what's about to beset the rest of Europe, and perhaps the US as well. Politics and economics make for strange bedfellows, and we're about to see plenty of strangeness in 2010. That tends to increase equity market nervousness (and volatility) and raise the prices of hard assets (that is, commodities of all kinds, including the big three of gold, oil, and real estate.)

**The rise of Asia.** Oddly, as the developed economies descend into a kind of slow-growth bumbling Keynesian fever dream, the emerging economies of Asia, particularly the giants China and India, are increasingly finding ways to loosen their socialist shackles and liberalize their economies. It's a slow, laborious process, but it's one that will continue implacably as emerging markets' growth surges again in 2010, outpacing developed markets, probably by a wide margin. One trend worth watching is the realignment of Japan under its new government away from the US and towards Asia, particularly China. This may be the answer to Japan's economic malaise, but it may also heighten geopolitical tensions in the region.

There are other themes and trends, of course, but these are likely to be the backdrop for markets in 2010. ■

Please [click here](#) to visit our website for more timely information on the markets, financial planning, and new products from R.N. Croft Financial Group Inc.

[www.croftgroup.com](http://www.croftgroup.com)