

## **Shrugging it off**

### *Markets rally despite steep job losses*

*February 6, 2009* – The staggeringly awful job declines in January in Canada and the US did not faze the stock markets even a little bit. In fact, North America’s major equity indexes all gained on the week, as investors began placing bets that deepening job losses would spur the Democrat majority in the US Congress to pass the near trillion-dollar “stimulus” bill early next week.

January’s job losses hit record high-water marks (or perhaps that should be “low water” marks). In Canada, 129,000 jobs disappeared as the economy struggles with an ever-deepening recession. The unemployment rate jumped to 7.2%, up from 6.6% in December. And the monthly loss was larger than any single month in the past two recessions – and that includes the 2000-02 dot-com bust, which was pretty terrible by any measure.

South of the border, nonfarm payrolls plunged by 598,000 in January, following a 577,000 drop in December. The unemployment rate ratcheted up to 7.6%. And for all of 2008, US job losses amounted to a revised 3 million.

Everywhere, manufacturing was responsible for the bulk of the job losses. Canadian manufacturing has been decimated by the shutdown of the auto industry in Ontario, but declining exports across the board have shuttered factories in every sector. Same goes for the US, where the goods-producing sector lost the most jobs since 1975.

The widely watched purchasing managers’ index published monthly by the Institute for Supply Management in the US actually rose a tad in January, to 35.6 from December’s 32.9. The index shows an economy still deep in contraction (any number over 50 indicates growth), but for January at least, the rate of decline slowed, as both new orders and production ticked up. Any sustained pickup in new orders indicates anticipated higher consumer demand. That may not come anytime soon, however, as a concurrent Commerce Department report showed that consumer spending fell 1% in December, the fifth consecutive monthly decline, as personal incomes shrank and the savings rate grew. And although productivity accelerated at an annual 3.2% rate in the fourth quarter, the number is a little misleading, because it resulted from a larger rate of decline in the number of hours worked than the rate of decline in output, reflecting the growing wave of layoffs in the period.

These kinds of numbers are typical of a steep consumer-led recession. And it's virtually certain that we'll be seeing more ugly monthly job-loss numbers for the next six to nine months at least as the "deleveraging" process continues to, in effect, normalize risk premiums through the entire global economy, notwithstanding the significant moral hazard of the growing US nationalization of bad private investment decisions. The attendant expansion of heavy-handed, politically motivated government intervention into every facet of the private economy will have ramifications that will once again distort risk premiums down the road, but with a seriously inflationary twist. It's an end-game that is likely to be played out in currency markets in two years' time, with severe devaluations of the greenback, and even possible dissolution, if things get really bad, of the entire euro common-currency structure. But that's a crisis for another day.

Right now, we have crises enough to keep us occupied for some time. The Bank of England, facing an economy that is shrinking the most since 1946 and faster than any other in the developed world, last week cut its key interest rate another 50 basis points, to 1%. Like the US monetary authorities, the BoC is rapidly running out of options for combating the combined economic bulldozer of falling price levels (inflation now below 2% annually), deep recession, and credit crunch. And like the US Federal Reserve Board, the BoC has plans to purchase banks' unmarketable assets, emphasizing that it will buy only those of "high quality." (Dung is still dung whether it comes from a Kentucky derby winner or a nag put out to pasture.) But such is the Orwellian "newspeak" that has replaced any sort of comprehensible discourse in today's fragile, politically-charged financial environment.

Trade protectionism is another many-headed monster that threatens to grow out of control, with catastrophic effects. We've alluded to the threat of trade protectionism frequently in these comments, and it appears that the danger is growing, not diminishing. We can see how quickly it surfaced in the Democrats' "stimulus" bill now before the US Congress. There was not even an attempt to camouflage the "Buy America" provision as something else, and only some jawboning (and expenditure of valuable political capital) by President Obama managed to water down the outright protectionist measures originally introduced as part of the bill.

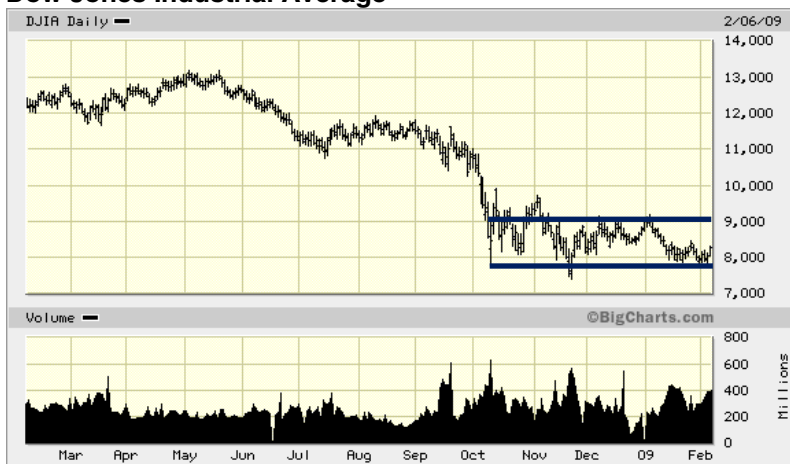
But don't imagine that the threat has somehow vanished. It's as lively as ever and liable to erupt again at any moment. Governments around the world have already enacted a raft of trade protectionist measures, and the movement is rapidly gaining momentum. Protectionism is even more insidious in its financial guise, as private capital flows to developing nations, particularly in Eastern Europe, dry up while domestic banking institutions in the developed world are strong-armed by governments to focus on getting credit flowing to domestic industries – a sort of back-door "buy local" policy. This inevitably spirals outward into retaliatory rounds of trade protectionism.

Stock markets weren't concerned with threats of trade or financial protectionism, leaving those esoteric matters for another day. Buoyed by rising base and precious metals prices, the mining sector led the broader S&P/TSX Composite Index to a 3.6% week-over-week gain.

The big US indexes were more enthralled by the political theatre being played out on Washington's main stage, and also rallied nicely on the week. The Dow Jones Industrial Average closed Friday with a triple-digit advance, and gained 3.5% week over week. The S&P 500 Composite blue chips advanced an even more respectable 5.2% on the week as investors began to have visions of giant barrels of pork padding companies' earnings down the road.

Looking at the big picture, though, we can see that stocks continue to be range-bound with no breakout or breakdown in sight. We can take some solace in the fact that the awful job losses signifying a deep recession have already been discounted. But we're likely to see that grinding sideways pattern for some time yet. ■

### Dow Jones Industrial Average



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