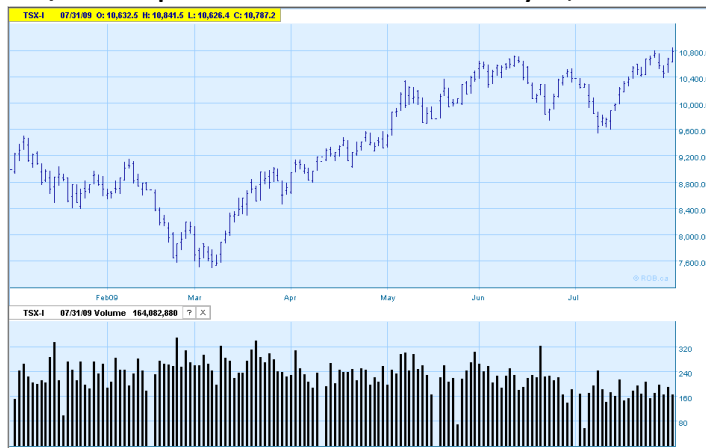


Bear gone

Markets post milestones as data point higher

July 31, 2009 – Stock markets achieved another milestone with the close of July’s trading last Friday. Following some uncertainty earlier in the week, buyers emerged Thursday and Friday to push North America’s major equity indexes to year-to-date highs. And while Toronto’s benchmark index has been sailing above year-to-date breakeven since the beginning of April, the big US benchmarks only just broke that barrier in mid-July. So it’s seven months of the year gone, with a bear market low in March, and markets in the black for the year to date.

S&P/TSX Composite Index – Year to Date to July 31, 2009



Courtesy Globeinvestor.com

What had investors’ knickers in a knot on Tuesday was the release of the New York-based Conference Board’s consumer confidence index for July. Analysts use this widely followed snippet of data as a sort of barometer of consumer spending potential for coming months. The news wasn’t good. The index fell to 46.6 from 49.3 in June, its second consecutive monthly decline.

The survey painted a bleak picture of consumer expectations, which are being darkened by a persistently high and growing unemployment rate and zero wage growth. The US unemployment rate, currently at 9.5%, is expected to rise to more than 10% in the second half of the year. A savings rate now above 5% and a continuing tight focus on household balance sheets raised concern that any sustained increase in consumer spending might be

delayed until well into 2010. That, in turn, could weigh on the pace of economic recovery in coming months.

But that little bout of anxiety was soon dispelled by some positive economic data that provided more signals that the recession is bottoming and that the debate in the second half of the year will be about the rate of growth rather than the rate of contraction.

In its so-called “Beige Book,” a summary of financial conditions throughout its 12 districts, the US Federal Reserve Board noted that economic decline had “begun to stabilize” as the slide in business investment eases and manufacturing, hiring, and housing showed signs of improvement in a number of areas.

Separately, the Commerce Dept. reported that while new durable goods orders fell 2.5% in June from the previous month, the drop could be attributed to a decline in aircraft and other transportation. Stripping out that sector, durable goods orders actually rose 1.1%, the second such monthly increase.

Durable goods orders notwithstanding, what caught investors’ attention by mid-week was an increase in US home prices. We’ve written in these comments that a turn in US home prices is essential for recovery, because so much consumer activity depends on confidence in real estate equity values. And last week, a key housing price index reported an uptick for the first time in nearly three years.

The Standard & Poor’s Case-Shiller index, which tracks house prices in 20 major US centres, posted a 0.5% increase for the three months ending in May from the previous three-month period ending in April. In an indication that first-time buyers are out bargain-hunting in force, the report noted that 15 of the 20 areas surveyed showed rising or stable home prices. With record-low mortgage rates and lucrative tax credits for first-time buyers still on the books for now, that trend is likely to continue in an on-again-off-again fashion in coming months. But it’s becoming increasingly clear that the depressed US residential real estate market has bottomed.

As for lagging indicators, some gross domestic product numbers released last week in both Canada and the US also suggested that growth is poised to resume in the third quarter.

In Canada, gross domestic product dropped –0.5% in May (a year-over-year 3.5% contraction), putting total second-quarter GDP on track for a –3.0%+ decline. The third quarter (already under way) is likely to see a sluggish recovery as manufacturing gets a boost from a revived auto sector and exports notch up on rising US demand.

US GDP posted a –1% contraction in the second quarter, which was in fact better than had been anticipated. Declining GDP was softened by massive government spending, which was virtually the only GDP component indicator to show an increase. The most encouraging sign in the report was that final sales of domestic product (i.e., demand) fell a hairline –0.2% in the quarter, compared with a steep –4.1% decline in the first quarter.

That augurs well for growing demand in the third quarter, setting the stage for a return to GDP growth.

Stock markets rebounded with enthusiasm late in the week after digesting the implications of all these data reports.

Canada's S&P/TSX Composite Index advanced 1% on the week, driven by strong commodity prices, especially metals, and signs of economic recovery in the US. A report by Standard & Poor's that Canadian banks have enough capital to cover losses and performed better than US banks under comparable stress tests. The index is up 20% year to date, and ahead 3.9% for the month.

The Dow Jones Industrial Average also advanced 1% on the week, climbing 8.6% for the month and 4.5% year to date. Similarly, the S&P 500 Composite rose 0.8% on the week, finishing the month up 7.4%, for a 9.3% year-to-date advance.

The S&P/TSX has rallied 43% from its March low, the DJIA 40%, and the S&P 500 45%. We still hear dire warnings that from some quarters that this is nothing but a "bear market rally." But the market has recently already undergone a relatively major correction and recovered nicely. A trend reversal is always possible, of course, but we're sceptical of another bear market in the offing. ■

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