

## Year ends on high note

### *Bull markets and the wall of worry*

*December 31, 2010* – It is the season for reviews, forecasts, and convenient lapses of short-term memory. The year-end ritual so beloved of pundits and analysts everywhere makes for some interesting cocktail chatter. But, really, there’s only one thing that counts – your portfolio. By all accounts, most of us should have done very well over the past year, especially if we’ve weighted back towards equities in our allocations.

Those who were gutsy enough to invest at the markets’ darkest hours back in the spring of 2009 have done more than “very well.” Consider that Toronto’s benchmark S&P/TSX Composite Index has advanced 76% since those days of crisis in early 2009. The S&P 500 Composite Index, America’s best-known blue-chip large-cap index, has gained 84% since bottoming in early March 2009. For the speculators among us, the S&P/TSX Venture Composite Index has climbed 231% since its low in late 2008. How do *you* spell “bull market”?

Yes, yes, pedantic logic-choppers will tell you that a “recovery” from a deep bear market isn’t really a “bull.” Well, if ever there was a definition of “bull,” that’s it. Of course, they are very often the ones who missed the ride, fighting it all the way up, fretting and worrying about “fragilities,” “vulnerabilities,” and “threats.” The markets have been “recovering” for nearly two years now. Disciplined investors with the courage of their convictions, and a solid allocation strategy, have been minting money. Others – mainly the wall-of-worry types – not so much.

And, yes, hindsight is always 20/20. No one can call a market top or bottom consistently or accurately. That’s true. But these days, it’s sounding more like an excuse. You’ll be hearing that excuse more frequently in the coming year, as stock markets continue their “recovery” back towards post-recession highs. Again, mainly from those deep thinkers who have missed the first – and second – legs of this bull market. Still, it seems pretty much unstoppable now. Judging from the flow of money away from Canada’s money market funds into long-term mutual funds, it seems even smaller retail investors are beginning to edge back into riskier asset classes. That trickle will eventually turn into a torrent as more sidelined cash flows into equity markets over the next year with a brightening economic picture and a renewed appetite for risk. The same story will be repeated in the US – but on a bigger scale, much bigger.

And the economic picture *is* brightening. While developing nations have been on a red-hot growth streak, the industrialized West hasn’t exactly been standing still. Factory

output keeps rising steadily, defying most predictions. Last week, for example, the US Institute for Supply Management's Chicago Business Barometer, considered a leading indicator of economic activity for the entire US, rose to 68.6 in December from 62.5 in November – an exceptionally strong bullish signal.

Perhaps more significantly, US commercial lending posted its first quarterly increase in two years, according to Moody's Analytics. The two-year stall in lending activity has been a major roadblock to a more robust recovery. So the 0.2% fourth-quarter increase in lending from the third quarter is a milestone, marking growing business confidence. And while loan growth will be sluggish until US business deploys the mountain of cash it's sitting on, the uptick in lending is a positive sign.

The other elephant in the room for the US economy is real estate. Home prices tumbled in October, weighed on by an oversupply of unsold properties and foreclosed homes that are sold at fire-sale prices. And most analysts expect prices to fall another 5% or so in the first half of 2011. Because so much of America's wealth is tied up in home equity, a convincing turnaround in the residential real estate market is a necessary condition for better-than-average recovery in consumer spending – and thus better-than-average economic growth. That probably won't happen until 2012. But stock markets are betting it *will* happen.

Meanwhile, lest we forget, the Canadian dollar ended the year just above parity with the US dollar, as commodity prices soared in the second half of the year. Gold surged to new highs above US\$1,400 per ounce by year-end, and oil climbed back above US\$90 for first time since late 2008.

Earlier I mentioned that the rewards go to those who have the courage of their convictions and a solid allocation strategy. That principle served well through a year that saw some hair-raising dips and rises in the big market indexes on the way to double-digit gains by year-end. Markets aren't static things and short-term sentiment can shift quickly as developing financial and political events pull at each end of the fear/greed rope. Next year will be no different, and may well be ushered in by one of those same hair-raising dips. Indeed, the only prediction that it's safe to make is the same one that J.P. Morgan, the great financier of the late 19<sup>th</sup> century, made when asked what the market will do: "It will fluctuate."

And so, through the manifold fluctuations of 2010, stock markets came to a satisfactory conclusion by New Year's Eve.

Toronto's S&P/TSX Composite Index, with its overweighting to resource and financial stocks, gained 14.4% for the year overall. In the fourth quarter, the index advanced 8.7% from the third, gaining 3.8% in December. In the last week of the year, the S&P/TSX Composite advanced 0.5% on the week.

The venerable Dow Jones Industrial Average of 30 big blue-chip US stocks gained 11% in 2011. The DJIA gained 7.3% quarter over quarter in the final three months of the year,

posting a 5.2% advance in December. The Dow Industrials closed the final week of the year just a hair above breakeven.

And everyone's favourite blue-chip index, the S&P 500 Composite Index finished the year with a 12.8% 12-month gain. The fourth quarter saw the S&P 500 log a 10.2% quarter-over-quarter advance, climbing 6.5% month-over-month in December. And for the final week of the year, the S&P 500 closed just a whisker above flat.

Happy New Year! ■

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