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Stocks ride recovery

Improving sentiment buoys markets

March 5, 2010 – The big North American stock indexes edged back up into the black in year-to-date terms last week, recovering ground lost through January and early February. An improving employment picture in the US and rock-solid fourth-quarter economic growth in Canada contributed to investors' growing optimism on both Bay and Wall Streets. And Canadian investors also seemed to find some good news in both the Bank of Canada's interest rate announcement and the federal government's budget, both released last week.

The US Labor Department stimulated more than just a little interest on Friday, when it released its February employment report. This closely watched piece of data indicated that while the US unemployment rate remained unchanged at 9.7%, payrolls actually fell only 36,000, quite a bit less than the loss of 86,000 expected by consensus forecast. What's significant here is that the torrent of job loss has eased, even though employers haven't started to fatten up their workforces yet.

The Institute for Supply Management, meanwhile, said that its two key purchasing managers indexes for the manufacturing and service sectors of the economy are now indicating solid economic growth. The ISM's factory index posted a reading of 56.5 in February, down from January's five-year high of 58.4. The ISM's nonmanufacturing index jumped to 53.0 in February, up from 50.5 in January. Any reading above 50 is considered to be expansionary.

Expansion in the manufacturing sector isn't limited to North America, either. A closely followed eurozone manufacturing index tracked by Markit Economics of London climbed to 54.2 in February, the highest level since August 2007 for the 16-nation common currency area.

However, owing to the dire fiscal problems besetting member nations Greece, Spain, Portugal, Italy, and Ireland, economic recovery in the euro area remains extremely fragile. At 9.9%, unemployment remains at an 11-year high. And the rate of inflation slowed to an annual 0.9% in February, down from 1% in January, while fourth-quarter GDP grew by a hairline 0.1%. The European Central bank left its key lending rate unchanged at 1.0% last week, and gave no hints that it is preparing to raise rates anytime soon.

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Meanwhile, eurozone politicos continued their sweaty wrestling match with Greece's leaders, who, full of a sense of boundless grievance and vast entitlement, felt it their bounden duty to demand rescue from their fiscal foibles by other, less profligate, member states of the eurozone. So far, no actual cash has changed hands in the agora, owing mainly to German Chancellor Angela Merkel's reality-based fear of being run out of office by hordes of enraged Bavarian burghers, who rightly sense that their own vast entitlements are likely to be eroded by any diversion of domestic fiscal resources to their spendthrift Aegean co-currency-unionists.

However this little European mystery play concludes – most likely, as we predicted in our previous notes, as some sort of financial euro-debt contraption involving the International Monetary Fund – it's not likely to leave anyone satisfied. And very likely, it'll be only the first stage of what will be some serious changes in store for the way the eurozone operates.

Meanwhile, back in the Great White North, the Canadian economy expanded at an annualized rate of 5.0% in the fourth quarter, led by a surging trade position, with exports rising 15.4% and imports growing 8.9%. Another key factor, final domestic demand, advanced 4.6%, rocket-propelled by 30% growth in residential investment. Business investment, however, fell 8.8% from the previous quarter, casting a shadow over the otherwise celebratory mood.

The Bank of Canada acknowledged the full-steam-ahead nature of fourth-quarter output, saying it was "spurred by vigorous domestic spending and further recovery in exports." The Bank left its target overnight lending rate at 0.25%, but observers were quick to point out that the "language" of the Bank's communiqué had changed to a slightly more hawkish tone, as it indicated that the risks to its outlook are now "roughly balanced" instead of being "tilted to the downside" as in previous releases. No wonder, since core inflation is running right at the Bank's target 2% level.

With fourth-quarter reports almost all in, it appears that earnings of TSX-listed companies are on track for a 38% annual increase, with financial and materials stocks leading the way. The bounceback in earnings is expected to continue through 2010. And investors seemed to take heart from a federal budget that maintained the lowest projected corporate income tax rate of any G-7 nation to 2012, the lowest tax rate on new business investment, and the elimination of all remaining tariffs on imported goods, including machinery and equipment, used by businesses.

Betting on an ever-brightening economic picture, investors bid stocks up pretty much across the board last week. Improving commodity prices and strong earnings in the financial sector helped pushed the S&P/TSX Composite Index to a 1.7% week-over-week gain by Friday's close.

On Wall Street, the improving jobs picture combined with sustained growth in both manufacturing and service sectors, and a late-Friday report of an increase in January

consumer lending boosted the Dow Jones Industrial Average to a 2.3% week-over-week advance and propelled the S&P 500 Composite Index to a 3.0% gain on the week.

The big North American indexes are back in the black for the year to date, as positive sentiment slowly returns to the market, and risk aversion begins to fade. And that all speaks to a market that will continue to advance by small increments, always climbing that ever-present wall of worry.■

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