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Another quarter, another gain *Stocks extend year-long rally with first-quarter gains*

April 2, 2010 – The first quarter of 2010 came to a satisfying conclusion all around, as investor, business, and consumer confidence gained more of a foothold, and economic growth displayed increasing signs of sustainability. And with some notable exceptions, global stock markets ended the first quarter on a high note, extending the rally that began from the March 2009 bear market low.



Courtesy Yahoo! Inc.

Along with the news that Canadians made, bought, and sold way more stuff through January than anyone had expected, came reports that US employers went on a hiring binge in March. And March manufacturing indexes everywhere indicated accelerating international trade, raising hopes for a sustainable recovery as fears of a double-dip recession faded.

As had been expected, Canada's gross domestic product edged up sharply in January. However, the 0.6% month-over-month growth rate was more than even the most optimistic projections, at about 0.5%. The goods-producing sector – manufacturing and construction – gave January's GDP the biggest lift. Canadian factories toiled up across the board with climbing output in 17 of the 21 manufacturing groups, according to Statistics Canada. And the construction sector added some heft, as hammers, saws, nailing guns, and cement mixers got to work on the 6% lift in housing starts in January.

All that clatter and noise from factories and construction sites also means growing employment, as monthly job creation continues to climb, with 21,000 new jobs in February following a 43,000 increase in January. The unemployment rate edged down to 8.4% in February, a trend that is expected to continue as the output gap narrows and economic slack is taken up.

Much was made of the January GDP three-month rolling-rate growth number, which calculates out to an annualized 6.9% for the November to January period, a pretty impressive number, for what it's worth. Back on the planet earth, January's GDP works out to a 1.3% year-over-year gain, and puts GDP on track for first-quarter growth of around 5% – higher if February and March output grows more than expected.

In the U.S., the employment picture brightened considerably in March, as 162,000 new jobs were created, the best month for jobs in three years. The overall unemployment rate remained stalled at 9.7%, however. However, the slow, but steady, growth in employment augurs well for US consumer demand, and reflects surging growth in manufacturing.

The Institute for Supply Management's March manufacturing index, a barometer of factory activity, surged to 59.6, up from 56.5 in February. It was the highest since July 2004. Any reading above 50 indicates expansion in the manufacturing sector. The ISM index follows an earlier report from the US Commerce Department that factory orders rose 0.6% in February.

Strong increases in manufacturing are not restricted to the US. Similar indexes around the world are indicating that manufacturing is leading the economic recovery worldwide. In China, for example, the Purchasing Managers' Index jumped to 55.1 in March from 52 in February. The Eurozone Manufacturing Purchasing Managers Index published by Markit Economics, climbed to 56.6, while in Germany, with Europe's largest economy, manufacturing posted the fastest growth in 14 years, as the index surged to 60.2. Even in Japan, conditions showed marked improvement, with the Tankan survey of business sentiment climbing to -14 in the first quarter from -24 in the previous quarter.

The resurgent global economy is bringing on a new set of challenges for governments everywhere, as the threat of inflation increasingly displaces liquidity and credit concerns as the focus for central bankers.

In Canada, for example, the Bank of Canada's periodic rate announcements have shaded to a decidedly more hawkish tone, even while the Bank has left its benchmark target overnight rate unchanged at 0.25%. But the stage is obviously being set for a rate hike as soon as its self-imposed June 30 deadline for keeping rates low expires, and perhaps even sooner if the core rate of inflation grows much beyond its current 2.0% level.

The US Federal Reserve Board continued removing support from the financial markets on Friday, when it ended its US\$1.25 trillion year-long program to buy mortgage bonds

from Fannie Mae, Freddie Mac, and Ginnie Mae, the government-controlled entities that issue most mortgages in the US.

In China, monetary authorities have tightened up on bank lending in the face of surging economic growth and the threat of developing asset bubbles, primarily in real estate. There are increasing signs that China may allow the yuan to appreciate against world currencies, while also raising interest rates and withdraw the massive stimulus measures it undertook to support the economy during the recession.

With some notable exceptions, stock markets rallied towards the end of the first quarter after a mini-correction in February, extending year-long gains without any major correction, and closing higher overall in March. Globally, money flowed into US and Canadian markets as investors fled growing risk in European bourses and extreme valuation in Asian exchanges.

The S&P/TSX Composite Index advanced 2.5% in the first quarter overall, and 3.5% in March. For the week, Toronto's benchmark was up 1.6%.

The big US indexes also posted impressive gains for a quarter marked with some high anxiety. The Dow Jones Industrial Average advanced 4.1% in the first quarter, with a 5.1% gain for March. For the week, the Dow Industrials rose 0.7%.

The S&P 500 Composite Index posted a 4.9% gain for the first quarter, following a monthly tally of 5.9% for March. For the shortened trading week, the broad large-cap index gained 1%.

Globally, returns were more muted in the first quarter. In Europe, fiscal troubles in Greece, Italy, and Spain weakened the euro and dampened investor ardour for continental stock markets. Germany's DAX index posted a 3.3% return in the first quarter, while France's CAC 40 eked out an advance of just 1% for the period.

Investors pulled back from Asian markets, especially in China, as officials there move to tighten lending and remove stimulus. The Shanghai Composite Index fell 5.1% in the first quarter, while Hong Kong's Hang Seng Index dropped 2.9%. Japan's Nikkei index, meanwhile, posted a 5.2% advance, as extremely low valuations in Japanese companies began to attract more investor interest.

Commodity prices remained range-bound through the quarter, alternately restrained by economic uncertainties in Europe and Asia and prodded by growing global economic recovery. Crude oil ended the quarter at US\$83.76 per barrel, rising 6% in the period. Gold, meanwhile, closed at US\$1,113.30 per ounce, for a first-quarter advance of 2%.

Going into the next quarter, markets are likely to react increasingly to the potential for higher interest rates in Asian emerging markets as well as continuing removal of financial market support by developed-world central banks. On the other hand, North American companies generally have clean balance sheets and strong cash positions, which may

indicate a trend to growing dividend payouts and a revival in mergers and acquisitions, two factors that are always positive for the stock market. ■

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