

## The continuing correction

### *Stocks log steep losses in second quarter*

*July 2, 2010* – Investors got no reprieve last week from the synchronized global stock market slide that took market indexes into correction in an event-filled and volatile second quarter. Against a backdrop of a slowdown in the pace of economic recovery just about everywhere, investors got busy adjusting earnings projections that seemed, through the first quarter, to have no place to go but the moon. But those pipe dreams all came to an abrupt end as investors increasingly sought assorted safe havens. And that search continued apace last week.

Canada's April gross domestic product report (data released last week by Statistics Canada) provides a microcosm of activity the world over. For the first time in eight months, Canadian output recorded no growth month over month in April, although it still added up to a 3.3% year-over-year rate of increase. The retail sector was the worst performer, joined by mining, manufacturing, and residential real estate.

Global manufacturing indexes, typically released in the first days of each month, paint a picture of pretty much synchronized slowdown in the pace of expansion. Now, this is quite a different thing from saying "contraction." For example, the US Institute for Supply Management's widely followed manufacturing index recorded a reading of 56.2 in June. Anything above 50 is considered to be expansionary in the manufacturing sector, so US factories are still gathering momentum. However, that reading is down from the 59.7 recorded in May – and that's what's been concerning market watchers. Because the slowdown in the pace of manufacturing has been repeated just about everywhere, from China and the rest of Asia (except Japan) to the eurozone and Canada.

Are we on the cusp of the second dip of a double-dip recession? That's the question preoccupying the deep thinkers on Bay and Wall Streets these days. The answer appears to be a resounding "We don't think so!" The venerable Alan Greenspan, formerly Chairman of the US Federal Reserve Board, and now often blamed in part – probably with at least some justification – for the financial meltdown that began in 2008, weighed in last week with his opinion that the economy is simply undergoing a "typical pause" in a recovery.

Let's hope he's right. Last week's tepid US private payrolls report doesn't give much encouragement, though private hiring in June actually rose 83,000 compared with 33,000 in May. However, more disconcerting was the total non-farm payroll figure, which fell

125,000 jobs. The unemployment rate slipped to 9.5%, but only because a large number of workers left the labor force altogether.

Consumer confidence dropped sharply in both Canada and the US in June as well, as worries about job growth continued to cast a shadow over the labor market.

The lower readings on these economic datapoints led to much speculation about central bank actions in coming months, particularly in Canada, where the Bank of Canada just raised its benchmark target overnight lending rate 25 basis points, to 0.50%, in early June. The Bank itself has not telegraphed any particular change in policy, and the deep thinkers seem divided on what the Bank's next move is likely to be when it next announces its interest rate policy on July 20. With second-quarter GDP expected to grow about 3% annualized and core inflation hovering just shy of the Bank's 2% mid-point target, there seems no pressing reason for the BoC to back off from its plan for monetary policy normalization.

Our own view, since it's only fair that we weigh on this with the rest of the market, is that the BoC will not raise rates at their next meeting, waiting instead for data from our neighbors to the south. It's just more evidence, as if we needed it, that we are living in a global market and need to adjust our position with an eye beyond our borders.

South of the border, "monetary policy normalization" isn't even close to being reintroduced to the Fed's lexicon. The president of the Atlanta Fed last week said that "inflation isn't much of a current worry," but that "if anything, there is a small risk of deflation that must be monitored." There you have it, straight from the horse's mouth.

Not too surprising really, given the continuing shadow of the eurozone debt crisis, which may eventually be resolved with Greece and perhaps Spain leaving the monetary union. Then, there's the active efforts of China's government to cool red-hot economic growth, and attendant inflation, with measures that include restricting lending, removing stimulus, and most recently, loosening the yuan's peg to the US dollar. Yields on 10-year US Treasury bonds last week dropped to their lowest levels since 2009, presaging a faltering recovery in the months ahead.

And that brings us full circle back to the stock markets, which, if anything, are an ultra-sensitive barometer of investor sentiment. That sentiment has been on the downswing for the past quarter, and showed little sign of letting up in the early days of July.

The S&P/TSX Composite Index ended June with a 4% month-over-month loss, adding up to a 6% drop from the close of the first quarter, and a year-to-date loss of 3.9%. For the week, Toronto's benchmark index slipped 4.4%.

New York's Dow Jones Industrial Average ended June with a monthly loss of 4.0%, for a quarter-over-quarter retreat of 10%. The DJIA was down 6.3% year-to-date to the end of June. And last week, the Dow Industrials fell 4.5% from the previous week's close.

The broad-based S&P 500 Composite Index closed June with a 5.4% monthly loss, and ended the quarter down 11.9%, for a year-to-date loss of 7.6% in the first half of the year. Last week, the S&P 500 recorded a 5% week-over-week loss.

Crude oil closed on June 30 at US\$75.63 per barrel, down 4.7% year to date, while gold ended the first half at US\$1,245.50, up 13.7% year to date. The Thompson Reuters / Jeffries CRB Index of commodity futures is down 8.8% in the first half of the year.

The correction continues. ■

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