

Growth on track for New Year

Commodity slide weighs on TSX

January 7, 2010 – A few words last week were enough to tell us the recession is well and truly behind us, and that the question for economic growth in 2011 is not “if” but “how much”: Facebook, Starbucks, and Bernanke.

Privately-owned Facebook Inc., the Internet social media phenomenon that was even the subject of a movie last year, decided to offer shares for sale to a select few investors in a private offering through investment banker Goldman Sachs LLP. Goldman Sachs’ US\$450 million investment in Facebook, with a commitment for another US\$1.5 billion, is thought to be preparation for a public offering later in 2012, according to some reports. Makes sense, of course, with Facebook valued by Goldman at US\$50 billion.

Facebook’s move is emblematic of a reviving IPO market and signals growing investor confidence and a returning appetite for risk. Other privately-held Internet companies have also jumped onto the IPO bandwagon as it gathers momentum, including messaging firm Twitter Inc., coupon aggregator Groupon Inc., and professional networking site LinkedIn Corp., which is preparing for an IPO this year.

Shades of the 1999 dot-com bubble? We won’t know until IPOs start getting priced in the market. But the point for now is that the intense interest in these offerings along with a global revival in merger and acquisition activity (up 22.7% year-over-year in 2010, according to analyst Mergermarket Ltd.) is signaling a resurgence of investor confidence not seen for over two years. And that augurs well for equity markets generally in 2011.

It’s particularly interesting in the high-tech world, which has been back-burnered for a couple of years now, what with banks imploding and so forth. But high tech hasn’t been standing still, and the evolution away from desktops and laptops continues apace, as mobile wireless devices (smartphone, tablets) increasingly fill day-to-day computing needs. The Nasdaq Composite Index, home of all things high tech, gained nearly 17% in 2010.

Another signal of growing confidence could be found in Starbucks Corp., the world’s biggest chain of coffee shops. Starbucks last week introduced a slightly modified logo, which caused a bit of a flap among marketing types as well as loyal customers. One lesson is that you should never, *ever* underestimate the power of brand identity. Another, perhaps more telling conclusion here is that Starbucks can even consider devoting

millions of bucks to what is really a fairly simple alteration of its unique twin-tailed siren logotype.

Starbucks mission to re-brand itself as a purveyor of stuff other than coffee speaks to a measure of business confidence that was nowhere in sight just a year and a half ago, when most companies were busy battering down the hatches, trying to stay afloat in the storm. And Starbucks is just one of many so-called “category killers” busily attempting to reinvent themselves to avoid losing market share in a suddenly vigorous competitive environment. That implies that all that corporate cash that’s been sitting idle, earning essentially nothing, is about to be deployed in a big way in new business investment.

Ben Bernanke, the chairman of the U.S. Federal Reserve Board sounded more upbeat on Friday than he has for some time. In Congressional testimony on Friday, he said, “We have seen increased evidence that a self-sustaining recovery in consumer and business spending may be taking hold.” Because central bankers’ utterances are by definition lagging indicators, this suggests that recovery in consumer and business spending is stronger than the Fed can or will say in its own very cautious projections.

Despite a December jobs report that fell short of expectations, with 103,000 new jobs created, the US unemployment rate fell to 9.4% from 9.8%, a level not seen since May 2009. The long-awaited “self-sustaining” recovery – that is, one that doesn’t rely on massive injections of liquidity through central bank money printing activities like quantitative easing – might already be underway. It is if you look at the continuing growth of manufacturing activity in the US and around the world.

The closely watched monthly manufacturing index published by the Arizona-based Institute for Supply Management indicated expansion in the manufacturing sector for the 17th straight month, rising to 57 in December from 56.6 in November. Any reading above 50 indicates growth. Similarly, the ISM’s non-manufacturing index rose to 57.1 in December from 55 in November, for its 12th consecutive advance.

Judging by the minutes of the Fed’s December meeting, released this past week, the US central bank appears committed to its US\$600 billion program of bond purchases (see “quantitative easing,” above), citing risks to economic growth, notably the weak US housing market and the unresolved eurozone sovereign debt crisis. The Fed wants to keep feeding the furnace. We can only hope that it recognizes when the gauges are creeping into the red zone.

With more appealing economic data coming out of the US, the renewed strength of the US dollar on rising Treasury yields has made dollar-denominated assets more attractive to investors. And it has consequently put downside pressure on commodities. Gold, for example, fell to a five-week low on Friday, touching a low of US\$1,352 per ounce before recovering. Commodities in general slid in the first week of the New Year, following a strong December rally.

Meanwhile, corporate profitability has been roaring back to life. A survey of analysts' earnings estimates by Bloomberg LP indicated that profits for S&P 500 companies are on track to hit a 19-year high for the fourth quarter of 2010. Not surprising, given the high level of productivity and the absence of wage pressure against a backdrop of reviving consumer demand in the year's busiest shopping season.

The stalled commodity rally weighed on the resource-heavy Canadian stock market last week. So despite an improving employment picture that saw 22,000 new jobs created in December and unemployment staying level at 7.6%, Toronto's benchmark S&P/TSX Composite Index lost ground in the first week of trading in the New Year. The index ended Friday with a week-over-week loss of 1.3%.

New York's Dow Jones Industrial Average finished the week overall in the black, despite some weakness on Friday arising from those lower-than-expected jobs numbers and an unfavorable ruling by the Massachusetts State Supreme Judicial Court on foreclosures made by Wells Fargo & Co. and U.S. Bancorp. The DJIA eked out an advance of 0.8% on the week. In an identical pattern, the broad-based S&P 500 Composite Index gained 1.1% on the week.

The New Year begins pretty much the way the Old Year ended, with economic growth on track and stocks generally favored over bonds.■

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