

Johnny Reid's market

Markets head higher and higher

April 1, 2011 – Stock markets took a cue from Canadian pop singer Johnny Reid last week. His hit single “Let’s Go Higher” pretty well summed up investor sentiment, which was buoyed by US employment gains and strong manufacturing reports. In fact, Canadian and U.S. stock indexes tested 52-week highs. Seems that bad news from the eurozone and the fast-unraveling NATO no-fly zone over Libya had no effect on investors’ revived equity enthusiasms.

The US Labor Dept. reported that 216,000 new non-farming jobs came online in March, following a gain of 194,000 jobs in February. Those monthly six-digit employment gains are just what everyone’s been waiting for. And most important, all the new jobs were created in the private sector – so they are “real” net *additions* to economic wealth (in the final analysis, of course, government “employment” is simply a redistribution of existing wealth).

Concurrently, the US unemployment rate fell to 8.8% in March, down another notch from the 8.9% logged in February. That, too, is going in the right direction.

The slow but steady increases in US private sector employment speak to growing business confidence. To date, US productivity has been exceptionally high. But that’s because so far, business has been able to produce more with the same unit of labor – mostly just to fill inventories depleted over the recession. But that can’t go on forever. Eventually you simply have to hire more bookkeepers, sales clerks, order fillers, truck drivers, and so on if you want to keep up with growing demand. And that’s precisely what’s been happening.

Employment isn’t the only thing that been going higher. Closely related is consumer spending, another all-important measure that acts as a barometer of economic health. In February, US consumer spending rose 0.7%, the eighth straight monthly increase.

Manufacturing activity remained in growth mode too. The Institute for Supply Management’s monthly gauge of US manufacturing for March came in at 61.2. Any reading over 50 signals growth in the manufacturing sector. While very healthy, the pace of growth eased very slightly from the February index reading of 61.4.

In Canada, manufacturing continued to power gross domestic product higher in January. Powered by heavy metal (cars and their parts, mostly), the manufacturing sector in Canada rose a 2.8% from the December, its best monthly growth since 2002. With assembly lines rolling an plants opening up all over the place, Canada's first-quarter 2011 GDP growth is now expected to come in somewhere around 4% annualized, considerably higher than the Bank of Canada's previous estimate of 2.5%.

Higher and higher for the Canadian dollar, too. All that employment and spending buzz in the US sent crude oil surging, so that nearby contracts for future delivery of West Texas Intermediate, the North American benchmark, traded at US\$108 per barrel. That, and the generally robust economic growth outlook for Canada, made the loonie more valuable against the US dollar, to the tune of US\$1.04 at one point on Friday, before settling back to close at US\$1.0362.

The "superloonie" had the Bank of Canada once again nervously warning exporters that weakness in the export sector is likely to continue given the strength of the Canuck buck, cutthroat international competition, and sluggish productivity growth in Canada. And you can bet your bottom loonie that the BoC is closely watching for creeping price pressures. It's held off on raising its target overnight lending rate for the past couple of announcements, despite a headline CPI of 2.2%, but that little gravy train might be coming to an end. And, depending on what the US Federal Reserve Board does, Canadian rates might just be poised to go, yes, higher.

The Fed's preferred inflation gauge, something called the core price index for personal-consumption expenditure, rose 0.9% year over year in February, up slightly from January's 0.8% reading. The all-items index, which includes food and energy prices, rose an annual 1.6%. So US consumer price inflation is still tame. But it's stirring. And with the Fed committed to complete its full second round of quantitative easing (QE2) by June, there's a very good probability that inflation will begin to garner more than a fleeting reference buried deep on page C17 of the business section. Consensus is that the Fed won't pull the trigger on a rate hike until next year. But there is a growing faction that believes a rate hike could come as early as the second half of this year. In which case, of course, the Bank of Canada will follow suit.

Meanwhile, the European Central Bank is going full steam ahead on a rate hike on April 7, having already telegraphed the move. Of course, it might just chicken out, given the dire banking and fiscal problems besetting Portugal, Ireland, and Greece. After all, the bill for bailing out Ireland's banks is now in the vicinity of US\$142 billion, with no haircut for bondholders. Portugal, currently between governments, revealed an even larger fiscal deficit than before, at 8.6% of GDP. S&P promptly cut Portugal's credit rating to near junk status. Greek sovereign debt was also downgraded – to a level below Egypt's.

Even the festering unrest in North Africa and the Middle East wasn't enough to drag markets down last week. As mentioned, crude oil prices remained elevated as Libyan anti-Gaddafi forces sought a cease-fire when US jet fighter support was withdrawn due to

“weather.” Though that weather was mostly political wind blowing in Washington, it could well herald the end of a NATO-enforced no-fly zone over Libya.

None of that mattered much to stock markets, however, which have already discounted any immediate risk to oil supplies. US inventories are bulging, and replacement sources (including Canada) are ramping up. So it was that Toronto’s S&P/TSX Composite Index advanced 0.6% week over week. For the month ending March 31, the S&P/TSX closed just a hair below breakeven, down 0.1% month over month. Year to date for the first three months of 2011, though, the index was ahead 5.0%.

The Dow Jones Industrial Average gained 1.4% week over week on that glass-half-full employment news. For March, the DJIA advanced 0.8% month over month, and gained 6.4% year to date to March 31.

Similarly, the S&P 500 Composite Index rose 1.4% week over week. For the month to March 31, the index, like Toronto’s, closed just a hair below breakeven, losing 0.1%. Year to date for the first quarter, though, the S&P 500 climbed 5.4%.

With stock market indexes now once again at or near their 52-week highs, you just know what the bulls are singing: “Let’s go higher!” ■

Please [visit](#) our website for more timely information on the markets, financial planning, and new products from R.N. Croft Financial Group Inc.

www.croftgroup.com