Good-bye to August, and good riddance

Bay Street bucks trend, climbs for second week

September 2, 2011 – Ahead of the North American long weekend, US stock markets lost ground as sagging consumer confidence readings and an unusual zero-growth new jobs report in the US pretty much put paid to hopes for a quick end to a dismal August in equity markets. The worry now is that once trading resumes in earnest after the holidays, the downtrend will also continue in earnest.

The New York-based Conference Board's Consumer Confidence Index, a widely-watched monthly gauge of consumer sentiment, sank to 44.5 in August, down sharply from a reading of 59.2 in July, and well off a high of over 70 registered earlier this year. The August reading was the lowest in two years, according to the Board.

In a way, it's not too surprising that consumers are feeling a bit down in the mouth. Many of them don't have jobs. The US unemployment rate stuck fast at 9.1% in August. Even more troubling, however, was the US Dept. of Labor's monthly payroll report, which did not paint an encouraging picture for employment. According to the report, there was no growth at all in non-farm payrolls in August. Not one new job was added, which got the econo-sphere buzzing, because consensus forecasts had predicted somewhere around 68,000 new jobs. Not only that, but July's report was revised down to 85,000 new jobs from an earlier report of 117,000. If the recent trend to downward revisions continues, August could conceivably end up showing a net loss in jobs instead of a zero reading. If that, in turn, is followed by net loss in September, the US can be considered to be in a recession, as two consecutive monthly contractions in payrolls typically signal an economic contraction underway.

As if that wasn't enough to give markets the heebie-jeebies, then the August purchasing managers manufacturing index from the Institute for Supply Management (ISM) did the job. On the one hand, as economists are overly fond of saying, the ISM manufacturing index for August posted a reading of 50.6. While down from July 50.9 level, it still indicates growth in the manufacturing economy – any reading above 50 indicates expansion. On the other hand, a reading of 50.6 is just the latest in a long string of declines in the index, that is, it's expanding at an ever slower rate. And, of course, that reading is just above the 50 threshold between growth and contraction.

In fact, the US manufacturing index echoes what's happening globally. Manufacturing is slowing down everywhere, and in some regions has actually contracted. The eurozone, for example, saw its manufacturing index drop to 49 in August. The only reason it didn't drop further was that German manufacturing stayed on the right side of 50, with a reading of 50.9, the only eurozone country to show manufacturing growth for August. The UK manufacturing index slipped to 49, shrinking the most in 26 months. And the HSBC Purchasing Managers Index for China posted a reading of 49.9 in August, up slightly from the 49.3 logged in July.

The pattern here isn't terribly encouraging, as manufacturing is an important barometer of economic activity, reflecting very quickly trends in consumer demand and global trade. With these under pressure over the past few months, markets have become understandably underwhelming, discounting future growth expectations through present value adjustments on financial asset prices. Okay, that's just econo-babble for falling prices, of which we've seen plenty in both equity and commodity markets in recent weeks. So much so that equity markets "corrected" through August, falling 10% or more from highs posted earlier this year.

The one anomaly in this otherwise uniform picture of economic gloom is Canada. While overall second-quarter economic growth sputtered into a slight contraction of 0.4% annualized, Canadian GDP actually expanded in June. And Canadian manufacturing grew in August, as measured by the RBC Canadian manufacturing purchasing managers index, which rose to 54.9 from 53.1 in July. According to the RBC survey, new orders came in at the fastest pace since April, while businesses raided inventories and ramped up production to fill orders. In the process, new hiring saw a boost, which will contribute to job growth in coming months.

Some of Canada's anomalous manufacturing growth can be attributed to a recovery from severe supply chain problems resulting from the Japanese earthquake in March, which led to production slowdowns in the auto sector. In addition, energy production is returning to normal following production disruptions arising from wildfire outbreaks in Alberta earlier in the year. That pace of growth is unlikely to continue, given the slowdown globally, and given that much of Canada's economy is trade-driven, and that mostly with the US, where growth has faltered, and growth estimates for the rest of the year have been revised down significantly. Last week, for instance, the International Monetary Fund is reported to have revised its 2011 annual US growth forecast to 1.6% from the 2.5% it had projected just two months ago.

And speaking of trade, Canada's current account deficit widened again in the second quarter, as Statistics Canada reported that the deficit rose by $5.3 billion, to $15.3 billion in the period. Essentially, a trade deficit means that the country imports more goods, services, and investment income than it exports. The account has been in deficit for the past three years, with no relief in sight as long as the Canadian dollar remains strong and US demand remains weak.

None of which fazed Bay Street last week, as the S&P/TSX Composite Index registered its second consecutive weekly gain, rising 2.2% week over week, led by gold and materials stocks. For August, however, the S&P/TSX lost 1.3% and finished the month down 5.0% on the year to date.

On Wall Street, the Dow Jones Industrial Average dropped 0.4% on the week, as investors reacted to the poor new jobs report with a swift exit ahead of the long weekend. The Dow Industrials slumped 4.4% in the month, but remained ahead 0.3% for the year to date.

The S&P 500 Composite Index ended the week with a 0.4% weekly loss. For August, the index posted its worst monthly slump, down 5.7%, since May 2010. That pushed the index to a year-to-date loss of 3.1%.

It all sounds pretty crummy, and we ask how much worse can it get? Well, look at it this way: the yield curve hasn't inverted, so at least that's not flashing a recession warning, even though the 10-year US Treasury yield sank to 1.99% last week, just four points above its record low. And then, market analysts and technicians who study these things tell us that a lousy August in the stock markets often presages a strong year-end rally. That's some small consolation, at least, for the glass-half-full-types.■

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