

Dueling oracles

Markets climb a wall of worry

January 6, 2012 – Forget the “apocalypse.” That event, supposedly predicted by an ancient Mayan calendar for December of this year, pales in comparison with those economic prophecies of doom now being issued by our latter-day soothsayers – the economists, analysts, pundits, and columnists whose job it is to, well, make prophecies. And the first week of the New Year typically sees a flood of these things as our oracles clamor for a piece of digital real estate to try to make themselves heard above the noise. Luckily for us, their track record isn’t great. And this year will be no exception.

Last week, the big North American stock indexes gained on the week, continuing a rally that started in the final days of December. But the oracular pronouncements were almost uniformly depressing. “Yes, there are job gains, but it’s only a temporary blip before things get really bad.” “Yes, the markets are higher, but the imminent eurozone implosion will soon fix that.” And so on. If things are so bad, why are more investors buying equities than selling them?

Start with employment. When the labor market is slack and a lot of people are unemployed, they don’t buy stuff. When they don’t buy, stores don’t sell, and factories don’t produce. That’s why most policymakers and every economist wait anxiously for the monthly employment reports produced by various statistics-collecting agencies.

In the US, the Labor Department announced last week that non-farm payrolls grew by 200,000 in December, outstripping the consensus estimate of 150,000. Along with that, the unemployment rate fell to 8.5%, near a three-year low, from a revised 8.7% in November.

Earlier in the week, another closely watched indicator suggested continuing improvement in the US economy. The Institute for Supply Management’s manufacturing purchasing managers index climbed to 53.9 in December, up from 52.7 in November. The gauge posted its best reading since June, as factory activity showed broad-based growth across a wide range of industries from car manufacturers to coal producers.

Investors were further heartened by improvements in more detailed metrics included in the ISM report, which showed increases in both new orders (the highest since last April) and hiring (which tracked the broader Labor Department payrolls report).

The Canadian economy, by contrast, added fewer jobs than expected in December. Some 17,500 new jobs were created, a marked change from the large net job losses posted in October and November. Still, consensus estimates had called for about 20,000 new jobs. And the unemployment rate edged up to 7.5% from November 7.4% rate.

With GDP growth only flat in October, the tepid jobs report raises suspicions that the pace of Canada's economic growth has slowed somewhat. Still, Canadian manufacturing improved somewhat in December as both the RBC Canadian Purchasing Managers Index and the Ivey Purchasing Managers Index posted higher readings for December. The RBC index in fact reached an eight-month high, climbing to 54 in December from 53.3 in November, while the Ivey index rose to 63.5 from 59.9 in November.

The Canadian employment and purchasing activity came with a number of caveats and provisos, of course, mostly tracking back to the strength of the Canadian dollar as safe-haven-seeking capital inflows keep the loonie near parity with the US greenback, putting downward pressure on both factory and commodity exports in the near term. That in turn could well weigh on GDP growth in the first half of 2012.

The signals of growth in both the US and Canada contrast markedly with conditions just about everywhere else. Europe ex-Germany, of course, saw manufacturing contract again in December. The eurozone as a whole is almost certainly in a recession now as its leaders continue to attempt to extricate the eurozone from the debilitating sovereign debt problem. And while Japan saw a small increase in factory output in December, the economy is likely to post a contraction in the fourth quarter as exports shrink on declining European demand. China, too, is struggling with a slowing economy, with growth also dampened by a falloff in European demand. The International Monetary Fund is expected to revise its 2012 global growth forecast downwards, to less than 4%.

It's against this backdrop, then, that the oracles gave their readings last week. As you'd expect, the broad gray middle (where predictions generally were not much changed from the status quo) was flanked by off-the-wall outliers, whose zany predictions ranged from gold at US\$10,000 per ounce to the S&P 500 Composite well below 1,200 by the end of 2012. At one point, the media focused on an amusing battle of the dueling gold oracles, one of whom issued a bearish price forecast to general hoots of derision, and then last week recanted. Yes, folks, the fun never ends!

And last week, the fun continued on the big North American markets, with the main indexes ending the week on higher ground. The S&P/TSX Composite Index gained 1.6% week over week, while the Dow Jones Industrial Average rallied for a 1.2% advance and the S&P 500 Composite Index rose 1.6%.

Predictions about the economy and financial markets come and go, and most people don't remember them a day, let alone a year, later anyway. We're safe in saying that the surest road to financial ruin is to invest by prediction – deploying assets willy-nilly according to which way the daily oracular wind blows. We can also predict that a greater measure of investment success will accrue to investors who know their tolerance for risk (and don't

lie to themselves about it), allocate portfolio assets accordingly, and then stick to their plan!■

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