REVIEW & COMMENTARY
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Feast or Famine

It seems these days it is either one or the other of those sentiments most commonly expressed on business shows. From March 2009 to April 2010, the markets feasted on low interest rates, corporate profits and the potential growth prospects of China, India, Brazil and other emerging economies. Then, from late April until recently, the market pulled back dramatically due to sovereign debt issues among several of the countries in the Eurozone, tepid economic statistics from the US, and a prevailing perspective that the US and global recovery was a illusory and the fears that the US was headed toward a "double dip" recession.

Which is it? Well, our opinion is that it may be neither- it may simply be somewhere in the middle. Levels of pessimism in late June reached heightened levels which according to a measurement by JP Morgan was the highest since March of 2009 when the market bottomed. The tug of war between fears of inflation and deflation leave little room for anything else, namely more mundane news like improving earnings, increased dividends, and some countries, including Canada, that are actually increasing interest rates and employment. US earnings season is upon us and the number of negative pre-announcements is at a 3 year low suggesting earnings, on the whole, will not be disappointing. While fewer pre-announcements and better earnings and guidance is not necessarily an indication of future events, it has eased the "famine" trade and supports our arguments that the US and the rest of the world is not going to double dip but have a recovery that may be at worst, below average.

But let's discuss the double dip a little more. Double Dips "DD" aren't new and aren't that frequent- they are commonly talked about in the aftermath of every recession. This talk was prevalent in the early 1990's and after the tech crash in the early 2000's. It is not as common as many today think, but did happen in the early 1980's in the US, in the 1990's in Japan, and in the late 1930's ('37-'38) after the US economy recovered from 1934-1936. But all these DD's had one thing in common – they were all preceded by the central banks' premature monetary tightening.

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If we ignore the US and Europe just for a moment, let's have a look at what some other countries are doing. Australia and Canada are leading the pack, marginally raising interest rates and creating jobs; Canada's last employment report was over 4 times greater than expectation. China is imposing restrictions on its own growth but has decades of significant growth ahead of it as does India. India and China alone represent about 17% of world GDP according to the IMF and both are expected to grow 10.5% and 9.4% this year and 9.6% and 8.4% next year. Germany, part of the Eurozone, in desperate shape 10 years ago is now booming and will have, according to the Economist, a bigger current account surplus, as a share of GDP, than China this year. If we add Brazil into the mix, these four countries as well as Canada and Australia represent just under one third of global GDP. And if they do well, it would suggest that there may be enough growth around for the US to avoid the dreaded DD.

Throughout the world there are problems- there always have been and always will be. We think it fanciful to consider that governments will become debt free- there is a natural level of indebtedness that is prudent and manageable. And while it might be painful to get to that level, we would be hard pressed to think any democratic government would push so relentlessly that they would imperil the constituent's livelihood. While there are risks that governments will legislate themselves into another recession, it would be hard for us to support such self destructive behaviour.

If more modest growth is before us, then our strategy, which does well even in more buoyant times, should be even more prudent for investors. While the market was in turmoil in June many of the more senior dividend paying conservative stocks did very well. Admittedly, this may partially be from a flight to safety but this is exactly why buying dividend paying stock strategies have long term benefits- they do best when the market is at its worst. Being able to survive the famine mentality is vital to accumulating and maintaining long term wealth.

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