REVIEW & COMMENTARY
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50 shades of fear

While this is a rather shameful attempt to play off a recent best seller, it does describe the perception by many investors of the equity markets over the past few years. It also resonates with us, given our message has been consistent and unwavering, that long term investors will be rewarded for buying and holding good companies, with prudent and disciplined managers who return income to shareholders. As we have discussed, and will continue to discuss, the constant flow of bad news that has saturated investor's news sources continues but the equity markets, for the patient, have been rewarding. While the SP/TSX index remains roughly 15% from its all-time high, the SP500, an index of most of the largest publically traded companies in the US, is within 100 points of reaching its all- time high (roughly 6.4% at the time of writing). And if we look at how much these indexes have risen from the lows, US indices have doubled. The SP/TSX has also risen dramatically but lags the SP500, primarily because it is more resource weighted. So the question is simply, with all the concerns and fears that investors are bombarded with regularly, why are equities doing so well? Maybe, just maybe, the market is getting tired of all the bad news.

How many times have the following terms dominated the news; 'Fiscal cliff', 'bail out', 'austerity', 'low-growth', 'no growth', 'recession', 'reflation', 'inflation', 'stagflation', 'gridlock', 'deadlock', 'deficit', 'downgrade', 'kick the can down the road', 'trade off', 'sell off', 'foreclosure', 'meltdown',' takeover', 'take-under', 'takeout', 'downward spiral', `short sale', 'short selling', (that is 25 but we could keep going). Many of these fears are legitimate and serious if not resolved on a timely basis. The future will not be without pullbacks and uncertainty but it isn't all doom and gloom. Where is the good news? It is out there but it doesn't get much traction and certainly not great ratings. Like past commentaries, let`s discuss some.

According to the Associated Press, US home foreclosures are at 5 year lows and US Real Estate prices are stabilizing. This is important and very positive news since it dates before the economic upheaval in late 2008. As well, corporate balance sheets are as strong as they ever have been; CNBC reported that in mid- September investment grade corporate debt issuance hit 61 billion dollars in a single week! In the US, and thankfully more so in Canada, many senior companies are raising their dividends all indicating that they have confidence in their business and ability to generate cash and profits. The unemployment rate is stable at home and showing modest traction in the United States. Interest rates remain low, and will be held down by the US Federal Reserve (as long as Mr. Bernanke is Chairman) well after the recovery shows persistent strength.

U.S retail sales climbed more than forecast in September, indicating continued resilience on the part of US consumers who have managed to reduce their level of indebtedness over the past few years, a trend that is expected to continue.
China is slowing but showing signs of stabilizing. It is important to remember that their Central Bank initiated this slowdown by tightening credit and decreasing money supply well over a year ago. While it is easier to slow growth than create it, they will want to manage future growth and the necessary fire power to enhance growth once they decide to do so. Moreover, recent reports on the Chinese economy are improving. Exports and money supply grew more than expected in September. Overseas shipments increased almost 10% from a year ago, just slightly less than double what a Bloomberg survey of economists had predicted, and China's M2 money supply grew at almost 15% last month. This is the fastest pace in over a year, yet inflation remained relatively dormant, increasing at the slowest pace in over 2 years.

All this good news seems to coincide predictably and contradictorily with the International Monetary Fund which issued its second warning this year of lower global growth estimates in early October. Headlines stated the warning but buried the estimates which had been lowered from growth of 3.5% to 3.3%- worrisome, but in our opinion not as dramatic as the headline or the short term reaction in the market. It is important to remember that most economists' batting average on accurately predicting the future wouldn't get them into the starting line up of a Major League Baseball farm team. Admittedly, global growth is a concern and has increased downward pressure on almost all commodity prices, one reason Canadian equity markets have underperformed US indices which tend to be more industrial weighted than resource weighted. Regardless, growth is expected and that is without showing growth from China. If the Chinese central bank attempts to stimulate their economy and if they are successful, growth estimates will most likely be revised upward.

Certainly, the US election has been a focal point for the media and will remain one until early November at which time whoever becomes President will affect capital markets as investors digest whether their influence will be positive or negative. Romney`s recent debate success has the polls showing a much more even race and while there was a modest uptick in equity prices after the first debate, the second debate has become even more important. Maybe then, we'll have 60 shades of fear rather than 50 but our message will remain the same.

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