RBC Wealth Management

Terrence W. Webb
Senior Vice President, Branch Director
Senior Portfolio Manager - Portfolio Focus
50 Castle Street
Great Barrington, MA 01230
413-747-6321 Phone
800-543-9212 Toll Free
413-747-6301 Fax
terrence.webb@rbc.com

Wednesday, March 28, 2012

Zen and the Art of Optimism

Overcoming the cynicism and pessimism that has accumulated over the last decade regarding our political and economic circumstances requires a particular kind of acceptance: one which most investors have been unable or unwilling to embrace and which caused many to miss out on the tremendous investment opportunities of the last three years.

The stock market has historically been one of the most reliable leading indicators of economic activity. It started to go down well before the financial explosion of 2008 and, similarly, has been rallying strongly since March of 2009 despite an environment fraught with doubt and concern. Since December 31, 2008 the S&P 500 has increased by 56%. More impressive, but less meaningful, is the gain of 112% from the lows of 2009.

Thus far in 2012, the S&P has returned about 12.4% - an impressive start to the year. Investing is an expression of belief in the future: while it has been a volatile ride, those with faith in the ability of the US to recover have been rewarded just as in past cycles. In this article, I list a number of the key economic data points which lead to my continued optimism for both the economy and financial markets:

- Retail sales rose 1.1% in February to $364.4 billion - a new historic high. This represents a gain of 6.3% from 1 year ago and compares to the low for monthly retail sales in March of 2009 of $294.9 billion. The previous peak was $340.8 billion in November of 2007.

- US Auto sales were up almost 2% in February vs. January and gained 7.1% from a year ago. Auto companies are running triple shifts and workers are racking up overtime.

- Small business optimism is improving with the sixth consecutive monthly increase in February of .4% to 94.3. This is still well below levels achieved when business conditions are considered strong, but a substantial improvement from lows of around 80 for the index in early 2009. This indicates a growing intention to hire and make capital investments.

- February earnings and wages had the best reading since October of 2007.

- The US added 227,000 jobs in February - the third month in a row with over 200,000 jobs created.

- Temporary hiring has been increasing for almost 3 years which is a precursor to permanent hiring. The 2.4 million temporary and contract employment jobs at the end of February is the highest since May 2008 and companies are increasingly converting temporary workers to permanent status.

- Over the last 12 months private payroll employment is up by 2.247 million jobs - the largest 1 year gain since the 12 month period ending in May of 2006.

- Manufacturing employment is growing at the fastest rate since 1998. Over the last 3 months 15% of new job creation has been in manufacturing even though that sector only represents 9% of total payroll jobs. Demand for skilled workers has increased so much that many companies are now paying signing bonuses and referral fees.

- There is evidence that job growth may be better than current data indicates since each report over the last 6 months has been revised upwards.

- Initial unemployment claims have been falling sharply for close to 3 years - this is a leading indicator of where unemployment rates are likely to go.

- Solid employment growth is beginning to lift consumer confidence which rose to 70.8 in February compared to 61.1 in January (although it fell to 70.2 in March, future expectations rose). In early 2009 consumer confidence readings were below 30.

- Housing starts increased to an annualized rate of 699,000 units in January. This compares to a low of 479,000 in February of 2011. The average number of units built since 1960 is approximately 1.4 million. During the boom years of 1998-2006 the average was 1.76 million units with a peak of 2.2 million units annualized in January of 2006. Home sales are running at the same level as 1945 despite the fact that our population has doubled. Rental rates are now higher than the cost of purchasing a home in many parts of the country and, with historic lows for interest rates, housing affordability is at all time highs.

- I believe we have passed the bottom of the housing cycle and that single family homes and equities are the two best investment opportunities that can be found.

2011 tested our faith, however, based on the fundamental data referenced above and as per my article "Let the cat out of the bag" on January 27th, I believe we are well positioned for the bull to continue its run to levels significantly above most expectations.