May 10, 2010

Topic: Market Outlook

August we started to anticipate a market correction. The indexes had moved up impressively from their March 9, 2009 lows and a pause seemed warranted.

In November, we had to change our opinion, as the adage "the trend is your friend" predominated and that trend remained inexorably upwards.

In February, we thought that the bull run was over as the March 9, 2009 up-trend line was punctured by each of the major North American indexes. But, after an 8% pull-back, the upwards march continued. Right up until Monday, May 3rd.

In four trading days since then, the indexes recorded cumulative losses amounting to 6.9% for the DJIA; 7.6% for the S&P500; 9.3% for the NASDAQ; and 4.1% for the S&P/TSX Composite.

That is all about to change. Some of last week's plunge will be erased at the open (Monday, May 10). But, we think this market rebound will be temporary.

While on the face of it, it looks like the flailing European countries have been rescued. We think this is only a brief respite since the underlying problems remain. And what becomes paramount now is whether the respective governments can turn their countries' ships around. In the meantime, there is now a further almost US$1 trillion of debt that has flooded into the European market. Like in the USA, this debt eventually has to be repaid.

It is fortunate that the U.S. economy is showing improving signs, although the housing sector is far from out of the woods. Because China is starting to slow. This is a good thing, even though it may slow the fragile global economy. China could not keep up its frenetic pace without a bubble (or two) forming in some of its domestic sectors. Fortunately, the Chinese government is applying some financial brakes to slow its over-heated real estate sector. At the same time, upward pressure on the yuan seems to have abated.

We remain committed to a 10%-15% pullback. It is just delayed. But, maybe not long. We would be selling on strength.

Bob Weir

Bob Weir, B.Sc., B.Comm., CFA
Managing Director, Research Services