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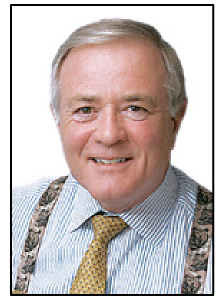
William Rutherford

Slowing economic growth upends market in April

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The month of April continued its winning ways in the equity market. For the month, the market was up just 0.9 percent. But up it was. It was a photo finish, as the market dropped dramatically at the end of the month into negative territory for the month and year, only to get a small burst at the end, to finish up for the month and just into positive for the year. Expectations are that revised numbers later this quarter will show the economy in reverse.

For the month of April, the indices were: DOW up 0.4 percent, NASDAQ up 0.8 percent, and the aforesaid S&P up 0.9 percent. Year-to-date, the indices were DOW up 0.10 percent, NASDSQ up 4.3 percent, and S&P up 1.3 percent. Transports year-to-date are off 6.0 percent, a worrisome sign. International benchmarks registered impressive gains. Germany is up 16.8 percent, Italy is up 21.2 percent, France is up 18.1 percent, Japan is up 11.9 percent, and China (Shanghai) is up 37.3 percent. However, with respect to international holdings, dollar investors have to adjust for the increase in the dollar versus the foreign currency.

The downdraft was triggered by a weak economy. First quarter GDP managed a meager 0.2 percent growth, well below expectations. This slow growth caused the Federal Reserve to pull back from expected plans to raise interest rates, perhaps postponing the expected increase until fall. Fed futures forecast only a 6 percent chance of a rate rise in June, setting the stage sometime in the future for the weakest tightening ever, according to Mohamed A. El-Erian, chief economist for Allianz. The waning of interest rate expectations caused a rapid fall in the value of the dollar, which fell almost 5 percent in a week, after an 11 percent gain in the first quarter. Because oil trades inversely to the dollar, oil futures climbed. The result of these gyrations was some easing in the worries regarding the strong dollar and a stabilizing of oil stocks. The buildup in oil reserves appears to be slowing, which has also helped stabilize oil prices. The U.S. benchmark crude price WTI jumped 25 percent after tumbling 11 percent in the first three months of the year. The result of these sea changes in various markets caused the equity markets to rerate stocks, and those stocks, which had done well at the start of the month, were crushed at the end of the month. Many gains disappeared despite the markets hitting all-time highs just weeks before. For instance, the NASDAQ Biotechnology index fell 2.8 percent in April, and 8.1 percent in the final week of the month, after jumping 13 percent in the first quarter. The result was a "spring cleaning."

On the brighter side, auto sales were healthy. Buyers were trading up to higher priced autos. The Purchasing Managers Index (PMI) was unchanged at 51.5 percent. Anything over 50 percent indicates growth. The significance is that the PMI had dropped every month since October, so this was the first month it had not dropped since that time. Consumer sentiment was 95.9, up from 93.0 but just short of expectations of 96.

Many factors are involved in the slowing economy. One can speculate about the effect of the more than $150 billion in fines imposed on the financial sector and the effect on bank lending. Add to that the billions in new costs because of new regulations on banks. All of these new costs affected lenders financial statements and the regulations made it harder to lend. Small community banks are especially hard hit by regulations which they could not afford and which affected their lending. Many were essentially put out of business. Unavailability of credit makes it very difficult for small businesses to form and to grow, and thus impacts job creation.

New regulations make it harder for new companies to go public. This robs them of capital needed for growth, and robs retail investors of the opportunity to profit from Initial Public Offerings and stock appreciation. In some respects, we are our own worst enemy.

Also casting a pall over the markets were the usual players – Ukraine/Russia, Greece, and the Middle East – with no progress in sight. Still investors seemed to be thinking that this year would be like last, where we had a softening in the first half of the year and a strengthening in the second half, with a rise in interest rates. Our guess is that is the most likely scenario. We continue to advise cautious but confident investing, with a well-diversified portfolio.

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