



Weekly economic and market comment 10-30-11

The week ahead: Several key data releases are scheduled in the coming week. The most important for the markets are:

- Tuesday, November 1: The October manufacturing ISM index will be released at 10am EDT and is expected to be 52, up slightly from last month's 51.6 and indicating sluggish, but positive growth.
- Wednesday, November 2nd: The results of the two day Fed meeting will be released at 12:30pm EDT. The board will continue to be split on whether to be more accommodative and the third quarter GDP estimate of 2.5% will likely keep the Fed on hold for the time being. Those advocating more accommodation have let it be known that there is more accommodation in the pipeline should economic prospects deteriorate. At the same time, the Fed probably does not want to preempt year-end action by Congress to deal with the questions of more fiscal stimulus and longer-term debt reduction. It is more likely that additional measures will be adopted to coordinate with the outcome of the fiscal/budget outcome.
- Thursday, November 3rd: The non-manufacturing ISM index will be released at 10am EDT. While this index gets less attention than the manufacturing index, I consider it as important because it covers more of the economy. The forecast is 53.5 up from last month's 53 and indicating moderate growth.
- Friday, November 4: The very important October employment index will be released at 8:30am EDT and is expected to show that payrolls increased by 90,000 jobs. Several lesser but important predecessors will be released in the middle of the week including the widely watched ADP report of private hiring on Wednesday.

The Economy: Is the U.S. becoming "lean and mean"? The third quarter GDP report was very positive, not because of the 2.5% growth, but because of the composition. Specifically:

- The inventory growth was much slower than the propensity to spend and actually subtracted 1.08% from growth, i.e. growth would have been 3.6% if not for this subtraction. As a result of this and coupled with the momentum in growth at the end of the third quarter, I am raising my fourth quarter GDP growth forecast to 2-3%.
- Investment in equipment and software contributed 1.2% to growth. Although the jobs picture still looks very weak, the robust investment will help make the U.S. competitive and productive. In the longer run this will benefit labor as the U.S. increases exports and produces more of its own demand.

Equities: The strong gains in equity prices in the last four weeks reinforce my opinion that the market has seen the low. And, as indicated above, the economic data is stronger than I previously expected, another supportive factor. However, the market “looks ahead” and despite my improved outlook for the first quarter, the first half of 2012, looks weak. The outcome of budget negotiations will have a huge effect on both the economy and the market in my opinion. Thus as attention shifts from Europe to the U.S. in the next few weeks, the stock market looks vulnerable, although from a higher level than I previously thought.

My near term forecast is for the S&P to peak somewhere between last week’s high and 1320 in the next two weeks, well above 1260, the top of my previous short-term range. As attention focuses on the U.S. budget and growth prospects in 2012, I think the S&P will correct back to the 1150-1200 level. This would counter the usual trend for the market to rise in the November-December period. Beyond that, I think the market will respond to the success (or failure) of the year-end budget negotiations.

Third Party Research Disclosure

This third party publication is not prepared or approved by Stuart Investment Management Limited and therefore does not meet Canadian research disclosure requirements applicable to Stuart Investment Management Limited. The opinions, estimates and projections contained in the publication are those of the author alone as of the date indicated and are subject to change without notice. Stuart Investment Management Limited makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors or omissions which may be contained therein and accepts no liability whatsoever for any loss arising from any use of or reliance on the report or its contents. The provision of this publication is not to be construed as an offer to sell or a solicitation for or an offer to buy any securities.

Stuart Investment Management Limited, its affiliates and/or their respective officers, directors or employees may from time to time acquire, hold or sell securities of issuers mentioned in this publication, related securities, or options, futures or other derivative instruments based thereon.