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Time to invest? Could be

Stocks poised to climb 'wall of worry': analyst

By: Joel Schlesinger

It's that time of year again- when economists and financial experts gaze into their crystal balls to predict growth for the new year.

If the past year was marked by the stock market and the Canadian economy taking two steps forward and one-and-a-half steps back, 2011 will also be a mixed bag of good and bad business news. But depending on your perspective- job-hunter, investor, retiree, homebuyer or borrower- the remaining 357 days of this year will be better for some than others.

Yes, it's true. Economists are again predicting growth, but slow growth, even slower than last year. But it's growth all the same, which beats economic shrinkage, job losses, market crashes, sweaty palms and sleepless nights.

“We're forecasting 2.6-per-cent economic growth for 2011 compared to three per cent for last year,” says Derek Burleton, deputy chief economist with TD Bank Financial Group in Toronto.

At RBC, economists are calling for a more rosy 2011. They're predicting about 3.2-per-cent growth compared to 3.1 for 2010. It's not awe-inspiring, but one of the bank's top economists says it's a sign that Canada is in recovery mode.

“It's certainly an improvement relative to the decline of 2.5 per cent that we saw in 2009,” says Paul Ferley, assistant chief economist at RBC. “However, it will remain an issue that it was in 2010 that the pace of increases is still fairly modest, given the severity of the downturn in 2009.”

In Manitoba, this year looks brighter than it does for other parts of the country- an improvement over 2010. Last year, growth in the province at 1.8 per cent lagged behind the national average, according to RBC's numbers.

But Ferley says Manitoba experienced slower growth in 2010 compared to other provinces only because it didn't have as much ground to recover, because its economy didn't shrink in 2009.

“Manitoba didn't have growth either that year, but it had flat output in 2009,” he says, adding that no growth is better than negative growth.

RBC predicts that this year Manitoba's economy will grow by 3.5 per cent.

Yet, despite the predictions of economic recovery and moderate growth, some Canadians may be left “scratching their heads,” wondering just where that growth is happening, Burleton says.

And that's partly because the recovery has yet to trickle down to many households.

“Under the surface, the news isn't quite as good with respect to benefits for households,” he says. “A lot of the gain reflects a stronger U.S. outlook that will benefit the export sector, but we don't expect that to be a one-for-one improvement in the job sector.”

Jobs will be created, he says, but employment growth will be even more modest than economic growth.

In Manitoba, the unemployment rate should fall slightly more than the national average as manufacturers see renewed demand for equipment south of the border because many major U.S. corporations, with strong balance sheets, are now looking to make capital purchases for new technology to improve productivity, says Tony Demarin, a chartered financial analyst and president of BCV Financial in Winnipeg.

“The corporate sector is as healthy today as it's been in 50 years,” he says. “You have to go back to the 1950s in terms of balance-sheet strength.”

And that's good news for investors, he says.

In fact, many large corporations are posting record profits.

“The reason for that is they've been very cautious about bringing on expensive labour,” he says. “That's why you see a jobless recovery going on in the U.S.”

Large corporations with global reach will fare better than those focused solely on serving domestic markets and the United States because they will benefit from exposure to developing markets where economic growth will be closer to six per cent per year.

“In the developing world, more and more people are moving off farms and into the cities, and this will have a positive effect on the entire world, despite Japan, the United States and Europe growing more slowly than they have in the past,” Demarin says.

China, India and other developing nations with large populations now have fast-growing middle classes with a thirst for consumer products. It's a scenario that is only now beginning to take hold, and it will continue as a trend long after 2011, he says.

But perhaps the best indication of a good year for the stock market more than anything else is investor sentiment. Because the benefits of economic growth have yet to fully arrive at the homes of the average family, a good number of people are still very cautious about where they put their money.

“Markets always climb a wall of worry,” Demarin says. “If you go back over the last 50 years, there's always an event that will give you caution, and that's generally a condition for good equity prices.” Because so many investors are worried about a double-dip recession, many are still shying away from putting money in the stock market. When few people are buying, that's usually a good time to start investing because high demand for stocks isn't driving up prices.

“Remember, you have to buy in with room for upside,” he says. “If you wait until everyone is completely euphoric, the chances are the equity market reflects all that and you're buying in at the peak.”

Even 2012 should be a bull market for stocks, Demarin says. Investors won't see this year and next the rapid growth seen in years past, but the returns will still outpace those provided by fixed-income investments. Expect to see high single-digit and low double-digit percentage annual equity market returns in 2011 and 2012, he says.

After that, things may get dicey, he says.

“Markets tend to go in cycles and the next bear market shouldn't come until 2013.”

In the meantime, however, it's not entirely a risk-free environment. The European debt crisis will continue to cause ripples of worry in the markets. But Demarin says for the time being it's looking like Germany will backstop failing European Union members. Those bailed-out nations' governing parties face tough political and economic decisions in the coming year. Their populations will be forced to swallow the bitter medicine of austerity- job cuts, slow economic growth and government cutbacks- and that could lead to protests, strikes and further instability over the short term.

“It's a question of how much pain the citizens of Europe want to take,” Demarin says. “It might get to the point where they throw in the towel and say, 'It's too much pain so let's just restructure the debt and default.' “

And if that happens, any forecasts you've read in the past few weeks- including here- just might get thrown right out the window.

Navigating the shoals

An interest in interest rates

For the borrowers and the lenders out there, the Bank of Canada interest rate is expected to remain at about one per cent until summer. “They'll wait until some of these risks die down, such as Europe, and as well we've got inflation falling back a little bit, providing a little wiggle room,” says TD economist Derek Burleton. “We've got rate increases expected to be a percentage point over the latter half of next year, but we don't expect the bank to resume rate increases until July.” For borrowers, those who want to lock into a fixed mortgage may want to think about doing that well before the summer, and fixed-income investors should invest in short-term securities until rates move higher. “If you're going to be an owner of fixed income, you certainly want to stick to short-term instruments so you can pick up higher interest rates as they come out over the next couple of years,” says financial analyst Tony Demarin with BCV Financial.

Taking profits from rising markets

With the next two years expected to be growth years for equity investors, and 2013 expected to be a bear market, does that mean investors should take profits before 2013? Demarin says long-term investors ideally never want to sell good companies, even in bad markets. As a value investor, who uses a strategy similar to Warren Buffett, Demarin says he recommends investors sell only in certain circumstances. For one, they sell if they need money. In that circumstance, investors need to be wary of tax implications (taxes on capital gains) and selling the right investment. Regardless of needing money or not, it's generally best to sell the stock of a company whose business fundamentals are deteriorating. This happens when a company sees increased competition from new players and/or the market it serves is shrinking. Or, the company made some bad business decisions. Another instance is when a company is overvalued with little chance of increasing its stock price; it has become the flavour du jour. “You take that capital and invest in companies that have a better outlook,” he says. But this strategy can be tricky, as many investors sell their winners too early and hold on to losers too long. It all comes down to discipline. If a company has a good balance sheet (lots of shareholder equity compared to debt), it's likely a good investment no matter the market conditions. “The point is, you don't just panic-sell just because you see on TV that the stock market is dropping,” he says. “You have to look at the fundamentals of the businesses you own.”