April Malaise

This April has seen many stock market gyrations, yet the month will end in almost exactly the same place it started barring a major move on the last trading day. After steadily rising nearly 25% since last September, April's ups and downs seem to indicate that investors are no longer too excited about future prospects, yet still aren't scared enough to head for the exits.

Uninspired Indicators

Part of the reason for sideways trading in April was the lack of strong signals. News was either uninspiring, or when good news surfaced, something less positive usually lessened its impact.

U.S. GDP rose at a 2.2% annual rate in the first quarter after analysts had predicted 2.5% growth. GDP increase for the year is projected at only 2.3%, with projections for 2013 at only 2.7%. None of these numbers are strong, but GDP growth is still steady, stable, and high enough to quell discussions of a second recession.

New job creation provides another tepid indicator. Like March, April should yield only minimal job creation, and initial jobless claims rose substantially in recent weeks. New job projections for 2012 remain around 2 million, which is neither very good nor bad.

Housing appears to have bottomed in most of the country with some isolated markets finally heading north. In parts of California and Florida, bidding wars are even reemerging. The housing market is expected to pick up steam – but not until next year.

Retail spending increased at 2.9% in first quarter, and saw its strongest gain since fourth quarter of 2010. But, gains are likely short-lived as consumers increasingly used savings and plastic to expand spending. Anemic wage growth of only 2% may limit future increases.

The driver behind increased spending is likely rising consumer confidence. The University of Michigan index came in at 76.4 on April 27, which was well above analyst expectations of 75.7. Increased confidence tends to indicate potential future bright spots in spending, home purchases, hiring, and a willingness to take risks such as moving or starting a business.

Bigger Trends

I believe more meaningful trends that will impact the economy and profits in the mid-term can be found in small business sentiment, European struggles, and emerging market growth rates.

Small business sales and profits, which have lagged larger firms since the recession, are finally up. Growing optimism is driving more aggressive growth plans. A recent PNC Bank survey revealed small firms expectations for continued sales increases. Even more significant, 80% of respondents report they're considering expanding their business because of rising demand. Since small business has historically been the primary job creating sector of our economy, improvements in sales and sentiment should bode very well for economic growth and hiring.

But, Europe poses a less positive outlook balancing U.S emerging economic health. Spain's sickly economy faces a "crisis of huge proportions", according to Foreign Minister Jose Manuel Garcia-Margallo. Unemployment hit 24%, its highest level in two decades, and Standard and Poor's downgraded the government's debt two-notches to BBB+ from A. Britain has also fallen into its second recession since the financial crisis after a shock contraction at the start of 2012.

Yet, bad news with the second tier European nations was offset in mid-April by Germany's top economic institutes' claims that their economy is picking up steam despite the turmoil of the European debt crisis. The institutes raised their growth forecast for this year to 0.9 percent from a forecast of 0.8 percent in their last outlook in October. German business leaders are more optimistic and low unemployment is making consumers more confident.

Europe as a whole seems to be following a similar growth pattern as the U.S., albeit with an even lower growth trajectory. Investors aren't encouraged by lack of convincing progress, but they also don't seem too nervous about ongoing problems. More lukewarm news.

Emerging markets growth is also slowing. China's economy has cooled which provides some big U.S. and European companies their biggest growth area. Brazil's 2011 growth of only 2.7% in 2011 also disappointed investors.

Yet, many Western chief executives predict a return to rapid growth in China, fueled by the government's easing monetary policy and expansion in faster-growing inland cities. Most executives are still optimistic about the long-term growth prospects for China, and see recent weakness as nothing more than a blip in the rise of the world's second-largest economy.

Brazil's growth rate for 2012 is also predicted to increase to a more robust 3.2%. Policy changes announced April 3rd that encourage industrial growth should reduce the cost of operation in Brazil by lessening the "Brazil Tax" as their many inefficiencies are known.

Future Implications

While various indicators don't seem to provide a clear direction, larger and longer term trends suggest continued economic growth and steady, if slow, progress. The strengthening of small business in the U.S. and expectations for renewed growth in foreign markets, particularly emerging market powerhouses of China and Brazil, should propel the U.S. forward in the relatively near-term. As these trends play out, I believe greater enthusiasm among investors will continue to drive markets higher later in the year, albeit at a moderate pace.

For now, the U.S. equity market is likely near fully valued. If you've been waiting until the market recovered to take some money off the table, now might be a good time to act. Yet, I also believe that valuations remain low enough and expectations for future growth high enough to make long-term investments attractive. One major caveat is that current valuations raise the market's susceptibility to bad news. And, the U.S. government has ample opportunity to unsettle investors later in the year. More on that large topic next month.

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