



The Stock Market – A Leading Indicator

The stock market is generally referred to as a leading indicator of economic activity. A leading economic indicator is an indicator which changes before the economy changes. So in terms of the stock market, it is expected that stock market performance would decline prior to an economic contraction and stock market performance would improve prior to an economic recovery. The reason for this hinges on investors' expectations of the future i.e. the projections and estimates of future earnings or more generally, economic activity.

Many investors buy stocks based on the estimated intrinsic value of that stock. One way to determine the intrinsic value of a stock is to look at the present value of expected future cash flows. Strong economic growth, generally, should translate to strong corporate profits which could lead to greater cash inflows for the investor via dividends. Should investors hold the view that the outlook for economic growth is positive then the estimated intrinsic value of a stock may increase. If the investor believes that an economic contraction is approaching, this will lead to the belief that corporate profits would decrease which should lower the projected intrinsic value of the stock.

The intrinsic value of the stock is an important benchmark figure for investors. When the intrinsic value is below the current price of the stock then investors are likely to sell which could drive stock prices down and if the intrinsic value is greater than the current price then investors are likely to buy which could push stock prices up. These movements occur based on investors' expectations of what is in store for the economy.

While the stock market has shown to be a relatively reliable predictor of the future state of the economy it should not be used as the only gauge but in conjunction with other leading indicators such as initial jobless-claims, average weekly hours (manufacturing), manufacturers' new orders for consumer goods/materials, building permits for new private housing units and the consumer sentiment index. These indicators are components of the Leading Economic Index (LEI) which is released monthly by The Conference Board (a New York based not-for-profit business membership and research organization established in 1916).

The LEI has ten components in total: interest rate spreads, money supply, S&P 500 stock index, average weekly hours (manufacturing), building permits, jobless claims, new orders for goods / materials, vendor performance (slower deliveries diffusion index), new orders for nondefense capital goods and consumer expectations. The latest report was released on 21 May 2009 for the month of April 2009 showing that the index rose 1.0 percent in April. Based on revised data, this index decreased 0.2 percent and 0.5 percent in March and February respectively. During the six-month span through April, the index decreased 0.6 percent.

Of the ten indicators, seven increased in April. The factors that bolstered the index, in order of largest contribution were the

stock market, interest rate spread, consumer sentiment, jobless claims, manufacturing hours, supplier deliveries and new orders for consumer goods and materials. The factors weighing down the index were the real money supply, building permits and new orders for nondefense capital goods.

According to Ken Goldstein, a Conference Board economist, "The leading indicators suggest that while the recession will continue in the near term, the declines will be less intense". He also noted that "If the indicators continue on the current track, that point might be reached in the second half of the year". The translation here is that there may be an easing of the US recession beginning in the second half of 2009.

As an investor it can be quite useful to pay attention to these leading indicators. If it is evident that a recession is on the horizon then you may want to take profits on certain stocks for example of companies that sell discretionary goods and purchase stocks of companies that may do well despite a recession such as health care and utilities. Conversely, if a recovery is visible you may want to purchase stocks at low prices with the expectation that their expected intrinsic value and therefore price will eventually rise.

Current Happenings in Local and International Markets:

- Caribbean foreign-direct investment expected to drop sharply in 2009
 - Sagicor strong enough to withstand downturn, says Chairman
 - Dip in NML second quarter EPS...
 - JMMB posts \$668-m net loss for Q4
 - Caribbean central banks working on regional regulator
 - US Jobless rate jumps to 9.4 percent in May, even as layoffs slow to 345,000
 - New US jobs data sends oil prices briefly above \$70 per barrel
 - Australia Unexpectedly Grows 0.4%, Skirting Global Recession
 - Barclays Abu Dhabi Holders to Sell \$6.8 Billion stake
 - GM Files Bankruptcy to Spin Off More Competitive Firm
 - Chinese Manufacturing Grows, Adding to Recovery Signs
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Table 1: Regional Market Performance (as at 4 June 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	778.14	-1.71	-3.42	-7.69	-31.93
All Trinidad	1,071.83	-0.82	-2.74	-7.18	-27.57
JSE Index	83,076.98	0.46	4.11	3.65	-25.15
JSE Select	1,889.67	0.76	10.89	-4.79	-39.10
All Jamaica	69,245.12	1.03	10.28	-6.42	-38.40
BSE Composite	842.91	0.11	-3.53	-8.37	-20.93

Table 2: International Market Performance (as at 4 June 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	942.46	3.93	3.88	4.34	-31.57
Nasdaq Composite	1,850.02	5.61	4.90	17.31	-26.09
Dow Jones Industrial	8,750.24	4.12	3.84	-0.30	-29.38
German Dax	5,064.80	2.67	3.31	5.29	-27.29
FTSE 100	4,386.94	-0.01	3.38	-1.07	-26.52
Nikkei 225	9,668.96	2.30	9.52	10.54	-33.02
Hang Seng	18,502.77	3.45	12.95	28.60	-23.30
DJ Eurostoxx	2,487.08	1.38	2.79	1.45	-32.76

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