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MARKET STRATEGY

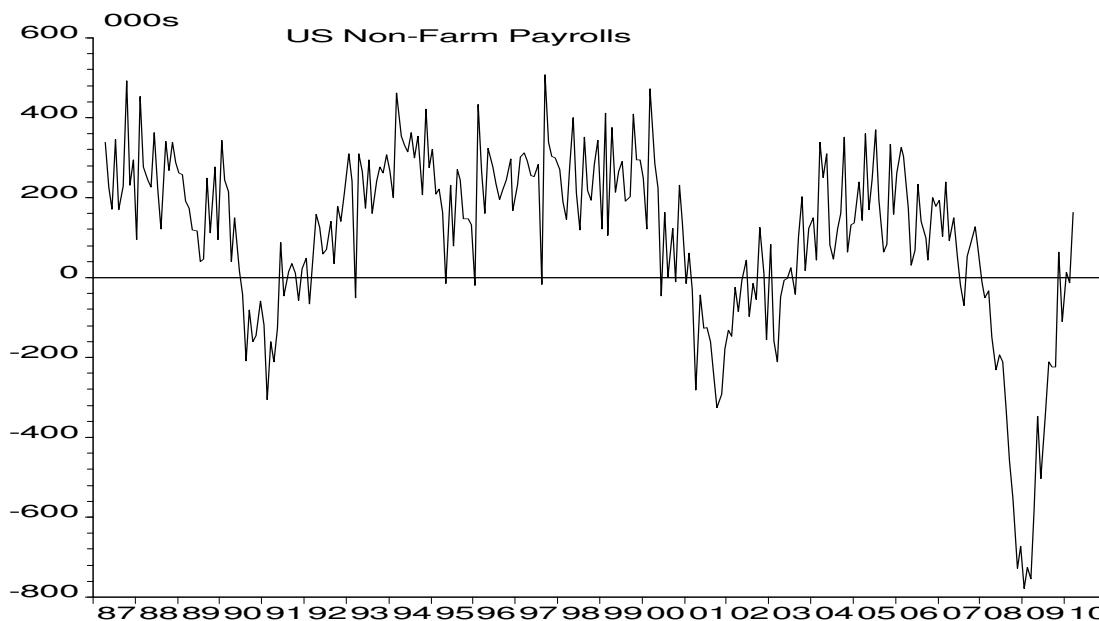
INVESTMENT RESEARCH

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A sustainable recovery in the making - good news for equities.



Source: DATASTREAM

They may have fallen shy of expectations but last Friday's Non-Farm Payrolls for March were a big deal because they provide one of the first tangible signs of a sustainable US recovery. Corporate profitability has been picking up, investment has picked up and now jobs are picking up. Also, both the non-manufacturing and manufacturing ISM surveys together indicate that the US economy's underlying momentum is improving, which is good for business confidence. It means more investment and more jobs.

Jobs boost personal income and consumer spending, which adds to the top line for companies. Since the corporate sector remains under pressure to cut costs and restructure, this means that, in coming through to the bottom line, earnings are still likely to surprise on the upside.

With a sustainable recovery in the making the US Treasury market will come increasingly under pressure. This, as was hammered home at what were recently poorly bid auctions, will be all the more so with the issuance required to fund the federal deficit.

Where does this leave equity markets? Rising yields in the Treasury market is where the downside lies for equities but we suspect they will take their cue from earnings – until, that is, the Fed indicates it is ready to tighten or withdraw from its ultra-easy monetary policy. This, as we continue to be reminded, is not for a while. The Fed will read an unemployment rate of 9.7 percent as indicative of a low rate of resource utilization and, meanwhile, both inflation and inflation expectations remain tame.

Tactically, relative strength indicators show that the rise to new highs for equity markets has pushed them into extreme overbought conditions but we are sounding like a broken record on this one. Equity markets have been reluctant to yield to any profit-taking. The fundamentals are strategically supportive and, with a sustainable recovery in the making, even more so now in the US. Long may Wall Street's leadership continue - upwards that is!

IMPORTANT NOTES

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