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# Healthy economy not enough to entice fearful U.S. investors

## American markets lag well behind Canada

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For some time I have wondered why, when most economic indicators and corporate earnings in the U.S. have been flying high, American stocks have not done better than they have.

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And does the market's ambivalence to fundamentals mean people investing in the U.S. are in for recovery or a pratfall?

Earlier this week, Reuters cited a Merrill Lynch report that during this year's second-quarter earnings season, profits for companies in the Standard & Poor's 500 index rose 14 per cent, double the pre-earnings season estimate. The report added that nearly 78 per cent of the companies reporting had beaten earnings estimates while 20 per cent missed, compared to long-term averages of 59 and 19 per cent respectively.

However, Merrill warned: "These earnings growth rates may prove to be too robust and may cause the market problems later on in the year. Keep a close watch."

While company earnings continue to shine, so did the economy, with U.S. gross domestic product growth of 3.4 per cent for the second quarter of this year, marking the ninth straight quarter that the economy grew by more than 3.0 per cent.

The reaction, according to the Associated Press: "On Wall Street, the GDP report failed to inspire investors. The Dow Jones industrials lost 64.64 points."

In fact, while the S&P/TSX Composite Index has climbed 15.7 per cent this year, the Dow Jones Industrial Average is down 1.8 per cent, and the S&P 500 is up a meager 2.1 per cent.

So much for the convention that stock markets are leading indicators that move up or down about six months in advance of the economy. This is the summer of our disconnect.

Says Hendrickson Financial of **Edmonton**, concerning the Dow Jones: "It continues in the trading range bound by 10,550 and 10,700. It can be likened to a spring; the longer it continues in this range, the more compact the spring becomes. Eventually it has to unleash the energy built up and potentially could go in either direction. Based on our technical analysis and the current sentiment readings, we expect the direction of the Dow to be down through the rest of August."

The reason American investors have been paralyzed is that they are living in abject fear.

They're afraid of record high oil prices, a new king in Saudi Arabia, a war in Iraq that could expand to Iran, the off-shoring of jobs to India, a loss of manufacturing to China, an auto industry trying to survive on paper-thin margins, a housing bubble, and of course the old suspects - the wavering American dollar, the trade deficit and the current account deficit. The UBS index of U.S. investor optimism, which rose to 108 points in January 2004, retrenched to 58 points during July, around its two-year low. Reported UBS: "The price of energy remains the topmost concern, cited by 71 per cent of investors nationwide as hurting the investment climate 'a lot,' followed by the outsourcing of jobs to foreign countries (61 per cent) , and the federal budget deficit (51 per cent)."

If you wonder why Americans are afraid to invest, consider that **Lawrence Kogan**, CEO of the Institute for Trade, Standards and Sustainable Development in the U.S., warned Americans this month about protectionism in the European Union. Said **Kogan**: "Nothing less than America's very enterprise system, individual freedoms and international interests -- its core political and economic values -- are at stake."

No wonder American investors are petrified.

The greatest evidence of American fear is the record amount of cash on the sidelines. And as The Speculative Investor newsletter in the U.S. says: "It is completely wrong to assume that a mountain of 'cash on the sidelines,' such as the $2.4 trillion currently sitting in money-market funds, is necessarily going to find its way into the stock market."

It won't happen until the fear felt by American investors dissipates.

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