Stocks buoyed by recovery hopes



RICHARD DREW / The Associated Press

A surge of investor optimism about the economy gave the market its best July in 20 years. Blue chips enjoyed their best month since October 2002.

Investors give market its best July in 20 years

By Tim Paradis
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NEW YORK — New hope for the economy just gave the stock market its best July in 20 years.

Investors placed big bets over the last month that the profit machine at U.S. companies will continue to rev higher and that the longest recession since World War II is finally easing its grip. If that turns out to be wrong, the huge gains of July mean there will be an even bigger price to pay if companies don't deliver.

The Dow surged 725 points or 8.6 percent for the month, with most of the gains arriving in bursts in the final 15 days. The extraordinary run shaped July into the best month for the blue chips since October 2002 and the best July since 1989. The Dow has risen four of the past five months.

The broader Standard & Poor's 500 index, a benchmark for many mutual funds, also ran at a strong pace, and July was its best performance since 1997. Even with the gains, the S&P is still down 37 percent from its peak in October 2007.

The companies that fared best in July were those that signaled they were patching up their businesses after a terrible winter and fall. Caterpillar Inc.'s earnings for the April-June quarter fell, but the company raised its profit forecast for the year. Its stock surged 33.4 percent for the month.

Earnings reports that fueled the rally often contained a few dark spots, and many companies have been increasing their bottom line by taking a knife to costs. Eventually they will have to bring in more revenue because trimming costs can't increase profits forever.

Stu Schweitzer, global markets strategist at J.P. Morgan's Private Bank in New York, said the lower expenses means companies will be better positioned to reap big earnings when the economy does grow and revenue starts to tick higher.

Economic reports are starting to support traders' bets. The government reported Friday that the economy shrank at a pace of just 1 percent in the second quarter, better than analysts anticipated. In the first three months of the year, the economy shrank at a pace of 6.4 percent, the steepest slide in nearly 30 years.

Despite the improving outlook, the economy still faces significant hurdles. Analysts worry that difficulty for consumers in borrowing, unemployment and a still-weak housing market will choke off growth. Key re-

See STOCKS on page 2B

STOCKS

FROM PAGE 1B

ports next week on manufacturing, housing, employment and the service industry could also reshape the market's view about where the economy is headed.

"I don't think this is a one-way staircase back up to where we came from. I fully expect potholes along the way," Schweitzer said.

On Friday, the Dow rose a modest 17.15, or 0.2 percent, to 9,171.61. The S&P 500 index rose 0.73, or 0.1 percent, to 987.48, while the Nasdaq composite slipped 5.80, or 0.3 percent, to 1,978.50.

For now, companies aren't hemorrhaging money like they were last fall and early this year. Traders began the latest rally July 13 when they rushed to buy stocks ahead of a strong profit report from Goldman Sachs Group Inc. The bank's profit turned out to be huge, and strong report cards since then from companies like AT&T Inc. and microchip producer Intel Corp. confirmed that a range of companies were finding their footing.

Three of four companies in the S&P 500 index have reported results that topped analysts' expectations, according to Thomson Reuters. About 300 of the 500 companies have turned in their reports.

That unexpected bounty has pushed major market indexes to their best levels of the year. On July 23, the Dow rose above 9,000 for the first time since January. The rally pushed the Dow back into the black for the year and it is now up 4.5 percent.

The Nasdaq traded above 2,000, and the S&P 500 index neared the 1,000 mark, a level not seen since November.

"We're on the edge between recovery and speculation," said Rick Lake, portfolio manager of Aston/Lake Partners LASSO Alternatives Fund in Greenwich, Conn.

Lake said the market's ability to bounce higher in July even after getting bad news signals that many investors are looking to jump on the rally.

Major stock indexes surged off 12-year lows in early March to rally almost 40 percent by mid-June before stumbling until July's earnings reports restored hopes for a rebound in the economy.

Investors have been putting money into areas that are expected to do well in a recovery. Materials companies in the S&P 500 index rose an average 12 percent for the month. Aluminum maker Alcoa Inc. jumped 13.8 percent.

By comparison, energy company stocks rose only 3.6 percent. Oil posted its first monthly drop since January. Exxon Mobil Corp. edged up only 0.7 percent.

Analysts credit some of the buying to short-covering, in which investors have to buy stock after having earlier sold borrowed shares in a bet they would fall. That can make doubts into short-term buyers and give an artificial lift to stocks.

Investors still have plenty to worry about. The GDP report found that consumers cut spending by 1.2 percent in the second quarter, after a 0.6 percent increase in the first quarter.

The unemployment rate stands at 9.5 percent, and the Federal Reserve predicts it will top 10 percent by the end of the year.