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SOARING STOCKS SHRUG OFF GLOOM

Russ Wiles, The Arizona Republic

Several weeks ago, the stock market was on the ropes.

The Dow Jones industrial average had slumped 700 points over a few days, and warning lights seemed to be flashing everywhere:

* Inflation was creeping higher as hopes for interest-rate cuts faded.

* Profit growth seemed likely to slow noticeably for the first time in about five years.

* Subprime mortgage lenders were going belly up like fish in a polluted creek.

* Leading indicators pointed to a flat, if not recessionary, U.S. economy.

* A credit crunch in China threatened to pull down the world's workshop.

But rather than cascading into a full-blown retreat, the market shooed away those issues as if they were but gnats on a warm spring evening.

Since bottoming at a five-month low below 12,000, the Dow has recouped its lost ground and then some, closing Friday at a record-high 12,962, up 350 points for the week and 4.9 percent so far in April.

What's even more remarkable is that the rally materialized even though not much has changed on the economic front.

"It has been surprising how fast the market rebounded," said David Fernandez of Wealth Engineering LLC in Scottsdale. "I'm even more cautious now."

Barbara Walchli, Phoenix-based portfolio manager of the Aquila Rocky Mountain Equity Fund, believes the late-February and early-March slump was the result of investors finally recognizing that the economy was indeed braking.

"The (Federal Reserve) has been trying to slow the economy so that the (expansion) cycle can continue for another several years, and some of that involves problems," Walchli said.

But despite several ongoing worries, from subprime mortgages to worldwide political tensions, Walchli foresees stock market returns of 8 to 15 percent this year. And she believes that will be followed by another good showing in 2008.

Walchli doesn't consider a U.S. recession likely anytime soon, in part because global economic growth is so solid: the International Monetary Fund is forecasting a gain of 4.9 percent this year and next.

Scottsdale money manager Stanley Rulapaugh also views recent anxiety as overblown.

"I don't see why the market went down in the first place," he said. "There's nothing wrong with the economy."

Rulapaugh points out that unemployment is at a mild 4.4 percent, with the number of foreclosures and troubled mortgages still at relatively low levels compared with homeownership in general.

And while interest rates and inflation have heated up a bit lately, Rulapaugh notes such behavior is normal in an expanding economy.

Meanwhile, serious investors will be carefully watching corporate-profit numbers, as roughly one in four companies in the Standard & Poor's 500 index releases first-quarter earnings reports next week.

The Wall Street consensus is that earnings growth finally will moderate.

"The bar is set lower this quarter than it has been in the recent past, with median year-over-year growth of only 7.2 percent expected," wrote Dirk van Dijk, research director at Zacks Investment Research in Chicago.

Yet he's quick to point out that earnings still look healthy.

"The early returns are showing that positive surprises are once again far outnumbering disappointments -- currently at almost four to one," he said.

Zacks sees full-year profits for companies in the S&P 500 rising 10.7 percent in 2007, down a bit from the 13 percent pace of 2006.

Fernandez said stocks have become expensive compared to bonds, and he's gradually shifting some client assets.

He's particularly wary of real estate weakness and its impact on consumer finances.

"It's been like a slow-moving snowball," he said.

But Rulapaugh views the reverse as true, describing stocks not only as cheaper than bonds but capable of gaining from positive earnings surprises.

And Walchli said stocks also could benefit from expanding price/earnings ratios after several years of compression.

Even real estate weakness, in her view, could provide a boost for the stock market despite general concern that it has dampened economic growth.

"Housing had attracted so much capital," she said. "It's possible some of that could move into stocks."

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