

Market Watch

Big Picture

U.S. debt ceiling debate at an impasse

In the U.S., talks to raise the nation's debt ceiling remained deadlocked in the final stretch before the August 2nd deadline. A vote by the House of Representatives on a short-term fix to avoid default was delayed Thursday after the Democrat-controlled Senate vowed to reject the plan, as it would set up another congressional fight over the debt limit within months. Demand for long-lasting U.S. manufactured goods – items ranging from toasters to aircraft – fell 2.1% in June, and economic activity slowed through mid-July, with the Federal Reserve reporting the recovery lost steam in eight of 12 regions. Providing some offset to this string of soft economic data, new jobless claims while still elevated, fell below 400,000 for the first time since early April.

Eurozone bond markets also remain fragile as the yields on Spanish and Italian government bonds continue to move higher. From an international perspective, India raised interest rates for the 11th time in 18 months, as it battles persistently high inflation currently at nearly 9%. Canadian home prices surged 1.3%, rising for a sixth straight month in May, but are expected to ease in the months ahead.

Markets

Debt ceiling debate overshadows strong corporate earnings

Global stocks slumped and the S&P 500 Index fell for a fourth consecutive day on Thursday as optimism over a debt ceiling compromise faded. Shell posted quarterly profits of US\$8-billion, up 77% from a year earlier, as a result of higher oil prices and new projects in Qatar and the Athabasca oilsands. Potash Corp. reported record quarterly earnings, up 81% year-over-year, and boosted full-year outlook as a result of strong fertilizer prices. Thompson Reuters saw a management shakeup after disappointing results for its Market Division, which includes the Reuters newswire service and computer programs for the financial industry. CN Railways chalked up a 4% profit increase, despite adverse weather conditions.

Ford trimmed its losses in the second quarter, beating Wall Street expectations, and announced a new US\$1-billion plant in India, the world's second-fastest growing auto market. Visa's quarterly profit rose 40%, but revenue is expected to drop when the company announces a new fee structure to comply with financial reform law passed last year. Amazon's sales leaped 51% in the past year, as e-commerce continues to boom despite global economic uncertainty. Boeing shares rallied as a 6% gain in revenue shattered expectations. Barrick Gold reported a US\$1.1-billion profit, but warned that soaring cost inflation continues to plague new projects. UPS profit rose 26% as growth in China and Europe offset flat volume in the U.S.

Our Recommendation

Opportunity for stocks once volatility subsides

- **Equities.** Steve Uzielli, Portfolio Manager, Portfolio Advisory Group (PAG) wrote: "Although we continue to favour equities over bonds, the current political debate in the U.S. with regard to raising the debt ceiling, and the ongoing euro debt crisis, makes us cautious in the immediate short term."
- **Fixed income.** Anthony Mentor, Associate, PAG, highlights the following recommendations: "Term Call – given the recent decline in yields, we no longer see value in the mid-to-long end of the curve and recommend investors stay short at this time. Sector Call – underweight Canada, overweight Municipals, Provincials and Corporates. Currency Call – we recommend Canadian investors remain in Canadian dollars for their fixed income holdings. Alternative Strategies – new call – marketweight high yield, marketweight Emerging Markets Debt, underweight inflation protected debt."
- **Portfolio strategy.** Scotia Capital Portfolio Strategist Vincent Delisle says: "We expect more debt noise to challenge equity markets leading up to the August 2 deadline on lifting the U.S. debt ceiling, but would view this as an opportunity to rebalance portfolios towards equities and gradually raise cyclical exposure."

For more information or a copy of our in-depth ScotiaMcLeod Weekly Strategy report, please call:

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