

# Market Watch

## Big Picture

### Flaherty: Canada “still on track” as GDP contracts

Canada’s GDP fell at an annualized pace of 0.4% in the April-June period, dragged down by lower exports of oil and autos to the U.S. But the Canadian economy is still on track, according to Federal Finance Minister Jim Flaherty, who blamed second quarter weakness on one-off, external factors. Fires in Alberta contributed to a 3.6% decrease in oil and gas extraction in the quarter, and supply chain disruptions in Japan created a 6% drop in auto and parts production. Raw material and producer prices were down in July for a third month, signaling weakness, but Canadian manufacturing output increased in August for a second straight month, with the index at its highest level in four months.

The U.S. manufacturing index also defied forecasts, showing expansion in August. But overall, manufacturing activity and new orders across Asia, Europe and North America fell to the slowest pace in almost two years. Global trade flows among G7 and emerging markets were weak, with imports rising just 1.1% in the second quarter versus 10.1% in the first quarter, and export growth slowing to 1.9%, from 7.7%. A surge in Chinese exports was the exception. Many top U.S. retailers reported better-than-expected August sales despite consumer confidence falling to its lowest level in more than two years.

## Markets

### Stocks rally on U.S. optimism

U.S. stocks surged 5% in a four-day rally on optimism the U.S. will avoid a recession, after Fed Chairman Ben Bernanke said the central bank has tools to boost growth and that the economy will probably improve in the second half of 2011. Stocks retreated on Thursday as investors awaited Friday’s report on jobs. Exxon announced an alliance with Russian state-controlled oil giant Rosneft to develop massive oil and gas deposits in the Russian arctic. The U.S. Department of Justice is seeking to block a merger between AT&T and T-Mobile, on concerns the deal could harm competition by pairing the No. 2 and No. 4 wireless operators in the U.S.

IBM will pay US\$387-million for Toronto-based Algorithmics, which manages risk and regulatory requirements for 25 of the world’s top 30 banks. As Blockbuster closed its last outlet in Canada, Google launched YouTube Movies, giving Canadians online access to 3,000 titles for between \$3.99 and \$4.99. Food inflation will continue as a threat in 2012 as estimates for the U.S. corn harvest were cut after punishing heat last month resulted in smaller ears of corn. Corn used as animal feed will also result in more expensive beef, lamb, pork and poultry. Diamonds have emerged as a safe haven investment alongside gold and the Swiss franc, with demand driving prices up nearly 50% since the start of 2010.

## Our Recommendation

### Investment bias still favours equities

- **Equities.** Steve Uzielli, Portfolio Manager, Portfolio Advisory Group (PAG) wrote: “Notwithstanding all the negativity in the market, current weakness offers investors a chance to buy shares of quality companies at a significant discount. Our investment bias still favours equities over other asset classes thesis.”
- **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: “forward P/Es look cheap, and we expect a modest rebound in valuations when pessimistic sentiment stabilizes.”

## The Month in Review

### August: U.S. debt deal too little, too late

The United States averted a default on August 2nd as Congress approved a last-minute deficit-cutting plan that lifts the debt ceiling enough to last beyond the November 2012 elections. The \$2.1-trillion of deficit savings over 10 years falls well short of the \$4-trillion that Standard & Poor's said would be needed as a "downpayment" to put America's finances in order. As a result, Standard & Poor's downgraded the United States' AAA credit rating on Friday, August 5th.

### Stock markets seesaw amid global uncertainty, debt tensions

Volatility was high in August as stock markets reacted to sovereign debt concerns in the U.S. as well as Europe, compounded by mounting evidence of a global economic slowdown. Six times during the month, the S&P 500 moved in excess of 4% in a single day. The S&P 500 ended the month down 5.3%, and down 4.2% year-to-date.

### Europe growth slows amid austerity measures

France cut its economic growth outlook and announced extra budget savings of 12-billion euros this year and next, including a temporary tax on the wealthy until the country hits its deficit target of 3% of GDP in 2013, down from 7.1% in 2010. The Bank of England cut its 2011 growth forecast for the U.K. to 1.5% from 1.8%, and signaled that interest rates would stay on hold amid growing economic headwinds.

### Canadian wage rises beat G8, lag emerging economies

Wages in Canada are forecast to rise 2.6% in 2011 and 2.8% in 2012. Commodity-rich provinces will lead the way, with wages in Newfoundland and Labrador up 3.5% this year and 3.4% in 2012, while Alberta wages gain 2.9% and 3.4%. Canadian wages will rise faster than other G8 countries, including Germany at 2.5% and the U.K. at 2.1%, but lag emerging economies such as India, Russia and China, at 11.7%, 9.8% and 8.4%, respectively.

### Gold touches new record; oil falls

Gold prices matched investors' roller-coaster emotions, touching an all-time high of \$1,911.46 an ounce on August 23, and then plunging \$200 before rebounding. Oil fell during August, to US\$88 from US\$95 a barrel, with OPEC cutting its forecast for global oil demand growth this year, predicting slower consumption in developed economies.

### Tech fortunes mixed

Google purchased Motorola Mobility Holdings Inc. for US\$12.5-billion, acquiring a smartphone manufacturing division for its Android software platform. IBM announced a breakthrough in cognitive computing, and released prototypes of a new computer chip designed to mimic the way the human brain works. Shares of Cisco jumped as modest profits signaled the company was making solid progress on its turnaround effort. Dell slashed its 2012 revenue forecast on fears that corporate and government spending are waning.

### Nestlé raises prices; Kraft to split

Nestlé raised its outlook on strong momentum, particularly in emerging markets, and price increases that are offsetting the soaring costs of coffee, cocoa and sugar, which hit 30-year highs earlier this year. Kraft Foods plans to split into two public companies, a fast-growing snacks business with global growth potential and a slower-growing grocery business in North America that will pay attractive dividends.

---

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

**Jolene Laing, CIM, FCSI**  
Associate Portfolio Manager  
(604) 535-4733 | [jolene\\_laing@scotiamcleod.com](mailto:jolene_laing@scotiamcleod.com)

