

Market Watch

Big Picture

Europe to expand rescue fund; U.S. growth beats estimate

Germany approved the expansion of a European bailout fund on Thursday, joining France, Finland, Italy and Spain in agreeing to give the fund more power to resolve the debt crisis in Greece and beyond. There was a new wave of strikes and protests as international auditors arrived in Greece to scrutinize new austerity measures needed to meet the terms of the July bailout. France presented its 2012 budget Wednesday, the first to cut spending since the Second World War. The U.S. economy grew at a 1.3% pace in the second quarter, faster than previously estimated, and much improved from the anemic 0.4% pace in the first quarter.

As new applications for jobless benefits fell to a five-month low in the U.S., Fed Chairman Ben Bernanke urged Congress to act on long-term unemployment, calling it a “national crisis,” with about 45% of the unemployed out of work for at least six months. Prime Minister Stephen Harper, Finance Minister Jim Flaherty and Bank of Canada Governor Mark Carney met in Ottawa to consider a less aggressive deficit-cutting program, given slowing economies in Canada, the U.S. and around the world. The government had pledged to balance the budget by 2014-15. Home prices in Canada rose for the eighth consecutive month to a new record high, up 1.3% in July from June.

Markets

U.S. data, euro hopes lift stocks

The S&P 500 climbed for a fourth time in five days Thursday after the outlook for the U.S. economy brightened a little and German lawmakers backed a beefed-up European rescue fund. Oil prices will stay above \$100 a barrel next year, despite fears of a global recession and steep fall in demand, according to a Reuters poll of 32 analysts. China unveiled its first gold vending machine, which allows shoppers to insert cash or use a bank card and withdraw gold bars or coins.

Shares in Research In Motion spiked Tuesday on speculation that U.S. billionaire Carl Icahn is buying a stake in the company. Icahn has a reputation for being an active investor, using his influence and votes to effect change in underperforming companies. Shares of RIM are down 60% this year. Samsung became the second cellphone manufacturer to agree to pay Microsoft royalties for the use of Google’s Android operating system, which Microsoft claims infringes on its intellectual property rights. Amazon launched the new Kindle Fire at just US\$199 – less than half the price of an iPad. The 7" WiFi tablet with Android operating system gives users access to a large, growing number of movies, magazines and music.

Our Recommendation

Short-term cautious but investment bias still favours equities

- **Equities.** Steve Uzielli, Portfolio Manager, Portfolio Advisory Group (PAG) wrote: “Equity valuations appear attractive and current events will ultimately lead to an excellent buying opportunity, but in the near term macro issues will continue to be the primary determinant of equity market direction.”
- **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: “Investor sentiment has collapsed in recent weeks, but our view is that perceptions are currently overshooting the actual damage to the economy and earnings.”



The Month in Review

September: Debt and recession fears weigh on markets

Stock markets were volatile in September as the eurozone crisis continued to deepen. Italy and France introduced austerity measures, but Italy's sovereign credit rating was downgraded nonetheless, as were the ratings of several banks in Italy and two in France. The bailout of Greece hung in the balance as investors awaited crucial votes, particularly in Germany and Finland where there was opposition to further rescue funds. Economic data showed Europe at the brink of recession, with the U.S. not far behind as manufacturing activity and trade flows weakened worldwide. The U.S. stock market lost 4.8% in September, with Canada's TSX down 7.8%.

Canada and U.S. economies slow

The International Monetary Fund cut its projections for Canada's economic performance to 2.1% this year and 1.9% in 2012 – a sharp downward revision from 2.9% and 2.6%, respectively, in April as a result of “ongoing fiscal withdrawal and downdrafts from the U.S. slowdown.” The OECD predicts the U.S. economy will grow just 1.4% in 2011, down sharply from a forecast of 2.6% only three months ago.

Global manufacturing and trade weaken

Global 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%.

Canada drops out of top 10 in competitiveness

Canada fell to 12th place, from 10th, in global competitiveness according to the World Economic Forum's survey of 139 countries, which noted the need for “greater R&D spending, and producing goods and services higher on the value chain.”

Oil demand slows; deepwater drilling makes comeback

As global demand for oil continues to slow, OPEC cut the growth forecast for 2011 by another 200,000 barrels per day. Meanwhile, deepwater drilling in the Gulf of Mexico has staged a comeback, with 23 rigs in operation. A 500-page report released on Wednesday by federal investigators suggests that BP and its chief contractors, Transocean and Halliburton, will face criminal charges for causing the gulf oil spill.

Swiss franc capped

The Swiss National Bank stunned traders by capping the franc's exchange rate at 1.20 to the euro, ending its allure as a safe haven currency, to protect the Swiss economy. Japan assuaged fears of a currency war, saying it would not follow suit.

Food prices and poverty rise

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. Data released by the U.S. Census Bureau showed one in six Americans, or a record 46.2 million people, living below the poverty line.

IBM buys, Facebook earns, Microsoft pays

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. Facebook's revenue doubled to US\$1.6-billion in the first half of the year, as advertisers flocked to the social network. Microsoft boosted its dividend by 25%, after a 23% increase a year ago, in a bid to lift the performance of its stock price, which has badly lagged other major tech companies.

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

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