

Market Watch

Big Picture

U.S. growth slows; Japan debt outlook downgraded

The Federal Reserve held its first-ever news conference, forecasting lower U.S. growth and higher inflation for 2011, and announcing the end of a controversial bond-buying program. Fed Chairman Ben Bernanke promised to keep inflation low and the central bank renewed its pledge to keep interest rates near zero to stimulate the economy. GDP growth in the U.S. slowed to 1.8% in the first three months of the year, from 3.1% in the final three months of 2010, as higher food and gasoline prices dampened consumer spending and harsh weather dampened output. But March saw orders for U.S.-made durable goods such as cars and industrial machines up 2.5%, and February's loss was revised to a gain, signaling the factory sector remains strong and businesses continue to invest in new equipment.

Britain's economy grew at a snail's pace in the first quarter, with GDP gaining just 0.5% after contracting by the same amount in the previous three months. Standard & Poor's downgraded Japan's debt outlook to "negative" from "stable," warning the huge cost of last month's earthquake – now estimated at 50 trillion yen (US\$613-billion) – will hurt already weak public finances. With public debt sitting at US\$10-trillion, the highest of any advanced country, Japan now faces a recession as industrial output plunged 15.3% in March from February, and consumer spending fell 8.5% versus a year ago.

Markets

Earnings drive stocks to nearly three-year high

On Thursday, the S&P 500 reached its highest level since June 2008, as better-than-expected corporate earnings tempered investors' concern over slowing economic growth. Quarterly earnings highlights included Barrick Gold, which shone with profits of US\$1-billion, for a 32% increase year-over-year. However, Barrick's stunning \$7.3-billion takeover bid for copper miner Equinox Minerals brought some criticism from investors and analysts. Potash Corp. profits skyrocketed 71% year-over-year as high grain prices motivated the world's farmers to increase their harvests using fertilizer.

Economic bellwether CN Railway reported profit rose 31% despite a severe winter that halted some operations of smaller rival CP, which reported a 67% decline. PepsiCo profit declined 20% from the same period a year ago due to higher commodity costs and ongoing strategic and brand-building investments in emerging markets. Starbucks lowered its outlook, warning that rising fuel and dairy costs will hurt earnings more than anticipated, which caused shares to slide despite a 7% rise in U.S. sales. UPS raised its full-year earnings forecast after first-quarter profit rose 66%. 3M Co. sales rose 15% to \$7.31-billion with emerging markets accounting for more than one-third of sales.

Our Recommendation

Earnings season positive for equities

- **Equities.** Steve Uzielli, Portfolio Manager, Portfolio Advisory Group, says: "We still believe equities are vulnerable to a pullback but are biased toward buying any market weakness."
- **Fixed income.** Anthony Mentor, Associate, Portfolio Advisory Group, 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 – overweight Canada, overweight Municipals, Provincials and Corporates. Currency Call – we recommend Canadian investors remain in Canadian dollars for their fixed income holdings. Alternative Strategies – overweight high yield, marketweight Emerging Markets Debt, overweight inflation protected debt."
- **Portfolio strategy.** Scotia Capital Portfolio Strategist Vincent Delisle anticipates eventual monetary tightening means we are passing the mid-way point of the cycle. It doesn't imply outright equity weakness, but it portends lower expected equity returns

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

