

# Market Watch

## Big Picture

### IMF warns U.S. on debt

The United States is putting the global recovery at risk for failing to take its debt seriously enough, according to the International Monetary Fund (IMF) in a newly released report on the world economy. The report maintains that “a continued absence of credible medium-term fiscal strategy threatens to eventually drive up U.S. interest rates, disrupt financial markets and adversely affect global prospects.” The U.S. faces a deficit of nearly 11% of its GDP in 2011, the widest in the G20. U.S. house prices tumbled 4% in the fourth quarter, versus a year earlier, amid record foreclosures. Inflation rose at its quickest pace in more than a year in January, but not enough to suggest a build-up of inflationary pressures.

Canada’s annual inflation rate slipped to a relatively tame 2.3%, from 2.4% in December, putting the Bank of Canada under no pressure to raise interest rates on March 1. Global trade has returned to pre-recession levels, driven by emerging-market exports and imports, according to the Bureau for Economic Policy Analysis. The volume of world goods traded surged 15.1% in 2010 after contracting by 13% in 2009. Goods traded in December exceeded the previous peak, which was set in spring 2008. Germany raised its growth outlook for 2011 to 2.5%, from 2.0%, taking the country’s GDP back to its pre-crisis level.

## Markets

### Libyan unrest rattles markets

U.S. stocks fell for a third day on Thursday on fears that rising oil prices caused by Middle East turmoil will derail the global economic recovery. Oil prices surged to 2-1/2-year highs near US\$120 a barrel with news that Libya’s oil output was severely cut, but Saudi Arabia pledged to fill any supply shortfalls. Worries remain that unrest could spread to other oil-producing countries in the region. Gold fluctuated near a seven-week high as investors flocked to the metal as a safe haven. General Motors made a US\$4.7-billion profit in 2010, marking its first full-year profit since 2004. GM was bailed out of bankruptcy in 2009 by the U.S. government, which still holds a 33% stake.

Hewlett-Packard fell short of revenue expectations and trimmed its 2011 projections on weak consumer PC demand, sending its shares plummeting 12%. Target profit jumped 10.5% over the holiday quarter versus a year ago as same-store sales rose 2.4%, beating rival Wal-Mart, which reported a 1.8% decline. Sears Canada fourth quarter profit dropped 28% as debt-laden consumers avoided buying big-ticket items. Tim Hortons hiked its dividend by 31% as it announced strong quarterly results and warned of price increases due to soaring commodity costs. Canadian corporations ended the year with a bang – profits advanced 7.9% in the fourth quarter over the previous quarter, with gains mainly driven by financial, energy and mining companies.

## Our Recommendation

### Rally could take a breather; buy on sustained weakness

- **Equities.** Steve Uzielli, Portfolio Manager, Portfolio Advisory Group, says: “the positive influence of strong corporate earnings, healthy balance sheets, and reasonable valuations continue to be supportive of equities for 2011; investors should be prepared to buy on market weakness.”
- **Fixed income.** Anthony Mentor, Associate, Portfolio Advisory Group, highlights the following recommendations: “Term Call – we recommend investors move further out the yield curve to a market neutral duration position. 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 – overweight high yield, marketweight Emerging Markets Debt, underweight inflation protected debt.”
- **Portfolio strategy.** Vincent Delisle, Scotia Capital’s Portfolio Strategist, writes: “Since the start of the year, equity markets have successfully managed to shrug off regime changes in Egypt and Tunisia, but with riots now spreading to more oil-sensitive areas of Libya, Bahrain, Yemen, and Iran, the rally that “keeps on going” could take a breather, in our view.”

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

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