

# Market Watch

## Big Picture

### Europe struggles to rekindle growth amid austerity

European Union leaders met in Belgium on Monday to discuss ways to rekindle growth and create jobs, as aggressive austerity measures have propelled many eurozone countries back into recession. The jobless rate in the eurozone hit 10.4% in December, a record high since the euro was introduced in 1998. Leaders of 25 out of 27 EU states adopted a treaty pledging to cut back on high deficits or face sanctions from the European Union. Greece's banks and other private creditors want the European Central Bank (ECB) to join the bond swap being negotiated; however, the ECB insists on seeing the private-sector agreement before deciding on its strategy. The ECB holds an estimated €36-billion to €55-billion of Greek sovereign debt.

The U.K.'s Chancellor of the Exchequer lodged a complaint with U.S. Fed Chairman Ben Bernanke over the Volcker rule, part of the planned financial overhaul of U.S. banking laws. The chancellor claimed the rule would make it more difficult and costlier for banks to buy and sell foreign sovereign bonds, which could impair the ability of his country and others to sell their debt. The Bank of Canada's Mark Carney also said the rule could hurt bond markets because of restrictions it places on the trading of foreign government securities, including Canadian government bonds. U.S. housing prices reached a new post-bubble low, with prices 33% below the 2006 peak.

## Markets

### U.S. data calms EU jitters

Stocks fell leading up to the EU summit as financial markets fretted over the lack of progress in the Greek debt talks and about Europe's gloomy economic outlook. However, losses were recouped later in the week as a drop in U.S. jobless claims fueled optimism. Honda slashed its profit outlook to the lowest level in three years after a period of "unparalleled difficulty" including natural disasters in Japan and Thailand and a strong yen. Britain's manufacturing sector unexpectedly returned to growth in January as orders rose for the first time in six months, with increased demand from Brazil, China, the Middle East and the United States.

The price of natural gas tumbled 17%, the biggest January loss in three years, as mild weather and increased production resulted in a supply glut of the heating fuel. Facebook announced its highly anticipated initial public offering of stock, as it seeks to raise US\$5-billion in the largest Internet IPO ever. Facebook may command a valuation more than five times higher than Google. Data showing weak demand for business loans in the U.S. suggests a potential risk of deflation – a cycle of falling prices, slower growth and declining incomes.

## Our Recommendation

### Data supportive for equities but market vulnerable to short term pullback

- **Equities.** Steve Uzielli, Portfolio Manager, Portfolio Advisory Group (PAG), wrote: "While economic data in the U.S. continues to show modest improvements and earnings data has been fairly supportive, the market appears overbought."
- **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: "S&P 500 technicals are supportive and low bond yields still favour an equity overweight bias."

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

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