

Market Watch

Big Picture

U.S. economy strengthens; Europe gains support

The U.S. economy is growing at a moderate pace, according to the Fed's latest snapshot of regional economic conditions, called the beige book, released Wednesday. The report cited strength in manufacturing and retail sectors and weakness in real estate and financial services. U.S. producer costs rose more than expected in December, up 1.1% versus an expected 0.8%, driven by energy and food costs. Heating oil jumped 12.3%, and vegetables and fruits surged 22.8% and 15.4%, respectively. The USDA lowered global harvest estimates for key crops because of dry weather in South America and floods in Australia, intensifying fears of a global food crisis.

Tensions in European credit markets eased after successful bond auctions in Portugal, Spain and Italy and pledges of support from China and Japan. China will purchase Spanish debt and Japan vowed to buy more than 20% of new eurozone bonds issued to support Ireland's €85-billion bailout. The German economy grew 3.6% in 2010 – double the European average – a dramatic turnaround after a 4.7% contraction in 2009. U.S. banks seized more than a million homes last year, topping a record 918,000 in 2009. In Canada, new home construction finished the year 29% ahead of 2009, but showed signs of slowing, with December starts down 15% from a month earlier and building permits plunging 11% in November.

Markets

Jobs undermine U.S. optimism

Despite optimism over corporate earnings and a narrowing trade deficit, higher jobless claims caused U.S. stocks to pare advances after the S&P 500 reached its highest point since August 2008. The TSX finished higher for the first time this year on Tuesday, buoyed by resources, as oil prices fluctuated near a 27-month high. China imported a record amount of copper in 2010 – 4.29 million tonnes, slightly more than in 2009, and up from just 2.64 million tonnes in 2008. Canada's HudBay Minerals will acquire Norsemont Mining for \$520-million to get access to a major copper deposit in Peru. Alcoa reported a fourth-quarter profit, after a year-ago loss, as aluminum prices rose 11% in 2010.

Uranium prices surged amid concerns over a potential supply shortfall – 10 transactions involving more than 2 million pounds of uranium-oxide concentrate were conducted in the past week. Canadian Pacific Railway revealed plans for \$1-billion in capital spending in 2011, with the top priority being the renewal of track infrastructure. The iPad cut into PC sales in the fourth quarter, as worldwide shipments of personal computers increased a modest 2.7% from a year earlier, instead of the 5.5% gain predicted, and U.S. sales declined 6.6%. MySpace cut 50% of its staff as the once top Internet social networking site reinvents itself as a music and entertainment website for the under-35 crowd.

Our Recommendation

Focus on dividend paying stocks

- **Equities.** Steve Uzielli, Portfolio Manager, Portfolio Advisory Group, says: "From current levels we would expect modest capital appreciation over the coming year, which makes a focus on dividend paying stocks increasingly important."
- **Fixed income.** Anthony Mentor, Associate, Portfolio Advisory Group, highlights the following recommendations: "Term Call – Given the recent rise in yields, 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 – Recent weakness in the Canadian dollar means little upside to foreign currency trades. Alternative Strategies – overweight high yield, marketweight Emerging Markets Debt, underweight inflation protected bonds."
- **Portfolio strategy.** Vincent Delisle, Scotia Capital's Portfolio Strategist, writes: "Entering 2011, we prefer equities over bonds, but would caution that, in our view, the risk-reward outlook is not as compelling as it was six months ago."

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

