

Market Watch

Big Picture

Euro tensions; U.S. manufacturing accelerates

Prime Minister Papademos warned Greece may default on its debts in March unless unions accept further salary cuts. Inspectors arrive on January 15 to assess Greece's progress in cutting its deficit and to approve the next portion of bailout funds. France drew solid demand at its first debt auction of 2012 with yields rising only slightly despite fears for its AAA rating. Debt sales next week by Italy and Spain are seen as the year's first big tests of eurozone countries' ability to borrow at affordable levels. U.S. manufacturing grew at its fastest pace in six months in December, as the index of factory activity rose to 53.9, from 52.7 in November. Readings over 50 indicate expansion.

Many U.S. retailers reported solid sales gains for December, capping a tough holiday season that saw heavy discounting. More expensive stores such as Macy's and Saks as well as specialty retailers such as Victoria's Secret did well, while Target and J.C. Penney lowered their outlooks. A survey by the Canadian Federation of Independent Business found small business confidence rose in December to 65.0 – almost a point and a half higher than in November – with business owners in Alberta and Saskatchewan the most optimistic. A national survey found more than two-thirds of Canadians plan to contribute the same amount or more to their RRSP as last year, despite the tough economy.

Markets

U.S. starts year on upswing

U.S. stocks rose for a third day on Thursday, to a two-month high, as positive reports on manufacturing, construction and employment bolstered optimism. In China, the Shanghai Composite dropped to its lowest level since March 2009 on concerns that a European recession will curb exports. Ford was Canada's top-selling automaker in 2011 for the second consecutive year, boosted by sales of the F-Series pickup truck, which make up three-quarters of its total sales. Chrysler Canada sales jumped 13% in 2011 to their highest level since 2002. Electric car sales sputtered in 2011, as high prices and supply bottlenecks led to lower-than-expected sales for both Nissan's Leaf and General Motors' Chevrolet Volt.

A European slowdown will impact global IT spending, according to two big research firms – Gartner lowered its 2012 growth forecast to 3.7% from 4.6%, while Forrester dropped its view to 5.4% from 9.6%. A record 1.2 billion apps were downloaded during Christmas week as an estimated 20 million Android and Apple devices were activated by people who received iPads and smartphones as gifts. Food price inflation will ease in 2012, according to the Food and Agriculture Organization; however, economic instability and currency market fluctuations will likely lead to continued volatility.

Our Recommendation

Outlook remains cautiously optimistic

- **Equities.** Geoff Ho, Director, Portfolio Advisory Group (PAG), wrote: “With a rather volatile and challenging 2011 behind us, we look ahead to 2012 with slightly more optimistic lenses as valuations look compelling, corporate balance sheets are strong, and dividend yields are attractive in this low interest rate environment.”
- **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: “Our 2012 objective will be to raise cyclical exposure when easing monetary policy is extended, China's PMI index bottoms, and the S&P500 settles above its 200-day average.”



The Month in Review

December: U.S. stocks ride out volatile year

The European debt crisis took a front seat once again in December, causing more stock market volatility. While 2011 saw political turmoil, revolutions and natural disasters, the resilient U.S. stock market ended the year virtually where it began, and global markets as measured by the MSCI World Index slipped by less than 5%. The Canadian TSX ended the year down 11%.

EU leaders draft Brussels treaty

In early December, leaders of 23 European Union nations agreed to a new treaty that would enforce caps on government borrowing and spending, seen as crucial to solving the debt crisis, but the U.K., Sweden, Hungary and the Czech Republic rejected the accord.

Britain heads to recession

Falling output and rising job losses heightened fears that Britain is facing another recession. The U.K.'s industrial output fell 0.7% in October, its fastest decline in six months. Unemployment in Britain reached a 17-year high – 2.64 million people are jobless, with women and young people hardest hit.

Brazil slowdown

Brazil's economy ground to a halt in the third quarter, as domestic consumption, as well as China's demand for Brazilian exports like iron ore and soybeans, slowed. Economists expect Latin America's largest economy to grow 3% this year versus 7.5% in 2010.

Ratings woes

Ratings agency Fitch warned the U.S. of a downgrade to the country's AAA rating unless it comes up with a "credible plan" by 2013 to tackle its ballooning budget deficit. Ratings agency Standard & Poor's put 15 eurozone countries on credit review, and warned that the AAA credit ratings of France and Germany were at risk.

Canadian industries gear up

Canadian industries were operating at 81.3% of capacity in the third quarter, up from 79.9% in the second quarter and a low of 69.4% in mid-2009. Natural resource-rich provinces will lead Canada's economic growth next year, with Saskatchewan and Alberta projected to expand 2.9% and 2.8%, respectively.

Record Canadian household debt

Canadian household debt hit a new high, at 153% of annual disposable income, surpassing both the U.S. and Britain. For one in 10 Canadians, the cost of servicing their debt consumes more than 40% of their income.

H-P downgraded

Standard & Poor's cut Hewlett-Packard's credit rating on Wednesday, on concerns over management turnover and increased debt, particularly from HP's US\$11.7-billion acquisition of British software company Autonomy last month.

GE, Agrium, lululemon profit

General Electric forecast double-digit profit growth in 2012 on a sales increase of about 5%. Agrium quadrupled its annual dividend and announced it would expand its Vanscoy potash mine at a cost of \$1.5-billion. Despite profits being up 51% versus a year ago, lululemon shares slumped as revenue missed analysts' targets.

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

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