

Market Watch

Big Picture

U.S. economy enters 2011 on a high note

The new year began with fresh evidence that the U.S. economy is on the mend. U.S. private employers added 297,000 jobs in December, almost triple expectations. And, new jobless claims declined to the lowest monthly average since July 2008. Construction spending rose 0.4% in November, double economists' forecasts, and the Institute for Supply Management's gauge of U.S. manufacturing climbed to a seven-month high as factory output grew for a 17th straight month. China says it will let the yuan rise 5% against the dollar in 2011, but warned the move is to combat inflation by reducing the cost of commodity imports, and would do little to narrow China's trade surplus with the United States, which topped US\$190-billion for the year.

The year 2010 was a blockbuster year for global mergers and acquisitions, with deals totalling more than US\$2-trillion, up 20% over the previous year. Emerging markets posted their most active year ever, accounting for over one-quarter of market share. In Canada, IPOs made a stunning comeback, with new stock issues worth \$5.5-billion last year, versus \$2-billion in 2009 and just \$0.7-billion in 2008. A gauge of confidence among Canada's small business owners hit a nine-month high in December, as confidence improved in 10 of 13 sectors, compared to a month earlier, with the biggest improvements in manufacturing, natural resources, real estate, insurance and construction.

Markets

Greenback strength weighs on commodities

Canadian stocks fell for a third day on Thursday as a strengthening U.S. dollar hurt commodity prices, and gold stocks continued to lose their safe haven appeal amid evidence of a U.S. recovery. Facebook received a US\$500-million cash injection from Goldman Sachs and a Russian investment firm, in a deal that values the company at a whopping US\$50-billion. Goldman intends to raise and invest an additional US\$1.5-billion through privately traded shares, allowing Facebook to delay going public. The business networking site LinkedIn is planning to file for an initial public offering within months.

Microsoft announced it will create a Windows operating system for smartphones and tablet computers with Britain's ARM Holdings, which made the chip for the iPad. Lenovo unveiled a hybrid laptop/tablet – the IdeaPad laptop runs on Microsoft's Windows 7 and its removable screen/tablet runs on Google's Android. RIM announced a deal with Sprint to create a PlayBook tablet that can access both WiFi and cellular networks, closing the gap on the iPad. Record global auto sales are expected in 2011 with China, India and Russia leading the way and the U.S. poised for its second year of double-digit percentage growth. Soaring global food prices have sparked fears of social unrest as the UN reported 55 foods in December reached record levels, including rice, meat, wheat, milk and cheese.

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."



The Month in Review

December: U.S. growth surprises

While Canada's recovery stumbled in the third quarter, slowing to 1% growth on an annualized basis, the U.S. posted surprising growth as productivity was revised upwards to 2.3%, from 1.9% reported previously. This marked a vast improvement from a contraction of 1.8% in the second quarter. U.S. retail sales rose for a fifth straight month in November, marking the best month for department stores in two years. Private sector jobs jumped the most in three years, with 93,000 jobs added in November. An index of national factory activity measured 56.6, well above the 50 level, which indicates expansion.

U.S. housing market remains weak spot

U.S. home values continued to fall amid rising foreclosures and the expiration of homebuyer tax credits. An estimated decline of US\$1.7-trillion in 2010 will eclipse the 2009 loss of US\$1.1-trillion, leaving more than 23% of homeowners with negative equity – that is, holding a mortgage for more than the value of their home. Experts predict no full recovery in the housing market before 2014.

Markets end 2010 on two-year high

Overall, global stocks ended 2010 at their highest levels in 28 months. The S&P 500 rose 13% in 2010, up 6.5% last month alone, marking the best December since 1991. The TSX surged 14% in 2010 helped by strong commodities performance, with gold rising 30% and oil up 15% over the year. Global investment firm UBS Securities projected the TSX will rise more than 10%, to 14,500, in 2011 on stronger earnings fundamentals and some “valuation catch-up.”

The loonie rose 4% over the year, ending 2010 half-a-cent higher than the U.S. dollar, which gained 1.3% against a basket of currencies. The euro finished the year with losses of about 7% versus the greenback.

Canadians deeper in debt

Household debt in Canada surpassed the U.S. for the first time in 12 years, prompting Bank of Canada governor Mark Carney to warn of a “brutal reckoning” unless Canadians prepare for a return to higher interest rates. The Canadian debt-to-income ratio is at a record 148:1.

Google forges ahead into smartphones, notebooks and e-books

Google launched its new smartphone in the U.S., featuring front- and back-facing cameras and 16 GB of memory. In mid-2011 Google will begin selling the first notebooks to run its Chrome operating system. The long-awaited Google Editions could turn the e-book business on its head, allowing readers to buy e-books from online retailers, store them in an account, and read them on any device with a Web browser.

American auto industry powers up

U.S. auto sales surged in November, with GM sales up 11.4% versus a year ago and Ford sales rising 24.3%. Ford unveiled the US\$550-million revamp of its assembly plant in Wayne, Michigan. The birthplace of many gas-guzzling SUVs will now produce a redesigned Focus as well as electric and hybrid vehicles.

Canada plans solar expansion

The Canadian solar industry is set to grow 35% over the next 15 years, creating 35,000 jobs and displacing millions of tons of greenhouse gases. Solar energy currently meets just 0.1% of Canada's hydro needs, but generating capacity is planned to expand to 12,000 MW from 200 MW by 2025.

Corporate IT market rebounds

Worldwide sales of computer servers rose 13%, highlighting solid corporate demand for information technology and marking the fastest quarterly revenue growth since 2000.

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

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