

Market Watch

Big Picture

U.S. manufacturing heats up; China cools

U.S. manufacturers expanded at the fastest rate in seven years during February, and other economic data signaled an improving economy. Productivity climbed more than estimated and labour costs dropped more than forecast. New U.S. jobless claims fell to a 2½-year low last week and retail sales rose 4.3%, versus an expected 3.8%. In Canada, GDP grew at an annualized rate of 3.3% in the fourth quarter of 2010, up from 1.8% in the prior quarter, mainly due to rising commodity prices and a surge in exports. Consumer spending also played a role, rising 1.2%, the fastest rise in three years. Higher exports combined with lower imports cut one-third from the current account deficit, the measure of how much Canada relies on foreign investment.

Growth in China's manufacturing industry slowed to a six-month low due to interest rate hikes and other measures to cool inflation. The risk of global inflation is on the rise as demand grows for commodities ranging from oil and metals to corn and wheat. At the USDA Outlook Forum, the agribusiness sector predicted food inflation would surge in the second half of this year as wholesale prices filtered through to consumers. Similarly, record prices for iron ore, used to make steel, will soon filter into the cost of everyday goods such as cars and washing machines. The U.S. revised China's holdings of U.S. Treasury debt sharply higher to US\$1.160-trillion after determining that China had been buying debt through broker-dealers in Britain.

Markets

Improving U.S. data spurs rally

Markets surged on Thursday amid improving employment, manufacturing and retail data. The Dow Jones Industrial Average rose the most in three months and the S&P 500 advanced for the fourth time in five days. Bombardier landed its largest ever private jet deal – the sale of as many as 120 aircraft to Warren Buffett's NetJets for over US\$6-billion. Apple launched the iPad 2 as competition heats up in the tablet market with the RIM PlayBook soon to be released. Apple has sold 15 million iPads since last April. U.S.-based Groupon, which raised US\$950-million from private investors in January, launched a discount coupon site in China, offering subscribers discounts on eating, shopping and entertainment in Beijing and Shanghai.

The strength of the commodity sector will continue, according to U.S. and Australian officials who predict Chinese and Indian demand will fuel a global commodities price rally for another two years before supply catches up to demand. Iron ore is expected to hit record prices next quarter and talk of a silver shortage has pushed prices to 31-year highs. Investors looking for a safe haven pushed gold prices to a fresh record close on Wednesday of US\$1,437.70. As the Ivory Coast, the world's top cocoa producer, inches closer to civil war, the price of cocoa beans has soared to a 32-year high.

Our Recommendation

Rally could take a breather; buy on sustained weakness

- **Equities.** Steve Uzielli, Portfolio Manager, Portfolio Advisory Group, says: "The market has proven to be remarkably resilient and remains overbought; we still believe a modest pullback is likely and would ultimately be healthy for the longer term sustainability of positively trending equity markets."
- **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: "We believe it is too soon to chase defensives and prefer raising cash instead. Focus is now in Financials, Tech, and Industrials."



The Month in Review

February: Middle East unrest adds tension to global markets

Global economies continued to recover in February, but events in the Middle East added considerable tension to markets. Anti-government uprisings toppled regimes in Egypt and Tunisia, and protests broke out in Libya, Yemen, Bahrain and even Iran. As Libya shut down its oil production and unrest threatened to spread to other oil-producing nations, investors worried that rising oil prices could derail the global recovery.

U.S. growth forecast lifted by 1%

Deutsche Bank raised its U.S. growth forecast for 2011 by a full percentage point to 4.3% as the U.S. unemployment rate unexpectedly fell to 9% in January, the lowest level in 21 months. The drop from November's 9.8% marked the biggest two-month decline since 1958.

IMF warns U.S. to cut deficit and debt

The U.S. is putting the global recovery at risk for failing to take its debt seriously, according to the International Monetary Fund. In its report, the IMF says 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. deficit is nearly 11% of GDP, the widest in the G20.

Global trade returns to pre-recession levels

Global trade has recovered from the recession, 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 in spring 2008.

Stock exchanges to merge

The New York and German stock exchanges announced plans to merge, which would create an exchange powerhouse trading US\$20-trillion annually with operations in the U.S. and throughout Europe. A \$7-billion proposed merger between Canada's premier stock exchange and the London Stock Exchange is generating controversy as it undergoes scrutiny by Ottawa as well as Ontario and Quebec regulators.

Oil and gold surge on Middle East turmoil

Brent crude oil prices surged to 2½-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. Gold fluctuated near a seven-week high as investors flocked to the metal as a safe haven.

Copper climbs; demand to double

Copper hit a record US\$10,000 a tonne as potential supply shortages loom and demand continues to climb. China consumes 40% of the world's copper, which is used extensively for construction. Rio Tinto CEO Tom Albanese forecast demand for iron ore, copper and aluminum to double over the next 15 to 20 years.

Tech giants stumble

Shares of technology bellwether Cisco tumbled 15% after quarterly profit fell to US\$1.5-billion from US\$1.9-billion a year earlier. Hewlett-Packard fell short of revenue expectations and trimmed its 2011 projections on weak consumer PC demand, sending its shares plummeting 12%.

Food prices soar; poverty rises

Corn prices surged to their highest since July 2008 after the USDA slashed its domestic and international forecast. Agrium's quarterly profit rose as high grain prices fueled demand for fertilizer. The World Bank reported that higher food prices have pushed 44 million more people into extreme poverty since June 2010.

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

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