

Market Watch

Big Picture

July 8, 2011

Debt woes in Portugal and China

Moody's slashed Portugal's credit rating by four levels to Ba2, well into junk territory, just two months after a €78-billion (US\$112-billion) bailout, warning that the country will likely need a second round of financing. China pledged to clean up massive levels of local government debt totaling over US\$2-trillion – US\$500-billion more than initially reported – racked up as a result of stimulus spending in recent years. Moody's warned that bad debt could reach between 8% and 10%, putting state-run banks as well as the economy at risk. The European Central Bank (ECB) raised interest rates by 0.25% for the second time this year to tackle inflation, even as economic recovery remains uneven and belt tightening dampens growth.

U.S. factory orders rose 0.8% in May, after falling 0.9% in the previous month, suggesting supply disruptions stemming from the Japanese earthquake in March are fading. Slack global demand for industrial metals dampened Canadian factory prices in May as the industrial product price index fell 0.2%, the first drop in 10 months, but producers benefited from falling oil prices, with the raw material price index dropping 5.1%, after seven straight monthly gains. U.S. private sector employment jumped 157,000 in June, as companies hired four times more workers than in May, strengthening views the economy was pulling out of the doldrums seen in the first half of the year.

Markets

Stocks rally on jobs, retail sales

The S&P 500 index closed higher for the seventh time in eight days Thursday as encouraging news about jobs and retail sales added to optimism for a potential resolution to Greece's fiscal issues. Fertilizer giant Agrium announced it will purchase Canadian turf manufacturer Evergro for \$50-million. Disney will sell online video site Hulu, and is in talks with potential buyers thought to include Google, Microsoft and Yahoo as well as U.S. TV distributors and international media and technology companies.

Facebook announced Skype person-to-person video calling just after Google launched its own video calling feature called Hangouts, which also offers group video calling for up to 10 people. Google's Chrome Web browser has grabbed more than 20% of global market share since its launch in December 2008, while the popularity of Microsoft's Internet Explorer has fallen to 44% from 59% two years ago. BMW achieved the best six months of sales in the company's history, driven by a 60% jump in sales to China versus a year ago. Toyota announced a \$500-million upgrade to Ontario plants over the next two years, which could add 500 jobs to the current workforce of 6,500 in Cambridge and Woodstock.



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Our Recommendation

Equity risk-reward outlook improving

- **Equities.** Steve Uzielli, Portfolio Manager, Portfolio Advisory Group (PAG), wrote: “our conclusion remains that the current equity market correction, a symptom of a mid-cycle slowdown in the global economy, represents a buying opportunity.”
- **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: “U.S. earnings growth should be sustained well into 2012, albeit at a slower pace... earnings are growing, but we think the odds of a major positive surprise [for Q2] are low.”

The Month in Review

June: Greece passes vote to avoid default

In June, financial markets were unnerved by a deteriorating political situation in Greece as the government battled massive public protests in order to pass a crucial austerity package that would clear the way for international funding and avoid a default. The EU and IMF continue to negotiate a second rescue package, with Europe’s private sector – banks and insurance companies – sharing the burden, estimated at €15-billion (US\$164-billion) and aimed at funding Athens until late 2014.

U.S. and U.K. AAA credit ratings at risk

Rating agency Fitch warned it would downgrade the United States’ prized AAA credit rating if the government fails to make debt payments due August 15. The warning comes as some Republicans suggest that withholding the congressional approval President Obama needs to raise the borrowing limit and allowing the U.S. to default, even briefly, would force the White House to deal with runaway spending. Moody’s warned the United Kingdom is at risk of losing AAA status, if weaker growth causes a slippage in the government’s plan to eliminate its budget deficit over four years.

Japan production recovering

Japanese industry is recovering faster than anticipated, according to export data, with manufacturers restoring lost production and mending supply chains after the March earthquake. The disaster in Japan impacted Canada’s international trade deficit in April, which more than doubled as both exports and imports fell, with automotive products playing a large role.



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Emerging markets attract more investors

The Institute of International Finance raised its forecast for net private capital inflows to emerging market economies to more than \$1-trillion for 2011, as investors flock to higher growth economies.

Canada: higher inflation and commodity exports

Canadian inflation reached 3.7% in May, driven by fuel prices, which were nearly 30% higher in May than a year earlier. Canadian exports have shifted dramatically towards commodities, as opposed to finished goods, over the past decade – commodities grew to more than 61% of exports, by value, from 42%, while finished goods declined to 39%, from 58%.

OPEC to earn record US\$1-trillion

OPEC is set to make record revenues of US\$1-trillion this year, up 32.5% from last year and nearly double revenues five years ago. North America is seen as the world's fastest growing oil-producing region outside OPEC, with output estimated to climb 11%, to 15.6 million barrels a day, by 2016, mainly from the Alberta oilsands.

Aircraft orders take flight

Optimism reigned at the Paris Air Show where Airbus and Boeing scored US\$72-billion and US\$21-billion of new orders, respectively, with Asian airlines being the biggest buyers. Boeing increased its forecast for aircraft demand over the next 20 years to \$4-trillion, representing 33,500 new jets.

Web traffic to quadruple by 2015

Cisco expects global Internet traffic to quadruple in five years and predicts Asia's volume will surpass North America by 2015. The global mobile advertising market is predicted to reach US\$28-billion in 2015, from US\$5-billion this year.

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

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