June 24, 2011

Market Watch

Big Picture

Fed downgrades U.S. growth forecast

The Federal Reserve cut its U.S. growth forecast for the second time this year, bringing the midpoint of its 2011 projection to 2.8%, down from 3.2% in April and 3.65% in January. While the Fed said the slowdown was temporary, due to supply-chain disruptions in the auto sector and higher food and energy prices, it acknowledged that high unemployment could persist into 2013 and kept interest rates at historic lows while ending its easing program as planned. Canada's economy will also slow with inflation remaining above 3%, according to the Bank of Canada, which predicted growth would speed up later this year.

Greece's embattled government survived a confidence vote on Wednesday, increasing the chances that parliament will approve an austerity package that is crucial to avoiding a sovereign default and bankruptcy. European finance ministers and the IMF have said they would hold back a €12-billion payment due in July unless the package is approved. China's factory sector barely expanded in June, from May, due to monetary tightening and slack global demand, but industrial production is still up 13% compared to the same time last year. Canadian household net worth jumped by 1% to $6.3-trillion in the first quarter, a new record high, following a 2.2% ($146-billion) gain in net worth in the fourth quarter of 2010.

Markets

Global stocks slide; oil plunges

Global stocks slid on Thursday as U.S. jobless claims rose and Greece's debt crisis continued to rattle investors. The TSX tumbled as oil prices plunged on word that the International Energy Agency will release 60 million barrels of oil from strategic government stockpiles. FedEx said it is increasingly bullish about the global economy after posting a 33% jump in quarterly profit. Optimism also 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.

The World Bank encouraged developing countries to use derivatives to hedge against sudden changes in food prices, while G20 farm ministers made a deal to tackle high food prices through increased agricultural output and other initiatives. The U.S. will end massive ethanol subsidies, even as the industry struggles with high corn prices. Prices of some rare earth metals used in high-tech applications have doubled in just three weeks amid heavy stockpiling in China. A new system for domain names was approved, so virtually any word can follow the dot in a website address, but the catch is the price – US$185,000.

Our Recommendation

Equity Risk-Reward Outlook Improving

- **Equities.** Paul Danesi, Director, Portfolio Advisory Group (PAG) wrote the recent summer swoon in equities is "not the beginning of a new bear market," but appears to be a typical mid-cycle slowdown. Tactical indicators "indicate the market may be close to bottoming and investors should be considering increasing their equity exposure".
- **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 – overweight high yield, marketweight Emerging Markets Debt, underweight inflation protected debt."
- **Portfolio strategy.** Scotia Capital Portfolio Strategist Vincent Delisle says: "U.S. 10-Yr bond yields have been hovering near the 3% level for three weeks, but the VIX has started to move up recently in a sign that markets are more fearful, a positive contrarian signal."

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

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