

Market Watch

Big Picture

Global recovery slows; factories lose steam

Slowing factory growth around the world and weakness in job creation in the United States cast doubt on global economic momentum this week. The ISM index of U.S. factory activity fell to a two-year low and similar indexes in China and Europe sank to multi-month lows, due to a variety of factors, from supply chain disruptions in Japan to austerity measures in Europe and tightening in China, as well as high oil prices. U.S. private employers added just 38,000 jobs last month, well short of expectations for 175,000. Canada's GDP is expected to cool to 2% in the second quarter, after growing at an annualized rate of 3.9% in the first quarter, driven by manufacturing, mining and oil and gas extraction.

Spain continued to inspire investor confidence, selling US\$5.67-billion in government bonds despite a eurozone debt crisis that continues to unfold. Australia's GDP shrank 1.2% in the first quarter, its biggest decline in 20 years, after the economy was hit by floods and cyclones, which disrupted iron ore shipments and coal mines. The IIF raised its forecast for net private capital inflows to emerging market economies to over \$1-trillion for 2011, as investors flock to higher growth economies. Cisco expects global Internet traffic to quadruple in five years and predicts Asia's volume will surpass North America by 2015. China has more than 1 million millionaires, ranking behind the U.S. with 5.2 million, and Japan with 1.5 million.

Markets

Dismal data triggers sell-off

On Wednesday, weak job creation data and evidence of slowing factory activity around the world sparked the stock market's worst day this year, with the S&P 500 dropping 2.3% and the TSX down 2.0%. The U.S. housing market added more concerns over the recovery with reports that prices continued to fall for the ninth straight month in March, to 2003 levels. Shares of Cameco, the second-largest uranium miner in the world, which lost a quarter of their value since the Japanese disaster, tumbled again this week after Germany said it would phase out all nuclear power by 2022.

BlackBerry continues to dominate the Canadian smartphone market, with a 42% share in March, followed by Apple with 31% and Android with 12%. 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%. Ottawa announced plans to end the Canadian Wheat Board's marketing monopoly on spring wheat, durum and barley crops in August 2012, ending the world's last major agricultural monopoly. Farmers will no longer need to sell crops via the board, and will have the freedom to find the best possible prices.

Our Recommendation

Buy market weakness selectively

- **Equities.** Steve Uzielli, Portfolio Manager, Portfolio Advisory Group, says: "To the extent equity markets do retrench further, our inclination is to buy the weakness selectively as the underlying bull market trend remains positive; however, in the very short term there are likely no catalysts for markets to move higher until Q2 earnings season commences in early-mid July."
- **Fixed income.** Anthony Mentor, Associate, Portfolio Advisory Group, 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 – overweight 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: "In the near term, weaker economic visibility and QE uncertainty are likely to sustain the "risk-off" trade."



The Month in Review

May: OECD raises growth forecast

In its May report, the Organization for Economic Co-operation and Development (OECD) raised its 2011 outlook for the United States to 2.6% from 2.2% predicted in November, and revised the eurozone forecast to 2.0% from 1.7%. Japan's outlook was slashed to 0.9% from 1.7%, reflecting the economic fallout from March's devastating earthquake. Overall global growth was forecasted at 4.2% for 2011 and 4.6% in 2012.

Canada taps foreign markets for growth

Canadian exports are predicted to grow 12% this year and reach pre-recession levels next year as U.S. growth picks up, according to Export Development Canada. The gains are expected to be fuelled by higher commodity prices and a U.S. housing recovery that will boost Canada's long-struggling lumber business. Sales at Canadian-affiliated companies abroad hit \$500-billion in 2010, surpassing Canadian exports of \$450-billion, as Canadian companies increasingly tap into foreign markets by producing goods and services abroad.

Greece fights spiralling debt

Standard & Poor's cut Greece's debt rating to single-B, putting pressure on the EU and IMF to revamp the country's bailout. Greece will start selling state assets such as telecoms, ports and a water utility, and slash an additional €6-billion (\$8.3-billion) this year, as borrowing costs surge, with record yields exceeding 17% for Greek 10-year bonds.

U.S. GDP growth lower than expected

First-quarter GDP growth in the U.S. remained unchanged at 1.8% yesterday, while economists had expected a revision up to 2.2% from the Commerce Department. High gasoline and food prices were blamed for stalling consumer spending, which slowed to a pace of 2.2% annualized, compared to 4% in the previous quarter. At the same time, government spending fell at a 5.1% rate in the battle against budget deficits.

Microsoft buys Skype

Microsoft paid US\$8.5-billion cash for Internet phone company Skype, marking the largest deal in Microsoft's history and beating out other suitors believed to include Google and Facebook.

Social networking firms go public

The first U.S. social-networking firm to go public, LinkedIn's IPO valued the company at more than US\$3-billion. Shares more than doubled to \$94 on the first day. Beijing-based Renren – dubbed the Chinese Facebook – launched a successful IPO, raising over US\$700-million. The IPO for Yandex, “the Google of Russia,” saw shares skyrocket 40%.

GM Volt in overdrive

GM is expanding production of the Chevrolet Volt to 60,000 a year, from 16,000, to meet tremendous consumer demand for the car, which can be recharged through a home electrical outlet. Chrysler is set to repay US\$7.5-billion in bailout loans to the Canadian, Ontario and U.S. governments.

Crops in demand

European Union agricultural exports jumped 21% in value to a record €91-billion (US\$135-billion) in 2010, due to emerging economies' demand and higher prices. Ukraine, one of the world's top grain exporters, removed its export quotas, easing concerns over a looming shortage as drought threatens crops in Europe and the U.S. The cost of coffee beans doubled in the past year, as global coffee consumption rose to record levels in 2010, driven by its growing popularity in Asia.

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

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