

# Market Watch

## Big Picture

### U.S. loses AAA rating

Standard & Poor's downgraded the United States' AAA credit rating last Friday, criticizing lawmakers for a deficit reduction plan that falls well short of what "would be necessary to stabilize the government's medium-term debt dynamics." Fears of a downgrade spread to Europe, with rumours that France would be next, but three major agencies reaffirmed its AAA rating. The European Central Bank began buying billions of euros worth of Italian and Spanish bonds, which lowered yields and kept the two countries' borrowing costs manageable. The Bank of England cut its 2011 growth forecast for the U.K. to 1.5% from 1.8%, and signaled that interest rates would stay on hold amid growing economic headwinds.

Prime Minister David Cameron denied that the government's austerity drive triggered Britain's worst riots in decades after four nights of violence and looting throughout London and three major cities. U.S. productivity dropped 0.3% in the second quarter, following a decline of 0.6% in the first quarter, marking the first back-to-back declines since 2008. U.S. and Canadian trade deficits increased in June amid falling exports as global demand cooled. U.S. small business optimism dropped for the fifth straight month in July, and the percentage of Canada's business leaders' expecting their firms' profits to improve over the next six months dropped to 46.2%, from 58.8% in the first quarter.

## Markets

### Stocks seesaw; gold hits \$1,800

Volatility reigned this week as shock over America's downgrade combined with pent-up worries over a slowing U.S. economy and Europe's widening debt crisis. The Dow Jones Industrial Average fell 5.6% on Monday, rose 4% on Tuesday, fell 4.6% on Wednesday, and gained 4% on Thursday. Gold prices topped a record US\$1,800 an ounce. OPEC cut its forecast for global oil demand growth this year, predicting slower consumption in developed economies. Shares of Cisco jumped 17% Thursday, as modest profits signaled the company was making solid progress on its turnaround effort.

Apple surpassed Exxon Mobil to become the world's largest company, with market capitalization of US\$337-billion. Nestle raised its outlook on strong momentum, particularly in emerging markets, and price increases that are offsetting the soaring costs of coffee, cocoa and sugar, which hit 30-year highs earlier this year. Tim Hortons reported its profit increased by 1.5% in the second quarter, boosted by strong sales growth, particularly in the U.S. AOL lost one-quarter of its market value on Tuesday after reporting a loss and cutting its earnings outlook, renewing concerns over its ability to turn itself around.

## Our Recommendation

### Decline in stock prices represents a buying opportunity

- **Equities.** Steve Uzielli, Portfolio Manager, Portfolio Advisory Group (PAG), wrote: "Although return expectations should be modest in the context of a slow growth economic environment, we believe potential equity market returns are beginning to modestly outweigh the risks at current levels."
- **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 Hugo Ste-Marie says: "The equity downtrend is at odds with the upward trend in earnings."



## The Month in Review

### July: Debt troubles smoulder; stocks retreat

After weeks of feuding, Democrats and Republicans finally agreed on raising the debt ceiling, just hours before the August 2nd deadline, when the U.S. would have been unable to make its payments. Throughout July, tension from the U.S. debt talks and the deepening debt crisis in Europe, marked by violent protests in Greece and negotiations to secure a second bailout, weighed on global stock markets, causing the S&P 500 Index to lose 4.5% in the final three weeks of the month.

### China slows slightly, but not enough to stem inflation

The Chinese economy expanded 9.5% in the second quarter, down from 9.7% in the first quarter, marking its weakest growth in two years. But inflation continued to soar, hitting a three-year high of 6.4% in June.

### Europe, India tackle inflation

The European Central Bank (ECB) raised interest rates by 0.25% for the second time this year to tackle inflation, even as economic recovery remained uneven and belt tightening dampened growth. India raised interest rates for the 11th time in 18 months, as it battled persistently high inflation of nearly 9%.

### Canada's rich get richer

The Conference Board of Canada reported the gap between the average income of the poorest and the richest Canadians grew by nearly one-third, to \$117,500 in 2009, from \$92,300 in 1976. Canadian home prices surged 1.3%, rising for a sixth straight month in May, but are expected to ease in the months ahead.

### PCs lose ground to tablets and smartphones

In the second quarter, personal computer shipments climbed 2.6% from a year earlier, less than the 2.9% forecast, amid a sluggish global economy and growing popularity for smartphones and the iPad. PC sales in the U.S. slipped 4.2%, compared to 12% growth a year earlier, amid falling laptop prices and weak demand from corporations and budget-strapped government agencies. Tablet computers and smartphones are predicted to drive consumer electronics revenue to a record high of US\$190-billion in 2011.

### Google and Apple smash expectations

Shares jumped 12% as Google reported a 36% surge in net revenue over the second quarter. The search engine giant's forays into display and mobile advertising, its Android operating system and its social networking site Google+ all paid off. Apple delivered its best quarter ever, with revenue up 82% and profits up 125% year-over-year. IBM beat estimates and raised its full-year profit forecast. Intel trimmed its forecast for 2011 as mobile devices increasingly eat into the PC market.

### E-commerce thrives

Amazon's sales leaped 51% in the past year, as e-commerce continues to boom despite global economic uncertainty. European online music service Spotify is now available in the U.S., giving listeners access to a catalogue of 15 million songs from all major U.S. labels. The number of paying subscribers to Internet audio providers is expected to grow to 161 million by 2016, according to ABI Research.

### Agrium and Potash benefit from strong fertilizer prices

Fertilizer giant Agrium announced it will purchase Canadian turf manufacturer Evergro for \$50-million. Potash Corp. reported record quarterly earnings, up 81% year-over-year, and boosted full-year outlook as a result of strong fertilizer prices. The food sector is now Canada's largest manufacturing industry, with sales topping \$80-billion, and the country's largest employer.

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