

January 10, 2012

Here's What We're Thinking

The Investment Committee of the Portfolio Advisory Group meets weekly to formally discuss markets, sector allocation and investment recommendations. Below is a brief synopsis of our current market view.

- The “January Effect” dictates that as goes the first 5 days of January, so goes the year; if that proves to be true, then hopeful investors will be rewarded as the first five trading days of 2012 have seen major equity indices moving higher; however, low trading volumes continue to indicate a lack of investor conviction to start the year.
- U.S. bellwether **Alcoa Inc.** kicked off the unofficial earnings season last night after the market close; although they posted a loss in Q4, revenue in the quarter beat expectations and the company provided a positive outlook for 2012 including global aluminum consumption growth of 7%(+12% in China).
- Analyst estimates for Q4 earnings on S&P500 Index companies are calling for 6.2% year over year growth which would be the slowest pace since Q3 2009; that said earnings have exceeded expectations consistently over the past several quarters.
- China reported trade data overnight indicating exports and imports grew at their slowest pace in more than two years last month which has led to speculation of monetary easing by Chinese authorities to encourage economic growth.
- Although last week was quiet on the European headline front, the debt crisis in the region as the leaders of Germany and France met yesterday to further discuss implementation of the agreement reached in early December to better align fiscal policy in the region.
- U.S. consumer borrowing grew at the fastest monthly pace in 10 years in the month of November; consumers have increased borrowing in 13 of the last 14 months indicating American confidence may be turning more positive.
- U.S. economic data released last week continued their improving trend as ISM Manufacturing hit 53.9, its highest level since July, and ISM Non-Manufacturing hit 52.6 versus the previous month's 52.0. Any reading above 50 indicates economic expansion. Employment data reported last Friday also showed signs of improvement and housing appears to be bottoming.
- While acknowledging risks over the coming year which will contribute to ongoing market volatility, including the European debt crisis and a slowing economy in China, our outlook for 2012 is cautiously optimistic as valuations look compelling, corporate balance sheets are strong, and dividend yields are attractive in this low interest rate environment.
- Equities are likely to remain range bound, and the U.S. market is currently above the top end of the narrow trading range established since last August. This is a trading market and investors are encouraged to trade around core positions to add incremental performance.
- The trading range is developing a more upward sloping trend of late so although there are opportunities to take profits where certain stocks have become fully valued, our emphasis is more on buying on pullbacks versus selling strength.
- Although weaker global economic growth has negative implications for commodity demand, if economic data continues to improve our conservative outlook may prove to be too cautious and there is likely greater upside potential in 2012 than downside risk.
- For fixed income exposure, the current low rate environment offers little value in the mid to long end of the curve and we recommend investors remain short duration at this time. From a sector weighting perspective, investors should be underweight Canada's and overweight provincials, municipals and corporates. The recent narrowing of high yield spreads leaves us at a point of indifference on these credits. With the Canadian dollar expected to outperform most major currencies over the coming year, we recommend Canadian investors remain in Canadian dollars for their fixed income holdings.
- Austerity measures in Europe and the U.S. will ensure growth in developed economies remains slow in 2012, offset by comparatively stronger growth in emerging markets which argues for the continued need for global diversification. Over the longer term, however, valuation and fundamentals will return to the forefront.
- There are a number of attractive investment opportunities at present but macro risks lead us to advocate a balanced portfolio, a focus on enhancing returns via dividends, and a need to be more tactical in this volatile market.

For more information on how these ideas pertain to your investment portfolio, please contact your ScotiaMcLeod advisor.

PAG Report

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