



# **Weekly Market Insight**

*July 11, 2008*

## **NORTH AMERICAN & INTERNATIONAL ECONOMIC HIGHLIGHTS**

The US stock market is officially in a bear market and the TSX lost more than 6% since the beginning of July. A year from now we will refer to the current period as the "bad times".

But between now and then, what will define the next six to twelve months? The following is a brief list of the main themes that we think will dominate the economy and markets in the near term.

### **Economic Activity**

We are probably at the bottom of the cycle. In the US, the economy is probably shrinking and in Canada, we are starting to see growing consistent signs that the labour market is slowing. We probably will stay at this bottom for a few more months with some early signs of a sustained recovery becoming visible in the fourth quarter of 2008.

### **Inflation**

The trend is up. The main reason for higher inflation down the road is surging energy and food prices. Note that until recently the Fed and the Bank of Canada were focusing only on core inflation (which excludes food and energy prices). But realizing that the current rise in food and energy prices is more structural in nature, both central banks are now focusing more and more on "all-items" inflation that includes the food and energy components. Accordingly, look for US inflation to reach 4.2% by year-end. In Canada, we have not yet felt the impact of higher food prices due to the appreciation of the dollar. But in economics almost everything is determined at the margin. And with the Canadian dollar remaining more or less at current level, food inflation will no longer be protected by a rising currency, and therefore it will take overall inflation in Canada to 3% by year-end.

### **Interest Rates**

With inflation rising and the economy slowing, we are in stagflation. The Fed and the Bank of Canada are in a difficult position since raising rates now to fight inflation will further damage an already fragile economy. So what to do? The best guess is that both central banks will wait until the end of the year, when the signs of a sustained recovery are extremely clear before starting to raise rates. Accordingly, we expect the Fed to raise rates by 150-200 basis points and long-term rates in the US to rise by roughly 60-70 basis points. In Canada, with inflation a bit lower and economic growth stronger than in the US, the Bank will probably raise the bank rate by only 100 basis points with long-term rates rising by only 30-40 basis points.

### **The Stock Market**

The US market is officially in bear territory and probably will stay there for a while. Given current sentiment, it is hard to see a recovery in the near term. In fact, we expect additional sell-offs in the very near term. In terms of the duration of the market decline, we are still 2-3 months short of the average duration of all previous bear markets as the magnitude of the decline is still 5%-10% short than the average. Having said that, we believe that the market is cheap (and probably will get cheaper in the coming months or two). This means that currently there are many opportunities from a 2-year investment horizon perspective.

In Canada, the recent decline in the stock market reflects the ongoing impact of the credit crunch on the financial as well as general fears that the stagflationary conditions will further damage the Canadian economy. The energy sector will remain relatively robust due to our belief that energy prices will remain elevated. Overall, it is difficult to see a sustained recovery in the TSX before there are convincing signs that the US market has reached a bottom. As is the case in the US, at current valuations, the non-commodity segment of the market is very cheap.

**Benjamin Tal**  
Senior Economist

## International Stock Indexes

Thursday, July 10, 2008

Region/Country	Index	DAILY					52 WEEK				3-yr % chg
		High	Low	Close	Chg	% Chg -   +	YTD % chg	High	Low	% Chg	
<b>World</b>											
World	<b>DJ World Index</b>	258.45	255.86	257.88	-0.26	-0.1	-14.3	320.33	257.88	-17.3	6.6
World	<b>DJ World ex U.S.</b>	234.16	231.14	232.03	-1.64	-0.7	-14.6	291.11	230.68	-16.6	11.1
World	<b>MSCI EAFE*</b>	n.a.	n.a.	1896.38	-21.57	-1.12	-15.8	2388.74	1886.68	-18.2	9.1
<b>Asia Pacific</b>											
Asia-Pacific	<b>DJ Asia-Pacific</b>	136.73	135.06	136.28	0.37	0.27	-13.8	172.49	133.78	-16.4	9.2
Australia	<b>All Ordinaries</b>	5067	4999	5020.5	-68.9	-1.35	-21.8	6853.6	5020.5	-21.6	6.2
Australia	<b>S &amp; P/ASX 200</b>	4986.7	4916.9	4937.4	-74.5	-1.49	-22.1	6828.7	4932.9	-22.4	5.3
China	<b>DJ CBN China 600</b>	24524.88	23686.62	23844.45	-357.81	-1.48	-42.4	44631.83	21535.15	-20.3	43.6
China	<b>Dow Jones China 88</b>	266.4	257.13	259.62	-3.33	-1.27	-45	530.54	236.45	-22	40.1
China	<b>Shanghai Composite</b>	2952.04	2862.06	2875.45	-45.1	-1.54	-45.3	6092.06	2651.61	-26.6	n.a.
Hong Kong	<b>Hang Seng</b>	22020.66	21498.87	21821.78	15.97	0.07	-21.5	31638.22	20387.13	-4.3	16
India	<b>Bombay Sensex</b>	14046.59	13763.94	13926.24	-38.02	-0.27	-31.4	20873.33	12961.68	-7.7	24.5
Indonesia	<b>Jakarta Composite</b>	2276.23	2241.92	2276.23	-9.8	-0.43	-17.1	2830.26	1908.64	-0.4	27
Malaysia	<b>Kuala Lumpur Composite</b>	1141.97	1129.93	1135.49	-4.32	-0.38	-21.4	1516.22	1121.25	-16.9	7.9
New Zealand	<b>NZSX-50</b>	3177.46	3112.49	3112.56	-64.9	-2.04	-23	4332.29	3094.42	-26.6	-1.5
Pakistan	<b>KSE 100</b>	11773.12	11702.52	11773.12	-23.35	-0.2	-16.4	15676.34	11162.17	-16.7	15.8
Philippines	<b>Manila Composite</b>	2466.46	2446.54	2450.62	-30.91	-1.25	-32.3	3873.5	2339.84	-34.8	9.3
Singapore	<b>Straits Times</b>	2902.33	2875.61	2901.58	-16.04	-0.55	-16.3	3831.19	2792.75	-18.1	10.4
South Korea	<b>Kospi</b>	1542.34	1495.44	1537.43	18.05	1.19	-19	2064.85	1519.38	-19.5	14.6
Sri Lanka	<b>Colombo Stock Exchange</b>	2409.11	2381.58	2405.6	23.99	1.01	-5.3	2681.27	2354.98	-2.8	7.2
Taiwan	<b>Weighted</b>	7141.02	6976.6	7075.65	27.4	0.39	-16.8	9809.88	7048.25	-24.4	4.5
Thailand	<b>SET</b>	727.47	713.19	721.86	0.73	0.1	-15.9	915.03	721.13	-14.5	3.9
Japan	<b>Nikkei Stock Avg</b>	13139.85	12930.32	13067.21	15.08	0.12	-14.6	18238.95	11787.51	-27.3	4.2
Japan	<b>Nikkei 300</b>	264.77	260.49	263.46	0.94	0.36	-12.5	358.46	234.2	-25.6	5.5
<b>Europe</b>											
Europe	<b>DJ Stoxx 600</b>	282.41	276.94	277.95	-5.95	-2.1	-23.8	399.71	277.95	-30	-0.1
Europe	<b>DJ Stoxx 50</b>	2871.33	2820.99	2833.72	-52	-1.8	-23.1	3998.93	2833.72	-28.7	-2.7
Euro zone	<b>DJ Euro Stoxx 50</b>	3325.11	3265.21	3283.01	-59.5	-1.78	-25.4	4557.57	3275.2	-27.3	0.6
Euro zone	<b>DJ Euro Stoxx</b>	314.45	308.96	310.38	-6.09	-1.92	-25.2	441.18	310.38	-29.2	1.8
Austria	<b>ATX</b>	3793.55	3673.41	3676.86	-116.4	-3.07	-18.5	4926.07	3524.64	-25.2	5.9
Belgium	<b>Bel-20</b>	3070.16	3011.17	3022.3	-64.32	-2.08	-26.8	4645.08	3010.44	-34.8	-0.9
Czech Republic	<b>PX 50</b>	1451.5	1430.9	1448.5	-6.7	-0.46	-20.2	1936.9	1405.1	-23	5.8
Denmark	<b>OMX Copenhagen</b>	380.44	375.17	378.18	-2.26	-0.59	-15.7	492.84	368.52	-21.7	6.3
Finland	<b>OMX Helsinki</b>	8435.5	8296.66	8344.53	-90.97	-1.08	-28.1	12656.77	8256.47	-28.7	4.1
France	<b>CAC 40</b>	4293.12	4209.64	4231.56	-108.1	-2.49	-24.6	6125.6	4231.56	-30.7	-0.5
Germany	<b>DAX</b>	6384.64	6254.31	6305	-81.46	-1.28	-21.8	8105.69	6182.3	-21.7	11.1
Hungary	<b>BUX</b>	20879.07	20534.52	20558.86	-260.91	-1.25	-21.6	30118.12	19870.33	-29.7	1.9
Italy	<b>S &amp; P/MIB</b>	28827	28319	28437	-334	-1.16	-26.2	42367	28306	-32.5	-4.6
Netherlands	<b>AEX</b>	407.95	399.29	401.93	-8.9	-2.17	-22.1	561.9	401.93	-28.2	1.1
Norway	<b>All-Shares</b>	512.23	503.91	504.31	-7.92	-1.55	-11.5	605.05	442.79	-15.8	15.1
Poland	<b>WIG</b>	40163.52	39606.23	39632.83	-370.2	-0.93	-28.8	66045.6	39429.79	-39.9	11.1
Portugal	<b>PSI 20</b>	8778.05	8653.53	8678.1	-173.61	-1.96	-33.3	13702.03	8486.91	-35.7	5.1
Russia	<b>DJ Russia Titans 10</b>	6833.15	6753.01	6792.22	-4.95	-0.07	-11.4	7920.96	6226.15	-5.1	40.7
Russia	<b>RTS Index</b>	2191.74	2163.44	2186.35	7.5	0.34	-4.5	2487.92	1820.3	6.7	43.7
Spain	<b>IBEX 35</b>	11892.4	11699.5	11739.5	-260.3	-2.17	-22.7	15945.7	11739.5	-21.4	6.2
Sweden	<b>SX All Share</b>	273.76	268.26	268.58	-5.18	-1.89	-23.7	427.24	268.58	-36.9	1.2
Switzerland	<b>Swiss Market</b>	6871.49	6763.87	6803.07	-118.37	-1.71	-19.8	9299.8	6772.74	-26.4	2.5
Turkey	<b>Istanbul National 100</b>	36039.19	35105.76	35574.64	-28.63	-0.08	-35.9	58231.9	33208.24	-31.6	8.5
U.K.	<b>FTSE 100</b>	5529.6	5392.6	5406.8	-122.8	-2.22	-16.3	6730.7	5406.8	-19.3	1.1
U.K.	<b>FTSE 250</b>	8654.6	8499.3	8519.9	-134.7	-1.56	-20.1	11922.9	8480.1	-27.9	4.3
<b>Americas</b>											
Americas	<b>DJ Americas</b>	331.83	326.18	330.62	2.34	0.71	-12.3	399.86	328.28	-15.9	4
Argentina	<b>Merval</b>	1940.32	1916.6	1940.15	-7.63	-0.39	-9.8	2351.44	1833.71	-15.2	11.8
Brazil	<b>Sao Paulo Bovespa</b>	60588.93	58337.52	60252.74	716.79	1.2	-5.7	73516.8	48015.55	4.6	35.1
Canada	<b>S &amp; P/TSX Comp</b>	13776.48	13572.63	13743.88	133.04	0.98	-0.6	15073.13	12132.13	-4.3	10.5
Chile	<b>Santiago IPSA</b>	2833.08	2797.85	2803.82	-19.62	-0.69	-8.1	3496.18	2427.11	-16.9	10.8
Mexico	<b>IPC All-Share</b>	28101.94	27499.56	27877.33	-218.46	-0.78	-5.6	32836.12	25284.88	-13.6	26.2
Venezuela	<b>Caracas General</b>	39040.62	37843.68	37941.22	-982.51	-2.52	0.1	42249.77	34172.43	-6.3	20.2
<b>Other Countries</b>											
Egypt	<b>CASE 30</b>	9572.73	9462.55	9566.59	56.64	0.6	-9.3	11935.67	7517.75	14.6	n.a.
Israel	<b>Tel Aviv</b>	1031.41	1012.99	1023.42	-3.24	-0.32	-15.9	1237.13	964.38	-10.9	16.7
South Africa	<b>Johannesburg All Share</b>	28009.41	27650.78	27687.48	-321.93	-1.15	-4.4	33232.89	25135.13	-7.1	24.2

\* Europe, Australia, Far East; U.S.-dollar terms

Three year percent change is annualized.

Sources: Reuters; WSJ.com

MARKET INDICES	Jul 10	a month ago	a year ago
S&P/TSX Composite	13743.88	14736.20	14131.93
S&P 500	1253.39	1358.44	1510.12
Dow Jones Industrial Average	11229.02	12289.8	13501.7

INTEREST / FX RATES	Jul 11	a month ago	a year ago
Prime Can (%)	4.75	4.75	6.25
Prime US (%)	5.00	5.00	8.25
30 Day BA Can (%)	3.150	3.145	4.58
3 month US T-Bill (%)	1.65	1.96	4.96
3 month Can T-Bill (%)	2.321	2.790	4.574
10yr US Bond (%)	3.836	4.176	5.11
10yr Can Bond (%)	3.68	3.86	4.66
10yr-2yr US Spread (bps)	138.00	127.00	17.70
10yr-2yr Spread Can (bps)	59.00	51.00	-2.00
US\$/Cdn\$	0.9905	0.9742	1.0477
US\$/Euro	1.5914	1.5345	1.3794
Yen/US\$	105.980	108.000	122.0440

INTERNATIONAL INTEREST RATES	Jul 11		
	3 mo LIBOR (%)	Spread vs US (bps)	a wk ago (Spread—bps)
United States	2.79	NA	NA
Canada	3.43	64	68
Euro-zone	4.96	217	217
Switzerland	2.80	1	1
Japan	0.92	-187	-186
Australia	7.76	496	500
	10 Year Bond (%)	Spread vs US (bps)	a wk ago (Spread—bps)
United States	3.84	NA	NA
Canada	3.68	-15.6	-25.5
Euro-zone	4.92	108.3	100.7
Switzerland	3.12	-71.6	-71.7
Japan	1.59	-224.2	-233.5
Australia	6.36	252.8	244.8

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