

Global Investment Perspective

March 2010

At a glance

- Global equities rebounded in February following a sharp fall in January.
- Investors remain concerned about interest rate hikes and rising government debt in developed countries.
- We expect inflation to remain at normal levels and our view is that interest rates should also remain low.
- Corporate bond valuations remain attractive relative to the very low yields on government bonds.

Global equities rebounded in February following a sharp fall in January. However, year-to-date, the Morgan Stanley Capital International (MSCI) World Index is still down about 1.7%. This reflects investors' concerns about interest rate hikes and rising government debt in developed countries. The eurozone was among the worst-performing regions, driven by concerns that Greece's sovereign-debt rating could be lowered in the face of worsening deficits and a failure to implement tough measures to curb public sector spending.

Pace of recovery could ease

From a macroeconomic perspective, there is more evidence of recovery across a number of countries, primarily in emerging market economies, which are likely to continue to lead the global turnaround. However, there are signs that leading economic indicators have peaked in most markets. This could indicate a possible slowdown in the pace of gross domestic product (GDP) growth in the coming months and quarters. Core inflation is likely to remain within a normal range in most economies.

Preference for defensive sectors maintained

Due to mixed investor sentiment and current growth concerns, we maintain our preference for defensive sectors, such as health care and telecommunication services over financials and cyclical stocks.

Risk persists in government bonds, but it appears to be priced in

Within fixed income, we maintain our neutral position in government bonds over cash, as valuations for the former reflect the risks of higher issuance and normalization of monetary policy. While there is concern Greece's credit rating could be downgraded if the government fails to contain its debt, the risks appear to be reflected in current prices. For corporate bonds, we maintain our positive view on investment-grade and high-yield debt.

Market

Major market indices

Returns to February 28, 2010

Index	February
S&P 500	3%
S&P/TSX	5%
MSCI EAFE	-0.7%
MSCI Europe	-2%
MSCI Pacific ex-Japan	3.2%
MSCI Japan	1%
MSCI Emerging Markets	0.4%

Source: TD Newcrest

All returns were calculated in US\$ except for the S&P/TSX Composite Index, which is calculated in C\$.

US

Mixed economic outlook — pace of recovery eases and risk of negative earnings surprises grows

US markets rose in February, fuelled by better-than-expected improvements in economic activity as well as encouraging corporate earnings releases. The outlook remains mixed. There is clear evidence of faster economic growth, but little progress has been made in reducing the deficit and unemployment. Also, US leading indicators appear to have peaked, indicating a possible slowdown in the pace of recovery. Increases in the already optimistic corporate earnings growth estimates for 2010 are a concern because they increase the chances for negative surprises. Overall, we retain our moderately cautious view.

Europe

Record unemployment and weak consumption support view of anemic 2010 growth

European equity performances were mixed. Risk aversion rose because of worries over Greece and other indebted eurozone countries. Elevated levels of unemployment and weak consumption continued to support our view of anemic eurozone growth in 2010. We also remain concerned that current valuations reflect an overly optimistic level of economic and corporate earnings growth for 2010. We recommend only a moderately cautious stance on European equities and maintain our moderate underweight versus cash.

Japan

Weak spending and high unemployment threaten a sustainable recovery

Japanese stocks continued to fall in February. Manufacturing and trade activity improved, but not enough to support a self-sustaining recovery. Consumer spending remained weak and unemployment was still high, adding to deflation (declining prices). We maintain a moderately cautious view and expect Japan to perform in line with other developed markets. Overall, we recommend an underweight position versus cash.

Asia ex-Japan

Optimistic earnings growth projections risk disappointment and concerns over interest rates

Equity markets in Asia ex-Japan rose in February, but the gains masked sharp divergences among key markets. The outlook for Asia ex-Japan remains positive, with the Consensus Economics 2010 GDP growth forecast standing at 7.9% in January. However, concerns about higher interest rates could rein in enthusiasm about the pace of recovery. The consensus forecasts for company earnings growth in 2010 rose further, and are now at a particularly optimistic rate, so we believe the risk for disappointment persists. We maintain a moderate underweight in Asia ex-Japan equities relative to cash.

Emerging Markets

Maintain preference for Latin American and Turkish equities on valuation grounds

Emerging market equities fell in February, driven by a 5.9% drop in eastern European stocks. From an economic perspective, emerging markets are likely to continue to lead the recovery. We maintain our moderately cautious view on emerging market equities relative to cash, and we expect them to perform in line with developed markets. We also maintain our preference for Latin American equities over those in emerging markets in Asia, and we continue to like Turkey on valuation grounds.

Canada

Stronger economic data boosts markets, but defensive sectors remain most attractive

All ten subsectors of the market finished February in positive territory. Financial stocks led the market higher as investors focused on solid earnings and announced lower provisions for credit losses, something that suggests the economic recovery could be gaining momentum. We remain cautiously optimistic on Canadian equities, primarily because long-term strength in emerging markets will likely continue to benefit Canada's resource-heavy economy. We continue to favour defensive sectors over more economically sensitive cyclical stocks.

Currency

Currencies at a glance (At February 28, 2010)

Currency	US\$ exchange rate	1-month change in US\$ terms
Canadian dollar	1.05	-1.9%
Euro	0.73	1.4%
UK pound	0.66	4.8%
Japanese yen	88.83	-2.2%

Source: Bank of Canada

US Dollar

Uncertain growth outlook and waning risk appetite dominate

Although the US Federal Reserve raised the discount interest rate it charges other banks in February, we retain the view that it will err on the side of caution in tightening monetary policy. The dollar is likely to continue to be influenced by investors' appetite for riskier assets — as risk appetite declines, investors tend to sell riskier assets and seek the safe haven of US dollars.

Euro

Greece bailout will be major short-term swing factor

Resolving Greece's fiscal crisis is likely to dominate eurozone currency news. One of the first steps is due mid-March when Greece reports to the European Union on its proposed budget reforms. With inflation contained and growth still patchy, we continue to believe interest rates will be kept low for a long time.

UK Sterling

Short-term volatility likely, given political uncertainty and eurozone debt woes

Uncertainty will plague the pound in the lead-up to this spring's general election. Even then, the picture is unlikely to be clear, at least in the short term, particularly if the result is a hung

parliament. The pound could also be subject to short-term volatility given the fiscal difficulties of the peripheral eurozone countries.

Japanese Yen

Potential for volatility is high

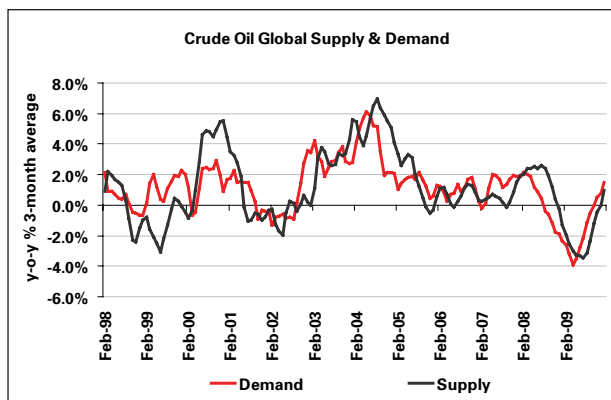
It is probably safe to assume that Japanese authorities continue to view excessive yen strength as undesirable for the economy. There has been no market intervention or even any recent comments to this effect. Still the authorities are unlikely to stand by and allow the yen to resume its upward trend unchecked. This means the potential for volatility remains high.

Canadian Dollar

Rising stocks push loonie higher versus US dollar

Rising stock prices saw the loonie gain against US dollar. The loonie remains primarily tied to the fortunes of Canada's commodity-heavy stock market, which tends to rise and fall on global economic news. The loonie still has a chance to breach par with the US dollar, but we see fair value at closer to US\$0.90. In early March, the loonie was trading around US\$0.98.

Commodity



Sources: Barclays Capital, Bloomberg, Citigroup, HSBC Global Asset Management and Thomson Reuters Datastream (January 2010).

Oil

Subdued demand likely to keep oil trading in a target range of US\$65-85, which we revised up from US\$60-80

Oil had a good month in February, with the spot price gaining 9.3%. Supply and demand dynamics are slowly improving, as are global growth prospects. We have raised our target range for oil from US\$60-80 per barrel to US\$65-85. However, on balance, the overall level of economic activity is likely to continue to keep oil demand at subdued levels. Key risks to our central view would include a fall in the US dollar or a disruption to supply. Both scenarios would result in higher prices.

Interest rate/ Fixed income

Sources: Datastream, Bloomberg, Merrill Lynch, Barclays Capital and HSBC Global Asset Management

Unless otherwise indicated, all returns are expressed in US\$.

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Mixed Sources

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US

Neutral position versus cash still recommended

US government bonds posted further gains during February, increasing by 0.4%, despite ongoing concerns about sovereign risk, particularly for Greece. With labour markets still weak, we do not expect any changes in the federal funds rate over the next six months and possibly for longer. Market expectations also continue to shift closer to our view that US interest rates will be kept low for an extended period. Overall, we recommend a neutral position in US Treasuries.

Eurozone

Corporate debt still preferred on valuation grounds

A flight to safety sparked by Greek debt concerns saw eurozone government bond prices rise 1.2% in February. The market has reacted strongly to weak fiscal situations in Portugal, Italy, Greece, Ireland and Spain. Greece's financial turmoil is likely to generate volatility in markets, but currently the concerns appear to be well-reflected in market prices. Given the exceptionally low yields offered by government bonds, our preference remains for corporate debt on valuation grounds.

Canada

Corporate bonds continue to offer better value than government bonds

The federal budget released in early March signalled a tightening of government spending once the current round of stimulus measures expires over the next 12 months. Markets responded positively to the government's prudent approach. We still prefer corporate bonds because they offer better value than government bonds. Strong GDP data saw the consensus forecast call for rate hikes of 1.25% to 1.50% over the next 12 months. We still forecast only 0.5% in hikes, but our bias is toward adjusting this upward.

Emerging Markets

Valuations remain less attractive than high-yield corporate bonds

US dollar-denominated sovereign debt in emerging markets gained 1.5% during February. The month was characterized by improving economic news across the region. But rising inflation, especially in Latin America, and increasing concerns over the tightening of monetary policy are less positive elements. Valuations of emerging market debt continued to be less attractive than high-yield corporate debt.

Investment Grade

Underlying conditions and the demand for yield remain supportive for this asset class

Investment-grade corporate debt gained 0.4% in February. We do not expect significant spillover from debt woes in peripheral eurozone countries because they only account for a modest fraction of the total corporate bond market. Overall, valuations are historically attractive, company fundamentals are improving, and technical factors should stay supportive of investment-grade bonds.

High Yield

Risk-adjusted returns still appeal

High-yield corporate bonds gained 0.16% in February. With yields still attractive and the risk of a financial system collapse largely in the past, we believe that investors can capture attractive yields in the high-yield market with relatively contained default risk. Given the volatility in other riskier asset classes, risk-adjusted returns in high-yield bonds continue to look appealing.

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