

Flash Crash and Burn

Equity markets were clobbered this week in a continued flight from risk, as European sovereign debt worries, and the required fiscal austerity, cast scepticism on the pace of economic recovery. The S&P 500 fell 4.1%, with banks doing most of the damage (down 6.1%) as the Senate passed a relatively strict financial reform bill. Cyclical were also hit hard, but the selling was aggressive across all sectors as even the defensive telecom and consumer staples were down more than 2%. Interestingly, the S&P 500 broke below the “flash crash” intraday low on Friday morning before recovering through the day, erasing all of the post-panic rebound. The TSX fell 4.1%, with all sectors in the red including a sharp decline in gold.

This week’s decline yanked the S&P 500 into correction territory for the first time since the bull market began last March, and it’s now down 11% from its April 23rd high, while 200-day moving averages have now been breached across all major North American markets. Much of this correction reflects near-term unwinding of sentiment, which was stretched to its limit a month ago—see the bullish survey readings and distinct lack of positive response to very strong earnings results. In that sense, the market looks ready to be bought as sentiment turns negative. However, there’s more to this story.

A year ago, with great relief, we began highlighting a number of factors that hinted at stronger economic growth and equity market performance ahead, including firming commodity prices and relative strength in cyclicals, a breakout in Chinese equities and a move in TIPS spreads off their deflation-scared lows. These factors have turned quite decisively in recent weeks. Commodity prices have stumbled, with oil and copper both cracking below their 200-day moving averages, while the energy, materials and technology sectors have slid to the bottom of the leaderboard in the past month. Chinese stocks have all but broken down, with the CSI 300 down 27% from its August-09 peak and, importantly, taking out the prior low set in September-09. Inflation expectations have also started to come down, with this week’s benign U.S. CPI report acting as reinforcement. While TIPS spreads have seen nothing like the collapse of 2008, they have rolled over and warrant a close eye—stock prices and deflation, real or feared, don’t get along.

All told, a good share of this equity market correction is sentiment related, and will come to pass, but part of it also reflects the potential for more challenged economic growth ahead. However you weight these two factors, the equity bull market has matured, and more modest gains lie ahead.

EarningsWatch... Still overshadowed, the Q1 earnings season continues to come in better than expected. With more than 90% of S&P 500 companies now reporting, 81% have beaten earnings expectations, while a solid 67% have posted revenue surprises. This week saw upside surprises from the likes of Home Depot, WalMart, Target and Deere. In Canada, 48% have beaten earnings expectations while a not-so-stellar 36% have beaten on revenue. The Canadian banks begin reporting next week, with BMO kicking off the festivities on Tuesday.

Market Performance as of May 21, 2010

	Current Price	Performance (percent)					
		1 Week	1 Month	3 Months	1 Year	YTD	2009
CAC 40	3,431	-3.6	-13.8	-9.0	6.6	-12.8	22.3
DAX	5,829	-3.8	-6.4	1.9	18.9	-2.2	23.8
FTSE 100	5,063	-3.8	-11.5	-5.5	16.5	-6.5	22.1
Dow Jones	10,193	-4.0	-8.4	-2.0	22.9	-2.3	18.8
S&P/TSX	11,521	-4.1	-5.1	-1.6	15.8	-1.9	30.7
S&P 500	1,088	-4.2	-9.8	-1.9	22.4	-2.5	23.5
NASDAQ	2,229	-5.0	-11.0	-0.7	31.5	-1.8	43.9
NIKKEI 225	9,785	-6.5	-11.8	-3.3	5.6	-7.2	19.0
S&P/ASX 200	4,326	-6.8	-13.1	-7.1	13.7	-11.4	33.4

Source: Bloomberg

Earnings Season Summary

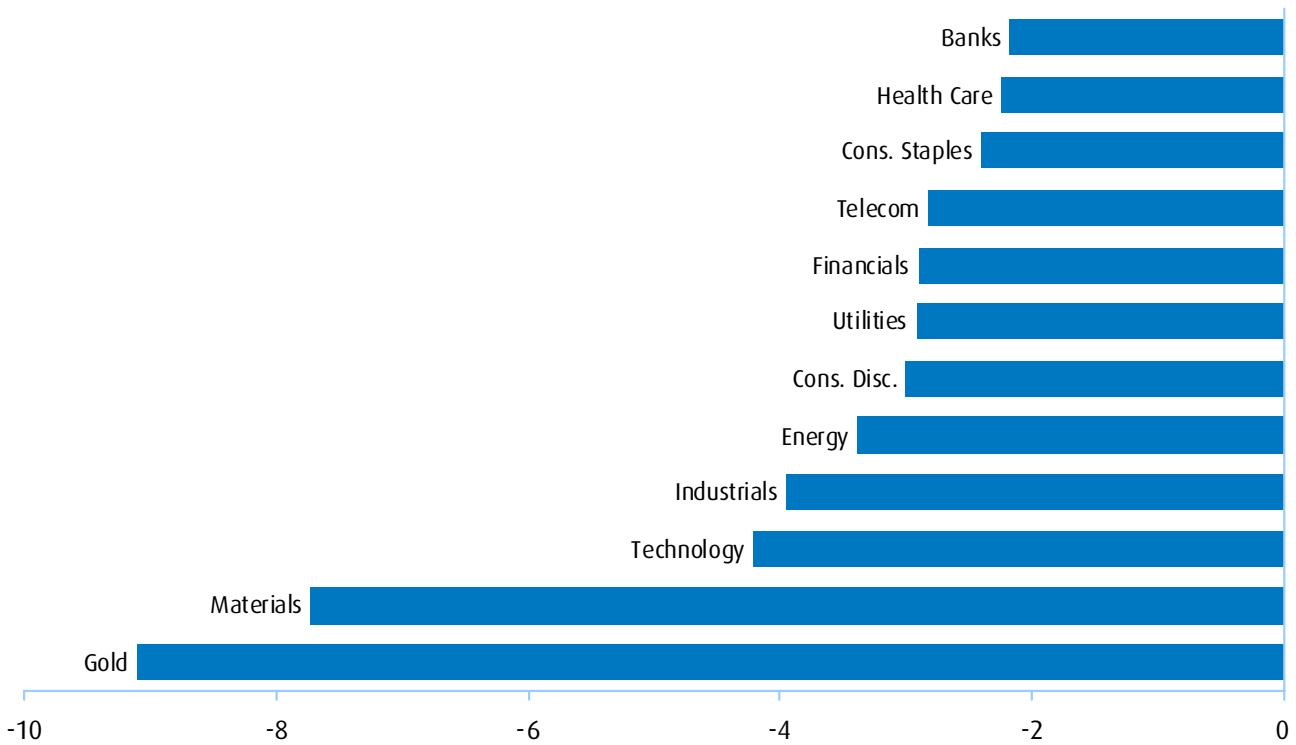
(% beating estimates)

	2010Q1*	2009Q4	2009Q3	2009Q2	2009Q1
Earnings per share					
TSX	47.7	49.8	52.9	52.7	49.3
S&P 500	81.7	76.4	82.3	72.3	67.5
Revenue					
TSX	36.3	46.2	40.3	44.4	33.3
S&P 500	67.0	67.8	59.1	50.9	38.6

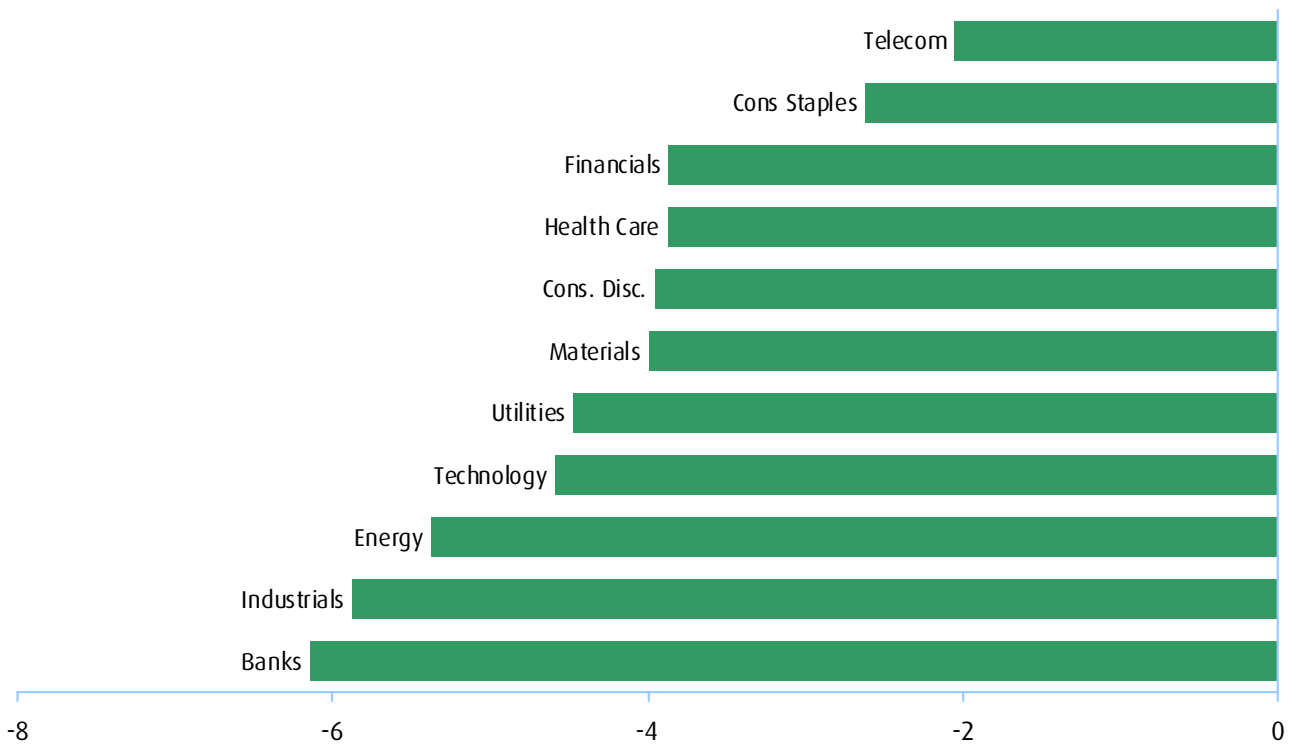
*Earnings season to date. Source: Bloomberg.

Weekly Sector Performances as of May 21, 2010

TSX (percent)

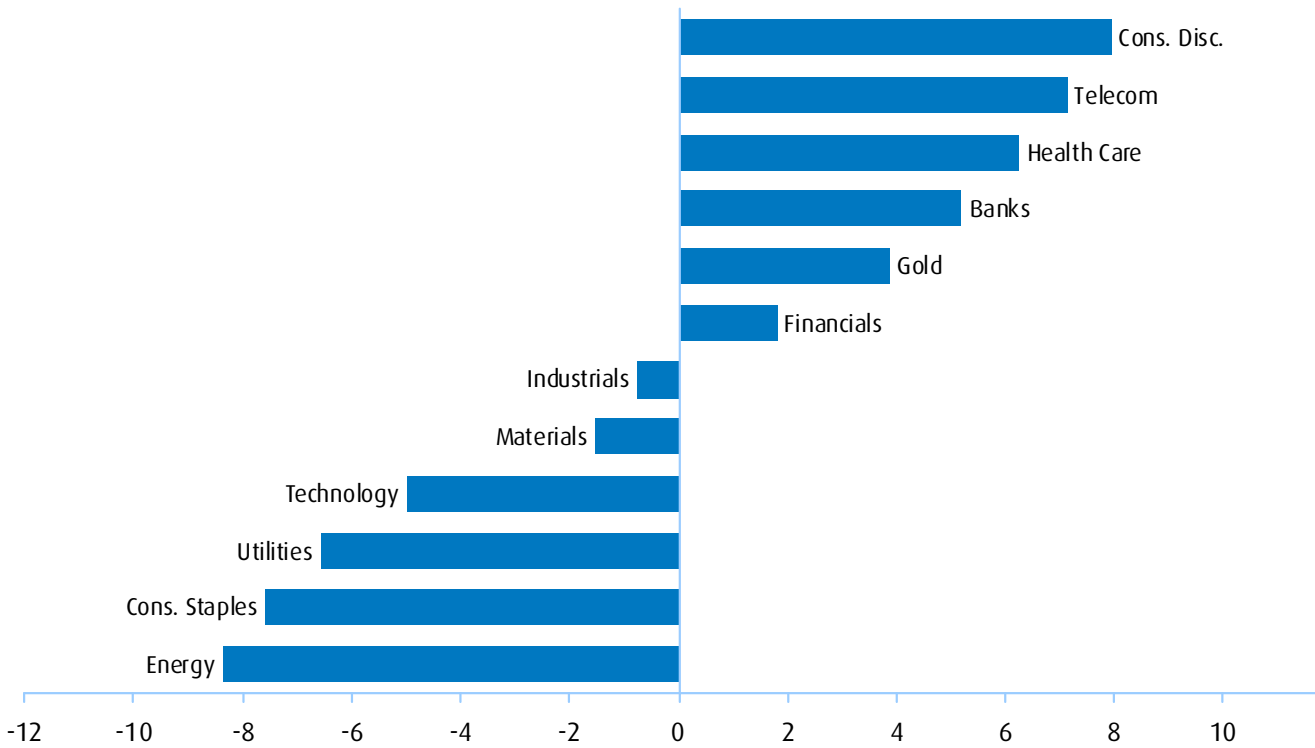


S&P 500 (percent)

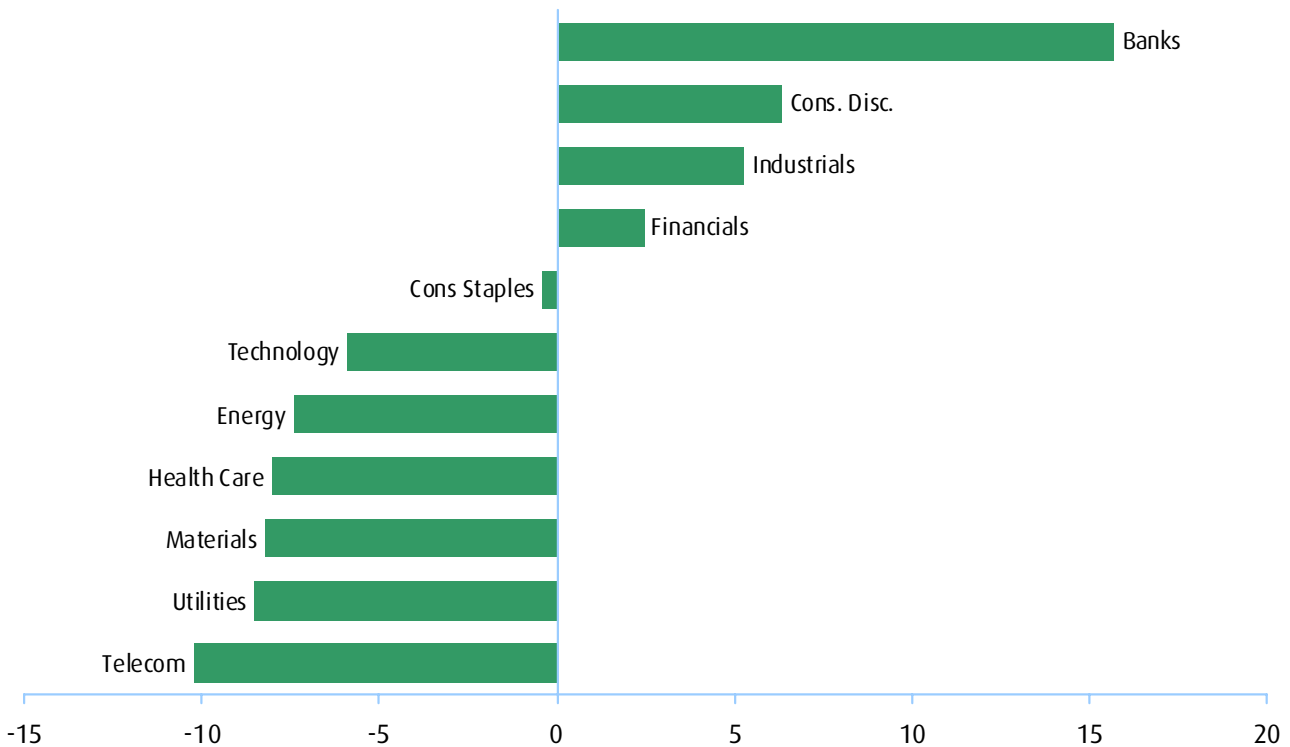


Year-to-Date Sector Performances as of May 21, 2010

TSX (percent)



S&P 500 (percent)



North American Sector Performances as of May 21, 2010

S&P 500 Sectors	1 Week	1 Month	3 Months	1 Year	YTD	2009
Telecom Services	-2.0	-4.9	-0.8	2.9	-10.2	2.6
Cons Staples	-2.6	-5.4	-2.5	16.4	-0.4	11.2
Financials	-3.9	-11.4	2.0	25.8	2.4	14.8
Health Care	-3.9	-8.5	-8.8	14.2	-8.0	17.1
Cons Discretionary	-4.0	-9.4	4.9	41.8	6.3	38.8
Materials	-4.0	-11.6	-5.9	16.4	-8.2	45.2
Utilities	-4.5	-6.0	-4.1	11.6	-8.5	6.8
Information Technology	-4.6	-11.3	-1.9	32.0	-5.9	59.9
Energy	-5.4	-12.1	-6.8	6.7	-7.4	11.3
Industrials	-5.9	-10.3	1.7	34.2	5.3	17.3
Banks	-6.1	-9.9	9.9	33.6	15.7	-8.9
S&P 100 Large Cap	-4.2	-10.1	-2.8	18.9	-3.8	19.1
S&P 400 Mid Cap	-5.0	-9.8	1.3	35.4	3.2	35.0
S&P 600 Small Cap	-6.0	-9.5	4.2	36.8	5.1	23.8
S&P 500	-4.2	-9.8	-1.9	22.4	-2.5	23.5

TSX Sectors

Banks	-2.2	-5.2	5.6	40.8	5.2	54.4
Health Care	-2.2	-2.1	6.3	31.0	6.3	28.6
Cons Staples	-2.4	-3.4	-7.9	2.6	-7.6	6.1
Telecom Services	-2.8	2.0	6.7	21.1	7.1	0.7
Financials	-2.9	-6.2	1.5	28.3	1.8	38.3
Utilities	-2.9	-6.4	-6.6	18.1	-6.6	12.7
Cons Discretionary	-3.0	0.6	5.4	26.4	7.9	11.1
Energy	-3.4	-7.4	-5.5	6.8	-8.4	35.0
Industrials	-4.0	-6.6	0.6	24.9	-0.7	23.7
Information Technology	-4.2	-6.8	-9.3	-11.2	-5.0	44.3
Materials	-7.7	-2.1	-2.6	11.8	-1.5	33.4
Gold	-9.1	6.6	5.0	6.3	3.9	5.7
Income Trusts	-3.9	-7.5	-5.8	21.7	-2.2	29.5
REITs	-4.0	-4.6	-1.7	35.1	-0.6	42.4
S&P/TSX 60 Large Cap	-3.8	-4.5	-1.0	12.5	-1.9	27.9
S&P/TSX Mid Cap	-5.1	-7.0	-3.7	29.9	-1.7	41.7
S&P/TSX Small Cap	-6.8	-8.8	-4.3	33.8	-2.7	56.2
TSX	-4.1	-5.1	-1.6	15.8	-1.9	30.7

Source: Bloomberg

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