

Hungary Like the Bear

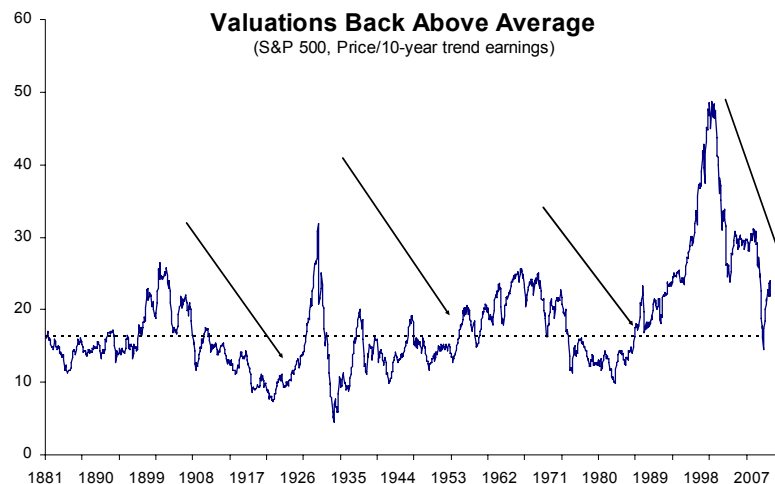
Equity markets fell this week, extending the correction that began in mid-April as sovereign debt concerns continued to swirl. This time, Hungary was the culprit, announcing a larger-than-expected deficit on Friday and saying that it had only a slim chance of avoiding a Greek-style crisis. Greece, Hungary, who's next? A wise person once said that there is never just one cockroach in the closet, and when the closet is the size of Europe, it has the makings of a long summer. Still, there was some good news lost in the flight from risk. Canada and the U.S. both added jobs in May (albeit fewer private-sector jobs than expected in the U.S.), Asian trade data continued to hint at strong demand, and the last of the Canadian banks to report beat earnings expectations. All told, the S&P 500 fell 2.3%, and is now almost 12% below the closing high set on April 23rd. The TSX fell a more modest 0.9%—energy stocks, which suddenly look like environmental saints, outperformed their U.S. counterparts.

Valuations... Equity markets continue to be challenged by concerns over the pace and sustainability of the global economic recovery. While most of the sentiment-related selling pressure is now likely behind us, challenges remain for stocks. For one, the bull market has matured and the sweetest part of the cycle for stock prices, the transition from recession to recovery, is behind us. Another new challenge is the fact that longer-term valuation metrics are again almost unanimously above their long-run norms. While further cyclical valuation expansion is certainly possible, this suggests that the pace of stock price appreciation is set to moderate.

Market Performance as of June 4, 2010

	Current Price	Performance (percent)					2009
		1 Week	1 Month	3 Months	1 Year	YTD	
NIKKEI 225	9,901	1.4	-10.5	-2.4	2.4	-6.1	19.0
DAX	5,939	-0.1	-1.1	2.5	17.3	-0.3	23.8
S&P/ASX 200	4,472	-0.1	-5.9	-6.0	13.7	-8.4	33.4
S&P/TSX	11,570	-0.9	-3.8	-2.2	10.4	-1.5	30.7
FTSE 100	5,126	-1.2	-5.3	-7.3	16.8	-5.3	22.1
NASDAQ	2,219	-1.7	-8.5	-3.2	20.0	-2.2	43.9
CAC 40	3,456	-1.7	-6.3	-9.7	4.3	-12.2	22.3
Dow Jones	9,931	-2.0	-9.1	-4.9	13.5	-4.8	18.8
S&P 500	1,065	-2.3	-9.3	-5.2	13.0	-4.5	23.5

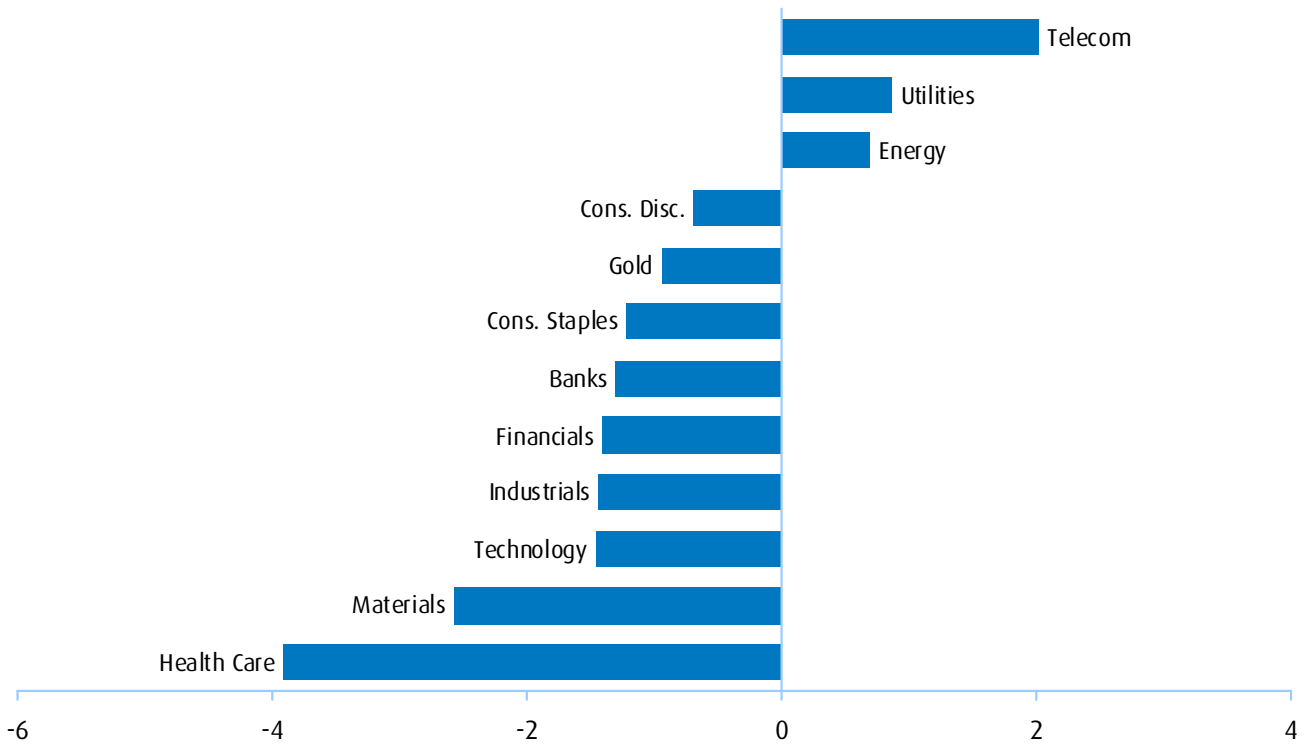
Source: Bloomberg



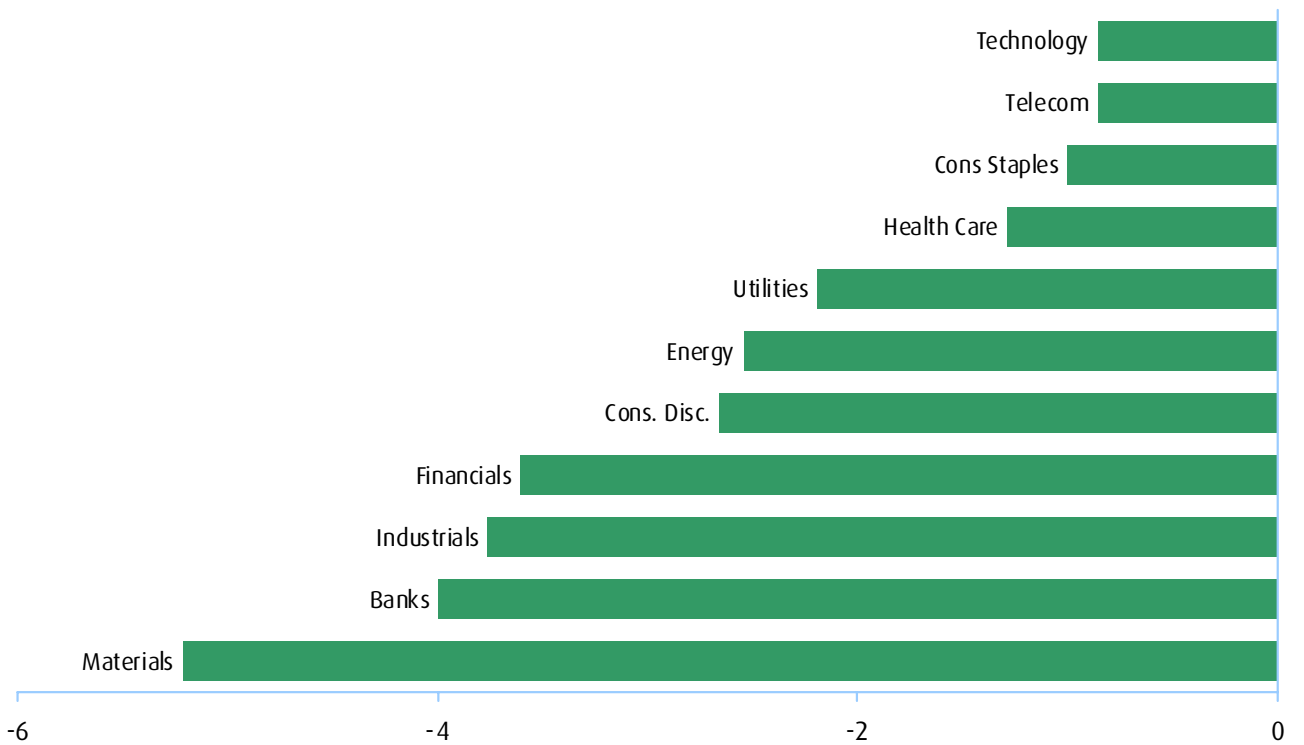
The purest long-term valuation measure is the price-to-trend earnings ratio, which now sits at 22 for the S&P 500 versus a long-run average of 18 and a low of about 14 in March 2009. Note that this type of expansion is not uncommon even at above-average valuation levels—similar behaviour was observed during the post-tech wreck cyclical bull market that stretched from 2002 to 2007. Indeed, tame inflation and a falling unemployment rate hint that the price-to-trend earnings ratio could drift higher still in the near term. Meantime, the S&P 500 market cap now represents about 68% of U.S. GDP. That's up from less than half when stocks bottomed last year and well above the 55% historical average. Also, Tobin's Q, which measures the market value of corporate equity relative to the replacement value of underlying assets, has behaved the same way, hinting that stocks are again on the expensive side if viewed from through a long-term lens. Overall, the message is equity valuations have room for more downside in the years ahead, even if we're currently enjoying a period of cyclical expansion.

Weekly Sector Performances as of June 4, 2010

TSX (percent)

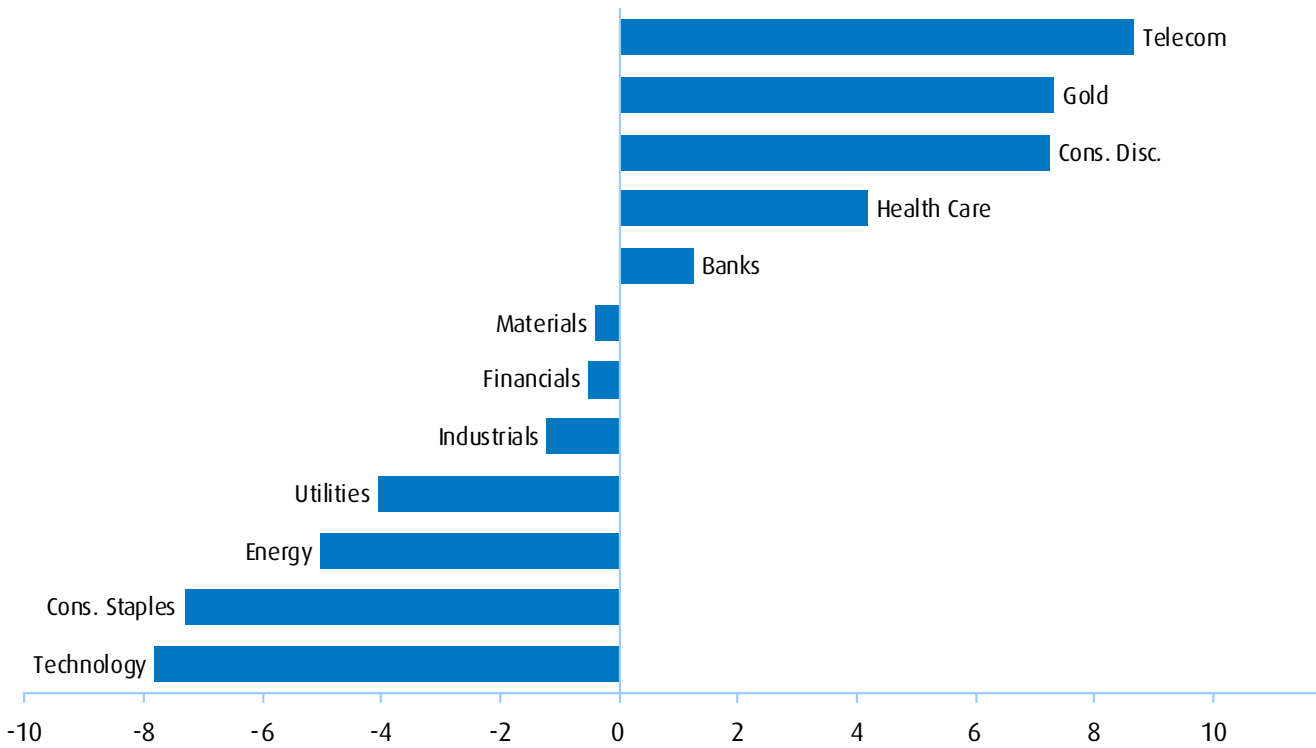


S&P 500 (percent)

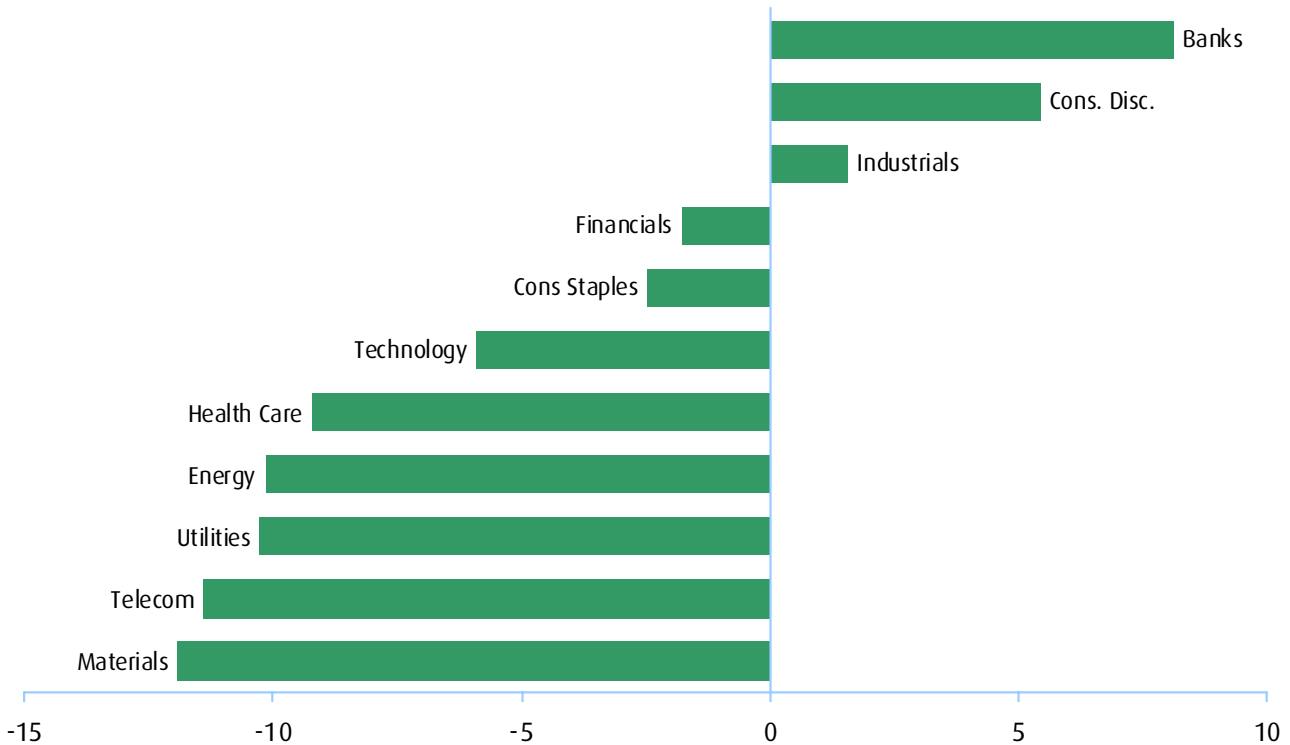


Year-to-Date Sector Performances as of June 4, 2010

TSX (percent)



S&P 500 (percent)



North American Sector Performances as of June 4, 2010

S&P 500 Sectors	1 Week	1 Month	3 Months	1 Year	YTD	2009
Information Technology	-0.9	-7.6	-3.0	21.4	-5.9	59.9
Telecom Services	-0.9	-4.2	-1.6	-0.7	-11.4	2.6
Cons Staples	-1.0	-5.3	-5.4	9.5	-2.5	11.2
Health Care	-1.3	-8.0	-10.2	10.2	-9.2	17.1
Utilities	-2.2	-7.7	-5.4	3.8	-10.3	6.8
Energy	-2.5	-12.6	-9.1	-3.9	-10.2	11.3
Cons Discretionary	-2.7	-8.8	0.9	31.0	5.5	38.8
Financials	-3.6	-11.7	-5.2	13.8	-1.8	14.8
Industrials	-3.8	-12.1	-3.4	20.2	1.6	17.3
Banks	-4.0	-14.2	-0.4	21.5	8.1	-8.9
Materials	-5.2	-11.2	-10.9	5.3	-11.9	45.2
S&P 100 Large Cap	-2.0	-9.6	-6.0	10.4	-6.0	19.1
S&P 400 Mid Cap	-3.5	-9.3	-3.0	23.3	1.3	35.0
S&P 600 Small Cap	-3.9	-10.3	-2.0	20.9	2.1	23.8
S&P 500	-2.3	-9.3	-5.2	13.0	-4.5	23.5

TSX Sectors

Telecom Services	2.0	1.8	6.2	17.1	8.7	0.7
Utilities	0.9	-1.0	-4.2	18.3	-4.1	12.7
Energy	0.7	-3.3	-1.3	4.4	-5.0	35.0
Cons Discretionary	-0.7	0.2	4.1	24.6	7.2	11.1
Gold	-0.9	0.9	7.8	10.0	7.3	5.7
Cons Staples	-1.2	-1.4	-7.5	3.2	-7.3	6.1
Banks	-1.3	-7.5	-2.1	23.7	1.3	54.4
Financials	-1.4	-6.2	-3.5	15.5	-0.5	38.3
Industrials	-1.4	-4.0	-2.5	21.1	-1.2	23.7
Information Technology	-1.5	-7.8	-10.7	-20.2	-7.8	44.3
Materials	-2.6	-2.9	-2.2	11.2	-0.4	33.4
Health Care	-3.9	-4.2	1.4	32.9	4.2	28.6
Income Trusts	-0.5	-3.8	-3.3	18.6	0.2	29.5
REITs	-1.2	-2.9	-2.0	29.5	0.6	42.4
S&P/TSX 60 Large Cap	-0.7	-3.9	-1.9	6.4	-1.9	27.9
S&P/TSX Small Cap	-0.9	-4.1	-2.5	33.0	0.1	56.2
S&P/TSX Mid Cap	-1.3	-3.7	-3.0	28.0	-0.1	41.7
TSX	-0.9	-3.8	-2.2	10.4	-1.5	30.7

Source: Bloomberg

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