



An investor's guide to 2011

Mark Jasayko and Neil McIver peer into our financial future; Higher gold and oil prices, flat stock markets among fearless forecasts

BY MARK JASAYKO AND NEIL MCIVER, SPECIAL TO THE SUN JANUARY 1, 2011

The global economy navigated through pretty rough waters during 2010 in the form of debt crises in Europe and Dubai, a "flash crash" in May, and some double-dip concerns with respect to the United States and global economies. However, there were plenty of bright spots. There are tentative signs governments' additional stimulus spending is working. Stock markets in particular responded favourably, despite the gold market reminding us that someday the bill will come due for all of this spent liquidity. There was also some cheer in the markets with respect to changing political winds in the U.S., particularly policies that are more kind to businesses and investors.

Early indications suggest this will be a year in which European government debt will be a source of anxiety and volatility. Mounting inflation pressures in China and the U.K. suggest that this will become a focus for investors and policy-makers. Finally, the success of stocks will depend upon how well companies adapt as governments begin to scale back their efforts to bail out the global economy. Here are some predictions on how a number of important aspects of the economy will fare this year:

Currencies

The U.S. dollar is still the currency of choice during panics as demonstrated during 2010. Expect the same for this year as the euro continues to struggle while the weaker EU members battle against bloating debt loads and rising interest rates.

Trade flows between Canada and the U.S. will continue to provide an anchor with respect to the exchange rate between the two currencies. If any global economic crises develop during

2011, the Canadian dollar will be pushed down to the 95-cent range as foreign investors rush to the U.S. dollar. If not, a Canadian dollar trading at par will be a common sight next year.

Stock markets

The significant exposure to natural resources continued to help the Canadian stock market this last year but will act as an anchor this year as the demand for those resources begins to slow to a more sustainable level. In addition, our large financial sector will see some headwinds as longer-term lending rates crawl higher. Expect flat to single-digit returns for the Canadian stock market.

In the U.S., liquidity in the form of government spending and close-to-zero short-term interest rates continued to support stocks. The new year will begin with an extension of tax cuts, which will add to investor optimism.

This optimism, coupled with the fact that U.S. stocks are trading in the lower half of their fair value range, should be enough fuel to power U.S. stocks to a gain of over 10 per cent.

Also, the third year of a presidential cycle is a good one on average.

Interest rates

Even though short-term rates are near zero in the U.S., long-term rates have risen by over one per cent since the beginning of November as bond investors fret about potential inflation resulting from printing money to pay for government spending.

This year promises to be volatile for long-term interest rates which will likely finish about half a percentage point higher than current levels. Canadian rates should follow a similar track.

Gold

Although gold received more media coverage in 2010, the No. 1 performing asset class over the last decade is still relatively unloved. The potential for fiscal and monetary crises can only help. Also, its limited supply usually does not get much attention.

The current market value of all the gold ever mined would still only pay half of the debt that the U.S. expects to accumulate over the next decade.

Partly based on that reasoning, gold came within \$75 of our forecast high of \$1,500 an ounce. This year, the price should flirt with \$1,700 at some point.

Crude oil

Oil is finishing 2010 slightly above the range that we had predicted.

The futures market suggests that oil could approach \$100 during 2011, which would represent a three-year high.

Although a less-than-vibrant global economy will keep a lid on prices, supply factors should keep prices in the \$90 range for most of the year.

Natural gas

Because of the difficulty of exporting natural gas to other continents, North American supply and demand issues dominate its price. North American winter weather is important. Last year, we predicted that heating demand would add to the price over the winter but that those gains would be given back once spring arrived. That's what happened and we expect the same price behaviour for 2011.

Grain/commodities

Food security for large emerging economies continues to be a hot-button issue and should continue to contribute to a slow and steady rise in grain prices as well as other food commodities.

Canadian real estate

In Canada's major urban centres, real estate prices are still at the affordability ceiling. However, in many other regions, prices have come down from record levels. Residential real estate, which is especially sensitive to mortgage rates, will face headwinds as longer-term interest rates rise. Additionally, Canadians are carrying record debt loads. Even a small rate rise will push a significant number of people out of the housing market. Expect nationwide declines in real estate prices, averaging about five per cent by the end of 2011.

Carbon credits/cap & trade

One of the biggest non-stories of the past year was the Cancun Global Warming summit. Notwithstanding the obvious irony of holding the event in a location popular with people trying to escape an icy winter, the lack of interest in the event underscores the fact that jobs and economic stability will always trump altruistic fantasies. There is falling public interest in

threatening the fragile global recovery with potentially costly social schemes. These items will not be an economic hurdle in the near future.

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