

# Outlook

Research & Recommendations with a Global view

ALLIANCE

DIRECT MANAGEMENT

January 2012

## Economic Trends & Developments

### Rising Equity Markets Greet New Year

Stock markets around the globe rallied sharply as 2012 trading got underway. Upward moves by Major indices in the U.S. were led by the NASDAQ amidst apparent bargain hunting following the December tax-loss selling period.

Most major indices elsewhere also moved higher, led by Brazil's Bovespa, which jumped more than 3% in the opening days of the New Year. Leading equity sectors in this early January rally included Materials, Financials and Hi Tech.

In the following chart of the Volatility Index "VIX", which we use as a dependable gauge of investor sentiment,

we see that investor anxiety has declined sharply in recent months. Low readings, in the 15 to 20 area, show a high level of investor confidence, while readings at the 35-45 level, and higher, show a high level of investor anxiety and fear.

Significant stock market rallies tend to launch when the VIX is at the lower levels, and given the steady downward trend in the VIX since early fall, we are decidedly bullish regarding equity markets in the near term.

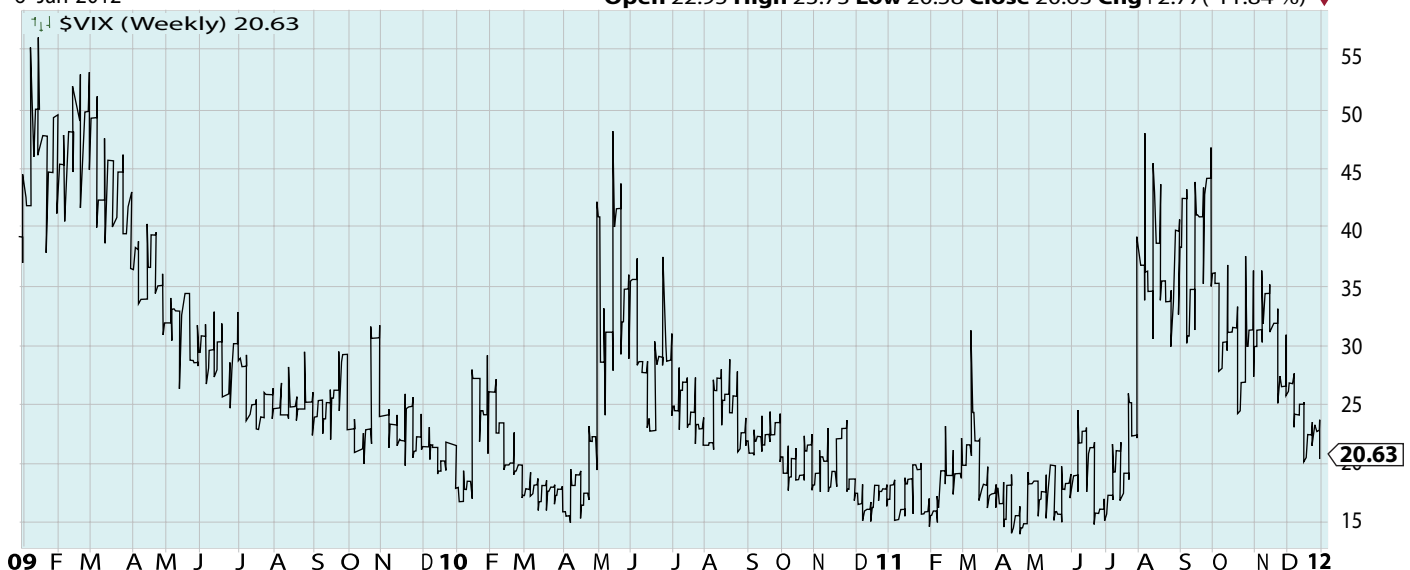
Following the sharp market correction that occurred from late April to early October, 2011, Alliance Direct

believes that resumption of the cyclical bull since October, coupled with the steady rise in investor sentiment, augurs well for equity performance in 2012.

A continued decline in the VIX in the near term would further bolster the positive 2012 outlook for stock markets and increasingly attract the huge amount of funds that has been sitting on the sidelines awaiting this return of confidence. Encouragingly, this brighter investment outlook is supported by improving economic fundamentals.

**\$VIX (Volatility Index - New Methodology) INDX**  
6-Jan-2012

Open 22.95 High 23.73 Low 20.58 Close 20.63 Chg +2.77(-11.84%) ▼



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# U.S. Economic Recovery Persists

Positive signals on the U.S. economic front lend increasing support to a brightening outlook for the world's largest economy in the months ahead. While a U.S. recession in 2012 is not yet out of the question, there are many reasons to favour the "continuing recovery" scenario.

Unemployment continues to decline while manufacturing is on the rise. Auto sales were very strong in the last two months of the year and construction activity has turned upward. Significantly, 2012 is a presidential election year and we believe that the White House will do everything in its power in the months ahead to improve consumer and investor confidence; such an improving trend will very much favour the incumbent, as it generally does.

We will not be surprised to see the introduction of another bout of Quantitative Easing in late spring or through the summer to accelerate the improvement in confidence and underpin a nice market rally leading up to the election.

A majority of investment analysts are expecting QE3 and, while this may be a bit of wishful thinking on their part, given the boost to stock markets that would be provided by additional QE,

the Fed has repeatedly spoken of its readiness to step in with such a program if it feels it is needed to head off any potential reversal in the economic recovery.

## Employment Picture Brightens

As this report was being readied for publication, it was announced that the U.S. employment rate had fallen to 8.5% - the lowest since February 2009 - as companies added 200,000 jobs in the month of December.

Coupled with the news that weekly applications for unemployment benefits had fallen to levels last seen in 2008, Alliance Direct's bullish outlook for the economy and stock markets in 2012 is further enhanced.

Since the campaign for a Republican presidential nominee began many months ago, the media and most other observers have declared that the No. 1 issue in the U.S. presidential campaign would be "jobs, jobs, jobs".

If we should see steadily rising employment numbers over the next three quarters, we believe it would go a long way towards ensuring a second term for President Obama. 2011 saw significant improvement in the jobs numbers, and 2012 appears poised to continue, and possibly accelerate, this improving trend.

United States: Monthly Data

Data Series	Back Data	July 2011	Aug 2011	Sept 2011	Oct 2011	Nov 2011	Dec 2011
<a href="#">Unemployment Rate (1)</a>		9.1	9.1	9.0	8.9	8.7	8.
<a href="#">Change in Payroll Employment (2)</a>		127	104	210	112	(P) 100	(P) 20
<a href="#">Average Hourly Earnings (3)</a>		23.12	23.08	23.13	23.20	(P) 23.20	(P) 23.2
<a href="#">Consumer Price Index (4)</a>		0.5	0.4	0.3	-0.1	0.0	
<a href="#">Producer Price Index (5)</a>		0.3	(P) 0.1	(P) 0.8	(P) -0.3	(P) 0.3	
<a href="#">U.S. Import Price Index (6)</a>		0.1	-0.4	(R) -0.1	(R) -0.5	(R) 0.7	

U.S. Bureau of Labor Statisti

The U.S. economy generated at least a 100,000 jobs each month in the six month period ended in December, the first time it has accomplished that since 2005-06. The December hiring was broadly based across all major industry groups, including construction.

Also significant was the fact that average hourly pay rose, as did the average length of the work week.

# No Hard Landing for China

Amidst much clamoring over the past year regarding the coming demise of China's robust economic growth, Chinese officials have apparently demonstrated their ability to accomplish two immediate economic priorities: (1) they have managed to reverse what had become a worrisome trend of economic over-heating & inflation and (2) they achieved this taming of inflation without sending their huge economy into a free-fall. After a lengthy period of rising reserve requirements for Chinese banks, the government in December lowered the reserve requirements. This "easing" stance implies that overhe-

ating has been contained, and that growth is once again the primary economic policy objective. China's growth rate in 2012 will moderate, but it will remain the envy of most major countries. The following matrix published by China's National Bureau of Statistics illustrates the high level of stability in many of China's key economic and financial sectors.

Rising consumer-sector growth in China is gradually lessening the country's dependence on export growth; this is perhaps the most important - and most promising - trend we see in China today, particularly as

it affects the global economy. China and the other BRIC countries, as well as most other Asian nations, continue to lend strong support to the world economy, and the U.S. recovery is clearly adding to the improving global picture.

Fears of a hard landing in China, i.e. a rapid slowdown approaching recessionary levels, appear to be unfounded today and we expect that the pundits in the financial media will quickly turn their attention to other real and/or perceived problem areas in the global economic picture.

## China's Leadership Changes

This year will see the Communist Party of China elect a new Central Committee at its 18th National Congress in the second half. In turn, this Central Committee will appoint 7 new members to the Politburo Standing Committee "PSC", generally seen as the primary leadership team in the country – where the major decisions are taken. In this major transition of the PSC, President Hu Jintao and

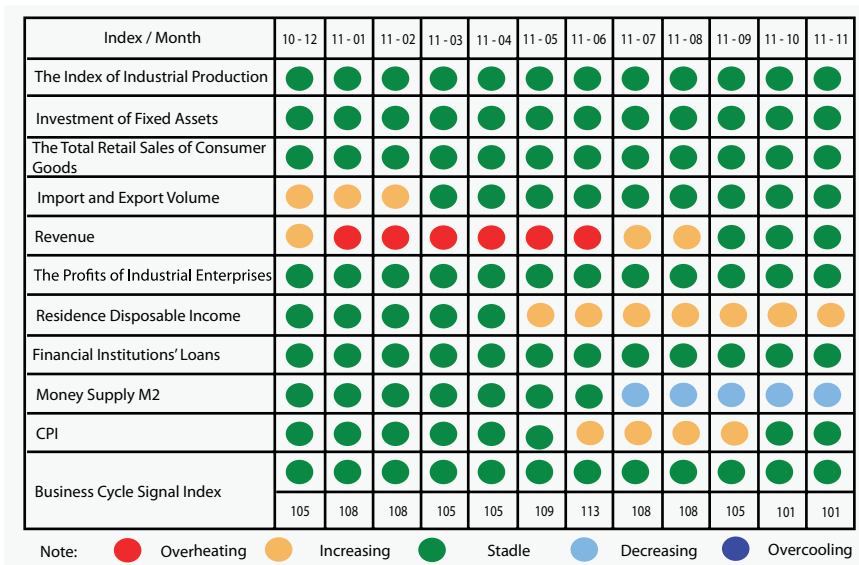
Premier Wen Jiabao will each be replaced by, respectively, Xi Jinping and Li Keqiang, who were selected by the predecessors of Hu Jintao and Wen Jiabao. These transitions are not sudden or in any sense radical; they have been planned for years; and the outgoing Hu Jintao and Wen Jiabao will continue to exert major influence on the deliberations and decisions of the PSC and, in time, will select the replacements of these two new appointees. At any given time,

at least three generations of top level leaders/past leaders are involved in the affairs of the State. Primary government objectives in China at this time are (1) the promotion of growth in the internal, consumer-led economy, (2) the furthering of China's presence and stature in global free markets and, (3) maintaining and nurturing, above all else, social stability.

Alliance Direct anticipates no abrupt changes in Chinese government policies, but we do expect to see a steadier rise in the strength of China's currency, the renminbi "RMB", in the foreseeable future as the country attempts to maintain price stability and thus limit inflation in order to keep China's long term growth trajectory on track while improving the standard of living for its people.

In this scenario, we remain confident that the global bull market for commodities will persist for many years. This outlook favours that "ABC" triumvirate of major commodities-exporting countries; Australia, Brazil and Canada.

**China's Macro-Economic Climate Index (Dec. 2010 – Nov. 2011)**



## Concerns over EU Problems to Abate?

While the financial problems in several EU countries are a long way from being solved, Alliance Direct anticipates that the constant news and the fears being expressed in the investment community and in the financial news media will quiet down somewhat in the months ahead; EU leaders have suggested the creation of a Eurozone fiscal union which would encompass strict and enforceable rules to contain debt

levels for all members and pave the way for comprehensive reform and re-building. The current hope is that this will be accomplished in the very near future. If politicians cannot see their way clear to endorse such a regional program (in conjunction with various forms of financial assistance/rescue) then it appears that a Eurozone of a somewhat different shape may be the only alternative. Either way, we believe that 2012 will see

a major change that will assuage global financial markets and bring about a healthier, more optimistic investment climate for 2012.

It appears that the powers-that-be in the EU have finally arrived on common ground whereby solutions may be at hand. The photo is a scene from one of the many high level EU meetings held in 2011 in an attempt to wrestle the region's problems towards an acceptable solution. As usual at these meetings, German Chancellor Angela Merkel is at the center of the proceedings in light of Germany's stature as the most powerful economy in the EU.



## Commodities Boom Fuels Exploration

Two macro trends over the past 2-3 decades have together spawned a dynamic long term boom for all manner of commodities:

(1) A 20+-year slump in mineral exploration & development owing to weak metals prices that saw the discovery and development of world-class mineral deposits decline steadily in the face of modest demand. This dramatically lowered long term, readily available supplies and set the stage for critical shortages and higher prices in the event that demand were to rise significantly, and;

(2) A protracted period since the 1970s that saw China, and numerous other "emerging" nations embark on industrial modernization that would bring about unprecedented growth in demand for the entire range of basic materials, including metals, exceeding even the most optimistic and prescient forecasts.

To this day, long term secure sources of many minerals remain woefully inadequate in light of growth expectations. The unquestionably bright outlook for all manner of basic commodities in the years ahead is evidenced by the strong commitment of investment in exploration and development of new sources of natural resources and agricultural products to support global growth. Exploration growth is driven by rising demand and prices as global consumption moves ever higher. Alliance Direct has a very positive stance towards commodities demand and prices in the long term, and is accordingly very bullish on the outlook for metals and energy exploration and development equities in 2012.

### Metals Exploration

Over the past couple of years, more than half of global mineral exploration has focused on gold in light of that metal's soaring price and relative scarcity of new deposits. Large gold producers such as world leader

Barrick must find enormous amounts of gold in newly discovered deposits and develop such deposits in order to sustain production levels in the years ahead. The requirement for new gold sources has fuelled an all-out exploration drive by companies of all sizes. While final figures for 2011 are not yet in, it is estimated that spending on gold exploration reached a record high approaching \$8.7 billion, or >50% of the total spending on non-ferrous mineral exploration for the year. Canada was the leading country for gold exploration expenditures in 2011 owing to its vast natural resources wealth and its preferred status in terms of political "security" and rule-of-law. Other regions of strong gold exploration include Latin America and West Africa. The strong performance of global silver prices in 2011 also fuelled a sharp rise in exploration spending for this widely popular store-of-value metal that also boasts a steadily growing number of critically important industrial applications.



**Photo : Airborne Geophysical survey by Geotech seeks new mineral deposits.**

Global copper exploration expenditures of about \$3.5 billion in 2011 will have achieved a new historic record. The year 2011 also saw robust levels of spending on exploration and development of many other metals, including Rare Earth Elements ("REEs"), base metals such as zinc and lead,

as well as less common metals such as molybdenum, lithium, chromium and indium which are similarly experiencing growing world usage.

### Energy Exploration & Development

Consumption of oil and natural gas has skyrocketed among the major emerging economies - and most other smaller nations - keeping prices high and boosting exploration/development activity to record levels. Alliance Direct anticipates steadily rising crude oil prices as the global economy strengthens in the years ahead, and believes that many junior and mid-sized oil & gas companies offer extraordinary growth potential as they find and produce from new petroleum sources, both onshore and offshore. As well, the Oil Service sector is poised for rapid growth during this long term petroleum industry boom.

In North America, new technologies such as horizontal drilling and multi-fracing have seen an explosion in natural gas supplies, virtually overnight, to levels that would fulfill generations of demand. This has led to a large surplus of natural gas in the U.S. and prices have slumped to multiyear lows under \$3.00 per mcf.

Meanwhile, natural gas prices in Europe, Asia and in many other regions are several times that of the North American price, with no end in sight. The U.S. has an opportunity to solve its energy-shortage problems and save hundreds of billions of dollars annually if it can efficiently convert much of its imported crude oil usage to natural gas. It is not rocket science to do this, but the major barrier appears to be politics/big business.