

Markets are now in a consolidation phase after the strong up move of the last six months. There is more of an air of optimism around, but still a nervousness that some major negative may be around the corner. The optimism springs from a sense that the worst of the recession is behind us, particularly in the U.S. We, however, are not as positive as some others on how strong growth will be in the next eighteen months. World markets have become much more sanguine though, about negative news. Last year markets were in turmoil with concerns about a Greek default. After many struggles, the Eurozone leaders threw money into the pot to avoid such a calamity. The European Central Bank has faced reality and, like the U.S. Fed, realized the risks of not bailing out the bankrupt are too great. This year's problem nation appears to be Spain, which is a much larger economy than Greece. But unlike last year, markets seem immune to such turmoil, feeling another bail-out will be forthcoming if required.

So with all world's central banks ready and willing to add liquidity if any problems arise, investors have become more confident. Over the last three years the combined liquidity added to the system by all central banks amounts to over \$9 trillion. As one writer put it, that's enough to have bought every person in the world a 55" 3D tv set. Someday the piper must be paid, but there is no evidence that day can't be pushed still further into the future.

Still, many questions remain about where we are headed in the next year or so. In no particular order of importance, let's consider some of them and their impact on the economy and markets.

The U.S. election in November will certainly require our attention. Republicans and Democrats have two very different views on how to address America's economic problems. The party that sits in Congress and the White House will have the power to change how the budget deficit and debt costs will be addressed. To overly simplify, the Republicans will want to cut spending, while Democrats will attempt to increase revenues. Each has its risks. Reduced spending would lower demand in the economy, but so too will higher taxes. In particular, higher taxes on capital gains and/or dividends will impact investment decisions. In the short term, expiring tax incentives as of January 2013 would lower GDP by as much as 5% and must be dealt with immediately in the new-year. Longer term, social security, Medicare and Medicaid spending has to be dealt with.

French elections will be held in the next few months. The Socialist party opposition is slightly ahead in polls, and has campaigned on a platform that includes being less generous to the weaker members of the Eurozone, which would be cause for concern.

The Middle East continues to be a hotbed of unrest. Iran and Syria are concerns, but perhaps more of a swing factor is Egypt. A new government that is secular and moderate could form a coalition with Saudi Arabia to bring more order to the region. On the other hand a government closer to Iran and anti-Israel would suggest more dis-harmony.

China is passing the baton to a new group of leaders this year in the midst of a relatively slower growing economy. As with many things in China, it is still a question mark as to what their policy stance will be; hopefully not back to hardline politics. Everyone still counts on China to be a driving force for world economic growth, not least would be Canada.

There are more questions but fewer answers. In closing, here is an interesting statistic on market valuation brought to our attention by Strategas Group. Since the bottom of the S&P 500 in 2009, earnings for the index constituents are up 95%; however revenues have only increased 1%. This has not been a demand driven turnaround for companies but one dependent on cost-cutting. Nevertheless, the flood of excess liquidity in the system has to go somewhere, and the financial markets are the beneficiary. As one commentator put it, *"there are a lot of hammers and not many nails"*.