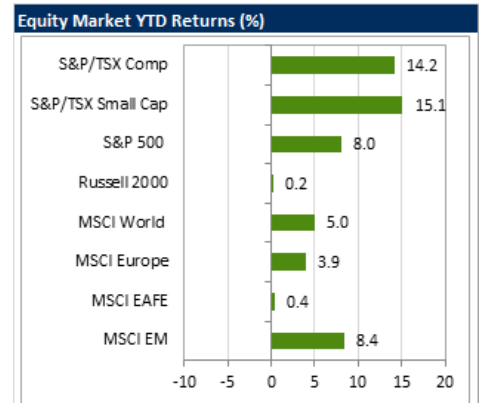


## Round Numbers

- The S&P 500 Index (S&P 500) hit another important milestone, with the index breaching the round number of 2,000 for the first time. Interestingly, the 2,000 level on the S&P 500 translates into a perfectly round 200% gain since the intraday March 2009 lows.
- The US Federal Reserve (Fed) is expected to end its asset purchases in October, which could leave the stock market vulnerable to a pullback given the historical experience of previous rounds of quantitative easing (QE) ending. But given the accelerating US economy we believe any weakness should be short lived.
- The US labour market continues to improve with monthly nonfarm payrolls of 200,000+ over the last six months, the longest streak since 1997. Additionally, initial jobless claims have trended consistently lower with the 4-week moving average hitting a round number of 300,000 for the week ending of August 22.
- The continued job gains in the US labour market reflects the gradually improving US economy and the very low probability of a US recession over the next 12 to 18 months. This view is particularly germane given the historical relationship between recessions and equity bear markets.
- The European economy seems to be going the other way, with economic growth stalling in Q2/14. With deflationary pressures mounting, officials are likely to implement QE in the coming months, keeping the liquidity spigot open.

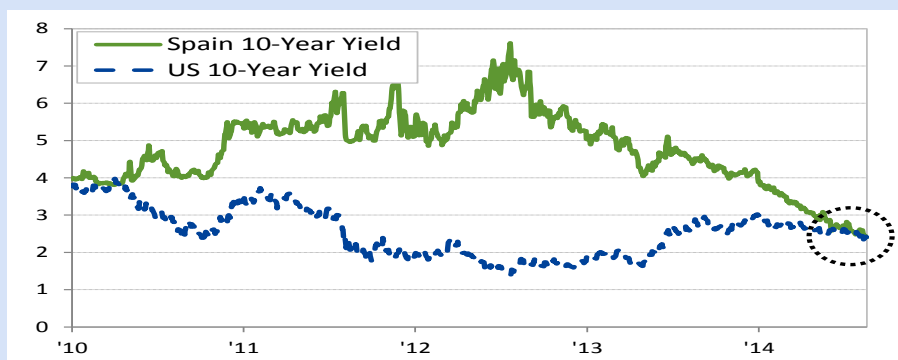


Canadian Sector	Curr. Wt	Recommendation
Consumer Discretionary	5.6	Market weight
Consumer Staples	2.8	Market weight
Energy	26.4	Overweight
Financials	34.3	Overweight
Health Care	2.6	Underweight
Industrials	8.2	Overweight
Information Technology	1.8	Overweight
Materials	12.0	Market weight
Telecom	4.4	Underweight
Utilities	1.9	Underweight

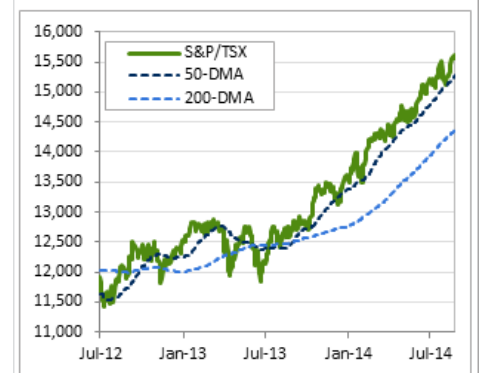
Technical Considerations	Level	Reading
S&P/TSX Composite	15,558.2	
50-DMA	15,274.2	Uptrend
200-DMA	14,373.6	Uptrend
RSI (14-day)	63.9	Neutral

### Chart of the Week

Spain Bond Yields Are Trading Below US Bond Yields.  
A Clear Sign of Deflationary Pressures in the Europe.



Source: Bloomberg, Raymond James Ltd.



Source: Bloomberg, Raymond James Ltd.

Please read domestic and foreign disclosure/risk information beginning on page 5

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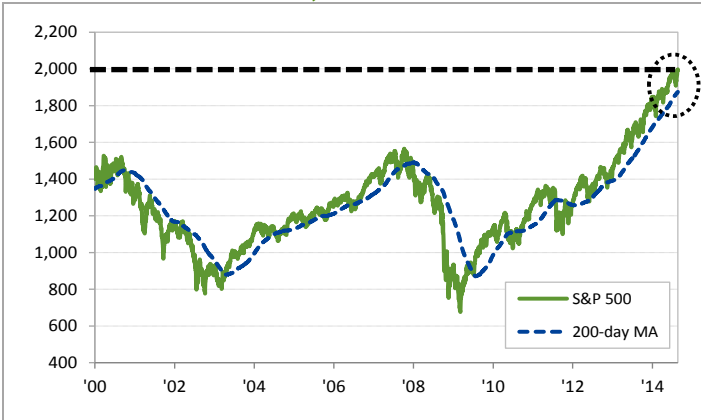
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### Round Numbers

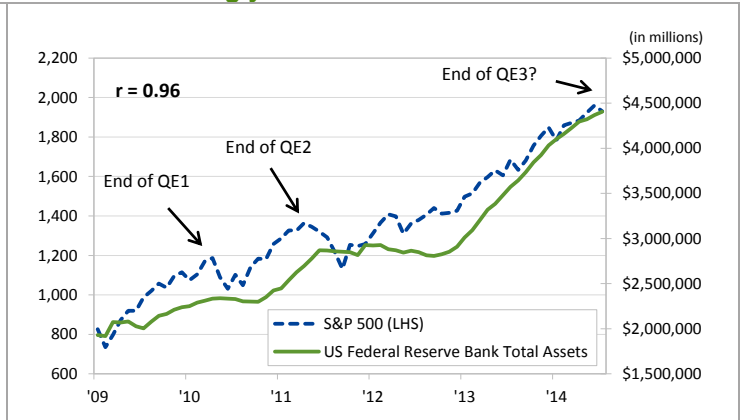
This week the S&P 500 hit another important milestone, with the index breaching the round number of 2,000 for the first time. Interestingly, the 2,000 level on the S&P 500 translates into a perfectly round 200% gain since the intraday March 2009 lows of 666. I've always found it fascinating that the S&P 500 bottomed, to the point, at the notorious occult number of 666. The North American (NA) equity markets continue to grind higher, much to the chagrin of the market doomsayers who consistently beat the drum that the market top is nigh, and correction imminent. We, on the other hand, have maintained a bullish view for much of this bull run and do not deviate from this current view even in light of these new milestones. That said, as we transition into the fall, we believe equity markets are approaching a critical juncture that could dictate stock market performance in the coming quarters and signal whether this current bull market has more room to run, or as the bears have prognosticated for months, that the market top is in fact nigh.

We are strong believers that the equity market gains over the last 5.5 years have been driven by a combination of improving economic and fundamental conditions and the very accommodative monetary actions taken by the Fed and other global central banks. We believe that the NA and global economy continues to heal and slowly improve following the Great Financial Crisis, which has and should continue to lead to stronger corporate earnings. For example, S&P 500 trailing earnings have rebounded from a low of roughly US\$45/share in late 2009, to US\$111/share today. If, as we've conveyed in recent reports, corporate earnings are the key driver of long-term equity returns, then surely a more than doubling of corporate profits must be bullish and supportive of stock prices. But, it is hard to refute the importance of the QE policies on stock prices during this rally. The Fed has implemented three rounds of QE in efforts to drive down bond yields and engender a wealth effect through asset price inflation. During the last two iterations of QE, the stock market rallied strongly before pulling back shortly after the end of each program. Moreover, we note that the correlation between the Fed's expanding balance sheet and rise in the S&P 500 is a very high 0.96. With the Fed expected to end its asset purchases in October, the stock market could be vulnerable to a pullback given the historical experience of previous QEs. But we believe any potential weakness should be short lived and prove to be another buying opportunity.

**S&P 500 Breaches the 2,000 Level**



**S&P 500 is Strongly Correlated with Fed Balance Sheet**



Source: Bloomberg, Raymond James Ltd.

### Improving US Labour Market

There is a strong positive feedback loop with labour markets where job growth leads to increased spending, which leads to stronger corporate sales and profits, which then leads to further job gains. We believe we are beginning to see this in the US where monthly nonfarm payrolls have been 200,000+ over the last six months, the longest streak since 1997. Since the 2009 recession, the US labour market has shown inconsistent gains, with notable slowdowns during the summer of 2010 through 2012. However, over the last year monthly job gains have become more consistent averaging 211,000 year-to-date, up from the average 196,000 in 2013. With the decent job gains the unemployment rate has declined from a peak of 10% in 2009 to 6.2% currently. While some of the decline in the unemployment rate can be attributed to a lower participation rate as workers drop out of the labour force, the 8 million jobs created since the end of the recession has greatly contributed to the drop in the unemployment rate.

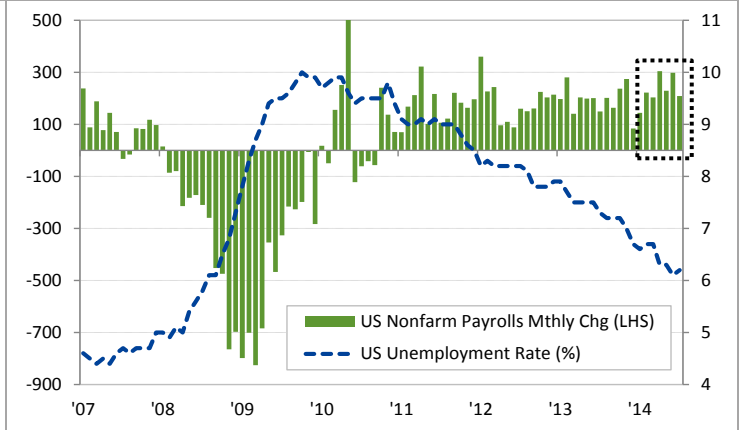
Looking at US initial jobless claims, a good leading indicator of the US labour market, it tells much the same story as they have trended consistently lower since the 2009 peak. In fact, looking at another round number, the 4-week moving average of US jobless claims hit 300,000 for the week ending of August 22, the lowest level since 2006. Now it's not all roses in the US labour market with anemic wage growth, a high U6 unemployment rate (includes those underemployed) and clear signs of structural problems (e.g., skills mismatch). This is why the Fed has been reluctant to hike interest rates and adopt a more hawkish stance. We believe the Fed is likely to maintain its accommodative stance until the unemployment rate hits sub-5.5%, which by our calculations could be H1/15.

In sum, the continued improvement in the US labour market reflects the gradually improving US economy and the very low probability of a US recession over the next 12 to 18 months, in our opinion. This view is particularly germane given the historical relationship between recessions and equity bear markets.

#### Initial Jobless Claims Hits New Lows of 300,000



#### Job Gains are Driving Unemployment Rate Lower



Source: Bloomberg, Raymond James Ltd.

**Europe Next to Follow with QE?**

While the US economy is accelerating, the European economy seems to be going the other way, with economic growth stalling in the second quarter. Eurozone GDP declined to flat (0%) growth in Q2/14, from a modest gain of 0.2% in Q1/14. This negative trend has continued in Q3, with PMIs, industrial production and confidence measures all trending lower. More concerning is the growing deflationary pressures in the Eurozone, which is impelling policy officials to take further action. Eurozone inflation peaked at 3% in 2011 and currently stands at 0.4% y/y. Even more concerning to officials are market-based inflation expectations, which have “de-anchored” from the European Central Bank’s (ECB) 2% inflation target. This is what ECB President Mario Draghi referred to in his recent speech at Jackson Hole when he stated “the Governing Council will acknowledge these developments and within its mandate will use all available instruments needed to ensure price stability.” His comments last week were the strongest indication yet that the ECB could implement QE. Following the speech, large US investment firm PIMCO predicted that the ECB could implement QE in Q1/15.

Given weak economic growth, declining inflation, and clear signals from the ECB that they are getting closer to QE, Eurozone sovereign bond yields have declined precipitously in recent months, with many European sovereign bond yields now below the US. For example, Spain’s 10-year bond yield declined to 2.4% on August 21, which was equivalent to the US 10-year yield, resulting in a 0% spread. We find this particularly disconcerting given: 1) Spain’s unemployment rate is 25% versus the US unemployment rate of 6.2%; and 2) Spain’s 10-year yield hit a peak of 7.6% in July 2012, with little economic improvement since then to support the tightening of spreads. Clearly, the prospect of deflationary pressures is rattling investors, as they disregard the inherent risks of weak sovereign debt by the peripheral European nations. We’ve seen this story before with a less than desired outcome.

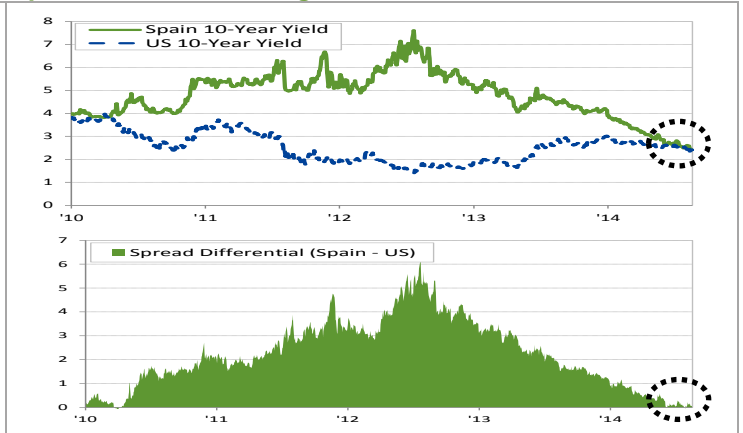
**Conclusion**

The US economy is improving which is triggering the Fed to curtail and soon end its QE3 program. Europe, however, is weakening which will likely lead to the ECB implementing its own QE. With continued elevated global liquidity, along with an improving US economy we see little evidence of a looming US recession and therefore maintain our positive investment outlook.

**Deflationary Pressures Are Building in the Eurozone**



**Spain Yields Are Hitting New Lows Versus US**



Source: Bloomberg, Raymond James Ltd.

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