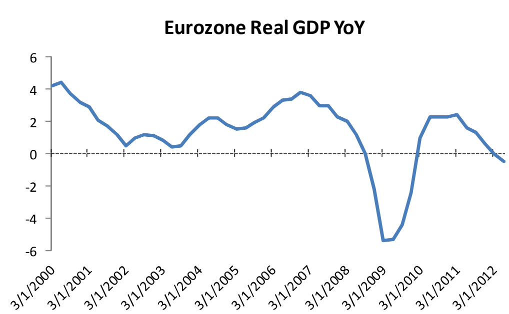
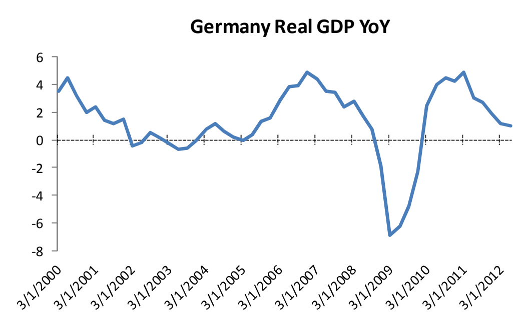
The conflict between fundamentals and liquidity is being won hands down by the easing policies of the world's central banks. Over the past seven years the money supply of the US has increased by 55%; the Eurozone by 50%; and China by 245%. This monetary expansion continues and has been combined with government mandated low interest rates and what Mr. Bernanke, Chairman of the U.S. Federal Reserve, describes as "extraordinary actions" and "nontraditional tools". Given that world economies are at best stagnant, and that corporate demand for funds is almost nonexistent, this great pool of excess liquidity has found a home in financial markets. In addition, the group of assets that can be considered safe (if only on a relative basis) is becoming smaller and smaller. The number one safe haven is the US, and both treasury bonds and stock markets are benefitting from this increased demand. Still the fundamentals must be dealt with at some point, and most of them remain negative or at least concerning.

Europe

European Central Bank head Mario Draghi has made a concerted effort to save the Euro and the Union by announcing the bank's intention to buy the short term sovereign bonds of the weaker nations, such as Spain and Italy. This would ideally keep interest rates low enough to buy time while those countries deal with their economic and debt problems. It is a long way from proposing such a plan and making it work. First, the countries involved must formally request the aid and agree to some austerity measures. Secondly, certain countries, particularly Germany, have serious concerns about such a policy. And finally, implementation will take time and success is by no means guaranteed. Nevertheless, it is very positive that Europe is finally recognizing that real change in policy is required. We are also pleased that discussions on a closer fiscal and banking Union are on the table as well.

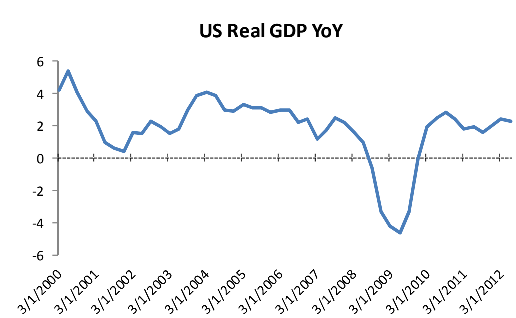
This does not mitigate the fact that the Union is slipping into recession. GDP in Spain was down 0.4% in the second quarter, Italy was down 0.7%, and the OECD predicts even Germany will be in negative territory in the second half of 2012. This should cause Germany to realize it must be more amenable to helping the weaker members of the Union if only for its own sake.





US

Compared to Europe the US looks the picture of health, but quarterly GDP growth remains below 2% and unemployment above 8%. Mr. Bernanke, in his Jackson Hole speech, called the economy "far from satisfactory" and that "insurance against downside risks" is required. Still the economy is improving, if slowly, and corporate America is in good financial health.



The November election will be important to determine the direction of the economic, tax, and regulatory policies for the foreseeable future in that country. Uncertainty is never a good thing, and the problems are very real, but most forecasts assume some compromise will be reached between Democrats and Republicans on methods to deal with the budget deficit, the "fiscal cliff", and the debt ceiling. When is open to conjecture, but the pressure will be felt immediately following the election. The possibilities are endless depending on which party controls the White House and Congress, but it is safe to say that the market will be happier if Republican policies have the edge. When the seriousness of the short and long-term issues to be confronted in the next 6-12 months the risks of a misstep are heightened and so too are the risks to financial markets.

The Congressional Budget Office recently released its midyear report which made for a chilling read. Under "current law" (the fiscal cliff happens) the economy would shrink by 2.9% in the first half of 2013 and unemployment would reach 9.1% in 2014. The good news "?", is that after the suffering, the budget would be in surplus by 2048! A more realistic outlook the report also provides would suggest a better near term economy but a worse longer term. Pick your poison.

China

China, one of the world's largest economies, is definitely in a slowdown. Expectations for the second half of this year are for reported GDP growth of 7%. In reality it will likely be significantly lower, given trade and output data such as July exports to Europe being down 16%. Even the Vice Premier admits official GDP data is "man-made" and "for reference only". The country is in a "catch 22" situation where the rest of the world is counting on growth in China, but China needs more from the rest of the world for itself to grow.

It is of some interest that Europe is hoping for help from China, but income per capital is still 3–4 times larger in Greece than in China (World Bank and IMF data).

Canada

Canada remains at the mercy, in many respects, of world economic events. Slowing global growth is negative for the economy but the easing policies of global central banks are positive for commodity prices and the Canadian economy. The Bank of Canada is one of the few central banks in the world suggesting a tighter policy may be forthcoming. To quote Mr. Carney "*modest withdrawal of …….stimulus may become appropriate*". Such a change in policy would be a drag on growth.

The collapse of Long Term Capital Management in 1999 was probably the watershed event that marked a new era where so many long-held theories about economics and financial markets have been found wanting. You may recall LTCM was managed by several PHD's who were considered some of the brightest minds in finance. After deep research they determined there was less than a 1% chance of their investments losing money. However the company was wiped out, the financial system teetered, and we all discovered what a "black swan" event was. The economic theories of Keynes and the relationship between interest rates and price/earnings multiples are but two examples of axioms called into question in the last decade. One adage that has so far remained worthwhile: "don't fight with the fed". (And now maybe "don't fight the ECB"). The point being; don't ignore, but be careful and cynical of economic and market forecasts that are based on historical precedents (such as "this always/never happens").