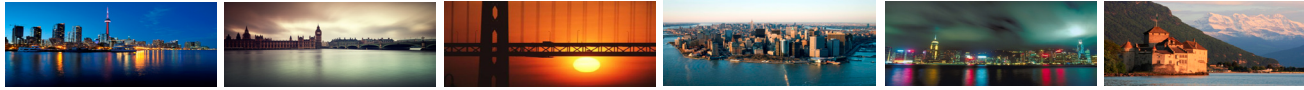


RBC Wealth Management | Global Insight Weekly



- » Most equity markets traded lower for the second-straight week. European risks dominated investors' attention.
- » For Greece, an “orderly exit” from the Eurozone is like an oxymoron. (page 2)
- » While we’ve been quite cautious about Europe for a long time, some perspective is in order. (page 3)
- » Global Roundup: Updates from the U.S., Canada, Europe, and Asia. (pages 3-4).

Equity Scorecard – May 11, 2012

Index (local currency)	Level	Weekly	MTD	YTD
S&P 500	1,353.41	-1.2%	-3.2%	7.6%
S&P/TSX Comp	11,681.26	-1.6%	-5.0%	-2.3%
FTSE 100	5,575.52	-1.4%	-2.8%	0.1%
Hang Seng	19,964.63	-5.3%	-5.4%	8.3%
Dow (DJIA)	12,820.60	-1.7%	-3.0%	4.9%
NASDAQ	2,933.82	-0.8%	-3.7%	12.6%
Russell 2000	790.06	-0.2%	-3.3%	6.6%
STOXX Europe 600	251.97	-0.4%	-2.1%	3.0%
German DAX	6,579.93	0.3%	-2.7%	11.6%
Nikkei 225	8,953.31	-4.6%	-6.0%	5.9%
Straits Times	2,883.40	-3.6%	-3.2%	9.0%
Shanghai Comp	2,394.98	-2.3%	-0.1%	8.9%
Brazil Bovespa	59,436.71	-2.2%	-3.8%	4.8%

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All values in U.S. dollars unless otherwise noted.
 Priced as of May 11, 2012, market close
 (unless otherwise stated).
 For Important Disclosures, see pages 5-6.

Markets & the Economy

Market Scorecard – May 11, 2012

Bond Yields	5/11/12	5/4/12	12/30/11	YTD Chg
US 2-Yr Tsy	0.258%	0.254%	0.239%	0.02%
US 10-Yr Tsy	1.843%	1.879%	1.876%	-0.03%
Canada 2-Yr	1.300%	1.254%	0.956%	0.34%
Canada 10-Yr	1.969%	2.020%	1.941%	0.03%
UK 2-Yr	0.404%	0.404%	0.327%	0.08%
UK 10-Yr	1.963%	1.996%	1.977%	-0.01%
Germany 2-Yr	0.091%	0.082%	0.144%	-0.05%
Germany 10-Yr	1.516%	1.584%	1.829%	-0.31%
Commodities (USD)	Price	Weekly	MTD	YTD
Gold (spot \$/oz)	1,580.73	-3.7%	-5.0%	1.1%
Silver (spot \$/oz)	28.89	-4.9%	-6.9%	3.8%
Copper (\$/ton)	8,207.00	-0.6%	-3.8%	8.1%
Oil (WTI spot/bbl)	96.13	-2.4%	-8.3%	-2.7%
Oil (Brent spot/bbl)	112.51	-1.0%	-6.5%	3.5%
Natural Gas (\$/mBtu)	2.37	2.8%	13.0%	-20.6%
Agriculture Index	410.24	-2.8%	-5.8%	-5.6%
Currencies	Rate	Weekly	MTD	YTD
US Dollar Index	80.28	0.98%	1.9%	0.1%
CAD/USD	1.00	-0.56%	-1.4%	2.1%
USD/CAD	1.00	0.46%	1.4%	-2.0%
EUR/USD	1.29	-1.26%	-2.4%	-0.3%
GBP/USD	1.61	-0.51%	-1.0%	3.4%
AUD/USD	1.00	-1.52%	-3.9%	-1.8%
USD/CHF	0.93	1.25%	2.4%	-0.9%
USD/JPY	79.90	0.06%	0.1%	3.9%
EUR/JPY	103.22	-1.22%	-2.3%	3.6%
EUR/GBP	0.80	-0.77%	-1.4%	-3.5%
EUR/CHF	1.20	-0.02%	0.0%	-1.3%
USD/SGD	1.25	0.64%	1.3%	-3.4%
USD/CNY	6.31	0.07%	0.5%	0.2%
USD/BRL	1.96	1.67%	2.7%	5.0%

Source: Bloomberg. Note: Page 1 equity returns do not include dividends. Bond yields in local currencies. Copper and Agriculture Index data as of Thursday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing. Data as of 9:20 pm GMT 5/11/12.

Examples of how to interpret currency data: CAD/USD 1.00 means 1 Canadian dollar will buy 1.00 U.S. dollars. CAD/USD 2.1% return means the Canadian dollar rose 2.1% vs. the U.S. dollar year to date. USD/JPY 79.90 means 1 U.S. dollar will buy 79.90 yen. USD/JPY 3.9% return means the U.S. dollar rose 3.9% vs. the yen year to date.

European political developments, Spanish banking system risks, and weak Chinese economic data dragged down global equity markets.

Greece's election outcome was so fractured (see page 4 chart) there are uncertainties about when a new government will be formed, whether it will support the austerity measures already in place, and whether it will seek to remain in the euro area.

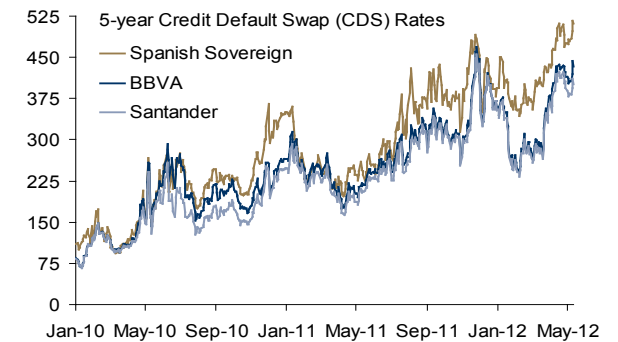
Throughout the week investors fretted about the Spanish banking system. Spain's government nationalized Bankia, its third-largest bank which was recently formed from a group of cajas, or regional banks. On Friday it also announced it will establish a "bad bank" to segregate distressed loans within the banking system and will require banks to increase loan loss provisions by a total of 28 bln euro on top of 54 bln previously set aside. While we believe this is a step in the right direction, it's much less than many analysts deem necessary. We believe significant extra provisions will be needed.

Apparently the market concurs. The cost to insure against a credit default by Spanish banks has jumped right along with the cost to insure against a default on Spanish sovereign bonds (see Exhibit 1). This negative feedback loop may not be broken until Eurozone resources are applied.

Comments, conjecture, and news headlines about Europe moved equity markets in both directions. Technical trends were also a key driver. Once again hedge funds dominated activity. Any upticks were mainly due to short covering. Large institutions became engaged at times, but mostly remained on the sidelines.

U.S. earnings results didn't help. First-quarter earnings and revenue growth are still pacing ahead of expectations, but momentum has slowed recently. Cisco Systems' warning that enterprise spending could fall short of expectations, Fossil's big European shortfall, and Macy's in-line guidance dampened the mood.

Exhibit 1: Tight Correlation Between CDS Rates of Spanish Government Debt and the Largest Spanish Banks



Source: RBC Wealth Management, Bloomberg; data through 5/10/12

GREECE: EURO OR DRACHMA?

Despite Greece's uncertain political future and bleak fiscal landscape, our European economists still doubt the country will exit the euro currency. "An 'orderly exit' is an oxymoron, and a disorderly exit is in no one's interest," wrote James Ashley, RBC Europe Limited senior economist. After all, if Greece were to exit the Eurozone either by choice or compulsion, it would raise speculation about which country would be next, so it would extend, not end the crisis.

Ashley added, "That is not to say that we should stop worrying—indeed, to be sanguine when faced with such a wide array of risks and uncertainties would be folly of the highest order. There is perfectly just cause as to why financial markets have taken renewed fright again in recent weeks." The deterioration in European economic data suggests the recession will likely linger, banking system risks have been reignited via Spain, and political risks have reasserted themselves. Further, discussions about additional public funding for Portugal could bubble to the surface in coming months.

Bottom line: Europe will likely challenge markets for some time.

ASSESSING THE EUROPEAN FALLOUT

The latest Eurozone developments have renewed concerns about two specific issues:

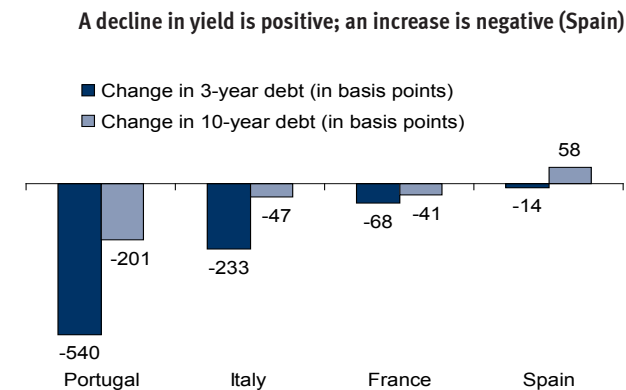
- European and global financial system risks, and
- The potential for further weakening of the European and global economies.

While we have been quite cautious about Europe for a long time, some perspective is in order here.

Clearly, pressure on the Spanish banking system has risen. But the overall European financial system has stronger firewalls since the European Central Bank (ECB) injected massive liquidity into the region's banks. Sovereign bonds have rallied and yields have declined for Portugal, Italy, and France since the ECB first announced its liquidity (LTRO) plans in early December (see Exhibit 2, left chart). In other words, contagion is not spreading from Spain the way it would have last year.

While we don't expect the ECB to ease monetary policy in the near term, it has the capacity to act forcefully if conditions were to deteriorate. Additionally, policymakers seem well aware they have not contained the crisis. New initiatives could be announced in the months ahead.

Exhibit 2: Sovereign Debt Performance Since Initial LTRO Announcement



Source: RBC Europe Limited, RBC Wealth Management, Bloomberg; data through 5/11/12

Regarding the economy, momentum has deteriorated recently, not only in Europe but also in the U.S. and China. Indices that measure whether the flow of economic data is exceeding or undershooting economists' forecasts have lost momentum since February and have recently slipped into negative territory (see Exhibit 2, right chart).

The Eurozone recession seems poised to persist at least through the second quarter. Other regions and the world's largest economies—the U.S. and China—cannot completely dodge its headwinds but are holding their own so far and should deliver modest growth this year.

Bottom line: While the global economy remains in slow-down mode, Europe has not deteriorated to such a degree that would push the rest of the world into recession.

JPMORGAN CHASE'S BLUNDER

That being said, America's globally oriented financial firms are not immune from misjudging European risks. JPMorgan Chase, a bank that has prided itself on sound risk management, aggressively lobbied against tougher trading regulations and recently disputed news reports of trading risks, disclosed a \$2

billion loss on derivatives trades linked to Europe. The stock fell 9.3% on Friday. While RBC Capital Markets LLC analyst Gerard Cassidy maintains his Outperform rating on JPMorgan shares and points out the loss is not large from a capital or earnings perspective (he forecasts 2012 earnings of roughly \$20 bln), he acknowledges: "The bigger issue, in our view, is the hit to credibility. JPM has been regarded on the street as the best managed universal bank. With this blemish, questions will be raised about further exposures and whether risk management practices are adequate. In addition, the company's plan to maximize shareholder value by maintaining the exposure as needed leaves open a certain level of uncertainty, which markets do not like."

This blunder makes it more difficult for the industry to water down the Volker rule.

Global Roundup

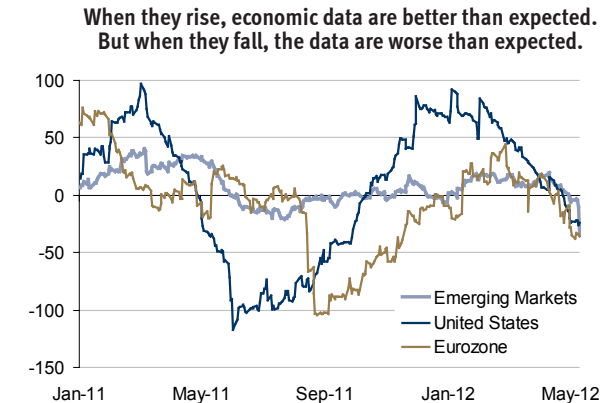
UNITED STATES

- Despite the losses in the broad market indices, S&P 500 **defensive sectors** such as Telecommunications and Utilities **traded higher** for the week. Also, small-capitalization and semiconductor stocks outperformed, which was a positive sign.
- **U.S. Treasuries were little changed** and jostled back and forth based on European headlines. The 10-year Treasury yield closed at 1.823% on Wednesday, its lowest level since early February.
- **Coming up:** Empire Manufacturing and Advance Retail Sales (May 15); FOMC Meeting Minutes (May 16).

CANADA

- **Canadian equities experienced a volatile week and closed in negative territory**, with notable **weakness in the Materials sector**. The resource-heavy index fell 2% mid-week, its largest

Citigroup Economic Surprise Indices



Source: RBC Wealth Management, Bloomberg; data through 5/10/11



Global Roundup

one-day plunge in six months, on **concerns regarding political instability in France and Greece** coupled with **negative economic surprises from China**. However, **positive data out of North America** helped lift the markets and partially offset earlier losses as the week came to a close.

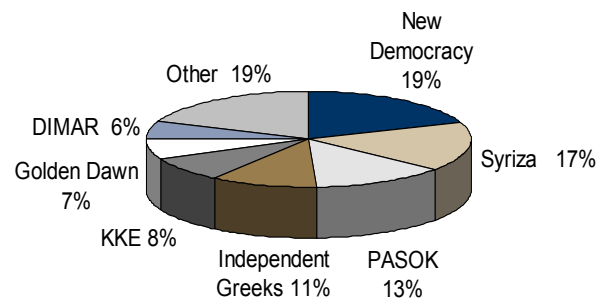
- The **Canadian yield curve flattened** in response to strong domestic data on Friday. **Shorter-dated maturities** saw their **yields move higher** as the market started to **factor in rate hikes** that had been priced out of the market in the previous two week's trading based on the fear that uncertainty in Europe would force the Bank of Canada to the sidelines.
- On the economic front, **Canadian housing starts unexpectedly surged** by 14% in April to an annualized pace of 244,900. While strength in the housing market has been robust so far in 2012, **RBC Economics believes there will be some easing** in the coming months to a more sustainable pace of growth.
- **Canadian employment data was well ahead of expectations**, with the goods-producing sector adding 70,000 positions and the service sector cutting 11,800. The overall positive data came on the heels of a stellar 82,300 jobs number in March. The **unemployment rate ticked up** to 7.3% from 7.2% in March, but the gain was **attributable to an increase in participation rate** by 0.2% as 72,500 returned to the labour force.

EUROPE

- **Equity markets were weak** over the past week, extending losses. Both the **STOXX Europe 600 ex U.K.** (stock index for Continental Europe) and the **FTSE all share** (stock index for the U.K.) are now **flat year to date**.
- While **headlines were dominated by political considerations** with the results of the French election and Greece struggling to form a

Exhibit 3: Greek Elections – A Divided Nation

The inconclusive election results from last Sunday have brought Greece back into the spotlight, jeopardizing the country's ability to repay its debt, and its membership in the Eurozone.



Source: RBC Dominion Securities, Bloomberg

coalition Government, on the whole, **corporate news was positive**. The announcement of telecoms tycoon Carlos Slim's Eur 2.6bn (USD 3.4bn) offer for a stake in Dutch telecom KPN was seen as a sign of good value on the Continent. Moreover, with just under 50% of all companies having released quarterly earnings, 51% have beat expectations, while 34% have missed, the rest being in line. That is an **encouraging earnings season**.

- In the U.K., **industrial production fell** 0.3% month over month in March, **in line with market expectations**. However, **manufacturing figures surprised on the upside**, rising 0.9% versus the consensus expectations of a 0.5% rise. With revisions to the manufacturing February data, there was little impact on the quarterly figures, which continue to suggest growth in manufacturing production was flat between Q4/2011 and Q1/2012. The **Bank of England left bank rate at 0.5%** and maintained the size of the asset purchase facility at £325bn.
- **Coming up:** German regional elections (May 13); March European industrial production (May 14); Euro area GDP (May 15); Merkel meets Hollande tbc (May 16); U.K. employment (May 16).

ASIA PACIFIC

- The **Hang Seng Index posted its weakest performance in eight months** and closed under the psychologically important 20,000 level at 19,964, a decline of 5.3% over the week. Singapore's Straits Times Index declined 3.4%. Events in Europe combined with weak Chinese data sparked the sell-off.
- **China's April trade data disappointed** investors. Exports grew by 4.9% year on year, much lower than consensus forecasts for 8.5%. Import growth was even weaker at only 0.3% year on year versus forecasts of 10.9%. While weak export growth is indicative of soft global demand (processing and assembling activities were notably weak), the **big decline in import growth implies weak domestic growth** in China. Iron ore demand fell to a 10-month low.
- **China's consumer price inflation** in April **declined** to 3.4% from 3.6% in March, as forecast. Inflation peaked in July 2011 while house prices peaked in August 2011.
- **RBC Capital Markets notes** that the week's soft economic data in China increases the **chances of a near-term cut in the banks' required reserve ratios**, although the benchmark interest rate is forecast to remain unchanged for the rest of the year. However, **growth is forecast to pick up in the second half of the year** so that full-year Chinese GDP reaches 8.4%.
- **South Korea** kept its benchmark **interest rate unchanged** at 3.25% for the eleventh-consecutive month. **Indonesia** kept its **benchmark rate unchanged** at 5.75% despite rising inflation.
- **HSBC (0005.HK)**, the largest weighting in the Hang Seng Index, **reported first-quarter earnings that beat expectations** primarily due to better performance in its Global Banking & Markets division. Cost management also improved.

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	Count	%	Count	%
Buy (TP/O)	775	51.77	222	29.65
Hold (SP)	656	43.82	156	23.78
Sell (U)	66	4.41	3	4.55

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Outperform (O): Expected to materially outperform sector average over 12 months.

Sector Perform (SP): Returns expected to be in line with sector average over 12 months.

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