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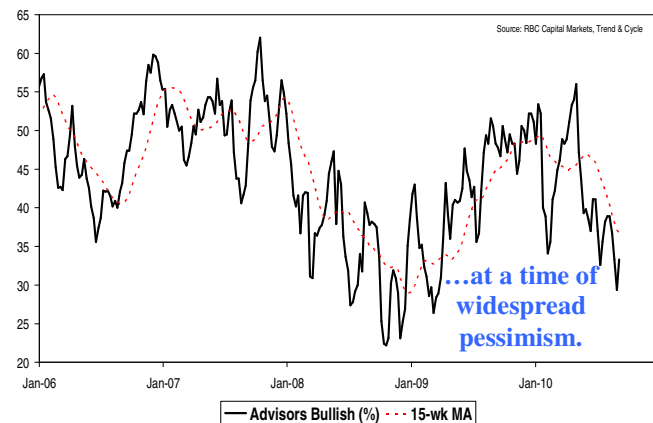
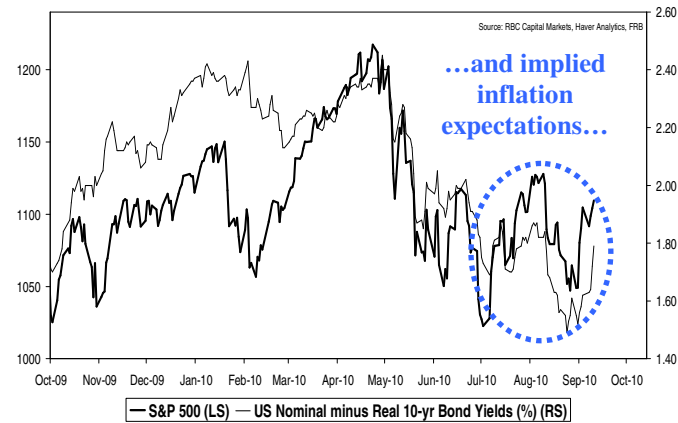
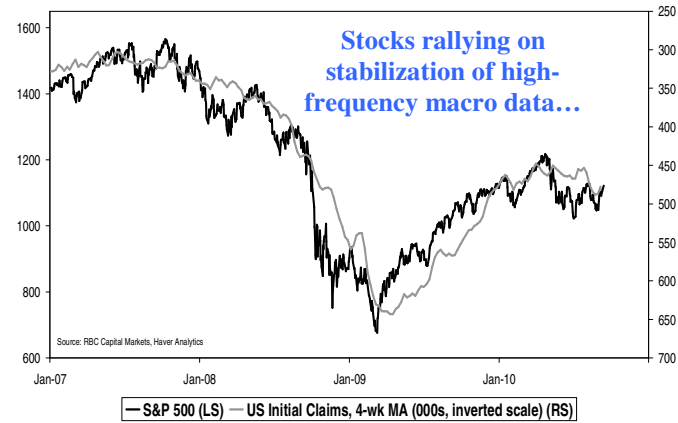
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U.S. Equity Strategy Weekly

Incremental Share Price Support is Building

- **High-frequency macro and financial market data continues to flow in positively for share price performance.** These data include the uptick in the ECRI's much-watched weekly leading index, two consecutive weeks of improvement in UI claims, a rise in market-implied inflation expectations and additional strength in globally-sensitive prices including copper, oil and the Baltic Dry Freight Index.
- **The sustainability of the recent uptrend will depend on the message delivered by leading fundamental data.** Incrementally positive news surfaced at a time of widespread pessimism, which has proved positive from a contrary perspective. Nevertheless, the message from most leading indicators is still one of caution. **Keep an eye on the upcoming Philly Fed and Empire State manufacturing data, released through the week, for confirmatory signals of recent market strength.**
- **A fresh round of consumer frugality?** Another leg down in housing prices over the next 6 months is a risk, given the recent surge in inventory levels. Absent an offsetting improvement in the labor market, this could magnify balance sheet stress and raise the demand for precautionary savings. **A more discerning consumer would probably benefit the performance of Consumer Staples over Consumer Discretionary stocks. We would also anticipate low-end retailers to outperform their higher-end counterparts, extending a trend in place since April.**
- **It seems like an opportune time to add some ballast in the Industrials sector.** Relative valuations for the sector have recently moved above the top-end of a 30-year range, supported in large part by an epic surge in sell-side earnings optimism. However, the risk of downgrades over the next 6 months looms as leading indicators of manufacturing new orders have rolled over. **Machinery & Equipment stocks appear to have overshot fundamentals, whereas Aerospace & Defense have lagged.**

Incremental Support for Shares Prices is Building



- **High-frequency macro data continues to flow in positively for the equity benchmarks.** The ECRI's much-watched leading index jumped by 1.2% in the week while Unemployment Insurance Claims have improved for two consecutive weeks. Our market economists warn that the latter might be infected by distortions surrounding the Labor Day holiday, but share prices don't seem to care at this stage. We will get a better read on UI claims when they are released on Thursday morning.

- **Intra-market activity is also favoring higher share prices.** Ten-year Treasury yields are breaking out of their 4-month downward sloping channel, primarily due to the recent increase in implied inflation expectations. The latter has been joined by additional strength in globally-sensitive prices including copper, oil and the Baltic Dry Freight Index.

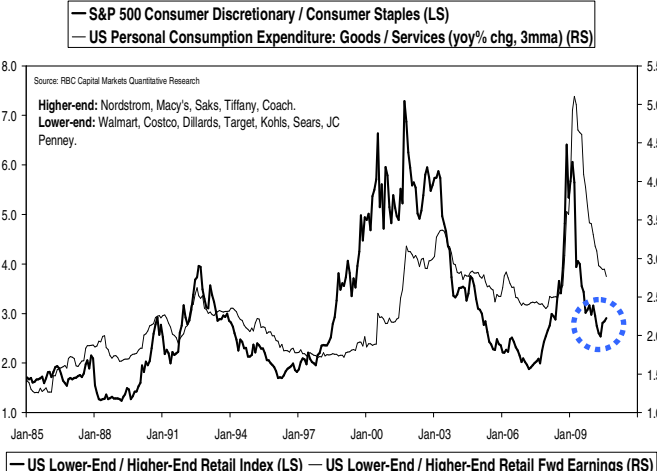
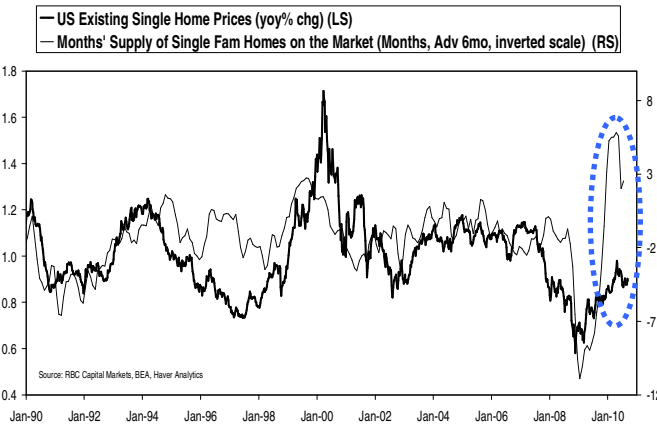
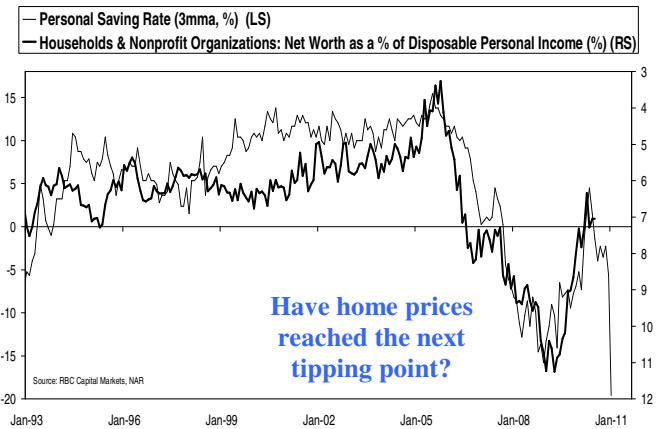
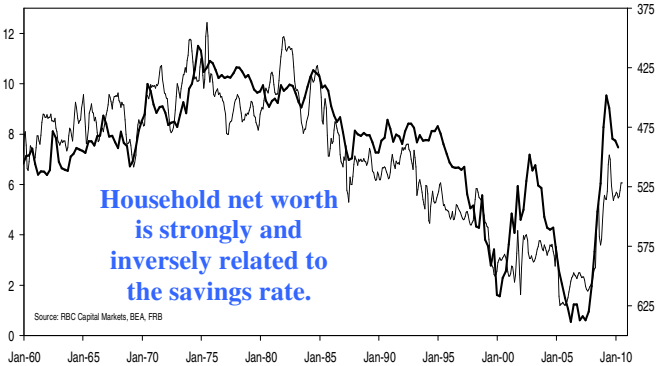
- **These incremental positives surfaced just as the equity bulls went into hibernation.** Sentiment surveys show that the percent of bullish equity investors still hovers near a cycle low. This is a positive development from a contrary perspective assuming, of course, that the data flow continues to lean against the embedded pessimism.

- **While this trading rally might find more legs, its sustainability depends upon an upturn in reliable leading data.** The message from leading macro indicators remains one of caution. We will be closely monitoring the Philly Fed Business Outlook Survey and Empire State Manufacturing data, released through the week, for important confirmatory signals of recent market action.

Bottom Line: While there are some promising signs, we still lack the information needed to eliminate our below-benchmark equity recommendation. This week's macro data releases could prove pivotal to our decision-making process.



Strategies to Hedge a Fresh Round of Consumer Frugality

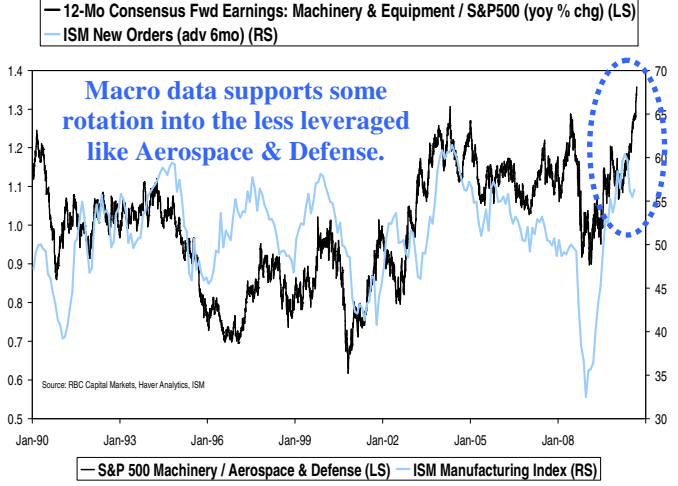
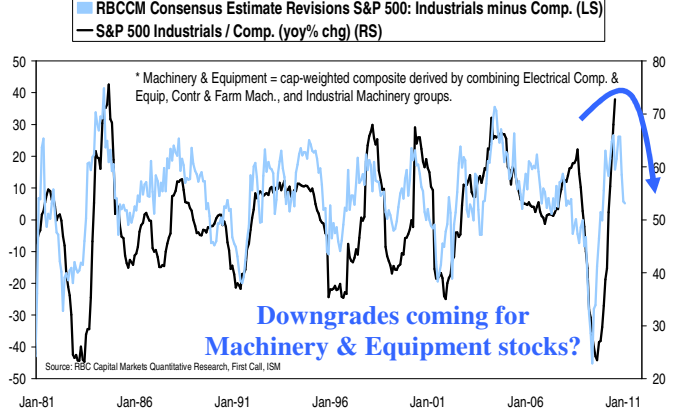
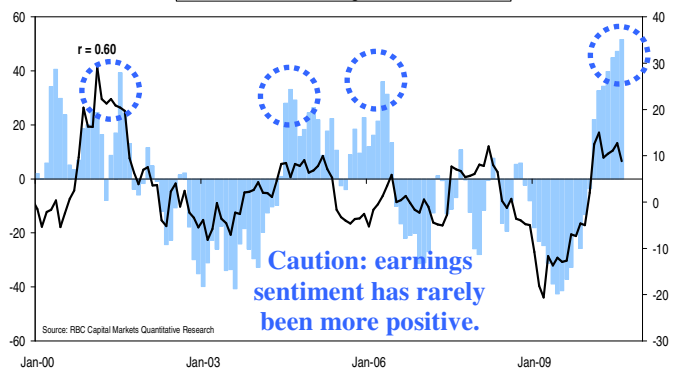
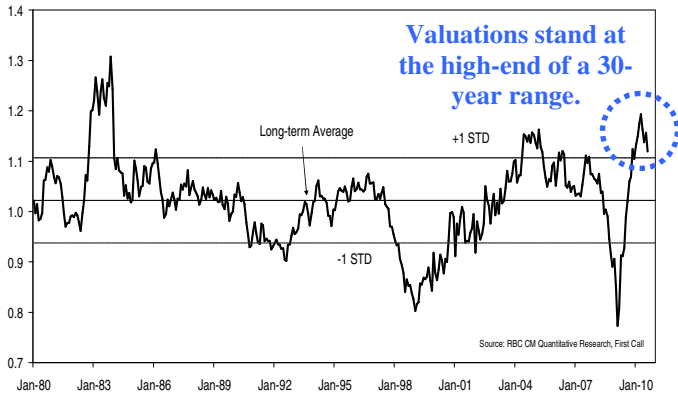


- The spending profile for the consumer has been sub-par, at best, to this point in the recovery. A multi-year phase of weak asset price performance, in the context of a struggling labor market, has raised the level of personal sector balance sheet stress. **As the chart beside highlights, the state of the household balance sheet plays a critical role in shaping savings behavior.**
- Another leg down in housing values would spell very bad news for consumer spending. Residential real estate is the largest single asset for most households and accounts for about one-third of the sector's net worth. **Our market economists recently pointed out that the dramatic spike in inventory levels might have placed house prices back onto a dangerous trajectory through to mid-2011.**
- **A fresh increase in the demand for precautionary balances would probably favor Consumer Staples.** As the chart beside shows, spending on "discretionary" categories has started to lose momentum relative to "necessities". An extension of this recent development would probably generate additional performance headwinds for Consumer Discretionary stocks, especially relative to their Consumer Staples peers.
- **We'd also expect to see important relative price shifts within the Consumer Discretionary sector.** For example, higher-end retailers would probably start to lag their lower-end counterparts. While this started to a small degree in April, the budding trend would probably be extended on fresh signs of household balance sheet repair.

Bottom Line: Another down leg in house prices, absent a labor market offset, would force savings rates higher to the benefit of Consumer Staples and relatively demand inelastic stocks within Consumer Discretionary.



Is the Clock Ticking on Industrials? Add some group ballast



- **Relative valuations no longer look compelling for the Industrials sector.** On a relative-price-to-forward earnings (see chart beside) or book value basis, sector valuations have moved beyond the top-end of their 30-year relative valuation range.
- **Analyst optimism towards the sector’s earnings outlook is running very hot.** This is a key underlying support for sector performance and is likely to keep any valuation concerns at bay until the fundamental outlook begins to change in a less favorable direction.
- **Leading data now warn that earnings expectations are at risk of coming down for some of the more economically-leveraged groups within the sector.** The chart beside shows that ISM Manufacturing New Orders leads turning points in forward earnings expectations for Machinery & Equipment names by 6 months. Further declines in the macro indicator will probably place the industry group at risk.
- **Within the Industrials sector, it looks like a good time to rotate some money into the less economically-leveraged groups.** The chart beside shows that Machinery stocks have “gone vertical” relative to less leveraged groups, like Aerospace & Defense. This has occurred at a time when the former group has lost some macro support, according to the recent trend in the leading manufacturing index.

Bottom line: It seems like an opportune time to rotate some Industrials-dedicated money away from Machinery & Equipment and towards Aerospace & Defense.



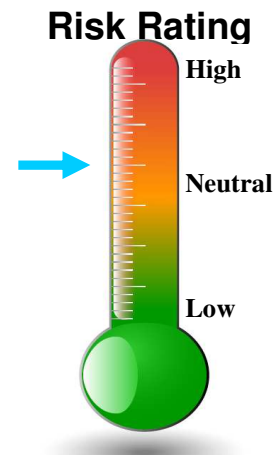
RBC CM US Equity Market Views

Market Outlook (Next 6 - 9 months)

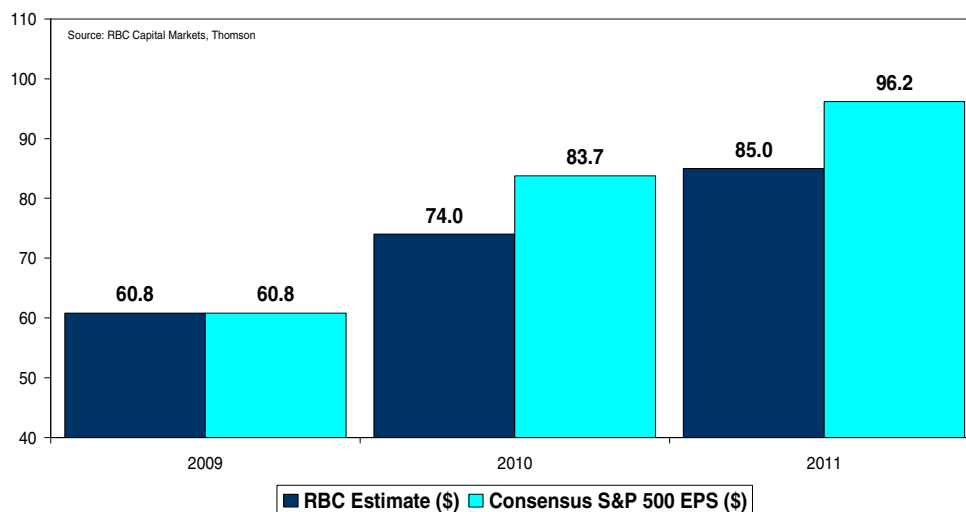
Overweight	
Market Weight +	
Market Weight	
Market Weight -	X▲
Underweight	

▲/▼ Directional Bias.

Source: RBC Capital Markets



S&P 500 Earnings Outlook



S&P 500 Sector Recommendations Summary

U.S. Equity Sectors	Current Recommendation	Recent Change (Sep 1, 2010)
Consumer Staples	Overweight	None
Energy	Overweight	None
Health Care	Overweight	None
Information Technology	Overweight	None
Telecom Services	Market Weight	None
Utilities	Market Weight	None
Financials	Market Weight	None
Industrials	Underweight	None
Consumer Discretionary	Underweight	None
Materials	Underweight	None

Source: RBC Capital Markets



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