LONDON CAPITAL MANAGEMENT

# Monthly investment commentary

December 2009

## NOVEMBER'S HIGHLIGHTS

- Stronger than expected third quarter corporate earnings results and supportive economic data helped most equity markets shrug off October's pull back.
- Canadian third quarter gross domestic product (GDP) increased by 0.4% (quarter/quarter, annualized), signaling the end of the recession.
- Better than expected U.S. housing data and employment figures (though still hovering around 10% unemployment) helped boost investor confidence that the U.S. is also emerging from the recession.
- Gold prices surged 12.6% in November (ending the month at $1180/oz USD), fuelled by a weaker U.S. dollar, inflation concerns and heightened investor interest as the shiny metal's attraction built-up momentum.
- The Canadian dollar strengthened further versus the U.S. dollar, ending November at $0.94 USD.
- Bank of Canada and the U.S. Federal Reserve continued to lend support to the economic recovery and held the central bank rates steady at their ultra-low levels.

## HOLIDAY CHEER

After a brief retreat in October, equity markets regained their momentum in November and gave investors an early dose of holiday cheer (see Table 1). The S&P/TSX and S&P500 got support from positive third-quarter earnings results, strong commodity prices (particularly gold) and improving economic data. Of note, both the Canadian and U.S. economies saw positive 3rd quarter annualized GDP results – a sign that an economic recovery is underway.

Emerging markets remain this year's runaway winner; the MSCI Emerging Markets Index is up 71.7% (total return) in US dollars year to date, as exceptional economic growth (such as India's 7.9% rise in third quarter GDP) continues to fuel optimism and investor interest. In contrast among world equity markets, the Japanese NIKKEI 225 was noticeably left out in the cold, falling nearly 7% in November alone, though still modestly positive for the year (see Table 1, including EAFE results which ended flat for November largely due to negative results from Japan). The Japanese economic recovery continues to be tenuous as it struggles with deflation concerns and a strong Yen versus the U.S. dollar. Similar to the challenges faced in Canada, the strong Yen has reduced the competitiveness of Japanese exports and has dampened the manufacturing industries recovery efforts.

**Table 1**– Summary of major market developments

| Market returns* | November | YTD |
|---|---|---|
| S&P/TSX | 4.9% | 27.4% |
| S&P500 (US$) | 5.7% | 21.3% |
| S&P500 (C$) | 3.4% | 5.3% |
| NASDAQ | 4.9% | 36.0% |
| Russell 2000 | 3.0% | 16.1% |
| FTSE 100 (U.K.) | 2.9% | 17.1% |
| NIKKEI 225 (Japan) | -6.9% | 5.5% |
| EAFE (C$) | -0.6% | 8.9% |
| EAFE (local currency) | -0.1% | 14.6% |
| Canadian Bond Market** | 1.3% | 6.9% |
| World Bond Market (US $)** | 1.0% | 1.8% |

*local currency (unless specified); price only
**total return
Source: S&P, National Bank, Royal Bank

Turning to the bond markets, narrowing interest rate spreads between government bonds and credit products (such as corporate bonds) have fuelled much of the gains in bond markets this year (see Table 1). As this trend abates and interest rates begin to rise (currently held exceptionally low by central banks attempting to inject life back into their domestic economies) investors can expect more modest results going forward.

## A GOLDEN ATTRACTION

Gold prices surged 12.6% in November, fuelled by a weaker U.S. dollar, inflation concerns and the built-up momentum that has heightened investor interest in the precious metal. As a result, the Canadian Materials sector (also helped by strong diversified metals and fertilizer prices) was the strongest performing sector on the S&P/TSX (see Table 2). In contrast, the tech-giant and dominant Canadian Information Technology company, Research in Motion, came under pressure as analysts downgraded the stock amidst increased competition concerns – pulling down the Information Technology sector and making it the only sector to post a negative return in November (see Table 2).

**Table 2 -** Sector level results for the Canadian market

| S&P/TSX sector returns* | November | YTD |
|---|---|---|
| S&P/TSX | 4.9% | 27.4% |
| Energy | 1.5% | 29.0% |
| Materials | 14.1% | 38.4% |
| Industrials | 5.6% | 15.8% |
| Consumer discretionary | 2.9% | 5.5% |
| Consumer staples | 6.4% | 2.9% |
| Health care | 2.6% | 27.0% |
| Financials | 3.8% | 35.2% |
| Information technology | -3.5% | 25.7% |
| Telecom services | 3.2% | -2.0% |
| Utilities | 5.3% | 4.8% |

*price only
Source: National Bank

## "A SHIP IS SAFE IN HARBOUR, BUT THAT'S NOT WHAT SHIPS ARE FOR" *William Shedd*

Despite equity markets recovering strongly from March lows and historically low yields on bonds it hasn't prevented a stampede into fixed-income investments. On the surface the attraction is obvious. A historic financial crisis that saw corporate giants brought to their knees, extreme equity market volatility, and dramatic stock markets losses that left many investors now viewing equities as a hazardous minefield and bonds as a safe refuge. But at today's very low yield levels, bonds too become risky. Bonds benefited from falling interest rates - a long-term trend that started in the 80's and accelerated as the financial crisis saw central banks slash rates to near zero. So with little room left to decline, and an economic recovery afoot, upward pressure on rates is building – a scenario which sees current bondholders in a more precarious position. What to do? The key is balance.

When matching personal investment goals with anticipated investment returns from fixed-income assets, the reality for many investors will be that fixed-income products alone will not be sufficient to meet their long-term financial goals. A balance between equity investments and fixed-income products will be needed to preserve and grow capital over the long term.

As William Shedd, an American theologist, once wrote: "A ship is safe in harbour, but that's not what ships are for." By strictly avoiding investment risk, you can inadvertently increase your risk of never reaching your destination. The key to effective long-term investing is not to avoid all risk, but rather to balance the risks with the rewards – the basis of building a strong financial security plan.

## OUR MOST IMPORTANT MESSAGE OF THE YEAR!

As far as the economy and capital markets are concerned, 2009 gave us its worst…and then turned around and gave us renewed hope that better days lie ahead. Which brings us to our most important message of the year: From all of us at London Capital Management Ltd., may 2010 bring you renewed hope for a year full of great opportunities, rewarding challenges and emerging possibilities! Happy holidays!