LONDON CAPITAL
MANAGEMENT

Monthly investment commentary

February 2010

JANUARY HIGHLIGHTS

- Equity markets and commodity prices declined as investors' worries outmatched strong corporate earnings results and economic recovery expectations.
- North American fourth quarter corporate earnings reported in January exceeded analysts' expectations, but not enough to satisfy investors who felt much of that earnings growth was already priced in to stocks.
- Despite improving forecasts for global economic growth, concerns over sovereign debt in some euro zone countries (eg. Greece, Portugal, Spain) increased significantly. Market volatility followed as investors worried about still more financial crisis fall-out.
- Bond holders (and the U.S. dollar) benefited from the uncertainty and volatility in equity markets, and posted strong January results.

Equities kicked off 2010 on a negative note with most major markets in negative territory – a give back of some of the strong gains made in 2009 (see Table 1). Positive investor sentiment took a breather during the month as even encouraging news was met with some skepticism.

FEAR OF THE UNKNOWN

If there is one thing that equity markets can't stand, it is uncertainty – and there was plenty of it in January. The International Monetary Fund (IMF) raised its 2010 GDP forecast for global economic growth to 3.9% from a previous forecast of 3.1%. Despite the positive revision for global economic growth, recovery in most advanced economies is expected to be relatively slow by past standards. Global growth in 2010 and 2011 is expected to be driven by the emerging markets, and primarily driven by strong domestic demand from their rapidly expanding middle class. But like a teenager's parent moving out of the driver's seat (however anticipated the occasion may be), it is no less unsettling. Case in point; consider the equity market's reaction to the Chinese government pulling in the reins on its domestic lending policies. During the financial crisis, China implemented one of the largest and most aggressive stimulus plans anywhere in the world. Now that economic activity in China is recovering, action was needed to avoid an asset bubble based on these unsustainable levels of available capital. While pulling back on domestic lending is important for long-term sustainability, in the short-run investors took it as a threat to the pace of growth in China, and therefore a threat to global growth in general. Global equity markets sold-off in response.

Table 1– Summary of major market developments

Market returns*	January	2009
S&P/TSX Composite	-5.5%	30.7%
S&P500	-3.7%	23.5%
- in C$	*-1.8%*	*6.1%*
MSCI EAFE	-3.5%	20.9%
- in C$	*-2.9%*	*10.1%*
MSCI Emerging Markets	-4.5%	58.7%
DEX Bond Universe**	1.8%	5.4%
BBB Corporate Index**	3.1%	18.9%

*local currency (unless specified); price only
**total return, Canadian bonds
Source: Bloomberg, MSCI Barra, NB Financial, PC Bond, RBC Capital Markets

Global sovereign debt concerns, particularly from some of the euro zone countries such as Greece, Spain and Portugal, caused still more risk-avoiding behaviour from investors. Concerns and uncertainty drove investors away from risky assets (such as equities and commodities) and into the perceived safe arms of U.S. Treasuries, U.S. dollars and bonds in general. In times of trouble, the liquidity of the U.S. dollar continues to be appealing and remains the default place to run for risk-adverse investors. This held true in January, helping the U.S. dollar regain some value.

Closer to home, stubbornly high unemployment in North America has become the proverbial 'elephant in the room' when discussing economic recovery, and continues to be unsettling to consumer sentiment and capital markets alike. President Obama's new banking reform recommendations, aimed to limit growth and risk-taking by the big American financial institutions, also caused some market volatility in January. The problem for investors was not so much the proposals themselves, but the uncertainty they create while under discussion. Not knowing exactly how and how much of a profit can be made, does not sit well with shareholders.

LONDON CAPITAL MANAGEMENT

Table 2 - Sector level results for the Canadian market

S&P/TSX sector returns	January	2009
S&P/TSX	-5.5%	30.7%
Energy	-6.3%	35.0%
Materials	-8.4%	33.4%
Industrials	-5.3%	23.7%
Consumer discretionary	-0.4%	11.1%
Consumer staples	-2.8%	6.1%
Health care	-2.1%	28.6%
Financials	-4.9%	38.3%
Information technology	-4.2%	44.3%
Telecom services	-2.5%	0.7%
Utilities	-3.5%	12.7%

*price only
Source: National Bank

EARNINGS SURPRISE, BUT SENTIMENT DIVES

Despite fourth quarter corporate earnings coming in above analysts' expectations, investors felt the improvements in earnings growth had largely been priced-in and markets failed to rally further on the positive earnings news. In other words, the bar that companies are expected to clear (with strong earnings growth) has been raised. The year-over-year comparisons to an abysmal 2008 fourth quarter, though relatively strong, failed to impress today's more discerning and skeptical investor.

In Canada, the effect of the market sell-off hit the resource sectors hardest, as falling commodity prices and tempered expectations for global economic growth dragged down the Energy and Materials sectors (see Table 2). The sell-off in commodities was widespread. The strengthening U.S. dollar and global economic concerns pushed most commodity prices down (e.g. oil, natural gas and gold prices were each down 8%, 9% and 2% respectively) and resource-rich nations such as Canada, Brazil, Australia, and Norway, saw their equity markets decline significantly in January.

While investor sentiment took a hit in January, the broader economic and market outlook remains relatively positive. With the financial crisis of 2008 and 2009 still fresh on our minds, investors may be jittery and market volatility is to be expected, but this shouldn't cloud their long-term outlook for equities. Notwithstanding some recent weaker-than-expected statistics, both global and domestic economic growth continues to grind ahead on its path to recovery, and Canadian and U.S. corporations are showing improving (even strong) earnings growth.

PRECIOUS METALS

At the 2010 Olympic and Paralympic Games, we know the medals presented to the athletes will be priceless - representing not months, but years of hard work, dedication and sacrifice – and their value will only increase over time. Speaking purely as an investment over the past four years (see Chart 1), the metals in question have done pretty well too!

Chart 1 - Priceless metals

	Turin, Italy 2006	Vancouver, Canada 2010	% increase in value	Annualized rate of return
Gold/oz	$556.63	$1083.80	95%	18%
Silver/oz	$9.24	$16.21	75%	15%
Bronze/lbs	$1.98	$2.80	41%	9%

Source: Bloomberg.

All values shown in U.S. dollars as of January month-end of Olympic year. The price of Bronze was estimated by a mix of 90% copper and 10% zinc.

A RAINY-DAY PLAN

The Vancouver Organizing Committee for the 2010 Olympic and Paralympic Winter Games (VANOC) have saved the day because they had a rainy-day plan! Months and weeks of unseasonably warm weather were no doubt 'unexpected', but VANOC's snow-making, snow-storing, snow-preserving and snow-moving plans have been nothing short of, well…earth moving! Until it happens, we won't know when or even why the next bout of volatility or market sell-off will occur. But that doesn't mean we shouldn't create a plan to deal with it when it does. If achieving your financial security plan is top on your list, create a long-term, diversified investment strategy that builds-in room for short-term 'events' that don't always go as planned.

EH! O' CANADA GO!

Canada greets the world this month at the 2010 Vancouver Winter Olympic Games, and over 250 Canadian athletes will compete in the Olympic and Paralympic Games. With every skate, lap, end, run, jump and game, we wish them success and share our pride in their commitment to their sport and to representing Canada. Eh! O' Canada Go!

Copyright LCM, You may not reproduce, distribute, or otherwise use any of this article without the prior written consent of London Capital Management Ltd.

The views expressed in this commentary are those of London Capital Management Ltd. (London Capital) as at the date of publication and are subject to change without notice. This commentary is presented only as a general source of information and is not intended as a solicitation to buy or sell specific investments, nor is it intended to provide tax or legal advice. Prospective investors should review the offering documents relating to any investment carefully before making an investment decision and should ask their advisor for advice based on their specific circumstances. London Capital is a subsidiary of London Life Insurance Company. London Life and London Capital are members of the Power Financial Corporation group of companies.