Market Matters

JULY 2013 HIGHLIGHTS

- It was a positive month for global equity markets, with developed markets outperforming their emerging market counterparts.
- The S&P500 rebounded strongly from June's decline and achieved new highs in July. While recent economic data has been mixed, corporate earnings have shown strength and overall consumer confidence is at post-recession highs.
- The S&P/TSX Composite also rebounded in July, but it was stock specific activity that dominated the month.
- Emerging market results are being weighed down by an unwinding of riskier, higher-yielding investments (largely within emerging markets) moving to safer jurisdictions with an anticipation of rising yields (such as developed markets).
- Uncertainty over how and when the U.S. Federal Reserve will revert to a 'normal' policy setting continues to set the tone for fixed income markets worldwide, causing bond price volatility. In Canada, longer-term bond prices declined in July, while corporate bonds and shorter-term bonds managed small gains.

Table 1
Summary of major market developments

Market returns*	July	YTD
S&P/TSX Composite	2.9%	0.4%
S&P 500	4.9%	18.2%
- in Canadian dollars	***2.6%***	***22.2%***
MSCI EAFE	4.2%	13.5%
- in Canadian dollars	***2.8%***	***11.2%***
MSCI Emerging Markets	1.2%	-5.2%
DEX Universe Bond Index**	0.2%	-1.5%
BBB Corporate Index**	0.5%	0.3%

*local currency (unless specified); price only
**total return, Canadian bonds

Table 2
Other price levels/change

	Level	July	YTD
CAD per USD exchange rate	$0.973	2.4%	-3.5%
Oil (West Texas)*	$105.03	8.8%	14.4%
Gold*	$1,308	6.9%	-22.0%
Reuters/Jefferies CRB Index*	$283.94	3.0%	-3.8%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	July	YTD
S&P/TSX Composite	2.9%	0.4%
Energy	3.7%	2.8%
Materials	1.2%	-30.7%
Industrials	1.0%	14.4%
Consumer discretionary	3.7%	25.1%
Consumer staples	6.9%	21.9%
Health care	5.1%	43.1%
Financials	3.4%	6.0%
Information technology	3.1%	23.8%
Telecommunication services	-0.4%	-2.8%
Utilities	1.5%	-4.8%

*price only
Source: Bloomberg, MSCI Barra, NB Financial, PC Bond

SHOPPING AND PRICE-CHOPPING

The pursuit of cost synergies, expanded markets, and market presence, topped July's shopping list as a number of Canadian merger and acquisition announcements were made, including:

- Empire Co's bid for Safeway Canada
- Loblaws' bid for Shoppers Drug Mart
- Hudson's Bay Company's bid for Saks

By and large these were seen as positive moves that are expected to move forward after regulatory steps and waiting periods have passed.

Less positively received news came later in the month from Russian potash company, Uralkali. Uralkali made a surprising and bold pronouncement that they would be pursuing a 'volume over price' strategy and ending their cooperative affiliation with Belaruskali, a Belarus-based peer company. Canada's PotashCorp, Agrium Inc., and U.S. based Mosaic Company comprise approximately a third of the global market share. This change in dynamics throws a significant wrench into future plans for the small group of global potash companies as Uralkali's attempt to ratchet sales volumes is anticipated to lower potash prices.

This latest bad news for Canada's fertilizer companies is salt on the wound for the beleaguered materials sector whose negative stock performance has overwhelmed Canadian market results – putting Canada's equity market results well behind many developed market counterparts. The outlook for the sector continues to be reliant on global economic conditions, of which China's slowing growth rate (while still 7.5%) has cast a shadow over the outlook. With all that said...the point is that this is a 'known risk', and a lot of negative news for resource companies has already been priced in, which by definition has diminished the downside risk for these stock prices.

THE NEW GOOD = LESS BAD

Like the Leaf's brief playoff performance after so many years of not making it to the playoffs, economic news out of Europe isn't so much 'good' as it is 'not as bad as before'. Eurozone economic growth remains challenged and significant sovereign debt problems are not resolved, but recent 'green shoots' of economic recovery are beginning to emerge. The European Central Bank's 'whatever it takes' accommodative stance has helped to diminish the fear of a made-in Europe financial crisis. All in all investor confidence is improving, and European equity markets have benefitted with relatively strong results.

COMMUNICATION STRATEGIES

The global monetary policy tract is predicated on the fact that world economic growth is sluggish. The Bank of England, the European Central Bank, and the Bank of Canada each left their policy rates unchanged recently, and provided forward-looking guidance (some for the first time) on their intentions to leave rates low for longer. But bond market volatility has ensued over recent months because of uncertainty and fears about the U.S. Federal Reserve's (the Fed) plans to taper and eventually tighten monetary policy. As the month of July unfolded, the Fed went out of its way to communicate that any change in its accommodative stance will be data dependent (and not on a pre-set course), and that their interest rate policy was unlikely to change until some time in 2015. The communication strategy worked and bond markets stabilized, but it is likely that each U.S. economic release will now be scrutinized in the context of its potential influence on the Fed's policy. As a result, we could expect to see further market volatility within fixed-income markets.

SURPRISE – NO SURPRISE

Whether it's company news, geo-political news, or the latest speech from market-moving policymakers like Ben Bernanke, there will always be 'surprises' and the ensuing market-jarring responses. You can't predict what tomorrow's surprise will be, but as professional portfolio managers we are practiced at incorporating new factors into our analysis every day. It's doing your homework, and it's a part of the daily process for GLC's investment teams, not just on the big volatility days. Each portfolio manager and analyst starts every day knowing the companies they want to watch, so when opportunities or challenges present themselves, our homework is done, our research is up to the minute, and we're ready to act.

That's why it's no surprise that having a diversified portfolio that benefits from professional portfolio management is an excellent long-term investment decision.