LONDON CAPITAL MANAGEMENT

# Monthly investment commentary

September 2009

## AUGUST'S HIGHLIGHTS

- World equity markets benefited from more economic signs that the global recession is nearing its end.
- Second quarter corporate earnings for the S&P/TSX came in ahead of expectations and boosted investor confidence.
- Oil touched a high for 2009 at just above $74/barrel (West Texas price in U.S. dollars) before settling just under $70 by the end of August.
- The Canadian dollar lost some strength against the U.S. dollar in August and ended the month at $0.91 (U.S.).

## BACK TO SCHOOL AND BACK ON TRACK

If summer is about slowing down and taking time to recharge, September is about channeling that energy towards getting life geared up and back on track again. So it seems fitting that the global economy seems to be following the same trend.

Over the summer months more positive signs of economic recovery continued to emerge:

- Recently released U.S. housing data showed a slight rise in housing prices (second quarter results showed the first gain in three years). While the figure alone doesn't signal the end of the housing market troubles, a sustained economic recovery for the U.S. was hard to imagine while housing prices were still falling.
- Economic growth returned to Canada for the first time in 11 months. Canadian GDP results released at the end of August showed a slight (but noteworthy) 0.2% increase in month-over-month economic growth.
- U.S. consumer confidence measures rose significantly in August with more consumers believing that things were going to get better for the U.S. economy.

With hard evidence backing up the 'green shoots' we saw this spring, August's economic data spurred hope and bold proclamations from economic pundits (though certainly not all in unanimous agreement) that we have turned the corner and the 2008/2009 recession is indeed ending. The positive sentiment helped each of the world markets noted in Table 1 gain ground in August.

Of particular note, European equity markets made strong gains as major players such as France and Germany reported that their economies grew in the second quarter of 2009. While the U.S. and U.K.'s economies continued to shrink in the second quarter, each declined less than expected. Both countries also announced expanded stimulus programs such as the U.K.'s quantitative easing measures, and the widely popular American 'cash for clunkers' program that rewards consumers trading-up their old cars for new ones. Investors responded favourably to those actions as well as the improved economic outlook and the FTSE 100 and S&P500 made strong gains in August (see Table 1).

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

| Market returns* | August | YTD |
|---|---|---|
| S&P/TSX | 0.8% | 20.9% |
| S&P500 (US$) | 3.4% | 13.0% |
| S&P500 (C$) | 5.1% | 1.9% |
| NASDAQ | 1.5% | 27.4% |
| Russell 2000 | 2.8% | 14.5% |
| FTSE 100 (U.K.) | 6.5% | 10.7% |
| NIKKEI 225 (Japan) | 1.3% | 18.4% |
| EAFE (C$) | 6.9% | 8.5% |
| EAFE (local currency) | 4.1% | 15.2% |
| Canadian Bond Market | 1.1% | 4.6% |
| World Bond Market (US $) | 0.8% | 0.3% |

*local currency (unless specified); price only

With inflation concerns remaining at bay and credit conditions normalizing (at least relative to where they were a year ago), bond markets managed positive returns throughout this summer.

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

| S&P/TSX sector returns* | August | YTD |
|---|---|---|
| S&P/TSX | 0.8% | 20.9% |
| Energy | -0.4% | 18.3% |
| Materials | -0.1% | 15.5% |
| Industrials | 4.2% | 12.2% |
| Consumer discretionary | 2.4% | 4.7% |
| Consumer staples | 2.1% | -0.8% |
| Health care | 5.4% | 15.3% |
| Financials | 0.8% | 36.8% |
| Information technology | -1.3% | 53.8% |
| Telecom services | 5.2% | -5.0% |
| Utilities | 1.1% | -0.5% |
| *price only | | |

A look at the sector returns for the S&P/TSX in August (see Table 2) shows more mixed results. The Health Care and Telecom services sectors posted the strongest absolute returns. Within the Health Care sector (a very small weight in the index), it was a single stock story as health care equipment and services company, SXC Health Solutions Corp, beat earnings expectations. Within the Telecom services sector investors became attracted to the higher dividend yields of that sector, while merger rumours between BCE and Telus also helped boost that sector higher in August.

In contrast, Canada's resource sectors reacted negatively to concerns that the Chinese government would begin tightening the reigns of their generous lending and stimulus programs, slowing economic growth expectations and potentially weakening the demand for resources. As a result, the pull-back in the Energy and Materials sectors muted gains for the broader index.

## QUICK CUTS LED TO BETTER THAN EXPECTED EARNINGS

In general, equity market fundamentals have also been improving and providing positive recovery signs. While valuation levels have risen, they remain constructive, and the outlook for corporate earnings is also improving. The reporting of second quarter corporate earnings for constituents of the S&P/TSX resulted in more companies than not beating analysts' earnings expectations (albeit from the rather dire expectations that prevailed earlier in the year). Many of these positive results came from companies which had already undergone quick and painful cost-cutting measures that included lay-offs, production and inventory cuts. These leaner, meaner companies are now well positioned to benefit from even mild economic growth once demand picks up. As a result, we have already begun to see market analysts raising their earnings forecasts for next quarter.

## TWO STEPS FORWARD, ONE STEP BACK

Despite the positive economic data and an improving corporate earnings outlook, equity markets remained volatile throughout the month of August. While some of this can be attributed to seasonality (trading volumes are traditionally low during summer months, increasing the market's tendencies to be volatile), it also serves as a strong reminder of the fragility of investor confidence in the current recovery.

The trend in economic and market data is encouraging but the credit crisis and housing bubble fall-out (such as high unemployment levels and significant household and government debt levels) could still threaten to derail or slow recovery efforts – making ongoing market volatility and short-term equity market pull-backs possible. But short-term market gyrations don't have to derail your long-term investment plans. Take September's challenge to get organized and get your long-term investment plan back on track. A well diversified investment portfolio that is appropriately allocated given your time horizon and risk tolerance can go a long way towards getting you back to that calm, relaxed feeling that comes with a good summer holiday…even in September.