Monthly investment commentary

May 2008

APRIL'S HIGHLIGHTS
• Stock markets regained some footing as investors began to believe the worst of the credit crisis may be over.
• Soaring energy and food prices dominated headlines in April. From the start of the year to April 30th, the price of oil was up approximately 20%, while corn was up 55% and soybeans were up 19%.
• U.S. Federal Reserve dropped interest rates 0.25% (to 2%) on April 30th.
• Bank of Canada dropped interest rates 0.50% (to 3%), citing concerns over slowing economic growth.
• Energy sector helped pull the S&P/TSX up into positive territory for the year-to-date.

A LITTLE SPRING IN THE MARKETS

Spring is here, and finally, a little relief from the cold. A few rays of sunshine managed to find their way to the stock markets this April, and investors are feeling a bit 'sunnier' than just a few short weeks ago. Most major stock markets around the globe had strong results in April (see Table 1). European and Japanese markets generally outperformed North American markets in April, though they remain in negative territory for the year after having fallen hard in the first quarter of 2008. Business confidence remains a concern across the euro zone as the Euro's strength and high oil prices are increasingly weighing on the region. Japan's economic future remains uncertain, though the strong results from the NIKKEI provided some much needed relief from the worrisome headlines.

The Canadian S&P/TSX managed to pull itself into positive territory (though ever so slightly) on a year-to-date basis (see Table 2). Canada's natural resources, and in particular our oil supply, has made Canada a net beneficiary of surging oil prices. The Canadian Energy sector contributed significantly to the S&P/TSX return in April. While the outlook for commodities remains bullish, in part due to the weak U.S. dollar, it is unclear how much of the current surge in prices is due to momentum driven speculation, rather than the fundamentals of supply and demand. A noted exception in April's commodity boom was gold which, after a record breaking run in the first quarter, dropped in price and pulled the Canadian Materials sector down with it.

Table 1– Summary of major market developments

Market returns*	April	YTD
S&P/TSX	4.4%	0.8%
S&P500 (US$)	4.8%	-5.6%
S&P500 (C$)	2.8%	-3.6%
NASDAQ	5.9%	-9.0%
Russell 2000	4.1%	-6.5%
FTSE 100 (U.K.)	6.8%	-5.7%
NIKKEI 225 (Japan)	10.6%	-9.5%
EAFE (C$)	3.0%	-4.2%
EAFE (local currency)	7.0%	-9.7%
Canadian Bond Market	-0.5%	2.4%
World Bond Market (US $)	-1.2%	1.3%

*local currency (unless specified); price only

The Canadian Telecommunications and Information Technology sectors also had a strong month. These sectors are dominated by a handful of very large Canadian companies, such as Research in Motion (RIM), Rogers, Telus and Shaw Communications. As a result, company-specific news can often drive the performance of the entire sector. Such was the case in April as RIM and Rogers to name a few reported strong earnings for their first quarter. In difficult market conditions when earnings growth can be difficult to find, investors often place a higher premium on those companies that can produce greater than average growth in this current economic environment.

The bond market proved just as quick to change directions as the equity markets. For the month of April, the Canadian bond market lost ground for the first time this year as investors re-gained confidence in the equity market outlook - at least for the moment.

NOT OUT OF THE WOODS YET

Despite the reprieve in market sentiment, economically speaking we aren't out of the woods yet. The circumstance that started the crisis (the declining values of the American housing market) is, by most accounts, not over yet. And wasn't it just a few short weeks ago when the mid-March announcement that Bear Stearns had succumbed to credit crisis rocked investor confidence? So how is it that within those few short weeks capital markets showed significant strength and resilience?

When the U.S. Federal Reserve helped JPMorgan Chase to rescue Bear Stearns, it sent a signal to the capital markets. The U.S. government and U.S. Federal Reserve would not allow the American financial system to crumble at the expense of the current credit and liquidity concerns. A recent article in The Economist magazine coined the action as "a kind of '*No Bank Left Behind*' Act". The boost in confidence has helped several U.S. commercial banks, investment banks and savings & loan companies raise large amounts of capital from both shareholders and the bond markets, thereby significantly improving their balance sheets. Investors allowed themselves to believe that financial institutions, though clearly bruised, would eventually pull through to see another day.

Table 2 - Sector level results for the Canadian market

S&P/TSX sector returns*	April	YTD
S&P/TSX	4.4%	0.8%
Energy	8.7%	9.1%
Materials	-1.8%	5.3%
Industrials	6.2%	3.7%
Consumer discretionary	-1.3%	-16.1%
Consumer staples	-1.1%	-7.6%
Health care	-0.6%	-4.1%
Financials	4.1%	-5.8%
Information technology	7.0%	5.3%
Telecom services	9.4%	-4.7%
Utilities	2.0%	-4.5%

*price only

FOOD AND FUEL

Consumers around the world struggled to deal with higher food and fuel prices in April. Record highs were being set almost daily in April (and well into May) for commodities, including oil, corn and rice.

From emerging markets (where food shortages are creating political and social unrest), to here in North America (where it is walloping people's pocketbooks), food and fuel prices have dominated headlines and have been the topic of much economic debate.
While clearly not a simple matter, we've outlined just a few of the factors that have contributed to the recent food inflation:

- **Rising fuel costs:** The high price of oil and traditional fuel sources have increased food transportation costs and diverted some crops toward the production of alternative fuels, such as ethanol made out of corn.
- **Less arable land due to urbanization:** With less arable land available, farmers are seeking to increase their crop's yield per acre. Fertilizer demand and costs have risen significantly, increasing the farmers' input costs.
- **Increased demand from developing countries:** The emerging middle class within developing countries is improving their diet and shifting to higher protein foods. More grain is required to feed more livestock to meet this increasing demand.

OPPORTUNITY COSTS

The Investment Funds Institute of Canada's (IFIC) latest report indicated positive net inflows into short-term, low yielding money market funds, and negative net outflows from long-term investment funds - meaning that many Canadian investors missed out on April's stock market rally. During times of market volatility, avoiding capital markets can feel like the most 'comfortable' investment strategy to take. Yet, depending on your investment goals, time horizon and personal risk tolerance, short-term decisions to remain out of the markets can come at long-term costs.