Market Matters

OCTOBER HIGHLIGHTS

- Equity markets had a spring-loaded positive rebound in October.
- Better than expected U.S. economic and corporate data, and news of Europe's progress on dealing with their sovereign debt issues created the catalyst for market moves.
- The risk-on trade resulted in major world equity markets and commodity values rising strongly, while fixed-income investments and more defensive sectors saw more muted results.
- Market volatility continues to be on the boil as macro-driven factors dominate market movements.
- Political posturing among European leaders continues to rattle investors' confidence in Europe's economic stability.

Table 1
Summary of major market developments

Market returns*	October	YTD
S&P/TSX Composite	5.4%	-8.9%
S&P500	10.8%	-0.3%
- in C$	*6.0%*	*-0.3%*
MSCI EAFE	9.6%	-9.2%
- in C$	*4.3%*	*-9.1%*
MSCI Emerging Markets	8.9%	-11.3%
DEX Bond Universe**	-0.4%	7.0%
BBB Corporate Index**	-0.5%	5.9%

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

Table 2
Other price levels/change

	Level	October	YTD
USD per CAD	$0.9992	3.9%	-0.6%
Oil (West Texas)*	$92.67	17.2%	1.5%
Gold*	$1,724	6.6%	21.6%
Reuters/Jefferies CRB Index*	$319.84	7.3%	-3.9%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX sector returns*	October	YTD
S&P/TSX	5.4%	-8.9%
Energy	11.0%	-12.0%
Materials	5.9%	-13.3%
Industrials	12.0%	-0.2%
Consumer discretionary	2.2%	-15.9%
Consumer staples	1.5%	3.9%
Health care	-4.0%	25.1%
Financials	1.7%	-5.1%
Information technology	0.6%	-43.5%
Telecom services	1.7%	11.4%
Utilities	-0.2%	1.6%

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

ELASTIC MARKETS

With elastic qualities, equity markets snapped back from early-October depths to post very strong monthly returns. Of particular note, the S&P 500 saw the biggest October rally since October 1974. Positive impetus came from both sides of the Atlantic:

- Firmer North American economic and corporate earnings results.
- European policy makers fashioned the closest thing we've seen to a workable plan to move beyond their current debt calamity.

October's positive developments are far from complete solutions to either of the U.S. and European economic clouds that hung over the financial markets in the third quarter of 2011, but they were enough to breathe some life back into equities and commodities alike.

MACRO DOMINATION

For several months now, market-watchers have been marveling at the unity with which stocks are either rising or falling. Systemic and macroeconomic-driven shifts in investor confidence are dominating market changes in and out of asset classes on almost a daily basis. Consider October's results on tables 1, 2, and 3. Cyclical investments (those more levered to economic conditions in the short-term) were almost unilaterally up (see major world equity markets, oil prices, the Canadian dollar, and the Canadian resource sectors). Conversely, more defensive investment holdings (such as bonds, U.S. dollars, and some of the defensive industries like the Utilities, Telecom and Consumer Staples sectors) benefited much less from the market rally - regardless of some positive corporate earnings results within those sectors as well.

ACTIONS SPEAK LOUDER

October's economic data releases would have you believe that severe pessimism over the short-term economic outlook for the U.S. was over-done. What consumers and businesses are actually doing is not consistent with their reported ultra-low confidence levels.

In October we saw evidence of a clear improvement in consumer spending, employment, investment and some financial indicators. As an example, recent data releases show a better than expected improvement in motor vehicle sales. Vehicles are big-ticket purchases. They are also major commitments which can easily be postponed. The recent improvement in the number of motor vehicles sold highlights discretionary spending strength, and that's good news. Despite the confidence shock from the debt-ceiling fight and the S&P downgrade, economic growth in the U.S. has actually accelerated (estimated real gross domestic product (GDP) rose at a 2.5 per cent annual rate). In addition, corporate earnings results showed positive surprises, confirming that corporate America is open for business and making money.

TRYING…AND TRYING

European policy makers trying to work out a plan to resolve Europe's sovereign debt issues are beginning to resemble participants in a big-brother style reality show. Imagine, they are several episodes into the season and just when personality fractions and tensions between participants are highest, they've been assigned yet another team-building challenge forcing everyone to work together. We are not making light of the seriousness of the European debt problems, however the recent events have highlighted political leadership that is both trying…and trying.

The political chaos *(word origin: Greek)* in Greece continues to send immediate ripples throughout global capital markets. The European deal, though light on details, has shown that Europe is able to come up with credible policies when forced. Equity markets rewarded them for that in October, but the deal is still leveraged on the success of Greek politicians to pass the required austerity measures. Greek politicians should heed the words of Simonides, a lyric poet from ancient Greek times, *"Not even the gods fight necessity".*

DRAMA (WORD ORIGIN: GREEK)

How could Greece, a minor economic player, keep the global economy on edge?

As with the financial crisis of just a few years ago, it's not so much where it started, but how far it could spread that becomes the real concerns. Currently, Greece needs an additional €130 billion in loans to effectively avoid national bankruptcy, but political wrangling over required austerity measures to secure the loan have created ongoing uncertainty. Without the loan, the Greek government will default on its debt. This is where the real problems would start.

European banks with direct exposure to Greek debt (there are some big ones) would be hit hard, as would the plethora *(word origin: Greek)* of financial institutions with indirect exposure. The resulting spread of financial troubles would more than likely knock Europe into recession (which in turn would weigh on other global economies such as the U.S. and Canada), and the precedent for other European nations with precarious economies defaulting on their debt would be set - a scenario that global leaders are currently working very hard to avoid.

NOT A MARKET-TIMERS FRIEND

Straight down markets feel badly for all of us, but markets that so quickly and uniformly soar are a market-timer's nightmare. This is when market-timers tend to give up significant gains – those that long-term investors' benefits from. If being on the wrong side of a single market exit or entrance decision is disrupting your portfolio, rethink the benefits of a long-term investment plan – when decisions are made on your time, not the markets'.

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