Market Matters

JANUARY HIGHLIGHTS

- The World Economic Forum (WEF) released guarded but positive news at its annual meeting in January. The WEF said the global economy faces fewer headwinds in 2013 compared with last year and is expected to grow a modest 3.5 percent. However, the global economic recovery remains fragile.
- Global stock markets continued their dramatic improvement. The S&P 500 index posted its biggest monthly gain since October 2011 and best January performance since 1997, advancing 5 percent. While the return from emerging markets was soft, the MSCI EAFE index gained a strong 5.8 percent.
- Canada's S&P/TSX composite index gained 2 percent as resource stocks declined and commodity prices were mixed.
- Canada's bond market weakened while investors continued to focus on equity markets.

IT'S A SMALL WORLD AFTER ALL

We live in a world where the 500-year-old remains of England's King Richard III are unearthed and confirmed, by DNA match to a Canadian-born descendant of Richard's sister, to be his "beyond reasonable doubt". It is a world where astronauts, transported to the International Space Station by Russia, host a Super Bowl party in space, and where the U.S. Treasury freezes the assets of top global gangsters. "Though the mountains divide and the oceans are wide[1]," we are all affected by our increasing inter-connectedness. It's a small world after all.

Ours is a globalized world where the economies of emerging markets and low-income countries are the main driver of global growth. Yet, while current expectations for growth in developing economies is much higher than for the developed countries, China, Asia, Africa and other emerging nations are affected by what happens in Europe and the United States.

Even though real recovery is weak in developed economies, restructuring and fiscal consolidation are expected to allow for a slow increase in the rate of growth over the next several years. Recent survey data for the eurozone indicate some stabilization in economic activity in early 2013, setting the stage for a moderate

Table 1
Summary of major market developments

Market returns*	January	2012
S&P/TSX Composite	2.0%	4.0%
S&P 500	5.0%	13.4%
- in Canadian dollars	***5.3%***	***11.0%***
MSCI EAFE	5.8%	13.5%
- in Canadian dollars	***5.4%***	***11.1%***
MSCI Emerging Markets	1.3%	13.9%
DEX Universe Bond Index**	-0.7%	3.6%
BBB Corporate Index**	-0.1%	7.7%

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

Table 2
Other price levels/change

	Level	January	2012
U.S. dollar per Canadian dollar	$1.003	-0.2%	2.1%
Oil (West Texas)*	$97.43	6.0%	-7.2%
Gold*	$1,664	0.1%	5.6%
Reuters/Jefferies CRB Index*	$303.99	3.0%	-3.4%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	January	2012
S&P/TSX Composite	2.0%	4.0%
Energy	2.4%	-3.6%
Materials	-3.6%	-6.9%
Industrials	7.4%	12.7%
Consumer discretionary	4.1%	18.7%
Consumer staples	-0.9%	20.4%
Health care	10.8%	24.1%
Financials	2.8%	12.8%
Information technology	9.7%	-3.2%
Telecommunication services	3.3%	6.4%
Utilities	3.9%	-0.8%

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

[1] Sherman Brothers. *It's a Small World After All.* Disney, 1963.

recovery to the end of the year and into 2014. Real GDP growth in Canada was up 1.3 percent at the end of November, on a year-over-year basis, consistent with an economy that continues to grow, albeit at a slow pace. U.S. real GDP declined 0.1 percent annualized in the fourth quarter due to likely temporary factors caused by Superstorm Sandy and a cut in federal defense spending. It is expected to rebound to 2.3 per cent in the first quarter, which is supported by recent economic data out of the U.S., including job growth and a recovering housing market.

Overall, the global economic recovery remains fragile, but the balance of risks is now less slanted to the downside than it has been in the four years since the onset of the global financial crisis.

THAT'S NOT ALL FOLKS

January proved a strong start to the year for global stock markets, which continued the dramatic improvements made since last June. The S&P 500 index posted its biggest monthly gain since October 2011 and its best January performance since 1997, advancing 5 percent. The MSCI EAFE index gained a solid 5.8 percent.

Investors reacted positively to a compromise by U.S. lawmakers that temporarily postponed the economic impact of the "fiscal cliff" and fourth quarter company earnings that exceeded expectations. Encouraging economic data from China and diminishing fears about Europe's sovereign debt crisis also provided support to global stock markets.

The S&P/TSX composite index closed out January with a gain of 2 percent as resource stocks slid and commodity prices were mixed. The biggest detractor was the poor performance of gold stocks, which contributed to the decline of the materials sector, the only one of two sectors in the S&P/TSX to post a negative return in January.

BOND VOYAGE

Investors have grown hungrier for higher returns over the past two months, driving investment into equities and away from bonds. Canada's bond market weakened in January, with all bond sectors posting negative returns.

Prices for U.S. Treasuries were volatile after the Federal Reserve said it would continue buying bonds due to a temporarily stalled economy, but uncertainty about growth in the world's largest economy kept yields within recent ranges.

The decline in bond prices pushed bond yields higher in Canada. The 10-year Government of Canada benchmark bond yield closed the month at 1.99 percent, up from 1.82 percent at the end of December. Rising yields run the risk of slowing down economic recovery because mortgage rates, for example, are linked to bond yields.

Equity valuations relative to those of bonds continue to favour equities. But even when income generation is low, and the outlook for returns is modest at best, fixed income investments serve investors as excellent volatility and risk management vehicles, when they are included as part of a diversified investment portfolio.

YOUR FUTURE OUR MISSION

Most investors can benefit from a diversified approach to equities and bonds that helps balance growth and volatility in a long-term investment portfolio. Diversified asset classes and exposure to risks such as economic growth, liquidity, interest rates, inflation and political risk need to be considered. A balanced combination of both approaches – a diversified asset allocation strategy and a risk allocation strategy – can help to preserve capital in an uncertain global economy.