LONDON CAPITAL MANAGEMENT

Monthly investment commentary

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JANUARY'S HIGHLIGHTS

- The downturn in the Canadian economy accelerated. Housing and employment statistics were markedly negative.
- Canada, along with countries around the globe, announced additional measures (including tax incentives and spending promises) to stimulate the economy and stock markets.
- The Bank of Canada rate was lowered to 1%, while the U.S. Federal Reserve rate was kept at 0.25%.
- Equity markets around the world reacted to the continued parade of negative economic news, but remained well ahead of their November 20th, 2008 lows.
- Bank stocks weakened significantly as bailout packages continued to be debated, and negative earnings and writedowns were reported.
- Barack Obama was sworn in as the 44th President of the United States, bringing into office the nation's hopes for economic recovery.

IT'S GOING TO BE A LONG WINTER

Beyond the proclamations of a groundhog on February 2nd, January's market and economic data all but closed the door on hopes for sunnier days in the near term. In January, equity markets were unable to sustain the significant bounce that we experienced off of the November lows. All major world markets noted in **Table 1** had negative returns for the month. There was precious little variation from the script of the last several months – as more of the same made headlines this month:

- a dysfunctional credit environment
- more writedowns and negative earnings news from corporations around the world
- dwindling economic growth expectations from every corner of the world
- ongoing housing market weakness, and rising unemployment.

The bear market is not hibernating this winter.

THE WIDE BRUSH OF THE CREDIT CRISIS

Government bond yields hit new lows in mid-January, but as concerns about how governments were going to fund their spending plans grew, demand for these bonds began to fade. The result was a drop in prices for government bonds, and a negative return for bond markets in January (see **Table 1**).

Table 1– Summary of major market developments

Market returns*	January	2008
S&P/TSX	-3.3%	-35.0%
S&P500 (US$)	-8.6%	-38.5%
S&P500 (C$)	-7.3%	-24.4%
NASDAQ	-6.4%	-40.5%
Russell 2000	-11.2%	-34.8%
FTSE 100 (U.K.)	-6.4%	-31.3%
NIKKEI 225 (Japan)	-9.8%	-42.1%
EAFE (C$)	-9.5%	-32.8%
EAFE (local currency)	-6.3%	-42.1%
Canadian Bond Market	-1.0%	6.4%
World Bond Market (US $)	-1.6%	9.2%

*local currency (unless specified); price only

One theme prevailed across the globe - it was a bad month for banks. It turns out getting your government to set aside billions of dollars to help banks make ends meet is one thing, but getting your government to agree on how they disperse that cash is another. Ongoing uncertainty about relief and bailout packages (along with poor fourth quarter earnings results) further diminished investors' confidence in banks. Stock prices for many banks hit new lows in January.

What about Canadian Banks? Canadian banks (while not in the same worrisome boat as banks in the U.S. and Europe) were not exempt from January's downdraft, affecting banks around the world. Regardless of the clear advantages that Canadian banks have over many of the foreign competitors (in particular, having avoided the full brunt of the sub-prime mortgage meltdown) investors did not make those finer distinctions in January. The wide brush of the credit crisis, combined with a worsening

economic outlook, pulled the Canadian Financial sector down all the same.

Despite the downturn in the Financial sector, the Canadian S&P/TSX managed to hold up better than many other world markets in January. Looking at **Table 2**, we can see that relative strength (that's what we call a 0% return these days) in the Materials sector helped the Canadian index mitigate losses. Gold companies (making up a little more than half the weight of the Materials sector) continued to attract investors to its traditionally defensive status, giving a boost to the Materials sector.

Table 2 - Sector level results for the Canadian market

S&P/TSX sector returns*	January	2008
S&P/TSX	-3.3%	-35.0%
Energy	-4.2%	-36.3%
Materials	0.3%	-27.1%
Industrials	-7.9%	-26.9%
Consumer discretionary	-7.7%	-37.5%
Consumer staples	-1.5%	-7.8%
Health care	13.1%	-34.4%
Financials	-7.1%	-39.0%
Information technology	29.7%	-54.3%
Telecom services	-3.1%	-27.4%
Utilities	-2.1%	-24.0%

*price only

While negative returns prevailed, there were a few outliers. Research in Motion, the largest player in the Information Technology sector by far, had a particularly strong month. Several factors converged to boost the company's stock, including a successful launch of their new 'Storm' touch screen product, positive earnings results, and even concerns over a key competitor's ailing CEO (Steve Jobs, CEO of Apple) all contributed to boost the stock price of the Waterloo, Ontario company of Blackberry fame. The Health Care sector also had strong returns, in part due to that sector's traditionally defensive nature. Yet the Health Care sector in Canada represents a minute weight in the S&P/TSX and therefore contributed little to the overall results of the index this month.

TAKING RISKS

The barrage of negative economic and market results has dampened the spirits of investors and consumers around the world, creating uncertainty and concern over their financial futures. Not surprisingly, this has resulted in more and more money flowing out of equities, and into money market and fixed-income products. This trend has prevailed despite money market and fixed-income products providing historically low yields, and a near-term outlook that supports little more than…well, historically low yields. Today, the certainty of zero (or near zero) return on an investment is an easier sell than the uncertainty of short-term equity returns.

But for long-term investors, who are currently sitting out of equities, the risk is theirs. For unless it truly is 'different this time', they are betting against the long standing market trend in which equities outperform bonds – making so-called "risk-free" assets a risky bet in achieving a long-term financial goal.

We know that negative economic headlines tend to persist well after the end of a bear market. Which also leads us to know that waiting to re-enter the market until the economic signals all point towards recovery is likely waiting too long to benefit from a market recovery. There is no free-lunch in investing. With the expectation of returns, comes the understanding that there will be risks. Being realistic about your investing time-horizon and the financial goals you wish to achieve will help you gain comfort with the investment path you need to take, even in uncertain times.

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