Market Matters

MAY HIGHLIGHTS

- Macro-economic concerns drove capital market results, with the main culprits being:
  - Europe's continuing sovereign debt problems
  - China's slowing economic growth
  - Weaker than hoped U.S. economic data
- Investor anxiety rose sharply
- Risk assets (commodities and equities) sold-off
- Government of Canada 10-yr bond yields fell to 60 year lows.

LITANY OF MACRO CONCERNS

A litany of macro-economic problems shook investors' confidence, bringing about frequent bouts of market volatility and an equity market sell-off in May.

Europe's ongoing quagmire, softer U.S. economic data, and persistent China growth fears are mostly to blame for the swift blow to investor's risk appetite. All major risk assets (equities and commodities) took it on the chin in May (see Table 1 and 2). One of the main casualties of the risk-off wave has been commodities (see Table 3). Hit hard by the escalating concerns over slower Chinese economic growth, the commodity-linked Energy and Materials sectors created a significant drag on the Canadian S&P/TSX.

Investors once again fled to fixed income instruments in safe haven countries to shelter themselves from the equity market volatility. This drove strength in the U.S. dollar and moved bond market results into positive territory for the month. Bond yields fell further to 60 year lows for Government of Canada 10-year bonds. At the risk of sounding like a broken record, it is hard to conceive of an environment in which yields can go much lower - not impossible, as we have seen – but difficult to conceive. As a result, we believe the opportunity for bond prices to continue to rise in the long term is limited.

RE-THINK EQUITIES – YES, EVEN NOW.

While feelings of 'market fatigue' are understandable, we believe there is a compelling case for investing in stocks for long-term growth. At GLC Asset Management Group Ltd. (GLC) we believe that now, perhaps more than ever, is the right time to maintain a long-term investment strategy in a diversified and appropriately balanced portfolio – which for most investors, includes investing in equities.

Table 1
Summary of major market developments

Market returns*	May	YTD
S&P/TSX Composite	-6.3%	-3.7%
S&P500	-6.3%	4.2%
- in Canadian dollars	*-2.0%*	*5.9%*
MSCI EAFE	-8.2%	-2.8%
- in Canadian dollars	*-8.0%*	*-4.1%*
MSCI Emerging Markets	-7.2%	1.5%
DEX Universe Bond Index**	2.1%	2.0%
BBB Corporate Index**	1.9%	4.1%

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

Table 2
Other price levels/change

	Level	May	YTD
U.S. dollar per Canadian dollar	$0.968	-4.4%	-1.6%
Oil (West Texas)*	$86.65	-17.3%	-12.5%
Gold*	$1,566	-5.7%	-0.5%
Reuters/Jefferies CRB Index*	$272.97	-10.8%	-10.6%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	May	YTD
S&P/TSX Composite	-6.3%	-3.7%
Energy	-9.1%	-9.3%
Materials	-6.7%	-12.4%
Industrials	-2.3%	2.4%
Consumer discretionary	-3.3%	11.0%
Consumer staples	-3.7%	6.5%
Health care	-4.5%	16.8%
Financials	-6.4%	2.4%
Information technology	-10.1%	-6.6%
Telecom services	0.7%	-2.5%
Utilities	-3.2%	-1.9%

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

PORTFOLIO MANAGER INSIGHTS

With today's challenging market and economic backdrop, we asked some of GLC's senior portfolio managers about their views on investing in the equity markets during these volatile times. Here's what they had to say:

DAVE GILL, SENIOR VICE-PRESIDENT, EQUITIES, LONDON CAPITAL INVESTMENT MANAGEMENT (A DIVISION OF GLC)
"When we look at stocks in general right now, we see some pretty good fundamentals like decent earnings growth, attractive valuations, and healthy balance sheets. When you frame that against our base case of modest albeit uneven global economic growth, the backdrop for equities is encouraging particularly when one takes a longer-term view. Are there macro-risks? Absolutely, with the game changer being the Eurozone crisis, but you've also got a potential hard-landing scenario in China, and softer economic data out of the United States more recently. A lot of these risks are well known, and the market has begun to price them in. Admittedly, it's difficult to know how some of these risks will ultimately play out, particularly the European dilemma given the lack of progress and clarity to date. But again, while we recognize the potential for some near-term volatility, we continue to like the outlook for stocks over bonds right now, particularly when one takes a longer term view. In fact, in the London Capital Diversified Fund we are maintaining a moderate overweight position in equities."

What's your main message to investors? "I suppose our main message to investors is to not let today's bad weather cloud your longer term forecast - there's still a compelling story for equities. We've seen similar bouts of volatility in the not too distant past when sentiment turned extremely negative. Often, that's precisely the moment when some of the best investment opportunities arise."

PATRICIA NESBITT, SENIOR VICE-PRESIDENT, EQUITIES, GWL INVESTMENT MANAGEMENT (A DIVISION OF GLC)
"Investors globally are concerned about the state of macro affairs. I can assure you that we are as well, having invested significant time and energy into the plausible outcomes. Having said that, challenging though it may be, it is not a time to panic despite claims to the contrary by our friends in the media.

In any situation, there will be winners and there will be losers, no matter how challenging the environment gets. Here's just one example of many; right now, we like companies that save consumers money. When people are inundated with negative news about the economy and markets, they go looking for places that help them stretch their hard earned dollars further. So we see dollar stores and discount retailers doing a brisk business these days. If you don't believe me, just head down to your local HomeSense, Dollarama, or Winners store on a weekend! It's an ironic twist, but the very same reason that some people are concerned about stocks can create a very attractive buying opportunity for professional portfolio managers like us. "

What's your main message to investors? "When markets are volatile, it can be hard to see the benefit of investing in equities, but that doesn't mean there are no attractive stock opportunities out there. Right now, we feel good about the positioning and long-term prospects for GWLIM's equity portfolios."

BEN FAWCETT, SENIOR VICE-PRESIDENT, EQUITIES, LAKETON INVESTMENT MANAGEMENT (A DIVISION OF GLC)
"I'm not Pollyannaish about the state of affairs for the global economy. Europe, and even the U.S., have a lot of work ahead of them, reforming their economies while reducing indebtedness. While that will be a good thing in the long-run, in the short-term it's going to make for some rocky stock markets. The problem is that right now stock markets and their investors are far too focused on the short-term, and they are reacting to every headline. Frankly, I think that is masking a lot of great companies that are building up tremendous shareholder value, and that's creating great opportunities for the portfolios we manage. Right now, the market may not be differentiating these companies from one another, but I believe that when we see companies whose leadership teams, product line-ups and competitive positioning puts them at an advantage over others – that they will outperform over the longer term.

We manage concentrated portfolios, and I want to have conviction in each and every holding we own – and right now I do. It takes a lot of discipline, even for professional portfolio managers, but the reward is finding companies that are taking the right steps today to be tomorrow's leaders."

What's your main message to investors? "Try not to focus on the short-term market swings - as hard as that is. I'm a firm believer that companies that are creating good shareholder value will compensate those investors who maintained their conviction and patience during volatile markets."

A COMFORTABLE BALANCE

Finding the right balance of fixed income and equity exposure so that you can comfortably stick with your long-term investment plan is often the most significant factor in determining how your portfolio performs over the long term. What's right for you depends on your financial goals and timelines, and your tolerance for market volatility.

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For most investors, maintaining a portion in equities is key to the growth they need to meet long-term financial goals. The fixed income component adds the stability desired during periods of heightened market volatility. By combining these two elements in a proportion that's right for you, each asset class can play its role and provide you with the opportunity for greater capital appreciation, while mitigating the risk and volatility of your portfolio.