Monthly investment commentary

July 2009

JUNE'S HIGHLIGHTS

- The Canadian dollar declined -5.7% in June relative to the U.S. dollar as investors were reminded of the economic challenges that remain for Canada. On a quarterly basis, the Loonie's value rose 7.9%.
- The resilience and renewed growth of emerging economies (particularly in China) boosted commodity prices throughout the second quarter.
- Oil prices ended June at $69.97/barrel (West Texas. US$) - a 78.5% rise year-to-date!
- Unemployment levels in the U.S. and Canada have hit multi-year highs – indicating economic challenges remain an issue.
- The decline in manufacturing, energy and retail trade contributed to the worst nine-month period of Canadian GDP growth (or lack thereof) in almost 50 years.
- Even with a modest pull-back at the end of June, equity market returns in the second quarter were exceptionally strong as investors' confidence improved significantly from historic low points in March.

HALF-TIME UPDATE

June's equity market returns may seem lack-luster as both the S&P/TSX and the S&P500 were flat for the month (see Table 1). However, June ended a six-month period that has been anything but dull for financial markets. A soaring rally off of early-March lows reversed the double digit losses of the first quarter. Most major world markets are now squarely in positive territory for the year (see Table 1).

The second quarter revival in stock market confidence was based on the view that the financial system is on the mend and evidence that the U.S. consumer is down but not out. News of economic growth from emerging markets and better-than-feared U.S. bank stress-test results also played an important role in the market's recovery. Each report that 'wasn't as bad as anticipated' helped reduce uncertainty and risk aversion – a necessity for sustainable financial market recovery.

While an improving economic outlook helped boost commodity prices and resource sectors, it was actually the Financial sector that had the greatest positive impact on the S&P/TSX in the second quarter (see Table 2). Having been largely shunned during the darkest hours of the first quarter, investors were drawn back to Canadian banks and insurance companies this spring, as major players reported positive earnings news.

Table 1– Summary of major market developments

Market returns*	June	Q2 2009	YTD
S&P/TSX	0.0%	19.0%	15.4%
S&P500 (US$)	0.0%	15.2%	1.8%
S&P500 (C$)	6.3%	6.0%	-2.9%
NASDAQ	3.4%	20.0%	16.4%
Russell 2000	1.3%	20.2%	1.8%
FTSE 100 (U.K.)	-3.8%	8.2%	-4.2%
NIKKEI 225 (Japan)	4.6%	22.8%	12.4%
EAFE (C$)	5.6%	14.1%	0.5%
EAFE (local currency)	-0.5%	15.4%	2.9%
Canadian Bond Market	1.4%	1.3%	2.8%
World Bond Market (US $)	0.7%	-0.8%	-1.1%

*local currency (unless specified); price only

Bond markets rallied in June (see Table 1) almost entirely on the back of strong corporate bond performance. Corporations (still needing to raise capital to help them through challenging economic conditions) finally found acceptance among investors in the second quarter. Corporate debt issuance began to flow again, and the risk premium or additional yield offered (i.e. spread), between government and corporate bonds narrowed back to levels not seen in months. So while the 'safe-haven' trade and government bonds (both in Canada and in the U.S.) lost their appeal in the second quarter, corporations found takers for their debt – essentially a sign that investors believe these companies will still be around to pay them back.

COMMODITY CURRENCY?

Despite a weakening of the Canadian dollar in the month of June, the Canadian dollar increased by 7.9% in the second quarter relative to the U.S. dollar. The rise can be attributed to higher commodity prices and an improving economic outlook, though the theory broke down in June when the Bank of Canada expressed worries about the challenges that continue to face the Canadian economy. While commodity prices continued to rise, the central bank's warning was enough to create a meaningful headwind for the Loonie. Currencies can fluctuate as a result of innumerable causes (from market conditions, to political and/or economic factors). So while other factors do occasionally push the Canadian dollar around (such as in June), in a resource-rich country like Canada, commodity prices remain by far and away the dominant driver.

Table 2 - Sector level results for the Canadian market

S&P/TSX sector returns*	June	Q2 2009	YTD
S&P/TSX	0.0%	19.0%	15.4%
Energy	-2.6%	20.7%	19.3%
Materials	-6.6%	4.1%	12.1%
Industrials	4.3%	16.4%	3.6%
Consumer discretionary	5.4%	9.7%	0.3%
Consumer staples	4.8%	9.0%	1.8%
Health care	6.4%	7.1%	9.2%
Financials	5.5%	32.7%	22.5%
Information technology	-2.1%	43.3%	55.9%
Telecom services	-4.5%	-2.4%	-11.0%
Utilities	8.6%	13.5%	-1.4%

*price only

POUNDING THE PAVEMENT

Progress has been made in dealing with the economic crisis but a quick recovery is not guaranteed and a few 'standout' challenges remain – in particular, unemployment levels. The job market does not appear to have bottomed and this threatens to overshadow the existing stimulus efforts.

Employment is a good measure of what is happening in the economy. Unfortunately, the current job market is a big concern for Canadians and Americans alike. The Canadian unemployment rate climbed to 8.4% at the end of May according to statistics from the Labour Force Survey, reaching an 11-year high. The total number of jobs lost in Canada since the peak last October stands at 363 000. In the U.S., the statistics are even more concerning. The unemployment rate reached a 26-year high of 9.5% at the end of the second quarter as the government and the private sector shed jobs. The total number of jobs lost in the U.S. since the onset of the current recession stands at approximately 6.7million.

To put it bluntly, the macro-economic picture can show all the 'green shoots' of economic revival it wants, but if the micro-economic picture (the average household) continues to struggle with declining and uncertain income flow…then how's a green shoot to last without water (consumer spending) and sunshine (improved consumer sentiment)?

The upturn in a number of leading economic indicators this past quarter is a sign that economic progress has been made, and it is most definitely a turn in the right direction. Having said that, more is needed before an early recession exit is in the bag. After a very healthy spring rally, stock markets are likely to find the next leg up a bit more challenging.

THE BEST ADVICE BILL GATES EVER GOT

Keep things simple. In an interview with Microsoft's Bill Gates, he was quoted as saying that the best advice he ever got was from friend and fellow billionaire, Warren Buffet, to 'keep things simple'. If it's good enough for Bill and Warren (two self-made billionaires), it's good enough for me!

There is a lot of complexity that can be thrown into investing, but if the greatest minds keep it simple because they know they can't predict which data point will elicit a market rally, and which will spark the next sharp decline, then why should you risk your money trying? The best savings and investment plan you will ever have, is the one that you can stick with.

Diversify; match long-term financial plans with long-term goals; and stay within your risk tolerance. Simple – huh?