LONDON CAPITAL MANAGEMENT

Monthly investment commentary

November 2009

OCTOBER'S HIGHLIGHTS

- Global equity markets lost ground in October and ended their seven month winning streak.
- Commodity prices, boosted by a weak U.S. dollar, rose significantly:
  - Gold was up 4.4% to $1046/oz (U.S. dollar)[1]
  - Oil was up 9.6% to $77/barrel (West Texas, US dollar)[1]
  - Base metal prices for copper, nickel and zinc were up 7.1%; 6.5%; and 14.7%, respectively.[1]
- Third quarter U.S. GDP advanced by 3.5% (quarter over quarter, annualized). This was the first quarterly expansion in the U.S. economy since the second quarter of 2008.
- With the economic recovery well under way in some countries, economic stimulus measures (such as quantitative easing and ultra-low central bank rates) are starting to be withdrawn. Australia and Norway raised central bank rates, while the Bank of Canada and the U.S. Federal Reserve left their central bank rates unchanged.

THE CHANGING COLOURS OF AUTUMN

A seven-month equity market advance came to a halt in October, and just like the autumn leaves, equity returns turned from green to red.

After rallying hard since March, the cyclical and Financial sectors were hardest hit in the late October market reversal. This helps to explain why the S&P/TSX – with ¾ of its weight in the Energy, Materials and Financial sectors – was a laggard among global markets this month (see Table 1). Also within the Canadian equity market (see Table 2), the Information Technology sector was dragged down by Blackberry-maker, Research in Motion (RIM). RIM shares plummeted after quarterly earnings' results (along with a lackluster earnings forecast) disappointed investors.

Table 1– Summary of major market developments

Market returns*	October	YTD
S&P/TSX	-4.2%	21.4%
S&P500 (US$)	-2.0%	14.7%
S&P500 (C$)	-0.8%	1.9%
NASDAQ	-3.6%	29.7%
Russell 2000	-6.9%	12.7%
FTSE 100 (U.K.)	-1.7%	13.8%
NIKKEI 225 (Japan)	-1.0%	13.3%
EAFE (C$)	-0.1%	9.6%
EAFE (local currency)	-2.3%	14.7%
Canadian Bond Market**	-0.1%	5.5%
World Bond Market (US $)**	-0.1%	0.7%

*local currency (unless specified); price only
**total return
Source: S&P, National Bank, Royal Bank

The bond market (see Table 1) while weaker than previous months, managed to retain most of its gains. Corporate bond returns were modestly positive in October as yield spreads continued their narrowing trend.

Table 2 - Sector level results for the Canadian market

S&P/TSX sector returns*	October	YTD
S&P/TSX	-4.2%	21.4%
Energy	-1.5%	27.1%
Materials	-3.6%	21.4%
Industrials	-4.1%	9.7%
Consumer discretionary	-3.0%	2.5%
Consumer staples	-1.8%	-3.3%
Health care	-6.7%	23.7%
Financials	-7.5%	30.3%
Information technology	-9.1%	30.2%
Telecom services	-0.1%	-5.1%
Utilities	-1.3%	-0.4%

*price only
Source: National Bank

Following a period of relative strength, the Loonie reversed course at the end of October and depreciated against most major currencies. The Loonie closed the month at 92.2 U.S. cents, just two weeks after hitting its best level in fourteen months (98 U.S. cents on October 14, 2009) [2]. This type of volatility has been persistent since late 2008 and doesn't show signs of easing yet.

ON GILDED WINGS

While the U.S. dollar strengthened in late October, it remains at relatively weak levels. This has helped to underpin higher prices for commodities in general, including oil, base metals, soft commodities (like corn) and gold. Gold bullion in particular stood out as it hit new highs in October, ending the month at $1046/oz (USD) [1]. The U.S. dollar weakness was the main driver of higher gold prices, however investor demand for gold also increased as inflation expectations ticked upward (though still not excessive), as well as anecdotal suggestions of strong physical jewelry demand from emerging markets like China and India. Despite the stronger gold price, the share prices of gold companies declined as quarterly earnings results were weaker than expected.

IF HALF THE BATTLE IS JUST SHOWING UP…WE'RE NOW IN THE SECOND HALF

Despite third quarter earnings coming in ahead of analysts' expectations, the equity market failed to gain momentum in October.

What's not surprising? The markets taking a breather after a seven-month run that pushed global markets 50-60% higher from their March lows.

What is surprising? Even a stronger-than-expected rise in U.S. GDP data, the strongest and most tangible sign yet that the recession is ending, sparked a one-day rally…and nothing more.

What's up with that? Put simply - the easy part of the bull market is over.

The quick reversal of equity markets at the end of October tells us that recovery hopes, which drove the initial strong market rally from its depths in March, are no longer enough. We are now in the "prove it" phase where equities and cyclical sectors must show tangible fundamental improvements to gain investor approval.

While on the surface, all equities benefited from the initial market rebound, market pundits will tell you that it was really the low quality stocks that have led the recovery rally up to this point (i.e. those stocks that were hammered in the downturn were being rewarded simply for surviving). Going forward, expectations are that quality stock fundamentals (such as strong earnings growth, solid balance sheets and attractive valuations) will begin to re-assert themselves as the easy gains have already been realized.

The bar will be set to highlight companies that are poised to prosper in today's economic environment. In contrast to the first and second quarter corporate earnings of 2009, simply picking yourself up off the floor won't be good enough.

THE WEIGHING MACHINE

Benjamin Graham, the American economist noted for being the first proponent of value investing, famously wrote: "In the short run, the market is a voting machine, but in the long run it is a weighing machine." In other words, popular opinion (the voting machine) may rule the day for a period of time, but in the long run, investors will reward cold, hard proof (the weighing machine) that a company is poised to prosper. It is the market's weighing machine that:

- allows professional money managers (i.e. the people who spend their day 'weighing' companies) to add value, and
- places the advantage of equity investing squarely with long term investors.

[1]National Bank
[2]Bloomberg