Market Matters

AUGUST HIGHLIGHTS

- Global equity markets continued to rally, showing resilience in the face of ongoing economic concerns.
- Hopes grew (and were later answered) for policy and stimulus action to rescue fragile economies and lift investors' confidence.
- Economic stimulus announcements from Federal Reserve Chairman, Ben Bernanke, and (early in September) China and European Central Bank (ECB) President Mario Draghi helped capital markets gain ground.
- The S&P500 outperformed its global counterparts with strong year-to-date returns.
- A rebound in commodity prices helped the Canadian S&P/TSX recover from a difficult first half of the year.
- The Canadian bond market weakened as investors modestly shifted back to equities.
- Oil (WTI) prices were up 10%.
- The Canadian dollar was up 1.7% against the U.S. dollar.

MARKET RESILIENCE

Economic indicators lead us to believe that we are experiencing another 'soft patch' for the U.S. economy, a recessionary state in Europe, and slowing growth prospects in China. Economic data tells us what 'has' happened – they are backward-looking. Capital markets on the other hand are forward-looking, and this summer equity markets managed to stay relatively resilient as forward-looking expectations grew for U.S., Chinese and European policy and stimulus action to rescue fragile economies and (even more fragile) investor confidence.

RESPECTABLE GAINS

While volatility continued throughout the summer, global equity markets booked respectable gains (more so for developed country equity markets) (see Table 1). Of note, the American S&P500 has steadily outperformed its global counterparts with strong double-digit year-to-date returns leading into the fall. Corporate earnings in the U.S. have continued to please investors by meeting or beating analysts' expectations for eleven quarters in a row.

Table 1
Summary of major market developments

Market returns*	August	YTD
S&P/TSX Composite	2.4%	0.0%
S&P 500	2.0%	11.8%
- in Canadian dollars	*0.3%*	*8.5%*
MSCI EAFE	1.3%	4.8%
- in Canadian dollars	*0.7%*	*1.1%*
MSCI Emerging Markets	-0.4%	4.3%
DEX Universe Bond Index**	-0.1%	2.6%
BBB Corporate Index**	0.3%	5.4%

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

Table 2
Other price levels/change

	Level	August	YTD
U.S. dollar per Canadian dollar	$1.014	1.7%	3.1%
Oil (West Texas)*	$96.41	10.1%	-2.6%
Gold*	$1,674	3.3%	6.3%
Reuters/Jefferies CRB Index*	$309.59	3.4%	1.4%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	August	YTD
S&P/TSX Composite	2.4%	0.0%
Energy	1.2%	-4.1%
Materials	6.7%	-8.7%
Industrials	-0.1%	6.1%
Consumer discretionary	0.9%	12.3%
Consumer staples	2.2%	12.3%
Health care	3.4%	11.3%
Financials	2.1%	5.2%
Information technology	5.2%	-11.2%
Telecommunication services	1.4%	3.7%
Utilities	-1.7%	-2.2%

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

Granted, analysts' revisions have been steadily lowering the bar for corporate earnings throughout much of 2012 – but a strong record for U.S. corporations none-the-less.

Meanwhile, the lagging Canadian S&P/TSX has only recently caught some traction as commodities have begun to recover from steep declines earlier in the year. Commodity prices and Canada's resource sectors (see Table 2 and 3) were helped by a combination of Chinese domestic stimulus announcements and positive policy action in the U.S. and Europe - all of which combined to improve the outlook for global growth, which in turn helps resource-based economies such as ours.

The Canadian bond market results were flat to negative in the month of August. The meager income generated from current low bond yields has not been sufficient to offset bond price drops due to investors' modest shift back to equities. Fixed income investments, even when income generation is low, continue to serve as excellent volatility and risk management vehicles. While they remain an important part of a diversified portfolio, when held alone in a portfolio, they may not be sufficient to meet the growth and income needs of many investors.

UNDER PRESSURE

A number of ongoing concerns continue to weigh on investors: Europe's debt issues; signs of an economic slowdown in China; growing anticipation over the U.S. Presidential election; and the approaching 'fiscal cliff'[1] in the U.S. Each one magnified the pressure on policymakers to, quite simply, 'do more'. *(If only 'doing more' were quite so simple.)*

Calls were eventually answered in late August and early September with announcements from the U.S. Federal Reserve, the Chinese government, and the European Central Bank (ECB) – and capital markets quickly responded favourably.

- In late August, U.S. Federal Reserve Chairman Bernanke confirmed his commitment to 'stay the course'- keeping interest rates at über low levels for the foreseeable future and re-affirmed his willingness to offer up stimulus programs for the fragile U.S. economy.
- Early in September China's central government launched a one trillion yuan ($150bn USD) infrastructure spending package to help keep flagging growth alive.
- In Europe, ECB President Mario Draghi announced his Outright Monetary Transactions (OMTs). In short, Mr. Draghi made good on his summer-time commitment to 'do whatever it takes to save the euro'. The new OMT program would allow for the purchase of unlimited amounts of bonds to provide a "fully effective backstop" to stricken European economies, such as the familiar headliners like Spain, Greece and Italy. It's the ECBs most aggressive action yet.

News of these substantial stimulus programs should provide significant support to the global economy, but we caution investors from believing they are magic elixirs for capital markets. As the details of the programs roll-out, we anticipate ongoing market volatility in the coming months.

[1] The fiscal cliff in the U.S. refers to a number of different policies (such as tax cuts and stimulus programs) that are set to change around the same time, most on January 1, 2013. The worry is that this sudden change in consumer cash flow will derail an already fragile U.S. economic recovery.

BE YOUR OWN POLICY MAKER

When you look at your own long-term investment portfolio, diversify with:

- Some equity holdings: Your personal economic stimulus package for when equity markets are in-favour and rising.
- Some fixed income holdings: Your own bond-buying package that offers an 'effective backstop' for times when investors are cautious and equity markets are out-of-favour.