GLC ASSET MANAGEMENT GROUP

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Market Matters

Q3 2013 Highlights

- Global equity markets had a strong quarter as, on balance, economic data was better than anticipated (e.g. Europe, China and Japan all demonstrated varying levels of improvement).
- The combination of a global economy that appears to be gaining momentum and supportive monetary policy also helped the Canadian equity market post a very strong third quarter.
- The Canadian bond market was initially weighed down by rising yields (in anticipation that the U.S. Federal Reserve would be cutting back on quantitative easing), only to see much of that reverse at the end of the quarter as the U.S. Federal Reserve did not do as expected.
- Economic data in the U.S. remained mixed, with just enough good news to help the S&P500 resume its upward trend, and just enough bad news to cause the U.S. Federal Reserve to surprise the markets in mid-September and maintain (not cut) its quantitative easing program.

A FEW TREATS IN THE BAG

Global stock markets bagged some sweet results this quarter, managing to shrug off a number of modest scares.

While economic data in the U.S. in the third quarter was a mix of sweet and sour news, U.S. equity stocks resumed their upward trend after a second quarter consolidation. Outside the U.S., economic data from Europe, China and Japan have all demonstrated varying levels of improvement, and global equity markets took notice (see Table 1).

Specifically within Canada, expectations remain for sluggish economic growth, but for the quarter it appears that the Canadian stock market managed to 'thread the needle' as an improving global economic growth outlook helped offset domestic concerns such as housing and consumer debt levels. The S&P/TSX composite index saw good breadth of stocks participating in the third quarter rally. The health care and consumer discretionary sectors were top performers, helped by several company specific events. The energy and beleaguered materials sectors saw a strong bounce back in August as oil, gold and base metal prices responded to better economic data out of China and Europe. This was partially offset by the decline in fertilizer company stock prices due to the

Table 1
Summary of major market developments

Market returns*	September	Q3 2013	YTD
S&P/TSX Composite	1.1%	5.4%	2.8%
S&P500	3.0%	4.7%	17.9%
- in Canadian dollars	*0.7%*	*2.4%*	*22.0%*
MSCI EAFE	4.3%	6.9%	16.5%
- in Canadian dollars	*4.8%*	*8.5%*	*17.3%*
MSCI Emerging Markets	4.0%	4.9%	-1.7%
DEX Universe Bond**	0.5%	0.1%	-1.6%
BBB Corporate Index**	0.5%	0.4%	0.1%

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

Table 2
Other price levels/change

	Level	September	YTD
U.S. dollar per Canadian dollar	$0.970	2.3%	-3.8%
Oil (West Texas)*	$102.33	-4.9%	11.5%
Gold*	$1,332	-4.7%	-20.6%
Reuters/Jefferies CRB Index*	$285.54	-1.9%	-3.2%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX sector returns*	September	Q3 2013	YTD
S&P/TSX Composite	1.1%	5.4%	2.8%
Energy	1.5%	5.7%	4.8%
Materials	-5.1%	4.0%	-28.8%
Industrials	4.7%	2.9%	16.5%
Consumer discretionary	3.2%	7.7%	29.9%
Consumer staples	0.5%	2.8%	17.2%
Health care	-2.1%	10.9%	50.9%
Financials	2.2%	6.4%	9.1%
Information technology	-0.8%	6.0%	27.3%
Telecom services	3.5%	4.8%	2.3%
Utilities	1.9%	-4.3%	-10.2%

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

breakup of the Russia/Belarus potash cartel. Strong quarterly earnings results from Canadian banks helped boost the results of the Canadian financial sector.

BONDS: NOT AS SCARY AS YOU MIGHT THINK

Within the Canadian bond market, the corporate bond sector performed best as the additional yield/income over Government of Canada bonds helped negate capital losses from increasing yields. Likewise, the shorter duration fixed-income products offered less sensitivity to rising interest rates and outperformed their longer-term fixed income counterparts.

Much has been made about the end of the 30-year bull market for bonds. While we hold the view that the 8-9% returns of past years are unlikely to repeat, we firmly believe that fixed-income remains an important asset class to hold for most investors. Beyond the income component lies a unique characteristic of fixed-income products – a tendency to perform best in times of economic uncertainty. This was highlighted in September when a surprise announcement from the U.S. Federal Reserve (Fed) highlighted more economic concern than had been priced into the markets. As a result, bond markets swiftly rallied, counteracting the headwind of the rate increases earlier in the quarter.

THE FED'S TRICK

All eyes were on the Fed during the third quarter, leading to market volatility as investors scrutinized each piece of economic news for signs of whether they would begin to taper their asset purchase program. On balance, economists and market watchers alike felt that U.S. economic data was mixed (but at least not worse) than when the Fed first made mention of plans to eventually cut back on their quantitative easing program. So it was a surprise to market watchers when the Fed announced in mid-September it was going to maintain (not cut) its asset purchasing program. The Fed cited concerns over the impact of rising rates and fiscal uncertainty in the economy and labour market as key reasons to maintain the current pace of quantitative easing.

The good news: There is continued stimulus to boost the economy.
The bad news: The Fed feels the U.S. economy still needs it.

WHAT'S AROUND THE CORNER

Markets have now shifted their focus from Fed watching to the latest suspense theatrics out of Washington (i.e. the U.S. government shut down and U.S. debt ceiling limit on October 17th). While the government shutdown may cost the economy, it is the Oct. 17th debt limit that is the real ghoul around the corner. If Washington cannot clear up their issues within the first half of October, concern over a possible technical default will dominate investor sentiment. Expect market volatility, especially as developments in Washington unfold.

DON'T BE SCARED, BE PREPARED

Telling Wall Street and Bay Street not to obsess over each piece of economic data and political gamesmanship is about as useful as adding a gravity detector to a parachute. We need to accept that short-term volatility will occur and ensure it doesn't detract us from our long-term investment goals. For the average investor, it means having a well diversified investment portfolio (in most cases, that means a combination of equities and fixed income) to mitigate short-term volatility within a portfolio and help maintain focus on long-term investment goals. As professional portfolio managers, it means having a clear and defined investment process in place so we can stay focused on recognizing and acting on opportunities as they present themselves – even during periods of extreme market volatility.

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