GLC ASSET MANAGEMENT GROUP

Market Matters

JULY HIGHLIGHTS

- Major world equity markets experienced significant volatility marking the start of a period of considerable market unrest.
- Investor sentiment soured with uncertainty. Concerns over European sovereign debt early in the month were quickly overshadowed by the U.S. debt problems, and early August economic news only heightened investor anxiety.
- Bond markets fared well as investors took flight to the safety and stability of fixed-income investments.
- Gold prices hit new highs in July (the upward trend continued in August) as investors sought out the yellow-metal's safe-haven characteristics.
- Better than anticipated corporate earnings results provided some support to equity markets, but not enough to withstand the broader negative macro-economic news.
- The Bank of Canada continued to hold rates steady, now decidedly more cautious about removing accommodative borrowing rates.

Table 1
Summary of major market developments

Market Returns*	July	YTD
S&P/TSX Composite	-2.7%	-3.7%
S&P500	-2.1%	2.8%
- in C$	*-2.9%*	*-1.2%*
MSCI EAFE	-3.6%	-5.2%
- in C$	*-2.5%*	*-3.0%*
MSCI Emerging Markets	-1.3%	-4.5%
DEX Bond Universe**	2.0%	4.3%
BBB Corporate Index**	2.6%	5.1%

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

Table 2
Other price levels/change

	Level	July	YTD
USD per CAD	$1.0456	0.8%	4.0%
Oil (West Texas)*	$95.96	0.9%	5.1%
Gold*	$1,623	7.5%	14.5%
Reuters/Jefferies CRB Index*	$342.08	1.2%	2.8%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX sector returns*	July	YTD
S&P/TSX	-2.7%	-3.7%
Energy	-1.7%	-3.4%
Materials	1.6%	-8.6%
Industrials	-6.6%	2.5%
Consumer discretionary	-6.6%	-8.8%
Consumer staples	-0.2%	3.7%
Health care	4.3%	62.7%
Financials	-5.6%	-1.6%
Information technology	-8.8%	-36.9%
Telecom services	-3.2%	7.0%
Utilities	-0.3%	-0.8%

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

THE NAME OF THE GAME

Market volatility has been the name of the game this summer as investor uncertainty grew concerning exactly how (and if) the world's largest economy would avoid defaulting on their financial obligations. In fact, tracking the equity markets through most of July looked a lot like a boot camp exercise drill: down 5, up 5, down 8, up 5, down 10, etc… Then, in the last days of the month as the August 2nd debt ceiling deadline of loomed, investor sentiment and equity market results took a more definitive negative turn.

Tables 1 and 2 highlight the early stages of investors trading off risk assets (equities and cyclical commodities) in search of safety (bonds, U.S. Treasuries, and defensive commodities like gold).

CASTING A LONG SHADOW

While currently overshadowed by macro-economic events, investors should keep in sight attractive market fundamentals despite the fog of emotions. Companies are in the midst of reporting second quarter earnings, and results are looking strong. For the S&P500 companies that have reported so far, approximately three quarters of them have beat expectations. Financial results have been strong for both top-line and bottom-line growth. The combination of falling prices and rising profits has driven stock valuations down to very attractive levels from earlier in the year and compared to historical levels. It appears in the near term; however, macro-economic concerns will override attractive market fundamentals in North America. As a result, we expect continued unsettled market conditions as investors digest the economic news that has affected market conditions so far this summer:

- U.S. lawmakers struck a watered-down deal to raise the debt ceiling and avoid a potential default situation. In doing so, they highlighted just how much heavy-lifting is yet to be done before the U.S. finds itself on more stable fiscal economic ground.

- U.S. manufacturing and consumer spending data provided further evidence that the U.S. economic recovery is sluggish and still fragile.
- Eurozone sovereign debt problems remain unresolved. Concern is growing among investors that the European Central Bank is not being aggressive enough in backstopping the debt markets of countries such as Spain, Italy, Greece and Portugal.
- Standard and Poor's (S&P) announced they were downgrading the U.S. long-term government debt rating by one notch, from "AAA" to "AA+".

WHAT DOES THIS MEAN FOR MARKETS?

Investors are increasingly worried that the U.S. economy is headed toward another recession and about the possibility that Europe's debt crisis might spread to larger economies. As a result, equity markets have experienced general weakness and some days of sharp pullbacks. Major stock markets erased year-to-date gains as investors came to recognize that the U.S. debt deal was not a silver-bullet solution. At this point, investor sentiment around these issues has been priced into the markets, however it is not clear how much additional emotional risk aversion will develop and we continue to expect significant market volatility going forward.

We are less likely to see disruptions in bond markets. When investors are nervous, they tend to run to government bonds. We have seen a decline in bond yields as a result. Ironically, even U.S. government debt (the debt that has just been downgraded) has seen its price actually rise. This reflects a shortage of places for U.S. government debt investors to go. The Canadian bond market has been a beneficiary (Canada is still rated AAA), but realistically our bond market can only sop up so much investment. In the end, large creditors to the U.S. still have confidence in the U.S. and are expected to remain put.

KEEPING COOL

With investors focused on the very near future and in a skittish mood, it appears difficult to see what catalysts will move the market higher. While this is true, a lot of bad news is already priced in and, unless the news continues to get worse, we expect sentiment (and equity prices) to normalize over the coming months.
Last year at this time we saw a similar crisis in confidence. After a spike in fear, policymakers took steps to reassure markets. The result was a strong market rally. Since then, evidence has continued to accumulate that, while not robust and with many challenges, the U.S. economy continues to move forward. And, we have to recognize that companies have done a stellar job in managing through these conditions.

Keeping an eye on long-term fundamentals will prevent investors from knee-jerk reactions and their potential damage. We have all seen the statistics showing that investors tend to sell when they are scared (i.e. when others are selling and prices are low) and buy after confidence is restored (i.e. when prices are high) hurting their overall long-term returns.

GOING FORWARD

GLC Asset Management Group's (GLC) portfolio managers and analysts are always monitoring factors that affect the investment mandates they manage. This includes economic and market conditions to identify opportunities that provide long-term investors with attractive risk-adjusted opportunities.

While market volatility may be taking top headlines now, in the longer term investors will benefit from renewed confidence as market fundamentals and corporate balance sheets take precedent over headlines and top-of-the-hour news reports. This plays right into the GLC's strengths of professional active portfolio managers with disciplined and process-driven investment styles.

As professional money managers, we know volatility can create significant opportunities and we remain ever-watchful for any investment opportunities that may emerge. Likewise market volatility can create opportunities for investors who benefit from professional financial security advice and a diversified, long-term investment plan.

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