LONDON CAPITAL MANAGEMENT

Monthly investment commentary

July 2008

JUNE'S HIGHLIGHTS

- June was not kind to equity markets as investor sentiment soured - again.
- Inflation concerns heightened as consumers from the U.K. to U.S.A. felt the pinch of rising oil and food prices.
- Oil prices (West Texas) pushed past $140/barrel.
- The commodity boom continued to boost the S&P/TSX, making it the only major global market to still have positive returns for the first half of 2008.
- On June 10th the Bank of Canada left the overnight interest rate where it was - surprising the bond markets and marking a distinct shift from economic stimulus to inflation protection.

WHAT ELSE IS NEW?

This June, oil prices hit new highs; inflation concerns increased; banks announced more writedowns; U.S. consumer confidence dropped and markets experienced significant volatility. Same old, same old! Despite many of the same economic conditions being present in April and May, investors were less inclined to overlook them in June, making this past month particularly unkind to equities (see Table 1).

Table 1– Summary of major market developments

Market returns*	June	Q2 2008	YTD
S&P/TSX	-1.7%	8.4%	4.6%
S&P500 (US$)	-8.6%	-3.2%	-12.8%
S&P500 (C$)	-6.5%	-4.1%	-10.5%
NASDAQ	-9.1%	0.6%	-13.6%
Russell 2000	-7.8%	0.2%	-10.0%
FTSE 100 (U.K.)	-7.1%	-1.3%	-12.9%
NIKKEI 225 (Japan)	-6.0%	7.6%	-11.9%
EAFE (C$)	-5.8%	-4.0%	-10.7%
EAFE (local currency)	-9.0%	-2.1%	-17.3%
Canadian Bond Market	-0.1%	-0.7%	2.2%
World Bond Market (US $)	0.1%	-2.3%	0.2%

*local currency (unless specified); price only

There is no denying the commodity boom continues to have a positive influence on the Canadian stock market in 2008. The S&P/TSX posted its strongest quarter since the end of 2006, and by the end of June was the only major global market to be in positive territory for the year. This is a particularly impressive feat when most other major markets are in double-digit negative returns for 2008 (see Table 1).

Table 2 - Sector level results for the Canadian market

S&P/TSX sector returns*	June	Q2 2008	YTD
S&P/TSX	-1.7%	8.4%	4.6%
Energy	1.6%	22.0%	22.4%
Materials	11.1%	17.2%	25.6%
Industrials	-8.8%	2.9%	0.5%
Consumer discretionary	-8.9%	-11.4%	-24.7%
Consumer staples	-1.9%	1.1%	-5.5%
Health care	-10.2%	-12.0%	-15.1%
Financials	-9.1%	-4.2%	-13.3%
Information technology	-11.5%	3.1%	1.4%
Telecom services	-4.9%	2.1%	-11.1%
Utilities	-0.3%	5.4%	-1.3%

*price only

In Canada, the Energy and Materials sectors were the only sectors that remained in positive territory this June and are the run-away favourites so far in 2008, whereas the Financial sector (still plagued by bank writedown announcements) and the Consumer Discretionary sector exerted the most significant drag on the S&P/TSX (see Table 2). The Information Technology sector experienced significant volatility as it moved in sync with Research in Motion (RIM). Despite RIM's strong profit results, it did not meet market expectations and this caused a sharp double-digit drop in share value towards the end of the month.

The Canadian bond market also had a tough go of it in June. Mark Carney, Governor of the Bank of Canada, shocked the market by failing to do 'the expected'. While the bond market had been betting on a 0.25% drop in the Bank of Canada interest rate, Mark Carney was looking deeper at inflation concerns. He chose to leave rates where they were, and this action (or rather inaction) caught the market off guard and caused the bond market to slip into negative territory.

THE BIG SQUEEZE

Americans are facing a significant financial 'squeeze' that seems likely to last into the early parts of 2009. The price of gasoline in the U.S. is up by 40% from a year ago. By year-end U.S. consumers will have absorbed an extra $100 billion ($US) in energy costs if gasoline prices stay close to current levels. Across North American, with every new price increase, it is becoming apparent that the rising price of oil has turned from a sign of positive economic growth, to an emissions-filled cloud of gloom as consumers hand over more money with each tank of gasoline. The shift has been pronounced on both an economic and social front. 'Fuel-efficiency' has replaced 'bigger is better' as the new car-braggers adage. Even the toughest-looking motorcyclists are experiencing a 'greener and cleaner' image this summer.

Adding to U.S. consumers' concerns, their home values continue to fall. An increasing number of American home owners are finding themselves 'upside down' on their mortgages (i.e. owing more on their mortgage than their house is worth). All of this has brought U.S. consumer confidence down to its lowest level in decades, and is putting a big squeeze on Americans' household cashflow.

REASON FOR OPTIMISM

Fortunately for Canadians, we do not face the kind of financial pressures that Americans have. While not immune to the slowdown in the U.S., Canadian economic weakness has been less broad based and has largely been centered in exports. Personal wealth has continued to grow in Canada. Household net worth is still advancing as Canadian real estate assets have continued to increase in value, and our retail sales have been relatively robust.

Perhaps the biggest reason for optimism among equity investors is a contrarian market indicator. Current market sentiment is bearish, which tends to be a leading indicator for market growth and recovery. When investors expect the worst, bad news tends to become 'just the expected' and is already priced in, while any mildly positive news is received as a pleasant surprise to which the markets tend to rally.

With few 'new' issues facing the economy, investors tend to revert to focusing on stock fundamentals (i.e. those company specific attributes that give insight into a company's financial health and potential for future earnings growth). That's good news because currently stock fundamentals are looking a lot better than you might initially think. We continue to see solid earnings growth in many sectors, global stock valuations are looking attractive, and finally, globalization and emerging market growth continues. Even if emerging market growth slows somewhat from its earlier torrid pace, it continues to bode well for resource-rich countries like Canada.

A VOICE OF REASON

Recent market volatility and difficult economic environments cause investors to feel anxious about their investment portfolios. Yet amidst the media noise and hype that surround us, a voice of reason can ring clear and help investors maintain an appropriate perspective.

Analysts and economic commentators can make their name by having strong opinions and absolute conviction. We know that when markets are volatile they get more than their usual 'air time', but we also know they don't 'get it right' every time. Be cautious of extreme recommendations. Avoiding equity markets all together is not without significant risk. The opportunity lost with time out of the equity markets can be costly to long-term portfolios. Likewise, a large bet on any one sector or commodity (no matter how attractive and resilient it may appear right now) will likely increase the volatility and risk in your portfolio.

Economies and markets will experience times of prosperity and times of contraction. To our knowledge, no one has timed each shift with unfailing accuracy. Develop your savings plan and targets; build your long-term investment portfolio to be diversified and risk-appropriate; do your best to stick to it; and don't forget to enjoy your summer!