GLC ASSET MANAGEMENT GROUP

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Market Matters

Q3 HIGHLIGHTS

- After significant weakness in the second quarter, global equity markets sprang to life over the summer, reflecting the growing belief by investors that the efforts of global central bank authorities will help the world economies grow instead of contract. (see Table 1)
- A 'risk-on' trade ensued with cyclical equity sectors, commodities and corporate bonds outperforming their more defensive counterparts.
- "Whatever it takes" – Mario Draghi, President of the European Central Bank, announces his Outright Monetary Transactions plan – an unlimited bond-buying mechanism to support struggling Euro nations.
- "As long as it takes" – Ben Bernanke, Chairman of the U.S. Federal Reserve, announces his third major quantitative easing plan. An aggressive plan with no pre-determined end-date to stimulate the U.S. economy and support the recovery of jobs.
- More of what it takes – Policy makers around the world (including Canada, U.K., China, Australia) kept interest rates low and/or expanded their stimulus measures to support economic growth.

SUMMER REVIVAL

Anticipation of stimulus packages and quantitative easing ignited the summer rally for equities. By late summer, verbal commitments by central bankers added fuel to extend the rally. In particular:

- European Central Bank announced its most aggressive plan yet to tackle their sovereign debt crisis;
- China commits 1 trillion Yuan toward infrastructure spending; and,
- U.S. Federal Reserve's launches its third round of quantitative easing (QE3).

The improved investor outlook spurred the 'risk-on' move from cash and fixed-income, back into equities.

The recent policy announcements from central bankers is supportive of global economic growth, and thus very constructive for hard assets, which helped Canadian equities to play catch-up to global peers. Canada's large exposure to resources, which pressured performance earlier in the year, was a benefit during the third quarter (see Table 2). Prices for copper (+6.8%), gold (+11.1%), and oil (+8.5%) each rallied strongly over the quarter.

Table 1
Summary of major market developments

Market returns*	September	Q3 2012	YTD
S&P/TSX Composite	3.1%	6.2%	3.0%
S&P500	2.4%	5.8%	14.6%
- in Canadian dollars	*2.2%*	*2.1%*	*10.8%*
MSCI EAFE	1.2%	3.9%	6.0%
- in Canadian dollars	*2.3%*	*2.5%*	*3.5%*
MSCI Emerging Markets	4.1%	5.1%	8.5%
DEX Universe Bond**	0.7%	1.2%	3.3%
BBB Corporate Index**	1.1%	2.3%	6.5%

*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	$1.017	0.3%	3.3%
Oil (West Texas)*	$92.05	-4.5%	-7.0%
Gold*	$1,774	6.0%	12.7%
Reuters/Jefferies CRB Index*	$309.30	-0.1%	1.3%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX sector returns*	September	Q3 2012	YTD
S&P/TSX Composite	3.1%	6.2%	3.0%
Energy	2.0%	7.7%	-2.1%
Materials	9.7%	12.8%	0.1%
Industrials	-0.3%	2.0%	5.8%
Consumer discretionary	0.7%	1.4%	13.1%
Consumer staples	-1.5%	2.6%	10.7%
Health care	7.9%	7.9%	20.1%
Financials	1.9%	3.7%	7.2%
Information technology	1.7%	2.0%	-9.7%
Telecom services	-0.4%	3.8%	3.2%
Utilities	1.4%	0.9%	-0.9%

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

Among its peers the American S&P500 stock market stands out for having a terrific year thus far with double-digit gains. While on balance the economic data released over the third quarter was mixed, investors focused primarily on the positive - an improving housing market backdrop; attractive corporate earnings; and strong action by the U.S. Federal Reserve to press on the stimulus gas pedal harder, and for longer.

Leave it to bond investors to be more cynical than equity investors. As expected, the improved risk appetite of investors was initially negative for bond prices. However rising yields fully reversed towards the end of September as bond investors worried about the implementation plans of the stimulus measures, and took on a decidedly less enthusiastic 'wait and see' approach.

We continue to see investor sentiment as being fragile and relatively fickle. Over the coming months there will be no shortage of political and economic events to capture media headlines, not the least of which will be political leadership changes in China, U.S., and Italy, and upcoming deadlines for fiscal cliffs, austerity targets, and debt ceilings. In the near term, we anticipate market volatility, but as you can see from this recent quarter, volatility is not limited to downside results. Investors who left the Canadian market during the first half of the year would have locked in negative results, without the benefit of the upside volatility that ensued over the summer. A clear lesson in the benefits of maintaining a longer-term perspective on investing.

THE NEW GUARD IS AVANT-GARDE

July 26, 2012 - Mario Draghi, President of the European Central Bank vows to do 'whatever it takes' to preserve the euro.

September 13, 2012 - Ben Bernanke, U.S. Federal Chairman announces stimulus action for 'as long as it takes' and effectively declares war on stubborn U.S. unemployment rates.

Over the course of history, central bankers (particularly from large, established regimes) have largely been seen as outmoded, orthodox and rigid. Things have changed. Today's leading central bankers are seeking out unconventional and aggressive solutions to the threat of a global economic slowdown and a dreaded deflationary spiral. The goal for growth is not just to get the economy to pick up speed, but to grow fast enough and for long enough to restore employment (particularly in the U.S.) and to meet sustainable deficit/spending goals.

None of these are expected to happen overnight, and while these developments are encouraging, the approach is, by its very nature, untested. Over a longer time horizon we remain cautiously optimistic that the synchronized global easing will have the desired effect and get the global economy (and equity markets) on a stronger growth trajectory.

LESSONS IN LATIN

Based on trends to net cash flows into long-term investment funds in Canada, we feel fairly comfortable suggesting that investors, in general, remain too defensively positioned. Our current assessment of capital markets in North American show that equity valuations remain below historical averages (i.e. relatively cheap), and bonds remain largely overbought (i.e. relatively expensive). But averages don't speak to you – we get that. What is right for you and your long-term investment portfolio is personal and has everything to do with your comfort with *quid pro quo* (Latin for 'this for that'). Relative to bonds, equities offer you a greater outlook for long-term capital growth. For that, you accept greater volatility, particularly over the short-term. Relative to equities, bonds offer less volatility and for that you accept a weaker outlook for long-term capital growth. Basically, *quid pro quo* is the Latin version of 'no free lunch' in the investment world.

Caeteris paribus (Latin for 'all things being equal'), most investors can benefit from a diversified and balanced approach of both equities and bonds to help balance the equation for volatility and growth in a long-term investment portfolio. *Carpe diem!*

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