Monthly investment commentary

September 2010

AUGUST HIGHLIGHTS
• Equity markets reflected investor concerns that the global economic recovery is tenuous. • Bond markets and gold prices benefited from the uncertainty felt by investors. • Canada's economic backdrop continues to benefit from commodity demand and a stronger fiscal position than the U.S. both from a consumer and federal standpoint. • Depressed housing prices and lack of jobs continue to be weak points for the U.S. economy, heightening concerns over the pace of their recovery from the financial crisis. • European sovereign debt issues abated (at least temporarily) in August. • Developing countries continued to show strength and their importance to the global economic landscape. • The Canadian S&P/TSX index was one of the few developed markets to show a positive return – albeit with a significant divergence among sectors. The Materials sector was the key driver behind the index's positive return.

DOWN GREAT-ED EXPECTATIONS

For most of 2010 the uncertainty surrounding global economic growth has subdued investors' confidence and has plagued the financial markets. The great expectations for a speedy 'V-shaped' recovery have dissipated. While global economic growth continues to be positive (anticipated to be around 4% this year); investors are coming to the conclusion that the journey back to economic health may take longer than previously hoped.

Table 1– Summary of major market developments

Market returns*	August	YTD
S&P/TSX Composite	1.7%	1.4%
S&P500	-4.7%	-5.9%
- in C$	*-1.2%*	*-5.0%*
MSCI EAFE	-2.9%	-7.5%
- in C$	*0.2%*	*-8.7%*
MSCI Emerging Markets	-1.6%	-1.5%
DEX Bond Universe**	2.0%	6.8%
BBB Corporate Index**	2.2%	9.2%

*local currency (unless specified); price only
**total return, Canadian bonds
Source: Bloomberg, MSCI Barra, NB Financial, PC Bond, RBC Capital Markets

Most major equity markets dropped in August in accordance with the sense of malaise (see Table 1), although the S&P/TSX Composite index remains in positive territory on a year-to-date basis. In contrast, bond markets benefited from the apprehension of investors towards risk assets in the month.

LOSS OF MOMENTUM

Despite the fact that the U.S. economy is still growing (annualized GDP growth expanded by 1.6% in the second quarter), there has been a loss of momentum in overall economic activity, and that was reflected in the results of the S&P500 (see Table 1).

There are areas of significant economic improvement that can be seen in the U.S., such as:

- Credit conditions in the U.S. are gradually improving (lending standards for small business have even begun to ease).
- Corporations have lots of cash on the books and corporate profits are strong.
- Both business and household balance sheets are well on the road to repair (the U.S. personal saving rate averaged 5.9% in 2009 and is expected to be higher this year).

However, key areas for concern remain the stubbornly high unemployment rates, and a (still) weak housing market. Although the U.S. tax credit did help put a floor under housing sales in the past year, it has not provided a foundation for self-sustained growth. For that, we need to see more jobs. With fewer Americans working, and their home prices still depressed, the American consumer has had trouble feeling good about their financial situation. The healthier and cash-heavy corporations appear poised to invest more and boost hiring, but at this point it remains a 'wait and see' scenario for Americans looking to get back to work.

Canada is inevitably tied to the health of our closest neighbour, but our current economic well-being is notably better at this point in the recovery stage. Canada's leading economic indicators are stronger than in the U.S. and our economic growth prospects have improved with the increasing global demand for commodities and healthier underlying economic and financial sector fundamentals. Still we expect the Canadian economy to lose some steam as the housing and domestic consumer spending led rebound of earlier this year subsides.

POTASH BOOSTS GROWTH

Canada's S&P/TSX index was a noted outlier among stock markets in August. The driving force behind lifting results into positive territory in August came from the Materials sector (see Table 2).

Table 2 - Sector level results for the Canadian market

S&P/TSX sector returns*	August	YTD
S&P/TSX	1.7%	1.4%
Energy	-2.0%	-6.4%
Materials	17.2%	16.4%
Industrials	0.7%	5.2%
Consumer discretionary	0.7%	11.0%
Consumer staples	4.1%	1.5%
Health care	12.0%	38.0%
Financials	-3.7%	-2.4%
Information technology	-16.7%	-27.5%
Telecom services	5.2%	14.5%
Utilities	0.6%	2.2%

*price only
Source: National Bank

Gold stocks were helped by higher bullion prices, as demand for gold (considered a safe-haven asset) increased with investor anxiety. However, the real-headliner in the Materials space was the hostile take-over bid for Potash Corporation of Saskatchewan (PotashCorp) by BHP Billiton, an Australian mining company. PotashCorp makes up 3.5% of the S&P/TSX and the fertilizer company's stock soared sharply (up 46% in August) as the news broke and rumours of 'white knight bids' swirled.

At the other end of the spectrum, yet another stock-specific story drove down the results of the Information Technology sector. Research in Motion (RIM)'s newest Blackberry Torch has failed to light up the life of investors (i.e. sales in the U.S. were slower than hoped for), and a number of countries (such as the United Arab Emirates, Saudi Arabia, and India) threatened to ban RIM's service over national security surveillance concerns. All in all the troubles and lack-luster results put downward pressure on the stock to the tune of a 23% hit for the month.

PERFECTION IS THE ENEMY OF SUCCESS

It has been said that many a goal has been derailed by the pursuit of perfection. The saying is particularly true for investing. Every day there are investors who obsess over trying to time the exact top or bottom of the market, or a sector, or a stock - looking to make 'the perfect trade' to catch all of the upside and none of the downside. They are inevitably (or at the very least eventually) disappointed. When was the last time you met, or even heard of, anyone who has managed to repeat the feat? Did you believe them?

Instead of building an investment plan that depends on nerves of steel to make perfect moves, at the perfect time, with perfect foresight, consider building an investment plan with a margin of error already factored in.

- Dollar cost averaging in your investments helps you avoid having to perfectly time the market, allowing you to buy more when prices are low and less when prices are high.
- Diversification means you don't have to wonder what the next hot sector, country, currency or asset class is going to be in order to benefit from it.
- Have a long-term perspective to avoid the anxiety and rash decisions that come with worrying about timing your investments around short-term market volatility.

A reasonable investment plan that can work for you (in good times and bad) is much more likely to allow you to focus on reaching your investment goals than having to be perfect just to get there.