Market Matters

Q1 2013 HIGHLIGHTS

- S&P500 hit a record high level, 1569, at the end of the first quarter – marking a 131% rise since the March 9, 2009 bear-market low of 676 (sixth best bull market for the index since 1929!).
- The S&P/TSX Composite lagged its global peers. The Materials sector suffered significant declines as mining and gold companies continue to lose favour with investors.
- Bond market returns are reflecting the low interest rate environment, but demand for bonds continued to be supported in the first quarter by growing concern over peripheral Europe's debt problems, increased market volatility, and central banks' 'low for longer' position on interest rates.
- Positive economic momentum (e.g. housing and employment) in the U.S. is outshining more muted expectations for Canada.
- Political uncertainty and sovereign debt problems remained key issues for capital markets so far in 2013:
  - Indecisive elections resulted in a failure to create a government and likely re-elections for Italy.
  - The small island country of Cyprus became the latest European-Union (E-U) member to suffer a debt and banking crisis as harsh measures against bank deposit accounts were needed to keep the country afloat.
  - U.S. politicians have yet to reach a plan to moderate the negative economic effects of tough spending cuts. The sequester deadline has come and gone, but the brunt of the spending cuts are expected to hit in the 2nd and 3rd quarters of 2013 – buying limited time for politicians to come to terms.
- China's tighter fiscal policies (particularly aimed at curbing a hot housing market) and disappointing February manufacturing data created headwinds for many emerging market stocks.

Table 1
Summary of major market developments

Market returns*	March	YTD
S&P/TSX Composite	-0.6%	2.5%
S&P 500	3.6%	10.0%
- in Canadian dollars	***2.3%***	***12.4%***
MSCI EAFE	1.3%	8.9%
- in Canadian dollars	***-0.8%***	***6.8%***
MSCI Emerging Markets	-1.0%	-0.8%
DEX Universe Bond Index**	0.4%	0.7%
BBB Corporate Index**	0.9%	2.2%

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

Table 2
Other price levels/change

	Level	March	YTD
U.S. dollar per Canadian dollar	$0.983	1.2%	-2.2%
Oil (West Texas)*	$97.10	5.8%	5.7%
Gold*	$1,596	0.8%	-4.0%
Reuters/Jefferies CRB Index*	$296.39	1.2%	0.5%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	March	YTD
S&P/TSX Composite	-0.6%	2.5%
Energy	0.4%	3.4%
Materials	-2.0%	-10.7%
Industrials	-0.4%	13.7%
Consumer discretionary	5.1%	11.8%
Consumer staples	1.2%	5.2%
Health care	4.7%	22.7%
Financials	-2.3%	3.1%
Information technology	3.0%	17.3%
Telecommunication services	2.0%	10.4%
Utilities	-2.3%	-0.7%

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

A SPRING IN THE AMERICAN STEP

The first quarter of 2013 ended on a happy note as Wall Street celebrated new highs for the S&P500 and Dow Jones Industrial Average indices (1569 & 14579 respectively). Of interest, on a total return basis (i.e. when dividends are included) the S&P500 has been hitting new highs since about this time last year, supporting the adage 'dividends pay'!

The strong run for U.S. stocks has helped to improve investors' sentiment towards equities, enticing them back into stock markets after years of financial and economic woes kept them away. Even the extended saga of the sequestration spending cuts haven't meaningfully dampened investors enthusiasm, though some of that may be timing as the brunt of the cuts are expected to hit over the next six months or so. We anticipate a renewed sense of political urgency will re-emerge as the year progresses, and likely some market volatility to go with it.

STILL FEELS LIKE WINTER

Not all markets have been experiencing the same sunny disposition and positive momentum as the U.S. (see Table 1):

- S&P/TSX Composite results were overshadowed by weakness in the Materials sector.
- European markets were plagued by the latest round of sovereign debt concerns centered around Cyprus.
- Emerging market indices, like the Shanghai Composite, have been struggling as governments try to better moderate economic growth.

A SIMMERING GOULASH

Simmering just below the surface, Europe's stew of sovereign debt problems threatens to bubble over with frustrating frequency. The Cyprus banking crisis dominated market concerns at the end of the quarter. Cyprus did manage to reach a deal to permit financing and reorganizing of Cyprus banks, but the framework of future bailouts targeting bank deposits leaves the sour taste of worry that a precedent has been set for more fiscally significant economies within the E-U. The European Central Bank has stirred the pot to reassure investors with their announcement of the Outright Monetary Transactions (OMT) program last summer, but as issues continue to heat up, we may need to see the OMT secret sauce put into action to provide the next wave of relief.

BETWEEN A ROCK AND A HARD PLACE

Most major S&P/TSX sectors grew over the quarter (see Table 3) while the Canadian Materials sector followed a weak 2012 with further losses to start 2013. Metal and mining commodities like copper, zinc, nickel and aluminum all weakened over the quarter. Copper inventories have been increasing as current supply is outweighing demand, while disappointing February manufacturing data out of China dampened the commodity demand outlook. Likewise, mid-quarter, Chinese authorities announced tighter tax and down-payment rules on housing, which weighed on the outlook for these commodities closely tied to housing.

Representing 8.4% of the S&P/TSX Composite, Canadian gold companies continued their share price declines. The improving economic sentiment has eroded the 'risk-off' demand for the safe-haven features of gold bullion, while high operating costs and failure to meet earnings expectations are causing investors to turn away from the gold-related companies.

Take the commodity factor out of the Canadian market, and it's worth noting that many Canadian companies are profiting and growing. Their earnings forecasts remain underpinned by the positive economic momentum of the U.S. recovery. Our largest trading partner is reflecting better employment, strengthening house prices, improving consumer sentiment and a strengthening currency. While Canada's economy lacks the momentum seen in the U.S., many Canadian companies with large markets in the U.S. stand to benefit – helping to explain the significant divergence in sector results of the S&P/TSX Composite (see Table 3).

NO FOOLIN'

Like an April 1st spoof, bull markets can test our better judgement. Rather than chase hot performance with pendulum shifts in and out of assets, focus on your long-term plan and base your asset mix decisions on your financial goals, risk tolerance and time horizons. If it doesn't make sense from all three perspectives, it may not be the right move for you. ...no joke!