Monthly investment commentary

September 2008

AUGUST HIGHLIGHTS
• Global commodity prices (as measured by the Reuters/Jefferies CRB index) continued to fall, down 15% in July and August.
• Canada's second quarter GDP results fell short of expectations as the Canadian economy grew a meager 0.3% (q/q % change), while the U.S. economy surprised to the upside with the U.S. GDP growing 3.3% (q/q % change).
• U.S. Federal Reserve kept overnight lending rates at 3% at their August 5th interest rate announcement.
• The Canadian dollar depreciated 4% against the U.S. dollar and ended the month at $0.94 U.S.

HARSH BACK TO SCHOOL WAKE-UP CALL

Most world markets managed to eek out reasonable gains during the month of August (see Table 1), masking significant volatility and market unrest. Just how volatile have the markets been? Between the three year period from 2003 to 2006, a daily market move on the S&P500 of greater than two per cent occurred only twice. Since early July 2008, the S&P500 has had daily fluctuations of more than two per cent a total of six times.

Table 1– Summary of major market developments

Market returns*	August	YTD
S&P/TSX	1.3%	-0.4%
S&P500 (US$)	1.2%	-12.6%
S&P500 (C$)	3.9%	-6.2%
NASDAQ	1.8%	-10.7%
Russell 2000	3.5%	-3.5%
FTSE 100 (U.K.)	4.2%	-12.7%
NIKKEI 225 (Japan)	-2.3%	-14.6%
EAFE (C$)	-0.5%	-13.9%
EAFE (local currency)	0.8%	-18.4%
Canadian Bond Market	0.7%	3.8%
World Bond Market (US $)	1.2%	2.6%

*local currency (unless specified); price only

In Canada, the Materials sector followed commodity prices downward (see Table 2). Gold, zinc, aluminum, and copper prices all fell between 8-10% during the month. By contrast, Canadian energy companies bucked the trend and gained back some of the July losses (well, that is until September came around). Energy companies owe their August gains to a combination of conservative analysts (who had already factored in lower oil prices into their earnings estimates, therefore muting the reaction to falling oil prices), and a celebrity visit to the oil sands from none other than Bill Gates and Warren Buffett. The idea that the two revered billionaire investors took an interest in the Canadian oil industry was enough to generate excitement and foster stock price gains among the Canadian oil companies. The consumer sectors found some summer sunshine in the falling oil prices in the hopes that Canadian consumers won't have to spend their entire paycheques at the pumps.

Table 2 - Sector level results for the Canadian market

S&P/TSX sector returns*	August	YTD
S&P/TSX	1.3%	-0.4%
Energy	4.4%	11.3%
Materials	-7.0%	2.6%
Industrials	2.7%	5.7%
Consumer discretionary	7.9%	-19.9%
Consumer staples	4.6%	-6.0%
Health care	4.9%	-11.3%
Financials	1.0%	-9.9%
Information technology	2.5%	7.7%
Telecom services	7.1%	-7.2%
Utilities	-0.8%	-2.9%

*price only

At the time of writing, further market volatility has affected world markets, and in particular the Canadian S&P/TSX. Like the U.S. relay team, a dramatic drop dashed spirits as a significant re-pricing of oil, gold and other metals has led the way to a meaningful loss in the Canadian S&P/TSX during the first week of September, 2008. Couple this with recent weak economic data signaling a slowdown in global economic growth (further hurting the outlook for future commodity demand), and throw in some indiscriminant selling amidst the market noise, and you've got a pretty harsh back to school wake-up call.

LIVE BY THE SWORD…

Since 2004, the S&P/TSX has handily outperformed the S&P500 and many other world indices because of surging commodity prices. With oil prices down over $30 dollars per barrel since its early summer highs, it appears the trend is broken. From July 15th to the end of August, the S&P/TSX has lagged the S&P500 by 9% in Canadian dollar terms.

Just a few months ago some may have considered it crazy to suggest that by the start of September the Energy and Materials sectors would be posing a significant drag on the Canadian equity markets the U.S. dollar would begin a stage of significant strengthening, and the economic data coming out of the U.S. would be starting to look good when compared against Canada's economic outlook….but that is exactly what's been happening. The Canadian economy grew by a meager 0.3% in the second quarter of 2008 (q/q % change), while the U.S. posted a better than expected result, growing their GDP by 3.3% during the same period.

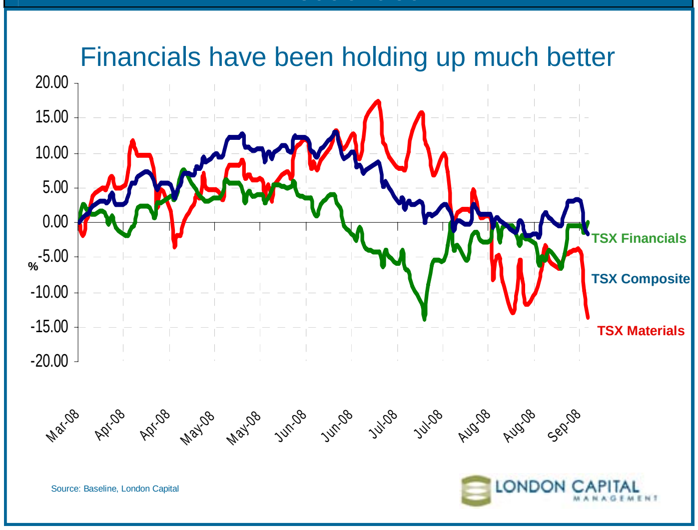
The Canadian economy has shifted focus from a 'cart in front of the horse' view that oil will save our economy from slowing, to a realization that a slowing global economy could lessen demand for commodities, and dampen market and economic expectations.

… OUT WITH THE BATH WATER

Investors are cautioned not to throw the baby out with the bath water, as the expression goes. It isn't all bad news in investment land. Lower oil prices have provided some much needed inflation relief to developing and emerging economies alike, allowing central banks greater flexibility to effect monetary policy changes. Easing energy costs are expected to relieve production, manufacturing and consumer expenses around the world – a possible boon for global equities in general.

Specifically in Canada, the lower commodity prices have already provided relief to industries hurt by rising fuel prices, including the consumer sectors. And despite the tendency to be guilty by association and get whipsawed by the happenings of U.S. banks and lending institutions, the Canadian financial companies (particularly the banks) recently posted better-than-expected earnings for the second quarter. In the early goings of September, the Canadian Financial sector has held up relatively well amidst the market downturn. (See Chart)

Bulk of Recent Damage in TSX is Due to Resources



The short-term market gyrations are expected to continue as global market exhibits a hyper-sensitivity to every spoonful of economic data released. But telling Wall Street and Bay Street to relax and not obsess over each piece of economic data is about as effective as telling Usain Bolt not to show his bravado after breaking the world 100m sprint record and winning his first Olympic gold metal – ain't gonna happen. Rather, sticking to a well diversified portfolio and long-term investment strategy will help mitigate volatility. Likewise, trying not to sweat the short-term highs and lows of the markets will be a much more comfortable approach to achieving your long-term financial goals.