LONDON CAPITAL
MANAGEMENT

Monthly investment commentary

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NOVEMBER'S HIGHLIGHTS

- Economic indicators continued to point toward a deepening global economic slowdown.
- The National Bureau of Economic Research (NBER) officially declared that the U.S. has been in a recession since December 2007.
- Commodity prices, including oil, continued to fall as expectations for global demand decreased.
- Record high equity market volatility continued throughout the month of November.
- The S&P/TSX and S&P500 hit multi-year lows before a significant one-week rally (albeit a short-lived rally as you likely already know).
- Gold stocks shone brightly in November and pushed the Canadian Materials sector up 9%.
- The projected failure of the BCE deal drove the Canadian Telecommunications sector down sharply.

COLD COMFORT

Meaning of the phrase cold comfort: Slight consolation or encouragement in the face of a reverse.

The fact that North American stock markets had one of the best weeks on record at the end of November was cold comfort, as 2008 has thus far provided few places to hide from the significant and prolonged downturn in equity markets. In fact, the market upswing (driven by the Citigroup bailout and strong policy moves by the Chinese government) immediately followed new lows in the equity markets. Those market-lows of November came when U.S. lawmakers postponed any auto-sector bailout decision until early in December – sending the CEOs of American automakers home empty-handed on their private company jets.

Likewise, it provided little comfort when the National Bureau of Economic Research (NBER) proved many economist and pundits right by proclaiming that the U.S. has been in a recession since December 2007. Too bad, they couldn't be more helpful and tell us when it will end!

As more lousy global economic news emerged, the grim market trend of extreme volatility, negative sentiment, and depressed stock prices continued in November. Most major world markets were down, further adding to the dismal year-to-date returns (see Table 1).

Table 1– Summary of major market developments

Market returns*	November	YTD
S&P/TSX	-5.0%	-33.0%
S&P500 (US$)	-7.5%	-39.0%
S&P500 (C$)	-4.4%	-23.6%
NASDAQ	-10.8%	-42.1%
Russell 2000	-12.0%	-38.2%
FTSE 100 (U.K.)	-2.0%	-33.6%
NIKKEI 225 (Japan)	-0.8%	-44.4%
EAFE (C$)	-3.6%	-35.6%
EAFE (local currency)	-5.0%	-42.7%
Canadian Bond Market	2.4%	3.4%
World Bond Market (US $)	3.1%	6.6%

*local currency (unless specified); price only

While most commodity prices were being pressured by expectations of lower global demand, gold prices glowed (up 11.5% in November). Among the myriad of drivers that can affect the price of gold at any given time, a few stood out in November:

- safe-haven buying - as investors find comfort in holding hard assets during uncertain times;
- concerns over longer-term U.S. dollar weakness - as the government begins to pay off the expense of their economic stimulus and relief plans; and
- speculation that China may consider diversifying its foreign exchange reserves into gold – which would create a significant increase in demand.

The strong rise in gold company stocks was the most significant driver of the Canadian Materials sector in November (see Table 2).

The Canadian Telecommunications sector was the laggard this month. The sector was hit by the news that the BCE deal is unlikely to go through after an unfavourable solvency analysis by KPMG. BCE stock prices fell 29% in the month, and remaining Telecommunication companies weren't far behind as they also stood to benefit from the

deal going through. Contrary to the Canadian backdrop, the U.S. Telecommunications sector (viewed as being a relatively more defensive sector) rose 6.4% in November.
The positive returns of the Canadian and world bond markets in November reflect the strong demand for the safety of Government bonds, with little regard for the yield being offered. Government bond yields are now at historically low levels. At the end of November, a three-month Government of Canada bonds yielded 1.7%, while a similar three-month U.S. Treasury bill yielded a mere 0.1%.

Table 2 - Sector level results for the Canadian market

S&P/TSX sector returns*	November	YTD
S&P/TSX	-5.0%	-33.0%
Energy	-4.3%	-30.1%
Materials	9.4%	-36.7%
Industrials	-11.6%	-29.8%
Consumer discretionary	-5.4%	-38.1%
Consumer staples	-2.2%	-14.7%
Health care	-8.5%	-31.8%
Financials	-8.5%	-32.6%
Information technology	-8.0%	-50.2%
Telecom services	-13.4%	-26.8%
Utilities	-5.8%	-25.2%

*price only

WHEN IS IT SO BAD, IT'S GOOD?

Is there a point where things get so bad, it's good? Yes. In every capital market there are essentially two drivers – fear and greed. Right now, fear is winning. Capital market volatility, tight credit conditions, broad economic concerns, and murky outlook for companies have caused a significant shift in asset allocation – away from all things 'risky' (i.e. equity and credit products like corporate bonds), into all things 'secure and safe'.

The continued demand for government bonds with little to no regard for the ultra-low yields is a clear sign that investors are now significantly more focused on the return of their money, than the return on their money. Companies and households have forgotten about profit maximization, and have become pre-occupied with minimizing debt. This is a primary reason why interest rate cuts have yet to stimulate increased economic activity - simply put, no one is interested in accumulating more debt.

The shift in assets that has taken place over the last several months have meant that 'good' companies have been sold right along side the 'bad' companies at depressed prices. This broad-based and indiscriminate selling has created additional downward pressure on the stocks –and so a cycle of prolonged downward pressure on stocks plays out. Despite the best intentions to buy low and sell high, many have done just the opposite, essentially cashing in losses to invest in assets with little to no expected return.

While no one can pinpoint the exact moment, as time wears on there will be a shift as fear begins to subside and investors (perhaps timidly at first) begin to seek out a return for their investments. When that happens, the reverse flow from fixed-income products and cash will create an abundance of buyers in the equity market, rewarding those investors who resisted the temptation to abandon their well-diversified, long-term investment strategies.

WHAT ARE MONEY MANAGERS DOING?

Stock markets move in cycles. Whether you are in an up cycle or a down cycle, like we are now, the role of a professional money manager remains largely unchanged - stay focused on return objectives; adhere to a given risk tolerance; and consider the appropriate time horizon. Simply put, you want a professional money manager to buy stocks that compensate you for their commensurate risk, with the end goal being a portfolio that generates excess return over the long run. To do that they stay disciplined and stick to a defined investment process - regardless of the market backdrop. While this may sound boring during such volatile market conditions, consider that the alternative (which by definition is an undisciplined and haphazard approach to buying and selling stock) has yet to prove itself as a successful long-term investment strategy.

WARM WISHES

Despite the chill in the markets or in December's air, we would be remiss if we did not take the opportunity, from everyone here at London Capital, to send our warmest wishes to you and yours over the holiday season. As we close the book on 2008, we hope you will join us in raising a glass to a long-term investment, whose value only goes up with time – to family, friends and good health!

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