Monthly investment commentary

June 2009

MAY'S HIGHLIGHTS

- Improving global economic outlook boosted commodity prices, investor sentiment and equity markets.
- The commodity-heavy S&P/TSX had a spectacular rise of over 11% for the month.
- Oil prices ended the month at $66/barrel (WTI, US dollars) - up over 30% in May.
- The Canadian dollar rose 8% in May to 91.6 cents US.
- Canada's first quarter GDP dropped 5.4% (q/q annualized), but was still better than expected and favourably received by capital markets.
- The widely anticipated GM chapter 11 bankruptcy filing was confirmed on June 1st.
- U.S. bank stress test results showed few surprises with ten out of 19 banks tested requiring more capital.
- Canada's big five banks all reported better than expected earnings for the first quarter of 2009.

EXTRA-ORDINARY TIMES

Given that the record books seem to be growing by the week, to say these have been extraordinary times for capital markets seems like a blatant understatement. But perhaps the most remarkable trend we noted in May was investors' ability to hold steadfast to their recent rosier outlook.

Consider that, despite these grim records being set in May…

- **Unprecedented** 'stress tests' of U.S. banks showed $75 billion more capital required.
- **Largest** automaker in North America announced plans for bankruptcy protection and the need for approximately $60 billion in bailout support.
- **Worst** first quarter Canadian GDP result since March 1991.

…the following records were also achieved:

- **Highest** one-month percentage return for the S&P/TSX since December 1999.
- **Best** S&P 500 three-month performance in more than 60 years of data – up 25% from March 1 to May 31, 2009. (source: Bloomberg).
- **Biggest** single-month rise in the Canadian dollar since 1950.
- **Highest** level in a year and **biggest** monthly increase on record for the Canadian consumer confidence index (source: The Conference Board of Canada).

Indeed investors chose to see the brighter side of things in May.

Table 1– Summary of major market developments

Market returns*	May	YTD
S&P/TSX	11.2%	15.4%
S&P500 (US$)	5.3%	1.8%
S&P500 (C$)	-3.9%	-8.7%
NASDAQ	3.3%	12.5%
Russell 2000	2.9%	0.4%
FTSE 100 (U.K.)	4.1%	-0.4%
NIKKEI 225 (Japan)	7.9%	7.5%
EAFE (C$)	1.7%	-4.8%
EAFE (local currency)	4.6%	3.4%
Canadian Bond Market**	-0.1%	1.4%
World Bond Market (US$)**	-1.0%	-1.8%

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

BUILDING CONFIDENCE

World markets made substantial gains in May and now find themselves near or above the break-even point for the year (see Table 1). The S&P/TSX led the way as it benefited from signs of renewed or better than expected economic growth (particularly in emerging markets like China), rising commodity prices (like oil and gold), and better than expected first quarter earnings results from all five big Canadian banks. Each of these factors played right into Canada's largest and most influential market sectors.

Ninety-five percent of the S&P/TSX gains in May came from a combination of the resource sectors (Energy and Materials) and the Financial sector (see Table 2).

Table 2 - Sector level results for the Canadian market

S&P/TSX sector returns*	May	YTD
S&P/TSX	11.2%	15.4%
Energy	14.8%	22.5%
Materials	21.8%	20.0%
Industrials	1.1%	-0.7%
Consumer discretionary	-0.1%	-4.8%
Consumer staples	3.2%	-2.9%
Health care	1.0%	2.7%
Financials	9.3%	16.1%
Information technology	2.6%	59.3%
Telecom services	4.8%	-6.8%
Utilities	1.7%	-9.2%

*price only

REVERSING THE FEAR TRADE

The shift in investor sentiment had the reverse effect on the bond market. Improving global economic data has all but ended the safe-haven bid (for the time-being at least), and investors have begun to draw money away from cash and bonds and into equities. Around $120 billion (US$) has been pulled out of global money market funds since March lows*, no doubt helping to fuel the rebound in stock prices. The sheer size of the remaining money market assets still offers ample buying power should more concrete signs of recovery emerge. (*source: BMO Capital Markets)

U.S. Treasuries, in particular, have weakened sharply over the last few weeks. A rapidly rising supply of debt issuance in the market (think of how much money the U.S. government needs to raise to fund bailout packages and stimulus spending) and a better economic outlook are significant contributors. The Government of Canada bonds have followed a similar, although more muted, pattern, creating a drag on the Canadian bond market (see Table 1). While the sell-off in bonds may ease, these themes and the overall low interest rate environment may continue to weigh bond markets for some time to come.

LOONIE MIGRATES NORTH

If a vacation abroad is in your plans for the summer, you probably can’t help but be happy that the Canadian dollar is making a strong come-back. However, on the other side of the coin (pun intended), for Canadians in the business of manufacturing goods for export, especially into the United States, the rising Canadian dollar is like salt on a wound. And for Canadian investors with foreign holdings, the currency exchange completely evaporated (and then some) returns (see Table 1).

While a number of factors have played into the rise of the Loonie (such as rising oil prices), the Canadian currency's strength is just as much a statement about the lack of appeal of other currencies (particularly the U.S. dollar), as it is the attractiveness of the Canadian currency. For one, the Bank of Canada has not yet engaged in the currency-diluting process of quantitative easing, as other major central banks have done. And if the global economy looks like it is poised to recover, then commodity prices and Canada's economy will be the immediate beneficiaries of the rebound. While the Canadian economy is not out of the woods yet, it does appear that. for the moment, even our bad news is still less bad than everywhere else.

YOUR NEXT BULL RUN

We've seen a deceleration of the downturn in the economy, and that can be a precursor to a more sustained economic recovery. Will this be the start of a new bull market? That’s a guessing game – and you don’t want to leave your investment decisions to that. Understand your risk tolerance, know your time horizons, diversify, and stick to your plan, and the next bull run will be yours!