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February 2010

Markets turn higher as concern over sovereign debt subsides

Markets demonstrated an increased appetite for risk in February as world equity markets, commodities and gold all rallied back following a difficult month in January. The price of oil in particular, entirely reversed its January decline, gaining 9% in February and leading the Canadian equity market to a 4.8% rise for the month. Equity markets south of the border gained almost 3% (in U.S. dollars) with the Canadian dollar also making back its losses from January, rising 1.8%. The Euro continued its slide, although at a more gradual pace, losing a further 1.7% last month while gold rebounded somewhat following a two month slide to gain 3.4%. As for bonds, credit spreads continued to tighten modestly on improving economic fundamentals while longer rates continued to creep higher.

The Euro zone soap opera has continued to play out pretty much as expected. German and French officials pledge ultimate support for the Euro but waffle when it comes to admitting that they will have to backstop Greek debt. The Greeks come up with new and ever more severe austerity plans (they are now on their third proposal) and the entire nation goes on strike to protest. Everyone is beginning to understand that while Greece won't be allowed to default, Euro zone exports benefit from the depreciating Euro, so why not let the crisis drag on a little longer? Like a bored teenager with a short attention span, global markets are growing tired of the whole drama and have started to move on. Despite the improved sentiment surrounding Greece, we caution that like Dubai before it, Greece will not be the last sovereign debt crisis markets are forced to deal with.

As focus has moved back to fundamentals, equity markets have benefited from the continued rebound in corporate earnings. Just to help matters along, U.S. fiscal and monetary policies remain enormously stimulative, and appear set to stay that way for the remainder of the year. Eventually, the stimulative policies in the U.S. will need to be removed and very difficult decisions regarding spending, taxation and monetary policy will need to be made. In our view, these changes have the potential to be destabilizing and have significant potential to be negative for equity markets down the road. In the meantime however, U.S. elections this coming November pretty much ensure a lack of fiscal discipline until next year at the earliest. An interesting counterpoint is Canada, where the latest budget is already putting fiscal discipline in place. With the Bank of Canada also likely to move rates higher sooner rather than later, in our view, the Canadian dollar has the potential to continue its strength relative to the U.S. dollar.

Within our client portfolios we have been doing what we said we would do: actively manage through a volatile market using our value discipline. In energy, we have selectively reduced some of our allocation to oil-focused equities and started to add names with better exposure to gas. We also took advantage of market declines early

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in the month to add to U.S. infrastructure, construction and technology names that we felt offered compelling value. Within our bond portfolios we have been reducing the maturity of our portfolios and we have started to look at floating rate notes to protect against rising short term Canadian rates.

Overall, we are quite pleased with the opportunities we feel the market has offered us and our ability to execute and take advantage of them. With the global macroeconomic environment still very fluid, we continue to believe there is more opportunity ahead to add significant value for our clients.

John Wilson
Chief Investment Officer
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