



CUMBERLAND

## Strategy Review

March 2010

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### Bond Focus Moves from Greece to U.S. Treasuries

The first quarter closed with a bang as equity markets globally continued to run and closed the quarter at or near new recovery highs. The Canadian market had its second strong month in a row, climbing 3.5% for the month and is now up 2.5% year to date. The strong relative performance of the Canadian economy including GDP, employment and commodity prices has supported further relative strength in the Canadian dollar, rising 3.6% in March, 5% for the year and now closing in quickly on parity with the U.S. dollar. For any of you considering a European vacation, now is as good a time as any since the inception of the Euro. Even with the continued fade of the U.S. dollar relative to the Loonie, the greenback did manage to gain ground for the third consecutive month against the Euro, which fell just under 1%, and is now down 5.7% this year against the U.S. dollar. The U.S. equity market had an exceptional month in U.S. dollar terms rising almost 6% for the month and now up 3.7% for the year. For Canadians who haven't hedged U.S. dollar exposure, U.S. equity returns look much more muted, up just 2.3% for the month and 1.2% for the year in Canadian dollars. On the commodity front, improving economic fundamentals continue to underpin a bullish market view on future demand for oil, and so crude managed a further gain of over 4% to close the month above US\$83, up over 12% year to date. Finally, gold feels like it has been lost in the shuffle as the U.S. dollar gains strength relative to the Euro in what increasingly looks like a "less ugly" contest. Bullion dropped a little less than half a percent this month but still closed well over US\$1100 an ounce and is up 1.5% year to date.

Three themes we have been highlighting over the past few months are the resolution of the Greece fiscal crisis within the Euro, the potential for rising

longer maturity U.S. treasury rates and the case for continued strength in the Canadian dollar. All three moved meaningfully along our forecast path in March. The EU (which means France and Germany) finally agreed to backstop debt for Greece should it be required, although Germany insisted that the IMF play at least a minority role in any funding (if for no other reason, it seems to us, than to embarrass Greece and so warn others within the EU from pursuing the same fiscal recklessness). The solution was cheered by the investment community as yields on Greek debt started to fall and the Euro stabilized. Make no mistake, fiscal funding problems within both the Euro zone and other sovereign issuers are generally far from over, and you should count on further sovereign debt "crises" down the road.

Rising U.S. Treasury yields, particularly at longer dated maturities, has been a key concern of ours for the past quarter or so as ballooning supply and the potential for sharply lower demand seemed destined to collide as we moved through the first half of 2010. We have been approaching (and have now reached) the end of the massive purchasing program of Treasuries and mortgage-backed securities by the U.S. Federal Reserve. And while they will not be selling any of their \$1.5 trillion hoard any time soon, they claim to not be buying anymore either. Meanwhile, it took almost a day or so but pretty much everyone has now figured out that the new healthcare reform bill passed in the U.S. will not reduce the deficit at all over the next decade but will instead add as much as \$500 billion or more to an already massive problem. The Treasury market is showing every sign of reaching the same conclusions as we have, as yields rose dramatically in the latter part of the month. Foreign central bank participation and overall measures of bidding demand



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are both falling sharply even as the U.S. Treasury brings larger and larger issues to auction. In our view, holding shorter dated maturities and within Canada, moving toward floating rate notes as pressure increases to raise short term rates is our best path to protecting client capital.

Our client portfolios generally have performed very well through both March and the first quarter of the year. Sectors where our allocation and stock picking have made especially strong contributions to portfolios include Materials (with the exception of gold), Energy and Consumer Staples. Sectors where our allocation and stock picking have been a drag on portfolio performance include Financials, Industrials, Technology and Health Care. Obviously, everything within a portfolio does not work at the same time, and overall we remain very pleased with our current portfolio positioning. That said, we are actively looking for new opportunities within both Financials and Technology.

In summary, equity markets are off to a very good start in 2010 and we have been able to capitalize on that strength to the benefit of our clients. Although some would say (and have been saying for pretty much the entire “bear rally”) that equity markets don’t deserve to be at current levels, we would rather be right in practice instead of just in theory. While there are many risks spanning the economy, interest rates, sovereign debt and solvency, equity markets have just simply offered the best reward relative to risk across asset classes. For those seeking capital appreciation, to miss a 70% rally in an asset class the size of equities isn’t being careful. Quite

simply, it is just being wrong. We remain mindful of how far equity markets have come, and we have been steadily moving equity allocations toward higher yielding and/or less economically sensitive investments. Value is now definitely harder, but not impossible, to come by. In our view, there is still enormous opportunity to add value to our client portfolios, perhaps now more than ever.

**John Wilson**

Chief Investment Officer

March 2010

**Cumberland Private Wealth Management Inc.** is an independent world class investment firm that provides discretionary investment management and wealth management services for high net worth individuals, their families and foundations, with \$1 million or more in investable assets. All of Cumberland’s investment mandates are centered on building and preserving our clients’ financial wealth. Founded in 1997, the firm is privately-owned by its employees and headquartered in Toronto, Canada.