GLC ASSET MANAGEMENT GROUP

Market Matters

Q2 HIGHLIGHTS

- Investor confidence eroded in the second quarter of 2012.
- Sovereign debt concerns reignited in Europe while economic data out of the U.S. and China showed a slowing growth trend.
- Investors sought safe havens, driving bond yields lower and the U.S. dollar higher.
- The Canadian DEX Universe Bond index gained 2.2% (all of that gain taking place in May – the most volatile month of the quarter)
- Commodity prices dropped and pulled the resource heavy Canadian S&P/TSX Composite index down 6.4%.
- The S&P 500 index outperformed most of its global peers by declining only 3.3% in the quarter and staying firmly in positive territory on a year-to-date basis.
- Inflation pressures in both Canada and the U.S. have been well contained, leaving room for supportive monetary and fiscal policy actions:
  - In the U.S., the Federal Reserve extended Operation Twist—selling short-term notes to fund purchases of long-dated debt in an effort to lower consumer borrowing costs.
  - In Canada, the Bank of Canada maintained the overnight rate at 1.0%.
  - European leaders agreed to pump money directly into stricken banks and allow some countries to tap into rescue money by easing stringent budget requirements.
  - China positioned itself to take a more accommodative stance to stem slowing growth.

Table 1
Summary of major market developments

Market returns*	June	Q2 2012	YTD
S&P/TSX Composite	0.7%	-6.4%	-3.0%
S&P500	4.0%	-3.3%	8.3%
- in Canadian dollars	***2.5%***	***-1.4%***	***8.5%***
MSCI EAFE	5.0%	-6.7%	2.0%
- in Canadian dollars	***5.3%***	***-6.6%***	***1.0%***
MSCI Emerging Markets	1.7%	-6.4%	3.2%
DEX Universe Bond**	0.0%	2.2%	2.0%
BBB Corporate Index**	0.0%	2.0%	4.1%

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

Table 2
Other price levels/change

	Level	June	YTD
U.S. dollar per Canadian dollar	$0.982	1.4%	-0.2%
Oil (West Texas)*	$84.84	-2.1%	-14.3%
Gold*	$1,597	2.0%	1.4%
Reuters/Jefferies CRB Index*	$284.19	4.1%	-6.9%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX sector returns*	June	Q2 2012	YTD
S&P/TSX Composite	0.7%	-6.4%	-3.0%
Energy	0.2%	-8.1%	-9.1%
Materials	1.4%	-11.2%	-11.2%
Industrials	1.3%	1.0%	3.7%
Consumer discretionary	0.5%	-1.4%	11.6%
Consumer staples	1.3%	1.1%	7.9%
Health care	-4.8%	-3.7%	11.2%
Financials	0.9%	-5.9%	3.3%
Information technology	-5.2%	-17.8%	-11.5%
Telecom services	2.0%	1.6%	-0.5%
Utilities	0.2%	-1.7%	-1.7%

*price only
Source: Bloomberg, MSCI Barra, NB Financial, PC Bond, RBC Capital Markets

THE GLARE OF A VOLATILE QUARTER

Investor confidence that built up in the first quarter was eroded by the dire economic headlines of the second quarter. The macro-economic concerns fuelled a significant flight to safety and the quarter was marked by heightened volatility and a significant down trend in equity and commodity values. Of note, the most significant loses took place in May, overshadowing a much more positive month of June (see Table 1).

The media's glare fell on Europe and its ongoing debt problems, but a distinct shadow also fell on the U.S. and China for concerns over their slowing economies. China reported disappointing industrial production and retail sales data that pointed to continued economic softness, while in the U.S. job growth decelerated and failed to meet expectations. Canadian, German, UK and U.S. government bond yields hit new 60+ year lows during the quarter.

Net result…we've seen evidence of slower global growth than several months ago, but still on the positive side of the growth ledger.

GLC ASSET MANAGEMENT GROUP

CANADIAN MARKET

The cyclical nature of the Canadian S&P/TSX composite index resulted in a rockier quarter than for most global markets as commodity prices (tied closely to global economic growth trends) declined on slowing growth prospects for China and the U.S. Canada's commodity-link goes a long way in explaining the recent underperformance of our equity market versus our neighbour's to the south.

Taking a deeper look into the Canadian equity market, the resource sectors were the significant laggards in the quarter (see Table 3). Energy and Materials sectors were down 8.1% and 11.2% respectively for the second quarter of 2012. Oil prices in particular had a tough quarter, dropping close to 18%. Higher oil prices had been supported by unrest in the Middle East, but we saw that take a back seat to global growth concerns in the second quarter, and the give-back has been quite dramatic. The stronger U.S. dollar also played a role in dampening commodity prices (see Table 2). Aluminum, nickel, copper, zinc and gold all declined over the quarter. While tough on our stock market, it is worthwhile to remember that lower commodity prices can result in an indirect tax cut for consumers (e.g. at the gas pumps) and should help support retail spending.

Canada's fallen Information Technology star, Research in Motion, continues to struggle with weakening market share, poor corporate results and news of layoffs. The litany of hard knocks for the company pulled share prices lower, and brought the sector down a sharp 17.8% for the quarter.

Not surprisingly, some of the more defensive sectors (Telecommunications and Consumer Staples) led the way in Canada and posted positive results for the quarter. Canadian industrials stocks also fared well even though they tend to be more cyclical in nature.

A BALANCED DIET TO DEAL WITH MARKET FATIGUE

The current fundamentals of the stock market show corporate earnings (particularly those in North America) that continue to demonstrate considerable resiliency overall. Even if revenue and earnings growth rates slow (as one might expect after the sharp economic recovery that we've witnessed) many companies are in good shape with debt/leverage ratios at historic lows and cash balances close to record highs. To find evidence of the solid health of companies in general you need look no further than the continual stream of dividend hike announcements, including such announcements from the less-traditional dividend-paying industries such as Energy and Technology. In terms of valuation, stock prices are attractive and they remain well below their longer term averages. Overall market fundamentals compel us to remain constructive on equity markets in the long-term, even with the recognition that volatility in the near term is likely.

We also recognize that the low bond yields that fixed-income investors are experiencing are largely sentiment driven. While we continue to see the value of fixed-income in mitigating volatility in a diversified portfolio, bond markets are exposed to similar market risks as sentiment can quickly shift.

Feelings of 'market fatigue' are certainly understandable as these are challenging times for investors in terms of both very low interest rates, and very low confidence in equity markets. However, we believe this is no time to hide in the shadows (cash or fixed income only) as a compelling case for long term investors to maintain a balanced portfolio continues to build.

Copyright GLC, You may not reproduce, distribute, or otherwise use any of this article without the prior written consent of GLC Asset Management Group

The views expressed in this commentary are those of GLC Asset Management Group Ltd. (GLC) as at the date of publication and are subject to change without notice. This commentary is presented only as a general source of information and is not intended as a solicitation to buy or sell specific investments, nor is it intended to provide tax or legal advice. Prospective investors should review the offering documents relating to any investment carefully before making an investment decision and should ask their advisor for advice based on their specific circumstances.