GLC
ASSET MANAGEMENT GROUP

December 2014

Market Matters

2014 Highlights

- Equity markets were characterized by flashes of volatility that dissolved abruptly, followed by a return to steady gains.
- The S&P/TSX Composite index gained 7.4% price only (and more than 10% on a total return basis) in 2014 even as oil prices fell and economic growth expectations out of China weakened.
- US equities posted another year of strong performance particularly in Canadian dollar terms. US equities benefitted from low interest rates and an accelerating economy.
- China joined the US to top the list of 2014's best-performing equity markets among larger economies, while Russia completed the bottom of the list.
    - With China's property market struggling, few investment alternatives and speculation on further stimulus measures, retail investors piled into equities pushing Chinese equities up strongly in the last few months of the year.
    - Russia is dealing with a shrinking economy following Western sanctions and the collapse in oil prices.
- Strong fixed income market results exceeded most expectations for 2014. A sharp drop in oil prices – the biggest yearly decline since 2008 – and a weaker global economic outlook pushed inflation expectations lower and helped push back market views of when the Bank of Canada would begin hiking interest rates.

HAT TRICKS AND BREAK-AWAYS

The S&P/TSX Composite finished 2014 with relatively good returns overall (see Table 1), but the Organization of Petroleum Exporting Countries (OPEC)'s refusal to cut oil production and weaker demand from Europe and China had a major effect on the resource-heavy Canadian index. The downhill slide of the resource sectors in the second half of the year created significant divergence in sector results (see Table 3). Defensive sectors benefited, as investors shied away from the riskier cyclical sectors. Consumer Staples achieved **a market hat trick** – outperforming the other sectors on a month, quarter and year basis.

Table 1
Summary of major market developments

Market returns*	December	Q4 2014	YTD
S&P/TSX Composite	-0.8%	-2.2%	7.4%
S&P 500	-0.4%	4.4%	11.4%
- in Canadian dollars	*1.1%*	*8.2%*	*21.7%*
MSCI EAFE	-1.5%	1.5%	3.2%
- in Canadian dollars	*-2.0%*	*-0.4%*	*1.3%*
MSCI Emerging Markets	-2.7%	-0.4%	2.5%
FTSE TMX Canada Universe Bond Index**	0.6%	2.7%	8.8%
FTSE TMX Canada all corporate bond index **	0.3%	1.9%	7.6%

*Local currency (unless specified); price only
**Total return, Canadian bonds

Table 2
Other price levels/change

	Level	Dec.	Q4 2014	YTD
U.S. dollar per Canadian dollar	$0.860	-1.8%	-3.6%	-8.6%
Oil (West Texas)*	$53.27	-19.5%	-41.6%	-45.9%
Gold*	$1,185	1.7%	-1.9%	-1.7%
Reuters/ Jefferies CRB Index*	$229.96	-9.6%	-17.4%	-17.9%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX sector returns*	December	Q4 2014	YTD
S&P/TSX Composite	-0.8%	-2.2%	7.4%
Energy	-0.1%	-16.6%	-7.8%
Materials	0.7%	-7.6%	-4.5%
Industrials	-0.6%	-0.9%	20.0%
Consumer discretionary	2.2%	13.4%	26.4%
Consumer staples	7.9%	19.8%	46.9%
Health care	0.7%	15.3%	30.2%
Financials	-3.2%	1.0%	9.8%
Information technology	4.9%	15.4%	34.0%
Telecom services	-1.4%	9.6%	10.5%
Utilities	-2.1%	4.0%	11.3%

*price only
Source: Bloomberg, MSCI Barra, NB Financial, FTSE TMX Global Debt Capital Markets Inc.

The biggest loser was the Energy sector. **Crude oil prices experienced a massive yearly slump** of -46% (almost all of that coming in the 4th quarter). Excess oil supply was exacerbated by US producers and OPEC ceding no ground in their bid for market share (i.e. the US producers hit new output highs, while OPEC refused to cut its supply quota). Europe's fragile economic outlook and China's declining pace of economic growth are contributing to oil demand expectations that have been insufficient to stem the drop in oil prices. Ultimately low prices will have an impact on the growth of new supply, and prices will bottom and recover. Alas, it's timing the bottom that will be difficult to predict.

Harsh 2013-2014 winter conditions started out the year by putting a deep freeze on first quarter US economic results, but throughout the year strengthening employment, manufacturing, retail sales data and benign inflation added up to a stronger American economy overall. This served as a solid backdrop for US stock market momentum to continue. US equities outperformed every other developed market in 2014. That's **a third straight year of double digit gains!** The Utilities sector scored the American team's market hat trick in 2014.

Among its global economic peers, the Chinese equity market stands out for its **break-away rise in 2014**. The Shanghai Composite gained 53% in 2014, with more than 35% of that taking place in the last quarter aided by speculation that the new trading link with Hong Kong would boost foreign demand for Chinese equities.

THE UNDERDOG SCORES

Canadian bonds defied economists' forecasts to deliver **a rally that bested nearly all expectations for 2014**. Fixed income indices rose across the board, with longer duration bonds and provincials as the top performers within the Canadian fixed income market. Faltering global growth and a series of international crises kept investors' demand for bonds high and revived the refuge appeal of Canada's debt investments. The flight to quality and risk reduction has been very rewarding for Canadian fixed income investors (see Table 1).

A year earlier, market pundits predicted that yields would be on the rise as central banks sought to normalize interest rates. Instead, yields on 10-year government of Canada bonds ended the year one percentage point lower at 1.79 per cent. We don't foresee a sharp or sudden rise in interest rates in the near future, particularly as Canada deals with a low dollar, benign inflation and dropping oil prices. However, by and large, positive economic conditions continue to suggest that our central bank can't put off rate increases indefinitely. A modest rise in interest rates over the latter half of 2015 seems reasonable.

A COIN TOSS

The US dollar gains made it the year's star major currency (up 13% in 2014 against a basket of global currencies). With Europe and emerging markets still struggling and Canada and other commodity countries weakened with crude oil's drop, the US greenback continues to be viewed as the most attractive option.

The flip side of that 2014 coin toss include big losers like the Russian ruble which plunged 46% for the year (its worst performance since Russia defaulted in 1998) and the fledgling bitcoin currency, which did even worse than the ruble, falling 58%.

GREAT DEFENCE

To sum it up, **defensive investment strategies thrived in 2014.** Portfolio positioning with an underweight in the more cyclical Energy and Materials sectors (as can often be found in the more income-focused portfolios) proved fruitful.

Mainstay (some say boring, we say beautiful) investment advice served investors very well in 2014:

- Stay diversified, by asset classes (stocks and bonds) and by country;
- Don't panic and make rash decisions during periods of volatility.

KEEP YOUR STICK ON THE ICE

'Keep your stick on the ice': Hockey-talk for staying calm and focused on the play at hand, and ready to take advantage of opportunities. Great plays may look spontaneous but are actually practiced and rehearsed over and over. Likewise take time to review your investment plan to ensure it meets your needs for both expected risk and expected return. When volatility hits, keep your head in the game and stick with the game plan.

2015 will no doubt deliver its share of highs and lows for investors, but if you keep your stick on the ice you can significantly increase the odds that you'll achieve that gold medal game hat-trick - reaching your investment goals when you want, how you want, and with the amount you want. Have a great 2015!