GLC ASSET MANAGEMENT GROUP

Market Matters

AUGUST 2013 HIGHLIGHTS

- Political and economic concerns grew throughout the month and weighed on global equity and fixed income markets.
- Bond yields rose sharply over the summer months with anticipation that the U.S. Federal Reserve would soon begin to taper their asset purchasing program.
- Bond values dropped overall, but were partially offset by income generation and a bid up in prices during the last week of August as concerns over possible U.S. military action in Syria diminished investors' risk tolerance.
- The Canadian Materials sectors rebounded from oversold conditions and received a boost from higher gold prices (a further reaction to diminished risk tolerances amid the geopolitical concerns in the Middle East).
- Balanced investors benefited from a diversified portfolio as domestic equity gains offset foreign equity losses, and fixed income holdings mitigated equity market volatility.

UNREST & UNCERTAINTY ARE UNLOVED BY INVESTORS

Political unrest in the Middle East drove increasing volatility across equity markets. The initial focus was on clashes of new and old regime supporters in Egypt, but intensity and global focus moved quickly to Syria where U.S. military action seemed all but imminent at month's end. Uncertainty and unrest are unloved by investors, and resulted in global equity declines. European equities in particular traded sharply lower as investors also appeared to take profits after what has been a relatively strong summer for European equities.

The Canadian equity market was one of few bright spots as a rebound in the beleaguered Materials sector helped to move the S&P/TSX composite index into positive territory. The Materials sector had significant gains in the month. While gold company stocks were helped by a bid for safety as geopolitical worries escalated, this was not the key driver of the improved performance. Rather the Materials sector benefited from a recovery from oversold conditions. In short, much of the negative sentiment and slow global growth forecasts appeared to be priced into stock values, and positive manufacturing data out of the Eurozone, China and the U.S. helped boost the outlook for global economic growth and thus the Materials sector in

Table 1
Summary of major market developments

Market returns*	August	YTD
S&P/TSX Composite	1.3%	1.8%
S&P 500	-3.1%	14.5%
- in Canadian dollars	***-0.9%***	***21.2%***
MSCI EAFE	-1.7%	11.6%
- in Canadian dollars	***0.7%***	***12.0%***
MSCI Emerging Markets	-0.3%	-5.4%
DEX Universe Bond Index**	-0.6%	-2.1%
BBB Corporate Index**	-0.7%	-0.4%

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

Table 2
Other price levels/change

	Level	August	YTD
CAD per USD exchange rate	$0.950	-2.5%	-5.9%
Oil (West Texas)*	$107.65	2.5%	17.2%
Gold*	$1,398	6.8%	-16.6%
Reuters/Jefferies CRB Index*	$291.16	2.5%	-1.3%

*U.S. dollars

Table 3
Sector level results for the Canadian market

S&P/TSX Composite sector returns*	August	YTD
S&P/TSX Composite	1.3%	1.8%
Energy	0.4%	3.2%
Materials	8.3%	-24.9%
Industrials	-2.7%	11.3%
Consumer discretionary	0.6%	25.9%
Consumer staples	-4.3%	16.6%
Health care	7.8%	54.2%
Financials	0.7%	6.8%
Information technology	3.7%	28.4%
Telecommunication services	1.7%	-1.2%
Utilities	-7.5%	-11.9%

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

general. In the short term stock prices can be driven largely by sentiment as opposed to hard numbers (or fundamentals) and therefore over-shooting either to the upside or the downside is a common phenomenon.

UNWINDING TRADES

Investors seeking greater yield have also been weighing out the merits of investing closer to home. During the early recovery years after the financial crisis foreign investors flocked to emerging markets for higher yielding investments. But the potential for rising yields in the U.S., coupled with improving economic conditions, has created a rush of capital leaving emerging markets for markets closer to home in the U.S. and Europe. The move of capital has been significant and has depressed currency and equity values in emerging markets such as India, the Philippines, Turkey and Indonesia.

YOU CAN PLAY IN SOFTER TONES, BUT THE TUNE IS UNMISTAKABLE

Since first mentions in May of an eventual pull back in the U.S. Federal Reserve's (Fed) asset purchasing program investors' blood pressure has been on the rise over what the 'end to easy money' would mean for capital markets. Over the summer months the Fed has gone to great lengths to soften and quantify its intentions, clarifying that timing would be data dependant and not tied to an imminent or near-term rise in the Fed's low interest rate policy. That's all well and good, but the message was clear - eventually tapering of the asset purchasing program will begin, and the stronger the U.S. economy is, the sooner that day will come.

Speculation about the timing and breadth of the Fed's first move to pare down its monthly asset purchases has been a key bond market driver since those early days in May as bond markets have ebbed and flowed along with the speculation. Each piece of U.S. economic data continues to be scrutinized with a 'what will Fed think of this?' approach. While recent U.S economic data has been mixed, there is a positive momentum to the recovery that has taken hold. As a result, bond yields have risen, bond prices have fallen, and all fixed income products have felt the negative effects. Shorter duration fixed income products saw slightly negative short-term returns, while longer duration bonds suffered more recently. While corporate bonds offer a higher yield than their government counterparts, they faced a further drag on their values in August as a record amount of new issuance occurred in the month. Supply was high as corporations moved to lock in financing at the current low interest rate levels.

MAGNITUDE AND SPEED

While bond prices rose in value with the geopolitical concerns at the end of August, it was not enough to offset the negative headwind of rising yields within the month. The effect of rising yields on bond returns is not only determined by 'how big?' a move is, but 'how fast?' a move occurs. While bonds kick out an income (in good times and bad), the negative effect of a sharp jump in bond yields, such as the one we had this summer, can't be offset in the short term by the income the bond will generate over time. A stabilizing, or even modest increase, in yields over a longer time frame will allow more income contribution to total returns, and at slightly higher yield levels than just a few months ago.

EXTOL THE BENEFITS OF A DIVERSIFIED PORTFOLIO

When market conditions create headwinds for one asset class or another, it can be difficult to convince investors of the merits of a well diversified portfolio…but then months like August come along and provide a worthwhile case study. Holding domestic equity helped you offset a difficult month for foreign equity. Holding bonds in your portfolio helped to mitigate significant equity market volatility.

Diversifying your investment portfolio, such that not all investments will react in the same way to the same events, creates two unique side effects – the ability to mitigate your downside risk and the ability to mitigate the anxiety that goes with it.