August Market Comments

General Comments

Summarizing the market for investors today is relatively easy: Fear, investment paralysis, and no return for waiting on the sidelines. There seems to be two alternatives:

- **Prioritize safety** and receive minimal yields from fixed income and money market instruments. Alternatively, buy "safer" dividend-paying stocks at all-time-high prices with low growth potential. This strategy focuses on not losing money, but guarantees very little potential gain. And if economic growth or inflation occurs, these investments may actually have the greatest risk of loss since they are over-owned and expensive.
- **Prioritize growth** by purchasing well-managed, dominant companies at low valuations and attractive earnings potential. This sounds good because over the long-term, investors could make a significant return, particularly with the emergence of new consumers in Asia and Latin America. However, there is a great deal of uncertainty about the global political climate, high levels of debt, and the social turmoil in nearly every country of the world. Many investors in equities suffered over the last decade with virtually no gains from a buy-and-hold strategy, and experienced two disasters that temporarily cut stock prices in half! Buying potential for growth is tempting, but any political misstep seems to bring the potential for furious selling.

What investors are looking for is something that consistently pays high-single digit returns, with no risk, on a consistent basis. Today, accepting no risk means getting no return, and seeking a reasonable return implies taking some risk of losing money. Many investors' need for a return often leaves them increasingly frustrated with the choice of making a guaranteed nothing, or experiencing more risk than they think they should just to make a reasonable return.

The problem is that investors focus too much on an uncontrollable variable: the market; rather than focusing more on the controllable factors of their own situation. A financial plan is key in understanding the life expenses that must be funded, and the types of investments and strategies likely to achieve those goals. Understanding why you are the custodian of money and how you behave with it in different environments allows you to make better investment decisions.

Fixed income investors may improve their returns by simply moving from the government bond and GIC markets to the corporate bond market, convertible debentures, and preferred shares. It's a little more work, and doesn't produce extravagant returns, but may form a good income producing base to a portfolio. Prescribed annuities ~~can~~ may also form a great tax-effective, income-producing alternative.

Equity investors should have a discipline they stick to. My discipline focuses on owning companies with desirable quantitative characteristics that also have a strong technical chart pattern. The process selects companies that are profitable, growing, re-invest in themselves, manage their business well, have an improving outlook on their business both internally and by analysts, and investor money is flowing into the company. This is overlaid with global factors including economic statistics, the shape of the yield curve, flows of money into various sectors, and sentiment measures to determine if a security or index should be owned.

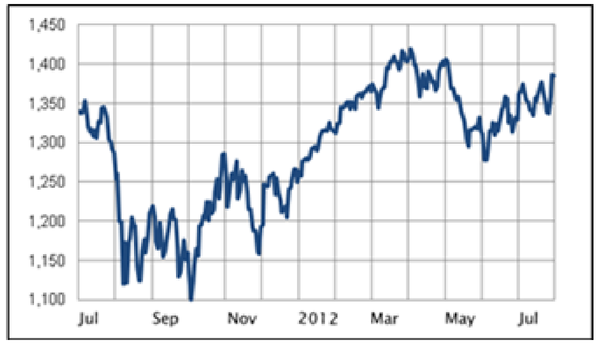
No one can consistently predict the market. Wealthy families are not successful because they know the future. It's because they understand their situation, have a savings plan, live within their means, and stick to a discipline when investing.

Market Snapshot

S&P/TSX Index (Canada)

Source: Thomson ONE

S&P 500 Index (US)



Source: Thomson ONE

Market Observations

- **The low for the Canadian stock market (S&P/TSX) was set intraday on June 4th**, representing a year-to-date loss of 6.6% for Canadian equity investors on average. The index has oscillated since that bottom, but overall it recovered 4.4% in two months (a week ago it had only recovered 2.2%).
- **The long-term trend of the Canadian market is negative, or bearish.** The index is well below every average that is four years or less. However, this bear market has been going on in Canada for 16 months now, suggesting investors may be closer to the end of weakness than the beginning.
- **Over the last two months, a base may have formed in the Canadian market, while the US market has nearly fully recovered to its March highs**. The potential of a disaster from a political misstep has not gone away, but two weeks before the Greek election in June, investors started buying equities. Fearing the Greek election and selling was the wrong conclusion.
- **Early in 2012, experts called for the collapse of natural gas prices by this summer**. After significant price lows in May caused by high production levels and inventories, natural gas prices climbed over 70%. Injections to storage have slowed substantially, drilling rig activity abruptly fell off, and hot weather may have created extra demand for air conditioning. Those that bought this hated sector were tremendous winners.
- **Nearly every stock market in the world has lost money for investors this year**, and appear to be in a negative or bear market - especially Europe and parts of Asia, including Japan.
- **The best countries to have invested in are the United States, Singapore, and Mexico.**
- **The U.S. stock market may have regained its dominance** as the primary place for capital market investment. I am not referring to the US economy, but rather the US stock market. With Europe at a continual uncertainty stage, and no capitalist stock market to rival it in the East, the U.S. is again becoming the stock market that institutions and individual investors are wanting to own the companies listed on.
- **The defensive sectors are exhibiting a leadership role for money flows**. Telecommunications, Consumer Staples, Health Care and Utilities are the areas investors have been buying. These companies often have a high predictability and consistency in earnings and pay a dividend. Unfortunately, both on a historic basis and compared to other industries, these sectors are also very expensive.
- **Investors have still been attracted to bonds during 2012.** The first quarter of 2012 was strong for stocks, and so Canadian bond averages actually posted a negative return. This equity strength turned out to be a "dead cat bounce" as stocks fell abruptly in May (after looking like they might hold firm due to strong April earnings), and investors moved out of equities back to the sidelines, fixed income, and dividend-paying equities. **The year-to-date gain of the Canadian DEX Bond Universe is 2.7% as of July 31, 2012.**

- **Government bonds pay less than inflation,** if bought or owned today. Investing in them could be called defensive, since if things in the world get worse, investors could drive yields even lower and prices higher. Right now five-year government bonds in Canada pay 1.3% and in the United States pay 0.6%. This mirrors what is happening in the equity market – buying safety is expensive.
- **Earnings surprises have been positive in July** with 67% of S&P 500 companies exceeding estimates (just over half of them have reported so far). Economic surprises relating to individual country statistics (rather than company results) have generally been extremely negative.

Managed Accounts – June and July Transactions

Managed accounts are discretionary accounts in which I can proactively make trades in a client's best interest based on a written Investment Policy Statement and an intimate understanding of their financial goals. Conflicts of interest from commission are eliminated since commissions are not charged on individual trades. Logistical difficulties in contacting clients and obtaining authority for changes they would likely want are eliminated and all parties gain time not spent on discussing small details of individual securities. Instead, time can be focused on wealth planning and discussing what the client feels is important and wants to discuss.

The comments below represent changes I have already made for managed clients, but also represent a good source of ideas for those that manage their own portfolio and rely on me for implementation, ideas, and a source of professional feedback.

Summary: *The last two months had a very conservative bias to it. I was expecting stocks to perform more poorly than they did, and raised cash to make additional acquisitions. Portfolios have less equity exposure than their average target and with fewer individual equity securities than typical. Had July been weaker, money would have likely been more heavily deployed into equity. There is a possibility that the low was already reached in early June. Ultimately August and September events will determine if portfolios begin to move away from their defensive posture.*

Selling of securities was mixed between taking some profits in successful investments such as Apple, the Gap and Rogers and eliminating disappointments that no longer ranked well in my discipline such as Canadian Energy Services, Devry, Trican, and Tyson Foods Note that Apple is still a large holding in the portfolio. Gold has lost its long-term bullish trend and so direct investment in bullion was eliminated, although positions in individual gold companies remain.

Strong companies like Oracle experienced a price dip that presented an opportunity to buy more shares, and subsequently appreciated approximately 7%. Potash Corp's stock price was at very depressed levels, and has started to turn upward, with strong relative money flows into it, matching its typical period of seasonal strength. This stock is likely a trading position. Constellation Software and Tim Hortons have fantastic earnings profiles, investor money flows, and likely form a core part of the portfolio.

New Positions:
- Constellation Software
- Potash Corp
- Tim Hortons

Existing Positions Added To:
- Oracle

Reduced Positions:
- Apple
- Rogers Communications

Completely Sold Positions:
- Canadian Energy Services & Technology
- Devry
- Gap
- Ishares Gold Bullion Exchange Traded Fund
- Trican Well Service
- Tyson Foods

Covered Calls Written:
- Intel September $29

Note: Covered call writing has been minimal since volatility levels have become so low. In general, this means speculators are paying very low premiums to investors who own stock to guarantee a future sale price. Options are not paying enough to do many covered calls right now.

Brad A. Hunter, CA, CFP, CIM
Portfolio Manager, Director, Wealth Management | **Richardson GMP Limited**
Suite 4700 • 525 8th Avenue SW • Calgary, AB • T2P 1G1

Direct 403.355.6033
Toll Free 1.866.867.7735
Email Brad.Hunter@RichardsonGMP.com
Web **www.bhunter.ca**