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Canadian stocks struggle in first half of 2011

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Market performance

Lacklustre global stock market performance in June and much of the second quarter was driven largely by economic news as opposed to corporate fundamentals. Concerns about a potential Greek debt default and high crude oil prices made many investors uneasy and added to market volatility. While the debt situation in Greece will likely take years to sort out, oil prices have offered some recent relief for the global economy by declining significantly. The price of oil fell from a recent peak of US\$114 a barrel in April to less than \$100 a barrel by mid-July. Higher oil prices lead to increased costs for businesses and also cause households to cut other discretionary spending. As a consequence, economic growth declines – and eventually oil prices also fall. We have just witnessed this cycle.

This year, Canadian stocks, as represented by the S&P/TSX Composite Index, have underperformed foreign markets as reflected by the MSCI World Index. From its April 5 peak to its June 20 trough, the TSX incurred a 10% correction. There are two main reasons why Canadian stocks have lagged in 2011. First, domestic stocks were pricier than foreign stocks on valuation metrics such as price-earnings ratios and price to book value. And second, the Canadian market has significantly greater exposure to the volatile resource sector, which has declined more than the broad markets.

Recent performance of key stock markets as of June 30, 2011

	Three-month period ended	Six-month period ended
S&P/TSX Composite Index	-5.15%	+0.16%
S&P 500 Index C\$	-0.67%	+2.79%
MSCI World Index C\$	-0.10%	+2.40%

Source: TD Newcrest

Portfolio performance

Despite the general decline in investor enthusiasm for stocks lately, foreign markets have done reasonably well this year. Investors have become more selective and generally favour stable companies that trade at lower valuations. We like this environment since it is well suited to our investment approach – which is to focus on quality stocks at reasonable valuations.

In our view, higher oil prices were not sustainable and our portfolio managers adopted a cautious positioning with our portfolios since the beginning of this year by reducing our resource sector



concentration and putting more emphasis on well-managed companies with strong balance sheets and good growth prospects. This disciplined approach has produced attractive results. Our portfolios have generated positive returns for our investors this year, including, in most cases, during the recent market correction.

We expect foreign markets to continue to outperform, due largely to their compelling valuations. In particular, valuations in emerging markets have come down to more reasonable levels. Also, although emerging countries have been going through a cycle of tightening to control inflation – with measures such as hiking interest rates and imposing higher reserve requirements on commercial banks – the efforts appear to be working with some success and are not unduly curtailing growth.

Portfolio tactics

Combined top 15 equity holdings as of June 30, 2011 of a representative balanced United Financial portfolio with alpha-style equity exposure:*

1. AltaGas	6. Canadian Utilities	11. Pason Systems
2. Bell Aliant	7. CCL Industries	12. Laurentian Bank of Canada
3. Power Financial	8. Astral Media	13. Telus
4. E-L Financial	9. TransCanada Corp.	14. BCE
5. Empire Company	10. Microsoft	15. Monsanto

Combined top 15 equity holdings as of June 30, 2011 of a representative balanced United Financial portfolio with value-style equity exposure:*

1. Toronto-Dominion Bank	6. Suncor Energy	11. Comcast
2. Microsoft	7. Boeing	12. Mullen Group
3. Barrick Gold	8. Royal Bank of Canada	13. DaVita
4. ExxonMobil	9. Oracle Systems	14. Franklin Resources
5. Potash Corp. of Sask.	10. Praxair	15. Roche Holdings

*Approximately 37% fixed-income, 7% enhanced income, 49% equities and 7% global real estate.

To see the top 15 holdings of the individual United Pools or of the United equity Alpha mandates, please visit the United Financial web page by right clicking on this link and selecting “open web link in browser”: <http://www.assante.com/wp/optima/financials.jsp#united15>.