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The flip side of market uncertainty is opportunity

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Although the U.S. debt ceiling was raised before the deadline and a default was avoided, the government's effort failed to satisfy the markets and at least one of the major rating agencies – Standard & Poor's. On the evening of August 5, Standard & Poor's announced it was dropping the credit rating of the United States' long-term debt from AAA to AA+. The downgrade was not unexpected but nevertheless it affected sentiment.

A lower credit rating for the United States, and continued questions about the European debt situation, created another bout of market volatility; this time on the downside. While volatility may cause some anxiety, it is also the reason why stock investors have received a premium return over other asset classes over longer periods of time. From a medium- to long-term perspective, we do not think equity market downside risk is significant, given the attractive market valuations.

The reality is that when there are fewer uncertainties and markets are less volatile, market valuations are higher and therefore less attractive because there is greater downside risk. A good example of downside risk was the tech bubble of 2000. Investors were too comfortable and set themselves up for a decade of lower returns due primarily to valuation. The price-earnings ratio or P/E of stocks at that time was more than 25. Investors were paying \$25 for every \$1 of earnings versus a normal average of \$15 for every dollar of earnings, or a P/E of 15. Today, markets are trading well below the average P/E, and this is why we are confident and optimistic.

In this type of volatile market, we believe it is important for investors to continue to keep a sense of perspective, and to avoid being unduly influenced by all of the noise in the media about doom and gloom. We are not necessarily on the brink of another recession. And if we do slip into one, history has shown that recessions do not last forever, and that corporate earnings recover. We continue to hold to the view that long-term investment success depends on buying quality investments, not overpaying for them, and holding them as part of a professionally managed and diversified portfolio that is tailored to your requirements.

Since the announcement of the U.S. Federal Reserve's second round of quantitative easing, known as QE2, stock markets gained about 20%, before giving up some returns recently. Expectations at the beginning of the year were too optimistic and had brought at least one issue – inflation. The price of oil went up to US\$114 a barrel, and that hurt both consumers and businesses – shoppers shopped less and businesses postponed hiring. To add to these challenges, emerging markets were at the peak of fighting inflation and Japan had a massive earthquake which led to a supply shock in other countries. These factors are unwinding quickly – oil recently fell back to the US\$80 level.



Our portfolios have done reasonably well this year, but have recorded some losses. We are pleased that our recent asset mix changes have already added value to the portfolios. For example, global bonds, to which we increased our exposure, were the best-performing asset class during this recent period of market volatility.

We do not plan to reduce our equity exposure in this market because valuations are very attractive. Markets are not expensive even if you factor in a recession and slower earnings growth. We anticipate that some of our current positioning will change as certain areas become relatively more attractive. To be more specific, we will likely see lower cash in our underlying funds, higher currency hedge ratios, more exposure to resource sectors, a larger exposure to emerging markets, and buying stocks as part of our disciplined portfolio rebalancing. We are confident investors will be rewarded over the long term.

Combined top 15 equity holdings as of July 31, 2011 of a representative balanced United Financial portfolio with alpha-style equity exposure:*

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

Combined top 15 equity holdings as of July 31, 2011 of a representative balanced United Financial portfolio with value-style equity exposure:*

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

*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>.