



FIRSTCAPITALFINANCIAL
WEALTH MANAGEMENT • RISK MANAGEMENT

T H E

First Capital Financial

Q U A R T E R L Y

DECEMBER 31 • 2009

R E P O R T

Economic Environment

The 4th fiscal quarter of 2009 has concluded with further signs of economic recovery underway. Continued strength in commodity prices including oil –a barometer of global economic health, surging output in developing countries led by China and stabilization in labour markets all suggest that the darkest days are behind us. The ‘Great Recession’ in which the global economy suffered its deepest slump since the second world war may finally be on the wane.

There has been a lot of collateral damage however, with unemployment in the developed world approaching 10%, record increases in debt levels and housing markets anywhere from 10% to 40% lower than the high water marks last set in March of 2007. Canada is the one exception to this, where housing prices have remained more or less flat since the recession began. Further, although interest rates remain at historic lows (good for global economic growth), economic stability is worryingly fragile and is still dependent on government support. Too, over-indebted households, weak banking systems and unsustainable trade imbalances remain, each of which will act as a drag on the long and winding road of recovery.

The massive amounts of debt arising from unprecedented government stimulus, while rescuing the world economy in the short term, will present problems for it in the longer term. Demographic pressures continue to build as Baby Boomers retire en masse, burdening already stretched social and economic programs. More debt will inevitably lead to higher taxes and a reduction in government benefits for all. Both will mute consumer spending which accounts for two-thirds of economic activity in the developed world. In turn this will likely weigh down the global economy, corporate profits and stock prices. The hope however is that increased demand from emerging economies (the number of cars sold in China in 2009 was greater than that of the United States –a first) will help to pick up slack from developed economies, and, together with rising productivity levels, result in economic growth continuing throughout 2010.

Our outlook for 2010 is a mixed picture. Low interest rates, low inflation, a re-capitalized banking system and improving consumer and business sentiment all represent economic positives. Weighed against this are the risks of sovereign-debt (Dubai, Greece, Italy), protectionism, surges in bond yields (Britain before the election) or the too-early withdrawal of government stimulus, each of which represent economic negatives. This indeterminate picture has us erring on the side of caution, with an overweighting in bonds and on the equity-front, defensively positioned for the twists and turns that lie in wait for the year ahead.

Canadian Equity Funds

Canadian Equities delivered a strong performance in 2010 on the strength of Canada's banking and resource sectors. Continuing strong demand from emerging economies and a relative improvement in demand from the developed world, combine to suggest that the our TSX Composite may well see additional gains in the new year. Unchanged from our position last quarter, is the view that Canada's economy and stock market is well positioned to outperform more broad-based indexes where commodity price increases drag down, rather than bolster returns. We remain cautious however in our outlook, as many economic obstacles are in the path ahead for the upcoming year.

Global Equity Funds

U.S. and global markets similarly witnessed a dramatic turn-around in 2009, posting double-digit gains for the year. Intervention by Central Banks and governments around the world turned the tide of pessimism towards a more positive (however somber and stoic) outlook by the end of the first fiscal quarter in 2009. Equity markets began an impressive rally around March, as the consensus of opinion emerged that the world economy had been pulled back from the brink. Where global markets go from here remains unclear. Were we to see a continuing (however slowly) improvement in economic conditions and corporate profits, stock exchanges may well see additional gains in the year. A softening of economic growth (particularly as government stimulus packages are wound down), could easily send markets lower as investor sentiment shifts again towards the less-optimistic. The jury is out in the near term, but our view is that the 2nd half of 2010 is where more of any gains to be earned from equities, are likely to materialize.

Fixed Income Funds

Both government and corporate bonds had a good year in 2009. Medium-to-longer term government bonds helped by cuts to interest rates, posted gains in the 3%-5% range. More impressive were corporate bonds which, together with their 6%-8% yields, saw capital gains on the value of their bonds of anywhere from 15% to 25%. Most corporate bond holders enjoyed average returns better than 20%, from an asset class that matched or bettered equities, despite their more conservative risk profile. With interest rates likely to remain stable in 2010 and the narrowing of spreads between government and corporate bonds, our view is that fixed-income investors should see stable interest yields in the year ahead. Generally, bonds serve to protect capital while delivering solid, predictable investment returns. This is precisely our expectation for 2010. Should equity markets retreat from their current levels, investors will appreciate the emphasis on capital protection that bonds offer and their steady yields, as they wait for markets to add to the gains they delivered in 2009.

CALL ONE OF OUR ADVISORS TO SEE

HOW WE CAN DETERMINE THE RIGHT

INVESTING STRATEGIES FOR YOU.

PHONE: 705.646.0480 • 800.376.2293

FAX: 705.646.0482

www.fcfcorp.ca