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WEALTH MANAGEMENT • RISK MANAGEMENT

T H E

First Capital Financial

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R E P O R T

Economic Environment

At the mid-point of 2008, global capital markets continue to be negatively affected by credit concerns, a global slump in housing and soaring commodity prices. This is reflected in declines in virtually every stock market around the globe, weakness in the US dollar and rising unemployment numbers.

Economists are mixed, but thus far the global economy has managed to stave off recession, as Emerging Markets led by China, continue their frenetic pace of economic growth. This contrasts with the Developed World, where economies remain stalled, and the manufacturing sector contracts.

Inflationary concerns appear to be growing by the day, as the prevailing view permeates the media that record-high commodity prices will strain the ability of producers and consumers to absorb these costs. While these concerns are valid, we are of the view that inflation is unlikely in a slowing economy, where competition to maintain market share is more likely to ensure continued low prices at the retail level. Thus, the shift in focus by Canadian and US Central Banks from growth to inflation is curious, as there has never been a time where inflation has posed a risk when economic growth is contracting.

With all of the uncertainty about the direction of the real economy and global markets, the question always turns to how best to position one's portfolio in this environment going forward. As always, diversification is key, as not all asset classes are affected equally from a general slowdown. Government and corporate bond have fared reasonably well compared with international equities, as have Canadian equities with significant exposure to commodities -oil, gas, potash, wheat, corn amongst others. Further, those funds utilizing a more defensive Value management style have tended to weather global market fluctuations better than their relevant benchmark indexes, as they hold stocks acquired at a discount to present value.

Investing requires patience and resolve at all times, and it is important to remember amidst the doom and gloom that markets have perfect track records over the long term. That is, for every market downturn, equities have historically erased all short-term losses and gone on to deliver the highest return of any asset class available to investors. This remains our view and our outlook beyond the present, to the future.

Canadian Equity Funds

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INVESTING STRATEGIES FOR YOU.

On aggregate, the TSX in Canada has delivered solid return for investors, posting a gain of X% YTD. This gain is almost solely the result of skyrocketing commodity prices led by Oil. This gain is deceptive as most sub-sectors are either flat or are trading lower. Most notable is the heavily weighted banking sector, which has posted losses of Y% to-date. Our view is that additional gains are likely to be seen from commodities, as demand from developing countries will remain strong. Real short term risks remain however, as, in the eventuality of a prolonged slowdown in developed countries, reduced demand for commodities could send prices down sharply. That said, we are of the view that commodity prices will continue to prop up the TSX for the balance of 2008.

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Global Equity Funds

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Virtually every stock market around the globe including those in emerging markets has seen their indexes sell off in 2008. In some cases this has meant double-digit declines, as stock prices react to a global economy suffering from high commodity prices and tighter credit. This has taken its toll on some of the best-known companies including Bear Sterns, Sony and Nokia. While the declines have been spread across most sectors, these have been measured on the whole, in contrast to the panic selling witnessed in 2007. As always, markets are crude devices of speculation in the short term, but are sophisticated weighing machines over the long term. This means that quality companies generating increasing amounts of free cash flow will continue to see their stock prices rise over time, regardless of their short term outlook. The outlook is mixed at best for international markets in the 2nd half of 2008, however we may see some surprises to the upside as the global economy may muddle-through better than presently thought.

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Fixed Income Funds

As predicted, government bonds have posted gains, as bond prices have reacted positively to interest-rate cuts in North America. This coupled with the yields from the bonds themselves, has seen this asset class deliver positive for investors year-to-date. In the last month, concerns over inflation have recently sent bonds prices back from their earlier highs in 2008. However the outlook remains good on both a relative and absolute basis and government bonds continue to offer investors a secure investment, with low correlation to equities. Corporate Bonds have seen slight gains in the first half of the year too, as default rates remain low and much of the pessimism of downgrades has already been factored in. Our view is that both government and corporate bonds are an essential component of any diversified investment portfolio and serve to hedge against market downturns, while delivering solid, predictable yields over time. We are confident that the balance of 2008 should support this view.