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R E P O R T

Economic Environment

2008 has begun with many of the previous years issues worsening in both scale and scope. Most notably, the U.S. housing and sub-prime market has deteriorated significantly, sending equity markets lower and increasing the likelihood of a global recession.

Central Banks around the world have responded by cutting interest rates, to stimulate economic growth through liquid, inexpensive credit. The direct intervention by the US Federal Reserve to provide capital to prevent the total collapse of venerable Wall Street giant Bear Stearns is indicative of the depth of concern for the viability financial system as a whole.

The backdrop of worsening economic conditions has predictably sent the US dollar lower and gold prices higher, with the price of bullion hitting \$1000 per troy ounce. Inflation too has resurfaced, with the core rate of inflation moving higher as a result of surging oil and commodity prices.

With all leading indicators suggesting a continuing downward trend for both equity markets and the real economy, the question arises as to how to protect one portfolio during periods of market turmoil? Diversification is the cornerstone, with asset classes such as government bonds acting as a hedge against plunging stock markets. Too, holding funds with significant positions in government Treasuries also serves to mitigate the effects of market losses. Mindset is another. Recognizing that stock markets move in short-term cycles in response to economic news, but the long-term trend is up. Given the stock market's rising trend, market declines have been an opportunity for long term investors to acquire equities at lower prices.

In summary, the economic environment looks anything but promising in the near term, but this too shall pass. The resilience of capital markets and capitalist economies to resolve economic difficulties, while continuing to create wealth over the long term has been proven over the last century. However the balance of 2008 unfolds, we remain confident in the medium-to-longer term that a well-diversified portfolio of equities and fixed-income investments will serve investors well.

Canadian Equity Funds

Canadian equities have held up relatively well compared with global markets, given the continued strong demand for Canadian commodities from both developed and emerging market countries. Banking stocks have not fared as well, with exposure to U.S. sub-prime mortgages and illiquid asset-backed commercial paper sending bank shares to their lowest levels in years. Our view is that a global slowdown will have an adverse affect of Canadian markets, although more muted than other international.

Global Equity Funds

International markets will rise or fall on their own merits, in contrast to 2007, where the rising Canadian dollar was largely responsible for whether investors made or lost money. A flight to quality companies is expected to accelerate, where the very best of firms are sought after, leaving those less so with evaporating market values. Again, the view is that the second half of 2008 may see a modest recovery in stock levels from their present or possibly lower levels reached before then. Longer term, this asset class holds considerable promise, as investors should likely see any gains in equities augmented through additional currency returns, as the Canadian dollar moderates from its present level.

Fixed Income

Year-to-date has seen government bonds deliver positive returns, as interest rates have come down in Canada. Corporate bonds have not fared as well, as declining bond prices have offset yields. Our view for the balance of the year remains positive however, and we expect returns from government issues to come in the 5% to 7% range, and corporate bonds in the 7% to 8% range, as even a modest improvement in the outlook for the economy should see the values for corporate bonds stabilize, allowing investors to enjoy returns from higher-yielding corporate bond issues. This asset class should also serve to protect investors from continuing weakness in equity markets; a role that bonds have historically played over the long term.

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