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R E P O R T

## Economic Environment

The first fiscal quarter of 2009 witnessed a continuation of last years Bear Market, with most indexes trading lower. Governments and central banks around the world continue to work to stabilize the global economy, through additional measures designed to ensure the smooth flow of credit to business and consumers. The initiative of the Obama administration to assume the bad debts of banks, coupled with the purchase of US Treasury Bonds and record-low interest rates are geared to stimulating consumer spending and economic growth. A similar approach was taken in the early 1990s to resolve the Savings and Loan crisis and yielded positive results. Here, history suggests that this posture may see the US economy stabilize and begin growing again.

Housing prices still have yet to reach bottom and unemployment levels continue to rise. It is generally recognized that the latter is a lagging indicator, suggesting that the world economy may be further into the recession than originally thought. This is tentatively encouraging, as the further into the recession we are, the closer we may be to its end.

OPEC, which supplies about two-fifths of the world's oil decided against further production cuts at a meeting in Vienna in mid March. Oil which has fallen about \$100 a barrel, has returned to the \$50 level. Commodities in general and oil in particular are leading indicators, meaning that a rise in oil suggests the global economy may be beginning to stabilize; the first step towards a full economic recovery.

Consumer confidence understandably remains low. This represents the single biggest obstacle to an improvement in both the equity markets and the real economy. Consumers represent two-thirds of all dollars spent and a drop in consumer spending has exacerbated the downturn. That said, it is our view that consumer sentiment is actually worse than current economic conditions necessitate. This is often the case, where the outlook - whether on the upside (irrational exuberance) or the downside (excessive pessimism)- is more extreme than the prevailing reality. Based on this observation, one can expect that markets may begin to move to the upside where the economy shows even the most tentative signs of recovery. Sharp intraday rallies at the end of March support this view. While a few positive days are not sufficient to conclude with certainty that the markets have moved off their lows set in February, it does give investors some reason for optimism looking forward.

We remain circumspect at this time, convinced that the world economy, though saddled with immense challenges, will ultimately prevail, with improving global markets towards the end of this year and a resumption of economic growth in 2010.

# Canadian Equity Funds

Canada's stock market has fared best among Developed World exchanges, reflecting our relative strength in banking and the modest rebound in commodity prices. Year-to-date, Canadian banks have earned close to \$20 billion in profits; a sharp contrast to US, UK and Swiss banks, most of which have had to rely on government assistance to remain solvent. Dividends from Canadian banks have yet to be reduced, although the expectation is that before the global recession ends, there remains an equal probability that this may yet happen than not. With Canada's economy so heavily dependent on the overall global economy, our view is that the direction of Canadian stocks will experience continued volatility throughout the year, as the global economy looks for a bottom to the current economic downturn. One note of optimism comes from the reality that commodities are leading indicators. This fact augurs well for Canada's TSX Composite, which may prove to be the Canary in the coalmine for the balance of 2009.

## Global Equity Funds

Global markets remain under pressure, led lower by the Financial Services sector, which has declined by roughly half since September of 2008. Though massive government bailouts have prevented another corporate failure of the magnitude of a Bear Stearns or a Lehman Brothers, consumer confidence remains at record lows. The de-leveraging of the consumer continues to weigh heavily on consumption, sending even the most venerable of companies stock prices to 10-year lows. Until a definitive bottom is reached, the prevailing negative near-term outlook for stocks is likely to remain poor. That being said, the late-March mini-rally in stocks suggests that equities may be oversold, and that even a glimmer of positive economic news may be sufficient to bring stocks up from their present levels. Equities as an asset class remain an important component of a well-diversified investment portfolio and we remain confident that better days are ahead for patient investors, who may yet see some improvement in stock markets before year-end.

## Fixed Income Funds

Bonds have outperformed equities in 2009, with government and corporate bonds delivering nominal gains year-to-date. Of the two, corporate bonds are expected to yield higher returns as the par value of investment grade bonds recover from their steep declines. It is our view that corporate bond prices reflect an overly pessimistic default risk, one that is higher than any recession including the 1930s Depression. A modest improvement in the global economy may be sufficient to cause investors to re-price this risk and recognize the intrinsic value that corporate and high-yield bonds currently offer. Historically speaking, high-yield bonds have outperformed equities in terms of total returns in each of the past three recessions. It is for this reason that we remain bullish on this asset class for investors

One note of caution with respect to government bonds derives from the concern that the massive amounts of fiscal stimulus being injected into the economy will re-ignite inflation, eroding returns for investors. We are monitoring this carefully and remain committed to increasing client's exposure to Real Return bonds as a hedge against possible inflationary risks.

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