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Economic Environment

The third fiscal quarter of 2009 has been characterized by rising markets driven by the view that the world economy has turned the corner and a sustained recovery is underway. Those holding this bullish view cite rising commodity prices, an improvement in housing starts, a return to normalcy in terms of credit markets and economic growth in specific countries including Canada's, where GDP actually increased in Q2 (however insignificantly).

Government spending, low interest rates and continued strength in emerging markets have mitigated the worst of the economic downturn and have contributed to the beginnings of the next period of economic expansion.

This being said however, the question of where markets go from here remains very much in doubt. Unlike the recession of 1982-1983 where interest rates reached nearly 23%, Central Banks around the world have already fired their salvo, and have no further ammunition to encourage economic growth through interest rate cuts. Similarly, governments around the world have borrowed unprecedented (for peacetime anyway) amounts of money and have reached the limits of what they can do to get the economy moving again. What remains for governments in terms of action is more now of what they don't do, namely raise protectionist barriers to trade.

For now, inflation remains benign and may continue to be a non-issue for the near term. Our concern however is that the net effect of massive government borrowing is higher taxes -sooner than later to pay for it all, and higher inflation as governments attempt to inflate their way out of debt. Neither auger well for a global economy tentatively looking for firmer footing, from which to climb its way out of the economic hole it presently finds itself.

We are sticking to our view that the challenges still facing the global economy will ultimately be overcome, with continued improvement in growth in 2010. However, Q4 corporate profits may not prove enough to support the current run-up in equities, suggesting that the next short-term move in markets may be down.

Canadian Equity Funds

Canadian equities continued their upward march on the strength of rising commodity prices and surprisingly strong earnings from the financial sector.

Year-to-date, the TSX Composite has posted gains of almost 30%, as investors continue to pour money into Canadian companies. As emerging countries continue to demand Canadian resources, the expectation is that our stock market may outperform more broad-based indexes, where commodity prices drag down rather than bolster returns. Despite the somewhat more rosy outlook, as cautioned last quarter, actual and not anticipated top-line revenue growth is needed for Canadian markets to improve on present levels.

Global Equity Funds

U.S. and global markets have nearly caught up with Canada's TSX Composite, posting gains of better than 25% since the start of the year. The persistent belief that the worst is behind us, has advanced the MSCI World Index, where expectations of a solid economic recovery in 2010 are fully priced in.

Disappointing earnings could stall global markets or more likely, take them back to levels seen earlier in the year. The structural problems in the global economy (low savings rates, inflated asset prices and unsustainable trade imbalances) are still very much a reality. As such investors should not expect too much from equities in the short term, whatever 2010 may see in terms of economic recovery.

Fixed Income Funds

Bonds, led by corporate bonds continued to perform well in the 3rd quarter.

With inflation all but non-existent, government bonds are likely to finish

2009 with a real return better than 4% for investors. An improving outlook for the economy has sent corporate bonds prices up, giving investors gains in the 15% to 20% range from as asset class normally thought of more for capital protection than growth. Our view is that additional gains in the face value of corporate bonds will be modest, leaving investors with solid yields in the 6% range. Government bonds may well prove to be a sensible safe haven for investors looking to lock-in some of their recent gains from equities.

Going forward, bonds continue to serve an important role in portfolios, through protecting capital and delivering steady, predictable returns for investors.

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