

"The only thing we have to fear is fear itself."

Franklin D. Roosevelt

Inaugural Address, March 4, 1933



WATSON DI PRIMIO STEEL

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## Investment Perspectives

### 2009: A Year of Uncertainty and Then Opportunity

While recessions are very difficult events to predict and accept, they are a natural part of an economic cycle. Prior to 2002, the year when the United States was subject to a brief recessionary period after the technology bubble burst, we had not encountered a recession in North America since the early 1990s. Now, after more than 16 years of economic growth, we are experiencing a corrective downturn in global growth.

Most recessions last less than one year and equity markets typically rebound six months prior to the recovery in economic activity. The current U.S. recession is officially 14 months old and world markets had rebounded 15% to 20% at year end from their November 2008 lows. However, uncertainties in financial markets persist. For example, world economic

growth is expected to be only 0.5% this year compared to 3.2% last year and 4.9% in 2007. As a result, the U.S. unemployment rate is forecast to increase significantly to 8.8% in 2010 from 4.6% in 2007, while the Canadian unemployment rate is predicted to increase to 8.3% next year.

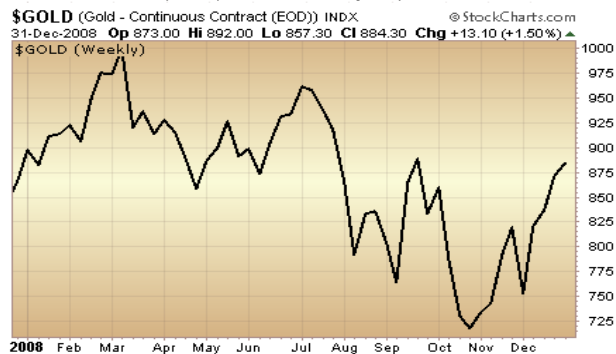
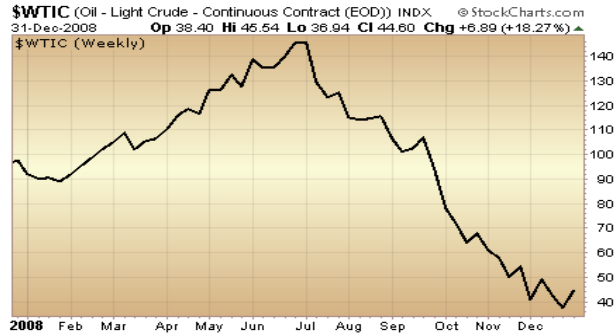
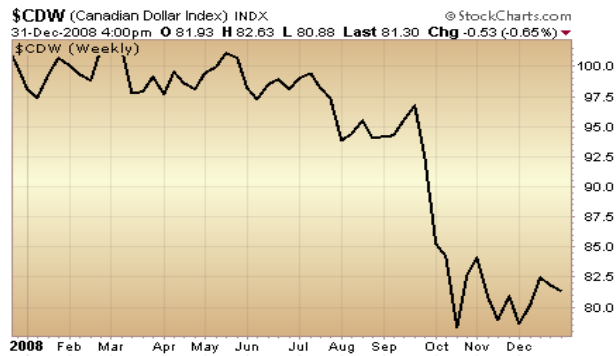
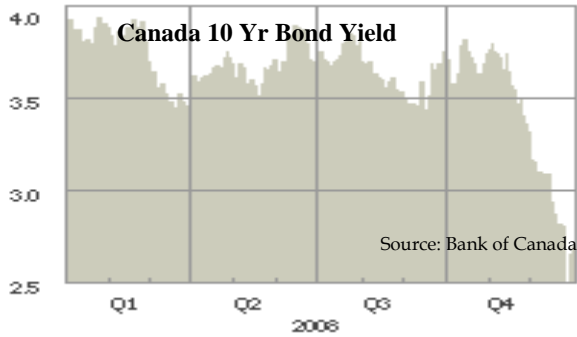
On the positive side, global growth is forecasted to return to 3.0% in 2010. Today's equity valuations – measured by price earnings multiples and dividend yields – reflect the uncertainties highlighted in the news media, but do not consider the possibility of a recovery any time soon. Therefore, we see 2009 as a year of uncertainty and then opportunity as fundamentals eventually improve.

*As always, we thank you for your continued support and confidence.*

### Equities:

Measured in Canadian dollars on a total return basis, the TSX fell 33.0%, the S&P 500 fell 23.9%, and the EAFE fell 29.4% in 2008. While markets have fallen by similar magnitudes in the past, the speed and severity by which the correction occurred took most people by surprise. From October 2007 to November 2008, the peak-to-trough market declines were 49%, 53%, and 56% respectively. Most of these losses came in the six-month period ending

November 2008. As the charts on the left side of this page indicate, markets strengthened in the last six weeks of the year, possibly indicating a bottom. In past market corrections of this magnitude not all sectors were affected to the same degree. In the 2000 to 2002 correction, for example, much of the decline could be attributed to the technology sector. This time there was no place to hide as all sectors fell during the year.



## Fixed Income and Interest Rates:

Over the last 12 months, the U.S. federal funds rate fell from 4.25% to a new target range of 0.00% to 0.25%. In Canada during that period, the overnight target rate fell from 4.50% to 1.50%. The U.S. 10-year treasury yield declined from 4.04% a year ago to 2.25% at the end of December 2008. As illustrated to the left, the yield on the 10-year bond declined from 4.09% to 2.69% over the past year. Some analysts feel that the recent low 10-year bond

yields may indicate future deflation of approximately -1% per year for the next ten years. While this is possible, it is unlikely. The counter to this deflation argument is that lower interest rates historically stimulate economic activity. In addition, monetary and fiscal stimulus has increased around the world. In combination, lower interest rates and increased economic stimulus can lead to future inflation and higher interest rates.

## Currencies:

In a reversal from 2007, the Canadian dollar fell versus the U.S. dollar from about par to \$0.82 at the end of 2008, a decline of about 18%. The Canadian dollar weakness illustrates the surprising resilience of the U.S. dollar. In the last six months of the year the U.S. dollar

rose over 11% against the Euro. The U.S. dollar was also strong against the pound sterling and Australian dollar. Forecasters predicting a flight from the U.S. dollar to gold, as U.S. and global economies weakened, were proven incorrect.

## Commodities:

Lower oil and commodity prices were the main theme over the last half of 2008 as it became clear that global economies were entering a recessionary period. Oil fell from a high of over \$145 per barrel in July to about \$44 per barrel at year end. As economic difficulties surfaced in 2008, many pundits predicted a dramatic increase in the price of gold as inves-

tors moved away from the U.S. dollar and into hard assets. However this did not happen as gold was relatively stable in 2008, rising a modest 5.7% from \$836 at the beginning of the year to \$884 at year end. This situation of stable gold prices and a rising U.S. dollar could bode well for an improving economic outlook.

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