

**"If you are shopping for common stocks, choose them the way you would buy groceries, not the way you would buy perfume."**

**- Benjamin Graham**



**WATSON DI PRIMIO STEEL**

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## Investment Perspectives

### The Great Recession Ends – Now What?

Most economists believe the recession has ended and that we are in the early part of an upturn thanks to strong government spending programs and lower short-term interest rates. The world economy, having declined by 1.0% in 2009, is generally anticipated to grow by 3.5% to 4.0% in 2010. The Canadian and U.S. economies are both forecasted to expand by 2.7% in 2010 following the GDP declines in each country of 2.5% in 2009.

The next stage of the recovery should see improvement in consumer spending and business investment. We will also experience higher interest rates as central banks do not want to create an inflationary problem by keeping rates artificially low for too long. Unfortunately, there are a couple of risks that we face at this time. First, growth in the economy could be weaker

and, therefore, corporate profits less than expected. Second, rising interest rates could become an obstacle for further stock market gains.

It is worth noting that the expected 2010 North American GDP growth of 2.7% is much lower than the typical rebound of 4.0% to 6.0% following a recession. The reason for a cautious outlook is that this recession was caused by a financial crisis stemming from the United States. Although we have seen tremendous improvements since 2008, we need to ensure continued progress in the lending practices and stability of financial institutions. Finally, further advancements in equity markets very much depends on whether or not anticipated profit growth is achieved.

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

### Equities:

The thumbnail charts on this page show the year's price performance of the S&P/TSX Composite, the S&P 500, and the MSCI EAFE. Despite two difficult months at the beginning, 2009 witnessed a synchronized global recovery in equities from March onward. With overnight interest rates near zero, central banks spurred demand for increased risk taking, which provided the early momentum for stocks. Again Canada's equities outperformed the U.S. and other international developed markets. The S&P/TSX Composite rose 35.06% on a total return basis over 2009 led by financials, information technology, and energy; combined comprising 61.54% of the index. The laggards have been the so-called defensives like utilities, telecom, and consumer companies. Nonetheless positive

returns were derived across all ten sectors of the index.

Income trusts posted a total return of 42.21% in 2009. With the liquidity driven surge, most income trust prices enjoyed good gains while steady distributions helped enhance total returns.

Internationally, those developing economies that implemented meaningful stimulus initiatives – notably China – posted the highest equity returns for 2009. The MSCI Pacific ex-Japan total return index was up an impressive 47.67% (in \$C). The loonie's powerful rise against other major currencies (i.e. \$U, € and £) compounded Canadian investors' underperformance in U.S. (7.94%) and EAFE (13.06%) returns.





## Fixed Income and Interest Rates:

The unprecedented monetary easing continued throughout 2009. The U.S. Fed funds rate held constant in the zero to 0.25% range, while the Bank of Canada maintained its commitment to a 0.25% overnight rate. Inflation pressures are unlikely to materialize soon in a world expected to have subdued economic growth, significant excess productive capacity to work off, and current double-digit unemployment rates in the U.S., the world's largest economy. Until the economic recovery proves to be durable, and la-

bour market conditions improve, central banks will wait to raise short-term rates for fear of destabilizing the recovery. Forecasters predict rates to stay "exceptionally low" until mid-2010, and then climb gradually. The US 10-year treasury yield climbed from 2.25% a year ago to 3.85% at year end. The yield on a Canada 10-year bond, as illustrated to the left, rose less sharply from 2.69% to 3.61%. In both countries we continue to observe steep, upward sloping yield curves, which signals recovery.



## Currencies:

In 2008, with global stock markets in turmoil, the loonie had fallen to \$0.814 to the U.S. dollar. In 2009, the Canadian dollar is up 17.2% at year end against the U.S. dollar and more than 23% off its low in December 2008. Canada's currency also gained versus other major trading partners. Our dollar's rise, like similar export-led economies, reflected higher commodity prices (leaders were oil, copper and zinc). The loonie also took support from investor selling of

U.S. dollars, as America's multi-year trillion dollar deficits raised concern. Further, the fiscal position of Canada is much better than many other developed countries. With the lowest debt levels among the Group of Seven nations, Canada's currency is viewed as a relatively safer investment. The Canadian dollar is expected to strengthen further - trading around parity with the U.S. dollar.



## Commodities:

As China and other emerging markets escaped from the recession, demand for commodities grew in 2009. Commodity prices, particularly copper and zinc, climbed the most at 141.4% and 111.9%, respectively, after falling over 50% in 2008. Forecasters suspect that commodity prices could remain higher as real demand strengthens with the recovery, and restocking in the Western world tightens the commodity market. The left-hand \$WTIC chart illustrates the rally in the price of oil, which gained US \$34.76 per barrel to

reach US \$79.36 (+77.9%). The long-term secular trend for energy consumption is positive as developing economies continue to fuel their growth. Gold, displayed in the bottom chart, continued its climb, closing at US \$1,096.50 per ounce at year end. The price of gold was up 24% as the U.S. dollar's weakness increased gold's investment appeal as an alternative currency. Analysts anticipate that currency fears, rather than inflationary pressures, will continue to bolster investment demand



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