

"Great investment opportunities come around when excellent companies are surrounded by unusual circumstances that cause the stock to be misappraised."

- Warren Buffett



WATSON DI PRIMIO STEEL

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## Investment Perspectives

### Tracking the Recovery

The European Union's debt crisis has temporarily subdued the recovery. This setback to investors' confidence has triggered volatile equity markets and a rise in the price of gold. Given the severity, and financial nature of the crisis, it is not unreasonable for the recovery to be weaker, and take longer, than a classic rebound. With the prevailing pessimism, it is important to keep in mind that reasonable progress has been made since last year and that the global economy is continuing to recover.

The Conference Board still expects the world economy to grow at 4% in 2010. Developing countries will lead the recovery with average GDP growth rates of around 6%. As of 2009, half of the current growth in the global economy is credited to progress in the emerging markets. Unlike most industrialized countries, these regions do not have fiscal sustainability issues. Nevertheless, developing markets cannot do it

alone. A return to sustained, robust world growth must include the United States and other mature economies. Real risks remain to be dealt with, specifically how developed countries can repay their super sized debts.

The consensus view is that slower global growth may persist in the near-to-medium term, if not longer. But most forecasters do not expect us to experience another recession soon, which is often referred to as a double dip. Since inflation is not a concern in the short term, we can expect that the current low interest rate environment will continue much longer than originally expected. To summarize, the economic recovery is intact. It is just weaker than normal.

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

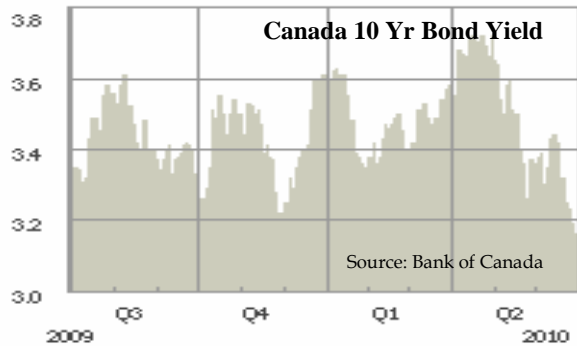
### Equities:

Markets performed well until April. In May the market's earlier progress--on rebounding corporate earnings--gave in to renewed recession fears and risk aversion. Events turned on Greece's debt crisis and triggered a great deal of volatility in equity markets. Negative investor sentiment took hold causing a two-month synchronized sell off in global equities. The pullback removed almost 10% from the Canadian market's April high.

The left-hand charts show the six-month price performance of 3 major markets: Canada, U.S. and international. Though lower, Canadian stocks performed better than their U.S. and international counterparts. For the first half of 2010, the S&P/TSX Composite is

down by -3.85%. Only four of ten sectors-- combined 30% of the index--finished in positive territory: health-care, telecom services, consumer discretionary and materials. The hefty cyclical sectors: information technology, energy and consumer staples declined on downward revision to forecasts on lower growth prospects.

Measured in Canadian dollars, the S&P 500 and the EAFE fell -6.5% and -13.7%, respectively. All 10 sectors of the S&P 500 declined. Year-to-date the Canada - USD dollar exchange rate has had little influence on Canadian investors' returns. Conversely, underperformance in the European markets was magnified by the euro's (and pound sterling's) depreciation.



**\$CDW (Canadian Dollar Index) INDX**  
 30-Jun-2010 4:00 pm © StockCharts.com  
 Open 95.15 High 95.28 Low 93.91 Last 93.95 Chg -0.84 (-0.89%)



**\$WTIC (Oil - Light Crude - Continuous Contract (EOD)) INDX**  
 30-Jun-2010 © StockCharts.com  
 Open 75.42 High 76.86 Low 74.42 Close 75.66 Chg -0.30 (-0.39%)



**\$GOLD (Gold - Continuous Contract (EOD)) INDX**  
 30-Jun-2010 © StockCharts.com  
 Op 1240.30 Hi 1247.90 Lo 1235.10 Cl 1242.60 Chg +2.10 (+0.17%)



## Fixed Income and Interest Rates:

The Bank of Canada was expected to gradually reduce its monetary stimulus mid-year. On June 1st, the Bank raised its key policy rate by a quarter of a percentage point to 0.50%, based on the solid domestic rebound. Given that Canada's inflation outlook remains tame, and that the global economic recovery may be protracted, the pace of the rate-hiking policy is expected to slow.

Meanwhile, the U.S. held to its emergency level of monetary accommodation. The U.S. Fed funds rate remains in the range of zero to 0.25%. Slower economic growth prospects abroad only add to the U.S. policy dilemmas of continued disinflation and persis-

tently high unemployment. Forecasters believe that the Fed is unlikely to begin tightening until early 2011. Even then, historically low policy interest rates may prevail for an extended period.

Greece's debt crisis spurred investors' flight to quality, which led to lower government bond yields in Canada and the U.S. The yield on the 10-year Canada bond, as shown to the left, fell from 3.61% to 3.08%. Both the U.S. 2-year and 10-year Treasuries fell to recent lows of 0.61% and 2.97%, respectively. Generally such a decline in yields signals slower growth. Both yield curves, however, remain steep and far from the flat/inverted levels typical before recessions.

## Currencies:

By June 30th our dollar had depreciated a modest 1.36% against the U.S. greenback, closing at \$0.9429. The US dollar was the benefactor of capital flows as foreign investors flocked to US treasuries amidst the EU turbulence. The Canadian dollar's resiliency—only down to 92 cents—during this period reflects positively on foreign investors' view of our credit

quality. Until recently the Canadian dollar behaved strictly as a commodity currency, moving with the direction of commodity prices.

Meanwhile the loonie appreciated against other trading partners. Notably the euro experienced the worst difficulty falling roughly 14% against the U.S. dollar and 11% against the Canadian dollar.

## Commodities:

After 2009 rebounds the price of industrial metals fell on economic tightening in China. Economists attribute weakness in commodity prices to lower demand in rapidly industrializing nations.

The rally in oil also ended, though energy prices have remained volatile. Year-to-date crude oil prices have traded over US \$86 to under US \$66 a barrel. Uncertainty about the global economic recovery generally pushed energy prices down. The left-hand \$WTIC chart shows the sideways movement in oil from US

\$79.36 to US \$75.66 (-4.7%) this year.

Safe-haven buying on sovereign debt worries drove gold up 13.3% so far. Displayed in the bottom chart, it touched an all-time record high US \$1,265.30 an ounce on June 25th. Ongoing concern about a decline in the U.S. dollar could lead to further demand as investors seek an alternative reserve currency. Also the decline in U.S. interest rates, in general, supports gold because the lost income opportunity is negligible.

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