The BIG Picture

March 2010

One year later

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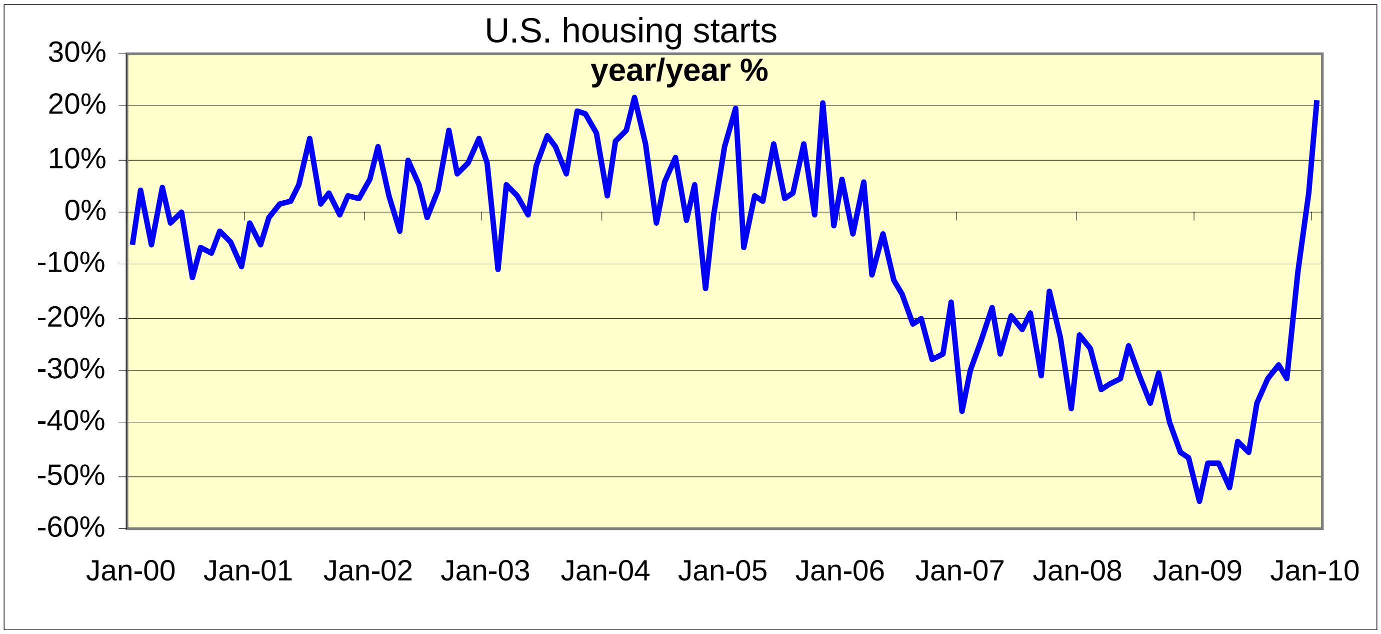
In years to come, it is likely that March 9 will come and go without much fanfare. The financial markets move on, and many dates that were significant are eventually overshadowed by other significant dates. However, March 9, 2010 marks the first anniversary of the market bottom in North America that followed the global financial crisis. While markets still have considerable ground to make up in order to return to their highs, investors around the world can breathe a collective sigh of relief as they contemplate this anniversary. Over the past 12 months, the recovery in the world's equity markets has been remarkable, particularly as the preceding decline was marked by historic levels of volatility and speculation that another depression was at hand. Many pundits described a "panic" atmosphere that prevailed during that time and many of the headlines of the day suggested that investors should not expect any kind of improvement until some distant future. However, as the past year unfolded, a sense of optimism eventually allowed stock markets around the world to regain a healthy portion of the lost ground. All regions have recorded significant improvements while developing nations appear to be leading the charge going forward.

The epicentre

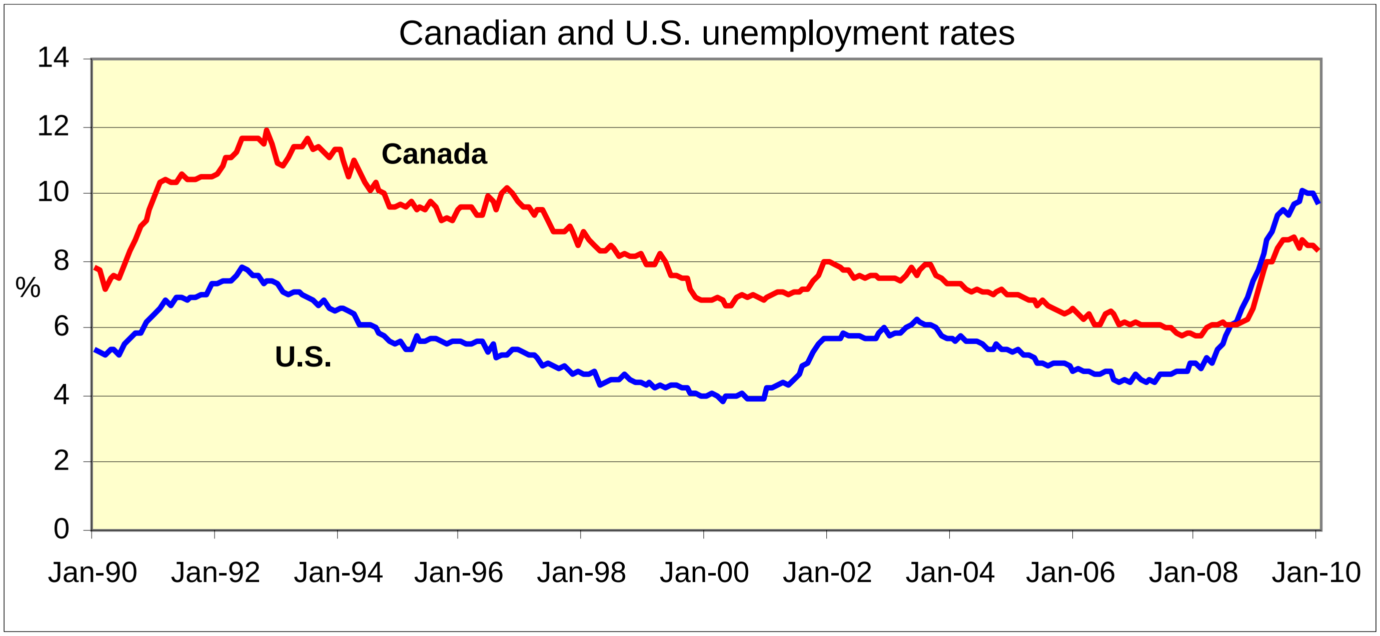
With imbalances within the U.S. housing market cited as the main culprit in the financial meltdown, it is not surprising that a recovery in this sector has been slow to develop. Over-leveraged borrowers and poorly understood mortgage-backed securities led to multiple bankruptcies of both individuals and institutions.



Source: U.S. Department of Commerce

More recently, however, as can be seen in the graph on the previous page, housing starts have begun to recover. Lower prices, improved availability of credit and tax rebate programs have prompted bargain hunters to come back into the housing market. Annual growth in housing starts turned positive in December 2009 for the first time since March 2006. While the actual level (591,000 in January 2010) remains far below the 2.27 million peak posted in 2006, more modest building levels have produced reduced inventories. At the beginning of 2009 there was a 12.4-month supply[1] of unsold homes. By the end of 2009 this had diminished to an 8.1-month supply. As supply is absorbed, additional construction activity can be anticipated. It will obviously take some time see a full recovery in the housing sector, but some encouraging signs have appeared. Other early signs of economic improvement have also begun to emerge.

Jobs, jobs, jobs



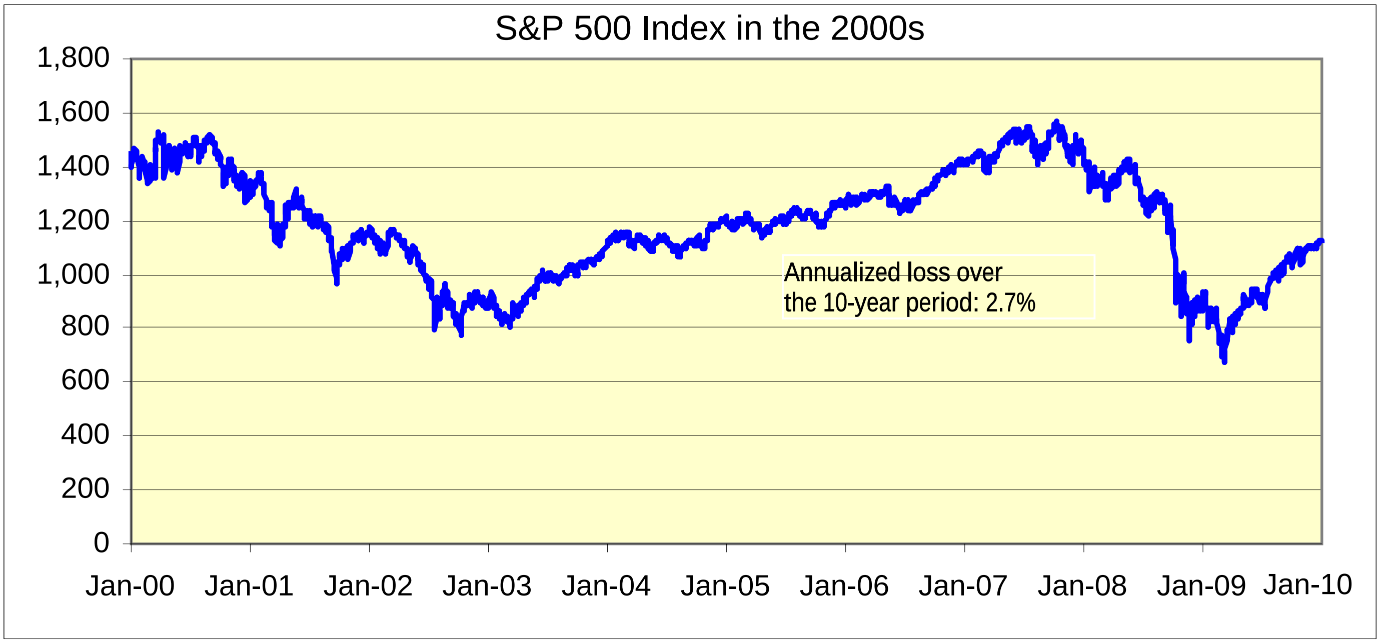
Source: Statistics Canada; U.S. Bureau of Labor Statistics

Unemployment in the U.S. and Canada was very low ahead of the recession's onset. The 5.8% unemployment rate in Canada during the early part of 2008 was the lowest in three decades. However, the change was swift once the recession began. Stateside, 8.4 million jobs were lost between January 2008 and January 2010. These jobs will be slow coming back, but the unemployment rate has begun to ease lower. In Canada, the story was never quite as bad. Job losses were still significant as 415,000 people were left without work. The unemployment rate remained below that seen in the U.S. and has now dipped further. It will take time for the unemployment rate to return to pre-recessionary levels, but early signs are favourable.

[1] **U.S. Census Bureau**

The lost decade

Over very long terms, equity markets have been shown to rise at nearly an 8% annual pace[2]. However, there can be wide differences between decades. The 1990s generated unusually large gains as the broader U.S. equity market (S&P 500 Index) rose at an annualized 15.3% rate. While a resumption of more normal returns could have been anticipated by the time the 1990s wound down, few would have predicted the dramatic weakening that characterized the decade of the 2000s.



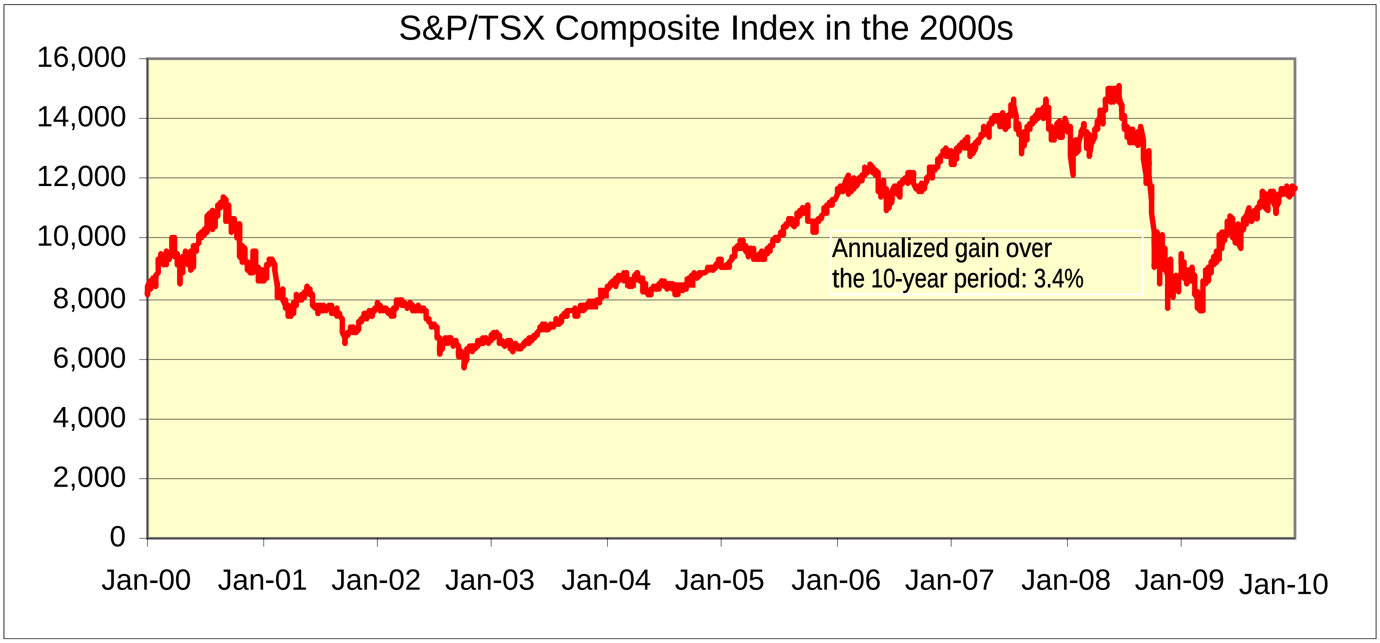
Source: Bloomberg

The graph above shows the weakening trend that eventually produced a market bottom of 761.2 for the S&P 500 on March 9, 2009. This was the lowest closing level since September 12, 1996 and marked the first time in 35 years that the index had recorded a decline over a 10-year period. The weakness was accompanied by unprecedented volatility (see Appendix 1). Even with a dramatic 64.8% rise from the March 9 low through to the 1,115.1 close on December 31, 2009, the market was in negative territory for the decade. The 2.7% annualized loss for the 10 years does, however, form a base for an optimistic market view of the decade of the 2010s. In order for the return on the index to move back to its long-run average, an annualized return of approximately 12% would be required over the 10-year period. While there are clearly no guarantees, the longer-term view remains favourable as the global economy improves.

A similar story played out in Canada. Still, with the domestic index, there are a number of biases that are not present in the U.S. market. Sector breadth is far from even as some sectors have as many as 50 constituent

[2] **Between December 31, 1949 and December 31, 1989, the S&P 500 rose at an annualized 7.9% rate (not including dividend returns).**

stocks while others have as few as four. Nevertheless, the longer-term returns of the Canadian index have been largely in line with the U.S., albeit at a slightly lower 7.2%[3] level. Canada's decade of the 1990s saw gains, but not on the same scale as in the U.S. equity market. The S&P/TSX Composite Index rose at an annualized 7.8% pace. Again, a return to more normal returns might have been anticipated at the close of the 1990s, but returns for the decade of the 2000s were well below the long-term trend.



Source: Bloomberg

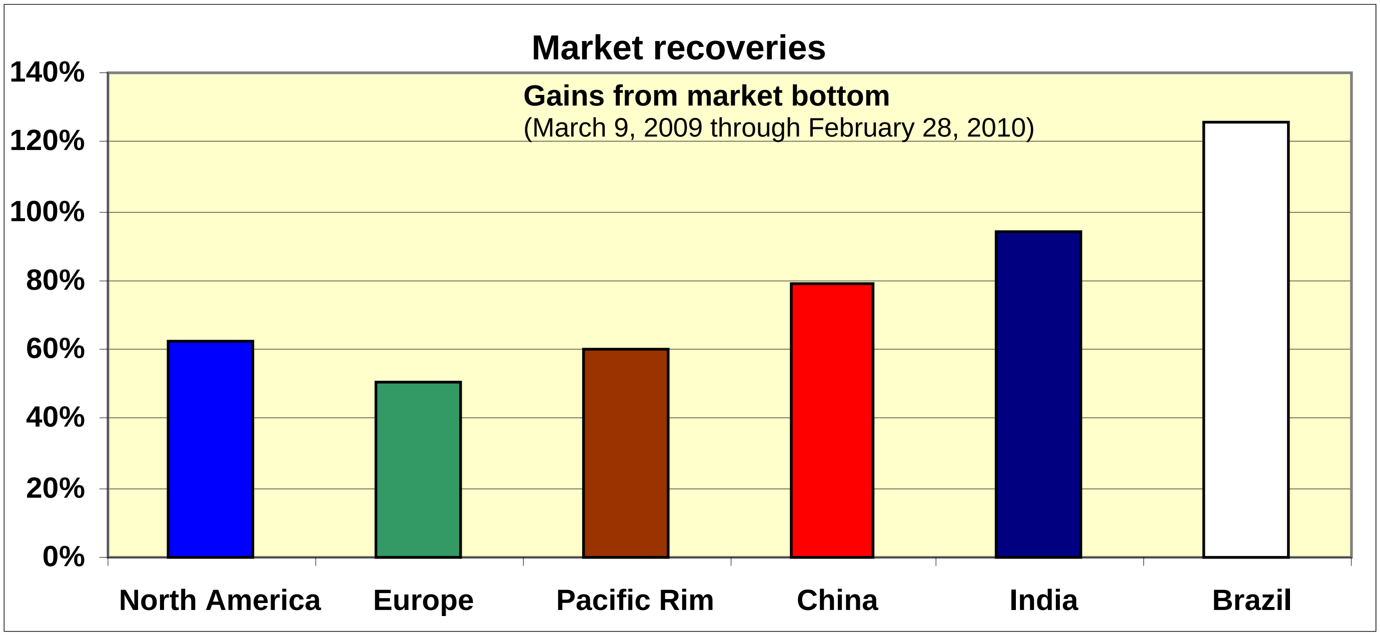
The graph above shows both the bursting of the tech bubble and the fallout from the global financial crisis. The former retrenchment produced a closing level of 5,695.3 on October 9, 2002 – a four-year low. The subsequent episode of weakening resulted in a 5.4-year low close of 7,566.9 on March 9, 2009. As was the case in the U.S., market volatility rose to exaggerated heights as the financial crisis intensified (see Appendix 2). The local market's sharp 55.2% gain from the March 9 low produced a closing level of 11,746.1 on December 31, 2009, yet the index was only modestly positive for the decade. The 3.4% annualized gain for the 10-year period leaves the market well below its long-run trend. In order for the return on the index to move back to its long-run average, an annualized return of approximately 10% would be needed during the decade of the 2010s.

Global growth

In spite of the strong gains seen in the developed economies, it has been the developing nations that have shown the most rapid pace of recovery in the last 12 months. The Shanghai market has climbed 99.6%, India's BSE is up 94.4% and Brazil's Bovespa has recorded a 125.9% advance. After posting GDP growth of 10.7% in the final quarter of 2009, China's central bank has begun its efforts to rein in the economic

[3] **Between December 31, 1956 and December 31, 1989, the TSX rose at an annualized 7.2% rate (not including dividend returns).**

expansion. Meanwhile, recent forecasts point to economic growth of 7.7% for India and 5.4% in Brazil during 2010. Growing populations and rising affluence in these countries represent a significant demographic shift that will alter the global economy over the long term. Developed countries will likely experience more subdued expansion while developing countries can be expected to exhibit greater growth. Even if developing nations fall short of current expectations as 2010 unfolds, their anticipated growth rates are well above even the most wildly optimistic forecasts for the developed economies.



Source: Bloomberg

Conclusions

- The equity markets and world economy have improved dramatically over the past 12 months, particularly in the context of the harshly negative sentiment that prevailed in March 2009.
- The stock markets' "lost decade" of the 2000s should provide the basis for much stronger gains as equity indexes move back toward their long-term growth trends.
- More moderate growth in the world's developed nations and shifting demographics point to continued above-average economic and market growth in developing countries.
- Diversification is crucial to capturing the best returns from all regions and having professional advice is key to being able to capitalize on these opportunities.

Appendix 1

Volatility in the U.S. Market (S&P 500 Index)
Post-Second World War to February 28, 2010

	Trading days*	5% trading days	% of the time
Since Second World War	16,351	75	0.5%
1946 to mid-sep 2008	15,982	41	0.3%
Sep.15/08 to Dec. 15/08	65	29	44.6%
Dec.15/08 - Mar. 23/09	66	5	7.6%
Mar. 23/09 - Feb. 28/10	238	0	0.0%

Appendix 2

Volatility in the Canadian Market (S&P/TSX Composite Index)
April 23, 1984 to February 28, 2010

	Trading days*	5% trading days	% of the time
Since April 23/84	6,392	51	0.8%
Apr. 23/84 to Sep.15/08	6,031	17	0.3%
Sep.15/08 to Dec.15/08	64	32	50.0%
Dec.15/08 – Mar.23/09	65	2	3.1%
Mar.23/09 – Feb.28/10	232	0	0.0%

*A 5% trading day occurs when the difference between the high and low levels of the day is equal to or greater than 5% of the previous day's closing level.