DAVIDSON PROFESSIONAL WEALTH MANAGEMENT

RBC Dominion Securities

Lifelong Wealth Management Solutions

Market Commentary

March 8th, 2012

Professional Wealth Management Since 1901

RBC Dominion Securities

First, the really dry stuff:

Economic Growth Forecasts:

Forecasts put North America on track for a material level of economic growth, and emerging markets for something even more.

From their current depressed levels, regional equity indices should achieve modest returns over the next 12 months.

RBC Investment Strategy Committee - Economic Forecasts

Real GDP	Forecast 2012	Change	Forecast 2013	Change
United States	2.00%	N/C	2.00%	N/C
Canada	2.00%	N/C	2.25%	N/C
Europe	-0.50%	(0.50)	0.50%	N/C
United Kingdom	0.50%	(0.50)	1.50%	N/C
Japan	1.75%	(0.50)	1.50%	N/C
Emerging Markets*	6.00%	(0.50)	6.00%	N/C

These forecasts are consistent with our belief that we will remain in a secular bear market for an extended period of time, and supports our intention to implement bear market investment strategies in our portfolios.

Equity Markets	29-Feb-12	Forecast Feb-13	Change	1 Year Est. Total Ret.%
S&P 500	1366	1450	75	8.3
S&P/TSX Composite	12644	13250	(250)	7.7
MSCI Europe	1392	1435	35	8.0
FTSE 100	5872	6300	550	11.4
Nikkei	9723	9700	(50)	2.0
MSCI Emerging Markets	1079	1200	N/C	14.2

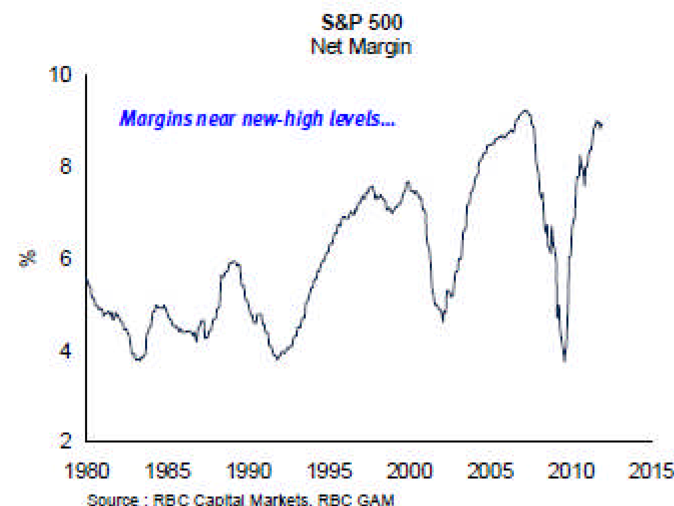
Taking our Cues

Global leading economic indicators turned up just in time … . A reading above 50 indicates conditions supporting economic growth.

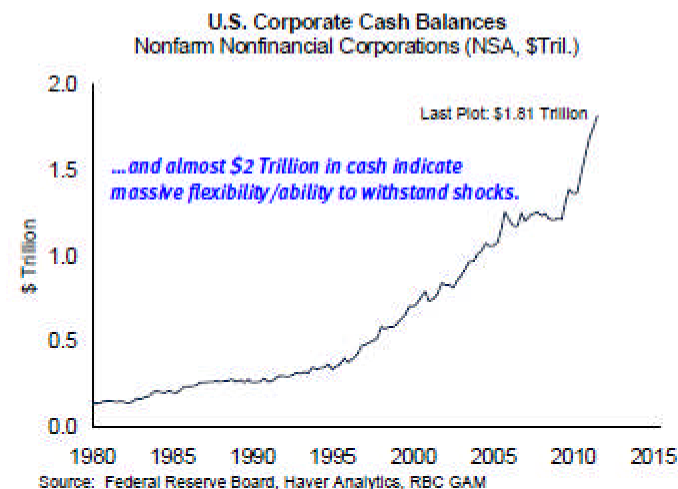
Likewise with the US Institute of Supply Management (ISM).

The Health of Corporations:

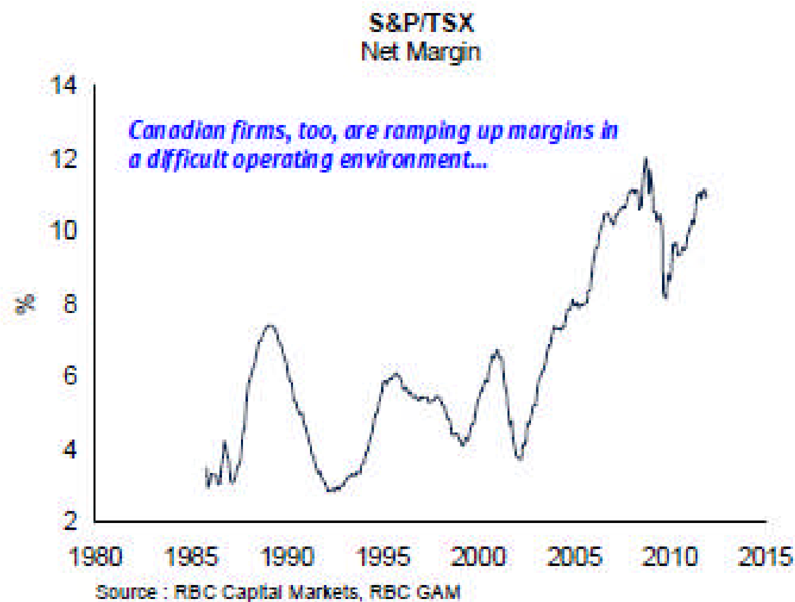
Corporate profits remain healthy with profit margins at elevated levels. Given the economic conditions, corporations have been running very lean.



The result is high cash balances which should allow for investment as well as for more immediate benefits to shareholders through share buybacks and dividend increases.

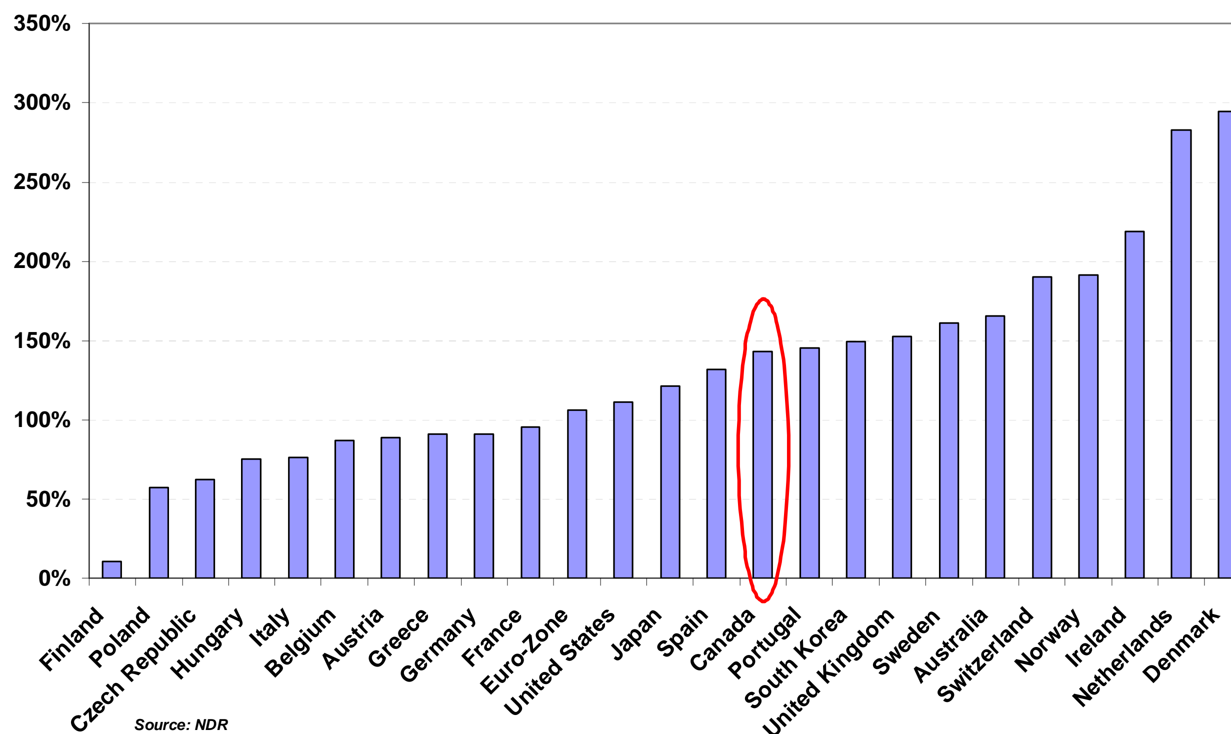


The corporate sector in Canada is experiencing some of the same conditions.



The Household Debt Stakes

While we may not be the worst offending jurisdiction, Canada seems to be working its way up in this category, and we now find ourselves at a higher household debt level than our neighbours to the south.

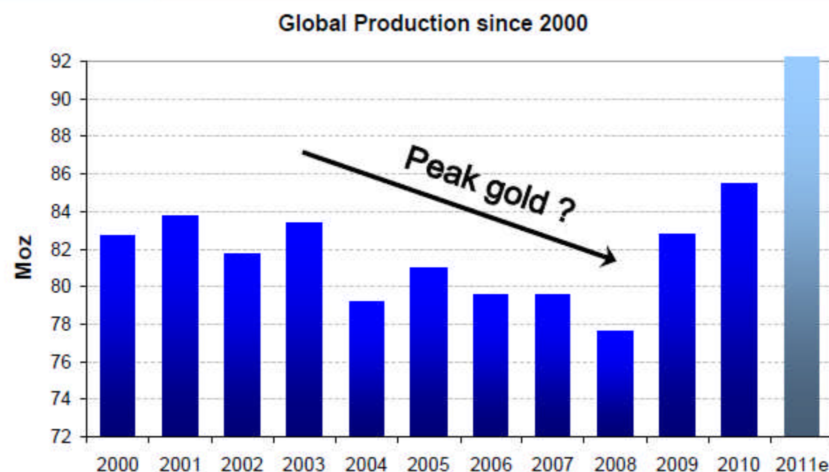


Scratching Beneath the Surface of Gold: Supply & Demand

Future appreciation for the price of gold may not be the “no-brainer” that so many investors believe it to be. As we learned in the internet bubble, fundamentals do eventually matter.

In Economics 101 we learned that the price of a good or service is determined, in a free and rational market, by the intersection of supply and demand. Understanding the behaviour of gold prices the last 10 or so years can only be partly explained by the fundamentals of the gold market.

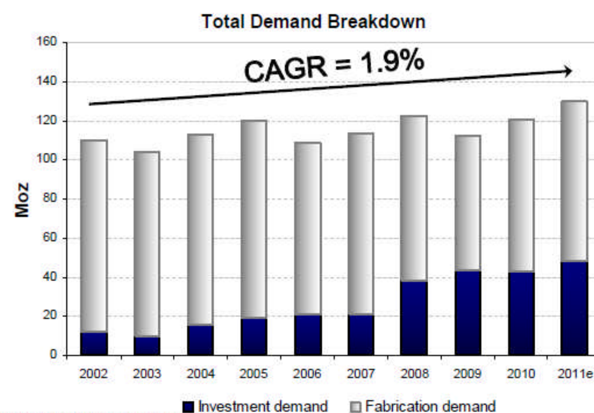
Falling Supply? Not Really!



The growth in demand is being driven primarily by newfound investment interest (which is ephemeral) and not by enduring uses for the precious metal like industrial applications, or even for jewellery. The advent of gold exchange-traded funds (ETF's) and similar investment vehicles has facilitated, if not spurred, this growth in investment demand ("The government is going bankrupt! Protect yourself and your family by owning physical gold! Call this number now to place your order…").

Naturally, supply will increase in response to price. The time lag between a price increase and new supply coming onto the market makes it less obvious than it might otherwise be.

VERITAS Soaring Demand? Not Really!

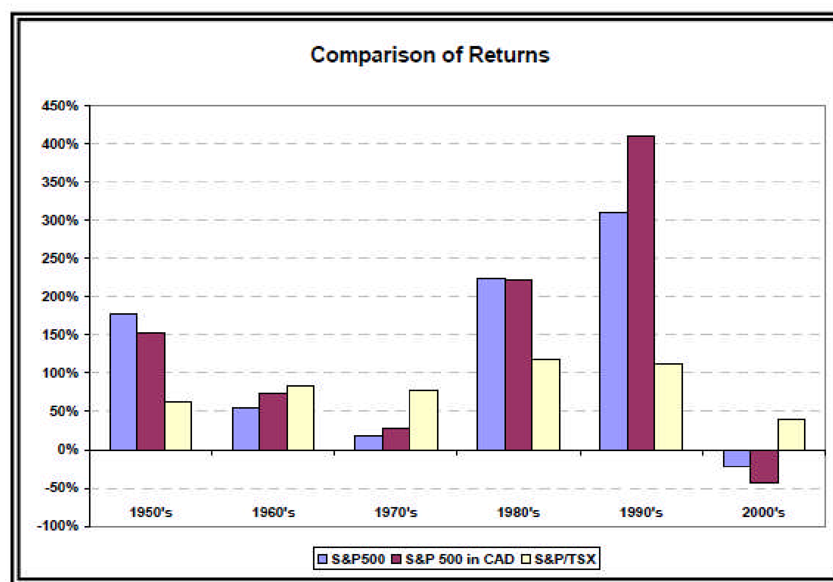


Nonetheless, the rate of growth in non-investment demand for gold has been very modest. Based on an examination of the supply and demand fundamentals, it seems that the real catalyst for the run up in the price of gold is investment / speculation underpinned by a healthy dose of fear. For those who follow fundamentals, there would appear to be a day of reckoning for the price of gold somewhere in our future.

"What motivates most gold purchasers is their belief that the ranks of the fearful will grow," he said. "During the past decade that belief has proved correct. Beyond that, the rising price has on its own generated additional buying enthusiasm, attracting purchasers who see the rise as validating an investment thesis. As 'bandwagon' investors join any party, they create their own truth – *for a while*."
Warren Buffett

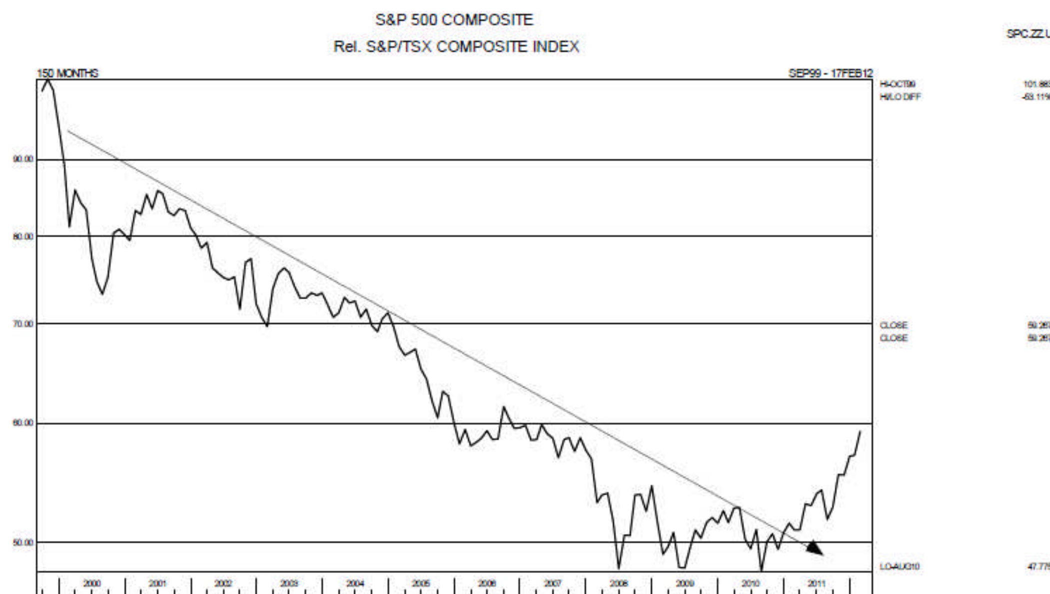
Where to find superior equity returns: Canada or the US?

A few investors might still remember the view of Canadian investors at the end of the 1990's when the Canadian market had bumbled along with anaemic equity returns for many years, while the US equity markets posted some of their best returns. No surprise, because it is in the nature of investors to do so, that investors piled into US equities just in time to capture some of the worst long-term performance ever produced by US equity markets. (See graph below)



Given the dynamic nature of capital markets, trends come and they go, and it appears we may be in the early stages of another shift in this trend. I noted in early 2011 that the US equity market had begun outperforming ours in the second half of 2010, and that we need to recognize that this may be the beginning of something new. In the first half of 2011 we adjusted our portfolio weightings in recognition of this very thing.

As the graph below illustrates, the long-standing outperformance of the TSX over the S&P 500 appears to have been broken and has shifted back in favour of the S&P 500.



Even in spite of the widely-reported US government debt issues along with a political system that many Canadians believe dysfunctional, the size and structure of US equity markets argues in their favour during certain points in the global economic cycle.

The Canadian economy, and by extension its capital markets, are economically sensitive and perform at their best when global economic growth is strong. Over the last decade, China's growth has been the primary engine of Canada's economic performance. If China should stumble at some point (which is likely) Canadians will feel it in many ways, including through their portfolios.

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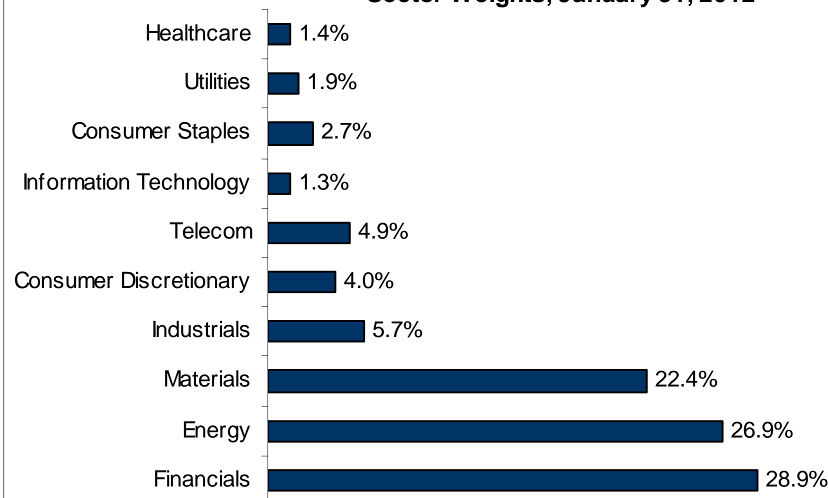
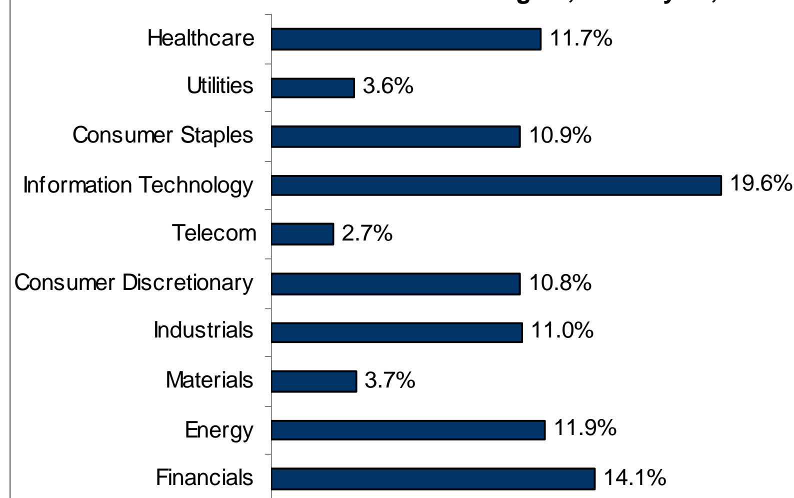
Canadian equity markets being concentrated in resources and finance, lacks certain defensive qualities that come with investment in healthcare and pharmaceuticals, utilities and consumer staples that the US market offers. Furthermore, the size of the largest companies in Canada is dwarfed by the size of the multinational mega-caps that reside in the US.

Investors who invest while looking in the rear view mirror enjoy the benefit of knowing exactly what they should have done, but all too often it's too late.





And finally, a word about investment performance:

[Congratulations for getting this far!]

Successful investors, equity investors in particular, but not only equity investors, understand the ins and outs and ups and downs of gauging the performance of their investments. Some investment assets perform in a straight line, where the investment return is delivered at the expected rate and at the expected time. Bonds and GIC's are the perfect example of this type. Little risk, little return. That's how the investment world operates.

Other classes of investments move in cycles and are subject to a variety of influences. Their performance is not nearly as steady or predictable and will have their ups and downs; but in return, we understand that, over time, there will be commensurate reward. Equities and real estate fall into this category. They will have periods of stunning performance, and then will fall into periods of quite the opposite.

In the world of equity investing, we want gauge to how a portfolio has performed under certain economic and capital markets conditions. In order to understand the context of these conditions, we generally refer to an established benchmark or index. If the equity portfolio outperformed the index, say by suffering a loss of 2% at a time when the index lost 10%, we accept that it has achieved commendable performance under what appear to be hostile market conditions. Conversely, we like to see a portfolio that returns the same or even more than the index during more investment friendly periods, although we have to be mindful of the amount of underlying risk we take on to achieve this. It is a simple truth that portfolios that are designed to outperform an index during favourable periods (ie market advances) are generally calibrated to underperform during less favourable periods (ie lose more value during market declines) too. When we pursue greater gains in investment markets, we inevitably take on more risk in the process; it is simply an extension of the risk / reward trade-off.

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