REVIEW & COMMENTARY
2ND QUARTER 2012

Bipolar Markets

These are trying times for all investors. It seems that every day, any minor world event is magnified by the financial press heralding either that "happy days are here again", or the end of the world may be near. TV and print journalists always find an 'expert' to exacerbate the market's latest concern and market swings. What so many investors have lost is a long term perspective; increasing numbers of investors' attention spans have been worn down by the constant volatility of the equity markets to the point where many fluctuate week to week, if not day to day. This is neither practical nor healthy and rarely leads to decent long term returns. Stock markets around the globe faltered in the second quarter, primarily due to sovereign debt concerns in Europe and worries of slowing economic growth in the U.S. and major emerging markets. (It is interesting to note that the *Economist* reported that their measurement of global GDP for the first quarter of 2012, which includes 52 countries, actually accelerated to 2.9%, up 0.1% from the fourth quarter of 2011.) From its April 2nd peak to its low point on June 1st, the S&P 500 Index fell by 9.9%. Smaller companies and foreign stocks suffered larger corrections as investors perceived these sectors as having more exposure to a weakening economic environment. A strong 4.0% advance in June for the S&P 500 helped to cut the quarter's losses.

One of the main causes for the mood swings in the second quarter was the impact of the Syriza party who surprised everyone on May 6th Greek elections by placing second, and was unwilling to form a coalition to support the bailout package. A Greek exit, which appeared more likely at that time, would have had potentially catastrophic repercussions for other ailing European nations, the United States and the entire global economy. The June 17th election of the pro-bailout factions was greeted with exuberance.

According to Thomson Reuters, the median forecast of 21 analysts pegs the second quarter growth rate in the Chinese economy to 7.6% down from 8.1% in the first quarter, or the lowest level since the first quarter of 2009. Uncertainty regarding the future strength of the Chinese economy weighed heavily on the Canadian equity markets as the price of oil moved from a high of $107 per barrel to a low of $77 a barrel. Other commodities were similarly affected by the potential of a global slowdown.

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Another concern for the equity markets was Moody's downgrade of 15 international banks including our own Royal Bank of Canada. Overall, this did not have a tremendous effect on the share price of these companies, however, it is uncertain if this was because of anticipation by the market or the lack of credibility afforded the rating agencies post the financial crisis.

It will be interesting to observe the events that are likely to affect the second half of 2012 and how they will be interpreted by investors. In the United States, we will have the rhetoric surrounding the presidential election as well as the potential expiration of the Bush tax cuts coupled with the ongoing speculation as to what the Federal Reserve will do with regards to easing of monetary policy. Europe will continue to be a cause of concern as it has been the last few summers, and the acceleration\deceleration of the Chinese economy will continue to wreak havoc on the commodity markets in Canada.

With so many negative headlines, it is easy to lose sight of the long-term positives for equity investors. We believe the valuations of high quality dividend paying stocks remain very attractive given the historically low level of interest rates. In turn, these low rates make alternative investments, such as money market funds and bonds appear to offer unattractive long-term returns. With time and some over-due and badly needed attention to the financial health of many global economies, investors who have maintained an appropriate long term perspective will be rewarded.

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