

SEGFUNDS UPDATE

PUBLISHED BY INDUSTRIAL ALLIANCE PACIFIC INSURANCE AND FINANCIAL SERVICES

Shaky markets

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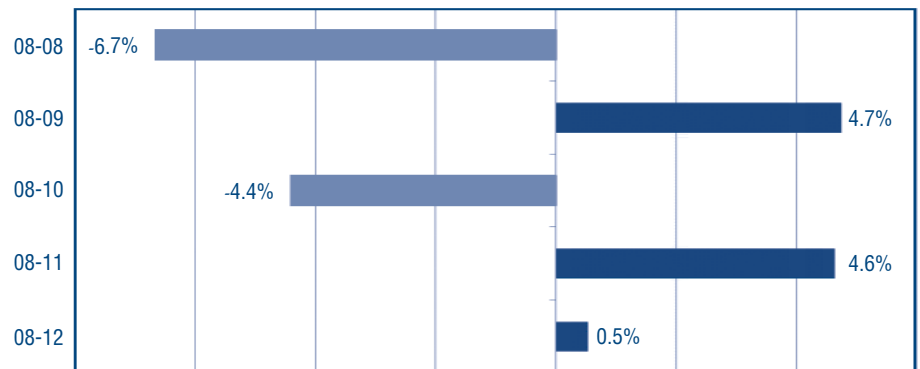
A simple look at the month-end performances posted by the Canadian financial markets does not do justice to the turmoil that took place during the month of August. Indeed, -1.2% for the Canadian equities market (S&P/TSX index) and 1.2% for the Canadian bond market (DEX Universe index) are nothing to write home about. However, the full picture becomes clearer when we look at the returns of the foreign markets: -5.7% for the S&P 500 (U.S. market) and -9.0% for the MSCI - EAFE (international market), expressed in local currencies. The main explanation for this difference between the Canadian and foreign markets is, of course, the Canadian market's heavy proportion of gold stocks (13.52% of the S&P/TSX index at August 31, 2011). These stocks profited from a climate of deep uncertainty and the strength of gold, a safe haven currency, resulting in the Canadian stock market outperforming others in August.

Let us now look at the weekly movements of the U.S. S&P 500 index during the month of August in order to better understand the emotional climate suffered by investors. For the first five days of the month, i.e. the week ending August 5, this index's return was -7.2% (still in local currency); the following week, ending August 12, it was -1.7%; for the week ending August 19, it was -4.7%; and for the week ending August 26, the return was +4.7%. The last few days of the month of August were also positive (+3.6%), resulting in the cumulative monthly return of -5.7%, as stated earlier. The least we can say is that this type of rollercoaster ride is nerve-racking for investors! There are two avenues of analysis to explain these market movements: the "fundamentals" avenue, based on the state of the economy, and the "emotional" avenue, which looks at the increasingly visible phenomenon of investors' crowd behaviour, or what some call "risk on/risk off."

First, there is the economic situation. The media made a great fuss over the downgrading of the U.S. debt by the credit rating agency Standard & Poor's to explain the storm that hit stock markets in August. This reduction in the credit rating from AAA to AA+ took place on August 5, after the S&P 500 index had already dropped 7.2%. Without minimizing the significance of this event, it appears that this downgrade did not change much in investors' risk assessments, despite all the media space devoted to the news. It is more likely that the market succumbed to its own mounting concerns over the strength of the U.S. economic recovery and the sovereign debt problems in Europe.

Here assiduous readers will recognize two themes that recur regularly in our reflections on the markets and the state of the economy. Europe's sovereign debt problems have been making headlines since February 2010, and

Manic market behaviour:
Daily S&P 500 index returns for the week of August 8, 2011 (in US \$)



Source: IAIM

the lack of vigour in the U.S. economy—the unemployment rate does not seem able to go below 9%—has been a nagging concern since the recovery began.

Since the start of 2010, investors have been seeking signs to support their ingrained conviction that, like the eternal cycle of the seasons, after a great recession, economic activity will naturally resume, and the employment situation will naturally improve. However, the deterioration in U.S. economic data (GDP growth slowing since the third quarter of 2010, decline in the Philly Fed Leading Index, and disappointing employment figures yet again) is back at the forefront of the worries which, until now, investors had managed to push aside. This wake-up call is one of the main causes of the bearish trend seen in August.

Amplifying this "fundamental" movement is the trend increasingly observed in markets with mob behaviour, which can be likened to a manic attitude. As mentioned earlier, this phenomenon is often called "risk on/risk off." Picture the market as a relatively homogeneous whole that moves its holdings quickly and without other distinction than between "risky" or "less risky" assets. When

the context is favourable to economic expansion and profit growth, the market launches into buying risky assets, i.e. the risk switch is "on". When the economic environment begins to cool, the market starts selling off its risky assets and buying safer ones, abandoning the equities market and the more cyclical stocks to take refuge in bonds, the U.S. dollar and gold.

This phenomenon is behind the large swings seen in August. As proof, the correlation of returns among the various stock market sectors became very pronounced in August, showing in a quantitative way that the market was alternating between "sell" mode and "buy" mode on the stock market, without much distinction as to sector or the specific stocks it was buying or selling.

This being said, the question that investors must now ask themselves is: are we heading into another recession, or is this simply a "bad patch" in economic growth? And, in echo to this fundamental question, should we be selling our risky assets, or buying more of them?

Let's place this alongside what we know at this moment about the U.S. economic situation. The most recent data on job creation in the U.S. (September 2) shows no new jobs; the September 1 reading of the ISM manufacturing index (leading indicator) is just above 50, suggesting a slowdown but not a recession; retail and car sales are good. Therefore, there are a certain number of positive indicators, or at least indicators that are not negative, with the exception of employment. How can the confidence of consumers and company managers be restored, and how can the economy be restarted?

Recently, U.S. Federal Reserve Chairman Ben Bernanke, in addition to announcing his intention to keep the U.S. key rate exceptionally low, as it has been for several years already, until 2013 (but without announcing a third round of quantitative easing), called on the U.S. government to take up the baton and play its part in stimulating the economy, by adding its own political and fiscal measures to the monetary measures the Fed has been taking for some time.

One potential avenue of intervention that is being invoked more and more would aim to make mortgage refinancing easier for individuals by forcing the hand of lending institutions. U.S. consumers could save tens of billions of dollars in interest if they refinanced their mortgages at the current market rate, but the refinancing process is made rather complicated (deliberately?) by banks. In addition to putting money back in consumers' pockets (which could lead to a renewal in spending), this approach could solidify the current stabilization of home prices and, through the principle of the virtuous circle, breathe new life into the very anaemic construction sector. To be continued in the U.S. political arena... ~

The market's manic behaviour, illustrated by the "risk on, risk off" catchphrase, is amplifying the downward market movement, caused by the lack of vigour of the U.S. economy and Europe's sovereign debt problems.

Table of net returns as at August 31, 2011

	Unit value	Net assets in millions	Simple returns ¹			Compound annual returns				Investment Advisor
			1 month	3 months	YTD	1 year	3 years	5 years	10 years	
	\$	\$	%	%	%	%	%	%	%	
INCOME FUNDS										
APEX Money Market	1.25	2.1	0.8	1.0	1.6	1.7	0.9	1.6	1.4	Industrial Alliance
APEX Fixed Income	8.10	3.4	0.8	2.4	3.6	3.0	4.2	3.3	4.0	Industrial Alliance
BALANCED FUND										
APEX Growth & Income	9.92	9.7	(1.0)	(3.6)	(1.8)	4.4	0.6	1.4	4.0	Industrial Alliance
CANADIAN EQUITY FUNDS										
APEX Canadian Value (Dynamic)	17.32	590.5	(6.2)	(9.7)	(12.6)	0.0	(2.5)	1.8	9.2	Dynamic
APEX Canadian Stock	11.30	7.3	(1.6)	(7.7)	(6.6)	5.1	(3.1)	(0.1)	4.6	Industrial Alliance

Reference indexes - Returns as at August 31, 2011

Total return

	Simple returns ¹			Compound annual returns			
	1 month	3 months	YTD	1 year	3 years	5 years	10 years
	%	%	%	%	%	%	%
Money market index							
DEX 91 day Tbill Index	0.1	0.2	0.7	0.9	1.0	2.2	2.5
Bond index							
DEX Universe Bond Index	1.2	3.3	5.5	5.4	6.8	5.9	6.4
Equity securities indexes							
S&P/TSX Composite Index	(1.2)	(6.9)	(3.5)	9.9	0.4	4.0	8.1
MSCI - World (Can. \$)	(4.6)	(9.3)	(5.5)	5.3	(4.0)	(2.6)	(1.0)

Returns after deduction of management and administration fees. Past performance is not a guarantee of future returns.

¹ The rates for the period are non-annualized.

Our Managers



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