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the financier

Private Investment Management

Markets bounce back, on a shift in investor focus towards the positive

The curtain finally came down on a very volatile “2011”, a year during which investor confidence was negatively impacted by the prospects of a double dip back into recession in the U.S., sovereign debt failures in Europe and a hard economic landing in China. Investors also feared the consequences of higher oil prices, in the wake of the Arab spring that toppled regimes from Tunisia to Egypt and required NATO’s military intervention in Libya. In the end however, the year did culminate in positive fashion and equities did rally to a positive fourth quarter finish, on hope that 2012 will usher in economic and political change.

Bond Markets

Despite the announcement of a second bailout plan by European authorities, the concerted intervention of six central banks, loans granted by the ECB to several European banks and financial support from certain better-off EU nations to the IMF to bolster their more indebted counterparts, many pundits continue to doubt the effectiveness of the proposed measures.

These actions temporarily revived investor confidence, as did the release of encouraging economic indicators in the U.S. However, the precarious situation in Italy and Spain, a somewhat mixed German bond issue, fears of a credit rating downgrade for certain European nations and banks and the possibility of a continental recession in 2012, led some investors to seek shelter in fixed-income securities from more stable countries in the past two months.

While this situation favoured Canadian bonds as a whole, longer-term issues within this asset class displayed the strongest showing (with provincial and municipal bonds at the forefront). High-yield bonds also notched respectable gains, despite fluctuating credit spreads.

Stock Markets

Canadian equities, eked out a positive return during the fourth quarter, however most of the gains were front-end loaded. The S&P/TSX Composite benefited from standout performances by individual issues within the Health Care, Industrials, Energy and Telecom sectors to end the period with a gain of 3.59%. Canadian equities, whose performance since 2005 has been highly correlated with that of emerging stocks, lagged behind their global peers during the quarter and year, on worries that growth across the developing world was slowing. This underperformance is traced back to the performance of the Technology and Materials sectors, which shed 15.54% and 4.54% of their value during the quarter.

In the U.S., stocks posted respectable gains across the board and the S&P 500 held on to most of its October advance to end the period 8.67% higher, on widespread strength that sent all ten sectors into the black. Leading the way were Energy stocks which continued to react positively to higher oil prices, tightening supplies and increasing demand. Other cyclical sectors also climbed sharply, namely Industrials, Materials and Consumer Discretionary, on increasing evidence the U.S. economy is expanding at a faster pace than most experts had expected.

On the international scene and to no one’s surprise, events out of Europe continued to dominate the headlines; however, news out of the emerging markets quickly gained ground towards quarter end. However, investors chose to neglect all the noise and instead focused on fundamentals. Consequently, the MSCI EAFE index rose by 0.98% over the period, however, the advance was hampered by a less than stellar performance by Japanese stocks, which declined by 5.31% over the period.

Outlook

Heading into 2012, the main question remains: Will volatility abate and will financial markets begin to look beyond Europe, which has already slipped into recession? Sovereign debt issues may remain a concern in the short term; however, investors have begun focusing on the positives. In this respect, the outlooks for the U.S. and Canadian economies in 2012 are fair and both are expected to weather the European storm without major consequences. Notwithstanding, U.S. equities are expected to outperform, on the strength of domestically focused businesses, whose earnings will not be affected by a strong dollar and the softening of export demand.