

# RBC Dominion Securities Month-In-Review: March 2009

Portfolio Advisory Group

## What Moved the Markets

In the early days of March, equity markets appeared to be on-track to post another sharp decline. By March 9<sup>th</sup>, the TSX had declined 6.8%, the Dow had fallen below 7,000 and the S&P 500 had touched 666.79 in intraday trading. All three indices had broken through lows from November of last year. But markets reversed course on March 10<sup>th</sup> and began a double-digit financials-led rally that erased a good portion of prior month losses. In 13 trading sessions the TSX rallied 18.9% and the S&P 500 climbed 23.1%. ***In percentage terms, it was the best monthly performance since November 2001 for the TSX and October 2002 for the S&P 500.***

Early on, economic news was discouraging. In the U.S., **American International Group (AIG)** posted a record loss and unemployment spiked to 8.1%. In Canada, unemployment climbed to 7.7% and a release showed that fourth-quarter GDP contracted at the fastest pace since the start of 1991. In Europe, Germany rejected appeals for a single multibillion-euro bailout of Eastern Europe, which has been hard-hit by the financial crisis.

News that several U.S. banks were profitable year-to-date helped to reverse investor sentiment, and the improved mood was fuelled further by a stream of better-than-expected economic data and details on U.S. Government plans to get the economy back on track. U.S. housing starts, new home sales and existing home sales all came in better than expected, and U.S. retail sales surprised to the upside. The U.S. Treasury revealed details on the Private Public Investment Fund (PPIF), a two-prong plan to remove toxic assets from banks' balance sheets. Following on the release of details of a large-scale quantitative easing strategy by the Bank of England, on March 18<sup>th</sup> the U.S. Federal Reserve announced its own plans to buy up long-term government bonds. The Bank of Canada noted that it would outline a framework for the possible use of quantitative measures in April.

While the rally was led by financials, there were also strong gains in the energy space. Crude prices climbed 10.9% for the month, even as OPEC decided to focus on member compliance rather than further production cuts. On March 23<sup>rd</sup>, **Suncor (SU)** announced plans to acquire **Petro-Canada (PCA)** in an all-share deal; the merged entity would be the largest energy company in Canada.

In the last few trading sessions markets retreated, in part due to reports that **General Motors (GM)** and **Chrysler** may require use of the bankruptcy code to ensure their survival. Overall, however, the market rally, improving economic data and aggressive monetary policy created a sense of hope that the economy was transitioning from the abyss to something that is "less bad".

## Number Crunching

Equity Indices	Index Level	Month	YTD*
S&P/TSX Composite Index	8,720.39	7.4%	-3.0%
Dow Jones Industrial Average	7,608.92	7.7%	-13.3%
S&P 500 Index	797.87	8.5%	-11.7%
NASDAQ Composite Index	1,528.59	10.9%	-3.1%
MSCI World	805.22	7.2%	-12.5%
MSCI EAFE	1,056.23	5.9%	-14.6%
MSCI World TR	2,575.82	7.6%	-11.8%

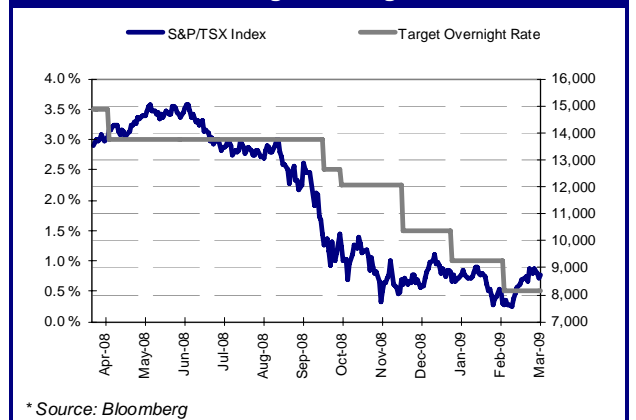
S&P/TSX Sector Performance	Index Level	Month	YTD*
S&P/TSX Financials	1,047.33	11.6%	-7.7%
S&P/TSX Energy	2,090.05	8.1%	-1.2%
S&P/TSX Materials	2,437.67	7.4%	7.7%
S&P/TSX Industrials	816.52	7.0%	-11.0%
S&P/TSX Consumer Discretionary	739.93	3.2%	-8.6%
S&P/TSX Telecom Services	657.27	-0.8%	-8.8%
S&P/TSX Information Technology	196.44	7.9%	8.8%
S&P/TSX Consumer Staples	1,360.23	-1.5%	-6.7%
S&P/TSX Utilities	1,312.01	-8.4%	-13.1%
S&P/TSX Healthcare	257.50	-7.6%	2.0%

Currencies (in Canadian Dollars)	Exchange	Month	YTD*
US Dollar	1.2602	-1.3%	3.4%
Euro	1.6698	3.3%	-2.0%
British Pound	1.8052	-1.2%	1.3%
Japanese Yen (100)	1.2734	-2.6%	-5.2%

Commodities (US\$)	Spot Price	Month	YTD*
Crude Oil (WTI per barrel)	\$49.66	10.9%	11.3%
Natural Gas (per million btu)	\$3.78	-10.1%	-32.8%
Gold (per ounce)	\$919.15	-2.5%	4.2%
Silver (per ounce)	\$12.97	-1.1%	13.9%
Copper (per pound)	\$1.82	17.0%	31.6%
Nickel (per pound)	\$4.42	-1.7%	-16.0%
Aluminum (per pound)	\$0.61	3.6%	-10.1%
Zinc (per pound)	\$0.60	17.0%	9.3%

\*YTD return data is simple price return. All indices are in local currency unless otherwise noted.  
Source: Bloomberg

## S&P/TSX Index - Target Overnight Rate, LTM



## A Closer Look – Quantitative Easing (QE)

“Quantitative Easing” was one of the buzz words of March. But what exactly is QE and how will it impact the value of your investments?

### Traditional policy is not enough

The financial crisis has driven government lending rates down to zero or near-zero in many countries (Figure 1), and resulted in unprecedented fiscal stimulus. Yet capacity utilization continues to decline, unemployment is rising, housing prices continue to fall and households are in the midst of a major deleveraging process, all of which raise the risks of a deflationary mindset taking hold. Deflation is damaging as it causes consumers and business to postpone purchases in anticipation of lower prices, which potentially creates a self-fulfilling downwards cycle of reduced economic activity, lower corporate profits, and further deflationary pressures. This has prompted authorities to pursue additional monetary easing through non-traditional policies; ie QE.

### What is QE and how does it impact the economy?

Essentially, authorities print money to buy up securities such as government and corporate bonds in the marketplace. This increases the amount of money supply in the economy, and particularly in the banking sector. It also lowers the cost of borrowing for longer term debt by pushing down interest rates and credit risk premiums. For example, US 30-year mortgage rates have fallen from 6.5% to an all time low of 4.78% via this means. In addition, the BoE’s purchasing of UK government bonds has pushed overall interest rates lower (Figure 2), prompting the US Federal Reserve to broaden its program to include US Treasuries, with similar results.

### What are the risks of a QE strategy?

Generally, increasing money supply in this way would be considered highly inflationary. However, the increase in money supply (Figure 3) has been offset by falling velocity of money (the rate at which it is recirculated in the economy, Figure 4) which implies that demand for credit has fallen and cash is being hoarded within the financial system, thus blunting the inflationary impact. As deflation is regarded as both the greater evil and the greatest near term risk, pursuing blatant reflationary policy is seen as the best way to quickly eradicate this problem. Longer term, as the economy recovers and the velocity of money increases, authorities will be charged with the delicate task of balancing the removal of this excessive stimulus with the desire to avoid derailing the economic recovery by raising interest rates and withdrawing money supply too aggressively.

### So what is an investor to do?

With the risk of both deflation and inflation on the horizon, and the equity downturn weighing on sentiment, this is a challenging time for investors. To balance the goals of generating inflation-beating performance and capital preservation, investors should ensure that portfolios include some exposure to securities that have historically shown resilience during inflationary periods; this could mean shares of energy and gold producers and real-return bonds (bonds with a coupon that is tied to inflation).

	Fiscal Stimulus (billions USD)	% GDP	Key Rate	Key Rate 12-mos Prior
China	\$586	14.0%	5.31%	7.47%
US	\$787	5.5%	0.25%	2.25%
UK	\$50	2.5%	0.50%	5.25%
Canada	\$34	2.0%	0.50%	3.50%
Japan	\$85	1.7%	0.10%	0.50%
Eurozone	\$260	1.5%	1.50%	4.00%
Germany	\$39	1.3%	--	--

Figure 1, Source: Bloomberg

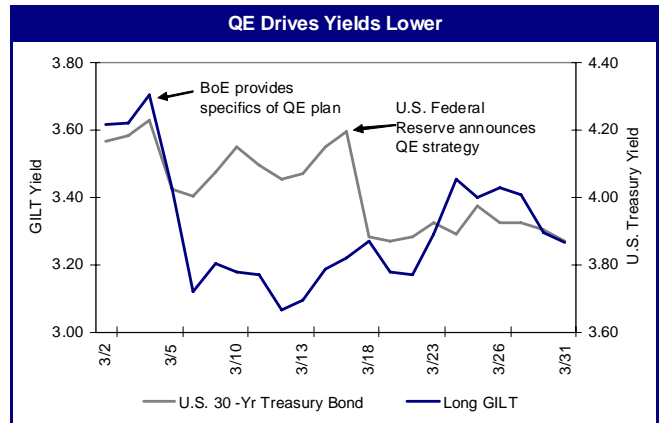


Figure 2, Source: Bloomberg

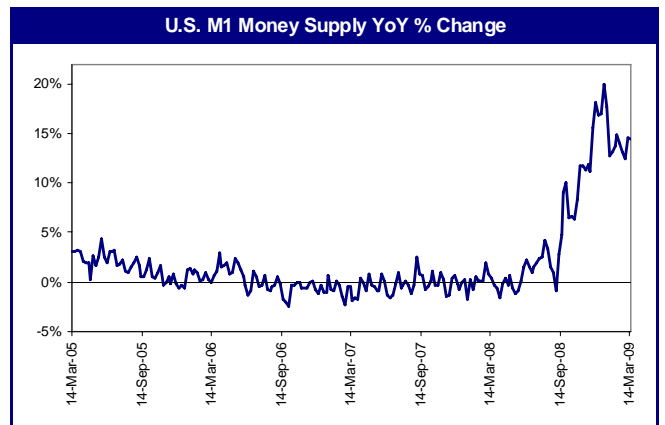


Figure 3, Source: Bloomberg

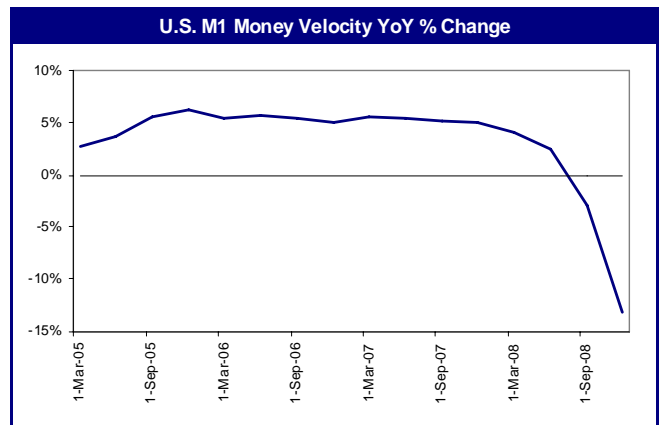
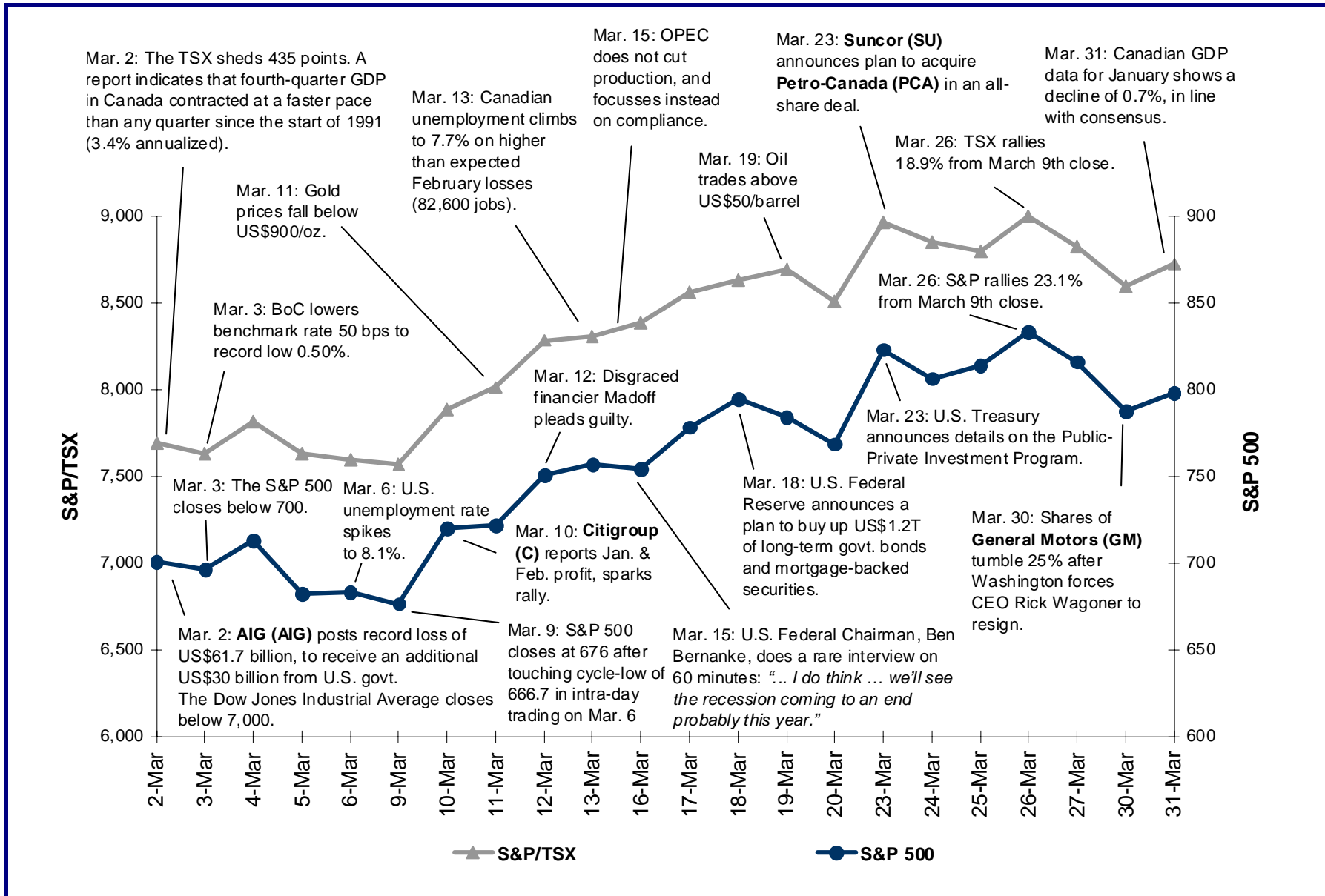
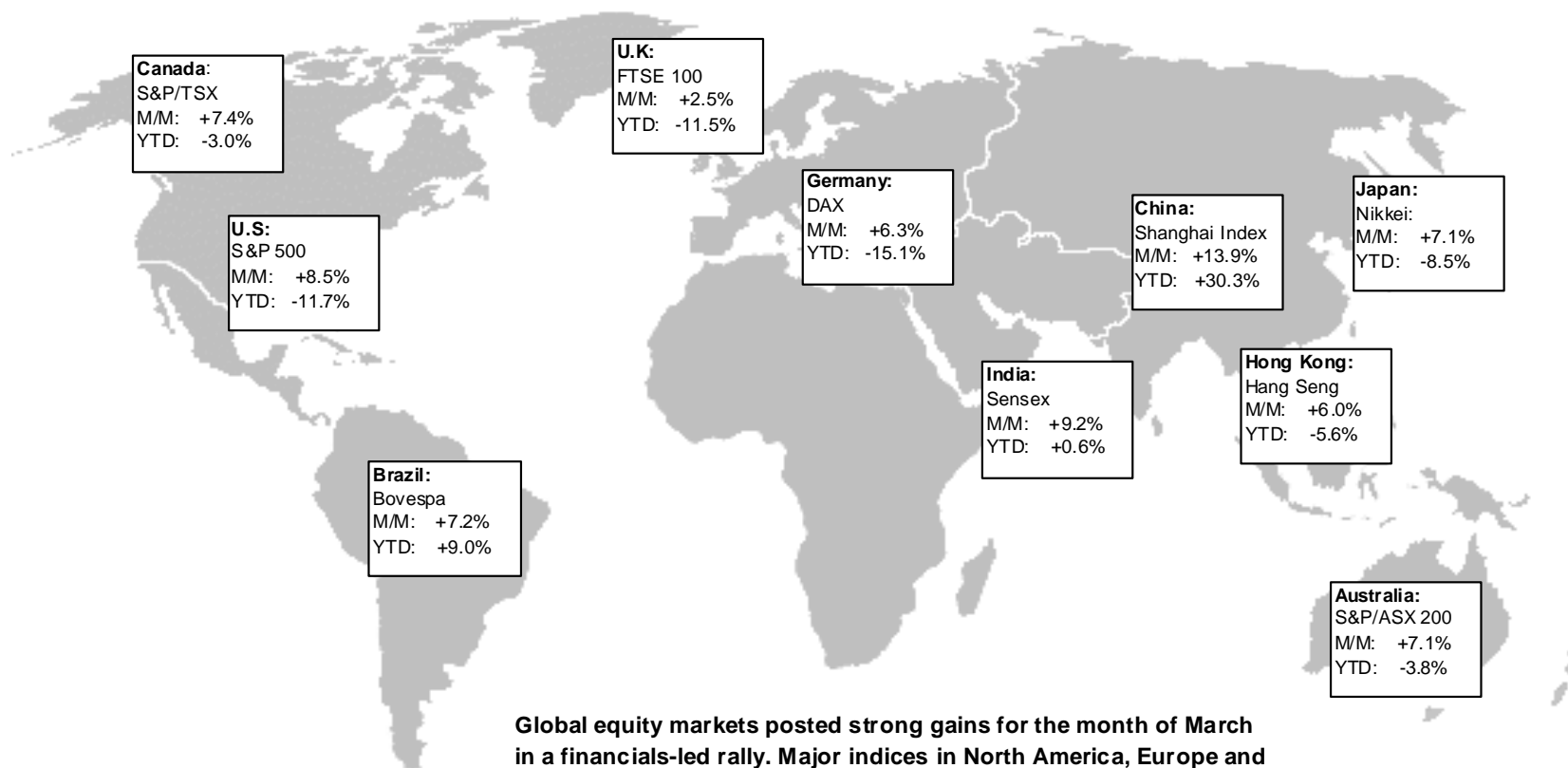


Figure 4, Source: Bloomberg

## North American Equity Performance – March 2009



## World Markets – March 2009



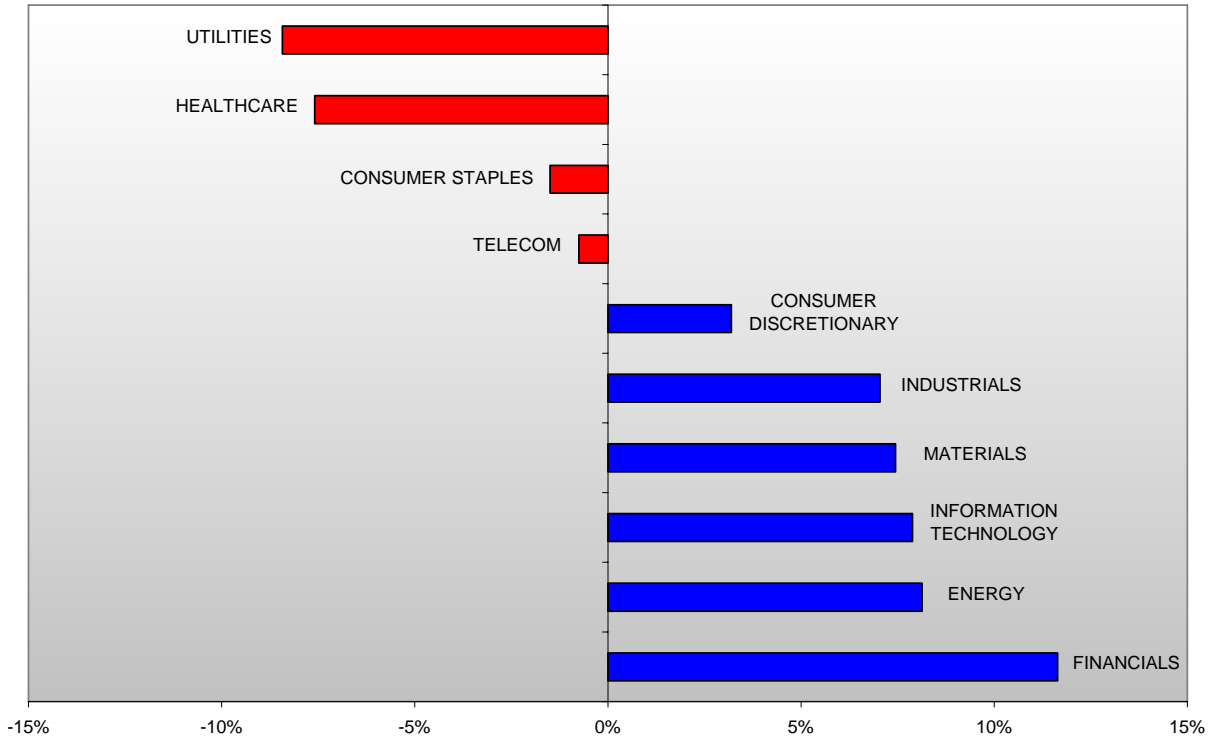
Global equity markets posted strong gains for the month of March in a financials-led rally. Major indices in North America, Europe and Asia pared back prior-month losses, and emerging market indices moved further into positive territory.

\*\*\* All returns calculated in local currency.

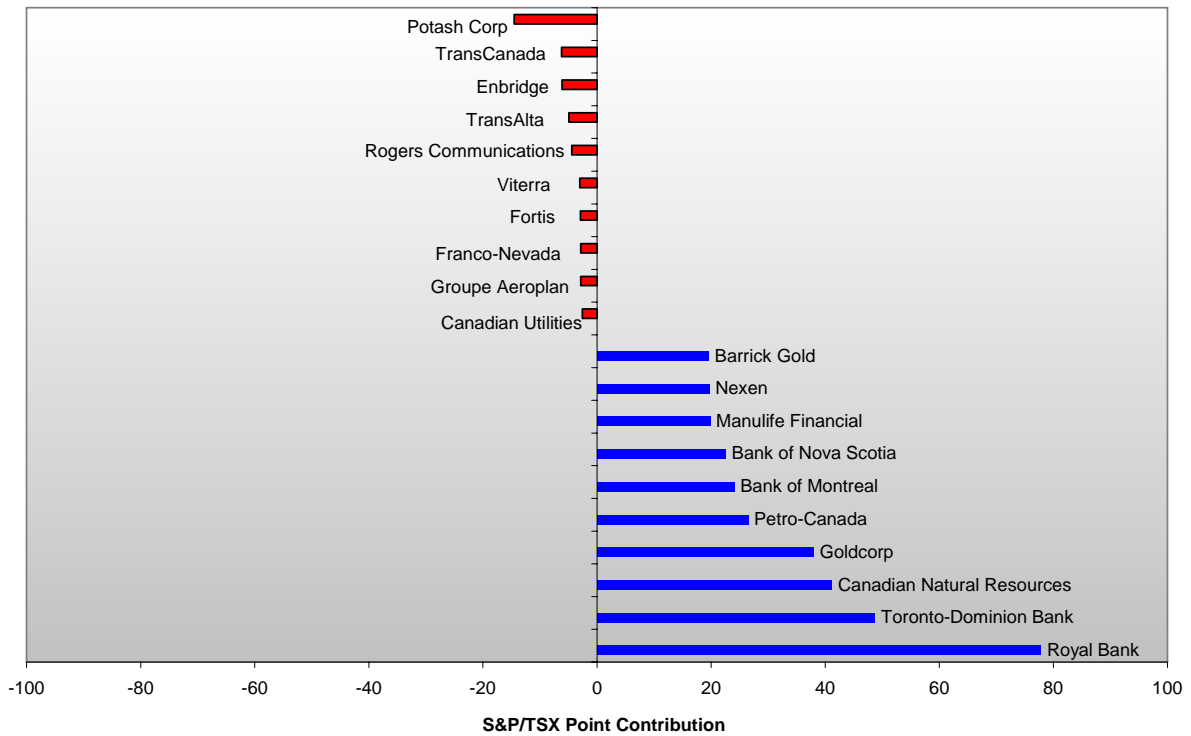
Source: Bloomberg

# Canadian Equities – March 2009

S&P/TSX Sector Movement



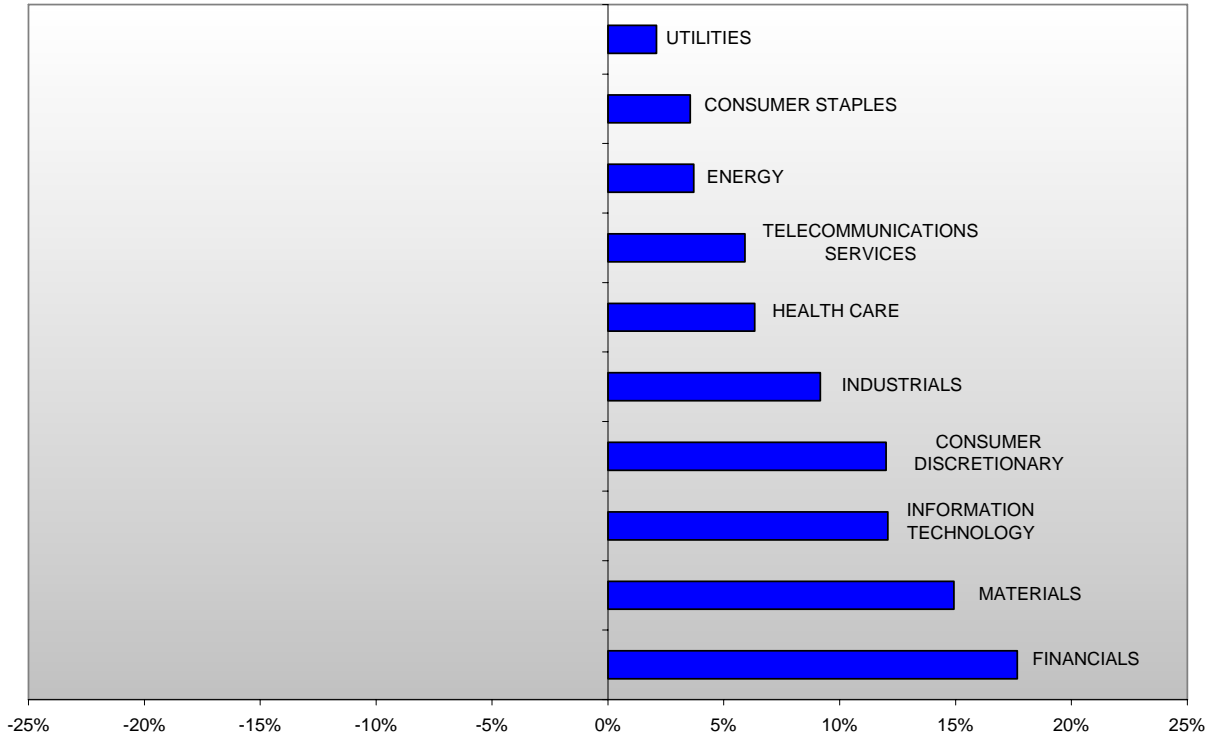
Top 10 S&P/TSX Contributors/Decliners



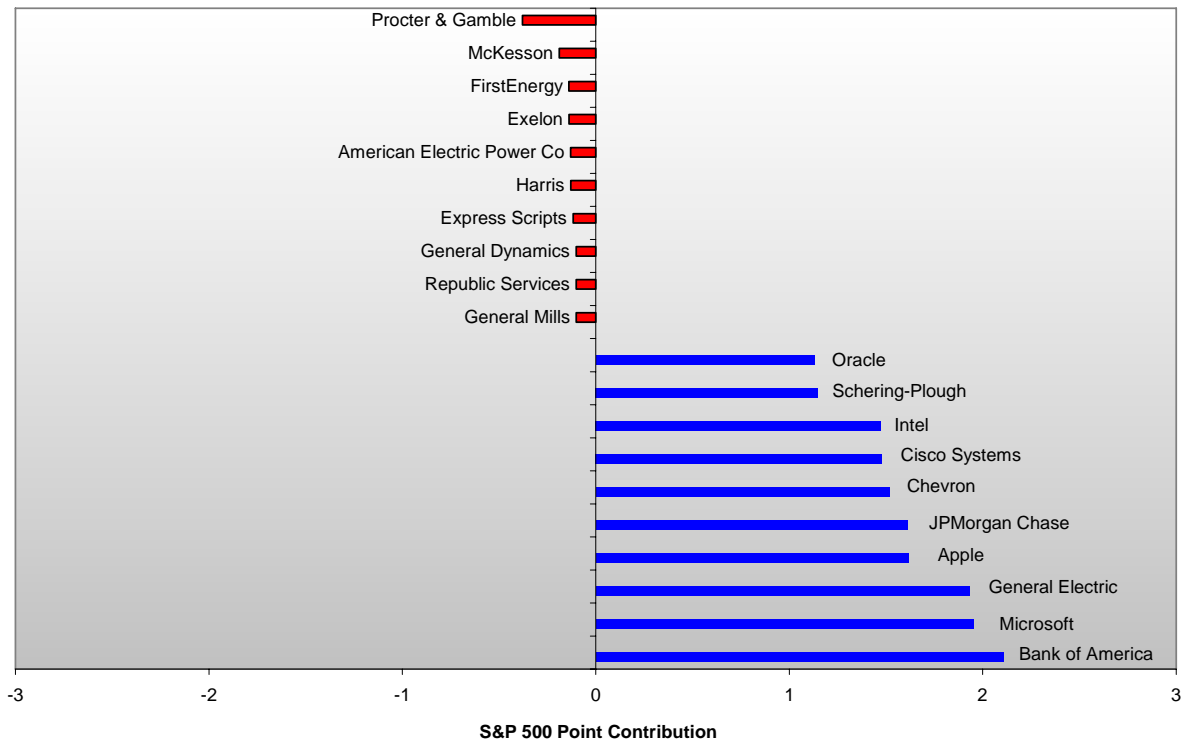


# U.S. Equities – March 2009

### S&P 500 Sector Movement



### Top 10 S&P 500 Contributors/Decliners



## Canadian and U.S. Economic Data – March 2009

Better Than Expected	Event	Period	Consensus	Actual	Prior	
Mar 2	US	ISM Manufacturing	FEB	33.8	35.8	35.6
Mar 5	CA	Building Permits MoM	JAN	-5.00%	-4.60%	-3.60%
Mar 12	US	Retail Sales Less Autos	FEB	-0.10%	0.70%	1.60%
Mar 13	US	Trade Balance	JAN	-\$38.0B	-\$36.0B	-\$39.9B
Mar 17	US	Building Permits	FEB	500K	547K	531K
Mar 17	US	Housing Starts	FEB	450K	583K	477K
Mar 18	US	Consumer Price Index (MoM)	FEB	0.30%	0.40%	0.30%
Mar 18	US	Current Account Balance	4Q	-\$137.1B	-\$132.8B	-\$181.3B
Mar 19	CA	Consumer Price Index MoM	FEB	0.30%	0.70%	-0.30%
Mar 19	US	Leading Indicators	FEB	-0.60%	-0.40%	0.10%
Mar 20	CA	Retail Sales Less Autos MoM	JAN	0.40%	1.30%	-3.10%
Mar 23	US	Existing Home Sales MoM	FEB	-0.90%	5.10%	-5.30%
Mar 24	US	House Price Index MoM	JAN	-0.90%	1.70%	-0.20%
Mar 25	US	Durable Goods Orders	FEB	-2.50%	3.40%	-7.30%
Mar 25	US	New Home Sales	FEB	300K	337K	322K
Mar 26	US	GDP QoQ (Annualized)	4Q F	-6.60%	-6.30%	-6.20%
Mar 27	US	U. of Michigan Confidence	MAR F	56.8	57.3	56.6
<b>As Expected</b>						
Mar 3	CA	Bank of Canada Rate	3-Mar	0.50%	0.50%	1.00%
Mar 5	US	Mortgage Delinquencies	4Q	-	7.88%	6.99%
Mar 6	US	Change in Nonfarm Payrolls	FEB	-650K	-651K	-655K
Mar 13	CA	Int'l Merchandise Trade	JAN	-1.0B	-1.0B	-0.7B
Mar 16	CA	Capacity Utilization Rate	4Q	75.00%	74.70%	78.10%
Mar 18	US	FOMC Rate Decision	18-Mar	0.25%	0.25%	0.25%
Mar 31	CA	Gross Domestic Product MoM	JAN	-0.70%	-0.70%	-1.00%
<b>Weaker Than Expected</b>						
Mar 2	CA	Gross Domestic Product MoM	DEC	-0.70%	-1.00%	-0.70%
Mar 3	US	Total Vehicle Sales	FEB	9.4M	9.1M	9.6M
Mar 6	US	Unemployment Rate	FEB	7.90%	8.10%	7.60%
Mar 9	CA	Housing Starts	FEB	145.0K	134.6K	153.5K
Mar 11	CA	New Housing Price Index MoM	JAN	-0.20%	-0.60%	-0.10%
Mar 13	CA	Unemployment Rate	FEB	7.40%	7.70%	7.20%
Mar 20	CA	New Motor Vehicle Sales MoM	JAN	6.00%	5.50%	-10.80%

**Key Takeaways:**

As was the case in recent months, economic data generally reflected the challenging economic times:

- U.S. and Canadian unemployment spiked to 8.1% and 7.7% respectively.
- U.S. Mortgage Delinquencies climbed to 7.88%.
- Total Vehicle Sales in the U.S. came in at 9.1 million.
- Canadian GDP fell by 0.7% in January building on Q4's negative momentum.

On the bright side, while data was weak, in many cases it was better than consensus. U.S. housing data, particularly, was ahead of expectations:

- U.S. New Home Sales rose 4.7% m/m in February confounding expectations of a 2.9% fall.
- U.S. Existing Home Sales rose 5.1% in February to an annualized 4.72 million units. Expectations within financial markets were for a 0.9% m/m drop to 4.45 million units.
- U.S. Housing Starts rose 22.2% m/m in February to 583k units annualized from the prior month's 477k.
- U.S. Durable Goods Orders were positive (3.4%) after a sharp decline in January.
- ISM Manufacturing, which was expected to weaken, unexpectedly gained 0.2 points. March results, released on April 1 improved to 36.3, suggesting that the index may be bottoming.



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