

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

Portfolio Advisory Group

## What Moved the Markets

Global equities reached new 11-month highs in September as positive economic headlines, positive corporate earnings and a pick up in M&A activity signaled to investors that the world economy was indeed on the road to recovery. The US dollar fell to a one-year low against a basket of currencies and gold reached a new 18-month high as investors turned to more risky investments instead of the safety of the greenback.

Positive leading economic indicators and the ISM Manufacturing Index crossing the '50 mark' provided a backdrop for Fed Reserve Chairman Ben Bernanke's comments that the US recession was likely over. The FOMC kept the target for the Fed Funds rate in the 0-0.25% range given the unemployment rate remains at a 26-year high of 9.8% and the housing market is only now beginning to show signs of stabilizing. Significant M&A news during the month include **Kraft's (KFT)** unsolicited US\$16.7B offer for **Cadbury (CBY)**, **Dell's (DELL)** US\$3.9B acquisition of **Perot Systems (PER)**, **Abbott's (ABT)** US\$6.6B acquisition of **Solvay SA's (SVVSY)** pharmaceutical unit, and **Xerox's (XRX)** \$6.4B acquisition of **Affiliated Computer Services (ACS)**.

Economic news from Canada was mixed as the unemployment rate reached a better than expected 8.7% in August but retail sales in July were disappointing. During the month, **Barrick Gold (ABX)** announced a massive US\$4.0B equity issue, the largest in Canadian history, to eliminate its gold hedges and gain full leverage to changes in gold prices. In a second attempt, **EnCana (ECA)** announced plans to split into two distinct and independent natural gas and integrated oil companies. The transaction is expected to close on November 30, 2009. **Research In Motion (RIM)** shares plunged near the end of the month after the company reported Q2 results and Q3 guidance that fell short of analyst expectations. The Bank of Canada maintained its pledge to leave the benchmark target at a record low of 0.25% until the middle of next year.

Chinese data for August showed that Beijing's policy stimulus continued to support a solid recovery in domestic activity as investment spending remained strong, industrial production grew at its fastest pace in a year and retail sales were steady. The Shanghai Index continued to decline during the month with sentiment hurt by a huge supply of new share issues. China's eight-day National Day holiday begins on Oct. 1. Japan's Nikkei average dropped to its lowest close in two months as the yen jumped to an 8-month high against the dollar which put heavy pressure on shares of exporters.

### Number Crunching

Equity Indices	Index Level	Month	YTD*
S&P/TSX Composite Index	11,394.96	4.8%	26.8%
Dow Jones Industrial Average	9,712.28	2.3%	10.7%
S&P 500 Index	1,057.08	3.6%	17.0%
NASDAQ Composite Index	2,122.42	5.6%	34.6%
MSCI World	1,126.98	3.8%	22.5%
MSCI EAFE	1,552.84	3.6%	25.5%
MSCI World TR	3,665.76	4.0%	25.5%

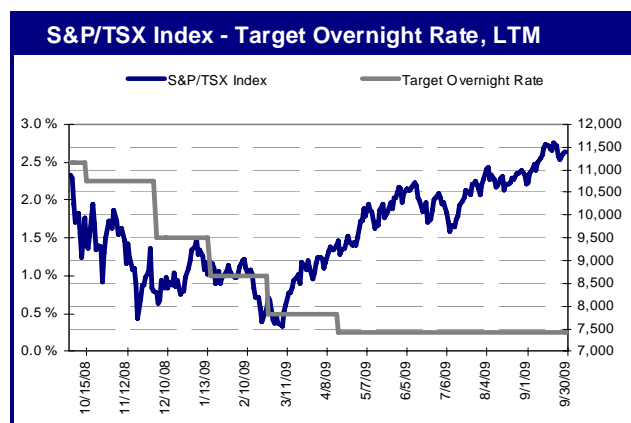
S&P/TSX Sector Performance	Index Level	Month	YTD*
S&P/TSX Financials	1,596.93	2.9%	40.8%
S&P/TSX Energy	2,729.27	9.1%	29.0%
S&P/TSX Materials	2,849.17	8.9%	25.9%
S&P/TSX Industrials	1,049.30	2.0%	14.4%
S&P/TSX Consumer Discretionary	854.77	0.9%	5.6%
S&P/TSX Telecom Services	684.82	0.0%	-5.0%
S&P/TSX Information Technology	258.58	-6.9%	43.2%
S&P/TSX Consumer Staples	1,435.20	-0.7%	-1.5%
S&P/TSX Utilities	1,522.98	1.4%	0.9%
S&P/TSX Healthcare	334.70	15.0%	32.6%

Currencies (in Canadian Dollars)	Exchange	Month	YTD*
US Dollar	1.0695	-2.2%	-12.2%
Euro	1.5658	-0.1%	-8.1%
British Pound	1.7092	-4.1%	-4.1%
Japanese Yen (100)	1.1923	1.5%	-11.3%

Commodities (US\$)	Spot Price	Month	YTD*
Crude Oil (WTI per barrel)	\$70.61	0.9%	58.3%
Natural Gas (per million btu)	\$4.84	62.6%	-13.9%
Gold (per ounce)	\$1,007.70	5.9%	14.2%
Silver (per ounce)	\$16.65	11.7%	46.1%
Copper (per pound)	\$2.79	-4.9%	102.1%
Nickel (per pound)	\$8.08	-6.6%	53.5%
Aluminum (per pound)	\$0.84	-0.6%	23.1%
Zinc (per pound)	\$0.89	4.7%	63.0%

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

Source: Bloomberg



\* Source: Bloomberg

## A Closer Look – The Inflation /Deflation Debate

In many Western economies, headline inflation continues to trend below 0% while core inflation (inflation that excludes volatile food and energy prices) is at risk of decreasing below 1%. While most people agree that price level movement is a concern, debate ensues as to whether we should be more worried about the threat of deflation in the short-term or inflation in the long-term. Despite the immense amount of monetary stimulus delivered and deficit spending, we view the risk of inflation as being low through 2010 for the following reasons:

### 1. Monetary Policy and Inflation

A concern is that the immense amount of money printed and injected into the financial markets by central banks around the world will eventually lead to the devaluation of paper money and give rise to inflation.

However, much of this excess liquidity has not been making it into the economy due to both reduced lending, brought about by tightening lending standards, and reduced borrowing demand, which is the result of retrenching consumption. Instead, banks have been largely holding this cash, borrowing at a cost of almost zero, and investing it in government bonds for a higher yield and thereby, slowly repairing their balance sheets. This situation is unlikely to reverse itself in the near term, as housing markets are only just starting to stabilize, and unemployment continues to rise.

### 2. Fiscal Policy and Inflation

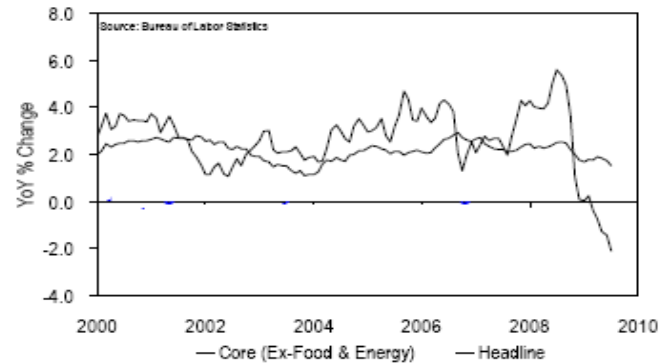
The concern is that the large amount of deficit government spending will create excess demand that will increase wages and prices, thereby fuelling inflation.

The output gap is an economic measure that compares actual GDP and potential GDP. A positive output gap, when actual output is greater than full-capacity output, tends to lead to inflation as both production and labor costs rise. Historically, a negative output gap has been associated with a declining inflation rate. Currently, there is a large negative output gap, reflecting that the economy is running well below capacity. Manufacturing capacity utilization is running below 70% in the U.S. and unemployment continues to rise. In this environment, there is enough slack in the economy that it can grow at an above-trend rate for an extended period of time before the gap closes and inflation becomes a concern.

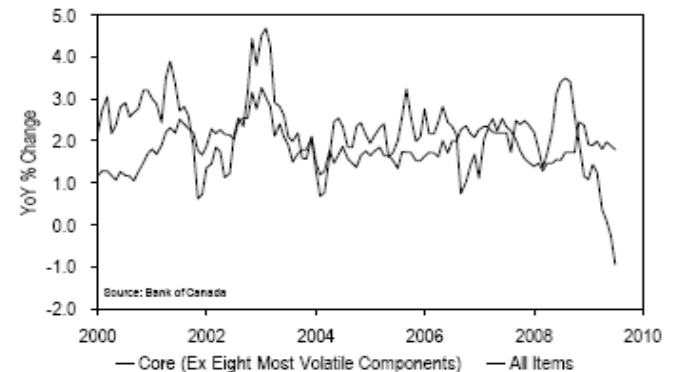
### Future Outlook

For 2011 and beyond, the risk of inflation is higher, but ultimately depends on the success of current monetary and fiscal policies, and future efforts to unwind them on a timely basis. If policies are reversed too quickly, the economy could risk falling back into recession.

United States Consumer Price Index  
Headline vs. Core CPI Inflation



Canadian Consumer Price Index  
All Items vs. Core CPI Inflation

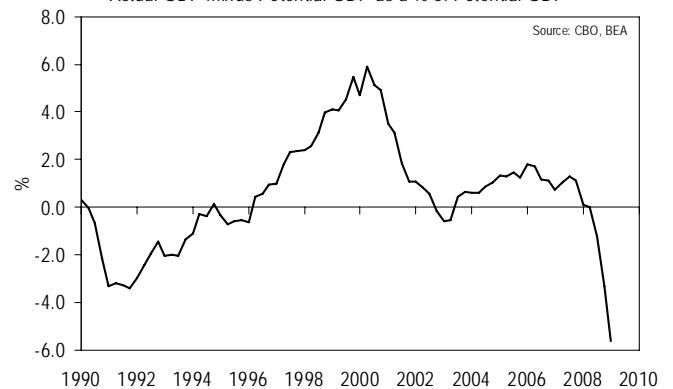


Senior Loan Officer Survey on Bank Lending Practices  
Loan Officers Reporting Tightening Standards

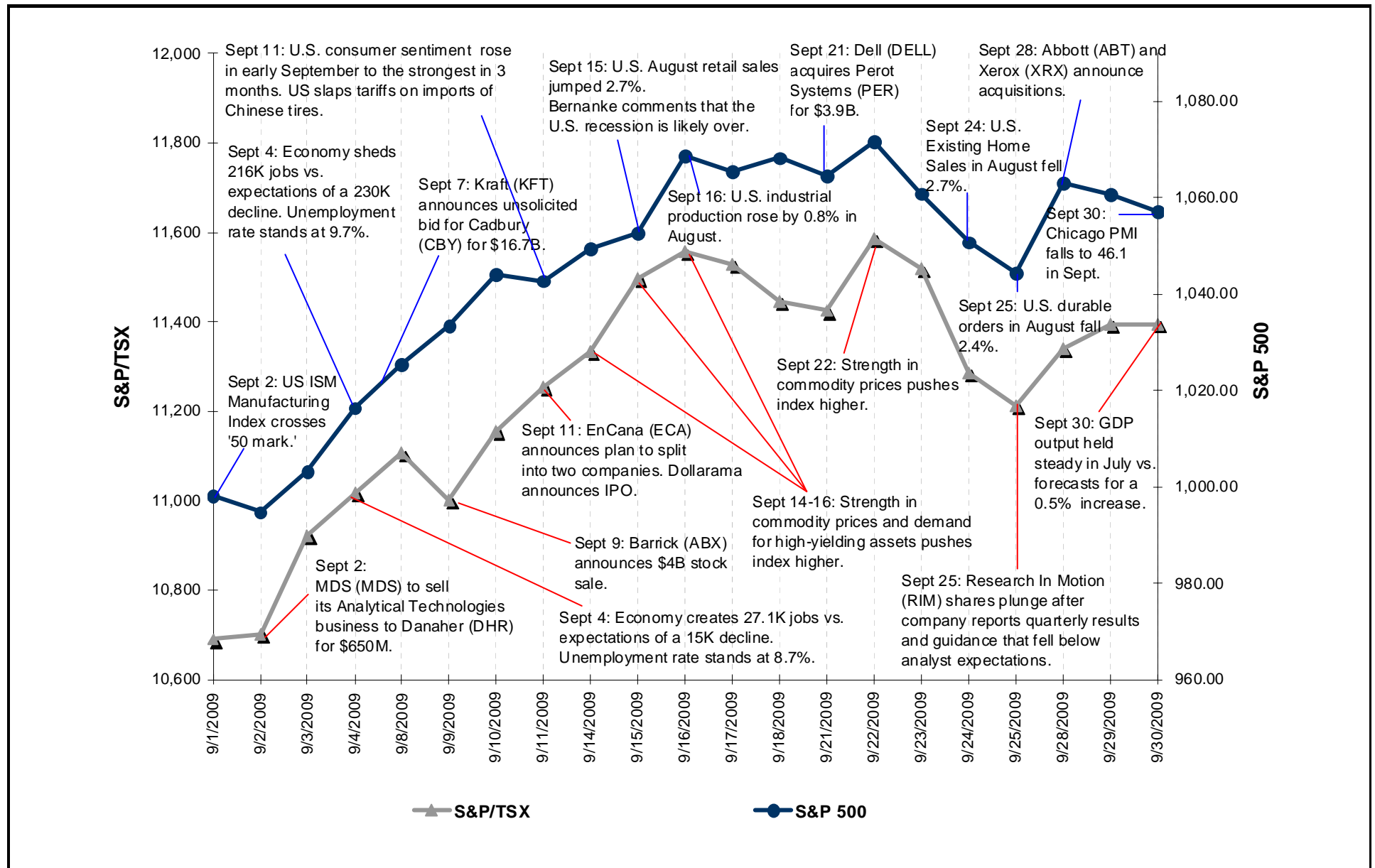


U.S. Output Gap

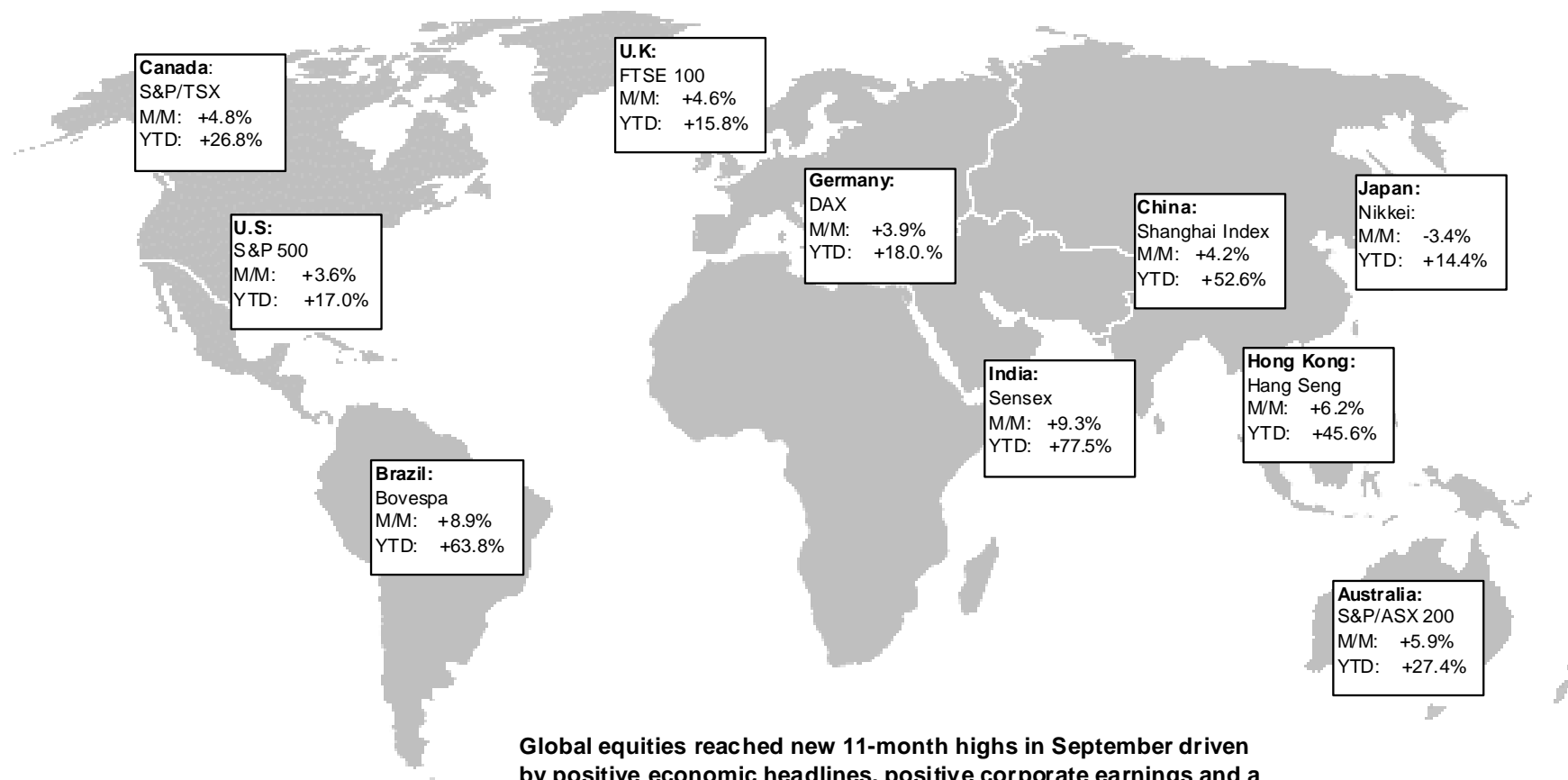
Actual GDP minus Potential GDP as a % of Potential GDP



## North American Equity Performance – September 2009



## World Markets – September 2009



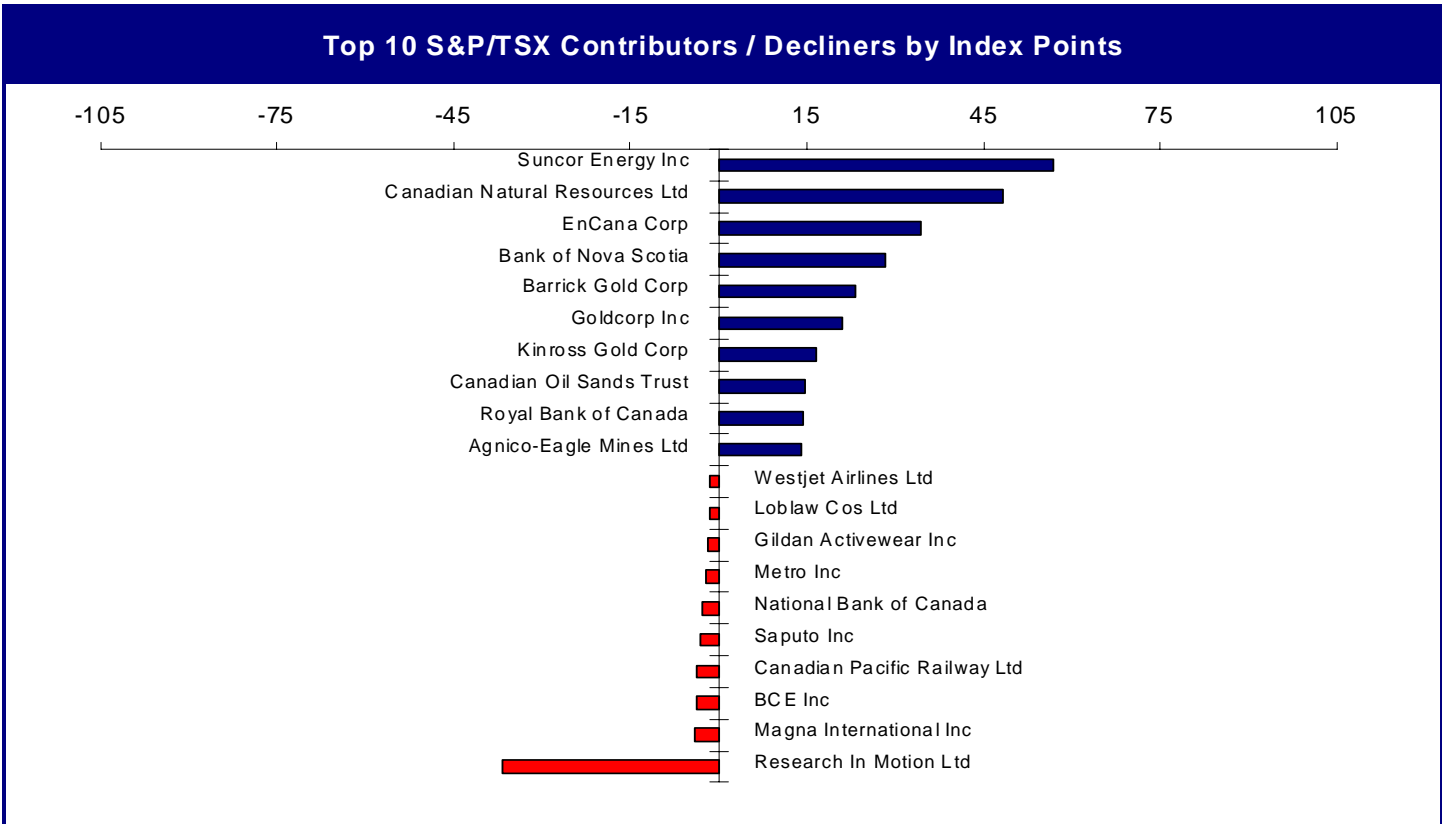
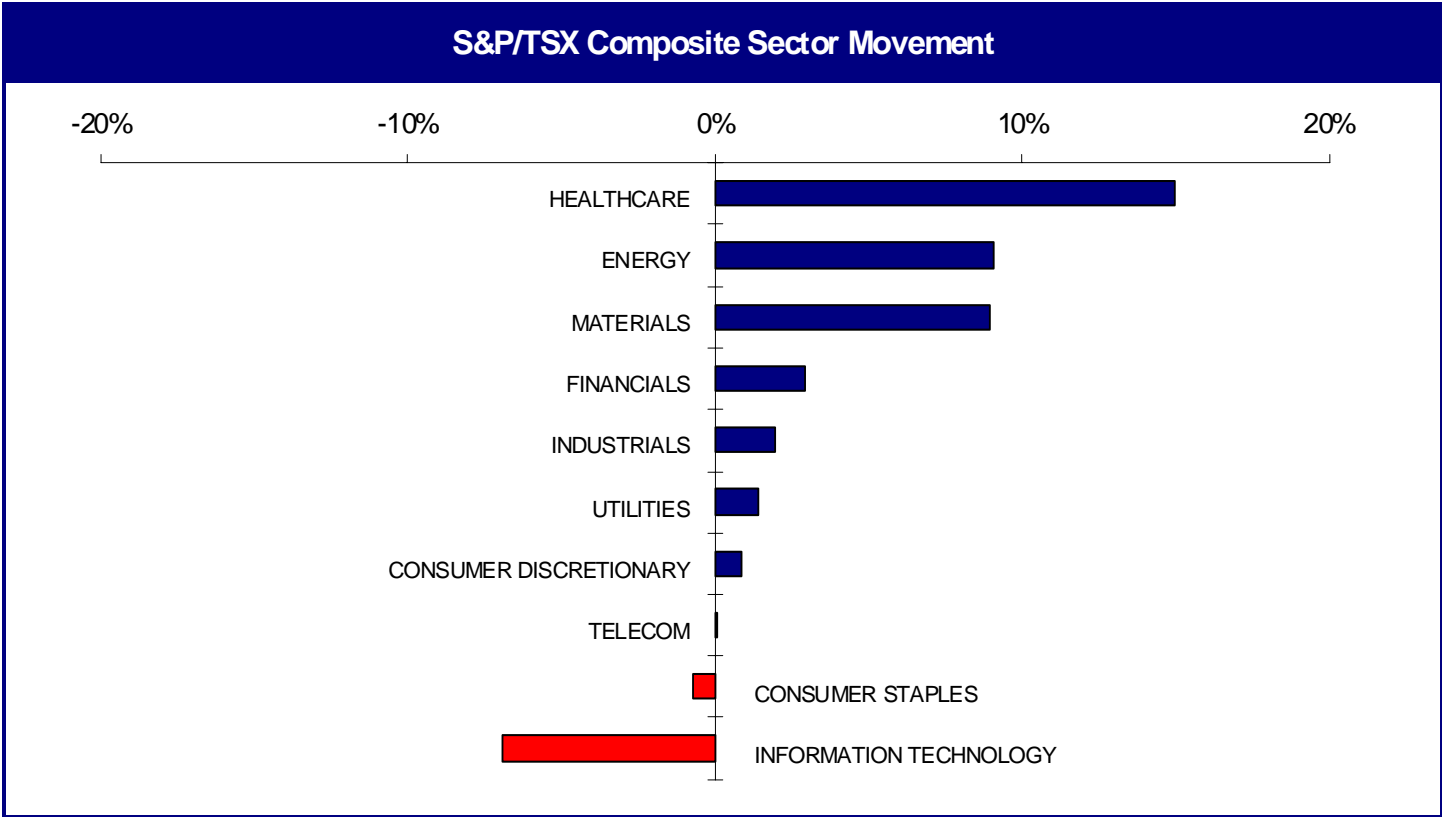
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Japan's Nikkei Index lost 3.4% during the month as the appreciation of the yen against the dollar put heavy pressure on shares of exporters.

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

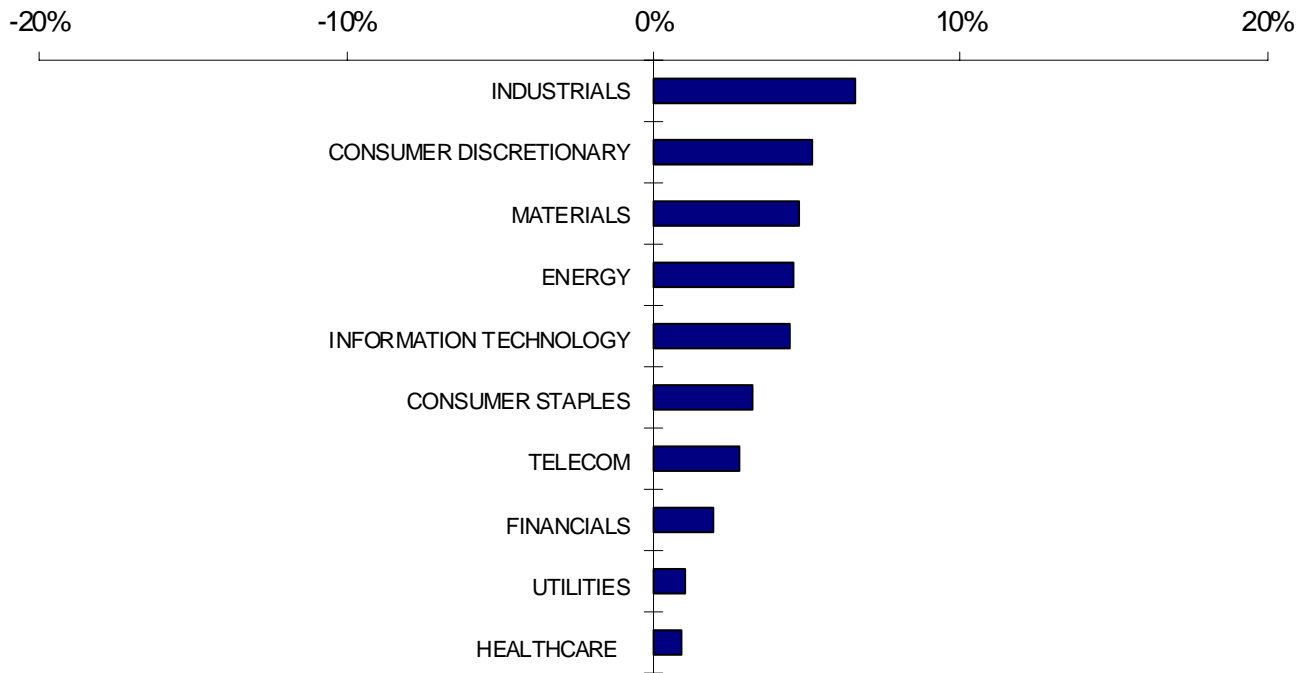
Source: Bloomberg

Canadian Equities – September 2009

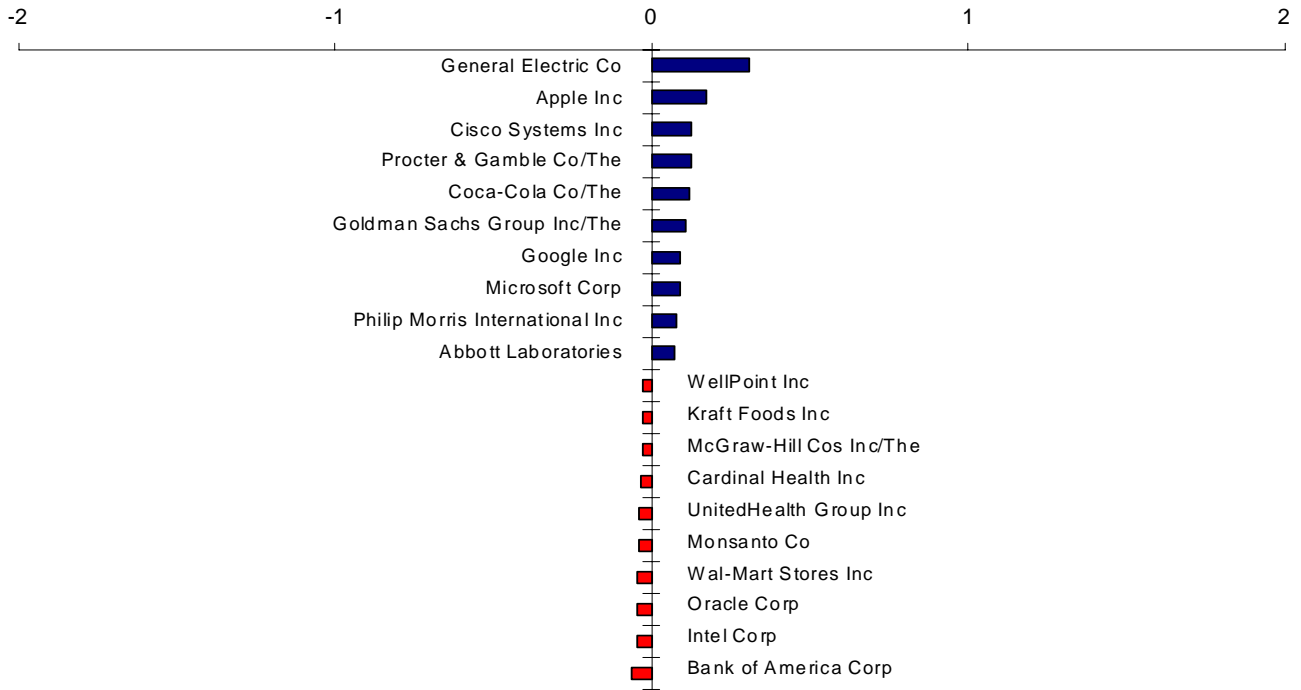


U.S. Equities – September 2009

S&P 500 Sector Movement



Top 10 S&P 500 Contributors / Decliners by Index Points



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

Better Than Expected		Event	Period	Consensus	Actual	Prior
1-Sep	US	Total Vehicle Sales	AUG	13.3M	14.1M	11.3M
1-Sep	US	ISM Manufacturing	AUG	50.5	52.9	48.9
2-Sep	US	Nonfarm Productivity	2Q F	6.40%	6.60%	6.40%
3-Sep	US	ISM Non-Manf. Composite	AUG	48	48.4	46.4
4-Sep	CA	Net Change in Employment	AUG	-15.0K	27.1K	-44.5K
4-Sep	CA	Ivey Purchasing Managers Index	AUG	54.5	55.7	51.8
4-Sep	CA	Unemployment Rate	AUG	8.80%	8.70%	8.60%
4-Sep	US	Change in Nonfarm Payrolls	AUG	-230K	-216K	-247K
9-Sep	CA	Housing Starts	AUG	139.5K	150.4K	132.1K
11-Sep	US	U. of Michigan Confidence	SEP P	67.5	70.2	65.7
11-Sep	CA	New Housing Price Index MoM	JUL	-0.10%	0.30%	-0.20%
14-Sep	CA	Capacity Utilization Rate	2Q	65.50%	67.40%	69.30%
15-Sep	US	Producer Price Index (MoM)	AUG	0.80%	1.70%	-0.90%
15-Sep	US	PPI Ex Food & Energy (MoM)	AUG	0.10%	0.20%	-0.10%
15-Sep	US	Advance Retail Sales	AUG	1.90%	2.70%	-0.10%
16-Sep	CA	Manufacturing Sales MoM	JUL	2.50%	5.50%	1.90%
16-Sep	US	Consumer Price Index (MoM)	AUG	0.30%	0.40%	0.00%
16-Sep	US	Capacity Utilization	AUG	69.00%	69.60%	68.50%
17-Sep	CA	Leading Indicators MoM	AUG	0.50%	1.10%	0.40%
25-Sep	US	U. of Michigan Confidence	SEP F	70.5	73.5	70.2
30-Sep	US	GDP QoQ (Annualized)	2Q T	-1.20%	-0.70%	-1.00%
30-Sep	US	Personal Consumption	2Q	-1.00%	-0.90%	-1.00%
As Expected						
10-Sep	CA	Bank of Canada Rate	10-Sep	0.25%	0.25%	0.25%
16-Sep	US	CPI Ex Food & Energy (YoY)	AUG	1.40%	1.40%	1.50%
16-Sep	US	NAHB Housing Market Index	SEP	19	19	18
17-Sep	CA	Bank Canada CPI Core YoY	AUG	1.60%	1.60%	1.80%
17-Sep	US	Housing Starts	AUG	598K	598K	581K
23-Sep	US	FOMC Rate Decision	23-Sep	0.25%	0.25%	0.25%
Weaker Than Expected						
4-Sep	US	Unemployment Rate	AUG	9.50%	9.70%	9.40%
4-Sep	US	Change in Manufact. Payrolls	AUG	-60K	-63K	-52K
8-Sep	CA	Building Permits MoM	JUL	0.40%	-11.40%	1.00%
8-Sep	US	Consumer Credit	JUL	-\$4.0B	-\$21.6B	-\$10.3B
17-Sep	CA	Consumer Price Index MoM	AUG	0.10%	0.00%	-0.30%
17-Sep	CA	Consumer Price Index YoY	AUG	-0.70%	-0.80%	-0.90%
21-Sep	US	Leading Indicators	AUG	0.70%	0.60%	0.60%
22-Sep	CA	Retail Sales MoM	JUL	0.70%	-0.60%	1.00%
24-Sep	US	Existing Home Sales MoM	AUG	2.10%	-2.70%	7.20%
25-Sep	US	Durable Goods Orders	AUG	0.40%	-2.40%	4.90%
25-Sep	US	New Home Sales MoM	AUG	1.60%	0.70%	9.60%
29-Sep	US	Consumer Confidence	SEP	57	53.1	54.1
30-Sep	CA	Gross Domestic Product MoM	JUL	0.50%	0.00%	0.10%
30-Sep	US	Chicago Purchasing Manager	SEP	52	46.1	50
30-Sep	US	ADP Employment Change	SEP	-200K	-254K	-298K

**Key Takeaways:**

In the month of September, economic data was mixed for both the US and Canada. Positive news from the US included the ISM Manufacturing Index rising above the '50 mark' and strong retail sales. This was offset by a higher than expected unemployment rate and a drop in consumer confidence. Better than expected unemployment figures and increasing housing starts in Canada were offset by weak retail sales.

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