



WEALTH MANAGEMENT



Second Quarter Market Commentary

June 2008

The second quarter of 2008 saw the Canadian stock markets improve over the first quarter but not without continued volatility. The Canadian stock index S&P TSX was in record territory prior to its recent pull-back. The US, European and Asian markets continued to struggle with another negative quarter.

The economic issues remaining at the forefront continue to be the US sub-prime mortgage mess and the threat of US recession, but added to those is the recent run-up in oil prices. Crude prices shot up to beyond \$140 per barrel which was certainly noticed by anyone who pulled into a gas station in the last month. Rising fuel prices have a way of trickling down to the consumer beyond gasoline though, as just about everything we buy is delivered to the store by one or more of ships, trains and trucks all of which use significant amounts of fuel. Transporters will only absorb so much added fuel costs before this must be passed down to the consumer in the form of higher prices for goods and services. While CPI numbers indicate that inflation is not a problem yet, the central banks are certainly taking notice.

Central banks in the developed world are caught between a rock and a hard place, that is the slowdown in growth which under normal business cycle conditions could lead to lower interest rates versus the threat of rising inflation which often leads to higher rates. The Bank of Canada and the US Federal Reserve have both stopped the easing of interest rates and have indicated that higher rates are indeed a possibility should inflation become a problem. This environment with little or no growth along with rising inflation is known as stagflation and this is a challenging environment for central banks. Moving rates lower to stimulate growth could lead to excess inflation and raising rates to fight inflation could hurt growth. Central banks will likely stay on the sideline until one of the two emerges as the greater threat.

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As mentioned previously, the Canadian stock market has posted positive returns thus far in 2008. But sometimes an index does not give one the true flavour of the overall market. We are currently in one of those times. While we have commented in previous reports about the concentration in the Canadian market, a recent research piece by Scotia McLeod shows some interesting facts. As of June 18th, 68% of the return of the S&P TSX can be attributed to four stocks; Potash Corp., Encana, Canadian Natural Resources and Research In Motion (RIM). Furthermore, 100% of the return can be attributed to 10 stocks (surprise, surprise, the other six are resource stocks). While the index is showing some positive returns thus far in 2008, those returns are coming from very few sources.

Just as a few winners have pushed up the TSX, profit taking in those winners or a correction in resource prices could just as easily send the TSX downward. While it may be tempting to want to overweight Canada because of the recent success versus other stock markets, proper diversification remains the most prudent approach for long term success.

Please call us if you would like to discuss these issues or any other questions you may have regarding your investment portfolio.

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