



## MONTHLY MARKET COMMENTARY

INVESTMENT RESEARCH

APRIL 2011

### March 2011 Review

	March 31, 2011	December 31, 2010	% Change
TSX	14,116.1	13,443.2	5.0%
S&P 500	1,325.8	1,257.6	5.4%
DJII	12,319.7	11,577.5	6.4%
NASDAQ	2,781.1	2,652.9	4.8%
10 Yr. Cda Bonds	3.34%	3.12%	12bp
10 Yr. US Bonds	3.46%	3.29%	17bp
90 Day Cda T-Bills	0.96%	0.98%	(2) bp
90 Day US T-Bills	0.10%	0.12%	(2) bp
US\$ vs. Can\$	\$1.030	\$1.002	2.8%

### Shock Absorbers

The month of March proved to investors how resilient the stock market has become. During the month, it was faced with two unexpected events; a sudden rise in oil prices (approximately US\$10 a barrel) and a devastating earthquake/tsunami in Japan (the world's third largest economy). Despite these shocks, world equity markets were essentially unchanged during the month and up strongly for the quarter. The Morgan Stanley Composite Index (MSCI AC) closed the month at 343.64, basically unchanged from February's month end of 344.82. Closer to home, the TSX closed at 14,116.1 versus 14,136.5 (down 0.1%), while the broad U.S. stock market (S&P 500 Index) closed at 1,325.8 versus 1,327.2 (down 0.1%). For the quarter, equity markets were strong with the TSX up 5.0%, the S&P 500 up 5.4% and the MSCI AC up 3.9%.

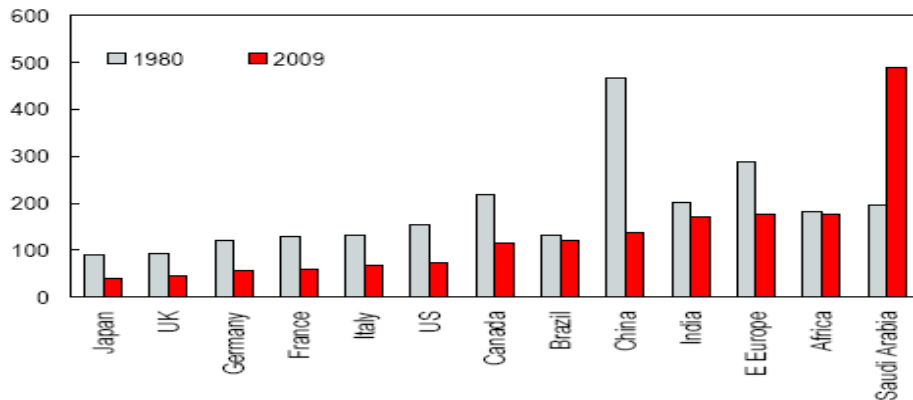
The Japanese stock market (Nikkei 225) fell by 8.2% for the month. Given the challenges the country faces, it was much less than many had expected. Judging by the headlines and "nuclear" problems, many would have expected a much greater decline (in the 20% range). The rebuilding of the areas affected in Japan will certainly cost more than the previous earthquake (Kobe in 1995) and the country faces an oil price materially higher today than in 1995 (US\$30 a barrel). In 1995 the Nikkei fell by 12%.

**How can we account for these muted declines in the stock market?** We believe there are several variables at play or “shock absorbers” that have lessened the impact of not only these exogenous (unforeseen) events, but more importantly other unforeseen events (within reason) that may occur. First we deal with the current shock; oil and Japan and then discuss why we feel the stock market can withstand other “reasonable” shocks.

**Energy:** The price of oil was already on the rise prior to the unrest in the Middle East. The rise started as the global economy recovered from the recession. At the depth of the economic downturn, oil prices (West Texas Intermediate) hit a low of US\$35.12 a barrel and continued to rise and by mid-December 2010 (what we believe was just prior to the uprising in the Middle East), oil was at US\$88 a barrel. Currently, the price of oil is US\$108 a barrel. We attribute the rise in the price of oil from December to the events in the Middle East. Global economic growth is very strong (more later) accompanied by supportive monetary policy (low interest rates) and in our view, will not alter the direction of the overall economy. As a reminder, oil prices peaked in October 2008 at US\$148 a barrel and interest rates were much higher.

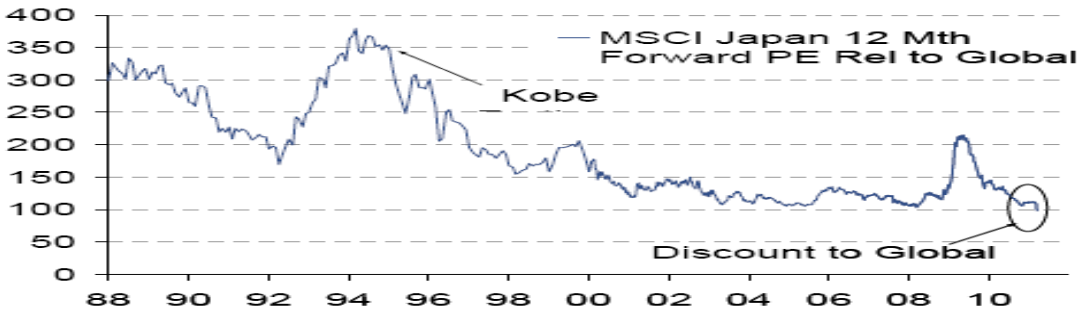
Oil has become less important for economic growth. We illustrate this in the graph below. Our starting point is 1980. With the exception of Saudi Arabia, all countries energy intensity has lessened, in some cases (China), dramatically.

**Tons of Oil Consumed per Million US Dollars of GDP**



Source: BP, World Bank

**Japanese Impact:** Today, Japan’s economic influence is considerably less than in 1995, accounting for only 9% of global GDP, down from approximately 18% in 1995. From a stock market point of view, Japanese equities account for only 8% of global equity markets, down from 30% in 1995. There are strategists (not us) who recommend investing in the Japanese stock market. Their main argument for investing in Japan and what we believe limits the downside for all equity markets is the valuation of the stock market. We illustrate the Japanese stock market on the following page.



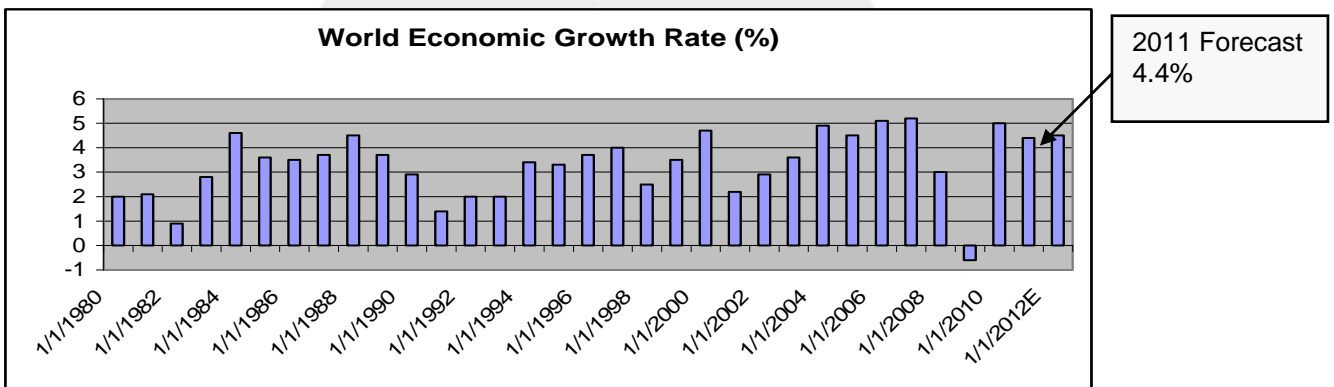
The graph illustrates the price earnings ratio that exists today versus in 1995. As mentioned, the decline in the Japanese stock market has been more muted than many expected due to the lower valuation that exists today.

**The Ability to Handle Other Unforeseen Events:**

There are two reasons we believe the global stock market and economy has the ability to manage other shocks; the strong state of the global economy and the inexpensive valuation of the stock market.

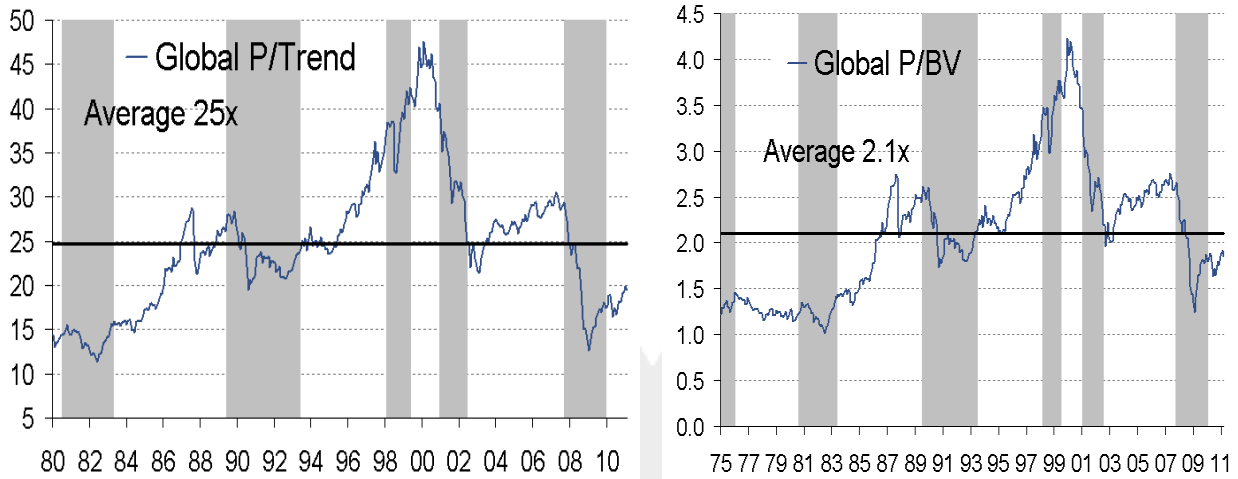
In January 2011, the IMF forecast global growth to be 4.4% (led by India and China). 2010 economic growth was even stronger at 5.0%. In other words, the global economy has considerable momentum and it will take several shocks to reverse this trend. The 4.4% is above historic norms as the graph below illustrates.

This strong growth rate has been translated into robust profit growth by most corporations. Profit margins (not shown) are close to record highs, providing a buffer to the shock. The high oil price and some economic dislocations from Japan (auto and electronic sectors) will cause a slight trimming in economic growth but starting from a strong point in the economic cycle. In the case of Japan, most economists look for a rebound in the second half of 2011, as the country embarks to reconstruct the damaged areas. If these events occurred during the financial crisis the impact to the global economy and stock market would have been far worse.



Source: IMF-January 2011

The second reason and perhaps the most important reason we feel the stock market can withstand further reasonable shocks is the valuation of the global stock market. The left graph below is the trailing P/E (we use the average ten-year earnings in calculating the E to “smooth” out economic cycles) of the Morgan Stanley World Composite Index and the graph on the right is the price to book value of the same index. A lower ratio for both indicates stock markets are inexpensive. Both are below the longer-term average and significantly below the start of the previous economic recession/financial crisis. Perhaps the way to view these two graphs is the gap that exists between the current valuation and long-term average provides a buffer for unforeseen events.



Source: Citigroup; last data point is March 31, 2011

We continue to believe the stock market offers value and will continue to move up, despite some volatility. There are sufficient buffers (strong economic growth and low valuation) and drivers (strong profit and dividend growth and the lack of attractive alternative investments) to continue to recommend purchase of the overall stock market.

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 Director of Research

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Company	Ticker	Disclosures
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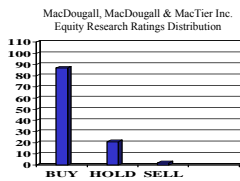
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Glossary of Terms:

EPS	Earnings per Share
P/E	Price to Earnings Ratio
EBITDA	Earnings before Interest, Taxes, Depreciation and Amortization
Market Cap	Total Shares Outstanding multiplied by Shares Price
Enterprise Value	Fully Diluted Shares Outstanding
PEG	P/E Multiple Divided by Growth Rate
ADR	American Depository Receipt
WACC	Weighted Average Cost of Capital
Risk Free Rate	10 Year Treasury bond
Yield	Dividend divided by Share Price
ASP	Average Price
DSOs	Days Sales Outstanding
Capex	Capital Expenditures
CPU	Cost per Unit
EVA	Economic value Added
EV / EBITDA	Enterprise Value / Earnings before Interest, Taxes, Depreciation and Amortization
DCF	Discounted Cash Flow
Holts DCF	Holts Discounted Cash Flow
DYT	Dividend Yield Target
Yield	Yield
BSOPM	Black Scholes Options Pricing Model
BETA	Quantitative measure of the volatility of a stock, mutual fund, or portfolio, relative to the overall market
MF	Mutual Fund

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