

Monthly investment commentary

OCTOBER 2006

Fall is now officially here and taking their signs from Mother Nature, it appears the snowbirds (along with the markets) saw fairer weather down south this past month. But it isn't all sunshine for snowbirds. Like typical fall weather, September saw a mixed bag of economic sunshine and rain!

A SLOWDOWN IN GLOBAL WARMING

Referring to table one, the U.S. markets lead the pack, appearing to have taken over the market leadership that the Canadian markets gave up. The rest of the global markets did well in September, finishing off a strong third quarter. Europe in particular had a strong quarter and that boosted the EAFE index returns.

Just like your local meteorologist on any given fall day, the IMF's (international monetary fund) forecast is calling for some good news and some bad news. While still expecting an economic slowdown in global GDP, the 2007 growth forecast was revised up to 4.9%. Global GDP growth is still outshining anything experienced in the 1990's. This warm economic wind is blowing in from countries like China and India, as emerging economies are driving that growth.

Table 1- Summary of major market developments

Market returns	September	Q3 2006	YTD
S&P/TSX	-2.6%	1.3%	4.3%
S&P500 (US\$)	2.5%	5.2%	7.0%
S&P500 (C\$)	3.4%	5.4%	4.9%
NASDAQ	3.4%	4.0%	2.4%
Russell 2000	0.7%	0.1%	7.8%
FTSE 100 (U.K.)	0.9%	2.2%	6.1%
NIKKEI 225 (Japan)	-0.1%	4.0%	0.1%
EAFE (C\$)	1.2%	3.6%	8.0%
Canadian Bond Market	1.1%	4.9%	3.3%
World Bond Market (US\$)	0.5%	2.9%	0.8%

*local currency (unless specified); price only

Shifting winds

Looking at Table two, you will note that the S&P/TSX's September returned -2.6%, a sharp one month pull back. In Canada, sector returns were split down the middle with half of the sectors returning negative returns, including the Energy sector which led the way with a significant downturn of 9.2% in September (oil and natural gas prices being the primary culprit).

For fixed-income investors there was a welcomed Chinook. The Canadian bond market rallied this month, returning a healthy 1.1% for the month of September and finishing the quarter at 4.9% (after a disappointing second quarter). A decrease in oil prices and the slow down of the U.S. economy resulted in decreasing inflation pressures. As a result, the U.S. Federal Reserve moved to the sidelines and kept interest rates where they are, helping to boost sentiments in the bond markets.

Table 2 - Sector level results for the Canadian market

S&P/TSX sector returns	September	Q3 2006	YTD
S&P/TSX	-2.6%	1.3%	4.3%
Energy	-9.2%	-10.2%	-3.4%
Materials	-6.8%	-0.5%	14.7%
Industrials	0.2%	-0.5%	3.3%
Consumer discretionary	0.3%	2.5%	4.7%
Consumer staples	-2.5%	2.5%	-2.8%
Health care	-7.4%	-11.3%	-
Financials	1.4%	8.7%	13.6%
Information technology	12.8%	23.3%	6.9%
Telecom services	10.0%	24.3%	18.7%
Utilities	-0.4%	4.7%	-5.6%

*price only

A slick downturn for oil, Canada's black gold

The Energy sector was the worst performing sector in September, now officially a negative contributor year to date (down 3.4%), and down a sharp 10.2% this past quarter. Energy and materials (two dominant TSX/S&P sectors and the recent darlings of the Canadian market) are pulling back, erasing earlier gains.

A number of factors played into the downturn for oil and natural gas commodities:

- Slowing economic growth (oil prices are closely tied to GDP)
- Mild weather patterns (an uneventful hurricane season, and mild winter forecast)
- Oil inventories up from last year (tilting the supply/demand scales)
- Decreased focus on geopolitical uncertainties (with tempers having cooled in the Middle East)

Combine the above list with the seasonal slowdown for commodities in the spring and fall, and it is easy to see why oil and natural gas prices have dropped in September.

Canadian housing market

Built tough...with extra insulation! The Canadian housing market continues to show significantly different (and more positive) signs than in the U.S. The boom and bust pattern does not apply to Canada, and in reality, the exceptional increases in housing prices has been narrowly confined to Calgary and Edmonton, whereas the rest of the country saw much more modest gains. In order to have a crash in housing prices, you need to have a boom first! Canada's only price boom has been in Alberta, and it is still seen as being unlikely to reverse itself anytime soon. Affordability stress levels have increased, but remain below previous danger levels. It is also important to note that the speculative investor demand that saw the increase of products like 'interest only' and 'negative amortization' mortgages, never found its way to Canada.

The sector with the highest returns this month in Canada was Information Technology. The 12.8% September return was one of the best we've seen from that sector in quite a while, and almost all of it thanks to one stock. Research in Motion (RIM) reported

better than expected numbers at the end of the month, sending that stock rising over 20% and pulling the Information Technology sector up with it.

Corporate USA

In the U.S., the S&P500 saw a positive return for the month of September, contributing to strong year to date results (up 7.0% in US\$). This result is in direct contrast to the increase in negative media attention around the weakening U.S. economy, and in particular, the U.S. housing market. In fact, the economic slowdown does appear to be happening faster and sooner than at first predicted. Housing starts are 20% below where they were a year ago, and home sales are sharply down. Also significant (but getting less media attention) are the positive numbers that support the notion that we are not in for a recession in the U.S. Inflation is, so far, staying down and prices at the gas pumps have been lowering, both a comfort to the U.S. consumer. Personal income growth is actually picking up in the U.S., and it is predicted that we will finish the 13th consecutive quarter of double-digit earnings growth for the S&P500 index (only the second time since 1950). These are all good signs for the U.S. economy. Even with the expected slowdown in economic growth, this will provide cushioning to the U.S. consumer to help soften the blow of their declining home values.

DRESSING FOR THE WEATHER

The price of oil is likely to remain closely tied to economic growth, and therefore a slowdown in global economies could see commodities, and the Canadian stock market, facing some increased volatility. As we work our way through this potential point of inflection, investors will be best served with a well diversified portfolio (both in Canada and abroad) to weather this season's market volatility.