Review and Commentary - 2012

2012 was another 'interesting' year, to say the least. Our last commentary ***50 Shades of Fear*** discussed the reasons so many equity investors remain on the sidelines incapacitated by the media swirl around the latest and most pressing 'threat' to equity prices. After one obstacle is overcome another more menacing and nerve-wracking one seems to appear. Some of the more notable 'shades' were; the Eurozone fiscal default, skyrocketing sovereign debt yields from the PIIGS, US elections, hurricanes, tsunamis and most recently, the 'fiscal cliff' in the US. After a deal was reached by US politicians, barely a breath was drawn before a new cause for inactivity- the US debt ceiling deadline which occurs in approximately 60 day- became the new focus. Despite all these fearsome re-appearing shades since the 2009 market sell off and recession, equity investors who have had the courage to look well past the dilemma du jour, have been rewarded. The TSX/S&P Total Return index was up approximately 7.2% in 2012 despite negative returns in many of the Energy and Material stocks which heavily influence the benchmark. The Dow Jones Total Return Index was up a similar percentage but the S&P 500 (less Resource weighted than the TSX/S&P Composite) was up over 12% (in Canadian dollar terms). In fact, throughout the world only equity markets in China, Argentina, Japan, Brazil and Spain underperformed the TSX/SP and of those, only three provided negative returns.

Last year's predictions were…

Equities will provide positive returns for North American Investors and unlike 2011 perform better than bonds.

While the Eurozone issues may require more drastic measures, they will be resolved but only after the markets push the politicians to act.

China will successfully engineer a soft landing.

Certainly the first two predictions appear correct and while we believe the last will prove to be correct, a bit more time may be required.

Major North American fixed income indices of investment grade bonds posted positive returns but not on the scale of major equity index returns. This is the first time in a many years that this has happened. The Canadian Long Bond Composite provided the best return of 5.2%. The other shorter duration bond composites returned less and the benchmark 5 year Canada bond (1.5% GOC 2017) provided a negative return of 1.5%.

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Eurozone concerns faded into the background by year- end but it was only a few months ago that investors were gripped by the market volatility surrounding the protests in Greece and other countries as their governments adopted in some cases severe, but in all cases necessary, austerity programs. Equity markets would fall precipitously as sovereign bond yields in these countries moved equally in the other direction.

There is a sense of irony unfolding as US representatives repeatedly preached to the Eurozone countries about their fiscal excesses when it is quite apparent they appear unable to manage the process of bringing their own fiscal affairs under control. Another interesting note was that despite all that turmoil, the Greek equity index provided one of the strongest returns in the last quarter of 2012.

Only toward the end of the year did the evidence start to build that China appears to be regaining some of their economic ‘mojo’. Steel production in December, along with China’s Purchasing Managers Index (PMI) showed the strongest gains in over a year. Commodity prices worldwide improved in the closing weeks of 2012 lending further support that investors believed in China’s recovery. Chinese equities, measured by the Shanghai Index, posted a gain of almost 15% in December 2012 and over 10% in the final quarter of 2012 giving further confidence to an economic rebound. Though equity prices are not always an infallible measure of future economic growth they have historically proven to be more often right than wrong as a leading economic indicator.

We expect the following for 2013;

1) **The TSX/SP Composite will have another positive year and Energy and Materials will provide positive returns.**
2) **China’s economy will continue to improve further strengthening commodity prices and world growth.**
3) **US politicians will continue to marginalize the interests of their country versus their own self-interests and not appropriately balance their own fiscal affairs subjecting their country to minimal economic growth in 2012.**
4) **Mid and long term bonds in Canada and the US will underperform equities again and we would weight a 50% chance the long bond will provide a negative return in 2013.**

Again we close with the quote from Jon Birger in our 2011 year end commentary “…there is no shortage of fundamentally attractive stocks to choose from- just a shortage of investors willing to own them.” If the present economic tides calm, and investors look further down the investment horizon, we would not be surprised to see a significant uptick in equity prices as fixed income investors scramble back into equities. However, this prediction may be best saved for 2014.

Regardless, stay the course, invest conservatively and prosper.

Thank you for your support in 2012.

Stodgell Investment Management Limited