

Bonds, anyone? Global recovery in full swing. MARKET AND INVESTMENT REVIEW ----- December 7th, 2009

- **A bond primer for Canadian investors:** For balanced investors (such as us), bonds (and here we mean primarily government bonds and senior corporate debt), represent (over time) approximately 40% of a portfolio. Two outstanding ETFs, **iShares Canadian Bond Index Fund (XBB)** and **iShares Canadian Short Bond Index Fund (XSB)** now make it possible for anyone to include bonds in their portfolio. **XBB** and **XSB** are large (well in excess of C\$1 billion), trade in large volumes, are very transparent and well diversified (290 positions for **XBB** and 187 for **XSB**). One might well ask why buy bonds? Bonds reduce risk --- they are a safe-haven in times of crisis --- and smooth out the volatility of returns because of a low correlation with stocks (see chart below). In Sept. - Nov. 2008, during the largest crisis in capital markets since 1929, Canadian bond prices dropped briefly by less than 2% primarily because investors had to unload



bonds to cover losing stock positions. By November the trend was fully reversed. So, if you had a balanced portfolio with an allocation of at least 30% to Canadian bonds, then 30% of your portfolio was 'safe'. This concept is widely understood, but what isn't as well known is that in a balanced portfolio, excess returns, generally from stocks, are, in the rebalancing process, added to the bond side of the ledger. As the stock portfolio climbs, the less risky part of the portfolio benefits as well and an ever greater nominal amount is sheltered. Both **XBB** and **XSB** are better alternatives to cash or other equivalents which pay next to nothing in real terms today.

Global economic update: Based on their December review, the **National Bank** reports that the key leading global indicators "herald a strong worldwide recovery in 2010." In Q3 BRIC countries continued to outpace OECD countries, but all developed countries except the U.K. were showing strong signs of life. After some 20 months of recession, the U.S. recovery is on solid ground: business investment is up, labor productivity is up sharply, unemployment is peaking and consumer spending has remained resilient. The threat of a jobless recovery is receding as several key indicators do not support that view. Consumer spending has not collapsed because household purchasing power has held out despite job losses --- for example, the aggregate wage bill was unchanged in October. Extended tax credits for new home owners may result in a robust housing market which in turn will sustain U.S. consumer spending.

- **Canadian Banks:** It wasn't such a long time ago that 'experts' were predicting that Canadians banks would cut their dividends. They never did and it looks like they will not any time soon based on their most recent quarterly results. The **Globe & Mail's** comment this Friday sums up the situation: "Canada's banks are earning a lot of money, and are poised to earn a whole lot more." Indeed our banks (like the big U.S. banks) have an embarrassment of riches, and they may want to increase (not lower) dividend,s but will not do so very quickly for fear of igniting political interest.

For more info call Mark Kryzan or Terry Shaunessy at 403-802-3108.

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