

## THE RETURN OF RISK TAKING

Markets and asset-class trends were varied in May. Investors continued to extend their desire to underwrite increased volatility in their equity portfolios, while concerns over forecast government deficits dampened fixed-income investors' sentiment.

The MSCI World Index ended the month almost unchanged at 0.59%. The strongest sectors were those benefiting the most from the so-called reflation trade, with Materials (+6.37%) and Energy (+5.62%) leading the way. A sense that government support could benefit the largest financial sector players generated a relief rally, with the sector appreciating by 5.14%. Consumer Discretionary was the worst performer in May (-5.53%), followed by Information technology (-4.18%) and Telecommunications (-2.88%).

The swift appreciation of the Canadian dollar during the month impacted returns. To better isolate equity market trends, index and sector returns are presented in local currency. The S&P 500 Index bounced upward during the month of May (+5.59%), led by Financial Services (+13.28%), Energy (+10.68%), Health Care (+6.86%), Materials (+5.82%) and Consumer Staples (+5.65%). Telecommunications (-1.27%) and Consumer Discretionary (-0.97%) were the laggards.

The brief and accurate summation of the month probably is that risk is back in style, as investors have abandoned scenarios of economic depression in favour of others implying stabilization as a result of massive government interventions. The asset classes (equities, high-yield bonds, commodities, financial company stocks) and geographies (emerging economies, natural resource endowed countries and their currencies) that performed the best attest to this fact.

Corporate officers certainly made the most of this window of optimism by issuing ample quantities of stock to investors eager to secure a stake in the expected rebound. Top U.S. banks rushed to tap the equity market following the government's stress tests. May was the highest monthly equity issuance ever in the U.S., and the fourth largest globally<sup>1</sup>.

To be sustained, recent investor optimism will have to witness confirmation of economic stabilization in the absence of further short-term economic shocks. One should expect volatility to persist in coming weeks, as the tug of war between optimists and pessimists continues. We should note that the pessimists still form the majority. A recent Barclays Capital survey conducted with over 600 institutional investors found that only 17.5% thought risky assets had further to rise<sup>2</sup>.

### Canadian Equities

Canada finds itself at the intersection of multiple positive economic and market trends. As a result, the S&P/TSX Index appreciated an outstanding 11.46% during the month, and is up 28.87% for the three months ended May 31. Materials (+21.93%), Energy (+15.80%) and Financial Services (+9.62%) were the strongest performers in a period when all ten sectors appreciated. Seven of the top 10 contributors to the index return for the month were members of the Energy and Materials sectors, while the other three - unsurprisingly - were financial sector companies. Consumer Discretionary (0.33%) and Industrials (1.33%) appreciated the least.

### Fixed-Income Assets

The risk seeking trend mentioned above had a strong impact on Canadian fixed-income assets. The DEX Universe Bond Index was down 0.13% in May, while at the opposite end of the spectrum its long-term BBB corporate bond component appreciated +8.84%!

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<sup>1</sup> Thomson-Reuters, May 28, 2009

<sup>2</sup> Financial Times, June 1, 2009

Investors reacted strongly to forecasts calling for exploding government deficits and saber-rattling by credit agencies aimed at the UK government debt. Yields on U.S. Treasury bonds reached six month highs, with long-term bond yields moving up the most. This is a critical development, as government efforts in the U.S. to lower mortgage rates are now at risk of becoming fruitless. Additionally, a key technical link between mortgage-backed securities and government bond markets could get triggered, inducing strong volatility in the U.S. fixed-income markets in coming weeks.