NATCAN MARKER

February 20, 2009

"S" AS IN STIMULUS

This week, the 44th President of the United States signed into law a massive package of economic and fiscal measures designed to combat the current recession and financial crisis. Coming editions of the Marker will deal with the specifics of this policy response. In the interim, investors could benefit from understanding how the present economic backdrop provides political justification for massive government spending to combat the prevailing deflationary forces.

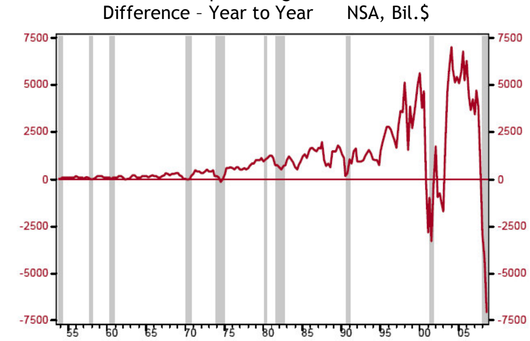
A PATIENT IN A STATE OF TRAUMA FOLLOWING CARDIAC ARREST

The U.S. economy is the largest in the world. The share of consumer spending to total GDP reached 70% in recent years relative to a long-term average of 64%. The consumer sector balance sheet was valued at $70 trillion at year end 2008. Hit by a collapse in residential real estate values and an equity bear market, consumer net worth is estimated to have fallen by more than 10% (over $7 trillion) during the year, a level of loss only previously experienced during the 1930's. To add perspective, let us consider that total U.S GDP at year end 2007, measured in dollar terms, was approximately $14 trillion.

Faced with losses of such magnitude, the entire consumer sector moved into retrenchment mode by cutting back spending, repaying debt, and resuming saving from wages. Each of the preceding actions subtracts from economic growth. Goldman Sachs reports real consumer spending fell during the fourth quarter of 2008, despite the price of gasoline dropping to $1.60 from $4.00 per gallon at the peak. This was the first such reaction to falling energy prices since World War II[1]. Merrill Lynch reports that consumer spending on discretionary goods and services has contracted at an annual rate of 15% since last summer[2], while automobile sales are trending down at a 10 million per year level from post 9/11 levels of 15–16 million. It comes as little surprise that U.S. GDP shrank 3.8%[3] in the fourth quarter of 2008.

RECORD WEALTH IMPLOSION

Households & Nonprofit Organizations: Net Worth
Difference – Year to Year NSA, Bil.$



Source: Federal Reserve Board, Merrill Lynch

Clearly, U.S. consumer spending has suffered the equivalent of massive cardiac arrest. With the patient in a state of trauma, authorities feel they must act to stimulate the economy back into growth mode. To do so, the banking system must be repaired as it is the agent through which transactions occur in the real economy. The task at hand is truly daunting, and voters are demanding action from a new administration elected on promises of change in Washington.

GLOBAL RAMIFICATIONS

While much maligned for financial profligacy, the U.S. consumer has also been referred to as the world's buyer of last resort. Spending cutbacks are being felt around the globe. Japan's economy contracted 3.3% in the final quarter of 2008. Chinese authorities reported some 20 million migrant workers had lost their jobs in recent months[4]. Finally, Canada recently experienced its first monthly trade deficit in over 30 years.

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The current economic backdrop is extremely challenging. Authorities around the globe are responding with massive stimulus programs. Investors now face an environment that is public policy dependent. Whether invested in U.S. bank stocks, Canadian discretionary companies, or government or corporate bonds, the coming months are likely to be volatile. Extended time horizons and great discipline are almost certainly the winning attributes under prevailing circumstances.

Michael Quigley, CFA, CAIA
Senior vice president, Distribution

FINANCIAL MARKETS

RETURNS AS AT FEBRUARY 6, 2009 (%)	MTD	QTD	YTD
S&P/TSX	3.66	0.59	0.59
S&P 500	5.22	-2.94	-2.94
S&P/TSX Small Cap	1.53	1.62	1.62
Russell 2000	6.08	-5.03	-5.03
MSCI EAFE	2.66	-7.01	-7.01
MSCI World	4.22	-4.50	-4.50
DEX Universe Bond	0.51	-0.45	-0.45

	RATES AS AT FEBRUARY 6, 2009
CAD/USD	1.24
CAD/Euro	1.60
US Treasuries yield 10-yr/30-yr	2.98/3.68
GOC bond yield 10-yr/30-yr	3.04/3.77
Fed Fund Rate (target)	0.25

Note: Returns in Canadian dollars, London 4h exchange rates. Source: Datastream, PC Bond, MSCI-Barra, and Bloomberg. PC-Bond, a business unit of TSX Inc. Copyright © TSX Inc. All rights reserved.

1 Goldman Sachs, *U.S. Economics Analyst*, Issue no. 09/04, January 30, 2009.
2 Merrill Lynch, *Merrill Lynch Economic Commentary*, January 26, 2009
3 Annualized
4 Johnson, Ian, and Andrew Batson. "China's Migrants See Jobless Ranks Soar." *Wall Street Journal*, February 3, 2009.

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