SECOND QUARTER COMMENTARY

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THE INDEPENDENT ACCOUNTANTS' INVESTMENT COUNSEL INC.

Investors see Positive Momentum...

Like the sun's re-emergence after a storm, economic prosperity will return and markets will rejoice. It is difficult to see that and think positively when we are drowned in wave after wave of bad economic news. No one is suggesting that there is clear sailing ahead. However, getting caught up in the negative sentiment of the day and ignoring history, key economic fundamentals and the human strength to endure and prosper can lead us all to make costly mistakes with our investments.

It appears that co-ordinated efforts by governments around the world have averted a collapse of the financial system. There are signs that credit is starting to flow again and the underlying housing collapse has subsided to some degree. Deeply discounted corporate bonds have bounced back and retail lenders are again pushing for new business. Fiscal stimulus programs are beginning to work as government funds flow back into the economy. Leading economic indicators such as housing starts, consumer confidence and shipping volumes have halted their steep declines and are providing positive signals to investors. These are some of the "green shoots" that you may hear economists talking about. From the second week of March, stock markets have responded in a positive way to signs that the recession is easing or that economic recovery is imminent in the latter part of 2009 and in 2010. To some degree, the market now discounts economic news contrary to this view. After three months of week-over-week gains, investors began to take profits and consider data that shows the global economic recovery may be more prolonged than originally thought. Despite a drop in the price of commodities and weakness in stock prices in the month of June, investor sentiment remains bullish in general. Corporate earnings have not declined as much as expected. The common belief is that the market has moved beyond the bottom and will unlikely revisit those lows. History has shown us time after time, the biggest gains coming off of the bottom are made in the first two months following the market's low point. We should keep in mind that stock markets are still well below their highs of 2008. Fundamental ratios and financial metrics remain favourable despite paired back projections. In two to three years from now, we are likely to look back and appreciate that 2009 was a good year to be invested. Money on the sidelines will start to come back into stocks and put further upward pressure on prices. In ten to fifteen years from now, 2008 – 2009 will seem like a minor distraction for the long-term investor.

Government Intervention...

There seems to be little debate that without the swift action of governments worldwide, a severe depression was averted. Purchasing distressed assets and injecting capital into financial institutions put a severely damaged financial system back onto a firm footing. One of the more frightening prospects of this recession at its onset was the possibility of one of the "big three" automakers failing. Fast forward to July 2009 and we have now seen the orderly restructuring of not one, but two of the "big three" with billions of dollars of government assistance and investment. All of a sudden, deficit spending became the norm though we renamed this "fiscal stimulus". Infrastructure spending, meant to quickly create jobs and programs with defined terms, has been created to shore up confidence and create jobs. Fiscal conservatives began to advocate not only for deficit spending, but for government borrowing that exceeded the likes of anything we have seen before. The US government is heading towards an astonishing $3 trillion deficit. In comparative terms, this can be likened to the Canadian government posting a $300 billion deficit. Even with our fiscal sensibilities and fiscal restraint, Canadians are now facing a $50 billion federal deficit as well as massive provincial deficits. These are truly astonishing numbers by any measure.

Herein lies a massive challenge for governments and central banks worldwide. While everything that is being done today has short-term economic benefits, the long-term implications will be inflation, currency devaluation and a higher cost of borrowing.

While nobody can foresee the future, analysts and economists are more bullish moving into the third and fourth quarters of 2009. Central banks have committed to keeping short-term interest rates at historical lows well into 2010. Bond yields at the short end (1 – 3 year maturities) remain low and challenging for fixed-income investors but also provides added stimulus to the stock market. As always, we advocate diversification.

Please contact your local IAIC Representative if you have any questions regarding this commentary.

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