February In Review

Equity markets gained momentum in February led by global equities. The MSCI World Index returned 4.48% due to better-than-expected economic activity in China and the Eurozone. The S&P 500 Index returned 4.00% largely because of strong North American corporate earnings, which supported the market. Canadian equities also showed strength as the S&P/TSX Composite Index returned 3.93% led by the materials, financials and energy sectors. Canadian bonds, as represented by the DEX Universe Bond Index, returned 0.35% for the month, and are up 1.48% this year.

- Finance Minister Jim Flaherty unveils ‘fiscally prudent’ 2014 federal budget. The budget intends to close tax loopholes and minimize perceived tax abuses in an effort to eliminate the deficit by 2015. The proposal aims to save at least $7.4 billion over the next six years by cutting public servants’ benefits – the largest boost to projections – and by generating $3.2 billion in revenue by increasing taxes on tobacco products. The budget also outlines delays to national defense spending and seeks to address U.S. cross-border price discrimination.
- U.S. labour market fails to surpass market expectations in January. With the market expecting 184,000 new jobs, the U.S. only added 113,000 to the payrolls, and posted an unemployment rate of 6.6%, a five-year low. North of the border, Canada added 29,400 new jobs during the same period, an improvement over December’s declines.
- Natural gas prices heated up in February. A severe cold snap increased demand for the heating fuel, pushing intraday prices to a high not seen since December of 2008, before ending the month lower. Weather also impacted other commodities as Brazil, the largest coffee and sugar grower, suffered its driest January in six decades, severely damaging crops and causing prices to rise. Hedge funds responded by increasing their bullishness on commodities to the highest levels since 2012.
- China moves to rein-in credit. The Chinese central bank stepped into the money market removing US$8 billion to reduce the amount of available credit in the world’s second-largest economy. For the second time since June 2013, China has removed excess cash from the economy in an effort to reduce informal lending to businesses, known as ‘shadow banking’.
- Eurozone economies are slowly gaining traction. The European Commission sees economic growth in the 28-country European Union (EU) at 1.5% in 2014, and 2% in 2015. From the larger EU economies, Britain and Germany are forecasted to be the drivers of growth for the region over the next two years. In Ukraine, lawmakers ousted President Yanukovych in an effort to stop widespread protests that had afflicted the country since a deal with the EU was cancelled in favour of closer ties with Russia.

What We Are Watching

The Federal Open Market Committee will meet for two days in March. They will determine if any changes are required to the current interest rate policy, as well as the appropriate level of reduction in monetary stimulus, if any at all.
Portfolio Strategy

Fixed Income: In February, bond markets remained volatile, with interest rates initially increasing as the U.S. Federal Reserve Board (the Fed) continued reducing bond purchases. As the market grew more cautious, and the appetite for risk diminished, interest rates gave back some of their gains and fell. While U.S. economic growth remains strong, the Fed should continue to slow the pace of bond purchases, and will likely wrap up the program later this year. In response to the market volatility, our fixed income strategy ended the month with a neutral average maturity versus the benchmark. Broadly speaking, we believe bonds are fairly valued at current levels given the economic and geopolitical risks. Our underweight exposure to short-term bonds helped to offset the slight drag created by our underweight in provincial bonds, which returned more than federal bonds. We remain positioned with an overweight to federal bonds relative to provincial bonds, and a bias towards quality in corporate bonds.

Equities: Equity markets had a strong showing in February relative to January. Within our Canadian equity strategy, we remain overweight the energy and materials sectors, as well as the gold subsector. We continue to be overweight the consumer discretionary sector with a preference towards media companies, and remain overweight in banks and life insurers that are leveraged to interest rate changes. In the U.S., we are positioned to take advantage of an improving economic environment while reducing the risks of potential interest rate increases. We maintain a favourable outlook for industrials, with their strong international exposure, as well as health care based on our expectation of expanded usage due to U.S. health care reform and a strong product pipeline in the pharmaceuticals subsector. Recently, political risk out of Ukraine and Russia has caused some concern; however, it is worth noting that economically, Ukraine is small, with a gross domestic product (GDP) of $175 billion, roughly equal to four days of U.S. GDP, or slightly more than the market capitalization of The Coca-Cola Company. We continue to monitor the situation in Ukraine and its impact on market sentiment, but failing any further escalation, we believe that it is unlikely to have any material economic consequences.

CURRENT ASSET ALLOCATION VIEWS

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>View</th>
<th>Neutral</th>
<th>Underweight</th>
<th>Overweight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Continuing to wait for compelling opportunities to redeploy cash.</td>
<td>·</td>
<td>·</td>
<td>·</td>
</tr>
<tr>
<td>Bonds</td>
<td>Bond yields expected to rise over time.</td>
<td>·</td>
<td>·</td>
<td>·</td>
</tr>
<tr>
<td>Equities</td>
<td>Strong returns in February have made some markets overvalued.</td>
<td>·</td>
<td>·</td>
<td>·</td>
</tr>
</tbody>
</table>

* Source: TD Newcrest & Bloomberg

© Copyright 2014 1832 Asset Management L.P. All rights reserved.


This document has been prepared for Scotia Private Client Group® clients and may not be redistributed. It is for general information purposes only and is not intended to provide personal investment advice. Information herein was obtained from various sources believed to be reliable but is not guaranteed for its accuracy. All opinions, projections and estimates herein reflect the author’s judgment as of the date of the document, may not be realized, and are subject to change without notice. Scotia Private Client Group is under no obligation to update this commentary and readers should assume the information contained herein will not be updated. Neither Scotia Private Client Group nor any director, officer or employee of any of its members accept any liability whatsoever for any damages or losses arising from any use of this document or its contents.