



Fourth Quarter 2008

Volume 9.5

**IN THIS ISSUE**

Market Commentary

S&amp;P/TSX Composite Sector Performance

Market Benchmarks

Highlights

Report of the Quarter

**Market Commentary**

**Canadian Markets** - Turmoil in global financial markets and fears of a global recession continued to shock equity markets throughout fourth quarter. Canadian equity market started off the first half of 2008 on positive ground; however, the S&P/TSX Composite Index along with other world indices plummeted in both the quarter and the year, with global equity markets losing trillions of dollars in 2008. ▶

**US Markets** - As deep gloom continues to spread through the U.S. financial markets, it is no surprise that the U.S. equity market retreated during fourth quarter 2008. The S&P 500 Index experienced negative returns for the fifth consecutive quarter, and posted one of its biggest annual declines in history. In Canadian dollars, the S&P 500 Index returned -9.37% for the quarter and -21.20% for the year 2008. ▶

**International Markets** - Throughout the quarter, the worst global financial crisis since the Great Depression walloped international markets and led to the most dramatic international government intervention since the 1930s. ▶

**Emerging Markets** - The world's emerging market economies displayed typically high volatility. Countries in Eastern Europe with high current-accounts deficits and foreign debts were especially sensitive to the economic downturn. Similar to last quarter, European, Middle Eastern and Latin American markets were hardest hit, whereas Asian and African markets were spared the worst. ▶

**Highlights*****Performance & Risk Analytics Product Manager Wins Award For Excellence in Performance Measurement Writing***

BNY Mellon Asset Servicing, the world leader in securities servicing, announced that analytics product manager David Asermely has won The Spaulding Group's prestigious Peter O. Dietz award for excellence in performance measurement writing for his white paper "Long/Short Portfolio Analytics." ▶

## **Report of the Quarter**

### ***Value Added Chart***

One of the most frequently asked questions our clients ask themselves about their managers is: "How has the manager's performance fared compared to their benchmark?" 📌

## Fourth Quarter 2008

<b>IN THIS ISSUE</b>	<b>Market Commentary</b>	S&P/TSX Composite Sector Performance
	Market Benchmarks	Highlights
		Report of the Quarter

## Market Commentary

### Canadian Economic Overview

The fourth quarter of 2008 continued to reflect the dismal course of the U.S. economy and severe turbulence in global financial markets. Global economic growth, which weakened in the first half of 2008, remains unsettled. Economic activity has been moving slowly over the year, as the economy has suffered from plunging commodity prices, a depreciated Canadian dollar, severe losses in the value of the stock market and an automotive recession. The Bank of Canada expects 2009 performance to follow in the footsteps of 2008's fourth quarter. However, moderate improvement is expected into 2010 as the economy benefits from stronger global growth and improvements in credit conditions.

With the economy so depressed, Canada reported weak employment figures in fourth quarter 2008. Employment declined by roughly 34,000 jobs in December while the unemployment rate rose to 6.6%. The economy did add 98,000 jobs from December 2007 to December 2008; however, this is at a much slower pace than the 358,000 jobs added over the same period in 2007. South of the border, the U.S. reported job losses of roughly half a million in December 2008, pushing up the unemployment rate to 7.2%.

### Monetary Policy

On October 21, 2008 the Bank of Canada lowered the target for the overnight rate to 2.25%. On December 9, it further reduced the target for the overnight rate to 1.5%, stating that global financial markets remain harshly strained and that the Canadian economy is entering a recession as a result of the weakness in global economic activity. The outlook for inflation in Canada has been lowered, with the Bank of Canada expecting core inflation to remain below 2% until the end of 2010. In the short term, the Canadian economy is likely to see lower interest rates, continued pressure on commodity prices, a budget deficit and lower housing prices – all contributing to a weaker Canadian dollar. The Bank of Canada states that further monetary stimulus is likely to be needed to achieve the 2% inflation target over the medium term.

In 2008, the Canadian dollar experienced its biggest decline on record, weakening 19% since the global recession negatively impacted the demand for commodities. The commodity-driven currency may also continue its decline into 2009, as falling crude oil prices affect investment in Canadian oil-producing regions. The Canadian dollar weakened relative to its U.S. counterpart in the fourth quarter of 2008. Nevertheless, the Bank of Canada holds that the depreciation of the Canadian dollar will continue to somewhat offset the effects of lower commodity prices and weaker global demand. The Canadian dollar started 2008 at US\$1.004, closed at US\$0.9406 on September 30 and finished at US\$0.8100 on December 31.

### U.S. Monetary Policy

The U.S. housing market collapse, along with persistently weak credit conditions, a weak job market and slower consumer spending, led the Federal Reserve to slash interest rates three times during fourth quarter 2008. On October 8, the Federal Open Market Committee (FOMC) announced a lowering of the target rate for federal funds to 1.5%, citing weakening economic activity. On October 29, the FOMC lowered the target again

to 1%, citing a decline in consumer expenditures. Then on December 16, the FOMC decided to establish a target range for the federal funds rate of 0-0.25% as the outlook for the U.S. economy weakened further. Tighter credit conditions, the ongoing housing contraction and slowing export growth are all likely to weigh on economic growth over the next few quarters. However, the FOMC hopes that ongoing measures to promote market liquidity will help foster moderate economic growth in the U.S. over time.

## **The Bond Market**

While third quarter 2008 saw Canadian bond prices fall as investors worried about credit conditions, fourth quarter saw positive returns for Canadian bonds, with government bonds leading the way as interest rates were slashed. The broad market DEX Bond Universe Index finished off the quarter returning 4.50%, up from -0.37% in third quarter. The index returned 6.41% for the year. Canadian bonds at the long-term maturity tiers were the best-performing segment of the market for the quarter, returning 5.21%. Mid-term and short-term bonds also achieved positive results, returning 4.25% and 4.30% respectively.

U.S. bonds outperformed U.S. equities during fourth quarter as interest rates fell across the board, reflecting the ongoing economic crisis. U.S. investors sought the relative safety of government bonds in 2008. In Canadian dollars, the Barclays Capital Aggregate Bond Index finished off the quarter with a strong 21.43% return, and the year with 31.64%.

## **Canadian Equity Markets**

Turmoil in global financial markets and fears of a global recession continued to shock equity markets throughout fourth quarter. Canadian equity market started off the first half of 2008 on positive ground; however, the S&P/TSX Composite Index along with other world indices plummeted in both the quarter and the year, with global equity markets losing trillions of dollars in 2008. The S&P/TSX Composite Index fell -22.71% in fourth quarter, following a decline of -18.22% in third quarter. This brings the year-to-date return for the index to -33.00%, while in 2007 it returned 9.83% for the year.

Nine out of the 10 sectors posted negative returns for the fourth quarter, with the Financials, Information Technology and Energy sectors leading the losses. These sectors returned -29.91%, -27.24% and -27.19% respectively. Consumer Staples was the only sector posting positive performance for the quarter, returning 3.29%. For the year, the worst performers of the S&P/TSX Composite Index were the Information Technology, Financials and Consumer Discretionary sectors, which returned -54.18%, -36.45% and -35.41% respectively. Weak credit conditions have weighed on the earnings of financial services companies in Canada, while fourth-quarter losses in the Information Technology sector were driven mainly by the losses reported by wireless technology giant Research in Motion. Growing evidence of global financial turmoil worked against energy and metals products. These stocks plunged on declining crude prices during the year, and on fears that a widespread economic slump will adversely affect world demand for oil and other materials produced by resource companies in Canada.

## **Canadian Style Analysis**

Canadian stocks at the large capitalization tier continued to outperform their smaller capitalization counterparts in fourth quarter and for the year, since smaller capitalization stocks tend to take the biggest fall during economic downturns. Many smaller-cap stocks have continued to face margin pressure from the recent market volatility, pushing investors toward the safety of larger capitalization stocks. The S&P/TSX 60 Index returned -22.68% for the fourth quarter and -31.17% for the year, while the S&P/TSX Small Cap Index returned -26.79% for the quarter and -45.49% for the year. Growth stocks were the preferred investment style for the quarter – a reversal of the trend toward value stocks during third quarter. The MSCI Canada Growth and Value indices returned -19.06% and -25.63% for the fourth quarter of 2008. Growth stocks also outperformed value stocks for the year, with growth stocks returning -31.39% and value stocks returning -32.56%.

## **The U.S. Markets**

As deep gloom continues to spread through the U.S. financial markets, it is no surprise that the U.S. equity market retreated during fourth quarter 2008. The S&P 500 Index experienced negative returns for the fifth

consecutive quarter, and posted one of its biggest annual declines in history. In Canadian dollars, the S&P 500 Index returned -9.37% for the quarter and -21.20% for the year 2008. Among the weak performers, the Financials, Materials and Information Technology sectors were hit hardest in the quarter, returning -26.76%, -19.63% and -13.77% respectively. These three sectors were also the worst performers for the year, returning -44.11%, and -32.03% and -28.88%. The weakening credit market has continued to weigh on the earnings of financial services companies, while commodity price reductions due to slowing global growth have negatively impacted the materials and energy sectors.

According to the Federal Reserve, the U.S. economy is expected to worsen in 2009 with little recovery before 2010. The economy is suffering from slowing global growth, weak job data, weak credit and housing markets and low consumer confidence levels. However, the delayed effects of financial stabilization and fiscal stimulus programs should provide some overall improvement to the economy in 2009.

## **U.S. Style Analysis**

U.S. value stocks led over growth stocks at the large capitalization tier as measured by the Russell 1000 Value and Growth indices. Small capitalization stocks, as measured by the Russell 2000 Value and Growth indices, saw a similar trend as equity investors piled toward value stocks to avoid the risk of a huge decline in growth stocks. In Canadian dollars, the Russell 1000 Value and Growth indices returned -9.64% and -10.35%, and the Russell 2000 Value and Growth indices returned -12.79% and -15.76%.

## **International Markets**

Throughout the quarter, the worst global financial crisis since the Great Depression walloped international markets and led to the most dramatic international government intervention since the 1930s. Emerging markets generally suffered more than developed ones, and large deficits coupled with foreign debt forced some emerging economies – including Pakistan and Hungary – to seek help from the IMF near the end of 2008. In addition, the GDPs of previously robust economies such as Taiwan, Hong Kong, South Korea and China are shrinking. This is due to a global lack of demand for their exports, blamed largely on increasing difficulty in accessing cheap capital and lower commodity prices.

Global economic policies are now focussed on containing the financial crisis amid the ongoing economic downturn; in developed markets, however, no other central bank has matched the aggressiveness of the Fed's key interest rate adjustments. In 2008, the Fed cut the key lending rate from 5.25% at Dec. 31, 2007 to 0% - 0.25% at Dec. 31, 2008. The European Central Bank, responsible for the Eurozone monetary policy, cut rates from 4.0% at Dec. 31, 2007 to 2.5% at Dec. 31, 2008 despite pressure for more drastic action. The conversion rate between the two currencies was €1 = \$1.47 at Dec. 31, 2007 and €1 = \$1.39 at Dec. 31, 2008. The Fed's drastic action has had a notable effect on strengthening the USD from its weakest point in April when €1 = \$1.60.

Throughout developed Europe, governments injected hundreds of billions of dollars into banks and financial markets to promote liquidity and to offer guarantees on deposits and bank debt. These interventions, though contrary to the free-market economies of those countries, undoubtedly staved off a wider evaporation of public and private capital.

In the fourth quarter of 2008, The MSCI EAFE Index, the pre-eminent international equity performance benchmark, finished the quarter with a return of -6.99%, with small-weighted European countries Austria, Belgium, Norway and Greece each recording negative returns in excess of -20%, thus hurting the overall combined return. The MSCI EAFE's annual return for 2008 is -28.78%.

The MSCI World, which measures the equity performance of 23 developed market indices, returned -9.03% for the fourth quarter of 2008, which brought the annual performance to -25.37%.

The MSCI EMU – the pre-eminent Europe-only equity performance benchmark – returned -9.30%, lagging behind its constituent index, the MSCI Euro, which returned -8.52%. Respectively, their 2008 calendar year performance is -33.82% and -32.88%.

The poorest performance by a developed international market for the second consecutive quarter was the

MSCI Austria Index, which lost -34.07% following a third-quarter loss of -38.32% and bringing one-year performance to -60.25%. The Belgian BEL-20 Index, heavily weighted with beleaguered Fortis and Dexia as well as brewer InBev, was also notably stricken, ending the quarter down -26.84% and bringing one-year performance to -57.66%, just ahead of the MSCI Greece (-57.48%) and the MSCI Norway (-54.86%).

The strongest national index for the quarter was the MSCI Japan, returning 5.66% as a relatively low risk exposure mitigated any severe losses. The MSCI Japan also had the top annual return, incurring a relatively small loss of, while Switzerland was the second top performer, losing -12.32% for the year.

## Emerging Markets

The world's emerging market economies displayed typically high volatility. Countries in Eastern Europe with high current-accounts deficits and foreign debts were especially sensitive to the economic downturn. Similar to last quarter, European, Middle Eastern and Latin American markets were hardest hit, whereas Asian and African markets were spared the worst. The MSCI Emerging Market index closed well into negative territory for the fourth consecutive quarter, losing -15.89% for an annual loss of -41.44%. The top performing multinational emerging market index for the quarter was the MSCI Emerging Markets Far East Index which lost -7.28%, producing an annual return of -38.09% for 2008. The hardest hit for the second consecutive quarter was the MSCI East Europe index, which lost -39.04% for the quarter, resulting in an annual loss of -61.24% for 2008. The top performing national emerging market index was the MSCI China, which returned 3.63% for the quarter while the bottom performer was Pakistan, which lost -42.35%. Pakistan and India continue to free-fall through bear-market territory with annual 2008 market index performance numbers of -67.54% for Pakistan and -55.76% for India. A small degree of these market losses reflects the rupee's recent depreciation of nearly 25% against the U.S. dollar through 2008. However, the single largest factor was capital flight from the country, with nearly \$13 billion moving out of the India Sensex exchange during 2008.

Commodity-heavy Latin American markets that enjoyed significant market surges throughout 2007 again suffered deep losses this quarter as demand dried up and commodity prices plunged. The MSCI Emerging Markets Latin America Index, which until third quarter 2008 had enjoyed eight consecutive quarters of growth, lost -23.33% during the fourth quarter, producing a 2008 annual return of -39.06%.

The global financial crisis and plummeting oil and commodity prices have caught up with the less resource-based economies of Mexico and Central America. Mexico's central bank remains focussed on controlling inflation, though its efforts are being overpowered by the depreciating peso. The year so far has been relatively stable in economic terms compared to the effects of the global downturn felt in other emerging markets, with inflation of around 7%. The MSCI Mexico lost -18.74% this quarter and -28.63% for the year.

Elsewhere in Latin America, Brazil's dependency on oil revenues resulted in such capital flight that Brazil experienced intense currency devaluation through the end of 2008 due largely to the decrease in the value of oil. The MSCI Brazil lost -27.01% through fourth quarter 2008, resulting in an annual loss of -45.03%.

The MSCI Far East – the broadest Asian-only developed country equity performance benchmark – recovered 3.81%, bringing annual performance to -15.30%. The index uses a weighting of nearly 91.5% for the MSCI Japan Index, whose gain of 5.66% relieved much of the downward pressure coming from the lesser weighted MSCI Hong Kong's return of -5.67%, and the MSCI Singapore's return of -14.38%. The MSCI Pacific Basin Index, which includes the MSCI Far East members along with Australian and New Zealand markets, returned 0.08% for the quarter as Australia's quarterly performance of -14.78% further diminished the return of this index. The MSCI Pacific Basin Index ex Japan produced a -12.77% loss, illustrating the widespread losses in the Pacific Basin.

Emerging Asian markets fared relatively well this quarter compared to their global counterparts, with double-digit losses being the exception rather than the rule. The MSCI Emerging Markets Asia Composite lost -8.89% over the quarter and -40.91% for the year, reflecting the poor performance of nine Asian Nations in the early part of 2008.

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<sup>1</sup>All numbers reflect gross index performance in Canadian currency

<sup>2</sup>Comprises 90% of the MSCI EMU, taking the largest and most liquid securities.

[↑ Back to Top](#)

## Fourth Quarter 2008

<b>IN THIS ISSUE</b>	Market Commentary	S&P/TSX Composite Sector Performance
	<b>Market Benchmarks</b>	Highlights
		Report of the Quarter

**Market Benchmarks****As of December 31, 2008 - Canadian Dollars**

	<b>QTR Ending</b>	<b>YTD Ending</b>	<b>1 Year Ending</b>	<b>3 Years Ending</b>	<b>5 Years Ending</b>	<b>7 Years Ending</b>	<b>10 Years Ending</b>
<b>Cash</b>							
DEX 91day T-Bill	0.72	3.33	3.33	3.91	3.32	3.15	3.69
DEX 30day T-Bill	0.54	2.56	2.56	3.59	3.11	2.97	3.49
<b>Bonds</b>							
DEX Bond Universe	4.50	6.41	6.41	4.71	5.54	6.16	5.99
DEX Bond Long Term	5.21	2.66	2.66	3.39	6.76	7.70	6.59
DEX Bond Mid Term	4.25	7.01	7.01	4.80	5.56	6.43	6.15
DEX Bond Short-term	4.30	8.55	8.55	5.53	4.80	5.05	5.51
DEX Conv. Res. Mort. 3	3.75	10.58	10.58	6.67	6.22	6.14	6.71
DEX Conv. Res. Mort. 5	3.55	10.55	10.55	6.40	6.44	6.70	6.91
<b>Equity</b>							
S&P/TSX Capped Comp Index	-22.71	-33.00	-33.00	-4.80	4.16	4.50	
S&P/TSX Comp Index	-22.71	-33.00	-33.00	-4.80	4.16	4.50	5.34
S&P / TSX 60	-22.68	-31.17	-31.17	-3.04	5.56	5.08	5.74
S&P/TSX Completion	-22.72	-38.78	-38.78	-9.69	1.90	3.31	
S&P/TSX SmCap	-26.79	-45.49	-45.49	-15.01	-6.28	-0.93	
BMO SC Blended Index (wtd)	-27.69	-46.49	-46.49	-13.97	-2.75	3.00	5.08
<b>Foreign Bonds</b>							
Barclays Capital Aggregate Bonds C\$	21.43	31.64	31.64	7.47	3.70	1.56	3.35
<b>Foreign Equity</b>							
MSCI World	-9.03	-25.37	-25.37	-5.89	-0.91	-2.59	-2.35
MSCI EAFE Index	-6.99	-28.78	-28.78	-5.19	1.17	0.10	-1.01
MSCI World Net	-9.17	-25.84	-25.84	-6.39	-1.41	-3.07	-2.79
MSCI EAFE Net Dividend	-7.06	-29.18	-29.18	-5.63	0.73	-0.32	-1.38
S&P 500 Total Return Idx	-9.37	-21.20	-21.20	-6.66	-3.08	-5.08	-3.51

[↑ Back to Top](#)

## Fourth Quarter 2008

**IN THIS ISSUE** Market Commentary

Market Benchmarks

**S&P/TSX Composite Sector Performance**

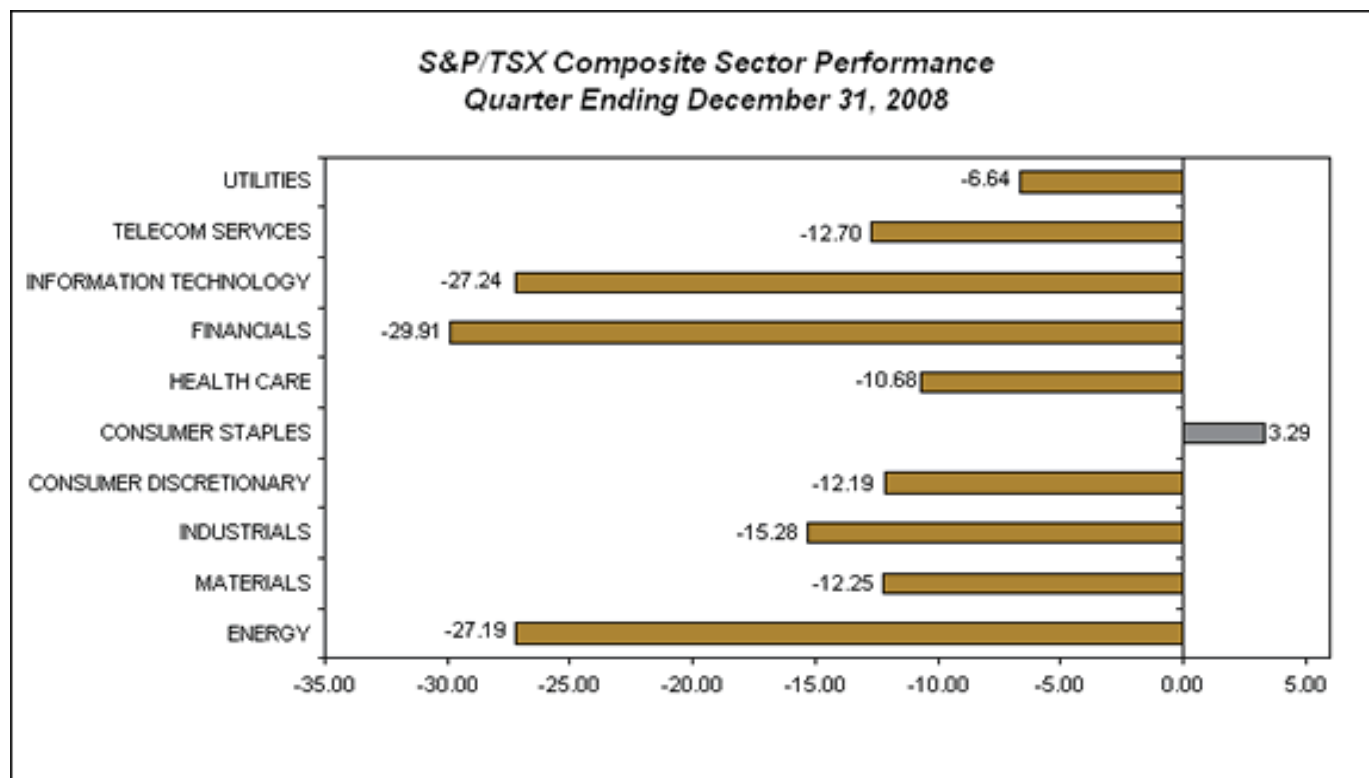
Highlights

Report of the Quarter

**S&P/TSX Composite Sector Performance**

As of December 31, 2008

CLASSIFICATION	QTR ENDING	YTD ENDING	YEAR ENDING	3 YR ENDING	5 YR ENDING	7 YR ENDING	10 YR ENDING
TOTAL GROSS OF FEES	-22.71	-33.00	-33.00	-4.80	4.16	4.50	5.34
ENERGY	-27.19	-33.88	-33.88	-8.78	10.08	12.62	16.49
MATERIALS	-12.25	-26.48	-26.48	10.22	10.49	12.27	10.19
INDUSTRIALS	-15.28	-25.06	-25.06	-1.71	2.58	-0.50	3.33
CONSUMER DISCRETIONARY	-12.19	-35.41	-35.41	-8.00	-1.31	-1.38	0.87
CONSUMER STAPLES	3.29	-6.08	-6.08	-2.10	0.50	3.31	9.22
HEALTH CARE	-10.68	-30.15	-30.15	-18.93	-15.58	-18.03	-10.38
FINANCIALS	-29.91	-36.45	-36.45	-9.33	2.06	4.73	6.69
INFORMATION TECHNOLOGY	-27.24	-54.18	-54.18	-4.73	-4.06	-10.00	-9.68
TELECOM SERVICES	-12.70	-24.85	-24.85	2.66	6.61	3.88	8.37
UTILITIES	-6.64	-20.46	-20.46	-1.62	7.58	9.72	8.78



## Fourth Quarter 2008

<b>IN THIS ISSUE</b>	Market Commentary	S&P/TSX Composite Sector Performance
	Market Benchmarks	<b>Highlights</b> Report of the Quarter

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## Highlights

### Performance & Risk Analytics Product Manager Wins Award For Excellence in Performance Measurement Writing

BNY Mellon Asset Servicing, the world leader in securities servicing, announced that analytics product manager David Asermely has won The Spaulding Group's prestigious Peter O. Dietz award for excellence in performance measurement writing for his white paper "Long/Short Portfolio Analytics." As the winner, Asermely will be invited to keynote the group's PMAR (Performance Measurement, Attribution & Risk) conference in May 2009.

Asermely's paper, published in the Summer 2008 edition of The Journal of Performance Measurement®, highlights best practices in aggregating and analyzing performance analytics for enhanced active equity portfolios – such as 120/20 and 130/30 products – and market-neutral portfolios. He worked closely with investment managers and plan sponsors for two years in researching the study. An employee since 2001, Asermely is responsible for product management within BNY Mellon Asset Servicing's Performance & Risk Analytics product line.

"We're proud of David for winning this prestigious honor and for his continual efforts to advance our thought leadership in this area," said Greg Stewart, first vice president and regional product manager at BNY Mellon Asset Servicing. "Long/short products have drawn intense market interest the past few years, and we believe David's work brings great value not only to our organization but more importantly to our clients who manage or invest in such portfolios."

Each year, The Journal of Performance Measurement's advisory board casts ballots to decide who will be the Dietz recipient. The award is named for Peter O. Dietz, whose seminal work, "Pension Funds – Measuring Investment Performance," was the basis for industry performance reporting standards. Dietz is also known for the Modified Dietz Method and other formulas to calculate rates of return still widely used today.

To read David's whitepaper in its entirety, click on the link provided below.

[http://www.bnymellon.com/news/commentaries/assetservicing/whitepaper\\_longshort.pdf](http://www.bnymellon.com/news/commentaries/assetservicing/whitepaper_longshort.pdf)

## Fourth Quarter 2008

<b>IN THIS ISSUE</b>	Market Commentary	S&P/TSX Composite Sector Performance
	Market Benchmarks	Highlights
		<b>Report of the Quarter</b>

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## Report of the Quarter

### Value Added Chart

One of the most frequently asked questions our clients ask themselves about their managers is: “How has the manager’s performance fared compared to their benchmark?”

BNY Mellon Asset Servicing developed a Value Added chart that graphically represents the value a client attains from a manager above what they would receive from passive investing.

The Value Added chart allows you to quickly determine whether a manager’s investment strategy has paid off overall, as well as the time periods in which the manager’s strategy has beat its benchmark.

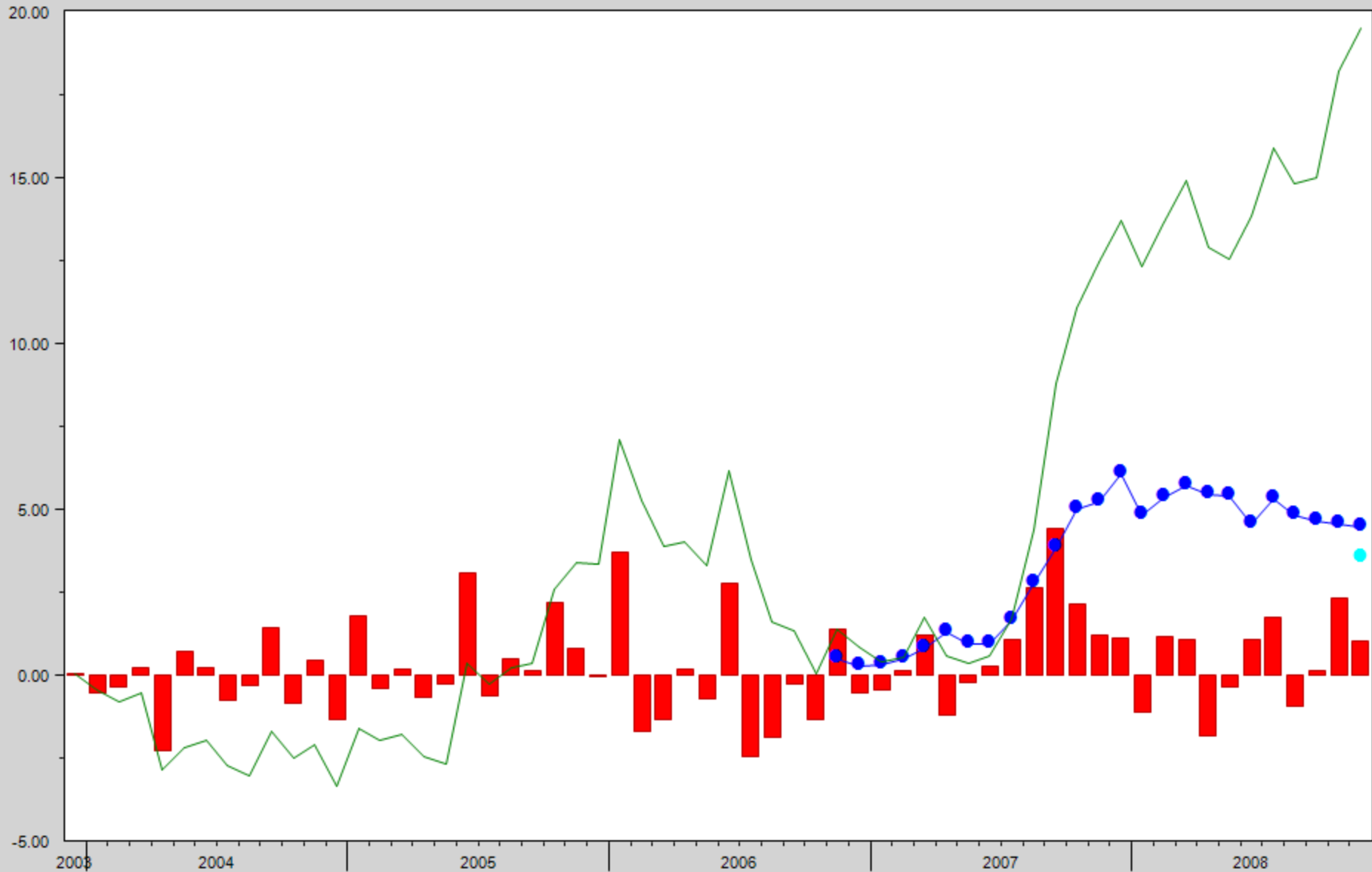
Key Features Include:

- Visually depicts the annualized and cumulative value that a manager provided compared to a market proxy.
- Gauge a manager’s performance in different investment climates by monitoring the value added for individual months, quarters and longer custom time periods.
- Specify the time period and market proxy to allow for a more meaningful comparison of the manager’s performance.

[This sample chart](#) illustrates how the investor benefited from investing with ABC Large Cap Growth Manager relative to the market proxy, Russell 1000® Growth Index, for a five-year period ending November 30, 2008. Cumulatively, the value added by Manager ABC was approximately 2,000 basis points while the annualized value added was about 360 basis points to the investor’s performance.

If you have any questions regarding this report or any of our products and services, please contact your Investment Analytics Consultant.

**ABC Large Cap Growth Manager  
5 Years Ending November 30, 2008  
Value Added**



Market Proxy: Russell 1000 Growth Index Perf Only

- Annualized since 200312
- Cumulative Value Added
- Annualized Value Added
- Value Added