LANDRY
INVESTMENT
MANAGEMENT

Market Review
Third quarter 2013

Over the past 40 years, stock market returns have been 10 percentage points higher from November to March than from May to October. But that has not been the case in 2013, with the MSCI World Index advancing 8.2% in U.S. dollars in the third quarter. This performance testifies to the strength of the force propelling the market. The rise is due to two factors. First, the U.S. Federal Reserve has changed its stance on its quantitative easing program. In the spring, Fed Chairman Ben Bernanke said the central bank would taper its bond purchases as soon as the unemployment rate improved significantly. All global markets immediately declined. More recently, Mr. Bernanke qualified his statement, saying that the Fed was evaluating a broad range of labour market indicators. The markets immediately concluded that the Fed would postpone the end of its quantitative easing program.

The second factor is the improved economic indicators, not only in the United States but almost everywhere in the world, even in Europe. There is no doubt that the financial markets are floating on a sea of liquidity. In 40 years of analyzing the financial markets, we have never seen such easy financing conditions. The interest rate spread between junk and investment-grade bonds is very narrow but, above all, the volume of financing available is impressive. Last month, Verizon Communications carried out a record bond offering totalling US$49 billion, including a 30-year tranche for no less than $15 billion! This bond issuance eclipsed the previous record, Apple's US$17-billion offering.

The U.S. stock market has reached the phase where the mergers and acquisitions departments of the large banks are taking over from investors. As long as financial conditions remain flexible, banks will generate transactions to take advantage of the fact that equities are far less expensive than bonds, pushing stocks upward until the speculative phase that marks the peak. But we aren't there yet.

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Performance in Canadian dollars	Third quarter 2013	9 months 2013
Canadian equities	6.2%	5.3%
U.S. equities	2.9%	24.0%
Europe and Pacific equities	9.1%	20.2%
Emerging markets	3.4%	-1.0%
Bonds	0.2%	-1.6%
Real estate investment trusts	-3.1%	-8.5%

Source: Bloomberg

WORLD ECONOMY

The three major economic blocs of the developed countries, namely the United States, Europe and Japan, have a synchronized easing policy. Some were predicting that a currency war would break out between the three blocs as they would devalue their currencies to stimulate exports, but that has not happened. The result is improved economic indicators almost everywhere in the world – a trend that should continue. This context does not mean we are embarking on an economic boom; it merely indicates that sustained global economic growth is foreseeable in the years to come.

COMMODITIES

The price of commodities on a global scale is a key factor affecting Canada's economic growth, the value of its exchange rate and the performance of its stock market. Canadian investors have already suffered the consequences of weak natural resource prices for three years, with the Toronto Stock Exchange underperforming the New York Stock Exchange by 54% during that period.

Natural resource prices move in a very long cycle that can last from 10 to 25 years. The last up cycle occurred from 2001 to 2011. During that period, the Canadian dollar rose by 60% against the U.S. dollar. The current weakness of the natural resource price cycle began in 2011. It may be a brief respite in the long upward cycle that began in 2001 or it may be the start of a new downward trend. It is impossible to provide a definitive forecast for long-term prices except to point out that the global economy is currently not strong enough to push natural resource prices up sharply.

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OIL PRICE

The price of crude oil is by far the most important of the natural resource prices – not only because it constitutes a mega market but, above all, because energy is a basic production cost throughout the economy. Any increase in the price of oil causes an increase in costs and, moreover, a reduction in production capacity as less-efficient plants shut down. The price of oil also has a strong impact on consumer spending because it is very difficult for consumers to reduce their energy consumption over the short term.

At the start of the 2000s, the price of a barrel of Brent crude ranged from $20 to $30. At the start of this decade, it has fluctuated from $100 to $120, even though in recent years we have gone through a major technological change with the advent of shale gas, which has increased supply unexpectedly. The additional supply provided by this new technology should stabilize prices for a few more years, but the long-term trend for the oil price is upward.

U.S. STOCK MARKET

The earnings of the companies in the S&P 500 Index are currently about $110. With the index at 1,650, large U.S. companies are trading at a multiple of 15 times earnings, a ratio roughly equivalent to its long-term average.

The positive factors for the U.S. stock market continue to be the same: tremendous liquidity in the financial system, extremely profitable companies with the strongest balance sheets of the past 30 years and a favourable economic outlook.

EUROPEAN STOCK MARKETS

While the U.S. stock market is trading at valuations comparable to its historic average, the European bourses are trading at a discount to their historic averages. Not only are these stocks less expensive than their U.S. counterparts but they offer another advantage: the earnings of European companies are far from their peak, which implies that investors may be able to take advantage of both an increase in their earnings and an increase in the multiple.

EMERGING MARKETS

Emerging markets are also trading at a discount to their historic averages but it may be too soon to increase such positions. In the current cycle, the United States was the first country to see an economic upturn, as is often the case. Europe is starting to emerge from recession but the global economy does not yet seem to be strong enough to return emerging markets to the growth rates they were recording before the 2008 crisis.

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DASHBORD

		September 30, 2013
Canada		
	Canadian dollar vs. U.S. dollar	-
	Corporate bonds	=
	Long-term government bonds	=
	S&P/TSX 60	=
	Small caps	=
	REITs	-
United States		
	U.S. dollar vs. euro	=
	Long-term Treasury bonds	=
	S&P 500	+
	Nasdaq	+
Europe		
	Euro vs. U.S. dollar	=
	MSCI Europe	+
Asia		
	Yen vs. U.S. dollar	=
	MSCI Japan Index	+
Emerging markets		
	MSCI Emerging Markets	=

= : neutral + : overweighted – : underweighted