GLOBAL CURRENTS
INVESTMENT MANAGEMENT

# Fourth Quarter 2008 – Global Equity

## Global Markets

The fourth quarter of 2008 completed a year of extreme volatility and disillusionment in the global equity markets. Despite a rally off November lows, most markets recorded significant losses for the final quarter of 2008. During the quarter, global policymakers embraced quantitative easing to help alleviate financial and credit market distress across the world. Despite significant government actions, credit markets remained strained and the global economic recession continued to run its course. At year end, investors were left to contemplate significant losses across almost all asset classes.

The MSCI World index was down -21.77% in USD terms and -9.17% in CAD terms as the Canadian dollar fell dramatically against most world currencies during the quarter. Index markets were negative across the board, with major indices in Europe reporting significant declines in local terms: Austria -42.63%; Belgium -36.36%; Italy -22.26%; and the United Kingdom -8.71%. In Asia, major country indices reported declines as reflected by Japan -22.36%, Singapore -25.69%, and Hong Kong -18.91%, respectively. In Canadian dollar terms, the Canadian market underperformed the World and EAFE markets as the S&P/TSX Composite returned -22.71% versus -9.17% for the MSCI Word Index (CAD) and -7.06% for the MSCI EAFE (CAD). Performance in emerging markets was also dismal, with the MSCI Emerging Markets Index reporting -21.99% in local terms.

From a global perspective, all sectors reflected significant negative performance over the quarter with the exception of Utilities, which provided flat performance. From a style perspective, value continued to outperform growth on a relative basis across all capitalizations, as measured by the Russell indices.

## Outlook and Positioning

As the fourth quarter of 2008 ended, investors closed out a brutal year for stocks of any kind. The breadth and depth of the declines caused a pervasive flight to the safety of US Treasuries, leaving only the government as a willing risk taker in the marketplace. The lack of confidence in the marketplace coupled with an effective credit freeze for many borrowers exacerbated an already challenging investment environment. Despite the gloom and doom of this backdrop, history reflects that equity markets often rebound well in advance of a recession's end, with performance gains that are typically significant.

Given the presence of forced sellers, illiquid markets, and the pursuit of gold and Treasury notes by investors – the need for more stability in the capital markets is evident. Despite significant government actions to date, we believe that the process of deleveraging continues. There is some likelihood that the market is under-reacting and that many companies still need to cut leverage. In short, there is more potential for transfer of assets from 'weak hands' to 'strong hands' in the marketplace. Price is the primary way markets accomplish this critical function as one party's loss is another party's bargain. New capital is generally attracted by lower prices and ultimately the markets begin to clear and normalize. As the current scenario plays out across the world's markets, unsustainable business models are being punished and the imbalances of the credit infrastructure are being corrected. Unfortunately, the process of working through this crisis has been painful and there may be more distance to travel for specific companies and sectors.

We anticipate that economic growth will be difficult to generate in most developed economies in early 2009, with the duration of the slowdown mainly a function of the speed, impact and magnitude of the economic stimulus. Clearly the contraction in economic activity around the world and the risk of deflation will provide further impetus for central bank rate cuts – with the US essentially moving rates to zero. Additionally, we anticipate that fiscal policy actions and other initiatives planned by the new US president could be beneficial if actions are taken swiftly and executed correctly. Interest rates continue to fall around the world as inflation expectations fade. Commodity prices continued to decline during the quarter, taking pressure off of consumers around the world. As true value investors, we believe that markets have begun to 'normalize' and securities are increasingly tied to their underlying fundamentals.

Currently, we are very optimistic about the prospects of specific global companies going forward. We believe stocks are oversold and attractively valued in our models. Input cost pressures are moderating. We anticipate solid opportunities for high quality firms with strong profits and dividends and strong balance sheets – i.e., the strong get stronger. We see value in virtually all sectors with a focus on seeking superior business models that combine a large margin of safety with significant recovery potential. Our research analysts are evaluating their sectors for stocks that can generate solid returns over time, including quality emerging market companies and high value-added basic industries. Although we are 'bottom up' stock pickers, we believe Asia is an extremely interesting region currently: high yields, low valuations; low expectations; solid balance sheets; and, plenty of cash. We are finding good values in Japan across all market capitalizations.

We believe we can add substantial value for our clients across a variety of market environments, and accordingly, we continue to refine the portfolio as we build a 'portfolio for all seasons.' Our outlook incorporates the potential for a range-bound market going forward, where we believe active investment management will be critical in discerning which stocks have the potential to rise over time. We believe a range-bound market can play to our strengths. Specifically, we anticipate that many companies may experience a contraction in price-to-earnings multiples and profitability during the first quarter of 2009. As this process occurs, we are identifying those stocks with earnings resilience, stable free cash flows and a quality business proposition that can deliver significant returns to shareholders over time. The market dislocation has created a near-term opportunity to build meaningful long-term positions in quality companies at very low valuations. We are satisfied that we have positioned the portfolio to take advantage of opportunities and we believe that investors who stay the course may benefit going forward.