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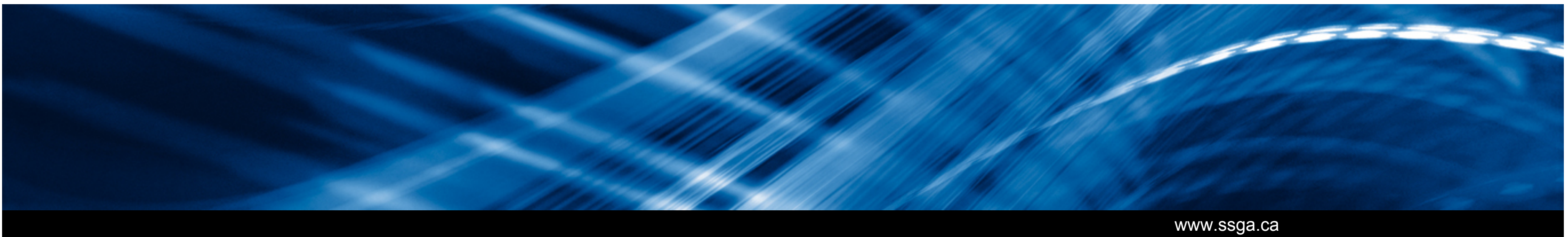

Month End Investment Commentary Report

As of 31 Oct 2012

University of Western Ontario

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Canadian Fixed Income Market Commentary

October 2012

Global Economic Background
According to the WEO, the IMF now expects the global economy to slow from 3.8% in 2011 to a sub-trend 3.3% in 2012, down 0.2 point from its July assessment. The IMF continues to expect the recovery to be sustained and even improve next year, but it now expects 2013 growth to come in no better than trend at 3.6%-three ticks weaker than it forecasted in July and fully a half point weaker than the April forecast. Moreover, the deterioration in the IMF's global forecasts are broad-based with growth in both advanced and emerging economies tracking much weaker than expected earlier this year. Notably, a deeper than expected European recession this year and profoundly anemic recovery next year, along with a more severe slowdown across Asia-Pacific, will keep advanced economy growth at a disturbingly sluggish 1.3% in 2012 and just 1.6% in 2016. And more severe and persistent slowing across China, India and Brazil will slow overall emerging economy growth from 6.2% in 2011 to well below 6.0% in both 2012 and 2013.

Although the downgrade in the IMF's forecast is frankly not all that surprising (after all we and most other forecasters have been progressively downgrading our outlooks all year), what heightened the negative tone of the WEO was its assessment that the outlook has become much more uncertain and that the "risks for a serious global slowdown are alarmingly high." Specifically, it estimates the probability that growth in the global economy could slow to below 2.0%-effectively a global recession, which has occurred only four times in the last four decades-has shot up from a modest 4% in April to a worrisome 17% now. Although the possibility of a hard landing in China is arguably part of this downside risk, the IMF focuses its attention on potential negative shocks associated with a worsening of the euro crisis, the US fiscal cliff and perhaps another debt ceiling debacle, and even a new oil shock.

Canadian Economic Background
The September jobs report was a positive surprise. Specifically, employment rose a robust 52,100, the strongest print since April. Moreover, this gain followed a solid 34,300 rise in August. Overall job creation has been distinctly choppy during 2012, and the roughly 23,400 average monthly pace is consistent with no better than labor market stability. Indeed, the unemployment rate has been range bound between 7.2% and 7.6% all year.

Inflation remains benign. Consumer prices (CPI) rose a moderate 0.2% (seasonally adjusted) in September, down from a 0.4% rise in August. The Bank of Canada's (BoC) core index (which excludes changes in indirect taxes and eight typically volatile items including food and energy) was unchanged on the month. Year-over-year, the CPI inflation rate remained unchanged at 1.2% and core inflation actually fell three ticks to 1.3%, keeping both well below the BoC's 2.0% target but within the 1.0-3.0% inflation control zone.

As expected, the Bank of Canada left is policy rate unchanged at 1.00%. But it struck a more hawkish tone in its policy statement, opining that "some modest withdrawal of monetary policy stimulus will likely be required" (emphasis added). The Bank appears to be more confident that a moderate recovery will be sustained and that the output gap closed in the next year. However, the timing of the "required" rate hikes remains unclear. Although the BoC opines that the global economy is evolving as expected and that "financial conditions have improved," it still believes that "sentiment remains fragile," highlighting the downside risks to the outlook. Consequently, we continue to believe that the BoC will probably not tighten until the second half of 2013 at the earliest.

The BoC also released its quarterly Monetary Policy Report this week, in which the Bank made only modestly changes to its economic outlook for the next couple of years. Specifically, it now forecasts GDP growth of 2.2% in 2012 (up from 2.1% in the July report), 2.3% in 2013 (unchanged), and 2.4% in 2014 (down from 2.5%). Just as in the July forecast, this recovery profile is only slightly stronger than the BoC's assessment of potential growth (2.0-2.2%), which means the economy should close the remaining modest output gap (estimated at 0.7% of GDP in Q3) only slowly and therefore won't return to full employment before late in 2013. Consequently, the Bank's expectations for inflation are benign-likely running below the 2.0% target until the end of next year.

Retail sales rose a moderate 0.3% in August, following a solid 0.7 % gain in July. These were the first back-to-back gains since last fall. However, the details of the report were far from inspiring. Indeed, the largest (2.9%) gain came from gasoline stations, which likely reflected higher prices. Abstracting from this, retail sales would have slipped 0.1%.

Canadian Bond Market
Following two consecutive positive quarters, the DEX Universe Bond Index TM marked a slight pause in October and closed the month down -0.19%, which brings year-to-date total return of the index to 3.10%. Government of Canada bond yields ended the marginally higher, with the 10 year Government of Canada benchmark rate closing the month at 1.79%, up 6bps for the month.

As can be expected in a rising rate environment, sectors that suffered the most from rising rates where those with the longest duration such as Provinces and Infrastructures, which lagged the broad index with negative returns of -0.43% and -0.55% respectively for the month while Industrials, Telecoms and Securitisation sectors led the way, up 0.24%, 0.21% and 0.21% respectively.

Inflation linked bonds outperformed their long term nominal peers by 0.76% as DEX Real Return Index™ returned -0.01% in October while real yields rose by 2 bps to close the month at 0.15%, which now brings long term breakeven inflation to 2.00%, up 4bps from September 28th levels.

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Performance shown is gross of fees and expenses.
CanPE-0353

SSgA Enhanced Canadian Universe Bond Fund Investment Commentary

October 2012 performance attribution (bps)

Dura.	Curve	Corp.	Provi. / Agencies	Carry	Others	Month Total
-1	+1	0	-1	0	-2	-3

Past performance is not a guarantee of future results.

The SSgA Enhanced Canadian Universe Bond Fund returned -0.22% in October, underperforming the DEX Universe Bond Index™ by 3 basis points (bps). Overall, the underperformance of the fund for the month can be attributed to our overweight to specific issue in the agencies sector as well as to a reversal of the September month-end accrual effect at the index level.

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SSgA Canadian Short Term Investment Fund Commentary

October 2012

The Canadian Short Term Investment Fund returned 0.11% for October, outperforming the DEX 91 Day T-bill Index™ by 2 bps. The fund's performance for the period is explained by the positive yield carry of the fund over the index which has more than offset transaction costs. As of October 31st 2012, the Fund had an average term to maturity of 30 days for an annualized yield of 1.24%, compared to 91 days and 0.97% for the Index.

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US Markets Investment Commentary

October 2012

Overview and Outlook

After enjoying the robust returns promoted by proactive policy maneuvers during the third quarter, investors seemed understandably nervous that October might prove more challenging, especially in light of its checkered seasonal heritage. Volatility nevertheless remained mild through the early autumn, and financial assets endured nothing worse than choppy trading that led to lackluster monthly results. While October opened reasonably well, with equities buoyed by a fresh rate cut in Australia and signs of improving activity in the US, a surprising drop in the US unemployment rate from 8.1% in August to 7.8% in September marked a short-term peak in sentiment on October 5. Share prices ebbed through the following week after the International Monetary Fund trimmed its global growth forecast for both 2012 and 2013. The onset of quarterly earnings reports prompted equities to bounce back during the middle of the month amid warmly received profit news at several financial firms. That aura dissipated quickly, however, after earnings results and outlooks at many technology companies seemed unusually bleak. Consumer and industrial names were hardly immune from disappointment, as sliding prices for metals and energy corroborated concerns that scattered hints of economic improvement in Asia would not be able to compensate for tepid western demand. Still, activity data was not weak enough to inspire any meaningful progress in bonds, even after the brutal destruction unleashed by Hurricane Sandy hobbled New York and New Jersey at the end of the month. Investors thus found worthwhile returns scarce during October, but despite mixed earnings news and ongoing fiscal challenges in the US and Europe, the clear commitment of major central banks to financial stability seemed to keep the downside risks contained.

Equity returns during October were uneven, as benign financial conditions and hints of macroeconomic improvement had to compete with a sense of gathering headwinds for corporate revenues and earnings growth. Still, with the vast majority of equity benchmarks around the world having posted solid third-quarter gains that lifted them to nicely positive year-to-date returns, one could easily view the consolidation through October as a healthy result for a period that often invites risk reduction in preparation for year end. Gravitational forces seemed a little stronger in US equities, despite heartening news on retail sales, consumer confidence, and housing starts. Ironically, the resilience of US spending may have prompted global investors to eschew the perceived sanctuary of the US in favor of more aggressive equity positions internationally. Even though eurozone activity indicators remained distinctly sluggish, stability in peripheral bond markets lent cheap equity valuations an increasing allure. And third-quarter GDP figures in the UK, which reflected 1.0% growth for the period, were a refreshing surprise. Signs of improvement also arose from China, where retail sales and manufacturing data outpaced expectations and allayed fears of any imminent collapse in activity levels. A healthy October rebound in MSCI China offset measurable equity pullbacks in Taiwan, India, and Russia, allowing the MSCI Emerging Markets Free (EM) Index to limit its October loss to 0.6%. The MSCI World Index of developed equity markets fared slightly worse, conceding 0.7% for the month, but without an unusually weak showing from US equities, the World Index would have risen by 0.7% instead. Equities in the MSCI Euro Index, even amid continued tense negotiations on aid for Spain and Greece, added 2.6% for October to extend their year-to-date performance to 13.6%. Over the same period, MSCI World has advanced 12.3% and MSCI EM has climbed 11.3%.

Fixed income continued to exhibit negative correlation with equities during October, as yields and share prices tended to peak and bottom together. But by the end of the month, bonds and stocks shared similarly lukewarm results. Most major government yields increased by no more than 10 basis points for the month, with intermediate maturities in the UK providing an exception that stretched to 15 basis points in light of solid British growth for the third quarter. Australian yields were also a bit jumpy as the term structure steepened following the somewhat unexpected rate cut from the Reserve Bank. But the more interesting bond action showed up in higher-yielding situations. Peripheral eurozone yields eroded further, despite Spanish delay in making a formal request for financial aid. For the moment, confidence that help will be available when needed has continued to preserve solid market access for the more troubled euro sovereigns. Corporate bond yields declined during October as well. Even though equities stayed restless, low volatility and adequate economic figures ensured persistent demand for incremental yield, driving spreads to tighten far enough that in many cases, yield levels actually ended the month lower. The end result was respectably positive returns for credit-oriented bond benchmarks, while most government debt indexes finished the month with small losses. Investors who held broad positions in non-US bonds on an unhedged basis saw modest currency weakness erode the mild benefits of exposure to the smaller European markets where yields continued to decline.

As we approach the closing stretch of 2012, financial assets have already delivered impressive returns for a year that has seen lackluster global growth, palpable financial stress in Europe, and plenty of simmering tensions across the Middle East. Moreover, while our political leaders have deftly managed to prevent these situations from deteriorating in a disorderly fashion, the attendant uncertainties persist. Volatility measures are nevertheless signaling little in the way of trouble in the near term. For the eurozone, broad completion of 2012 financing and benign yield behavior suggest that stability can continue into 2013. Meanwhile, leadership transition in China has been unfolding smoothly enough for growth indicators there to perk up. Perhaps the more perilous shift will arrive in the US, depending on the outcome of the closely contested elections on November 6, where not only the presidency but also the configuration of Congress remain exceptionally close calls. Investors have been contemplating for many months the deep fiscal retrenchment that will restrain growth in 2013 if legislators cannot adopt remedial measures, but there are enough difficult combinations of electoral and policy outcomes that confidence could still suffer noticeably before we reach the end of the year, particularly when earnings estimates for the next 12 months already seem too optimistic. Share prices may nonetheless continue to draw support from the same combination of factors that have already provided such impressive resilience during 2012: widespread investor caution that has kept positioning defensive; ongoing search for both present and future income; expensive bond markets that offer little long-term appeal aside from their ostensible stability; and perhaps most of all, unmitigated central bank accommodation. Even if minimal interest rates and maximal rhetoric have done little to heal the imbalances in major economies, they continue to provide meaningful support for security prices, leaving investors to weigh the risks of holding stocks and bonds against the potential costs of avoiding them.

US Equities

Solid data from purchasing managers and news of resilient auto sales allowed US stocks to begin October on a firm note, building further on four consecutive monthly gains. But major averages encountered resistance as firm September employment data drove them close to five-year highs, and a batch of downbeat comments from corporations heightened anxieties at the onset of quarterly earnings reports. Although buoyant profit news from a number of banks allowed share prices to rally toward their highs again at mid-month, disappointing results and outlooks from blue-chip names in other sectors soon sank equity averages down to fresh lows for the month. Credit downgrades of several Spanish regions helped dent budding optimism on the euro, allowing the US dollar to gain strength and curb risk appetites towards the end of the month, but share prices managed to resist further damage as Hurricane Sandy approached the US Northeast. While the storm proved every bit as destructive as advertised in the New York City area, and US stock trading needed to close completely on both October 29 and 30, firm September data on consumer spending helped equities finish the month with a hint of optimism. Major US averages still ended their Halloween session cowering near October lows, and the S&P 500® conceded 1.8% for the month. That outcome represented the first monthly loss since May, but it only trimmed the year-to-date return on the S&P back to 14.3%.

The early autumn lethargy in US stocks cut a broad swath, limiting returns across all capitalization tiers. Many of the largest companies, often citing international demand concerns, offered little protection from lackluster earnings reports. The Dow Jones Industrial Average slumped 2.4% for the month, its higher dividend yield failing to overcome profit disappointments among many constituents. The Russell 2000® Index of smaller stocks also underperformed the S&P 500, shedding 2.2% in October, as a number of biotechnology names endured sharp monthly declines. The Russell 2000 remains a mild year-to-date laggard, with a return of 11.8% since the start of 2012. While the Russell 2000 stayed choppy through the month, the S&P Midcap 400 Index™ showed some natty resilience towards the end of October, limiting its decline to 0.8%. Healthcare weakness hurt the mid cap benchmark as well, but a number of sprightly industrial names helped steady the overall index. Since the start of 2012, the Midcap 400 has now added 12.9%.

With financial stocks showing their mettle in October, value-oriented portfolios notched noteworthy outperformance, snatching year-to-date leadership away from growth styles, which took some ugly hits in the technology arena. The Russell 1000® Value Index slipped just 0.5% for the month, retaining a year-to-date gain of 15.2%, while the Russell 1000® Growth Index sank 2.9% during October, paring its performance since the start of 2012 back to 13.4%. The divergences were similar on the small cap side, as the Russell 2000® Value Index conceded 1.3% in October, but the Russell 2000® Growth Index slumped 3.1%. On a year-to-date basis, value styles built further on the lead that they established during September. Russell 2000 Value has now climbed 12.9% since the start of 2012, while Russell 2000 Growth lags behind with a 10.5% year-to-date return.

Only two sectors in the S&P 500 managed positive returns during October, and the financials led the way with a 1.9% advance for the month. Boosted by decent earnings, favorable credit conditions, and rising optimism about US housing prices, the latest advance in the financials cemented the 2012 leadership position of the sector, which now sports a snazzy year-to-date return just shy of 24%. The only other group to move higher for October was the utilities, which had room to rebound after a sluggish summer. Their 1.4% October gain lifted the utilities to a 5.8% year-to-date advance, allowing the sector to overtake energy, where a 1.9% loss trimmed the 2012 return to 5.5%, a figure that represents the weakest S&P sector performance since the start of the year. More painful losses in October afflicted the information technology sector, which dropped 6.7%, and the telecommunications services group, which gave back 4.3%. Within technology, shares of computer makers had a rough month, as several firms came through with lackluster profits. Even stock in the mighty device maker Apple could not avoid unwelcome spoilage, suffering its first double-digit monthly decline in nearly five years. Profit disappointment also weighed on telecom issues, but the group retains a 20.5% gain since the start of 2012, good enough for second place among the ten S&P sectors. Third place on a year-to-date basis now lies with the impressively consistent consumer discretionary sector. Even though discretionary as a whole slipped 1.6% in October, several housing-related names contributed solidly positive returns, and the sector now shows a year-to-date advance of 19.5%.

Global Fixed Income

Government bond markets around the world, like most equity averages, experienced a consolidation period during October. While yields for the largest sovereign borrowers were already accustomed to narrow fluctuations, given tepid growth prospects on the one hand and historically low yield levels on the other, the pioneering monetary plans of the European Central Bank also kept the term structures in the more beleaguered eurozone nations from suffering unpleasant volatility. For unhedged investors in global debt instruments, currency fluctuations were likely a greater source of angst. As October wore on, the US dollar gradually strengthened, picking up pace later in the month. A growing sense that the US Federal Reserve, having already committed to open-ended mortgage purchases, might not have much more to offer anytime soon, may have lent support to the greenback. At the same time, the euro and the yen had cause for weakness. After the euro rallied vigorously through the summer and even into early fall, further gains could hurt much needed competitiveness in the eurozone. In addition, uncertainty about the timing of a formal aid request from Spain, where the unemployment rate reached a record level north of 25%, has put the euro a bit more on the defensive. As for the yen, continued economic languor and hard-pressed exporters have traders wondering if the resolve of the central bank may finally bend. The Bank of Japan did add to its asset purchase program towards the end of October, but given the business woes at several major Japanese electronics firms, the potential for even more aggressive action would seem to remain.

The global tendency to lower official interest rates continued during October, with Australia easing early in the month, and Brazil and South Korea following suit in the subsequent week. A handful of smaller countries, including Hungary, Thailand, and the Philippines, also trimmed interest rates during the course of the month. While government bond markets around the world seem visibly expensive relative to the last several decades, the global bias to accommodation continued to make selling bonds a frustrating exercise. Fixed income volatility stayed muted throughout October, with the only notable bursts of excitement coming from the eurozone periphery, where building confidence in the resolve of the European Central Bank made Spanish, Italian, and Portuguese yields hard to resist. Even though Spain continues to delay its acceptance of a formal aid program, fearing the loss of fiscal flexibility that it would entail, the knowledge that support is available if needed has been enough to entice income-hungry lenders into the debt of the more troubled sovereign borrowers. Unfortunately, these October success stories were not enough to compensate for modest yield rises in other countries and in the case of unhedged investors, for the bouts of currency weakness that afflicted the Japanese yen, the Swedish krona, and the Canadian dollar. As a result, the Citigroup World Government Bond Index (WGBI) endured a modest 0.6% loss during October, trimming its year-to-date advance to an unexciting 2.8%. The US Treasury market contributed a small amount to the monthly WGBI loss, as the Barclays Capital US Treasury Index slipped 0.2% in October. But the Treasury Index has added just 1.9% since the start of 2012, making it less profitable than the WGBI on a year-to-date basis.

Echoing the ongoing resilience of sovereign debt in southern Europe, corporate debt enjoyed a nicely prosperous October as well. While equity investors fretted over margin compression and revenue sustainability in the latest earnings reports, corporate bond buyers stayed calm in the knowledge that these details would have scant impact on their fixed coupons. Because many corporate bond spreads still look generous relative to the levels of absolute government yields, it was easy for those spreads to continue compressing. The moves were large enough in the US that even though Treasury yields climbed slightly over the course of October, most corporate bond yields ended distinctly lower, and the Barclays Capital US Corporate Index added an impressive 1.3% for the month as a whole. Agency-backed mortgages, however, after reacting vigorously to the Fed's mid-September announcement of regular purchases, spent October retreating from those earlier gains. With average prices more than 8% above par, investors seemed nervous about how damaging increased prepayment speeds could become. Even with its steady income, the Barclays Capital US MBS Index slipped 0.2% during the month, matching the Treasury Index decline, and giving back almost all of its September gains. Still, the MBS Index is ahead by a solid if unspectacular 2.6% since the start of 2012. The small losses in government and mortgage issues held back the Barclays Capital US Aggregate Bond Index during October, but thanks to the strong showing from corporate issues, the Aggregate climbed 0.2% for the month. This represented its seventh monthly advance in a row, lifting the year-to-date gain for the Aggregate Index to 4.2%.

In spread terms, non-investment-grade debt found progress in October to be a bit choppier than the sustained tightening that occurred on the investment-grade side, as lackluster corporate earnings trends could pose greater concern for less established borrowers. Nevertheless, yield spreads on high-yield bonds still narrowed slightly over the course of the month, and holders of the debt continued to clip coupons that seem low historically but remain irresistibly tempting against a backdrop of minimal official interest rates. Robust investor demand for stable income has allowed issuers of high-yield paper to sell bonds with less desirable features, but as long as risk appetites stay firm and credit conditions remain benign, weaker covenants and payment-in-kind options may not become problematic. Ample coupon levels allowed the Barclays Capital US High Yield Index to crank out a solid 0.9% gain for October. Although this result was the benchmark's weakest since May, when equity dislocations helped sink the High Yield Index to a monthly loss, it was more than enough to satisfy holders looking for alternatives to investment-grade paper, which at intermediate durations, barely clips 15 basis points per month. Even more impressively, the High Yield Index has climbed 13.1% since the start of 2012, keeping close pace with most equity averages.

Alternative Assets

Shares in US real estate investment trusts (REITs) stumbled out of the gate in the fourth quarter, but they quickly attracted fresh sponsorship as other equities held firm and their weak finish to the third-quarter appeared to catch the attention of bargain hunters. Real estate stocks then held to a narrow range until mid-October, when solid earnings from several financial companies boosted them to their highs for the month; releases of loan reserves at major banks seemed to encourage optimism regarding property values. But REITs could not hold their gains after earnings reports from other sectors began looking less consistent. Corporate caution ahead of the presidential election and subsequent fiscal cliff prompted increasing concerns about demand for lodging and office property, two areas that were notably weak during October. The Dow Jones US Select REIT Index℠ lost value steadily towards the end of the month, touching a four-month low before bouncing back on the final day of October. With a 0.9% decline for the period, the US REIT Index fell only half as much as the S&P 500 for the month, but its year-to-date return of 13.4% still represents modest underperformance of large cap US equities. Property stocks outside the US, by contrast, continued to build on their 2012 strength during October, turning in a fifth consecutive monthly gain. Indeed, having suffered only one losing month in the last ten, the non-US real estate sector has advanced by more than 30% on a year-to-date basis.

Commodities had a rough October, giving back a large chunk of their summertime progress, as unexpected resilience of the US dollar deflated earlier hard-asset enthusiasm that had arisen from the aggressive quantitative easing plans of the US Federal Reserve and other central banks. Despite the open-ended mortgage buying program at the US Fed, poor economic conditions in Europe and Japan took a toll on their currencies. Crude oil traded lower for a second consecutive month on ample inventories, and industrial metals gave back the bulk of their September gains as stockpiles remained bloated; nickel and zinc prices declined by double digits on the month. Precious metals held up slightly better, but still conceded more ground than most equity markets. Agricultural commodities were somewhat more stable, with corn nearly flat for October. Among the few winners for the month were lumber, which surged on signs of strength in housing; cattle, which gained on firm beef demand and worries about future supply; and natural gas, which rallied with the onset of colder weather. Reflecting the broader retreats, however, the S&P GSCI® Commodity Index slumped 4.1% in October, dropping it back to a 0.7% loss position since the start of 2012. As for the Dow Jones-UBS Commodity Index℠, its 3.9% October decline was similar, but it is hanging onto a thin 1.5% advance on a year-to-date basis.

October commodity weakness took a toll on inflation expectations in eurozone countries, but they held in much better in Anglo-Saxon nations. Since nominal yields moved little over the course of the month in most government markets, real yields accordingly climbed in France and Sweden, but they held in much steadier or even slipped in the US and the UK. With recent inflation prints driving decent income accruals, inflation-linked bonds enjoyed respectable October returns. In the US, Treasury inflation-protected securities (TIPS) continued to exhibit deeply negative real yields at all maturities within ten years. Although shorter-term real yields were higher for the month, their longer-term counterparts remained under downward pressure, and the Barclays Capital US TIPS Index climbed 0.9% to extend its year-to-date advance to 7.2%. Linker benchmarks outside the US did slightly less well, held back by several real yield increases in Europe and mixed currency performance. But thanks in part to currency resilience earlier in 2012, year-to-date returns for non-US inflation-protected debt have climbed into the low double digits.

Sources: Bloomberg, FactSet, Morgan Stanley, JPMorgan, RBS, Credit Suisse, Citigroup, SSgA Performance Group, MSCI

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