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Taking Stock with Steele

Your Monthly Newsletter

The purpose of this newsletter is to share insights and expertise. Our goal is to ensure that our clients are well-informed of changes affecting local business decisions and our investment recommendations. We believe Knowledge Pays and we want our knowledge to help pay for you.

ECONOMIC TIDBITS *AN INVENTORY OF NOTABLE DATA AND INFO*

- Since our last newsletter, equity markets are mostly unchanged. Uncertainty surrounding the Greek election, a bank bailout in Spain, spiking Spanish and Italian bond yields and poor economic data were offset by improved odds of monetary stimulus across the globe.
- Global economic growth continued to contract in May, though only slightly. The biggest surprise was in Chinese manufacturing, with the May PMI data coming in at 50.4, very close to breakeven, provoking worry about a near-term contraction in Chinese manufacturing activity. Chinese policymakers cut interest rates by 25 bps in response to slowing economic growth.
- Greek elections ended in a New Democracy party (aka pro–bailout party) victory. The election result should ease the risk of a disorderly Greek exit from the Eurozone however the Greek economy remains in disarray. The focus will likely shift to Spain as its economy continues to contract and its budget deficit lingers well above the EU target. <u>*See Fig. 1 for chart of Spanish 10-year bond yields.*</u>

LE JIT A "JUST-IN-TIME" RUNDOWN OF OUR CURRENT INVESTMENT THEME

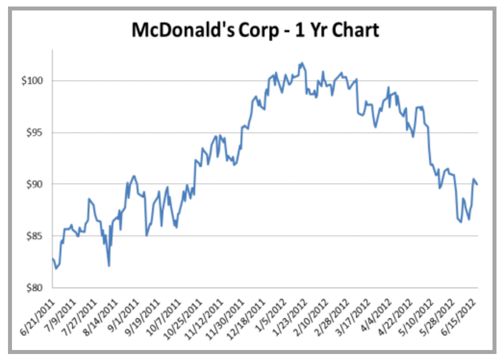
Still Defensive Though Consumer Discretionary Interesting

- A defensive stance is merited but various individual stocks within the frothy sectors have pared gains and are looking somewhat attractive
- This highlights a key tenet of investing – if you are bearish on the broad market don't become bullish on a single stock, and vice versa
- We will continue to closely watch these "special cases" and will become interested in buying when the market outlook has improved
- **McDonald's Corp (MCD)** and **Glentel Inc. (GLN)** are two investment ideas related to this theme:
  - McDonald's franchises and operates fast-food restaurants in 119 countries on six continents. <u>*See Fig. 2 for 1-year chart.*</u>
  - Glentel operates four branded wireless retail operations in North America, providing telecom services to individuals and businesses. <u>*See Fig. 3 for 2-year chart.*</u>

Fig. 1

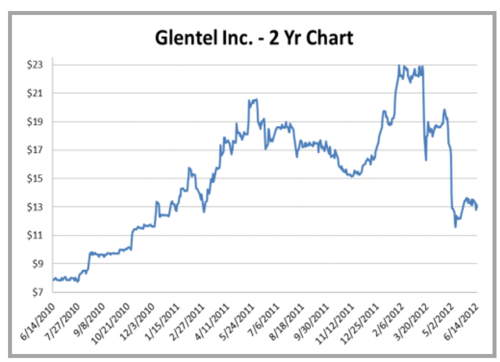
Data Source: Bloomberg.com

Fig. 2



Data Source: Market-Q

Fig. 3



Data Source: Market-Q

RIDING THE CURVE *A CATALOGUE OF OUR MONTHLY FIXED INCOME FAVOURITES*

Pembina Pipeline Debenture C Maturing on Nov. 30th, 2020 (PPL.DB.C)

- Pembina operates and services an energy transportation network in North America
- This is an 8.5 year debenture with a conversion price of $28.55 (current: $26.80)
- This debenture yields 4.66% until maturity at a current trading price of $107.50

Sun Life Financial Perpetual Preferred C (SLF.PR.C)

- Sun Life is a worldwide provider of protection and wealth accumulation products
- At $21.80, the issue has a yield of 5.1% versus the yield on bank perpetuals of ~4.4%

THE BIG PLAN SOME PERSPECTIVE ON MARKET PERFORMANCE AND DIVIDENDS

The 1982-2000 period provided equity investors with the best risk-adjusted returns of all time (~15.4% real total annual return with little volatility). This period has skewed investor return expectations with the average U.S. state and corporate pension plans anticipating a long-term nominal equity return of ~11% nominal and ~8% real (assuming a 60/40 mix and long-term bond returns of 3.5%). (Credit Suisse, 2012)

In reality, since 1871, annual equity returns came in at ~8.5% nominal and ~6.4% real, as measured by the S&P 500. Due to the number of the wars in the years before 1871, long-term equity returns would likely be even lower if index data existed for the pre-1871 period. It is also fair to mention that the S&P 500 is a somewhat aggressive index (relative to the DJIA and FTSE which had lower returns since 1871).

Additionally, **since 1871, the periods of 1942-1968 and 1982-2000 (~31% of the time) accounted for ~91% of all capital appreciation**. If you were only invested for the other 69% of the time, your return would be a measly 4.8% nominal and 2.7% real. So what will your return look like if you only get the opportunity to invest in a stagnant market environment? Very poor if you are not collecting dividends, which have been ~4.45% annually in the long-run.

This nonlinearity of equity returns makes one thing abundantly clear – collecting dividends allows you to achieve a positive real return in most market environments. **Dividends have accounted for ~52% of equity returns** over the past 141.5 years and they provide you with a return, even when the market is stagnant, its normalized state.

What else do these stats hint at? In the long-term, owning cyclical companies that pay immaterial dividends depress equity returns. As Canadian investors, it is important to remember that commodity supercycles eventually end. One should maintain a trading mindset when investing in this sector. Additionally, it is important to determine whether a stock or sector is strong enough to withstand competition, innovation and economic malaise. Dividend payers are typically in proven sectors that have longevity.

returns listed above were drawn from http://www.econ.yale.edu/~shiller/data.htm

JEANNINE'S TIP O' THE MONTH – TIP DELAYED UNTIL THE JULY ISSUE; STAY TUNED!

Current Rates & Data

Govt of Canada	
90 day	0.87%
1 year	0.91%
2 year	0.92%
5 year	1.16%
10 year	1.70%
30 year	2.33%

U.S. Treasury	
90 day	0.09%
1 year	0.17%
2 year	0.29%
5 year	0.67%
10 year	1.57%
30 year	2.66%

Canada Prime Rate
3.00%

U.S. Prime Rate
3.25%

Canada CPI Y-o-Y (Apr)
2.00%

U.S. CPI Y-o-Y (Apr)
2.30%

Exchange Rates	
CAD/USD	0.973
USD/EUR	1.26
JPY/USD	78.9

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All rates mentioned within this newsletter are as of June 18th, 2012, unless otherwise stated.