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Taking Stock with Steele

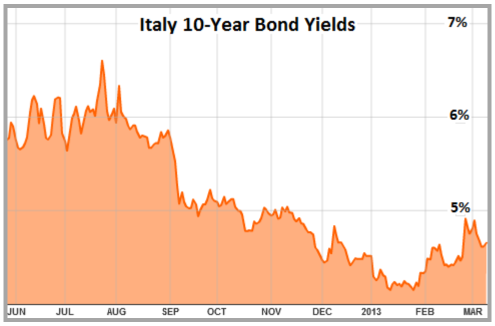
Your Monthly Newsletter

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*

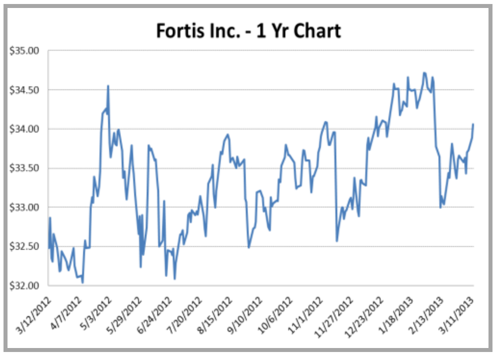
- Since our last newsletter, equity markets were mixed. On the back of strong jobs, manufacturing and services data, the Dow Jones Industrial Index hit an all-time high and the S&P 500 Index made fresh 5+ year highs. The S&P/TSX Indices were even for the month as commodity prices fell and the Canadian economic outlook remained poor aside from data showing a strong jobs market in February.
- U.S. and Japanese markets appear to be on their own these days, making all-time and 4.5 year highs, respectively, as markets were supported by strong economic data and central bank pledges to swamp their economies with monetary stimulus. On the other hand, European and emerging markets were relatively weak as economic data generally came in below expectations, central banks persisted on being cautious with stimulus plans and an Italian election was inconclusive with Euro-skeptic, anti-reform parties securing the majority of the votes. <u>*See Fig. 1 for a chart of Italy 10-yr bond yields.*</u>
- U.S. policymakers have yet to address the Sequester which is set to reduce government spending by ~$120 billion annually. Though the Sequester deadline was on March 1st, it is likely that cuts will have little effect until March 27th, when government agencies lose access to funding. Though the market's rally shows it is unfazed by the looming cuts, its resolve will be tested should the cuts take place.

Fig. 1



Data Source: Bloomberg.com

Fig. 2



Data Source: Market-Q

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

Rally is Getting Tired, 'Sell in March' May Trump 'Sell in May'

- Canadian and U.S. equity markets are up ~9% and ~16% in the past 3 months, respectively, and the seasonally weak period approaches
- May be prudent to shift into defensive names earlier this year
- **Fortis Inc. (FTS)** and **Shoppers Drug Mart (SC)** are two investment ideas related to this theme:
  - Fortis operates an electricity and natural gas distribution utility business in Canada. <u>*See Fig. 2 for 1-year chart.*</u>
  - Shoppers licenses retail drug stores in Canada under the banners Shoppers Drug Mart and Pharmaprix. <u>*See Fig. 3 for 2-year chart.*</u>

Fig. 3

Data Source: Market-Q

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

Liquor Stores N.A. Debenture A Maturing April 30th, 2018 (LIQ.DB.A)

- Liquor Stores own and operates retail liquor stores in Canada and the U.S.
- This is a 5.1 year debenture with a conversion price of $24.90 (current price: $18.50)
- This debenture yields 4.30% until maturity at a current trading price of $107

MARKET VALUATION ARE EQUITIES CHEAP, EXPENSIVE OR SOMETHING IN BETWEEN?

We are never short on those who believe equities are cheap and those who believe equities are expensive. We'll attempt to rationalize both beliefs below.

Data Supporting the 'Equities are Cheap' Stance

Most bulls will cite equities as being cheap relative to "forward earnings" (average analyst earnings estimates for the upcoming year). The forward P/E (price/earnings) multiple for the S&P 500 is currently 13.5x, below its long-term average of 15x. Moreover, investors have remained underinvested in the stock market during the Great Recession and greater equity market inflows will support equities going forward.

Rebuttal: Analysts are innately aggressive in their estimates and the 13.5x forward earnings multiple includes an assumption for 10.5% annual earnings growth. With zero earnings growth in 2012, the broad assumption that earnings will quickly rebound seems optimistic. As for equity underinvestment, the effect of equity inflows is trivial as every buyer of stock is offset by a seller who receives cash for his or her shares.

Data Supporting the 'Equities are Expensive' Stance

Defensive investors ignore analyst estimates and maintain that the best way to measure equity market valuation is past earnings. The S&P 500's trailing P/E is 17.5x, above its long-term average of 15x. In addition, corporate profits are at an all-time high as a % of GDP due to the widespread downsizing seen in 2008-2011, record low interest rates, a low household savings rate and historic levels of government deficit spending, all artificially inflating earnings. In an attempt to remove abnormalities in corporate profits and reduce the short-term focus of traditional P/E indicators, many investors look to the Schiller PE10 Index. The PE10 index currently sits at 23x, well above its long-term average of 16x. Based on this indicator, those who consider themselves deep value investors should exercise extreme caution at this time.

Rebuttal: Past earnings don't reflect future growth and can underestimate value. Valuing equities based on normalized corporate profits ignores the effects of long-term trends like outsourcing and that profits may remain above average for a long time.

Where Does Steele Wealth Management Stand?

Data shows it is important to remain invested in a diversified portfolio and we would only support minor adjustments to asset allocation in response to market valuation. We do see reason for added caution as equities continue to climb in spite of lackluster economic data and earnings but we do not see valuations as extreme at this time.

JEANNINE'S TIP O' THE MONTH *ENHANCING YOUR SWM EXPERIENCE*

RRSP Contribution receipts were mailed Friday March 15th, watch for these to arrive.
As a reminder – all of your tax documents can be accessed via your online access for convenience.

Current Rates & Data

Govt of Canada

90 day	0.93%
1 year	1.02%
2 year	0.96%
5 year	1.36%
10 year	1.91%
30 year	2.61%

U.S. Treasury

90 day	0.09%
1 year	0.15%
2 year	0.25%
5 year	0.88%
10 year	2.03%
30 year	3.24%

Canada Prime Rate

3.00%

U.S. Prime Rate

3.25%

Canada CPI Y-o-Y (Jan)

0.50%

U.S. CPI Y-o-Y (Jan)

1.60%

Exchange Rates

CAD/USD	0.973
USD/EUR	1.303
JPY/USD	95.92

This newsletter has been brought to you by Steele Wealth Management

Brian Steele, CA, CFA | Jeannine Campbell | Laura Prust, CPCA
Kelly Townsend | Matthew Bell, CFA | Keith Gummow, CFP, CLU, Ch.F.C.

Phone: (519) 883-6030 Toll-Free: 1 (877) 642-6408

Email: steelewealthmanagement@raymondjames.ca

Address: 1001-20 Erb Street West | Waterloo, Ontario | N2L 1T2

Website: www.steelewealthmanagement.com

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All rates mentioned within this newsletter are as of March 15th, 2013, unless otherwise stated.