Canadian Wealth Management
4th Quarter Newsletter, 2009

SOCIETE GENERALE GROUP

4th Quarter Hi-Lights

- In 2009 equity markets staged one of the most impressive rallies on record to end the year with solid double-digit gains
- Corporate bonds rallied on an epic scale offering once-in-a-generation opportunities and investments in other asset classes also proved rewarding
- Most client portfolios recorded healthy returns and higher-risk portfolios often enjoyed returns in double digits for the year
- In the New Year the odds are heavily in favor of an economic recovery that will continue to gain traction in response to fiscal and monetary stimuli. We do not see significant risks of systemic and widespread problems that may take us again to the verge of a meltdown
- However, this does not mean that the ride towards economic recovery will be smooth and uneventful
- The Dubai debt crisis and the downgrade of Greece's national debt have brought into focus the issue of sovereign risk
- The exceptional and unusual investment opportunities of 2009 are not likely to repeated, but we anticipate the year ahead to produce positive returns for many of the asset classes in portfolios

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Vantage point

Sovereign risk comes into focus

After 2008 brought us to the brink of financial and economic disaster, in 2009 we saw financial markets returning to stability and a gradual but clear improvement in economic conditions. Equity markets started the year on a note of doom and gloom, discounting a Great Depression, and bottomed in early March. As it became evident that the vast array of fiscal and monetary counter-cyclical measures were going to work, at least in the short run, equity markets staged one of the most impressive rallies on record to end the year with solid double-digit gains.

Equally impressive was the rally in fixed-income markets, especially corporate bonds. Consistent with the negative sentiment in equity markets, the spreads between high-quality investment-grade corporate bonds and government bonds had widened early in the year to unprecedented levels, in effect predicting massive corporate defaults. As perceptions changed, corporate bonds rallied on an epic scale offering once-in-a-generation opportunities to investors.

After a very painful period for most investors in 2008 and early last year, the picture had brightened up considerably by the end of 2009. Most portfolios will have enjoyed healthy returns from a variety of sources. Clients were generally well placed to benefit from the market moves mentioned above as we were buyers of equities early in the year and were overweight corporate bonds and preferred shares while substantially underweight government bonds.

In the New Year the odds are heavily in favor of an economic recovery that will continue to gain traction in response to fiscal and monetary stimuli. Funds earmarked by governments are still in the pipeline and they will boost aggregate demand as they are disbursed. Business inventories declined sharply in 2009 and are now very low. Even a small increase in inventories from such depressed levels will provide an important engine of growth. Similarly, as businesses held back on capital investments during the credit crunch, there is significant pent-up demand for capital goods. These factors will contribute to world economic growth in the year ahead when most large economies will be well out of recession.

To be clear, we do not see in the year ahead significant risks of systemic and widespread problems that may take us again to the verge of a meltdown. On the contrary the outlook is rather positive, on balance. However, this

does not mean that the ride towards economic recovery will be smooth and uneventful. Indeed, the road ahead is likely to be bumpy and full of potholes. One of the main negatives will remain the stubbornly high levels of unemployment. This implies further risk of consumer credit defaults for the financial institutions. As a result credit supply will remain impaired as banks will continue to be very protective of their balance sheets.

Central banks will continue to navigate in treacherous waters between the dangers of deflation and inflation and markets participants will be watching them with jittery anticipation. As economic conditions improve, central banks will implement their exit strategies from quantitative easing (QE) and will attempt to reduce their bloated balance sheets. First, this implies not acquiring additional assets from banks and second, selling back into the market assets already bought. The European Central Bank (ECB) has already hinted that operations to unwind QE may start soon. However, other central banks may be less decisive. The US Federal Reserve Bank (Fed) is likely to be slower in its approach for fear of stifling the recovery and because of difficulties in finding buyers for assets of doubtful quality. The Bank of England will also find it hard to unwind QE as it is under pressure to monetize the Government's ever increasing public debt. Thus concerns about inflation further on the horizon will legitimately persist.

A big bump encountered recently on the road to recovery was the surprise request made in late November by the state-owned conglomerate Dubai World to reschedule USD 22 billion of debt, in fact an admission of insolvency. Dubai, one of the emirates which form the United Arab Emirates, has embarked for many years on a spending spree with borrowed money to build a major metropolis.

Dubai's credit problems sent shock waves through financial markets reminiscent of the worst days of 2008. In the end Dubai's cash-and-oil-rich UAE neighbour Abu Dhabi stepped in with a rescue package and the world breathed a sigh of relief. Although the Dubai scare proved to be short-lived and localized, it brought into focus the issue of sovereign risk. Indeed if anyone needs to be reminded, countries can go bankrupt in particular if their debt is denominated in a currency other than their own.

In the midst of the Dubai crisis, major rating agencies downgraded Greece's sovereign debt to BBB, which is perilously close to non-investment

grade. Greece is a member of the Eurozone but if its sovereign debt drops below investment grade it will no longer be eligible as collateral for the ECB, raising the possibility of default.

The creation of the Eurozone has meant that member countries cannot issue debt in their own currency but only in euros, in effect a foreign currency for them that can be issued only by the ECB. In principle this is a good idea meant to promote fiscal responsibility. But as we live in a world of moral hazard, responsibility is a rare commodity. The weak countries of the Eurozone live and act in hope of finding their own Abu Dhabi should they get in trouble because of fiscal profligacy. However, will the German or French taxpayers (the presumed Abu Dhabis of Europe) be willing to rescue their down-at-heels partners? We will eventually find out, but in the meantime the euro is likely to remain under pressure.

The exceptional and unusual investment opportunities of 2009 are not likely to be repeated, but we anticipate the year ahead to produce steady positive returns for many of the asset classes in our portfolios, including equities. We do not believe that the recent equity rally - which has been indeed supported by ample liquidity provided by central banks - has led to another asset bubble. One has to remember that the recovery has started from very depressed levels and we are still well below previous highs. Indeed in most cases we are at end of a “lost decade” with equity indices still below points reached ten years ago. Moreover, valuations (in terms of price/earnings ratios) are still attractive and likely to improve moderately as the earnings momentum remains favorable. Investors worldwide still hold an unusually high proportion of assets in cash and they may well continue to redeploy it towards riskier asset classes.

Although equities are not likely to produce the stellar results of 2009 in the year ahead, we expect a positive performance from this asset class and are maintaining our exposure at normal levels. However current market conditions call for a more selective approach. In developed markets we will give preference to US markets to which we have assigned a positive grading. Of all the major developed economies only the US is emerging out the recession with major reductions in unit labour costs and productivity gains. An undervalued currency will also help the US corporations to compete successfully on a global scale.

The large amount of public issuance to cover huge public deficits and concerns about the long-term sustainability of public finances are likely to gradually push up long-term yields in the coming months. As a consequence, we have a negative view on the sovereign bonds. We have a more positive view on investment grade corporate bonds for which the risk/reward profile is still attractive.

Equities

CHANGES IN MAJOR INDICES*

REGION	INDEX	Q4	2009
Canada	S&P/TSX Composite	3.9%	35.1%
US	S&P 500	6.0%	26.5%
UK	FTSE 100	6.2%	27.9%
Eurozone	DJ EuroStoxx	3.9%	26.9%
Japan	Nikkei	4.2%	19.0%

* Price returns in local currency

CANADA

Canadian equities posted another strong quarter, generating a total return of just under 4%. Unlike prior quarters, it was the more conservative sectors (Utilities and Consumer Staples) that led the way. Energy and Material stocks also performed well, rising 6% and 5.4% respectively. The Financial sector was the noticeable laggard, posting a slightly negative return for the quarter (- 0.7%). Despite this poor quarter, however, Financials posted the highest total return for the year, rising 45.6% thanks to very strong performance from the Banks earlier in the year.

These numbers are rather remarkable when one considers where the S&P/TSX Composite Index was in early March of 2009. Since then, it has risen about 55%! Clearly, much of this has been driven by rising commodity prices and the weakening US dollar. The stability and resilience of our Banking system, during the recent crisis, was also a major contributor to this amazing comeback.

Economic conditions in Canada appear to be improving, albeit slowly. Our Unemployment Rate has risen since the start of the year, but seems to have stabilized around 8.5%. The Housing market, in many regions of the country, appears to be improving. Interest rates remain low, especially at the short end, and inflation measures remain subdued. Real GDP has risen for 2 consecutive months (September and October), and it is expected that Canada will have a positive GDP figure for Q4.

Clearly, there are many headwinds as well, with Capacity Utilization remaining weak, manufacturing data continues to be sluggish, Retail Sales and Consumer Confidence are subdued, and our Dollar continues to rally against the USD (which is not generally good for an exporting country like Canada). However, most economic indicators are trending in the right direction, and it is very hard to make a case against the fact that there is a very real economic recovery under way.

UNITED STATES

It has been over nine months since the S&P 500 bottomed on March 9 at 676.53. Since then, the index has rallied 64%, the largest nine-month gain since 1933. This 64% nine-month gain was preceded by a nine-month decline of 51% and markets still have some way to go to return to previous highs. The financial

sector has been the best performing sector of the equity market revival, mainly due to the implicit guarantees and major fiscal benefits provided by the US Government. However, during the last quarter, like in Canada, the sector was down 3.6% vs. a rise of 5.5% for the S&P 500. Leading the way during the 4th quarter were Technology stocks, which rose 10.5%. They were also the leader for the year, rising an impressive 60%. Health Care and Consumer Discretionary stocks also performed well during the quarter, along with the Material stocks. The Material sector had a great year, ranking only behind the Financial sector, posting a rise of 45.2%.

Economically, there are clear signs of recovery in the US as well. Job losses have shrunk substantially and businesses are now expanding the workweek. As a result, income is actually growing modestly. Employment growth also appears to be on track for early 2010, which should further boost household income. Household wealth has also stabilized, and even adjusted somewhat to the upside over the past two quarters. In Q2 and Q3, net consumer wealth rose by a combined USD 4.9 trillion, unwinding about a third of total losses imposed by the financial and housing meltdown.

Despite the encouraging evidence, the recovery remains fragile. A jobs recovery, though increasingly likely, is not yet certain. Even if employment materializes, it will take a while for inflationary pressures to build again. For these reasons, Fed officials have been very cautious in embracing the recent improvements and reiterated their commitment to an extended period of low rates.
Among mature economies, the US equity market offers very good prospects for 2010 as earnings gain momentum reflecting significant productivity gains. A still-undervalued USD will also be beneficial for companies with overseas exposure in sectors such as materials and industrials.

UNITED KINGDOM

During the final quarter of 2009, the UK equity market delivered positive returns although the market traded in a fairly narrow range for most of the period. The FTSE 100 index posted a return of 5.4% for the quarter, resulting in a solid 22% return for 2009. As the year drew to a close investor sentiment remained cautiously optimistic despite the many economic and political challenges ahead for 2010. One of the key considerations for the UK economy relates to the ending of government stimulus packages.

During the quarter the best performing sectors were cyclical and related to global economic recovery themes. Not surprisingly, the mining and energy sectors posted relatively strong gains. The UK retail sector also delivered good results mainly driven by better-than-expected corporate results from large companies.

The UK banking sector suffered as capital raising efforts weighed heavily on sentiment, including the largest ever rights issue from Lloyds Banking Group. Economic data in the UK continued to be mixed although recent GDP data broadly points to economic stabilization; an encouraging backdrop for the equity market as we approach the start of a new calendar year.

EUROZONE

The ECB has made the first move of an exit strategy and announced an end to long-term emergency loans and a tightening in refinancing terms. This is in response to an overall improvement in bank funding and confirms that the financial crisis in the Eurozone is finally behind us. Economic data has continued to support the improving outlook in core Europe although life remains very difficult in countries such as Greece and Ireland that are still hamstrung by sizeable fiscal deficits. Europe's services and manufacturing industries are expanding at the fastest pace in two years and exports are at the highest level for twelve months. Unemployment remains at unacceptable levels at just under 10% and - along with rising inflation - this remains a challenge for policymakers in 2010.

JAPAN

The Japanese equity market was one of the worst performing equity markets over the course of 2009. The Nikkei was also one of the worst performers over a two-year period. This is somewhat surprising given that Japanese institutions should have benefited from their long-standing experience of confronting and overcoming deflation problems, which were relatively new for the other leading economies.
The yen's post election rally has finally petered out and we are still obliged to note the inverse relationship closely linking the Japanese equity market and currency. Moving forward, the prospects of Japanese markets depend on the global economy indeed pulling itself out of the recession. The Nikkei's performance during 2010 is likely to be dependant on the pace and sustainability of the US and global economic recovery and of course the yen. On balance we give the Japanese the benefit of the doubt and anticipate an improved performance in 2010.

SOUTH EAST ASIA

Asian markets have rallied strongly since March, although the pace has slowed during the final quarter of 2009. We remain concerned about the potential for a short-term pull back, but believe the long-term fundamentals remain positive, particularly when compared to Western markets. Domestic demand remains relatively strong, and debt levels are low compared to the West.

EMERGING MARKETS

The economies of the main new entrants in the European Union present a mixed but improving picture. In Poland the economy is expected to slowly recover, supported by stronger global demand and a rebound in business investment, although growth will remain well below pre-crisis levels. In Hungary restrictive fiscal policy combined with a weak labour market will continue to take its toll on domestic demand. However the past Hungarian currency depreciation and the global recovery will support exports. In the Czech Republic the recovery in exports and in investment will allow the economy to rebound in 2010-11. In Russia growth collapsed during 2008 and early 2009 as energy prices plunged and the global credit crunch severely impacted on Russian liquidity. Net capital outflows rapidly reduced money supply growth and sharply constrained corporate and household access to credit. Counter-cyclical fiscal spending, the rouble devaluation, rising oil prices and government support for big companies stabilized conditions, allowing a recovery starting in late 2009.

Bonds

CHANGES IN MAJOR INDICES
Bloomberg/EFFAS Federal Government Bond Index (in local currency)

REGION	Q4	2009
Canada	-0.1%	-1.6%
US	-0.8%	-3.8%
UK	-1.9%	-1.3%
Eurozone	0.6%	4.4%
Japan	0.7%	0.9%

There was a clear bifurcation of bond returns in 2009. Government (or Sovereign) bonds experienced negative returns in many regions around the world. As shown above, this was especially true in North America, where Canadian government bonds (down 1.6% on the year) and US Treasuries (down 3.8% for the year) performed very poorly. This was due, in large part, to the dramatic “rush to safety” that occurred during the financial crisis in late 2008 and early 2009. The result was that government bond prices became inflated, and once fears of a financial collapse waned, so too did investors’ desires to hold government bonds. As a result, money came out of the government bond sector throughout the year.

On the other hand, corporate bonds performed very well in 2009, as their price behaviour was exactly opposite of their government counterparts. Once investors’ risk appetite started to return, the inflow into corporate bonds was quite remarkable. The performance of the Canadian corporate bond index illustrates this point, as it generated a total return of 16.2% for the year.

As a result, our clients’ fixed income portfolios performed very well as we were overweight corporate bonds and preferred shares (which also were very strong in 2009), and underweight government bonds.

In the US, the story was similar, as a whole range of factors - relatively high real bond yields produced by low or negative inflation rates, very steep yield curves, quantitative easing and the flow of funds into the bond markets from investors normally wedded to cash - provided a very favorable environment for corporate bonds in 2009. Some of these ‘supports’ are likely to become less potent in the months ahead.

Looking forward, faced with still very high unemployment the Fed has recently reiterated their commitment to an extended period of low interest rates. However as signs of recovery multiply there is increased speculation that US interest rates could rise to more ‘normal’ levels. While the outlook for interest rates in the US is less benign, UK policy makers remain concerned with an economy still clearly in recession, with stubbornly declining bank lending and with lack of growth in money supply and we can rule out an early rise in UK interest rates.

Inflation data on both sides of the Atlantic suggests that the trough in both producer and consumer price inflation for the current cycle was passed around July. We do not expect the inflationary outlook to deteriorate significantly but it seems prudent to maintain our exposure to inflation-linked (also referred to as “real return”) bonds. Our view is that the Central Banks will likely stay on the sidelines until at least the middle of the year. At that time, if the

economic recovery has taken hold, a slow and steady series of rate increases will likely begin. Unless the economic data is overwhelmingly strong, we don't believe the US Fed will raise rates aggressively, as Ben Bernanke has made it abundantly clear that he does not want to cripple any recovery prematurely (which he believes was one of the major causes of the Great Depression).

The large amount of public issuance to cover huge public deficits and concerns about the long-term sustainability of public finances are likely to gradually push up long term yields in the coming months. As a consequence, we have an overall negative view on sovereign bonds.

For corporate bonds we maintain a positive view. The risk/reward profile is still attractive but less than before as spreads are line with expected default rates. Primary issues with a 3-5 year maturity are the preferred segment in order to limit exposure to interest rate moves.

CURRENCIES

In 2009 the US dollar depreciated against most major currencies to end the year weaker despite a rally in the closing months of the year. The vulnerability of the US currency was in response to very low short-term rates and concerns over very large fiscal deficits. Low-cost financing turned the dollar into the favorite currency for so called carry trades – market participants borrowing dollars to buy higher-yielding assets. Last but not least, major holders of FX reserves especially in Asia attempted to diversify into other currencies adding to the dollar's negative momentum.

One of the main beneficiaries of the weakening USD was the Canadian Dollar. Our dollar started the year at approximately 82 cents, dropped down to around 77 cents during the peak of the financial crisis in March, but then steadily rallied throughout the rest of the year, closing at 95 cents on December 31st. For the year, our Dollar rose 15.5% versus the USD. While it is true that the USD suffered against most currencies, the CAD did especially well thanks in large part to the economic recovery in the emerging economies where the demand for natural resources was very strong.

As the year drew to a close, the negative trend for the US dollar started to reverse versus the Euro and we expect this to continue in the months ahead. The very fact that the dollar has been used to finance carry trades implies the possibility of a quick turnaround. As US short-term rates are expected to rise such trades are quickly exited to avoid the risk of currency loss. Also, the process of reserves diversification seems to have slowed as holders of reserves become happier with the current composition. The relative strength of the US economy has also reminded traders that the greenback still is the investment currency of choice.

The euro was strong across-the-board for most of the year but lost its positive momentum in the final quarter of 2009 in response to concerns over the sovereign risk of some members of the Eurozone. These factors are expected to continue to weigh on the euro in the months ahead.

Commodities - Alternative investments

COMMODITIES

In the last quarter gold has made most of the headlines as it has surged to new highs. A combination of inflationary concerns driven by the printing of money, and the related weakness in the US dollar, have driven investors to look for a store of value. The news that the Indian central bank had made significant gold purchases led to an acceleration of the rally.

Other commodities have benefited from the better growth outlook with metals such as copper and platinum and agricultural products including wheat, corn, rice and coffee - all enjoying significant moves upwards.

Also helped by the improved economic backdrop is oil, which had a move up in early October then stabilized in the high USD 70's per barrel. Oil stocks remain high as does OPEC spare capacity, and these factors are likely to moderate any short-term rise in the oil price.
Natural Gas, which had been a noticeable laggard, started to rally in September off its lows for the year. AECO rose to $5.50 (CAD per gigajoule) from $2 in September, thanks to a cold snap that swept through most of the continent, but actually ended the year lower than where it started.

We expect the pattern of stronger economic numbers to continue over the next few months and this should continue to support commodities. The rise in gold is driven by speculative investment and as such the extent of the rally is very difficult to anticipate; currently there is significant momentum, but investors should be aware that this is a high-risk trade as it depends on continued investment demand.

ALTERNATIVE INVESTMENTS

After a very difficult 2008 the hedge fund industry emerged leaner and reasserted its nimbleness and ability to react to changes in the market.

The primary drivers of returns have been the normalization of markets and reduced competition from proprietary trading desks and other hedge funds. The largest gains have come from the Convertible Bond players as well as from managers in the Event Driven space that have benefited from corporate restructurings and attractive merger deal spreads. On the other hand, hedge funds managers investing in the Equity space failed to capture this year's rally.

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