



## Outlook 2013

By Eric Bushell

*Signature Chief Investment Officer Eric Bushell recently outlined the major investment themes the Signature Global Advisors team will be monitoring as we enter 2013:*

**The continued progression of the global “yield trade.”** In mid-December, the U.S. Federal Reserve renewed its commitment to keeping interest rates near record lows by intervening in capital markets. This time, however, the Fed stated that it would buy US\$45 billion in Treasury bonds per month until the U.S. unemployment rate drops to 6.5%. Low rates are aimed at inducing business and consumer investment, and this appears to be taking hold in the U.S. property market, which is showing signs of improvement. Low rates also push yield-seeking investors up the risk curve. We are seeing yields compress for investment-grade debt and high-yield bonds, so we believe that capital will begin to flow into higher-yielding equities in sectors such as consumer staples and health care – provided policymakers can maintain market stability.

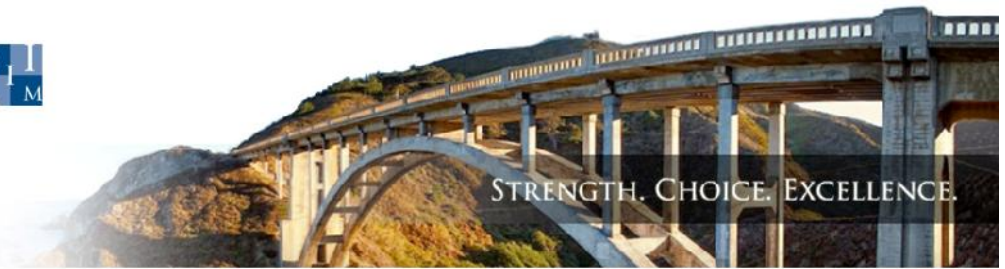
Companies are responding by increasing dividends and share buybacks in an effort to attract equity investors. We are seeing a Canadian-style “income trust-ization” of the global corporate sector, and companies are giving investors the option of focusing on growth or income. This is the result of the unprecedented, zero-rate environment, coupled with ongoing risk aversion. Sector weights for the Signature funds are based on this view, and we are focused on stable, global companies that will have the best access to low-cost funding.

**Canadian competitiveness and performance challenges.** We have struggled to find high-quality, liquid, higher growth investment opportunities in the Canadian marketplace for some time, and the universe continues to shrink. As a result, we will continue to focus on global opportunities in our equity, balanced and income portfolios.

Canada, compared to its competitors in the U.S. and Mexico, carries a higher cost structure in terms of labour, currency, property and competitiveness. A stable property market has been one of Canada’s main benefits, but we are seeing some weakness here. Gas and energy prices have moderated, and a chill has set into the mining industry as massive cost overruns are affecting companies in that sector. Multinational corporations will continue to seek the best cost structures, and we will see more jobs leave Canada for lower-cost jurisdictions.

**Continued involvement in the financial markets and underlying economy by policymakers.** Virtually all of the major market moves through 2012 came as result of actions by the European Central Bank and the U.S. Fed. Central banks and governments are increasingly controlling both short-term and long-term interest rates, as well as foreign exchange, in an effort to preserve their country’s competitiveness.

A prime example is Brazil, where taxes are imposed on foreign investors simply trying to take advantage of the country’s currency strength or attractive interest rates. Brazil’s central bank is managing its foreign exchange rate lower to compete with Mexico, and tariffs are being used to protect domestic industries. State-controlled entities such as Vale and Petrobras are acting as government agents to expand the country’s workforce and consume a high amount of domestic content. In this way, Brazil has become a politicized economy that is turning foreign investment away.



We are in the midst of striking a new bargain for foreign investment in emerging economies, and this will intensify in 2013. Where foreign capital once flowed indiscriminately into countries like India and Brazil, more and more investors will wait for the right terms. This will be a challenge for emerging markets that need foreign capital. In more developed economies, central bankers are attempting to maintain the image that they have inflation and interest rates under control. But just because the ECB says that Italy will have access to borrowing doesn't mean that the country, with 120% debt-to-GDP ratio, won't default at some point. Risks remain.

**Heightened mergers and acquisitions activity.** Since the bankruptcy of Lehman Brothers in 2008, companies have been on the defensive, and each time they have become confident enough to expand another crisis has put their plans on hold. Provided capital markets remain open and functioning, we expect to see increased M&A activity in sectors where regulatory hurdles are easier to navigate, such as industrials. Such deals can be debt-financed at very low rates and can be very accretive if the buyer does not issue shares to fund the purchase. Ultimately, this will benefit equity investors while shrinking equity markets.

**A new era of smaller, more focused local banks.** The past few years have shown that there are few brand or capital synergies to large global banks, and the regulators continue to remove the synergies related to liquidity by putting restrictions on cross-border capital flows. The local capital requirements for each jurisdiction have made the cost of global banking prohibitive for UBS, for example. The bank is paring down its business to be a wealth manager with a smaller global equity investment bank, and its stock price is being rewarded. Credit Suisse is considering a similar strategy.

In the U.S., bank size could be limited by putting lower caps on the amount of deposits a single bank could hold. Alternatively, regulators could force the break-up of larger banks, which could be a benefit to shareholders where banks are trading below par.

### Positioning

The Signature funds are entering 2013 fully invested, emphasizing higher-quality, global, income-oriented securities. We have started to gradually decrease the government bond holdings in all of our balanced mandates, but we believe that corporate credit securities still present value. From a sector perspective, our funds are underweight resources, and we are carrying a healthy position in gold bullion as a hedge against inflation.

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