Quarterly Insights

INDEX WEALTH MANAGEMENT

June 29, 2012

Economic & Investment Outlook

The global economic recovery paused in the second quarter, as concern over the future of the Eurozone affected the pace of growth and increased financial market volatility.

Canadian first quarter economic growth was below expectations at 1.9%, however excess slack in the economy has continued to diminish. The impact of slowing international economic activity pushed Canada's trade balance from a surplus into a deficit position in April.

Manufacturing rebounded in March, reversing the previous month's contraction and pointing to a resumption of modest growth. Warmer than usual weather across much of the country helped retail sales rise 0.4% in March to more than offset February's decline.

Employment gains were modest in May, however average monthly job creation over the past six months has been a strong 28,000 positions.

Annual wage growth, which ticked up to nearly 3.0% in May, is now outpacing inflation.

The U.S. economy also grew at an annual rate of 1.9% in the first quarter of this year. Employment growth continues to be below expectations, but has been consistently positive since September 2010.

Numerous housing reports continue to suggest that the sector is in the process of establishing a bottom. Sales of existing homes rose again in April, and the inventory of both unsold existing homes and distressed properties, is trending down. Moderate price increases are occurring in some regions.

Homeowners are using record-low borrowing rates to refinance loans and pay down principal. Mortgage debt is decreasing, as home equity rose to $6.7 trillion in the first quarter, which is the largest gain in percentage terms in sixty years.

Euro Follies

On the last day of the quarter, another summit of Europe's leaders produced another hopeful plan, and an apparent concession by German Chancellor Angela Merkel.

In recent weeks European financial issues have re-emerged, as concerns about the banking system moved away from the peripheral countries of Portugal, Italy, Ireland and Greece to the region's fourth largest economy, Spain.

In the past twelve months €193 billion or 18% of GDP, has been withdrawn from Spain. As economic growth contracts, unemployment has reached 25%. Despite the ongoing support of

Global

Pause

-

European

Hope

Inside this issue:

The European central bank, Spain required a €100 billion loan from other euro-zone countries to recapitalize its banking sector.

As many European governments have embarked on significant fiscal austerity paths in an effort to reduce debt burdens, they have struggled to increase economic growth and maintain the support of their electorate for ongoing spending cuts. The result has been a broad political push against austerity in favour of more pro-growth policies in many countries.

Despite the Greek election which favoured a coalition that supports enacting previously agreed to austerity measures, Europe's issues are only inching toward resolution. Politicians, who have to answer to their own local electorates, have been reluctant to embark on bold solutions that sacrifice their own interests for the greater good of the region as a whole. Responses to date have only been short-term solutions that deal with issues as they arise. As a result, confusion and volatility persist in financial markets as the problems grow more complex and the solutions become more demanding.

The status quo is no longer an option for the Eurozone. If the region wants to maintain the Euro currency and mitigate future capital flights, then the union needs to be strengthened through stronger fiscal amalgamation, unified oversight of the banking sector and the mutualisation of some portion of the region's debt. Changes on this scale will not be easy and will involve treaty alterations that could take years to complete. The latest summit does not change this. It will ultimately come down to decisions of whether the core countries will increase financial support for the periphery countries, and whether in return the periphery will cede control over future spending.

Returns

Financial market volatility increased in the second quarter, as many global markets experienced double digit declines, before rallying to cut some of these losses by quarter end.

Second quarter returns to June 30th in local currency terms for world equity markets are:

Country	Index	2012 Q2 Return
Canada	S&P/TSX	-6.52%
United States	S&P 500	-3.29%
United States	NASDAQ	-5.06%
United Kingdom	FTSE 100	-3.42%
Japan	Nikkei	-10.68%
France	CAC 40	-6.63%
Germany	DAX	-7.64%
Hong Kong	Hang Seng	-5.42%

As some investors seek protection from the risks of the potential dissolution of the Eurozone, they continue to purchase fixed income securities in record amounts. In early June this demand pushed 10-year bond yields to generational lows in both Canada (1.62%) and the U.S. (1.44%). When compared to current inflation rates, these yields ensure that the real purchasing power of investors' capital is being eroded.

This downward trend in yields moved toward the extreme in Germany, which is viewed as the most stable credit in the Eurozone. In May, Germany issued €5.8 billion of 2- year notes with a zero rate of return, meaning that investors were willing to receive nothing for the privilege and safety of lending funds to the German government.

As equities have experienced heightened volatility and broad returns that are largely unchanged over the past five years, inflows into U.S. bond mutual funds have exceeded equity fund inflows every year since 2007. In fact, there have been net redemptions from equity funds in each of the past five years.

With the diminishing demand for equities, dividend yields have been rising in absolute terms since 1999. In June, the yield on the S&P 500 Index was more than 60 bps higher than the yield on 10-year U.S. treasuries. Currently, almost 60% of S&P 500 Index companies now yield more than 10-year treasuries and more than a third have also grown their dividend faster than the rate of inflation over the past five years. This relationship is very similar for S&P/TSX Index companies as well.

Historically, a relationship where dividend yields are this far above bond yields has not occurred since the late 1960s. Our belief is that despite the recent volatility, equities currently represent a far superior investment alternative compared to fixed income investments for investors who have an intermediate time horizon.

The Bottom Line

The deterioration in financial conditions in Europe, if not contained, poses a serious risk to financial markets and global economic growth.

We will continue to focus on strategies in client portfolios that are intended to mitigate financial market volatility by purchasing dividend paying equities and preferred shares of companies with strong balance sheets and selectively using call option strategies to enhance portfolio income.

The Evolving Landscape of Canadian Financial Regulation

National regulators in Canada are trying to improve confidence in the investment advice industry and the protection of investors.

Anyone advising investors on securities must be registered with the provincial or territorial securities regulator. The regulators from the 10 provinces and 3 territories have teamed up to form the Canadian Securities Administrators (CSA).

Being registered, however, does not mean that all firms and individuals have the same skills, provide the same services, charge the same fees, or owe the same duty to their clients.

Independent discretionary portfolio managers, like Index Wealth Management Inc. are regulated directly by the provincial securities commissions.

The CSA has given two industry organizations, the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) much of the responsibility to regulate themselves, under guidelines set by CSA.

The CSA has proposed amendments to their regulations, which would raise the minimum requirement for all firms to provide investors with clearer and more meaningful information, regardless of which organization is responsible for their regulatory oversight. These include:

- in dollar amounts, what the dealer or adviser was paid by the investor for the products and services provided,
- in dollar amounts and percentage terms, how the investments performed during the year and over longer periods, and
- disclosing the amounts of some fixed income commissions and embedded fees.

These initiatives from the regulators are well intentioned, but are they enough?

The Canadian Foundation for Advancement of Investor Rights (FAIR Canada) is an independent national non-profit agency that seeks to advance the interests of investors, and the integrity and fairness of Canadian capital markets. They say, “FAIR Canada is generally supportive of the IIROC and MFDA proposals. However, they do not move far enough towards the necessary complete overhaul of the relationship between the client and the adviser. We call on the CSA, IIROC and the MFDA to undertake a review of regulatory initiatives around the globe to ensure that Canadian investor protection keeps up with international best practices.”

A conflict of interest is present any time a financial adviser is not thinking exclusively about what is in the best financial interest of the client they are advising. Any person advising in securities should have an obligation to put the investor’s interest before their own.

We are supportive of what the regulators are doing and we encourage all investors to stay centered on their own interests. Focus on professional advice, not on products. When you take your car into the shop you expect them to sell you tires only when you need tires, not to say “I have a new kind of tire that I am putting on all my customer’s cars.”

The CSA provides a variety of materials on investing topics, including choosing and working with an advisor. All CSA materials are available in the Investors’ Tools section of the CSA Website.

http://www.securities-administrators.ca/investortools.aspx?id=84&linkidentifier=id&itemid=84

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Index Wealth Management Inc., is an independent portfolio manager with offices in Vancouver, Calgary and Winnipeg. Our firm provides discretionary investment management services and structures equity protection and monetization strategies for individuals, foundations and non-profit corporations

We construct portfolios for our clients utilizing Exchange Traded Funds (ETFs) as the core holdings. Depending on a clients investment goals, objectives and "risk comfort zone" these ETFs can then be combined with equity option strategies to enhance income or reduce the volatility of the annual return of a portfolio.

INDEX
WEALTH MANAGEMENT

Managing Uncertainty, Compounding Returns