

The Guardian Insight

Timely Perspectives from the
GCA Investment Committee

Dec 18th, 2009

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Current Sentiment:

Presentations by members of GCA's Investment Committee at our most recent gathering developed no clear conviction to the near-term direction of markets. The range of possible outcomes over the near-term, from rising inflation to deflation, and growth from cheap money to stagnation from continued housing malaise south of the border, left the group convinced that the balance of risks associated with these unknown outcomes supported the case for no changes in asset mix policy.

Current Observations:

Improving (though not necessarily robust) consumer confidence, manufacturing surveys, and employment reports would seem to validate the classic case that an equity market run will lead the underlying economy by 6-9 months. In fact many of the metrics provided by our proprietary quantitative equity ranking platform would suggest that this has indeed been a classic recovery with highly cyclical securities leading the way.

Despite rallies averaging about 60% for Western equity markets, the biggest inflows of assets from money market funds have surprisingly been to balanced and bond funds – not equity funds. So with consumer confidence still at recessionary levels, which based on history is highly unusual given how the markets have rebounded, a twisted irony is that a risk remains that the retail investor, typically the last one to the party, still kicks in with even more money to fuel the market rise even further.

While it is true that the lows in housing activity, like those we are seeing now in the US, have historically coincided with sustained rallies in the equity markets, our friends to the south face an unusual circumstance now where delinquency and foreclosure rates are 2 to 3 times

greater than the previous peaks that we have witnessed in 40 years. With the vast majority of the wealth of the 'average' citizen in North America being tied to real estate, not the stock market, the prospect of further foreclosures in the US and thus price depressing supply to the real estate market, makes the idea of a rebound in wealth driven spending hard to fathom. This, coupled with the prospect of rising interest rates at some time in 2010 which would place further pressure on the consumer, suggests that any type of robust GDP growth and corresponding corporate earnings growth in the US continues to seem overly optimistic.

Moreover, the underlying technical factors of the market suggest a reason for increased caution. With trading volumes at markedly lower than average levels, price appreciation stagnating and leadership from financials falling off over the past months, valid arguments can be made of impending bouts of profit taking lurking ahead. Early indications of rotation out of higher risk to lower risk stocks suggests investors are becoming more risk averse.

Conclusion:

As is typical, the scorecard is mixed and leads us to a continued 'neutral' placement of portfolios along our underweight, neutral or overweight equity continuum. Clearly the underlying mood of the committee is one of conservatism with our ever-present eye on capital protection. Added risk should only be taken when pessimism and opportunity reign, and ultra conservatism should only be implemented when speculation is at extremes. Neither present themselves right now so a middle of the road approach is indeed appropriate.

Guardian Capital Advisors Investment Committee

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