

## NEI Investments



### Performance

The Portfolio returned 2.89% for the quarter. This was higher, by 1.67%, than for the internal benchmark comprised of 80% bonds. This was a quarter where global equities led other asset classes and investors saw returns that they have been waiting for. The asset allocation strategy for the portfolio contributed to performance. The component funds outperformed their respective benchmarks and delivered healthy positive returns. At the underlying fund level, the Acuity Clean Environment Fund contributed the most to performance, outperforming the index by 8.73%. However, all funds in the Portfolio contributed significantly this quarter.

### Portfolio Commentary

For US Equities, the first quarter of 2011 was the best start to a year since 1998 as the S&P 500 Total Return Index gained 10.6% in C\$ over the three-month period ending March 31, 2012. The S&P/TSX Composite Total Return Index followed suit in January and despite pulling back in March, ended the quarter with a respectable 4.39% advance. International equity markets, including Emerging Markets (EM), outpaced Canadian Equities. During the first three months of the year, the MSCI EAFE Index (C\$) increased 8.9%; the MSCI EM Index (C\$) was up 12.0%; and despite tumultuous headlines, the MSCI Europe (C\$) Index added 8.8%.

Government Bonds, as we have been forecasting for some time, appear to have hit a wall in Q1. The DEX Government Bond Index returned -0.80% while the broader DEX Universe Index declined 0.21%. By contrast, the DEX All Corp. Universe Index delivered a 1.42% in Q1 as spread tightening compensated for higher government yields

Consumer spending increased during the quarter and corporate profitability remains solid, a reflection of the aggressive cost cutting that companies engaged in during the recession. According to estimates compiled from Bloomberg, profit per share at S&P 500 companies rose 1.7% in the first quarter and are expected to grow 8.6% this year.

In Europe, stocks rose in January and February in light of a second bailout package for Greece and news that the ECB would be providing additional funding for European Banks to the tune of 529B€. At the end of March, Euro zone finance

ministers agreed to boost the region's "firewall" to roughly 800B€.

However, despite these initiatives, global equity markets weakened in March as a fresh crop of concerns surfaced amid talk of yet another bailout for Greece, renewed concerns over Government debt levels in Spain and Italy and slowing growth in China. US Equity markets bucked this trend however, continuing to advance while many other markets paused. Canadian and Asian equity markets were most affected by concerns over a slowing Chinese economy as lower demand for Canadian natural resources and the implications for export driven Asian economies weighed.

### Outlook

In our view, the main themes that will impact equity market returns going forward are: 1) Sustainability of US job creation and its impact on Consumer spending, 2) Solvency of Spain and to a lesser extent, Italy, 3) Soft landing for the Chinese economy. Unfortunately, there are no quick and easy answers to address any of these issues. As market participants weigh the various potential outcomes, we expect that volatility will increase over the remainder of the year given that valuations for equity markets are approaching fair value.

We continue to believe the most likely scenario for the global economy is a muddling through (often referred to as the "New Normal") as many Governments implement multi-year austerity plans to repair their balance sheets. Accordingly, we expect that economic growth will likely be subdued and volatility will remain at heightened levels.

Despite progress in Europe, the attention has turned once again to Spain and Italy. Europe, in our opinion, will continue to struggle and barely post positive growth for the second half of 2012 and heading into 2013.

In this scenario, the US (with Consumer spending picking up and Housing showing signs of stabilization) and Emerging Markets (even with slower growth from China) appear to be the main engines of global growth. Canada should also benefit, although an already high currency and further signs of overheating in the housing market may pose a risk should the Bank of Canada increase rates drastically. The market expects a "normalization" of the interest rates over time but given the high level of household debt and the Canadian currency hovering around parity a large rate increase could easily derail the recovery. We anticipate the "normalization" will be done very gradually starting in 2013 and that the bank's benchmark rate will move from 1% towards a 3-4% range (often considered a non-inflationary level) over the next three years or even longer.