

Guardian Capital



GUARDIAN CAPITAL LP

Performance

The Ethical Balanced Fund returned 4.43% for the Quarter, as compared to a return of 4.06% for a blended benchmark. Equities outperformed bonds this quarter and global equities led returns of all asset classes. Asset allocation drove investment returns; however, the strategic asset allocation policy of the fund does not allow for increased allocation to, and accompanying risk associated with equities.

Portfolio Commentary

During the first quarter, the S&P/TSX returned 4.4%, but is still down -9.8% for the trailing twelve months. The S&P500 rose 12.6%, its best Q1 since 1998, and is firmly in positive territory for the trailing twelve months with a positive return of 8.5%. (All figures are in local currencies). Global markets were virtually all positive: Germany (+17.9%), France (+9.4%), U.K. (+4.7%), the BRIC's ranging from China (+9.9%) at the low end to India (+15.2%) at the high end of the spectrum. The only notable declining markets were Spain (-5.8%) and Portugal (-0.9%). Eight of ten S&P/TSX sectors rose, of which three posted double digit returns: Health Care (+15.7%), Consumer Discretionary (+14.0%) and Financials (+11.0%). Telecom (-0.9%) and Energy (-0.5%) declined. Energy, the second largest sector in the Index, fell as natural gas prices collapsed and the Canadian light and heavy oil differentials widened against the U.S. This was the result of limits within the pipeline infrastructure, refinery outages and increased pipeline capacity demand of the cross-border Bakken light oil play. The First Quarter saw "the Greek bond swap" and, "associated credit default event" take place. Two huge tranches of European bank borrowing from the ECB (LTRO). Spanish and Italian bond yields declined to the 5% range (from +/- 7%), while U.S. and Canadian bond yields rose. The 10 year U.S. treasury yield increased 44 bps in 9 days.

The yield curve flattened in Canada as market participants started to build in tighter monetary conditions from the Bank of Canada. This was advantageous, because the fixed income portfolio remains postured to take advantage of curve flattening with barbell (cash and longer dated bonds). The overweight position in longer term Provincial bonds, although providing

positive carry over Canada bonds, deteriorated in relative price as spreads widened. This had a negative effect on the portfolio. Volatility remained high in fixed income markets during the first quarter, as ten year U.S. Treasuries backed up 45 basis points over a short period. They ended the quarter 34 basis points higher in yield at a 2.21 yield. Canada bonds also moved higher in yield but not to the same degree as U.S. yields.

In the global equity sections, stock selection was positive in Information technology (Apple and Seagate Tech.). In this sector our proprietary research platform, GEMX, has surfaced a cluster of stocks in the hard disk drive market. Companies in this theme include: Western Digital and Seagate. These are the two remaining senior players in this space and both are positioned to do well. In the Healthcare sector and number of our holdings performed well including Novo-Nordisk and United Health Group.

Outlook

While we were cautious entering 2012, we now see a short-term window of opportunity. We have not changed our view on the outlook for Europe (the die is cast for a recession), United States (U.S. muddles through), Canada (poised for slower growth), or China (successful in engineering a soft landing).

What changed is that some risk factors were pushed into the future. Hence, we are entering a window of time that could see North American stock markets benefit from inexpensive markets (cheap in historical terms and particularly relative to interest rates), continued monetary liquidity (low short rates to continue) and an improving U.S. economy (although modest growth).

Stock markets should also be supported, if not buoyed, by monetary ease occurring virtually across the world. While monetary ease is a recent occurrence in the emerging markets, in Europe and the U.S. the process has been in motion for some time. Owing to the fiscal and debt difficulties in Europe and the fragility of the U.S. recovery, these should continue. The Federal Reserve does not want to risk truncating growth owing to the difficulty in getting this recovery (and the previous one at the start of the century), started in the first place. Fiscal tightening to handle the U.S. deficit is unlikely until after the Presidential election.