

Guardian Capital



GUARDIAN CAPITAL LP

Performance

The Ethical Growth Fund returned 5.21% (after all fees) during the first quarter of 2012, as compared to the S&P/TSX Composite return of 4.39%. Global equities, representing 28.2% of the portfolio, contributed to the outperformance. Only two sectors, Energy and Telecommunications had negative returns this quarter. Global indices performed better than Canadian ones, with the MSCI World Index (C\$) returning 9.50%.

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&P 500 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.

Strong performance from a variety of non-resource, non-financial stocks: Viterra rose 49% on take-over news, Gildan climbed 44% (recovering from its "cotton-induced" fourth quarter decline), while Magna rose 21% and Finning 24%. Stock selection within Materials contributed 80 bps to relative outperformance: Methanex rose 40%, recovering from its second half 2011 decline, as methanol prices did not decline as perhaps the market had expected. Our Gold stocks outperformed the Gold sub-index: Osisko (+18%) more than offset Kinross (-11%,

to our point-of-sale). Not owning Agrium (+26%) was a negative, since it outperformed our holding in Potash Corp (+8%).

Stock selection within Energy (-0.5%) was a major negative, contributing 360 bps of underperformance. Our natural gas exposed companies, owned for their exposure to natural gas liquids (as opposed to the dry gas players) were nevertheless hit hard by steep decline in natural gas prices: Paramount (-33%), Trilogy (-30%) and Celtic (-36%). Each of these three companies has volume creation beyond just waiting for a recovery in gas prices. Paramount is spinning off their oil sands assets, and selling their Bakken oil play. Trilogy has a strong Montney oil asset and both Trilogy and Celtic have a hundred sections in the Duvernay, a condensate rich natural gas play gaining increasing attention. Crew (-15%) was hurt by widening Canadian heavy oil differentials. Our underweight in Financials (+11.0%) cost 50 bps to relative performance. Not owning the life insurance companies, which rose 17% to 28%, was also a negative. Partially offsetting this was our Bank selection – we owned the best two banks, and avoided the worst two banks. Not owning strong performers mid-caps: Aastral Media (+39%, on a take-over), SXC Health Solutions (+31%) and Linemar (+54%), cost 30 bps to performance.

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.