Point of View

Special Market Update: Kevin Elliott, Portfolio Manager, Fidelity Canadian Growth Company Fund

Will the November 2008 equity market lows hold?

- The Canadian market closed on February 23 with the financials sector down over 20% this year; banks led the decline. The consumer discretionary sector also saw steep declines, driven by the automotive and consumer durables industries. The best-performing areas of the market this year have been the materials and health care sectors.
- The recent sell-off was primarily driven by U.S. financials, triggered by a lack of clarity on plans to rescue U.S. banks, along with fears of nationalization. The offsetting risk trade saw investors flock into bonds, gold and the U.S. dollar as potential safe havens.
- Recent lows should hold, provided financial stocks can rally on renewed investor confidence and further clarifications from U.S. Federal Reserve chair Ben Bernanke and U.S. president Barack Obama on a bank strategy. However, short-term volatility will likely continue. One positive sign is that base metal stocks already appear to have stabilized, based on increasing visibility concerning the Chinese fiscal spending plan.
- The real test over the longer term will be the credibility and impact of the fiscal stimulus spending plans, and whether they will be able to break the deflationary spiral that is currently underway.

Should we expect to see a U.S. dollar crisis?

- One argument is that a flight to safety, along with the U.S. dollar's reserve currency status, should help to support its value. The opposing argument is that dramatic quantitative easing will result in foreign U.S. dollar buyers "going on strike." The real question may not be how the U.S. dollar performs in relation to specific currencies, but how all currencies behave in relation to hard assets, because the majority of central banks and currencies face very similar challenges.
- One important element of this debate is the relative dominance financial services have in a given economy. In the U.S., the proportion of total banking assets to GDP is much lower than in most European nations. Also, the amount of government issuance required to offset a loss of these assets is smaller in the U.S. than in most European nations.
- This means the European currency and the pound may be under more pressure relative to the U.S. dollar as central banks in Europe and the U.K. grapple with their arguably more tenuous banking issues.
- The Canadian dollar should do well, relative to the U.S. dollar, given the relative strength of the Canadian banking system, as well as the likelihood that hard assets (e.g. resource prices) will appreciate.

What are the risks and opportunities for equities?

- This is clearly the time for investors to benefit from active management. Given the dynamics of a volatile and ever-changing market, investors may benefit from managers who actively avoid sectors that are unlikely to recover and experience share price recoveries, while focusing on the opportunities that arise as we emerge from this crisis.
- There are concerns tied to the future growth prospects of the U.S. financials sector, which is likely to be constrained by re-regulation and consumer de-leveraging. We expect consolidation, bankruptcies and a de-aggregation of financial services that will see the separation of lending from investment banking and capital market activities. Also, consumer discretionary companies, which benefited from the leveraging cycle that is currently unwinding, will likely continue to face strong headwinds.

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- Investment opportunities will be found by "following the stimulus dollars," which include new funding for health care, alternative energy and infrastructure. In these areas, growth-oriented companies currently trading at record-low valuations may offer good prospects.

- Hard asset prices will benefit from a global currency debasement, so companies related to these commodities should also benefit. Among these companies, the focus should be on the supply-demand fundamentals for the underlying commodity (and particularly on supply reductions rather than demand trends).

- Canada is well positioned to take advantage of these opportunities. Positive developments for base metals, oil, fertilizers, etc., which are benefiting from China's fiscal plan, as well as supply reductions and currency debasement, should all bode well for the Canadian market over the longer term.

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