

## I remember

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**R**emember when in the 70s, term deposits yielded returns of over 10%? It was a happy time for savers, retirees and pension funds. For borrowers, however, it was quite the opposite. Mortgage rates and personal loan rates were around 20%. The main reason for these high interest rates was inflation. The increase in oil prices caused an increase in prices, leading to an increase in salaries, causing a new increase in prices. It was the famous inflationary spiral.

Let us review what happened. After a decade of inflation in the United States, President Jimmy Carter named Paul Volcker Chairman of the Federal Reserve. Volcker did not wait to put an end to this “holiday” (the inflationary spiral of the 1970s), and immediately set up money supply controls. At the same time, he raised interest rates, with a goal to lowering the level of inflation. This period led to financial difficulties both for certain industries (automobile) and for many consumers, who had to declare personal bankruptcy. The Fed raised its key rate from 11% in 1979 to 20% in June 1981 (Graph). Inflation was vanquished at the price of a heavy recession in 1982-83. In 1983, the U.S. unemployment rate exceeded 10%.

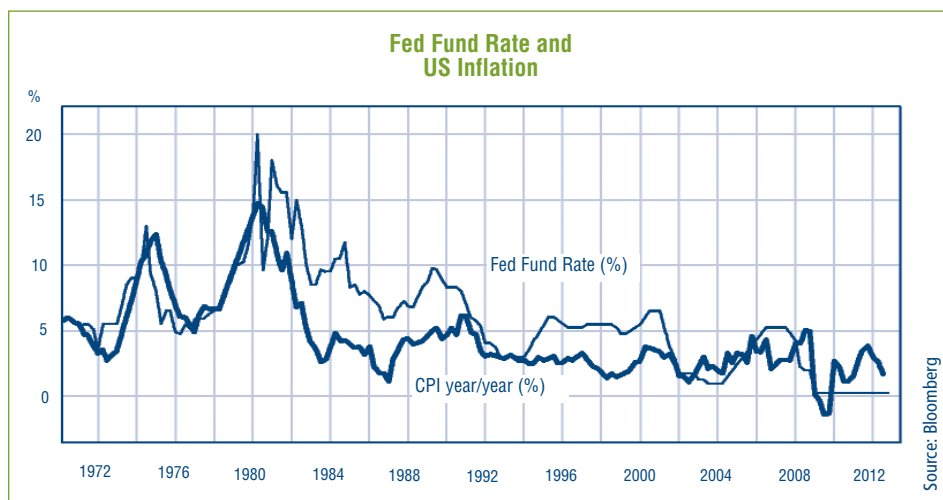
From this period on, central banks managed their monetary policies with a goal to controlling inflation. Since then, interest rates and inflation rates have continued to drop. Those who benefit from it today are consumers, businesses, and governments in debt. But savers, retirees, and pension funds are suffering heavily.

As for governments, some have benefitted. Low interest rates are beneficial for countries that have huge debts like the United States. Low interest rates encourage public authorities to accumulate debt and to continually postpone realizing essential savings. This is what happened these last few years in Canada, the United States and, especially, Europe.

The current financial situation of some European countries is tied to the discrepancies between the economies of the various countries. In a free market, a country with a weaker economy will see its currency depreciate, making its exports more competitive, that is, cheaper on the international markets. However, the price of its imports will increase. A depreciation of a country's currency is generally not a sign of a healthy economy.

However, since the creation of the Economic and Monetary Union (EMU), currency depreciation is no longer possible

**Those who benefit from the low interest rate environment today are consumers, businesses, and governments in debt. But savers, retirees, and pension funds are suffering heavily.**



because there is a single currency, and therefore a single monetary policy. Several countries did all they could to integrate the euro in order for everyone (governments, businesses, consumers) to benefit from interest rates that are lower than those prevailing before the advent of the euro. Since then, it is the European Central Bank (ECB) that defines the main orientations of monetary policy for the 17 euro-zone countries by setting a single key interest rate. The ECB does not have any instrument for differentiating one country from another. Now, the unity of the 17 countries is being put to the test because some countries are showing a better balance sheet than others.

Since 2008, European leaders have met eighteen times without really ever agreeing on what solutions to adopt. At the 19th European summit held in Brussels on June 28 and 29, euro zone members finally decided to create a mechanism to recapitalize banks directly by means of a rescue fund. In addition, consensus was achieved at the meeting on a 120 billion euro growth pact. After a difficult quarter for equities, following this summit, investors welcomed this agreement by pushing stocks up.

### Financial market Review

The stock markets' positive momentum of the beginning of the year faded in the second quarter. Europe seemed to be getting nowhere as the same problems persisted, that is, the chaotic financial and political situation in Greece, the precariousness of the banking system in Spain, and the fears of contagion to other countries. All eyes are on France and Germany, which remain the most financially solid of the European countries. In a world where information moves at lightning speed, the financial markets remain volatile.

All the major stock market indices had negative returns this quarter. The U.S. market, represented by the S&P 500, was down 2.7% in local currency (-1% in Canadian dollars). The performance of Facebook since its entry onto the stock market (-30%) hurt the technology sector of the S&P 500, which posted a return of -4% in the second quarter.

The international indices—MSCI - EAFE and MSCI - World—also had a rough quarter, with returns of -5.4% and -4.3% respectively in local currency (-5.3% and -3.2% in Canadian dollars terms). The countries largely responsible for this poor performance were Greece, Portugal and Spain.

The Canadian stock market, represented by the S&P/TSX Composite Index, generated a return of -5.7% in the second quarter. Given that raw materials prices have tumbled since the start of the year and that natural resources account for nearly 50% of the Canadian index, this poor performance is not surprising. Cyclical sectors such as energy, materials and technology delivered the worst returns, with -7.3%, -10.8% and -17.8% respectively. The Research In Motion disaster (-48%) during the quarter weighed down this sector's performance. Defensive sectors such as consumer staples, telecommunications and utilities posted returns of 1.4%, 2.8% and -0.5% respectively.

The stock and bond markets have been moving in opposite directions since the start of the year. The first months of 2012 showed some optimism reflected in the stock markets, which posted positive returns at the end of the first quarter, while the Canadian bond index offered a slightly negative return in light of the increase in the interest rate curve. Then in the second quarter, the wind turned in favour of bonds, as investors sought safety because of the uncertainty coming from Europe. Thus, the DEX Universe Bond Index ended the second quarter up 2.2%.

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## Table of net returns as at June 30, 2012

	Unit value \$	Net assets <sup>1</sup> in millions \$	Simple returns <sup>2</sup>			Compound annual returns				MER <sup>3</sup> %	GSB Fund Fee Rate <sup>4</sup> %	Investment Advisor
			1 month %	3 months %	YTD <sup>1</sup> %	1 year %	3 years %	5 years %	10 years %			
<b>FOCUS FUNDS</b>												<b>ECOFLXTRA</b>
Focus Prudent	14.40	165.0	0.5	(0.1)	0.9	2.2	4.1	2.4*	3.7*	2.63	0.50	Various Managers
Focus Moderate	14.42	236.5	0.9	(1.2)	0.9	(0.6)	3.8	1.1*	3.4*	2.72	0.60	Various Managers
Focus Balanced	14.36	390.0	1.3	(2.2)	0.8	(3.4)	3.5	(0.2)*	3.1*	2.85	0.60	Various Managers
Focus Growth	14.26	125.6	1.8	(3.2)	0.7	(6.2)	3.2	(1.6)*	2.8*	2.89	0.75	Various Managers
Focus Aggressive	14.14	56.4	2.2	(4.2)	0.7	(8.8)	2.9	(3.0)*	2.5*	2.90	1.00	Various Managers
<b>INCOME FUNDS</b>												<b>ECOFLXTRA</b>
Money Market	16.94	210.8	0.0	0.0	0.1	0.1	0.1	0.8*	1.3*	1.50	0.50	Industrial Alliance
Short Term Bonds	15.34	217.4	0.0	0.5	0.2	2.1	2.4	2.7*	2.6*	2.16	0.50	Industrial Alliance
Bonds	26.97	2,552.6	(0.1)	1.6	1.0	7.3	4.7	5.0*	4.5*	2.18	0.50	Industrial Alliance
<b>DIVERSIFIED FUNDS</b>												<b>ECOFLXTRA</b>
Diversified Security	17.33	328.4	0.5	(1.3)	(0.3)	0.0	3.6	2.5*	4.0*	2.68	0.50	Industrial Alliance
Diversified	30.50	1,593.7	1.2	(2.8)	(0.1)	(3.6)	3.5	0.5*	4.0*	2.69	0.60	Industrial Alliance
Diversified Opportunity	18.46	197.7	1.4	(4.6)	(1.1)	(7.5)	3.1	(0.7)*	4.1*	2.78	0.75	Industrial Alliance
Fidelity Canadian Asset Allocation	15.06	463.6	0.6	(3.4)	(1.5)	(5.7)	3.3	0.0*	4.6*	3.07	0.75	Fidelity
Canadian Balanced (QV)	11.02	79.6	0.7	(1.9)	0.9	(1.8)	5.6*	0.3*	3.4*	3.03	0.75	QV Investors Inc.
SRI Balanced (Inhance)	10.70	6.8	0.8	(1.5)	2.3	0.0	-	-	-	3.01	0.75	Vancity
Diversified Income	18.30	172.7	1.1	(4.9)	(0.6)	(7.2)	7.9	2.4*	-	2.67	0.75	Industrial Alliance
Global Diversified (Aston Hill)	10.15	40.8	0.6	(2.5)	3.3	(0.3)	8.0	(0.3)*	-	3.07	0.75	Aston Hill
Tactical Income (Aston Hill)	14.66	194.8	0.4	(1.3)	2.3	(1.6)	9.0	-	-	3.08	0.75	Aston Hill
<b>CANADIAN EQUITY FUNDS</b>												<b>ECOFLXTRA</b>
Strategic Equity Income	10.82	142.8	0.7	(2.8)	2.9	(2.9)	6.5	(2.9)*	4.5*	2.43	1.00	IA Clarington
Dividend Growth	13.08	701.4	1.6	(3.4)	1.1	(5.1)	6.2	0.4*	7.5*	2.67	1.00	Industrial Alliance
Canadian Equity (Leon Frazer)	15.37	186.1	0.5	(3.8)	(1.1)	(3.6)	9.0	2.1*	-	3.02	1.00	Leon Frazer
Canadian Equity Index	15.94	154.7	1.3	(6.2)	(2.6)	(12.9)	1.7	(3.5)*	4.4*	2.77	1.25	Industrial Alliance
Select Canadian <sup>6</sup>	21.76	38.5	1.3	(7.9)	(5.1)	(15.9)	1.6	(2.8)*	4.9*	2.73	1.25	Industrial Alliance
Canadian Equity Value	33.61	343.8	2.1	(5.8)	(1.8)	(12.7)	1.6	(4.5)*	3.5*	2.78	1.25	Industrial Alliance
Canadian Equity (Dynamic)	14.83	475.5	2.0	(5.4)	(2.4)	(20.1)	1.0	(4.6)*	7.9*	3.14	1.25	Dynamic
Canadian Equity (Jarislowsky)	12.57	101.1	1.4	(4.6)	(1.3)	(10.5)	2.1	(2.9)*	5.1*	3.11	1.25	Jarislowsky
Canadian Leaders	11.52	9.0	0.5	(7.5)	(3.5)	(17.2)	(1.5)	(3.3)*	-	2.79	1.25	Industrial Alliance
Fidelity True North <sup>®</sup>	22.29	318.2	1.8	(2.9)	0.7	(7.2)	4.6	(2.5)*	5.3*	3.20	1.25	Fidelity
Canadian Equity Growth	19.59	272.4	1.1	(7.0)	(2.3)	(13.1)	4.6	(1.2)*	6.7*	2.75	1.25	Industrial Alliance
Fidelity Canadian Opportunities	25.80	172.6	(0.6)	(4.7)	0.5	(7.7)	12.5	3.4*	7.2*	3.20	1.25	Fidelity
Canadian Equity (Small Cap.) (QV)	16.76	32.5	2.3	0.8	12.1	5.9	14.4	0.9*	9.1*	3.17	1.25	QV Investors Inc.

## Table of net returns as at June 30, 2012 (continued)

	Unit value \$	Net assets <sup>1</sup> in millions \$	Simple returns <sup>2</sup>			Compound annual returns				MER <sup>3</sup> %	GSB Fund Fee Rate <sup>4</sup> %	Investment Advisor
			1 month %	3 months %	YTD %	1 year %	3 years %	5 years %	10 years %			
<b>U.S. &amp; INTERNATIONAL EQUITY FUNDS</b>												<b>ECOFLEXTRA</b>
Global Dividend (Dynamic)	10.08	56.1	1.1	0.8	5.2	(3.0)	7.9	(1.7)*	-	3.11	1.25	Dynamic
Global Dividend (BNP Paribas)	13.65	5.3	5.0	(1.6)	4.7	(2.1)	8.8	(6.9)*	-	3.06	1.25	BNP Paribas Inv Partners
Global Equity	11.20	78.5	2.8	(3.9)	6.7	(4.9)	-	-	-	2.97	1.25	Industrial Alliance
Global Equity (Templeton)	8.74	191.1	5.7	(7.9)	1.1	(12.6)	(0.3)	(9.1)*	(2.0)*	3.22	1.25	Templeton
Global Equity (Mackenzie Cundill)	11.27	12.2	5.7	(12.2)	4.5	(13.3)	2.2	(6.1)*	1.7*	3.37	1.25	Mackenzie Cundill
Fidelity NorthStar®	9.59	33.6	1.1	(4.0)	3.5	(6.1)	5.3	(4.4)*	-	3.23	1.25	Fidelity
Global Equity Small Cap. (DB Advisors)	8.67	88.9	1.1	(7.3)	1.7	(8.5)	5.4	(5.3)*	-	3.22	1.25	DB Advisors
International Equity Index	6.02	12.6	5.1	(5.7)	1.9	(11.0)	(1.0)	(8.7)*	(1.4)*	2.71	1.25	BlackRock
International Equity	11.33	230.2	3.8	(4.6)	4.5	(13.1)	1.4*	-	-	2.88	1.25	Industrial Alliance
International Equity (Templeton)	10.59	52.9	5.3	(7.8)	(1.0)	(15.1)	(2.5)	(10.2)*	(2.1)*	3.17	1.25	Templeton
International Equity (MFS McLean)	8.59	6.1	4.4	(5.7)	2.7	(8.9)	(0.4)	(7.2)*	(1.3)*	3.08	1.25	MFS McLean Budden
Fidelity European Equity	8.16	51.2	3.9	(5.4)	8.4	(8.6)	2.5	(6.5)*	1.2*	3.21	1.25	Fidelity
U.S. Equity Index	8.06	26.1	2.3	(1.4)	8.1	8.3	8.2	(3.7)*	(1.8)*	2.74	1.25	SSgA (State Street)
U.S. Equity	8.80	285.5	2.2	(2.9)	8.8	5.3	6.3*	(3.7)*	-	3.01	1.25	Industrial Alliance
U.S. Equity (MFS McLean)	9.19	33.8	1.4	(3.5)	6.1	2.3	3.9	(4.8)*	(1.1)*	3.02	1.25	MFS McLean Budden
U.S. Equity (Sarbit)	14.00	23.6	5.6	(0.2)	9.4	1.7	13.6*	-	-	3.17	1.25	Sarbit
<b>DISTINCTION FUNDS**</b>												<b>ECOFLEXTRA</b>
Distinction Prudent	12.12	4.7	0.8	(2.2)	1.3	(0.9)	4.3	0.5*	-	2.85	0.60	Industrial Alliance
Distinction Conservative	12.43	8.4	0.9	(3.2)	0.7	(2.9)	4.2	(0.1)*	-	2.87	0.60	Industrial Alliance
Distinction Balanced	12.96	30.9	1.2	(2.7)	1.2	(2.8)	5.2	(0.8)*	-	2.91	0.75	Industrial Alliance
Distinction Monthly Income	13.20	5.6	1.0	(1.3)	2.2	(0.5)	6.6	(1.1)*	-	2.73	0.75	Industrial Alliance
Distinction Growth	12.80	14.5	1.8	(4.6)	0.7	(6.5)	4.2	(3.0)*	-	3.05	0.75	Industrial Alliance
Distinction Bold	12.93	2.6	2.2	(5.5)	0.5	(8.1)	4.3	(3.8)*	-	3.12	1.00	Industrial Alliance

Returns after deduction of MER (Management expense ratio). Past performance is not a guarantee of future returns.

The EcoStrategist in Brief | Ecoflextra economic and financial bulletin, produced monthly, and its more exhaustive annually version, are available on the Company's website under *Investment Vehicles* and *Publications*.

<sup>1</sup> Total net assets of the fund including individual and group contracts.

<sup>2</sup> The rates for the period are non-annualized.

<sup>3</sup> Management expense ratio (GST and HST included).

<sup>4</sup> The GSB fund fee rate (guaranteed surrender balance) is used to determine the GSB Fee based on the year-end GSB. The GSB fund fee rate applies to the Guaranteed Surrender series only.

<sup>5</sup> Indexes presented in this document are total return index.

<sup>6</sup> Not offered in registered contracts and TFSAs.

\* Simulation of past returns as if the fund had been in effect for these periods.

Index funds: Simulation of past returns from the return of the index that the fund aims to reproduce.

\*\* Distinction Funds are only offered in the Guaranteed Surrender Series.

Reference indexes<sup>5</sup> - Returns as at June 30, 2012

	Simple returns <sup>2</sup>			Compound annual returns			
	1 month %	3 months %	YTD %	1 year %	3 years %	5 years %	10 years %
<b>INDEXES RELATED TO INCOME FUNDS</b>							
DEX 91 day Tbill Index	0.1	0.3	0.5	1.0	0.7	1.7	2.4
DEX Short Term Bond Index	0.1	0.9	0.9	3.8	3.8	5.1	4.8
DEX Universe Bond Index	0.0	2.2	2.0	9.5	7.0	7.0	6.5
S&P/TSX Capped Income Trusts (Total Return)	2.6	4.2	9.5	17.5	28.6	11.8	15.7
SB - World Government Bonds (Can. \$)	(1.5)	2.9	0.6	8.5	0.8	6.4	2.6
<b>INDEXES RELATED TO CANADIAN EQUITY FUNDS</b>							
S&P/TSX 60	1.5	(5.4)	(1.1)	(10.6)	4.5	(1.0)	7.6
S&P/TSX Completion Index	0.1	(6.5)	(2.8)	(9.4)	14.6	0.4	8.5
S&P/TSX Composite Index	1.1	(5.7)	(1.5)	(10.3)	6.7	(0.7)	7.6
S&P/TSX Capped Composite Index	1.1	(5.7)	(1.5)	(10.3)	6.7	(0.7)	7.6
S&P/TSX SmallCap Index	(2.1)	(13.1)	(7.9)	(19.6)	12.7	(3.7)	4.0
<b>INDEXES RELATED TO U.S. &amp; INTERNATIONAL EQUITY FUNDS</b>							
S&P 500 (Can. \$)	2.5	(0.8)	9.7	11.4	11.4	(0.6)	1.2
S&P 500 (Can. \$) (Reuters)	2.5	(0.8)	9.6	11.4	11.4	(0.6)	1.2
MSCI - World (Can. \$)	3.5	(3.2)	6.1	0.4	6.2	(3.8)	1.1
MSCI - World Small Cap. (Can. \$)	2.1	(4.3)	6.8	(2.8)	10.8	(1.8)	4.8
S&P Citigroup High Income Equity Index (Can. \$)	5.1	(2.0)	4.4	(0.2)	11.6	(4.9)	-
MSCI - EAFE (Can. \$)	5.4	(5.3)	3.2	(8.9)	1.4	(6.9)	1.0
MSCI - EAFE (Can. \$) (Reuters)	5.3	(5.3)	3.1	(9.0)	1.5	(6.9)	1.0
MSCI - Europe (Can. \$)	6.3	(5.2)	3.2	(11.1)	2.4	(7.2)	1.5
<b>EXCHANGE RATE (Can. \$ / US \$)</b>							
As at June 30, 2012: 1.0191	(1.5)	2.0	0.2	5.7	(4.3)	(0.8)	(3.9)
<b>EXCHANGE RATE (US \$ / Can. \$)</b>							
As at June 30, 2012: 0.9813	1.6	(2.0)	(0.2)	(5.4)	4.5	0.9	4.1

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Investors' patience has been severely tested for several months. Europe's inertia in resolving the sovereign debt crisis is causing the countries most in debt—Greece, Spain, Portugal and Italy—to sink deeper and deeper. At a time when inflation seems to be under control and when the economic activity of the euro zone is stagnating, on July 5,

the European Central Bank lowered its key rate to 0.75%, its lowest level ever. Faced with this bleak economic and financial environment, some central banks including those of China and India lowered their key rate. The U.S. Federal Reserve and the Bank of Canada, meanwhile, declared they would maintain their current rate until 2013. ■