

A Catastrophic Event

To say the very least - we've been through tumultuous times. And just when things appear to be righting themselves against the horizon and financial markets appear to be headed in the right direction, another tragedy strikes and global equity markets feel the repercussions.

The loss of lives and depth of suffering in Japan is tragic; our thoughts and prayers are with them. The Japanese economy will struggle for some time to come. When uncertainty strikes, we often look to history for what may lie in the days ahead. After past disasters of similar magnitude - such as the 1995 Kobe earthquake, and Hurricane Katrina in 2005, economic impacts were largely felt for one to two quarters (three to six months) and are usually for the most part centered in the direct area of the disaster. These nations began rebuilding and returned to a relative sense of normalcy in a timely manner. Apart from a major hit to a world financial centre, earthquakes and other disasters similar to Japan tend to have short term impact on the markets. The following events bear witness:

CATASTROPIC EVENTS - MINIMAL IMPACT

Natural disasters in the last 25 years have not had a severe effect on markets:

Date	Event	Damages	% change			
			Gold	S&P 500	TSX energy	TSX materials
Oct. 1989	San Francisco quake	\$ 11-billion	6.8	-0.2	-1.2	5.1
Aug. 1992	Hurricane Andrew	\$ 25-billion	2.0	1.6	7.0	2.1
Jan. 1994	Los Angeles quake	\$ 44-billion	-1.9	-0.2	-0.9	-5.4
Jan. 1995	Kobe quake	\$118-billion	-0.4	2.8	2.5	-6.8
Sep. 2004	Hurricane Ivan	\$ 19-billion	4.2	-1.4	8.1	3.5
Aug. 2005	Hurricane Katrina	\$100-billion	6.3	0.3	8.2	3.6
May 2008	Sichuan quake	\$ 86-billion	-0.6	-3.2	2.4	2.9
Feb. 2010	Maule quake	\$ 30-billion	-0.1	6.2	0.7	0.9
Average			2.0	0.7	3.4	0.7

% chg: 21 days after event; all figures in US dollars

Source: Desjardins Securities

Although Japan has a tremendous clean up and rebuild task ahead, markets have already begun rebounding, and turmoil is expected to subside soon, based on previous history. Major catastrophes result in investor tension and upset, but do not debilitate global markets. The overall effect on markets tends to be minimal and anticipation of a global economic impact is considered quite limited. On average, the S&P has actually gained 0.7 per cent one month after a major natural disaster. Gold and energy sectors have fared well in the period after.

Japan's Nikkei index, which dropped almost 11 per cent on the Tuesday following the quake to 8,605 points, is still well above its low two years ago of 7,173. Many investors have snapped up market bargains after the initial drop. The Yen is surging based on anticipation of demand, repatriation, and short term speculation. As a strong Yen hurts Japanese exports (Japan is the world's 3rd largest economy) many look to the intervention of the Finance Ministry and Bank of Japan. The Bank of Japan (BOJ) has announced it will consider every measure to provide sufficient liquidity, starting with a massive 15 trillion yen open market operation, where the BOJ will buy bonds from banks to provide them with short-term liquidity. In addition, the BOJ doubled its risk-asset purchase program to 10 trillion yen. Japan's financial system remains solid.

Following the Kobe quake, GDP growth in 1995 and 1996 averaged 1.9 and 2.6 per cent, above the long-term trend. Most believe this trend will hold true, as reconstruction efforts begin. What will be the effect here at home? With Japan only representing 2% of our exports, overall the effect is anticipated to be minimal. Even if Japan were to experience 2% less GDP, global GDP would only be affected negatively by a quarter point.

Japan has a long history of earthquakes and is better prepared than most countries to deal with them. Many businesses will have earthquake or flood insurance, and rebuilding is anticipated to begin quickly. Japan's ability to restore their power generation will play into the equation, as current energy rationing could continue with rolling blackouts until capacity is regained. The government will invest in infrastructure and reconstruction efforts in the affected areas, and the economic dynamics of reconstruction will buoy the economy. In rebuilding, commodities fare well (lumber, steel, concrete, conduits, etc.) construction and engineering firms experience increased earnings, as do all who are involved in the clean up and reconstruction of towns, plants, and infrastructure. Currency will fluctuate, and markets will rebound. Barring further events, it's believed that Japan should bounce back in the second half of this year.

Life will, albeit slowly, return to some form of normalcy in Japan. But it will take time. This most recent seismic and potential nuclear disaster, combined with Europe and its debt problems, political unrest in the Arab world, China's steps to curb inflation – may all combine to make it difficult for you to envision good days ahead. But there will be. The slow but certain economic recovery in the US will drive capital markets. Short term profit-taking activities will result in market fluctuations as always. With all due sensitivity to Japan and other serious situations around the globe, remember that disasters like this are in fact opportunities to pick up very real bargains in the marketplace when others panic sell.

In good time, the markets will moderate themselves - they always have. As will your investment portfolio. Now is not a time to panic, sell, or do anything else drastic in the heat of the moment. Our investment time horizon is beyond the next month or couple of quarters. Rest assured that all investments in your portfolio have been chosen according to very strict criteria, mandated valuations, and are high quality companies who provide a margin of safety against permanent loss in situations like this. These events remind us of the importance of maintaining a well-diversified portfolio. I anticipate mid-term recovery and I am highly confident that your investments will regain lost ground in good time. As with every momentous change in life, it's time to regroup, reality check, and push on. Stay the course, as you always have, and you will be glad when you look back on this time.

We have our families, a roof over our head, our cities are intact, and we're able to continue on in our daily lives as we have become accustomed to. Patience is all we really need now. We've been down this road before, more often than we all care to be. But we can and will be patient. Our portfolios will rebound - they always have. It may be difficult, but please maintain perspective in these trying times. If you have concerns of any nature, give us a call.

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