

Weekly Trend Watch

February 12, 2010



Inflation/Deflation Timer - Current Indication:

Neutral

The Inflation-Deflation Timer is a trend-following model, and this class of model is incapable of calling tops or bottoms, and therefore its value is in the ability to spot trends. The trends we are looking for are: inflation, deflation and neutral.

This publication is an ongoing monitor of the Inflation-Deflation Timer model, for more information on the model, see:

http://www.qwestfunds.com/publications/newsletters_pdf/newsletter_november_2009.pdf; and
http://www.qwestfunds.com/publications/newsletters_pdf/newsletter_february_2010.pdf

Cam Hui, Board of Advisors, Qwest Investment Management Corp.

Qwest Commentary

A neutral reading

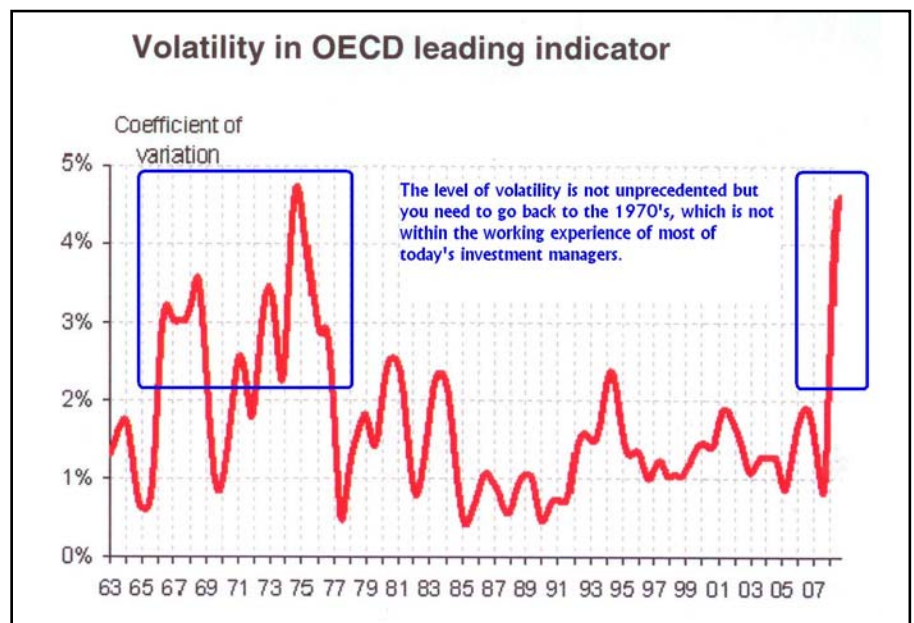
The Inflation-Deflation Timer model remains at neutral after moving from an inflation reading to neutral in late January 2010.

A New Era for dynamic asset allocation?

We believe that investors face a highly uncertain macro-economic environment, which is an ideal environment for the utilization of dynamic asset allocation techniques to preserve wealth and at the same time earn a reasonable return.

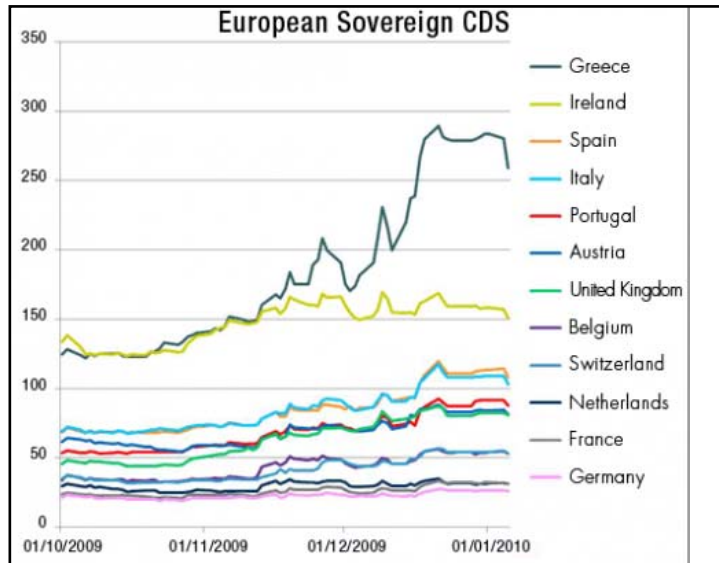
The accompanying chart from Macquarie Equities Research illustrates our point. The volatility in the OECD leading indicator has skyrocketed in the wake of the Great Recession. This level of volatility is not unprecedented, but most investment managers working today haven't experienced it in their own working lives and may not be able to properly adjust to the current environment.

Consider, for example, Europe's problem with Greece. If Germany, France, and the Netherlands don't bail out Greece, then what will become of Portugal and Spain? How about Italy and Ireland? On the other hand, if they do bail out Greece, then will Portugal and Spain be next in line? What will they do when Italy and Ireland come calling?



In aggregate, this is big!

There are no good places to hide during periods of macro-economic volatility, not even in the fixed income markets. The accompanying top chart shows the prices of credit default swaps, or the cost of credit insurance, for the debt of selected European countries. Just imagine the results from a buy and hold strategy with a portfolio of sovereign debt issued by countries like Greece, Portugal, Italy and Spain. Even a diversified bond portfolio would have been negatively impacted and risk greatly increased for future performance.



For another perspective, the bottom chart shows the price returns of XBB, an exchange traded fund designed to track the DEX Bond Universe, a diversified index of Canadian bonds. Even diversified Canadian bond portfolios have experienced high degrees of volatility during periods of economic crisis.



Could we undergo another crisis and see history repeat itself? Buy and hold strategies are likely to perform sub-optimally in such environments. Only dynamic asset allocation models can successfully navigate this form of turmoil.

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