

“FOMO” Fear of Missing Out April 2009

While we are waiting to see how the swine flu pandemic plays out, let us take a moment for some happy thoughts. They say that the best way to stay healthy is to have a positive disposition. In that spirit, here we go:

- In the US, consumer confidence rebounded during April.
- The percentage of consumers who say that jobs are hard to get edged down in April after rising thirteen of the previous fourteen months. This tends to confirm the recent downticks in weekly initial unemployment claims.
- The home price story is not all bad news recently. Indeed, after more than a year and a half of declines, California's median home price finally managed a meager gain, rising 2.2% month over month.
- Corning is bringing back some laid off workers on stronger-than-expected demand for glass used in making flat-screen televisions.
- Sharp is forecasting a strong recovery in profits and sales in all its business divisions during the second half of the year.
- IBM said recently that it will increase its quarterly dividend by 10% and will repurchase an additional \$3 billion of its stock.
- The April 28th *Financial Times* reported that the high yield bond market may be starting to open up again. About \$7 billion was raised in April, the highest volume since last July.
- The stock market held up remarkably well on April 27th and 28th despite nervousness over bank stress tests, swine flu, and the forced downsizing of the US auto industry.
- The Q1 earnings season is off to a good start as 64% of the 235 S&P 500 companies reporting so far have a positive surprise and all 10 sectors are beating their Q1 forecast as well.
- Yardeni Research's Fundamental Stock Market Index rose during the week of April 18 as jobless claims edged lower and the Consumer Comfort Index moved higher.
- *Condé Nast* has decided to shutter *Portfolio* after two years of struggle. The introduction of the glitzy magazine about Wall Street launched in the spring of 2007 marked the end of the bull market. Now its demise may mark the end of the bear market.
- Confidence in the Euro Zone rose in April from a record low in March. The European Commission's economic sentiment indicator jumped up to 67.2, from a revised 64.7 in March, but remains well below its long-term average of 100. Households and firms are less pessimistic about the outlook.
- Michael Douglas and Oliver Stone have signed on for a sequel to the 1987 classic *Wall Street* also marking a physiological turning point.

We are encouraged with the bottoming action we are seeing in Global economic data. We do think that the next 6 months will likely be defined by very slow growth, and any recovery will be very mild in the short term. We are convinced a meaningful recovery will be accompanied with very rapid inflation and another bull market for Commodities.

Last weeks biggest news story in my view was the optimism that is coming out of China that growth is returning. The world's fastest growing economy and biggest user of raw materials has been faltering for the first two months of the year, but March data appears to be turning for the better. Global GDP growth is depending on China to lead us out of the recovery and according to two separate reports; there are signs of life here. That didn't stop some individual commodities from some pain, but looking at the weekly performance for the S&PTSX subgroups, it is no surprise to us that Materials were up 7.5% last week.

The US Dollar has been under pressure recently as the Obama Administration's spokespeople were out in force yesterday telling the world just how seriously weak the US economy is and just how weak it shall remain "*for quite some time this year.*" This was the statement made yesterday on Fox News Sunday by Dr. Lawrence Summers, the Director of the White House' National Economic Council and the gentleman most likely to replace either Mr. Geithner or Dr. Bernanke at some point in the future. Dr. Summers minced no words when he said that he expects "*the economy will continue to decline*" and that unemployment will continue to work its way higher for quite some long while into the future. We really did not find his comments all that surprising, but apparently the rest of the world has, and in the process has marked share prices materially lower and has marked the dollar down even more swiftly.

Some leading economic indicators improved again in April and have now turned positive. This suggests that the US economy will resume growth within a 3-6 month time frame. Improvements were seen in several indicators including the CRB Index (Commodity Research Bureau) of raw materials which is in a strong uptrend, the leveling off of the four-week trend of initial unemployment claims and upside surprises from recent economic results. In addition, the US stock market is now well above its 100-day moving average signaling greater confidence among investors in the future outlook for the economy.

While the US Government was working on yet another multi-billion dollar bailout of former insurance giant AIG, its executives were busy doling out their own personal bailout in the form of "retention" bonuses worth more than \$200 million. At around the same time, Bank of America President Ken Lewis - whose company was a recipient of \$45 billion in US TARP loans - refused to make any excuses or concessions with respect to more than \$3 billion in bonuses paid in December of 2008 to executives of its newly acquired brokerage unit, Merrill Lynch. If that was not enough, there were few signs of contrition from the public companies at the center of the global sub-prime loan fiasco.

In March of 2009, the US Congress, sensing the public's mood, hopped onto the bandwagon and threatened to unilaterally (and, apparently, unconstitutionally) tax the AIG bonuses at a 90% rate while demanding that the names of the bonus recipients at AIG and Merrill be made public. Into this fray rode the recently installed CEO of AIG, Edward Liddy, who must have been wishing that he had taken a less dangerous job. Liddy, facing the wrath of congress, did his best to explain why the bonuses were being paid (which were not granted on his watch) and then read several anonymous and threatening emails that had been sent to executives at AIG.

It was at this point that the American heartland apparently decided that they had seen enough. In a scene worthy of the 1970's movie Network ("I'm mad as hell, and I'm not going to take it any more"), busloads of angry locals descended on the stately Connecticut homes of AIG executives and threatened to take robust and definitely non-legislative action if the government did not do

something. For awhile it looked like a good old-fashion public lynching was in the cards before cooler heads prevailed and the mob (by Connecticut standards) dispersed.

And then, almost as if by miracle, the bank stocks began to rally, first little by little, and then with a 50% upward burst in a period of seven days, fueled by near record profits at Goldman Sachs and Wells Fargo. Anger seemed to be replaced overnight with the smell of money, as if the mass venting of anger and frustration had somehow signaled a bottoming to the despondency and fear that has gripped so many of the world's consumers and investors.

If so, such a moment would not be a first. While most of us are familiar with the Great Depression of the 1930's, few are aware of an almost equally awful time that lasted from 1893-1898. The years preceding the collapse had been prosperous ones with the building out of the American railroads, a huge stock market boom and fortunes made by the capitalists of the time. But in 1893, a financial panic swept the country and a run on the banks ensued. The stock market crashed, unemployment soared to 15%, and deflation gripped the land devastating debt holders as the value of their assets collapsed. Anger and bitterness prevailed between the rural and urban classes and between workers and their employers for more than five years. In 1898, the economy finally began to recover as employees began to accept lower wages and return to work. The memories, however, prevailed for many years to come.

In 1900, the great novel the *Wizard of Oz*, by L. Frank Baum was published. The novel was allegorical on many levels, the most obvious of which to adult readers in 1900 would have been the utter vilification of bankers and capitalist rogues in the form of witches and their flying monkey henchmen. The Wizard himself was the great deceiver, US President, William McKinley. The yellow brick road and Dorothy's silver slippers (changed to Ruby slippers for the movie) represented the intense debate during that period over the gold standard and the proposed free coinage of silver (which would have caused inflation, thus helping the debt ridden farmers of the time). Dorothy and her heartland friends and family represented all that was good about America, suggesting that it is here that economic and moral salvation lies.

The great recession of the 1890's, the Great Depression of the 1930's and even today's more modest version, all have similar characteristics of "new era" thinking fueling economic bubbles, misallocation of capital, corruption and greed. Financial collapse and panic ensues, and, finally, convenient scapegoats are found to explain the extremely complex events that led to the collapse in the first place. It is this mass catharsis of finding and vilifying evil-doers that helps to set the table for the next upward cycle. For this we all owe AIG and its executive's some degree or gratitude for their audacity and unapologetic greed.

The last twelve months have proven to be a period of extreme fluctuations – investors first worried about inflationary pressures as oil rose to \$144 US a barrel, but by the end of 2008 deflation became the major concern. As a result, it turned out to be a good year for the bond market which rallied very strongly. This may, however, turn out to be the next bubble to break as governments increasingly resort to printing money.

The rout set off by the sub-prime mortgage collapse continues to play havoc with capital markets. It has landed such a devastating blow to economic activity to the point where the World Bank is now forecasting that the global economy will likely shrink for the first time since World War II.

Deflation has become the predominant short term risk across the globe, in particular for the United States and Japan.

Despite all the despair and market volatility that we have seen through the first quarter, there are a number of positives beginning to appear and there may even be a twinkle of light at the end of the tunnel. Some of the encouraging signs stem from the intense attention that the G20 have given to the problem. A plethora of support has been put in place ranging from a variety of stimulus packages and quantitative easing strategies.

Some leading economic indicators have turned more positive, credit spreads have narrowed and the U.S. Treasury has been successful in raising needed funds. The stimulus measures being enacted by President Obama are having positive psychological effects, which is a key requirement to repairing confidence. Some bank nationalization has been done successfully, the problem of toxic assets is being addressed and the all important housing market is showing signs of bottoming. Commodity prices have bottomed, and in fact bounced off their lows led by oil.

An economic recovery will only be confirmed when risk assets once again outperform defensive assets on a consistent year over year basis. A return of inflation is inevitable although the timing is uncertain. While today risk aversion has investors flocking to the safety of U.S. treasury bills, this is not where one would want to be when the first signs of a recovery and inflation appear on the horizon. We hope the worst is behind us and we are beginning to see opportunities after a shaky start in January and February.

The current economic and market environment is probably the most challenging that many in the financial community have ever seen. As such, one may expect to witness significant mood swings as the year progresses, alternating between hope, despair, greed and fear. Many, unfortunately, still believe that this recession will end up like other recessions since World War II - not lasting very long. What we are experiencing today however, is far different from anything seen in the post war era. Having said that, we find the markets ending the quarter in the midst of a rally, one that may have some good "legs" beneath it. However, we cannot take our eyes off the ball when it comes to earnings and the economic reality that exists today. What we may be experiencing is a rally focused on short covering, reallocations, pension contributions and performance anxiety. Despite the massive stimulus measures being undertaken globally, we continue to believe that a recovery is going to be a very long process. As such, we are anticipating using market strength to once again reduce equities. Meanwhile, with governments all over the world attempting to buy jobs through massive infrastructure spending, we will be adding to stocks exposed to this area. Recent purchases were also focused on sectors that may be less significantly impacted by the current economic slowdown and that have both visible earnings and the potential for dividend growth. Furthermore, after years of avoiding the Canadian banks, we added to this sector. In spite of a weak global economy, we continue to be positive on the long term outlook for commodities, in particular gold, energy and food. Depletion, lack of investment and cancelled or delayed projects because of financing problems will ultimately lead to fears of shortages and higher prices once global economies recover. Furthermore, it is just a matter of time before the world economies are hit by an inflationary cycle resulting from the massive global stimulus measures.

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