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The Newsletter for the Informed Investor – www.rbc.com/vito.finucci

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The **big** Picture



Presidential Promises – The Economic Sweet Spot

Despite recent events in the Middle East and Japan, the outlook for the global economy in 2011 can be described as mixed, but on balance, positive. There is growing evidence that a sustainable recovery is developing in the USA coupled with robust growth in emerging markets that is expected to offset risks elsewhere.

Following a period of heightened uncertainty largely due to media announcements of double-dip recessions, equity markets have been propelled higher by better-than-expected earnings and economic growth, attractive valuations not seen in decades and positive multi-year technical indicators.

Markets entered 2011 with the wind at their back.

In fact, at one point, North American markets were up 6-8% until recently. The markets have been extremely volatile over the past few weeks as politically motivated uprisings in Tunisia, Egypt, Bahrain and Libya have escalated investor fears about the possible fallout from interruptions in oil supplies which could undermine global economic growth. Reductions in oil output could have a more serious impact on the entire global economy

IN THE LONG RUN THE PESSIMISTS HAVE THE UPPER HAND

than news out of Greece, Ireland or Dubai which dominated headlines in 2010. A rise of \$20 per barrel in crude oil prices adds US\$400 million a day to the overall costs in the US economy, offsetting gains made from lower taxes or stimulus spending.

The last two oil price shocks (1973-74 and 1979-80) each led to a recession in the U.S. economy and subsequent bear markets in equities. Recent events pretty well wiped out that 6-8% gain we enjoyed in the span of about two weeks. Markets had basically gone up since recent lows last August and as we have been writing, we were overdue for some sort of pullback/pause.

These recent developments were simply the excuse for the correction.

Although the problems in the Gulf region are serious and could prove disruptive to the economic recovery underway, they also reinforce the growing reality that our world is changing because of the impact of information and technology. All of the uprisings in Egypt, Bahrain and Libya were prompted by access to information on the Internet via smart phones, Twitter and social networking sites. While short term it creates a lot of uncertainty and questions, I can't believe ridding the world of repressive dictatorships one by one is a bad thing in the long run.

It's hard to believe we can match the volatility of 2010, with some of the most extreme swings in month by month in the history of markets.

Investors came into 2011, the "Year of the Rabbit", constructive about the outlook. Mutual fund buyers, who shunned equities in favour of bonds during most of 2010, bought more common stocks in January 2011 than in any month since 2003. In February, inflation which had not been a problem suddenly became a concern. While most Americans realize they can't run trillion-dollar deficits indefinitely, few seem willing to make the sacrifices necessary to bring expenditures in line with receipts. Even fewer politicians are willing to do so and run the risk of not being re-elected.

And speaking of elections, the U.S. Presidential election is in November 2012. The American economy (and the stock market!) tend to do much better when a President's term is nearing an end than at the beginning of the term. For the stock market, the sweet spot is usually the third year of a Presidential term, which is 2011 for the Obama administration. Stock markets tend to historically lead to economy, and that's been the case in past cycles.

From 1946 to 2009, 62% of the American economy's growth came in years 3 and 4. One third alone came in year 4 of terms. Common sense would tell us that Presidents seeking re-election are more likely to find ways to stimulate the economy to spur growth, and tend to put tough economic policies on the back shelf.

The last losing third year was 1937, and was marginal (3%). The average return on the Dow Jones in year 3 was 19%, and for the TSX 23%. Positive returns were had in 15 of the last 15 periods. The pattern is not perfect of course. The last year 3 (2007) recorded only small gains.

By the way, subpar fourth years occurred in 1956, 1960, 1980 and 2008. In all of those years – all except 1956 – the incumbent party lost the White House.

While the outlook for global economies and equity markets remains quite constructive in the short term, it is important to acknowledge the global economy faces an unusual high level of uncertainty in various pockets around the world. A fragile U.S. recovery marked by still high unemployment, weak housing and exploding debt. Many European governments have opted for extreme fiscal austerity to deal with sovereign debt problems. The exceptional measure taken by the U.S. Federal Reserve through its quantitative easing may have alleviated deflation fears, but brings longer-term risks. Recent numbers out of China pose a risk of a slowdown combined with inflationary pressures.

The ramifications of the Japanese earthquake continue to unfold in an unpredictable fashion. The fears of radiation exposure to the environment are real, and add to the uncertainty.

In the short run, combining positive economic recovery with the Presidential cycles, it seems as optimists will prevail. Over the next 12-18 months as we head into the U.S. election, the economy should continue to experience moderate growth, strong corporate profitability, improving consumer spending, and continued massive monetary and fiscal stimulation. These qualities more than not are favourable for equity investors and it is important not to lose sight of that fact.

In the long run, the pessimists may look like they have the upper hand. But history has shown time and time again that the pessimistic outcome does not have to occur. Government spending is out of control, the Federal Reserve is printing money like never before to facilitate the misbehaviour and lack of discipline of its own Congress. At this time one can argue there does not seem to be a politically viable solution out of this mess. What we need, not just in the USA, but all around the globe is the political will to make the sage and tough decisions.



The Little Picture (perhaps the real Big Picture)

On July 6th, we will be sponsoring the 22nd annual Children's Golf Classic for our local Children's Hospital. This event has raised over \$2.2 million over the years and I am pleased to have been the title sponsor for most of that period. If any of you would like to support the event via donation, products or services to auction off, it would be greatly appreciated. All donations > \$10 will get a tax receipt.



NOTES

Plotting from Within?

Sovereign Debt as a % of GDP in the G7
(*Gartman Letter* April 2010)

1950	105% (still bloated from effects of WWII)
1980	40%
1960	60%
1990	55%
1970	35%
2000	75%
1975	30%
2010	105%

All governments, at all levels, bloated from “entitlements”.

The Economist reports landline use in U.S. homes continues to decline. In early 2005, 7.3% of homes were mobile only. By the end of 2008, the proportion reached over 20% (August 15, 2009).

You say “Potato”, I say “Couch Potato”

Total U.S. Revenue for video games, consoles, accessories in 2008: \$21.3 billion
% growth since 2006: 58%

Amount 16 million Americans spent on Yoga products in 2008: \$5.7 billion
% growth in yoga spending since 2008: 87%

How many cities in the USA have populations > 1 million people?
9 (NYC, LA, Chicago, Houston, Philly, San Diego, San Antonio, Dallas)

How many cities in China have > 1 million people?
224!!! (In fact, there are 22 cities with > 5 million)

PRODUCT CORNER

Universal Life – Consider the Benefits

- Tax-deferred growth
- Tax-free adjustable death benefit
- Immediate increase to future estate values
- Premium flexibility
- Works extremely well for corporate assets

Universal life insurance combines an insurance portion with an investment portion.

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Let’s discuss how reallocating assets from fixed-income investments to a diversified portfolio within a Universal Life contract can greatly increase the ultimate asset value passed on to beneficiaries.



PORTFOLIO CORNER

The energy names recommended last quarter have been outstanding. The bank names as well.

In Canada, still like the ex-energy trusts and natural gas names.

In the USA, casinos, financials and shipping names.

(Call to discuss specifics relative to your portfolio)

Around the globe



Canada (Strong Buy)

- Expected 2011 growth of 2.9%
- Concern in Canada is the housing sector may be cooling
- Expect rate increase next 12 months
- Dollar strong, balance sheets good
- Expect bank dividends to increase

U.S.A. (Very Strong Buy)

- Expected 2011 growth of 2.7%
- US jobs market has barely budged, consumers slow to return
- QE2 may soon be ending
- Questionable housing market
- But despite all that we are heading into a Presidential election

Latin America (Avoid)

- Still too much left wing political governments for my liking
- New government in Brazil has to prove itself
- Prefer North America

Europe (Avoid)

- Over past 12 months, Euro dropped 16% vs. US dollar
- Bailout of Greece raises concerns more may follow...Portugal? Spain? Ireland?
- For 2011, consensus is for 1.5%
- Eventually Europe will right itself but too many other parts of the world look better right now

Asia (Buy)

- Recent trade numbers out of China surprised everyone on weak side.
- This area of the world already has inflation
- Japanese earthquake has maimed the world's 3rd largest economy
- Australia strong thanks to commodity/resource producers.

QUOTES

"There is a way to happiness, cease worrying about occurrences beyond our will." Epictetus

"I choose my friends for their good looks, my acquaintances for their good characters, and my enemies for their intellects, a man cannot be too careful in the choice of his enemies." Oscar Wilde

"It is incumbent on every generation to pay its own debts as it goes. A principle which if acted on would save one-half of the wars of the world." Thomas Jefferson

"Politics is like show business. You have a hell of an opening, coast for a while, and then have a hell of a close." Ronald Reagan

"I have a simple question: Who's the last President to give you a balanced budget?" Bill Clinton on Bill Clinton

A special welcome to all new clients who have joined us.

Thank you especially to clients who have mentioned our name to people they know. As a sign of gratitude, four times a year we'll randomly select a client who has introduced our services to a friend for special acknowledgement via a nice dinner at one of the finer restaurants in London.

PLEASE DON'T KEEP A SECRET FROM US!

We are very happy and proud of the clients we serve in our practice and we are always open to serve more clients just like you. Should you be talking to someone who is unhappy with their current advisor, we would be grateful if you passed on our number 519-675-2011 or 1-800-265-5911. Thanks for keeping us in mind.

Congrats, Cathy B. Our winner this quarter!

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