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

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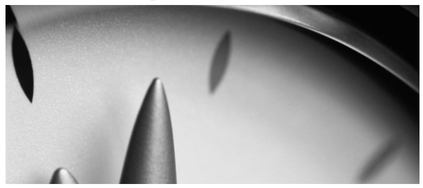
The big Picture



Kicking the Can Down the Road (But the Can is Getting Heavier)

"Successful investing is not an easy job. It requires an open mind, continuous study and critical judgment. Changes of trend occur when least expected. Policies profitable for the last ten years will not be best in the next ten." John Templeton, September 1959

Let me get this right.

After fumbling what was once a decent economy and its legacy as the cradle of civilized society, Greece has already accepted one lifeline from its European neighbours, is on the verge of getting another, but still hasn't made the sacrifices needed to get its act together, and its citizens expect to go on with business as usual and have everyone else make the sacrifices and pay for it?

It is rumoured European nations are not only willing to lend perhaps as much as an extra $50-60 billion to go on top of the $157 billion already doled out, but they seem offended Greece may eventually want out of Club Euro. No one can deny that the bailout of Greece has thus far been a colossal failure. With only 10 million or so citizens, does anyone really believe any of this will ever be paid back, and in essence it becomes a "gift" instead of a loan?

This is a saga that will not disappear overnight, because it took scores of years to evolve. Notions of entitlement have deep, uncompromising roots.

Greece needs to be reminded that if they abandon the Euro for their own currency, it would devalue immediately, lifting that nation's deficit to 200% of GDP, which would mean certain bankruptcy. The stakes are getting higher. Greece needs cash quick to meet obligations due in July, but seems intent on biting the hand that feeds. Two-year Greek bonds are now paying 25% if you buy them, which in effect guarantees some type of debt restructuring or outright default.

The European Sovereign Debt Crisis is coming to a slow boil, and seems to have taken the Japanese Sovereign debt crisis and the U.S. financial/budget crisis off the front pages. Greece can be restructured, certainly, but the question is not a matter of pain or no pain, but who will bear the pain.

The fundamental problem for Greece is there is no sign of economic recovery, with GDP negative for 2010, 2011 and most likely 2012. Within two years Greece will have a debt-to-GDP ratio of 160% that can only come down under very optimistic (i.e. unrealistic) growth scenarios. This week has seen yet more rioting by Greek unions, in effect protesting even more austerity. Unemployment is 15% and rising.

For the record, this may not be the first time Greece defaults. They have long made a practice of defaulting on debt.

The first recorded sovereign debt defaults were the Greek city-states, over 2000 years ago. In fact, Greece has been in default 150 of the last 200 years.

Having survived a vote of confidence, Greece's President now has won the right, as a Socialist, to sell the idea to his people that their taxes will rise materially, government spending will be cut by 30% for years, public services will be cut, unemployment will rise to 20-25%, food prices most likely will rise … and probably that tourism, perhaps Greece's most important industry, will suffer as a high Euro makes it an unfeasible site for many visitors. Greece has basically become the guinea pig for reform of the European Union.

But economic reality has hit hard. The concept of believing one can retire at age 53, with retirement salaries tied to inflation, and at 75% of the pay of their last few years working was unrealistic from the get go. On average, they work 20 fewer days a year than their German counterparts, and work 10 hours less per week on average as well.

Ireland is a different story than Greece. Ireland's problems stem almost entirely from the activities of six privately owned banks. Sadly, because Ireland, just a short 20 years ago, showed how a small country could drag itself out of poverty through the energy and hard work of its citizens. The Irish have a different national character than their Greek counterparts, and once they get righted, the markets would soon be willing to take on Irish debt. Russia, Argentina and other countries have defaulted and within a few years were back in the capital markets.

European leaders will continue to kick the can down the road. But the can is getting heavier. There is an endgame here. The average guy on the street can see that bailing out countries is really a back-door way to bail out banks on the back of taxpayers. First Greece, then Ireland, then? Maybe Portugal, then Spain and maybe Italy. Spain and Italy would be too big to save. Short of the rest of the Eurozone basically guaranteeing all debt for a long time, you are asking Finnish, and Dutch, and German and French voters to agree to take on and pay more taxes. I don't see it and come election time those voters will have their say at the polls. It will require current political leaders to convince their constituents to share in the Greek pain. This bubble, the bubble of government debt, may make the recent housing bubble seem minor.

MORE QUESTIONS THAN ANSWERS

The Fed's $600 billion QE2 program is scheduled to end in June. There are many questions wondering if assets like stocks and commodities will be able to stand up without the Fed's propping?

There are bullish and bearish arguments.

The bulls believe everyone knows QE2 is about to end so it's "in the market" so no big deal. It's like taking training wheels off a bicycle. Maybe rates stay low for some time, so no QE3, but maybe QE 2.5?

The bears say when QE1 ended there was a nasty correction (in March 2010) of 17% that summer. The uncertainty seems to have finally caught up with equity markets. The markets were able to withstand the Japanese earthquake and the subsequent nuclear fallout, floods in Australia, regime change in Egypt and other unrest in the Middle East, civil war in Libya, $110 oil, the Greek and Euro problems, and the possibility of a U.S. government shutdown as a result of the debt ceiling.

My view is the current pull back was inevitable, as markets were almost straight up since last September. I still believe the underlying fundamentals are constructive. The U.S. economy did grow in Q1 and the principal factors driving growth are still in place: exports, capital spending and the consumer. Overall, the world economy continues to expand on a modest growth path. There are many who are betting against the USA. I believe throughout history betting against the Americans has been a mistake. Let me share one interesting statistic: The U.S. economy is over $15 trillion. That is bigger than China, Japan and Germany … COMBINED.

The annualized return the last 20 years in the US S&P 500 has been 8.7%. For the past decade, it's been zero. I started this edition with a quote from Sir John Templeton. Most pundits look backwards and extrapolate out that next ten years will be lousy as well. I'm not in agreement.

The consumer remains positive. Corporate balance sheets are the best in decades, fund flows have finally turned positive (for 2010, equity outflows were $92 billion, for Q1 2011, inflows into equities were $42 billion), and last but not least, the positives of the Presidential election cycle to which I've spoken many times already.

The risks are well known, and documented. I believe most of them are already built in to current market prices. What is not expected is a lot of good news. Jobs data always lags and is always revised. If QE2 ends in June and if it is typical that central bank stimulus takes 6 to 12 months to trickle down to the street level, we could see a lot of good news start to be published by year end.

History has shown incumbent Presidents are tough to dislodge. Some more interesting facts: No U.S. President has won an election since 1950 when the unemployment rate was > 7.2% (currently 9.1%). And furthermore, the U.S. unemployment rate has never, ever in its history, fallen 2% in an 18-month period. This President has already made history, my bet he's working on doing it again, and that should be good for equity markets.

The Little Picture (perhaps the real Big Picture)

On July 6th, the 22nd annual Children's Golf Classic was held at Sunningdale Golf and Country Club. This is a cause close to my heart and I am pleased to announce we raised an incredible $200,000*, 100% goes to our local Children's Hospital in London. This brings our accumulated total to $2.5 million over the years. A special thank you goes to all clients and friends who contributed.

*Exact amount to be determined, not available at press time.

NOTES

From the end of the 2001 Recession to the beginning of the Great Recession of 2008, small businesses created more than 7,000,000 jobs while large business laid off 1,000,000. Twelve months to March of 2011 only 505,473 new businesses were started, the smallest amount in a decade. (USA Today June 13, 2011)

No wonder they are broke?

In California, firemen are retiring at 52 with $150,000 a year pensions. With firefighter's life expectancy reaching beyond 82, according to California Public Employees Retirement System Data, it means they will receive pensions for nearly as many years as they worked. (investors.com September 8, 2010)

The average American sits in traffic for 38 hours a year, wasting 98L of gas per person. The worst traffic cities were Los Angeles (72 hours), Chicago/Washington (60 hours), Dallas (58 hours) and San Diego (57 hours). (US Census Bureau, Bureau of Labor)

The average government job in Greece pays almost three times the average private-sector job. The national railroad has annual revenues of 100 million Euros against an annual wage bill of 400 million, plus 300 million Euros in other expenses. ("Beware of Greeks Bearing Bonds" by M. Lewis, Vanity Fair October 1, 2010)

Amazon.com now sells more e-books than hardcover books. It took Apple 28 days to reach 1 million unit sales of its IPad after its April 2010 launch. It took the IPod two years to sell its first million units.

PRODUCT CORNER

Fixed Income Ideas

Claymore Investments is the #1 ETF issuer in Canada, over $1.45 billion in but a few short years. Owned by U.S. investment giant Guggenheim, who manages over $120 billion for the ultra net worth in the USA. They have been innovative in their products but in particular their fixed-income products.

There are three in particular we have been using:

Advantage Short Duration (> 1 year) High Income ETF	4.50%*
Advantage Convertible Bond ETF	6.00%*
Advantage High Yield Bond ETF	6.80%*

*Yields pay as return of capital so very tax effective

PORTFOLIO CORNER
(All prices as of close June 20, 2011)

For patient contrarian investors, I still believe the natural gas trade is setting up for 2012. Shippers remain in the doldrums, but the same thing applies to them.

At these levels, commodity/material names are OK after this pullback. Names like Teck Resources Ltd. (TCK.B $43.23), Silver Wheaton Corp. (SLW $30.55), Cameco Corp. (CCO $22.75) have been hammered as part of the Japanese nuclear fallout. Encana Corp. (ECA $29.45). In financials, I am cautious with the banks but OK with Manulife Financial Corp. (MFC $15.95) and Sun Life Financial Inc. (SLF $28.20). RIM has been a disaster but hold for now. They are down but not dead.

U.S. side – San Juan Basin (SJT $23.50, 6.00% yield), Akamai Technologies Inc. (AKAM $29.25) and the agriculture names after this pullback (Mosaic, Potash). I have to believe the U.S. financials (BAC, GS, MS, WFC) are compelling values here for patient investors.

Around the globe

Canada (Strong Buy)
- GNP growth of 2.5% for 2011.
- Cdn $ has been strong overall.
- Best fiscal situation in G8, business friendly taxes.
- Housing vulnerable to a correction?

U.S.A. (Strong Buy)
- Growth expected at 3.25% for 2011
- US $ remains weak overall, but economic outlook has improved significantly from six months ago.
- Jobs market and housing remain biggest concern.
- Strength of Presidential cycle trumps all.

Latin America (Avoid)
- New administration in Brazil and a socialist one in Peru.
- Only Brazil of interest, rest too left for me.

Europe (Avoid)
- GNP growth expected of only 1.5% in 2011.
- The burden of paying down the government debt of the "PIIGS" will be heavy and persistent; will be a drag for years to come.
- Not sure political will exist to fix problems

Asia/Emerging Markets (Buy)
- High food costs really hurting EM's via inflation.
- Outlook for China less certain, Japan putters along.
- Outlook for South Korea and Taiwan more positive.

Quotes

"The most disagreeable thing that your worst enemy says to your face does not approach what your best friend says behind your back."
Alfred de Musset

"The most terrifying words in the English language are: I'm from the government and I'm here to help."
Ronald Reagan

"To know the road, ask those coming back."
Chinese Proverb

"You can complain because roses have thorns or you can rejoice because thorns have roses."
Tom Wilson

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, Teresa F. Our winner this quarter!