RBC Dominion Securities

Money NEVER SLEEPS

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

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Vice-President & Director
Vito Finucci
(519) 675-2011
vito.finucci@rbc.com

Alyson Medeiros, CFP
Associate Advisor, Financial Planner
(519) 675-2505
alyson.medeiros@rbc.com

Jodie Fuller
Associate Advisor
(519) 675-2511
jodie.fuller@rbc.com

Trish Gordon
Assistant
(519) 675-2021
trish.boughner@rbc.com

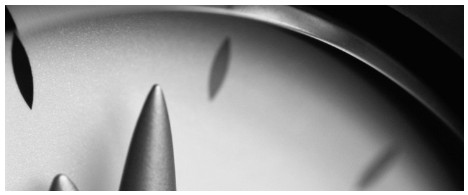
Theresa Kelly
Assistant
(519) 675-2021
theresa.kelly@rbc.com

Fax: (519) 675-2020

Website:
www.rbcds.com/vito.finucci

RBC Dominion Securities Inc.
148 Fullarton St., Suite 1900
London, Ontario N6A 5P3

The big Picture



The New, New Deal and the death of capitalism?

(Capitalism is down, but not out)

"We will bury you, and you capitalists will sell us the shovels."
Nikita Khrushchev, Russian Premier 1960

It seems these days everyone is a historian, including the new U.S. President Barack Obama. The Obama administration has drawn lessons with respect to handling the economic challenges the world is currently experiencing. The bulk of his ideas are rooted in a New-Deal-like philosophy, which means heavy government spending, heavy government regulations and heavy government involvement in private wages.

While there is no doubt that certain aspects of the New Deal were helpful (Federal Deposit Insurance, for instance), it wasn't the idyllic blueprint it's been made out to be 75 years later. Many of the Acts implemented played roles in artificially raising wages while making it harder for businesses to generate profits. Farmers being paid to not grow crops, including wheat, led to tenant farmers starving and forced the famous mass migration of African Americans out of the South and into Northern cities. Taxes tripled from 1933 to 1940 and protectionism led to global dissention. The previous notion was that businesses' competition drove down incomes and the government had to step in to level the playing field. The fact of the matter is, it took World War II to propel the U.S. out of the grip of the Great Depression. By the way, 9,000 banks went bust by 1940.

Call me a naive Italian kid from Niagara Falls, but I find it ironic that we fix the excesses of spending money we don't have (we, being individuals and the government) by spending oodles more money we don't have. I worry about unintended consequences down the road, like high inflation, deficits which can never be paid down, protectionism and much, much higher taxes for the next generation(s).

In the end, the New Deal of the 1930s manipulated wages, slowed business and, while it did provide a fairer work environment, it harmed a lot of people including many of the poorest in the country. While most historians will agree that over-indebtedness and deflation were the main causes of the Great Depression, the flat-footed Federal Reserve without question made matters worse, and that history has driven the current policy of Ben Bernanke, who has been both pro-active and innovative.

Higher taxes hurt the cause then, and will again if allowed to happen, but for many, higher, more intense regulations were also problematic. In today's world, deregulation has been firmly affixed to the Republicans (even though it has been a trend for decades), so with the Democrats firmly in charge, expect the hammer to come down. There is a notion that more regulations could have caught or stopped people like Bernie Madoff. The fact is, smart crooks will almost always circumvent any systems of rules.

What I worry about is that many of President Obama's policies (including the recently proposed budget) are predicated upon a class divide. It has become trendy to attack "the rich," businesses, and success in general. With the President's "read-my-lips" pledge that no new burden fall on 95% of the American people, one must logically deduce that the remaining 5% will bear all costs of the programs and spending. The proposals concentrate enormous power in Washington, and the tough love of the Reagan years to reduce big government will be wiped out in one budget. The U.S. has traditionally had a relatively limited central government, but federal spending as a share of GDP is exploding from its modern norm of 20% to a number yet to be determined.

Governments are indeed critical to economic growth, but not in the manner we see unfolding. While times and circumstances change, the principles of economic growth do not, and the basic ideals have stood the test of time:

- Low tax rates
- Ease of starting a new business
- Stable money
- Property rights
- Minimal barriers to doing business
- The incentive to prosper

Are there many reading this that believe that the trillions being proposed to revive our global economies would be better managed in a massive government-managed or -directed program versus incentivized private ones? There are many who argue the current government bail out plans are offsetting Bernanke's efforts and in fact impeding the pace of economic recovery.

The blunt truth is that government spending has historically been a poor substitute for private business and consumer investing and spending. Were it otherwise, the Soviet Union would have won the Cold War and Japan, which had numerous New-Deal-type stimulus spending packages in the 1990s, would have boomed instead of staying in recession for 12 years. To this day, the Japanese Nikkei stock index has not come close to its high of 1989. No instead, what we have is these countries and other former "repressed" nations moving more towards the current U.S. model as the U.S. itself talks about moving away from it.

Events can cause economic downturns, like 9/11 did. But the most damaging economic downturns of the 20th century can more than not be attributed to bad government policies. The Great Depression was ignited by trade war, high taxes and bad monetary policy. The great inflation of the 1970's was caused by the Federal Reserve's excessive printing of money. The current crisis was brought on by a weak U.S. dollar, the recklessness of Fannie Mae and Freddie Mac and regulatory errors such as mark to market accounting. Government spending or not spending has absolutely zero to do with any of these items.

The good news is that President Obama:

- Has history as a guide
- Has precedents as a guide
- Seems to be very intelligent and open to ideas
- Is seen as pragmatic

The new president must be prepared to make tough and occasionally unpopular decisions, and with his popularity and a willing public (right now anyway!), that should help. I do have misgivings about printing so much money, while the infrastructure spending (if done right) should pay loan term dividends and generate jobs. Ultimately corporate tax cuts to make us more competitive globally would be the fastest way to job creation.

One thing is for sure: future generations are going to have one heck of a debt bill waiting for them. In Canada, we just about had the reckless spending of the 1960s–1970s paid off, only to ring up $70 billion in one budget. In the U.S., assume the new administration will be decisive and full of surprises. I worry about the liberal roots, but the situation facing all the world is bigger than ideology and politics. But with that, we must still encourage risk taking and the rewards that go with it! It is at the root of capitalism and must be allowed to breathe.

Don't expect to see any real economic improvement or good news in the labour market for a while. In history, the evidence is overwhelming: Stock market bottoms happen, and the markets jolt upwards while the economy continues to get worse, sometimes by a lot and for a while. Global markets bottomed in June 1921, but global economies took two more years. The 1973–1974 monster bear market bottomed in October 1974, but the U.S. economy kept sliding until March 1975.

Look past the naysayers and the pessimism and remind yourself it's better to be a little early than a lot late.

Last, but not least, I leave you with one of my favourite pieces. I've read many times that President Obama is an admirer of Lincoln. Let's hope he's read this piece and understands its implications:

> *You cannot bring about prosperity by discouraging thrift.*
>
> *You cannot strengthen the weak by weakening the strong.*
>
> *You cannot help the wage earner by pulling down the wage payer.*
>
> *You cannot further the brotherhood of man by encouraging class hatred.*
>
> *You cannot help the poor by destroying the rich.*
>
> *You cannot keep out of trouble by spending more than you earn.*
>
> *You cannot build character and courage by taking away man's initiative and independence.*
>
> *You cannot help men permanently by doing for them what they could and should do for themselves.*

Abraham Lincoln, 1859

Notes

According to the World Economic Forum, Canada has the world's soundest banking system:

1. Canada
2. Sweden
3. Luxembourg
4. Australia

Other Notables:

16. Switzerland
40. USA
44. Britain
134. Algeria (last)

Reuters October 9, 2008

Despite all the CEO bashing going on…

Time taken at work to earn $1,000:

Janitor	103 hours
High School Teacher	43 hours
Chief Executive Officer	2 hours 55 minutes
Brad Pitt, actor	4 minutes 45 seconds
Dr. Phil, TV Host	2 minutes 42 seconds
Howard Stern, Radio Host	24 seconds

Time Magazine, October 30, 2006. "America By The Numbers."

The White House, home of the U.S. President, has 35 bathrooms.

www.whitehousehistory.org

One year ago, Royal Bank of Scotland bought ABN Amro for $100 billion. For that same amount today (as of December 5, 2008), one could buy Citibank ($22 billion), Morgan Stanley ($10B), Goldman Sachs ($21B), Merrill Lynch ($12B), Deutsche Bank ($13B) and Barclays ($13B)…and still have $8 billion in change!

Quotes

From ABC's *This Week* in discussion about the Jon Stewart–Jim Cramer riff, there are three basic rules in life:

1) Don't play poker with someone named Slim.

2) Don't buy a Rolex from someone out of breath.

3) Don't take investment advice from someone who is shouting.

"You miss 100% of the shots you never take."
Wayne Gretzky

"The first half of our life is ruined by our parents, and the second half by our children."
Clarence Darrow

Portfolio corner summary

Fixed-income ideas (as at April 11, 2009):

GIC RATES**

30-day cashable	0.65%
1 year	2.00%
2 year	2.30%
3 year	2.80%
4 year	3.02%
5 year	3.26%

HIGH-INTEREST SAVINGS …DAILY INTEREST

Altamira Cashperformer*	Cnd $	1.05%
Altamira Cashperformer*	U.S.$	0.60%
Manulife Bank Investment Savings*		1.25%

* CDIC Insured

FIXED-INCOME MUTUAL FUNDS

Fund	1yr	3yr	5yr	Inception
Fidelity Cdn Short Term Bond	4.01%	4.10%	3.23%	5.37%
Fidelity Global Bond	12.3%	N/A	N/A	4.21%
RBC Cdn Short Term Income Fund	4.50%	4.00%	2.90%	5.10%
RBC Monthly Income	-16.0%	-2.9%	3.30%	6.20%

HIGHER YIELD CANADIAN INVESTMENT GRADE CORPORATE BONDS

ISSUER	MATURITY	YIELD	RATING S&P
Royal Bank Capital Trust[1]	30 Jun 2010	5.04%	A
GE Capital Canada	07 Feb 2011	4.77%	AA+
Wells Fargo	12 Dec 2012	5.66%	AA
Manulife'	26 Jun 2015	5.80%	AA –
GE Capital Canada	17 Jan 2017	6.61%	AA+
Investors Group	07 Mar 2018	6.91%	A+
Great West Life Co.	21 Mar 2018	6.41%	A+

[1] Hybrids ** Only indications, all prices and yields shown with CC and subject to change with market conditions. Liquidity is a major issue in the corporate bond market and buyers should be prepared to hold to maturity.

Around the globe

Canada (STRONG BUY)
- Commodities will make a comeback – oil must go higher if economies recover
- Banks in better shape than most
- Strong Canadian dollar will help attract capital
- Unemployment up over 7%
- Housing in better shape than the U.S.

U.S. (STRONG BUY)
- U.S. recession longest of postwar period (16 months, average 10)
- U.S consumer has taken huge hit to their balance sheet between real estate and investments
- Housing key to recovery, unemployment could reach 10%
- President Obama's initial policy fails to inspire markets
- Mark-to-market accounting ruling may hold a key

Europe (HOLD)
- Effect of financial crisis on European economy has deepened as European banks suffer from high leverage and exposure to Eastern Europe
- Expect Euro rates to decline further as now behind
- In U.K., pound collapse has added to grief
- Slow to respond last year now hurting them

Asia (TRADING BUY)
- Chinese growth down markedly, expected 6–7% for 2009 (from 10–12%)
- Massive $600 billion U.S. stimulus will help
- Japan in serious recession (Q4 down almost 13%) with export collapse
- Korea/Taiwan struggle with sharp fall in exports
- Factories operating at historically low output levels

Latin America (AVOID)
- Too many "left"-leaning governments
- Unstable currencies
- Except for Brazil, not comfortable with any of the others

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 with a nice dinner at one of the finer restaurants in London.

Congrats, Tom S.

Our winner this quarter!

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.