



RBC  
Dominion  
Securities

# THE GEE NOTE

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October/November



## MARKET COMMENT

RBC Capital Market's base case for the global economy is for an uncertain and uneven recovery with moderate economic growth,

rising interest rates and a relatively benign inflation outlook. However, forecasting confidence is clouded by a multitude of macro variables including the deleveraging of the financial system, record sovereign debt and deficit pressures as well as stubbornly high unemployment and weak consumer confidence. Governments have responded by injecting a record level of stimulus as the antidote, offsetting the current deflationary risks with longer-run inflationary pressures.

In the near term, RBC CM is more concerned about the deflationary risk to its base case scenario. The challenge with deflation is that it is multi-faceted and can be contagious if left to fester. In addition, today's market participants have not had experience with deflation on a global scale.

### How should Canada-based investors position themselves in this environment?

This report combines our macro perspectives (economics, fixed income & currency, credit, equity strategy) as well as a sector-by-sector view from our fundamental analysts. The output is designed to provide a "what if" road-map in the event that the global economy should enter an extended period of either deflation (in the near term) or inflation over the longer term.

### What should outperform in a deflationary environment?

- Long-dated government bonds,
- Cash (prefer US\$ over commodity-linked currencies),

- Emerging markets with strong domestic demand (e.g., China, India, Brazil).

### What equities should outperform in a deflationary environment?

While equities as an asset class are likely to be pressured in a deflationary environment, TSX sectors with relatively low price and volume elasticity, strong balance sheets and supportable yields should offer a performance advantage in a demand-light deflation.

- **Financials** – RBC CM favorites are **TD Bank (TD)**, **National Bank (NA)**, and **CIBC (CM)**.
- **Consumers** – **Dollarama (DOL)** represents an interesting consumer growth story that should also benefit in a deflationary environment and **Thomson Reuters (TRI)** has strong revenue stability as well as opportunities to realize internal efficiency improvements.
- **Industrials** – **SNC Lavlin (SNC)** is positioned to benefit from spending on infrastructure.
- **Telecom & Cable** – **BCE Inc. (BCE)**, **Rogers Communications (RCI)** and **Shaw Communications (SJR'B)** have businesses that should be resilient during a deflationary period yet offer attractive dividend yields for investors.

It is worth noting that RBC CM would expect gold to be one of the first asset classes to recover from a deflationary period as it begins to price in inflationary expectations. **Barrick Gold (ABX)**, **Goldcorp (G)**, and **Agnico Eagle (AEM)** are low-cost producers with positive balance sheet and cash flow profiles that would benefit from this environment.

## What should outperform in an inflationary environment?

Equities, short-dated credit (prefer C\$ over non-commodity-linked currencies). While equities as an asset class are likely to perform well in an inflationary environment, TSX sectors with relatively high price and volume elasticity, and financial leverage should offer a performance advantage. Energy, Information Technology, and Materials rank at the top of this list. **Canadian Natural Resources (CNQ), Suncor (SU), Research In Motion (RIM) and Teck Resources (TCK'B)** should perform well in this environment.

## Selling Put Options—"How to buy stocks below market price"

Want to be paid to buy stock? Many stock investors use "limit orders" to get into long positions. Another way to buy stock for less than the current market price is an options strategy called cash-secured puts. Cash secured means that you have the cash in your account to buy the stock at the designated strike price. Selling puts is usually done with options that have high implied volatility. This is a neutral to bullish strategy which can be used to generate income, or to enter long stock positions.

Selling puts obligates you to buy the stock when assigned. This strategy brings income into your account, income you keep if the stock is above the strike price at expiration. Traders sell puts if they think the stock is going to stay flat or go up slightly, but only if they are willing to buy the stock if assigned. For this reason, selling puts can be an excellent way to initiate long stock positions, and get paid to do so.

For example, you sold the Encana January 2011 \$28 put option for \$.65 when the current price is trading for \$30.40. If Encana is anywhere above \$28 by January 22, 2011, you keep your credit of \$.65. If the stock is below, you will be assigned, and you will purchase the stock at the strike price of \$28. But the trade itself is profitable until \$27.35, since you pocketed the \$.65 credit.

Puts can be sold cash-secured or naked. If they are cash secured, then you have the cash in your account to purchase the stock at the strike price if assigned. If naked, then margin is required.

## Exiting Short Positions

When an option has been sold, the position can be closed in one of three ways:

- **Buying back the option** - After an option is sold, it can be bought back at any time. This is done when there is a risk of assignment that the option seller wants to avoid. For instance, if you sold a put, the stock went up through your strike, and you do not

want to be assigned and forced to buy the stock, you could buy back the option to close the position.

- **Letting it expire** - If the option gets all the way to expiration, it will expire worthless if it is out of the money. Typically, this is what you want to have happen with options that you have sold.
- **Assignment** - Canadian and American-style options (all equity and ETF options) can be exercised at any time before expiration. So you could be assigned at any time after you have sold an option. Most traders view this as a negative, but it is not necessarily so. If you are using cash-secured puts to acquire stock, then assignment means you have achieved your objective at a below-market price.

## Rules for Selling Put Options

Selling options is best done when implied volatilities, and therefore option premiums, are high and expected to fall. This is because higher implied volatility brings in more premium income to your account. It is important to remember, however, that selling options involves considerable risk, and high implied volatility can always go higher.

## Stock Selections

### **Suncor - An Oil Favorite \$33**



BP Petroleum's recent oil spill disaster in the Gulf of Mexico has refocused attention to the Oil Sands as a more preferable source of energy. As an integrated oil company that merged with Petro Canada in 2009, Suncor's production has shifted from a 100% oil sands focus to one considerably more diversified. Suncor enjoys a strong balance sheet and cash flow with a series of projects in the oil sands providing further growth. Suncor is a buy for long term capital gains with a one year target of \$46.



## Turning 71 in 2010?

If you are turning age 71 in 2010, you must convert your RSP, Individual Pension Plan (IPP), Locked-in Retirement Account (LIRA) or Locked-in RSP to one of the many maturity options that are available by the end of this year. Keep in mind that in order to make your RSP contribution for 2010 and claim it on your 2010 tax return, you do not have the extra 60 days after 2010 to make your RSP contribution to your own RSP since you will not have an RSP after 2010 to contribute to — contributions cannot be made to a RIF.

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**Gee Note via E-mail**

Please continue to send us your e-mail addresses.

We received quite a few addresses last month and would like to continue with a distribution list made exclusively of e-mail addresses. In the future, this will also allow us to provide our clients with prompt updates of events affecting their investments in addition to investment research. All e-mail addresses will be kept confidential.

We are aware that not all our clients have access to e-mail; we will still continue to send the Gee Note by mail.

If your e-mail has changed, or if you would like the Gee Note sent to your inbox, please e-mail me at [william.gee@rbc.com](mailto:william.gee@rbc.com). Thank you for your response and feedback, and keep the e-mails comin'!!



~ Please recycle this paper ~

Bill's Fortune:

*"You never see the stock called  
HAPPINESS quoted on the exchange"*

*Henry Van Dyke*

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## September Recommended Stocks

<i>Canadian Stock</i>	<i>Price</i>	<i>Target</i>	<i>Yield</i>	<i>Current Rating</i>
Bank of Montreal (BMO)	62.00	73.00	4.5	Buy
Bank of Nova Scotia (BNS)	54.60	56.00	3.6	Hold
Bombardier (BBD'B)	5.00	6.00	2.0	Buy
Manulife	12.80	16.00	4.0	Buy
TD Bank (TD)	73.00	86.00	3.2	Buy
Royal Bank (RY)	55.00	63.00	3.5	Buy
Research in Motion (RIM)	50.00	90.00		Buy
Capital Power (CPX)	24.00	23.00	5.1	Hold
Suncor (SU)	33.35	46.00	1.2	Buy

<i>U.S. Stocks</i>	<i>Price</i>	<i>Target</i>	<i>Yield</i>	<i>Current Rating</i>
Bank of America (BAC)	11.50	16.00	0.3	Buy
Microsoft (MSFT)	25.00	33.00	2.5	Buy
Corning (GLW)	18.00	26.00		Buy
Citigroup (C)	4.00	6.00		Buy
EMC (EMC)	21.50	25.00		Buy
Ford (F)	11.25	16.00		Buy
Keycorp (KEY)	8.30	10.00		Buy
General Electric (GE)	16.00	20.00	3.0	Buy

**Prices as of 10/22/2010, Recommendations subject to change without notice  
Targets, Yields and Ratings provided by RBC Capital Markets**

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## FIXED INCOME - WHAT'S YOUR INTEREST?

BONDS	COUPON	YIELD	PRICE	MATURITY	DETAILS		
<b>STRIP BONDS</b>		<b>1 YEAR</b>	<b>2 YEAR</b>	<b>3 YEAR</b>	<b>4 YEAR</b>	<b>5 YEAR</b>	
Best Rates		1.40%	2.00%	2.50%	2.70%	3.25%	
<b>SHORT TERM GOV'T STRIPS</b>				<b>30 DAYS</b>	<b>60 DAYS</b>	<b>90 DAYS</b>	<b>180 DAYS</b>
Best Rates					1.00		
<b>BANKER'S ACCEPTANCE</b>				<b>30 DAYS</b>	<b>60 DAYS</b>	<b>90 DAYS</b>	<b>180 DAYS</b>
Minimum \$50,000				n/a	n/a	0.72%	0.95%
<b>GIC'S</b>		<b>1 YEAR</b>	<b>2 YEAR</b>	<b>3 YEAR</b>	<b>4 YEAR</b>	<b>5 YEAR</b>	
Best Rates		2.00%	2.35%	2.55%	2.90%	3.10%	
<b>US MONEY MARKET</b>				<b>60 DAYS</b>	<b>90 DAYS</b>		
<b>MINIMUM \$50,000</b>							
U.S. T-Bill, U.S. Money Market				n/a	n/a		
<b>OTHER</b>				<b>PRICE</b>	<b>YIELD</b>		
NorthWest Healthcare (NWH.UN)				\$11.58	6.90%		
<b>ETF (EXCHANGE TRADED FUNDS)</b>		<b>PRICE</b>	<b>YIELD</b>	<b>TERMS</b>			
BMO Emerging Market Bond Fund Hedged to CDN \$ (ZEF)			5.70%				

### \*\*\*RATES SUBJECT TO CHANGE WITHOUT NOTICE\*\*\*

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# RBC CM Strategy Focus List

The Strategy Focus List selects stocks that are expected to outperform based on fundamental, technical, and quantitative analysis.

## Fall 2010 Focus List Stock Selections and Updates

### Strategy Focus List

#### Exhibit 3: Focus List Stocks

Symbol Stock Price as of  
August 31, 2010

ARC Energy Trust	AET.un	\$19.81
Bank of Montreal	BMO	\$58.90
Barrick Gold Corporation	ABX US	\$46.76
BCE Inc.	BCE	\$33.37
Brookfield Asset Management Inc.	BAM US	\$25.64
Canadian Natural Resources Ltd.	CNQ	\$34.30
Canadian Pacific Railway Ltd.	CP	\$62.81
Enbridge Inc.	ENB	\$53.05
EnCana Corporation	ECA US	\$27.49
Goldcorp Inc.	GG US	\$44.22
Metro Inc.	MRU.A	\$45.14
National Bank of Canada	NA	\$61.58
Potash Corp of Saskatchewan Inc	POT US	\$147.25
Research in Motion Ltd	RIMM US	\$42.84
Royal Bank of Canada	RY	\$51.00
Sun Life Financial Inc	SLF	\$25.04
Suncor Energy Inc.	SU	\$32.31
TD Bank Financial Group	TD	\$72.15
Teck Resources Limited	TCK.B	\$35.67
Thomson Reuters Corporation	TRI US	\$34.80

**Stocks added to the Fall 2010 Focus List:**

**Stocks removed from the Fall 2010 Focus List:**

Note: Prices are in Canadian dollars unless otherwise specified.

Source: RBC Capital Markets Equity Selection Sub-Committee

*No changes  
this quarter.*