RBC Dominion Securities Inc.

Money NEVER SLEEPS

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

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The big Picture

The Abyss or the Dawn of a New Golden Age?

"The budget should be balanced, the Treasury should be refilled, public debt should be reduced, the arrogance of officialdom should be tempered and controlled, and the assistance to foreign lands should be curtailed, lest Rome become bankrupt. People must again learn to work instead of living on public assistance."

Cicero, 55 BC
(so, evidently we've learned nothing in the past 2,066 years)

In early April, market commentators were glowing after a decent first quarter which saw a swift 8-11% gain for most North American indices. In a matter of weeks, optimism turned as Greek/Eurozone issues flared up again, China slowed more than expected, and the USA faces a fiscal cliff by year end.

One could reasonably argue that since Greece should never have been in the Eurozone in the first place, its leaving may be the right thing for it to do, if for no other reason but to bring back a devalued drachma so Greece could once again be competitive. Lessons from the Asian crisis in 1997 would lead the Greeks to believe that's the correct path.

The problem is that any nation leaving the Eurozone is something its architects never imagined, nor planned for. Now the daily media will lead one to believe Spain and Italy are closely behind Greece on the same path. The first piece of good news I have is that we are closer to the end of this crisis, than to the beginning.

As always, the media will try to get every ounce of fear out of a crisis to keep eyes glued to the screens (or to sell more newspapers or increase "hits" on websites). So it indeed seems like the world has taken a turn for the worse the last couple months. But are we looking into an abyss? The search for nominal preservation of capital has reached such an extreme that many investments are making historic lows. Consider the following:

- Cash held by U.S. corporations is at 50 year highs
- For one of the few times in history, 60% of the S&P 500 stocks have a greater dividend yield than the 10 year U.S. Treasury bond
- Bond markets seem to be indicating the world is coming to an end:

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- The U.S. 10 year treasury hit a 200-year low (prior low was 1.55% set in Nov. 1945)
- The Dutch 10 year yield (1.61%) hit a 500-year low
- The German 10 year bond at 1.20% is at a 200-year low
- The UK five year government bond yield hit a 110-year low
- The French 10 year yield (2.35%) hit a 260-year low

- The market capitalization of the Italian financial sector equals the same as that of Colgate Palmolive ($47B)
- The market cap of all Eurozone financials ($360B) is less than that of Canadian financials ($377B)
- The market cap of all Portugal equities ($16B) is the same as that of Whole Foods (the 191st largest stock in the S&P 500)
- The market cap of Italy + Spain ($396B) barely exceeds that of Taiwan ($370B)

The markets have been so tough that by definition, prices are low. I know from experience that when it feels so wrong, it soon becomes so right. The best time to buy equities is when fear is high and one can easily argue the last three years have been an abundance of bad news. This is now the fifth time we have seen this type of scenario in the past 15 years. No one can predict the outcome, but all prior four cycles evolved in a similar fashion and all to new highs. It's every bit as valid now as it was in 1999, 2001, 2003 and 2008.

The fact is the absence of any banking collapses (so far!) is good news. Bank runs are happening but they are symptoms of liquidity constraints. Liquidity should not be confused with solvency.

Having been around long enough, I've seen this picture before. Just after I began in the business, the 1987 Black Monday crash was followed by the 1989 "mini-crash", the S&L Crisis was making headlines and Saddam Hussein had invaded Kuwait. The market fell hard in 1990 and investors were like deer in headlights. Housing had plummeted and more U.S. banks had failed that period than ever in history. The media spread the debt scare: it was debt gloom and doom all the time. Pre-Euro nations struggled, Greece (yep, same country) suspended payments on its long term debt in 1993. Bill Clinton won the presidency with the "It's the economy, stupid" campaign. The year 1992 was tough, but then 1993-1999 was the greatest run I've ever seen.

I believe we could be on the threshold of a new Golden Era.

Optimistic views are divided. Right now the bear argument is a lot easier to make. That's why the bullish argument will probably transpire. Many investors (and pundits) make the mistake of believing that government runs the economy, but the government is not the economy. What we need right now is a lot less government.

Humans, by nature seem to have a penchant for pessimism. Instead of being grateful for our lots in life, humans will obsess over problems and blow them out of proportion. In doing so, they become oblivious to good news – hence the "Occupy" movement and confrontation. It is unrealistic to expect economic gain without expecting some pain. One of the unfortunate attributes of the exponential growth of technology is the inevitable creative destruction that comes with it. I would add that all this government interference over the last several years has greatly contributed to delaying and prolonging the healing process that naturally occurs in free markets.

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Going back to some of those earlier global bond rates, I would be very careful as the bond market (especially governments) could be the next bubble forming. Interest rates are at all time lows, yet investors line up to buy them. According to U.S. statistics, investors were net sellers of $15 billion of stock funds in Q1 2012 and net buyers of $77 billion of bond funds.

Unless bond yields fall to zero, which can't happen, logic dictates there is not much upside left for bond investors. But there is potentially an awful lot of downside.

With the U.S. S&P 500 exactly where it was 13 years ago, it could be time to argue that equities may be ready to rise from their deep sleep soon. In fact, the past "lost decade" is the worst rolling 10 year S&P 500 average in history. The stock market itself has become in the eyes of many, if not most small investors, a sort of electronic casino.

I believe we are about to have one of those moments in history. The recent Wisconsin election was a precursor to how voters are thinking: less and smaller government that is fiscally responsible. I think the surprise is going to be the level of productivity the U.S. can deliver on the back of cheaper energy, reindustrialization, and smarter policymakers and policies. The November 7th U.S. presidential election will be a chance to signal the desire to roll back the size and scope of government, and reduce the "entitlement" mentality. I think that there is a good chance that we should all get used to the phrase "President Romney."

NOTABLE QUOTES

"There is a great difference between knowing and understanding. You can know a lot about something and not really understand it." – Charles Kettering

"People who look down on other people don't end up being looked up to." – Robert Half

"Well done is better than well said." – Benjamin Franklin

"It's not whether you get knocked down, it's whether you get up." – Coach Vince Lombardi

Around the globe

Canada (Buy)

- Canadian economy has stumbled as of late – expected GDP is 2% for 2012
- Not excessive government debt but household debt still seems excessive
- Lower recent dollar will help exports
- Commodity sector totally contingent on China
- Energy sector has been beat up as of late

U.S.A. (Strong Buy)

- Has had impressive rebound since fall
- Coming U.S. election has mixed economic implications
- Federal Reserve has committed to keeping interest rates ultra low until 2014
- Housing seems to have bottomed

Europe (Avoid)

- Remains focal point for global markets – 2012 GDP outlook keeps getting reduced – now 0.0% to 0.5% reflecting effects of austerity
- Germany and France may avoid recession but Greece, Spain, Portugal and Italy look less fortunate
- Much work still needs to be done; seems to be a moving target

Asia (Hold)

- Japan continuing to recover from earthquake and tsunami (2012 GDP 1.75%)
- China still trying to engineer a soft landing – don't know how reliable their published data is – expected GDP of 8.00% -8.50% for 2012
- Asia markets will be driven in 2012 by regional politics (leadership change in China in October; Korea elections in December)

Latin America (Avoid)

- Cracks starting to appear – I'm not a fan mainly due to their left of centre politics
- Brazil – only possible buy

DID YOU KNOW?...

Percentage of Individuals Who Have Never Used The Internet

UK – 12%	Spain – 30%
Germany – 16%	Italy – 40%
France – 19%	Portugal – 42%
Greece – 45%	EU Total – 25%

Source: Wall Street Strategies February 6, 2012

Was Facebook Really So Hot?

	Facebook	McDonald's	Amazon	Bank of America
Market Cap	$100B	$101B	$81B	$76B
Annual Sales	$3.7B	$27B	$34B	$80B
Annual Earnings	$1.0B	$5.5B	$1.2B	$1.4B
Yr/Yr Sales	88%	12%	40%	-2%
Assets	$6.3B	$32B(2010)	$19B	$2.3Trillion

Source: Wall Street Strategies February 2, 2012

And the winner is... Bono

Thanks to Facebook, the U2 singer could overtake the world's richest rock star, Sir Paul McCartney, who is currently worth roughly 665 million pounds. Bono's Elevation Partners equity firm bought 2.3% of Facebook in 2009 for $90 million – an investment that will be worth over $1.5 billion when the deal is complete.

Source: Nasdaq, May 17, 2012