RBC Dominion Securities

Money NEVER SLEEPS

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

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The big Picture

A Litany of Worries

The U.S. Presidential election has not been the only tug-of-war in town, the battle in the financial markets has been much more exciting. Every time the bears have the upper hand, the bulls manage to rally, and when the bulls seemed like they had leverage, the bears managed to knock them down. The arguments are well documented:

THE BEARS:

- The economy is tanking and the recession will be a long and deep one
- Financials have yet to come 100% clean, and have more writedowns to report
- Consumers are in debt and unemployment is rising, which may lead to less spending, selling their homes, or stop meeting financial obligations
- Housing situation is a sinkhole and is only going to get worse
- Inflation is exploding, which will hurt both consumers and corporations
- U.S. dollar remains weak, contributing to higher commodity prices and will not rebound strong enough or fast enough

THE BULLS:

- Business balance sheets (except for financials) are the best they have been in years
- Q1 2008 earnings reports mostly beat estimates
- Long-predicted recession still isn't here, regardless of what measurement is used
- Stocks are the most undervalued they have been in years
- Despite oil at $135, global markets have not collapsed

From September 2007 to March 2008, most global markets suffered some serious downside, building in a serious recession and here we are almost in July 2008 and we have yet to officially announce a recession.

Does History Repeat Itself?

In 1990 Citigroup (then Citibank), wrote off $100 million in real estate exposure. That came out of left field at the time and in Q1 1990, Citi's earnings declined 56% and loan loss provisions rose 80%. By 1991, the company's stock tumbled to multi-decade lows as a consequence of its exposure to $13 billion in commercial real estate, mostly in the western U.S. The company's debt was lowered to junk and as a last straw, they cancelled their dividend entirely. Citibank had paid a dividend since 1813.

Enter Prince Al-Waleed who invests $590 million (a big sum at the time) and in return received a note convertible to a 5% equity stake. The convertible paid an 11% yield.

Flash Forward: After posting a 57% decline in earnings for Q3 2007 due to real estate loan write-offs, the company turns to the nation of Abu Dhabi who invests $7.5 billion and gets a stake that pays an 11% dividend and a 5% equity stake. And by the way, the dividend was cut from .54 to .32.

Citibank's stock hit a low of $2.50 in December of 1991.

Citigroup's stock hit a high of $57.00 in December of 2006.

It is approx. $20.00 at time of writing.

The Green Movement and the Consumer

Consumers seem to be so focused on headlines relating to gas and food prices, that one must wonder if other producers will try to sneak in some subtle price increases. Nobody seems to complain about the soaring cost of shampoo but if it says "new and improved" or "greener", people would seem to gladly pay more.

Recession by Numbers:

In the recession of 1981-82 (a big one by any measurement), initial jobless claims fell to 660,000, making their highs within a couple of months of the recession's end.

In the sharp but short recession of 1980, initial claims peaked at 625,000, and peaked literally the very day the recession ended.

The long, deep recession of 1973 to 1975 saw jobless claims bottom out at 230,000, and peaked at 660,000, again a month or two from the bottom. Finally in 1960-1961, claims rose from 250,000 to 430,000. Only in the 1970 recession did jobless claims not get to 400,000 (peaked 330,000)

Judging by history then, the recent rise in jobless claims is really rather modest, and keep in mind with a much larger workforce and economy.

What Recession?

All this terrible economic news continues to get reported and markets seem weighed down by it all. It can't be the end of the world when people buy 19 million Apple I-Pods in just a three-month period, or $400 million worth of the new "Grand Theft Auto" videogame in just one week. Best Buy reported June 17th and beat estimates. Consumers are still consuming.

Signs of the Times?

Many airlines have been steadily increasing prices trying to pass on higher energy prices. Many have even started charging extra for the first piece of luggage. What a public relations nightmare this will be. Hey, airlines were losing money when oil was $10 a barrel, they certainly won't be profitable at $135/barrel.

Contrarian Sign?

On March 13th, Goldman Sachs demoted their high profile strategist Abby Cohen for being bullish too long. This was just days before Bear Stearns announced their demise. Is Goldman's move a bullish contrarian indicator?

More on U.S. Banks...

With data taken from the FDIC:

1. Since 1934, there have been only two years with no bank failures (ironically they were 2005 and 2006)
2. In 2007, the U.S. had only three failures.
3. During the S&L crisis in the late 1970s, banks were failing at the rate of two per day and did so for two years (and by the way, the U.S. economy did not go into recession).

So again, the $13 trillion U.S. economy should be big enough to sustain the impact of the subprime crisis.

NOTES

Exxon Mobil set a profitability record for any U.S. corporation when it posted net income of $11.7 billion for the 2007 Q4. It is estimated the three biggest U.S. oil companies netted almost $10 million an hour combined in the quarter. Exxon's profits convey that the decline in production is being more than offset by the rise in oil prices. (Wallstreet.com Feb 1 '08)

Windfall Taxes? Why?

Over the last three years, Exxon Mobil has paid an average of $27 billion annually in taxes. A number so large, it's almost incredible. According to IRS data for 2004:

Total # Tax Returns:	130 million
# Tax Returns – Bottom 50%:	65 million
Adj. Gross Income – Bottom 50%:	$922 billion
Total Tax Paid by Bottom 50%:	$27.4 billion

Conclusion: In other words, one corporation (Exxon) pays as much taxes ($27 billion) as the entire bottom 50% of individual taxpayers of 65 million people.

Further the tax rate for the bottom 50% is only 3% of adjusted gross income where as for Exxon it was 41%! And the left wants more! (Gartman Letter Feb 8 '08)

ANOTHER BUBBLE?

U.S. Department of Agriculture budget:	2000	$75.1 billion	2007	$88.7 billion	(+18.1%)
Number of U.S. farms	2000	2.167 million	2007	2.09 million	(- 3.5%)

(Or an increase of $39,656 per farm to $42,440 per farm!) *(Gartman Letter Jan 29 '08)*

There is a lot being written about North America losing manufacturing jobs. But according to Goldman Sachs, the U.S. has been losing manufacturing jobs since the high in 1943. It has been falling steadily ever since. Somehow, we have to believe that a trend that is now 65 years in the making is reasonably intact. This is not a new phenomenon but an old one of six decades. *(Gartman Letter Feb 8 '08)*

Portfolio Corner Summary

(As of close June 19, 2008)

This quarter's recommendations:

Fidelity Special Situations Fund ($15.22) Rare that I recommend mutual funds but this fund has the freedom to invest in any stock regardless of market cap, sector, or region. Has been out just over one year and returned 37.2% and top quartile ranked. Its manager, Canadian Mark Schmehl, has been called a "Young Peter Lynch." Hold for at least 24-36 months.

Carnival Cruise (CCL – NYSE $35.00) This is my oil is going lower play. Is the largest cruise and leisure travel player and a great play on boomer demographics. Operate under brand names Carnival, Princess, Holland, Hellenic and Seabourn. Last year $13 billion in revenues with decent balance sheet and a nice 4.40% dividend yield. High of $59 Jan 2005.

Also look at **Dryships (RRYS $80.50)** and **Diana Shipping (DSK- $32.00)**, for same logic i.e. lower oil prices.

Around the globe

Canada (SELECTIVE BUY)
- Still rising oil, gas and commodity boom
- Ontario (50% of country's economy) hurting and manufacturing getting pummeled
- Lower rates stalled at last BOC meeting
- If not comfortable chasing commodities and too early for banks, what's left to own?

U.S.A. (STRONG BUY)
- U.S. most despised nation on earth right now – pessimism rampant to their currency, President, corporations, economy etc.
- New President regardless, come Jan 2009 – may signal change?
- Market has gone no where since Bush became President (eight years!)
- Due!

Europe (HOLD)
- EU and Bank of England have stubbornly refused to lower rates and have chosen to fight the inflation fight
- Recent Irish vote may be threat to unity
- France's Sarkozy more friendly to West than predecessors
- Will EU exist five years from now?

Asia (TRADING BUY)
- Chinese market down 30% first half of this year
- Inflation in region a problem since virtually all of their energy is imported
- Still a great long-term story

Latin America (AVOID)
- Brazil has led region with phenomenal growth
- Get huge benefits from the commodities boom thanks to land rich in natural resources
- But…politics still too left leaning – has had great run

Welcome to the Team!

Please join us in welcoming Theresa Kelly to our RBC DS team. Theresa joins us from RBC (Royal Bank) and will help us cover Trish's maternity leave which starts this fall. She is on a quick learning curve and I am sure we will all be patient as she absorbs all that information! Please take a moment and welcome her next time you call. (VF)

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.

Congrats, Metta H.

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.