RBC Dominion Securities

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The Newsletter for the Informed Investor – http://dir.rbcinvestments.com/vito.finucci **January 2007**

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The big Picture

The Price is Right – Reload
Climbing the Wall of Worry
Worries Abundant but Fear will Fade

First things first. The year 2007 is the third year of the President's term. In the ENTIRE history of the S&P 500, there have been only two negative third years of any President's term. The last one was 1939 (as we entered World War II) and the other 1931 (in the midst of the 1929-1932 depression); both extremely unusual times. All other third years were double-digit positive, except for single positives in 1947 and 1987 (even despite a 20% crash in October 1987). THE AVERAGE RETURN FOR THE THIRD YEAR OF A PRESIDENTIAL TERM IS 20%. Let me repeat that: The average return in the USA in the third year of a president's term is 20%, and it's been 68 years or so since we lost money in the third year. While there is no guarantee, the odds are in our favour. Of course, given that just about everything else has gone wrong for "Dubya", who knows?

I could end this issue right here and simply predict a 15-20% upside. The odds favour it. If the S&P is up, the world markets should be too. Good times are close at hand. But I am feeling verbose as I write on New Year's Day, so allow me to expand.

Since the last Fed hike in mid summer, bond yields have dropped almost 1%, and most major market indices are up over 10%. After 17 consecutive hikes and the long pause since, the economy has slowed but not derailed. Inflation expectations have calmed. Of course there are always risks, but the history of returns through similar economic scenarios is simply too compelling to ignore. A soft landing extends the economic cycle and feeds investor confidence. The great run we've had the last 4 months is confirming that, and even though we are due for a pause/pullback, use such corrections to "Re-Load", because the upside potential for stocks could be significant.

While growth slows, especially in housing and autos, the sectors most exposed to rate increases, recession seems unlikely. North America's winter has been a mild one, and energy prices have fallen. Global inflation seems to be holding in a 2% to 2.5% range, acceptable for most central bankers. All this would point to some interest rate relief (i.e. lower rates) sometime in 2007.

Nevertheless, there is an old adage on Wall Street that says bull markets climb a wall of worry and worries are abundant. Worries about the US Economy, corporate profits, the weak US dollar, twin deficits, interest rates, a new Fed Chairman, energy costs, the Iraq war, and just worries about so many worries. As you might expect, there are lots of reasons for investors to take profits and run. Even though none of the worries in the air are new or unforeseen obstacles we can be assured that varying interpretations will unfold and trigger

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emotional responses in the market.

The economy IS sending mixed signals. The bad news is that the housing industry is undergoing a sharp correction that may not have run its course yet, and auto production is less than stellar, but the growth in the service sector has more than offset those shortcomings. Believe it or not, the US economy grew 30% between September 11th, 2001 and September 11th, 2006. The USA's GDP is $3 trillion higher than five years ago and yet all we hear and read is the bad news. That change alone surpasses the entire size of China, the world's hottest domestic economy, yet some pundits wrote off the USA years ago. (The world economy grew $15 trillion since 9-11-01, the USA accounting for 20% alone). What's driving the world's accelerating prosperity?

Technology, communications and more democratic, capitalistic ways of thinking. Put it this way: Today's average hand held blackberry is 120 times more cost efficient than the desktop computer of 1990.

The bottom line is that Canada has had a good run for the last three years, led by the commodities. I think there's a ton of value in the US market that's going begging. I'm not sure how that changes overnight, but it will change. The great rally we've recently experienced can slip away because a lack of faith and too much fast money floating around and not enough long-term money. From the low valuation multiples, piles of corporate cash, its history of innovation, liquidity and safety, it's hard to believe investors will continue to shun the USA. The hedge fund boom and more importantly the private equity boom going on tells you the smart (and big) money already knows this and has a huge jump on the average investor who remains content holding cash.

The interesting aspect to the recent rally is the fact that there are as many unanswered questions now as there were when equities touched lows last July. Tranquility is a pit stop for stocks, where fear lurks and doubt prospers. Unlike the enlightenment it provides in other areas of life's endeavors, in the markets tranquility actually drives investors a long way from nirvana. Folks who were bearish six months ago remain bearish today, and even some former bulls have crossed and joined the other team. To me, that's great news and adds to the "wall of worry" argument.

So in my opinion, the markets will continue to be strong in 2007, but broaden out across sectors, which is healthy. The full year of 2007 will be very good and, odds are, so will 2008 (an election year in the US). I've been harping on Financials, Techs and Healthcare as leaders, and so far the first two groups are doing that, and Healthcare is coming. The Technological Revolution will continue, with biotechnology close behind.

Bulls remain a rare breed and pessimism abounds. I know a lot of managers who cashed out in August waiting for a big pullback in September/October. They are still waiting and left 10-15% (or more) on the table. I think the NASDAQ will be leading the next two years, but the main problem with the NASDAQ is the emotional baggage (back from 2000 to 2002) that comes with it, which triggers swift moves to the exits at the first sign of trouble. As these companies smooth out their execution, we should see valuations increase.

Corporate earnings remain solid, inflation is under control, oil prices have fallen, interest rates have peaked (and are likely to fall), the consumer remains strong and foreign markets grow more prosperous. I remain very positive for 2007, besides, statistically, history is on our side.

Notes (or things that make you go, huh?)

Corruption and Culture – From 1997 to 2002, Canada's UN mission in New York generated zero unpaid parking tickets. The countries of Chad and Bangladesh had 1,243 and 1,319 unpaid parking violations respectively. *(National Post Dec. 8, 2006)*

The combined economies of Texas and California are still larger than the GDP of China. *CNBC Oct. 25, 2006*

The world's 5 largest oil companies earned a combined $240,000 per minute in the third quarter.

Japan at a glance: Low birth rate of 1.25% (too low to replace workforce), 21% of the population is over 65 (highest of any nation in the world), life expectancy of 78 years for males, Percentage of immigrants in Japan 1% (one of the lowest in the world). *Fortune Magazine Sept. 18, 2006*

The top 1% of nation's earners paid 34% of total taxes, top 5% paid 54%, top 10% paid 66%, top 25% paid 84% and top 50% paid 97% . . . Bottom 50% paid 3.5% of total taxes paid. Top 1% had an average gross income of approx. $295,000 *(all figures US from 2003, Gartman Report)*

The Little Picture

As many of you know, I have been the major sponsor of the Children's Golf Classic for the past 17 years. Last year's tournament raised an amazing $180,000, bringing the running total to over $1.4 Million since day one. Next year's event will be held on June 25th, 2007 and Canada's top golf name, Mike Weir, will be joining us for the event. In addition, the Weir Foundation will help to raise some money for our local Children's Hospital. If you are interested in helping, either through financial donations, services or products donated via your company or organization, all contributions are well appreciated and stay 100% locally. Cash donations greater than $10 will receive a tax receipt.

Portfolio Corner Summary

(as of close January 2nd, 2007)
Did lots of "homework" over the holidays and have a lot of names I like to start 2007

This Quarter's Recommendations:

Boston Scientific (NYSE – BSX $16.90) – This maker of medical instruments has been hurt by doubts about the safety of its stents (small devices used to open key arteries often in the heart or brain). Also last year they won the $25 Billion takeover of Guidant, probably overpaying. They have 18% of the global pacemaker market, 29% of defibrillators, and 48% of stents. Stock was as high as $46.00 in 2004 and $24.00 in 2005. I think it's cheap here. Aggressive hold 12-18 months. (12 month range – Hi $26.56, Lo $14.43)

Sandisk (NASDAQ – SNDK $41.75) – The world's largest maker of flash memory cards used in digital cameras, music players and other consumer products to store images and songs. Earnings grew 300% in 2003, and have slowed since but should grow by 20% in 2007. Old high of $85 in 2000, $16 in 2006. Aggressive hold 12-18 months. (12 month range – Hi $79.80, Lo $37.34)

General Electric (NYSE – GE $37.50) – The biggest conglomerate in the world with $148 Billion in sales in 2005. Well diversified in energy, appliances, lighting, industrial products, medical imaging, locomotives, nuclear power, aircraft and financial services among others. Net income up almost $1 billion in the last 3 years and stock has barely budged. Was $60 in August 2000 and has been sideways the last 4 years but I think it's on the verge of a big breakout. Buy for 12-18 months. Conservative, nice 3% yield as well. (12 month range – Hi $38.49, Lo $32.06)

Yahoo and EBay (NASDAQ – YHOO $25.60 EBAY $30.00) – Two of the largest Internet players in the world, both are big brand names, and both have fallen on hard times. I think in both cases there's a lot of pressure on management to produce or face changes. Other players could buy both out. Revenues for YHOO in 2006 were $5.25 Billion and EBAY $4.55 Billion. Aggressive names, hold for 12-18 months. (12 month range – YHOO – Hi $43.66, Lo $22.65 – EBAY – Hi $47.86, Lo $22.83)

Ford (NYSE – F $7.50) – My very aggressive pick for 2007. Question is, can they turn it around? If they can, it's much higher than $7.00. New CEO Alan Mulally worked wonders at Boeing when they looked like they were done. Can he do it again? Costs have been cut, plants closed, if they can come up with some models consumers want to own…who knows? Looking for $10-$12 in 2 years. Very Aggressive. (12 month range – Hi $9.48, Lo $6.06)

OK, need to have at least one Canadian name, right?

CGI Group (TSX – GIB.A $8.10) – Information tech firm with a lot of business processing for the financial services sector. Sales of $3.4 Billion in 2006, net $454 million. Old high of $34.50 during tech crazy 1999, has been sideways for the last six years. Aggressive with $12-$13 target in 18-24 months. (12 month range – Hi $9.94, Lo $6.50)

"Quotes"

"Even the greatest of whales is helpless in the middle of desert."– *Chinese Fortune Cookie*

To do great and important tasks, two things are necessary: a plan and not quite enough time.
Anonymous

"Reality is the leading cause of stress amongst those in touch with it." – *Jane Wagner*

Losers are aggressive, winners are assertive
Losers take chances, winners make choices
Losers see thunderstorms, winners see rainbows
Losers let it happen, winners make it happen.
Denis Waitley

"Forgive your enemies, but never forget their names"
John F. Kennedy

Portfolio Review: As is our tradition, we like to look back and see how our calls did. Except for Canfor, pretty good overall. Note – October 2006 numbers reflect only 3 months.

Date Recommended	Name	Price Then	Price Now	Total Return
October 2005	Deutsche Telecom	$18.00	$18.20	5.10 %
	Canfor	$14.65	$10.80	-26.00 %
	Bank of America	$41.96	$53.39	37.25 %
	Open Text	$16.47	$23.90	45.10 %
January 2006	Jean Coutu	$13.65	$13.80	0.00 %
	BCE	$27.95	$31.50	27.65 %
	Annaly Mortgage	$12.00	$13.90	20.58 %
April 2006	Johnson 'N Johnson	$59.60	$66.00	12.40 %
July 2006	Cedar Fair	$26.50	$27.80	8.30 %
	Bank of Montreal	$59.15	$69.00	18.85 %
	Intel	$18.25	$20.25	12.05 %
October 2006	Altria	$76.55	$85.80	13.13 %
	March Networks	$18.82	$21.35	13.40 %

Around the globe

Canada (SELECTIVE BUY)
- ❖ TSX for 2006 returned 14.30%.
- ❖ Economy slowing in line with USA; inflation in line, weakening currency will help manufacturing.
- ❖ Commodities, Mines, Metals, Gold and Oil have all had big runs, can they repeat?
- ❖ Prefer US and Overseas at this point.

U.S.A. (STRONG BUY)
- ❖ For 2006 – Dow Jones 15.6%, NASDAQ 8.9%, S&P 500 13.1%
- ❖ Growth slowing but recession unlikely, slackening demand for housing and autos have reduced GDP; market now turns to chance of rate cuts in 2007.
- ❖ Lower oil prices, lower interest rates and election cycle all bode well.
- ❖ Market gaining confidence in Bernanke Fed.

Europe (BUY)
- ❖ 2006 Returns – Britain 10.7%, France 17.5%, Germany 22.0%.
- ❖ Growth gaining traction, inflation under control, Euro very strong.
- ❖ High levels of corporate profitability; many mergers/takeovers.

Asia (STRONG TRADING BUY)
- ❖ 2006 Returns – Hong Kong 34.2%, Japan 6.9%, China 97.5%.
- ❖ China economy still running over 10% growth, but Japan has been strong.
- ❖ Low unemployment, lower oil prices are a big plus since most import 100% of their oil.

Latin America (AVOID)
- ❖ For 2006 biggest market (and most democratic) was Mexico up 48.3%
- ❖ Except for Mexico, most recent governments elected have been extreme left wing and historically do not make for good economics.
- ❖ 2-3 years down the road will be serious issues.

Looking ahead

January
- ❖ First 5 days used as a barometer for the rest of the year (86% correlation)
- ❖ Last month of the best three months (Nov/Dec/Jan) in markets

February
- ❖ Last 23 years: 15 up, 8 down
- ❖ Many market technologies modify market predictions in February based on January's market

March
- ❖ Recent record: 14 up, 9 down
- ❖ Sixth best month historically
- ❖ Usually decent in third years

(Source: 2007 Stock Traders Almanac)

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, Hank V.

Our winner this quarter!