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
(519) 675-2505
alyson.medeiros@rbc.com

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

Trish Boughner
Assistant
(519) 675-2021
trish.boughner@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

BETTING ON THE EAGLE AND THE RED, WHITE AND BLUE

Last week, the U.S. Interior Department removed the bald eagle from the Endangered Species Act list. According to officials, there are now 10,000 mating pairs of bald eagles (with at least one pair in each of the 48 continental states). This number is a dramatic increase from the 417 mating pairs believed to be in existence in 1963. Of course, at one point, there was an estimated 500,000 pair soaring across the USA. The eagle has survived and come back, and it's something we can all cheer about.

The U.S. stock market seemingly endangered as well over the last few years, has roared back similarly, although its glory has not provoked awe from the masses. Rising from the ashes from its 2000-2003 underperformance, lately it has resembled another bird of symbolism – the Phoenix. But most investors act like ostriches, sticking their heads in the sand and ignoring the value proposition equities have provided, waiting for the "pullback" or correction (they've been waiting at least 10 months!).

But there is more to the story. . .

Investors would rather spread their wings and leave the safety of the nest (i.e. cash, GICs) but they are afraid of the "experts". The average investor has a lingering sense that there is another long-term capital management fiasco around the corner, either from collateralized or sub-prime mortgages, private equity deals or from hedge funds.

The biggest problem for the markets right now is the seemingly birdbrain fixation on inflation, despite the obvious pockets of economic vulnerability. Housing is weakening, autos are having their problems, and the exploding economies from emerging markets, most notably China and India, are deflationary not inflationary.

The U.S. Federal Reserve remains "hawkish" but there will come a time soon where they will turn "dovish" and play a role in supporting a slowing economy (heading into an election year as well!) and start lowering interest rates. The bright point is that the U.S. economy is broad and deep, and has sustained the ability to withstand all manners of shock in the past seven years.

The amount of liquidity (cash) out there is astounding. Stocks in general are cheap and simply, supply and demand comes into play. Stocks are both cheap and scarce, add to the equation solid earnings, increasing dividends, and lots of cash on the sidelines, and you get the explosive situation we are experiencing. There are still too many investors who think that simply because the market is up it must come down, and they have already missed out on fantastic opportunities, and will miss more.

Of course, as I always caution that doesn't mean every sector or stock is a buy, or that the market isn't going to test your will or resolve from time-to-time.

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Considering how fast the market has risen of late, it is reasonable to expect some sort of pullback, but as I've been saying for some time, those pullbacks will not be deep nor long in duration, and will represent another buying opportunity.

As it stands, stocks have become the only asset class that is attractive, as real estate and bonds are not producing significant returns.

In Canada, the Bank of Canada remains "hawkish" on inflation as our economy is probably growing at 3.5%, well above previous estimates of 2.5%. The run of the Canadian dollar is also well above prior ranges. We continue to be the beneficiary of a solid commodity environment and it looks like it will continue to be so, even though I believe the easy money has been made.

In China, the economy continues to roll at 8-10% growth. While I understand the long-term story and am a believer in free markets, I also understand manias. According to a May 30th article on Bloomberg, there are now over 100 million brokerage accounts in China and the market has reached a capitalization of $2.47 trillion. In a recent single session, $53 billion in shares changed hands. It's wonderful when everyone can be an owner, but the problem is the Chinese market has gotten ahead of itself. Recent 9-10% downside hits in the Shanghai exchange reinforce my point. Sure there are great values there, but the hype is so elevated that the entire market is vulnerable, and the powers that be can't get the genie back in the bottle without huge risks. (So how to slow a market without derailing it?)

Unlike the U.S.A. in 1984, 1987 or 2001, it will be interesting to see how all these nations that have provided pools of cheap labour are going to handle the shock of waddling in recession. How intense will the backlash against capitalism be in China, Brazil or India when they start facing economic hiccups?

What remains interesting to me as a market observer is that what seems to be the greatest threat to this bull market is prosperity. Or should I say, too much prosperity may be the greatest threat to this bull market? How we reconcile this both as investors and humans is always the conundrum. There seems to be enough pockets of worry to keep interest rate rises to a minimum. Enthusiasm for the U.S. economy is low. I heard this straight from floor traders on the NYSE just a few weeks ago on my recent visit to the Big Apple. The world has low expectations for the U.S.A., President Bush's approval ratings are at all-time lows, and their currency has been hammered. In reality, Americans are the world's biggest and most productive savers, at the pace of $3 trillion per year mainly in stock and home price appreciation. They invest in computers, trucks, patents, power lines, etc., things that give rise to increased economic output.

Despite the positives, investors have been "un-bullish". According to Bloomberg (June 18th), "hold" ratings climbed past "buy" ratings for the first time ever this February when the tally was 47.8% and 45.3% respectively. "Sell" ratings now represent 7% of all recommendations, up from 2% in March 2000 (the cycle peak!), the most bearish ever! And finally, while in New York, I learned the NYSE short position on stocks was at an all time high, the highest since 1931. For the record, historically, these are all positive contrarian indicators.

In the last great bull market of the 1990s I think everyone lost their religion. The penance has been to not get greedy and sell any rallies. The worst mistake is believing that something is overbought because the price has risen. There are many investors who have missed a 3000-point upside on the indices, simply waiting for a 500-point correction. Heck, new highs beget new highs.

If you recall our January 2007 issue, we said the average return in year three of a President's term was 20%. And guess what, halfway through the year, we are halfway there. In my opinion, we are in the third or maybe fourth inning of a major market move and the next move higher will be propelled by the USA and its economy.

The single most important message here is to be optimistic. If one had no faith in the market or in their timing ability to be there when the market took off late last summer, then isn't it a big stretch to assume one will correctly pick the bottom of a correction?

I remain very optimistic and think the overall trend will be up until next summer heading into the U.S. election. We can talk about that in future issues, but I do believe most global markets will be strong, but the good old U.S.A. will lead the way. In the words of legendary investor Warren Buffet, betting against America has never been right.

Overweight tech, financials (anticipating lower interest rates) and healthcare. The best current earnings growth will be in industrials, the best take-over candidates are in commodities (energy, natural resources, etc) and the greatest percentage gains over the next year or two will be in old and new hi-techs.

Bet on the red, white and blue.

The Really Big Picture

RAISING $$ TO HELP SICK KIDS GET BETTER!

On June 26th, the 18th Annual Children's Golf Classic was held at Sunningdale Golf Club. This year we were honoured to be teamed up with Canadian golfer Mike Weir and his foundation. The results were staggering: We raised an incredible $562,000 (net) for our local Children's Hospital of Western Ontario, the largest single charitable event in London's history. I am proud to have been involved and want to personally thank all our clients who made cash donations, gave auction items or services in-kind. **Thank you!**

Photo at right: Vito Finucci, Canadian Golf Legend Mike Weir and David Agnew, National Director - RBC Dominion Securities

Quotes

"Wouldn't it be much worse if life were fair and all the terrible things that happen to us happen because we really deserve them?"
JM Straczynski

"Age is mind over matter, if you don't mind, it doesn't matter."
Baseball Great, Satchell Paige

"A narcissist is someone better looking than you are."
Gore Vidal

"Last week I stated this woman was the ugliest woman I had ever seen. I have since been visited by her sister, and now wish to withdraw that statement."
Mark Twain

"Until I was 13, I thought my name was SHUT UP." *Football Legend, Joe Namath*

Portfolio Corner Summary

(As of close July 5, 2007)

This quarter's recommendations:

Neo Material Technologies (TSX – NEM $3.90) – NEM manufactures and distributes rare earth & zirconium based engineered products. Supply auto, electronics and glass industries. Sales have gone from $70 million in 2004 to $184 million in 2006. Very profitable with decent balance sheet. Very Aggressive 18-24 month play for potential double.

Motorola (NYSE – MOT $17.80) – One of the world's largest wireless players with almost $43 billion in sales. Management has not executed but pressure is mounting. Lagging brand name that hit $55 in March 2000. Hold for 18-24 months.

* **Special Note** *

Congratulations to those of you who took our recommendations in January 2006 to buy BCE at $27.95. With the $42.75 offer, all-in with dividends (and Bell Aliant spin-off) total return of approx. 70% in 16 months. We are very proud of our track record in the Portfolio Corner since we started it in 1995. Both our track record (i.e. Number of winners vs. losers) and percentage returns are well above average. If you haven't followed it closely, maybe you should!

NOTES

China is undergoing the biggest economic transformation since the Industrial Revolution transformed the world. Economic growth is strong at 8-9% and China is now the 4th largest economy in the world but GDP per capita is $7,600 U.S., very low by international standards. (FYI – U.S. is $43,444 and Canada $35,494 – source Wikipedia). But many forget China is still a planned economy and the government remains communist.

"Tax Freedom" day in Canada is now late June, early July. As compared to the USA, in 2006 it was April 26th. That means the average Canadian has to work two months more out of the year to cover our higher taxes. *(Gartman Letter)*

U.S.A. defense spending is the lowest in 65 years! Ex-inflation, defense spending in the U.S.A. has risen steadily since 1958 when it was $55 billion. By 1968, that was $100 billion, by 1978 $150 billion, 1988 $360 billion, 1998 $350 billion, but estimated to be $600 billion in 2007 or up 12 fold since 1958. However, U.S. GDP in 1958 was $2.3 trillion, so defense spending was 2.4% of GDP. Today GDP is $12 trillion so it is spending 0.5% of GDP on defense. Consider as well the U.S. was at peace in 1958 and is at war with terrorism today. *(Gartman Letter)*

Around the globe

Canada (SELECTIVE BUY)

- ❖ Canadian dollar best performing currency year-to-date: since January 1st 2007, the C$ up 8.18% vs. US$.
- ❖ TSX up 8.42% over the past quarter.
- ❖ Canadian economy not slowing like U.S. and takeovers are abundant; last 12 months huge names like BCE, Alcan, Inco and Falconbridge all targets.
- ❖ Commodities appear to be late cycle.

U.S.A. (STRONG BUY)

- ❖ Growth remains just below long-term pace as impact of higher rates and housing slowdown take a toll; low inflation.
- ❖ Soft economic landing seems to be in place
- ❖ U.S. corporate and consumer balance sheets appear strong.
- ❖ Look for interest rate cuts.
- ❖ Bet on the Red, White and Blue going into the election.

Europe (BUY)

- ❖ Germany and France (the two largest economies) are beginning to recognize gains from fundamental economic reform; continues to surprise on the upside.
- ❖ European equities up 12.26% this past quarter measured in US$, Germany up 19.03% alone.
- ❖ New leaders push for labour reform.
- ❖ Huge reform going on will pay big dividend later.

Asia (TRADING BUY)

- ❖ China still humming along while Japan continues to languish as domestic consumption still suffers hangover from the decade of deflation in the '90s.
- ❖ Most economies growing 4-5%, twice the western rates but overall growth is at a healthy rate without significant inflationary pressures.
- ❖ Expect volatility but overall should be solid.

Latin America (AVOID)

- ❖ Too left overall despite the fact Brazil (largest economy) seems to get it.
- ❖ With Venezuela scaring off foreign investment, disaster inevitable.
- ❖ Too volatile, too corrupt, too unpredictable overall.

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, Kerrie I.

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.