RBC Dominion Securities

Money
NEVER SLEEPS

The Newsletter for the Informed Investor

July 2005

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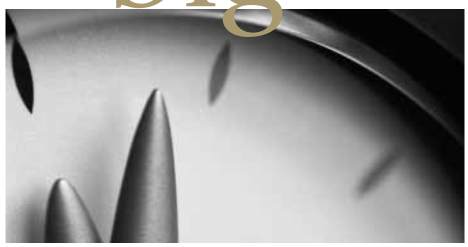
The big Picture



"A RIVER RUNS THROUGH IT"

The Market is Scrambled, But it Hasn't Cracked Yet

In Africa, there is the most remarkable scene that occurs each year at the Mara River. In an effort to move from the Serengeti in the south, up to 300,000 wildebeest and thousands of zebras and antelopes must cross the river to reach fresh green grass. However, in those waters lurk scores of crocodiles. No ordinary predator, these crocs can weigh as much as a ton, and they feed in a relentless way. I have been reminded of the scene as the market continues to trade in a very narrow range, collapsing at pivotal crossing points on the charts. For the Dow Jones, this crossing point is 10570 and for the NASDAQ the number is 2100 (just crossed as of July 8th close). I suppose because it's not a matter of life and death, investors don't have the resolve that those wildebeest have to get to the other side. Then again, the only thing lurking in the waters of the markets are doubt and fear of the possibility of losing money.

This past quarter marks the 5-year anniversary of the market's March 2000 peak, and though much has changed, there are some similarities. Then it was all about tech and telecom, now it's all about energy. Then it was investors on offence; today it's all about defence. Then it was about how fast money could be made; today it's about how to avoid losing money.

Here we are at the halfway point of 2005, and most world markets are down 4% to 6%. The TSX is up 8%, but follow this: Energy represents 25% of TSX, and that index is up 32%, so pretty well the entire gain has been energy, little money has been made anywhere else.

We have spent the entire year with higher oil prices as enemy number one and higher inflation/interest rates as enemy number two. That one-two punch has terrorized the markets all year long, more than terrorism itself. Look closely and you will find such worries are both widespread and exaggerated and already priced into markets.

Inflation is not as bad as people think. Over the past 12 months (excluding energy) prices are up 2.4%. As for rising rates, it seems pretty limited to the US only and on the short end. The 10-year bond rate is down over 1% from a year ago. I don't think these should be worries.

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Big Picture

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If you want something to worry about, consider long shot risks, which the markets are overlooking. On the list would be if Bush appoints a disaster to replace Fed Chairman Greenspan. Another would be the building social tensions within Europe causing economic disintegration there. Others would include a large terrorist attack, but I highlight how the initial negative knee jerk reaction to last week's London bombings in the morning turned into a decent up day by close. Last but not least to worry about is the possibility of a new era of repression in China which stymies its economy and could impact the world economy as well.

It seems like the "smart" money thinks there's value out there. From January to April, 225 public companies in the USA have agreed to be bought out, at an aggregate sum of $246 Billion. This doesn't even include the private deals via leveraged buyouts, whose recent targets have included well-known names like Polaroid and Toys R Us. On top of that, 339 companies in the first third of the year have started stock buy-back programs taking another $132 Billion of equity out of circulation.

How does one explain the most prominent buy this past quarter by billionaire Kirk Kerkorian's bold move with respect to General Motors? With the stock trading at $27 and just downgraded debt to junk status, KK made a bid of $31.00 to now own about 9% of the company. Fool? Value? Not according to the media who have been trashing GM on a daily basis. As of today's writing, GM is trading just under $36 US. So far, so good for Mr. Kerkorian.

On the black gold (oil) front, there still remains a black cloud. While the markets have not risen as oil trades above $61 US per barrel, the great news is, they have not collapsed either. High crude prices will hurt the economy if it doesn't slow. Just think how much more the average Londoner is paying with prices at $0.94 per litre, versus $0.64 a couple of years ago. With two vehicles filled up with 40 litres per week, it works out to an extra $1,200 (after tax!) per year on gas alone. Picture the increased costs to a business which transports goods, or travelling salespeople, etc. It was no surprise last week Fed Ex missed the analyst's earnings numbers by a wide margin thanks to, that's right, higher oil costs. The economy and markets are facing a dilemma in the sanguine attitude that $50, $60 or even $80 a barrel for oil doesn't matter to the economy. There is a large camp out there preaching that both could handle a spike in black gold. There in lies the problem: this egotistical approach always leads to a challenge. When the street says $60 US is no big deal, you could bet crude would rally to test that. Another impact of crude is the psychological effect it has on business spending towards durable goods (products designed to last three years or longer). For the time being, this story has to play itself out, and in my opinion, inventories have been growing at a rather rapid pace for something that is so hot in demand. So far, the market seems to have digested $60 oil like I digest an all-you-can-eat buffet. (i.e. No problem!)

Coming into July, there seems to be a buoyant feeling in the air. Obviously it has a lot to do with the market's response to the London bombings and world resolve. There was better inflation news thanks to a benign employment report. One huge factor overlooked was the US debt situation. According to the Congressional Budget Office, tax revenues have been $1 Billion a day ahead of last year's pace for April and May. That's $1 Billion per day folks!

The result is that the nation's budget deficit could decline to $325 Billion by year end, well below the record $412 Billion established in 2004. The bottom line is tax receipts are soaring. This is why supply side economics makes sense. When economic opportunities are created and taxes are not prohibitive, it generates boundless revenues for everyone, not just the government. Too bad our elected officials have yet to wake up to this phenomenon.

I stick to my opinion that the second half of 2005 will be good and 2005 overall will be a good one. I think increasing corporate earnings, steady interest rates and lower oil prices, all combined, will be the catalysts. Stay tuned.

The Little Picture

(But in reality, the REAL Big Picture)
On July 13th we held the 16th Annual Children's Golf Classic. I am ecstatic to report we raised an incredible $150,000 for the local Children's Hospital, easily topping last year's $133,000. This brings our total raised over the years to almost $1.3 million dollars. A special thank you to all our friends and clients who were very generous with their donations. We've already started working on next year's event! Again, a special thanks from the bottom of my heart.

Around the globe

Canada (Selective Buy)

- ❖ Canadian Dollar has appreciated 25% since 2003, has started to bite as inventories saw second largest increase in history and exports fell.
- ❖ GDP 1.7% in Q4 was the worst in five quarters (largest 2 quarter collapse in 31 years), but unemployment (68%) best since Dec. 2000.
- ❖ Recent political scandals and excessive spending hurt confidence.
- ❖ Commodity sector still strong.

USA (Strong Buy)

- ❖ Housing remains firm, employment growth continues.
- ❖ US dollar has quietly gained strength.
- ❖ GDP expected at 3% for 2005.
- ❖ Corporate earnings continue to outpace expectations (this quarter will be 10th in a row real numbers best analysts).

Europe (Switch)

- ❖ Q4 GDP meagre 0.2% growth hard to swallow (50% of expectations).
- ❖ Dichotomy evident as Spain/France grew at .8%, Italy/Germany had negative.
- ❖ Recent votes in France and Netherlands threaten entire EU.
- ❖ German economy in a mess, with 50-year highs in unemployment.
- ❖ UK has 30-year low at 2.6%.
- ❖ I don't like signals.

Far East (Trading Buy)

- ❖ Higher oil prices, rising rates in USA and Chinese tightening are cooling demand for Asian goods.
- ❖ China still growing at over 9% per year despite efforts to slow it down.
- ❖ Japan had surprise with Q1 GDP of 5.3%.
- ❖ Potential revaluation of China's currency has caused flows to Hong Kong and Korea.

Latin America (Trading Buy)

- ❖ Has quietly been one of best areas in world.
- ❖ Levered to US dollar strength, corporate earnings solid.
- ❖ Still too much political instability and corruption.

"Quotes"

"What makes a good marriage, makes a good investor – low expectations"
Warren Buffet

"The sign on the door to success says 'PUSH' "
- Unknown

"We should not let our fears hold us back from pursuing our hopes"
– JFK

"I do not believe that friends are necessarily the people you like best; they are merely the people who got there first"
– Peter Ustinov

"Take your time – not mine"
– Robert Half

Looking ahead

July

- ❖ Historically best month of third quarter.
- ❖ From 1990 to 2004, 1st day up 12 of 15.
- ❖ Avg return 0.9% S/P, Dow 1.1%.
- ❖ Up 29, down 25 last 54 years.

August

- ❖ Worst month past 15 years.
- ❖ 6 of last 8 years last 5 days average loss 3.1%.

September

- ❖ Biggest % loser over last 54 years.
- ❖ Day after Labour Day up 8 of last 10.
- ❖ Last up September was 1998 – last 5 all down.

(Source: 2005 Stock Traders Almanac)

Notes

The length of service of US Airways' most junior captain – 19 years
(Source: Forbes Magazine June 20-05).

When Gillette and Proctor and Gamble merge, the company will own 21 brands that each generate at least $1 billion each in sales. Notable names include Always, Bounty, Crest, Downy, Head and Shoulders, Iams, Olay, Pampers, Tide, Braun, Duracell, Gillette.
(Source: Fortune Feb. 21-05).

It costs $5460 a year to smoke two packs of cigarettes per day in New York City, mainly due to sin taxes.

In 1942, manufacturing industries represented nearly 40% of total payrolls. Today it's approximately 10%. What more needs to be said?
(Source: Gartman Letter June 13-05)

Last quarter, of the S&P 500 stocks, 83% met or beat analysts' expectations. The average increase was 16.5%. Of the 500, 250 increased dividends and only 5 cut them. So why is the market flat?

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 through a nice dinner at one of the finer restaurants in London.

Congrats to Murray W.
Our winner this quarter!

Portfolio Corner

(Prices as of close January 4, 2005. Full research reports available on request.)

This Quarter's Buys:

Time Warner (TWX-NYSE$16.30) – Giant communications and entertainment company which owns franchises like Time Magazine, Sports Illustrated, Fortune magazine, Warner Bros. Movies, Warner Music, America-on-Line, and one of the biggest cable networks in the USA. Spins off $2-3 Billion in free cash flow each year, has reorganized management. Buy for 18-24 months. Stable.

Teradyne Inc (TER-NYSE $13.70) – Barton based semiconductor and circuit board company with almost $1.8 Billion in sales in 2004. Down from $20 in last 12 months and $40 in April 2002. Great leverage to chip market and good balance sheet. Aggressive buy for 12-18 months.