



STUART INVESTMENT MANAGEMENT LIMITED

May 2009

VOLUME 19, NUMBER 5

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The month ended with the venerable Chrysler Corporation being forced into a 'clinical' bankruptcy by the US government. The intended outcome being that the company will emerge from bankruptcy controlled by its union and the equally venerable Italian Fiat company. This would result in Fiat taking a large minority position and management control, in exchange for Chrysler's technology and access to the Fiat line of small cars which may now be produced and sold in North America by Chrysler. This also allows Fiat access to a North-American wide dealer, and a spare parts and service network, the lack of which has typically stopped other European auto manufacturers from effectively penetrating the US and Canadian markets in the past. Whether Fiat will be more successful than Daimler in running Chrysler remains to be seen.

The Chrysler bankruptcy has resulted in a forced layoff of all the Chrysler assembly-line employees in North America until the Fiat acquisition is completed which is anticipated to take two or three months. General Motors Canada announced they would cut their workforce by 57% to 4,400 over the next 5 years. This will add significantly to the unemployment numbers as the US has already cut an estimated 742,000 jobs in March alone, and unemployment rose to a 25 year high of 8.5%. Stuart Investment Management's economist, David Horner, predicts the US unemployment rate will peak at 10%, before starting to decline slowly in late 2010. The Canadian unemployment rate was slightly better at 8%, the highest since January 2002.

The rising global unemployment and the decimation of personal wealth as a result of the downturn have

caused civil unrest and street protests in several countries such as Germany, South Korea and Turkey. The G20 Leaders meeting in London in early April caused several days of street protests which resulted in at least one death. The G20 Summit finally resulted in an agreement of these nations to pump an additional US\$1 trillion into the troubled global economy through entities like the International Monetary Fund, and a strong commitment to crack down on tax havens.

POSITIVE PROGRESS

However, not all the news was negative. China's economy was showing signs of recovery and the current forecasts are for that country to grow between 5% and 8% this year, down from its 2007 peak of 13%, but faster than all of the western world economies. Goldman Sachs and a few of the US financial institutions reported positive results for the first quarter and Goldman indicated that it wanted to repay the US\$10 billion in government bailout funds it received in the fall of 2008. The Conference Board of Canada reported that the Consumer Confidence Index improved 'considerably' in April after a reported small rise in manufacturing output in February. We are not sure if it is a good or a bad thing, but the Province of Ontario received its first ever federal equalization payment from Ottawa in April. The federal government also reported that it still expected to report a small budget surplus for the just ended 2008-2009 fiscal year.

The markets were generally positive over April, with the Dow Jones Index rising 7.3% and the TSX rising 6.9% over the month. The S&P 500, the NASDAQ Index and the Value Line Index recorded gains of 9.4% 12.3% and 20.6% respectively while the Canadian Dollar eased off 5.4% versus the US Dollar.

In previous commentaries we mentioned the growing problem with piracy on the high seas and the apparent inability of nations to deal with it. There have been 102 recorded piracy incidents in Q1 2009. Three pirates, who boarded the Maersk Alabama and held the captain hostage, were killed by a US SEAL team. A fourth pirate was arrested and sent to the US for trial. On the subject of high seas, the battered shares

of **Carnival Cruises** and **Royal Caribbean** rose after the US appeared to be thawing its relationship with Cuba, which would allow US cruise ships to visit there for the first time in 47 years!

In Canada, **Suncor** and **Petro-Canada** announced plans for an \$18.4 billion merger pending Canada's Competition Board approval for the deal. This will convert **Suncor** from primarily an oil sands producer to a fully integrated oil company, and provide it with several additional refineries which could be altered to upgrade heavy crude from its oil sands operations.

The Bank of Canada cut the Bank Rate to an all-time low level of 0.25% and stated that it will probably maintain this rate until June 2010. These falling rates and lower home prices are making home ownership more affordable for the average family in both the US and Canada. Median US home prices have dropped 12.4% in 2008 and 27% from their peak in July 2006, and home re-sales fell by 7.1% since March 2008, but the most encouraging number was that first time buyers accounted for 53% of all purchases in March 2009.

HORNER'S CORNER

Our economist, David Horner, had the following comments about the reasons for the sharp rally in equity prices:

"I view the primary reasons for the sharp 30% rally in equity prices as:

- *The near-term deeply oversold condition of the market in March,*
- *Optimism that the economic contraction is subsiding, and*
- *Liquidity looking for a home as the Fed floods the market at the same time credit demand is declining.*

In addition, analysts and corporations lowered their earnings expectations so dramatically that actual earnings came in somewhat better than expected.

Looking forward, I suspect that earnings from non-financial companies will continue to decline in 2009. More write-offs from downsizing will continue for several more quarters and, on balance, profit margins will be negatively impacted as production volumes continue to decline for at least one more quarter. On the other hand, stock prices are forward looking and, once production is brought in line with future sales projections, companies will presumably be lean. Further, they will be reluctant to hire until an upturn in demand is firmly established. Thus, productivity should begin to increase quickly and that will reverse

the decline in margins. Based on this reasoning, much of the recent rally in stock prices is justified.

Has the sharp rebound already captured the most optimistic growth and earnings scenario or is there more to come? In my opinion, the news on the economy will continue to be quite mixed through the second quarter although, in comparison with the circumstances last fall and winter, the news will continue to be better. Thus, although several economists and analysts I respect are calling for new market lows, I disagree. This is not the "Great Depression" but rather the "Great Recession".

At the same time, I don't see a lot more upside to the market. The factors that will contribute to an economic recovery are the stimulus and an aggressive Fed. However, the Administration has been straight forward in acknowledging that it will not be "business as usual" with regard to policies. The recent willingness to let Chrysler declare bankruptcy and their failure to give into the various constituencies that had claims on any remaining equity in Chrysler sends a loud and important signal to investors. Clearly, businesses and jobs will become more important than capital providers. This is a clear reversal from the policies of the past four Administrations, especially the most recent one. In addition to the effect of policy changes, the "hangover" from the credit crisis will leave banks, private equity and hedge funds less willing to "leverage up" as rapidly, once growth returns. Increased and, hopefully, improved regulation will also play a role. Thus, what we monetarists refer to as the "power of money" is not likely to be restored to the heady levels of the early 2000's. Thus, wealth increases are likely to accrue more slowly.

The bottom line is that, after rising steadily for two decades, profits as a proportion of GDP is likely to reverse course, leading to gains in the government's share and, to a lesser extent, labour's share. In this climate, equity prices are not likely to move back to the 2007 level for at least several years. My forecast is for the S&P to remain in a range from, say, 750-950 for the remainder of the year."

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