



STUART INVESTMENT  
MANAGEMENT LIMITED

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## VOLUME 19, NUMBER 8

This month's Market Commentary begins with B.C. experiencing the hottest summer on record - up to 41.2°C in Bella Coola, with wildfires raging out of control all over the province, and Eastern Canada having one of the cooler summers on record through the end of July. This is a result of the Jet Stream deviating from its normal Summer Pattern with a "loop" extending up into the Yukon and Northwest Territories, keeping the warm dry air to the south and west of it and cool, moist air to the north and east of it.

The markets were generally positive over July, with the Dow Jones Index rising 8.58% and the TSX rising 3.97% over the month. The S&P 500, the NASDAQ Index, and the Value Line Index recorded gains of 7.41%, 7.82% and 10.19% respectively while the Canadian Dollar popped up another 7.74% versus the US Dollar from US\$0.8602 to close at US\$0.9268.

While the markets have staged a remarkable comeback since the doldrums of March 2009, we at Stuart Investment Management Limited remain very cautious as we feel that, contrary to what one reads in the financial press and sees on TV about "Green Shoots" of recovery, there are still a few shocks to come, primarily from the commercial real estate markets, and secondly from rising credit card defaults. We think there will be one more test of the market lows before the economy starts to gradually recover into mid 2010 and 2011.

### A MIXED BAG

Probably the most significant event over the past few months was the filing for bankruptcy by **General Motors** - the ultimate ignominious outcome for the one-time pillar of the old Dow Jones Industrial Average ("DJIA"), and the epitome of American business. **General Motors** and **Citigroup** have now been kicked out of the DJIA and replaced by **The Travelers Companies** and **Cisco Systems**. **Chrysler**

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also followed **General Motors** along the bankruptcy path, as did countless smaller auto parts suppliers to the large automobile manufacturers. **Ford Motor Company**, by responding to its problems earlier and more urgently, managed to survive the turmoil and posted the best gain in sales of all of the North American car manufacturers in the month of July. SIML feels that the recent jump in automobile sales should be regarded cautiously, as a very large percentage of the sales jump was due to the US\$1 billion "Cash for Clunkers" program which paid up to US\$4,500 cash for Americans who traded in a ten year-old or more, high gas consumption vehicle for a new vehicle with a significantly higher gas mileage. The total original allocation for this "C for C" program was snapped up within days of it being announced and there is a congressional move afoot currently to allocate a further US\$2 billion to extend the program and get auto workers back to work and clear automobile inventories off dealers' lots.

The jump in auto sales may temporarily slow the rate of job losses in the USA which also reports that the

number of real estate sales contracts has bounced off record lows, while personal incomes posted their biggest increase since May 2008. However, consumers are not spending this, but saving more, as the savings rate jumped to 5.7% from 4.5% the previous month. With a US unemployment rate that topped 9.5% for the first time in 25 years, consumer spending is unlikely to resume soon, and the “Back-to-School” period in August should give a key indicator of this trend.

After some trepidation as to China’s intentions with regard to its US Dollar Treasury Bills, US Government Bonds, and its US Dollar cash reserves, US Treasury Secretary, Timothy Geithner, took a trip to China and met with the Chinese Central Bank Governor, Zhou Xiaochuan. This agenda was of major concern as China’s forex reserves now exceed

US\$2 trillion. They agreed that the US Dollar “will remain the world’s main reserve currency for a long time to come”. At the same time a Chinese auto manufacturer made a bid to buy the ubiquitous “Hummer” truck brand from a bankrupt **General Motors!** The premiers of China and Taiwan also exchanged their first official direct messages in over 60 years promoting “peaceful cross-strait development and deepening mutual trust”.

China suffered another major earthquake in Yunnan Province in July which injured 325 people but caused the relocation of over 400,000. This was in the same general region where they had the magnitude 7.9 earthquake last year, that left almost 90,000 dead or missing, and fatal quakes in 1988 and also in 1970 during the chaos of the Cultural Revolution. Almost coincidentally, a large swathe of Asia including China and India were darkened by the longest solar eclipse of the century. This would have been taken as a very bad portent in ancient times, and thousands of people bathed in the sacred Ganges River at Varanasi to “protect themselves from disaster and calamities”!

Still in the East, the United States and India have signed a defense deal and agreed on India’s adherence to nuclear non-proliferation rules. This treaty allows for the US and other countries to provide nuclear reactors and sophisticated armaments to India, which could benefit corporations such as **General Electric, Westinghouse Electric, General Dynamics, Lockheed Martin Corp and Boeing Co.**

London’s venerable Big Ben rang in its 150<sup>th</sup> anniversary on July 11<sup>th</sup>. North Korea’s erratic

dictator, Kim Jong-II has apparently contracted life-threatening pancreatic cancer, but was apparently well enough to attend a recent meeting with ex-President Bill Clinton in Pyongyang, or it was a body-double, which he has been known to use. And, former CBS news legend Walter Cronkite died on July 17<sup>th</sup> at his Manhattan home at the age of 92.

The Governor of Alaska, ex-vice presidential candidate, Sarah Palin, resigned unexpectedly which may signal a run for higher office! The USA implemented an increase in minimum wages from US\$6.55 per hour to US\$7.25 per hour on July 24<sup>th</sup>. This is not expected to boost the already weak economy and employers will respond to the increased wage costs by cutting hours and/or workers to compensate. Sonia Sotomayor, the controversial first Hispanic female nominee to the US Supreme Court, appears to have cleared the final hurdle toward her appointment to the Highest Bench. The Securities and Exchange Commission of the USA made permanent an emergency rule banning the ‘naked’ short-selling of securities in a misguided attempt to reduce market volatility.

The indications that the global economy may be reviving in Asian countries has caused a renewed interest in base metals with metal prices rebounding off their lows and a renewed interest in the base metal shares and also in gold companies. One of SIML’s old favorites, **Freeport-McMoran Copper & Gold Inc.** beat the street estimates but still reported a profit drop for the second quarter. The stock responded by climbing to a recent high of US\$65.03 in anticipation of better results in the second half of 2009.

The fallen Canadian icon, **Nortel Inc.** was another victim of the bankruptcy epidemic, with Sweden’s **LM Ericsson Telephone Company** swooping in to scoop up **Nortel’s** wireless business and the associated patents in a US\$1.13 billion acquisition. The good news was that all of the major Canadian banks and a number of the credit unions in British Columbia and Quebec passed a Standard & Poor’s stress test, and were deemed to have, “...performed better under our stress tests than do those we rate in the U.S. under similar tests,” S & P said.

### **A POSITIVE SPIN**

Late last year when the markets were being hammered by the financial meltdown in the USA, we asked our clients to check their records for taxable capital gains

they had taken over the preceding three years from all of their accounts, not just those held by SIML.

A number of our clients did this exercise and we were able to sell off some losing positions in their accounts to generate tax losses in their accounts for the 2008 Tax year. We then recommended our clients file with Revenue Canada to carry these losses back for up to three years against capital gains taxes previously paid.

We are happy to report that a number of our clients did exactly this and we were able to get one of them a cash tax rebate of almost \$74,000 representing capital gains taxes paid to Revenue Canada over the preceding three years. This cash somewhat offset the sting of the market losses in their portfolios over the last five months of 2008, and the current market rebound has helped recoup further value for them.