



STUART INVESTMENT
MANAGEMENT LIMITED

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May 2010 definitively reversed the positive trends of the previous three months and was the Dow's worst month in 70 years! The TSX closed down 3.67% and the Dow Jones Industrial Average, the S&P 500 and the NASDAQ lost 7.92%, 8.2% and 8.3% respectively. The Canadian dollar also weakened against the US dollar, as the events described below caused a flight to the perceived "safety" of the US dollar.

In May's Market Commentary we stated, "signs of an improvement in the Canadian economy were legion, but should be viewed with caution in light of the ongoing unsettlement in the Euro markets." How prescient this was, as Canada's economy continued to improve, while the European and the US markets rocked with turmoil.

We had also mentioned non-residents purchasing over \$100.7 billion of Canadian securities since the beginning of the year, but at the same time, Canadians were taking advantage of the temporary strength in the Canadian dollar to purchase over C\$6.3 billion in foreign shares and bonds at historically cheap prices. Significantly, over 80% of stock purchases were in the European and Asian markets.

Canada's relatively smooth transition through the market turmoil, in particular the stability of the Canadian banks, stood in contrast to the panicky markets in Greece, Spain, Italy and most of Europe in May. This will serve Canada's interest as it hosts the G8 and the G20 Summits in and around Toronto this month from June 24th to 27th! The taxpayers of Canada are questioning the huge cost of the security operation for the Summits, rumoured to be in excess of \$1 billion. We are advising clients that the offices of Stuart Investment Management fall within the highest security zone to be established for the Summits, so there may be restricted access to our offices for these four or five days. We have established alternate backup plans should we be

prevented from accessing our offices by demonstrators and anticipate that our business will operate smoothly during the period. The continuing rebound in the equity and debt markets allowed the Canada Pension Plan Investment Board to report strong returns of 14.9% for the year ended March 31st, 2010, causing its assets to grow \$22.1 billion to \$127.7 billion. The CPPIB used some of its new-found returns to purchase stakes in two New York skyscrapers in a \$1.45 billion deal, shortly after their \$4 billion acquisition of the private **IMS Health Inc.** Another favourite of SIML's is **BCE Inc.**, which posted a 61% rise in first quarter profit.

OIL AND WATER

The US Commerce Department revised the US GDP for the first quarter to 3.0%, down from an earlier report of 3.2%, as hard hit state and local governments curtailed spending at the steepest rate since 1981. Consumer spending however held up well, and the manufacturing sector grew at the fastest pace in 6 years. Jobless claims however cast a pall over the market as the number of unemployed workers applying for benefits rose unexpectedly to 471,000, increasing the unemployment rate to 9.9%. The number of people receiving jobless benefits is 4.63 million, with another 5.3 million receiving extended benefits!

The ongoing disaster of the **BP** oil spill in the Gulf of Mexico, and fears of a European sovereign debt crisis were front and centre when live videos of Greek civil servants rioting in the streets of Athens caused a "Flash Crash" on Wall Street. The Dow Jones dropped 1,000 points in the space of about 30 minutes, only to recover most of it before the end of the following day. The cause of the crash was originally attributed to a trading error, but it proved decisively that the supposed "circuit-breakers" built into the markets do not work! Grand old blue-chip companies like **Procter & Gamble**

temporarily dropped 37% in minutes, giving nimble traders the buying opportunity of the decade!

The “Flash Crash” cannot have helped the 775 US banks that are currently on the Federal Deposit Insurance Corporation’s list of “troubled banks”. Their names are never disclosed for fear of starting a run on the named banks, but the FDIC said on average “only about 13%” of banks on the list are subsequently seized by regulators. To further the bank woes, over 10% of American homeowners missed at least one mortgage payment in the first quarter, with about 8% or 4.3 million homeowners currently at risk of losing their homes. This resulted in **Fannie Mae** losing \$13.1 billion in the first quarter and asking the government for an additional \$8.4 billion in government aid, bringing the total since 2008 to a staggering \$84.6 billion. Fannie’s “brother” company, **Freddie Mac** also indicated a need for an additional \$10.6 billion in aid after losing \$8 billion in Q1! The US House of Representatives approved a \$6 billion “Cash for Caulkers” program to encourage homeowners to invest in energy improvements, and they claimed this legislation would create 168,000 jobs!

The oil leak in the Gulf of Mexico continues at the time of writing, almost 2 months after the initial explosion, with the shares of **BP Plc.**, **Transocean Ltd.**, **Halliburton**, **Anadarko Petroleum Corp.** and **Schlumberger Ltd.** all dropping dramatically, with no obvious solution. President Obama imposed an immediate moratorium on deep-water offshore drilling for at least 6 months which could cause hardship in many smaller companies and layoffs amongst their workers. Happily, **General Motors Corp.** posted its first quarterly profit in 3 years.

GREEK TRAGEDY & SPANISH WOES

The ongoing problems in Greece resulted in their parliament finally agreeing to a massive austerity program as a pre-condition of bailout funds from the International Monetary Fund. Unfortunately, Greece’s coddled unionists saw no reason to have their gold-plated benefits cut to satisfy the IMF. Italy, Spain, Portugal and Ireland have all followed Greece in implementing austerity programs and it promises to be a turbulent European summer as these measures begin to bite and the workers start to protest.

Germany was a beacon of relatively good news, as its economic growth marginally beat the forecast with 0.2% growth, with a primarily export-led recovery. The weakening of the Euro has made German exports more attractive to the rest of the world, which may help Germany regain the title it lost to China last year as the

world’s biggest exporter. A German ban on “naked” short-selling also helped weaken the Euro versus the Dollar, in spite of the European Union putting up \$1 trillion to defend the Euro! Chancellor Merkel’s handling of the European crisis has left her with few allies in her country, and this was compounded by the resignation of the German President, Horst Koehler over his comments about German military actions abroad. Germany also committed the oleaginous Karlheinz Schreiber to 8 years in prison for tax evasion, just as Canada’s Oliphant Commission mildly castigated Canada’s Brian Mulroney for his dealings with Herr Schreiber after he left the PM’s office.

Across the pond in the UK, the Labour party’s Gordon Brown, finally faced reality and resigned after losing the confidence of the voters, allowing Conservative David Cameron to form a coalition government with the Liberal Democrats led by his near-twin, look-alike, Nick Clegg. How long this unlikely coalition will last in the face of Britain’s own financial problems, is open to conjecture.

Circling against the sun, Russia plans to spend \$13 billion on the re-armament and modernization of its military over 10 years. Turkey agreed to allow Russia to build and control its first \$20 billion nuclear power plant on the Mediterranean Coast. Dubai World has agreed to restructure debt worth \$23.5 billion, but it would still carry \$14.4 billion after the restructuring.

China added to its hoard of US treasuries with purchases of \$895.2 billion to bring its total holdings to \$3.5 trillion! The country also issued 20 billion Yuan (\$3 billion) in one year bills while opening up the possibility of a revaluation of the Yuan. Unfortunately China’s continued support of the paranoid North Korean dictatorship has escalated tensions in the Korean Peninsula to levels not seen since the Cold War, with both sides currently on full alert and the US sending a carrier group for “exercises” with the South Korean navy.

DOUBLE CONGRATULATIONS!

Clients of SIML will be delighted to hear that our Chairman, James E.D. Stuart was recently awarded the 65th Anniversary Medal commemorating the Victory in the Great Patriotic War 1941-1945. It was awarded to him by the President of the Russian Federation for his wartime service aiding the Russians on the Murmansk Run. It was a long time in coming, but greatly and gallantly deserved, and very much appreciated by the Russian people!

As many of you know, Jim Stuart will be turning 90 on June 20th, 2010 and we believe that he is now the oldest

registered broker in Canada, still putting in a full day at the office every day, in spite of exhortations by his family to take a little time for himself! We all offer our heartiest congratulations to him and wish him good health and happiness to him and his family for many, many more years.