



## STUART INVESTMENT MANAGEMENT LIMITED

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**JULY 2011**

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June initiated the move into the normal Summer Doldrums, with the Toronto Stock Exchange down the most with a 3.64% loss following weakness in the commodity markets and Canada's favourite high tech stock, **Research In Motion**, dropping precipitously on negative sentiment. The Dow Jones Industrial index, the S&P 500 and the NASDAQ all backed off, down 1.24%, 1.83% and 2.18% respectively, and over the Second Quarter all of these indices lost ground with the exception of the DJIA which eked out a 0.77% gain in the Quarter. The Canadian Dollar had a small 0.42% rise versus the US to US\$1.0368 from US\$1.0324 at May 31, 2011, and was up 0.53% over the Quarter.

#### **ALL MUST BE WELL IN ONTARIO!**

**The Liquor Control Board of Ontario** monopoly posted yet another record year with revenues of \$4.55 billion, up 5.6% over the previous year, and it paid a record \$1.55 billion to the Ontario Government! The sooner this monopoly is broken up and privatized, the better!

The economic news for Canada continues generally positive, in spite of rumblings of upset in Europe and the USA. The Canadian jobless rate fell to 7.4% as coveted full time employment grew by 32,900, in spite of public sector jobs falling 44,300! Simultaneously, the average hourly wage rose 2.2% over last year, and productivity for the First Quarter rose by 0.4%, beating the US productivity gain of only half this number. Canadian housing starts were also higher than expected at 183,600 units for May, due to an increase in multi-unit construction. Canada's healthy housing sector has played a key role in pulling Canada out of the recession, unlike the current situation in the USA. Foreigners voted with their wallets by purchasing \$8.2 billion in Canadian stocks and bonds in May while Canadians sold off over \$376 million of foreign securities.

The negatives were that Canadian inflation jumped to an 8 year high at 3.7% in May, driven mainly by a 29.5% increase in fuel prices at the pump. This almost guarantees that the Bank of Canada will be raising interest rates soon which could choke off the delicate recovery. Canada's trade deficit widened to \$924 million from \$417 million in April as both exports and imports fell. Canadians' household debt-to-income ratio rose again to 147.3% of disposable income as overall household debt hit a record \$1.5 trillion, making individual Canadian families as indebted as the British or the Americans.

#### **The Canada Pension Plan Investment Board**

continued its offshore acquisition strategy with a \$285 million purchase of 50% of Hong Kong Interlink's large scale industrial development. The **Maple Group Acquisition Corp.**'s hostile \$3.6 billion counter bid for control of the Toronto and Montreal Stock Exchanges', **TMX Group**, appears to have thwarted a \$3 billion friendly merger bid from the **London Stock Exchange**. The outcome of the Maple Group bid is still dependent on multiple regulatory approvals, none of which can be assumed to be rubber stamped! **The Royal Bank of Canada** managed to sell all of its money-losing US retail banking units to **PNC Financial Services Group Inc.** for \$3.62 billion in cash, a much better price than analysts had been expecting, but RBC will still take a \$1.6 billion loss on the sale. **Telus Corporation** signed a \$1 billion contract with the B.C. Government to provide high speed internet access to rural areas and to schools and other B.C. Government agencies. Earlier, Telus announced independently that they planned to spend \$670 million to expand their B.C. network, and the Government contract will help cover this cost.

Britain's Prince William and his new wife, Kate Middleton, commenced their Canadian tour amidst breathless excitement, with the Prince commanding a Canadian Sea King Helicopter on a short exercise with the Canadian navy. His wife wisely stayed aground!

## AMERICAN EXHAUSTION?

The Congressional posturing over the expanding of the US debt ceiling continues into July exactly as predicted in last month's Market Commentary, maximizing the uncertainty in an already jittery market. This has to be resolved by Congress before July 23<sup>rd</sup> or the US Government will have to issue orders to stop or cut payments for certain entitlements after August 2, 2011. The US growth in employment slowed sharply in May with only 54,000 net new jobs added, as US consumer sentiment worsened on economic jitters, and American consumer spending was the weakest in the past 20 months. This sentiment is seemingly divorced from the Dow Jones Industrial Average which has risen over 83% from a 12 year low in March 2009! US industrial output however, managed a weak growth of 0.1% in May, mainly due to supply chain disruptions in the auto sector after the Japanese tsunami and earthquake. Recent data from the US shows a troubling mix of weakness combined with rising inflation as the Core CPI unexpectedly rose 3.6% on an annualized basis. The US Trade Deficit unexpectedly narrowed as imports fell after a 9.9% drop in the US Dollar over the past 12 months, and strong exports of cars, computers and machinery were partially offset by rising oil imports. In an effort to counter rising oil prices, the US and other oil consuming nations planned to release 60 million barrels of oil from strategic government reserves, as US oil supplies hit the highest level for May in 31 years! So far, very little relief at the pump is evident to the writer!

The venerable **International Business Machines Corp.** turned 100 years old on June 16, and an anonymous bidder paid \$2.63 million for a lunch for 7 guests with Warren Buffet, the "Oracle of Omaha". In the ongoing saga of stock exchange takeovers and mergers, the **Deutsche Bourse AG** and the **NYSE Euronext** pledged to pay a one-time \$1.37 per NYSE share dividend should they receive at least 75% approval for the takeover.

## AROUND THE WORLD IN 30 DAYS

Further to last month's scandal with IMF head Dominique Strauss-Kahn being accused of sexual improprieties by a New York hotel chambermaid, it appears her story has changed several times making a conviction less likely, but the damage to his career is complete. Christine Lagarde, the highly regarded French Finance Minister and ex-chairperson of Baker & McKenzie, a large Chicago-based international law firm, was appointed the new Managing Director of the **International Monetary Fund**. Francois Baroin replaced her as French Finance Minister.

Japan announced a \$6.2 billion credit line for small businesses struggling to recover from the aftermath of the destruction caused by the earthquake and tsunami, and kept its interest rates unchanged at between zero and 0.1%! China has just grabbed bragging rights for the world's longest bridge with its 42 km Jiaozhou Bay Bridge which was built in a record 4 years at a cost of \$1.5

billion (Louisiana's Lake Pontchartrain Causeway was the old titleholder at 38 km!). The Chinese trade surplus of \$13.1 billion was weaker than expected because of soaring imports and weaker global demand growth and Chinese lending and money supply grew at the slowest pace since 2008, giving signs that the world's second largest economy is slowing down. Simultaneously the Chinese inflation rate rose 5.5% in May with food prices rising 11.7%, which is a hot political issue in China. The Government has raised bank lending criteria and raised the income tax threshold for individuals from approximately \$309 to \$541 (3,000 Yuan) per month to partially offset inflation in basics. Only about 12% of the workforce earns more than 3,000 Yuan per month, implying 88% of workers will pay no income tax. (We should be so lucky in Canada!) China was redeploying some of its vast foreign exchange reserves into Euro sovereign debt, swinging away from US Treasuries, where it currently owns approximately \$1.115 trillion or 26% of the Government debt issued by Washington! The Euro switch is a gutsy call in the light of the current turmoil in European debt markets, but probably necessary to avoid Chinese over-reliance on US paper.

Very surprisingly, the dictatorial and isolated nation of Burma received a record \$20 billion in foreign investment in the past year, mostly from China, Hong Kong and Thailand, most of it invested in power projects. Egypt's new Democratic Government issued \$1 billion in Eurobonds, backed by a US Government guarantee which cut the yield by the equivalent of \$100 million. The Egyptian economy is forecast to grow only 1% this year, the slowest pace since 1992.

The Greek Government managed to narrowly survive a no-confidence vote and passed two austerity packages in spite of virulent street protests in Athens and other cities. The packages proposed tax hikes and spending cuts in an attempt to deal with the country's massive external debts which are at approximately 150% of GDP. The measures cost the Greek Finance Minister his job and Greece is now branded with the world's lowest credit rating of `CCC` by Standard and Poor's who said the nation is ``increasingly likely`` to face a debt restructuring and the first sovereign default in the Euro zone's history! The Government of Portugal has instituted a ``one-time income-tax surcharge`` to help the country reach its budget deficit target. Canadians will remember the `one-

time income-tax` instituted to pay for the First World War which is still with us almost 100 years later!!

Finally, Her Majesty Queen Elizabeth II has been given a 9% pay cut by the British Government over the next 3 years, by paying her only 15% of the income of the Crown Estate, in an attempt to cut Britain's budget deficit to 10% of GDP.