



## *The Angas Shick Group* **Weekly Commentary – April 15, 2011**

**The Goldman effect or Reversion to the Mean** After two years of almost a straight upward incline, the markets are performing like a Yo-Yo these days defying anything that seems the least bit rational. The question is, why?

Some might believe that Goldman Sach's influence on the market is greater than the economic fundamentals driving it. Certainly their comment this week about exiting Canadian equities had a negative effect on share prices and caused pro-traders to aggressively short commodities. One wonders if this is a case of self-fulfilling prophesy or just sober second thought on the ability of the market to maintain the same forward momentum.

As a student of Behavioral Finance, I believe very much in *Mean Reversion* which is a theory suggesting that prices and returns eventually move back towards the mean or average. This *mean* or average can be the historical average of the price or return or another relevant average such as the growth in the economy or the average return of an industry. In simple terms, *Common Sense* dictates that everything has a design limit and tends to break down if it exceeds that limit for too long.

The last 20 years of history tells us that the design speed limit (annualized return) of the S&P/TSX Composite Index is 7.2% (9.7% when you include dividends). The problem is this is an annualized return and NOT an annual return and that is why successful investors have learned to be more discerning about what they own and more patient with the process. Speculators on the other hand are constantly trying to beat the odds, stretching the design limits and causing much of the volatility (Yo-Yo effect). There are other influences at play of course; global politics and economics to name a few but these too are extensions of fairly predictable human nature.

**Where are we going from here?** Here is a sample of some of the questions we received this week and our answers: "*Can the market go down further*"? YES. "*How much further*"? Markets adjust all the time and in our opinion, the S&P/TSX might very well pull back 8-10% due to the uncertainties following the wake of QE2 as it ends in June. "*Is this a certainty*"? NO, and even if it does, it will be a very short-lived correction. Notwithstanding the remaining global debt problems, there is too much evidence in support of an economic recovery underway to suggest we will slip back into a serious recession. "*What about inflation*"? We actually need a bit of inflation to confirm that economic expansion is underway. I don't believe that this will become a problem in the short to mid term and look at interest rates remaining low for some time ahead.

**Changing Headlines.** What a difference a week makes. On April 6<sup>th</sup>, the Financial Post reported "Canada poised to lead G7 in global recover" referring to a statement from the OECD expecting Canada to lead the pace in the first half of 2011. This week, the Globe and Mail reports that the strength of the loonie is causing Canada's economic performance to boomerang giving way to a slower pace that could persist beyond 2013.

The recent hike in gasoline prices is also causing a drag on the economy by adding an extra cost to consumers which in turn, lowers their overall spending ability. For these reasons, we don't see inflation as a major threat at the moment but the Bank of Canada has warned that interest rates will soon start to trend higher nonetheless.

**Oil Prices Poised to Drop Back.** The high price of oil is beginning to dampen economic growth in some regions of the world which will lower demand and lead to a sharp drop in price. There is mounting evidence to suggest that when the supply risk factor subsides a bit more on the supply side, crude oil could drop the \$90

a barrel ceiling favoured by the oil producing states. Interestingly enough, the consensus among analysts is \$84 to \$90 a barrel as they build their models and formulate their opinions on the stocks they cover.

**Lobby efforts continue.** According to a survey conducted on behalf of the Canadian Association of Petroleum Producers and the American Petroleum Institute, 85% of Americans want government policies that support the use of the oil sands and 86% believe that unless American families and businesses stop using oil and gas, the oil sands need to be developed. Further, the survey respondents widely agreed that pipelines are the best way to get Canadian oil to the U.S. Regardless of whether this is a bias survey or fact, Canada may stand to benefit from the outcome.

**Still thinking about buying a rental property?** Last week, we featured Macquarie analyst, Michael Smith's report on **REITS versus CONDOS** that was also covered in the financial press. Please read **Part II** (attached) for a continuation of this interesting report on alternative ways of owning income property..

**From the Investment Desk.** The ETF space is becoming more and more crowded these days but we like what Claymore has done in the U.S. High yield area with their **Claymore Short Duration High Income ETF** (CSD). It holds only 14 positions with a weighted average coupon yield of 7.82% and a duration of just over a year. The yield to maturity is 6.08% and the portfolio cash yield is 7.47%. Depending on the circumstance, this might be a suitable replacement or compliment for investors who hold corporate bond ETFs.

Emerging market debt/GDP ratios are better than developed markets and the gap is expected to widen. With this in mind, we are looking into emerging market bonds as an investment idea through either mutual funds or ETFs. Two vehicles we are studying at the moment are the **BMO Emerging Market Bond ETF** (ZEF) and the **AGF Emerging Market Bond Fund**. Although the cost might be slightly higher, we prefer the AGF fund because it offers more active management and buys bonds in local currencies where available on the evidence that these currencies are strengthening against the U.S. dollar along with their local economies.

U.S. stocks are coming back onto our radar screen. Joining **Chesapeake Energy Corp** (CHK) that we featured a few weeks ago, is **Abbot Laboratories** (ABT). Abbot has a diversified business model comprised of Pharma (57%), Nutritionals (16%), Diagnostics (11%), Vasular (9%) with their drug Humira for the treatment of arthritis as the main growth driver. 43% of their sales are in the U.S. and the remainder international including emerging markets. The stock yields 3.8% and with solid prospects for growth and a payout ratio of less than 50% today, we see the likelihood of dividend increases in the future.

Every week, we look for trivial pieces of information that may lead us to an investment opportunity or act as a warning for things we should avoid. General Motors is restoring the leasing options on Chevrolet and GMC cars dramatically lowering monthly payments to spur new car sales. We would rather not comment on the wisdom of this move for the car industry that has just pulled back from the abyss after their last disastrous experience with new car financing plans but it will no doubt be very good for car parts manufacturers such as **Magna International** (MG).

### **Quote of the Week**

*"it is a thousand times better to have common sense without education than to have education without common sense."*

Robert Green Ingersoll 1833-1899

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