SHAUNESSY INVESTMENT COUNSEL INC.

The benefits for balance and discipline.

WEEKLY INVESTMENT PRE/ REVIEW ------February 2nd, 2009.

Overwhelming the consensus view of the markets is pessimistic and fear-driven. This is our weekly bid to counter that narrow opinion. This time we are looking at investment themes and assumptions, for example:

- On a year to date basis to January 30th the TSX Composite is down 3.26%. The S&P 500 is down 8.57%. An adage called the January Indicator says that as January goes, so the year must follow. But analysis of DJIA returns (on which the adage is based) indicates that the likelihood is not even a 50/50 and in 1930 (a year that supposedly parallels 2009) the Dow posted positive results in January yet fared badly for the next 11 months. Surely the wisdom is that investors should not follow market wisdoms blindly. Often these wisdoms are just anecdotal information or coincidence dressed up as "proof".
- The Super Bowl Indicator is another market wisdom: this one holds that if a team from the old NFL wins, then markets will rally and this has been the case 32 times in the past 40 years. Well, this year both contestants are old teams! Regardless, see our comments above. Understandably, in uncertain times investors seek certainty more than anything else. We find it is wiser to be agnostic and to believe that the only certainty is that the future is very uncertain and therefore stick to an intelligently diversified portfolio. Come to think of it, we've been agnostics all along: peak energy, China and India, decoupling -- all are investment themes popularized by mutual and hedge funds that did not prove useful.
- A new twist on an old investment theme? While we're for a return to $200 oil, this from Richard Savage, Head of Energy Research, Mirabaud Securities in London: oil may never recover to the peak prices posted last summer because US demand, which accounts for 25% of global demand, is being permanently eroded as US consumers switch to more fuel efficient vehicles and embrace alternative and renewable energy initiatives. It seems the pendulum of opinion has now swung in the opposite direction. As a balanced manager, we can be indifferent to this interesting but ultimately not useful discourse.
- It seems that the mighty QPP as well as other of large pension plans have lost bucket loads of money. Are there any lessons to be drawn here? In the case of the QPP and the Ontario Teachers' Pension Plan, in spite of all their internal controls, senior management suffered an acute case of hubris that allowed them to ditch a prudent mix of stocks and bonds in favour of investing in hedge funds, commodities, ABCP and private equity etc. The lesson (according to the Globe) is that it's better to stay dull (as in traditional global balanced dull), especially, we would add in a markets that are at either extreme. A bull market will trigger greed and a bear market fear; what a balanced approach provides is a framework to minimize the damage that emotion may cause.
- On the other hand, one can speculate about the future: for example, as demand for metals and minerals collapses, mining companies have slashed spending and cut production. This, according to Barron's, is laying the seeds for the next bull market in materials: "Mines by their nature deplete every day. If you're not replacing capacity ...when the market moves into deficit, there will be an explosive reaction." This is interesting because materials stocks are one-third of the TSX Composite and therefore can have a significant impact. A balanced portfolio is diversified by sector, region as well as asset class.
- In the same speculative vein, we know that with record withdrawals from mutual funds and caution now the by-word for all managers, that a huge amount of cash is sitting virtually idle. This, plus the need of institutions to rebalance their portfolios by boosting equity holdings some 10%, suggests to us that equity markets are due for an enormous correction upward as has historically been the norm following a significant market correction downward. We are not anticipating this by increasing our equity exposure beyond normal levels --- that would defeat the inherent purpose of the balanced approach --- but these investment themes do provide a measure of confidence and a way of relating to future market events.

By now perhaps we've beaten this issue to death: the simple lesson is, as Warren Buffet put it: "To invest successfully over a lifetime does not require an extraordinarily high IQ, unusual business insights or inside information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework." In our case the framework is dull and dreary balanced investing.

For more info call Mark Kryzan or Terry Shaunessy at 403-802-3108. ***There will be no review next week.*** ***Disclaimer below.***

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