



Q1: not as bad as feared and the bottom for housing. **WEEKLY INVESTMENT PRE/ REVIEW ----- March 31st, 2009**

US housing hits bottom writes John Aitkens: John is the TD's investment strategist and we follow his analysis because he is very focused on the fundamentals of US housing and we agree that as the housing market corrects, so the prospects for a sustained recovery improve. John's most recent report (March 27th) concludes that the first quarter will mark a cyclical low for U.S. housing starts. Interestingly, today brought the latest update on US housing: most observers called the January numbers "dismal", and noted that the 19% year over year decline as reported by the **S&P/Case-Shiller Index** of 20 major cities, is "the steepest loss on record". However, those numbers, in Aitkens' eyes, mean something quite different. Today's historically low levels of new home construction, mortgage rates that are now less than 5% and mortgage lending standards that are easing rather than tightening mean that housing is primed for a recovery. Lower mortgage rates combined with the declining new home prices have driven principal and interest payments for new home buyers down to 17.1% of income, the lowest housing costs since the early 1970's. A high and rising unemployment rate does not preclude a new housing recovery. In fact all past housing recoveries have begun during recessions, before the cyclical peak in unemployment. Single family housing permits increased 16.1% in February, the strongest gain in over 25 years. This surge was triggered by the \$8000 investment tax credit for new home buyers signed into law in mid-February. The current supply of new and existing homes does remain high and the excess supply will only be absorbed over 3 or 4 years. The S&P 500 homebuilding stock index has doubled from the low on November 21st and is within 1% of setting a new recovery high. This reinforces John's belief that the U.S. economy will start to recover mid-year 2009 and he recommends that investors overweight stocks in their portfolios. In Canada, he recommends overweighting energy, materials, financials and technology where valuations are compelling and the 2010 earnings recovery should be substantial. It is worth noting too that today's "dismal" housing stats did not trip up the rally in US stocks following 2 negative sessions.

Automotive: Governments, investors and media shifted focus over the weekend to North American car manufacturers. For decades, the "big" three, **General Motors, Ford** and **Chrysler** have not been among the 50 largest companies in the US by market capitalization: on Monday, before the 25% sell off, General Motors, the only listed car company left in the S&P 500, was ranked a lowly #448. Investors have written off these companies (and their debt), and therefore what happens to them is of little consequence to capital markets even as parts suppliers, steel companies (now mostly foreign owned) and the economies of Michigan, the US upper Midwest and Ontario will be affected. Monday's market reaction may therefore have been more emotional than rational. It didn't help that the Obama administration warned on Monday that some US banks may need yet more financial assistance (**Bank of America** slid 18%, **Citigroup** lost 12%) and it was financials in fact, on both sides of the border, that led the one day market decline. The underlying concern for investors may be the overall picture that is emerging: the US government now has a major interest and direct role in the US banking, financial services, home mortgage and automotive industries. That running these industries is not the job of government and in the long term weakens the economy and capital markets, is a not an uncommon concern among investors. In addition to directing these large sectors of the economy, the Administration also wants to overhaul the healthcare and education systems, win the war in Afghanistan and reverse a recession. No wonder Mr. Obama is turning grey and public confidence in the administration is being tested.

Air Canada: Our view is that if it sleeps, rolls or flies --- don't buy it. Long term investments in hotels, car manufacturers or airlines are always be avoided. We've lost track of just how many times Air Canada has restructured or filed for bankruptcy protection and left investors much poorer, but it may well do so again in 2009, just six years since the last such event. Sadly, this is a normal state of affairs for this sector (look at the number of airlines around the world that are in trouble) and we can already see the ugly headlines. Not unlike the drama being played out with **General Motors**, the Air Canada saga will drain away some investor confidence. Bankruptcies --- which naturally will peak in the next 6 months --- are a normal course of events in a recession, and will temporarily dampen investor enthusiasm for stocks.

First Quarter Results: As the first quarter came to an end, investors snapped up top-performing US bank and technology shares with the result that the **S&P 500** "had its best month since October 2002" according to Forbes. For the day, the Dow Jones industrial average gained 1.16%, to close at 7,608.92. The **S&P 500** rose 1.31% to 797.87. The **Nasdaq Composite Index** added 1.78%, to 1,528.59. On a year to date basis and a year/ year basis, however, the **S&P 500** is down 11.7% and 39.7% respectively. The **S&P 500** has now had a record 6 consecutive negative quarters. The **TSX Composite** also got a decent lift of 1.44% on the day to 8720.39, and on a year to date and a year/ year basis results are less rosy but not as bad as once feared: -2.97% and -34.7% respectively. Broadly speaking, equities in Canada are now valued at the same price as in April 2004 and US equities are another 30% less than that. With many blue chip stocks offering a decent dividend, we feel that, just like John Aitkens' home buyers, at these prices, investors will buy aggressively when they sense that overall the economy and the financial system is returning to health.

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