

- The quote is from **Bob Dylan's Subterranean Homesick Blues**. For our purposes substitute analysts, economists and reporters for 'leaders' and bond spreads for 'parkin' meters'.

Daily reporting on the stock market --- who needs it? News reporters track daily events and because space and time may not permit them to elaborate, they often do not provide context. This does create 'perceptual' problems and most investors don't need to pay attention to these news reports. For example, on Monday market activity results were as follows: the **TSX composite** was -250.18 points to 10,394.78, the largest one day drop in a month. Reporters often add in colourful commentary, such as: "markets started the week by moving sharply lower" or "markets took a big tumble todayetc." The **Globe and Mail's** headline on Tuesday read: 'A fragile confidence is shaken' and concluded (with help from **Gluskin Sheff** clairvoyant **David Rosenberg**) that investors are seriously spooked and "are now voting with their pocketbooks". On Tuesday markets declined a further 87.38 points or 0.84% on moderate volumes; on Wednesday as this is being written, markets are down yet again, this time spooked by high oil reserves. For all we know, investors are selling to realize profits and buy back at what they hope will be lower prices at a later date. The negative reporting and instant analysis is unhelpful: the reality remains that while the **TSX Composite** is down this week, so far this has not been a large sell off as trading is relatively light (183 – 218 million shares daily, while heavy trading involves twice as many). The loss on Monday represents 2.3% of market value which is *neither insignificant nor surprising* given how volatile markets have been in the last 6 months. And lastly, on a year to date basis, including Monday and Tuesday's losses, the TSX Composite remains up by more than 14%. Perhaps most importantly, unless you are a day trader and need to make transaction decisions about your portfolio *every day*, it doesn't matter one whit.

- **Trends investors should be aware of --- bond yield spreads:** The US 10-year Treasury bond yield has been moving fast and is now at 3.8%. At the end of 2008 (just six months ago!) the yield was 2.1%. The five-year average is 4.2%. The sharp decline in bond prices reflects the bond market's confidence in the economic recovery, an over-supply of bonds and a fear of inflation. Importantly, prices are not lower because of any widespread sell off of long-term US bonds by foreign holders (as various bearish analyst had predicted) according to **Eric Lascelles**, chief economist and rate strategist with **TD Securities Inc.** There is now, as we already mentioned in our newsletter of June 2nd, a significant spread --- the largest in 25 years --- between short and long term rates. Short term rates are being held down the **US Federal Reserve Board** and other central banks, including the **Bank of Canada**. *The lesson for investors? stay balanced.* Those who panicked and fled equity markets in December to invest heavily in long term bonds, paid a substantial price for 'safety'. Those who invested in short term debt (Treasuries) or held cash, didn't give up capital, but earned next to nothing and have actually fallen behind because equity markets are up and dividend yields have been excellent. Bond markets --- that is the collective wisdom of those *who actually buy and sell bonds for a living* --- are forward looking, rarely wrong and are signaling to equity investors that the tide is turning irrespective of daily fluctuations.

- **The tipping point?** As investors we are keenly aware that central bankers are walking a tightrope, especially in the year to come: they need to reassure bond investors that short term rates will rise before inflation gets out of control and simultaneously they need to convince equity investors that rates will not rise too soon and squash the recovery. This drama will play out over the coming several quarters, if not year. Now, if it is very difficult for the **Bank of Canada** or the **Fed** to isolate the tipping point when the stimulus must end, how hard is it for investors to time the market? Bond yield spreads provide a reliable insight, but not exact timing.

- At the risk of being repetitive, in **summary:** balanced investors with a mid term outlook (at least 18 months) can, because their approach *is* balanced between bonds and stocks and in other qualitative terms, safely ignore the minute by minute market news and the instant analysis (which is often wrong). On the other hand 'parkin meters' rarely give wrong signals, though it can take a frustratingly long time for a clear picture to emerge; 'leaders' provide entertaining and occasionally insightful analysis, but it encourages short term thinking, volatility and ultimately leads to losses. Short term thinking also tends to also be excessively bullish or bearish --- currently the latter. See below for some encouraging news that is not being widely reported.

- **Market volatility and credit worries declining:** though things may seem uncertain based on market performance so far this week, volatility is actually waning. According to the **National Bank** the **VIX** volatility index of the **Chicago Board Options Exchange** has fallen below 30 for the first time since September 2008 and is now only one standard deviation above its long term average of 20.1. Credit markets are also returning to normal as consumer confidence in the US and in Canada returned in spades in May. Earnings remain an area of concern as the expectation is that they will be dismal until at least year end though analysts appear to have stopped slashing earning forecast, so some sort of balance is possibly returning.

- **Motor vehicle production to surge:** According to **TD's Chief Strategist, John Aitkens**, North American motor vehicle production has fallen so far that the projected increase in production to September 2009 is 56.2%! This

represents the fastest growth rate in production since 1971, when production rebounded after a strike by **GM** workers. Typically such production forecast are adjusted down, but “even half this amount of growth would provide an extraordinary boost to the economy” according to John Aitkens. **TD** expects a recovery in motor vehicle production to add at least 3% to Q3 industrial production growth and well over 1% to Q3 real GDP growth and additionally warns that consensus forecasts, which have been trending down, will have to be revised significantly upward in the coming month.

- From this perspective, the decline in index values this week may actually be an opportune moment to realign portfolios and make sure equity exposure is sufficient.

For more info call Mark Kryzan or Terry Shaunessy at 403-802-3108.

DISCLAIMER: Readers are advised that information contained in newsletters, email correspondence or the web site published by Shaunessy Investment Counsel Inc. (“Shaunessy”) should be used solely for informational purposes. Shaunessy cannot be held liable for any loss or damages arising directly or indirectly as a result of a reader’s reliance on information provided by Shaunessy. Our opinions and analyses are believed to be accurate at the time made and are written in good faith, but no representation or warranty, expressed or implied, is to be made as to their accuracy or completeness. We are not responsible for errors, omissions or for providing future updates. All information should be independently verified and readers should seek professional advice prior to making an investment decision. The information provided by Shaunessy also does not constitute a representation or a solicitation for the purchase or sale of securities or form part of an offer to provide investment management or advisory services.