

Hyperbole: Financial marketers are the ones usually guilty of only ever putting their best foot forward, especially when they trumpet their recent best performance in spite of a little contradiction in the fine legal print which states that “past performance is not an indicator of future results”. But these days **GM**, surely gets a prize of some sort for gross exaggeration with their **Volt 230 MPG** campaign. Consider this: the **Volt** only goes 40 miles before its gasoline engine has to kick in; the 230 MPG claim is based on city driving only because highway driving in electric drive mode is very limited before that pesky gasoline engine kicks in; and, if you read the news release from **GM** (most folks won’t of course) you’ll find that the 230 MPG claim is actually a cost equivalency claim and even that boast is biased because it’s based on an average national electricity rate of \$0.11/kWh while in most large urban centers in the **U.S.** --- the target markets --- electricity is double that rate. At that higher cost existing hybrids offered by **Toyota** and **Honda** are almost as efficient, may be cheaper to buy and offer a proven technology from firms that are not emerging from financial (and moral?) bankruptcy. Just because your government invested your tax dollars in **GM**, it doesn’t mean you should buy their stock (rolling or otherwise). **Bottom line:** **GM’s** claims are a stretch. In particular it is hard to believe the underlying theme, namely that **GM’s** car will be so good that it will revolutionize the car business, resuscitate the company and justify the enormous public investment.

Which way the economy? Recently it was reported by **Thomson Reuters** that 74.5% of Q2 **S&P 500** company earnings exceeded analysts’ estimates. Now, national economic data is confirming that economies have indeed turned the corner. Recently for example, **Germany** and **France** ‘surprised’ (this how the **Globe and Mail** reported it) with positive growth (admittedly a modest at 0.3% in Q2) in sharp contrast to a decline in GDP of 1.3% in France and 3.5% in Germany in Q1. Interestingly, a good part of the recovery is attributable to a rise in exports to **China** and other emerging Asian economies such as **Indonesia** and **Thailand**. Euro-zone exports to those countries rose 6.4% in April and May following a decline of 6.2% in Q1. Not all of Europe is doing as well: **Britain**, **Spain** and **Italy** are still in recession with an end in sight while **Baltic** countries and **Eastern Europe** (except **Poland**) are getting poorer daily with no end in sight. A global recovery is underway as other countries like **South Korea** see a jump in industrial activity (+5.7% m/m in June). This recovery was jump-started in part by the enormous Chinese fiscal stimulus program in place since the beginning of 2009. In **North America** all the talking heads have been toning things down by warning repeatedly that the recovery, though underway, is ‘*fragile and lacks depth*’. Yet the reality is that the **U.S.** economy is poised for a strong recovery, and Canada will benefit. **TD Newcrests’ John Aitkens**, who has been consistently reminding us that in a recession lie the seeds of new growth, reported recently that: car manufacturing --- and this was true even before the ‘cash for clunkers’ program kicked in --- is set for a major production build in Q3 with significant GDP impact; **U.S.** single family housing starts have increased 32% from January/ February lows, faster than in 4 of 5 recent recoveries; the earnings revisions demonstrate the degree to which companies have become more productive and are now on track to be highly profitable and the extent to which investors and analysts are not intone with what is happening; and, generally inventories of just about everything are now so decimated that the economy is due for the sharpest inventory correction in the post-war era. It isn’t clear yet exactly when the Canadian economy bottomed out (May or June), but as of July it is in recovery mode. Just like re-booting a computer involves a little lag time, so we expect that re-booting the economy may take three months or so, during which time capital markets will remain volatile as investors revise, revisit, reconsider and reassess their options and investments.

Which way for Canadian stock investors? Let’s face it: as a Canadian investor, if you were looking to lose money, the **S&P 500** has provided plenty opportunity to do that. In recent years, as the Canadian loonie soared, gains in U.S. dollars were often wiped out. On top of that the **TSX** returns have over long stretches trumped the performance of the big board. The **S&P 500** reached an intra-day peak of 1552 on March 24th 2000 only to crash to 768 on October 10, 2002. A new intra-day high of 1555 was set on July 21, 2007 only to retreat to 752 on November 20, 2008. Since then the **S&P 500** has climbed over 33% to 1004 points last Friday. Putting this volatility aside, longer term performance is 8.8% (compound total annual rate of growth) since 1988 with a median return of 10.9%. In our view, global capital markets are pushing to re-establish a valuation-equilibrium among themselves and to return closer to long term rates of return. In this view, losers like the **S&P 500**, unless there has been a systemic and widespread decline in the **U.S.** economy and the companies that make up the index, must return to something approaching the previous historic rates of return and valuations relative to the other senior competing markets. Most other senior stock markets are down too, so resuming value is not automatic. What is compelling, and is largely overlooked by many analysts, is that large cap **U.S.** stocks are entering a period in which they will have enormous growth potential thanks to the powerful combination of: historically low interest rates; the enormous economic stimulus spending program (source of the home grown recovery); declining **U.S.** dollar valuations (good for exports); significant gains in productivity (a benefit of all the lay-offs); global leadership in key industries (technology, healthcare) and global brand presence (Johnson & Johnson and the like); historically low

inventories; and still a significant amount of investors' cash on the sidelines which could trigger a big run-up in stock prices if this herd decides to move in unison. Given this scenario, we see a high probability that the **S&P 500** will recover in the next year from present levels to 1400 for a potential 40% increase in the value of the index from where we are today. **Canada's TSX** will go along for the ride and could secure respectable gains of +20% to 25% having already posted impressive returns this year. The **TSX** however is dominated by relatively few companies and has limited sector diversification and a stall by any of the leading players will hurt proportionally more. Our economy too is vulnerable: the manufacturing heartland is struggling and the oil sands sector, which in any case could never support the entire country, is perhaps a diminished economic star (costs now including environmental penalties) . Government debt both federally and just as importantly, provincially, is soaring and a rise in consumption, personal and even corporate taxes is sure to follow elections at both levels of government. In every respect, unlike the **U.S.**, **Canada** is an economy of price takers and lacks the horsepower and market presence to make economic headway on its own. **Conclusion:** investors looking at a 3-year investment window should rebalance their stock portfolio so Canadian stock investments are complemented by a growing dose (to as much as an equal amount) of the **S&P 500** index, which now incidentally, is available as a currency hedged instrument from **iShares (T-XSP)**.

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