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"Philip, do those silly economists have it wrong again?"

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- Buy the car (perhaps), but not the company: From the **Globe and Mail** last week: **Ford Motor Co.** "stunned" analyst by announcing that it made nearly U.S. $1 billion between July and September of this year. It's stock price popped by 8.2% on the news. Heartening as the reports are (after all even mighty **Toyota** is not making money right now and **Chrysler** is in shambles), the North American automotive sector just isn't as profitable nor does it have the future prospects of other sectors, say pharmaceuticals, technology or even financials. Ford's profit is the product of nearly U.S. $31 billion in sales in Q3: utilities provide a comparable but far less risky return.

- Cars and the broader economy: John Aitkens (TD Newcrest) has been following the sector and its impact on **U.S. GDP** closely, and reported this week that motor vehicle production in Q3 increased 42.3% relative to bankruptcy depressed Q2 as **Chrysler** and **GM** came back on line. The auto sector added 1.66% to Q3 U.S. GDP. In spite of the production increase, inventory levels *declined* 15.2% in Q3 because of the "cash for clunkers" (C4C) program as well as healthy demand over an above that. In Q4, production will be hard pressed just to keep up with sales, let alone provide the 30% output growth needed to normalize light vehicle inventories by year end. This inventory situation is expected to continue well into 2010 with ongoing motor vehicle output growth continuing to contribute strongly to Q4 GDP and into 2010. Mr. Aitkens forecasts significant upward revisions to U.S. GDP forecasts for both periods as analysts/ economists begin to more widely recognize the impact of an ongoing shortage of inventory.

- **Stand firm in the face of fear: Donald Guloien, CEO of Manulife Financial Corp.**, refuses to hedge all of the company's stock portfolio --- *and he's right!* **Standard & Poor's**, the credit rating agency, said it might downgrade Canada's largest life insurer for a second time this year in part because it is concerned that **Manulife** hasn't hedged it's entire stock portfolio and therefore risks further losses in the event of a future meltdown in capital markets. What **Standard & Poor's** cannot consider is that (a) we have just gone through a horrendous meltdown, so a second one is unlikely and, (b) (this is **Mr. Guloien's** point) the only way shareholders will recover from the market downdraft is by fully participating in the subsequent market updraft. These days investors are quite impatient and the company may yet cave in to, as **Mr. Guloien** put it: "subjecting shareholders to what I think is the ultimate indignity, which would be to hedge it all out at the bottom of the market."

- Canadian energy exports: first, **natural gas** which accounts for more than half of Canadian energy export earnings seems vulnerable. Steep increases in pipeline tolls, low commodity prices, a high Canadian dollar, falling demand plus ample reserves all add up to a discouraging outlook for the sector going into 2010. Also, U.S.'s natural gas reserves have been boosted by the addition of shale gas (total reserve estimates now range from 90 to 116 years at 2007 production rates, seemingly putting an end to the notion that North American gas has gone into terminal decline) and the economic prospects for relatively expensive Canadian natural gas is a little more uncertain. On the oil front, the **oil sands** output is vulnerable to start-up challenges and environmental costs (possibly imposed by end-users and to be paid for *by the Canadian tax payers* for the next decade or so if the oils sands industry gets its way). Consumer demand for gasoline in the U.S. may have stalled for a variety of reasons including general economic conditions; because of the uptake in renewable fuels and new car technologies and, a lower demand for gas guzzling light trucks and SUVs. Some observers are asking if it is demand and *not* the supply that has peaked. These conditions make investing in the **TSX** --- a three horse race between financials, energy and other materials sectors --- riskier and diversification beyond Canada advisable. The prospect of mergers and acquisitions of energy trusts and other resource companies (chiefly gold), will make Canada appealing in 2010, but, over a longer term investment horizon, exposure to both the dollar-hedged **S&P 500** and **EAFE,** available on the **TSX** via **ETFs,** is a safe bet.

- **Housing starts in Canada** rebounded in October and rose to the highest level since December 2008. Despite a decrease in single family unit starts in October, the 3-month trend is up overall. At the same time, inventory levels of single dwellings shrank in September, marking a sixth consecutive decrease. According to **National Bank Financial**, these observations suggest that the housing sector will continue to expand in the fourth quarter. Initial data points to an increase in units of 29% (annualized rate) in Q4 over Q3. This bodes well for residential investments on a national basis and supports the view that the Canadian housing market, and the economy as a whole are in recovery mode.

- **Here's a thought: What if the economists are wrong?** That was the headline in the **Globe and Mail** this weekend, and it's about time too. Globe columnist **Derek DeCloet** points out that not only have economists, but the entire market consensus has been wrong in the past in the aftermath of market and economic corrections. "When it comes to economics and finance, the human mind is fascinating but flawed. Time and again we discover that the majority view is way off the mark, even 180 degrees off. But very few absorb the lesson. So the cycle turns, a new consensus is built, and we believe it yet again" writes DeCloet. This is similar to epiphany that **James Grant** (see our September 24th newsletter) experienced. His reference to **Arthur Pigou** is worth repeating: "The error of optimism dies in the crisis, but in dying it gives birth to an error of pessimism. This new error is born not an infant, but a giant." And as **DeCloet** and

others point out, history just does not support the view that following a recession, economies will stagnate. In fact, history teaches that the strength of the economic recovery is a direct product of the depth of the downturn that preceded it. Perhaps it's not too late for **British economists** to alter their view and make amends before they're called to explain themselves again in **Buckingham Palace**.

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