



## VW reports that 2008 is its most profitable year ever. **WEEKLY INVESTMENT PRE/REVIEW ----- March 3<sup>rd</sup>, 2009**

- In 1938, Joe Kennedy's SEC adopted the "uptick rule" which mandated that when a listed security was sold short it had to be done at a price higher than the immediately preceding sale or on an uptick. The point of this rule was to stop "bear raids" in which short sellers would act in concert to relentlessly drive down the price of a stock by repeated short selling at lower prices. For almost 70 years, the uptick rule remained in place until July 2007, when the SEC eliminated it. Almost immediately, the volatility of the market jumped as more and more hedge funds, reverse return ETFs and individuals employed short selling as an integral part of their investment strategy without the inconvenience of waiting for a rise in the target share price. Whether the absence of an uptick rule is a significant contributing factor to market volatility is a question for future market historians, but it is probably safe to say that its elimination did little to stabilize equity markets just when prominent financial stocks (Bear Stearns, Lehman, Citigroup etc) had their melt down. Since August 2007, various Wall Street and Washington luminaries have called for the reinstatement of the rule. On Feb 25, 2009, while testifying in front of Congress, Ben Bernanke favoured its restoration. We expect that the uptick rule, along with a host of other Wall Street reforms, will be forthcoming shortly under the Obama Administration. As with the possible re-introduction of the uptick rule, it is back to the future with financial regulation on a larger scale - can the Glass-Steagall Act v.2009 be very far behind? (The Glass-Steagall Act referred to here, officially named the **Banking Act of 1933**, mandated a separation of bank types according to their business (commercial and investment banking, securities industry), and it founded the Federal Deposit Insurance Corporation for insuring bank deposits. Increasingly, regulators and legislators are talking in terms consistent with the principles established by Glass-Steagall.)

- According to **Brian Milner** (Investor Sentiment, the Globe and Mail) investors are surrendering to the "recency" effect; a temptation to look forward strictly on the basis of recent dramatic events --- if markets plunged 50% last year, they will next year and if markets went up by 20% or oil rose \$100, they will continue in the same manner. (on the up-side it's been called irrational exuberance and euphoria). Regardless, we agree that bad news begets negative expectation, and really bad news begets horrible expectations and a constant regurgitation of all of the above (something we called the bad news **backwash**). At this stage of the *economic* cycle, the world has excess capacity, thus, there is a surplus of bad news: inventory must disappear, factories must be closed, oil and gas will be shut-in, mining activity will cease, trade will dwindle, GDP will shrink while unemployment will rise along with bankruptcies (both personal, corporate and national) and government debt. It was refreshing to hear **John Aitkens**, Investment Strategist with **TD Newcrest** describe this process in a calm, detached, objective manner --- without any hyperbole --- in his conference call last week. He compared our present decline to similar "V-shaped" globally synchronized declines and recoveries in 1958 and 1974. The very trimming of inventory and capacity brings about the end of the recession and sparks the next cycle which is signaled by the market's sudden and sharp recovery. In 1974 global industrial production declined over 12% (we sit on an 8% global decline today) only to rebound very sharply beginning in early 1975 and over the 1973-76 periods all major economies were synchronized, much as they are today. There is no "recency" or backwash in this analysis. Of more immediate relevance is John's observation that double-bottoms are not un-common and that he does not expect a US recovery to begin until mid-year led by opportunistic corporate raiders and consumers with good credit. The rise in both gold and industrial commodity prices since late 2008 is a positive development however indicating that the deflation risk is in check. The spread in corporate bond yields over 10 year government debt is also normal as is overall debt sensitivity at this stage in the economic cycle.

- March did not get off to a good start: markets, spooked by **AIG** reported quarterly loss of US\$61 billion; with Warren Buffett's Berkshire Hathaway newsletter in hand reporting a loss of 9.6%; and with large downward revisions to GDP, everyone hit the sell button once again. And yet, good things are happening too: **Bell Canada** snapped up a national electronics retailer, **The Source**; **Ford** may sell its Volvo business to **Geely Holding Group** of China. **HSBC** raised approximately US\$17 billion to possibly hunt for acquisitions. **VW** reported record profits of US\$7.7 billion, up 15% from 2007, and announced its intention to continue to seek growth even in these tough times and to surpass Toyota in global sales by 2018. Who said an auto manufacturer based in a developed country could not be competitive?

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