



In market mergers, 10-year yields and other events: *a renaissance of hope?*

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- An **in market merger** is when companies in the same industry decide to merge for potential product and operating cost synergies with the hope that 1+1 equals something greater than 2. An acquisition is the same thing, but predatory.
- In our March 10 weekly note, we observed that "M&A activities can pave the way for renewed interest in stocks." At the time we wanted to highlight that approximately **US \$150 billion in M&A deals** were already under way to reshape the **global pharmaceutical sector**. Not only that: pharmaceutical companies are tapping corporate debt markets to finance these transactions. According to Bloomberg, Roche raised about US\$40 billion in two record breaking bond sales to help fund its acquisition of Genentech Inc. Globally investors have digested record volumes of corporate bonds so far this year. Observers have noted that there's a strong demand for non-financial, non-banking credit.
- Locally, **Agrium Inc., CF Industries Holdings Inc. and Terra Industries** have been in a hostile three way dance for several weeks as Agrium and CF are dueling it out to see who becomes the dominant North American producer of ammonia and other nitrogen-based crop nutrients. With share prices relatively low (down about 50%), takeovers are the most affordable way to expand a business.
- Today **Petro-Canada** and **Suncor Energy** announced their intention to tie the knot in a \$19.3 billion all-stock merger. It's too early to tell if the deal will be consummated or what the real underlying reasons for the move might be, but in the face of all the gloom and doom in Q1 2009, the prospect of major deals like this, provides a **renaissance of hope**. It has been our contention for some time that a lack of investor confidence rather than a lack of fundamental value has been the main obstacle to a stock market recovery. When rivals, such as Petro-Canada and Suncor or global 'pharma' giants decide that combining forces adds more enterprise value than head to head competition, the market will begin to swing upwards. The bottom line is that M&A are a catalyst because: 1) deals are typically done at a premium to the current market price; 2) the remaining shares within an industry sector generally rise to reflect the new takeover benchmark; and, 3) investor greed quickly begins to replace fear. We are strong believers in point #3, especially with cash yielding 0% and GOC 10 year bonds returning 2.6%. Globally, governments have undertaken massive stimulus policies that will shortly become evident in economic statistics (Q1 results may include a few pleasant surprises) and will, in turn, further bolster confidence. We look for more M&A in the natural resource sectors (particularly gold) in Canada and in the technology, healthcare and financial sectors in the US.
- **US long-term bond yield** fluctuated wildly last week (largest single day change) following the **US Federal Reserve's** announcement that it would buy back up to US \$300 billion in US Treasuries. The yield on the US 10-year bond dropped to 2.5% from 3% in one day and is hovering at 2.6% today. The **U.S. Treasury** then followed in its turn, today announcing it will provide US\$75 billion to US\$100 billion to seed a program to buy up the so-called "toxic assets" choking bank balance sheets. With leverage and private sector participation, the Treasury estimates that it may absorb \$500 billion of toxic assets, with a potential to reach up to \$1 billion. These efforts combined with the stimulative policies already adopted by the Obama administration in January, have triggered a government bond rally that is also impacting corporate bonds and reducing spreads between corporate and government bonds. In our view, these events are significant signals of a broader and sustainable change in capital markets that will cause a reversion of interest rate spreads and equity valuations to more normal ranges.
- **US existing home sales rebound in February, rising 5.1%** to a stronger-than-expected annual pace of 4.72 million units, the National Association of Realtors reported today. The national median existing-home price for all housing types fell to US\$165,400 dollars in February, down 15.5 percent from a year ago, improving on a similar trend observed in January. US housing prices are now falling back to a long-term equilibrium in line with US median income. February home sales in Canada, as reported last week, jumped up 8.5%, the biggest such jump since 2004.
- Not surprisingly, **stock markets in Canada and the US posted strong gains today**. The Dow Jones industrial average climbed 6.84%, or 497.48 points, to 7,775.86, with all 30 of the index's components up. Financials led the way with Citigroup gaining 17%, American Express up 16%, and Bank of America up 19%. The broader S&P 500 closed above 800 points - a key technical indicator - gaining 7.08%, or 54.38 points, to 822.92. Financials once again charged ahead, with energy, industrials and consumer discretionary sub-indexes posting gains of about 7%. In Toronto, the Petro-Canada/ Suncor news helped power the S&P/TSX index to a 5.32% gain, or 452.16 points, to 8,958.51. Petro-Canada ended the day up 20.4% at \$35.70, while Suncor slipped 0.52% to \$30.74. The energy sub-index traded 6.89% higher, second only to the financial sub-index, which gained 8.49%. Last week all three markets ended higher - the first time since May that they have posted back-to-back weekly gains.

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