

Investment

Review & Update



OCT 2007

Topsy Turvey

Topsy Turvey is a phrase my father used to describe a world upside down or in disarray. It is an entirely appropriate description for the current world markets. Media commentators and Market Analysts continue to speculate on what is happening in the markets for the last three months. The "R" word, recession is muted by some, while others suggest that the economy will simmer before returning to a modest boil. So varied are their opinions that it is difficult to form a clear view. What is evident is that resource prices as expressed in USD continue to rise as the USD weakens against the Canadian Dollar, now at 30 year highs. The lack of liquidity of Asset Backed Commercial Paper (ACBP) has made it difficult for some investment houses to quantify their exposure to loss from the sub-prime crisis. To help ease this credit crunch, central banks (US, UK, CAD, AUD) have been helping the financial market by providing more liquidity through their regular money

market operations. The US Federal Reserve (FED) has intervened by lowering their benchmark interest rate by half a point to 4.75 percent. The US central bank has embarked on a path of cutting interest rate, their first since 2003, hoping to keep the US from sinking into a recession sparked by fallout from the housing market. This is the "cure" that the financial market has hoped for, the question remains whether more of this medicine dispensed will work this time. The financial market's initial reaction is positive and both the equity and bond markets have rebounded. The US Fed decision on September 18 provided the excuse to bring in cash from the sidelines and a short buying flurry that caused a rise at the end of the month.

In contrast, the state of real economy in the US seems to be divorced from this market rise! Weaker retail growth, lower manufacturing growth, weaker housing prices, weaker

employment numbers and lower interest rates resulting in a weaker currency does not auger well for the US or inspire taking US exposure. We would recommend that any investments in US should therefore be hedged for currency, and should be typically underweight compared to other funds

Of major interest is the announcement by China to establish a Superfund which will invest its current trade surpluses in assets other than the US Dollar. This will reduce the demand for the greenback even further and we can expect to watch a further slide in its strength. As Warren Buffet warned a few years ago, current account deficits from trade will ultimately result in the depreciation in US Dollar purchasing power, and as China watches this decline it has decided to take action to reduce its risk and diversify into acquiring other assets. China

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recently acquired a premier chrome producer from Zimbabwe and is active in trying to secure supply of other resources by acquiring the production source. Apart from China, Asia and other emerging markets have recovered strongly compared with their developed world counterparts. BNP Paribas has even predicted that there will be a decoupling of Asia's dependence on their US asset performance.

Interestingly the strength of the resource base, the strong fiscal and current account positions provide a strong incentive for investing in the energy and resource based companies from Canada. Our economy and housing market is currently in a much better state than the US but risk of slower

economic growth in US could affect us. Global demand, especially from the developing BRIC markets (Brazil, Russia, India and China) as well as the growth in emerging markets provide further incentive to diversify away from the US and even Europe.

Capital conservation remains our primary priority and we will recommend an ease back into the markets, as we see become more confident. Secondly as we desire to achieve absolute returns, current cash accounts are earning a fair return, and provide the liquidity to recommend the return into the market once this confidence returns. . Traditionally, the month of October has been the most volatile but perhaps presents a good entry point as the period of

November through March is historically the period in which most positive market performance is experienced. We will therefore be on a lookout for this opportunity to recommend a reallocation according to your strategic asset allocation, when the opportunity arises.

If you have any questions please call Malcolm Ross at 604-331-2521 or Victor Whang at 604-331-2524.

Best regards,



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