

November 2011 Market Commentary Courtesy of Front Street Capital

Below is a market commentary from one of Canada's most highly respected portfolio managers, Norm Lamarche of Front Street Capital. Norm has managed money for a quarter century and has seen his share of market cycles. Norm began his career with the Bank of Canada and is therefore, well versed in economic matters from a variety of perspectives:

THE IRRATIONAL MARKET

November 23rd, 2011 Conference Call - Summary

- In Europe, they have all the tools available to fix their problems, but governments react only when they are at the brink of failure;
- Until that happens and the cohesive plan is in place, market will continue to trade on headline risk (media headlines)
- Germany is playing hardball; it does not want to risk its' fiscal balance sheet unless they see harsher measure put in place by their other Euro counterparts;
- Italian, Greek, Spanish, Portuguese governments need to change behaviour - they need more discipline, but it won't happen overnight;
- Euro currency was doomed to fail, because you can't tie so many countries together with conflicting demographics, efficiencies, ideas, priorities, and growth rates into one currency;
- There is a huge disconnect between fundamentals and sentiment, and the **market had been driven down by fear to irrational levels**
- Over the long term, in a normalized world, stocks will eventually always trade based on fundamentals, not news headlines. When the market focuses on fundamentals again, we are positioned to take advantage of it;
- We don't invest in everything – we focus on key themes, both economic and geopolitical, that can continue to thrive in this challenging environment;

Great Stories but Weak Share Prices

- Every day in the market place, the companies we own are behaving like stocks instead of businesses;
- When yields on European bonds widen, markets go down, and our stocks suffer as well;
- We operate in the capital markets just like everyone else does;
- We are in a period of fear, and people are afraid to own stocks in spite of their low valuations;
- No different than gold. Bullion is hitting record highs, but the gold stocks are not responding;
- Due to the European fears no one wants to own stocks right now, which is foolish;
- We've been kicked in the teeth by the market so many times in 10 years it's hard to blame investors for fearing stocks, however, this is precisely when the greatest opportunities present themselves to investors. Adding money to your long-term portfolio at these prices will likely produce above average results in the future;
- **Question is: can the risk that exists today get worse and grow into contagion?**
- **We don't think that's the case**
- **We sold out of GOLD bullion over the summer**

Politics vs. Capital Markets

- When things go bad, politicians realize that they don't run economies anymore...capital markets do;
- We saw that in 2008...when U.S. politicians were squabbling about everything - one day they vote something down...and the next day, they are back at it, voting for it positively. Why? Because capital markets went down 600-700 points on the news of their initial disagreement;
- Capital markets are forcing politicians to go back and rethink things until they get it right; that's what's happening right now in Europe;
- It happened in Canada in early to mid-1990s when the CDN \$ was 0.60 cents relative to U.S.D. and the credit rating agencies cut our credit rating to below AAA;
- Back then, Canadian bond Interest rates were 4%-5% **above** equivalent U.S. treasury bonds in order to attract fearful investors;
- Why? The Canadian government was spending more than it was taking in
- Politicians did this year after year until global investors said: enough is enough, we're not buying your bonds anymore; clean up your act!
- There was a buyers' strike on Canadian Government debt (bonds) because the spread in interest rates was so wide relative to equivalent U.S. bonds.
- Politicians tend to drag things to the very last moment;
- In the stock market investors are trading today based on the headline news (media headlines)
- **Over periods of time, we feel that market investors can outgrow the macro-economic noise from Europe**

Economy: Not as Bad as what the tape tells you

- US economy is actually in OK shape, not great, but its growing;
- Much of that growth is occurring in the energy sector;
- In Canada, there is no recession going on in Sask., Alberta, or B.C. they are importing skilled workers into these areas;
- Same thing in Pennsylvania, Texas, Louisiana, North Dakota, Wyoming;
- There's a shortage of rail cars, truckers, in some parts of the U.S.
- **Whether U.S. economy grows at 2%, or if it's on the verge of recession, it doesn't Matter, this capital spending is still happening.**

Summary:

- We continue to buy and own quality growth companies with clean balance sheets, just like we did in late 2008. Eventually when the dust settles and the market trades again on fundamentals instead of fear like it did in 2009, (markets gained 50% off the 2009 bottom) we will be positioned for it.
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I encourage you to remain rational in your decision-making and not allow emotions to rule the day.

John Soutsos, EPC, Branch Manager

Senior Financial Consultant

jsoutsos@ipcmississauga.com 905.568.2000