

**Index Performance** *January 15, 2010*

<u>Composite</u>	<u>Close</u>	<u>Weekly %</u>	<u>YTD %</u>
S&P TSX	11,685	-2.21%	-0.52%
DJIA	10,610	-0.08%	1.74%
S&P 500	1,136	-0.78%	1.88%
NASDAQ	2,288	-1.26%	0.83%

Source: TriVest Wealth, various market data sources

**In this Issue**

Welcome back to our seventh edition of the TriVest Market Digest. In this edition, we examine the pickup in new secondary equity issues, the U.S. Fed interest rate policy and potential consequences, exchange rates, and worsening economic conditions in Europe. In the Energy Corner, we examine some of the potential implications from Apache’s announcement to take a major stake in Kitimat LNG Inc’s planned natural gas export facility.

**Follow the Flow, Buy High and Sell Low – New Issue Business**

*“A-B-C. A-Always, B-Be, C-Closing. Always be closing, always be closing. A guy don’t walk on the lot lest he wants to buy. They’re sitting out there waiting to give you their money.” – Glengarry Glen Ross*

The secondary market for new equity issue business in addition to Initial Public Offerings (IPOs) to no surprise has rebounded concurrently with the market performance. According to an article entitled “Stock, Bond Sales Rebounded” in the Wall Street Journal, for all of 2009, global stock and bond underwriting rose 38% to \$7 trillion. Specifically, world-wide equity issues, were up 42% to \$903 billion, while global volume for high-yield junk bonds more than doubled to \$178.9 billion. In Canada, total financings for 2009 were \$60-billion, up 70% from 2008, and surpassing the previous record of \$47.6-billion set in 2007.

The corporate bond issuance market is also on fire, with concerns that a bubble is building as more and more companies come to market looking to take advantage of the recent spread compression. For example, spreads on non-

**Contact us:**

Email: [inquiry@trivestwealth.com](mailto:inquiry@trivestwealth.com)

Phone: 403.536.6444

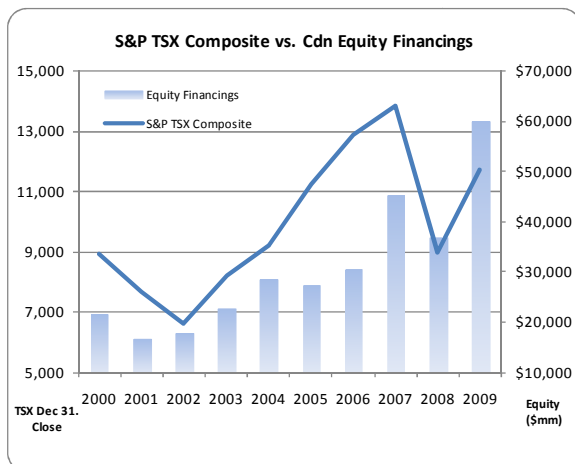
[trivestwealth.com](http://trivestwealth.com)

financial credit have on average moved in by 15-20 basis points over the last week alone eliminating the spread to the secondary market. This compares to 12 months ago when new issues were being done at a 100 basis point discount to the secondary market.

This reminds us of a thesis paper we read in the October 2000 edition of The Journal of Finance entitled "The Equity Share in New Issues and Aggregate Stock Returns." In it the main conclusion is that issuing firms tend to prefer issue new equity before periods of low returns and tend to shun equity, in favour of debt, before periods of high returns. "The study offers some suggestive evidence that the stock market as a whole may be inefficient and that managers exploit this inefficiency with their financing decisions. In particular, the equity share sometimes predicts significantly negative returns on the market." The paper can be read at:

<http://pages.stern.nyu.edu/~jwurgler/papers/equityshare.pdf>

What concerns us is the rapid rush of new issue business over the past few months. The chart below shows the Canadian TSX Composite versus total common and preferred share equity financings and IPOs.



Source: www.iiac.ca

**Contact us:**

Email: [inquiry@trivestwealth.com](mailto:inquiry@trivestwealth.com)

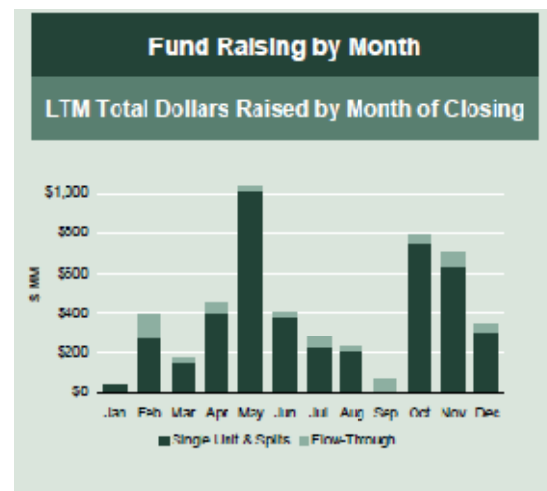
Phone: 403.536.6444

[trivestwealth.com](http://trivestwealth.com)

Specifically, what worries us is the price of these new issues, many being done at 52-week highs and at little discounts. Therefore we have elected to not participate at this point in time preferring to buy in the open market where we can often find better discounts on down-dip days. We have noticed, for example, in the energy sector more than a few of the recent new equity issues have been done immediately following the release of a positive development, therefore at a noticeable "premium" to its recent trading average.

For example, one natural gas producer this past Thursday provided a favourable operational update first thing prior to the market open resulting in its share price closing up 16% on the day. Not surprisingly, a bought-deal was immediately announced after the close at a 7% premium to the previous day.

Another concern is the recent pullback in new fund issues in Canada during December. Current offerings set to close in January/February also add up to only C\$122.9 million. These new funds often take advantage of the secondary market to expedite the investing of their newly raised cashed positions.



Source: TD Waterhouse

Of the new Canadian closed-end fund offerings completed in 2009, we've also noticed that the majority of the money raised went into income funds, followed by gold funds.

According to the most recent data published by the Investment Company Institute (ICI), equity mutual funds suffered the fourth consecutive month of redemption with an outflow of U.S.\$3.5 billion in December, The decline, however, was again concentrated in stock funds that invest primarily in the U.S. with \$6.5 billion in redemptions. This brings cumulative outflows to \$23 billion in four months. So we have to wonder where is the money coming from to support the flurry of recent equity deals in North America?

#### **See No Evil, Hear No Evil – U.S. Fed and Interest Rate Policy**

*“Wally: These streets are bumpy. Dave: You're driving on the sidewalk!” - See No Evil, Hear No Evil (1989)*

We came across a great article this past week in the Financial Times entitled “Ben Bernanke has learnt so little.” The article was written by Edward Chancellor, a member of GMO's asset allocation team. GMO is a global investment management firm that manages \$102 billion in client assets. The article criticizes the U.S. Fed's outright ignorance regarding the effects of a low interest rate policy. In particular, the Fed argues that the prolonged period of low interest rates after the technology bust, was justified because the recovery was weak and there was a risk of deflation. Sound familiar?

Mr Bernanke's researchers argue that there is only a “tenuous connection” between low interest rates after 2002 and the housing bubble that emerged. Instead they blame the housing bubble

on unchecked financial innovation such as mortgage securitisation. They also conclude that better regulation rather than a more restrictive monetary policy will prevent dangerous bubbles from forming in future.

If one does not properly learn from the past is one destined to repeat it? As for example, the latest is the Commodity Futures Trading Commission (CFTC) which has put together a list of proposals this past week to rein in energy speculation. In particular, they are proposing hard limits on the number of futures a single investor can hold. Details of the announcement can be found at:

<http://www.reuters.com/article/idUSN1418252620100114>

Again, are speculators to blame for higher energy prices, or maybe the Fed should ask themselves whether or not a low U.S. dollar and low interest rates have had an effect? That brings to mind a quote we mentioned in an earlier edition of the Market Digest by United Energy “You buy a horse for two goats, go on vacation and come back to find that horse is now worth seven goats. Is it a bull market in horses or a bear market in goats?”

We think Mr. Chancellor, offers a very interesting synopsis. He argues that the Fed has not changed much since the Greenspan years, as they still believe that bubbles can only be recognised after the fact. Nor does the Fed accept responsibility for the consequences of its glaring macroeconomic imbalances of the last decade. Specifically, there were many useful leading indicators of an approaching crisis that went ignored such as *“the rapid growth of private sector credit, the falling savings rate, and the gaping current account deficit of the mid-2000s.”*

He also argues that securitisation was unlikely the prime cause of the global housing bubble since

#### **Contact us:**

Email: [inquiry@trivestwealth.com](mailto:inquiry@trivestwealth.com)

Phone: 403.536.6444

[trivestwealth.com](http://trivestwealth.com)

home prices soared in many countries that did not have exotic mortgage products. Maybe the loose monetary policy of the world's reserve currency had a more extensive effect?

*“Furthermore, housing bubbles are not difficult to spot. At GMO, we look at the ratio of home prices to median household income. **When this ratio reaches two-standard deviations from the mean, we’re pretty confident a bubble has formed.** The connection between a loose monetary policy and asset price bubbles is pretty obvious to anyone with the slightest economic intuition: low rates make it cheaper to borrow, while acquisitions financed with credit drive up asset prices.”*

**Big Brother and Low Interest Rates**

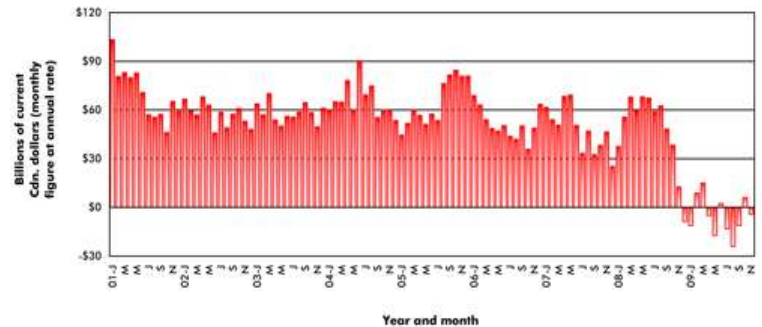
*“Canadians are generally indistinguishable from Americans, and the surest way of telling the two apart is to make the observation to a Canadian.”- Richard Staines*

The U.S. reported this past week that its trade deficit widened to US\$437 billion in November. This rising deficit is in addition to the Government’s fiscal budgetary deficit of \$1.4 trillion in 2009 and an expected \$1.0 trillion in 2010.

Canada also reported unexpectedly a trade deficit in November led by rising imports of energy, machinery and automobiles. Canada remains on track for its first annual deficit in goods trade since 1975. Let’s just hope that were not about to return back to those wonderful Trudeau years!

Specifically, the deficit totalled C\$344 million in November which was below Bloomberg analyst expectations of a C\$500 million surplus. According to Statistics Canada, the country’s trade deficit from January to November 2009 totalled C\$4 billion, figures. This compares to the country’s

C\$47.6 billion surplus over the same period in 2008.



Source: Reed Construction Data

Keeping this in mind, we came across a good article at Reed Construction Data entitled “U.S. foreign trade position becomes more familiar; Canada’s remains an anomaly” which can be found at:

<http://www.reedconstructiondata.com/news/2010/01/u.s.-foreign-trade-position-becomes-more-familiar-canadas-remains-an-a/>

The article brings up a good point that as a result of currency traders bidding up the Canadian loonie on its exposure to higher commodity prices, the Bank of Canada has little control over interest rate policy. *“Rates in Canada cannot be raised ahead of those in the U.S. for fear that the value of the loonie will rise further and create even more of a problem for exporters.”*

**Staying A-Float**

For an excellent perspective on the link between asset markets and exchange rates we highly recommend reading the article entitled “Floating all boats” in The Economist, which can be found at:

[http://www.economist.com/businessfinance/displaystory.cfm?story\\_id=15276683](http://www.economist.com/businessfinance/displaystory.cfm?story_id=15276683)

**Contact us:**

Email: [inquiry@trivestwealth.com](mailto:inquiry@trivestwealth.com)

Phone: 403.536.6444

[trivestwealth.com](http://trivestwealth.com)

The article theorizes that since the Bretton Woods system collapsed there have been enormous asset bubbles corresponding with the growth of the financial sector and a significant increase in consumer debt. This link is no coincidence as floating exchange rates and booming asset markets have reinforced each other.

With previous exchange-rate systems linked to gold, governments were constrained from debasing their currencies by printing more money therefore it was rather difficult for countries to fund and sustain trade deficits. With a floating exchange rate system, the trade constraint was removed allowing countries like the U.S. to continually run deficits.

Previous exchange-rate systems had been linked, directly or indirectly, to gold. The aim was to put a constraint on the ability of governments to debase their currencies by printing money. The corollary was that countries found it hard to fund trade deficits for long. Surplus countries that built up their foreign-exchange reserves either resulted in asset bubbles at home such as Japan or fuelled them abroad such as the U.S.

With floating exchange rates, the trade constraint was removed. This allowed America to enjoy its long-running deficit while allowing other countries to run huge surpluses.

*"The move to fiat money (paper not backed by gold) created the huge expansion in global money supply that the pessimists had predicted. According to Mr Duncan, **under Bretton Woods global foreign-exchange reserves grew by 55% between 1949 and 1969. They then grew by almost 2,000% between 1969 and 2000. This extra money was used to push up asset, rather than consumer, prices.**"*

*"Freed from the need to defend their currencies, and with consumer inflation a minor problem over the past 20 years, central banks could afford to let interest rates drift steadily lower. Even countries with pegged exchange rates, such as Latvia and China, "imported" the loose monetary conditions of the developed world. This policy put a floor under asset prices and eventually created the conditions for the credit crunch of 2007-08. Only by lowering rates almost to zero have the authorities managed to stabilise matters again."*

Overall, the burden of the cost of servicing the debt from the recent credit crunch has now been transferred from the private to the public sector. Maybe just after all *"an era of austerity, which the floating-rate system was designed to avoid, is going to occur after all."*

#### **PIIGS Index Anyone? – Portugal, Ireland, Italy, Greece, Spain**

*"Clark Griswold: There it is, kids, my motherland.  
Rusty Griswold: Dad, Grandma is from Chicago.  
Clark Griswold: Shut up, Russ." - European Vacation (1985)*

Moody's Investors Services stated this past week that the Portuguese and Greek economies may face a "slow death" as they dedicate a higher proportion of wealth to paying off debt and investors demand a premium to hold their bonds. Overall, the two countries "failed to shore up their competitiveness and budget positions during the good times," and now have "structurally low competitiveness" within the euro zone, and very large current-account deficits, the credit-rating firm said. For example, Greek debt premiums to German equivalents are up a whopping six times from only two years ago, while spreads in Portugal up double since 2008. The Greek and Portuguese governments may be forced to raise taxes, hurting

#### **Contact us:**

Email: [inquiry@trivestwealth.com](mailto:inquiry@trivestwealth.com)

Phone: 403.536.6444

[trivestwealth.com](http://trivestwealth.com)

investment and prompting emigration, according to the report.

For a good summary of the situation and some of the potential outcomes from these countries we recommend the article entitled "Are we about to see the end of the much-vaunted eurozone?" located in The Guardian, which can be found at:

<http://www.guardian.co.uk/commentisfree/2010/jan/03/peter-oborne-end-of-eurozone>.

In Spain, unemployment has reached 19.3% with unemployment for those between the ages 16-24 is a catastrophic 42%. In Greece, youth unemployment is 25%, in Ireland 28.4% and Italy 26.9%. It therefore argues that marginal eurozone countries such as Greece, Spain and Ireland are not just in recession, they are in depression. By remaining inside the euro, individual countries are stripped of the ability to manage their own economies. That is why the global recession has been far, far more devastating for some eurozone members than would otherwise have been the case.

*"In the medium term, economies like Greece and Spain are certain to break away from the euro. The refusal of the political elites to recognise this inevitability means that 2010 is going to be very painful, very bloody and very dangerous."*

#### **Energy Corner – Natural Gas, On the Hunt for New Markets**

*"North America faces a chronic and accelerating natural gas shortage that sooner or later will be described as a crisis." – Energy Bulletin (2005) article entitled "Natural gas- the next fossil fuel shortage."*

Apache Corp. Announced this past week that the company is purchasing the majority control of the planned \$3 billion Kitimat LNG export facility.

What is interesting is that this facility was originally to be built as a regasification facility! Given the current overabundance of natural gas plans have been redrawn to complete it as a liquefaction facility. The decision to commence with construction will be made by 2011 and opening targeted for 2014. The facility, located in Bish Cove BC, could move as much as 700 mmcf/d of natural gas which represents approximately 20% of B.C.'s current production.

So why did Apache purchase it? Well, Apache has a sizable stake with its partner EnCana in northeastern B.C.'s Horn River shale gas play. Details of Apache's history in the region can be found at:

[http://www.apachecorp.com/explore/Browse\\_Archives/View\\_Article.aspx?Article.ItemID=595](http://www.apachecorp.com/explore/Browse_Archives/View_Article.aspx?Article.ItemID=595)

Roughly 800 mmcf/d is estimated to be added from the Horn River play in NE B.C. over the next few years upon further drilling and take-away capacity being built. There could be further significant upside to come from the region, which is estimated 500 tcf of resource potential. With an overabundance of natural gas in North America, it makes sense for someone such as Apache to invest in long-term infrastructure allowing it to get the best possible price for its natural gas. This includes providing it with access to European and Asian markets.

My how things have changed in the past 10 years, as it wasn't so long ago that pundits were fretting about a shortage of natural gas on the continent. So confident were these concerns that as a result there has been a total of \$9 billion of new LNG projects built over the past 4-5 years, and U.S. LNG re-gasification capacity has increased to 17 bcf/d up from 5 bcf/d in 2006. To put this into perspective, the U.S. currently is importing only

#### **Contact us:**

Email: [inquiry@trivestwealth.com](mailto:inquiry@trivestwealth.com)

Phone: 403.536.6444

[trivestwealth.com](http://trivestwealth.com)

0.75 bcf/d of LNG. The 17 bcf/d of capacity also represents 31% of total U.S. production, 240% of Canadian exports to the U.S., and roughly 28% of total U.S. demand. Therefore it isn't much of a surprise when you hear of plant conversions from re-gas to liquefaction, such as the Kitimat LNG terminal on the Canadian west coast. The question is how many more of these facilities will be converted, and when will natural gas be priced as a global commodity?

### **Haiti - SOS**

By now most of you have read about the tragic earthquake that has struck Haiti. The Canadian Government has announced that it is earmarking up to \$50 million to match Canadians' donations to charities aiding relief efforts in the country.

TriVest has made a contribution to the relief effort and for those looking for ways to contribute or help, we've enclosed below a link to the the Government of Canada's website. This includes a list of registered humanitarian organisations.

[http://www.international.gc.ca/humanitarian-humanitaire/canadians\\_help-aide\\_canadien.aspx?lang=eng#organizations](http://www.international.gc.ca/humanitarian-humanitaire/canadians_help-aide_canadien.aspx?lang=eng#organizations)

### **Contact Us**

TriVest maintains a small client/portfolio manager ratio to ensure the highest level of communication and service. The minimum investment required to establish a client relationship is one million dollars of investible assets per household.

We encourage you to find out more about the firm and our investment services by contacting us.

Please feel free to email back any feedback or things you would like to see or discussed in future issues. If you wish to be deleted from future

TriVest Market Digest emails, please reply with "Remove" in the subject header.

Have a great weekend,

Best Regards,

Martin Pelletier & Craig Stanford

**TriVest Wealth Counsel Ltd.**  
Suite 103, 620 12th Avenue SW  
Calgary, Alberta  
T2R 0H5

**Martin R. Pelletier, CFA**  
Managing Director, Portfolio Manager  
403.536.6444  
martin.pelletier@trivestwealth.com

**Craig B. Stanford, MBA, CFA**  
Managing Director, Portfolio Manager  
403.536.6443  
craig.stanford@trivestwealth.com

### **Contact us:**

Email: [inquiry@trivestwealth.com](mailto:inquiry@trivestwealth.com)

Phone: 403.536.6444

[trivestwealth.com](http://trivestwealth.com)

### DISCLOSURES

Copyright © 2009 TriVest Wealth Counsel Ltd. or "TriVest Wealth" All rights reserved. This report is prepared for the use of TriVest Wealth clients and subscribers of this report and any unauthorized use of, distribution, disclosure or copying of this report in whole or in part, or in any form or manner, without the express written consent of TriVest Wealth is prohibited. If you wish to be removed from the subscriber list, TriVest Wealth will make every effort to do so upon appropriate notice. If you would prefer not to receive further messages from this sender: 1. Click on the Reply button. 2. Replace the Subject field with the word REMOVE. 3. Click the Send button. You will receive one additional e-mail message confirming your removal.

TriVest may own, buy, or sell, on behalf of its clients, securities of issuers that may be discussed in or impacted by this report. As a result, readers should be aware that TriVest may have a conflict of interest that could affect the objectivity of this report. TriVest Wealth may also engage in the trading strategies described in this document for its clients and may, as market conditions change, amend or change its investment strategy including full and complete divestment. This report should not be regarded by recipients as a substitute for the exercise of their own judgment and readers are encouraged to seek independent, third-party research on any companies covered in or impacted by this report.

Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other financial instrument or any derivative related to such securities or instruments. This report is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. Any decision to purchase or subscribe for securities in any offering must be based solely on existing public information on such security or the information in the prospectus or other offering document issued in connection with such offering, and not on this report.

Materials prepared by TriVest Wealth in the composition of this report are based on public information. The information herein was obtained from various sources believed to be reliable but the accuracy and completeness of the information is not guaranteed, and in providing it neither the author of this document nor TriVest Wealth assume any liability. This report may contain links to third-party websites and is not responsible for the content of any third-party website or any linked content contained in a third-party website. The inclusion of a link in this report does not imply any endorsement by or any affiliation with TriVest Wealth.

All opinions, projections and estimates constitute the judgment of the author as of the date of the report and are subject to change without notice. TriVest Wealth is under no obligation to update this report and readers should therefore assume that TriVest Wealth will not update any fact, circumstance or opinion contained in this report.

Neither TriVest Wealth nor any director, officer or employee of TriVest Wealth accepts any liability whatsoever for any direct, indirect or consequential damages or losses arising from any use of this report or its contents.

**Contact us:**Email: [inquiry@trivestwealth.com](mailto:inquiry@trivestwealth.com)

Phone: 403.536.6444

[trivestwealth.com](http://trivestwealth.com)