VERITAS

Summer 2012

DID YOU KNOW...

- Seventeen percent of all meals ordered at restaurants in the US are consumed in cars.
- The last Canadian penny, in circulation since Canada adopted its own currency in 1858, was minted on May 4th, 2012.
- Citing public safety concerns, Fort Lee, NJ is issuing $85 jaywalking tickets for texting while walking.
- Canadians now make up the largest segment of international purchasers of US real estate, rising from 11% in 2007 to 24% now.
- Ford Motor Co.'s debt was recently upgraded from junk status, permitting the company to reclaim ownership of its blue oval logo which had been pledged as loan collateral.
- Ten percent of business travelers are responsible for two thirds of an average airline's profitability.
- A meagre six percent of cola drinkers in the UK consume 60 percent of the cola drunk there.
- Cockroaches are highly so cial creatures, forming societies based on social structures and rules; are capable of making collective decisions for the common good; and suffer ill health when left alone.

CURRENT SITUATION

In what is becoming an unfortunately common refrain, first quarter strength in equity markets quickly ebbed in the second quarter. Despite a positive return in June, as at June 30th, Canada's TSX was down 1.5% for the year. The negative performance was fairly widespread, with only three of the TSX sub-groups posting positive returns. One of the hardest hit sectors this past quarter was technology hardware on the back of the precipitous slide in the share price of Research in Motion (RIM - not held). The heavyweight energy and materials sectors continued to lose ground as well, as commodity prices remain weak in the face of market uncertainty stemming from the continuous recycling of information out of Europe, and ongoing speculation that China's economy is slowing materially. Reminding us of how dependant Canada's economy is on natural resources, we were amazed to learn that oil and gas exports plus oil sands investment (infrastructure and machinery) accounted for one third of Canada's economic growth in 2010 and 2011.

Market sentiment has taken a negative turn in the last couple of months, largely in response to the political uncertainty in Europe. We acknowledge again that there are global issues that may well affect Canada, but these issues are largely known. Europe will continue to be a strain because there is no quick fix for the issues affecting the region, and the solution is taking longer to find because of the lack of consensus among the leaders there. However, assuming a solution will be found, which we believe will happen once the political posturing has run its course, we see evidence that suggests that there could be less pessimism in the markets than there is today. Despite the negative *market* sentiment, business and consumer sentiment has been steadily improving, albeit somewhat unevenly. Positive manufacturing trends, especially in the US, has led to jobs growth. The improvement in US manufacturing fundamentals, especially in these challenging times, is an important milestone. It was the reverse of this, the sending offshore of manufacturing jobs, once considered the backbone of the US economy, that was one of the largest contributors to the significant decline in consumer confidence that in turn accelerated the economic slowdown witnessed prior to the credit crisis. We are also seeing steady improvement in corporate earnings, principally from rising revenues, not cost cutting, suggesting the profitability is sustainable. And finally, even though global economic growth has been sluggish, US exports have remained resilient. While part of the resiliency is due to the recent weakness in the US dollar, the caliber of exports has been improving at the same time, containing more "value added" components, which require more labour, another plus for jobs.

Although global uncertainty has slowed the pace modestly, North American companies are still hiring. Canada added 58,000 new jobs in April, the majority of which were full time, private sector positions, regarded as the highest quality hires. In the US, as at March 31st (employment data tends to lag), employers were seeking to fill more positions than at any time in the last four years (i.e. since before the 2008/09 meltdown). To put this in perspective, the number of open staffing positions at the end of March was 3.74 million. It appears that the biggest impediment to getting those positions filled remains that of matching skills to requirements. This is in part an employee mobility problem largely brought on by candidates being unable to sell their homes to enable to them to relocate. The good news is that tighter housing inventories are providing a floor for US house prices, which are actually trending upwards in most markets. If the trend continues, it may presage further declines in the US unemployment rate.

Despite it being well covered in the press of late, we have to take a quick look at Europe, where nothing really has changed. However, we noted with curiosity that Angela Merkel, Germany's leader, essentially advocating integration, was quoted as saying that as a viable solution to Europe's problems, she envisions "radical" steps towards a political union in Europe that would include sharing an elected president. We posited this in a previous edition of *Veritas*, suggesting that if the EU was to survive, it would have to take on a more federal political structure, something that Ms. Merkel seems to think as well.

OUTLOOK

In the main, our outlook remains as it was in the Spring. Interest rates are still expected to rise, but the hike might be delayed because of the recent decline in the price of oil. This has temporarily reduced consumer price pressures, taking some of the inflationary threats out of the system. That said, with natural gas prices up 50% since the last edition of *Veritas*, the reduction in inflationary pressures might be short lived. Equity valuations remain compelling, and weaving together many data points including the positive readings on jobs in North America, low interest rates, historically strong personal and corporate balance sheets, expanding manufacturing in the US, we do not believe that stocks will continue to languish as they have. Furthermore, we do not see bonds continuing to receive the support they do currently. Given negative real bond returns, the yield trade should reverse in favour of conservative equities, a benefit to our clients.

STRATEGY

"If you are not willing to own a company for ten years, you have no business owning it for even ten minutes" (with apologies to Warren Buffet). Unfortunately, the ten minute holding period has become the order of the day, and the market's horizon has become commensurately short. With average holding periods of stocks now less than three months, fundamentals are of no consequence when one does not expect to own the company by the time they report their next quarterly, let alone their annual, results. In this kind of environment where stocks are rented and markets are afflicted with "short termism", discipline is required to look beyond next week to ascertain whether a company is one that one would want to own for the next ten years. But this is precisely what we as investors, charged with the stewardship of the assets of others, must do.
We will continue to own companies that have sound fundamentals, and try to avoid the torpedo stocks that lack them. Aiding in the effort is a focus on companies that put their customers and clients first.
Please do not hesitate to call for discussion.

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