

## A Confession

First and foremost, we advertise ourselves as fundamental, bottom up, company analysts. We must know with whom and in what we are risking our clients' dollars. And we are adamant in hewing to our categories of corporate tests - management, their financial record, their competence in building a business franchise and their awareness of potential risks, their commitment to managing cash flow, paying dividends and maintaining a fit balance sheet. At a minimum, we must tick all these boxes before selecting a company for inclusion in our portfolios.

The reason for basic tests is to reduce our future mistakes below the number of our past mistakes. Our tests are the accumulated scars of being wrong!

But, as the Hollywood starlet of the 1930's, Mae West used to say, "I used to be Snow White, but I drifted a little.", we are not completely averse to listening to more heretical voices in our business. These might include quantitative analysts, "the black boxers", or momentum investors, "rate of changers" or the technicians!

We confess we have listened to more than one technician in our lifetime. Heck, you never know when they might know something we don't. And there is a lot we don't know. We allow that we have brandished the odd ruler in investigating trend lines and ascending wedges. Don't ask what an ascending wedge is!

Our drift from the fundamentals is to try to appreciate investor psychology. We want to understand why markets or share prices are trading at odds with our fundamental perception of a company or the big picture. Always, we try to marry the action on the graphs with the underlying company fundamentals or the overarching macro forces.

## Sell in May and Go Away? Not Necessarily!

On Wednesday we visited with one of the great "fossil" technicians (his word not mine, but he was impolite enough to include me in the category) of the investment business. He is Ray Hanson of RBC Capital Markets. He is on his semi-annual sales junket, something we find extremely helpful. He had a story of change to tell.

Ray contends that from early March 2009 to its peak, the 43% equity rally is the biggest rally in the shortest period of time since the 93% rally off a bear market low of July 1932. He believes it is a false start. He poses a question of endurance. After the rally in 1932, the Dow gave up 2/3 of its gains before embarking on another uptrend. Most large bear markets average 30 months in length. We are only at 17 months as at June.

Ray's start point is the traditional four year market cycle. He suggests that the S&P 500's market bottom of 800 points in October of 2002 and which was followed by a bull market peak of 1,576 in October of 2007, set up the market for a severe 2008 sell-off.

He argues the high in 2007 deferred a 4-year normal correction cycle, and is as yet unfulfilled. He thinks we will not see the low in these markets until later in 2010 which would coincide with his expectations of two, four year cycles - 2002 to 2010.

He argues that the "re-inflation" equities that have fuelled the rally (and supported by no-rate interest rates) have now exhausted their upside run. Energy stocks, metals, banks, and speculative smaller companies are starting to break down. We would agree that their valuations by most measures are stretched. We see or hear little of the sustainable "green shoots" in the public statements or in the earnings from these companies. Well, let me qualify that, we know commodity prices and interest margins are well up from their lows but not enough to support the higher prices in the energy, mining and banking stocks, the heaviest weights on the Toronto market.

## Ray Hanson's Positive Story

Ray is not without some positive news. His charts of consumer staples, utilities, telephone companies, technology stocks, and bonds are constructive. For the most part these defensive companies and assets were left behind in the spring rally. They are bottoming. We guess that the winners will be sold and recycled into the laggards. While trading these swings is not something we do, the outcome is good news for us. It is in these groups and in deeply valued companies, that we have the greatest concentration of investment.

## Mark Carney's Tour - A slow recovery

Paralleling Ray Hanson in travels last week was the Governor of the Bank of Canada, Mark Carney. Mark's words were tempered. He spoke to a protracted global recovery. In our mind, the global economy needs time to heal from its dance with unsustainable debt. Mark Carney's bullet points were the "economic recovery...will be more muted than normal" and the lengthy recovery results from a "...synchronized global recession, fed by delays in restoring financial stability".

Which brings us to the conclusion that we think Ray's technical outlook marries that of Mark Carney's bank outlook. Or would that be the other way around? Regardless, Mark's commitment to hold the policy interest "rate at that level (1/4%) until the end of June 2010" tells us all we need to know about the fundamental vigor of the business cycle. Be patient.

Ray's conclusion to my colleagues was that we had lived through so many cycles that, "they should encase us in Lucite and place us on the boardroom bookshelf as a reminder of market cycles and of what market cycles can do to technicians and money managers".