



# MACDOUGALL, MACDOUGALL & MACTIER INC.

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## MONTHLY MARKET COMMENTARY

INVESTMENT RESEARCH

APRIL 2010

### March 2010 Review

	March 31, 2010	December 31, 2009	% Change
TSX	12,037.73	11,746.1	2.5%
S&P 500	1,169.43	1,115.1	4.9%
DJII	10,856.6	10,428.0	4.1%
NASDAQ	2,398.0	2,269.1	5.7%
10 Yr. Cda Bonds	3.57%	3.61%	(4)bp
10 Yr. US Bonds	3.83%	3.84%	1bp
90 Day Cda T-Bills	0.30%	0.24%	6bp
90 Day US T-Bills	0.15%	0.05%	10bp
US\$ vs. Can\$	\$0.9848	\$0.9515	3.5%

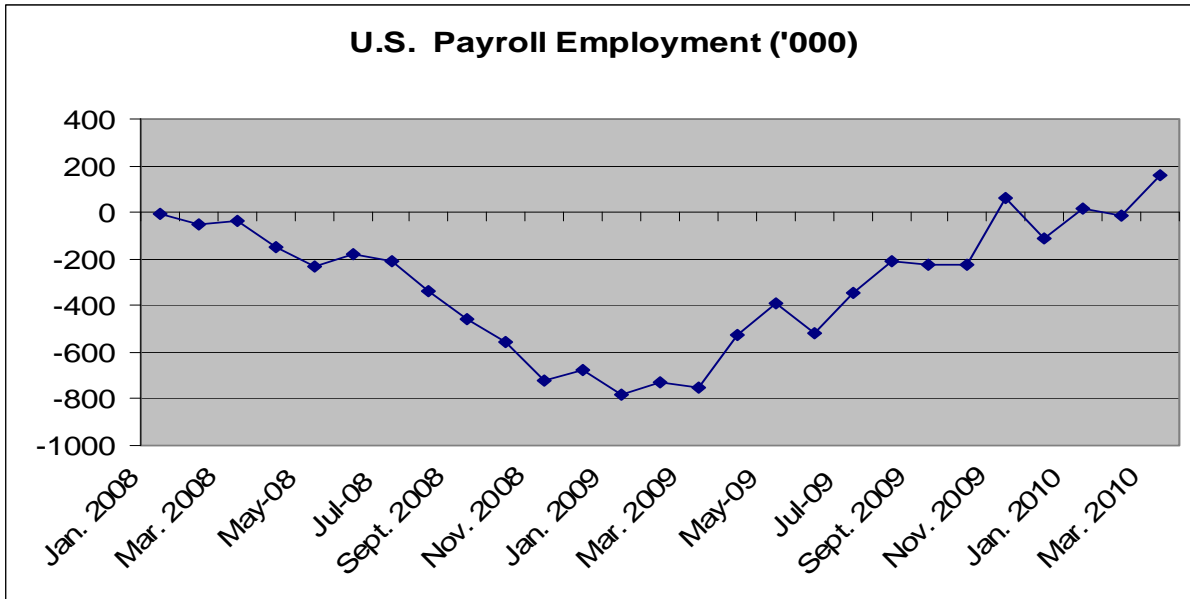
### Creating a Virtuous Circle

Stock markets continue to do well. Despite financial market concerns over sovereign debt risks in Greece, Portugal and Spain, the sizeable buildup in debt and deficits by many countries global stock markets have shown resilience as other economic numbers continue to show a definite sustainable recovery in the global economy. We use the word sustainable to imply the private sector (businesses) will “pick up the baton” from the public (government) sector in advancing the economy. We explain our reasoning below:

The latest job numbers (March employment figures) in the United States are impressive. The graph on the following page highlights the long journey to pass the “zero” line. A number above/below zero indicates jobs are being created/lost. Although we recognize this one month number may not be repeated in the next month (approximately 40,000 are related to hiring for the U.S. census), it is clear the worst is behind us and it is only a matter of time before job creation, as opposed to job losses, become the norm. Canadian job numbers (March not released as yet) have been much stronger, as gains have occurred for five of the last seven months. We concentrate on jobs as being an important, if not the most important economic variable for a sustained economic recovery. The argument for focusing on job gains is as more people are employed, consumer spending will increase. As consumer spending rises, businesses will hire more people as their

confidence (and sales) rise. A “virtuous circle” is created as further gains lead to higher consumer spending leading to more business hires leading to more consumer spending etc.

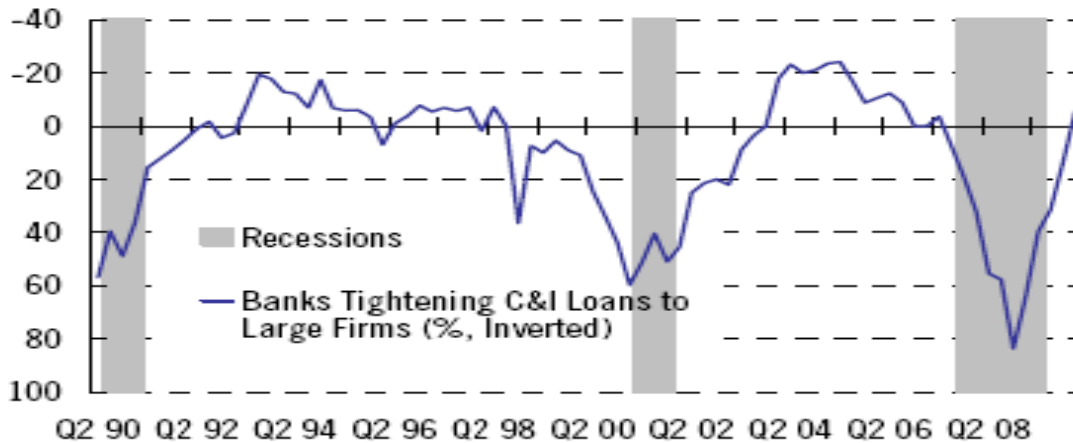
**The Start of a Virtuous Circle?**



Source: U.S. Bureau of Labor Statistics

Another encouraging sign for a sustainable recovery is based on the access to credit (money). In 2008, accessing credit became very difficult, as the traditional methods; equity, bonds and bank financing “shut down”. This necessitated governments to step in to provide access or facilitate credit to the private sector. Slowly, during 2009, the equity and bond markets opened up as we witnessed a rush of equity and bond issues, which continues today. The final channel to open up is bank financing which we illustrate below. A line above/below zero indicates financial institutions are making it easier/more difficult to obtain credit. This survey is conducted by the U.S. Federal Reserve. The line calculates the percentage of loan officers tightening/loosening credit. At one time in 2008 over 80% of loan officers indicated it was tightening (making it more difficult) credit. At the end of January 2010 loan officers indicated they were losing credit conditions.

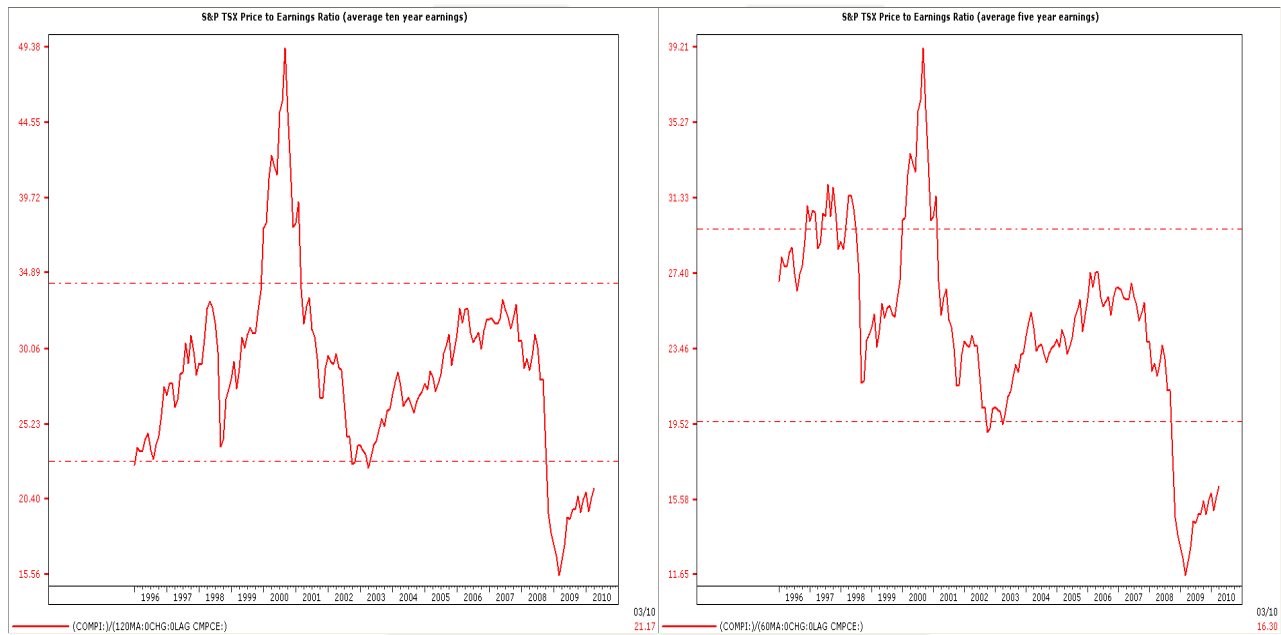
**US Loan Officer Survey 1990 to 2010**



Source: U.S. Federal Reserve Board

Finally, we highlight the valuation of the Canadian stock market in the graph below. Investors may feel the stock market is over-valued given its recent run-up. We use an adjusted price to earnings ratio to show that the Canadian stock market is far from being overvalued. A low/high price to earnings ratio indicates markets are inexpensive/expensive. Traditionally, to calculate the price to earnings multiple, one uses either the 12-month trailing earnings or the forecasted 12-month earnings. We use a slightly modified method. The left graph uses the average earnings over the past ten years to calculate the price earnings ratio while the right graph uses the past five years. For example, the current reading based on the left graph is 21.0X. The cumulative earnings of the TSX listed companies for the past ten years is \$5,732. We divide by ten to arrive at a ten-year average of \$573. Dividing this number into the current TSX index of 12,000 one arrives at 21.0X. We use average earnings in an attempt to “normalize” the earnings outlook. In recessionary conditions earnings are depressed, while in a strong economy earnings tend to be very robust. In both cases the market looks inexpensive.

**S&P TSX Price to Earnings (Normalized) Ratio**  
 (Left/Right graph uses an average ten/five year earnings in the calculation)



Source: Morningstar/CPMS

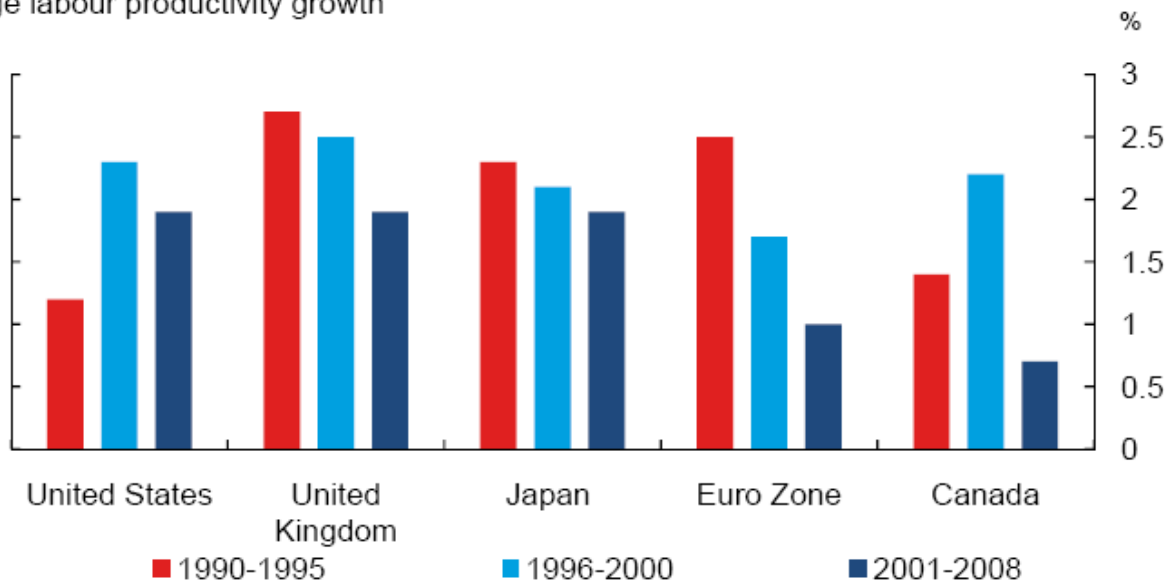
**Canada: Praise and Challenges:**

We were planning on devoting this second sector praising Canada, as the world appears to have noticed how the prospects for Canada look excellent. There have been various economic and media reports praising Canada. The title of one report was “**And The Winner Is...CANADA!** The term “winner” is used in the context of winning the Academy Awards. The report highlights the effective financial regulation that helped Canadian banks avoid the large losses that have “caused havoc in the U.S. and European financial sectors”. The report also notes how the fiscal (government debt and deficits) picture of Canada compares favourably to that of most other developed countries. The author of the report notes that Canada will be a major beneficiary due to its natural resource sector as the global economic recovery. The author sums up his view by saying “**Canada is in a favourable economic and financial spot.... And the equity market (Canadian) still merits an overweight for global investors.**”

After reading the report we felt quite good. As we prepared for this month’s commentary we heard some not so kind remarks about Canada from our own Bank of Canada Governor Mark Carney, scolding Canadians for the lack of productivity and innovations shown over the past decade versus other industrialized nations. Then a few days later another senior official from the Bank of Canada was also critical about Canada’s lack of productivity and innovation. We decided to review the evidence on Canadian productivity and innovation. Below are our findings.

Productivity is defined as the quantity of output produced by a given quantity of labour input. Productivity is not defined as a workers/countries willingness to work, but defined as the way one works. For example, if two workers are given the same task, say splitting wood, the worker who splits more wood in a given hour is said to be more productive at the task. It is likely the more productive the person (workforce) the higher the wages and benefits. All other things being equal (rarely the case) the higher the level of productivity, the higher the standard of living a country enjoys. A higher standard of living does not relate solely to wages but a better education/health care/ transportation system.

Average labour productivity growth



Source: Bank of Canada March 24, 2010

As stated above, having a productive workforce is not the only ingredient (witness Japan) to creating a vibrant, successful economy. Nevertheless, Canada’s productivity (output per work-hour) has been cut in half from the previous decades, but more importantly has lagged our trading partners.

It is easy to dismiss the lack of productivity growth when economic times are improving but as Governor Carney states “...the subject of productivity is described as too dull, or worse, too threatening for Canadians....However who would not want to be productive in their work? Is there a child whom we do not want to reach his or her full potential?...Our ambitions for the Canadian economy should be bold. We are a country of immense strengths and, as demonstrated during the recent crisis, considerable resilience.” The benefit Canada currently enjoys does not mean these benefits will last five or ten years from now.

Some of the reasons why Canada, as outlined by Governor Carney and academics, has lagged other countries are as follows:

- 1) Canada under-invests in machinery and equipment and training its workforce. Using our worker who splits wood, Canada may invest in more “axes” than “chainsaws”. One of the reasons given why this

under investment has happened in the past is the relatively high corporate tax rates, particularly for new investments. As Governor Carney noted, there is no excuse now as this has improved dramatically as Canada now has among the most attractive tax rates in the industrialized world.

- 2) Canadian workers have about half the amount of information and communications technology (ICT) of their American counterparts.
- 3) Although Canada has a highly educated workforce and seemingly all the right ingredients to be an innovative leader, it ranks 16<sup>th</sup> among OECD countries in the amount of business research and development. Some studies suggest “too many businesses in Canada are technology followers, not leaders”.

To paraphrase one of the Bank of Canada officers given corporate balance sheets in Canada are healthy, profits improving and costs of borrowing low there should be little reason holding corporations from modernizing.

In summary the short and medium-term outlook for Canada is excellent, but to build upon these positives there appears to be longer-term structural issues Canadians must deal with in order to keep pace with our global trading partners. Canadians need to improve on these longer-term issues or else we risk becoming last year’s Academy Award winner (who won?), a distant memory.

Sources:

- 1) And the Winner is.....Canada. BCA Research March 24, 2010.
- 2) The Virtue of Productivity in a Wicked World. Bank of Canada. Remarks by Mark Carney, Governor of the Bank of Canada. March 24, 2010.
- 3) Beyond Recovery: Sustaining Economic Growth. Remarks by Paul Jenkins, Senior Deputy Governor of the Bank of Canada, March 29, 2010.
- 4) Innovation and Business Strategy: Why Canada Falls Short. Peter Nicholson, Council of Canadian Academics, International Productivity Monitor, Spring 2009.

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Company

Ticker

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EPS	Earnings per Share
P/E	Price to Earnings Ratio
EBITDA	Earnings before Interest, Taxes, Depreciation and Amortization
Market Cap	Total Shares Outstanding multiplied by Shares Price
Enterprise Value	Fully Diluted Shares Outstanding
PEG	P/E Multiple Divided by Growth Rate
ADR	American Depository Receipt
WACC	Weighted Average Cost of Capital
Risk Free Rate	10 Year Treasury bond
Yield	Dividend divided by Share Price
ASP	Average Price
DSOs	Days Sales Outstanding
Capex	Capital Expenditures
CPU	Cost per Unit
EVA	Economic value Added
EV / EBITDA	Enterprise Value / Earnings before Interest, Taxes, Depreciation and Amortization
DCF	Discounted Cash Flow
Holts DCF	Holts Discounted Cash Flow
DYT	Dividend Yield Target
Yield	Yield
BSOPM	Black Scholes Options Pricing Model
BETA	Quantitative measure of the volatility of a stock, mutual fund, or portfolio, relative to the overall market
MF	Mutual Fund

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