



# MACDOUGALL, MACDOUGALL & MACTIER INC.

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## MONTHLY MARKET COMMENTARY

INVESTMENT RESEARCH

MAY 2010

### April 2010 Review

	April 30, 2010	December 31, 2009	% Change
TSX	12,210.7	11,746.1	3.9%
S&P 500	1,186.7	1,115.1	6.4%
DJII	11,008.6	10,428.0	5.6%
NASDAQ	2,461.2	2,269.1	8.5%
10 Yr. Cda Bonds	3.57%	3.61%	(4)bp
10 Yr. US Bonds	3.83%	3.84%	(1)bp
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%

### From “L” to “U” to “V”

The last few days of the month reminded us of some of the challenges the global economy faces, in particular the indebtedness of the industrialized nations. Greece is currently in the headlines as they will certainly need aid from their larger, financially strong, European nations to help them refinance their upcoming debt maturities. Some of the other smaller nations within Europe are vulnerable to refinancing risk if they do not enact dramatic budget cuts. To date, this debt related problem has been localized (specific to that country) and has not spread to the larger European countries, such as Germany or France. One can monitor this situation by looking at German ten-year bonds, currently trading at 3.0%, while Greece is at 9.0%. If investors felt the larger countries such as Germany or France was to face similar problems, their bond yields would not remain so low.

We are of the view that threats from the sovereign credit crisis, worries over interest rate increases or other “tightening” measures (especially in the emerging markets such as China) and regulatory overkill (e.g. U.S. financial service sector) will be trumped by the power of the ongoing business cycle, the near zero returns by holding cash and strong corporate profits. We view any stock market correction as an opportunity to buy equities.

Economic indicators are pointing to a robust economic recovery with the emerging market economies of Brazil, Russia, India and China leading the way followed by North America, Europe and Japan. The initial signs of economic stabilization prognosticators were warning the outlook for the economy would resemble an “L”, implying the economy would not get worse, but an improvement was unlikely. As the initial signs of an economic recovery was occurring (e.g. industrial production) the “L” became replaced with a “U”, implying the recovery was happening but only at a modest pace. Today, the “U” has turned into a “V” (still with us?) implying the economic recovery is happening at a much more rapid pace. Below we quote various economists:

“ALERT! U.S. RECOVERY STRENGTHENING. Last week saw unexpectedly strong US retail sales, following a return to significant job creation. This week saw an unexpected surge in the leading indicators. The implication is that the US recovery may become stronger than we had been expecting.” –DundeeEconomics April 23, 2010.

“But the recent upside surprises (on the global economy) on activity, and in particular in capital spending, retail demand, and industrial production, are inducing us to recognize clear upside risk, in particular in the US and Japan. Company earnings are coming in even more impressively, with recent US earnings announcements already leading to a more than 10% upward revision in the Q1 consensus.” –J.P. Morgan April 23, 2010.

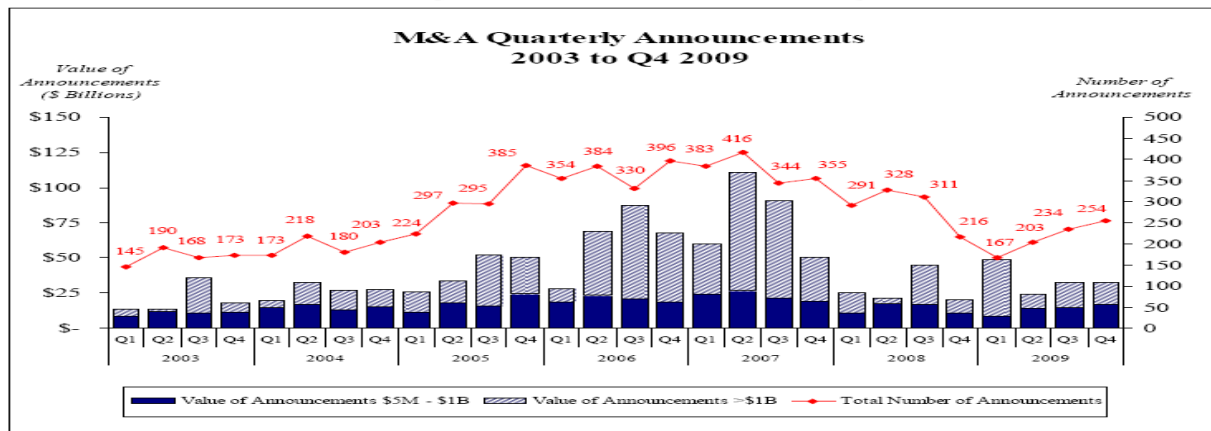
“As we have repeatedly warned in the past, U.S. GDP growth could accelerate to a more than 5% annual rate going forward, as projected by our model. In the meantime, the economy seems to be on the cusp of a major rise in job creation over the next few months.”-Bank Credit Analyst, April 23, 2010.

We do not want to give the impression all economists are predicting a robust recovery, but the tone is decidedly much more upbeat than even three months ago. Even central bankers, normally conservative in nature, have acknowledged this recovery is occurring faster than expected. For example, the Bank of Canada commenting on the economic recovery in Canada states; “In Canada, the economic recovery is proceeding somewhat more rapidly than expected in January.”-Bank of Canada, Monetary Policy Report, April 2010

There are still many issues the stock market needs to come to grips with but the short to medium-term outlook looks quite bright as the combination of low interest rates, an improving economy, rising profits and reasonable valuations should support higher equity prices.

### The Upcoming Mergers and Acquisitions Boom

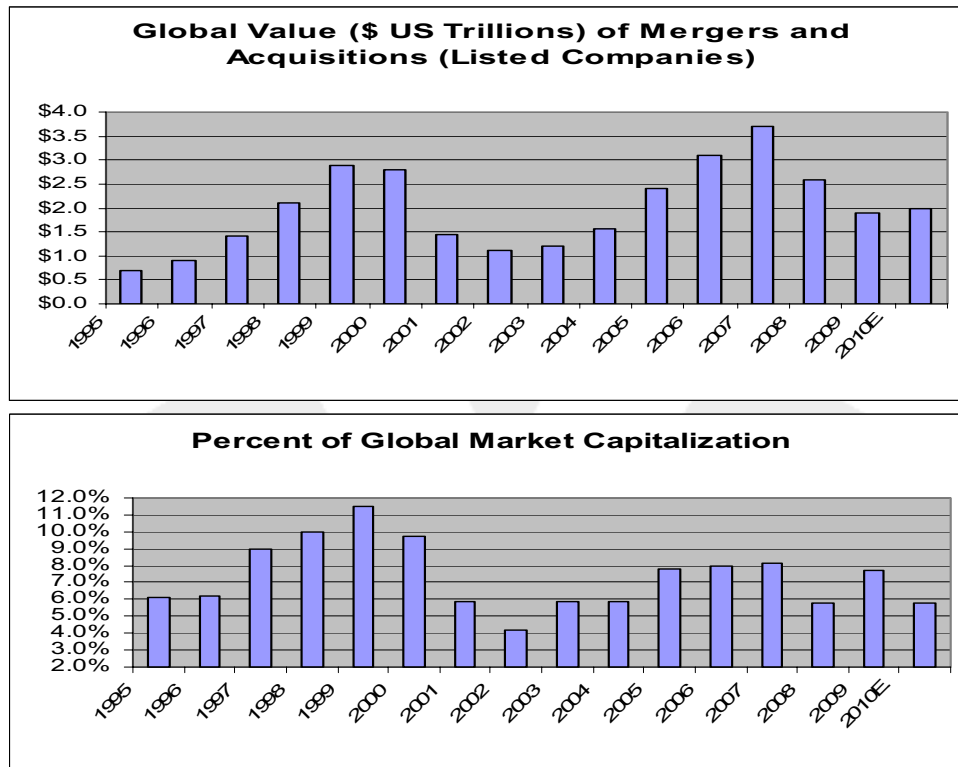
Mergers and Acquisition (M&A) activity in Canada and globally is recovering. Canada for example, saw the fourth quarter of 2009 as the third consecutive quarter of increasing activity, while globally, 2009 appears to have been the bottom of the cycle and 2010 looks like the start of a multi-year rebound. The graph below illustrates the number of deals announced and the dollar value of them (in Canada).



Source: CROSBIE

During the fourth quarter of 2009 the three largest transactions in Canada included Ontario Teachers' Pension Plan and Canada Pension Plan's proposed \$6.6 billion takeover of Transurban Limited, the \$4.1 billion acquisition of Harvest Energy Trust by Korea National Oil Corporation and New Brunswick Power Holding Corporation's sale of power generating assets to Hydro-Quebec for \$3.2 billion. One interesting note is in 2009, the value of Canadian acquisitions abroad exceeded the value of foreign takeovers of Canadian companies by a ratio of 1.2 to 1, the first year since 2004. We question the notion that Canadian businesses are being "hollowed-out". We view the opposite as with our strong Canadian dollar, banking system and balance sheets that Canadian corporations are in an excellent position to be the acquirer not the acquired.

We illustrate the level of activity, projected for 2010 versus prior years in dollar terms and as a percentage of market capitalization.



Source: Citigroup

The pattern of M&A is predictable. Typically, there is a two to three year lull, normally associated during a recession, whereby financing (equity and debt) is difficult to obtain and confidence by the management of companies towards the economy is low. As signs of a recession are ending, financing becomes more available and management confidence rises, this increases the level of M&A. We believe we are in this "pick-up" stage as financial conditions, economic activity and management confidence have improved noticeably. The peak in mergers and acquisitions activity is typically defined as the peak in economic activity. We point the reader to the year 2000 which marked the end of the technology boom and the peak in economic activity. At that point in time, the cost of equity was very inexpensive (high price to earnings ratio), especially for technology related companies, providing them the incentive to go "hunting".

In 2007 it was the cost of corporate debt that was very low providing the necessary incentive for management to act. We do not know which form of financing will prove to be the cheapest (perhaps a high Canadian dollar or other currencies versus the U.S. dollar), but the trend towards more mergers and acquisitions will be noticeable as the business cycle matures. We are still in the early stages of this trend/business cycle. In the next monthly comment, we will comment on the reasons for and outcome on mergers and acquisitions.

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**Director of Research**

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<u>Company</u>	<u>Ticker</u>	<u>Disclosures</u>
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Glossary of Terms:

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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