



MACDOUGALL, MACDOUGALL & MACTIER INC.

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MONTHLY MARKET COMMENTARY

INVESTMENT RESEARCH

NOVEMBER 2011

October 2011 Review

	October 31, 2011	December 31, 2010	% Change
TSX	12,252.1	13,443.2	(8.9)%
S&P 500	1,253.3	1,257.6	(0.3)%
DJII	11,955.0	11,577.5	3.3%
NASDAQ	2,684.4	2,652.9	1.2%
10 Yr. Cda Bonds	2.28%	3.12%	(84) bp
10 Yr. US Bonds	2.05%	3.29%	(124) bp
90 Day Cda T-Bills	0.91%	0.98%	(7) bp
90 Day US T-Bills	0.02%	0.12%	(10) bp
US\$ vs. Can\$	\$1.012	\$1.002	1%

Super Mario to the Rescue?

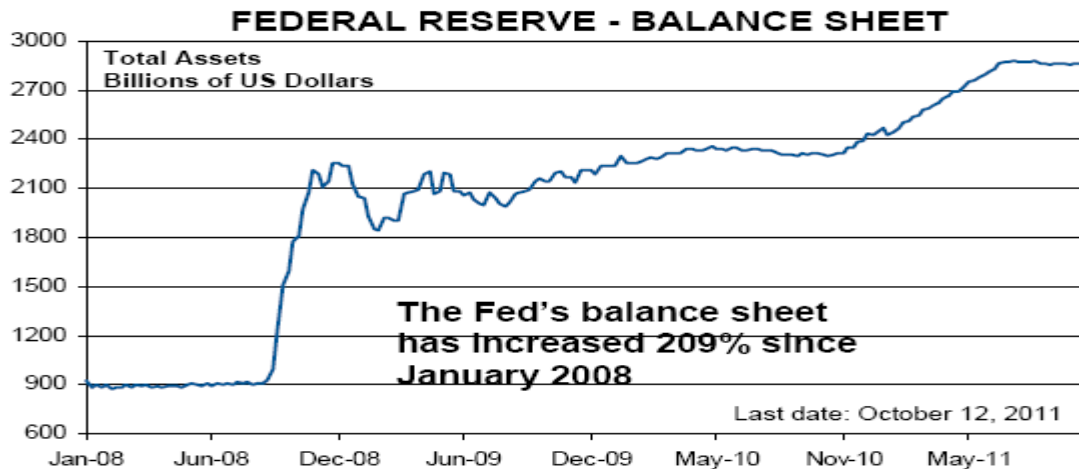
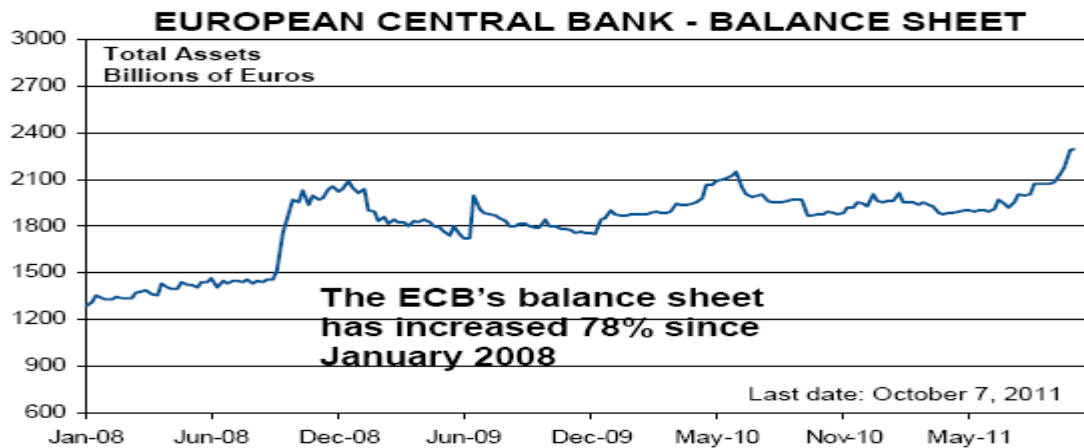
The month of October was a strong one for equity investors. In Canada, September's loss was partially reversed by the strong month of October with the TSX up 5.4%. In the U.S., all major stock markets reversed September's losses. For the month the S&P 500 was up 10.4%, the Dow Jones up 9.5% and NASDAQ up 11.1%. The prime cause for the rally (some call it a relief rally) was due to the agreement the Euro-zone members struck with the financially troubled country of Greece. Prior to the agreement many investors felt the financial markets would need to go through another "Lehman" moment, whereby a sudden default from a relatively small country, in this case Greece, would cause a massive ripple effect across financial markets and another severe recession. Last minute negotiations among Greece, France and Germany prevented this from happening, despite some nervous events along the way. There are other European countries that will likely need assistance (think Italy and Spain) so this saga is far from over, but we do feel we have a powerful friend/ally in the newly appointed President of the European Central Bank (ECB), Dr. Mario Draghi (or his nickname has become Super Mario). He assumed the presidency of the ECB on November 1.

Dr. Draghi is well versed in financial markets and is a trained economist, unlike the previous ECB boss Jean-Claude Trichet. Dr. Draghi earned his doctorate in economics from MIT and studied under two Nobel laureates; Dr. Franco Modigliani (known for his work on capital markets and monetary policy) and Dr. Robert Solow (known for his work on economic growth). In contrast, Mr. Trichet's education was in political science.

Dr. Draghi's first decision as President of the ECB was to lower interest rates by one-quarter of one percent. This may seem a trivial move, but this was not expected, as most forecasted Dr. Draghi to continue the policies of the former president and leave interest rates alone. Mr. Trichet's philosophy and indeed the ECB is deeply rooted in a different era: an era of high inflation.

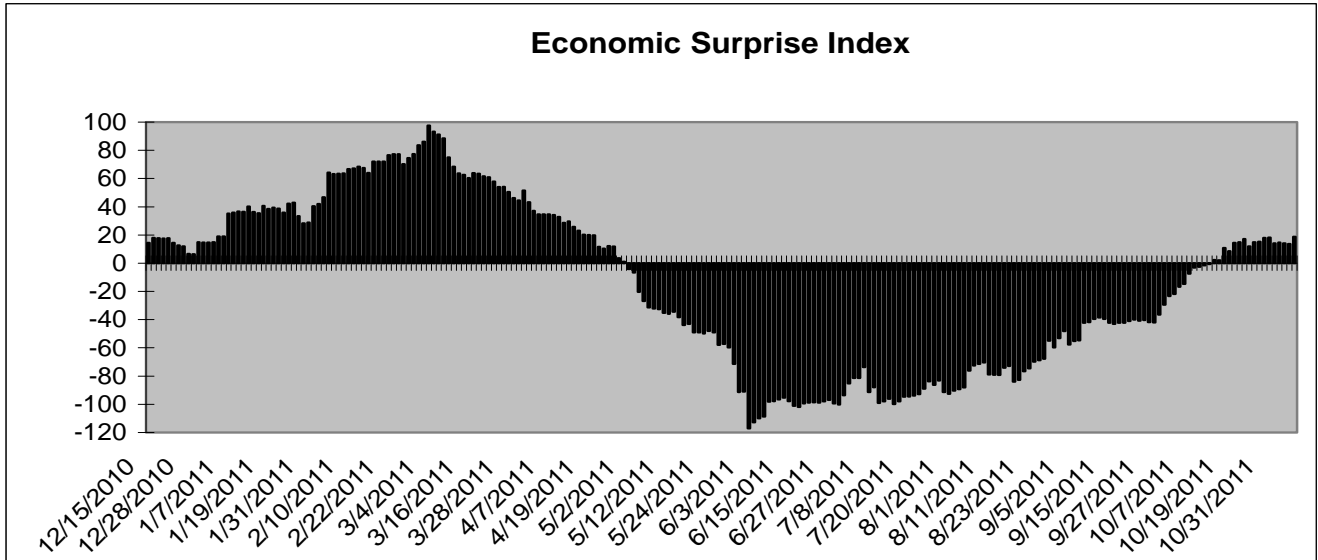
Our view is Dr. Draghi is looking at the world through different coloured lenses and is much more pragmatic/realistic seeing the European debt situation as it is; a potentially deflationary world event (recession, banking crisis) if left unattended. Political leaders may "fumble" for a solution in the short-term, but we expect the ECB to be more proactive in bringing stability to financial markets, similar to the U.S. Federal Reserve. In our view it is too late to prevent Europe from falling into a recession, but the potential contagion spill-over affects from Greece and other stressed countries can be muted with a proactive central banker.

Below we illustrate how much the Federal Reserve has done to support financial markets versus the European Central Bank. The "ammunition" to support the European banks/financial markets is certainly available and we can only hope the new man at the top will not be shy, should another country debt crisis arise, to use his "dry" powder.

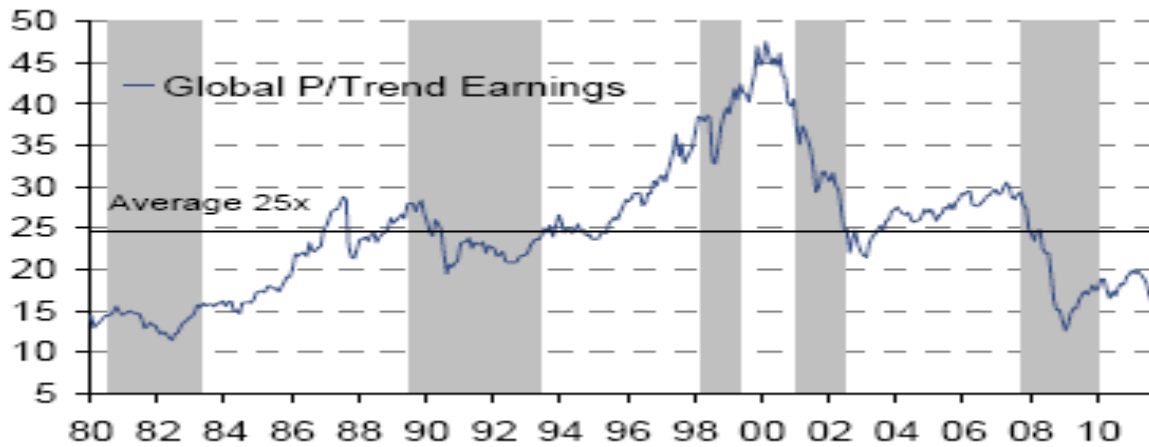


Source: Dundee Economics

Across the Atlantic Ocean the view is much brighter. In the United States, economic releases have been encouraging and generally surpassing economists' expectations. Below is an index (Citigroup Economic Surprise Index) that captures economists' expectations versus the actual numbers. A positive/negative reading indicates more/less strength in the United States than expected. As we write this, the index readings are positive and are at levels not seen since the spring of 2011.



In addition to the better than expected economic statistics, U.S. and Canadian companies have been reporting third quarter earnings stronger than expected. As the U.S. bank *Citigroup* notes, "About 69% of firms (U.S.) have reported above-consensus results compared to a long-term average of 62%". The 2011 S&P earnings in the U.S. are on track to be in the \$100.00 range implying a relatively low P/E of 12.6X. It is not just the U.S. equity market that is inexpensive, but global markets. We illustrate this below. This graph, courtesy of *Citigroup*, is the P/E of the MSCI World Equity Market using a ten-year average earnings (to smooth out cyclical extremes).



The sovereign debt situation will be with us for many years, but the European debt problem must be solved by the Europeans. It is unlikely other countries (think China), as has been suggested, will participate financially in any significant manner. Europe is a rich continent and has the resources to deal with their problems. The most likely scenario is that the stronger countries (Germany) will come to the aid of the financially strained countries, if the Euro and Euro-zone is to survive. Eventually an arrangement will be agreed upon, but how to share the pain among the different countries/members is the major headwind to a quick settlement.

Ian Nakamoto
Director of Research

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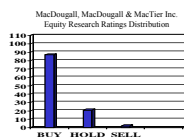
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Glossary of Terms:

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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