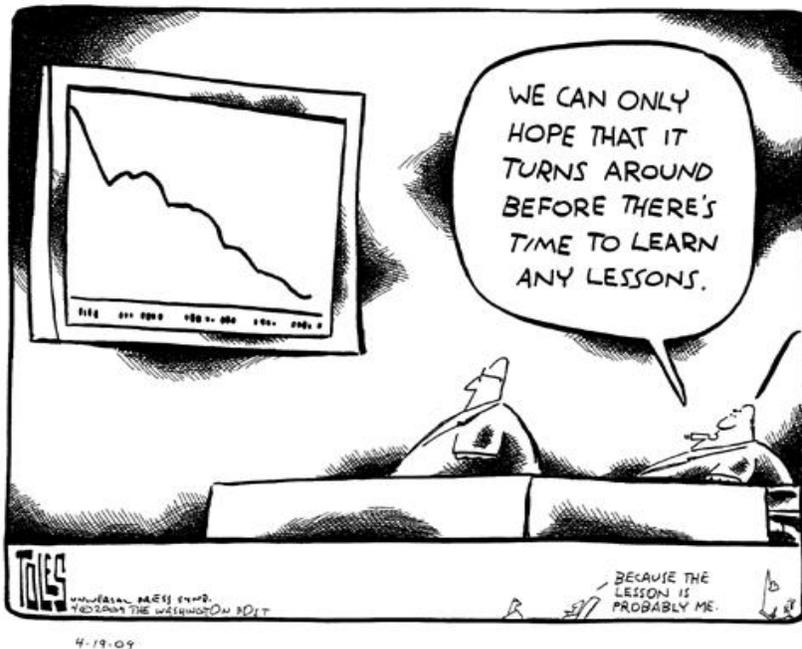


E.Q Trendwatch™

March-April rally brings near-term test



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Interview of Economist Nouriel Roubini, April 20, 2009:

Steve Forbes: *What is the best financial lesson you have ever learned?*

Nouriel Roubini: *It is that, you know, it is better to be safe and be cautious and not to leverage too much. You know, leverage can be deadly. I mean, I think it is crucial [to understand this] of capital and equity, in corporations, in financial institution and also in the household sector. You know, when your households were buying homes with zero down payment, the leverage was infinite, it was even worse than financial institutions. So I think leverage is deadly. I think that is the lesson. We need more capital or equity; a little bit less debt, relatively speaking.*

Steve Forbes: *And finally, other than your own books, what is*



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the best book you have ever read, [the best] financial book? [We felt sure he would say "Juggling Dynamite"!]

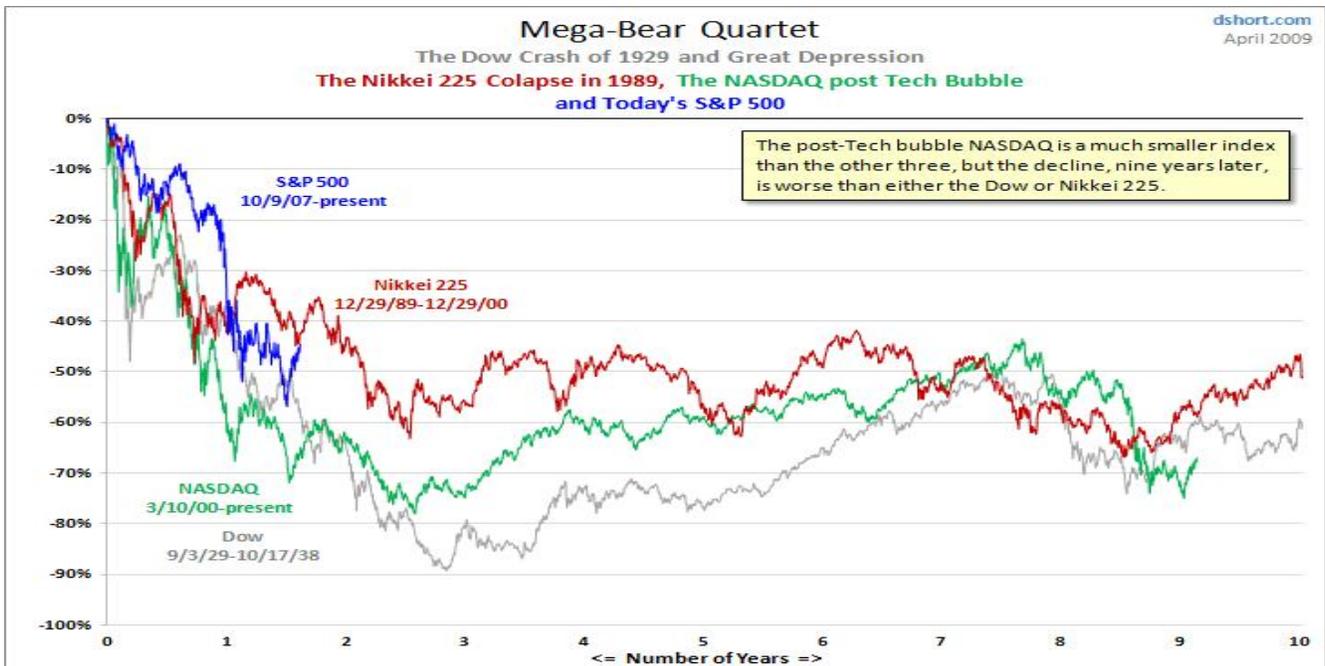
Nouriel Roubini: *Some of the classic selections, you know, The Great Crash by Galbraith. You know, you go and reread those books and you change the dates, and it is amazing how much things look like exactly the same. It means that history repeats, you know? In many ways, financial crisis are very similar to each other. And as we know, if we do not learn from the past, we are going to be bound to repeat the same mistakes. Hopefully, next time around, we will learn the lesson and we will have a more robust system.*

VPIC comment: We would have to agree whole-heartedly with both of Roubini's answers.

Equity markets update

As Galbraith so aptly put it: "there are two classes of forecasters: those who don't know and those who don't know they don't know". In the face of this reality, every day we must use practical tools to manage risk to capital in an uncertain world. And right now we seem to be at a pivotal juncture in market psychology.

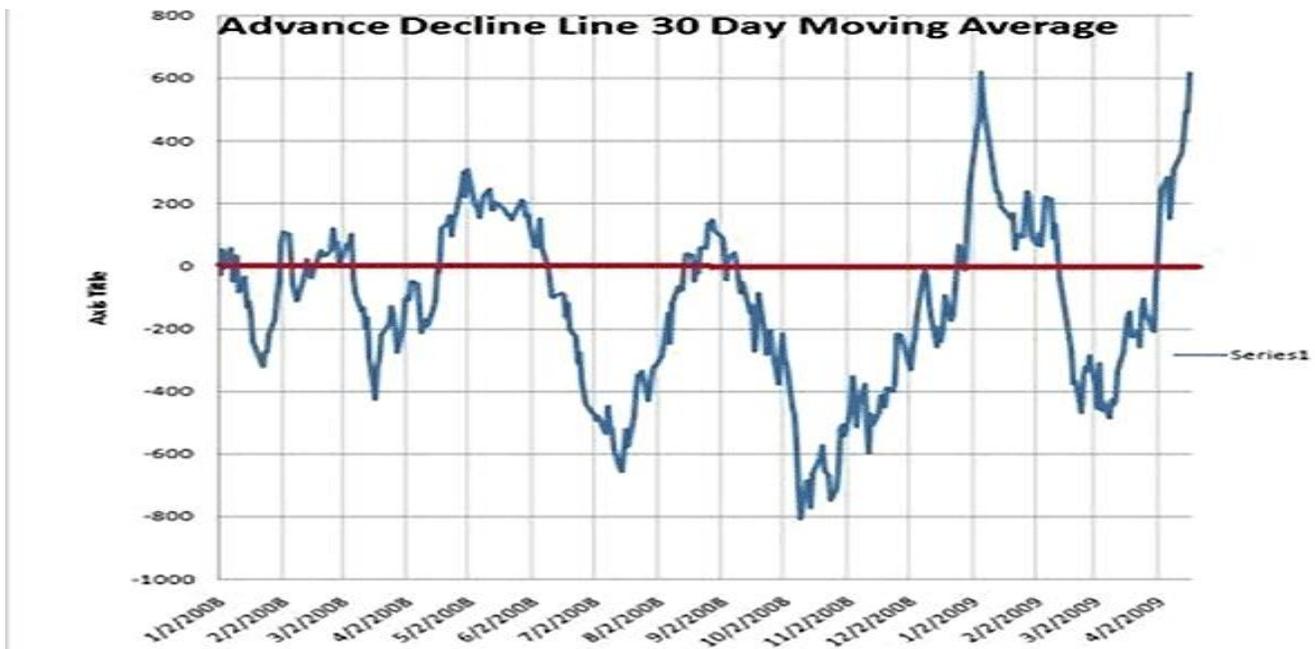
As we look at the chart below of the four worst markets in the last 80 years, we can observe with some certainty that this bear (in blue) has either seen its bottom, or is more than half way there...hmmm.... scarce comfort can be found in this conclusion.



From the March 9 lows, world markets staged an impressive rally. The S&P 500 climbed more than 29%; the TSX more than 25%; technology in the form of the NASDAQ is up 35% and the Canadian banks more than 50%. Meanwhile year to date returns have been much less stellar with the TSX up 5.6% and the S&P 500 down 2.85% so far in 2009. The fact that financials and technology have led the recent rally could be a promising sign. For a long time we have mentioned that financials and tech traditionally lead a sustainable market expansion; and without their leadership interim rallies are suspect at best.

We would love to believe that recent strength in these sectors signals the start of the next cyclical bull. But alas, it is still premature to call an “all clear”. **Until the short term moving averages succeed in breaking through the long term moving averages, markets are so far still in a cyclical bear, within a secular bear market, and so defensive action is still the order of the day.**

As shown in the chart below, at April 17, 89.2% of the S&P 500 share prices were trading above their 30-day moving average making them “overbought’ on this metric. This is not to suggest that they cannot stay overbought for some time yet, but as the chart shows, each time markets get this overbought, eventually a pullback corrects the imbalance.



Source: Capital Observer

Whatever the eventual status of the March-April rally, from present levels another downside test or two is probable and likely in the not too distant future.

The following charts tell the story of the dramatic bear market rally we have seen over the past two months.

Technology



Canadian Financials



Canadian TSX



Canadian dollar



As we have marked above, the snap back rally is now hitting some formidable resistance at the horizontal blue lines. Only the next few weeks or months can tell the tale of whether markets are able to break through overhead resistance and signal the next

cyclical bull.

In the interim, pullbacks are normal, healthy ways of releasing exuberant demand from overbought markets. The real question is whether the next downside test will need to revisit the lows of March. It is possible that future retests, dramatic as they may seem, will bounce higher than the March lows. If markets were to reach even the November lows for example, we think it possible that waves of buying there may well arrest the next decline above this bear's worst levels from March. Given the probability of decline here though, the best course of action is to guard gains and be grateful for them.

And so we have taken the opportunity at the end of April to reduce our initial equity positions that we entered in early February. In doing so, we have now taken profits on the Canadian financials (XFN), Canadian TSX 60 (XIU) and the NASDAQ (QQQQ) positions we held. At this point and unless or until they break down from here, we still have partial positions in the S&P 500 (SPX), Canadian Reits (XRE) and the Canadian Dividend ETF (XDV).

The long always cheerleaders are still out in full force, urging everyone to buy, buy, buy. But they always say that, so we have learned to filter out the noise of perpetual optimism.

At the other end of the spectrum there is now a famous club of "bear" commentators who called the downturn a couple of years ago and are now continuing to receive significant media attention with dire predictions of untold doom yet to come.

Yes, our firm called the downturn as well, and yes the PR for getting that right and protecting our clients has been very positive. But before we become intoxicated with the views or prophetic abilities of ourselves or anyone else, we are insistent on keeping affixed to practical plans and sober thoughts. The truth is that no one can actually predict what the stock market does next. Not Meredith Whitney, not Nouriel Roubini, not Richard Russell, not little old us.

As we have said many times, all we can really do is calculate the probabilities of various outcomes. All we can devise are management rules that track the actual trends of money flow in world markets and respond prudently and in keeping with the goal of participating where possible in the up trends and avoiding the bulk of each downtrend.

In the big picture, a challenging economic backdrop is likely to continue for some time. Our prior excesses have earned us a slow recovery; the journey back to health will take some time. In money management, method and daily diligence will likely continue to trump blind risk and auto-pilot hope. Those who are not up for real work now should fess up and step aside.

Those betting on great doom or great boom from here are both likely to be caught without a workable plan. For those that have devised an objective method for participating in market rallies and limiting downside exposure, life and wealth building are likely to go on just fine.

Creative solutions are born from crisis

"Everyone stumbles over the truth from time to time, but most people just pick themselves up and hurry off as though nothing ever happened."

--Winston Churchill

Crisis has a way of crystallizing insight. For the first time in several years, many people today are engaged in creative thought and honest discussion about important issues.

Right now, it seems more people are stumbling over truth and stopping to pick it up and pass it around. The following are just some of the exciting developments that are springing out of this time of adversity:

- A fresh realization that financial "architects", leverage and debt are not saviours of our brave new world, but the same old demons back from history to haunt us yet again. See Taleb: [Ten principles for a Black Swan-proof world](#).
- A realization that hard work and daily focus on building our expertise, profession or business have always been the most reliable source of wealth creation in the world. Blindly tossing our savings at passive investment in other people's companies is a crap shoot more likely to destroy capital than build it.
- Those that have stubbornly insisted on maintenance of their cartels and a self-serving status quo are toppling. Big oil and big "dumb" automakers are being overtaken by new solutions that will drive the economy, create jobs and resolve the pressing issues of our planet.

- Clean, alternative energy and water management are the next big boom areas for the world. And there are many brilliant initiatives already available:
 - **Wind turbines and solar panels** can efficiently take our homes off the conventional power grid;
 - New innovation being developed to triple the fuel efficiency of regular cars. The race to 100 miles per gallon is now full out and will be achieved in the not too distant future;
 - Huge leaps are being made in **fusion technology** towards an almost endless supply of clean electricity with virtually no radioactive waste.

Far from doom and gloom, we think this is one of the most exciting, hopeful times to be alive in all of human history. With a multitude of ingenious inventions and innovations already in the offing, all of the choices that we make from here will define our future.

Quotes of the month:

"Don't mistake personality for character." -- Wilma Askinas

"Real people live with fair value accounting every day. When you go to a bank for a loan and use your stock portfolio as collateral, the bank is not interested in what you think the assets may be worth once they recover."

-- Kurt N. Schacht

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