Real life needs active management FEBRUIARY 29 2008. ISSUE 2

E.Q Trendwatch™

2008: The winter of discontent

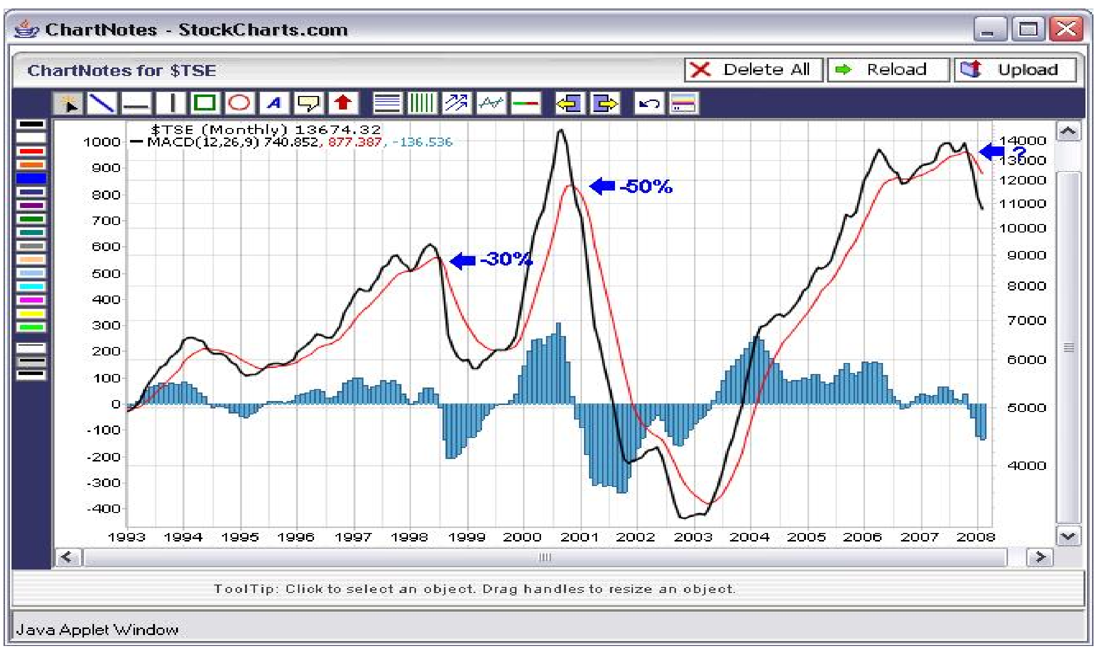
"There are fears of recession, write-downs, bank failures, stagflation, a weak dollar and stocks crashing. It is a very dire situation." ***- Charles Comiskey head of U.S government bond trading, HSBC Securities USA Inc.***

Cory Venable CIM, FCSI, CMT
Technical Market Analyst

So much has happened during the month of February it is hard to know where to begin. Suffice to say the economic data over the past 30 days has continued in its unanimously negative trend to the shock and dismay of those who were not expecting the current downturn to transpire.

Danielle Park LL.B., CFP, CFA
Portfolio Manager

Equity prices have continued in their downward channel continuing the bear market that began around the world in 2007. The last two times the signal line broke below trend on the TSX was in 1998 and 2000 when bear markets swiped -30% and -50% respectively from the value of invested capital. See arrows below. We are monitoring it now very carefully to see how this bear will play out, as we wait safely at arm's length.



TSX (Canadian stock Index) MACD 1993 to February 28, 2008

Venable Park Investment Counsel Inc.

Venable Park Investment Counsel Inc.
VIIP
www.venablepark.com

33 Clapperton St.
Barrie ON L4M 3E6
Tel: (705) 792-3991
Toll Free: 866-792-3991
Fax: (705) 792-3992

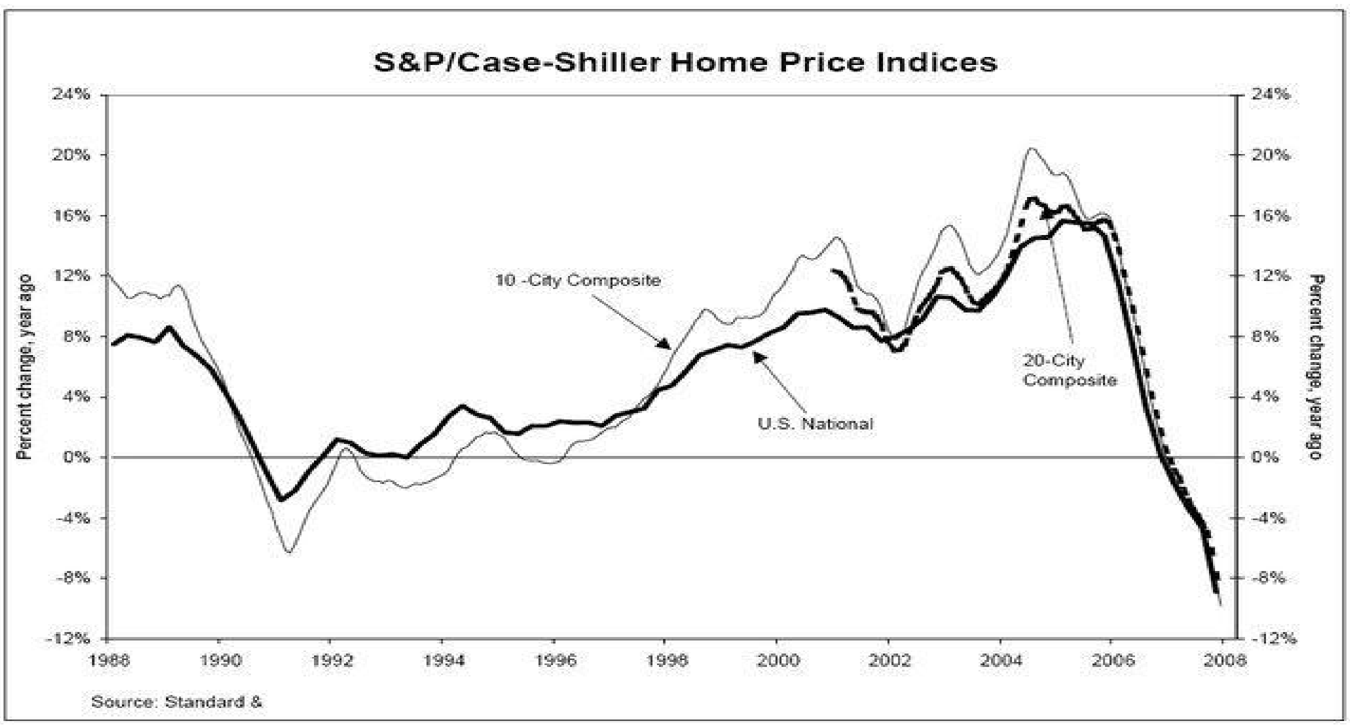
A recap of where we are and how we got here

This month the housing data from the US and many other countries around the world (Europe: UK, Spain, Ireland, Central and Eastern Europe) confirms a bubble market in the breaking. All over sentiment has widely turned from a passionate love of real estate to a passionate loathe of real estate, as many people are now caught on the wrong side of falling prices and rising mortgage rates. It is important to note that even though the US Federal Reserve has dramatically slashed rates and poured liquidity into credit markets over recent months, mortgage rates in the US have actually moved higher.

This is making life very difficult for consumers that are already over-levered and behind in their monthly payments. A whole new crop of slogans and services are now evolving into popular culture courtesy of this crisis. There are a host of services appearing to help people walk away without paying their debts. One popular site is called youwalkaway.com where people pay $995 for expert advice on how best to hand their homes to the lenders in foreclosure. Another popular term is “jingle mail” referring to the thousands of people who are now mailing their house keys back to their mortgage companies in lieu of payment.

Frankly, who can blame them? The facts facing many are almost too ugly to imagine. (Although we at VP did foresee this train-wreck scenario as long ago as 2005). Today a now common tale was featured on CNBC where a man who had purchased his home for $455,000 in 2005 with a teaser rate mortgage, today finds himself walking away with a mortgage still owing of $453,000, and a home recently valued at $285,000. He says the bank can have it. Most others in the same scenario are coming to the same conclusion.

The latest Case/Schiller Housing Index released this week paints a vivid portrait of the housing market’s ongoing decline to the end of November.

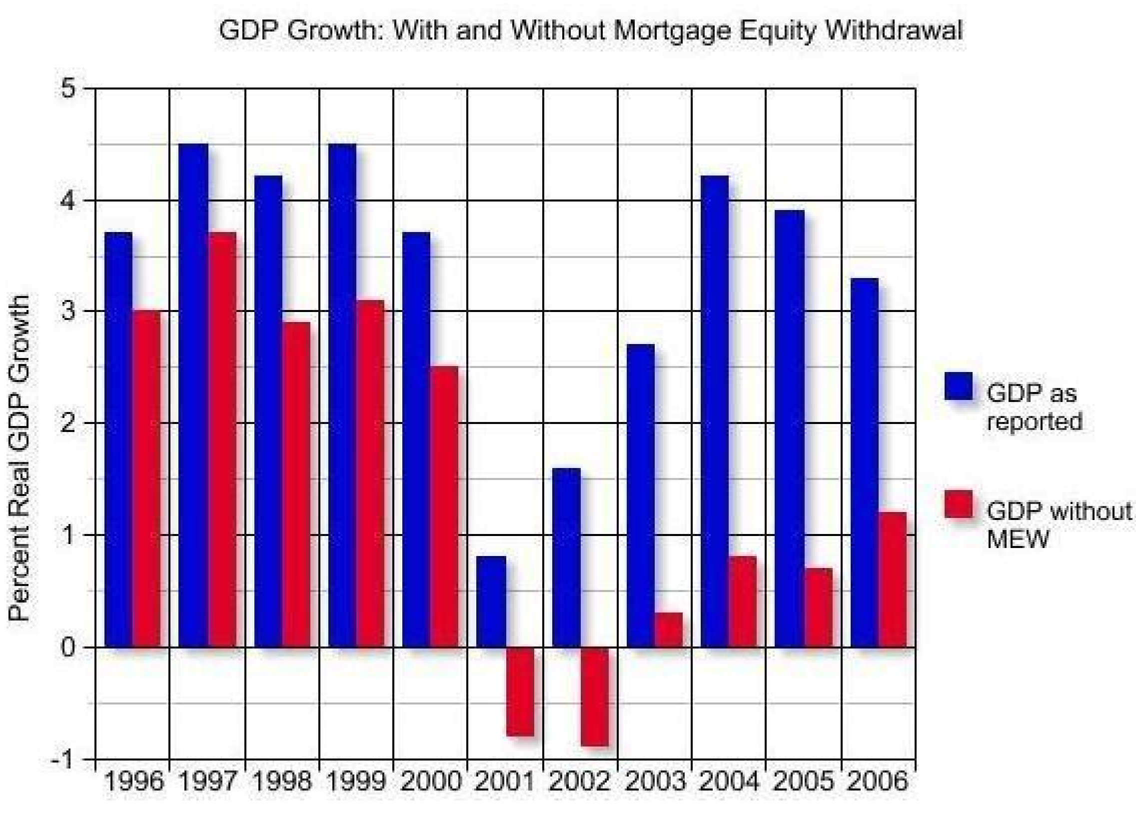


Prices have already contracted 3 times more than they did at the bottom of the 1991 housing recession.

While average home prices have fallen almost 10% to the end of November, there is still no bottom yet in sight. At a present decline of -10% in home prices some 16% of existing US homeowners already have negative equity values in their homes (ie., their mortgage is bigger than the market value of their house). If prices drop further to an average decline of -15%, some 10 million households would have some 2.6 trillion of mortgage debt "under water." The keeper of this index, Robert Schiller, believes that prices could fall by an average of 20-30% before a bottom is reached.

Meanwhile the US housing industry is still pumping out new homes at a rate of 1.2m a year. With an existing inventory of unsold homes at more than 10 months supply, the construction industry really ought to stop building homes completely for 2 years in order to let demand absorb the existing supply. But of course, the housing industry is not able to stop on a dime. They will continue to build, although their rate of build will necessarily fall below 1 million units per year over the next few quarters. At the peak in 2005, they were building 2 million units a year. So the slowdown will necessarily detract from employment and growth and it will take some quarters for demand to rise again and firm up housing prices.

AND LET'S REMEMBER WHY THE REST OF US CARE ABOUT THE US HOUSING MARKET:



Source:* *www.frontlinethoughts.com

This chart tells the inconvenient truth: without pumped up housing prices and "mortgage equity withdrawals" (MEWs) from 2000 to 2006, the US would have experienced 2 full years of economic recession and GDP growth that averaged less than 1% for the past 8 years! Without this housing supported growth in the US, Canada its most dependent feeder fish, would also have suffered very sub-par growth. To just say that Canada has come to sell more of our raw materials to India and China this cycle is to omit the fact that much of the demand from "Chindia" for our raw goods was in response to the developed world's demand for their finished products. Much of this demand for finished goods came via the over-levering of housing markets as people bought more, re-financed and bought more again. For now at least, the music has stopped. People with falling home values, and negative equity do not borrow to spend.

A new study was presented in NY, NY Friday on the current state of the credit meltdown and what losses are so far evident. It's called "Leveraged Losses: Lessons from the Mortgage Meltdown". Those with an interest can read the full paper at http://www.brandeis.edu/global/rosenberg_institute/usmpf_2008.pdf.

A year ago, optimistic calls were that subprime write-downs would amount to a smallish 50-100 billion all in. Now at the end of February, the best estimation is that bank write downs will sum to the 400 billion range. And because this will deplete the value of assets on reserve for banks, this will have a magnified impact on their ability to make loans: a write down of 400 billion amounts to a loss of about 2 trillion from available credit in the system. Almost a full trillion of that will evaporate from credit that would otherwise have been available to consumers and business.

So consumption will continue to slow for some time yet. Consumers will have to work at paying down their debt, or declaring bankruptcy and build up some savings. These are all necessary and ultimately positive, healthy trends. In the meantime, corporate profits will continue to compress, and the economy will continue to contract and those who are not prepared will continue to be surprised.

Opportunities flow from assets re-pricing

The most immediate impacts of the US downturn, and the Federal Reserve slashing interest rates is that the US dollar has continued to fall as against all of the world's major currencies. This has been supportive of higher prices in our energy and gold index holdings. Those up-trends are still in play, although adding new capital to these sectors at present levels would be highly speculative.

Meanwhile assets that have been over-priced and unattractive for the past several years are now falling closer and closer toward our value buy zone. Things like financials, REITS (real estate investment trusts) and Semiconductors (see chart below) have been badly hit in this downturn. As prices come down, their dividend yields go up and their price/risk becomes decidedly more attractive. Some assets are already at price levels not seen since the bottom of the last downturn in 2002. This is devastating for anyone who has been holding these investments over the past several years, but it is good news for those who have been out and patiently waiting for this inevitable retracement. So far prices are still dropping, so we have no interest in grabbing falling knives. But the turn will come eventually and our work will signal real opportunity.

Semiconductor index (SMH) in C$ terms-showing present levels testing 2002 price bottom

At a future point we will be looking to add some more US dollar exposure to our accounts. Of late the Canadian economic numbers have also turned decidedly soft after a year long lag where it seemed that the US economy was falling apart without us.

Now each week brings confirmation that we in Canada are actually not immune to the fate of our southern neighbour. Our economy is still a minnow to the US whale, and we will continue to be reminded of our symbiotic relationship with them over the coming months. This should ultimately prove corrective of our currency which will once again make US based holdings more attractive for us to own.

Quote of the day:

> *"Waste neither time nor money, but make the best use of both. Without industry and frugality, nothing will do, and with them, everything. "* - Benjamin Franklin

Remember you can visit our blog: www.jugglingdynamite.com for our weekly commentary and media spots.