

# E.Q Trendwatch™

## The Bear of 2008 goes all in its path

*"In a bear market, everyone loses, and the winner is the one who loses the least. Remember, a few months ago when everyone was saying, "Get the hell out of US securities and into foreign securities." It didn't work out quite that way. Foreign markets have fared even worse than US markets. For instance, Europe's largest economy, Germany (DAX) is off slightly more than 20% this year. France is down 22%. The Euro Stoxx 50, a gauge for the 15-nation euro zone, has declined about 24%. How about those "hot" emerging markets? The Hang Seng in Hong Kong is down nearly 21%. The Shanghai Composite has lost half its US value. The Indian Bombay index is down 38%."*

*—Richard Russell- June 30, 2008*

We are happy to report that the clients at Venable Park have enjoyed positive gains throughout the global bear market that started in 2007. Although markets had a typical bear market bounce through April and May, June was the worst for equity losses since the 1930's. As we write this, July has begun on another wave of heavy selling.

As Bloomberg reported this week, "it must be a bear market because even billionaire Warren Buffett's Berkshire Hathaway Inc. has slumped almost 20 percent since December 2007."

"The decline exceeds the drop of the Standard & Poor's 500 Index and marks the worst first half for the Omaha, Nebraska- based investment and holding company since 1990. Price competition has driven down revenue at Berkshire's insurance units, which account for about half of its income."

We have long been a fan of Warren Buffett and his investment discipline. But the fact is that Berkshire is a publicly traded company. This means that Buffett is not actually in charge of Berkshire's share price. Like all publicly traded securities, Berkshire shares are driven by the ebb and flow of mass psychology in the market auction. When assets in the world become wildly over-priced as they did from 2005-2007, Berkshire's shares are swept up in the over-optimism and over-pricing too. In market cycles, what goes up must come down and now Berkshire is losing value along with the overall markets. So much for it being a "quality" "defensive" holding.

All that we can control is our exposure to the market cycle. Doing that well is the source



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of all lasting value in asset management. This is why the “trick” is having a discipline to buy and sell market assets, not buy and hold.

Yes, over 40 years Buffett’s company has performed very well. Over 30 years, stocks in general have been rewarding investments. And if you have 30 years for your equity investments to prove profitable, then you can just passively hold them. No need to fret about timing your exposure. Always buy, never sell. Don't worry, be happy.

As Barry Ritholtz points out: "Words such as these can only be spoken by someone who has never worked on a trading desk or managed assets professionally -- or if they did, they lost most of their clients' money." The reality is very few individuals can afford 30 years waiting for their investments to work out.

**So what have Venable Park clients missed over the past 12 months in world markets?**

The US S&P 500 stocks are down by a lot.

The more conservative Dow 30 Index? Down more.



Conservative Canadian banks? Very bad.

Income paying REITS? Awful.



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Europe and Asia? Ouch!



China? One of the worst.



Canada?

Even with parabolic energy prices,

the Canadian market is now below where it was last July.



To date the last leg of record-high energy, has made our overall Canadian market (and Brazil) correct less than other world markets. And we did have energy exposure in Venable Park accounts up until this month in the form of the XTR the income trust ETF that is 50% energy companies. However, in late June our rules gave us a sell on that exposure and so we left. At this point, **energy is in a parabolic spike that is full of great price risk to investors.** It is important to note that the Canadian market, because of its over exposure to energy, and because of the break down of other key sectors within it, is now precariously exposed to coming declines.

Even while energy prices have been making relentless new highs, the TSX composite has actually made no lasting gains over the past 12 months as the chart above (right) demonstrates. And although energy has been making new highs, over the past 7 months our petro-currency the Canadian dollar has actually been breaking down as against the US dollar. From the all time spike of \$1.10 US, the Canadian dollar is now trading below .98 once again. Despite the hope of some that "this time will be different" for Canada, currency markets seem to understand our vulnerability to the US led

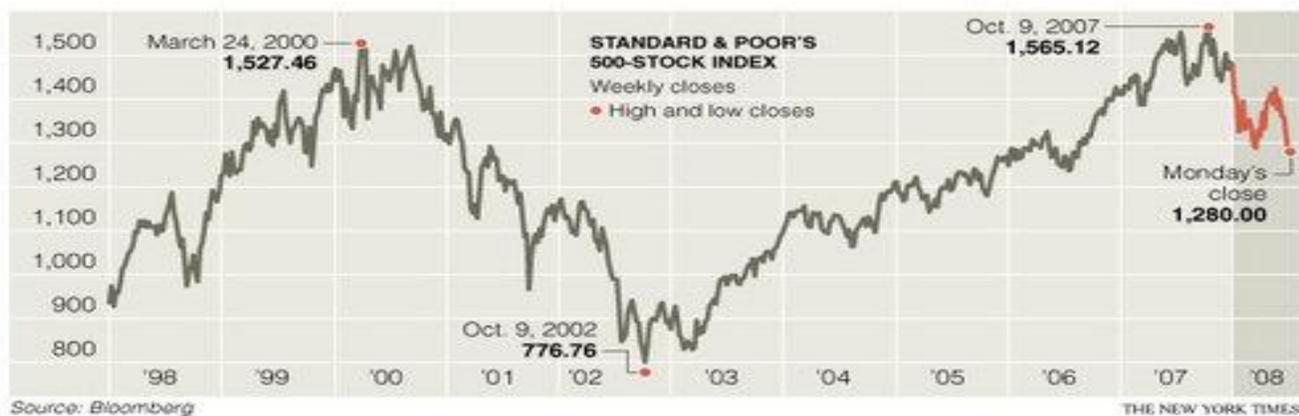
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slowdown. Clients will note that we have bought US dollars for our accounts twice over the past couple of months. We are presently parking this capital in a short term US T-Bill ETF the "SHV" in preparation for upcoming US equity buys in the months ahead.

### Secular Bear thesis still in play

As the ongoing correction plays out around the world, it is becoming more and more obvious that the secular bear thesis we, and some others, postulated in 2000 is now in full swing. The following 10-year chart of the S&P 500 shows that this latest business cycle peak of 2007 failed to make a higher high in the stock market. The peak of October 2007 only matched the peak of March 2000 and then turned down again. And the broad market gains were the best it got. Other sectors like Technology and Pharmaceutical peaked out still 50% below the cycle peaks in 2000.

The question we are watching intently now is to what extent the market lows of 2002 will be retraced now by the market lows of this contraction. Time will tell. Other range bound secular markets like this one have gone back to test the prior low (776 on the chart of the S&P below, 5678 on the TSX) and found support there. In the worst secular bear cycles, each contraction period has made a series of lower lows. Very few people, who are blindly holding equities in these markets, realize that the prior lows of 2002 are feasible targets this downturn. And sadly this is something the investment sales world is not bringing to anyone's attention.



As badly as the market indices have performed in 2008, it is unfortunate to see that once again the vast majority of money managers have actually lost more money for their clients over the past year than have the overall markets. As we now enter the historically worst four months of the year for equities, we are grateful to be one of the few firms that has a risk management discipline that has kept our capital out of harm's way over the past 18 months. It has also poised us ideally situated to take advantage of the re-pricing now under-way.

***Have a wonderful summer...***

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