

Hello,

We have witnessed a strong rebound in the world market indexes over the past month, as investor concern over the state of financial stocks subsides and a belief that various government bailout programs around the world will help developed-country economies regain their footing. The [S&P 500](#) is now 20% above its March 9 low, and the [financial sector](#) is up by 50% over the past two weeks.

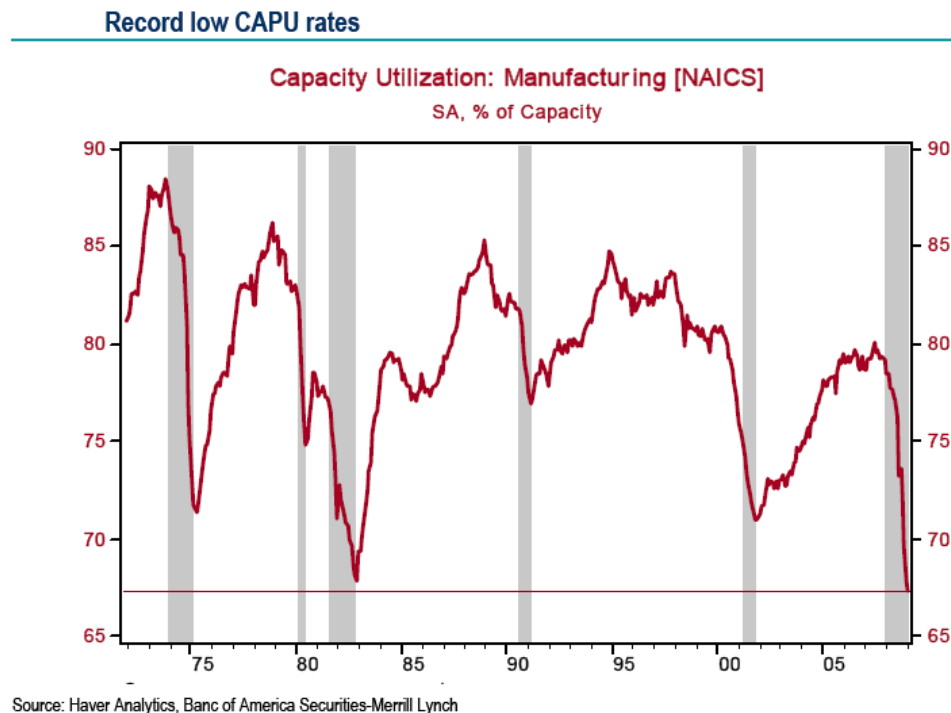
The question on everyone's mind is: have we bounced off the bottom? Is the worst behind us?

As we have said before, there is no shortage of long-winded commentary proclaiming that we are entering the next Great Depression, and the same volume of material has been written predicting a massive rally based on compelling valuations.

So what should we do right now?

North American Economy Still Faces Headwinds

The economy itself has not "turned around". Below is a chart of manufacturing capacity utilization, which is below the level last seen in the recession of the early 1980s.

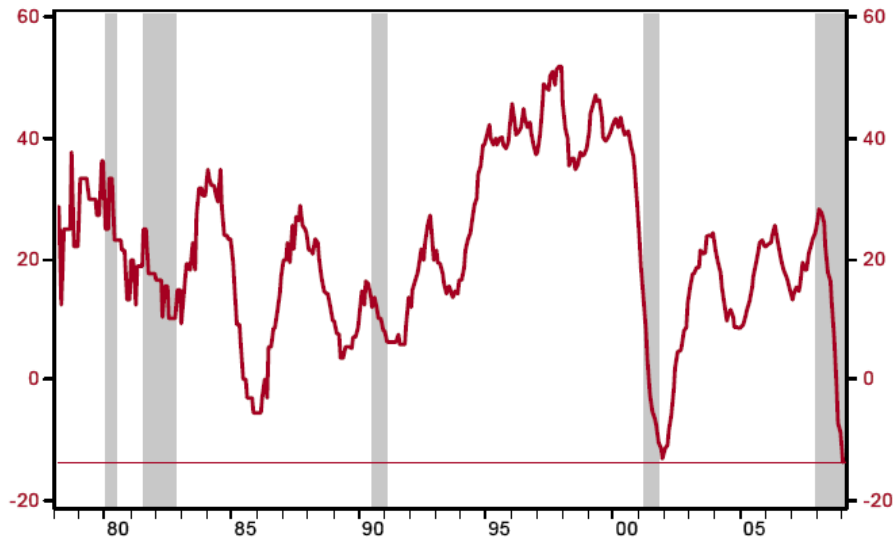


Spending on technology (a reflection of business sentiment towards capital expenditures) is also at record lows:

This is worse than the tech wreck of 2001-02

IP: Computers, Communications Equipment, and Semiconductors

% Change - Year to Year SA, 2002=100



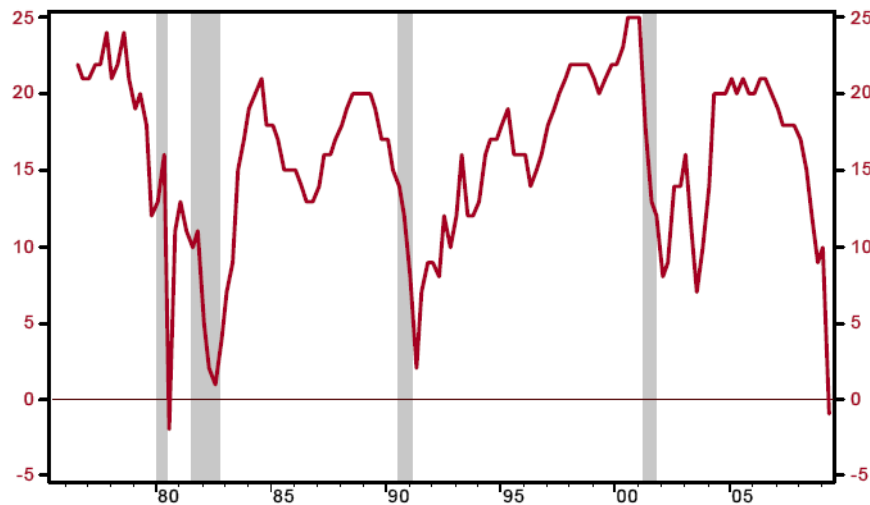
Source: Haver Analytics, Banc of America Securities-Merrill Lynch

In order for sentiment to really turn around, people need to feel secure in their jobs. However, hiring intentions are at a nearly 30-year low:

Hiring intentions go negative

Manpower Employment Curr Quarter Outlook: All Industries: Net Higher

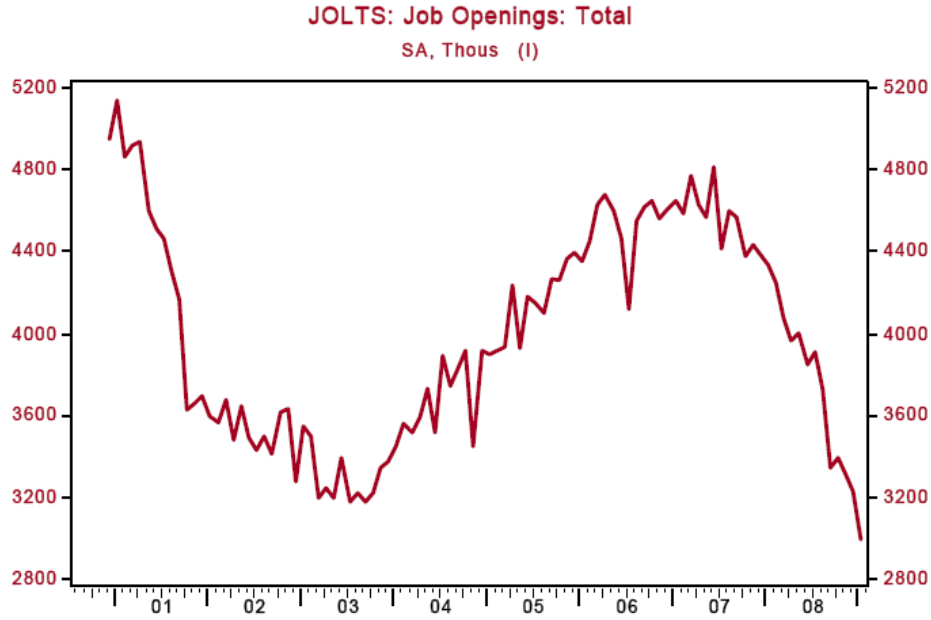
SA, %



Source: Haver Analytics, Banc of America Securities-Merrill Lynch

It is also tougher to find a job out there, as the number of job openings has dried up to a level not seen since 2003:

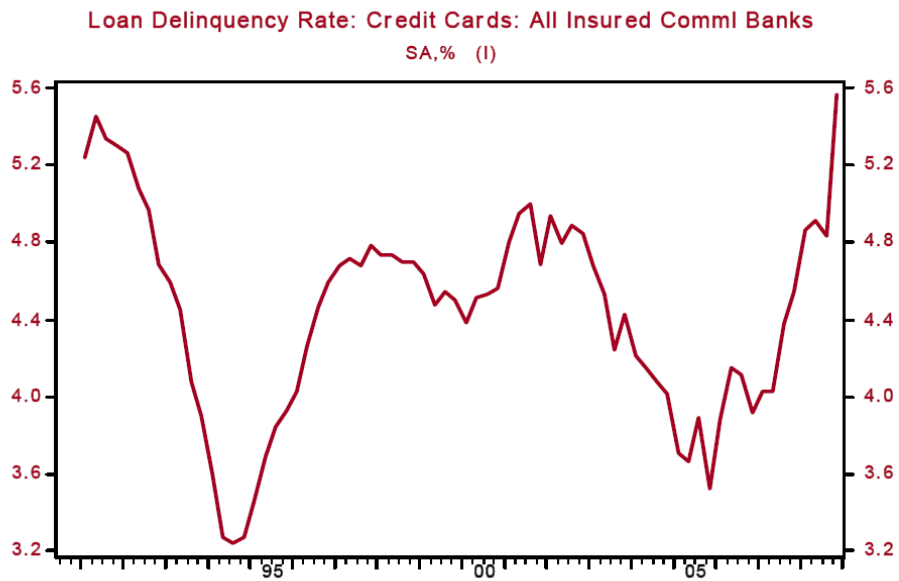
Job openings fall below 3 million



Source: Haver Analytics, Banc of America Securities-Merrill Lynch

When you've lost your job, paying off your credit card bills becomes difficult:

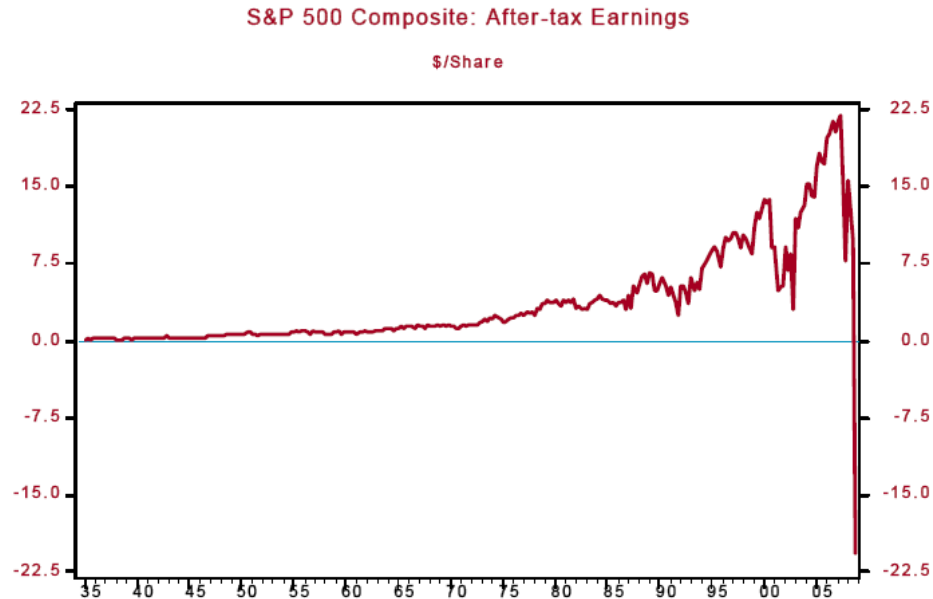
Credit card delinquency rates rise to an all-time high



Source: Haver Analytics, Banc of America Securities-Merrill Lynch

Finally, just before we look at the markets themselves, we see that overall after-tax earnings in the S&P 500 stocks have collapsed:

An unprecedented earnings recession



Source: Haver Analytics, Banc of America Securities-Merrill Lynch

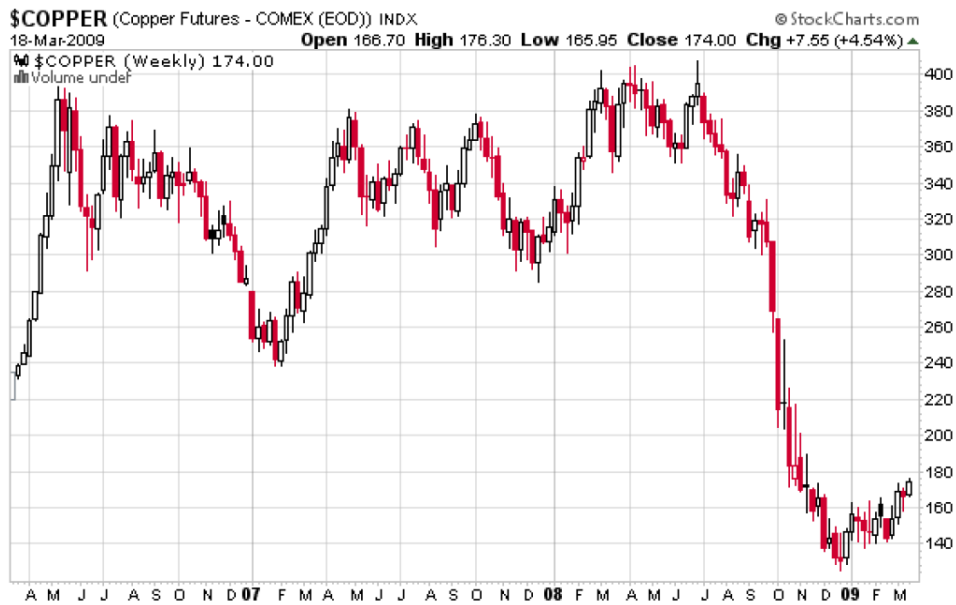
Charts Don't Lie: Markets Tend To Bottom During Recessions, Not After They're Over

It is in the aftermath of a crisis that the seeds of a rally are planted. Excess returns are only possible when one can buy quality companies not just at "fair" or "average" values, but at anomalously "cheap" valuations. These types of values tend to make themselves apparent during world-wide panics about the future prospects of the economy and markets.

The stock market, being a forward-looking mechanism, is already beginning to price in a recovery, as this month's rally in the world indexes shows. First, we look one of two world economy bellwethers, the Baltic Dry Index. This global index tracks the cost of shipping raw materials used in the manufacture of finished goods. We can see that it has been building a base since late last year and is showing a strong sign of recovery (more than doubled since the beginning of the year):



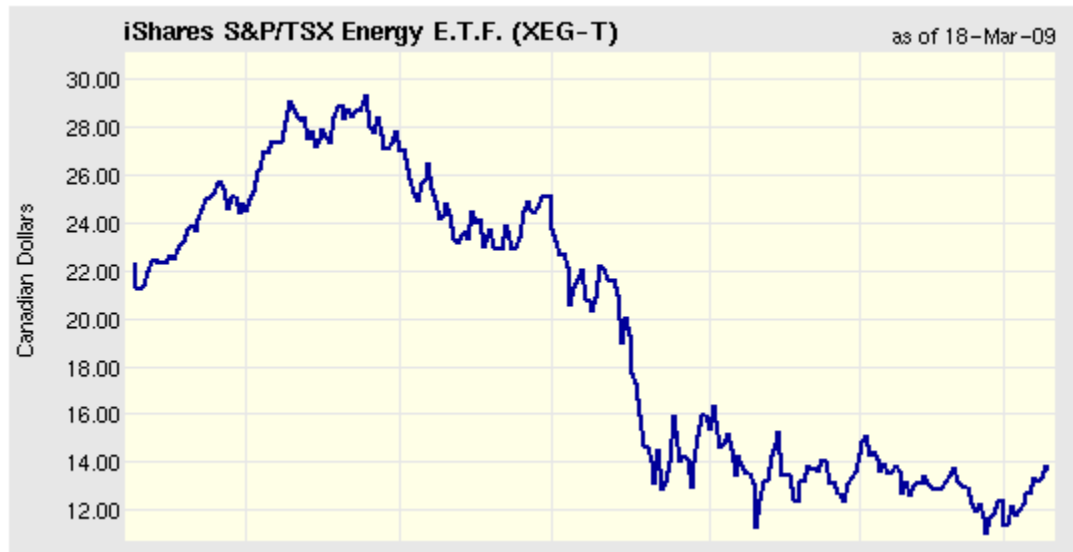
The price of copper is another good indicator of what the future holds: it is used in nearly all manufacturing and construction processes, so a rise in demand usually portends stronger economic growth ahead. Below we can see that its price has been steadily rising since January (up 22% since the beginning of the year):

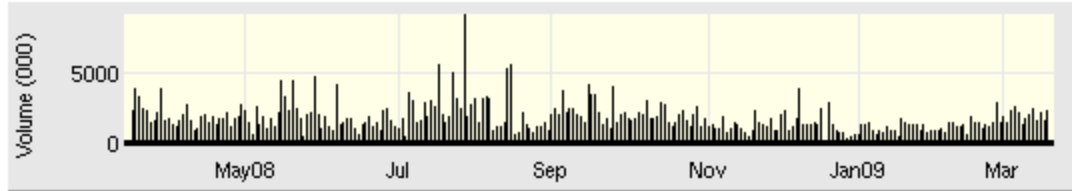


The Canadian Real Estate Investment Trust Index is showing good support at \$7 and yields nearly 12% in annual cash flow:



The Canadian Energy Index has also bounced off strong support and is establishing a new uptrend, while yielding nearly 5% in an annual dividend:





The world's top 100 companies are also beginning to show some strength, and are on the verge of breaking out of their downtrend which began in May 2008 (and yield 4.5% while you wait):



In all cases above, we have some good pieces of information: two low points (one set last November, one set earlier this month) that should act as support points. As long as the market can hold above these points, we remain confident about its long-term prospects.

All the best!

Andrew Johns