



Wealth Management Consultants Inc.



BULLETIN
June 2009

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The next bubble

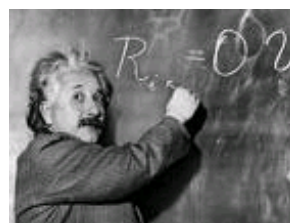
Interesting for how long a few analysts had predicted that housing was in a bubble which eventually had to burst. But the run-up was so thoroughly enjoyable, that few bothered to give the possibility of a deflating housing bubble much thought. After all, the ATM, called real estate, worked to perfection. Have a desire, borrow against the forever appreciating value of the real estate holding, and lenders were all too obliging to assure that credit would be available to anybody at all times with very few and all too often no questions asked.

Bubbles, excesses, followed by more bubbles and more excesses. Along the way some spectacular bankruptcies. When Penn Central collapsed in 1970, it was as if the financial world had lost its bearings. In 1974 Franklin National Bank followed, and few could understand how such mismanaged could go undetected for so long. The Continental Illinois National Bank and Trust Company, once amongst the largest banks in the US, became insolvent in 1984. But good times always returned. Starting 1984 the Dow Jones rose by an average of 33% per year until the fateful October 19, 1987, when it lost 22.6% in a single session.

Towards the end of the 1980s, the most popular books explained why Japan would soon own the entire world. And for a while it certainly looked like it. The Japanese had become rich beyond imagination, expressed in the Nikkei trading around 39,000 in December 1989. And yet a relentless drop followed, and all the Japanese' many purchases made at almost unimaginable prices, be it art or real estate or entire corporations, soon looked foolish from the Japanese perspective and brilliant from the view of the sellers. In early 2009 the Nikkei traded barely above 7,000.

The tech bubble is still in recent memory, a time when there was a mad demand for stocks selling sometimes at a hundred times projected future earnings, or even more. Those who pointed out how foolish this was were laughed at and written off as hopelessly outdated.

And yet as painful the lessons from the tech bubble were, nothing compares to the excesses which were created in recent years. Leverage allowed creating never-ending increases in riches, and there were few limits to leverage. As Michel Girard explained to his readers in La Presse, imagine getting a \$3.5 million mortgage for a house worth \$100,000. Bankers happily calculated VAR, Value At Risk, and the results were always satisfactory, not surprising since the underlying assumptions were always incorrect.



As we suffer through this crisis we know two things, namely that one day the current mess will be cleaned up, and that a new bubble will then develop. As Albert Einstein so famously said, "Only two things are infinite, the universe and human stupidity, and I'm not sure about the former."

By Rolf Spielmann, CFA
Senior Vice-President of BLUE BRIDGE™





The commercial real estate decline

The Great Recession started with the flap of butterfly wings – defaults in an obscure corner of the U.S. real estate market, sub-prime residential mortgages. That zephyr grew to hurricane force, spreading damage across the market, and then to the financial industry and economy. Next up will be fallout in commercial real estate. As the economy weakens, consumer spending has declined and unemployment has increased to 8.9% (versus a post-war average 6%), so the demand for commercial real estate has suffered. Office vacancies have expanded, hotel occupancy contracted, and retail store traffic slowed. The weak demand compounds itself: as leases expire, tenants fail to renew, leaving space empty, or they demand dramatically lower rates given that competitive space is available elsewhere. Thus, as home prices plunged 30%, commercial building values have dropped comparably.

The problem is worse still. Typical commercial buildings are financed with 80% loan-to-value ratios, for 10 years and with “balloon” mortgages on which all principal is due at maturity. (Residential mortgages usually amortize with minor shares of principal due monthly.) Thus, a building worth, say, \$10 million with \$8 million of mortgage financing but suffering a 30% drop in lease revenue may be worth only \$7 million. The building is “underwater”: its value is insufficient to refinance the loan or to sell the building to pay off the loan. Owners lose their equity, of course, but mortgage lenders also lose 12% of their investment. Multiplied by thousands of buildings nationwide, the problem is huge. According to stress tests (*The Wall Street Journal*, “Local Banks Face Big Losses”, May 19, 2009), small and medium-sized banks could lose \$100 billion on commercial real estate loans and \$100 billion on other loans. *The Journal* projects 600 of the 940 banks tested could lose enough capital to set off alarms at the bank regulators. Moreover, large money center banks could lose similar magnitudes on their commercial realty loans, as could the market for commercial mortgage-backed securities.

The other effect of this market’s decline is the severe drop in construction jobs and in demand for construction materials. Thus, the commercial real estate depression is likely to spread and to last several years as leases expire and mortgages come due. It is likely the federal government will cushion the losses this industry and its lenders and suppliers suffer. Indeed, the Treasury Department already has applied TARP funds to failing commercial mortgages.



One good aspect of the situation is that it is less surprising than was the fall of residential real estate. For the commercial market, the size and timing of the problem is better understood, so the amount and timing of resources needed to mitigate industry losses seem clearer and are more spread out. Nonetheless, the commercial real estate decline will create headwinds that further delay broader economic recovery.

By Matthew Gelfand, Ph.D., CFA, CFP®
Managing Director
Lynx Investment Advisory, LLC
Washington





European Market Entry Timing

Intuitae is following a chosen number of diversified and flexible managers in Europe with performance goals about three to four times the risk-free market rate. Three-quarters of them had zero positions invested in equities at the end of March, while 100% of them had equity positions of 20% or more at the end of the first week of May. These managers, each with different investment and allocation styles, represent for Intuitae a barometer of market feeling. Note that all the managers succeeded in conserving capital over 2008, with none of them losing more than 3%.

Three sorts of reasons explain this change:

- Higher volumes on European markets: this argument got the better of the most pessimistic managers. The initial weeks of rising prices occurred on moderate volumes; the rise in the early days of May took place on strong volumes.
- Some leading indicators seem to support to the scenario of an asynchronous economic recovery. The notion of the uncoupling of economies is thriving, supported by strong numbers from Asia in general and China in particular (with an April rise in the industrial production index to over 50).
- Finally, the eyes of some European managers are also turning toward the U.S. They see changes in the real-estate market as being one of the leading indicators of movement in the economy. The most optimistic of them predict that the real-estate market will hit bottom in the last quarter of 2009. The current trend is toward destocking of goods, with almost no new goods arriving on the market and mortgage credit costs never having been so low.

Another strong trend is emerging in asset allocation by these flexible managers: a downward trend in the monetary portion of portfolios, mainly in favour of bonds (government or corporate) with short or medium maturities.

To conclude, our main recommended managers, through their allocation policies, are clearly urging us to get out of the wait-and-see situation predominating up to now. So-called risk-free assets should be sold, giving way to a reasonable positioning in riskier assets, with a long-term outlook. Since asset allocation contributes 70% to 90% of

a portfolio's performance (according to studies), these managers are playing a decisive match to achieve their annual performance.

Nonetheless, and despite the risk this presents in case of a new market collapse, ignoring these managers' signals could be detrimental in the future. The entry timing effect can be smoothed by taking positions in diversified risk pockets on a gradual and regular basis through these flexible managers.

By Luc Granger
Associate
Intuitae Paris



European news

Record GDP drop in euro zone

The euro zone slid a little further into the recession during the first quarter of 2009, with gross domestic product (GDP) in the 16-nation euro currency area falling by an unprecedented 2.5% in the period from January to March, worse than the United States.

According to recently published statistics, the euro-zone economy was notably dragged down by Germany, whose GDP fell by 3.8% — its biggest economic plunge since at least 1970, when West Germany started to compile records. Year-on-year data, adjusted for working days, show the GDP for Germany, Europe's largest economy, contracted by 6.9% on the year in the first quarter, compared with a 1.8% drop in the final quarter of 2008. Germany is paying the price for the implosion of its exports and its industrial investments. On the other hand, both household and government spending increased slightly.

The recession is also hitting Italy, whose GDP shrank by 2.4% from the prior quarter, the sharpest drop in 30 years. In the Netherlands, for their part, the GDP contracted by 2.8% in the first quarter of 2009 and 4% on a year-on-year basis, the worst decline since the Second World War.

Source: lemonde.fr

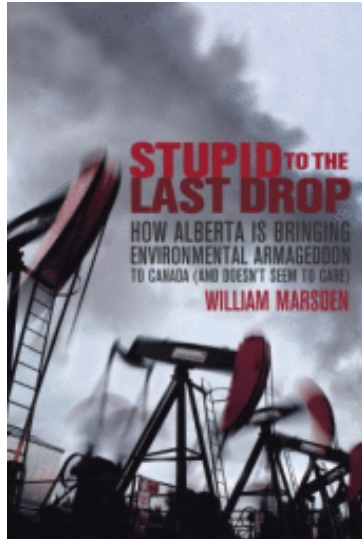


Stupid to the Last Drop

How Alberta is bringing Environmental Armageddon to Canada (and doesn't seem to care)

By William Marsden
Vintage Canada 2007

Every story has two sides, and when it comes to mega projects like the Alberta tar sands, it is to be assumed that not everything is perfect and unquestionable. With all the riches the exploitation of the tar sands promise to Canada, and Alberta in particular, somewhere along the line a price is being paid. And while some seem blind to the environmental damage done to Alberta, others see mostly insurmountable problems. The truth usually lies somewhere in the middle. We recommend Mr. Marsden's book, to our readers, for regardless if one believes the full extent of his doomsday scenario, fact is that the environmental crisis which is being created is not as widely discussed as it ought to be.



Mr. Marsden is not friend of the Federal or Alberta Tories, nor an admirer of the governments, and he is most certainly no friend of the oil companies. Yet reading this book one wonders at times if oil companies are truly 100% devious, if Alberta's provincial government is really more corrupt than the government of Kazakhstan, if the federal government willfully and consistently closes both eyes when it comes to the rights of native people.

One gets the impression that everybody who dares to address environmental issues immediately gets muzzled. The evil Americans have secured more than their fair share of Alberta's oil production and they refuse to accept that Canada should explore other markets as well. As the profits of the oil companies literally explode, Ottawa and Edmonton continue to subsidize their operations. If Americans are evil, then Albertans and the feds are clearly stupid, such is the message of this book.

As one-sided as Mr. Marsden story is, it gives food for thought. Clearly not everything is well in the oil patch, there are many unsolved problems and environmental issues, and in order to be truly successful, the process of

extracting oil from the tar sands needs to be urgently improved. And yet we have come a long way. 60 years ago the Americans studied ways to produce oil in Alberta using atomic bombs. The book explains in much detail how this scheme was devised. The Soviets had some initial success using atomic bombs to increase oil production; alas the initial euphoria was soon replaced by the urgent need to contain radiation. Today it seems almost unreal to think that in the 1950's calculations were made which showed that 1 million atomic bombs might be sufficient to liquefy all the oil trapped in the tar sands. That surely could be considered stupid. With all his many faults, today's oil man has come a long way, and we all benefit from it!



Selection of Financial & Economic Indicators

Index	DJ Ind	DJ Transp.	Nasdaq	S&P500	S&P/TSX
May 29	8500.33	3202.45	1774.33	919.14	10370.07
Monthly var.	+ 4.07%	+ 1.85%	+ 3.32%	+ 5.31%	+11.21%
Year-to-date	- 3.15%	- 9.46%	+12.51%	+ 1.76%	+15.38%
Year-over-year	- 32.74%	- 41.10%	- 29.66%	- 34.36%	- 29.53%



Index	FTSE	DAX	CAC40	SMI	Nikkei
May 29	4417.94	4940.82	3277.65	5349.74	9522.50
Monthly var.	+ 4.11%	+ 3.59%	+ 3.73%	+ 2.37%	+ 7.15%
Year-to-date	- 0.37%	+ 2.72%	+ 1.85%	- 3.34%	+ 7.48%
Year-over-year	- 27.02%	-30.38%	-34.63%	- 28.78%	-35.26%

Commodities	Gold	Copper	Crude Oil	Lumber	CRB
May 29	980.30	219.75	66.31	191.70	249.83
Monthly var.	+10.20%	+ 7.91%	+30.15%	+19.07%	+12.34%
Year-to-date	+11.27%	+57.02%	+54.21%	+12.90%	+13.15%
Year-over-year	+ 9.96%	- 39.06%	- 47.93%	- 22.17%	- 40.82%



Devises	\$CA	¥	€	£	\$AU
May 29	1.0915	95.3400	1.4158	1.6190	0.8010
Monthly var.	+ 8.57%	+ 3.37%	+ 7.02%	+ 9.48%	+10.35%
Year-to-date	+10.46%	- 4.94%	+ 1.42%	+11.04%	+13.62%
Year-over-year	- 9.88%	+ 9.64%	- 8.98%	-18.32%	-16.20%

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