



EDITORIAL

No news means good news

With no major catastrophe on the political scene, markets entered 2012 on a highly positive note. Stocks have risen substantially and, more important, with little volatility.

From an economic standpoint, the United States has continued to show remarkable resilience, with numbers topping expectations in employment and confidence levels, as well as real estate. These clearly are encouraging signs. Accordingly, we have brought high-yield **U.S. bond positions into our clients' portfolios** and lowered our aversion to American stocks.

As for Europe, the signs are less encouraging, and an economic slowdown is perceptible. However, Mario Draghi, the new European Central Bank President, succeeded where his predecessor failed: **for the moment, he has greatly reduced banks' liquidity risk. To achieve this, Mr. Draghi adopted a misleading but effective approach.** Officially, the ECB does not wish to print money but, unofficially, it is doing so already with its unlimited extension of liquidity facilities for European banks. The stress on banks has been dissipated for the moment, but the long-term problem remains: there is a structural deficit in the developed countries, and the social protection they provide is exceeding their ability to pay as their populations age. Tough negotiations can be expected.

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FEATURE ARTICLE

The European ratings downgrade and its consequences

By Rolf Spielmann

Read the article p.2



ECONOMY

Gold: a relic with future?

By Rolf Spielmann

Read the article p.3



BOOK REVIEW

Red Alert: How China's Growing Prosperity Threatens the American Way of Life

Read the article p.4



MARKET WATCH

Selection of Financial & Economic Indicators

Read the article p.5



The European ratings downgrade and its consequences

"Today's rating actions are primarily driven by our assessment that the policy initiatives that have been taken by European policy makers in recent weeks may be insufficient to fully address ongoing system stresses in the Eurozone", this is how S&P justified its decision to downgrade Italy, Spain, Portugal, Cyprus, France, Austria, Malta, Slovakia and Slovenia. Italy now has the same rating as Kazakhstan. Portugal's debt is rated junk.

These are not proud moments for Europe! True, Wolfgang Schäuble cautioned that the judgment of rating agencies should not be overvalued, but politicians always make such statements when sovereign ratings are downgraded. When they are upgraded, those same politicians commend the rating agencies for their wise judgment!



Besides slightly increasing the risk premium, what has really changed? Not much indeed. Debt loads are such that they are no longer sustainable. It was a foregone conclusion that only Germany would keep its AAA rating and stable outlook. S&P's downgrade of European sovereign debt was not a surprise. A surprise would have been had debt not been downgraded.

In the olden days, to hold sovereign risk brought about the danger that the King would imprison or execute you so that he could avoid repayment. No such danger today, our physical life is quite safe, but our financial survival is still not guaranteed.

We have come a long way since the dark Middle Ages, in some ways at least, but in others we

have failed miserably. Throughout history Kings and Emperors were the victims of deteriorating public finances, and modern governments face the same problematic. At one time it was warfare which bankrupted the Kings, today it is the cost of the welfare state.

There are those who claim that we can print ourselves back to financial health. I do not share this view. Yes we can create more money, but we must accept at the same time that this money

will be worth less and less. What is the problem today is that promises were made to baby boomers at a time when the life expectancy was in the 60s. Now that those promises are cashed in, the life expectancy is in the 80s. The difference is countless trillions of dollars which are simply missing.

Reread the S&P statement above. The problem nowadays is the deplorable absence of strong political leadership in the developed world. The resulting uncertainty leads to volatility. Volatility leads to economic slowdown. A slowdown increases the pent-up frustrations of savers and investors. Until the day strong leaders emerge, a new generation of Ronald Reagan's, Margaret Thatcher's, Paul Volker's, more ratings cuts will become the norm. Without being alarmist we must acknowledge that the current crisis in Europe looks eerily similar to the financial turmoil of the 1920s/1930s when economies fell like dominoes. Could it be that S&P was not too fast on the trigger, no, that it was too slow on the trigger?

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ECONOMY

Gold, a relic with a future?

Confusing, isn't it, this very precious metal. Back in 1980 it traded at \$850, after which it promptly lost 70% of its value. Not too long ago it reached \$1,900 before a big correction set in. So what is it really worth?

It is worth to you what you think it is worth to you. Whenever the topic of Gold comes up and **the fact that I'm Swiss, I'm** immediately told that I must be a Gold bull, for a European and particularly a Swiss is supposed to be a Gold bull. History can explain this view. North Americans have lived in a relatively safe place, while Europe was torn apart by wars and revolutions. Europeans therefore see Gold as a safety net, for all too often in the past owning Gold equaled survival.



Contrary to fiat money, Gold supply is limited. The printing of currency is limited by the speed of the printing press only, whilst producing an extra ounce of Gold is expensive and time consuming. Throughout history, about 165,000 tons of Gold have been mined, most of which is still in existence. Current annual production is about 2,600 tons. It is assumed that about 50% of yearly demand is used for jewelry. A commodity that has a known inventory and supply is much exposed to demand factors. Now that central

banks have returned as buyers, likely for about 600 tons in 2012, available supply is limited.

\$850 in 1980 equals \$2,335 today according to the Federal Reserve Bank of Minneapolis. We are therefore far from the previous high. This is not to say that we must return to the previous high, because we know that the market was cornered in 1980, hence that the run-up to \$850 was entirely artificial. Every bubble meets its pin, and in 1980 the Gold bubble was not spared. What it tells us is that in a historical context we are far from previous highs.

The breakdown of the Bretton Woods Agreement in 1971 led to a breakdown of fiscal discipline. Long-term stability was thoughtlessly jeopardized for short-term gain. We now have to live with the consequences of past errors and sins. The recipes of getting out of the mess are debt forgiveness, default, or inflation; none of them particularly palatable, for all of them are expensive for investors. Where to turn?

Some call the run-up in the Gold price the greatest Ponzi scheme of all times. For a non-believer in Gold, it might look like this. For a believer in its lasting value, Gold is however like fire insurance. You do not buy a policy because you know that your house will burn down, you buy it because of the possibility that it may burn down, remote as this possibility might be.

Nobody should put all their money into Gold, but I suggest that holding 10% of a portfolio in Gold may let you sleep a tiny bit better.

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BOOK REVIEW

RED ALERT: How China's Growing Prosperity Threatens the American Way of Life

Is China's growth depleting the world of its natural resources? So says bestselling author Stephen Leeb in his new book, *RED ALERT: How China's Growing Prosperity Threatens the American Way of Life*, which warns that American living standards will dramatically decline without a mass mobilization towards the development of renewable energy.

Using data accumulated from world governments, international agencies and transnational mining companies, Leeb demonstrates how China's enormous appetite for natural resources has exerted a heavy pressure on global supplies, resulting in dramatic price spikes for just about every major commodity, including oil, copper and corn, in the last 10 years.

Fascinatingly, Leeb attributes America's decade long economic malaise, particularly the declining income of the middle class, to the surge in the cost of natural resources, which functions as a massive tax on business and the cost of living, an appealing thesis by virtue of its simplicity. According to Leeb, the credit crisis was, in fact, precipitated by the increasing need of Americans to borrow to keep their standard of living at the same level, as prices for just about everything rose, epitomized by the price of a barrel of oil reaching \$150 in the summer of 2008.

Leeb's gravest concern, however, is that America seems unaware of the fact that it is in a full fledged economic war with China for the world's remaining resources. While America lies asleep, oblivious to the existential threat of resource scarcity, China scours the globe, securing major resource deposits to fulfill the needs of future generations. Equally impressive, the country is investing half a trillion dollars a year, on renewable energy development and infrastructure, planning for a future when fossil fuels are either depleted or too expensive to extract.

Interestingly, Leeb argues that China's aggressive pursuit of renewable energy constitutes a danger to the United States, as the world lacks the necessary resources to roll out two separate large scale renewable energy systems, threatening a long lasting, and perhaps even permanent, negative impact on the American way of life if the country does not begin taking immediate action.

Leeb is careful to distance himself from the notion that *Red Alert* is "anti-China," describing the "Middle Kingdom" as an adversary pursuing its own self-interest, rather than an enemy. As essential commodities become increasingly depleted, Leeb claims today's 'resource liberalism' will give way to 'resource nationalism', a process, he maintains, has already begun with China's restriction of rare earth exports in 2010, Saudi Arabia's reduction in oil exploration, for the stated goal of preserving oil reserves for future generations, and even India's expected decrease of iron ore exports, of which it is the world's third largest exporter, by 30%-40% in the 2010-2011 fiscal year, in an effort to supply increasing domestic demand for the metal.

If Leeb is right, America is running short on time. He advises resource scarcity advocates and environmentalists to join forces, even though they've rarely seen eye to eye in the past, as both groups have similar end goals, i.e. to begin building massive scale renewable energy infrastructure. Without dramatic action, America risks losing everything as the cost of oil and essential metals become prohibitively more expensive. As he states, this is not a shooting war, but the outcome of the conflict may very well yield similar results, with the loser suffering a much lower standard of living.

New York : Business Plus, 2011.





MARKET WATCH

Selection of Financial & Economic Indicators

	Last	1 month	3 months	Year to date	1 year	3 years*	5 years*
EQUITIES							
S&P 500	1312,41	4,48%	5,32%	4,48%	4,22%	19,24%	0,33%
Dow Jones Industrial	12632,91	3,55%	6,43%	3,55%	9,12%	19,80%	2,80%
S&P/TSX Composite	12452,15	4,37%	2,38%	4,37%	-5,65%	15,97%	1,94%
CAC 40	3298,55	4,39%	2,31%	4,39%	-14,12%	7,86%	-6,56%
DAX	6458,91	9,50%	5,17%	9,50%	-8,74%	14,19%	-0,99%
MSCI Europe	3387,67	3,43%	3,14%	3,43%	-8,00%	10,87%	-4,00%
MSCI Asia Pacific	123,59	6,00%	0,53%	6,00%	-10,89%	10,08%	-5,54%
MSCI Emerging Mkt	368,17	7,42%	3,26%	7,42%	-4,23%	21,39%	4,63%
MSCI World	2160,40	4,33%	3,59%	4,33%	-3,27%	13,65%	-2,97%
COMMODITIES							
CRB Commodity Index	499,00	3,52%	-2,20%	3,52%	-10,00%	15,82%	6,68%
Gold Spot US	1737,60	11,12%	1,33%	11,12%	30,37%	23,26%	21,61%
Crude Oil WTI	98,48	-0,53%	5,98%	-0,53%	-1,30%	15,55%	9,36%
Lumber	248,20	-4,94%	-3,69%	-4,94%	-22,92%	-8,50%	-5,19%
Wheat	666,00	2,03%	0,23%	2,03%	-28,33%	1,10%	0,66%
CURRENCIES							
CAD/USD	0,9975	1,90%	-0,17%	1,90%	-0,15%	7,01%	3,26%
EUR/USD	1,3084	0,95%	-5,59%	0,95%	-4,45%	0,70%	0,08%
GBP/USD	1,5760	1,40%	-2,03%	1,40%	-1,59%	2,72%	-4,32%
USD/JPY	76,27	-0,83%	-2,43%	-0,83%	-7,03%	-5,34%	-8,77%
EUR/CAD	1,3118	-0,90%	-5,41%	-0,90%	-4,30%	-5,92%	-3,08%

Returns are expressed in local currency and include dividends.

*Returns above one year are annualized.

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