



**BLUE BRIDGE SUPPORTS HEC
MONTREAL in the 2011 Course
Croisière EDHEC**

Several important Quebec companies have already joined Blue Bridge in this adventure. By doing so, they bear witness to the dynamism of the Canadian economy and show their support of HEC Montreal, Quebec's first business school.



FEATURE ARTICLE

Research and experience

by Rolf Spielmann

Daily we are bombarded with forecasts and predictions, most of which are mere guesses and false prophecies. One often learns the hard way that one cannot, must not, rely on other peoples opinions, for nobody controls the market. We all succeed and we all fail (...) [Read more p.2](#)

ECONOMY

How the Apple iPhone is deepening the U.S. trade deficit

by Alain Roch



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BOOK REVIEW

More Money Than God: Hedge Funds and the Making of a New Elite



Hedge Funds, the great money makers, or the great villains, or the great

whatever you wish to call them. Some of them are superb vehicles for intelligent investing, and some are(...)

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Selection of financial and economic indicators



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FEATURE ARTICLE

Research and experience

Daily we are bombarded with forecasts and predictions, most of which are mere guesses and false prophecies. One often learns the hard way that one cannot, must not, rely on other people's opinions, for nobody controls the market.

We all succeed and we all fail. As Leigh Pullen of QV Investors wrote in a December 2010 Update, failure is a great teacher if we can learn from our errors and not succumb to the notion they are permanent. Leigh also mentioned the words of the late Andrew Eisenhower who once told a graduating class of engineers, "Good judgment comes from experience. The best experience comes from bad judgment."



Leigh goes on explaining how as a young man in the sixties he turned \$1,000 into \$3,000 and then the same \$3,000 into \$500 before the company he was invested in defaulted. And it made me think of my experience when I came to Canada in 1971 with \$200 in my pocket. This was the equivalent of almost 1,000 Swiss Francs, which meant that in Switzerland I was rich and in Canada much less so.

With the \$200 I opened up a brokerage account which in those years was considerably easier than getting a telephone connection. And I invested my

accumulated wealth in Massey-Ferguson shares. The basis of my research? In my native Switzerland rich farmers owned Massey-Ferguson tractors and the not so rich farmers owned Hürlimann tractors, hence Massey-Ferguson had to be a superior company.

Well this experience left me reduced to one meal a day for a rather extended period of time, and yet looking back this probably was the best investment I ever made. I learned, just as Leigh had a couple of years before me, that investing is not admiring a tractor's red color, but that it entails profound research into the value and the quality of an investment. Leigh summarizes his investment lessons by saying that his test for selection of companies for investment is management commitment and acumen, measurable returns on shareholders' investment, clearly developed business franchise and strategic outlook, a bullet proof balance sheet, growth rates comparable or better than the benchmarks, and the ability and willingness to pay dividends...with other words everything that 40 years ago I had overlooked at Massey-Ferguson.

Too many things still get overlooked by too many "analysts", reason for the flood of often unsubstantiated research material. I think that an investor has two choices. He can either do his own homework and analyze and dissect corporate reports and balance sheets, or he can entrust the management of his money to an experienced money managers. Experience of course is not expressed in the number of years in the business; it is in the soundness of the track record. It is the track record which expresses if tough lessons have been learned and turned into an advantage. That is what differentiates managers, and it is the basis of their success or failure.



Rolf Spielmann, CFA
Premier Vice President
BLUE BRIDGE®



ECONOMY

How the Apple iPhone is deepening the U.S. trade deficit

For 2010 as a whole, the U.S. trade deficit hit \$497.8 billion, up substantially from \$374.9 billion the previous year.

Nearly 55% of this trade deficit was due to the imbalance in U.S. dealings with China. The American solution is simple: all that's needed to bring down the deficit is to adjust the Chinese exchange rate, in other words, to revalue the yuan in relation to the dollar.

The situation is more complex, however. To underline how hard it is to interpret U.S. trade deficit figures, we turn to a working document produced in Japan by two academic researchers, Yuquig Xing and Neal Detert, who have broken down the value chain of an iPhone ("How iPhone Widens the U.S. Trade Deficits with PRC").

In U.S. Customs statistics, a Chinese-made iPhone is shown as having an import value of \$178.96. With more than 75 million sold since it came out, **Apple's headline product may have pushed the U.S. trade deficit up by \$1.9 billion**, and this alone may be responsible for 0.8% of the imbalance in U.S. trade with China. "Even high-tech products invented by American companies will not increase the U.S. exports, but to the contrary exacerbate the U.S. trade deficits," the study laments.

How is this possible? Quite simply because most of the materials are produced abroad and assembled in China, in Foxconn's Shenzhen facilities, before being sold in the United States. The finished product is considered to be an import from China!

But does China really get much benefit from this \$179? Indeed, Apple's smartphone is assembled in Chinese plants, but a high proportion of its components are manufactured elsewhere. Although U.S. Customs records it as a \$179 Chinese import, the device contains 34% Japanese content, 17% German content, 13% Korean content and, through the magic of international trade, 6% U.S. content! China's value creation in an iPhone is just 3.6%.

Customs statistics fail to measure the value added by nationality, looking only at the value of the finished product. In fact, the deepening of the U.S. trade deficit with China goes in tandem with a reduction in U.S. imbalances with other Asian countries, Japan in particular. Who remembers that Japan accounted for nearly 40% of the U.S. trade deficit in the late 1980s (compared with less than 10% at present)?

At the time, the United States felt that the Japanese currency should rise in value to reduce the Japanese trade surplus. Since then, the yen has risen and Japanese companies are producing in China!

There is no miracle solution, and it is easy to understand the position of Beijing, and of certain U.S. industrial firms such as

Apple, that don't want too sudden a revaluation of the Chinese currency. Let's go back to our example. If China adjusts its exchange rate too quickly, the short-term effect on Apple's margins is negative (unless it can raise its selling price): production costs in China will be up sharply. But over time, the main loser is the Chinese industrial firm, which risks seeing Apple's production relocated to countries with lower labour costs, such as Malaysia, for instance.

The development of Chinese domestic demand will reduce the country's trade surplus, but for the United States, it is far from certain that the trade deficit with another low-wage Asian country will not soar. There is no magic solution to major international imbalances. Resolving them will require more than exchange rate adjustments.

This leads the two authors quoted above to two conclusions. First, trade balance statistics should include all countries where production takes place and not just the country where the finished product is assembled. Thus, the iPhone's value would not be attributed in its entirety to China but also to Germany and Japan, which produce components, and to the United States, which contributes the design.

The authors also challenge the "currency war" idea. The United States has long accused China of "manipulating" its currency, the yuan, so that "made in China" goods can be sold for less and take over world markets. As it happens, a large proportion of these "made in China" goods are in fact brought to market by foreign companies, many of them American.

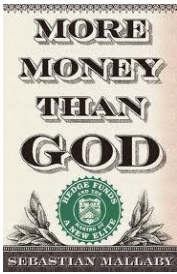
The authors suggest a solution for restoring the U.S. export balance. They have calculated the cost of relocating the assembly of products to the United States, where labour costs "ten times as much." The iPhone's production cost would go up by \$68, reaching \$240.

The company could still sell the product at the same price, the report notes, but would have to accept a slight cut in its profit margin. This margin would then be only 50% on each iPhone sold, as much as when the product came out in 2007, compared with 64% today. If high-tech firms "are willing to share their profits with low-skilled American workers by keeping assembly jobs in the U.S., it would be more effective in reducing the U.S. trade deficits than targeting the exchange rate policy," they conclude. This observation takes aim at Apple and its margins as much as at the U.S. government and its currency war.

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BOOK REVIEW



More Money Than God: Hedge Funds and the Making of a New Elite

Hedge Funds, the great money makers, or the great villains, or the great whatever you wish to call them. Some of them are superb vehicles for intelligent investing, and some are shoddy creations by unqualified and sometimes dishonest people. Depending on which one you invested in, you will either love or loath hedge funds.

Mr. Mallaby has written an interesting and very well researched book on hedge funds and the people behind them. Going back into the 1950s he outlines how they were able to become so successful in an otherwise conventional world.

Nowadays the call for tighter regulation of hedge funds is very loud, and again you will be for or against it depending on your past experiences. Mr. Mallaby is clearly of the opinion that more regulation is not the answer, and that investing in hedge funds should be available to smart people who can judge the soundness, or lack of it, of an investment. He has a point, smart money is called smart for a reason.

What makes hedge funds different from your standard stock and bond portfolio? They are not as tightly regulated, hence the call for more regulation. Successful managers, and sometimes not so successful ones as well, charge a performance fee. Given their freedom to invest,

they are often isolated from market swings. They go long and/or short and they use leverage to their hoped-for advantage. Their managers often have their own money invested in the funds and they live or die by their performances.

Does this make them a threat to the financial system? That is difficult to argue. The average hedge fund used leverage much more responsibly than had the large US investment banks. They do not consider themselves as too large to fail, and management more often than not operates as a unit rather than each member looking only for his own personal advantage.

Hedge fund managers cannot be believers in the efficient-market theory and they have taught us to look beyond existing knowledge. As such hedge fund managers were far ahead of academics who held on to their convenient theories for far too long. Much knowledge was gained by trial and error, which is a better teacher than academic research into a convenient but non-existing world. Excesses aside, we have much to be thankful for to hedge funds, and Mr. Mallaby helps us understand that popular hedge fund bashing is not a good idea. Let him convince you. But always remember, by investing in hedge funds you will have to make a judgment call. Better to be an astute investor!



MARKET WATCH

Selection of Financial & Economic Indicators

Index	DJ Ind	DJ Transp.	Nasdaq	S&P500	S&P/TSX	MSCI World
February 28	12226,34	5084,90	2782,27	1327,22	14136,50	1351,65
Monthly var.	2,81%	1,19%	3,04%	3,20%	4,31%	3,33%
Year-to-date	5,60%	-0,43%	4,88%	5,53%	5,16%	5,60%
Year-over-year	18,41%	22,98%	24,31%	20,17%	21,53%	19,26%

Index	FTSE	DAX.	CAC40	SMI	NIKKEI	EURO50
February 28	5994,01	7272,32	4110,35	6610,44	10624,09	3013,09
Monthly var.	2,24%	2,75%	2,62%	2,03%	3,77%	2,01%
Year-to-date	1,59%	5,18%	8,03%	2,71%	3,86%	7,89%
Year-over-year	11,94%	29,90%	10,83%	-1,50%	4,92%	10,43%

Commodities	GOLD	COPPER	CRUDE	WHEAT	LUMBER	CRB
February 28	1408,10	449,40	97,00	817,00	307,80	352,58
Monthly var.	5,86%	0,90%	5,21%	-2,82%	-1,57%	3,26%
Year-to-date	-0,82%	1,25%	6,13%	2,86%	-3,81%	5,94%
Year-over-year	26,03%	36,85%	21,66%	57,34%	13,12%	28,32%

Currencies	\$CA	¥	€	£	\$AU
February 28	0,9710	81,7500	1,3800	1,6260	1,0185
Monthly var.	3,00%	0,43%	0,80%	1,56%	2,16%
Year-to-date	2,51%	-0,68%	3,22%	4,23%	-0,54%
Year-over-year	7,74%	8,04%	1,28%	6,62%	13,74%

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