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Editorial
A lesson from aeronautics

Rolf Spielmann

The American aircraft manufacturer Sikorsky's X2 experimental helicopter is a marvel of engineering, it has reached speeds of 430 km/h. The previous record, 400 km/h was held since 1986 by a Westland Lynx helicopter. Sikorsky's counter-rotating rotors make it possible to produce equal amount of lift on each side of the rotors, therefore providing stability. It is an interesting concept with far-reaching applications. This is but one of many...

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European Observer
The exchange-rate war and its consequences

Luc Granger

September 2010 saw an accentuation of "monetary protectionism" by certain countries. Like Japan, China and some other emerging countries, including Thailand and Brazil, the United States is trying to devalue its currency to restore its international competitiveness. This is an easy way for these countries to export their problems, applying an "everyone looking out for himself" policy...

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Book Review
Red Plenty: Inside the Fifties' Soviet Dream

Francis Spufford
Faber & Faber 2010

During the awful years of the Cold War, to us Westerners, the Soviet Union always was a mystery, no doubt just as we were to the Soviet population. Nikita Khrushchev saw with his own eyes and in disbelief the wealth of the United States during his US visit in 1959 and promised his countrymen that by the 1980s they would live in a land of plenty. What has always amazed, even puzzled, is that Soviet leaders could make so ...

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A lesson from aeronautics

The American aircraft manufacturer Sikorsky's X2 experimental helicopter is a marvel of engineering, reaching speeds of 430 km/h.

The previous record of 400 km/h was held since 1986 by a Westland Lynx helicopter. Sikorsky's counter-rotating rotors make it possible to produce equal amount of lift on each side of the rotors, thereby providing sound stability. It is an interesting concept with far-reaching applications and it is but one of many technological advances which are built into the X2.

But why are we talking about helicopters? Because 24 years to design a helicopter that can fly 30 km/h faster seems like a long time. The careful, well thought-out engineering which is built into the X2 is reassuring because it has been thoroughly researched, tested, tested some more, improved and then improved some more, and finally built into a prototype. It will take years before an army pilot will fly this helicopter or before civilians get to use it. Untold hours of testing will be required to assure the highest level of safety, as we duly require of the aviation industry. Regulators will assure that every perceived protocol is strictly observed and that nothing will be left to chance.

This stands in sharp contrast to the financial industry where safety used to be, but no longer is, an issue. Safety, i.e. the preservation of capital, became an afterthought in a world of opportunities, bubbles and general blindness. And regulators did little to stop this process. While in aviation the regulators must be at the leading edge, in finance they regularly seem one step behind the disaster. True, the fancy financial instruments with which unwary investors were showered also have been tested, but apparently always in a perfect world, the

kind of world an aviation expert would assume at his own peril.

In the aviation industry we would never find a situation where, for example, Boeing hires an independent firm to certify a new airplane, and Boeing pays the firm good money for the certification. In finance, however, this is the accepted way, with the rating agencies being those "independent" firms, and few are questioning whether this is a healthy situation. While we demand that the aviation industry lives up to the most stringent requirements so that we can safely fly from point A to point B, we let the financial industry apply the greater fool's theory and we get mad as hell when we, the public, end up being the ultimate fools... Regulators then feel sorry for us, offering an insincere *mea culpa* and remedying the situation with taxpayer money.

Airplanes are not financial instruments, but when we look at the careful engineering that goes and always has gone into a plane, we must wonder how we so readily let shoddy financial engineering ruin us. There is a lesson in this. Every evening there is a Convair 580 flying over my house on its way to Montreal's Dorval airport. Its airframe was built 60 years ago and today, with new engines, it is as much a workhorse as it was 60 years ago. In 60 years' time will we still marvel at, and benefit from, the financial instruments which are offered to us today?

By Rolf Spielmann, CFA
Senior Vice President of BLUE BRIDGE®





The Exchange Rate and its consequences

(Translated from French)

September 2010 saw an accentuation of “monetary protectionism” by certain countries. Like Japan, China and some other emerging countries, including Thailand and Brazil, the United States is trying to devalue its currency to restore its international competitiveness. This is an easy way for these countries to export their problems, adopting an “everyone for himself” policy. Such behaviour by central banks has obvious short-term tactical aims: preparing to their own advantage for the mid-November G20 meetings in Korea. Nevertheless, we have to wonder about the long-term consequences of massive and recurring central bank interventions in currency markets.

In practice, the intervention by a central bank most often involves the sale of its own currency in exchange for a “friendly” currency (thus, for example, the Swiss National Bank sold last summer Swiss francs for Euros). The crucial question that arises concerns the financing of these operations by currency-issuing bodies. Japan admitted that monetary creation was the reason for its intervention. The case of the U.S. Federal Reserve with its quantitative easing program, Mark II, as well as that of the Swiss National Bank are examples of the same tactic. All these interventions bring additional liquidity to the international monetary system, which it hardly lacked in before.

The more the issuing institutions create money to restore their competitiveness, the more they potentially weaken the value of their currency, BUT ALSO that of the world’s other currencies. In a system of flexible exchange rates, an overabundance of Currency A can be transmitted to Currency B. It is easy to imagine the forces currently pushing the dollar down deciding to

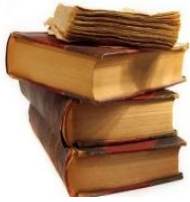
turn against it and push it up, especially against the euro, should there be a change in sentiment. This new situation requires asset managers to be increasingly vigilant against a loss of value in the currency in which their wealth is denominated. Facing this risk of loss of value in a currency, the European-based managers we see in our monthly meetings are most often recommending:

- investing in raw materials and gold;
- favouring equities and real estate;
- investing outside the reference currency in a basket of currencies.

There is nothing especially original in this advice, you may say, except that investors may now be pushed to invest their treasury rather than keeping it mostly liquid. Cash invested in a client’s reference currency risks losing its status as an absolutely secure asset, with the yield being insufficient to offset the currency’s loss in value. What remains to be done is to measure this loss in value on a regular basis using a pertinent indicator, since it is quite evident today that the inflation rate is a very imperfect measure of this phenomenon of currency erosion. But that is a whole other story.

**By Luc Granger, Founding associate
Intuitae Family Office**





Red Plenty: Inside the Fifties' Soviet Dream

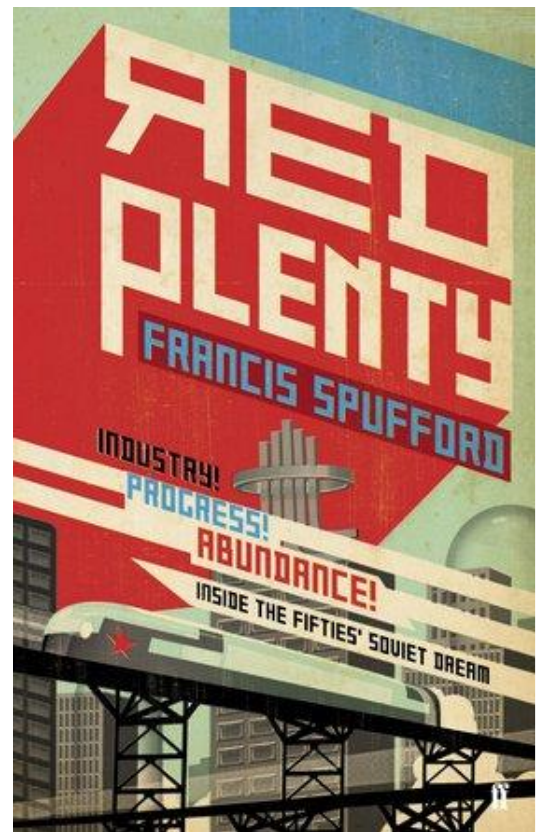
By Francis Spufford
Faber & Faber
2010

During the awful years of the Cold War, to us Westerners, the Soviet Union always was a mystery, no doubt just as we were to the Soviet population. Nikita Khrushchev saw with his own eyes and watched in disbelief the wealth of the United States during his US visit in 1959, consequently promising his countrymen that by the 1980s they would live in a land of plenty. What has always amazed, even puzzled, is that Soviet leaders could make so many promises and find so many believers. In this book, Francis Spufford explains in much detail what made the system believable during the time it lasted.

The race for economic (hence military) dominance between the USSR and the US was a feature of daily life after World War II. The Soviet Union, particularly in the 1950s officially showed impressive growth rates, despite the known fact that productivity was low. It was clear what was happening: growth was the result of capital being burned, which is not a sustainable situation, for capital is not unlimited in an unproductive world. It took the discovery of Siberian oil in the late 1960's to sustain the system a while longer.

Despite rosy official declarations and government reports of powerful economic growth, reports out of the Soviet Union confirmed that life was miserable for anybody not belonging to the Nomenklatura and Mr. Spufford examines why this situation was so easily accepted by a disadvantaged population. Of course, those were the years before the internet when information traveled slowly. Regardless, Mr. Spufford explains convincingly how we all, living in one system, find it difficult to imagine living in another system. We know and knew how awful the Soviet system was, but Mr. Spufford also gives us reason to examine our own system encouraging us to maybe be a bit more critical of the world we are living in.

A system built on promises and artificial data cannot last, as the collapse of the Soviet Union has shown. The official rate of the Ruble was always slightly higher than the US\$ exchange rate, but the unofficial rate showed that the Ruble was close to worthless. What amazes is how long this system managed to survive, how long this Potemkin village could fool, not only its inhabitants, but also the outsiders. This is a fascinating story that will grip not only those who lived through the Cold War, but also those who wish to understand what those years were like. In its review, The Economist points out the one problem of the book: The prize that it deserves to win, should it be for fiction or for non-fiction? You, the reader, shall decide!



Selection of Financial & Economic Indicators

Index	DJ I	DJ Transp.	Nasdaq	S&P500	S&P/TSX	MSCI World
October 29	11118,49	4754,29	2507,41	1183,26	12676,24	1222,23
Monthly var.	3,06%	5,13%	5,86%	3,69%	2,49%	3,65%
Year-to-date	6,62%	15,97%	10,50%	6,11%	8,14%	4,60%
Year-over-year	14,47%	31,44%	22,61%	14,19%	16,51%	10,49%

Index	FTSE	DAX.	CAC40	SMI	NIKKEI	EURO50
October 29	5675,16	6601,37	3833,50	6472,23	9202,45	2844,99
Monthly var.	2,28%	5,98%	3,18%	2,79%	-1,78%	3,53%
Year-to-date	4,85%	10,81%	-2,61%	-1,13%	-12,74%	-4,09%
Year-over-year	12,50%	21,91%	6,26%	2,97%	-8,29%	3,70%

Commodities	GOLD	COPPER	CRUDE	WHEAT	LUMBER	CRB
October 29	1358,40	374,95	81,38	717,25	280,70	300,67
Monthly var.	3,66%	2,59%	1,79%	6,42%	22,74%	4,81%
Year-to-date	23,94%	12,14%	1,92%	30,83%	20,47%	5,69%
Year-over-year	30,49%	27,10%	5,69%	45,12%	33,41%	11,19%

Currencies	\$CA	¥	€	£	\$AU
October 29	1,0215	80,4500	1,3925	1,6025	0,9810
Monthly var.	0,73%	3,65%	2,16%	2,04%	1,55%
Year-to-date	2,44%	13,59%	-2,83%	-0,93%	9,24%
Year-over-year	5,46%	10,71%	-5,43%	-2,44%	8,94%

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