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## EDITORIAL

The markets finally saw a positive month in October, the first since the beginning of the crisis. The market rebound stemmed from some hope that the euro zone will resolve its internal problems and recapitalize its financial institutions once and for all. It is worth mentioning here that since the 2008 crisis, EU members have implemented only temporary measures. As a result, all eyes were on the 14th European summit on the state of the crisis. In our opinion, a lasting resolution to the problems requires time, money and plenty of concessions from all concerned. Indeed, there is no point recapitalizing the banks if there is no change to the sovereign debt problem.

In spite of the cautious approach we have adopted in the past several months, I would like to take the opportunity to specify that although the extreme scenarios we are considering include the end of the euro and the complete crumbling of the European banking system, they are not our most probable scenarios. We are positioning ourselves based on a scenario of low, even sluggish, economic growth. The latest economic data tend to indicate low growth in the United States and a recession in Europe. China, the second largest economy in the world, will no doubt make the difference in some way in 2012. However, none of the three has the same level of flexibility that they had in 2008.

In terms of strategy, we are consolidating certain bond positions while investors appear to have regained confidence in more risky assets. We are aware that our current strategy of underweighting equity is now entering a delicate phase while many managers and investors are counting on an end-of-year recovery, as has been the case in the past. Given the nature of our mandates, we have to adopt a defensive approach in order to protect the capital. As a result, we are waiting for more convincing signs to increase our clients' exposure to risk. At the moment, many more market movements are being determined by unexpected and sometimes illogical political interventions, rather than economic data or the financial health of companies. We had therefore already decreased our underweighting in equities at the low point in the markets in order to mitigate this unknown factor; we are currently not prepared to increase exposure to risk.

In terms of diversification, we are finalizing proposals for real assets. Firstly, they will enable our clients to invest, via different managers, in large-scale real-estate, infrastructure and agricultural projects that provide diversification and significant sources of revenues. Other solutions, such as investments in the forestry or energy industries, may subsequently be integrated. These products respond to a need expressed by many of our clients and are geared toward those who are prepared to sacrifice liquidity (for four to eight years) in order to hold real assets that could generate more revenues.

**Minh Nguyen, CFA**  
Chief investment officer  
**BLUE BRIDGE**



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FEATURE ARTICLE

# US real estate, has it reached bottom?

For a market that could never go down, US real estate has done remarkably poorly. Then again, those who had loudly declared that the housing market could only go up had not looked at history, they had only looked at the most recent past. And those who banked on eternal appreciation, be it borrowers or lenders, learned the sobering truth that if a market can go up, it can also go down.

Today, after a number of years of misery, foreclosures are still a problem and while the US NAHB Housing Market Index shows that prices might be bottoming, there are no signs of a rebound.

The problem is not the availability of money, there is plenty of money out there, maybe far too much money. The problem is that America is forced to deleverage after an unprecedented period of leveraging. This necessity makes it almost impossible to get households out of their debt-minimization mode. This might turn into a positive development longer-term, but it is rather negative short-term.

The ineffectiveness of record-low interest rates to spur demand is a fact that troubles policy makers and central bankers. The global banking and balance sheet crisis that burst upon the scene in 2008 has left an enormous overhand of deleveraging, of deflationary psychology and of uncertainty. Look at the daily fluctuations in equity markets and you will agree that uncertainty is the only certainty. Consumers know this, they only need to look at their balance sheets to understand that economic survival depends on saving and not on spending.

The liquidity trap has rendered monetary policy ineffective. Central banks can provide enormous amounts of excess reserves, but if there is no demand for money, there will not be any productive investments. There is a reason why QE1 and QE2 gave us limited results despite their size.



Now we are in a quandary. The often hailed US labor flexibility is at stake. There was a time when workers moved with jobs. The house would be put up for sale, equity would be cashed in, and shortly thereafter a new house would be bought in another place.

But the world has changed. With all too many home owners staring at negative equity in their homes, to sell and move is no longer an easy option. With this the positive flow of available labor has dried up, thus hampering an economic recovery. Unemployment has remained stubbornly high in this vicious cycle: No rebound in the housing market – no labor flexibility – no economic expansion –no decline in unemployment – no rebound in the housing market.

The glimmering light at the end of the tunnel is demographics which are far better in North America than in Europe and Japan. The overall US population has grown by 7% over the past 5 years and over the coming 5 years the number of 20-34 year olds will increase by 4%. Household formation therefore will continue on an upward slope and as such housing stands a chance of rebounding in due course since over the past three years housing starts have run at about 50% of household formation.

But this is not a short-term solution, deleveraging might take another 5 years, maybe longer. We have to accept that time has come to pay the price for past exaggerations. Unfortunate as this may be, the upside is that this will gradually create the basis for a healthier future.



**Rolf Spielmann, CFA**  
**Senior Vice President**  
**& Chief Strategist**  
**BLUE BRIDGE**



## ECONOMY



## Hedge Funds : The evolution of an industry

The need to diversify beyond the stock market is something we try to convey to all of our clients. But when 10-year treasury yields are well below the S&P 500 dividend yield and sovereign debt issues are contaminating global markets, the case for OECD bonds is understandably harder to make. On the other hand, current sluggish growth in the developed world and low interest rates make for compelling parallels with the Japanese story of the 1980's, in which case rates could dip even lower and government bonds would be big winners. In this unpredictable environment, we are advocating as much as ever the concept of proper diversification and it is in that sense that we have been focusing a lot of our research on different alternative investment solutions. This month, we thought it would be pertinent to draw an *état des lieux* on the Hedge Fund industry which has gone through an extreme makeover during the last 4 years.

Hedge Funds were hit hard during the financial crisis. According to Hedge Fund research Inc., the average fund lost 19% in 2008, making it the worst year on record for the asset class. Those returns, coupled with massive investor redemptions, fund blow-ups and frauds such as Bernie Madoff's Ponzi Scheme, cut the industry's size by one quarter and more importantly tarnished the industry's image with investors. Today, reports suggest that total hedge-fund assets have surpassed \$2 trillion, above their previous pre-crisis peak of almost \$1.9 trillion in 2007. This recent comeback cannot be compared to the dynamics of the industry prior to the financial crisis when managers found it easy to raise money and investors tolerated opacity as a trade-off for double digit returns.

Nowadays, the Hedge Fund industry is indeed more regulated and more transparent. Investors have increased their due diligence requirements before committing capital, third parties are now providing independent risk and exposure information and managers have shown a willingness to disclose information that is easier to understand and made available faster. Blue Bridge acknowledges that this

has become industry standard. We receive updates on detailed positions from hedge funds and we get direct access to their managers. Now whilst this transparency has enabled us to analyse several strategies and approve new ones for our clients, it has also reiterated which role we wish hedge funds to play in our client portfolios and which misconception of the industry we should be avoiding.

In fact, it has been through promises of good returns in good and bad times that many hedge funds have disappointed. While the average fund lost 19% in 2008, it also had disappointing returns in 2009 (20%) and in 2010 (10.3%) when compared to the S&P 500 which rallied 26.5% and 15.1% during those same periods. It is in this context that Blue Bridge is not aiming to pay hedge fund managers for beta or directionality. While Mr. John Paulson made billions by correctly betting against the housing bubble, his flagship fund has suffered great losses this year, down more than 30% at the beginning of August. It is particularly this type of directionality that we are trying to avoid as the role for hedge funds in our client asset allocations remains de-correlation and low volatility.

We can assert with confidence that the days when hedge funds ran unchecked because of the returns they produced and the aura around their billionaire managers are over. However, it is now for investors to utilize this transparency to conduct better due diligence and identify the best suited hedge funds to reach optimal portfolio diversification.



**Cédric Cayla**  
**Investment Manager**  
**BLUE BRIDGE**



## BOOK REVIEW

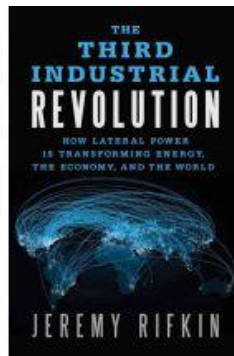
# The third industrial revolution: How Lateral Power Is Transforming Energy, the Economy, and the World

Facing the prospect of a second collapse of the global economy, America and the world are in a desperate search for a sustainable economic game plan that can take us into the future.

Jeremy Rifkin's new book, *THE THIRD INDUSTRIAL REVOLUTION* explores how Internet technology and renewable energy are merging to create a powerful "Third Industrial Revolution" that will transform the way we work and live in the 21st century. Rifkin asks us to imagine hundreds of millions of people producing their own green energy in their homes, offices, and factories and sharing it with each other on an "energy internet," just like we now create and share information online. The democratization of energy will bring with it a fundamental reordering of human relationships, from hierarchical to lateral power, impacting the way we govern society, conduct business, educate our children and engage in civic life.

While the First and Second Industrial Revolutions were accompanied by national economies and nation state governance, the Third Industrial Revolution scales laterally across continents, creating continental economies and continental political unions. According to Rifkin, we are beginning the long transition from nationalism to continentalization and from geopolitics to biosphere politics.

After decades of advising European heads of state, the European Parliament issued a formal declaration calling for the implementation of Rifkin's Third Industrial Revolution. The five pillar infrastructure plan, which will usher in a new economic era, create thousands of new businesses and millions of new jobs, is now spreading to other nations in Asia, Africa, and the Americas.



The Third Industrial Revolution is an insider's account of the next great economic paradigm, including a look into the personalities and players — heads of state, global CEOs, social entrepreneurs, and NGOs — who are pioneering its implementation around the world.

Jeremy Rifkin is president of the Foundation on Economic Trends and the author of eighteen bestselling books, including *The Hydrogen Economy* and *The End of Work*. He has been a guest on *Face the Nation*, *The Lehrer News Hour*, *20/20*, *Larry King Live*, *Today*, and *Good Morning America*. *The National Journal* named Rifkin as one of 150 people in the U.S. that have the most influence in shaping federal government policy.

By Jeremy Rifkin

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## MARKET WATCH

## Selection of Financial &amp; Economic Indicators

Index	DJ Ind	DJ Transp.	Nasdaq	S&P500	S&P/TSX	MSCI World
October 31th	11955,01	4892,57	2684,41	1253,30	12252,10	1254,20
Monthly var.	9,54%	16,79%	11,14%	10,77%	5,41%	13,60%
Year-to-date	3,26%	-4,19%	1,19%	-0,35%	-8,86%	-2,02%
Year-over-year	7,52%	2,91%	7,06%	5,92%	-3,35%	2,62%

Index	FTSE	DAX.	CAC40	SMI	NIKKEI	EURO50
October 31th	5544,22	6141,34	3242,84	5731,27	8988,39	2385,22
Monthly var.	8,11%	11,62%	8,75%	3,61%	3,31%	9,43%
Year-to-date	-6,03%	-11,18%	-14,77%	-10,95%	-12,13%	-14,59%
Year-over-year	-2,31%	-6,97%	-15,41%	-11,45%	-2,33%	-16,16%

Commodities	GOLD	COPPER	CRUDE	WHEAT	LUMBER	CRB
October 31th	1711,60	358,10	92,58	628,25	224,20	319,84
Monthly var.	5,50%	13,61%	16,89%	3,12%	6,21%	7,27%
Year-to-date	20,56%	-19,32%	1,29%	-20,90%	-29,94%	-3,89%
Year-over-year	26,00%	-4,49%	13,76%	-12,41%	-20,13%	6,38%

Currencies	\$CA	¥	€	£	\$AU
October 31th	0,9993	78,3500	1,3849	1,6068	1,0537
Monthly var.	4,86%	-1,67%	3,45%	3,11%	9,06%
Year-to-date	-0,33%	3,51%	3,58%	3,00%	2,90%
Year-over-year	2,17%	2,61%	-0,55%	0,27%	7,41%

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