

- **P. 1 Sticks or carrots**
- **P. 2 Few words on security valuation**
- **P. 3 Crash Course: The American Automobile Industry's Road From Glory To Disaster**
- **P. 4 Selection of Financial & Economic Indicators**



### **Sticks or carrots**

Where do we get our motivation from to perform well? Is it the bonus we bring home as a reward for a job well done, or is it the satisfaction we gained from doing the job well? There are no clear answers to this, albeit when one listens to the daily bashing of greedy bankers, the answer seems obvious!

In his book "Drive: The Surprising Truth About What Motivates US", Daniel Pink argues that the stick and carrot approach no longer works and that we are moving to "Motivation 3.0". In this context, "Motivation 1.0" was our fear in prehistoric times of being eaten by wild animals. "Motivation 2.0" was the idea to reward better performance with better pay, but this approach, Mr. Pink concludes, is now more of a motivation killer than a motivator.

Examples of "Motivation 3.0" would be Linux and Firefox which were created by volunteers who found satisfaction in the process of creating something for the common good. The motivation then would be for an individual to gain more control over his life and by doing so he would be driven by his own will to succeed and his personal, not imposed, diligence. Every individual wished to have a "purpose", indeed we need a purpose to live a worthwhile life. The question

then is what truly drives that purpose, is it monetary rewards or intrinsic rewards.

Having come into the work place in the mid-1960s, I have witnessed many changes, some good and some not so good. I believe that the work place was more human 40 years ago than it is today. I have always watched people trying to better themselves, but I feel that today they pay a higher price than an earlier generation did. I see young professionals who work inhuman hours at low pay for the chance of one day being named a partner, or allowed to join a stock-option plan. I see that people struggle more than in the past to make ends meet. And all the while those people likely dream of a chance to better control their lives and destinies. But reality is one thing and a dream is something else.

Globalization has brought us many advantages, but it has sharply increased competition, which is the offset to the low prices we see at Walmart. "Motivation 3.0" is no doubt a wonderful idea and its time may well come, but "Motivation 2.0" is still very much the driver of today's world. Yes the greed of bankers may discredit "Motivation 2.0", but only few are bankers and the rest is struggling daily and hoping for the monetary rewards that are supposed to come with hard work. Sticks and carrots may work a while longer!

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

## Few words on security valuation

The Reserve Bank of India announced on March 19<sup>th</sup> that it was immediately increasing its short-term rates – its repo rate from 4.75% to 5% and its reverse repo rate from 3.25% to 3.5%. This interest rate hike was triggered because “developments on the inflation front are a source of growing concern”.

Even though reports released by the Reserve Bank at the end of January 2010 were already expressing the concerns of India’s Central Bank, this interest rate hike took the market by surprise since the expectation was for an announcement in April. The day after the news release the Sensex 30 Index, one of India’s main equity indices, fell by (0.95%) but then recovered in the following days.



The strong stance taken by the Reserve Bank of India against inflation, particularly inflation of food prices, is understandable if we consider that in 2005 India still counted approximately 456 million people living on US \$1.25 or less per day, which is 41.6% of its population. The World Bank projects that this number should decrease to 25.4% by 2015. These high numbers imply that this more restrictive monetary policy, which actually began in October 2009, may have further to go.

This is a good opportunity to remind ourselves of what financial theories say about the impact of interest rates on valuation of equity and fixed income securities. As this newsletter does not allow for an exhaustive theoretical review, the following will be brief and risks over-simplifying.

The overall principle followed by valuation models is that the value of a security should be equal to the sum of its discounted future cash flow. If you hold a fixed-income bond that pays an annual coupon of \$50 and

reimburses the principle, say \$1,000, at the end of two years, the value of this bond should be equal to the sum of the discounted coupon payments of \$50 each in years one and two and the discounted payment of the principle at maturity.

The cash flow paid by a security, equity or bond, cannot be simply added. They have to be discounted first to reflect the “time value of money,” summarized by the saying “one dollar today is worth more than one dollar tomorrow.” Without going into the details of the mathematical formula, the process of discounting is a simple one as it requires dividing each cash flow, in our example \$50, \$50 and \$1,000, by a discount rate. This discount rate is based on the rates provided by the money market and includes a premium to compensate for various risks, e.g. default, inflation, lack of liquidity etc. The process of valuing equity follows the same logic. However, because equities do not pay a coupon, measuring of cash flow can be done in various ways and one of them is to look at dividends.

Everything else being equal, we understand from the explanation above that the increase in interest rates, which are strongly influenced by the intervention of central banks, could have a negative impact on the valuation of equities and bonds. This impact will be either gradual or rapid, depending upon whether this change of interest rate was anticipated by the markets.

This brings us back to the warning shots given by the Indian Central Banks regarding inflation. The question is whether the coming quarters will bring more surprises. Rising inflation would likely trigger further interest rate hikes, which could have a negative impact on valuations of Indian equities and bonds. It also raises questions on the situation of China, which has already taken some measures to cool down its economy and contain inflation. The market consensus is that the prospects for India and China are positive. The IMF, in its recent World Economic Outlook Update, mentioned that in 2010 their respective GDP’s are expected to grow by 7.7% and 10%. However, equity and bond holders should still be prepared for a bumpy road.

***By Gwenolé Le Blevennec  
Lepercq, de Neuflyze & Co***



## **Crash Course: The American Automobile Industry's Road From Glory To Disaster**

*By Paul Ingrassia  
Random House, 2010*

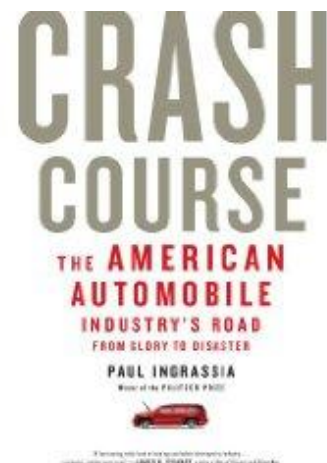
Your reviewer purchased a spanking new Pontiac Firebird in 1975...and has not gone near a GM, and neither a Ford, or Chrysler dealership every since, so bad, no actually so horrendous was his experience with that car. This was all too common an experience amongst car buyers, and in this book Mr. Ingrassia gives us an excellent idea how this all came about, how complacency won over efficiency, how labor and management alike made all the wrong choices as they watched their market melt away. Instead of improving assembly lines and designing efficient cars, they enjoyed a few years of glory building gas-guzzling, money-making SUV's before the rise in oil prices killed that segment of the market and they were forced to subsidize every car they sold.

What makes this book worth reading is the fact that Mr. Ingrassia, a former Wall Street Journal reporter and editor, knows the industry inside out, from factory floor to executive suite, from the questionable motives of the unions to the equally questionable motives of management. He describes in chilling details how intransigence of management and unions alike created an insane and self-destructive world that neither side either recognized or had the courage to attempt fixing.

One reads about the notorious "job banks" which guaranteed laid-off workers almost 100% of their salaries indefinitely. While this sounds like a bad joke, it was a reality which made American clunkers more expensive than finely-engineered foreign cars. This crazy system enticed workers to voluntarily be laid off, and frankly why not, better to be paid 95% of salary for watching TV than 100% for assembling cars.

America's native car industry failed in many ways. Global competition was not recognized until it was far too late. Quality was not an issue, if it had four wheels a car was ready to be shipped to a dealer. The assumption was that oil prices would forever stay low, despite ample indications that global supply was diminishing. Management assumed that unions would play ball and give up some perks, but the unions were not ready to give an inch to their fat-cat bosses. And so the house of cards collapsed, as it had to.

This is a sobering tale, one that so far has been told in detail in very few books only. Mr. Ingrassia's book is an eye opener; there is a wealth of inside information of a world that was destined to collapse. The question is, why did so many consider it a surprise when the inevitable finally happened?



## Selection of Financial & Economic Indicators

Index	DJ I	DJ Transp.	Nasdaq	S&P500	S&P/TSX	MSCI World
March 31	10856,63	4374,62	2397,96	1169,43	12037,73	1200,53
Monthly var.	5,15 %	5,81 %	7,14 %	5,88 %	3,51 %	5,93 %
Year-to-date	4,11 %	6,71 %	5,68 %	4,87 %	2,48 %	2,74 %
Year-over-year	42,68 %	62,98 %	56,87 %	46,57 %	38,04 %	49,10 %

Index	FTSE	DAX.	CAC40	SMI	NIKKEI	EURO50
March 31	5679,64	6153,55	3974,01	6873,37	11089,94	2931,16
Monthly var.	6,07 %	9,92 %	7,15 %	2,42 %	9,52 %	7,43 %
Year-to-date	4,93 %	3,29 %	0,96 %	5,00 %	5,15 %	-1,18 %
Year-over-year	44,66 %	50,65 %	41,56 %	39,49 %	36,75 %	41,52 %

Commodities	GOLD	COPPER	CRUDE	WHEAT	LUMBER	CRB
March 31	1114,50	355,35	83,76	464,00	287,20	273,34
Monthly var.	-0,39 %	4,21 %	5,15 %	-10,64 %	11,75 %	-0,52 %
Year-to-date	1,67 %	6,19 %	5,54 %	-14,31 %	40,10 %	-3,54 %
Year-over-year	21,01 %	93,06 %	70,49 %	-12,90 %	67,66 %	24,02 %

Currencies	\$CA	¥	€	£	\$AU
March 31	1,0157	93,4430	1,3507	1,5178	0,9168
Monthly var.	3,34 %	-4,98 %	-0,91 %	0,13 %	2,05 %
Year-to-date	3,52 %	-0,44 %	-5,70 %	-6,02 %	2,09 %
Year-over-year	19,42 %	5,61 %	1,69 %	5,80 %	31,91 %

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