

When stocks go crazy on the upside, well, they are usually part of an index. Apologists rationalize: “You pay for liquidity.” True, but portfolio managers also clone indices. The greatest example of this practice came less than a decade ago when Nortel climbed to 30% of the Toronto index, driven by portfolio managers who felt that to not own the stock was a career-destroying move. The other day Nortel came out with another poor quarter and today Nortel’s market cap is less than 1% (that’s one per cent) of the old high.

Recently institutional investors have bought fresh billions upon billions of bank shares because a) they understand the balance sheets? or b) bank shares are liquid and have big index representation? Likewise some, in fact all, of the high cap gold shares, the “go to” shares, are priced where they are because they a) represent value? or b) they are liquid and dominate the index?

We love gold more than most, but serious fissures are appearing in the “go to” gold stocks, in their finances and in their operations. In the 1970s an esteemed member of the gold mining industry told us: “It doesn’t matter what the gold price is if there’s no gold in the ground.” Too true. Today, after a decade of not coming close to replacing reserves, the gold mining industry is now in big trouble and chickens are coming home to roost. History has a habit of repeating and we note that few of the big names in gold mining in the 1960s managed to survive into the 1980s, notwithstanding the twenty-fold gold price increase of the 1970s. In Texas they say “Big hat, no cattle” to describe a blowhard; “Big expenses, few ounces” may work for more than a few miners.

Gold aside, all resources have been hammered.\* Investors in Canadian resources must feel as though they have emerged from Abu Ghraib. But the good news is that the new petro-currency, the loonie, has also been hit. After untold damage to Canadian manufacturers, foresters and even government budgets, reality is slowly returning. Without accusing the Canadian government of fomenting a competitive devaluation, that is in effect what is happening. In Canada and elsewhere. And the US has to encourage it in order to soothe the holders of trillions of greenbacks sloshing around the world.

- \* Plain vanilla commodities have certainly been hit hard, but in recent months plastics, industrial gasses (even though producers often have no raw material costs – they mine the sky), silicon for solar heating panels, funny things like niobium (IAMGOLD appears to be earning more from niobium than its half dozen gold mines) have all had fat price increases.

(over)

Policy makers, with a combination of action, rhetoric and a break in inflationary psychology have (sort of) restored confidence in the greenback. This is great, because they can now refocus on stimulating the economy, where the global bear market in real estate is deepening. This wouldn't matter that much but for the fact that banks have lent considerable jillions and a considerable percentage of their assets to entities secured with real estate. For six months we've heard a lot about sub-prime stuff; going forward we will hear more and more about shaky prime loans. Speculation in up-market real estate probably exceeds speculation in Nortel at its peak. North America has spent the last decades building too many mansions and malls and not enough factories. The day of reckoning is near.

It mystifies us that so many experts suggest real estate (they mean urban real estate) is "bottoming." True bottoms usually arrive with no comment, no interest and certainly no TV channels devoted entirely to the subject. Agriculture, iron ore, steel, these all had decades of bear markets. Forest products have been through a wringer and Nortel speaks for itself.

But it's an ill wind... The lower loonie will help the foresters; Domtar is finally making money. And the worse real estate gets, the more they will print. And that's good for (selected) stocks (buy value, not necessarily the index) and (selected) commodities (you know which ones!).

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