

A friend runs a small business selling products to four big markets: manufacturers, commercial, hospitality and, of course, government. As such, his business represents an economic bellwether. He pointed out that sales to the first three areas have been declining steadily for the past six months and the time for layoffs was approaching. (Government spending plows steadily along). Why, then, was the stock market doing so much better?

The great paradox. But, as we have said for decades, money makes the markets go and hyperinflation is on the horizon. This, not the real economy, is what the stock market is reflecting. The differential between the market and the economy can only increase as the Canadian government and nearly all governments print, print, print. As we have also pointed out, the worst inflations arise during periods of recession – with falling tax revenues and rising social costs there is only one source of money for governments. And good stocks are some of the few safe havens for money.

Nevertheless most of the financial community still clutches at the idea of the stock market being a (leading) indicator for the economy. Not only that, but they all hope the economy will return to the state it was in a few years ago with a big financial sector, a big service sector, a big real estate sector, and, in Canada, a big resource sector. This is what we know, so, amazingly, we pin our hopes on Teck.

In general, governments have big money for cars, for banks, for real estate, for consumer credit, everything to feed John Q as never before. The very activities that got us into this mess. At least certain business leaders in the US understand this and we quote Mr Jeffrey Immelt, CEO of General Electric, in his annual report:

“I have also learned something about my country. I run a global company, but I am a citizen of the U.S. I believe that a popular, thirty-year notion that the U.S. can evolve from being a technology and manufacturing leader to a service leader is just wrong. In the end, this philosophy transformed the financial services industry from one that supported commerce to a complex trading market that operated outside the economy. Real engineering was traded for financial engineering. In the end, our businesses, our government, and many local leaders lost sight of what makes a nation great: a passion for innovation.”

No truer arrow was ever shot, but the US still has a long list of great companies which adhere to the strongest capitalistic ideals. Canada, however, is being hollowed out at a scary pace. Nearly every Canadian branch plant of a US parent has been closed (with jobs and tax revenues moving south) and the benefits of the 80¢ dollar have now disappeared for the few surviving Canadian manufacturers. As for the poor foresters, the news could not be worse. Without the oil patch and Hydro-Québec, Canada would probably look a bit like those East European countries lining up at the IMF.

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As a big trading nation we have to wonder who's minding the store. Canadian GDP was down 5% in Q1 even with an 80¢ dollar – where would it have been with a 90¢ dollar? Our Finance Minister recently talked about a \$50 billion deficit. Again, where will that number be with a 90¢ dollar? Does anybody care?

Trading nations like China and Japan know how to deal with this sort of situation. If hedge funds or anybody else bids up the Yuan, well, China prints as many Yuan as the market wants, puts a lid on the exchange rate, and gathers up ever more US dollars. If they feel they have too many dollars, they buy gold, copper or something else. But they do not let the Yuan run away.

Canada will learn the hard way. With our economy in its current rocky condition, a strong loonie is no blessing – it's a huge handicap. Sooner rather than later exploding deficits will drive the loonie lower, and shares higher, but for a lot of companies real earnings appear several quarters away. More importantly, the next real bull market will likely be in Mr. Immelt's world rather than in the areas which drove the last bull market (and are still in favour). It will take a long time for the decades of over-expansion of the service sector to be absorbed and real economic recovery to take place.

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