

# Taking Stock with Steele

Your Monthly Newsletter

*The purpose of this newsletter is to share insights and expertise. Our goal is to ensure that our clients are well-informed of changes affecting local business decisions and our investment recommendations.*

*We believe Knowledge Pays and we want our knowledge to help pay for you.*

## ECONOMIC TIDBITS AN INVENTORY OF NOTABLE DATA AND INFO

- Since our last newsletter, markets have been volatile as improving economic data and eased monetary policy went head-to-head with renewed worries about Greece's ability to appease European finance ministers and restructure its debt in time for a March bond payment.
- The JPMorgan Global All-Industry Output Index hit an 11-month high in January, rising for the third straight month. Manufacturing expansion remained negligible as China struggles to engineer a "soft-landing" without stoking near-term inflation. Major employment gains were seen in the U.S., Germany, the UK, Brazil and Russia as the service sector in the developed world continues to lead the recovery. See Fig. 1 for chart of the JPMorgan Global All-Industry Output Index
- With a bond payment looming on March 20<sup>th</sup>, Greek leaders, bondholders and EU/IMF officials continue to work on bond swap and bailout terms. The EU/IMF demands have become progressively more rigid as Greek economic growth and data continues to come in worse than expected.

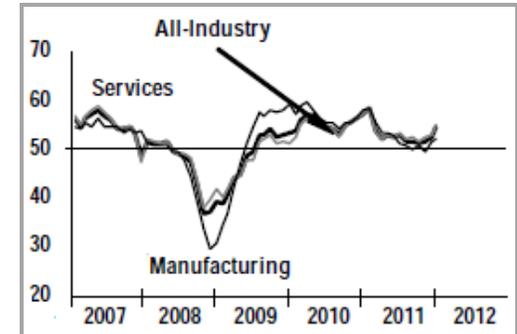
## LE JIT A "JUST-IN-TIME" RUNDOWN OF OUR CURRENT INVESTMENT THEME

### Revisiting Stocks in the Doghouse

- In a risk-rally, many "dogs" are left behind as investors tend to treat "once bad" companies as "always bad" companies
- Buying dogs can be dangerous as the valuation gap between the dog and its peers or historical trading multiples can stay wide indefinitely
- It is important to identify how the dog will close the valuation gap
- **TransAlta (TA)** and **SNC-Lavalin (SNC)** are two investment ideas related to this theme:
  - TransAlta is an electricity generation and marketing company. It is trying to shake-off the "coal-producer stigma" by investing heavily in renewable and gas-fired energy. See Fig. 2 for 2-year chart.
  - SNC-Lavalin is a global engineering and construction company. SNC is trying to soothe investor concern about its operations in Libya following the onset of a civil war in 2011. See Fig. 3 for 2-year chart.

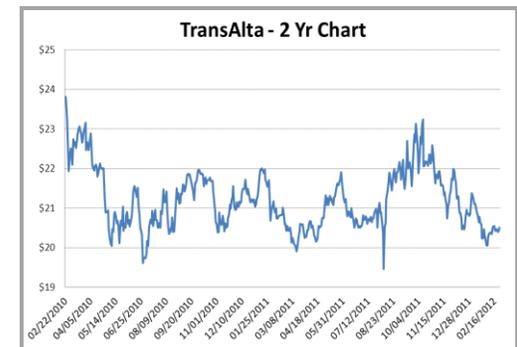
Fig. 1

### JPMorgan Global All-Industry PMI



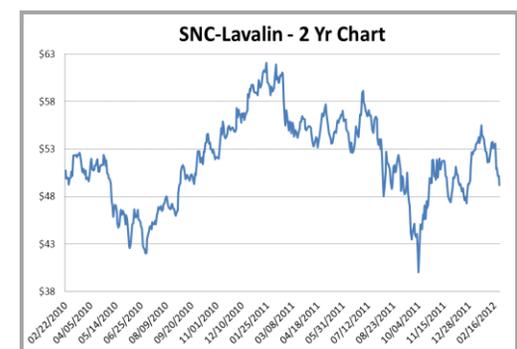
Data Source: JPMorgan/Markit/ISM/IFPSM

Fig. 2



Data Source: Market-Q

Fig. 3



## RIDING THE CURVE A CATALOG OF OUR MONTHLY FIXED INCOME FAVOURITES

### Cominar REIT Debenture E Maturing June 30<sup>th</sup>, 2017 (CUF.DB.E)

- Owns and operates a diversified set of real estate properties, primarily in Quebec
- This is a 5.3 year debenture with a conversion price of \$25 (current price: \$23)
- This debenture yields 4.89% until maturity at a current trading price of \$104

### West Coast Energy Perpetual Preferred J (W.PR.J)

- West Coast is a subsidiary of S&P 500 component Spectra Energy which stores, distributes, gathers and processes natural gas in North America.
- At \$25.26, the issue has a yield of 5.54% versus the yield on bank perpetuals of ~4.4%

## THE BIG PLAN THE INEVITABLE RETURN OF INTEREST RATE RISK

Since 2009, buying long-dated high-grade sovereign and corporate bonds rewarded investors with steady income and sizeable capital gains as credit risk remained low and yield curves flattened across the developed world due to global “ZIRP” (zero interest rate policy) and a general “flight-to-safety” in response to the ongoing Euro crisis.

### Investors Are Complacent About Inflation Risk and Interest Rate Risk

- Currently, Canadian investors have to buy 10+ year and 30+ year government bonds to match the central bank’s targeted and current inflation rates, respectively
- Interest rate risk is higher for bonds with longer maturities/“durations” as the bond price must factor in the interest rate change over a longer period of time
- So at this moment, bond investors are forced to expose themselves to great amounts of interest rate risk in order to avoid locking in a negative, inflation-adjusted return

### How Significant Is This Exposure?

- Ten and thirty year Government of Canada (GofC) bonds have durations of roughly 9 and 20 years, respectively. Duration indicates how sensitive a bond’s price is relative to changes in interest rates at a given time.
- A 1% increase in the yield of ten and thirty year GofC bonds will result in a price drop of approximately 9% and 20%, respectively, easily wiping out several years’ returns

What should investors do? We have been recommending for some time to invest in high-grade corporate bonds, debentures and preferred shares issued by established financial, real estate, foodstuff and utility companies. The additional yield received by taking on credit risk offsets much of the downside related to interest rate risk.

Avoid GICs as they generally yield less than the current inflation rate, unless the need for principal protection is of utmost importance.

## JEANNINE’S TIP O’ THE MONTH ENHANCING YOUR SWM EXPERIENCE

**2011 Income Tax Receipts** – Be sure that you have received all income tax receipts before filing your income tax return. In early March, we will provide a checklist of all the Canadian Resident income tax receipts you will receive. The checklist will be available online or by mail.

### Current Rates & Data

#### Govt of Canada

90 day	0.93%
1 year	1.01%
2 year	1.06%
5 year	1.42%
10 year	2.00%
30 year	2.60%

#### U.S. Treasury

90 day	0.10%
1 year	0.15%
2 year	0.27%
5 year	0.81%
10 year	1.94%
30 year	3.10%

#### Canada Prime Rate

3.00%

#### U.S. Prime Rate

3.25%

#### Canada CPI Y-o-Y (Dec)

2.30%

#### U.S. CPI Y-o-Y (Dec)

3.00%

#### Exchange Rates

CAD/USD	1.003
USD/EUR	1.313
JPY/USD	78.91

**This newsletter has been brought to you by Steele Wealth Management**

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All rates mentioned within this newsletter are as of February 16<sup>th</sup>, 2012, unless otherwise stated.

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