

Good morning,

Weaker retail sales (-0.4%) sparked the retreat to “basics” yesterday, in a flight to quality/USD repatriation move that had stocks ending lower and Treasuries higher (see chart below, right). The retail sales figure had somewhat been anticipated when the April Federal Budget deficit was released, on the back of lower tax receipts. The 30-yr on-the-run yield came down to 4.087%. The S&P 500 ended at 883.91 (-2.69%). In Canada, the TSX closed at 9706.07 (-3.69%) with the CAD trading lower, at 1.1756 C\$/USD. Credit also widened. The CDX IG12 closed at 153bps (+5bps) and the bond issuance window seems to be closer to a quick end. Libor continued to compress and 3-month ended at 0.88313%, with some analysts pointing out that \$400Bn in deposits on the sidelines is the driving factor. The Fed did not conduct any Treasuries purchases yesterday. In the Agency market, the Fed's steady purchases are nurturing a solid demand in this asset class, further supported by the fact that after the injection of Treasury capital, the US government will own an additional \$85bn of preferred stock in Fannie and Freddie. Finally, RR Donnelley announced its interest to buy the assets of Quebecor World, which is in bankruptcy proceedings, for \$1.35B (\$957MM in cash and 30MM shares of RRD stock = \$394MM (non-binding)).

Yesterday, we discussed how the correlation between oil and stocks (S&P 500) had weakened and suggested the possibility that the ongoing monetary expansion would disconnect commodity prices from aggregate demand. The logical question therefore rose, on whether this is the time to allocate capital into commodities and away from debt and stocks. Yesterday at 10:30am, the market was surprised by a drop in weekly inventories of 4.7MM barrels. The decrease is explained by the OPEC's success in cutting output, rather than an increase in demand. On this news, crude oil rose to \$60. However, the prospect of a weaker economy that retail sales had earlier shown, forced crude oil to follow stocks (chart below left).

May 13/09: Intraday: 30-yr Benchmark (white) vs. S&P500 (orange)



Source: Bloomberg

Analysis: Tincho's letter

May 13/09: Intraday: Crude Oil (white) vs. S&P500 (orange)



Are we left to reject the wisdom of a long-commodities position? I think yesterday's behaviour is somewhat connected to our Thesis No. 3: “Knowledge of an exit plan is a condition for the stocks AND credit markets NOT to fall”.

The market has not heard anything positive on this side yet. I know, Thesis No. 3 is difficult to contrast, but I am not trying to hide here. The thesis is related to the more fundamental issue that is the non-neutrality of the monetary expansion we are in. I will definitely elaborate more on this, which is also reflected on the negative 30-yr swap spreads we are currently seeing. Interestingly enough, there actually was an implicit commentary on the exit plan, when the Fed yesterday said **that they consider the recent jump in Treasury yields more as a reflection of a better economic outlook than a signal it needs to step up purchases of U.S. government debt.** Immediately after the release, an analyst made the comment that the Fed is approx. 20% ahead of schedule in its Treasuries purchases, a signal that it may extend or increase its program. Finally, in the middle of all this debate, the Financial Times published an article warning of the risk that the US will lose the AAA rating.

(Please, note that Tincho's Letter will not be published until next Tuesday, as we have a regatta at the Mississauga Sailing Club on Thursday evening and Monday is Victoria Day in Canada)

Martin Sibleau

martin@sibleau.com

(647) 999-2055

Disclaimer: The comments expressed in this publication are my own personal opinions only and do not necessarily reflect the positions or opinions of my employer. I prepared and distributed this publication as an independent activity, outside my regular salaried work. No part of the compensation I receive from my current employer was, is or will be directly or indirectly related to any comments or personal views expressed in this publication. All comments are based upon my current knowledge. You should conduct independent research to verify the validity of any statements made in this publication before basing any decisions upon those statements. The information contained herein is not necessarily complete and its accuracy is not guaranteed. If you are receiving this communication in error, please notify me immediately by electronic mail or telephone. The comments expressed in this publication provide general information only. Neither the information nor any opinion expressed constitutes a solicitation, an offer or an invitation to make an offer, to buy or sell any securities or other financial instrument or any derivative related to such securities or instruments. The comments expressed in this publication are not intended to provide personal investment advice and they do not take into account the specific investment objectives, financial situation and the particular needs of any specific person. All rights reserved.