

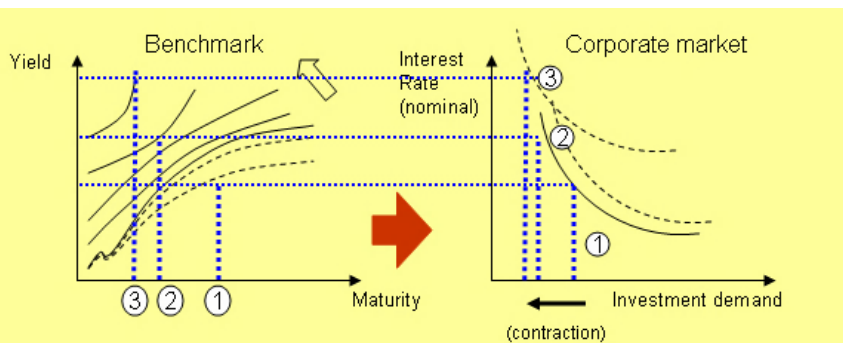
Tincho's letter

Toronto, Thursday, May 7th, 2009

Good morning,

Today we have the release of the stress tests results, which were ridiculously leaked over the past days. I don't expect surprises, given the action in the markets yesterday. The Fed bought \$6.95BN of only one issue, an Apr/12, upsetting investors, given the short-term and small amount (18.3% of total offered). The 2-10yr curve finished steeper, agency debt and TLG debt continued to rally, as well as corporate credit. The CDX IG12 closed at 146bps (-11bps), and the S&P500 reached 919.5pts. **Why not?** If you think about it, the Fed is **only 1/3rd** done with its Treasuries purchases. There is still a lot of liquidity to be pumped in, which should keep NOMINAL asset prices from falling, as per our Thesis No. 1 (refer earlier letters). On this note, the market doesn't care about the billions of capital that banks may need. It's scary, because at the end of the day, fundamentals have to justify price levels.

A few friends asked what I meant yesterday, when I wondered if the markets are co validating high coupons. Even if current spreads are tighter than months ago, they are still wider than pre-crisis. And issuers' fundamentals have not improved, let alone bottomed. We may understand the issuers' reasons for settling at any cost, but how do we explain investors' appetite for these issuances? **Are investors being compensated for the risk taken?** Since Monday only, we have seen these issuances (I am not including lending Banks', for obvious reasons): **GE Capital** (\$2BN non-guaranteed, 5-yr, 5.9%), **Nalco** (\$500MM, 8-yr 8.25%), **Canadian Oilsands** (\$500MM, 10-yr, 7.75%), **DTE Energy** (\$300MM, 5-yr, 7.6%), **Husky Energy** (\$1.5Bn in total, 5-yr & 10yr, 5.9% & 7.25%), **Xerox Corp.** (\$750MM, 5-yr, 8.25%), **Crown Americas LLC** (\$400MM, 8-yr, 7.625%), **Host Hotels** (\$400MM, 8-yr, 9%), **Goodyear** plans to sell \$500MM 7-yr, **Teck Resources Ltd.** (5/7/10 yr at 9.75%, 10.25% and 10.75%), **Providence Health and Services** (\$250MM, 5/7/10-yr, 5.05%/5.8%/6.25%), **Silgan Holdings** (\$250MM, 7-yr, 7.25%), **Hospira** (\$250MM, 6-yr, 6.4%), **International Paper** (\$1BN, 10-yr, 9.375%), **Cigna Corp.** (\$350MM, 10-yr, 8.5%), **Psychiatric Solutions** (\$120MM, 6-yr, 7.75%) and **Coca-Cola** (\$550MM, 6-yr, 4.25%). **Is this a renaissance in issuance or a window of opportunity taken by issuers?** If the market believes issuers can pay these coupons, then the expectation is they will sell assets, restructure or increase prices. **Selling or restructuring requires management to have a strategic view and I find it hard to believe there is a solid understanding of what the future keeps for us.** If I am right, the recent steepening of the yield curve may be indicating that inflation expectations are to take a leading role, **bringing REAL interest rates down.** The graph below addresses this point:



On the left, we see the yield curve for the benchmark rate (Treasuries). If the steepening becomes serious, we may even see a significant drop in the bid for long-term government debt (Under high inflation, the mid-to-long term points may disappear altogether). A bit of this is taking place now, as the front-end of the curve gets a heavier bid. Consistent with the dynamic in the benchmark market, we see that (on the right) the **clearing** NOMINAL interest rate (i.e. the rate that allows the demand for capital to meet supply) increases exponentially, **contracting** the demand for capital goods. A more detailed discussion is beyond the scope of this letter, but the point is this: **If you are an issuer and "see it coming", you may want to refinance your way out of it.** This could explain this late wave of debt refinancing at high costs. The coupons seem high on a nominal basis. **Meanwhile, investors fleeing cash buy the bonds and hedge them by selling Treasuries, adding fuel to the fire.**

(I am aware that I have lately not referred to events in Canada or the Canadian dollar. I promise to remedy this soon) IT'S MAY AND THE SAILING SEASON STARTS IN LAKE ONTARIO, WITH THURSDAYS REGATTAS. I WILL THEREFORE NOT BE ABLE TO WRITE THE FRIDAY LETTERS UNTIL OCTOBER. PLEASE, ACCEPT MY APOLOGIES.

Martin Sibileau

martin@sibileau.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.