A View from the Trenches Toronto, Tuesday, September 22nd, 2009

Good morning,

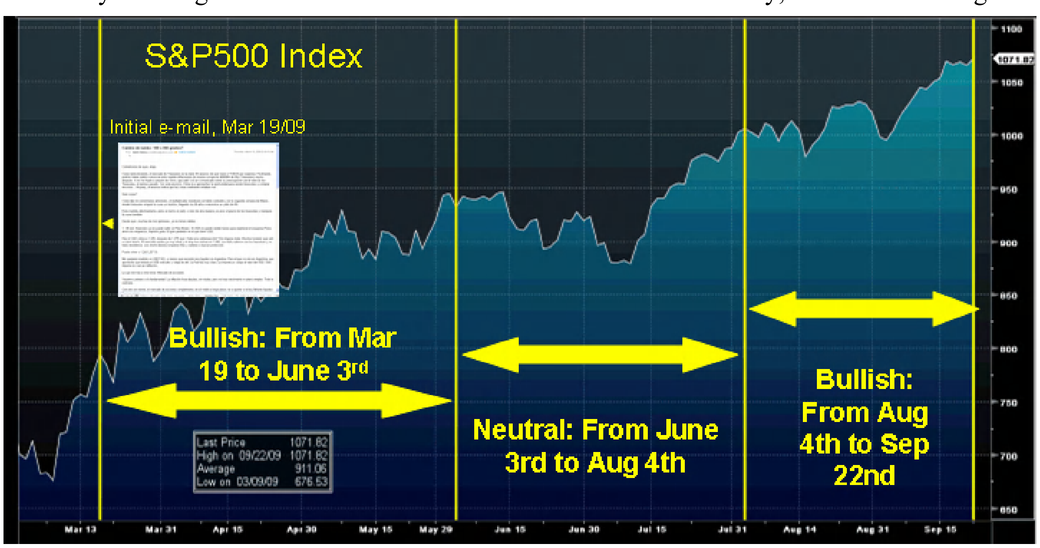
I want to start today's comments reiterating my neutral call on equities. This is on equities only, not on credit. Credit is undergoing a different dynamics. Again, my call is different from that of the bears out there. I do not have a bearish call. My call is based on my uneasiness with the following issues:

1. - No clarity on exit strategies. As an update, Bloomberg reported yesterday afternoon that the Fed has started talks with dealers on using reverse repos. This program would increase the supply of Treasuries, in conjunction with a rising federal fiscal deficit in the US. Unless there demand picks up, interest rates will increase (Treasuries sold off), with a huge crowding out effect on other asset classes. There is also the logistical side of it, as the Fed could bypass the dealers and transact with money funds directly. There will be dislocations. On the other hand, if there is demand for the increased supply of Treasuries, it will be at the expense of equities. Therefore, the equity market faces a real challenge.

2. - Recent dispersion in monetary policy answers. We are in a global world and it is not enough to see good actions carried out by only some governments. The recent developments in the UK are flagging some cracks in the front. While the world is discussing exit strategies, last week the Bank of England's Governor King said he was considering lowering the interest rate banks earn on deposits. The GBP sold off on the news and finished the week 3.2% lower vs. the Euro. What is worse, the sterling lost big time against gold. As we said on Monday, we don't want to see gold become a reserve asset. But when it does, it will not be instantaneously against all currencies. No, it won't. It will first start rising against a weak currency, and then it will spread like a cancer to the rest of the global currencies. Right now, we see the tumor in the GBP. Let's hope it doesn't spread.

3. – Political instability is increasing. One gets the sense that the world is rapidly fracturing into right and left again. We did not have that in 2008 and unity was critical to save us from a run against the financial system. That unity is not there anymore. On top of this, we face the developments in Iran. My feeling is that the world is misreading the problem here. As much as the market does not believe in inflation until it sees a jump in the CPI, I get the impression the market does not see a conflict in the Strait of Hormuz, until it happens. And when it happens, it will be too late.

Thus, please note that my call is not bearish based on fundamentals. The sell-off of 2008 and the rally of 2009 were never about fundamentals. It was, is and will be about liquidity. Liquidity has to spread via asset acquisitions carried out by Central Banks. When the asset mix changes, liquidity suffers, volatility increases, and I want to sit on the sidelines. Politics determines the asset mix. Politicians (I include central bankers under this category) arbitrarily decide what and when they will buy Treasuries, mortgages, bank's capital, etc.
Lastly, I thought I would include a chart of the S&P500 (source: Bloomberg), since I started writing and measure it against my recommendations. My initial call on Mar 19/09 was bullish ("A View from the Trenches" was sent via email in those days) on the Treasury Purchase Program announcement. On June 3rd, I turned neutral and remained neutral until August 4th. The reasons behind can be reviewed at: www.sibileau.com/martin/2009/06/03 and www.sibileau.com/martin/2009/08/04 . As well, during this period, I wrote many times against those who believed the end was near. Yesterday, I turned neutral again.



Martin Sibileau martin@sibileau.com **(647) 999-2055**