

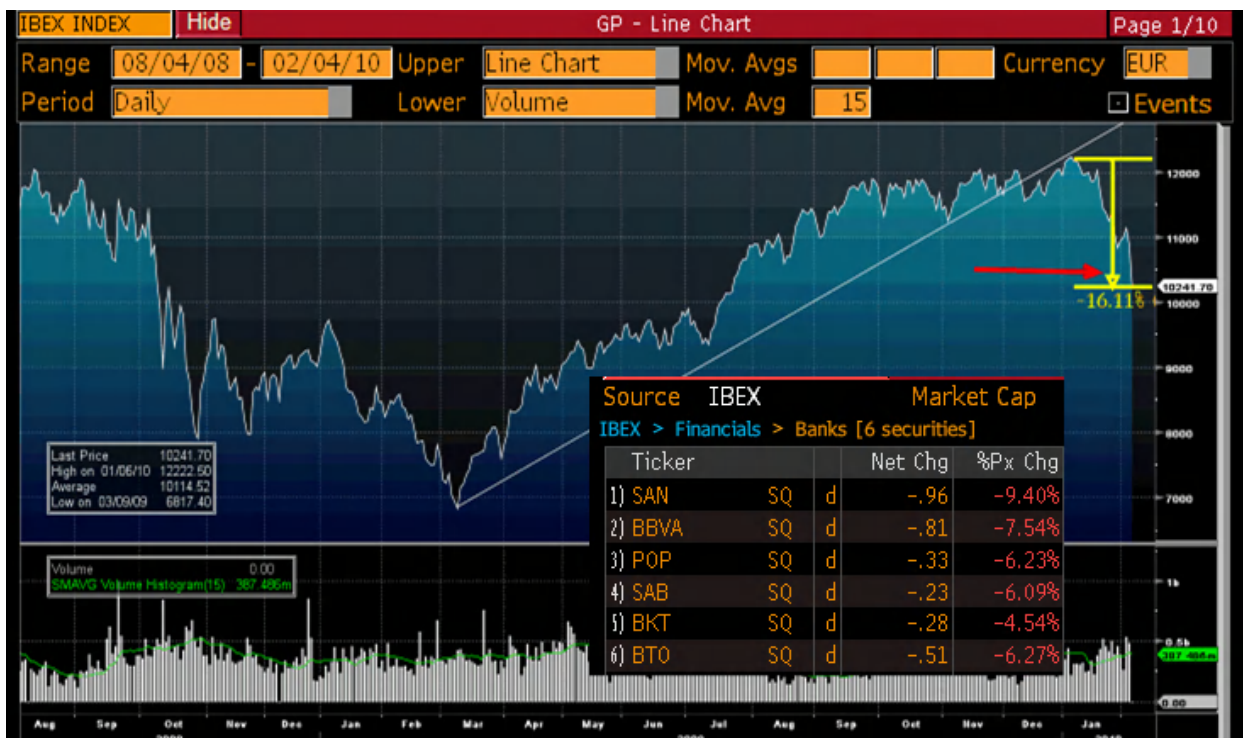
A View from the Trenches Toronto, Friday, February 5th, 2010

Good morning,

Below, we attach the same chart shown yesterday (Source: Bloomberg) on the IBEX (Spanish stocks), with banks' share prices at yesterday's close (i.e. updated). As days go by, our earlier comments sound more and more prophetic. By now, it should be obvious to everyone that the dam is broken, that the bears are out to do more damage but also...that this problem has a solution. That solution is more quantitative easing, by the European Central Bank. Will we see it? No! Will it be there? Yes. Mr. Trichet & Co. are currently trying to find a way to simultaneously rescue the Euro (and its financial system) and to save face. We know he can't get both, but we are optimistic that the ongoing situation has a solution. It will still get uglier before it gets better, but such is human nature and our duty is to profit from any circumstance as much as we can.

The damage has been mainly driven by valuations in financials. So far, and this is our personal view, the fact that the Euro is still not the main reserve currency, is saving the day for the rest of the world. Liquidity costs for the world's reserve currency, the USD, have not reacted accordingly. If this sovereign risk contagion (from public sector to financials) had happened in the US, things would be different. We should keep this very much in mind, which is why I believe both the price of gold and the Canadian dollar (in USD) are still holding relatively within their upward trend, although the challenge rises by the hour. But we must also keep it in mind because when the finest hour arrives for the US, a steeper yield curve will push us to review our default rate assumptions.

As well, it seems as if the market (still) shared our view on the temporary nature of this problem, and that there is light at the end of the tunnel. That light is the explicit recognition by monetary authorities worldwide, but especially in Europe, that inflation will be the only way to make the debt burden bearable. When that recognition is finally made, we will be buyers of gold, commodities and commodity currencies. Perhaps the recognition comes sooner rather than later. In the meantime, we see central banks holding their policy rates at record lows, like the European Central Bank did yesterday. That's a good sign, but it is not enough. Perhaps we need an explicit commitment, like the one the Bank of Canada made last year, to calm animal spirits. However, the time to only play monetary policy is gone. None of this will work, anywhere, if a commitment of the same weight is not done on the fiscal front too.



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