

E.Q Trendwatch™

Global Bubblenomics

Bubbles are defined as incidents where price valuation of a given asset class jumps two-standard deviations above the long-term average growth rate. Bubbles have been a frequent product of human behaviour throughout history. Researchers across many decades and all different assets—stocks, bonds, commodities, currencies, real estate, antiques, and art—have identified 28 different bubbles. In every single incident, these bubbles ended with prices dropping precipitously back to trend. No exceptions. Ever.

While cheap money is still sloshing around the planet, risk appetite remains recklessly high. As our readers know, we have been concerned about this behaviour in capital markets for some time. In our April 2005 newsletter we had this to say about worldwide over-use of credit and the bubble it was building in global asset markets:

“...[former US Fed Reserve Chair] Greenspan argued as recently as October 2004 before the America’s Community Bankers Annual Convention that for a variety of reasons, real estate cannot experience a bubble. This will no doubt seem a bizarre comment to anyone who remembers first hand previous real estate bubbles and the damage they inflicted to the economy as a whole.

History reminds anyone who will heed it that the interest rates of the past 5 years have been artificially and intentionally low. This artificial condition was brought on by governments all around the world in order to stimulate the economy out of the slow down which flowed from the stock markets’ crash of 2000, the negative effects of the 9/11 attacks and the US led war thereafter. Consumers have been lulled into an artificial sense of security in borrowing higher and higher levels of debt, simply because record low rates have allowed them to make the relatively modest interest payments. Variable rate debt puts the borrower at the highest risk of solvency problems in a rising rate environment, and yet consumers all over the world have been taking it on with great fervour over the past few years.”

-Venable Park Newsletter April 4, 2005

One of the problems with bubbles is that they are by their nature irrational, so predicting precisely when and what will be the final catalyst for their demise is difficult. Something always happens to bring about the big pop. That said the current climate could rage on for a while longer making us conservative cautious ones look boring and out of step with this “new era” where valuations are irrelevant and optimism runs rampant around the world.

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Years from now, we believe that this period will be referred to as the “credit” bubble or the “LBO bubble,” just as we now all refer to the “tech bubble” of the late 90’s.

One of the rare managers to publicly denounce the last bubble in stocks was Jeremy Grantham. Grantham was fired by some of his clients for moving to a large overweight of cash in 1998 before the last bubble peak in March of 2000. He was eventually shown to be right in that call and having stuck to his discipline, his firm was one of the few ideally positioned to snap up bargains for clients when the markets hit their cycle low in late 2002. Grantham is director of strategy for GMO a firm that now manages \$141 billion for mostly institutional clients in the US. This week, after returning from a 6-week round the world trip, he writes that we are now seeing the first worldwide asset bubble ever in history:

“It’s everywhere, in everything...from Indian antiquities to modern Chinese art; from land in Panama to Mayfair; from forestry, infrastructure, and junkiest bonds to mundane blue chips; it’s bubble time!”

What Grantham sees as extraordinary about this bubble this time, is that it is ubiquitous:

“...this time, everyone, everywhere is reinforcing one another. Wherever you travel you will hear it confirmed that “they don’t make any more land,” and that “with these growth rates and low interest rates, equity markets must keep rising,” and “private equity will continue to drive the markets.” To say the least, there has never been anything like the uniformity of this reinforcement.”

He goes on to note that every bubble has always burst: “the bursting of the bubble will be across all countries and all assets, with the probable exception of high grade bonds...since no similar global event has occurred before, the stresses to the system are likely to be unexpected. All of this is likely to depress confidence and lower economic activity.”

-GMO April 2007 Quarterly Letter

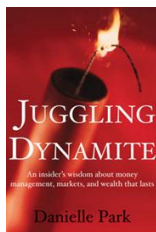
For our part we remain devoted to our risk management rules and in protecting the hard-saved capital of our clients.

The April 28 Globe and Mail featured an interesting story in its Financial Facelift section entitled “Paying a price for speculative strategy.” The article features a 36-year old woman called Sally. The piece has some useful commentary on the challenges facing individual investors being serviced by the investment sales machine:

“Sally, who is well educated and ambitious has a problem. Its not earning money, rather, it is keeping it. She has invested in two-dozen mutual funds and a clutch of junior resource companies. Much of her portfolio has lost money. For a person who began to save at the age of 5 and who spent her childhood doing odd jobs to make money, watching her money go down the drain has been a wrenching experience. “I don’t know what to do with what I have,” Sally explains. “I work very, very hard, and I save hard, and I don’t feel like I’m properly taking care of my assets. I have two financial advisors and I don’t trust either one of them. I am starting to feel confused and quite heartbroken.” (p. B11)

Our tip for Sally: read Danielle’s new book and get away from financial “advisors” who are paid to sell you risk.

Juggling Dynamite now available in fine book stores everywhere



We are pleased to announce that Danielle's new book is now available in Canada with release in the US scheduled for September. Complimentary copies of the book were mailed to all our clients April 27.

For others, discount prices are available on line at <http://amazon.ca> and <http://www.chapters.indigo.ca>

Chart of the day: Inventory of US vacant homes for sale 1956- 2007



BUSINESS NEWS NETWORK TELEVISION (Channel 49 on Cable)

For those that are interested, **Cory** will be the **guest Technical Analyst on *The Chart Room*, Friday May 4, at 3:40pm**, and **Danielle** will be the **guest Portfolio Manager on *The Street* at 9:20am on Wed May 23**. The clips can also be viewed for the week following the appearances on the BNN website at http://www.bnn.com/shows/past_archive under past video archive for the date and time in question as well as through a link on our web home page at www.venablepark.com.

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