CastleMoore Investment News

Uniquely Superior Portfolio Management

Investor Amnesia?

By

Ken Norquay, CMT, Partner

The majority of investors have such short memories. Do you have investors' amnesia? To find out, take this simple test:

QUESTION: Do you remember the "cover story" for the August 2007 stock market sell off? (The market dropped about 13% in 4 weeks.)

ANSWER: The sub-prime mortgage story. American home-buyers had been hustled into borrowing more money than they could afford at artificially low interest rates. When their mortgage rates bounce up to normal, millions of them could not afford to live in their homes and mortgage defaults started happening everywhere. Home prices has started to tumble.

QUESTION: Do you remember the cover story for the January 2008 stock market sell off? (The stock market dropped about 13% in 12 days!)

ANSWER: [a] Sub-prime +: it appeared that many many banks all over the world bought billions and billions of dollars of these junk mortgages. They bought so much that the US mortgage collapse threatened the banks themselves! Central banks in Canada and in Europe were stepping in to bail the big banks out. The problem was worse than they thought.
ANSWER: [b] The US economy was slipping into a recession. Corporate earnings would be lower. Unemployment would be higher.

Imagine the possibility that the stock markets might stabilize now, or bounce up, as they did after the August 2007 sell off. And imagine they might have another sell-off into autumn 2008.

QUESTION: Can you guess what the cover story for THAT sell off might be?

POSSIBLE ANSWERS:
[a] Sub-prime ++?
[b] Recession +
[c] Some new story. Perhaps the collapsing US dollar could have an effect on the world's banking system. For example, the central Bank of Canada holds many billions of US dollars. In the past 5 or 6 years, the

Rodin: Naked because he didn't sell?

US dollar has dropped by about one third against the CD dollar. Does that mean the central Bank of Canada is under water? Yes it does!

QUESTION: Is bad news a reason to sell all your stocks and cash in all your mutual funds?

ANSWER: No. The time to sell your stocks was in advance of the August 2007 sell off. The time to sell was in July 2007 when CastleMoore got its sell signal. The time to sell your stocks ahead of the January 2008 sell off was in November 2007 when CastleMoore got its second 2007 sell signal. When will it be time to sell your stocks ahead our imaginary autumn 2008 sell off? We'll let you know.

Mutual funds salesmen staunchly maintain that no one can "time the market." Too bad! If we COULD time the market, we could avoid losing our capital in months like August 2007 and January 2008.

QUESTION: Will CastleMoore get it right every time?
ANSWER: No

QUESTION: Will we keep trying to get it right?
ANSWER: Yes we will. You can count on it.

There is a clear difference in style between CastleMoore's investment management techniques and the non-techniques of the "Buy and Hold" mutual funds. We keep trying to get out of the market before the sell-offs. They keep trying to hold great stocks right through the sell-offs and they keep hoping those great stocks will go right back up again.

The reason we created CastleMoore was to offer investors this choice. It seemed to us that all investment professionals were offering various flavours of the same thing: buy and hold. In other words: buy. The investment industry had forgotten all about selling. They had forgotten all about those times when stock markets go down.

- Ken

ken@castlemoore.com
1.905.847.8511 or toll free 1.877.289.5673

What's The Deal With Bonds?

By
Robert "Hap" Sneddon
FCSI, President

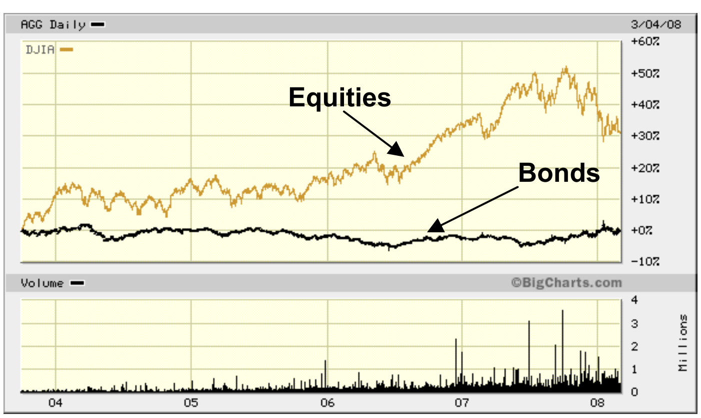
CastleMoore's benchmark, a relative measurement of our performance, consists of 35% Cdn bonds, 35% Cdn, 15% US and 15% International equities. Along with our procedures to protect assets, this mix reveals our conservative bearings. With the exception of high quality bonds that clients transfer-in, we do not hold bonds for our model portfolios today. In fact, we haven't purchased any in over 18 months.

As the chart below reveals, bond holdings have been a drag on capital the last few years, especially when compared to equities.

But what about today? With the stock market action and recession talk of late, logic would suggest bonds could be a place to hide. As readers familiar with our style will know common sense isn't always profitable.

Today, bonds might be too risky. The stock market jitters have once again bid prices to a four year high (They've hit these same peaks or "resistance" in early 2003 and mid 2005, hence being deemed dead money). It may be like buying stocks anytime in 2000. It can feel good but that's about it.

Granted it also seems like the risks are high in the equity markets too. Notwithstanding, the data points to a drop in prices and a rise in yields. In fact, in the US we have seen the retreat begin. Despite all the talk of recession there are some underlying forces preventing bond prices from moving higher.



Bonds haven't paid. The risk/reward favours equities.

The chief headwind is inflation. Even prior to the recent large decreases in the prime lending rates in North America inflation was contained but moving to the higher end of the acceptable range. The liquidity injected lately has the potential to accelerate the pace. The US real estate dilemma may mitigate some of the move; it may also signal stagflation al la Japan during the 90's. While some assets, such as real estate may continue to decline, commodity-related ones could rise creating an economy that's between a rock and a rock. In these periods the normal levers available to monetary authorities become less effective.

When rates rise or purchasing power declines you don't want to own fixed income, unless of course it's cash or money market. This is how we've managed this area of portfolios over the last year and a half.

Now we always entertain the opposite scenario, whatever portfolio decisions we reach in the Investment Committee. In this case, that would be a general decline in asset prices across the board.

Here's a quick reference to terms of relevant conditions that effect bonds (Investopedia 2008):

Inflation: The rate at which the general level of prices for goods and services is rising, and, subsequently, purchasing power is falling. **Erodes bond capital.**

Deflation: A general decline in prices, often caused by a reduction in the supply of money or credit. Deflation can be caused also by a decrease in government, personal or investment spending. The opposite of inflation, deflation has the side effect of increased unemployment since there is a lower level of demand in the economy, which can lead to an economic depression. **Increases bond capital.**

Stagflation: A condition of slow economic growth and relatively high unemployment - a time of stagnation - accompanied by a rise in prices, or inflation. **Erodes bond capital.**

While we are assuming inflation is rising if things do break the other way, we'll buy bonds.

- Hap

robert@castlemoore.com
1.905.847.1125 or toll free 1.877.289.5673

Head Office
12-2441 Lakeshore Road West
Oakville, ON L6L 1H6
www.castlemoore.com

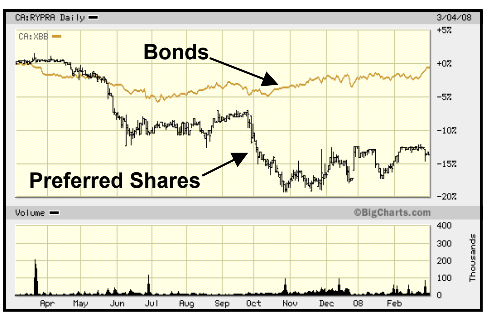
Phone: 1.905.847.1400
Free: 1-877-289.5673
Fax: 1.905.847.8511
E: info@castlemoore.com

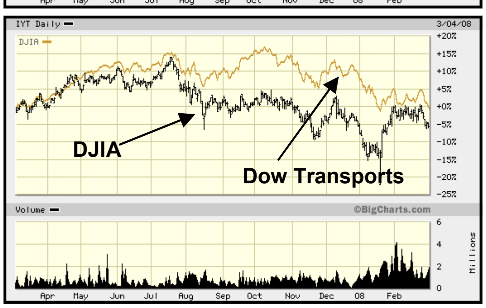
"Buy, Hold...And Know When To Sell"

What make CastleMoore Unique and Valuable?

CastleMoore Inc. helps investors manage their life savings. We are not stock brokers or mutual fund salesmen. We are discretionary investment managers specialising in "buy low, sell high" strategies instead of "buy and hold" strategies like the other guys. At CastleMoore we manage our clients' investments through a methodical and disciplined set of systems that virtually removes any individual bias and emotion from the investment process. What we do works. We rely heavily on loss avoidance techniques when making investment decisions. Our clients are investors that pay particular attention to asset prices, have little tolerance for investment losses, and strong expectations of getting their money's worth. Clients appreciate CastleMoore's all-inclusive, comprehensive fee schedule. If we are required because of volatile markets, to be more active within our client accounts CastleMoore bears all the costs associated with more frequent transactions. Our team's previous experience in national and international firms and small boutiques provides us the ability to deliver a high quality and cost effective professional portfolio management service. A CastleMoore client enjoys the benefits of having focused portfolio management without the distractions of also providing a "super market" of financial services. We just manage investment portfolios effectively – plain and simple. CastleMoore is uniquely superior portfolio management. To know more, including how we gradually and gently transition your existing portfolio to our models please contact us

Canaries in the Coal Mine — Health Update





With the market volatility in January and, now, at the time of publication, in early March, I thought it best to update some of the "canaries" I put out in the last newsletter (JAN/FEB 08) for readers to watch. These were the bond/preferred share and Dow Industrial/Dow Transports average relationships and copper prices. The death of these little birds told coal miners when to head to safety. Historically, these can do the same if you're invested on the long side.

BONDS/PREFERRED SHARES: While both have moved up in value in nominal terms (bonds flat, pfds down 12%) their relationship has pretty much stayed consistent. The spread tells us that investors still worry about issuers ability to pay. Incidentally, the divergence began in late spring 07', 2 months after we sold all our bank positions. There's more patience needed. As always, there will be a good buying opportunity sometime soon.

DOW THEORY: The action in this relationship since the lows in January have been encouraging. The transports have actually out performed the DJIA. Ideally, you need the transports to lead the economy. Often, its only obvious after the fact just when a recession started. If a US recession began in August 07, then it could already be through most of the move. Whether spot on, its analogous to the maxim: "nothing to fear but fear itself". At any rate, markets always forecast 6 months ahead, and don't tell you much about today.

COPPER PRICES: Not much to say here. The chart says it all. The $2.90/lb USD level held. I suggest that the $3.40 area provides new short/intermediate term support. Deep support levels are still at the latter levels. Copper is showing that its still needed, that economies are moving ahead.

-Hap

CASTLEMOORE INC.
Uniquely Superior Portfolio Management

The Winter of Our Discontent

By
Sheldon Liberman
Portfolio Manager

Winning may not be everything, but losing isn't anything. –Charles Shultz

The severity of this winter in Ontario has, on occasion, invited comparison to the winters I experienced growing up in Montreal. Yes, we received more snow, and temperatures were, on average, more frigid. In fact, there is a section of town called "Snowed-in." Yes, they spell it S-N-O-W-D-E-N, but they're not fooling me.

As I recall, however, Toronto is a windier town, and wind can add more discomfort to the winter experience than either temperature or snow levels (unless, of course, you have a car, but I exclude that case because our family car typically winters in Florida).

As an aside, I'd like explain why I believe that most Jews believe in the effects of global warming: it's because we have Jewish mothers who like to tell us how much colder the weather was when THEY had to walk to school. This applies in Montreal, Toronto, Miami…

Yiddishe mamas notwithstanding, once you get to thinking about winters in Montreal, you can't help but to thing it's known for: hockey, either the playing of it, or the almost-required-by-law devotion to les Canadiens—the "HABS".

Of course, the Habs were easy to be devoted to. No North American professional team has won more champions, besides the New York Yankees of baseball. So it would be fair to say that winning wasn't something Montrealers were accustomed to, it was something we expected. This applied only to hockey.

Well, I wasn't good enough to play for the Habs, or even for the other Canadian-based professional hockey team that existed at the time, but I moved to that city anyhow and eventually became a portfolio manager (more about my career path in an upcoming issue)

Of course, as I grew out of adolescence and developed other interests, hockey—all sports, really—took on a reduced role in my life. I maintain an interest in sports in general, and not necessarily for the usual reason. I find that sports often serves as a useful microcosm for society in general. Put another way, societal changes are often visible in the sports universe in a more easily understood way.

I could cite many examples, but the one that strikes as close to home as any of them is the issue of short term gratification. You see, when I followed hockey closely, I noted that coaches were hired for the long haul. Names like Toe Blake, Emile Francis, Punch Imlach, Harry Sinden, Sid Abel, and Billy Reay each managed his respective team for what seemed to me to be an eternity. And the overall winning (or losing) percentage wasn't any different than as now.

Many years later, the point stays close to home. Portfolio Managers are expected to outperform their respective benchmarks each and every quarter, despite that fact that no investment methodology has ever done that, no matter how successful its long term track record has been. Last year was a tough one in the business, and I know of portfolio managers with good long term records who lost customers for one off year, and under circumstances beyond their control.

The bottom line: if you must fire something, try a puck

More from Shultz:
"My life has no purpose, no direction, no aim, no meaning, and yet I'm happy. I can't figure it out. What am I doing right?"

"Life is like a ten speed bicycle. Most of us have gears we never use."

"Don't worry about the world coming to an end today. It is already tomorrow in Australia."

"There's a difference between a philosophy and a bumper sticker."

-Shel

sheldon@castlemoore.com
1.416.306.5770 or toll free 1.877.289.5673