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LePoidevin Letter

The Scariest Words in Investment Commentary

According to U.S. legislation, the Federal Reserve, which determines U.S. interest rates and money supply, has as its mandate "to promote the two co-equal objectives of maximum employment and price stability." [1]

In 2006, the U.S. unemployment rate had shrunk to 4.6%. Home construction was reaching record levels, and car and truck sales soared, leading to scarcities in many commodities - and to a rise in inflation.

Not to worry, though: the U.S. Federal Reserve Board would aim to create a **soft landing**. U.S. interest rates would be ever so slowly increased, just enough to curb inflation but not so much as to derail the economy.

As interest rates began to rise, however, nothing seemed to change. Housing and energy demand remained strong, which fostered yet higher commodity prices. Oil continued towards $140 per barrel. Still, U.S. interest rates continued to increase slowly, toward the goal of a soft landing.

If ever one could apply the saying "the straw that broke the camel's back", that inching toward a "soft landing" was it. Interest rates had increased from 1 to 5 percent by the time the U.S. housing bubble began to crack. As the prices of homes declined, mortgage delinquencies surged, which in turn created losses at banks. Interest rates were then lowered to try to maintain the soft landing goal; but it was too late, and a global recession began.

Today, once again, commodity prices have surged, and we are heading to higher inflation. This time, however, it is not strong U.S. and European demand that is fuelling the rise, but rather commodity demand primarily driven by China's housing boom.

[1] Frederic Mishkin – "Monetary Policy and the Dual Mandate"
Speech given at Bridgewater College, Bridgewater, Virginia.

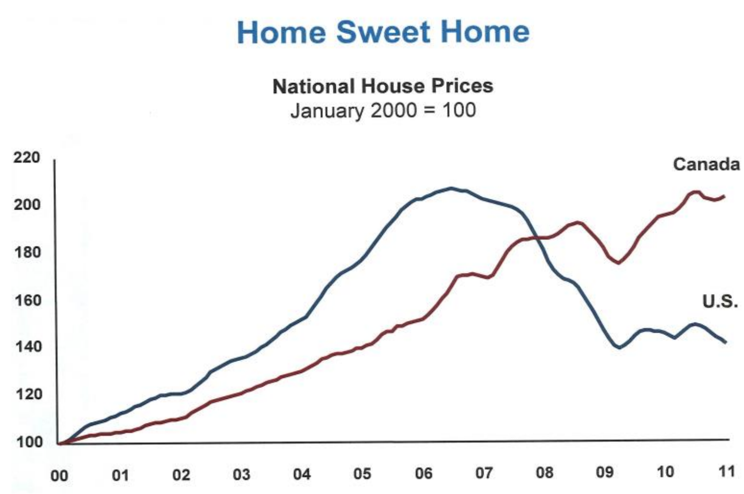
Déjà vu…China has raised interest rates five times, and increased the banks' mandatory level of cash holdings - in order to create a soft landing.

In my 25 years of investment experience, I have heard the term "soft landing" many times. But I have never seen one. My experience causes me to believe that China is likely to surprise to the downside.

Keep in mind, the most vulnerable sectors in the hard landing of 2008 were the commodity sectors. Remember, too, that the Canadian dollar had declined from 1.10 compared to the U.S. dollar to 0.76 by December 2008. And our currency still seems to be tracking commodity prices.

In the February 2011 LePoidevin Letter, "Investors Overly Optimistic On Economic Outlook", I stated that "it just might be a good opportunity to take some chips off the table and relocate back to government bonds." Since that time, stock market indices have declined 5% to 10%, while longer term government bonds have increased about 5%. Investors' moods have grown much more cautious in the current sell-off, providing an opportunity to take some profits in bonds and add more capital back to stocks.

Since its dual mandate includes maximum employment, the present 9% unemployment rate will likely keep the U.S. Federal Reserve from raising interest rates (from zero) for some time to come. With 5-year U.S. interest rates at a mere 1.7%, investors will have little choice but to seek higher yielding alternatives. In Canada, I continue to invest in straight preferred shares, which can still be acquired at a discount to par. In the U.S., I favour the attractive dividends offered by utilities, healthcare and consumer staples.



Canada's housing prices have increased 13% above their 2008 pre-recession peak. Certainly, record-low interest rates and easily available credit contributed to these strong gains; yet many analysts are also pointing to high numbers of wealthy immigrants as being a strong contributing factor.

In past years, immigrants were able to fast track the immigration process by satisfying the following three criteria as a "Federal Immigrant Investor": they had prior business experience, they had a minimum net worth of C$1,600,000, and they made a Canadian secured investment of $800,000.

Citizenship and Immigration Canada (CIC) has announced some dramatic changes to these procedures, effective July 1, 2011. The number of Federal Immigrant Investor applications accepted for processing will be capped at 700 for the coming 12 months. "Given the demand for this program, especially from Chinese Nationals, we expect this imposed cap limit to be reached extremely quickly....probably within a matter of days," says attorney David Cohen. [2]

As well, the Federal Skilled Worker Program will accept fewer applicants, and only from a list of 29 eligible occupations. Each of the eligible occupations will further be capped at 500 acceptances.

Moreover, CIC will not be accepting any new Federal Entrepreneur applications.

With this announcement by the government that it is significantly curtailing immigration, it will be interesting to see what will happen to the Canadian housing market - especially in Vancouver and Toronto.

Investors concerned about housing prices should avoid bank stocks and consider some diversification outside of the Canadian dollar.

Sincerely,

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[2] Canadian Immigration Newsletter