



## **Global Securities Market Bulletin**

January 20, 2012

Issue No.138

**Courtesy: Global Securities Research**

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### **COMMENTARY – Four good reasons to get off the fence**

*Staying cautious does not imply staying 100% in cash*

**Elvis Picardo, CFA**

Investors who were spooked by surging market volatility and elevated headline risk since August 2011 may be tempted to continue sitting on the fences until the risks recede. The problem with this approach is that if it carries on long enough, wealth erosion will be the inevitable result. Staying 100% in cash may offer peace-of-mind, but that comes at a price in an environment where cash deposits offer interest rates of less than 1%. While we continue to advocate caution in this market, we wish to stress the point that this cautious approach does not translate into a 100% preference for cash. Note that our Portfolio Strategy Report released on December 16 recommended an asset allocation of 55% for stocks, 20% for bonds and 25% for cash. As we had noted in that report, although headwinds abound, a number of positive factors could spur positive market performance in 2012. We reiterate these factors below, and suggest that they present investors with four good reasons to get off the fence and get into the markets –

1. **Stimulative monetary policy:** Monetary policy around much of the world is expected to remain easy until next year. Earlier this week, the Bank of Canada left the benchmark overnight rate unchanged at 1% for the 11<sup>th</sup> consecutive time, the longest stretch since it began targeting that rate in 1994. The tone of the BoC press release, indicating that the outlook for the global economy has deteriorated and uncertainty has increased since October, does not suggest that the BoC governor Mark Carney may be in any hurry to raise interest rates. In the US, where the Federal Reserve has emphasized its intention to leave the Fed Funds rate at exceptionally low levels (i.e. near zero) at least through mid-2013, more clarity on this timeframe may be obtained after the FOMC meeting next week. Europe and China are also easing monetary policy. The risk of cheap money is that it may encourage speculative excess, but given the massive increase in risk aversion over the past six months, central banks obviously believe that may be a risk worth taking at this time.
2. **Earnings growth:** Expectations on this front have been coming down marginally, but overall, analysts are still forecasting solid earnings growth. US earnings reports released so far have been somewhat mixed, with solid numbers by technology stalwarts IBM, Microsoft and Intel offsetting weaker numbers from other bellwethers. S&P strategist Howard Silverblatt points out that slightly less than half (or 49%) of the approximately 100 S&P companies that have reported Q4 earnings so far have exceeded estimates, which is historically a low rate. Nevertheless, EPS estimates for 2012 are still quite bullish. Based on current forecasts (based on analysts' estimates for all index constituents), S&P 500 2012 EPS is estimated at a record \$105.93, up 9.5% from an estimated \$96.76 in 2011 (which is itself a new record for S&P 500 earnings). For the TSX Composite, 2012 EPS is forecast at \$996, up about 9% from an estimated \$915 in 2011.
3. **Valuation support:** The S&P 500 and TSX are both currently trading at about 12.4x estimated 2012 EPS, forward multiples that are below their long-term averages. Unless earnings decline precipitously in the year ahead, those valuations should provide support to equities and equity indexes.
4. **Solid balance sheets:** Corporate balance sheets have become stronger in recent years, thanks to the lessons of the 2008 credit crisis, with leverage in the non-financial Canadian corporate sector presently at a record low.

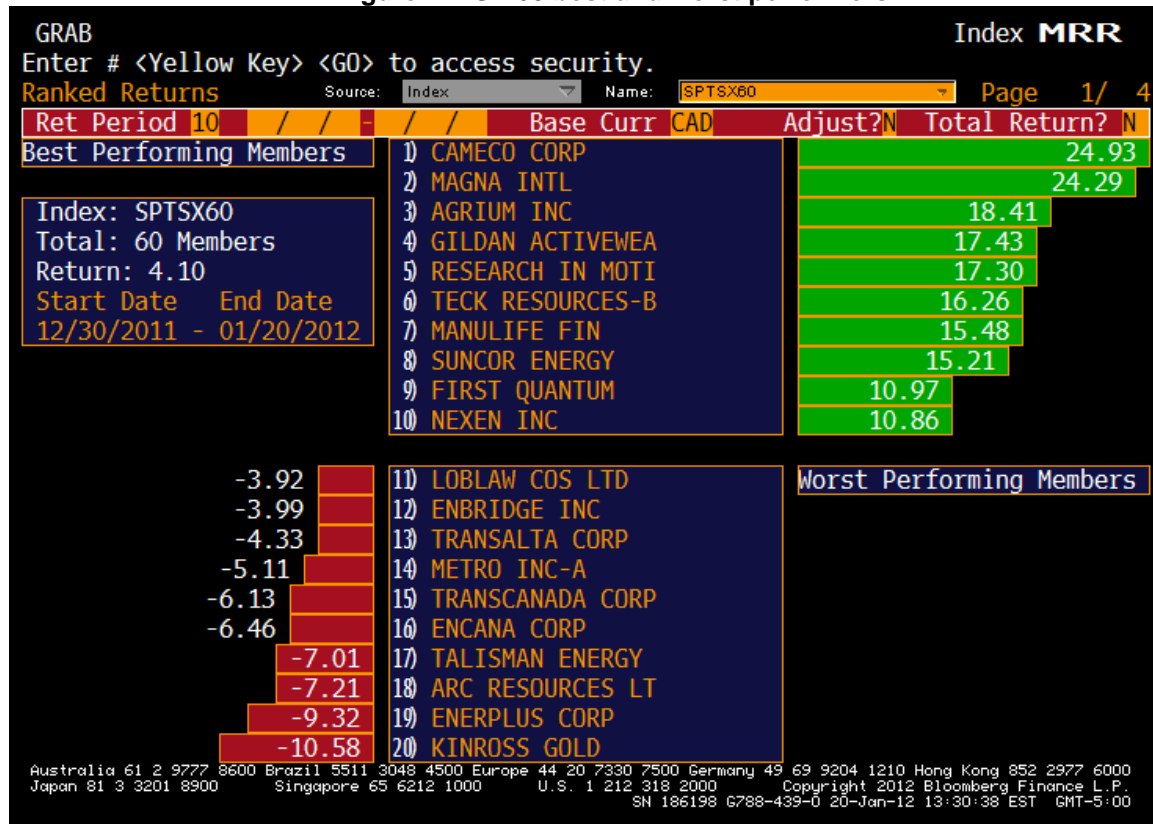
Strong balance sheets not only make it exponentially easier for companies to withstand periods of financial stress and turmoil, but they may encourage consolidation in sectors such as energy and commodities, where long-term fundamentals are sound and short-term weakness presents a buying opportunity. M&A activity would help provide a floor to stock prices in this case.

**Bottom-Line:** With the S&P 500 and TSX Composite having advanced 8% and 7% respectively from their late-November lows, many equities have rebounded from their deeply oversold levels of just a month ago. Five of the 10 best performers on the TSX 60 so far this year (Figure 1) were among the worst performers on the index over the past 12 months, with an average decline of almost 40%. These five are Cameco, Magna, Teck Resources, Research in Motion, and Manulife.

As we had noted in last week's Bulletin, despite the unsettled environment, there continues to be no shortage of "Buy" candidates for both ends of a barbell strategy. The stocks that we prefer at the present time are those that are supported either by their defensive characteristics such as high dividend yields and stable cash flows (such as AT&T, PPL, Duke, and Rogers) or by attractive valuations and positive long-term fundamentals for the higher-beta names (such as Sherritt, Suncor, and higher-risk solar play MEMC Electronic Materials).

- On a broad sector basis, we continue to see selective opportunities in the following –
- For dividend plays – Canadian utilities and pipelines, US telecoms, US pharmaceuticals
  - For higher-beta, cyclical plays – Canadian energy and commodities, US technology.

Figure 1: TSX 60 best and worst performers YTD



Source: Bloomberg

**(Trade Update) Kinross Gold – Reiterate Buy, target lowered to \$16**

We reiterate our Buy rating on Kinross Gold (TSX: K, \$10.33) following its 20% plunge this week. Concurrently, we are lowering our price target to \$16, from a longer-term target of \$22 earlier.

Kinross plummeted on Tuesday after saying it would take a non-cash charge, primarily relating to the goodwill recorded for its Tasiast mine in relation to the acquisition of Red Back Mining in 2010. As at September 30, 2011, the book value of total assets of Tasiast was \$7.1 billion, of which \$4.6 billion was goodwill. The news essentially confirms the market's belief all along that Kinross paid too much for Tasiast.

The company also said this week that it expects 2011 full-year production to be about 2.6 million gold equivalent ounces (GEO), with cost of sales at approximately \$600 per GEO, within the range of previous guidance. In 2012, Kinross expects production of 2.6-2.8 million GEO, with cost of sales expected to be between \$670 and \$715.

Kinross also said that its three major growth projects at Tasiast, Fruta del Norte and Lobo-Marte will require significant capital expenditures over the next several years. Due to the industry-wide escalation in project capital and operating costs, it will be conducting a capital and project optimization process.

Notwithstanding these developments, we believe that the risk-reward for Kinross looks particularly attractive after the recent plunge, which has further widened the discount at which the stock trades to its peers on a NAV basis. While analysts' EPS estimates for 2012 have been cut to US\$1.02 (from US\$1.24 at the time of our last update on December 9), that still represents earnings growth of 26% over last year's estimated EPS of US\$0.81. On that basis, the stock trades at a forward multiple of about 10x, which we believe is a very attractive valuation for a senior gold producer. We reiterate our Buy target on Kinross, with a revised price target of \$16.

**Market Snapshot at 12:55**

<b>S&amp;P TSX</b>	<b>12392.44</b>	<b>+11.75</b>	<b>Commodities</b>			<b>Yields (%)</b>		<b>Can.</b>	<b>US</b>
<b>TSX Venture</b>	<b>1568.08</b>	<b>+13.88</b>	<b>Canadian \$</b>	<b>98.71</b>	<b>-0.16</b>	<b>90 Day T-Bill</b>	<b>0.81</b>	<b>0.04</b>	
<b>DJIA</b>	<b>12715.03</b>	<b>+91.05</b>	<b>Gold (Spot)-US\$</b>	<b>1666.30</b>	<b>+7.95</b>	<b>2-Year Bond</b>	<b>1.04</b>	<b>0.24</b>	
<b>S&amp;P 500</b>	<b>1314.85</b>	<b>+0.35</b>	<b>Oil (WTI-Feb.)</b>	<b>98.46</b>	<b>-1.93</b>	<b>10-Yr. Bond</b>	<b>2.06</b>	<b>2.03</b>	
<b>NASDAQ</b>	<b>2785.82</b>	<b>-2.51</b>	<b>CRB Index</b>	<b>309.91</b>	<b>-2.05</b>	<b>30-Yr. Bond</b>	<b>2.62</b>	<b>3.11</b>	

**Thought for the Day**

"It is not disbelief that is dangerous to our society; it is belief." – George Bernard Shaw

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