



Global Securities Market Bulletin

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COMMENTARY: Caution warranted as risk appetite surges

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The S&P 500's 52% rally from its 12-year intra-day low of 666.79 set on March 9 makes this five-month advance the steepest since the 1930s Depression. The rally has been accompanied by a huge turnaround in financial conditions as well as risk appetite, one that has occurred much faster than most market participants expected at the beginning of the year. With bullish sentiment once again running rampant, however, we believe caution is warranted at these levels.

Numerous and diverse indicators confirm that the risk pendulum has swung from extreme aversion to something resembling complacency within a matter of months. These include:

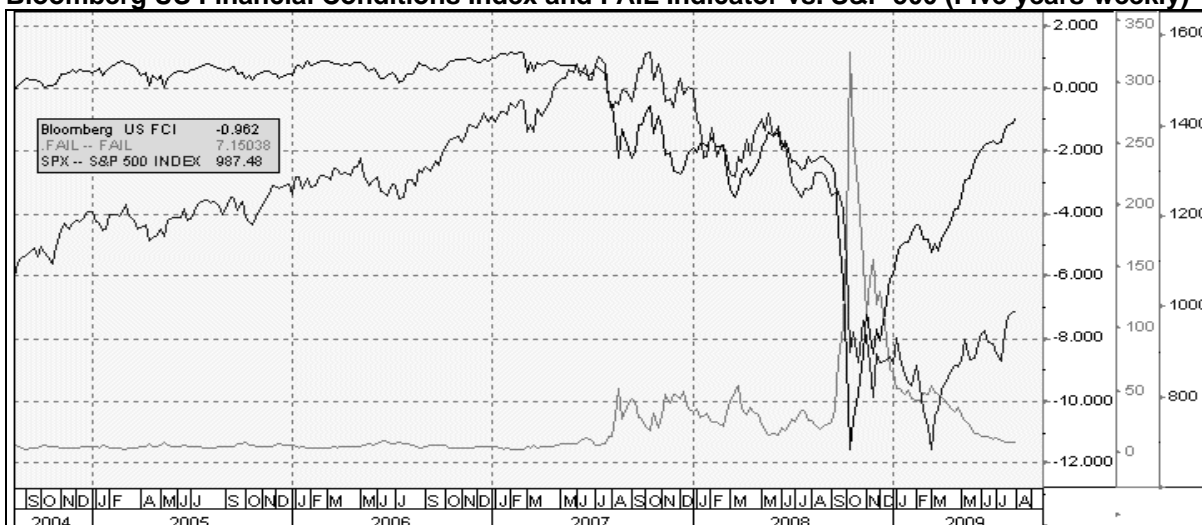
- **Record rebound in the riskiest US bonds** – US corporate bonds rated CCC have surged 80% since March 9, with the average price of CCC bonds trading at a one-year high of 73.1 cents this week, compared with a record low of 31.6 cents on December 12, 2008. Bank of America strategists noted last month that this rebound represents the fastest and sharpest recovery during a credit cycle, with prices that are 10% higher than at similar points during the last two recessions. The high-yield market is now trading as if less than 8% of all issues will default over the next year, whereas the actual default rate since July 2008 has been close to 9.4%, according to Standard & Poor's. S&P also forecasts that the default rate a year from now may be at 13.9%, or as much as 18% if economic conditions get worse.

- **Renewed enthusiasm for emerging market assets** – Emerging markets, led by China and India, are expected to outperform the advanced economies in terms of economic performance this year. As a result, enthusiasm for emerging market assets is surging, with China's CSI-300 equity index up 95% and India's Sensex up 57% YTD. The MSCI Emerging Markets Index this week traded at a trailing P/E of close to 18x, the highest since October 2007. A Bloomberg article today noted that demand for emerging-market debt is driving the price of their credit-default swaps (which insure against debt defaults) below those of governments and municipalities in advanced economies for the first time.

- **Complete reversal in risk metrics and financial conditions** – The TED Spread (the spread between three-month USD LIBOR and three-month US T-Bills) this week slipped below 30 basis points – the lowest since March 2007 – compared with an average of 148 basis points from August 2007 to February 2009. The VIX, at its current level of 24.40, is at its lowest since September 2008, but still above its long-term average of 20. As a result, our proprietary FAIL[®] indicator (which combines the VIX and TED Spread for a composite measure of market risk) is trading just above 7, its lowest level since July 2007. The Bloomberg US Financial Conditions Index this week climbed to -1 for the first time since October 2007 (see Chart below), when the S&P 500 reached a record high.

In our opinion, these developments reflect unbridled optimism for a V-shaped recovery in the global economy, whereas the reality may likely be quite different. We therefore recommend using the rally to trim positions in risky assets such as junk bonds and emerging market stocks/bonds.

Bloomberg US Financial Conditions Index and FAIL Indicator vs. S&P 500 (Five years-weekly)



Source: Global Securities Research, Bloomberg

Trade Update

Yamana Gold: Decline this week presents a buying opportunity

Yamana Gold (TSX: YRI, \$9.96), recommended as a Buy at \$9.77 last week, has declined 6.5% since reporting its Q2 results on Tuesday. We believe this dip presents a buying opportunity for investors with moderate risk tolerance.

The company's results missed analysts' expectations, with revenues of US\$269.8 million and net income of US\$9.6 million or US\$0.01 per share, well below average forecasts for revenues of US\$318 million and EPS of US\$0.095. Revenues fell 20% from a year ago mainly due to lower prices for copper and silver. Net income plunged 77% from US\$42.1 million a year ago, due to lower mine operating earnings (which fell 46% to US\$94.9 million), an unrealized derivatives loss of US\$34.1 million and a forex loss of US\$28.5 million. Total gold production increased 6% sequentially from Q1 to 244,161 ounces, with silver production up 9% to 2.5 million ounces.

The stock lags its peers by a considerable margin, with the third-worst price performance on the 26-member TSX Capped Gold Index. It has declined 13% over the past year, compared with a gain of close to 8% for the index. Yamana now trades at a forward multiple of 16x analysts' average FY10 EPS estimate of US\$0.56.

We continue to rate Yamana as a Buy with a medium-term price objective of \$12.

Market Snapshot at 12:30 am

S&P TSX	10890.53	+97.16	Commodities		Yields (%)	Can.	US
TSX Venture	1191.78	+3.66	Canadian \$	92.33	-0.45	90 Day T-Bill	0.24 0.17
DJIA	9399.70	+143.44	Gold (Spot)	954.88	-8.38	2-Year Bond	1.47 1.30
S&P 500	1013.60	+16.52	Oil (WTI-Sept.)	70.57	-1.37	10-Yr. Bond	3.61 3.86
NASDAQ	2005.09	+31.93	CRB Index	264.35	-0.42	30-Yr. Bond	4.07 4.61

Thought for the Day

"The significant problems we have cannot be solved at the same level of thinking with which we created them." – Albert Einstein

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