



Palos Weekly Commentary

Investment Themes



U.S. Equities closed higher as U.S. banks reported better-than-expected earnings

U.S. Equities closed higher for the week as U.S. banks reported better-than-expected earnings bringing in much needed relief to the market. Speculators are betting that the end of the current credit crisis is nearing and are thus, deploying capital back into financial sector in anticipation of a sharp reversal of price trend. Additionally, rising oil and gasoline prices fueled by higher than expected manufacturing activities led to a surge in energy stocks.



Crude oil closed higher as the weakening U.S. dollar spurred demand

Crude oil closed higher for the week as the renewed greenback weakness spurred demand for the commodity as an inflation and dollar hedge. Crude oil, amongst other commodities, has been selected by traders as a hedging instrument of choice due to its liquidity, supply constraints and OPEC's production discipline.



Corporate spreads closed lower as economic concerns are alleviated

Corporate spreads closed lower for the week as U.S. banks reported better-than-expected earnings alleviating economic concerns. The banking results invigorated risk appetite as shown by narrowing yield differentials between US treasuries and junk bonds.



U.S. Treasuries closed lower as rate cute forecast is reduced

U.S. Treasuries closed lower for the week as rallying equity and energy markets led traders to reduce their speculative positions. The magnitude of the rate cute anticipated at the next FOMC meeting has reduced to 25 bps. The improved confidence in the global economy has steered investors away from

Treasuries to equities and commodities. While most indices are still showing considerable financial stress, some tolerance for risk is slowly emerging. Indeed, the yield curve flattened further during the week as 2-Year short yields rose more than 10-year long yields.



The Canadian dollar closed higher as commodity prices spurred demand

The Canadian dollar closed higher for the week as rising commodity prices increased demand for the Loonie. Given that about half of Canadian exports are made up of natural resources, commodity prices are considered the primary drivers. Furthermore, better-than-expected data for Canadian factory shipments softened the hardliners that the strong Canadian dollar is destroying manufacturing competitiveness. There are many new theories on economic decoupling that suggest reduced correlation between the performance of the Canadian dollar and U.S. economy. Increased belief in the independence of Canadian economic prospects in a global economy has built significant confidence and resiliency in the Loonie.



Chicago Rice Soars to Record on Supply Concerns

The price for rice jumped on the Chicago Exchange to a record high, extending the rally for a fourth week in a row on speculation that export restrictions may reduce supplies in many markets. Countries including Vietnam, China, Egypt and India are curbing rice exports to ensure domestic supplies and control rising food costs. Wheat, corn, rice and soybeans prices have risen to the record levels this year. Demand for bio-fuels, along with increased competition for cropland between food and fuel uses, is taking up much of the increase in global crop production. Corn is trading around its all time high gaining nearly 175% since August 2006. The price of Cocoa is approaching a 28 year high.



Investment Themes

- **Equity Markets:** U.S. Equities closed higher as U.S. banks reported better-than-expected earnings
- **Energy Markets:** Crude oil closed higher as the weakening U.S. dollar spurred demand
- **Credit Spreads:** Corporate spreads closed lower as economic concerns are alleviated
- **US Treasury:** U.S. Treasuries closed lower as rate cute forecast is reduced
- **Canadian Dollar:** The Canadian dollar closed higher as commodity prices spurred demand
- **Commodity:** Chicago Rice Soars to Record on Supply Concerns

Comment Corner

Palos is applying the "uncertainty principle" when it comes to the way the current financial turmoil will play out. Given that it is not possible to know the exact direction of the global market economy, we take the position that we do not want to be without an exposure to commodities. The financial crisis may have increased the cost of capital and reduced credit availability to the point of killing off any hope of re-balancing the world economies.

In other words, the restoration of US employment growth can only come from the application of fiscal and monetary stimuli, and not from very strong export demand. In this connection, the eventual impact of the huge monetary push is risking an inflationary spiral that could sustain commodity prices near record levels even under depressed economic activity. Natural resources are in limited supply in a world where emerging market demand is accruing. It should be pointed out, even if it appears counter intuitive, that low economic activity and heightened commodity prices can co-exist for as long as the US dollar remains under downward pressure.

--- **Hubert Marleau**, President & Financial Adviser with an unrestricted practice

Figure 1: Performance

Funds	Value	Weekly Returns	Year-To-Date Returns
Palos Income Trust Fund, L.P.	CAD\$ 11.51	1.86%	1.88%
Palos Equity Income Fund - RRSP	CAD\$ 10.35	1.70%	5.59%
Palos International Equity Income Fund PLC - CAD	CAD\$ 8.65	0.82%	1.43%
Palos International Equity Income Fund PLC - EUR	EUR€ 7.72	0.00%	-8.27%
Palos International Equity Income Fund PLC - USD	USD\$ 9.89	0.61%	-1.54%
CTI Palos Equity Fund, L.P.	CAD\$ 12.72	3.81%	5.47%
CTI Palos Equity Fund - RRSP	CAD\$ 10.75	3.24%	7.52%
CTI Palos Bond Fund, L.P.	CAD\$ 10.39	-0.53%	1.42%
CTI Palos Bond Fund - RRSP	CAD\$ 9.90	-0.46%	-0.97%
Gauthier Palos Gobal Macro Fund, L.P.	CAD\$ 8.94	3.69%	-2.06%
MVest Opportunity Fund, LLC	N.A.	N.A.	N.A.
Palos Capital Pool, L.P.	N.A.	N.A.	N.A.
Palos Majestic Commodity Fund L.P.	CAD\$ 10.00	N.A.	N.A.

Figure 2: Benchmarks, Interest Rates & Commodities

Benchmarks, Interest Rates & Commodities	Value	Weekly Change	Year-To-Date Change
S&P 500 Total Return Index	1,390.33	4.33%	-4.73%
S&P TSX Composite Total Return Index	14,237.06	4.06%	3.67%
S&P TSX Capped Income Trust Total Return Index	156.75	3.23%	11.51%
MSCI All Countries World Total Return Index - CAD	597.55	1.69%	-8.18%
DEX Universe Bond Total Return Index	N.A.	N.A.	N.A.
US Government 10-Year Yield	3.71%	0.24%	-0.37%
Canadian Government 10-Year Yield	3.69%	0.13%	-0.34%
Crude Oil Spot	USD\$ 116.83	USD\$ 6.69	USD\$ 20.83
Gold Spot	USD\$ 912.20	-USD\$ 11.40	USD\$ 69.50
US Government 10-Year/Moody's BAA Corporate Yield Spread	320 bps	-24 bps	56 bps
USD/CAD Exchange Rate Spot	0.9958USD/1.00CAD	0.0192USD/1.00CAD	-0.0230USD/1.00CAD

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