



## Palos Weekly Commentary

### Investment Themes



#### **U.S. Equities Rally on Investment Banking Earnings and Mortgage Buying**

U.S. markets closed higher for the week, as increasing mortgage purchases by large U.S. mortgage lenders will help to stabilize the money market. Street consensus indicated that U.S. GDP growth will decline to 0.1 percent in Q1 before picking up again in the two subsequent quarters; there is renewed speculation that the Fed will try to revive the economy by cutting interest-rates again. The weekly rally was bolstered by stronger-than-expected earnings from U.S. Investment Banks, alleviating market concerns over the Bear Sterns debacle.



#### **Crude Oil Declines on Higher Inventories and Lower Industrial Production**

Crude oil closed lower for the week, as forecasts indicated that U.S. crude oil inventories increased. Furthermore, the outlook on U.S. economic activity has increasingly weakened during the week as industrial production dropped more than forecasted in February, thus hampering forward demand.



#### **Corporate Spreads Rise Slightly as U.S. Concerns Stabilizes**

Credit spreads widened only slightly during the week as concerns over the credit crunch did not abate. Concerns over default rates, inflationary pressures, the

fate of U.S. financial institutions and further asset write-downs continued to pressure corporate yields to higher levels.



#### **U.S. Treasuries Price in Declining Inflation Expectations**

U.S. Two-Year Treasuries closed lower for the week as opposed to Ten-Year Treasuries, which closed higher for the week. As a result, short rates rose and long rates declined, thus flattening the yield curve, favouring longer terms and effectively betting against inflation.



#### **Canadian Dollar Declines with Commodity Prices**

The Canadian dollar closed lower for the week, as commodity prices fell. Furthermore, traders speculated that the Bank of Canada will have no choice but to follow the Fed in cutting key lending rates. Consequently, the Loonie weakened vis-a-vis the US dollar as crude oil and gold prices declined. Commodities, a heavy component of Canada's GDP, comprise approximately half of its exports.

### Investment Themes:

- **Equity Markets:** U.S. Equities Rally on Investment Banking Earnings and Mortgage Buying
- **Energy Markets:** Crude Oil Declines on Higher Inventories and Lower Industrial Production
- **Credit Spreads:** Corporate Spreads Rise Slightly as U.S. Concerns Stabilizes
- **US Treasury :** U.S. Treasuries Price in Declining Inflation Expectations
- **Canadian Dollar:** Canadian Dollar Declines with Commodity Prices

## Comment Corner

Market sentiment has been very fickle during the past few weeks. Yet there are strong reasons to believe that things are about to change for the better, albeit in a muddy fashion. Recently, FRB has creatively instaurated new programs like TAF, TSIF and PDCD and substantially reduced the federal fund rate by 300 bps to make liquidity both abundant and cheap. The resulting combination steepened the yield curve, widened credit spreads, decreased real rate and weakened the exchange rate. History has often demonstrated that the above developments should create a sufficient amount of 1) compensation for speculators to absorb unanticipated inflation and traders to endure further recessionary conditions and 2) rewards to commit investors to deploy their capital for long term investments and induce consumers to spend their hoards of cash. Given that recessions typically last about twelve months and that the current one started last August, the actions of the Central Bank should soon mitigate the cleansing effect of the business cycle. Given the «asset deflation» nature of this downturn, it will take several years to bring back the economy and the financial system in equilibrium. While current actions will ease the pain, the process toward higher evaluations will be slow and gradual. In this regard, dividends may prove to be a strong alternative asset because a large part of the potential gain that should come from stabilization is upfront.

## Performance

Funds	Value	Weekly Returns	Year-To-Date Returns
Palos Income Trust Fund LP	CAD\$10.94	-3.01%	-4.88%
Palos Equity Income Fund - RRSP	CAD\$9.98	-2.64%	-0.20%
Palos International Equity Income Fund PLC - CAD	CAD\$8.56	0.12%	-1.95%
Palos International Equity Income Fund PLC - EUR	EUR€7.77	-2.75%	-9.82%
Palos International Equity Income Fund PLC - USD	USD\$9.98	-0.20%	-2.64%
CTI Palos Equity Fund LP	CAD\$11.47	-4.32%	-4.96%
CTI Palos Equity Fund - RRSP	CAD\$9.72	-2.63%	-2.85%
CTI Palos Bond Fund LP	CAD\$10.55	0.37%	2.96%
CTI Palos Bond Fund - RRSP	CAD\$9.97	-0.12%	-0.34%
Gauthier Palos Global Macro Fund LP	CAD\$8.16	8.81%	-2.70%
MVest Opportunity Fund LLC	N.A.	N.A.	N.A.
Palos Capital Pool LP	N.A.	N.A.	N.A.

## Benchmarks, Interest Rates & Commodities

Benchmarks, Interest Rates & Commodities	Value	Weekly	Year-To-Date
S&P 500 Total Return Index	1,329.51	1.09%	-9.01%
S&P TSX Composite Total Return Index	12,775.64	-4.95%	-7.17%
S&P TSX Capped Income Trust Total Return Index	141.07	-3.93%	-0.39%
MSCI All Countries World Total Return Index - CAD	559.26	-1.90%	-14.07%
DEX Universe Bond Total Return Index	N.A.	N.A.	N.A.
US Government 10-Year Yield	3.33%	-0.13%	-0.74%
Canadian Government 10-Year Yield	3.45%	-0.04%	-0.62%
Crude Oil Spot	\$101.43	\$8.78	\$5.45
Gold Spot	\$920.00	\$54.20	\$82.00
US Government 10-Year/Moody's BAA Corporate Yield Spread	358 bps	14 bps	93 bps
USD/CAD Exchange Rate Spot	0.9770USD/1.00CAD	-0.0339USD/1.00CAD	-0.0418USD/1.00CAD

Sincerely,

Charles Marleau

Tommy Nguyen

Minh Nguyen

Robert Sands Jr.

