

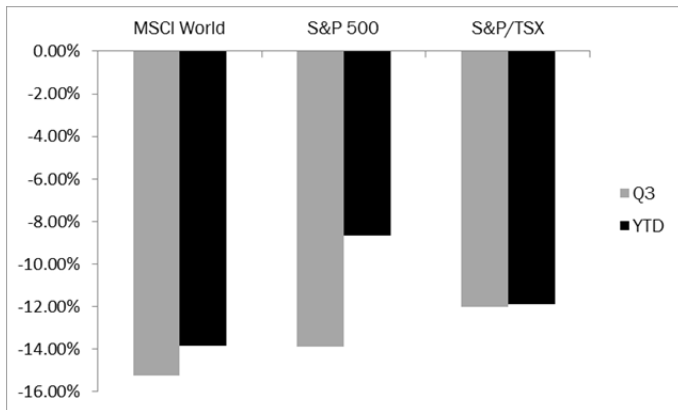
GAVIN

Management Group Inc

Contrary to Popular Belief...

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Financial markets continue to be burdened with concerns for the outlook of the global economy. Stock markets have borne the brunt of all this uncertainty. Local currency results, ending Q3 2011 are presented below:



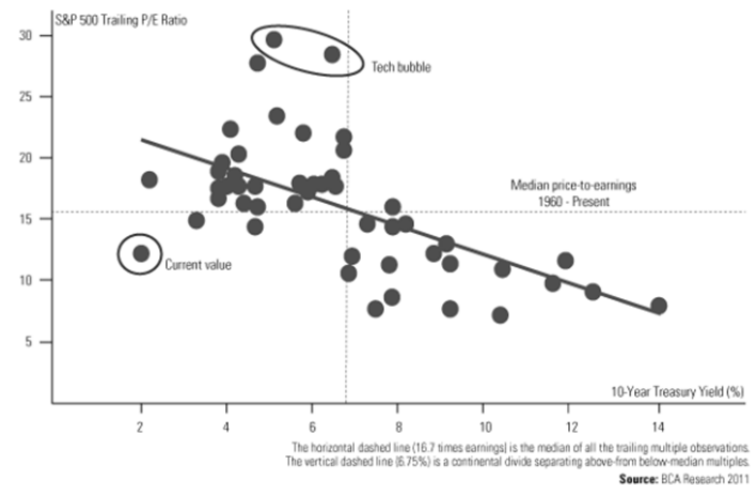
The threat of a debt default in Greece, the exposed weakness of multiple European banks, the potential for a double dip recession in the US and an economic slowdown in China have all contributed to investor pessimism. While not necessarily a bearish indicator, the VIX (a measure of equity market volatility commonly called the Fear Index) has climbed 142% year-to-date.

The proof is in the pudding (so to speak) as individual investors have dramatically abandoned the U.S. stock market. There has been \$85 billion of equity market outflows from June to August this year. This is quickly approaching the previous three-month record of \$88 billion, which came out of domestic equity funds between September and November of 2008! Thus far in 2011, individual investors have sold about \$75 billion of domestic equity funds. Astonishingly, since the beginning of 2007, domestic equity mutual funds have had net outflows of more than \$400 billion (in the same period, \$835 billion of fixed-income funds have been purchased!). That spread between stock outflows and bond inflows – \$1.235 trillion – is unprecedented in the annals of financial history. The story in Canada is similar with the same spread surpassing \$4.852 billion thus far in 2011.

Investment professionals constantly monitor fund flows. Evidence suggests that individual investors have a tendency to get wrapped up in the news, pulling the plug on equities when the stock market has already bottomed out and jumping into stocks when they are near a peak; a classic “buy high, sell low” scenario. Along with fund flows, contrarian investors point to

multiple indicators that suggest now is a good time to be investing in equities.

Equities are currently undervalued. When a stock trades at fair value, it means the equity is “fairly” priced based on a discounted cash flow model. In the US, an analysis reveals that equities are approaching the lows we saw during the financial crisis; implying a 20% upside to current equity prices. In Canada, the upside ranges from 20% to 25%. The chart below (Source: BCA Research 2011) shows the trailing P/E ratio of the S&P 500 versus the current yield on a 10-year Treasury bill over the past 50 years. The chart reveals that today’s relationship between P/E multiples and yields is a “clear outlier” to historical trends.



Dividend yields are attractive. The current dividend yield on the S&P 500 is currently 0.67% higher than that of the 10-year Treasury; implying investors could receive a higher return with stocks simply by receiving the dividend.

Another contrarian indicator is The Investors Intelligence Bull/Bear ratio (IIBBR). This index reflects the sentiments of market participants that deal daily within the financial markets. The ratio is currently very bearish and investing in the opposite direction to the recommendations has resulted in better market timing. Similarly, short positions in the S&P 500 have increased significantly to their highest level in four years; signifying an increase in bets the market will fall.

Does GMG suggest liquidating fixed income positions and loading up on equity? No. GMG continues to apply a balanced, long-term approach to investing. However, GMG does hope to be calm worried investors that feel their only option is “under the mattress”.