



Iceberg! Iceberg! Iceberg! Iceberg!

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On Christmas Day 2007 we published a special edition of our **BalancedView** entitled **The Unsinkable Ship**. In it we made the simple argument:

In our estimation producing great rates of return for the past year is akin to being pleased with oneself for receiving a free round of drinks at the bar on the Titanic five minutes before the last vestiges of The Unsinkable Ship were swallowed by the unforgiving waters of the North Atlantic.

Our thesis was as follows: the popping of the housing bubble, the credit crunch and the collapse of the US dollar created an ice field that warranted prudent navigation, not full steam ahead.

Standing on the front of the ship with the wind in your face felt good in 2007, then January hit. Iceberg!

Equity Indices	1 Month %
S&P/TSX Composite Index	-6.10%
S&P/TSX Composite Index TR	-6.00%
S&P/TSX Equity Index	-6.50%
S&P/TSX Capped Income Trust Index	-3.10%
Dow Jones Industrial Average	-4.20%
S&P 500 Index	-5.30%
NASDAQ Composite Index	-7.80%
MSCI World	-6.90%
MSCI EAFE	-8.60%
Dow Jones Euro Stoxx 50	-10.50%
FTSE 100	-7.80%
CAC 40 Index	-12.10%
DAX Index	-13.00%
Nikkei 225	-10.80%
MSCI World TR	-6.90%
Shanghai Stock Exchange Composite	-14.20%

Markets around the world have provided a reminder that they are still capable of going down, sometimes quite quickly. Some stock markets have already fallen more than 20% from last year's highs, the common definition of a bear market. The U.S. market sell off reflects a sharp erosion of confidence due to rapidly deteriorating economic indicators, including December's spike in unemployment to 5%, a plunge in the ISM Manufacturing Index and this week's fall in the ISM Composite Non-Manufacturing Index. All of a sudden the health of our impenetrable service economy is showing signs of vulnerability. The 8.6 decline in January to 44.6 is a level even lower than the 44.8 recorded in October 2001.

The U.S. is teetering on the brink of its first recession since 2001. This period reminds us of the 1990-91 consumer led recession, one that was triggered by weak consumer spending, a declining real estate market, a spike in oil prices and the S&L crisis. The National Bureau of Economic Research determines whether a recession has technically begun months after the fact. Regardless of whether the NBER labels this a recession, we are at an economic tipping point.

With soft corporate earnings, an accelerating decline in housing and an intensified credit crisis, investors have begun to rapidly climb the wall of worry.

The magic question: *what should an investor do?*

First let's start with what not to do. A rule of thumb for Canadian investors is to buy bank stocks in times of market downturns. This is what psychologists call a "bias blind spot", which is the tendency not to compensate for one's own cognitive biases. Canadian banks are so dominant in our business community and so prevalent in our daily lives that we have a tendency to confuse opportunity with familiarity.

Buying bank stocks here is the equivalent of hitting an iceberg, backing up and hitting it again.

Money management is about capitalizing on opportunity and the management of risk. Opportunity ultimately is based on valuation and risk is based on minimizing exposure to the unknown.

The recent decline in equity prices around the world means there are many areas of opportunity, what is unknown is how much further we have to go with the credit crunch.

At present, credit markets are focused on the potential domino effects of ratings downgrades to collateralized debt obligations (CDOs) and bond insurers. The banks have much more to lose if this happens.

So now, *what should an investor do?*

A better way to take advantage of the opportunities created by recent declines is to invest in securities and asset classes that reduce exposure to current ailments and seek out the investments that have been hit with the broad bear market brush. This is the precise objective of our **TrueBalance™** strategy at Barlow.

Our next issue will outline some of the strategies we are deploying to traverse today's market environment.



TrueBalance™