

NOVEMBER 28, 2007

ECONOMIC INDICATORS Canada

	Dec. 2006	Oct. 2007	
GDP ⁽¹⁾	2.8	2.4 ⁽³⁾	↘
CPI ⁽¹⁾	1.6	2.4	↗
Unemployment	6.1	5.8	↘

United States

	Dec. 2006	Oct. 2007	
GDP ⁽¹⁾	2.9	2.6 ⁽²⁾	↘
CPI ⁽¹⁾	3.2	3.5	↘
Unemployment	4.5	4.7	↗

(1) Year-over-year % variation
(2) September 2007 (3) August 2007

Sources: Statistics Canada, U.S. Dept. of Commerce, U.S. Dept. of Labor Statistics.

EQUITY INDICES

% Change	2007 in local currency	2007 in C\$	
S&P/TSX	4.2	4.2	↗
S&P500	1.0	-14.4	↘
Russell 2000	-4.9	-19.3	↘
Nikkei	-12.1	-18.1	↘
S&P 350 Europe	-1.8	-6.3	↘

FANNIE, FREDDIE AND COMPANY

On November 9, U.S. financial services company Fannie Mae declared a 3rd quarter loss of \$1.4 billion. On November 20, its competitor Freddie Mac declared an even worse \$2 billion loss. They also stated that more losses are likely on the way for the 4th quarter. These events opened up a new chapter of the U.S. mortgage crisis.

Who are Fannie and Freddie?

Fannie Mae and Freddie Mac are privately-owned corporations that are authorized by the U.S. government to purchase residential mortgages from financial institutions, pool them, package them into bonds and sell them to investors. These bonds are also known as “mortgage-backed securities”. Fannie and Freddie add their mortgage guarantee (for a fee) to the creditworthiness of these mortgage pools, resulting in lower interest rates and easier access to home ownership for U.S. citizens.

Despite both having been involved in accounting manipulation scandals earlier this decade, Fannie and Freddie still maintain their “AAA” credit rating and their stock price remained relatively stable until this month.

What do the misfortunes of Fannie and Freddie mean to the market?

Fannie Mae and Freddie Mac are considered among the safest financial institutions in the U.S. Their combined assets are 40% larger than those of the largest U.S. bank. Markets were stunned by their announcements. Their stocks -which were moderately affected by the subprime mortgage crisis until October 31- tanked 43% and 49% respectively since then. Fannie and Freddie are not subprime lenders, so most market participants assumed that they would not experience abnormally high loan delinquency rates. Their announcement signaled the opposite. Markets are now worried that just about any financial institution can be affected by rising mortgage delinquencies.

How can Canadian investors protect themselves against these events?

These events remind us of a recent conversation with an investor about risk management. The investor asserted that his portfolio, made up of a few Canadian bank stocks, had little risk. We beg to differ. To us, no corporation is totally immune to the risk of deep financial troubles. But while corporations can (and do regularly) fail, markets as a whole cannot. This is why we believe that a properly diversified portfolio must hold hundreds, and preferably thousands of securities diversified by both sectors and countries.

Raymond Kerzérho, Director of Research

This article is provided for your information. Conclusions and opinions given do not guarantee future events or performance. Facts and data provided are from sources we believe to be reliable, but we cannot guarantee they are complete or accurate. This article is not intended to provide legal, accounting or tax advice and should not be relied on in that regard. Before making an investment or adopting an investment strategy, each investor should review his investment objectives with his financial advisor. PWL Capital Inc. and individuals and companies who are related may, at any time, buy or sell securities that are hereby described in this newsletter as a market maker or a broker.

