

August 16, 2007

## ECONOMIC INDICATORS

### CANADA

	Dec. 2006	June 2007	
GDP <sup>(1)</sup>	2.7	2.1 <sup>(2)</sup>	↘
CPI <sup>(1)</sup>	1.6	2.2	↗
Unemployment	6.1	6.1	-

### UNITED STATES

	Dec. 2006	June 2007	
GDP <sup>(1)</sup>	2.9	1.8 <sup>(3)</sup>	↘
CPI <sup>(1)</sup>	3.2	2.7	↘
Unemployment	4.5	4.5	-

(1) Year-over-year % variation

(2) April 2007 (3) June 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	1.1	1.1	↗
S&P500	-0.8	-8.3	↘
NASDAQ	1.8	-5.9	↘
NIKKEI	-4.4	-9.8	↘
S&P 350 Europe	0.2	-5.5	↘

PARKYN  
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## THE SUBPRIME MORTGAGE CRISIS IN FIVE POINTS

On August 9, the subprime mortgage crisis intensified when BNP Paribas froze refunds on three of its asset-backed securities funds. What happened? While we can't review all aspects of the situation, we can briefly answer five key questions.

### What is a subprime mortgage (SPM)?

An SPM is a residential mortgage that includes one or many of the following elements: a borrower with weak credit, a lack of borrower income documentation and a very high loan-to-value ratio. In extreme cases, institutions granted loans for 100% of the value of the house with a reduced interest rate in the first two years in return for a much higher rate for the remaining years to maturity.

### How can they exist?

Banks are responsible for the safety of their depositors' money. This is why regulators control them to lend money prudently. A large share of the SPM market is held by unregulated, non-bank entities. They "securitize" most of the mortgages they underwrite, i.e. they package them into bonds and sell them to institutions with the help of Wall Street firms. By doing so, the lenders remove these loans from their balance sheet and avoid the need to collect deposits.

### What is the origin of the problem with SPMs?

Defaults rose substantially in 2007, triggering credit concerns among holders of SPM-backed bonds. To make matters worse, many organizations which invest in SPM-backed bonds don't only invest their capital, they also borrow in the short-term "commercial paper" market in order to leverage their return and risk. They frequently have to refinance what they borrow in order to stay in business. Today, they are having a tough time refinancing: this is called a "credit-crunch".

### What happened on August 9?

When BNP Paribas froze three of their funds, they sent a shockwave to the market. Not because of the freeze itself, but because they had stated shortly before that the subprime situation was not a significant risk for them. Market confidence collapsed, and a lot of commercial paper issuers (even the high quality ones that have nothing to do with subprime) are currently having difficulties refinancing.

### What is the bottom line for prudent long-term investors?

Governments and Central Banks have demonstrated that they can manage crises like this, thus minimizing the damage to the economy. The 1987 stock market crash, the 1998 Asian crisis and the September 2001 terrorist attack all could have turned into disasters but were handled correctly. Nevertheless, the market is likely to remain volatile for some time, with most of the pain inflicted on speculators and investors with poorly designed portfolios. Long-term investors who hold well-diversified and robust portfolios are likely to experience volatility, but with little or no permanent damage. In our view, true long-term investors who are willing to withstand a reasonable level of volatility will be rewarded with a decent long-term return.

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