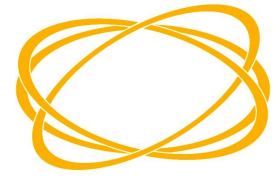


Q4 2008 Market Commentary



GALILEO

Date: 12/31/08

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The news is all bad and will only get worse. The global economy is now gripped by a major recession. Lay-offs are soaring, unemployment is headed higher, America is the land of the bail-outs. Hedge funds are falling like dominoes and investors continue to yank assets from mutual funds. China's economy is headed over a cliff and India's economic growth has been downgraded far and wide. So much for being saved by emerging markets. And just in case that wasn't enough, we had to throw in the largest 'Ponzi scheme' ever in history (the fall-out will be significant).

Conventional wisdom from all the so-called experts dictates that this recession will be very long and very deep. The only point of disagreement between them is how long...two years or five?

And of course everyone knows that any move up in markets from here constitutes a bear market rally and will shortly roll-over back to the November 21 lows (S&P 741 and TSX 7647) because of all the bad news to come. This view is now virtually gospel amongst the 'enlightened' stock market strategists.

Of course, these predictions are based on past recessions used as models and data points from the October/November period that are used as the new normal.

But in our view, none of the past patterns are necessarily relevant since the unfolding of events over the past six months simply has no precedent. What we experienced in October/November was a complete cessation of credit in the wake of Lehman's demise.

In our view, it is an enormous mistake to extrapolate forward from the last two months when trade and commerce virtually stopped overnight. We must also add that since the vast majority of pundits missed the downturn altogether, why will they now be right going forward? In all candor, we do not have answers as to the future but we offer some thoughts.

The worst of the credit crisis is behind us and confidence is slowly creeping back into the system. Markets dropped in precipitous fashion during the past four months and prices now discount much of the bad news still to come.

Recessions are always a good excuse to reduce head count. Corporations will emerge from this recession with much leaner cost structures and higher margins.

The simultaneous collapse in commodity prices and credit lines dictates that most if not all new capacity projects have been deferred or cancelled. When global growth returns, many commodities will be in very short supply which will result in much higher prices than today.

China's economy is experiencing a significant slowdown, greater than we had anticipated in our September letter. The news flow is set to remain ugly over the next two quarters. However, the authorities in Beijing have fully appreciated the challenges ahead and have moved aggressively to offset the slowdown from both a monetary and fiscal policy stand point. We think it realistic to expect a positive impact on the economy to be visible by the second half of 2009.

No economic recovery can begin in the United States until housing prices start to stabilize. The incoming Obama administration needs to focus on the housing market as a priority issue.

Any sustainable recovery in equities must be led by fixed income markets. The spread on corporate bonds and preferred shares relative to government obligations needs to narrow. On a risk adjusted basis, the potential returns here are substantial.

We believe the consensus view of a long drawn-out recovery will likely be wrong. Observing events over the past year, we suspect whatever the future holds, it will happen faster than most of us expect. But recognizing the risk of a delayed recovery, we think that yield is essential on any new investment in today's market. We have done our best to build meaningful yield into the majority of our portfolios.

Despite the carnage of the last few months, we think investors should not lose sight of the massive economic stimulus that is now being applied to economies around the globe. Massive amounts of cash (as high as \$8 trillion) sits on the sidelines in cash earning next to nothing. As confidence returns, this cash will be re-deployed and will drive markets up. Our advice is to stay the course. Its too late to sell and long term investor have the advantage now.

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