LIBERTY
International Investment Management

MARKET UPDATE

Q4 | January 1 to December 31, 2020

IN THIS ISSUE:

I believe the opening paragraph of a January 8, 2021 *BloombergOpinion* newsletter perfectly summarized the markets in 2020:

"Global pandemic? Buy stocks. Vaccine for that pandemic? Buy stocks. Big job gains? Buy stocks. Big job losses? Buy stocks."

"The Labor Department reported the economy shed 140,000 jobs last month, far short of expected small gains. Not great! But, of course, stocks rose because that is what they must do."

There were some shifts during the year, such as:

- A tightening of the gap between growth and value stocks.
- A subsequent rotation out of US tech stocks and into small-cap and larger value stocks.
- A drop in the US dollar which helped spur commodity prices and emerging market stocks.

In particular, the mega-cap technology stocks, including Facebook, Apple, Amazon, Google, Microsoft and Nvidia in particular, lost their edge after September 1st. This group was up an average 65% in 2020 but down an average 3% during that period.

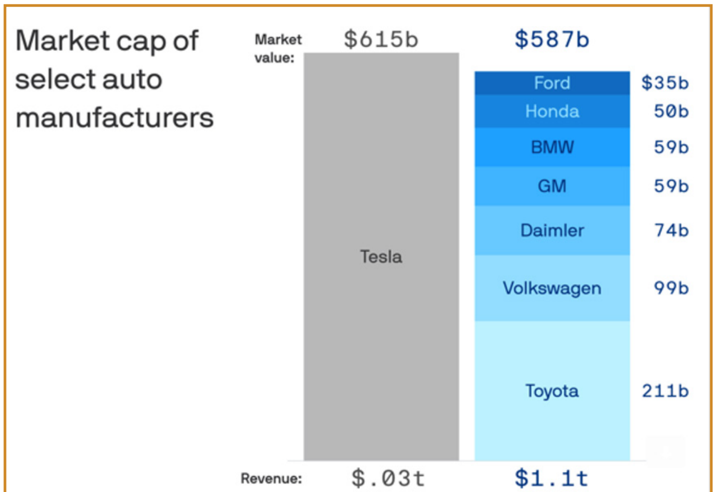
The chart below illustrates this shift. Only Google had a positive performance during that 4-month period.

COMPANY	SEPT. – DEC. 2020 PERFORMANCE	2020 TOTAL PERFORMANCE	PRICE / EARNINGS MULTIPLE
Amazon.com Inc.	-6.92%	76.26%	67.3
Apple Inc.	-1.11%	82.31%	33.5
Facebook Inc.	-7.54%	33.09%	27.6
Google Inc.	5.89%	30.85%	32.2
Microsoft Corp.	-2.13%	42.53%	32.6
Nvidia Corp.	-5.51%	122.30%	59.0

Data Courtesy of *Bloomberg LP*

Compared to other stocks, their valuations are stretched. As of this writing, their average Price-Earnings (P/E) multiple is 42, almost 1 ½ times that of the S&P 500 Index at 31.

They're not alone. In 2020, Tesla enjoyed a 743% price rise; not bad for a company whose market cap, now US $834 billion, is larger than all the other global automobile manufacturers combined (see the chart). It currently trades at almost 1,400 times earnings, 51 times book value (less than two times is considered good) and 28 times sales. It explains the insanity in the markets in 2020.



Data: YCharts. Reproduced from Raazum Capital. Chart: Axios Visuals

The late-year 2020 Rotation

From September 1st to the end of the year, investment dollars rotated into small cap stocks and emerging market names. During that time, the Russell 2000 Small-Cap Index (RTY) was up 25% and the Emerging Market Index (MXEF) rose 15%.

Small-cap stocks, in terms of performance, often represent the market leaders when an economy exits a recession.

Also, a drop in the US dollar made Emerging Market stocks more attractive. The Emerging Market Index (MXEF), on a comparative basis to the S&P 500 Index, was much cheaper. Its P/E multiple is currently 16 times earnings, or about half of the S&P 500 Index multiple (31 times).

As we wrote in our September newsletter, three of our emerging market holdings, HDFC Bank, Fomento Economico de Mexicano (Femsa) and Jardine Matheson, were out of favour throughout the year until the rotation occurred.

Since September, their share prices rose 41% (HDFC), 29% (Femsa) and 35% (Jardine) respectively. And yes, we were buying those names during that time.

Jardine Matheson benefits from a lower US dollar because its largest revenues are in Indonesian Rupiahs. That currency weakened to 16,625 rupiahs to 1 USD during the stock market selloff in March, only to return to its previous level around 14,000, a difference of almost 19%. That provides a huge boost to Jardine's Indonesian based profits.

The implications of a weaker US dollar

The US dollar declined after April 2020 when the Federal Reserve cut interest rates to near zero. This caused bond investors to sell US bonds and buy fixed income instruments from other countries where the yields were higher. By year-end, the US dollar currency index was down almost 7%.

In a *Reuters* article published on December 23, 2020 by Saqib Iqbal Ahmed, over two-thirds of analysts in a *Reuters* poll said the US dollar would keep falling until at least mid-2021 as investors continue shifting into comparatively riskier assets and seeking higher yields.

If this occurs, it leads to the following implications:

- → US multinational companies with high overseas revenues benefit from a US dollar drop as their reported sales and profits increase from the foreign exchange translation. Bank of America Global Research estimates that every 10% drop in the US dollar translates to a roughly 3% boost to S&P earnings.

- → Most commodities are priced in US dollars. A decrease in the greenback raises commodity prices. Since late April, the S&P / Goldman Sachs Commodity Index has jumped about 74%.
- → Emerging market countries enjoy economic improvement because most of their debts are in US dollars. A strengthening of their currencies helps them pay off their debt faster and gives them greater buying power. Countries like Indonesia and Korea may be major benefactors in 2021.
- → With a weaker US dollar, the United States imports inflation, making US Treasury inflation-protected securities (TIPs) a compelling investment.

The US Federal Reserve plans to keep interest rates low until inflation rises above the Fed's 2% target. If the Fed has to raise interest rates sooner than expected, we anticipate a market correction, especially among the mega-cap tech names listed above. In 2020, we saw increases in raw materials, food and insurance prices that were far greater than 2%.

A K-Style Recovery?

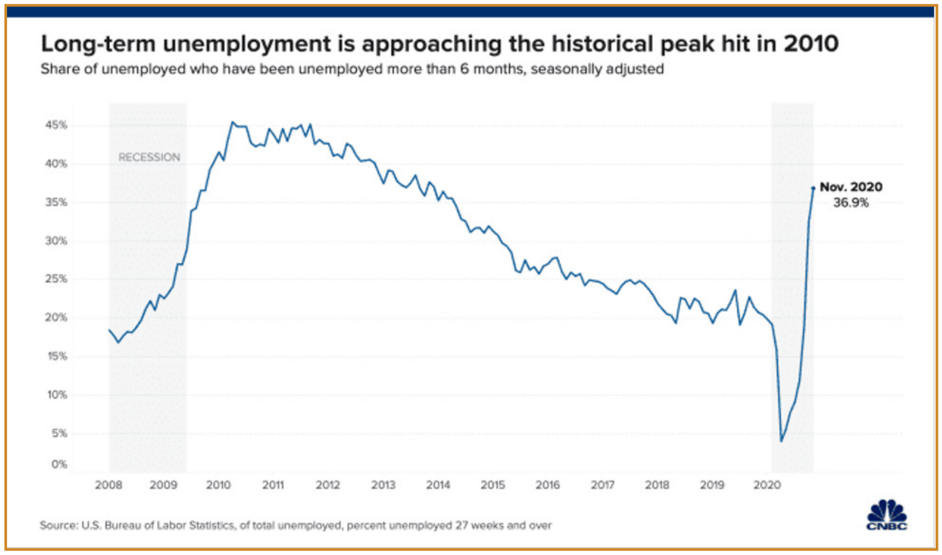
Greg Lacurci wrote in a January 1, 2021 *CNBC* article "The Covid19 recession and the extreme inequality it wrought will be among 2020's legacies."

"Rich, white and college-educated Americans saw jobs recover quickly, along with their wealth balloon as the stock market and housing prices reached new highs. Racial minorities, low earners, women and those without a college degree were more likely to be unemployed and fall into poverty."

"The result is a financial chasm between the have and the have-nots that emerged faster than prior downturns, according to economists."

The diverging experiences of those at the top and bottom have led many economists to identify the recovery as having a "K" shape, whereby the "haves" continue to see their net worth rise, while the "have-nots" see their net worth fall.

Meanwhile, long-term unemployment is not improving as the chart shows.



According to *Opportunity Insights*, "Wealthy Americans are also spending about 5% less money than before the pandemic, while the lowest earners are spending about 3% more. That suggests the wealthy may be boosting their savings, while others are unable to do so.

This could lead to lower profitability for corporations as higher unemployment keeps consumer spending lower.

Expectations for 2021

To summarize:

- → Emerging Market currencies have 25% of undervaluation to recoup, asset manager Pictet estimates. Data from the Institute of International Finance (IIF) show investors shovelling money into Emerging Market assets at the fastest rate in nearly a decade.

This is driven by hopes of a China-led growth recovery but also the lure of higher emerging market interest rates, given zero per cent or negative yields across richer countries.

→ Many are of the view that the central banks will keep the cheap money flowing. Central banks worldwide spent US$1.3 billion an hour since March on asset purchases, Bank of America Research calculates. There were also 190 rate cuts in 2020 year – roughly four of every five trading days.

→ But with global GDP seen expanding 5.4 per cent next year – the most since 1973 – it might be hard to justify pushing the pedal further to the metal, especially if inflation creeps higher.

  And not much policy room is left anyway. JPMorgan estimates that over 80 per cent of sovereign bonds from richer nations pay negative yields after factoring in inflation.

→ President-elect Joe Biden has vowed the United States will be "ready to lead" again on the global stage, but Bank of America analysts caution that China, North Korea or Iran may look to test him early on with "provocative actions."

  In some areas – big data, 5G, artificial intelligence, electric vehicles, robotics, and cybersecurity – Mr. Biden's policies might be just as combative as Mr. Trump's.

  Tech and e-commerce companies account for almost a quarter of U.S. corporate profits, while tech comprises 40 per cent of MSCI's emerging equity index.

→ A K-style economic recovery could limit corporate profitability and slow down the stock market's growth.

Liberty's investment plans for 2021

Here are Liberty's investment plans in 2021:

For new clients or new additions of money from existing clients:

→ Half the cash, or 50%, that are allocated for equities will be invested immediately.

→ If the market drops 20%, we'll allocate another 25%.

→ If the market drops a further 20%, for a total sell-off of 40%, we'll allocate the rest of the cash.

For all clients:

→ No changes need to be made to client asset mixes – we don't believe bonds should be sold.

→ Our provision of 20% cash times their equity weight remains in place in case the market corrects.

→ No stock changes need to be made because we were already in the industries that fared well during the Covid19 recession such as healthcare, medical devices, and technology.

→ If commodity prices rise, we have exposure through various stocks to benefit from it, such as Lindsay Corp., Nutrien Ltd., TC Energy, Dover Corp., Balchem Corp., Intertek Group, Alfa Laval, etc. We don't have to own mining or oil and gas companies outright as we participate through growing revenues of the companies listed above.

→ Commodity stocks do well during the good times but lose money in the bad times, often netting no share price growth over time. Also, their dividend histories fluctuate. We prefer to own companies that generate free cash flow so the dividend can grow uninterrupted.

INVESTING FOR MILLENNIALS – PAY ATTENTION TO THESE THREE ESSENTIAL METRICS WHEN PICKING A STOCK

In this edition, we begin a new section called Investing for Millennials. It will be penned by Audrey Leung.

By Audrey Leung

People new to investing often struggle to pick a stock because they don't know where to start. Among the vast amount of data available, what parameters should we pay attention to and how should we understand them? Here are three fundamental metrics to help you get started:

1. Free Cash Flow

Free cash flow is the cash a company has left over after paying for operational and capital expenditures. To calculate free cash flow, simply subtract capital expenditures (CapEx) and cash dividends from cash from operations (CFO).

FCF = CFO – CapEx - Dividends

There are different ways a company can make use of its free cash flow. It can pay down debt, pay dividends, repurchase shares, make acquisitions or reinvest cash back into the firm. Therefore, free cash flow analysis enables us to understand a company's ability to use its cash.

For example, can the company pay debt interest on time? Does the company have enough money to grow and innovate in the long-term? Does it have the financial ability to make acquisitions?

Firms that have a steady generation of free cash flow are rare. On the contrary, those companies that have consistently low or negative free cash flow may suffer from liquidity issues or may fall behind the performances of their competitors because they may lack adequate market share and pricing power.

2. Debt to Cash Flow

As its name suggests, the Debt to Cash Flow ratio (D/CF) is a company's total debt divided by cash from operations. This ratio gives us a sense of whether a company can pay down its debt with its cash flows.

Debt to Cash Flow Ratio = Total Debt / Cash from Operations

For instance, a Debt to Cash Flow ratio of 3.0 means that the company needs three times its current cash flows to pay down all its debt. A high ratio signals that the company may have liquidity and solvency issues.

During a recession, a company may have to spend more time paying off debt and cutting costs than earning revenues and profits. A general rule of thumb is to invest in companies that have a Debt to Cash Flow ratio lower than 2.0.

It is also important to compare the ratio with other companies in the same industry. If a company has a much higher Debt to Cash Flow ratio than its peers, ask yourself why? Is the company not generating cash, or are they carrying too much debt? The reason would likely provide insights into the company's operations.

3. Leverage

Leverage calculates the amount of debt a company has relative to its total capital.

A leverage position that's too low may force a company to pass on good investment opportunities, while one that's too high may cause a company to struggle with interest and debt payments.

How much leverage is appropriate? To answer this question, it's important to understand the relationship between a company's return on invested capital (ROIC) and its weighted average cost of capital (WACC).

ROIC is the amount of return a company generates from its invested capital. For example, if a company generates $1 million in profit and it issued $10 million in capital to earn that profit, the return on that capital would be 10% ($1 million divided by $10 million).

WACC is the weighted average cost of a company's capital, including equity and debt.

Imagine that you incur a mortgage to buy a condo and rent it out. ROIC is the percentage return you gain from rent, minus mortgage payments and expenses, divided by the purchase price of the property.

WACC is the percentage cost for you to take on the mortgage, including interest, taxes and fees. As long as your ROIC is higher than your WACC, you are turning a profit. Otherwise, you are losing money.

Similarly, for a company to make money using its debt, its ROIC must be higher than its WACC. As the company takes on more debt, its cost of borrowing increases - lenders need to be compensated for the higher risk. Therefore, a good leverage position is one where the WACC is close to but not greater than ROIC.

Same as the previous metric, it is crucial to compare a company's leverage position to its peers. Find out why the company has a higher or lower leverage position than most in the industry, and whether it is justifiable.

While performing any financial analysis, be sure to research thoroughly and look deeper into the numbers.

FUN WITH MATH: ACCOUNTING SHENANIGANS: INVENTORY ACCOUNTING

By Thomas Zagrobelny

> "These kinds of illusory profits can be especially risky in periods of overvaluation because they hide the economic reality that will eventually drive a correction."

We would like to think that when a company's profits increase, it is because something about the business has improved, like higher product sales, better prices on required materials, or lower overhead costs.

Unfortunately, that is not always the case. A company can manage its profits just by changing how key figures are counted. This is why an investor must look at a company's press releases and financial statements critically. In this section, we'll give an overview of one potential issue caused by inventory accounting.

Profit is essentially the revenue earned with costs subtracted. A simplified example of profit is paying $100 for steel, reworking it, and then selling it for $120. In this case, the profit is $20: The $120 earned less the $100 cost. One of the most important costs that companies report is called cost of goods sold (COGS). In our example, COGS is the $100 of steel bought.

In practice, matching the exact COGS to the goods sold can be difficult and impractical, so there are three methods used to estimate inventory:

- First-in, First-out (FIFO): With this method, you keep track of all goods purchased by date. You assume that the oldest materials are used first.
- Last-in, First-out (LIFO): With this method, you keep track of all your materials. You assume the newest materials are used first.
- Average cost: With this method, the cost of all materials available across the entire period are averaged, and this average drives the cost of goods estimate.

For example, during an inflation era where prices are rising over time:

- Jan 2020: 1kg steel bought for $100
- Apr 2020: 1kg steel bought for $120
- Nov 2020: 1kg steel bought for $125
- 2020 sales: $300 of sales using 2kg of steel

Revenue	**$300**	*minus*	FIFO COGS	$220 ($100 from January + $120 from April)	=	**Profit**	**$80**
Revenue	**$300**	*minus*	LIFO COGS	$245 ($125 from November + $120 from April)	=	**Profit**	**$55**
Revenue	**$300**	*minus*	AVG COGS	$230 ($345/3kg applied to 2kg)	=	**Profit**	**$70**

One very important implication is that if a company has $55 of profit using LIFO in the above inflationary environment, it can increase its profit to $80 just by changing the accounting method to FIFO.

International Financial Reporting Standards (IFRS) require companies use FIFO. However, U.S. companies (using the United States accounting principles, called GAAP) can choose between FIFO, LIFO, or average cost.

Under GAAP, if a company decides to change its inventory accounting method, it has a choice of whether to restate previous periods or only change the calculations going forward. While all relevant information surrounding the decision and treatment must be included in the accounting footnotes, that means investors must carefully read and understand those footnotes.

This means it is fully possible for a US company expecting $55 of profit under LIFO to change to FIFO to achieve $80 of profit instead. Investors might even compare the new profit under FIFO to the previous period's lower profit under LIFO. This would give an illusion of greater-than-actual growth.

Economists also often consider aggregate corporate profit, making individual accounting restatements easily lost in the noise. An economist might mistakenly conclude that US profits are rising more than they really are if enough companies restate their inventories to inflate figures under the right economic conditions. These kinds of illusory profits can be especially risky in periods of overvaluation because they hide the economic reality that will eventually drive a correction.

The first defence against this kind of "figures management" is to be aware of it and to read financial statements carefully, including the footnotes.

Understanding financial shenanigans also gives hints to the conditions that encourage them, like an inflationary environment allowing profit padding. On the other hand, a company could switch from FIFO to LIFO to lower its taxes paid by deflating profits.

It is important to consider the overall market conditions and each company's situation to get a gauge on management incentives and likely behaviours. This is yet another reason why Liberty looks for long-sighted, well-managed companies that are less likely to play accounting games.

RESPONSIBLE INVESTING: WHAT HAS CHANGED IN 2020?

By Annie Bertrand

Responsible investing incorporates Environmental, Social and Governance (ESG) factors when selecting investments. The main question that investors want to know is: Do ESG investments perform as well as non-ESG investments?

Source: riacanada.ca

In the graph above, the performance gap has widened in the last 10 years in favor of ESG investments. When an investor has a long-term horizon, it makes sense to consider the ESG factor along with other investment metrics.

In November 2020, the Responsible Investment Association (RIA) published the 2020 Canadian Responsible Investment Trends Report. Dated December 31, 2019, the report is based on survey data collected from more than 100 asset managers, asset owners and publicly available sources.

The report shows that assets managed in Canada using a responsible investment strategy increased to $3.2 trillion compared to $2.1 trillion at the end of 2017, up 48.5% over a two-year period. This was divided among institutional investors ($2.3 trillion in 2019 vs $1.7 trillion in 2017) and individual investors ($882 billion in 2019 vs $436 billion in 2017).

The most frequently used responsible investment strategy is known as ESG integration. When we think about ESG investments, almost instantly the words climate change come to mind. However, this global challenge is only one of the many ESG key issues. Some of the other key issues are water scarcity, women in leadership, executive compensation and community relations.

The year 2020 brought another crucial matter to the spotlight last May with the death of George Floyd in Minnesota. Diversity and inclusion became the main preoccupations in the second half of the year.

Some firms chose to create or revise their HR policies to include a sustainable program, while others preferred to make a public demonstration. Coca-Cola, Pfizer and Unilever were part of a group of companies that withdrew their advertising from Facebook and Instagram for the month of July as a pressure tactic to address the shortcomings of these platforms in spreading hateful messages.

Shareholder engagement is the second-most used responsible investment strategy. Every share an investor owns gives them the right to vote in shareholder meetings. That's a direct way to influence corporate ESG programs. At Liberty, we use that shareholder power on behalf of our clients to vote against executive compensation increases.

How can an investor determine a company's ESG performance?

Reliable data is the main concern when it comes to evaluating performance. As ESG disclosure is voluntary, companies can use multiple reporting standards to measure their ESG performance. Therefore, their ESG performance is difficult to compare if reporting standards are different.

Last November, CEOs of Canada's eight largest pension funds joined the effort to request that ESG data be standardized for reporting. They mutually agreed that the best framework to use would be from the Sustainability Accounting Standards Board and the Task Force on Climate-related Financial Disclosures. Unfortunately, Canada has been late to the party, both in number of companies that are reporting their ESG performance, but also in adopting recognized standards.

On a company website, under the Investor Relations menu, you can usually find the most recent sustainability report. Take the time to read it in addition to the subsequent financial reports to evaluate if the company is truthful in its ESG goals.

Alternatively, an investor can access specialized ESG research providers, like ***Sustainalytics***. They rank a company's ESG performance against its industry group and against the global universe of corporations who have reported ESG data.

Occasionally, newspapers such as *The Wall Street Journal* publish their research on ESG factors, providing lists ranking the sustainability of companies. When considering such lists, it's important to learn about the scoring method used by the newspaper as, like research suppliers, they often build their own methodology for evaluating ESG performance.

The main hurdle that remains is the lack of global standards in the ESG space. The number of ESG investment funds and ETFs that have been created recently is staggering.

If you are concerned about "greenwashing", do an in-depth research on ESG strategies used by the manager of the funds or ETF prior to investing. Do the same level of research on the sustainable plan of a particular company. Research is the way to ensure that your investment follows your values.

Why do I have to pay commissions anymore? An app like Robinhood lets me trade for free.

The Millennial-favored trading app "Robinhood" is best known for pioneering the "commission free" trade. It, and the rest of the online brokerage industry, rely on what's known as "payment for order flow" as their profit engine in lieu of commissions.

Taking payments for order flow from Wall Street firms is a controversial, but legal practice done by most electronic brokers. However, Robinhood sticks out because it is the company's biggest revenue source. Robinhood made $180 million off trades in the second quarter alone in 2020.

Market makers, such as Citadel Securities or Virtu, pay e-brokers like Robinhood for the right to execute customer trades. The broker is then paid a small fee for the shares that are routed, which can add up to millions when customers trade as actively as they have this year.

According to a CNBC report, the Securities and Exchange Commission recently charged Robinhood with deceiving customers about how the stock trading app makes money and failing to deliver the promised best execution of trades.

"Between 2015 and late 2018, Robinhood made misleading statements and omissions in customer communications, including in FAQ pages on its website, about its largest revenue source when describing how it made money – namely, payments from trading firms in exchange for Robinhood sending its customer orders to those firms for execution, also known as 'payment for order flow,'" the SEC statement read.

"One of Robinhood's selling points to customers was that trading was 'commission free,' but due in large part to its unusually high payment for order flow rates, Robinhood customers' orders were executed at prices that were worse than other brokers' prices," the statement went on to say.

The SEC order found that Robinhood provided inferior trade prices that cost customers $34.1 million, even after considering the savings from not paying a commission.

So, if you think your trading commissions are zero, think again. There is no free lunch.

Interest rates on my GICs are pathetically low. Are there any alternatives to GICs?

A recent check of 1-year GICs issued by banks, depending on the amount invested, showed coupons ranging from 0.4% to 0.75%. This is similar to 5-and-10-year Government of Canada bonds.

With inflation currently around 0.7%, the real returns on GICs are negative, meaning a GIC investor's spending power is declining.

One alternative solution to this dilemma is to buy inflation-protected bonds. In Canada, they are known as Government of Canada Real Return Bonds (RRB). In the United States, they are known as US Treasury Inflation-Protected Securities (TIPs).

The idea of owning these bonds is to receive a coupon payment plus the rate of inflation each year to keep your spending power growing.

For example, one of the Government of Canada RRB bonds pays a 3% coupon that matures on December 1, 2036. Tack on the 0.7% CPI inflation rate in Canada in 2020 and an investor would be paid out 3.7%, better than current GIC rates.

There are caveats, however:

- These are long-dated bonds and will have more price volatility attached to them than shorter-term bonds. However, if you plan to hold them to maturity, the annual change in price is irrelevant.

  The current real return is negative, about -0.34%. Investors have to decide if the risk of a slight negative yield is worth the reward if inflation accelerates in the next 15 years.

- If we return to a 1970s-like economy, the last time inflation spiked to a peak of 18%, these are the only bonds that would hold their value. All other fixed instruments would drop significantly in value to equal the inflation impact.

Liberty clients with fixed income mandates have historically held 5% in inflation-protected bonds. We are planning to raise that level to 10% in 2021.

Who needs bonds? Why don't I just own stocks?

More financial gurus and pundits are claiming these days that it's a better idea to add to equity positions and do away with bonds altogether. The latest acronym bandied about is TINA (There Is No Alternative).

Their reasoning is based on the supposition that:

- Interest rates are expected to remain low.
- Bond returns after inflation are minimal or negative.
- Interest rates at zero benefit the long-term ownership of stocks.

Historically, bonds are half as risky as stocks, so adding more equities to an asset mix increases the volatility and the range of potential gains and losses.

Take, for example, an investor has been advised to change their asset mix from 60% equities and 40% fixed income to 80% equities and 20% fixed income.

On the former asset mix of 60/40, the historical range of returns in any one year might be plus or minus 25%. At 80/20, the range of returns jumps to plus or minus 35%.

It's alright to take this risk if your time horizon is quite long, but for those investors at or nearing retirement, the change could be catastrophic. Consider this outcome:

An investor has $1 million with a 60/40 asset mix and needs $50,000 a year to pay for living expenses in retirement.

If the market falls 40%, the 60/40 asset mix may produce a 20% drop in performance (bonds often rise during a large stock market sell-off). The equity side of the portfolio would drop 24%, while the bonds might rise 4% in value.

The capital drops to $800,000 less the $50,000 drawdown to $750,000.

To get back to breakeven, the investor would need a 33% stock market increase. At a hypothetical 10% stock market return per year, this may take 3-5 years to accomplish (remember, there's $50,000 a year being drawn down while waiting for the stock market to fully recover).

For the 80/20 asset mix, the downward damage of a 40% stock market correction would be closer to 28%. Combined with the $50,000 drawdown, the portfolio would be down to $670,000 or 33% lower. Breakeven would require a 49% rise, or 5-7 years, almost twice as long as the 60/40 investor.

Bonds have a strategic place in investor portfolios, especially when risk-adjusted returns are considered. That's why investing isn't about how much you make on the upside, but rather how much you avoid losing on the downside.

Is there a future for preferred shares?

If lower interest rates are here to stay, the preferred share market may actually disappear in the future. That's because, from a company standpoint, the cost of servicing that debt is greatly reduced by buying back their preferred shares and issuing bonds.

In 2020, the Canadian banks issued Limited Recourse Capital Notes (LCRNs). It is a new type of debt instrument that is treated like equity by the regulators when calculating a bank's capital requirement and helps strengthen the bank's balance sheet. LRCNs have been issued as 60-year notes with interest rates around 4.50%, an extremely long holding period that can be eroded over time by inflationary forces.

For the banks, the interest on the LRCNs is tax deductible and helps pad their profits, whereas the dividends paid to preferred shareholders are not tax-deductible because it's paid with after-tax money. So, good for the banks and bad for preferred share investors.

In the near-term, prices for bank rate-reset preferred shares have risen toward their $25 par values on the expectation that they will be bought out. This is great for investors, except that they are left looking for an alternative to their previous 5% to 10% yields.

If we can't trade Chinese stocks on US markets, how can we participate in the growing Chinese economy?

Companies earn revenues from every country where they do business. Therefore, investors need to remember when they make an investment and build a portfolio that it isn't where the company is domiciled but instead where their revenues are made.

For example, Unilever is a consumer stock that does business in China - between 5% and 10% of their revenues are derived from China's economy. Given that China is under a totalitarian regime, if the government ever decided to take away Unilever's business rights, it wouldn't bankrupt the company.

If an investor owned a Chinese company with all its revenues based in China and the Chinese government decided to take it over, shareholders would end up losing everything because there is no common law in the country, and, therefore, no recourse.

For Liberty clients, about 50% of the revenues of the stocks they own originate in North America. The other 50% comes from the rest of the world. That's our method to invest globally without having to incur extreme country risk.

If you have any questions, let us know.

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