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TRADITIONAL CYCLE TURN OR "STOP GAP" MEASURES?

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Two overnight news releases last week helped to propel equity markets higher and pushed up bond yields in Canada and the U.S. These events are worth reviewing as they are indicative of traditional and non-traditional economic cycles.

MARKET OVERVIEW

The Chinese Central Bank started the ball rolling by cutting reserve requirements for commercial banks by 0.50%. This surprise move, after the reserve requirement was raised six times this year, followed the worst one day drop in Chinese stocks in four months. It also follows news of weakening housing prices and signals that the bank may have been successful in its effort to stem the rise in inflation that infected home and food prices.

Although positive in the short-term for commodity prices that have been boosted by Chinese infrastructure demand, a sustainable longer-term pickup in Chinese growth (and equity prices) will depend on rates dropping to that magical level that the market decides is "enough" to guarantee success. In addition, because this move follows signs of weaker housing prices, it can be seen as a confirmation that the Chinese housing market was indeed in a bubble. And because of the US and European experience with managing a deflating housing bubble, market scepticism should be expected to be more critical than normal.

Regardless, this move can be seen as part of a traditional market cycle as the Chinese economy engine appears to be responding to central bank actions.

The second piece of news was the announcement by the world's major central banks to provide cheaper US dollar funding to European banks. This is an example of non-traditional "stop gap" measures. Rather than being seen on the same level as a central bank rate cut that is seen as "enough" to generate a self-sustaining recovery, this move instead highlights the seriousness of the situation in Europe where inter-bank lending has ground to a halt due to fears of counter-party default.

This move can temporarily decrease European bank funding costs, but it will not prevent sovereign defaults from blasting a hole in European (or US) bank balance sheets.

Non-traditional "stop gap" measures can help to temporarily propel some financial markets higher, but so far do not seem able to create a self-sustaining expansion/recovery. In the US, QE1 helped generate +70% equity returns over 12 months. QE2 helped push markets up 25% over six months. The FED has indicated that QE3 will require a clear risk of deflation, but it remains to be seen whether QE3 will be seen as "enough" or whether investor exhaustion results in 10% returns over three months or any improvement at all.

On another note, the Chinese central bank move took place on a Wednesday rather than the "traditional" Friday news release. This might indicate urgency or global central bank co-ordination (denied by China). *If the latter, is this more indicative of traditional measures or something else?*

YORKVILLE STRATEGY

Although the recent news regarding coordinated efforts by the world's central banks managed to drive equity markets +4% in one day, we continue to maintain an overall defensive strategy in our portfolios. While the recent news was certainly a net benefit to the markets, we do not see it fundamentally solving the current structural issues facing the markets today.

As a result, our fixed income portfolios continue to be underweight credit and overweight duration with a US and Canadian dollar bias relative to the global

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benchmark. Our equity portfolios are positioned in a similar defensive fashion with material underweights to cyclical sectors such as industrials, energy, and materials, and material overweights in cash and consumer discretionary and staples, with a US bias relative to Canada. We have been slowly putting some of the large cash position to work, selectively adding to existing positions, as well as building out a meaningful position in Canadian Banks which have been trading well below their historical average valuations. However, relative to our peers, our cash position continues to be significant.

With the holiday season among us, we like our current positioning with a bet on the resurging consumer. Black Friday sales and spending indications suggest that our money is in the right place. Because we expect that the Christmas seasonality effect may lead to a "Santa Clause" rally in December, we added two additional "seasonal" positions to the portfolio to capitalize on this.

Stuffing our Stockings with Tiffany & Co and Apple

As you may have heard, Black Friday and Cyber Monday set new records this year, with sales increasing by 6.6% totaling $11.4 billion. Even in the face of serious macroeconomic concerns, consumers spent on average $400.00 compared to last year's number of $365.34, according to the National Retail Federation. In keeping with the holiday spirit, we too did some shopping in our equity funds by adding two familiar holiday-themed names in Tiffany & Co. and Apple.

Our own surveys suggest that brand name luxury goods such as jewelry and consumer electronics, especially the new iPad, iPhone 4S, and MacBook Air will be *the* gifts for the holiday season. Take the simple example of walking through the Eaton Centre, the Apple store is by far continuously the busiest store in the mall - and people are walking out with Apple products in hand. The Tiffany's store in Yorkville is no exception. This gives us tremendous comfort in our investment thesis.

Digging deeper, we like both companies over and above their holiday dominance because of their market leading status in branding, marketing, and product innovation. As a result, they are able to pass on premium prices to their customers while their competitors are slashing prices to increase sales. While both companies do face risks, such as commodity costs with Tiffany's or the death of Steve Jobs, we believe that both companies have achieved a level of dominance in their markets which have entrenched the sustainability of their business models.

KEY DECISIONS

Yorkville's Investment Strategy Committee meets on a weekly basis in order to derive an action plan for each of our portfolios that is relative to today's market. All strategies that were discussed within this newsletter came from these meetings. Below are the key decisions made and the Investment Meeting from which they were derived:

DECISION	DATE OF MEETING
Buy Apple	Nov. 30, 2011
Increase weight in Canadian Banks	Nov. 30, 2011
Buy Tiffany & Co	Nov. 24, 2011
Maintain an overweight in cash	Oct. 12, 2011
Maintain an underweight in all cyclical sectors	Sept. 15, 2011
Increase allocations to US Equities	Sept. 15, 2011