

June 2011

Overview

Gas Pains?

As we know all too well, the price of gasoline rose sharply in the first few months of this year. Fortunately for our peace of mind the government assures us that they are on the case, as this recent **Globe and Mail** headline confirms:

“Ottawa to grill gas-industry executives over soaring pump prices”

Now we can look forward to the formation of yet another parliamentary committee to investigate the supposed predatory pricing proclivities of the big, bad oil barons. The nature of the probe is reflected in the verb ‘grill’ which implies a combative interrogation in search of the real truth. This, in spite of the numerous Competition Bureau investigations over the years and similar parliamentary ‘grillings’ that have all consistently reached the same conclusion: absolutely no evidence of price fixing or industry collusion at the gas pump.

No doubt our freshly minted Conservative government fully anticipates the result to be the same this time around as well. They also know that by the time this committee actually goes to work, the pricing equation is likely to be quite different from today given extreme gas-price volatility and the many pricing variables in force. But the government badly wants to be seen as the voters’ protector against price gouging and they suspect that the average Canadian reflects Mr. Tony Clement’s ignorance of pricing mechanics as he declared about the gasoline-price changes: “No one

understands how that can happen”.

It is certainly true that no one happily pays substantially higher prices at the gas pump. Paying more to drive the same distance takes away discretionary income that we would much rather spend on other items and in effect acts like a tax hike in slowing economic activity. Higher gas prices, and energy prices generally, also eventually work their way into other components of the consumer price index, raising the spectre of inflation-driven pressure on interest rates. So it’s pretty hard to find any beneficial impact from higher gas prices.

Prices have been volatile. In Ontario, the average pump price for regular gas plunged from its peak of \$1.35 per litre in June, 2008 (with oil also at its \$145 per barrel high) to \$.70 by the end of that year, thanks to the recession. (Was there a parliamentary investigation into that change? Not that we recall.) From that point, prices moved steadily upwards to \$1.14 by the end of 2010 when crude oil was at \$90. Prices then took a big jump back to the old high at \$1.38 in early May even though oil at \$110 remained

well below its old high. While prices have edged back to the \$1.30 area currently, they remain elevated.

Why elevated? The primary determinant for gasoline pricing is crude oil and it is also elevated due both to supply concerns emanating from current mid-east turmoil, especially the loss of Libyan production, and to increasing demand in a better economic environment, especially in emerging markets like China. Beyond the crude input, gasoline pricing gets complicated but is also subject to the laws of supply and demand. Demand rises with economic activity and supply is often limited as refineries operate near capacity (there has been zero new refinery construction in North America in 30 years, thanks to low profit margins, environmental restrictions and NIMBY fears) leaving output susceptible to disruptions such as breakdowns of aging equipment and extreme weather, witness recent flooding concerns in the Gulf Coast area. This matters to us because pricing of refined products is a continental issue. Formulation of product output is also a big factor as consumers and government

OVERVIEW CONTINUED...

regulations demand lighter fuels (hardest to produce), while crude supply tends to heavier oil (hardest to refine). A further complication is that a number of eastern Canadian refineries, including in Ontario, use foreign oil input and that oil is priced on the Brent index which is currently

about 13% higher than the Texas standard. And one more issue is the role of speculators who now can easily buy gasoline-based investment products which own gasoline, and thereby add to its demand, but never actually use it.

We are certain the government investigation will dig deeper, spend millions and take weeks rather than hours, but we expect their conclusion to match ours: gasoline prices are set by market forces, not conspiracy.



QUOTE
of the
DAY

"The only problem with quotes from the internet is that you never know if they are real."

~ Abraham Lincoln

IN THE OFFICE

THANK YOU TO ALL WHO DONATED TO OUR 9TH ANNUAL SPRING CHARITY LUNCHEON. TOGETHER WE RAISED OVER \$5,000 FOR BIRD STUDIES CANADA.

Those who attended the lunch heard Dr. Alan Morgan present a stirring case for the “man-made” theory of the climate change debate. In summary, he said, “the earth has been warming and cooling in cycles, and we are in a warming cycle. But the level of CO2 tends to peak around 280 parts per million (ppm) based on measurements over the past 800,000 years. We are currently around 390 ppm, almost 40% higher than those previous peaks.”

Dr. Jody Allair from Bird Studies then thanked our clients for their donations. He told us that Bird Studies started as Long Point Bird Observatory in 1960 in Port Rowan and became Bird Studies in 1998. Their head office is still in Port Rowan but they are now a national charity with regional offices across Canada. They promote understanding, appreciation and conservation of wild birds and their

habitat, not only in Canada, but elsewhere as well. Jody invited our clients to visit the head office for a tour of their facilities; quite a few people signed up.

Continuing in the charity theme, Andréa Miljkovic, one of our portfolio managers, has signed up to bike 200km in the Enbridge Ride to Conquer Cancer, benefiting the Princess Margaret Hospital. She will be biking from Toronto to Niagara Falls on June 11 and 12. She is already at 90% of her fundraising goal. We wish you well, Andréa, and will have a pillow ready for your office chair on June 13!



We would like to take this time to remind you that you can help save a tree by having your newsletter emailed to you. If you would like to receive your newsletter electronically, please contact us at 519-578-6849, or toll free 1-888-578-7542, or via email at:

reception@raelipskie.com



Dr. Alan Morgan



Dr. Jody Allair



CHARTING OUR TIMES

We are:

Ken Rae, CFA

Brian Lipskie, CFA

Ted Brough, CFA

David Paleczny

Jo-Ann Carlisle, CIM

Thomas Pick, M.B.A.

Andréa Miljkovic, CFA

Derek Rae, CIM

David Martin, CIM

Marie Marchildon, CFA

*Rae & Lipskie
Investment Counsel
provides discretionary
“fee-only” portfolio
management for high
net-worth individuals,
endowments, and
charities.*

Rae & Lipskie
Investment Counsel Inc.

20 Erb St. West, Suite 201
Waterloo, Ontario N2L 1T2

T 519 578 6849

F 519 578 7269

Toll Free 1 888 578 7542

4145 North Service Rd., Suite 200
Burlington, Ontario L7L 6A3

T 905 333 4915

F 905 333 4937

Toll Free 1 888 578 7542

Most people are aware of the tremendous impact that social networks are having on society these days. The statistics are mind-boggling when it comes to user numbers and time spent on the various services. Facebook even has its own movie. There are a multitude of such network sites out there these days with the early leader MySpace having long been eclipsed by the behemoth Facebook which is now reputed to have over 600 million users, each with an average of 90 postings a month to their purported 130 friends. Twitter is another very popular network with over 200 million users who wait anxiously for tweets from such luminaries as Lady Gaga (#1 with over 10 million followers), Justin Bieber and, yes, in third place none other than President O’Bama (who found his apostrophe in Ireland). Groupon (short for group coupon) is a different form of network which, along with countless imitators, offers discount coupons to its over 40 million members. These sites have a broad orientation while others are more narrowly focused, including Flixter for movies (over 60 million users) and LinkedIn for business.

This is where the chart below comes in. LinkedIn, a professional business

network with over 100 million users, went public with an IPO (initial public offering) in May. Shortly before the offering the anticipated pricing was in the low \$30’s per share but it actually came to market at \$45. Such was the (irrational?) buyer exuberance that it immediately rocketed to \$120 before easing back to the current mid-\$90’s, as shown in the chart. This price values the company at nearly \$10 billion, a number that is extremely difficult to justify given that LinkedIn doesn’t actually make much money. At a minimum it takes a huge leap of faith. We can expect to see more such issues at extreme values as Groupon recently turned down a \$6 billion offer from Google, the online gaming company Zynga apparently is mulling a \$10 billion-plus IPO and Facebook, which has transacted shares privately at a \$50 billion valuation, is rumoured to want at least double that in an IPO.

Only time will tell if this is a bubble environment for internet shares. These companies are the growth phenoms of our time and investors are willing to pay, big time, for that growth. For those excited investors we would have just one word of caution: Nortel.

