

May 17, 2013

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## Palos Weekly Commentary

### ■ Palos Income Fund

*By Charles Marleau*

#### Telus Corners Ottawa

In 2008, Ottawa decided to set aside a portion of each spectrum auction to new startups. Ottawa thought this would break the dominance of Rogers, BCE, and Telus. However, Ottawa's plans are being jeopardized as the startups are now under financial pressure and looking for White Knights. On May 16, 2013 Telus announced that it reached an agreement to acquire Mobilicity for \$380 million. This bid puts Ottawa between a rock and a hard place. The situation is a dilemma forcing Ottawa to make a difficult decision.

If Ottawa approves the transaction, then its strategy for increasing competition failed, as the spectrum for Mobilicity will end up in the hands of Telus. However, if Ottawa does not approve the acquisition then it will have blood on its

hands. The most likely scenario will be bankruptcy for Mobilicity and 150 jobs being eliminated. "Damned if you do and damned if you don't."

Why is Telus doing all of this? In our view, the company is doing it for strategic reasons and to make a point. Earlier this year (January 15th, 2013) Rogers agreed to buy Shaw Communications' unused Spectrum for \$300 million. However, this agreement is being scrutinized by the government. As it stands now, spectrum is not transferable by law. If Ottawa amends this law and approves the Rogers transaction, then the Telus deal to acquire Mobilicity has merit. However, Telus may believe that sometimes defense is the best offence. The mere existence of a Telus bid for more spectrum may force Ottawa to reject the Rogers deal. It could set a dangerous precedent for Telus/Mobilicity and future spectrum consolidation.

**Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns)\***

	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL 100	\$9.50	10.71%
Palos Equity Income Fund - RRSP	PAL 101	\$7.05	6.34%
Palos Merchant Fund L.P. (Mar 28, 2013)	PAL 500	\$8.56	7.20%
Palos Majestic Commodity Fund L.P. (May 16, 2013)	PAL 600	\$11.14	4.91%
S&P TSX Composite			2.54%
S&P 500			17.80%
S&P TSX Venture			-23.31%

**Chart 2: Market Data\***

	Value
US Government 10-Year	1.95%
Canadian Government 10-Year	1.92%
Crude Oil Spot	US \$96.02
Gold Spot	US \$1,364.70
US Gov't10-Year/Moody BAA Corp. Spread	197 bps
USD/CAD Exchange Rate Spot	US \$0.9727

\* Period ending May 17, 2013

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This is a win/win situation for Telus, and a lose/lose situation for the government. Furthermore, Telus structured the deal in such a way, that if the deal with Mobilicity does not go through, the monetary loss is next to nil.

## ■ Palos Merchant Fund

By George Kaneb, Cameron McDonald

IOU Financial Inc. is a core holding of the Palos Merchant Fund LP. Its operating subsidiary IOU Central was recently named as a finalist for the American Business Awards. The press release is below.

## IOU Central Named as Finalist for Financial Services Company of the Year in the 2013 American Business Awards (SM)

*IOU Central fills the gap between traditional banks unable to justify cost-benefit of smaller loans and small businesses in need of capital to seize growth opportunities.*

Atlanta, GA (PRWEB) May 10, 2013

[IOU Central](http://www.ioucentral.com), a leading online small business lender, announced today that it has been named a finalist in the Financial Services Company of the Year category in The 2013 American Business Awards and will ultimately receive a Gold, Silver, or Bronze Stevie® Award.

As a leader in alternative financial services, IOU Central evaluates loan applications for owners of healthy small businesses that have been in operation for at least two years and are looking for a six- to 12-month loan between \$5,000 and \$100,000. Because the application process is technology-driven, many borrowers get an answer on approval and have a check in hand in days, as opposed to the typical weeks-long process associated with traditional banks. Over the past year, IOU Central has nearly tripled the number of loan applications processed and had an almost 300 percent increase in the dollars loaned to small businesses.

“We’re thrilled to be selected by the American Business Awards as a finalist for Financial Services Company of the Year,” said Robert Gloer, president and COO of IOU Central. “As a company that puts a tremendous amount of effort into bringing small business owners the best possible lending solution, it’s rewarding to be recognized as a leader in new lending

options and a trusted alternative to traditional banks.”

The American Business Awards are the nation’s premier business awards program. All organizations operating in the U.S.A. are eligible to submit nominations – public and private, for-profit and non-profit, large and small. More than 3,200 nominations from organizations of all sizes and in virtually every industry were submitted this year for consideration in a wide range of categories. The American Business Awards will be presented at two awards events: the ABA’s traditional banquet on Monday, June 17 – in Chicago for the first time, after 10 years in New York; and the new product & technology awards event on Monday, September 16 in San Francisco.

Details about The American Business Awards and the list of finalists in all categories are available at

<http://www.StevieAwards.com/ABA>. Sponsors and partners of The 2013 American Business Awards include the Business TalkRadio Network, Callidus Software, Citrix Online, Dynamic Research Corporation, Experian, John Hancock Funds, LifeLock, PetRays, and SoftPro.

## About IOU Central

IOU Central is a leading online lender specialized in helping small businesses with healthy cash flow. Typical customers include medical and dental practices, grocery and retail stores, restaurant and hotel franchisees and ecommerce companies. In a unique approach to lending, IOU Central’s advanced, automated application and approval system accurately assesses applicants’ financial realities, with an emphasis on day-to-day cash flow trends. It makes loans of up to \$100,000 to qualified applicants within a few business days, with affordable charges favorable to cash-flow management. IOU Central’s speed and transparency make it a trusted alternative to banks. Based in metro Atlanta, Georgia, IOU Central is a privately held subsidiary of IOU Financial (CNSX: IOU), which is headquartered in Montreal, Canada. For more information, visit <http://www.ioucentral.com>.

Read more: <http://www.virtual-strategy.com/2013/05/10/iou-central-named-finalist-financial-services-company-year-2013-american-business-awards-#ixzz2TZyWHXst>

\*Principals and insiders of Palos may also be insiders of IOU Financial Inc.

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## ■ Risks, Hedges and Opportunities

By Adam Smalley

### Cross-Border Banking

In late April, the portfolio managers at Palos sold a portion of the funds' exposure to Canadian banks and redeployed the proceeds into US banks. The rationale behind this decision was as follows:

- View that US growth would outpace Canadian growth in the near- and intermediate-term
- Risk of a housing correction in Canada
- View that the Canadian dollar would depreciate versus the US dollar because of monetary policy differences and deteriorating terms of trade between the two countries

The passage of three weeks is certainly not enough to validate the thesis, however, the trade has performed well so far. The graph below plots an index of US banks (white line) and Canadian banks (yellow line) since the beginning of the year. Outperformance by US banks began in March and accelerated in April.



The portfolio managers expressed this view by selling a portion of Royal Bank of Canada (TSX: RY) and Bank of Nova Scotia (TSX: BNS) and redeployed proceeds into JPMorgan (NYSE: JPM), SunTrust (NYSE: STI) and Wells Fargo (NYSE: WFC). The Fund maintained its position in Toronto-Dominion (TSX: TD) due to its substantial exposure to the United States.

## ■ What is New on the Macro Level?

An article recommended by Hubert Marleau

## Bank of Canada Review - Spring 2013

May 16, 2013

Source: <http://www.bankofcanada.ca/wp-content/uploads/2013/05/boc-review-spring13.pdf>

## ■ An Excerpt from “The Dividend Dance,” a yet to be published book

By Hubert Marleau

### On Monetary Policy

Central Banks have two major roles in the conduct of monetary policy. Firstly, they inject into or remove from the economy monetary fuel either by changing the cost and/or supply of money. Secondly, they provide liquidity to or withdraw it from the financial system to prevent tail-end effects on risky assets.

Of course, the direction and vastness of their actions can produce various effects, negative or positive, on foreign exchanges, the banking system, the bond market, and commodities and stock markets. They may even institute moves that may refresh or pause certain actions. For example, central banks apply monetary stimulus to counterblow the exporting deflation-manipulated exchange rates, counterweight soft economic patches or counterbalance global synchronized disinflation. In this connection, it crucial to have indicators that can help investors pinpoint possible directional changes in monetary. These are:

- 1) the differential between inflationary expectation and actual inflation. Currently 2.35% less 1.00% equals 1.35%. The wider the differential, the more likely monetary could get tighter and vice-versa.
- 2) the inflation composition of the misery index (inflation plus unemployment rate). Currently the misery index is 8.5 and inflation makes up 12% of the index. The turning point is between 20% and 25%
- 3) the effectiveness of monetary policy like the money multiplier (M-2/monetary base) and velocity of money (NGDP/M-2). Currently the money multiplier is 3.57 compared to 9.32 five years ago. An increase could trigger an end to QE. Moreover the velocity of money is 1.53 compared to 1.86 five years ago. An increase could also trigger an end to QE.



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4) Interest-rate sensitive expenditures as a percentage of GDP expressed in nominal terms. Currently, it stands at 24.5%. In 2009, it stood at 21.2%. That is usually close enough to the point where the Fed starts to send feeders to see if a monetary change could be well absorbed by the market.

*If you have any questions about the weekly commentary, the securities that we follow, or investment ideas, please contact us at [info@palosmanagement.com](mailto:info@palosmanagement.com)*

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**Chart 3: Palos International Fund (Total Returns) \*\***

	Last	YTD Returns
Palos International Equity Income Fund PLC - CAD	CA \$5.22	5.12%
Palos International Equity Income Fund PLC - EUR	EUR 6.95	4.23%
Palos International Equity Income Fund PLC - USD	US \$6.56	2.27%
S&P TSX Composite - CAD		2.23%
S&P TSX Composite - USD		0.25%

\*\* Period ending May 14, 2013