

Gluskin Sheff + Associates Inc.

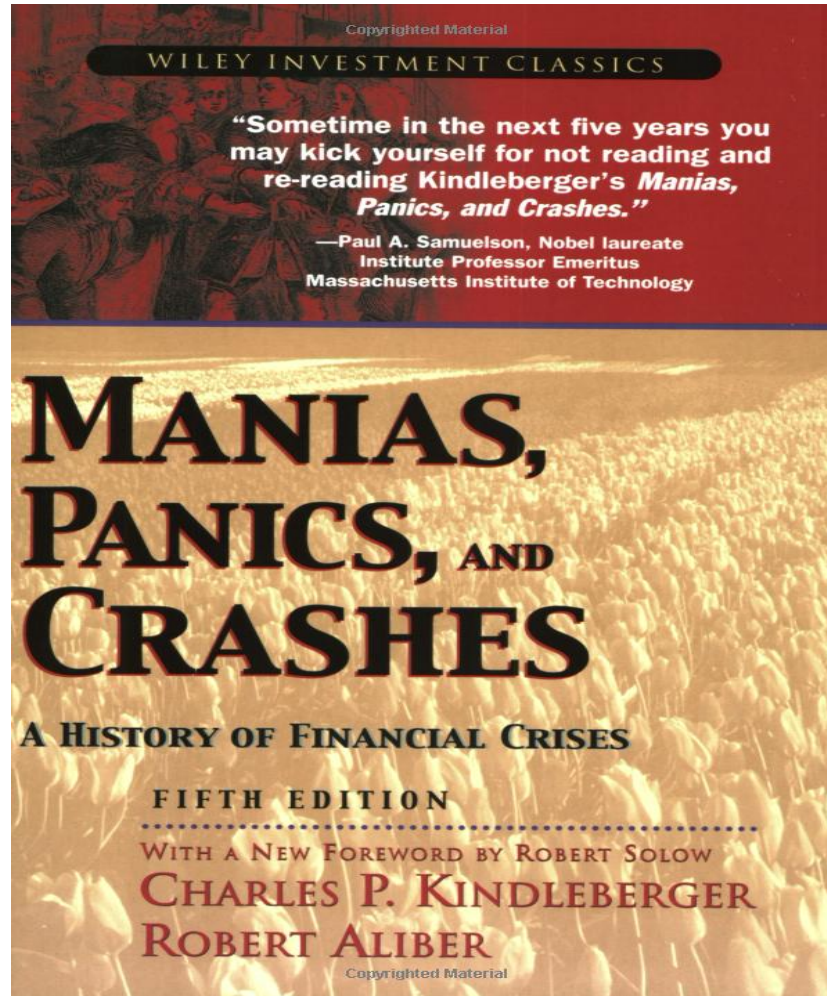
FOCUS ON THE FOREST, NOT THE TREES

David A. Rosenberg



Crisis? What Crisis?

THE KINDLEBERGER CLASSIC – MANIAS, PANICS AND CRASHES



WAS YOGI BERRA A “CLOSET” ECONOMIST?

10 Famous Quotes from the Legendary Baseball Player and Coach Yogi Berra

“A nickel ain't worth a dime anymore.”

“I wish I had an answer to that because I'm tired of answering that question.”

“When you come to a fork in the road, take it.”

“I don't want to make the wrong mistake.”

“I never said most of the things I said.”

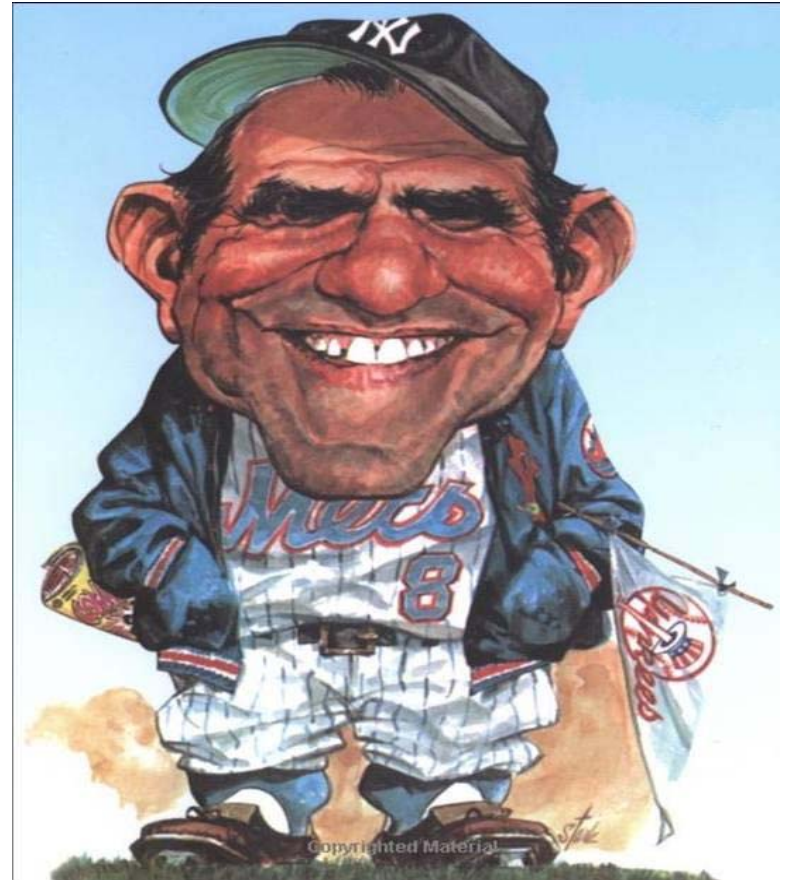
“The future ain't what it used to be.”

“In theory there is no difference between theory and practice. In practice there is.”

“I always thought that record would stand until it was broken.”

“It's like déjà vu all over again.”

“It's tough making predictions, especially about the future.”



BOB FARRELL'S 10 MARKET RULES TO REMEMBER

- 1 Markets tend to return to the mean over time
 - 2 Excesses in one direction will lead to an opposite excess in the other direction
 - 3 There are no new eras – excesses are never permanent
 - 4 Exponential rapidly rising or falling markets usually go further than you think, but they do not correct by going sideways
 - 5 The public buys the most at the top and the least at the bottom
 - 6 Fear and greed are stronger than long-term resolve
 - 7 Markets are strongest when they are broad and weakest when they narrow to a handful of blue chip names
 - 8 Bear markets have three stages – i) sharp down, ii) reflexive rebound, and iii) a drawn-out fundamental downtrend
 - 9 When all the experts and forecasts agree, something else is going to happen
 - 10 Bull markets are more fun than bear markets
-

IS EVERYONE PLAYING BY THE “OLD RULES”?

Bob Farrell, August 3, 2001

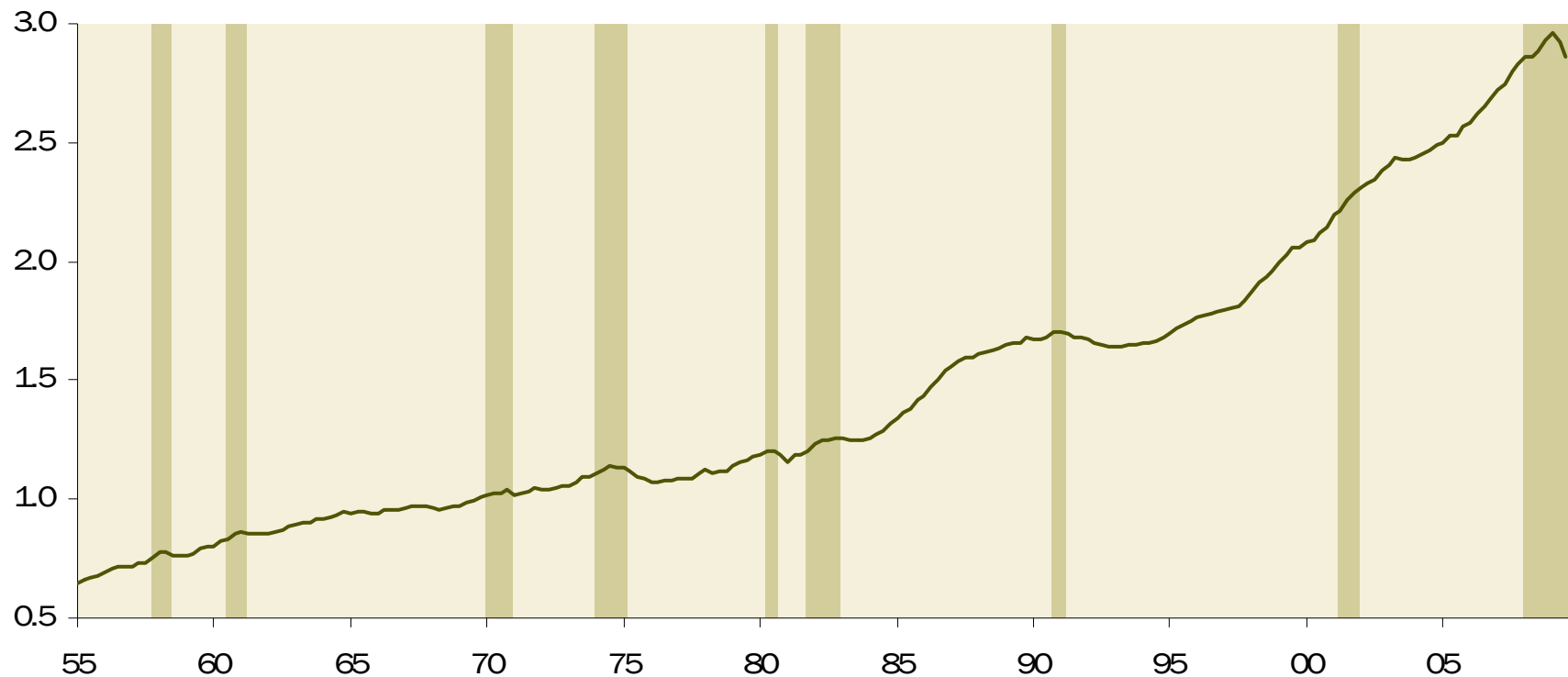
A Secular Inflection Point?

“Change of a long term or secular nature is usually gradual enough that it is obscured by the noise caused by short-term volatility. By the time secular trends are even acknowledged by the majority they are generally obvious and mature. In the early stages of a new secular paradigm, therefore, most are conditioned to hear only the short-term noise they have been conditioned to respond to by the prior existing secular condition. Moreover, in a shift of secular or long term significance, the markets will be adapting to a new set of rules while most market participants will be still playing by the old rules.”

THE U.S. WILL SPEND YEARS DELEVERAGING THIS CHART

United States: Total Private Sector Debt* Relative to GDP

(ratio)



Notes:

*Household, business and financial sector

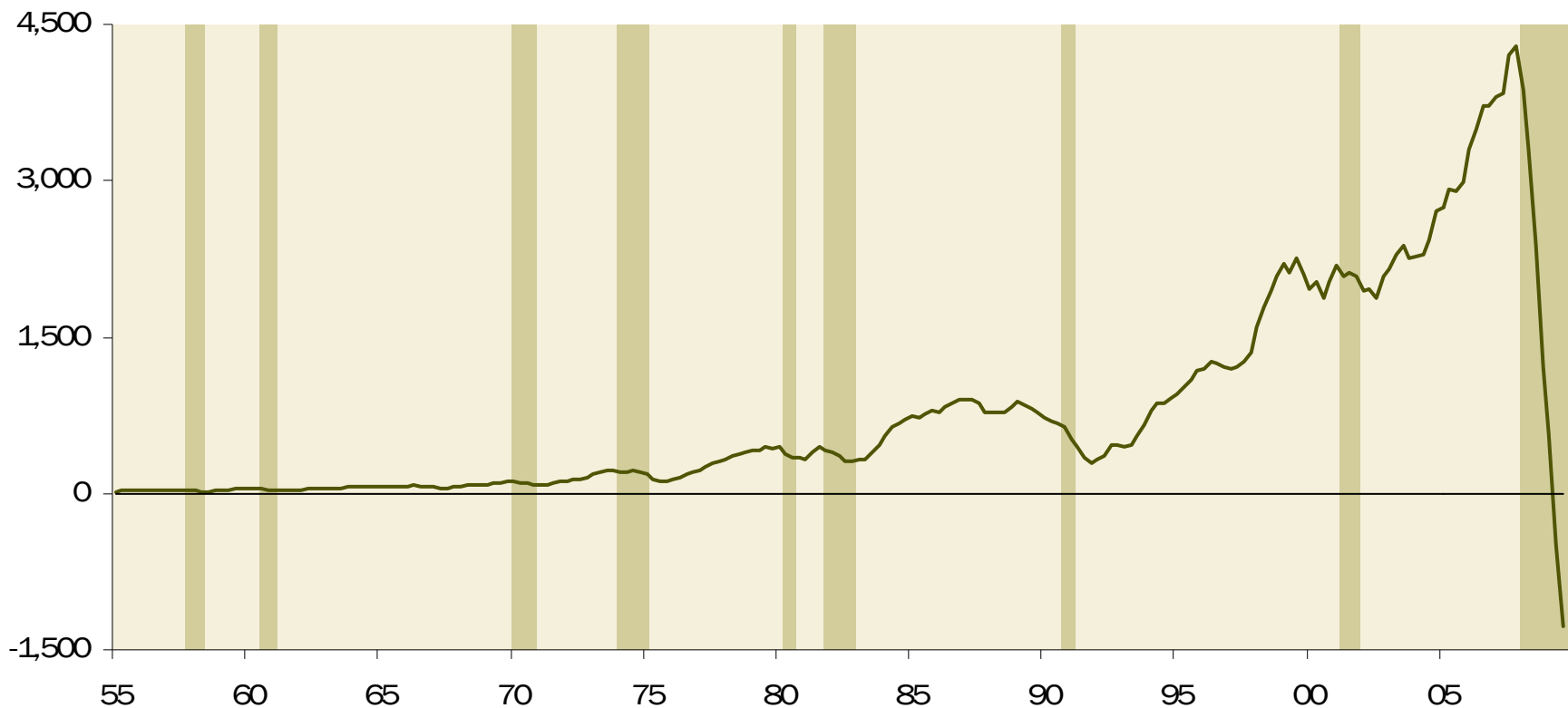
Shaded region represent periods of U.S. recession

Source: Federal Reserve Board, Bureau of Economic Analysis

DELEVERAGING CYCLE INTENSE BUT IN EARLY YEARS

United States: Total Private Sector Debt*

(year-over-year change, \$billion)



Notes:

*Household, business and financial sector

Shaded region represent periods of U.S. recession

Source: Federal Reserve Board

WHEN IN DOUBT – RELY ON SOMEONE ELSE’S RESEARCH!

Findings from Rogoff-Reinhart Report¹

- Home prices do not bottom for six years
- Equity markets do not bottom for 3½ years
- GDP declines for two years (-9% peak-to-trough)
- Unemployment rate rises for four years (by seven percentage points)
- Government debt almost doubles (+86% in real terms)

Findings from McKinsey & Company ² :

“While we cannot say for certain whether these sectors will deleverage, we do know that nearly every significant financial crisis in the post-World War II period was followed by a lengthy and painful period of deleveraging. These episodes lasted on average six to seven years, with total debt as a percentage of GDP declining by roughly 25 percent. GDP contracted in the initial years of deleveraging but rebounded in the later years. If history is a guide, therefore, we would expect a significant period of deleveraging to come, which will dampen GDP growth.”

Where are we? The bottom of the fourth inning

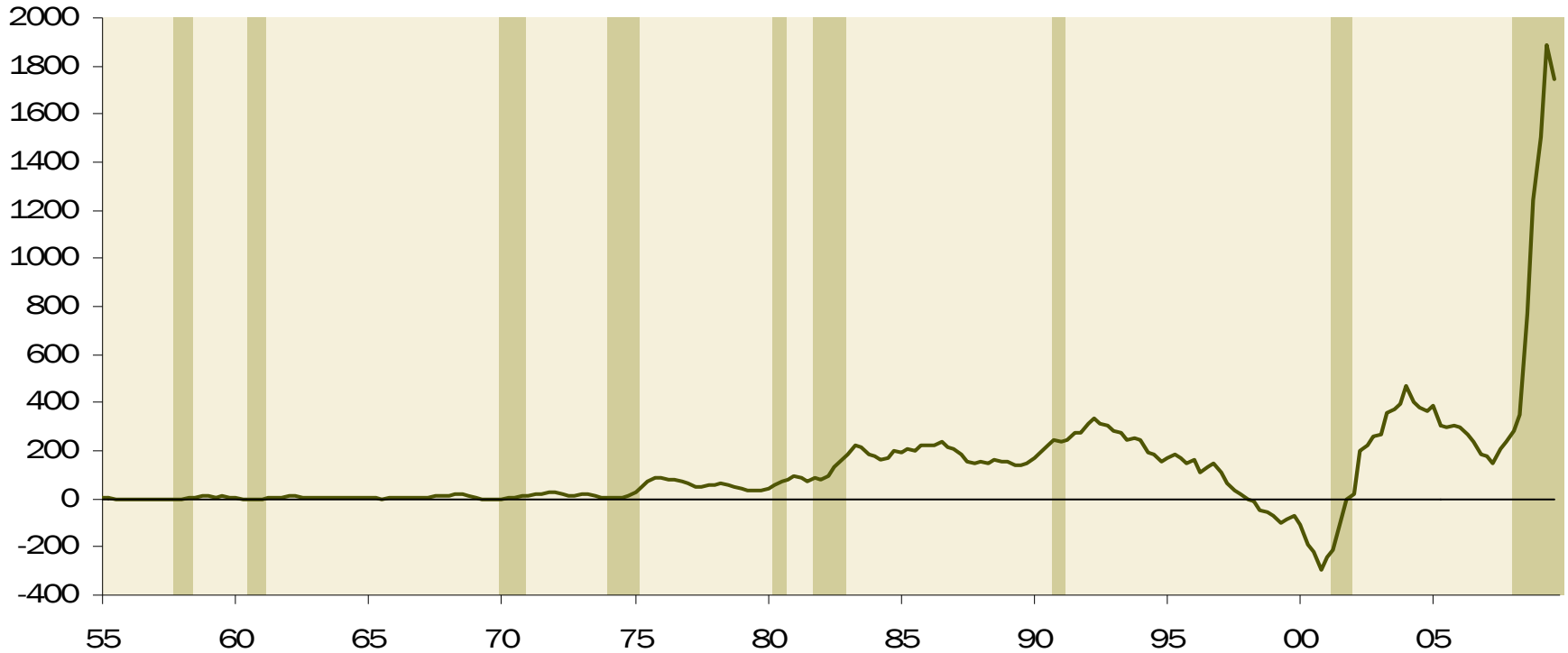
Notes:

1. “The Aftermath of Financial Crises”, December 2008
2. McKinsey Global Institute, *Debt and deleveraging: The global credit bubble and its economic consequences*, January 2010, pp. 17

MASSIVE EXPLOSION IN FEDERAL GOVERNMENT DEBT

United States: Federal Government Debt

(year-over-year change, \$billion)



Notes:

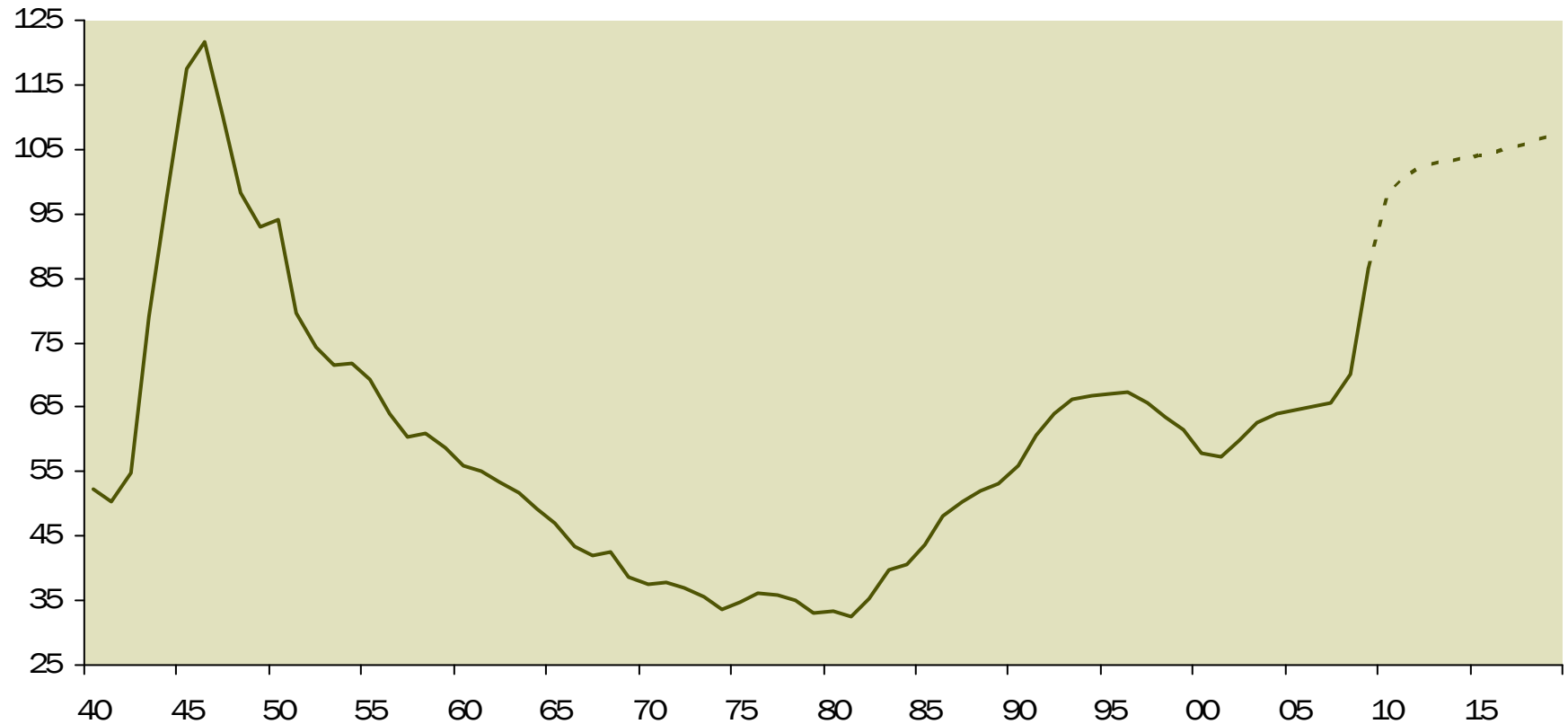
Shaded region represent periods of U.S. recession

Source: Federal Reserve Board

UNDER STATUS QUO, U.S. FISCAL DEBT RATIO TOPS 100% NEXT YEAR

United States: Gross Federal Debt as a percent of GDP

(percent)



Notes:

Dotted line represent OMB forecast

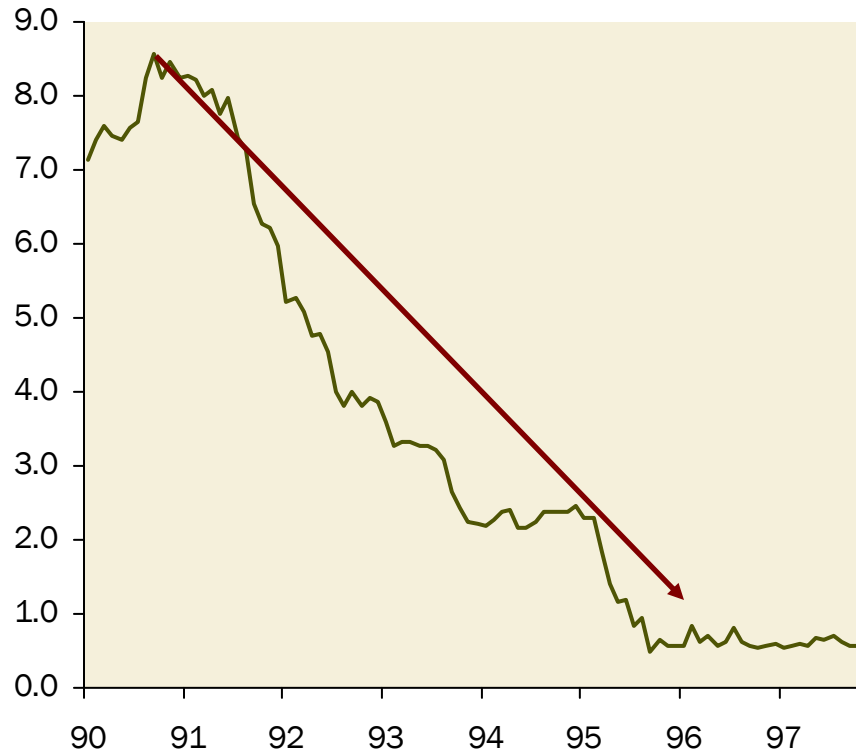
Source: Office of Management and Budget (OMB), Haver Analytics



WHEN T-BILL YIELDS ARE 0%, YOU KNOW IT'S JAPAN ALL OVER AGAIN

Three Month Bill Yield (percent)

Japan



United States



Note:

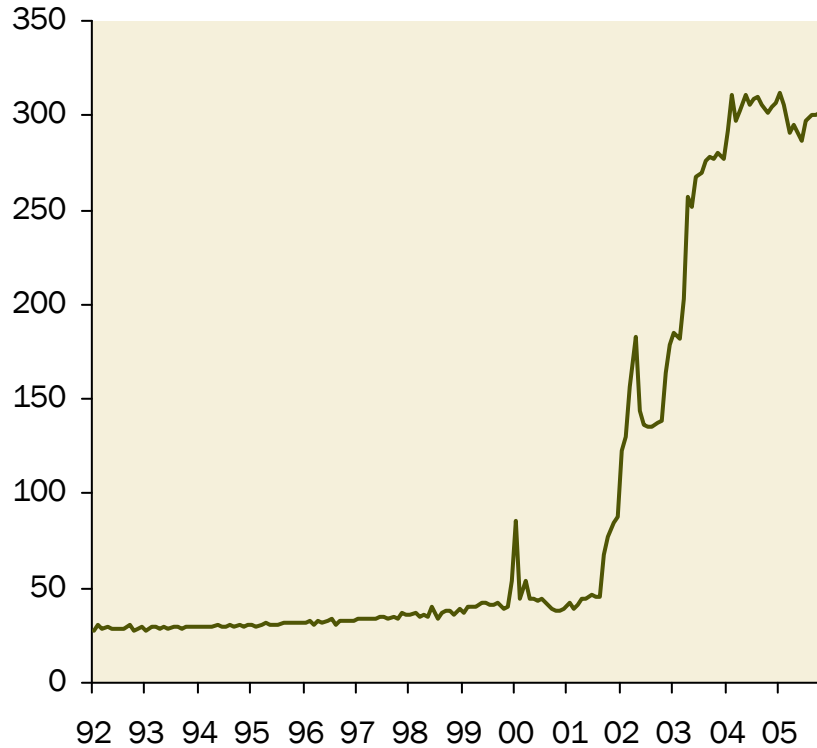
Source: Haver Analytics

UNPRECEDENTED EXPANSION OF THE CENTRAL BANK'S BALANCE SHEET

Reserve Bank Credit Outstanding

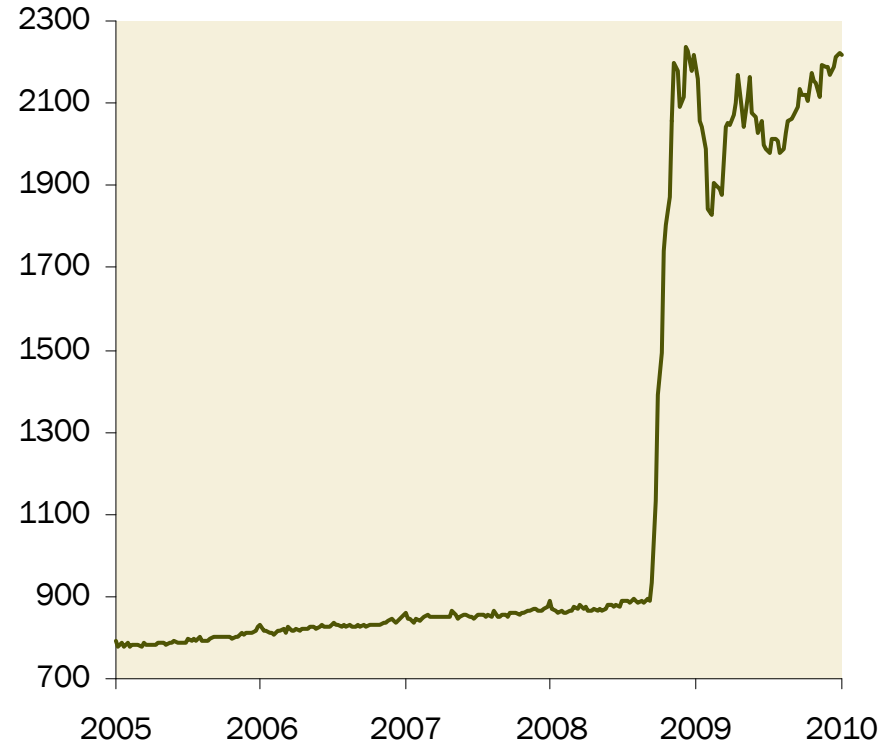
Japan

(billion ¥)



United States

(billion US\$)



Notes:

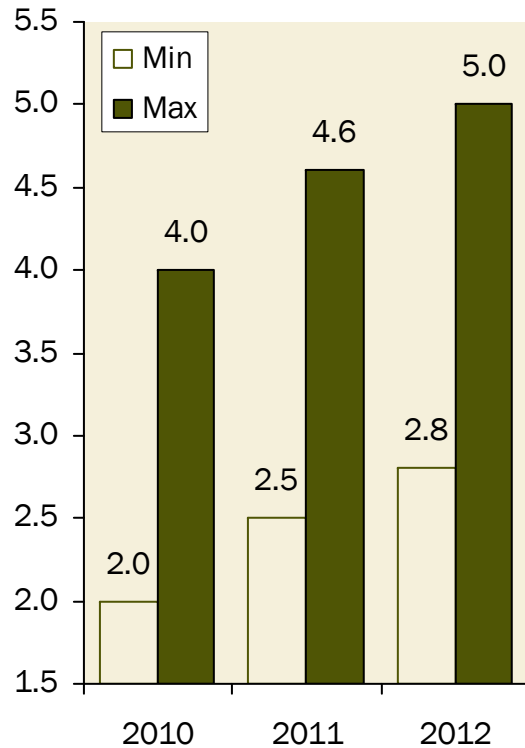
Source: Bank of Japan, Federal Reserve Board

RANGE OF POSSIBLE OUTCOMES EXTREMELY WIDE

United States: Federal Reserve's Range Forecast

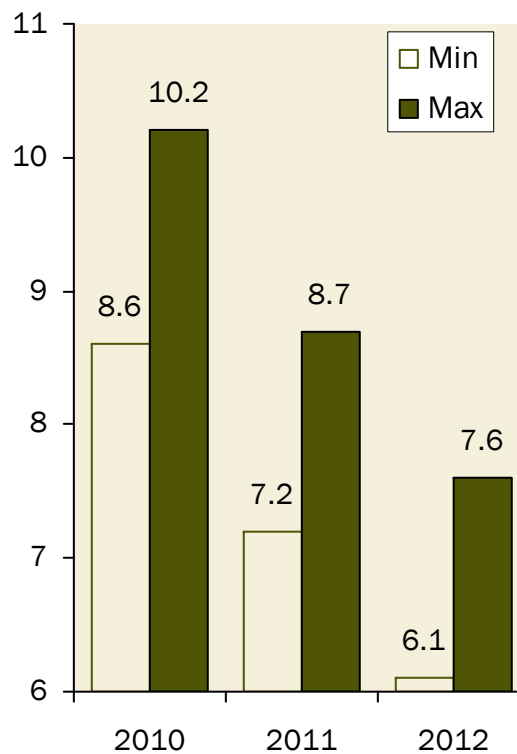
Real GDP

(annual percent change)



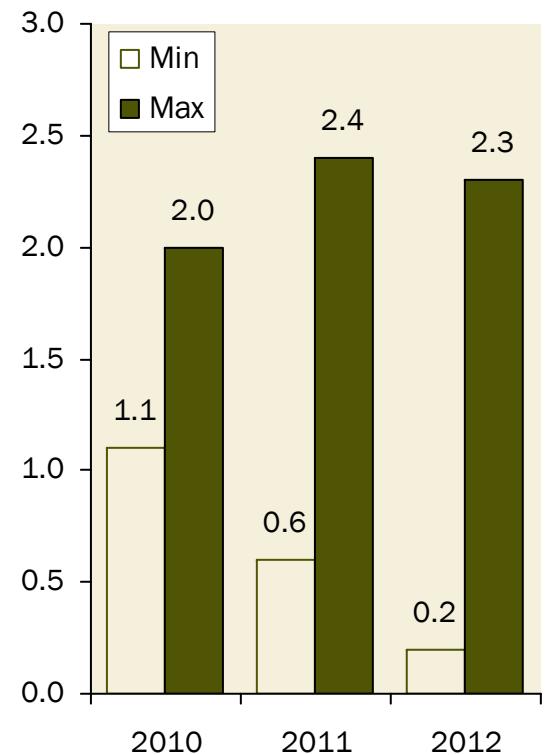
Unemployment Rate

(percent)



Inflation*

(annual percent change)



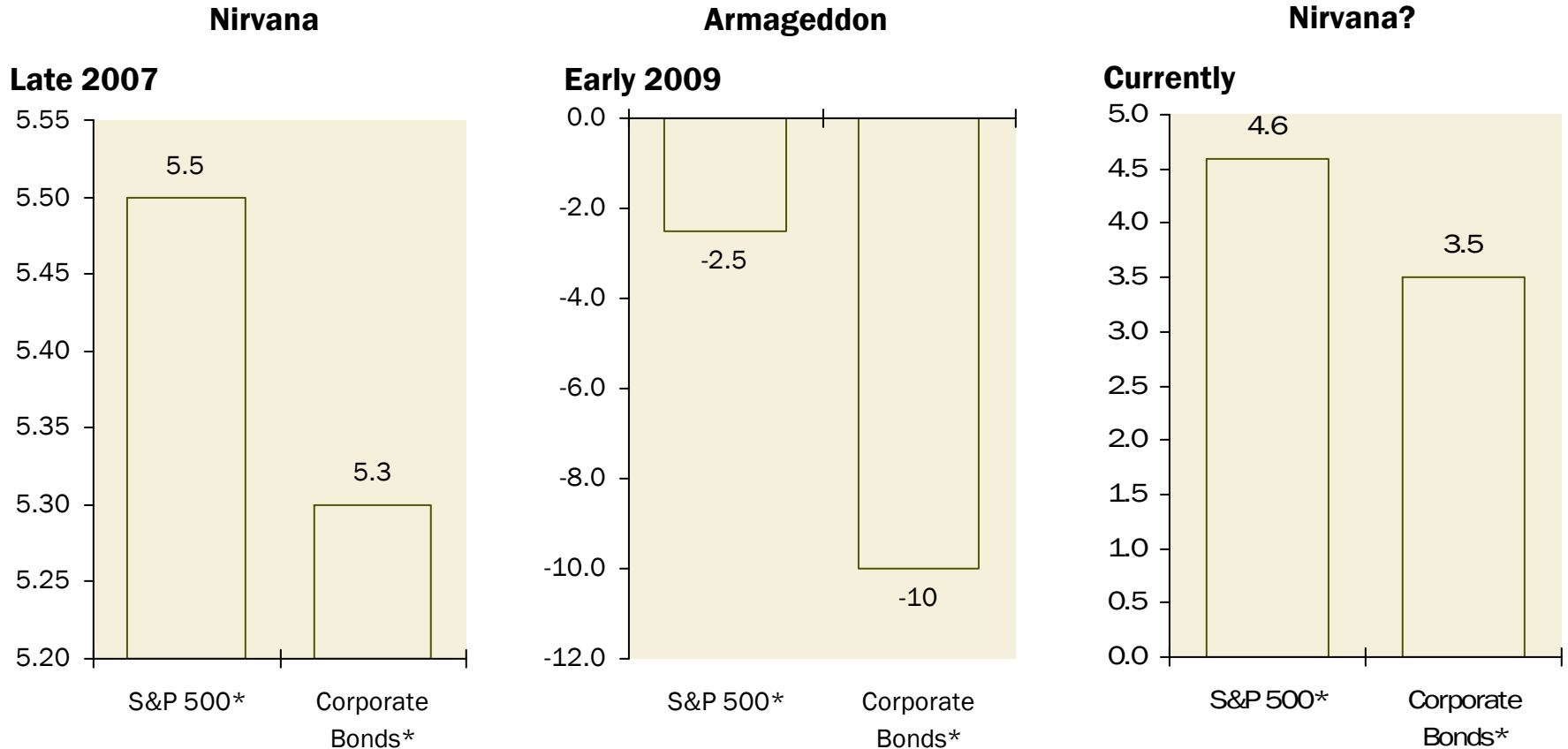
Notes:

*Looking at the PCE Price Index.

Source: Federal Open Market Committee

WHAT IS PRICED IN?

United States: Real GDP Growth Being Discounted (annual percent change)

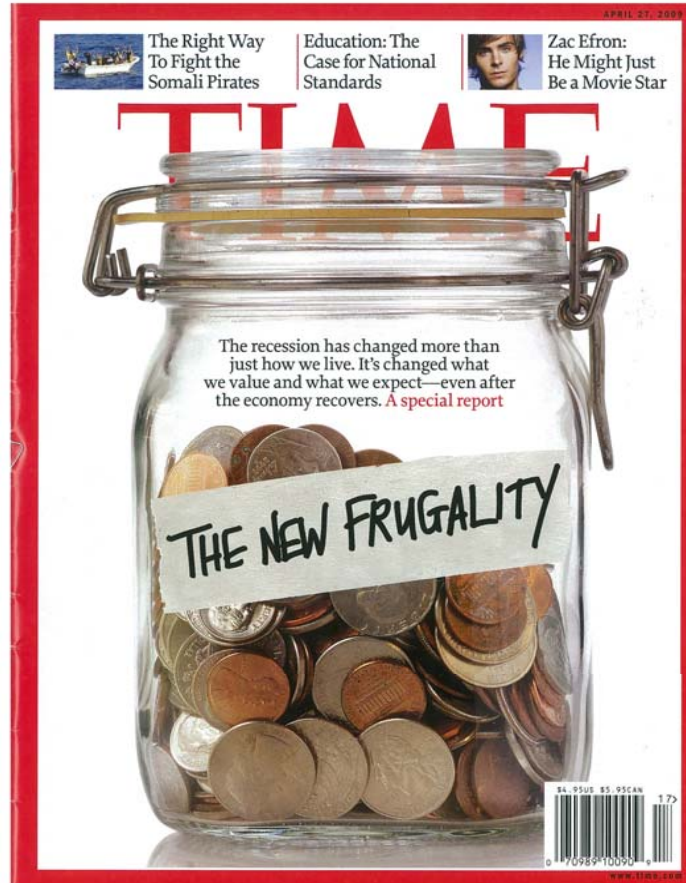


Notes:

*Looking at U.S. growth.

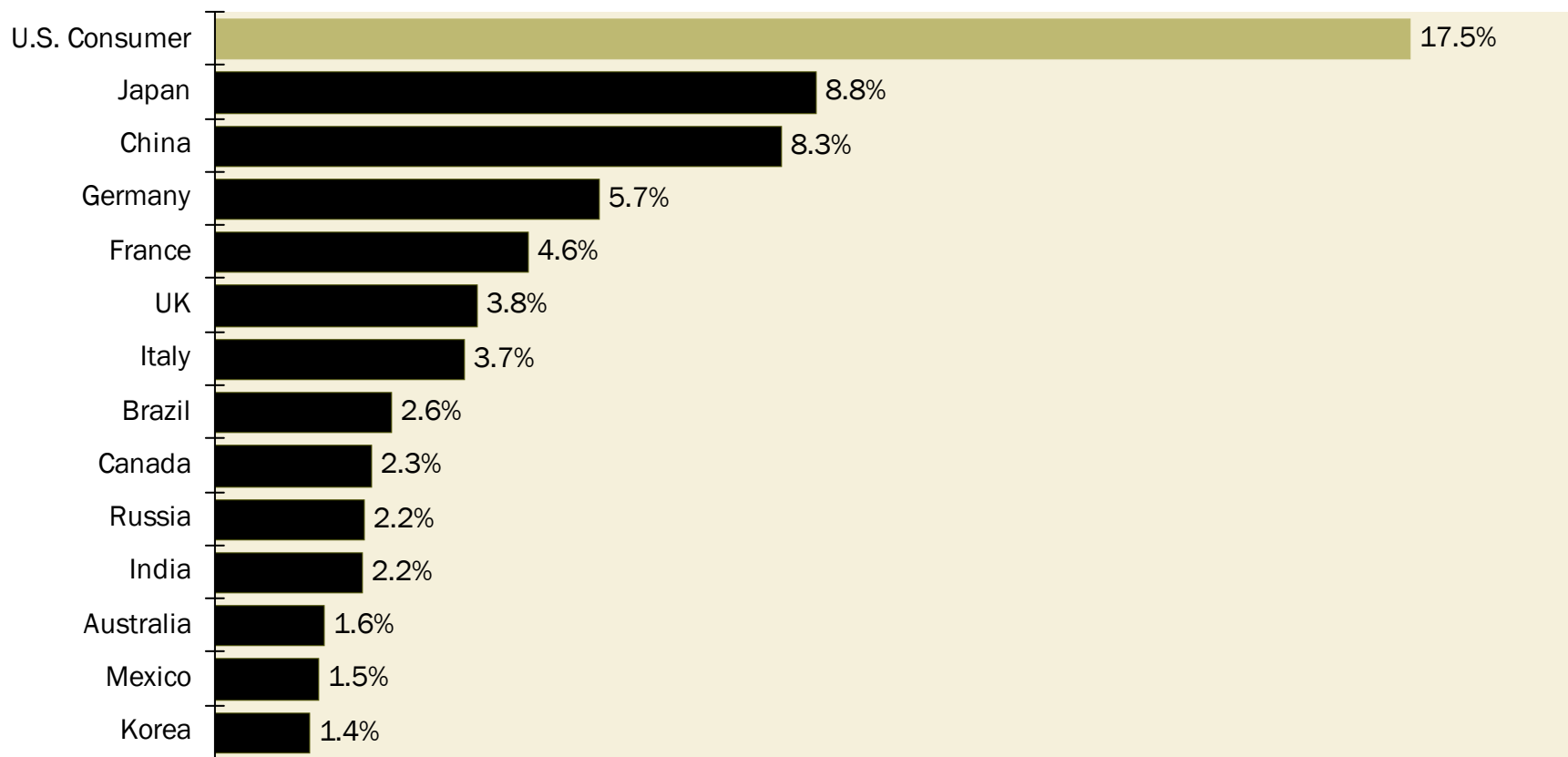
Source: Haver Analytics

THE NEW FRUGALITY



THE U.S. CONSUMER IN PERSPECTIVE: THE BIGGEST ECONOMY IN THE WORLD

(percent share of global GDP: 2009)



Note:

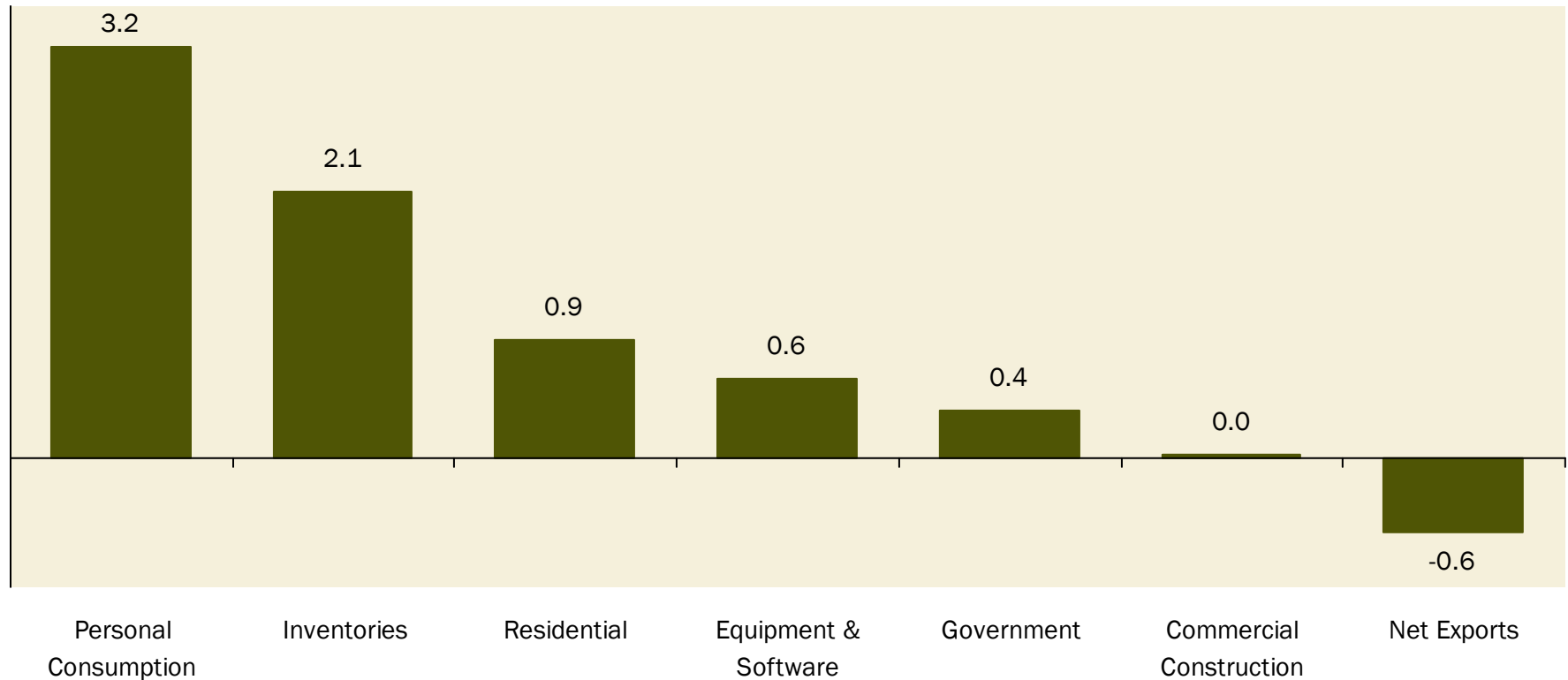
Source: Bureau of Economic Analysis, IMF

NO RECOVERY WITHOUT THE CONSUMER

United States

GDP Components: Average Contribution to Change in the First Year of Economic Recovery

(percentage point)



Notes:

Data back to 1949, which covers 10 cycles

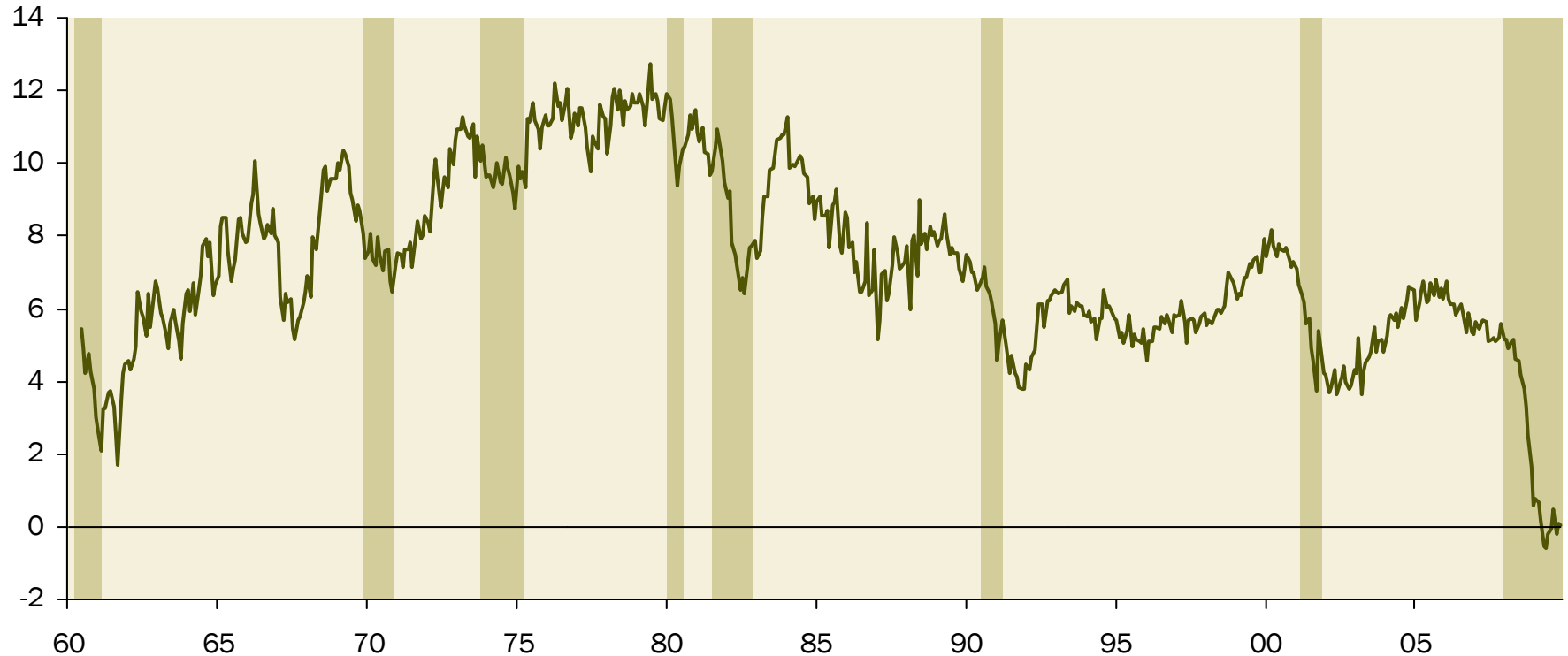
Source: Haver Analytics

CONSUMER CYCLE ENDED IN 2008 Q3

United States

Personal Consumption Expenditures

(17-month percent change annualized)



Notes:

Shaded region represent periods of U.S. recession

Source: Bureau of Economic Analysis



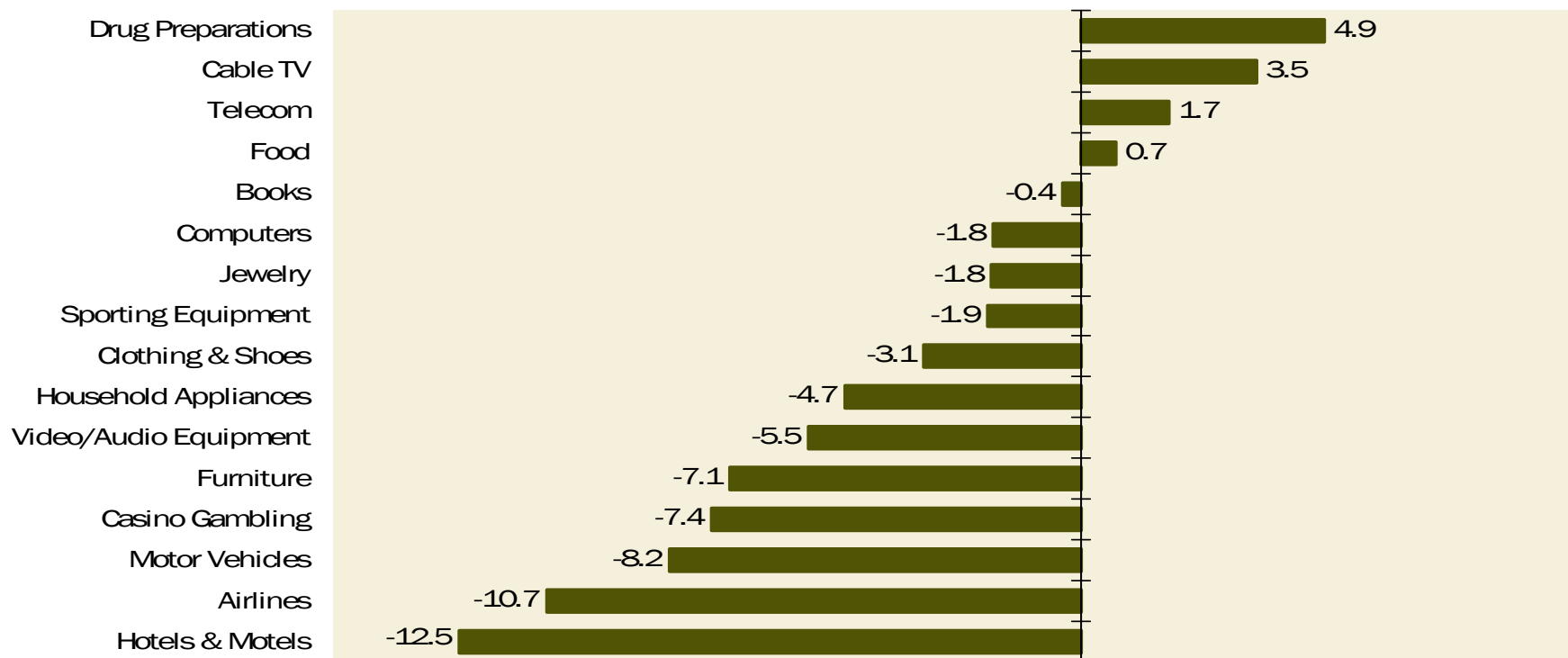
"Something is definitely going on. We're back to eating dog food."

RECORD DECLINE IN CONSUMER DISCRETIONARY SPENDING

United States

Personal Consumption Expenditures

(June 2008 through November 2009, percent change annualized)



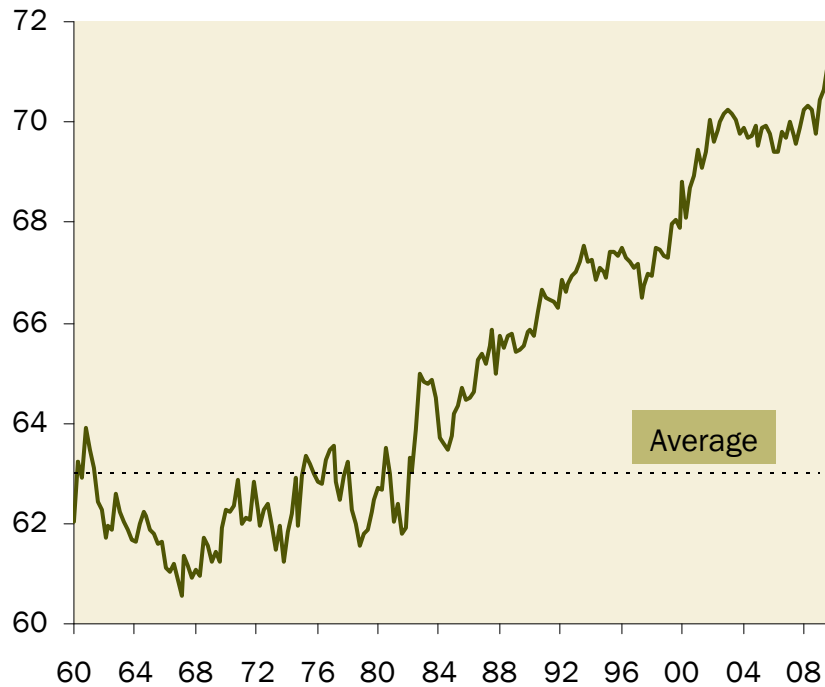
Note:

Source: Bureau of Economic Analysis

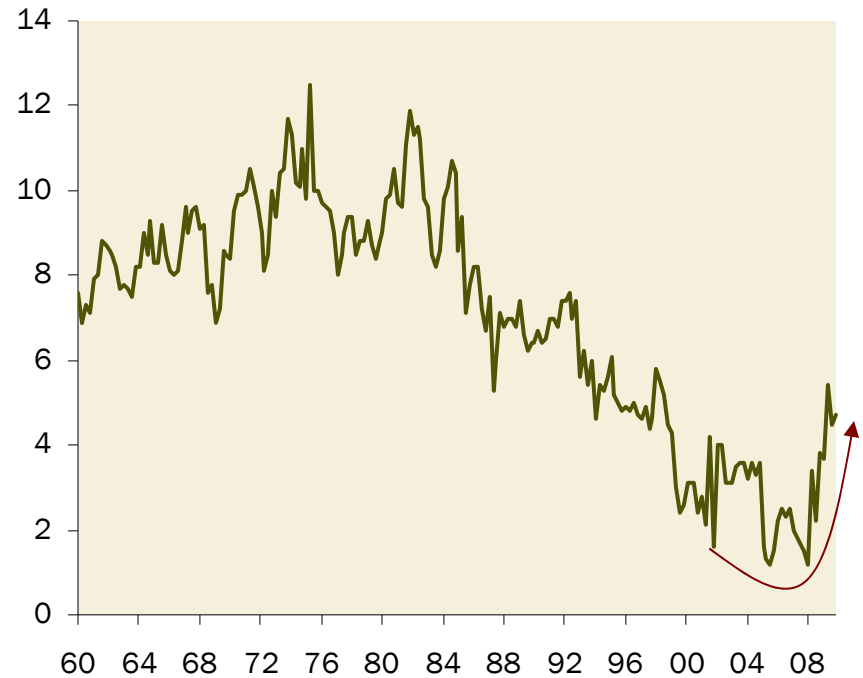
DO NOT LOOK FOR THE CONSUMER TO LEAD US OUT OF RECESSION

United States (percent)

Consumer Spending as a share of GDP



Personal Savings Rate



Note:

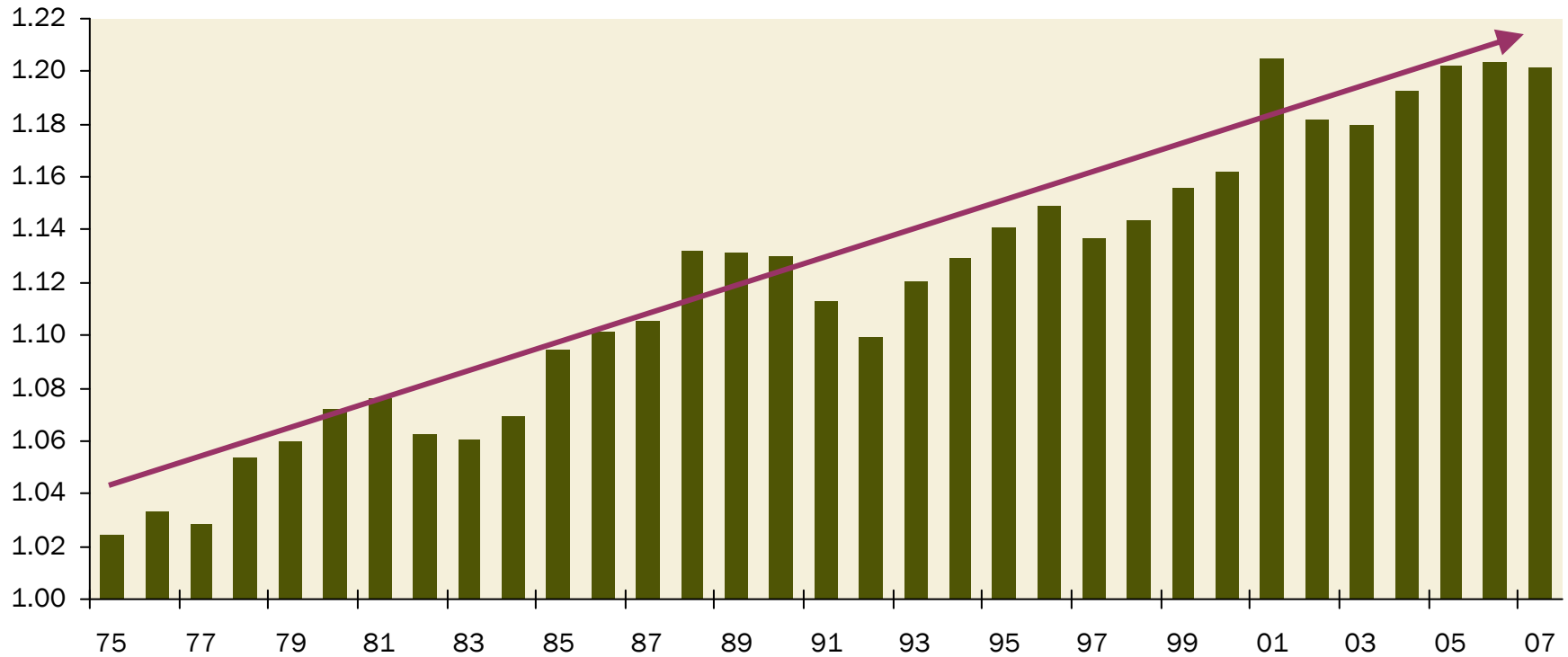
Source: Bureau of Economic Analysis

TOO MANY VEHICLES?

United States

Ratio of Vehicles to Licensed Drivers

(ratio)

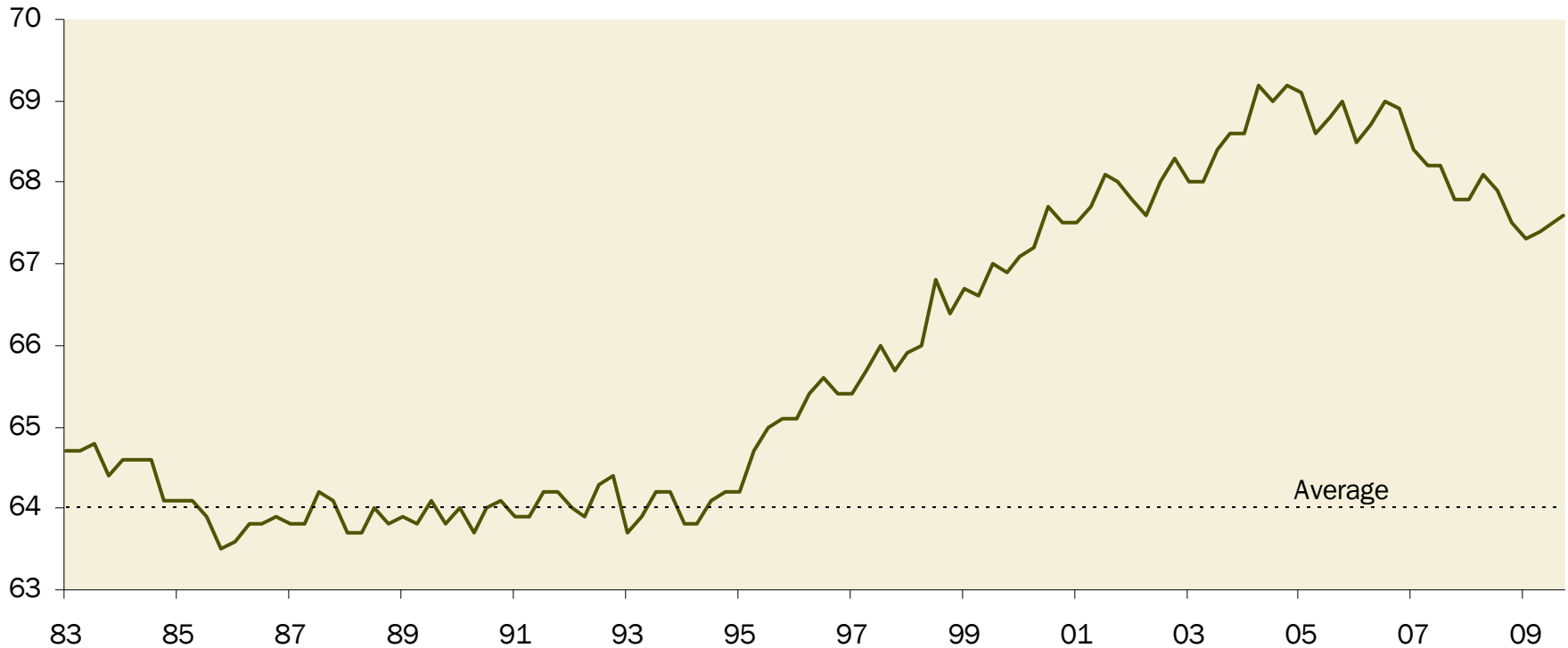


Source: Federal Highway Administration

HOMEOWNERSHIP RATE IN MEAN REVERTING PHASE

United States

Homeownership Rate (percent)



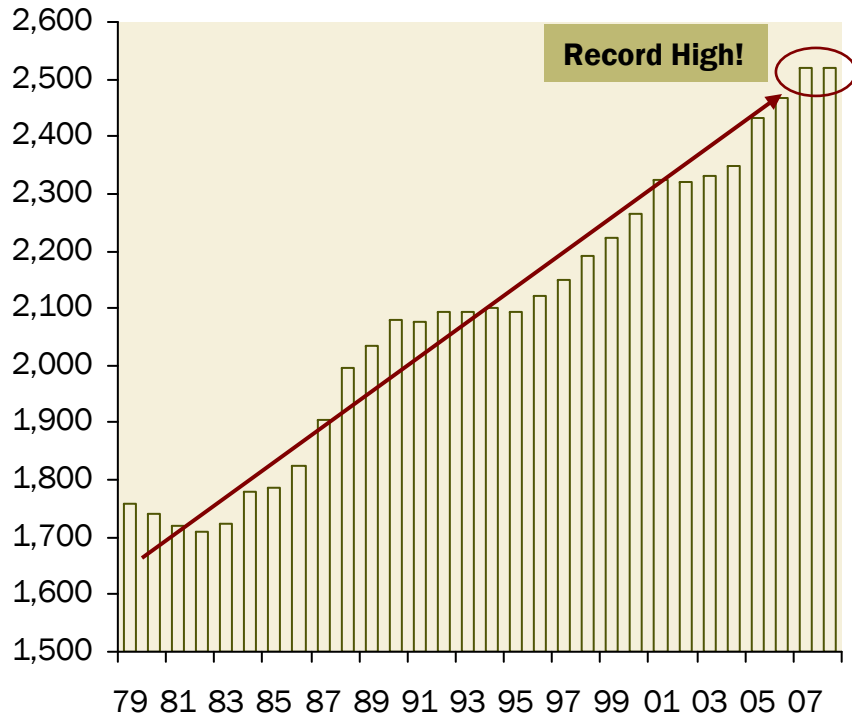
Note:

Source: Census Bureau

TOO MUCH HOUSE?

United States

Average Square Feet of Floor Area in New Single-Family Homes Sold

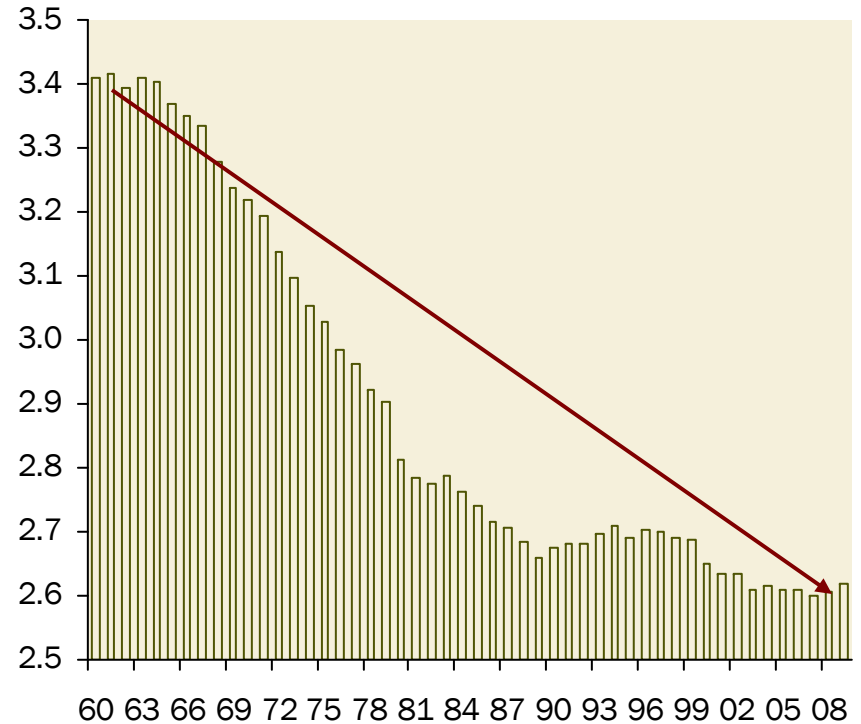


Note:

Source: Census Bureau

Persons per Household at a Record Low

(persons/household)

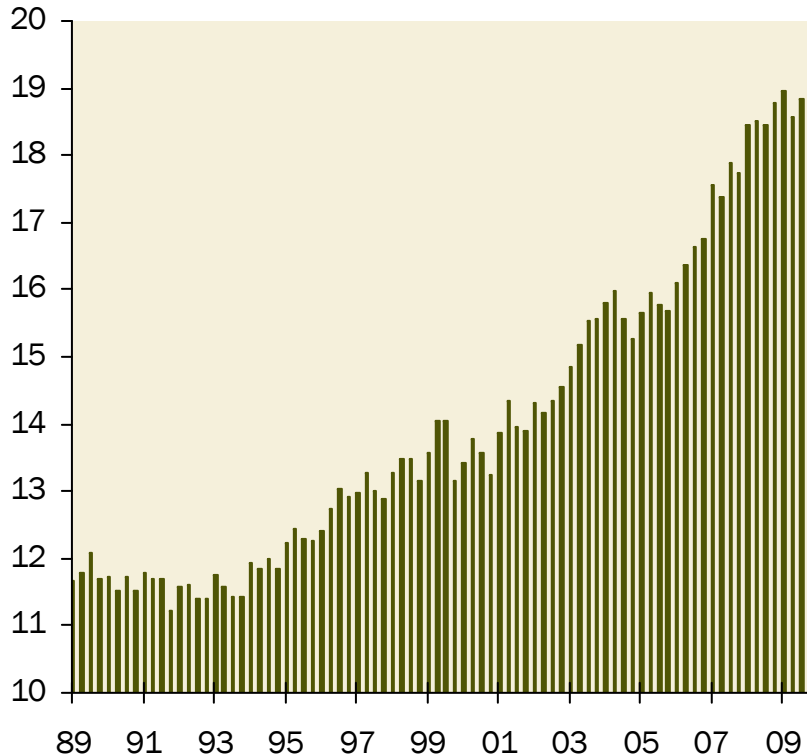


RECORD LEVEL OF VACANT RESIDENTIAL REAL ESTATE

United States

Total Vacant Housing Units

(million units)

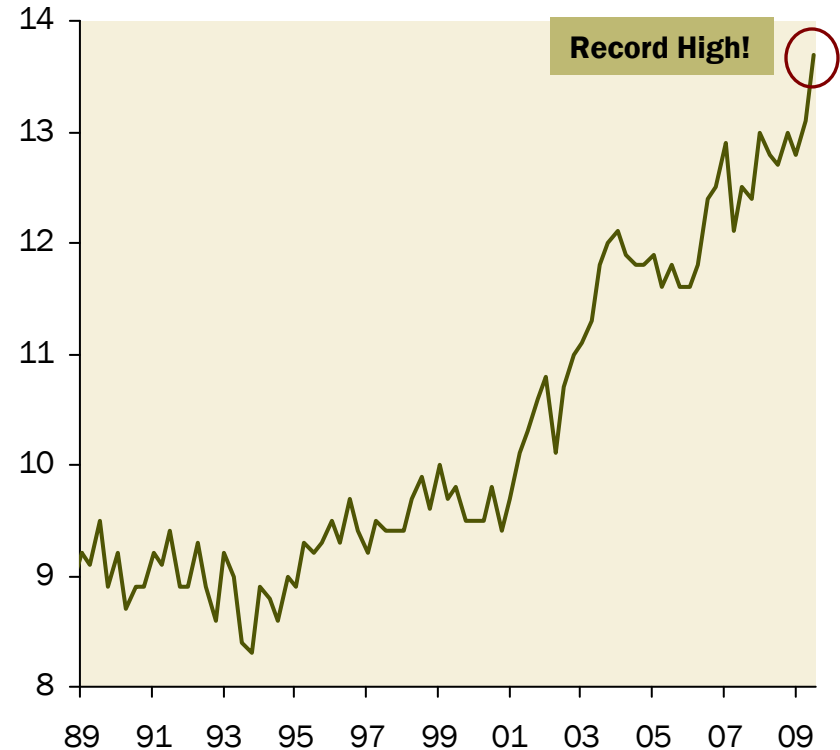


Note:

Source: Census Bureau

Total Housing Vacancy Rate

(percent)

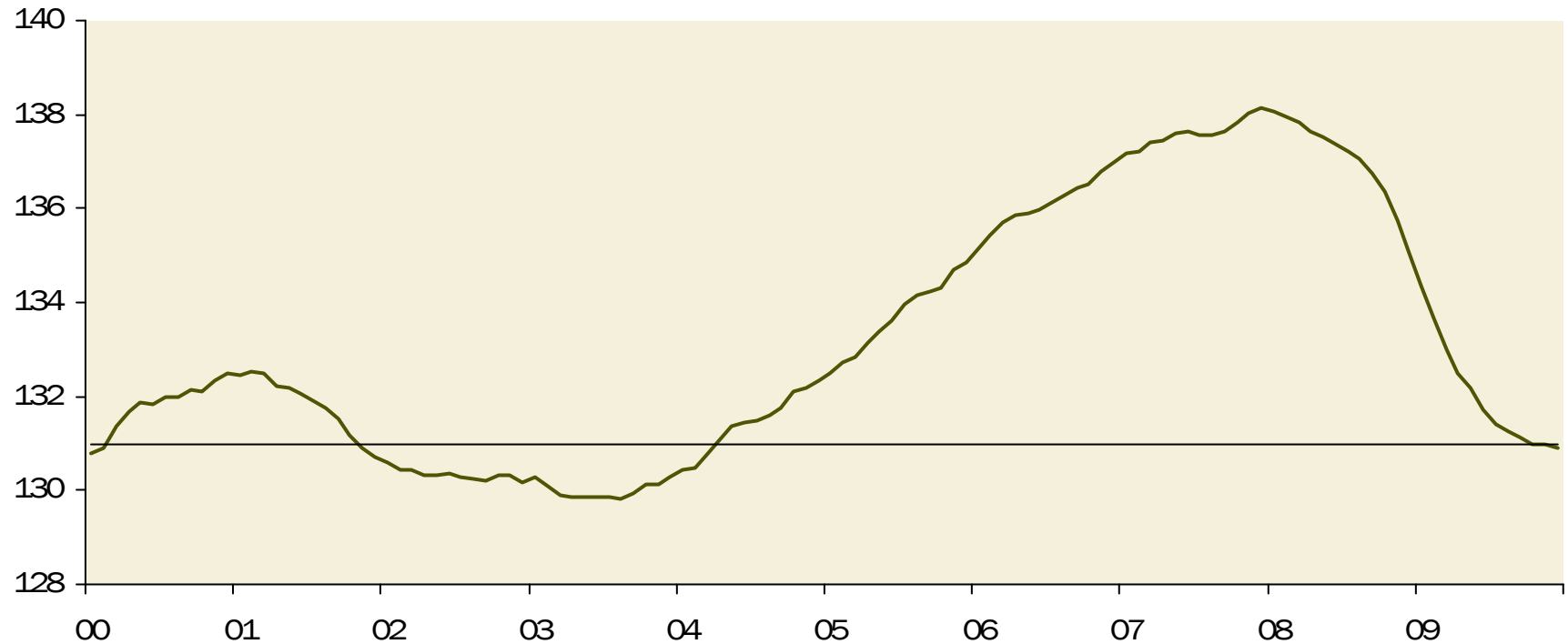


The Mother of All Jobless Recoveries

THE LOST DECADE

United States: Nonfarm Payrolls

(millions)



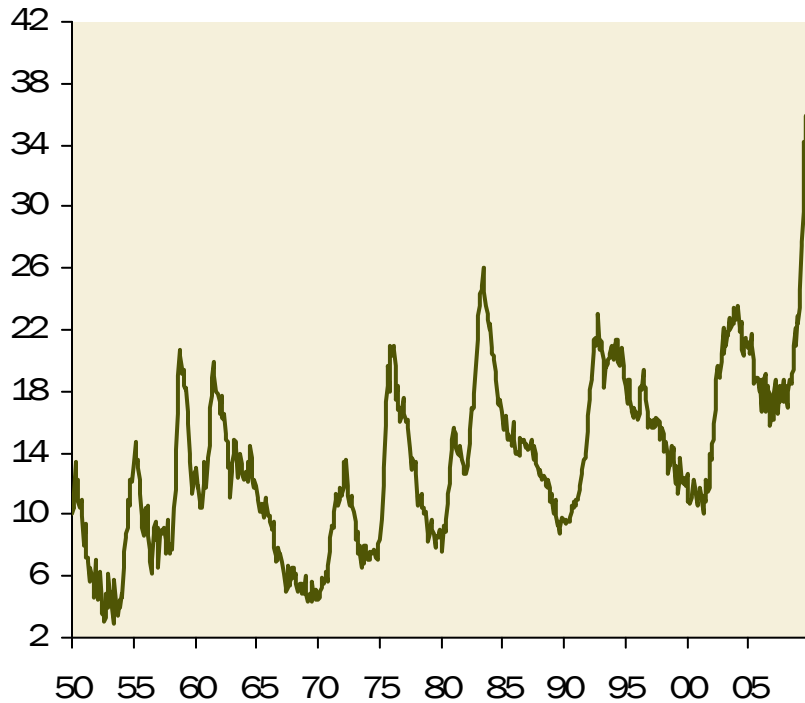
Note:

Source: Bureau of Labor Statistics

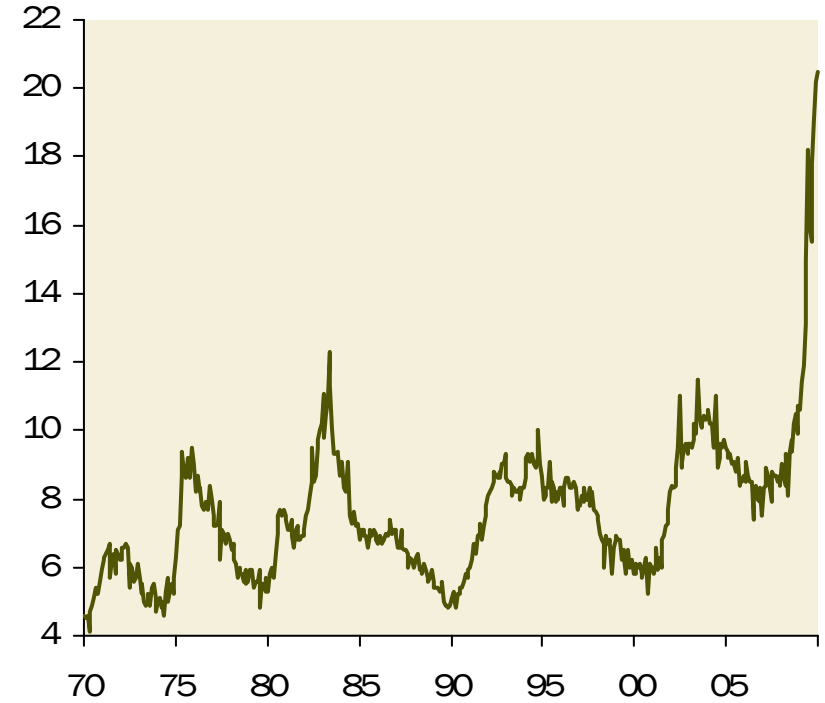
STRUCTURAL LABOUR MARKET PROBLEMS IN THE U.S.

United States: Nonfarm Payrolls

Percent of Unemployed 27 Weeks & Over
(percent)



Median Duration of Unemployment
(weeks)



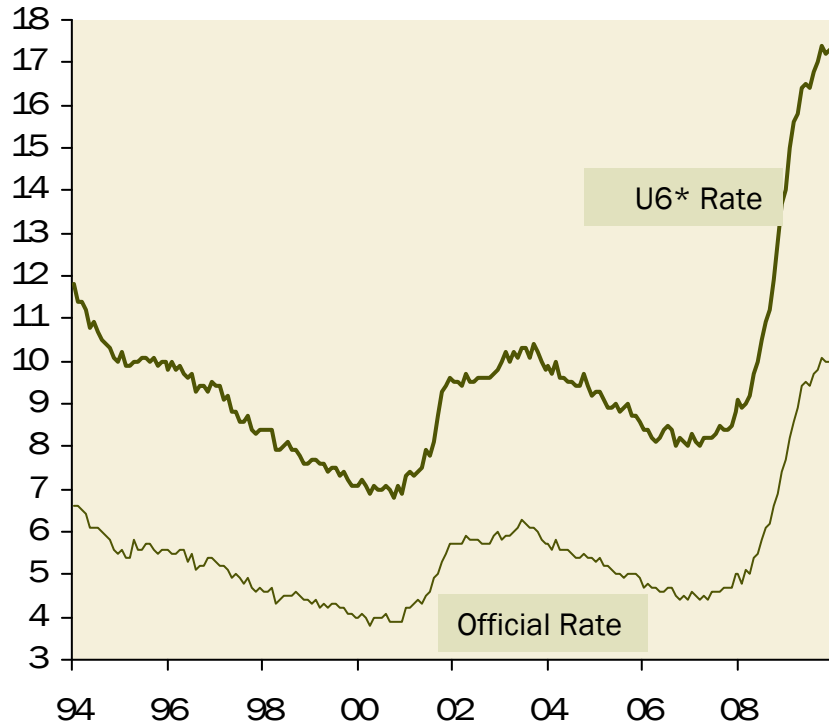
Note:

Source: Bureau of Labor Statistics

RECORD LEVEL OF SLACK IN THE LABOUR MARKET

United States: Unemployment Rates

U6* Rate versus Official Rate (U3 Rate)
(percent)



Spread between U6 and U3 Jobless Rate
(percentage point)



Notes:

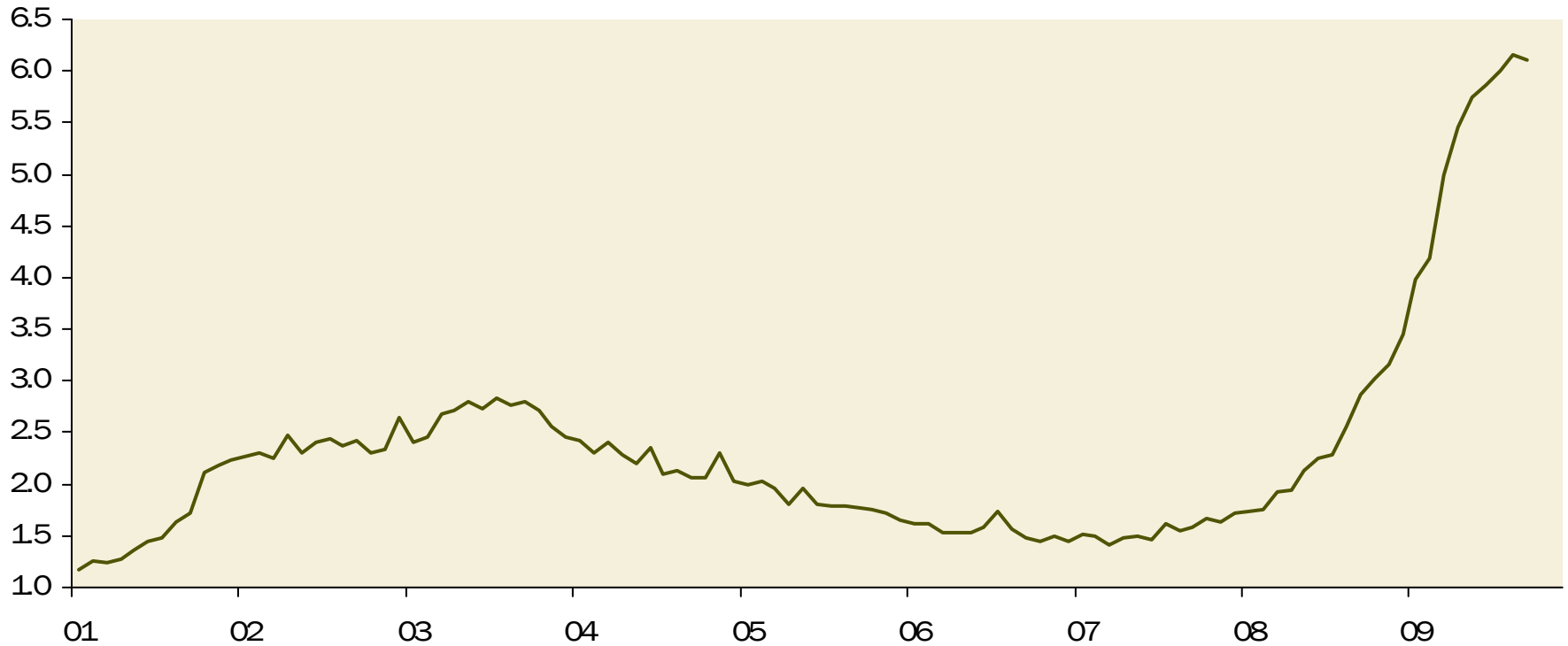
*Includes all marginally attached workers and those employed part-time for economic reasons

Source: Bureau of Labor Statistics

THE TRUEST PICTURE OF EXCESS LABOUR SUPPLY

United States: Number of Unemployed per Number of Job Opening

(ratio)



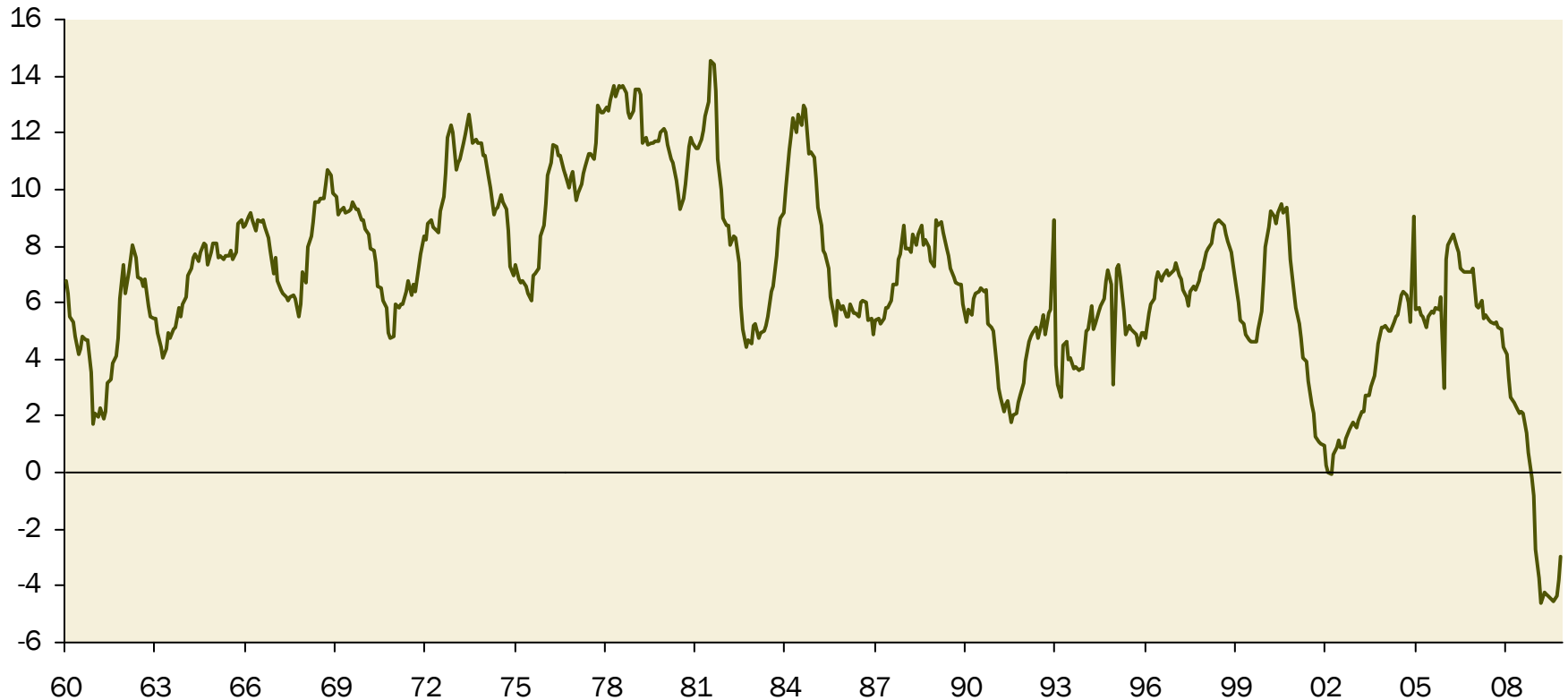
Note:

Source: Bureau of Labor Statistics

DEFLATION IN “ORGANIC” PERSONAL INCOME

United States: Personal Income minus Government Transfers

(year-over-year percent change)



Note:

Source: Bureau of Economic Analysis

GOVERNMENT BENEFITS ARE THE ONLY SOURCE OF INCOME THAT IS GROWING

United States

Components of Personal Income

(year-over-year percent change, November 2009)



Note:

Source: Bureau of Economic Analysis

Trauma Hits the U.S. Household Balance Sheet and the Income Statement

WHAT BANK OF AMERICA THINKS OF THE CREDIT BACKDROP

Mario Bartiromo: “What is the lending environment right now?”

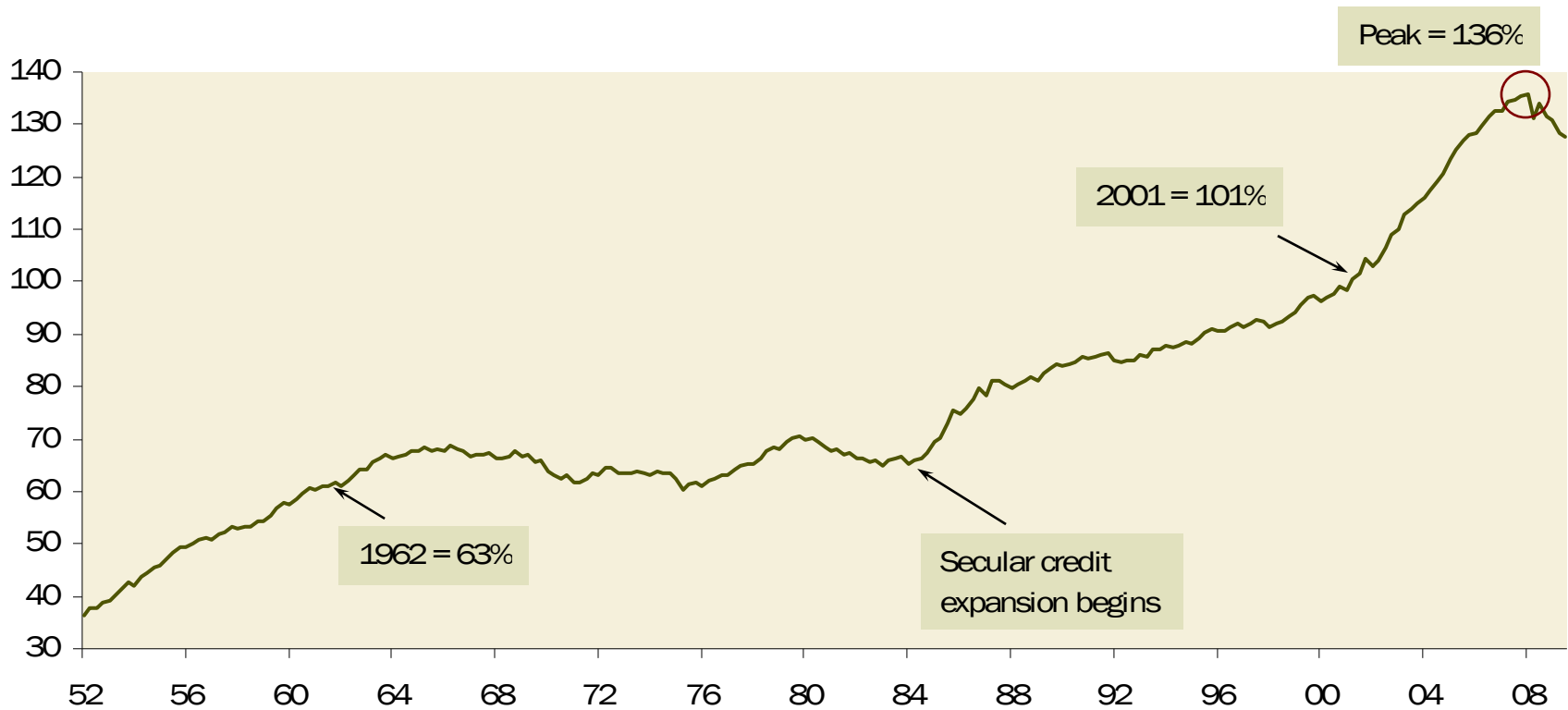
Ken Lewis: “There is a dramatic decline in demand, with even some sociological implications – consumers wanting to save and not spend. I don’t know if that’s permanent or not.”

(BusinessWeek interview, May 4, 2009)

DEBT-TO-INCOME RATIO ROSE AS MUCH IN THE PAST 7 YEARS AS IT DID IN THE PREVIOUS 39 YEARS

United States: Household Debt-to-Income Ratio

(percent)



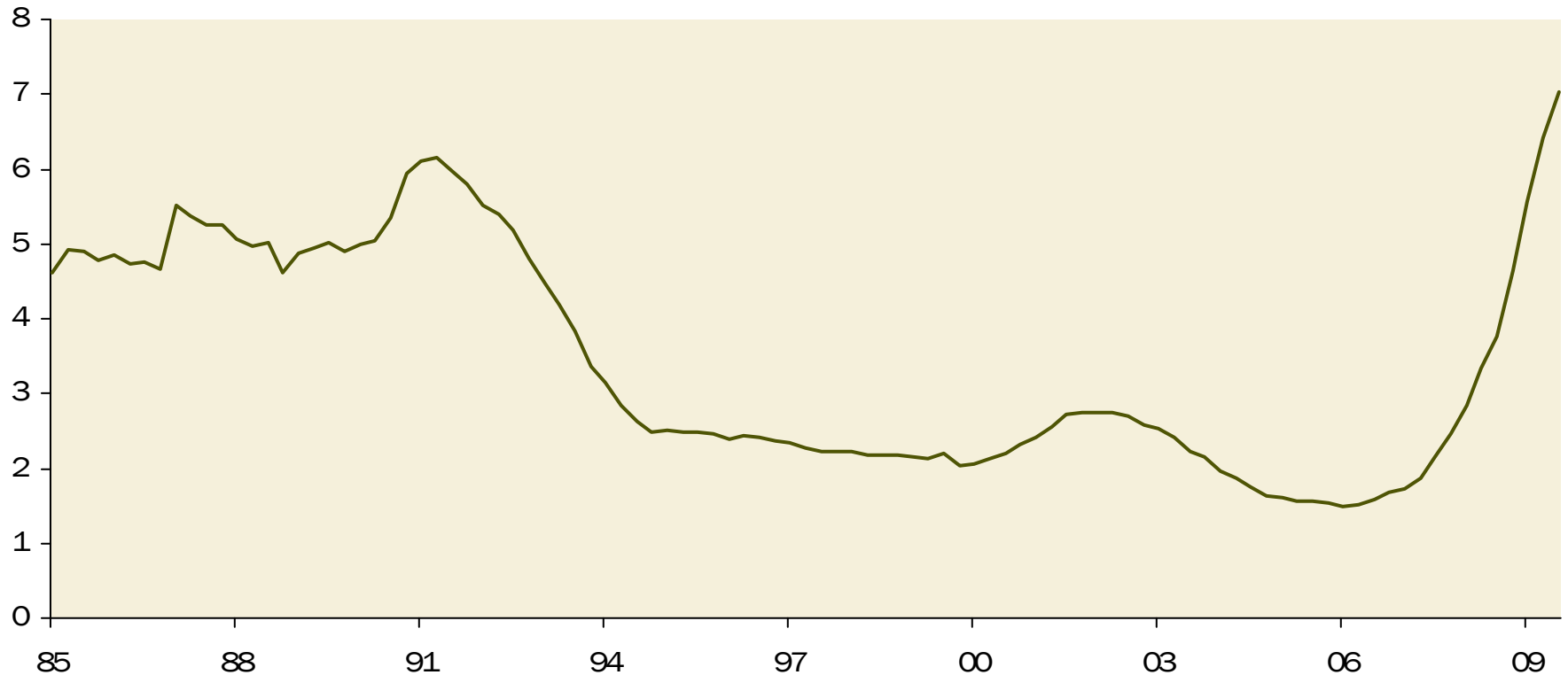
Note:

Source: Federal Reserve Board

LOAN DELINQUENCY RATES CONTINUE TO RISE

United States: Loan Delinquency Rates: All Insured Commercial Banks

(percent)



Note:

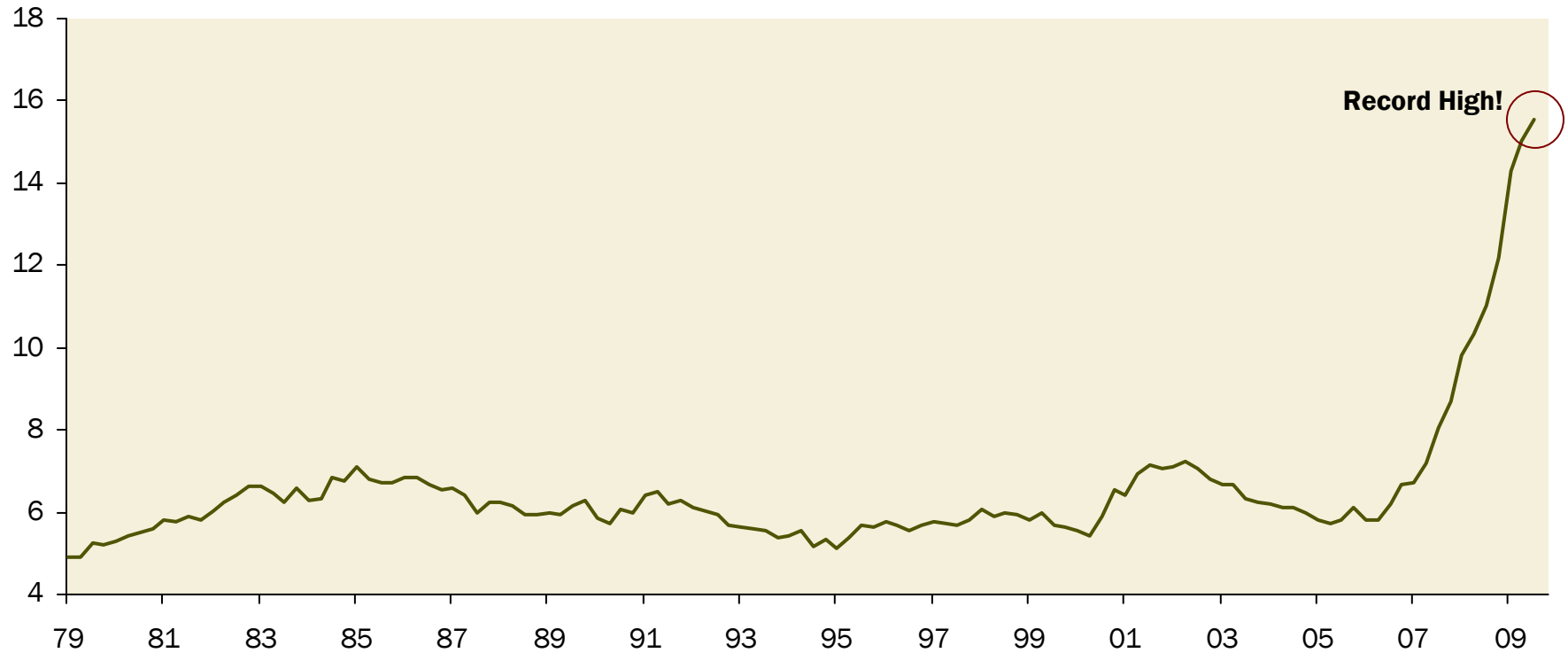
Source: Haver Analytics

MORE THAN 1 IN 7 U.S. HOUSEHOLDS IN FORECLOSURE OR ARREARS

United States

Mortgage Past Due and in Foreclosure

(percent)



Note:

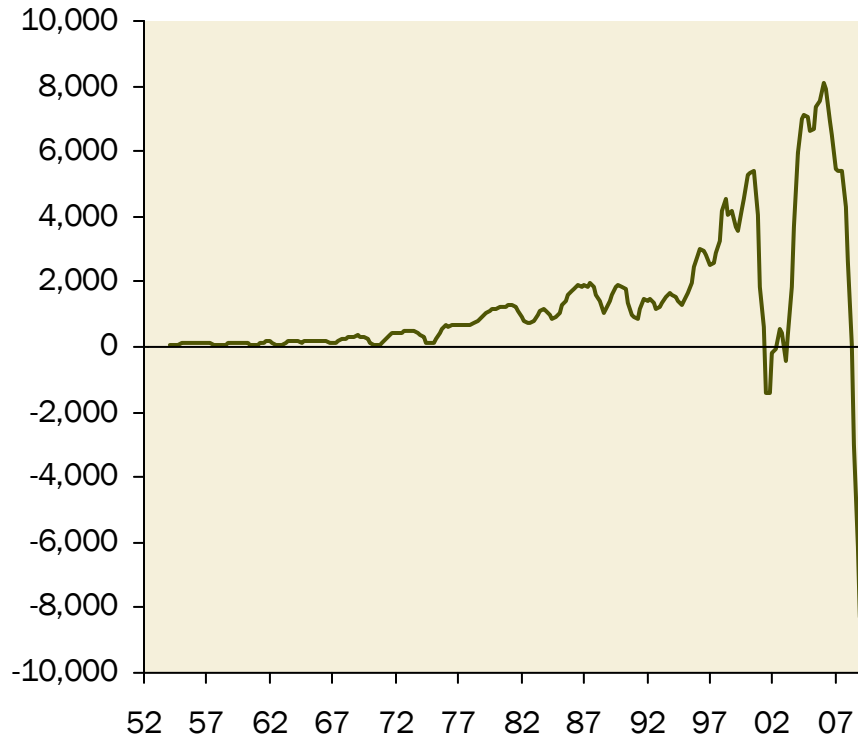
Source: Mortgage Bankers Association

HOUSEHOLDS SHRINKING THEIR BALANCE SHEETS

United States: Total Household (US\$ billions)

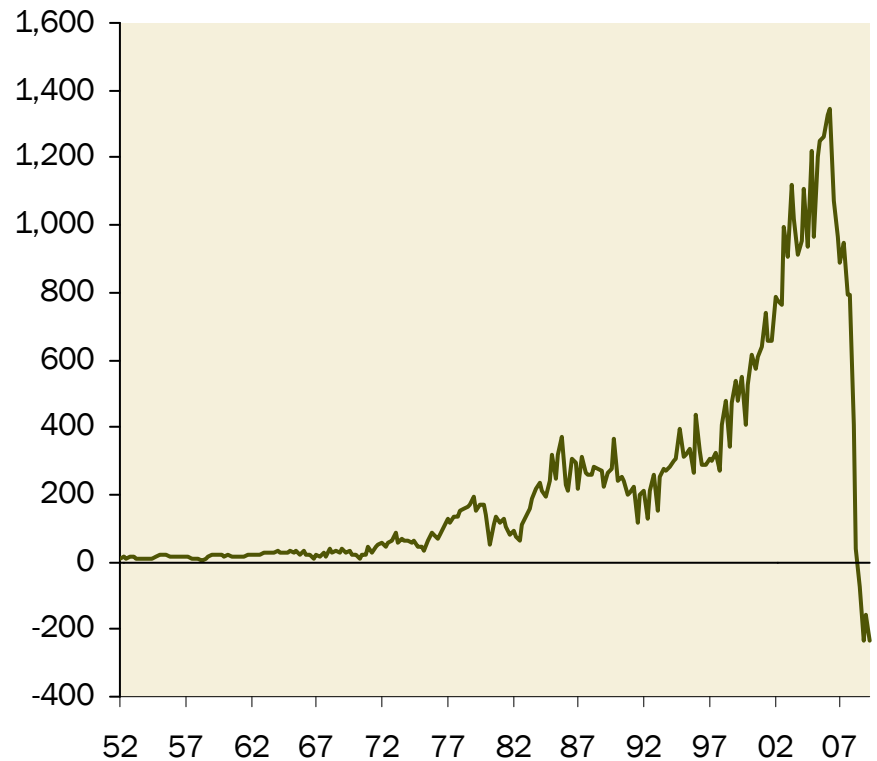
Assets

(four quarter moving average of the year-over-year change)



Credit Market Debt

(level, \$blns)



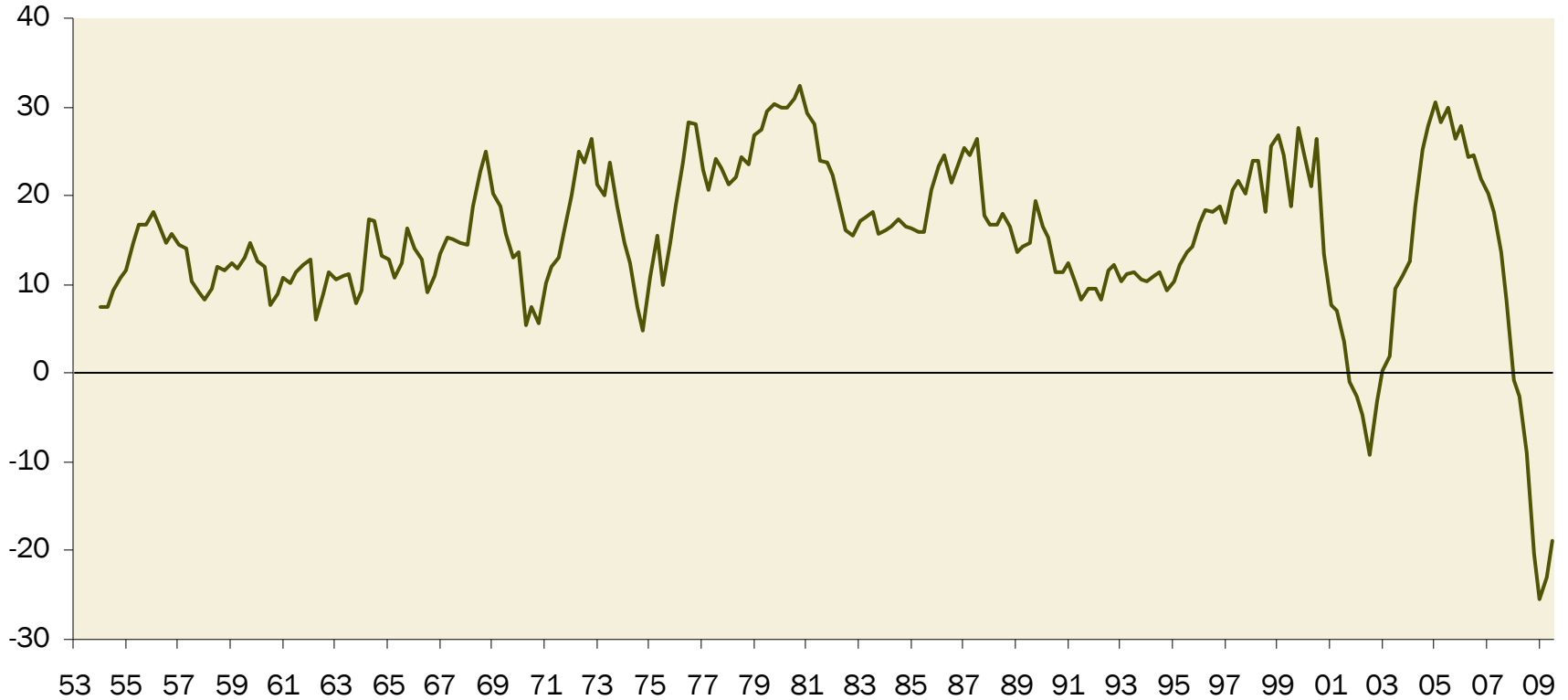
Note:

Source: Federal Reserve Board

RECORD IMPLOSION IN HOUSEHOLD NET WORTH

United States: Household Net Worth

(two-year percent change)



Note:

Source: Federal Reserve Board

NOT AGED BUT STILL AGING

United States: Median Age of Baby Boomers



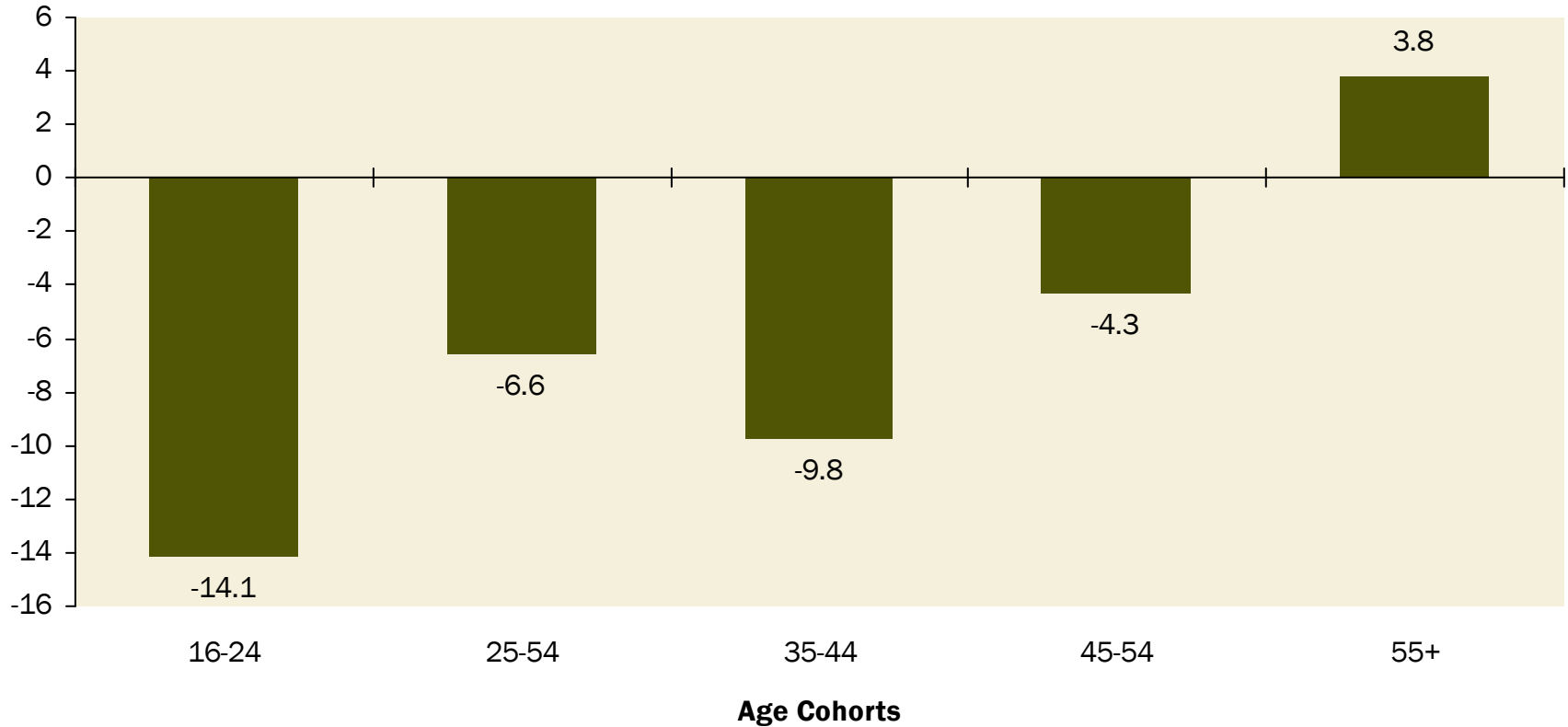
Note:

Source: Census Bureau

THE “LATE BOOMERS” ARE GRABBING THE JOBS

United States: Employment Growth by Age

(percent change from December 2007 to December 2009)



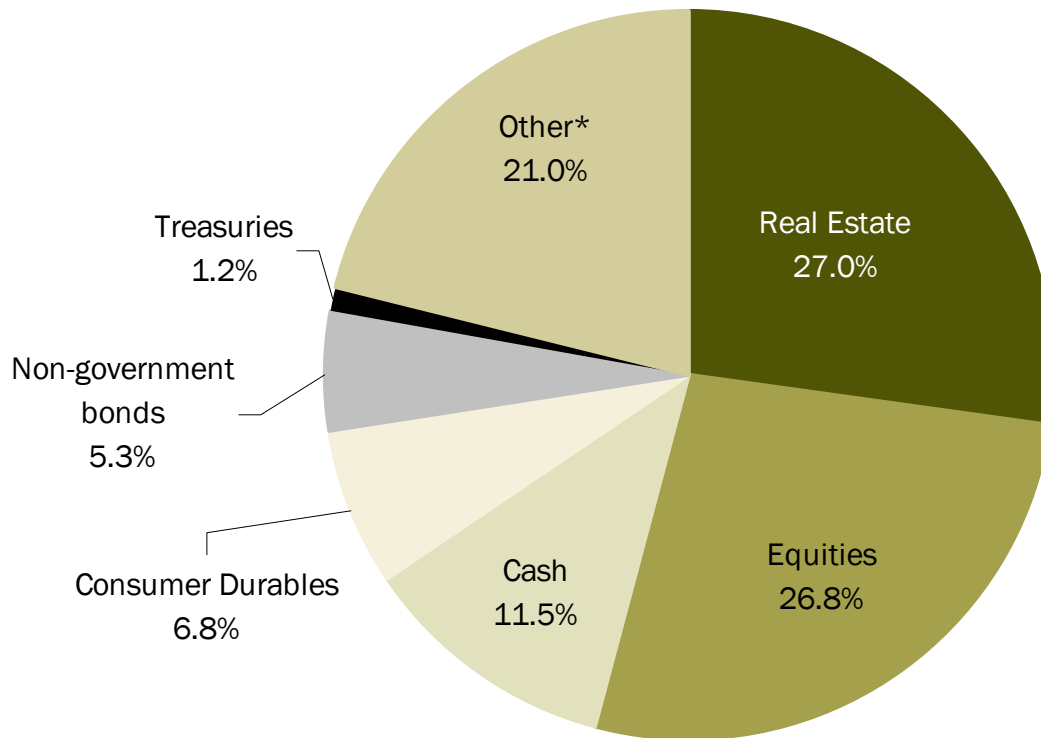
Note:

Source: Bureau of Labor Statistics

FIXED INCOME SECURITIES UNDERREPRESENTED IN THE HOUSEHOLD BALANCE SHEET

United States: Share of Household Assets

(percent, 2009 Q3)



Notes:

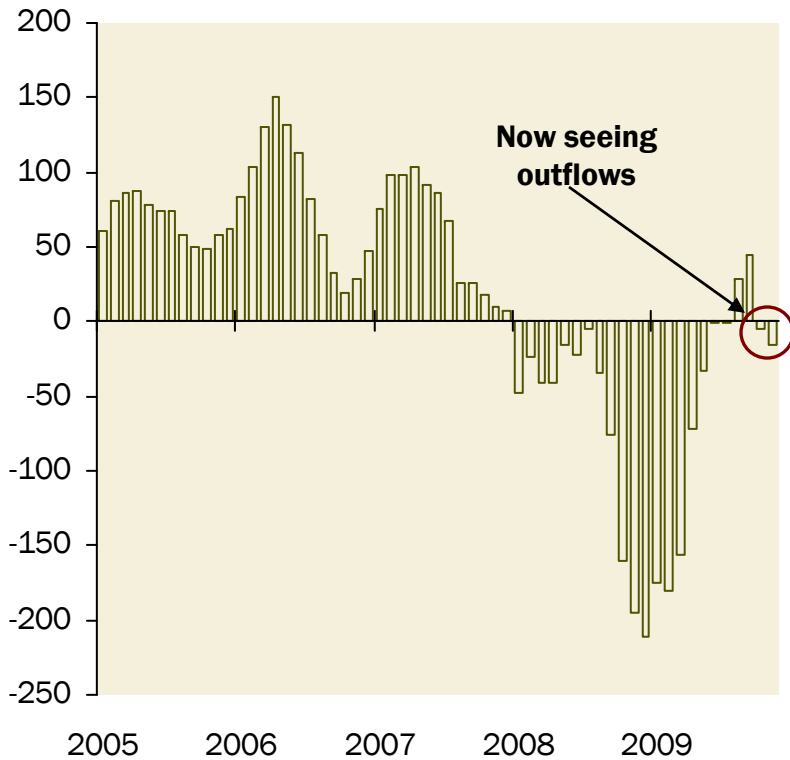
*Life insurance and pension reserves

Source: Federal Reserve Board

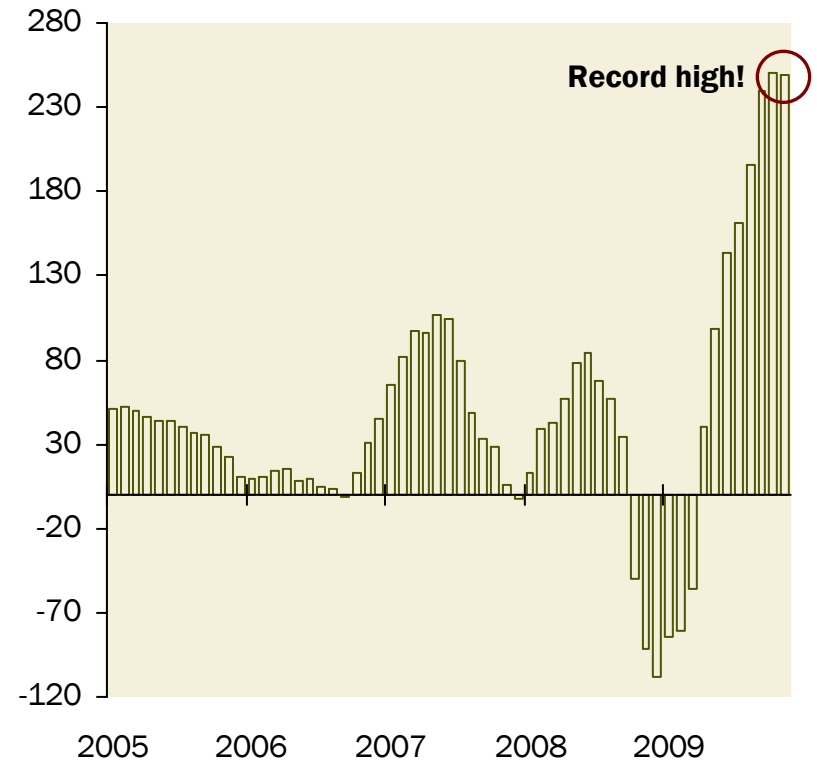
RECORD FLOWS INTO INCOME GENERATING FUNDS

United States (6-month moving total: US\$ billions)

Equity Funds: Capital Appreciation Funds



Income Funds*



Notes:

*Sum of bond funds and hybrid funds

Source: Investment Company Institute (ICI)

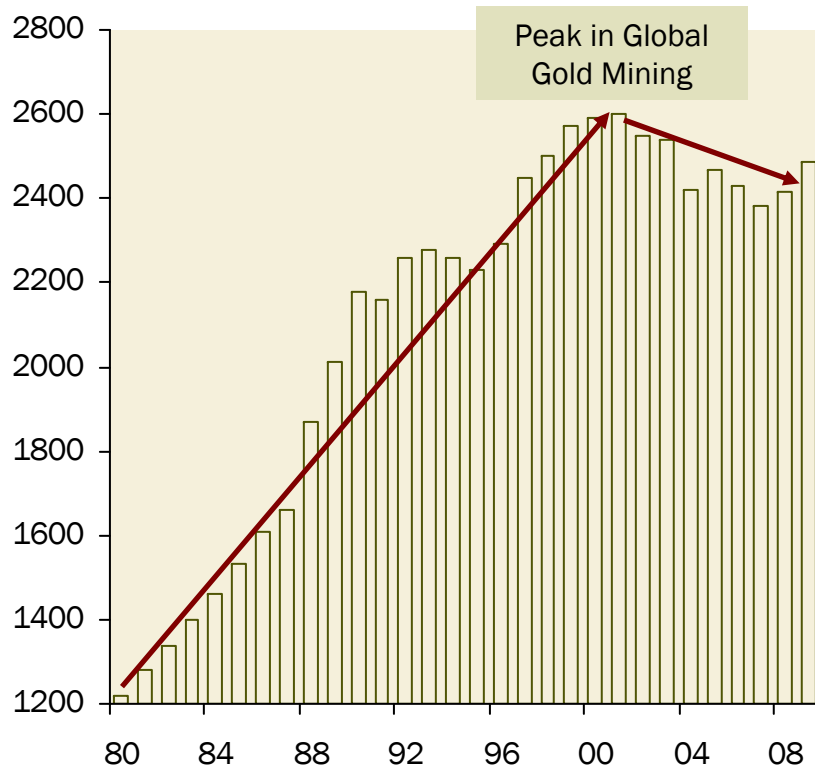
The Loonie Flies Over The Eagle



TWO REASONS TO BE BULLISH ON GOLD

Annual Global Gold Mining Output

(tonnes)

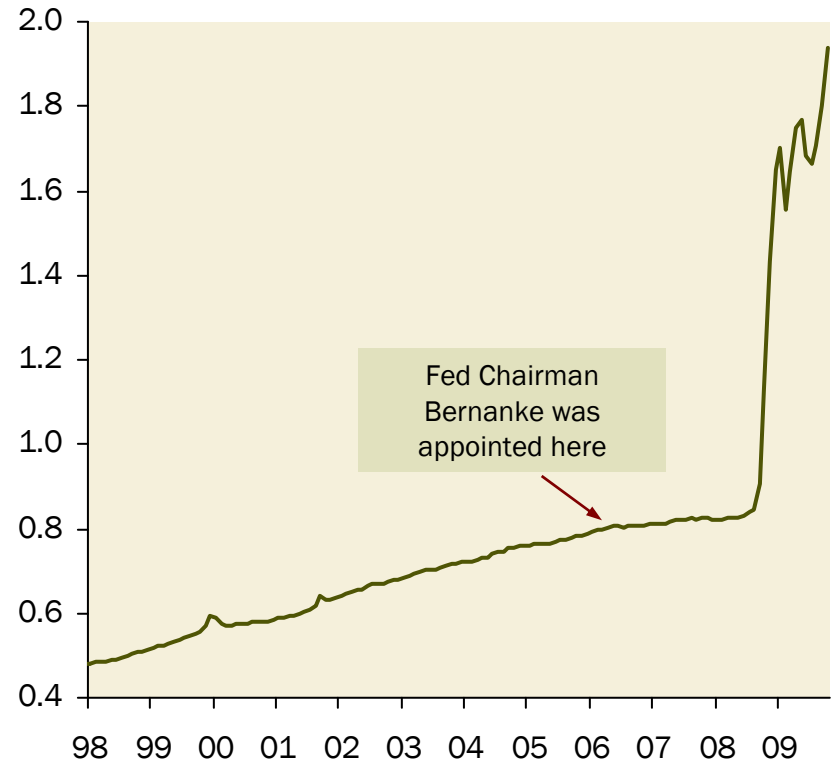


Note:

Source: U.S. Geological Survey, World Gold Council, Haver Analytics

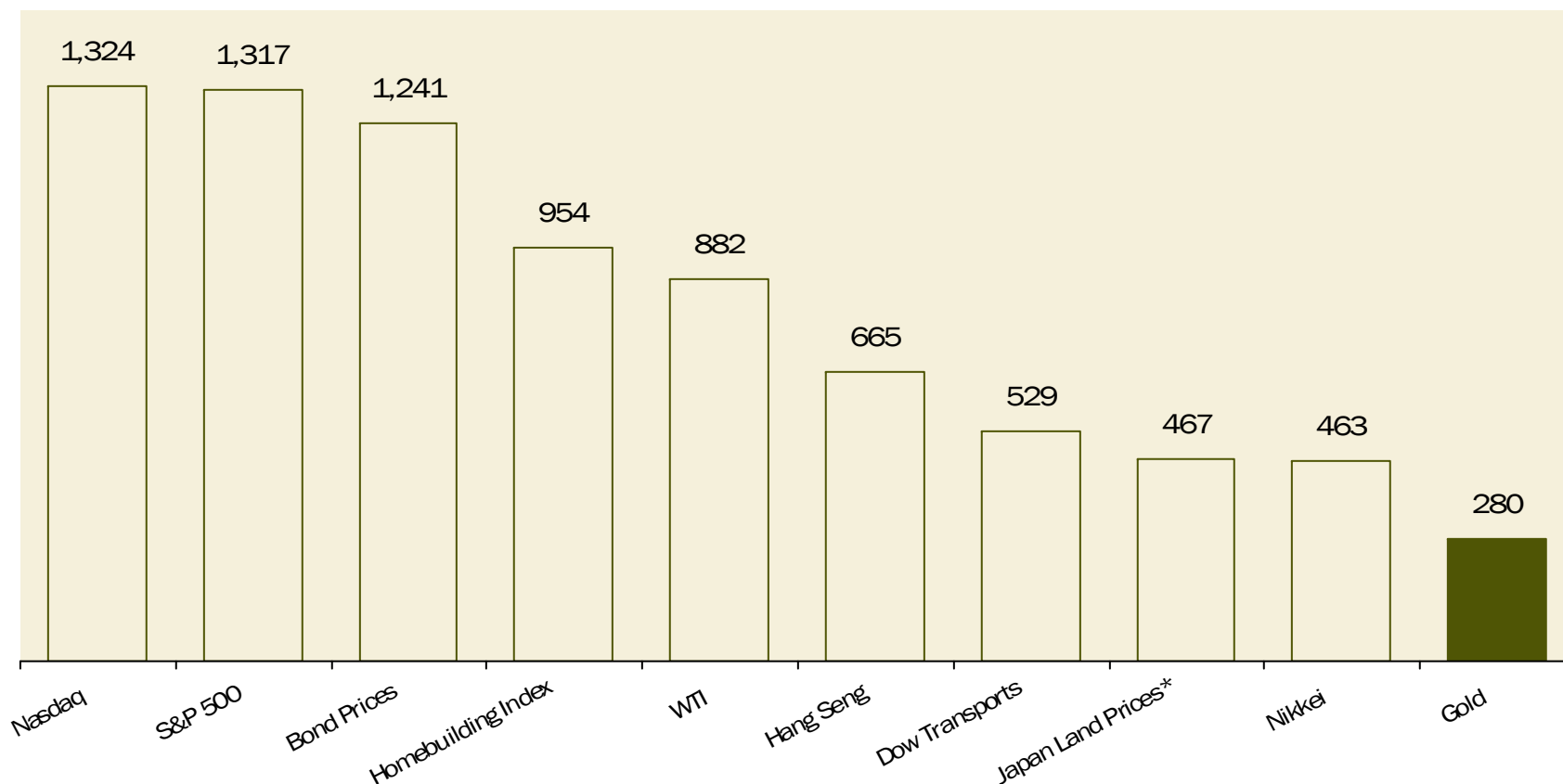
U.S. Adjusted Monetary Base

(US\$ trillion)



PUTTING THE GOLD RALLY IN CONTEXT WITH PRIOR SECULAR BULL MARKETS

(trough-to-peak percent change)



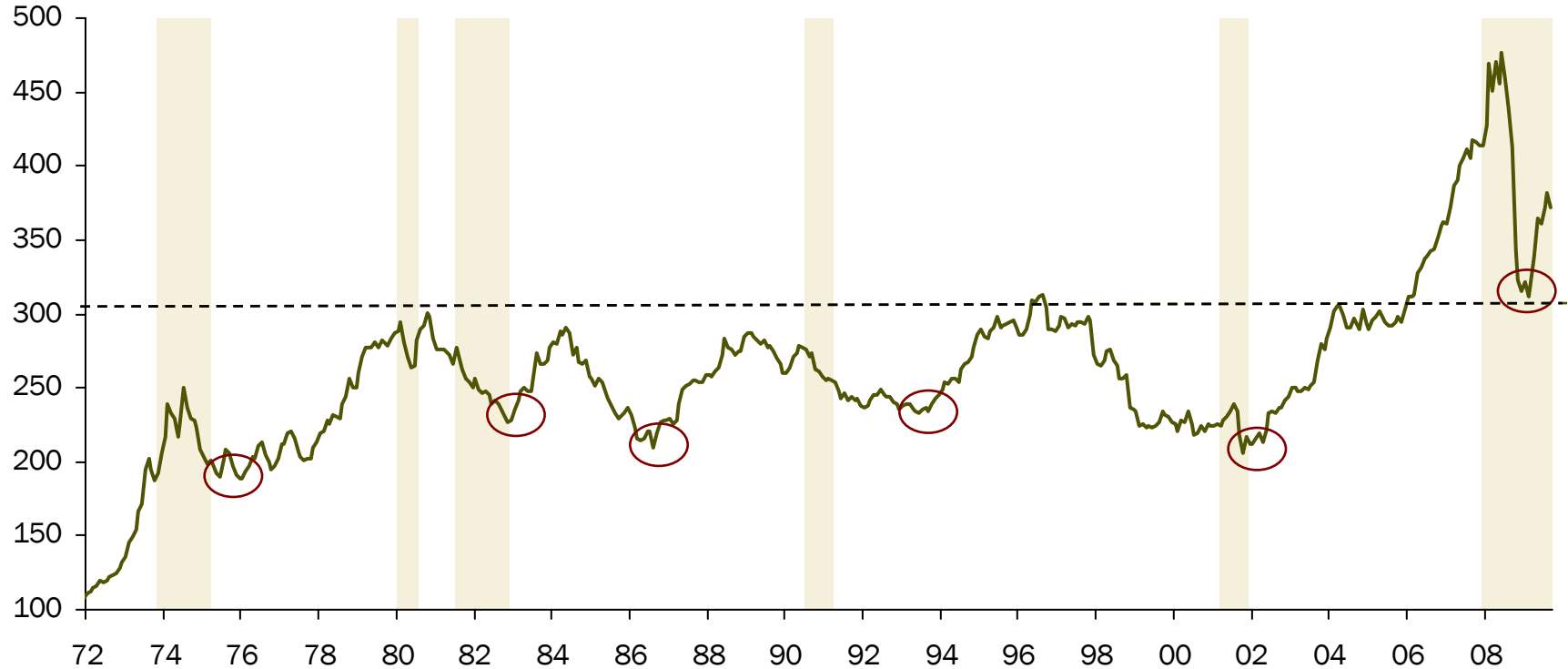
Note:

*Residential Japan land price index of the six big cities

Source: Haver Analytics, Bloomberg

COMMODITY PRICES BOTTOMED AT PREVIOUS PEAKS

CRB Spot Index



Notes:

Shaded area represent periods of U.S. recession

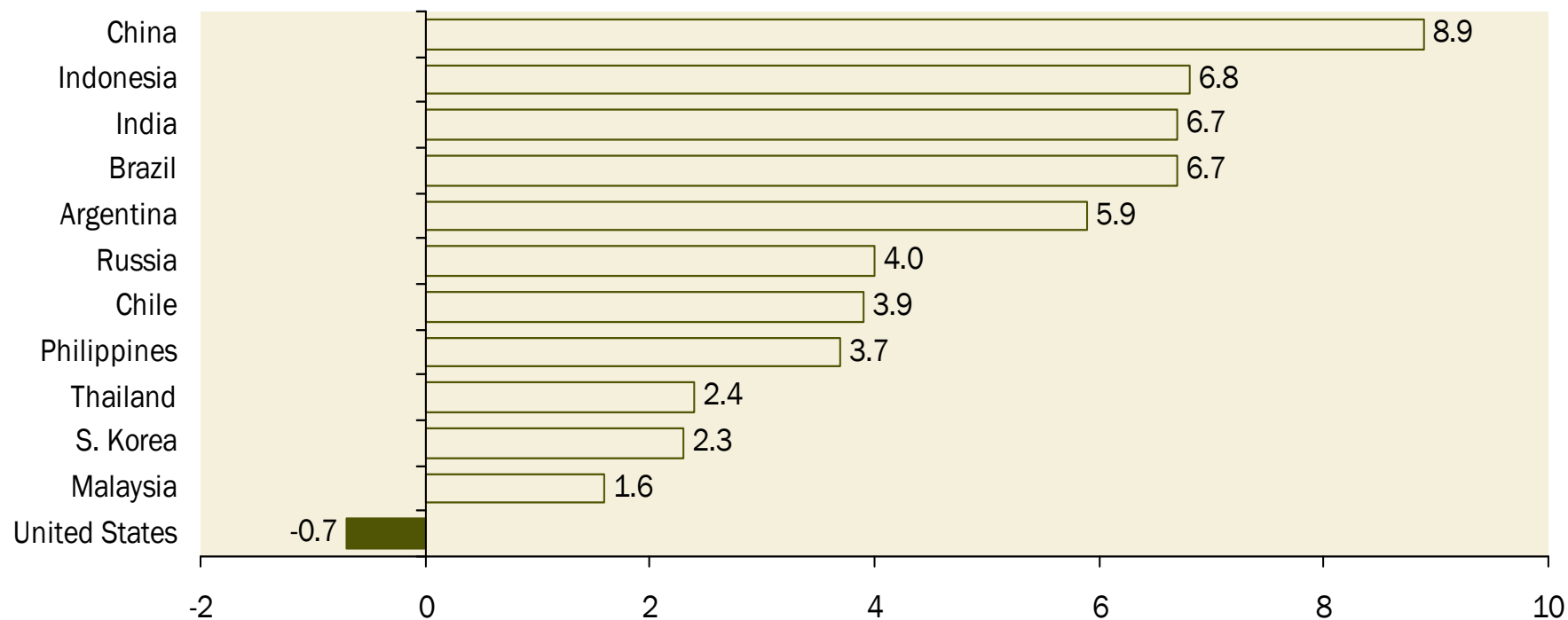
Source: Haver Analytics

Decoupling Was Working Until Lehman Collapsed

Real GDP

Pre-Lehman Recession

(3Q 2008/4Q 2007, percent change at an annual rate)



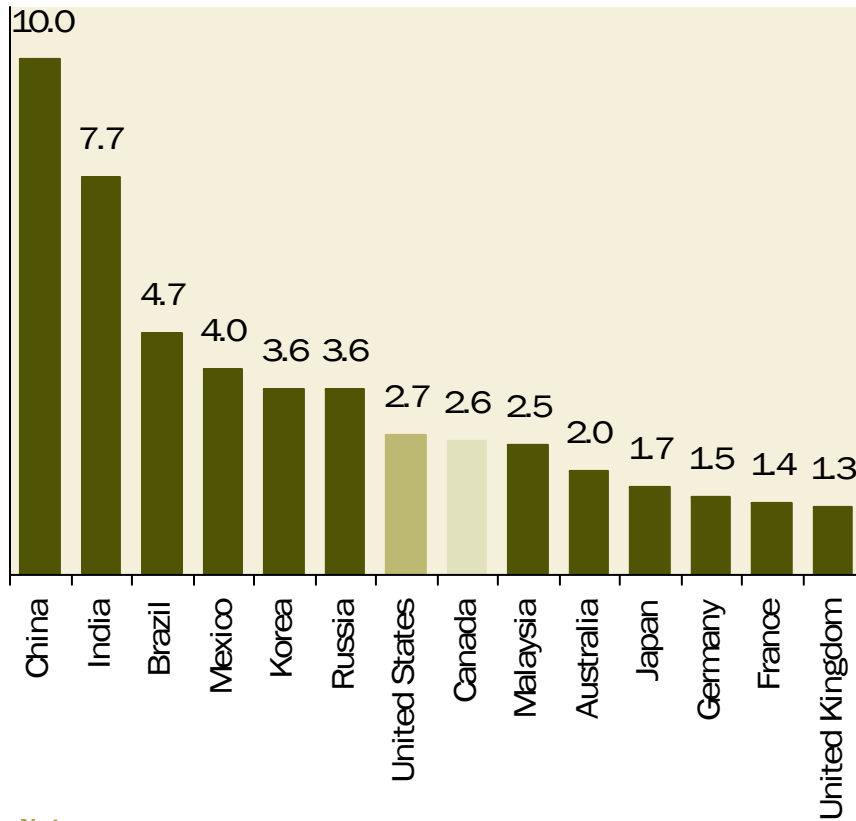
Note:

Source: Haver Analytics

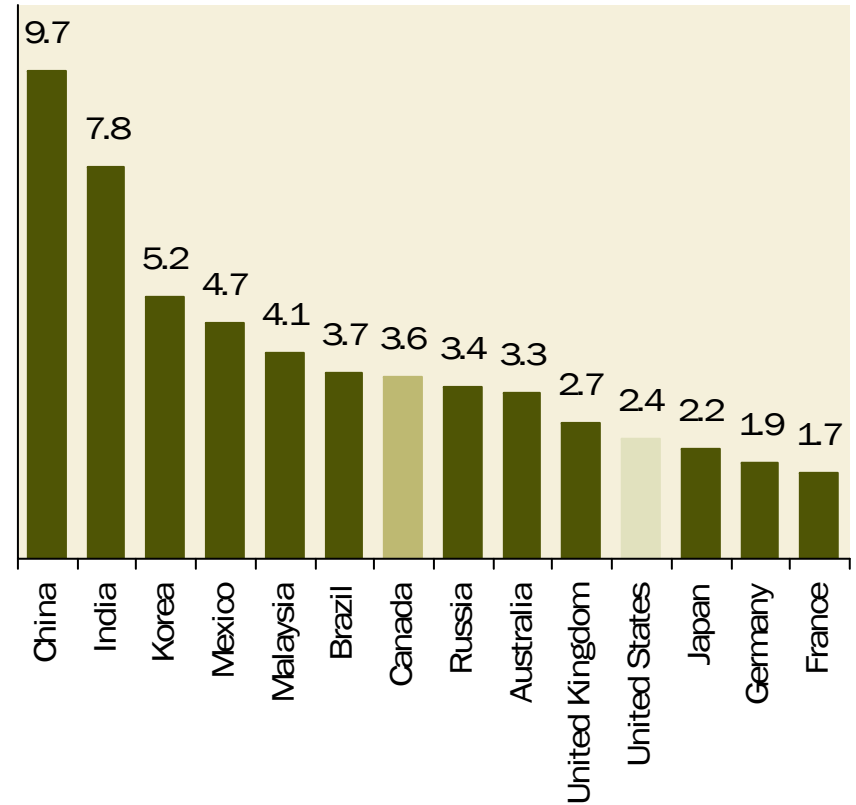
ASIA TO REMAIN THE GROWTH LEADER

Real GDP (annual percent change)

2010*



2011*

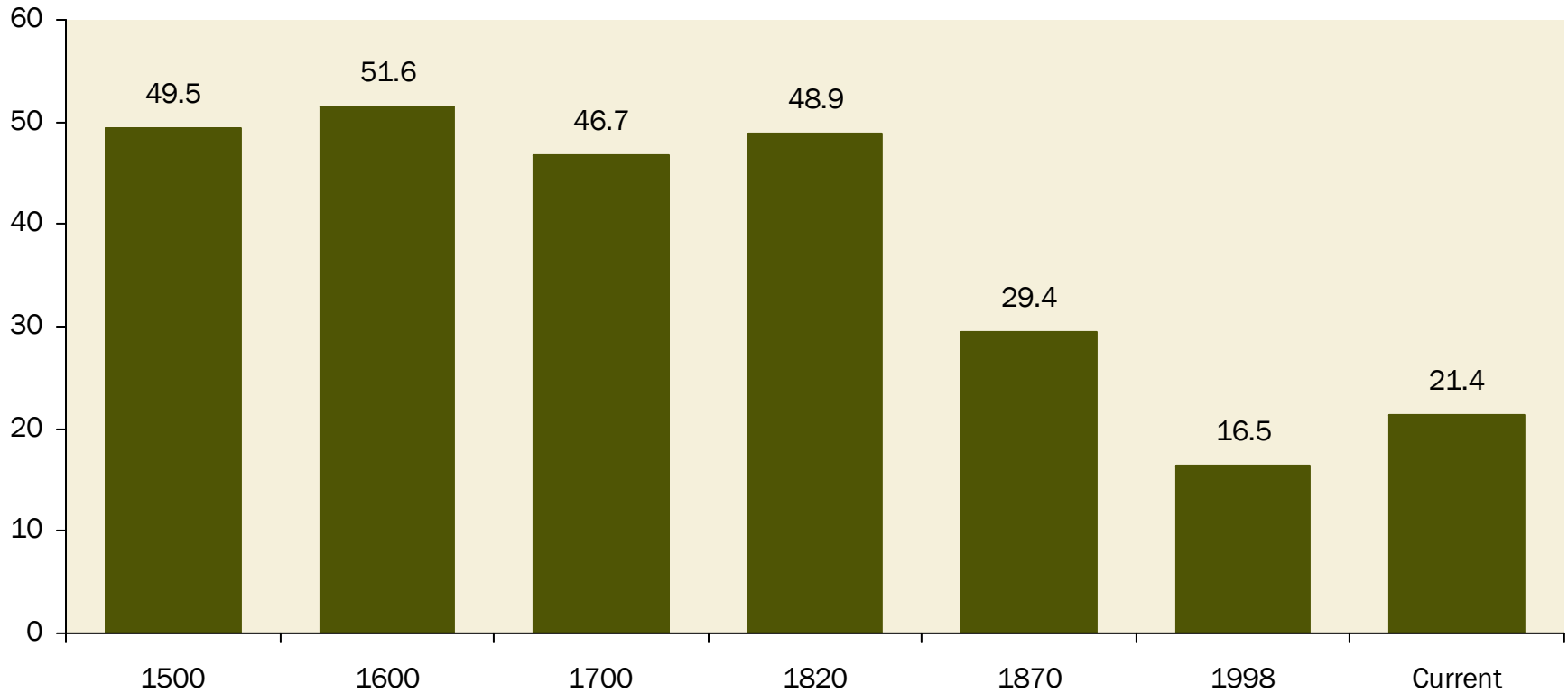


Note:
*IMF Forecast
Source: IMF

“CHINDIA” CAPTURING MARKET SHARE IN GLOBAL GDP

China-India Share of Global GDP

(percent)



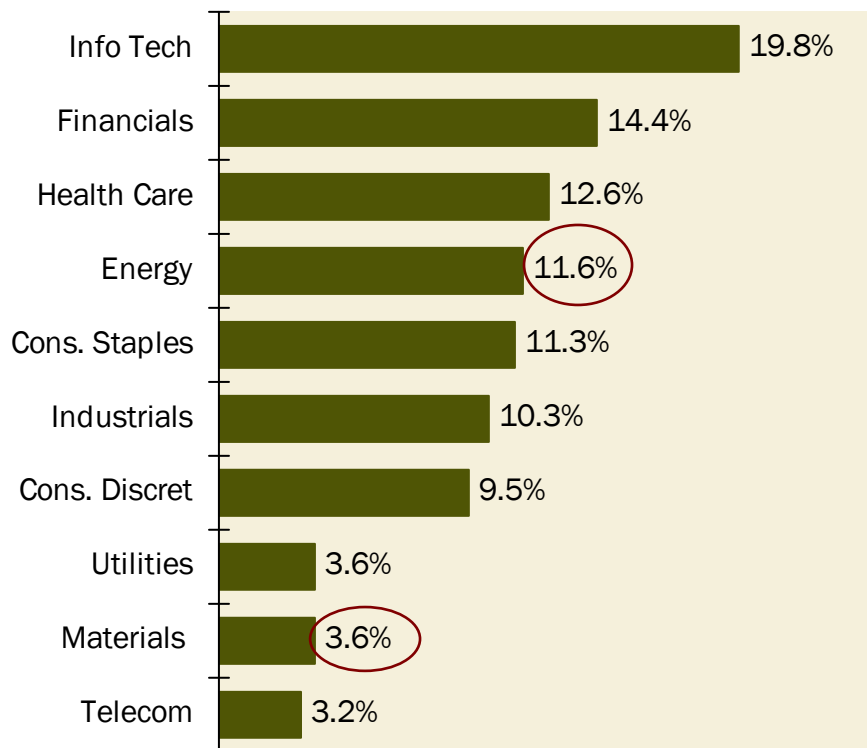
Note:

Source: Angus Maddison, *The World Economy: A Millennial Perspective*, OECD (2001), IMF, Morgan Stanley Research

CANADIAN MARKET GEARED MORE TOWARDS BASIC MATERIALS

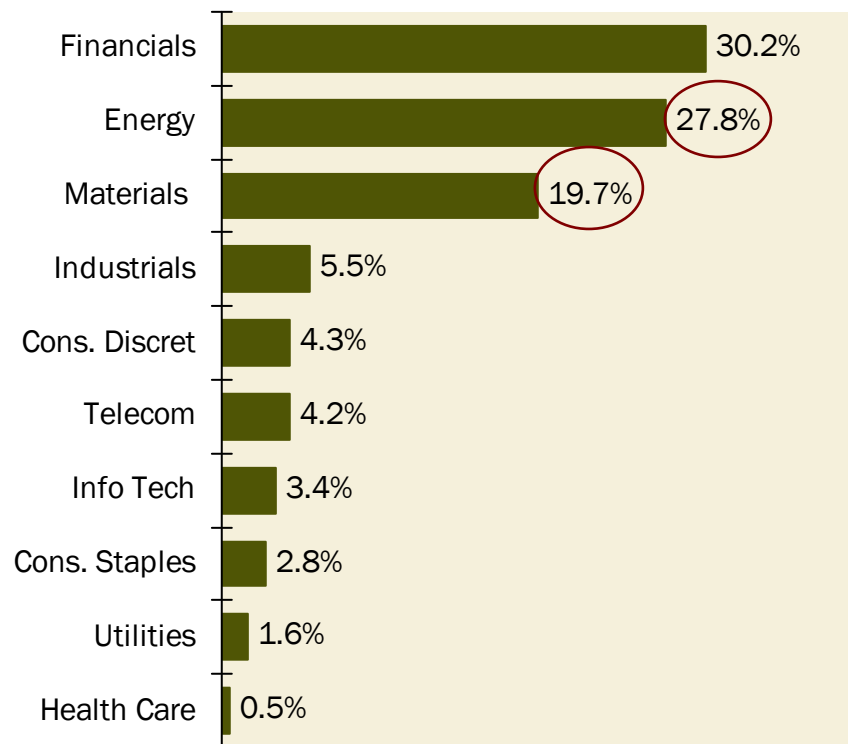
S&P 500 Composite Index

(percent, as of December 31, 2009)



TSX Composite Index

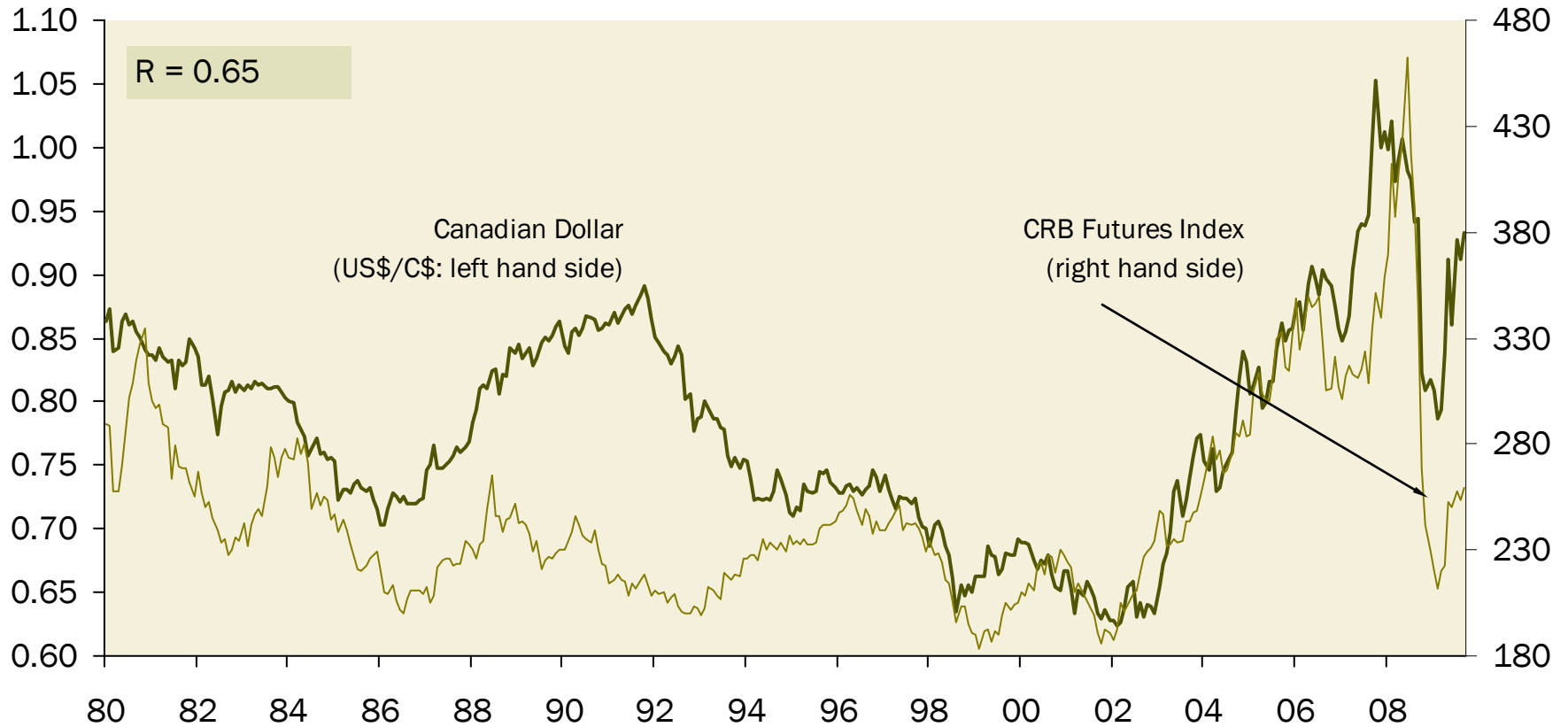
(percent, as of December 31, 2009)



Note:

Source: Bloomberg

COMMODITY PRICES AND THE CANADIAN DOLLAR MOVE TOGETHER

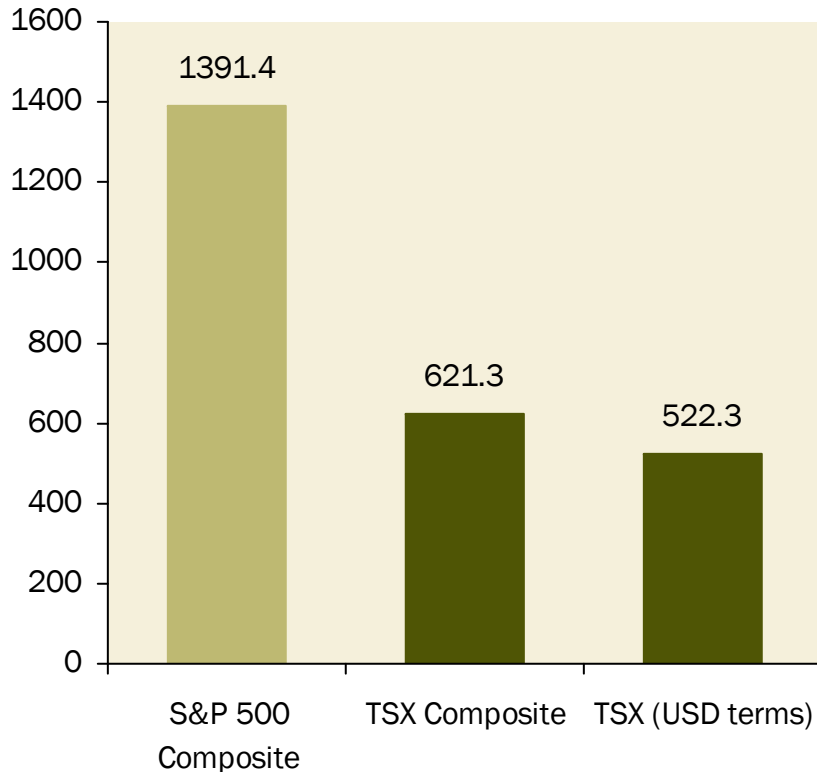


Note:
Source: Haver Analytics

HALFWAY THROUGH THE CANADIAN STOCK MARKET OUTPERFORMANCE

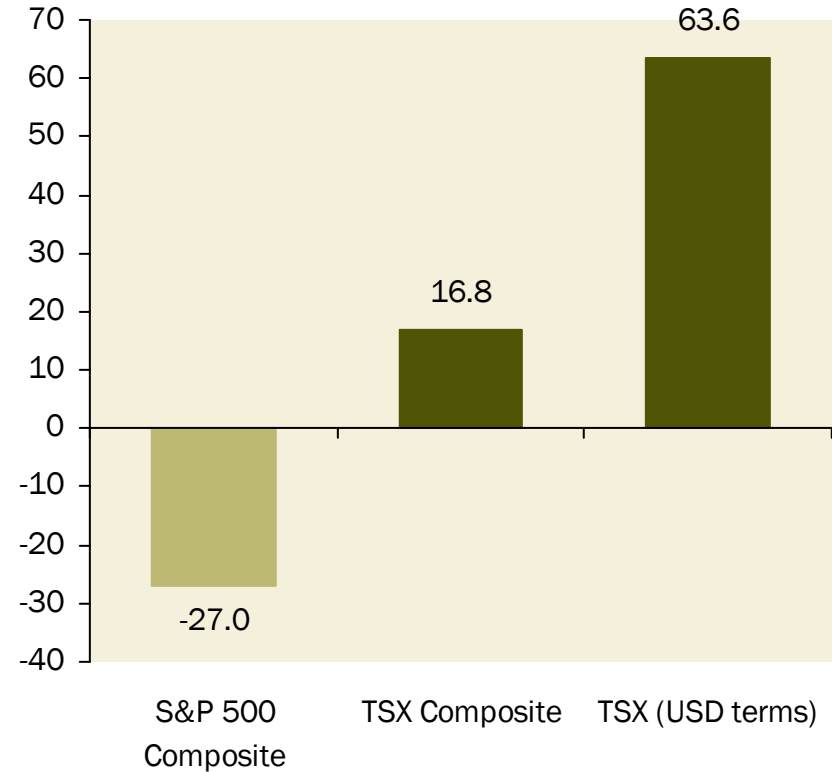
Then ...

August 12, 1982 – March 24, 2000*



... And Now

March 24, 2000 to December 31, 2009



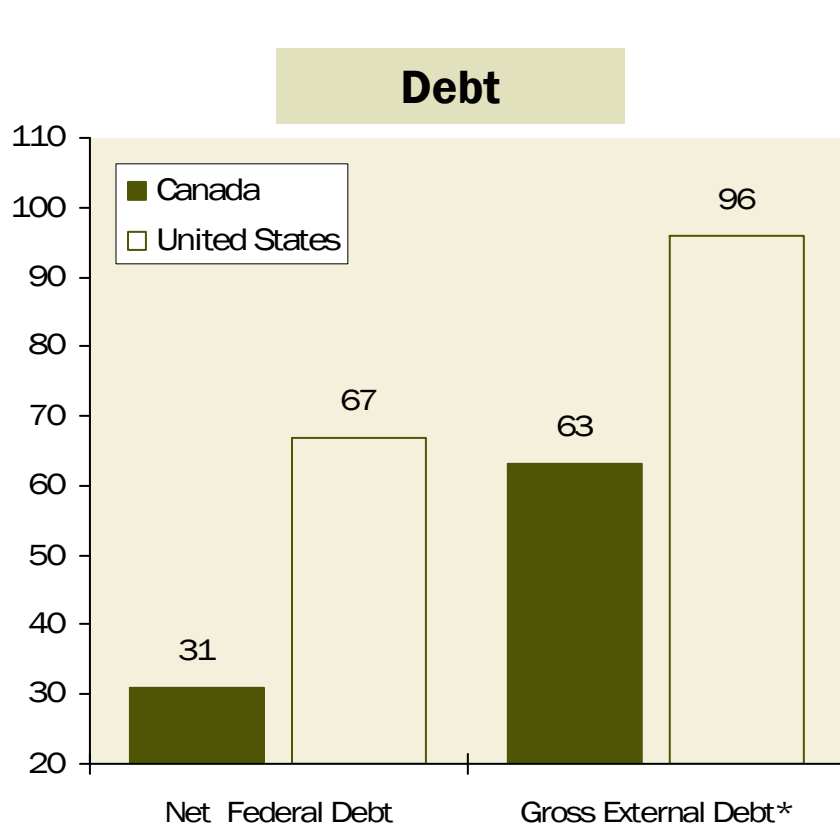
Note:

*Dates reflect the trough (August 12, 1982) and the peak (March 24, 2000) in the S&P 500 Composite Index

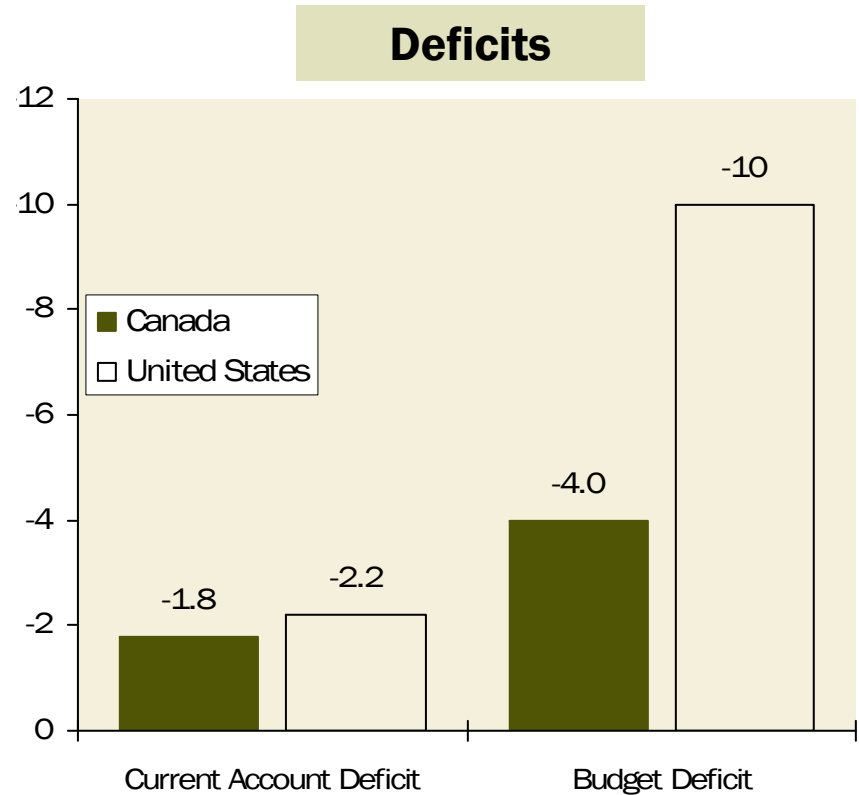
Source: Bloomberg, Haver Analytics

CANADA IN BETTER SHAPE THAN THE U.S.

(as a percent of GDP, 2010 forecast)



(inverted scale)



Notes:

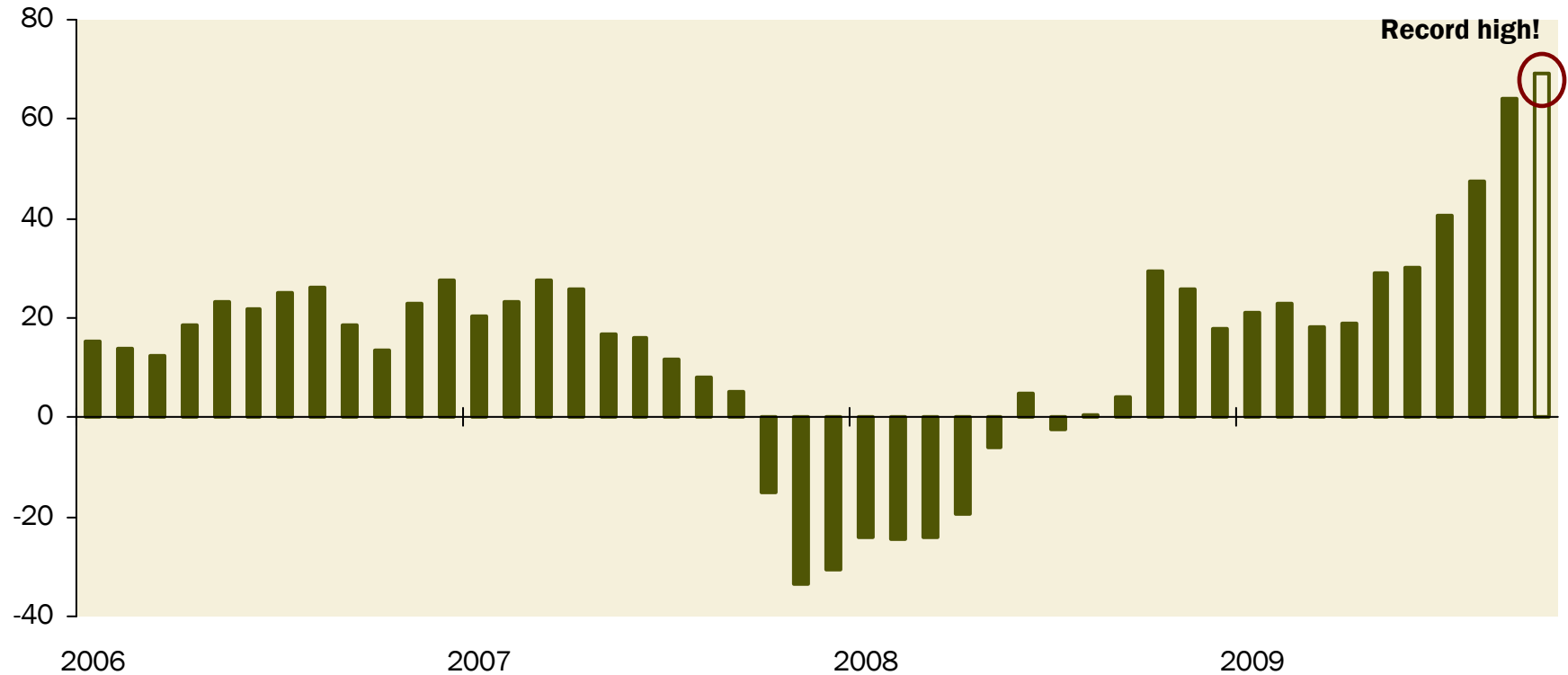
*Using 3Q 2009 figures

Source: Haver Analytics, IMF forecast

FOREIGN INVESTORS REDISCOVER CANADA

Canada: Net Foreign Purchases of Canadian Stocks and Bonds

(12-month total, C\$ billion)



Note:
Source: Statistics Canada

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