David A. Rosenberg
Chief Economist & Strategist
drosenberg@gluskinsheff.com
+ 1 416 681 8919

November 23, 2010
Economic Commentary

Gluskin Sheff

MARKET MUSINGS & DATA DECIPHERING

Breakfast Lite with Dave

WHILE YOU WERE SLEEPING

Lingering concerns over the Irish debt issue (the Bank of Ireland Plc is off 20% today; and the government has collapsed and an election will likely be held in early 2011) and heightened military tensions between the two Koreas (this was no missile test — bullets were fired for the first time since the war nearly six decades ago) are undercutting the risk-on trade with European bourses down across the board. There were also some heavy losses across Asia, which were taking hold even before any shots were fired (for example, the Hang Seng index was clocked in overnight trading, down 627 points or a 2.7% slide — the sharpest decline in six months — and the Shanghai index slid 1.9% to a six-week low. There is some market chatter about Chinese banks hitting their loan quotas and as such intend to close their credit books). There is also talk that China is going to take more aggressive tightening moves to combat inflation pressures. All 10 groups that make up the MSCI World Index are in the red so far today.

The U.S. government's crusade against the hedge fund industry — three are now under investigation — is serving as added cloud overhanging the financials. The U.S. retailing stocks have been behaving quite well (the SPDR Retail ETF is at a three-year high!) and Black Friday will likely prove to be a key inflection point. However, it is fair to ask just how robust the consumer spending outlook is when Wal-Mart comes out and says it will meet any price by its rivals and TJ Maxx, the very same day, cuts $100 off each iPad?

This renewal of risk aversion has triggered a retreat in the commodity currency countries — the Aussie is down for a third day in a row. As an aside, the Australian government said it is contemplating whether to start restricting foreign investment in its rural land and agricultural food production sector — food security is emerging as major strategy theme, not just for governments but for investors too. The Canadian dollar is gradually moving down towards its fair-value range of 92-93 cents — still about a nickel to go — although fundamental support should be provided by the country's fiscal rectitude with Finance Minister Flaherty reiterating his stance that the 2011 budget will focus on spending restraint, deficit reduction and further declines in corporate tax rates. Resource prices are drifting lower from their very lofty levels — oil is down fractionally and copper is heading south for the third day in a row.

SETTING THE RECORD STRAIGHT … AGAIN

The equity market certainly did turn in a surprisingly vigorous rally in the past few months but it would be a mistake to relate this to any real fundamental improvement in the economic backdrop. As we will likely see in today's FOMC minutes, the Fed is yet again going to take a knife to its growth and inflation forecast as it has done with regularity over the past eight months.

IN THE FULL ISSUE OF BREAKFAST WITH DAVE

- While you were sleeping: lingering concerns over the Irish debt issue and heightened military tensions between North and South Korea are undercutting the risk-on trade today
- Setting the record straight … again: the equity market certainly did turn in a surprisingly vigorous rally in the past few months but it would be a mistake to relate this to any real fundamental improvement in the economic backdrop
- Nothing Cavalier in the Cleveland Fed's price measure: its trimmed-mean CPI series, which removes the volatility in consumer prices, is now just 77bps YoY from dipping below zero
- More evidence on households cutting back on credit

To be sure, the double-dip has been avoided for now, but what is interesting is that nobody really believed in that scenario back in the summer, nor was any Wall Street research department calling for such even though for a time the risks were rising. The bottom in the equity market rally came, not on a piece of data towards the end of August, but on the back of the comments from Ben Bernanke in Jackson Hole that another round of quantitative easing was coming our way. This is why the rally ended, not on any particular piece of economic data, but right after the FOMC meeting a few weeks ago — a classic case of buying the rumour and then selling the fact. This is how markets often work since so much perception and psychology is involved.

The double-dip has been avoided … for now …

NOTHING CAVALIER IN CLEVELAND FED PRICE MEASURE

The Cleveland Fed attempts to take the volatility out of the consumer price data, and so in October, its trimmed-mean series came in below 0.049%, so close to zero, and the YoY trend has receded to a record low of 0.77%. So, we are going to end up with something close to 3% real GDP growth for 2010 when all is said and done and that put nary a dent in the near-10% unemployment rate nor did it stop the trend in underlying consumer inflation from practically being cut in half. Now you know why Bernanke is worried.

MORE EVIDENCE ON HOUSEHOLDS CUTTING BACK ON CREDIT

No sooner did we quote some research out of the New York Fed regarding the consumer frugality theme that we saw a similar report drawing similar conclusions out of the Federal Reserve Bank of Cleveland — titled *Mortgage Borrowers Deleverage*.

… But what is interesting is that nobody really believed in that scenario back in the summer, nor was any Wall Street research department calling for such even though for a time the risks were rising

Yes, Virginia, the deleveraging cycle is not just about banks taking write-downs but also about a secular shift in household attitudes towards debt as we discussed yesterday.

The conclusions from the Cleveland Fed:

"Consumers have been able to deleverage by reducing both the amount of debt and the term to maturity of their mortgage debt. Loan-to-value ratios have steadily declined since they peaked, falling 680 basis points for existing homes and 520 basis points for new homes. Moreover, consumers have reduced their exposure to mortgage debt by reducing the debt's term to maturity. In June, 2007, the term to maturity of all loans closed was 29.5 years; however, as of September of the term to maturity of all loans closed was 27.6 years."

Gluskin Sheff

Gluskin Sheff at a Glance

Gluskin Sheff + Associates Inc. is one of Canada's pre-eminent wealth management firms. Founded in 1984 and focused primarily on high net worth private clients, we are dedicated to the prudent stewardship of our clients' wealth through the delivery of strong, risk-adjusted investment returns together with the highest level of personalized client service.

OVERVIEW

As of September 30, 2010, the Firm managed assets of $5.8 billion.

Gluskin Sheff became a publicly traded corporation on the Toronto Stock Exchange (symbol: GS) in May 2006 and remains 49% owned by its senior management and employees. We have public company accountability and governance with a private company commitment to innovation and service.

Our investment interests are directly aligned with those of our clients, as Gluskin Sheff's management and employees are collectively the largest client of the Firm's investment portfolios.

We offer a diverse platform of investment strategies (Canadian and U.S. equities, Alternative and Fixed Income) and investment styles (Value, Growth and Income).[1]

The minimum investment required to establish a client relationship with the Firm is $3 million for Canadian investors and $5 million for U.S. & International investors.

PERFORMANCE

$1 million invested in our Canadian Equity Portfolio in 1991 (its inception date) would have grown to $9.1 million[2] on September 30, 2010 versus $5.9 million for the S&P/TSX Total Return Index over the same period.

$1 million USD invested in our U.S. Equity Portfolio in 1986 (its inception date) would have grown to $11.8 million USD[2] on September 30, 2010 versus $9.6 million USD for the S&P 500 Total Return Index over the same period.

INVESTMENT STRATEGY & TEAM

We have strong and stable portfolio management, research and client service teams. Aside from recent additions, our Portfolio Managers have been with the Firm for a minimum of ten years and we have attracted "best in class" talent at all levels. Our performance results are those of the team in place.

We have a strong history of insightful bottom-up security selection based on fundamental analysis.

For long equities, we look for companies with a history of long-term growth and stability, a proven track record, shareholder-minded management and a share price below our estimate of intrinsic value. We look for the opposite in equities that we sell short.

For corporate bonds, we look for issuers with a margin of safety for the payment of interest and principal, and yields which are attractive relative to the assessed credit risks involved.

We assemble concentrated portfolios — our top ten holdings typically represent between 25% to 45% of a portfolio. In this way, clients benefit from the ideas in which we have the highest conviction.

Our success has often been linked to our long history of investing in under-followed and under-appreciated small and mid cap companies both in Canada and the U.S.

PORTFOLIO CONSTRUCTION

In terms of asset mix and portfolio construction, we offer a unique marriage between our bottom-up security-specific fundamental analysis and our top-down macroeconomic view.

Our investment interests are directly aligned with those of our clients, as Gluskin Sheff's management and employees are collectively the largest client of the Firm's investment portfolios.

$1 million invested in our Canadian Equity Portfolio in 1991 (its inception date) would have grown to $9.1 million[2] on September 30, 2010 versus $5.9 million for the S&P/TSX Total Return Index over the same period.

For further information, please contact questions@gluskinsheff.com

Notes:

Unless otherwise noted, all values are in Canadian dollars.

1. *Not all investment strategies are available to non-Canadian investors. Please contact Gluskin Sheff for information specific to your situation.*
2. *Returns are based on the composite of segregated Canadian Value and U.S. Equity portfolios, as applicable, and are presented net of fees and expenses.*

IMPORTANT DISCLOSURES

Gluskin Sheff may own, buy, or sell, on behalf of its clients, securities of issuers that may be discussed in or impacted by this report. As a result, readers should be aware that Gluskin Sheff may have a conflict of interest that could affect the objectivity of this report. This report should not be regarded by recipients as a substitute for the exercise of their own judgment and readers are encouraged to seek independent, third-party research on any companies covered in or impacted by this report.

Individuals identified as economists do not function as research analysts under U.S. law and reports prepared by them are not research reports under applicable U.S. rules and regulations. Macroeconomic analysis is considered investment research for purposes of distribution in the U.K. under the rules of the Financial Services Authority.

Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other financial instrument or any derivative related to such securities or instruments (e.g., options, futures, warrants, and contracts for differences). This report is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. Any decision to purchase or subscribe for securities in any offering must be based solely on existing public information on such security or the information in the prospectus or other offering document issued in connection with such offering, and not on this report.

Securities and other financial instruments discussed in this report, or recommended by Gluskin Sheff, are not insured by the Federal Deposit Insurance Corporation and are not deposits or other obligations of any insured depository institution. Investments in general and, derivatives, in particular, involve numerous risks, including, among others, market risk, counterparty default risk and liquidity risk. No security, financial instrument or derivative is suitable for all investors. In some cases, securities and other financial instruments may be difficult to value or sell and reliable information about the value or risks related to the security or financial instrument may be difficult to obtain. Investors should note that income from such securities and other financial instruments, if any, may fluctuate and that price or value of such securities and instruments may rise or fall and, in some cases, investors may lose their entire principal investment. Past performance is not necessarily a guide to future performance. Levels and basis for taxation may change.

Foreign currency rates of exchange may adversely affect the value, price or income of any security or financial instrument mentioned in this report. Investors in such securities and instruments effectively assume currency risk.

Materials prepared by Gluskin Sheff research personnel are based on public information. Facts and views presented in this material have not been reviewed by, and may not reflect information known to, professionals in other business areas of Gluskin Sheff. To the extent this report discusses any legal proceeding or issues, it has not been prepared as nor is it intended to express any legal conclusion, opinion or advice. Investors should consult their own legal advisers as to issues of law relating to the subject matter of this report. Gluskin Sheff research personnel's knowledge of legal proceedings in which any Gluskin Sheff entity and/or its directors, officers and employees may be plaintiffs, defendants, co-defendants or co-plaintiffs with or involving companies mentioned in this report is based on public information. Facts and views presented in this material that relate to any such proceedings have not been reviewed by, discussed with, and may not reflect information known to, professionals in other business areas of Gluskin Sheff in connection with the legal proceedings or matters relevant to such proceedings.

Any information relating to the tax status of financial instruments discussed herein is not intended to provide tax advice or to be used by anyone to provide tax advice. Investors are urged to seek tax advice based on their particular circumstances from an independent tax professional.

The information herein (other than disclosure information relating to Gluskin Sheff and its affiliates) was obtained from various sources and Gluskin Sheff does not guarantee its accuracy. This report may contain links to third-party websites. Gluskin Sheff is not responsible for the content of any third-party website or any linked content contained in a third-party website. Content contained on such third-party websites is not part of this report and is not incorporated by reference into this report. The inclusion of a link in this report does not imply any endorsement by or any affiliation with Gluskin Sheff.

All opinions, projections and estimates constitute the judgment of the author as of the date of the report and are subject to change without notice. Prices also are subject to change without notice. Gluskin Sheff is under no obligation to update this report and readers should therefore assume that Gluskin Sheff will not update any fact, circumstance or opinion contained in this report.

Neither Gluskin Sheff nor any director, officer or employee of Gluskin Sheff accepts any liability whatsoever for any direct, indirect or consequential damages or losses arising from any use of this report or its contents.