

Gluskin Sheff + Associates Inc.

INVESTMENT OUTLOOK, THEMES, AND STRATEGIES FOR 2011
David A. Rosenberg

March 2011

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
-

BULLISH SENTIMENT ENTRENCHED FOR 2011

Cover story: USA TODAY Investment Roundtable

In 2011, it's all about stocks

5 top experts agree: New year's looking great for stocks, not so great for bonds



By Adam Shell
USA TODAY

NEW YORK — Five Wall Street heavyweights say it's time for individual investors to shun the perceived safety of bonds — and get over their fear of the U.S. stock market — so they can take advantage of what they predict will be a third straight year of solid gains for stocks in 2011.

The major theme from USA TODAY's 15th annual Investment Roundtable is that the bond market is looking riskier amid signs the economy is gaining traction. The five panelists say stocks, which get a boost from stronger growth, will post better returns than bonds in 2011. They are advising investors, many still leery two years after the financial crisis, to start shifting some investment dollars out of bonds and back into stocks.

"If you don't believe in a depression, and I don't," says BlackRock's chief equity strategist Bob Doll, "stocks will go up and bonds will go down in the next few years."

Adds David Bianco, chief U.S. equity strategist at Bank of America Merrill Lynch: "We're broadly bullish on U.S. equities. It's important for investors to get back into the asset class. Go buy mutual funds. Go buy index funds."

With the odds of a double-dip recession fading, assets perceived as safe, such as bonds, may be riskier than investors think. And "risk assets" like stocks may be better priced than they appear, says Abby Joseph Cohen, senior investment strategist for Goldman Sachs' Global Markets Institute.

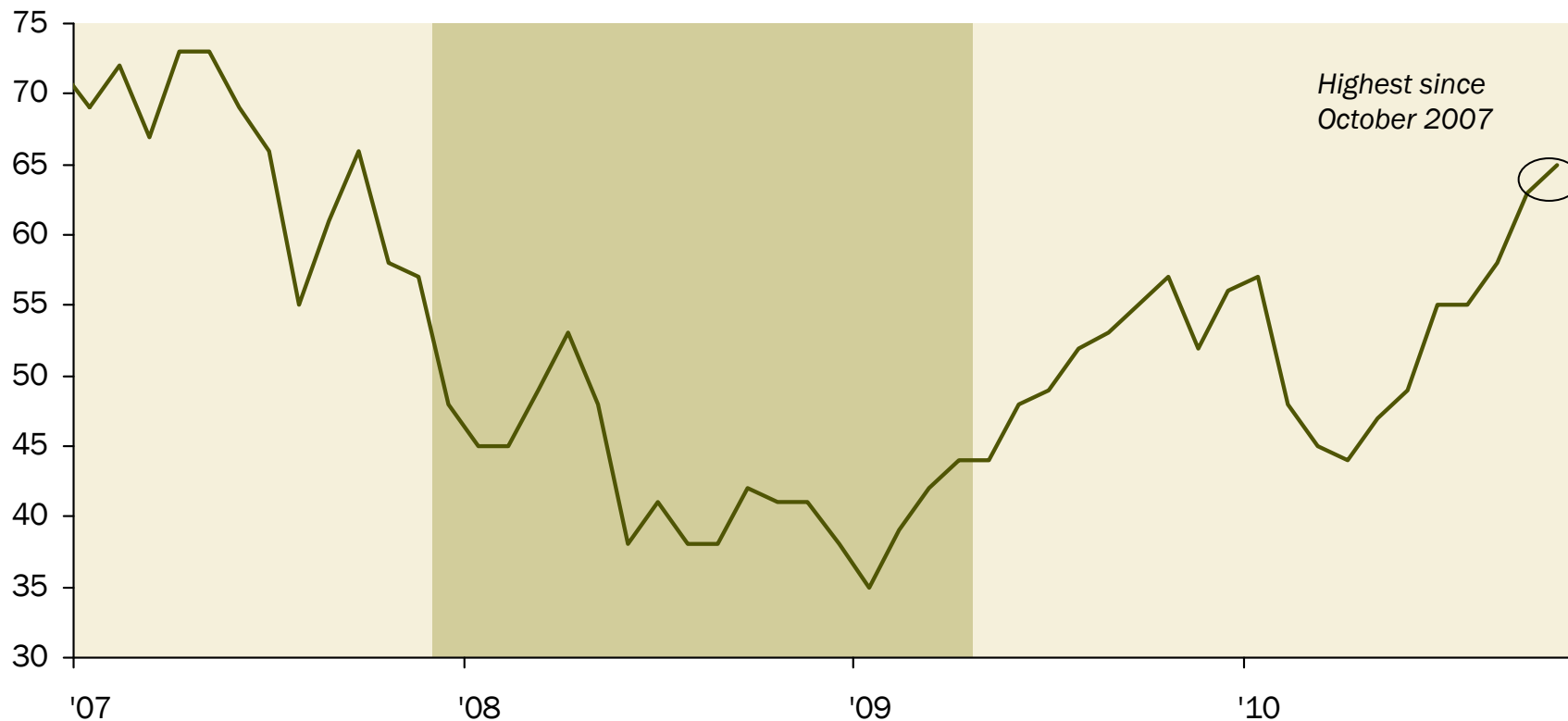
Each panelist predicted double-digit gains in 2011. Dan Chung, CEO and chief investment officer at Alger Funds, was the most optimistic, saying stocks could rise more than 20% sometime in 2011. Earnings will surprise to the upside, he says.

Richard Bernstein, CEO and chief investment officer of Richard Bernstein Advisors, says 11% stocks best of house the

YOU'RE SO VANE

Market Vane Bullish Consensus Stock Index

(percent bullish)



Notes:

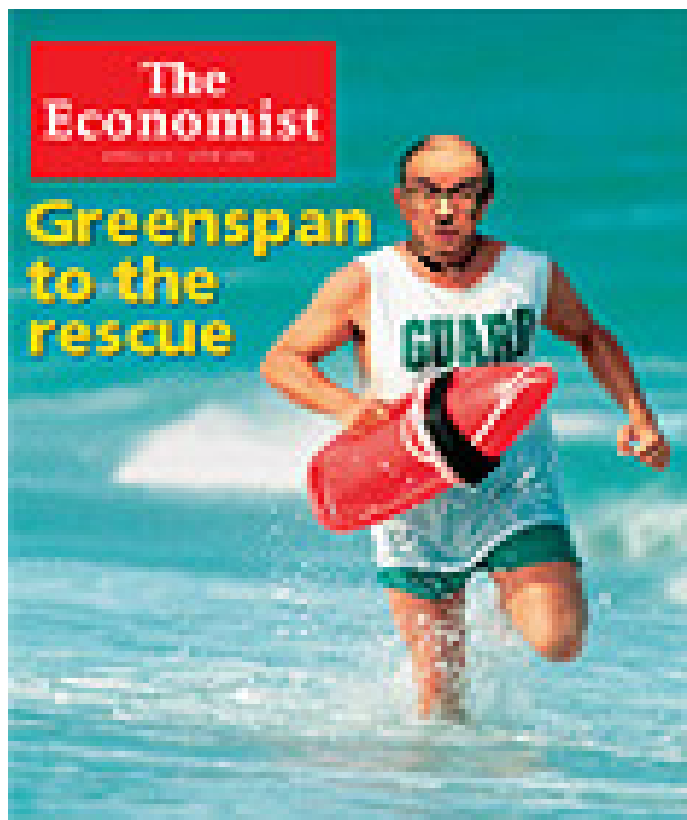
Shaded regions represent periods of U.S. recession

Source: Barrons

THE SUPPORTING CASTS

Greenspan to the Rescue

(Who knew he would have to cut interest rates another 400bps?)

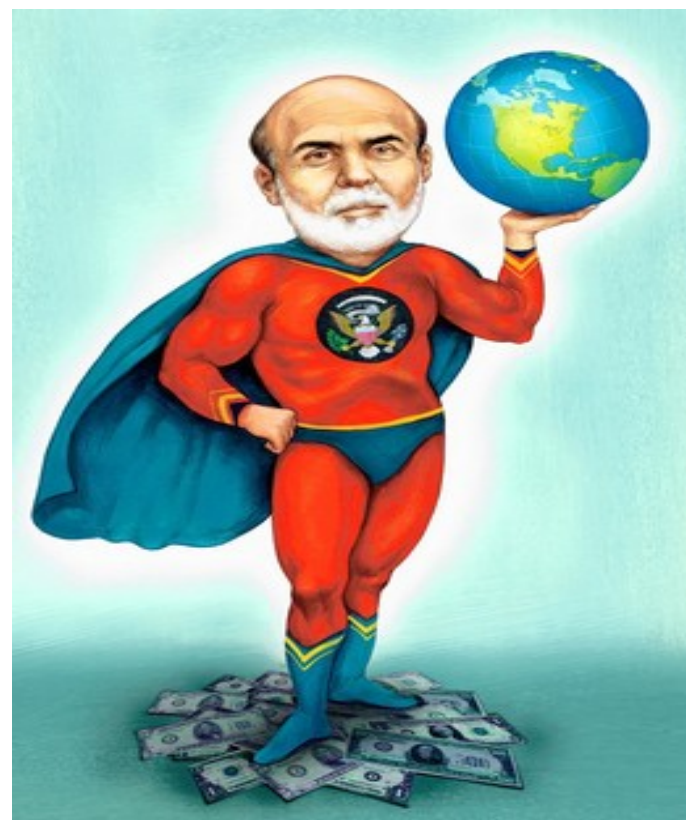


Note:

Source: *The Economist* (April 21, 2001), *The Wall Street Journal* (*The Journal Report*, January 3, 2011)

From the Wall Street Journal's Year-End Review

(Markets continued to benefit from interventions in 2010; The question is, can the Fed and others exit neatly?)



ARE MONEY PRINTING & FISCAL DEFICITS REALLY THE ROAD TO WEALTH CREATION?

United States

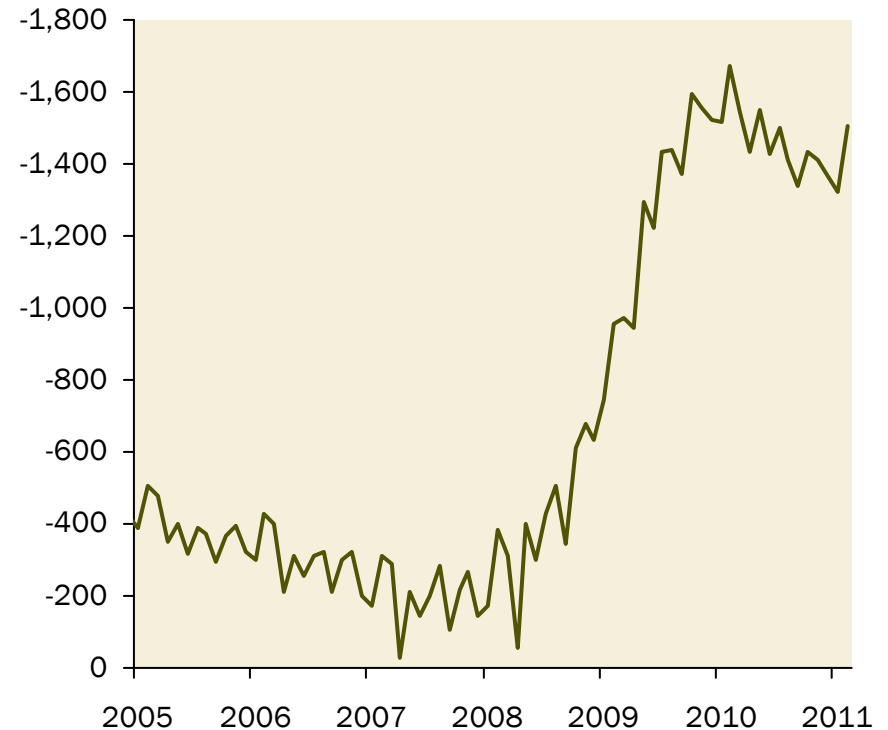
Federal Reserve Credit Outstanding

(US\$ billions)



Budget Deficit

(inverted scale, US\$ billions, 12-month moving total)



Note:

Source: Federal Reserve Board, Department of Treasury

SHARE OF PERSONAL INCOME COMING FROM UNCLE SAM HITS A NEW HIGH

United States

Government Transfers as a Share of Personal Income

(percent)

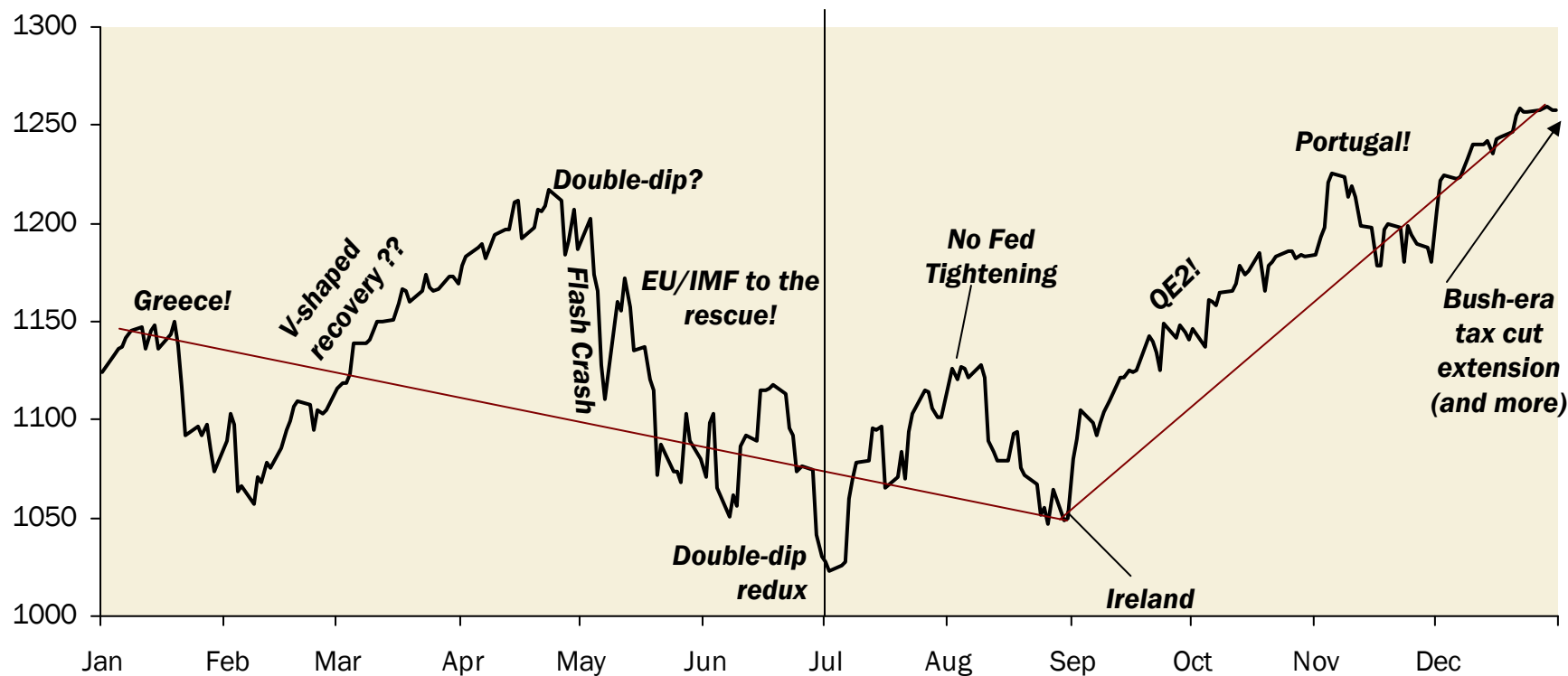


Note:

Source: Bureau of Economic Analysis

S&P 500 – 2010 IN REVIEW: QE2 SAVED THE YEAR

United States: S&P 500 Composite Index



Note:

Source: Haver Analytics

2010 IS A MICROCOSM OF THIS INTENSE ROLLER COASTER RIDE

United States: S&P 500 Composite Index

(2010, percent change)



Jan. 18 to Feb. 8 Feb. 8 to April 23 April 23 to May 7 May 7 to May 12 May 12 to May 26 May 26 to May 27 May 27 to June 1 June 1 to June 3 June 3 to June 7 June 7 to June 18 June 18 to July 2 July 2 to Aug. 9 Aug. 9 to Aug. 30 Aug. 30 to Nov. 5 Nov. 5 to Nov. 16 Nov. 16 to Dec. 31

Note:

Source: Haver Analytics

EVENT RISK – 2011 VERSUS 2010

2010

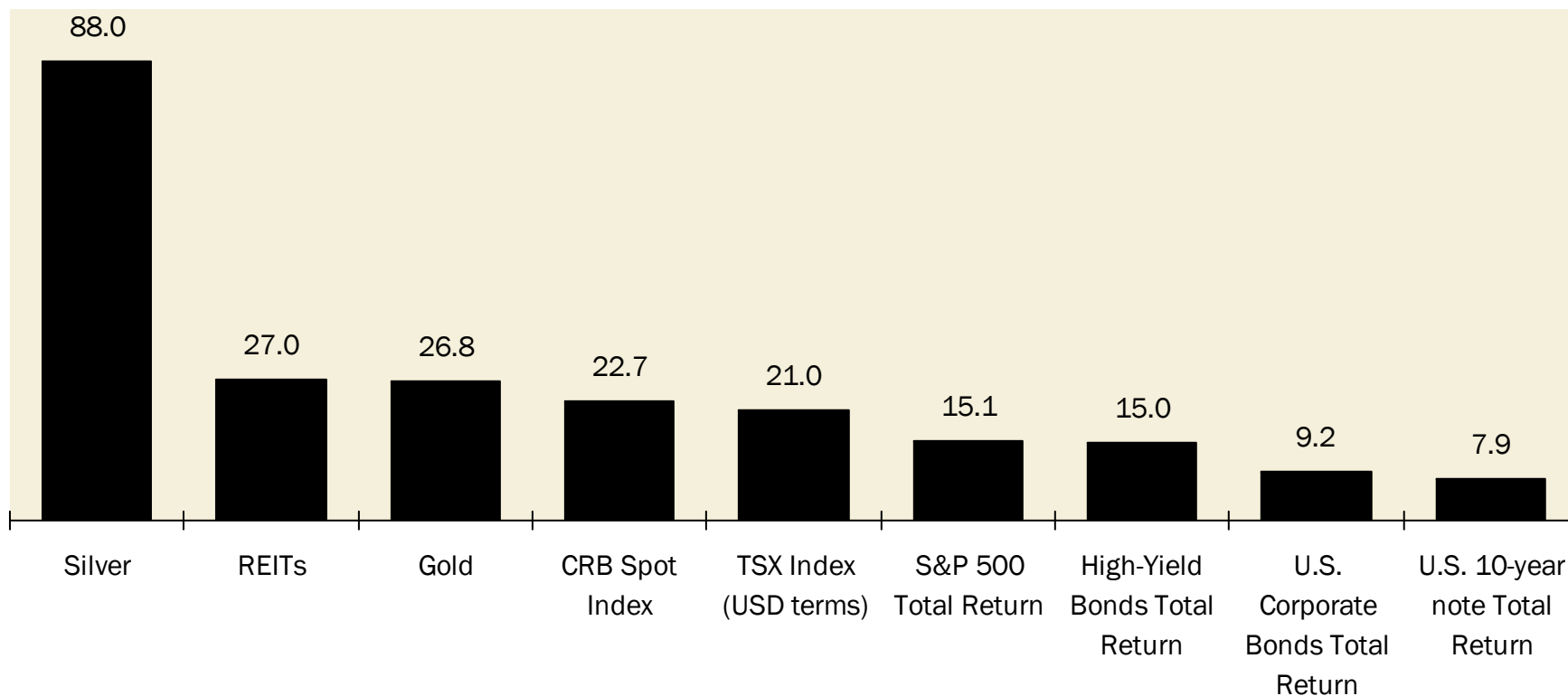
1. Europe
2. End of QE1?
3. Midterm elections
4. Bush tax cuts

2011

1. Middle East/North Africa
2. Japan
3. Europe
4. Food and fuel inflation
5. Policy tightening in EM (and ECB policy mistake?)
6. End to QE2?
7. U.S. debt ceiling
8. State governments vs. public sector unions
9. Federal/Ontario elections
10. Payroll tax cuts/bonus depreciation allowance (end on Dec 31)

VARIOUS ASSET CLASS PERFORMANCE FOR 2010

(percent change)



Note:

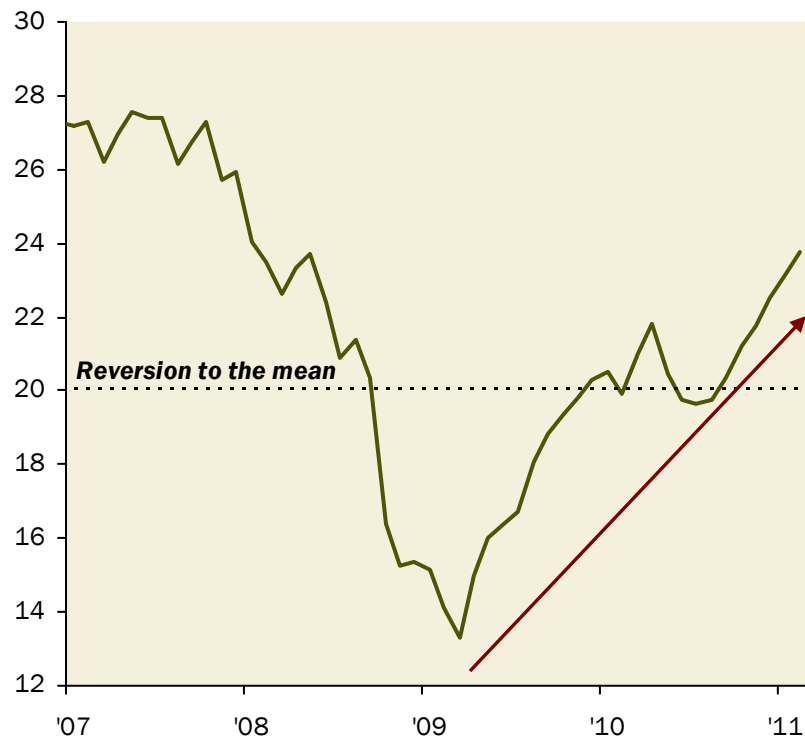
Source: Haver Analytics, Bloomberg

SEARCHING FOR WHAT IS SCARCE: VALUE & YIELD

United States

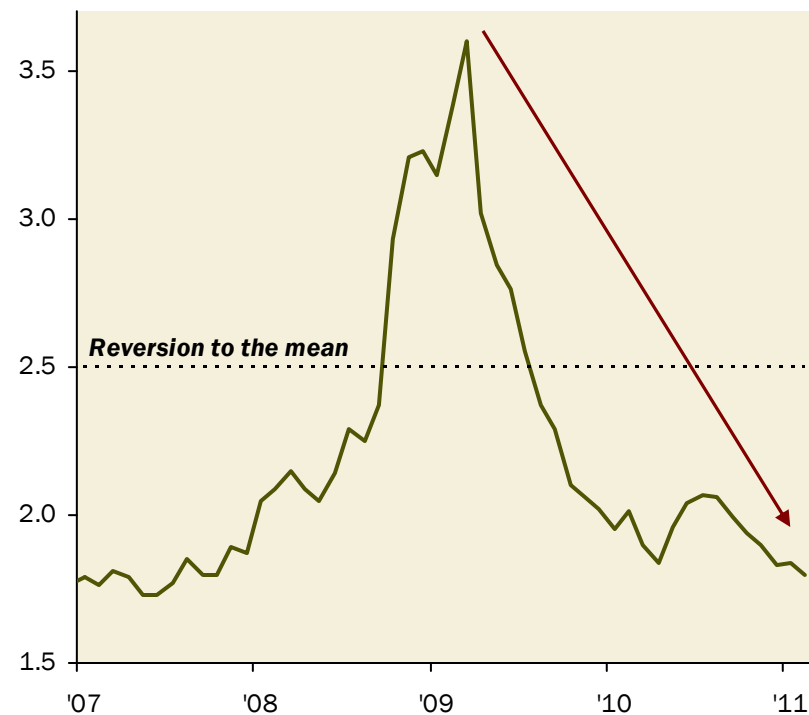
Shiller Cyclically Adjusted S&P P/E Ratio

(ratio)



S&P 500 Dividend Yield

(percent)



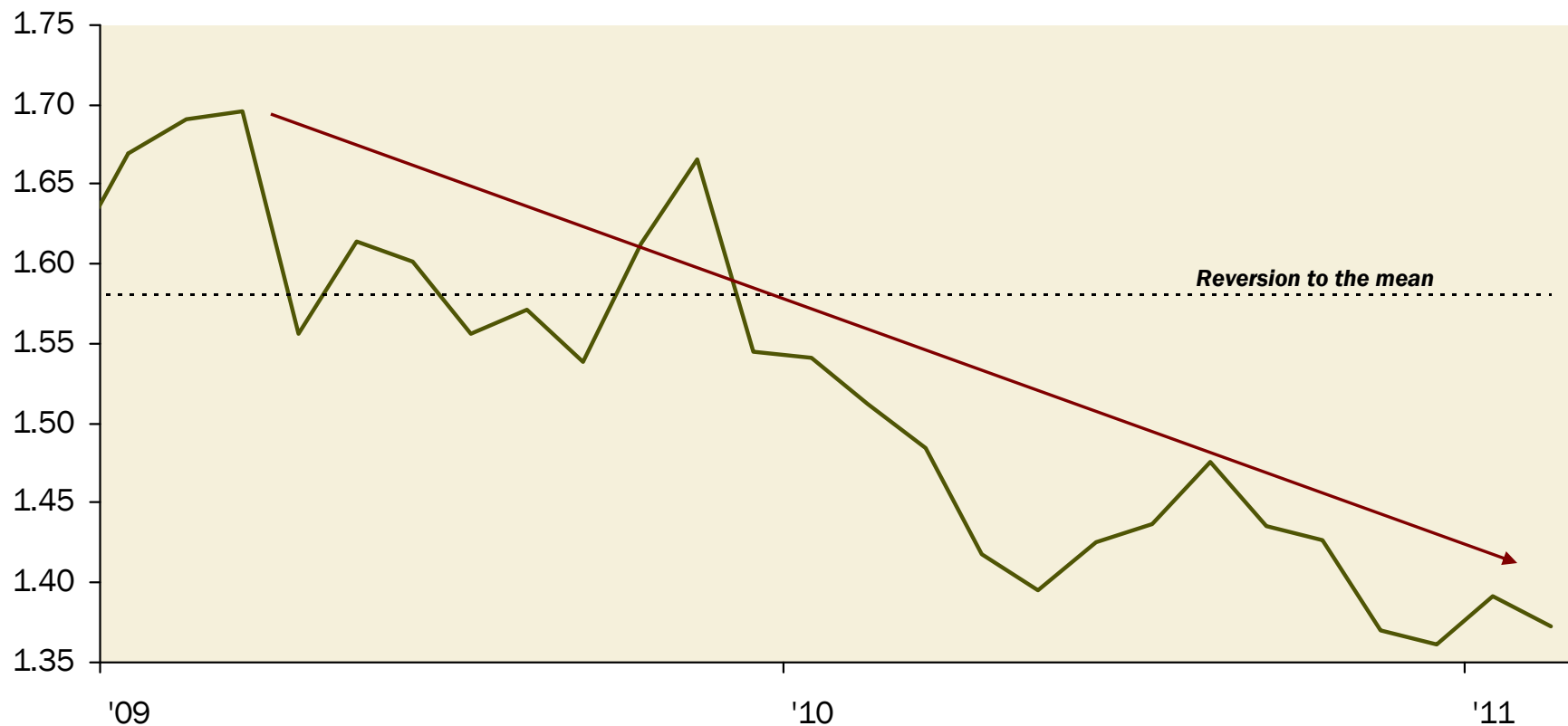
Note:

Source: Robert Shiller, Standard and Poor's

FOR 2011, BIGGER IS BETTER

Ratio of S&P Large-cap to Small-cap Equities

(ratio)



Note:

Source: Wall Street Journal

FOR 2011, THE LESS CYCLICAL-ECONOMIC SENSITIVE THE BETTER

Ratio of S&P 500 Defensive and Cyclical Stocks, January 1, 2010 = 100*

(ratio)



Source: Standard & Poor's

THE FOCUS THIS YEAR WILL BE ON HIGH QUALITY STOCKS

Ratio of S&P 500 Low Quality (B and below) Over High Quality (A- or above) Ranking Index

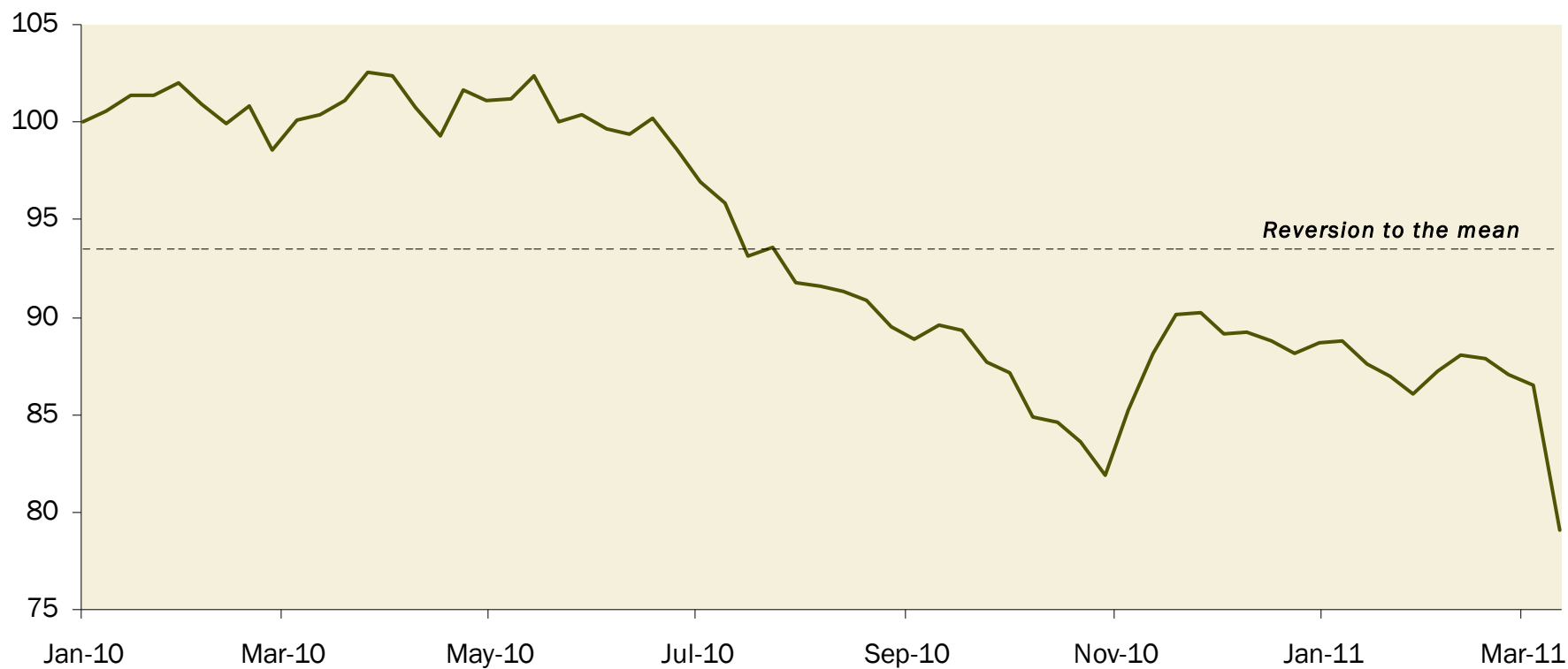


Note:

Source: Bloomberg, S&P 500

IF JAPANESE STOCKS MEAN REVERT, THE NIKKEI WOULD SOAR NEARLY 20%

Ratio of Nikkei to Global Stocks (Jan 1/2010=100)



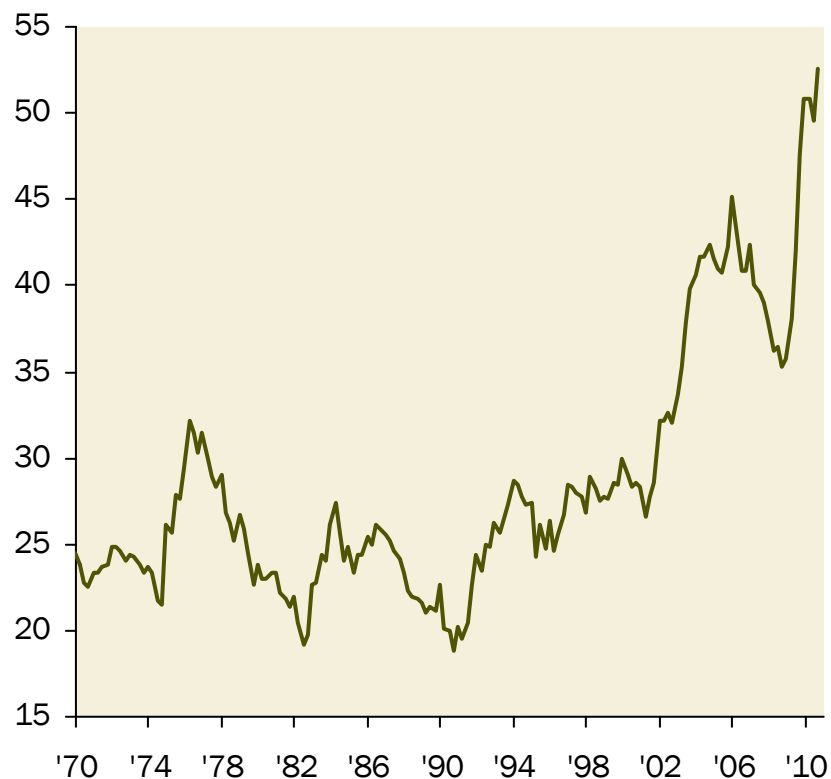
Note:

Source: Wall Street Journal/ Financial Times/Haver Analytics

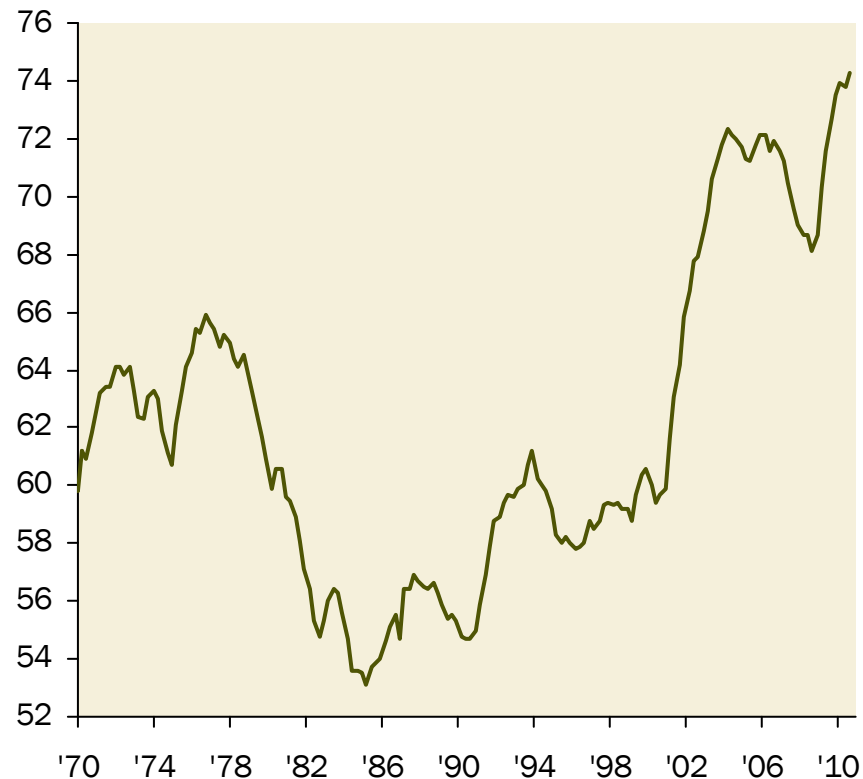
CORPORATE SECTOR FINANCES IN GOOD SHAPE

United States: Nonfarm Nonfinancial Corporate Business (percent)

Liquid Assets to Short-term Debt Ratio



Long-term Debt to Credit Market Debt Ratio



Note:

Source: Federal Reserve Board

HELICOPTER BEN BERNANKE



BERNANKE'S THOUGHTS ON GOLD AND MONEY

“Like gold, U.S. dollars have value only to the extent that they are strictly limited in supply. But the U.S. government has a technology, called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes at essentially no cost. By increasing the number of U.S. dollars in circulation, or even by credibly threatening to do so, the U.S. government can also reduce the value of a dollar in terms of goods and services, which is equivalent to raising the prices in dollars of those goods and services. We conclude that, under a paper-money system, a determined government can always generate higher spending and hence positive inflation.”

Deflation: Making Sure “It” Doesn't Happen Here, speech to the National Economists Club, Washington, D.C., November 21, 2002

MONEY HAS TO BE PRINTED



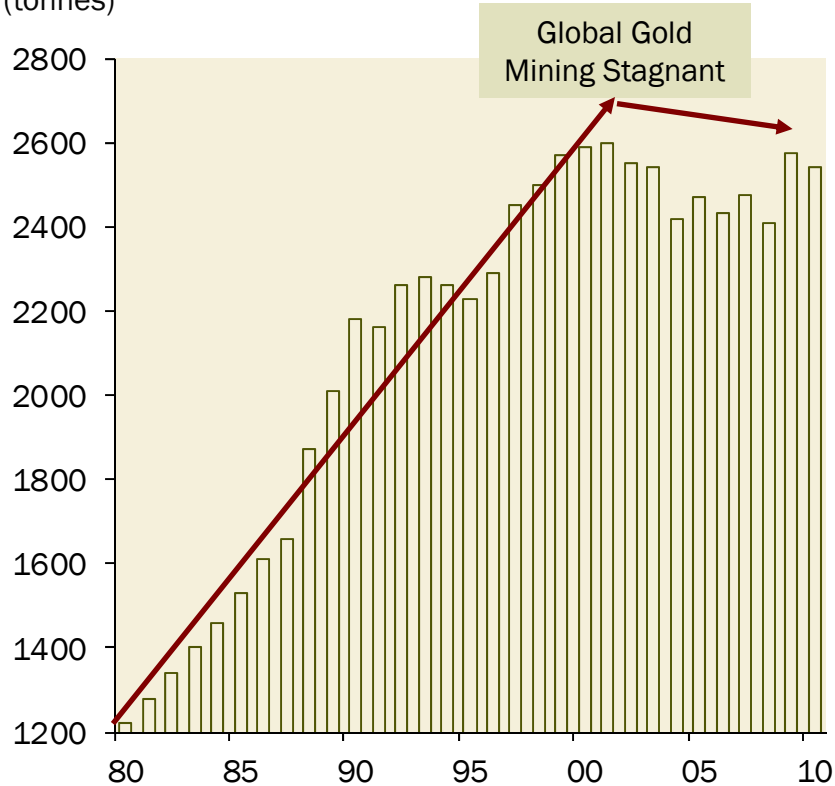
GOLD HAS TO BE MINED



TWO REASONS TO BE BULLISH ON GOLD

Annual Global Gold Mining Output

(tonnes)

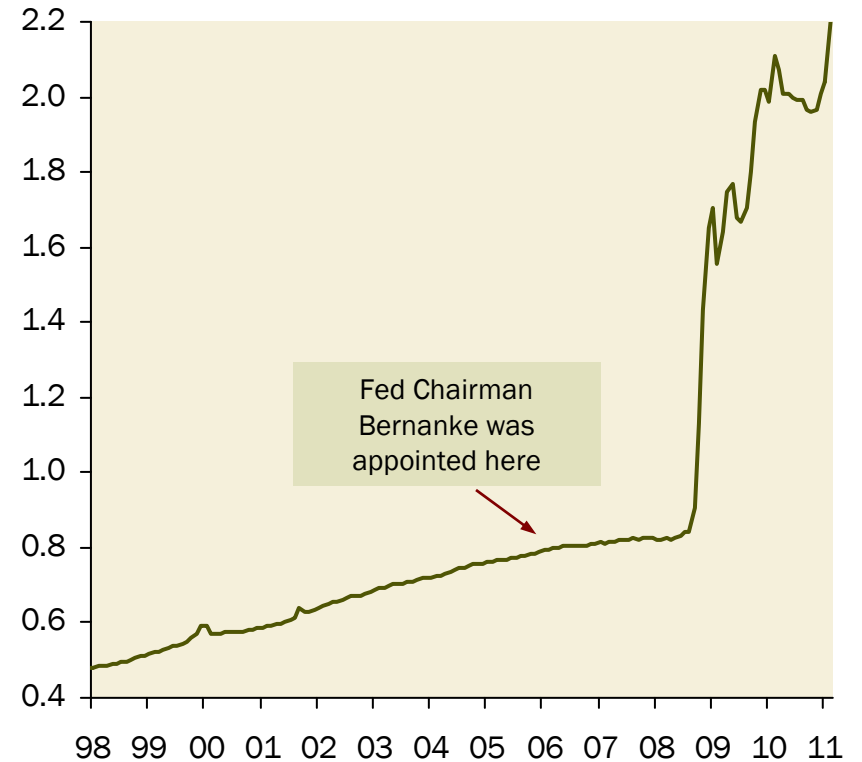


Note:

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

U.S. Adjusted Monetary Base

(US\$ trillion)



THE RATIO OF GOLD PRICE TO M2 MONEY SUPPLY: THE BULL MARKET IN BULLION HAS FURTHER TO RUN

United States (percent)



Note:
Source: Haver Analytics

CALL IT THE WILE E. COYOTE ECONOMY



THE FED STILL SEEMS CONCERNED

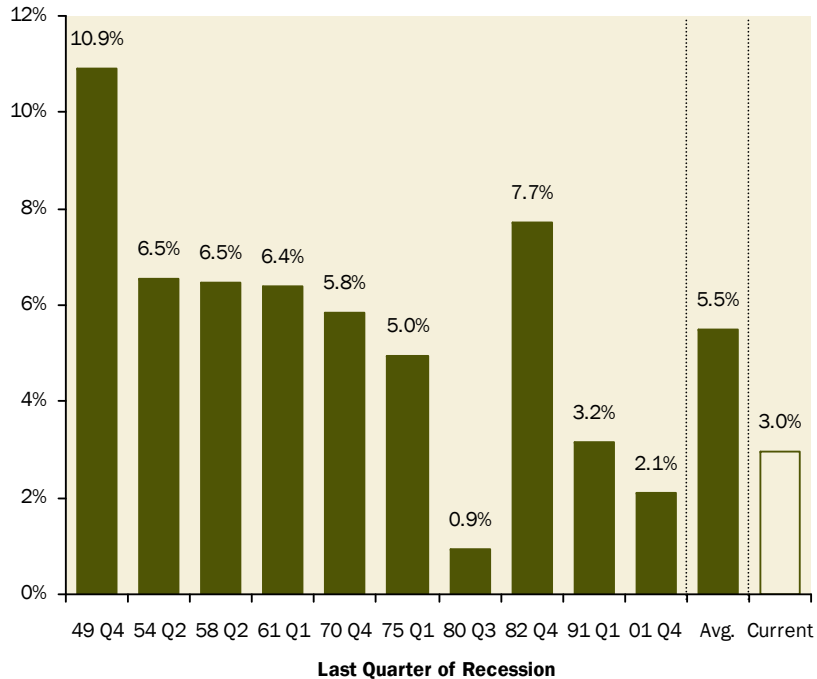
Most participants continued to anticipate that the recovery in economic activity was likely to be restrained by a variety of economic factors, including still-high unemployment, modest income growth, lower housing wealth, high rates of mortgage foreclosures, elevated inventories of unsold homes, and tight credit conditions in a number of sectors. In addition, although many business contacts expressed more optimism about the economic recovery, a number had aimed their recent investments primarily at enhancing productivity rather than expanding employment, and hiring for some businesses was reportedly focused on temporary workers.

(The Minutes from the January 25-26, 2011 Federal Open Market Committee Meeting, released on February 16, 2011)

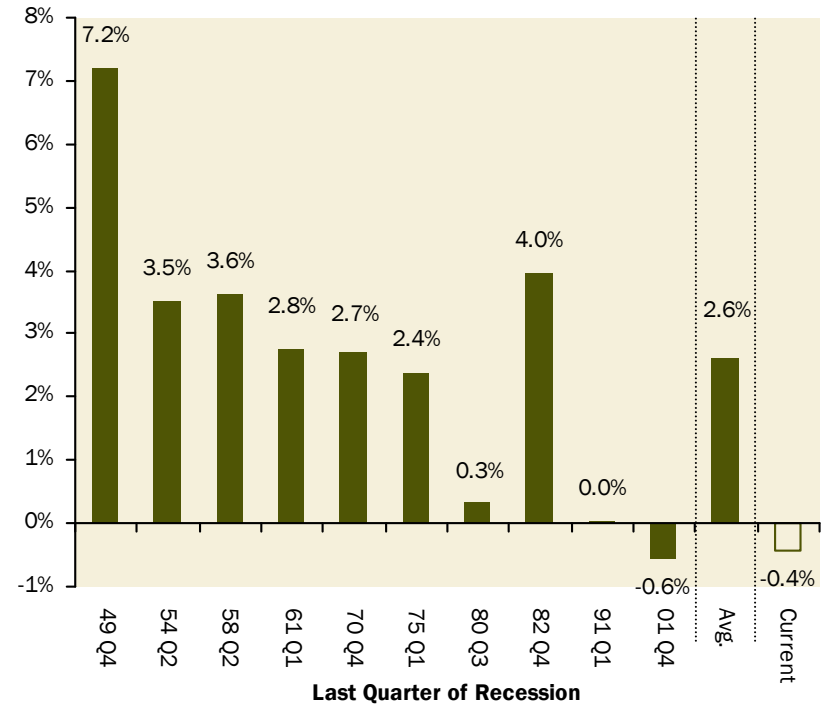
SO FAR, A SUB-PAR U.S. ECONOMIC RECOVERY

United States

Real GDP Six Quarters After A Recession Ends
(annualized percent change)



Employment Six Quarters After A Recession Ends
(annualized percent change)



Note:

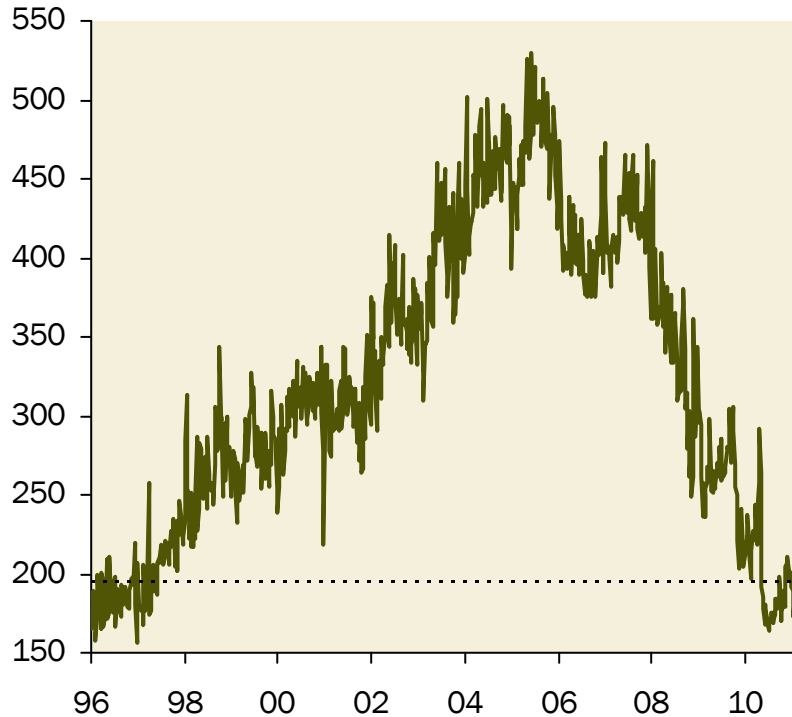
Source: Bureau of Economic Analysis, Bureau of Labour Statistics

NO REVIVAL IN HOUSING DEMAND

United States

Mortgage Loan Application for Home Purchase

(seasonally adjusted, March 16, 1990 = 100)

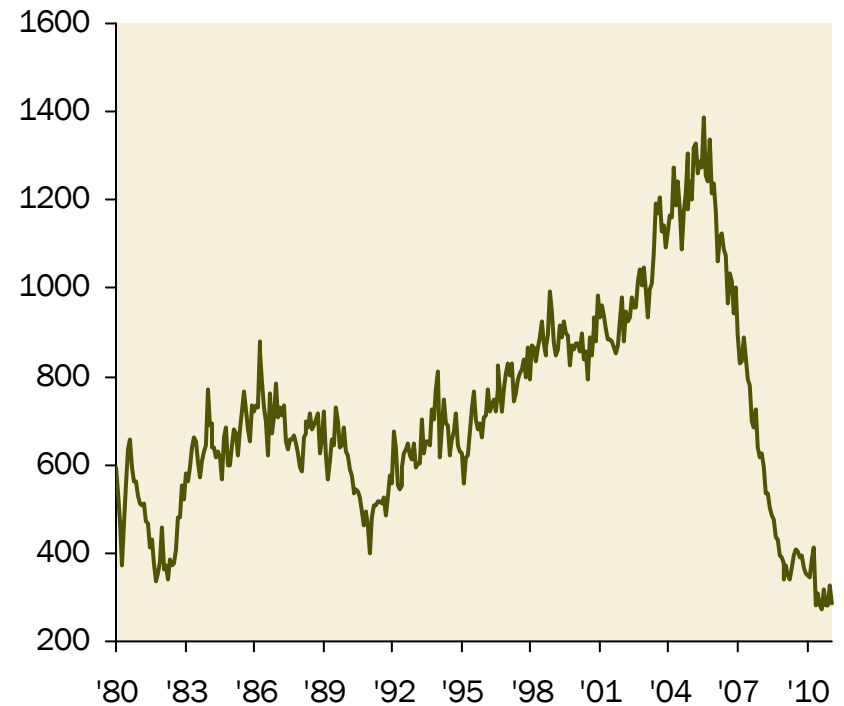


Note:

Source: Mortgage Bankers Association, Census Bureau

New Home Sales

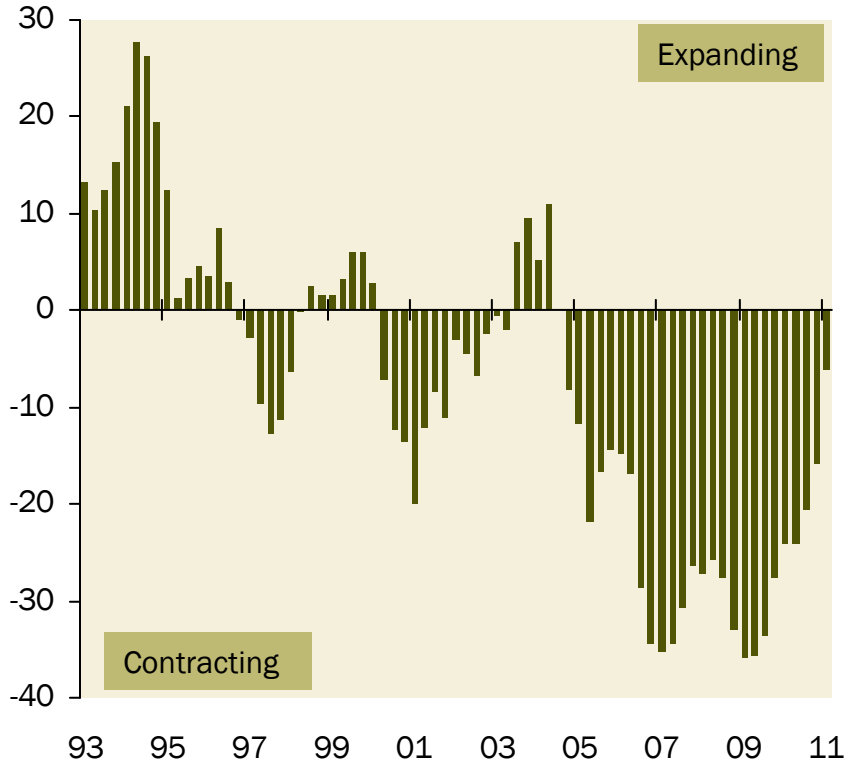
(seasonally adjusted, \$ thousands)



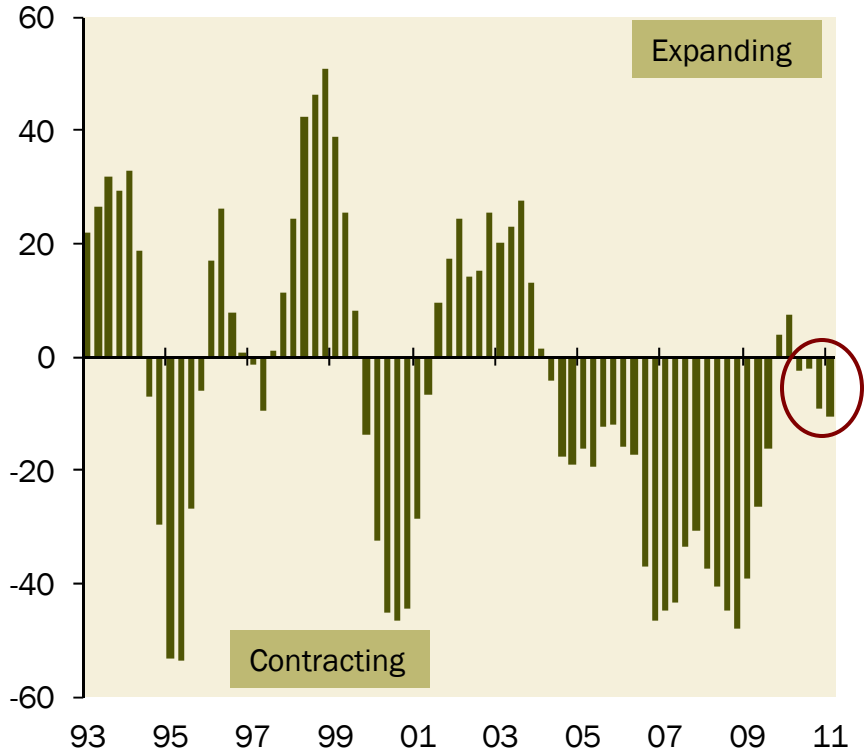
HOUSEHOLD DEMAND FOR CREDIT IS DECLINING

United States: Senior Loan Officer Survey (4-quarter moving average, percent)

Banks Reporting Stronger Demand for Consumer Loans



Banks Reporting More Demand for Residential Mortgages



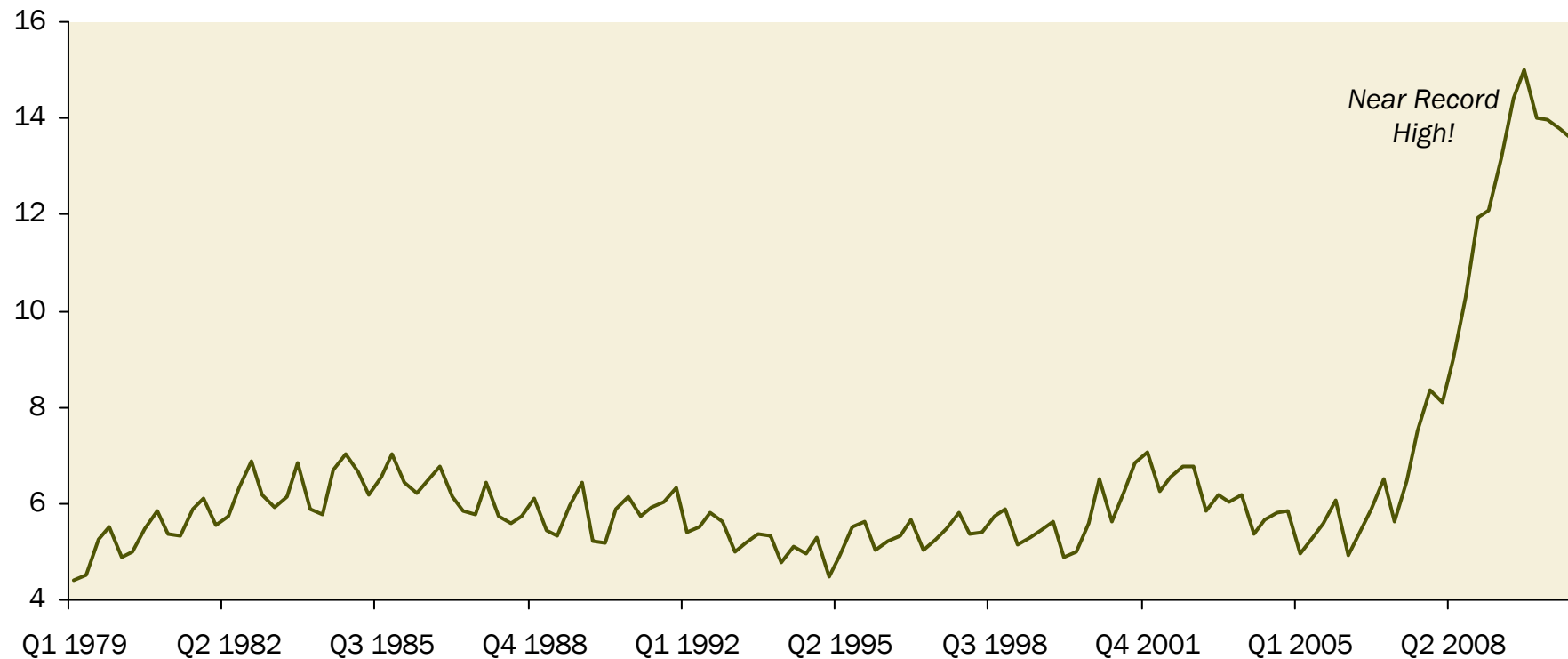
Note:
Source: Federal Reserve Board

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

United States

Mortgage Past Due and in Foreclosure

(percent)



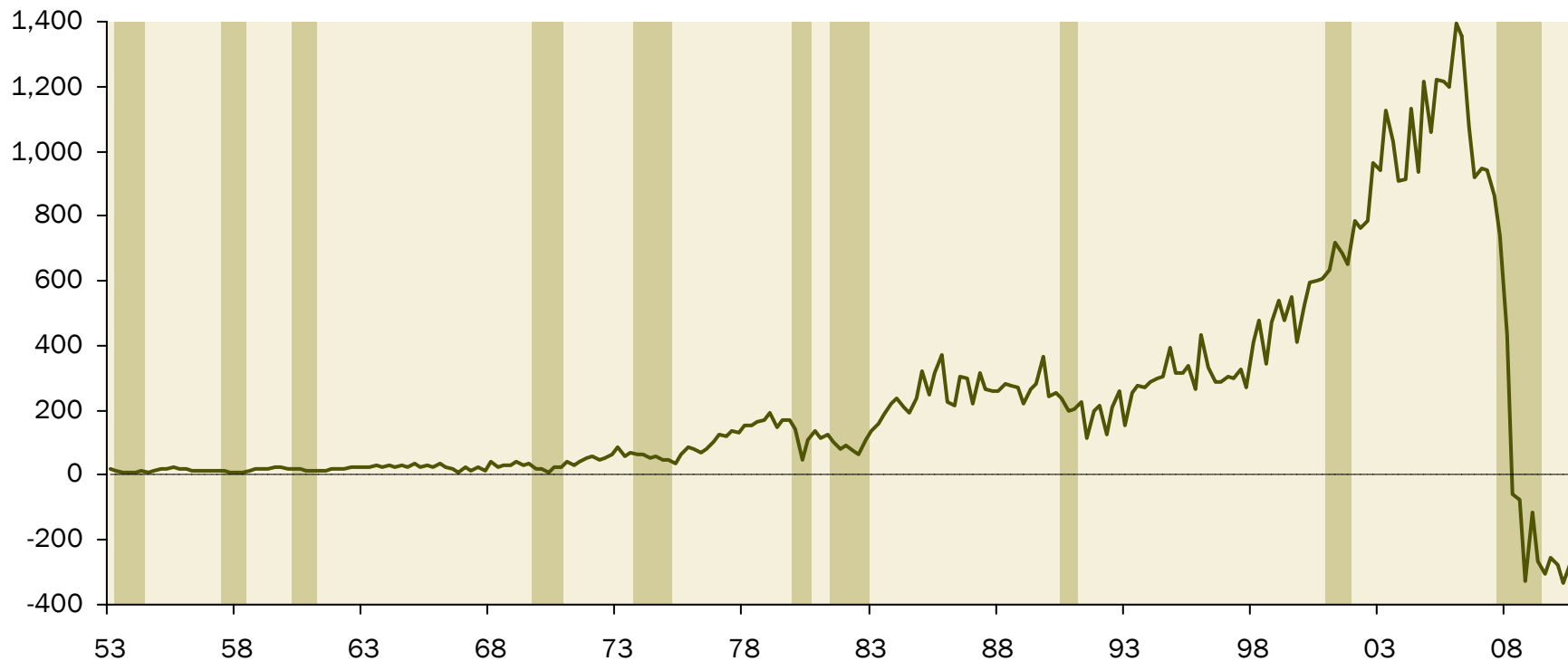
Note:

Source: Mortgage Bankers Association

UNPRECEDENTED CREDIT CONTRACTION

United States: Household Credit Market Debt

(seasonally adjusted at an annual rate, US\$ billion)



Notes:

Shaded region represent periods of U.S. recession

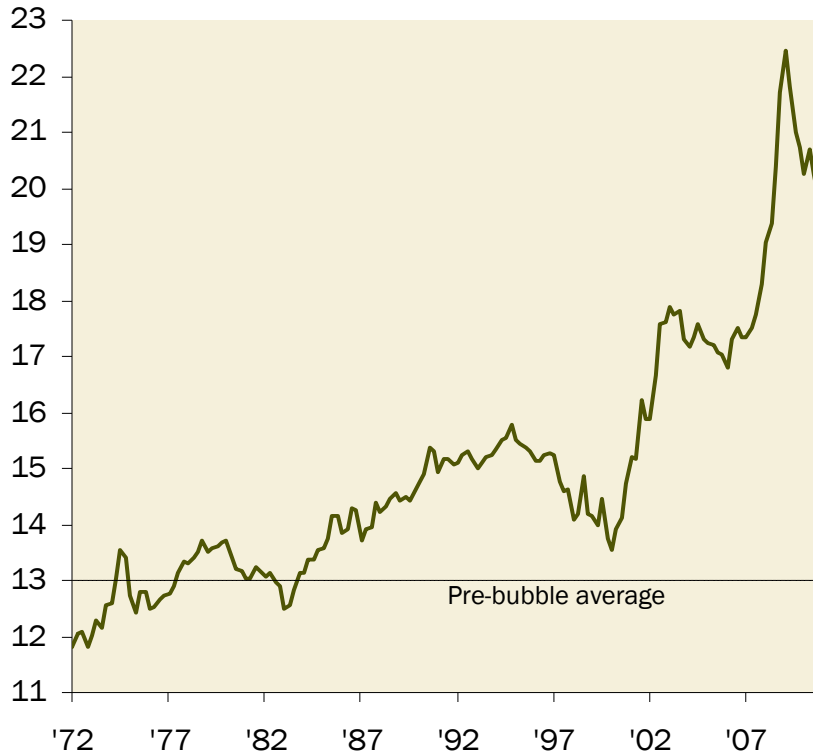
Source: Federal Reserve Board

STILL MORE TO GO BEFORE THE HOUSEHOLD BALANCE SHEET IS REPAIRED

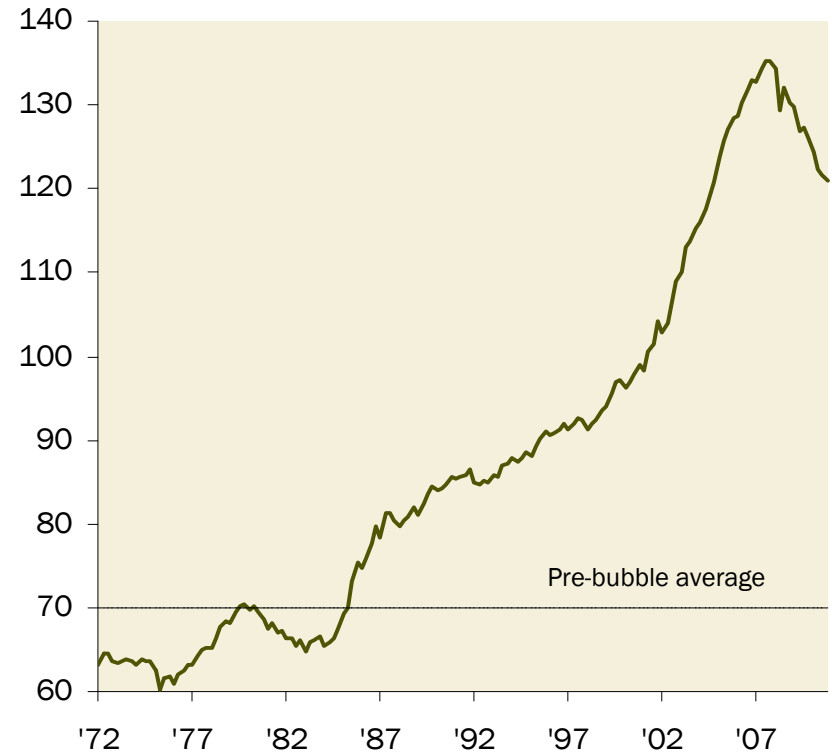
United States

(percent)

Household Debt-to-Asset Ratio



Household Debt-to-Income Ratio



Note:

Source: Federal Reserve Board

MCKINSEY ON FINANCE: PERSPECTIVE ON CORPORATE FINANCE & STRATEGY

McKinsey&Company

McKinsey on Finance

Number 35,
Spring 2010

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A new look at carbon
offsets



Findings from McKinsey & Company:

*“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.”*

WHAT, ME WORRY?

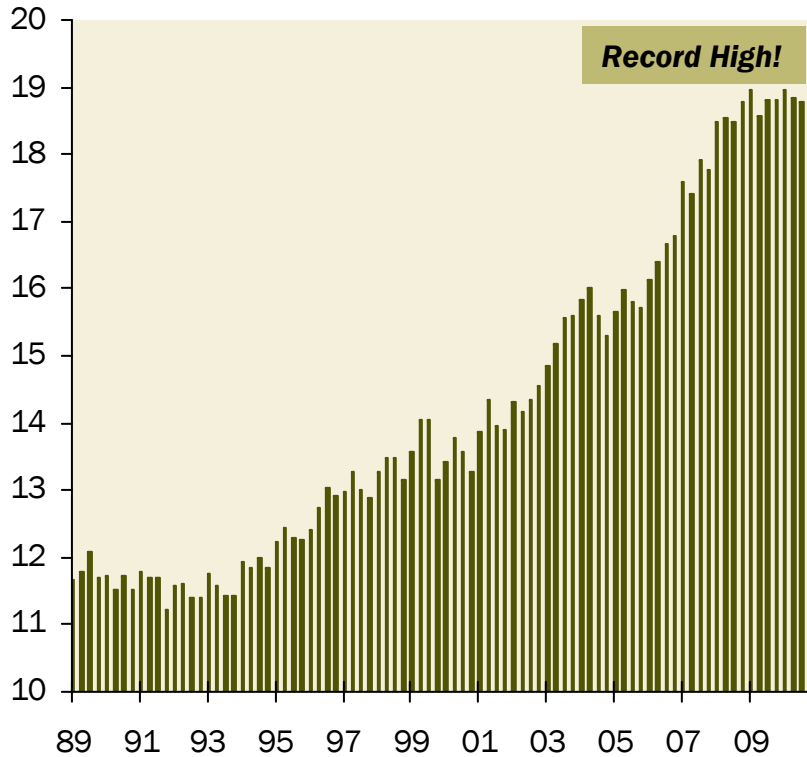


RECORD LEVEL OF VACANT RESIDENTIAL REAL ESTATE

United States

Total Vacant Housing Units

(million units)

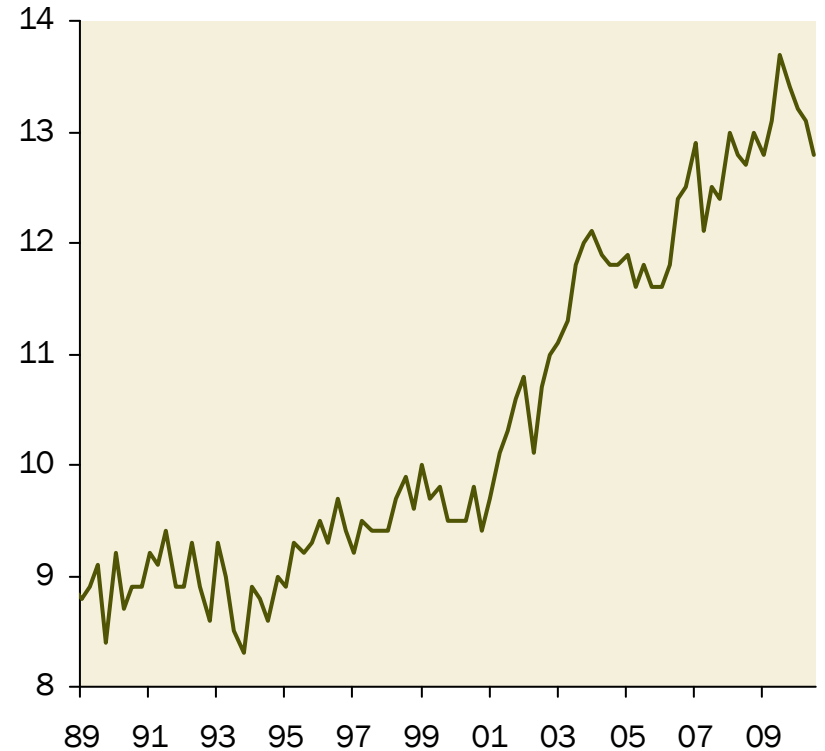


Note:

Source: Census Bureau

Total Housing Vacancy Rate

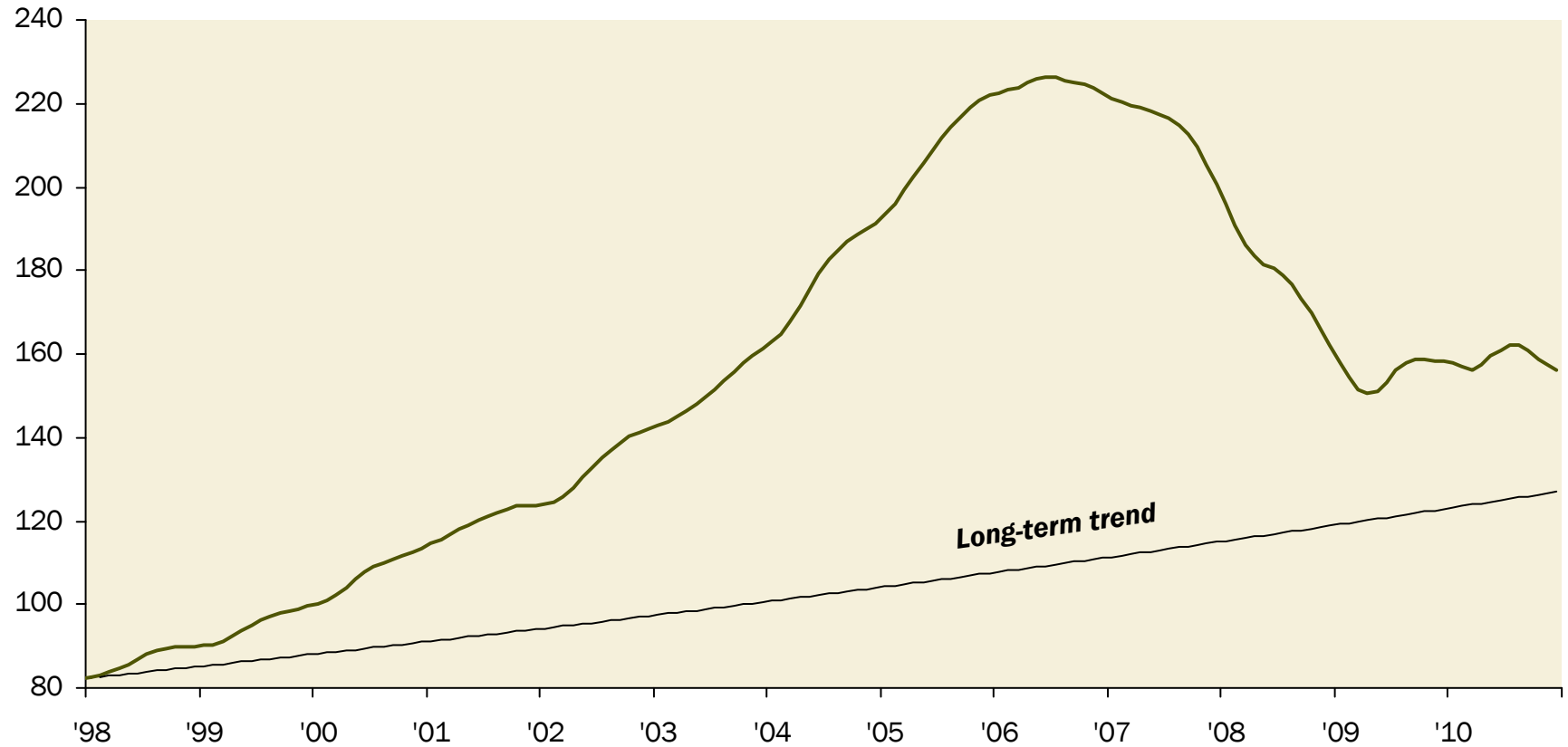
(percent)



HOUSE PRICE DEFLATION NOT OVER

United States: Case-Shiller Home Price Index Composite 10

(not seasonally adjusted, January 2000 = 100)



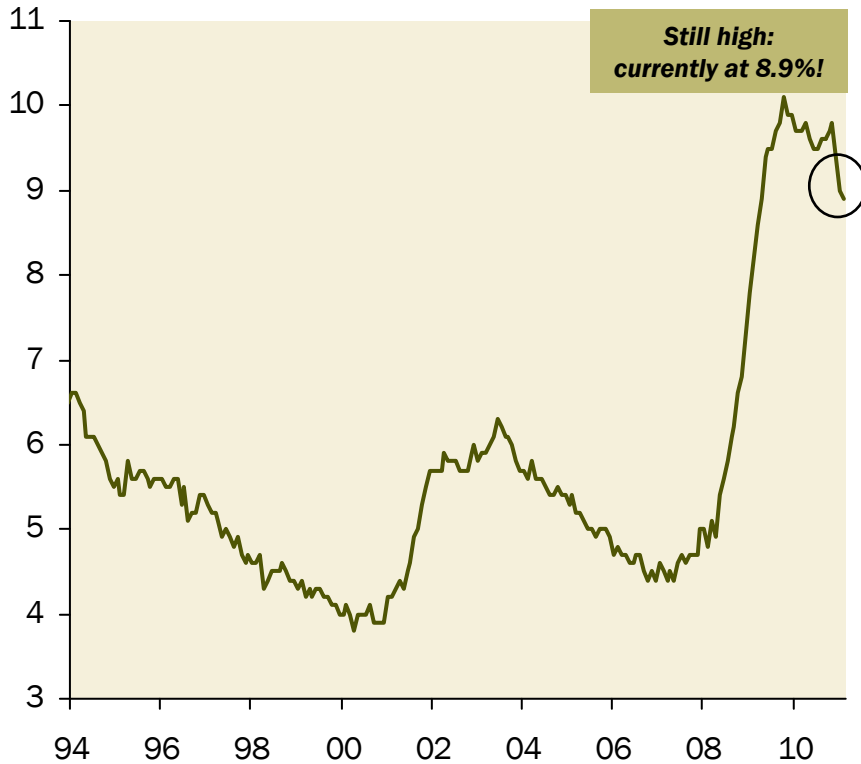
Note:

Source: Robert Shiller ("Irrational Exuberance"), Haver Analytics

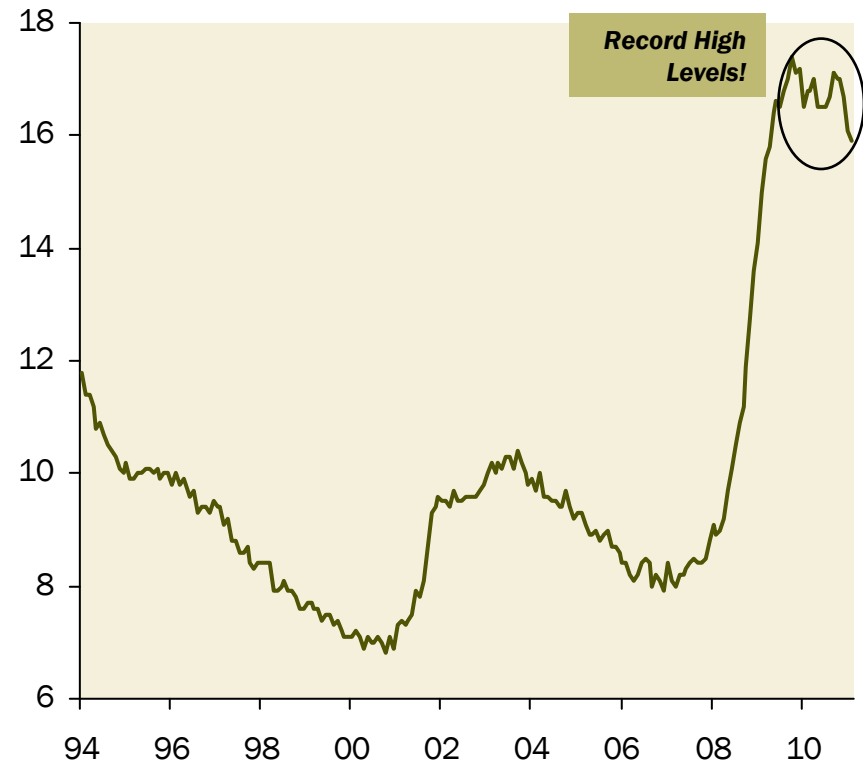
UNEMPLOYMENT STILL A MAJOR PROBLEM...

United States (percent)

Official Unemployment Rate



U6 Unemployment Rate*



Notes:

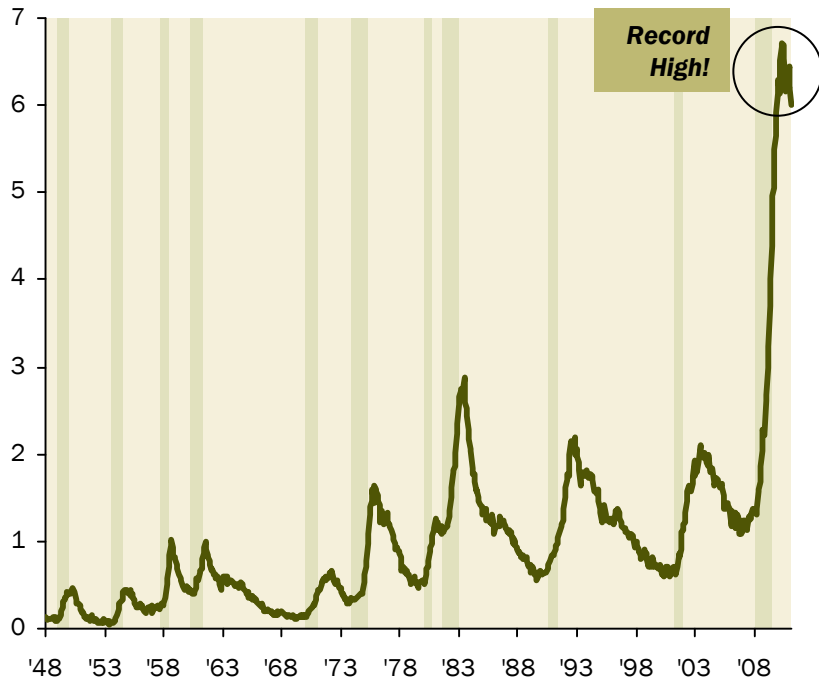
*Includes all marginally attached workers and those employed part-time for economic reasons.

Source: Bureau of Labor Statistics, Federal Reserve

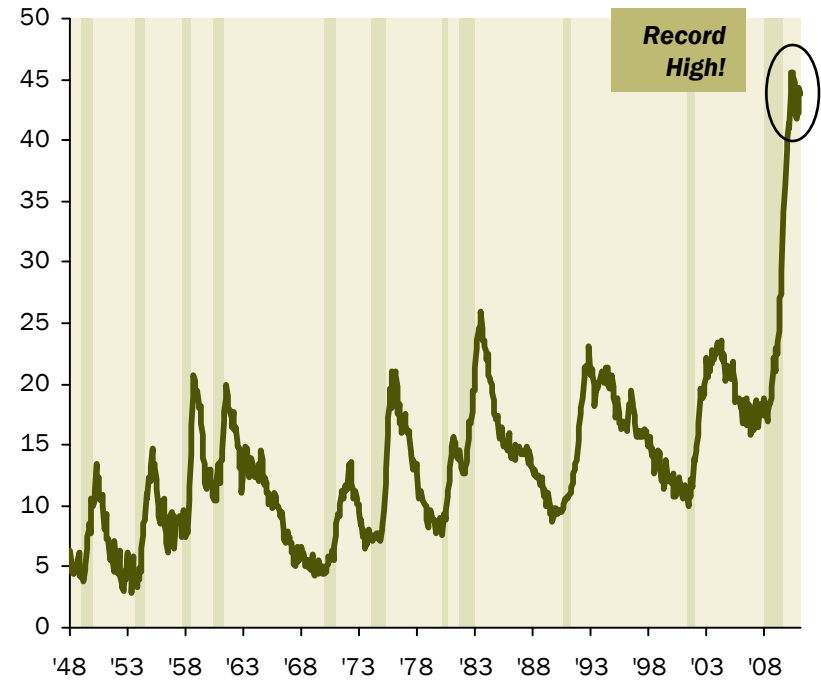
... NOT ONLY ECONOMIC, BUT SOCIAL TOO

United States: Civilians Unemployed for 27 Weeks or Over

Total
(millions)



As a percentage of total unemployed
(percent)



Notes:

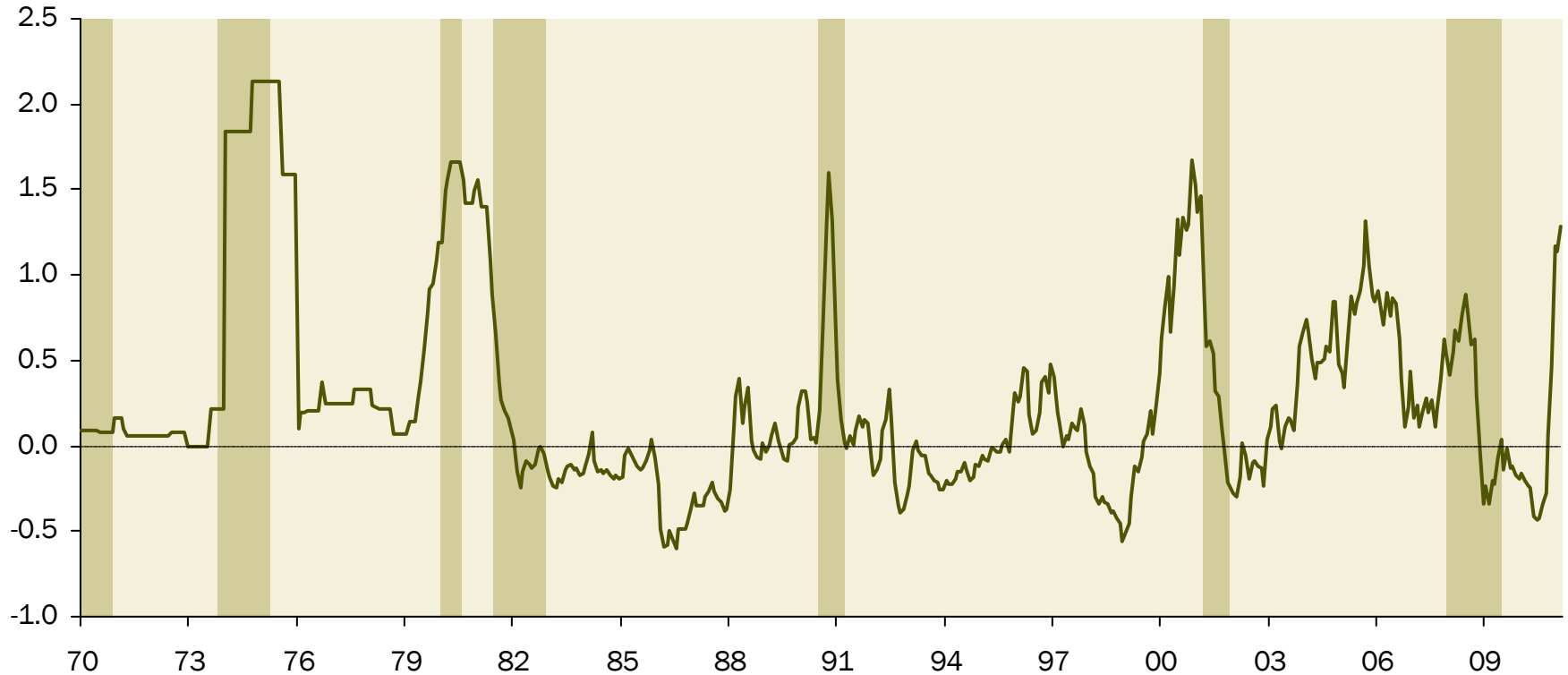
Shaded area represent periods of U.S. recession

Source: Bureau of Labor Statistics

LOOK AT THIS — THE TWO-YEAR MOVE IN OIL PRICES

Oil Price: West Texas Intermediate

(2-year percent change)



Notes:

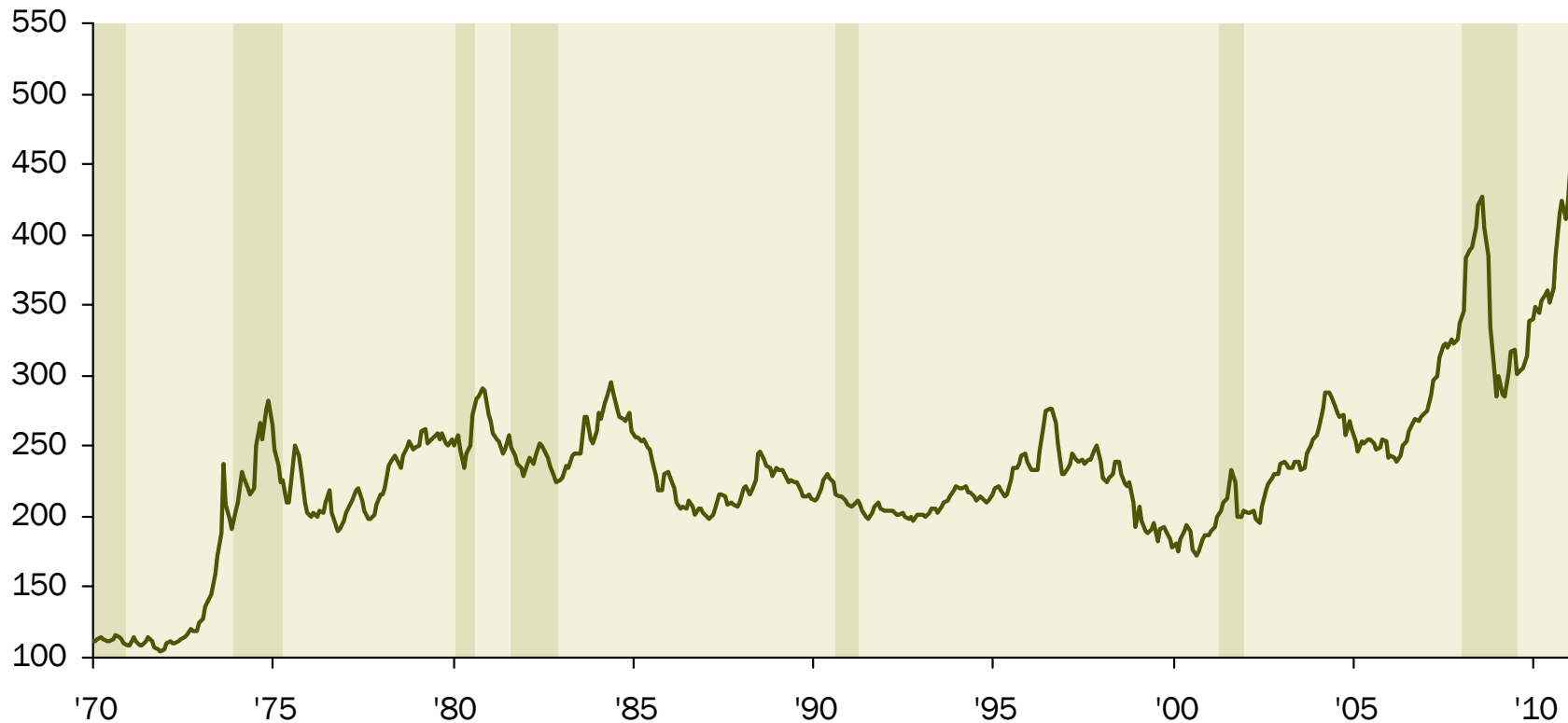
Shaded region represent periods of U.S. recession

Source: Haver Analytics

FOOD INFLATION – BIG NEWS FOR EMERGING ASIA

CRB Spot Commodity Price Index: Foodstuffs

(index, 1967=100)



Notes:

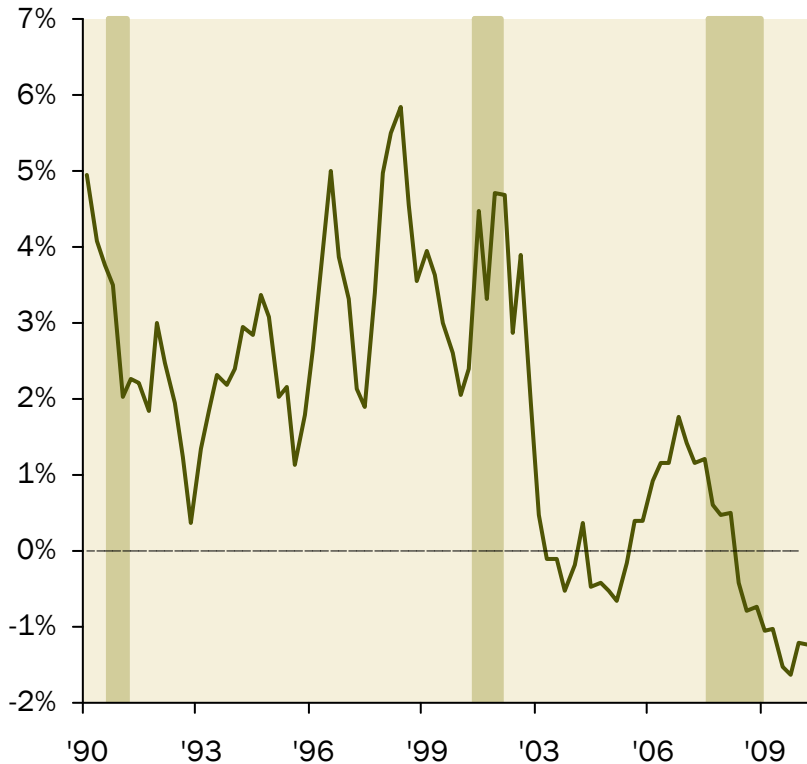
Shaded region represent periods of U.S. recession

Source: Commodity Research Bureau

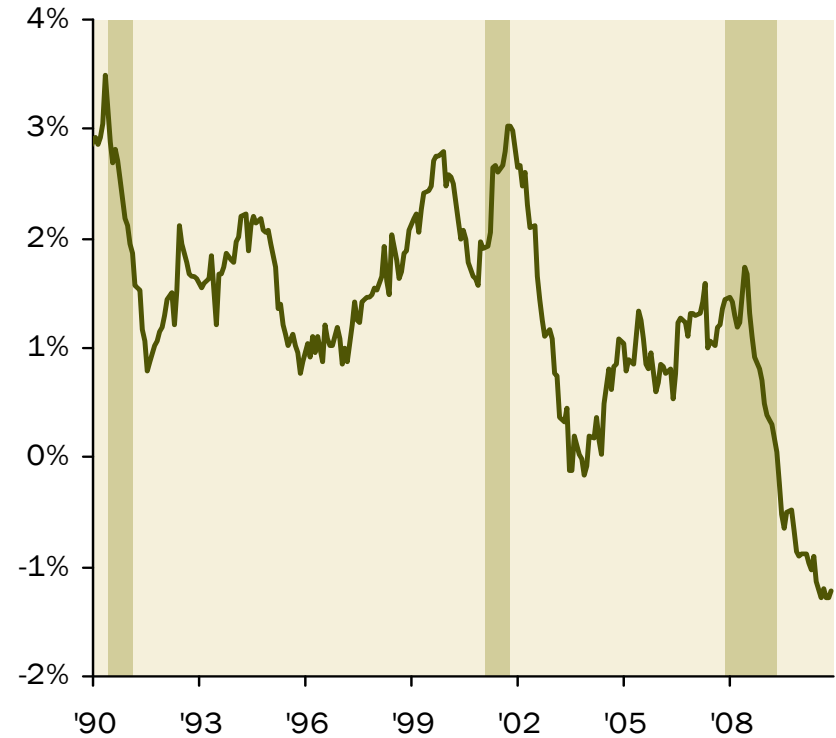
STATE & LOCAL GOVERNMENT CUTBACKS REMAIN A KEY MACRO RISK

United States (year-over-year percent change)

Real State & Local Government Gross Investment



Employment: State & Local Government



Notes:

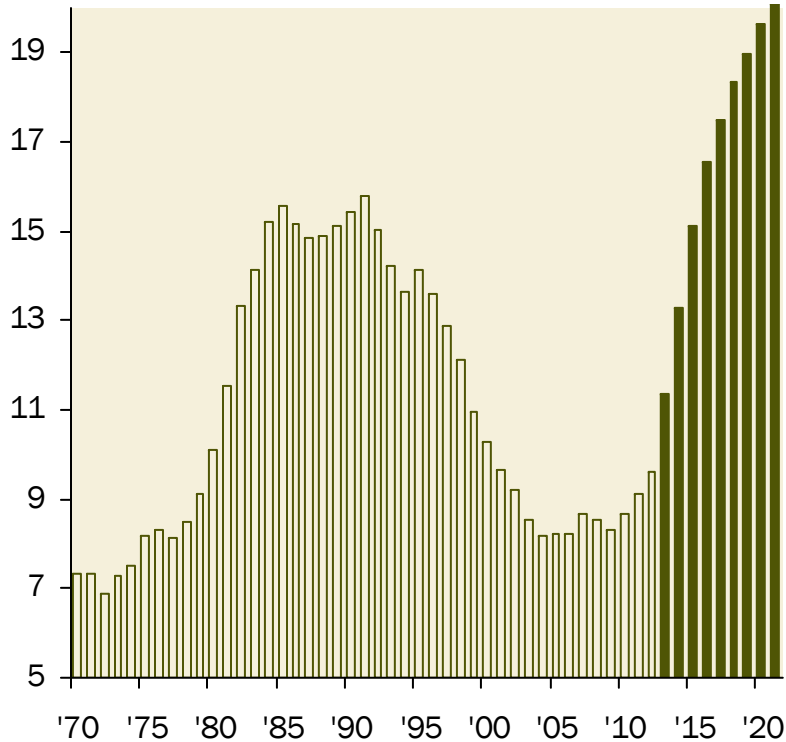
Shaded region represent periods of U.S. recession

Source: Bureau of Economic Analysis, Bureau of Labor Statistics

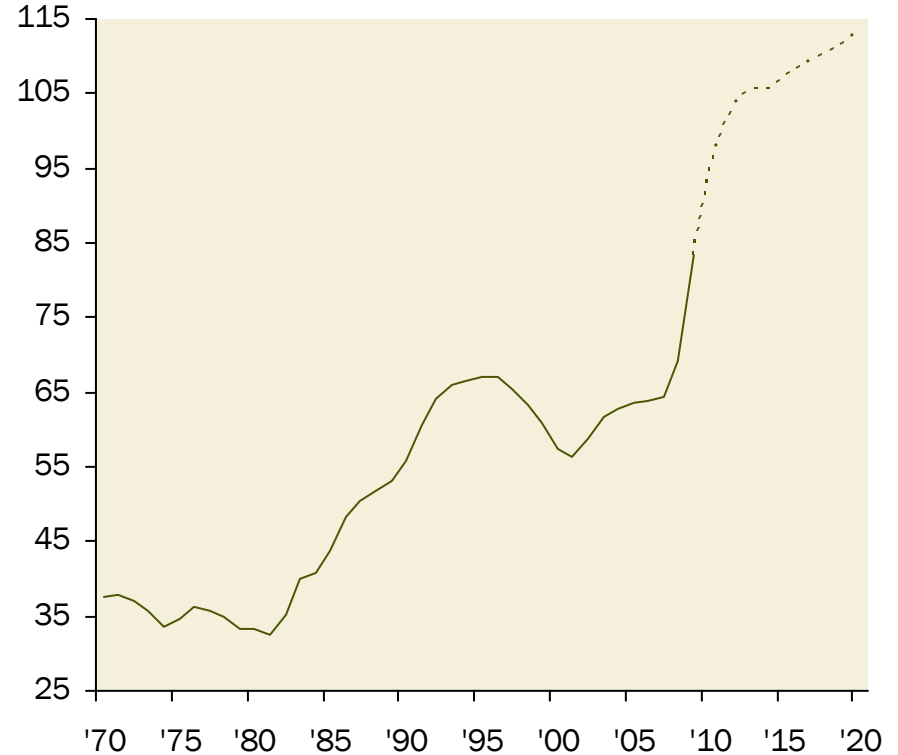
A CHALLENGING ENVIRONMENT FOR THE FEDERAL GOVERNMENT

United States: Government Finances (percent)

Interest Payments as a Share of Total Revenue



Debt as a share of GDP



Notes:

Shaded bars and dotted lines represent estimates (interest payments/total revenue estimates by Gluskin Sheff and debt/GDP estimates by the OMB)

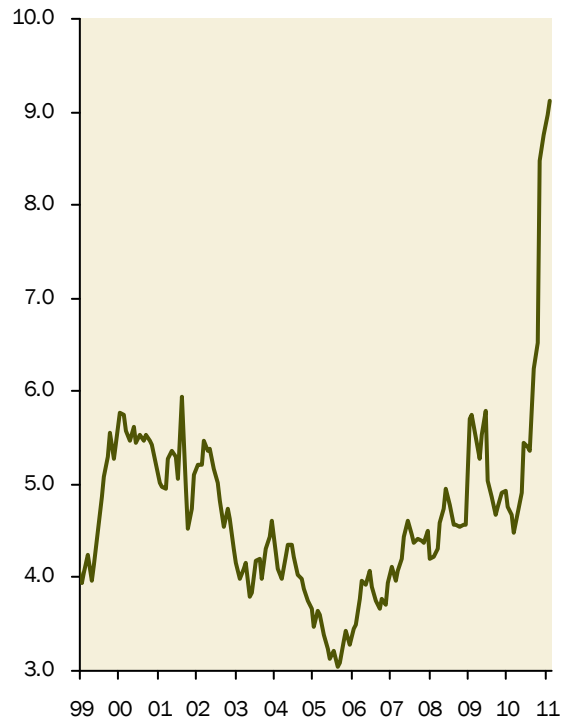
Source: OECD, U.S. Office of Management and Budget (OMB)

DEFAULT RISKS HIGH & RISING IN THE EUROPEAN PERIPHERY

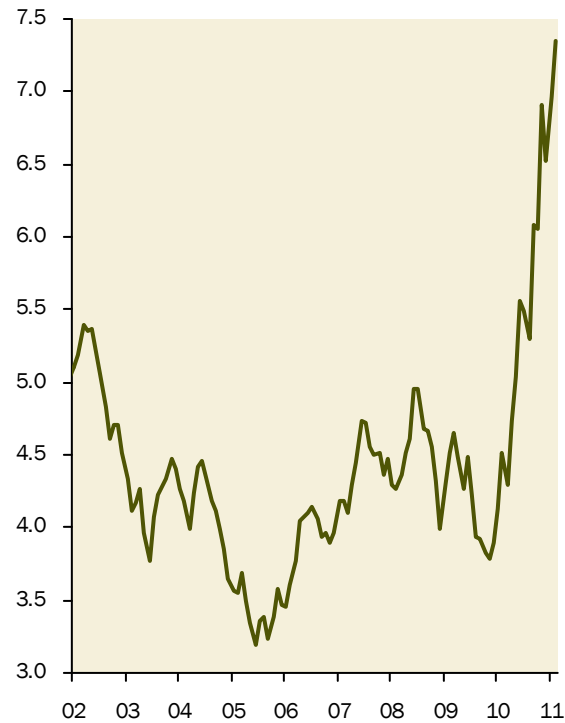
10-Year Government Note Yield

(percent)

Ireland



Portugal



Greece



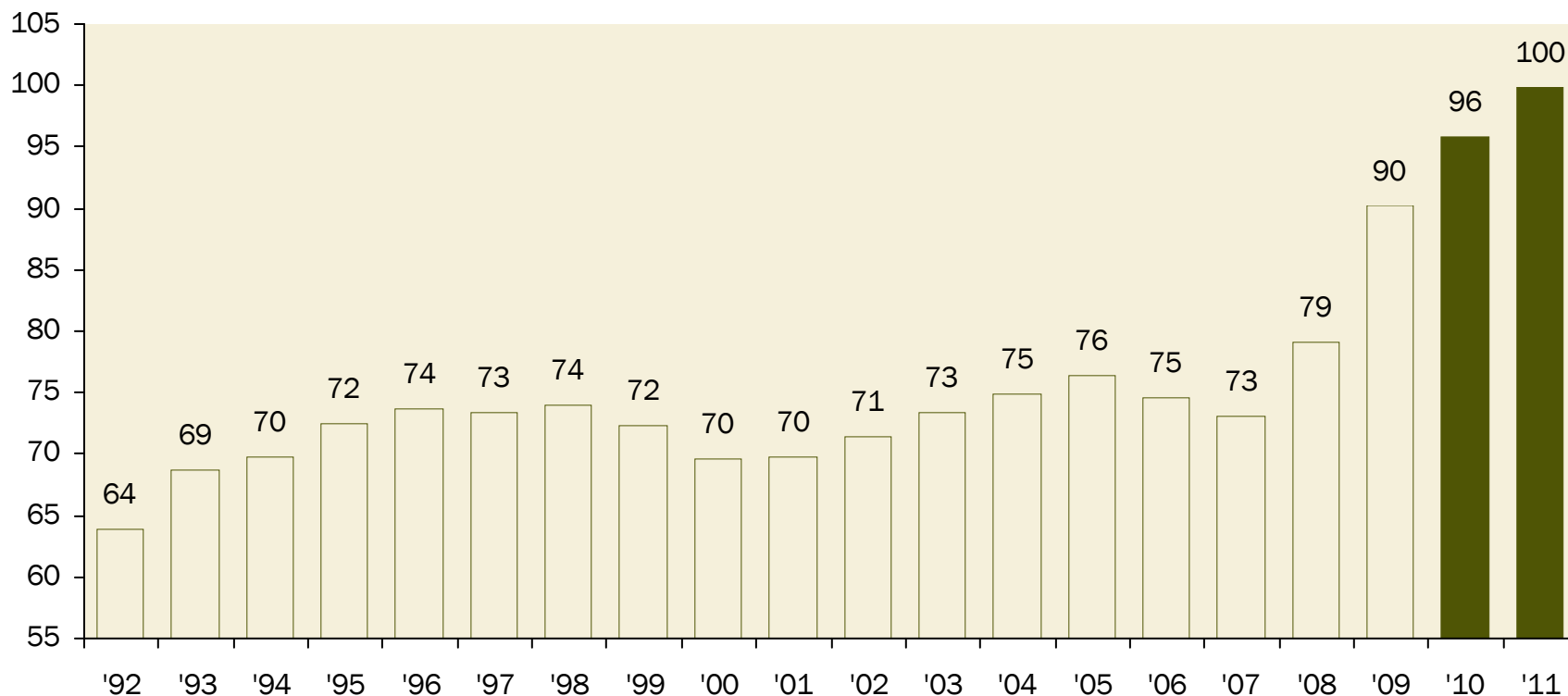
Note:

Source: Haver Analytics

THE WORLD IS AWASH IN DEBT

OECD: Gross General Government Debt-to-GDP Ratio

(percent of nominal GDP)



Notes:

Shaded bars represent OECD estimates

Source: OECD

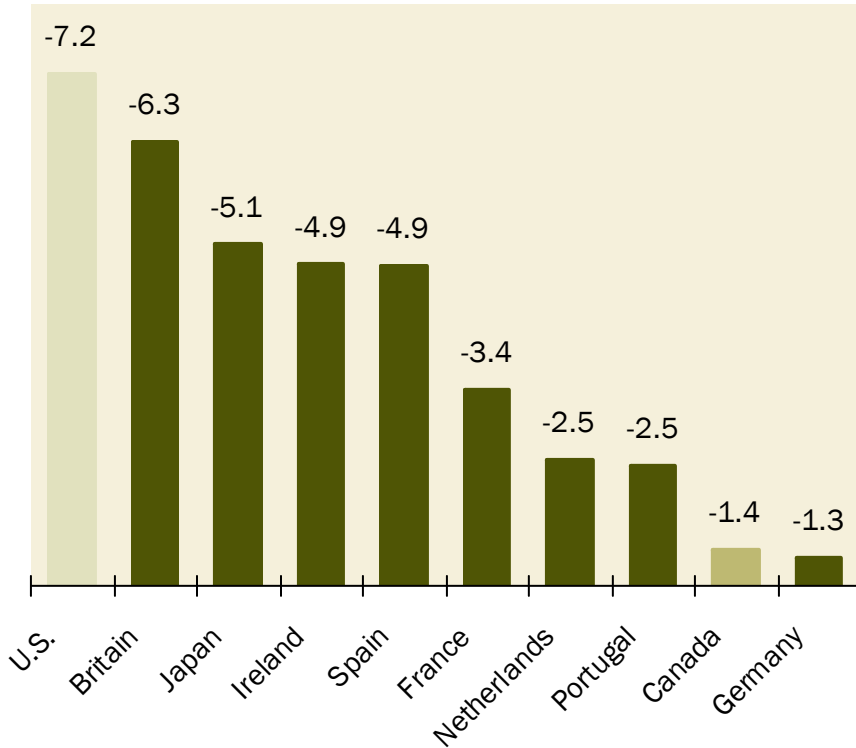
THE CANADIAN RENAISSANCE



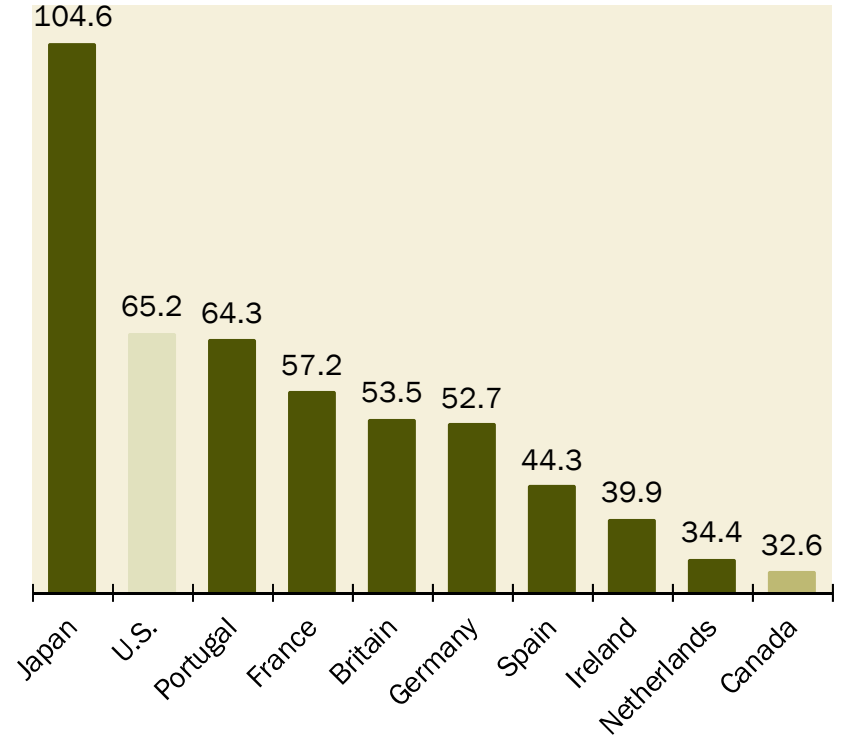
CANADA, ONE OF THE FEW COUNTRIES WITH A “AAA” BALANCE SHEET

As a percent of GDP, 2010 Estimate

Primary Budget Deficit, Cyclically Adjusted*



Net Debt*



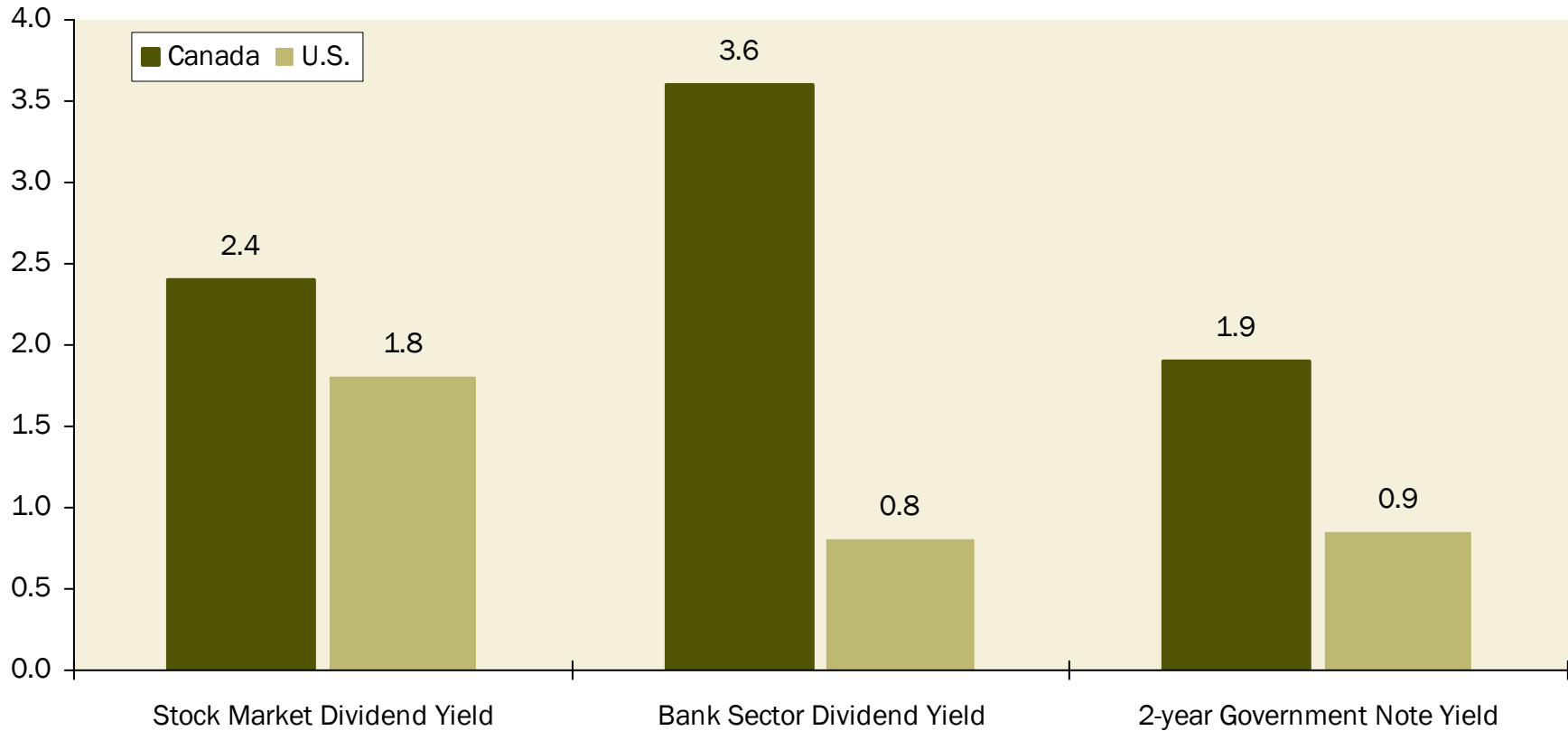
Notes:

*General government.

Source: Organization for Economic Cooperation and Development

CANADA OFFERS A YIELD PREMIUM

(percent, as of February 2011)



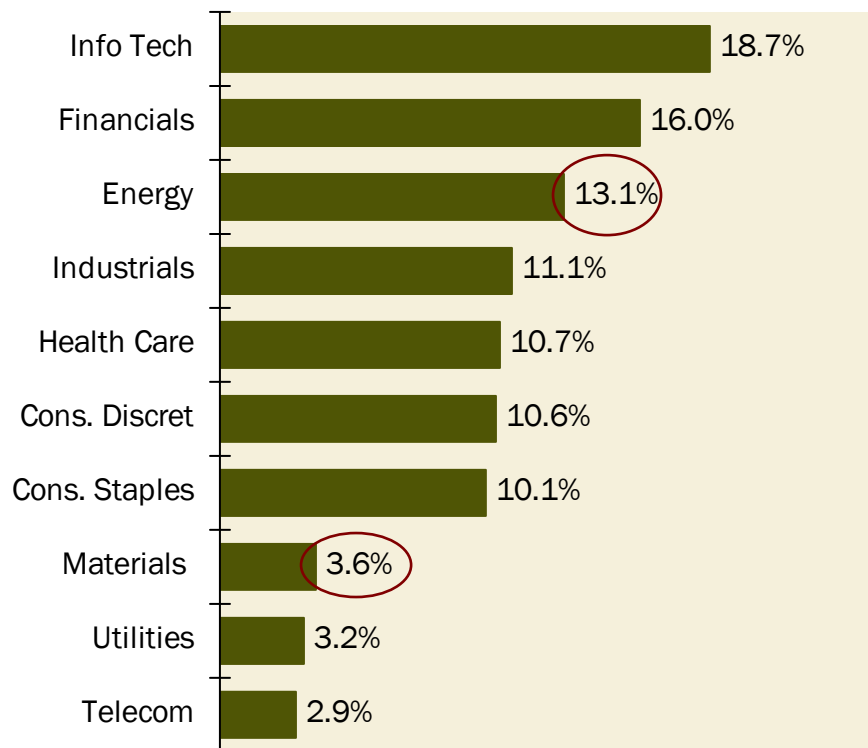
Note:

Source: Haver Analytics

CANADIAN MARKET GEARED MORE TOWARDS BASIC MATERIALS

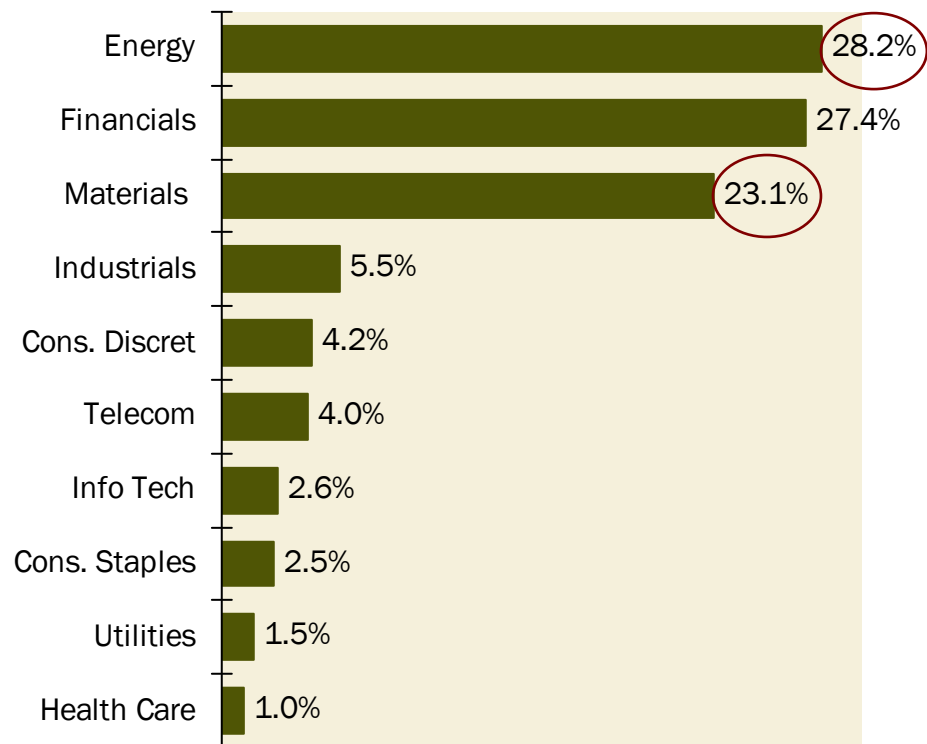
S&P 500 Composite Index

(percent, as of February 28, 2011)



TSX Composite Index

(percent, as of February 28, 2011)



Note:

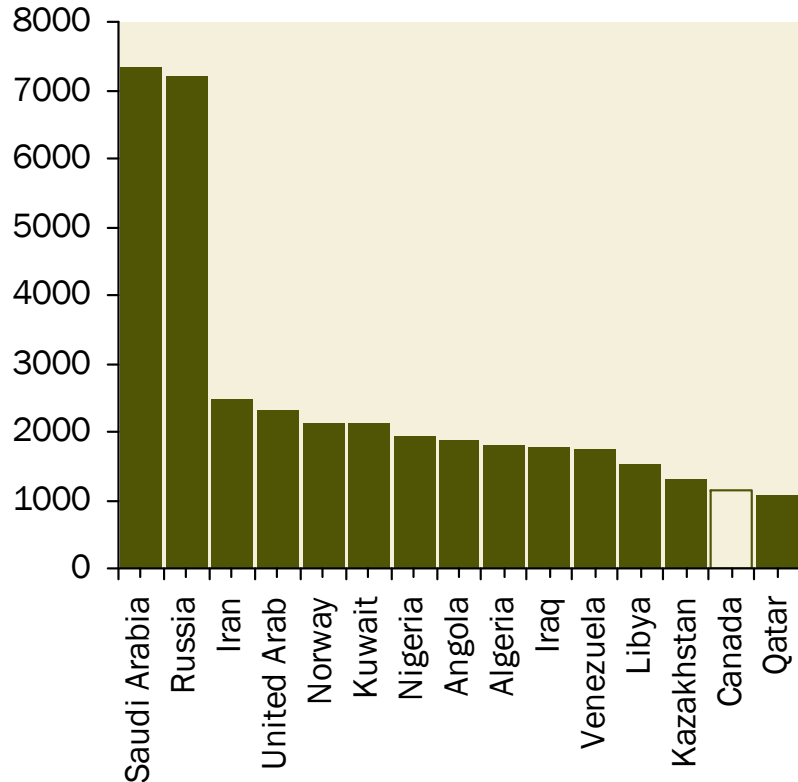
Source: Bloomberg

WINNERS & LOSERS FROM THE OIL SHOCK

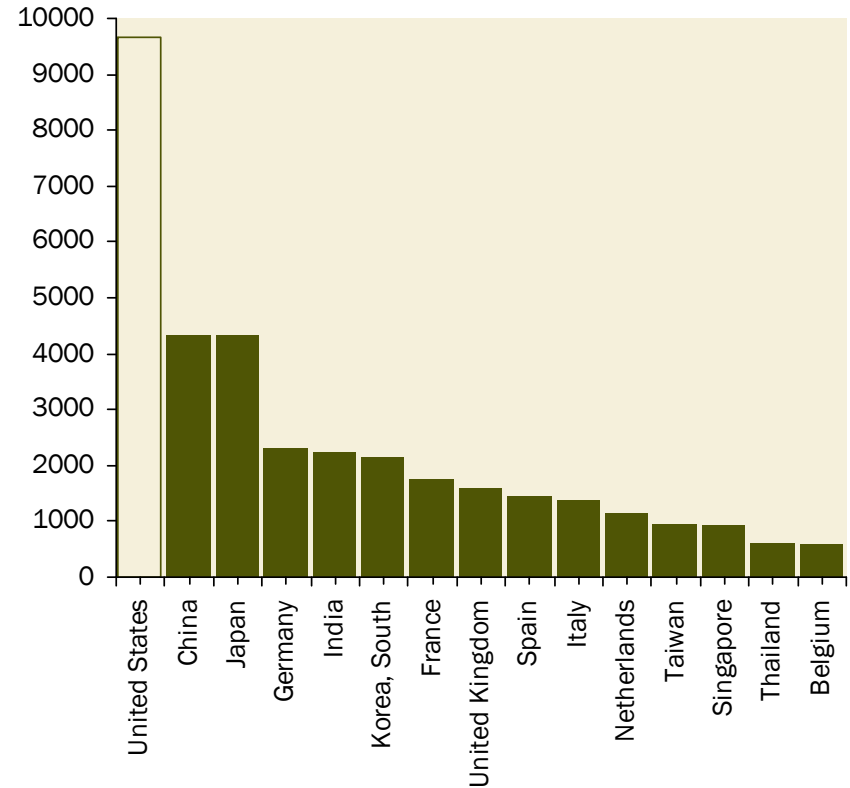
Oil: 2009

(thousand barrels per day)

Top World Net Exporters



Top World Net Importers



Source: U.S. Energy Information Administration

HAS CANADA BEEN RE-RATED?

Canada: Canadian Dollar

(US\$/C\$)



Note:

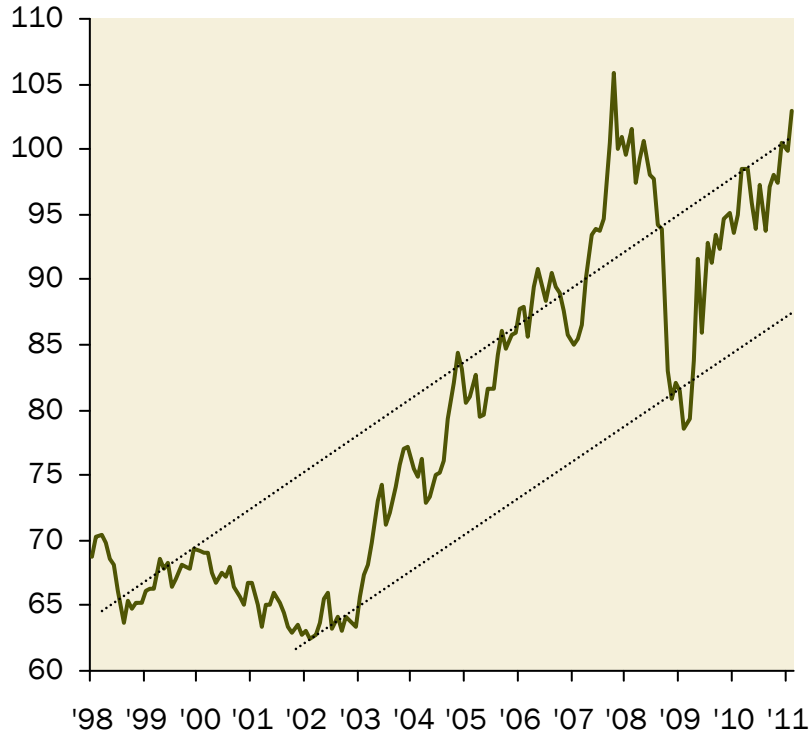
Source: Haver Analytics

CANADIAN DOLLAR NOT JUST A USD STORY

Canadian Dollar

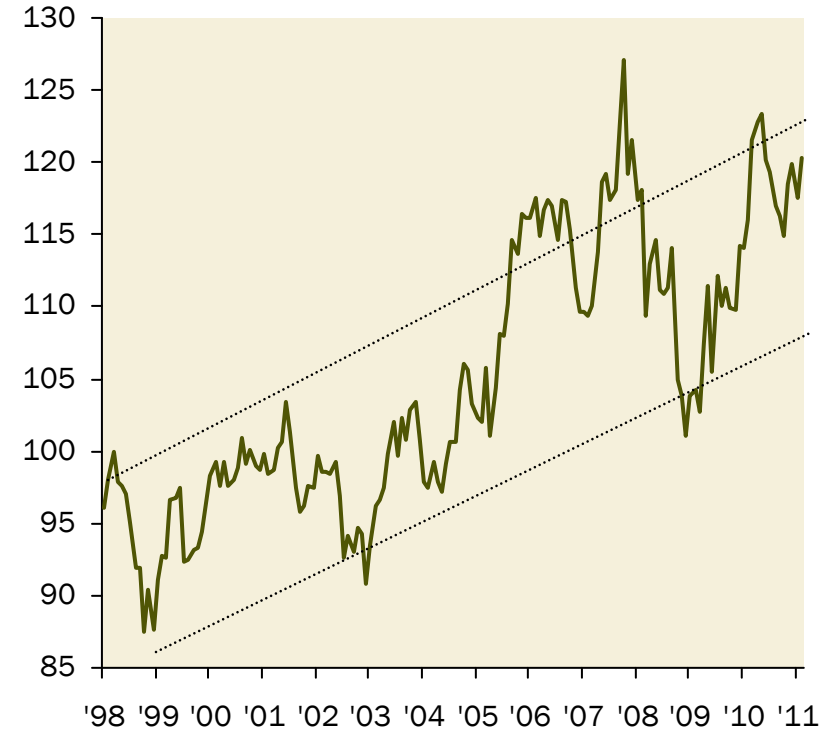
Against the U.S. Dollar

(US\$/C\$)



Versus Six Major Currencies excluding USD*

(1992 = 100)



Notes:

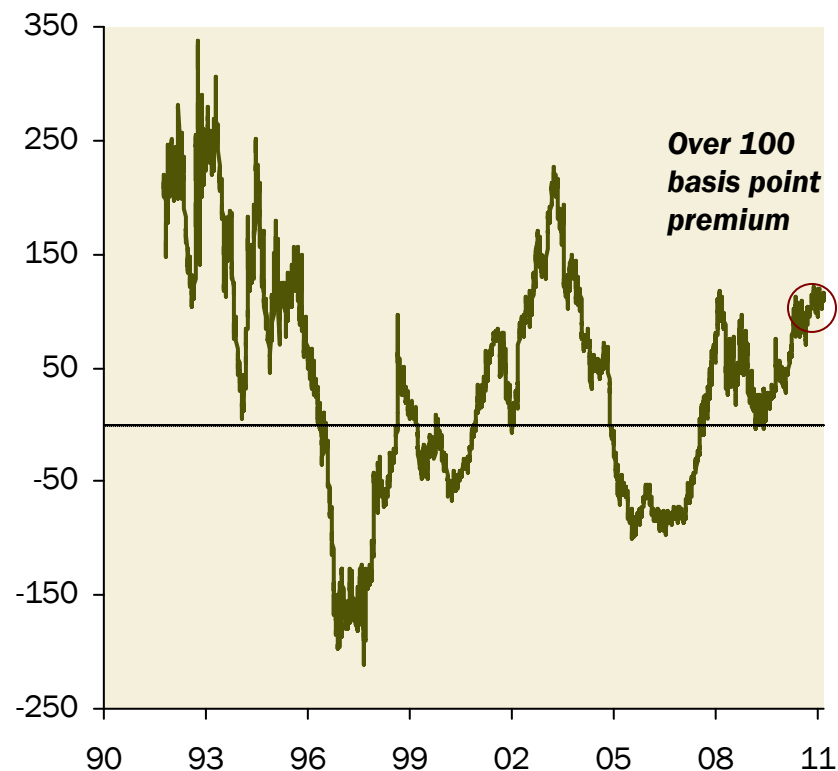
*A weighted average of bilateral exchange rates for the Canadian dollar against the currencies of Canada's major trading partners. The six foreign currencies in the basket are the U.S. dollar, the Euro, the Japanese Yen, the U.K. Pound, the Chinese Yuan, and the Mexican Peso.

Source: Haver Analytics

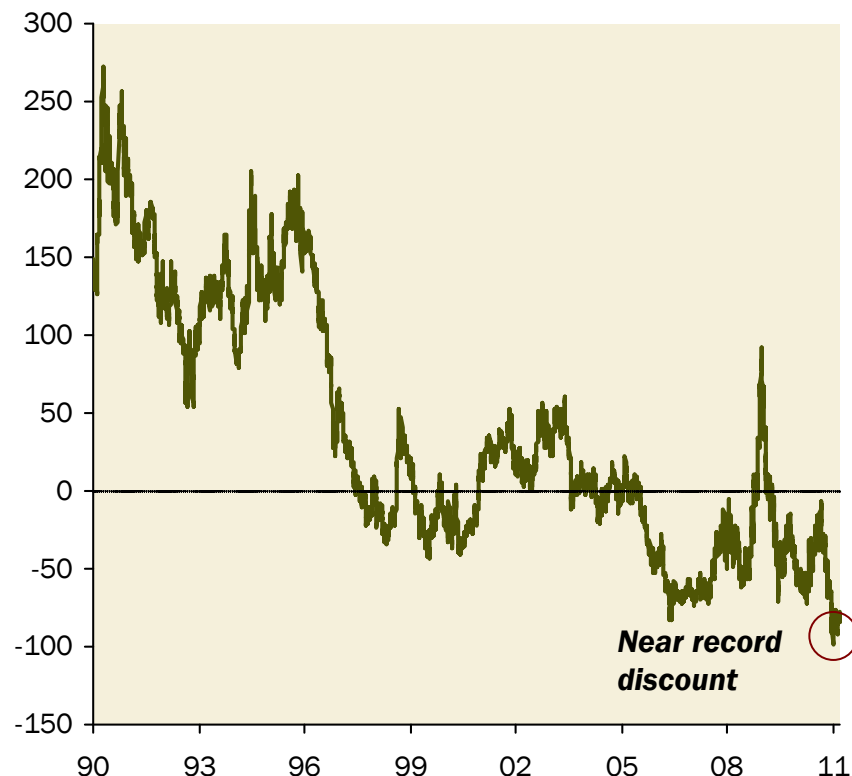
SHORT END OF CANADIAN YIELD CURVE REFLECTS ECONOMIC STRENGTH ... THE LONG END REFLECTS A SOLID BALANCE SHEET

(basis points)

Canada minus U.S. 2-Year Government Note Spread



Canada minus U.S. Long Government Bond Spread



Note:

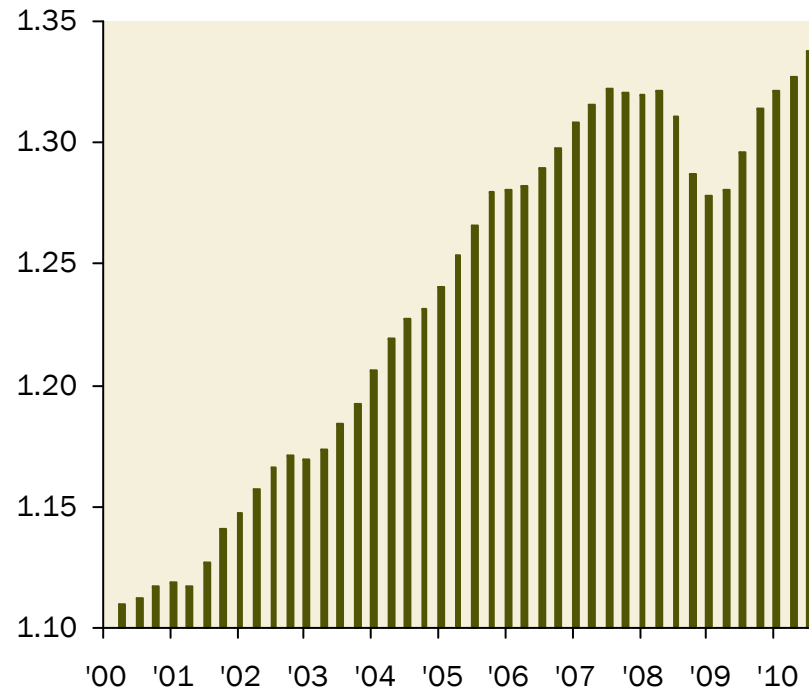
Source: U.S. Federal Reserve Board, Bank of Canada

TWIN PEAKS – LEVEL OF BOTH REAL GDP AND EMPLOYMENT BACK TO ALL TIME HIGHS

Canada

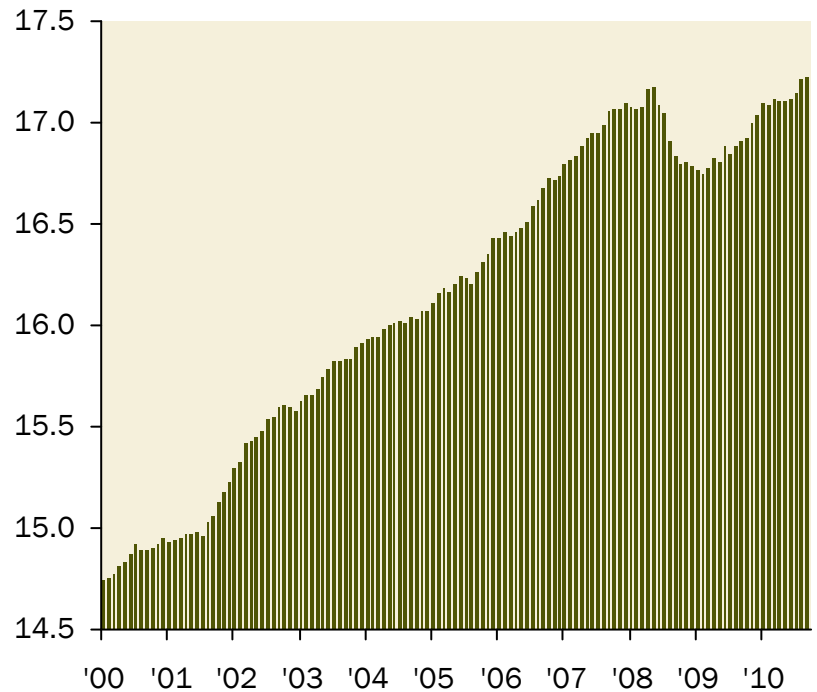
Real GDP

(C\$ trillion, 2002)



Employment

(millions)

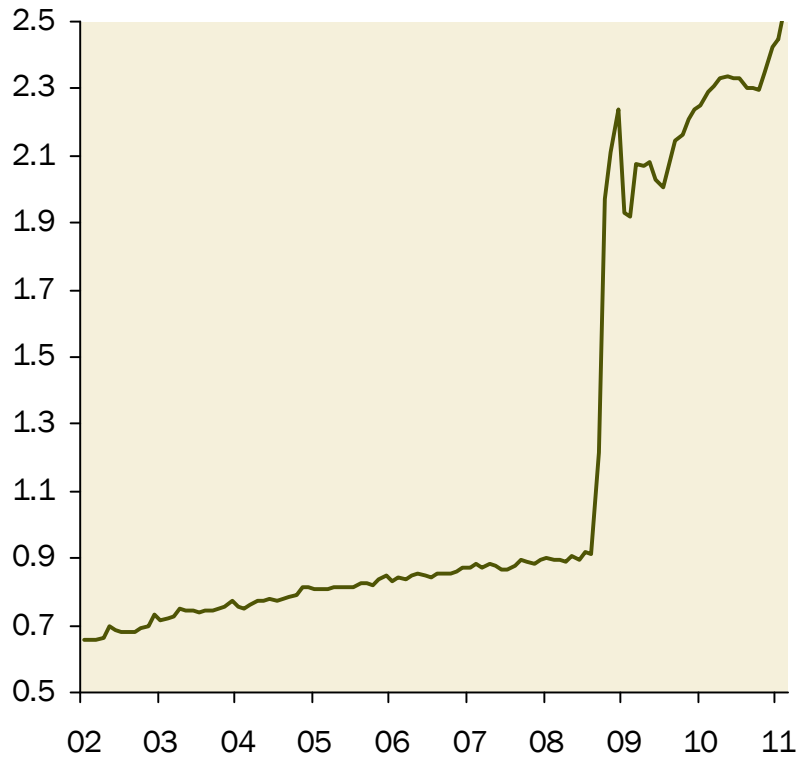


Note:

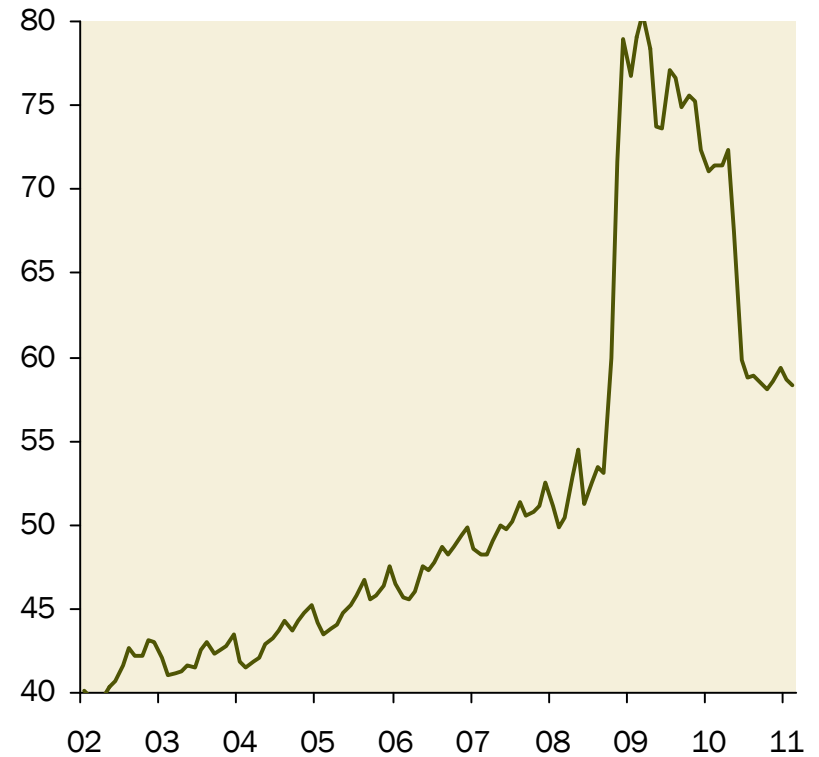
Source: Statistics Canada

A TALE OF TWO CENTRAL BANKS' BALANCE SHEETS: FED EXPANSION, BOC CONTRACTION

Federal Reserve Balance Sheet – Total Assets
(\$ trillions)



Bank of Canada Balance Sheet – Total Assets
(\$ billions)

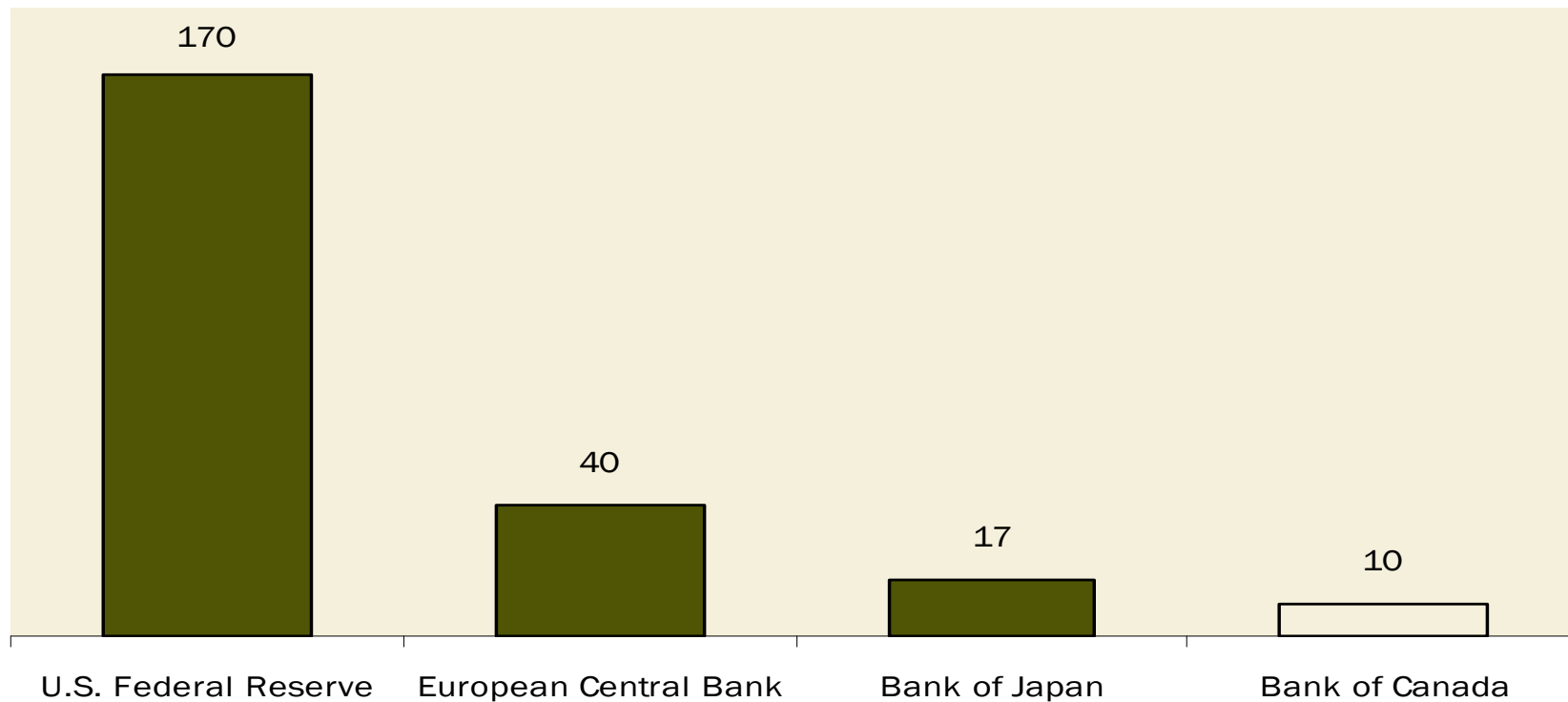


Note:
Source: Federal Reserve Board, Bank of Canada

NO QUANTITATIVE EASING IN CANADA

Percent Change in Central Banks' Balance Sheets Since Mid 2008

(percentage)



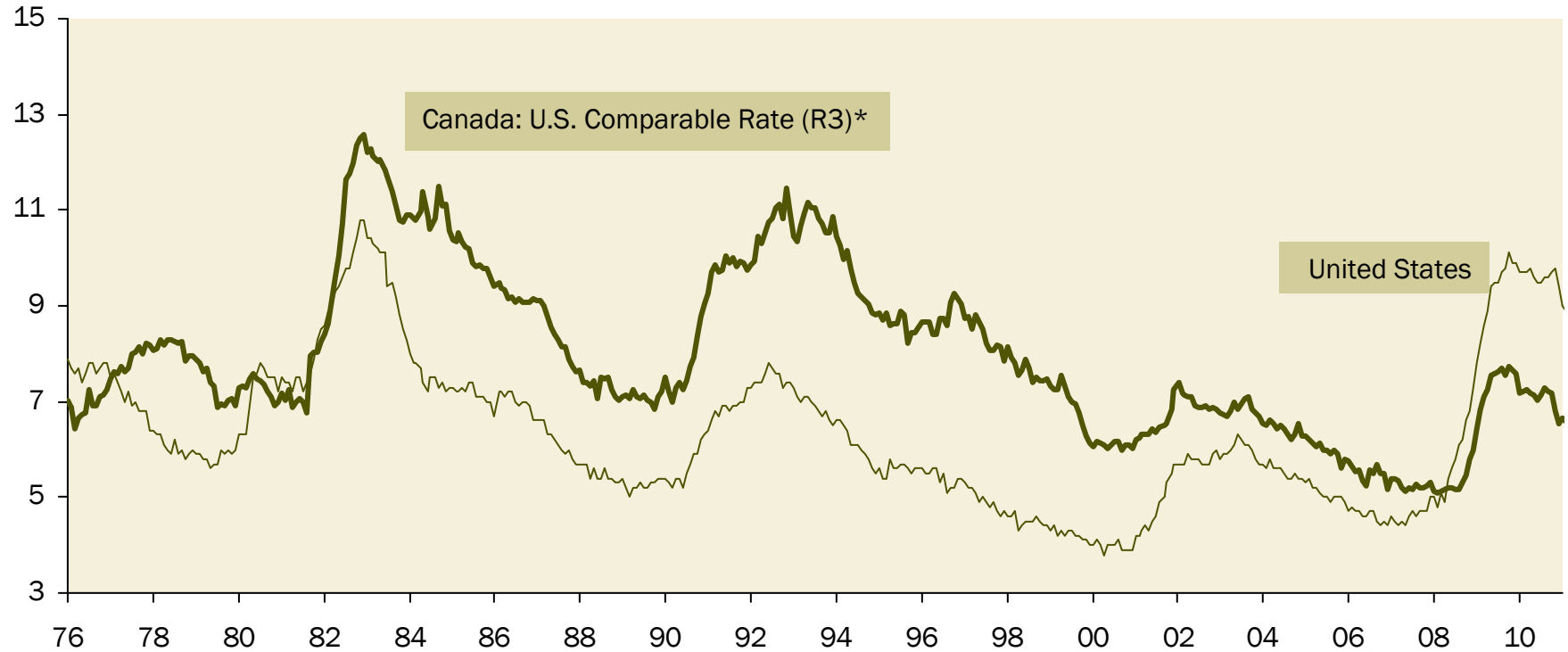
Note:

Source: Federal Reserve Board, ECB, BoJ, and Bank of Canada

CANADA'S JOBLESS RATE IS NOW SIGNIFICANTLY LOWER THAN THE U.S. RATE ...

Unemployment Rate

(percent)



Notes:

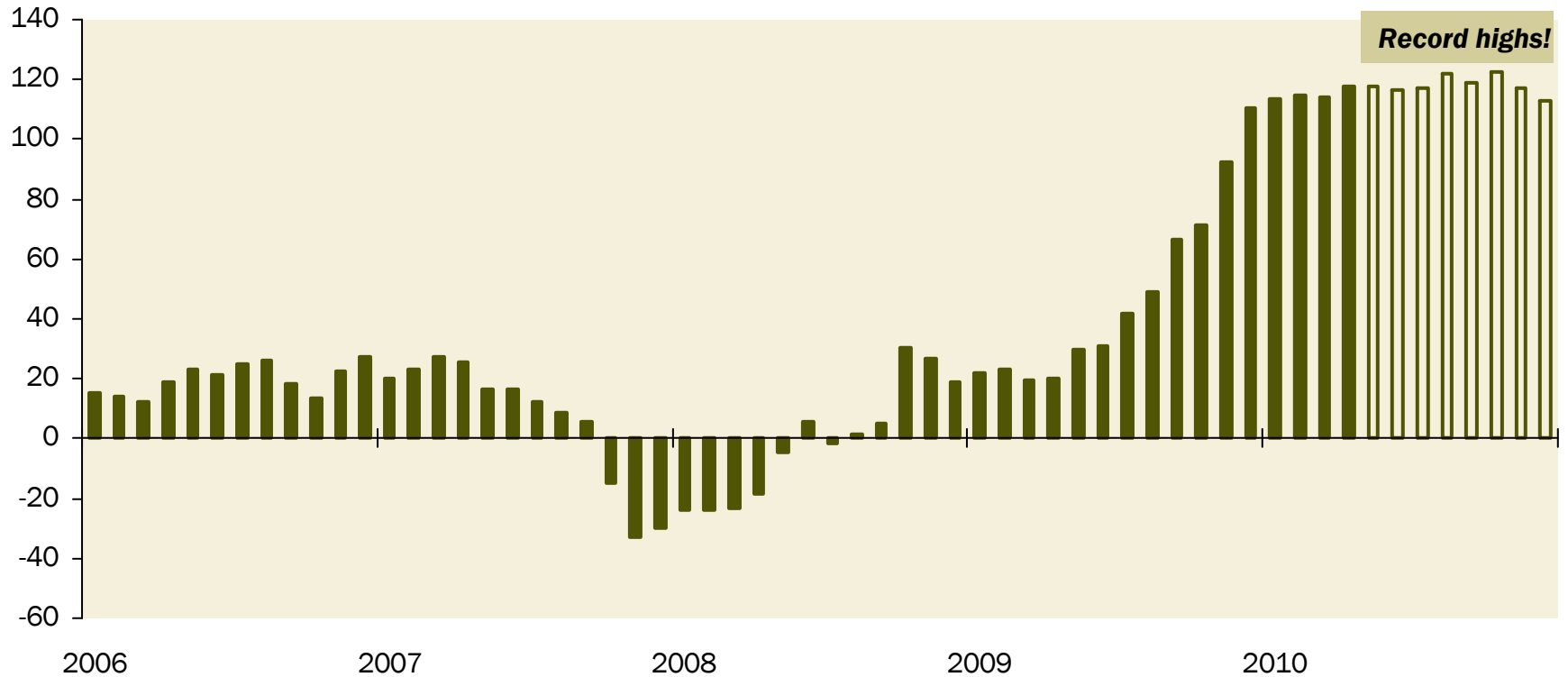
*Seasonally adjusted by Haver Analytics

Source: Statistics Canada, U.S. Bureau of Labor Statistics, Haver Analytics

FOREIGN INVESTORS REDISCOVER CANADA

Canada: Net Foreign Purchases of Canadian Stocks and Bonds

(12-month total, C\$ billion)



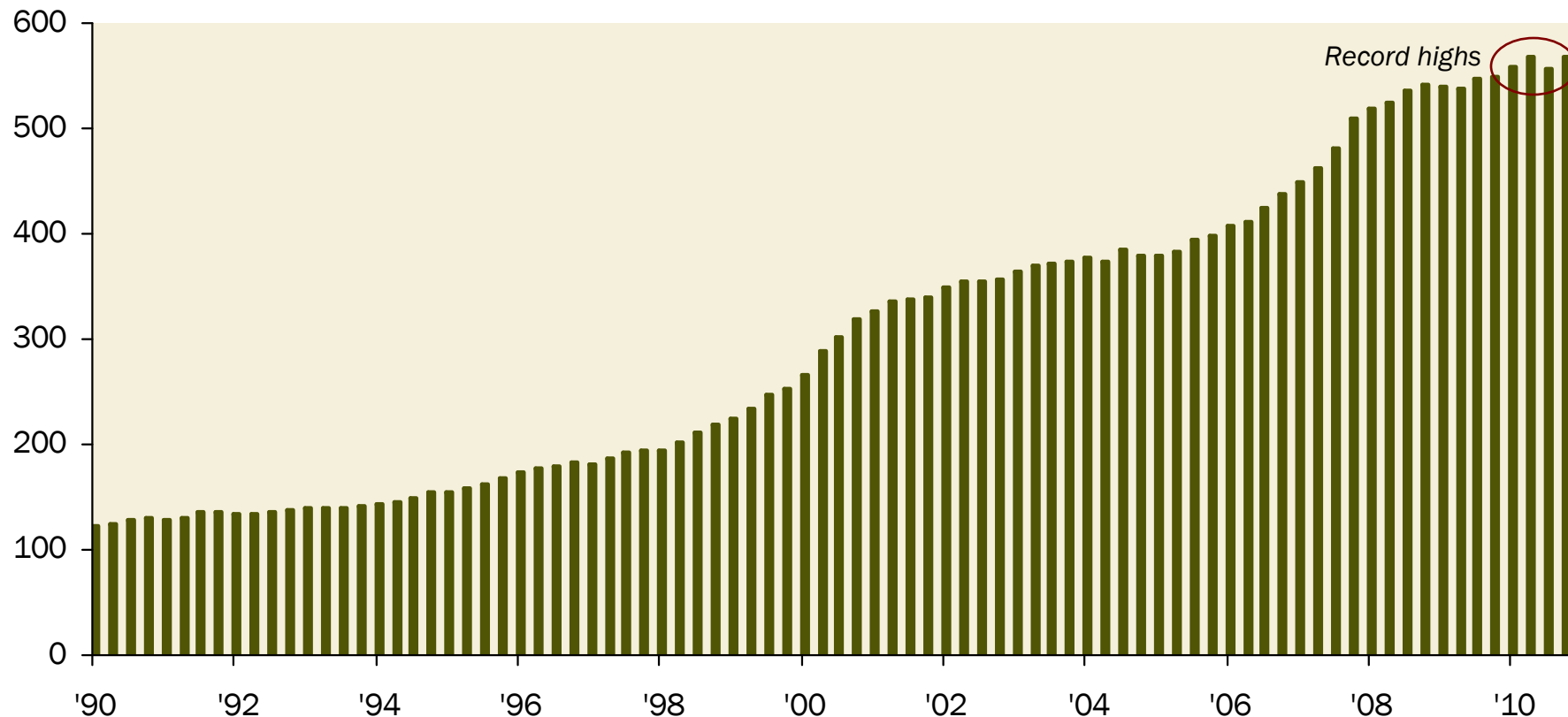
Note:

Source: Statistics Canada

LONG-TERM INVESTMENT INFLOWS FROM ABROAD ALSO VERY SUPPORTIVE

Canada: International Investments – Foreign Direct Investment in Canada

(C\$ billion)



Source: Statistics Canada

NOT JUST MONEY FLOWING INTO CANADA: PEOPLE TOO

Canada: International Immigration

(thousands of persons)



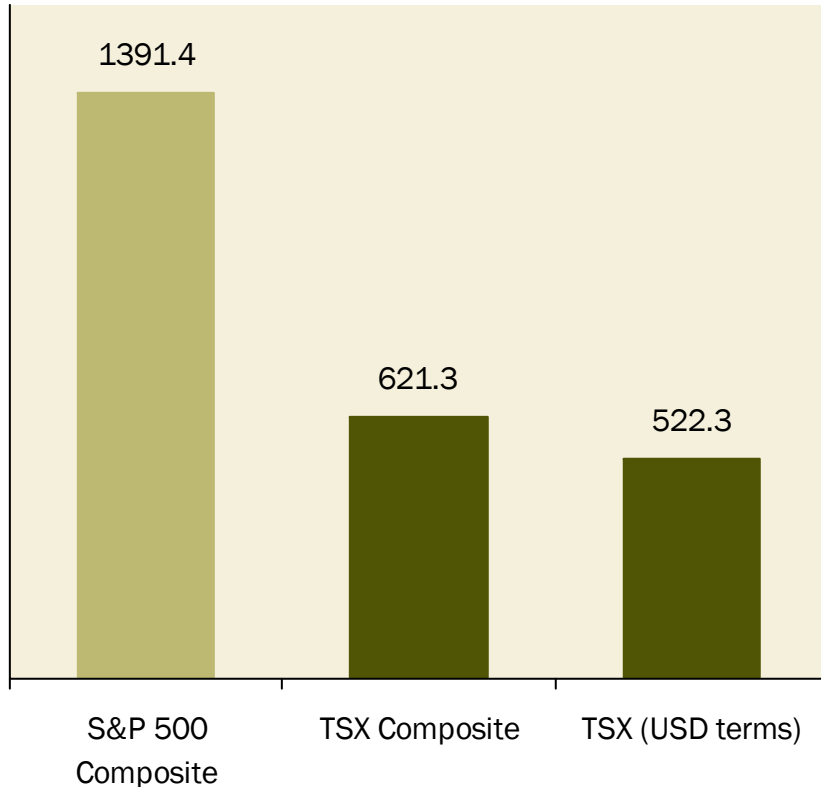
Note:

Source: Haver Analytics, Citizenship and Immigration Canada

HALFWAY THROUGH THE CANADIAN STOCK MARKET OUTPERFORMANCE

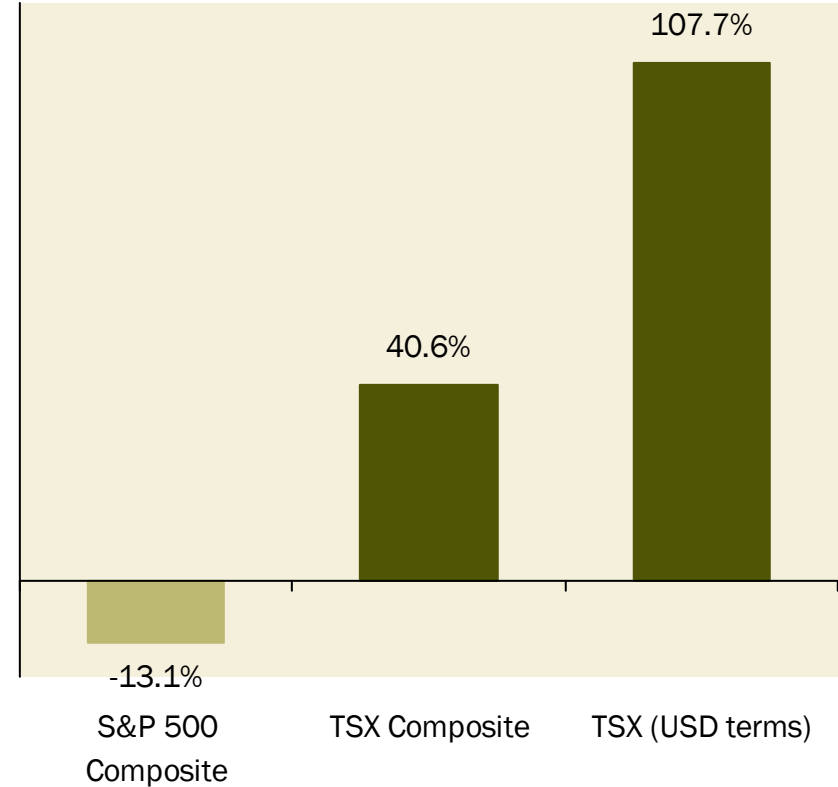
Then ...

August 12, 1982 – March 24, 2000*



... And Now

March 24, 2000 to February 28, 2011



Notes:

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

Source: Bloomberg, Haver Analytics

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