

# Outlook and Opportunity

Investment strategies and forecast for 2012



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# Was 2011 a challenging year?

- Paulson Fund loses 46% in 2011 through to November
- Legg Mason's Bill Miller will exit main fund after it falls behind peers



Source: Bloomberg News

# Will 2012 be an easier year ?

## ■ Paranormal Activity

The New Normal as PIMCO and other economists would describe it was a world of muted western growth, high unemployment and relatively orderly delivering. Now we appear to be morphing into a world with much fatter tails, bordering on bimodal. It's as if the Earth now has two moons instead of one and both are growing in size like a cancerous tumour that may threaten the financial tides, oceans and economic life as we have known it for the past half century. Welcome to 2012.



Bill Gross

PIMCO has \$1.35 Trillion in AUM

Source: WSJ

# Will 2012 be an easier year ?

- **10% rise in S&P 500**

“Part of our relatively bullish view is that the [U.S.] economy and earnings will continue to advance and the stock market therefore recognizes that, follows that if you will,” Mr. Doll said in an interview. “All we’re looking for to get to our 1,350 target is a 10 per cent gain, which is sort of six [per cent] from earnings, two from dividends, and a measly two per cent from some valuation or P/E improvement.”



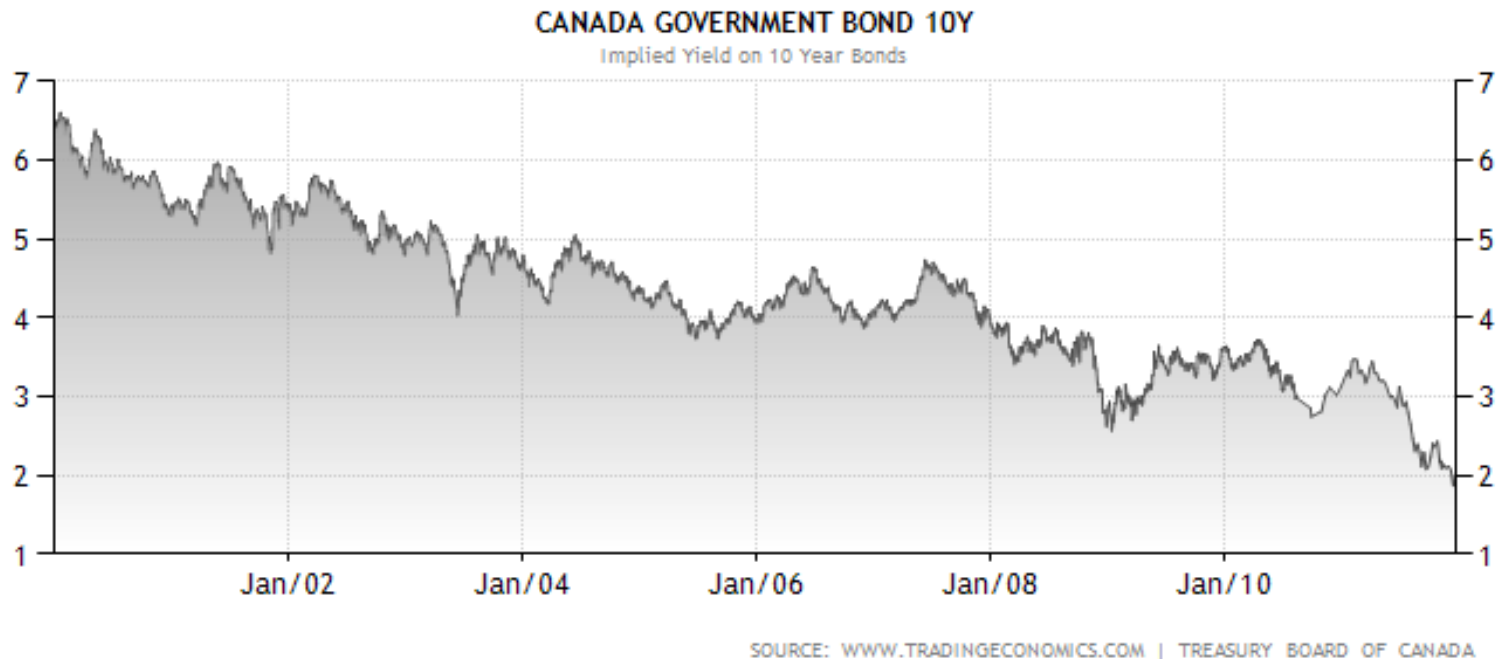
Bob Doll

Blackrock has \$3.35 Trillion in AUM

Source: Globe and Mail

# Winning Strategy in 2011?

- Since January, Canadian government and corporate bonds have returned 9.6 per cent, almost doubling the global average of 5.5 per cent.



Source: Tim Kiladze; Globe and Mail

# Losing Strategy in 2011?

- Emerging Markets: China, India, Brazil and Russia all disappoint.

China CSI300 -26%

India BSE500 -26%

Brazil Bovespa -19%

Russia RTS Std -17%

Source: Bloomberg.com



Ghost towns in China: Chenggong satellite aerial image. Empty city.

# How did the Canadian stocks perform?

- TSX declined close to 11% in 2011.



Source: Yahoo Finance



# How did the U.S. stocks perform?

- S&P 500 was flat in 2011. Closing at the same level first achieved in Oct. 1998



Source: Yahoo Finance



# Past winners...

- Emerging Markets + 65% in three years
- Real Return Bonds + 30% in two years
- Sprott Energy Fund + 75% in two years
- Bissett Dividend Fund +28% in two years
- Teck Cominco + 650% in three years
- TD Bank, Bank of Nova Scotia + 80% in three years
- Motorola up 80% in one year
- Apple + 250% in three years
- Wynn Resorts + 185% in two years



# Past losers...

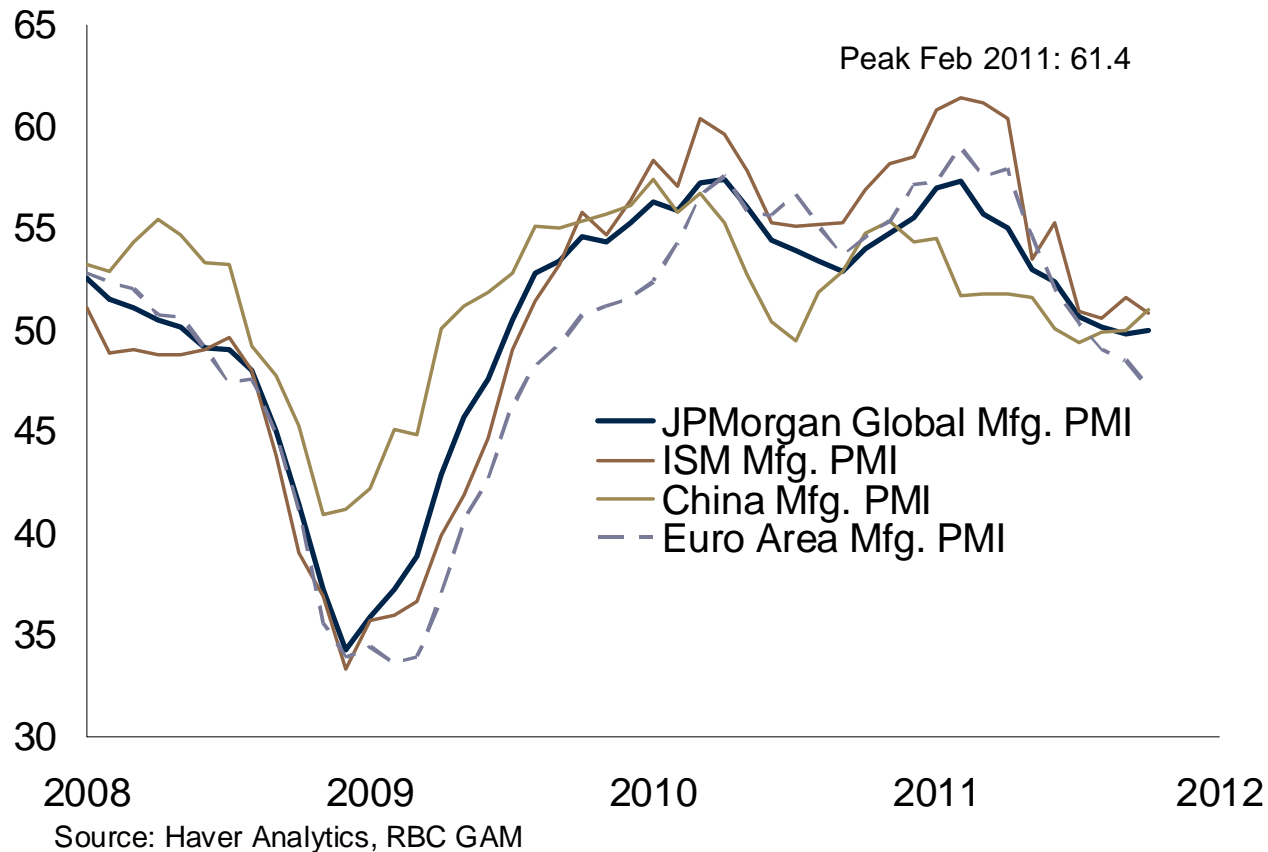
- Smart Technologies -65%
- Research in Motion -70%
- Cemex - 35%
- Nokia - 35%
- Bank of America - 40%



# What lies ahead for the economy?

- Below 50 is bad and above 50 is good. There is not going to be a lot of growth.

## Global Purchasing Manager's Indices

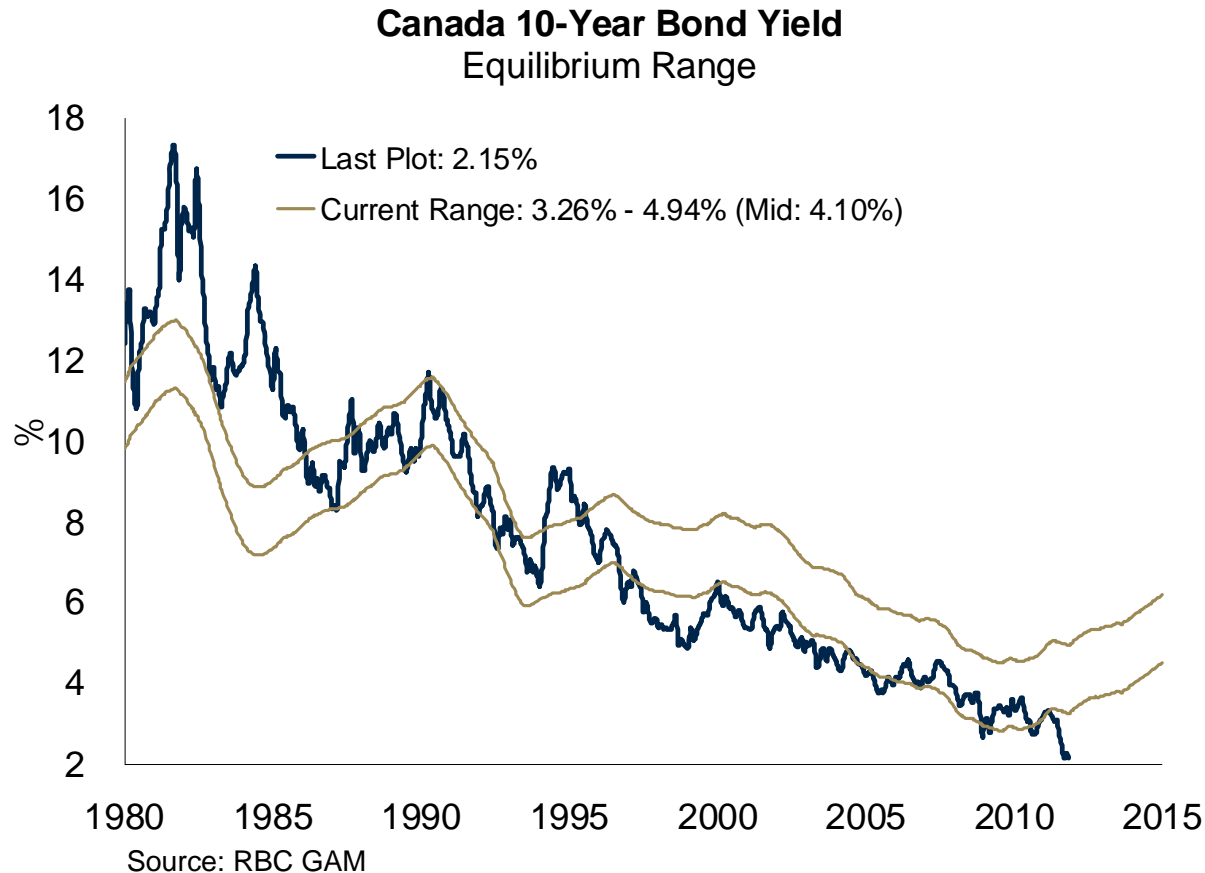


# What lies ahead for the economy?

- **Significant threats to the recovery** came from the fiscal gridlock in Washington, the controversial downgrade of **U.S. debt**, **tightening monetary conditions in China** and the **evolving and intensifying sovereign debt/banking crisis in Europe**. Of these, Europe's crisis is the most radioactive.
- **Employment**, critical to the development of a self-sustaining business cycle expansion, is moving ahead, but at an uneven speed. Still, coupled with balance sheet repair already in-hand, the outlook for consumption is positive, barring continuing shocks to confidence.
- **Sovereign debt** has clearly emerged as a key challenge to sustaining normal rates of GDP growth. Even major economies, including the U.S. and U.K. are approaching debt/GDP levels which have in the past limited growth.
- **Peak in global PMIs** suggests moderating growth over the months ahead, but levels are not yet consistent with the approach of recession. Recent releases suggest stability in U.S. and China/more weakness in Europe.
- Our base case remains modest recovery/mild inflation for North America and Asia, but mild recession for Europe.

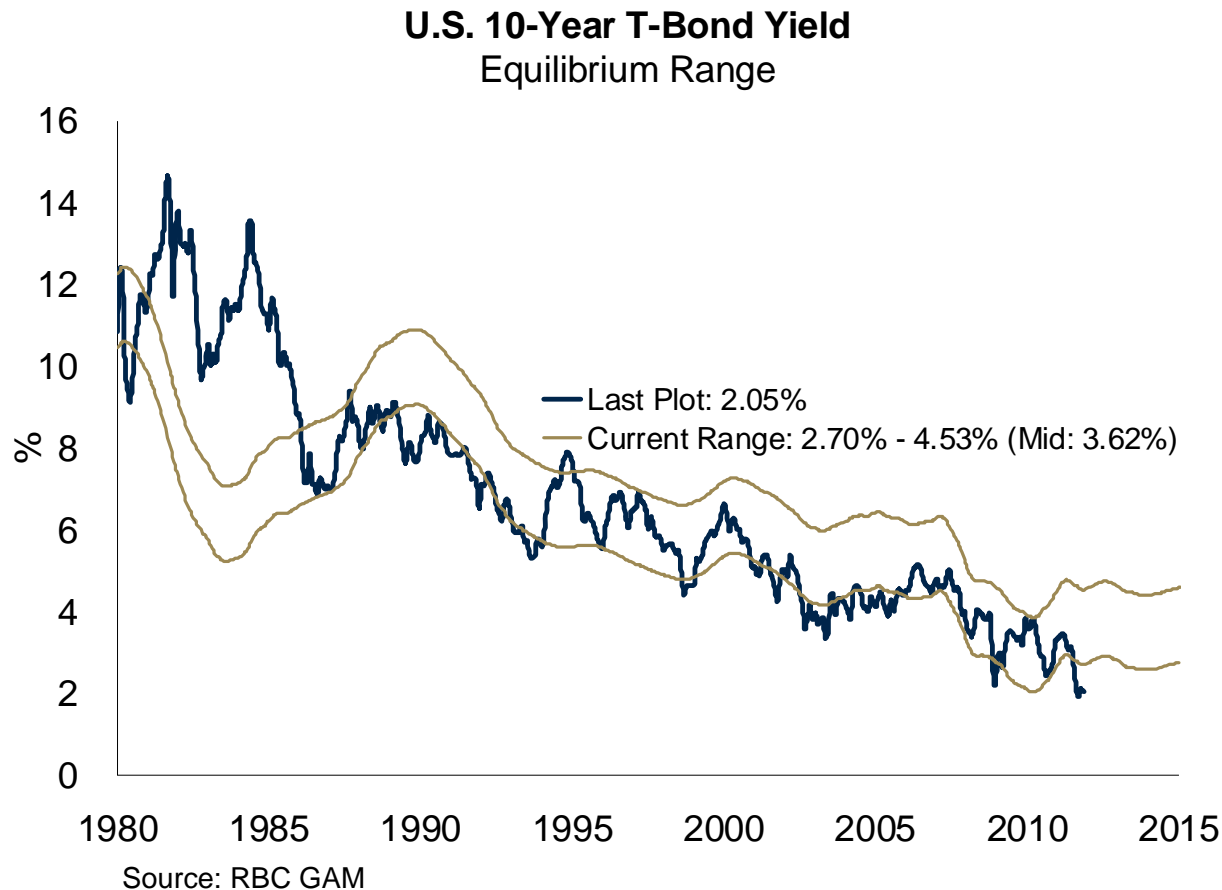
# How attractive are Canadian bonds?

- Canadian bonds are priced well above normal levels.



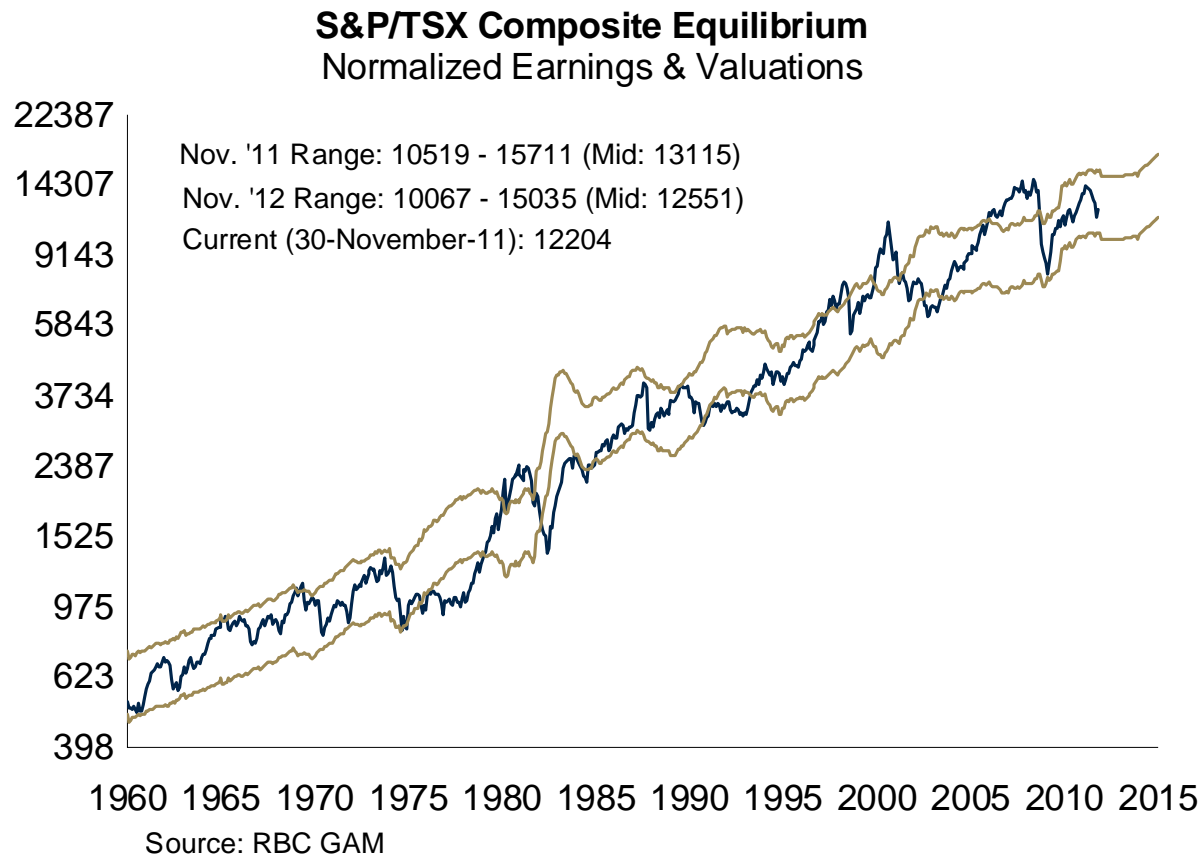
# How attractive are U.S. bonds?

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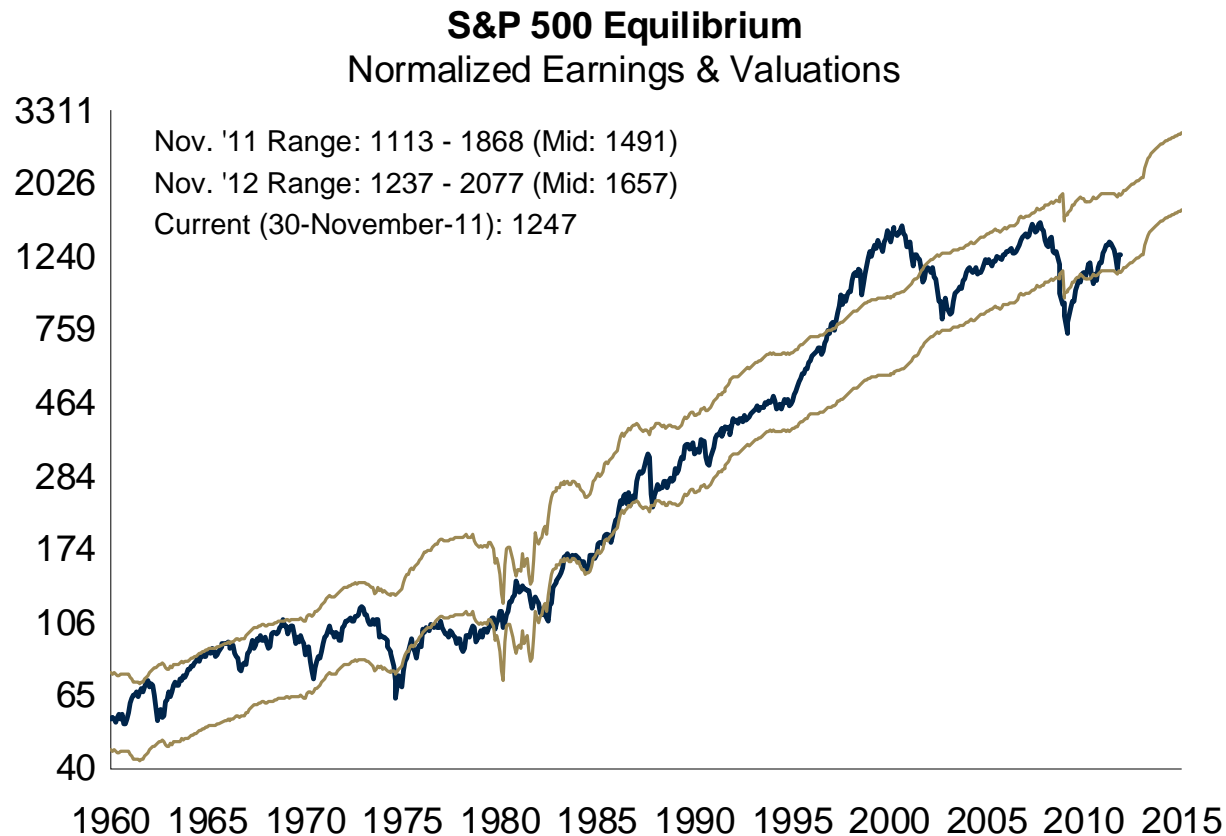
- Canadian stocks are at the lower end of their normal valuation range.





# How attractive are U.S. stocks?

- U.S. stocks are at historical lows. Cheap!



Source: RBC GAM

# Strategy recommendations....

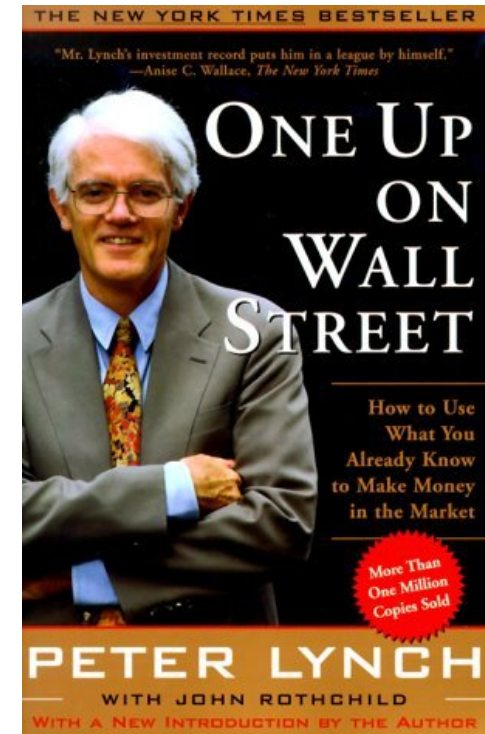
- Overweight cash on stocks, underweight bonds. Expect continued volatility.

	Benchmark	Past Range	REVISED Summer 2011 (June 22)	Fall 2011	New Year 2012
<b>Cash</b>	5.0%	1.5%-16.0%	5.0%	7.5%	7.5%
<b>Bonds</b>	40.0%	25.0%-54.0%	35.0%	35.0%	35.0%
<b>Stocks</b>	55.0%	36.0%-65.0%	60.0%	57.5%	57.5%

# Equity markets and risk

“In this business if you’re good,  
you’re right six times out of ten.  
You are never going to be right nine  
times out of ten.”

Peter Lynch  
29.2% Magellan Fund  
1977 to 1990



# Salary plus bonus strategy

The salary plus bonus investment strategy is designed to generate a predictable flow of income, while providing growth of capital over time. Every holding in the portfolio generates income to form the SALARY. And, the expected rise in the price of the underlying securities in the portfolio forms the BONUS.



# Actionable idea #1 – GICs + Pref. Shares

- GICs offer attractive rates compared to high quality bonds.

Example:

2-year Royal Bank bond yields 1.5%

2-year GIC yields 2.05%



# Actionable Idea #2 – Preferred Shares

- **Tax Advantage:** Often offer better after-tax return than similar credit quality bonds.
- **Security:** Rank above the interests of common shareholders.
- **Exchange Traded Markets:** Liquid in three business days.
- **Example:** Sunlife Series 12 (SLF.PR.I)
  - 4.7% yield to call
  - Interest Equivalent 5.7%
  - P1 Low credit rating
  - Dec. 2016 reset
  - 5yr GOC +275bpts



Preferred Shares are considered a fixed income investment.



# Actionable idea #2

- Barometer High Income Pool – Private Placement Only

## Investment Objective:

The investment objective of the Pool is to achieve long-term capital appreciation and a steady level of income, and to minimize risk by diversifying product type and purchasing income investments that exhibit the best risk reward.

8.5% compound annual return since Feb/2007

6 cents/unit monthly distribution

Tax-efficient income flow.

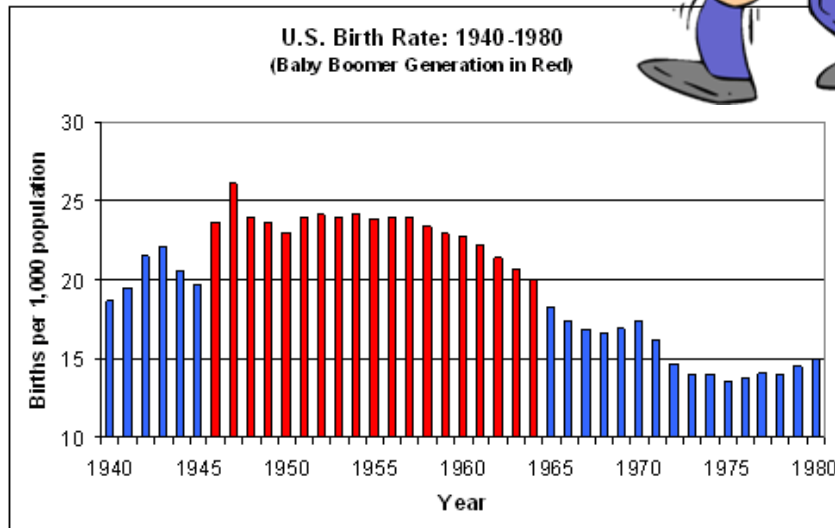
Lakeview Disciplined High Income Fund



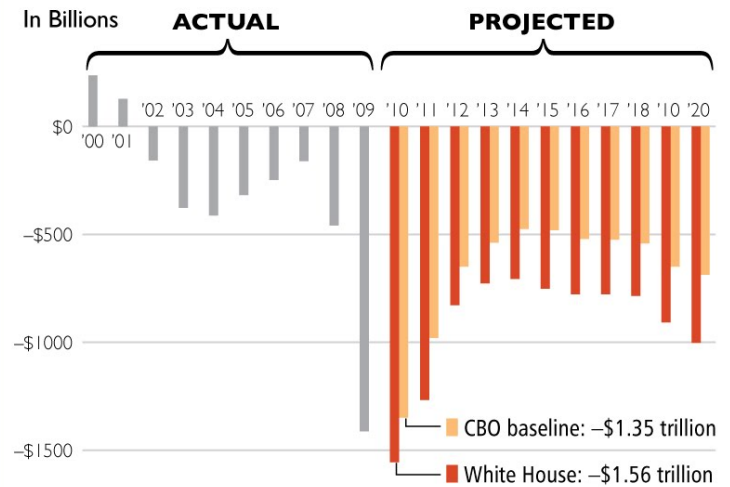


# Actionable idea #3 – Emerging Mkts

- Developed Economy 3-D's
- Debt, Deficits and demographics



## Obama Budget Adds \$2.5 Trillion to Deficits



Sources: Congressional Budget Office, January 2010 Budget and Economic Outlook; and Office of Management and Budget, February 1, 2010, Summary Table I.

[heritage.org](http://heritage.org)

# Actionable idea #3 – Emerging Mkts

iShares MSCI Emerging Markets

■ XEM.TO

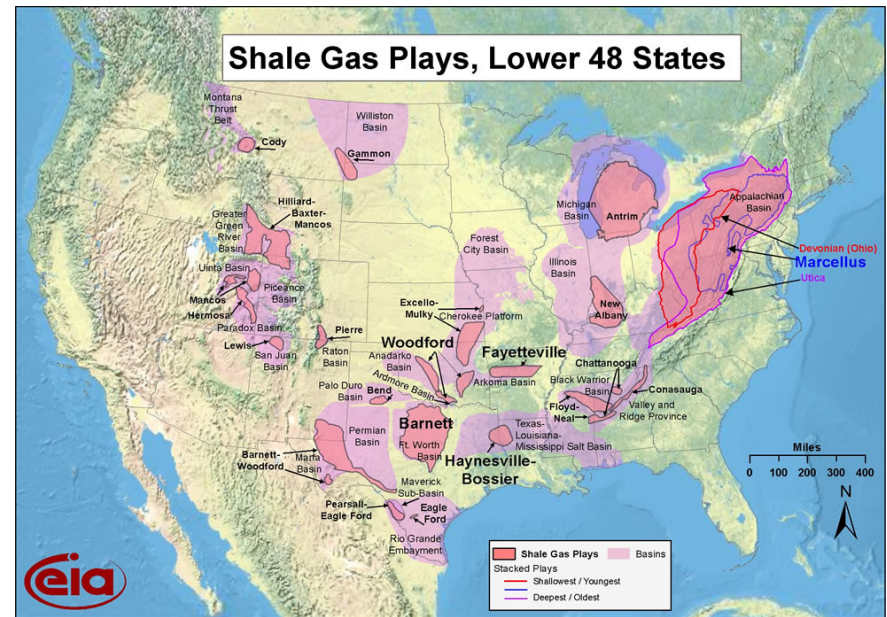
11 Jan, 2012



One of few areas of the world expect to produce decent economic growth.

# Actionable idea #4 – Natural Gas

- U.S. desperately needs: Jobs + solution to foreign oil dependency.



Stop sending money to the middle east. Develop their own resource.

# Actionable idea #4 – Encana ECA/TSX



70% decline in Natural Gas Commodity prices since the peak in 2008

# Actionable idea #4 - Encana

- 1-Year target price \$31, implied return 60%

Dividend yield 4.2% or \$0.815 per share

P/E=32, P/B=0.8

Market cap \$14.375 billion

Recent high of \$34

One of North America's largest natural gas producer, through a well-defined focus on unconventional deposits.



# Actionable idea #5 – Digital World

- Digital age has changed the meaning of real time news and information.
- Knowledge is information: Digital library.





# Actionable idea #5 – Thomson Reuters TRI/TSX

## THOMSON REUTERS CORPORATION

■ TRI.TO

Jan 05, 2012



Trouble in the global financial sector, a key market for Thomson Reuters



# Actionable idea #5 – Thomson Reuters

- 1-Year target price \$38, implied return 45%

Dividend yield 4.5% or \$1.26 per share

P/E=20, P/B=1.2

Market cap \$22.880 billion

Recent high of \$41.50

One of world' largest natural information publishers serving 5 professional markets:

Financial markets, legal, tax and accounting, healthcare and scientific.



# Actionable idea #6 – \$ Devaluation

- Historically, excess debt has been handled with either inflation or deflation.
- Inflation is a lot less painful than deflation.
- Inflation = Printing money
- Deflation = Austerity



# Actionable idea #6 – Kinross Gold Corp K/TSX

KINROSS GOLD CORP.

■ K.TO

Jan 05, 2012



Sharp sell-off in Gold Bullion in the fall of 2011.

# Actionable idea #6 – Kinross Gold Corp.

- 1-Year target price \$20, implied return 60%

Dividend yield 1.0% or \$0.22 per share

P/E=11, P/B=1.0

Market cap \$14.1 billion

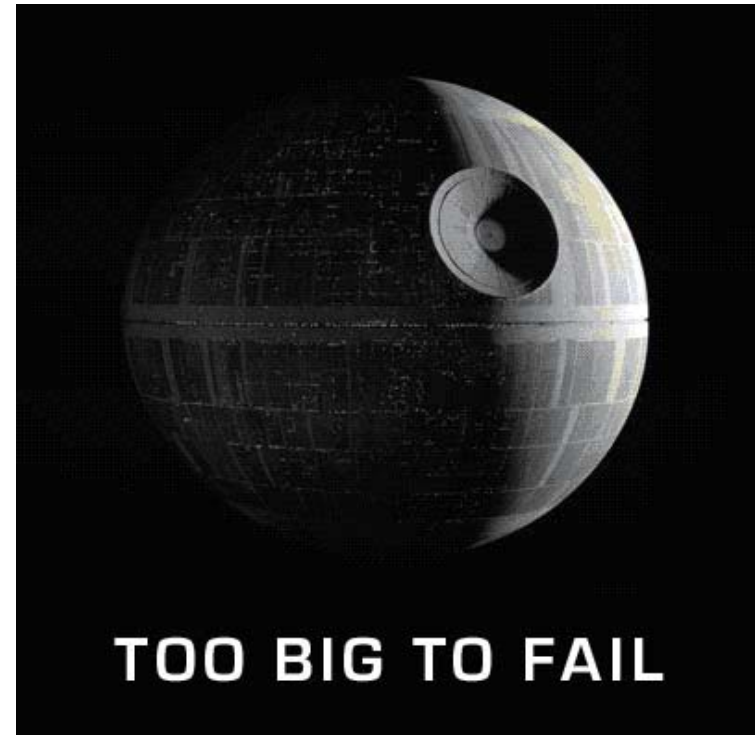
Recent high of \$18

Canadian Tier 1 gold company.  
Grown by acquisition with major  
development projects in the U.S., Brazil,  
Chile, Russia, Ecuador and Africa



# Actionable idea #7 – Too Big to Fail

- Banks are under pressure due to:
  1. Mortgage exposure.
  2. Euro debt exposure.
  3. Increased capital requirements.



# Actionable idea #7 – JP Morgan Chase JPM/NSYE

JP Morgan Chase & Co. Common St

■ JPM

Jan 05, 2012



Euro debt crisis has a sharp impact on U.S. banks



# Actionable idea #7 – JP Morgan Chase

- 1-Year target price \$50, implied return 40%

Dividend yield 2.8% or \$1 per share

P/E=6.9, P/B=0.7

Market cap \$135.5 billion

Recent high of \$48

Second largest bank in U.S. with \$2.3 trillion in assets and 5,495 branches in 60 countries around the world.





# Actionable idea #8 – The Consumer

- Consumer extends far beyond North America



# Actionable idea #8 – PepsiCo PEP/NSYE

Pepsico, Inc. Common Stock

■ PEP

Jan 05, 2012



Soft drinks and snacks offer stability and defense

# Actionable idea #8 - PepsiCo

- 1-Year target price \$72, implied return 12% (JP Morgan Research)

Dividend yield 3.1% or \$2.06 per share

P/E=14.1, P/B=4.3, ROE+20%

Market cap \$103.5 billion

Recent high of \$72

Pepsi, Gatorade, Tropicana, Aquafina,  
Doritos, Lays, Quaker



Pepsi definitely beats Coke in the snack food arena.

# Actionable idea #9 – Drugs

- More people going to the doctor.
- More prescriptions being written.
- Little innovation in new drugs.
- Lipitor coming off patent.



# Actionable idea #9 – Teva Pharma TEVA/NASDAQ

## Teva Pharmaceutical Industries

■ TEVA



Generic drug business is intensely competitive.



# Actionable idea #9 – Teva Pharmaceuticals

- 1-Year target price \$58, implied return 33%

Dividend yield 1.8% or \$0.78 per share

P/E=8.0, P/B=1.7

Market cap \$41.2 billion

Recent high of \$57

Israel based company grown by acquisition into the one of the World's largest generic drug company.



Teva's competitive advantage is their vast product portfolio, making them a one stop shop.

# Actionable idea #10 – Terex Corp TEX/NYSE

Terex Corporation Common Stock

■ TEX

Jan 05, 2012



In need of product replacement cycle.

# Actionable idea #10 – Construction

- Infrastructure needs + construction recovery.





# Actionable idea #10 – Terex Corp.

- 1-Year target price \$27, implied return 75%

Dividend yield 0.0%

P/E=34, P/B=0.8

Market cap \$1.66 billion

Recent high of \$38

Terex manufactures a wide array of capital equipment for the construction and infrastructure markets (i.e. aerial platforms and cranes).



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