RBC Dominion Securities

Lifelong Wealth Management Solutions

Davidson Professional Wealth Management

of RBC Dominion Securities

Market Commentary

September 9th, 2011

Professional Wealth Management Since 1901

RBC Dominion Securities

Overview

The US economy has witnessed an abrupt change of course over the last couple of months. Gridlock over the debt ceiling in the US accompanied by the S&P credit rating downgrade delivered a hit to consumer and business confidence. Hopes for a strengthening economy have faded, and instead, the outlook is for anaemic economic growth and continued historically low interest rates. As a result, economic forecasts have begun to build in a material possibility of recession and capital markets have responded accordingly.

The disappointingly weak US non-farm payroll numbers released last Friday, along with the heightened volatility of global capital markets through the summer, serve to deliver a message of immediacy to politicians and underline the need for them to act decisively. As Winston Churchill noted, "Americans can always be counted on to do the right thing...after they have exhausted all other possibilities.". They've been working through all other possibilities and the time for doing the right thing is fast approaching. Whether or not these events are enough to turn economic growth negative has yet to be determined. ISM numbers released Tuesday morning give some reason for hope (see attached charts).

For outside observers, the efforts of European leaders to work towards a resolution of their sovereign debt issues is like enduring water torture: each move is incremental at best, as they try to minimize the political backlash. The problem exists on two fronts: the first is that some European governments may have little hope of servicing and repaying their debt over the long term; the second, is that their banks are holding what turns out to be way too much of this debt, which is in the process of being marked down by the market, thereby undermining their capital ratios and their ability to do business. This is a tangled mess, and no one expects them to emerge from it for years to come.

Many assets in capital markets are trading near extreme valuations. Bond prices are bid high, putting related yields at historic lows (the 10 yr US treasury bond is yielding around 2%, and the equivalent 10 yr Canadian government 2.25%), and equities in general are valued near, if not below, the lower limit of their fair value bands.

One of the notable differences between autumn 2011 and autumn 2008, is that the concerns of the market today are in plain sight, whereas in 2008 it took months to identify and fully understand the fundamental issues. Also, by the autumn of 2008, the US economy was already fully into recession.

Why not just give up on stocks?

There's no doubt about it, some equity investors are beginning to lose their patience with the whole equity investing thing. With the best years for stocks but a distant memory, and now being in a period of seemingly unending volatility, equity investors are calling into question their faith in the endeavour and beginning to lose hope that equity markets will ever deliver. As we've noted in past, equity markets have an established history of running in cycles of multi-year bear markets followed by multi-year bull markets, and mini-bulls and mini-bears within those cycles (see attached chart). Just as bull markets have an end, so too do bear markets and, based on past experience, it would appear we are closer to the end than to the beginning of this one.

Over a long enough period, bear markets have a tendency to shake out marginal investors (e.g. those who have unrealistic expectations for the times; others who are employing ineffective investment strategies; and those who find it impossible to ignore the "noise" that comes with market volatility). We know, however, that many of them will return once the next bull phase has become well-established and the flow of funds that they bring to the markets will help to propel the bull through the latter part of its phase.

In light of this, we made a major strategic shift with our equity investment strategies some time ago and moved from employing a core growth investment strategy to a series of dividend yield / growth strategies. With dividends, which are not as sensitive to the macro-environment as are stock prices, comprising the main source of investment return, capital appreciation becomes secondary. By receiving a steady flow of dividends, investors are compensated for holding on through periods of market volatility.

As a result, we tend to view down markets as opportunities to build portfolio positions at attractive prices and compelling dividend yields (the dividend yield being a function of the stock's price: the lower the price, the more rewarding the yield).

Charts for Investment Commentary, September 2011

Expectations of RBC RISC are for slower economic growth in 2011 and 2012 in North America as well as other parts of the world.

Forecasts for equity markets, one year out, remain relatively attractive.

RBC Investment Strategy Committee - Economic Forecasts

Real GDP	Forecast 2011	Change	Forecast 2012	Change
United States	1.75%	(1.25)	2.50%	(0.75)
Canada	2.50%	(0.25)	2.50%	N/C
Europe	2.00%	0.50	1.50%	N/C
United Kingdom	1.25%	(0.25)	2.00%	0.25
Japan	-0.50%	(1.25)	2.75%	0.50
Emerging Markets*	6.75%	(0.45)	6.50%	(0.40)

CPI	Forecast 2011	Change	Forecast 2012	Change
United States	2.75%	(0.25)	1.75%	(0.25)
Canada	2.75%	0.25	2.25%	0.25
Europe	2.50%	N/C	1.75%	N/C
United Kingdom	4.25%	0.25	2.25%	N/C
Japan	0.25%	N/C	0.25%	(0.25)
Emerging Markets*	6.00%	0.20	5.25%	0.35

RBC Investment Strategy Committee - Capital Markets Forecasts

Central Bank Policy Rates	31-Aug-11	Forecast Aug-12	Change	1 Year Est. Total Ret.%
United States	0.25	0.25	(0.25)	0.3
Canada	1.00	1.50	(0.75)	1.5
Europe	1.50	1.50	(0.25)	1.7
United Kingdom	0.50	0.50	(0.75)	0.6
Japan	0.10	0.10	N/C	0.1

Equity Markets	31-Aug-11	Forecast Aug-12	Change	1 Year Est. Total Ret.%
S&P 500	1219	1325	(125)	10.6
S&P/TSX Composite	12769	13500	(1000)	8.2
MSCI Europe	1347	1500	(225)	15.2
FTSE 100	5395	5750	(675)	9.8
Nikkei	8955	10500	(500)	19.2

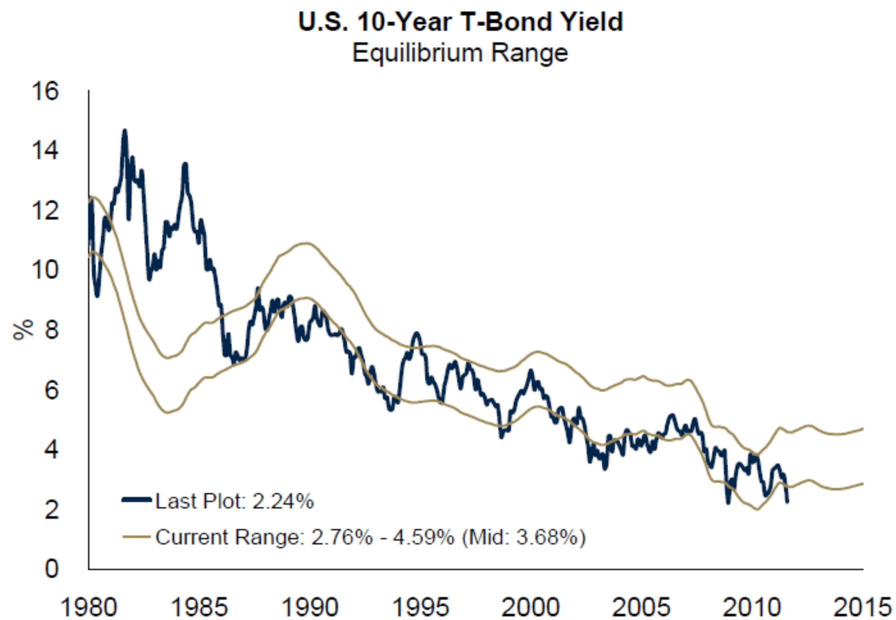
10-Year Government Bonds	31-Aug-11	Forecast Aug-12	Change	1 Year Est. Total Ret.%
United States	2.24	3.25	(0.75)	(5.5)
Canada	2.49	3.50	(0.40)	(4.4)
Germany	2.22	3.50	(0.40)	(6.9)
United Kingdom	2.60	3.25	(0.85)	(4.1)
Japan	1.03	1.50	(0.25)	(1.5)

Currencies	31-Aug-11	Forecast Aug-12	Change	1 Year Est. Total Ret.%
CDA per US	0.98	1.02	N/C	(2.9)
US per Euro	1.44	1.25	N/C	(11.9)
Yen per US	76.66	85.00	(5.00)	(10.0)
US per Pound	1.62	1.64	0.03	1.8

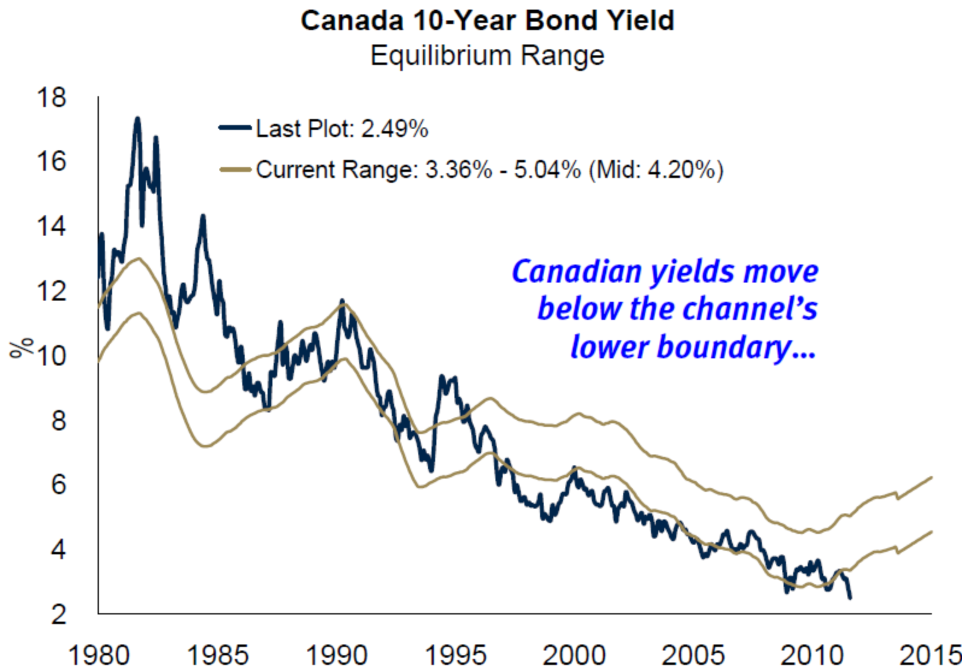
* GDP Weighted Average of China, India, South Korea, Brazil, Mexico and Russia.

Implied in the charts above, and illustrated even more clearly below, is an expected return to a more normal interest rate environment at some point in the future. Today's historically low interest rates are indicative of the historic nature of the economic stresses we are experiencing.

Source: RBC GAM



Source: RBC GAM

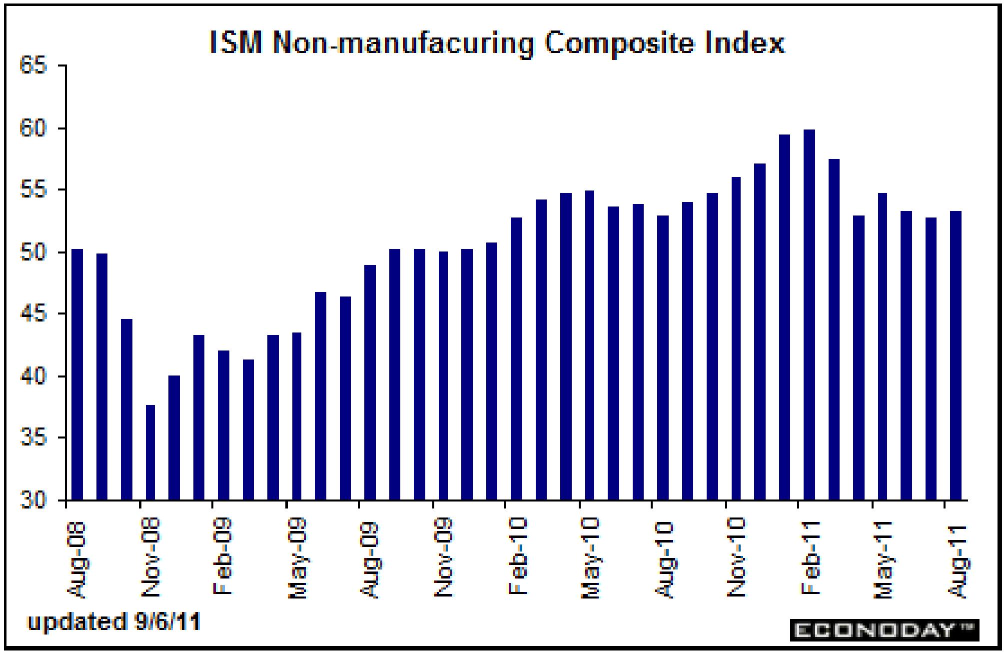


Source: RBC GAM

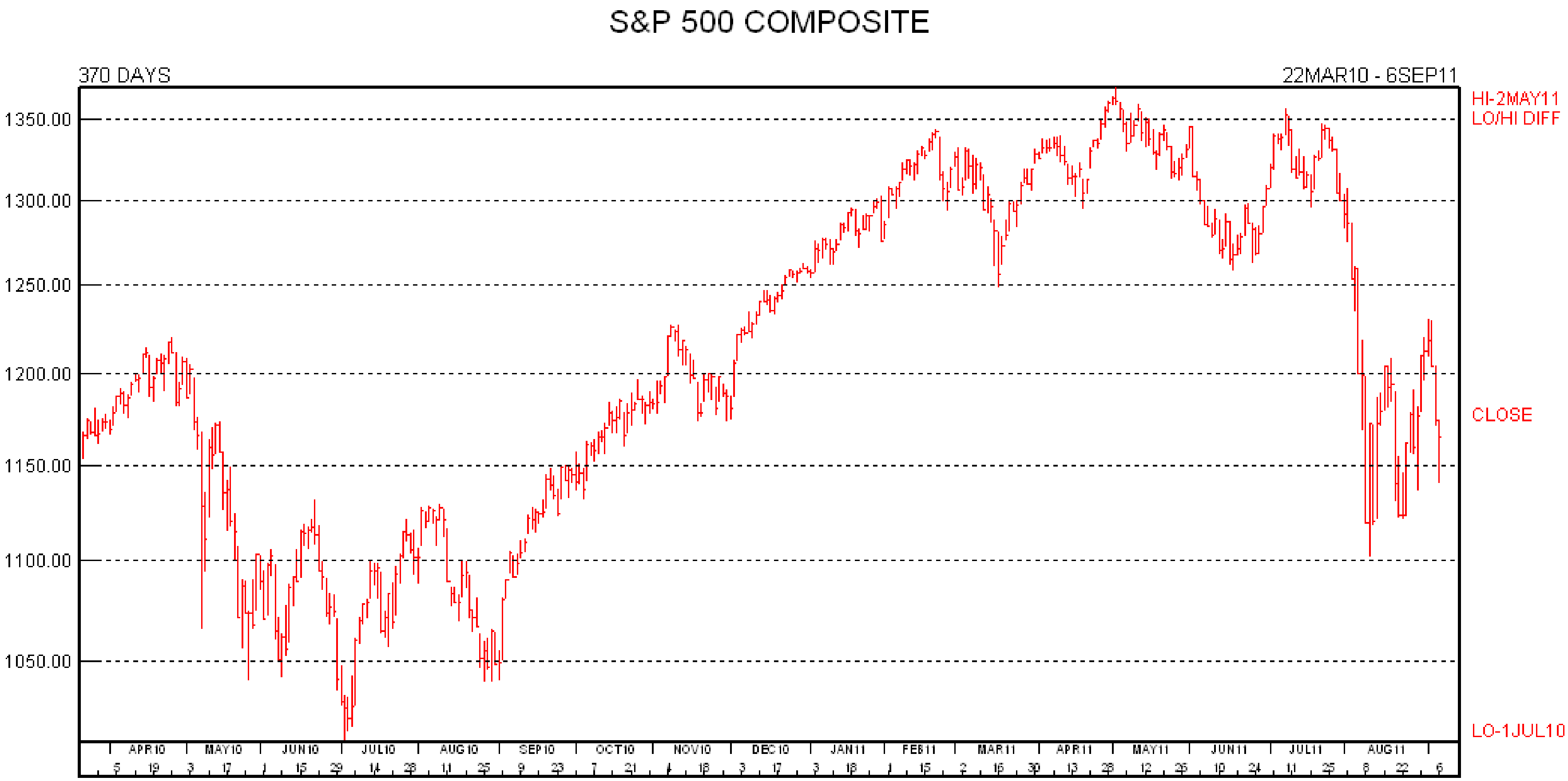
A reason not to panic:

Steady growth is the message from the Institute For Supply Management whose non-manufacturing composite, released Sept 6th, edged six tenths higher to 53.3, a very respectable rate given August's heavy run of negative economic news. The reading is above 50 to indicate monthly growth and, because its slightly higher than July, it also indicates a slight acceleration in growth. New orders show slight but welcome monthly acceleration to 52.8 for a 1.1 point gain from July. The drawdown in backlog orders slowed, which is a positive, while export orders picked up nicely in the month. Though orders have been soft in recent months, business activity, that is production, still remains brisk at 55.6. The ISM's sample, which includes firms in the service sector together with construction and mining, added to their workforces in the month though only slightly and at a slightly lower rate than in July. Supplier deliveries, which slowed in what is a sign of demand, were a major positive for the composite.

The ISM Non-manufacturing index covers companies that employ 90% of the US workforce.

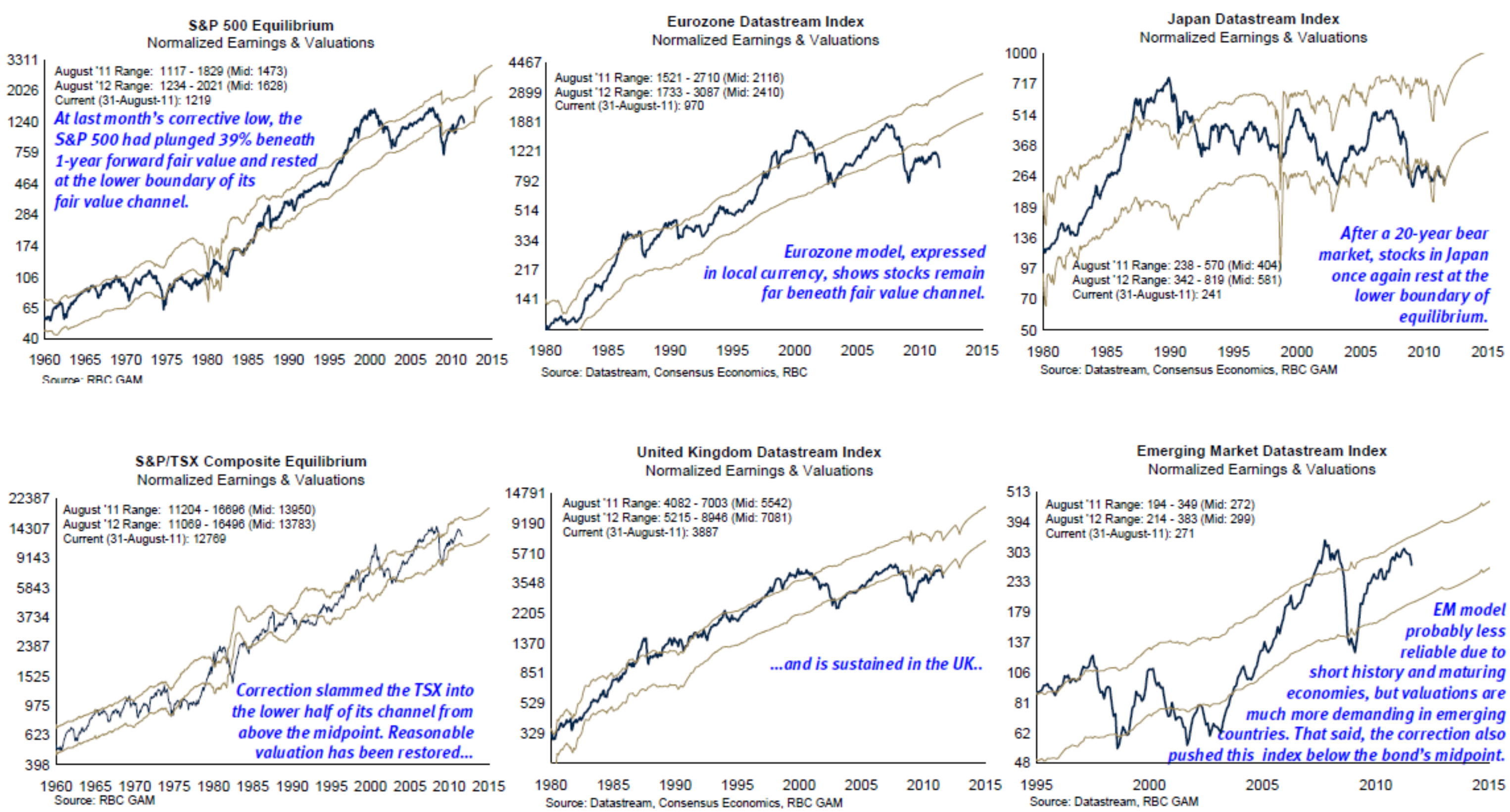


Both this summer and last lived up to their reputations as being periods of seasonal weakness.



As matters have stood since late 2008, equity markets remain attractively valued at or near the lower end of their fair value levels. While this is a useful measure for identifying value in equity markets, it doesn't provide guidance as to the timing of market moves.

EQUITY MARKETS: MAJOR EQUITY MARKETS STILL SHOW SUBSTANTIAL RISK PREMIUMS/SOLID TOTAL RETURN PROSPECTS WHENEVER A "NORMAL" ECONOMY APPEARS



Markets go through alternating bull and bear phases, as show below. Bear markets can be profitable, but require different investment strategies and more nerve than do bull markets.

Long-Term Market Cycles 1920-2011

4

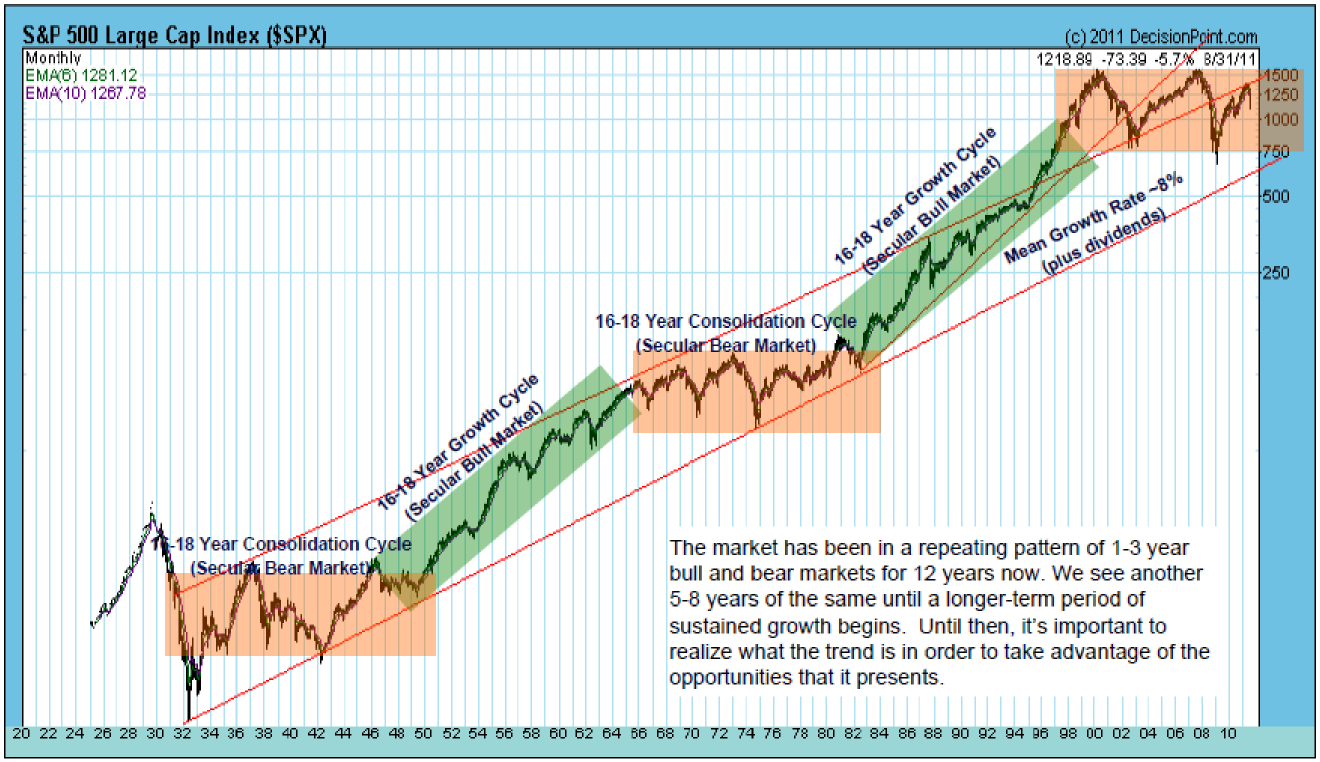


Chart courtesy of Decisionpoint.com and RBC Wealth Management