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

**October 4, 2010**
Economic Commentary

MARKET MUSINGS & DATA DECIPHERING

# Breakfast Lite with Dave

### IN TODAY'S ISSUE OF BREAKFAST WITH DAVE



## SHORT-COVERING DOLLAR RALLY AHEAD?

The economy is weakening and equities are rallying (though again, as we saw on Friday, with volume declining across the board). The U.S. dollar is faltering to six-month lows against the euro despite the fact that Spain was just got downgraded and Ireland's bank bailout just took its deficit-to-GDP ratio to Zimbabwe-like levels of 32%.

Gold continues to make new highs with the dollar's weakness; ditto for commodities in general. The Canadian dollar has firmed to the upside even though most of the incoming Canadian data have been coming in worse of late than what we have seen stateside.

It's all about the dollar. When it goes down, the liquidity spigots gets turned on. When it rallies, it's a sign of a flight-to-safety. Let's just say that we could well be in for a big short squeeze here on the U.S. dollar. According to the latest Commitment of Traders, the net speculative long position on euros is at 27,451 contracts (125,000 euros), which is a huge swing from the mid-May net short position of 105,145 contracts and the most that the non-commercial accounts have been long the euro since the week of November 10th, 2009. What happened back then? Well, the euro went from 1.50 to 1.47 a month later, 1.45 two months later and 1.37 three months later.

While we are still huge long-term fans of gold, it looks hugely overbought here and even a 10% correction would not violate any secular trend-line. The net speculative position on gold is 280,300 net long contracts (100 troy ounce) which ranks in the top three crowded trades ever for the yellow metal (silver, however, is not even close at 52,830 net longs — the record is 72,657).

When you assess the correlations, any short-covering rally in the U.S. dollar would be:

- Positive for Treasuries (lower yield)
- Negative for equities
- Positive for the VIX
- Negative for gold
- Negative for commodities
- Negative for risk (credit, small caps, emerging markets)

## BOND BUBBLE? GIVE ME A BREAK!

You literally could not pick up a newspaper this weekend and not see an article on the dangers of investing in the bond market. Everywhere there are comparisons of dividend yields to bond yields — of course the key difference that nobody talks about is how capital is preserved with a bond in contrast to a stock and how a bond will inevitably mature at par whereas a stock by definition has an infinite duration. Talk about apples-to-oranges comparisons but they seem to sell nonetheless. Just have a look at *How to Play Rising Rates* on page B7 of the weekend WSJ to see where the consensus views are on the direction of bond yields. The weekend FT runs with *Asia Gambles on U.S. Treasuries*.

**The ISM index dipped from 56.3 in August to 54.4 in September, the lowest since November 2009 — if not for the surge in the inventory component, it would have been lower**

Then there is the column on page B1 of the weekend WSJ titled *The Bond Bubble: Are Small Investors Taking Too Big a Bet?*. Well, the answer would seem to be "no" because the retail investor has merely been shifting funds out of money market funds into short-duration bond funds. According to Morningstar, of the $168 billion of the funds that has been ploughed into bond funds, only $1 billion of that has been diverted into long bond funds (33 times that went into short-term bond funds). And keep in mind that the share of all mutual fund assets that is sitting in bonds is 24% — up from 20% at the start of the year but hardly a bubbly level.

## PRECIOUS METALS … PRECIOUS INDEED

Two articles worth reading on one of our favourite topics: First, have a look at *Faster, Cheaper and Fairer* on page 13 of Barron's, and note the citation of the venerable Louise Yamada —according to her work, gold will not enter a *"bubble unless and until it gets to $5,200 an ounce*." To think we're bulled up with a $3,000 forecast!

Then turn to *Silver Lining* on page 83 of the Economist — not only is it also viewed as a safe-haven like gold, but there is a major source of demand coming from solar panels (from photovoltaic cells) which are in a secular growth phase. At the same time, total new supply (75% of which comes from the by-product of copper, zinc and lead mines) has been stagnant now for past six years. In a world awash with monetary easing, it's nice to own something that has an inelastic supply curve.

## PRIVATE SECTOR CONSTRUCTION ALSO SLIDING FAST

Once again, we saw the dominant forces of government intervention in the economy with Friday's release of the August construction, which received little fanfare. Private sector outlays fell 0.9% on the month and right across the board — residential down 0.3%, lodging down 1.5%, office down 0.1% , commercial down 2.8%, transportation down 1.8% and manufacturing down 0.2%. What saved and helped generate a headline 0.4% gain was the 2.5% surge in public sector construction expenditures (led by a 5% bulge in highway spending).

# 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 June 30, 2010, the Firm managed assets of $5.5 billion.

Gluskin Sheff became a publicly traded corporation on the Toronto Stock Exchange (symbol: GS) in May 2006 and remains 54% 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 Value Portfolio in 1991 (its inception date) would have grown to $10.9 million[2] on June 30, 2010 versus $5.4 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 $10.9 million USD[2] on June 30, 2010 versus $8.6 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 Value Portfolio in 1991 (its inception date) would have grown to $10.9 million[2] on June 30, 2010 versus $5.4 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 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.