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

October 4, 2010
Economic Commentary

MARKET MUSINGS & DATA DECIPHERING

Breakfast with Dave

WHILE YOU WHERE SLEEPING

The on-off risk trade is off again.

- Bonds are rallying.
- The U.S. dollar is posting a recovery of sorts (see more on this below).
- Commodities are seeing a reversal as oil slips from an eight-week high.
- European equities are lower across the board — now down six days in a row.
- Asia, in a flash of decoupling, managed to eke out a 0.4% advance even with the Nikkei selling off and the Kospi flat. The Asia-Pac index is now up 17% from the May lows and currently testing six-month highs.

On the data front, it was really light — U.K. construction weakened, off last month, and that's about it.

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).

IN THIS ISSUE

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)

We disagree with this new-found consensus view that double-dip recession risks have been averted

WHAT'S ON MY MIND

Five developments are driving investor sentiment at the current time, and each one deserves to be addressed.

1. Double-dip risks have been averted

We disagree with this new-found consensus view. People don't see that the principal driver of economic growth in Q3 was a 30%-plus annualized surge in auto production (related to the GM IPO). This alone added 1½-percentage points to current quarter growth — for an economy that likely expanded at a 1-2% rate, which means that pretty well all, if not most, of the GDP gains were situated in automotive assemblies. The fact that ISM new orders and backlogs fell so sharply in September, together with the 5% slide in August automotive shipments, is a tell-tale sign that this contribution to GDP growth will reverse course in the fourth quarter, when indeed, odds of a renewed contraction in GDP are nontrivial.

$95 of earnings next year on the S&P 500 — this is the bottom-up estimate that is currently driving equity valuations

Moreover, from our lens, after netting out the massive inventory contribution to headline GDP growth in the last year, we have real final sales growth running at a mere 0.8% annual rate. Assuming that the inventory rebuild process has hit its peak, and that we do end up seeing 1.7 percentage points of fiscal restraint (in terms of GDP impact) for 2011 (under status quo fiscal policy), then arithmetically the economy will end up contracting 0.9% next year barring a major offsetting positive aggregate shock to domestic spending.

2. A muddle-through economy will generate $95 of earnings next year

Indeed, this is the bottom-up S&P 500 operating EPS estimate that is currently driving equity valuations — if you don't believe it, then go to page 26 of Barron's (*Facing Up to the Real Third Quarter*). That would be a 14% gain on top of this year's anticipated 36% bounce. But here's the problem, the economy is no longer accelerating, it is decelerating. And to show how a sub-2% real GDP growth can wreak havoc with corporate earnings when margins are close to peaks rather than troughs, the national accounts data show vividly that on a sequential seasonally-adjusted basis, pre-tax corporate earnings (without IVA and CCA) barely rose at all in Q2 (+0.9% QoQ). So continued double-digit YoY growth (the consensus is +24% for Q3) is masking the slowdown evident on a quarter-by-quarter basis.

Here's the rub: to get that $95 operating EPS for 2011, we either need to see at least 7% nominal GDP growth, which last happened in 1989 when inflation was 5%, not close to zero, or margins manage to reach new all-time highs. We won't entirely rule this out, but will give it 1-in-25 odds of occurring. All we can say is that the base case is for low single-digit nominal growth and some margin compression so frankly we could be looking at something closer to a $75 earnings stream next year. Moreover, when one slaps on a 10x multiple on that — consistent with the economic uncertainty commensurate with a post-bubble deleveraging cycle — then getting to 750 at some point in the S&P 500 is not at all out of the question.

Home prices in the U.S. have not stabilized

3. Home prices have stabilized

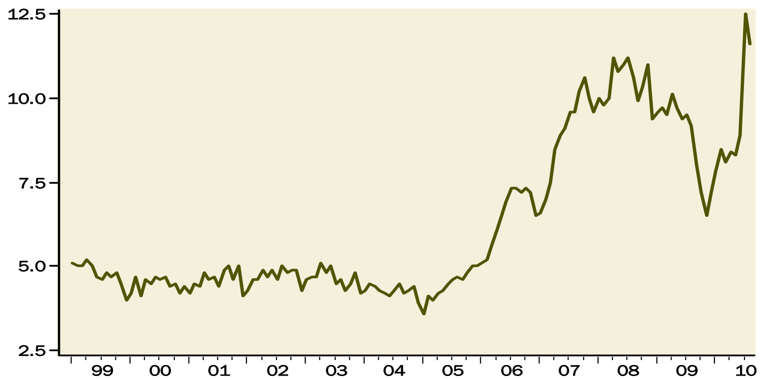
We have no clue where this notion comes from but we seem to hear it all the time. If anything, we are in the process of seeing another leg down. The seasonally adjusted Case-Shiller 20-city index dipped in July for the first time in four months. Core Logic home prices fell for the first time in five months. The FHFA home price series dropped 0.5 % in July and this followed a 1.2% slide in June. Median new home prices fell 0.6% in August and are now down in each of the past three months and in four of the past five — down to seven-year lows to boot. And median resale values slid 1.9% on top of a 0.5% decline in July for the first back-to-back declines since the turn of the year.

Housing inventories are still way above what is considered to be the norm

There is still 8.6 months' supply of new housing inventory to work off. That backlog in the resale market is 11.6 months' supply or double what is typically a market in balance. There are 3.982 million homes and condos that are listed for sale right now, double what was typical of the housing boom years. There are two million housing units for sale that are sitting empty, almost double the norm, and another 3.7 million vacant units being held off the market for unspecified reasons — a million above the norm as well (a proxy for the foreclosure pipeline).

CHART 1: HOUSING INVENTORY STILL AT RECORD HIGH LEVELS

United States: Months' Supply of Total Existing Homes
(months)



Source: Haver Analytics, Gluskin Sheff

Let's just say that given this massive overhang of inventory, if home prices don't decline at least another 10%, then the laws of supply and demand will end up being repealed as far as it pertains to residential real estate. The reality is that the supply excess is more acute now than it was at the depths of the real estate collapse two years ago.

With this still overhang of housing inventory, expect a decline of at least another 10% on home prices

4. The mid-term elections are a critical inflection point

There seems to be tremendous enthusiasm that November 2nd will unleash dramatic political change. This is greatly exaggerated. While it is a no-brainer that the GoP will make huge gains, it is still not even clear that it will take the House, let alone the Senate. Last week's Barron's contained an article actually showing that despite the hoopla, the Republicans could end up a few seats shy of an outright majority in the House. As for the Senate — the GoP needs to take 10 of the 12 most competitive contests (see *House Majority Still Uncertain, Republicans Say* on the front page of the Sunday NYT).

The next question is that even if the GoP do take the House and/or Senate, how will President Obama respond? Will it be like Bill Clinton's conciliatory approach in 1994 or the Obama response to Scott Brown's victory. The reason why gridlock may have been effective in the Clinton and the Reagan eras was because both knew how to compromise. Moreover, the real election, as far as the executive branch is concerned, is two years away. To be sure, while President Reagan was a transformational figure, and also followed a failed one-term Democratic presidency under Carter, he still governed over two recessions as the inflationary excesses of the 1970s had to be expunged (today it is credit and asset bubble excesses). If we recall, the equity market did not end its secular bear phase for a good two years after the Gipper won his first election. Not even he could tinker with mother nature.

5. QE2 is coming, and it will work

First, there seems to be quite a bit of dissent at the Fed over further balance sheet expansion. While Chicago's Evans and New York's Dudley voiced support on Friday, others like Dallas' Fisher, Kansas City's Hoenig and Philadelphia's Plosser are skeptical. In other words, QE2 is not a done deal.

You literally could not pick up a newspaper this weekend and not see an article on the dangers of investing in the bond market

Second, why everyone thinks that taking the 10-year T-note yield down another 50-75 basis points is going to accomplish much in a cycle that has already seen the funds rate sliced 550bps and the 10-year yield down nearly 300bps, is a legitimate question.

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*.

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.

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

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.

ISM — ANOTHER POOR REPORT

The only difference between the September ISM report and the one we saw in August is that the headline in the former was as soft as the components. There is no hiding the fact that we are on the precipice of seeing the mini inventory cycle peak out — the same cycle that accounted for about two-thirds of the lift-off in real GDP from the 2009 lows. That, and the prospect that we are going to shift from fiscal stimulus to restraint in the coming year, suggests that something else is going to have to come to the fore and provide the next underpinning to this anaemic and fragile recovery or else renewed contraction lies ahead. Double-dip risks have been delayed, not derailed.

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 from 51.4 to 55.6 — the highest level since July 1984 — the headline ISM actually would have gone down even further, to 53.6.

The inventory build-up, which for most of this cycle was intentional, now seems to be involuntary. How do we know? Well, for one, production slipped to 56.5 from 59.9, its lowest level since June 2009 just as the recession was about to end. Normally, this level of production is consistent with a 47.4 inventory index, not 55.6, as was the case last month. And, order books are now being squeezed — down from 53.1 in August to 51.1 in September — also the lowest since June 2009.

What is critical here is the orders-to-inventories ratio, which leads the headline ISM by roughly three months and strongly suggests that we will be sub-50 and as such 'double dip' talk will re-emerge before the end of the year. See what this ratio has done in recent months:

May: 1.44x

June: 1.28x

July: 1.07x

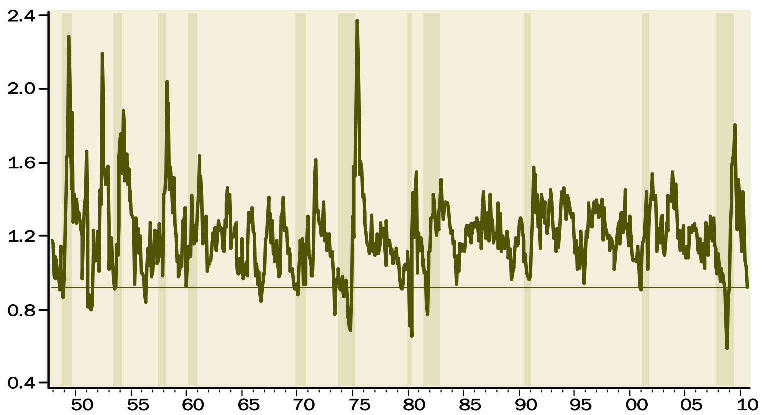
August: 1.03x

September: 0.98x

Ouch! Detect a pattern here, folks? The orders-to-inventory ratio is all the way back to January 2009 levels, when the economy was knee-deep in recession. All we can tell you is what the historical record says — at this level in the past, the economy slipped into contraction 75% of the time.

CHART 2: ISM ORDERS-TO-INVENTORIES RATIO — UH OH!

United States: ISM Manufacturing Survey: New Orders-to-Inventories Ratio



Shaded region represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

Yes, the ECRI (Economic Cycle Research Institute) weekly leading economic index has improved now for four weeks in a row, and went from the worst point of -10.25% just over a month ago to -7.87% as per the September 24th week (from -8.70% the week before), but the problem is that the damage has already been done. Never before has the ECRI gone to such negative levels without a downturn eventually taking hold.

The ISM prices-paid followed commodity prices higher and came in at 70.5 from 61.5 in August. But this is still well off the nearby peak of 78.0 posted in April and the reason we are not at all worried about the "inflation" implications from this figure is because there was absolutely no confirmation from the other price-pressure points within the report.

Backlogs slipped from 51.5 to 46.5 — the lowest since April 2009 when recession and deflation strains were intensifying. Supplier delivery delays eased from 56.6 to 52.2 — the lowest since July 2009. So there is no evidence that the commodity bump is percolating through the production process — this will likely show up more in a squeeze on profit margins than any sustained inflation increase.

The inventory cycle looks to be behind us, and with that, one would expect the transports to give way towards some sort of corrective phase

We had said a month ago that the ISM index for August was bogus even if it did help trigger the best September for the equity market since 1939. If memory serves us correctly, the next secular bull market did not begin for another 10 years, but why bother ruining the start to everyone's week with that one? In any event, we did get some ratification to the view that ISM was a huge headfake. For August, the ATA's (American Trucking Association) Truck Tonnage Index fell 2.8% seasonally adjusted, which was, dare we say, the sharpest decline since March 2009 (the same month that the government decided to effectively bail out the entire insolvent banking industry) and down now in three of the past four months.

The inventory cycle looks to be behind us, and with that, one would expect the transports to give way towards some sort of corrective phase. Bob Costello, Chief Economist at the ATA, had this to say after the trucking data were released:

"We fully anticipate sluggish economic growth for the remainder of this year and the latest tonnage numbers are reflecting that slowdown."

Forewarned is forearmed.

CHART 3: TRUCKS NOW SUCKING?

United States: Truck Tonnage Index
(year-over-year percent change)

Shaded region represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

Gluskin Sheff

LACKING CONFIDENCE

The confidence data tells us that the mood of the U.S. household sector is still depressed

We highlight the weakness below the surface in the latest consumer spending report but the reality is that the confidence data are already telling us that the mood of the household sector is depressed. The final reading of the UofM consumer sentiment was up a tick from the earlier September result, but at 68.2 for the entire month, it was still lower than the 68.9 reading in August (confirming the softness in the rival Conference Board survey). To put 68.2 into context, on average this metric averages 74 in recessions and 90 in economic expansions. So maybe the NBER has its methodology but the reality is that the consumer sector is sure not buying into this end-of-recession declaration.

The components of the UofM survey were rather sickly too. Homebuying plans slipped to their lowest levels since January of this year. Auto buying intentions plunged 10 points to the lowest level since October 2009. If 0% policy rates followed by a QE1 experiment that tripled the size of the Fed's balance sheet couldn't revive credit-sensitive spending, why is the world convinced that throwing more spaghetti against the wall in the form of QE2 is going to be any more successful? In fact, "expectations" are critical to any forecasting model (as we will show below) and in some sense, the public does not believe the Fed will be successful at reflating the economy. How do we sense that? Well, only 14% of the households polled last month believed there is any more room for lower interest rates; and that compares to the 36% who believe that they are actually going to have to go up! No wonder auto and home sales are stuck in the mud — if you believe that you are going to be refinancing at some later date into a higher interest rate environment, then why load up on debt (especially when the scars are still healing from the last credit cycle)?

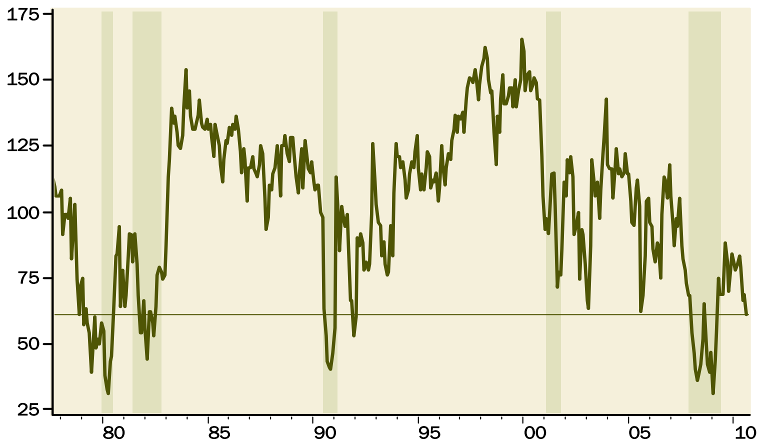
What really caught our eye was the subindex in the UofM survey that captures "expected change in business conditions". Look at this — 123 in January; 107 in August; 101 in September. It averaged 101 in September! In the first quarter of 2009, long before the onset of the 'green shoot' era and amidst a 5% plunge in real GDP, this metric was sitting at 102. This is troubling.

As far as the coming 12 months are concerned, 64% of respondents reported that they believe that economic conditions will be "bad", while only 25% said "good". Brother — and people think we're down in the mouth with our forecast. What is disturbing is how the general population is truly throwing in the towel, and not just for the next 12 months. When asked the same question on the economic outlook for the next five years, 58% said "bad" and just 31% said "good". No wonder heads are going to roll on November 2nd. And to think that this is what this venerable consumer sentiment survey has to say after all the monetary, fiscal, and bailout steroids that the government has injected into the system. Maybe it's time to go back and reread the Amity Shlaes masterpiece "The Forgotten Man" to see why it was that the New Deal in the 1930s ended up doing more harm than good when all was said and done.

The chart below says it all — the index assessing the public's assessment of the economic landscape has plunged from 83 in May to 61 in September. This is the lowest level since April 2009, but lest you think this is a contrary indicator, think again — it bottomed in February of last year, a month before the stock market hit its trough. And it peaked in January 2007, months before the stock market peaked and long before the economics community realized we were heading into a giant-sized credit-induced recession.

CHART 4: THE GENERAL PUBLIC CUTS ITS ECONOMIC FORECAST

United States: University of Michigan Consumer Sentiment Survey: Consumer Expectations: Business Conditions During the Next 12 Months
(relative score)



Shaded region represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

As for a really comprehensive take on the consumer sentiment survey, have a look at the Floyd Norris column in the Saturday NYT —*Recession May Be Over, but Consumer Pessimism is Plumbing New Depths* (page 3 of the business section). A very good read, indeed. And if you want to see how the new frugality has cut a wide swath across income strata, have a look at *Wealthy Take Bigger Helping of Fast Food* on page A2 of last Thursday's WSJ — it will blow your mind. As for those at the lower income threshold and how their spending behaviour is changing, see *These Families Shop When Aid Arrives* on page B1 of the weekend WSJ.

CONSUMER SPENDING — LESS THAN MEETS THE EYE

Everyone went gaga over the August consumer spending and income data without bothering to notice what really drove the numbers — the generosity of Uncle Sam. Personal disposable income did rise what seemed to be a healthy 0.5% or $52 billion, but the reality is that 70% of that increase reflected the huge retroactive 'emergency' jobless insurance checks, which boosted the government transfer portion of personal income by 1.6% or $36 billion.

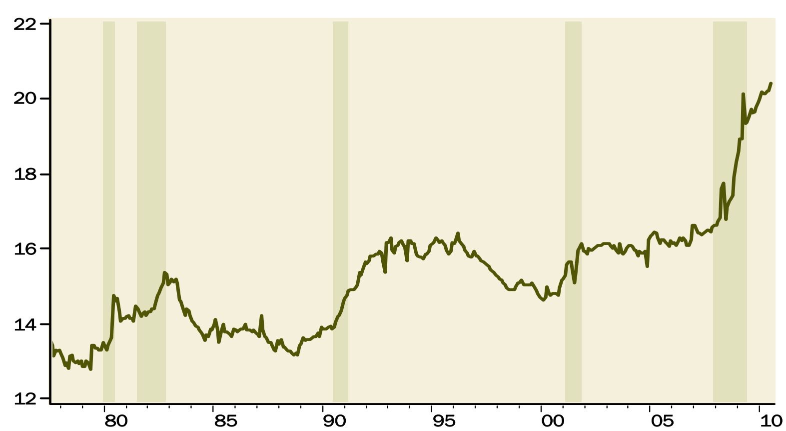
Outside of that, after-tax income rose a more modest $16 billion, and if the spending-savings split would have been the same with or without the handouts, then absent this transitory effect, consumer expenditures would have risen 0.1% in nominal terms, not the 0.4% that was reported; and this in turn would have implied that consumer spending would have declined 0.1% in real terms as opposed to the +0.1% that was officially reported. So once again, there is no 'organic' growth as far as the consumer is concerned as spending in August was only sustained by the long reach of the White House.

As an aside, real personal income excluding government transfers, which are one of the four ingredients that go into the recession-expansion call by the NBER, dipped in August for the second month in a row. The recession may be over, but for at least this critical component of the economic cycle, the recovery has not yet begun.

As the chart below illustrates, the government now accounts for a record-high of over 20% of personal disposable income. Fully one half of the rebound in GDP from the 2009 lows can be traced to this unprecedented degree of stimulus.

CHART 5: GOVERNMENT TRANSFERS AS A SHARE OF DISPOSABLE INCOME

United States
(percent)



Shaded region represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

Let's go back then to the definition of a recession versus a depression. A recession is when the government is compelled to stimulate the private sector. A depression is when the government feels forced to sustain the private sector. As far as August was concerned, consumers would have mildly retrenched if not for the surge in transfer payments, which accounted for 70% (!) of the total growth in personal disposable income during the month. The economy remains on life support, pure and simple.

Oh yes — we are sure that much is going to be made over the bump-up in auto sales in September to 11.8 million units at an annual rate versus 11.4 million in August and consensus estimates of 11.5 million. Keep in mind that the late start to Labour Day gave September a huge lift so timing issues were at play here — that sales gain was highly exaggerated, in other words. And let's make no mistake — replacement demand is 12 million units so anything less than that means that the outstanding stock cars, light trucks and SUV's are being taken off the laneways, parkways and highways of America — the 20% of the public that went into the Great Recession as a three-car family are going the way of the dodo bird as frivolity increasingly gives way to frugality in this post-bubble deleveraging cycle.

Auto sales have come in below 12 million units (annualized) for 13 months in a row. As is the case with housing, auto sales "should be" running at a rate that is 50% higher than that given record-low financing costs. That is the reality. The two sectors most correlated with interest rates and credit availability are still bouncing off multi-decade low levels. The reason is simple. Whether you look at it relative to incomes or assets, the household sector is still carrying on far too much debt on their balance sheets — there is still $5-6 trillion of deleveraging to go so we are barely past the third inning of the debt-extinguishing ball game.

Fully 30% of the consumer sector has a sub-620 FICO score as the debt binge of the last cycle lingers in terms of what impact it had on credit quality as it pertains to households at the margin — accessing debt for a huge chunk of society is a big impediment to the 'typical' revival in the credit-sensitive sectors that we normally see after a massive Fed easing cycle. Indeed, only 47% of American households have decent credit scores but many of these folks are still traumatized by the massive plunge in net worth over the past three years and are now moving to rebuild savings and accelerate their mortgage paydowns by shifting to shorter-term amortization periods upon refinancings. Cash-ins are in and cashouts are out in these new frugal times. Get used it.

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 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).

Look, we're not saying that infrastructure spending by your local pork-barrel politician is necessarily a bad thing, but it may be important for Mr. Market to re-think what sort of P/E multiplied should be applied by an economy that is increasingly being run by the government.

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.