MORGAN MEIGHEN & ASSOCIATES
Investment Management

inFocus
TIMELY INVESTMENT INSIGHT

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We are pleased to provide the latest edition of inFocus, the semi-annual newsletter from our Private Wealth Management team

## IN THIS ISSUE



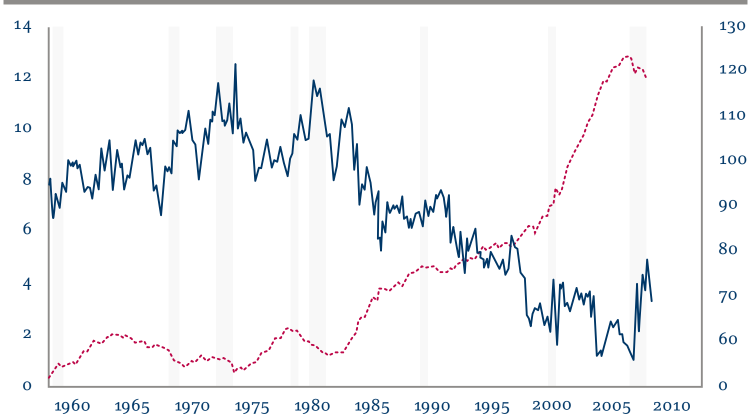
We would like to thank all of our authors for their contribution to this edition of inFocus.

# Looking at the Future of Two Worlds

What a difference six months makes! In our last newsletter article titled "Capital Markets: A Road to Recovery", we detailed the likelihood of recovery in both fixed income and equity markets given the focus by central banks and the improving underlying conditions. While many readers were skeptical of the rebound, statistics and perspective fortified our optimism and produced attractive results for clients. Buying and holding high quality, dividend paying securities led by capable management has again proven sound. Now, where do we go from here? Our investment theme looking forward is "tales of two worlds".

From a fixed income perspective, the credit crunch sparked a "flight to safety" as fearful investors sought refuge in government bonds. With federal and provincial bond prices driven so high that the corresponding yields are negligible, we view this sector to be vulnerable to correction. The massive stimulus programs initiated at all public levels, and reduced tax receipts of recession have combined to widen deficits. These budget gaps will require additional funding through increased bond issuance in future, with higher supply putting upward pressure on yields. Corporate bonds represent the "other world" in fixed income. This year, the historical high water mark for bond issuance was broached in September, with a full quarter left in the year to extend the record. As the credit crunch receded, and risk premiums declined from depression level expectations, corporate bonds have rewarded investors with both capital gains and exceptional real returns. We feel this sector of the bond market still represents a decent rate of return as the economy stabilizes and returns to growth again.

U.S. PERSONAL SAVINGS (——) AND HOUSEHOLD DEBT (-------) AS PERCENT OF DISPOSABLE INCOME




CONSUMER CREDIT PLUS MORTGAGE DEBT
Source: TD Securities

The equity markets similarly can be separated into two worlds. The developing world has obvious growth ahead; positive demographics of young, growing populations, unencumbered public and private balance sheets, and the tailwinds of urbanization and modernization. For the first 18 of the last 20 centuries, China and India were the world's dominant economies, and they appear keen to recover their leadership from the West. Canada is well positioned as the bridge to the fast growing regions given its resource companies, and we have among our holdings many attractive firms actively participating in these foreign markets.

The "other world" is the developed economies, with focus on the U.S., U.K., Europe and Japan; all mired in mounting debt, increasingly challenged demographic patterns, and rising unemployment. In future, additional handcuffs of

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# De-synchronized Economic

**Surinder K. Suri**
PRESIDENT, GLOBAL ECONOMIC MANAGEMENT AND ASSOCIATES

The global economic implosion of 2007-2008 merits a consistent policy framework from the newly minted G-20. The inclusion of China, India, Brazil and Russia into the G-20 elevates the dialogue on how to procure sustainable balanced growth. The massive fiscal and monetary stimulus engendered by the U.S. and other advanced economies could aggravate the macroeconomic imbalance unless it is withdrawn in a gradual and timely fashion. Domestic demand expansion in China is an essential requisite to secure balance.

The eminence of the dollar as the reserve currency is being questioned because of its recent sharp descent. China needs to deepen its capital markets and institute reforms to take on the reserve currency mantle. The enlarged mandate of the IMF to secure macroeconomic adjustments is a precondition to restore balance.

## EMERGING ECONOMIES

With an economic stimulus of 1.7% of GDP, substantial increased lending by the banks and excessive monetary spending, the Chinese economy is leading the global economic recovery. China's growth in 2010 is estimated at 8.6% and at 9.0% in 2011. India's fiscal stimulus of 0.6% of GDP and monetary easing will secure a growth rate of 7% next year and 9% in 2011. Both countries will be major recipients of foreign direct investment. Asian emerging economies are likely to advance by 6.5% in 2010.

> "THE EMINENCE OF THE DOLLAR AS THE RESERVE CURRENCY IS BEING QUESTIONED BECAUSE OF ITS RECENT SHARP DESCENT."

## UNITED STATES

The Administration's budget deficit in 2009 is estimated at 12% of GDP and according to the Congressional Budget Office it will take several years to redress this imbalance. The debt-to-GDP ratio will escalate to 104%. Also, the current account deficit is likely to remain around 6% of GDP. These deficits are untenable and will erode the value of the dollar in international markets.

The Fed has provided liquidity on an unprecedented scale and will embark on a measured exit strategy. Current expectations are for the federal funds rate to stay near zero in the near term and begin to rise by mid-2010. The financial sector reforms have led U.S. banks to shore up their capital via equity issues. Corporate sector investment will lag as companies restore their financial position. High debt levels, deleveraging and weak employment growth will restrain consumer expenditure. Following a loss in output of 2.5% in 2009, the U.S. economy is forecast to gain 2.0% in 2010. The consumer price increase is likely to range between 0.7 and 1% over the next twelve months.

## CANADIAN POLICY & PROSPECTS

The Federal fiscal deficit of 3.3% of GDP and the debt-to-GDP ratio of about 30% result from the measures adopted to stimulate the economy. Canada's fiscal position is significantly better than other OECD countries. However, a balanced budget position is unlikely prior to 2015. Provincial budget deficits have risen sharply and Ontario's budget deficit of $25 billion will necessitate spending cuts in the province. It is anticipated that the Bank of Canada will maintain the call money rate at 0.25% into the first half of 2010. The commercial banks are well capitalized and borrowing costs will remain low. Canadian dollar strength is supported by an increase in commodity prices and the depreciation of the U.S. dollar. The Canadian dollar is expected to trade in the range of 95-98 U.S. cents over the next six months in response to a firming of commodity prices due to an increase in Asian demand.

Domestic demand is resilient due to an improvement in the balance sheet of consumers. Housing activity has picked up in major centers. Employment growth is reflected in healthier consumer sentiment. After a decline in real output of 2.2% in 2009, the Canadian economy is expected to advance by 2.75% in 2010 and the core inflation rate is likely to trend toward 1.5% in 2010. Corporate earnings will improve in response to domestic demand and marginal gains in unit labor costs. Business investment outlays will gather strength. Labor productivity is considerably lower than in the U.S. and it should be the focus of policies.

## CONCLUSIONS AND RISKS

Divergence in economic growth between the Asian economies and North America is evident. The contrast is sharper with the E.U. and Japan. European output is expected to contract by 3.5% in 2009 and to gain by only 1.5% in 2010. Japan will likely witness a loss in output of 4% and the turnaround reflects an increase of only 1.2% next year. Fiscal deficits in the E.U. and in Japan are worrisome.

Commodity prices are expected to rise. Crude oil prices are anticipated in the range of $70 to $85 dollars per barrel. Natural gas prices are depressed because of excess supplies and weak demand. A modest increase in natural gas prices is probable in 2010. The fledgling global economic recovery may experience a financial fall-out unless the financial reforms are implemented soon. A protracted economic recovery could fan protectionist measures. Skepticism concerning the relative weight of the U.S. dollar in the reserve currency basket will lead to volatility in foreign exchange markets. The European Central Bank and the central banks in Asia and Japan are unlikely to favor an appreciation of their currencies in the current economic climate. Most probably gold will appreciate in this context.

The global savings difference between the advanced and the emerging economies needs to narrow. High savers in China and the emerging economies will over time satisfy their pent-up demand for consumption. Corporations in Asia and Latin America are stepping up their activity in either acquiring or entering into joint ventures with their counterparts in North America and Europe. The focus of this investment is the resource sector and over the next few years it will increase in other sectors.

# CONCERNED ABOUT FRAUD?

In the aftermath of the credit crisis, a number of fraudulent investment schemes have come to light. One of the most publicized cases has been that of Bernard (Bernie) Madoff in the United States, who pled guilty to perpetrating a Ponzi scheme that defrauded thousands of investors of billions of dollars. This scheme, which Madoff claimed began in the early 1990's, is speculated to be one of the largest cases of investment fraud to have ever happened in the United States. During his plea allocution, Madoff admitted that he had never made any legitimate investments with his clients' money as he had led them to believe instead, he simply deposited the money into his business account at Chase Manhattan Bank. In Canada, Earl Jones, an unregistered investment adviser based in Montreal, has been accused of defrauding at least 50 investors of over $30 million in total in another possible Ponzi scheme. And unfortunately, the list of alleged investment fraud cases continues to increase as the year progresses.

## How do you protect yourself from fraudulent activity?

There are several key considerations that you should take into account before investing. First, are you dealing with a registered adviser? Many fraudulent investment schemes, such as the one perpetrated by Earl Jones, could have been avoided if investors had made a simple phone call to check if the adviser they were dealing with was registered with the relevant regulatory bodies. Anyone selling securities or offering investment advice in Ontario must be registered with the Ontario Securities Commission (OSC), unless they are exempt from this requirement. Outside of Ontario, investment advisers must be registered with their respective provincial securities regulatory body. At Morgan Meighen & Associates, all of our portfolio managers are qualified, approved and registered with each relevant provincial commission to provide investment management advice to individual and institutional investors. In addition, the firm is a member of the Investment Counsel Association of Canada, and many members of our investment team are individually governed by professional associations, such as the CFA Institute, (Chartered Financial Analyst) to adhere to a strict code of ethical behaviour and standard of professional conduct.

Another key consideration before investing is the process itself. How do you initially deposit your funds? Who has access to your account? Are you able to easily contribute or withdraw from the investment plan? To invest with Morgan Meighen & Associates, our clients create an account with a widely recognized subsidiary of a Canadian chartered bank - TD Waterhouse. We ourselves do not act as the custodian or accept funds directly from clients. The mandate extended to us by our clients is solely for trading purposes, and payments to third parties do not occur without the client's express written permission.

Next, beware of anyone promising high returns for low-risk investment opportunities, or investments based on "hot tips" or "insider news". Our investment team diligently researches each holding in your portfolio. We seek to invest with companies that are financially sound, have a credible management team, and a solid track record of performance. Your portfolio is created on an individual basis, with your risk tolerance and required return objectives in mind.

Lastly, ensure that you understand how the investment works and have been given enough time to make a decision. Overly complicated investment structures, or high-pressure sales tactics should immediately trigger alarm bells. It is important to have a well thought-out investment plan to ensure that your financial needs are being fully considered.

## How do I find out more?

To learn more about how to protect yourself from investment fraud, please go to the website for the Investment Counsel Association of Canada (www.investmentcounsel.org) or contact one of the investment professionals at Morgan Meighen & Associates. We are always happy to answer any questions you may have regarding your investments!

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increased regulation, government interference in commerce, additional entitlement programs and higher savings rates lead us to believe that future returns in these locales will be unremarkable. The U.S. is the dominant economy of the West, and with over two-thirds of GDP dependent on consumer spending, a quick recovery to the heady days before the credit crunch is unlikely. Canadian investors will continue to acquire reasonably priced hard assets in the U.S. and abroad given our improved fiscal standing and favourable exchange rates. Increasingly, we find it very attractive to acquire world class multinationals in the U.S. and abroad. Well known consumer brand names, at reasonable valuations and yields, round out any sector deficits in our domestic market. Thus our clients can have exposure to fast growing economies, but have the benefit of familiar accounting and securities standards without the challenges of direct currency translation. These themes will increasingly guide our investment selection in coming periods.

While the “two worlds” analysis is sobering, we suspect that the shock sustained by the Western world’s financial system in the last year may have permanent implications for investors. The equity culture of the baby boomers will likely shift incrementally in favour of fixed income and more conservative securities.

The markets we have experienced over the past year are those in which our investment management process shines. Looking ahead, markets may be volatile yet likely range bound, and should provide active managers such as ourselves the opportunity to add significant value. We are confident that our focus on risk management, absolute returns, and customized portfolios provides comfort that resonates with our clients. The high quality characteristics of investments we prefer are the keys to both wealth creation and preservation. The last year has been traumatic and challenging for all, and we are grateful for the trust and confidence that our clients continue to place in us.



# IN THE NEWS
## AT MORGAN MEIGHEN & ASSOCIATES

THE SEVENTH TORONTO POST OFFICE, c.1867

We’ve moved! It is with great pleasure that we announce the completion of our move to 10 Toronto Street. Following extensive restorations and renovations the historical building that was once the Seventh Toronto Post Office (built in 1851-1853) has become the new home of Morgan Meighen & Associates. We look forward to seeing you there soon!

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Please join us in welcoming Shauna George to the Private Wealth Management team as an Assistant Vice-President. Shauna has an extensive background investing in global equities, and is a CFA Charter holder. In addition to contributing new investment ideas and monitoring our existing holdings, Shauna will be assisting with the marketing initiatives being undertaken by the firm.

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Did you notice anything new? To celebrate our move, we have created a new visual identity. Rest assured that while our look may have changed, we remain as committed as ever to providing you with exceptional investment management combined with high quality, personalized client service.

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