



# Economic Update for Canadian Institute of Plumbing & Heating

## November 10, 2011

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# Disclaimer for Charts / Graphs:

Past performance is not indicative of future results, which may vary.

Statistical information comes from sources that we believe to be reliable source(s); however, no information or related data has been independently verified by us. We assume no duty or obligation to update any information or data.

The information contained in this report is based on generally available information, its accuracy and completeness cannot be assured, and such information may be incomplete or condensed.

Some indices are unmanaged and investors cannot directly invest in them. The composite index results are for illustrative purposes only and do not represent the performance of a specific investment.

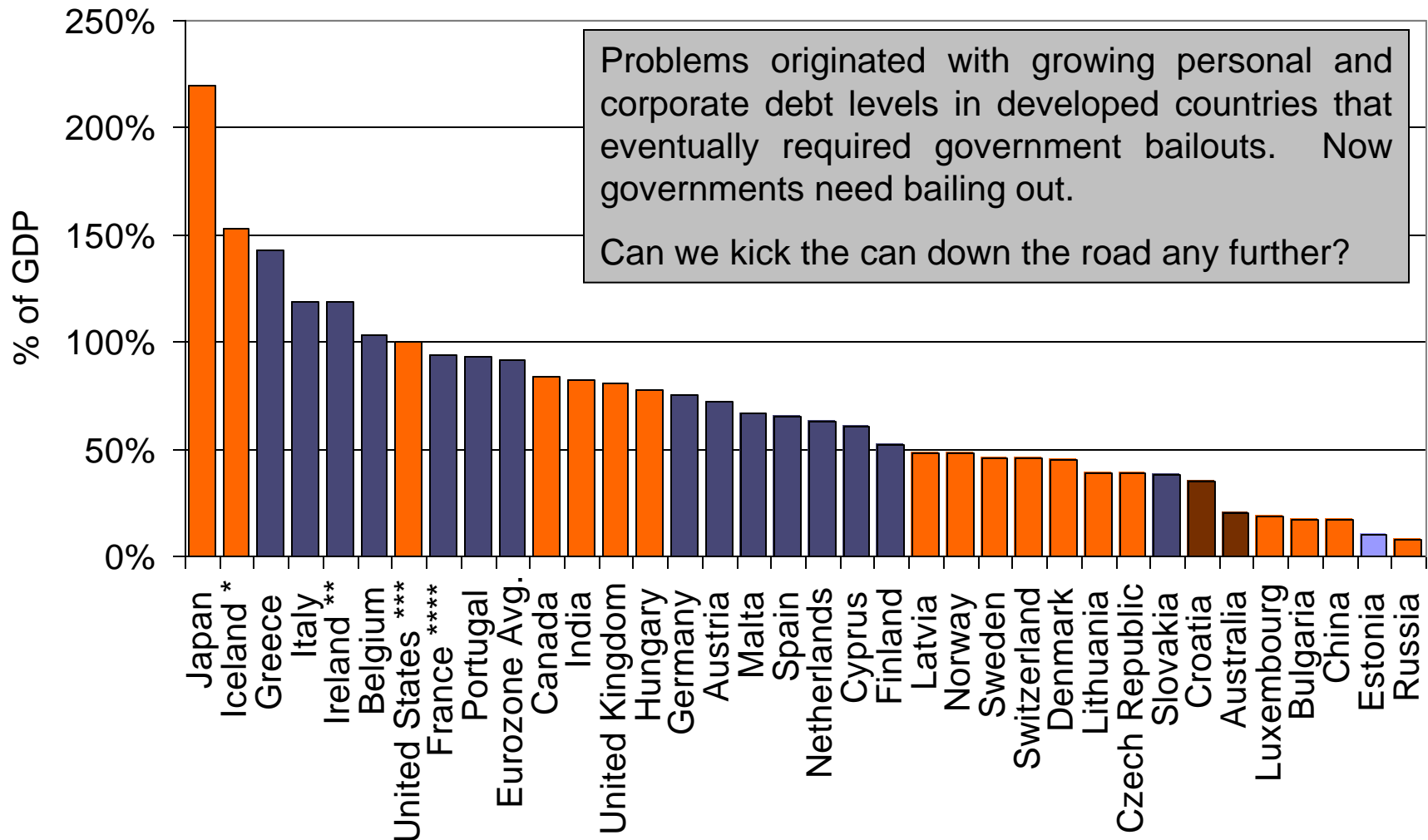
Supporting documentation will be furnished upon request for all claims, comparisons, recommendations, statistics or other technical data.

Other Kerr Financial personnel may have made investment decisions or take positions that are inconsistent with the recommendations or views in this publication.

# Contents of presentation

- Status of the euro zone
- China's soft landing
- US economy
- Canadian economy
- Current market valuations and outlook
- Ideas on what to invest in

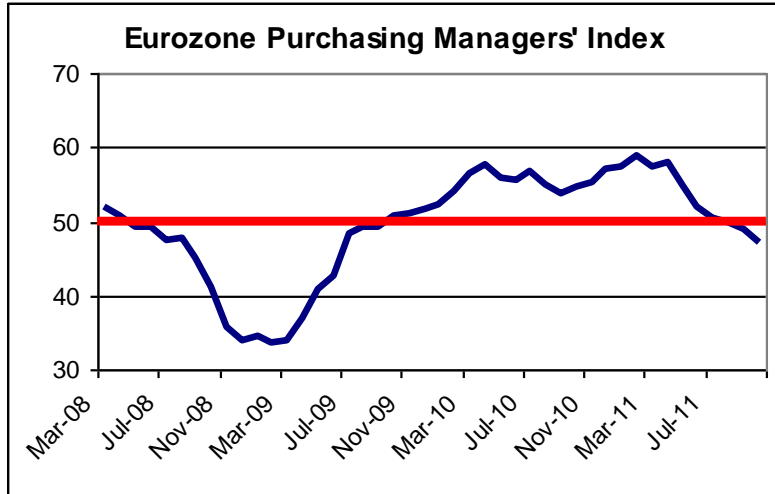
# Sovereign Debt as a % of GDP



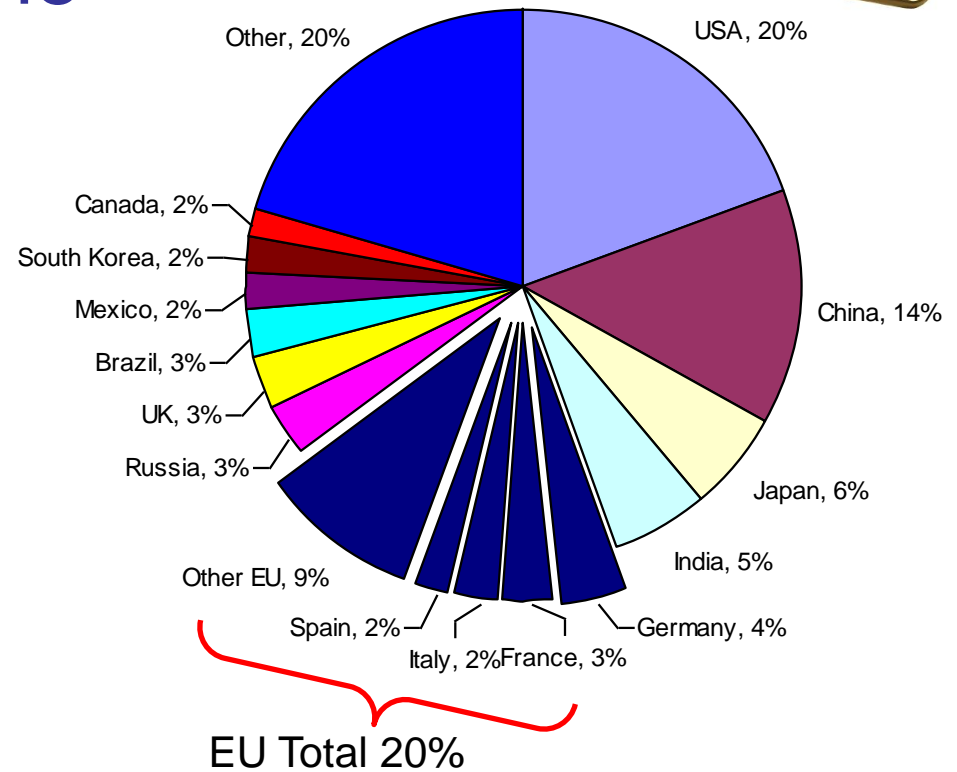
\* Iceland post IMF Bail out, \*\* Includes NAMA, \*\*\* Includes TARP & debt held by gov. accounts, \*\*\*\* Includes SFEF

Source: Moody's Investor Service "Country Credit Statistical Handbook"

# Status of the euro zone



GDP by Country 2010



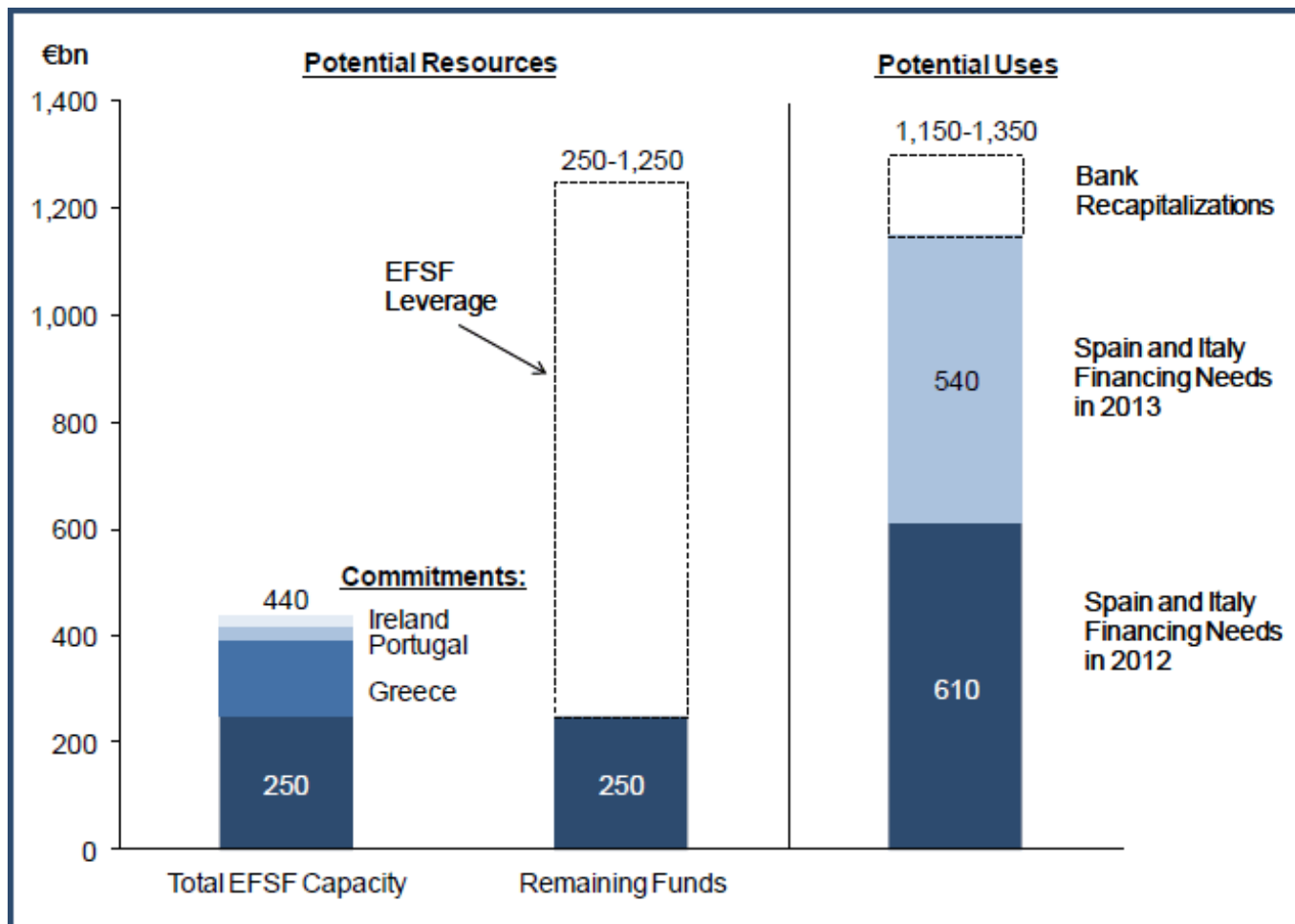
US banks have \$518 billion exposure to the PIIGS from sales of insurance against credit losses from government, bank and corporate debt.

# Status of the euro zone cont...



ECB's balance sheet is €2.3 trillion and may step in after Italian government in place

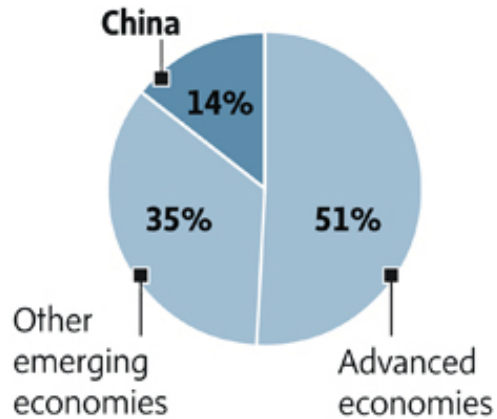
The ECB is becoming lender of last resort



# China's Soft Landing

**1** China now has a commanding share of the global economy. ...

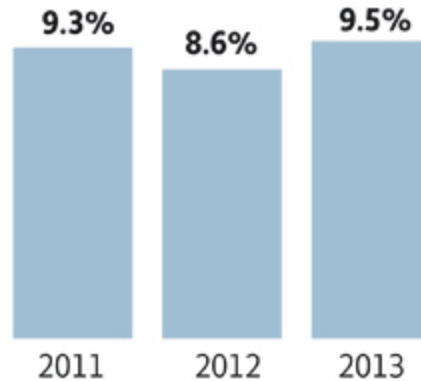
## SHARE OF GLOBAL GDP, 2011



**2** But its red-hot economic growth is slowing. ...

## OECD FORECASTS

Average annual growth of GDP



**3** Yet tight credit conditions initially intended to cool overheated property markets remain.

## MONETARY TIGHTENING POLICIES

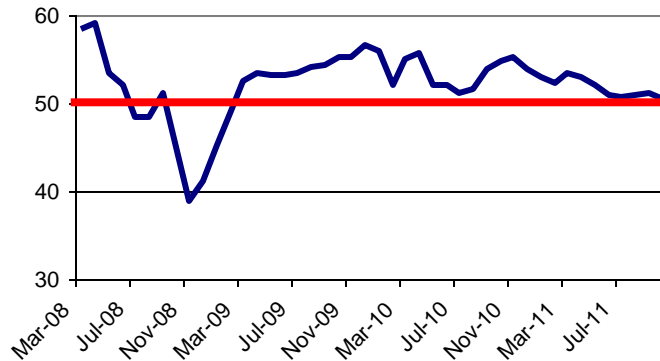


\*M2 is the benchmark gauge of how much cash, bank deposits and other money is in circulation.

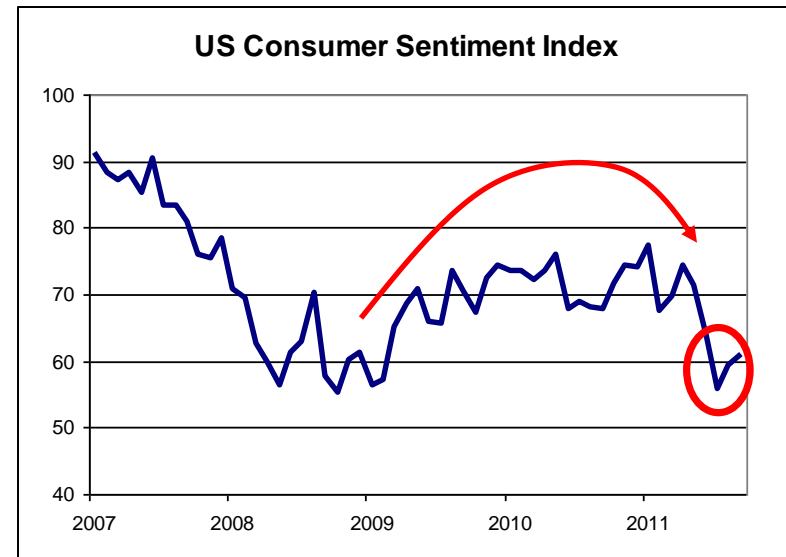
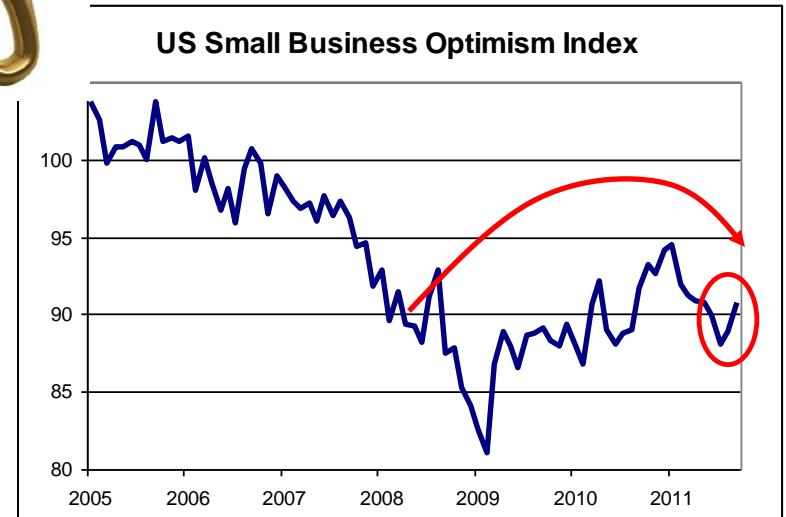
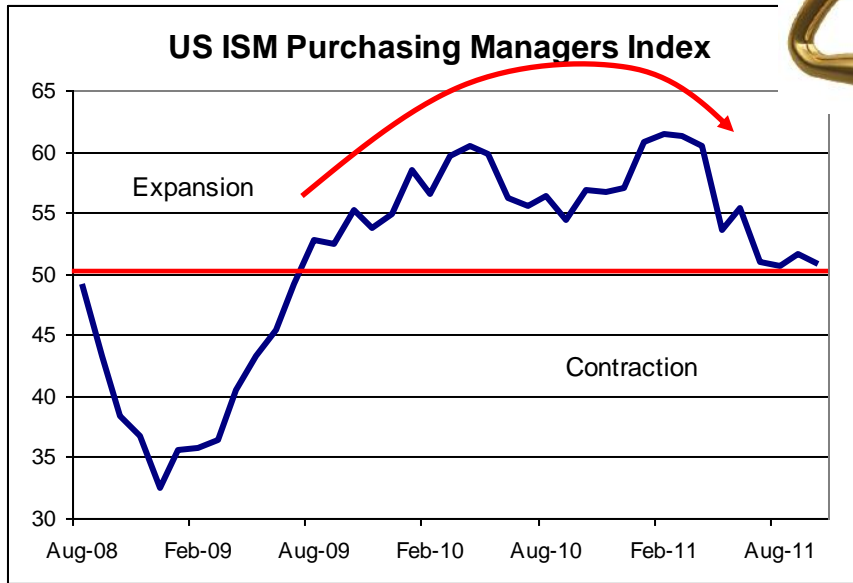
THE GLOBE AND MAIL » SOURCES: ASSOCIATED PRESS; REUTERS; FINANCIAL TIMES

Chinese industrial output in October grew at its weakest annual pace in a year and inflation fell sharply.

## China Purchasing Managers' Index



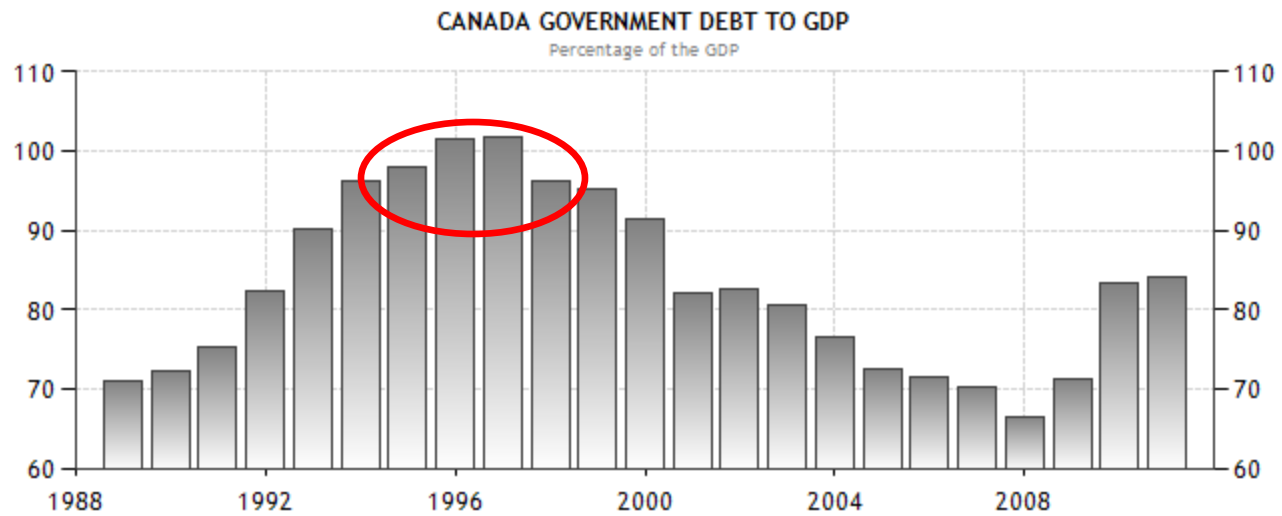
# US Bad News



Mainly sentiment and survey indicators have been the recent bad news. They can change rather fast and are influenced by news events and public opinions as opposed to hard data from other indicators.

Today, investors are cautious and spending a lot of time looking in the rear view mirror at 2008.

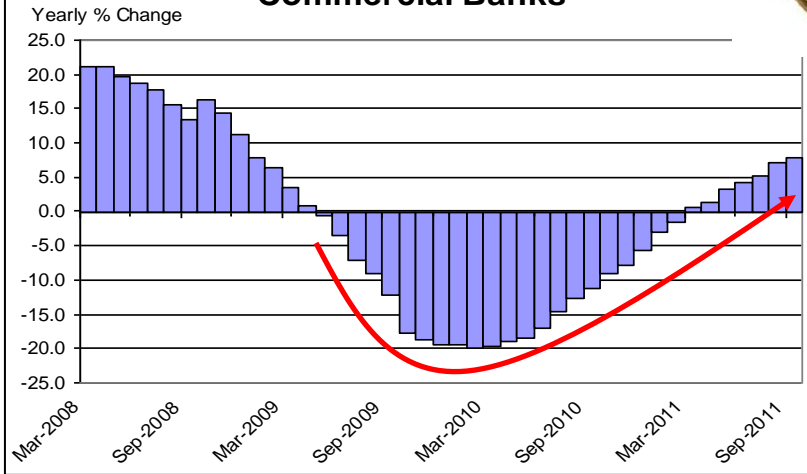
# Been there before



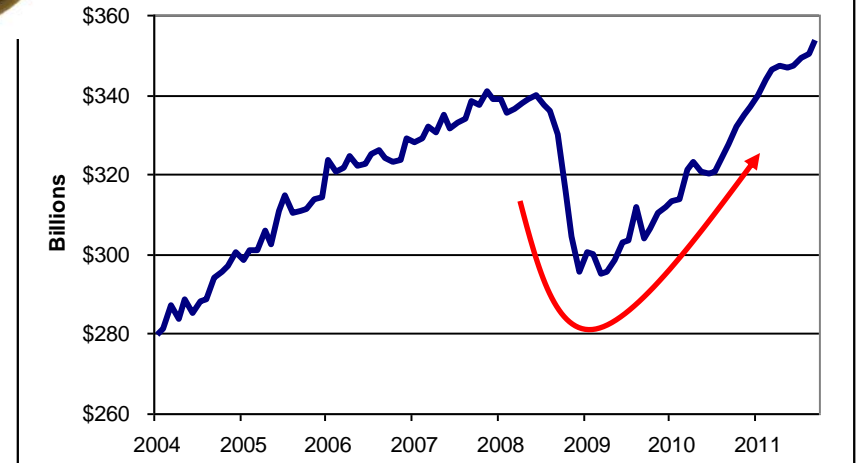
# US Good News



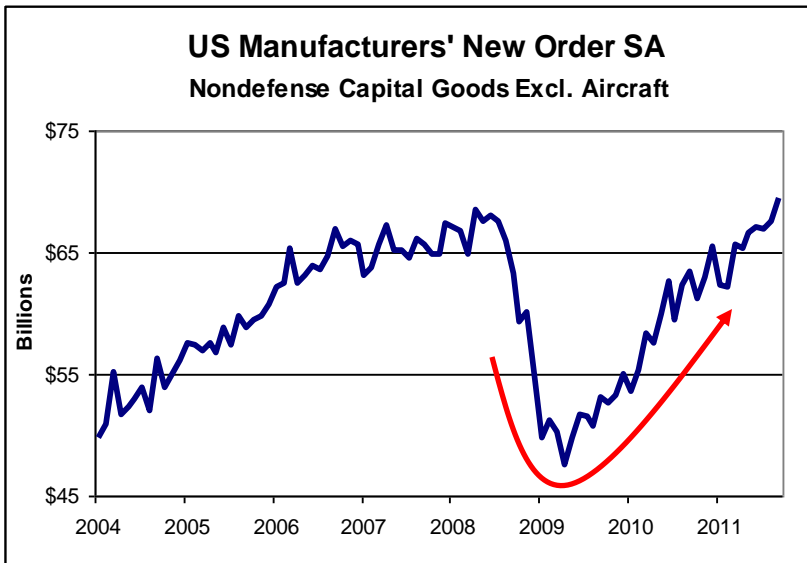
## Commercial & Industrial Loans at US Commercial Banks



## US Total Retail Sales SA (Excluding Food Services)



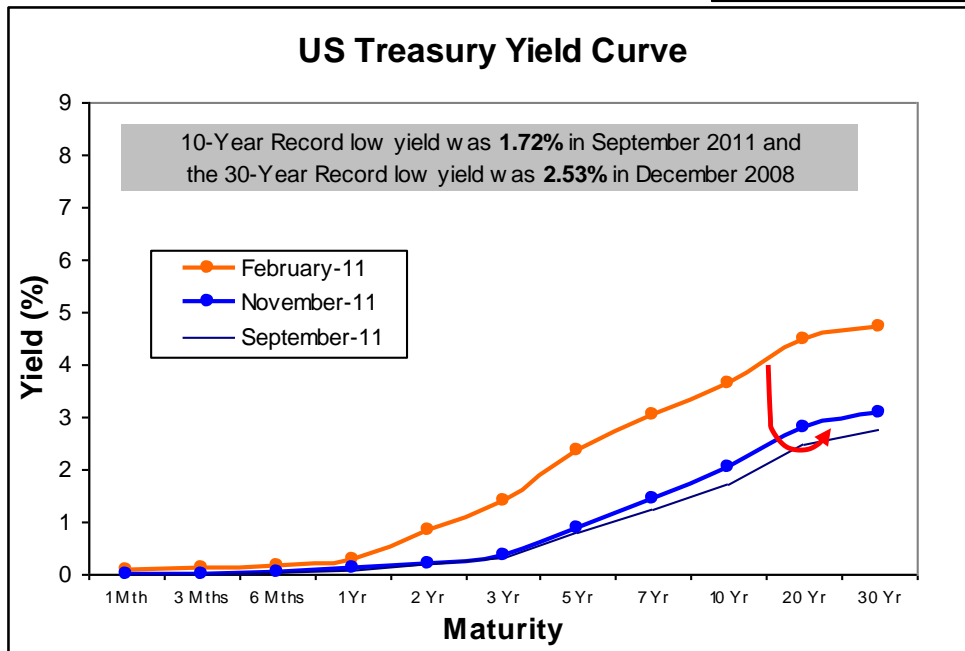
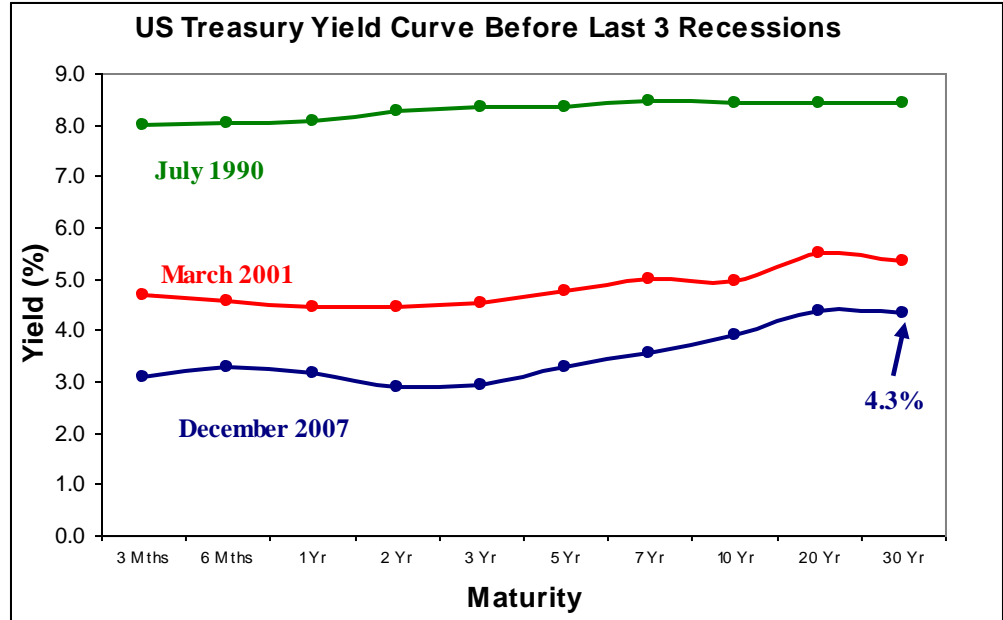
## US Manufacturers' New Order SA Nondefense Capital Goods Excl. Aircraft



- US Retail sales increased 1.1% in Sept., the most in 7 months and vehicle sales climbed by 3.6%, the most since March 2010
- Existing US home sales in August rose a surprising 7.7% from July
- Total US consumer spending rose by 2.4% last quarter
- US September consumer credit grew sharply

# US Yield Curve

Flat yield curves normally precede a recession.

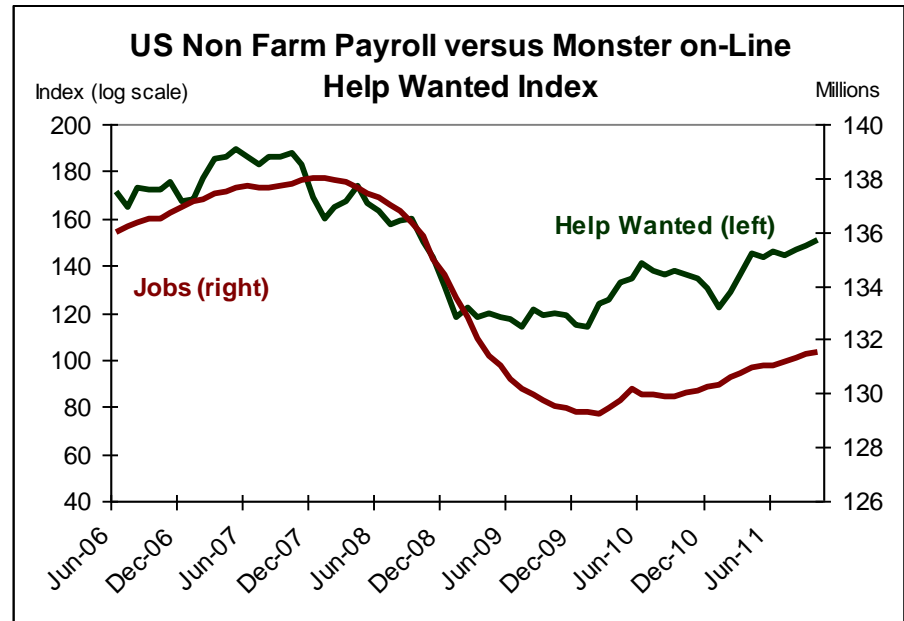
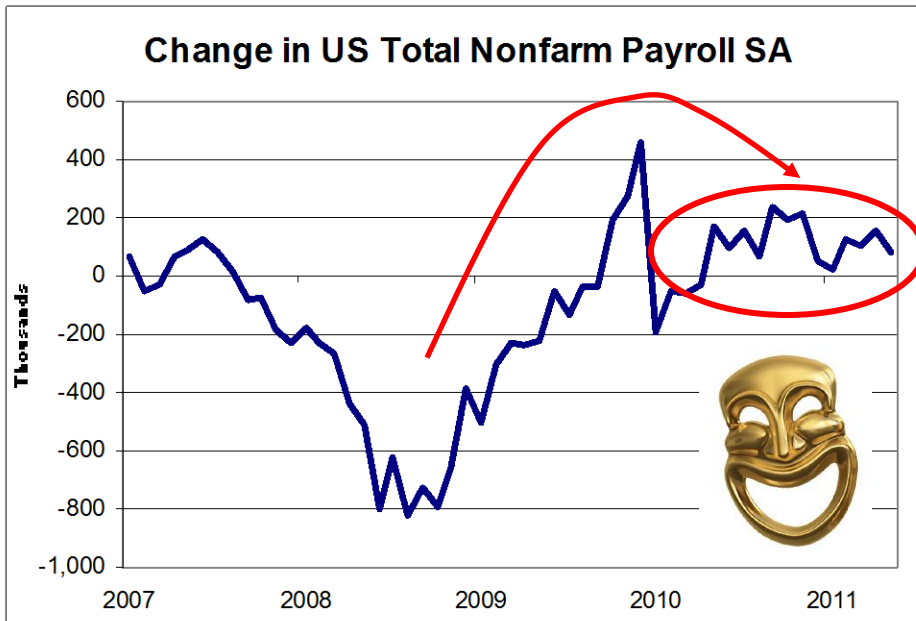
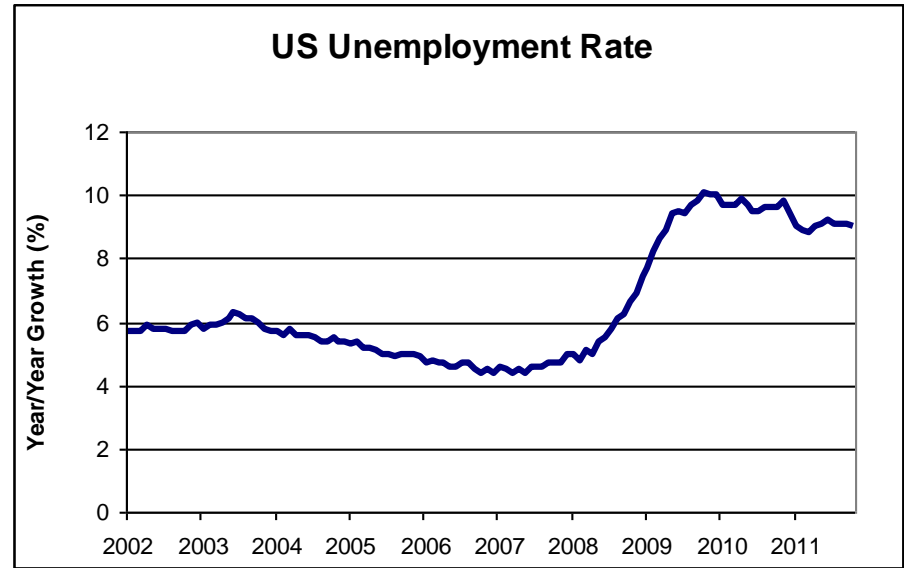


Our current yield curve is not flat, but the near record low rates might be enough to signal a recession

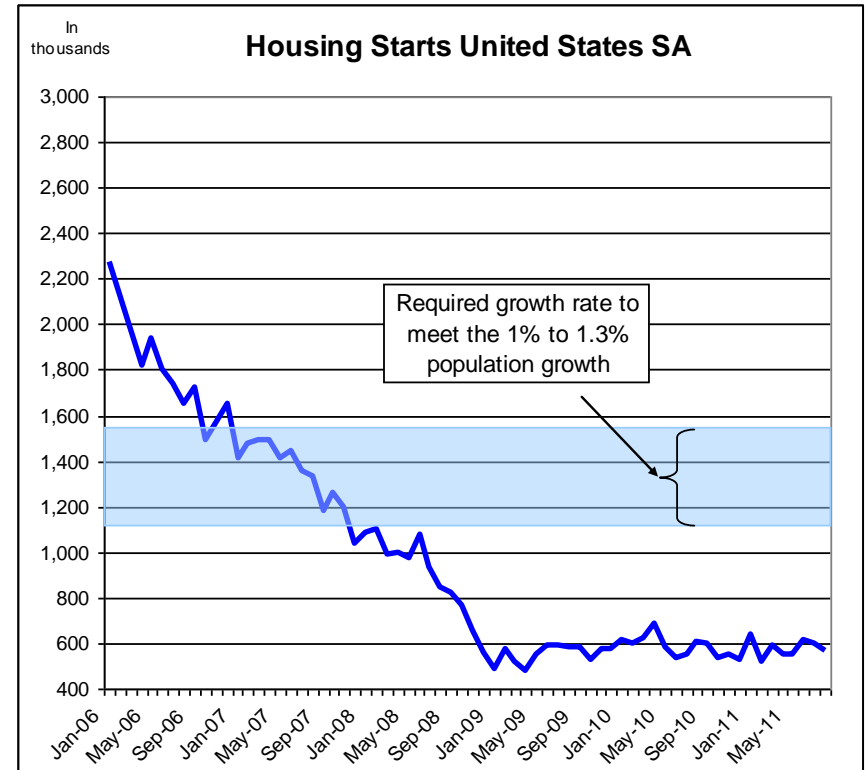
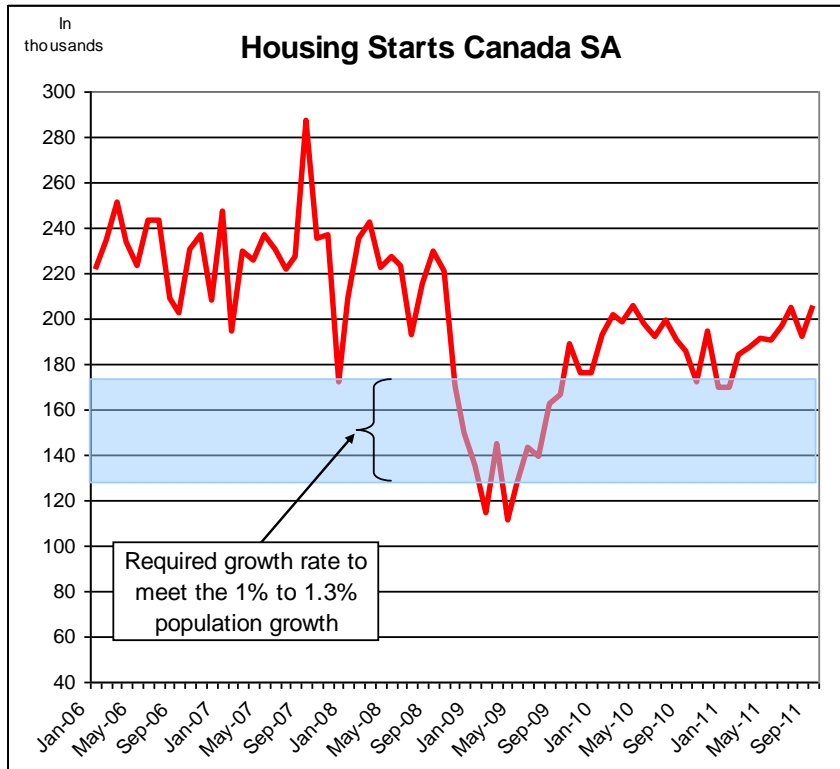
# Key Issues for the US

In the last three months Household employment has gained more than one million jobs – best 3 month tally since 2006 and the outlook remains favourable.

CEOs are not seeing a slowdown.



# Comparing Canada to the US

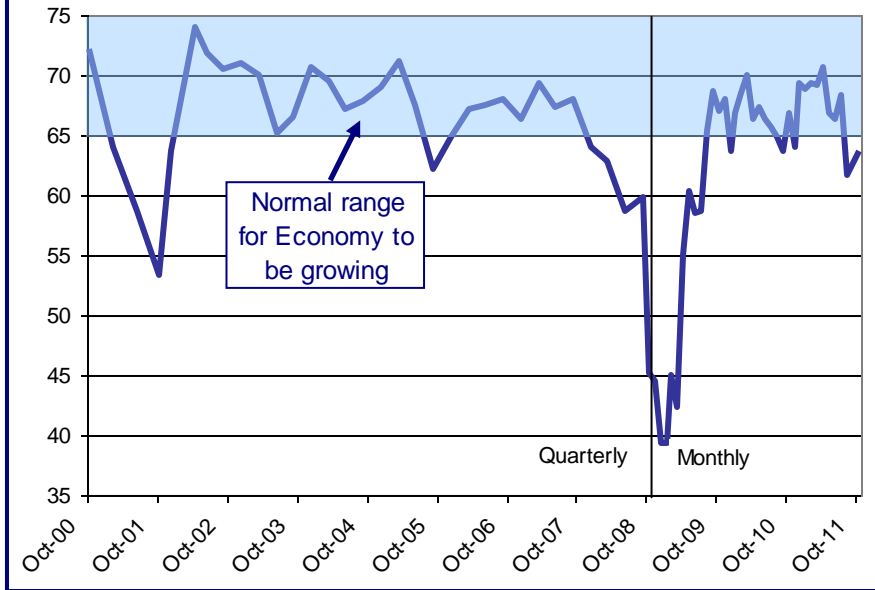


Single-family home construction is now at its lowest level in two years and off more than 29% since the end of 2009. Multiple-unit starts, which are mostly made up of condominium construction, have climbed 70% during the same period and the sector is at its highest level.

A Hedge fund manager who correctly predicted the housing collapse is now beating the market has neared bottom.

# Canadian Economy

## Canadian Business Barometer

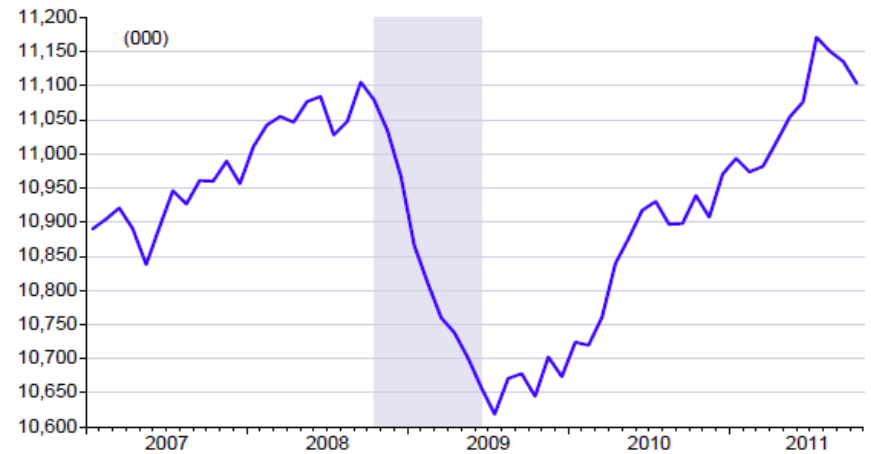


In 2009, exports were 75.02% to the US, 3.37% to the UK and 3.09% to China

Canada's unemployment rate is currently 7.3% versus 9.0% for the US

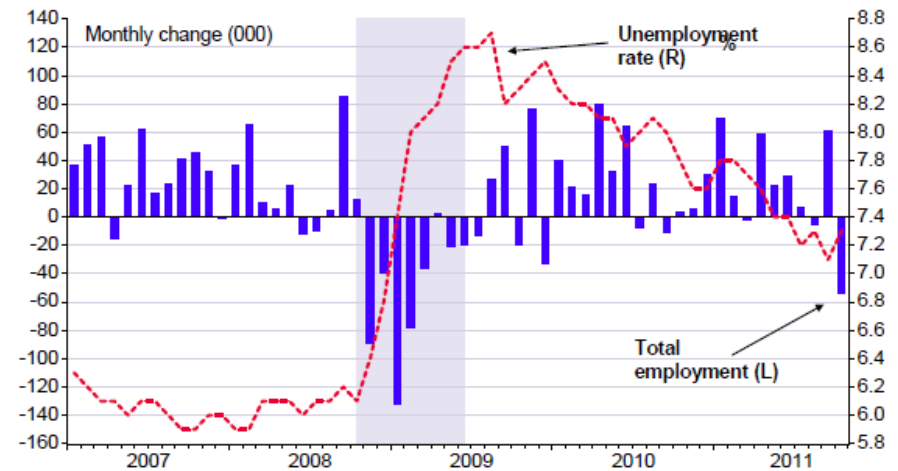
## Private jobs declined for a third month in a row

Private jobs



## Almost all September gains were lost in October

Employment and unemployment rate

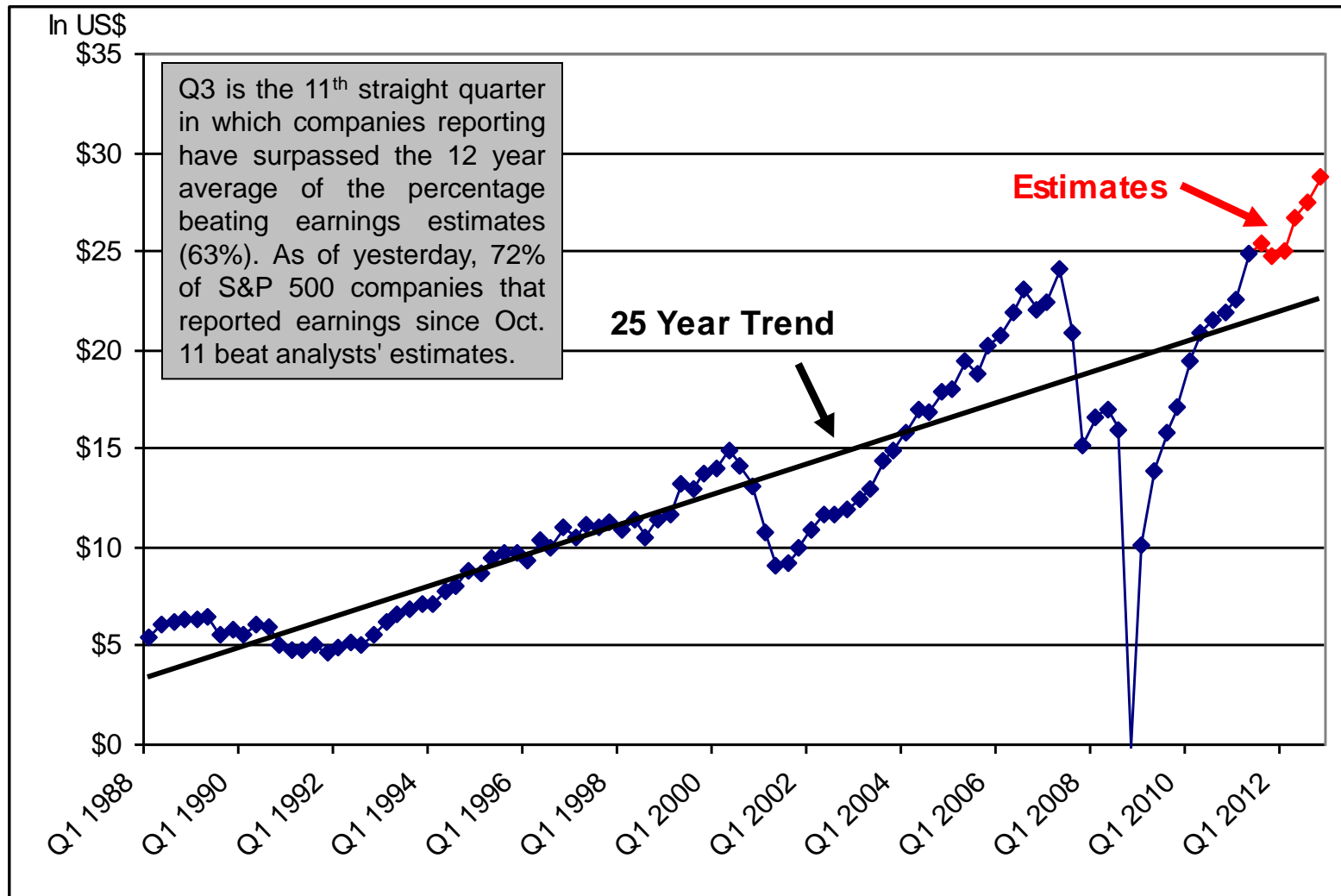


NBF Economy & Strategy (data via Global Insight) 2011-11-04

# Are the Equity Markets Attractive?

# Current Market Valuations

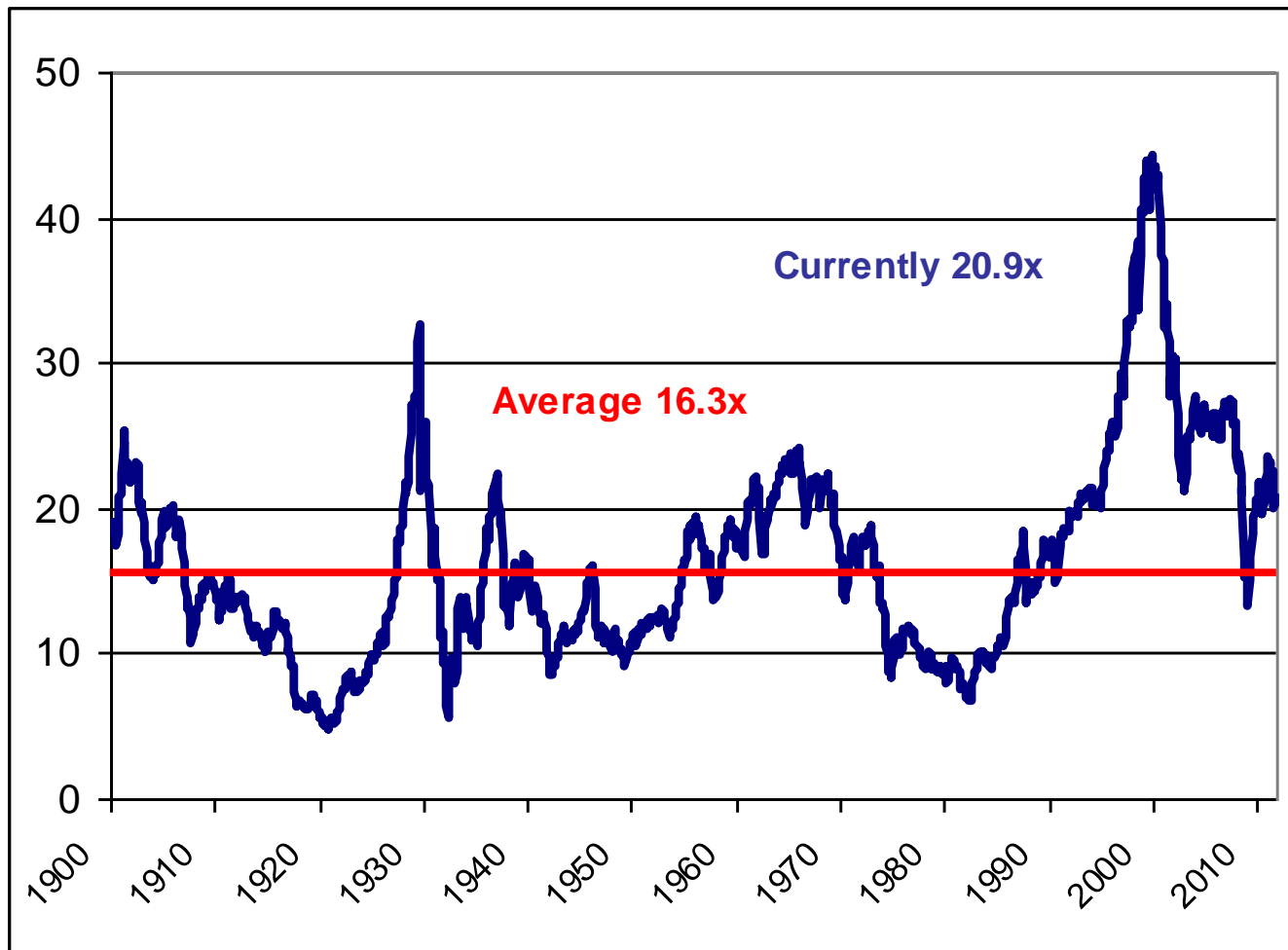
## S&P 500 Earnings and Estimates (Bottom Up)



# Current Market Valuations Cont...

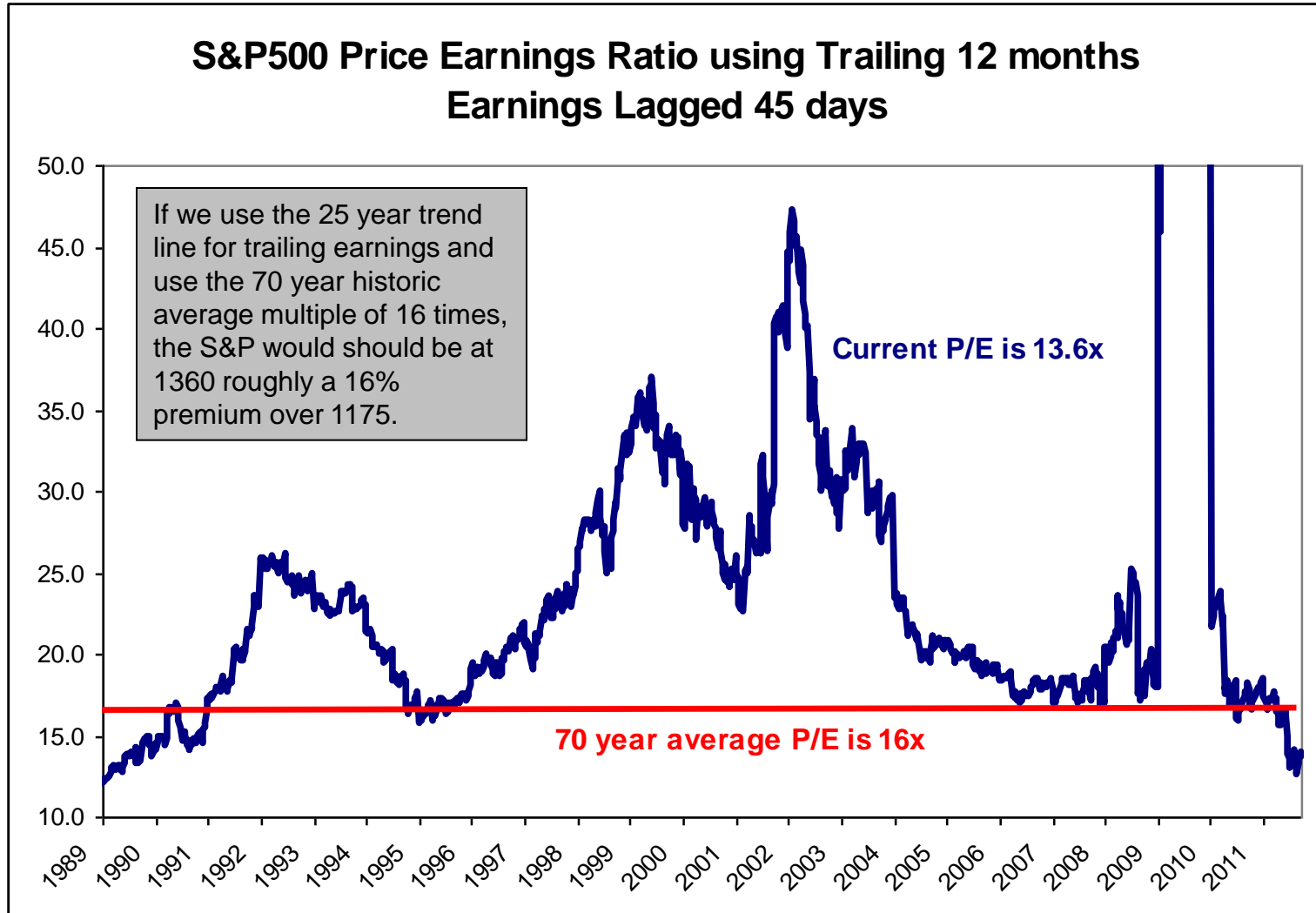


## US Case Schiller P/E

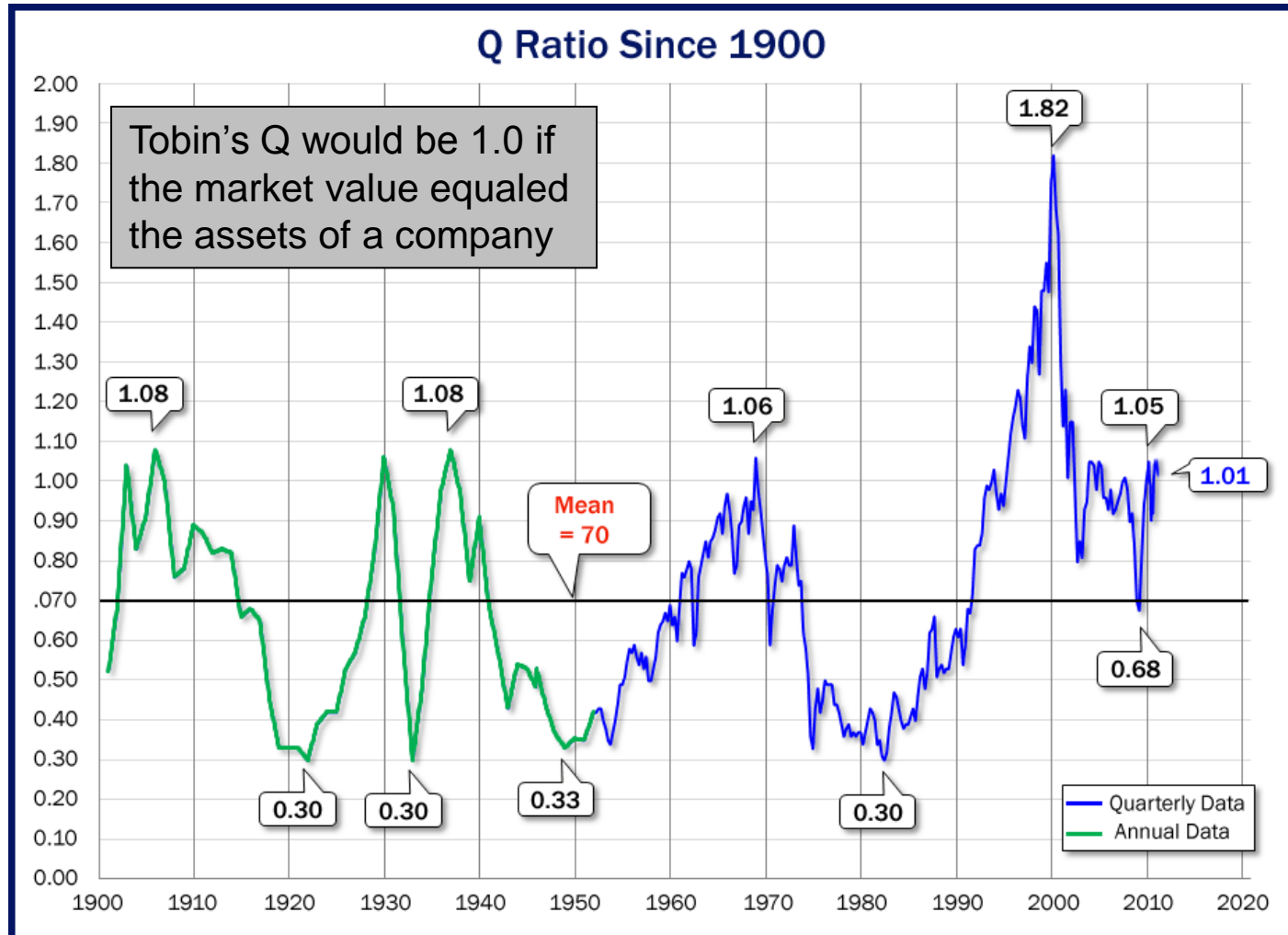




# Current Market Valuations Cont...



# Current Market Valuations Cont...



# Simple way to think of things

## Growth in Canada/United States:

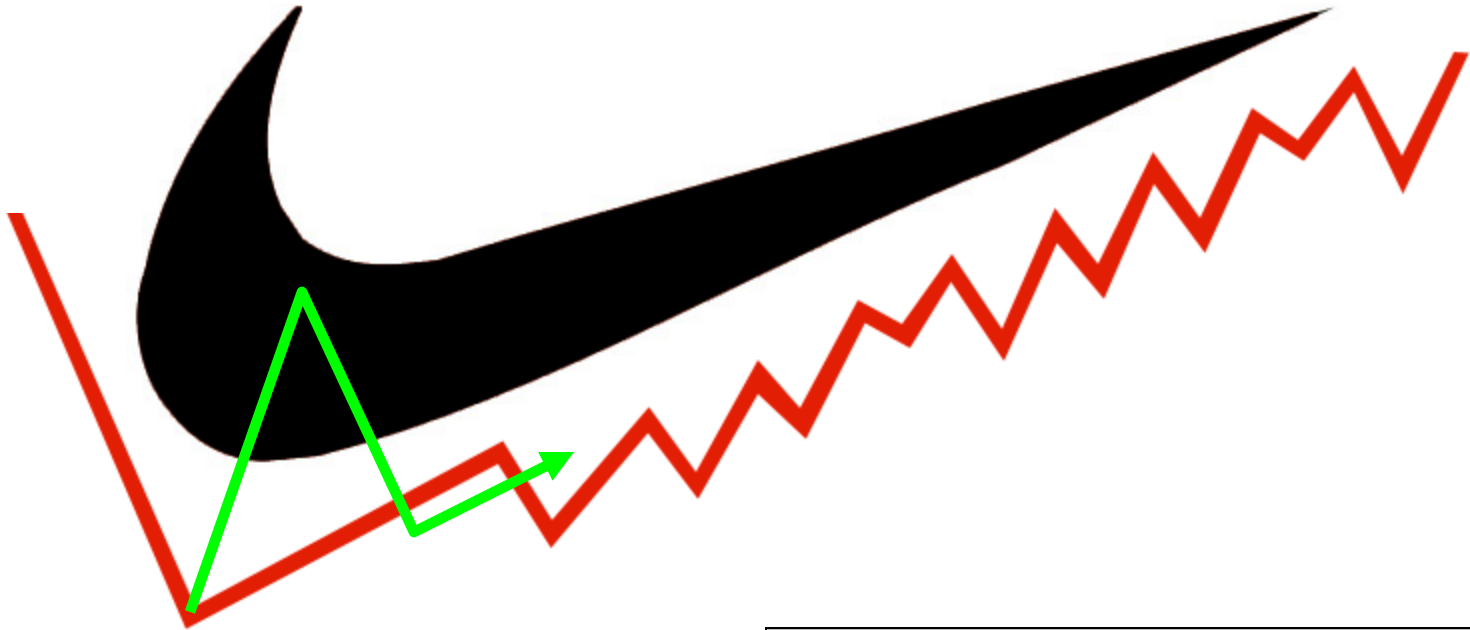
|                                |            |
|--------------------------------|------------|
| Productivity improvement       | 1.5%       |
| + Population Growth            | 1% to 1.5% |
| <hr/>                          |            |
| = Overall real economic growth | 2.5% to 3% |

## Example McDonalds:

|          |   |
|----------|---|
| 3% to 4% | Same Store Sales Growth                         |
|          | = Combination of Price Increase + Volume Growth |
| 1% to 2% | Stock Buyback (using free cash flow)            |
| 3%       | Dividend Yield                                  |
| <hr/>    |   |
| 7% to 9% | Earnings Growth*                                |

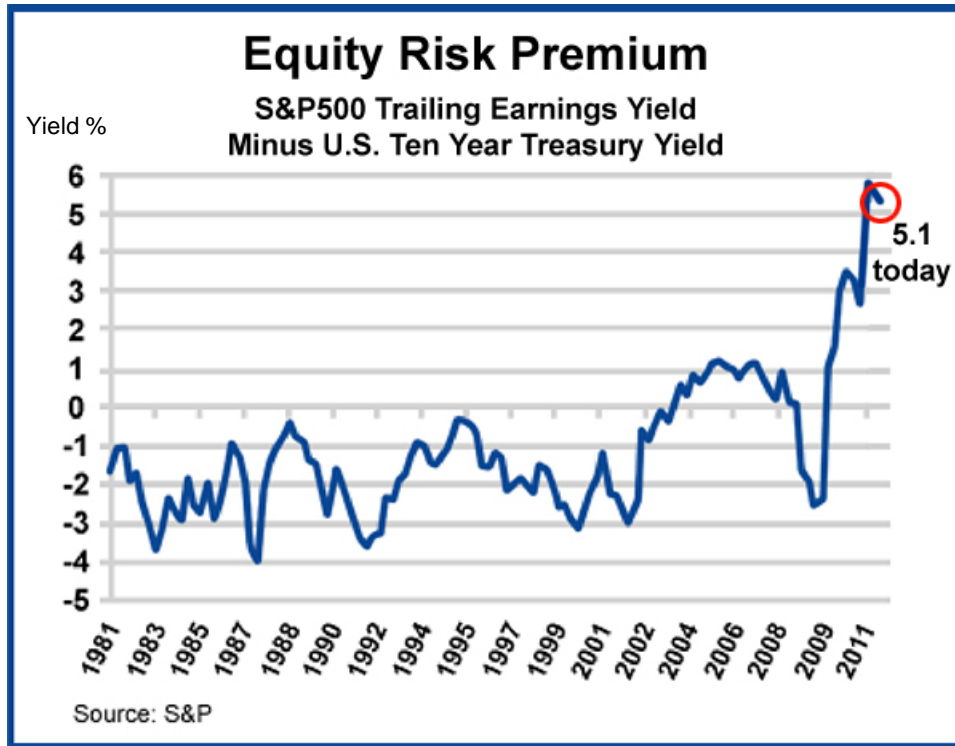
\*Excludes margin improvement, changes in tax rate, and changes in leverage etc...

# Our Outlook



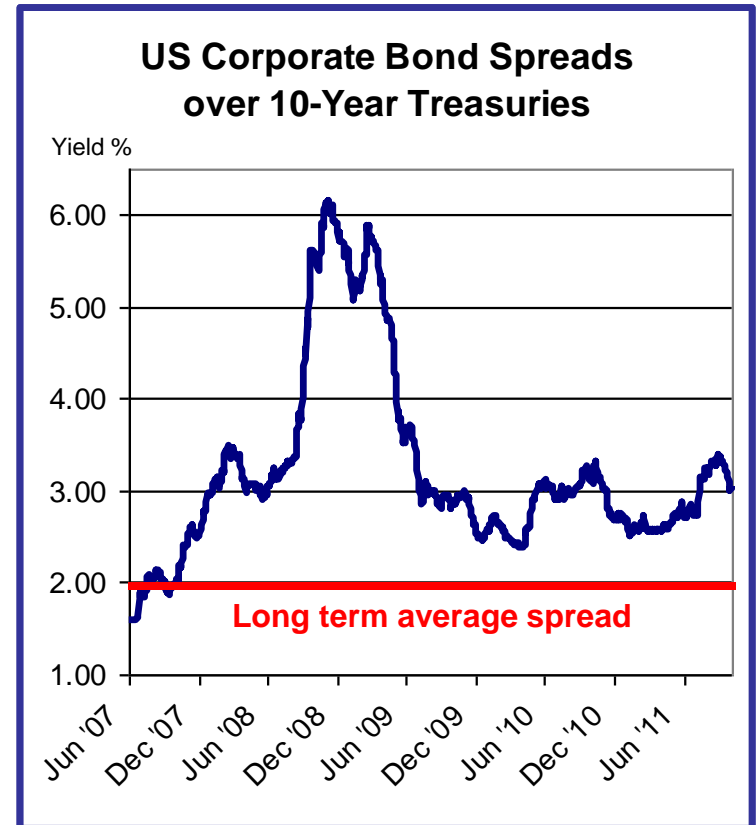
Long and slow growth over the next 5 to 10 years as the world de-leverages itself.

# Things to Consider When Investing



Equities look relatively attractive when compared to bonds

For 30 years ended September 30, 2011 Treasuries maturing 20 years or more beat the S&P500 (while rates declined)



Corporate bond spreads still have room to narrow and should be considered over governments

# Theme investing

- Global Food Shortage
  - Equipment Suppliers like John Deere (DE)
  - Fertilizers like Potash (POT)
- Homeland Security
  - Network security or video surveillance such as Fortinet (FTNT) and NICE Systems (NICE)
- Global Energy
  - Energy Saving companies that improve heating, ventilation and air conditioning systems
- Technology innovation
  - World is continuously changing and technology will always advance. NASDAQ (QQQ) covers them all.
  - [http://www.youtube.com/results?search\\_query=a+day+of+glass&aq=f](http://www.youtube.com/results?search_query=a+day+of+glass&aq=f)

# Conclusion

- Sentiment is weak and could push us into a recession, but hard data suggests we are still improving.
  - Canada will follow the US and China's economies
- Volatility will continue for the next few months due to EU
- Equities are more attractive than bonds
- Corporate bonds are more attractive than government bonds
- Focus on dividend paying stocks

## Other key points but not discussed:

Alternative asset strategies that can reduce overall portfolio volatility

Always unexpected risks like turmoil in the middle east or natural disasters etc...

# The End



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Please contact us if you would like to be added to our semi-monthly market report.

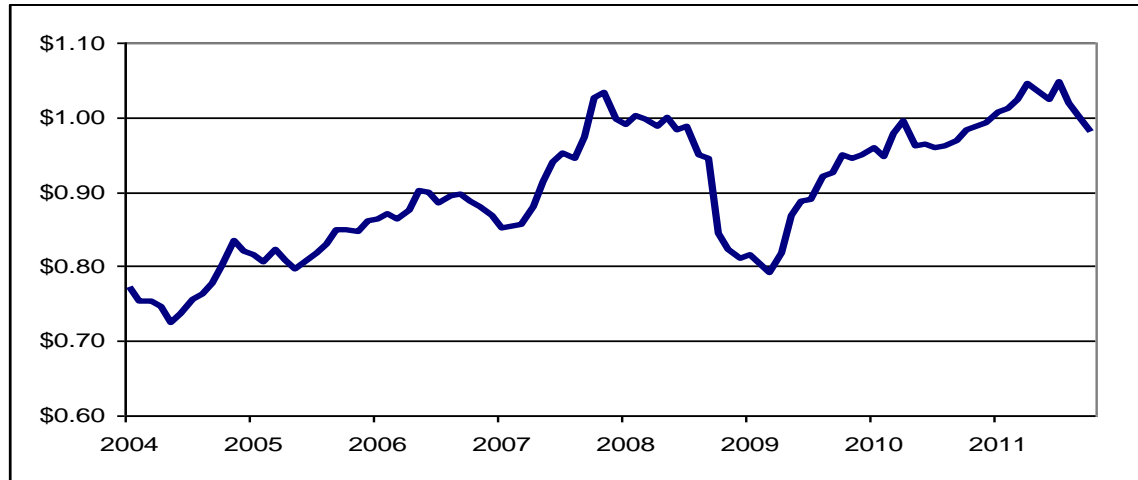
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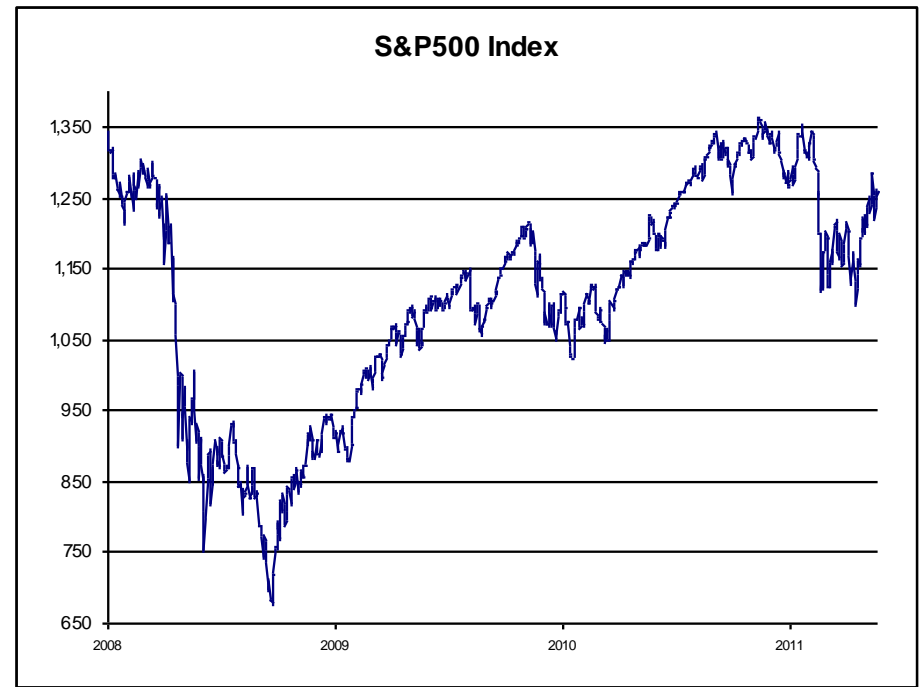
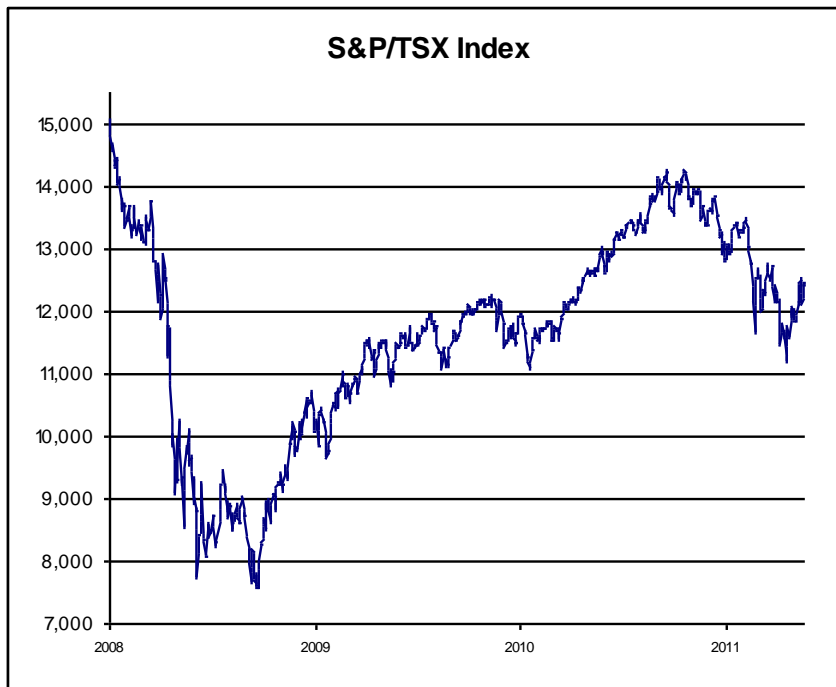
Extra Graphs and Charts not Used

# Canada/US Dollar Exchange Rate



Goldman Sachs: Predict the Canadian dollar will surpass \$1.08 within 12 months. The Canadian economy is closely linked to the US cycle. They expect US growth to remain sluggish through 2012 but they expect Canada to outperform in relative terms, and this would be positive for the CAD. The recent improvement in the labour market is supportive of their view, as is their solid outlook for commodities. On the other side of the equation, they continue to expect broad Dollar weakness due to persistently wide twin deficits. The Dollar will also likely continue to be weighed on by the Fed's monetary stance relative to elsewhere, as they expect further easing beyond the 'operation twist' that was announced at the September meeting.

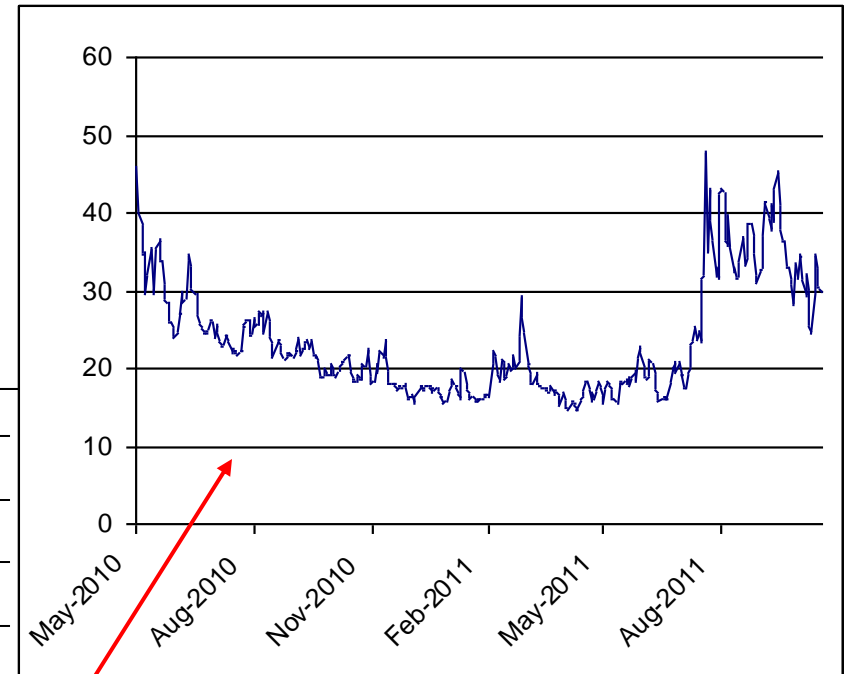
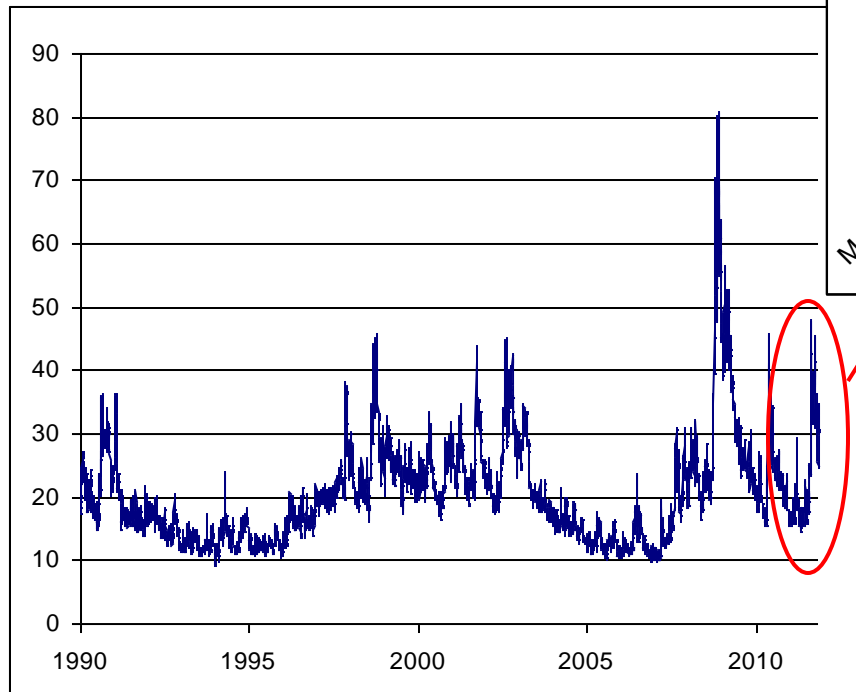
# Current Market Valuations



# Current Market Valuations Con...

## Market Volatility

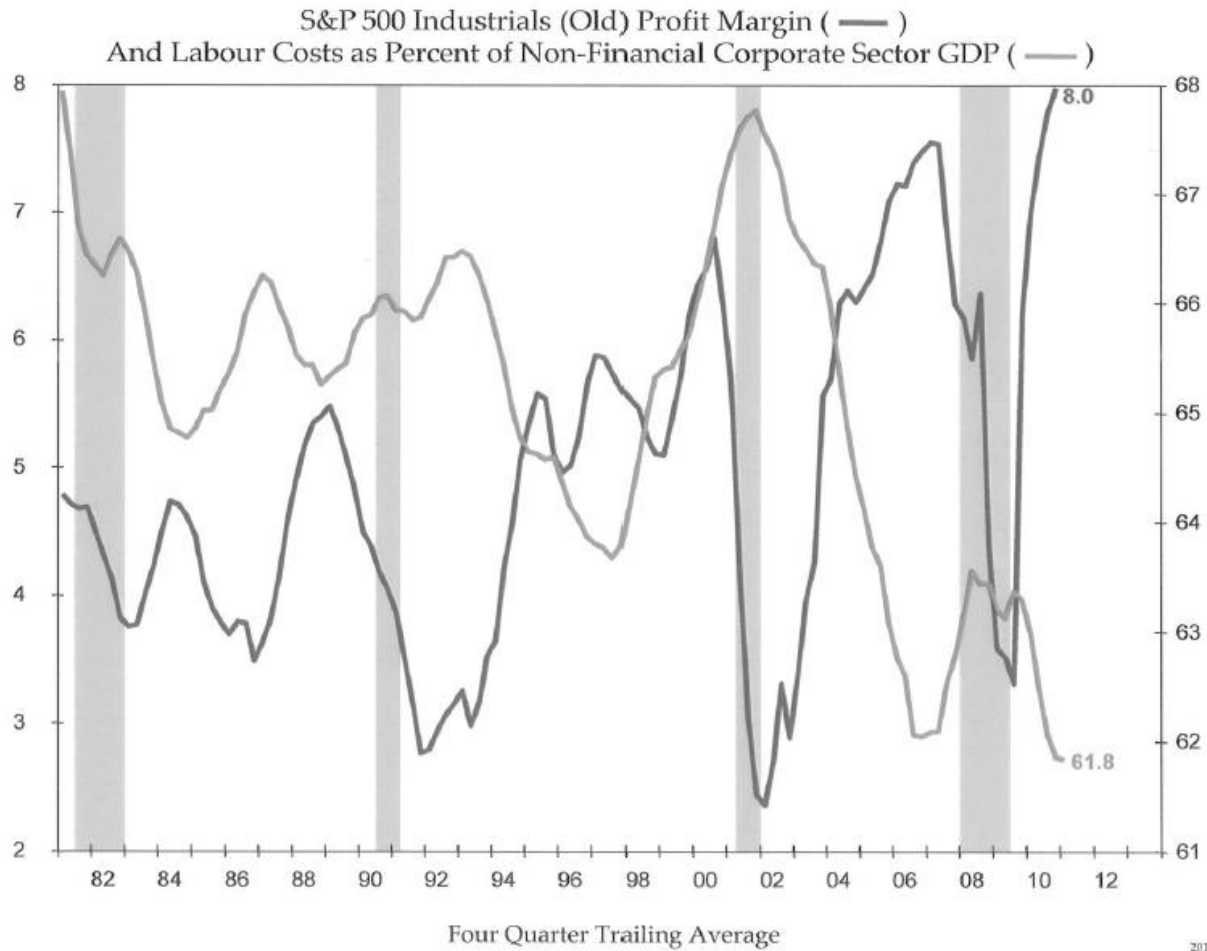
It was surprising to see how much the markets recovered recently while the VIX remained at elevated levels.



# Current Market Valuations

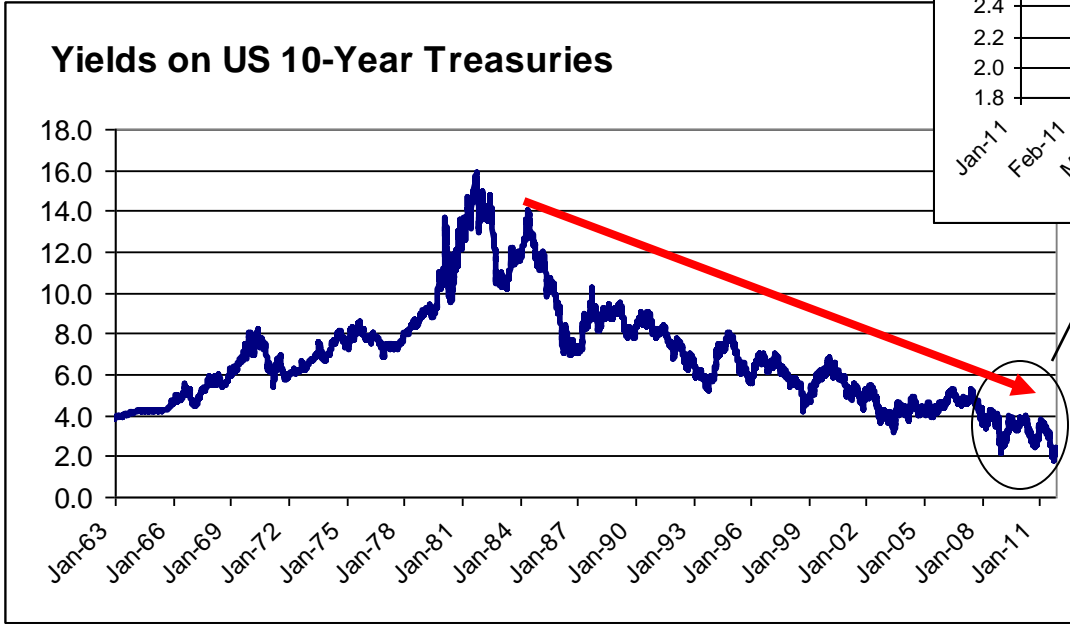
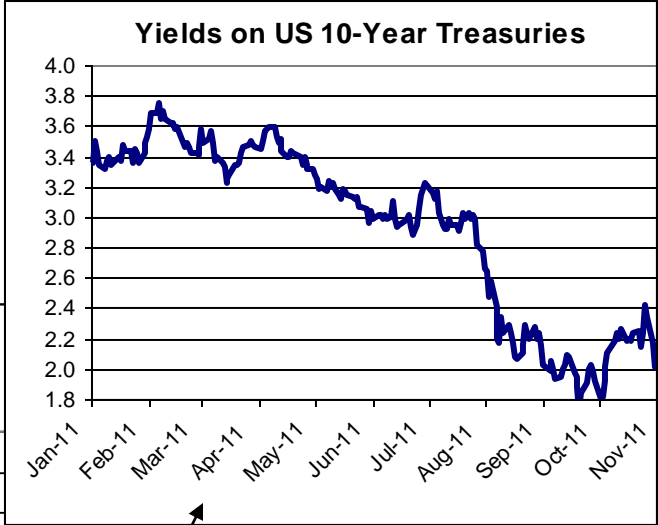
|                | Dividend Yield |                 | Implied Equity Return |                 | MSCI P/B |
|----------------|----------------|-----------------|-----------------------|-----------------|----------|
|                | Current        | Historic Median | Current               | Historic Median | Current  |
| <b>US</b>      | 2.2%           | 3.2%            | 5.5%                  | 6.2%            | 2.00     |
| <b>Canada</b>  | 2.6%           | 3.3%            | 6.3%                  | 7.2%            | 1.94     |
| <b>China</b>   | 3.3%           | 1.5%            | 12.8%                 | 7.2%            | 1.85     |
| <b>Brazil</b>  | 4.0%           | 3.3%            | 12.6%                 | 15.4%           | 1.42     |
| <b>Japan</b>   | 2.3%           | 1.7%            | 8.7%                  | 1.2%            | 0.97     |
| <b>UK</b>      | 3.5%           | 4.5%            | 10.7%                 | 10.9%           | 1.59     |
| <b>Germany</b> | 4.0%           | 3.2%            | 12.3%                 | 6.6%            | 1.24     |
| <b>Greece</b>  | 4.2%           | 4.2%            | 22.0%                 | 8.5%            | 0.46     |

# Current Market Valuations Con...

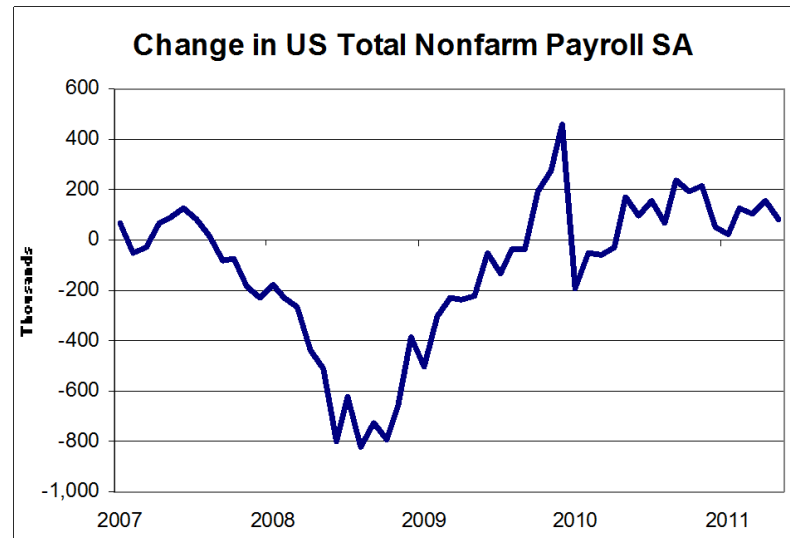
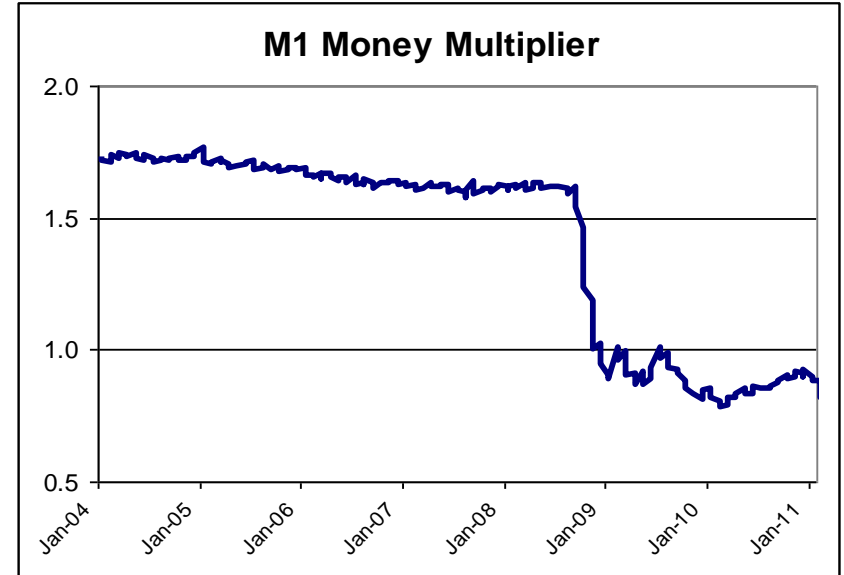
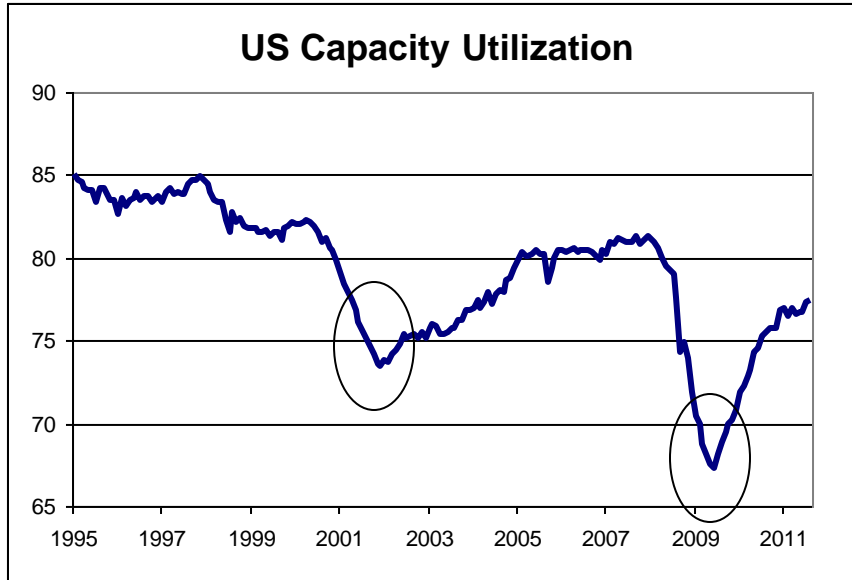


# No Inflation Pressure

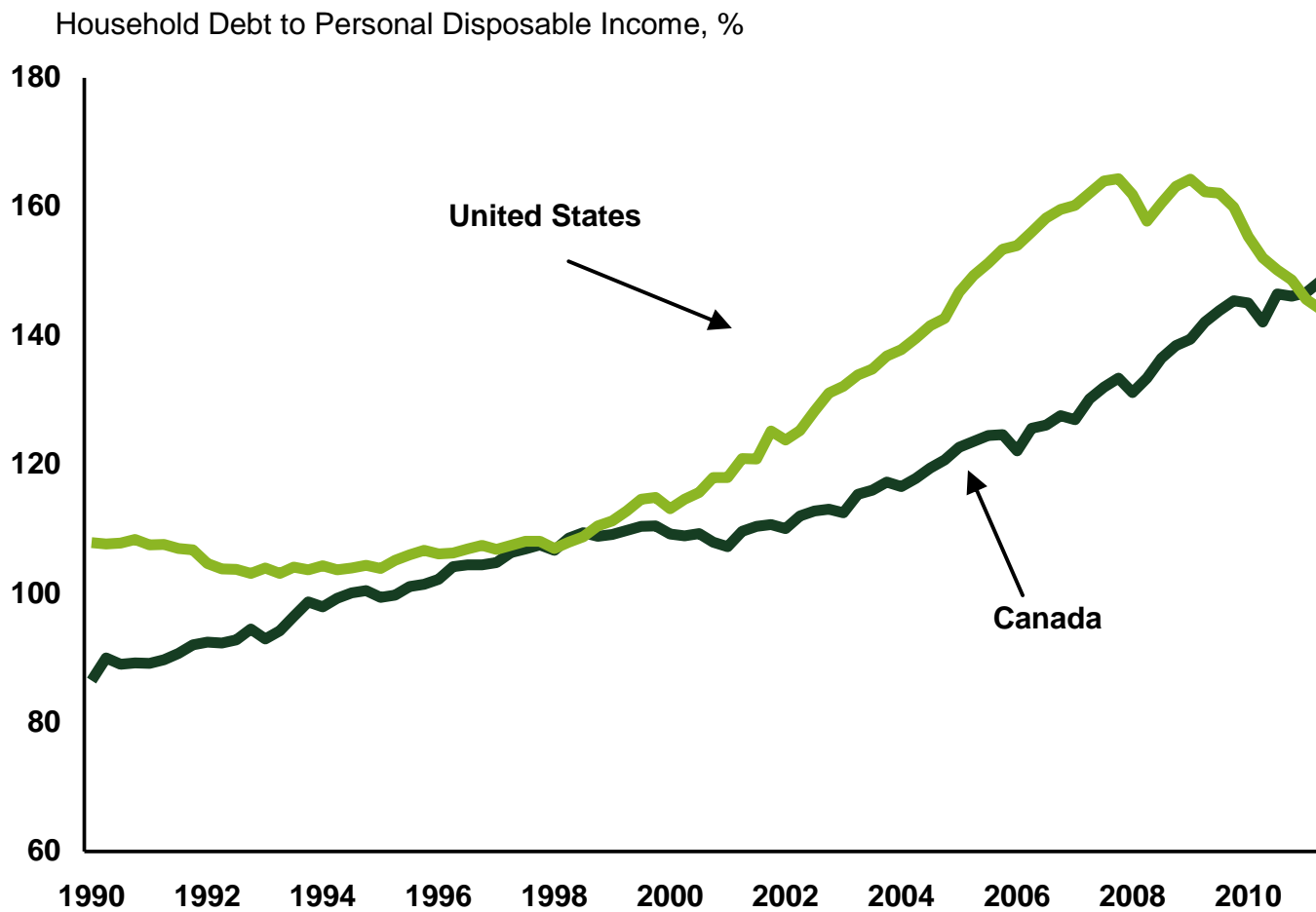
Bond yields move up on inflation worries. Interest rates are expected to remain low as long as the US 10-Year T-Bills stays under 4%.



# No Inflation Pressure

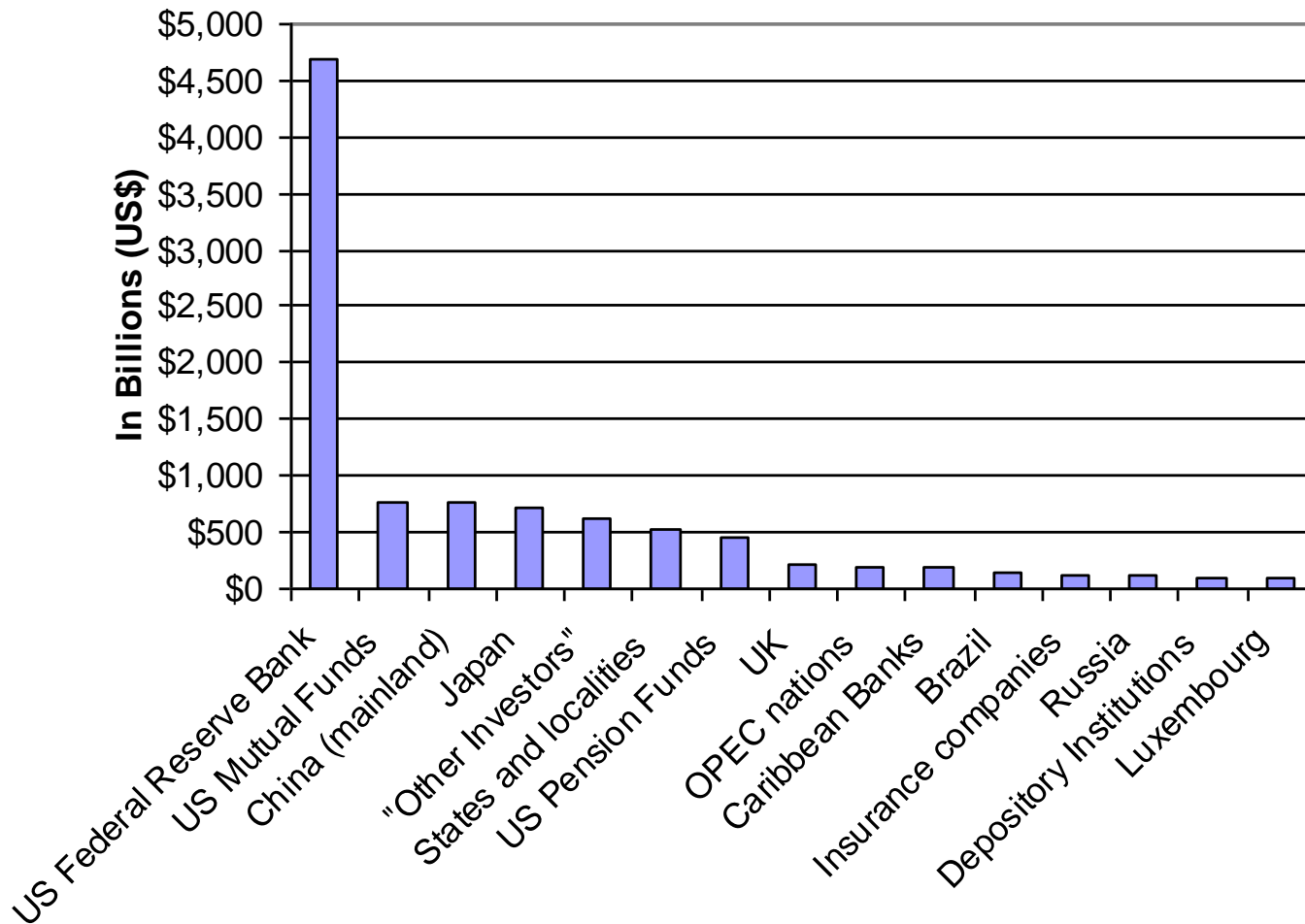


# Comparing Canada to the US



Source: Statistics Canada, TD Economics

# Who Holds US Debt?



# Status of the euro zone cont...

Long term solution is to issue Euro Bonds – like the United States did when it was formed

Need to coordinate national policies on issues like tax, wages and retirement ages - require unanimous agreement.

58% of Greeks do not like the recent bail out package but 72% want to keep the euro as their currency.

