CI Investments Fall Roadshow

Signature GLOBAL ADVISORS

Summary of presentations by Signature Global Advisors
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Shifting political framework

- After having been fairly stable for 30 years, the political and economic framework for investing is shifting.
- Since 1980, deregulation, globalization and reductions in trade tariffs and impediments to cross-border capital flows have deepened the interconnectivity of the global economy and financial system. Trade as a percentage of global GDP increased 10 to 15 times during the period.
- Now, the financial crisis is becoming a social and political crisis in more countries. We are seeing more protectionism and re-regulation, and not just in the financial sector. There is recognition that there needs to be more financial stability. Central banks and governments are becoming more interventionist.
- The developed markets are now going through what the emerging markets did in the last 10 to 20 years. Examples are Mexico (1994), Asia (1997-98), Russia (1998), Brazil (1999), South Africa (2001), and Argentina (2002).
- The outcome has been recession and slow growth, with large numbers of unemployed, lower tax revenues and governments accumulating more debt than at any period in peacetime. Western economies are now are struggling to adapt and to delever their governments.

Repricing assets

- New financial regulations, Dodd-Frank in the U.S. and Basel III, which sets international capital requirements for banks, will decrease risk, mainly by increasing the amount of equity in the banking system.
- A clear consequence will be a reduction of return on equity for global banks and broker dealers because they will no longer be able to hold inventories of securities (which was a major contributor to the financial crisis). To preserve returns, banks will pursue offsets such as repricing assets. These developments will increase the cost of capital in the economy and make the financial system less liquid.

European debt markets

- Lenders to Italy were complacent up until July 7 and then European debt markets went on strike. If they don't reopen in the coming months, European governments will force changes, likely through capital controls that will mandate banks, insurance companies and pension funds to take greater exposure to government securities.
- European banks and non-financial companies haven't been able to tap the European investment-grade debt market for four months.

Emerging markets

- We are still positive on China but expect growth of 8%-9%, not double digits.
- There are some important cyclical concerns in China – such as the housing market, the shadow banking system, the overflow from the stimulus and local government debt – but they will not undermine long-term growth. A bigger issue is the structural change from an export-driven economy to a domestic-led economy.
- We think India has a lot of potential, but we have concerns on the policy side. We expect Indonesia and Thailand to outperform next year. In Latin America, we like Chile, Colombia and Brazil.
- The export play that we saw from 2003-2007 is over. Cheap labour supplying goods to the developed markets will continue, but the greatest growth will be in domestic sectors, led by their own consumers. As a result, consumer staples, consumer discretionary, financials and health care should outperform in emerging markets.

Market roundup

- **Rates** – AAA ratings are becoming rare. Interest rates are going to stay low and global investors will continue to buy Canadian government securities.
- **Credit** – Spreads are going to stay wide. Liquidity risk is going to be higher now that broker-dealers cannot intermediate in debt markets. There will be more volatility and corporations are increasingly going to issue bonds rather than seek bank financing, particularly in Europe.
- **Commodities** – There is no confidence in fiat currencies, so they will continue to fall in relation to commodities. Commodities hinge on emerging market growth and stability.
- **Property** – There is a wide pricing, depending on the market. For example, high-grade Manhattan office space is yielding 4%, but suburban office space outside of Washington is yielding 10%.
- **Equities** – With regulators changing the cost of the capital, markets will favour high-quality companies with strong capital bases.
- **Foreign exchange** – We think the Canadian dollar will stay between US$0.90 and US$1.10. At this point, our hedges are neutral.

James Dutkiewicz
Portfolio Manager

Why are interest rates so low?

- Emerging market central bank and sovereign wealth funds are growing and need to invest is highly liquid and safe fixed-income assets. That includes U.S. Treasuries, European sovereign debt and, prior to 2009, government-sponsored entities such as Fannie Mae.
- Until 2007, the market was balanced. Growing demand from these funds was having a dampening effect on interest rates, but it wasn't a major force.
- In 2008, the formerly AAA-rated CDOs (collateralized debt obligations) were no longer safe or liquid because of the sub-prime issues. Then the GSEs – Fannie Mae and Freddie Mac – were no longer viable investments and the funds sold the majority of these holdings.
- Now, European sovereign credit, except for Germany and France, is no longer safe and liquid.
- What's left of the supply side isn't enough for the ever-increasing demand, which is now having a very powerful dampening influence on interest rates.

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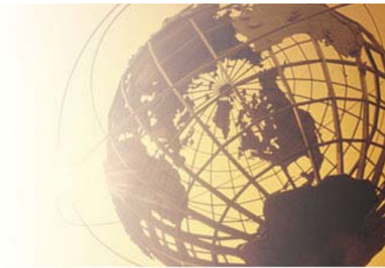

Europe

- Greece has grown into a much larger issue than it was two years ago, because European policymakers delayed a comprehensive solution. What was manageable 24 months ago is a crisis now because the Greek economy has contracted by another 15% and there's been no increase in revenue. Debt to GDP has increased from 100% to 170% in that period.
- The contagion has moved well past Greece. But Greece is not systemic, Italy is. Italy is a highly rated G7 nation, with a large economy. When you lend your money to a G7 sovereign nation, you're relying on the political system in that country to ensure that debtholders are not put at risk.
- Over the summer, Berlusconi created an ongoing systemic risk by promising budget amendments. The bond market eased off and Berlusconi reneged on the amendments. Then, the pressure was on again.
- That's why Italian bond yields are rising. If there is some sort of a restructuring of Italian debt, there will be a lot of losses, and it puts the flow of global capital at risk.
- Globalization isn't just about trading of goods and services, it's about capital flowing around the world. If the Italian government is going to act so cavalierly towards its debtholders – more than half of Italian debt is held by foreigners – then it calls into question how much British or Canadian bond funds will lend outside their borders.

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