



Life in the Aftermath of the Global Credit Crisis – Where Do We Go From Here?

October 2009



RBC Global
Asset Management™

The recession is dead – long live the recovery!



1. Debate now shifting from recovery or no recovery to ... sustainable or unsustainable?
2. What are the longer-term implications of the credit crisis and the epic policy response?

“Years of massive misallocation of capital cannot be followed by effortless recovery”

– Tim Price, PFP Wealth Management

Things are looking up!

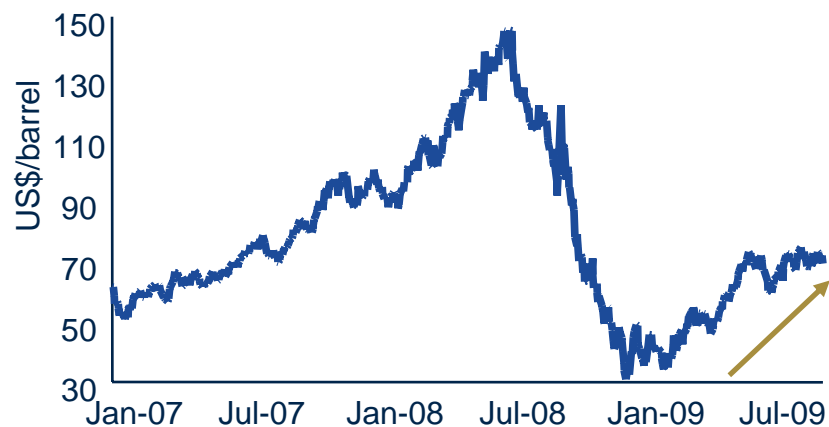


MSCI World Index



Source: MSCI

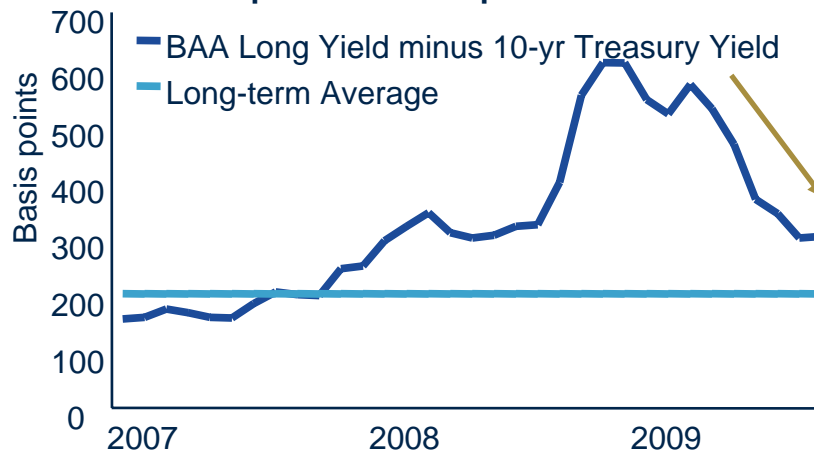
WTI Crude Oil



Copper

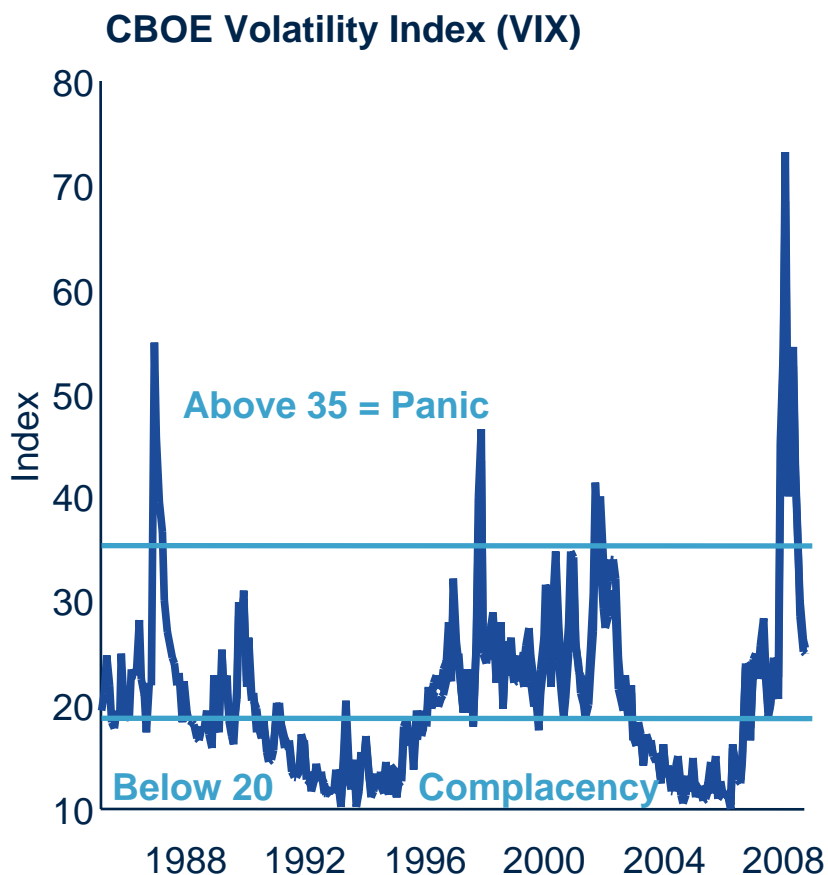


U.S. Corporate Credit Spreads

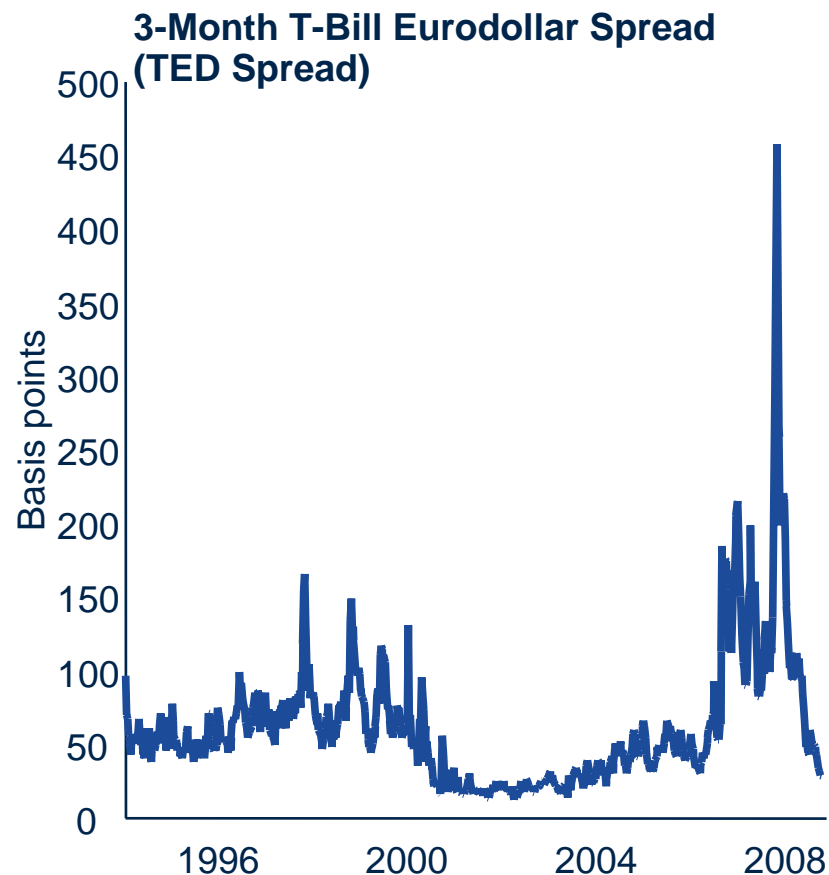


Source: RBC Capital Markets, Global Financial Data Inc.

Appetite for risk has vastly improved



Source: Chicago Board Options Exchange. Note: pre-1990 data based on S&P 100, post-1990 on S&P 500.



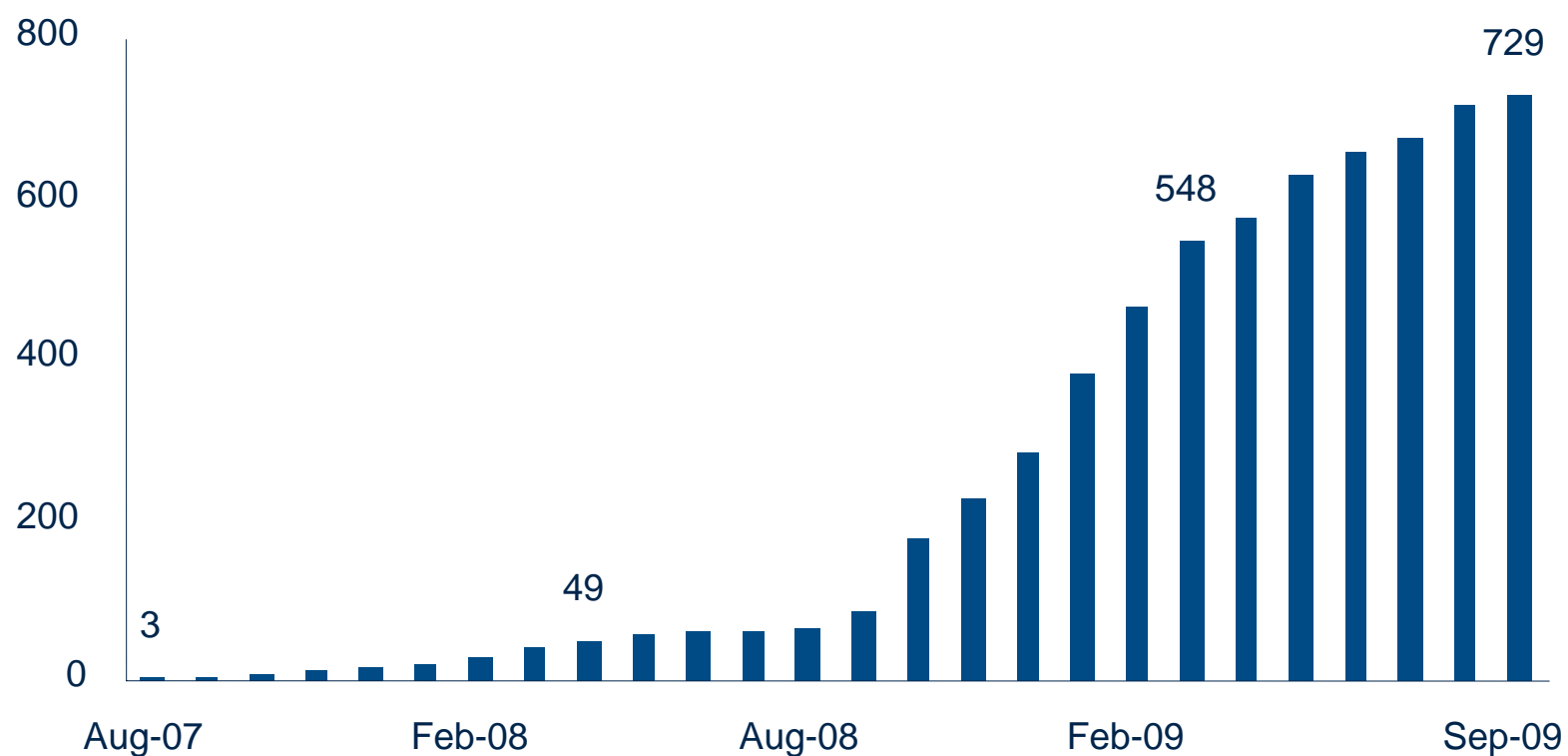
Source: Datastream

Note: Eurodollars are U.S. dollar deposits in banks outside the U.S. The eurodollar rate reflects the cost of U.S. dollar funds for large non-U.S. financial institutions.

The enormous global policy response



Cumulative Number of Global Policy Initiatives to Date

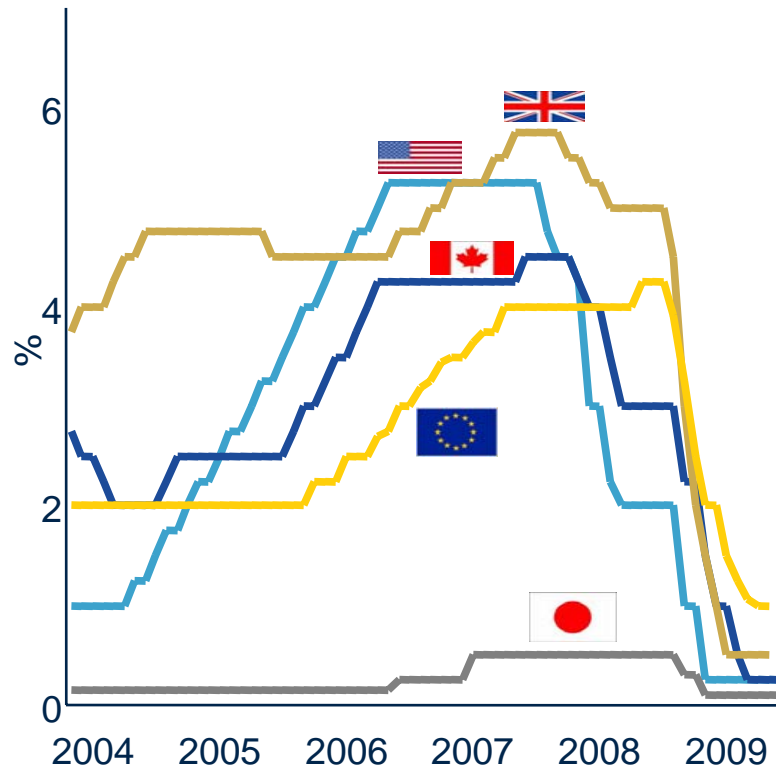


Source: ISI Group

Unconventional has become conventional

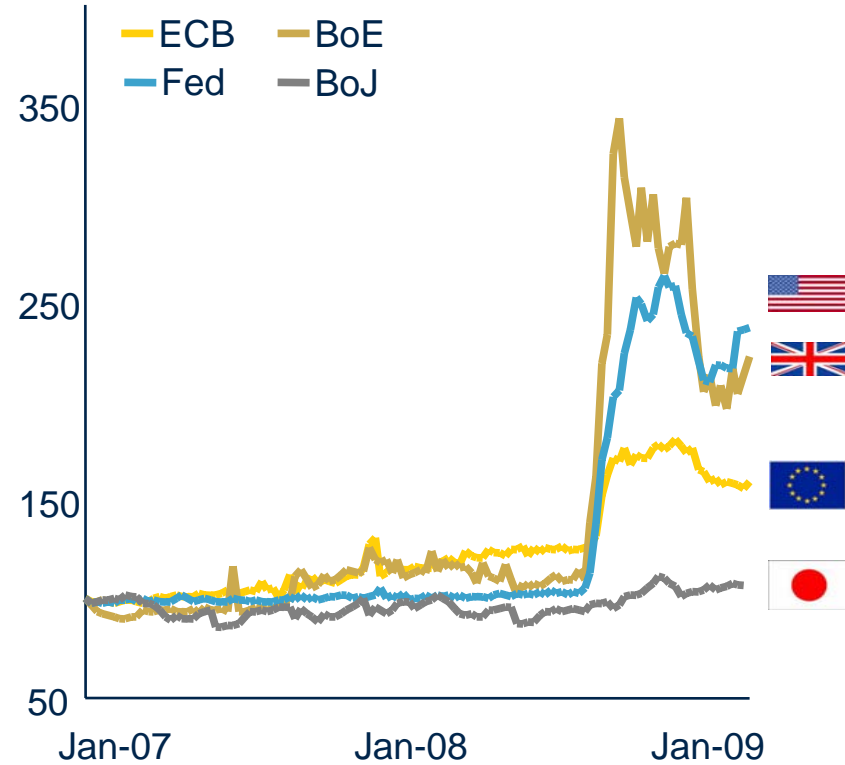


Central Bank Policy Rates



Source: Datastream

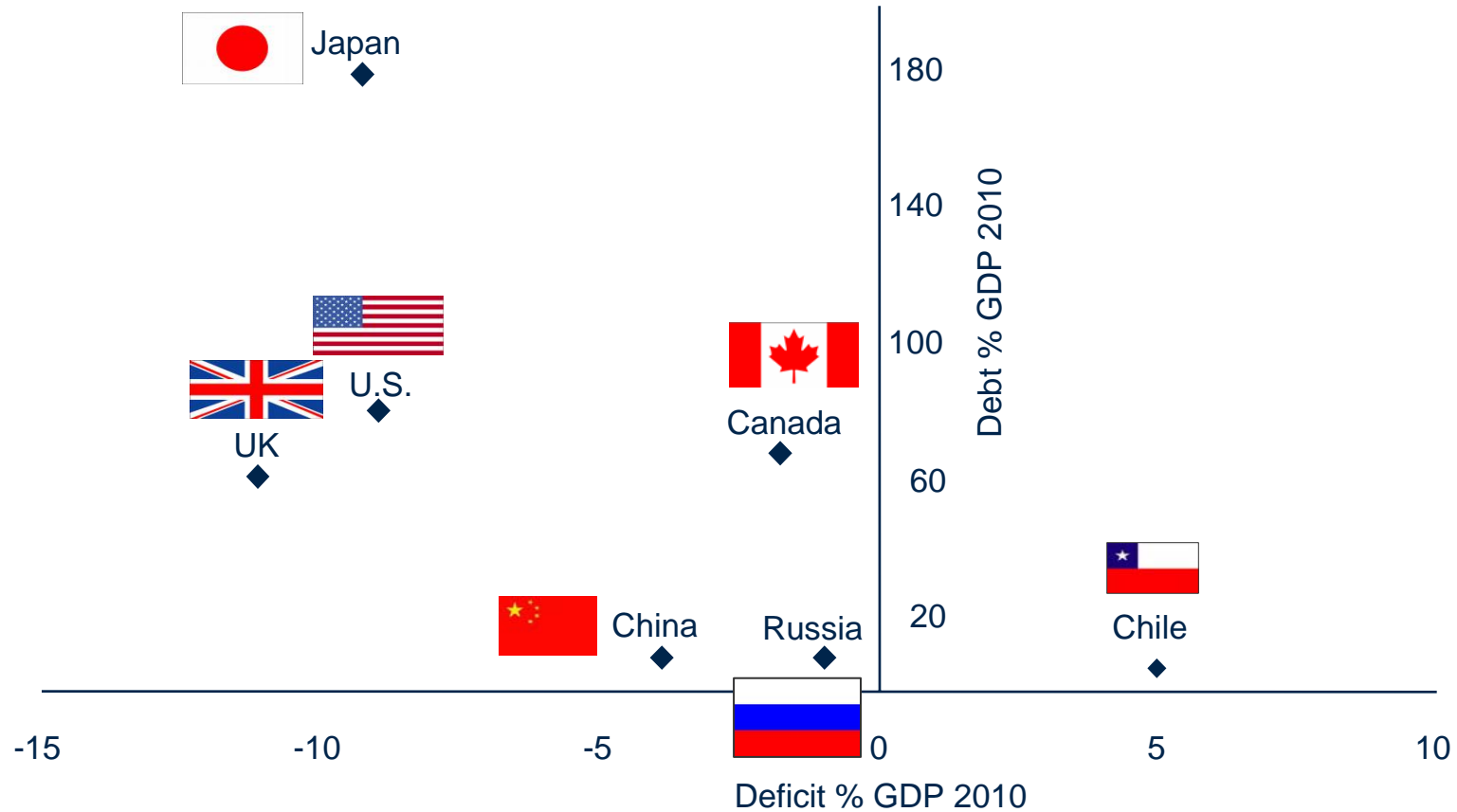
Central Bank Total Assets Index, Jan. 2007 = 100



Source: IMF

Longer-term implications of soaring debt and deficits

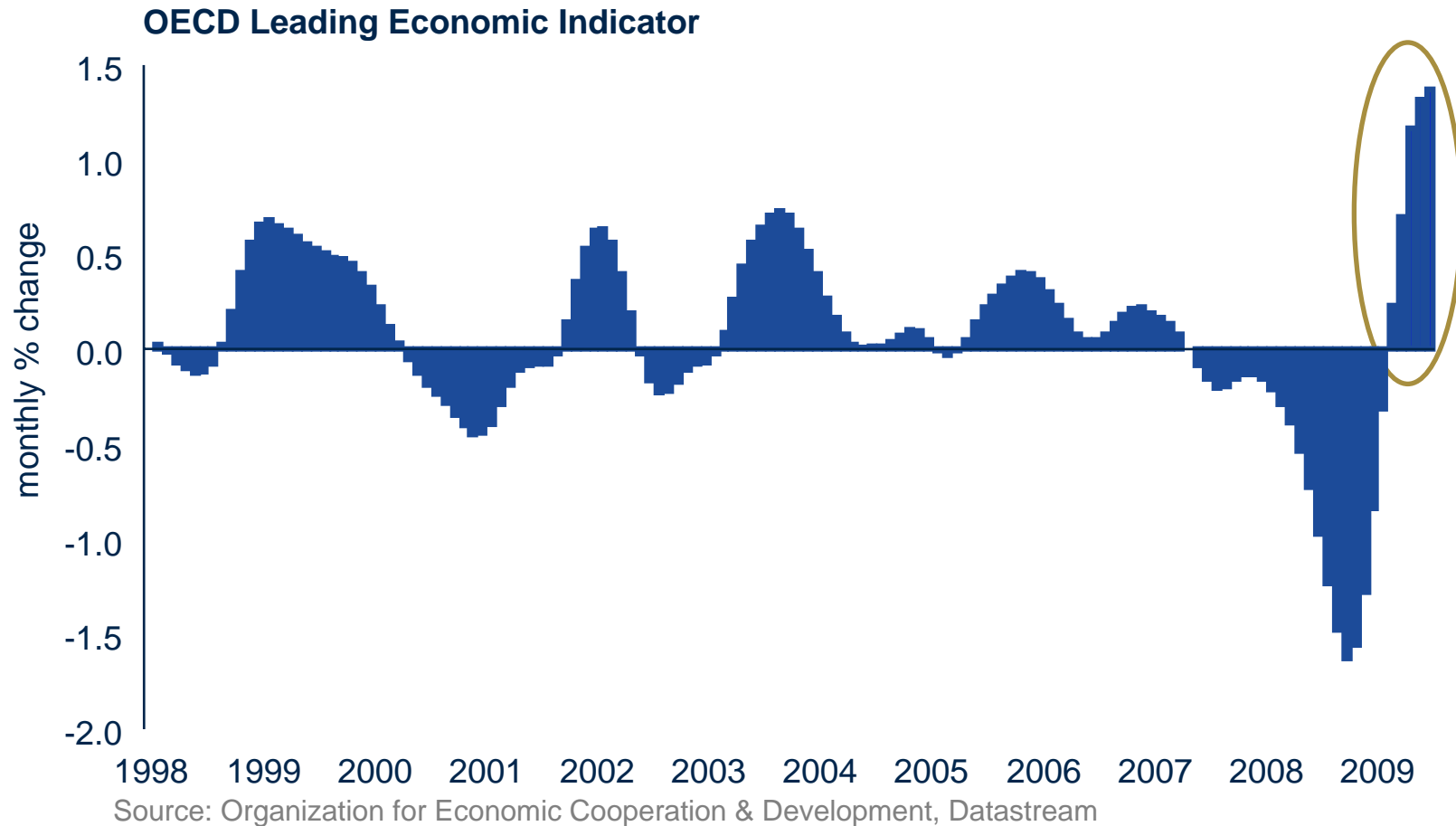
What's sustainable?



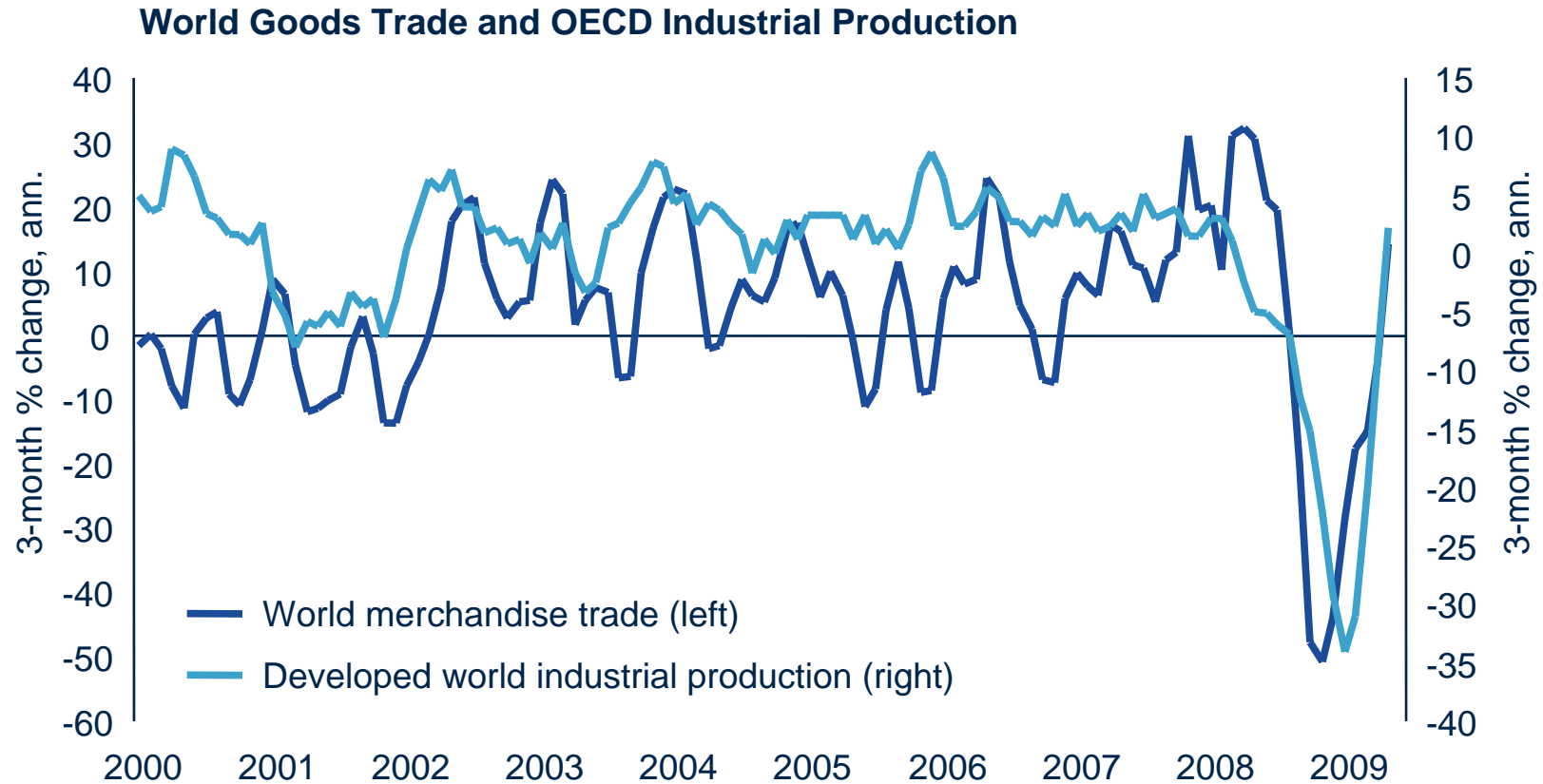
Source: UBS/OECD

Policy gaining traction

Global economic conditions improving

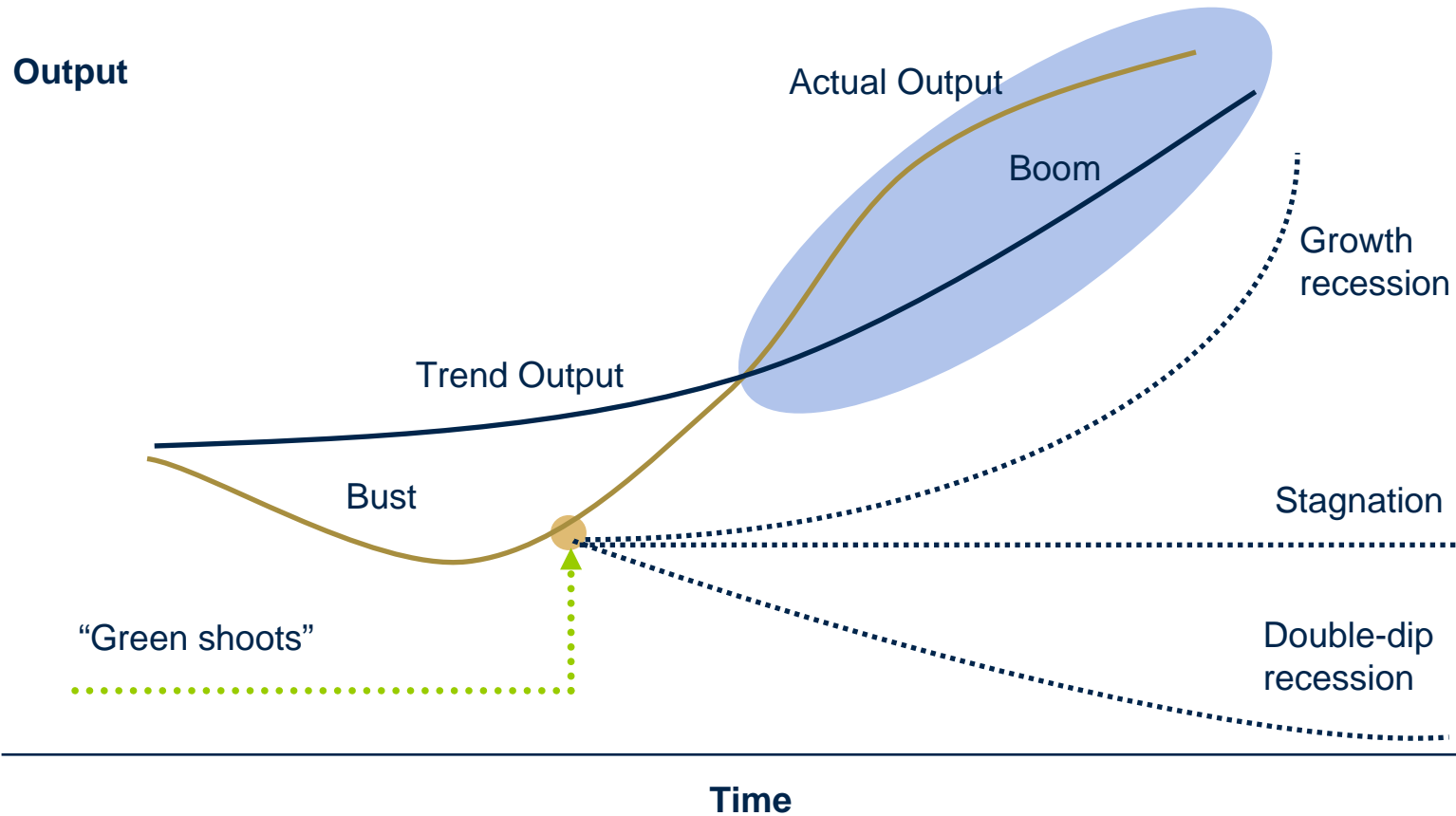


A V-shaped recovery is underway



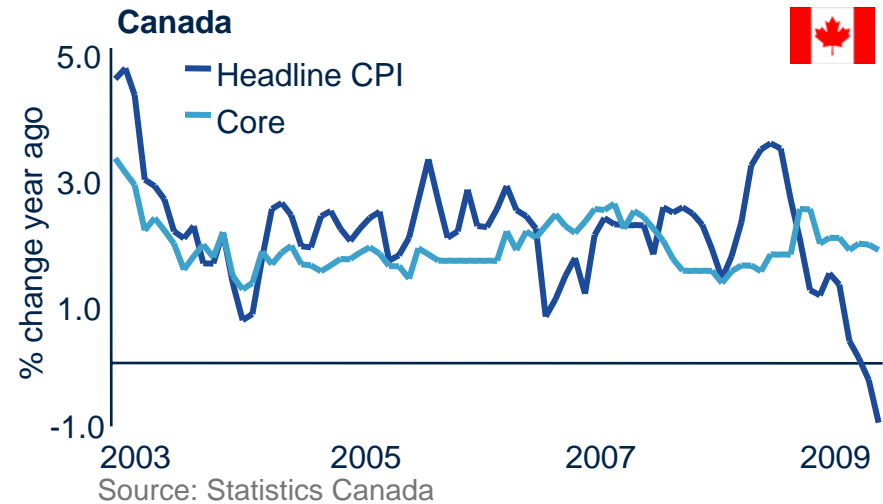
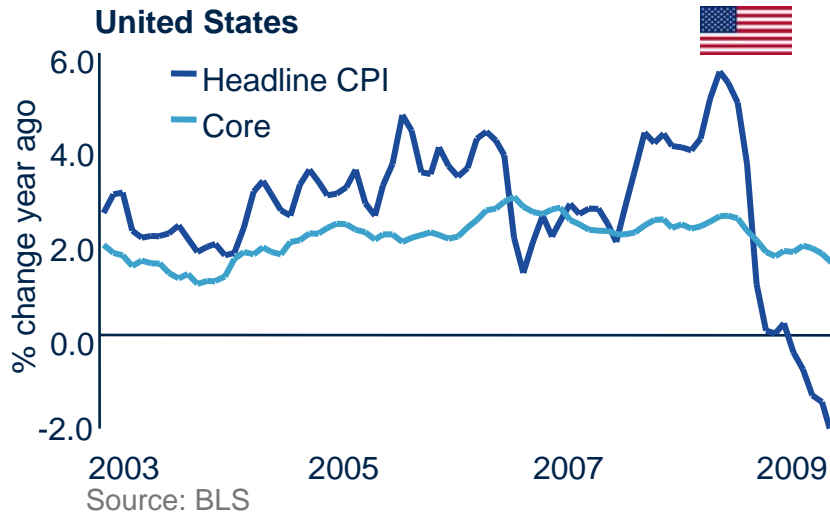
Source: IMF, OECD

The great debate – where do we go from here?

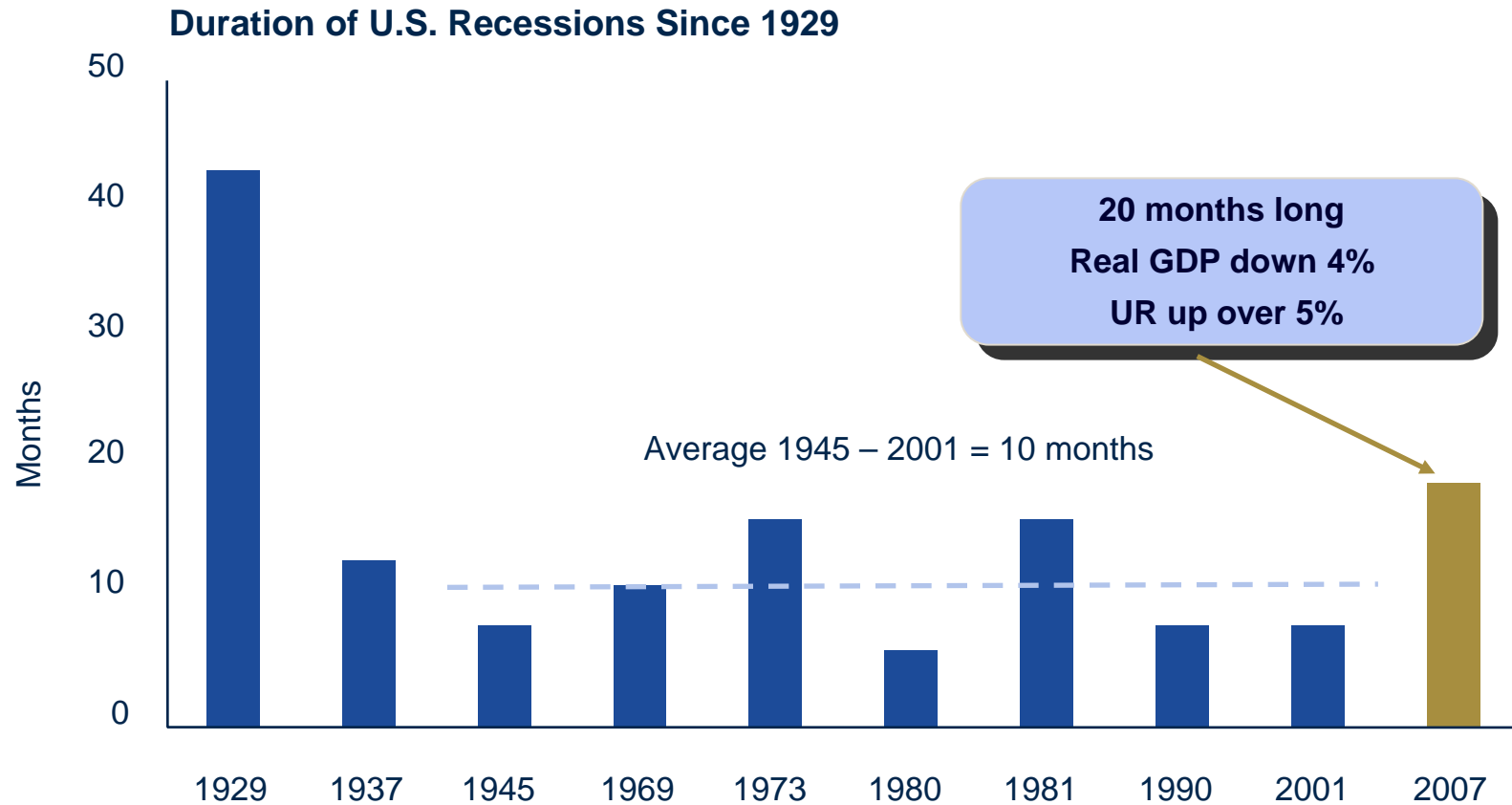


Source: Financial Times

Inflation absent now – different story post 2011

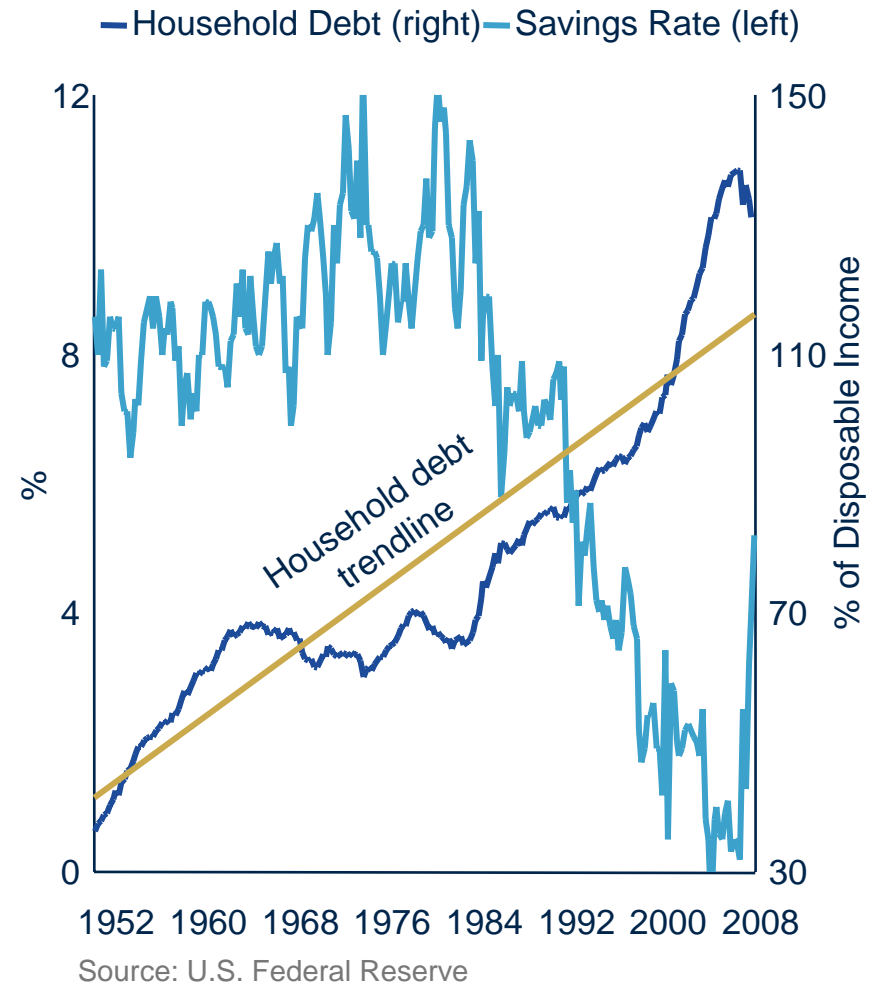
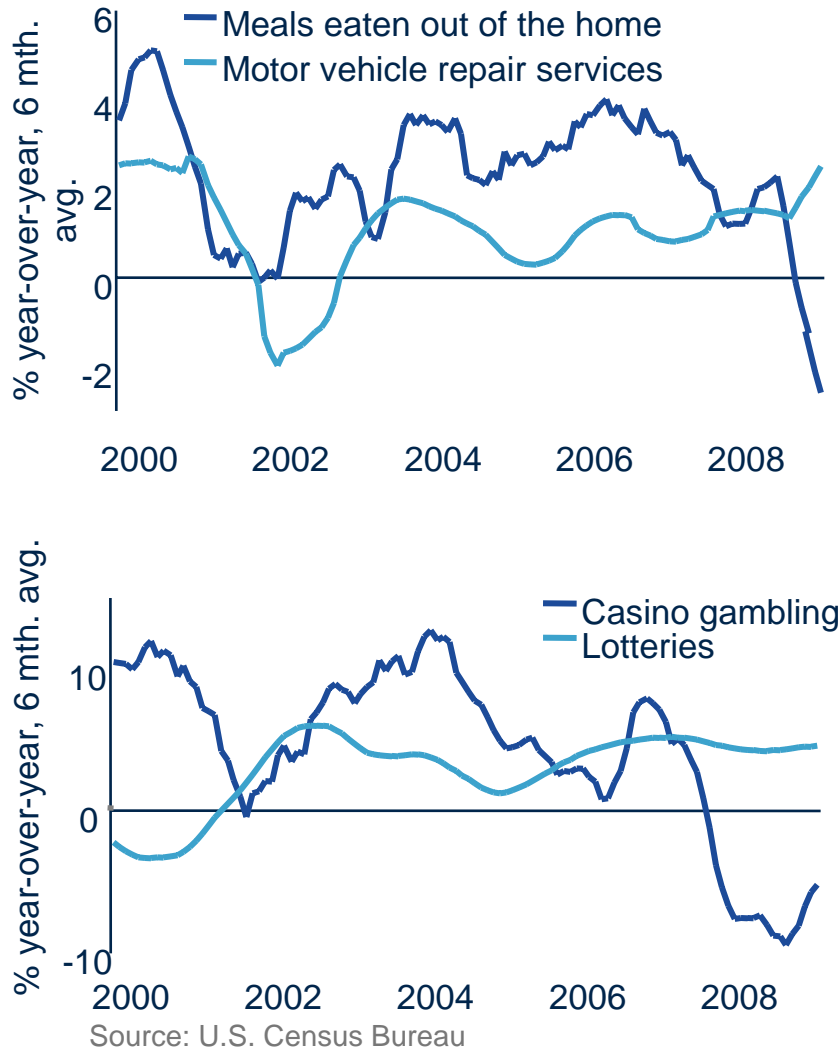


U.S. – The second-longest recession in 80 years



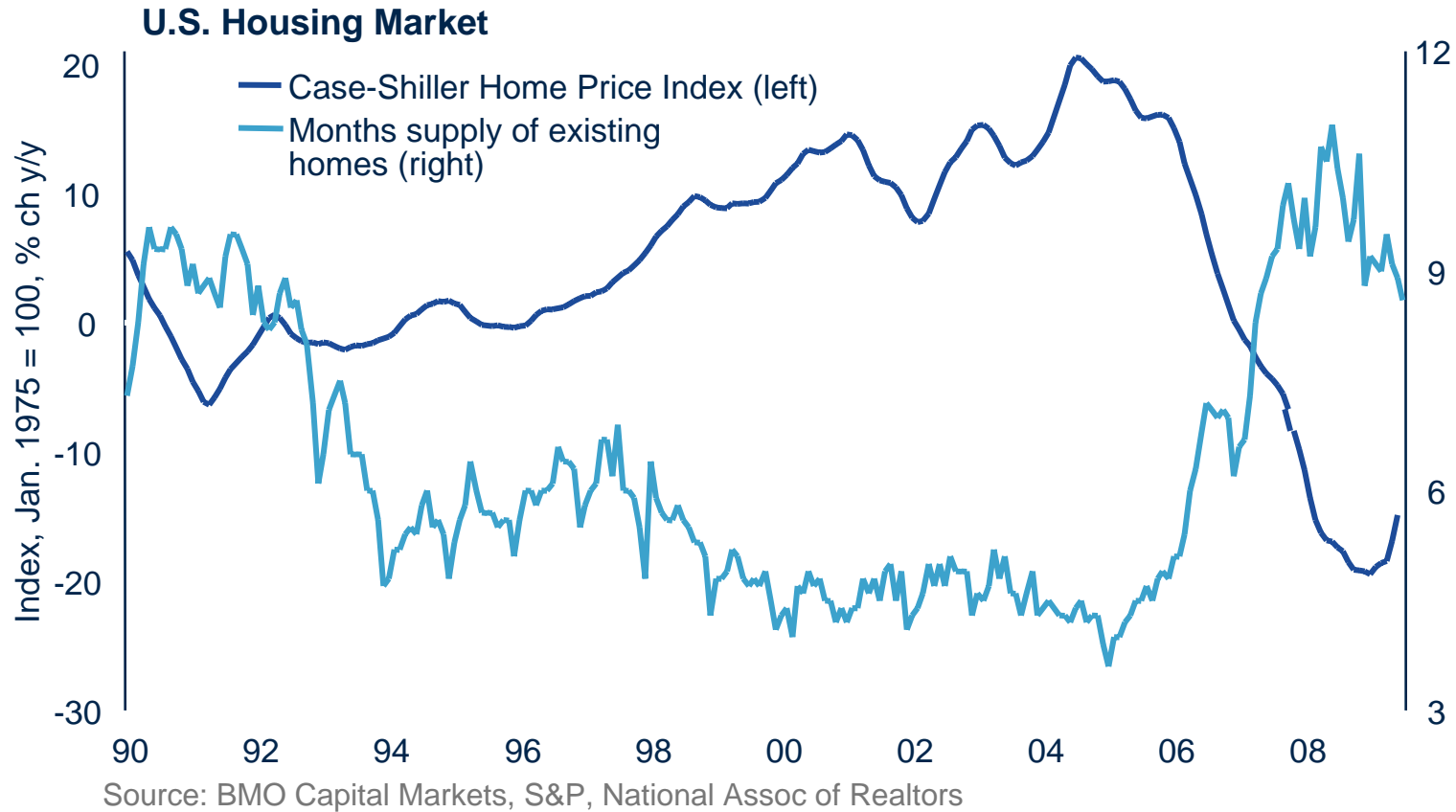
Source: NBF Economy & Strategy (data via NBER)

A shift in U.S. spending patterns is underway



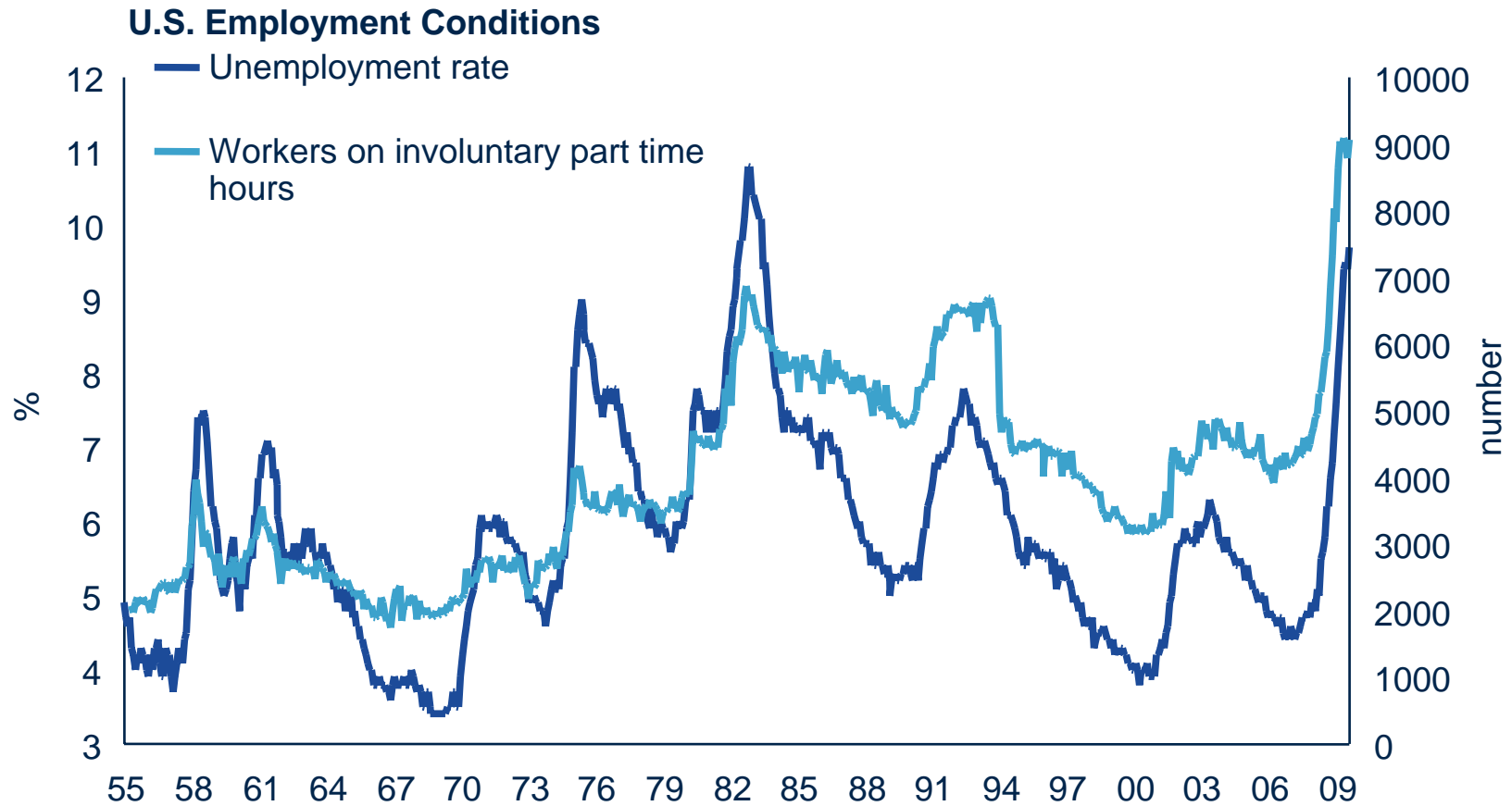
Consumer headwinds

Housing market is recovering but still weak



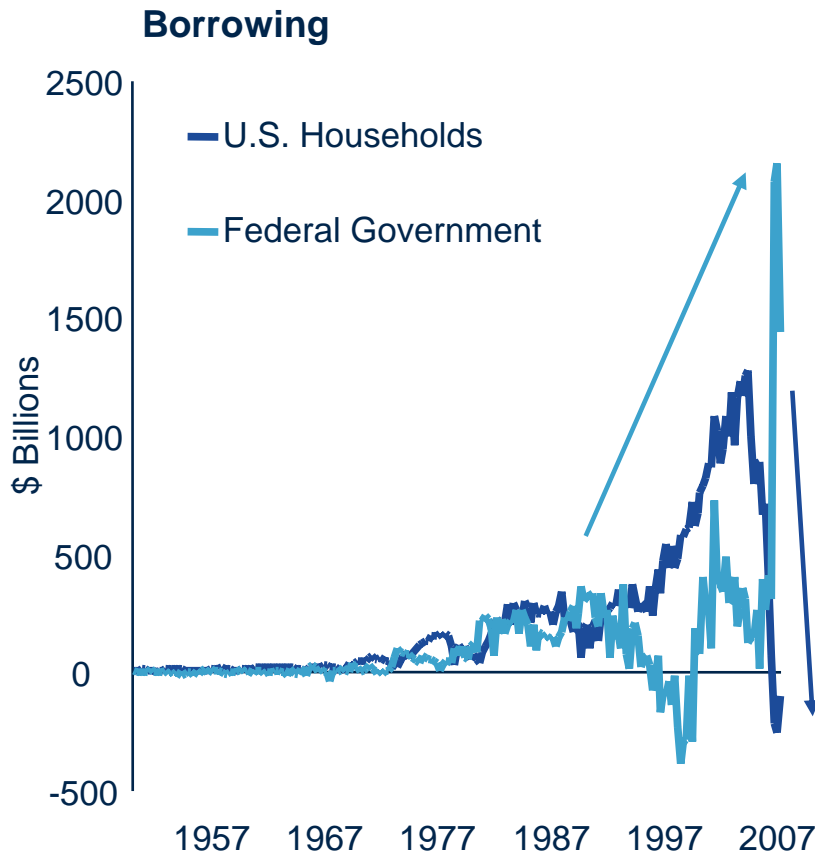
Consumer headwinds

Labour market soft

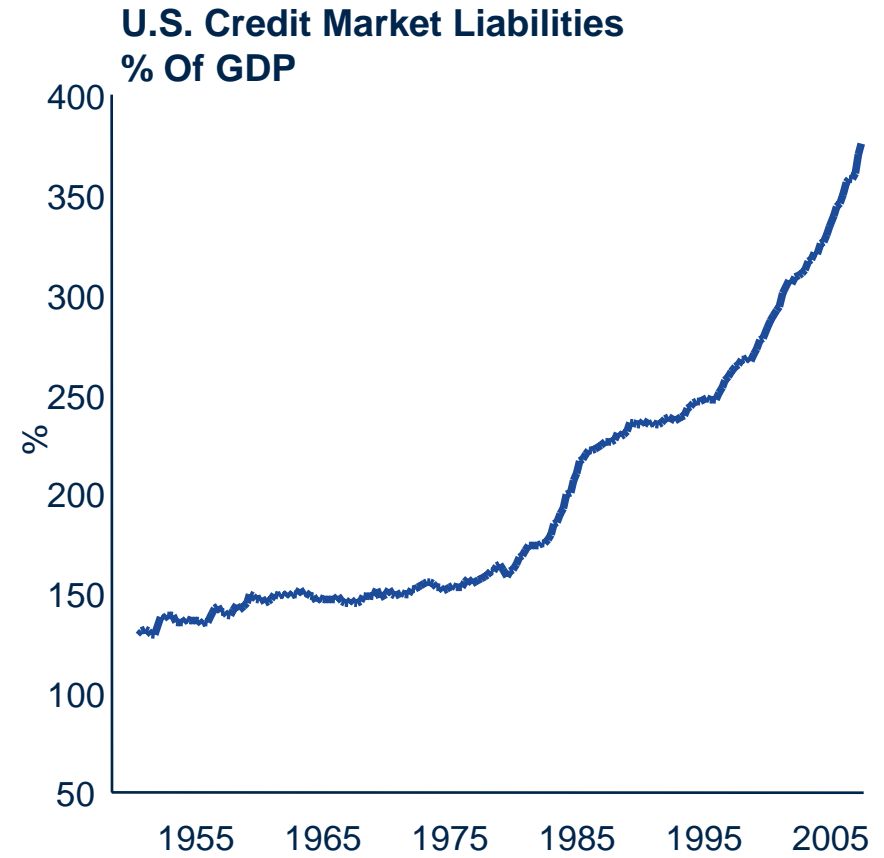


Source: Bureau of Labor Statistics

Debt role reversal



Source: Flow of Funds



Source: U.S. BEA

Fiscal challenges

Big in Canada, staggering in the U.S.



“America’s fiscal train wreck is leaving the station”

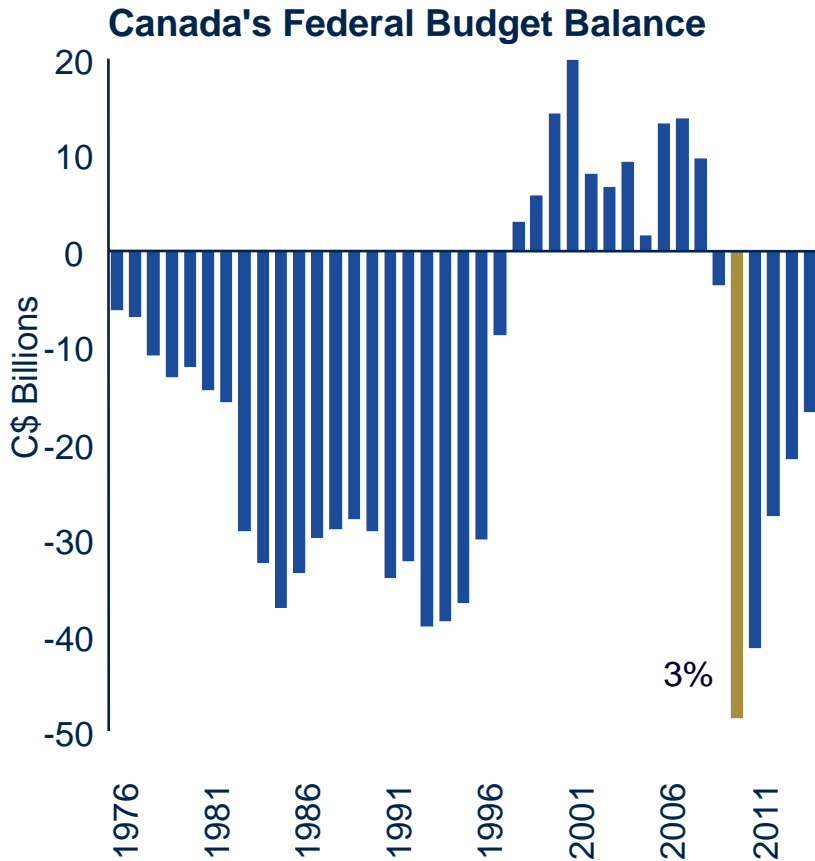
- Richard Berner, Morgan Stanley

Budget watchdog has dire warning for Ottawa

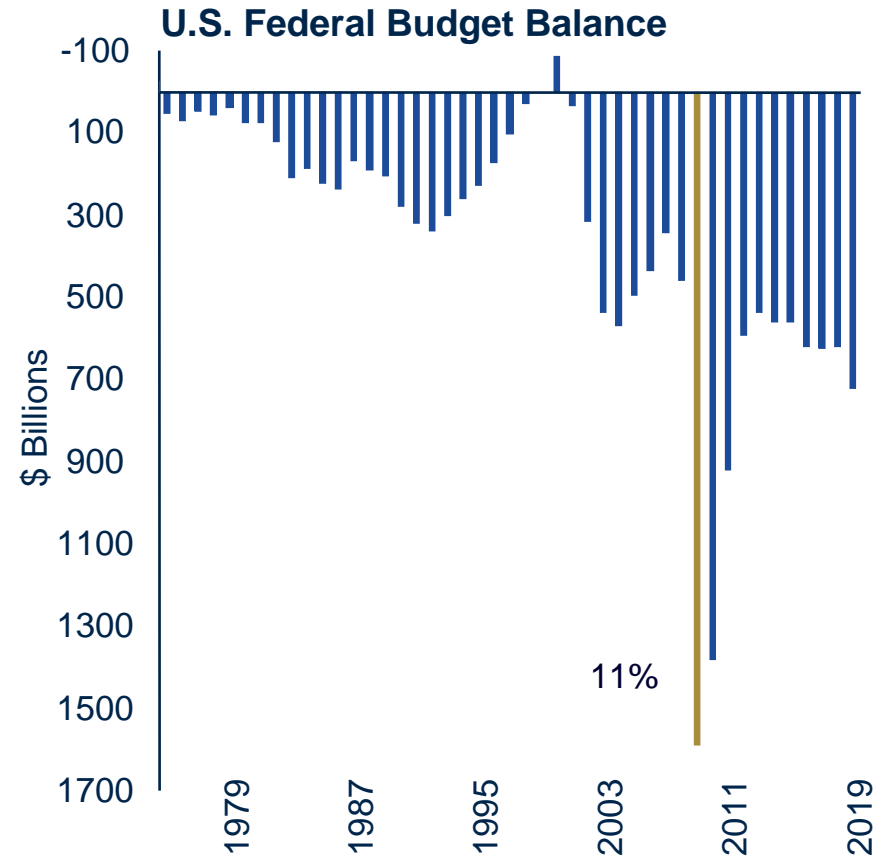
- The Globe and Mail, Sept. 1, 2009

Fiscal challenges

Big in Canada, staggering in the U.S.



Source: Finance Canada, Parliamentary Budget Office
Projection (July 6, 2009)

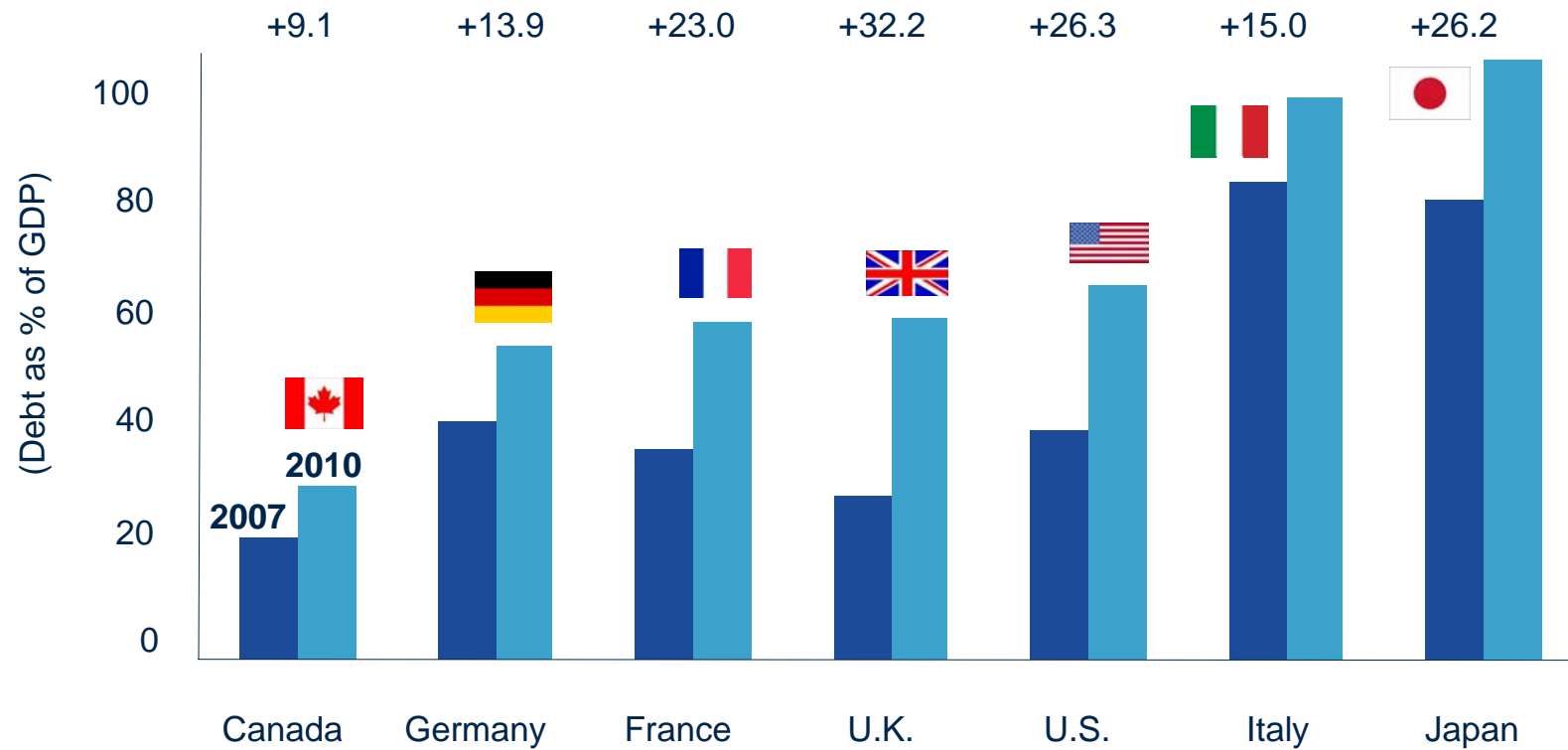


Source: Congressional Budget Office

Canada in enviable position



3-year Percentage Point Change in Debt/GDP Ratio



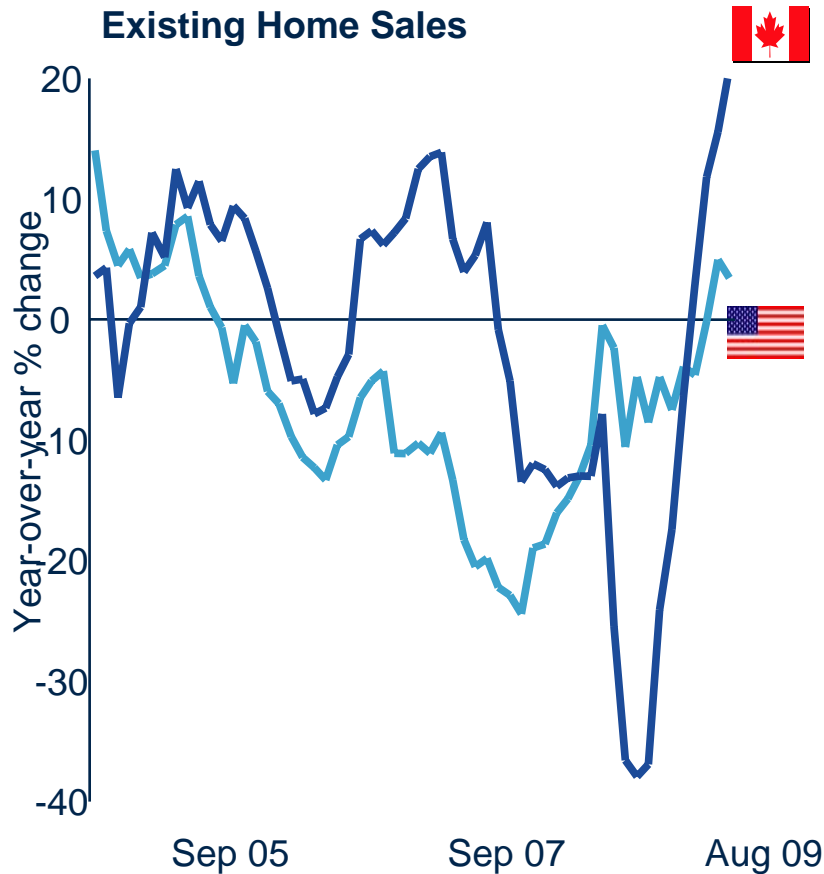
Source: OECD, June 2009 Outlook, BMO Nesbitt Burns

Oh Canada!



- › **Canadian recession was short but sharp**
- › **Unemployment rate fell in September – still lost 357,000 in recession**
- › **Bifurcated economy – consumer versus external sector**
- › **Canada in enviable position compared to many countries**

Canadians are buying houses again!



Source: Can. Real Estate Assoc., National Assoc. of Realtors



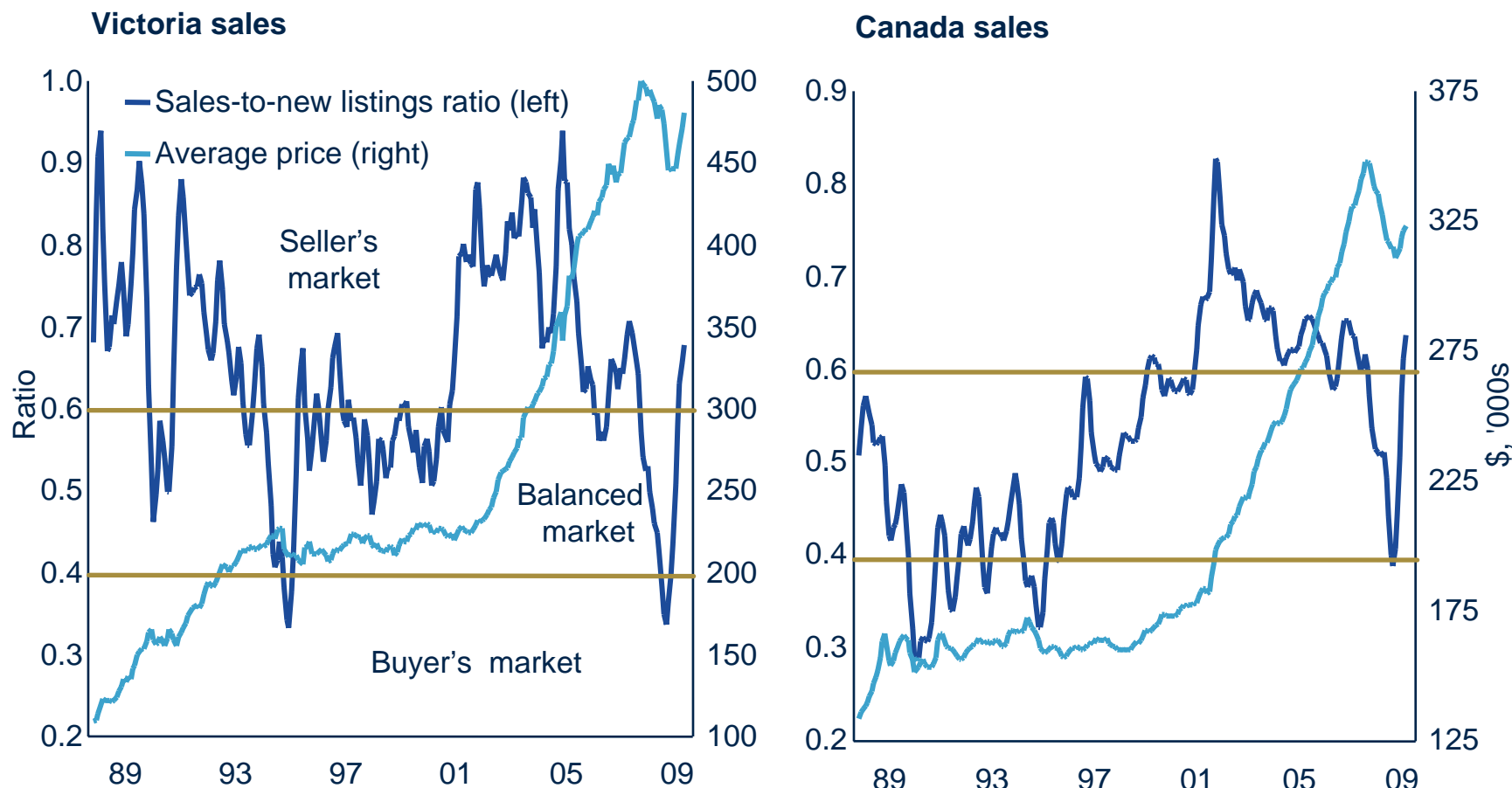
This house on West 5th Ave. in Kitsilano sold for \$1.142-million - nearly \$200,000 over the asking price.

Source: The Globe and Mail, September 27, 2009



Victoria a seller's market



New listings ratio and 3-month average resale house prices



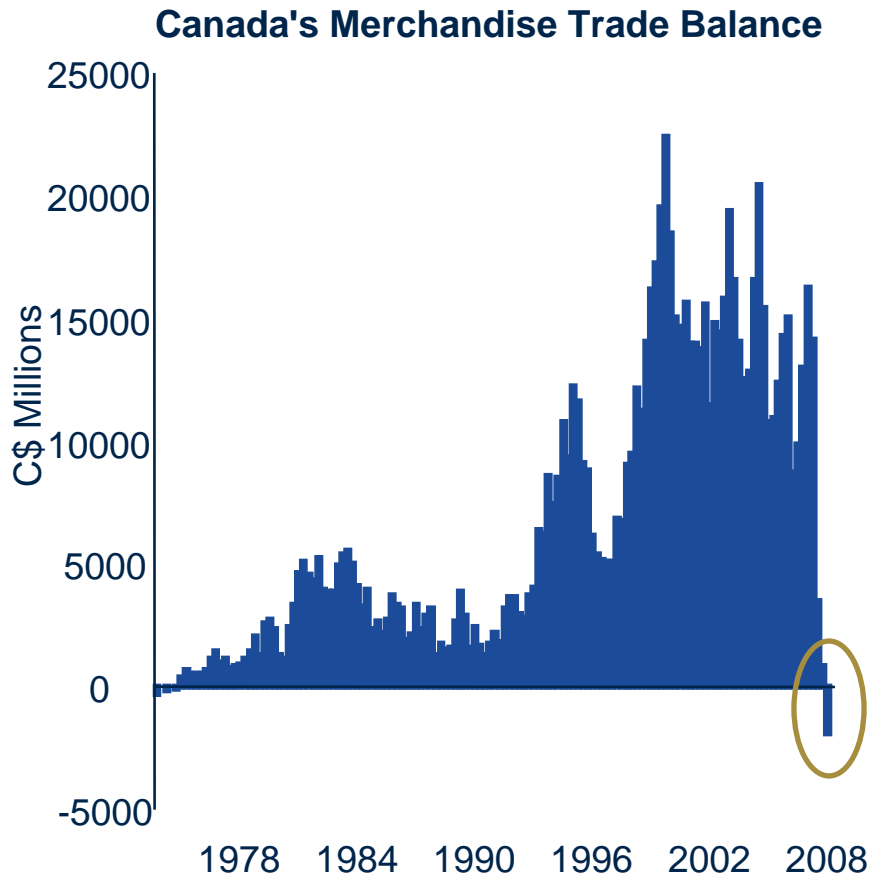
Source: Canadian Real Estate Association

Canadian labour market in better shape

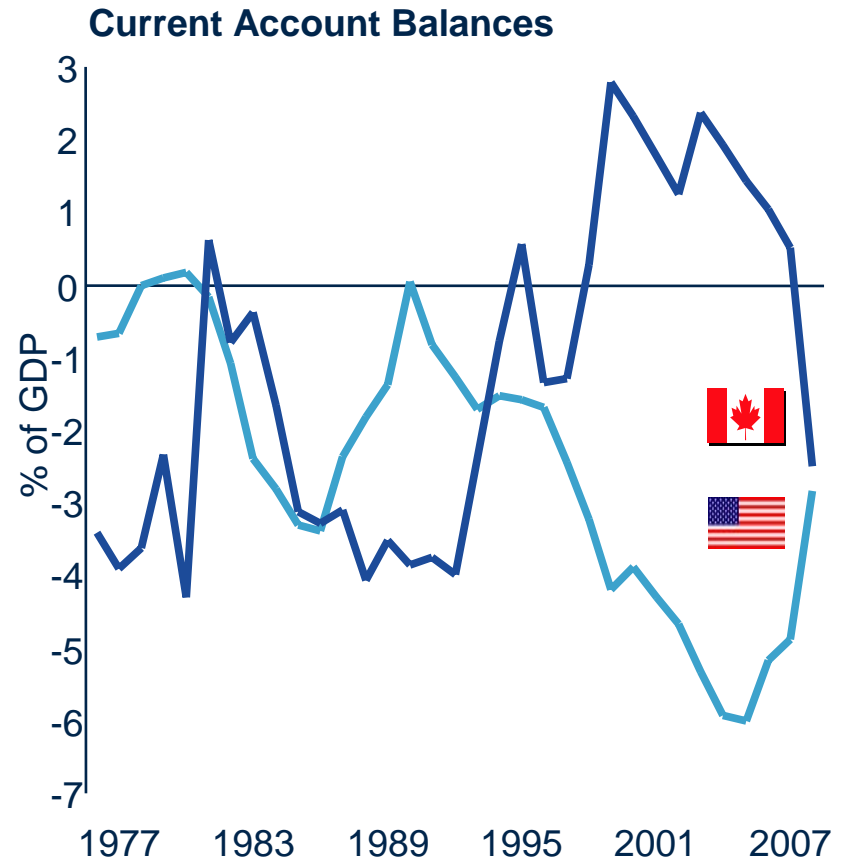


	 U.S.	 Canada
	(%)	(%)
Unemployment rate	9.8	8.4
Highest in:	26 years	11 years
Percentage job losses	5.3	2.8
Youth unemployment rate	18.2	15.1
Average duration of unemployment	24.5 weeks	15.0 weeks
Long duration unemployment as a share of the total	33.4	17.0
True unemployment rate	17.0	10.3

A reversal of fortunes – first trade deficit in 33 years



Source: Statistics Canada



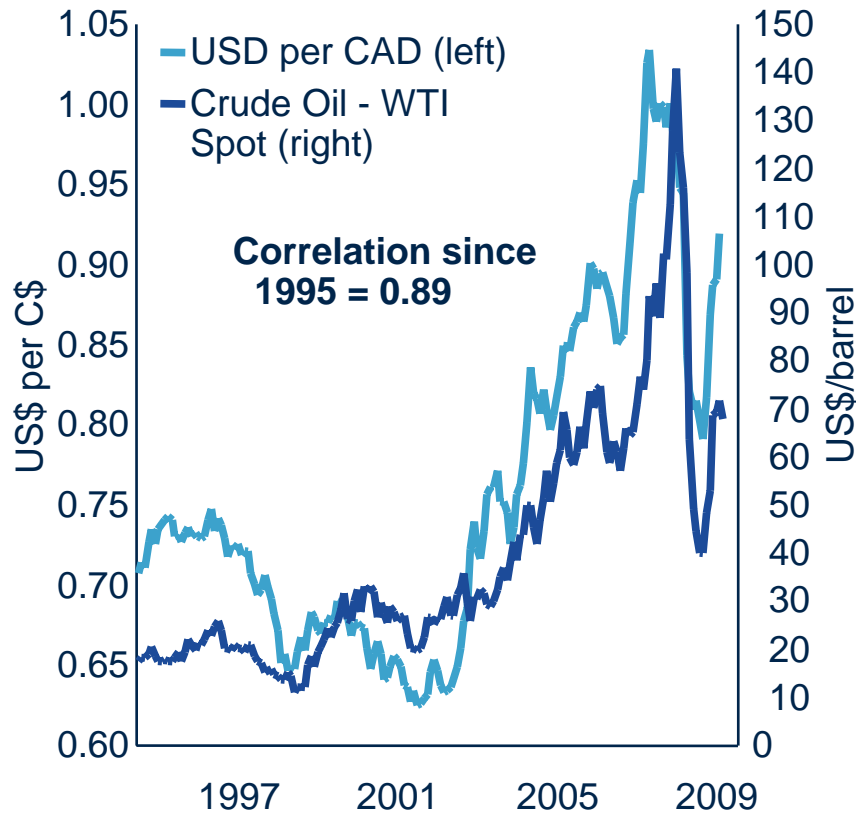
Source: Bureau of Economic Analysis, Statistics Canada

Canadian dollar on the way to parity

But not justified by fundamentals

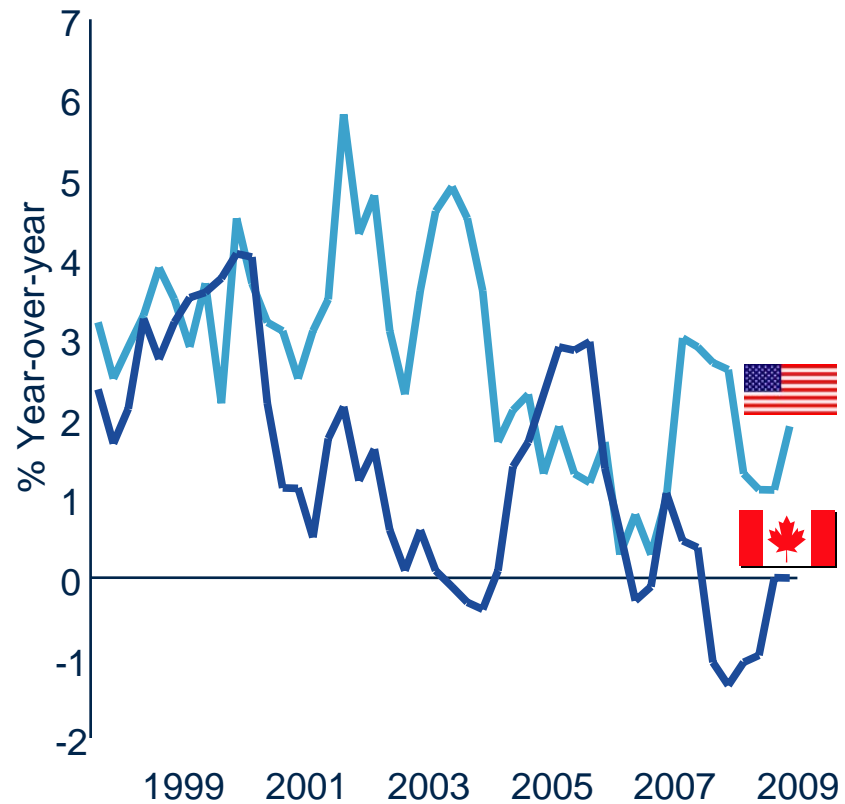


Canadian Dollar and WTI
Monthly since 1995



Source: Bank of Canada, Datastream

Labour Productivity



Source: Statistics Canada, US BLS

Role of U.S. dollar called into question

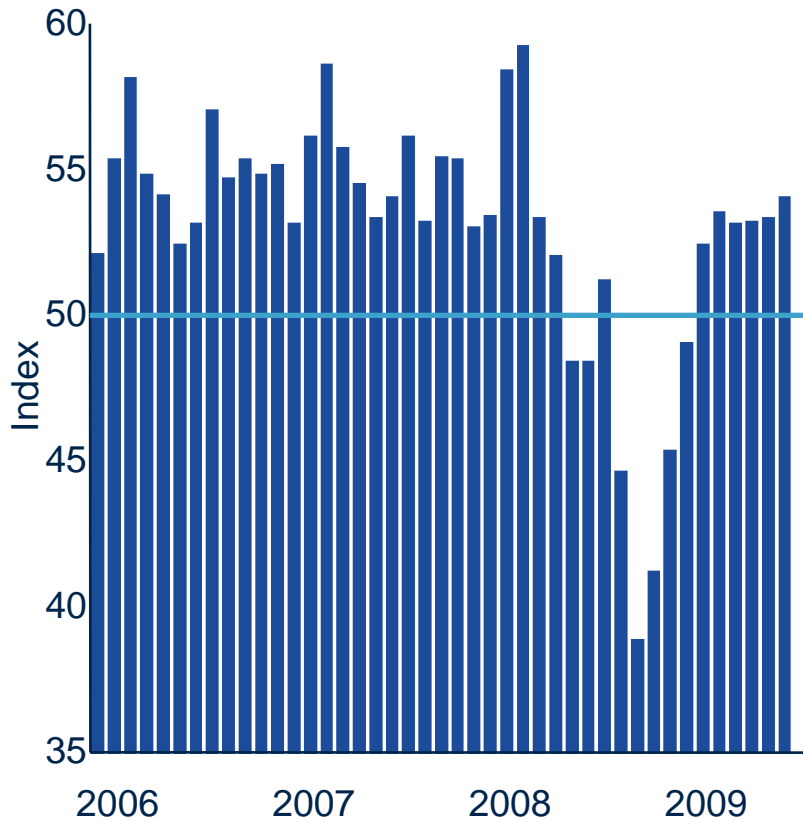


Source: Financial Times and Google Images

China's economy leading world recovery

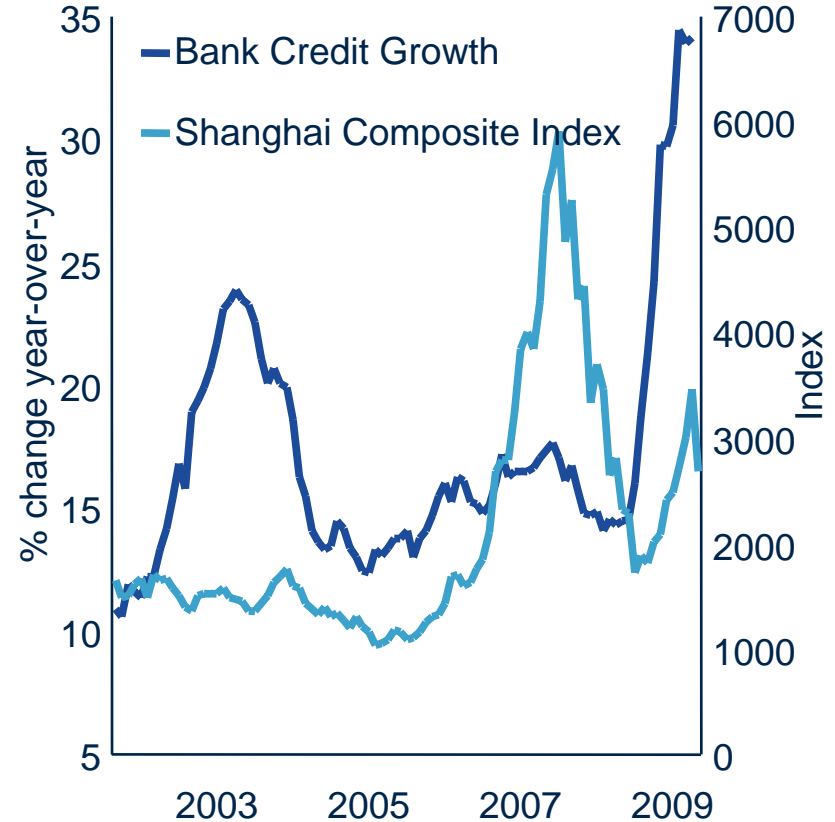


Purchasing Managers Index: China



Source: NTC Research



Chinese Credit Growth and Equities



Source: CEIC, Datastream

Theme for a decade: The rise of the Asian consumer

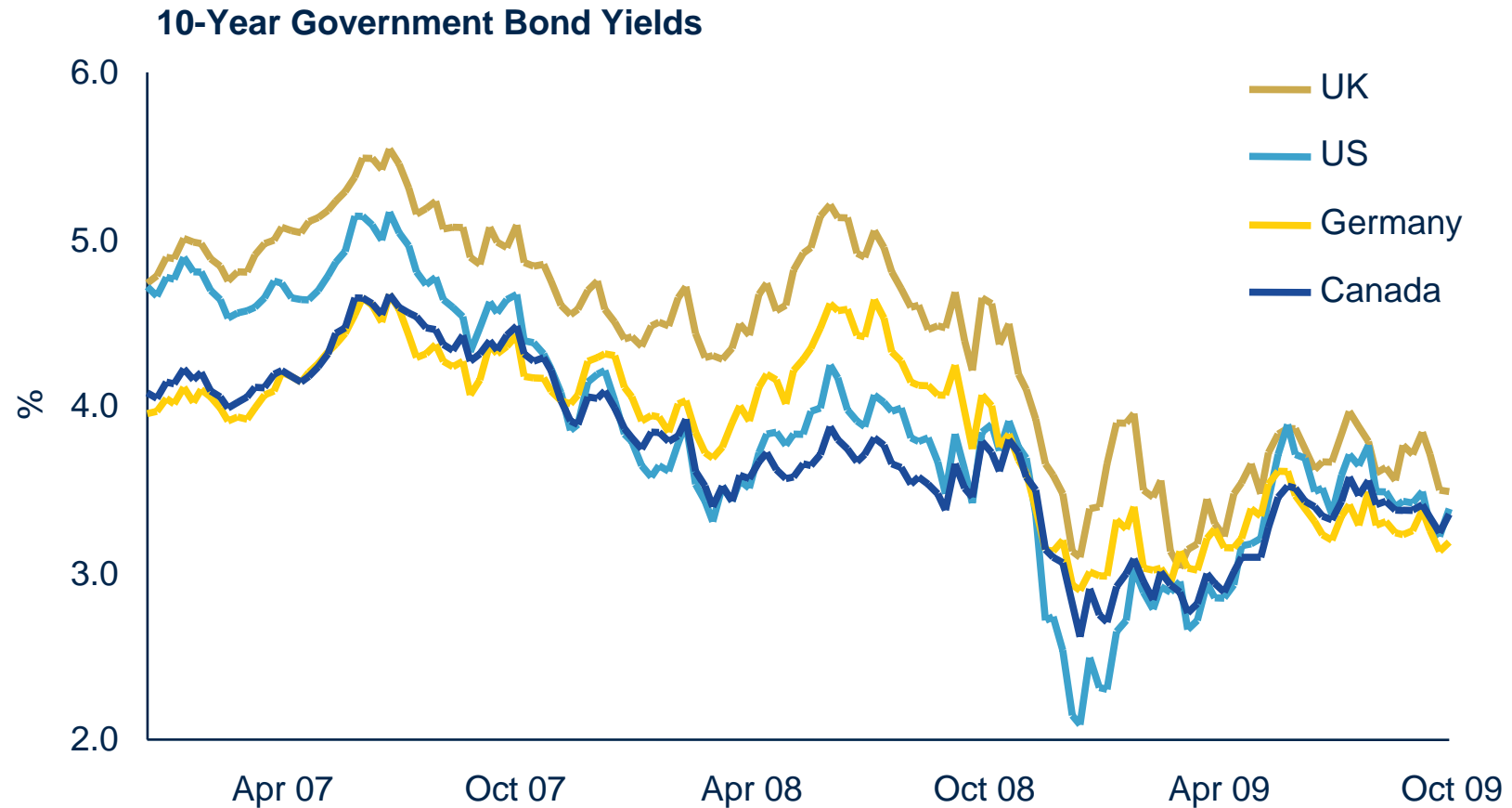


	 <u>U.S.</u>	 <u>China</u>
Population (mm)	307	1,338
Life Expectancy (Years)	78	73
GDP per capita (U.S. \$)	46,678	3,155
Savings rate (%)	4.6	49.9
Internet users (% of population)	73.0	13.0
Car ownership (% of households)	87.0	6.0

Source: CIA World Factbook, BEA, National Statistics Bureau of China, People's Bank of China, Euromonitor.

Bond yields range bound for now

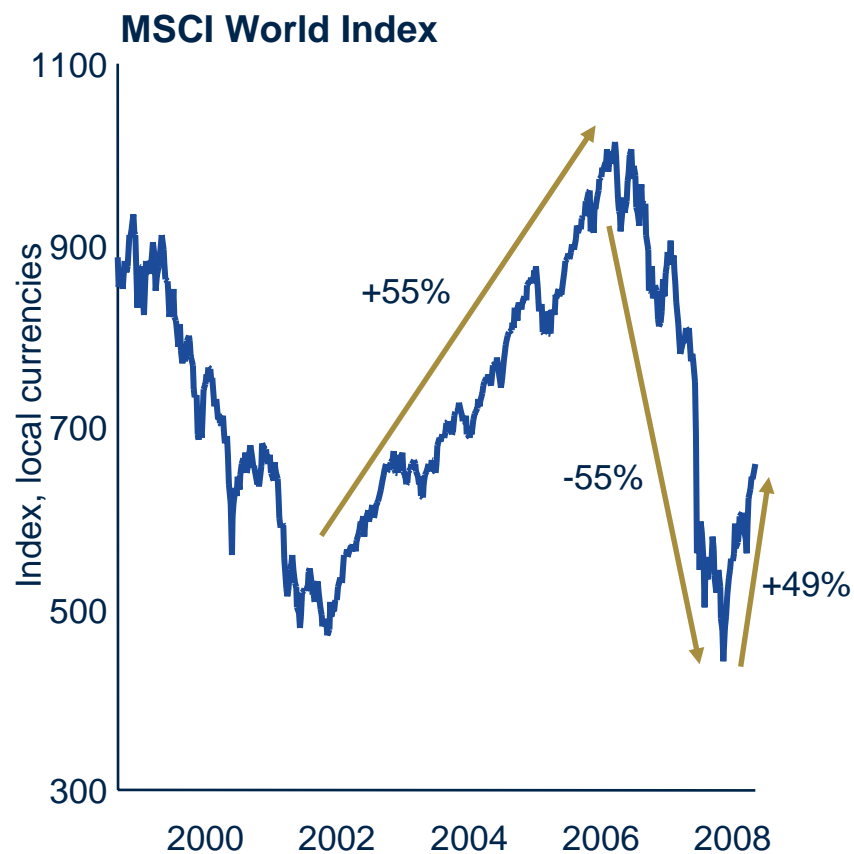
Economic recovery and wall of supply = higher yields



Source: Datastream



Opportunities Still Exist



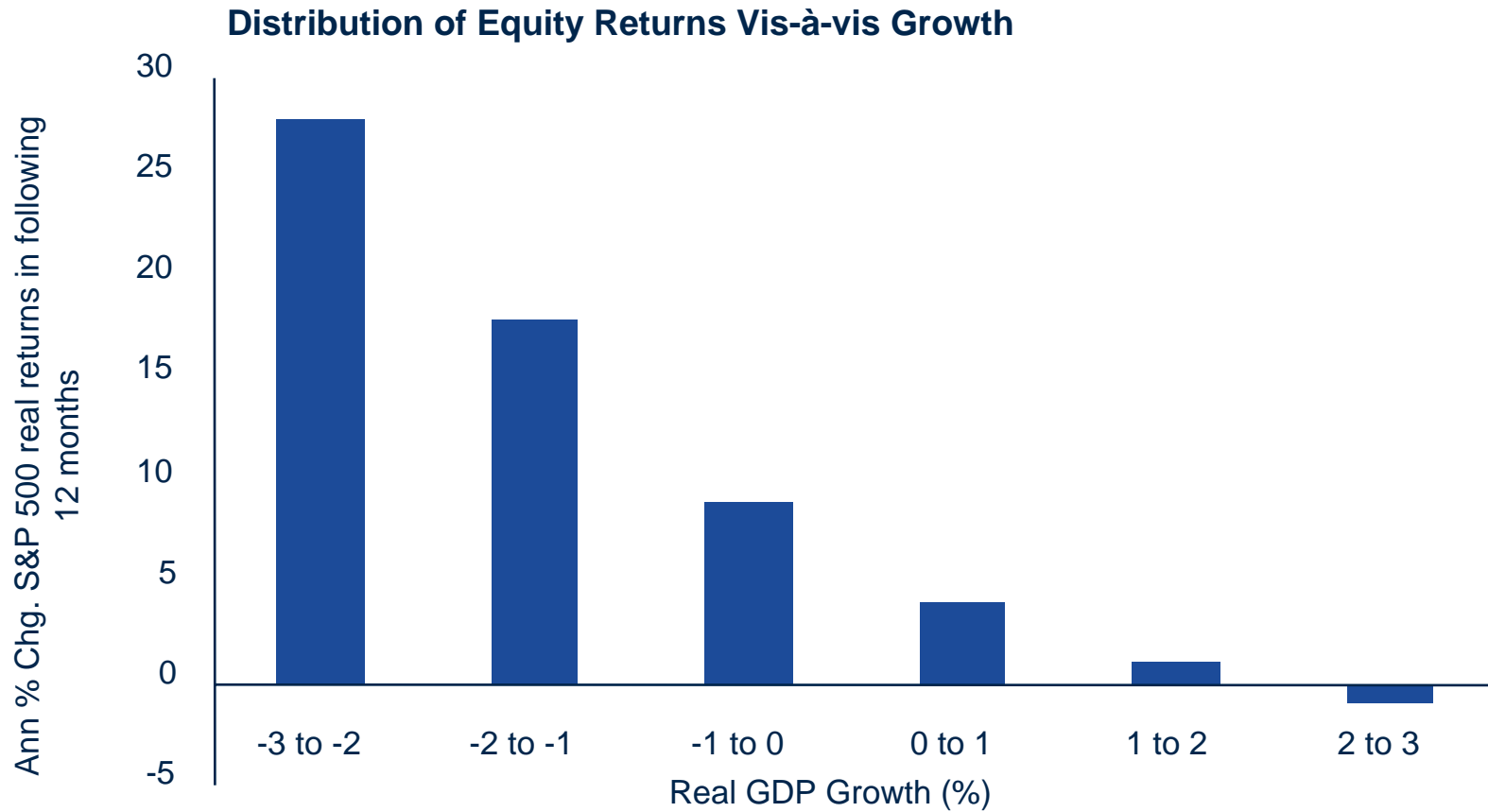
Source: MSCI

Market		Credit Crisis (%)	Recovery (%)	Current vs. Peak (%)
Russia		-80	113	-58
Brazil		-60	95	-22
India		-64	98	-28
China		-73	78	-52
U.S.		-58	54	-35
Germany		-56	52	-33
Japan		-62	46	-44
Canada		-51	45	-29
U.K.		-49	40	-37

Source: Odlum Brown Ltd.

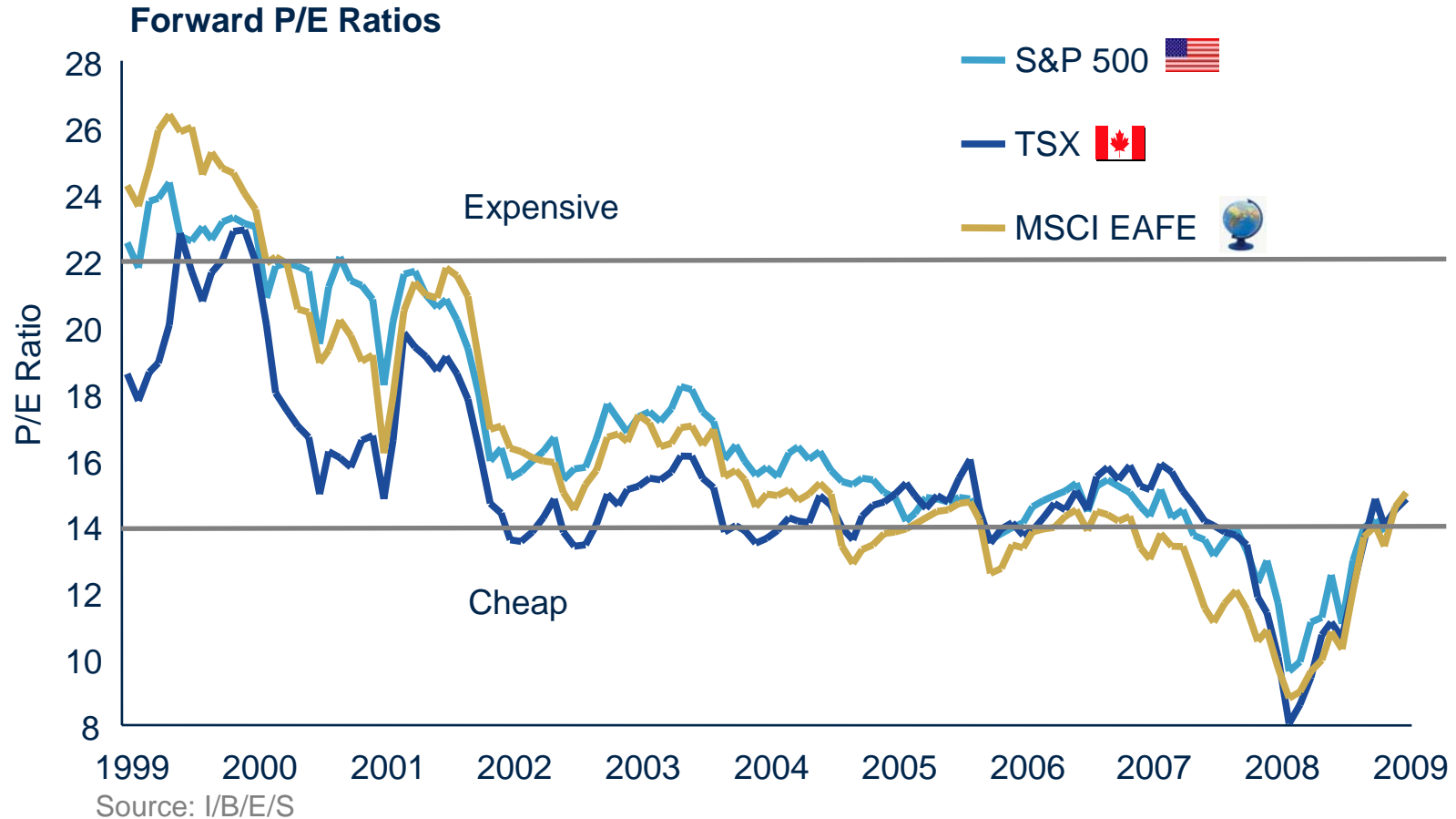
Note: Returns are in local currency, ex dividends as of Aug 21, 09

Sweet spot for stocks



Source: BCA Research

Perception vs. Reality



Risks to the outlook



1. Policy mistake
2. Lingering credit crisis evolves into debt crisis
3. China stumbles
4. Inflation and higher taxes
5. Protectionism
6. Geopolitical factors
7. U.S. dollar collapse

What lies ahead?



- › Recovery is underway, supportive of further gains in risk assets
 - Financial system and credit growth weak
 - Deleveraging proceeding
 - Consumer headwinds – weak labour market and declining net worth

- › The worst case scenario is off the table – rally likely continue unless growth disappoints or Fed signals rate hike at hand

- › Equity market valuation provides key support for investors



A world of unintended consequences

Policy	Intended Consequences	Unintended Consequences
Fiscal Stimulus	Support economy/fill gap left by tapped out consumers	Soaring budget deficits, credit rating downgrades, rising real interest rates
Quantitative Easing	Provide liquidity	Inflation fears, rising nominal bond yields, weaker U.S. dollar, Fed credibility
Re-regulation	Ensure credit crisis not repeated	Stifle risk taking, innovation, reduce growth
Zero Interest Rates	Prevent deflation/depression	The next bubble

Implications for asset allocation strategies



1. Recovery is underway despite longer-term challenges
2. North American central banks have signaled short-term interest rates to stay low for a prolonged period of time – markets ahead of themselves in pricing in rate hikes
3. Bond market still caught in cross currents of disappointing growth and rising fears of inflation. Better opportunities in corporate and provincial bonds
4. Equity market may now consolidate recent outsized gains but environment still supports risk assets



Your Questions



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Standard deviation is used to measure the volatility of returns and to compare the risk of various alternatives. It is assumed that the distribution of returns remains close to an average. Standard deviation measures negative deviations from average returns as well as positive deviations. Standard deviation is a statistical measure that indicates the range around the average return within which two-thirds of results will fall into, assuming a normal distribution around the long-term average. Past performance is not indicative of future results. Models are theoretical portfolios that consist of recommended holdings and transactions. The performance of a model does not reflect any single client's experience, and actual returns achieved by clients may differ due to the timing and fees associated with the execution of trades.

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