
Investing in a World of Global Economic Imbalances

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CIBC Global Asset Management Inc.

Agenda

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- B** Daunting Fiscal Challenges
- C** Strategy Implications
- D** Conclusion
- E** Supporting Exhibits

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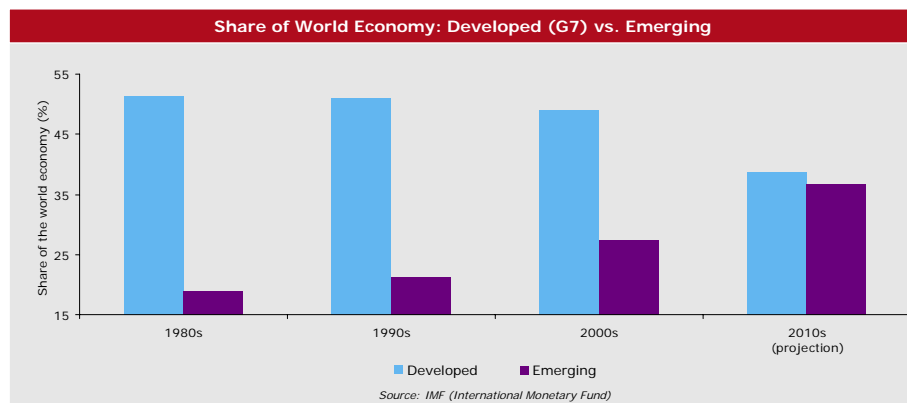
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A. Widening Global Imbalances

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A Different Global Landscape

- The emerging world as a share of the world economy has grown dramatically during our lifetime.
- The emerging world will be bigger than the developed world by the middle of this decade.



A Tale of Two Worlds

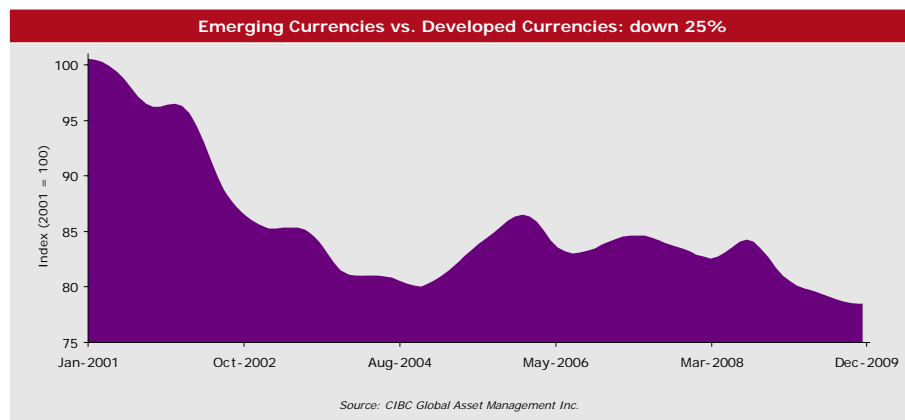
EMERGING		DEVELOPED
Rising	← Inflation →	Low
Surpluses	← Current account →	Deficits
Accumulation	← Wealth →	Depletion
Sound	← Fiscal →	Deteriorating



- The imbalances between the developed and the emerging world continue growing.
- In the absence of a major foreign exchange readjustment, global imbalances will increase.

End of Foreign Exchange Manipulations

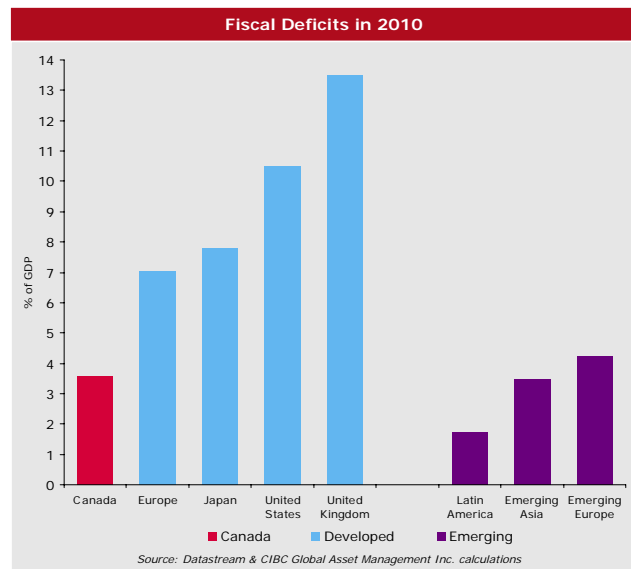
- Although emerging currencies have gained some ground against the U.S. dollar, they have depreciated by 25% when compared to a basket of developed market currencies.
- The global rebalancing hasn't started yet.



B. Daunting Fiscal Challenges

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Widening Fiscal Imbalances - Now

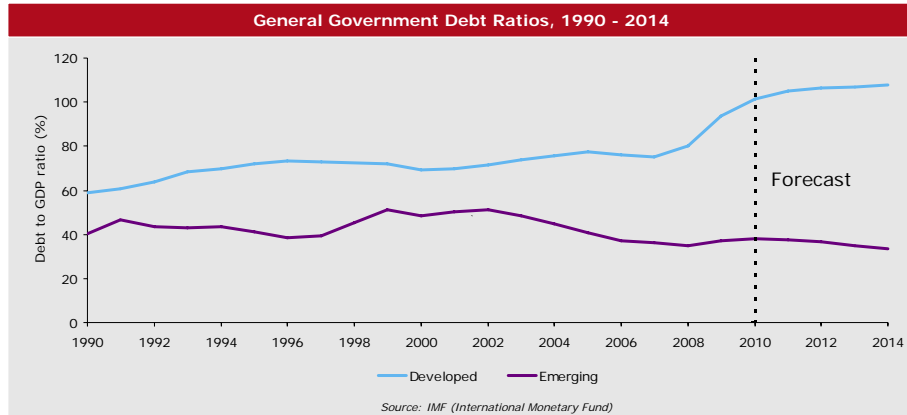


- To cushion the 2008-2009 economic downturn, governments in the developed world have accumulated huge fiscal deficits.

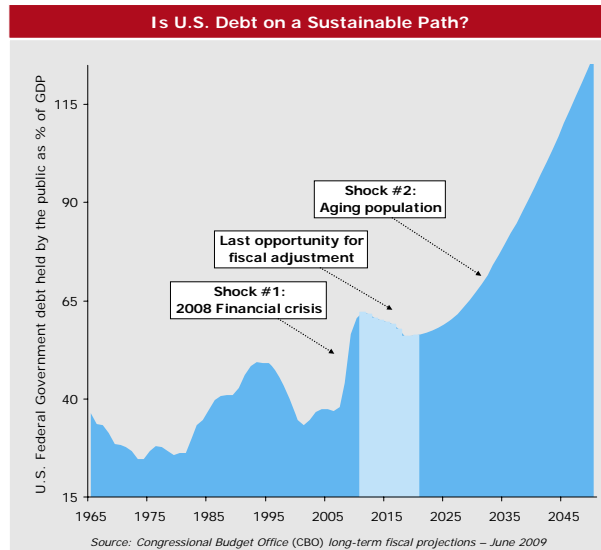
- It hasn't been the case in the emerging world.

Widening Fiscal Imbalances – Going Forward

- Already wide fiscal imbalances between developed economies and emerging ones are projected to widen further over the next decade.
- Debt to GDP ratios should average 106% in the developed world but only 36% in the emerging world.

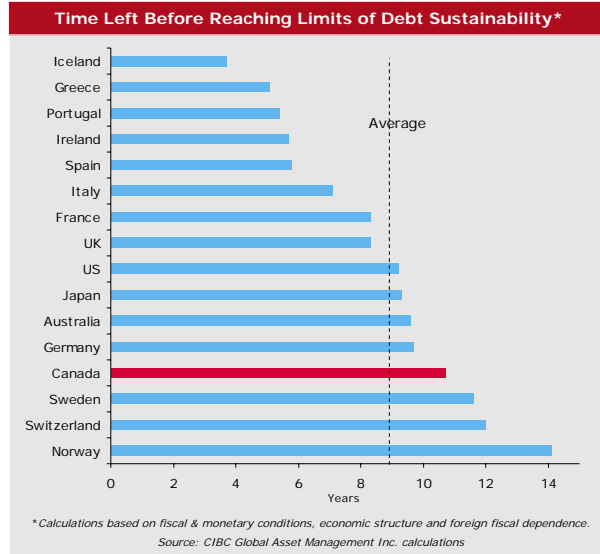


Pushing Fiscal Policy to the Limits of Sustainability



- The developed world could soon be pushing fiscal policy to the limits of sustainability.
- While a widespread fiscal crisis is not imminent, fiscal discipline is urgently needed.
- To gather enough ammunition to respond to the next adverse macro shock, a large fiscal adjustment will be required over the coming years as developed economies start growing again.

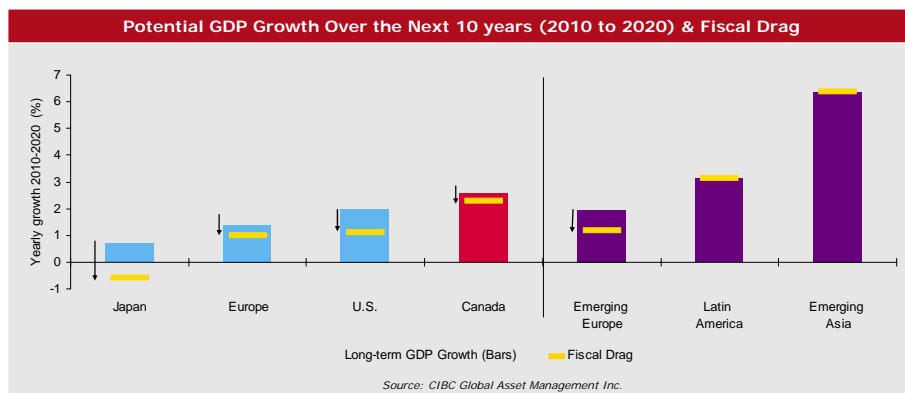
Urgent Need for Fiscal Discipline



- Time is running out for governments in the developed world.
- They have less than ten years to restore fiscal balance.
- Fiscal austerity will significantly depress economic activity in the developed world over the next decade.
- Governments will have to cut spending and increase revenues by a combined 6% of GDP between 2010 and 2020, a fiscal adjustment of around 0.6% per year.

Bad Timing

- Fiscal austerity is critical, but the timing could not be worse: economic growth is set to slow markedly in the developed world.
- Tightening efforts on the fiscal front will act as an additional source of drag on growth.

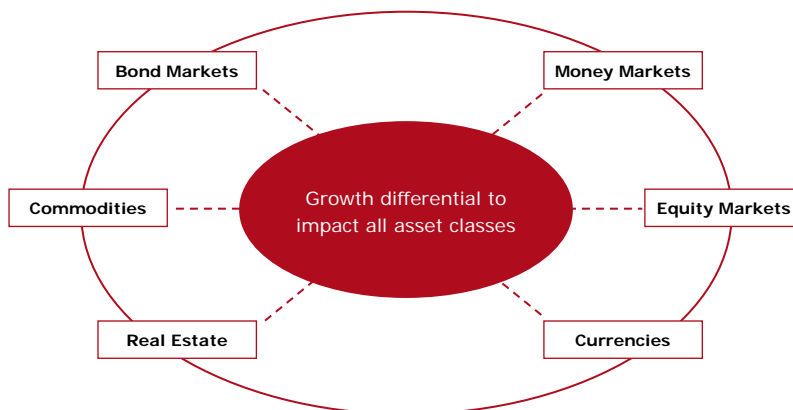


C. Strategy Implications

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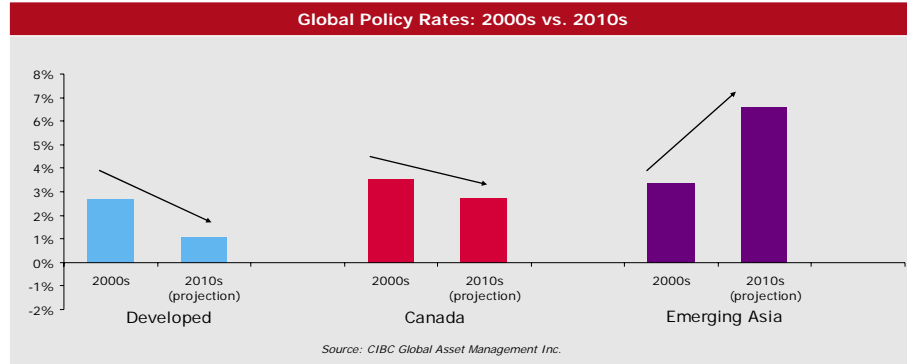
The #1 Determinant of Relative Returns

- Growth in emerging world to exceed growth in the developed world by roughly 4% per year.



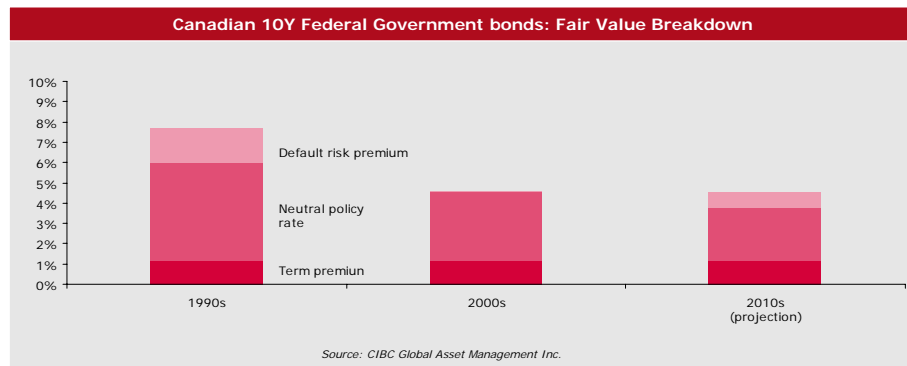
Implications for Money Markets

- **Lower neutral policy rates:** Neutral short-term policy interest rates are determined by long-term economic growth and trend inflation. Looking forward, both factors point to lower short-term rates in the developed world.
- **Accommodative policy bias:** Central banks in the developed world will be tempted to keep policy rates accommodative to offset the drag on economic activity owed to fiscal austerity.
- Policy rates are expected to drift higher in the emerging world.



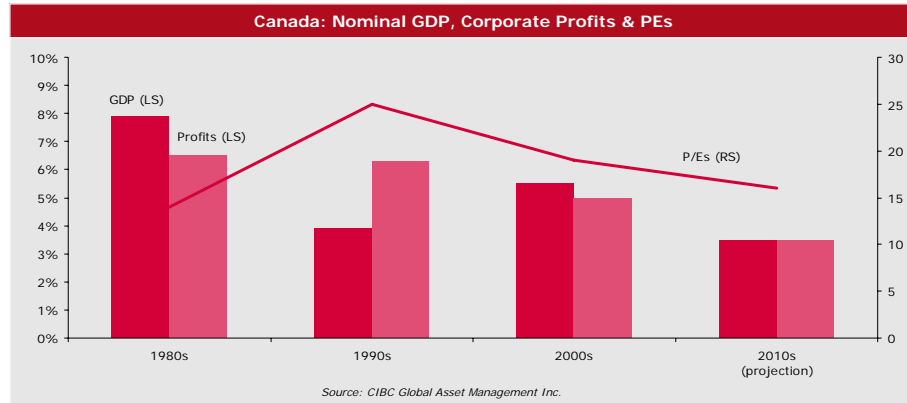
Implications for Government Bonds

- In the developed world, sovereign default risk premiums are projected to substantially rise in the next decade.
- However, neutral policy rates are projected to decline substantially.
- The net impact is likely to be stable to modestly lower bond yields.



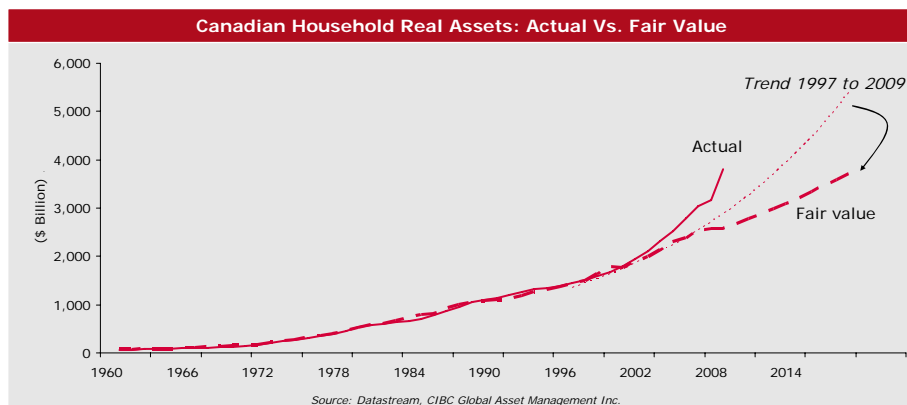
Implications for Equities

- Over the long-term, corporate profits tend to grow at the same rate as economic activity but are subject to wider cyclical fluctuations. As the Canadian economy shifts to lower gear over the next decade, profit growth should gradually decelerate.
- Unfortunately, the cyclical backdrop is not likely to allow for a significant expansion in PEs. Taken as a whole, this points to more modest gains in equities.



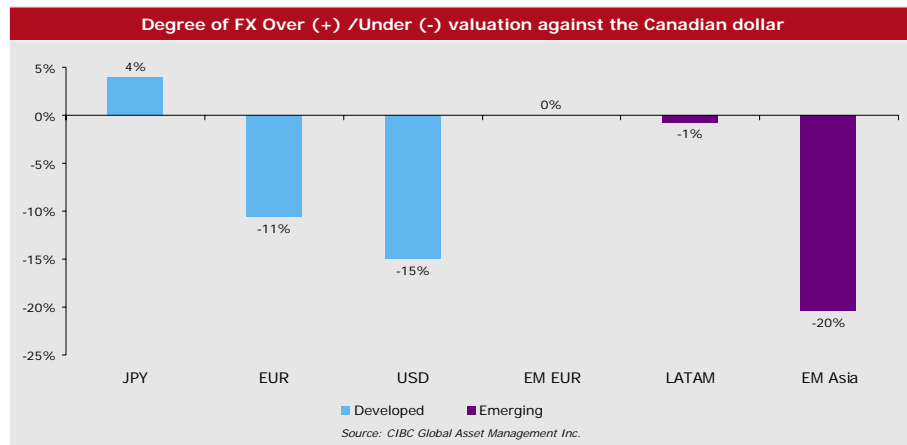
Implications for Real Estate

- Lower revenue growth prospects in the developed world limit the upside for tangible assets.
- In many countries such as Canada, real estate markets already qualify as overvalued – further limiting potential future returns.



Implications for Currencies

- The Canadian dollar is overvalued against most currencies.
- For Canadian investors, the biggest FX imbalance is against emerging Asian currencies.



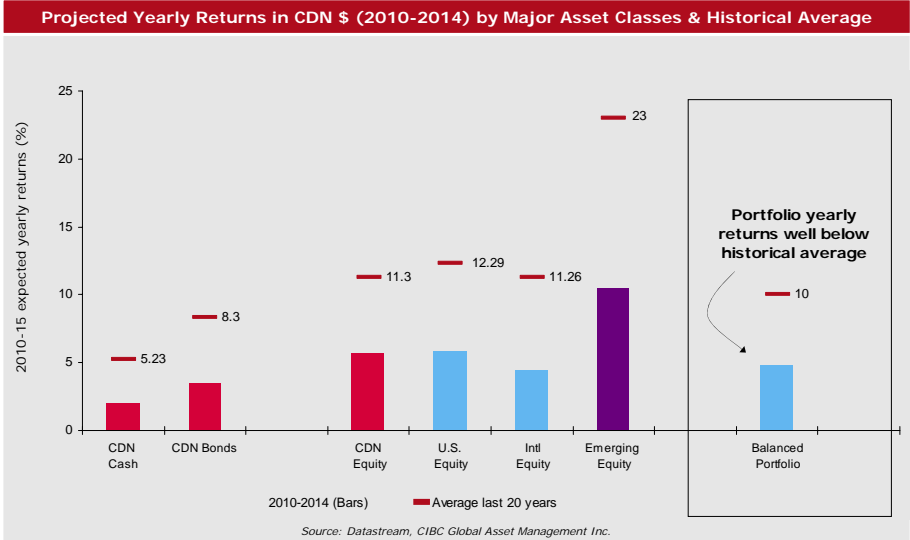
D. Conclusion

State of the World Today

- Global imbalances between the developed and emerging world are **intensifying**.
- A widespread fiscal crisis is not imminent, but **fiscal discipline** is urgently needed in the developed world.
- The fiscal austerity expected to be required in the developed world over the next decade will **limit any upside** in economic activity.
- Traditional assets classes in the developed world are projected to deliver **lower returns**.
- Relative growth differentials will shape the global financial landscape, impacting all asset classes from money markets, bonds, equities to real estate, resulting in a more meaningful role for **tactical asset allocation**.

Implication for pension funds
Lower expected returns than actuarial assumptions and/or plan requirements.

Lower Growth = Lower Returns for All Asset Classes



What Can Be Done

Asset Class	Regime Shift	Implication / Recommendation
Asset mix	<ul style="list-style-type: none"> More disappointing returns from nearly all asset classes 	<ul style="list-style-type: none"> More meaningful role for Tactical Asset Allocation
Currencies	<ul style="list-style-type: none"> Emerging Asian currencies still significantly undervalued even against the Canadian dollar 	<ul style="list-style-type: none"> Overweight emerging markets / Underweight developed markets
Risk Management	<ul style="list-style-type: none"> Structural change in risk metrics 	<ul style="list-style-type: none"> Underestimating risk in developed markets / overestimating risk in emerging markets
Foreign Equities	<ul style="list-style-type: none"> Emerging equities offer significantly more upside than international equities 	<ul style="list-style-type: none"> Overweight emerging markets / Underweight developed markets Within developed markets, favor US equities over Europe and Japan
Canadian Equities	<ul style="list-style-type: none"> Beneficiary of strong commodity demand & healthy domestic demand Equities to outperform bonds 	<ul style="list-style-type: none"> Overweight equities over cash and bonds
Canadian bonds	<ul style="list-style-type: none"> a) Favorable cyclical backdrop b) Rising default risk premium on government bonds (i.e. nominal and inflation-linked) c) Falling default risk premium on corporate bonds 	<ul style="list-style-type: none"> Overweight bonds vs. cash Overweight corporate bonds / Underweight government & inflation-linked bonds
Global Real Estate	<ul style="list-style-type: none"> Unattractive valuation in many countries & poor growth prospects 	<ul style="list-style-type: none"> Reduced exposure to developed markets / Focus on Asian markets
Money markets	<ul style="list-style-type: none"> Lower neutral policy rates and accommodative policy bias 	<ul style="list-style-type: none"> Lower cash returns / Invest excess cash

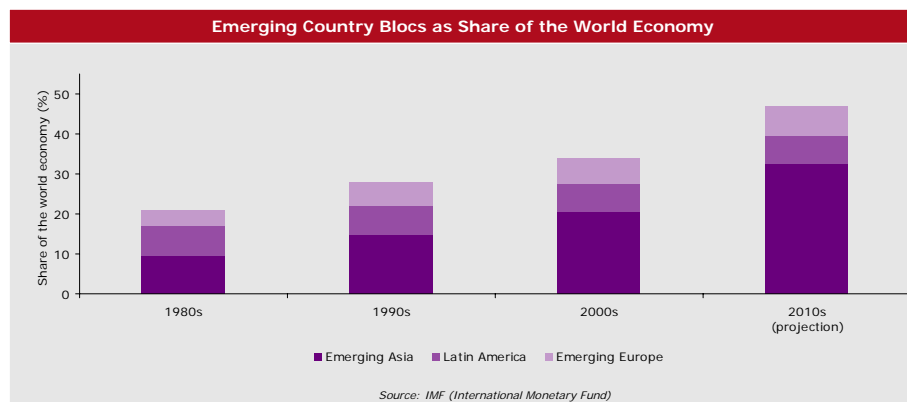
Investment Opportunities

Asset Class	Developed World	Canada	Emerging Europe	Latin America	Emerging Asia
Money market	●	●	●	●	●
Bonds	●	●	●	●	●
Equities	●	●	●	●	●
Currencies	●	●	●	●	●
Real estate	●	●	●	●	●
Risk	●	●	●	●	●

E. Supporting Exhibits

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World Share of Emerging Economies



Composition of the World Economy

% of the World Economy			
Developed World	44.24%	Emerging Asia	27.81%
Australia	1.00%	China	15.00%
Austria	0.40%	India	5.70%
Belgium	0.50%	Indonesia	1.44%
Canada	1.73%	Malaysia	0.60%
Denmark	0.25%	Philippines	0.46%
Finland	0.25%	Thailand	0.86%
France	2.71%	Taiwan	1.06%
Germany	3.48%	South Korea	1.90%
Greece	0.45%	Hong Kong	0.44%
Iceland	0.01%	Singapore	0.35%
Ireland	0.24%		
Israel	0.28%	Latin America	6.10%
Italy	2.10%	Mexico	2.18%
Japan	5.45%	Brazil	2.81%
Netherlands	0.85%	Argentina	0.76%
New Zealand	0.15%	Chile	0.35%
Norway	0.32%		
Portugal	0.28%	Emerging Europe	6.31%
Spain	1.73%	Hungary	0.25%
Sweden	0.46%	Russia	3.40%
Switzerland	0.40%	Poland	0.98%
United Kingdom	2.90%	Turkey	1.30%
United States	18.30%	Czech Republic	0.38%
		Frontier Markets	15.54%

Source: IMF (International Monetary Fund)

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