



2012 Outlook & Portfolio Strategy*

Modest market declines expected as Europe remains the wildcard

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December 20, 2011

* Based on our research report dated December 16, 2011



Summary.....1

- 2011 – a roller-coaster year for global stock markets
 - Characterized by gut-wrenching volatility and spiraling macroeconomic risk
 - “Sell in May and go away” validated in spades
- European debt situation is the biggest wildcard
 - Speedy and credible resolution = positive outcome for markets
 - Uncontrolled crisis = Europe possibly in recession, global growth lowered by as much as 3 percentage points (IMF)

Summary.....2

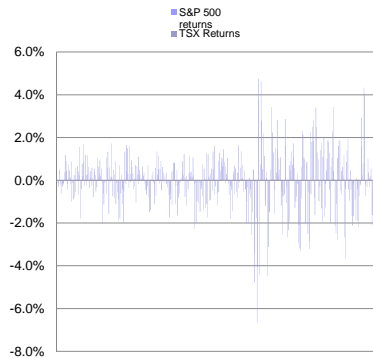
- Our end-2012 target for TSX = 11,000
- Our end-2012 target for S&P 500 = 1,200
- Major risks to our forecast
 - EU strains, sovereign debt defaults, bank failures
 - Limited options for Fed, China hard landing, currency volatility (stronger US dollar)
- Recommended asset allocation
 - Stocks 55% (down 5%), Bonds 20% (up 5%), Cash 25% (no change)

Market Review.....1

- Remarkable difference in performance of 15 major equity indexes before and after April 30
 - Average change (Jan. 1 – April 30) = +3.3%
 - Average change (April 30 – Dec.14) = -17.7%
- Sovereign debt was biggest driver of this performance slump
- Other contributing factors
 - S&P downgrade of US credit rating on August 5
 - Fed's pledge on Aug. 9 to keep rates at near-zero until mid-2013

Market Review.....2

S&P 500 and TSX daily returns: Jan.1-Dec.14, 2011



■ Volatility has surged

- Dramatic rise since August in daily returns variance (see Chart)
- Volatility up 83% over Aug.1-Dec.14, compared with average from January to July

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5

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Market Review.....3

CDS for European vs. N. American firms



■ Europe is the epicenter

- Europe is now the epicenter of the crisis (like the US in 2008)
 - Markets demanding higher premiums to protect against possibility of European corporate defaults
 - CDS for European companies close to record premium relative to US firms (Graph)

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6

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Market Review.....4

TSX Sector Performance

TSX Group	2010 Performance	YTD 2011 Performance
Health Care	50.3%	44.4%
Telecom Services	16.3%	14.2%
Consumer Staples	8.3%	4.2%
Utilities	12.6%	-2.1%
Industrials	14.4%	-3.2%
Financials	6.3%	-10.5%
Energy	10.0%	-17.0%
Consumer Discretionary	21.8%	-19.2%
Materials	35.8%	-22.1%
Information Technology	-11.6%	-51.8%
TSX	14.5%	-14.1%

Index hit by risk aversion

- Investors have marked preference for defensive sectors
 - Materials and Energy groups reversed last year's gains
 - Financials group down 10.5% YTD
 - IT worst performer for second year (thanks to RIM)

Economic Fundamentals.....1

- Renewed uncertainty in global economy since August
- IMF attributes this to two adverse developments
 - Much slower recovery in advanced economies
 - Large increase in fiscal & financial uncertainty
- IMF global growth estimates
 - About 4% in 2011 and 2012 (down from 5% in 2010)
 - Risks clearly to downside, specifically – escalation of European crisis, softer US growth

Economic Fundamentals.....2

- While European crisis has worsened over past couple of months.....
-recent data suggests US economy may be heading into 2012 on strong note
- Economists more optimistic than IMF about US growth
 - Bloomberg survey of economists forecasts US growth at 2.2% in 2012 (up from estimated 1.8% this year)
 - IMF forecasts 1.8% in 2012 (up from 1.5% this year)

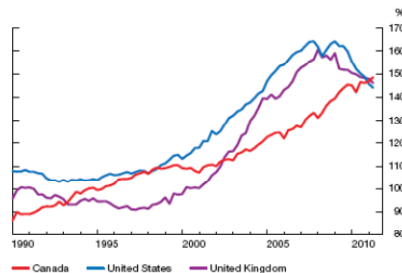
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9

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Economic Fundamentals.....3

Debt-to-income: Canadian households vs. US and UK



Canada slowing down

- Canada forecast to slow down in 2012 by Bank of Canada and IMF
 - 1.9% growth rate forecast for 2012 (down from 2.1% this year)
 - BoC continues to highlight rising Canadian household debt as risk factor (see Figure)

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10

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Economic Fundamentals.....4

- Europe may not escape recession if debt crisis drags on (and contagion spreads)
- China and India expected to slow down in 2012
- Sovereign debt very likely to be “elephant in the room” well into next year
- European debt situation may be biggest wildcard to affect global economy in 2012

Outlook.....1

TSX Groups – Forecast EPS change in 2012 & Valuations

TSX Group	Forecast EPS change (%)*	Forward Index P/E**	Indicated Dividend Yield
Consumer Discretionary	11.5%	10.2	3.4%
Consumer Staples	8.1%	12.9	2.7%
Energy	11.4%	13.9	2.9%
Financials	4.5%	9.7	4.3%
Health Care	34.3%	12.7	2.3%
Industrial	22.6%	13.1	2.2%
Info Tech	-4.2%	6.1	0.3%
Materials	34.4%	10.1	0.9%
Telecom Services	3.9%	12.6	4.6%
Utilities	6.3%	17.7	4.7%
TSX	13.3%	11.1	2.9%

*Forecast EPS change in 2012

** Forward P/E based on 2012 EPS estimate

Earnings Estimates

- Index EPS forecast for TSX in 2012 = \$1,038 (up 13% from \$915 in '11)
- We believe \$1,000 barrier may be difficult to break
- Index EPS forecast for S&P 500 in '12 = \$107.32 (up 16% from \$97.27 in '11)

Outlook.....2

TSX Technical Picture



Index in downtrend

- “Line in the sand” at 10,900 has to hold
- A test of this key support is very likely in 2012
- Definitive break above 12,000 may negate risk of further decline
- Line in sand for S&P 500 is 1,020

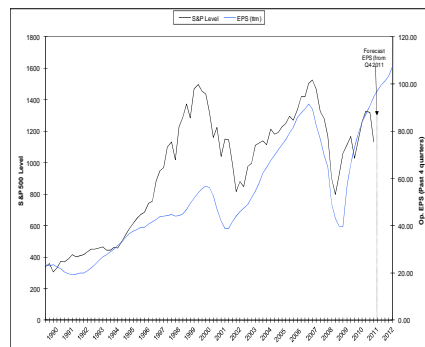
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13

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Outlook.....3

S&P 500 vs. 4-quarter op. EPS – 1990 to 2012



Valuations in line with earnings growth forecasts for 2012

- TSX multiples =
 - 12.6x 2011 forecast EPS,
 - 11.1x 2012 forecast EPS
- S&P 500 = 12.5x 2011 EPS, 11.3x 2012 EPS
- End-2012 targets
 - TSX = 11,000 (based on 11.2x our 2012 EPS estimate of \$975)
 - S&P 500 = 1,200 (based on 12x our 2012 EPS est. of \$100)

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14

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Outlook.....4

- Key risks that could impact our forecasts
 - Strains in European Union
 - Sovereign debt defaults
 - Bank failures (which could trigger Credit Crunch Part II)
 - Limited policy options for Fed
 - Hard landing in China
 - Currency volatility

Portfolio Strategy.....1

- Positive drivers could spur upside performance in 2012
 - Extremely stimulative monetary policy
 - Solid earnings growth
 - Oversold conditions
 - Valuation support
 - Solid balance sheets

Portfolio Strategy.....2

■ Portfolio strategy recommendations and investment themes for 2012

1. Use barbell strategy for investment portfolios – balance longer-term core positions in defensive sectors with tactical trading positions in cyclical stocks
2. Opt for short-term bonds over sovereigns – balance sheets of many corporates with bonds below investment grade are arguably in better shape than highly indebted nations
3. Keep risk tolerance in mind when deciding between blue-chips with above-average dividend yields or their bonds
4. Avoid dividend debacles

Portfolio Strategy.....3

■ Portfolio strategy recommendations and investment themes for 2012 (....contd.)

5. Follow these three principles for dividend payers – stick with quality, check payout ratios and stability, evaluate long-term fundamentals
6. Consider covered calls for additional yield
7. This is a good time to prefer preferred shares
8. Exercise caution on bank shares – while Canadian banks deserve a premium valuation, they may not prove totally immune to pressures in global banking sector if they intensify
9. Canadian REITs may encounter profit-taking

Portfolio Strategy.....4

- Portfolio strategy recommendations and investment themes for 2012 (....contd.)

10. Opportunistic M&A may continue
11. Accumulate senior gold producers

Our recommended asset allocation is now –
Stocks 55% (down 5%), Bonds 20% (up 5%), Cash 25%
(unchanged)

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