



## EQUITY RESEARCH

December 21, 2009

### INVESTMENT STRATEGY

#### 2010 Outlook & Portfolio Strategy

#### A challenging year ahead

Elvis Picardo, CFA  
Analyst & Strategist

Global Securities Research  
(604) 443-5400

#### Index Levels

<b>TSX</b>	11554.72
<b>TSX Venture</b>	1427.72
<b>DJIA</b>	10414.14
<b>S&amp;P 500</b>	1114.05
<b>Nasdaq Composite</b>	2237.66
<b>MSCI World Index</b>	292.46
<b>Risk Metrics</b>	
<b>VIX</b>	20.49
<b>TED Spread</b>	0.21%
<b>FAIL<sup>®</sup></b>	4.20

Prices and levels as at close on December 21, 2009

#### Interest Rates & Commodity Prices

<b>Canada T-Bill (90 days)</b>	0.11%
<b>US T-Bill (90 days)</b>	0.04%
<b>Canada 10-year Govt.</b>	3.51%
<b>US 10-year Treasury</b>	3.68%
<b>Canada 30-year Govt.</b>	4.08%
<b>US 30-year Treasury</b>	4.57%
<b>CRB Index</b>	274.78
<b>Spot Gold</b>	US\$1092.70
<b>Crude Oil (Jan.)</b>	US\$72.47
<b>Canadian Dollar</b>	94.12 US cents
<b>USD/Euro</b>	1.4280
<b>USD/JPY</b>	91.19

Source: Bloomberg

#### Summary

- We believe equities may be range-bound for a few years as the new consumer frugality leads to a tepid economic recovery.
- With debt levels rising in Canadian households, the Bank of Canada identified household balance sheets as the only one of five categories to pose an increased risk to the Canadian financial system over the past six months.
- The rally in equities has driven valuations to levels where they are no bargain. With the TSX and S&P 500 having gained 5% since the beginning of November, valuations have become more extended.
- Our end-2010 targets are at 12,500 for the TSX Composite and at 1,200 for the S&P 500, implying total returns of 11%-12% in 2010.
- Major risks to our forecast include the risk of a double-dip recession, sovereign risk, and inflation concerns / higher interest rates.
- We continue to believe that the risk-reward payoff is presently tilted in favor of stocks over bonds. Accordingly, we are raising the equity allocation in our recommended asset mix by five percentage points at the expense of bonds. Our recommended asset allocation is therefore – Stocks 60% (up 5 percentage points), Bonds 20% (down 5 percentage points) and Cash 20% (unchanged).

Head Office: 11<sup>th</sup> Floor 3 Bentall Centre, 595 Burrard Street, Vancouver, BC, Canada, V7X 1C4  
Tel (604) 689-5400 Fax (604) 689-5401 Website: www.globalsec.com

BRANCH OFFICES: NANAIMO, NORTH VANCOUVER, PENTICTON, PORT ALBERNI, PORT COQUITLAM, PRINCE GEORGE, QUALICUM BEACH, QUESNEL, VICTORIA, WEST VANCOUVER, WILLIAMS LAKE, WINNIPEG

**MARKET REVIEW****BRIC giants outperform in banner year for global equities**

*The January Barometer proved to be inaccurate this year.*

In our Market Strategy report a year ago, we wrote that the calm after the storm of 2008 could lead to modest upside for global equities in 2009, based on our forecast of a contraction in volatility and improvement in risk appetite. But the year commenced on an ominous note, with the Dow Jones Industrial Average (DJIA) and S&P 500 down over 8.5% for their worst January performance on record. Fortunately, the “January Barometer” – which holds that as this month goes for the S&P 500, so goes the rest of the year, a trend that has an accuracy ratio since 1972 of over 90%, according to the Stock Trader’s Almanac – proved to be incorrect this year.

While US benchmark indexes tumbled to 12-year lows and the TSX fell to a 5½-year low by the first week of March, sentiment turned around shortly after, enabling global equities that month to stage their strongest monthly rally in six years. The rally has continued with hardly a pause since then. In fact, the S&P’s 15% advance in both Q2 and Q3 was its best two-quarter performance since 1975.

*Global market capitalization is up 76% from the March low.*

Stimulus efforts by governments around the world have enabled the global economy to rebound faster than earlier expectations. As a result, global equity markets have currently recouped just over half of the \$37 trillion in losses they had collectively incurred from the October 2007 record high to the March 2009 low. Global market capitalization currently stands at about \$45 billion, up 76% from the March low but still down 28% from the record high.

The BRIC (Brazil, Russia, India and China) giants have outperformed most developed markets this year (Table 1), just as they did during the 2003-07 bull market. The resource-heavy TSX-Venture index, which at its low in 2008 had declined 80% in US\$-terms, has more than doubled this year in terms of US\$.

*The BRIC markets are up by an average of more than 90% in 2009. They had total returns of over 500% on average during the 2003-07 bull run, outperforming the S&P 500’s 83% returns by a factor of six.*

**Table 1: Major equity indexes – YTD\* change**

Country	Index	YTD change
Canada	TSX	27.6%
Canada	TSX-Venture	79.4%
US	DJIA	17.7%
US	S&P 500	22.1%
US	Nasdaq Comp.	40.2%
Mexico	Bolsa	42.2%
Brazil	Bovespa	77.9%
UK	FTSE 100	17.2%
Germany	DAX	21.2%
France	CAC 40	17.9%
Russia	RTS Index	124.3%
Japan	Nikkei 225	14.5%
Australia	ASX 200	24.9%
India	Sensex 30	73.3%
China	CSI 300	86.6%

\*as of December 18, 2009

Source: Bloomberg, Global Securities Research

*The positive correlation of the TSX with commodity prices is not always a good thing, as was evident during the second half of 2008.*

The TSX Composite continued to display a high degree of correlation with US and global equity markets, and a significant degree of correlation with commodity prices (Table 2). The positive correlation between the TSX Composite / Canadian dollar, and commodities using the CRB index and crude oil as proxies, is graphically shown in Figure 1. The popular perception that Canada's fortunes are determined by commodity prices is obviously unchanged. That this link is not always a good thing was amply evident during the second half of 2008, when plunging commodity prices triggered a precipitous decline in the TSX.

**Table 2: TSX Correlation Matrix**

Security	SPTSX	SPX	INDU	MXWD	CRB	CL1	CADUSD	DXY	VIX	.FAIL
11) SPTSX	1.000	0.836	0.801	0.811	0.563	0.509	0.585	-0.411	-0.694	-0.524
12) SPX	0.836	1.000	0.985	0.882	0.546	0.463	0.676	-0.440	-0.749	-0.581
13) INDU	0.801	0.985	1.000	0.869	0.502	0.446	0.645	-0.420	-0.719	-0.557
14) MXWD	0.811	0.882	0.869	1.000	0.600	0.506	0.704	-0.554	-0.657	-0.522
15) CRB	0.563	0.546	0.502	0.600	1.000	0.867	0.657	-0.560	-0.386	-0.223
16) CL1	0.509	0.463	0.446	0.506	0.867	1.000	0.534	-0.352	-0.384	-0.293
17) CADUSD	0.585	0.676	0.645	0.704	0.657	0.534	1.000	-0.659	-0.551	-0.422
18) DXY	-0.411	-0.440	-0.420	-0.554	-0.560	-0.352	-0.659	1.000	0.321	0.251
19) VIX	-0.694	-0.749	-0.719	-0.657	-0.386	-0.384	-0.551	0.321	1.000	0.815
20) .FAIL	-0.524	-0.581	-0.557	-0.522	-0.223	-0.293	-0.422	0.251	0.815	1.000

Source: Global Securities Research, Bloomberg

**Figure 1: TSX and C\$ vs CRB and Crude Oil – YTD**



Source: Global Securities Research, Bloomberg

The TSX Composite's 27.6% advance this year has been led by the Information Technology sector (up 47.8%) and the three heavyweight groups that together comprise over 77% of the index – Financials (up 34.7%), Materials (up 31.6%) and Energy (up 30.4%). Defensive groups such as Utilities (up 12.4%) and Consumer Staples (up 3.1%) have underperformed the broad index by a wide margin, as investors eschew companies with stable cash flows in favor of higher-beta plays. Telecom Services (down 3.4%) is the only sector to be in the red so far in 2009, as the group has been weighed down by concerns about increased competition from new entrants in the Canadian wireless space.

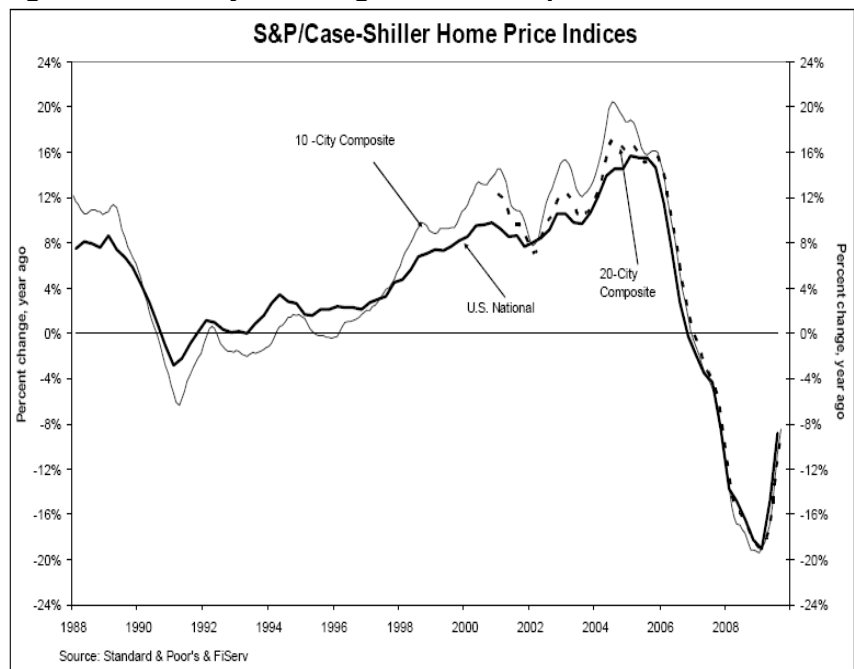
**ECONOMIC FUNDAMENTALS**

The International Monetary Fund, in its World Economic Outlook released in October, projected that the global economy would expand by about 3% in 2010, after contracting by about 1% in 2009. It forecast that advanced economies would expand sluggishly through much of 2010, with unemployment continuing to rise until later in the year. Following a 3.5% contraction in 2009, the IMF forecasts annual growth of about 1.25% in 2010 for the advanced economies. Global growth is expected to be led by emerging economies including China, India and a number of other emerging nations in Asia. The IMF estimates real GDP growth for emerging economies of close to 5% in 2010, up from 1.75% in 2009.

*Global growth of about 3% in 2010 is expected to be led by the emerging economies.*

The economic situation in the US has improved markedly in recent months, as housing and unemployment – the biggest drags on the economy during the recession – slowly improve. The US housing index peaked in Q2 of 2006 and then fell 32% by Q1 of 2009, as prices in that quarter fell by a record 18% from a year earlier. The index is now beginning to recover from the lows seen earlier this year, with US home prices as measured by the S&P/Case-Shiller indices gaining in Q3 for the second consecutive quarterly increase (Figure 2).

**Figure 2: Year-on-year change in US home prices**



Source: Standard & Poor's

US jobs data released earlier this month were better than the most optimistic forecasts, with payrolls down by only 11,000 in November and the unemployment rate declining by 0.2 percentage points to 10%. The index of leading indicators rose in November for the eighth consecutive month, confirming that the recovery may be sustained.

*A V-shaped recovery for the US economy may not yet be in the cards.*

But a V-shaped recovery for the US economy may not yet be in the cards. Federal Reserve chairman Bernanke recently said the US economy faces formidable headwinds including a weak labor market and tight credit.

The new norm for the US economy may be “the new normal” as defined by PIMCO, which expects it to expand at an average 2% pace in the years ahead, compared with a 2.8% average rate in the five years leading up to the beginning of the recession in December 2007. In our opinion, it may be a while yet before the embattled US consumer recovers from the \$11 trillion of collective net worth destroyed by sliding home prices and equity values in the 2006-08 period. Although the net worth of US households rose by \$2.67 trillion to \$53.4 trillion at the end of Q3, it was still 17% below the \$64.5 trillion level of 2006-07.

In Canada, the economy expanded at a 0.4% annualized pace in Q3, to register the first quarter of positive growth in four. The Bank of Canada (BOC), in its October Monetary Policy Report, forecast that the Canadian economy, after contracting by 2.4% in 2009, will expand by 3.0% in 2010 and 3.3% in 2011. It noted that this is a “somewhat more modest recovery” in Canada than the average of previous economic cycles.

*Personal bankruptcies in Canada rose 41% from a year ago in Q3.*

The Bank this month left its key interest unchanged at a record low of 0.25% and reiterated its pledge to leave it there until June 2010. However, it recently sounded the alarm bells on the rising debt levels of Canadian households, who are adding debt even as households in the US and UK are reducing debt. The Bank notes that this additional indebtedness has translated into increased financial stress; personal bankruptcies in Canada rose 41% from a year ago in Q3, bringing the number of bankruptcies as a proportion of the population to its highest level since 1991.

In its Financial System Review, the Bank identified household balance sheets as the only one of five categories to pose an increased risk to the Canadian financial system over the past six months. The Bank noted in its report that the proportion of Canadian households whose debt-service costs are greater than 40% of disposable income – a level where they become financially vulnerable – would increase to 8.5% from 5.9% if borrowing costs rise as quickly as current government bond yields suggest, surpassing the peak of 7.4% in 2000.

*The situation in the booming Canadian housing market is a far cry from that south of the border.*

The Bank’s concern may be attributed at least in part to the booming (some say “frothy”) Canadian housing market, where the situation is a far cry from that south of the border. In November, sales of existing Canadian homes surged 73% from a year ago to 36,383 homes, just 0.4 percentage points below the 2007 record for this month. Year-over-year gains were led by BC (165%) and Ontario (77%), while the average price for a house nationally rose 19% from a year earlier to C\$337,231. On a seasonally-adjusted basis, home inventories in November amounted to four months, the lowest level in over two years.

Inflation is obviously not something that the markets are concerned about currently, as evidenced by yields of around 4% on 30-year Canadian government bonds and 4.5% on 30-year US Treasuries. Fed chairman Bernanke expects the substantial slack in the US economy, denoted by the unemployment rate and the level of unused manufacturing capacity, to keep inflation low. In Canada, the BOC expects inflation to return to its 2% target in Q3 of 2011, from 1.4% presently, as the output gap closes. Note that there is considerable slack in the Canadian economy as well. Capacity usage for Canadian industrial companies fell to a record low of 67.5% in Q3, the 10<sup>th</sup> straight quarterly decline.

**OUTLOOK**

With the first decade of the new millennium just days away from coming to a close, we thought it might be an opportune time to check out the relative returns of various asset classes. The results (Table 3) were illuminating, to say the least.

*The S&P 500 seems headed for negative returns over the past decade, the first such performance since the 1930s.*

The S&P 500 was down 25.4% for this decade as of end-November, and including dividends, has produced a negative return of 10.8% during this period. Barring a last-minute surge, it seems destined to end this decade in the red (for 10-year returns) for the first time since the 1930s. US government bonds have outperformed the S&P 500 by a huge margin – more than 130 percentage points – during this decade. So much for equity risk premiums!

In fact, US equities have performed the worst of all asset classes shown in Table 3. The bursting of the technology bubble at the beginning of this decade had a long-lasting impact on the Nasdaq Composite, as a result of which it has generated negative returns of 44%.

The TSX Composite has also outperformed the S&P 500 by a wide margin, but the decade's stars were undoubtedly commodities such as gold (the best performer), copper and crude oil.

**Table 3: Returns for asset classes this decade (Jan.2000-Nov. 2009)**

Asset Class	Benchmark	Total Return	Annual Return
Stocks	TSX Composite	67.7%	5.35%
	S&P 500	-10.8%	-1.15%
	Nasdaq Composite	-44.0%	-5.67%
Bonds (Government)	Bloomberg US Govt. 10+yr. Index	120.6%	8.30%
Bonds (Corporate)	Barclays Corporate Bond Index	89.4%	6.65%
Real Estate	Dow Jones US Select REIT Index	157.6%	10.00%
Commodities	CRB Index	35.2%	3.09%
	Crude Oil	201.9%	11.78%
	Gold (Spot)	309.6%	15.27%
	Copper	269.3%	14.07%

The question is whether the above results represent a new investing paradigm or a temporary deviation? Should investors overweight commodities and fixed-income assets at the expense of US equities?

Some market experts opine that the markets are currently in the middle of a 16-year cycle that favors commodities over equities. As we have noted in previous Strategy reports, our view continues to be that equities have not embarked on a new multi-year bull run, but may be range-bound for a few years as the new consumer frugality leads to a tepid economic recovery.

*We believe equities may be range-bound for a few years as the new consumer frugality leads to a tepid economic recovery.*

As for commodities, the long-term outlook may be positive, but less so than is commonly believed. We base our view on the fact that a new era of slower global growth and a decline in long-term Chinese metal intensities may help restrain commodity price gains. The strong negative correlation between commodity prices and the US dollar may also hamper commodities if the greenback reverses course. While the US dollar has been in secular decline for years, the short-USD trade has become an extremely one-sided one, making the risk of a reversal a tangible one.

The mushrooming US deficit, which for the fiscal 2009 year set a new record of \$1.42 trillion, is one of the factors forcing the greenback lower. No respite seems to be in sight, as future deficits are projected to total \$9.1 trillion in the coming decade.

*While the USD seems destined to head lower, it may find support from higher yields.*

With the US budget deficit as a percentage of GDP approaching a record 10% (Figure 3), the dollar seems destined to head lower. However, it may find support from higher yields, if the Federal Reserve tightens monetary policy faster than current expectations and/or inflationary concerns begin rising. According to federal funds futures prices, the implied probability of the federal funds rate being at 0.75% by the time of the FOMC meeting on November 3 is 31.6%; the implied probability of the rate being at 1.00% by that date is currently 25.3%.

**Figure 3: US budget deficit to GDP (%) vs. DXY**



### Earnings Estimates

As we had noted in our previous Strategy reports, earnings estimates for the companies that constitute the TSX Composite continue to be too optimistic for 2010.

Index earnings for the TSX – based on “bottom-up” analysts’ earnings estimates – have been adjusted marginally higher to \$634 for 2009, from \$623 last month. Our \$637 index EPS estimate for the TSX is less than 1% above consensus. TSX index EPS for 2010 – based on bottom-up earnings estimates – continues to be ratcheted higher, from \$796 last month to \$831 at present, an increase of 4.4%. While we have also raised our forecast for 2010 TSX index earnings to \$795, our estimate remains at 4.3% below the consensus number. Table 4 provides a summary of YTD sector performance and our forecast earnings change for TSX sectors for 2009 and 2010.

A similar degree of optimism about an earnings rebound is also evident for the S&P 500, where index EPS is forecast to surge 35% in 2010 to \$75.60 (Table 5), after rising 13% in 2009.

*We have serious reservations about the likelihood of S&P 500 earnings growing 35% in 2010.*

As Figure 4 demonstrates, an earnings rebound of that magnitude would take EPS for the S&P 500 back to the levels seen in 2005 (Figure 4). Given the degree to which the economic landscape has changed since then, we have serious reservations about the likelihood of this level of earnings being attained.

**Table 4: TSX Sector Performance, Forecast EPS change and P/E**

TSX Group	YTD '09 Performance	Forecast EPS change (%)*	Forward Index P/E**
Information Technology	47.8%	17.6%	13.5
Financials	34.7%	22.7%	11.3
Materials	31.6%	55.0%	19.3
Energy	30.4%	29.2%	17.8
Health Care	26.7%	25.0%	12.7
Industrials	20.8%	10.8%	15.4
Utilities	12.4%	1.8%	15.1
Consumer Discretionary	8.6%	25.0%	13.5
Consumer Staples	3.1%	9.5%	13.1
Telecom Services	-3.4%	0.0%	11.6
<b>TSX</b>	<b>27.6%</b>	<b>24.7%</b>	<b>14.4</b>

\*Forecast EPS change in 2010

\*\* Forward P/E based on 2010 index estimate

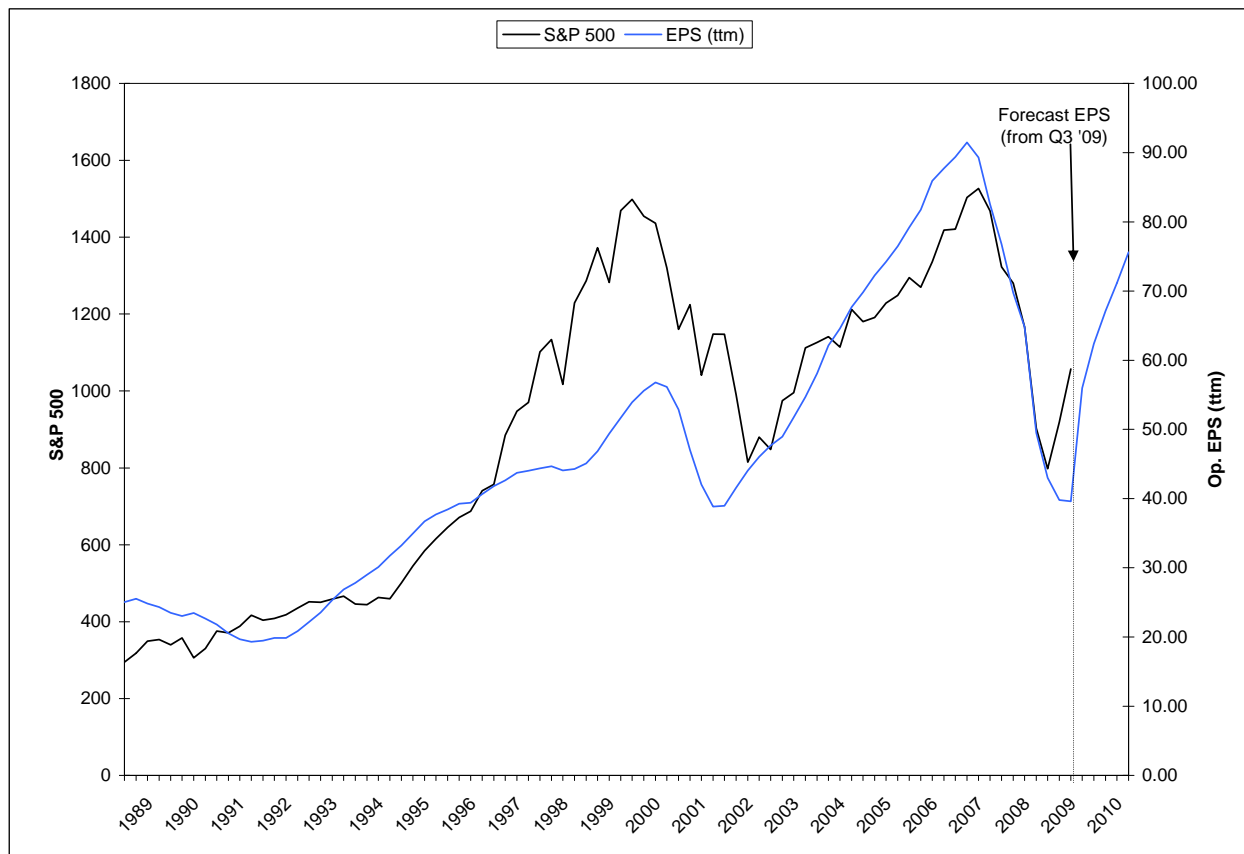
Source: Global Securities Research, Bloomberg

**Table 5: S&P 500 Quarterly Operating EPS**

Period	2008-A	2009-E	% Change	2010-E	% Change
Q1	\$16.62	\$10.11	-39.2%	\$16.52	63.4%
Q2	\$17.02	\$13.81	-18.9%	\$18.54	34.3%
Q3	\$15.96	\$15.78	-1.1%	\$19.83	25.7%
Q4	-\$0.09	\$16.28	N/A	\$20.71	27.2%
<b>Total</b>	<b>\$49.51</b>	<b>\$55.98</b>	<b>13.1%</b>	<b>\$75.60</b>	<b>35.0%</b>

Source: Standard & Poor's

**Figure 4: S&P 500 vs. 4-quarter op. EPS – 1989 to 2010 (forecast)**



Source: Global Securities Research, Standard & Poor's

## Valuations

As noted in our Strategy report last month, the rally in equities has driven valuations to levels where they are no bargain. With the TSX and S&P 500 having gained 5% since then, valuations have become a little more extended.

The TSX Composite currently trades at forward multiples of 18.0x 2009 index earnings, and at 13.8x consensus 2010 index EPS of \$831. The S&P 500 trades at forward multiples of 19.7x 2009 index earnings, and at 14.6x 2010 earnings.

While 2009 valuations are rich on a historic basis, the appreciable drop in 2010 valuations is predicated on optimistic earnings numbers being achieved. Valuations would appear quite extended if index EPS estimates for 2010 prove to be too optimistic.

Our end-2010 target for the TSX Composite is at 12,500 (based on 15.7x our 2010 index EPS of \$795). For the S&P 500, our end-2010 target is 1,200 (based on 16x index EPS of \$75).

*We forecast total returns of 11%-12% for the TSX and S&P 500 for 2010.*

Those targets imply upside of about 9% for the TSX Composite and S&P 500 from current levels. Based on approximate dividend yields of 2.9% for the TSX Composite and 2.1% for the S&P 500, total returns including dividends may be in the range of 11%-12% for these indexes.

## Risks

We summarize below some of the key risks that could derail our forecast/s.

- **A double-dip recession:** While the odds of the global economy sliding into a double-dip recession are presently quite low, there is a possibility – albeit a slim one – that this could occur once the massive doses of economic stimulus are withdrawn. US unemployment numbers and housing prices must continue to stabilize to obviate the possibility of a double-dip recession in that nation.
- **Sovereign risk:** The issue of sovereign risk has emerged as a major one in recent weeks, following the Dubai debacle and the downgrade of Greece's credit rating. Moody's said earlier this month that sovereign debt risk is rising globally, particularly in the US and UK, and that uncertainty over the pace and intensity of fiscal and monetary exit strategies will add to sovereign risk.
- **Inflation concerns / higher interest rates:** As noted earlier, inflation risks are not being given much credence by market participants at present. But faster than expected economic growth in the US may take up the economic slack at a rapid pace, and stir up inflation concerns. With the Federal Reserve having pledged to keep the federal funds rate low for an "extended period", there is a risk that when it does start raising the federal funds rate, it may do so faster than current expectations in a bid to avoid falling behind the curve.

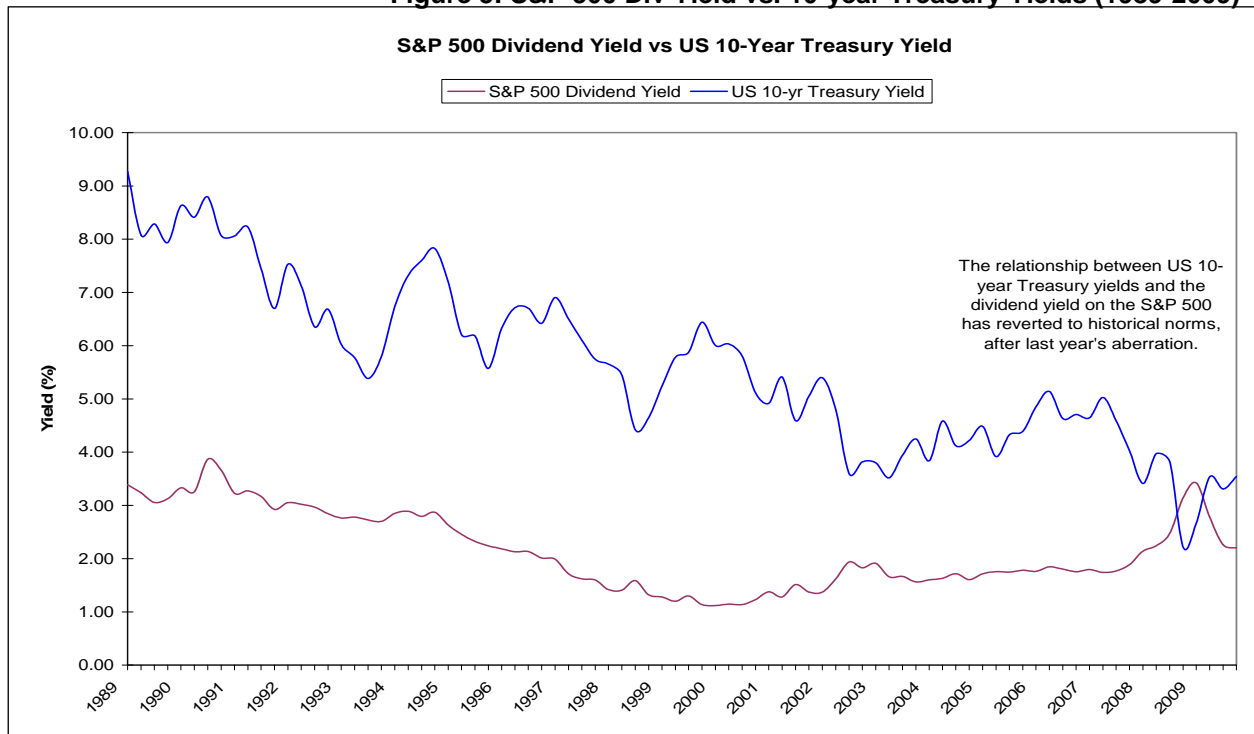
**STRATEGY**

Based on the foregoing discussion, we believe the following investment themes are likely to play out in 2010.

1. **High-yield bonds may have very limited additional upside:**  
As noted in our November report, the risk pendulum has swung from extreme (risk) aversion earlier this year to one of unbridled enthusiasm for risky assets. One manifestation of this risk appetite can be seen in the huge appetite for high-yield bonds, sales of which surged to a record \$162.5 billion so far this year, surpassing the previous high of \$149 billion in 2006. 2009 has been one of the best years ever for junk bonds – which are bonds rated below Baa3 by Moody’s and BBB- by S&P – as they have returned a record 56% this year including reinvested interest. Additional upside for these bonds may be very limited next year.
  
2. **Blue-chips with above-average dividend yields may be better long-term investments than their bonds:** A year ago, the dividend yield on the S&P 500 exceeded the yield on 10-year US Treasuries for the first time in decades. By mid-2009, however, the relationship had reverted back to historical norms (Figure 5). But there are still a number of Canadian blue-chips clustered in the telecom, utilities and financial sectors that offer dividend yields higher than the yields on their five-year bonds. Stocks give investors an opportunity to participate in their growth, while dividends paid by Canadian stocks are eligible for a tax credit. We strongly recommend opting for the (blue-chip) stock rather than the bond in cases where the dividend yield is higher.

*We recommend opting for the (blue-chip) stock rather than the bond in cases where the dividend yield is higher.*

**Figure 5: S&P 500 Div Yield vs. 10-year Treasury Yields (1989-2009)**



Source: Global Securities Research, Standard & Poor's

- 3. Expect a shakeout in the Canadian income trust sector:** As of January 1, 2011, income trusts will lose the tax advantage that had made them such compelling income-oriented investments. Concerns that they would be subject to heavy selling upon conversion have proved to be unfounded so far. Our analysis indicates that as of mid-December, the 28 income trusts that have converted to corporations since 2008 had gained an average of 5.7% (excluding outliers) from the day of conversion. With more than 165 income trusts yet to convert their corporate structures, one can safely assume that the bulk of these conversions will occur in 2010. We expect a substantial shakeout in the sector, with the smaller, weaker players selling out to their larger and better capitalized rivals.
- 4. M&A activity may pick up in 2010:** Mergers and acquisitions activity is picking up in sectors such as energy, financial services and technology. According to a Bloomberg report, the average premium in M&A activity involving US companies rose to 56% this year, from 47% in 2008. M&A activity may pick up further in 2010, as valuations in a number of sectors are still attractive and the markets remain receptive to debt/equity offerings for funding acquisitions. In Canada, energy and commodity producers may continue to garner most of the attention from potential acquirers.
- 5. Risk appetite may recede to more normalized levels:** As we had expected a year ago, risk metrics have contracted significantly in 2009. The TED Spread has shrunk to 21 basis points from 135 basis points at the beginning of 2009, while the CBOE Volatility Index or VIX has declined by 50% this year. We expect risk appetite to recede to more normalized levels in 2010, since incremental gains in risky assets will be harder to come by.
- 6. Higher short term rates are quite likely in 2010:** As noted earlier, by making an implicit pledge to hold benchmark interest rates low for a definite period, is there a danger of the Federal Reserve and Bank of Canada falling behind the curve in terms of controlling inflation? The US Treasury yield curve has already steepened to a record, with the difference between 2-year and 10-year Treasury notes at 281 basis points, on concern an accelerating economic recovery may fuel inflation. Higher short term rates are quite likely in both Canada and the US in 2010, but the magnitude of the increases will be determined by the inflation outlook.
- 7. Position portfolios for a potential reversal in the US dollar:** Higher interest rates may reverse the carry trade that has seen the greenback decline 12% against its major trading partners since the first week of March. The massively one-sided short-USD trade is showing early signs of reversing, and while it may be premature to call the greenback's recent gains a sustainable, long-term reversal, investment portfolios may need to be positioned for such an eventuality. Given the strong negative correlation between commodity prices and the US dollar, this would necessitate being cautious in overweighting commodity producers in investment portfolios.

*We are raising the equity allocation in our asset mix by five percentage points at the expense of bonds.*

We continue to believe that the risk-reward payoff is presently tilted in favor of stocks over bonds. Based on our view that the TSX and S&P 500 may provide total returns of 11%-12% in 2010, we are raising the equity allocation in our recommended asset mix by five percentage points at the expense of bonds. **Our recommended asset allocation is therefore – Stocks 60% (up 5 points from 55% earlier), Bonds 20% (down 5 points from 25% earlier) and Cash 20% (unchanged).**

**Table 6: Recommended Asset Allocation – Changes over past year**

Asset Class	Weighting				
	Dec.'08	Apr.'09	July '09	Nov.'09	Dec.'09
<b>Stocks</b>	45%	50%	50%	55%	<b>60%</b>
Change in weight		5%	0%	5%	5%
<b>Bonds</b>	30%	30%	30%	25%	<b>20%</b>
Change in weight		0%	0%	-5%	-5%
<b>Cash</b>	25%	20%	20%	20%	<b>20%</b>
Change in weight		-5%	0%	0%	0%
TSX	8564.93	9073.14	9773.92	10878.35	11463.4
TSX change (%)		5.9%	7.7%	11.3%	5.4%
S&P 500	896.47	834.38	882.68	1042.88	1102.47
S&P 500 chg.(%)		-6.9%	5.8%	18.1%	5.7%

This publication is not, nor is it to be construed as, a solicitation or recommendation to investors to purchase, sell or hold any of the securities referred to herein. Investors should consult their own broker(s) to determine the suitability of any securities referred to herein as these securities and the trading strategies incorporated into any trading recommendations will not be suitable to all investors. Further information concerning this publication, including information respecting Global's research dissemination procedures, recommendation rating system, recommendation follow-up matters, suspension or discontinuance of coverage and related matters may be found at the research page on Global's website, the address for which is [www.globalsec.com](http://www.globalsec.com), under the caption "Research". Unless noted otherwise, none of the material operations of the issuers referred to herein have been viewed by the report writer(s). The contents hereof may not be reproduced in whole or in part without the prior written consent of Global Securities Corporation ("Global") Copyright 2009. All rights reserved. Global is a member of the Canadian Investor Protection Fund.