Preparing For Epic Era of Monetary Malfeasance

The HITCH Update — (*The* HAHN *Intellectual* Tap-dancing *&* Chicken Heroics *Update*)

Quarterly Strategy Comments & Updates
- March 2009 -

Key Considerations & Decision Points:

Major Current Investment Themes & Key Issues

1. **A new world of challenges is confirmed: Central banks unite to wave the wand of fiat money. It is the analog of the 1930s "beggar thy neighbor" actions.**
2. **US Fed has now gone "all in," openly "printing money." There will be long-term repercussions. We have moved into selected commodities and cyclicals.**
3. **Time to think like Latin Americans, Zimbabweans, and citizens of kleptocracies.**
4. **We continue to maintain that odds still favor a "Stop/Go/Stop" scenario.**
5. **At a point, global destocking…a downside of globalization…is due to snap back.**
6. **Further possible unravellings still do not allow us to forecast a sure end to the current Global Purgatory stage. However, considerable risks are being removed.**
7. **Looking for end to 4 decouplings–China/US trade, industry de-inventorying, and consumer spending vs. income and household debt. 3 are now near complete.**
8. **Selected signs of financial unfreezing/loosening continue to emerge … slowly.**
9. **Major bond trap ahead … but delayed until Fed stops buying treasuries.**
10. **Risk now cheap. Some sectors and asset classes are very inexpensive.**
11. **The seemingly paradoxical USD rally phase is likely now over. The last "positive"—the unraveling of AIG CDS positions— is near complete.**
12. **A tradable equity market rally is finally underway. Now, two different scenarios possible: A long-term trading range or restart of "flight to asset" mania.**
13. **Timely to accumulate positions in materials, oil, cyclicals & emerging markets.**

Long-term Investment Themes — Post Global Intermission

14. **A split "2-speed" bi-polar world … moving to multipolarism politically.**
15. **Foundations for a global "velocity inflation" boom being reset.**

Significant Event (SE) Watch

(Significant Events currently monitored, that are anticipated to support or trigger future strategy shifts.)

Triggered:

1. **Mega US government stimulus budget greater than $1 trillion.**
2. **Bottoming of Baltic Dry Index and other cyclical indicators.**

(For complete list of past triggered SEs, please Appendix I.)

Pending and New:

1. **US dollar decline and reversal of Yen/Euro currency cross.**
2. **Confirmation of cyclical and leading indicators.**

Investment Stance – Key Distinctions

Lowering cash, monitoring various scenarios.

Risk Assessment: (Overall Financial Markets) Medium to High.

7-Year Return Outlook Raised: From 7% to 10% per avg. HAHN balanced portfolios.

Other Strategy Resources: Global Strategy Chart Panorama- Preparing for an Epic New Era
Global Wealth Perspective – April 2009

SECTION I
General Overview

A great transition is occurring presently … a great transfer of wealth and realignment of capital, both intra-country and globally. This is as sure and as ineluctable as the nose on one's face. The devil, however, is in the timing. Here, we find ourselves challenged as all mortals.

Yet, seen in retrospect with the benefit of perfect hindsight, re7cent and current conditions are of epic importance and will have demanded a response in real time. Current trends will not continue forever, and 5 to 10 years from now, an entirely different set of conditions and concerns will prevail. What will they be?

Only 10 years ago, the entire Asian continent seemed submerged in the financial crisis of that time. Who would have predicted that the next economic powerhouse and store of world surplus reserves would reside on this very same continent less than 10 years later? In retrospect, that time of crisis for Asia actually signified a time of opportunity. Is there opportunity again to be found in the present time of crisis? If so, where?

Just where lies the bottom for the stock markets … the top for bond markets and the US dollar… the beginning uptake in the next reflationary cycles? Calling turning points is a hazardous exercise, for we cannot know their occurrence with any certainty until well after the fact. There are just too many large factors at play, and most of all frustrated by the non-forecastable nature of crowds. Even the simplified world of technical chartists is found rudderless these days with breached trend lines and whip-sawed support zones.

The world of commerce and money will indeed continue to surprise the unwary and those that only navigate by the rearview mirror. This need not be so … though the devil will be in the timing. In this issue of the HITCH, we will try to look ahead. There is good news and bad news. There are long-running developments that can be expected to continue.

But before looking ahead, a brief look back is appropriate. For some years, we have been stressing the unsustainable path of world economic and financial developments, on occasion speaking of "the end of finance," the exorbitant and ridiculous pricing of risk, as well as placing high probabilities on a Minskean-type event interrupting the financial globe. Such events indeed did unfold. But, the real world is always worse than the "probability adjusted" models … especially when the worst of the discounted scenario unfolds. Even us — considered incorrigible "pessimistic" bears for a long time — have been chastened by the sheer power of the various financial unravellings, unwindings and deleveragings of the past year or so.

But, crucially, we must now recognize the breadth, depth and gravity of what has unfolded to date. As we will show, the worst is behind. Markets have already clearly re-priced the future … markedly. Risk has now been shunned and behaviors have diametrically changed.

We must now be biased "opportunists" … although careful ones at that. After all, it is après deluge, and no longer before financial collapse."

Looking ahead, we had been anticipating 3 scenarios to play out around the world over the next 3 to 5 years. Last quarter we added a fourth — Stop/Go/Stop — which really was a compression of the first 3. (Please see 2008 4Q HITCH for further detail.) But, now, we

must also again reconsider the probability we had assigned to the end-stage "global inflationary boom." Given the beginning and united actions of central banks to print money and inflate their balance sheets, we must raise the probability of this outcome. More properly, we will now call this 3rd end-stage scenario the global "velocity inflation" boom.

Therefore, we must still deal with the current recessionary ditch that the world finds itself within. Just when will it haul itself out of the sump? Could there really be a risk of another Great Depression? Finally, we comment on some of the more peculiar and pivotal factors at play at this present time.

SECTION II
Strategy Considerations

The Penultimate Act

The cat is out of the bag—the great game of inflation and implicit global devaluation has begun. We always were sure that it would. One of the key central pivot points for investment strategy is now clear: Central banks are printing money. We hope we will not be thought as false alarmists. However, no one should underestimate the crucial significance of recent events. It is momentous … as if the entire world will have shifted upon it axis.

That term "printing money", has become an over-worked term that has lost its real technical meaning. What we mean by this term is actual fiat money creation … money out of thin air. There are no offsetting immunizations or reserves. Both the Bank of England and the Federal Reserve have announced outright purchases of market securities. Other central banks can be expected to follow. In the case of the Federal Reserve, it intends to buy asset-backed mortgage bonds and treasury bonds totaling $1 trillion (on the top of the $650 billion in mortgage bonds announced in 2008). The bell tolls. Central banks are desperately trying to re-inflate monetary channels.

There will be an inflationary outcome of some kind because there is now rampant "monetary" inflation. This is the essence of inflation and all its outworkings. The only question remaining, concerns the manner of its manifestation. Will it be reflected in consumer prices, financial asset prices, real assets, changes in the external accounts, currency movements or wealth transfers … all or none? This is a critical question as we want to direct portfolio assets to areas that are indeed inflating the fastest in value.

At the outset, we think monetary inflation will be reflected in financial assets prices, currencies and external accounts. At times such as this, it is worthwhile to recall the lessons of similarly inflationary eras (corrupt kleptocracy) as the Weimar Republic, various spirals in Latin America and lately in Zimbabwe. Once a "velocity inflation" began, people rushed to get rid of their cash.

Eventually, we then expect incomes, general consumer prices and real assets also to be re-inflated. But this should only be expected to occur belatedly … perhaps as much as several years hence. For the time-being, key monetary transmission channels of stimulative largesse are blocked. Firstly, banks are deleveraging and raising loan quality. Consumer households are also deleveraging. As such, monetary stimulus is not likely to result in substantial loan growth. Monetary stimulus will find other channels for now, most certainly financial assets as these monies are being first directed to treasury bonds.

The big conundrum and crucial question of the present time is this: What will happen to the enormous holdings of US treasuries by foreign central banks and sovereign wealth funds (SWFs)? These represent deferred inflation. How so? The purchase of US treasuries originally suppressed US interest rates, boosted (or at least supported) the US dollar while the growing trade deficit had the added effect of exporting inflation abroad to the exporters. These foreign central banks, in turn, immunized much of this inflationary impact by buying US bonds. Now we come full circle … years later. In economics, as in real life, it is near impossible to escape the ultimate consequences of ones' actions.

As such, the Fed's intent to buy treasury bonds may actually be an anticipation of a tsunami of foreign sales. Indeed, global reserve growth (more than half of this in US dollars) is stalling. In the case of some countries, reserves are actually falling (i.e. Russia). Should the Fed's purchases of treasury bonds be primarily sourced from foreign central banks, they will actually be underwriting global growth. If there will be any benefit for the US, such actions will at least have forestalled a steep sell-off in US bond markets. But, let's not forget that the US budget deficit this year is projected to $1.75 trillion (12.74% of GDP). It goes without saying that there will be a large supply of treasury bonds. A very big buyer is needed. The Fed has volunteered.

However, there are bound to be complications. Such policies could also heat up inflation in such countries as China. That would imply that the yuan would be forced to appreciate, causing further destabilizations for treasury bonds. As such, the jury is out as to the final effects upon US bond prices on the very near term. That said, we are of the view that US treasury bonds are significantly overpriced at present. The recent bounce therefore offers an ideal selling point.

The Whims of Crowd Psychology

Last quarter we commented upon the specter of the behavioral responses of investors, wondering whether the black mood will have already reflected the anticipation of the worst outlook possible. Investor sentiment around the world had been remarkably unified and extreme in their apocalyptic views at the time. We pondered the question: Could equity markets already have fully discounted the extent of economic declines both in the past and yet ahead? We thought then that stock markets may be vulnerable to positive surprises. We were not wrong. We were just early.

As it turned out, remarkably, investor moods soured even further. Sentiment surveys plumbed to all-time lows in pessimism. A recent poll by CNN/Opinion Research Corporation revealed that 45% of respondents believe that another Great Depression is currently underway. Nine out of ten people questioned stated that US economic conditions are poor. This signals unprecedented concern and retrenchment-type behavior. Could this momentum of pessimism continue? Anything is possible. However, there is only one-tenth of all people left to convert to the gloomy consensus. These last conversions will not be enough to add any meaningful additional extra selling pressure. Therefore, it is likely that the rush of the crowd has spent itself for now.

Our increases in equity weightings to significant overweights proved esarly, and cost dearly in the opening months of 2009. Of course, such a position has been rewarded handsomely during the explosive recovery rallies now taking place. Nonetheless, we would have preferred lower volatility in our portfolio performances during January and February. Of course, everyone likes positive volatility.

While it is clearly too early to adamantly conclude that an economic recovery will soon be underway, it is at least possible to conclude that the current dejected moods are not sustainable. Virtually all measures of investment market sentiment are at extreme lows. Cash levels relative to the market values of securities markets are at an all-time recorded high. Liquidity levels relative to stock market capitalization is now at an unprecedented 40%. And, margin debt is low. (These high cash levels now are fated to eventually clash with the tsunami of inflationary money.)

Now, even hints of economic firming … anything that might suggest that the world will not end and skies will not fall … are sure to propel violent market recoveries. Markets are now so compressed under pessimism and abandoned hope (psychologically terrorized investors, now feeling compelled to sell after 60% and 70% declines have already occurred) that recovery rallies will be brutal and quick. The greatest financial market movements always take place within so-called “bear markets.”

As mentioned, one such equity market recovery has been underway. Here we observe another strong consensus view. Virtually every one is sure that it is a false start … namely, a classical bear market trap. It poses an interesting opportunity to take a contrarian view. We will come back to this thought.

In the meantime, we still maintain that signs of economic firming (not yet a recovery, but possibly the Stop/Go/Stop) should be visible by mid-2009. In fact, small shades of such trends are already evident, (and this before any significant impact of government stimulus spending has taken place. We list some of these indicators later in this report). If so, such a development would well underpin a recovery rally in global stock markets running into late Spring if not later.

What Chance Another Great Depression

Another Great Depression? We think not. At least, not now. If anything, major components of a depressionary period have already occurred as will show. There are many key differences in the structure of today’s economies as compared to 70 and 80 years ago. That said, some of the financial excesses occurring of late, are worse. Certainly, total debt levels are much higher in relative terms. Today’s policy economists are also fairly well versed with the mistakes of that earlier time. That may simply mean that different mistakes will be made today. On a more serious note, global policymakers today are therefore extremely concerned that trade protectionism will break out. According to popular theory, trade protectionism played a role in the severity of the 1930s global slowdown. As such, there is an acute sense that similar mistakes must be avoided today at all costs.

That said, whether an economic depression occurs or not, it is already true that the current crisis is already well behind us. It is worth reflecting on the “regularity” of different types of downturns, including the advent of major crises.

There have been countless domestic economic recessions over the last century around the world … in the many thousands. There also have been many crises which will have included banking and currency collapses, not to mention deep recessions. A research paper issued by the International Monetary Fund (IMF)[1] counts over 42 instance around the world where all three occurred between 1970 and 2007 alone. Over this period, over 124 currency crisis have occurred. Much less frequent but normal, are the big downturns—the

[1] IMF Working Paper: Systemic Banking Crises: A New Database, prepared by Luc Laeven and Fabian Valencia, September 2008.

really big collapses involving economic depression, banking system implosions and sometimes causing global financial contagions.

A recent report series studies 21 such types of occurrences over a little more than a century.[2, 3] The more recent examples include Japan (1991), South Korea during the Asian crisis a decade ago, as well as Sweden (1991). What must we conclude from such studies? For one, big crises do happen fairly regularly and the one currently impacting the US and other nations around the world is not much different in character (at least, to date).

However, here we dare mention some good news (we say “dare” because the current climate of rampant gloom will want to treat bearers of constructive news as mad heretics). Compared to the average historical experience of the 21 major financial crises (referred to earlier, and also including the 1930s Great Depression in the US), the recent downturn in America to date is already far advanced. For example, consider that the average stock market decline during those 21 periods was a drop of 55% in real terms (adjusted for inflation). By comparison, US equity markets have already fallen some 62-63% in real terms during the current experience (based on the S&P 500 stock market index, peak to trough).

Whereas real prices of housing declined an average of 36% over the 21 sample periods, this is already near being exceeded in the US (perhaps cumulating to a total real decline of 45% or so by the end of 2009.)

One aspect of the current downturn that has not yet matched or exceeded the sample mean, is the economy itself. Here the average experience was a peak to trough decline in the economy of 9% in real terms, requiring approximately 2 years. That would equate to an end of the economic recession in the US by the end of 2009. (The official start has been determined to be January 2008 by the National Bureau of Economic Research). If so, forward-looking analysts could soon lose their pessimism. The turning point may not be that far away, and to the early bird goes the worm.

Therefore, it likely is true that the worst is already behind. Time will tell. But we must also recognize that our brief comparisons have only to referred to the average “crisis experience” in our sample set, and not the worst. Therefore, further deterioration is possible. That said, could housing prices drop another 50%, stock markets an additional 60%? While one should never say never, at the same time we forget at our peril, that monetary systems are fiat contraptions that are expressly designed for purposes of manipulation. In times past, when all else has failed, policymakers have always resorted to massive inflation. That outcome presents a completely different set of challenges as we have already begun to discuss. Indeed, this is the specter unfolding right now.

Lest anyone think that we are unbridled optimists, we are not. We strive to be realists, aloof of all emotion. Actually, we do not believe that the worst for the US is behind. While it is reasonable to celebrate the soon end of the current phase of the crisis (the free-fall stage), significant challenges yet lie ahead including the possibility of social unrest. Enormous problems are being simply deferred. For example, inflationary bubbles do exact enormous hardship and damage … far more than has played out over the past few years in the form of financial losses. Inflations distort economies, cause costly malinvestment, greatly disadvantage retirees and contribute to wealth transfers. These challenges lie ahead though financial recoveries (in nominal terms) may soon be celebrated.

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[2] Carmen M. Reinhart & Kenneth S. Rogoff. This Time is Different: A Panoramic View of Eight Centuries of Financial Crises, April 16, 2008

[3] Ibid, The Aftermath of Financial Crises, December 19, 2008

Says Martin Wolf, rationalizing the band-aid solutions of monetary stimulus and bail-outs to date, "[…[i*t makes no sense to avoid action that would greatly lower the real economic costs of the crisis* ***now,*** *to eliminate a hypothetical and avoidable fiscal crisis later on. This would be like committing suicide in order to stop worrying about death"* (Financial Times, March 17, 2009). Maybe so. But the analogy is not apt because we need not face a terminal economic outcome ever, were sensible and sustainable policies followed in the first place.

Ever the global reconstructionist, Mr. Wolf does shoot himself in the foot. While the current global crisis is the biggest on record and is taxing the resuscitative powers of monetary and government authorities and their fiat money making machines, he admits there are bigger crises to come. For example, he estimates that the present value of the fiscal costs of ageing in the US is 15 times the cost of the current financial crisis.

Another conclusion of the earlier mentioned study of past crisis periods, was that government debt levels during such times soared an average of 86% in a 3-year period. Of course, this has lasting consequences, much more so now than in prior crisis periods. Why? The cause has already been disclosed in Mr. Martin's comments. The demographic problem of ageing populations is one reason why hugely increased debt levels will not easily be paid down. By comparison, the high US government debt levels resulting from World War II were paid down quickly, thanks to a rapidly growing and young population which still had a habit of saving.

The great structural problems that still stand to worsen for American and other high-income countries include a widening wealth skew, shifting global economic power, demographic issues and, major inflationary pressures. We do expect the US economy to resume growth, but it will labor under high debt and government deficits for some time, its growth capacity much less attractive than other countries.

For those reasons and others, we favor surplus countries such as China and other Asian nations, as they can at least afford to buy their recoveries. They would simply need to liquidate their enormous reserves. In fact, such measures are already helping Russia to ameliorate its current downturn.

An important point to remember is that the final solution if all else fails — fiscal policy, credit policy and monetary policy — is inflation! Governments will resort to inflation before they will allow another Great Depression. (Remember that if incomes can be inflated up in relation to outstanding debts, then the burden of previous debts will decline. This was the tactic that Britain successfully pursued in the 1970s. Yet, there are toxic effects for the long haul.)

The Great American Global Portfolio Unwinding

Returning to the topic of equity markets, we must ask an important question: Who is left that will be forced to sell equities? Just who was participating in the last downdraft through the early months of 2009? Pensions? We think that doubtful. Hedge funds were also already unwound. The carry-trades had mostly been laid flat (see Yen/Euro cross trends) Could it have been private investors? Perhaps. But retail investors never rushed into stocks this past cycle in the first place (rather into real estate), in fact being net sellers of financial assets for the past several years. In the UK, private investors now own the smallest equity

portion on record (9.6% of the UK market). Quite possibly it could have be foreign sellers … perhaps SWFs and private investors.

We had been looking for the end to 4 decouplings – China/US trade, industry de-inventorying, consumer spending vs. income and household debt and global portfolio capital repatriation back to the US. We think that all of them are near complete except overall debt deleveraging.

The repatriation flows of American portfolio capital invested overseas must be near complete. Consider, for example, that foreign holdings of Korean equities are now the lowest — 29.4%—since the Asian crisis of 1998. If so, that is one factor that is no longer favorable for the US dollar. As such, over the past several quarters we have moved to an increasingly underweight position in US equities. Apart from fundamental reasons, portfolio capital flows back into foreign equity markets — in other words, a reversal of repatriation trends — are likely to contribute to their outperformance. This already appears to have begun. In fact, many emerging markets have not made new lows this year, showing relative strength. This has supported our view to further shift exposures into these regions.

The US Paradox: Jumping on the Straw Man

The world of currencies has again entered the world of the surreal. We remember that it was only 15 months ago that the Canadian dollar soared to 1.10 against the USD. We thought then that it was a travesty … a crippling, devastating blow to Canada in the name of "free market" economics. We were so incensed at the time that we wrote a special issue of our Global Spin, entitled *Dear Policymakers: Time to Manage the Dollar for Canadians* and sent a copy to every Member of Parliament in Ottawa. We never heard a word. Please misunderstand that we are all for free markets but not sick markets. That financial markets should malfunction from time to time is not a debatable subject. They have malfunctioned and continue to do so.

While "rational" lunacy (of the "we're still dancing" kind … i.e. everybody knew of the unsustainability of trends but didn't want to leave the party until the end) drove many financial markets and currencies to unsustainable excesses in 2007. Today lunacy still affects the US dollar. Why should the US dollar, the epicenter of crisis and huge external deficits be a pillar of strength?

There were a number of explainable, logical reasons in the case of USD. However, no longer. First, credit "ring-fencing" triggered the dollar to rally from its record low against the euro. Then, the declining USD and global equity markets caused a rush of liquidation of overseas portfolio investments (as already outlined). According to estimates, some $5 trillion in foreign securities had been held by Americans. Most likely, a global flight to qualify was never a significant factor in the recent USD rise. But now, the last support for the dollar is near over. That is the effects of the CDS market unwindings. We will explain.

But first, we must debunk the idea that the US dollar has soared because there is a structural dollar shortage in the world. This is nonsense. The world is hugely net long the USD. That must be the case because the US has run massive external deficits for years. Just why should global reserves have grown so rapidly in recent years, at times at a pace of over 20%, if that were not the case? Now reserve growth is falling. That means there is less demand for US dollars.

However, there is a strong case to be made that short-term liquidity problems in the CDS (credit default swaps) contributed to the US dollar rise. After all, this market is primarily denominated in USD. Given the enormous credit defaults and virtually-bankrupt credit default insurance sellers, a mad dash to close these positions was underway. This could be near an end. Why? The US government has bailed out a whole host of CDS participants (somewhat secretly) by pumping $170 billion into AIG (the most profligate credit insurance seller of all). As such, the settlement pressure in USD is declining for now.

No so long ago, we recall that the popular consensus held that the US dollar would fall forever. The dollar had already fallen to less than 1.60 to the euro at the time. Pessimism was extreme. Of course, timing these turning points is hazardous. That said, we believe that the top for the USD has occurred. (The recent Fed announcement to buy treasuries seems to have cemented this turning point.)

According to Brad Setser, CFR analyst, international central banks bought $600 in US treasuries in 2008. While that is a record, it pales relative to the total of $1.6 trillion in US bonds that the US Fed sold that year. If it were not for the special capital flow effect already outlined, such an amount of bond sales could not have been absorbed. But now, new trends are in the wind. We think the net effect will lead to a lower USD dollar. We therefore, are hedging foreign assets back into the Canadian dollar. The good news is that a weaker US dollar will contribute to economic recovery through more favorable import substitution opportunities. We explain this next.

The Beggar Thy Neighbor Sweepstakes are On

The imbalances that world finds itself with couldn't be more tragic. In the main, of course, it was the free-run of these imbalances to the point of unsustainable excess that resulted in the current troubles in the first place. The nations that stand to recover first are those who can effectively devalue their currencies (relatively and in trade-weighted terms). Initially, this produces a positive effect through import substitution, but also improves export competitiveness. However, as exports plunge in a global recessionary environment, it is import displacement that provides the best opportunity for relative GDP growth. (Brazil was one of the first countries to recover economic growth in the 1930s, even driving an industrialization boom, due to devaluation for the most part.)

Macroeconomics Pronounced Voodoo

We of course make many references to economic concepts, quote economic data, and even from time to time comment upon macroeconomic and its various predictions. We need to recant. In case you didn't know, the field of economics is not a science.

The results are in. Macroeconomics is no more effective than voodoo. The late great global financial crisis reveals this to be the case. Why? The vast majority economists did not predict the economic wreckage of the current crises (practically none!). What has been witnessed is a systemic failure of the economics profession. Therefore, the knives are out everywhere for economists.

There has emerged a small number of scholars who are bravely exposing the empty tower of macroeconomics. In a recently issued paper, The Financial Crisis and the Systemic Failure of Academic Economics,[4] the authors pull no punches. They point out that:

[4] Various contributors. Corresponding author: University of Kiel, Department of Economics, Olshahusenstrasse 409,

> "[…] systemic crisis" appears like an otherworldly event that is absent from economic models. […]The economics profession has failed in communicating the limitations, weaknesses and even dangers of its preferred models to the public […] makes clear the need for the establishment of an ethical code. […] In hour of greatest need, societies around the world are left to grope in the dark without a theory. […] The tradition [of crisis phenomena] has been neglected and even suppressed."[5]

Apart from these few brave academics, the scientific fraud and failure of macroeconomics qualifies as the most unspoken fact in history. Yet, at various gatherings of international economists recently, no one admits to this dismal record. Their obvious failure remains an open, unspoken secret. They continue on with their voodoo, further offering up policy prescriptions to governments intended to rescue countries from the current crisis. Now, of course, their divinations all reveal a pessimistic future. Almost all of them now endorse opening the money spigots. These prescriptions are likely to be just as ineffectual as "bloodletting" or an "application of leeches" to a patient suffering from dementia.

We should beware. It has yet to be proven that an economist is a more successful investor or forecaster than anyone else.

The Lost Decade and the Premise of Long-term Investing

It has been dastardly difficult to have been a money manager over the past decade. Securities market returns have been poor; the whole oyster of world return opportunities bereft of "mother of pearl." In fact, even a balanced portfolio (less average management expenses) would have underperformed cash. Even those balanced managers who may have outperformed over this period, still would not have generated high nominal returns sufficient for future retirement needs of an ageing society. Should we shoot the money managers? Perhaps some of them. However, we surely are not apologists for markets, nor economic and monetary policies. Though these are beyond our control, we nevertheless try to manage assets successfully in spite of them.

Yet, the return history of the past decade or so raises a troubling question about the verity of a central human doctrine. In fact, it concerns the one main investment principle that we endorse. Longer-dated assets classes (stocks, bonds … etc) should be expected to outperform cash over time. For, if this were not true, there would be no incentive for progress and achievement. This is a central doctrine of human history and progress, though there indeed will have been periods of time where there occurred long periods of lost hope.

Quoting Peter Bernstein, writing in the Financial Times, February 25, 2009:

> *"If the long-run expected return on bonds in the future were higher than the expected return on equities, the capitalist system would grind to a halt, because the reward system would be completely out of whack with the risks involved. After all, from the end of 1949 to the end of 2000, the S&P 500 provided a total annual return of 13.1%, while long Treasuries could grind out only 5.8% per year."*

Our answer? The concept still holds true. However, the equation must now be viewed as the population-weighted, per capita averages of the entire world, not necessarily applying to

[5] The Financial Crisis and the Systemic Failure of Academic Economics. Various contributors. Corresponding author: University of Kiel, Department of Economics, Olshahusenstrasse 409,

any one country. Therefore, more than ever investors in stagnant nations must “go global.” To repeat, the underlying principle that longer-dated assets classes will outperform cash must now be viewed from a weighted global perspective. There are quite a few reasons to support this perspective. (For instance, stimulative global monetary conditions for speculators is now set by the loosest major central bank.) Given the power shifts that are expected to continue (as already proven) some regions of the world can and will experience long periods of time where some long-dated assets are outperformed by cash.

Where Will the Carpetbaggers Go Next?

The most maligned and unpopular character today is the caricatured greedy, Wall Street executive. According to popular perception, they are now the enemy. No doubt, many of them are now out of jobs and without bonuses.

We will not have seen the last of them. Where will the carpetbaggers go next? Now that American President Obama has put a salary cap on Wall Street bankers (and AIG retention bonuses pulled back), they will soon decamp and innovate somewhere else. But where? Anytime that government has legislated controls of a similar type, it usually has signaled the end of that industry. Example: Consider that price controls that where put upon the US steel companies in the early 1960s Kennedy era. It may have been the bell that signaled the eventual demise of US manufacturing.

Today, we likewise may be witnessing the beginning of the end of US predominance in international finance. We anticipate the world’s financial capital or general nexus point to move East … to Asia. In fact, we might anticipate that Singapore or Shanghai could become the world’s new Switzerland.

This migration of money-making talent will already have begun. Consider these headlines and anecdotes.

> “Ex-Leaders of Countrywide Profit From Bad Loans” (New York Times – March 4, 2009)
>
> A recent survey in the City (London) indicates that 49 per cent of British-based bankers would consider leaving their current employ, were a cap put on their bonuses. In fact, 71% of all bankers with six to ten years experience indicated that they would leave. (Reuters, Feb. 27, 2009)

Actually, banking is again becoming a very profitable business. Healthy loan margins have returned. Many executives will start new companies. Those financial firms that can remain autonomous, will be competing against hobbled financial behemoths that are government owned and run by relatively low-paid civil servants. Which team of managers will be most successful? Place your bets.

Phoenix: Back to Materials

We repeat our comment on commodities and cyclicals of last quarter. We have continued to raise our weightings in commodity and cyclical sectors this past quarter. We here review our reasons why. The sudden economic slowdowns of the past quarter (virtually around the globe) slammed commodity prices. For example, oil prices per barrel have plummeted from a high of $147.15 (June 2008) to a low near $35 in less than 6 months.

However, a longer-term commodity uptrend is not necessarily dead. Like the Phoenix, it is liable to be resuscitated. There are a number of long-term trends factors which suggest that this ultimately will play out. As the old saying goes, “the best cure for high commodity prices are high commodity prices.” In the same vein, ultra-low commodity prices will in time lead to a cure … namely, much higher prices.

Despite the sharp declines in demand over the near-term, underlying long-term, global, secular trends remain supportive. For example:

- The world continues to urbanize. The UN forecasts this trend to continue, particularly in the 3rd world. This will contribute to continued economic growth and demand for materials.
- The World Bank estimates that demand for food will rise by 50% by 2030, as a result of growing world populations, rising affluence, and the shift to Western dietary preferences by a larger middle class.
- The number of countries which lack access to stable water supplies will rise from 21, with a combine population of 600 million, to 36 countries by 2025 — affecting 1.4 billion people.
- The IEA (an OECD organization) recent estimates that China and India will account for 50% of the incremental energy demand to 2030. What has changed? And, almost all the increase in energy production to 2030 will occur outside of the OECD countries. (This consolidates mutual dependence.)
- Infrastructure needs around the world, from energy to water to transportation, are enormous. Simply replacement spending, not to mention expansion of infrastructure, will require large spending and demand for materials.

Various forecasters now think that the major developed nations will contract by 0.5% to 1% in 2009 (which indeed would be their worst collective recession since the 1930s). By contrast the IMF forecasts that emerging economies are tipped to grow by around 4.5% in 2009. Albeit a sharp slowdown from a recent growth pace of 7-8%, this could be one of the mildest downturns ever for emerging economies. Real income is still expanding per capita, and this growth rate is still above their average over the past 3 decades.

We suspect that the official forecasts for the emerging economies may be too sanguine over the near-term, but we do expect that emerging economies stand to recover more quickly and sustainably … but only after inventory adjustments have run their course. We anticipate that demand for industrial commodities and metals will then again surge.

This inventory cycle snap-back effect, of course, will be common everywhere, not just the emergent world. However, we do think it stands to be more violent for countries that are heavily oriented towards manufacturing, such as is the case for many of the high-growth Asian countries. During the overheated boom stage, when commodity prices were still soaring, there were reports of speculative stockpiling. For example, it had been reported that China built up enormous supply of coal, iron ore … as much as 160 day’s supply. Much of these stockpiles have been run down, recent reports suggesting unsustainably low levels. In fact, China has been aggressive in re-establishing strategic reserves of key commodities.

But there is more than just a simple (though pronounced) inventory cycle effect at work. The “global madness of crowds” is also seen most pointedly in the rapid responses of

industry around the world. Companies around the globe have responded rapidly to an economic slowdown, abruptly changing strategies and investment spending. We would hazard to observe that these shifts may be the most rapid ever … another symptom of a globalized world. For example, mining companies, from Rio Tinto to Companhia Vale, from large to small, have slashed project spending. The same applies to oil developments. In Canada alone, approximately $45 billion in oil sands-related spending has been either delayed or cancelled.

What stands to play out with respect to commodity prices, is similar to what a water skier experiences on an inside turn as the boat slows down. The ski rope goes slack and the skier begins to sink into the waves. Then, suddenly, the rope snaps tight, generating a sling-shot effect. A massive acceleration occurs, propelling the skier to a speed even faster than the boat. Given the interplay of fickle investment sentiment and these demand dynamics, we think that a demand turnaround, when it arrives, could be just as quick and volatile.

Also, required adjustments and write-offs of malinvestment also appear to be occurring quickly (unlike the long, delayed decline of Japan over the past 15 years). While such rapid changes will accentuate an apparent economic downturn over the near-term, it also stands to shorten the length of time required to clear malinvestment before re-seeding the next recovery.

Other Thoughts and Current Observations

- Another key condition to realize is the Occidental world is going through a deleveraging cycle (debt reduction, credit destruction) as opposed to more usual business cycle (inventory and investment spending driven.) For the most part, the ROW (rest of world) s only experiencing the trade reverberations of the former as well as the related financial impacts (though the 6-7 transmission channels of a globalized world.) However, even the most severe of financial crisis tends to pass within a 2 year period.

- Detractors to the view that emerging countries will recover economically first, (Brad Setser) say that 3 bangs are hitting the Asian NICs (newly industrialized countries) at the same time — consumption decline, export decline, capital spending decline. All the same, such conditions are easier to weather if a country possesses a huge surplus (exchange reserves) which can serve as a buffer.

- MSCI Asia Ex-Japan Index has been holding in … not breaking through November 2008 lows. It usually leads the price of the oil. Is this significant at this time? This may be a demonstration of the relative and underlying strength of this region. We continue to raise weights in emerging markets.

- History suggests that those nations that are able to depreciate their currencies (especially if they have a large propensity or capability of import displacement) are the first to recover … or to show relatively strong GDP growth. What countries have best chance for import displacement? China? Brazil?

- Buy gold? Oil is the better buy. While gold may yet trend higher, it has lost much relative value against stocks. The gold/oil ratio has soared and is very attractive. We are raising sector weights in oil and gas. Current oil prices are unsustainable.

No new oil exploration and development is profitable under the $60 per barrel level. Buy oil stocks.

- Too early on corporate bonds? Is a wave of defaults still ahead? The default rate could be as high as 11 to 15% in 2009 according to Ed Altman, expert on bond default history. It may have become a trade that may be too popular.

- Buy emerging market bonds rather than corporate bonds? This is an attractive strategy given the enormous yield spreads available presently. Not many emerging market credits are likely to default and a weakening US dollar will add to returns (assuming no strong USD peg).

- The Great Destocking (not Great Depression). Asia's exports to China have fallen 4x faster than China's exports to either Europe or the US. Companies have been drawing down inventories en masse everywhere. When does the inventory ratio hit rock bottom?

- If indeed Stop/Go/Stop is still likely, then how best to get leverage on commodities? Leverage on oil --- Russia, the GCC, or NA oil stocks? "DUBYA" (or "W", the same scenario we call Stop/Go./Stop) is the scenario that Paul Kasriel also endorses

- It has come to the point where market commentators are feeling apologetic for making a positive case … any type of positive case. The negative news and economic statistics appears so obviously negative, to say anything positive is to risk the wrath of a world of armchair strategists.

- Global GDP outlook? WTO says that trade growth will be the lowest in 25 years. The IMF says global real GDP will be 0.50%, the lowest rate since WWII.

- How sustainable are recent rates of economic decline … exports/imports … production declines … price declines … etc.? For example, annualized rates of PPI decline for finished goods was at 24.3%, intermediate goods at 39.7% in 4Q 2008. This rate of decline is not sustainable.

- Reality check: The US government deficit is project to hit 12.64% of GDP in fiscal 2009!!! And this for a country that has no public health care program and 30% of its baby-boomer with negative net worth! (See recent Peterson Institute report for comparison between US and Europe.) Consider that if long-rates were to rise to 8% as inflation heads to near 10% (continued budget deficits of 8 to 10% of GDP) a catastrophic loss of over 30% would accrue to long bonds.

- What are insiders doing? Insiders have again increased the purchases of company stock. This is a positive indicator.

- Where is the world's safe haven … especially as there are no more "hard money" currencies? Our analysis would suggest — Germany, Canada, South Korea, Singapore … even France. With the exception of Germany, these are all relatively small countries. Canada's bonds could yet become the Swiss bonds of the Western hemisphere (only $390 billion in debt outstanding at the present time. S. Korea has about $250 billion in government debt, Singapore only $150 billion.) Buy safe haven debt! Currently, we are heavily overweighted in Canadian government bonds.

- Are we there yet? Equity markets have fallen at the steepest rate since the 1930s, some commodities prices have collapsed, automotive sales are at 1958 levels, existing and new housing sales at 1972 levels. Yet, all kinds of brave forecasters only now emerge to announce that auto sales can fall 30% more, housing sales volumes decline another 34% … etc. It seems that unsustainable hubris is out and macabre "in extremis" is in. Signs of an equity market bottom?

- Consider the diametric differences of the current crisis from 1997/1998. Then, large MNCs bought into Asian and other emerging countries at bargain basement prices. FDI actually rose during this period. Today, the reverse is true though of a different scale. Emerging market players (this being true only for China to date) are taking advantage of low prices to establish sufficient commodity supplies, snapping up resource companies.

- China's buying current spree. Says Chris Puplava "Brilliant, purely brilliant! That is what strategic thinking is called! China, concerned about their U.S. reserves being devalued by U.S. monetary policy, is exchanging their holdings for long-term oil contracts from countries all over the world, locking in oil prices at exceptional levels, like the $11.40/barrel estimate for the Russian deal." (18% piece of Rio Tinto, Canada's Tanganyika Oil, OZ Minerals, lending $10 billion to Brazil's Petrobas, huge sums to Russia's Rosneft … etc.)

- Could Asia emerge as the financial hub of the world soon, too? Asian banking systems, though NPLs are rising, are relatively intact.

- Big picture vista: Since 1997, global surpluses have built to extremes, generating huge demand for US treasuries and agencies. Two types of surpluses developed over this period — oil driven and trade mercantilism. Now, with the world's chief economic locomotive sidelined, the second type of surpluses will fall … perhaps entirely disappear. What will it be spent upon? Domestic stimulus spending, international commodity supply … something else?

- The US remains the world's biggest manufacturer by value of goods produced. It hit a record $1.6 trillion in 2007 — nearly double the $811 billion of 1987. For every $1 of value produced in China factories, the United States generates $2.50." (Associated Press article.)

- If valuations at the beginning of a return series are a prime determinant of longer term results (not to ignore GDP growth) then now is a great time to enter the wealth management business or to start a global portfolio!

- Globalization: An untimely death? Many are now saying that the world has recently experienced a "globalization" bubble and that it has bust. As such, globalization and the expansion of global trade is over … that the so-called global commodity super-cycle was just "super short." Both FDI and crossborder capital flows will collapse and stay down for a decade or more. This is too extreme. What about the development cycle … the rise of living standards? This is not over. Just what would happen to overall world growth, were China ever to attain the consumption levels of the US. Currently, the Chinese living standard (GDP per capita) is still only 10% of the average American. In some ways, globalization could still be said to be in an intermediate stage … with far to go. For example, even at this late great date, there

still is no global accounting standard, or even a unified methodology for calculating different monetary aggregates.

- To date, the US government has made promises and guarantees amounting to $7.6 trillion. What would be the final outcome, supposing that the GFC (Global financial crisis) will pass? US federal government. debt would then rise to near 100% of GDP (from under 50% presently) and the wealth skew would become even more extreme. While these are not favorable developments, fundamentally undermining economic growth capacity, it is survivable for a time (at least until the baby boomers are into heavy liquidation mode.) Reinhart & Rogoff study showed that average crisis (currency and banking) resulted in a 86% rise in government debt in real terms during first 3 years after crisis stage. This would be equivalent to an additional $8 to $9 trillion in the US currently.)

- How far lower goes real estate? The ARMs threat seems to be allayed. Some $420 billion in hybrids are rescheduled to be refinanced this year. In many cases, rate resets are lower … not higher? Of course, Option ARM resets will be worse (still about $200 billion of these outstanding.) Hussman argues that we are now likely past the first wave of the mortgage foreclosures. (These usually peak 6 months after issuance, and the ARMs top reset period was set in mid-2008.) The ARMs threat therefore seems to be allayed. Some 420 hybrids are rescheduled to be refinanced this year. In many cases, rate resets are lower … not higher. Of course, Option ARM resets will be worse (still about $200 billion of these outstanding).

- The overall wealth destruction effect upon the average US household has been enormous. A recent CEPR report update, reports the impact upon various age cohorts. For example, over 30% of baby boomers may now have negative net worth. (As of the end of 3Q 2008, home equity represented 44.7% of the value of US homes. Recall that only about half of US homes have mortgages … around 50 million.)

- One scenario to consider is a hyper-inflationary boom in China as reserves are drawn down for domestic spending and not sterilized. The result? A sharply rising yuan against the USD. This would be the last and final down-leg for the US dollar. For now, the argument is that Chinese exports will not fall significantly as they compete in the low-price segment of global markets. These are the products towards which consumers will shift in recessionary times.

- What chance that global crisis continues with further waves of volatility. A US dollar decline, a popping of the US and Japanese bond bubbles, an inflationary spiral …. etc. could yet unfold. What would be the implications? Two main bubbles likely yet to collapse — the USD and the US treasury market. Our current asset mix and weights reflect these probabilities.

- Bill Gross of PIMCo says buy what the government will be buying (agencies bonds, senior bank debt, preferred shares … auto companies … etc.). But should we be buying the bonds that they will be selling? When the end of the US bond bubble, and the bond trap sprung? Several aspects to keep in mind: Ray Dalio of Bridgewater says that the Fed will eventually have to buy treasury bonds … in other words, monetize bonds. This would be a source of buying, indeed. As mentioned earlier, the additional factor of supply will be foreign sales of treasury bonds. This is indeed unfolding.

- Banking and lending yields spread are now most lucrative in decades. Banking is again hugely profitable if they can lend to good credits. This suggests that the “carry trade” could again emerge? It also creates ideal conditions for new types of financial companies to launch that will arb out high yield spreads and risk (picking the good bits of loan portfolios sold off presently. See earlier comment.)

- Is it much too early still to buy commercial real estate? About 150,000 retail chain stores are anticipated to shut down in 2009, according to ICSC (International Council of Shopping Centers). A structural factor to consider with respect to mortgage pools, is that single loans in this sector are large. Therefore, it may require only one large loan to go bad to burn through first several tranches of syndicated loans or asset-backed paper. We continue to shy away from commercial real estate trusts, though yields may indeed appear mouth-watering.

- An interim equity rally … a fake-out rally? During Japan’s lost decade following the Nikkei high of 1989 there were 13 rallies that accomplished a 25% retracement of the previous loss, and there were 5 that recovered 40% or better (Source: Bob Hoye) The two best years for Wall Street in the 20th century were 1933 and 1935.

- The case for metals: Is it too early? However, there are many reasons to consider the positives. For example: The recession is already well into 2nd year; huge re-inflation is underway worldwide; commodity prices are generally far too low with many resource companies working below cost of production; capacity shutdowns and project cancellations have been significant; forced liquidations have occurred. As well, speculators are probably now out of the commodity system; financial/portfolio investors have probably turned tail; China continues to push plans to stockpile.

Just when will the world and US economies again turn up? Here is a list of developing positives:

- Crude oil prices recently again broached $50 per barrel. Oil prices clearly look to have bottomed.
- US housing starts turned in February
- The Conference Board's index of leading economic indicators has risen for two months in a row.
- Producer prices have increased for two straight months.
- Consumer prices rose in January -- the first monthly gain in six months.
- Real consumer incomes have risen sharply in 3 of the past 4 months.
- The Baltic Dry Index, which measures the cost of shipping key raw materials like copper, steel and iron, has more than doubled from its recent lows.
- Existing-home sales rose in December, and participants in weekly surveys think that another rise took place in January.
- Pending home sales went up in December.
- Builders' confidence inched up this month.
- Thanks to lower interest rates, applications for both new mortgages and refinancings of existing mortgages are rising.

- Real hourly earnings rose 4.5% in December following a 3.3% increase in November.
- An index of consumer expectations rose in January.
- Retail sales shot up by 1% in January -- the first monthly rise since June.
- The decline in consumer credit moderated in the latest month.
- New orders for consumer and nonmilitary capital goods went up in January.
- The ISM index of manufacturing went up last month.
- The ISM index of services rose last month for the second month in a row.
- The money supply is soaring, a sign that there's plenty of liquidity in the economy.
- The 3-month London interbank offered rate, a measure of banks' willingness to lend to each other, has dropped to 1.2% from close to 5% a number of weeks ago.
- Other measures of the state of the financial markets, like the TED spread and the 2-year swap spread are down, as well.
- Prices of credit default swaps for banks have fallen from their peaks.
- The corporate-bond markets are thawing out, too; some $127 billion in dollar-denominated debt was issued in January, the most for any month since last May.
- Some securities on banks' books are starting to recover in value.
- China bank lending is soaring. Is this a positive sign, or a contrived on driven by government imperative? Chinese companies are more reliant upon retain earnings for their expansion spending, therefore, may now need to turn to banks.

Updated Expected Returns: Our expected return forecasts for our portfolios had been revised upwards in the 4th quarter. For the most part, this is due to the lower starting point for equity markets, given their substantial declines during 2008, and the decline of the Canadian. We will be revising these estimates in the near future, now taking into account the monetary effects of recent central bank actions. We do not expect to reduce our overall return forecasts. However, the composition stands to be much different.

All long-term return projections for all portfolio mandates are based upon 7-year real and nominal returns. *(For further information, please see the corresponding exhibits at the back of this report.)*

Asset Class	7 Year Averages		Gains	Gain	Gain	Income	Dividends	Interest
(CAD)	Real	Nominal	Total	Currency	Security	Total		
Cash	0.56%	2.00%	0.00%	0.00%	0.00%	2.00%		2.00%
Cdn. Stocks	9.44%	11.00%	7.50%	0.00%	7.50%	3.50%	3.50%	
US Stocks	5.80%	7.31%	3.81%	-4.51%	8.32%	3.50%	3.50%	
International Equities	7.06%	8.59%	6.19%	-0.35%	6.54%	2.40%	2.40%	
Emerging Equities	10.99%	12.58%	9.58%	-0.35%	9.93%	3.00%	3.00%	
Cdn Govt. Bonds	1.75%	3.20%	-0.70%	0.00%	-0.70%	3.90%		3.90%
US Govt. Bonds	-2.89%	-1.50%	-5.50%	-4.51%	-1.00%	4.00%		4.00%
Int. Govt. Bonds	1.35%	2.80%	-1.00%	-0.35%	-0.65%	3.80%		3.80%
Other Alternative	6.27%	7.79%	5.29%	-4.51%	9.80%	2.50%	1.00%	1.50%
With Expected Added-Value								

(Forecast revised as of December 2008 and remains valid)

SECTION III – LONG-TERM INVESTMENT STRATEGY SUMMARY CHANGES

Please contact HAHN Investment for further details.

Wilfred J. Hahn, March 2009

Appendix I
History of Significant Events

<u>October 2007 – Triggered</u>
US household sector now moving into recession mode.
Housing Downturn (Still ongoing)
Major Credit Event Watch. (Ongoing)
Reverse Bond Conundrum (In force)
Fed Reaction to 1, 2 & 3 above (Capitulation?).
<u>Triggered and Revised</u>
"Liquidity Watch" now broadened to "Liquidity & Insolvency Watch"

<u>Jan. 2008 – Triggered (New and in force):</u>
Tentatively … a US dollar bottom in sight.
US households further moving into recession mode.
Housing downturn (Still ongoing).
Major credit event watch. (Ongoing and still heightening!)
Reverse Bond Conundrum in Force (But, temporarily overwhelmed by liquidity flight.)
Fed Reaction to [factors] above *(Capitulation … multiple rate cuts ahead!)*
"Liquidity & Insolvency Watch"

<u>March 2008 –Triggered (New and in force):</u>
US Economy: Recession. (January 2008?)
US Financial and Economic Coupling with ROW. (Europe next to slow)
Tentatively … a US dollar bottom in sight?
US households further moving into recession mode.
Housing downturn (Still ongoing).
Major credit event watch. (Ongoing and still high.)
Reverse Bond Conundrum in Force (But, temporarily overwhelmed by liquidity flight.)
Fed Reaction to 2, 3 & 4 above *(Capitulation … multiple rate cuts ahead!)*
"Liquidity & Insolvency Watch"

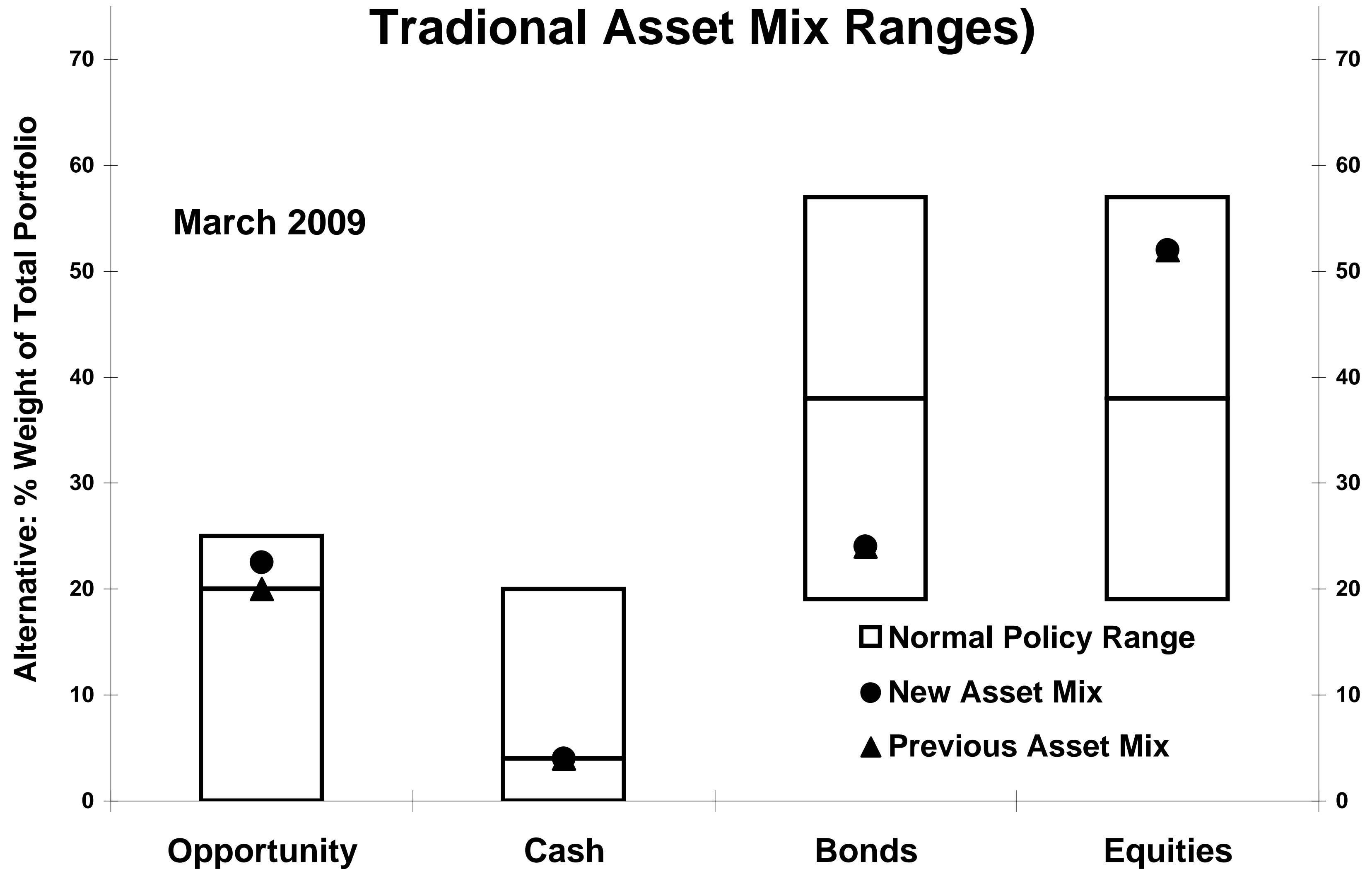
<u>June 2008 –Triggered (New and in force):</u>
US financial and economic coupling with ROW.
BRIC/Emerging markets slowdown in 2008. Latin America overdone.
US dollar rally likely over. New weakness ahead.
US households further moving into recession mode.
Housing downturn still ongoing.
Major credit & insolvency watch. Ongoing and still high alert.
Reverse "Bond Conundrum" in force though interrupted due to policy responses.
Commodity top.
Geopolitical Developments/Interventions: SWFs, China, Middle East financial flows.

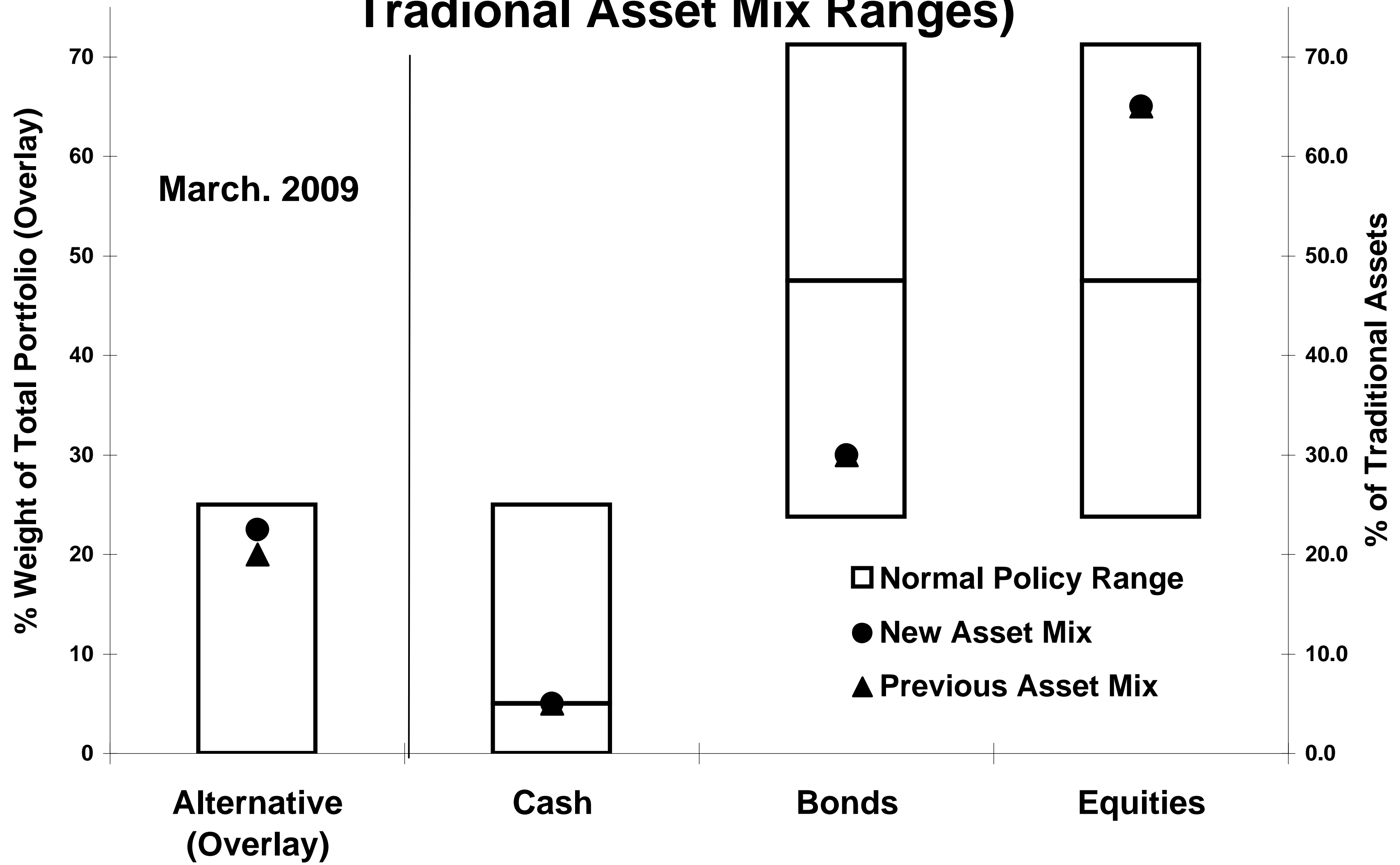
<u>Sept. 2008 – Triggered (New and in force)</u>
BRIC/Emerging markets slowdown in 2008. Latin America overdone.
US households further moving into recession mode.
Housing downturn still ongoing.
Major credit & insolvency watch. Ongoing and still high alert.

Reverse "Bond Conundrum" again in force. Policy reactions to #4, #5, & #6 above *(Multiple interventions yet ahead!)*

<u>December 2008 – Triggered (New and in force)</u>
Capitulation of US Central Bank

<u>March 2009 – Triggered (New and in force)</u>
Mega US government stimulus budget greater than $1 trillion.
Bottoming of Baltic Dry Index and other cyclical indicators.
Reversal of Yen/Euro currency cross.


HAHN Benchmark Asset Mix (Opporunity vs.
Tradional Asset Mix Ranges)
Alternative: % Weight of Total Portfolio
March 2009
70
60
50
40
30
20
10
0
Normal Policy Range
New Asset Mix
Previous Asset Mix
Opportunity
Cash
Bonds
Equities


HAHN Benchmark Asset Mix (Opporunity vs.
Tradional Asset Mix Ranges)
March. 2009
% Weight of Total Portfolio (Overlay)
% of Traditional Assets
70
60
50
40
30
20
10
0
70.0
60.0
50.0
40.0
30.0
20.0
10.0
0.0
Normal Policy Range
New Asset Mix
Previous Asset Mix
Alternative
(Overlay)
Cash
Bonds
Equities

7-Year Asset Class Return Forecasts

% Real returns per annum, 2008 - 2013, in Cdn. Dollars

Blue figures - expected annual return (inflation adjusted) includiing anticipated value-added

Real Return (CAD) **Est. Value Added** **Est. Total Real Returns CAD**

15.00%
13.00%
11.00%
9.00%
7.00%
5.00%
3.00%
1.00%
-1.00%
-3.00%

0.56% 9.94% 6.30% 7.56% 9.63% 1.85% -2.79% 1.45% 6.27%

1.00%
0.50%
0.50%
0.50%
10.99%
9.44%
7.06%
5.80%
6.27%
0.10%
0.10%
0.10%
1.75%
1.35%
0.56%
-2.89%

	Cash	Cdn. Stocks	US Stocks	Global Equities	Emerg/Alt Equities	Cdn Govt. Bonds	US Govt. Bonds	Int. Gov. Bonds	Other
Est. Total Real Returns CAD	0.56%	9.94%	6.30%	7.56%	11.99%	1.85%	-2.79%	1.45%	6.27%
■ Est. Value Added	0%	0.50%	0.50%	0.50%	1.00%	0.10%	0.10%	0.10%	0.00%
□ Real Return (CAD)	0.56%	9.44%	5.80%	7.06%	10.99%	1.75%	-2.89%	1.35%	6.27%

7-Year Asset Class Return Forecasts

% Nominal returns per annum, 2008 - 2013, in Cdn. Dollars

Blue figures - expected annual nominal return includiing anticipated value-added

	Cash	Cdn. Stocks	US Stocks	Global Equities	Emerg/Alt Equities	Cdn Govt. Bonds	US Govt. Bonds	Int. Gov. Bonds	Other
Est. Tot. Return (CAD)	2.00%	11.50%	7.81%	9.09%	13.58%	3.30%	-1.40%	2.90%	7.79%
Est. Value Added	0%	0.50%	0.50%	0.50%	1.00%	0.10%	0.10%	0.10%	0.00%
Nominal Return (CAD)	2.00%	11.00%	7.31%	8.59%	12.58%	3.20%	-1.50%	2.80%	7.79%