



Are We There Yet?

Life In the Midst of the Great Global Credit Crisis

December 2008

Presented by:

**Patricia Croft, Chief Economist
RBC Global Asset Management**



The Greatest Credit Bubble of All Time



- 1. Liquidity – too much and too cheap**
- 2. Trend to deregulation**
- 3. Boom in securitization**
 - ◆ Democratized credit provision but disconnected lender and borrower**
- 4. Overconfidence in financial models**

...Ended in Tears

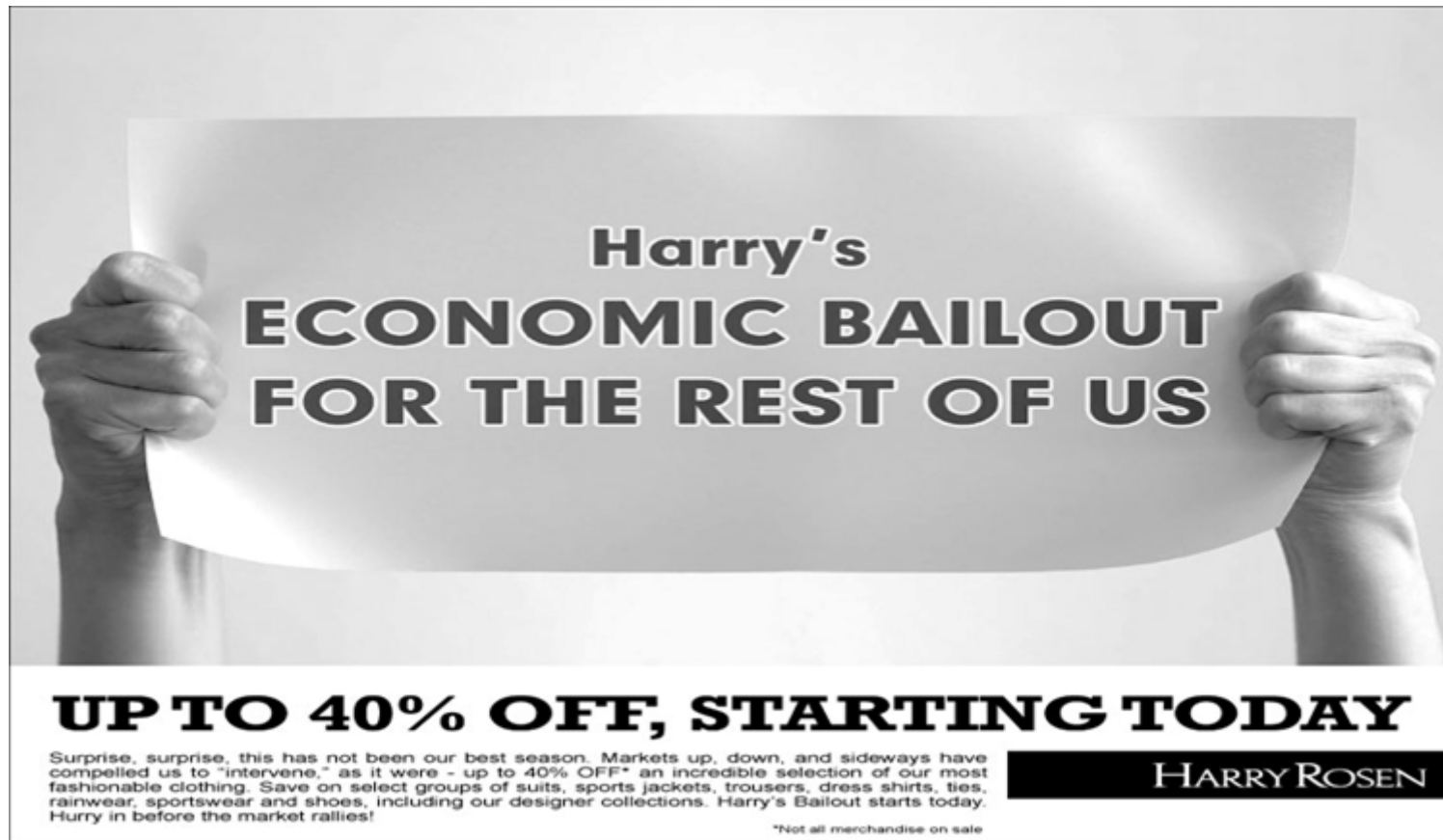
(Un)Happy Anniversary



- ◆ **Problem confined to sub prime**
- ◆ **Problem confined to the US**
- ◆ **Minimal losses**
- ◆ **No impact on the real economy**
- ◆ **Global decoupling**
- ◆ **Inflation**
- ◆ **Cross product contagion to ABCP, MBS, SIVs, monoline insurers, auction rate securities, LIBOR financing**
- ◆ **Problem now global**
- ◆ **Writedowns to date \$900 bn – estimates of \$2 trillion**
- ◆ **US, UK in deep recession**
- ◆ **Global downturn- China, India slowing**
- ◆ **Deflation**

Merriam-Webster 2008 Word of the Year?

Bailout: “a rescue from financial distress”



Harry's
ECONOMIC BAILOUT
FOR THE REST OF US

UP TO 40% OFF, STARTING TODAY

Surprise, surprise, this has not been our best season. Markets up, down, and sideways have compelled us to “intervene,” as it were - up to 40% OFF* an incredible selection of our most fashionable clothing. Save on select groups of suits, sports jackets, trousers, dress shirts, ties, rainwear, sportswear and shoes, including our designer collections. Harry's Bailout starts today. Hurry in before the market rallies!

HARRY ROSEN

*Not all merchandise on sale

Where to Hide?



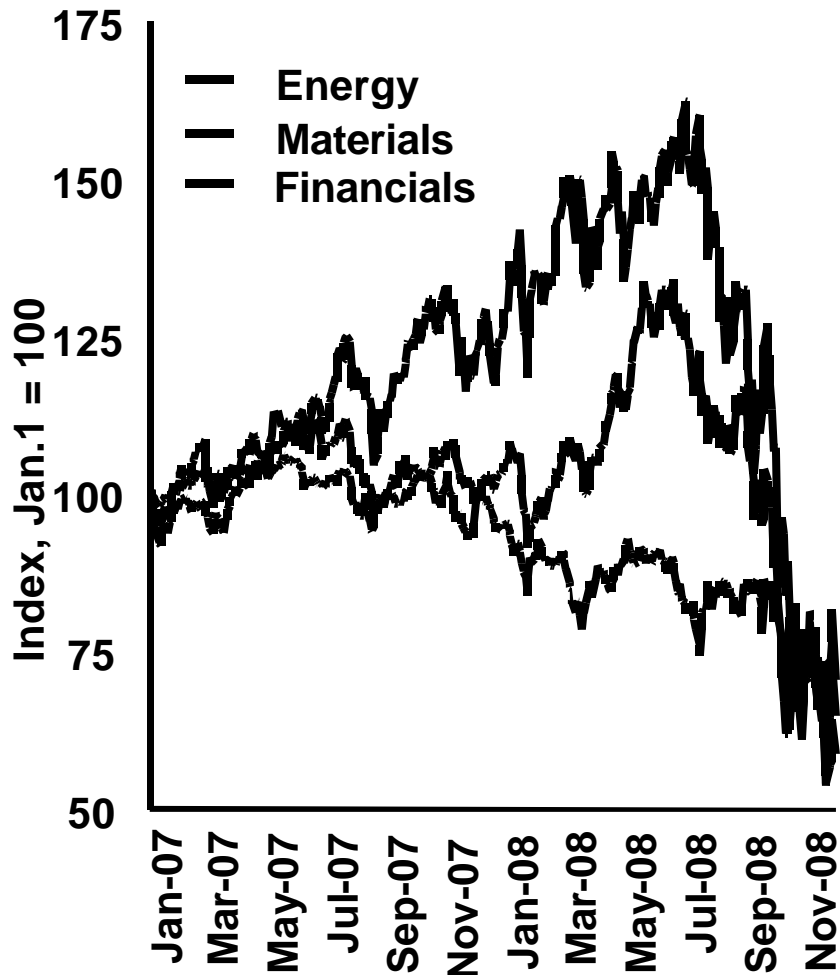
Asset Class Performance

(Local Currency as of Nov 21st low, %)

Dow	-39
S&P500	-44
Nasdaq	-49
UK	-42
Japan	-48
EAFE	-45
S&P/TSX	-39
BRIC	-66
DEX Universe	3.4
Oil	-49
Gold	-7

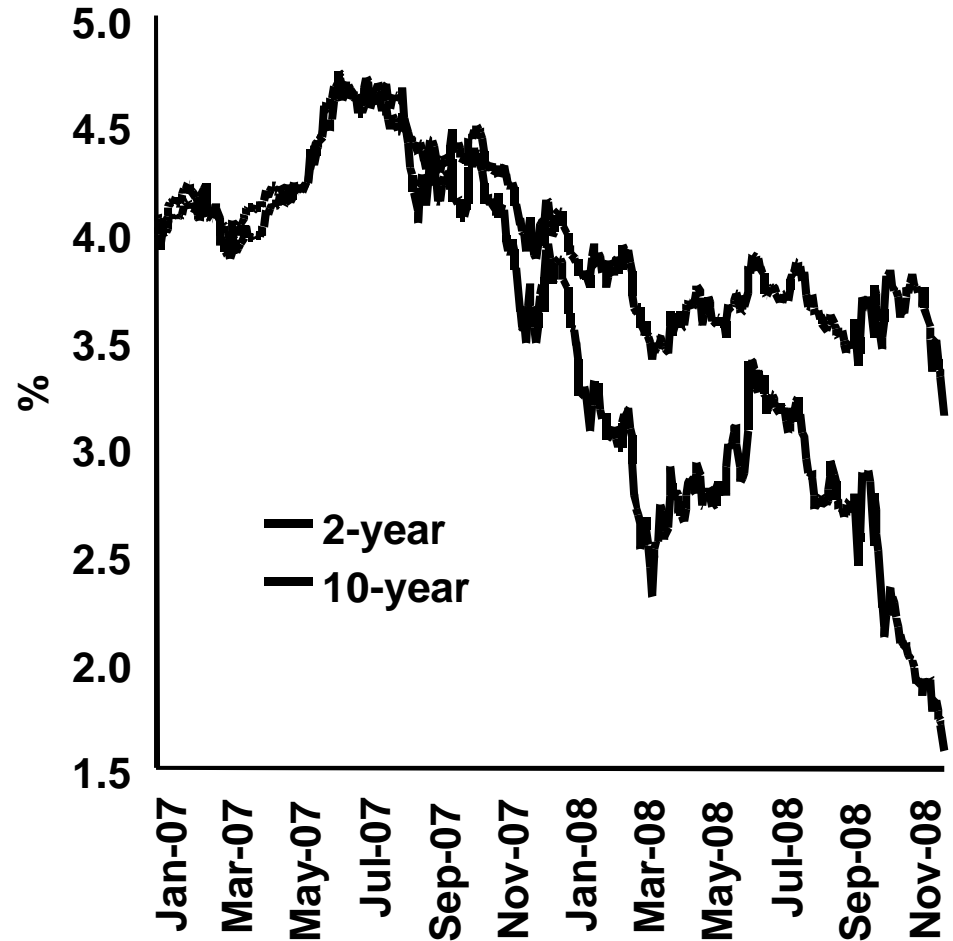
Markets Pricing in Double D: Deflation/Depression

TSX Sectors Since January 2007



Source: Datastream

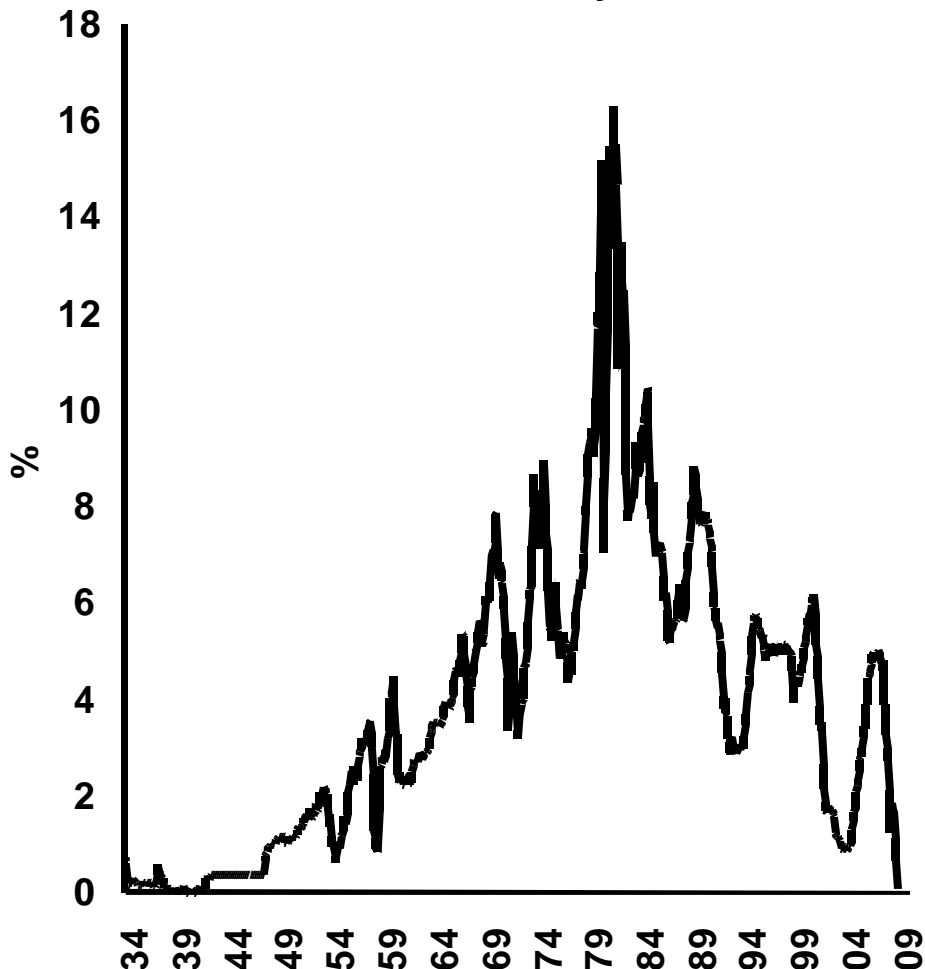
Canadian Treasury Bond Yields Since Jan. 2007



Source: Bank of Canada

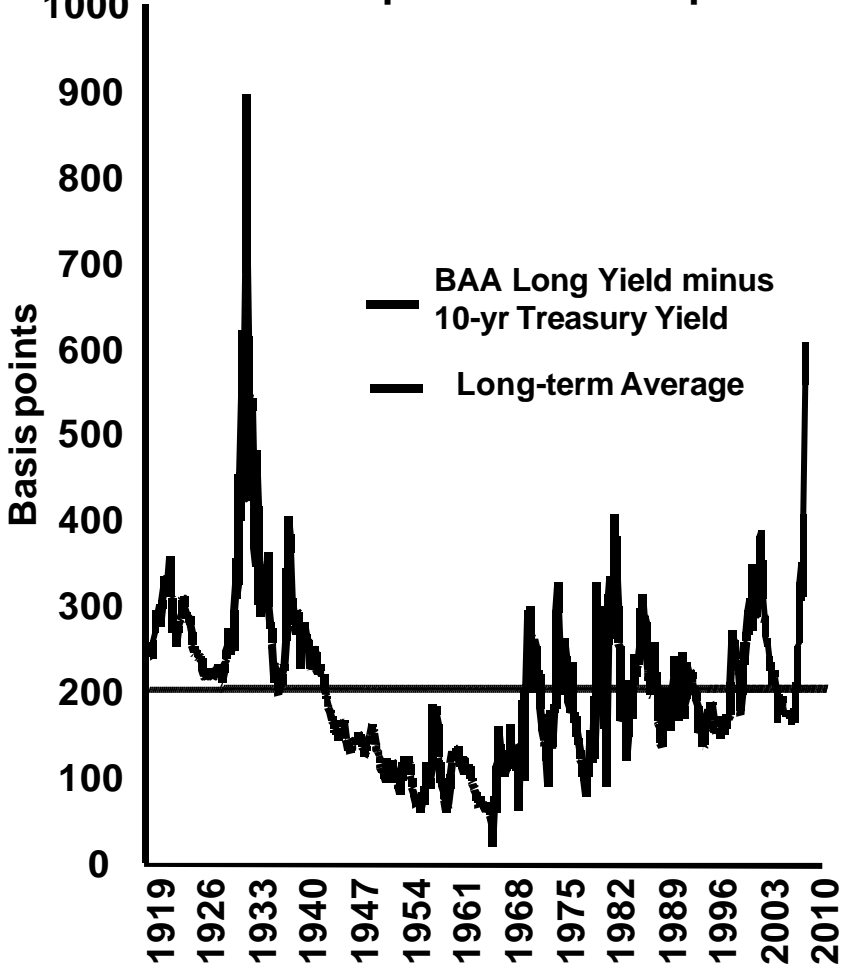
Let's Party Like It's 1929

U.S. 3-Month Treasury Bill Yield



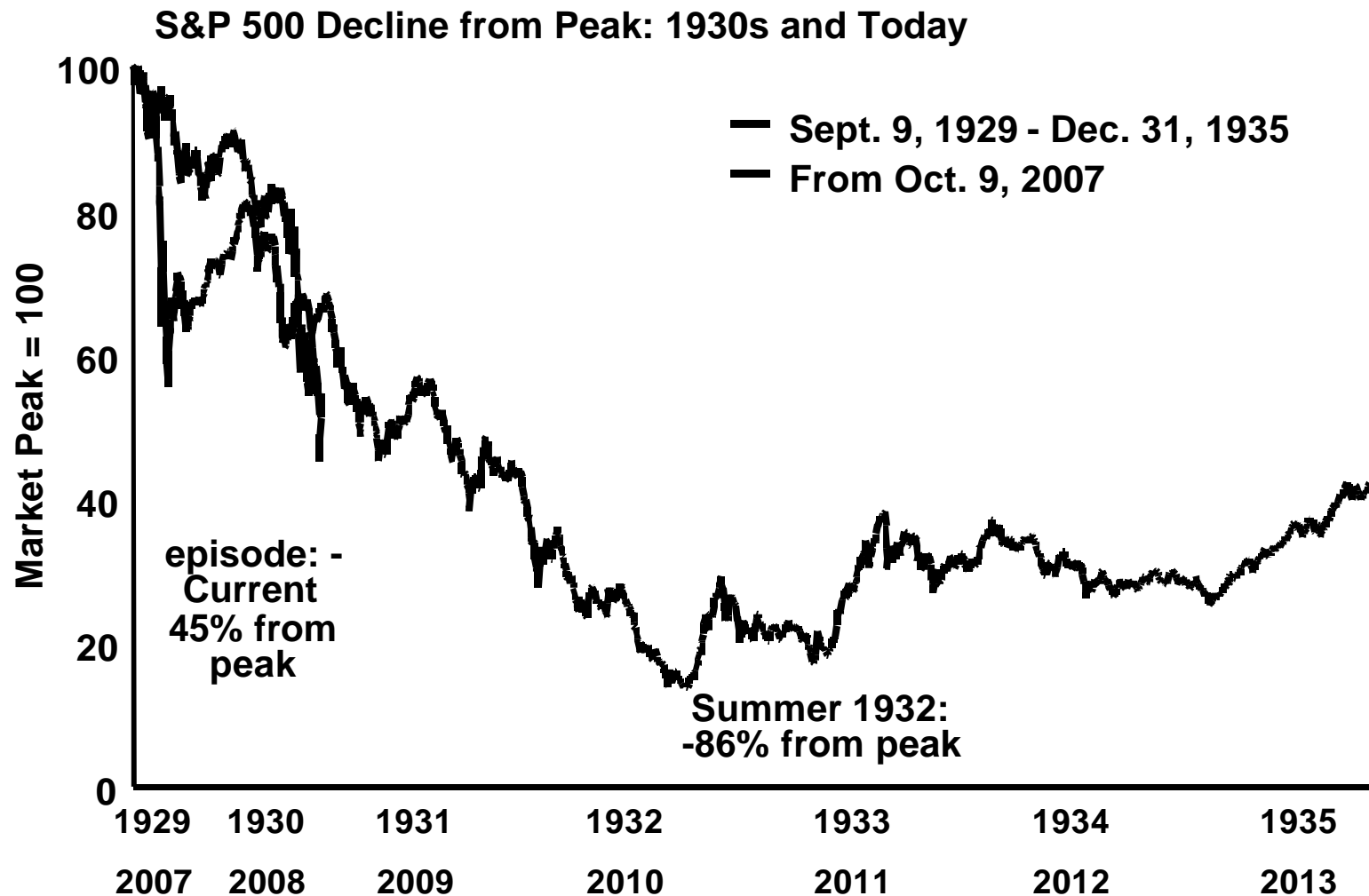
Source: U.S. Federal Reserve

U.S. Corporate Credit Spreads



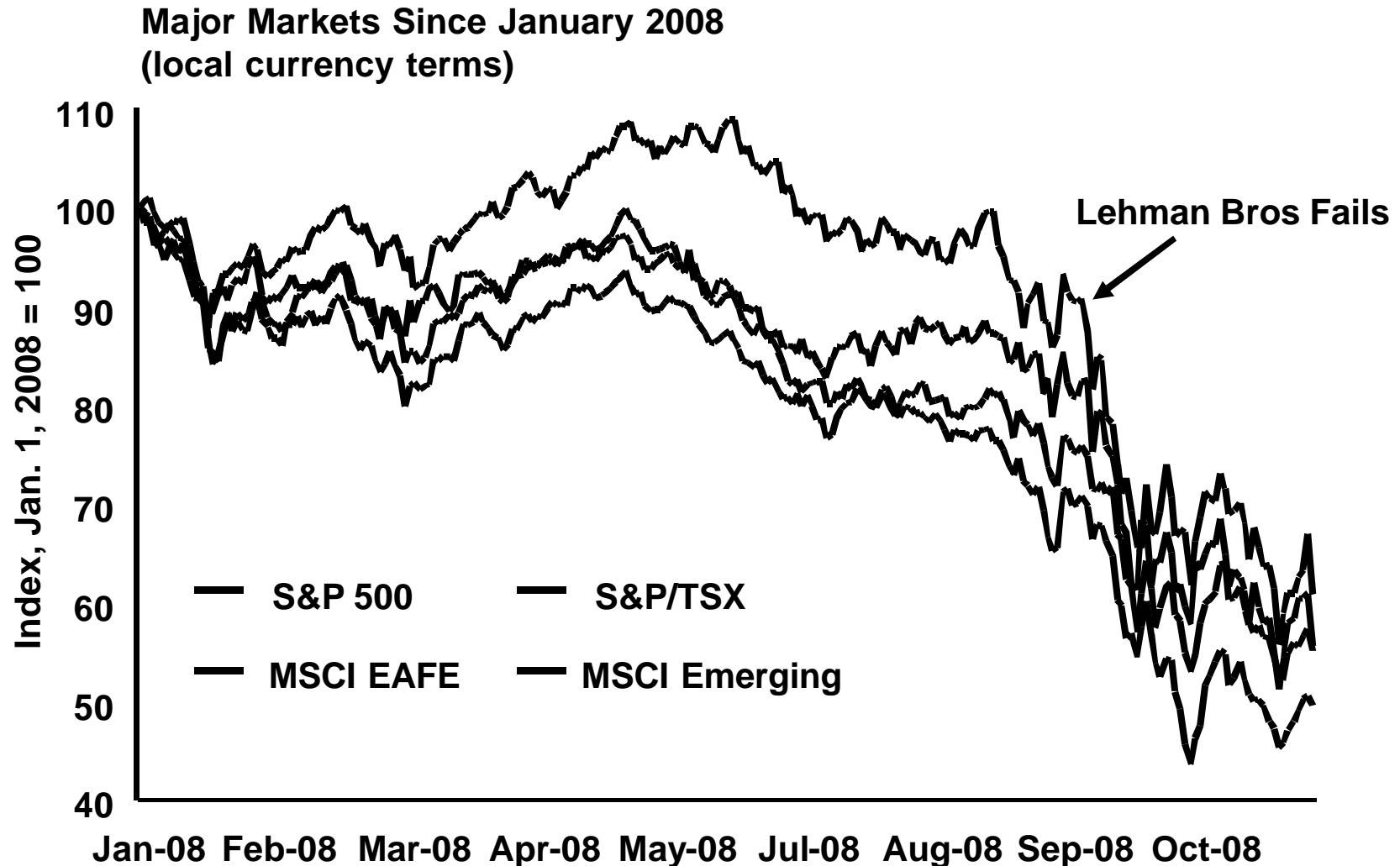
Source: RBC Capital Markets, Global Financial Data Inc.

Let's Hope Stocks Don't Mimic Credit



Source: NBF Economy & Strategy, RBC Capital Markets, Global Financial Data, PH&N

Global Equity Markets Deep in Bear Market Territory



Source: Datastream

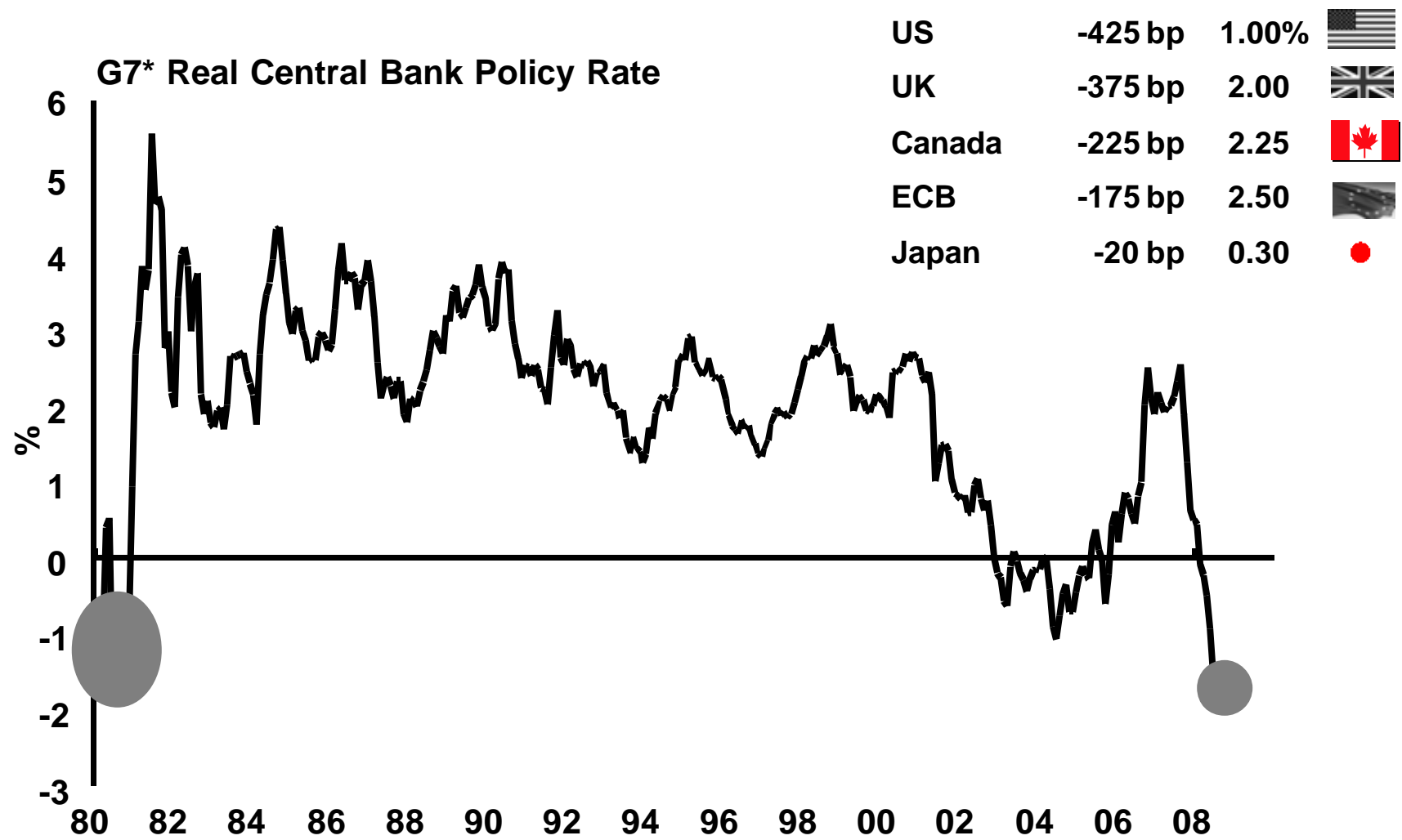
Reasons to Be Realistic

1. **Risk of depression/financial market meltdown averted but troubles remain**
2. **US in recession – how long and how deep?**
3. **World economy in recession – how long and how deep?**

Reasons to Be Optimistic

1. **Massive fiscal and monetary policy response**
2. **Financial system beginning to thaw**
3. **Main Street wants out and Smart Money wants in**
4. **More interest rate cuts and further fiscal stimulus ahead – oil prices plummet**

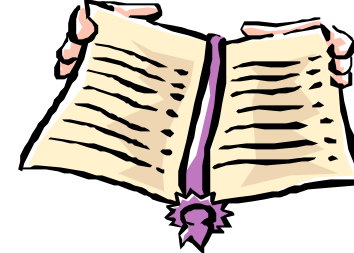
Real Interest Rates Exceptionally Low



*GDP weighted average of US, Japan, Eurozone, UK & Canada target interest rates minus inflation

Source: National Central Banks, National Statistical Agencies, PH&N

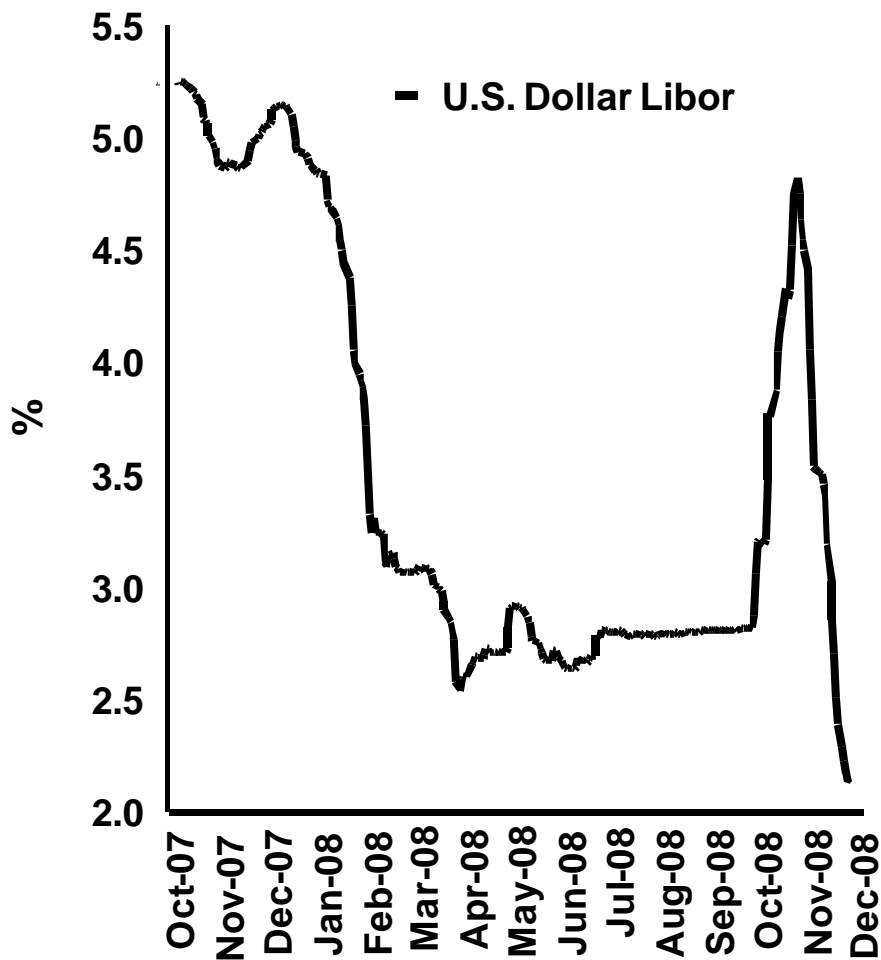
Fiscal Package De Jour



Country	Package Size	% GDP
China	\$586 billion	14%
US	\$700 billion	2%
UK	\$38 billion	2%
Germany	\$40 billion	1.2%
Eurozone	\$160 billion	1.2%
Japan	\$51 billion	1.2%
Canada?	\$30 billion	2%

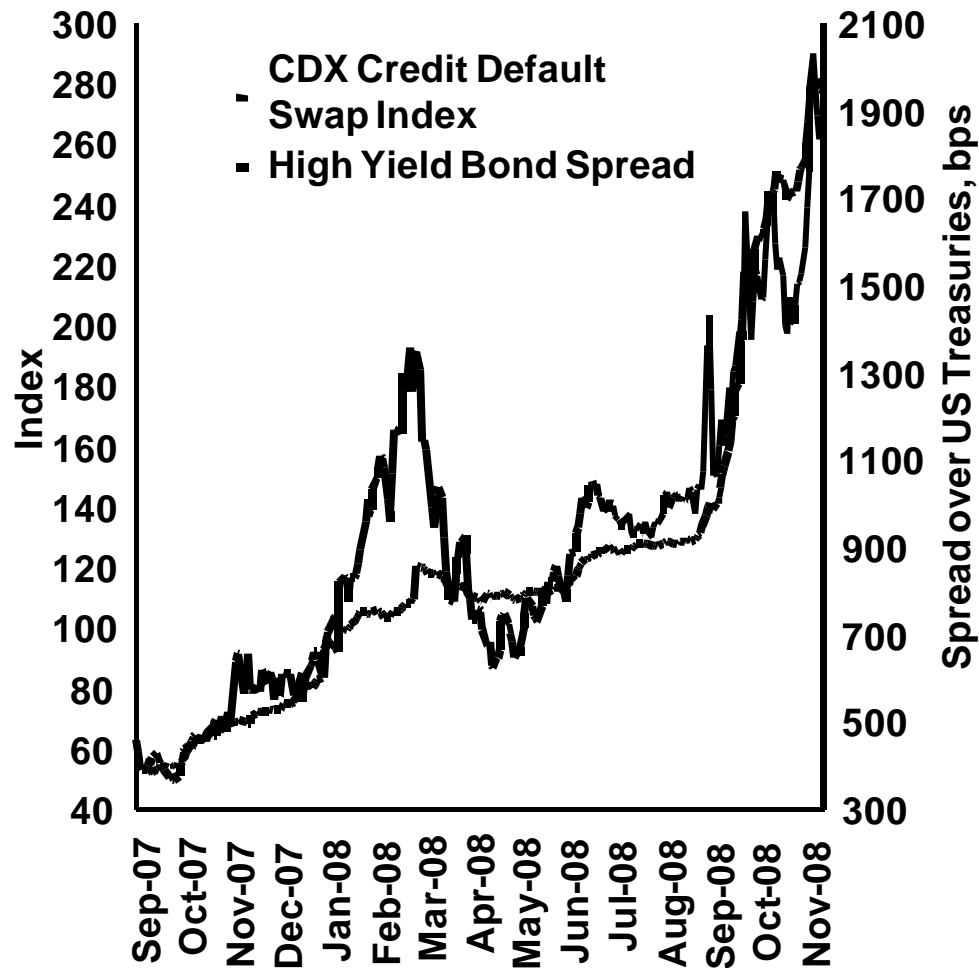
Are We There Yet?

Systemic Stress Declining....



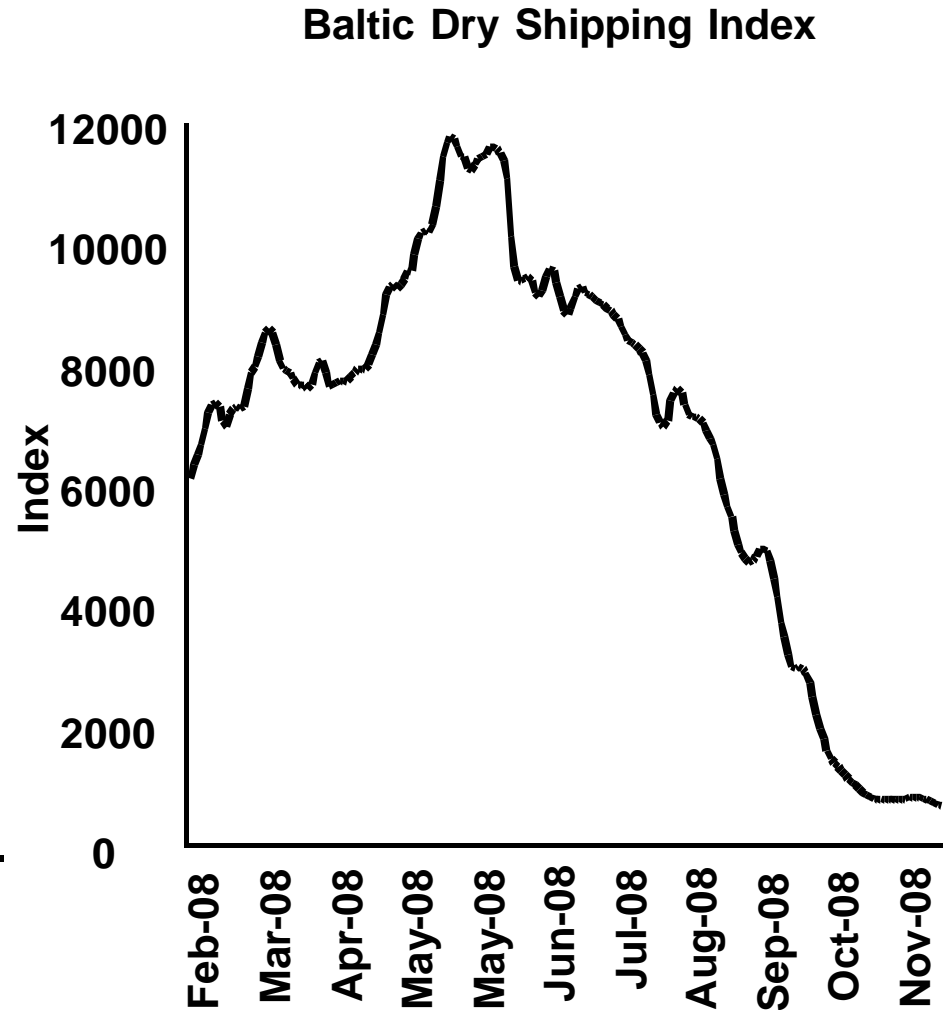
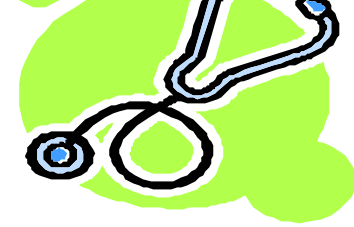
Source: U.S. Federal Reserve, Bank of England

.... But Fundamental Stress Remains High



Source: Bloomberg, Merrill Lynch, Datastream

Dr Copper Says The Patient Is Not Well

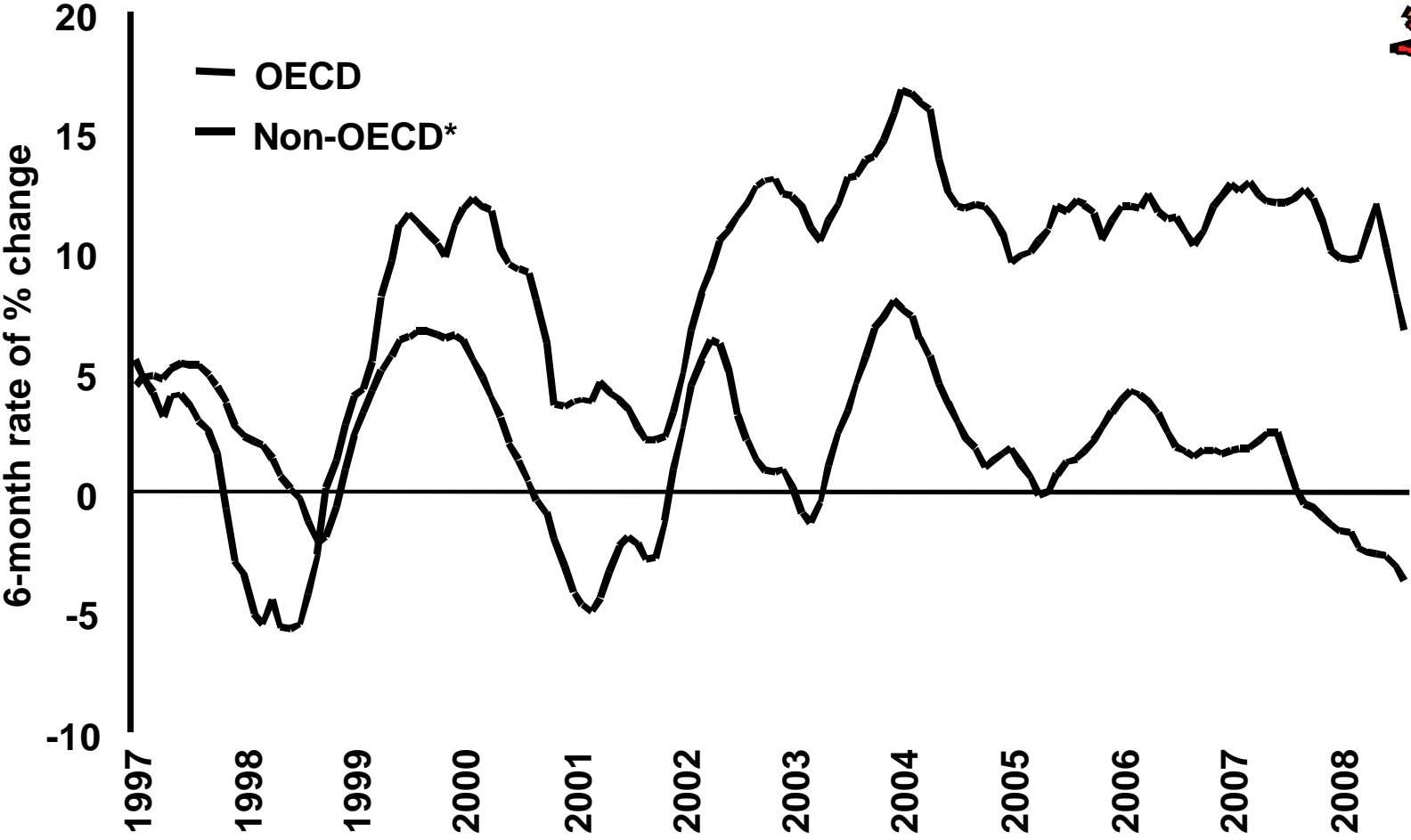


Source: The Baltic Exchange, Datastream

Leading Indicators Signal Downturn



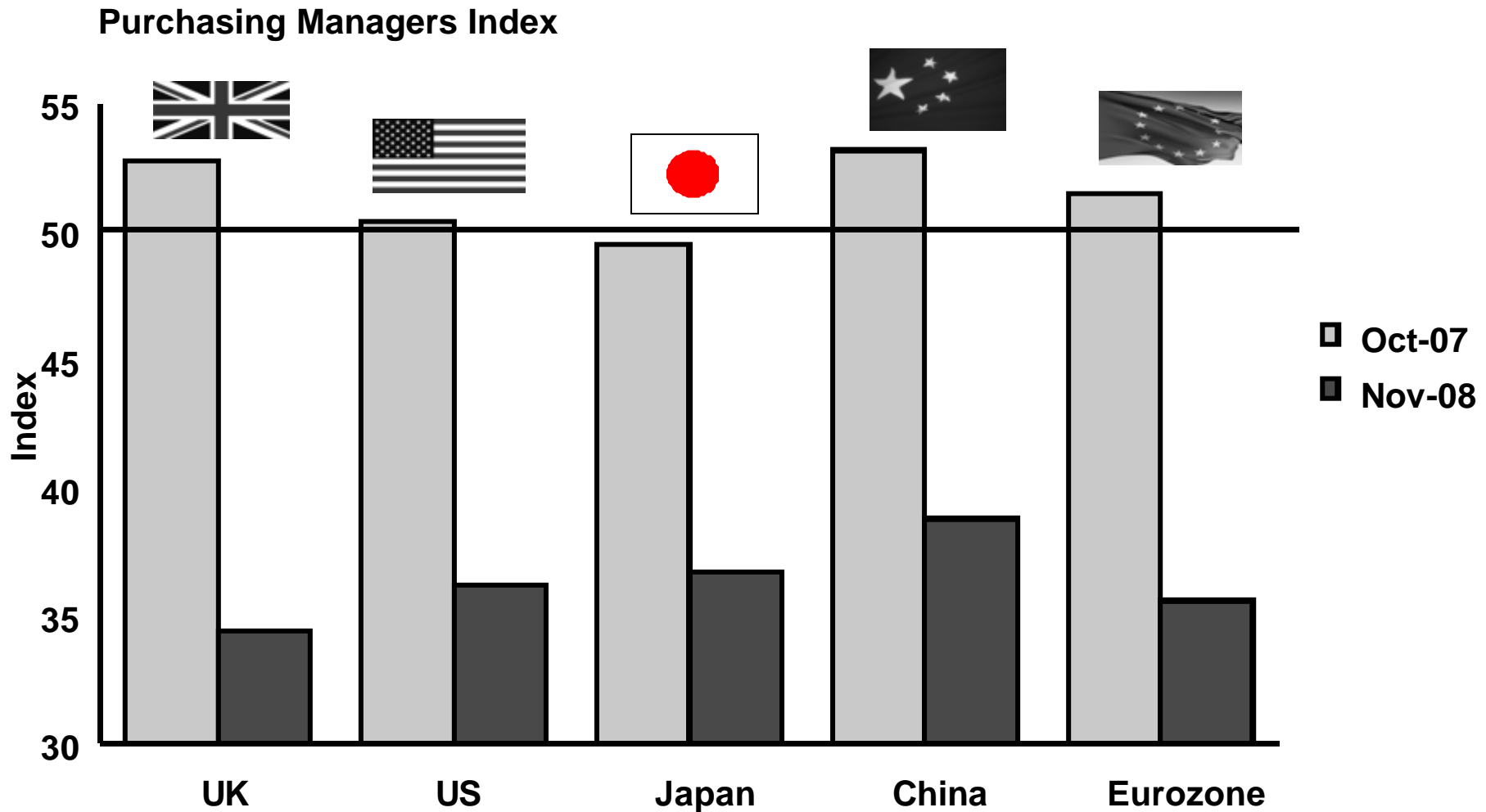
Leading Economic Indicators: OECD & Selected Non-OECD



* Trade-weighted average of China, India, Brazil, Russia, Indonesia & South Africa

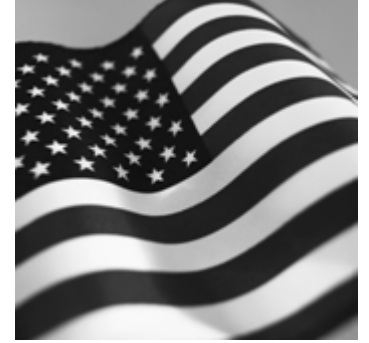
Source: Organization for Economic Cooperation & Development, PH&N

World Economy in Recession – Not Just About the Consumer



Source: Bloomberg, Normura, Institute for Supply Management, Markit Group, Ivey

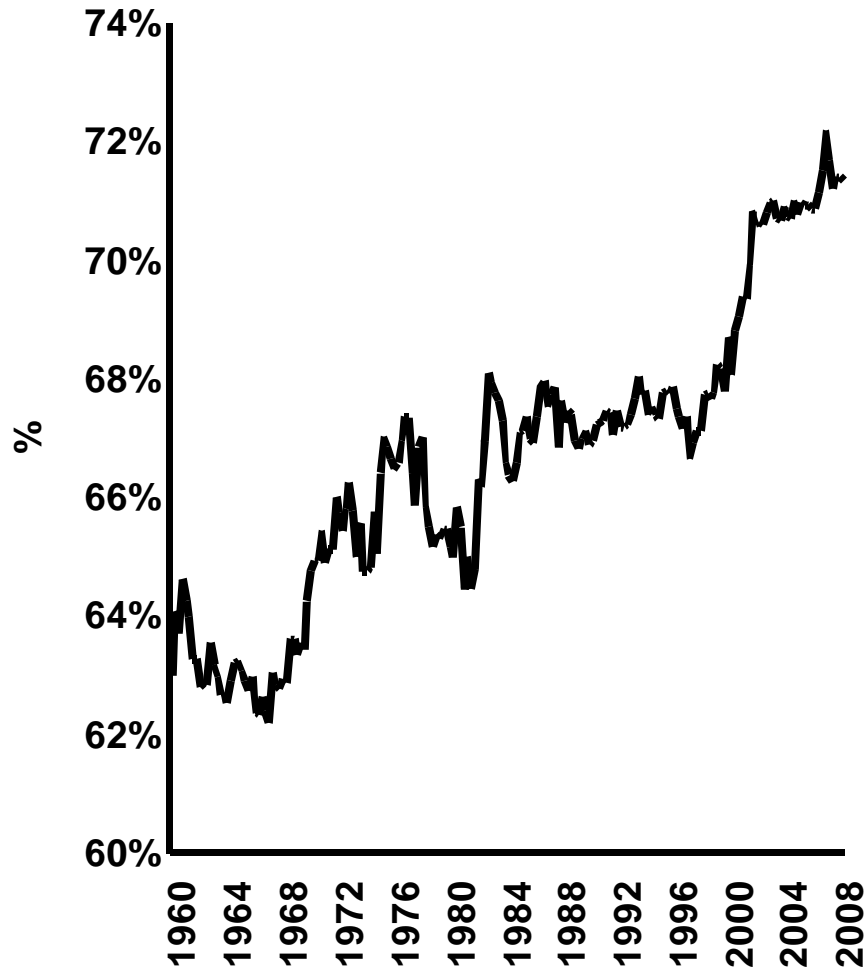
U.S. in Recession – Now What?



- ◆ **Recession began in December 2007**
- ◆ **Now spread beyond the consumer in a negative feed back loop**
- ◆ **No meaningful recovery expected until well into 2009**

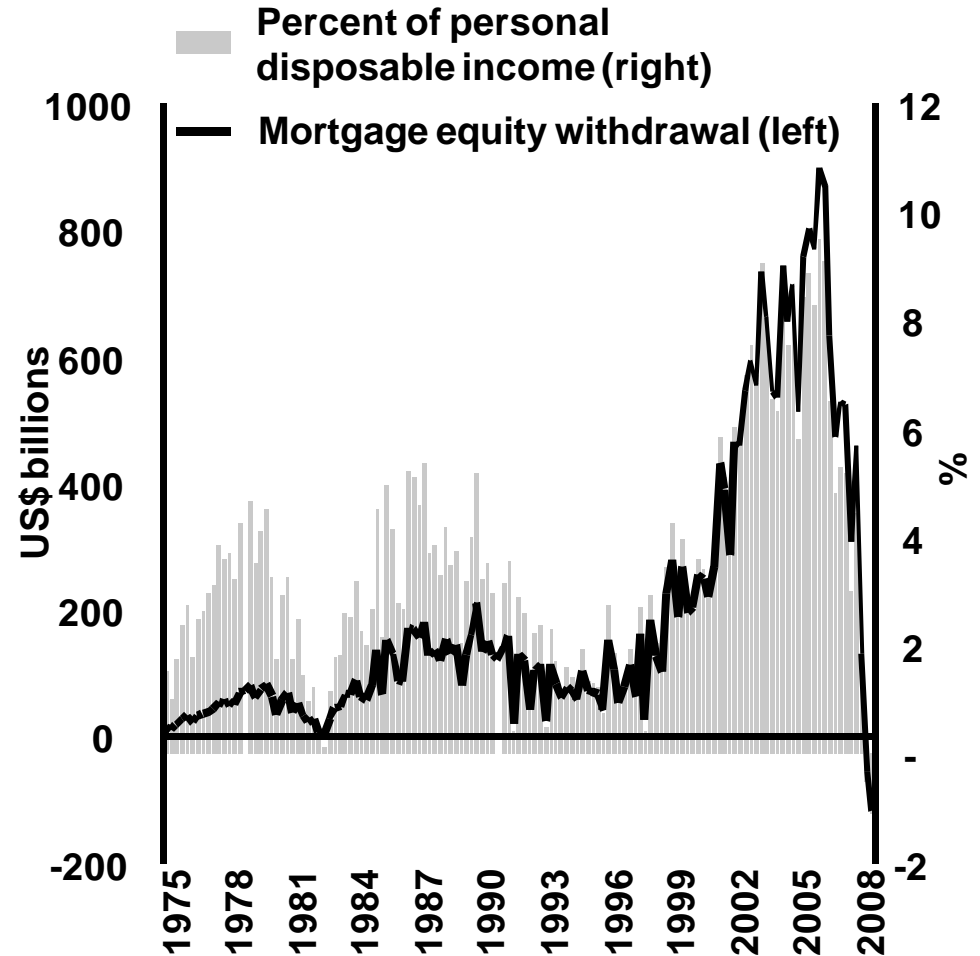
It's All About the Consumer

U.S. Real Consumer Spending Share of GDP



Source: US Bureau of Economic Analysis

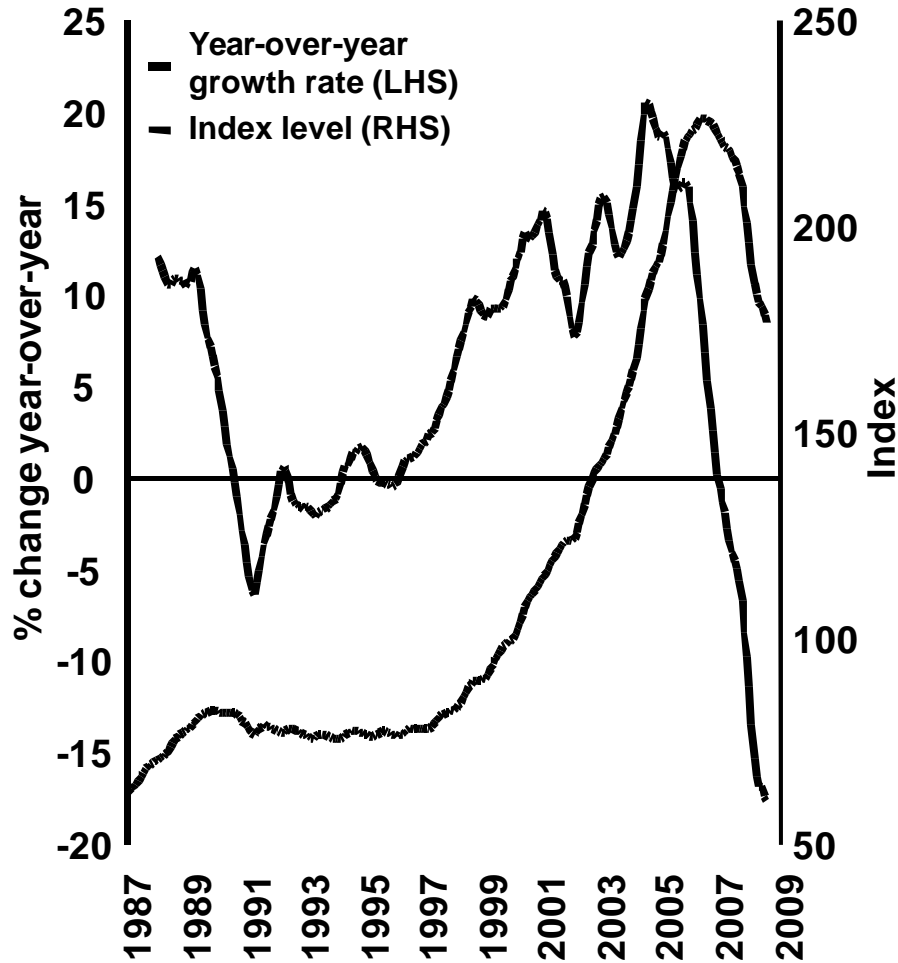
U.S. Mortgage Equity Withdrawal



Source: US Federal Reserve, BMO Nesbitt Burns, PH&N

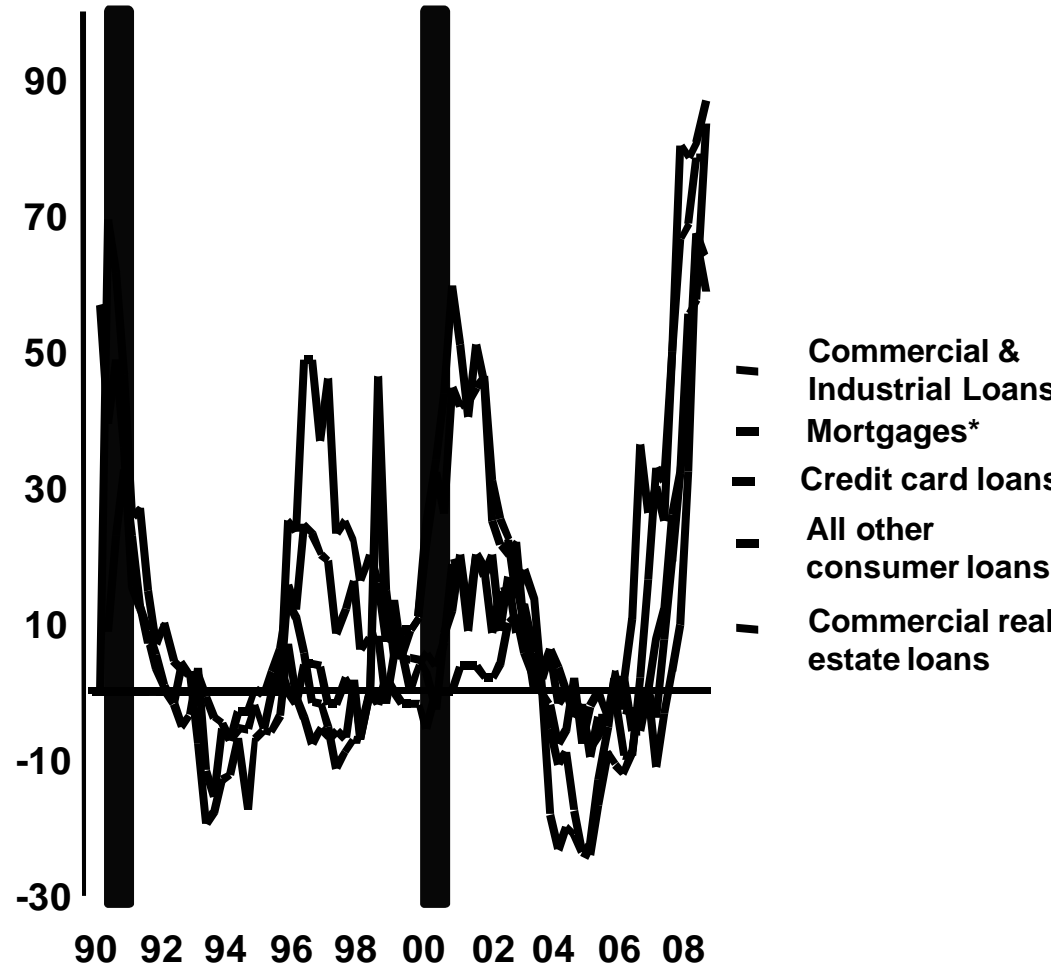
U.S. House Prices Falling – Credit Has Dried Up

S&P/Case-Shiller US Home Price Index



Source: MacroMarkets LLC

Banks Tightening Lending Standards

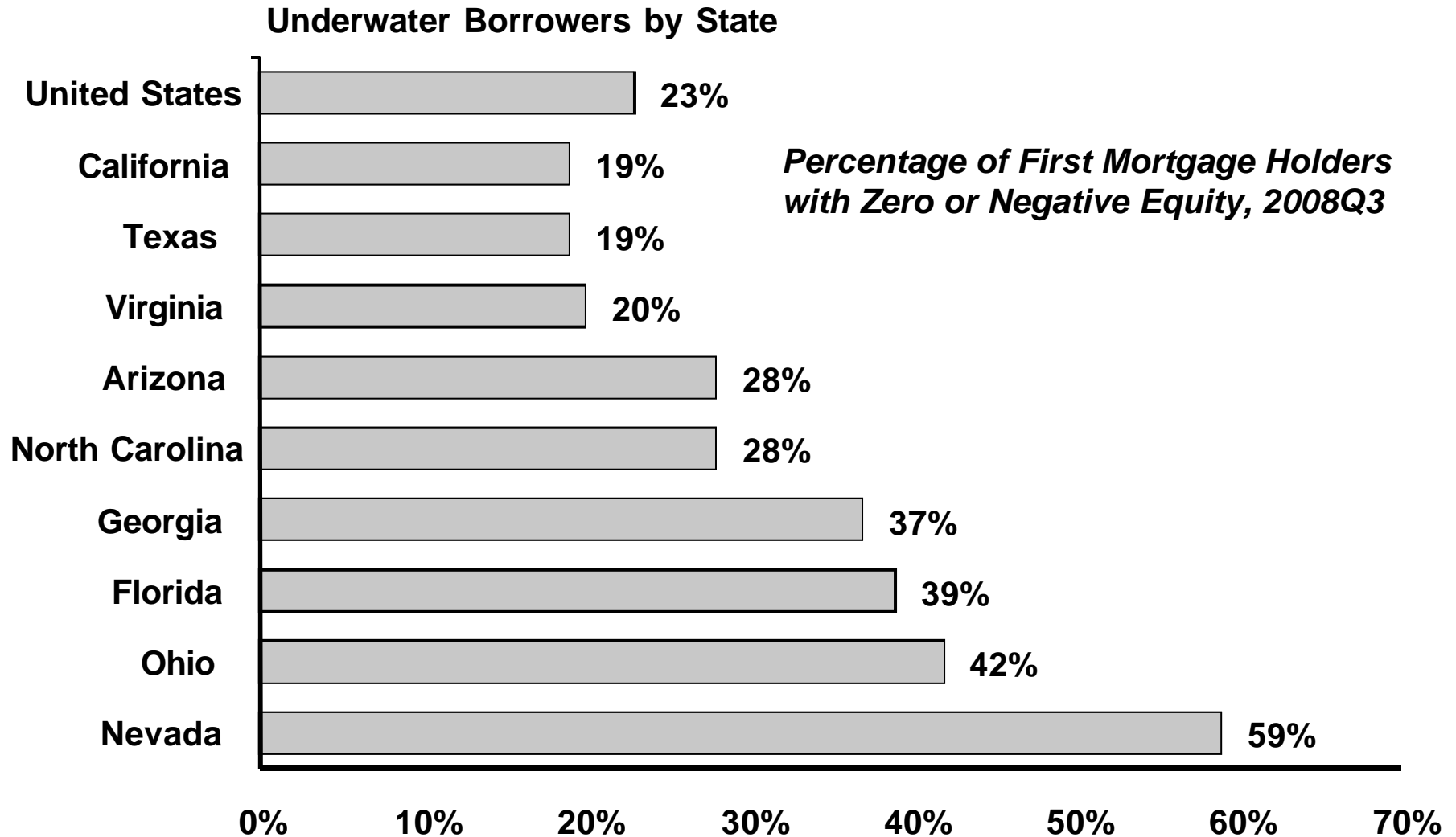


Shaded areas indicate U.S. recessions

*2007 Q2 onward calculated by PH&N

Source: Federal Reserve Senior Loan Officer

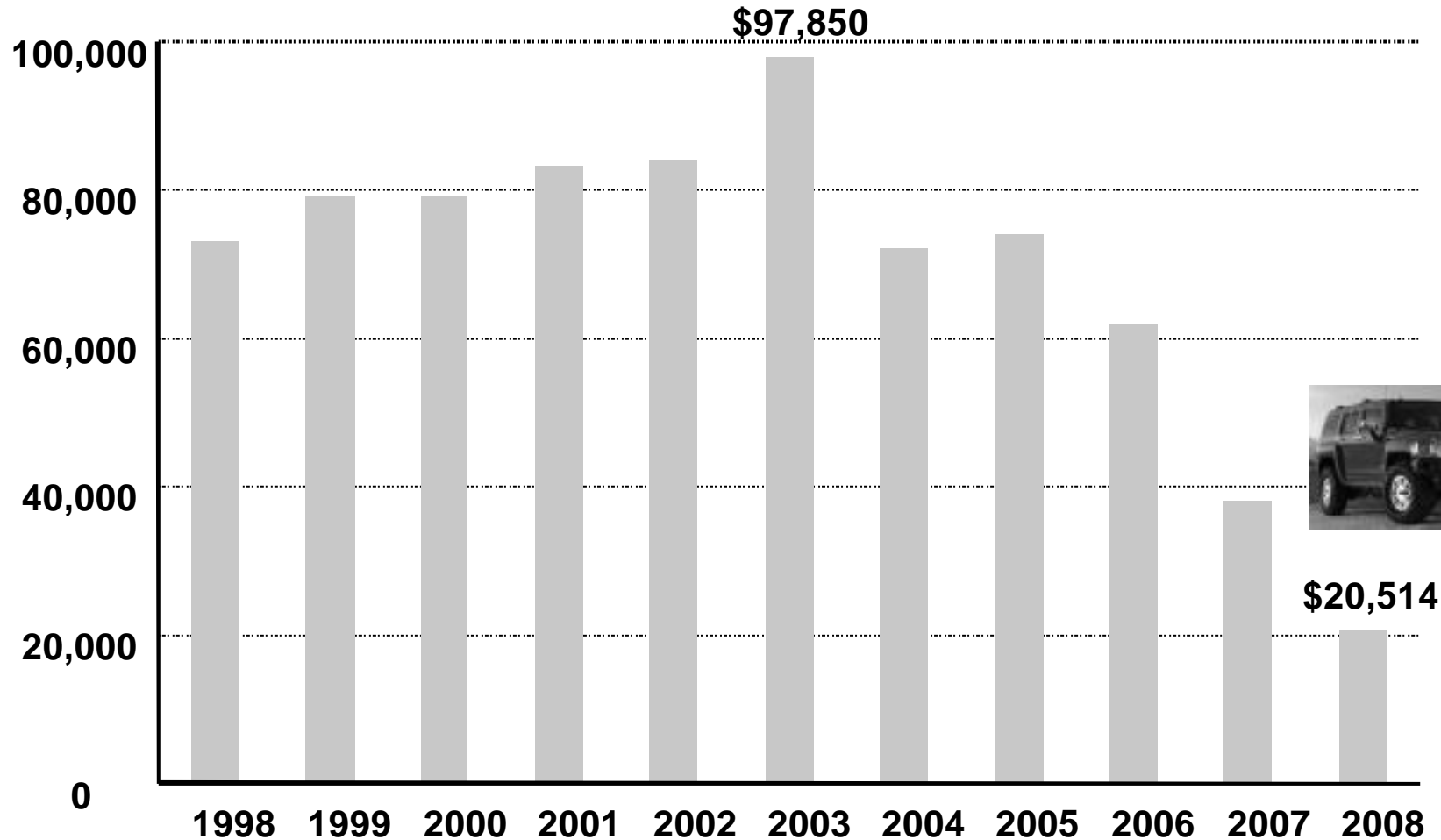
Many Borrowers Have 0% Equity or are Under Water



Source: Zelman & Associates, Equifax, Moody's Economy.com, Case Shiller

In Detroit Homes Cost About as Much as Cars

Average Home Sale Price in Detroit 1998 to 2008

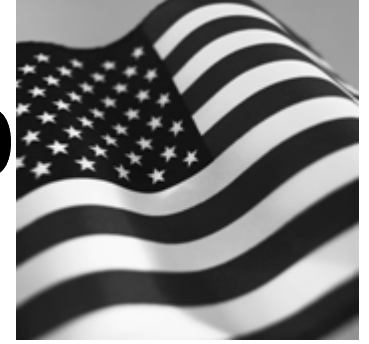


Source: Detroit Board of Realtors

Look What \$1.75 Buys You!



No Recovery Until Well Into 2009



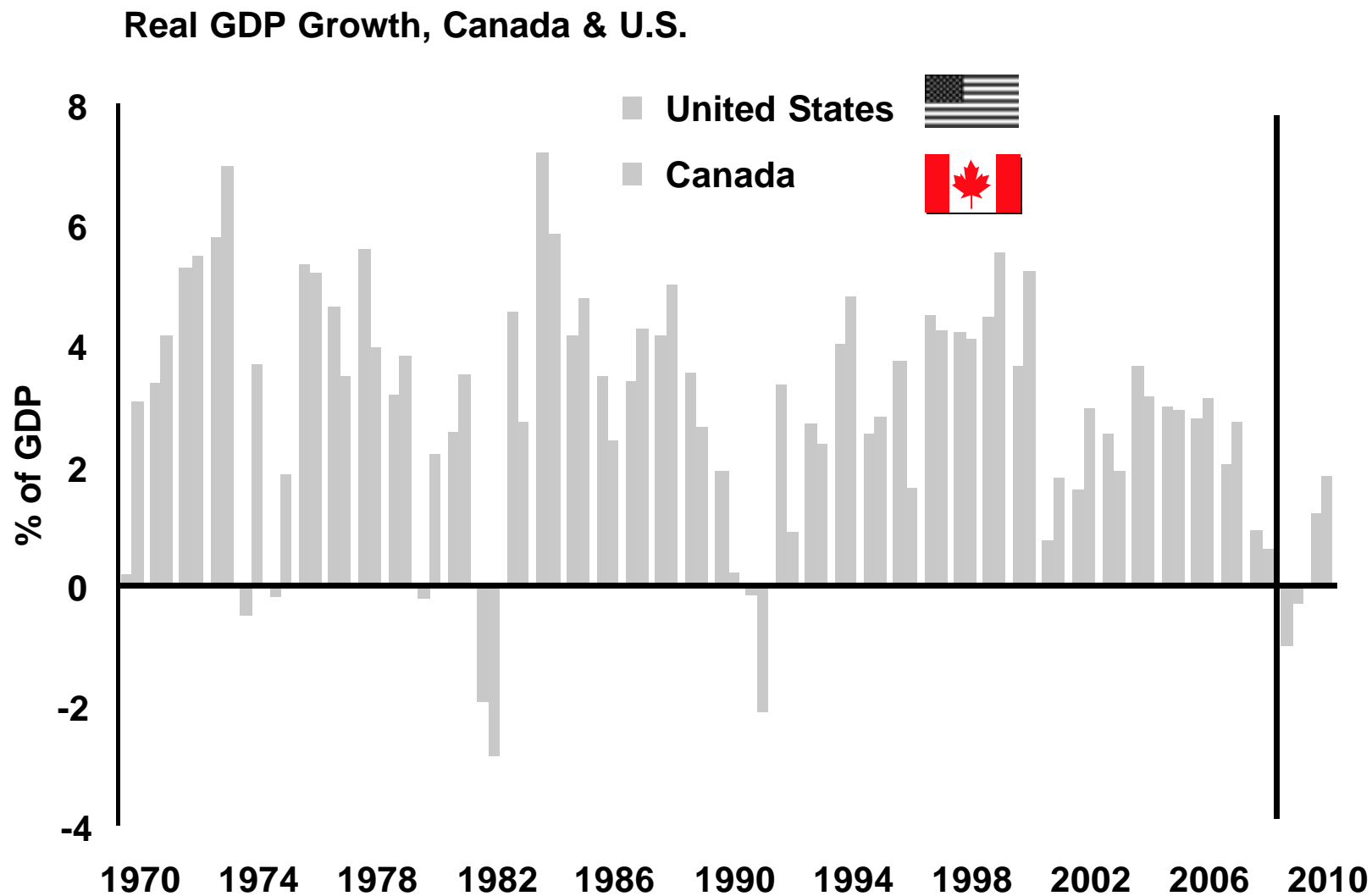
- ◆ **Depth of recession depends on policy response**
- ◆ **Further Fed easing ahead**
- ◆ **Additional fiscal stimulus package in the works**
– **budget deficit over \$1 trillion**
- ◆ **Unemployment rate will rise to at least 8.5%**
- ◆ **Rebuilding of savings will be a multi year process**

Canada Not Immune - Recession at Hand

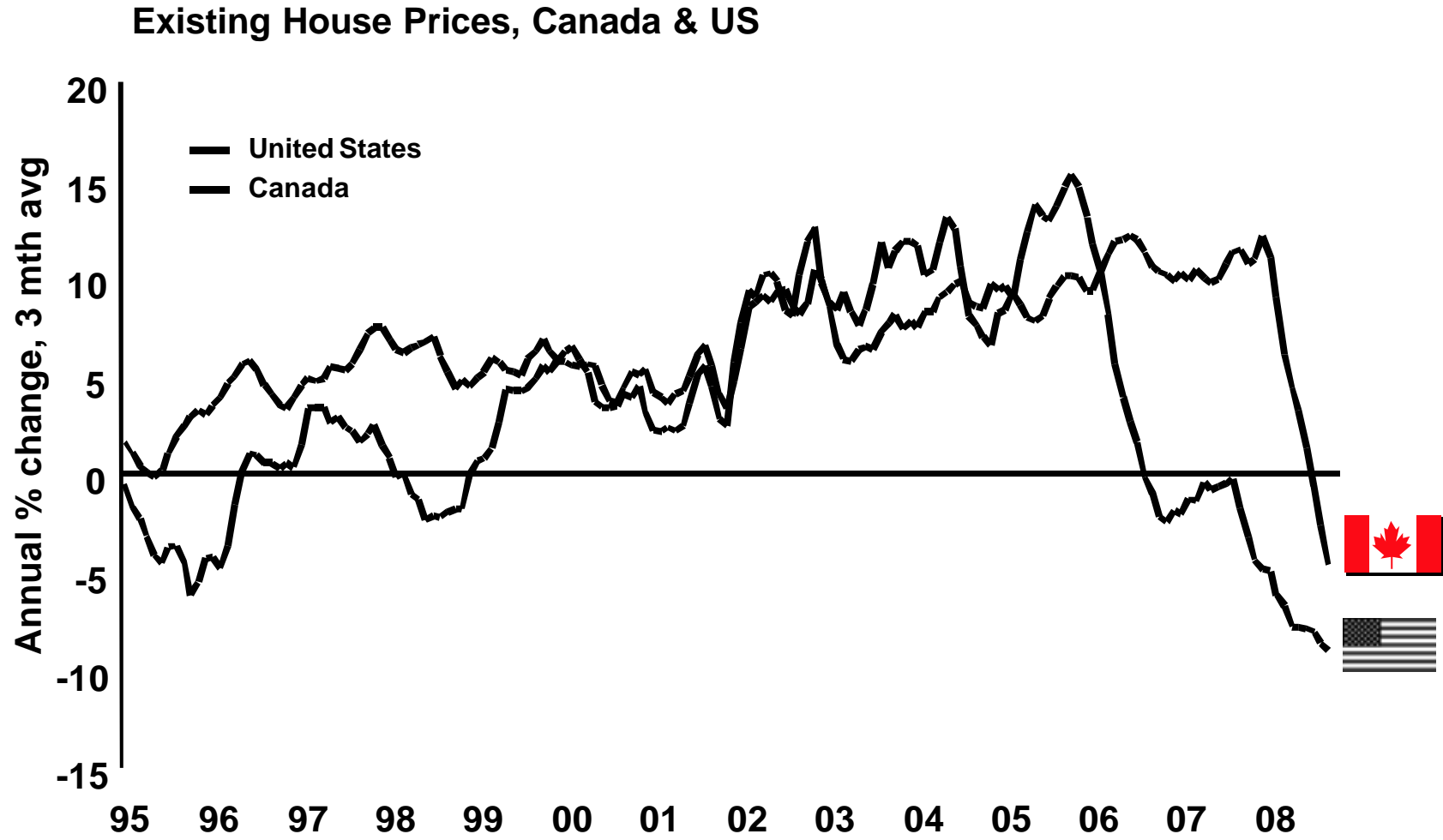


- ◆ **Canadian labour market now under pressure**
- ◆ **Consumer confidence at 26 year low – jobs at risk while housing markets cool off significantly**
- ◆ **Weak commodity prices resulting in resource projects postponed or scaled back**
- ◆ **Lower C\$ offers some relief**
- ◆ **Further fiscal/monetary stimulus likely**

The Recession of 2008/09



Canadian House Prices Cooling Off Quickly



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

Take Your Pick!

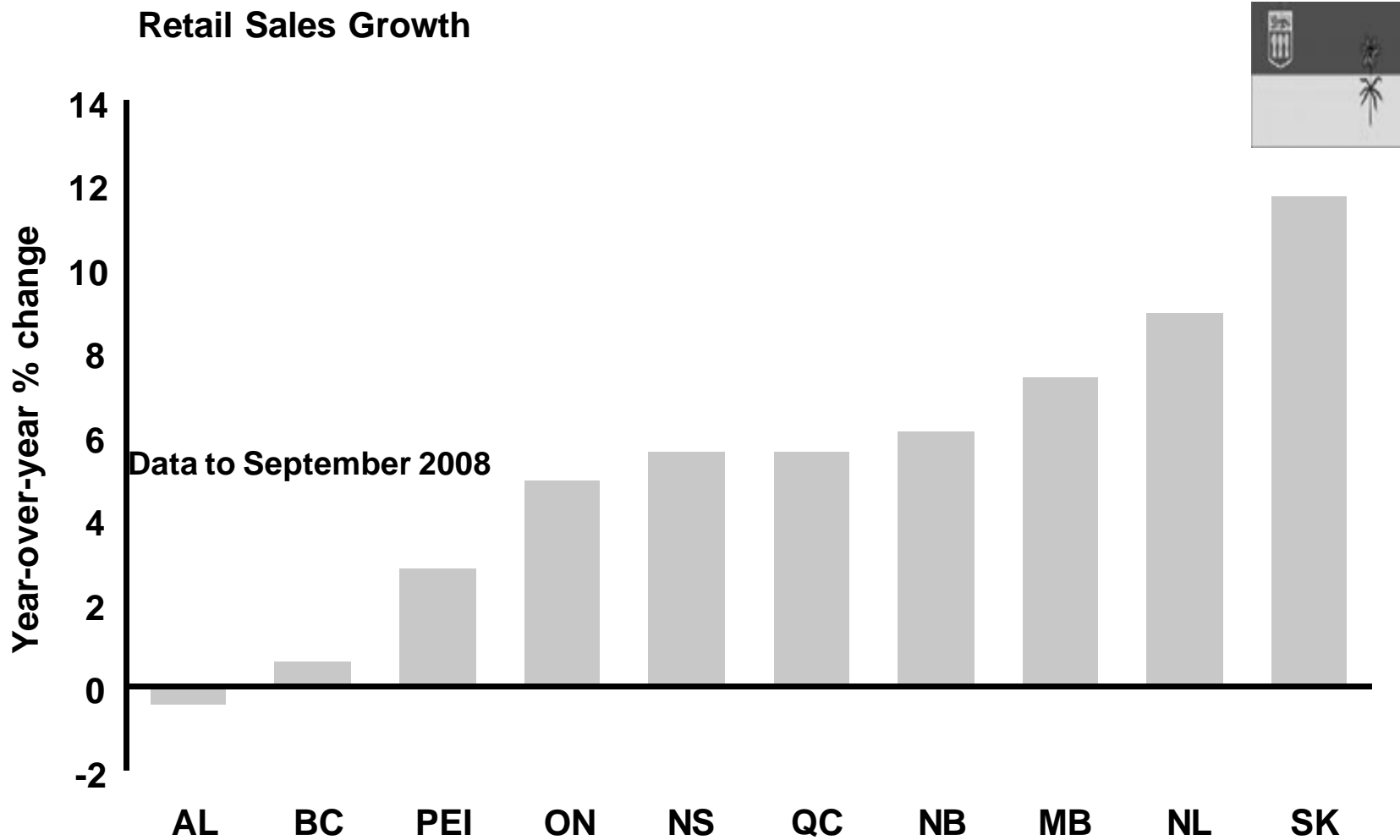


\$1,128,000 Marpole Vancouver



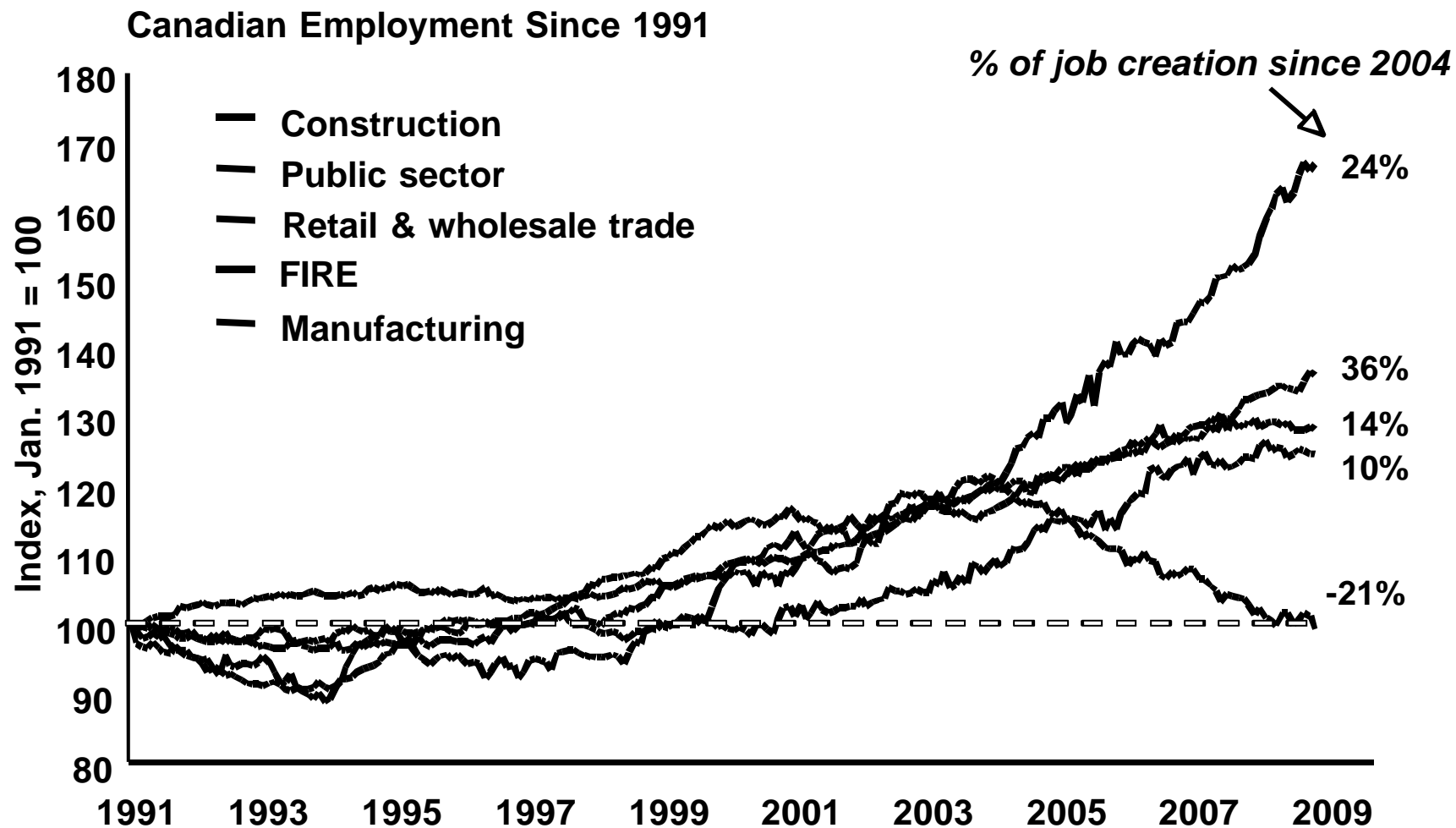
\$7,000 LESS in Normandy France

Shop Til You Drop in Saskatchewan



Source: Statistics Canada

Job Losses Ahead for Canada

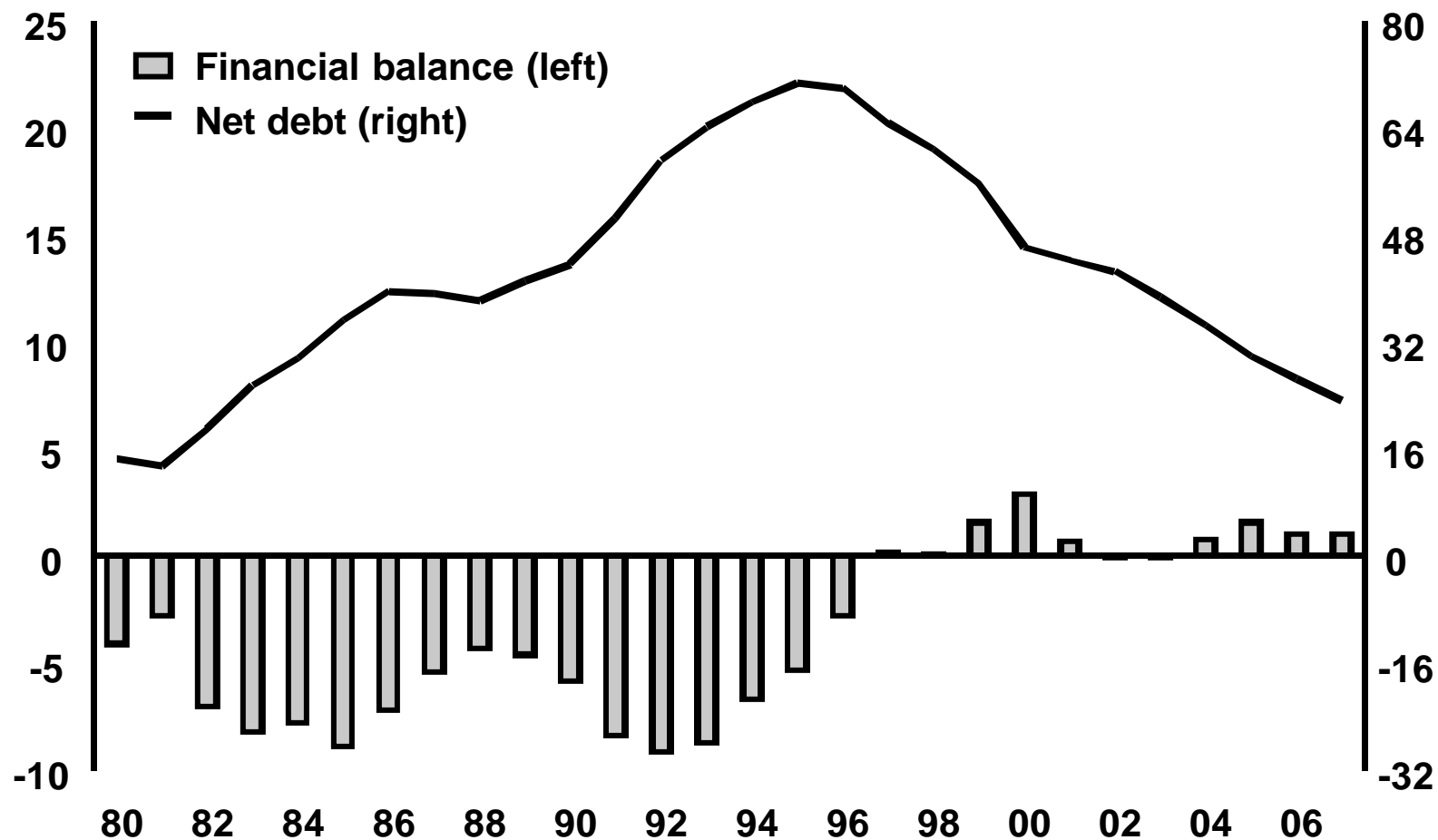


Source: Statistics Canada

Federal Deficit Inevitable



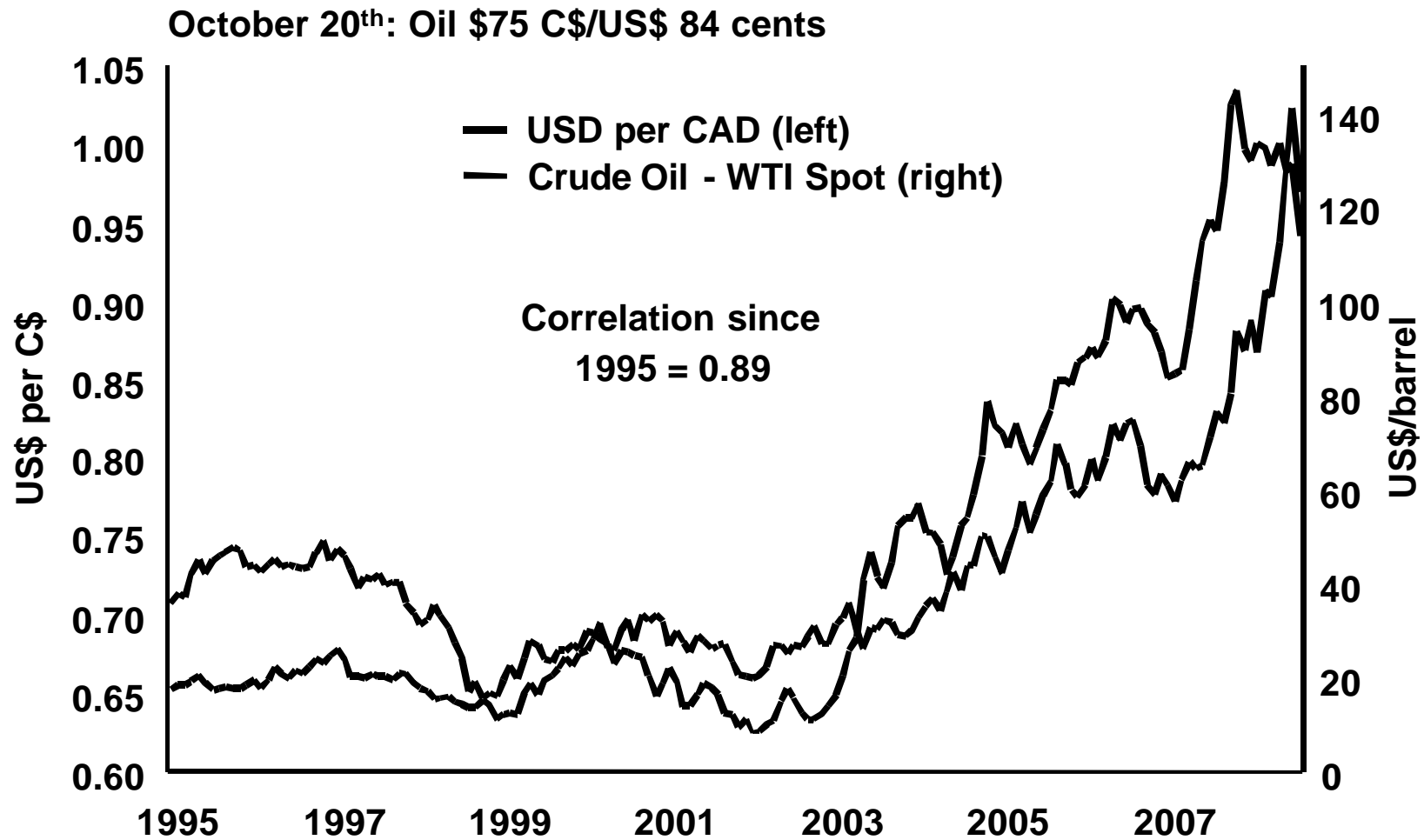
Canada: Deficit and Debt % of GDP



Data is general government, national accounts basis.

Source: Finance Canada, OECD Economic Outlook No. 83, June 2008.

C\$ Driven by Oil and US Outlook

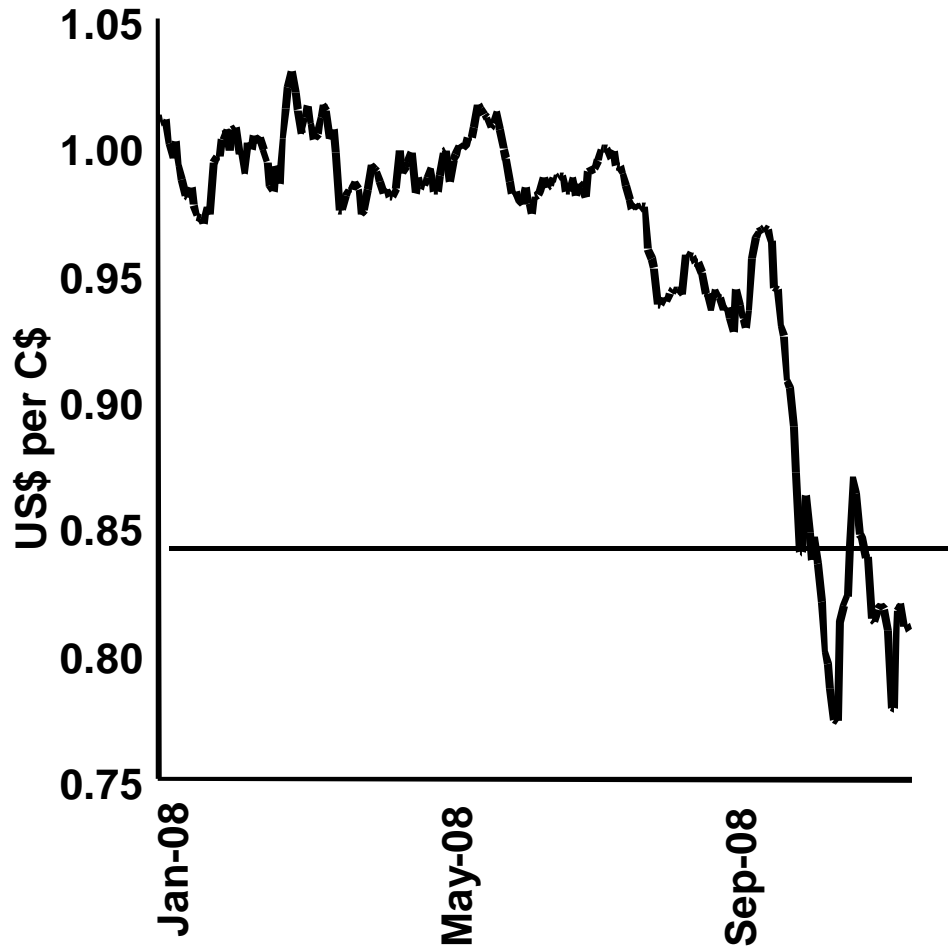


Source: Bank of Canada, Datastream

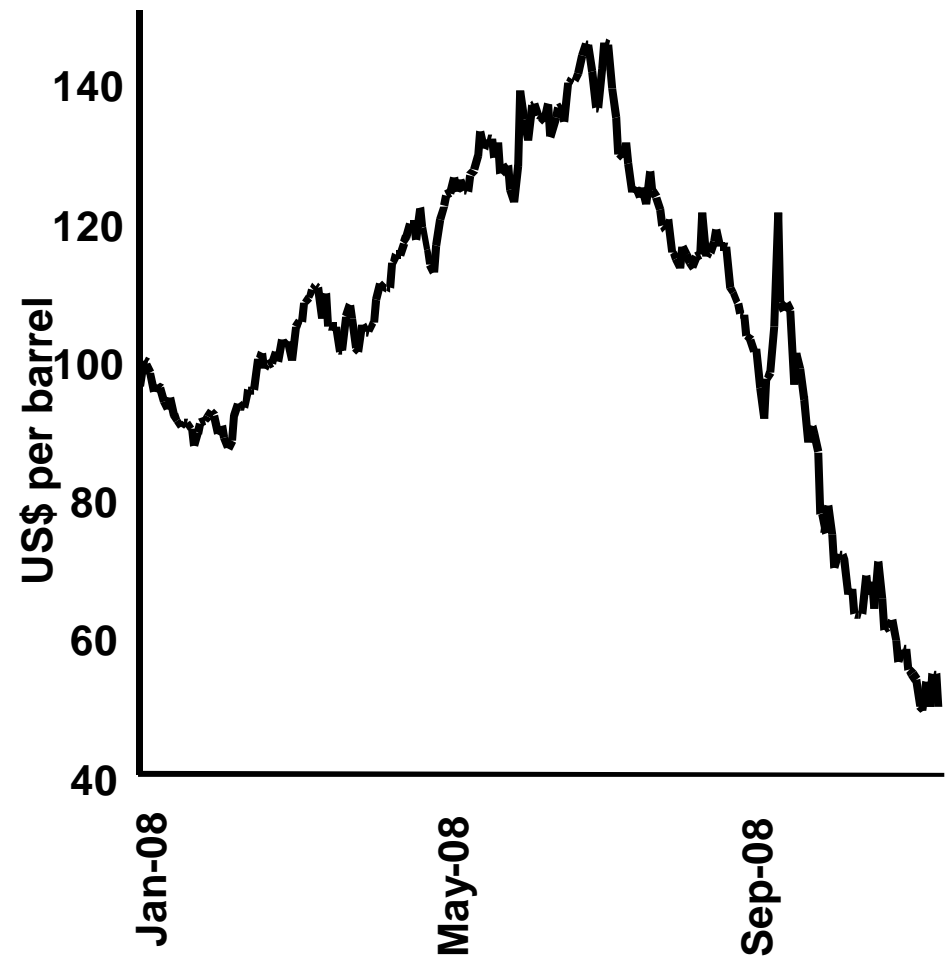
Loonacy?



USD per CAD

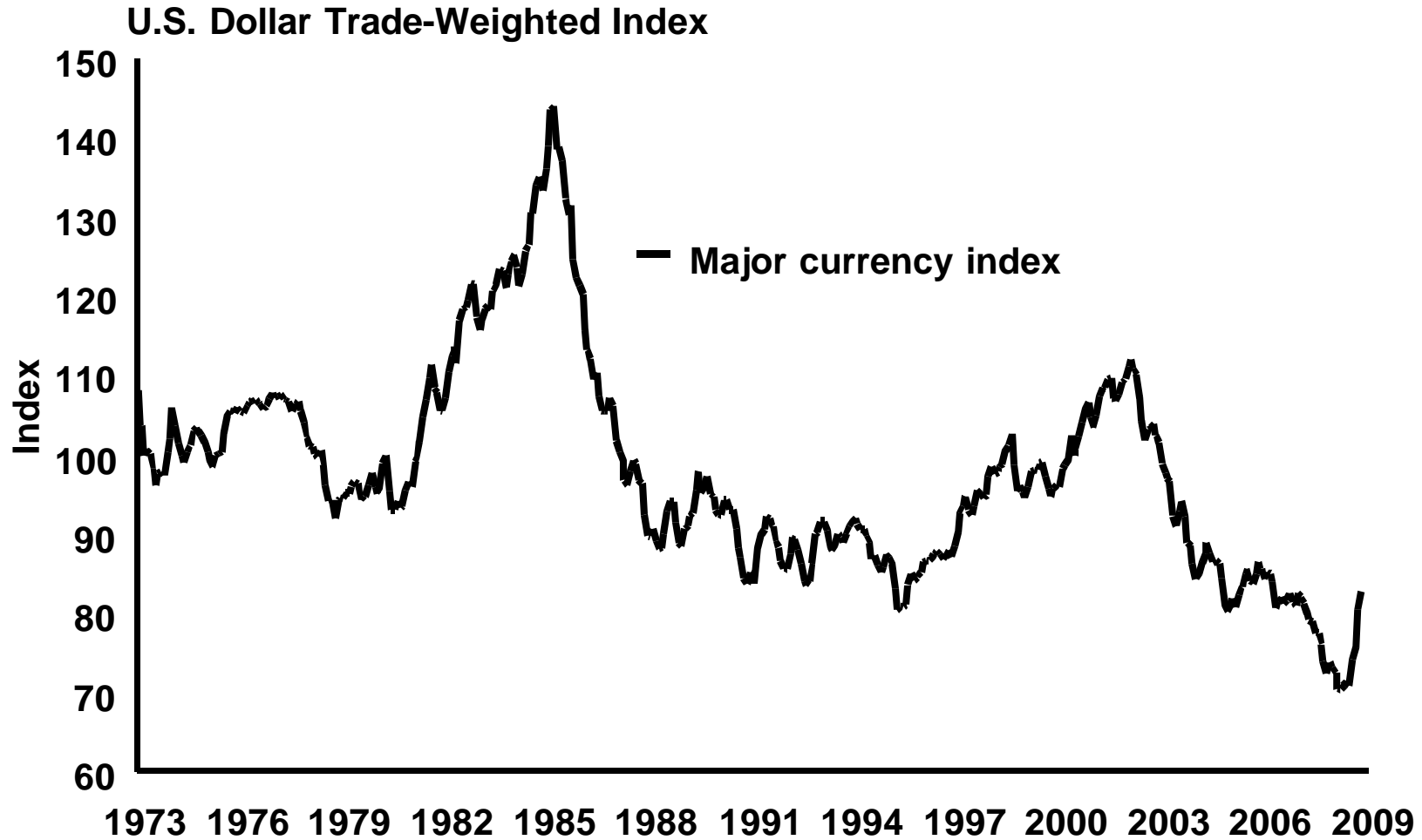


WTI Spot Price



Source: Bank of Canada, Datastream

U.S. Dollar Has Bottomed – For Now



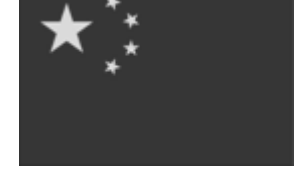
Source: U.S. Federal Reserve

World Economy In Recession – Worst Since 1980s

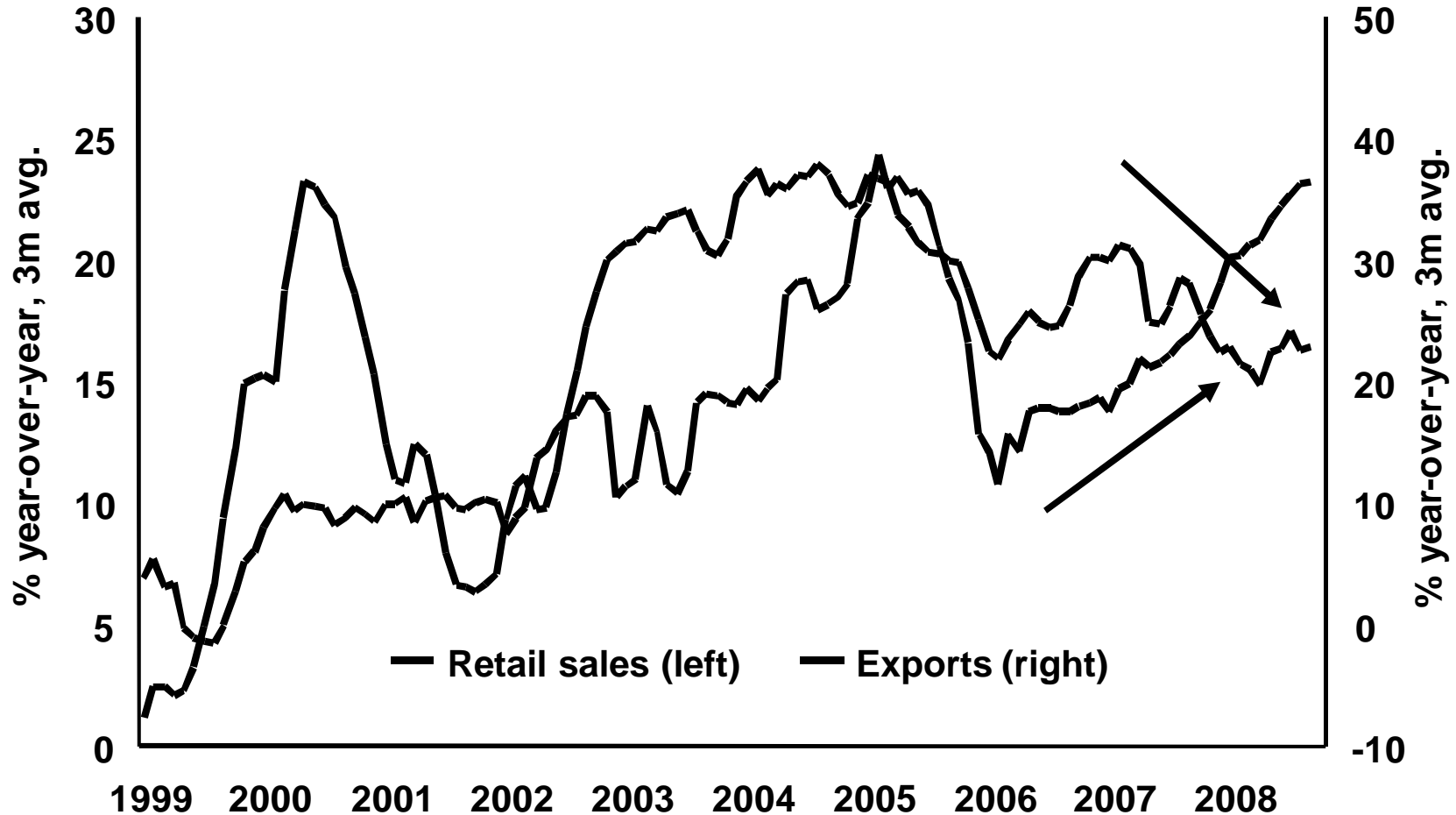
- ◆ **Europe in recession led by Germany, Ireland and Spain – ECB slow to cut rates**
- ◆ **Bank of England slashes interest rates, recognizing economy already in deep trouble**
- ◆ **Japan's economy fragile – strong yen won't help**
- ◆ **India slowing – central bank cuts rate for first time in 4 years**
- ◆ **China easing massively as economic growth stalls**

**World growth to slow to 1.5% in 2009 –
a deep recession Recovery a 2010 story**

China Feels The Impact of Globalization

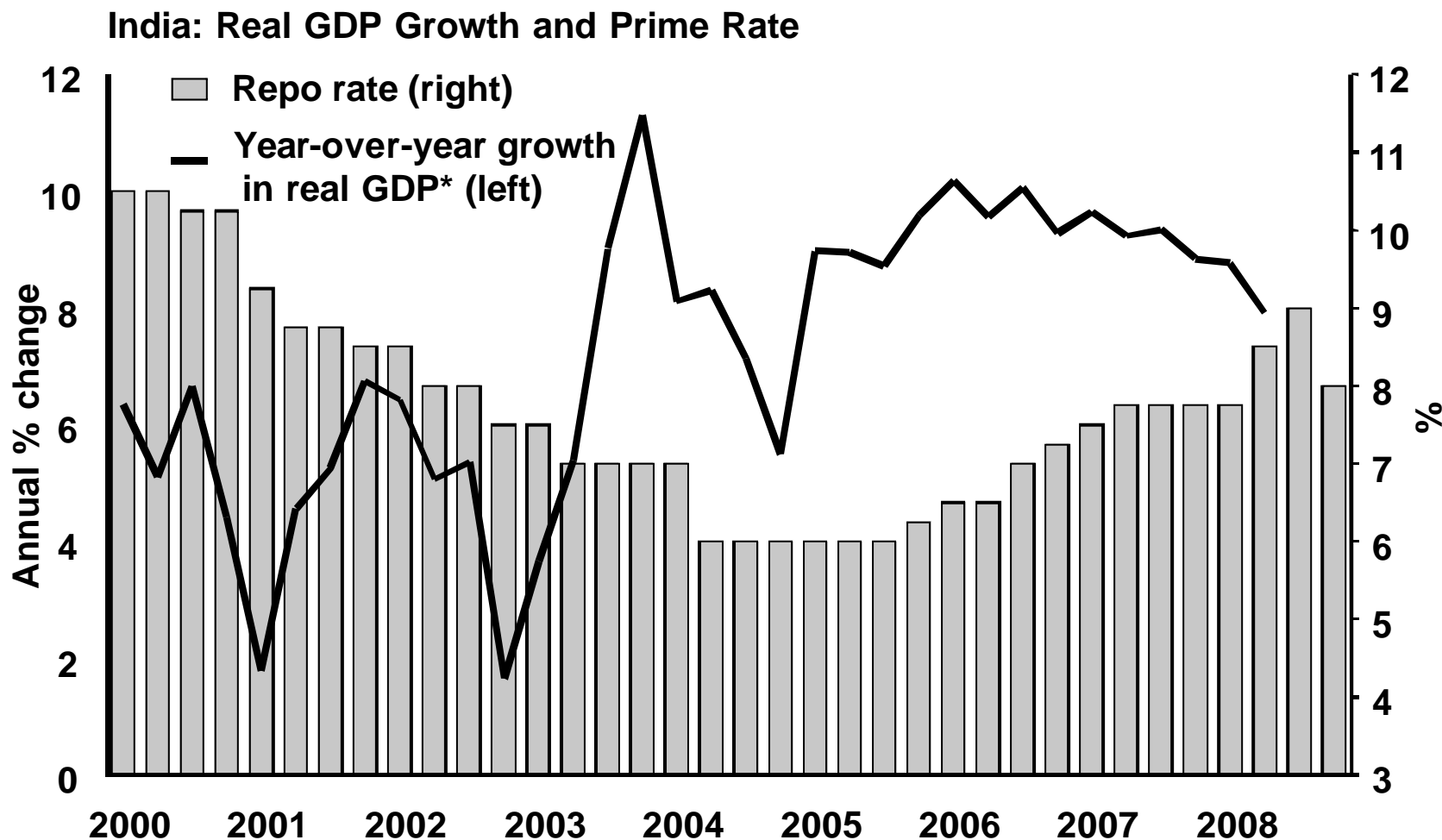


China: Retail Sales and Exports



Source: National Bureau of Statistics of China

India Cuts Rates As Growth Slows



*At factor cost

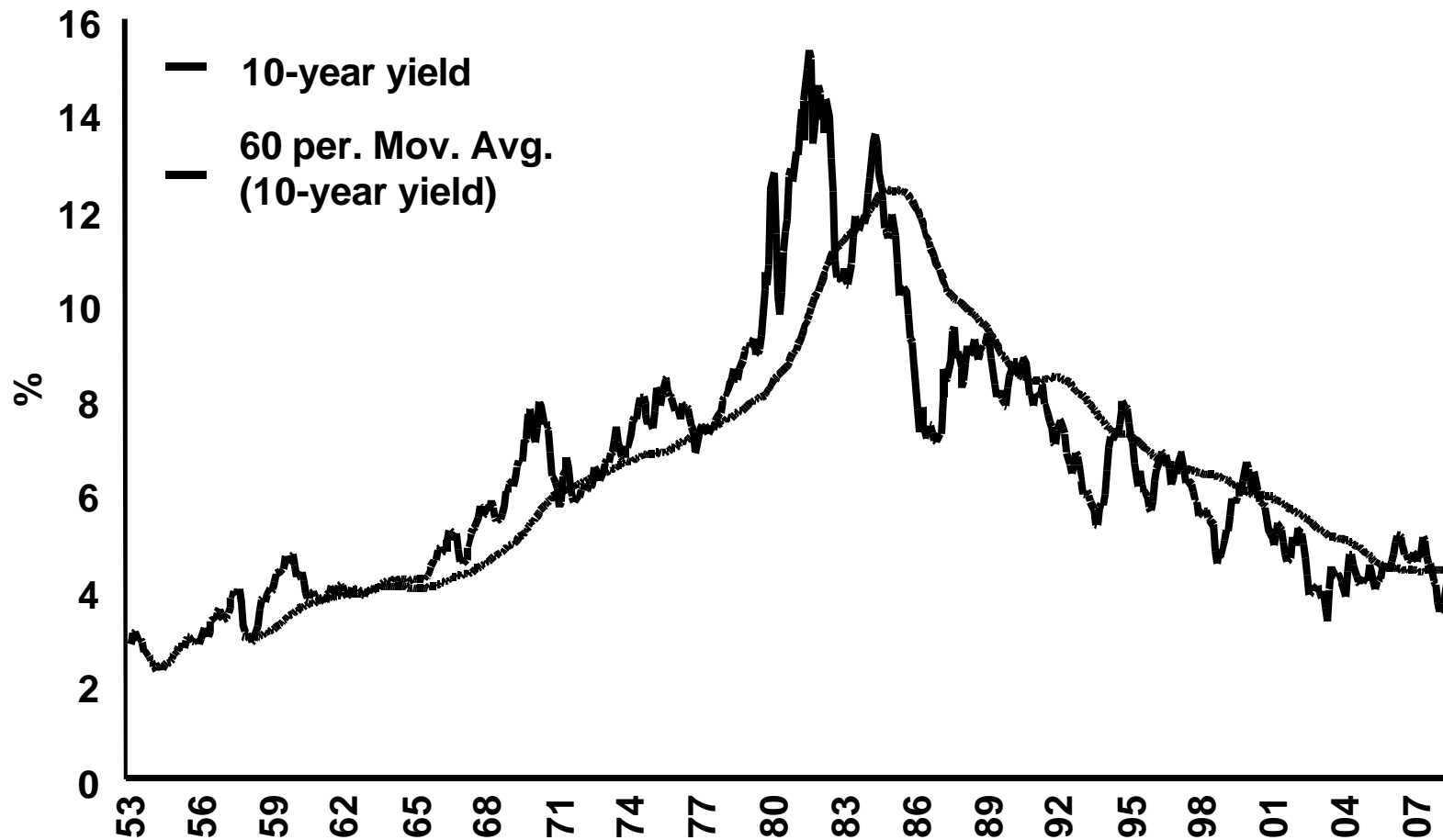
Source: Central Statistical Organization, India

2009/10 – Risky Business

- 1. Global financial system remains frozen**
- 2. Global depression and deflation**
- 3. Further fallout from credit crisis**
- 4. Geopolitical factors/protectionism/China/Russia**
- 5. President Obama – expectations so high**

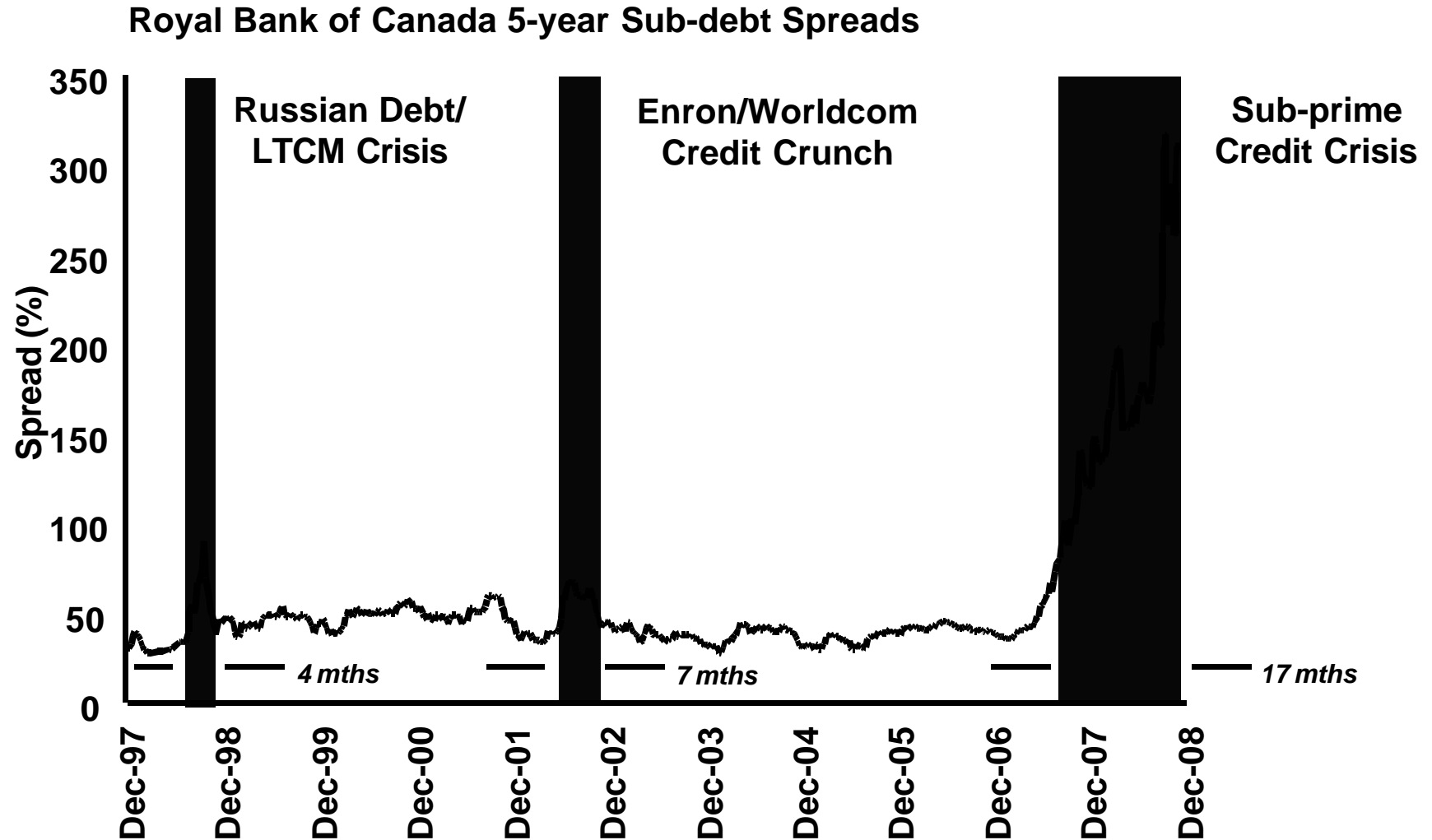
Long Term Downtrend Not Over Yet

U.S. 10-Year Treasury Bond Yield



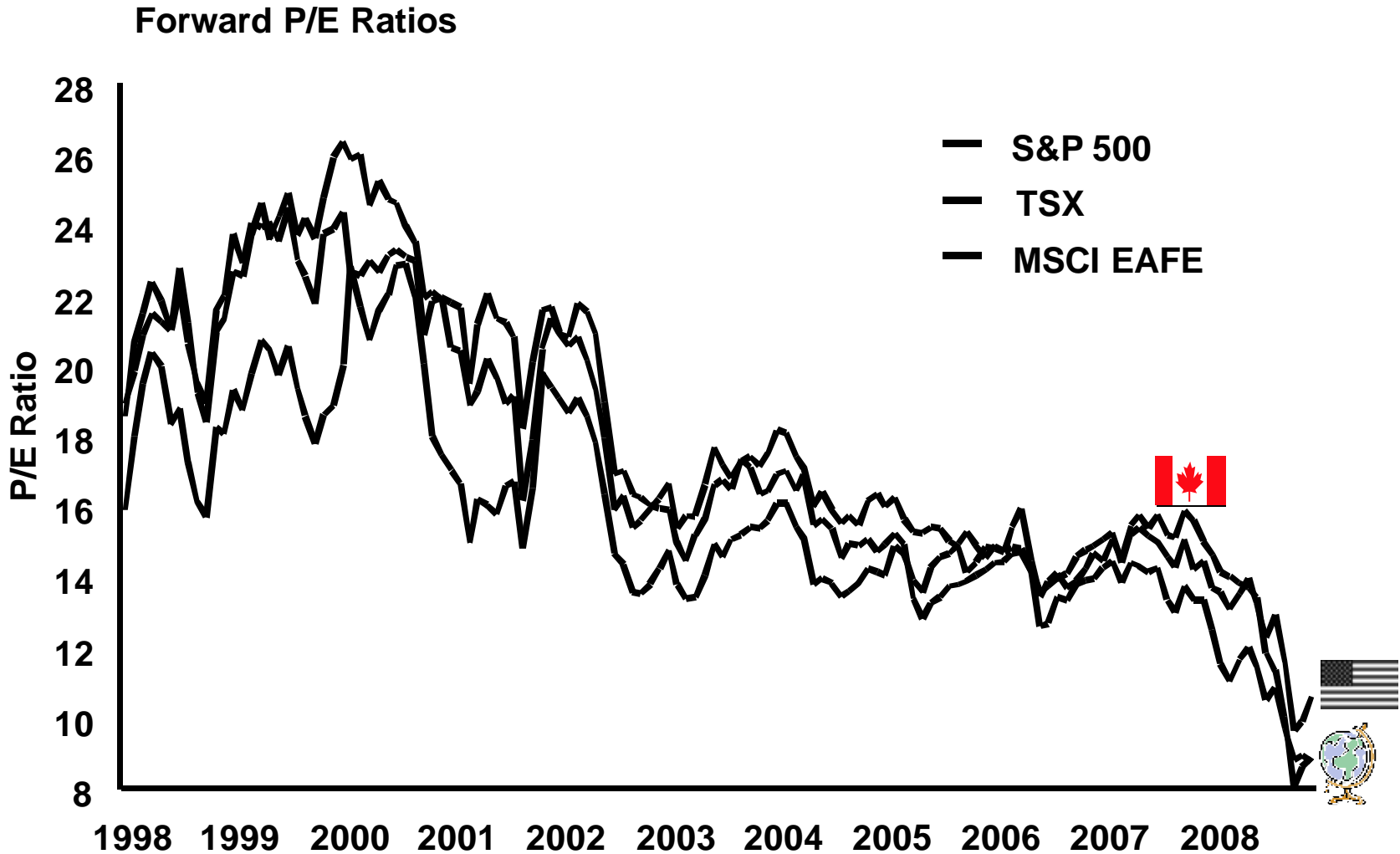
Source: U.S. Federal Reserve

Crisis Brings Opportunities



Source: credit\royalbank 11/28/08

Equity Valuations Look Very Attractive

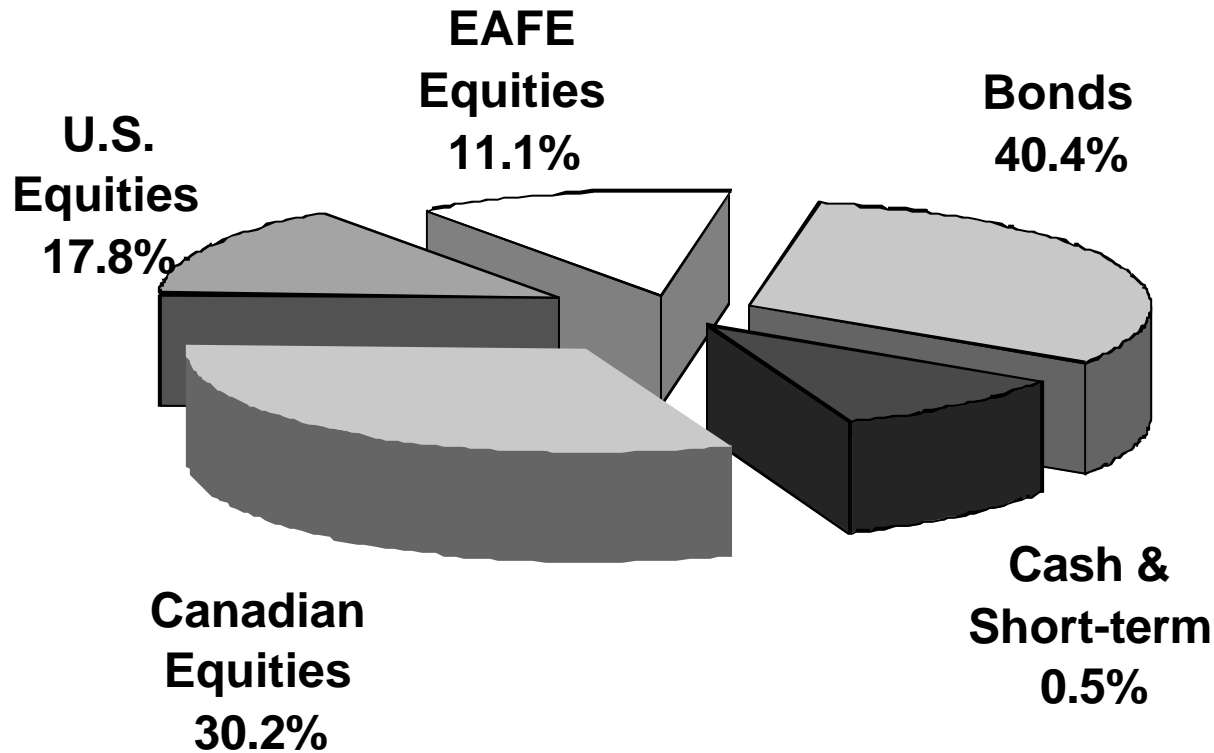


Source: I/B/E/S

PH&N's Asset Mix

Buying Stocks Amidst Uncertainty

PH&N Balanced Fund at Dec 3rd, 2008



Summary

- 1. World economy in recession – worst since 1980s – need more clarity to have more conviction**
- 2. Deflation fears will give way to inflationary concerns**
- 3. US consumer deleveraging could take years to play out – lacklustre recovery**
- 4. New era of interventionism, higher cost of capital, less use of leverage, higher risk aversion, more financial regulation**