

OUTLOOK 2009

What's Next for the Markets & the Economy

TRANSCRIPT

OUTLOOK 2009: A GLOBAL FORECAST & INVESTMENT OPPORTUNITIES FOR THE YEAR AHEAD

PANELISTS

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CHAPTER ONE

The Economy & the Markets

ADAM QUINTON: Gentlemen, thank you for joining me today. It's a great pleasure having you to share this discussion about the outlook for 2009, and I'd like to introduce you to our audience who are going to be watching: Rich Bernstein, Chief Investment Strategist; Dave Rosenberg, North American Economist; and Michael Hartnett, our Global Emerging Markets Strategist.

What's 2009 got in store? And Dave, I'll start with you. Perhaps you can give us the, the view on the economy. Is it going to get worse from here, and when does it start to get better?

DAVID ROSENBERG: Well, the economy is certainly going to get worse. I imagine Rich will talk about, you know, whether the markets are going to get worse or not. But there's no doubt, every leading indicator, all our tea leaves are suggesting that the economy is certainly going to deteriorate.

Economy will reach a bottom at end of '09 or beginning of '10.

--David Rosenberg

And our hope and our forecast is that we're going to reach some sort of bottom either at the end of the year or the beginning of 2010. This is not a garden-variety recession, or what we've been accustomed to in the post-World War II period that was brought on by either high and rising inflation or brought about by excessive manufacturing inventories like in technology or automotive or aggressive Fed tightening ... none of those. This is a balance-sheet recession. This is a new paradigm.

AQ: Housing prices peaked I think mid '06, so two and a half years ago now. As we go through '09, are house prices specifically going to hit a bottom and, if not recover, at least start to move sideways?

DR: Well, that's, that's a great question. When I take a look at the supply-demand contours right now, I don't have a good feeling, because we're over 11 months supply of unsold inventory in the new housing market. We have to get that inventory-to-sales ratio, Adam, below eight months supply, below eight months supply, before we can think of calling for an end to the real estate deflation.

This is a \$23 trillion asset class. There ain't nothing in the world as big as that. And so nothing really, as far as I'm concerned--I'm talking about the next sustainable bull market--the next sustainable economic expansion is not going to happen absent a recovery in residential real estate prices.

AQ: Rich, what about the markets? As Dave said, the economy is one thing; the market is another.

RICHARD BERNSTEIN: Well, I think we can really go out on a limb here and say that 2009 is likely to be better than 2008. I think we can say that with reasonable confidence.

Extreme levels of volatility will go down as '09 progresses.
--Richard Bernstein

You know, our models are showing that the extreme levels of volatility that my colleagues have correctly predicted for 2008 going down as the year progresses, which is good, because normally when volatility goes down, markets do tend to rally. Whether that rally is a sharp rally or not I think is open for discussion. But I think perhaps the worst of the storm is behind us. But that being said, we still think, for 2009, investors should keep pretty much of a defensive bias in portfolios, even if the market goes up.

AQ: And you've talked about in the past about as volatility goes down we see changes in leadership, so what does that mean in '09?

RB: It's hard to say how much but on the margin it's probably more bullish for the equity market overall. And people might say, "Why is that?" The simple explanation is that volatility is a measure of risk. As companies are perceived to be less risky their cost of capital goes down, they can borrow more easily and the economy begins to grow overall.

CHAPTER TWO

Is There a Silver Lining?

"Selectively, there will be some very good opportunities."

AQ: This is obviously a very difficult environment for, I was going to say, a lot of our clients, essentially all of our clients. Is there anything that any of you can see that would be what you might call a silver lining in this environment?

RB: There are areas of the markets which have become illiquid, and that's very bad for institutional investors because they need liquidity to trade back and forth.

Opportunity for individual investors in holding bonds to maturity.
--Richard Bernstein

For instance, if I'm going to hold a bond for two or three or four years to maturity, and I'm not particularly worried about inflation--which I'm not--then this is a great opportunity to take advantage of something that the institutional investors can't touch. And I think whenever individual investors are faced with that kind of situation, they should take advantage of it.

AQ: Michael, anything internationally that comes to mind that fits the same sort of description?

Less correlated stock market could create opportunities.
--Michael Hartnett

MICHAEL HARTNETT: The best news that could happen this year is we get a less correlated market and there's more market differentiation i.e. becomes instead of a, one big stock market with everything going up and down by the same amount, it becomes a market of stocks both here and internationally.

What Rich has just said with regards to fixed income, it's the same for equity. Selectively there will be some very good opportunities.

Any company that can exhibit growth and fairly steady growth is going to be a big, big out-performer, which is why the idea of large multinational companies that are what we call best of breed would work very well I think for an individual.

CHAPTER THREE **Politics & Fiscal Stimulus**

"We're going to get a large-scale fiscal stimulus."

AQ: Dave, what does politics mean for the economy in 2009?

DR: Well, we're going to get large-scale fiscal stimulus. There's no question about that.

Fiscal stimulus will combine tax relief with industrial policy.
--David Rosenberg

It's going to be a combination of immediate tax relief, especially aimed at low- and middle-income households, and, of course, some sort of urban renewal or some sort of major industrial policy. If it's done properly, it's going to raise our long-term economic potential; it's going to improve productivity; it's going to enhance labor ability; it is going to cushion the blow. I think people have to adjust their expectations as to the extent to which this is going to turn around the economy in year one.

AQ: So if this stimulus just cushions the economy, what does it do to the markets? Because, obviously, the stimulus is significant and in some way shifts the balance of the economy. So how does an investor capture the benefit of that? Which are the sectors to focus on?

RB: Well, the knee-jerk reaction is to go and say we should be buying consumer-cyclical type stocks, things like autos and housing and retailing and things like that. There's a great tendency for people to try and invest in these so-called early-cycle sectors, but right now it looks like it's too early to invest in the early-cycle sectors.

People should look at essentials, i.e., consumer staples & healthcare.
--Richard Bernstein

I would say people should still look at essentials, whether that be in the consumer-staple sector--things like foods and beverages and household products--or even the health care sector as well.

CHAPTER FOUR **Staying with Quality in 2009**

“Focus on income growth, safety, duration.”

AQ: Rich, '09 versus '08--are we sticking with quality? And, I know, to the point about asset allocation and bonds, I mean, you've been favoring a bigger proportion of fixed income in people's portfolios. I mean, is that changing as we go into '09?

RB: Not so far. Certainly, for the beginning of '09, we're sticking with our quality theme both on the fixed income and on the equity side. On the equity side, what you found in 2008 was that companies that were self-financing, that could still enhance shareholder value by increasing dividends or repurchasing shares, outperformed the market dramatically. And I think that's going to continue through most of 2009.

Quality is very important on the fixed-income side.
--Richard Bernstein

On the fixed-income side, quality I think is very, very important. I think there's a tendency to try and jump into lower-quality bonds and try and anticipate the narrowing of spreads. I think that that's going to be probably more risky than people think in the first half of the year. At the other extreme, Treasuries remain in a tremendous bull market, and for the first time in my career you identify a bull market and nobody wants to participate. It's really quite ironic.

DR: And Adam, in a deflationary environment, you know, just to reinforce what Rich is saying, it comes down to the characteristics we talked about before; it's about safety and it's about liquidity. So it means that you are not to focus on capital appreciation; you are to focus on income growth, safety, duration.

CHAPTER FIVE

Advice & Guidance from the Experts

“There are a lot of good companies that are a lot cheaper today.”

AQ: So let's get a little bit personal. We're all advising our clients, but we're also looking after ourselves and our families. So sort of going around the metaphorical table here, how do you think about investments just from a personal point of view, and are you doing anything within the context of your own personal portfolio that you think is worth sharing with people?

DR: Well, look, we're in a very epic period of our economical financial history. The fact is: what we have really is we have a global recession on our hands of significant proportions ... lots of uncertainty. So I say the theme is very simple, very elegant theme, not a complicated theme ...

In periods of uncertainty, fixed income and gold are key “themes.”
--David Rosenberg

... I want to own fixed income. I also would say that gold--and I'm not just saying this because I'm a Canadian--is going to be very attractive. What is a hedge against uncertainty? And gold certainly fits that bill.

AQ: So Rich, what's your advice to yourself?

RB: What's my advice to myself? I've been telling myself that I should be looking at some of these opportunities in the fixed-income markets right now. The other thing that I would look at, getting back to what everybody said ...

Look at high-quality, large-cap, dividend-paying companies.
--Rich Bernstein

...is high quality, large-cap, dividend-paying companies that have secure dividends. There are companies in the S&P 500 that are yielding 5%, 6% and 7%. And I think any investor who is interested in secure income for the next several years with maybe a call option on the economy's growth should be looking at these companies with these very stable secure yields.

AQ: Michael?

Take advantage of market weakness to buy good companies.
--Michael Hartnett

MH: Well, again, I'll come back to this, using the volatility that we saw in 2008, the market weakness that we saw in 2008, to buy good companies. I mean, it's just one of the oldest lessons. If you buy good companies you're going to do well over time, and I think that there are a lot of good companies that are a heck of a lot cheaper today than they have been over

the last sort of three, four years. And this is not to say that there's going to be a raging bull market. I don't think anyone believes that for a moment.

But I think that next year the big change will be from enormous correlation across all stocks to a lot of differentiation between winners and losers. And, arguably, what you'll see in 2009 is one of the great stock-picking paradise environments that we've seen for a very, very long time.

AQ: Gentlemen, great discussion. Thank you very much.

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