



**“Be Fearful When Others Are Greedy And Greedy When Others Are Fearful” - Warren Buffett**

<p><b>Canada</b></p> <ul style="list-style-type: none"><li>➤ Canadian economy and banking system faring well through global slowdown</li><li>➤ Inflation moderating, monetary tightening on hold through first half of 2012</li></ul> <p><b>United States</b></p> <ul style="list-style-type: none"><li>➤ U.S. economic expansion continues in the third quarter despite persistent European headwinds</li><li>➤ Housing market stabilizing across most regions</li><li>➤ Private sector adds 140,000 new jobs in October</li><li>➤ U.S. debt super committee to report recommendations to Congress on November 23</li></ul>	<p><b><u>Third Quarter 2011: A Greek Tragedy Nears its End</u></b></p> <p>The long running soap opera with Greece, and its untenable debt position, continued to haunt stock markets for most of the third quarter of 2011 ending September 30. During the quarter, global stock markets declined by an average of 17% as panic again gripped investor’s imagination.</p> <p>Yet despite all the turmoil, a cynic would wonder what the fuss is all about? After all, Greece has a long and sordid history of financial mismanagement. Since 1826 Greece has defaulted on its debt five times, most recently from 1932 to 1964. In fact since Greece was an independent country in its current form, it has been in default for more than 50% of its existence.</p> <p>As we wrote in our last two quarterly reports, we believe that Greece will default yet again and that this eventuality is well understood by the financial markets again (note: on October 26 Greek debt holders “voluntarily” agreed to a 50% write down of their investment, thus technically avoiding a default by Greece). Since we last wrote on this issue in June, the majority of European banks have written down their Greek debt holdings by 50% or more, meaning that most of the economic losses have now been absorbed by the equity holders of French, Greek and German banks.</p> <p>Looking out further, our view is that Europe is slowly moving toward a more comprehensive economic and political union with a central taxation and budget authority residing in Belgium. Once in place, the current hodge podge system of each European Union member state issuing its own debt will be replaced with a region-wide Euro Bond. A Euro Bond will borrow at the economic weighted average of all of Europe, thus ensuring that a relatively small regional player such as Greece will not have a major impact on the global banking system and economy in the future.</p>
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<p><b>Europe</b></p> <ul style="list-style-type: none"> <li>➤ European economic growth grinds to a halt during third quarter</li> <li>➤ European banks to raise 400 billion Euro to comply with new Basel III capital requirements</li> <li>➤ Euro-region bank layoffs top 85,000 for the year</li> <li>➤ European Central Bank (ECB) lowers interest rates from 1.25% to 1.00%</li> <li>➤ Italian bond yields continue to spike higher suggesting little or no confidence in ability of Italy to manage their debt loads</li> <li>➤ European member states create \$USD 1.5 trillion emergence lending fund</li> </ul> <p><b>China</b></p> <ul style="list-style-type: none"> <li>➤ Chinese inflation</li> </ul>	<p>Greece aside, economic growth in the U.S., Europe and even China has slowed from the first quarter of 2011. Partially this is a result of two transitory factors: the spike in the price of oil from the shock of the civil war in Libya; and the disruption in the global supply chain after the Japanese tsunami of March 2011. It could also be argued that the U.S. Federal Reserve, through its so-called “quantitative easing” program, created unnecessary inflation in many commodities including oil, agricultural commodities, and textiles.</p> <p>In addition to these economic factors, the global economy is also suffering from a lack of confidence in our governments, especially in Europe. The result of this loss of confidence is hard to quantify, but is certainly one of the reasons for the recent weakening in global growth estimates. The short-term slowdown in the global economy has reduced speculation in the oil markets, with crude falling from a high of about \$110 per barrel in March to a low of \$79 in September. In turn, gasoline prices have moderated, which will help with consumer sentiment and consumer spending going forward. In Japan, full power has been restored throughout the Japanese electrical grid, and the supply chain is coming back to normal at a faster than expected rate.</p> <p>However, despite these improvements, consumers in the U.S. are still struggling with high debt levels, and are responding by increasing their savings rates. The desire to reduce debt at the consumer level, combined with slowing government spending going forward, will mean relatively slow economic growth in the U.S. for years to come. In turn, high savings rates will keep interest rates low and inflation in check.</p> <p>Along with Europe, the great wild card in analyzing global economic trends today is China. On the surface, Chinese economic growth appears to be very strong at 9.6% per annum. However, these high growth rates are almost entirely driven by two factors: real estate development, and infrastructure spending. Consumer spending remains a relatively small percentage of the Chinese economy (36%) as Chinese citizens</p>
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<p>rates and economic growth beginning to moderate</p> <ul style="list-style-type: none"> <li>➤ Chinese government continues to tighten capital availability for speculative real estate lending</li> <li>➤ Beijing and Shanghai housing and office prices down more than 20% from peak</li> <li>➤ Housing prices across 100 largest cities x-Beijing and Shanghai unchanged year-to-date</li> <li>➤ Interior region housing construction in China to average 4-5 million new homes per year for foreseeable future</li> </ul>	<p>are prodigious savers, in part to make up for a lack of government supported social security, unemployment insurance and health care. So the big question when looking at China, is just how sustainable is its growth rate going forward?</p> <p>There certainly is evidence that the coastal regions of the Chinese real estate market are in a valuation bubble, and the government has reacted by severely restricting the availability of mortgages. They are also using the state-owned banks to provide cheap construction loans to real estate developers in order to increase the supply of new homes. Together, this will either create a “soft” landing for their real estate market or, worse case, a crash. Either situation is likely to slow Chinese economic growth going forward. On this front, the most recent economic data out of China is encouraging in that consumer spending and the service sector of their economy continue to expand at targeted rates.</p> <p>With respect to investment spending on infrastructure projects, the Chinese government is sitting on \$US 3 trillion of foreign reserves, and can fund investment projects almost indefinitely. Investment spending represents about 35% of the Chinese economy and continues to expand rapidly. Taken together, we believe that consumer spending and infrastructure will continue to grow, but real estate spending will decline. Overall growth in China is likely to slowly decline from today’s headline numbers of 9.6% to a more sustainable 7.5% rate over the next several years.</p>
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**Economic Outlook 2011-2012:**

**Main Street Growth Slowing** – All-in-all, recent geopolitical events will cause a measurable reduction in global growth, while ensuring that short-term interest rates will remain at extremely low levels. The most recent long-term, global growth projection from the IMF (International Monetary Fund) is for 3.4% annual economic growth, which is down about 1.0% from earlier this year. Driving much of this anticipated growth is Asia ex-Japan which is forecast to continue to grow at about 6.8% per year. This macro environment, while slower than we would like, continues to be supportive for

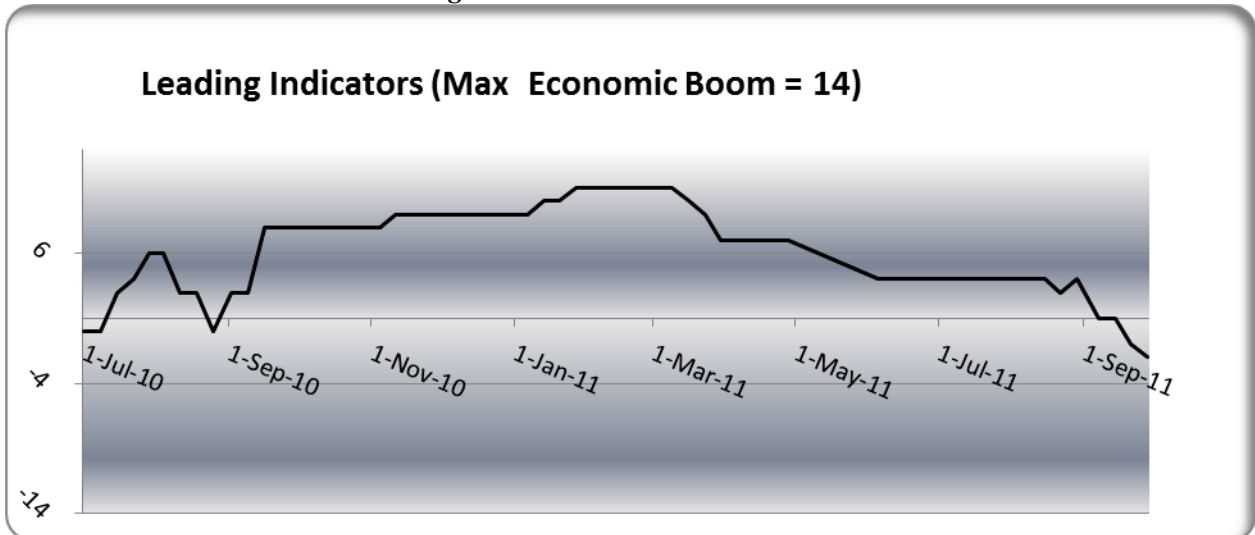




investments in stocks, corporate debt and selective commodities including copper, oil, gold and silver.

**Leading Economic Indicators Still Soft** - Looking out 12 months, our leading economic indicators (**Chart 1**) declined further during the third quarter of 2011, and are at levels that suggest economic growth is likely to remain sluggish for at least a couple of more quarters in North America. Employment growth in the key U.S. market has slowed, but there are signs that the all-important U.S. housing market is beginning to stabilize. If so, bank lending and employment growth may begin to improve materially in the second half of 2012.

*Chart 1 - Global Economic Leading Indicators*



**The Game Plan** - Modest economic growth, low inflation, and high debt levels suggest that the economy, and public stock markets, will remain vulnerable to shocks such as this year's economic fears over Japan and the Middle-East. It would be sensible to assume that the markets will remain more volatile than the underlying economy, thus creating trading opportunities from time-to-time. For the next few years, stock and bond market returns are likely to remain at, or below, their long-term averages meaning that high yield and alternative investments should play a larger role in portfolios. These types of investments will reduce volatility, help to preserve capital when public markets are under pressure, and generate steady income for reinvestment or retirement needs.

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**Capital Markets Outlook:**

**Bond Markets** – Government bond yields in Canada and the U.S. dropped dramatically during the third quarter of 2011, as investors sold stocks and commodities to invest in bonds which tend to be viewed as a safe haven when economic growth slows. The U.S. 10-year Treasury bond yield finished the quarter with a yield-to-maturity of 1.80% (see **Chart 2** below). Shorter-term interest rates in Canada and the U.S. are still below 1.0%, although these rates may begin rising in the second half of 2012 as policy makers begin the process of normalizing interest rates. Inflation expectations have moderated in Canada and the US with the bond market signaling less than a 1.5% inflation rate as the most likely course going forward.

**Chart 2: US 10-Year Bond Yield – Six Months Ending October 27, 2011**



In this environment, we continue to see little upside to owning government bonds as the risks outweigh the potential returns by a considerable margin. Investment grade corporate bonds, high-yield “blue chip” stocks, and rent producing real estate all offer superior risk/return tradeoffs versus passively investing in sovereign debt.

**North American Equity** – The decline in stock markets during the past three months has moved the markets from a modestly overvalued position to a significantly undervalued position as of September 30. The current level of the S&P 500 in the United States is “discounting” future long-term returns for equity investors of about 7.2% per annum. **Chart 3** on page 6 highlights the most likely paths for the stock markets going forward.

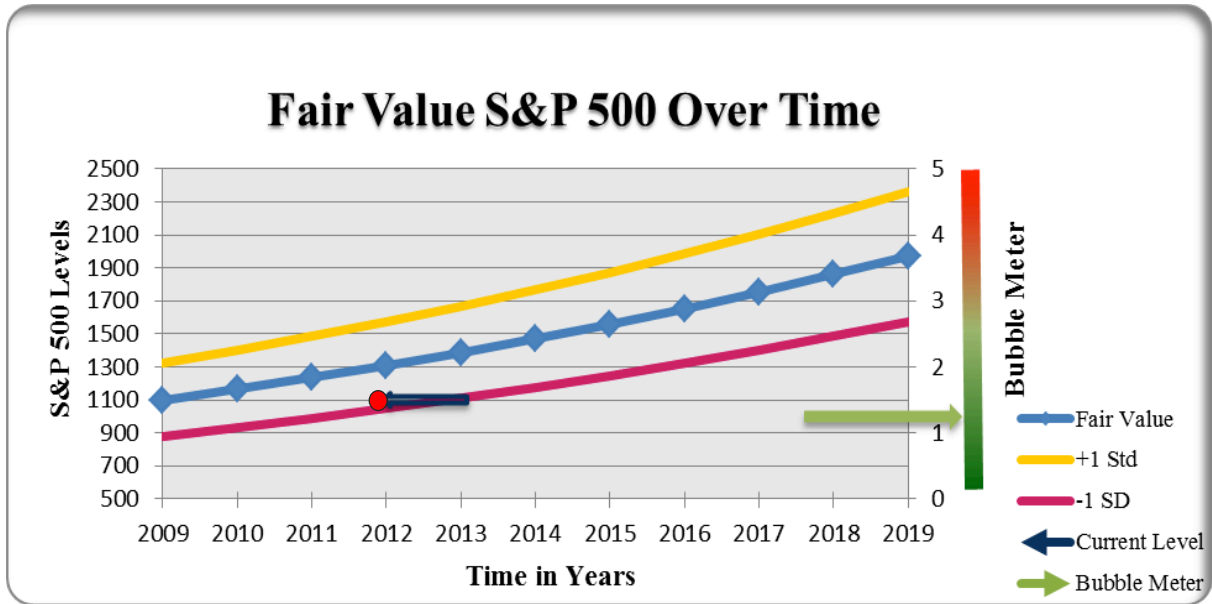




The blue “Fair Value” line shows our current and future estimates for the fair value of the S&P 500 equity index in the U.S. On the right axis we have superimposed our “Bubble Meter” readings which are used as a gauge to help determine the level of speculation in the stock markets. All else being equal, low speculation means less downside risk for investors and vice versa. Today, the “Bubble Meter” is in a negative position, meaning that there is excessive pessimism in the global stock markets.

With respect to valuation, the U.S. stock market as of September 30, 2011, was well below its fair value (red dot on Chart 3) using what we believe to be conservative inputs into our dividend discount models. With reinvestment opportunities at relatively low levels, corporations will continue to increase their dividend payouts and stock buybacks, which should help to move the markets higher over time, perhaps significantly.

*Chart 3 - S&P 500 Fair Value over Time*



**Bullion and Precious Metals** - Prices for gold and silver continued to climb during the second quarter of 2011, with gold trading as high as \$2,000 per ounce. There are many factors driving this trend, the most important of which appears to be the ultra-low interest rates that currently prevail in most of the world’s developed economies, and political and economic instability in the Middle-East and Europe. With short-term interest rates well below current inflation rates, so-called “real” (after inflation) interest rates are now negative. This same phenomenon occurred throughout most of the 1970’s which, not coincidentally, was the last great period of gold outperformance. Negative real interest

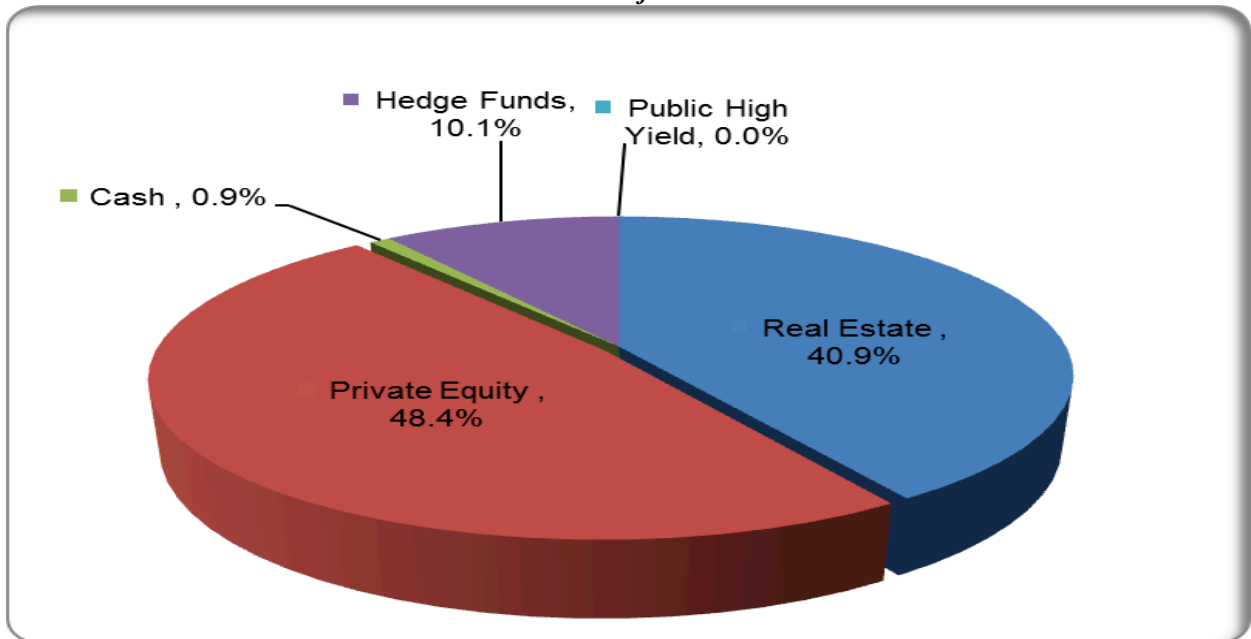


rates discourage savers from investing in short-term paper, and in this environment some of the normal demand for money market and savings accounts finds its way to gold. Gold is now viewed as a substitute for paper currencies, especially when investors are not being properly compensated for investing in U.S. dollars. In addition to low interest rates, there are several additional factors driving gold higher including a perception that the global banking system is still at risk, fears of large sovereign debt levels, investor demand for alternative assets, high gold mining costs and a lack of new mine supply.

**MacNicol & Associates Alternative Asset Strategy Update:**

**MacNicol Alternative Asset Trust**– We continue to invest the Alternative Asset Trust into a mixture of North American real estate (the 360 Degree Fund), hedge funds (the Absolute Return Fund), and private equity (the Emergence Fund). **Chart 4** below highlights the asset mix of the Trust as of September 30, 2011.

*Chart 4 – Alternative Asset Trust Investment Profile*



During the quarter, the Alternative Trust made additional investments in U.S. real estate, with an emphasis on residential and commercial mortgages, bridge loans and garden apartment complexes. These investments are primarily focused on business friendly and growing regions of the U.S. including Georgia, Florida and Texas. The Trust also increased its investment with the Georgian Partners private equity fund. Finally, the expected initial public offering of Union Agriculture was delayed because of poor stock

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market conditions during the third quarter. The Alternative Trust has a meaningful position in this company, and we look forward to its public market debut in the near future.

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