CI INSTITUTIONAL ASSET MANAGEMENT

Signature GLOBAL ADVISORS

Idea Exchange

by Eric Bushell and Drummond Brodeur

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Hangovers, Handoffs, and Hope

In the developed countries, governments and consumers alike are now paying the price for years of collective excess, and they are waking up with one very big hangover.

Gross imbalances in consumption, savings, and global trade between the developed and developing world—coupled with inappropriate financial regulation, excess leverage, and weak lending standards—led to the financial crisis of 2008/2009, the worst global financial meltdown in a generation. Government intervention, particularly in developed nations, averted absolute disaster but has resulted in many countries now facing elevated levels of public debt at a time of high structural unemployment and slow growth.

We are currently entering a period of transition characterized by handoffs from the public to the private sector and from the developed to the developing world.

The public sector now needs to gradually withdraw its support, but the pace of withdrawal is a concern. The damage done to government finances has been so profound that we are going to see a gradual dismantling of the western social safety net because it is no longer an affordable proposition. This is already happening in Europe, and it is going to come to Canada, as governments learn to live within their means.

The good news is that the capital markets are clearly open and functioning. Investment-grade bonds set an underwriting record in 2009, and this year will be a record year for underwriting of high-yield bonds. Companies are now able to refinance and in many cases are paying down short-term bank borrowings with longer-term debt from public markets. Consumer spending patterns and corporate inventories are beginning to behave in a more normal fashion. But all is not well yet.

The hangover…

In the wake of the financial crisis, global healing is continuing at a slow pace. Quarter-by-quarter, banks are fixing their balance sheets. In the biggest change to global banking regulation in decades, the Basel III agreement, announced in September, deals with financial reform and systemic risk in financial institutions. The agreement sets new, substantially higher capital requirements and minimum liquidity standards globally. The Basel III agreement requires banks to have more equity and less leverage—which translates into more liquidity and better quality funding. These requirements will be implemented in national jurisdictions as governments incorporate them into their regulatory regime.

Over the course of the last decade, Europe's external trade and capital accounts were balanced, but there were significant imbalances within Europe. Financing moved from surplus countries, such as Germany, to deficit countries, such as Ireland and Spain, which in turn imported a lot of goods. The decline in interest rates that the monetary union brought to Ireland and Spain set off 10-year housing booms, and wages rose 20% in relation to fairly stagnant wages in Germany. With the end of the boom, the collapse in asset values, and rising fiscal deficits, countries such as Germany are no longer willing to lend.

Europe is going into a structural adjustment period. This means that imports, borrowing, and spending need to change in order to restore competitiveness. But the question is how to restore competitiveness in a monetary union where there can be no change in exchange rates. The answer is that all of the adjustment will need to come from wages and asset prices, which will need to fall in deficit countries in order to restore competitiveness and a more balanced trade flow. The crisis in Greece was a warning. We see another 7 to 10 years of hard times in peripheral Europe. The European Central Bank is

going to try to keep interest rates low and allow some inflation in Germany because that helps the adjustment by pushing wages and assets higher.

In May 2010, the ECB, the European Union, and the International Monetary Fund came forward with a US$1 trillion package to backstop European governments that could not refinance maturing bonds or successfully tap the bond market to fund their deficits. This provided a liquidity backstop, but it did not fix what we believe is a more basic solvency problem.

Germany wants to find a tool that can manage the default process and fix the solvency problem. Our view is that it will take another crisis in Europe, emanating from one of these smaller jurisdictions, to push European policymakers to adopt the German solution. The liquidity facility should delay a crisis for two or three years, but ultimately the solvency problem needs to be resolved, and governments need to shrink their debt to a level they can service. This means slow growth in Europe and asset sales by European governments.

…and the handoffs

In this period of transition we are experiencing a handoff of economic leadership, first from stressed governments to the private sector, and more significantly from developed markets to the developing economies.

The G7 has become an anachronism. The financial crisis marked a shift in the centre of global economic power, which will ultimately mean a change in financial, political, and military power. Emerging economies now represent about 37% of global GDP, but that will likely be 60% in 15 to 20 years.

Globally, there is a leadership change happening as we move from a G7 to a G20 world, and it involves trade and foreign exchange negotiations and policy in different countries—all aimed at eliciting constructive changes in behaviour in the international community. As this transition unfolds, the challenge is to figure out how to sustain the recovery, how to balance the need for stimulus against the need for fiscal restraint, and how to decide on the measures that should be used to accomplish these goals. Especially important is the question of how to rebalance global growth and demand from the savings-poor/consumption-rich U.S. to a savings-rich/consumption-poor China.

China is overtaking the U.S. as the lead trade partner to many nations. Economic allegiances will shift and start to influence geopolitical allegiances. For example, in the last 10 years, Japan's trade with China has grown to double its trade with the U.S.

The dynamic between the U.S. and China is similar to the dynamic between Germany and Ireland or Spain. Over the last decade and a half, China has had huge current account surpluses, accumulated foreign exchange reserves, and kept its currency pegged to the U.S. dollar. That has kept U.S. interest rates down and has played a role in fostering the accumulation of U.S. consumer debt and some of the housing bubble. Now there needs to be an adjustment.

But how is this adjustment going to take place? In this case, it will be partly with currency and partly with wages rising in China and stagnating in the U.S. Wages in China are now growing at a rate of about 15% a year, and inflation is about 4%. We need to see higher savings in the U.S. and a period of lower consumption and fiscal adjustment. China needs a lower savings rate and more consumption.

Will the Chinese renminbi become a new reserve currency? Currently, there are two global reserve currencies, the euro and the U.S. dollar. But the bankruptcy of Lehman Brothers shattered global confidence in the U.S. financial system and badly damaged the solvency of Europe. China, the world's largest trader and the second-largest economy, does not at this juncture have a freely traded currency. However, because of the Lehman Brothers debacle, China is looking to accelerate the internationalization of the renminbi. Developing an offshore renminbi worked in Hong Kong by encouraging developing countries to pay for Chinese goods in renminbi instead of U.S. dollars.

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The Chinese understand the need to deepen capital markets by making the renminbi available to their core trading partners in the developing world. With this step, they are moving toward becoming a more developed nation.

Follow the money

There is a rapid capital migration from the developed world to developing economies, primarily because companies have mobile capital. Wal-Mart bid on Massmart Holdings to get a retailing foothold in Africa. PepsiCo is deploying its multi-billion dollar capital spending program in Russia and India. American corporations are spending where they see need for incremental capacity. Investors, pension funds, mutual funds, insurance companies and others are also seeking growth by moving capital into those geographies.

However, the flows of capital into these developing countries are too big for their relatively small capital markets to absorb and therefore significant inflows have a distorting effect. We are actually seeing central banks in emerging markets trying to put up barriers to capital inflows. Such inflows can create bubbles in property markets; people then borrow against these newly inflated asset values and the banking system becomes exposed to the vicissitudes of flighty capital. In short, a banking crisis can result when there is too much capital pushing up asset values. Remember, this is what happened when money flowed into central and Eastern Europe and the Gulf States and drove bubbles there; even in the U.S., huge foreign inflows supported inflated asset values.

Investment implications

In the developed markets there will be gradual healing, slow growth, and excess capacity. Low inflation is keeping interest rates down and driving a yield frenzy, with investors facing reinvestment risk as existing assets mature. It is similar to the income trust phenomenon in Canada between 2001 and 2007, which began when Alan Greenspan took U.S. interest rates to 1%. U.S. interest rates are now at zero, so we think this will continue to support yield-oriented assets.

Goldman Sachs recently published a 20-year outlook for global GDP. It estimates 5%-6% annual growth in the developing economies and 1%-1.5% in the developed world. There is going to be a big scramble for growth, particularly in equity exposure in developing economies. This is why we think the trend will be toward income investments in the developed world and equity investments in the developing world.

With 10-year U.S. Treasuries yielding about 2.5%, bonds are currently expensive, trading at more than 30X their interest level. Equities are around 12X P/E, which is cheap on an historical basis, but fair considering a low-growth environment. That means that the cost of debt is only 3% and the cost of equity is 10%-11%. More corporations are taking advantage of low interest rates for long-term borrowing and using it to shrink the number of shares outstanding through buybacks. Mergers are another place where low-cost debt will be used as financing. Low interest rates are leading this trend toward “de-equitization.”

Fund positioning

Equities – overweight, with a bias toward yield and companies that can latch onto emerging market growth in different ways.

Government bonds – underweight, because they are expensive and we have a view that the long-term bull market in bonds is over. However, it appears interest rates will be stable for the next year or two.

Corporate bonds – overweight, and we favour high yield. Financials are being heavily regulated and becoming less risky.

Property – overweight because low interest rates are fuelling an asset price recovery and driving up the value of REITs.

Cash – levels in most funds are below 10% because the fundamental bedrocks beneath the financial markets are still shaky, so we need to be cautious.

Foreign exchange – we are at an inflection point. Over time it will become clear whether China’s renminbi will join the euro and U.S. dollar as a reserve currency.

CI Institutional Asset Management Performance Summary

Summary as of October 31, 2010

GROSS RETURNS (%)

	1 mos	3 mos	6 mos	1 year	2 year	3 year	4 year	5 year	6 year	7 year	8 year	9 year	10 year
BALANCED STRATEGY													
CI Signature Canadian Balanced[1]	**1.34**	**4.61**	**4.53**	**12.96**	**15.45**	**4.57**	**6.26**	**8.59**	**10.22**	**10.85**	**11.31**	**9.49**	**7.89**
45% Dex Universe, 30% S&P/TSX, 12.5% S&P 500, 12.5% S&P EPAC PMI	1.61	6.00	5.62	10.99	11.21	1.65	3.07	4.95	5.95	6.43	7.12	5.83	4.33
CANADIAN EQUITY STRATEGY													
CI Signature Canadian Growth Equity	**2.67**	**6.52**	**2.03**	**15.02**	**15.27**	**-5.92**	**0.02**	**4.24**	**6.90**	**8.32**	**9.53**	**7.28**	**3.22**
S&P/TSX Composite Index	2.71	8.94	5.25	19.45	17.58	-1.73	3.61	6.99	8.93	9.93	11.91	9.54	5.12
CI Signature Canadian Equity Plus[2]	**1.78**	**5.74**	**2.30**	**13.07**	**15.84**	**0.62**	**4.25**	**8.21**	**10.66**	**11.67**	**12.45**	**11.03**	**10.91**
55% S&P/TSX Composite Index, 45% S&P Global PMI	2.74	8.67	5.09	14.42	13.88	-2.74	1.27	4.63	6.40	7.08	8.24	5.90	2.25
CI Signature Dividend	**1.61**	**4.88**	**4.45**	**14.02**	**17.14**	**3.29**	**3.31**	**5.27**	**6.62**	**7.44**	**7.97**	**7.13**	**7.36**
60% S&P/TSX Composite Index, 40% BMO 50 Preferred Index	2.43	7.69	7.70	17.58	17.30	1.55	3.67	5.83	6.99	7.67	9.01	7.60	5.07
FIXED INCOME STRATEGY													
CI Signature Corporate Bond	**1.69**	**4.70**	**7.03**	**13.90**	**16.57**	**9.30**	**7.46**	**7.50**	**7.45**	**7.64**	N/A	N/A	N/A
*50% DEX Universe Corporate Bond, 50% Merrill Lynch US High Yield Master II (C$)**	0.91	3.78	6.53	10.52	16.35	9.98	6.92	6.61	6.38	6.41	6.91	6.25	6.70
CI Signature Canadian Bond Plus[3]	**0.12**	**2.84**	**6.39**	**9.64**	**11.75**	**8.27**	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DEX Universe + Maple Overall	0.23	2.91	6.48	7.64	9.41	7.26	5.88	5.80	5.96	6.13	6.27	6.10	6.74
CI Signature Canadian Bond	**0.15**	**2.80**	**6.05**	**9.06**	**9.65**	**7.19**	**5.97**	**5.87**	**6.04**	**6.11**	**6.13**	**5.96**	**6.60**
DEX Universe + Maple Overall	0.23	2.91	6.47	7.71	9.41	7.11	5.74	5.69	5.87	6.05	6.20	6.04	6.68
CI Signature Short Term Bond	**0.28**	**1.32**	**3.46**	**3.82**	**4.24**	**5.04**	**4.59**	**4.45**	**4.26**	**4.33**	**4.45**	**4.44**	**5.19**
DEX Short Term Bond Index	0.25	1.41	3.89	4.30	5.91	6.17	5.44	5.09	4.83	4.84	4.92	4.86	5.57
FOREIGN EQUITY STRATEGY (Cdn$ Returns)													
CI Signature Global Equity[4]	**2.48**	**7.63**	**3.98**	**13.19**	**18.52**	**1.08**	**0.22**	N/A	N/A	N/A	N/A	N/A	N/A
S&P Global PMI	2.78	8.33	4.85	8.36	9.09	-4.47	-1.98	1.41	3.00	3.31	3.53	1.26	-1.49
CI Signature EAFE Equity	**3.52**	**11.75**	**11.47**	**12.07**	**12.10**	**-6.00**	**-1.61**	**2.93**	**4.53**	**3.18**	**3.98**	**1.31**	**-3.14**
MSCI EAFE	2.73	9.45	6.42	2.62	8.73	-6.79	-3.80	0.82	3.01	4.03	4.44	2.20	-0.51
U.S. EQUITY STRATEGY (Cdn$ Returns)													
CI Signature U.S. Growth Equity	**0.33**	**4.65**	**-0.71**	**6.33**	**2.72**	**-2.39**	**-3.36**	**-0.47**	**0.95**	**0.08**	**0.72**	**-2.18**	**-3.98**
S&P 500 Index	2.91	7.16	1.16	9.88	4.04	-4.06	-3.90	-1.18	-0.15	0.05	0.25	-1.73	-3.96
INCOME STRATEGY													
CI Signature Income & Growth	**1.99**	**5.72**	**4.57**	**13.96**	**17.19**	**3.95**	**5.17**	**7.91**	**9.26**	**10.07**	**10.84**	**10.31**	N/A
20% ML US High Yield, 25% S&P Global PMI, 20% DEX Corp., 35% S&P/TSX Comp	2.01	6.73	5.79	13.31	15.96	2.70	3.69	5.61	6.50	6.88	7.87	6.09	4.00
CI Signature High Income	**3.02**	**8.84**	**10.43**	**22.34**	**20.33**	**6.35**	**5.38**	**7.82**	**9.39**	**11.15**	**11.92**	**12.14**	**12.48**
40% ML HY Master II, 10% DEX Corporate, 40% S&P/TSX Comp., 10% S&P Global PMI	2.00	6.62	6.19	14.74	18.77	4.88	4.79	6.33	6.89	7.22	8.42	6.55	4.62
SPECIALTY STRATEGY													
CI Signature Commodity	**3.00**	**10.95**	**5.38**	**13.90**	**22.22**	**2.86**	**9.79**	**15.73**	**19.30**	**20.82**	**22.31**	**20.49**	**20.69**
*27.5% TSX Energy, 27.5% TSX Materials, 22.5% S&P Global Energy, 22.5% S&P Global Materials***	3.57	13.43	7.29	16.09	20.37	-0.09	6.13	10.85	13.60	15.65	16.18	15.18	15.48

Notes to Benchmarks:
**Prior to September 30, 2009: 75% DEX Universe Corporate Bond / 25% Merrill Lynch US High Yield Master II (C$)*
October 1, 2009 to Current: 50% DEX Universe Corporate Bond / 50% Merrill Lynch US High Yield Master II (C$)

***Prior to July 31, 2006: 50% S&P/TSX Energy & 50% S&P/TSX Materials*
Benchmarks of the CI Signature Strategies are for the institutional versions of the strategy and may differ from the mutual fund strategy.

Notes to Performance:
[1]Prior to and including April 30, 2010 performance retuns of the CI Signature Canadian Balanced Fund are based on the Class-I performance of the CI Signature Canadian Balanced Fund (CIG685), a prospectus offered mutual fund strategy. Beginning May 1, 2010 performance returns of the CI Signature Canadian Balanced Fund are the pooled fund strategy rates of return.

[2]Prior to and including July 31, 2010 performance retuns of the CI Signature Canadian Equity Plus are based on the Class-I performance of the CI Signature Select Canadian Fund (CIG677), a prospectus offered mutual fund strategy. Beginning August 1, 2010 performance returns of the CI Signature Canadian Equity Plus Fund are the pooled fund strategy rates of return.

[3]Prior to and including July 31, 2010 performance returns of the CI Signature Canadian Bond Plus Fund exclude cash and are based on the fixed income component of the CI Signature Canadian Balanced Fund, a prospectus I-Class mutual fund strategy. Beginning August 1, 2010 performance returns of the CI Signature Canadian Bond Plus Fund are the pooled fund strategy rates of return and include cash.

[4]The rates of returns of the CI Signature Global Equity Fund are based on the Class-I performance of the CI Signature Select Global Fund (CIG6885), a prospectus mutual fund strategy. This fund was not a reporting issuer during the period prior to July 14, 2010 and the expenses of the Fund would have been higher during this period as the Fund would have been subject to additional regulatory requirements applicable to a reporting issuer.

The returns of the CI Signature strategies are based on the corresponding prospectus Class-I mutual fund strategy CI Signature Dividend Fund (CIG610), CI Signature Corporate Bond Fund (CIG9010), CI Signature Canadian Bond Fund (CIG837), CI Signature Short Term Bond Fund (CIG7220), CI Signature Income & Growth Fund (CIG6116), CI Signature High Income Fund (CIG686). Benchmarks of these strategies are for the institutional version of the strategy and may differ from the mutual fund strategy.

The rates of returns of the CI Signature Commodity Fund are based on the prospectus Class-I performance of the CI Signature Canadian Resource Fund (CIG611).
The indicated rates of return are historical simple total returns (1 year periods and less) or average annual compound total returns (2 through 10 years). All performance returns are gross of fees. Investment returns will fluctuate. Past performance is not a reliable indicator of future performance. *CI Institutional Asset Management and the CI Institutional Asset Management logo are trademarks of CI Investments Inc.™*

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