MARRET ASSET MANAGEMENT INC.

Macro Themes

- Excess Debt and Deleveraging
- Corporate sector in great shape – except financials which will derisk for several years
- Consumer sector – improved but long way to go
- Sovereigns
  - Europe – 50-60% complete (defaults)
  - Japan – demographic time bomb
  - USA – easiest to fix if political will arrives
- We are in the early stages of a global sovereign debt crisis followed by a decade of deleveraging

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Canada in the 1990's

A Case in Successful Deleveraging

- Political will did not develop until the Canada Bond Market refused to finance deficits – esp. foreign investors
- Debt/GDP ratio falling from 90% to 50% took a decade
- Decade of the 1990's was the most favorable time to delever in a century
  - Strong economic growth
  - Declining inflation and interest rates
  - High productivity – internet, cell phones, PC's
  - Consumer and corporate leveraging
  - Currency devaluation

Can the US Reflate to Lower Debt/GDP

- We don’t think so
- We can’t find a sizeable country that has successfully reflated – Weimar Republic and Zimbabwe show risks
- US Treasury market will not allow reflation
- Fed has an inflation mandate so they can’t buy all the Treasuries

Market Implications

- Elevated volatility and correlations until USA is on sustainable path to lower Debt/GDP
  - Favor quality, liquidity and hedges
- Positive correlation between stocks and bonds whenever solvency enters government bond yields – hedges, overlays and Long/Short strategies provide protection
- Safe Havens
  - Bullion – Currency Volatility
  - AAA Corporates – Hedged against UST
  - Blue Chip Dividend Stocks – hedged against indices
  - Short Positions – stocks, commodities, high yield

Aftermath of Sovereign Debt Crisis

- Long period of deleveraging
- Weak growth, low inflation, low interest rates, with periodic positive spurts
- Continued high market volatility based on recession/inflation scares
- Yield is the best risk adjusted return
  - High Yield especially
  - High Grade
  - Dividend Stocks
  - REITs
  - Technology