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ANNUAL INVESTMENT OUTLOOK

Chairman: **Noble Chummar**
President, The Empire Club of Canada

Head Table Guests

William F. White, Chairman, IBK Capital Corp., and Director, The Empire Club of Canada; Rosie MacLennan, Olympic Gold Medalist, Trampoline; John MacLennan, CEO, MacLennan Advisory Services; Dr. Roberta Bondar, President and Director, The Roberta Bondar Foundation; Mike Crum, Director, Development and Alumni Engagement, Ontario, the University of British Columbia; Brian Koscak, Chairman, Exempt Market Dealers Association, and Partner, Cassels Brock; Richard Carleton, CEO, Canadian Securities Exchange; Bill Packham, Executive Managing Director, Desjardins Group; Sue Lemon, CEO, CFA Society, Toronto; Alex Squires, Director, Brant Securities, and Director, The Empire Club of Canada; Rory Cattanach, Partner, Wildeboer Dellelce LLP; Tim Patriquin, President, Treble Victor Group; Jay Smith, First Vice-President, CIBC Wood Gundy; Glenn Nolan, President, Prospectors and Developers Association of Canada; Steve Brophy, Senior Vice-President and Managing Director, BMO Nesbitt Burns; David Brown, Partner, Weirfoulds LLP; Joe Hinzer, President, Watts, Griffis and McOuat; Thomas Kloet, CEO, TMX Group; and Stephen Dekuyper, Chaplain, King-Bay Chaplaincy.

Introduction by Noble Chummar

Ladies and gentlemen, welcome to our club's annual economic outlook. It's our country's opportunity to look into the crystal ball from the perspective of industry titans. Many people have looked into the Empire Club's crystal ball in the past. Some have been right and some have been wrong. In 1914, Prime Minister Borden stood at this podium and correctly predicted the outcome of World War I. In 1967, Richard Nixon stood at this podium and said that America would triumph in Vietnam. As I said, some have been right and some have been wrong. The good news is that our three speakers today have never been wrong. So we're looking forward to hearing from them.

Ian Russell is President and CEO of the Investment Industry Association of Canada. Ian spent 20 years at Investment Dealers Association, championing regulatory and tax matters related to the securities industry and capital markets in Canada. He is a frequent columnist in industry publications and is a presenter and speaker on industry issues and developments. This past June, Mr. Russell was appointed Chairman of the Standing Committee on Regulatory Affairs at the International Council of Securities Associations. Mr. Russell has an honours degree in economics and business from the University of Western Ontario, and a postgraduate degree from the London School of Economics and is a Fellow of the Canadian Securities Institute.

Nick Barisheff is the founder, president and CEO of Bullion Management Group Inc., a company dedicated to providing investors with a secure, cost-effective, transparent way to purchase and hold physical bullion. Widely recognized as an international bullion expert, Nick has written numerous articles on bullion and current market trends, which have been published on various news and business Web sites. Nick has appeared on BNN, CBC, CNBC and Sun Media, and has been interviewed for countless articles by leading business publications across North America, Europe and Asia. His first book "$10,000 Gold: Why Gold's Inevitable Rise is the Investors Safe Haven," was published in the spring of 2013.

André-Philippe Hardy is Head of Canadian Research at RBC Capital Markets, one of our country's premier investment banks that provides a focused set of products and

services to corporations, institutional investors and governments around the world. Prior to assuming his current position, André led the Equity Research team with direct coverage of banks and insurance companies. Throughout his career as an equity analyst, André was ranked consistently as a top analyst in his sectors. Prior to RBC Capital Markets, André spent over a decade at Merrill Lynch Canada and TD Securities.

Ladies and gentlemen, please welcome our first speaker, Mr. Ian Russell.

Ian Russell

Thank you, Noble, and good afternoon ladies and gentlemen. The current economy might be called the Michael Corleone economy. As soon as we think we're out of the slowdown, we're back into it. But what does the Investment Industry Association of Canada's (IIAC) recent survey of CEOs of Canada's investment dealers indicate? It indicates that the economy is coming back, slowly but steadily. The industry is optimistic, tepidly optimistic for 2014. Industry executives are positive about both the state of the markets and the state of the industry, and that is crucial because both depend on each other. Last year, through an IIAC sponsored survey, we learned that Canadian investors have a high degree of confidence in their investment advisors. That level of confidence and trust is important. As market conditions improve and advisors recommend opportune investments, their clients will likely heed their advice. That will benefit the markets and the economy. This year's sense of tepid optimism echoes last year's survey. The survey found executives expressing cautious optimism about 2013, and those expectations were borne out. Last year saw slow but steady growth, giving us reason to be optimistic that this year's results will also confirm our survey's results.

The recent survey also underlined the fact that two important challenges face the industry and the economy. First, small boutique investment dealers face severe challenges in today's markets. The country can't afford to lose them. They are critical to competition, to the diversity of markets, to access scarce capital,

and to the growth of small and medium-sized enterprise. Second, major regulatory changes need to be implemented this year and next. These years could be make-or-break for many small firms. I'll have more to say on both of these points in a couple of minutes.

First, I'd like to look at some of the survey results, and the reasons for cautious optimism. The fact that 48 per cent of the CEOs surveyed see the state of capital markets as being more or less the same as last year's signals stability. This is a positive important signal to investors. Ten per cent of respondents predict that their firm's profitability will significantly improve this year, something, which not a single CEO anticipated last year. This reflects the effort that some small firms have made to cut costs, add scale, build business, and generally put themselves on a sounder footing. If the overall picture improves, they are positioned to benefit. The majority of CEOs see investors as more likely to participate in the markets, and reduce their holdings in cash and equivalents. Sixty per cent said investors would be more likely to participate in equities this year and reduce their cash holdings. Interestingly, fewer investment firm CEOs indicate that they have plans to acquire a firm or enter into a joint venture, only one-third as many as last year. That's despite the fact that conditions are actually more encouraging this year. Why the reduced inclination to acquire? Well, quite simply, some of the more valuable firms have already been acquired in the industry. As the attractive candidates disappear, those firms looking to expand believe it makes more sense to do so by buying assets and hiring away the personnel they need. Many firms face a tough challenge just to survive, and for some 2014 will determine whether or not they do.

One potential roadblock, as I mentioned, is the regulatory burden. Eighty-four per cent of CEOs in the industry interviewed for the survey cited regulatory burdens as a barrier to growth. That's a higher percentage than any other factor. In view of the tsunami of rules that has been put in place and the burdens they

create, the industry will be looking for clear justification for any new rules. The industry, and Canadian companies seeking capital, can illafford additional, unjustifiable regulatory burdens that discourage small business investments. This will undermine the growth and the competitiveness of the Canadian economy. As a case in point, regulators must exercise discretion and judgment in auditing compliance with the suitability rules, as well as other new regulations. Why? Mechanical box-ticking; regulatory scrutiny of suitability decisions could result in excessive compliance costs and discourage investments with highly variable returns, such as speculative equities.

Speculative investments have a rightful place in properly diversified portfolios. These outcomes would damage the health and vitality of the venture marketplace, thereby reducing entrepreneurial opportunity and undermining the competitiveness of the economy. The impact of the regulatory burden is greatest on small firms, in both the institutional and the retail sectors. They were hit hard by both the 2008 market collapse and the ensuing structural developments in the marketplace. Last year was an abysmal one for the small dealer firms in Canada. Half of the boutique firms in the industry continue to lose money, and 13 investment dealer registrants resigned from the self-regulator, Investment Industry Regulatory Organization of Canada (IIROC), or announced their intention to resign. And we expect this trend to continue as consolidation takes place in the industry.

The next year or so has the potential to be a make-orbreak situation for many small investment dealers. The cost burden of the complex performance reporting rules and the tight deadlines for implementation, and the uncertainty of imposing a fiduciary standard, could be the catalyst for significant change. Firms that have scoped out their needs in terms of technology and compliance resources and have a strategic implementation plan will do well. Those that have not will face an uncertain future.

Yet overall, the survey offers good news for the new year. It's

good to see signs of optimism from investment dealer CEOs. And that's good for the industry and for the companies and the investors that depend on robust capital markets. But we cannot let a sense of tepid optimism disguise the fact that smaller firms face serious challenges in today's capital markets. Their survival is crucial to a competitive industry, to capital raising opportunities for small and medium-sized Canadian businesses, and to investor choice and opportunity. Government needs to provide the right investment incentives. Regulators need to provide an effective regulatory framework. And the industry needs to provide the right ideas to bring capital together with investment opportunities. As I stated at the outset, the industry is optimistic. We all have a stake in the survival of Canada's envied, small and mid-cap venture markets. Thank you.

Nick Barisheff

Good afternoon. Last year saw the greatest decline in gold prices in 32 years and my book, "$10,000 Gold," was published. How's that for timing? However, I'm confident that the gold drivers that were set out in my book are still very much intact. Last year, COMEX Futures Exchange distorted gold prices and provided investors with the second-greatest opportunities to buy gold since 2002. On April 12, the gold price declined by $150, and on June 20, by $80, because of naked short-selling of futures contracts. These precipitous drops triggered sell stops and margin calls and the Western media jumped in to declare that the bull market in gold was over. In sharp contrast to the falling price of paper gold, the demand for physical gold soared. The U.S. Mint and the Canadian Mint both ran out of stock. Many retail coin stores ran out of stock and premiums rose by as much as 20 per cent for gold and 40 per cent for silver. The lower price also represents a problem for miners. Because average mine production costs now exceed $1,200 an ounce, many high-cost producers will be forced to shut down, causing supply and demand

pressures. Clearly the physical price of gold cannot decline much further for any length of time and this correction is close to an end. In addition, the days of COMEX dominance of the gold price are numbered, since the monthly deliveries on the Shanghai exchange already surpass global mine supply. However, the main driver of the gold price is and always has been increasing money supply. An increase in the money supply is the very definition of inflation, as it devalues currencies and destroys purchasing power. If an increasing money supply led to prosperity, Zimbabwe would be the richest country in the world.

This chart shows that gold and the U.S. government debt have shared a lockstep relationship since 2001, despite the divergence in 2013. Over the longer term, the U.S. debt and gold should return to equilibrium. Since the official public debt in the U.S. is $17.3 trillion today, in order to bring the debt-to-gold relationship back to equilibrium, gold should not be $1,800 an ounce. Since there is no political will to curtail either debt or introduce austerity measures, I believe gold will surpass $1,800 and likely set new highs in 2014. It is not just the U.S. that has this debt problem. Ever since President Nixon closed the gold window in 1971, the world has been in a global fiat currency experiment, where every dollar in existence has been created through the issuance of new debt. Without the stability of gold backing, this has encouraged unbridled currency creation and reckless credit expansion at an exponentially increasing rate, taking fewer and fewer years to double. Since President Obama took office in 2008, the U.S. cash debt has increased from about $10 trillion to over $17 trillion. This figure doesn't take into consideration the very real $127 trillion of unfunded liabilities, such as Medicare, prescription drug plans and Social Security. For this, taxpayers will ultimately be responsible, and this works out to about $1.1 million for each U.S. taxpayer.

The debt build-up is not limited to the U.S., but includes most Western economies. The systemic risks that caused the financial

meltdown in 2008 have got worse. The world's financial system was almost destroyed in part because of $1.2 trillion in mortgage derivatives. Today, interest rate derivatives alone are 450 times higher at $561 trillion or seven times global GDP. What could possibly go wrong? Long-term treasuries ended up in 2013 pushing 3 per cent and will likely rise if the feds tapering measures increase. In the U.S. a 1-percent rise in interest rates translates into an additional $170 billion of annual interest costs and increases both the debt and the deficit. All other Western countries face similar situations. Interest rates at 3 per cent in Japan will consume all of the country's tax revenues just to service the interest payments. The bigger problem will, however, be declines in bond portfolios if interest rates rise. In Europe, most banks hold significant amounts of sovereign debt as part of their capital. As interest rates increase, the value of their holdings will decrease incrementally. And due to the high leverage ratios, some banks may need either bailouts or bail-ins to shore up their capital ratios. And those same banks may find that their interest rate derivatives have unexpected counterparty risks.

The debilitating effort of the growing debt is clearly illustrated by the next chart. It shows that in the '50s, for every dollar of increased debt the economy grew by four dollars. In 2013, for every dollar of debt increase the economy only grew by 50 cents. And during the last decade, if you were to use real GDP rather than nominal GDP, the real GDP only increased debt an average of eight cents for every additional dollar of debt. You don't need to be a mathematician to understand that this trend is not a recovery and is unsustainable over the long term.

Now, while demand for gold in the West dropped to an all-time low in 2013, the unprecedented demand for physical gold from Eastern buyers confirms that Eastern nations will no longer tolerate the debasement of the U.S. Treasury holdings. China bought a record 2,200 tons of gold last year. This is close to total global mine production. Many informed gold watchers feel this is a

conservative figure, and the true figure will remain a mystery until China chooses to disclose it, likely in 2015. China is the world's largest gold producer, and not only buys all of its own domestic production, but also buys through its opaque sovereign wealth funds, the remaining balance and then at some point in time, transfers it to the central banks. In 2009, China announced its gold reserves at 1,054 ounces. It would not be surprising to see that China owns over 5,000 tons by 2015. If we add the purchases of the other Far Eastern, Middle Eastern and central Asian countries like Russia, far more physical gold was purchased than was mined. Now, the movement away from the U.S. dollar is intensifying. China has now signed over 25 trade agreements that circumvent the U.S. dollar in which they settle trade imbalances with the participants' own currencies. This will continue to place downward pressure on the demand for dollars, and if the dollar loses its reserve currency status, America's ability to print unlimited amounts of money without consequences will be over.

This chart shows the lifespan of the five previous reserve currencies that preceded the U.S. dollar. The average is 94 years. Gold's lifespan as stable money is 3,000 years and counting. If we take the demise of the British pound as the world's last reserve currency in 1920 as the starting point, 2014 will mark the ninety-forth year of the U.S. dollar's lifespan. During this time, it has lost 97 per cent of its purchasing power. I firmly believe we're in the late stages of the U.S. dollar's reign as the world's reserve currency.

Considering the strengthening fundamentals we witnessed for gold in 2013, despite its poor price performance, it appears that an opportunity similar to that of 1976 is a strong possibility. Gold rose 450 per cent from 1971 to 1974. It then retreated 43 per cent over the next 18 months. Many investors lost confidence and sold their gold holdings, vowing never to invest in gold again. The New York Times proclaimed the end of the bull market. However, during the next four years, gold climbed 750 per cent.

A similar percentage increase from today's price would see gold trading at $10,000 an ounce.

While there may still be price declines, I feel today's situation is similar to that of the 1970s, and we have the second-greatest opportunity to buy gold since 2002. Today, many investors are tempted to sell their underperforming precious metals holdings and use the proceeds to purchase U.S. securities. But there's an old Wall Street saying: "Buy low, sell high." Not sell low, buy high. While no one knows with absolute certainty the exact timeframe for these developing events, the most conservative route for portfolio protection is diversification with at least a 10-per-cent allocation in gold. Gold is the most negatively correlated asset to financial assets and acts like portfolio insurance in a decline or a crisis. For true portfolio protection, however, you need physical gold, to which you hold clear title and the bullion is stored in allocated storage or your own vault. It is critical that your bullion holdings have no counterparty risk, and are not proxies or derivatives such as gold certificates, futures contracts or ETFs.

Thank you, and all the best in 2014.

André-Philippe Hardy

Thank you. Good afternoon. It's a pleasure to be here to talk about RBC Capital Markets for the economy, interest rates, equities and currencies in 2014, as well as highlight our favourite stocks. Let me start with a quick word about who we are. As I show on the slide, RBC Capital Markets is part of the Royal Bank of Canada, one of the top-15 largest banks in the world, and the fifth largest bank in North America, as measured by market cap. The bank has strong credit ratings, a strong capital base, and a highly liquid balance sheet. Within Royal Bank resides RBC Capital Markets, a premier investment bank with over 7,000 professionals, operating out of 15 countries, offering a wide range of products and services. And then you have the RBC Capital

Markets research team, which is within Capital Markets. The research team is approximately 300 professionals across the globe and has more than 1,500 equities under coverage, including over 800 in the U.S., and just under 400 in Canada. Specific to Canadian equity research, the RBC Capital Markets research department has been marked number one by both Brendan Wood and Greenwich, which are the two prominent providers of institutional investor surveys. Globally, sector expertise is offered in economics, emerging markets, portfolio and quantitative strategy, currencies, credit and equities across a wide range of industries and market cap.

Let me talk about the overall backdrop and what 2013 looked like. The year 2013 was characterized by optimism in risk assets with challenges in global rates investing.Without accelerating growth, rates investors suffered a difficult period, as worries about tapering and tightening ebbed and flowed, leading to a sharp boost in real and nominal yields. But high-yield credit and equity investors cheered as they benefited from a much more constructive environment.

Now, while the absolute yield lows are likely behind us and the shadow of eventually more hawkish central banks will hang over our heads, we look to 2014 as a year where investors in all asset classes will have greater transparency to position themselves reasonably and take advantage of volatility when it strikes. From an economic perspective in 2014, we expect that the most relevant themes will be the United Kingdom and Eurozone attempting to play catch-up with the accelerated pace of recovery in the United States, while Canada looks to benefit from improvements in its biggest trading partner's economic health. While Europe and the United Kingdom were out of recession in 2013, the pace ahead will continue to be slow and steady, with regulatory and policy uncertainty still in force. Our main conclusion for fixed income in 2014 is a simple one. The world of low yields will be with us for quite some time, with slow growth and tepid inflation.

We predict that mildly bearish positions could pay off, while credit trends look to remain healthy and high-yield corporates continue to be one of the stronger sources of relative investor returns. Equities in 2014 have a strong outlook in our view, with economic recovery in the early to middle innings, central bank supportive, street expectation still low, and valuations rising but justified.

With the broad picture behind, let's dig into the outlook for the Canadian economy and interest rates. Although Canada failed to exit 2012 with a bang, as growth averaged just 0.9 per cent in the final half of the year, there was a fair degree of optimism about what 2013 held. Some of the factors behind the late 2012 weakness were expected to fade, i.e. oil export disruptions, while the prospect of stronger U.S. demand and a more favourable composition of U.S. growth held the promise of a long-awaited turnaround in exports. Uncertainty surrounding the U.S. fiscal outlook and the brinksmanship that came with it weighed on capital spending, but the assumption was that saner heads would prevail in 2013 and investment demand would improve.

In any event, 2013 failed to live up to expectations. Developments in the U.S. certainly played a role, with growth this year expected to be about 0.7-per-cent weaker than what the Bank of Canada had assumed in late 2012. However, some of the blame lies closer to home. In particular, business capital spending failed to show any significant momentum and is currently flat on a year-ago basis. Some one-third of all private investment is tied to mining, oil and gas development. Supply disruptions and uncertainty about pipeline development in this sector have contributed to the poor investment performance, while the fiscal brinksmanship in the U.S. may also have been partially to blame. Now some of the pipeline constraints in the energy sector may ease as we head into next year. Together with an improvement in U.S. growth tied in large part to a lessening of 2013 onerous fiscal drag, there is some room for optimism that the investment contribution that

was meant to show up this year has simply been delayed to next year. Other sectors of the economy are expected to have a less marked effect on swings in the Canadian growth and inflation outlook. The Canadian consumer is expected to contribute half of the expected 2.6-per-cent growth in overall GDP next year. The gains should represent a combination of a slightly firmer job market and wages, while we're assuming a relatively stable savings rate. The steady pattern of modestly above potential growth that we envision translates into predictable reduction of economic slack. However, the output gap is still expected to be slightly less than 1 per cent of potential GDP at the end of next year. It is, therefore, most likely that core inflation will be holding below the Bank of Canada's 2-per-cent target at that time. Given our base case assumption that core inflation is still below 2 per cent at the end of next year, and assuming that systemic risks from having rates too low for too long remain contained, the Bank of Canada should be content to leave its started overnight rate at 1 per cent. However, the potential for a rate hike some time in the first half of 2015 should influence shorter term yields, particularly over the final half of the year.

Over the balance of 2014, our interest-rate forecast looks for medium- and long-term interest rates to rise, consistent with a steadily improving economic backdrop, and expectations of tighter monetary policy in 2015. While we expect rates to rise, they are expected to remain low by long-term standards. For example, our forecast for U.S. 10-year bond yields of 3.6 per cent at the end of 2014 represents higher bond yields than today, but that level is in line with where yields were prior to the European challenges of the second half of 2011.

Moving on from the rates world to equity land, I'll focus my remarks on equities on the world's largest economy and stock market. The U.S. returns in 2013 were excellent but not exceptional. The year's returns were very strong but not really out of the ordinary, as 2013 was the sixth-best year in the post-war

period. What really is exceptional, however, is how a 1.7-per-cent GDP year turned into an almost 30-per-cent year for the SNP 500. Further, it was striking how steadily the market progressed without a single pullback of 6 per cent or greater. Now despite this strong performance, it is difficult to find any major event or announcement as the catalyst propelling the markets higher. A case could easily have been made that the most important news headlines should have been headwinds for the market. Taper talks sent rates significantly higher. Sequestration and the government shutdown took a chunk out of GDP growth, but the market was unfazed by these developments.

Perhaps 2013's big story was actually the lack of a big story. Maybe the market's big run was simply a big relief rally, or relief that the dysfunctional government in Washington didn't do anything truly damaging, and relief that our friends in Greece, Italy and Spain kept themselves sufficiently out of the headlines. If we were to capture 2013 in one word, it would be multiples. This benign environment allowed an undervalued market to continue its renormalization process. As can be seen on the screen, the spread between corporate bond yields and earnings yields has fallen significantly with equity valuations doing most of the heavy lifting as PEs rose roughly two points from 12.6 times. We believe that the equity valuations will continue to drift higher until these two lines converge. Specifically, RBC Capital Markets has a target of 2,075 for the SNP 500, approximately 13-percent higher than current levels. The SNP's almost 30-per-cent return in 2013 as I mentioned was the sixth highest since 1947. Before I wrap up the outlook on equities, it is important to highlight that after a year like 2013, historical performance shows that years with strong returns are often followed actually by solid returns. More specifically, of the 10 best years since 1947, subsequent year returns have averaged 14 per cent. In fact the real driver of down years is typically a recession, and currently, the likelihood of a recession is below average in our view.

Shifting to currency markets, G10 foreign exchange was a tale of two halves in 2013, with the Canadian dollar undoubtedly in the bottom half. Leading the way were the Euro and U.S. dollar, two currencies that had underperformed in recent years. But other currencies like the British pound held up well too. The Canadian dollar was lumped with the laggards down 7 per cent against the U.S. dollar and more against the Euro. Looking forward to 2014, we believe that the Canadian dollar will continue to underperform the U.S. dollar. Our call for Canadian dollar underperformance in 2013 was based on Canada's struggle in financing its current account deficit. While the deficit itself is nothing new, until a year ago it was easily financed with long-term capital in-flows. The slowdown in global reserve accumulation coupled with lower demand for fixed-income havens means that Canada's deficits now exceed its long-term capital in-flows and the gap has to be plugged by short-term capital in-flows. If Canada had higher rising short-term rates, that would be easier to achieve, but the Bank of Canada, as we discussed, is not expected to raise interest rates until 2015. That leaves a cheaper Canadian dollar as the primary mechanism for resolving the funding gap.

So to sum up our views on the macro outlook, RBC Capital Markets anticipates a continuation of the constructive global economic and market trends that define 2013, mainly broadly rising equity indices, moderate but positive economic conditions, and still low but rising interest rates. Against this backdrop, RBC Capital Markets global equity research department recently presented our top-30 global ideas for 2014, which we show on the screen. These 30 stocks represent the most attractive equity investment ideas within our coverage universe for people with a 12-month investment time horizon, and we focus on larger cap and liquid names which are most suitable for a global investor. There are eight Canadian names on the list: Brookfield Asset Management, CAE, Dollarama, Domtar, Goldcorp, Suncor, TD Bank Financial, and Tech Resources.

Thank you very much for your time.

The appreciation of the meeting was expressed by William F. White, Chairman, IBK Capital Corp., and Director, The Empire Club of Canada.

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