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# 'On the road to recovery': panel; Big-Picture Views, Current Issues, Outlook And Picks.

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Illustrations: Color Photo: Peter J. Thompson, National Post / "We're happy with what we've seen so far" in equities, Robert Decker says.

Color Photo: Peter J. Thompson, National Post / "I think we're in a sustainable recovery now," David Graham says.

Color Photo: Peter J. Thompson, National Post / "Corporations have managed relatively well," Gerry Brockelsby says.

Color Photo: Peter J. Thompson, National Post / "We've got good earnings potential," Mark Jackson says.

What is the outlook for equities and the Canadian dollar? How does China affect the commodity market? What are some key risks and how are you positioned to deal with them? Buy & Sell columnist Jonathan Ratner posed these and other key questions to an all-star panel of Canadian money managers in a series running today and tomorrow in the Financial Post. The panel's stock picks will be featured exclusively on financialpost.com this Friday. Q What is your outlook for the equity market?

Brockelsby We're on the road to a sustainable recovery. The doubt, fear, gloom and depression that we went through in terms of investor psychology still prevails to a degree, but that is being beaten back by a strong upturn in earnings that are greatly exceeding expectations. This is a V-shaped recovery, this is not a U, L or W. We have the strongest gains in productivity you've ever seen. Employment growth and capital spending will accelerate as confidence in the recovery improves.

Decker We're happy with what we've seen so far in the equity markets with respect to earnings and valuations, especially as it relates to fixedincome alternatives. It's the sentiment and the lack of participation that bothers us. I think there has been a bull market in pessimism. That pervasive sentiment is the only impediment to a sustainable bull market. It is similar to what we saw after the 1987 crash--where psychology was damaged quite dramatically, which reduced volumes and participation levels. Notwithstanding that, the market was 50% higher one year after the crash and more than 100% higher two years after the crash. So time heals the wounds and because of the strong earnings and the robust nature of the productivity-led recovery, stocks are still our preferred asset class.

Graham I think we're into a sustainable recovery now. The only concern I have is the extent to which it is already built into the market. We're coming off a couple of very strong quarters of GDP growth in Canada and the United States, and we see that slowing down as we get through that inventory rebuild. As people see the numbers start to slow, they may become a little more concerned, so I'm cautiously optimistic. The consumer is out there spending, but what concerns me is that the savings rate has dropped down to 3%from about 5% a couple of months ago.... The Fed has to keep its foot on the gas pedal. They won't raise rates until sometime next year.

Jackson A lot of people expect a pullback here, but there is always potential for a market pullback of 5% to 10% or more. I'm not overly concerned about that. Earnings are eventually going to run through and drive stock prices higher. Consumers are coming back in the United States--people didn't think they would. I think people are still underestimating the potential return of the U.S. economy as productivity has been very, very good. That's going to flow through to earnings even if the economy slows down a bit.... At this point in the cycle, it is very risky to be out of the market, especially when you have positive earnings.

Decker What's interesting about psychology is the huge gap between professional sentiment and individual sentiment. Professional money managers are fairly optimistic that the fundamentals are good in terms of valuations and earnings, but with the Goldman Sachs fraud announcement the pullback in the American Association of Individual Investors survey was very abrupt, yet you didn't see that with the institutional-investor surveys. So the headline risk is still preventing people from racing into the bull market. I'm not sure it's going to be a melt-up, but I think there is going to be a more gradual move because there is deleveraging macro risk involved. It's always going to crop up, whether it is Greece now or Dubai last quarter. That will prevent wholesale participation by individuals. They'll have to start losing money in the bond market in order to focus them on the risks of locking into low fixedincome rates. This has been the biggest misallocation of capital I've ever seen--the huge move into the bond market after a generation of low interest rates.

Brockelsby The amount of money that went in bond funds in the past year was heavily in favour of bonds by a 10-to-1 margin. With confidence in the economy improving, we expect a substantial amount of funds to flow from bonds to stocks.

Jackson People don't expect to lose money in bond funds. Things like Greece, Goldman Sachs and regulation are headwinds, but that might be what stops the melt-up. Sovereign risk is not to be underestimated and if the euro falls apart, would probably be negative near-term. But companies taking costs out and having earnings momentum will drive the stock market.

Decker The biggest fundamental positive out there is the shape of the yield curve. That has been a dominant theme for us since the dark days of March 2009. Stock prices are determined by three things: the risk-free rate, risk premium and earnings. Those are bullish for stocks right now, but it's the risk premium that's moving us back and forth.

Graham Even though I'm cautious, I think there is more risk of the market going up than down. I think if we get any meaningful rise in U.S. rates, then the consumer will step back.

Jackson As long as earnings can keep up, we can handle higher rates. It's when earnings aren't keeping up that it becomes a real risk to the market.

Brockelsby Corporations have managed themselves relatively well during the financial crisis. Balance sheets are in very good shape with significant liquid reserves and manageable debt. Productivity gains are record-setting as corporations reduced cost structures to the bone during the financial crisis. As a result, earnings are growing at a record pace, which will improve further as top-line revenue increases in a sustainable economic recovery scenario.

Decker It's going to be a tricky transition, though, because you've got the consumer trying to save more, governments madly dis-saving to maintain the entitlements, and there is a mismatch of revenues and expenses there. If you look at Greece, the entitlement system is way above the ability to generate sufficient revenue to support it. They are just an extreme example of the OECD, but it's the same problem everywhere you look.

Brockelsby I hope we don't get bailed out by the resurgence of tax revenues before they get religion about the entitlements. That's the risk long-term.

Jackson Canada got bailed out through devaluing the dollar and raising taxes big-time.

Decker The United States is going to have to do the same thing. They are going to have to have a gasoline tax, a VAT, or both. They can't just get all the tax revenue they want from Wall Street.

Graham We're fortunate in Canada because the stock market is roughly 20% below its peak and the housing prices are probably better than they were.

Jackson With half of it in resources, the Canadian equity market drives its marginal dollar from out of growing economies like Asia, India and Brazil. Then you've got banks, which managed to get through this economy fairly unscathed. Regulation is going to hit them, although nowhere near what people are expecting. We've got pretty good earnings potential and the banks that have operations in the United States are going to see good recoveries as well.

Q What are your views on the strong Canadian dollar?

Brockelsby The last time the Canadian dollar had a strong run to US$1.10, it was a shot across the bow for the manufacturing sector in Canada. I think there has been a lot of repositioning in anticipation of a relatively strong Canadian dollar.

Graham I still think we're seeing regional disparity as far as the dollar goes. In Alberta, for example, it's hurting agricultural businesses. There are pockets where it's definitely going to hurt.

Decker Another big disadvantage we had versus the United States was the total package of labour costs, including post-retirement benefits and health. That gap is completely gone now. The disadvantage for the United States now will be the increase in payroll taxes and health-care program costs. So the adjustments have already been made... We don't need a US75¢ dollar to make us competitive.

Brockelsby The Canadian dollar is tied to the commodity markets. With developed economies playing catch-up to the emerging economies, we believe the commodities sector will remain relatively strong.

Jackson Developed economies are now creating demand at the margin. It used to be other way around.

Tomorrow How are the panelists are playing the financial sector and the impact of regulation, their outlook for China and commodities, and biggest risk factors.

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THE PANEL

Gerry Brockelsby, Marquest Asset Management Marquest manages pooled funds for high-net-worth individuals. These include funds focused on resources, small-cap equity, large-cap equity and global asset allocation.

Robert Decker, Aurion Capital Management Aurion manages money in three areas -- pensions, its high-net-worth LP products and more recently as a sub-advisor for Dynamic Aurion Tactical Balanced Fund and Dynamic Aurion Canadian Equity Fund.

David Graham, CIBC Global Asset Management Graham oversees the management of a variety of funds, but is focused primarily on the CIBC Monthly Income Fund and value funds for both retail and pension clients.

Mark Jackson, NATCAN Investment Management NATCAN manages nearly all asset classes. Jackson is primarily responsible for the Altamira brands and retail-focused products.