

## Economic Outlook – Summer 2009

### *Next leg of recovery won't be as easy*

With the help of several trillion dollars, the world's central banks have patched up the global financial system and staved off a deep collapse of the global economy. The move back from the brink by the U.S. economy in recent weeks has initiated talk of moving into the second phase of the recovery, in which U.S. demand steadily improves and the world economy gradually follows suit.

Although the speed of the recovery to date has been a bit surprising, significant progress has in fact been made in addressing some causes of the downturn. Sanity is returning to U.S. housing markets, with average house prices once again in line with median incomes and unsold housing inventories no longer rising. A more stable U.S. housing sector is the first step towards recovery for the broader economy and has also sent a key signal to Canada's housing market that the worst is probably over. In the financial sector, leverage has been cut and transparency somewhat restored, the "shadow banking system" has evaporated and mortgages are no longer being handed out willy-nilly. More broadly, tighter access to credit is forcing the global economy to rapidly adjust to a new, lower level of consumption.

The talk now turns to the shape of recovery; that is, the timing (how long it will take) and its contours (a sharp rebound, a slow grind or a double-dip). There are three questions that investors should consider at this juncture: First, at what point will gross domestic product (GDP) stop shrinking? From the perspective of economists, the point at which GDP stops contracting signals the end of a recession. Given the strength of the rebound apparent in the indicators noted above, we expect U.S. and Canadian GDP to stop falling in the next three to six months. However, simply because an economy is no longer shrinking does not mean it is healthy. Second, when will economic growth return to its long-run trend of around 3% per year? In our view, this is still a long way off. Finally, at what point does the recovery spark a new bull market in stocks? The market's



40% rebound from its March lows suggests plenty of good news has already been priced into the outlook.

A large stock market gain in such a short time is entirely appropriate when you consider the improvement in the global financial system since March. However, we would remain cautious so long as stock and bond markets continue to price in a relatively smooth recovery and the imminent return of inflationary pressures. Indeed, since mid-June, market optimism has moderated on similar concerns. In past recessions, this was the time when the "green shoots" of recovery blossomed into something more durable; but as

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# CUMIS Market-based Funds

Gross Annualized Rates of Return as at June 30, 2009

FUND	3 Month (%)	1 Year (%)	3 Year (%)	5 Year (%)	10 Year (%)
<b>Money Market</b>					
Canadian Money Market Fund (PH&N)	0.3	2.4	3.8	3.4	3.6
<b>Fixed Income</b>					
Retirement Security Fund (CUMIS)	1.1	4.4	4.7	4.9	5.6
Universe Bond Index Fund (BGI)	1.4	6.7	6.1	5.8	6.3
Income Fund (Ethical)	2.2	6.6	6.1	5.9	—
Fixed Income Fund (McLean Budden)	1.9	8.0	6.5	6.0	6.4
Short-Term Bond & Mtgage Fund (PH&N)	2.4	7.5	5.9	5.0	5.7
Bond Fund (PH&N)	4.0	7.1	6.1	6.1	6.7
<b>Balanced</b>					
Balanced Fund (Ethical)	8.9	-11.2	1.8	4.8	—
Balanced Core Fund (McLean Budden)	9.9	-7.2	1.5	4.0	5.8
Balanced Fund (Mawer)	9.4	-7.5	1.9	5.3	6.4
Balanced Fund (PH&N)	13.0	-8.7	0.6	3.5	4.4
<b>Canadian Equity</b>					
S&P/TSX Composite Index Fund (BGI)	20.0	-25.6	-0.6	6.8	6.3
Canadian Equity Fund (Bissett)	25.7	-18.4	-1.8	4.8	—
Growth Fund (Ethical)	17.0	-21.6	-0.4	5.2	—
Special Equity Fund (Ethical)	16.8	-22.6	-5.4	5.7	—
Canadian Small Cap Fund (Franklin Templeton)	14.8	-46.0	-14.7	—	—
Large Cap Canadian Equity Fund (Mawer)	19.8	-17.2	1.5	8.0	9.6
Small Cap Canadian Equity Fund (Mawer)	21.7	-23.4	-2.2	6.9	13.3
Canadian Equity Core Fund (McLean Budden)	21.2	-19.7	0.8	6.3	9.6
Canadian Equity Value Fund (McLean Budden)	17.4	-13.7	0.5	5.7	10.7
Pure Canadian Equity Fund (PH&N)	23.5	-22.2	-0.9	5.6	7.9
Canadian Equity Fund (PH&N)	22.6	-26.0	-3.9	2.3	4.6
<b>Dividend</b>					
Dividend Income Fund (PH&N)	22.4	-13.9	-2.4	3.1	9.4
<b>U.S. Equity</b>					
U.S. Equity Index Fund (BGI)	6.9	-15.9	-7.2	-5.3	-4.8
U.S. Equity Fund (Mawer)	3.7	-9.5	-2.9	-3.0	-1.6
American Equity Fund (McLean Budden)	7.7	-14.3	-4.8	-3.5	—
U.S. Equity Fund (PH&N)	7.8	-17.8	-8.5	-7.0	-6.3
<b>Foreign Equity</b>					
EAFE Equity Index Fund (BGI)	15.9	-21.2	-6.5	-0.5	-1.2
International Fund (Bissett)	16.1	-19.2	-7.3	-0.8	—
International Equity Fund (Ethical)	15.8	-23.0	-5.5	-0.1	—
Non North American Equity Fund (Mawer)	17.5	-18.0	-2.5	4.3	4.2
Global Equity Fund (McLean Budden)	10.6	-13.6	-4.9	-2.1	-0.5
Overseas Equity Fund (PH&N)	18.2	-12.3	-5.1	-0.5	—
Growth Fund (Franklin Templeton)	10.7	-18.5	-6.2	-1.3	—
<b>Actively Managed Asset Allocation Funds</b>					
LifePoints® Balanced Income (Frank Russell)	7.5	-2.4	2.8	4.7	—
LifePoints® Balanced Growth (Frank Russell)	10.1	-9.6	-0.1	3.8	—
LifePoints® Long-Term Growth (Frank Russell)	12.3	-15.5	-2.6	3.3	—
LifePoints® All-Equity (Frank Russell)	14.2	-21.6	-5.4	0.6	—
<b>Index Managed Asset Allocation Funds</b>					
Conservative Balanced Index Fund (BGI)	7.0	-5.7	1.7	3.3	3.7
Moderate Balanced Index Fund (BGI)	10.0	-11.3	0.1	3.5	4.1
Aggressive Balanced Index Fund (BGI)	13.0	-16.6	-1.6	3.4	3.8
<b>Target-date Funds</b>					
LifePlan™ Retiree Fund (McLean Budden)	6.3	-1.4	3.2	4.4	5.6
LifePlan™ Retirement 2010 (McLean Budden)	6.6	-2.1	3.0	4.5	5.7
LifePlan™ Retirement 2015 (McLean Budden)	8.1	-4.5	2.2	4.1	5.5
LifePlan™ Retirement 2020 (McLean Budden)	8.9	-6.1	1.6	3.8	5.4
LifePlan™ Retirement 2025 (McLean Budden)	9.8	-7.5	1.1	3.6	5.3
LifePlan™ Retirement 2030 (McLean Budden)	10.6	-9.1	0.7	3.4	5.2
LifePlan™ Retirement 2035 (McLean Budden)	11.5	-10.5	0.2	3.1	5.1
LifePlan™ Retirement 2040 (McLean Budden)	12.3	-12.1	-0.5	2.8	4.9

Note: All performance data is shown on a gross or "pre-fee" basis except for Retirement Security Fund

1 - Retirement Security Fund charges 1.2% in Investment Management Fees. The returns shown above for RSF are net of fees.

2 - Please see the Fund Fact Sheets posted on the CUMIS website (www.cumis.com) for benchmark returns on all fund(s).

3 - Pooled funds are not guaranteed, their values change frequently and past performance may not be repeated.

4 - All managers charge additional expenses against the fund which are not included in above fees.

# News from the Government

## 2009 Solvency Funding Relief Measures

In the 2009 Ontario Budget, the government announced proposed measures that would provide temporary solvency funding relief to Ontario registered defined benefit pension plans affected by the financial market turmoil and take steps to ensure greater transparency while helping to protect the security of pension benefits. Regulation 909 (Regulation) made under the Pension Benefits Act (PBA) has now been amended to put these changes into effect.

## Summary of Solvency Funding Relief Measures and Other Changes to Regulation 909

### Temporary Solvency Funding Relief Measures

The temporary solvency funding relief measures are limited to eligible plans, and are effective with the first filed valuation report with a valuation date on or after September 30, 2008 (the solvency relief report):

- The administrator of an eligible plan may elect any or all of the following solvency funding relief options:
  - Defer new special payments (going concern and solvency) determined in the solvency relief report for up to one year;
  - Consolidate pre-existing solvency special payments into a new five-year schedule; and
  - With the consent of the members and former members, extend funding of any new solvency deficiency in the solvency relief report for up to five additional years. The consent requirements do not apply to jointly governed plans
- If the administrator elects at least one of the above options, any gains in future solvency valuations may be used to reduce or eliminate any solvency special payments determined in the solvency relief report.

### Revised Standards for Commuted Values

All plans may make use of the revised CIA commuted value standard for solvency valuations with a valuation date on or after December 12, 2008.

### Contribution Holidays

For plan fiscal years ending between June 30, 2010 and December 31, 2012, contribution holidays will not be permitted unless an actuarial cost certificate that demonstrates sufficient funding excess is filed with the Superintendent.

### Transfer Ratio and Commuted Values

Section 19(5) of Regulation 909 has been revoked and replaced. It now requires the prior approval of the Superintendent to

transfer any part of the commuted value where the transfer ratio is less than one and the administrator knows or ought to know that, since the last valuation report, the transfer ratio has declined by 10 per cent or more.

### Changes to the Rules for Ontario Locked-In Accounts

The Regulation makes numerous important changes to the rules governing locked-in accounts. Locked-in accounts include Locked-In Retirement Accounts (LIRAs), Old Life Income Funds (Old LIFs), New Life Income Funds (New LIFs) and Locked-In Retirement Income Funds (LRIFs). The following points summarize the key changes to the rules, indicate when these changes come into effect, and provide answers to some of the questions that are likely to arise as a result of these changes.

### What are the key changes to the rules?

- From **January 1, 2011** to **April 30, 2012**, owners of **Old LIFs and LRIFs** will have a one-time opportunity to withdraw in cash or transfer to an RRSP or RRIF up to 50% of the total market value of the assets of the fund.
- From **January 1, 2010** to **December 31, 2010**, owners of **New LIFs** will have a one-time opportunity to withdraw in cash or transfer to an RRSP or RRIF an additional 25% of the total market value of the assets of the fund that were transferred into their New LIF account on or before December 31, 2009.
- After **December 31, 2009**, anyone who purchases a New LIF will have a one-time opportunity to withdraw in cash or transfer to an RRSP or RRIF up to 50% of the total market value of the assets of the fund.
- **On or before September 30, 2010**, financial institutions are required to give notice of these and other related changes to owners of Old LIFs and LRIFs.
- **On or before January 1, 2010**, financial institutions are required to give notice of these and other related changes to owners of New LIFs.
- **As of January 1, 2011**, all of the rules that govern locked-in retirement accounts (LIRAs) are consolidated into Schedule 3 under the Regulation.

## Old Age Security

Old Age Security (OAS) benefit rates are unchanged for the July to September 2009 quarter.

Basic OAS benefits, paid to people age 65 and over, are \$516.96 per month. The Guaranteed Income Supplement is \$652.51. The Spouse's Allowance and the Widowed Spouse's Allowance are \$947.86 and \$1,050.68 respectively for the July to September 2009 quarter.

## Economic Outlook ...con'd

we're well aware, this is no ordinary recession. Most major global economies are still shrinking. A new U.S. regulatory regime is being imposed that is causing uncertainty. The emergence of protectionism remains a severe threat to global growth. Finally, there is very little pent-up consumer demand to be unleashed by low interest rates – quite the opposite is true as excess consumer spending was at the root of the problem for the U.S. economy.

Rather than being in the early stages of a consumer-led rebound, the U.S. and global economies may simply be in the later stage of an inventory re-stocking cycle. The collapse in global purchasing managers' indices in late 2008 suggests that companies, where it was possible, virtually stopped production until they could determine the severity of the downturn. For a time, consumers stopped consuming as well, shaken by the ominous news flow. After authorities intervened and prevented the worst-case scenario from occurring, some demand returned, aided as well by government fiscal stimulus spending. Even though the recovery was (and is) government-sponsored, companies still have to produce and sell goods and services – the alternative is to close up shop. The numbers we've seen suggest production is gearing up slowly as demand returns from the abyss. Case in point: U.S. durable goods orders rose for the third time in four months in May, but remain 23% lower than a year earlier.

This supply-side improvement now needs to be validated by consistently stronger demand. However, we expect demand to persist at a level still well short of normal equilibrium for many quarters. Each month continues to bring news of further U.S. job losses numbering in the hundreds of thousands. Mortgage and credit card delinquencies continue to run at very high levels. Higher gasoline prices have diverted precious dollars. U.S. households are still in the early innings of a very long debt-reduction ball game.

Over time, confidence will build and the cycle will become self-reinforcing, but this is a slow process vulnerable to setbacks. In the meantime, there is a high likelihood that the U.S. economy will experience a "double dip", falling back into negative GDP growth for one or more quarters over the next 18 months. Some disappointment for markets is likely, as the pace of economic improvement has tapered off to a level that still indicates the presence of some economic malaise. In this context, the sharp rise in the Canada-U.S.



exchange rate to over 90 cents seemed a bit aggressive, as was the move by markets to factor in U.S. Federal Reserve and Bank of Canada interest rate hikes by year-end.

There are also some longer-term issues that will weigh on markets. One is the growing concern about inflation, a theme fuelled by the billions of dollars in government spending and the trillions of dollars being injected by the U.S. Federal Reserve into the financial system. Bond yields have climbed back to pre-crisis levels and seem poised to march higher at the first sign that the Fed's promised "exit strategy" might not work out. For now, we are more concerned about deflation, given the extremely large gap between what companies are producing and what they could produce if they were running "flat out." Canada's unused production capacity is at its highest ever level and labour markets are soft worldwide. It will take many months before broad-based pricing pressures emerge, even if crude oil and food prices remain elevated.

It will be equally difficult for global monetary authorities to craft a strategy that reduces the pace of government borrowing and spending. Ongoing borrowing will drive interest rates higher and threaten the health of the recovery. At the same time, if households get the sense that higher taxes are on the way, they may once again hunker down and conserve funds. A mere four months after U.S. stock markets hit multi-year lows, much seems to have changed. However, the greatest financial crisis in the history of capitalism will require years, not months, to repair.

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