

VSFA 2004

" DIVEST GLOBAL or GO AGROUND "

Time to Reduce International Exposure

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Quiz Question

- *Can you think of a common every day activity that 94% of the world's population has NOT experienced and, the percentage grows each year?*
- *(Remind me please to revisit this question at end of session...)*

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- *"Go Global or Go Aground"what went wrong?*
- *Topic: It's time to repatriate International assets.*
- *Thesis: international risk premia is too high to justify current commitment levels - 26% median exposure.*
- *Core sentence: Demise of "super power" stalemate replaced by regional and religious clashes.*
- *Embassies, Consulates know more of "systemic IT risk"*

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International

Climate Change

- Not only meteorological climate change in our atmosphere...
- Earth's orbit/axis fluctuates - getting "hotter" everywhere, every way
- Trite Astrophysics metaphor perhaps, but consider...

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International Investing

Past Performance

Historical Total Equity Market Returns

MSCI Indices Jul/04

	Europe	Global	\$CAD EAFE	Japan	CANADA	USA
5 yr	-2.3	-3.7	-3.2	-7.5	5.7	-3.9
10 yr	8.8	6.8	3.9	-3.4	10.6	11.4
15 yr	9.7	7.2	4.5	-2.3	8.5	12.1
20 yr	13.9	11.4	11.1	6.9	9.8	13.5
25 yr	12.6	11.9	11.1	8.7	9.9	13.6
30 yr	14.4	13.5	13.3	11.1	11.7	12.8

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International Investing

Climate Change

Non - Canadian Allocation History – Median % Commitments

	<u>1980</u>	<u>1985</u>	<u>1990</u>	<u>1995</u>	<u>2000</u>	<u>Jun-04</u>
US	7.8	8.4	9.6	11.4	13.7	13.9
Int'l	3.4	4.2	6.3	7.4	9.5	10.5
EMG	0.1	0.3	1.7	2.4	3.1	1.8
TOTAL	11 %	13 %	18 %	21%	26 %	26 %

API SURVEY

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International Investing

Climate Change

Expost "median" returns Jun-04 \$CAD API Segregated Funds

	<u>Balanced</u>	<u>Domestic</u>	<u>Can-Eq</u>	<u>Global</u>	<u>EAFE</u>	<u>Bond</u>	<u>EMRG</u>	<u>USA</u>
5 yr	6.1	<u>8.5</u>	9.6	-0.3	-0.1	6.9	3.3	-3.5
10 yr	9.6	<u>10.6</u>	11.4	10.1	6.2	8.8	4.9	10.1
15 yr	9.5	<u>9.9</u>	9.7	11.8	11.1	9.2	5.2	10.7
20 yr	9.8	<u>9.7</u>	11.3	15.6	11.4	10.5	na	12.7
25 yr	9.6	<u>9.6</u>	10.6	14.3	15.4	10.3	na	13.1
30 yr	9.4	<u>9.5</u>	10.1	12.9	13.1	10.2	na	12.2

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International

Climate Change

- Political Science 101
Belief Sets of Sovereign Countries Differ
- Pure Democracies are rare in world - former British Colonies, Northern & Western Europe...
- Most others –
 - *Republics* (USA - duopoly)
 - *Theocracies* (Iran)
 - *Dictatorships* (Libya)
 - *Plutocracies* (Mexico, Central & South America, SE Asia)
 - *Fiefdoms* (Saudi- Arabia)
 - *Autocracies* (reforming USSR republics)
 - *Monarchies* (Thailand)
 - *Totalitarian* (China, North Korea)
 - *Democracies* in minority...

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International

Climate Change

- ***USA style Democracy*** is detested in most of world as "*hedonistic, godless, egocentric, selfish, indulgent*"
- ***Egalitarianism*** "equality for all" or ***Socialism*** is preferred ethic (ethos)...
- G7 "brand" Democracy does NOT deliver fairness
- Europe's Multi-National corporations respected, not of USA
- Majority of world's people believe in "***pre-destination***"
- "***Capitalism***" in all forms generally considered ***wasteful, exploitive, addictive, repugnant***

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- **ENTROPY** *Non-G7 Attitude "we are advancing" "the "Have" Countries are in state of decay*
- **ENTROPY** - insidious, ubiquitous, unavoidable "decay" of human infra-structures...
- **Examples** - our military, family and social structure, school system, Olympics, corporate governance, television, government, mutual funds, insurance industry, accounting, corporate America-endemic cheating is universal.
- *G7 decay ... caused by high-mobility of "line authority" and "staff advisory" employees*

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- *Elsewhere on Planet... less corruption, population mobility, paternalistic societies, plutocracies rule being curbed*
- Domestically the - New "Axis of evil" ... accountants, actuaries, fund managers, etc.
- Our Citizenry's *attitude to current situation* – just "ugly business" as usual --- not so!

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International Climate Change
External view of World's strongest Economy- USA

- JUGGERNAUT of wealth, mercantilism, militarism, corporatization --- destroys normative ways of life, imperialistic
- Source of SOCIAL INJUSTICE sentiment --- *wealth-to-poverty* ratio of world fundamentally wrong and deteriorating
- USA "exports" instability -Guatamala
- SUSPICION of Adam Smith's "*invisible hand*" of free market ... is "*evil incarnate*"

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International Climate Change
External view of World's strongest Economy- USA

- Pluralism, WORLD BANK and the promise of the 90's has faded.
- Fewer countries wish to emulate USA culture.
- USA Treasury Notes — the "tettering" balance that binds.
- "Socialism" meaning societal rules and customs rule overseas more than forces of economics.
- "*Caveat Venditor*" - *seller beware* is the standing rule, NOT "*caveat emptor*" -- only in G7

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Investment Climate Change
World Social & Demographic Changes

- World economic recovery ***Cycle # 11*** (since WW2) ... started in 2003 and faltering in 2004 ... GDP estimates lowered world-wide for 2005...
- USA-EURO economies in doldrums.
- China highest growth –“our century”
- Social ***Particularism*** (distinct learned behaviour versus integration) -- legitimization and rise of minority groups all over world

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Investment Climate Change
World Social & Demographic Changes

- Nation state ***pluralism*** - acceptance of *distinct minorities* -leads to increased political *conflicts*
- ***Multiple Modernities*** - (different “modern” states and fuller status for more sub-groups)
- Increasing and inevitable ethnic “conflict”
- Hot Spots --Taiwan, INDIA -Pakistan, Korea, Reforming former Russian Republics, China, Indonesia, Mexico, Spain, Argentina, Brazil-et al, Kurdsends in WAR.

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New World Order– Less Friendly than Pre-Cold War

- Reactionary youth in “hot climates”, bedlam of “marketing” hated
- “Sympathetic” socialism and communism abounds
- “Selflessness” to “Self interest” will take many generations
- G-7 confronting R-5...revival of religious fervor
- R5 – Buddhism, Hinduism, Mohammedan, Christianity, Judaism
- Islamic theocracies most strident, zealots want “past empire” grandeur

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International Investment

Coping with Climate Change

- Back to *“Prime Directive” Principle*
- *“every asset class & security is prohibited unless permitted”*
- BASIC WEALTH MANAGEMENT
 - recognize “long term” socio-politico economic trends
 - over-weight positive asset classes-sectors,
 - under-weight negative asset classes-sectors,
 - approve mandates and styles, hire managers
- *Determine global market trends,*
- *Fill in background-own securities, EFTs, Indices*

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Since 2000, we have postulated these major Global Trends.....

- 1) The US Economy (economic domination) is progressively suffering from systemic over - consumption and entering a period of long term secular -- cyclical GDP decline
- 2) International markets face triple waterfall threat

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- 3) US Treasury Notes in trillions owned by Japan, China and third world Banks-will "reverse"
- 4) "Overseas" quest for returns is over. Now is time to bring monies home!
- 5) CANADA -- "it doesn't get any better"

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International Investment Climate Change

- Our 30% foreign property window-sink hole!
- Our own government knows "international risks" far better than fund managers, pundits?
- Investing in a "blind trust" violates fiduciary rules
- If you must invest internationally limit to half weight
- Does a 100% Domestic Portfolio contravene "sound" diversification conventions? Not for a mature Defined Benefit Plan.

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International Investing Climate Change

SUMMARY Comments...

- ✓ The "***Go Global or Go Aground***" mantra reflected the delirium from demise of communism as a ***military*** and ***political*** threat
- ✓ What followed was dollarization and "invited" democratization globally for any country that wanted "development" - the 90's were ripe for "international" investing... ***that has all changed, flight to "gold" has begun***
- ✓ Near term prospects internationally present a dubious future. ***Canada poised for huge export surge***

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- ✓ **ISLAM** is attacking because of "**hate**"-it can win!
- ✓ **CHINA** - every household dreams on enjoying riches of the west- can displace America (Americans believe can loose-are retreating)
- ✓ **Ties** to USA exert downward pressure on our markets
- ✓ Coming "milestone" our equity market will separate from US equity market...

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- ✓ **De-linking** to US Equity Market will cause our market to soar
- ✓ **Private Equity** is highest process in world, public markets are lowest
- ✓ **Re-visit** your international allocation -- 26% is unjustified
- ✓ Fund Managers, Consultants, "lords of liabilities" (actuaries) all have "**over sold**" International Investing
- ✓ Clashing **empires** replaced with clashing **religions**

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International Climate Change-Conclusion

- ❖ *Time for re-examination -- Should "International" be a core asset class — NO !*
- ❖ Opportunities abound domestically-- **private** still "primitive" in Canada vs G6
- ❖ No "negative correlation" to Canada stocks after all in "international" equities
- ❖ Impetus to exit ... metrics show negative attribution to performance over all market cycles on average for Canada's tax-exempt funds

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International Climate Change-Conclusion

- ❖ Contention -- Few funds show **positive contribution** from "International" assets
- ❖ Investment climate — *does not always get better*
- ❖ Only "Trustees" not managers/consultants can alter asset allocation policy
- ❖ Fund managers have "vested" reasons to remain invested in perpetuity in USA and overseas markets

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International
Climate Change – Conclusion cont'd

- ❖ Requiem To DB Plans
- ❖ Consider this atypical but true scenario...
- ❖ DB Pension Master Trust Plan of 5 Pension Plans
- ❖ 30 yr annualized total ROR is 13.9% to Dec 31, 2003!
- ❖ Retained same two "balanced" managers for 30 years!

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International
Climate Change – Conclusion cont'd

- ❖ Assets tripled from 1990 to 2000 -- same Market Value now as in 2003
- ❖ Tri-annual valuation to Dec 31, 2003 concluded unfunded liability...?
- ❖ *"Long Live DB Plans — may they rest in peace"!*
- ❖ Last word ... "equity risk premia is rising Internationally"

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International Investing

Climate Change

Conclusion "...the future of tax-exempt funds lies in "private equity" and "direct ownership"...the lowest % allocation ...

"...the reasons for disinvesting arise long before action to do so is eventually taken..."

...the bedlam of marketing!!-No thank you!

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International

Climate Change

Answer to Quiz Question...

- *Can you think of a common every day activity that 94% of the world's population has NOT experienced and, the percentage grows each year?*

... any volunteers....?

Thank you, patient listeners!

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