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Gluskin Sheff

SPECIAL REPORT

Crossing Borders

INVESTING OUTSIDE OF CANADA PROVIDES DIVERSIFICATION BENEFITS

Over the past 60 years, numerous studies have documented the benefits of diversification. At the portfolio level, owning multiple companies with less than perfect correlation can reduce risk, without necessarily lowering return. While we actively diversify the holdings within our various portfolios at Gluskin Sheff, diversification can also be employed effectively at the country level. Over the past decade, the Canadian equity market, as represented by the S&P/TSX Total Return Index, has enjoyed considerable outperformance against both the S&P 500 and the MSCI EAFE Total Return Indices, as illustrated in Table 1, while slightly underperforming the MSCI Emerging Market Total Return Index.

SUMMARY

- Investing outside of Canada provides diversification benefits
- Opportunities exist in the U.S. equity market for stock pickers
- Our disciplined approach to U.S. equity investing
- Current valuation levels for international markets are attractive
- Sector exposure improves outside of Canada

TABLE 1: EQUITY INDEX COMPOUND RETURNS (1991 — 2011)*

Dec 1991 – Dec 2001	Annualized Return
S&P 500 TR Index	16.60%
MSCI EAFE TR Index	8.17%
MSCI EM TR Index	6.42%
S&P/TSX TR Index	10.36%
Dec 2001 – Dec 2011	**Annualized Return**
S&P 500 TR Index	-1.59%
MSCI EAFE TR Index	0.51%
MSCI EM TR Index	9.18%
S&P/TSX TR Index	7.02%

Notes:
** In Canadian dollar terms*
Source: Bloomberg, Gluskin Sheff

The Canadian outperformance was, in part, driven by strong levels of domestic growth, a stable banking sector and the growth in China, which positively impacted the demand for our commodities. The other material factor was the Canadian dollar, which appreciated from the $0.63 USD range in late 2001 to $1.00 in late 2011. For the greater part of the past decade, Gluskin Sheff has been overweight the Canadian market, which enjoyed strong gains. In the past several months, we have been moving more assets into our U.S. and international portfolios, given the valuation opportunities in certain markets and the diversification benefits offered outside of Canada.

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Gluskin Sheff + Associates Inc. is one of Canada's pre-eminent wealth management firms. Founded in 1984 and focused on serving high net worth private clients and institutional investors, we are dedicated to meeting the needs of our clients by delivering strong, risk-adjusted returns together with the highest level of personalized client service. For more information or to subscribe to Gluskin Sheff economic reports, visit www.gluskinsheff.com

CHART 1: CANADIAN DOLLAR EXCHANGE RATE

Canada
(US$ per C$)

Source: Bloomberg, Gluskin Sheff

If we were to go back a little farther and gauge the performance of the Canadian market against the U.S. and international markets in the previous decade (1991-2001), Canada underperformed the S&P 500 by a considerable margin, while slightly outperforming the international MSCI indices. These examples are not put forward to suggest a draconian move out of Canada, but rather a view that clients with concentrated portfolios should diversify their equity allocation outside of Canada. In sectors such as Technology, Consumer Staples, Consumer Discretionary and Industrials, investors can find much greater choice outside of Canada. At Gluskin Sheff, we have teams actively managing both U.S. and international equity portfolios.

OPPORTUNITIES EXIST IN THE U.S. MARKET FOR STOCK PICKERS

In the U.S., our focus is on companies that generate above average returns on capital, enjoy strong competitive advantages and have earnings streams that have illustrated defensive characteristics throughout the business cycle. This results in portfolios that typically have lower volatility than the broader market. Vis-à-vis Canada, the U.S. market has considerably more companies that offer defensive earnings streams. In a slower growth environment, we contend that those firms that have demonstrated a willingness to return capital back to shareholders will outperform the broader market. This return of capital can come in the form of dividends or share buybacks. Considering the low rates of return currently available from government bonds and cash, stocks that can deliver, for example, a 3% dividend and 5% buyback offer a solid return for long-term investors. Clearly, valuation levels are also fundamental to our analysis, given the impact of volatile price/earnings multiple swings in this slower growth environment.

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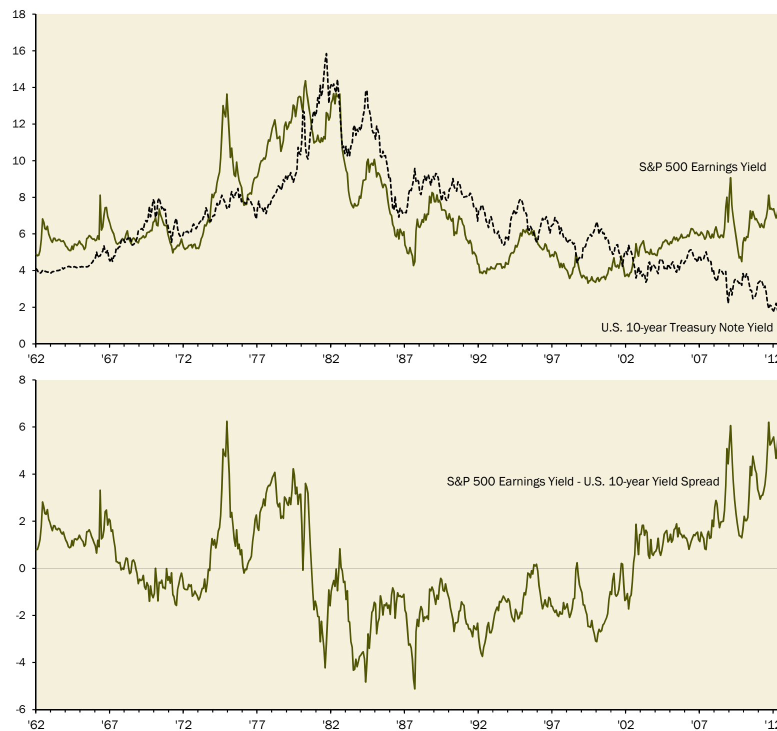
Currently, the spread between the earnings yield (earnings divided by total market capitalization) on the S&P 500, which is above 7%, versus the yield on U.S. 10-year government bonds, which is below 2%, is close to a 50-year high, suggesting that stocks may present good relative value. As well, over the past few years, we have seen strong money flows into U.S. government bonds, as

compared to lacklustre flows into the equity markets. Historically, when government bonds have reached these stretched levels as compared to equities, the subsequent 10-year period delivered considerably higher returns for stocks. Prudent stock picking at current valuation levels, particularly for large cap U.S. equities, should deliver good performance relative to government bonds over a multi-year time horizon.

CHART 2: S&P 500 EARNINGS YIELD AND U.S. 10-YEAR TREASURY NOTE YIELD

United States
(percent)



Source: Bloomberg, Gluskin Sheff

OUR DISCIPLINED APPROACH TO U.S. EQUITY INVESTING

Our two U.S.-focused equity portfolios are the GS+A U.S. Equity Portfolio and the GS+A U.S. Premium Income Portfolio, with the teams managing these portfolios working extremely closely together. We believe these portfolios are complementary and provide clients with good diversification opportunities into the U.S. market.

The U.S. Equity Portfolio targets companies that offer attractive growth prospects as well as "value" companies that offer stability and attractive total shareholder yields. We do not speculate on highly indebted firms, but rather gravitate toward conservatively financed entities. We target businesses that operate in segments with considerable barriers to entry, which serves to insulate their margins and returns from competitors. This is evidenced by the Portfolio's materially higher return on equity relative to the broader market. As such, the dividend yield of the U.S. Equity Portfolio is lower than that of the U.S. Premium

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Income Portfolio, given the former's mix of higher growth, higher ROE businesses. Some examples of holdings in the U.S. Equity Portfolio include the likes of Apple, Berkshire Hathaway, Home Depot, Ecolab and Intuit.

An example of a lesser known company in the U.S. Equity Portfolio is LKQ Corporation. Operating primarily in the North American market, this multi-billion dollar firm is the largest supplier of alternative auto parts for the car insurance industry. Due to heightened competition that has weighed down premiums, insurance companies have been looking for ways to cut the cost of making repairs to damaged vehicles. LKQ works with insurance companies and repair shops to supply safe, alternative parts, lowering the cost of a repair. Whereas in the basic mechanical market, alternative parts usage has over 80% market share, it is just 37% for collision repairs, a $16 billion market. However, this has been increasing by 1% per year, or $160 million, driving underlying growth for LKQ. Along with an increase in underlying market share, the expanding market should drive organic growth of 7-12% for LKQ. The company has recently expanded into the United Kingdom market, where alternative parts usage for collision repairs is less than 10%. From 2007 to 2011, which includes the 2008 crisis, the company has grown earnings by 35%, 39%, 15%, 34% and 29%, respectively.

The cornerstone of the U.S. Premium Income Portfolio is free cash flow.

The cornerstone of the U.S. Premium Income Portfolio is free cash flow. Excess cash is a fundamental advantage for a business as it allows competent management teams to reallocate those dollars towards the highest return potential. While income is our primary focus, it can come in multiple forms (such as dividends or share repurchases). Buying companies for the yield alone is neither thoughtful nor prudent if there is no underlying growth in the business to sustain those above-average yields. Sustainable income-producing investments usually have high visibility and recurring revenue, without sacrificing growth. Predictability in free cash flow allows management to focus on the long-term strategic decisions for the business rather than managing to quarterly earnings expectations.

An example of one of the Portfolio's holdings is Comcast. With 23 million cable subscribers who pay 30 days in advance (the business therefore requires minimal working capital to operate), Comcast has an enviable business model. Customer retention is extraordinarily high as 35% also receive their internet and phone service as part of a cable package. As well, there are few alternative providers. Free cash flow has grown by 25% per year in each of the last five years. It is this abundance of discretionary cash, along with a strong balance sheet, that allowed Comcast to acquire NBC Universal during the depths of the crisis at a trough price/earnings multiple, on trough earnings, from a distressed seller (General Electric). It is a wonderful business with high recurring revenue and pricing power that pays a 2.3% dividend and repurchases 4-5% of its outstanding stock annually.

Similar to the U.S. Equity Portfolio, the U.S. Premium Income Portfolio is able to gain exposure to a broad and complementary group of sectors (for example, Consumer Staples, Technology and Healthcare) that typically offer fewer attractive opportunities in the Canadian market.

CURRENT VALUATION LEVELS FOR INTERNATIONAL MARKETS ARE ATTRACTIVE

Despite the current challenges involving the European recession, sovereign debt crises and slowing growth in China, there are many attractive investment themes that have emerged in global equity markets. Our GS+A International Portfolio is positioned to take advantage of these themes. The Portfolio takes a similar approach to "bottom up" stock picking as other Gluskin Sheff equity portfolios, but in markets outside of the U.S. and Canada. We also rely on our team's "top down" views on different economies and sectors, as "top down" economic factors can have a significant impact on individual stock performance.

Not all countries around the world are in similar economic situations or stages of development. With a universe of approximately 45 different countries in which to invest, the Portfolio can invest in countries that are experiencing growth and are more isolated from external forces. In order to capitalize on differing growth trends globally, the International Portfolio has the flexibility to be selective in the countries, sectors and companies in which it invests. While there are many concerns about the external environment, many international equity markets are trading at very low valuations. Emerging markets and European equity markets are trading at forward price/earnings multiples in the single digits. Such depressed valuation levels are historically quite rare, and can often present attractive long-term investment opportunities for the disciplined stock picker.

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In addition to attractive valuations, many governments around the world have been implementing expansionary policies to stimulate their economies. Inflation has fallen quickly, which provides further flexibility for more stimulative monetary and fiscal policies. The International Portfolio seeks to benefit from long-term structural trends that we expect to remain in place for years to come. Such themes include: spending growth by emerging market consumers as their incomes rise and countries develop; factory automation as the need for improved productivity is required to offset rising labour and material costs; and rising food consumption as many countries' populations continue to grow and demand higher caloric intake and protein. The International Portfolio also seeks to invest in strong global brands not available on North American markets that are in a position to increase global market share.

Two examples of holdings in the International Portfolio are LVMH from France and Samsung Electronics from South Korea. LVMH is a globally diversified luxury brand company, which is best known for its Louis Vuitton brand. It has such a strong brand that despite a "no discount" policy, sales for the Louis Vuitton brand grew in the double digits during the global financial crisis, driven by the emerging market consumer. The company also benefits from owning other luxury brands such as Tag Heuer (watches) and Moet Hennessy (wines & spirits).

Samsung Electronics is a strong global brand and is the main mobile handset competitor for Apple with its Galaxy S product line. Samsung's large economies of scale and integrated business model provide the company with a competitive advantage over others in terms of technological lead and profit margins. In addition, regardless of which companies are competing in the mobile handset, tablet and PC markets, Samsung is poised to benefit as it is a major supplier of components such as memory and display for various types of devices. Despite the rivalry with Apple, Apple currently has no choice but to utilize Samsung

components throughout their product line. Samsung also has other segments including home appliances, TVs, consumer electronics and flat panels that could contribute more meaningfully to earnings in the future.

The International Portfolio offers significant diversification benefits as it has a relatively low correlation with North American markets and is currently diversified across 18 countries. While not initially obvious, the multiple currency exposure also acts to lower foreign exchange volatility. Since the Portfolio was launched, the net impact of all currency fluctuations has been almost negligible. Overall, we continue to identify very attractive investment opportunities in international equity markets, especially given the current environment of subdued expectations and depressed valuations.

SECTOR EXPOSURE IMPROVES OUTSIDE OF CANADA

We believe clients with a high concentration of their assets in our Canadian portfolios would be well served by increased exposure to our U.S. and international portfolios. The U.S. and international markets provide access to larger, highly liquid companies in a wide variety of sectors that are not as strongly represented in Canada, such as Technology, Consumer Staples, Consumer Discretionary, Industrials and Health Care. In what continues to be a challenging and volatile investment environment, we strongly believe that reducing country and sector concentration can provide significant diversification benefits and improve risk-adjusted returns.

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Yours very truly,

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Peter Mann
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Gluskin Sheff

Gluskin Sheff at a Glance

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OVERVIEW

As of March 31, 2012, the Firm managed assets of $5.5 billion.

Gluskin Sheff became a publicly traded corporation on the Toronto Stock Exchange (symbol: GS) in May 2006 and remains 46% owned by its senior management and employees. We have public company accountability and governance with a private company commitment to innovation and service.

Our investment interests are directly aligned with those of our clients, as Gluskin Sheff's management and employees are collectively the largest client of the Firm's investment portfolios.

We offer a diverse platform of investment strategies, including Canadian, U.S. and International Equity strategies, Alternative strategies and Fixed Income strategies.[1]

The minimum investment required to establish a client relationship with the Firm is $3 million.

PERFORMANCE

$1 million invested in our Canadian Equity Portfolio in 1991 (its inception date) would have grown to $9.3 million[2] on March 31, 2012 versus $6.2 million for the S&P/TSX Total Return Index over the same period.

$1 million USD invested in our U.S. Equity Portfolio in 1986 (its inception date) would have grown to $14.5 million USD[2] on March 31, 2012 versus $12.2 million USD for the S&P 500 Total Return Index over the same period.

INVESTMENT STRATEGY & TEAM

We have strong and stable portfolio management, research and client service teams with "best in class" talent at all levels.

We have a strong history of insightful bottom-up security selection based on fundamental analysis.

For long equities, we look for companies with a history of long-term growth and stability, a proven track record, shareholder-minded management and a share price below our estimate of intrinsic value. We look for the opposite in equities that we sell short.

For corporate bonds, we look for issuers with a margin of safety for the payment of interest and principal, and yields which are attractive relative to the assessed credit risks involved.

We assemble concentrated portfolios - our top ten holdings typically represent between 25% to 45% of a portfolio. In this way, clients benefit from the ideas in which we have the highest conviction.

Our success has often been linked to our long history of investing in under-followed and under-appreciated small and mid cap companies both in Canada and the U.S.

PORTFOLIO CONSTRUCTION

In terms of asset mix and portfolio construction, we offer a unique marriage between our bottom-up security-specific fundamental analysis and our top-down macroeconomic view.

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For further information, please contact questions@gluskinsheff.com

Notes:

Unless otherwise noted, all values are in Canadian dollars.

1. *Not all investment strategies are available to non-Canadian investors. Please contact Gluskin Sheff for information specific to your situation.*
2. *Returns are based on the composite of segregated Canadian Equity and U.S. Equity portfolios, as applicable, and are presented net of fees and expenses.*

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