Bill Webb
Executive Vice-President & Chief Investment Officer
bwebb@gluskinsheff.com

David A. Rosenberg
Chief Economist & Strategist
drosenberg@gluskinsheff.com

Gluskin Sheff

SPECIAL REPORT

In Search of the Holy Grail: Risk-Adjusted Returns

In our January 2012 quarterly package to clients, Bill authored a special report entitled, *How to Make Money — and Sleep Well at Night — in 2012 and Beyond*, in which he described the specific Gluskin Sheff investment strategies, tactics and themes that we have been emphasizing for the volatile and uncertain environment that investors face today. So far, 2012 is unfolding without any major surprises.

Now as we enter the second quarter of the year, we are jointly penning this brief essay to update our clients on the state of the capital markets and where we believe opportunity lies. Importantly, we want to reemphasize our team's best thoughts and strategies regarding how we will deliver attractive "risk-adjusted returns" for our clients.

Global equity and bond markets were generally strong during the first quarter of 2012, driven by the European Central Bank's backdoor quantitative easing (via the Long-Term Refinancing Operation (LTRO) program), expectations for better economic growth in the U.S. and hopes for a "soft landing" in China. Investors perceived that some of the "tail risks" to the global economy and capital markets had been mitigated, and were willing to refocus on company-specific fundamentals and profitability.

Although markets rallied and subsequently sold off a bit, we continued to follow the course that Bill described to you at the beginning of the year and we want to reinforce it here. We are pleased with the risk-adjusted returns that we have generated so far this year for clients who are diversified across a broad range of our strategies. From a bottom-up perspective, our Investment team remains constructive. We continue to identify many attractive opportunities to invest in the securities of great businesses where we have strong conviction that we can achieve our objectives: capital preservation, capital appreciation, reliable income generation and positive absolute returns for our clients.

From a bottom-up perspective, our Investment team members remain constructive. We continue to identify many attractive opportunities to invest in the securities of great businesses…

Our key conclusions have not changed materially from earlier in the year and can be summarized briefly as follows:

1. We expect a variety of income-oriented assets including dividend paying equities (in both Canada and the U.S.) and corporate bonds to perform well in 2012, as they did in 2011. Our flagship Premium Income strategy and our new U.S. Premium Income strategy (launched this past January) offer ways to invest in high-quality equities that generate reliable and often growing dividends, as well as in some preferred shares and corporate bonds. Our various credit and credit arbitrage strategies provide avenues to invest in corporate bonds or to take advantage of the tightening in corporate credit spreads over time.

We expect a variety of income-oriented assets including dividend paying equities (in both Canada and the U.S.) and corporate bonds to perform well in 2012, as they did in 2011.

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

2. As mentioned last quarter, we believe that investors should continue to have significant exposure to Canadian securities and to the Canadian dollar. That said, for clients who have few non-Canadian investments, we continue to systematically increase our exposure to U.S. and international equities in both our long-only equity portfolios as well as in our long-short alternative strategies. We are identifying and investing in many companies with strong balance sheets, high returns on capital, abundant free cash flow generation and attractive valuations, often accompanied by generous dividends or share buyback programs. While the U.S. economy faces some obvious challenges, the fact remains that Corporate America is in very strong financial shape. This is the kind of environment in which good fundamental research and stock picking pays off.
3. Disciplined, well-managed hedge funds will continue to play an important role in an investor's overall asset mix. In volatile and often range-bound markets, we will do our best to take advantage of the volatility in a more nimble, focused and prudent fashion to generate more consistent positive absolute returns. We did this amidst the volatility of the first quarter and will continue to do so.

Disciplined, well-managed hedge funds will continue to play an important role in an investor's overall asset mix.

We continue to hold the view that the overall income theme remains intact even if this strategy has lagged the broader indices so far this year. The reality is that the dividend yield for the MSCI All-Country World Index at 2.6% is nearly double the 1.5% yield in government bond markets and the spread between the S&P 500 dividend yield and Baa corporates is about as tight as it has been in the past five decades. Let's also not forget the solid shape that corporate balance sheets are in. Solid may even be an understatement here. For example, we just received the fourth quarter Fed flow of funds data. The report showed that 77.6% of total nonfinancial corporate debt is now locked in — long-term in nature. This minimizes roll-over or refinancing risk. A decade ago, this ratio was 65.8% and five years ago it sat at 72%. The liquid asset ratio (the ratio of liquid assets to short-term liabilities) rose to 59.3% in Q4 from 57.5% in Q3, 32.2% a decade ago and 42.3% five years ago. This is the highest liquidity ratio since the third quarter of 1955!

The extremely high levels of cash also lead to three other themes beyond just the positive background they establish for corporate bond investments:

1. M&A (mergers & acquisitions) are very likely going to emerge as a critical theme as this cash gets put to work.
2. The large cash stash on corporate balance sheets also provides the business sector with substantial leeway to buy back their stock. What this does is actually provide some critical valuation support for the stock market, especially important now as profit margins come down from their cycle highs and reported earnings flatten out in U.S. dollar terms.

3. Dividend plays may have lagged so far this year after the blowout outperformance in 2011, but this secular theme is intact. Dividend payments rose 10.3% in 2011 to $814 billion and this followed an 18.9% increase the previous year. This is an important source of cash flow returns for investors and the record-high level of cash on the corporate balance sheet points to higher payout ratios ahead. For investors, interest income has fallen 3% from year-ago levels given this Fed-engineered ultra-low yield environment. In fact, since the Fed embarked on this massive rate-cutting campaign in late 2007, interest income for the household sector has collapsed $350 billion or by roughly 30%. Even after the rough ride in 2008 and 2009 and the lack of payouts coming out of the banking sector, dividend income for the household sector has risen 9% over the five-year time frame that interest income has plunged 30%. At the rate the two lines are diverging, we are probably no more than a year away from seeing dividends replace interest as the most important source of non-wage earnings for the household sector.

This is not a case of being bullish or bearish, but a case of simply identifying the appropriate strategies for the time and assessing where there is value and where there is not. Even for the bears, one can certainly preserve capital by being in cash, but that is no way to build wealth. From our perspective, zero percent yielding cash is not an attractive option given the strategies we have available to generate attractive income in a low-yield environment. Capital preservation is of course crucial. Safety and income at a reasonable price remains a core strategy at Gluskin Sheff.

This is not a case of being bullish or bearish, but a case of simply identifying the appropriate strategies for the time and assessing where there is value and where there is not.

When you have the 5-year note yield at 1%, S&P dividend yield at 2%, investment grade bond yields at 3% and a high-yield BB-rated bond barely higher than 5%, you know the markets are telling you that income is scarce. As such, you want to own more income in your portfolio, and abandon those things that are in abundance.

Ordinarily, cash is king in a deflationary environment except when it is yielding zero percent; when that happens, it is cash flow that becomes king and that is exactly what ‘hybrids’, such as our Premium Income and U.S. Premium Income strategies, are devoted to providing — a lower-risk but high-yield way to approach the stock market. Complementing these strategies in a well-rounded asset mix are disciplined, non-correlating hedge funds that can take advantage of market volatility and generate consistent returns in all market environments.

In these volatile markets, different investment strategies will have their day in the sun, but it is key not to put all your eggs in one basket. Our clients will be well-served by investing in an appropriate and diversified mix of well-executed strategies across geographies and asset classes. This will be the key to finding the Holy Grail of attractive long-term risk-adjusted returns.

Yours very truly,

Bill Webb
Executive Vice-President &
Chief Investment Officer

David A. Rosenberg
Chief Economist &
Strategist

Overview of themes and strategies

THEME	STRATEGY	SECTOR/ASSET CLASS
Frugality	Identify where people spend their money and time in an economic downturn	Dollar/Discount stores Home improvement/ Gardening Tobacco/Beverages/Movies
Non-Cyclical	Focus on special situations that are not correlated with the economic cycle	Defense-Aerospace Healthcare
Capital Preservation	Buy high-quality corporate and government bonds in non-cyclical sectors; Minimize volatility via alternative strategies long/short equity strategies	Credit of Canadian Banks, Telecom, Retail, Municipalities Income-producing equities, preferreds and bonds
Income Orientation	Focus on reliable dividend growth and dividend yield; Being and staying ahead of the robust demographic (baby-boomers aging) shift towards income oriented investments. Safety and Income at a Reasonable Price (S.I.R.P.)	Canadian and U.S. Preferred shares Energy infrastructure Utilities
Mobility/ Connectivity and IT Infrastructure	Focus on those firms that benefit from the secular trend surrounding the portability of data and increased consumer usage of smartphones/tablets. Identify and invest in firms that benefit from cloud-based strategies that allow customers to be more efficient and realize cost savings.	Technology firms Cellular carriers/Tower companies
Other	Invest in hard "strategic" assets; Focus on burgeoning middle class in emerging markets	Asian consumers Food products

Gluskin Sheff at a Glance

Gluskin Sheff + Associates Inc. is one of Canada's pre-eminent wealth management firms. Founded in 1984 and 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.

OVERVIEW

As of December 31, 2011, the Firm managed assets of $5.3 billion.

Gluskin Sheff became a publicly traded corporation on the Toronto Stock Exchange (symbol: GS) in May 2006 and remains 45% 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 $9.2 million[2] on December 31, 2011 versus $5.8 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 $12.9 million USD[21] on December 31, 2011 versus $10.9 million USD for the S&P 500 Total Return Index over the same period.

INVESTMENT STRATEGY & TEAM

We have strong and stable portfolio 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.

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.

$1 million invested in our Canadian Equity Portfolio in 1991 (its inception date) would have grown to $9.2 million[2] on December 31, 2011 versus $5.8 million for the S&P/TSX Total Return Index over the same period.

For further information, please contact research@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.*

IMPORTANT DISCLOSURES

Copyright 2012 Gluskin Sheff + Associates Inc. ("Gluskin Sheff"). All rights reserved.

This report may provide information, commentary, and discussion of issues relating to the state of the economy and the capital markets. All opinions, projections and estimates constitute the judgment of the author as of the date of the report and are subject to change without notice. Gluskin Sheff is under no obligation to update this report and readers should therefore assume that Gluskin Sheff will not update any fact, circumstance or opinion contained in this report.

The content of this report is provided for discussion purposes only. Any forward looking statements or forecasts included in the content are based on assumptions derived from historical results and trends. Actual results may vary from any such statements or forecasts. No reliance should be placed on any such statements or forecasts when making any investment decision, and no investment decisions should be made based on the content of this report.

This report is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and particular needs of any specific person. Under no circumstances does any information represent a recommendation to buy or sell securities or any other asset, or otherwise constitute investment advice. Investors should seek financial advice regarding the appropriateness of investing in specific securities or financial instruments and implementing investment strategies discussed or recommended in this report.

Gluskin Sheff may own, buy, or sell, on behalf of its clients, securities of issuers that may be discussed in or impacted by this report. As a result, readers should be aware that Gluskin Sheff may have a conflict of interest that could affect the objectivity of this report. Gluskin Sheff portfolio managers may hold different views from those expressed in this report and they are not obligated to follow the investments or strategies recommended by this report.

This report should not be regarded by recipients as a substitute for the exercise of their own judgment and readers are encouraged to seek independent, third-party research on any companies discussed or impacted by this report.

Securities and other financial instruments discussed in this report are not insured and are not deposits or other obligations of any insured depository institution. Investments in general and, derivatives, in particular, involve numerous risks, including, among others, market risk, counterparty default risk and liquidity risk. No security, financial instrument or derivative is suitable for all investors. In some cases, securities and other financial instruments may be difficult to value or sell and reliable information about the value or risks related to the security or financial instrument may be difficult to obtain. Investors should note that income from such securities and other financial instruments, if any, may fluctuate and that the price or value of such securities and instruments may rise or fall and, in some cases, investors may lose their entire principal investment. Past performance is not necessarily a guide to future performance.

Foreign currency rates of exchange may adversely affect the value, price or income of any security or financial instrument mentioned in this report. Investors in such securities and instruments effectively assume currency risk.

Any information relating to the tax status of financial instruments discussed herein is not intended to provide tax advice or to be used by anyone to provide tax advice. Investors are urged to seek tax advice based on their particular circumstances from an independent tax professional.

Individuals identified as economists in this report do not function as research analysts. Under U.S. law, reports prepared by them are not research reports under applicable U.S. rules and regulations.

In accordance with rules established by the U.K. Financial Services Authority, macroeconomic analysis is considered investment research.

Materials prepared by Gluskin Sheff research personnel are based on public information. Facts and views presented in this material have not been reviewed by, and may not reflect information known to, professionals in other business areas of Gluskin Sheff.

To the extent this report discusses any legal proceeding or issues, it has not been prepared as nor is it intended to express any legal conclusion, opinion or advice. Investors should consult their own legal advisers as to issues of law relating to the subject matter of this report. Gluskin Sheff research personnel's knowledge of legal proceedings in which any Gluskin Sheff entity and/or its directors, officers and employees may be plaintiffs, defendants, co—defendants or co—plaintiffs with or involving companies mentioned in this report is based on public information. Facts and views presented in this material that relate to any such proceedings have not been reviewed by, discussed with, and may not reflect information known to, professionals in other business areas of Gluskin Sheff in connection with the legal proceedings or matters relevant to such proceedings.

The information herein (other than disclosure information relating to Gluskin Sheff and its affiliates) was obtained from various sources and Gluskin Sheff does not guarantee its accuracy. This report may contain links to third—party websites. Gluskin Sheff is not responsible for the content of any third—party website or any linked content contained in a third—party website. Content contained on such third—party websites is not part of this report and is not incorporated by reference into this report. The inclusion of a link in this report does not imply any endorsement by or any affiliation with Gluskin Sheff.

Gluskin Sheff reports are distributed simultaneously to internal and client websites and other portals by Gluskin Sheff and are not publicly available materials. Any unauthorized use or disclosure is prohibited.

TERMS AND CONDITIONS OF USE

Your receipt and use of this report is governed by the Terms and Conditions of Use which may be viewed at www.gluskinsheff.com/terms.aspx

This report is prepared for the exclusive use of Gluskin Sheff clients, subscribers to this report and other individuals who Gluskin Sheff has determined should receive this report. This report may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of Gluskin Sheff.

YOU AGREE YOU ARE USING THIS REPORT AND THE GLUSKIN SHEFF SUBSCRIPTION SERVICES AT YOUR OWN RISK AND LIABILITY. NEITHER GLUSKIN SHEFF, NOR ANY DIRECTOR, OFFICER, EMPLOYEE OR AGENT OF GLUSKIN SHEFF, ACCEPTS ANY LIABILITY WHATSOEVER FOR ANY DIRECT, INDIRECT, CONSEQUENTIAL, MORAL, INCIDENTAL, COLLATERAL OR SPECIAL DAMAGES OR LOSSES OF ANY KIND, INCLUDING, WITHOUT LIMITATION, THOSE DAMAGES ARISING FROM ANY DECISION MADE OR ACTION TAKEN BY YOU IN RELIANCE ON THE CONTENT OF THIS REPORT, OR THOSE DAMAGES RESULTING FROM LOSS OF USE, DATA OR PROFITS, WHETHER FROM THE USE OF OR INABILITY TO USE ANY CONTENT OR SOFTWARE OBTAINED FROM THIRD PARTIES REQUIRED TO OBTAIN ACCESS TO THE CONTENT, OR ANY OTHER CAUSE, EVEN IF GLUSKIN SHEFF IS ADVISED OF THE POSSIBILITY OF SUCH DAMAGES OR LOSSES AND EVEN IF CAUSED BY ANY ACT, OMISSION OR NEGLIGENCE OF GLUSKIN SHEFF OR ITS DIRECTORS, OFFICERS, EMPLOYEES OR AGENTS AND EVEN IF ANY OF THEM HAS BEEN APPRISED OF THE LIKELIHOOD OF SUCH DAMAGES OCCURRING.

If you have received this report in error, or no longer wish to receive this report, you may ask to have your contact information removed from our distribution list by emailing research@gluskinsheff.com.