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SPECIAL REPORT

Cash is Trash. Cash FLOW is King!

SUMMARY

- Provocative and thoughtful questions from a client
- The headlines are worrisome, but there are prudent ways to make money … and sleep at night
- The strategic
- The tactical
- The security-specific
- Answering our client's questions

PROVOCATIVE AND THOUGHTFUL QUESTIONS FROM A CLIENT

Earlier this month we had the privilege of attending a gathering with a group of current and prospective clients to share our views on the economic and investing environment; to discuss in detail how Gluskin Sheff has been managing our clients' assets in this milieu; and to answer a variety of probing questions on our strategies, our views, our disciplines and even on specific companies in which we are invested. We always enjoy meeting with our clients, whether in person, by phone or by videoconference. We take our fiduciary duties very seriously when we invest our clients' savings and these meetings are excellent opportunities for our team of professionals to listen to, reflect upon, and discuss our clients' objectives, concerns and questions. And they do ask a lot of great questions!

At a recent meeting, a client asked a couple of thoughtful and provocative questions that we want to share with you in this commentary. *"Markets have been extremely volatile for a number of years now and the headlines in the newspaper about the U.S., Europe and even China continue to worry me. I have some of my assets invested, but I'm still nervous and sitting on a lot of cash that's earning me close to zero with interest rates as low as they are. Is now a good time to invest? And if so, what strategies should I be considering and how should I be investing?"*

These were excellent questions that made us pause and reflect. It occurred to us that many other clients might be asking themselves similar questions, so we've decided to share our thoughts with you in this commentary.

THE HEADLINES ARE WORRISOME, BUT THERE ARE PRUDENT WAYS TO MAKE MONEY … AND SLEEP AT NIGHT

There is no question that many of the headlines we read in the newspapers are worrisome. Deleveraging (i.e., debt reduction) by consumers and below-trend economic growth in most of the world's developed economies are likely to persist for a number of years. Governments and central banks will continue to resort to aggressive and unconventional means of fiscal and monetary stimulus to offset this slower growth and avoid a deflationary stall, whether through forms of QE (quantitative easing) or fiscal stimulus where possible. Near-zero short-term interest rates (which the U.S. Federal Reserve expects to prevail until at least mid-2015) have the direct and indirect effect of reducing the expected returns for a number of asset classes, which makes the investing environment all that more challenging. In this setting, cash really is "trash" if one hopes to earn a return that will exceed expected inflation, and even more

Cash really is "trash" if one hopes to earn a return that will exceed expected inflation, and even more so if one hopes to generate an attractive return commensurate with taking appropriate and well-understood risks

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, visit www.gluskinsheff.com

so if one hopes to generate an attractive return commensurate with taking appropriate and well-understood risks.

The good news is that, while volatility and "news headline risk" have remained high in 2012, our portfolio managers and analysts have continued to focus on cash flow and we have been able to find numerous ways to make money this year across a variety of companies, sectors, asset classes and strategies. These are far from "normal" markets, but with a thoughtful approach and the right mix of strategies, we firmly believe that it is possible to navigate through the "noise" and that now *is* a good time to invest, and not to be "hiding in cash".

Our team is encouraged by the fact that we are able to find so many publicly traded companies in Canada, the U.S. and beyond that are in fantastic financial shape. These are well-managed businesses in a variety of industries that have strong balance sheets, churn out significant free cash flow and are generating very high returns on invested capital, which is ultimately how businesses create value. After going through the financial crisis of 2008/2009, many of the companies that we invest in are more focused than ever on running their businesses in a lean and efficient manner with very strong balance sheets. We see more management teams using their free cash flow to improve returns to shareholders, either by buying back their own shares in the market (when they are perceived to be trading below their intrinsic value) or by increasing the dividends paid to shareholders, who are hungry for income in this low interest rate and lower return world.

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In order to produce the attractive risk-adjusted returns that we have year-to-date, we have had to make a variety of decisions at the "strategic", "tactical" and "security-specific" levels.

THE STRATEGIC

At the "strategic" (or "asset mix" level) we have continued to allocate a significant portion of our clients' assets to a variety of income-generating strategies, in line with the S.I.R.P. theme ("Safety and Income at a Reasonable Price"), which we have been advocating for many quarters. Our flagship Canadian Premium Income strategy (with a 4.2% yield[1]) and our new U.S. Premium Income strategy (with a 2.4% yield[1]) have earned attractive returns so far this year by investing in high-quality equities that pay reliable and often growing dividends, as well as in preferred shares and corporate bonds from time to time. Our various fixed income and credit arbitrage strategies have enabled us to invest in investment grade and high-yield bonds and take advantage of the substantial tightening in corporate credit spreads that has taken place over the course of this year. As we highlighted earlier this year, we felt that corporate credit, generally speaking, was undervalued and was factoring in much higher default rates than we thought would actually occur, given the financial strength of the companies whose bonds we had invested in. Investors in our Enhanced Bond strategy (with a 3.8% yield[1]), Credit Arbitrage strategy (with a 5.4% yield[1]), Enhanced Credit Arbitrage strategy (with a 6.1% yield[1]) and Enhanced Yield

Notes:
1. See Important Disclosures page.

strategy (with a 6.9% yield[1]) have experienced attractive returns this year as corporate credit spreads have tightened.

From a strategic standpoint, it was also beneficial to systematically invest more of our clients' assets, beginning earlier this year, in companies listed on U.S. equity markets via our U.S. Equity strategy, our U.S. Premium Income strategy and within some of our alternative investment strategies. Investing more in the U.S. has allowed our clients to diversify their exposure and access a wider range of high quality companies with strong fundamentals, trading at very attractive valuations (like Apple, IBM, Comcast and Tyco International) in industries that are under-represented in the Canadian equity markets (like Health Care and Technology, to name just two).

THE TACTICAL

Year-to-date, our alternative investment strategies, which have a significant place in many clients' asset mixes, including the Income Long/Short strategy, the Equity Long/Short strategy and the Focused Long/Short strategy, have accomplished their objectives of delivering attractive absolute returns with relatively low correlation to the overall equity markets. These returns have come about through a combination of strong stock selection and through being more effective at a "tactical" level within our portfolios. In volatile and often range-bound markets (like those experienced for a good part of 2012), we have done our best to take advantage of the volatility in a nimble, focused and prudent fashion. These tactical shifts can involve managing the portfolios in a more "active" fashion, making changes to position sizes in particular stocks and ETFs (or cash weightings) or adjusting our overall exposure to the broad market or particular slices of the market according to our short- or intermediate-term views.

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This "tactical" approach to managing all of our portfolios has paid off this year as we have been able to adjust our positioning to benefit from the ebbs and flows of the equity and credit markets. We are spending more time as a team collectively discussing what we are seeing in the markets and adjusting our positioning in unison when we have conviction on a particular course of action. Volatility can be frustrating and discouraging for investors, but it is a fact of life in the investing world, and can be profitably exploited.

THE SECURITY-SPECIFIC

Over the course of 2012, our team has observed a gradual, but noticeable, general decline in the correlations between securities, which had been unusually high in recent years. These reduced correlations, combined with our focus on fundamental research, have enabled us to identify and own many outstanding businesses trading at attractive valuations. As a result, strong security selection has played an important role in generating returns. This year, some of our largest equity positions across multiple strategies have contributed significantly to these returns. These holdings include companies as diverse as Dollarama, The North West Company, Westshore Terminals, Brookfield Infrastructure Partners, Telus, General Growth Properties and Berkshire Hathaway.

Notes:
1. See Important Disclosures page.

We have also been patient and chosen to invest in certain sectors when we thought the time was right. Until August of this year, we had very little exposure to the common shares of Canadian banks (although we owned a lot of their corporate bonds) as they underperformed the broader Canadian market for most of the year. By August, the banks were trading at attractive valuations ranging between 9.5x to 11.0x forward earnings, with returns on equity in the high teens and dividend yields of almost 5%. When the banks reported their fiscal third quarter results, there were a number of expected and unexpected dividend increases and we moved quickly to take significant positions in a number of our strategies in some of our favourite bank franchises, including Bank of Nova Scotia, The Toronto-Dominion Bank and Royal Bank of Canada.

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In a similar fashion, we have recently increased our investments in the shares of gold mining companies in our Resource and Canadian Equity strategies, including Goldcorp, Agnico-Eagle Mines, Yamana Gold, Barrick Gold and Franco-Nevada (a gold-focused royalty company). Broadly speaking, gold bullion has significantly outperformed gold mining shares over the last decade as investors have flocked to invest in ETFs (exchange-traded funds) linked to gold bullion, while selling their shares in gold miners, resulting in significant valuation compression in the equities. As a result, gold mining shares have recently traded at some of the most attractive valuations that we have seen in many years, at a time when the price of gold bullion has climbed to almost USD$1,800 per ounce, driven by waves of monetary stimulus and by investors who view gold as a "store of value" in a world of competitive currency devaluations and a near-zero return on cash. In recent months, gold mining equities have finally begun to outperform gold bullion given their attractive valuations, widening profit margins and the fact that management teams are running their gold mining businesses with a much greater focus on cash flow and are even trying to increase dividends in order to distinguish themselves from gold bullion, which pays no dividend.

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ANSWERING OUR CLIENT'S QUESTIONS

Our client asked two straightforward questions: *"Is now a good time to invest? And, if so, what strategies should I be considering and how should I be investing?"* Our answer is an emphatic, "Yes! Now is a good time to invest, but in the right combination of equity, fixed income and alternative strategies." In this environment, cash really is trash and cash flow is king. It's not about being simplistically "bullish" or "bearish" on the equity markets or any other asset class, but about focusing on the fundamentals and having the right tools to exploit the opportunities and reduce the risks that always lie in front of us. At Gluskin Sheff, we believe that we have the right mix of strategies (all of which we manage in-house) to help our clients make money and sleep at night. That said, we are always trying to improve our processes and ensure that we have the best possible people working towards our main goal of delivering attractive risk-adjusted returns for our clients.

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This commentary began with us communicating with our clients and addressing their most important questions and concerns. Nothing is more important to us

than ensuring that we are up to date in our understanding of our clients and their changing circumstances and objectives. We view ourselves as being in a dynamic partnership that works best when we are actively and regularly engaged with one another. We do our best to stay in touch. That said, please don't hesitate to contact us if anything is on your mind or if you have questions of any kind. If you are unhappy about anything, please tell us what we are missing. If you are unsure of anything, please ask us. If you are happy, please tell us what we are doing right … and don't hesitate to tell your friends! We have the strategies and people to help. Thank you for your continued trust, support and confidence and the opportunity to be of service.

Yours very truly,

Bill Webb
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Gluskin Sheff

Gluskin Sheff at a Glance

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OVERVIEW

As of June 30, 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]

$1 million invested in our Canadian Equity Portfolio in 1991 (its inception date) would have grown to $9 million[2] on June 30, 2012 versus $5.8 million for the S&P/TSX Total Return Index[3] over the same period.

$1 million USD invested in our U.S. Equity Portfolio in 1986 (its inception date) would have grown to $13.9 million USD[2] on June 30, 2012 versus $11.9 million USD for the S&P 500 Total Return Index[3] 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, 2, 3. See Important Disclosures page.

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The Strategic (Page 2)

1. Yields are presented gross of fees and expenses as of October 11, 2012. Past returns are not necessarily indicative of future performance.

Gluskin Sheff at a Glance (Page 6)

1. Past returns are not necessarily indicative of future performance. Rates of return are those of the composite of segregated Canadian Equity and U.S. Equity portfolios, as applicable, and are presented net of fees and expenses and assume reinvestment of all income. Portfolios with significant client restrictions which would potentially achieve returns that are not reflective of the manager's portfolio returns are excluded from the composite. Returns of the pooled fund versions of the portfolios are not included in the composite.

2. Investment amounts are presented to reflect the actual return of the composite of segregated Canadian Equity and U.S. Equity portfolios and are presented net of fees and expenses.

3. The S&P/TSX Total Return Index and S&P 500 Total Return Index calculations are based on the securities included in the S&P/TSX Composite and S&P 500 Composite, respectively, and include dividends and rights distributions.