

Economic Outlook

presented by:

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Table of Contents

Outlook: The Big Picture	3
2008: In Review	4
Financial Meltdown.....	10
Economy	19
Policy Response	27
Crisis & Response	31
Equity.....	38
Strategy	60
Conclusion	69
Appendix	70



Outlook

The Big Picture

Economy	Growth		The U.S. economy is in recession (start date 12/07). Q108 and Q109 will show significant negative growth in GDP. If policy response hits its mark, U.S. economy should emerge from recession in the latter part of 2009.
	Jobs		Unemployment rate will continue to move upward, and non-farm payrolls will continue to decline. Unemployment rate could top 9.0%.
	Profits		Earnings will continue to be constrained by a weak economy. “Never waste a good crisis” mentality will allow corporate America to take write-downs and lower guidance.
	Inflation		Inflationary pressures have evaporated—replaced with some concern over deflation. Commodity prices have collapsed.
	Rates		Rates will remain low for some time to come.
	Risks		Banks don’t lend, exacerbating the current credit crunch. Global economies suffer more than the U.S. Deflation takes hold in the U.S.
	Investment Opportunities		Stable cash-rich companies—masters of their own destiny. Companies with high and growing dividend yields.

Source: RBC Wealth Management



2008 In Review



2008: A Year of Extremes

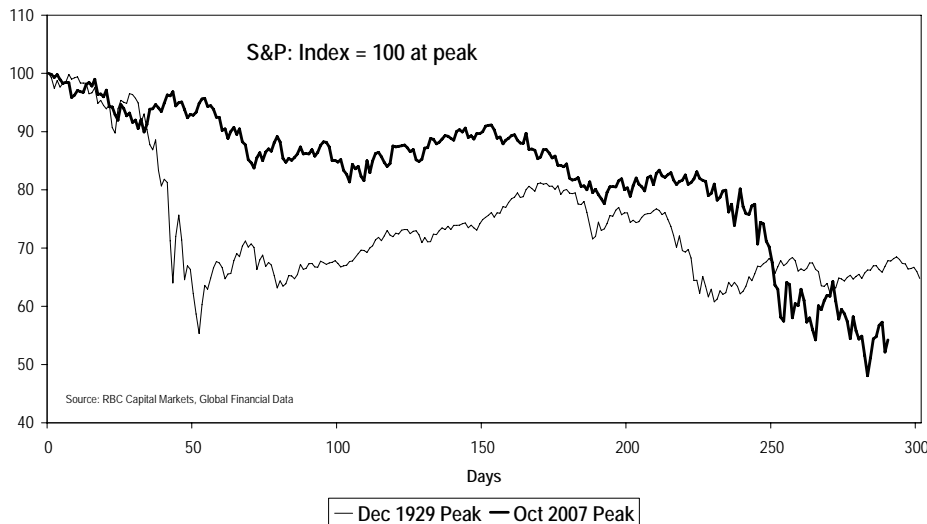
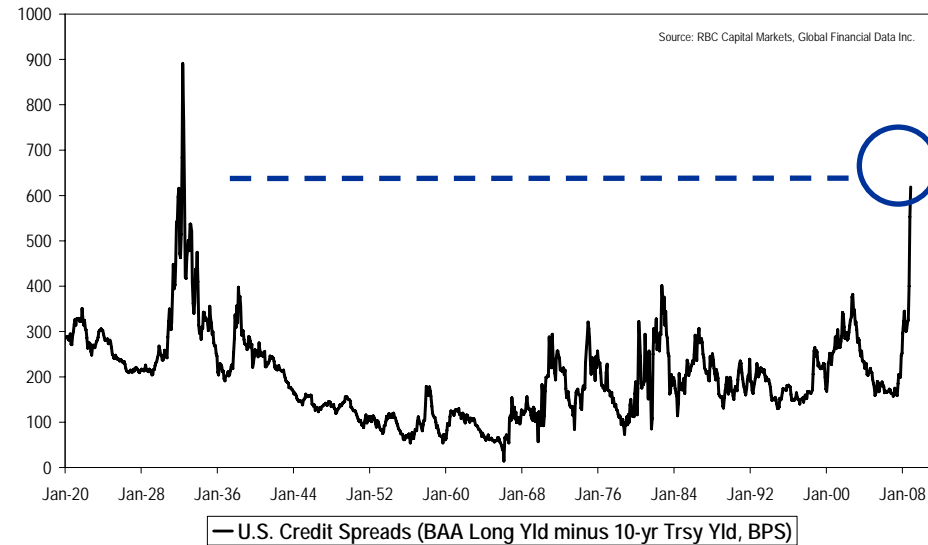
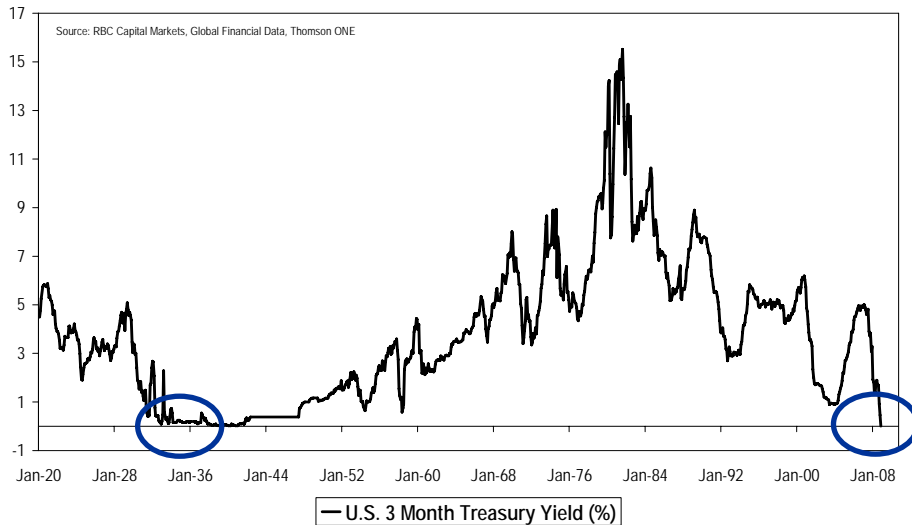
2008 will certainly be one for the history books—a year of extremes and significant milestones that we would just as soon forget.

The financial crisis that unfolded in the summer of 2007 gained momentum and took no prisoners. Major financial institutions both here and abroad were either brought to their knees or, in a number of cases, ceased to exist as a result of the carnage (Bear Stearns and Lehman Brothers are two notable examples).

- U.S. Economy enters recession (12/07), according to NBER.
- Unemployment spikes to 6.7%
- LEIs fall to some of their lowest levels in years.
- Commodity prices collapse. Oil tops \$145/bbl in July to end the year just above \$40/bbl.
- Short-Term Treasury yields went to zero, as a flight to quality took over.
- Dow Jones declined 33.84%, its worst year since 1931.
- S&P 500 declined 38.5%, its worst year since 1937.
- Nasdaq Composite declined 40.5%, its worst annual performance in the index's 38-year history, even eclipsing the 39.3% plunge in 2000 after the technology stock bubble burst.
- Volatility was very high.
- In October the Dow had two of the six biggest one-day percentage gains in its 113-year history and then gave back all the gains and fell to new lows.
- Four of the 20 biggest daily percentage declines in Dow history happened in the last four months of the year.
- Sector Performance: Not a single sector ended the year in positive territory.
- The worst-performing sector was no surprise—Financials—with a decline of almost 57%. Defensive areas such as Consumer Staples, Healthcare, and Utilities fared better, showing lower losses than that of the S&P 500 index overall.



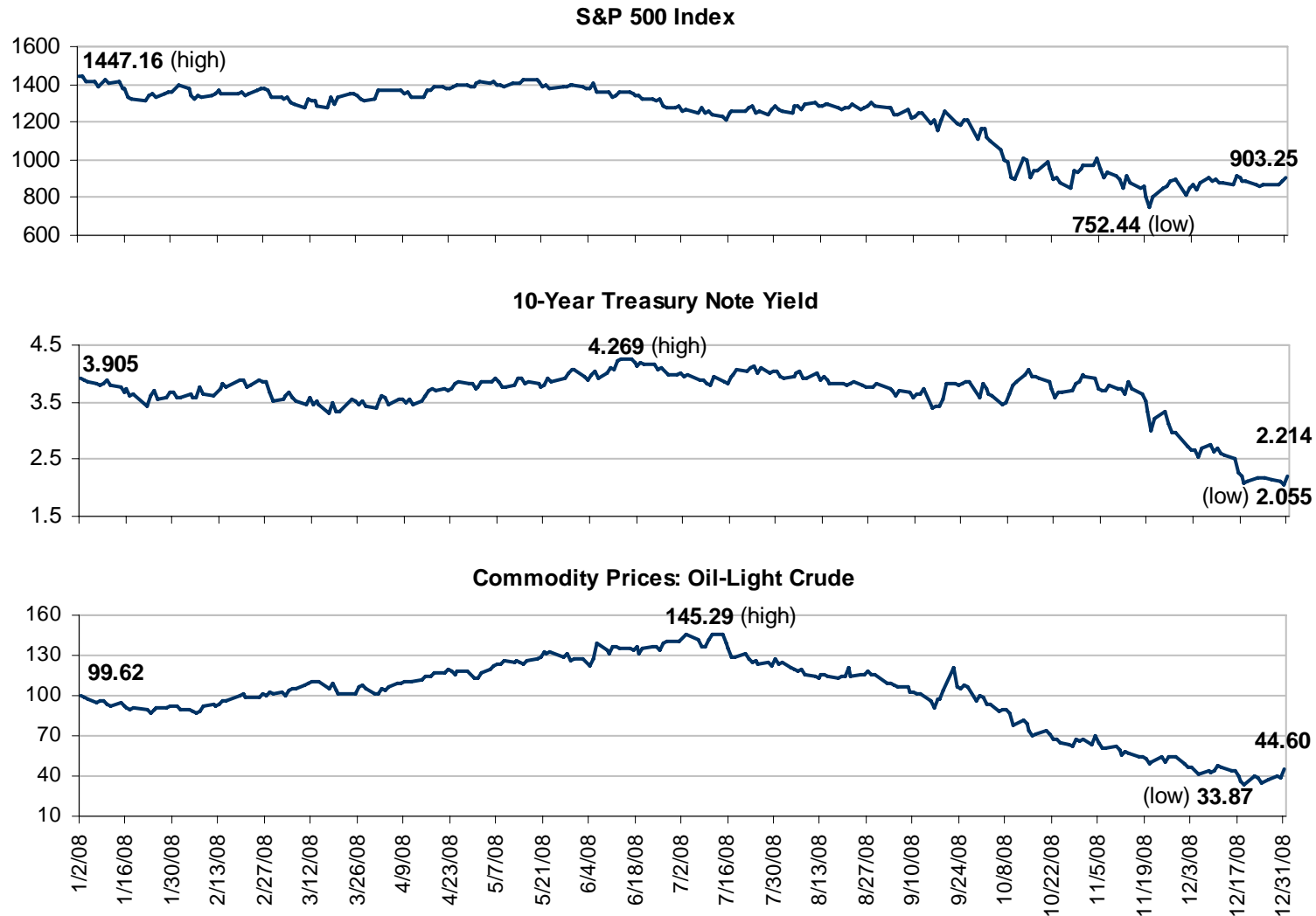
2008: A Year of Extremes



- T-bill yields are driven to 0% for first time since 1930s.
- Credit spreads at their highest level since 1932.
- At 290 trading days after the peak, this sell-off was more severe than the one post-1929.



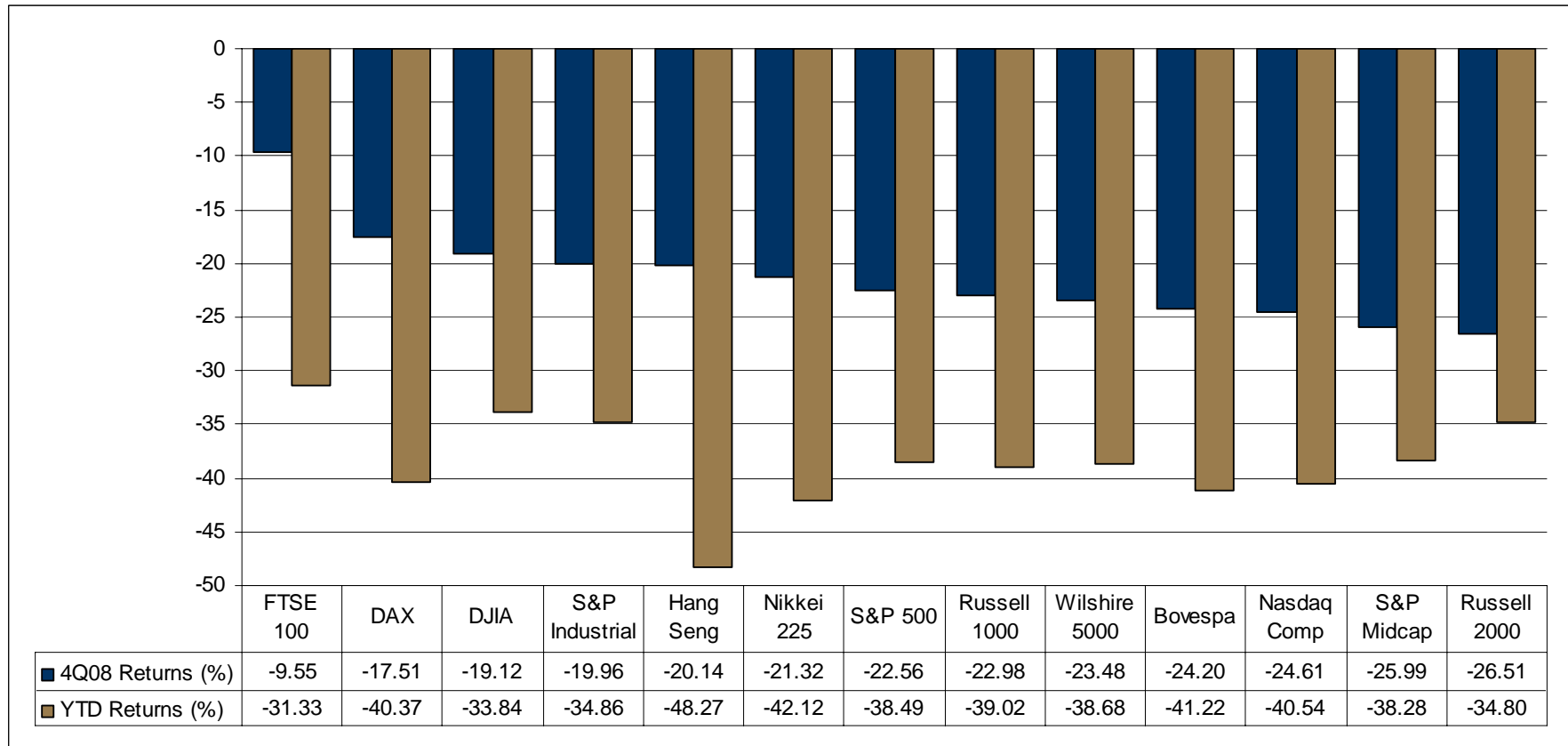
2008: A Year of Extremes



Source: Bloomberg, 12/31/08



Global Index Returns: 4Q08 & YTD

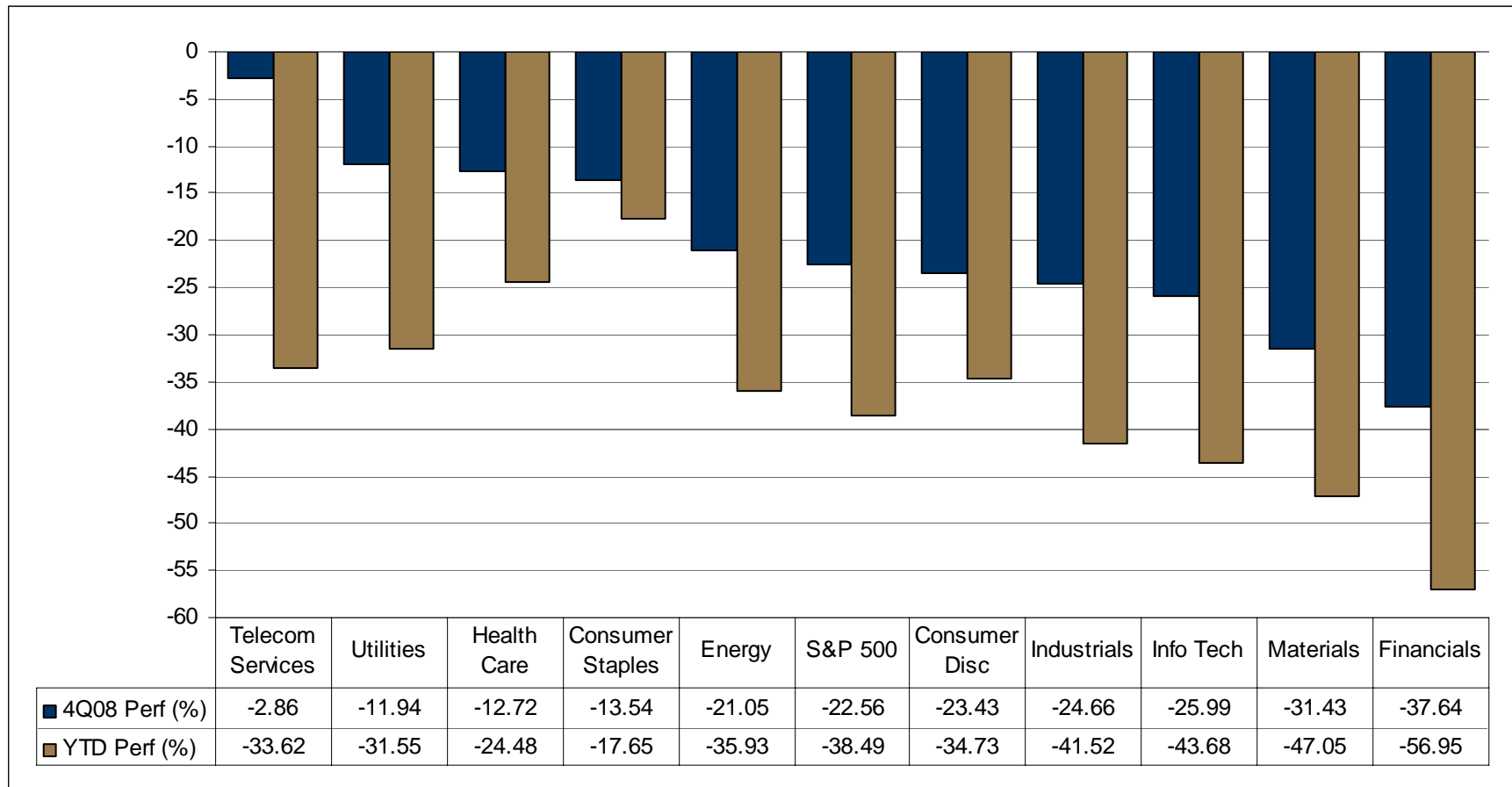


Quarterly Date Range: 9/30/08 – 12/31/08 and YTD Date Range: 12/31/07 – 12/31/08

Source: FactSet



S&P Sector Performance: 4Q08 & YTD



Quarterly Date Range: 9/30/08 – 12/31/08 and YTD Date Range: 12/31/07 – 12/31/08

Source: FactSet



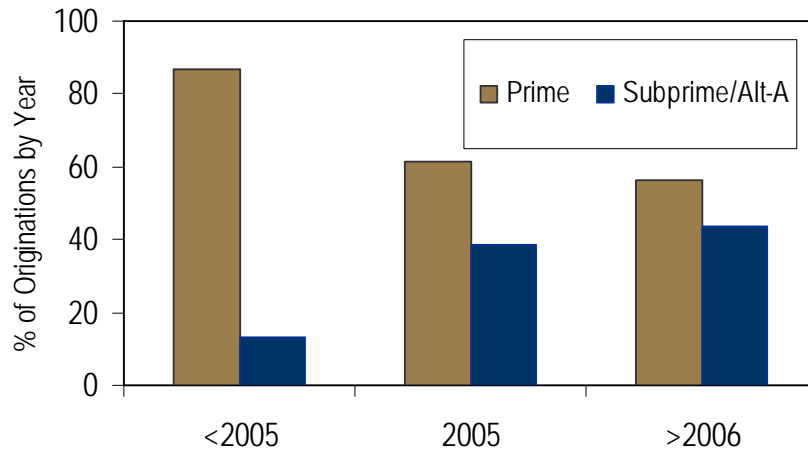
Financial Meltdown



Financial Meltdown

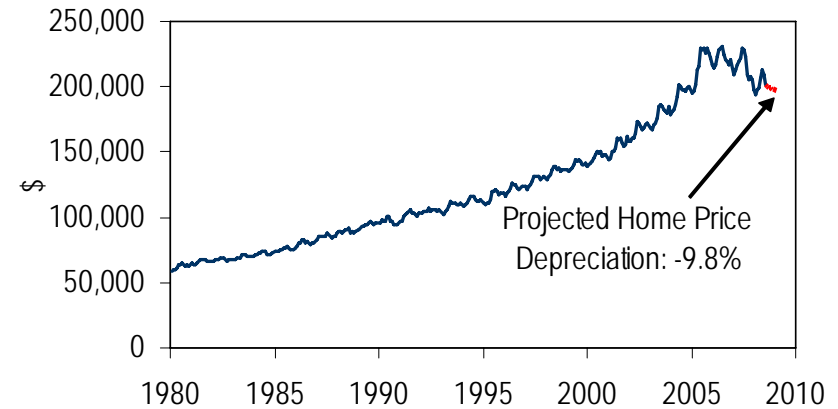
The Roots

U.S. Mortgage Originations
Type of Loan by Date of Insurance



Source: Lehman Brothers, Loan Performance, Inside B&C Lending, ISI

U.S. Housing - Median Sales Price
Existing Single Family Home



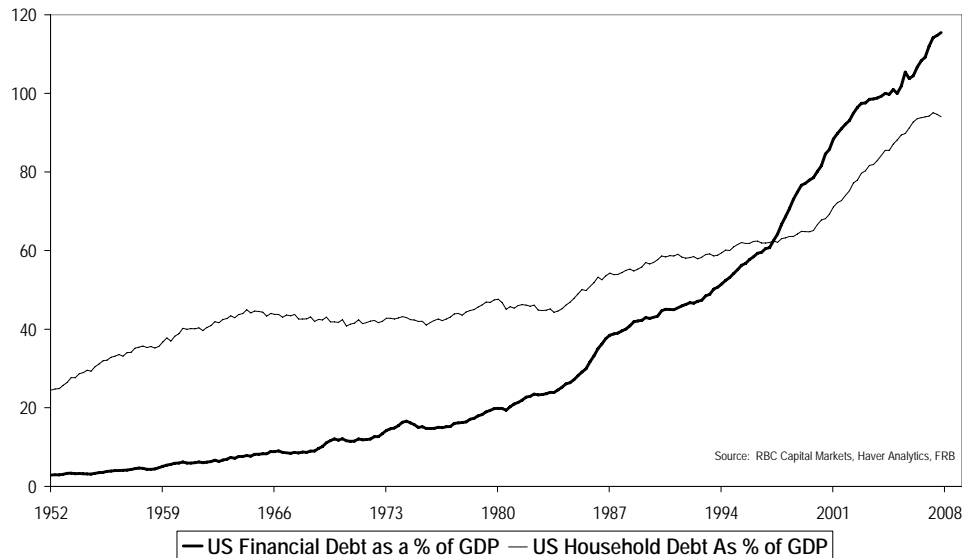
Source: National Association of Realtors, Existing Home Sales, Bank of America Securities LLC

- Loose lending practices led to problem mortgages.
- At peak, 50% of loans were sub or Alt-A loans.
- 46% of loans in 2006 utilized greater than 95% financing.

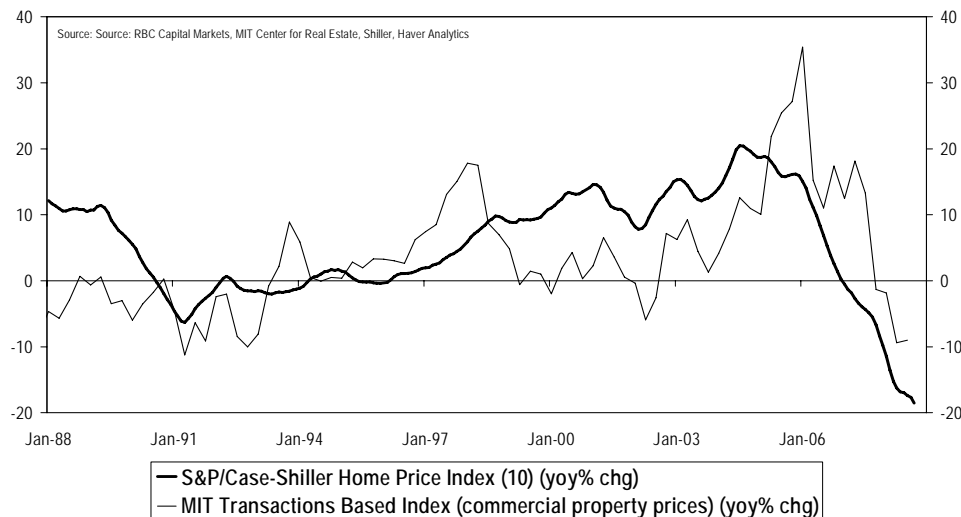


Financial Meltdown

An Epic Deleveraging Cycle



- Household and financial sector leverage is unprecedented.
- Residential and commercial real estate prices are deflating.
- The value of the collateral supporting these mountains of debt continues to fall.

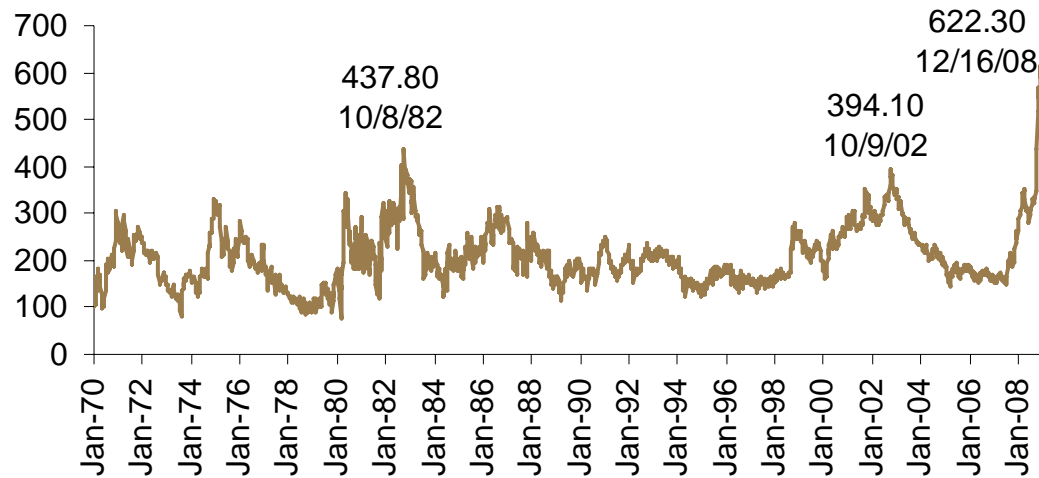




Financial Meltdown

Credit Spreads at Historic Levels

One Credit Spread is at a Very High Altitude
 Basis Point Difference Between
 Moody's Corporate Baa Bond Yield and the 10-yr Treasury Yield



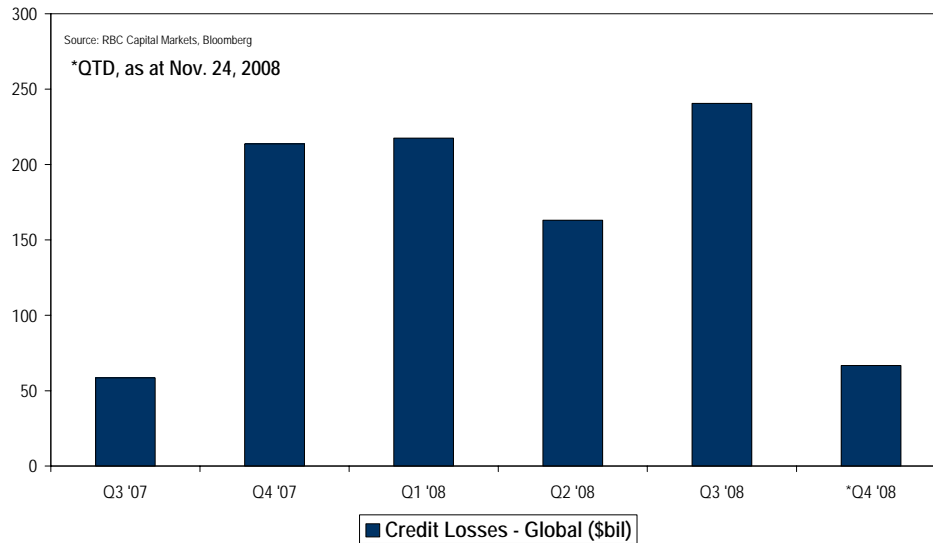
Source: RBC Wealth Management, Bloomberg; data is from 1/1/1970 through 12/30/2008.
 The spread was 591.5 on 12/30/08.

- Credit spreads are at some historic extremes.
- Risk aversion is high.

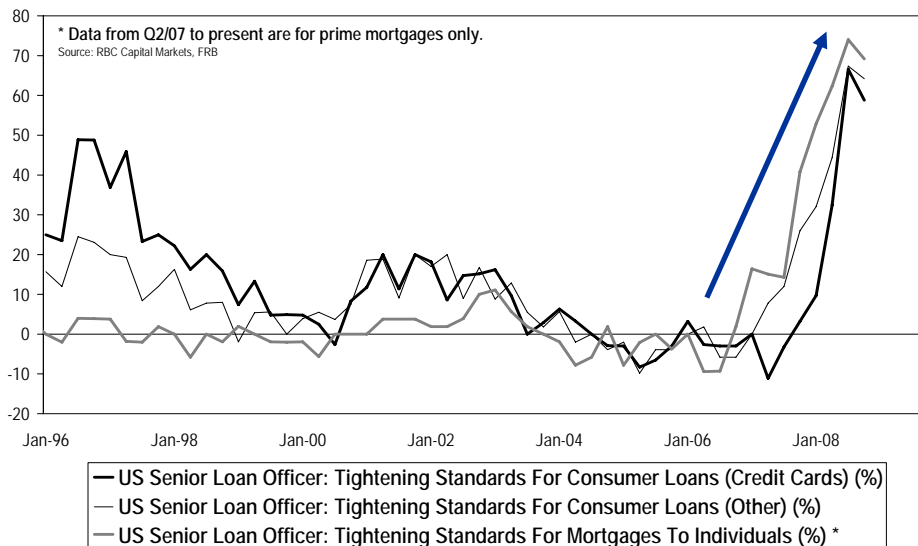


Financial Meltdown

An Epic Deleveraging Cycle



- The banks have been absorbing huge losses.
- Global write-downs are at \$1 trillion, with the U.S. comprising a 69% share.
- Banks are tightening lending standards and hoarding cash to shore up their balance sheets.

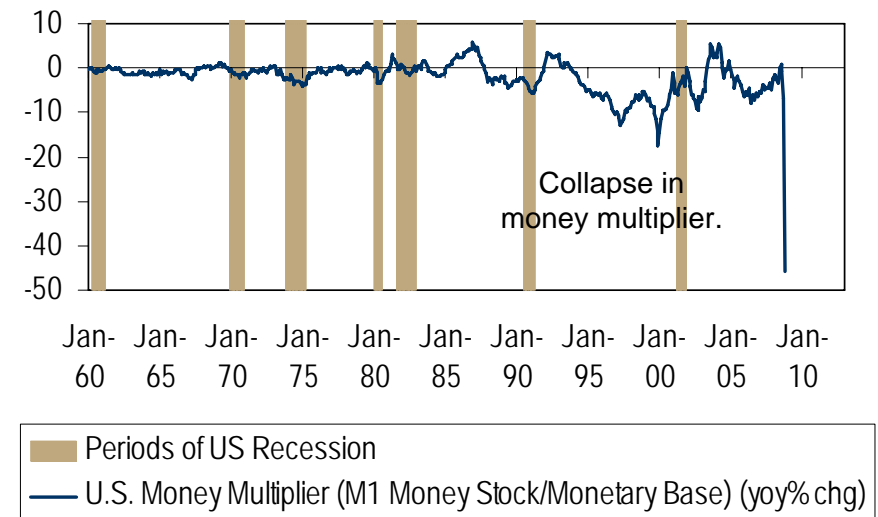
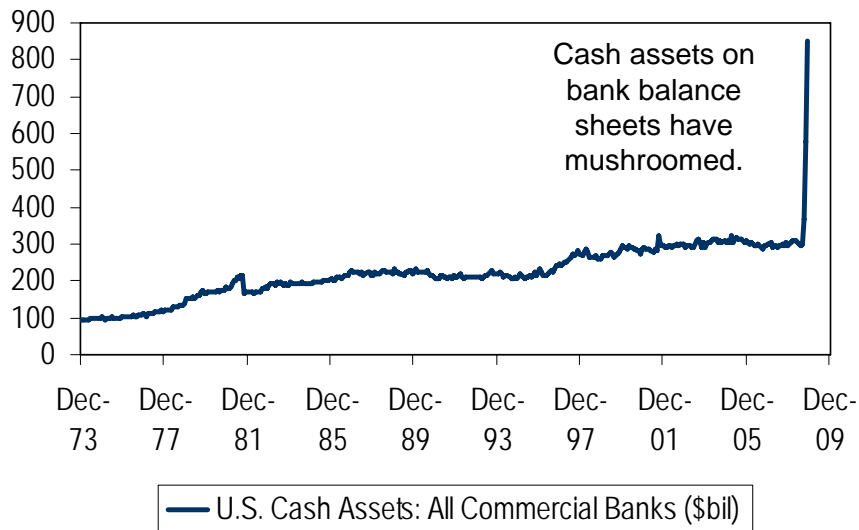




Financial Meltdown

A Liquidity Trap?

Banks Hoarding Cash, Collapse in Money Multiplier



Source: RBC Capital Markets, FRB

Source: RBC Capital Markets, FRB

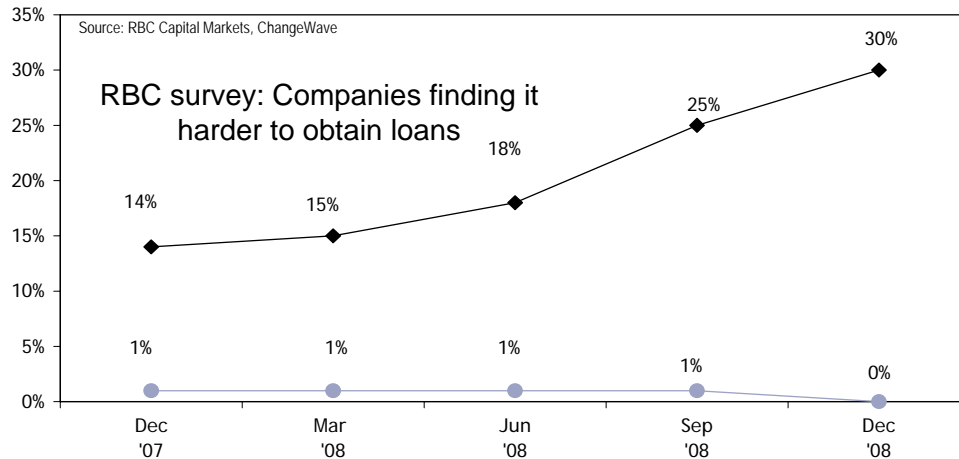
- Concerns over capital loss have led to cash hoarding.
- Some evidence that liquidity injections are not effective.
- The money multiplier indicates the magnified change in money (checkable deposits and currency) that results from an injection of additional reserves into the banking system. As the name suggests, the change in money is typically a multiple of the initial change in bank reserves. The deposit expansion multiplier also forms the core of the money multiplier, both of which depend on the reserve requirement ratio.



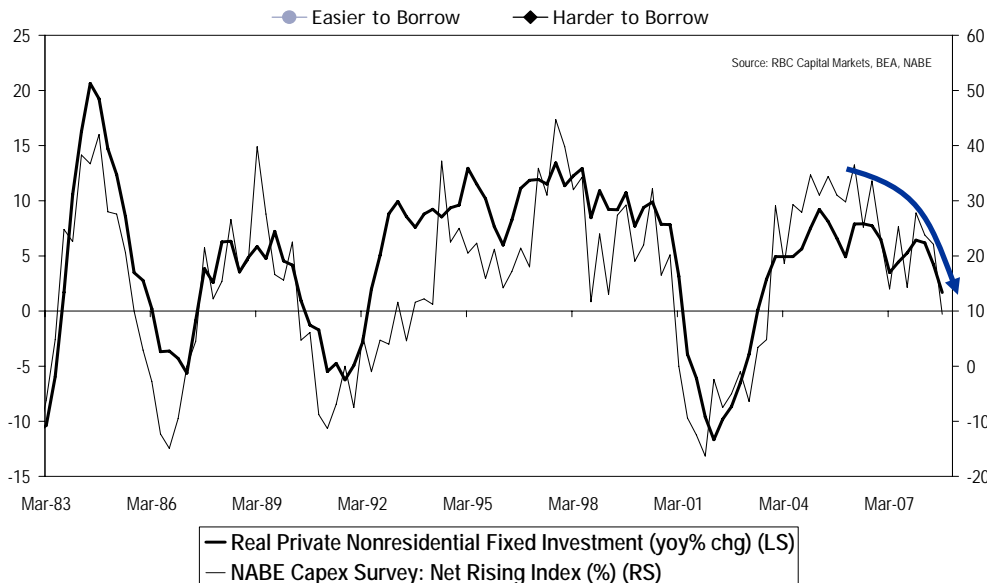
Financial Meltdown

Aggregate Demand is Taking a Hit

Would you say it is now harder for your company to borrow money than it was 90 days ago, easier to borrow money, or has there been no change?



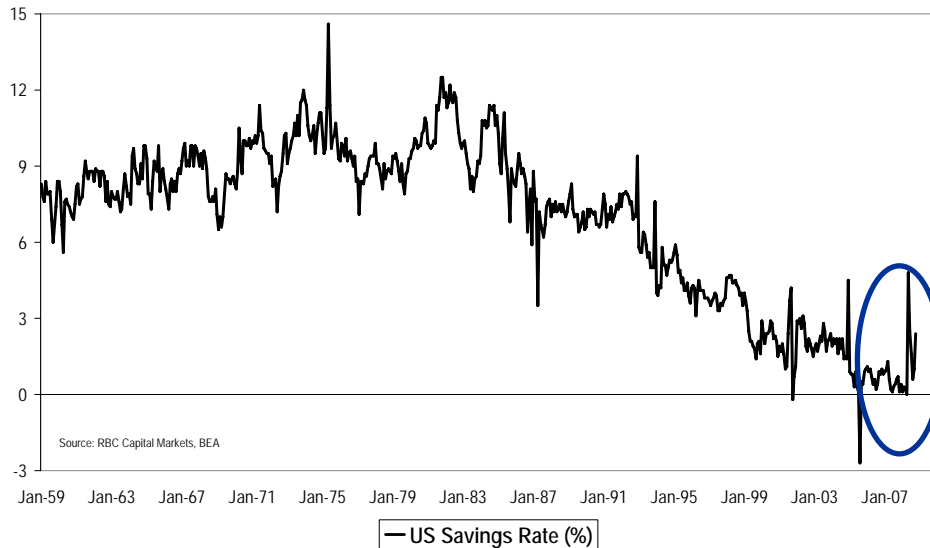
- Loans are hard to come by.
- Increased cost of, and restricted access to, capital will continue to weigh on investment spending.



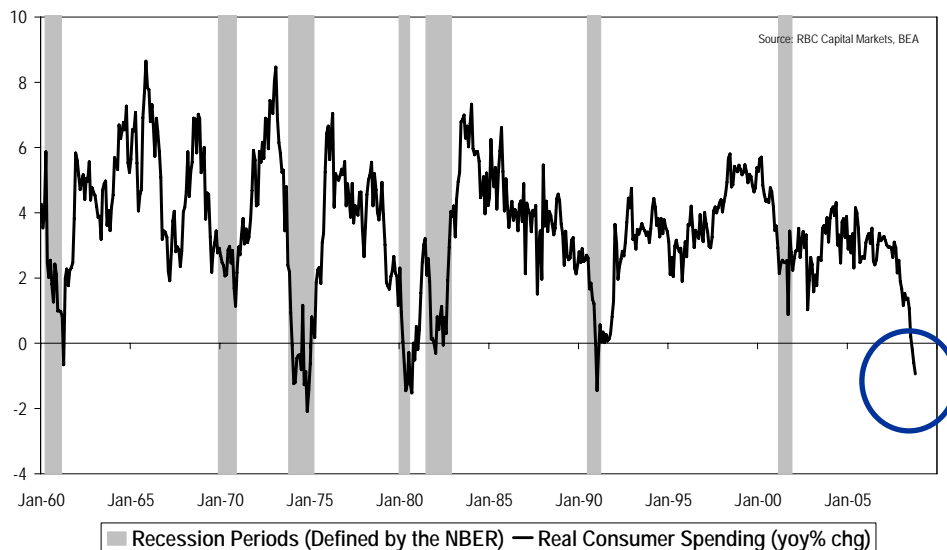


Financial Meltdown

Consumer Heads for the Hills



- Precautionary savings motives rise, forcing consumer spending into a nosedive.
- Consumer spending negative for only the sixth time since 1960.



Consumer Spending Contractions, Jan. 1960 - present

Start Date	End Date	Duration (months)
Apr-61	Apr-61	1
Jan-74	Jan-75	13
Apr-80	Jan-81	10
Dec-81	Jan-82	2
Dec-90	Feb-91	3

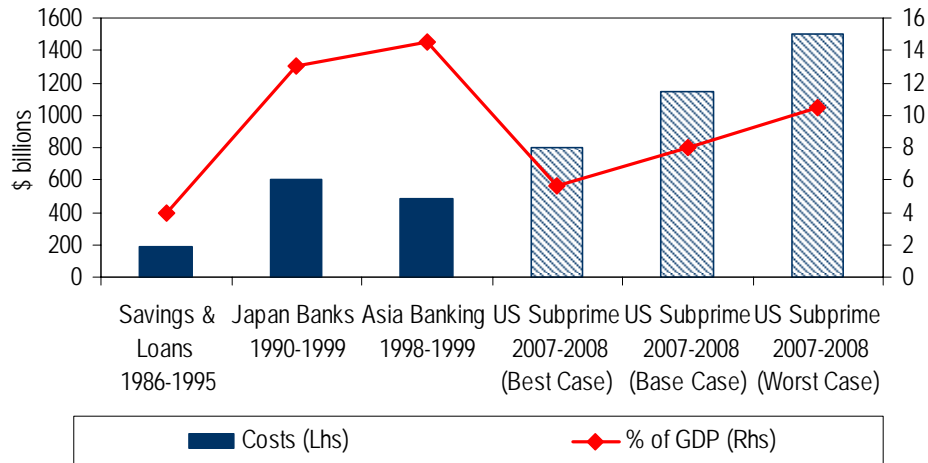
Source: RBC Capital Markets



Financial Meltdown

How Big is This?

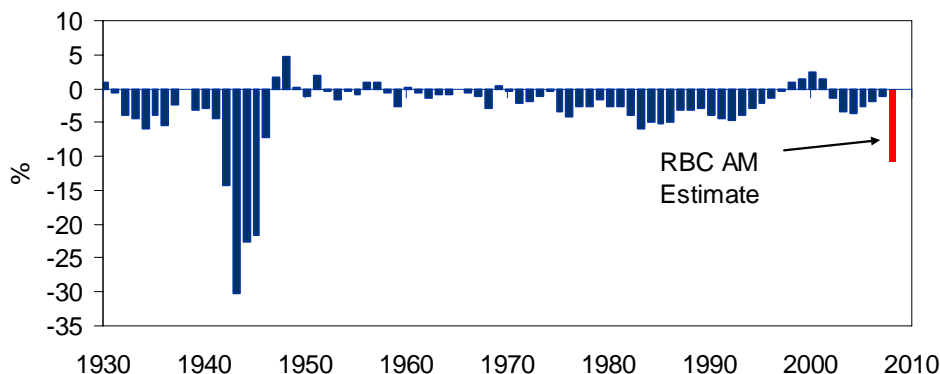
U.S. Credit Crisis in Perspective



Source: UBS Investment Research, RBC AM

- The cost of this bailout is huge in dollar terms.
- The deficit will balloon, but it is simply not even close to depression levels.
- The crisis is big, but the global economy has absorbed some huge hits over the past two decades.

U.S. Federal Surplus/Deficit as % of GDP



Source: Congressional Budget Office, RBC AM

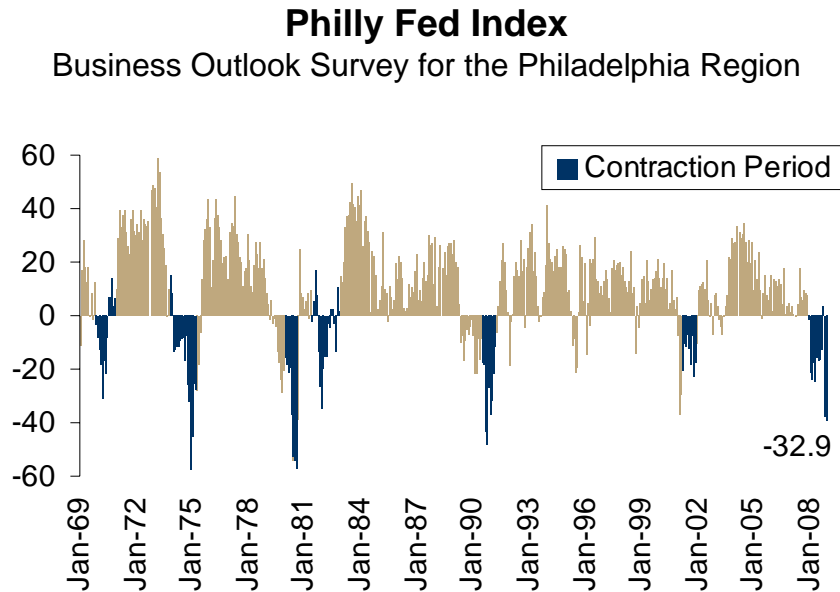


Economy

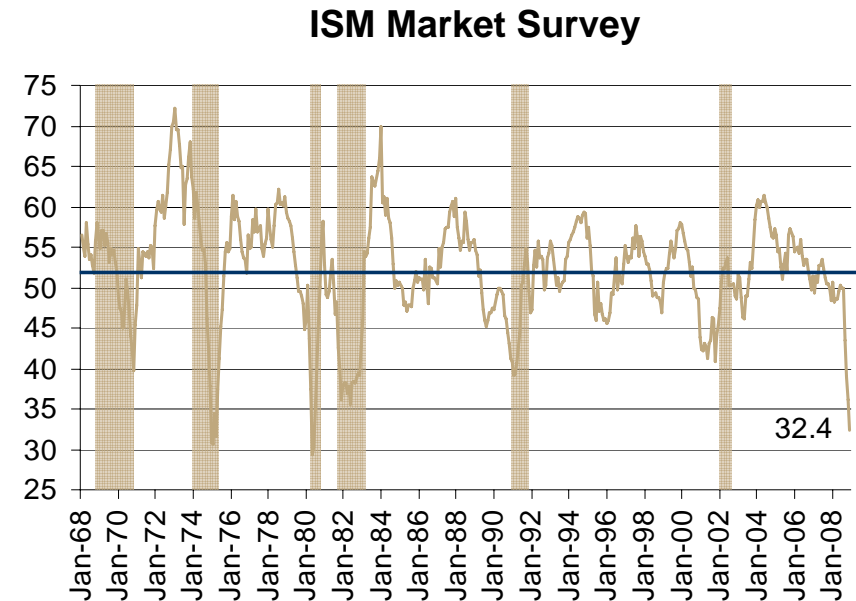


Economy

LEIs Collapse



Source: RBC Wealth Management, Bloomberg, Federal Reserve Bank of Philadelphia, National Bureau of Economic Research, as of 12/18/08.



Source: Bloomberg, as of 12/31/08

- Collapse in LEIs confirm extremely weak economy.
- The December Institute for Supply Management reading of 32.4% was the weakest since June 1980 – another deep recession.
- Philly Fed Index at its lowest level since the recession of 1990. A reading of -25 or lower indicates a severe contraction.



Economy

Unemployment Rate

U.S. Unemployment Rate



Source: Bloomberg

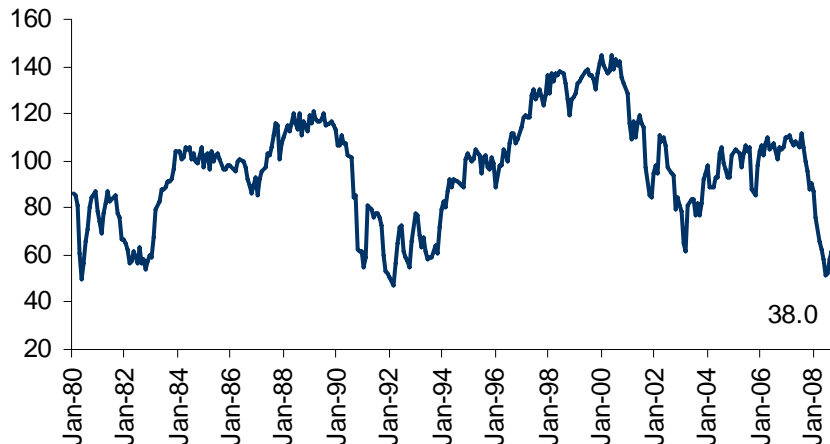
- Unemployment rate moves from 4.9% in January 2008 to 6.7% in November 2008.
- It remains clear that the labor market is weak.
- Before this cycle is over we could see unemployment above 9%, California is already over 8%.



Economy

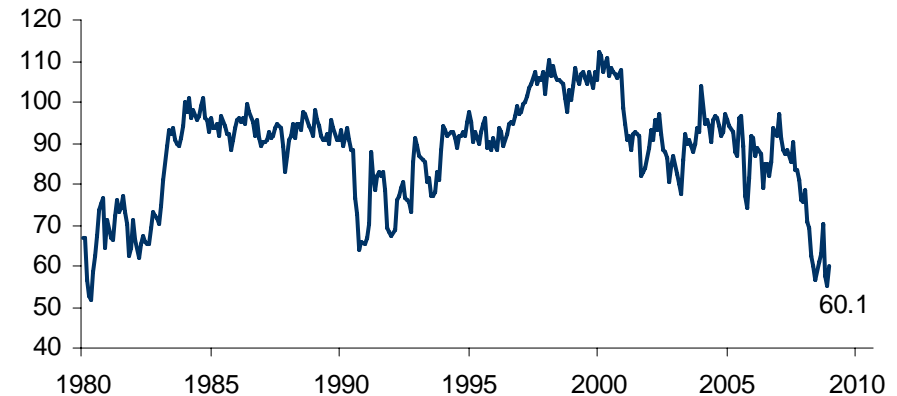
Confidence and Sentiment Plummet

Consumer Confidence Index



Source: Bloomberg, 12/30/08

University of Michigan Consumer Sentiment Index



Source: University of Michigan, 12/31/08

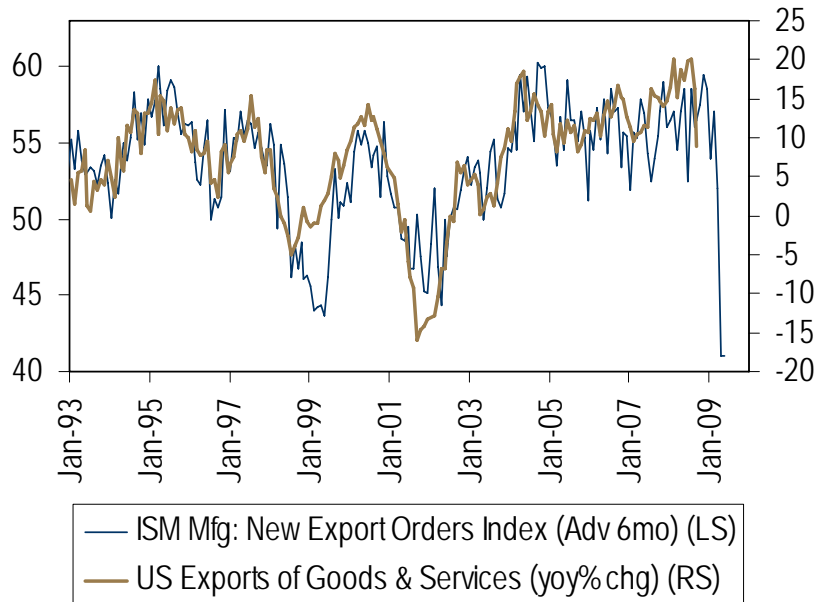
- The Conference Board's Consumer Confidence Index hit a record low of 38.0 for December. The December numbers demonstrate clearly how confidence has eroded in the face of falling home prices, falling stock prices, rising unemployment and the credit crisis.
- There is an underlying expectation that confidence levels will improve with the inauguration of the new president on January 20.



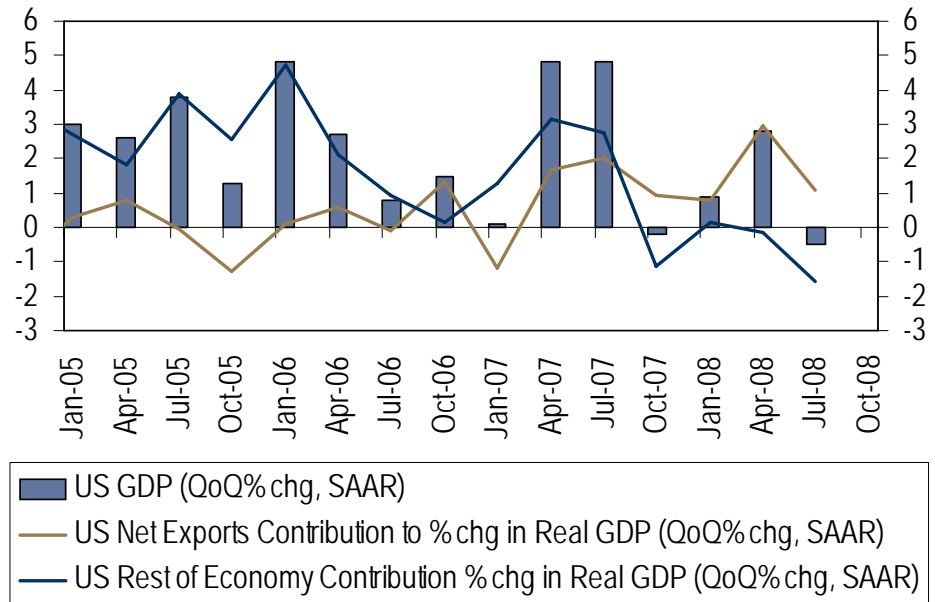
Economy

Exports

Exports Set to Tumble and Weigh on Economic Growth



Source: ISM, BEA



Source: RBC Capital Markets, BEA

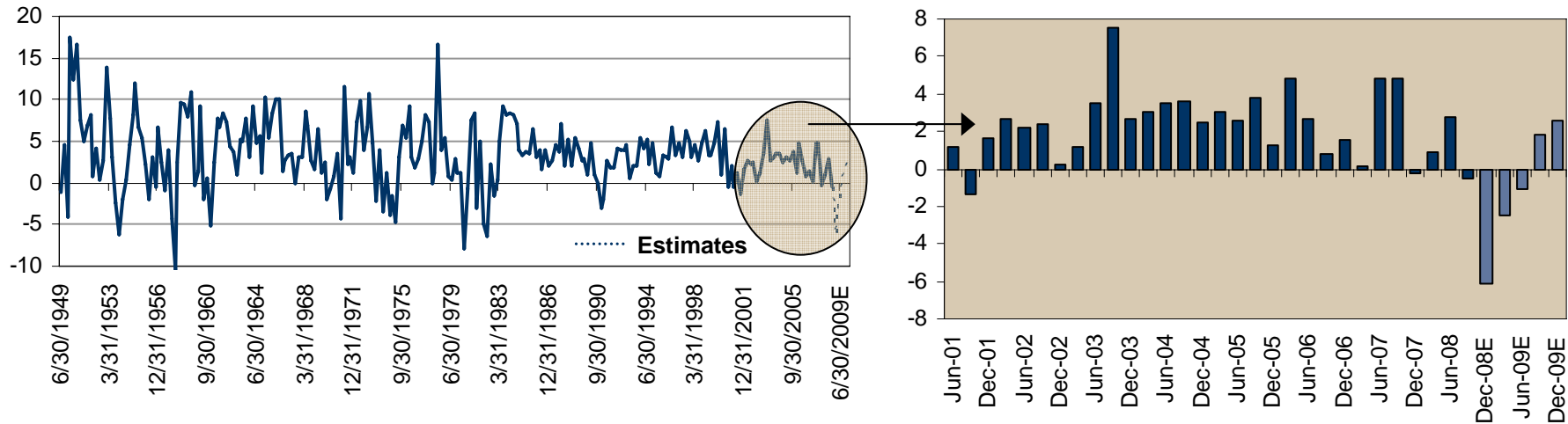
- Exports are most likely to decline. Are they the next shoe to drop?
- Exports are declining due to slowing global economy and the Dollar.



Economy

Economy in Recession

Gross Domestic Product



Source: Bloomberg, 9/30/08, RBC Capital Markets estimates 12/08-12/09.

- Recession began December 2007, according to NBER.
- 4Q08 GDP numbers will be very weak. Consensus estimates range from -4.0% to -8.0%. RBC Capital Markets forecast is for -6.1%.



Economy

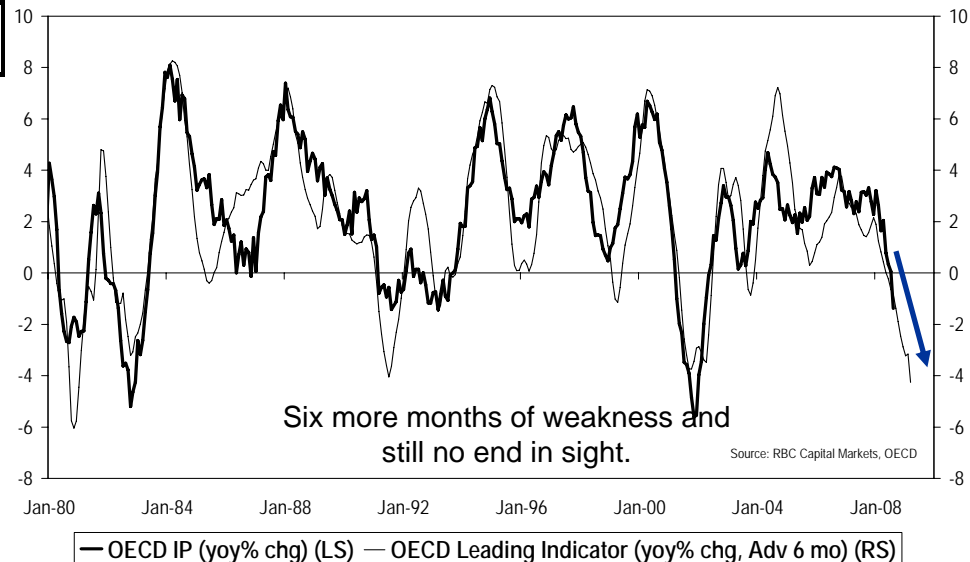
A U.S. and Global Recession?

US Recessions & GDP			Duration in Months	GDP contraction from Peak-to-Trough (%)
Mar-01	to	Nov-01	8	-0.4
Jul-90	to	Mar-91	8	-1.3
Jul-81	to	Nov-82	16	-2.6
Jan-80	to	Jul-80	6	-2.2
Nov-73	to	Mar-75	16	-3.1
Dec-69	to	Nov-70	11	-0.6
Apr-60	to	Feb-61	10	-1.0
Aug-57	to	Apr-58	8	-3.2
Jul-53	to	May-54	10	-2.6
Nov-48	to	Oct-49	11	-1.7
Feb-45	to	Oct-45	8	-1.1*
May-37	to	Jun-38	13	-3.4*
Aug-29	to	Mar-33	43	-26.6*
Avg Post WWII			10	-1.9
Avg			13	-3.8*

*Pre-WWII GDP are estimates based on annual data.

Source: RBC Capital Markets, NBER, BEA, Global Financial Data Inc.

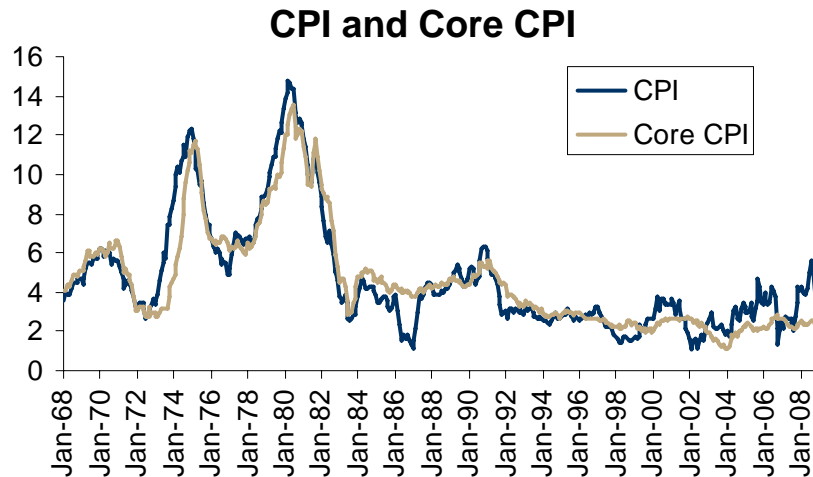
- A mid-1970s or early-1980s type of recession seems likely.
- Global economic growth continues to melt lower.





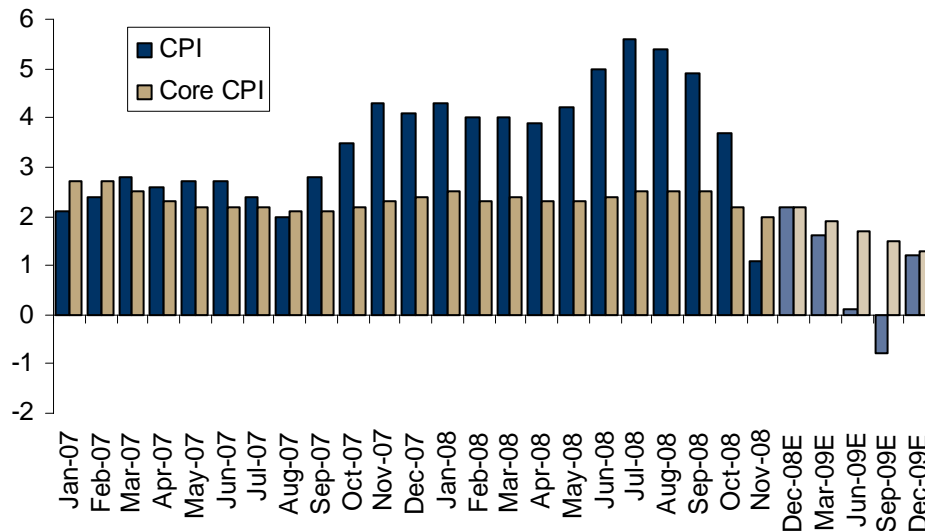
Economy

Inflation—Deflation



- Inflation fears are a thing of the past, now the fear is deflation.
- RBC CM forecasts CPI to turn negative in 3Q09.

Source: Bloomberg, data through 11/28/08.



Source: Bloomberg, data through 11/28/08; RBC Capital Markets estimates 12/08-12/09.



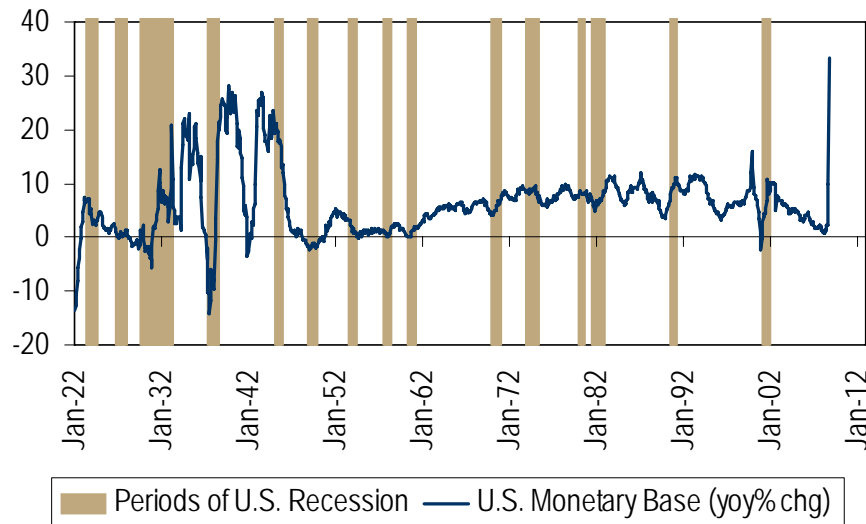
Policy Response



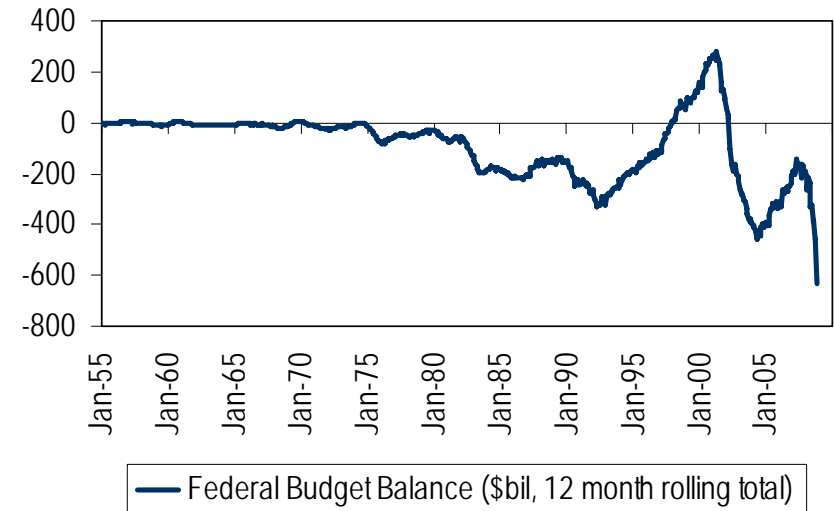
Policy Response

Massive & Necessary

Extreme Policy Measures to Stabilize Demand and Ward Off Deflation



Source: RBC Capital Markets, FRB



Source: RBC Capital Markets, Treasury

- The Fed and the Treasury are pulling out all the stops in order to stabilize the situation.
- With fears of deflation looming, policy makers have adopted a preventative posture with the Federal Reserve printing money and the government opening the fiscal spigot.



Policy Response

Federal Reserve Programs

Acronym	Program	Announced	Purpose	Mechanism	Commitment
TAF	Term Auction Facility	12-Dec-07	Inject funds to broader range of counterparties against broader range of collateral	Institutions bid for Fed advances via bi-weekly action	\$900bn
-	Discount Window	Altered on 17-Mar-08	Alleviate liquidity strains	Period that Fed lends directly to eligible institutions against eligible collateral extended to 90 days	\$92bn
OMOs	Single-Tranche Open Market Operation Program	7-Mar-08	Provide 28-day funding for Agency MBS	Fed lends to primary dealers through a repo auction	\$20bn per week
TSLF	Term Securities Lending Facility	11-Mar-08	Promote liquidity in Treasury and other markets	Treasury general collateral exchanged for program eligible collateral	\$250bn
PDCF	Primary Dealer Credit Facility	16-Mar-08	Provide overnight funding to primary dealers	Fed provides overnight funds against any tri-party eligible collateral	Not specified
AMLF	ABCP MMMF Liquidity Facility	19-Sep-08	Restore liquidity to ABCP markets	Fed lends directly to financial institutions to finance purchase of eligible ABCP from subsidiary money market mutual funds	Not specified
CPFF	Commercial Paper Funding Facility	7-Oct-08	Support liquidity needs of US Corporations	Fed lends to SPV at target fed funds rate. Borrowers issue 3m CP to SPV and receive cash	1.8tm
MMIFF	Money Market Investor Funding Facility	21-Oct-08	Provide liquidity to US money market investors	Provide senior secured funding to SPV to facilitate an industry-supported private-sector initiative to finance purchase of US \$ CD and CP issued by highly-rated financial institutions	\$540bn
TALF	Term Asset-Backed Securities Loan Facility	25-Nov-08	Help market participants meet the credit needs of households and small businesses	Lend on a non-recourse basis to holders of certain AAA-rated ABS backed by newly and recently originated consumer and small business loans. \$20bn of credit protection from TARP	\$200bn
-	Direct purchase of GSE obligations and MBS	25-Nov-08	Reduce the cost and increase the availability of credit for house purchase	Purchase the direct obligations of GSEs and MBS backed by GSEs	\$600bn
-		16-Dec-08	Liquidity	Fed cut to 0.25%	

Source: Federal Reserve, the Bloomberg Professional Service, National Research Sources estimates

- \$2.35 trillion-plus and counting



Policy Response

Treasury Department and FDIC Programs

Acronym	Program	Announced	Purpose	Mechanism	Commitment
GSE MBS PP	GSE MBS Purchase Program	7-Sep-08	Improve availability of mortgage credit	Treasury purchases GSE MBS in open Market	Not specified
-	Money Market Insurance Program	19-Sep-08	Avoid a "run" on money market funds	Guarantees share price of any publicly offered eligible money market mutual funds	\$50bn
TARP	Troubled Asset Relief Program	3-Oct-08	Restore liquidity and overall market functioning & improve balance sheet of financial institutions	Purchase assets from eligible institutions	\$ 700bn
EESA	EESA temporary increase in Deposit Insurance	3-Oct-08	Help restore consumer confidence	FDIC raises the basic limit to \$250k from \$100k	Not disclosed
TARP 2	TARP –Capital Purchase Program	14-Oct-08	Shore up capital of US banks	Purchase senior preference shares 5% dividend for first 5 years 9% thereafter	250bn
-	Temporary Liquidity Guarantee Program	14-Oct-08	To get LIBOR down and ease non-deposit funding	FDIC guarantees new issues of senior unsecured debt.	Not disclosed

Source: Federal Reserve, the Bloomberg Professional Service, National Research Sources estimates

- \$1 trillion-plus and counting

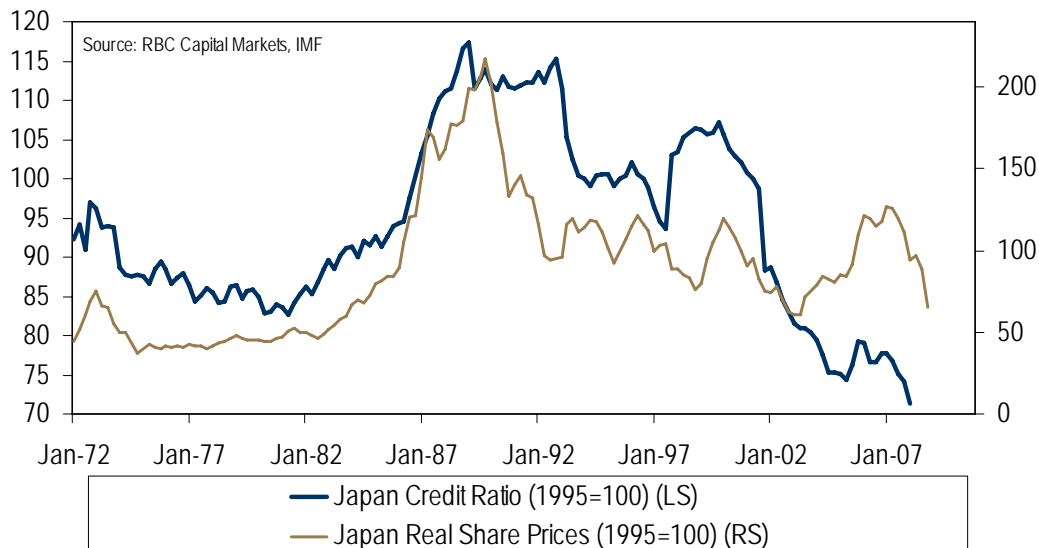
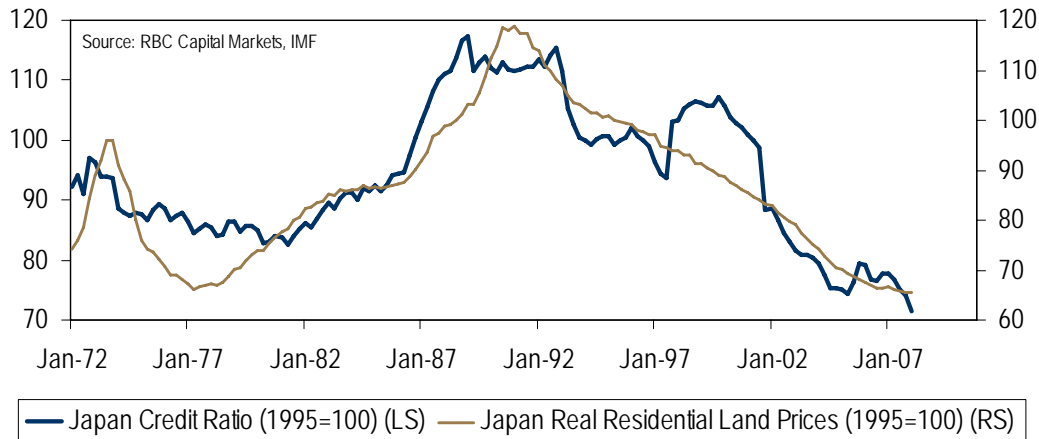


Crisis and Response



Crisis & Response

This is Not Japan



- The big fear is a self-reinforcing downward spiral between credit contraction and real economic weakness.
- Japan's lost decade(s): real estate deflation
- Stock market losses in response to a severe credit contraction.
- Deleveraging in the Japanese private sector began in the late 1980s. A case of too little, too late?



Crisis & Response

This is not Japan

Japan

- Property prices fell 80% in Japan (the peak to trough fall in U.S. house prices is likely to be 35% at worst).
- Japan was very late on its policy response (quantitative easing was not put in place until 11 years into the downturn, monetary policy was tight for the first 5 years of the downturn and hence the Yen had become nearly 100% overvalued by 1995, fiscal easing was more muted).
- Finally Japan would not allow restructuring and hence manufacturing productivity growth was zero and that allowed wages to fall.



Crisis & Response

A Tale of Two Crises

1929 and the Great Depression	2008, so far...
Booming U.S. economy gives 'roaring 20s' investor optimism.	Easy money causing high household debt and housing bubble.
New investment vehicles (Investment trusts; holding companies) along with growth in margin results in greater leverage and destabilize system.	New investment vehicles (Credit Default Swaps, sub-prime mortgage securities) combined with hedge funds and investment banks result in greater leverage and destabilize system.
Slower economy and tighter credit burst bubble. Panic ensues, stock market crashes in 1929.	Credit tightens, financial firms fail and stock market goes into a nosedive.

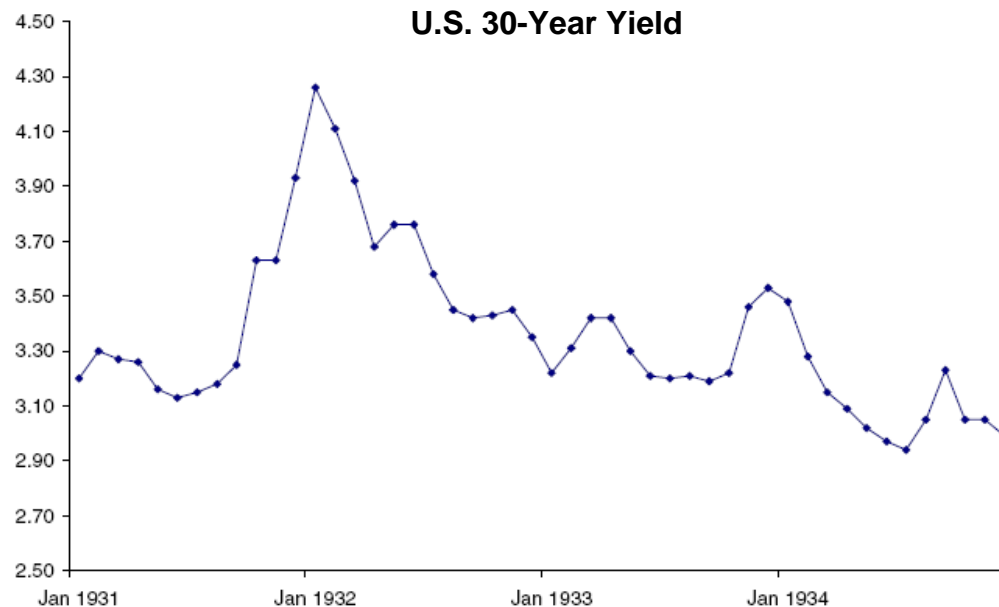
Government Response to Crisis include:		Government Response to Crisis Include:	
Futile attempts to balance budget limits fiscal response.	✗	Fed cuts interest rates to 0, injects hundreds of billions of dollars of liquidity into markets, broadening discount window, etc.	✓
Falling prices result in high real interest rates. Money supply falls by a third. Effectively monetary tightening.	✗	Government "backstops" major banks, passes spending bills (TARP) to buy distressed assets from banks to restore confidence. Bailouts and stimulus packages.	✓
Government passes Smoot-Hawley Tarriff Act, leading to retaliation, slowing global trade. The Result: 25% unemployment Prolonged Depression	✗	Global policy makers organize coordinated response. The Result: TBD Global economies going into arrest and move towards aggressive lowering of rates.	✓



Crisis & Response

This is Not the Depression

The Fed Raised Rates in Late 1931



Source: National Research Sources

- The Fed raised rates by more than 100 basis points in the last quarter of 1931 to support the dollar after the suspension of the gold standard by the UK in September of the same year.



Crisis & Response

This is not the Depression

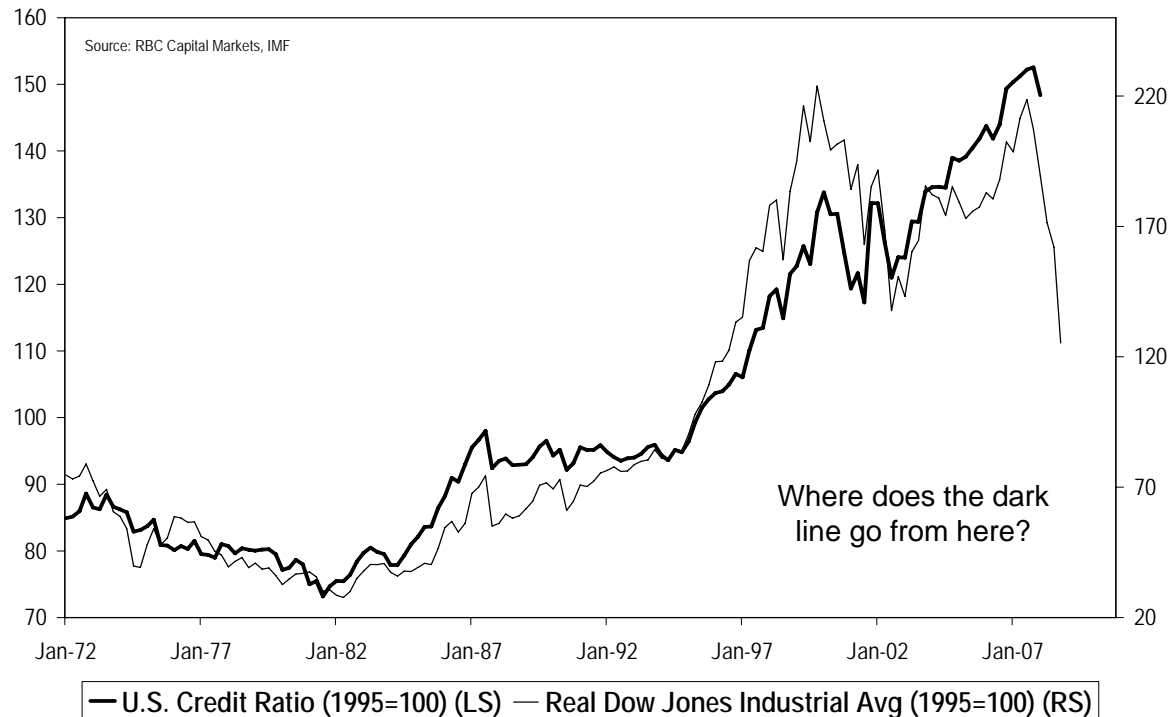
The Depression

- In the 1930s, rates and taxes were raised.
- There was no FDIC preventing a “run” on banks.
- There were no buffers such as unemployment and healthcare programs.
- There is no trade war which resulted in 50% in tariffs (Smoot – Hawley).
- Better tools available today than in the Great Depression to fight sustained deflations, not only for falling prices, but also for falling wages.



Crisis & Response

Respecting the Power of Deleveraging



- U.S. private sector deleveraging has just started; the question is how long will it last?
- The Fed went to “quantitative easing” on Nov. 25, 2008. This will allow government bond yields to be set low enough to allow fiscal reflation. The Gold Standard in place during the Depression made it impossible to “print money”.

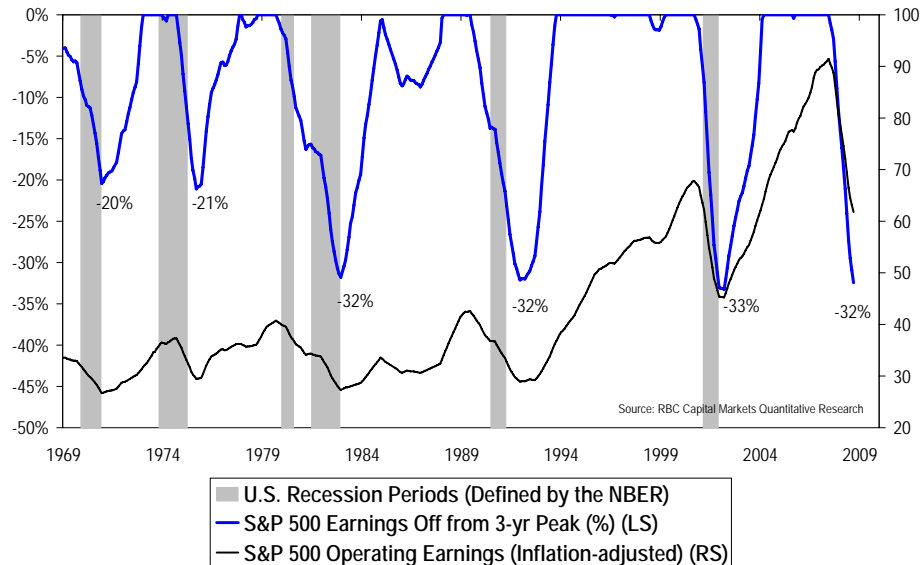


Equity



Equity Earnings Decline

S&P 500 Earnings Cycle



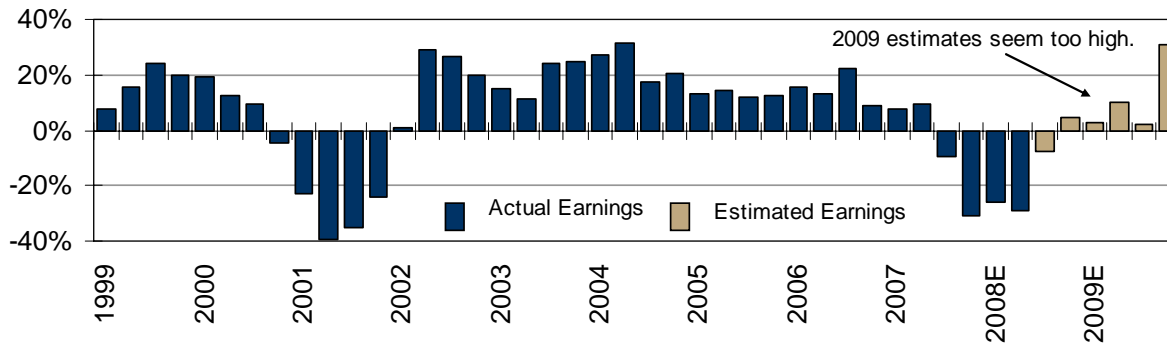
- Even though the downturn in earnings has been significant, almost four quarters of over 20% year-over-year declines, the decline in earnings is on par with other cycles.



Equity

Downward Earnings Revisions will Continue

S&P 500 Quarterly Earnings Year-over-Year Growth



- While the worst may be over in terms of earnings comparisons... we still feel that estimates are still too optimistic.
- “Never Waste a Good Crisis” may find its way into corporate America, meaning write-offs, layoffs, and lowered guidance.
- 2009 Consensus is currently at \$83.03, however, a combination of cycle analysis and quantitative modeling calls for \$63 for the S&P 500.

S&P 500 Quarterly Earnings Estimates from Wall Street Analysts

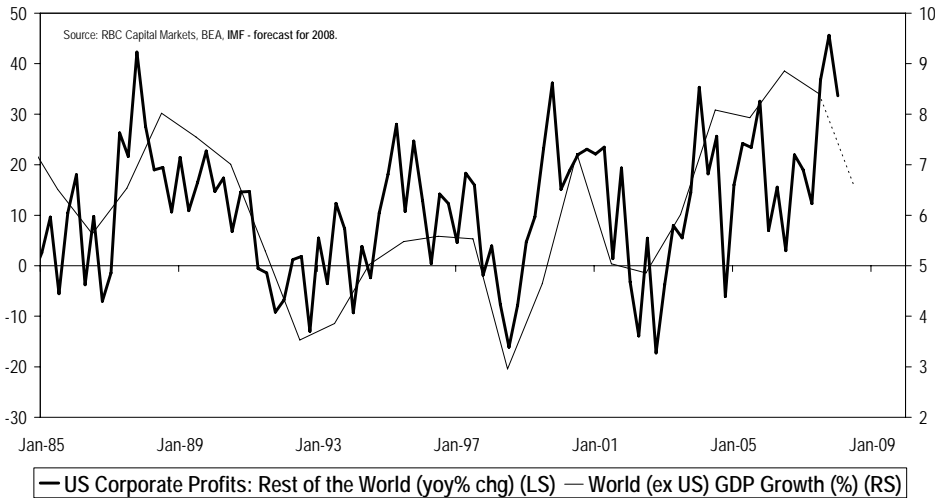


Note: Data reflects most recently available as of 12/31/08, quarterly growth rates represent YOY change and are based on operating earnings per share.

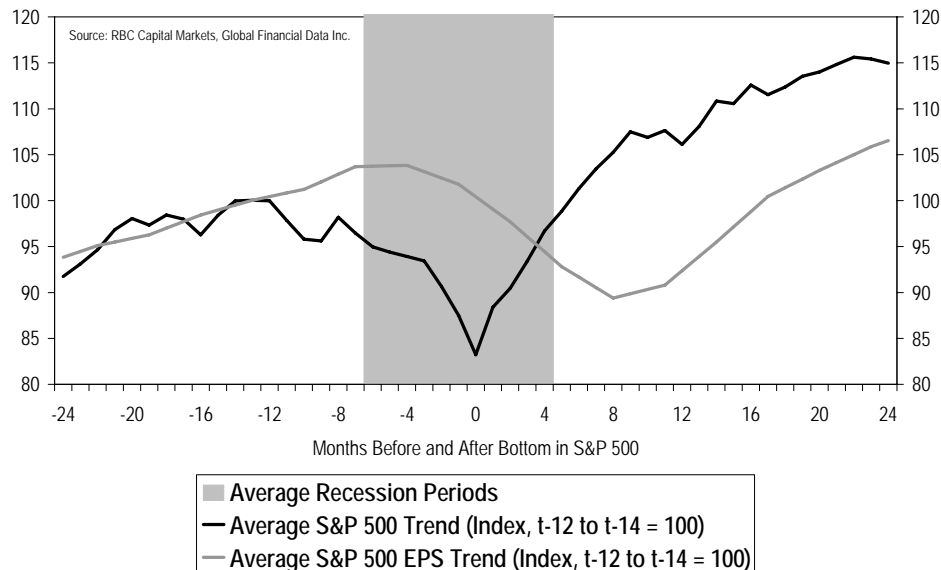
Source: Standard & Poor's, FactSet, estimates are FirstCall Consensus Bottom Up figures.



Equity Earnings



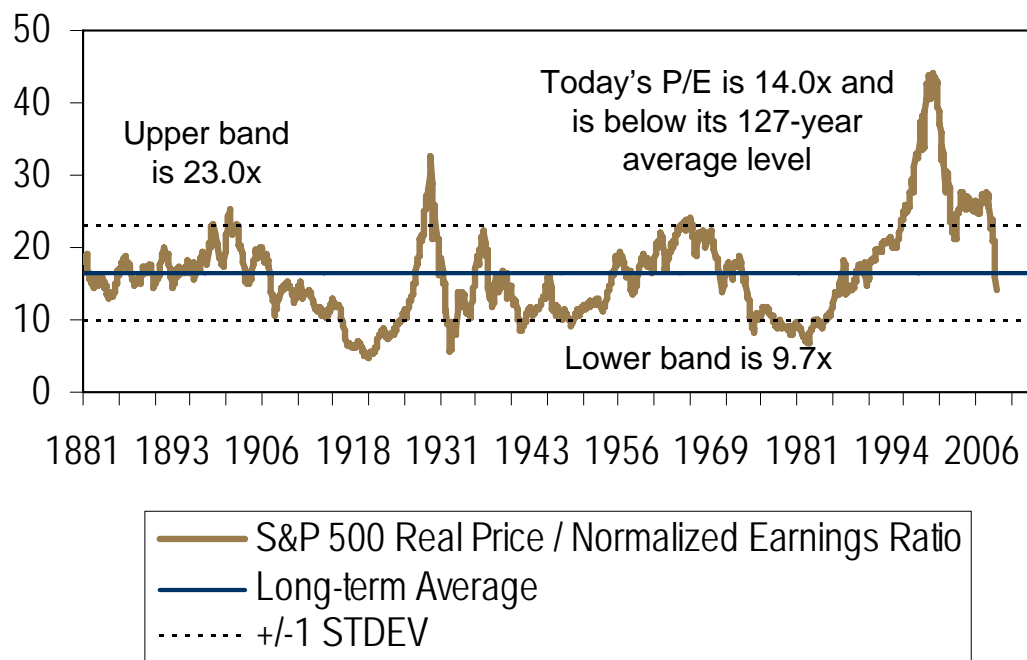
- Elevated costs, a lack of pricing power, and slowing volume growth are placing downward pressure on margins.
- Strength from the rest of the world can no longer be counted on.
- We anticipate that earnings will fall further during this economic downturn.
- Earnings recovery should lag the market's by roughly nine months.
- Don't wait for an upturn in earnings to buy stocks.





Equity Valuation

A Return to Value for the Market, A Return to “Deep Value” for Many Constituents



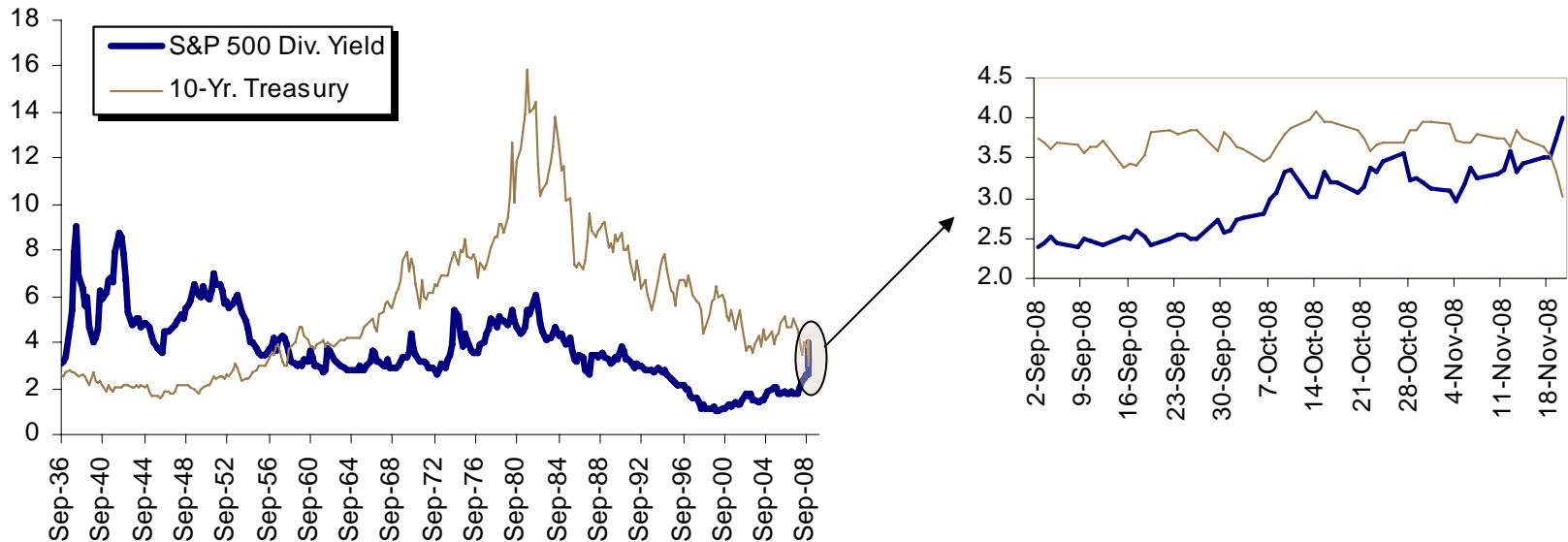
Source: RBC Capital Markets, Shiller

- According to RBC Capital Markets, if we look at the S&P 500 to normalized earnings ratio it is below its 127-year average. Undervalued?
- About 1 / 3 of stocks are trading at less than 1x their book value.



Equity Valuation

Historical Relationship Between the S&P 500 Dividend Yield and 10-year Treasury Yield



Source: RBC Wealth Management, FactSet, Global Financial Data, Standard & Poor's, Bloomberg; data through 11/20/08.

- For the first time in 50 years the yield on the S&P 500 stock index is above that of the 10-year treasury.



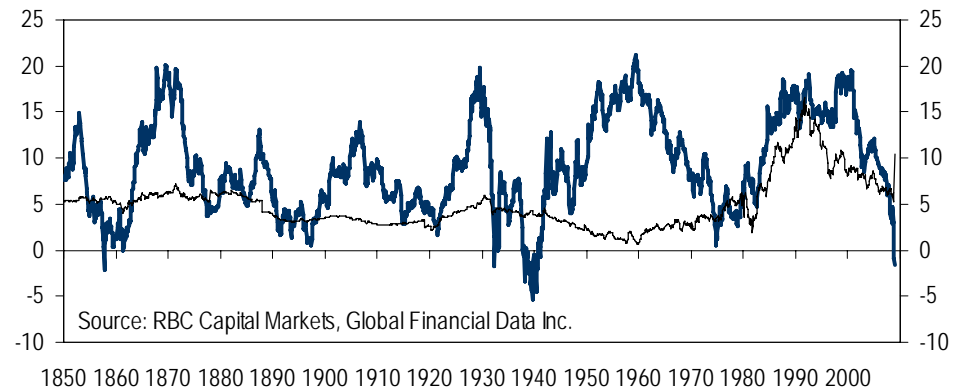
Equity Bear Markets

Characterizing the S&P 500 Bear Market

U.S. Bear Markets: S&P 500 Composite			
Mkt Top	Mkt Bottom	Peak to Trough Decline, %	Duration in Months
Mar-2000	Oct-2002	-49.1	31
Jul-1998	Oct-1998	-19.2	3
Jul-1990	Oct-1990	-19.9	3
Aug-1987	Dec-1987	-33.5	3
Nov-1980	Aug-1982	-27.1	21
Sep-1976	Mar-1978	-19.4	18
Jan-1973	Oct-1974	-48.2	21
Nov-1968	May-1970	-36.1	18
Feb-1966	Oct-1966	-22.2	8
Dec-1961	Jun-1962	-28.0	6
Aug-1956	Oct-1957	-21.6	15
May-1946	Jun-1949	-29.6	36
Nov-1938	Apr-1942	-45.8	42
Mar-1937	Mar-1938	-54.5	13
Jul-1933	Mar-1935	-33.9	20
Sep-1932	Feb-1933	-40.6	6
Sep-1929	Jul-1932	-86.2	34
Jul-1919	Aug-1921	-35.1	25
Nov-1916	Dec-1917	-43.1	13
Nov-1909	Oct-1914	-37.5	58
Oct-1906	Nov-1907	-40.4	13
Jun-1901	Nov-1903	-31.4	29
Post WWII Avg		-29.5	15
Pre WWII Avg		-44.8	25
AVG		-36.5	20

Source: Global Financial Data Inc.

A History of Bear Markets, 10-Year Annualized Stock and Bond Returns



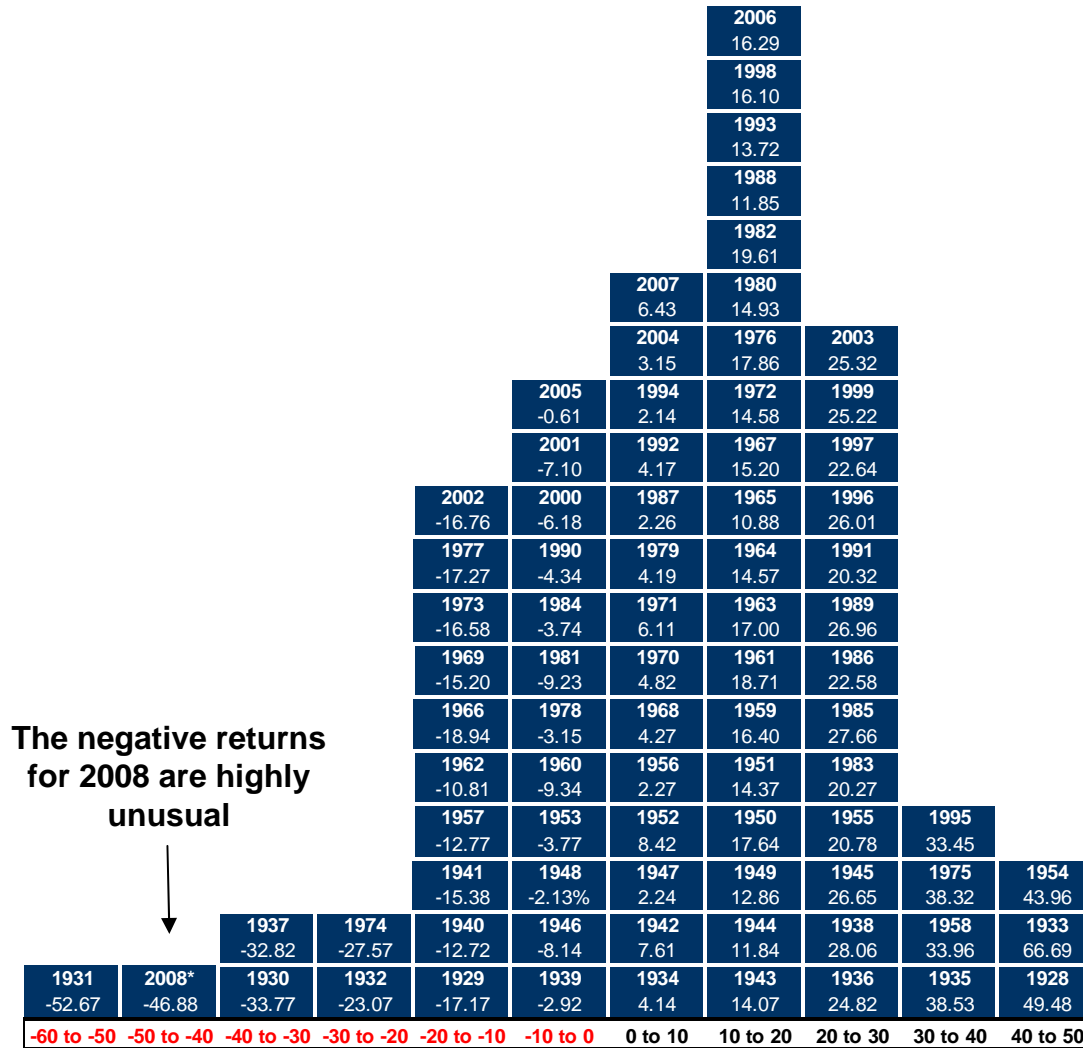
— S&P 500 Total Return Index (10-yr Annualized Returns)
— USA 10-year Government Bond Total Return Index (10-yr Annualized Returns)

- After September 15 this became a mega meltdown and the biggest bear market in the post WWII environment with the S&P 500 declining by almost 52% at its lows on 11/20/08. A 52% decline is within ear shot of the 54% recorded in the '37-'38 bear market the second worst since 1929.
- If the year had ended on 11/28 when the S&P 500 was down 40%, it would have been the second worst calendar year return since 1900. 1931 was worse at minus 47%.
- This bear market has retraced 103% of the 2002-2007 advance.



Equity

Extreme Markets



Dow Industrial Percentage Change 1928 - 2008*

*Data through November 20, 2008

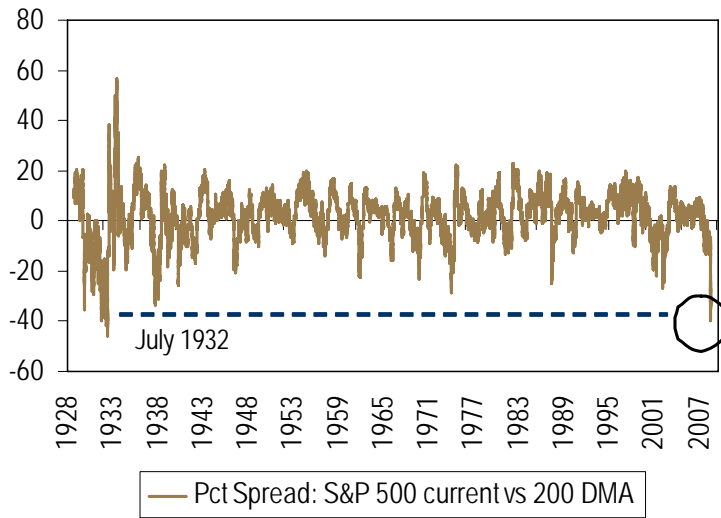
Source: Bloomberg



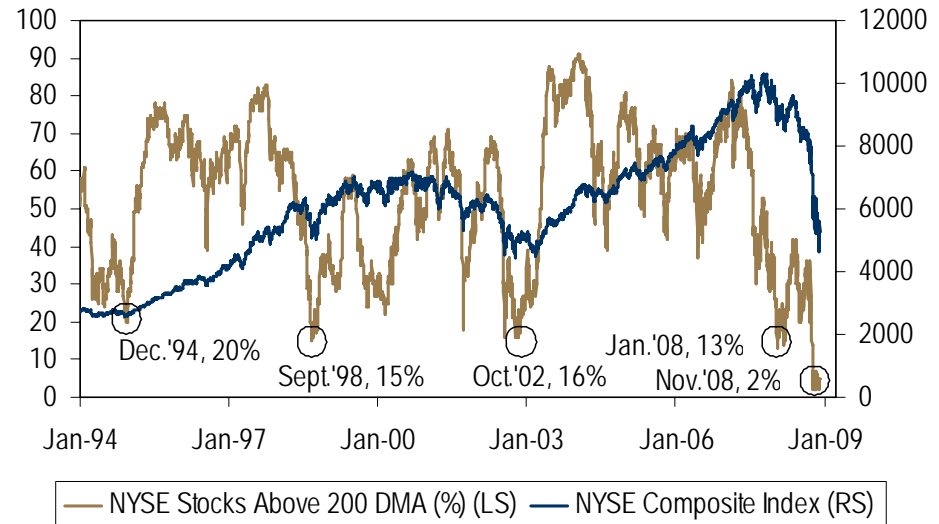
Equity

Extreme Markets

Heavy Price Destruction for the S&P 500, Severe Internal Market Damage



Source: RBC Capital Markets, Global Financial Data Inc.



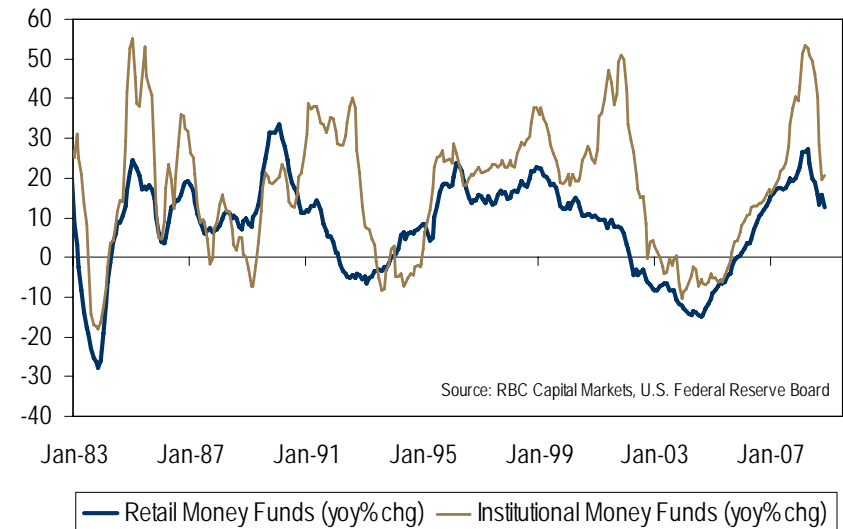
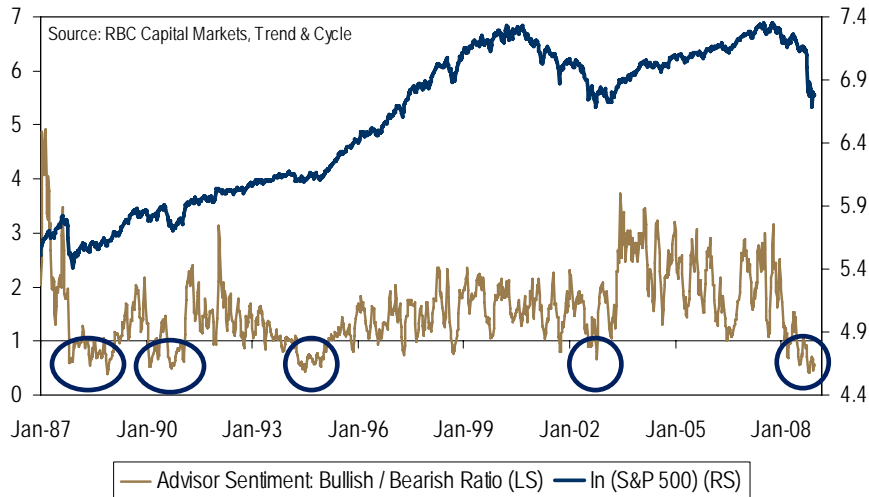
Source: RBC Capital Markets, Bloomberg

- Internal market damage and the psychological trauma it has generated are telling.
- For example, at the recent low in November 2% of NYSE shares were trading above their 200 DMA compared with 16% during the 2002 low and 15% in the sell-off after the LTCM fiasco.



Equity

Extreme Markets



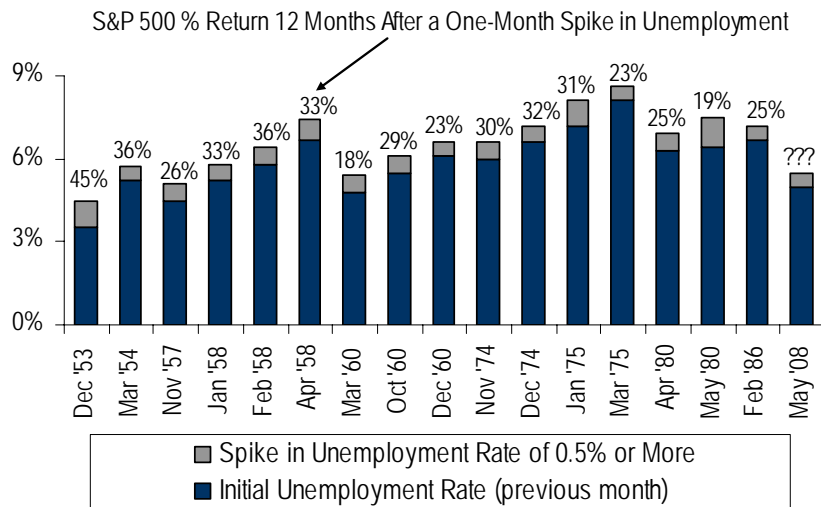
- Longer-term technical indicators argue that a lot of the damage is now priced into the stock market.
- Bearishness has been on par with historic extremes.
- A mountain of cash has been piling up on the sidelines. This will be important fuel for the next big equity market rally.
- High levels of bearishness and lots of sidelined cash should be thought of like potential energy: Absent a catalyst, that energy is likely to remain bottled up.



Equity

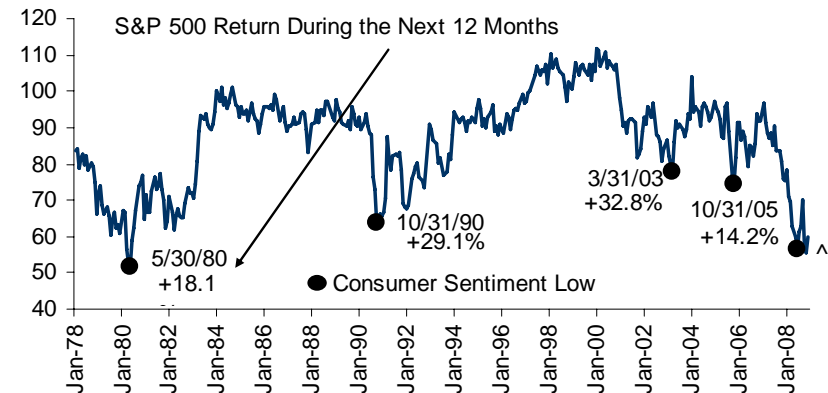
Extreme Markets

The S&P 500 Index has Historically Rallied After a One-Month Spike in Unemployment



Source: Source: JP Morgan Asset Management, RBC Wealth Management, Bloomberg, Bureau of Labor Statistics

University of Michigan Consumer Sentiment Index



^ It has yet to be determined if the last low point of the Index (55.3 in Nov. 2008) is the final sentiment low of this cycle.

Source: JP Morgan Asset Management, RBC Wealth Management, Bloomberg; data is through 12/31/08.

- Historically, since 1950, when the unemployment rate has spiked 0.5% or more in a single month as it has on 16 occasions prior to last May's spike, the S&P 500 rallied 12 months following the spike. The gains ranged from 17.6% to 45.0%.
- Consumer sentiment is reflecting a very weak outlook.

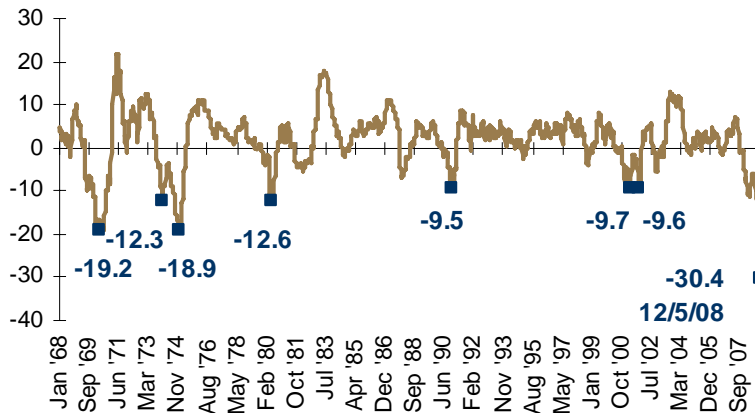


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Extreme Markets

A Key Leading Economic Indicator Has Collapsed

Weekly Leading Index Growth Rate (annualized)
Published by the Economic Cycle Research Institute



S&P 500 Performance Following
the Weekly Leading Index Cycle Low

Weekly Leading Index Date	Cycle Low	S&P 500 % Change in the Next...			
		6 mo.	12 mo.	18 mo.	24 mo.
5/8/1970	-19.2	6.0%	29.5%	18.9%	34.2%
12/28/1973	-12.3	-11.8%	-31.2%	-2.8%	-7.5%
12/27/1974	-18.9	41.2%	34.4%	54.5%	56.2%
5/9/1980	-12.6	23.4%	25.7%	17.1%	14.1%
11/9/1990	-9.5	19.8%	25.2%	32.6%	33.1%
4/6/2001	-9.7	-5.1%	-0.5%	-29.1%	-22.1%
10/26/2001	-9.6	-2.6%	-18.7%	-18.6%	-6.9%

Source: RBC Wealth Management, Bloomberg, Economic Cycle Research Institute; data is through December 26, 2008, the most recent WLI data point which was released on 1/2/09. The 12/5/08 reading of -30.4 is not necessarily the low point of this cycle.

- The Weekly Leading Index hit a low on December 5, a level not seen since 1948 when the index began.
- The market can rally after the Weekly Leading Index reaches a low point; it rallied after the 1970, 1974, 1980, and 1990 cycle lows.



Equity Extreme Markets

The VIX – Volatility Index – One Year



Chart courtesy Bigcharts.com and RBC Wealth Management

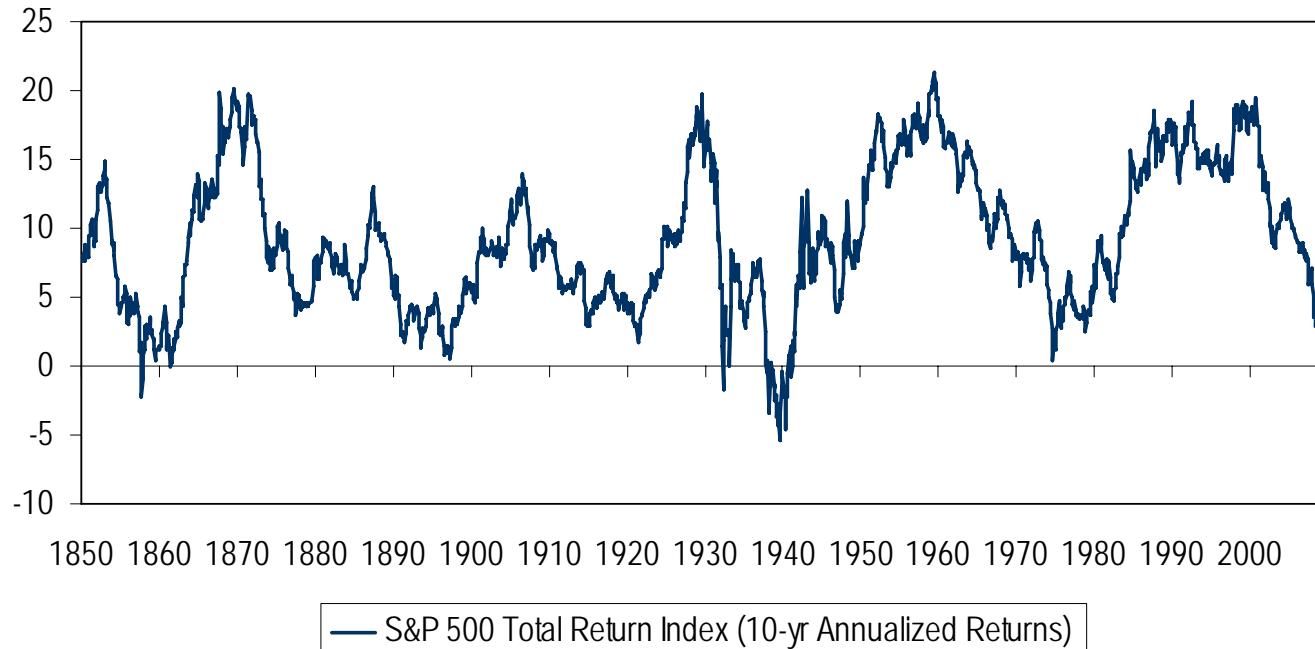
- The trend on the VIX may be changing from the highly-volatile ways of the past three months back to a steadier market.
- On October 24, 2008, the VIX reached an intraday high of 89.53.
- On November 20, 2008, as the S&P fell to its 11-year low, the VIX closed at 80.86.
- Looking at a different measure of volatility, for almost 21 years ending 9/6/08 the S&P 500 had two days that resulted in a gain or a loss of 4%. In the last 100 days from 9/6/08 to 12/16/08, the S&P 500 had 26 days that resulted in a gain or loss of at least 4%.



Equity

Extreme Markets

Annualized 10-Year Returns for U.S. Stocks Since 1850



Source: RBC Capital Markets, Global Financial Data Inc.

- Negative for only the 4th time in the past 158 years.



Equity

Extreme Markets

A Decade Lost (Annual Compound Returns)

Prior 10-Year ACR				Annual Compound Return	Total Return	
-3.65%	2Q39	to	Q249	8.62%	129%	
-2.79%	1Q39	to	Q149	9.12%	139%	
-2.74%	3Q39	to	3Q49	7.74%	111%	
-2.54%	1Q38	to	1Q48	11.76%	204%	
-1.42%	1Q40	to	1Q50	9.65%	151%	
-1.42%	2Q40	to	2Q50	12.19%	216%	
-0.65%	4Q38	to	4Q48	7.21%	101%	← WORST
-0.10%	3Q38	to	3Q48	8.12%	118%	
0.18%	3Q40	to	3Q50	12.57%	227%	
0.20%	4Q37	to	4Q47	9.61%	150%	
0.23%	4Q39	to	4Q49	9.09%	139%	
0.44%	2Q38	to	2Q48	9.52%	148%	
0.49%	3Q74	to	3Q84	15.58%	325%	← BEST
0.71%	1Q41	to	1Q51	14.47%	286%	
1.24%	4Q74	to	4Q84	14.76%	296%	
Average				10.67%	183%	

← WORST

← BEST

- Investment opportunities after 10 years of terrible performance can be quite amazing.
- When 10-year returns fell to 1% or less, the next 10 years produce an average cumulative return of +183%.
- The worst subsequent 10-year return was a +101%.



Equity

Bear Market Rallies

Bear Market Rallies during the Great Depression

Start	End	Duration (in months)	Percent
Nov-29	Apr-30	5	49%
Jun-30	Sep-30	3	16%
Dec-30	Feb-31	2	25%
Jun-31	Jul-31	1	29%
Oct-31	Nov-31	1	35%
Jan-32	Mar-32	2	25%
Average		2	30%

Trough was in July 1932 at 41

Source: National Research Sources

Bear Market Rallies in Japan

Start	End	Duration (in months)	Percent	Percent (in US \$)
Mar-90	May-90	2	20%	13%
Sep-90	Mar-91	6	35%	44%
Aug-91	Oct-91	2	18%	22%
Aug-92	Jun-93	10	50%	78%
Jun-95	Jun-96	12	37%	23%
Jan-97	Jun-97	5	20%	19%
Oct-98	Apr-00	18	62%	110%
Mar-01	May-01	2	23%	18%
Feb-02	May-02	3	29%	35%
Average		7	35%	40%

- Even within Bear Markets the rallies can be explosive.
- The rallies in the Great Depression and throughout the Japanese financial crisis have been impressive.



Equity

Market Performance Around Recession (Later)

Returns from Trough to End of a U.S. Recession

	Trough: March 1980	July 1982	Oct. 1990	Sept. 2001	
Recession Ends	<u>July 1980</u>	<u>Nov. 1982</u>	<u>March 1991</u>	<u>Nov. 2001</u>	
Length:	<u>4 Months</u>	<u>4 Months</u>	<u>5 Months</u>	<u>2 Months</u>	<u>Median</u>
Financials	20.1%	52.8%	57.6%	5.2%	36.4%
Information Technology	19.1	45.3	33.6	36.4	35.0
Consumer Discretionary	23.4	45.9	34.7	17.2	29.1
Consumer Staples	25.7	29.4	33.4	3.9	27.5
Industrials	22.5	39.9	28.0	11.2	25.2
Materials	25.6	35.4	24.0	14.7	24.8
S&P 500	20.5	33.2	26.3	10.0	23.4
Health Care	19.3	26.0	34.1	4.3	22.7
Energy	18.0	15.6	9.4	0.2	12.5
Utilities	20.7	17.2	6.5	(6.7)	11.8
Telecom Services	10.4	25.8	3.4	(11.5)	6.9

Note: Trough defined as closest month-end to trough

Source: IBES, First Call, National Research Sources

- Historically, financials show the best returns coming out of a recession. Is it time?



Equity

Markets Bottom Before Any Good News

Equities Tend to Trough Approx. a Quarter Before the Trough in ISM New Orders

S&P 500 Troughs	ISM Troughs	Lead Equities (in months)
Mar-80	Jun-80	3
Aug-82	Nov-81	-9
Jul-84	Sep-84	2
Oct-90	Jan-91	3
Dec-94	Jun-95	6
Aug-98	Nov-98	3
Oct-02	Apr-03	6
Average		2

Source: National Research Sources

U.S. Market and Earnings Troughs

Earnings Trough	Market Trough	# Qtrs. Market Trough Ahead of Earnings Trough	Price to 4Q Trailing Earnings at Earnings Trough	Earnings Decline from Market Trough to Earnings Trough
Sep-51	Sep-53	(8)	9	
Jun-58	Dec-57	2	15	-17%
Sep-70	Jun-70	1	16	-12%
Mar-75	Dec-74	1	10	-21%
Mar-83	Jun-82	3	12	-12%
Dec-91	Sep-90	5	22	-22%
Jun-01	Sep-02	(5)	26	
Average Periods		2	15	-17%
Median Periods		2	15	-17%

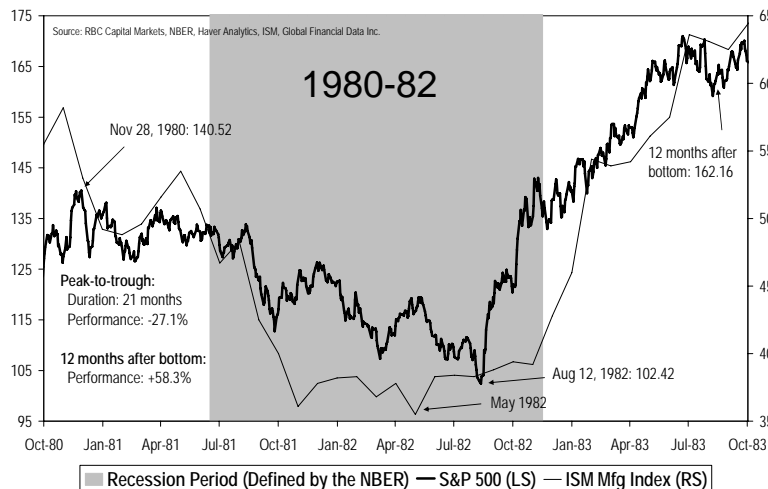
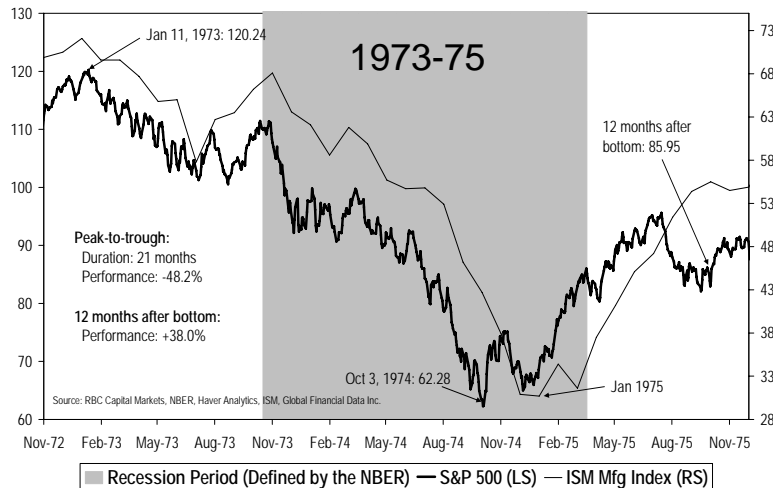
- You can't wait for the news to turn positive before investing.
- The markets tend to move ahead of economic news.
- The market typically bottoms:
 - 3 months ahead of a bottom in ISM
 - 3 months before U.S. GDP troughs
 - 6–8 months before unemployment peaks
 - 2–4 months before a bottom in ISM



Equity

What Might You Give Up by Waiting?

U.S. Recessions

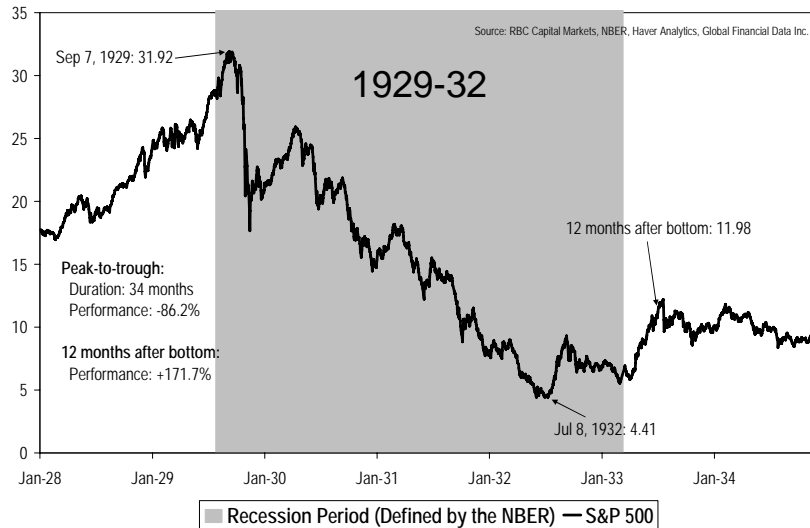


- Markets typically bottom before the end of the recession and ahead of an upturn in ISM.
- The market has always been in a rally mode the three months before the end of a recession.
- The market usually rallies 34% in the first 12 months after a bear market bottom has been made and 17% in the first 3 months.
- In the 1973–74 downturns the market turned up 3 months ahead of ISM and 3 months before the end of the recession.
- The market was up 13.5% by the time ISM turned up.
- In the 1980–82 downturn ISM turned up 3 months before the market bottomed. The market bottomed 3 months before the end of the recession and was up 58.3% in the 12 months following the bottom.

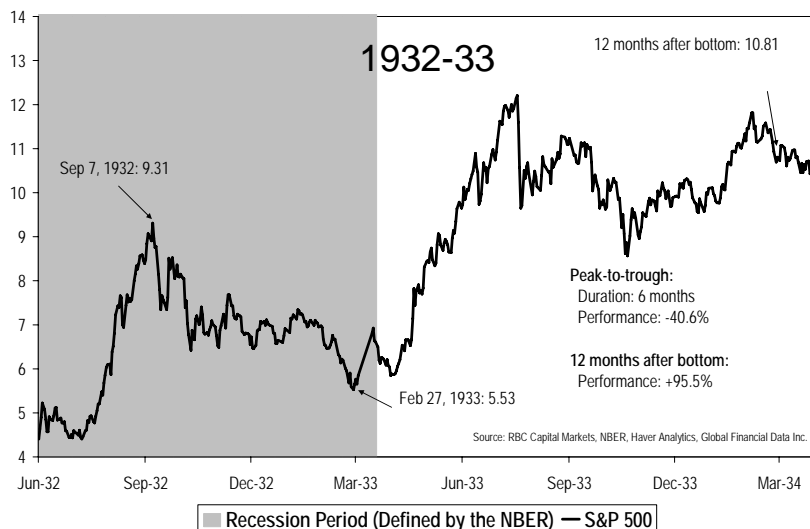


Equity

What Might You Give Up by Waiting?

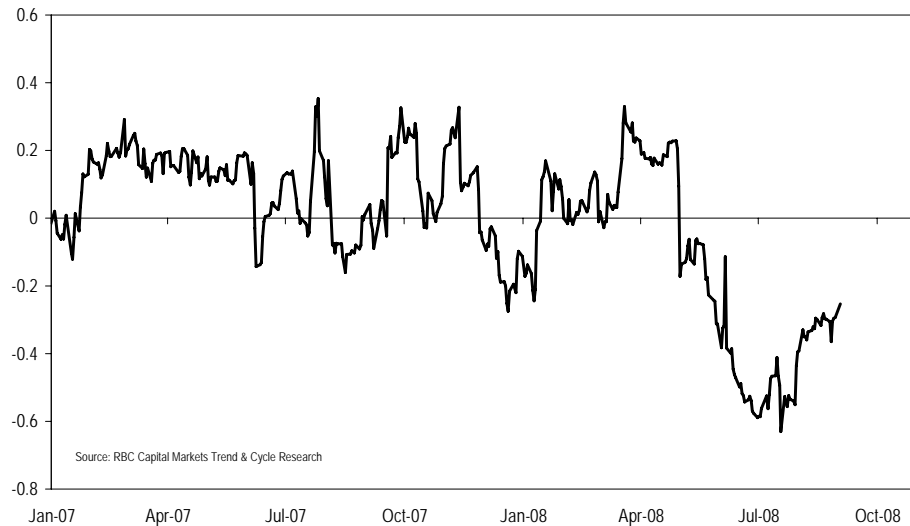


- The 1929–32 sell-off is the granddaddy of them all, having taken prices down by 86% before bottoming in July 1932.
- The 1932 bottom occurred 8 months prior to the end of a lengthy and painful economic contraction.
- A sharp but brief rally from July to September 1932 was short-circuited by the return of the bear that slashed 40.6% from stock prices.
- This secondary bear market ended in late February 1933, a month before the end of the deepest recession on record.
- Just how serious was the economy contracting? GDP was down 26.6% between August 1929 through March 1933.





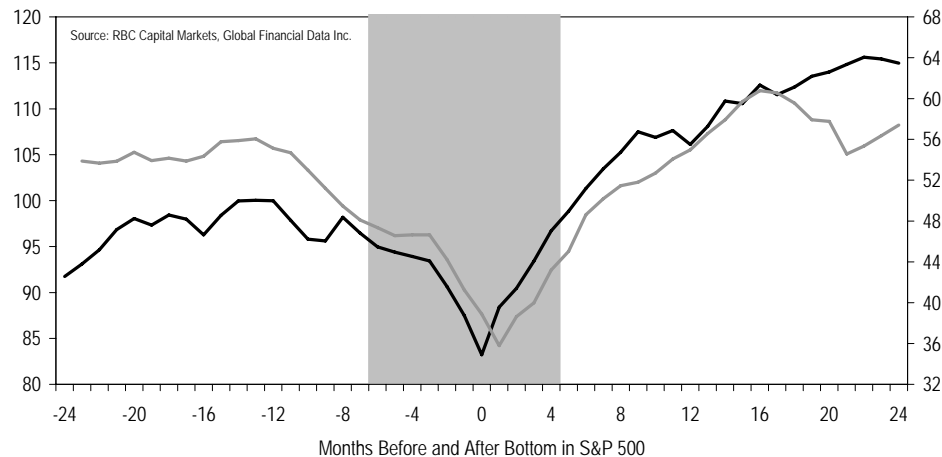
Equity Road to Recovery



— Oil & S&P 500: 30-day rolling correlation of daily returns



— S&P500 P/Forward Earnings (LS) — Mdy Corp Baa Spread (bps, inverted) (RS)



■ Average Recession Periods
— Average S&P 500 Trend (Index, t-12 to t-14 = 100) (LS)
— Average ISM Trend (RS)

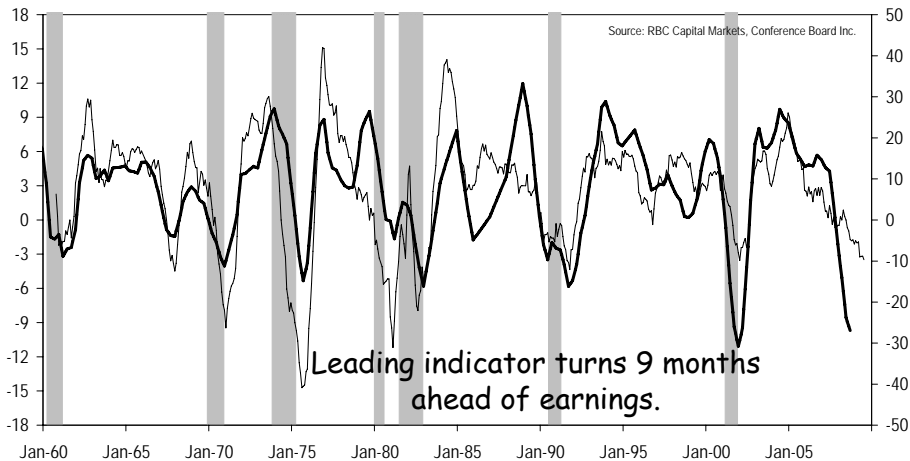
What brings about recovery:

- Lower oil prices will certainly help.
- Moderation in financial stress and credit spread compression will also be part of the bottoming process.
- Upturn in leading economic indicators (LEIs) will be necessary to confirm a sustainable low in share prices.
- A catalyst
- Improved credit ratios

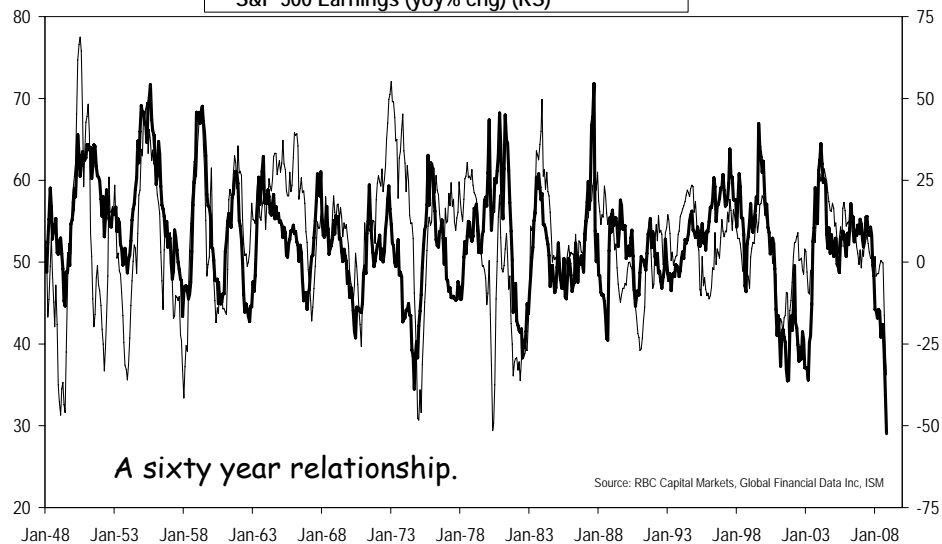


Equity

Road to Recovery



■ U.S. Recession Periods (Defined by the NBER)
 — Conference Board LEI (yoy% chg) (Adv 9mo) (LS)
 — S&P 500 Earnings (yoy% chg) (RS)



— ISM Mfg Composite Index (SA) (LS) — U.S. Stock-to-Bond Ratio (yoy % chg) (RS)

- An upturn in the leading indicators will first flag whether policymakers have stabilized the system...
- ...and this should coincide with a more lasting upturn in stock price performance.



Strategy



Strategy

Focus on predictability—companies that are masters of their own destiny.

- strong balance sheets
- relatively predictable cash flows
- minimal capital needs
- strong management teams
- market-leading products or services

Buy **dividend-paying stocks** and get paid while you wait for the market to recover.

- Because yields are currently elevated and corporate balance sheets have deteriorated, focus on companies that have the balance sheet strength to pay their current dividends and raise them once the economy improves.

Consider a **barbell sector strategy**.

- Combine a mix of defensive sectors that can hold up if the economic challenges linger, but also begin to focus on cyclical areas that could benefit from a forthcoming turn in leading economic indicators.
 - In the defensive area, we have an Overweight recommendation on the **Health Care** and **Consumer Staples** sectors.
 - In the cyclical area, we have Overweight recommendations on the **Industrial** and **Information Technology** sectors.



Strategy

Sector Recommendations

Sector	S&P Weighting 12/31/08	RBC CM's Current Stance*
Consumer Discretionary	8.4%	Market Weight
Consumer Staples	12.9%	Overweight
Energy	13.3%	Market Weight
Financials	13.3%	Underweight
Health Care	14.8%	Overweight
Industrials	11.1%	Overweight
Information Technology	15.3%	Overweight
Materials	3.0%	Underweight
Telecom. Services	3.8%	Underweight
Utilities	4.2%	Market Weight

*As of December 1, 2008

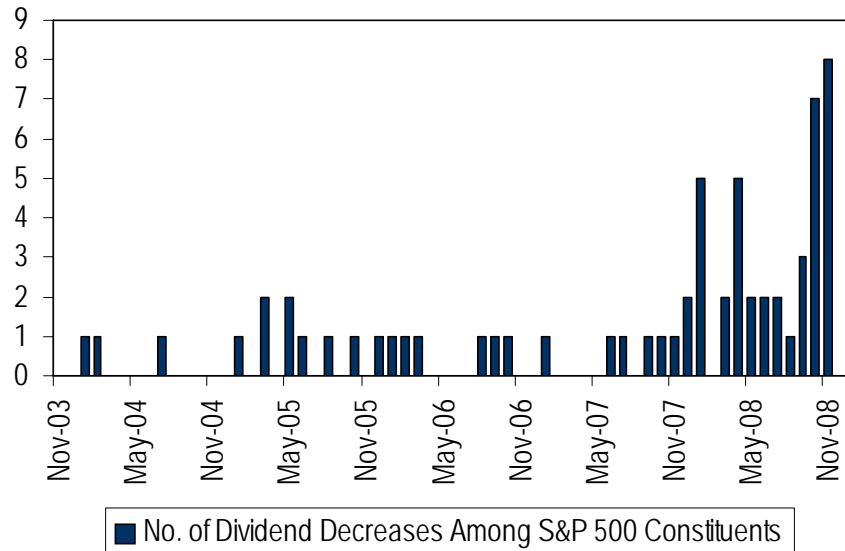
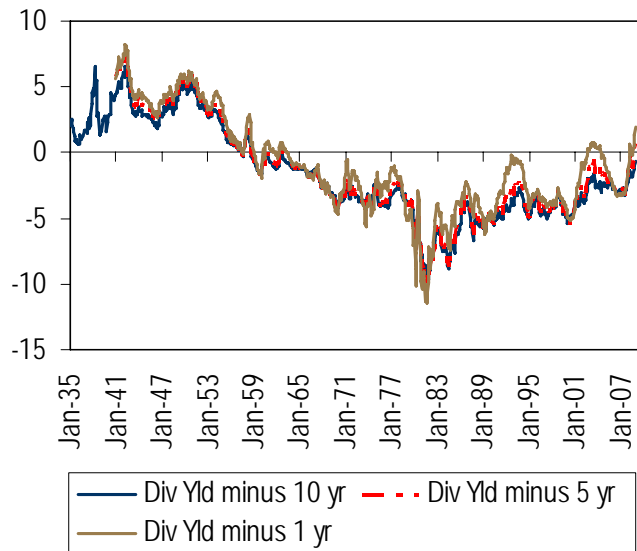
Source: RBC Capital Markets



Strategy

Dividends

Attractive Dividend Yields are Apparent, Dividend Cuts are a Growing Risk



Source: RBC Capital Markets, Global Financial Data Inc., Haver Analytics

Note: latest data point is month-to-date through Nov. 26.

Source: RBC Capital Markets, Standard & Poor's

- Why not get paid to wait?
- The yield on the S&P 500 is trading above the yield of the 10-Year Treasury for the first time in 50 years.
- Risk of dividend cuts has increased particularly in the troubled financial sector.

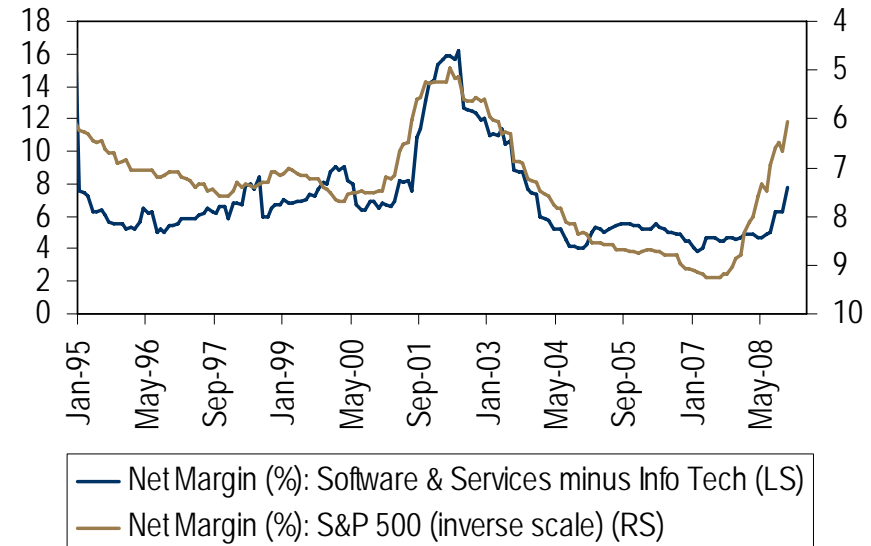


Strategy

Information Technology

Tech Spending Through Recession, Software Margins Outperform in a Downturn

Technology Spending Growth (yoy%)			
Recession Date	Total Technology Spending	Hardware Spending	Software Spending
1969	-3.1	-3.5	-1.1
1973	-3.0	-5.1	0.3
1980	15.9	15.3	20.1
1981	0.0	-1.8	7.9
1990	-0.5	-4.9	8.9
2001	-14.8	-18.6	-9.3
Average	-1.0	-3.1	4.5



Source: RBC Capital Markets Quantitative Research

Source: RBC Capital Markets

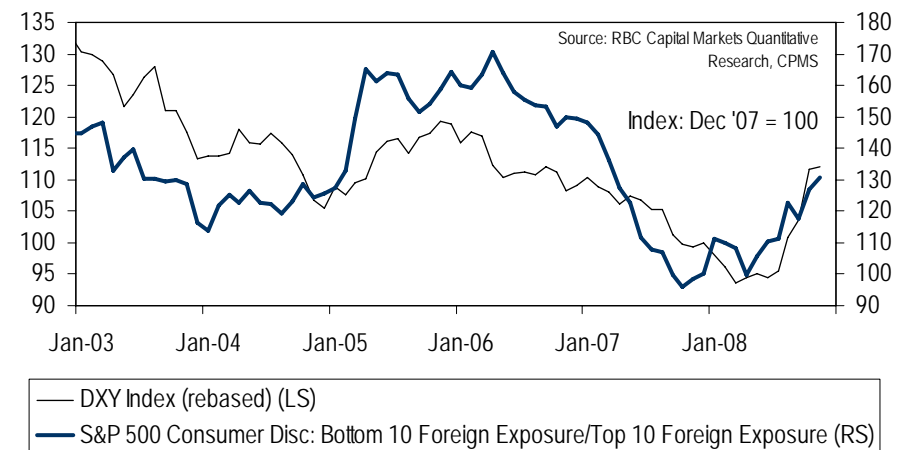
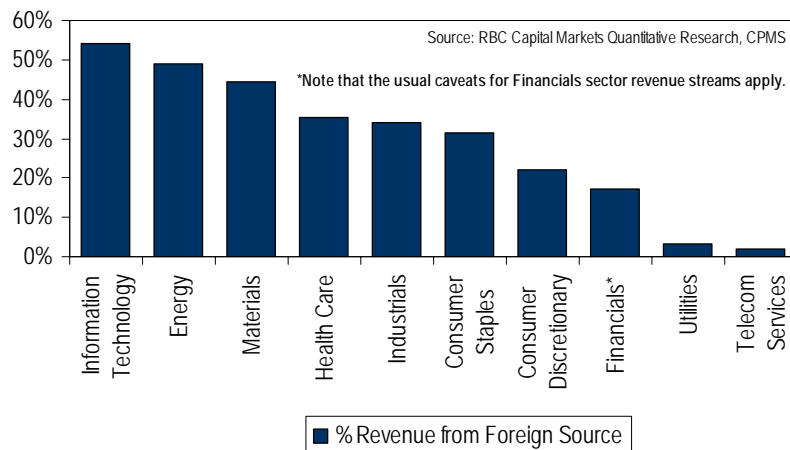
- Software spending is not impervious, but it is less vulnerable to a downturn in the economy.
- Software and services profitability outperforms when index-wide margins are under pressure.



Strategy

Low Foreign Exposure

Sector Share of Revenue Earned Abroad, Playing the Currency within Sectors



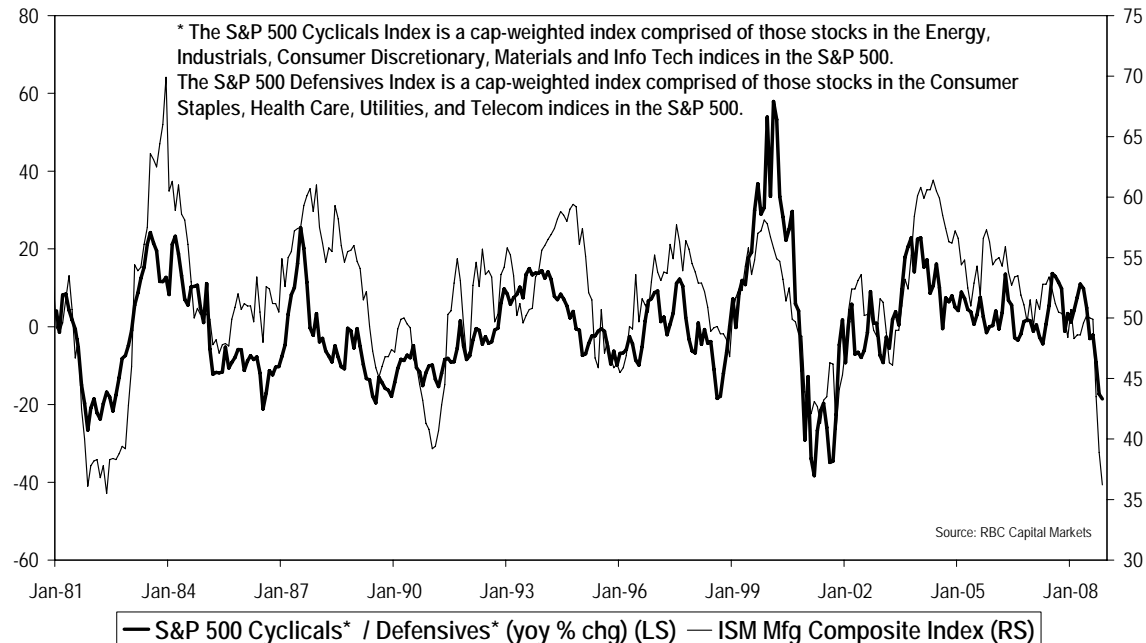
- Look for companies with low foreign exposure.
- Expectations are that the US dollar should continue to appreciate over the next six months, which will likely lead to opportunities in the Consumer Discretionary sector, known for its domestic concentration.
- Specifically within the sector, focus on names with a relatively low proportion of foreign-sources revenue, while at the same time de-emphasizing the foreign-oriented constituents within the sector.



Strategy

Non-Cyclicals Still Favored

Cyclical versus Non-Cyclical Sectors and the ISM



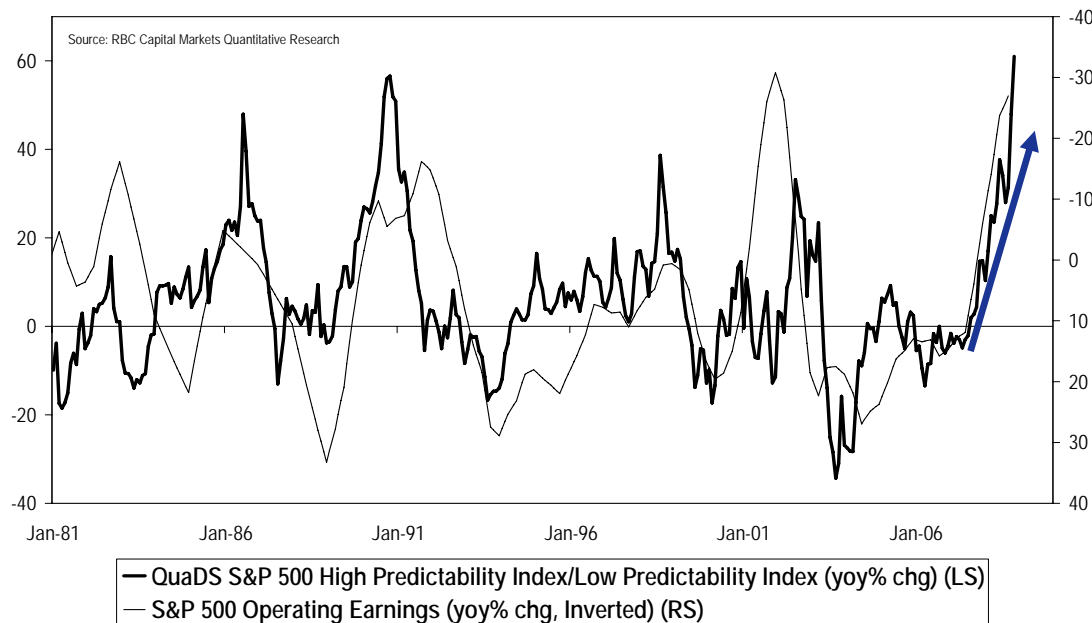
- Sector strategy still biased towards non-cyclical sectors in the U.S.
- Pressure on the economic and earning cycle is not the best environment for economically-leveraged sectors.
- Performance of the cyclical sectors almost always lag that of their relatively non-cyclical counterparts when forward-looking economic indicators are moving lower.



Strategy

High Predictability a Plus

High Predictability Attributes Providing Boost



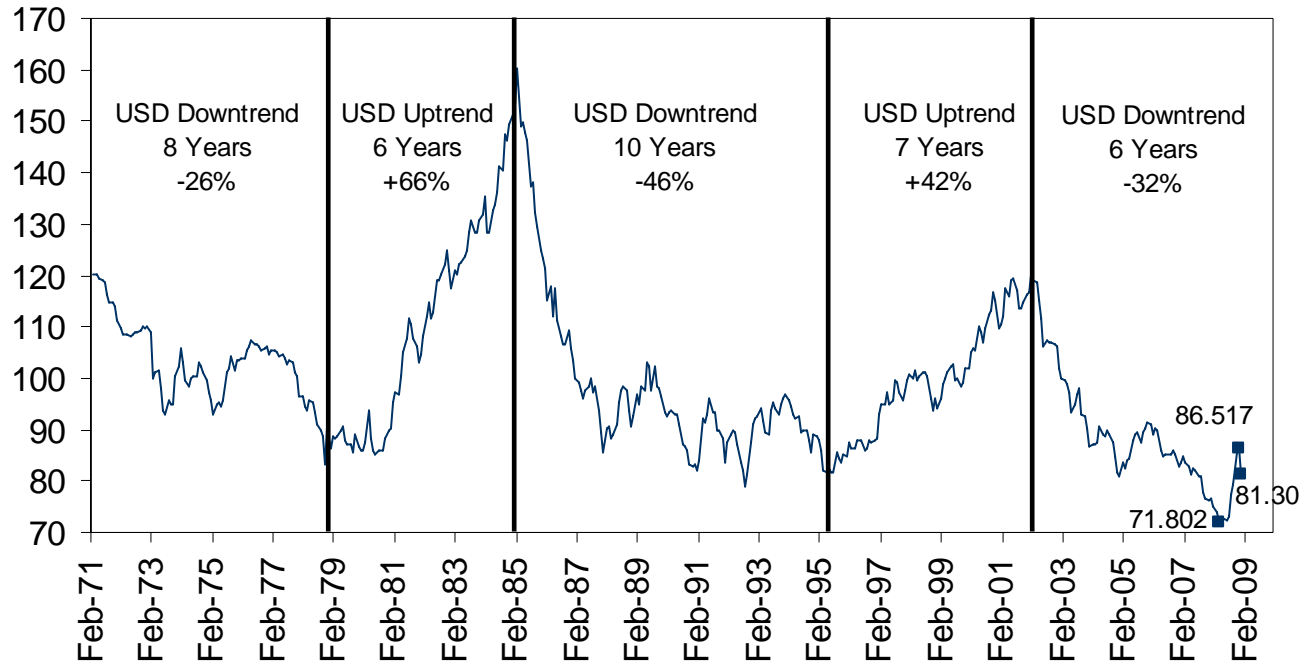
- Companies with fundamental stability typically outperform during times when the economy and earnings are sluggish.
- Look for:
 - strong balance sheets
 - relatively predictable cash flows
 - minimal capital needs
 - strong management teams
 - market-leading products or services



Strategy

U.S. Dollar

U.S. Dollar Currency Cycles



Source: RBC Wealth Management and Bloomberg, as of 12/31/08

- The USD rally that started in July and hit warp speed in October with more than a 20% gain has slowed to a crawl. This gain was the headline grabbing feature of FX returns in 2008.
- Analysts expect this trend has at least another six months to run as de-leveraging flows are well advanced, but rebalancing by real money investors has only just started.



Conclusions

The Credit Markets Hold the Key

■ Our key conclusions about the economy:

- While there are similarities between today's crisis and the Great Depression and Japan's deflation and stagnation period, we don't believe the current recession will morph into something that would rival those periods.
- Nevertheless, the economic disruptions could be more severe than the deep recessions of the mid-1970s and early 1980s.
- Signs of deflation are already cropping up in consumer data.
- Allowing deflation to persist and grip the U.S. economy is not a viable option.
- That is why the Fed has launched a series of strategies which have never been tried previously.
- Ultimately, once this crisis passes, we could wind up with a more stable, stronger, and more durable financial system.
- We could also end up with a U.S. economy based on *real*/entrepreneurial activity—not on the faux entrepreneurial activity that took place during the past five years.

■ Our thoughts about the stock market:

- We can't currently justify being bearish about the stock market following the severe decline in 2008 and because the market is not expensive from our perspective.
- However, we also can't currently justify being bullish because too many uncertainties linger—some of which are macroeconomic and some of which relate to corporate fundamentals.
- We believe a key catalyst for a rally would be the upturn in leading economic indicators, which would occur *before* GDP growth officially recovers and would likely occur before the unemployment rate peaks.
- Buoyant bounces are common during severe bear markets. Rallies of roughly 50% or more took place in the early stages of the Great Depression and throughout the Japanese deflation period. Rallies of roughly 30% were not uncommon.
- If such a rally is to be sustained, the turn in leading economic indicators would need to be durable.

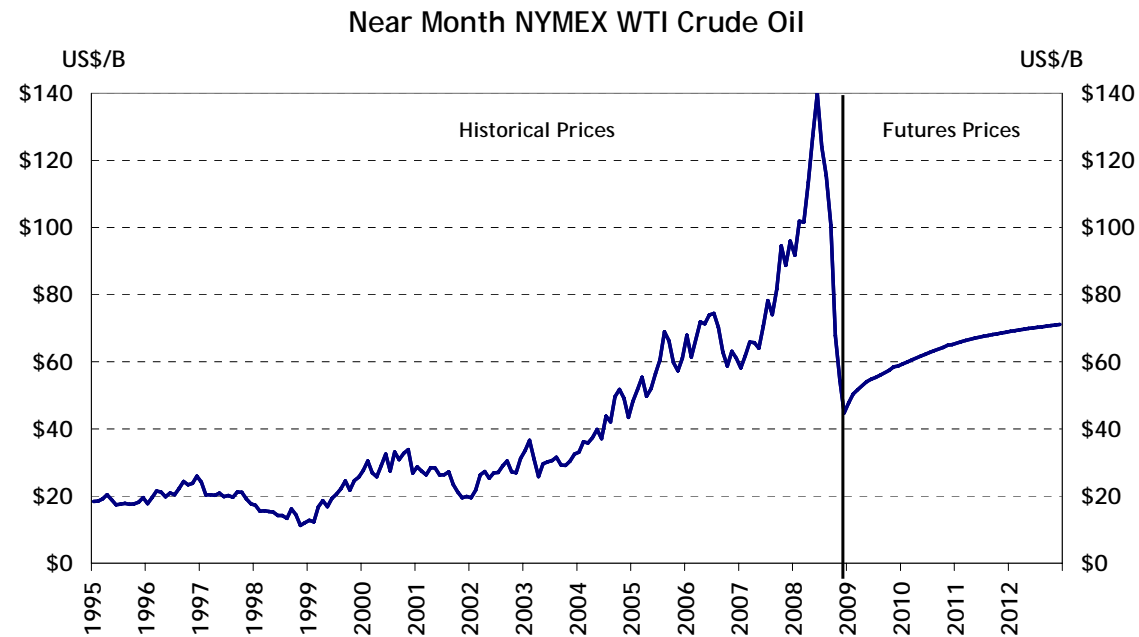


Appendix



Energy

Oil Prices Decline on Global Slowdown



Source: RBC Capital Markets, Bloomberg

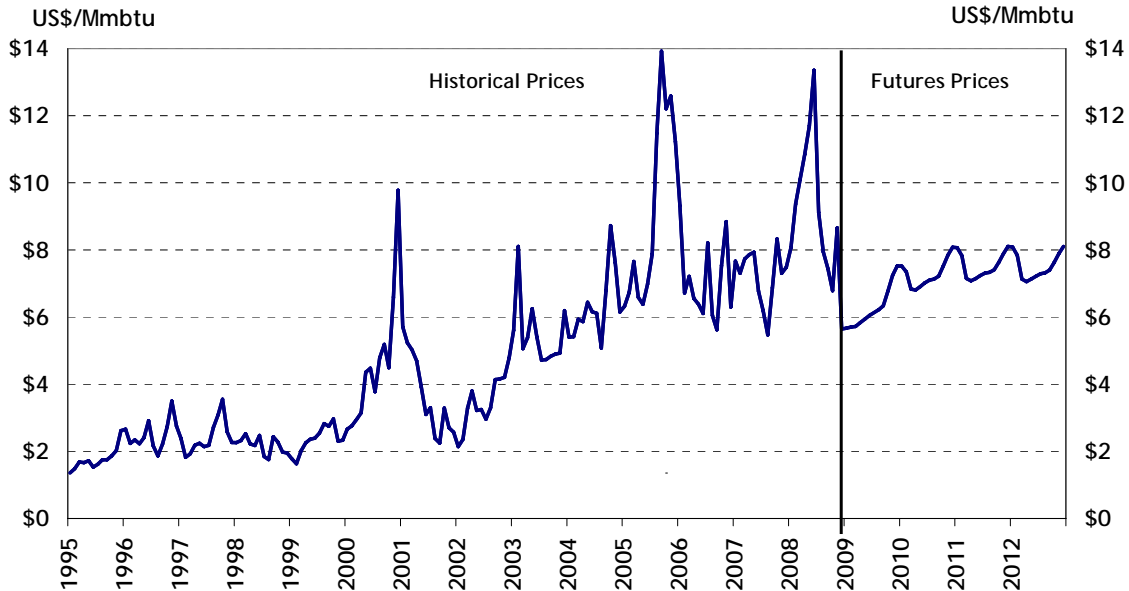
- RBC Capital Markets has lowered 2009 WTI oil price assumptions to an average of \$55/bbl. Global demand should fall by 0.6% due to the recession. The marginal cost of supply, currently at \$80/bbl., could decline further should F&D costs ease. We believe the price outlook could trend below \$50/bbl., should demand collapse more than anticipated.
- OPEC space capacity is now at 3.3 MMb/d, the highest in three years. Prices may still spike on real or perceived supply disruptions.
- For numerous political and social reasons, OPEC countries plus Russia and Venezuela prefer to keep oil prices at or over \$50/bbl. However, we believe structural issues and lack of adherence to stated production output goals make it difficult for OPEC to offset this demand decline. The market has taken a “show me” attitude, as a result.



Energy

Natural Gas Prices Decline on Economic Slowdown

Near Month NYMEX Natural Gas



Source: RBC Capital Markets, Bloomberg

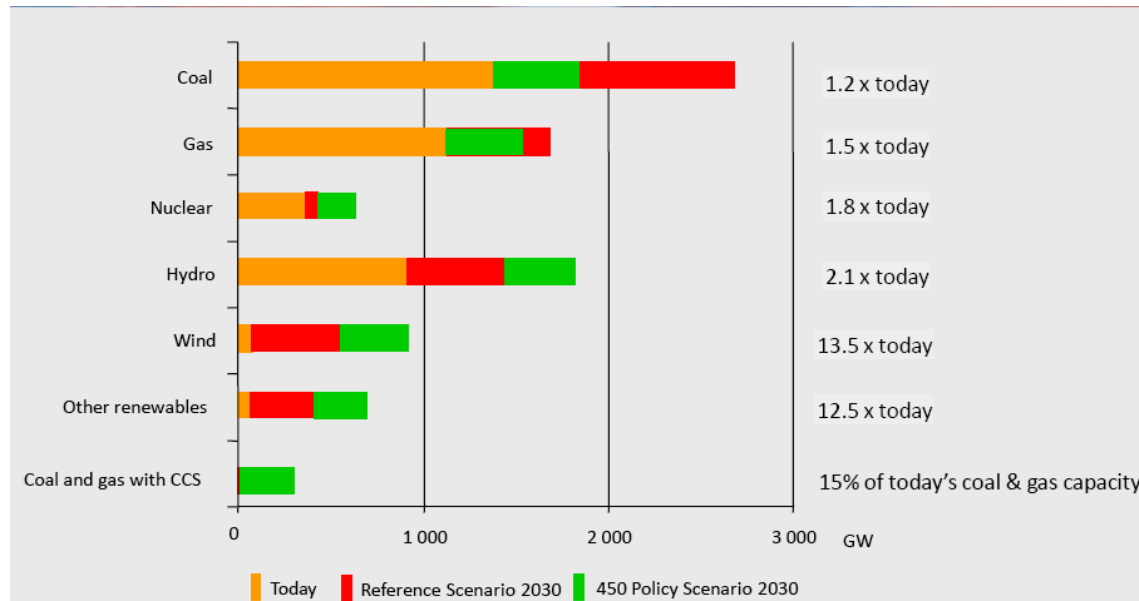
- RBC Capital Markets recently lowered Henry Hub natural gas price assumptions for 2009 to \$7/Mcfe. Storage levels are at 3.3 Tcf, slightly lower than 2008, but still 110 Bcf above the five year average. Marginal cost of production is \$7-\$8/mcfe, with a bias towards the low end.
- Shale gas now represents 10% of total U.S. Production, and is poised to increase to 20% of reserves over the next 5 years. In general, shale gas has not reached the marginal cost of production noted above. Shale gas discoveries have changed the outlook potential for North American natural gas in our view; the majors could view these areas as attractive acquisition opportunities.
- LNG (Liquefied Natural Gas) remains a wild card. Prices have trended lower than \$20/Mcfe; as inventories fill up in Asia and Europe, volumes could start to hit the United States.



Alternative Energy

Obama Administration Expected to be Supportive

Total Power Generation Capacity Today and in 2030, by Scenario



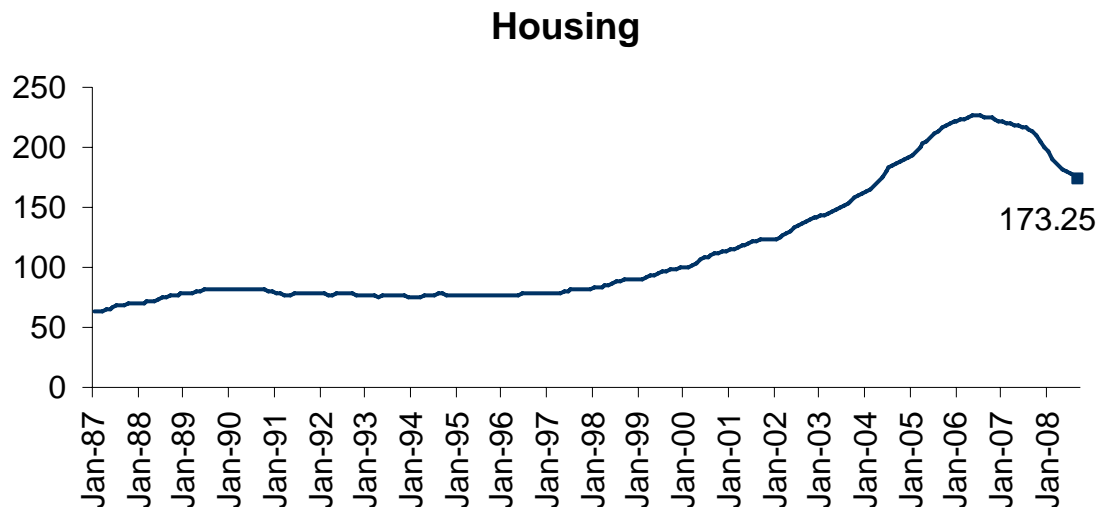
Source: International Energy Agency; World Energy Outlook, 2008

- In the 450 policy scenario, by 2030, the power sector undergoes significant change, as CCS, renewables and nuclear play a key role, per the International Energy Agency.
- Momentum for the alternative energy industry is driven by domestic and foreign government policy, as the bulk of “clean energy” solutions are not economic on their own. This is a more substantial driver than recent effect of higher oil and commodity prices.
- The new administration may push for at least 10% of electricity from renewable sources by 2012, and 25% by 2025. Wind and solar remain the most commercially advanced energy technologies. Support for a “smart grid” and improved transmission reliability is also expected.



Housing

S&P Case-Shiller Index Continues to Decline



Source: Case Shiller, September 2008

- A lack of buyers and tighter credit conditions continue to weigh on the housing market.
- According to the S&P/Case-Shiller Composite Index, October home prices were down 18% year over year.



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			Count	%
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