

The Guardian

Quarterly Review

Guardian Capital Advisors LP
Private Wealth Management

Q2 - 2010

JUST A FENCE?

G20 - JUST A FENCE?

A ten foot high fence. Riot police. Tens of thousands of protestors. Police cars set alight. A chaotic week. More than a billion dollars spent. And what was at the epicentre? Almost lost amongst the noise was the reason that an organization known as the Group of 20, or G20, was meeting and what the outcomes were. This group, which helps to set economic targets for large, developed economies, came together for its first policy meeting since the European sovereign debt crisis. Never mentioned were the 49 resolutions passed at the G20 meeting.

The 1970's were economically turbulent times, as currencies were moved off fixed rates of exchange and the gold standard was retracted, leading to a period of upheaval as companies and countries adjusted to the new paradigm. The 1970's had several oil shocks, most notably one in 1973, which lead directly to the formation of the G6. Charter members of this new compact where the United States, Britain, Germany, France, Italy, and Japan. With annual exchanges of views and informal trade talks, it was hoped that the Heads of State could create a more stable and predictable economic environment, and foster growth in developing economies. Canada applied for membership soon after the formation, and in 1977 the G6 became the G7. Alongside these seven nations, representatives from the European Community and the precursor to the European Bank - were invited to attend. With Russia's admission in 1997, the G8 was formed, and remains intact today.

The 1990's ushered in a new era of capitalism. Former Soviet-bloc nations were now free to pursue their own foreign and economic policy. China, post Tiananmen Square was keen to grow the middle class and reduce poverty. And the seeds were sown for growth in Brazil, India, Indonesia, and Africa.

While each nation seeks to further their own interests, the lessons learned from the post World War One policy of "beggar thy neighbour" and the far more successful post World War Two Marshall Plan suggest that suppressing singular interests in favour of wholesale improvements provides greater benefits to the World overall. The formation of the G20 in 1999, admitting Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Saudi Arabia, South Africa, South Korea, Turkey, and the European Union brought more than ninety percent of the Global economy together under one umbrella.

As trade barriers came down, capital moved more freely, creating demand for technology, resources, and financial innovation, and jobs in developing nations, where labour tended to be cheap. In turn, constituents of the G20 became more specialized, while interdependence increased exponentially; fates became married. This same interdependence, while fruitful during the robust expansion, can seem to punish even the most prudent during times of contraction. Now, with a fragile recovery under way, issues surrounding sovereign debt and a still-reeling banking system both become problems for the whole rather than for the one. The most recent meeting's declaration was "*The G20's highest priority is to safeguard and strengthen the recovery and lay the foundation for strong, sustainable and balanced growth, and strengthen our financial system against risks*". The global problems that beset us require global co-operation to fix, and to that end more than forty short-form resolutions were adopted at the closing of the summit, and while many are laudable, some were more noteworthy than others.

Austerity continues to be a watchword; "*advanced economies have committed to fiscal plans that will at least halve deficits by 2013*". A commendable step, to reduce overspending by fifty percent, but considerable latitude exists, given the extreme levels of stimulus that has been applied globally. Removing half, or more, of the record amounts of money that was already printed was more likely than not.



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“Advanced economies will...stabilize or reduce government debt-to-GDP ratios by 2016”. In simplest terms, the repayment of yesterday's excesses must begin; the can cannot be kicked further down the road forever.

Fuller employment moved to the fore, as *“unemployment in many countries remains at unacceptable levels”.* Through employment, both supply and demand can be created, with factories running closer to capacity and consumers having room in their budgets to spend on manufactured goods. Fuller levels of employment serve to stave off deflationary pressures; perhaps most importantly, employment generates tax receipts, which can be saved and used to reduce government debt. Fuller levels of employment would permit economic expansion, in turn allowing economies to grow into their recently printed supply of money, helping to defray inflation.

The same public support for financial institutions, through large injections of taxpayer money is unlikely to be repeated. Taxpayer loans, privatizations, or direct purchases of equity kept many banks afloat. While the moves were highly unpopular on Main Street, the public purse kept the wheels of credit turning, and the economy moving through 2008. Going forward, those banks which fail to learn from history may not find conditions nearly so kind in the future; *“progress has been made on reforms that will materially raise levels of resilience of our banking systems”.* While many G20 constituents were in support of a per-transaction fee to be collected by banks and contributed to a central funding pool, the idea failed to generate broad accord. Many saw this as an additional cost to consumers, leaving the public to pay for any future potential bailout by a thousand cuts today. Inability to agree on both the size of the fee and which bank transactions might trigger it, along with a failure to agree who should collect and administer these funds, saw the

The intent of the G20 was nonetheless very clear *“This will enable banks to withstand - without extraordinary government support - stresses of a magnitude associated with the recent financial crisis”.* Those unable to work under duress will see more dramatic action taken far more quickly *“we are committed to design and implement a system where we have the powers and tools to restructure or resolve all types of financial institutions in crisis, without taxpayers ultimately bearing the burden”.* Future meetings are likely to lend greater clarity on capital requirements for banks, though many models suggest that the Canadian banks, which led the way in the recent credit crunch, may become the base case for financial institutions once rules are set.

Formation of policy at the supra-national level remains fraught with peril, as nations - and indeed politicians - feel compelled to act in their own best interests first. A debt dependant nation like Japan opted out of debt to GDP controls, the United States agreed to deficit cuts, but openly preferred a policy of growth and expansion to solve their economic woes. Witness the *Sturm und Drang* in both Germany, as lender, and Greece, as debtor, when Germans were required to prop up the finances of the Greek government, and Greeks were expected to adopt austerity. Political hay was made standing in opposition to measures that were deemed critical at the time. Policy measures at a national level should more closely mirror the intentions of the G20 over time, providing greater stability and predictability in economic forecasting. Broad changes have been proposed; broad changes are coming. *“We are building a more resilient financial system that serves the needs of our economies, reduces moral hazard, limits the build up of systemic risk, and supports strong and stable economic growth”.* The trajectory may not be upward - yet - but global growth, or even stability, would provide investors with comfort to invest.



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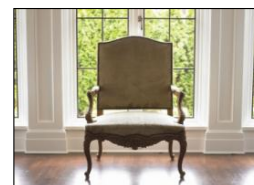
The failure of the media to report on the workings of the G20 meetings was widespread and shameful. The work being done to reframe capitalism within the social needs of the public is profound, and should help avoid a repeat of socialized capitalism seen over the last few years. The primary responsibility of the news media should have been to report on the work being done behind the fence, rather than the fence itself; it might not make for the same sensational viewing and reading, but it provides a deeper and far more interesting story.

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