

RockLinc

Investment Partners Inc.

**Investment Presentation – Insight for Life
Financial Uncertainty**

May 20, 2010

RockLinc Investment Partners Inc.

Presentation Outline

- A. Insight for Life - Overview
- B. RockLinc Overview
- C. Investment Philosophy and Principles
- D. What hit us?
- E. Major Economic Challenges/Opportunities
- F. Focus Industries & Businesses
- H. Where do we go from here?
- G. Summary

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A. Insight for Life - Overview

- ‡ Pastor Carl Muller – Trinity Baptist Church
- ‡ Dr. Stephen Swallow – Oakville Centre for Cognitive Therapy
- ‡ Dr. Gordon van der Pol – Ontario Osteopathic and Rehabilitation Centre (Burlington)
- ‡ Jonathan Wellum – RockLinc Investment Partners Inc.

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B. RockLinc Overview

- § Private investment management firm
- § Founded in January 2010
- § Focus – creating portfolios of high quality assets customized to our **client's needs**
- § Investing based upon:
 - § Independent thinking (network of relationships and strong advisory board)
 - § Understanding of individual businesses/investments
 - § Current opportunities – looking forward with an understanding of the past

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Advantages of Portfolio Management Firm

- ⌚ Minimal conflicts of interest
- ⌚ Annual management fee based on assets under management, not transactions
- ⌚ Business model is aligned with client
- ⌚ Fiduciary duty to act in best interest of clients (Investment Policy Statement is required)
- ⌚ Regulated by the Ontario Securities Commission
- ⌚ Assets held at TD Waterhouse
- ⌚ Transparency – client sees all holdings and transactions in each account
- ⌚ Detailed reporting package

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C. Investment Philosophy & Principles

- ❖ Focus on absolute rates of return
- ❖ Investing in safe assets providing downside protection (essential businesses with collateral)
- ❖ Concentrated portfolios – best opportunities
- ❖ Medium to long-term holding period – patience vs. speculating
- ❖ Buy at margin of safety prices – cheap

“Principles lead to Performance”

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Primary Client Needs

- ⌚ Preservation of Capital / Purchasing Power
- ⌚ Growth of Capital in Real Dollars
- ⌚ Tax Efficiency – maximize after-tax rates of return
- ⌚ Creating a steady, sustainable and tax efficient income stream

“Customized portfolios of exceptional businesses”

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Key Attributes of Investments

- ⌚ Powerful Franchises/Reputation – anchor revenue
- ⌚ Strong Balance Sheet – self funding
- ⌚ High Barriers of Entry - scarcity
- ⌚ Essential Business – pricing power
- ⌚ Understandable Business – simple preferred to complex
- ⌚ Successful Track Record – well positioned for foreseeable future
- ⌚ High Returns on Invested Capital – business model works
- ⌚ Management Characterized by Integrity

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D. What hit us?

1. **Debt Crisis – Both Private and Public Sectors - Utter lack of Discipline (Materialism)**
2. **Increasing Size/ Intervention of Government - Rationalized by Keynesian Economic Theory (Laziness/Entitlements)**
3. **Demographic Suicide – Fertility Rates Down Dramatically (Selfishness)**

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Debt Crisis - Three decades of Folly

! Savers becoming debtors

- debt levels have more than doubled on a per capita inflation adjusted basis (standards of living have not increased!)

! Focus on wealth creation/production shifted to consumption

- manufacture less and you will have less, we need more capital formation to produce required income stream

! Export focus shifting to imports

- you cannot run balance of payments deficits (sell off your country) over time and remain strong and solvent

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Economic Equation: Components Matter and Balance Sheet Matters!

$$\text{GDP} = \text{Consumption} + \text{Investments} + \text{Gov't} + \text{Net Exports}$$

The composition of GDP tells you a lot about the culture!

A viable economy grows by disciplined savings and investments leading to strong capital formation, growing exports and the ability to compete globally.

The developed world has become too dependent on driving wasteful consumption, running down our savings and at the same time demanding more and more from the most inefficient sector of the economy, the government! Simply stated, we have become debtor nations!

GDP has grown by piling up debt on debt!

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Debt Crisis – 5 key Causes

1. Cheap credit, excess liquidity led to a massive increase in debt without enough equity (these two must be balanced).

§ For example: debt to GDP levels in the developed world have gone from (1980 – 2009 2Q) McKinsey & Company

§ 244% - 471% - Japan

§ 154% - 296% - US

§ 189% - 466% - UK (this is from 1987 – 2009 2Q)

§ 108% - 366% - Spain

§ 131% - 333% - South Korea

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- § Debt numbers include private, public and financial institutions. Note: they DO NOT include the outrageous entitlement promises! If you were to add all the entitlement promises the global economy would be insolvent.
- § Government accounting is fraudulent, not accountable to GAAP, understate the problem.
- § Shift in the use of debt from borrowing and paying back to never paying off! This is destroying us! Tax system rewards and supports the use of debt.
- § Since the introduction of the Federal Reserve in 1913 the loss in purchasing power in dollars has been 96%. Today we see a record level of monetary theft and legalized counterfeiting on the part of the state.

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2. **Poor financial services leadership, ethics, risk management – pressure for greater returns (short-termism) regardless of long-term risk.**
 - ! Abuse of derivatives, excessive financial engineering and conflicts of interest with the various rating agencies led to the production of low quality mispriced assets rather than the strict credit adjudication and channeling of wealth to the best businesses.
 - ! Diversification of “garbage” never makes it a higher credit! When a crisis hits everything is correlated to 1 and there is no efficient frontier and **academic financial constructs are useless.**

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3. Lack of honest political and regulatory oversight
 - Total lack of leadership on the part of government. In Europe governments conspired to cover up their debt.
 - Corrupt politicians pushing agendas based in economic folly (home ownership as a right at all costs)
 - Don't expect the arsonists to put the fire out!
4. Massive global trading imbalances – global economy has been too dependent on a profligate American and European consumer (developed economies in general). Slowly selling off their countries to creditor nations.

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5. Cultural and moral values

- A national economy is the sum of the spiritual and mental qualities of its people; its output of value will only be as strong as the values held in the society. A society that has no values will not produce much value; a nation whose values are declining should not be surprised at a declining economy and declining levels of wealth.
- Most governments in the developed world are running Ponzi schemes (borrowing money to pay interest on previous borrowing) and our central banks are operating as counterfeiters— where is the honesty?
- Government policies are now our biggest risk! Sovereign debt is the new subprime!

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Increasing Size and Intervention of Government. This Must be Stopped

Keynesian Economics and our entitlement mentality has brought us to the point of bankruptcy.

The government does not add value to the economy. It removes value from the economy by imposing taxes on one citizen and providing cash to another. Or it borrows money that would otherwise be used by investors and redistributes it elsewhere. Or it prints more money and threatens the value of the dollar. Nothing is stimulated. Bureaucrats are substituting their uninformed political decisions for those of the marketplace.

Friedrich Hayek

“It is incumbent on every generation to pay its own debts as it goes.”

“I predict future happiness for Americans if they can prevent the government from wasting the labours of the people under the pretense of taking care of them”

Jefferson

Thomas

“ the way to crush the bourgeoisie is to grind them between the millstones of taxation and inflation”

V.I. Lenin

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Our Economic Model is Broken

2009 - \$1.5 trillion annual deficit added approximately \$28 billion to GDP in the US.

2010 - \$1.2-\$1.5 trillion annual deficit will add approx. \$300 billion to GDP in the US.

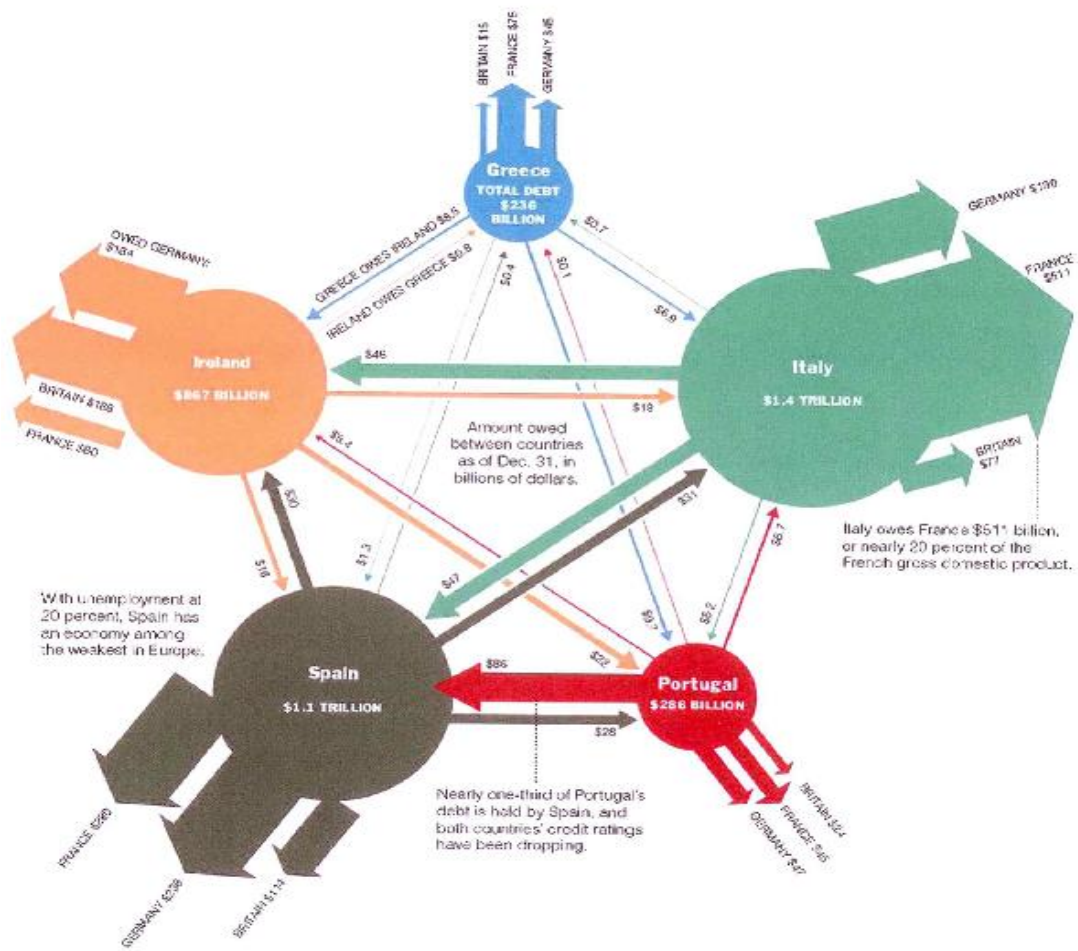
Liability goes up with no offsetting asset! This is economic and financial lunacy. Deficit financing is burying our economies, most countries in the developed world are past the point of return. We need to save not spend!

Gov't does not exist to redistribute wealth. Wealth inequality is essential and very positive when it results from personal contribution, merit and work!

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Performance of the S&P 500 Index, by Decade

- 1920s – 21.5%
- 1930s – (41.2%)
- 1940s – 32.9%
- 1950s – 259.5%
- 1960s – 53.7%
- 1970s – 16.1%
- 1980s – 234.2% - over leverage
- 1990s – 308.5% - over leverage
- 2000s – (24.1%) – impact of over leverage takes hold
- 2010s - ????????????????????



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Demographic Suicide - Death of the Social Welfare State

- ! The severe drop in global fertility rates is the most challenging factor facing the global economy that continues to largely ignore this reality.
- ! 2.1 children/women is the stable fertility rate
- ! Japan is in a death spiral (will lose 70% of workforce by 2050)
- ! Russia is in a death spiral (losing .40 - .50 % of population per year)
- ! Europe is entering a death spiral phase with birth rates averaging less than 1.5 and in some countries such as Portugal, Italy, Greece and Spain the rate is 1.1.

Bottom Line: These countries CANNOT pay down debt without restructuring /reneging or inflating/printing money!

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Demographic Suicide

- ⚠️ China hits a wall in 2024 (already starting to see impact with birth rates under 1 in some cities)
- ⚠️ China and India have increasing gender discrepancies, abort females at 10-20% higher rates

Bottom Line:

1. Our social welfare states can not survive with the demographic profiles we have created.
2. No culture has survived a birth rate that drops below 1.9 (takes 80 – 100 years to reverse)
3. Despite all this we must have the fortitude to invest long-term in the face of the coming restructuring of our global economy!

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Options in Dealing with a Debt Crisis

- 1. Grow out of the debt by expanding the economy much faster than growth in debt.**
- 2. Austerity Program – cut spending and pay down debt.**
- 3. Default – renege on financial obligations.**
- 4. Inflate the debt away by depreciating currency.**

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E. Economic Challenges/Opportunities

1. Aging Demographics

- § Both developing and developed countries are getting older and quickly! By 2050, most developed economies will have 50% of their population older than 50 years of age!

2. Entitlement Promises/Expectations

- § too high – not factored into current debt levels
- § Healthcare costs and expectations are now escalating.
- § Unfunded Pension obligations (particularly in the public sector) are out of control and valuing assets 20 years in the future is very difficult

3. Tax Rates Set to Rise

- § Pressure on all levels of Government to slash spending and raise taxes. (HST, VAT tax coming in US?)

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4. Deleveraging of Private Sector to Continue for Years

- § 30 years of accumulating debt will take some time to pay down to healthier and sustainable levels (Canadians have not even started!!!!)
- § Need to deleverage is exacerbated by an aging population and low fertility rates
- § Real personal disposable income will drop dramatically in the next decade

5. The Public Sector in Developed Nations is too Leveraged

- § Sovereign debt is massive and has become the new sub-prime
- § Countries today are in dire straits include, Japan, UK, Iceland, Ireland, Greece, Spain, Italy, Portugal, Dubai, and yes, even the US.
- § Canada and Australia are two of the best positioned countries
- § Bottom Line: Developed Nations are largely debtor nations and their governments are clueless! Solving a debt crisis with more debt??????

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6. Developing Nations currently acquiring more of the world's wealth

§ Produce more of the world's goods, save more money and therefore enjoy creditor status.

7. Huge pressure on developed nations to monetize their debt (print money)

§ Most paper currencies are being competitively devalued.

§ Be prepared for inflationary pressures.

§ Counterfeiting on the part of central banks is alive and well! All the major central banks in the world are printing money!

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8. Scarcity of Agricultural Commodities and Clean Water Supplies

§ Global population continues to grow and will not peak until approximately 2050 at over 9 billion people.

9. Significant Need to Invest in Basic Infrastructure within both Developed and Developing Nations.

§ Developed Countries have not invested adequately in maintaining their aging infrastructure and need to invest up to \$25 trillion over the next 10-15 years.

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F. Focus Industries & Businesses

1. Financial Services

- § Retail Banks (in strong well financed countries) – TD Bank
- § Asset Management / Custody & Servicing – Bank of NY Mellon
- § Property & Casualty Insurance – disciplined underwriting with investment acumen – Markel Insurance
- § Avoid significant exposures to Japan, Europe and UK (especially their debt).

Buy essential services with short term liabilities that can re-price as conditions change!

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2. Healthcare

- § Retail services including pharmacy in some countries – Shoppers?
- § Laboratory and diagnostic – Becton & Dickenson
- § Medical supplies and products – Johnson and Johnson
- § Pharmaceutical – bias towards generic - TEVA

Aging population - increasing demand for medical products and services. Must be careful not to be overly dependent on government subsidies and be positioned to take advantage of private services.

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3. Commodities – Natural Resources

- § Oil and Gas – Canadian Oil Sands, Birchcliff, Encana
- § Gold and Precious Metals – Barrick Gold, Goldcorp
- § Base Materials – BHP Billiton
- § Agricultural – Viterro, Agrium

Essential to the global economy, cannot be printed by central banks. Buy the commodities where the overall demand vs. supply favours the long-term price of the commodity.

Ensure that the majority of reserves are in safe countries that respect the rule of law.

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4. Real Estate and Infrastructure

- § Growth opportunities with expanding populations and wealth in developing nations.
- § Predictable and steady cash flows, lower volatility.
- § Inflation protection and strong yield component.
- § Exposure to a diverse group of industries such as:
Transportation (toll roads, airports, ports, rail), Energy and Water (pipelines, transmission and distribution systems), Communications (towers, cable networks), Social (educational and healthcare properties), timber, and industrial infrastructure.

Examples: First Capital, Brookfield Asset Management, TransCanada, American Water Works.

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5. Industrial Businesses

- § Essential to the economy.
- § Enduring businesses with high barriers of entry, providing some pricing power.
- § Many are global players providing diversified revenue streams.
- § Product cycles are long resulting in high levels of free cash flow and solid yields.

Examples: Nalco, CN Rail, Republic Services, Martinrea

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6. Consumer

- § Invest in consumer businesses that produce basic products that have a high priority on consumer spending.
- § Strong consumer businesses are characterized by high free cash flow and decent dividend yields.
- § Global footprints provide global growth opportunities.
- § Look for pricing power and the ability to adjust to changing cost structures.
- § Possess long product cycles, many multi decade.
Examples: Costco, Coca-Cola, Kraft Foods, Nestle, Church and Dwight, Tim Horton's

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7. Technology

- § The best technology companies are becoming basic infrastructure businesses and are essential to our modern world
- § Oligopolistic industries despite shorter product cycles, leaders can remain leaders for longer periods of time.
- § Huge cash flow generation with no net debt on balance sheets
- § Global franchises, providing global growth opportunities
Examples: Apple, Google, Microsoft, Intel

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8. Conglomerates

- § Look for a collection of businesses under one management team that can be purchased at a significant discount to net asset value.
- § Management team has a history of exceptional capital allocation, both in the purchasing and selling of assets.
- § Operate as a closed-end fund, providing diversification and very little overhead costs.

Examples: Leucadia National, Berkshire Hathaway

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G. Where do we go from here?

1. We need a new crop of principled leaders
 - Reject consensus thinking (short-termism)
 - i. Vision
 - ii. Discipline
 - iii. Effectiveness

 - Two Serious Shifts to Reverse:
 - i. Character replaced by personality
 - ii. Virtues have morphed into empty values

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2. **Turn our Universities on their Head/Invest in Next Generation**
 - § **Postmodernism has undermined the foundation of all learning, that is the pursuit of TRUTH.**
 - § **No unified epistemology, no truth. No truth, no hope. No hope leads to nihilism and despair.**

3. **Shrink the size and influence of government, our confidence cannot be in the State.**
 - § **Low tax base is critical**
 - § **Limited government is essential to maintaining freedoms and highest degree of accountability to capital.**
 - § **The right regulations, but not over regulation.**

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4. Protection of private property and the rule of law
 - § Private property & liberty are inseparable in civil society
 - § Protecting intellectual property is critical
5. Stable monetary policies that maintain a long-term relationship between creditors and debtors (sound money).
 - § Need to collateralize our money (cannot trust our central banks and governments to act honestly).
 - § Pay for our spending, eliminate budget deficits.

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H. Summary

- ❗ Be committed to the right set of principles and values, not just in the area of investing but in all you do.
- ❗ Be independent in your thinking. We are not paid to follow the crowd but to demonstrate wisdom in light of the current hour.
- ❗ Live below your means and do not accumulate debt. Learn to be content with less material items but do not be content with mediocrity.

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- ! This is a time for leadership, personal accountability and a much smaller government presence. The age of entitlements is slipping away. Good Riddance!
- ! Debt problems throughout the world are here as far as the eye can see! Buy **Hard Assets** in safe countries that are both scarce and essential to human life and progress.
- ! Speak out and be part of the Solution! Take nothing for granted. Optimism is essential!
- ! Put your faith and confidence ultimately in God! This world and it's powers, glory and wealth are all passing away!

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