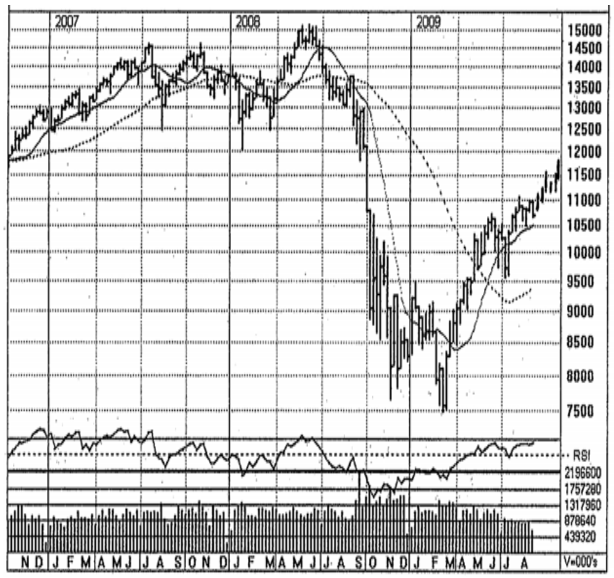
DECEMBER 2009 | REPORT

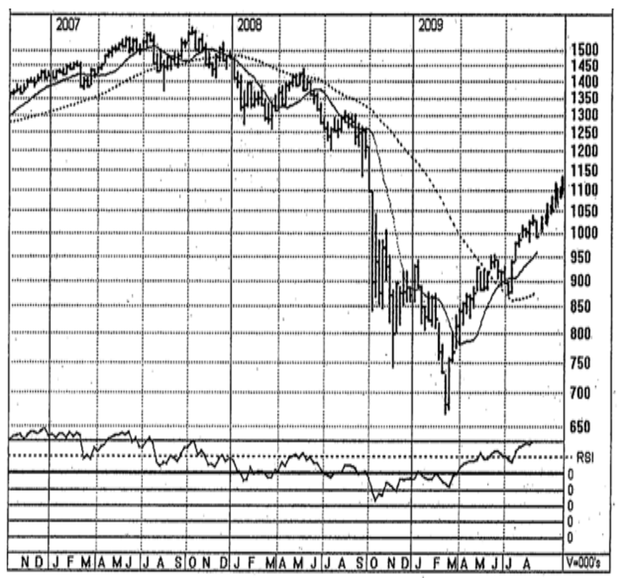
2009 ended strongly for Canadian equity investors as the S&P/TSX Composite Index advanced 2.93% for the month of December. The return for the year was 35.1% but, as we all know, the markets were in freefall at the end of 2008.

Fixed Income markets retreated during the month and the PC Bond Index fell 1.4% in the closing month of the year. For the full year the bond market in Canada produced a 5.4% return.

S&P/TSX A COMPOSITE INDEX



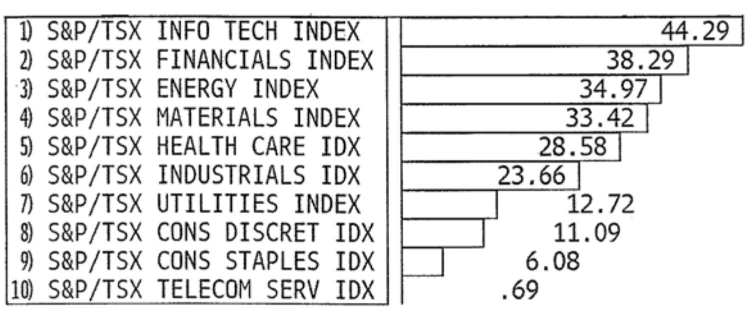
STANDARD & POOR'S 500 INDEX



Source: Independent Survey Company

2009 in markets around the world was a recovery year. The accompanying chart of the returns for the ten sub-groups that make up the S&P/TSX Composite Index shows that all sub-groups generated positive returns for the full year and that the gains were reasonably broadly based. This tells us that the major market movers this past year have been more macro factors rather than either company or industry specific trends.

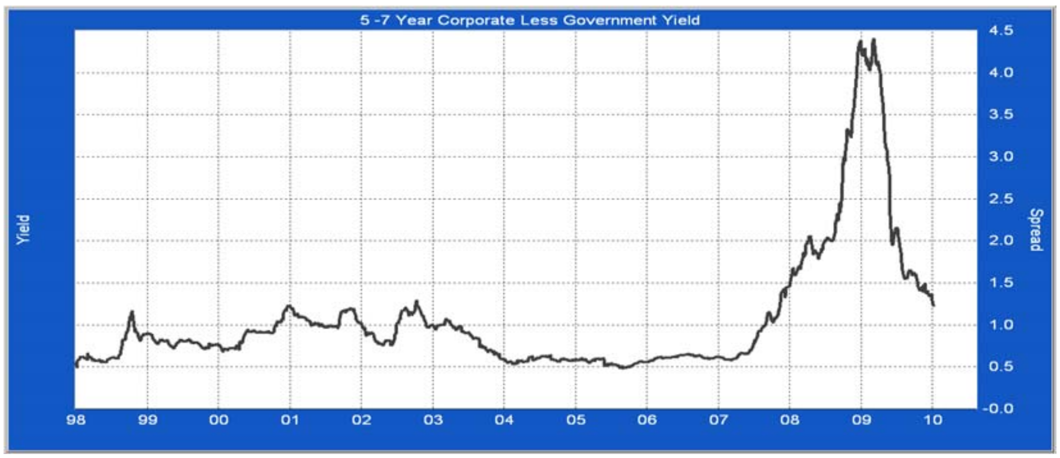
S&P/TSX SUB-GROUP RETURNS DEC. 2008 TO DEC. 2009



Source: Bloomberg

By now it is old news to point out that the severity of the 2008–2009 bear market was exacerbated by the mother of all macro events, the credit crisis, and that the rapid recovery in stock prices has been powered by the easing of the credit crisis. The best illustration of deteriorating financial markets and the subsequent improvement is the accompanying chart of corporate bond spreads or premiums. It can be seen that the premiums over Federal government borrowing rates for high quality corporate borrowers spiked up through the latter half of 2008 but have come down to levels slightly above the ten-year history.

CANADIAN CORPORATE BONDS: YIELD PREMIUM VS. CANADA BOND



Source: PC Bond

What got us out of the last crisis was quick reaction in the execution of both monetary and fiscal policy. Governments ratcheted up spending as quickly as they could while Central Banks drove short-term markets as close to zero as they could. This has been great for short-term borrowers, with the price being paid by lenders. The Central Bankers have been very clear that, as long as they see significant economic weakness, they will keep the price of short-term money at close to zero.

As markets and the economy emerge from the depths towards a more normal growth path monetary policy in North America remains highly stimulative. One well-spoken market strategist has characterized the current policies as financial heroin. Central Bankers also recognize this, which is why we had the recent example of Mark Carney, Governor of the Bank of Canada, cautioning Canadians that they should not take on financial obligations thinking that interest rates would remain at these levels forever. Governor Carney knows that the financial heroin of near zero short-term interest rates are appropriate only as long as the patient is near death but are not conducive to the long-term health of the economy. When Central Bankers speak clearly, it is best to listen. They have the power to sway markets.

The debate in financial markets currently is all about when interest rates will rise. We are less concerned with identifying whether they move at mid-year or wait until 2011 and more concerned with how markets will react to a change in monetary policy.

Broadly speaking, the major beneficiaries of low interest rates and easy money have been stock and bond markets so it would be reasonable to see stock prices back off from their recent peaks, perhaps by as much as 10%. Bond prices would likely weaken as well.

The U.S. Dollar and many other currencies have also declined against gold prices in the low interest rate environment so it would also be reasonable to see that trend reverse with higher short-term interest rates.

As the economies in North America and around the world recover, it is only normal that equity prices both shoot ahead and retrace part of the advance. Equity prices are shifting from being powered by easy money to rising corporate earnings. We pointed out last month that, on the basis of dividend yield, stocks in general appear cheap, both historically and relative to bond yields. Attractive valuations lead us not to be concerned with any market retracement that is driven by a Central Bank-led move from a highly stimulative monetary policy to a more neutral one.

The downside is that a stock market driven by rising earnings is unlikely to advance as quickly as the current bull move from March of this year. So we expect that the basic trend in stock prices will be up but that the rate of advance will slow considerably as we proceed through 2010.

If you have any questions about either our investment strategy or your portfolio specifically, please contact Brian Smith at your convenience.

Sincerely,

Richard D.W. Howson, CFA
Executive Vice President
Howson Tattersall
Private Asset Management

Brian M. Smith, CFA
Vice President, Private Clients
Howson Tattersall
Private Asset Management
416-355-2534 brian.smith@htic.ca