RAYMOND JAMES

Steele Wealth Management

Fourth Quarter 2013 – "The Great Melt-Up"

Tech Wreck Redux? Bubble Fears Grow as U.S. Markets Rise at a 45° Angle for 18 Months

The Team:

Brian Steele, CA, CPA, CFA
Laura Prust, CPCA
Jeannine Campbell
Kelly Townsend
Matthew Bell, CFA

U.S. Markets Ignore Poor Earnings and Rally on Momentum; the S&P/TSX Joins In

- The S&P/TSX Composite Total Return Index gained 7.03% during the 4th quarter of 2013.

- The generally more cyclical sectors – Industrials, Financials, Consumer Discretionary, IT and Health Care – led the TSX Composite Index in the quarter while the generally less cyclical sectors – Utilities, Consumer Staples, Telecom, Energy and Materials – trailed.

- Global stock markets continued to climb led by strong performances from U.S. and European markets. Following a slew of positive economic data in late 2013, the U.S. Federal Reserve opted to begin tapering its bond purchases in January 2014. Despite worry that the decision to taper bond purchases could have an adverse effect on the stock market, as the market performed poorly following the announcement to reduce stimulus in 2011, markets rallied strongly on the day of the announcement and finished the quarter on a strong note. It appears that investors want to believe that the Fed is accurate in predicting a sustained period of U.S. economic growth. Some market commentators conclude that the strong equity market performance was due to the Fed's reluctance to reduce its purchases by more than $10 billion per year and its verbiage along the lines of "we will provide additional stimulus if necessary" was better than expected as it ensures a slow tapering process (i.e. more support, longer).

- Global growth finished the quarter on a strong note with the JP Morgan Global Purchasing Manager's Index (PMI) trading near the peak of economic activity recorded in 2011. Economic activity dipped sharply in October partly due to the U.S. government shutdown but the slump proved temporary as activity fully rebounded in November. The West plus Japan continued to be the story of 2013 as the U.S., Eurozone and Japan drove improvement in economic activity. Chinese, Russian and Brazilian output improved slightly during the quarter while the Indian and Indonesian economies further weakened.

- In October, the U.S. government shut down for 16 days resulting in 800,000 government workers being temporarily furloughed. The shutdown was the 3rd longest in U.S. history. Though Democrats and Republicans disagreed on many budgetary items, the focus of the shutdown was on the Affordable Care Act, or Obamacare as it is informally known. The shutdown ended as lawmakers passed a bill funding government at sequestration levels until January 15th, 2014 and pushed the debt limit to February 7th, with no policy strings attached, setting us up for yet another potential crisis in Washington in the New Year. The shutdown is expected to reduce 4th quarter GDP by about 0.50%.

- Equity markets rallied despite Q4 marking the worst quarter for corporate earnings in years. With most internet stocks trading at seemingly irrational valuations (e.g. Facebook and Twitter are trading at 20.7x and 80x revenues, respectively) and select housing markets rebounding at unsustainable rates (e.g. London, Vancouver, Dublin, Sydney, Chicago) market participants are becoming increasingly worried that these are bubbles ready to pop.

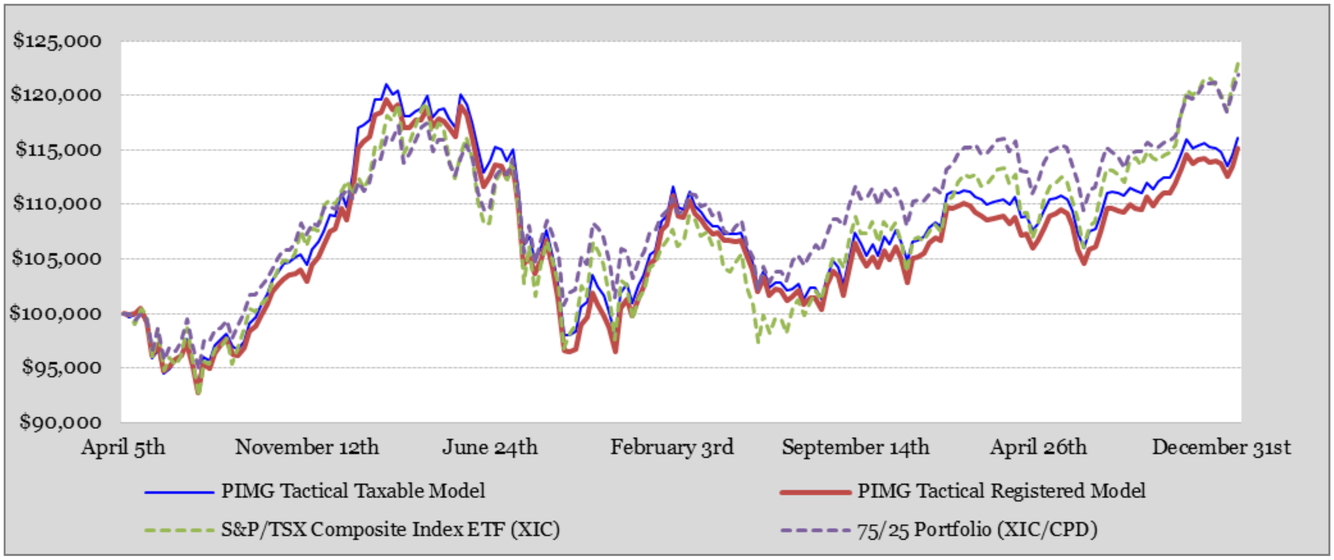
- The Canadian economy continued to underperform its neighbour to the south in Q4. Employment growth stabilized in Q4 following a year of volatility. The Canadian housing market was stagnant in Q4 with sales coming in at a normalized rate and flat price growth.

The S&P/TSX Composite Total Return Index

vs

The PIMG Tactical Taxable & Tactical Registered Models

April 5th, 2010 (Inception) to December 31st, 2013



	PIMG Tactical Taxable Model	PIMG Tactical Registered Model	S&P/TSX Composite Index ETF (XIC)	75% XIC / 25% CPD
Cumulative Return Since Inception	16.10%	15.10%	23.03%	21.95%
Compound Annual Return	4.08%	3.83%	5.70%	5.45%
Standard Deviation	9.66%	9.74%	13.25%	10.14%
Sharpe Ratio	0.11	0.09	0.20	0.24
Largest Monthly Gain	7.87%	7.80%	6.48%	10.63%
Largest Monthly Loss	-9.89%	-10.21%	-9.12%	-8.01%
Number of Up Months	24	23	26	29
Number of Down Months	21	22	19	16
Correlation with Tactical Taxable	--	0.99	0.86	0.87

We have assumed a 1% performance fee when calculating the returns for our PIMG models. To the best of our knowledge, the ETFs used as benchmarks track the indices they represent though material tracking error and misrepresentation can occur which is beyond our control. The 75% XIC / 25% CPD index is an index consisting of 75% iShares XIC (S&P/TSX Compositie Index ETF) and 25% iShares CPD (S&P/TSX Preferred Share Index ETF). Volatility and correlation data are calculated from weekly returns. For the purpose of calculating Sharpe ratios, a risk-free rate of 3% is assumed. All returns presented for the PIMG Models and the ETFs used for comparison are in Canadian dollars. Data used to calculate returns are derived from Market-Q (for ETFs) and Dataphile (for the Models). All returns presented are "total returns", meaning they include all dividend payments, interest payments, etc.

PIMG Tactical Taxable Model:

- Gained 3.28% during the quarter
- The model's asset allocation as at December 31st was 10.8% cash, 24.2% preferred equity and 65.0% common equity.

PIMG Tactical Registered Model:

- Gained 3.72% during the quarter
- The model's asset allocation as at December 31st was 6.9% cash, 4.0% convertible debentures, 24.4% preferred equity and 64.7% common equity.

The top five outperformers in this quarter were:

- TransForce Inc (Industrials/Transport) at +17.17%
- SNC-Lavalin Group Inc (Industrials/Engineering & Construction) at +13.39%
- Intact Financial Corp (Financials/P&C Insurance) at +13.00%
- Just Energy Debenture (Industrials/Energy Sales & Marketing) at +12.18%
- Canadian Natural Resources (Energy/Oil & Gas Extraction) at +11.41%

The top five underperformers were:

- Eldorado Gold (Materials/Gold) at -16.10%
- Yamana Gold (Materials/Gold) at -13.85%
- New Millennium Iron (Materials/Iron Ore) at -10.96%
- Legacy Oil + Gas (Energy/Light Oil) at -7.40%
- iShares S&P/TSX Capped Materials Index ETF (Materials/Diversified) at -4.58%

During the quarter we bought:

- Agrium Inc.: We purchased a full position in Agrium as its improving earnings stability and its valuation of ~10x trailing earnings make it an attractive stock to own. Agrium trades at a discount to most of its peers but we believe its above average earnings stability and dividend sustainability should allow it to trade at a premium. Agrium's unmatched retail operation and exposure to Albertan and Middle Eastern natural gas provide it with competitive advantages.

- Fairfax Financial Preferred I: We purchased a full position in Fairfax Preferred I following the sale of Fairfax Preferred C. We believe that Fairfax Preferred I trades at a major discount to Fairfax's other preferred shares when considering their respective reset rates. As Fairfax Preferred I approaches its reset date in 2015, we believe it will outperform the other preferred shares.

During the quarter we sold:

- Fairfax Financial Preferred C: We sold our position in Fairfax Preferred C as it appeared to be overpriced relative to Fairfax Preferred I and Fairfax Preferred K based on their respective reset rates. We believe Fairfax Preferred C will underperform the other Fairfax preferred shares from now until its reset date.

- Teva Pharmaceutical Industries Inc.: We sold our position in Teva after several earnings misses. The stock has been a serial underperformer in the Health Care sector despite its low valuation. We fail to see any catalysts that will help Teva break out of its tight trade range between $37-$41 and we believe capital is better allocated elsewhere.

- iShares S&P/TSX Materials Index ETF: We sold our position in the iShares S&P/TSX Materials Index ETF as the gold stocks continue to be under pressure and there is little reason to believe we will see a major shift in gold price expectations in the near-term.

- Canadian Oil Sands Ltd.: We sold our position in Canadian Oil Sands as it has continued to underperform its Energy sector peers. Now that oil prices are potentially on the path for long-term decline due to a clearer supply outlook in the U.S. and Middle East, high leverage, high cost oil producers like Canadian Oil Sands may come under major pressure in the coming months and years.

- Eldorado Gold Corp: We sold our position in Eldorado as it will require significant amounts of capital to continue growing. With gold prices hovering around the $1,200 level, Eldorado will be looking to raise plenty of external financing at a time when very few gold companies can attain financing, especially for smaller projects in mid- to high-risk jurisdictions. We fear that the stock will remain under pressure as investors worry about the prospect of additional equity offerings.

Going Forward:

Against a backdrop which saw the S&P/TSX Composite Index gain over 7%, the models' exposure to preferred shares and overweight positions in the Telecom, Utilities and Consumer Staples sectors resulted in underperformance. As the bull market approaches the 5 year mark and some sub-sectors (e.g. internet stocks, select housing markets) appear bubbly, we believe caution is warranted and that maintaining a balanced portfolio is essential to achieving favourable long-term returns over multiple economic cycles.

Heading into 2014, we are preparing to rearrange the models to better align with our mantra of diversification and current belief that investors need to be somewhat conservative in allocating capital. The two models are currently very similar with a 99% correlation to one another and we wish to create two models that are distinct to better serve our clients' needs. The Tactical Taxable model will remain our more aggressive option with a focus on equity market growth but will also incorporate some traditional fixed income securities to further reduce portfolio volatility. The Tactical Registered model will shift to a more conservative allocation with a focus on income producing equities and traditional fixed income securities. Making these adjustments will allow our clients to pick and choose between two distinct models depending on client account objectives. We expect to rearrange the models before the end of Q1 2014.

Positions with exposure to U.S. growth (e.g. TransForce, Algoma Central, Agrium) have continued to do well as expected while those with exposure to emerging markets have continued to do poorly. We wish to maintain our overweight allocations to the Utilities, Telecom, and Consumer Staples sectors as we expect market momentum to wane and for high income stocks to outperform.

The expected yield in our Models currently sits at 3.6% (Taxable) and 3.8% (Registered) from 3.8% and 4% at the end of Q3. This compared to the S&P/TSX Composite at a 2.7% dividend yield. We expect the portfolio yields to change dramatically throughout the quarter as we change the makeup of each model.

The Fed's decision to begin tapering its bond purchases and waning economic momentum combined with high stock market valuations and potential bubbles reinforces a conservative investing viewpoint. The risk of capital flight in emerging markets remains, particularly in Asia as economies stagnate and interbank lending rates spike, requiring government intervention for normalization. Although the 1997 Asian Financial Crisis had little effect on Western markets, a 2014 or later Asian Financial Crisis (whereby the world's #2, #3, #15 and #16 economies come under pressure) is surely to impair the psyche of the Western consumer and investor. We look forward to further diversifying the Models and minimizing long-term portfolio volatility.

Sincerely,

Steele Wealth Management