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Steele Wealth Management

Second Quarter 2013 – "The Hangover: Part III"

Investors Nauseated about the End of QE3/4; Emerging Markets Endure Capital Flight

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Visions of Fed Tapering Spark Market Drop; Emerging Markets Fall to an 18-month Low

- The S&P/TSX Composite Total Return Index lost 4.1% during the 2nd quarter of 2013.

- The interest rate insensitive sectors – Health Care, Consumer Staples and Discretionary, IT, Financials, Industrials and Energy – led the TSX Composite Index in the quarter.

- The interest rate sensitive sectors – Materials, Telecom and Utilities – trailed the TSX Composite Index in the quarter.

- U.S. and Japanese stock markets continued their resilient upward trend until late May when Bank of Japan Governor Kuroda took a stance against further monetary stimulus and triggered the worst selloff in Japanese stocks since the Tōhoku earthquake and tsunami in March 2011. U.S. investors subsequently began to doubt U.S. Federal Reserve Chairman Bernanke's commitment to quantitative easing and steadily began selling off stocks, bonds and commodities. Investors' fears were confirmed in mid-June when Bernanke announced that the Fed will consider tapering its bond purchases later this year should incoming data match Federal Reserve forecasts and that purchases may be halted by mid-2014 if the unemployment rate is "in the vicinity of 7%".

- The global growth outlook was mostly unchanged throughout the quarter. Eurozone economic activity is now contracting at the slowest rate in 16 months. The Spanish and French economies saw the rate of economic contraction meaningfully decline, reducing their output gap with Germany and thereby lowering Eurozone political risk. Japanese manufacturing activity hit a 28-month high and service activity hit the highest level since survey results were initiated in 2007. Intuitively, most other economies, particularly emerging markets, saw mild declines in activity offsetting Eurozone and Japanese gains.

- All is quiet in Europe as fears relating to the Cypriot "bail-in" have subsided and as European sovereign bond yields remain at tolerable levels. Greek bonds have been under pressure recently as the smallest Greek coalition partner abandoned the coalition, leaving it with only 153 of the 300 Parliamentary seats. The most anticipated Eurozone event is no doubt the German election which takes place in September. A new party, the anti-Euro currency AfD, has the potential to surprise similar to the M5S party in Italy.

- China carried on with its crusade against home prices, providing little stimulus to its economy notwithstanding signs of stagnation. Meanwhile, home prices rose at the fastest pace in two years in Q2. As a sign of credit market stress, the SHIBOR (Shanghai Interbank Offering Rate) touched 25% in June indicating a temporarily frozen Chinese credit market.

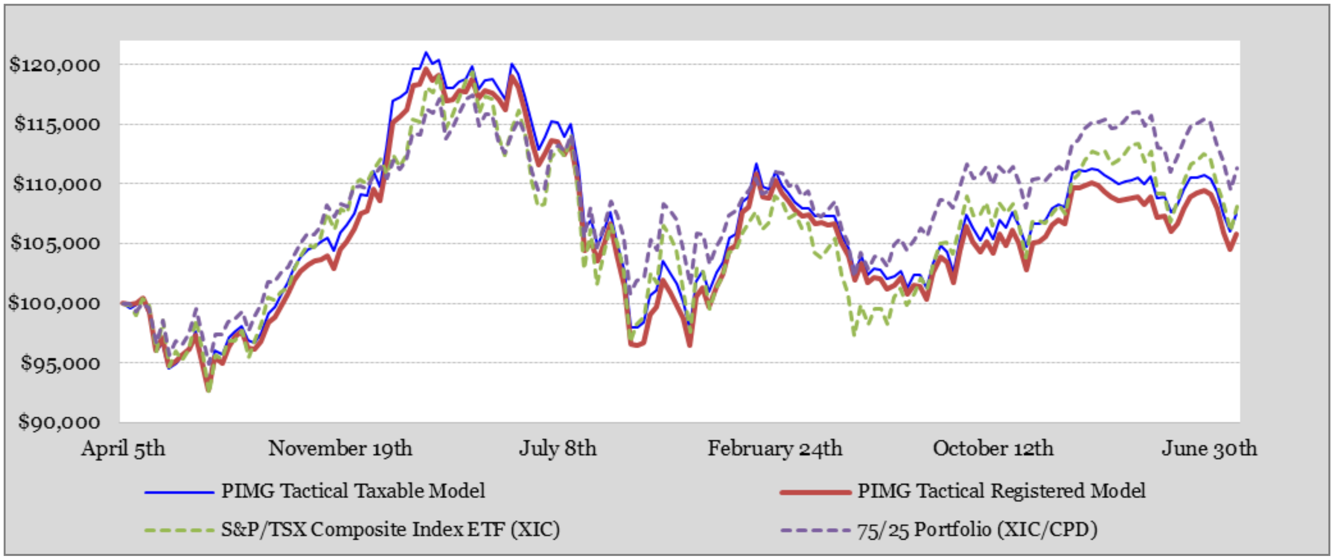
- The Canadian economy rebounded somewhat in Q2 after a disappointing first quarter. Manufacturing activity accelerated in the quarter to hit an 11 month high but finished the quarter at a more modest rate of expansion. Following 26,000 job losses in Q1, Canada added 107,000 jobs in Q2, with May producing the second most jobs for any month in 37 years. In addition, despite almost universal pessimism about the Canadian housing market, housing starts and building permits rose to more normalized levels in Q2.

The S&P/TSX Composite Total Return Index

vs

The PIMG Tactical Taxable & Tactical Registered Models

April 5th, 2010 (Inception) to June 30th, 2013



	PIMG Tactical Taxable Model	PIMG Tactical Registered Model	S&P/TSX Composite Index ETF (XIC)	75% XIC / 25% CPD
Cumulative Return Since Inception	7.55%	5.84%	8.06%	11.31%
Compound Annual Return	2.27%	1.77%	2.43%	3.37%
Standard Deviation	10.16%	10.23%	13.86%	10.61%
Sharpe Ratio	-0.07	-0.12	-0.04	0.03
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	19	18	20	24
Number of Down Months	20	21	19	15
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:

- Lost 2.8% during the quarter
- The model's asset allocation as at June 30th was 11.6% cash, 26.6% preferred equity and 61.8% common equity.

PIMG Tactical Registered Model:

- Lost 2.76% during the quarter
- The model's asset allocation as at June 30th was 7.3% cash, 3.8% convertible debentures, 26.9% preferred equity and 62.0% common equity.

The top five outperformers in this quarter were:

- Shopper's Drug Mart (Consumer Staples/Pharmacy & Retail) at +12.27%
- SNC-Lavalin (Industrials/Engineering & Construction) at +8.86%
- Canadian Tire Corp (Consumer Discretionary/Automotive & Sporting Goods) at +8.48%
- Bird Construction (Industrials/General Contractor) at +7.80%
- Progressive Waste Solutions (Industrials/Waste Removal & Storage) at +6.00%

The top five underperformers were:

- Eldorado Gold (Materials/Gold) at -32.96%
- iShares S&P/TSX Capped Materials Index ETF (Materials/Diversified) at -22.90%
- New Millennium Iron (Materials/Iron Ore) at -22.58%
- Teck Resources (Materials/Diversified) at -21.43%
- Rogers Communications (Telecom/Diversified) at -19.76%

During the quarter we bought:

- SNC-Lavalin: We purchased a full position in SNC-Lavalin as it had fallen nearly 20% from its recent high and we continue to like the company at the right valuation. We are comfortable buying SNC when it begins to trade at a discount to its peers as we believe the company will eventually trade at a premium (as was historically the case prior to the fraud allegations). We continue to believe that any charges, in addition to the ones already taken, will be insignificant to SNC's valuation, as is the case in most incidents of fraud.

- Intact Financial: We purchased a full position in Intact as it had missed what we saw as overly aggressive earnings expectations. At the purchase price, the shares had a respectable yield of 3% and traded at 12x earnings. We believe Intact trades at too little a premium relative to the Canadian banks and Lifecos considering its industry leading position and steady earnings profile.

- Legacy Oil + Gas: We purchased a partial position in Legacy as its valuation returned to an attractive level. Legacy continues to execute its production growth strategy and expand its reserve base. Trading at over a 60% discount to its most comparable peer Crescent Point, we believe Legacy's ultimate downside is limited due to its attractiveness as a takeover target.

- Yamana Gold: We purchased a partial position in Yamana Gold following a 40% drop in the stock since early November. Yamana is the lowest cost diversified senior gold producer and has one of the best growth profiles in the world. These attributes will limit Yamana's downside should gold prices continue to fall and allow Yamana to grow production should gold prices resume their upward trend.

- Fortis: We purchased a full position in Fortis following a one-month, 8% price decline which brought Fortis' valuation in line with its Utilities peers. We believe Fortis should trade at a sizable premium due to its relatively high growth profile. Fortis adds a tax-efficient, fixed income like element to the models that we value at this time.

- Bird Construction: We purchased a partial position in Bird Construction following a deluge of positive Canadian economic data, particularly May employment growth and housing starts. We believe a public-private partnership project focused company like Bird will benefit from a change in investor perception of the Canadian economy. Trading at 9.5x earnings (most peers at 10x+) and with net cash of over $100 million (most peers have substantial net debt), Bird is in a great position to pay its 6.15% dividend in any environment, acquire any ailing competitors (e.g. IBI Group, Armtec, Churchill) and benefit from an improvement in Canadian economic growth or construction sector sentiment.

<u>During the quarter we sold:</u>

- New Millennium Iron: We sold more of our position in New Millennium as the seasonal upswing in global, and particularly Chinese, manufacturing activity failed to transpire and as economic data in China continued to worsen throughout the second quarter. The increased odds of a Chinese credit crisis also make us worry about China-centric investments like iron ore producers.

Going Forward:

The models' defensive positioning allowed them to outperform in a very difficult market environment, particularly in Canada. Our overweight positions in the Consumer Staples and Consumer Discretionary sectors boosted performance in the quarter while our overweight Materials allocation continued to drag on performance. We have geared our Materials allocation toward gold companies as they tend to rally during equity market declines and lead the way when markets begin to recover. We wish to avoid stocks that rely on Chinese or emerging market growth as these economies can expect little in central bank stimulus due to the existence of both inflationary (rising capital asset prices) and deflationary (slowing economic growth) pressures and are experiencing capital flight, putting them at risk of abrupt credit crises.

After much deliberation, we decided to allocate the large cash balances held within the models to high-quality common equities. We found that there were far too few preferred share options beyond what we already hold in the models that provide attractive yields with low risk. We believe that our recent purchases (SNC-Lavalin, Intact, Fortis, Bird) will have a low correlation to the broad market and their sizable dividends (3.8% average) will limit their ultimate downside. As discussed above, we expect recently purchased Yamana Gold to offset market declines over the long-term. With cash levels at ~11% and ~7% in our Taxable and Registered models respectively, we clearly still cautious in our approach at the present time. We will look to add to positions tactically and will remain defensive in our positioning, likely looking to the Utilities, REIT, Consumer Staples, Telecom and Financials sectors for new purchases. That said, we are in no rush considering the deteriorating economic and market environment and the fact that we are in the midst of the seasonally weak period for common equities.

The expected yield in our Models rose to 3.7% (Taxable) and 3.8% (Registered) from 3.5% at the end of Q1. The yield improvement was mostly due to the addition of several high yielding common equities and was partly due to the slight decline in portfolio value. This is compared to the S&P/TSX Composite at a 2.9% dividend yield.

The lack of a strong December to April period and worsening economic data in emerging markets has sparked the flight of capital from these regions. The odds of market panics/crises rise substantially in such environments. In addition, if developed world investors lose faith in central banks' ability to drive asset price performance and/or prevent market panics, a key factor in U.S., Japanese, and Eurozone equity market performance of late, there will be very few reasons for anyone to be a stock market bull. As we believe the emerging market picture will not improve materially and that investors are beginning to doubt central banks' ability and willingness to support markets, we believe it is prudent to remain defensive.

Sincerely,

Steele Wealth Management