

**Raymond James**  
**Steele Wealth Management Group**  
Second Quarter 2008 – “Rising with Energy”



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## Quarter in Review

The S&P/TSX Composite Index gained 8.37% during the second quarter of 2008. The second quarter was not as volatile as the first, but higher energy prices and inflation worries left Canadian investors undecided about which direction the market is headed. Oil continued to create new highs throughout Q2, trading from \$101 in early April to finish the quarter at an even \$140. The Energy sector was up 23.1%, supported by an increase of 39% in the price of oil and 37% in the price of natural gas. It seems that basic materials are no longer the place to invest, yet the sector still posted a gain of 19.3% for the quarter, though most raw materials prices are unchanged. Leading the losing sectors were Consumer Discretionary and Health Care which slid 12% and 7.7%, respectively. The Consumer Discretionary sector led the losing sectors last quarter and continues to struggle with low consumer buying power, mostly due to high food and energy costs. The TSX index made a new high, just over 15,150, driven mostly by energy stocks which account for approximately 30% of the index.

Inflation is the topic of focus for policy makers as rising prices are eating into consumers' discretionary income which will in turn slow the economy. The European Central Bank was the first major 'federal' bank to raise rates to combat inflation and North American federal banks are now expected to do the same at some point in the near future. This poses a dilemma for the U.S. Federal Reserve as they just completed a long series of rate cuts which were necessary in 'saving' the U.S. economy from recession. The effect of the rate cuts will not be visible until late this year but the effect of inflation is beginning to look like a serious problem today. It will be interesting to see when and by how much rates are adjusted, as inflation data continues to bring fear into the minds of investors.

### S&P/TSX Composite: Year-to-Date



**Aggressive Growth Portfolio:** Gained 10.68% during the quarter.

The best performers in this quarter were:

- Agrium Inc. (Agriculture/Materials) at +60.35%
- Oilexco (Oil&Gas Production/Exploration) at +44.90%
- Hemisphere GPS (Information Technology) at +36.25%

The worst performers were:

- First Quantum Minerals (Materials – Gold/Copper) at -15.32%
- BioMS Medical (Health Care) at -13.67%
- Fairfax Financial (Insurance/Investment Management) at -12.25%

During the quarter we bought:

- Seaclyff Construction: a western Canadian construction company that operates in booming Alberta and British Columbia; recently completed its IPO and now offers the greatest growth potential of all its peers

During the quarter we sold:

- Petrobank Energy & Resources: we felt that we needed to cut back on oil and gas exposure in case of a retracement in the price of oil; we chose to sell Petrobank as its price is most dependent on the long-term price of oil and any retracement would effect its price significantly
- Churchill Construction: the stock was looking expensive compared to its peers and we decided that including a more growth focused company, like Seaclyff Construction, would be more appropriate
- Sierra Wireless: sold half of our stake as we believe it to have potential in the long-run but we also wanted to capture some profits as price volatility continues in these market conditions; we will accumulate shares if they look inexpensive
- Agrium Inc.: sold half of our stake to capture some profits as we believe the risk of holding agriculture stocks has risen dramatically in the last months; although, we continue to believe that these stocks have strong fundamental support and we will accumulate on retracements
- Research In Motion: sold half of our holdings following their April conference call as we wanted to capture some profits and limit our risk towards a miss in reported earnings as smart phone markets are clearly becoming more competitive; RIM lowered earnings guidance in their June conference call and this sale turned out in our favour; we still believe RIM to be a great buy at the right price

**G30 Balanced Portfolio:** Gained 1.08% during the quarter.

The best performers in the quarter were:

- Petro-Canada (Oil&Gas Production/Exploration) at +25.66%
- Nova Chemicals (Industrials/Plastics) at +13.72%
- Yamana Gold (Gold Production/Exploration) at +12.82%

The worst performers in the quarter were:

- Macdonald, Dettwiler, and Associates (Space IT) at -18.65%
- First Quantum (Materials – Gold/Copper) at -15.32%
- Quadra Mining (Materials – Gold/Copper) at -12.45%

During the quarter we bought:

- Petro-Canada: we needed some oil and gas exposure and Petro seemed to be the cheapest on a relative valuation basis of all its peers, trading at a forward price/earnings ratio of 5
- Suncor Energy: we needed more exposure to the energy sector and Suncor is one of the largest companies in Canada; they focus more on oil production and should see large gains should the price of oil continue to rise in the short to intermediate term
- Quadra Mining: will provide a lot of value going into the future; the stock was on a tear after reporting outstanding earnings last quarter, but this momentum was slowed as they announced a bought deal below the trading price to fund the development of their world-class Sierra Gorda property; we believe this to be the most undervalued materials company with predictable long-term earnings

During the quarter we sold:

- Manulife Financial: sold half of our holdings as it appeared to be overvalued compared to other Canadian insurance companies at the time of sale
- Nova Chemicals: oil and gas are major inputs in the production of Nova's products and where oil is at now will surely cut into Nova's margins in the long-run; we sold it for a profit soon after they reported solid earnings but warned of the effect that higher input prices will have in future months
- Petro-Canada: we captured a large part of oil's run from \$101 to \$140 and sold half of our PCA holdings when oil stabilized in the mid-130s; we still believe oil and gas stocks like Petro and Suncor will provide some of the best returns in the market if traded actively

## Going Forward

At the start of 2008, economists believed that the U.S. slowdown would remain a U.S. problem and that most other markets would be generally unaffected, but using the Chinese FTSE/Xinhua Index as a proxy, we can see that it is down 23% since January and is 40% off of its 2007 highs. Economists also believed that the U.S. economy would return to a period of strong growth by the second half of the year, but the general consensus is now leaning towards a recovery beginning in mid-2009 with some believing it will take longer. With the slow summer months ahead and investor confidence decreasing with every poor economic figure, we must be cautious going ahead. This means cutting losses short and taking profits when they arise.

Where to go from here?

In the G30 portfolio, we will be looking for high-quality, dividend-paying instruments that will provide steady income while the overall market is expected to bring little to no return. We believe that the market prices of our materials stocks will grow to reflect the high prices of copper and gold as companies release production updates and report earnings over the next few quarters. We continue to hold the 'stronger' Canadian banks as we believe that the banking sector will experience a strong rebound in the next couple years – the dividend yields range from 4%-6% and provide income while we wait for that rebound.

The battle between a healthy economy and high energy prices is set to continue but one thing is for sure – the market always wins; whether high oil prices push the world economy into recession which in turn will lower demand for oil and reduce oil prices, or supply catches up with demand or we can reduce our demand to meet our supply, the price of oil will stabilize and likely fall. We are cautious on the energy sector but we will maintain some exposure as we see some room for short-term profits.

In the Aggressive Growth portfolio, we will continue to hold a large weight in energy stocks, trading them frequently to realize returns, while continuing to look for unique situations and stocks with strong momentum.

As the summer heat is now reaching its peak, we will be busy maintaining well diversified, income-producing portfolios, while you...

Should take advantage of the heat and play some tennis or golf, discover a new hobby, or take the grandkids to the beach – whatever tickles your fancy.

Sincerely,



The Steele Wealth Management Group