Raymond James

Steele Wealth Management Group

Third Quarter 2009 – "Risk On!"

Bulls Take Control of the Board. Multiply. Conquer.

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Bulls Buy Risky Assets, TSX Up Over 50% from March Lows, Prices Remain Subdued

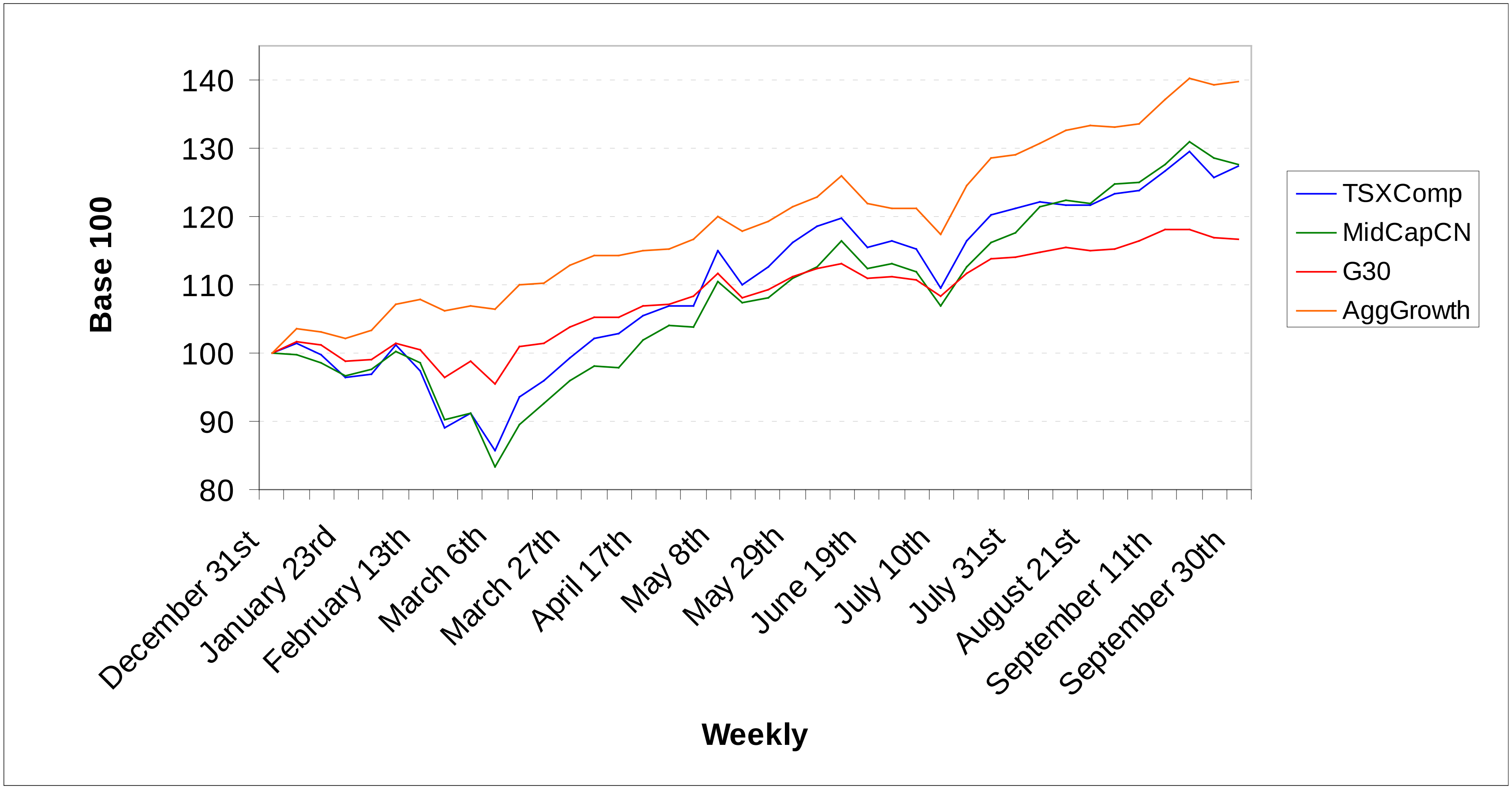
The S&P/TSX Composite Index gained 9.83% during the third quarter of 2009. Only the more defensive sectors, Consumer Staples and Utilities, significantly lagged the market with returns of -2.20% and +2.29%, respectively. The Health Care sector outperformed all sectors during the period with a return of +28.57%, although its breadth is negligible. The Financials and Materials sectors were the two runners-up, gaining 14.32% and 12.30%, respectively. Investors increased their portfolio risk by switching some of their more defensive holdings for equities within possible long-term secular uptrends. Equities fed off of tightening corporate spreads as perceived risks fell, benefiting those companies with debt-laden balance sheets. Canadian indices underperformed their U.S. peers as the once out-of-favour U.S. financials rallied hard relative to our fiscally conservative Canadian financials.

All of the leading economic indicators have trended up since March and/or April but have recently been showing signs of weakness. The U.S. ISM Manufacturing Index and the Factory Orders Index have made major moves from showing economic contraction to economic expansion over the past six months but the rates of increase for these two indicators have stalled, both posting a minor decline for the month of September. Those market mavens who called the bottom of the stock market in March using the inflection point in the second derivatives of these leading indicators may want to warn the public of a possible market top as a result of the slowing incline in the same economic indicators. The consumer and investor confidence indicators have not rebounded as well as the other indicators over the last six months but their incline has also stalled in September. Employment figures have been worse than expected recently, after reports that were better than expected from March to July. Unemployment rates are currently 8.4% in Canada (8.5% previously) and 9.7% in the U.S. (9.5% previously), but these numbers are skewed by the vast number of workers who have left the workforce.

Looking back to past double-dip recessions, indicators will stall for several months before performing a precipitous drop. We have yet to see convincing evidence, if any evidence, of inflation in anything but food and energy. If we do not see inflation, it will be difficult to assume further growth in equities or GDP. It is interesting to note that some “new-age” economists propose the inclusion of house prices in the inflation calculation. If we were to switch to that method, deflation would be rampant at the time being. That said, we will likely see deflation, the U.S. more so, in the next couple of years as rents fall to mimic the decline in house prices (rents are included in the inflation calculation and comprise approximately 30% of it). If we are going to see inflation overall, the non-rent portion will have to show near rampant inflation to trump the deflationary effect of falling rents.

It is far too easy to compare the U.S.’s, and the world’s, spending and bailout programs to that of Japan’s during its bout with deflation in the early 90s, which it still battles today. Constant stimulus did not help Japan defeat deflation although Japan did not see severe deflation as we define it; a drop in consumer prices. Japan’s Consumer Price Index varied between 1.6% and -0.9% since 1991, similar to our inflation rate today. While consumer prices have gently fallen, house and equity prices have dropped over 75%, since their 1990 peaks, a fact that we have pointed out before. We don’t believe the American government can own a portion of the majority of American homes long enough to eliminate the deflationary effects of millions of foreclosures, without creating an anti-growth environment which will cause private investment to fall and prices to continue their decline. We remain weary about the capacity of central bankers to fabricate sustainable growth and we look to position ourselves accordingly.

S&P/TSX Composite & Completion Indices vs the G30 & Aggressive Growth Portfolios: 2009 YTD



Aggressive Growth Portfolio: Gained 16.65% during the quarter.

The best performers in this quarter were:

- Neo Materials Tech (Materials/Rare Earths) at +85.92%
- Quadra Mining (Materials/Copper&Gold) at +66.67%
- Equinox Minerals (Materials/Copper&Gold) at +54.46%

The worst performers were:

- TMX Group (Diversified Financials) at +7.27%
- Bankers Petroleum (Oil&Gas Development/Exploration) at +12.56%
- Agrium Inc (Fertilizers & Farm Products) at +15.35%

During the quarter we bought:

- Equinox Minerals: we bought Equinox following a selloff due to disappointing production numbers; as the total resource base had not changed because of the news, we bought the stock based on its resource base and its allure as a takeover candidate
- Petrolifera Petroleum: we bought Petrolifera following a marketed offering which forced the stock down over 40%; we saw the company as undervalued based on current cash flows as well as possible future cash flows based on their vast exploration potential and the funds available to perform exploration and preliminary development activities

During the quarter we sold:

- Bankers Petroleum: we purchased Bankers because it was one of the only North American oil and gas equities trading below the value of its proven and probable (2P) oil reserves; we sold the stock because it traded up above the value of its 2P reserves

G30 Balanced Portfolio: Gained 6.24% during the quarter.

The best performers in the quarter were:

- Quadra Mining (Materials/Copper&Gold) at +66.67%
- Sherritt International (Diversified Materials) at +46.87%
- First Quantum Minerals (Materials/Copper&Gold) at +24.59%

The worst performers in the quarter were:

- Research in Motion (Information Technology) at -5.09%
- Dundee Corp. Pfd Share Series 2 (Diversified Financials) at -0.59%
- Canadian Utilities (Utilities & Power Generation) at +0.77%

During the quarter we bought:

- Research in Motion: we purchased RIM following the selloff which occurred as a result of their disappointing Q3 earnings report; we saw the report as less disappointing than the market and we believe the concerns about revenue deceleration are overblown for the time being
- Dundee Corp. Pfd Share Series 2: we purchased Dundee Pfd Series 2 to access some high yield while holding a defensive position; we believe Dundee’s credit rating is too low and that Dundee Bank’s appeal as a takeover candidate at a time when Canadian banks have more cash than ever before, could result in a ratings upgrade upon acquisition; also, part ownership by Scotiabank brings stability to the brand that cannot be quantified

During the quarter we sold:

- iShares HXU: we sold iShares HXU following the impressive run the TSX has had over the past six months; we believed the market was looking overbought and that it was an ample time to cut our loss on this holding

Going Forward

Excess capacity in the manufacturing and energy sectors is still very high, not just in Western countries, but in the BRIC and other emerging countries as well. Unemployment rates are expected to rise in the U.S. and most countries worldwide. The total outstanding consumer credit available is expected to decrease as banks see consumers as less and less credible as fewer individuals are expected to have jobs in the near future. With further expected credit contraction and a loss of bargaining power in the hands of the workers, there will be downward pressure on wages. Equity markets have priced in high GDP growth and a normalized level of inflation, and with no recovery seen in the consumer balance sheet, equity markets look overbought. We see a market correction as not only possible, but highly probable. We will be watching U.S. economic indicators closely over the next three months in attempts to time the top in investor and consumer confidence, and to position ourselves to take advantage of that timing.

We still maintain our deflationary view. All nations have applied some form of monetary and fiscal stimulus over the past 18 months and it is difficult to say that the world's reserve currency will see hyperinflation all on its own. We may see inflation and devaluation of all fiat currencies against hard currencies like gold, platinum and copper. If all currencies are devaluing against their doomsday replacement currency, gold, it will be difficult for one fiat currency to experience material inflation versus another fiat currency. We pay more respect to the low utilization rates and declining consumer balance sheets worldwide than to increasing money supply. Money supply can increase by any amount but if money velocity (the rate at which money is spent over a year) is falling because banks are unwilling to extend this added liquidity in the form of credit to businesses and individuals, business activity will not be affected by the increased money supply. We see fiscal stimulus as a much more important factor. Removal of the New Deal fiscal stimulus was the sole reason for the spike in unemployment and the stock market crash in 1937. We believe that the stock market may encounter many more negative events than positive events from this point forward.

Where to go from here?

As at the end of the quarter, our G30 portfolio consisted of 40.78% cash, 8.07% fixed income and 51.15% in equities; our Aggressive Growth portfolio consisted of 45.80% cash and 54.20% equity. We focused on buying out of favour small- and mid-cap equities with plenty of cash to achieve greater leverage while limiting our downside.

Although our stance continues to be bearish, we will pounce on out of favour stocks or sectors which we believe to be undervalued. More specifically, we will be looking for small cap equities with plenty of cash and stable, high-yielding large caps with fairly predictable earnings.

Sincerely,

The Steele Wealth Management Group