Raymond James
Steele Wealth Management Group
Fourth Quarter 2008 – "Helicopter Ben"
TARPs, 0% Benchmark Rates and Stimulus for All

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Quarter in Review

The S&P/TSX Composite Index dropped 23.53% during the fourth quarter of 2008. We commented on the steep drop that occurred in October and November and the market has since made a small gain of just over 1%. The TED spread which is the spread between the 3-month U.S. treasury and interbank loan yields and was mentioned in the mid-4th Quarter update, has continued to slide from its all-time high set in October and may indicate that banks are becoming more and more comfortable lending to each other, which could be the most important step in economic recovery. That said, most indicators are showing negative extremes not seen since the Great Depression and post-WWII period.

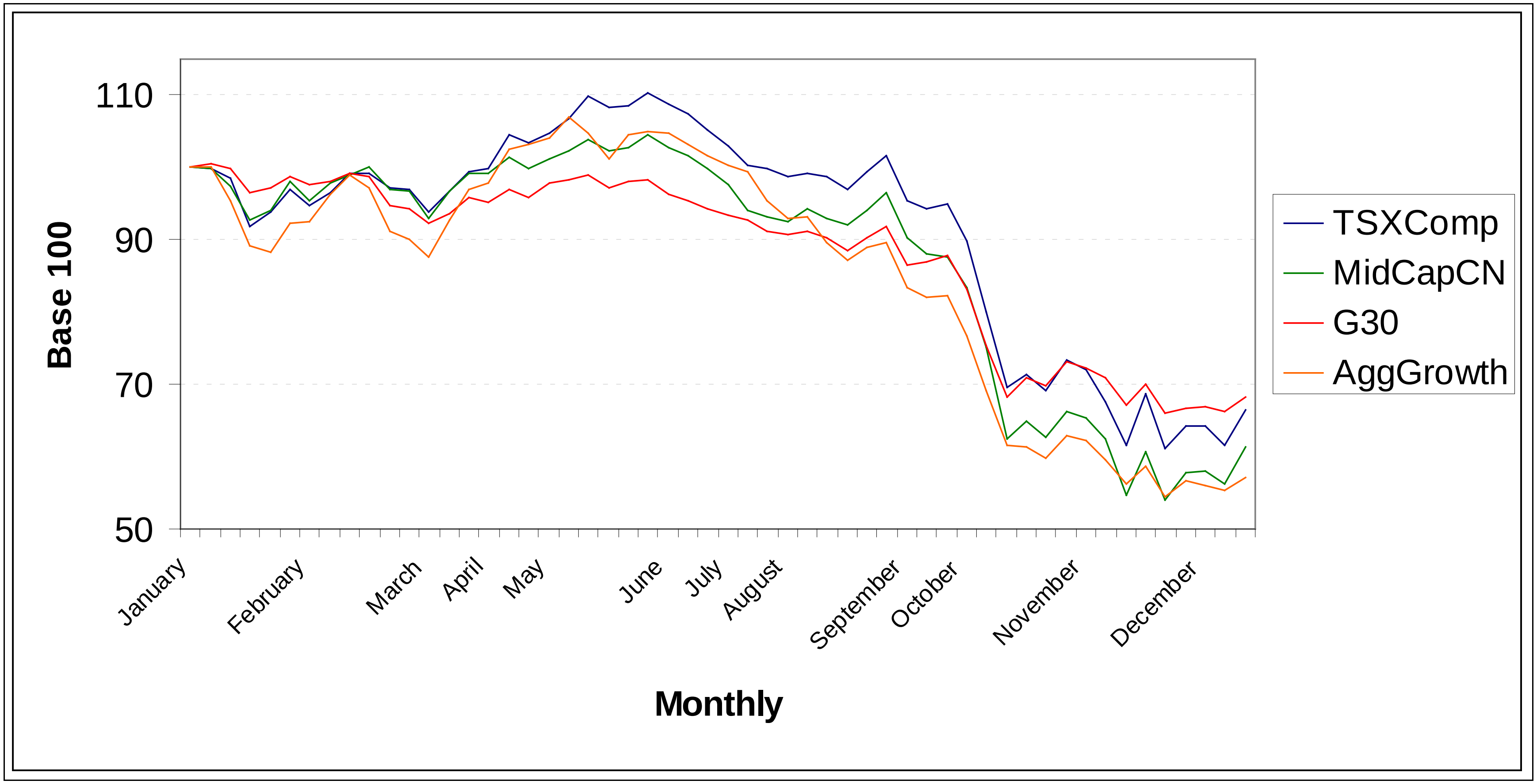
In the past two quarters, there has been on ongoing struggle between inflation and deflation. The threat of deflation was the focus of the fourth quarter as central banks everywhere slashed benchmark interest rates in an attempt to do away with deflation forever. U.S. Federal Reserve Chairman, “Helicopter” Ben Bernanke led the committee that set the U.S. benchmark rate in the range of 0-0.25%, its lowest level in history (they call him “Helicopter Ben” because he’s seemingly willing to ‘fly out’ and rescue even the worst managed companies, dropping taxpayer money from the sky without a care). Immediately after setting the rate, memories of Japan’s “Lost Decade” resurfaced, in which the Japanese central bank set their benchmark rate to zero in order to fight deflation, but ended up unsuccessful and the value of Japanese homes and the Nikkei plummeted and remained depressed for some time. In fact, the decline in home prices which started in 1990 is still ongoing with the total decline at 90% while the Nikkei is 63% off of its 1990 peak. A scary thought considering that the S&P 500 and U.S. home prices are only down 45% and 30% from their 2006 and 2007 peaks, respectively.

Although, central bankers were focused on deflation, the general public worried about a condition that is just as damaging to an economy, hyperinflation. The cash that central bankers are throwing at declining banks, auto companies and consumer balance sheets must come from somewhere and the consensus is that it will be printed at one time or another. This expectation of high inflation may be propping the market up as investors move from fixed income securities that are susceptible to inflation to stocks which generally adjust for it, artificially inflating the equities.

The Energy and Financials sectors led the decline with drops of 31.34% and 30.43%, respectively. The price of oil dropped from over $100 to under $45 throughout the quarter, frightening energy sector investors as oil approached the price level that is unprofitable for many oil sands operators. The financials suffered as they looked to shore up their balance sheets with common and preferred equity offerings which diluted their existing capital and forced stock prices down. The sector with the largest gain was Consumer Staples at 4.16% and comes at no surprise as investors flocked to more stable, dividend paying companies like George Weston and Shopper’s Drug Mart, as equity indices were declining.

On the next page is a comparison of our G30 and Aggressive Growth portfolios to our main benchmark, the S&P/TSX Composite index.

S&P/TSX Composite & Completion Indices vs the G30 & Aggressive Growth Portfolios: 2008



Aggressive Growth Portfolio: Lost 22.92% during the quarter.

The best performers in this quarter were:

- BioMS Medical (Health Care) at 0.00%
- Research in Motion (Information Technology) at -11.34%
- Agrium Inc (Materials/Fertilizers) at -12.42%

The worst performers were:

- Oilexco Inc (Oil Production/Exploration) at -97.27%
- Bow Valley Energy (Oil Production/Exploration) at -85.81%
- Quadra Mining (Materials/Copper&Gold) at -77.00%

During the quarter we bought:

- Agrium: we purchased more shares following the massive selloff in fertilizer stocks as our current holdings were insignificant

During the quarter we sold:

- Research in Motion: we sold our position in RIM because of our worries surrounding the higher end wireless market heading into recession and the continuous job cuts in the financial services sector
- BioMS Medical: this stock had held up quite well during most of the decline and we sold it on the basis that market risk had adjusted upwards, so the stock price will likely fall because of its risk profile

G30 Balanced Portfolio: Lost 15.93% during the quarter.

The best performers in the quarter were:

- Royal Bank of Canada (Banks) at +12.33%
- Canadian Utilities (Power and Gas Utilities) at +7.11%
- Rogers Communications (Telecommunications) at +5.22%

The worst performers in the quarter were:

- Quadra Mining (Materials/Copper&Gold) at -77.00%
- First Quantum Minerals (Materials/Copper&Gold) at -55.28%
- Horizons BetaPro S&P/TSX 60 Bull Fund (Materials/Copper&Gold) at -49.14%

During the quarter we bought:

- Potash Corp, Talisman, Barrick Gold and SNC Lavalin: we bought and sold these throughout October to capture some value from the volatility during the month
- Royal Bank of Canada: after a day of steep declines in the Canadian banks with Royal leading the way; we believed the sell-off was not justified and that the banks should rebound within a few days

During the quarter we sold:

- TD Bank and Rogers Communications: reduced our position in these holdings as they grew, on a percentage basis, relative to the rest of the portfolio as the market slumped
- Yamana Gold: we liquidated our position in Yamana as our total exposure to gold was far too high as a percentage of our total portfolio

Going Forward

The gears have clearly switched between deflation and inflation as many analysts now favour a higher probability applied to inflation in forecasts and surveys of the general public have resulted in more believing the inflation story over deflation. One point we would like to state is that in no point in history, has there been inflation when house prices were declining. That said, U.S. house prices are currently declining faster than any point in time aside from the Great Depression and we see no signs of a bottom forming. The Alt-A, “teaser” rate U.S. mortgages should begin seeing a higher rate of delinquency starting in 2009 as the bulk of those mortgages have rate resets beginning in early to mid-2009. On the other side of the coin is the argument that governments have not ever intervened in and guaranteed so much in the free markets. The true question is whether the stimulus can prevent the deflationary spiral from starting. As our price level calculations are backward looking, we’ll find that out in a few months.

Where to go from here?

As at the end of the quarter, our G30 portfolio consisted of 59.5% cash, 4.5% fixed income and 36% in equities; our Aggressive Growth portfolio consisted of 70% cash and 30% equity. We continue to hold cash in a savings account and remain cautious towards equities. As risk aversion has shifted down since November, corporate fixed income no longer looks as attractive as it was, but we will look to add some to our portfolio should risk aversion spike once again.

We are continuously looking for stocks to trade abnormally low, compared to their peers or the market, and pounce on that opportunity. We continue to hold plenty in cash as we do not believe this is the bottom. We plan on slowly buying up equities around the panic bottom of 8000 on the TSX. Even at the bottom, we will hold a fair amount of cash as the threat of deflation is real and we must protect our portfolio against it.

If there wasn’t enough uncertainty in the stock market without government intervention, there certainty is plenty of it now. It is impossible to tell whether government officials will see it as plausible to inject every company and sector with cash and if they do, there are serious repercussions. Either way, there is nothing more secure than holding your assets in cash-like securities, and for the time being, with rising unemployment in North America, increasing foreclosure rates in the U.S. and shrinking corporate and individual balance sheets, we feel comfortable holding plenty of cash.

Sincerely,

The Steele Wealth Management Group