Raymond James

Steele Wealth Management Group

Fourth Quarter 2009 – "Heavy Boats Don't Always Float"

Crowded Trades Sink. Abandoned Trades Prove Their Buoyancy.

The Team:

Brian Steele

Laura Prust

Jeannine Campbell

Kelly Townsend

Matthew Bell

Small Caps Continue to Outperform Large, Year-to-Date Laggards Outperform Leaders

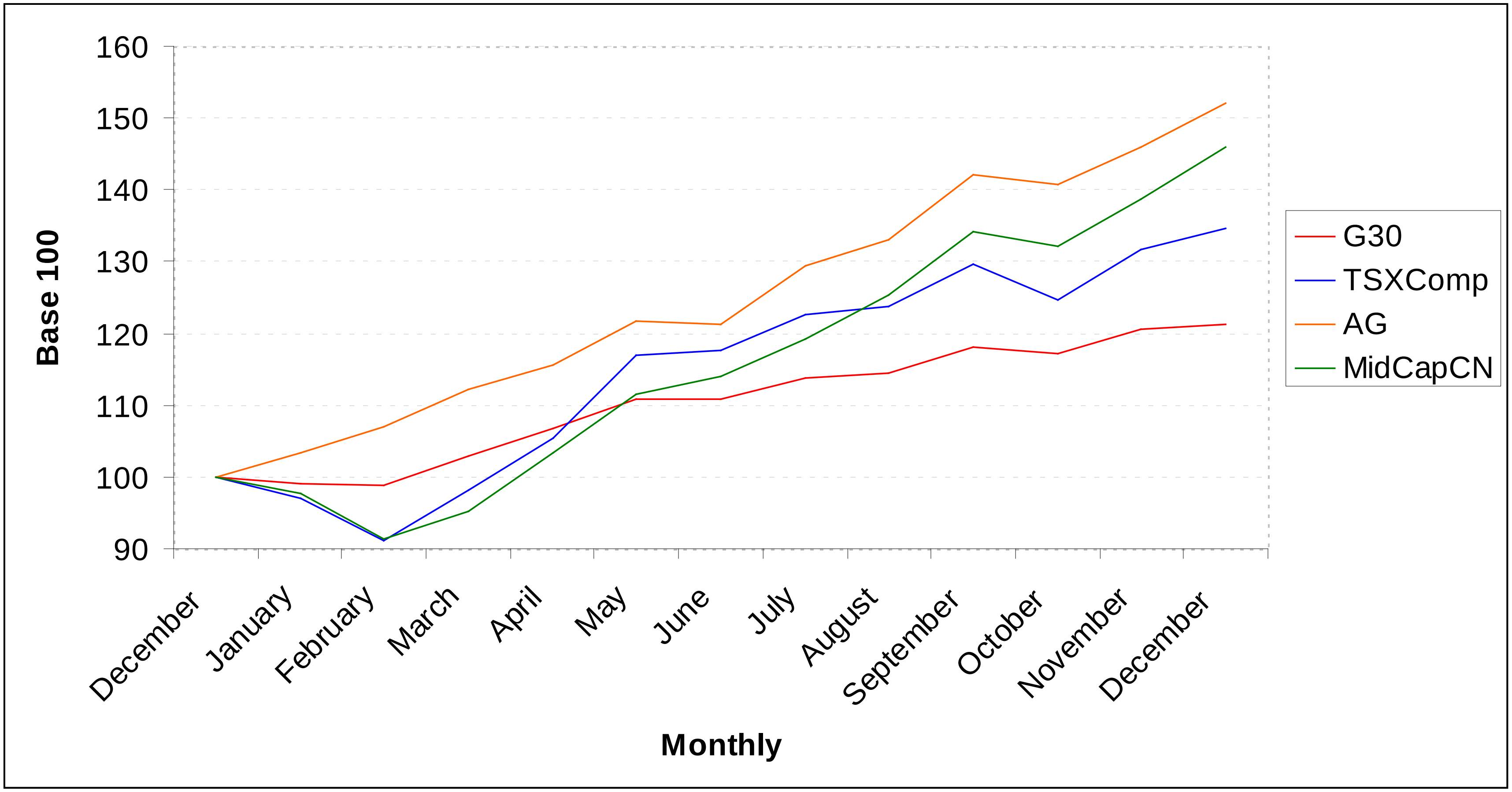
The S&P/TSX Composite Index gained 3.08% during the fourth quarter of 2009. Markets traded sideways for the greater part of the quarter with the more defensive sectors, Utilities and Consumer Staples, outperforming the others, gaining 11.73% and 8.40%, respectively. The laggards were the Financials and Health Care sectors declining 2.07% and 0.81%, respectively. In general, investors took profits in the year's winners and purchased the year's losers. High yields and low expected volatility helped the Utilities and Consumer Staples sectors appreciate while economic and regulatory risk restrained shares in the Financials sector, despite attractive yields and somewhat predictable earnings.

Last quarter, we noted that we were going to watch leading economic indicators more closely for signs of a reversal in the bullish trend. Overall, the indicators have been positive, with the U.S. ISM Manufacturing Index showing expansion for all three months, consumer confidence having risen, U.S. jobless claims falling to high, but more normalized levels, and personal income seeing a slight rebound. We noted last quarter that these indicators tend to stall before reversing and we have not seen any reason to believe that these indicators are not in this process as the data has been only slightly positive. The U.S. unemployment rate peaked at 10.2% in November, falling to 10% in the month of December, compared to 9.5% at the end of the third quarter. The Canadian unemployment rate rose to 8.5%, up from 8.4% at the end of the third quarter. A decline in the U.S. unemployment rate is positive but this data has been positively skewed by workers leaving the workforce or entering the "discouraged" category, effectively removing them from the unemployment calculation. It is also fair to note that unemployment benefits are at an all-time high as emergency offerings have been extended again and again, distorting the unemployment data for many years to come. The only concrete, negative news of the quarter is that U.S. third quarter GDP was revised from an initial estimate of 3.5% annualized down to 2.2% annualized, reflecting much slower growth than initially expected. All of the data above reflects the consensus towards anemic growth for the remainder of 2009 and 2010.

Consumer confidence, although in an uptrend, still sits at a Depressionary level. Investor confidence indicators appreciated significantly as equity markets rallied but have declined over 15% since August, reflecting investors' lack of confidence in a V-shaped recovery. A rapid rebound in equity markets without a strong rebound in consumer and investor confidence leaves equity markets open to significant downside risk. If consumers are unwilling to spur demand for production and investors are unwilling to assume the liability associated with production, there is little chance of a recovery. This idea is derived from what we saw in the Great Depression; all indicators related to current and near-term production rebounded to expansionary levels and in turn, economists began forecasting explosive growth. All the while, consumer and investor confidence remained at all-time lows (mostly due to high unemployment and lack of wage growth), and the economy fell back into recession with the ~50% rebound in equities quickly turning into a decline of approximately 80%. We do not believe there will be a bear market of this magnitude but we do believe that equities have outpaced all relevant fundamental data, most specifically, the confidence indicators.

We remain skeptical of attempts to stimulate growth using Keynesian techniques. These methods have never had a clearly positive long-term effect in any downturn and we cannot see how they will work this time around. The stimulus, if effective in deterring near-term deflation, will stimulate and promote future asset bubbles due to the increased leverage on public balance sheets and increased cash on private balance sheets. Private investors will be forced to chase ever diminishing returns while public “investors” will be unable to meet their liabilities due to the same diminishing returns, leading to increased political unrest around the world and increased risk to equity.

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



Aggressive Growth Portfolio: Gained 7.77% during the quarter.

The best performers in this quarter were:

- Agrium Inc (Fertilizers & Farm Products) at +22.23%
- Labrador Iron Ore IF (Materials/Iron Ore) at +20.63%
- Neo Materials Tech (Materials/Rare Earths) at +19.06%

The worst performers were:

- Petrolifera Petroleum (Oil&Gas Development/Exploration) at -10.19%
- TMX Group (Diversified Financials) at -6.68%
- Western Potash (Potash Development/Exploration) at +0.13%

During the quarter we bought:

- Western Potash: we saw WPX as undervalued relative to its peers, Athabasca Potash and Potash One; we believe that WPX has similar resources and as it further defines its properties, it will appreciate and trade similar to that of API and KCL (they currently trade at a 350%-400% premium to that of WPX)
- Open Range Energy: we purchased ONR to speculate on the price of natural gas after natural gas prices rebounded off multi-year lows; Open Range has one of the lowest costs of production and we felt it was a suitable way to gain leverage to the upside potential in natural gas without exposing ourselves to much downside risk
- Quadra Mining: we bought QUA after a stock specific sell-off; we felt that the reason for the sell-off, near-term production guidance, did not effect Quadra's long-term valuation and that Quadra would quickly recover

During the quarter we sold:

- Quadra Mining: we sold QUA after it outperformed its peers substantially; we repurchased at a lower price during the quarter following an excessive correction (see above)

G30 Balanced Portfolio: Gained 2.96% during the quarter.

<u>The best performers in the quarter were:</u>

- Canadian Utilities (Utilities & Power Generation) at +16.40%
- First Quantum Minerals (Materials/Copper&Gold) at +14.66%
- Quadra Mining (Materials/Copper&Gold) at +13.96%

<u>The worst performers in the quarter were:</u>

- Sherritt International (Diversified Materials/O&G) at -13.76%
- Toronto-Dominion Bank (Financials/Banks) at -3.87%
- Research in Motion (Information Technology) at -1.87%

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

- Quadra Mining: we bought QUA after a stock specific sell-off; we felt that the reason for the sell-off, near-term production guidance, did not effect Quadra's long-term valuation and that Quadra would quickly recover

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

- Quadra Mining: we sold QUA after it outperformed its peers substantially; we repurchased at a lower price during the quarter following an excessive correction (see above)
- 4.3% American Express Bond: we sold the American Express bond as the yield-to-maturity was less than 2%; we will look solely to preferred shares from here on out

Going Forward

With most indicators posting modest gains and investor confidence declining throughout the quarter, we continue to remain cautious towards equities. Our cautious view is further confirmed as Chinese officials recently announced that they will begin to pull back stimulus measures instituted throughout 2009. Protectionism is also becoming a concern as the U.S. has hiked tariffs on Chinese imports of steel piping/grating, tires and solar panels and China has introduced tariffs on nylon imports, all over the past four months. China is also considering tariffs on U.S. chicken and U.S. auto parts. Protectionism is often considered a key reason for the length and severity of the Great Depression. Next to with the withdrawal of stimulus, protectionism is the second greatest threat to the recovery, in our opinion.

Consumer balance sheets have begun to look marginally better with the slowing of employment loss and consumer credit contraction. Total consumer credit outstanding is still declining but an improving employment picture will stimulate credit expansion, raising consumer confidence as available funds increase, and in turn decreasing the unemployment rate. We do not believe that western governments will begin to pull stimulus measures until the credit cycle hits bottom and expansion is seen in most parts of all countries as it would be difficult to reason that inflation is a threat while consumer balance sheets continue to contract. We do not believe that the removal of stimulus in China will spark the withdrawal of stimulus elsewhere. If mature economies do begin to revoke stimulus measures before consumer credit expansion gains momentum, we would become aggressive bears towards all risky assets. This is especially true for the more problematic nations, the United States and the United Kingdom, and we do not see material rate increases in these two nations until after 2010.

Where to go from here?

As at the end of the quarter, our G30 portfolio consisted of 42.77% cash, 3.97% fixed income and 53.26% in equities; our Aggressive Growth portfolio consisted of 31.25% cash and 68.75% equity. We focused on buying out of favour small-cap equities with plenty of cash to achieve greater leverage while limiting our downside.

We maintain a cautious view and continue to favour large companies with visible earnings growth (outside of the Financials sector) and small companies with plenty of cash and substantial undeveloped value. We remain cynical about the Financials sector's earnings prospects in the face of possible house price volatility, both in the U.S. and Canada. The Consumer Staples and Utilities sectors should continue to outperform in what we expect to be a down or sideways market. Additionally, small, well-capitalized resource companies will continue to provide us with incredible leverage to the upside without the complete downside.

Sincerely,

The Steele Wealth Management Group