RAYMOND JAMES

Steele Wealth Management

Fourth Quarter 2012 – "Road to Nowhere: Policy, Not Yet Growth"

U.S.'s Obama Re-elected, Japan's Abe Elected, More Stimulus Elected

The Team:
Brian Steele, CA, CFA
Laura Prust, CPCA
Jeannine Campbell
Kelly Townsend
Matthew Bell, CFA

Markets Jeer then Cheer Obama; Japanese Markets Love Abe; Everyone Loves Stimulus

- The S&P/TSX Composite Total Return Index gained 1.9% during the 4th quarter of 2012.

- The Financials, Consumer Staples, Industrials, IT, Consumer Discretionary and Telecom sectors outperformed the TSX Composite Index throughout the quarter.

- The Materials, Energy, Health Care and Utilities sectors underperformed the TSX Composite Index.

- The cliffs (U.S. Fiscal, Chinese Growth and European Policy) that were outlined in our last quarterly report have seen some progress. Subsequent to quarter-end, U.S. policymakers came to an agreement on taxes, permanently extending the Bush tax cuts for families making less than $450,000 and individuals making less than $400,000. Despite a favourable compromise, several U.S. cliffs still have to be dealt with in the coming months (U.S. debt ceiling, Sequestration, Farm Bill). The Chinese Growth cliff has faded as economic expansion appears to be underway. The European Policy cliff has seen no progress as the European Central Bank's bailout pledge reduced the need to act.

- More stimulus was added by governments and central banks in the fourth quarter. The U.S. Federal Reserve initiated another round of quantitative easing (QE4) to replace Operating Twist, which was set to conclude. This program will operate in tandem with QE3/QE-Infinity for total monthly bond purchases of $85 billion. Japanese elections resulted in Shinzo Abe taking power with a pledge to unleash an unlimited amount of stimulus. His goal is to reach a higher rate of inflation, thereby depreciating the Yen, making Japan's exporters more competitive and boosting the country's economic growth outlook. Chinese fiscal stimulus powered the Chinese manufacturing sector in the fourth quarter with the approval of about $160 billion USD in long-term infrastructure projects. Other minor stimulus measures were enacted in Brazil and greater Asia. The Eurozone has yet to ratify a meaningful stimulus package despite continued economic contraction.

- The global growth outlook improved somewhat since the end of Q3. The Chinese manufacturing sector rebounded with Chinese PMI indices hitting their highest levels in 19 and 7 months, depending on the index. December data showed that the U.S. manufacturing sector is growing again, despite the uncertainty surrounding the Fiscal Cliff. Japanese economic activity remains subdued but Japan's newfound pro-inflation and pro-growth agenda should boost activity going forward. The Eurozone remains in recession but may benefit from faster Chinese growth and Japan's pro-growth policy, though additional policy support may be required to jumpstart activity in the region.

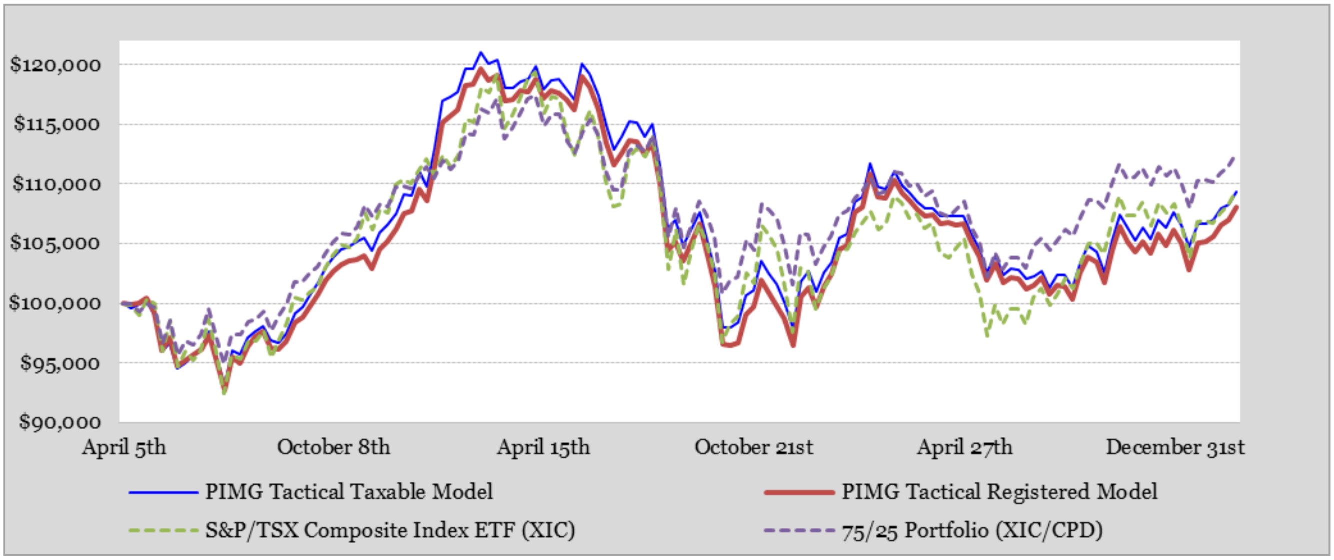
- North American inflation expectations were flat at quarter-end with most economists expecting a continuation of the slow growth environment. Markets and inflation expectations dropped following the re-election of pro-tax, pro-government Obama but his willingness to compromise on the Fiscal Cliff quickly reversed the losses. World inflation expectations rose in the quarter as Chinese growth appears to be back on track and as Japan's Abe is eager to set a long-term inflation target of 2% (from 1% currently).

The S&P/TSX Composite Total Return Index

vs

The PIMG Tactical Taxable & Tactical Registered Models

April 5th, 2010 (Inception) to December 31st, 2012



	PIMG Tactical Taxable Model	PIMG Tactical Registered Model	S&P/TSX Composite Index ETF (XIC)	75% XIC / 25% CPD
Cumulative Return Since Inception	9.38%	8.08%	9.38%	12.50%
Compound Annual Return	3.33%	2.88%	3.33%	4.40%
Standard Deviation	10.66%	10.73%	14.47%	11.01%
Sharpe Ratio	0.03	-0.01	0.02	0.13
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	16	16	17	20
Number of Down Months	17	17	16	13
Correlation with Tactical Taxable	--	0.99	0.86	0.86

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:

- Gained 3.95% during the quarter
- The model's asset allocation as at December 31st was 6.6% cash, 30.6% preferred equity and 62.8% common equity.

PIMG Tactical Registered Model:

- Gained 3.64% during the quarter
- The model's asset allocation as at December 31st was 4.8% cash, 4.0% convertible debentures, 28.3% preferred equity and 62.9% common equity.

The top five outperformers in this quarter were:

- Teck Resources (Materials/Diversified) at +24.61%
- Loblaw Companies (Staples/Grocery) at +23.44%
- Saputo Inc (Staples/Dairy Production & Distribution) at +19.57%
- Sun Life Financial (Financials/Life Insurance) at +17.13%
- New Millennium Iron (Materials/Iron Ore) at +14.78%

The top five underperformers were:

- Eldorado Gold (Materials/Gold) at -14.61%
- Teva Pharmaceutical Industries (Health Care/Generic Drugs) at -8.26%
- iShares S&P/TSX Capped Materials Index ETF (Materials/Diversified) at -6.96%
- Student Transportation (Industrials/Transportation) at -6.29%
- Just Energy Debenture (Industrials/Energy Sales & Marketing) at -5.34%

During the quarter we bought:

- Teva Pharmaceutical Industries: We purchased a full position in Teva as the stock had not kept up with the gains seen in the broad health care sector. We did not see any particular reason for this lack of participation and felt comfortable buying the stock at roughly 11x trailing earnings. The company's strong free cash flow should allow it to boost its dividend and/or buyback shares at a more rapid pace in the future.

- Shopper's Drug Mart: We purchased a full position in Shopper's as the stock traded at an attractive trailing earnings multiple of 14x, well below its historic level. We expect modest organic same store sales growth going forward, mostly driven by the aging trend which increase demand for pharmaceutical products over time. Though Shopper's only has a 2.5% dividend, it has recently been buying back stock at a rate of 4.5% per year which should further drive earnings growth over time.

- Canadian Tire Corp: We purchased Canadian Tire following the announcement that Loblaw Companies was spinning off its real estate to better optimize cash flows and focus on its retail business. As Canadian Tire is roughly in the same position as Loblaw (low valuation, limited growth prospects, undergoing strategy adjustments, large real estate portfolio), we believe it may be the next Canadian retailer to spin off its real estate portfolio. We believe Canadian Tire shares would get a material boost from spinning off its real estate. That said, we are comfortable holding the shares irrespective of a spin off as they trade at only ~11x trailing earnings and have plenty of free cash flow for share buybacks and dividends.

- Loblaw Preferred A: We purchased a full position of Loblaw Corp Preferred A as it had a term to retraction of 2.5 years and a yield to retraction of 3.6%. We believe this is an attractive yield as we consider the additional risk taken versus comparable bank preferred shares and GICs to be negligible.

- New Millennium Iron: We purchased a full position in New Millennium in late December as the stock typically sees gains between mid-December and late February. The stock performs well due to higher manufacturing activity and higher raw material demand during the fall to spring period as well as the boost in investor sentiment often seen early in the year. Global manufacturing activity has been stronger than expected in November and December and we believe the mid-December to late February trend may be underway. The stock also looked attractive on a fundamental basis with the market giving essentially no value to its massive taconite projects.

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

- Telefonica SA: We sold our position in Telefonica as Spanish yields resumed trading at elevated yields due to Spanish officials' unwillingness to take a sovereign bailout. The uncertainty regarding the bailout as well as the prolonged recession and lack of stimulus in the Eurozone convinced us that we had more to lose than gain by holding the shares.

- Open Text: We sold our position in Open Text as it missed quarterly earnings expectations for the second time in a row. Though we like the company's product line and believe its position as market leader in Enterprise software is defensible, the prolonged Eurozone recession continues to dampen the company's ability to grow. The company would appear inexpensive in a normal market but with world economies growing at a turtle's pace, we believe the shares are fairly valued.

- Legacy Oil + Gas: We sold our position in Legacy as the shares had performed well despite a widespread selloff in the Energy sector, particularly the oil weighted names. As much of Legacy's valuation is dependent on capital availability, merger and acquisition (M&A) activity and the valuation of Crescent Point Energy, we believed Legacy's upside was limited as capital remains scarce, M&A activity remains subdued and Crescent Point is trading near its 2.5 year low.

- WestCoast Energy Preferred J: We sold part of our position in WestCoast Preferred J as the shares are now callable. If called by the company, we are set to instantly lose about 2% of the value of our shares.

- Loblaw Companies: We sold our position in Loblaw following the announcement that it is spinning off its real estate to better optimize cash flows and focus on its retail business. At our sale price, Loblaw's grocery business (ex-real estate) was valued at roughly 8x trailing earnings, a ~1x premium to its U.S. peers and a ~1x discount to its Canadian peers.

Going Forward:

We saw a strong performance in our models in the fourth quarter as our overweight position in base metals and underweight positions in gold and energy benefitted from a revival in the Asian economic growth outlook. The gains seen in Saputo and Loblaw also helped somewhat as these securities were never expected to post double-digit quarterly gains. For the time being, we favour small- to mid-cap stocks in the base metals and industrials sectors as these stocks typically perform well in the seasonally strong December to April period. We will look to pare down our holdings in these sectors near the end of the seasonally strong period. We will maintain sizable positions in the Financials and Consumer Staples sectors primarily for yield but also due to favourable valuations.

The asset allocation of the model has been somewhat steady quarter-over-quarter, though minor adjustments were made within each asset class. The quality of the equity allocation was increased marginally as some non-dividend yielding equities (LEG, OTC, TEF) were swapped out for more stable dividend-yielding stocks (SC, TEVA, CTC.A), though the swap of Loblaw for New Millennium Iron near the end of the quarter offset this somewhat. We have started improving the interest rate risk profile of our preferred share allocation by selling down our positions in perpetual preferred shares and reallocating that capital to retractable and fixed-reset preferred shares.

Several systemic risks remain in play with markets susceptible to another flare-up in the Eurozone crisis, slower than expected growth in Asia or further disagreement and kerfuffle on Capitol Hill as they deal with several mini-Fiscal Cliffs in 2013. Though Japan's election of a pro-growth, pro-inflation prime minister may boost economic growth in the short-term, the long-term effect of such a shift in policy is unknown and could be calamitous for global markets. Global growth remains well below trend and we see little reason for the minor improvement observed, besides seasonality and the shift in Japanese policy.

We believe the recent improvement in Chinese and global economic activity is mostly seasonal and will ultimately be transitory. Chinese officials are still reluctant to approve large scale stimulus programs, Eurozone officials aren't expected to approve a meaningful stimulus program any time soon and U.S. officials will likely end (or reduce the scope of) outstanding stimulus programs shortly after the U.S. Fiscal Cliff is dealt with in its entirety. Consequently, as post-crisis economies and markets typically do not perform well following a reduction in stimulus measures, we will be looking to further reduce risk and increase our models' yield in the coming months.

The expected yield in our Models fell to 3.7% vs. 4.1% at the end of Q3. This decrease in yield was due to the increase in model value and the partial sale of higher yielding perpetual preferred shares. As previously stated, we predict that the model yield will rise in the coming months as we look to reduce risk by selling low-yielding cyclical securities and buying high-yielding defensive securities.

Sincerely,

Steele Wealth Management