FIRST QUARTER LETTER 2009

A SENSE OF NORMALCY RETURNING

During 2008, there was no place to hide, other than US Treasuries and the Yen by default. In the liquidity crisis of last fall, financial markets were behaving in an abnormal way. All asset classes and all types of securities lost value, while equity markets were undiscerning, selling-off both the good and the bad. This crisis is best illustrated by the shocking revelation that the Caisse de Depot actually ran out of cash in October to pay its pension liabilities, as many of its investments were tied up in illiquid securities like derivatives and structured products such as asset-backed commercial paper. As a result, the Caisse was forced to liquidate billions of dollars worth of quality stocks and bonds at distressed prices. This was also the case with many leveraged entities including global banks and hedge funds, and the forced indiscriminate selling across the globe led to panic which snowballed its way down to retail investors, causing some valuations to sink to unjustified levels. While most world stock markets are off to a negative start in 2009, at least some sense of normalcy is slowly returning in that some asset classes are performing positively such as high quality corporate bonds. In addition, distinctions are now being made between the stock market performance of companies that are doing well and companies that are not, and a re-pricing of equities with ridiculously low valuations is starting to take place. It's a good time to start putting cash back to work.

OUR FIRST QUARTER PERFORMANCE

For the first quarter ending March 31, 2009, we are pleased to report that the weighted average return of our all equity portfolios is +5.8%, versus -2% for the TSX, -11% for the S&P500, and
-11.8% for the MSCI World index. Our various balanced portfolios are up between +2.7% and +4.6% year-to-date, depending on the mandate. We have achieved these positive results with only minimal changes to our portfolio holdings, combined with a disciplined focus on the strategies described in our previous letter: Buying credit opportunistically, getting paid to wait by owning safe high yielding equities, adding defensive growth stocks, avoiding $US denominated securities, and building-up a store of value by purchasing companies that produce hard assets such as gold, uranium, oil and agricultural products as a hedge against eventual inflation and the debasement of paper money. We also continue to avoid international markets, including the US (where much dividend slashing is taking place), and remain underweight financials.

Eight out of our top ten holdings increased in value during the quarter as follows:
TVA (+67%), Caribbean Utilities (+21%), Calian Technologies (+19%), Potash (+14%), Stella Jones (+14%), XGD Gold Index (+9%), Bank of Montreal (+6%) and Vicwest (+4%). Other notable winners included Mosaid (+44%), Uranium One (+42%), and Direct Cash (+36%). Many of our holdings continue to report record profits, generate significant amounts of free cash flow, have conservative balance sheets, and pay-out generous distributions to shareholders, and as a result, the "oversold" valuations that these companies were trading at are slowly returning to more normal levels. Our babies which were "thrown out with the bath water" are gradually rising back to the surface.

We also participated in some opportunistic new issues involving motivated sellers forced to unload equities at "fire sale" prices, such as the disposal of ING Canada shares by ING Groep NV, and of Score Media shares by Canwest Global. At the same time, we have been beefing-up our holdings in high quality oil & gas royalty trusts such as Crescent Point and Vermilion, and have been adding "recession resistant" companies to our portfolio such as Cineplex Galaxy, Corby and Loblaw. Finally, we continue to

take advantage of abnormally wide credit spreads by selectively adding to our balanced portfolios quality corporate bonds and preferred shares of such issuers as Shaw, BCE and Canadian banks.

BEARS NOT OUT OF THE WOODS YET

In our January letter, we mentioned that on a macro level we were bouncing off of a murky bottom. On March 9th, another “bottom” was hit (the previous one was November 20th last year), and from that low point, stock markets have risen nearly 20%. Such dramatic rallies are typical of bear markets. Financial news had gotten so bad and investor pessimism had fallen so low, that the slightest positive (read “less negative”) statistic can give investors hope that the economy is about to turn, and short sellers a reason to run for cover which tends to magnify such rallies. We are not so naïve to think that the worst is over in the economy, however we do believe that we are not far-off the ultimate stock market bottom. Unemployment figures and bankruptcies will continue to make headlines. There will be many “false starts”, and for any consumer led recovery to really take root in these unprecedented times, unemployment will need to abate, US housing prices will need to stabilize, and the banking industry will need to resume extending credit on normal terms. Meanwhile, North American commercial real estate mortgages, corporate loans, and sovereign debt in areas like Eastern Europe are of growing concern throughout the global banking system.

It remains to be seen whether FASB’s laxer accounting standards for banks, allowing them to postpone inevitable losses, will make any difference in the long run, and how long it will take for the Obama administration’s cleansing of toxic assets in the banking system to translate into normal lending again. It also remains to be seen whether the trillions pledged by the G20 and all of the economic stimuli packages aren’t just short term jolts, while the world continues its painful deleveraging process in a deflationary environment. We are indeed sailing in uncharted waters.

The recent commodity rally may have more to do with China stockpiling resources than an indication that “real” sustainable demand has returned, however, we have no doubt that when it does return, the supply/demand imbalance combined with powerful inflationary forces from paper money devaluations will cause the prices of commodities to rise dramatically. The good news is that there are mountains of cash on the sidelines: US$3.9 trillion in US money market funds at the end of February versus US$3.1 trillion in US equity funds. This illustrates the enormous fire power ready to re-enter financial markets at some point. Stock markets will rise in anticipation of an improving economy, followed by leading indicators flashing green, and then the big money will start buying equities with real conviction, leading to a sustained rally. In the meantime, the key is to be “properly” invested (i.e. in the right securities and in the right companies), while positioning oneself for what will undoubtedly be the investment opportunity of a lifetime.

April 7, 2009