STONEGATE
Private Counsel LP

INVESTMENT REVIEW AND ECONOMIC OUTLOOK

Third Quarter 2009

Overview

World capital markets continued to enjoy positive returns during the third quarter. The MSCI World Index was up 8.23%, the S&P 500 Index rose 6.42% (both in Canadian dollars) and the S&P/TSX Composite Index added 10.61%. In the fixed-income market, the DEX Universe Index posted a total return of 2.71%. The positive market performance can be largely attributed to predominantly positive economic news that filtered into the market throughout most of the quarter. This included higher home sales and housing starts, improved auto sales, better than expected GDP for the second quarter, further strengthening of corporate balance sheets, and a sustained advance in the leading economic indicators index – all market-friendly news. Indeed, the only real negative news has been the escalating war of words between Iran and the rest of the world; something that the market has shrugged off for the time being. The Canadian markets got a further boost from a weakening U.S. dollar, which provided the impetus for a strengthening commodity complex, notably precious metals and energy.

During 2009, global capital markets have gone from "despair" during the March lows to "hope" and now approach "greed" in some areas of the market, notably higher-risk assets such as small-cap companies and some emerging markets. Although our outlook remains positive for both the equity and fixed-income markets, we can no longer make the emphatic argument that markets are extremely cheap as was the case earlier this year. Indeed, we would argue that markets are now fairly priced, reflecting a moderate economic recovery. Our constructive view of global capital markets is principally based on the following:

- **There remains a coordinated global commitment on the part of both the political leadership and monetary authorities to ensure that the current emerging economic recovery takes hold and is sustainable.** In effect this will mean a benign interest rate environment for some time, accompanied by plenty of liquidity to continue to fuel the markets.

- **The leading economic indicator index continues to expand, reflecting a stronger economy.** Recent economic data has largely been at the upper end of most economic observers' expectations – a trend we expect to continue for the near future.

- **Corporate profits are rebounding at a very strong pace.** The severity of the recent economic downturn has led many companies to make drastic cuts in operating expenses and lower breakeven points, resulting in much leaner corporate structures. With the economy rebounding, and with high operating margins, many companies are reporting much higher than expected profits. The offset has been that revenue growth has been sub-par, but for the moment markets appear to be focusing on the improving profit outlook.

- **At current levels, the markets are fairly priced.** Given we are in the early stages of a global economic recovery accompanied by very accommodative economic policies, we believe the markets can move higher from here. However, we do not expect to see the same market gains over the next 12 months that we have witnessed during the last six months. Going forward, market gains will be primarily driven by earnings growth, which at some point will require revenue growth.

- **We continue to see record amounts of cash on the sidelines generating little or no return.** As confidence continues to build we expect that some of this cash will eventually find its way into equities and higher yielding fixed-income instruments.

Thus, for the near term we believe that the path of least resistance for the markets is up. At this juncture there is very little to suggest that markets are about to begin a major correction.

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INVESTMENT REVIEW AND ECONOMIC OUTLOOK *(cont'd)*

KBSH performance continued to shine in third quarter

The KBSH Private Bond Fund continued its exceptional year-to-date performance. We continued to reduce the corporate portfolio weight, going back to a more neutral stance from our significant overweight position in the middle of the second quarter. Yield spreads are now approaching the middle of the long-term range (50 to 150 basis points) leading us to believe corporate bonds are now fairly valued. Spreads may in fact move modestly tighter, but we think things have changed and we do not believe that spreads will return to the tight spreads seen in early 2007, as leverage used by financial institutions is dialed back to a more acceptable level. For now, we are comfortable with a corporate bond weight of approximately 30% of the total portfolio with the duration of the corporate portfolio being longer than the market.

The KBSH equity strategies have also enjoyed strong absolute and relative performance. A cornerstone of our investment process is to search for great companies with strong relative earnings growth trading at attractive valuations. Currently, these companies are predominantly in the larger capitalization consumer staples and pharmaceutical companies and not in the smaller and more cyclical firms. We anticipate that a strengthening economy will bode well for equity markets and in particular the high-quality names that reside in our portfolios.

We remain convinced that all of our portfolios, equities and bonds alike, are properly positioned to take advantage of an improving economy. We continue to invest with conviction in high-quality franchise companies with earnings growth superior to that of the market, and at valuations that are justifiable. As such, we remain consistent with our growth philosophy.

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