INVESTMENT REVIEW AND ECONOMIC OUTLOOK

STONEGATE
Private Counsel

Fourth Quarter 2009

Overview

During the past year, the repricing of credit has been the primary driver of global capital markets; that phase is now over. Over the next year we expect the major drivers of capital markets to be global economic growth and changes in corporate earnings.

Capital markets began 2009 in a free fall, with risk aversion reaching extremes in early March when markets bottomed. The impressive subsequent turnaround continued into the fourth quarter, albeit at a more muted pace.

The positive market returns are largely attributable to a continuation of positive economic news both in North America and abroad. In the U.S., growth in unemployment appears to be subsiding, the housing market is improving and auto sales have picked up, as have retail sales. In emerging markets, growth continues to strengthen due to stronger commodity prices and increases in trade. By way of example, China's growth rate in 2010 is expected to approach 10%, up from 8.7% in 2009. Indeed, most of the news in recent months has by and large been market friendly, with the possible exception, in particular, of Iran, Pakistan and Afghanistan, which remain sources of instability.

Our outlook for 2010 is one of cautious optimism. Some of our key assumptions for 2010 include:

- **Global growth to exceed 3%, led by emerging markets.** The developed world will likely experience below average growth due in part to the high level of consumer and government debt.
- **Inflation will likely trend upward, but remain under control due to minimal pressure being exerted by the employment sector in the form of higher wages.**
- **After one of the worst earnings contractions during the last half century, corporate earnings are poised for a significant rebound.** A 30% to 40% earnings recovery is not unrealistic. The combination of a better economy, extremely lean inventories, and an increase in operational leverage due to companies shedding excess labour will lead to strong corporate profits, particularly in the first half of the year.
- **Our expectation of a strong rebound in capital expenditures and increased activity in mergers and acquisitions.** Corporate balance sheets are in pristine shape and it is cheaper to buy on Wall/Bay Street than to build.

Notwithstanding the above, although we believe that equity markets are likely to trend higher, some of the good news appears to be already priced into the market. The extremely low market valuations of nine months ago are now closer to fair value; the market is neither expensive nor cheap. Thus, earnings are likely to play a greater role in setting the market tone than they did several months ago. Although we are encouraged by the unfolding economic landscape, we remain cautious on the following issues:

- The current rebound in global economic activity has been largely engineered through the use of massive fiscal stimulus in conjunction with exceptional easy monetary policies; at some point these initiatives will have to be curtailed and the economy will have to transition from government led to one which is dependent on consumers and corporate spending for sustainable growth. The successful transition is of paramount importance and one that at this point is not assured.

- Policy errors with respect to raising interest rates too quickly in the face of a fragile economy are a source of concern.
- A flare-up of instability in nations such as Iran, Pakistan and Afghanistan would likely put further pressure on the already-high price for energy, something that the developed nations can ill afford.
- The need to refinance the mountain of public debt may in the near future cause a "crowding out effect," leading to significantly higher interest rates which could arrest economic growth.

Thus, for the near term we believe that the path of least resistance for equity markets is up. At this juncture there is very little in the way to suggest that markets are about to begin a major correction. The fixed-income markets are unlikely to significantly outperform given that most of the returns last year were due to a narrowing of corporate spreads – an exercise that is mostly over. What lies ahead will now depend primarily on the direction of bond rates. Longer term, some of the past excesses from the credit binge have not been addressed, such as commercial real estate, and the market will have to come to terms when monetary conditions begin to change.

We are very pleased to report our performance in 2009

Both the Private Global Value Pool and Private Fixed Income Pool handily outperformed their benchmarks, while the Private Canadian Equity Pool slightly underperformed.

Private Global Value Pool	31.84%
MSCI World Index Total Return (C$)	11.78%
Private Fixed Income Pool	11.33%
DEX Universe Bond Index	5.41%
Private Canadian Equity Pool	29.34%
S&P/TSX Composite Index Total Return	35.05%

Returns are for the 2009 calendar year and are gross of investment management fees and operating expenses.

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