First Quarter Commentary

APRIL 2009

The Independent Accountants' Investment Counsel Inc.

The Economy is Showing Both Positive and Negative Signs...

A magnitude of economic challenges set in over the past quarter with a constant flow of negative news. Layoffs and plant closures, bailouts, slumping retail sales, and a weak real estate market have continued to undermine the confidence of consumers and investors. Looking back, we can now observe that the turning point for the economy and the equity markets was actually in mid-summer 2007. At that time, mortgage defaults were on the rise and the markets began to understand the potential domino effect that the collapse of mortgage-backed securities could have on the US economy. Despite the mounting concerns, we saw continued strength in materials and energy into 2008, which masked the problems to some degree, particularly in Canada.

No investor should undermine the severity of the economic downturn we now find ourselves in. For hundreds of thousands of Canadians and millions of Americans, the loss of employment has been very painful. Many people now collecting EI benefits will never see their jobs return. There is consensus that some of the industries impacted the hardest, will undergo fundamental changes and permanently move North American jobs offshore. This has not only set back the millions who have lost their jobs, but has eroded the confidence of many more people who remain gainfully employed. All of this translates into an erosion of consumer confidence: one of the basic building blocks of a strong economy.

It may seem that all of the news is negative; however, we have begun to see positive developments. Some leading indicators hit benchmark lows early in the year and are now either stabilizing or in some cases turning for the better. Credit restrictions are starting to ease, and we are even observing some improvements in the housing sector.

More Troubles May be on the Horizon...

While we have enjoyed six weeks of positive momentum in the stock market, we should not assume that the volatility and declines across the board are entirely behind us. We can anticipate news of more bankruptcies, including the possibility of one or two companies that we have traditionally thought of as "too big to fail". In particular, the auto industry is on life support and many suspect that this is where the next blow will be dealt. Thirty-five years ago, the hit comedy "All in the Family" portrayed Archie Bunker stating: "What is good for General Motors is good for America" and many people agreed. GM was more than just a car company: It was a way of life. Today we find this iconic bastion of American ingenuity and know-how on the verge of collapse and many feel we need to let it go. Even with all of the best intentions to re-invent itself, GM will not survive without massive support from the US Government. Chrysler, though no longer a public company, appears to be in worse shape than GM. The rapid decline of the automotive industry was one of the first signs that credit issues, perpetrated by the collapse of sub-prime mortgages, had spread beyond Wall Street. Leasing and lending, the lifeblood of the auto industry, dried up over night. For weary consumers, this meant that even those who wanted to purchase a new vehicle had no means to do so. As mentioned, we are starting to see some positive signs with credit markets easing up and consumer confidence bottoming out, but it may be too little too late. These are companies that have just weeks to demonstrate they can compete globally in the twenty-first century. Unfortunately, they are saddled with over 100 years of history and twentieth century thinking grounded in protectionist policies.

We may have accepted the imminent demise of one of the Detroit Three, but the news of GM or Chrysler failing will ultimately have an impact on global stock markets in the short-term.

Long Term Fundamentals are in Place...

In the longer term, fundamentals are strengthening and are supporting higher equity prices. Let us consider four developments that bode well for the stock market. First, massive stimulus packages will begin to work their way into the broader economy in the latter half of 2009. Many industries will see improvements in sales and profits as demand for their product and services increase. Secondly, inflation is no longer an issue and Governments have reduced overnight lending rates to all-time lows. There is very little to suggest that monetary policy will change direction in the near-term. Third, we have all stopped worrying about $200 / barrel oil. Energy prices can undermine consumer confidence and drive up input costs for many industries. With oil now trading in the $40 - $50 range, some relief has been provided. Finally, a significant amount of capital in the banking system is slowly being put to work. This additional capital

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will allow firms to reinvest in their businesses, creating employment opportunities and growth for investors.

It is important to remind our clients once again that the stock market has always been a leading, not a trailing indicator of the broader economy. At some point, negative economic news no longer panics the markets. Investors anticipate the future, meaning today's news has already been priced into equities. This is why even the collapse of GM will not impede the long-term growth of the stock market. An orderly bankruptcy is anticipated and has already been priced in.

Will Markets Continue to Climb or Falter...

Some analysts have suggested that recent positive momentum we have experienced is an indicator that the broader economy will take a positive turn and begin to recover in the second half of 2009. However, others have suggested that some of the key numbers suggest that the recent fortunes of equity markets is a short-term phenomena and that we will experience further declines and test new lows. Those with a bearish outlook point to overleveraged consumers who will continue to deleverage their personal balance sheets over the next three or four years. Massive government stimulus packages will be inflationary, burdening governments and taxpayers for years to come. The bulls argue, that despite an overextended American consumer, the rise of the middle class in emerging markets will continue to stimulate global growth. They view government stimulus, used to build infrastructure rather than social programs, as sound fiscal policy that can be managed to ensure that cost and benefits are strategically aligned.

Investment Strategy and Tactical Adjustments...

The declines in stocks and bonds over the past year has unnerved many investors who have moved to safer, lower-risk investments. Others have taken the view that a market that drops 40% over a six-month period creates opportunities. Stay the course and shift the weighting of your portfolio a little more to undervalued sectors.

To provide insight into IAIC's strategic and tactical direction, it is worth examining our basic investment philosophy and then our current view of each asset class and economic sector. First, we need to state once again that IAIC investment plans are built upon the three basic themes: Diversification, Discipline and Value. This translates into a consistent investment strategy, maintaining a set asset allocation for each client. Within each asset class, a specified range provides some flexibility to overweight or underweight specific investments while maintaining the portfolio with minimum and maximum set points. The same principle applies to the economic sectors. Shifting to one end of a specified range or the other is not a change in strategic direction but a tactical shift that IAIC undertakes.

With respect to our current views regarding each class, we need to consider each individually.

Bonds: During the final quarter of 2008, the credit markets became very volatile with yield spreads between corporate debt and government debt widening significantly and rapidly. Those spreads, while closing to some degree, still remain relatively wide. Government debt has become very expensive yielding historically low returns for investors who value safety above all else. Normally IAIC purchases bonds to hold to maturity. The significant differences in yields between corporate and government issues have led IAIC to focus purchasing in the first half of 2009 on high quality corporate bonds unless otherwise directed by the client. In some portfolios heavily weighted with government bonds trading at premiums, it has been prudent to shift some of the longer-term government bonds to corporate issues.

Preferred Shares: Downward pressure on the prices of preferred shares has created an opportunity to purchase quality income-producing securities that offer tax efficiency and relatively high yields. Structured issues are typically impacted by the value of the securities that they are structured from. In many cases, the decline in the stock market has impacted the underlying asset value, resulting in the credit ratings of these instruments being downgraded. However, in most cases the market has discounted the value of these securities to maintain some cushion. Some positive momentum in the market will translate into firmer prices for structured issues. Turning to floating rate issues, low prime rates have driven the dividend down. To maintain yield, the prices of these securities have fallen dramatically. With quality floating rate issues, IAIC believes that patience will reward investors while providing excellent income yields. Finally, many institutions including the Canadian banks have issued 5-year retractable issues with yields that vary between 6.0% and 7.0%. These issues will either be retracted for their face value five years from now or extended for 5 additional years at the GOC 5-year bond rate + 4.0% - 5.0%. IAIC believes that that these issues are being used to shore up capital requirements (in the case of the banks, a critical measure of liquidity known as Tier One Capital) and the issuers have no intention of extending the terms beyond the initial five-year period. This effectively makes these shares five year fixed income instruments. For many portfolios, IAIC may be adding to the preferred share allocation with structured, floating or retractable issues or a combination of all three.

Income Trust Units: The final income-producing asset class is the Income Trust allocation. Many income trusts have declined in value in fear of distribution cuts as the underlying business deals with declining revenues and profits. Some of this market reaction is clearly warranted. We have seen some distribution cuts. However, in many cases, the cuts were prudent decisions to preserve cash and the issues still provide excellent yield opportunities.

Equities: Turning to equities, we have been shoring up the financial sector with Canadian banks. For many clients this has meant adding to existing positions. IAIC continues to hold a couple of US and International financial institutions but we are not adding to those positions at the present time. IAIC believes that the Canadian banks in particular, offer excellent value. Excellent P/E ratios and dividend yields with fairly safe dividends offer an excellent opportunity to add to this sector.

IAIC has also been adding to the resource sector. As oil dipped below $40 / barrel IAIC deemed a buying opportunity in energy stocks. After trimming energy and resources in the first half of 2008, we found ourselves actively purchasing in this sector in the first quarter of 2009.

Please contact your local IAIC Representative if you have any questions regarding this commentary.

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