FIRST QUARTER COMMENTARY

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THE INDEPENDENT ACCOUNTANTS' INVESTMENT COUNSEL INC.

Cautious Optimism Returns to the Markets...

Most investors have now put the market meltdown of 2008 behind them, and are looking ahead to a sustainable global economic recovery over the coming 12 – 24 months. The DJIA has recently surpassed 11,000 and the TSX is trading at approximately 12,000. We believe that the biggest gains in the stock market for this cycle have been realized. As corporate earnings rise, increases in stock prices will slow, having already factored in a moderate to robust economic recovery.

We anticipate that global equity markets will provide positive returns to investors throughout the remainder of the year. Earnings surprises to the upside are outnumbering those to the downside providing equities with positive momentum.

Interest Rates and the US/CDN $ Exchange Rate...

With interest rates ate historical lows, it is not hard to forcast the forward direction over the next 12 months. In Canada, short-term rates are set to rise over the coming months. The Bank of Canada is indicating that they want to ease into higher rates over a longer period in small increments. With solid GDP numbers in the first quarter of this year, the central bank clearly wants to shift away from stimulus measures to focus on growth and inflation. The US Federal Reserve has a bigger hill to climb before the American economy returns to a level of sustainable growth and is thus indicating they will continue to hold the line on rate increases.

The implications for Canadian investors: while inflation and high interest rates result in a devalued currency in the long-term, the effects can be totally opposite in the short-term. Capital can easily move throughout the world seeking the highest return, creating a demand for specific currencies. This puts downward pressure on currencies such as the US dollar, where comparable interest rates are lower then other jurisdictions. So while short-term Canadian rates are expected to rise over the second half of this year, US rates are expected to remain at record lows, potentially having an impact of the US/CDN exchange rate in favour of the Canadian dollar. We have already seen evidence of this. There are numerous other factors that will impact interest rates and exchange rates. A strong dollar will hurt Canadian exports, particularly manufactured goods heading to the US. This will naturally have a negative impact on the Canadian economy, which will be factored into the Bank of Canada's decisions. A lower US dollar will have a positive impact on US exports, which should effectively aid the economic recovery the US is now undergoing. A prudent hedging strategy against US dollar exposure is to invest in US stocks with large international operations.

Changes to Income Trusts...

One particular issue that we have been addressing is the pending taxation of income trusts, due to take effect in 2011. In 2006, the Canadian government announced changes to the way that taxes are to be levied on income trusts beginning January 2011, effectively imposing taxes at both the enterprise and the personal levels, similar to the manner in which corporations are taxed.

At IAIC, we have treated income trusts as a sub-class of the broader "Income-Producing" asset class. The rational was to provide portfolios with a boost to the current income yield. We have always limited exposure to income trusts, realizing that many income trusts were subject to the same risks as the common shares of corporations. We have also strategically diversified within this sub-class allocation, proving exposure to four areas: power & pipelines, resource royalties, businesses and REITs.

Some income trusts have already converted to corporate structures in anticipation of the changes in 2011. Others have plans to convert and the remainders are planning on delaying any changes due to specific tax advantages. For example, REITs are exempt from the changes and will continue to operate as flow-through structures.

As we approach 2011, we will be reclassifying converted income trusts as Canadian equity. Our preliminary plan is to increase the ranges of each client's Canadian equity content and decrease the income-producing asset class by a similar increment. Depending on their new dividend payout policies, we will be adding some of the converted income trusts to our core list of Canadian stocks. This restructuring will occur over time and new ranges will be implemented within investment policy statements as annual reviews are undertaken with your IAIC representative.

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

145 Main Street East, Listowel, ON, N4W 2B5 – Tel: (877) 291-3040 Fax: (519) 291-1240