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THE INDEPENDENT ACCOUNTANTS' INVESTMENT COUNSEL INC.

Markets Finish Strong in 2010...

Stock markets continued their recovery in 2010, albeit at a more moderate pace than in 2009. This is a normal pattern that has been observed during the previous five recessions. The most significant gains are made in the months following the bottoming out of the market, which then levels out and continues to grow at a more sustainable pace as corporate profits improve.

However, after enjoying two years of positive momentum, investors should probably pare back their expectations for 2011. While the economy continues to recover and the majority of analysts are expecting positive returns from equity in this year, it will be hard to match or outperform 2010. Over the past year the TSX surged ahead 14% and the S&P 500 moved forward by over 10%. Even with the challenges in Europe, global markets performed well with emerging economies posting impressive growth. However, as we have mentioned previously, financial markets are forward looking and expectations are reflected in current prices.

A Slow Economic Recovery in the U.S....

While the Canadian market has performed extremely well, we cannot lose sight of the fact that our economy is dependent on exports and in particular, exports to our largest trading partner - the U.S.A. America's economic challenges translate into Canada's economic challenges. The U.S. economy officially came out of recession in June 2009 but the road back to prosperity has been slow. While

growth over the past year came in at 3.2%, it is slowing. According to the Federal Reserve Bank, much of the growth the U.S. has experienced is due to replenishing of inventories. The economy may be growing but end sales are not bouncing back at the same rate. This is reflected in the personal savings rate, which has surged. The savings mechanism of choice has been debt repayment as the consumer deleverages. Debt service is now 12% of disposable income, down from 14% a year ago.

There are a number of positives that can be taken from the data, which provides upside for the economy and for investors.

First, the recovery has been led by the manufacturing sector meaning the economy is being driven by private sector investment despite the significant injections of government stimulus. Still, manufacturing utilization is far below capacity. As the economy continues to recover, utilization should return to normal levels providing additional employment.

Secondly, inflation has been moderating and the slow recovery of employment should mean that inflationary pressures remain in check. While core inflation (adjusted for food and energy) is 1%, it is only expected to rise to 1.5% by 2013.

The bearish analysts among the bulls always turn to housing as the basis of their pessimism. Housing has unquestionably been a huge drag on the U.S. economy. Nearly every household has had their wealth eroded with prices falling by an average of 25% and as much as 50% in some areas. Housing starts, which averaged 1.4 million units annually, are now approximately 600,000.

However, data shows that housing has now bottomed and prices have stabilized. Some markets are even seeing prices starting to rebound. Every year, one million "households" are reaching the age where they are in the market for a home. But these people have been on the sidelines during the housing downturn meaning there is pent up demand.

Finally, consider the major barometer for the U.S. economy: automobile sales and manufacturing. After reaching a peak of approximately 17 million units, auto sales plummeted to just over 10 million units. The industry as a whole has downsized capacity and has significantly cut its labour costs. So while the industry previously could not even breakeven at 14 million units, its breakeven sales point is now somewhere around 11.5 million units. In 2010, sales were approximately 12.6 million units with US manufacturers leading the way. With an aging stock and 2 million net new drivers coming into the market place, vehicle sales and manufacturing are expected to continue to recover and lead the economy back to health.

In summary, there are a number of positive indicators that economists are keying on, translating into continued momentum for the US economy, with diminishing probability of slipping back into a recession. The current pace of the recovery should keep inflation under control and subsequently, interest rates at relatively low levels. Corporate earnings should continue to grow and fuel further growth in stock prices in 2011.

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