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MONTHLY MARKET COMMENTARY

INVESTMENT RESEARCH

JANUARY 2012

December 2011 Review

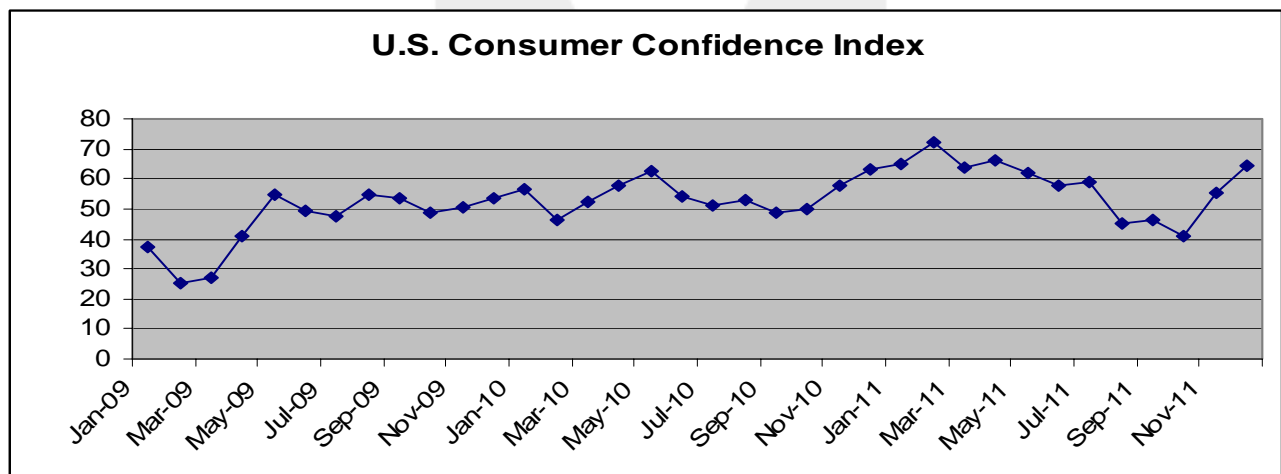
	December 31, 2011	December 31, 2010	% Change
TSX	11,955.1	13,443.2	(11.1)%
S&P 500	1,257.6	1,257.6	0%
DJII	12,217.6	11,577.5	5.5%
NASDAQ	2,605.1	2,652.9	(1.8)%
10 Yr. Cda Bonds	1.94%	3.12%	(118) bp
10 Yr. US Bonds	1.88%	3.29%	(141) bp
90 Day Cda T-Bills	0.80%	0.98%	(18) bp
90 Day US T-Bills	0.01%	0.12%	(11) bp
US\$ vs. Can\$	\$0.9833	\$1.002	(1.9)%

2012

Investors enter 2012 with an understandably cautious outlook. Economic indicators in most parts of the globe continue to be weak and the future of the Euro zone is very much in question. 2011 was a poor year for the Canadian stock market. For Canadian investors with a “buy and hold” strategy, the Toronto Stock Market had a negative return of 11.1%, including dividends a negative return of 8.7%. In the U.S. investors fared better with the S&P 500 ending the year the same as the start, but including dividends had a positive return of 2.1%. There are several reasons why 2011 proved to be disappointing, but we feel the prime reason was one of expectations. For the prior two years (2009 and 2010) stock markets did very well with the Canadian market up 30.7% and 14.4%, respectively, while the U.S. market (S&P 500) was up 23.4% and 13.8%, respectively. Investors were lulled into believing the nightmare of 2008 (the U.S. debt crisis) was over and better times lay ahead. Unfortunately this was not the case as the debt crisis re-appeared in Europe.

Despite the skepticism, we are optimistic 2012 will be a good year for investors (high single-digit to low double-digit returns). Our base case for 2012 is that it will be a mirror image of 2011. As mentioned entering 2011, investors felt positive towards the year and believed a continuation of the past two years was likely, but a series of economic shocks (the Arab uprising and rising oil prices, the Japanese tsunami, the U.S. debt ceiling debate along with the subsequent downgrading of the U.S. sovereign debt by Standard and Poor's and finally the European debt crisis) dampened investors' enthusiasm. For 2012, we enter the year with a

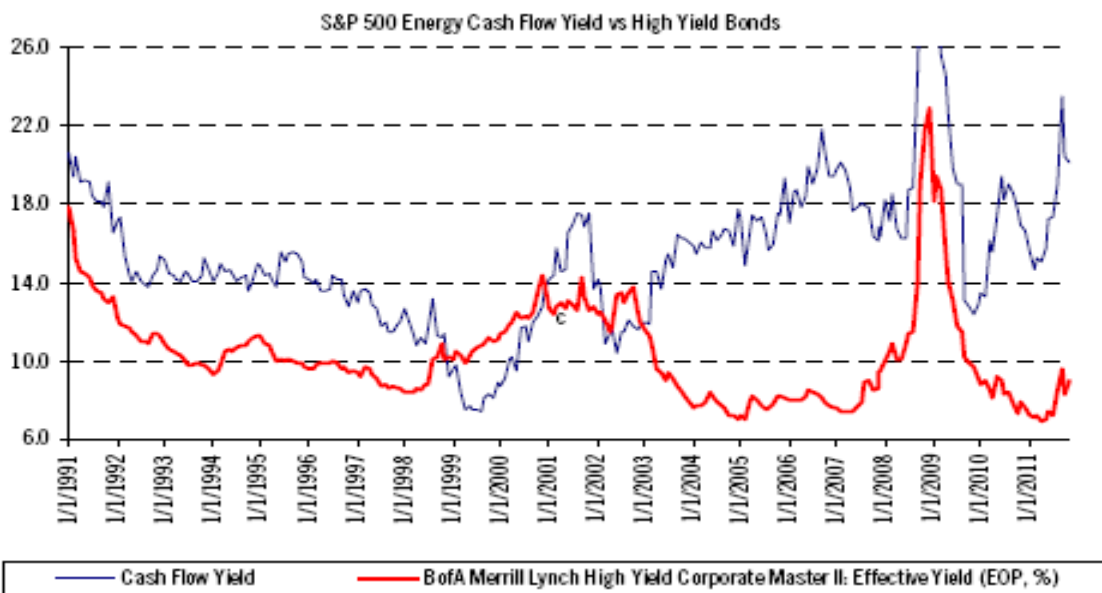
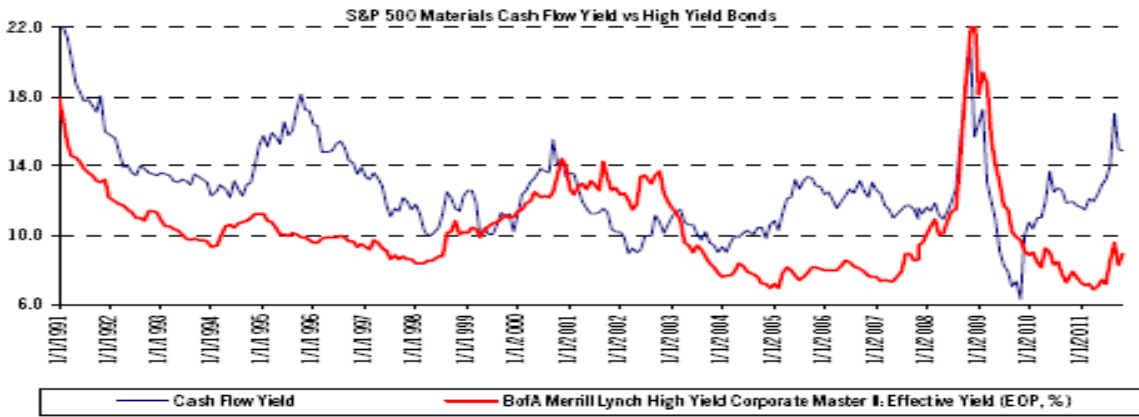
great deal of skepticism/pessimism and unknowns. We acknowledge the first half of 2012 will likely be challenging as the series of economic shocks of 2011 have left the global economy and investor confidence in a fragile state. Nevertheless we feel continuing economic growth emanating from the U.S. and China (albeit at a slower rate than in previous years for China), further policy moves by the European governments and central banks, resilient earnings, low interest rates, an undervalued stock market and strategic mergers and acquisitions will convince investors the stock market will be an attractive area to invest. It is unlikely at the end of 2012 investors will be in a euphoric mood as debt problems and unknowns will still exist, but certainly less bearish and will view mid-single digit returns as a successful year. What is missing today is confidence towards the economy and policy makers. We believe we are seeing early signs of confidence building, especially in the U.S. Below we highlight the latest U.S. confidence index (December 2011). It has regained much of the lost ground of early 2011. The U.S. stock market/economy generally follows this index. With confidence rising, due to a lower unemployment rate and stabilizing house prices, economic activity should increase. We view a combination of rising confidence, a pent-up demand for goods (autos as an example) and improving financial conditions (more bank lending for instance) as a net positive for the U.S. consumer. We feel the U.S. consumer will be a key driver for global growth in 2012.



There is widespread agreement among analysts that the stock market is undervalued based on conventional measures of the market such as the dividend yield (higher dividend yield than government bonds), the low price to earnings ratio (low teens) and historically low price to book ratio. In addition, we feel corporate buyers will be more active buying other companies.

The pace of mergers and acquisitions in 2011 has been strong, but we feel 2012 will be even stronger. If equity markets remain as undervalued as we feel they are and low interest rates remain in place, the attractiveness of company valuations by corporate purchasers will be very appealing. There has been a flurry of corporate acquisitions in Canada, particularly in the natural resource sector. According to Bloomberg, in Canada the largest number of acquisitions for 2011 occurred in the mining area with 259 deals being announced and/or completed totaling \$19.3 billion, followed by the oil and gas sector with 145 deals totaling \$15.1 billion. The average premium to the existing share price paid in the oil and gas area was 25%, while in the mining area it was 32%. We highlight the attractiveness of these two sectors below. The first graph is the materials sector followed by the energy sector.

In the graphs on the following page are two lines; one is the cash flow yield (cash flow per share divided by the share price, top line on the right side) of the materials sector (predominately mining companies) versus the cost to finance a take-over (high yield bond rate, bottom line on the right). The gap between the two lines represents the immediate cash flow accretion by the acquiring company. We believe this gap is attractive and likely signals further acquisitions by corporate buyers.



Source: Citigroup

Risks: There are risks to our forecast. We rarely if ever see an attractively/unattractively priced stock market without problems (concerns)/euphoria (enthusiasm). We see two major risks to our forecast; Europe and China. We are comfortable with the view that the U.S. will continue to grow and importantly, the U.S. Federal Reserve will provide all the needed stimuli to prevent a relapse/recession in the U.S. economy. In Europe the situation is far from clear. Euro-zone governments have been slow to respond to their crisis and investors generally view their responses as timid. We believe they will do enough to prevent a “riot” among investors (bond yields going much higher), but will only act with force if the situation deteriorates considerably more. In China the country will continue to grow, but the risks appear to the downside as recent economic numbers have generally been disappointing. There is a consensus view the period of China growing over 10% is over and a more moderate (though still robust) rate is likely, but 2012’s growth rate could be less than expected. We view China’s normalized growth in the 7.5% to 8.5% range. China’s longer-term growth plan of depending less on infrastructure building and exports and to rely more on consumer spending is underway. There has been much written on the Chinese “real estate bubble”, but to our understanding China’s 12th Five Year Plan is to build affordable housing with a total of 36 million units between 2011 and 2015, which we feel will offset the sharp downturn in private sector starts.

Conclusions: 2011's successful equity strategy was to buy those companies that either had a relatively high dividend yield (3% plus) and/or those companies viewed as economically insensitive. The background for 2011 was characterized as being one of slow economic growth with interest rates declining from already low levels. In 2011 economists constantly revised down their global economic growth forecasts which we believe led investors out of the economically sensitive companies and into the non-economically sensitive sector. During 2011 the Government of Canada/U.S. ten-year bond rate (see front page) fell from over 3% to under 2%, which we believe caused investors to seek high dividend yielding stocks. If these two events continue (a lowering of global economic growth forecasts and interest rates declines) the 2011 successful strategy will also be 2012's successful strategy. We feel owning stocks that have a good dividend yield, have a history of growing their dividend and are relatively economically insensitive is a sound long-term strategy. We do feel, however, that should our forecasts for 2012 be correct, economically sensitive stocks should be purchased, especially in the latter half of 2012.

Ian Nakamoto
Director of Research

Important Disclosures

<u>Company</u>	<u>Ticker</u>	<u>Disclosures</u>
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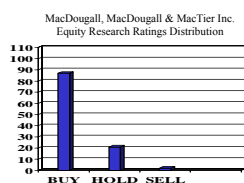
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Glossary of Terms:

EPS	Earnings per Share
P/E	Price to Earnings Ratio
EBITDA	Earnings before Interest, Taxes, Depreciation and Amortization
Market Cap	Total Shares Outstanding multiplied by Shares Price
Enterprise Value	Fully Diluted Shares Outstanding
PEG	P/E Multiple Divided by Growth Rate
ADR	American Depository Receipt
WACC	Weighted Average Cost of Capital
Risk Free Rate	10 Year Treasury bond
Yield	Dividend divided by Share Price
ASP	Average Price
DSOs	Days Sales Outstanding
Capex	Capital Expenditures
CPU	Cost per Unit
EVA	Economic value Added
EV / EBITDA	Enterprise Value / Earnings before Interest, Taxes, Depreciation and Amortization
DCF	Discounted Cash Flow
Holts DCF	Holts Discounted Cash Flow
DYT	Dividend Yield Target
Yield	Yield
BSOPM	Black Scholes Options Pricing Model
BETA	Quantitative measure of the volatility of a stock, mutual fund, or portfolio, relative to the overall market
MF	Mutual Fund

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