2013 Outlook

General Comments

According to the Mayan calendar, today, December 21, 2012 completes one of the great cycles and marks the end of the world.

But it also marks a new type of global economy with different ways of communicating, different participants, and different attitudes. One thing hasn't ended: **the need for investors to earn a return.**

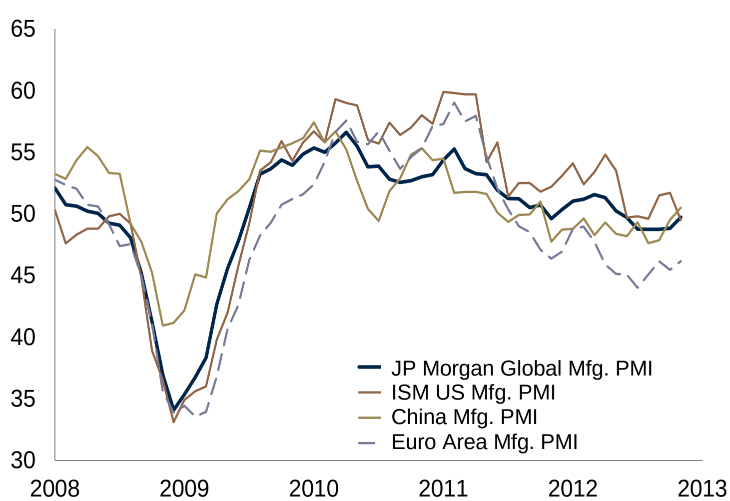
I expect equities to do better than anticipated in 2013. The great commodity boom last decade may have ended and Canada's resource economy faces some stiff headwinds. The US is becoming energy self-sufficient. Emerging markets have reached half of global output on a purchasing power parity basis and account for approximately 80% of next year's expected growth. European stock and bond markets have been pricing in a solution to their problems for three months now. The third round of quantitative easing is set to begin in the US, helping further a rise in production and housing recovery that is already well underway. Extremely low interest rates provide further economic stimulation. Owning government bonds may be the riskiest bet in 2013.

1. Equities Outperform Fixed Income

Advisors and investors appear pessimistic on both stocks and bonds. Investors fear that stocks may not do well because of slower economic growth from deleveraging of global debt levels. Austerity measures seem inevitable in the US and uncertainties in Europe still threaten to undermine global credit markets. On the fixed income side, government and investment grade bonds simply don't pay very much interest, leaving investors with less purchasing power after tax and inflation. There is also the fear that interest rates may start to rise as government stimulative measures become effective, which would cause the price of bonds to drop.

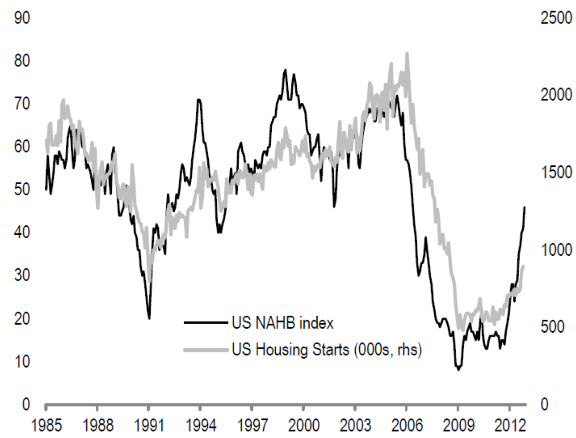
The Purchasing Manager's Indices (PMI) have been weakening since hitting a peak in January of 2011. The second half of 2012 has started to show a potential reversal in this trend. This measure is an indicator of the economic health of the manufacturing sector, based on five major indicators: new orders, inventory levels, production, supplier deliveries, and the employment environment. The current PMI for the largest areas in the world is greater than 50, representing expansion of the manufacturing sector.

Global Purchasing Manager's Indices



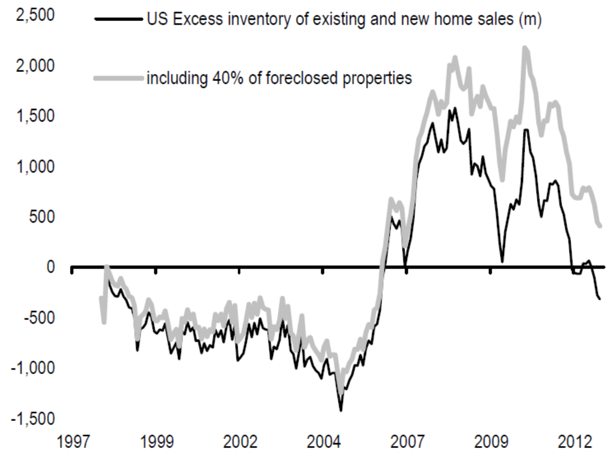
Source: Haver Analytics

US National Association of Home Builders index and US Housing Starts



Source: Thomson Reuters, Credit Suisse research.

US Excess Housing Inventory has fallen sharply

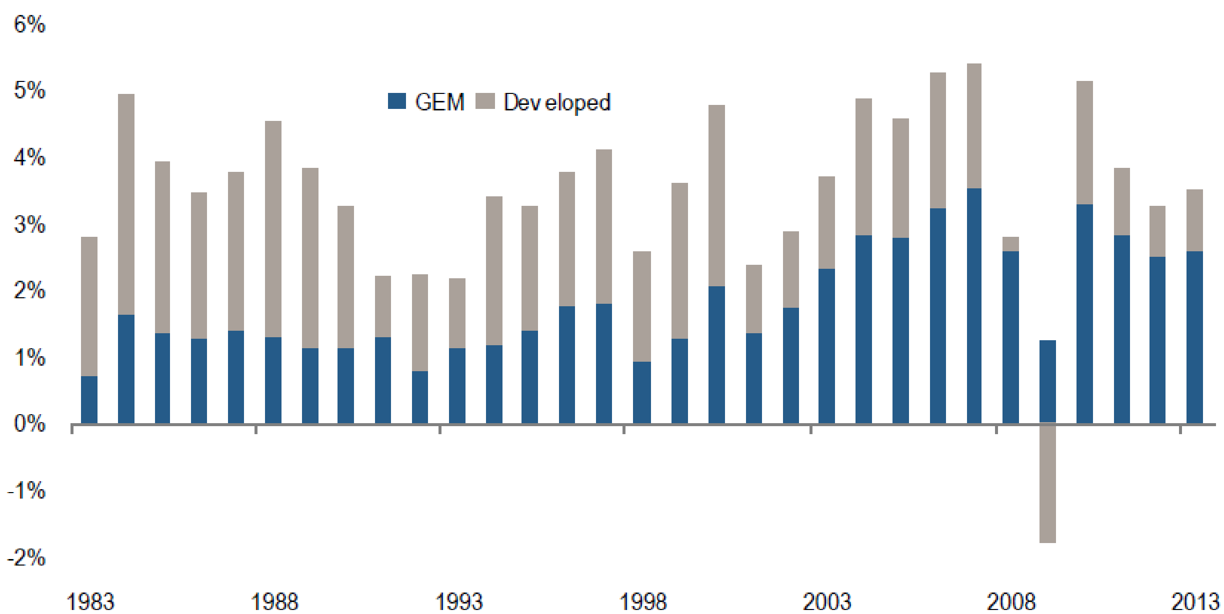


Source: Thomson Reuters, Credit Suisse research.

The housing market has improved substantially in the United States. Like the PMI, the housing market is a good leading indicator for equity prices.

Despite the economic meltdown in 2008, global growth has resumed at a similar pace to what it has been for the last few decades. The difference is that most of the growth is now coming from Global Emerging Markets (GEM) countries. Below, notice that GEM contributions to global growth are now at 80% of total. Emerging markets countries have far lower debt levels and significant populations that form a greater consumer base. One of the best places to buy emerging market growth is in shares of global companies listed on US stock exchanges.

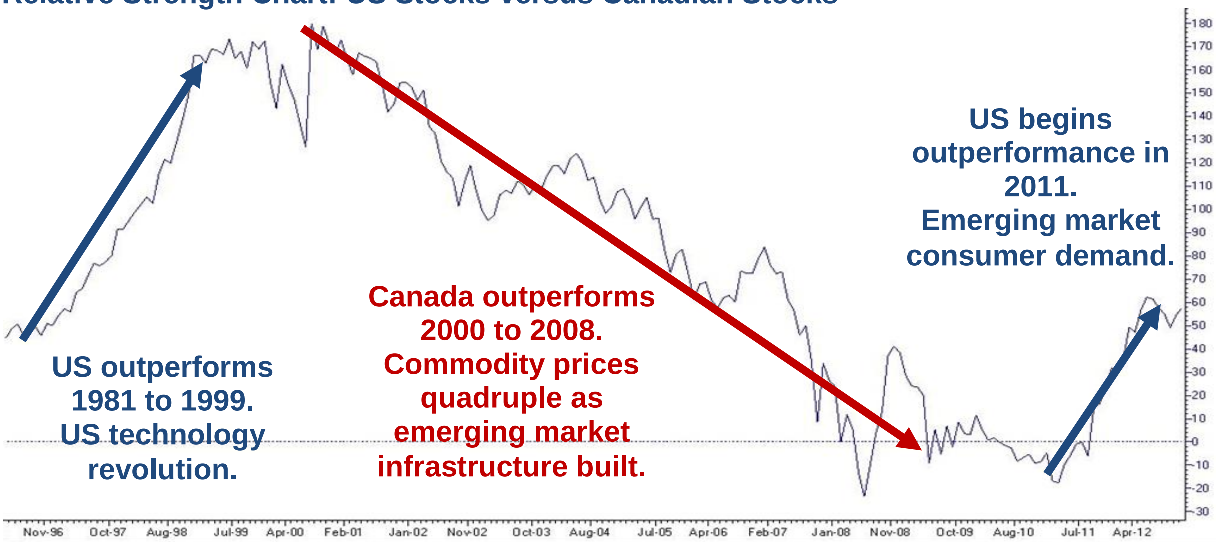
Global GDP Growth, with CS projections for 2013



Source: Thomson Reuters, Credit Suisse estimates.

2. Canada Underperforms Global Markets

Relative Strength Chart: US Stocks versus Canadian Stocks

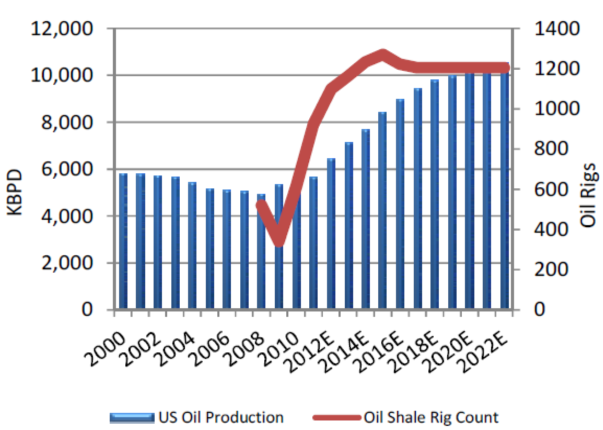


Source: Thomson One

Canadian markets were one of the best places to invest last decade during the commodity boom. Commodities may have a much harder time posting the same kind of gains going forward. China is now home to some of the most expensive real estate in the world, and the centrally controlled economy has slowed its pace of expansion and infrastructure spending. Canada's new trading partner, China presents somewhat weaker demand for raw materials.

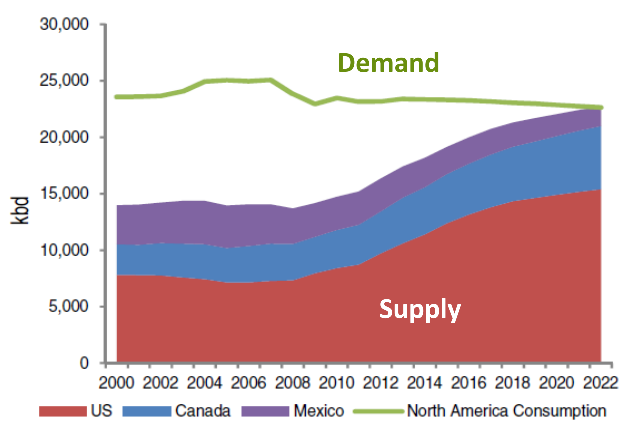
At the same time, our old trading partner, the US, is striving to become energy self-sufficient. This could potentially drive manufacturing costs lower in the US as commodity prices stay low, but stands to hurt Canadian energy exports to the US. The effect of technology allowing shale oil and shale gas recovery may nearly double US production over the next seven years.

US Oil Production Potential KBD



Source: EIA, Credit Suisse estimates, Baker Hughes, RigData, Smith Bits.

North America Liquids Independence



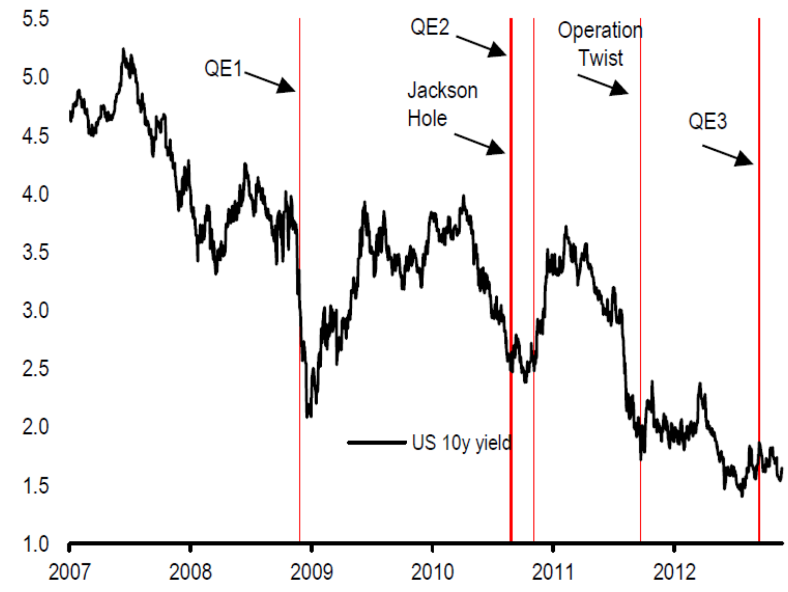
Source: EIA, BP, Credit Suisse estimates.

3. Bonds Underperform

Canadian 10 year bonds have followed a similar decline in yield as their American counterparts as shown in the graph on the right. In order to earn more than the current 1.6% yield, interest rates would have to fall even lower.

Previous rounds of quantitative easing have typically resulted in economic stimulation, inflation worries, and increases in 10 year yields. This makes investment in government bonds particularly risky at this point in time. As yields rise, bond prices fall – the longer the term to maturity of the bond, the more sensitive it is to interest rate changes.

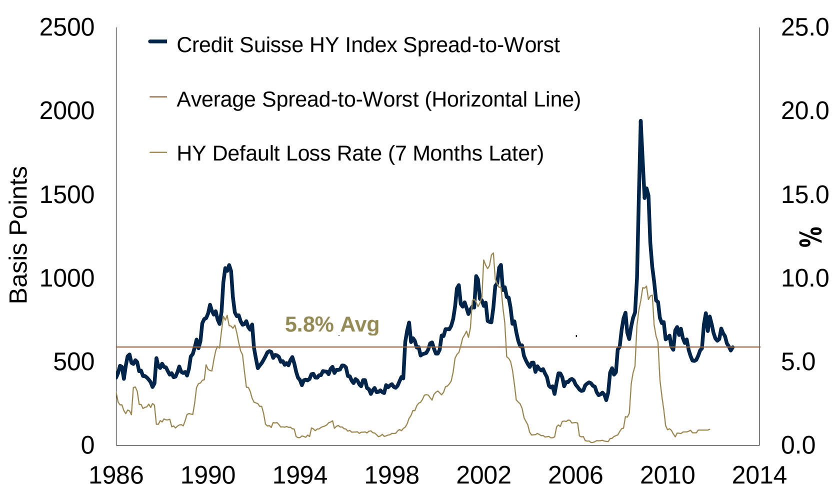
US 10 Year Treasury Yield



Source: Thomson Reuters, Credit Suisse research.

Government bond prices move inversely to interest movements. Corporate bonds are affected by interest rates, but are affected to a greater extent by changes in the credit and business quality of the underlying company. Should interest rates rise, it implies that inflation fears are likely present, often from a strengthening economy. Therefore, corporate bonds offer some protection from the potential of government interest rates rising: better business conditions often allow corporations to raise money less expensively (lower rates); and also corporate bonds pay a yield several percentage points higher than Canadian government bonds.

High Yield Bond Spread



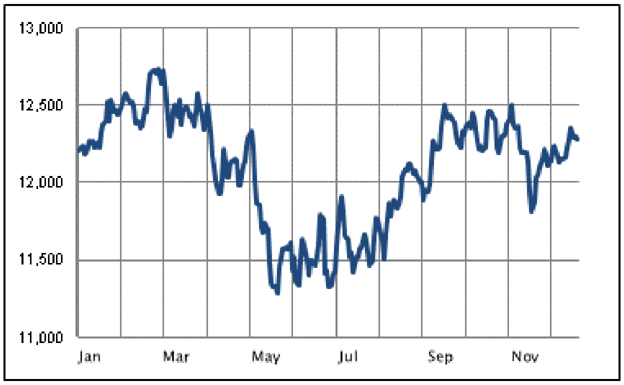
Source: Credit Suisse research.

Investment grade bonds currently pay roughly only 1% over government bonds depending heavily on the company and term.

Spread is the return above what US treasuries pay. Basis points are 100ths of a percent. High yield bonds are issued by corporations that do not have an investment grade rating. Currently, default rates are low in the high yield bond market while the spread earned above government rates is typical.

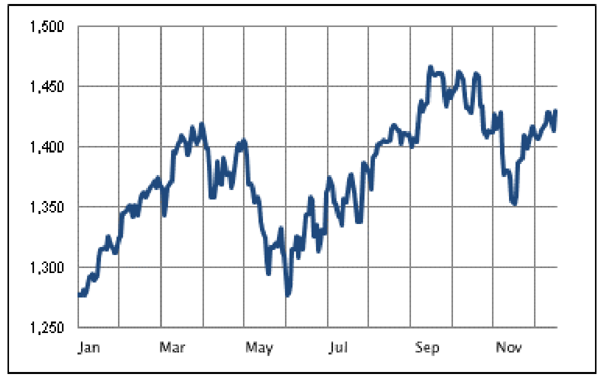
Market Snapshot

S&P/TSX Index (Canada) for 2012



Source: Thomson ONE

S&P 500 Index (U.S.) for 2012



Source: Thomson ONE

Managed Account Strategy

Fixed income is the base a good portfolio is built from. It significantly reduces the volatility of the portfolio and provides a steady flow of income. As investors reach retirement, stability in a portfolio becomes more important. A minimum level of fixed income should be set in a portfolio based on the investor's risk tolerance and consideration around matching investments to personal life objectives.

Managed portfolios are moving to a slightly underweight fixed income position. In particular, government bonds are being eliminated because of their low yields going forward and the risk that inflation causes them to decrease in price. Corporate bonds, convertible debentures, global bond funds, and preferred shares form the core of managed fixed income portfolios.

Equities are moving to a slightly overweight position.

Geographically, there has been significant addition of US stock positions, exchange traded funds in Germany, Belgium, Austria, and South Korea, and managed funds in emerging markets. Relative strength charts and fund flows are showing Canada with significant underperformance compared to many countries.

The Canadian stock market is comprised of primarily three things: banks, energy and mining companies. Managed portfolios hold very little in any of these three areas making the equity results more correlated to global markets than to Canadian ones. There remains a core of high-dividend Canadian telecom, media and food companies as well as a few specific dividend paying businesses to provide a more consistent level of income and less stock price variability. Consumer discretionary (especially clothing companies), technology, and health care stocks describe the current emphasis of companies in the portfolio.

There is an investment in a US real estate development in Washington DC, and for some investors a position in the asset backed commercial paper reformed by the Montreal Accord.

Managed accounts are discretionary accounts in which I can proactively make trades in a client's best interest based on a written Investment Policy Statement and an intimate understanding of their financial goals. Conflicts of interest from commission are eliminated since commissions are not charged on individual trades. Logistical difficulties in contacting clients and obtaining authority for changes they would likely want are eliminated and all parties gain time not spent on discussing small details of individual securities. Instead, time can be focused on wealth planning and discussing what the client feels is important and wants to discuss.

Business Development

I have two primary goals in 2013: Returns and Professionalism

Returns: I have invested in a computer-based quantitative modeling system from Morningstar that I have been using since my move to Richardson GMP. During 2013, I am hoping to combine some extensive work I have done studying the financial characteristics and price movements of stocks with my 18 years of experience managing money to produce good investment returns for my clients. By not being tied to a proprietary fixed income inventory and instead accessing most Canadian bond dealer inventories, I have already been able to make a significant difference in the average yield of client portfolios in the corporate bond market.

Professionalism: There are three tangible aspects that I hope our clients are able to see in the professionalism that we provide over 2013:

- Improvements in reporting. We intend to create custom year end reporting and are expecting a new software reporting package in the second half of 2013.
- Improvements in communication in the development of our website. We intend to develop video presentations, greater access to research and education for clients, and a better means of introducing the services we provide to prospective clients.
- Improvements in our organization and relationships with our clients. We have started Personal Reviews with clients to ensure that we understand their situation well, and are providing the planning and communication each client needs. Rita has primary responsibility for ensuring a positive client experience.

We also intend to hire another individual to help us with the large number of tasks we hope to complete this year, and allow me to focus on making money and reducing risks in client portfolios.

Business Changes

We wish you a Merry Christmas and all the best in the new year!

I appreciate the trust that each client has placed in us and strive to continue earning it.

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