

Asset Allocation	Q 2 2008	Q 3 2008
Can. Equity	15%	15%
Income Trusts	15%	10%
US Equity	20%	20%
Int'l Equity	10%	10%
Fixed Income	40%	45%

CANADIAN EQUITY:

Benchmark: S&P TSX Comp.
C\$ total returns to June 30th,
2008: 5.99%

INCOME TRUSTS:

Benchmark: S&P TSX Income
Trust TRI
C\$ total returns to June 30th,
2008: 24.5%

US EQUITY:

Benchmark: S&P 500
US\$ total returns to June 30th,
2008: **-11.9%**

INTERNATIONAL EQUITY:

Benchmark: EAFE (Net)
US\$ total return to June 30th,
2008: **-10.9%**

FIXED INCOME:

Broad Composite Index
C\$ returns to June 30th, 2008:
2.2%

We're half way through 2008 and the remedial market (a period of correction or adjustment of relative valuations) isn't done yet. In the first six months of 2008, a slowing US economy, rising energy prices and accelerating price inflation trumped the efforts of the US Federal Reserve and the Bush Stimulus Plan to keep capital markets from coming unglued. June produced the worst decline in the US stock market since 1930 and credit spreads on most *quality* fixed income securities blew past recent highs established during the Bear Stearns fiasco. Consequently, in balanced portfolios, portfolio protection was not forthcoming from corporate bonds or preferred shares. Matters seem to have been made worse by the "shoot first-ask questions later" fear mentality among Wall Street mavens as their own employment prospects dim and bonus and long term equity award hopes melt with each trading tick. Against this negative sentiment, we would make the following points:

- Fixed income investments, especially top investment grade bank preferred shares, at this time *offer unprecedented value*. For example, Royal Bank of Scotland preferred shares listed on the NYSE currently yield over 9% despite the fact that the bank recently increased its common equity by US\$12 billion --- i.e. thereby significantly improving its financial position. Similarly, the Royal Bank of Canada preferred shares currently yield 6%, which amounts to an 8%+ yield on a taxable account when the dividend tax credit is considered. Current yield spreads in excess of 300 to 500 basis points over the 10 year government bond yield are historically very high and are, in our view, not justified by the underlying risk and financial condition of most major global banks.
- Commodity prices, especially in the energy sector, seem to be affected by a tremendous inflow of funds into commodity indexes from pension plans, mutual funds and ETFs rather than by near term supply/demand considerations. Historically, commodity prices fall sharply during economic slowdowns and the current slowdown should be no different. When direct commodity investing is no longer rewarding, the commodity markets may have to deal with the exodus of funds from this asset class which could exaggerate the weakness on the downside. We also do not fully buy into the "Chindia" or "peak oil" theories: each story highlights important and fundamental economic truths, however the time frame for these changes is extended and the full impact is long term. In our view, the broad Canadian equity index and the C\$ --- both beneficiaries of the commodity cycle --- are therefore somewhat vulnerable. Canadian investments are better made in the context of a balanced portfolio to temper potential declines.
- Headline inflation is rising from higher gasoline and food prices but the inability of corporations to pass through price increases and maintain demand or for labour to extract higher wages and keep their jobs, means that current price inflation is more temporary than that experienced in the seventies. In our view, interest rates will reflect this reality and not rise to adversely affect investments, in particular long term bonds or preferred shares.

The bottom line: volatility remains high reflecting the underlying economic uncertainty. Valuations of stocks and other instruments are hard to follow week to week and a longer term view, such as ours, applied on a balanced and well diversified basis using quality investments, can provide rewards and protect invested assets.

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