REVIEW & COMMENTARY

4TH QUARTER 2003

Happy New Year

In some respects this year can't help but be happier than last. As we start out this year, we do not have the prospects of imminent military action and while the U.S. and Britain remain diligent in their pursuit of weapons of mass destruction, it would appear that the prospects for Iraq are improving. With this, our hope is that further stability will reach the Middle East. However, we are reminded all too regularly by what would appear to be the senseless loss of life and that the act of terrorism is no less a threat than ever before.

Until the latter part of last year, it was hard to keep the faith (that equity returns would once again prevail over others). Oil prices moved up strongly which has dampened the economic recovery in the U.S. But despite higher prices, it would appear that the economy is starting to show signs of sustainable growth. Our last commentary discussed the idea that, despite the common perception of a 'jobless recovery', we thought the job markets would improve. Indeed it has and as we gaze into the future, we certainly think that it will continue since the next step of the recovery will be improved corporate profits. This will lead to greater optimism and increased employment. Despite this and the ramifications for the economy, it is unlikely that 2003's equity returns will be easily replicated since the markets have already priced in a significant recovery. However, we do expect more historic levels of returns (8 to 12%) should be within minimal expectations barring any systemic shock to the capital markets.

Last year, we mentioned that the Presidential Election in the United States in 2004 should be a positive for the equity markets. Admittedly, we had not anticipated such a positive reaction but were comfortable that the stimulus package President Bush initiated would have teeth. And as the economy continues to improve, it would appear that his chances of winning a second term are improving. If this continues (and he does win), equity prices should trend higher because expectations will be that the fiscal initiatives that he put in place (tax cuts) will not likely be reversed. And lower future taxes make present income even more attractive. Add to this, the Bush administration's support of a weaker U.S. dollar and the U.S. economy will become even more competitive. A cheaper U.S. dollar makes U.S. goods more attractive to developing nations, so the cost of growth for many of these burgeoning economies will decrease providing increased global demand, which in turn, should sustain the upward trend in equities.

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Recent strength in resource and commodity prices has put Canada in a perfect position to prosper as well; the current strength in the Canadian dollar reflects these prospects. Demand for natural resources is increasing and Canada has lots of them. Gold, nickel and lots of oil make Canada a natural leader in the cyclical trends presently popular. Add to that less frosty relations with the U.S., a prime initiative of Prime Minister Paul Martin, and it is hard not to imagine increased economic prosperity regardless of the rising looney.

If we look at things that might cause concern in 2004, we might start with the price of oil. Prices in the low to mid 30's will have a drag affect on the economy making any sustained recovery tenuous. If prices do fall, the short-term effects will be outweighed by the long-term positives.

Another factor that concerns us is whether the torrid pace of growth in India, China and the Far East can be sustained. It has grown very quickly and along with this frenetic pace comes potential pitfalls. China, for example, has yet to develop a financial structure that can cope with such prosperity. Bad loans are escalating to the point where many banks' equity levels are questionable. The quality of infrastructure tends to suffer when economies expand so quickly and any disruption in these economies will send a chill through the capital markets. Of course, the ongoing threat of terrorism remains a concern, but life changed on September 11, 2001 forever. We just have to learn to accept it.

So our predictions are for a Happy 2004. Corporate profits should start to catch up with equity prices in the coming months. We can't imagine another year of stellar returns but would gladly accept them. We have managed to successfully weather bad markets over the past few years and look forward to better markets ahead.

Happy New Year and thank you all for your confidence and support.

Stodgell Investment Management Ltd.