REVIEW & COMMENTARY
1ST QUARTER 2011

Money, Money, Money

To date many of the investment predictions we had made for 2011 have come true, namely increased volatility, higher commodity prices, and bond prices that are having trouble keeping up with equities and cash returns. With the horrific devastation unleashed on Japan first from an earthquake and then a tsunami, markets were equally shaken and overwhelmed by a fearful tide of selling. Yet the indexes for the quarter in North America were positive. The resilience of the equity markets is compelling. Commodity prices, oil in particular, increased due to many factors, most notably the tension in countries in the Middle East and North Africa. Despite Bernanke`s assurance that inflation in the US is not a threat, bond prices have weakened; Canada`s long term bond returned -3.1% (US Long bond -1.8% in USD) while the TSX SP index posted 5.6% and the SP500 (USD) gained 3% for the quarter ending March 31, 2011. The Canadian dollar, as with the currencies of most resource based economies, remained strong relative to the US dollar. Looking forward, we see more of the same though we don't predict total equity returns will be exponentially stronger- in fact we would be comfortable predicting high single digits for the balance of the year.

In the next few quarters, we continue to see several major themes affecting the market. First, China, India and many other developing economies will continue to grow strongly. This will create a demand for goods and services that will continue for decades to come. Second, while the US economy has gained important traction, the issues Japan now faces assure that global monetary supplies will remain high. So even if Mr. Bernanke is able to withdraw the liquidity imposed by QE1 and QE2 on a timely basis, Japan`s monetary injections should maintain or possibly increase present global liquidity levels. While this will have some effect on inflationary expectations, interest rates will be lower for longer than we had thought at the end of last year. Thus, with ample liquidity, increased economic demand from emerging economies, further traction in the US recovery, and relatively low levels of interest rates, equities will continue to be an attractive alternative. Thus we see no reason for investors to become any more cautious on equities.

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With relatively low interest rates, recovering economies and the potential for a sustained uptick in demand from emerging economies, corporate leaders are faced with the dilemma of what to do with the hundreds of billions of dollars on their balance sheets and the responsibility of maintaining or increasing their competitive advantage. What are they doing? Buying companies! Corporate takeovers worldwide totalled 812 billion dollars- up 28% from a year ago according to a recent article in the LA Times. Interestingly, the number of deals is down meaning that deal size is increasing. Thus money supply is increasing and the number of companies is decreasing which again favours equity investors. If not acquiring or being acquired, corporations are increasing the returns to shareholders through higher dividends. Here in Canada, two more of the Canadian banks, namely TD Bank and Bank of Nova Scotia have joined National Bank in increasing their dividends in the first quarter. We anticipate the others will follow suit before year end. Dividend increases are not undertaken lightly and are an important indicator of managements' confidence in the future. The trend of Canadian corporations increasing dividends is not specific to the financial services industry. In Canada, within the past year a wide range of industry leaders- CN, Enbridge, BCE, TransCanada Corporation, for example have increased their payouts strongly suggesting that corporate boards see better times ahead.

While some studies have shown that takeovers are not always a positive indicator- many boards get overconfident toward market tops- but dividend increases are definitely a positive market indicator. Investor confidence is still lacking among many investors as the enormous amount of cash on the sidelines is showing only marginal declines. Pullbacks in the equity markets are being met with purchases from those underinvested over the past two years. While volatility will remain, we continue to believe that long term investors will be rewarded not only in higher prices but increased dividends.

Stodgell Investment Management Ltd.