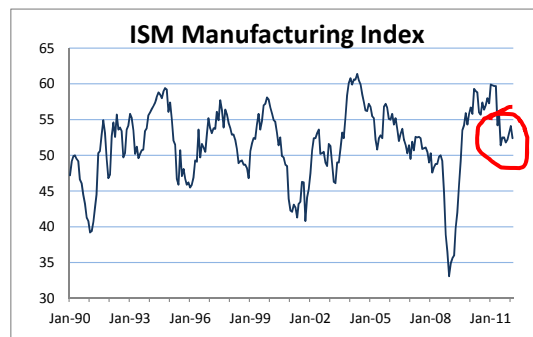
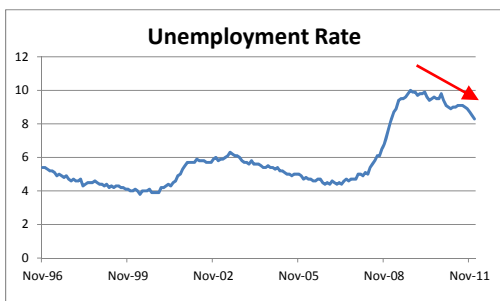


It has been a wonderful 4 months for stock markets: Toronto +14%; S&P 500 +24%; German DAX +32%; and UK FTSE +20%. There have been solid reasons for the improvement. The U.S. economy continues to show signs of growth; unemployment is lower, consumer sentiment is higher, and business (as measured by such things as the Institute for Supply Management and various Federal Reserve District surveys) is showing stronger results. Strong is only a relative term these days. In addition, on the political front, Europe appears to be finally acting, not just talking about dealing with an orderly default for Greece, and the European Central Bank's Long Term Refinancing Operations (LTRO) have stabilized credit conditions at least for the short term. It must be said that the current environment feels a lot better than the depths we reached last year when economic concerns and credit market turmoil were at their height. Nevertheless, we are cautious about the outlook for the remainder of the year.

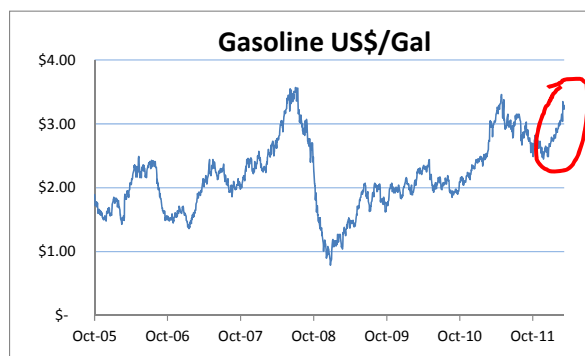


Recently there have been several tailwinds for world economics: the rebound from the Japanese tsunami; the relative cooling of tensions in Arab countries; mild winter weather; and reduced foreclosure activity in the U.S. Unfortunately, we cannot count on any of these being positive going forward. The weather is always mild in the spring; Syria and Iran could lead to new mid-east problems; and the banks settlement with states' attorneys general will allow for a renewed ramp-up in foreclosures. In addition, while U.S. unemployment and consumer confidence have been positive, they have not translated into improved consumer spending. Real consumption has been flat for three months. Also, we can't



ignore the recent increase in gasoline prices as a negative for consumer spending. These factors, as well as others, have caused many forecasters, including Citibank and Merrill Lynch to revise U.S. GDP in the second half to below 2%.

World economics are not providing any impetus to increased growth. Europe is generally regarded to be already in a recession, although presumed to be of the mild variety. China, as the leading emerging market economy, has been widely touted to be the engine for world economic growth. However, China's Premier has recently lowered the nation's growth target to 7.5% from 8%. It is not the number itself, but the message it sends about the direction of policy. The government wants improved quality not just growth for growth's sake, and at least suggests slightly less of a positive for other world economies. Canada, as a neighbor to the huge U.S. economy and an export and commodity dependent nation, cannot help but follow the lead of other world economies.



There is a flood of liquidity coming from government sources to prop up the private sector and the sovereign debt of weaker countries. The Fed has given us QE 1&2 and Operation Twist, the European Central Bank LTRO 1&2, and almost every other central bank has lowered interest rates and/or made market purchases to provide liquidity. In theory this liquidity would be channeled into financing productive growth assets. But here's the rub, this liquidity is in fact being hoarded by banks and corporations out of fear, or is being used to purchase paper assets such as stocks and bonds. In our opinion this excess money in the system has been a major factor in the strength of financial markets. "Don't fight the Fed"

has never been more true, and barring tail risk events such as defaults, wars or economic calamity, should continue to provide for positive markets in the near term.

Almost 200 years ago U.S. President James Madison summarized the situation at the time as follows: *"The circulation of confidence is better than the circulation of money"*. It still holds true today; money is not the problem, it's confidence we need. Only real economic growth will provide that confidence.