

BILL WEBB'S PORTFOLIO COMMENTARY

April 13, 2009

I wrote last quarter that I did not think 2009 would be an “easy” year for investors, as I expected volatility to remain high and the signs of stabilization and recovery to be both mixed and slow in coming. My suspicions have been confirmed by the continuing extraordinary volatility we saw in the capital markets last quarter. I expect this to be the norm for some time.

The first quarter of 2009 can be summed up as follows: In the face of weak corporate earnings, gloomy economic reports and disappointment over the lack of detail in the U.S. government's various plans to address the financial crisis, the equity markets sold off by between 15% and 20% as of the second week of March. The markets then rallied sharply, due in large part to a healthy amount of short-covering, some prominent merger and acquisition activity and a few economic statistics that were weak, but not as catastrophic as had been feared. By the end of March, the Canadian equity markets were down 2.0%, while the U.S. market was off 7.8% (in Canadian dollars). These numbers masked the wild ride over the quarter.

This heightened volatility is likely to persist until the global battle is decided between the deflationary forces of recession, overcapacity and a dysfunctional banking system, on the one hand, and the unprecedented monetary and fiscal stimulus efforts being made by all major governments on the other. No one knows how or when this struggle will be resolved. The forces on both sides are unlike anything we have seen before and simple analogies to either the Great Depression or Japan's “lost decade” miss many of the significant differences. My view is that we may now be entering a “secular sideways market” (at least for many of the equity markets in the developed economies). I can imagine an environment where the broad equity markets generally move “sideways”, but within broad trading ranges of 30% to 40% or more.

This is not an easy environment to invest in, but I do believe that we are well positioned to deal with such an environment, if it plays out this way. In our various “long-only” equity portfolios, we have been carrying higher than normal cash positions. These made the portfolios more defensive during the most recent market sell-off, but also provided us with “dry powder” to selectively invest in a number of securities that were unduly punished during the quarter. We will continue to have “dry powder” in our portfolios, and we are not trying to “call the bottom”. But we will not be afraid to take advantage of opportunities if we believe that the risk-reward characteristics of particular businesses and securities are attractive. We will also take profits and reduce positions when individual stocks have strong rallies and the risk-reward tradeoff becomes less attractive. For example, some of our larger positions, like RuggedCom and American Italian Pasta Co., rallied to 52-week highs during the quarter, and although we continue to hold significant stakes in these companies, we realized some profits. Believe me, in this type of market, these types of stocks are not easy to find, but that is what our team of analysts and portfolio managers spend their days doing — finding, researching and investing in such securities.

Our Alternative Multi-Strategy Funds performed admirably during this volatile quarter and are a crucial part of our investment offerings. Within these funds we have strategies that allow us to short securities that we feel are overvalued, in order to profit from anticipated price declines. These funds provide us with very important risk management tools and are well-suited for this kind of difficult market environment. Our investment team members contribute ideas on both the “long side” and “short side” of these portfolios. As a result, there is little wasted effort in our research activities.

The recent launch of our fixed income and credit arbitrage funds demonstrates our continuing commitment to having a wider range of attractive and appropriate investment strategies for these dynamic times. Our new colleagues, Mark Wisniewski and Dean Smith, have hit the ground running since joining us late last year. They have been a great addition to our team and to our capabilities as a Firm. I am particularly pleased by the high level of interaction and sharing of ideas and analyses between our analysts and portfolio managers (who have traditionally focused only on equities), and Mark and Dean.

My conclusion is the following: In Canada, we are now significant managers of three important asset classes: equities (across a variety of geographies and styles), alternative asset strategies, and fixed-income/credit arbitrage. We won't stop there, but the major tools are in place. Our clients will be the biggest beneficiaries of this.

Finally, let me say a word about our soon-to-be new colleague, David Rosenberg, who will join us in May. I've known David for about a decade and a number of my colleagues have worked with him in the past at other firms. All of the members of our investment team are admirers of David's work and are thrilled that he will be joining us. David has a unique ability to marry his understanding of the economy with the twists and turns of the capital markets. There could be no better time than now to be adding him to our team. The economic challenges and difficult capital market conditions make it extremely important to understand the economic environment that our investee companies must operate within. David's insights and analyses of the relative attractiveness of different asset classes, geographies and sectors will be invaluable in everything from helping the members of our investment team as they think about different industries, countries, and asset classes, to enhancing the work of our Asset Mix Committee. In short, I think that marrying the “big picture” with the “little picture” will result in a “clearer picture” and, consequently, better investment results.