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Happy New Year !

We wish you all the very best for 2010. Heading into a new year is typically a good time to reflect on the big picture & to look ahead, which is exactly what we have done in this issue.

**A Quick Recap of 2009**

Although global markets were falling into the abyss a year ago, we adopted a glass-half-full strategy for 2009 as we felt markets were pricing apocalyptic scenarios. The worst of the global recession came in the first quarter of 2009 and economic activity has been improving since then. Equity markets staged an impressive rally in the second half of 2009 with year-end tallies ranging between 26% (S&P 500) and 77% (EM). 2009 was a horrible year for the global economy, but equity markets managed to post solid performances, further illustrating the way markets feed off anticipation, not what is written in the daily newspapers. As far as we are concerned, the 2009 cyclical recovery has been highly similar to other post-recession rebounds, in terms of both timing and leadership. The magnitude of the rebound, not the sequence, has been historic.



## Canadian Banks & Diversified Financials

### *Long-Term Outperformance – Near-Term Regulatory Risk*

The Global Banking Siege pounded Canadian bank stocks in the earlier part of 2009, driven by the hysteria of a global financial collapse and the market's buy-in on the concept that Canadian banks had extremely high valuations and were extremely highly leveraged, even against global peers, and that dividend cuts were inevitable.

However, as fear of a financial collapse moderated and systemic risk declined, investors refocused on Canadian banks' balance sheet strength and earnings power and thus returned to the longer-term valuation measure of P/E multiples with a focus on the importance of earnings power and stability.

Canadian bank stocks responded to this market shift, recording their strongest rally in history, doubling off the late February lows. Bank absolute share price performance in 2009 generated a total return of 59%, the second-best year in history next to 1968; post the 1967 Bank Act, which removed the interest rate ceiling. Bank stocks' relative performance in 2009 was 26%, the fourth-best in history.

Bank share valuations have moved to reflect the strong fundamentals and high-return business models that generate superior long-term returns. However, we are currently in a share price consolidation phase before valuations move substantially higher.

The arguments for the consolidation phase are the magnitude of bank share appreciation, relative outperformance, uncertainties with respect to strength of the recovery (low growth), and, more importantly, the uncertainty with respect to the operating and financial constraints that the regulator is likely to place on the banking industry. We believe that regulators will overreact and require excessive deleveraging in the near to medium term before adopting a more balanced approach to capital. The bigger the capital cushion, the less effective or efficient the regulators need to be.



## Gold and Its Principle Drivers

### *Reaching for the Top*

We are now in a different phase of the recession as economists start to talk of recovery being in the works. We believe the following key drivers, and thus the main risks to our outlook, will be important with respect to the gold price over the next year:

- The continued deterioration of the U.S. dollar.
- The threat of inflation impacting the gold price in what is typically the last and largest leg of the cycle.
- The lack of mine supply growth due to a lack of exploration discovery and continued increase in official sector and investment demand.

Other risks to our equities outlook include technical risks, multiple contraction and expansion, and Geo-political risks.

#### *THE ROLE OF THE U.S. DOLLAR ON PRECIOUS METAL PRICE DRIVING*

Currencies are perhaps the most volatile of all globally traded entities and gold fits into this asset class because of its more than 2,000-year history as a currency and because of its close correlation with the U.S. dollar. We believe that in the first half to three quarters of 2010, the direction of the U.S. dollar will be the key driver of the gold price and, in turn, the silver price. Although the correlation is not always a nice tight inverse correlation, in general it has been that way for the past five years and has shown a very strong correlation for the past six months.

We believe the U.S. dollar will continue to be weak over its competitor currencies over the next year. The past six months have shown a very similar correlation between gold and the U.S. dollar as that seen since the start of this cycle in 2001. Factors that we believe will impact the direction of the U.S. dollar vary from the speed of the U.S. economic recovery to the impact of recovery in the European market and the sovereign risk that comes out of Europe, such as the recent issues in Greece and the debt downgrades it has been given.

## Energy

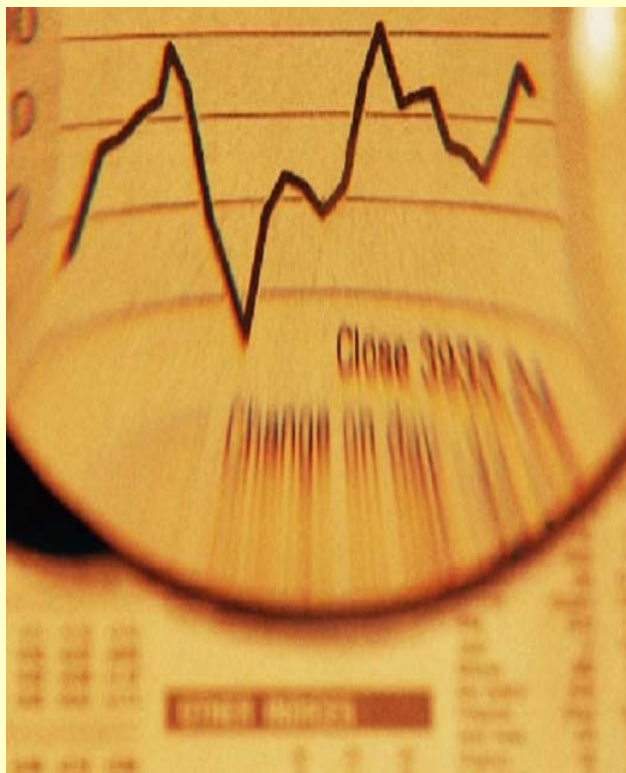
### *2010 Likely Better than 2009 vs. TSX & Market Weight*

In Q4/09, the S&P/TSX Utilities Index rose 11%, finally outperforming the red-hot TSX Composite at only 1%. Why did the S&P/TSX Utilities Index outperform the TSX in Q4/09 and why is it likely to continue outperforming for the 2010 RRSP season?

Typical late-year defensive market rally: Some investors move towards low-beta defensive names late in the year to cash in on their strong gainers in other higher-beta areas to soak up capital losses, or to book gains when wary of a potential correction.

Intra-dividend yield funds flow from Canadian banks and insurance companies (e.g., Manulife, which cut its dividend) as well as income funds that are slashing their distributions has been a fresh source of funds for monopoly-based Energy Infrastructure stocks lately.

Strong relative yields: Energy Infrastructure dividend yields look attractive versus negligible risk-free rates now being offered on multi-year GICs that are rolling over to 0.5%-1% from 3%-4%.





## China's Outlook

### *Near – Term Seasonality: Harsh Winter & Holiday Season*

As we start the year 2010, China is right in the heart of the harsh winter season in the northern provinces as well as the holiday season, with the Spring Festival starting February 14. China's construction and manufacturing activities tend to visibly slow down in January and February, as millions of migrating farmers head for their rural homes for their annual family reunion.

We note that the raw materials sectors have rallied hard since last March without any serious pullback. If any deep pullback in the raw materials sectors were to happen in the next few months, we believe it would most likely happen sometime in January-February 2010. This is because as construction activities experience a seasonal slowdown, the "mini de-stocking cycle" for most commodities, especially for base metals, will likely last until the end of February. During this period, slower Chinese imports, together with sluggish local demand, could dampen investors' sentiment after 2009's huge rally in the raw materials sectors and trigger some profit taking.

### Quotes for Thought

Success is getting what you want. Happiness is wanting what you get.  
*-Dale Carnegie*

In the business world, the rearview mirror is always clearer than the windshield.  
*-Warren Buffett*

If GM had kept up with technology like the computer industry has, we would all be driving \$25 cars that got 1,000 MPG.  
*-Bill Gates*

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