

Investor fear due to European sovereign debt problems and slowing economic measures, such as GDP, ISM purchasing managers indices and declining leading indicators, resulted in an equity market pullback during the quarter. The table below summarizes market performance as of June 30th, 2010 in Canadian dollar terms.

Market Indices (\$Cdn)	Year 2009	YTD 2010	Q2 2010
TSX (Canadian market)	31 %	-4 %	-6 %
S&P 500 (US market)	6 %	-6 %	-8 %
Nasdaq (mainly tech.)	23 %	-6 %	-8 %
MSCI World	12 %	-8 %	-9 %
MSCI EAFE (Int'l)	13 %	-12 %	-10 %
iShares Cdn Short Bond	4.3 %	2 %	1.6 %
US\$ relative to Cdn\$	-16 %	1 %	4 %

Because of the defensive stance taken, the YTD (year-to-date) growth and conservative growth portfolio composites had approximately a one percent loss, relatively better than the negative performance of the equity markets shown in the above table.

Portfolio Activity

Recognizing the weakness in equity markets we added convertible debentures to portfolios rather than the underlying equities. We added more shares of **Innergex CV 5.75% 30Apr17** which was described in last quarter's Portfolio Review. Prior issues of Portfolio Review are available on our website www.youfirstfinancial.com.

We have held units of Artis Reit in portfolios for a few years now and recently purchased the **Artis REIT CV 6% 30Jun20** convertible debenture. Artis is an unincorporated open-end real estate investment trust headquartered in Manitoba. It focuses exclusively on commercial properties; retail, office and industrial, with strong tenancies in place. The REIT's primary objectives are:

- to provide unitholders with stable and growing cash distributions, payable monthly
- to defer tax, from investments in a diversified portfolio of income-producing office, retail and industrial properties located in western Canada
- to enhance the value of the REIT's assets and maximize long term unit value through the active management of its assets and
- to expand the REIT's asset base and increase its distributable income through acquisitions in western Canada.

The **Artis REIT CV 6% 30Jun20** convertible debenture pays 6% interest annually and matures in 2020.

In some cases issuers of convertible debentures can make their interest payments by issuing shares of the underlying equity. **First Capital Realty (FCR – TSX)** has recently started making their interest payments in this manner so many accounts will hold a small number of FCR shares that will increase with each interest payment. Because of this possibility, it is important to buy convertible debentures where you are comfortable holding the company's equity. FCR is considered low risk since it owns shopping mall real estate with strong anchor tenants.

Towards the end of the quarter, we introduced **Telefonica S.A. ADR (TEF – NYSE)** to accounts that lacked telecommunications exposure. Telefonica, S.A., headquartered in Spain, provides a range of telecommunications services (telephone, mobile, Internet, data, and entertainment) in Spain, Portugal, a number of Latin American countries, and has been expanding its services in the rest of Europe. For the year ended 2009, net sales and rendering of services in Spain accounted for 35% of Telefonica's consolidated sales, Latin America comprised 41% and the rest of Europe accounted for 24%. Telefonica looks attractive at this point because its price has declined in sympathy with the overall European equity markets, the Euro is at the low end of its trading range relative to the dollar and the fundamentals look strong. It consistently increases its dividend, yields 8%, trades at a forward P/E of 8 and has very strong FCF (free cash flow), typical of the telecom industry.

Outlook

One of the macro themes for the rest of 2010 will be a relatively strong corporate sector, characterized by strong balance sheets, rising profits and increased capital spending. This will be offset by a weak housing market, consumer spending, employment and fiscal retrenchment. To support the economy, particularly in the US, *a continuation of the low interest policy is assured.*

This recession was not triggered by a policy response to overheating as is the case in a typical recession, but by a burst credit and asset bubble. Consequently, economic expansion depends on much more than interest rate adjustments. Monetization of vast amounts of debt is well underway but the great risk is how effective the central banks and

policymakers will be in reflating sick economies. As Japan can testify, central bank reflation and zero interest rates don't necessarily create a sustainable recovery. Despite the concerted effort of central banks to reflate their economies, *deflation remains a greater risk than inflation for the foreseeable future.*

The counter balance to the deflationary threat is the influence that high-growth emerging countries (i.e. Brazil, China and India) will have on the integrated global economy. There may have been a large debt problem this time, but there is also the emerging market growth engine this time. The bottom line is that this is an untested economic environment with a highly uncertain outcome. Suffice to say, *the recovery is intact, but will remain tepid.*

The correction we were expecting finally occurred this past quarter. The size of the correction was relatively modest so we only increased the equity portion of portfolios slightly. Given a slower economy and the deflation threat, we have kept our equity exposure at less than 60%.

RESP Reminder

If you have not yet made your 2010 RESP contribution for children 17 years and under this is a good time to invest up to \$2,500 per child and receive the 20% government grant. This year's deadline for RESP contributions is December 31st, 2010.

Proof of enrolment from post secondary institutions is required to withdraw funds from a RESP. This includes a receipt of payment letter or timetable on school letterhead with student name, address and enrolment confirmation for the 2010 – 2011 school year. We will prepare the EAP form that accompanies the proof of enrolment as requested.

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