Portfolio Review – Q4 2011

Note: For clients with non-registered accounts there is important **Income Tax** information enclosed.

Other reminders:

- The **RRSP** contribution deadline for 2011 tax returns is February 29th, 2012.
- **TFSA** – maximum contribution for 2012 is $5,000.
- March 31st, 2012 is the deadline for applying for the new **Ontario Tuition 30% Rebate**, for families earning less than $160,000.

The fourth quarter offered some relief for the equity markets although volatility remained high. European sovereign debt, a slowing global economy and the Chinese economic soft versus hard landing debate dominated the headlines. The Canadian market suffered due to the correction in commodities which represent approximately half of the TSX. The following table is a summary of market performance as of December 31st, 2011 in Canadian dollar terms.

Market Indices ($Cdn)	Year 2010	Year 2011	Q4 2011
TSX (Canadian market)	14 %	-11 %	3 %
S&P 500 (US market)	7 %	2 ½ %	8 %
Nasdaq (mainly tech.)	11 %	1 %	5 %
MSCI World	7 %	-3 %	5 %
MSCI EAFE (Int'l)	3 %	-10 %	½ %
iShares Cdn Short Bond	3 %	4.4 %	0.4 %
US$ relative to Cdn$	-5 %	2 ½ %	-3 %

For the full-year 2011, the YouFirst "Growth" and "Conservative Growth" portfolio composites outperformed the negative 1.7% return of the FPX Growth index benchmark by 0.3% and 1.5%, respectively. The FPX Growth index is a passive balanced benchmark, listed in the National Post, consisting of: 5% T-Bill, 25% fixed income and 70% equity (35% TSX, 15% S&P 500, 20% International).

Some of the securities mentioned will not necessarily be included in all portfolios due to the different risk profiles of our clients.

Portfolio Activity

During the quarter we added preferred shares to portfolios, even for registered accounts, because the yield on the preferreds was 1 – 2% higher than a corresponding bond. Preferred shares added were **Brookfield Office Properties** (BPO.PR.R – TSX) yielding 5.1% to redemption, **Bell Aliant** (BAF.PR.A – TSX) yielding about 4.7%, **Riocan REIT** (REI.PR.A – TSX) yielding more than 5% and two new issues, **Bell Aliant** (BAF.PR.C – TSX) yielding 4.55% and **Riocan REIT** (REI.PR.C – TSX) yielding 4.7%. All of these preferred shares offer inflation protection via an interest rate reset in 5 years, providing a yield spread premium ranging from 2 to 3½ percent higher than the 5-year Canada bond yield.

During the quarter, when sentiment towards US banks eroded, we added **Morgan Stanley** 4.5% 23Feb12 and **Merrill Lynch** (Bank of America) 5% 18Feb14 short-term bonds to portfolios. Both offered yields-to-maturity of more than 4.5%. We felt that these banks are relatively secure since they fit into the "financial institution too-big-to-fail" category.

MasterCard (MA – NYSE) was replaced by **Visa** (V – NYSE) in growth oriented accounts and sold in more conservative portfolios in order to purchase higher yielding securities. Visa recently became more attractive, boosting its dividend by 47%. Its yield now approaches 1%.

Thomson Reuters (TRI – TSX) has been a laggard due to the difficulties experienced by its major customers, the financial industry, so its holding within portfolios was reduced by about one-half. **CVS Caremark** (CVS – NYSE), a US based pharmacy chain, that held up well throughout the 2008 – 2011 downturn, was sold in anticipation of buying a consumer products company that has exposure to the emerging market middle-class and, therefore, greater growth potential.

To reduce specific security risk, for the remaining portfolios that held both Artis REIT units and **Artis REIT-F** CV 6% 30Jun20 convertible debentures, the convertibles were sold.

To offset capital gains at year-end some **Manulife** (MFC – TSX) shares and all of the **Paladin Energy** (PDN – TSX) holdings were sold. Paladin, a uranium miner, had suffered ever since the Japanese Fukushima tsunami disaster changed investor sentiment towards anything related to the nuclear industry.

Outlook

As headlines report that global uncertainty abounds, some extreme conditions are apparent in segments of the marketplace. These, along with their implications for investors and consumers, are outlined in the table on page 2.

Website: www.youfirstfinancial.com
Email: jgarner@youfirstfinancial.com
Tel: (416) 229-1251
Fax: (416) 229-1252

Extreme Condition	Implications
People, investors are fearful	• Fear of a slower economy causes people to retrench which slows the economy further. • Corporations curtail hiring and expansion projects.
Baby boomers are retiring	• Those unable to retire, take on part-time employment. • An employee and skills shortage occurs. • A shift from growth securities to income generating securities evolves.
Low short-term interest rates, inflation supposedly benign	• It is better to be a borrower than a lender. Banks' interest rate spreads are challenged (i.e. the interest rate difference between where the bank lends money versus the interest rate they pay on deposits is narrowing). • Home ownership, mortgage levels and house prices become extended. • Investors chase high-yielding securities such as utilities, pipelines, REITs (real estate investment trusts) and lower quality bonds. • Corporations that do not need to borrow, issue bonds to take advantage of low rates. • Corporations with long-term liabilities such as insurance companies have a difficult time because they cannot earn a sufficient return on their investment portfolio to meet their longer-term obligations.
Personal debt levels are high	• Consumers eventually reduce spending and increase savings.
Government debt levels are extremely high in some developed economies	• Sovereign bond yields climb to unsustainable levels (i.e. Italy > 7%) as buyers/investors lose confidence that their money will be returned. • Governments such as Greece, Ireland, Italy, Portugal and Spain implement severe austerity programs and raise taxes. • The US government's hiatus from dealing with their high debt problem will hopefully end after the November presidential election.
Corporations cash balances are high	• The likelihood of corporate bankruptcy is reduced even if the economy suffers through a recession. • When confidence returns and the economy improves, companies have the cash to invest in capital projects.
Very low natural gas prices	• The abundance of natural gas discovered in shale formations will instigate a switch to natural gas from other energy sources such as coal, oil and electricity. • LNG (liquid natural gas) plants are being built to export natural gas from North America.

Recognizing these implications we will curtail additions to our utility, pipeline or REIT holdings. Adding to energy companies that produce natural gas is a future opportunity once the decline in natural gas prices abates. In the short to medium term the US dollar remains the world's reserve currency, thus it is a safer bet than the alternatives (i.e. Euro). We continue to be on the lookout for attractively valued high-quality dividend growing stocks since a good portion of a stock's expected return, in a slow growth environment, will inevitably be from income.

Despite the headwinds, there are some positive indicators, as we head into 2012. These are the moderate valuations now in place in our market, the better US economic fundamentals, the remedial steps being taken in Europe, and the hope that constructive efforts will take hold in Washington, even during an election year.

If you have any questions or comments regarding items discussed in this newsletter please contact us.

Doug Garner, P.Eng., CFA
President, Portfolio Manager
Jane Garner, BA, EPC
Vice-President