Leon Frazer & Associates
INVESTMENT COUNSEL

experience counts...
managing private clients' money for 70 years

SEPTEMBER 2009

LEON FRAZER QUARTERLY REVIEW

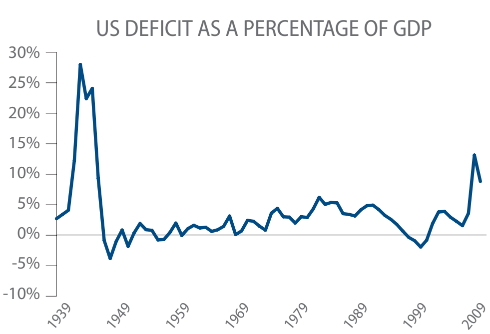
Equity Market Commentary: Economy Shows Welcome Signs of Recovery

EXCEPT FOR BRIEF RETRACEMENTS in late June and early July, equity markets have shown continued strength since early March. Financials and Materials led the advance, driving the TSX composite up 10.6% in the third quarter of 2009.

SOURCES OF STRENGTH NOW EVIDENT

Last quarter we stated we were becoming more optimistic about the economy in general. As the quarter unfolded, we maintained our optimism. We see indications that the worst of the economic problems are behind us and the recession may be over. Fiscal stimulus provided much needed support and governments worldwide need to be applauded for their coordinated action. The next question is: *What will the recovery look like?*

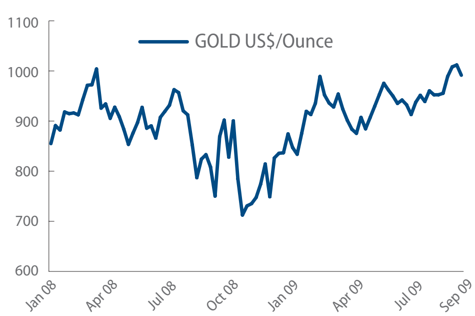
The economy is currently showing some sources of strength. The first is from fiscal stimulus, which includes new homebuyers and cash for clunker programs. We must remember, however, these are temporary programs and each has future implications, including borrowing from future sales and increased national debt. The second source of strength is the rebuilding of inventories. During the worst of the downturn, orders virtually ceased. Now that a number of months have elapsed, inventories have been worked down to the bare minimum. We now see signs these inventory levels are being rebuilt and this has positively affected several economic indicators. We do, however, expect inventory rebuilding and fiscal stimulus will run their course. Without another fiscal stimulus package or significantly elevated consumer spending, there is potential for some economic weakness in mid 2010, but we are confident the worst is over.



Source: usgovernmentspending.com

CASH ON HAND ALLOWS US TO TAKE ADVANTAGE OF OPPORTUNITIES

Taking advantage of this economic improvement, we have chosen to put some cash from the portfolios back to work. Interest rates on cash remain extremely low and desirable yields on dividend-paying stocks have allowed us to increase income to portfolios by reducing cash. There remain some concerns about a fall correction. If that occurs, we still have cash on hand to benefit from the opportunity.



Source: Thomson Reuters

The Canadian banks continue to exhibit best in class characteristics. Relative to international peers, writedowns are controlled, capital levels are strong and only six months after concerns about dividend cuts peaked, there is again talk of potential dividend increases.

The US dollar continued to weaken in the quarter and the debate about its role as a reserve currency intensifies with its weakness. We have been well served by our gold position in the portfolios as gold bullion broke through US$1,000 per ounce. Unfortunately, it has not been able to maintain upside momentum.

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Economy Shows Welcome Signs of Recovery

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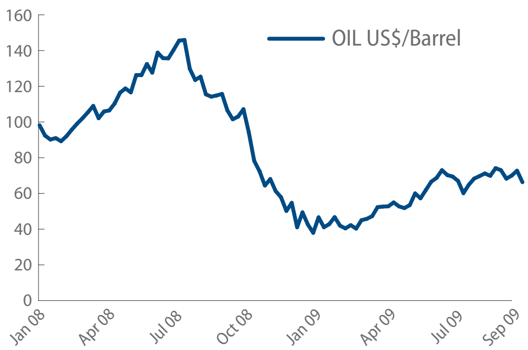
"Taking advantage of this economic improvement, we have chosen to put some cash from the portfolios back to work"

Recent earnings for energy companies have been weak compared to last year when crude oil prices were at record levels. However, after recovering from lows of around US$40 in the first quarter of 2009, crude oil prices have been in a range of US$60-70 during the quarter, well above levels needed to provide good returns to energy companies. Natural gas has been weak since last summer, as amounts in storage continued to increase. With signs of economic improvement, however, the commodity has bounced back somewhat from lows that date back to 2002.



Source: Thomson Reuters

INFLATION STILL NOT AN IMMEDIATE CONCERN

As discussed last quarter, inflation is not a direct concern. Signs of inflation have yet to appear, but future inflation is the most likely result of current aggressive monetary and fiscal stimulus. We have increased the income level in portfolios by using low yielding cash to purchase companies that pay increasing dividends. As a result, we continue to build portfolios that will provide our clients with the lifestyle they want in the future, from the savings they have accumulated today. ■

Fixed Income Commentary

"Our objective in managing fixed income holdings is to provide a stable income stream, while protecting the portfolio's capital value"

Investor confidence in an economic recovery continued to grow over the quarter. Still, many investors remain shaken from last year's sudden and steep decline in the equity market, as well as the quick rebound. Central banks have indicated interest rates will be left at the current low levels for some time to sustain recovery when the fiscal stimulus programs end. The combination of these factors has led to a huge increase in demand for corporate fixed income securities, as investors seek to increase their income levels but are nervous about equity markets. The result is a trend towards tighter credit spreads.

Government bond yields in Canada and the US rose initially, as governments increased their borrowing levels to fund the large stimulus programs, and fears arose that foreign investors would shy away from the large government debt load and the weakening US dollar. The increased debt issuance was well absorbed by both the US and Canadian markets, causing government bond yields to drop, netting a slight decline over the quarter.

Our objective in managing fixed income holdings is to provide a stable income stream, while protecting the portfolio's capital value. To achieve this goal, we invest in high-quality fixed income securities with a relatively short time horizon (generally around 5 years). For non-taxable accounts, bonds are the main fixed income investment. For taxable accounts we also purchase preferred shares. Many of our clients have a relatively small percentage of their portfolios in fixed income. For these clients, we have introduced the Jov Bond Fund and the Jov Leon Frazer Preferred Equity Fund which provide greater diversification and liquidity than individual securities.

Given the low level of government bond yields and the large corporate yield spreads which have existed since the credit crisis began in 2008, our focus is on corporate rather than government bonds. Our clients have benefitted as credit spreads have narrowed significantly, producing a moderate capital gain in addition to the ongoing income. Reduced concerns about corporate credit have allowed preferred shares to produce an even larger capital gain than bonds. While we do not expect a repeat of the recent large increase in value of corporate bonds and preferred shares, we will continue to take advantage of current attractive income levels. ■

Experience Counts

Managing Private Clients' Money for 70 years

Spotlight: Happy 70th Birthday, Leon Frazer!

On September 1, 1939, when the late Leon Frazer established Leon Frazer & Associates, the Great Depression had just ended and the Second World War was just beginning. As the firm prepared to welcome its first clients, German tanks rolled into Poland and most Canadians were preoccupied with going to war. Yet Leon was unfazed, feeling the time was right to begin building a firm that offered value to investors. Leon believed that ownership of assets was the only way to preserve the buying power of savings over time. If the Allies lost the war, our currency would be worthless. Leon realized, however, he could preserve the savings of his clients by investing in Canadian companies, products, real estate and machinery; assets of universal value. This same belief continues to be nurtured by Leon Frazer & Associates to this very day.

The history of Leon Frazer & Associates is unparalleled in the Canadian investment management industry. As the oldest independent investment counseling firm in Ontario and the second oldest in Canada, the firm has grown over the decades without ever deviating from its core values, principles and investment philosophy.

Leon Frazer started his own investment counseling business because he believed "many companies wanted the money of their clients, but few provided any real value." With the money management profession still in its infancy in Canada, Leon Frazer & Associates became the first investment counseling firm to be registered by the Ontario Securities Commission. Leon's goal was simple: to provide value to investors.

Today, providing value to investors remains the primary objective of Leon Frazer & Associates. After 62 years, George Frazer is still involved with the investment process, along with Bill Tynkaluk, who joined the company in 1956. "We have continued to complement our team of professionals," says Bill, "adding an excellent mix of experience and skills. We want to assure our clients we will continue to deliver consistent performance and service for another 70 years."

To help achieve this goal, both Bill and George have a team of investment managers who work side-by-side with them on all client accounts. The entire team remains completely committed to Leon's original premise of providing objective, unbiased investment counsel.

While holding to these same company beliefs, new people, processes and technology have been put in place to meet the changing dynamics of the times. This includes new additions to the executive management team. Dona Eull-Schultz oversees the day-to-day business strategy of the firm, including operations

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and administration. Dona brings over 30 years of investment management experience to Leon Frazer & Associates. Her dedication to client service has resulted in new internal processes being put in place to improve the accuracy, efficiency and professionalism of the firm's operational and back office systems. Applying knowledge gained through 30 years in the financial services industry, Doug Kee is responsible for maintaining the investment process discipline that Leon Frazer & Associates has adhered to so diligently for 70 years.

Although market and industry conditions have swung dramatically throughout the seven decades the firm has been in business, Leon Frazer & Associates has preserved its investment style and philosophy. This, combined with a passion for exceeding client expectations, has been the hallmark of the firm's outstanding success as an investment manager. Happy Birthday, Leon Frazer! ■

Leon Frazer Timeline

1939 TRIVIA FACTS

COMPANIES ESTABLISHED
- KFC
- Marvel Comics
- Peterbilt
- Rona
- Sara Lee Corporation

TOP FILMS
- Gone with the Wind
- Mr. Smith Goes to Washington
- Of Mice and Men
- The Wizard of Oz
- Stagecoach

BOOKS
- The Grapes of Wrath – John Steinbeck
- And Then There Were None – Agatha Christie
- Madeleine – Ludwig Bemelmans
- By the Shores of Silver Lake – Laura Ingalls Wilder
- Finnegans Wake – James Joyce

SONGS
- Over the Rainbow – Judy Garland
- God Bless America – Kate Smith
- Three Little Fishies – Kay Kyser
- When the Saints Come Marching In – Louis Armstrong
- Moonlight Serenade – Glenn Miller

Sources: http://en.wikipedia.org/wiki/Category:Companies_established_in_1939; www.filmsite.org/1939.html; http://www.goodreads.com/book/popular_by_date?year=1939; www.popculturemadness.com/Music/Pop_Old/1939.html

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