



## Equity Market Commentary: Investors Gravitate Towards Quality and Safety

MAJOR NORTH AMERICAN EQUITY INDICES AGAIN SAW GAINS IN THE FIRST QUARTER OF 2010 as markets took a breather from the torrid rise of the previous three quarters. The S&P TSX Composite was up 3.1% while the broad S&P 500 was up 5.4%. In Canada, the financial sector was the best performer during the quarter as banks reported earnings and loan losses that were, in most cases, better than analyst expectations.

Last quarter we wondered if the policy-driven rally had gone too far and expressed caution that analyst estimates for 2010 were too optimistic. While the overall market was positive, many of the sectors that dominated the rally last year were flat or negative this first quarter. Energy, Materials and Gold sectors all had flat or negative returns as investors gravitated towards quality and safety in the marketplace, often in the form of companies that pay growing dividends.

### INVESTOR FOCUS SHIFTS FROM GROWTH TO DIVIDENDS

In the shift from growth to dividends, Leon Frazer client portfolios are well-positioned. We hold a high concentration of companies from those industries that make up what we like to call "the backbone of the economy," namely Utilities, Pipelines and Telecommunications. All of our core holdings in these sectors increased their dividends during the quarter and enjoyed capital price appreciation. As investors, we enjoy getting back in dividends the dollars we spend every month on fees and services from the likes of BCE, Enbridge and the Banks.

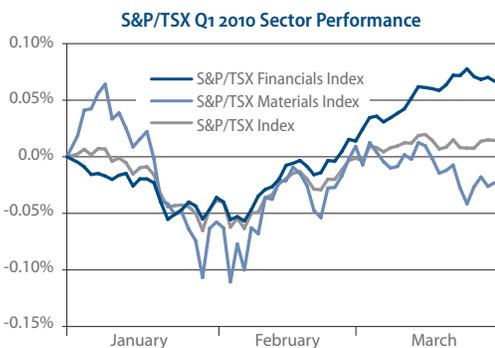
### DIVIDEND PAYOUTS CONTINUE TO INCREASE ACROSS MARKET SEGMENTS

Dividend increases were not limited to only backbone companies. In Q1 2010, 40% of the companies in a typical Leon Frazer client portfolio raised their dividends; a trend we expect to continue throughout the year. We anticipate more than half of our holdings will increase their dividend payouts by year-end. We believe this yield-hungry environment will continue for decades as baby-boomers retire and seek income to live.

LFA Core Holdings that Increased Dividends in Q1 2010		
Symbol	Company Name	Yield
BCE	BCE Inc	5.74
CCO	Cameco Corporation	1.03
CNR	Canadian National Railway	1.74
ENB	Enbridge Inc	3.49
FTS	Fortis Inc	3.86
RCI'B	Rogers Communications Inc	3.74
SC	Shoppers Drug Mart Corp	2.06
SJR'B	Shaw Communications Inc	4.39
TRI	Thomson Reuters Corp	3.15
TRP	Transcanada Corp	4.25

Source: Thomson Financial

*"Leon Frazer's conservative approach of investing in stable companies with increasing dividends is a time-tested strategy"*



Source: Thomson Financial

### DESPITE CHALLENGES, 2010 POISED TO BE A YEAR OF ECONOMIC RECOVERY

Looking ahead, we continue to believe 2010 will be a year of economic recovery, albeit slow, and equity markets will see modestly positive returns. Longer term, significant challenges still lie ahead for both the markets and the economy. Challenges include: a domestic economy struggling to create jobs

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***“In the shift from growth to dividends, Leon Frazer client portfolios are well-positioned”***

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## **Investors Gravitate Towards Quality and Safety**

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outside the government sector; huge government deficits created by fiscal stimulus that must now be reined in; and central banks contemplating their exit strategies from “exceptionally low” interest rate levels.

On the positive side, as developing countries build infrastructure to satisfy their rapidly growing populations, they are increasingly demanding the raw materials and energy produced by Canadian companies. As well, Canadian financial institutions continue to justify their new reputation as global leaders.

In sum, we believe the equity market could trade sideways for the foreseeable future due to the absence of catalysts to significantly move the market higher or lower. In this trendless

environment, it is more important than ever to choose quality companies and maintain a portfolio constructed to increase income year-after-year.

Leon Frazer’s conservative approach of investing in stable companies with increasing dividends is a time-tested strategy. Through the power of compounding higher-than-average dividend payouts, LFA portfolios have weathered many storms over our 70 year history. Should interest rates rise, either through inflation or oversupply of government debt, our portfolios should fare well, as they did the last time we faced a secular rise in interest rates. Look for this month’s issue of Market Perspectives for further discussion on Leon Frazer’s equity investment performance during periods of rising interest rates. ■

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***“We believe most of the tightening in credit spreads has taken place and the risk/reward balance is beginning to shift back to government bonds”***

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## **Fixed Income Commentary**

During the quarter, the Canadian government yield curve began what we believe will be a flattening trend over the rest of 2010. Yields on shorter-term bonds rose while longer-term bond yields declined. This reflects the bond market’s view that the Bank of Canada will begin to increase short-term rates, probably by mid-year, to moderate the pace of economic growth and rein in inflation, thereby justifying a decline in longer-term yields. In its March 2nd announcement, the central bank noted core inflation is slightly higher than its 2% target. Canadian banks have already announced increases in residential mortgage rates.

The picture is different in the US where, despite a temporary drop in US treasury yields during the Greek debt crisis, government yields were essentially unchanged across all maturities. The US yield curve is upward-sloping even to very long maturities, indicating concerns about the government’s ability to fund its enormous debt without producing massive inflation. On March 16, the US Fed reaffirmed its commitment to keeping the Fed Funds rate at “exceptionally low” levels for an “extended period,” while indicating there is evidence of some strengthening in the US economy. Given continuing concerns about the sustainability of the recovery in the US, the market is not

expecting an increase in rates until late 2010 at the earliest.

Credit spreads again narrowed, as they have for the last 4 quarters. Most of the improvement in spreads was related to lower credit borrowers, as yields for higher quality bonds are already historically low.

Our fixed income funds performed well during the quarter, outperforming the market indices. The JOV Bond Fund’s focus on high quality corporate bonds contributed positively to return and the Fund was well protected from the increase in shorter-term government bond yields. The JOV Leon Frazer Preferred Equity Fund continued to benefit from the right mix of perpetual and reset issues.

Looking ahead, our view is corporate bonds will provide positive returns in 2010. We believe most of the tightening in credit spreads (the difference between the yield on a corporate bond relative to a government bond of the same maturity) has taken place and the risk/reward balance is beginning to shift back to government bonds. We expect to deploy new cash in the JOV Bond Fund to government bonds to gradually increase their weight in the portfolio. The JOV Leon Frazer Preferred Equity Fund will maintain its focus on high quality issuers, and continue to reduce the weighting in perpetual issues. ■



## Spotlight: Wealth Planning—Leaving a Legacy

*We are pleased to share the following article, a collaboration written by Bruce Ball, National Tax Partner at BDO Canada Ltd. and Dona Eull-Schultz, Chief Operating Officer and Portfolio Manager at Leon Frazer, and originally published as a BDO client communication. BDO has 95 offices across Canada, with 1,600 professionals and more than 300 partners.*

As the Baby Boomer generation prepares to retire, the potential transfer of assets to subsequent generations is unparalleled. Some reports estimate wealth transfer amounts could approach \$1 trillion in Canada alone. The question is whether the next generation is prepared to deal with this newfound transfer of wealth.

A succession plan for wealth is often overlooked. For business owners, wealth transfer issues are similar to the succession planning issues they already face. As they reach retirement, business owners begin transitioning their operations to new leaders. This could take the form of a sale to third parties or employees, or could involve bringing in family members to run the business. Any individual who has accumulated wealth should address the same issues: have I set a succession plan for my wealth? What sort of legacy do I want to leave to future generations?

### WHY IS THERE A CONCERN?

A big concern among many tax and financial advisors is the lack of communication within a family when it comes to issues surrounding death and potential inheritances. This is a daunting exercise, but open and honest discussions will generally not be as difficult as one would expect. If difficult discussions do arise, the underlying problems are often related to pre-existing issues that need to be dealt with anyway.

Like their parents, many children also choose to avoid this conversation. As a potential beneficiary, it may be difficult for children to initiate discussions on wealth succession, since even where a child is acting in the best interests of everyone, their motivation may be questioned.

Since a child may be making significant investment and financial decisions for the first time with any inherited wealth, it will be important to invest wisely as financial or investment mistakes due to inexperience may carry a high cost. Overall financial and tax planning advice may be needed for the first time.

### BASIC ESTATE PLANNING VS. LEGACY PLANNING

It is important to draw a distinction between basic estate planning and what is referred to as “legacy planning.” The goals of estate planning are specific, such as:

- Maximizing and preserving the value of your assets
- Minimizing and deferring tax and other costs that will arise on your death
- Allowing for an orderly transition of assets to your beneficiaries
- Providing for your dependants.

Legacy planning takes estate planning one step further by dealing with other issues, such as:

- Educating the next generation on issues surrounding wealth management
- Improving communications within your family, ensuring that you share your intentions, hopes and concerns
- Setting family values and perhaps even a mission statement
- Establishing philanthropic goals, where desired.

The idea behind legacy planning is that adverse events can be managed by way of shared values and increasing the knowledge level of your family. This will allow family members to make decisions for themselves, while understanding how your wealth was established and respecting your values and desires. Legacy planning helps create a balance between safeguarding specific risks and reducing taxes, while allowing your family to deal with your wealth as adults.

### WHERE DO YOU BEGIN?

Before you develop a plan, you’ll need to gather some information and give thought to a number of key questions. The goal is to reach some conclusions on important issues and draw a clear picture of your financial and non-financial goals, including:

- What am I most proud of accomplishing over the course of my life?
- What are the top 3 impressions I want my family and or my community to associate with me?
- Is my family prepared to assume full responsibility for the business and financial matters currently under my management?
- Does my family know all of my key trusted advisors?
- Which family members will share in my estate?
- Where a vacation property is owned, will it be kept in the family or sold?
- Do I have philanthropic interests?

The second part of the process is to take this information and develop a plan to meet your goals. As the plan is developed, key components may include:

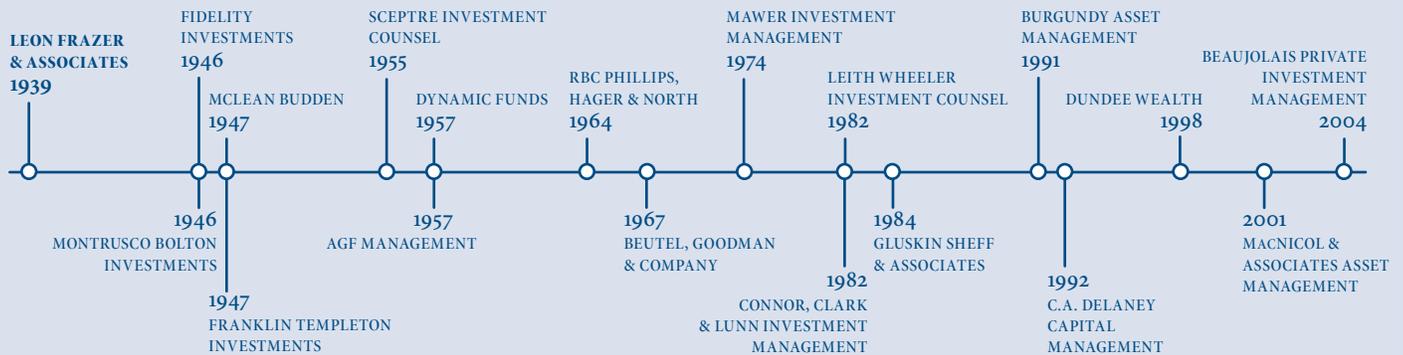
- A will, which is reviewed and updated regularly
- Setting a process for open communication, including how your wealth will be divided and why
- Assessing whether your family is capable of managing your financial affairs, and determining the best course of action
- Reviewing your tax issues and considering the tax planning alternatives available to you
- Addressing your insurance and retirement needs
- Determining the use of a retained vacation property
- If you have philanthropic interests, setting a plan to identify the charities you want to benefit.

While the experience may seem overwhelming, remember that planning for your legacy is a process and these issues are best dealt with over time with the help of your investment and tax advisors. ■



## Leon Frazer Timeline

### INVESTMENT MANAGEMENT FIRMS OPEN FOR BUSINESS



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