Leon Frazer & Associates
INVESTMENT COUNSEL

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

MARCH 2012

LEON FRAZER QUARTERLY REVIEW

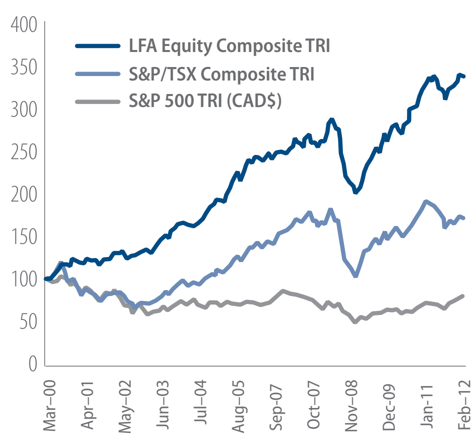
Equity Market Commentary: Long-term View Tells the Real Story

NORTH AMERICAN EQUITY MARKETS STARTED 2012 ON A POSITIVE NOTE, especially in the United States. The S&P/TSX Composite Total Return Index gained 4.4% during the quarter. South of the border, the S&P 500 Total Return Index gained an impressive 12.6% following an equally impressive 11.8% gain in the fourth quarter of 2011. The US market has benefited from domestic economic strengthening in the manufacturing and consumer sectors, as well as the housing market, which appears to have reached bottom. The S&P 500 now sits less than 10% away from its 2007 high while the S&P/TSX Composite is almost 20% away from its 2007 high.

RECENT PERFORMANCE ONLY PART OF THE PICTURE

With the S&P 500 and the S&P/TSX Composite topping out at 1,500 and 15,000 respectively in 2007–2008, the temptation when comparing recent performance is to shift focus toward the US market. Indeed, many pundits are now touting the virtues of diversification and the perils of resource-related concentration in the Canadian market. We believe the story is much different than a simple comparison of the widely quoted price-only indices.

The chart below depicts the relative performance for the Canadian and US markets since 2000, as well as the LFA Equity Composite, all on a total return basis. Clearly, the



Source: Bloomberg/LFA

recent outperformance of the US market is relatively meaningless when looking over a longer time frame. The reality is that Canadian dollar investors have not made positive returns in the US market for 12 years and counting, even when dividends are included! Meanwhile, our strategy of selecting a portfolio composed primarily of Canadian companies that maintain and increase dividends has produced compelling results and is a clear example why we do not alter our long-term strategy based solely on recent events. Going forward, we will continue to place overwhelming focus on Canadian dividend-paying companies in all Leon Frazer portfolios.

FOCUS ON THE LONG-TERM

Because LFA portfolios include selective positions in resource producers, they are not immune from cyclical setbacks, as we have recently seen. Our discipline forces us to participate, in moderation, in different sectors and markets where appropriate. Our aversion to large tactical shifts keeps our portfolios well diversified and focused on what matters – the long-term. The chart to the left shows Leon Frazer's equity selection process quite literally pays dividends over long periods of time, while making investment decisions based on recent history has long been the enemy of the retail investor.

MODEST ECONOMIC GROWTH WILL CONTINUE

The sovereign debt situation in Europe is much improved compared with three months ago. The European Central Bank (ECB) executed a massive $1 Trillion Euro bailout of the banking system which stabilized confidence and sent equity markets around the world higher. At the end of 2011, we estimated a bailout similar to the one

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Long-term View Tells the Real Story

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executed by the US Federal Reserve in 2008–2009 was at least as likely as the meltdown scenario that many were loudly predicting. The ECB's decision to inject liquidity into the banking system was prudent and predictable, as was our decision to remain fully invested last fall. Sovereign debt levels remain elevated in Europe and North America and will continue to be a drag on economic growth for years to come. We continue to stick to our view that modest economic growth will continue, fuelled by developing world demand and developed world recovery. This view is less concerned with making headlines and more focused on making money for our clients over the long-term.

OPTIMISTIC ON PORTFOLIO RETURNS

Leon Frazer client portfolios slightly lagged the market during the first quarter. The market is still down almost 10% year-over-year, while client portfolios are relatively unchanged. We continue to be optimistic on portfolio returns for 2012 given the dividend growth exhibited by our core holdings over the past 15 months. As a reminder, in 2011, approximately three quarters of our core holdings increased dividends with no capital appreciation from the portfolios. Thus far in 2012, we have already seen half of our core holdings increase dividends with very little response from the capital value of the portfolios. The pace and frequency of dividend increases in our portfolios is what gives us so much optimism going forward. The market tends to pay for dividend increases over time and we are confident our patience over the past year will be rewarded. ●

Fixed Income Commentary

"Longer-term, we expect bond yields will rise as the global situation stabilizes and there is moderate economic growth in North America"

Canadian fixed income markets slowed down in the first quarter of 2012 after an exceptionally strong performance in 2011. The DEX Short and Mid Term Bond Indices both posted returns of 0.0% in the first quarter, with the weak performance of the government sectors offset by the strong performance of the corporate sector. The S&P/TSX Preferred Share Index returned 1.3% in the quarter.

After trading in a very narrow range in January and February, yields on North American government bonds rose sharply in March after the US Federal Reserve indicated that, for the time being, they did not see a need for additional quantitative easing. However, since the announcement, yields have retreated somewhat. The entire yield curve shifted up over the quarter as the yield on one-year Government of Canada bonds rose 16 basis points to end the quarter at 1.09% and the yield on ten-year Government of Canada bonds rose 17 basis points to end the quarter at 2.11%. On a historical basis, government yields remain anaemically low, below both the annual inflation rate and the yield on the S&P/TSX Composite Index. North American central banks are expected to keep short-term interest rates anchored at low levels until they are confident the economic recovery has legs and the prospects of exogenous risks are diminished. Longer-term, we expect bond yields will rise as the global situation stabilizes and there is moderate economic growth in North America.

Provincial credit spreads were stable over the quarter and as a result, provincial bonds performed in line with federal bonds. Corporate credit spreads moved steadily lower, as investors' risk appetite improved. As a result, corporate bonds generally outperformed federal bonds. Corporate credit fundamentals in Canada remain strong, largely due to the belt tightening undertaken in the wake of the credit crisis.

The JOV Bond Fund performed well in the first quarter. The Fund's overall high commitment to corporate bonds, despite their conservative nature, contributed to the Fund's strong performance. The Fund will continue to favour an overweight to high quality corporate bonds. The duration of the Fund will continue to be held close to neutral in the near term, however, it will be shortened should event risk begin to wane and economic indicators improve.

The JOV Leon Frazer Preferred Equity Fund posted positive performance for the quarter. Despite the rise in government bond yields, perpetual preferred shares were the strongest performing subsector, buoyed by the strength of financials, in particular, insurance companies. The Fund's underweight in financials detracted from performance. The Fund will remain underweight perpetuals, as we expect them to underperform once bond yields begin to rise. To ensure the Fund's holdings are diversified across many industries, it will also remain underweight the financial sector. ●

Spotlight: The New Realities of Retirement

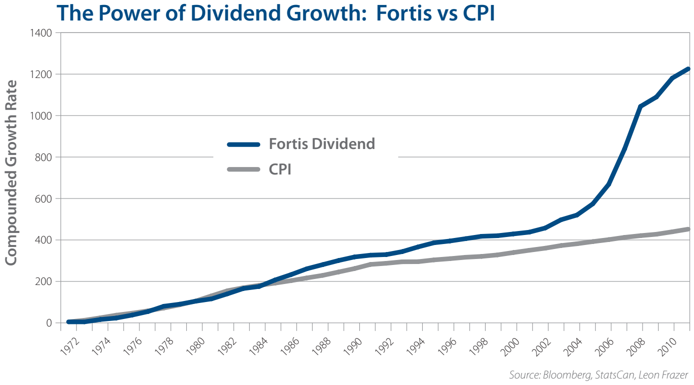
At some point in your life, whether you are ready for it or not, you will inevitably reach the retirement stage. When you do, your lifestyle will depend on how well you have planned for this time period. With over 70 years of investment expertise, we at Leon Frazer have managed private clients' portfolios through virtually every stage, from inception, through growth and to retirement. We understand the issues inherent in managing an investment portfolio over time and as counselors, we offer practical solutions for protecting your investment in a rapidly changing world.

THE LEON FRAZER PRINCIPLES

At Leon Frazer, we believe there are two essential components to a successful investment plan:

- invest as early as you can, since time in the market gives your portfolio a chance to grow, and minimizes the effects of day-to-day market volatility
- own equities that pay dividends and invest those dividends each year so you can reap the benefits of compounding returns

In our opinion, inflation is the key hurdle to a successful retirement. Dividend growth is a critical component to long-term total return, as seen in the following chart that compares the long-term growth of the Fortis dividend with inflation over the same time period. That's the power of increasing dividends.



We believe so strongly in these principles, we've adhered to them for over 70 years, whether your portfolio is in its' infancy, growth or retirement phase.

PLANNING FOR YOUR FUTURE FINANCIAL NEEDS

Life expectancy and future health care costs are perhaps the most difficult unknowns when planning for your future financial needs. The challenge is how to adequately save for a potentially long retirement and how to turn your assets into sustainable income once retired. In the 2012 editions of the Leon Frazer Quarterly Review, the Spotlight page will focus on these realities and address how we are managing your portfolio to deal with these hidden implications.

With life expectancy rising dramatically during the last century, investors today face a new set of challenges not encountered by previous generations. In Canada, the number of people age 80 or over increased 41.2% between 1991 and 2001. This number is expected to increase an additional 43% from 2001–2011; the actual number will be revealed once the 2012 Census is released shortly.

> *"To investors looking for a regular income stream to meet life's future challenges, dividend-paying stocks can be just the answer"*

With an aging population, the ratio of workers to retirees shifts towards retirees. Remember that workers are those who pay higher taxes, and pay into CPP and investment accounts. Retirees, on the other hand, receive government benefits and often pay less in taxes, thereby increasing the demand on government resources. This demographic shift is likely to result in less government support going forward and the need for more self-reliance. Future generations may not be able to count on government assistance during their retirement years.

Another side effect of an aging population is the impact of rising health care costs. Not only is it enough to simply plan for your retirement, you must take into account the financial implications of increased health care during this longer retirement period. In fact, many people are more concerned about the financial strain associated with a significant health situation, such as a chronic illness or disability, than they are about how it may compromise their quality of life.

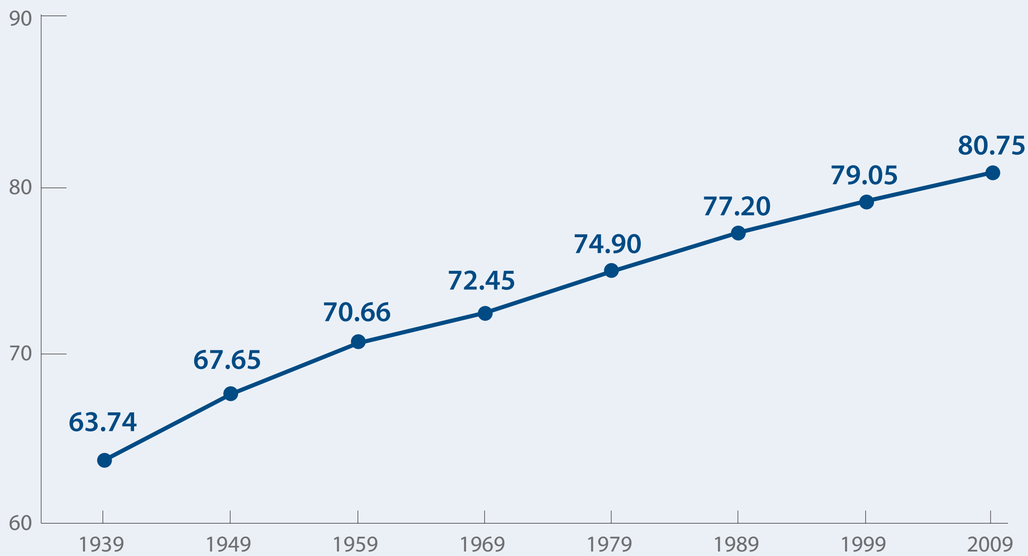
CONSTANT, RELIABLE STREAM OF INCOME ESSENTIAL

More than ever, it is essential to have a constant, reliable stream of income from your portfolio. If you are retired now, you know very well that generating regular income in your portfolio is more challenging than it used to be, and the things you need are not getting any cheaper.

For over seventy years, Leon Frazer & Associates has adhered to the strategy of investing in good quality, dividend-paying stocks with a history of increasing dividends. This time-tested strategy offers a proven record of inflation protection through capital appreciation and growing dividend income. To investors looking for a regular income stream to meet life's future challenges, dividend-paying stocks can be just the answer. Look for the next editions of the Leon Frazer Quarterly Review as we discuss these hidden realities in more detail. ●

Leon Frazer Timeline

Life Expectancy Since Birth



Source: Gapminder World

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