Leon Frazer & Associates
INVESTMENT COUNSEL

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

JUNE 2012

LEON FRAZER QUARTERLY REVIEW

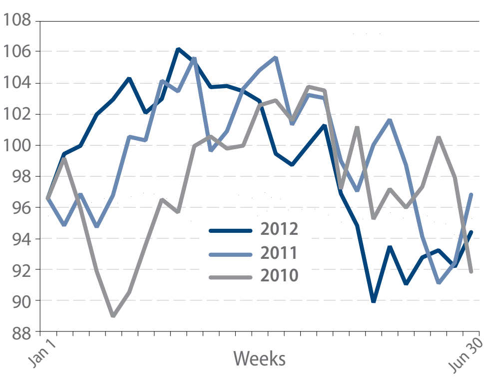
Equity Market Commentary: Second Quarter Frustration Once Again

THE SECOND QUARTER WAS ONCE AGAIN A DIFFICULT PERIOD FOR EQUITY INVESTORS IN BOTH CANADA AND THE UNITED STATES. The S&P/TSX Composite Total Return Index posted a -5.7% return while the S&P 500 posted a -2.8% total return. This marks the third straight year of second quarter frustration for equity investors in Canada, following -5.1% and -5.5% total returns for the S&P/TSX Composite in Q2 2011 and Q2 2010 respectively. In varying combinations, European sovereign debt worries, softening US economic data, and typical weak seasonality for equities were blamed for the poor market performance in all three cases.

COMPARING THE YEARS

The chart below depicts first half S&P/TSX Composite performance in each of the last three years. In each instance, the market followed a positive first quarter with a decidedly negative second quarter, to end the 6 month period relatively flat. Notice that 2011 and 2012 have been eerily similar, right down to the timing of the movements from week to week.

S&P/TSX Composite Total Return Index Performance



Source: Thomson Reuters

The second halves of 2010 and 2011 were very different. During the second half of 2010, the market rallied over 20%, fuelled by further monetary stimulus in the United States. In contrast, the second half of 2011 had a -9% market return, driven by fears of a global economic slowdown stemming from challenges in both the US and Europe.

MARKET WORRIES CONTINUE TO PERSIST

The narratives that have contributed to negative market sentiment are far from their ultimate conclusions. Market worries about Europe have persisted for the last 3 years and could continue for at least another 3 years. The US sub-prime mortgage bubble and subsequent recession began over 5 years ago and still shows no signs of a final resolution. Global growth continues, with strong developing world results hampered by the deleveraging of major western economies.

FOCUS ON WHAT REALLY MATTERS

At Leon Frazer, we attempt to cut through the macroeconomic noise to get to what really matters: *Earning our clients a return on investment that maintains or increases their standard of living over time*. Our focus on companies that maintain and increase dividends has not waivered, and despite three years of market preoccupation with the same problems, our client portfolios have continued to move forward with every dividend increase.

The following chart compares the monthly performance of the LFA Equity Composite with the S&P/TSX Composite since January 2010. Notice the consistent upward trend and lower variation of our returns when compared with the S&P/TSX Composite Total Return Index. We attribute this to our strategy of selecting dividend growing stocks from stable industries and the fact we do not own the Canadian market, which is over 50% concentrated in resource producers.

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"What really matters is earning our clients a return on investment that maintains or increases their standard of living over time"

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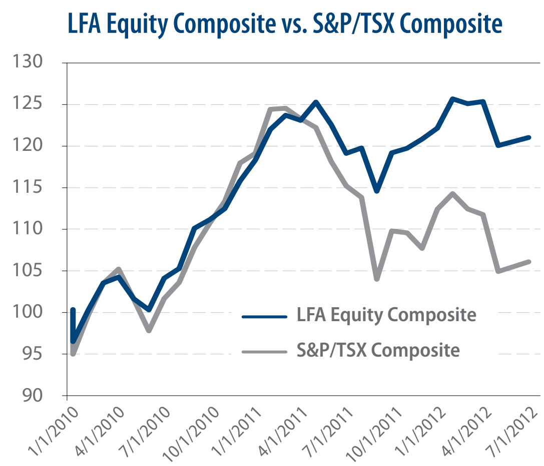


Source: Thomson Reuters

"We continue to favour equities to the highest extent possible in all portfolios"

LEON FRAZER ECONOMIC AND MARKET VIEW REMAINS UNCHANGED

Our economic and market view has not changed. We believe the slow North American economic growth path of 0% - 2.5% will persist in the near to medium term, while the market will remain range bound awaiting further resolution in Europe, the US election and a leadership transition in China near the end of this year. We continue to be wary of absurdly low interest rate levels combined with loose monetary and fiscal policy and favour equities to the highest extent possible in all portfolios. As always, our management team will look for opportunities and anticipates better times ahead, using the dividend increases of the companies in our portfolios as signposts we are on the right track. ●

Fixed Income Commentary

Canadian fixed income markets were a safe haven in the second quarter of 2012. The DEX Short and Mid Term Bond Total Return Indices posted returns of 0.9% and 2.8% respectively in the second quarter, while the S&P/TSX Preferred Share Total Return Index returned 0.9% for the quarter.

"Credit spreads widened over the quarter, particularly on securities with longer maturities, reflecting ebbing investor confidence"

North American yields resumed their downward trend this quarter. Yields on US treasury bonds are similar to the levels reached during the financial crisis in 2008, while yields on Canadian federal bonds are well below the levels reached in 2008. "Real" yields in both countries remain negative as government bond yields are below inflation rates. For the time being, concerns about European sovereign debt levels, the stability of the EU, China's growth prospects, the US election and the likely effectiveness of any further quantitative easing initiatives in the US will continue to weigh on the market. Jittery investors and central banks' commitments to ease monetary policy should ensure rates remain at extremely low levels in the near term. That said, we believe current yield levels are unsustainable in the long-term. In Canada, two-, five- and ten-year government bond yields were 1.01%, 1.23%, and 1.74% as at June 30, down 18, 34 and 37 basis points respectively since the end of March.

Credit spreads widened over the quarter, particularly on securities with longer maturities, reflecting ebbing investor confidence. Both provincial and corporate bonds underperformed similar term federal bonds. While trading was quiet in the quarter due to the credit spread widening that has taken place, the JOV Bond Fund will look to both increase its corporate bond exposure and lengthen the term of its corporate holdings given the strong credit fundamentals of many Canadian companies.

The JOV Bond Fund's performance was hurt in the quarter due to a duration position that was slightly lower than its target, and the widening of credit spreads given the Fund's high commitment to corporate bonds. While the term of the corporate bond holdings will be lengthened, the overall term of the Fund will be shortened as clearer resolution to sovereign debt issues becomes apparent.

The JOV Leon Frazer Preferred Equity Fund posted positive performance for the quarter, despite underweight positions in perpetual preferred shares. Given the decline in interest rates over the quarter, perpetuals were once again the strongest performing subsector, while floating rate preferred shares were the worst performing subsector.

The JOV Leon Frazer Preferred Equity Fund will remain underweight perpetuals as we expect them to underperform once bond yields begin to rise. The Fund will also remain underweight the Financial sector in favour of diversified holdings across several industries. ●

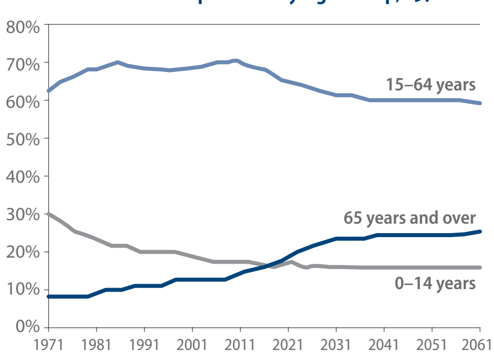
Spotlight: Retirement Reality – We're Definitely Living Longer!

The baby-boom generation is now starting to age and, accordingly, so too is the Canadian population. As baby boomers begin to reach age 65 by 2011, the aging of the population will start to accelerate significantly. The good news is, we are living longer, healthier lives. The bad news is, it may mean less money, less leisure and more work for those who haven't planned for an extended retirement.

LIFE EXPECTANCY CONTINUES TO SOAR

Last year, there were 5,825 Canadians aged 100 years or older. Ten years before, 3,795 Canadians made up the centenarian population. According to population projections released by Statistics Canada, there could be close to 80,000 centenarians by 2061. In fact, the growth of the seniors population will account for close to half of the growth of the overall Canadian population in the next four decades.

Distribution of Population by Age Group, 1971–2061



Source: Figure excerpted from André Léonard, Canada's Aging Population and Public Policy: 1. Statistical Overview, Publication no. 2011-63-E, Parliamentary Information and Research Service, Library of Parliament, Ottawa, forthcoming.

Canada's population is aging so quickly that in about a decade, Canada may have more people at the age where they can leave the labour force, than at the age where they can begin working, presenting considerable challenges for Canadian employers and for society in general.

AGING POPULATION PRESENTS CONSIDERABLE CHALLENGES

Statistics Canada says the numbers of retirement-aged Canadians in the workforce will continue to increase. In less than 10 years, one in five people in the workforce will be aged 55 to 64. In addition, the number of workers in Canada for every retired person is expected to fall to two in 2031, from five in the 1980s, as a wave of baby boomers retires from the workforce. As the ratio of the nonworking population to the working population (the dependency ratio) increases, the viability of many public programs comes into question.

The aging of Canada's population will cause escalating pressures on public expenditures in the areas of health care and old age security, while potentially slowing the growth of the labour force, reducing the growth of the economy, and limiting the growth in government revenues. 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.

SUCCESS MEANS PLANNING AHEAD

Unfortunately, even as baby boomers reach retirement age in record numbers, their financial readiness for retirement is being questioned. Those retirees who have prepared in advance, by setting up their portfolios to generate a consistent stream of income will be better poised to meet life's future challenges.

At Leon Frazer, we believe there are two critical components to a successful retirement plan. Invest as early as you can, with a vision for the long-term. Time in the market gives your portfolio a chance to grow, and minimizes the effects of day-to-day market volatility. Then, own equities that pay dividends and reinvest those dividends to take advantage of the power of compounding returns. A constant, reliable stream of income from your portfolio offers a proven record of inflation protection through capital appreciation and growing dividend income. It's a time-tested strategy we have been adhering to for over 70 years, and will continue to do so going forward.

Though there seems to be a perception the numbers of seniors will subside after the last baby boomers retire in 2031, Statistics Canada projections show the population will continue to age, albeit at a slower pace. As far out as 2061, the agency projects the over-65s will remain in excess of 25% of the population. Of these, moreover, about 40% will be over the age of 80, versus less than 30% today. The good news is, pressures from an aging society will emerge relatively slowly, enabling governments to plan and prepare in advance. Which gives us time to plan accordingly too. Here's to a successful retirement! ●

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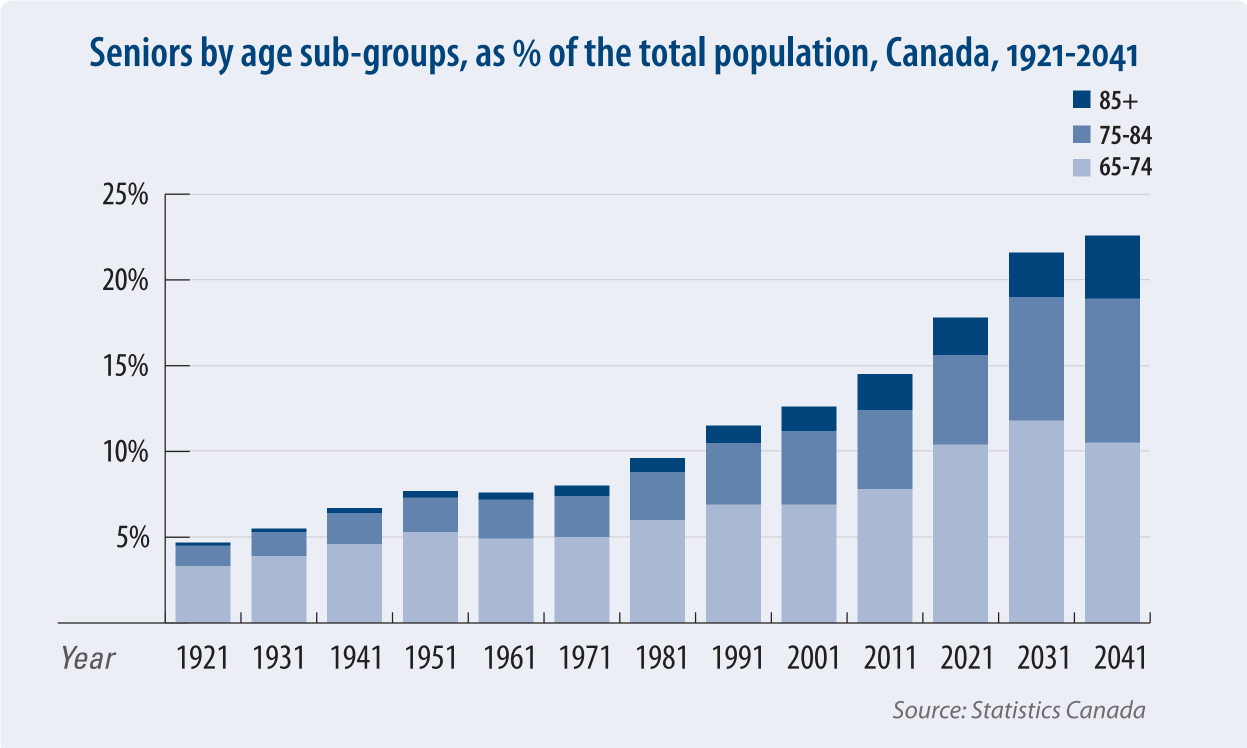
Leon Frazer Timeline



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The purpose of the LFA Equity Composite is to provide a reasonable indication of asset weighted historical performance of our institutional mandates, which include the IA Clarington Canadian Conservative Equity Fund (which has been managed by Leon Frazer since 1950), the JOV Leon Frazer Dividend Fund (which has been managed by Leon Frazer since 2007) and the Counsel Canadian Dividend Fund (which has been managed by Leon Frazer since 2009).
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