

**"Be fearful when others are greedy.
Be greedy when others are fearful."**

- Warren Buffett



WATSON DI PRIMIO STEEL

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Investment Perspectives

Market Cycle: Where Are We?

Global equity markets, generally down 20% over the past year, continued their decline in 2008 for two main reasons. First, economic forecasts of a possible recession in the United States progressively became the majority view. Each additional rise in the price of oil caused further concern about weakness in consumer spending, which is expected to lead to lower corporate profits. Second, inflationary risks have increased around the world due to the effect of higher commodity prices, including oil. As the decline from the previous peak has reached bear market territory, we believe that it is useful to examine prior bear markets for some insights. Since 1950, there have been eleven declines measuring a fall of 19% or worse. If we can exclude the technology bubble burst starting in 2000 and the serious stag-

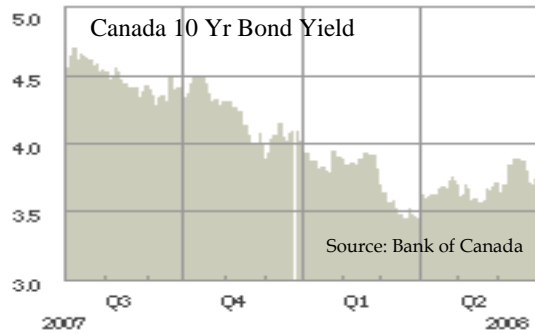
flation problems of 1973 then the average bear market over the past six decades has lasted 10 months with a decline of 25%. In other words, the current situation lasting 9 months and down 20% could mean that the worst of our problems are behind us. This assumes, however, that the economic issues facing the world economy are average in a historical sense. In the near term, these tough markets will likely remain volatile and continue reacting to the negative news headlines. Nonetheless, the stock markets are forward-looking entities and, therefore, more concerned about the future than the past. Although we remain defensive, we are cautiously optimistic as we prepare for the eventual recovery in the markets.

As always, we thank you for your continued support and confidence.

Equities:

The charts, shown on the left, illustrate the 12-month return performance for the S&P/TSX Composite (TSX), S&P 500 and EAFE indices. Year-to-date, the TSX generated a 6.0% total return, while the S&P 500 and EAFE indices fell -11.9% and -10.6% respectively in U.S. dollar terms. Over 12 months, the total returns for these major indices were 6.8% for the TSX, -13.1% for the S&P 500, and -10.2% for the EAFE. In Canada, the positive returns were

derived from a narrow segment of the market, namely commodity-related stocks. For example, the energy sector is up 24.3% and the materials sector is up 26.2% on a year-to-date basis. In contrast, the financial sector in Canada has fallen -11.6% over the same time period. In the United States, the significant decline has been led by the financial sector that fell -29.7% in the first six months of the year.



Fixed Income and Interest Rates:

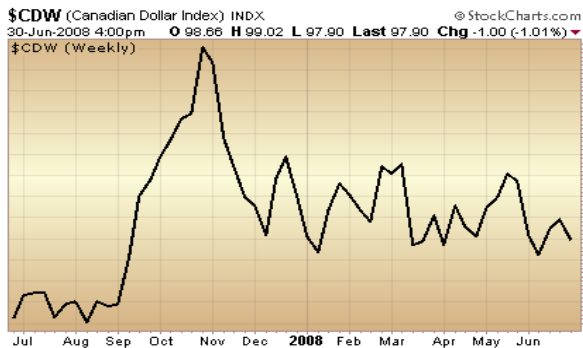
Over the last 12 months, the U.S. federal funds rate fell dramatically from 5.25% to 2.00%. In Canada during that period, the overnight rate fell from 4.50% to 3.00%. The U.S. 10-year treasury yield declined 1.0% from 5.0% a year ago to 4.0% at the end of June 2008. The yield on the Canada 10-year bond, as illustrated to the left, declined 1.0% as well from 4.6% to 3.6% over the past year. Long-term bond yields reached a bottom in Canada and the United States near the

end of the first quarter in 2008. More recently, long bond yields have risen by 0.25% in Canada and 0.63% in the U.S. These recent increases are an indication that inflation concerns are now resurfacing. Corporate spreads, the difference between corporate and government bond yields, have begun to widen again after a brief reprieve. This situation typically occurs when the outlook for corporate fundamentals and earnings erodes.

Currencies:

The Canadian dollar, as illustrated by the \$CDW chart, traded a year ago at under \$0.93 versus the U.S. dollar before rising to just over \$1.07 by November 2007. More recently, it has fallen back to close June 2008 at \$0.98 against the U.S. currency. The Canadian dollar's strength has been the result of higher commodity prices, par-

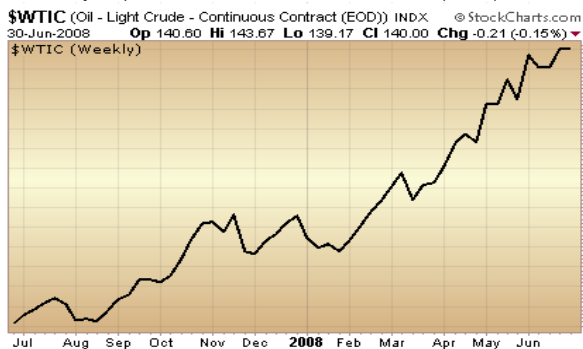
ticularly energy, and strong domestic demand. Many segments of the Canadian economy, however, are vulnerable to the negative effects of an overly-strong Canadian dollar. Concerns about the outlook for the U.S. economy – specifically demand for Canadian goods and services – may ultimately weigh on our currency.



Commodities:

The \$WTIC chart illustrates the price of oil doubling from around \$70 per barrel to \$140 over the past 12 months. At current levels, demand destruction is starting to occur. Sales of sport utility vehicles are down, public transit is on the rise and people are restricting travel in an attempt to consume less gasoline. Many economists are referring to the current rise in the price of oil as a bubble and are forecasting an eventual return in price to the \$75 to \$85 per barrel range.

However, supply constraints exist and demand remains strong from emerging nations, suggesting that the higher price of oil could be sustained for some time. Gold, as indicated in the bottom chart, rose from \$650 per ounce to over \$1,000 in March, before dropping to \$860. It closed at \$930 per ounce at the end of June 2008. Global inflationary pressures could account for this renewed upward trend.



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