

"Ben Graham wasn't about brilliant investments and he wasn't about fads of fashion. He was about sound investing, and I think sound investing can make you very wealthy if you're not in too big of a hurry".

Warren Buffett



WATSON DI PRIMIO STEEL

Investment Management

Knowledge Discipline Integrity

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## Investment Perspectives

### An Unusual Year

2005 proved to be an unusual year for investors. Data, available for the first three quarters of 2005, show that the vast majority (i.e. 86.6%) of Canadian investment managers were underperforming the S&P/TSX Composite (TSX) index last year. This was largely due to the composition of the index. Periodically, the increased weighting of specific companies (e.g. Nortel in 2000) or certain sectors (e.g. energy in 2005) causes dramatic swings in the overall market as measured by the TSX. Although the intent of an index is to represent a broad representation of the stock market in general, the rise and/or fall of energy stocks are now dominating the Cana-

dian indices. This situation is reminiscent of the technology boom leading up to the year 2000.

The aim of our value-oriented approach to investing is to avoid excessive exposure to any "hot" sectors, stocks, or markets. Although we believe that there has been a secular change in the demand for energy, we are committed to our disciplined style of asset management. In the long term, this methodology has shown to yield superior results and helps to ensure that we protect our clients' assets.

*Thank you for your business and continued support.*

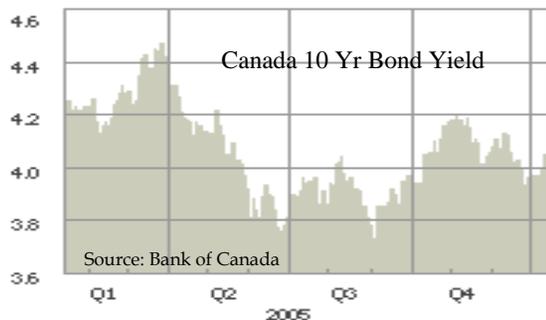
### Equities:

The charts, on the left side of this page, show the performance of the TSE Composite (TSX), the S&P 500 and EAFE indices over the past year. The Canadian stock market continued to be the best performer compared to the United States and international (EAFE) indices. In 2005, the TSX was up 24.1% on a total return basis while the S&P 500 and EAFE both provided returns of 1.4% and 7.2% respectively when measured in Canadian dollars.

The largest factor affecting equities in 2005 was energy prices. With the price of oil reaching highs of over \$70 per barrel, the Canadian energy sector rose a dramatic 63%. As a result, 75% of the TSX total return in 2005 came from

energy-related stocks. Further, the energy weighting in the TSX rose from 18.5% at the beginning of the year to a significant 27.4% at the end of the year.

This past year also proved to be an unusual year for income trust investors. The uncertainty created by the September 2005 federal government's decision to review the tax implications of income trust securities created unexpected volatility for this group as a whole. Even after the government announced a reversal in its intentions, many income trust securities continue to be valued lower than prior to the original announcement.



## Fixed Income and Interest Rates:

During 2005, the Canadian bank rate rose from 2.50% to 3.25%. Over the same period, the yield on the 10-year Canada bond, as illustrated in the chart to the left, fell from 4.30% to just under 4.00%.

The United States central bank has almost doubled the Fed funds rate over this period from 2.50% to 4.25%. Long rates inched up with the

yield on the 10-year U.S. Treasury increasing from 4.20% to 4.40%.

While the yield curves in both Canada and the U.S. have become almost flat, they have not yet inverted. Also, with both long and short rates higher in the U.S. than Canada, we would have expected to have seen the Canadian dollar weaken.



## Currencies:

The Canadian dollar, as measured against the U.S. dollar, began 2005 at \$0.83, fell to \$0.79 in May and finished the year at almost \$0.86, up 3.4% for the year. In recent years, the Canadian dollar has become very sensitive to changes in commodity prices. Increases in oil, gold and other commodity prices were large factors contributing to the continued strength in the Cana-

dian dollar. This strength continues to be a drag on any U.S. dollar assets held in our clients' portfolios.

The Euro currency continued to experience difficulty falling 13% against the U.S. dollar and 16% against the Canadian dollar.



## Commodities:

There were two significant events affecting commodity prices last year. The first was the rise in the price of oil. On a per barrel basis, oil rose from around \$42 to \$70 in August, closing the year at \$60. This represents a 43% increase over the year. The second notable event was the rise in the price of gold which began the year at \$436 and finished 2005 at \$513. Measured in Cana-

dian dollars, gold was up almost 14% for the year. Other commodities such as copper, uranium, and zinc all exhibited strong price rises for the year. Many economists attribute the strength in commodity prices to the continued industrial demand growth from China.



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