

"The stock market is filled with individuals who know the price of everything, but the value of nothing."

- Philip Fisher

\$TSX (S&P/TSX Composite Index) INDX © StockCharts.com
29-Jun-2007 4:00pm Last 13906.57 Volume 1.2B Chg -79.46 (-0.57%) ▼



\$SPX (S&P 500 Large Cap Index) INDX © StockCharts.com
29-Jun-2007 4:00pm Last 1503.35 Volume 13.7B Chg +0.79 (+0.05%) ▲



\$IEE (iShares MSCI EAFE Index) INDX © StockCharts.com
29-Jun-2007 4:00pm O 80.07 H 80.98 L 79.16 Last 80.97 Chg +0.48 (+0.60%) ▲



WATSON DI PRIMIO STEEL

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Investment Perspectives

Bond Yields Rise

Six months ago, the main issue was whether or not inflation would continue higher, or alternatively whether previous interest rate increases were about to cause a global recession. Long-term bond rates in the U.S. and Canada were at the mid-point of their two-year range and earnings growth was expected to slow. A scenario favouring lower inflation, lower interest rates and a soft landing for the economy was common. Today, long-bond rates have risen to the top of their two-year range while earnings growth remains slower and price earnings multiples remain reasonable. Talk of a soft landing and an economic slow down has shifted to expectations of renewed economic growth. This higher anticipated growth could lead to higher inflation and higher interest rates. In fact, 10-year bond rates seem to have broken out of a 17-year downtrend which has many analysts talking about

the next long-term bear market in bonds. Alongside this rising interest rate scenario, however, is much good news. Earnings growth in equity markets is still comfortably in excess of long-bond yields and there is ample global liquidity to keep interest rates at lower than normal levels. Corporate balance sheets are very healthy and stock buybacks continue to boost share values. In addition, private equity takeovers are bolstering markets around the world. In short, global growth is strong and this bodes well for equity markets as long as it is contained. Central bankers continue to tread the thin line between pushing interest rates too high and controlling inflation.

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

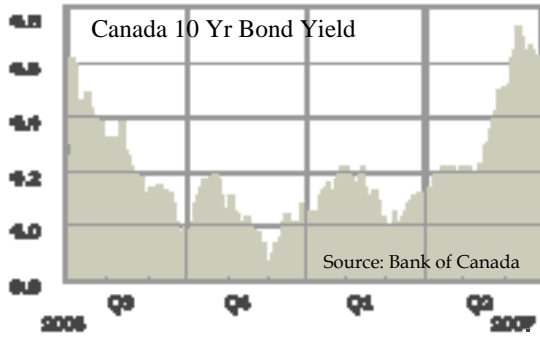
Equities:

The charts to the left show the 12-month price performance of the S&P/TSX Composite (TSX), the S&P 500 and EAFE indices. For the first six months of this year, the TSX provided a return of 9.05% on a total return basis. In U.S. dollar terms, the S&P 500 returned 6.96% year-to-date and the EAFE returned 11.09%. However, the strength of the Canadian dollar has substantially reduced these returns to -2.40% and 1.37% respectively.

Canadian cyclical stocks and hard assets (i.e. commodities) continued to outperform and it is difficult to know how long this trend will continue. A global recession would be the biggest risk to Cana-

dian markets. However, it appears a soft landing may have been successfully engineered and global growth may pick up once again. The U.S. market has done well on a price basis but the strong Canadian dollar has eroded all of these gains. Valuations in the U.S. large cap area look very attractive in comparison to both small capitalized companies and broad markets worldwide.

Earnings growth has slowed to single digits in both Canada and the U.S. but earnings yields in both countries remain comfortably higher than 10-year bond yields. Typically, this situation indicates favourable conditions for equities.



\$CDW (Canadian Dollar Index) INDX © StockCharts.com
29-Jun-2007 4:00pm O 93.32 H 94.88 L 93.23 Last 94.21 Chg +0.67 (+0.72%) ▲



\$WTIC (Oil - Light Crude - Continuous Contract (EOD)) INDX © StockCharts.com
29-Jun-2007 Op 68.85 Hi 71.06 Lo 67.07 Cl 70.88 Chg +1.54 (+2.23%) ▲



\$GOLD (Gold - Continuous Contract (EOD)) INDX © StockCharts.com
29-Jun-2007 Op 657.40 Hi 657.70 Lo 641.10 Cl 650.90 Chg -6.10 (-0.93%) ▼



Fixed Income and Interest Rates:

The major news in fixed income this year is the recent increase in long-bond yields. This rise has caused the previously inverted yield curve to return to a more normal (non-inverted) position. One reason for this change could be that a soft landing has already occurred, bringing with it an increase in global growth. This renewed strength in anticipated global growth is causing inflation concerns to resurface. Since higher inflation expectations generally lead to higher interest rates, the anticipation of further rate increases may have caused long-bonds to sell-off. However, these concerns may be overdone since core inflation contin-

ues to be muted and in a comfortable range. Global monetary conditions remain restrictive as a result. Another reason for the rise in long-bond yields may be related to a reduction in Asian purchases of U.S. Treasuries. Asian banks have been buying U.S. Treasuries to keep their own currencies from appreciating against the U.S. dollar. Some estimates suggest these purchases have pushed long U.S. bond yields between a half and a full percentage point below where they would otherwise have been. If Asian appetite for U.S. debt is declining, even higher long bond yields may result.

Currencies:

The Canadian dollar has been very strong, rising from \$0.86 to over \$0.94 year to date, in spite of the relatively lower interest rate yields in our country. This strength can be attributed to recent foreign acquisition activity in Canada and to higher commodity prices, particularly oil. Our currency has also been higher versus the euro and the pound

sterling, likely because speculators are entering the Canadian currency market, pushing the dollar higher than normal. The ongoing strength of our dollar continues to pose a significant challenge to Canadian manufacturers. However, it is also a positive force in lowering inflation as a result of lower import costs to consumers and business.

Commodities:

The chart to the left shows the volatility in the price of oil over the past 12 months. One year ago, oil was trading at US\$73 a barrel, but concerns over a slowing global economy caused it to fall to about US\$53 by January of this year. Since then, anticipation of renewed global growth has pushed oil back above US\$70. Also contributing to the strength in oil has been strong demand from BRIC (Brazil, Russia, India, and China) countries.

Gold, as indicated by the chart on the bottom left, has also been strong. The price of an ounce of gold has risen from US\$613 a year ago to slightly more than US\$650 as of the end of June. Since gold is seen as an inflationary hedge, this strength may be justified. Even though core inflation appears to be under control, renewed global growth could lead to higher inflation and consequently, higher gold prices.

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