LEITH WHEELER INVESTMENT OUTLOOK

Leith Wheeler
INVESTMENT COUNSEL LTD.

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U.S. Stocks. Why now? Why Leith Wheeler?

Looking back at 2006, Canadian investors will be very pleased with their equity returns. The Canadian market, represented by the S&P/TSX, advanced 17.3% in 2006 and has grown 13.1% per year compounded annually for the last 5 years. The US market, by comparison grew by 15.7% in 2006 (in Canadian dollars) and declined by 0.2% per year over the past five years. Even if we factor out the appreciation of the Canadian dollar, the S&P500 only rose 6.1% per year compounded annually, or less than one half of the annual return for Canadian stocks, over the last five years. So why invest in U.S. equities at all given their poor performance; not to mention the exorbitant U.S. trade deficit, weak housing market and the prospect of an economic slowdown?

One of the principal reasons for U.S. equity exposure is diversification, obtaining exposure in your portfolio to investment opportunities not available in Canada. The composition of the two markets is very different - the U.S. market is broad, and the Canadian market is relatively concentrated. To illustrate this point, the Energy and Materials (i.e. mining and forest products) sectors account for 44% of the Canadian market. While in comparison the same two groups represent only 13% of the U.S. market. The U.S. market offers the opportunity to gain exposure to sectors like Health Care and Technology which have very little representation in Canada. Case in point, in Canada we have 9 companies in the Health Care sector with a total market capitalization of C$11.7 Billion. The U.S. has 25 listed companies, including well known global firms like Johnson and Johnson whose market capitalization is $191.4 Billion or more than 15 times the size of the entire Health Care sector in Canada.

Indeed many listed U.S. companies, several of which are in Leith Wheeler's U.S. portfolios, are global in nature. For example Standard and Poor's has an index which contains the top 100 global companies. These are companies which have significant sales operations and assets outside their American country, and so are not solely dependant on the health or strength of the U.S. economy. Within this index there are 36 companies, (four times the number from any other country), with a combined weight of 48%. Contrast this to Canada with 2 companies, Alcan and Nortel and a combined weight of only 0.3%. Therefore, it can be argued that adding certain US equities can also give your portfolio significant global exposure.

Another reason to invest in the U.S. market is currency diversification. While it has been true that Canadian investors have seen the value of their U.S. investments hurt by the strength of the Canadian dollar in recent years, we hold the opinion that short-term currency fluctuations are almost impossible to predict. The relative fortunes of the Canadian dollar are subject to a variety of economic variables, not the least of which are the prices of energy and other resource commodities which account for a significant portion of the economy. Clearly the decline in energy prices in the second half of 2006 contributed to a relatively weaker Canadian dollar, however most other commodities remain near their cyclical highs. In our view, we haven't found much value in commodity related businesses and believe that there is too much optimism priced into this area of the market. Given that weakness in commodity prices could further weaken the Canadian dollar, we think that it is prudent for investors to have adequate currency diversification in their portfolio.

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Leith Wheeler may be best known for strong Canadian Equity returns generated from a proven approach to value investing. Our investing approach in the US is similar. We use Sprucegrove Investment Management, a Toronto based investment counsel firm, that is one of the top global equity managers in North America. Sprucegrove has managed our International Equities since 1995 and took over management of our U.S. equities in the fall of 2001.

We have developed a strong record of investment performance in U.S. equities (please see our website or contact Leith Wheeler), and the disciplined value investment style and process is consistent with our management of Canadian stocks. In both cases we look to invest in excellent companies that have strong management, yet are inexpensively priced. These companies are typically purchased with an investment time horizon of three to five years.

When investing we seek value in all areas of the market – small, mid and large companies. In 2003, for example, we were finding more value in smaller and medium sized companies and this was reflected in the U.S. portfolio where over half of the investments were companies in this size range. As the market recognized the value of these companies and their share prices rose, these positions were reduced or sold with the proceeds invested in more attractively priced businesses. More recently the U.S. portfolio has added larger companies whose share prices have lagged over the past seven years, despite impressive earnings growth. Coincidentally, this move into larger companies has also resulted in the purchase of many of the names in the S&P Global 100 Index. At this time, our U.S. portfolio is 83% invested in large capitalization stocks. These are world class companies who have gone from being very richly priced in 1999 to having some of the best valuations in a decade.

Ten of the largest companies in the U.S. Equity Fund and their returns in 2006 are outlined in the following table:

Company	2006 Return	Market Capitalization ($US Billion)
Microsoft Corp.	15.7%	$294.9
Citigroup Inc.	19.3%	$273.7
Johnson & Johnson	12.4%	$191.4
Berkshire Hathaway	24.9%	$169.6
JP Morgan Chase & Co.	25.4%	$167.5
Well Fargo & Co.	17.7%	$120.1
Hewlett Packard Co.	45.1%	$112.1
Verizon Communications	33.9%	$108.4
Merck & Company Inc.	42.3%	$94.7
Walt Disney Co.	44.3%	$70.9

Source: Standard & Poors

At Leith Wheeler we continually search for strong, well managed businesses trading at prices that will allow us to achieve above average returns over time. Those businesses are not all domiciled in Canada, and we are confident that the proven approach in the U.S. will continue to contribute to excellent portfolio returns for our clients.

Leith Wheeler Investment Counsel Ltd. (“Leith Wheeler”) is an employee owned firm providing portfolio management services for individuals, pensions and foundations.

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