LEITH WHEELER INVESTMENT OUTLOOK

Second Quarter 2007

25 Years: A Personal Retrospective

by Bill Wheeler

The phone sat on an overturned cardboard box. Our desks wouldn't arrive until the next day. It was twenty five years ago that Leith Wheeler opened for business. The landlord had already painted our name on the door. I was thrilled to see it that first day. It still gives me a buzz today.

Murray Leith and I had worked together in a small investment management subsidiary of Pemberton Securities (Pemberton was acquired by RBC in 1989). The opportunities to grow that business were limited because we were constrained against competing with Pemberton's investment manager clients for new business. We had a good investment record, some clients that might follow us and a youthful confidence that we could survive on our own.

We drew up a business plan one Saturday afternoon around my kitchen table. The plan required considerable generosity from our new banker friends. Murray and I were of like mind as to what we wanted to achieve: a high performance investment firm with a reputation for fair dealing. We agreed that our lifetime business objectives would be met by managing a total of $500 million of client assets. We didn't foresee that achieving the performance and fair dealing objectives would lead to significantly larger client assets than our $500 million plan.

By the time we opened our doors in 1982 a bear market in equities was in full swing and interest rates on long term Canada bonds were at 16%. The star performers of the prior cycle had been inflation hedge equities. Oils had been especially hot. Dome Petroleum was that cycle's Nortel, and it was well on its way to oblivion. Fortunately we never owned it. Dome's demise, and a broad market decline, created a new interest in sensible investing. We hoped that we could capture some of that interest.

We couldn't solicit our previous clients. The first they heard of our departure from Pemberton Securities was when Pemberton executives called to introduce themselves as their new managers. All we could do was hope that some of those clients would call us and move their accounts. Before the first day was done the phone rang and we had our first 'old' client. By the end of the month all our previous private clients had moved and we had a base of about $25 million. It was enough to cover overhead. I will always be grateful to those clients who left a big firm to take a chance on us. It is particularly gratifying that virtually all those clients, or their families, are still with us.

Leith Wheeler Investment Counsel Ltd.
Suite 1500
400 Burrard Street
Vancouver, B.C.
V6C 3A6

Tel 604.683.3391
Fax 604.683.0323
info@leithwheeler.com
www.leithwheeler.com

Shortly after start up, we installed a computer and a record keeping system for client accounts. Such technology would be a given today, but it was cutting edge then. We went with a big hard drive. With 10 megabytes, we were sure we'd never have to buy another. Murray, something of a skeptic, maintained a separate manual set of client records for over a year until he was convinced the computer program actually worked.

Our equity investment style was unusual. In 1982 there were two kinds of investment management firms and they were not called "growth" or "value" as they are today (in fact, Leith Wheeler wasn't described as a "value" firm until we had been in business for a year or so and a consultant told us that they had analyzed our portfolio and that was what we were). The two kinds of firms were those that suffered from the resource blow up and those that managed to dodge it. We fell into the latter group.

Twenty five years and several investment cycles later, the core investment approach and essential mission remains unchanged

We described our style as "careful, thorough and based on the idea that we would buy a stock if it made sense even if there was no stock market to buy it back". In other words, we would buy a stock only if buying the whole business made sense. Overall, our portfolios had certain statistical characteristics such as low price to book value, low price to earnings, low price to cash flow, and, at that time, a heavy exposure to smaller companies.

In the period prior to 1982 it was easy to explain our bond style: "see a bond, sell a bond" summed it up nicely. It was simple, and it worked for many years as inflation and interest rates rose. In 1982, with high interest rates, we reversed that stance and bought long term bonds.

We opened the doors with the idea that smaller pension funds and high net worth individual clients were underserved and that we would target those markets. With no sales experience and no sales training, the initial foray into the pension fund market proved to be harder than we thought. The typical 'beauty contest' where pension trustees bring in three or four managers for a 30 minute presentation did not work well for us. Murray would just be warming up when the trustees would call "time".

During our first year in business we made a presentation to the pension trustees of a large and growing local firm. We were thanked politely and the VP of Finance walked between us to the elevator to show us out. With his hand on our shoulders he said, "Look, if you are still in business a year from now, we will give you a bit of money to manage". Murray and I both knew what a polite brush off looked like and we gave it no further thought. A year later we were stunned to open a letter from the company advising us that we had been appointed to manage approximately $1 million for them and that they would make future additions if things went well. This experience convinced us that some formal sales training would help and we went off to school, one of the best investments we ever made. Today, we continue

to manage that portfolio which is now valued at more than $130 million.

Twenty five years and several investment cycles later have seen some major changes at Leith Wheeler. Yet the core investment approach and the essential mission, to produce exceptional investment results and to deal fairly with clients, employees and suppliers, remains unchanged.

One obvious change is the size of the firm. Today, Leith Wheeler manages over $8 billion in client assets and employs 37 people. Because rapid growth of an investment management firm often is accompanied by diminished investment performance, we have been careful to control the firm's growth. We currently limit our new business to individual clients, balanced pension, foundation and fixed income business but we have to decline Canadian equity only business and other assignments that use up our capacity in the Canadian market. This way, we can maintain our investment style and grow the firm at a manageable pace.

The use of technology has grown rapidly in our industry as a walk through any investment firm would confirm. While this firepower is necessary to be in business today, it does not provide an investment edge. The investment edge is the experience of the people, the process that is used in making investment decisions and the culture of the firm. One aspect of culture is the willingness of the investment professionals to build portfolios that look very different compared to the market.

"Would we buy the whole business?" is still the question that is asked before our clients own a stock

Leith Wheeler has developed and attracted excellent people. The firm's distinct investment style, the focus on performance and clients, and the opportunity to own stock and be a partner in a strong investment firm are our recruiting advantages.

As the firm grew, we hired new people who brought new ideas and new approaches to our investing. While we tried to indoctrinate them in the Leith Wheeler way, they questioned and measured many of the firm's investment approaches leading to changes in how things were done. The most obvious change is our abandonment of market timing in equities. In the early years we occasionally carried quite large cash balances in our equity portfolios as a defensive tactic and with a view to deploying the cash opportunistically. Fresh eyes looked at the firm's record and showed that our portfolio was different from the market and held up better in down periods. As a result, we would have been further ahead if we had just held more of the equities we liked rather than holding cash in an attempt to avoid down markets. Others would go on to examine many of the indicators we had been using to make the "cash or stock" decision and prove that the reliability of these indicators was too low to be of use. Faced with these insights, we changed our approach. That was almost 20 years ago and it has been a good move.

Today the Canadian equity team is comprised of four members. The two most senior members, Bill Dye and Dave Jiles, have been with the firm for 22 years and 12 years respectively. They have defined the firm's equity investment style as much

as they have been shaped by it. They have a history of constructing portfolios that look different than the market. While there are business risks to this approach, it is what our clients pay us to do. "Would we buy the whole business?" is still the question that is asked before our clients own a stock.

There have also been some significant changes on the fixed income side. While the "old guard" made a well timed decision to own long bonds in 1982, such astute moves became rarer in later years as inflation declined. Having cut our investment teeth during the inflationary 1970's, the old guard didn't foresee the extent to which inflation would be wrung out of the economy over the next 20 years. By the mid 1990's we realized we needed more fixed income expertise and found it in Dave Schaffner. Dave has since built a solid bond team and has expanded our expertise in both credit analysis and international fixed income investing.

International equity investing was another significant move. In 1995 we hired Sprucegrove Investment Management, a Toronto based firm that has a very similar investment philosophy to ours, to manage international equities. After seeing Sprucegrove also perform well in the US market, we terminated our efforts to invest in that market and, over 5 years ago assigned our US portfolio to Sprucegrove as well. Now, the people at Leith Wheeler are focused on what we do best, Canadian equities and fixed income, while Sprucegrove rounds out our portfolios with their international expertise.

Finally, perhaps a less than obvious change is the transition of the firm's management from the founders to the next generation. While transition is inevitable, the timing of our transition was partly circumstance and partly choice. The circumstance was Murray's illness and death in 2003. The death of my long term business associate and friend led me to choose to do sooner many of the things one puts off while building a business. In 2004 Dave Shaffner was appointed Chief Operating Officer. The next year he was made President. Dave has been supported by a management team of long time Leith Wheeler employees and by a Board of Directors. The Board includes two 'outside' directors who have provided us with good counsel. These moves completed the transition of the day to day management of the firm.

Today, Leith Wheeler is characterized by its energy and success. At a time when investment management firms are selling out to banks, life companies or going public, our firm is happily staying private. Most employees are shareholders. For the senior people, the firm's shares are the largest investment they have. This means there will be a continued focus on the original goals of the firm. Meeting these objectives will lead to a satisfied clientele and a great outcome for all.

Looking back over 25 years I am proud of what we've accomplished. We've achieved good investment returns. Our clients stay with us and are our best references. And, we have a great team in place that is committed to continuing our success. In my continuing role as chairman, I look forward to participating in the next 25 years.

Suite 1500 - 400 Burrard Street
Vancouver, BC
V6C 3A6

Phone: 604-683-3391
Fax: 604-683-0323
E-mail: info@leithwheeler.com

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

The Investment Outlook is not intended to provide advice, recommendations or offers to buy or sell any product or service. The information provided in this report is compiled from our own research and is based on assumptions that we believe to be reasonable and accurate at the time the report was written, but is subject to change without notice.

Leith Wheeler officers and employees may from time to time hold securities of issuers discussed in The Investment Outlook. If you are interested in our personal investing policy please contact us at

Contributing writer:
Bill Wheeler, CFA
Chairman

Editor:
Jon Palfrey, CFA
Vice President