LEITH WHEELER INVESTMENT OUTLOOK

Leith Wheeler
INVESTMENT COUNSEL LTD.

Third Quarter 2010

The Lost Decade

As the table below highlights, investment returns over the decade from the end of 1999 to the end of 2009 globally were decidedly negative, leading some in the financial press to coin this period the "Lost Decade". For a Canadian-based investor these returns have been further impacted negatively by the strong appreciation of the Canadian dollar.

Index	10-year Annual Total Return ($CDN)
S&P 500	-4.1%
MSCI World	-3.4%
MSCI EAFE	-2.1%

One will recall that the "lost decade" (1999-2009) began during a period of strong global economic performance and jubilant investor sentiment towards new business models related to advancements in technology, media and telecommunications (TMT). This euphoria would push global equity market indices towards record high levels, while equity valuations in TMT-related companies were stratospheric. However economic realities would prevail, causing the "TMT bubble" to deflate. This correction was exacerbated by a confluence of a mild recession, terrorism and war. In an effort to stem the fallout from weaker economic activity, central banks around the world eased monetarily, and the private credit market responded by extending inexpensive credit over a multi-year period. Business activity responded in kind and equity valuations re-inflated during the ensuing credit bubble. This second bubble also proved to be unsustainable and equity valuations deflated rapidly when the inexpensive, private credit market abruptly seized up in late 2008 and much of the developed world declined into a deep recession.

While price risk is inherent in equity markets and investors are prepared to accept periods of negative return, a negative return for the S&P 500 index over a period as long as a full decade is sobering. This is especially true for entities that possess long-lived liabilities such as pension plans. A Canadian-based, passive U.S. investment strategy would have meaningfully out-performed simply by holding U.S. government treasuries or bonds (compounded annual index returns in Canadian dollars ranged from 2.8% to 3.3% respectively) during the decade. The hazards related to vastly unrealistic investor expectations – both euphoric and pessimistic - that become manifested in equity valuations are well illustrated by the past decade's experience. Many intervening years may be required before the lasting impact of such expectations finally becomes exorcized.

And while global equity market performance has been challenging during the past decade and may well remain so into the next decade, all is not "lost". At the heart of the S&P500 and equity markets overall are real companies, populated by capable employees that strive to create and market products or services that are valued by the world at large. The "best" of these companies will typically have an inherent advantage, either in the assets they own and/or the quality of employees they attract. They will market industry leading products and/or services that provide the best chance to optimize value creation over the long-term. As a result, the equity market price weakness over the past decade has simply enabled investors to purchase these leading companies at valuations

On June 19th and 20th, 16 people made up a Leith Wheeler team that participated in the *Ride to Conquer Cancer,* a bike ride from Vancouver to Seattle.

The team raised over $65,000 to benefit the BC Cancer Foundation, in memory of Murray Leith and numerous other friends and family affected by cancer.

www.conquercancer.ca

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much more reasonable than they were a decade ago. As these companies succeed, their economic value will increase and will be recognized by the equity markets at some indeterminable point in the future.

Employing a fundamentally-driven, active investment philosophy, we at Sprucegrove concur: economic realities will always supersede market sentiment over the long-term. Identifying those companies possessing superior economics and participating in those economics through long-term share ownership is our primary focus. In the table presented below, the Fund's top ten holdings are illustrated, along with the compounded annual rates of growth for their respective sales per share (SPS) , their earnings per share (EPS), their book value per share (BVPS) and their share price performance. Also highlighted is their respective ten year average return on equity (ROE).

	10 Year				
	SPS Growth	EPS Growth	Bvps Growth	ROE	U.S. $ Annual Return
Markel	nm	11.0%	15.2%	22.5%	8.2%
Wells Fargo	nm	4.7%	11.8%	16.0%	2.9%
Merck	2.0%	8.8%	12.8%	36.0%	-5.9%
Johnson & Johnson	8.5%	11.4%	12.2%	27.8%	3.3%
Pfizer	4.9%	9.5%	17.4%	23.0%	-5.6%
3M	5.4%	8.1%	8.6%	31.6%	5.4%
Carnival Corp.	11.2%	3.1%	11.3%	13.0%	-4.0%
Apache	17.2%	22.3%	18.0%	17.0%	20.5%
Walgreen	13.8%	12.6%	15.5%	18.0%	2.3%
Berkshire Hathaway	nm	16.9%	8.3%	7.7%	5.9%
Average	**9.0%**	**10.8%**	**13.1%**	**21.3%**	**3.3%**
S&P 500	**1.1%**	**1.7%**	**5.4%**	**12.4%**	**-2.7%**

Many of these companies have been in existence for a great number of years, if not decades, and have successfully navigated previous economic and geopolitical difficulties including major recessions and war. These companies have created enormous equity value over their existence, including the past decade. Their economic value (primarily defined by book value growth) has increased at rates superior to that of the overall S&P 500 index. Even those companies that appear to have lagged - Wells Fargo and Carnival on an earnings growth rate basis or Berkshire Hathaway on a book value growth rate basis - are believed to have normalized earnings power well in excess of that implied by the data. These companies are presently being impacted more than the others by the current economic downturn or the weak capital markets but all have had the wherewithal to continue to invest for the future.

Keynes once lightly remarked that "in the long-term, we are all dead" in an effort to diminish the benefits of longer-term investment horizons. While the statement is true of mortals, for the enterprise that possesses advantages related to superior assets and employees, and that continues to make the necessary investments to sustain them, the long-term only represents an enormous opportunity to compound economic value. And today, we are able to take part in this compounding of economic value at reasonable valuations.

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