WINTER

2014

2014 And Beyond – A Leith Wheeler Perspective

2013 turned out to be an exceptional year for equity markets, which drove strong investment returns for clients. Our U.S. portfolio, in Canadian dollars, delivered returns over 40% while Leith Wheeler clients also enjoyed both Canadian and International stock returns close to 25%. Bonds delivered slightly negative returns given the increase in interest rates over the year, partly due to a brightening economic outlook. While these returns are encouraging, the natural question becomes what to expect in 2014 and beyond.

Global Growth

We expect global economic growth to continue to improve gradually, increasing 2-3% per annum. The U.S. housing market continues to gather forward momentum, as new home starts of over a million homes annually represents its best performance since 2008. Also, U.S. consumers have made substantial progress in improving their balance sheets, despite reasonably tepid job growth and income gains. Consumer spending has ticked up and retail sales are growing. Auto sales are on track for 17 million in annual sales, a level the U.S. has not seen since 2007.

Important U.S. Indicators are Improving

Sources: U.S. Department of Commerce: Census Bureau, CBO, Federal Reserve Bank of Atlanta

New home starts are on the rise with more room for improvement

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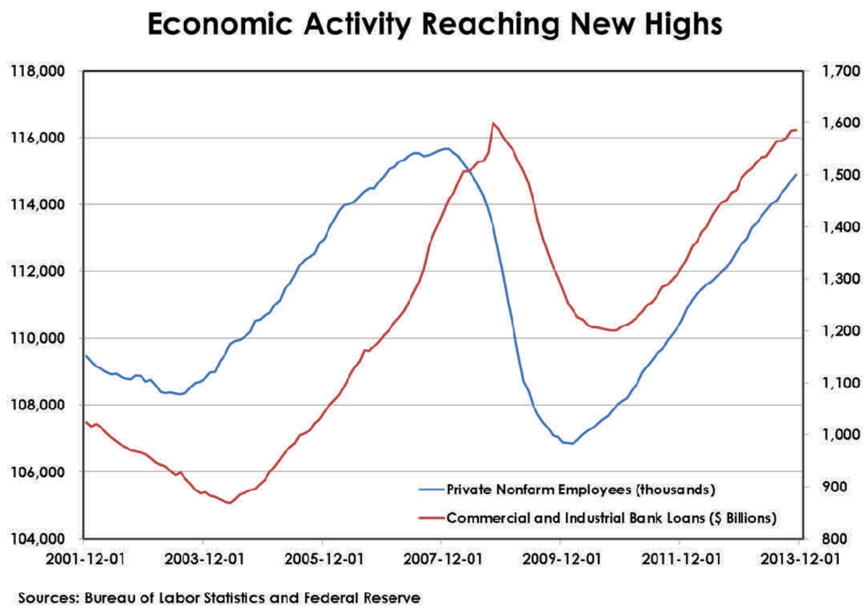
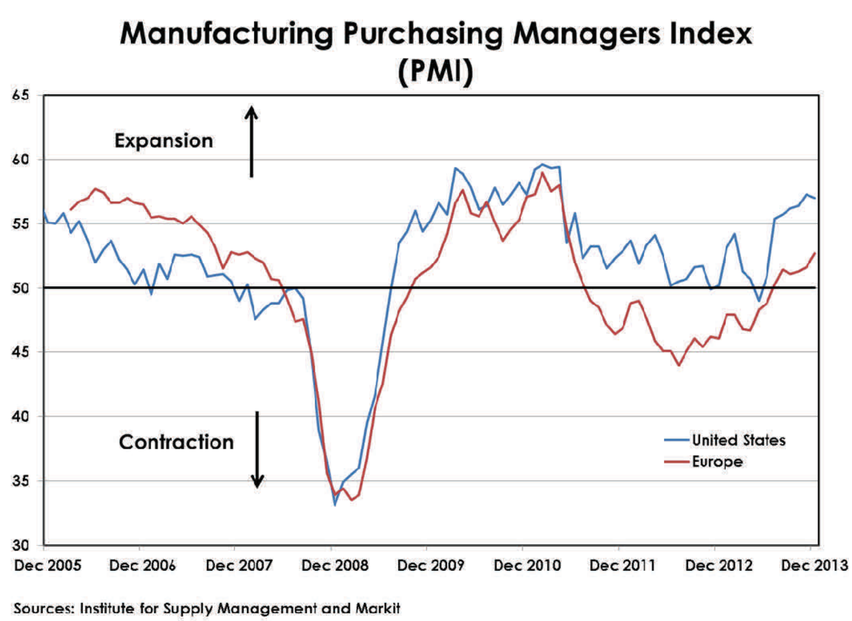


U.S. job losses have been completely reversed

Business spending has reached new highs which should help economic growth prospects

While the U.S. recovery is the brightest spark globally, part of the improvement will also come from Europe, which despite pockets of weakness, is starting to grow again after its deep recession. The recovery is being driven by the industrial heartland in the north, but even in southern Europe, Italy and Spain are no longer contracting as badly and are showing some signs of very gradual renewed growth. All of this translates into expected growth in the 1% per annum range for the Eurozone.



Europe is joining the recovery party

Emerging markets and China, which are critical for our Canadian natural resource companies, will most likely grow in the 6-8% per annum range. While lower than the past rates many have grown accustomed to, these levels are still quite reasonable in our view. The flip side to relatively slower growth from emerging markets and China is that developed countries will no longer have to contend with rising commodity prices.   For example, China's economic engine, which fueled increased commodity demand, hurt both capital spending and consumers here at home. A more reasonable growth trajectory for the emerging markets and China will mean less competition for the natural resources required to fuel our own economic growth and will act as less of a tax on domestic consumers.

The biggest determinant of global growth is the potential impact from corporate investment in plant and equipment. Business confidence has been somewhat contained due to tepid sales growth and uncertainty over the U.S. budget and debt ceiling. However, there are some encouraging signs that things are getting better, particularly in the oil and gas sector and some parts of the U.S. manufacturing sector. Even with an improvement from depressed levels, capital spending is expected to grow at a slower pace than in previous recoveries.

Stock Markets

Most major stock markets have now recovered the losses sustained in the Great Recession. The run in equities, coupled with a modest economic recovery, has raised concerns that stock valuations are being inflated by the money-printing of the U.S. Federal Reserve ("the Fed"). However, it's our view that the primary driver of stock market valuations has been corporate profit growth, not the Fed's actions. If you look at the last five years, the S&P 500 has almost doubled; however, less than one-third of that rise has been due to increased valuations or an expansion of their Price-to-Earnings multiples (a measure of the fundamental value of stocks). The vast majority of the move has been due to improved earnings. As bottom-up stock pickers, we continue to find reasonable value in the market and are not seeing the type of stretched valuations that are indicative of what most investors would consider a bubble, especially when compared to the current investment opportunities in bonds or cash equivalents.

Revenue expectations are improving as market participants become more confident with global growth. Over the last several years, companies have improved their balance sheets and are now refinancing their debt at cheaper rates, further helping profitability. Finally, capital is being returned to shareholders through increased dividends and improved stock buybacks. We expect the market can deliver 4-5% per annum earnings growth with an additional 3% dividend yield, for an overall return in the 7-8% range. It is likely going to be more of a stock pickers' market going forward, one in which selection skill will be important in generating excess returns.

Bonds

What the Fed recently took away in terms of reduced bond buying, starting in early 2014, they gave back in increased clarity. First, we have a pretty clear road map for how long the bond tapering will take, in that the current bond buying program will most likely be concluded by the end of 2014. The second piece of clarity the Fed provided, which is even more important for the markets, was a roadmap for increasing interest rates. By indicating that they will most likely be keeping rates low, even past the previous threshold of an unemployment target of 6.5%, it means that the threat of an increase in interest rates has been pushed off to the latter part of 2015 and potentially even 2016. We expect bond returns will continue to remain low, in the 2-3% range over the next few years. Although this level of return does not compare favourably to our stock return expectations, the inclusion of select bonds still offer the benefits of diversification and relative stability that most investors require to offset the volatility in stocks.

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Conclusion

With stocks still expected to deliver a premium over bonds; we remain overweight stocks in most of our client accounts, despite the recent strength in the market. To determine the appropriate balance between stocks and bonds we seek out and assemble client portfolios that represent good value, which also offer a level of insurance should things not work out as we expect. All good investment opportunities certainly do not exist solely in stocks, as short and mid -term high quality corporate bonds and select preferred shares, if applicable, also represent good opportunities for 2014. Although a repeat of 2013 should not be expected, returns in balanced portfolios for 2014 and beyond should continue following a road to recovery.

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