MARCH 2011 NEWSLETTER

Published for the friends and clients of Financial Advisor
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Tax

All of the T3's should be out now. The T5008's for capital gains and losses are not as useful as our in house capital gain/loss reports. If you would like this report please call Barb. We can mail, fax, or email it to you or your accountant. Taxes should be easier for the 2011 year. Other than the REITs, most income trusts have converted back to corporations. As a result

In spite of the tragic natural disaster in Japan, political upheaval in some middle east countries, and the well known fiscal problems in the U.S. and some European countries, the market continues to march in an upward direction.

	March 31/10	Dec 31/10	March 31/11	% Gain for Qtr	% Gain for Last 12 Mos.
S&P 500	1,167	1,257	1,332	5.9%	14.1%
TSX 300	11,957	13,443	14,130	5.1%	18.1%

Fortunately the vast majority of my clients have participated in this rally. The following are our largest equity holdings:

	March 31/10	Dec 31/10	March 31/11	% Gain for Qtr	% Gain for Last 12 Mos.
H&R REIT	$16.74	$19.43	$21.57	11.0%	28.8%
Royal Bank	59.70	55.15	60.66	10.0%	1.6%
TD Bank	75.98	74.25	85.90	15.6%	13.0%
Innergex	8.30	9.52	9.68	1.7%	16.6%
Trinidad Drilling	6.79	6.30	9.56	51.7%	40.8%
Average Gain (Not Including Dividends)				**18.0%**	**20.2%**

This basket of shares purchased one year ago had an average yield of 4.4%, so our largest 5 equity positions earned an average total return of 24.66%. Naturally most of you also own other shares, bonds, preferreds and money market, so only 100% equity portfolios would have achieved this type of return. The two best performers, H&R REIT and Trinidad Drilling were both clobbered during the market crisis, and fortunately 98% of you toughed out the bad times and many of you added to your positions.

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Canadian T-Bills and Bonds

	Sept 30/10	Dec 31/10	March 31/11
90 day	0.85%	0.99%	0.93%
180 day	0.97%	1.12%	1.10%
1 year	1.21%	1.36%	1.35%
2 year	1.33%	1.53%	1.83%
5 year	1.91%	2.30%	2.78%
10 year	2.75%	3.11%	3.37%
30 year	3.38%	3.58%	3.77%

U.S. T-Bills and Bonds

	Sept 30/10	Dec 31/10	March 31/11
90 Day	0.15%	0.125%	0.06%
180 Day	0.18%	0.148%	0.155%
1 year	0.24%	0.27%	0.23%
2 year	0.42%	0.61%	0.80%
5 year	1.27%	2.02%	2.25%
10 year	2.51%	3.34%	3.44%
30 year	3.68%	4.39%	4.48%

Short term rates are mostly influenced by government policy and longer term rates are mostly influenced by market forces. Note that in both Canada and the U.S. there is an upward bias for interest rates for terms beyond two years.

QE2

Immediately following the market crash in the fall of 2008 the U.S. government initiated a policy called quantitative easing (QE). This program involves borrowing money with short term T-bill auctions to buy long term bonds. The political goal was to bid up the prices of the long bonds, which lowers interest rates. This helps borrowers pay down debts at low rates, and also creates an environment where investors like us have no zero risk fixed income alternatives, and are almost forced into equity assets to make a reasonable return.

While I should be the last one to find fault with a policy that allowed our portfolios to bounce back so well in the last two years, I have reservations looking forward.

Firstly QE2 is supposed to expire in June, with the hope that the private sectors recovery can replace the Government's monetary stimulation. If QE2 expires without a QE3 to replace it, the main buyer of U.S. long bonds will be out of the market. We should expect prices to fall, raising long term interest rates. A QE3 program may be initiated to support bond prices, but perpetually borrowing money to artificially raise the price of an asset class doesn't seem sustainable to me.

Warning Flag

As most of my clients want balanced portfolios, I am constantly on the lookout for new bonds and preferred shares. While there are a few preferreds that look good (Fairfax and Innergex at 5.0%), some seemingly very low quality issues sell out very quickly.

Example:

- ✓ convertible debenture 7.75% for 5 years (sounds good)
- ✓ price of underlying stock $0.32 (are you kidding??)
- ✓ market cap of stock $18.6 million (really)
- ✓ listing VSX (wow)
- ✓ time to sell out issue 10 minutes (holy smokes)

This company which I will not name so I don't get in any trouble, may run a fabulous business. However, the fact that the investing public will devour the debentures of $0.32 stocks is a warning sign to me. Two years ago (check my March 2009 newsletter) we could get 8% with Royal and TD bank capital trusts. In the corporate bond market the pendulum from risk aversion to risk complacency may have swung too far.

Strategy Today

My nature is to avoid radical portfolio changes (they look so bad if I'm wrong), but the following is what I think might be good ideas now:

1) Be patient with money market balances, they may be very useful if interest rates rise.

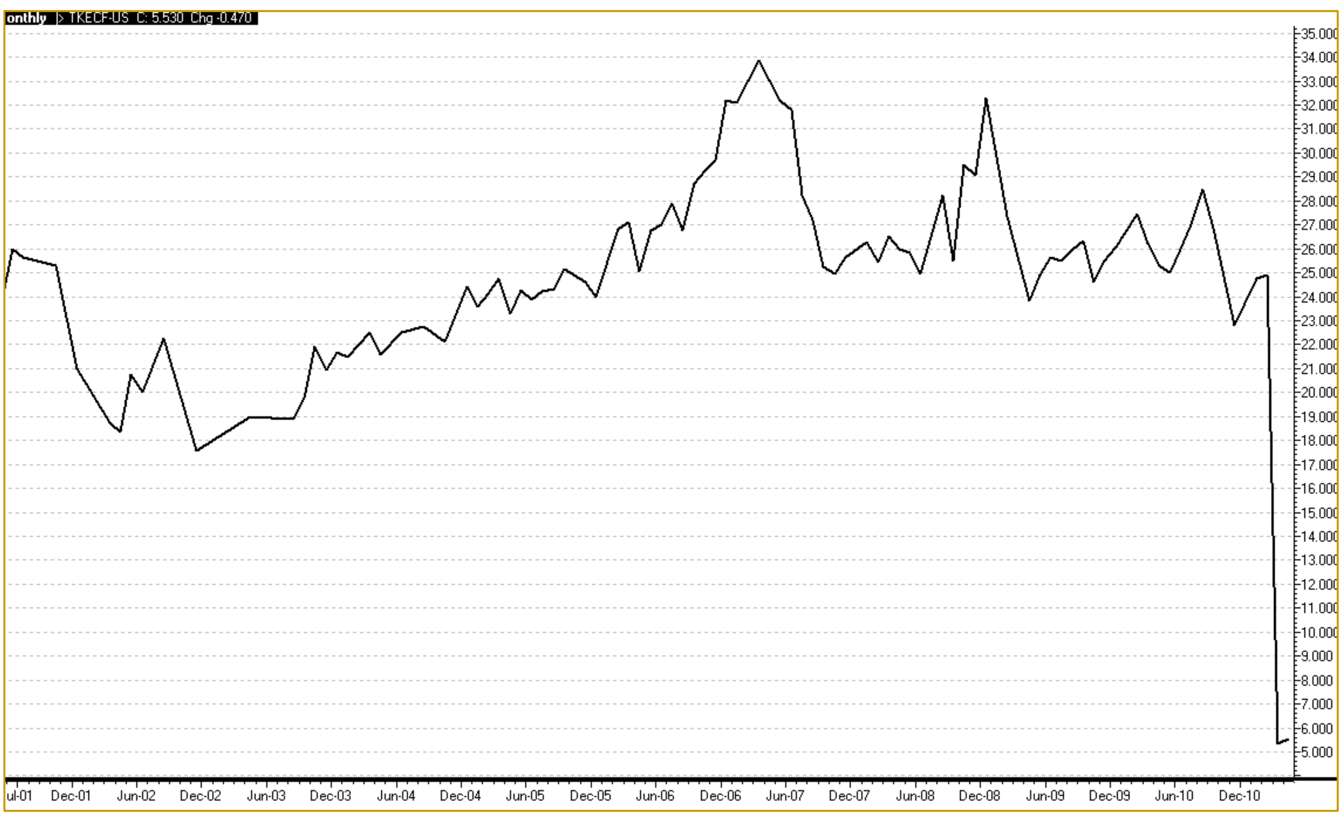
2) If you have a higher equity percentage than you like (the market rise has moved this % up) you could consider selling some dogs. A "dog" stock would be one where the company has not been able to adapt to changes in their business, or companies where the management continues to disappoint shareholders. While it is a painful process to take losses, it is usually better to sell the bad stocks, keep the good ones, and move on.

3) If you are significantly overweight with interest sensitive shares due to their rapid rise, you might pare back these positions slightly (REITs, utilities, etc).

4) I would think that energy shares should continue to do well. The index is not near its 2008 high and nuclear power enthusiasm should be dampened for a while. There are a lot of people in oil rich countries who don't get to participate in the rewards due to their ethnic group, tribe, or lack of connections to the ruling family. With the internet these people can see what they don't have, and the lavish lifestyles of their leaders. My own personal view is that there will be a lot of pressure to create multi-cultural democracies. While this should be good for all concerned in the long run, it should keep oil prices high in the short and medium term.

Argument for Diversification

While we always have a temptation to overweight our best idea, sometimes seemingly great companies get unexpected bad news. The following is a chart of Tokyo Electric, which up until the recent earthquake was a strong electric utility in a wealthy first world country. Now it is the owner of nuclear reactors leaking radiation. The ADR was $25.00 in February and is now $6.00. Fortunately this is not one of our holdings.



Tokyo Electric Source: Thomson One

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Getting Better

My recovery from shoulder surgery is doing well and I can now drive, write, and even jog again. I'd like to thank Dale Rowe for helping me out with driving and writing during this time.

All the best for the next quarter!

Ian Douglas Financial Advisor	Barbara Holmes Administrative Assistant	Lindy Edgett Receptionist

Note: For those of you who would like to receive future newsletters electronically, please email Barbara at barbara.holmes@raymondjames.ca and she will put you on our email list.
