Barrantagh

Investment Management

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- Major global economies continue to grow at an above trend pace led by the U.S. and Asia with Europe recovering.

- The U.S. economy has so far staved off the potentially negative impact of rising interest rates, elevated energy prices, a possible housing market slowdown and higher consumer/government debt. U.S. capital goods spending is strong and U.S. exports may accelerate to replace weakening consumer spending.

- Newly appointed Fed Chairman, Bernanke, has made it clear that he is targeting rising inflation and Fed tightening may well continue beyond mid year. The housing market and stock markets are secondary concerns to price stability for Mr. Bernanke.

- Our equity strategy continues to focus on companies evidencing visible and predictable out performance. We see increased risks in equity markets as a whole, but no sign of a significant retreat near term. Returns this year are expected to be modest and more volatility will likely be evident. Well run companies with successful strategies underway and free cash flow generation will outperform.

- Oil and gas equities experienced a sharp sell-off in February, which we regard as a short term anomaly in the long term trend. The supply/demand fundamentals suggest natural gas price recovery will occur as the year progresses and many high quality junior/mid cap gas producers currently trade at reasonable valuations in relation to their outlook for strong cash flow growth.

- Fixed Income markets continue to be characterized by high valuations and narrow credit spreads. Our strategy is to emphasize credit quality and adopt a higher than usual cash holding until opportunities present themselves.

Economic Update – Strength Continues

As suggested in our last review, global economies collectively are continuing to grow at an above-trend pace. The European economy is showing signs of life fueled by German exports. In Japan, the growth outlook is the strongest in the last ten years and the deflationary syndrome is finally giving way to positive inflation. The all important Chinese economy continues to advance at about a 9% rate in spite of tighter banking rules and rising wages. Overall, global economies grew in the last quarter of 2005 at a 4.6% rate.

In the short run there are no obvious reasons to expect the major global economies will run into trouble soon but some developments deserve careful monitoring. Positive economic trends in North America are underpinned for now by the U.S. consumer and the willingness of foreigners to finance the U.S. deficit. Should these conditions suddenly reverse, global economies and capital markets would stumble. Government policy and corporate restructuring are having a positive impact on Europe and Japan but the potential for policy error and complacency is real. More broadly the geopolitical backdrop is very unsettled with Iraq mired in civil unrest and the U.S. attempting to handle a nuclear standoff with Iran. Investors are aware that the avian flu virus is not fully under control and worries are growing that it could become a grave human pandemic. Perhaps the key current global issue is the changing of leadership at the Federal Reserve as Ben Bernanke takes the helm after more than 18 years of relative stability under Mr. Greenspan.

In the US, despite a hurricane induced weak Q4, the U.S. economy is set to achieve near 5% growth in the first quarter. Robust consumer spending is strongly supported by improving job markets and low interest rates compared with historical levels and previous gains in wealth. New claims for unemployment insurance remain low and monthly payroll increases of more than 250,000 jobs were reported in mid March. Furthermore, the U.S. economy seems to be adjusting well to the gradual increase in the fed fund rate which began in mid 2004. U.S. economic growth has taken place without inflation getting out of control despite severe shocks including hurricane Katrina and high energy prices. For now, concerns about a slowdown in consumer spending, negative effects of the rising twin deficits and fears of lagging investment demand are being diffused by reasonably healthy data releases.

Upon closer inspection, it would appear that the North American economies are in transition to a lower growth path. Although data is mixed, the housing market, one of the main supports to ongoing consumer spending, is showing signs of weakness. Households have never been as reliant on any one asset class as they are today on the value of their homes. At the same time the U.S. economy is entering a maturing business cycle phase. Capacity constraints are evident and unit labor costs are rising as wages catch up with productivity, ultimately putting pressure on corporate profits.

Equity Markets – Corporate Profit Focus

The continuing strength of global economies is a source of support to equity markets but the real issues in our view are the growing risks of earnings disappointments and multiple compression. Negative developments on these two fronts will cause equity markets to stall out. From our perspective, the markets seem unrealistically content that profits will continue to grow in line with recent trends. At this point in the profit cycle, margins are hovering near record highs and many leading indicators suggest that top line growth is beginning to moderate. In fact, earnings estimate revisions have been trending lower as analysts adjust their forecast to more closely reflect economic reality. At the same time corporations are letting the analyst community realize that their earnings forecasts are overly

optimistic. We believe the most dynamic phase of earnings expansion has passed, and therefore, markets are more dependent on an upward revaluation to produce market returns in line with recent trends. For this to occur, it would be necessary for higher earnings multiples to be applied in valuing securities. In our view, revaluation upwards is not likely as policy rates are still rising and a decline in financial market liquidity will likely follow. These are ingredients which have always been associated with a contraction in valuation multiples.

Regardless, stock market values should receive ongoing support from relatively low long term bond yields and record levels of merger and acquisition activity as companies consolidate to gain market share and operating efficiencies. On balance, we do not foresee a bear market for the broad North American indices, but we do anticipate modest returns accompanied by an increase in volatility. Of course, a period of earnings disappointments will not transmit uniformly across the equity market. Over the last year we have been careful to select equities where there is a high degree of cash flow growth predictability and stable growth prospects. At the same time we favor companies that pay dividends and have a history of dividend growth. Companies such as Shaw Communications, Shopper's Drug Mart, a number of financial institutions, and Telus meet our criteria. In our equity selection process we have attempted to strike a balance between appreciation potential and downside protection in the form of reasonable valuation, market liquidity and M&A value in some cases should the stock market fail to recognize intrinsic worth. A portfolio constructed on this basis is a sound defense against any of the exogenous events mentioned previously that could derail market confidence.

The markets have been and continue to be powered by the resource sector. We have added Alcan, a large aluminum producer to our base metal positions. We believe that Alcan is well positioned to take advantage of soaring commodity prices as capacity is shut down in places like China due to electricity (a key cost in manufacturing aluminum) shortages.

We would be remiss if we did not mention the energy sector given its importance to the Canadian economy and market. February was unnerving for oil and gas investors with nearly three months of gains erased. Nevertheless, we are confident that a position in oil and gas equities is still valid. The global supply and demand fundamentals remain chronically tight and will take years of heavy investment in exploration and infrastructure to restore a balance. We particularly favor natural gas producers at this time for several reasons. North American basins are maturing, leaving natural gas supply challenged and costs increasing. Record drilling activity over the last two years has done little to increase North American gas production and competition for liquefied natural gas (LNG) on a global basis is diverting cargos away from North American markets.

Our analysis shows that mid-cap and small-cap producers are well positioned to deliver strong returns and stock market appreciation in 2006. These producers have drilling prospects on large undeveloped land holdings and a history of successful low cost drilling. They are managed by skilled, "cycle proven" management teams, with proven skills in exploration and operations. The industry is financially strong with balance sheets that will permit growth through periods of weak commodity prices without equity dilution.

Fixed Income Markets – More Fed Tightening

Fixed income markets globally have felt the impact of strong economic growth, rising but contained inflation, high demand (i.e. high prices) for fixed income securities and rising event risk. These conditions have been catalysts for increasing short term rates relative to long rates (i.e. yield curve

flattening) making fixed income strategies based on interest rate movements very difficult. In the all important U.S. market, the transition from Greenspan to Bernanke is a complicating factor in forecasting U.S. monetary policy and, of course, U.S. interest rate policy has global ramifications.

On March 27, Mr. Bernanke announced a predictable 25 basis point Fed funds increase to 4.75%, the 15th hike since May, 2004. Investors focused intently on the rhetoric surrounding the hike for clues as to the direction of monetary policy going forward. Based on his actions and words so far it appears that Mr. Bernanke will not depart significantly from the direction taken by Mr. Greenspan. Mr. Bernanke remains concerned about inflationary pressures from a fully employed economy and from potential commodity price increases. Fixed income investors are now digesting the surprising strength of the U.S. economy which may dictate further Fed action.

Until recently, yields on long dated maturities were stubborn to move upwards because of a confluence of forces, particularly foreign demand, which suppressed yields at the long end. Even with the recent increase in yields the bond market, in our view, still remains fully valued. We have commented before on the key influences driving bond prices higher, including, strong global demand for yield, strong demand for long-dated bonds from institutions, the investment of Asia's surplus savings and narrow spreads between long and short dated government bonds. Looking ahead, a sharp and protracted economic slump would be required for a bull market in bonds to develop and our economic analysis places a low probability on this scenario. Accordingly, the investment opportunity in government bonds is not compelling. Turning to the corporate bond market, opportunities are not very obvious either. Credit spreads have narrowed to their lowest level in years. The search for yield and a massive improvement in corporate balance sheets in response to strong profits growth have propelled corporate bond prices ever upward. With the Fed continuing to tighten and earnings cash flow growth potentially slowing, it is difficult to foresee further corporate bond upward valuations. Accordingly, it is our basic view that waiting for a correction is prudent which implies holding unusually high cash balances. Generally, we remain underweight bonds in our balanced accounts and will remain in that position until clear opportunities emerge.

Barrantagh Investment Management Inc. provides disciplined portfolio management to institutional and individual investors. The firm is committed to a high level of client service provided directly by its experienced partners. We are dedicated to preserving our clients' capital while generating growth through consistent application of our value-based fundamental investment philosophy. We manage portfolios on a segregated basis to meet our clients' investment objectives. Because the firm is owned by our professional staff we maintain a completely independent and objective perspective.

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