

Living Beyond Your Total Returns

— JASON VINCENT, PFP, TEP, CHIEF OPERATING OFFICER AND VICE PRESIDENT, MULTI-FAMILY OFFICE

What two words have arguably had the most impact on investors over the past decade? In my view they're: total returns. This seemingly simple term has played a central role in discussions about portfolio construction and management for years. Mention total returns and people generally associate it with that near-magical, if not theoretical annual return figure of 8% to 10%. Individuals have built their lifestyles around it. Foundations, trusts and pension funds have based their financial commitments on it. Now many investors are feeling the ramifications of it.

So what's wrong with thinking in terms of total returns? Nothing in theory, but it's critical to fully appreciate how "living" with total returns looks over the course of market cycles. A portfolio's total returns are comprised of accumulated interest, dividends and capital gains. Focusing on total returns offers a straightforward, flexible way of constructing portfolios and, in most cases, I believe more aggressive portfolios. Here's how it has likely worked for many people:

Retirees, Mr. and Mrs. Brown, have a \$2,000,000 heavily equity-weighted portfolio, targeting 10% annual total return.

ESTIMATED TOTAL RETURN:	\$200,000 PER YEAR
—	Inflation and tax adjustments*
=	Anticipated annual cash flow/spending: \$144,000 annually
=	This will give them \$12,000 per month to spend. Or will it?

* Assuming a 3% rate of inflation and applying Alberta income tax rates.

During the past bull market, many investors set their spending based on total returns, thinking that, if necessary, they could subsidize cash flow requirements by selling assets. Clearly this worked for the past decade (excluding the past nine months) as markets rose. But what happens when markets turn and capital gains dry up? Look at a 10-year compounded annual return for the S&P/TSX Composite Total Return Index (as of March 31, 2009) and it now stands at 4.91%.

Yet, life's demands carry on and we believe many institutional and individual investors (particularly those who are retired) are facing significant spending commitments. They're facing many challenges, including the prospect of eroding their long-term capital in order to meet current cash flow needs.

It's a tough situation—one we prefer to help existing clients avoid and help new clients effectively address. In building portfolios, the conversation may come around to anticipated total returns. However, our first question is always: How much income do you need? We design portfolios with current or future cash flow as the top priority, whether it's for clients who are accumulating capital or are retired. A few things arise out of this approach:

- Matco Financial's private client philosophy involves a core approach to managing investments. In short, that means focusing first on income-generating securities such as bonds and dividend-paying stocks. As a result, investors see less portfolio volatility and higher yields.
- With income priorities driving planning, investors tend to be more realistic with their financial commitments.
- Once core cash flow objectives are addressed, then more aggressive securities or portfolios can be added according to the specific investment strategy.

Our approach isn't new, in fact it's a classic approach to investing that's meant to stand the test of time. We were building core income-first portfolios long before total returns figured so large in investment planning. We'll continue to help our clients live with a distinct view of their wealth for years to come. ■



MATCO FINANCIAL INC.

We are a wealth management office that believes a comprehensive approach to living well with money simply makes sense.

The result is strategies that help you shape what comes next, now and for generations. Strategies that integrate the investment portfolios, trust, estate and tax plans developed exclusively for you. Strategies that can be implemented seamlessly by our group or in concert with your advisors. Finally, consolidated reporting that gives you a comprehensive view of your wealth—raising hidden weaknesses and new opportunities. **This is what we do.**

As a private company, we have a personal stake in your success. We believe the most valued relationships are built one-on-one over time. We believe you judge risks and opportunities as much by the people involved as by the numbers on the page. **This is who we are.**



Matco Financial Inc.

Feeling the Effects of a Global Recession

— BILL K. DICKIE, CFA, PRESIDENT AND PORTFOLIO MANAGER

— JERRY A. OLYNUK, LLB, CFA, VICE PRESIDENT AND PORTFOLIO MANAGER

The real impact of the current recession showed up in startling GDP and unemployment numbers for the first quarter of 2009. Canadian real GDP shrank 0.7% in January alone, while first quarter U.S. GDP was estimated to have contracted an annualized 5.2%. The U.S. unemployment rate reached 8.5% in March, representing 5.1 million job losses, the highest total in the postwar era. Meanwhile Canada's rate spiked up to 7.7%. Surprisingly, U.S. consumer spending rose in January and February. Coupled with relatively positive news from major Canadian and U.S. banks, world stock markets rallied, climbing roughly 8% in March. The rally's strength, which represented yet another postwar record, had investors second-guessing whether a sustained rally from the 2008 correction was imminent. In our view, the recovery from February lows represented at best, a repricing of equities from a Depression-style scenario as the economy continues to send mixed signals to investors.

World leaders have been concerned primarily with avoiding a complete failure of the global banking system. The initial instalment of funds from the U.S. government's Troubled Asset Relief Program seemed to have a positive effect on bank balance sheets as Citigroup and Bank of America, for instance, reported a strong start to 2009. The meeting of G20 leaders also produced additional funding for the International Monetary Fund, which urgently required increased reserves to support Third World economies, especially in eastern Europe. In turn, this funding eased pressure on European banks, which had financed the bulk of expansion in these economies. The relative health of Canadian and Australian banks provided ongoing examples of prudence in a world of financial mismanagement and created momentum for a regulatory overhaul of global financial systems. These factors were the impetus behind the 15% rise in global Financials in March, as that sector led the overall stock market rally.

However, first quarter economic results were a relief only in the sense that they didn't surpass the negative expectations already built into forecasts. The market absorbed March U.S. job losses of 663,000, but the Manufacturing Index remained well below the 50 mark, which signals an expansion. The slide in Canadian real GDP hit both the manufacturing and service sectors as auto manufacturing collapsed and construction activity slowed dramatically. The increased consumer spending of January and February appears to have been an aberration in the face of increasing job losses, and increased household savings that invariably come at the expense of consumer spending on big-ticket items.

Taking Action

Our investment strategy at the outset of Q2 remains relatively unchanged. Given historic yields on Canadian and foreign equities, we favour defensive, dividend-paying stocks that will weather the absolute worst of the recession. We're approaching that stage as companies start reporting Q1 earnings and introduce further layoffs to reduce inventories and restore profitability. We're in month 17 of the current recession as compared to the 21-month duration of the worst recessions, so the retrenchment is reaching its limits. Positive earnings from the Financials sector would even support another leg up in the stock market. The real risks to this nascent recovery are economic shocks beyond the already sober assessment of investors. For instance, a disorderly bankruptcy of GM or Chrysler, or the liquidation of a major U.S. bank under the pending "stress tests" of the U.S. Treasury department would likely wipe out the cautious optimism of the past month. As we become incrementally less defensive on equity markets overall, we continue to factor these risks into the selection of financial and energy securities for our clients' portfolios. ■

OUR CURRENT INVESTMENT STRATEGY (for the period March 31, 2009 to June 30, 2009)

ASSET CLASS	STRATEGY (LONG-TERM)	TACTIC (SHORT-TERM)	ACTIVE BALANCED PORTFOLIO
Cash	Neutral	Unchanged	0.00%
Fixed Income	Neutral	Unchanged	50.00%
Canadian Equity	Neutral	Increasing	35.00%
U.S. Equity	Neutral	Decreasing	7.50%
International Equity	Neutral	Increasing	7.50%



Owning Companies that Pay

— LEE W. APPLETON, PORTFOLIO MANAGER AND ANALYST

For some investors, this past year has clearly been the worst of times. For some, now may very well be the best of times as dramatic market declines and investor emotion are producing extreme opportunities. We're focusing on high-quality, dividend-paying companies whose valuations, whichever way you measure them, are cheap—some are sitting at 20-year lows. These are not high-octane enterprises, but rather larger, well-established Canadian market businesses with track records demonstrating their ability to survive and even thrive in all market environments. These are companies whose dividend payments are currently outperforming the rate of return on Treasury bills and mid-term bonds. We're focusing on names such as CIBC, The Royal Bank of Canada and BCE.

For example, looking at CIBC, this company has weathered previous recessions seen in the early 1980s and the early 1990s. Our research shows over this 25-year period, CIBC never cut their dividends during tough times, but in fact increased dividend payments. This company is by no means immune to the repercussions of an economic downturn or investor panic as both history and its current share prices show. However, based on their track record and our ongoing analysis of their fundamentals, we expect the bank to weather this storm and continue to pay investors a healthy dividend and offer the opportunity for capital gains. We also think its current valuation of 7x trailing earnings per share (EPS) reflects the deep discount that comes with the emotionally charged, highly risk-averse theme in the Canadian market right now.

It's understandable that investors are cautious at the moment. However, we believe thorough analysis and strategic bottom-up stock selection provide a rational, fact-based approach to manoeuvring through this current market environment. In the Matco Equity Income portfolio, for example, we're working with opportunities that provide solid ground underfoot for investors ready to wade further into the equity markets—putting money to work and getting paid to wait for the recovery to come. ■



DIVIDEND YIELD OF CIBC



Source: CPMS, March 31, 2009

CIBC YIELD SPIKES (YS)

Date	Yield	6-month % Change	
		Before YS	After YS
Jun 82	11.22	-38%	82%
Jul 84	9.09	-25%	39%
Jul 86	6.34	-21%	32%
Oct 87	6.27	-18%	15%
Sep 90	6.22	-23%	44%
Jan 93	5.61	-15%	35%
Sep 99	4.24	-27%	46%
Oct 02	4.03	-29%	23%
Feb 09	8.06	-29%	?

As the graph demonstrates, CIBC has experienced nine yield spikes since 1981. As the accompanying table shows, during each spike, investors' emotions were tested with the severe sell-off. Following the yield spikes, opportunities were available for investors willing to look through the near-term environment and take advantage of longer-term opportunities.

Present Opportunities and Future Gains

— DANIEL S. CHENG, CFA, PORTFOLIO MANAGER AND ANALYST

Contrarians take note, amid the currently gloomy energy climate we believe opportunity exists now for those willing to look 12 to 24 months into the future. Our focus: junior to intermediate energy companies.

These companies have been seriously challenged over the past while. The majority of firms are natural gas weighted and with that commodity price sitting at a six-year low below \$4/mmBTU, production growth will be difficult this year due to reduced capital spending. In the near term, we expect tight credit conditions and little access to capital through equity markets will curtail exploration and drive consolidation activity in the junior to intermediate class. For the stronger firms with healthy balance sheets, it's cheaper to buy reserves than it is to drill.

Why look at these companies now? Though we expect volatility in the energy sector for the next six months, we're seeing junior and intermediate companies trading at very compelling valuations. As of the end of March 2009, for instance, junior energy companies were trading at approximately \$20,000 per flowing barrel of production while large caps were trading at about \$55,000 per flowing barrel—a significant valuation gap between the two. As the graph shows, on a reserve basis, you can buy companies at approximately 50% of the cost to drill, below \$10/boe as compared to \$20/boe to drill.

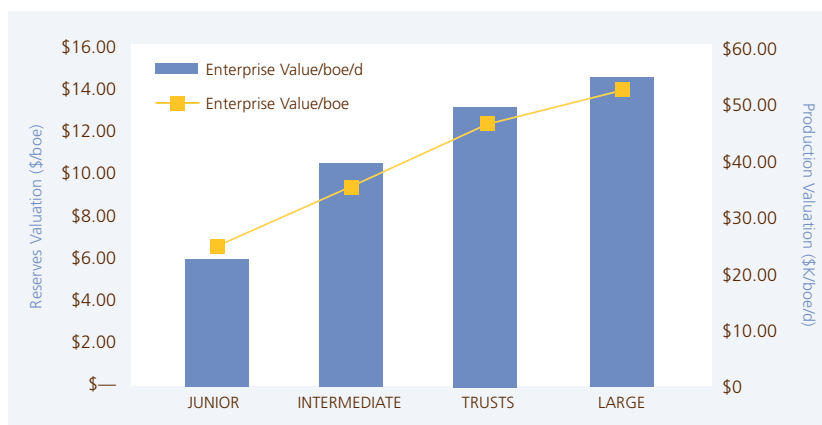
Are we rushing out to buy dogs at fire sale prices? No, based on our research and our unique relationship with Ross Smith Energy Group, we're focusing on those companies that are demonstrating their capabilities to survive and thrive—companies such as Progress Energy Resources Corp., Angle Energy Inc. and Vero Energy Inc.

Looking at the MFi Energy Fund (oil and gas) as an example portfolio, we're maintaining our bias towards junior and intermediate companies and are positioning the Fund to address an anticipated recovery in commodity prices in late

2009/early 2010. We believe the near term offers an opportunity to begin either averaging into energy holdings if you're not already in the sector, or to begin adding to existing positions, depending on your investment strategy. We believe this is an opportune time to look beyond the dreary daily headline news. ■



ENERGY SECTOR VALUATIONS ON PRODUCTION AND RESERVES BASIS



Source: Company Reports, Tristone Capital

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