

Investment

Review & Update



February 2007

Global Investing - A World of Difference!

One of the “golden rules” of investing is “Don’t follow the crowd!” One common thread among successful money managers is their ability to think creatively and invest somewhat unconventionally without being reckless or overly speculative. For example, David Swensen who has been the money manager for Yale University Foundation Fund for the past 25 years has successfully managed the University fund (annualized return of 16.9%) over periods of ups, downs and sideways markets and multiple economic cycles by investing unconventionally. He has authored a book called “Pioneering Portfolio Management - An Unconventional Approach to Institutional Investing” discussing how he has been able to achieve this success over 25 years with Yale.

However, the fact remains that many fund managers are happy to follow the crowd and

refuse to take the risk necessary to rise above mediocrity. The reason is that following the herd is very comforting versus being a contrarian when being wrong is a tough pill to swallow. That is why when the market is “hot” we have more people buying than when it is not and vice versa. Benjamin Graham, whose value style of investing has been an inspiration for many successful investors including Warren Buffet, wrote in his book “The Intelligent Investor”: “To enjoy a reasonable chance for continued better than average results, the investor must follow policies which are (1) inherently sound and promising, and (2) are not popular on Wall Street.” Warren Buffet has a similar rule as expressed in one of his annual meetings with investors: “Be fearful when there is greed and be greedy when there is fear.”

The Investaflex Team strives to look beyond the herd, and develop a disciplined approach when invest-

ing for clients. Late last year, we recommended global real estate as another alternate asset class and are now reaping benefits of an improved return and reduced risk for our clients. This year, we recommend further increasing global exposure and further diversification within our income strategy.

We believe that the global stock market provides opportunities for 2007. For instance, in the US, even though the residential real estate market is deteriorating, commercial real estate, the banking system, corporate balance sheets, interest rates and unemployment have been healthier than in the 1990’s, which was a time when the US stock market experienced some of its greatest appreciation. Asia, Europe and Canada are all in similar economic situations, where corporate balance sheets are excellent, interest rates are relatively low and employment is at all time highs. Barring any external shocks or

unforeseen circumstances, we believe performance of growth (equity) is likely to mirror 2006 and continue to favour global diversification into areas like Asia and Europe.

On the income side of client's portfolios, we are mostly invested in cash and bonds (government and corporate). The outlook for interest rates in North America is likely to depend on inflationary pressures and the state of the North American economy. We believe that we may be entering a period of interest rate uncertainty as the US and Canada central banks appear to be in an interest rate holding phase. We look to enhance income returns through exposure to quality income trust and mortgage-backed funds.

Having suffered price corrections due to the tax changes, income trusts as a sector remain a viable income option due to its steady cash flows. Most quality income trusts (except REITs) will become high yielding equities in four years' time when the new tax rules for income trusts come into effect. Mortgage Backed Securities typically offer a small premium over cash and provide a secure option for some yield enhancement. Investing in Fixed Income instruments has always been less exciting than equity investing; however, it is essential to reduce risk. Sometimes wise investing may mean smart risk reduction for long term capital preservation rather than allocating everything into growth and chasing the highest return.

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Recommendation

Based on the above analysis we recommend for existing cash holding and a portion of any additional investment to be allocated to:

1 National Bank Mortgage fund

We believe mortgage funds will provide superior risk adjusted return than cash in the current interest rate environment

2 Templeton Global Smaller Company and Mackenzie Universal World Real Estate fund

These two funds are the best candidates to increase our foreign asset exposure in Asian and European markets and will likely give us foreign exchange gains as their respective currency appreciates against the Canadian dollar. The funds also provide exposure to the alternative asset class of real estate, which will increase diversification of portfolios.

Our team will be reviewing each client file and recommending appropriate changes in the upcoming weeks. Please keep in mind that these are recommendations only. We encourage you to use discretion when deciding whether or not to proceed with these changes.

In the meantime, if you have any questions, or would like to discuss any of these issues with us, please do not hesitate to call us.

Sincerely,

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