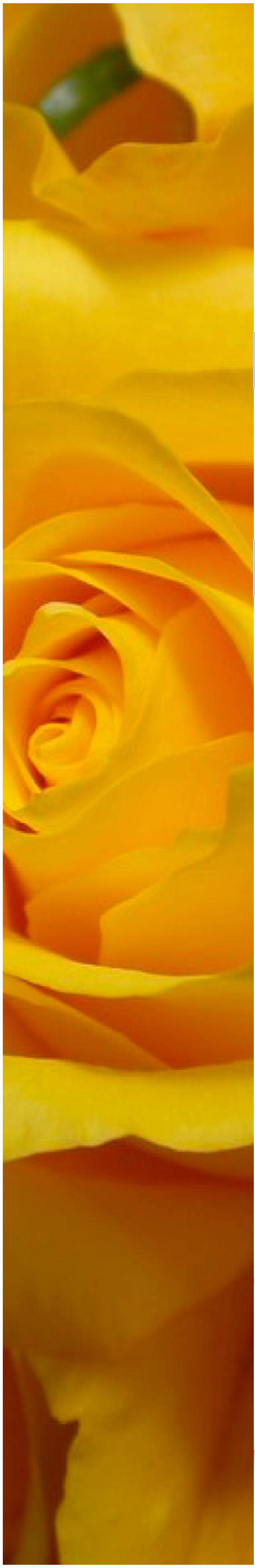


NEWSLETTER #5
JANUARY 2008

PERENNIAL
ASSET MANAGEMENT

Perennial Perspective

UPDATE

Despite the poor markets in the second half of 2007 and the first two weeks of 2008 our portfolios continue to grow. We assumed a radically conservative position for the year despite the consensus view being very positive. We are very pleased with our results and look forward to a much better 2008.

STEP BACK

As I considered things to write about in this newsletter I noticed on television investment shows that the talking heads have interesting ways of justifying their actions that really grab the viewer's attention.

Have you heard these?

"You never go broke taking a profit"
"Let your winners run and cut your losses quickly "
"The trend is your friend"
"A bull market climbs a wall of worry"
"Buy the dips"
"Buy on rumour, sell on news"
"Buy when there is blood in the streets"
"Don't try and catch a falling knife"
"Buy on bad news, sell on good news"

Spend a few moments thinking about what each of these means and you will conclude they are unclear, they conflict with each other and they provide no practical solutions to everyday investing dilemmas. The commentators may sound insightful but you will be more successful if you depend on a reasoned analysis.

What has become the most accepted piece of investment wisdom is,

"Invest for the long term".
What does this mean for your investment strategy?

INVEST FOR THE LONG TERM

Investors have interpreted this axiom to mean "**buy and hold**". The expectation is that one should do a lot of research to find a good company and buy it. After you have invested, the job is done.

Conducting in depth research before buying is an excellent plan. Understanding an investment's potential as well as its downside risk is necessary and should occur before any investment is made. However portfolio management does not end with the purchase. To properly manage a portfolio, stocks that have risen substantially and are no longer good value need to be sold and replaced with companies that are undervalued. This will provide greater returns over time and protect your portfolio when markets fall.

Selling is typically allotted much less time in the investment discussion even though it is more difficult than buying. Since selling is so difficult, money managers often do not sell and they regularly watch their profits disappear.

While you should not expect to be right all of the time, if you never sell, your portfolio may end up like a bottle riding the tide; increasing in value and then giving it back. To properly manage your portfolio it is best to keep your hand on the rudder, push the throttle and direct the portfolio to where you want it to go.

CYCLES

When I entered the investment business decades ago and was talking to potential clients, I used to hear a similar refrain from many business people I spoke with. It went something like this, "A guy told me to buy a company's stock once and I bought 10,000 shares. I lost half my money so no thanks". That was 1977. The stock market had fallen from the peak it had achieved in 1965 and had still not reclaimed the level it reached twelve years earlier. Twelve years of negative or flat returns made the investment business very unpopular. Today it is difficult to remember those times since the markets have performed so well in the 80's & 90's. The last two decades of great returns reinforced the belief that buy and hold is the correct way to invest. However, we should not forget the 70's because the markets have experienced long periods with poor returns many times.

What was different in the 70s that caused those poor market conditions? In the 70s we experienced continuously rising inflation and continuously rising interest rates. These two factors are hard on a company's real "after inflation" return and therefore on it's valuation. At the same time the 80's and 90's experienced falling inflation and falling interest rates. These factors were very positive for corporate valuations and investors enjoyed excellent investment returns.

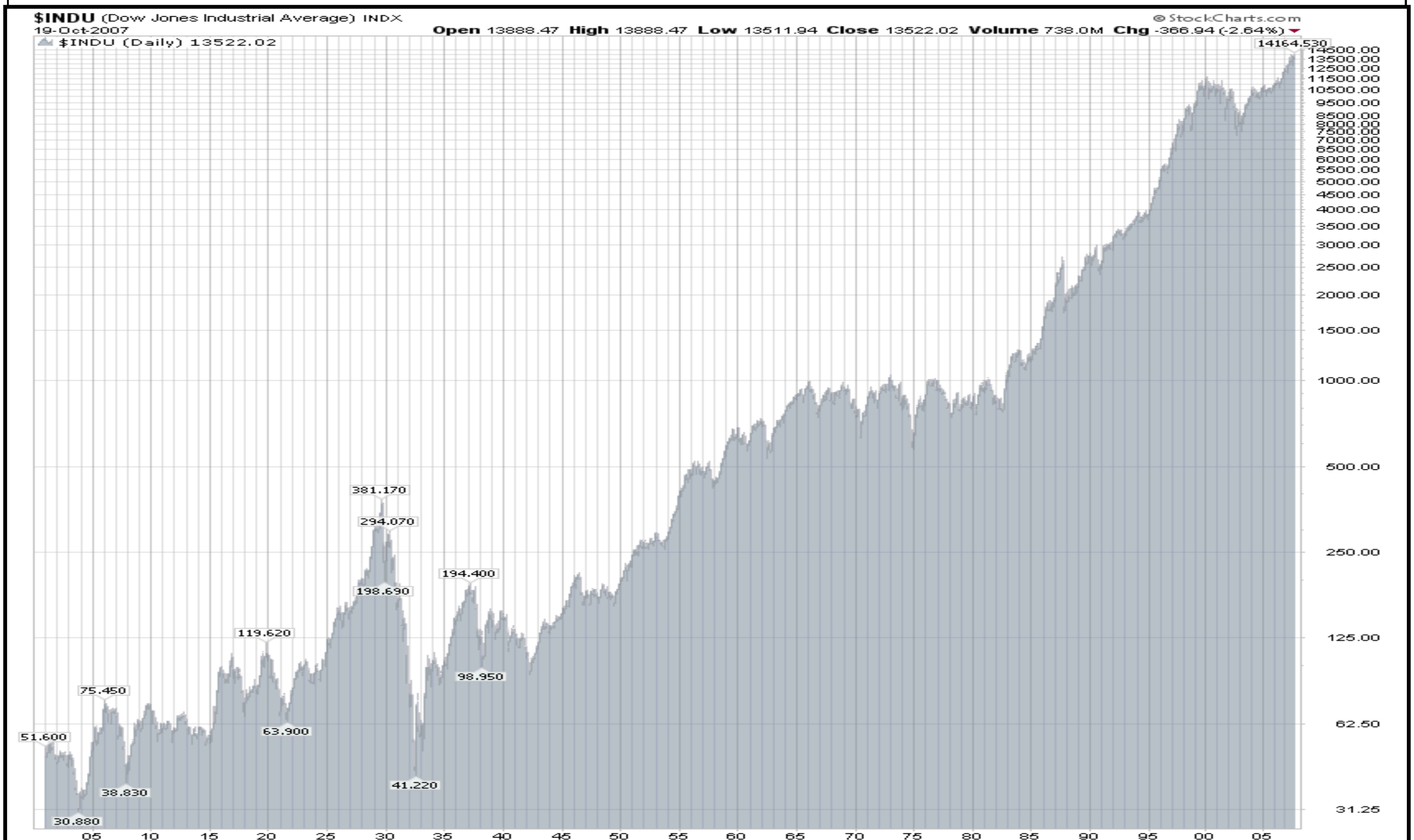
The graph on the next page details the long cycles since 1900 in the U.S. In the good times it is difficult to remember that stocks do not always rise and in the bad times, one can't even imagine considering investing in things other than GICs.

With perfect hindsight the following graph shows clearly when the buy and hold strategy was the best strategy and when one would have profited by being a more active seller. Interest rates, inflation and valuations appear to be the key to these long-term trends.

"Interest rates, inflation and valuations appear to be the key to these long-term trends."

Exhibit 1

DOW JONES INDUSTRIAL AVERAGE
1900-2007



A 1901-1920
The Dow rose 2% over 20 years. The compound rate of return was negligible.*

B 1921 –1929
The Dow Jones (Dow) rose 317%. A compound rate of return of 15.4%*.

C 1929—1954
The Dow went from 380 to 380. The market did not provide any return* for 25 years.

D 1954—1965
The Dow rose from 380 to 1,000. A compound rate of return of 8.4%* for 11 years.

E 1965—1983
The Dow remained below 1,000. The market did not provide any return* for 18 years.

F 1983—2000
The Dow rose from 1,000 to 11,000. A compound rate of return of 15.2%* for 17 years.

G 2000—2006
The Dow remained below 11,000. The market provided no return* for 6 years.

* Dividends were earned in addition to results presented.

MARKETS DO NOT ALWAYS RISE

With the sophisticated research capabilities investors currently have access to; it would be rational to assume that we could avoid the periods of market excess which have been prevalent in the past. So far this has not been the case. The last overvaluation, the tech bubble, was analyzed ad nauseam and yet the market still went through an upheaval on both the upside and the downside similar to all market manias. However, you do not need to experience a bubble to enter a period of negligible returns; all that is required is the proper market conditions like rising inflation and rising interest rates.

Current Market Cycle

The Japanese stock market's performance as measured by the Nikkei Index rose from 6,600 in 1980 to almost 39,000 at its peak in 1990. After this spectacular rise, the market reversed direction and in 2003 fell to almost 7,600; down approximately 80%. The Nikkei has never been higher than 18,300 since 1990. Over the last 17 years the index has been unable to regain half its value.

The British market as measured by the FTSE 100 peaked on December 30, 1999 at 6,950 and as of today remains below 6,000 about eight years later.

While the Dow Jones Index has broken through the high water mark set in 2000 and the resource based TSX has also risen to new highs, the S&P 500 and the Nasdaq remain below the levels they reached over 7 years ago when those markets peaked.

VALUATION AND INTEREST RATES ARE THE KEY

While discussing what happened in Japan and Britain is good for example purposes, our focus is North America and what is happening now.

Interests rates bottomed in the US in 2003 and have risen since. Inflation as measured by the US consumer price index (CPI) also bottomed in 2003. While neither interest rates nor inflation have risen to painful levels, the trend has reversed from falling to rising. The tailwind of falling rates has ended and stock valuations are now fighting a modest headwind.

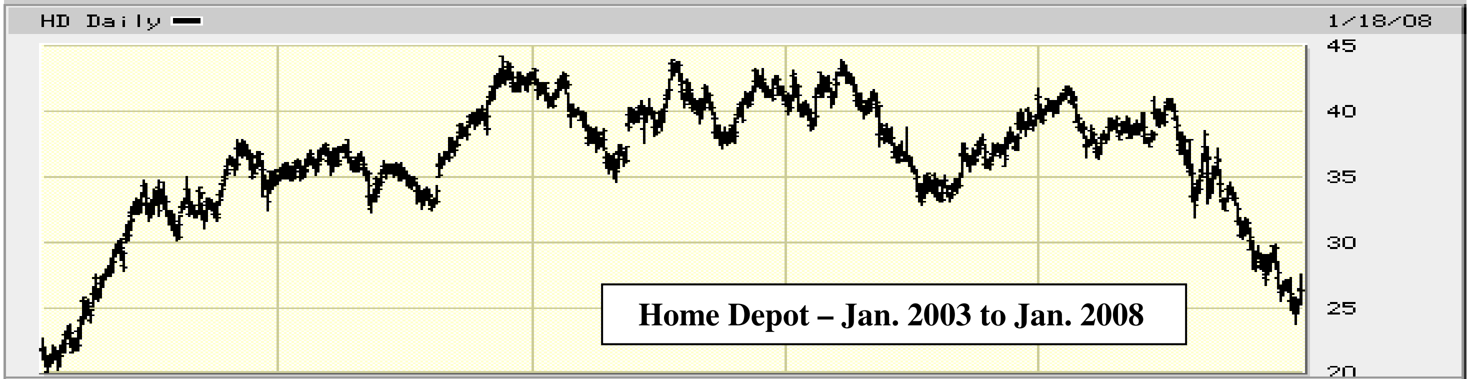
Historically the best indicators for the direction of rates have been precious metals such as platinum and gold. These assets plus most other commodities have experienced dramatic increases over the past 5 years leaving many of these commodities at historically high prices. These commodities have been reliable predictors and we should expect higher interest rates.

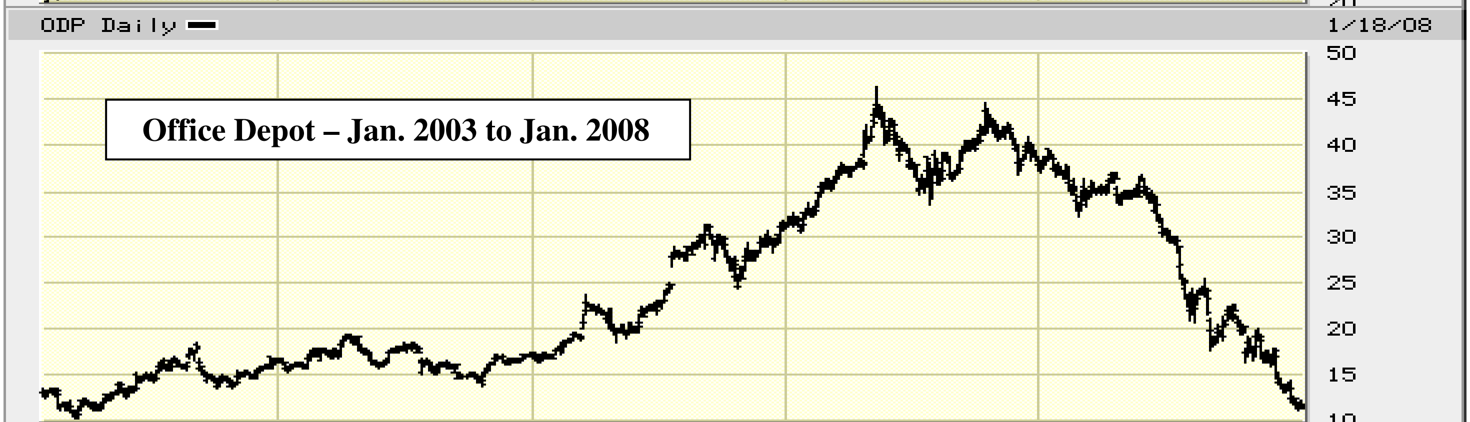
The history lesson is meant to show that selling stocks will be as important as buying stocks. Investors will need to be diligent about assessing value and growth and will need to harvest profits earned when companies reach the upper end of their value range. The long-term buy and hold investors that performed so well in the 1980's and 1990's will likely under perform in the years to come.

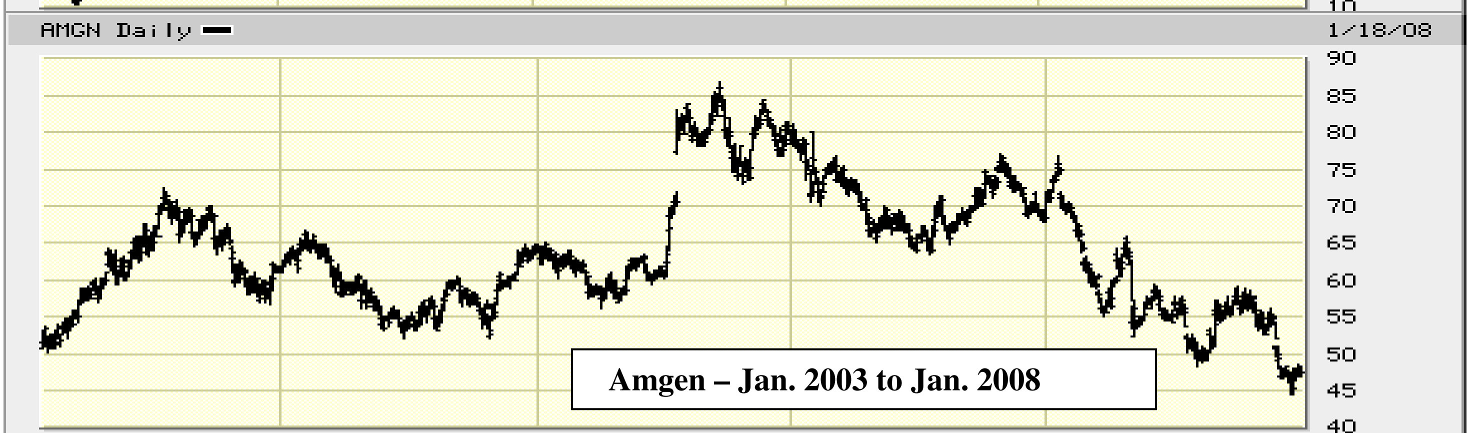
This sideways cycle began in 2000 and if history is any indication of what to expect, it will not end quickly.

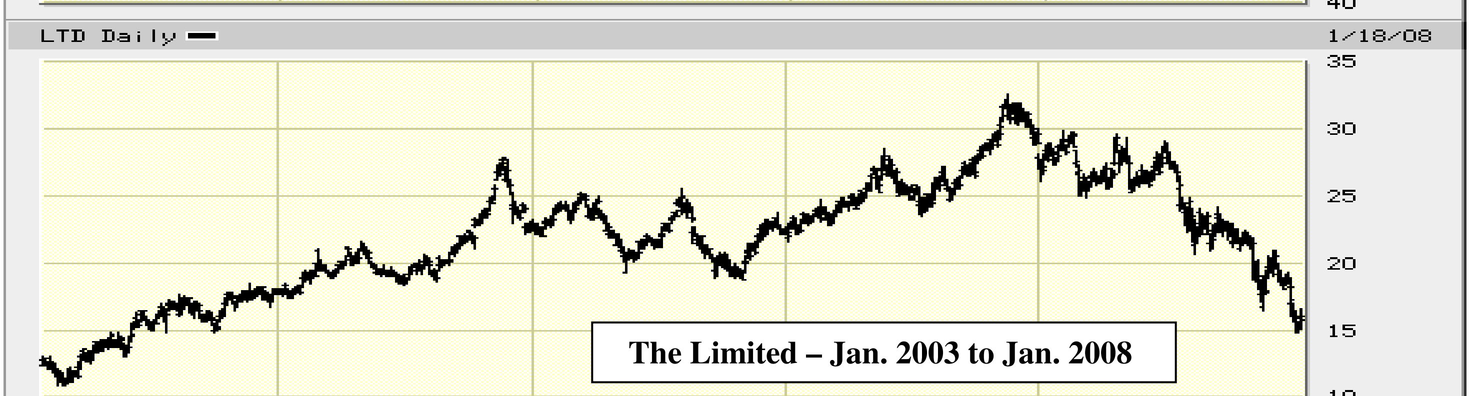
This concept applies to individual stocks as well as markets. The next page looks at companies that have already experienced this trading range phenomenon.

WATCHING YOUR PROFITS MELT AWAY









FINAL IMPACT

History provides insights when observed in the appropriate perspective. The most recent secular cycle, a bull, ran from 1982 to 2000. It was preceded by a secular bear starting in 1965 and ending in 1981. As we review today's markets in context we can no longer count on falling interest rates to continue to buoy stock prices ever upward. This does not mean you cannot make good returns in the stock market. Some of the greatest fortunes were made during difficult times. Selling over-priced companies and buying under-valued companies is necessary to ensure your portfolio retains the gains you earn.

Don't allow your portfolio gains to disappear due to complacency.

* * *

To earn a good investment return, you do not need to follow the crowd; you do not need to be a nimble trader and you do not have to own the hottest new stock. All you need to do is be reasonable and own stocks when they are trading at prices well below what they are worth.