



Second Quarter Ended June 30, 2005

Energy Stocks Carry Broad Indexes Higher

At the mid-point of 2005, the Canadian equity market has delivered a respectable 8% return. The TSX composite index returned 3.58% over the quarter, composed mainly of a 12.62% return from the energy sector and 4.48% from financial services. At Brownstone, our model portfolios mirrored general index performance with financial service holdings (our largest sector weight) outperforming the S&P/TSX financials by about 300 basis points, returning 7.26% over the quarter and 11.84% year to date.

Energy prices garnered most of the headlines over the past quarter, with crude prices reaching over \$60 per barrel. Energy sector performance reflected a strong profit outlook with impressive returns from the exploration and production, integrated, drilling and service companies. While this was good news for companies in the sector, the increase in energy costs cascaded through the economy in the form of higher gasoline prices and increased input costs for many manufacturers.

Concerns over tight supplies remain the central driver of crude prices. We expect daily volatility in energy prices to remain significant as geo-political events, world production volumes, and weather impact the long term outlook for energy supply. Our model portfolios contain approximately 20% in a wide range of energy-based equities.

While there are a broad range of issues that will likely shape the second half of the year for the domestic securities market, we see crude oil prices and interest rates as paramount. Rising input costs for manufacturers, which often have little ability to pass costs along to the consumer, will put some pressure on profit margins within Canada's manufacturing and transport sectors. Should we witness a clear deceleration in the North American economy, we can expect the monetary authorities to resist further rate increases.

At Brownstone we ensure our portfolios are well diversified and contain a number of holdings that exhibit resiliency in this type of environment. For example, the financial services sector continues to deliver excellent returns to its shareholders. While we acknowledge and monitor the risks from interest rate increases in North America and the potential for future weakness in the housing market, we feel that the Canadian financial services sector offers good prospects going forward. Additionally, while consumers in the U.S. are significantly leveraged to debt through the massive refinances of home equity over the past few years, this pattern has been followed much more moderately north of the border.

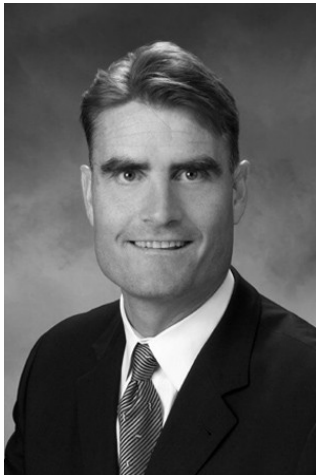
Canada, as the world's ninth largest producer of crude oil, is expected to enjoy continued strength in the Canadian dollar and relative economic outperformance versus its G7 peers. As well, Canadian companies are in good shape fiscally and have been reporting solid earnings growth so far this year. Despite this robust economic backdrop, it is likely that success in the markets over the balance of the year will be very company specific rather than through broad index performance.

Bond and Income Trust Market Deliver Respectable Returns

Much to the surprise of most rate forecasters and fixed income managers across North America, the bond market is putting in a respectable year. On a year to date basis the fixed income market is up about 5.6%. The decline of long-term yields was clearly not in the sights of bond managers and Federal monetary officials (including Alan Greenspan). The yields on virtually all maturities are lower today than the beginning of the year, providing some wind in the sails of the bond market.

The income trust market continues to perform well. The bulk of our holdings are housed in business trusts where we can properly diversify a number of the risks associated with these trusts. In our model portfolio, these trusts returned 4.6% over the quarter and 11.34% year to date.

Our most recent addition in the income trust market is Whiterock Real Estate Investment Trust (REIT). This is a small-cap REIT lead by a pair of executives with extensive real estate experience with Donaldson, Lufkin & Jenrette, Credit Suisse First Boston, JP Morgan Partners and Perry Capital. Whiterock has targeted office, industrial and retail assets in strong, secondary markets with a large percentage of national, multinational or government anchor tenants. Whiterock offers investors an annual yield of 13% and a material prospect for further capital appreciation.



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