



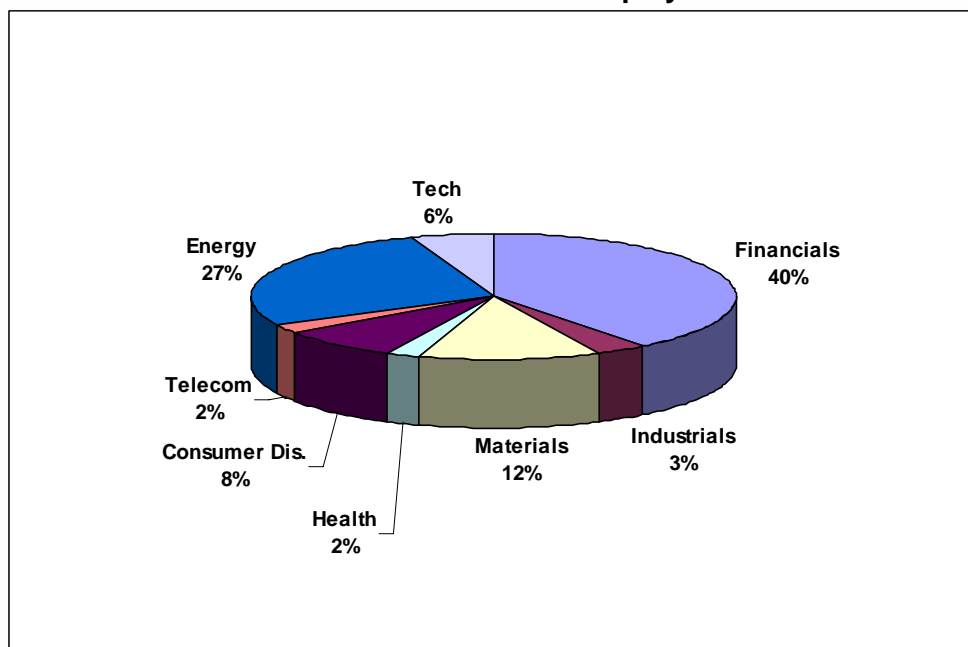
## Equity Market Correction – Familiar Territory For Long Term Investors

The investment euphoria that carried the Canadian equity markets to new highs throughout 2005 and early 2006 was abruptly halted with a general correction in global equity markets. The sell-off included virtually all market sectors including steady stalwarts of the Canadian market such as banks and insurance companies. This is not unfamiliar territory for investors. We have witnessed a number of corrections such as the Black October 1987, Asian currency crisis of 1997, September 11 terrorist attack, and the precipitous decline of technology stocks in 2000.

These episodes of market declines are never pleasant to experience, and more importantly, they vary widely in terms of the cause which triggers a decline, and the outcome on portfolios. The precipitous decline in global equity prices did not reflect a change in the long-term fundamentals of equity holdings, but instead a general repricing of financial assets. In light of heightened economic and geopolitical risks, investors adjusted risk levels and expected returns. Front and centre of this risk analysis was a renewed fear of inflation, which manifested itself in April's consumer price index report, and an aggressive move by Israel to stem attacks from Hezbollah. It is interesting to note that the un-ending war in Iraq seems rather commonplace at this point in time.

The Canadian equity market as measured by the S&P / TSX Index declined -3.5%. Sector losses were broad, ranging from -21% in technology holdings to -7.14% in the financial services sectors. Emerging and foreign equity markets suffered as well with markets such as Japan witnessing losses in excess of -10%. At Brownstone our diversified portfolios held up well to these declines, although were not immune in any case. Our model Canadian equity portfolio is in positive territory since the beginning of the year with a 3.6% return, after a second quarter decline of 6%.

### Brownstone Model Canadian Equity Portfolio



## Earnings Continue to Grow Despite Market Setback

In the near term, all eyes are on inflation, economic growth, and continued unrest in the Middle East. Once we have clarity on these issues, fundamental factors such as earnings growth will once again take centre stage. The bear market does not change our investment philosophy and we continue to seek investments with good relative risk reward prospects. In a market gripped by fear, a common reaction is to take profits by selling the winners. We resist this temptation and instead seek companies that exhibit our base criteria such as earnings growth, high ROE's and quality management.

The companies invested at Brownstone display continued profitability and we expect these firms to contribute to the continued growth of our portfolios. We believe the Canadian equity market will continue to be ripe with attractive investment opportunities, and our ability to participate in the small and micro cap companies ensures an adequate supply of growth oriented opportunities that are less correlated to broad macro-economic concern over inflation or Middle East unrest.

On a research point of interest, we recently acquired some of the most sophisticated software available in the financial world for screening investment opportunities. This software will provide us with further tools to ensure our selection of companies meet our investment criteria and result in portfolio structures that balance growth with risk.

### **Brownstone Executive Team**



[www.brownstoneam.com](http://www.brownstoneam.com)