



March 31, 2008

Credit Crisis Hangover Continues into First Quarter of 2008

There was virtually no place in the equity markets for investors to hide over the first quarter of 2008. The equity markets in North America reacted to a series of bad news, blindsided occurrences and dismal forecasts mainly related to a significant crisis in the world's credit markets. Although we have experienced a number of bear markets in the past, this particular problem threatened the life-blood of our financial systems; the ability of world's banks and financial institutions to extend each other credit.

This problem took years to develop, however it erupted suddenly in August 2007 and initiated a steady erosion of equity markets through to the end of March 2008. The spectacular fall of Bear Stearns, an institution that survived through the Great Depression, seemed incomprehensible and further ignited fear in the financial markets. Great uncertainty gave way to a run in gold prices, a falling U.S. dollar and sky high crude prices.

The US Federal Reserve and Congress confronted the crisis and exercised their financial muscle in an effort to counter-set its impact. Interest rates were slashed, cash injections were made and bailouts were funded. They even provided backing to the investment banking community which had never occurred before. Non-U.S. banks also stepped in and provided funding support. Financial markets around the world are interwoven in so many respects, and accordingly, the crisis spread to all four corners of the globe.

At Brownstone, we have always held significant invested positions in Canadian banks and financial services. Our portfolios will typically hold over 35% in this sector, as it has delivered significant returns with great consistency. Canadian banks were exposed to the credit problem, but in a greatly reduced measure than their American counterparts. Despite this favorable outcome, the stock prices of Canadian banks precipitously declined throughout the past quarter. The impact of a decline in financial services is felt across the country as Canadians have always held a good deal of banks and insurance companies as a steady means to grow and preserve capital.

We expect further problems in the U.S. market, yet we sense that the exposure of these problems will result in less equity market reactions. In other words, the bad news will continue for some time, yet the market is showing signs of reduced panic towards further credit news. Perhaps the collapse of Bear Stearns was so rapid and spectacular in scope that the market cannot fathom anything worse. It was interesting to note that the announcement of large write-downs at the Union Bank of Switzerland caused little market reaction or disturbance; perhaps a signal that the market has entered a bottom of this crisis.

Current market conditions have driven many stocks below their intrinsic values, presenting the opportunity to uncover value in sound companies. At Brownstone we are doing exactly that.