



September 30, 2009

From Drubbing to Rising Tides

We send this Brownstone Capital report to you as a means to reflect upon the state and health, or lack there-of, of the financial markets on a quarterly basis. In this report, at this time, we would like to reflect upon the state of affairs looking back and then with a view to the future. It is worth a reflection on how far the markets have come since the drubbing that all investors endured last year, right through to today where we enjoy a rising tide, improved sentiment, and hope that things will return to normal.

While we at Brownstone are most pleased to have achieved returns on our equity portfolios that have well outpaced the returns of the TSX Index and the investing public in general, we are more pleased about the greater level of investing stability that is permeating the landscape. The catastrophic financial events of the last two years appear to be settling out and a slow grinding recovery of the world is taking shape.

Economies worldwide remain a mess, however the general sense is that things have bottomed-out and the climb out of this recession is underway. The altitude of the climb is daunting given reduced consumer wealth, impaired credit markets, and the impact of freshly printed money. When it is "all said and done", this is a recession of significant proportions, and it will repair slowly. The operative word is "slowly".

The financial markets seem to be in a hurry these days. The investing public, media and Government just want this problematic period to conclude, and accordingly we have had a massive dose of positive moral suasion. Things are getting better – does everyone get it? So we buy in, the market rebounds and we all look to find a way out of this recession. Is it the mere optimism that will indeed pull us out of the ditch? Feel better, spend some money, invest in businesses, then hope. The cycle begins to turn and grow again.

The massive fiscal stimulus programs will test traditional economic theories regarding the injection of capital into a system. No text book can reference today's situation. What will be the final result of a massive cash stimulus program cast into a system that seized up like an engine with no oil? We shall see, and no one has the answer to the question.

Outcomes remain uncertain. Will inflation rear its head with this robust injection of capital? Perhaps no inflation will occur as there is massive unemployment and prices cannot rise on the back of a poorer consumer. Why is our dollar suddenly so volatile – bouncing around by the pennies each day? Can Canada's economy grow despite its narrow industrial base? The challenges remain; however we are identifying Canadian companies that are successful today and growing their operations. We invest in their enterprises as a means to grow your wealth.

We do not throw caution to the wind as we recognize that the financial markets are currently being fueled by the availability of cheap money, rock-bottom bond yields and the prospect of improved times. Despite the concerns that can surface on how stable or how fragile the economies are, we are confident that the ability to invest profitably exists in the range of investments available to us. At Brownstone we have invested capital into businesses that we are confident will deliver the results for our clients. I would like to highlight three such examples:

Boardwalk REIT

Boardwalk is one of the more stable real estate plays in the Canadian market today. Based out of Calgary, the company owns and operates over 36,000 rental units across the country. With its stable cash flows and sustainable distribution, the company currently provides its unit holders with a respectable yield of 5%.

DirectCash Income Fund

Calgary-based DirectCash has been in the ATM business since 1997. The company generates a recurring revenue stream driven through transaction, processing and maintenance fees. With strong revenue and earnings visibility, the Fund has been able to maintain a reasonable payout ratio and currently yields over 9%.

Saputo Inc.

Saputo is the largest dairy processor in Canada, the fifth largest cheese producer in the U.S. and the third largest dairy processor in Argentina. The recent strength in dairy prices both in the U.S. and internationally bodes well for Saputo, leading us to believe that this consumer staple stock is likely to experience strong earnings growth during the economic recovery.

We are thankful for the confidence that our clients give to us in our mutual objective of growing capital and managing risk. While we can transcend together from a market drubbing to a rising tide, there is never a question regarding the philosophical and real objective of our exercise together. Invest wisely, manage risk and grow capital over time.