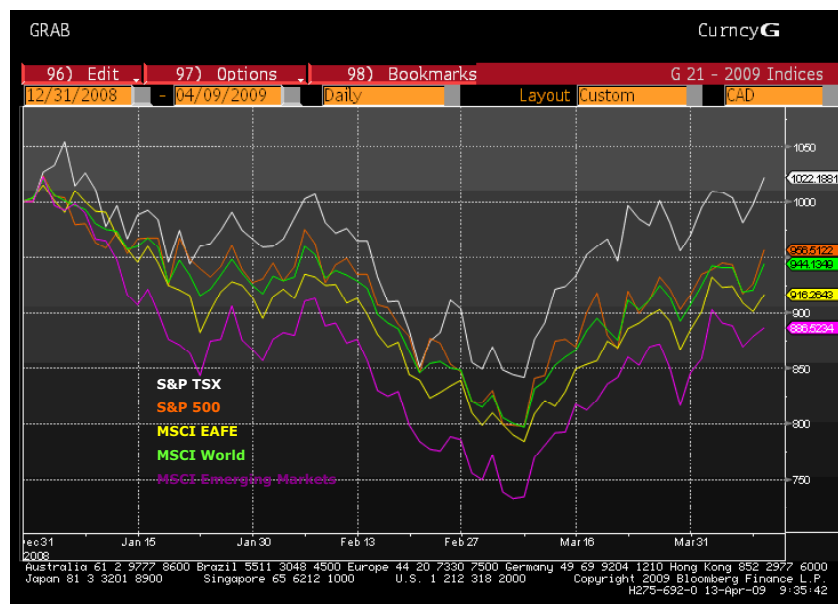


## Market Update

Most of us probably realized that flipping the calendar wasn't likely going to bring any tangible improvements to financial and rapidly deteriorating economic conditions, but any chance to distance ourselves from the terror of collapsing institutions and markets in 2008 seemed like a good idea. While we are pleased that we have added value to most of our benchmarks through the first Quarter of 2009, the first nine weeks of 2009 extended the string of bad news coming out of global markets.

Although there was a bit of a rally around New Year's, the stock markets continued down – most of them losing 20% or more between January 1 and March 9 and setting new lows in the current crash. However, as shown below, March 9 seems to have been some sort of inflection point as markets around the world began to rebound strongly.

**Chart 1**  
World Markets 2009



Source: Bloomberg

The Canadian stock market has been one of the leaders, even briefly moving positive for the year in early April. The catalyst for the "rally" seems to have been an internal memo at one of the large, troubled U.S. banks that indicated that, on a going concern basis, the bank expected to show a profit in the Quarter. Similar stories started to emerge from other banks and the global rally was clearly led by the much maligned financials. In Canada, where we have enjoyed accolades from other countries for our stodgy, conservative character reflected in an apparently tighter rein on our banks, the TSX was carried on a wave of buying enthusiasm. There was no doubt that the prices on Canadian banks had reached incredibly low levels as a result of the "baby and the bathwater" effect typical in market panics. Canadian banks – who are not completely pristine but do seem to manage themselves more like banks than hedge funds – saw their prices

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reach levels where their annual dividends were exceeding 9%. Granted that balance sheets have shown themselves to be opaque, but with the incredible support – and scrutiny – of governments in place and investors considering the meager 3% yields on government bonds, the risk premium available to investors was compelling. Bank stocks have moved up nearly 40% in the last three weeks of March. Collateral benefits to this action included a developing view that there may, indeed, be a future that includes building, farming and driving cars – so the TSX and Canadian dollar enjoyed some additional tail wind as energy and material stocks appreciated significantly. Even in technology, RIM which is a large component in the TSX (and a substantial overweight in our Canadian equities) increased over 70% from early March to early April.

There is an expression about small beginnings but great starts and we have seen many comments along these lines referring to March. For the month, stock markets are up over 7% on average which is welcome relief over the dismal experience since last summer. It is totally appropriate for clients to ask us if we think this is the start of something big. Our wholly unsatisfactory answer is “Yes, but...”

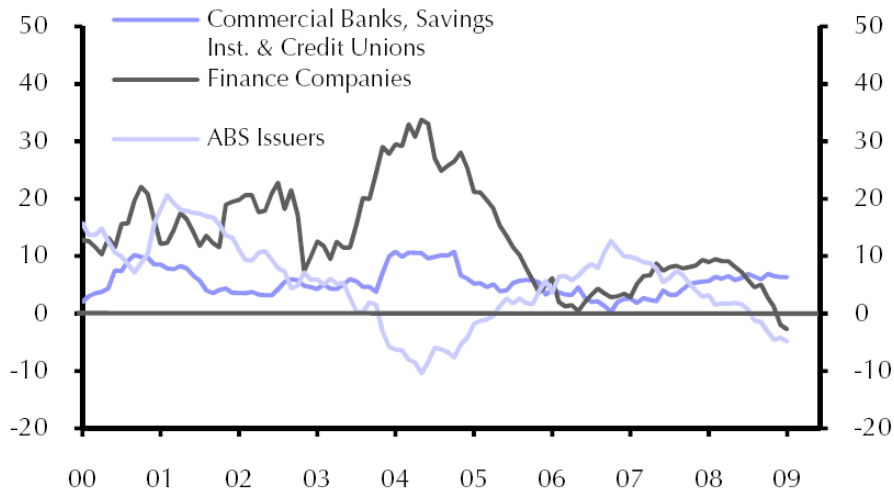
It certainly is a lot easier to highlight the negatives. There isn't anyone reading this letter that can avoid the daily dose of bad news – the most depressing being the dreadful numbers of people losing their jobs as manufacturing and financial industries scale back their payrolls. Millions of people have become unemployed. It seems inevitable that Canada and the U.S. unemployment rate will breach the 10% mark as it did in 1982. On a global basis, many millions more are slipping back into poverty. The costs to government social programs and the impact to society are large and growing. Until we start to see these job losses abate we can not claim that the worst is over.

However, as Canadians we are familiar with hard winters and we have developed the ability to search for those first green shoots in the spring. As we enter April, 2009 we can see this happening and, within the economy and the markets, we can also detect some greening that promise better times ahead.

Here are some signals that we view as positive:

1. The stock market can not be ignored. There is a lot of technical issues affecting markets but, by and large, the market is a global democracy where people vote every day with their own money on where they think the world is going and which investments will (or won't) be rewarded in the future. Historically the market has been one of the best early indicators as to how the economy will unfold – the law of large group decisions has a remarkably good record of getting estimates right. Undeniably, the strength of the recovery since March 9 shows investors are increasingly optimistic that the world will recover and the challenge is to identify which investments will benefit over the longer run. This is not to say that some dramatic new bad news won't cause people to change their vote but, so far, investors have taken employment and earnings declines in stride.
2. As credit completely dried up last year, it was like throwing sand into a transmission – the world's economy virtually stopped in a synchronized way. Consequently, governments have focused on re-creating credit flows through a bewildering array of non-traditional steps – quantitative easing, buying mortgages from the banks, TARP, TALF and industry bailouts – as well as more traditional fiscal programs (infrastructure and tax incentives) and monetary (although to historic lows with interest rates going to ¼% in Canada and less than ¼% in the U.S.). This tidal wave of liquidity is starting to have an impact.

**Chart 2**  
Consumer Credit by Fund Source (%Y/Y)

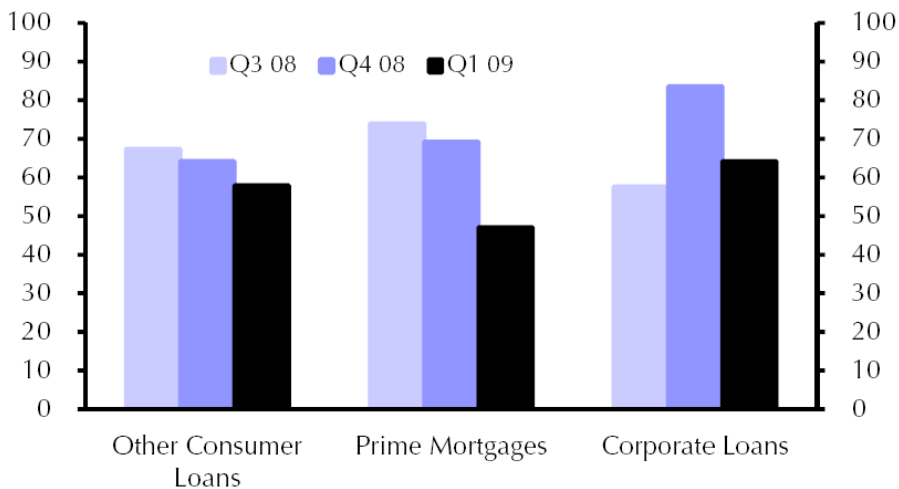


Source: Capital Economics

Chart 2 shows, in fact that U.S. banks are increasing the amount of credit they issue and Canadian banks are showing similar results. What has been taken from the system is the “shadow” banking system, companies such as GE Capital who have had their business model destroyed by the collapse of the securitized debt market. However, traditional deposit taking banks are profiting from the (almost) free money they take from depositors and then lending with a spread of 5% or more.

There continues to be the issue of creditworthiness with banks moving from the ninja loans (no income, no job or assets) to denying credit to long standing clients with sterling repayment records. Standards had to be improved but there certainly may have been an overshoot. Chart 3 would indicate that we may be seeing the pendulum starting to swing back, helped by moral suasion from the federal governments and their agencies.

**Chart 3**  
% of Banks Tightening Loan Standards

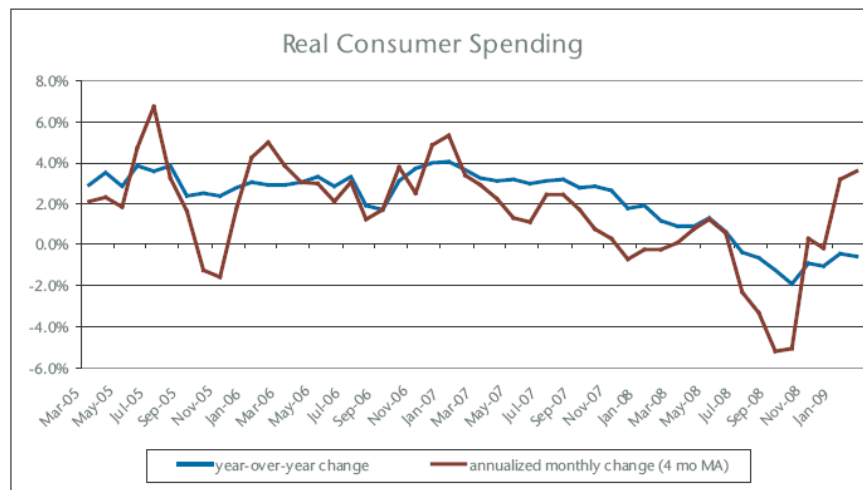


Source: Capital Economics

## INTEGRA Market Update

3. With the economy dropping so precipitously last fall, most companies moved quickly to slow production. The result has been that many North American manufacturers have drawn their inventory levels down by 20% to 30% and more in some cases. This drawdown has a negative impact on GDP and it is estimated that this may have reduced U.S. GDP by about 2% in the first Quarter. As we move forward, many of these inventories will have to be refurbished, albeit at lower levels but this will have a positive impact in future months.
4. TD Bank estimates Canadian house prices have fallen 24% over the last year. But this has the benefit of making housing more affordable and March saw a surprising jump of 14% in housing starts. Pictures of foreclosure tour buses in the U.S. may be depressing to sellers but, with such low prices attracting foreign and domestic buyers, this is the surest way to absorb this excess inventory, put a floor under prices and stem the mortgage default rates. Historically low mortgage rates and the ease of refinancing in the U.S. may make this period come to be viewed as an historic opportunity for home buyers.
5. The recent G20 meeting in London did the right thing in emphasizing the need to keep trade barriers down. Although fiscal stimulus is not consistent across countries, the focus on infrastructure spending and increased funding to the IMF to assist emerging markets favours Canada with our resources and expertise in developing them elsewhere. Recent improvements in commodity prices and the Baltic freight index measuring shipping are helpful signs for Canada's traditional basic materials businesses.
6. Optimism and confidence is the one area that governments can not legislate but it will be a necessary ingredient for any recovery. Recent surveys in Canada and the U.S. both point to an expectation that things are going to get better relatively soon. Recent rebounds in retail activity by Americans are evident as shown in Chart 4 below.

**Chart 4**



Source: Bureau of Economic Analysis, February 2009

It's likely that U.S. consumers will return to their more traditional level of contributing to 2/3rds of economic growth – down from over 70% in recent years. Lower prices are certainly helping and when employment stability returns then this measure will accelerate.

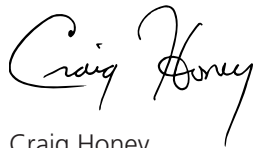
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We do not want to push the analogy too hard – we are likely going to be well past our actual summer of 2009 before more tangible evidence of an improving economy is available. However, investing has to be forward looking and after more than a year of increasingly dismal news it is nice to be able to point out a few hopeful signs of spring.

Since we began managing client portfolios in 1987 we have seen some tremendous upheavals in the economy and capital markets. By far, this last year has been the most stressful due to the doubt cast upon banking and other financial systems ability to manage themselves and even survive in a form we are familiar with. We believe that the systemic risk has been addressed but we now have to cope with the economic damage – which we know will be overcome as it has in the past. In the meantime, our focus and philosophy hasn't changed – manage client investment risk through prudent diversification, ensure liquidity, avoid the risks we don't understand and keep our eye on the long term.

We appreciate the business we have with you. We can certainly understand the anxious times everyone has had through the last year and longer. As always, please don't hesitate to contact me or any of the Integra partners to discuss our views or any other issue where you think we can be helpful.

Sincerely,



Craig Honey  
Partner & Chief Investment Officer



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