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WEALTH MANAGEMENT • RISK MANAGEMENT

EQUITY Associates Inc.

THE

First Capital Financial

QUARTERLY

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REPORT

Economic Environment

2010 concluded with the macro-economic picture looking tentatively more favorable. In North America, both business and consumer sentiment has improved, reflected in increased demand from both. Total Bank lending too has increased and on aggregate corporate profits have fully recovered from the sub-prime led economic crisis over the past few years, and have reached new all-time highs. Households are saving more and home prices have stabilized. Across a spectrum, financial conditions are improving. With this said, unemployment remains stubbornly high as companies are reluctant to hire and governments are either freezing new hiring's or shedding positions in an effort to bring their massive deficits under control. Overhanging demand are the leveraged balance sheets of consumers, where debt reduction is competing with spending, limiting the pace of economic recovery.

Europe continues to struggle, with the near-do-well members of the EU challenging the commitment of stronger countries –most notably Germany- to fund their financial predicaments. Fierce budget cuts in Greece, Ireland, Iceland and the United Kingdom will likely be echoed by Portugal, Spain and Italy in 2011. This will reduce European growth rates, thereby prolonging the return to more robust economic times. Strong exports from Germany and higher domestic retail sales should help the rest of Euro zone, though economic growth in the 27 member union will probably average between Japan on the lower side and North America on the higher side, of developed market economies.

Emerging markets led by China and India are expected to continue at their double-digit levels set in 2010. The industrial and technological transformation of developing countries has considerable distance to go, ensuring demand for commodities and energy are likely to remain high. Further, emerging markets are increasingly a source of demand for products and services from mature economies, adding additional stimulus to economic growth prospects there as well.

Overall, our view is that 2011 will likely look and feel much as 2010 has, where the recovery continues, albeit at a frustratingly subdued pace compared with normal recessions. The loss of fiscal stimulus will be offset by monetary stimulus in the form of additional quantitative easing. In the United States, the extension of the controversial Bush-era tax cuts should provide additional momentum to the demand side of the equation, as consumers will direct some of their higher after-tax income to spending. Budget and trade deficits will be with us throughout 2011, though the scale of both is expected to shrink. Even a modest improvement in these structural conditions will portend well for a slow, but unmistakably continuing economic recovery in 2011.

Canadian Equity Funds

Canadian Equities delivered low double-digit returns to investors, as global demand for Canadian goods –most notably commodities, energy and precious metals remained strong. Coupled with a solid banking sector which made some material acquisitions in the year, our TSX Composite posted its second consecutive year of gains. These returns exceeded our expectations, where more range-bound returns were expected, reflecting the continuing slower pace of economic recovery. The balance sheets of Canadian corporations on aggregate are well capitalized, suggesting that companies will use their cash to increase dividends, buy-back shares and continue their pattern of mergers and acquisitions. Any and all of these are good for shareholders and our outlook for 2011 is for additional gains from present levels. It is our view that these gains will derive primarily from dividend yields and secondarily from capital gains, as investors return to equities seeking higher returns than government bond alternatives presently offer.

Global Equity Funds

US markets have tracked Canada's as S&P 500 listed companies earned record profits, in part fuelled by a favourable currency environment and strong demand from emerging markets. In Europe and Japan however, with the exception of Germany and the UK, exchanges posted either minimal or even sharply negative returns depending on which country one is examining. The tale of two-cities within the Euro zone is best exemplified by the German DAX and the Greek Athex bourses, which posted returns of +18% and -32% respectively. Historically and on balance, domestic stock markets have provided a measure of the health of the underlying country. This reality is expected to continue into 2011, where countries whose economic prospects are better, see higher returns than those that are lagging. Finally, the relative unattractiveness of government bonds, now yielding record lows, augur well for equities in 2011. Currently, the dividend yields of large-capitalization companies are roughly twice that of government bonds, causing investors to revisit equities. In other words investors are being handsomely rewarded to take risk, and to the extent that investor demand for equities rises, stocks are expected to rise accordingly.

Fixed Income Funds

Both government and corporate bonds have performed well in 2010 as yields provided steady, predictable investment returns throughout the year. The outlook for 2011 however is somewhat less certain. Corporate bonds are anticipated to do well, reflecting the strong balance sheets of companies on aggregate. However government bonds increasingly can be seen to be risky, where interest rates are expected to rise in the 2nd half of 2011 and sovereign debt default worries weigh on the face value of the bonds themselves. For longer-term investors, a measured move to equities in 2011 may be prudent, while investors with shorter-term investment horizons may consider a move to bonds with shorter-maturity. The combination of yields and the tendency of a bond's price to move towards its par value as it nears maturity, makes these bonds look more attractive to investors who require yields to fund their present retirement income needs.

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