STONEBROOKE
ASSET MANAGEMENT

Investment Commentary

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Momentum Strategy

The financial markets have changed significantly in recent years, especially since the 2008/9 crash. Markets are far more volatile and subject to unusual patterns and behaviour. We attribute this to the shorter term nature of investment decision making and to algorithmic trading programs utilized by investment banks and hedge funds - there is a higher degree of speculation. Additionally there is this obsession by Central Banks to continually bail out the financial system by printing money. There are enough unknowns in the financial world without the need to try and forecast if markets are being, shall we say politely, *"managed"*.

Accordingly we are adjusting our investment management style and shifting more towards a *momentum strategy*. This essentially means we will monitor and invest in the sectors that are performing and stay away from the sectors that are underperforming. This sounds simple enough, buy what is going up and ignore what is going down. Practically it is not that easy nor is the methodology we have developed perfect. We have been back-testing various approaches using smoothed rate of change price data for a large group of sector exchange traded funds. We believe we have designed a strong analytical tool which works well, albeit with a tolerable lag, which is typical of any work involving technical analysis.

Our momentum work ranks the performance of the ten industry sectors in both Canada and the U.S. along with a mix of several other securities and bond funds. Only the top rankings are to be considered for client portfolios. It often takes a surprisingly long time for the rankings to change, i.e. for an

entrenched investment trend to reverse course. To borrow from the laws of physics "a trend in motion usually stays in motion" and usually, as we have found, for a period of time long enough for a very profitable swing trade lasting several months. At other times however a trend is inconclusive and can result in a losing short-term trade.

Since industry sectors are often highly correlated, i.e. move in the same direction, it is not necessary to make changes to the portfolio based on minor changes in the top rankings. In fact we have observed that the sectors we monitor can be further classified into about 4 supra-groups; defensive, growth, resources, and financials. While these four groups can still be highly correlated to each other, especially in a broad based market advance or decline, there is greater performance variation among these supra-groups than among the various industry sectors.

Additionally, we will be applying our standard technical and fundamental tools in an effort to improve on the core momentum strategy work. On the basis of the back-testing we have done we are very encouraged this new method of investing will keep us in the right sectors with enough accuracy to make a sizable difference in performance going forward.

TSX 300 : 11,597 | *90 Day T-Bills : .87%* | *Oil : $84.90 US* | *Cdn $: .98 US*
S&P 500 : 1,344 | *10 Yr Cda Bond : 1.74%* | *Gold : 1,604 US* | *Euro : 1.29 Cdn*

Crisis in Europe, Again

A steady diet of bad news continues to come out of Europe. The markets have understandably been gripped with fear. According to the media headlines it seems nothing less than the end of the Euro is in sight. Following the recent Euro Summit, (the 19th crisis meeting in the past two years), a relief rally of some magnitude took place. Judged on the magnitude of the rally it would appear the Europeans had finally succeeded in forging a permanent plan. Yet it is more of the same – *an agreement to agree on putting together a plan of understanding before the end of the year!*

The lack of political will is understandable given the inherent complexities. Uniting 17 different countries is no small task. It appears the pressures from financial markets will dictate the speed of events. Politicians are fearful of doing the wrong thing and/or they just do not understand the urgency of the matter at hand. Volatility can therefore be expected and in the end will serve to hasten the decision making process. As wisely said by Jean Monnet, the famous French political economist and one of the founding fathers of the European Union, “People only accept change in necessity and see necessity only in a crisis”.

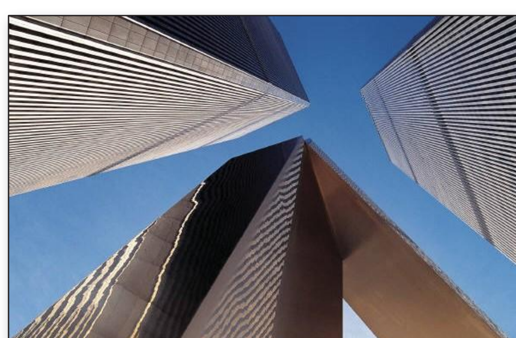
We remain hopeful and believe there is far too much investor pessimism that any solution can be found. We have begun to hear that apparently the Germans have looked at gold as a possible solution. The idea is to back all public debt over 60% of GDP with gold denominated Euro Bonds. This will act as security for German lenders and may just be an eloquent solution in restoring confidence in both the lending and currency markets. Lenders would have a measure of safety should a country go bankrupt and/or pull out of the Euro monetary system.

A Hot and Volatile Summer

The blistering stock market rally witnessed at the end of the quarter, like the summer weather, may be a sign of hot things to come. After the steady declines in the previous two months the markets were oversold and investors overly pessimistic. A rally was due even if just to clear the heavy short positions. It was our understanding that the heavy short position was directed against the Euro. With the announcement at the Euro Summit that a deal was pending the shorts ran to cover their positions in the currency market and started the buying frenzy in the broader stock markets.

While the European debt situation may appear resolved for the time being the larger issue is that economic conditions are beginning to surprise significantly on the downside and credit strains are rapidly increasing. Without monetary intervention the stock market may fail to advance further. Many investors may decide to run for the exits as they may view this latest rally as another opportunity to get out before the markets head down again.

It may be a hot season weather-wise as well as a volatile period in the financial markets this summer. There is however pressure building for Central banks to react preemptively by providing liquidity again. This should be positive for financial markets.



Gold Gets No Respect

The majority of research analysts expect the forward price of gold to be in the $1,200 – 1,300 price range instead of the current spot price of approximately $1,600 per ounce. With such a negative bias it is no wonder the gold mining stocks have fared so poorly. The simple reason for this view is that since gold peaked at over $1,900 in the summer of 2011 it has had a difficult time getting any traction. The analysts are blindly following the downtrend and this is having a major impact on the various companies' net present values.

Should sentiment change, as we indeed believe it will, and gold prices rise substantially higher, the analysts will need to adjust their valuation models. The potential upside is huge. This is no different than what happens to the stock market as a whole. Often the discounting factor is either too bullish or too bearish. When reality finally sets in prices adjust.

The deflationary threat, the result of excessive system wide debt, implies that the monetary authorities will continually be under pressure to print and to re-inflate. Money printing is positive for Gold and we continue to believe the price of bullion will rise much higher in the years to come.

Portfolio Strategy

It is a complex world where even a perfectly rational investment strategy is not guaranteed to be successful in a reasonable period of time. At many times in the past we correctly judged a high risk environment for stocks but we were far too early in our timing. Without a significant and immediate decline in stocks and with clear evidence of weak economic activity building we would naturally have doubts in our conviction and assume that the markets had discounted the risky environment.

In order to be more timely and to partially remove "judgment" from the investment equation we are moving towards a momentum based approach which follows market trends and places us in the industry groups and exchange traded funds that are showing positive relative strength.

At the current time the tables below outline the top ranked groups in the Canadian and U.S. markets;

Canada

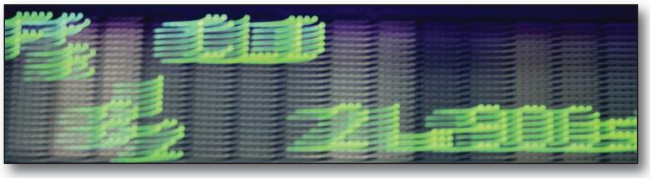
XST	XUT	HIX	XRE	XBB	XDV
(Bonds)	(UBliBes)	(Inverse)	(Real Estate)	(Bonds)	(Dividend)
1	2	3	4	5	6

U.S.

TLT	XLU	XLP	XLV	SH	XLY
(Bonds)	(UBliBes)	(Staples)	(HealthCare)	(Inverse)	(DiscreBonary)
1	2	3	4	5	6

The top rankings are concentrated in the defensive sectors; Consumer Staples, Healthcare, Utilities, and Bonds. As well, the Inverse or Bear Funds are ranked highly in both Canada and the U.S. These rankings have been in place for the better part of two months and are based on weekly data. It is the *weekly data series* which is the main focus of our work and where most of the portfolio recommendations will be derived from. We also monitor a *daily data series* in order to increase price sensitivity. The daily data often precedes the changes to the weekly rankings. At this point in time we are seeing changes in the daily series which are likely to partially shift the defensive posture shown in the weekly rankings. Groups that have lagged, such as Gold and the Growth sectors are improving.

Over the next several weeks we will be closely monitoring our momentum work and will be implementing changes to investment portfolios. The current relief rally will be important to monitor for it may be fleeting. If so, and the rankings above do not change materially then we will start committing to a more defensive stance.



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Technical Commentary

There is encouraging technical action in Gold bullion (GLD) and gold stocks (XGD) which suggests that the seasonal strength from July to October has started. The sector has been in a base building pattern for the past six weeks. Short term momentum indicators are trending higher. The gold charts are developing possible modified reverse head and shoulder patterns.

Responses to second quarter earnings reports in the next few weeks will be watched closely. U.S. equity markets peaked on April 4th, and moved lower on declining guidance. If equity prices move higher on difficult second quarter results, the stage will be set for a significant upside move until at least the end of the year. The defensive Utilities sector will need to be sold in favour of the Growth sector, Technology. Charts shown below.

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