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**Tradition says we are fine at this stage of the cycle
but "this time is different"**

During our careers to date, it has been best to put on 'blinders' when it comes to the worry of the day and have confidence that sudden major world events will have little or nothing to do with long-term market performance. The areas that generally give false sell signals have been: wars, politics, Y2K, SARS, avian flu, massive oil spills, terrorist attacks, etc. It has been best to either flat out ignore these events, or use them as buying opportunities. The latest examples are the ongoing tensions in the Middle East and the tragedy in Japan. At the time of any event, there is always the possibility that markets will trade lower as a result but market history tells us that eventually, the event will not be priced into markets. Pundits and media headlines often prophesize that 'this time is different' and that we should instead worry about the problem of the day materially affecting markets; but adhering to a 'this time is different' strategy has proven to be incorrect thereby coining the phrase that 'this time is different' is indeed the four most dangerous words in investment language.

For the first time in our careers though, we feel the need to pay heed to one topic of concern and that is the ongoing accumulation of massive amounts of government debt. More on this topic later.

We also need to pay attention to the strength and length of economic cycles. It is prudent to be a bit more conservative and decrease risk when 'good times' last for a reasonably long period of time, and conversely be more aggressive when bad times materialize (and we can buy good quality assets at low prices). We have enjoyed two good years so in that sense it is time to lighten up on risk somewhat. On the other hand, with interest rates so low, stock market valuations quite reasonable (at about 14 times forward earnings), and an economy still gradually improving, past market history says markets have the capacity to do reasonably well for a while yet.

Excessive and worsening government debt though tempers our enthusiasm for taking too much risk so we are factoring in this concern in terms of anything we buy at present. So for the first time in our careers, we are breaking our rule somewhat about ignoring market pundits… at least the ones that we feel know what they are talking about. We hope that these debt concerns will not turn into a major issue, but until we see tangible signs of improvement in terms of debt to Gross Domestic Product (GDP) levels, we feel it is prudent to heed these warnings. We have written in previous letters that aging populations requiring increased pensions and health care, combined with a lack off political will to deal with these issues, may result in trouble. Lately markets have enjoyed a strategy called 'quantitative easing or QE', (namely the U.S. Federal Reserve printing money) which in turn is being used to buy seventy percent of recent U.S. government bond new issues. This is helping keep U.S. interests rates low, but this program is due to expire in June of this year. As to when and if a sovereign debt crisis materializes, that's anyone guess. On the positive side, the bond market is pricing in no default risk whatsoever both in the short and long term. Japan has twice the debt to GDP problem as the U.S. yet Japanese two-year government bonds pay all of 0.25% and ten-year bonds pay only 1.2% per year. U.S. two-year bonds pay only 0.7% and ten year bonds pay just 3.4%. With rates this low, we can say the bond market is betting a debt crisis will not materialize; however as said earlier, until we see material improvement on this issue, we feel it is prudent to continue decreasing risk by emphasizing the following:

1. Investment grade corporate bonds
2. A pool of Canadian commercial mortgages with significant equity behind them
3. Stick with shorter to medium-term fixed income in case interest rates rise
4. Quality preferred shares
5. Real estate trusts owning low vacancy rate Canadian apartment or multiple suite residential buildings, office, retail and industrial properties
6. Overweight defensive areas of the stock market such as utilities, pipelines, and telecommunications
7. Underweight aggressive areas of the market such as resources and emerging markets

We have followed this course of action for the past year and half, and with scheduled bond maturities, and some planned changes this year in our 'Index and Stock Strategy', we should be finished most of this process in about a year. Incrementally decreasing risk in this manner has worked well thus far in terms of mainataining returns, while at the same time increasing investment quality, particularly with respect to fixed income issuers we use.

Tax season is always 'lots of fun' (not!). This year's t-slips were not too bad in terms of lateness but until the government changes rules, some types of issuers (REIT's, Limited Partnerships and Indexes) will be sent out towards the end of March. Each of those issuers has more complex reporting and therefore has an extra month to report. As pipeline, power and business trusts have had to convert now to regular corporations, things will be a bit easier next year. Checking your t-slips versus the 'pending list' that is sent to you in the initial mailing of tax documents will help to determine if you have all your slips. In the meantime, call us if we can be of any help. Cheryl is our team's 'tax headquarters' but any one of us can help.

Regards,
CIBC Wood Gundy

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Clients are advised to seek advice regarding their particular circumstances from their personal tax and legal advisors.