

Compass

HIGHVIEW
FINANCIAL GROUP™

Facilitating Excellence in the Management of Wealth

Fall 2011

Summary

Capital Markets Highlights:

- Global debt & deficit challenges continue to negatively impact global equity markets.
- This situation is causing heightened equity market volatility around the globe.
- Central bankers' continued commitment to providing extreme levels of liquidity, together with investors' search for relative safety, has led the bonds of most developed countries to perform well, compared to equities.

Signposts To Watch:

- Global Central Banks
- Financial System Stability
- Deleveraging
- Asset class fundamentals

Our Outlook For The Signposts:

- Continued coordinated & collaborative efforts of global central banks.
- Ongoing financial stability challenges.
- Persistent efforts by consumers & governments to deleverage their balance sheets.
- Equity values are attractive and fixed income asset values will remain high until global economies begin to recover.

Implications For Client Portfolios:

- Client portfolios have performed as anticipated in these volatile markets.
- Fixed income assets continue to be restricted to Canadian securities, with shorter average terms to maturity to protect from future rising interest rates and a healthy allocation to high quality corporate bonds to enhance yield.
- Our core equity mandates continue to emphasize medium-large companies with strong balance sheets and strong dividends.

Capital Markets Highlights

This year started out with much hope. In 2010, we had seen the continuation of the stock market recovery that had begun in March 2009, and increased levels of hope that the global economic recovery was indeed taking hold. For the first three months of 2011, global stock markets behaved reasonably well rising about 4% and Canadian bonds turned in a small positive performance. Since then, the seeming inability of European leaders to effectively address the large and growing debt concerns in many member countries, and the fear of a financial contagion has led to extreme volatility in the markets. Table #1 below details how it's been a challenging year for global equity markets. The increase in volatility can be seen in Chart #1 below of the CBOE Volatility Index, also known as the VIX or the "Fear Index", which measures the expected volatility of the S&P 500 stock market index volatility over the next 30-days.

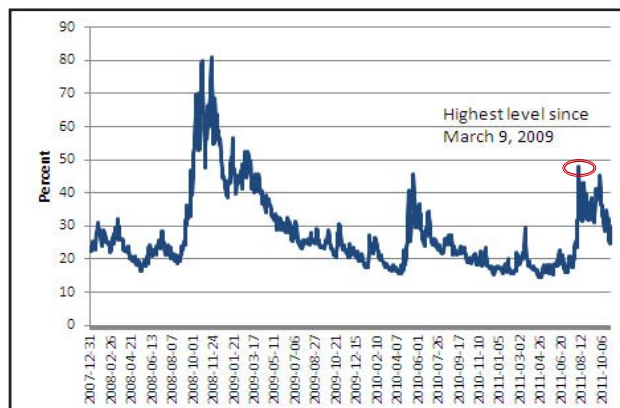




Table #1

Country	Index	Year-To-Date		Past 12 Months		2010	
		Local Currency	In C\$	Local Currency	In C\$	Local Currency	In C\$
Canada	S&P/TSX Composite	-6.9%	-6.9%	-0.8%	-0.8%	17.6%	17.6%
United States	S&P 500	1.3%	1.4%	8.1%	5.7%	15.1%	8.3%
United Kingdom	FTSE 100	-4.7%	-2.0%	1.5%	-0.1%	12.6%	3.5%
Germany	DAX	-12.0%	-8.4%	-7.0%	-8.8%	14.3%	1.3%
France	CAC 40	-14.2%	-10.7%	-11.8%	-13.5%	-0.3%	-11.7%
Italy	FTSE MIB	-17.7%	-14.0%	-22.3%	-23.8%	-9.8%	-20.8%
India	BSE Sensex 30	-12.0%	-12.6%	-10.4%	-20.0%	19.1%	16.5%
Japan	Nikkei 225	-10.5%	-6.7%	-0.4%	0.6%	-1.3%	5.8%
Hong Kong	Hang Seng	-11.2%	-11.1%	-11.3%	-13.4%	8.6%	2.0%
China	Shanghai Composite	-10.5%	-7.2%	-15.6%	-13.4%	-12.8%	-15.0%
World Developed Markets	MSCA World	-2.7%	-2.6%	2.3%	0.1%	12.4%	5.9%

All returns include both change in price and dividends paid (i.e. Total Return)

All of this volatility has caused the bond markets of the major developed economies to become a place of relative safety, which has caused bond prices to continue to rise, with the result being a generally lower global interest rate environment over the past year as illustrated in Table #2 below.

Signposts To Watch:

In stewarding our clients’ wealth, we believe that as primarily risk managers, it’s imperative that we keep focused on a set of key global economic, and sometimes political, ‘Signposts’ that can drive capital markets behaviour & ultimately the performance of our clients’ portfolios. Currently, the key four (4) Signposts that we’re watching are:

1. Coordinated and collaborative efforts of global central banks
2. Financial system stability
3. Deleveraging : Governments, Corporations and Consumers
4. Asset class fundamentals – how expensive or cheap are various types of investments relative to their historical averages?

Signpost #1 - Global Central Banks

Despite the list of financial, political and social issues that the world’s economies have to deal with there have been signs of at least some

Table #2

Term-To-Maturity	Country	31-Oct-11	31-Dec-10	Change
2-Year	Canada	0.99%	1.66%	-0.67%
	United States	0.24%	0.59%	-0.35%
	United Kingdom	0.51%	1.07%	-0.56%
	Germany	0.53%	0.86%	-0.33%
	Japan	0.14%	0.16%	-0.02%
10-Year	Canada	2.28%	3.12%	-0.84%
	United States	2.11%	3.29%	-1.18%
	United Kingdom	2.43%	3.39%	-0.96%
	Germany	2.02%	2.96%	-0.93%
	Japan	1.04%	1.11%	-0.07%
30-Year	Canada	2.92%	3.53%	-0.61%
	United States	3.13%	4.33%	-1.20%
	United Kingdom	3.39%	4.18%	-0.79%
	Germany	2.78%	3.41%	-0.63%
	Japan	1.97%	1.98%	-0.01%

Source: Bloomberg

willingness on the part of central bankers to act in a coordinated manner. On September 15th, five of the world’s most powerful central banks – from the U.S., the European Union, Japan, Switzerland and the U.K. – banded together to offer unlimited funding to the European banks through the end of the year.

It was hoped this would buy some breathing room to find a fix for the direct and indirect problems caused by the Greek financial condition. As a result, there appears to be a collective will amongst the G20 to attempt to maintain stability in the markets and at least make best efforts to steer the world back to economic health.





Despite this, serious regional risks exist, primarily in both Europe & the United States. For 2 years now, many members of the European Union (EU) have been faced with huge (and growing) debt and deficit levels. As the largest economy in the world (26% of global GDP), what happens in the European Union matters globally. Negotiations, bailouts and austerity packages have failed to restore the kind of growth needed to stem the declines in many economies. In the U.S., the Federal Reserve has intervened in the market by not only lowering interest rates to near zero, but has also injected trillions of dollars into the economy by purchasing Treasury and mortgage related bonds. While these actions have been a success from the standpoint of rates remaining low, the increased liquidity has not generated the economic stimulus that the Fed had hoped for.

Signpost #2 - Financial System Stability

In November 2010, a new global regulatory standard on bank capital adequacy and liquidity was developed in response to the deficiencies in financial regulation. Overseeing the implementation of these new standards is the Financial Stability Board (FSB). The FSB is located in Basel, Switzerland and represents the 20 largest economies in the world (G-20). Mark Carney, Governor of the Bank of Canada, was recently appointed Chairman of the FSB. We view both the establishment of this board and the appointment of Mr. Carney as positive developments.

Having said this, clearly, the stability of the European banking system is wavering and certainly more strained

than it was a year ago. The recently established European Financial Stability Fund may prove insufficient depending upon the assistance needed by Italy and Spain and the ability to lever up the fund to a size large enough to address potential future defaults. Austerity measures in Greece, Italy and elsewhere may not be enough or come soon enough for that matter. Big European banks may need to take substantial write downs.

Given the US debt & deficit situation, the U.S. dollar may well undergo another devaluation and, in addition, will be forced to keep interest rates very low perhaps well into 2013 thus meaning that, in all likelihood, Canadian rates will also remain quite low. Overall, though, the state of the North American banking system, while not overly healthy in the United States, is in much better condition and is much more stable than its European counterpart due to Federal Reserve actions of the past few years.

Signpost #3- Deleveraging

It's common knowledge at this point that prior to the financial crisis of 2008, most mature economies had become addicted to debt. Consumers, financial corporations and many governments increased their debt levels at an unsustainable rate particularly during the period of 2000 to 2008. Non-financial corporations (generally speaking) were the exception to this as many companies entered the financial crisis in good financial shape (and remain in good shape today).

In the United States, the level of government debt (and deficits) has been recognized as unsustainable.

Unlike Greece, Italy and others the market has not yet pushed the U.S. to take drastic measures. We suspect part of the reason for this is that the attention of investors has been so fixated on Europe. However, this grace period will not last indefinitely so the U.S. needs to be proactive in addressing its debt problems.

The reality is that the required global deleveraging process will likely be painful and last for many years. If managed effectively economies will eventually reduce their debts and deficits to more manageable levels (as Canada did in the late 1990's) and their economies will begin to grow once again. But it remains a fine balancing act. Cutting government spending too quickly will cause lower economic growth, which exacerbates the problem. Not cutting quickly enough can lead to debt levels spiralling higher and investors losing confidence, which pushes borrowing costs higher, which again exacerbates the problem.

Signpost #4- Asset Class Fundamentals

With all of the global economic & political concerns, equity valuations remain depressed which is presenting opportunities that our equity portfolio managers have been getting excited about. As a result, most of our equity portfolio managers have been adding to their favourite names and trading into better values such as some of the Canadian commodity names and buying some global consumer products and pharmaceutical stocks.

With respect to fixed income assets, valuations continue to be high due to the extremely low interest rate





environment. Our core Canadian bond manager expects the Canadian and U.S. economies to continue to recover with a large degree of monetary stimulus, although growth will likely be slower than that experienced in more recent economic recoveries. The household and financial deleveraging effects will likely keep inflation within the central banks' comfort zones. The Canadian and U.S. central banks have provided significant monetary stimulus over the past several years through very low interest rates, quantitative easing and most recently "operation twist". The reasoning behind these actions is to motivate investors to move out the risk curve by making government bonds unattractive through a lowering of bond yields.

Our Outlook For The Signposts:

Based upon the above four Signposts, HighView expects the following:

- » Continued coordinated and collaborative efforts of global central banks to provide significant amounts of liquidity in support of global economic growth.
- » Ongoing financial stability challenges as Europe focuses on addressing its debt & deficit issues and the United States continues to struggle with addressing its own fiscal situation.
- » Persistent efforts by consumers & governments to deleverage their balance sheets, but in a slow growth global economic environment, this will be a challenging and painful process that will last many years.
- » Depressed equity values are providing an excellent opportunity

for investors to acquire high quality companies while the excessive amounts of global monetary stimulus – which will ultimately bring about economic growth – are keeping bond valuations high by historical standards and will continue to cause many investors to move into higher yielding, non-government fixed income securities.

Implications For Client Portfolios:

Each of our clients' portfolios are constructed in a manner that is based upon satisfying each of their various investment goals, which are typically funding obligations either now or in the future, while balancing these objectives against each client's true tolerance for risk and portfolio volatility.

As a result, on a regular basis, we take a very close look at how we have structured client portfolios (i.e. investment mandates selected) and the investment managers that we have hired to determine if; a) they are behaving as expected, and b) they still make sense given the expected economic environment moving forward.

We have been pleased to see that our client portfolios have behaved as expected in this volatile market.

Fixed Income Assets:

Within the fixed income component of our portfolios, we are pleased that we have restricted the exposure to Canadian bonds only. We continue to feel that the potential advantage of getting an extra percentage point or two in a foreign bond is not worth the embedded risk.

The combination of our bond mandates remain structured with shorter terms to maturity than a typical bond fund to limit our exposure to the risk of rising rates. To offset the reduction in income that comes with the shorter duration, we continue to have a significant weighting to prudently managed corporate bonds.

Equity Assets:

Our core equity mandates focus on medium to larger companies with strong balance sheets, and prospects for growing cash flows and/or dividends. This has performed well and we see no reason to change the focus.

As a final note, we are pleased to advise that we have recently approved the addition of Dixon Mitchell Investment Counsel's Canadian Small Cap equity team as a manager for the HighView Small Cap Equity Mandate. We have worked closely with Dixon Mitchell for nearly five years and they have been the sub-advisor on our Canadian-Plus Equity Mandate. After hiring Chris Page, an industry veteran, Dixon Mitchell formally launched their new small cap offering in April of this year.¹ We view Page's hiring as a positive for the firm.



¹ In the interest of full disclosure, Chris Page worked for a period of time at HighView. His move to Dixon Mitchell from HighView was a logical transition as it allowed him to return to doing what he loves; which is being the hands-on manager of an equity portfolio.



Contact

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