



Balanced View

WEEKLY COMMENTARY

September 14, 2007



A class \$9.82 | F class \$9.84 | X class \$9.81

Short Term Pain for Long Term Gain

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This week's article is the first **BalancedView** to be penned by guest contributor, Dave Picton, President and Portfolio Manager at Picton Mahoney Asset Management. This Toronto based firm manages, what they refer to as, the "authentic hedge" component of our True Balance™ portfolio. We have known Dave a long time and have always held his thoughts in high regard and thus, were thrilled when he accepted our request to share his insights for this week's **BalancedView**.

In the period leading up to the summer we were concerned about the possibility of negative changes in economic expectations and the negative effects this could have on the stock market. We were also worried about the complacency of investors in general based on various measures of investor sentiment.

The declines in stock prices in most markets over the summer proved that our concerns were well founded. The good thing to be taken from the recent financial market turmoil is that a number of excesses are quickly being purged from the system. Risk is being re-priced to more sane levels as leverage gets punished in the financial system. This process should slow economic growth. However, if credit markets return to more normal operations the economic cycle should be weakened but intact. In other words, the economic cycle is experiencing "short term pain, for long term gain".

The question for most investors is what's next? As is often the case, the market is looking to the US Federal Reserve who has already taken action during this recent turmoil by stepping in and lowering the discount rate from 6.25% to 5.75%. The discount rate is the interest rate charged to banks and other financial institutions on loans they receive from their regional Federal Reserve Bank's lending facility. In recent days, further signs of a slowing US economy suggest that the Federal Reserve is apt to act again, perhaps by lowering the Federal Reserve Rate, which is the interest rate at which a depository institution lends immediately available funds to another depository institution overnight.

Picton Mahoney Long Short Portfolio

Performance Since January 2007



We would have liked to have seen a recovery in stock markets without the aid of central bankers. We think it that markets will continue to regain some of their recent losses, but will likely have some period of consolidation ahead before all is clear. We will likely be a seller of weaker stocks into shorter term rallies to buy stronger stocks on pull-backs.

The world wide search for yield over the past five years has stretched the valuations of most interest rate related financial assets. Government bond yields are low. In spite of recent turmoil, credit spreads on riskier corporate bonds are still relatively low and commodity prices are still at levels that make equity market returns this cycle seem paltry in comparison. Therefore, we still believe that quality, growth oriented stocks are the cheaper alternative to these other asset classes and that their attractive relative valuation will make them the continued target of the huge amounts of liquidity that still exist in the world's financial system.



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