

Spring - 2007



Dear Clients,

The market volatility that was lacking in 2006 returned with a vengeance in the first quarter of 2007. We witnessed several trading days with moves of 1% or more. The reality is 2006 was the aberration not 2007. Current volatility levels are much more “normal” and will probably continue through the balance of 2007.

The major news influencing the capital markets during the first quarter of 2007 was the collapse of the US “sub-prime” mortgage market. Sub-prime is a euphemism for less than investment grade mortgages. Just how much less was best illustrated by a recent article in the Economist. A 24 year old wed designer bought 7 houses in a 5 month period in 2006. He lied about his income and made no down payment on any of his purchases. He now has a total mortgage debt of \$2.2 million. Most of his properties are being repossessed, no surprise there. The size of the US Sub-prime market is large in absolute terms but the contagion may not spill over into the more traditional credit markets. No one is sure who is holding the bulk of these highly suspect “assets” but the suspicion is that hedge funds are the most likely beneficiaries. This unfolding saga will have a major impact on the US economy as we move into the second half of the year.

The fund’s performance in the first quarter benefited from exposure to technology and alternative energy companies. Unfortunately, their positive contributions were offset by the abysmal performance of the companies with exposure to the Western Canadian oil and gas service industries. The decline in drilling activity, especially for shallow gas, is beyond even the most pessimistic forecasts. What caused such a dramatic turnaround in the service industry’s fortunes? Lower natural gas prices certainly played a role but the uncertainty in the income/royalty trust sector caused by the government’s proposed tax changes has dramatically reduced the funds available for drilling. No drilling, no pipeline hookups, no well completions, etc. The industry has always been cyclical but this time with oil prices still above \$60.00 it was supposed to be different. The silver lining in all this doom is natural gas prices will probably rise the third quarter of 2007. Existing natural gas wells are depleting rapidly and with the current slowdown

in drilling the supply and demand equation will quickly change in favour of the producers. I'm optimistic this fall will see a pick-up in activity, we just have to get through an abysmal summer.

As for portfolio construction we have achieved a lot of what we set out to do at the inception of the Income and Growth Portfolio. For the first year of the fund's existence, the correlation (in other words: how the fund's value tracks the return on the indices) of the fund to the major indices, the TSX and the S&P 500, was 0.52 and 0.50 respectively. What that means is if you have other investments that track the major indices more closely, then by adding the Income and Growth Portfolio you will achieve very substantial "diversification" for your overall portfolio. Even more encouraging is the weekly portfolio volatility at 0.48%, is much lower than the TSX at 1.72% or the S&P 500 at 1.42%.

In summary, we have accomplished two out of three portfolio objectives since inception. We have designed an asset class of Portfolio that is relatively uncorrelated to the major markets, has significantly lower volatility than the markets but unfortunately, the returns to date have not met our expectations. Since inception, the Portfolio has basically earned its 5% distribution. However, in the past 6 months, the returns have been averaging about 1% per month. Going forward, I believe we can continue to provide this level of return with a very attractive risk/return profile for our unitholders.

Sincerely,

STEPHEN D. BARLOW

March 31, 2007