# Portfolio Review - Q4 2007

YouFirst FINANCIAL

### YouFirst Financial Inc.

YouFirst Financial is pleased to provide the inaugural edition of our Portfolio Review as an Investment Counsel / Portfolio Management firm. On a quarterly basis we will discuss the overall investment climate, portfolio changes and provide background on some of the securities held in the portfolios. Because of the different risk profiles of our clients, securities mentioned will not necessarily be included in all the portfolios. To date, more than 90% of our clients have transferred to our firm. We are sincerely grateful for your support.

### Escalating Fear

Throughout the fourth quarter of 2007 investor sentiment continued its shift from greed to fear. A significant sell-off occurred in November particularly in the financial and consumer discretionary sectors. Gold climbed from U$743 to U$834 in the fourth quarter due to a decline in the US dollar, the perceived safe-haven of gold during nervous times and higher jewellery demand leading up to the Christmas season. During the first few weeks of 2008 the market correction has continued. In the Outlook section we discuss the present investing environment further.

The table below summarizes recent market performance, all presented in Canadian dollar currency terms.

| Market Indices ($C) | Year 2006 | Year 2007 | Q4 2007 |
|---|---|---|---|
| TSX (Canadian market) | 15 % | 7 % | -2 % |
| S&P 500 (US market) | 14 % | -11% | -3 % |
| Nasdaq (mainly tech.) | 10 % | -6 % | -1 % |
| MSCI World | 21 % | -6 % | -2 % |
| MSCI EAFE (Int'l) | 27 % | -5 % | -1 % |
| S&P/TSX Medium Bond | 4 % | 3 % | 1 % |
| US$ relative to Cdn$ | 1 % | -15% | 0 % |

Portfolios for 2007 had positive returns despite the 15% decline in the US dollar, which negatively impacted any US dollar holdings and securities based in countries pegged to the US dollar.

### Portfolio Activity

During the fourth quarter additions were made to Petro-Canada (PCA: TSX) and China 3C Group (CGCG: US) and new purchases included Eldorado Gold (ELD: TSX) and Rogers Communications (RCI.B: TSX). We added to our PCA holding because, on a fundamental basis, it is one of the lowest valued stocks in the integrated oil universe and the overall demand for oil is expected to grow as emerging markets move toward developed country status.

China 3C Group was added to accounts that already held the stock. A recent price decline has provided an opportunity to increase holdings since the fundamentals for the company seem intact. It presently is trading at a low forward P/E ratio of 7, has been growing sales at more than 35% per year and has recently signed a contract with Carrefour, France's largest discount store chain similar to Walmart. Their core business is operating the consumer electronics' departments within China's major retail chains. This is a different business model than we experience in North America. Outsourcing makes sense for department stores because of the high rate of inventory obsolescence and the complexity of managing a large number of suppliers of consumer electronic equipment, including cell phones, fax machines, computers and games. Retail sales in China are growing at greater than 19% per year and with Chinese New Year approaching, we expect the company to have a good first quarter in 2008. One lesson regarding investing in countries with less developed capital markets is that corporate governance is weaker. In this instance, several early investors in CHCG have been selling their shares, putting pressure on the stock price.

Gold has been increasing in price due to the fear gripping the market and in reaction to a declining US dollar. As the US Federal Reserve reduces interest rates, the US dollar has declined relative to other currencies. To participate in this trend we purchased Eldorado Gold which is a mid-cap gold producer with mines in Brazil, China and Turkey. It is one of the lowest cost gold producers in the world but recently experienced a setback when the Turkish government revoked their Kisladag mining license. We purchased ELD after the license was

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revoked, believing it would be a short-term problem. The Company now anticipates a favourable court decision regarding their license and expects operations to resume early in 2008.

Rogers Communications (RCI.B: TSX) was initially purchased because of their:

- 50% increase in cash flow per share in 2008.
- ability to offer a "quadruple play", the bundling of wireless cell phone service, local Home Phone service, Cable TV and high-speed Internet access.
- wireless network that uses GSM (Global System for Mobile Communications) technology which is the primary standard that allows Rogers access to a broader array of equipment (cell phones, PDAs, network equipment, etc.) ahead of their Canadian competitors.

On November 28th the Canadian government announced how they were going to auction 105 megahertz of additional wireless spectrum. 40 megahertz will be set-aside for newcomers to the industry with the remainder up for auction to the incumbents. In early January, Rogers provided preliminary guidance showing that the rate of increase in wireless subscribers had slowed. In an effort to offset this news, Rogers made use of their strong cash flow to increase their annual dividend to $1 per share and introduced a share buy-back program of $300 million. We will continue to evaluate the competitive threat versus the increased cash flow benefits for this name.

Carmanah was sold in all accounts as the company's revenue growth declined and gross margin weakened. They have recently hired a new management team who are restructuring the company. For a few accounts, capital losses were realized by selling Kingsway Financial. Kingsway has had to set aside more reserves to compensate for claims at their US-based Lincoln General Insurance division.

Core names we hold in the portfolios are ATCO – power producer, utility and related service provider, EL Financial – undervalued insurance holding company, Thomson – electronic information provider, TEVA – generic drug developer, PetroCanada – energy provider, Hanfeng – Chinese fertilizer manufacturer and EVT – global closed-end fund trading at a 20% discount to NAV (net asset value).

**Outlook**

At the time of writing we are in the throes of another market correction. The volatility is extreme, one cause being the use of derivatives, typically by hedge fund managers, to rapidly gain exposure to, or exit from, the market. On the inflation front, the bond market is signalling that price increases are not a long term threat with long duration bond yields remaining under 4.3% in both the US and Canada. Inflation eats away at bond performance once cost of living increases and taxes are taken into consideration whereas equity prices tend to keep pace with consumer prices.

The pessimistic view is that the capital system is broken, evidenced by the banks' daily write-downs of sub-prime mortgages, ABCP (asset-backed commercial paper), and SIVs (structured investment vehicles). With so much at stake, the governments and Central banks are closely monitoring the economy, taking the necessary steps to avoid a global capital market collapse.

On the other hand, the optimists would point out that; the US Federal Reserve and the central banks are lowering interest rates, equities are undervalued relative to bonds, emerging market growth will likely continue, supporting demand for energy and minerals and if a US recession is imminent, we are likely already experiencing it. Historically when short-term interest rates are in decline the stock markets have done well even during a recession. The stock market is a forward-looking, leading indicator.

This is the time to remain calm, do our homework on desirable quality companies and be prepared to add these names to the portfolios once the market stops correcting.

**Reports**

For accounts that transferred to our new firm in December, we have provided year-end reports. Over time these reports will improve, adding features such as accrued interest and dividends. Any comments on the report content and format are welcomed.

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