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COMMODARI ANTINORI GROUP

SAFEGUARDING YOUR WEALTH

INVESTMENT COMMENTARY: JANUARY 2007

"The individual investor should act consistently as an investor and not as a speculator. This means that he should be able to justify every purchase he makes and each price he pays by impersonal, objective reasoning that satisfies him that he is getting more than his money's worth for his purchase."

– Benjamin Graham

Well, another eventful year is in the books! You met its challenges with enthusiasm and vigor and we wish you continued success in all your endeavors.

We are pleased to report that both Canadian and U.S. client portfolios once again posted healthy gains in 2006. For easy reference, we have enclosed your individual results along with a detailed review of your portfolio.

As usual, we encourage you to focus on long-term results and believe that short-term performance signifies little. What is most important is attaining your long-term goals. To that end, 2006 proved successful. We do feel however, that it is our responsibility to taper your expectations and wish to remind you that there will be periods when results will be much more subdued.

SUNSET ON INCOME TRUST UNITS

Pardon the pun, but we're still not converted! Even after the substantial decline in unit prices following Finance Minister Jim Flaherty's proposal to eliminate the trust unit tax exemption, we continue to see little merit in owning this kind of investment. The price of a stock in relation to some past quote doesn't mean anything to us. What really matters is the underlying business value.

We steered clear of the sector before the meltdown for the same reason we refuse to invest in it today - simply stated, there is a lack of sustainability in their business model and therefore little long-term appreciation potential.

Don't get us wrong, we were not always hardliners on this issue. We had no quarrel when income trusts first caught investor attention in 1996. At that time, they were reasonably priced, and primarily confined to the oil and gas industry. Since then however, crafty investment bankers exported the trust model to other industries and so the "business trusts" were born. These alchemists, packaged companies with dubious business models into income trust units and, with the help of hapless brokers, marketed them primarily to investors desperately searching for ways to increase yield at a time of historically low interest rates.

Mr. Flaherty did the right thing. He recognized that a problem was developing and if left unchecked,

the continual conversion of Canadian business into income trusts jeopardized Canada's competitive position in the world. Charlie Munger captured the idea best during the 2005 Berkshire Hathaway annual meeting when he said: "think of it like this, if you jump out of a window on the 42nd floor and you're still doing fine on the way down when you pass the 20th floor, it doesn't mean that you don't have a serious problem." We feel badly for unsuspecting investors who fell prey to the income trust euphoria, however we are not among those crying foul – the script was written well before the final curtain fell.

NO TIME FOR COMPLACENCY

The past four years have been spectacular for Canadian investors. In each of the three major markets – stocks, bonds, currency – Canada has consistently outperformed the United States and other major markets by a substantial margin. The Energy and Material sectors, which now represent 43% of the index, led the way, accounting for 38% of the 111% cumulative increase in the S&P/TSX Composite since December 31, 2002. With such a large portion of the Canadian market relying on the continued performance of the Energy and Material stocks, one must ask oneself how much longer will the party last? The last great commodity boom from 1977-1980 ended badly.

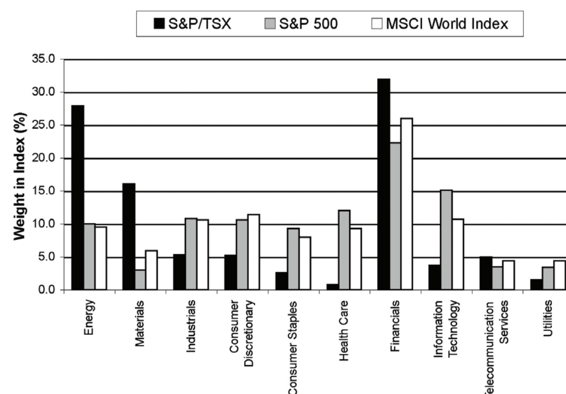
We will not hazard a guess at the unknown, but can say with certainty that after such glorious stock market performance, many investors become overconfident, complacent and overly optimistic risk-takers. Most Canadian investors believe that a few banks, a gold stock, and an oil company or two make a solid portfolio. Our view is that they are seriously underestimating risk with potentially flammable consequences.

At Commodari Antinori Group we are always cognizant of risk and seek to minimize it. This is why we substantially reduced your exposure to the Energy and Material groups throughout 2006. Quite simply, we feel that the biggest gains in these sectors are behind us and that relative to risk the potential reward is simply not large enough.

CANADA … DRY?

We continue to advise clients to look outside of Canada for investment opportunities. Our stock market isn't an endangered species but in a global context it is small, concentrated and becoming even more so as mergers and acquisitions continue.

Canada's weight in the MSCI World index is only 3.6%. In contrast, Japan, the United Kingdom and the United States account for 10.7%, 11.3%, and 49.3% of the index respectively. In addition to Canada's relatively small place on the world stage, our main bourse, the S&P/TSX, is highly skewed. Its top three sectors, Financials, Materials and Energy, account for over 75% of the index. If we look to the United States, the top three sectors in the S&P 500, Financials, Information Technology and Health Care, comprise just under 50%. The accompanying chart highlights just how poorly some sectors are represented in Canada.



Source: Bloomberg

A quick peek into your medicine cabinet, your pantry or your closet corroborates what this chart shows pictorially. Quite simply, most of the items you will find are from companies based outside of Canada.

Mergers and acquisitions are shrinking our already small domestic stock market. Many stalwart Canadian companies were acquired by foreigners in 2006. The "disappeared" include our oldest corporation, Hudson's Bay Company; our biggest base metals miners, Falconbridge and Inco; our premier steelmaker, Dofasco; and ATI, our second largest technology company. At this rate, who knows, Celine Dion might be the only Canadian icon left!

The unavoidable conclusion is that our home market is small and overly concentrated. Intelligent investors must look beyond Canada to reduce risk, enhance returns and access under-represented sectors.

UNCLE SAM SAYS "WELCOME"

Last year, many of you expressed skepticism when we began advising you to venture into the United States to buy large-capitalization businesses we felt were undervalued. We continue to believe that large-caps provide exceptional value and that in many cases, they offer you the opportunity to buy a dollar for $0.75.

This situation is a far cry from just six years ago. At that time, the herd was clamoring to buy these common stocks at outrageous prices. Today, few investors are paying attention – we are.

The crème de la crème of the S&P 500 declined on average 50% from their 2000 year highs to their 2002 lows. Since then, they have had a consolidation period of six years where the business fundamentals worked off the previously excessive share price. Sales have grown robustly, profits are up substantially and business prospects have expanded nicely yet the share prices languish.

A case in point is Pfizer. People got burned by the stock. It went from $50 to $20. Meanwhile, its sales have gone from $4.21 per share to $6.95 – up 65%. Its earnings per share are up 122% - and its dividend is up 145%. Yet its price earnings ratio is down 82%. Despite the improved fundamentals, many holders have sold their shares either in disgust, anger or both.

A concern for many of you has been the Canadian/U.S. exchange rate. The fact is, the Canadian dollar has gone from a low of U$0.62 in January 2002 to a high of U$0.91 in May 2006 – the time for concern is passed. We like the U.S. market because we are able to find incredible businesses trading at below intrinsic value (real worth) in contrast to Canada, where most names are currently trading above their real worth.

COMPANY DEVELOPMENTS

Our advice and recommendations to you are always based on sound logic and are never jaundiced with emotion. We aren't speculators. It's how we avoid debacles like the tech bubble and the income trust craze. As example of our investment strategy in action, consider some of our most recent recommendations.

On the positive side, we recommended that you sell your position in EnCana at a price a good deal higher than our original acquisition cost. We initially recommended that clients buy EnCana back in 2003. EnCana was created a year earlier when Pan Canadian Energy Corporation and Alberta Energy Company Ltd. merged to create one of the largest independent oil and natural gas companies in the world. We felt that EnCana - already a low-cost producer – led by then President and CEO, Gwyn Morgan, could benefit from additional synergies brought on by the merger. We were right!

EnCana is still a fine, well-managed company. However, we judged its share price, fuelled by the commodity surge, to have appreciated substantially above its intrinsic value. Similar thinking led us to advise clients to reduce exposure to the Energy and Material groups throughout 2006. As a result, client portfolios are now well below market weight in those sectors.

Another positive development this year has been the early blossoming of Dell. We originally recommended that clients buy Dell back in August of 2006 and since then it has increased in price considerably. We like Dell because it has many of the qualities we like in a business – favorable long-term prospects, a simple and easy to understand business model, durable competitive advantage, quality management, and most importantly, a cheap price. There is one concern however, Dell's delay to file financial results with the Securities and Exchange Commission. We are monitoring the situation, but feel comfortable because both the company and its founder, Michael Dell, have been actively buying shares and given our entry price, we have a built-in margin of safety.

In Canada, the big news was Jean Coutu Group's decision in August, 2006 to exit the U.S. retail pharmacy business. Sadly, Jean Coutu now finds itself in on a long list of Canadian businesses that have failed to make it south of the border.

We must admit, given their previous success in the U.S. with the Brooks and Osco chains, we thought they could successfully integrate Eckerd's into their U.S. operation. We were wrong and have since learned a valuable lesson – when a manager with a great track record meets a business with a poor one, the business's record usually wins.

Since our recommendation, PJC has not performed as we had hoped and is currently trading near our original cost. Today, our assessment of its intrinsic value suggests that we will recover our cost and be rewarded for owning the company although not as richly as initially believed. Rest assured, we are on top of the situation and will advise you accordingly.

CONCLUDING THOUGHTS

We are pleased with the companies that we have recommended and are confident in their future prospects. Should you have any questions or would like to meet with us to review your portfolio, please do not hesitate to contact us. We enjoy working with you and appreciate the confidence you have in us.

Wishing you and your family peace, health and prosperity in 2007!

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