VOLUME II , ISSUE I

COMMODARI ANTINORI GROUP

SAFEGUARDING YOUR WEALTH

INVESTMENT COMMENTARY: JANUARY 2008

"Your success in investing will depend in part on your character and guts, and in part on your ability to realize at the height of ebullience and the depth of despair alike that this too shall pass."

– John Bogle, Founder, Vanguard Group

It is with pleasure that we report to you on the progress of your investment portfolio and share our thoughts with you on the financial markets. Please find enclosed a detailed review of your holdings along with a tabulation of your individual results.

For the year ending December 31, 2007, the total return for the S&P/TSX Composite Index in Toronto was 9.8%, while in the United States, the Dow Jones Industrial Average and the Standard & Poor's 500 were 8.88% and 5.5% respectively.

For the most part, Canadian investors were left scratching their heads wondering why their results were so different from that of the S&P/TSX. A look beneath the surface explains the disparity. Quite simply, only 7 of the 303 constituents of this index contributed to the rise! Not owning any of those seven stocks made it difficult to match that return.

Portfolios managed by the Commodari Antinori Group performed well in 2007, albeit slightly lagging major indices. We are unhappy with this outcome, but our experience tells us that excellent long-term results will inevitably include some disappointing short terms. As always, we encourage you to look at your results over a three- to five-year period. On this basis, client results continue to be excellent and more recent clients can count on a similar outcome over time.

DON'T TRUST THE MARKET TO VALUE A STOCK

Some of our most recent purchases are currently trading below our initial acquisition price. Given the nature of stock markets, it is likely that virtually every stock we buy will trade below what we paid at some point before ultimately making money for clients in portfolios. While bruising to our ego, these temporary price declines cause us no alarm but raise an interesting question – do stock prices always reflect underlying business value?

BMO Nesbitt Burns®

A common view, especially among academics, is that every day, and for every listed company, the stock market magically sets the correct price. Does this mean that yesterday's price was incorrect? Perhaps the new price is the incorrect price and the old price was the correct one? We think this is ridiculous. The fact is, stock quotes simply reflect the price that millions of market participants are willing to pay or be paid to buy and sell shares at a point in time and depend on the state of mind of the people involved in the transactions. This means that in the short term, a stock can trade at virtually any price and for any reason or no reason at all other than the fact that for even a brief period of time someone is willing to pay or receive such a price – even a foolish one.

> *"Man would be better off if his stocks had no market quotation at all, for he would be spared the mental anguish caused him by other persons' mistakes of judgement."*
> *– Benjamin Graham, The Intelligent Investor*

Our perspective is less common and some would say radical. We suggest that the value of a publicly listed company, just like the value of your home, does not change in minutes, days or even months. Volatile markets which respond to the emotions of fear and greed do not change the value of the businesses we own. In the long term, it is always underlying business fundamentals that inevitably drive share prices – real dominance of industries, real innovation and real earnings – not mob psychology. This is why we are not disturbed by temporary price fluctuations.

THE SKY IS NOT FALLING

It is remarkable what a difference a year can make. Last year, in our January ***Investment Commentary***, we wrote that "… many investors [had] become overconfident, complacent and overly optimistic risk takers ..." and were "… seriously underestimating risk." Twelve short months later, we have witnessed an almost complete about-face as investors, urged on by negative headlines and volatile markets, are now clamouring for the exits.

Our advice to clients is to turn off the noise and not be consumed by the negativism and fear prevalent today, just as we advised you not to get caught up in all the positive hype at the start of 2007. At the risk of repeating ourselves, we remind you that with regard to investing, the time to be nervous is when there is nothing to be nervous about. At such time, prices are high as is the risk of loss. Conversely, the time to look for opportunity is when there is fear and uncertainty. Such uncertainty drives down prices as people irrationally unload shares, presenting opportunities for those that recognize business value and can buy and hold.

Having invested through numerous crises in the past – e.g., the savings and loan crisis of the early 1990s, the emerging markets crisis of 1997-1998, the corporate scandals of 2002 – we know that now is not the time to lose focus and that tomorrow's big winners are always bought during periods of deep gloom. This time is no exception.

Through 2007, we intentionally carried large cash positions in client portfolios. That was the right thing to do. Today, a survey of client accounts as at December 31, 2007, reveals that, on average, client portfolios hold 25% cash and cash equivalents. Moving forward, gradually putting that cash to work, makes sense. Although no one can predict with certainty what lies ahead for the stock market, history suggests that investing in quality businesses at discounted prices will continue to deliver above average long-term results.

"I made by far the best buys I've ever made in my lifetime in 1974. And that was a time of great pessimism and the oil shock and stagflation and all those sorts of things. But stocks were cheap."
–Warren Buffett, CNBC Interview, Dec 11, 2007

HAPPY DAYS – A REFLECTION OF THE TIMES

It is ironic to us how one of the most popular sitcoms on television in the 70s had Happy Days as its title. After all, that period was anything but Happy – lucky for Arthur Fonzarelli and the Cunninghams that the show was set in the 1950s. If not, it's probable that Mr. Cunningham's hardware store, Fonzie's garage and Arnold's restaurant would have all fallen on hard times.

Think back to this era. Several events come to mind: the OPEC oil embargo; President Nixon's resignation; the fall of Saigon; the Soviet Union's invasion of Afganistan; and, Islamic militant's seizure of the American embassy in Teheran, Iran. Headlines in the popular media pointed out that the dollar was down, inflation was up, trade deficits were increasing and the U.S. was losing influence around the globe. Additionally, it was argued that the approximate $500 million deposited in banks outside the U.S. could be converted to a stronger currency which would drop the dollar even further, possibly creating a monetary crisis. Sound familiar?

As you all know, we never try to predict where the stock market is headed in any given year despite the fact that we are often asked to do so. The same can be said with inflation, the dollar and other such variables. In our experience, trying to predict such events, although important, leads to costly distractions. We are, however, very interested in history. When it comes to investing, the only thing that one can predict with certainty is that history, just like human nature, tends to repeat itself.

Today, the U.S. dollar is down, central banks outside the U.S. hold approximately $13 trillion in deposits, crude oil has topped $100/barrel and the trade deficit continues to widen. These factors have once again caused a growing souring for all that is America.

We are not convinced that we will see the U.S. dollar take off like a circus clown shot out of a cannon as we did in the late 70s, but we do think that after having traded at below parity with the Canadian dollar – something we haven't seen since 1974 – recent weakness was a good opportunity to convert our loonies at a premium. We believe that despite current negative sentiment, the dollar will still be here a lot longer than you or I will be, and we will take advantage of any future opportunity to once again convert at a premium.

CONCLUDING THOUGHTS

During periods of fear and uncertainty, the key to superior results is to remain calm and to focus on the long term. Share prices of wonderful businesses, including some that we own, are dropping because the overall market is dropping. This is not fatal and does not normally lead to a permanent loss of capital. Often, we'll simply buy more of the shares at depressed prices, and time and patience usually brings us on-side.

Owning good companies reasonably priced relative to their intrinsic values will reward you over the long haul. We continue to have a high degree of confidence in the businesses we own and appreciate your patience as we wait for the market to inevitably reflect their value.

Should you have any questions or if you 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 2008!

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January 14, 2008

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