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QUARTERLY INVESTMENT REVIEW

December 31, 2011



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Report Highlights.....	1
Economic Commentary.....	2
Asset Mix.....	4
Bonds.....	5
Equities.....	7

Outside the United States, concerns about sovereign debt in Greece and other euro- zone countries, as well as about the sovereign debt exposures of the European banking system, have been a significant source of stress in global financial markets. European leaders are strongly committed to addressing these issues, but the need to obtain agreement among a large number of countries to put in place necessary backstops and to address the sources of the fiscal problems has slowed the process of finding solutions. It is difficult to judge how much these financial strains have affected U.S. economic activity thus far, but there seems little doubt that they have hurt household and business confidence, and that they pose ongoing risks to growth.

Federal Reserve Chairman Ben S. Bernanke's statement to the Joint Economic Committee of the U.S. Congress
October 4, 2011

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Report Highlights

The escalation of the European debt crisis dominated world headlines in the fourth quarter. Most of Europe is looking to implement severe austerity measures, including both spending cuts and tax increases. Therefore it will be extremely difficult to expect much in the way of economic growth out of Europe in 2012. The picture in the U.S. is more uplifting with positive indicators evident in employment and the housing sector, which have contributed to a strong rebound in consumer confidence. Canada is paying close attention to China given its impact on demand for commodities and hence pricing. With evidence of a slowdown there, the Chinese government has begun to ease monetary policy.

Asset Mix – An increase in equity exposure in the third quarter was rewarded in the short term with global markets lifting out of the third quarter doldrums. We continue with a slight underweight to bonds. The environment is quite unusual with the dividend yield on the stock market now higher than the interest rate on government of Canada bonds; this hasn't happened since the 1950s.

Bonds – The on-going European debt crisis contributed to put downward pressure on rates. The portfolio's exposure to U.K. Gilt bonds was eliminated to take advantage of the spread tightening that occurred between the U.K. and Canadian comparatives. Yield curve positioning was positive with the Canadian curve flattening. The portfolio ended the quarter with an overall duration shorter than the benchmark.

Equities – The Energy sector was a clear leader in both Canadian and foreign markets. **Canadian Oil Sands, Canadian Natural Resources** and **Ensign Energy Services** propelled Canadian equity results higher, while natural gas oriented holdings lagged. **Total S.A.** and **Exxon Mobil** were standouts in the foreign portfolio. A takeover bid for a competitor alerted investors to the value in Inmet Mining, moving the stock to the position of top contributor. **Agnico-Eagle** was added with Golds under pressure. Telecommunications stocks continued to garner investor attention. We added to insurers on weakness, eliminating **Intact Financial** which had dramatically outperformed. Foreign Industrials offered strong performance with **Honeywell** and **Wolseley plc** leaders. **Pitney Bowes** and **Philips Electronics** were eliminated based on a revaluation of fundamentals. Health Care selections stood out in the foreign portfolio. **Lowe's** offered a strong rebound while **Home Retail Group** and **Mothercare** continued to suffer. We expect the share prices to recover. **Cisco** and **Samsung Electronics** had strong rebounds. **General Motors** and **Corning Inc.**, a global leader in glass and ceramics technology-based businesses were added to the portfolio.

Economic Commentary

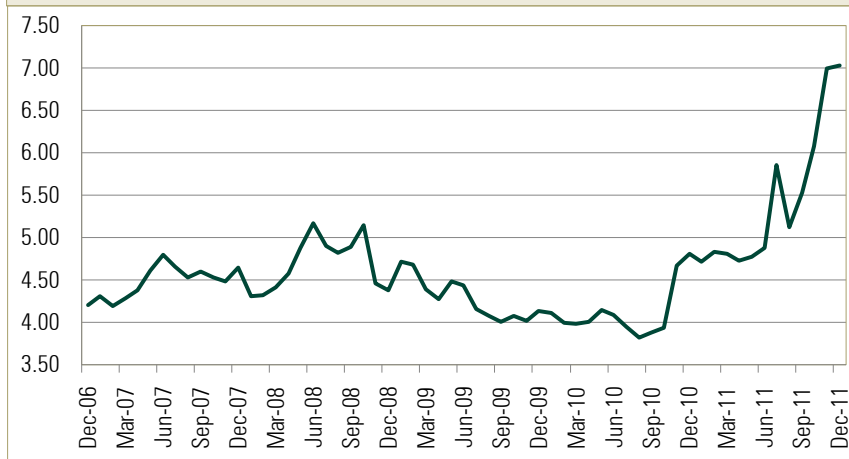
The escalation of the European debt crisis dominated world headlines in the fourth quarter and had a dramatic impact on movements in global financial markets. There was a transition of leadership in both Greece and Italy which added to the uncertainty. These changes, however, should provide a more stable government for these countries in the future. The spotlight remains, however, on the leaders of Germany and France, along with the European Union, to coordinate a viable framework which will allow Europe to effectively tackle its debt and deficit problems.

Greece continues to be a factor as the new Greek Prime Minister recently stated that the economy would collapse in early 2012, with the potential for a disorderly default unless the country accepted income cuts as a requirement to receive additional international funding. As a result, the potential break-up of the Euro still remains a possibility and will influence discussions that occur in the Eurozone over the next several months. Hungary, which is part of the European Union but does not use the Euro, is the latest country to indicate that without an aid package from the International Monetary Fund and the European Union it may not be able to repay existing debt.

Interest rate levels in some distressed European countries have soared in recent months, making it more difficult and expensive to raise funds in the capital markets. Over \$850 billion of refinancing is required in Europe during 2012, with over \$250 billion in the first quarter alone. The success of this refinancing will be a key determinant to how Europe weathers the current crisis. With most of Europe looking to implement severe austerity measures, including both spending cuts and tax increases, it will be extremely difficult to expect much in the way of economic growth out of Europe in 2012.

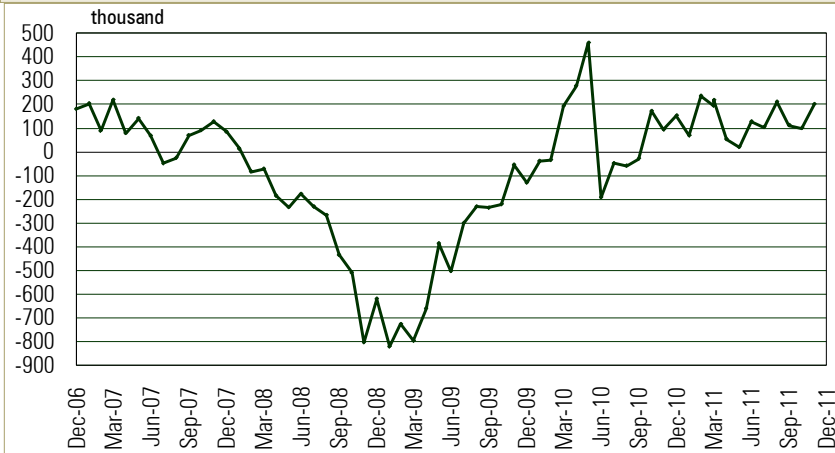
Economic growth in the U.S. has shown signs of improvement recently as positive indicators are evident in several areas. Job gains averaged 136,000 per month in 2011 while housing data suggests that the market may have bottomed. Sustained growth in both of these key sectors is required to form a solid base necessary for a broad economic expansion in the years ahead. Consumer confidence rebounded strongly to end the year and the purchasing manager surveys indicate that the economy is still expanding.

Italy 10 Year Bond Yield



Source: Bloomberg

U.S. Non-Farm Payrolls (difference – month to month)

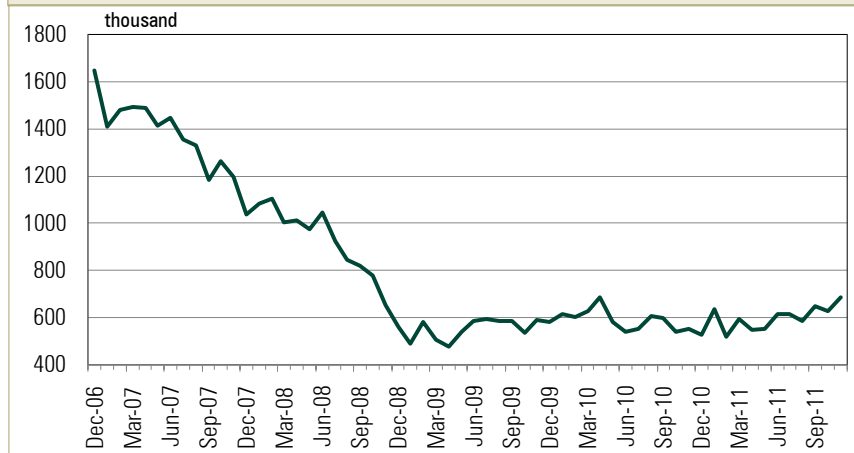


Source: Bloomberg

The political stalemate in the U.S. continues to hinder stronger action that could be taken to help kick-start the economy. The divide that currently exists between the Republicans and Democrats is as wide as it has been in years. With the election still eleven months away, frustration will continue as leaders concentrate on their political aspirations at the expense of doing what is best for the economy and the American people. The United States is somewhat fortunate that Europe has to deal with its significant deficit problems, otherwise global attention would be more focused on the lack of progress being made in the U.S. Despite its problems, however, the U.S. is still the safe haven market in times of global uncertainty.

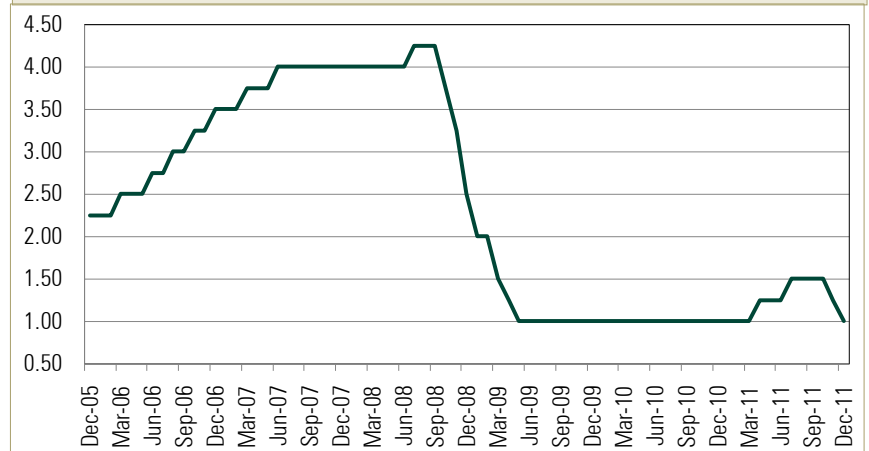
Major global central banks are keeping interest rates at historic low levels in order to support economic growth. They continue to provide liquidity to the financial system through other stimulative measures, including Operation Twist in the U.S. and other forms of quantitative easing. Additional measures could be implemented as necessary. After raising interest rates earlier in the year to combat potential inflationary pressures, the European Central Bank lowered its overnight rate to 1% in order to boost the economy.

U.S. Housing Starts



Source: Bloomberg

European Central Bank Overnight Rate



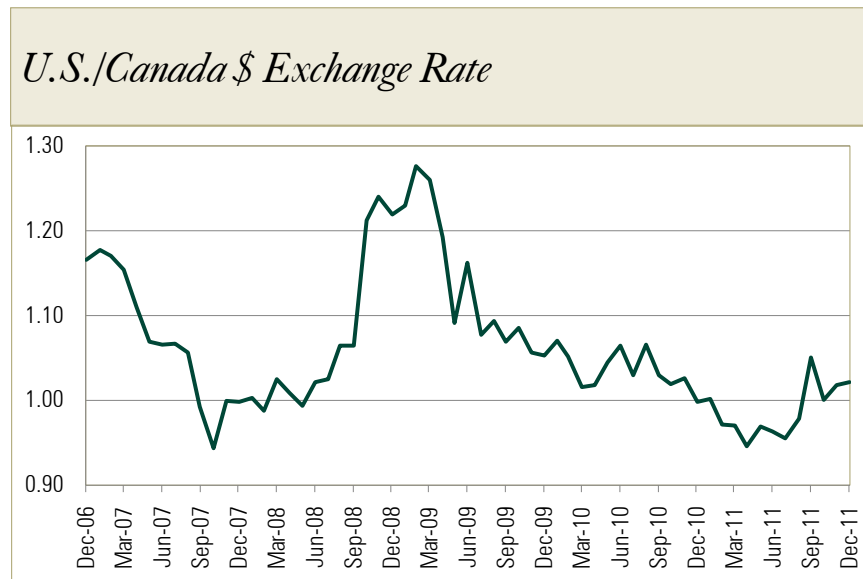
Source: Bloomberg

Economic prospects in China will also influence global activity, especially in commodity-driven markets like Canada. Markets are concerned that there could be a hard landing in China as economic growth slows from the massive growth rates experienced over the past few years. Much of the recent strength in the Canadian dollar has been the result of strong demand from China for commodities. In order to prevent a more dramatic slowdown, the Chinese government has begun to ease monetary policy by lowering the bank reserve requirements for the first time in three years.

In summary, on-going debt problems in Europe will continue to dominate market activity. Markets will remain volatile as investor appetite for risk changes due to political and economic headlines. Stronger leadership is required by leaders both in the U.S. and abroad in order to tackle the problems confronting the global economy. The European economy will likely contract in 2012, while the North American economies are forecast to show modest growth. Interest rates should remain low to start the year as global central banks continue to support economic growth and provide liquidity to world markets.

Asset Mix

There were no asset mix changes during the fourth quarter; equities had been increased late in the third quarter. During the quarter equity markets experienced a recovery with 2.8% price gain in both Canada and international markets, as reflected in the MSCI-EAFE index (MSCI-EAFE return expressed in USD). However, the flight to the U.S. dollar and improving economic data resulted in a strong recovery in the U.S. market with the S&P 500 up 10% in local currency terms during the quarter. We remain somewhat overweight foreign equities which appear more undervalued than their Canadian counterparts; this is particularly true in Europe where the sovereign debt crisis has been exceptionally hard on European centric companies. We have a neutral position with respect to Canadian Equities and remain somewhat underweight bonds. It is interesting to note that the dividend yield on the stock market is now higher than the interest rate on government of Canada bonds; this hasn't happened since the 1950s.



Source: Bloomberg

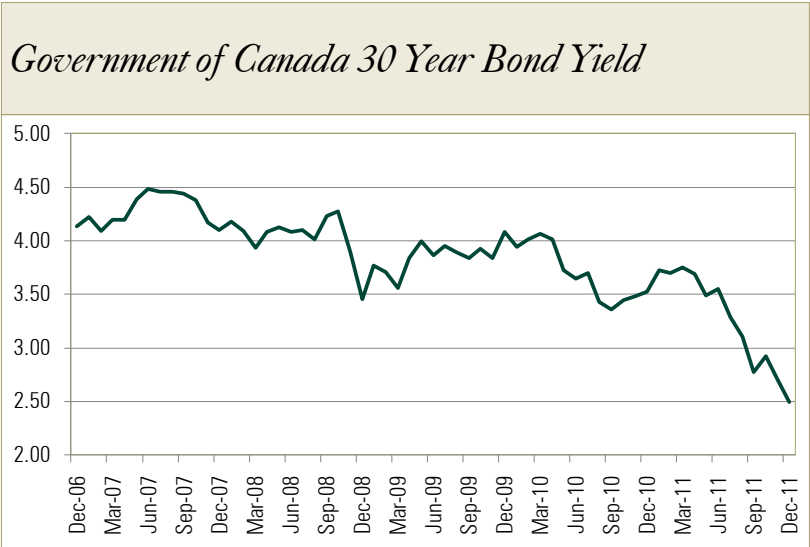
Our asset mix targets for unconstrained balanced accounts as at December 31, 2011 were as follows:

Asset Class	Long Term Neutral Target	Current Target	Variance from Long Term Neutral
Canadian Equities	30%	30.0%	0.0%
Foreign Equities	30%	32.0%	+2.0%
Bonds	40%	35.5%	-4.5%
Cash	0%	2.5%	+2.5%

Bonds

North American bond yields declined in the fourth quarter, however, the magnitude of the move was less than that experienced during the third quarter. The on-going European debt crisis contributed to the decline. The yield on the ten year Government of Canada bond decreased by 22 b.p. to 1.94% at the end of the quarter. The thirty year bond yield decreased by 28 b.p., ending the quarter at 2.49%. Interest rate declines were less dramatic in the U.S. as the U.S. economy is beginning to show some positive signs. The yield on the ten year U.S. Treasury bond declined by 4 b.p. to 1.88%, while the yield on the thirty year Treasury bond declined by only 1 b.p., ending the quarter at 2.90%.

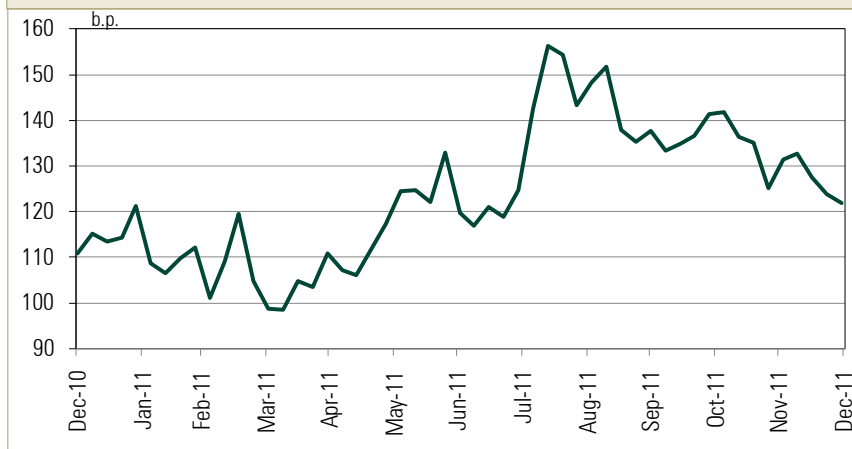
The yield spread between U.S. Treasury bonds and Government of Canada bonds widened during the quarter, particularly at the long end of the yield curve. The 30-year yield difference widened by 27 b.p. during the quarter. The U.S. Treasury position that was held in those portfolios that invest in foreign pay bonds was eliminated during the third quarter.



Source: Bloomberg

The 30-year yield spread between U.K. Gilt bonds and Government of Canada bonds tightened by 22 b.p. during the quarter. The position that was previously established in 30-year U.K. Gilt bonds was sold during the quarter to take advantage of the spread tightening that occurred and was a major contributor to the strong performance during the quarter.

5 Year vs. 30 Year Government of Canada Spread

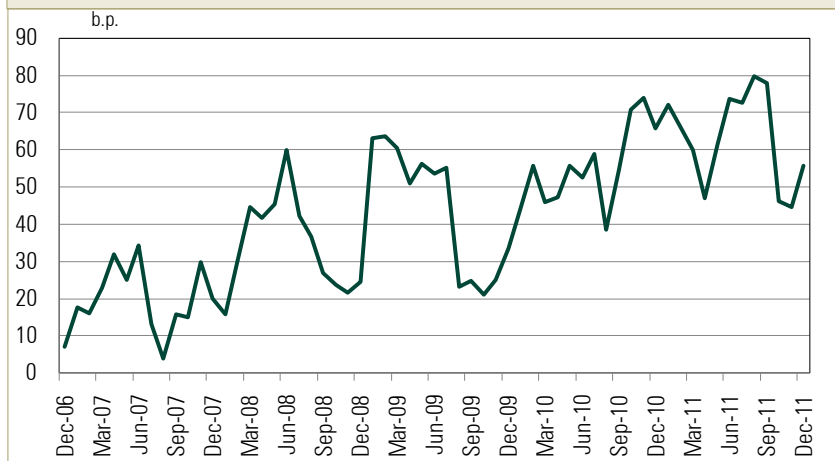


Source: Bloomberg

The spread between corporate bonds and government bonds was relatively unchanged during the quarter. The portfolio continues to be overweight corporate bonds, with a bias towards higher quality names. Provincial bond spreads were also relatively unchanged on the quarter. The provincial weight in the portfolios remains fairly close to the benchmark weight.

The portfolio ended the quarter with an overall duration shorter than the benchmark as bonds were sold to take advantage of the higher prices in the market.

30 Year Government of Canada vs. U.K. Gilt Spread



Source: Bloomberg

The yield curve flattened during the quarter as the spread between five year and thirty year Government of Canada bonds compressed, moving from 137 b.p. to 121 b.p. The portfolio was positioned to take advantage of a curve flattening environment and benefited from the movement in the yield curve.

Equities

The fourth quarter brought a reprieve from the sharp decline in equity markets of the third quarter. While the escalation of the European debt crisis dominated world headlines, with economic growth in the U.S. showing signs of improvement equity investors began to push up stock prices from recent depressed levels. The Canadian equity market didn't have as strong a rebound as the U.S. market faced with the additional uncertainty of a tenuous growth profile for China and the impact on our more commodity sensitive market. Europe lagged as investors looked toward a retracting economy in 2012.

The economically sensitive Energy and Industrials sectors led the Canadian market lower in the third quarter. Investors moved toward these sectors in the fourth quarter, with each offering solid double digit returns.

Our energy holdings provided strong absolute returns and a strategy of overweighting oil and gas producers was positive, even though the overall portfolio sector return slightly lagged the very strong market comparative. The volatility in the price of crude oil continued with the \$80 level at the end of September proving to be a turning point as crude reversed moving back over \$100 per barrel. **Canadian Oil Sands** and **Canadian Natural Resources** held spots two and three in terms of positive contributors to results for the quarter benefitting from a narrowing of the discount between stock valuations and the commodity price. **Ensign Energy Services** followed.

At the same time natural gas prices have been weak, with unusually mild weather contributing to the weakness. This has been the primary factor contributing to poor relative performance from **Encana** and **Talisman**. In addition, operational problems in **Talisman's** North Sea operations which have required them to reduce their short term production forecast have cast a shadow over the stock.

Strategies in Materials were the most positive for the quarter. Canadian-based global mining company, **Inmet**, surged almost 50 percent in price, ranking as the number one positive contributor to Canadian equity results. Competitor, **Quadra FNX Mining**, a leading mid-tier copper mining company received a takeover bid by Polish company **KGHM** in the fourth quarter at a 40 percent premium. Similar in size to **Inmet**, and having traded at similar valuations, the activity highlighted the value in Inmet. **Teck Resources** too was strong. While the economically sensitive stocks in the group rebounded sharply, investors' on again/off again love affair with Gold stocks switched to the negative side. An underweight was positive. We took advantage of the weak price environment, adding **Agnico-Eagle** to the portfolio, following the closure of one of its mines and the subsequent collapse of its stock price. **Agnico-Eagle** is the fifth largest gold mining company in Canada by market capitalization and gold production volume. It has transitioned from a company with a small number of producing mines in Canada, with significant base metal production, to a growth company with primarily gold production. The company is distinguished by its low political risk and very strong growth profile over the next few years as new projects ramp up production.

At the same time, Telecommunication Services continued to offer solid results, with the portfolio's substantial overweight again a positive strategy, complemented by slightly better security selection decisions. Canadian wireless data growth continues, in an environment where the feared

competition from new wireless entrants such as Wind Mobile did not turn out to be as fierce as previously thought. The stocks generally have good dividends, strong balance sheets and decent valuation characteristics, hence are attracting investors' attention and demand in uncertain markets. Profits were taken in **BCE**.

Financials settled down during the quarter following a very weak third quarter but as a group didn't participate in renewed investor interest given the high level of uncertainty associated with the ongoing turmoil in Europe. Insurers, **Manulife** and **Sun Life Financial**, continued to be negatively affected by the low interest rate environment. **Sun Life** reported a loss that disappointed even the reduced expectations from a preannouncement earlier in the quarter. The poor results combined with the appointment of a new CEO at the end of November brought the stock under significant pressure as the market feared a dividend cut. However, the new CEO reaffirmed the dividend and indicated that it would not be cut as long as normalized earnings support it – which is viewed as likely and hence we added to the position on the weakness. As life insurers were generally under pressure we also added to **Great-West Life**. Proceeds for the purchases came from **Intact Financial** which has dramatically outperformed the sector.

In the Consumer Discretionary area we reduced **Shaw Communications** with the stock having held up well during the market downturn, adding to **Thomson Reuters** and **Magna**; positions that were established during the third quarter.

Results for the quarter were held back by investments in **Superior Plus** and **Research in Motion**.

Industrial sector member **Superior Plus Corp.** operates three main businesses: propane distribution, chemicals distribution (for pulp and paper industry), and construction materials. The company cut its dividend in half during the quarter in order to re-direct cash flow to pay down debt and reduce leverage in the company. Given our projection that up to 75% of the shareholder base is income oriented retail investors, the stock fell as these investors exited the stock during "tax loss selling season". However, the fundamentals of the company are on track with management guidance. The stock's current yield of still about 10% is sustainable and we believe looking out medium term once the company's financial leverage comes down to moderate levels we could potentially see improvements in cash returns to investors. The company also appointed a seasoned operator as the new CEO and we see positive changes in the near term in operations. We added to the position.

Research in Motion's gap in their product introductions, as well as on-going negative media and analysts' criticism of its executive management, contributed to a continued decline in its share price. Most recently, the company reduced the earnings outlook and announced further delays in new product introductions. We continue to hold the stock because it's still producing significant free cash flow, has no debt, and is currently trading below book value and near tangible book value (excludes goodwill and other intangibles). A potential change in management leadership; an announcement of a takeover, partnership, or alliance, and; a break-up scenario would all contribute significantly to positive stock price performance. The stock is now trading below four times earnings and less than two times trailing EBITDA (earnings before interest, taxes, depreciation and amortization – a proxy for operating cash flow). It represents compelling value, with meaningful upside if any one of the above mentioned scenarios materializes.

The opportunity in foreign markets was clearly in the U.S. Following a 15% decline (local terms) in the third quarter investors rejoiced over signs of improved economic growth in the U.S. economy and buoyed consumer confidence pushing the S&P 500 up by 13%; the best calendar quarter return since the third quarter of 2009. European equities languished as investors contemplated the impact of austerity programs on economic growth.

Energy was very strong offering almost twice the return of the next strongest group - Industrials - with a 14% return. We had close to market exposure but lagged on security selection although still earning double digit returns. **Total S.A.** and **Exxon Mobil** in particular were strong performers. We had added to **Petrobras** early in the quarter.

Industrials in non-Canadian markets too offered opportunities. **Honeywell** was a top five contributor, performing well in its industrial and aerospace businesses, especially given its exposure to emerging and developing markets. The company delivered an excellent quarterly report and forecast continued improvement going forward. **Wolseley plc** had a return of over 30% for the quarter. The stock is garnering a lot of positive attention from analysts responding to a better than expected quarterly earnings report, with evidence of a continued recovery in the company's U.S. business. Positive news for the U.S. construction outlook outweighed concern over the environment for European activity. We took some profits on the strength. A reevaluation of the fundamentals of both **Pitney Bowes** and **Philips Electronics** led to the elimination of the positions. While **Pitney Bowes** offers a very attractive dividend yield, we have grown increasingly concerned about the company's attempts to grow revenues in new areas as the traditional business erodes. We are finding better risk/reward characteristics in **ABB Ltd.** and **Alstom S.A.** and added to the positions.

Strategies in Health Care had the most positive impact on relative results for the quarter, with portfolio heavyweight **Pfizer** leading the group, moving over 20% higher during the quarter. The company saw its largest drug, in fact the biggest selling drug in the world, Lipitor, lose its patent protection in the U.S. during the quarter. This event had been more than fully priced in our valuation model. Subsequent to the patent expiration **Pfizer** employed a very aggressive pricing strategy on Lipitor to significantly slow down market share erosion. With the long awaited event now having occurred, market perception of risk in **Pfizer** has improved, and its yield is attracting investors once again. **GlaxoSmithKline** plc continued a trend of positive quarterly returns. A positive earnings report and an increase in commitments to share buybacks made the stock an investor favourite. **Quest Diagnostics** too offered very solid results.

Consumer Discretionary stocks offered divergent returns. We had added to **Lowe's** in the third quarter, attracted to the company's 10% free cash yield, with the stock under tremendous pressure given the bearish outlook for the U.S. economy. The strong price rebound in the fourth quarter as investors reacted to improving economic data in the U.S. propelled the stock to the position of top contributor to foreign equity portfolio results. **Home Retail Group** and **Mothercare** continued to suffer faced with a weak environment in the U.K. With the ongoing European debt crisis, investors are not optimistic about the outlook for the U.K. economy, and this pessimism is negatively impacting cyclical companies. We believe both companies are likely to remain profitable during this weak period and expect the share prices to recover. **Panasonic**, the Japanese consumer electronics giant, has had a difficult year with the rapid decline in television prices. Now trading at about half of book value, we believe investors have become too pessimistic.

General Motors was added to the portfolio with the company's new philosophy which took hold three or four years ago starting to bear fruit. The cost disadvantage of the past has been eliminated in North America with the labour and health care bills being reduced substantially, while the pricing disadvantage is being eliminated with new models. The company's balance sheet ranks as one of the best in the industry. The stock price offers substantial upside potential. With Monsanto rebounding strongly in price we took profits, deploying proceeds into **Staples Inc.** Having been a disappointing performer this year, compelling valuation characteristics and the company's leadership position have created the potential for notable upside.

Cisco produced a sharp rebound in the Information Technology sector, while **Samsung Electronics** was the second most positive contributor to portfolio results. **Samsung** has enjoyed great success with smartphone sales this year, with unit sales now larger than **Apple's**. With earnings at all time highs the share price is reflecting the positive fundamentals. We took some profits. **Oracle Corp.** caught investors by surprise, reporting below expected earnings; the company had not 'missed' earnings estimates for a decade! The report pointed to delays and possible weakness in enterprise software demand. We continue to hold the stock, forecasting that it will benefit strongly in an improving macro environment given its industry leadership position and growth opportunities, supported by significant free cash flow generation. **Keyence** has not performed well in the weak Japanese stock market. The company is high quality, with a dominant business position. We expect the value to be recognized over the long term.

Corning Inc., a global leader in glass and ceramics technology-based businesses was added to the portfolio. The company's development of "gorilla glass", an extremely strong and scratch resistant product that is half the weight of regular glass, has a very promising future as television manufacturers embrace it and auto industry participants consider how they can benefit from the weight reduction to improve fuel economy. Long standing litigations associated with two of three significant joint ventures, related to silicone breast implants and asbestos, have weighed on the company. At this point they are largely behind the company, are well recognized in the stock valuation and have been properly reserved for. The stock price trades at a substantial discount to our estimation of fair value.

U.S. Financials generally produced good results during the quarter, while non-North American companies continued to languish. With **Munich Re.** holding up better than most European financials we eliminated the position. The most recent quarter's earnings were disappointing and with the elevated risk level surrounding bond markets in Europe we believe the funds are better invested in opportunities with lower risk. With **ING** trading near the year's low price and at less than one half of book value, with a restructuring on track, we increased the portfolio weight.