

February 2, 2012

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■ **Portfolio Management & Advisors**

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Palos Weekly Commentary

■ Palos Income Fund

By Charles Marleau

Canaccord Genuity Corp. and National Bank Financial Inc. are leading the initial public offering of American Hotel Income Properties (AHIP). Palos had a one-on-one meeting with management a few days ago. AHIP's strategy is consistent with our view -- you need to be creative in the REIT space for valuations on traditional REIT'S have crept up to uncomfortable levels according to Palos. However, AHIP's business is original and definitely deserved consideration. Some of AHIP's unique attributes are:

1. AHIP is a lodging REIT focused on railroad accommodations.
2. AHIP will have stable cash flows from its strategic relationship with U.S. railroad operators. Seventy-four percent of the rooms are covered under minimum occupancy guarantees with railroad companies. AHIP is

priced at attractive investment metrics:

- 9% yield with a 72% AFFO payout ratio.
- Debt level is very conservative.
- Hotel valuations remain attractive (20% below 2006 peak valuation.)
- AHIP is coming at 12.5% cap rate and at 13% discount to appraised NAV.

3. AHIP is presently running at an 86.1% occupancy rate. The occupancy rate should increase. Railroad companies are ramping up the use of these rooms as the US economy recovers and railing oil becomes the new norm. Palos estimates that the occupancy rate could approach 100% in the near future. In 2005 and 2006, the hotels achieved occupancy levels above 100% as railroad companies were booking the same room twice a day. Also, increased

Chart 1: Palos Domestic Funds*

	FundServ	NAVPS	5D Returns	YTD Returns
Palos Income Fund L.P.	PAL 100	CA \$9.14	0.59%	4.32%
Palos Equity Income Fund - RRSF	PAL 101	CA \$7.04	0.29%	3.23%
Palos Merchant Fund L.P. (Dec 31, 2012)	PAL 500	CA \$8.18	---	---
Palos Majestic Commodity Fund L.P. (Jan 31, 2013)	PAL 600	CA \$10.87	1.16%	2.40%

Chart 2: Market Data*

	Value	5D Returns	YTD Returns
S&P TSX Total Return Index	36,741.57	-0.30%	2.93%
S&P 500 Total Return Index	2,660.70	0.72%	6.24%
S&P TSX Venture Index	1,228.66	0.13%	0.63%
MSCI All Countries World TR Index (CAD)	3,538.86	0.65%	6.29%
US Government 10-Year	2.01%	0.07%	0.26%
Canadian Government 10-Year	2.04%	0.09%	0.24%
Crude Oil Spot	US \$97.77	\$1.89	\$5.95
Gold Spot	US \$1,669.40	\$12.80	-\$6.40
US Gov't10-Year/Moody BAA Corp. Spread	192 bps	1 bps	0 bps
USD/CAD Exchange Rate Spot	US \$1.0035	\$0.0092	-\$0.0017

* Period ending Feb 1, 2013

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occupancy rates will drive RevPAR (revenue per available room).

AHIP is a great investment opportunity for a growing part of US economic activity is tied to the railroad space.

■ Risks, Hedges and Opportunities

By Adam Smalley

January

Stock market returns in January were very strong - the TSX was up 2.3%. (The Palos Income Fund and Palos Equity Income Fund were up 3.5% and 2.6%, respectively.) Certainly, some of the stock market gains can be attributed to the US choosing not to drive over the fiscal cliff. However, there are some real, fundamentally positive things happening to North American economies that should, we think, result in above-average stock returns this year. We've written about these factors before but in short, they are: signs of a rebound in US housing, increased "on-shoring" driven in part by cheap energy, healthy corporate and consumer balance sheets, and our sanguine outlook on corporate profits. We certainly do not expect that the year's performance will be an extrapolation of January's, to be sure, and we are not by any means going "all in". However, for the first time in at least a few years, we have strong conviction that we are past the point of inflexion.

■ What is New on the Macro Level?

By Hubert Marleau

The Economic Recovery Stalled on Government Spending Cuts

GDP expressed in nominal terms for the December quarter of 2012 was up 3.3% from the comparable quarter of 2011. During this period under review, employment grew 1.9%, productivity decreased 0.4% and price inflation increased 1.8%. The lack of productivity gains suggests that the gap between potential and actual GDP may be much more structural than cyclical and, in turn, the inflation risk may be rising. Current N-GDP trends convey that ten-year US treasury notes should trade for yields of 2.50%. Ten-year yields, currently around 2%, are up 50 bps from six months ago. It should be noted that the 3.3% yearly increase in N-GDP was all about the money supply for it increased 7.9% in the last year. The turnover of money decreased 4.6% meaning that the private sector

is still hoarding cash or investing savings in the various markets. Should an increase in velocity occur, significant inflationary pressure would emerge. This would be particularly true, if indeed, the output gap is structural. The economy may appear to be in a soft spot, but the private sector is doing pretty well. Personal spending, nonresidential fixed investment and residential fixed investment offer hope for they are showing good increases in real terms. As matter of fact, governments are trimming their budgets causing a major drag on economic activity. But, is it not what we want, less government spending. If we had a bit less growth for much less government spending, it would be a small price to pay for fiscal sanity. This is how it looks now and perhaps for the near future.

■ An Excerpt from "The Dividend Dance," a yet to be published book

By Hubert Marleau

On shopping for Dividend Yield

Shopping for stocks that pay dividends is easy. There are numerous databases that provide long lists of dividend paying stocks. Publications like the Wall Street Journal, Barron's, IBD, Globe & Mail and Financial Post are good sources and cheap. Put simply, only stocks that deliver yields in excess 2.50% should be considered for investment. At that yield level, they offer more upfront return, greater tax advantages, superior market performance and better margin of safety than government bonds. In previous excerpts, I empirically demonstrated and theoretically argued that in the fullness of time, ten-year government bonds tend to yield about 65% to 75% of the growth trend of N-GDP. Assuming that the long term outlook for N-GDP growth is 4.00% per annum, it follows that ten-year Government Bonds should trade for yields of 2.50% to 3.00%. In this connection, stocks with dividend yields in excess of 2.50% should fare well if 1) their dividend is reliable and market prices fairly reflects value and 2) their representative company has favorable growth prospects and operates efficiently.

If you have any questions about the weekly commentary, the securities that we follow, or investment ideas, please contact us at
info@palosmanagement.com



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[English will follow]

Bulletin

L'équipe de Palos veille par tous les moyens à ce que ses clients investisseurs tirent pleinement parti des bénéfiques que procurent les comptes de placement assortis d'avantages fiscaux. Palos gère le Fonds de revenu actions Palos, un fonds commun de placement admissible aux comptes enregistrés tels les REER, le CELI, le REEE, le CRI, le FEER et le FRV. Les stratégies de placement mises de l'avant par ce fonds s'apparentent à celles poursuivies par le Fonds de revenu Palos S.E.C., le fonds vedette de la firme. Nous aimerions vous rappeler quelques faits importants concernant les cotisations au REER et au CELI :

REER	CELI
Pour l'année d'imposition 2012, les chèques doivent parvenir à Palos au plus tard le 25 février 2013 de manière à ce qu'ils soient traités avant le 1 ^{er} mars 2013	Aucune date limite
Le chèque doit être établi à l'ordre de « NBCN Inc. » (Le dépôt automatique/électronique est disponible sur demande)	Le chèque doit être établi à l'ordre de « NBCN Inc. » (Le dépôt automatique/électronique est disponible sur demande)
Cotisation maximale : consultez votre plus récent Avis de cotisation pour connaître votre maximum déductible au titre des REER, un tel montant pourrait s'avérer différent des plafonds rapportés ci-dessous : La cotisation maximale déductible pour l'année d'imposition 2012 est de 22 970 \$ La cotisation maximale déductible pour l'année d'imposition 2013 est de 23 820 \$	Cotisation maximale : consultez votre plus récent Avis de cotisation pour connaître votre limite de cotisation à un CELI 2013 : 5 500 \$ 2009 à 2012 : 5 000 \$ par année *Vous êtes admissible à un CELI depuis 2009, mais vous n'avez ouvert aucun compte CELI à ce jour; sachez qu'il vous est possible de cotiser jusqu'à 25 500 \$
Impôt : Les cotisations sont déduites du revenu gagné; l'impôt est reporté jusqu'à ce qu'il y ait retrait du compte, dans un tel cas, la somme retirée est considérée comme un revenu imposable.	Impôt : Aucune déduction d'impôt au titre des cotisations. Les investissements réalisés dans un CELI ne sont pas imposables et peuvent être retirés en tout temps, francs d'impôt. Note : il n'est pas nécessaire pour un individu d'avoir gagné un revenu pour cotiser à un CELI.

Création de richesse

Les comptes de placement assortis d'avantages fiscaux tels le REER, le CELI et le REEE constituent des véhicules de placement attrayants du fait qu'ils permettent aux actifs qu'ils renferment de fructifier à l'abri de l'impôt ou en report d'impôt, et ce, sur une période de temps prolongée. À titre d'exemple, sur une période de 30 ans, l'investisseur qui cotise 5 500 \$ par année (cotisations totales de 170 500 \$) et dégage un rendement annuel moyen de 8 %, se retrouvera au final avec des placements dont la valeur, sous l'effet de la croissance libre d'impôt ou en report d'impôt, totalisera quelque 678 402 \$.

Pour ouvrir ou cotiser à un REER ou un CELI, veuillez communiquer avec Alexandra Kaneb au 514-397-0188 poste 228. Il est également possible de communiquer avec Mme Kaneb par courriel à l'adresse akaneb@palosmanagement.com. N'hésitez pas à prendre rendez-vous avec nous pour discuter des placements que vous détenez chez Palos.



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Newsletter

The Palos team endeavors to ensure that our investors take full advantage of tax advantaged investment accounts. Palos manages a mutual fund, the Palos Equity Income Fund, which is eligible for registered accounts such as RRSP, TFSA, RESP, LIRA, RRIF and LIF accounts, and has similar investment strategies to the flagship Palos Income Fund LP. We would like to remind you of some important details regarding RRSP and TFSA contributions:

RRSP	TFSA
Checks should be received by Palos by Feb 25, 2013 for 2012 tax year, for processing before March 1, 2013	No deadline
Check made payable to "NBCN Inc." (Automatic/electronic deposit available upon request)	Check made payable to "NBCN Inc." (Automatic/electronic deposit available upon request)
Maximum Contribution: consult your latest Notice of Assessment for your specific deduction limit, as it may differ from those below: 2012 Maximum deduction limit is \$22,970 2013 Maximum deduction limit is \$23,820	Maximum Contribution: consult your latest Notice of Assessment for your contribution limit. 2013: \$5,500 2009 to 2012: \$5,000 per year *If you have been eligible for a TFSA since 2009 but have never contributed to any TFSA account, you can contribute up to \$25,500
Tax: contributions are deducted from earned income; tax is deferred until money is withdrawn from account and then is taxed as income	Tax: No deductions for contributions. Investments in TFSA accounts are not taxed, and are withdrawn at any time with no tax Note: you do NOT need to have earned income to contribute to a TFSA

Building Wealth

Tax-advantaged accounts, such as RRSP, TFSA and RESP accounts, are attractive investment vehicles because they allow investments to compound tax-free or tax-deferred over a long period of time. For example, if an investor contributes \$5,500 each year for 30 years (total contribution of \$170,500) and achieves an 8% return, the investment would compound tax-deferred or tax-free to a worth of approximately \$678,402.

If you would like to contribute to or open an RRSP or TFSA account, please contact Alexandra Kaneb at 514-397-0188 extension 228, or by email at akaneb@palosmanagement.com. We welcome you to make an appointment with us to discuss your Palos investments.

Chart 3: Palos International Fund**

	Last	5D Returns	YTD Returns
Palos International Equity Income Fund PLC - CAD	CA \$5.21	0.87%	2.87%
Palos International Equity Income Fund PLC - EUR	EUR 6.76	-1.62%	-0.66%
Palos International Equity Income Fund PLC - USD	US \$6.63	-0.20%	1.27%
S&P TSX Composite Total Return Index - CAD	36,904.64	0.10%	3.38%
S&P TSX Composite Total Return Index - USD	36,786.92	-0.92%	2.53%

** Period ending Jan 29, 2013