

February 8, 2013

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## ■ Portfolio Management & Advisors

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## Palos Weekly Commentary

### ■ Palos Income Fund

By Charles Marleau

#### Suncor, a difficult quarter

Suncor is one of the Fund's core positions. Unfortunately it reported fourth quarter results that were below street and Palos expectations. Specifically, Suncor's operating cash flow came in below what Palos was estimating. The miss mostly came from lower downstream cash flows. Downstream is the distribution of products derived from crude oil, such as gasoline, jet fuel, and diesel. The other reason for the miss was higher costs related to the oil sands infrastructure. Even though the quarter was disappointing, Palos believes that Suncor is still the best risk averse play in the oil industry. Since its earnings announcement, Suncor is down 6%. Palos viewed this sell-off as an opportunity to accumulate. According to our models Suncor remains undervalued and has

favourable short term catalysts. Palos believes that management will substantially increase the dividend in the second quarter of 2013.

It is important to note that Palos does not manage its positions from quarter to quarter; we look to the future. Unfortunately, glitches and unexpected events will always be encountered. At the end, what is important is that long term goals remain intact and that the company remains financially healthy.

### ■ Risks, Hedges and Opportunities

By Adam Smalley

#### Southern Exposure

Over the past several weeks the portfolio managers have increased the exposure of the funds to the US dollar. This shift happened based on our fundamental analysis of individual

Chart 1: Palos Domestic Funds\*

	FundServ	NAVPS	5D Returns	YTD Returns
Palos Income Fund L.P.	PAL 100	CA \$9.18	0.43%	4.77%
Palos Equity Income Fund - RRSF	PAL 101	CA \$7.05	0.25%	3.48%
Palos Merchant Fund L.P. (Jan 31, 2013)	PAL 500	CA \$8.41	---	2.82%
Palos Majestic Commodity Fund L.P. (Feb 7, 2013)	PAL 600	CA \$10.92	0.47%	2.88%

Chart 2: Market Data\*

	Value	5D Returns	YTD Returns
S&P TSX Total Return Index	36,835.51	-0.10%	2.82%
S&P 500 Total Return Index	2,670.85	0.38%	6.64%
S&P TSX Venture Index	1,205.81	-1.84%	-1.21%
MSCI All Countries World TR Index (CAD)	3,538.20	-0.52%	5.73%
US Government 10-Year	1.95%	-0.07%	0.19%
Canadian Government 10-Year	1.96%	-0.08%	0.16%
Crude Oil Spot	US \$95.72	-\$2.05	\$3.90
Gold Spot	US \$1,666.00	-\$3.40	-\$9.80
US Gov't10-Year/Moody BAA Corp. Spread	192 bps	1 bps	1 bps
USD/CAD Exchange Rate Spot	US \$0.9980	-\$0.0055	-\$0.0072

\* Period ending Feb 8, 2013

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securities as well as our macro overview. From a fundamental perspective, quite simply, we are finding relatively more attractive investment opportunities in the US than we did this time last year. In the US, several sectors – manufacturing, housing, chemicals, consumer products -- are gaining momentum and are set up to outperform this year, in our opinion. We're focused on finding the right stocks within these sectors. Leggett & Platt (NYSE: LEG) is a good example from our portfolio. Leggett manufactures value-added products that go into mattresses (springs, coils, power foundations, etc.), autos (seat mechanisms and controls) and other old-economy businesses that are showing signs of life. Leggett has an excellent management team (that we have met), trades at 8.5x TEV / 2014 EBITDA, pays a dividend of 3.9% and is up 8.5% year-to-date.

From a macro perspective, we think the US dollar is set up to outperform relative to the Canadian dollar (see this week's "What is New and Important at the Macro Level"). This macro view gives us conviction to carry out USD positions, at least partially, unhedged.

We measure both our direct and indirect exposure to the USD. Direct exposure, unhedged positions in USD-denominated securities, is about 15%, up from about 8% this time last year. Indirect exposure, which accounts for Canadian companies that have significant US operations, is around 25%, up from about 20% this time last year.

■ **What is New on the Macro Level?**

*By Hubert Marleau*

**What is Keeping the Canadian Dollar Near Par?**

The current account deficit of the Canadian balance of payment is about 3.3% of its N-GDP. One would think that the exchange value of the Canadian dollar should trade below that of the US Greenback. The financial stability of the banking system and the fiscal reliability of the federal government has provided confidence

in the Loonie to attract sufficient and cheap long-term foreign capital to finance the private sector and, indirectly, households. It explains why Canadian house prices are, on average, 20% higher than they were in the last quarter of 2007 and overvalued by 35% against income and 75% against rents. While capital inflows certainly played an important and robust role in keeping the Loonie near par, it may no longer be the reasons why it is still near par. It now seems that the Canadian exchange rate is maintaining its value because Canadian monetary policy is less accommodating than it is in the US. For example, the money supply is increasing at a much slower pace in Canada than in the US, the US yield curve is a lot steeper than it is in Canada and real rates are higher in Canada than they are in the US. Moreover, the Bank of Canada is not on a quantitative easing program of purchasing bonds in the open market. Yet, the recent relative CAN/US performance of inflation and employment suggests the opposite should be the case. The US monetary stance ought to be a little less accommodating than in Canada. Consequently, money inflows have been more short-term in nature suggesting that the financing of the current account deficit is different than it used to be. Of course, this does not necessary mean that the loonie is up the creek. But, the sustainability of the exchange value is somewhat more fragile than it was a year ago. In this connection, the Palos Income Fund has taken a few precautionary moves. The traders have increased the fund's direct exposure to US assets and Canadian companies that are either export-oriented or have a large amount of foreign assets.

*If you have any questions about the weekly commentary, the securities that we follow, or investment ideas, please contact us at [info@palosmanagement.com](mailto:info@palosmanagement.com)*

**Chart 3: Palos International Fund\*\***

	Last	5D Returns	YTD Returns
Palos International Equity Income Fund PLC - CAD	CA \$5.19	-0.33%	2.53%
Palos International Equity Income Fund PLC - EUR	EUR 6.75	-0.11%	-0.77%
Palos International Equity Income Fund PLC - USD	US \$6.64	0.27%	1.54%
S&P TSX Composite Total Return Index - CAD	36,675.57	-0.61%	2.74%
S&P TSX Composite Total Return Index - USD	36,774.86	-0.03%	2.49%

\*\* Period ending Feb 5, 2013

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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 <sup>er</sup> 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](mailto: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 <b>Feb 25, 2013</b> 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](mailto:akaneb@palosmanagement.com). We welcome you to make an appointment with us to discuss your Palos investments.

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