

2011 REVIEW

BUTLER | PHILBRICK AND ASSOCIATES*

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Butler | Philbrick and Associates*

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Butler | Philbrick Model

Total 2011 return: -0.9%
Peak-to-trough drop: -7.4%
Worst absolute loss: -2.4%

TSX 60 Total Return

Total 2011 return: -9.3%
Peak-to-trough drop: -17.1%
Worst absolute loss: -12.0%

Global Balanced Growth

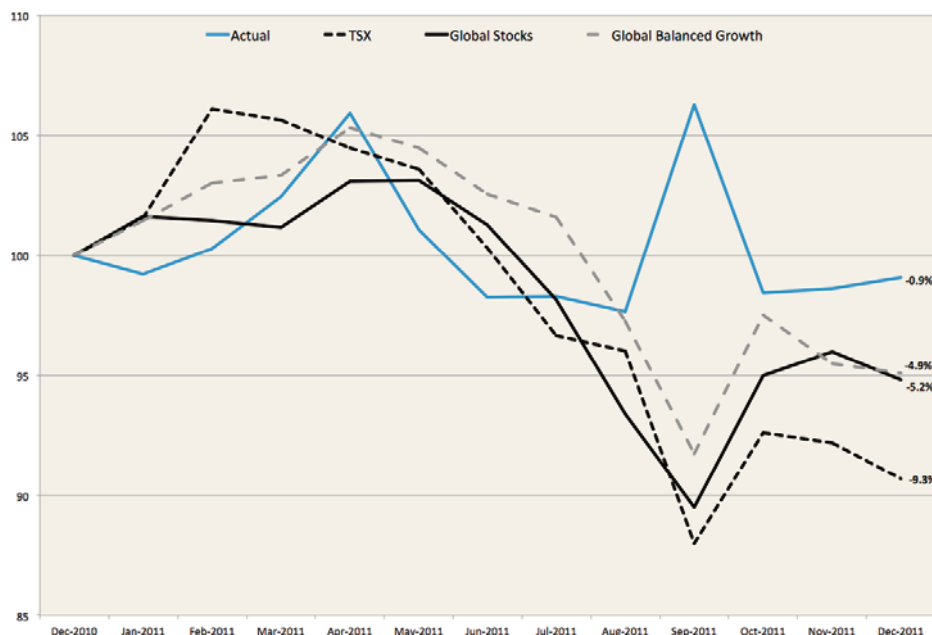
Total 2011 Return: -4.9%
Peak-to-trough drop: -12.9%
Worst absolute loss: -8.3%

Don't miss our evolved model profile on the last page.

SOUND AND FURY, SIGNIFYING NOTHING

I can't understand why people are frightened of new ideas. I'm frightened of the old ones. — Ralph Waldo Emerson

Actual Model Account Performance vs. Relevant Benchmarks



2011 crowned the meek and brought kings low. The most revered investment minds of our time were no match for the complexity of markets as coordinated central bank intervention warred with structural economic trends. In the end, there was an unanticipated truce, but every war has its casualties, and this year's markets were certainly no exception. US-centric 'balanced' investors finished first as the year ended with hope that the U.S. may avoid a global slowdown. We remain unconvinced...

As usual, all of the major investment houses were materially wrong in their 2011 market forecasts, to the tune of 8.3% on average. Not surprisingly, given that these investment firms generate profits from selling stocks, the forecasts were 8.3% too *optimistic*.

(continued on next page)

Taking Aim at 2012

Forecasts for the Standard & Poor's 500-stock index at year-end, plus each market strategist's accuracy in 2011.

	2012 FORECAST	2011 FORECAST*	S&P 500 actual close: 1257.6	% OFF FROM ACTUAL CLOSE
Average	1334		1372	8.3%
MORGAN STANLEY Adam Parker	1167	1238		1.6%
CITIGROUP Tobias Levkovich	1375		1300	3.3%
HSBC Gary Evans	1190		1320	4.7%
OPPENHEIMER Brian Belski	1400		1325	5.1%
UBS Jonathan Golub	1325		1325	5.1%
BANK OF MONTREAL Ben Joyce	1325		1350	6.8%
WELLS FARGO Gina Martin Adams	1360		1390	9.5%
BARCLAYS Barry Knapp	1330		1420	11.4%
J.P. MORGAN Thomas Lee	1430		1425	11.8%
GOLDMAN SACHS David Kostin	1250		1450	13.3%
DEUTSCHE BANK Binky Chadha	1500		1550	18.9%
CREDIT SUISSE Andrew Garthwaite	1340	Not applicable		
BANK OF AMERICA Savita Subramanian	1350	Not applicable		

Source: Birinyi Associates *2011 forecasts are as of Dec. 31, 2010

Source: Bloomberg

This is not surprising, and we certainly aren't chastising the analysts at these firms for being wrong in their calls. Rather, we are consternated by the audacity implicit in the forecasts themselves; we know empirically that they can't forecast the future, but they continue to make forecasts.

Unfortunately, for both these hubristic strategists and most investors, the strategists' jobs depend on there being an appetite for their prognostications.

Fortunately (for the strategists, if not for investors), everyone craves certainty (the precursor of control), so there is a nearly insatiable appetite for what they're selling. Further, almost no one holds them accountable for their silliness, so they can flourish in the kingdom of collective cognitive dissonance, better known as the 'stock market', until the end of time.

It seems to us that in the great chess match of markets, most participants try to win by moving the pieces in a pattern that would have enabled them to win the previous game. For example, if you examine the table to the left, you may be inclined to keep track of Adam Parker's top-ranked predictions in 2012 since he came so close in 2011.

Unfortunately, in markets your opponents change all the time, and new opponents play completely different games, so it is almost certainly folly to start tracking the top forecaster from the previous year in hopes of a repeat performance. We can almost guarantee that none will be forthcoming.

So what is one to do if one can't rely on the guidance of expert forecasters to direct one's investment decisions? Isn't the alternative to drift aimlessly on a sea of ambiguity?

Well yes; and no. Yes, it would be extremely constructive for you to let go of the pretense of knowledge and accept the reality of ambiguity. No, this does not mean your investment portfolio should drift rudderless on the market's stormy seas.

You see, there are some indelible truths about markets that we can make quite good use of. For example, we know (because we checked) that in every period of recorded market history it is possible to find something that increased in value.

Commodities and gold skyrocketed in the 1970s when stocks and bonds declined. Cash and government bonds, and eventually gold, rose dramatically in value during the Depression years of the 1930s.

In Japan, stocks have dropped over 75% in value since 1989, but bonds have delivered decent performance, and markets outside Japan rose to new heights. In 2001 – 2003, and again in 2008, stocks and commodities were crushed, but developed market government bonds delivered robust returns.

AN EXPANDING PARTNERSHIP

We are very pleased to announce that **Rodrigo Gordillo, CIM** has joined our team as a **Partner** and **Portfolio Manager**. Rodrigo spent five years independently growing a successful investment management practice based on the same principles we espouse at Butler|Philbrick and Associates*: systems, evidence, and independent research. In addition to his strong technical investment background, Rodrigo is relentless in his quest to spread the word about the power of systematic investing. We warmly welcome him to the team, and expect his enthusiasm to accelerate the partnership's growth agenda.

A GROWING TEAM

We are excited to introduce **David Varadi**, **Roxana Mosneagu** and **Matthew Zerker** to our team.

David is a living legend in the quantitative finance community, and he has already introduced many new techniques certain to improve the stability of your investment experience.

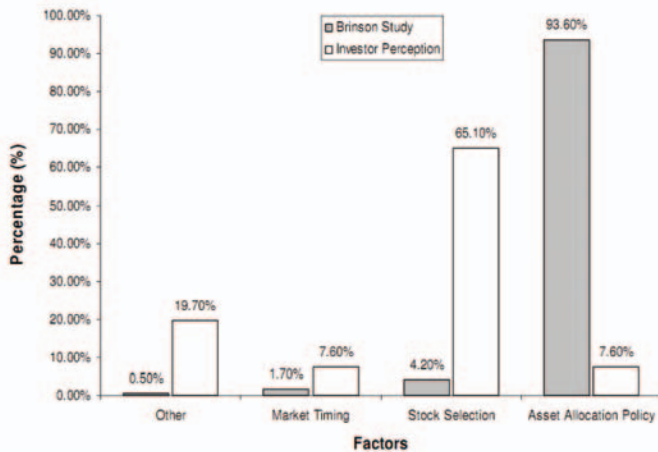
Roxana joined us last summer as an Associate. Her fastidious nature and Excel skills made her a natural to spearhead trading and reporting functions for the team.

Matt started as a summer student, but his tenacity and insatiable curiosity have made him indispensable. Welcome!

This occurs because there are structural differences between various asset classes such that they move in different directions according to different forces, and at different times. This miraculous phenomenon is called 'diversification', and *it is the only free lunch in investing*.

Unfortunately, Mr. Market has been stealing most investors' lunches for 20 years. We know this because numerous studies show that most investors lag markets by between 5 and 8% per year, and have done so for at least the past 20 years. 8% over 20 years is 466%; that is a lot of regret.

Mr. Market has been stealing lunches because (he's a bully – yes, I know) most Advisors do not understand the true meaning of 'diversification'. It is not possible to achieve meaningful diversification by investing exclusively in equities. So holding 50 stocks in your portfolio does not mean you are diversified, nor does holding 10 mutual funds. You can only achieve diversification by adding different asset classes to your portfolio. That's why almost 94% of the variability of your investment returns results from your *asset allocation decision*, not the particular stocks you choose to hold in your portfolio. Stock selection accounts for just 4.2% of the value derived from portfolio choices, but for most investors stock selection consumes 99% of their time and emotional capital.



Source: Derived from Scott Simon (1998, p.152).

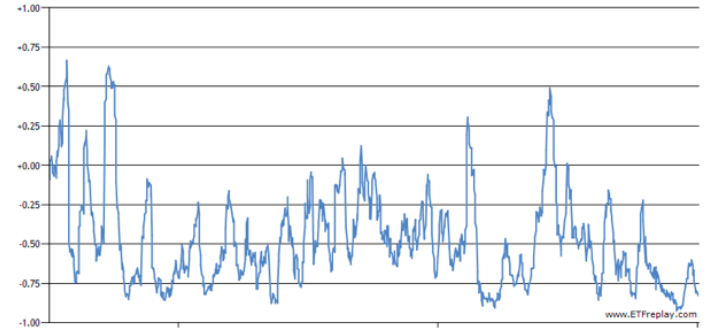
The lesson here is that investors (and Advisors) should allocate 95% of their effort to getting the asset allocation decision right and, only once they have solved that riddle should they start to think about stocks.

Of course, it isn't that Advisors don't consider asset allocation; in fact, it is the first step in almost everyone's investment process.

First, you sit down with an Advisor and discuss your return expectations and tolerance for market risk. Then the Advisor translates this information into a Strategic Asset Allocation: your allocations to stocks, bonds and cash.

Unfortunately, this decision marks the end of the asset allocation process, despite one indelible fact: by attempting to derive an optimal asset mix according to very long-term return, risk and

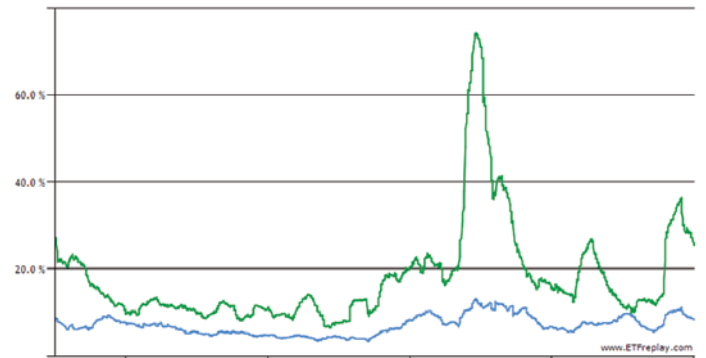
correlation assumptions, you are virtually guaranteed to always have a sub-optimal asset mix. This is because the expected return, risk and correlation qualities of each asset class fluctuate dramatically over time.



Source: Yahoo Finance

The chart above shows the changes in correlation between U.S. stocks and U.S. Treasury bonds between 2007 and present. The correlation has fluctuated between positive 0.67 (both move in the same direction at the same time) to negative 0.92 (both move in opposite directions at the same time). In other words, Treasury bonds often offer substantial diversification benefits, but at times they offer almost no diversification benefits at all.

Further, there are times when the volatility of your portfolio will be entirely dominated by one asset class even if you are diversified. The following chart illustrates how the volatility of stocks (in green) and the volatility of bonds (in blue) can shift dramatically over time.



Source: Yahoo Finance

In late 2008 for example, the daily gyrations of a balanced portfolio were almost completely dominated by stocks because they were so volatile. In fact, the true risk to a 'balanced' portfolio was over 400% higher at that time than a typical balanced investor would have expected to experience over the long-term. No wonder global investors have moved hundreds of billions of dollars from equities to bonds over the past 3 years!

Looking forward, the global economy and markets are sure to deliver more surprises, good and bad. Thankfully, our Core Diversified models thrive on uncertainty; that's why there has never been a better time to embrace the kind of balanced approach that we deploy for clients at Butler|Philbrick and Associates.

THE CORE DIVERSIFIED STRATEGY

In the land of the blind, the one-eyed man is king

Butler|Philbrick and Associates* is proud to introduce the newest version of our systematic investment methodology: The **Core Diversified Strategy**. Key features include:

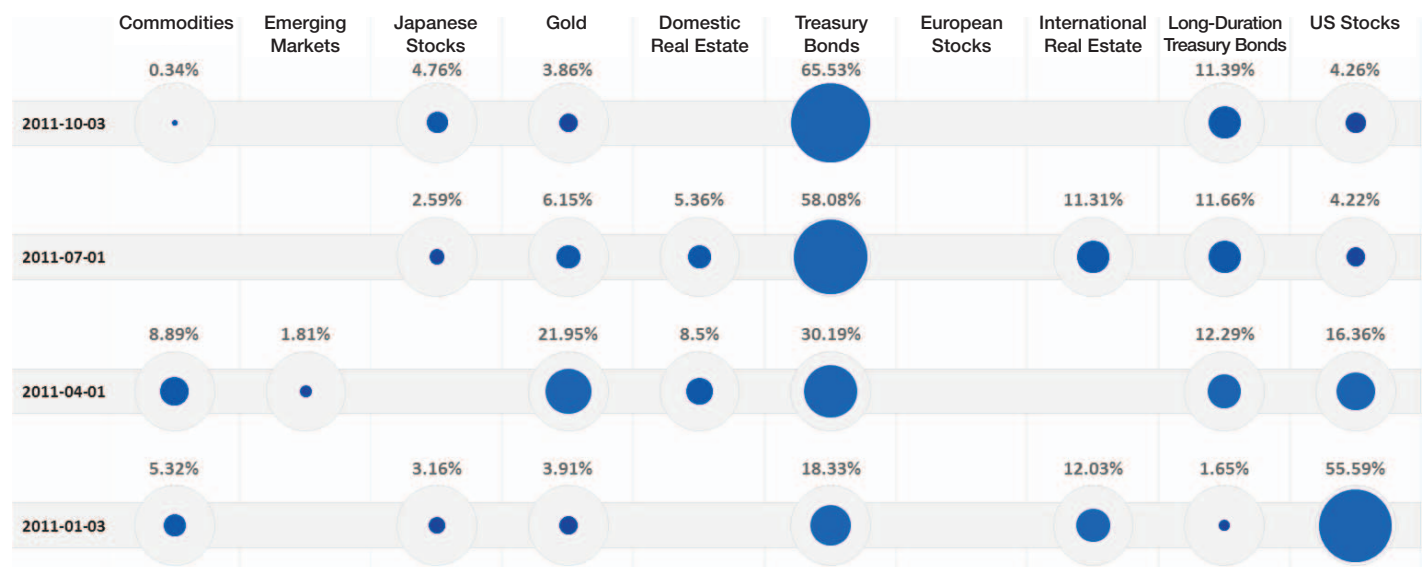
- Diversified across 10 global asset classes
- Dynamic and adaptive
- Balanced currency exposure
- Positive over 100% of 12-month periods
- Optimized for retirement sustainability
- High expected returns
- Active risk management
- Agnostic to market environment

Historical performance 1995 – 2011

		Year	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	Total	DD
Total Return	947%	1995	-0.15	2.07	1.80	1.35	4.60	1.11	1.75	-0.49	1.97	-1.02	2.22	3.55	20.31	-2.24
CAGR	14.82%	1996	0.86	0.07	1.34	2.18	1.45	0.04	-1.71	2.39	1.60	1.88	4.23	4.09	19.88	-2.73
Sharpe	2.16	1997	0.53	0.93	-1.12	-0.60	1.56	3.03	4.18	-2.11	5.82	-2.16	0.42	1.56	12.37	-5.28
DVR	1.98	1998	0.97	1.35	3.00	0.23	-0.45	1.27	-1.54	1.26	3.47	-0.78	1.03	0.17	10.31	-3.36
MAR	1.35	1999	0.82	-2.76	1.68	5.07	-0.95	2.52	-1.84	0.40	0.40	-0.58	2.16	5.79	13.09	-4.40
Max Daily Drawdown	-11.01%	2000	-1.14	2.11	2.24	0.37	1.10	2.93	0.84	1.23	-0.36	0.29	2.01	2.44	14.92	-2.50
% Winning Months	75%	2001	1.27	0.57	-1.55	-0.90	-0.22	1.91	0.30	1.89	0.09	2.15	-0.07	-0.15	5.34	-3.75
Average Winning Month	2.07%	2002	1.92	1.94	2.85	1.49	1.97	0.17	-1.04	2.69	2.97	-0.97	1.20	0.05	16.24	-3.12
Average Losing Month	-1.42%	2003	-1.23	1.94	-0.56	2.15	6.68	2.15	0.69	3.30	5.87	2.76	1.17	3.89	32.54	-3.62
Best Month	7.37%	2004	1.70	1.41	1.33	-8.53	-0.74	0.52	0.41	2.96	1.88	2.61	4.00	4.17	11.66	-11.01
Worst Month	-8.53%	2005	0.50	1.73	-2.34	0.29	2.80	1.76	2.69	-0.64	1.59	-4.28	2.07	3.61	9.90	-5.52
% Winning Years	100%	2006	5.13	0.52	1.66	0.82	-1.83	-0.12	1.67	1.91	1.50	1.64	3.69	1.99	20.06	-6.80
Best Year	32.54%	2007	1.56	1.41	0.29	1.09	0.13	-1.56	-0.45	1.53	1.77	4.16	1.29	0.33	12.08	-4.07
Worst Year	5.34%	2008	2.65	2.25	0.05	-0.96	1.06	1.15	-1.00	0.42	-0.53	-3.70	7.37	5.71	14.93	-6.44
Positive 12 Month Periods	100%	2009	-5.75	-0.33	2.62	-0.67	2.45	-1.99	3.64	2.25	3.14	-0.99	6.58	-4.15	6.29	-7.76
		2010	-1.97	1.28	2.30	1.92	0.83	2.19	0.48	3.62	2.45	2.24	-1.23	2.79	18.11	-7.80
		2011	1.06	3.01	-1.14	4.65	-0.30	-1.74	2.70	5.70	-0.05	-0.38	0.80	1.34	16.49	-3.31

Results are pro forma and for illustrative purposes only.

Portfolio adaptivity in action: 2011 quarterly model allocations



*Butler Philbrick and Associates is a part of Macquarie Private Wealth Inc.

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