



*“A nickel ain’t worth a dime anymore” – Yogi Berra*

<p><b>Canada</b></p> <ul style="list-style-type: none"> <li>➤ Canada adds 93,000 new jobs in June</li> <li>➤ BOC expected to increase short-term rates on July, 20<sup>th</sup></li> </ul> <p><b>U.S.</b></p> <ul style="list-style-type: none"> <li>➤ May retail sales surprise to the upside</li> <li>➤ Q2 earnings outlook remains positive</li> </ul> <p><b>Global</b></p> <ul style="list-style-type: none"> <li>➤ G20 – global commitment to sovereign deficit reduction highlights meeting</li> <li>➤ IMF raises global growth estimates for 2010 from 4.2% to 4.6%</li> <li>➤ China resumes Yuan appreciation and increases minimum wage rate</li> </ul>	<p><b><u>Second Quarter 2010: Speed Bump or End of the Road?</u></b></p> <p>The second quarter ending June 30, 2010, was a difficult quarter for stock markets around the world with many indices falling by more than 10%. Concerns about the mountains of sovereign debt that piled up during the 2008-2009 recession finally caught up with investors. As so often happens these days, investors simultaneously decided to flee all but the safest of assets, which turned out to be short-term treasuries, the U.S. dollar, and gold.</p> <p>With all of the economic uncertainty and volatility around us, it is tempting to succumb to the many doom-and-gloom prognosticators in the media, and conclude that a second global recession is just around the corner. No doubt there are plenty of reasons to take this fear seriously. Sovereign deficits and debts have reached a point where the bond markets have become unsettled, leaving little room for further government spending to assist in creating growth. Indeed, in many countries including Greece, Portugal, Spain and the UK, the order of the day is spending cuts and higher taxes. The same recipe will soon be coming to the U.S., where taxes on the wealthy will begin rising in 2011 as the Bush tax cuts are allowed to expire. The all-important U.S. consumer is not likely to lead global growth as they have in the past because of the need to pay down still inflated credit card, and mortgage debts. U.S. savings rates are running around 4.5% of income, and are not likely to fall anytime soon, meaning that consumer spending growth in the U.S. will remain lower than in past decades. So growth in the developed world is likely to remain uneven and relatively slow for many years to come as consumer and sovereign deleveraging continues.</p> <p>Outside of the developed world, the outlook for economic growth is far more attractive. In much of the developing world, consumer savings rates are extremely high and consumer debt</p>
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levels are low. The emerging middle-classes in China, Russia, Brazil, and Indonesia represent hundreds of millions of new consumers, and a tremendous source of potential growth for multi-national companies. The Chinese government is rapidly changing economic policies to encourage domestic consumption, as they can no longer depend on exports alone to drive their economy. The recent move by the Chinese government to allow their currency to rise, and to increase minimum wages, is a good start in this direction.

It is still our view that the most likely economic path for Canada and the U.S. in the next few years can best be described as “muddling along.” Economic growth is likely to remain lower than has been typical of the past 20 years, but the economic recovery that is underway may well last much longer than past recoveries. The reason is that economic cycles tend to end as capacity tightens, inflation accelerates, and interest rates rise. In a world of high unemployment and modest growth, inflationary pressures will remain on the back burner, and interest rates will therefore remain low. In fact, the high debt levels at the country and consumer levels, all but guarantee that deflationary forces will be more of a threat to our economies than inflation.

### **Economic Outlook 2010-2011:**

***The Year of the Main Street*** - Our leading economic indicators have recently declined, suggesting that the economy will slow in 2011. This is the primary reason, we believe, that the stock markets performed so poorly in the second quarter ending June 30, 2010. Nonetheless, the economy is functioning much better than in 2008, and employment is at least stable compared to the mass layoffs seen in 2008, and early 2009. Consumer savings rates will remain at high levels, but the end of mass layoffs will nonetheless encourage modest increases in consumer spending in 2010 and 2011. Real income growth in the U.S. is slowly rising despite the sluggish economy, and hours worked are also increasing. Manufacturing and service industries in the U.S. are both expanding, albeit at slower than normal rates. The U.S. housing market is currently going through a second correction with sales of new homes dropping precipitously in May and June. Much of this correction is likely short-term, as the U.S. government home buying tax credits expired at the end of April. Housing affordability in the U.S. is at record levels today, and many homes and condominiums can be owned at a lower cost than renting. However, getting approval for a mortgage is difficult as U.S. banks are more interested in dumping foreclosed inventory on the market than financing new purchases.

***The Game Plan*** - Modest growth, low inflation and high debt levels suggest that the economy, and public stock markets, will remain vulnerable to shocks such as the recent

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Greek sovereign default fears. It would be sensible to assume that the markets will remain more volatile than the underlying economy, thus creating trading opportunities from time-to-time, and the occasional frustration for longer-term investors. For the next few years, stock market returns are likely to remain below their long-term averages, meaning that income and alternative investments should play a larger role in your portfolios. These types of investments will reduce the volatility of your assets, help to preserve capital when public markets are under pressure, and generate steady income for reinvestment or retirement needs.

**Capital Markets Outlook:**

**Bond Markets** - Government bond markets in Canada and the U.S. performed very well during the second quarter of 2010, as investors, concerned with slowing growth, sold equities and rotated into the relative safety of bonds. The 30-year U.S. treasury yield (see **Chart 1** below) fell from 4.70% at the beginning of the second quarter to a low of 3.90% by June 30<sup>th</sup>, leaving little upside for government bond returns going forward. In order to generate higher rates of return and income, we are instead focused on investments in preferred shares, high-yield equities, and corporate debt. In many cases, yields are 3%-5% higher in these instruments, than are available in the Canadian and U.S. government bond markets.

**Chart 1: US 30-Year Bond Yield – Second Quarter, 2010**



**North American Equity** - North American stocks continue to trade below fair value as on-going concerns about future earnings are dampening enthusiasm for the asset class. **Chart 2** below highlights the current opportunity we see in the stock market today.

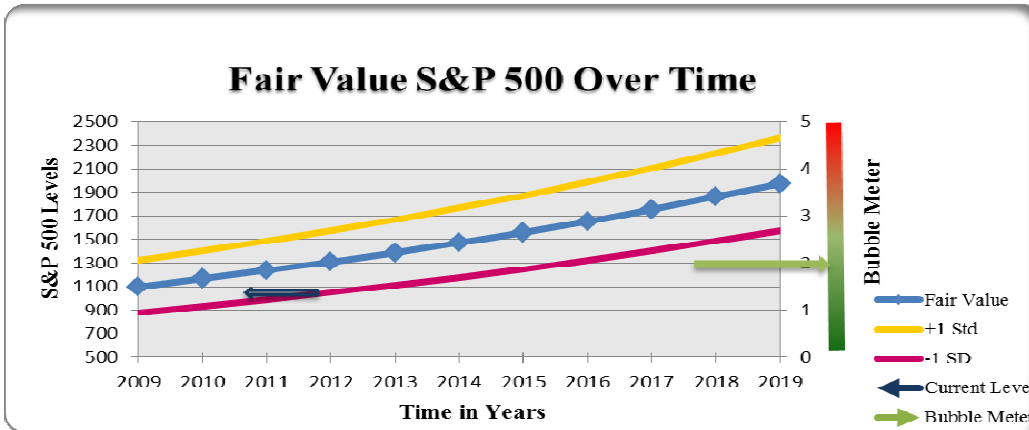




The blue “Fair Value” line assumes future nominal dividend growth of 5.2% per annum and an equity risk premium of 5.0% above 10-year government bonds. The +1 and -1 standard deviation lines represent the long-term average volatility of the S&P 500 (+/- 20%) and can be considered a proxy to account for forecasting error. On the right axis we have superimposed our “Bubble Meter” readings which are used as a gauge to help determine the level of speculation in the stock market. All else being equal, low speculation means less downside risk for investors and vice versa.

The U.S. stock market, as of June 30, 2010, was approximately 24% below of its short-term fair value. At today’s level the S&P 500 is discounting future growth rates for dividends of 4.5% per annum, which appears low to us given the already low dividend payout ratios and high corporate cash levels. With reinvestment opportunities at relatively low levels, corporations will continue to increase their dividend payouts and stock buybacks, which should help to stabilize the stock markets and move them higher over time.

*Chart 2: S&P 500 Fair Value over Time*



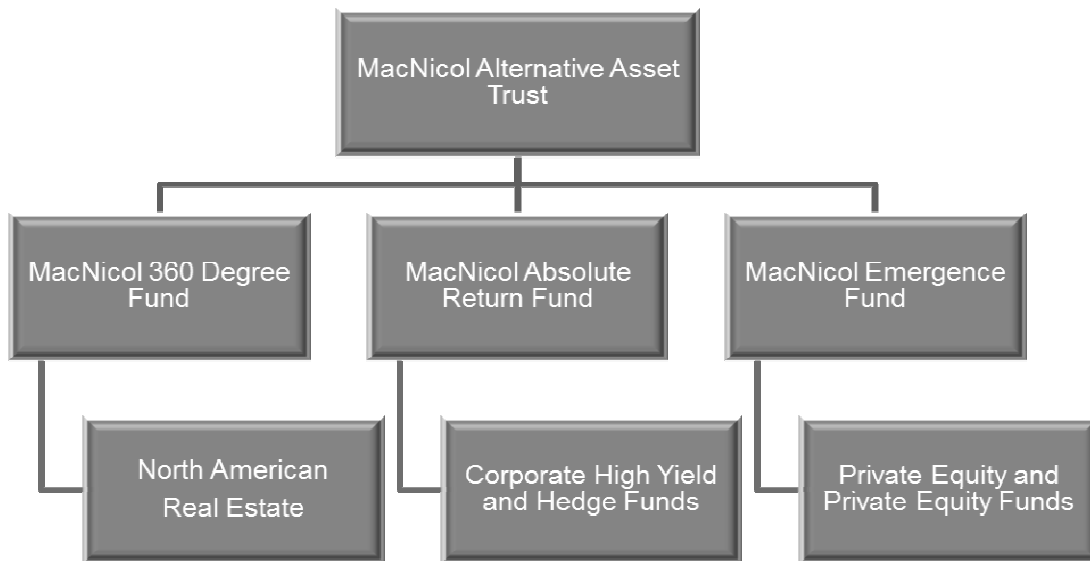
**MacNicol & Associates Alternative Asset Strategy Update:**

**MacNicol Alternative Asset Trust** – While alternative assets such as real estate, gold and private equity may already be represented in your portfolios, MacNicol & Associates Asset Management (MAAM) is in the process of rolling out several highly-diversified private pools exclusively dedicated to these and other alternative asset classes. Going forward, the MacNicol Alternative Asset Trust will be the primary platform for your investments in alternative assets. The **MacNicol Alternative Asset Trust** will invest in three separate private pools managed by MAAM: the MacNicol 360 Degree Real Estate





Fund (North American real estate and mortgages); the MacNicol Absolute Return Fund (hedge funds, high-yield debt), and the MacNicol Emergence Fund (private equity and private equity funds). These funds may also be owned individually for those wanting more exposure to a particular asset classes. The schematic below highlights the structure of the MacNicol Alternative Trust and its relationship to the 360 Fund, the Absolute Return Fund and the Emergence Fund.

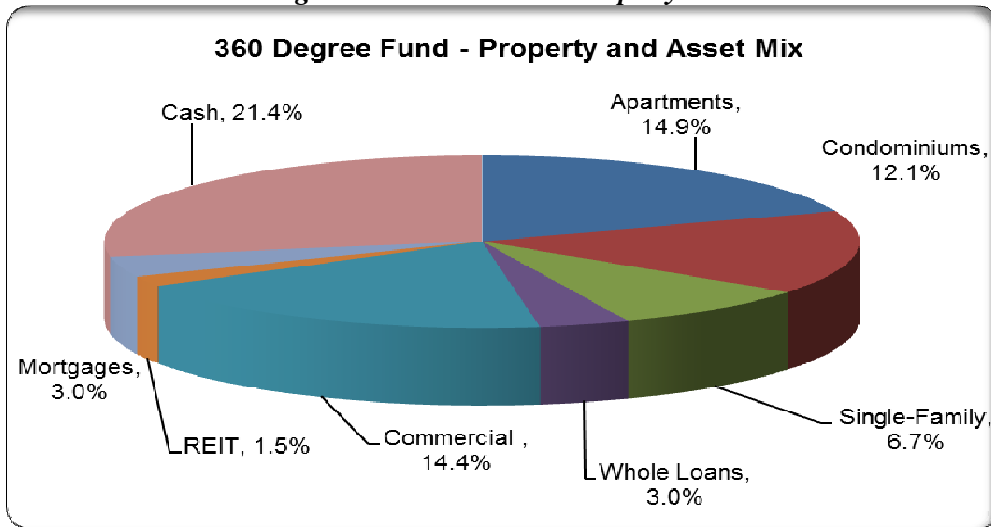


***MacNicol 360 Degree Realty Income Fund*** - The 360 Degree Fund was launched in November of 2009 with a mandate to exploit opportunities in the Canadian and U.S. real estate markets. The 360 Degree Fund is currently invested in several value-added strategies and managers. These strategies include the purchase and modification of non-performing first mortgages; deed-in-lieu strategies to gain clean title for eventual resale; lease-to-own and credit enhancement strategies designed to maximize the value of purchased homes in foreclosure, and investments in Senior RMBS (residential mortgage backed securities) pools originated in the 2002-2007 periods. These strategies all have one common denominator; the underlying properties are purchased at extremely attractive prices from forced sellers including Fannie and Freddie Mac, GMAC, community banks, hedge funds, insurance companies, and large U.S. money-centre



banks. The 360 Degree Fund will provide investors with steady income and capital gains, and the security of tangible and under-valued “hard” assets underpinning the valuations. **Chart 3** below highlights the current mix of properties in the 360 Degree Real Estate Fund as of quarter end, June 30, 2010. We continue to slowly deploy cash into additional opportunities in residential real estate including multi-family apartments, condominiums and single-family homes.

*Chart 3: 360 Degree Real Estate Fund Property Mix*



**MacNicol Absolute Return Fund** - The investment objective of the Absolute Return Fund is to generate positive absolute returns under most market and economic conditions, and to have little or no correlation to the U.S. and Canadian stock markets. In order to achieve its objectives, the Absolute Return Fund will invest in several value-added strategies managed by experienced and successful Canadian, U.S. and U.K. hedge fund managers. Most of these investments are not available in the public market, and are typically not accessible to individuals and smaller institutions because of high minimum investment thresholds, often in excess of \$5,000,000. In addition to investing in third-party managed hedge funds, the Absolute Return Fund will also take positions in securities or funds representing high-yield credit opportunities primarily in the corporate market. The majority of such investments will be in investment grade debt, preferred

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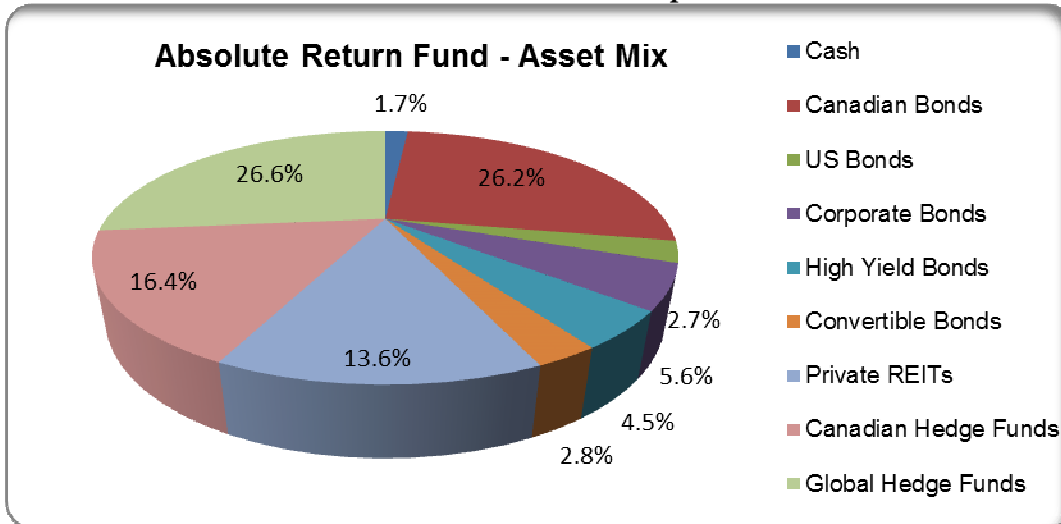
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shares and convertible bonds. **Chart 4** below summarizes the asset mix of the Absolute Return Fund as of June 30<sup>th</sup>, 2010.

**Chart 4: Absolute Return Fund Position Report**



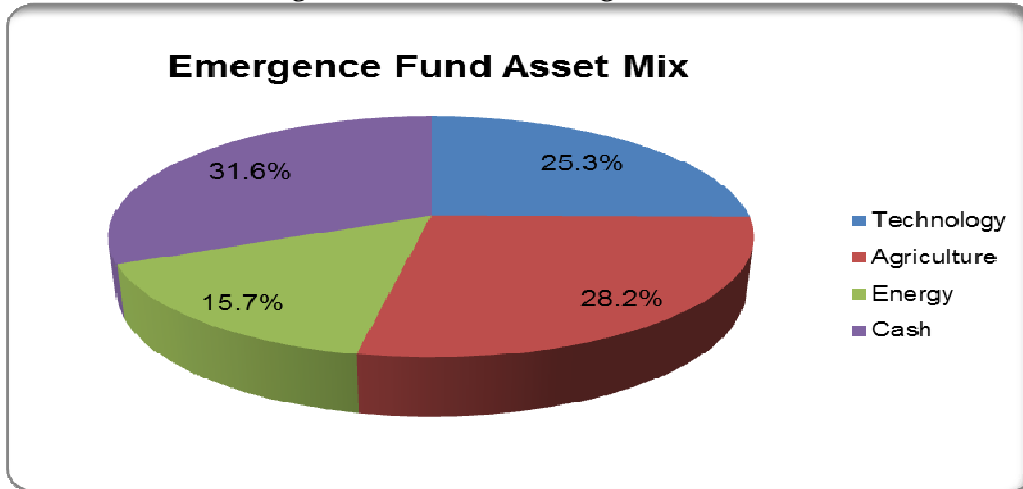
**MacNicol Emergence Fund** - The investment objective of the Emergence Fund is to generate capital gains by investing in a portfolio of privately held companies and private equity funds. The Fund seeks opportunities where capital exit strategies are clearly defined, and are likely to occur within a three-year time frame. The Emergence Fund invests in established private equity funds as well as direct investments in private companies with defensible franchises, high growth profiles and proven management. Investments will largely focus on profitable companies with high levels of proprietary technology addressing large target markets. The Fund looks for management teams with proven track records in building and monetizing private companies, and who are accessible and transparent to its investors.

The Emergence Fund seeks to provide growth capital, most often minority investments, in private companies that are looking for capital to expand or restructure operations, enter new markets or finance a major acquisition without a change of control of the business. Companies that seek growth capital will often do so in order to finance a transformational event in their life cycle. These companies are likely to be more mature than venture capital funded companies, able to generate revenue and operating profits but unable to



generate sufficient cash to fund major expansions, acquisitions or other investments. The primary owner of the company may not be willing to take the financial risk alone. By selling part of the company to private equity, the owner can take out some value and share the risk of growth with partners. Capital can also be used to effect a restructuring of a company's balance sheet, particularly to reduce the amount of leverage (or debt) the company has on its balance sheet.

*Chart 5: Emergence Fund Sector Weights*



**Corporate Developments:**

We wanted to give you an update regarding our office space. We have moved from Suite 708 at 100 Adelaide St. West to Suite 200. The move went well, made much easier by the fact we were staying in the same building. Our new office space has a spectacular view of the Group of Seven mosaics on the arch way adorning the building.

We are also launching a new website in the coming weeks and there will be a page in the site that will have pictures of our office and a small write up by a local historian that describes the arch way and other key features of the building. We hope you will find the website informative and an effective tool for listening, watching, and reading the presentations and material we post.

MacNicol & Associates Asset Management Inc.  
June 30, 2010

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