SANDSTONE ASSET MANAGEMENT INC.

Investment Insight

DIRECTION. CONFIDENCE. INDEPENDENCE.

SPECIAL YEAR AHEAD ISSUE:

OUTLOOK 2006 » Current Seas

We anticipate an exciting journey this year. Our strong crew has the equipment, knowledge and intuition to plot a course through coming inclement weather. We foresee having to tack more often this year:

- tack! away from the C$
- tack! toward China
- tack! for the best wind in Japan
- tack! currencies reveal where the new wind is.

read on for our complete Outlook 2006 …

D.C.I. Research Standards

- customized portfolio **direction,**
- **confidently** executed**,**
- through **independent** ideas

Sandstone's D.C.I. research standards are guided by three principles: Direction, Confidence, Independence. We adhere to these standards in our daily research efforts.

DIRECTION

We begin with an overall view of the global economy. Within the macro view, Sandstone utilizes asset allocation decisions to manage overall risk levels. Our direction is our own and we strive to avoid running with the herd.

CONFIDENCE

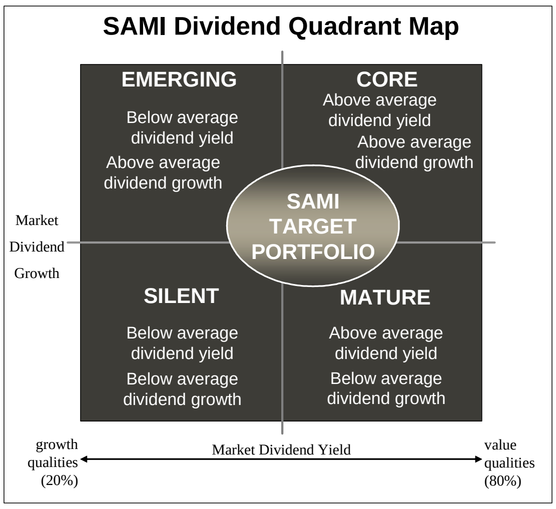
Sandstone's adherence to its research philosophy and process maximizes confidence in investment choices and minimizes downside risk. We take a conservative view of growth in determining underlying value, ensuring a higher level of confidence in potential returns.

INDEPENDENCE

Our over-riding research standard is independence. We strive daily to challenge the consensus view in order to deliver independent ideas to client portfolios. We do not engage in investment banking activities, nor do we operate a trading desk independent of client accounts. Through independence, our interests are aligned with yours.

Our Approach

We manage individual portfolios to meet our clients' risk adjusted return expectations. To accomplish this, we select securities to provide above average returns with below average risk and volatility. This is executed by favouring dividend-growth equities and attractively priced fixed-income securities. Our investment selection process is driven by our proprietary dividend quadrant map:



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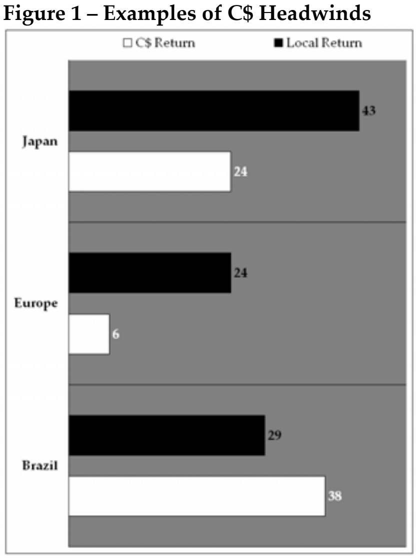
Outlook 2006

c u r r e n t   s e a s

After 25-years of tailwinds caused by C$ weakness, the past three years have seen significant headwinds to global performance

Our 'Current Seas' theme for 2006 is a play on words to emphasize the importance of changes in currency rates to your portfolio's value. After 25-years of tailwinds caused by Canadian dollar (C$) weakness, the past three years have seen significant headwinds to global performance. The C$ had another strong year against most major currencies, depreciating only against the Brazilian real and the Mexican peso (Figure 1). It may surprise many to know our strong call on the US$ was correct against all major currencies except Canada. Currencies will continue to be an important factor in our investment process, though recent trends may reverse.

Figure 1 – Examples of C$ Headwinds



We anticipate an exciting journey as we enter the very important 4th year of the economic cycle, paired with the 2nd year of the presidential cycle. Our strong crew has the equipment, knowledge and intuition to plot a course through coming inclement weather. As a result, we foresee having to tack more often:

Coming inclement weather will force us to tack more

- tack! away from the C$ (rebalance)
- tack! toward increasing cash for opportunity
- tack! to take advantage of easterly winds
- tack! for the best wind in Japanese Financials
- tack! 'current seas' show where the new wind is – Brazilian Bonds and the next great China play -Taiwan.

We hope you enjoy reading Outlook 2006, Current Seas …

It is only within the scope of this booklet to give broad overviews. For details please contact us directly.

Our spinnaker caught plenty of wind in 2005

2005 » spinnaker up

We are happy to report that our spinnaker caught plenty of wind – our sector and geographic picks worked out well. Some bouts of billowing occurred at the hands of the odd C$ cross-wind.

Table 1 shows how our recommendations performed during the year. Our best market calls were Japan and Brazil. Japan was negatively impacted by a significantly appreciating C$ while Brazil posted strong appreciation ahead of our established position. We established an index position in Japan and then branched out to individual securities. Taiwan was relatively flat after currency but gained momentum into year end. On the sector side, we were pleased with our moves in Energy and Materials, timing pull-backs and peaks well to realize significant gains on positions. Agriculture was volatile and we remain keen to add to this sector as markets present opportunities. Finally, our U.S. Dollar call last year was for a move of flat to up versus the C$, which played out.

Table 1 – SAMI 2005 Calls Worked Well

Asset Class	Recommendation	2005 C$ Return	Comment
Developed Market	Japan over U.S.	24 %	C$ appreciated substantially against the Yen
Emerging Market	Brazil	38 %	Concentrated on materials through mining trust
Emerging Market	Taiwan	4 %	Has yet to break out
Sector	Gold	15 %	Timed this well
Sector	Energy	26 %	Our energy picks performed well, remained overweight
Sector	Agriculture	21 %	A volatile year; late year momentum
Currency	USD / CAD	-3 %	We called for flat to higher US$; trade-weighted up 12%

global rebalancing
» tack! toward easterlies

The economic winds have continued to shift from westerlies to easterlies, with China as the source. This has been our long-term course and we see more consistent winds continuing, revealing a stand-alone Asian trading bloc much less reliant on the U.S. We stick to value on our 2006 tack.

Our long-term call is for a move to a more balanced equilibrium …

… we see the U.S. as a less important global economic engine but NOT a less important stock market

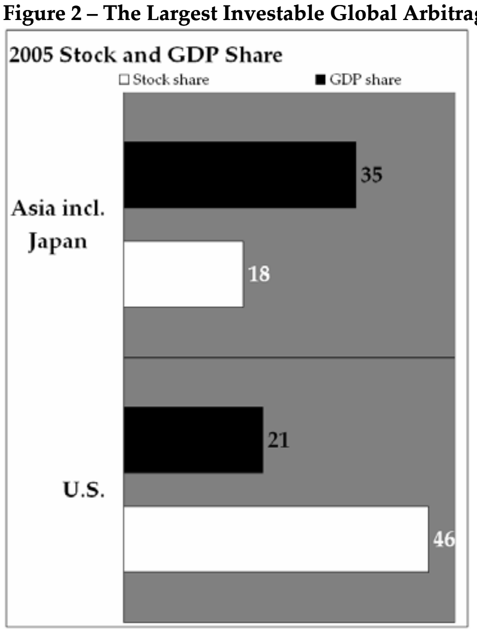
Globalization has had profound economic effects. These effects have played out over many years and have resulted in the current unstable equilibrium - the ever-increasing appetite of the U.S. consumer and the willingness of Asian countries to finance the growing U.S. deficit. Our long-term call has been for a move to a more balanced equilibrium, one in which the US becomes a less important engine to global growth balanced by the stronger economies of Japan and emerging economies. Evidence of this phenomenon is already in the figures:

- In 2005, Japan's largest trading partner was China, supplanting the U.S.
- In 2005, China's GDP figure was revised upward by 17% due to a growing domestic market rather than purely export.
- In 2005, Brazil became the 9th largest in PPP GDP in the world.

the largest investable global trend is the trade between rising GDP market share and disproportionate stock market representation

We foresee the largest investable global trend as the arbitrage trade between rising GDP market share and disproportionate stock market representation. We have shown this relationship in our past Outlook presentations and the update from 2004 to 2005 shows the trend continuing (Figure 2). For the past two years the U.S. lost 8 points of stock market capitalization with Asia picking up the lion's share of the gain. The table below shows the continuing imbalance between GDP and Market Cap for the U.S. vs Asia – a gap we expect will continue to close.

Figure 2 – The Largest Investable Global Arbitrage



Source: SAMI, CIA, World Federation of Exchanges

Tack! toward Asia for rising stock market share

Our conviction is that global rebalancing favours Asia and our investment stance will therefore stress a tack! toward Asia.

cycles
» sailing 101 - weather maps

We are at a key inflection point on the 4-year cycle

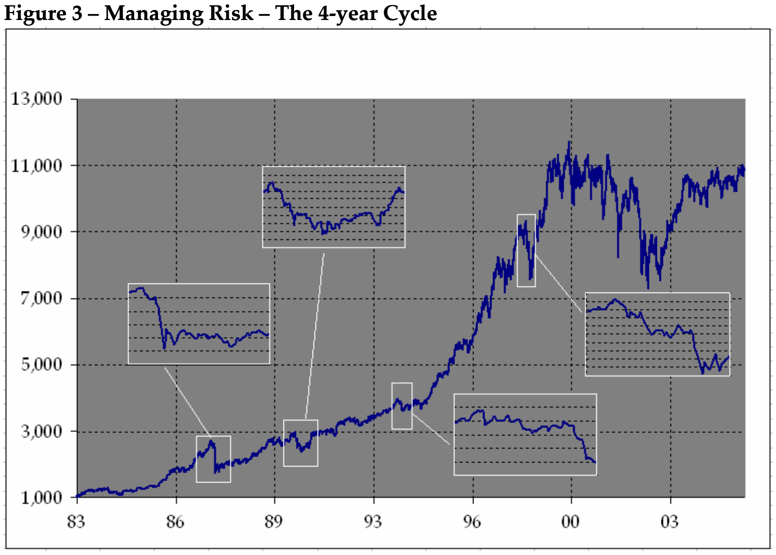
Check out the maps, we're due for some stormy weather. While we have discussed the importance of long-term secular trends these past few years, we have also discussed the prominance of the four-year economic cycle within this. We are at a key inflection point - this being the 4th year in the cycle as well the 2nd year in the presidential cycle when tough decisions are made. By the way, this is no coincidence that these two cycles meet and has traditionally been volatile at best. This is a time when managing risk outweighs the quest for return.

Our sailing 101 lesson uses several maps. Lesson number one looks at how the 4-year cycle dominates even a long-term secular uptrend (Figure 3). We foresee a larger correction sometime in the first half of 2006 creating tremendous opportunities to position ourselves in the latter part of the year.

Remember: Cash is also an asset class.

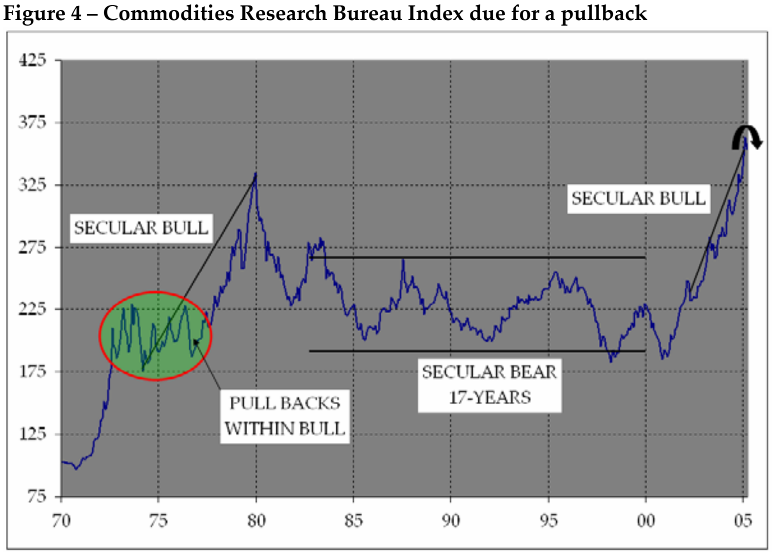
The DJIA shows a consistent pattern of corrective moves on a 4-year cycle basis

Figure 3 – Managing Risk – The 4-year Cycle



Lesson number two addresses our secular trends – the energy and materials sectors – to determine if lesson number one applies (Figure 4). Again, the 4-year cycle dominates and we expect a medium-term pull back and consolidation. There is a precedent here as the CRB corrected within the bull stage running 1969-1981 (circled area in Figure 4). We feel this process has begun and have been protecting profits and hedging long-term positions.

Figure 4 – Commodities Research Bureau Index due for a pullback



Source: SAMI, Commodities Research Bureau

We feel industrial metals should continue their long-term secular uptrend later in 2006. Energy markets will be more dependant on geo-political events and the emergence of a will to incorporate energy alternatives – bio-fuels, etc. Large integrated and long-term reserve plays will be favoured.

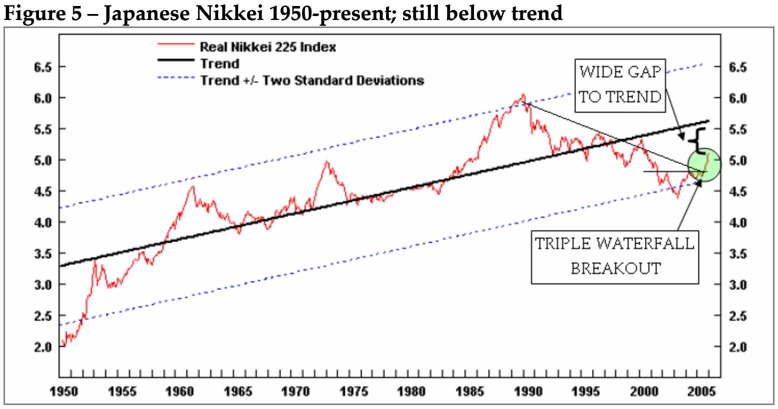
Energy markets will be more dependent on geo-political events

Lesson number three has us scanning the charts for wave signals in Japan (Figure 5). We invested in Japan last year on the basis that the triple waterfall had run its course and that economic conditions were poised to improve. Our reading of the Japanese weather map points to favourable long-term sailing conditions. Consolidation would be normal after such an extensive move but as Figure 5 shows, the Japanese market is still well below fair value.

the Japanese weather map points to favourable long-term sailing conditions

We can make an argument both from the secular chart and economic fundamentals (rising corporate profits, more intra-Asia trade) to continue to look to Japan to perform.

Figure 5 – Japanese Nikkei 1950-present; still below trend



Source: SAMI, BCA Research; chart is log-scale and inflation-adjusted

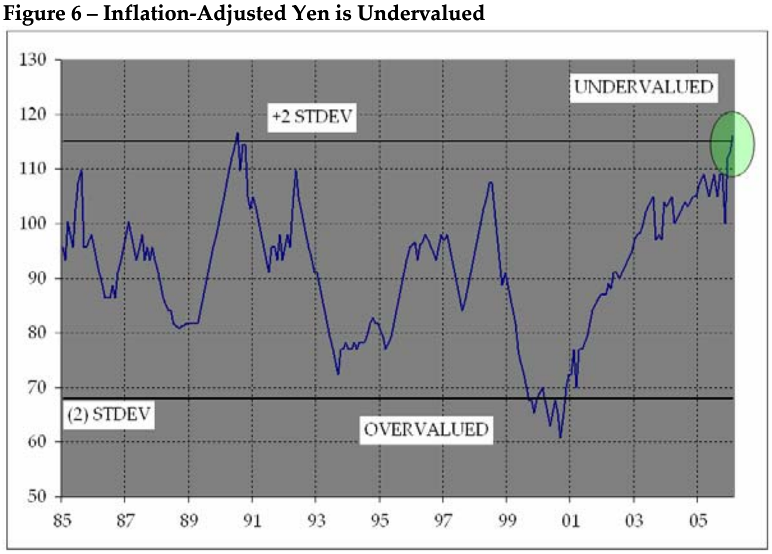
developed markets
» tack! for the best wind in Japan

The weather maps point out two important factors. We have markets and sectors that are overbought and markets and sectors that are oversold. To us, these are ideal conditions for risk control and provide an opportune time to raise cash levels and look to Japan for diversification benefits.

We are firm believers in the Japanese recovery for the following reasons:

- Japanese reliance on the U.S. as a trading partner has diminished (Figure 6). Pan-Asian trade is having a greater influence on the Japanese economy and we believe this should continue into the future.
- The Japanese financial system has taken its medicine. Japanese banks are now well-capitalized and looking to lend money and pursue growth.
- Dividend growth in Japan recently exceeded 30% per annum. The current 1% yield on Japanese stocks is a far cry from the 11% of the distant past but reform will push the market to comparable developed-markets.
- The momentum of the weak Yen is deteriorating and in recent weeks the Yen has been getting stronger. On a return to the mean basis the Yen is undervalued and oversold lending great diversification to Canadian and Commodity assets.

Figure 6 – Inflation-Adjusted Yen is Undervalued



Source: Gavekal

2006 could bring with it a U.S. storm warning in the form of the Consumer

Our position on the U.S. market is more defensive. We feel that 2006 could bring with it a storm warning in the form of the Consumer. Heavily indebted, one of the most interesting credit stories of 2006 could be a significant rise in personal delinquincies, particularly on hybrid mortgages and sub-prime loans that are set to roll into much higher interest rates. As a result of this potential storm, we have raised cash levels and will be looking at a broad-based pull back as an opportunity to add high quality global companies located in the U.S. Our particular areas of interest are defensive growth sectors such as healthcare and consumer staples.

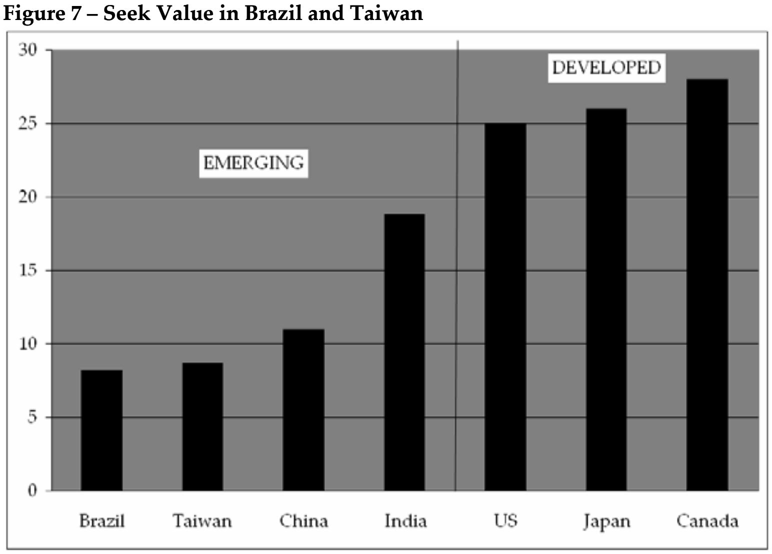
emerging markets
» tack! new wind in Brazil and Taiwan

We believe emerging markets have tipped the scales in their favour. Rising employment, per-capita GDP, foreign currency reserves, and falling foreign debt have pulled risk premiums down – this area of the world is race-ready, having transformed competition with skilled skippers, an enthusiastic crew and strong financial backing.

seek value in unrecognized and underloved assets – Brazil and Taiwan

Our favoured emerging markets for 2006 are Brazil and Taiwan. This is based on one of our favourite investment tenets – seek value in unrecognized and underloved assets – Brazil Bonds and Taiwan Equity fit nicely into these tenets.

Figure 7 – Seek Value in Brazil and Taiwan



Source: BCA Research

Brazil has paid off fully half of its external debt since 2003 and intends to pay the balance off this year

A look at a composite ranking of global valuations reveals Brazil as the cheapest market (Figure 7). Our belief is that Brazil is well-positioned to see multiple expansion on the back of political stability and an unheralded fiscal position. Brazil has paid off fully half of its external debt since 2003 and intends to pay the balance off this year. An improving fiscal position along with double digit government bond yields and falling inflation are the reasons we are most inclined to buy Brazilian bonds. Brazilian stocks have had a strong run and we would prefer to add names on a pullback – names in energy and agriculture are of most interest to us.

Correlation of the Brazilian real to the C$ is high, suggesting minimal risk.

Taiwan screens well on valuation but has the added kicker of 'unloved status'

Like Brazil, Taiwan screens well on valuation but has the added kicker of 'unloved status'. This is a page 16 story that finally has a catalyst to produce solid returns. Our Taiwan thesis is that the political risks are not only discounted but diminishing and that the country's future is highly integrated to China's prospects. Specifically, Taiwan is the largest foreign investor in China, 25% of Taiwanese exports flow to China and they share language and culture. Taiwan is the largest financial centre outside of Japan, a position China desires to take advantage of. Direct flights from Taipei to Beijing began in January 2005, signalling political will favours an expanding economic relationship. Backing the structural situation is a stock market poised to break out of a long-term range (Figure 8). Add to that a dividend yield of nearly 4% (far above local 10-year bond yields) and we think a tack! to Taiwan will put wind in our sails.

Figure 8 – Taiwan Poised to Rally

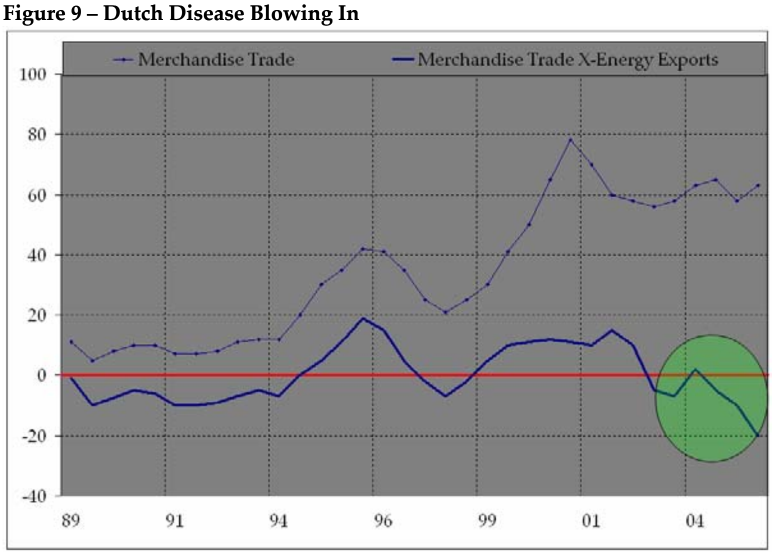
canada
» tack! away from the C$

Having sailed with our spinnaker up the past three years, we foresee changing wind conditions for Canada. This is especially evident in the currency cross-winds. We are set to tack in these conditions as the maps point to some choppy seas.

Figure 9 illustrates how reliant Canada has become on Energy exports. Our view is that Dutch Disease could be blowing in, accentuating unpredictable sailing conditions.

Canadian imbalance thanks to rising Energy trade

Figure 9 – Dutch Disease Blowing In

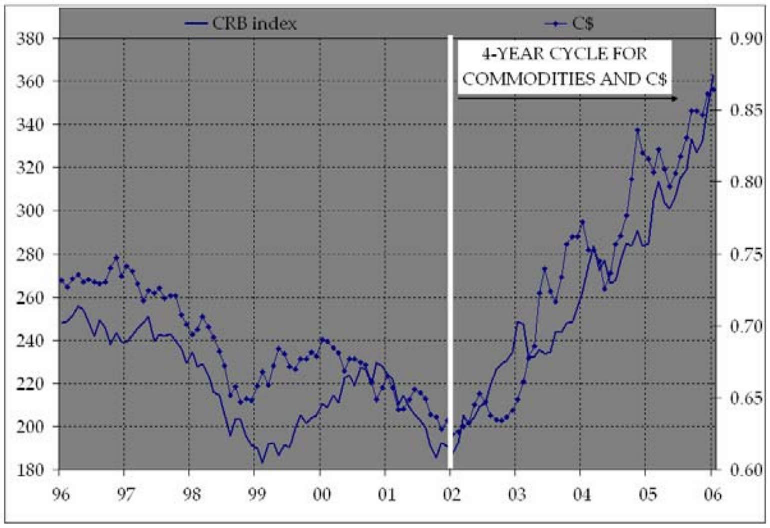


Source: BCA Research

The weighting in resources has increased to the point that diversification is difficult to achieve

The weighting in resources has increased to the point that diversification is difficult to achieve. The result is that Canadian investors will be tied closely to resource fortunes. As Figure 10 shows, the C$ has directly followed the prospects for commodities since 1996 and stresses the 4th-year position of the current commodity cycle. Commodity winds will continue to have important consequences for the performance of Loonie sails.

Figure 10 – Commodity winds fill Loonie Sails



While we believe that the commodity cycle will run for an extended period of time, signs of extremes are evident and managing risk through proper diversification is our number one concern. Our challenge will continue to be the value of the C$ and its implications for global investing.

2006 »
tack! currencies reveal new wind

We believe 2006 will be a year of opportunity following some challenging wind conditions. Our dividend sea anchor will see us through these conditions while asset allocation will position us to take advantage of new wind.

For 2006, we believe the major catalyst will be the U.S. Consumer

Our view is that global rebalancing requires catalysts. For 2006, we believe the major catalyst will be the U.S. Consumer. Armed with 8 credit cards in their wallet and nothing in the bank, the risk transfer from U.S. corporations to U.S. Consumers is complete. We feel 2006 will expose this risk, first taking most global markets along with it, followed by a second stage where top global companies and markets less-reliant on the U.S. will show their true colours. This is the opportunity we believe we'll get during the year. When we feel the time is right, we will tack! toward these new winds. Table 2 translates our tack! strategy into action:

Table 2 – tack! for investment performance

Asset Class	Recommendation	Strategy
Cash	Increase	Overweight cash to be positioned to buy on downturn
Developed Market	Japan	Build financials weight to benefit from rising GDP
Emerging Market	Brazil	Play bonds first, watch for equity entry point
Emerging Market	Taiwan	Several catalysts in its favour while being out-of-favour
Sector	Healthcare	Buy strong global franchises at deep discounts
Sector	Energy & Materials	Better opportunities down the road
Sector	Agriculture	Feed the world, fuel the world
Currency	Gold	Emerging as an alternative store of value

notes:

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