

Laketon Enhanced Dividend Fund

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Milos: Hello and welcome to this month's Laketon Audio Commentary featuring Brad Cann, Vice - President and portfolio manager of the Canada Life Laketon Enhanced Dividend Fund. These audio commentaries are designed to provide you with timely and useful information regarding financial markets as well to address various issues surrounding the particular investment funds that Laketon provides for the Canada Life Generations platform. My name is Milos Kostich and as VP Sales, Strategic alliances here at Laketon, it is my pleasure to have Brad Cann here in the studio once again to give us his take on what has certainly been a harrowing 6 months. Brad, welcome....

Brad: Thank you Milos.

Milos: Brad - What is your sense regarding overall market sentiment and what recent events do you think have most affected the Canadian market as a whole?

Brad: Well, Milos—It is very clear now that we are in the midst of a harsh Bear market and, the market sentiment is quite negative towards common share investments. This is just not a Canadian market issue, but it prevails across the whole globe. After last fall's huge market losses, one entered the year with some historical justification that the worst of the equity valuation damage was over, especially with the hope generated by the new US President, Obama.

So far, the selling has continued-- only the safety of gold or government T-bills have held their value. Canada's exposure as an exporter of resources and other goods depends upon trading with other nations, something that has slowed down dramatically around the world. Recall, that the 3 major industry sectors in the TSX are Materials, Energy and the Financials -- So, our market has not been able to withstand the negative sentiment towards the financial sector that has been the experience in many countries due to the "credit crunch"-- which seems to have its origin in the United States. As well, the energy industry has been hit hard, going in 6 months time, from the best of times to the toughest of times from a commodity pricing perspective.

Have we come down in valuation enough? That remains to be answered, but it is clear, in our opinion, we are now at a much better entry point for longer term equity investors than we have had in many many years.

Milos: Brad - do you feel that the Banking Sector is in for tough times, and is the market truly overreacting and tarnishing the Canadian Banks when the fundamentals may not support the valuation levels at present?

Brad: That is a very good question Milos, and this is going to require a rather lengthy answer so bear with me please. First, I believe all sectors in the economy are in tough times compared to the middle part of this decade and the banks are no exception. Earnings are under pressure due to the economic environment we find ourselves in. But, I would make a stark contrast between our banking system health, and that of our neighbors to the south the US, and other parts of the world. And these days, I am not the only one making these distinctions-- Our banks are near the top of the list for our capital ratios. Our bank exposures to the US real estate pricing bubble and mortgage crisis are relatively small and we believe Canada's mortgage underwriting was not that lax, on a relative basis, during this market upswing—and therefore, our banks exposure on mortgages is manageable—we believe in this downturn, like all downturns, there will be problem areas, but so far, it looks like we have the capacity, and I stress without the government supports used in the US, to handle the losses or expense charge-offs that come with a downturn. I would again point out many countries in the world regard our Canadian bank model with envy and are looking at restructuring based upon some facets of our model.

Now, on the bank dividends which seem to be a question for some investors-- First of all, to put this in the correct context—a corporation's dividend is a Board of Directors decision. This makes it a difficult issue to analyze with complete

accuracy as there have been examples where a Board makes a move, despite where most analysis even including management's, would have suggested otherwise

Secondly, the major Canadian bank's track record is enviable wherein I believe none of them have cut dividends going all the way back to the 2nd world war (excluding treating National Bank as a major) so being the first board to cut is a very serious decision stating the obvious

We also believe it is stating the obvious, that the major banks' payout ratios are becoming strained in this economic time—one or two of them are becoming stretched close to or slightly beyond the ideal range previously set by management—but this is not without precedent for short time periods, to exceed such a range "temporarily" My current belief is that, at the earliest, the dividend issue would become a pressing 2010 decision, if there are no signs of the downturn abating

My real hope is that, some of the massive government moves really around the world will show signs of starting to work by then, lessening the urgency of any cuts. So, in conclusion in the near term I believe the banks have raised capital in other ways, the dividends will not be touched anytime soon—given all the public available data that we analyze.

The major caveat of course-- is if the board has information that we are not privy to the board may have reason to make a different decision. -And, finally on the quantum, I would not expect cuts, if any, to be anywhere near the magnitude of the US bank cuts where dividends were taken to virtually zero—it would not make any sense given the Canadian situation—we would more likely see a trimming --to maintain a certain payout ratio.

Milos: Speaking about some of the other sectors within the fund, the enhanced dividend fund does have overweights in the telecommunication and utilities sectors, I am wondering how does the current market environment bode for these 2 sectors and what potential challenges might exist in the medium term?

Brad: Sure Milos, our overweighting in the Utilities and Telecom sectors is no accident. We believe these sectors have attributes that make them relatively resistant to, not immune to, the impacts of a recessionary economic climate that we find ourselves in. What do we mean? Well, these companies supply very basic services like electric power, phone service, cable TV and the like and the end customers only sever as a last resort in tough times. Often, they are not big ticket items. So, as a consequence revenues and margins are less affected by the slower economic growth. In addition, cash flows are more stable, allowing dividend payments to remain in place or even be increased. One final point is that these types of companies are regarded by many investors as a boring place to invest, thus they tend not to get wildly over-valued in the bullish phase of the cycle.

As to challenges, businesses all have them—here the telecom group must manage in the face of some potential competition in the wireless space and all of them will have to manage their costs more tightly in the near future.

Milos: The current weighting in preferred shares in the portfolio is around 16% presently Brad, do you see this weighting change or are you comfortable with the current level?

Brad: You are absolutely right Milos, our preferred share positions were acquired as part of our overall defensive posturing over the past 2 years. They also help to balance off the common equity exposure in our fund given our more conservative mandate. We are quite comfortable with our current weighting and we would likely only lower it, in favour of common shares, only when the economic picture gets a great deal clearer.

Milos: Brad - can you comment on future dividend streams for Canadian dividend paying issues growing and is the current economic environment a threat to the level and health of stock dividend payouts in general??

Brad: Historically, dividends in aggregate for the TSX, have been more stable than earnings have been. There is no doubt that in tough economic times, the cash flows and earnings available to pay dividends generally are not as plentiful for a lot of our companies. For investors, it is also true, that the "cost" of the investment required to buy a dollar's worth of dividends has been lowered dramatically—for instance, only a short time ago, it cost about \$35-40 to buy \$1 in dividends, currently some bank dividends can be had for about \$13-14 on an investment—so in our view, there should be a balancing of the risk and rewards—Secondly, using a portfolio approach to the dividend stream, leaves one a lot less

vulnerable to one single company lowering or even eliminating its dividend payments. The aggregate dividend stream for the whole portfolio will not be materially impacted by this.

Finally, it's our belief that, in the lower return environment that appears to be shaping up for the coming years, dividends will play a more significant part of investor's returns. This is music to our ears for our fund as we intend to keep reaping the rewards of the magic of compounding with our dividends.

Milos: Thanks Brad for all of your comments and discussion today, and I hope that you have shed some light on some important issues, also that you have given our listeners some perspective, because the positives certainly get overshadowed by all of the negative news that has been so prevalent in the last 6 months. I'd like to remind our listeners to log onto our website for a variety of other commentaries that are available from our portfolio managers in addition to quarterly fund commentaries for all of the Laketon segregated funds available on the Canada Life generations platform. So long until next time and thank you for tuning in!!!