LEITH WHEELER INVESTMENT OUTLOOK

Leith Wheeler
INVESTMENT COUNSEL LTD.

Fourth Quarter 2004

Last quarter we took a close look at Oil and Gas Royalty Trusts... and our investment conclusions were at odds with the popular opinion of the day. This likely didn't make us any friends among the devotees of these businesses, however, such insights are what lie behind the investment decisions we make on behalf of our clients. This quarter, we consider a less controversial, albeit significant industry in the Canadian stock market, and a large proportion of our client portfolios - Financial Services stocks.

Forget The Atkins Diet... Buy Stocks That Can Put On The Calories!

Ben Graham, one of the deans of value investing, once described the stock market as a voting machine in the short run and a weighing machine in the long run. The stock market can temporarily ascribe huge valuations to popular companies possessing virtually no profits. Think of some of the "hot tips" we all received during the technology bubble in the late 90's! This was the stock market acting like a voting machine. Over time, however, there is a convergence of a company's earnings and its valuation in the stock market. Ultimately, the stock market acts like a weighing machine.

Historically, our Canadian Equity portfolios have held large positions in financial companies' stock. These companies include the Canadian chartered banks, life insurance companies and investment management companies. Essentially, we have been able to buy companies that have grown their earnings faster than the market (they have put on the calories!) for below-average prices (they weren't receiving votes for "most popular" when we bought them).

When Boring is Good

The attributes of many Canadian financial companies may be well known but are worth repeating. These companies have very strong competitive positions (bordering on oligopolies), have solid balance sheets, generate tremendous free cash flow (which they have liberally distributed to shareholders in the form of rising dividend streams in recent years), and possess shareholder-oriented management teams. More often than not in the past decade, these companies have been valued at a **discount** to the broad stock market, likely because they are not very sexy (discussing the balance sheet strengths of the banks does not make for interesting cocktail party chatter) and do not have the intriguing growth "stories" of a number of technology and junior resource companies.

However, the combination of healthy earnings gains and below market valuations for many Canadian financial companies has lead to out-performance by this industry group relative to the broad Canadian stock market as shown in the table below.

Total Returns For Time Periods Ending September 30, 2004

	5 Years	10 Years	15 Years
S&P/TSX Financials Subindex	18.6% per yr	19.1% per yr	14.0% per yr
S&P/TSX Composite Index	6.2% per yr	9.0% per yr	7.8% per yr

Leith Wheeler is proud again this season to be a corporate partner with the Playhouse Theatre Company. Our sponsorship of the production of *Joni Mitchell:River* kicks off the 04/05 season on October 9th.
www.vancouverplayhouse.com

Leith Wheeler is also proud to be an event sponsor with Music in the Morning, and the upcoming concert series featuring pianist Anton Kuerti begins October 19th.
www.musicinthemorning.org

Where Do We Go From Here?

These financial companies have provided excellent returns to their shareholders in the past. But that is looking in the rear-view mirror. Which companies do we like going forward and what returns can clients expect over our 3 year investment horizon?

Many Canadian financial companies are currently generating record profits. The banks are being aided by low loan losses. The life insurance companies are being helped by low default rates on their large corporate bond portfolios. Short term prospects are positive, but the good times will not last forever. We believe that the most important factor that will differentiate these companies in the future will be their ability to wisely reinvest their substantial profits. What do they do with their cash? Do they have attractive reinvestment opportunities? What is the likelihood that they will be able to execute on these opportunities?

Our largest holdings are the TD Bank, Manulife Financial and the Bank of Nova Scotia. Their business platforms are strong and are generating growing streams of earnings, they have solid investment opportunities, and their management teams are excellent. Equally important, the valuations of these stocks remain appealing.

TD Bank has one of the largest and most profitable retail banks in Canada, TD/Canada Trust. It has a unique opportunity to grow earnings from this division at a faster rate than its competitors over the next few years by selling more products such as credit cards and insurance to its large retail customer base. Its pending acquisition of 51% of Banknorth was a shrewd way of entering the huge U.S. retail banking market while preserving its strong balance sheet and avoiding diluting its earnings per share. Future acquisitions through Banknorth and/or through TD Waterhouse, its discount brokerage subsidiary, should prove to be highly accretive to shareholders. Finally, we believe its CEO, Ed Clark, is one of the leading financial company executives in Canada, and probably North America.

Manulife is in the enviable position of having developed a powerful base of operations in Canada, the United States, and Asia over the past 100 years. It has the necessary scale in each of these markets to compete effectively. This scale was only enhanced with its April 2004 purchase of Boston-based John Hancock. Manulife has a unique culture of innovation and is continually developing new insurance and wealth management products that it can distribute across its global platform. This has resulted, and should continue to result in above average rates of growth in its revenues and earnings. Dominic D'Alessandro, the CEO of Manulife, has a superb record since joining the company in 1994.

The Bank of Nova Scotia (BNS) also has a unique and extremely profitable international banking business concentrated in North and South America and the Caribbean. The acquisition of its 97%-owned Mexican subsidiary, Inverlat, was done on extremely favorable terms and gives BNS a meaningful position in Mexico's growing market for financial services. BNS's management team, lead by CEO Rick Waugh, has provided its shareholders with the best total returns of the Big 5 chartered banks over the past decade, and we believe the bank is positioned to continue to outperform.

We feel the financial companies in your portfolio should, as a group, provide double digit total returns over our 3 year investment horizon. We don't believe we can say the same for the broad stock market or in particular the bond market over the same time horizon.

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