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GREEN LIGHT FOR RRIF CHANGES

All the tumult and fury on Parliament Hill last week produced the kind of high drama we rarely see in this country. It is not the mandate of this newsletter to comment on political matters unless they affect investment decisions so I won't add to the hundreds of thousands of words that have already been written about this historic showdown.

However, I can give you the answer to a question that several readers asked via e-mail after the storm broke. Yes, the reduced RRIF withdrawals for 2008 that were announced in the Economic Statement that triggered the crisis will stand.

Late Friday afternoon, I received a confirming phone call from a spokesman for the Department of Finance advising me that a one-time 25% reduction in the minimum amount required to be taken out of RRIFs, LIFs, and LRIFs will be honoured by the Canada Revenue Agency (CRA), even though no enabling legislation has been passed and conceivably might never be. Financial institutions will be officially advised next week.

This is consistent with past practice relating to tax announcements. Historically, the CRA applies all tax changes as soon as they are announced (or at a later date if the Finance Minister so specifies) even though the enabling legislation may not actually receive Royal Assent until months later.

But this time could have been different. On Nov. 28, the day after Finance Minister Jim Flaherty unveiled his Economic Statement, a notion of ways and means was introduced into the House of Commons to implement the tax measures announced in his speech, including the RRIF plan.

However, the formation of the Liberal-NDP coalition with Bloc support raised serious questions about whether any or all of the tax proposals would stand if a new government took over.

Retirees, many of whom make only one annual withdrawal at year-end, were left in a quandary. RRIF administrators wouldn't accept instructions to reduce the December payments without authorization from the CRA so for a while everything was in limbo.

Last Tuesday, I asked the CRA to clarify the situation so that people would know how to proceed. On Friday, the word came back to me from Finance: go ahead.

So here's what you need to know. If you wish (no obligation) you can

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YOUR QUESTIONS

U.S. dollar collapse?

Q - Could you please comment, perhaps in the next issue of the IWB, of the consequences as you see them, of a possible U.S. dollar collapse?

There have been prognostications of this by both investment gurus (Peter Schiff as an example) and academics. What might be the implications for the Canadian dollar?

I am just about to buy some of those high-yielding GICs you mentioned in the most recent IWB, but am spooked. The mattress or gold look better and better; just joking, sort of, she said with a wry grin. As always, I appreciate your advice, especially during these turbulent times. – Liza H.

A – The theory of a U.S. dollar collapse rests on the assumption that investors will eventually flee from the greenback once economic stability returns and the magnitude of the U.S. deficit becomes apparent. Part of this scenario includes a downgrade in the debt rating of the U.S. government, which seems a little far-fetched.

No one knows if things will play out that way. Right now, the greenback is regarded as a "safe haven" currency and money is pouring into U.S. Treasury bonds. This is one of the reasons why the loonie has taken such a steep plunge recently.

If the U.S. dollar drops, our currency could appreciate to par again but a lot will depend on the state of the commodity markets and our own government finances at that point. In short, there is no clear answer – the loonie could be dragged down with the greenback under some conditions, whereas under others it could rise.

One thing is likely – if the U.S. dollar falls, gold will probably appreciate. The two historically move in opposite directions.

– G.P.

Green light - continued from page 1...

withdraw only 75% of the total you would normally be required to take out of a retirement income fund in 2008. So if you receive equal quarterly payments from your plan, you can simply instruct the administrator to withhold the December payout since you've already taken out as much as is legally required this year. If you receive one year-end payment only, you can scale it back by 25%.

For example, a person who was 72 last Jan. 1 must withdraw 7.48% of the plan's value on that date. So for a \$100,000 RRIF, the normal basic withdrawal in 2008 is \$7,480, which is taxed at your marginal rate. Under the Flaherty plan, that person now only must take out 5.61% of the RRIF's value this year, or \$5,610.

Even if you need the money, you should consider deferring any withdrawal that exceeds the reduced minimum until early 2009. If your marginal tax rate exceeds the withholding tax applied to the RRIF withdrawal, you'll have the use of the extra money until you file your 2009 tax return in spring, 2010.

Of course, if you've already made the full withdrawal for 2008, this last-minute break may be worthless to you. You are allowed to repay 25% of the withdrawal to the plan by sometime in 2009 (the actual date is vague because it depends on the date the legislation is approved). But since the withdrawal has already had tax deducted from it and may in fact have been spent, repayment is not likely to be a popular choice. Nonetheless, the option is there.

If you still have a RRIF/LIF/LRIF payment coming to you this year, act quickly if you want to take advantage of the 25% reduction. If the plan administrator says it can't act, send them this article.

Gordon Pape's new book is *Tax-Free Savings Accounts: A Guide to TFSAs and How They Can Make You Rich*. Copies can be reserved now at <http://astore.amazon.ca/buildicaquizm-20>

MEMBERS' CORNER

Account breached

Member comment: Recently, my Bank of Montreal Investorline account was breached. An abnormal number of buys and sales were made by the perpetrator. I informed BMO as soon as I noticed the situation. On that call, I was told of the warranty and was promised an investigation. On the next call, I was asked if anti-virus or anti-spy software were installed on the computer. I told him none were installed. On the next day, another BMO advisor called and informed me the Bank would only cover half of the lost for failing to install the required software. Is it a reasonable deal?

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TOM SLEE: TIME TO FINE TUNE YOUR PORTFOLIO

Contributing editor Tom Slee is with us this week with some parting thoughts about 2008 and a cautiously optimistic outlook for 2009. Tom was a professional money manager in the insurance industry for many years. Here is his year-end report.

Tom Slee writes:

Let me start by wishing you and your families a happy holiday season and a healthy, prosperous New Year. Hopefully 2009 will prove to be a much better year for all of us.

Is that just wishful thinking? No. I happen to believe that we can be cautiously optimistic going forward. Sure the markets remain grim and the rallies are short-lived. There is widespread gloom. In an odd way, though, the desolation provides an unusual investment opportunity. Let me explain.

The 2008 stock market crash was not only steep, it was also far more widespread than most people realize. The narrow-based Dow is just part of the story. To get a real handle on the situation we have to study the mostly overlooked Dow Jones Wilshire 5000 Index. This is the indicator that gives us a broad picture. Right now, it also provides a departure point for our 2009 investment planning.

As the name suggests, the Wilshire 5000 (it actually contains more than 7,000 securities, including REITs and limited partnerships) tracks the performance of nearly all publicly-traded companies based in the United States, including the small caps. Vast and unsophisticated, it tends to be sluggish and remain relatively stable, mainly because of its sheer size. But not this time around. The Wilshire lost 25% of its total value in September. Then, in October the index had its worst month since 1987, finishing down 37% from the October 2007 high.

Such broad losses are almost unprecedented. As a rule, there are pockets of resistance when the markets take off in either direction. For example, defensive stocks perform comparatively well in a downturn. That is why money managers are always diversifying. So I expected the Wilshire to hold up better in the recent nosedive than, say, the Dow Jones Industrials. However, that didn't happen. In 2008 everything was swept away.

It tells us two things. First, there was nowhere to hide. All the conventional risk-spreading techniques went by the board. Second, and much more important, we now have a relatively even playing field when it comes to value: a sort of blank canvas if you will. With all the sectors offering exceptional value, we have an unusual opportunity to pick and choose while realigning our portfolios.

So that there is no misunderstanding, I am not suggesting that you should start making heavy commitments at this stage. In fact, it may be a good idea to disconnect your DRIPs (dividend reinvestment plans) for a while and build your cash position. My point is that this is a good time to upgrade your portfolio with some carefully selected switches. It's the sort of recommendation that advisors usually make after a prolonged run-up in the market but the technique works just as well in tough times. The difference is that instead of taking capital gains, most of us will have to book losses. The advantage, however, is that you are going to remain invested with an improved portfolio that should give you superior returns during the recovery.

Please note that this is not a policy shift here at IWB. We remain defensive on all fronts but we believe in being invested in order to take advantage of the eventual turnaround. The idea is to weed out any perennial losers while we are in this trough and take advantage of the extraordinary values available. After all, the oversold top-quality stocks are likely to lead the recovery, run away from us in fact, while the second-tier holdings in your portfolio lag. By fine tuning now, you improve your line-up and position yourself for the advance.

The difficult part is taking losses. We all fall into the trap of sitting with poor investments hoping that they are going to recover so that we can sell them at cost. It's a bad practice. Professional money managers learn to take their losses. After all, the loss has actually occurred. The value has gone. Yet, I still see advisors referring to "paper losses" as opposed to real losses. So bite the bullet and make a short list of any dubious investments. Then liquidate them during a rally, although I would not be too cute when it comes to market timing. The buy side of your switch will also have moved up, perhaps even faster.

Incidentally, at this stage of the exercise keep in mind that it's time to take capital losses and offset any capital gains that you were able to rack up in 2008 before the meltdown (or in the three previous years). I also suggest a second interim step. Once you have the sale proceeds, step back and secure your short-term needs. Do you have sufficient cash flow? Make sure you can meet your RRIF withdrawal requirements and that you have enough personal investment income without continually selling securities. Forced sales in a bear market can be very expensive. Having adequate liquidity

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Fine tune - continued from page 3...

will also allow you to remain calm during the turmoil. Peace of mind is worth a great deal.

At the same time, try to tune out all the doom and gloom merchants. I have mentioned this before but it's worth repeating. Whenever the market craters, pundits start trying to top each other's dire predictions. I often think there must be an award for the most depressing forecast. Ignore all of them. This is just a particularly painful recession, not the end of the system.

Turning to the buy side of our proposed switches I would apply a dose of common sense. Despite all the talk about an entirely new world, the chances are that we will be dealing with the same problems and opportunities a year from now. For instance, the major Canadian banks are going to be in place even if (worst case) we have a merger along the way. That is why I think Bank of Montreal (TSX, NYSE: BMO) looks particularly attractive at the moment. Trading at \$34.90 (US\$27.33), the stock is at 10 times earnings. The \$2.80 dividend provides an 8% yield, equal to about 11% from a bond after adjustment for the dividend tax credit. I wrote about BMO in detail in the Nov. 26 issue of our companion newsletter, The Income Investor.

As a general rule, focus on dividend-paying blue-chip companies that are likely to increase their pay-outs. I realize that high yields are normally a warning sign and that 2009 earnings going to be disappointing but the present yields are more the result of plunging stock prices than lower profits. The fact is that many of these top tier companies offer exceptional value. My old favourite, Enbridge (TSX, NYSE: ENB) at \$38.18 (US\$29.94), qualifies. The company has a solid growth

record and last week announced it is increasing its dividend by 12% to \$1.48 a year in 2009. That would provide a 3.9% yield along with long-term capital gains.

CN Rail (TSX: CNR, NYSE: CNI) also fits the bill. Currently priced at around \$43 and yielding 2.1%, CN could make \$4.30 a share in 2009. That means the shares are trading at about 10 times forward earnings.

Take a look as well at some of the front-line trusts. RioCan (TSX: REI.UN), the premier Canadian REIT, is way oversold and at \$13.43 yields 10.3% despite the fact that it's exempt from the new income trust tax now only two years away. Another trust that has been badly battered is Yellow Pages Income Fund (TSX: YLO.UN). Paying a \$1.17 distribution, YLO, at \$6.54, yields an astonishing 17.9%. Management has indicated that it intends to maintain the current distributions in 2011 and beyond despite the new tax.

On the other side of the coin, stay away from the commodity stocks. There is less demand for energy and potash prices are likely to weaken, at least over the short term. Many of the resource are going to have trouble meeting 2009 earnings expectations.

Let me say again that I am not advocating a wholesale portfolio turnover, just some cautious culling and strengthening while we have all these bargains around. Remember too that it's possible to carry any capital losses that result from the switching back three years and forward indefinitely if you have no offsetting 2008 capital gains. By the way, you may be interested to know that there is a proposal in the U.S. to allow investors to offset \$20,000 of capital losses against other income. It would be nice to see something along those lines in our January Budget – no matter who ends up giving it.

Members' corner - continued from page 2...

For your information, I opened the account more than 10 years ago. This is the first incident. I usually buy blue-chip stocks or those recommended in your publications in quantities of less than 500 for each selection. The total holdings rarely exceed five. I have sold less than five times. In this incident, some sales were over 1,000 shares. For buys, some were as high as several thousand. What options do I have to reclaim my loss? – T.C.

Response: This is an unfortunate situation and it is the first time I have heard about something like this happening. As far as recovering your losses is concerned, that really comes down to the nature of the agreement with the broker. That's covered in all the small print that pops up on your screen when you open an account but which no one ever reads.

You might try to arrange a meeting with a supervisor to discuss the situation, pointing out that you are a long-time client and that you would expect your business to gradually increase over the years. No one wants to lose good clients, especially these days, so perhaps they will cut you some slack.

Oh, by the way – get the software. Next time, it could be your bank account that gets emptied. – G.P.

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TOM SLEE'S UPDATES

Bombardier (TSX: BBD.B)

Originally recommended on April 9/07 (IWB #2714) at \$4.64. Closed Friday at \$3.98.

Over at Bombardier, the outlook, as you would expect, is deteriorating as corporate customers start cutting costs. Postponing aircraft deliveries is a high profile way to start. Consequently I have trimmed BBD's expected 2010 earnings (the company has a Jan. 31 year-end) to US50c, about flat with the anticipated 2009 numbers. Fortunately our weak currency is going to help because Bombardier prices its products in U.S. dollars but incurs the bulk of its expenses in loonies. The chances are, however, that the important aerospace backlog growth is going to stall.

Like other civil aerospace shares BBD, still regarded as a trading vehicle, has experienced a collapse in its share price and is likely to remain out of favour until conditions improve. Therefore, although the long-term fundamentals remain good, I would not add to your common stock positions at this time.

Action now: The stock remains a Hold.

Stantec Inc. (TSX, NYSE: STN)

Originally recommended on Aug. 28/06 (IWB #2832) at C\$20.48, US\$18.45. Closed Friday at C\$23.55, US\$18.59.

Stantec is having a strong year despite the economic turmoil and turned in some particularly good third-quarter numbers. The company reported gross revenues of \$348 million for the three months to Sept. 30, up 48% year-over-year, while earnings came in at 55c a share compared to 38c in 2007. That was well above the Street's consensus forecast of 47c. As a result, STN is on course to make about \$1.90 a share in 2008 and as much as \$2.35 in 2009.

Once again the company's geographic diversification and market range paid off. Certainly, the Urban Land division was hurt by a sharp downturn in the Californian housing market but its Alberta and Ontario operations remained stable. Incidentally, Stantec is moving quickly to cut its U.S. overheads by reducing staff levels. STN's Buildings, Environment, Industrial and Transportation practices all reported strong growth.

Looking ahead, I expect the company's housing business to remain a drag, especially if the Canadian real estate markets weaken. We may also have a few unpleasant surprises if clients run into trouble and are unable to meet their obligations. On the plus side, the Environment backlog is at record levels and Buildings has several new projects in the offing. Acquisition of Halifax-based Jacques Whitfield, a

profitable, environmental consulting services firm with gross revenues of \$230 million, is also going to bolster the bottom.

Nevertheless, we have to be realistic about what investors are likely to pay for an engineering company in this environment. My hunch is that people are unwilling to bid up this type of stock until the economy improves. So I am lowering our target to \$28. That is no reflection on STN; just a sign of the times.

Action now: Stantec is a Buy with a revised target of \$28. I have set a \$16 revisit level.

Bombardier Series 4 Preferred Shares (TSX: BBD.PR.C)

Originally recommended on March 8/04 (IWB #2410) at \$25.01. Closed Friday at \$14.73.

More aggressive investors should take a hard look at Bombardier's Series 4 Preferred Shares. At current levels, these offer above-average income as well as capital gains over the next year or so. Here is the situation. Bombardier 6.25% Cumulative, Redeemable Shares Series 4 pay a \$1.5625 dividend and are priced at \$14.73 yield 10.6%, equal to about 14.5% from a bond in non-registered accounts after adjustment for the dividend tax credit. The company can redeem them at a price of \$25.75 until March 31, 2009, and after that at gradually reducing prices until after March 31, 2011 when it can call them at \$25.

One caveat: the company has the right can convert the Series 4 into common shares at a price based on the redemption price but even that unlikely event would provide a capital gain. With the common trading at \$3.98, the Series 4 conversion price is equivalent to \$25.50. Most important, despite BBD's volatile aerospace business the company is generating a strong cash flow and maintains a solid, gradually improving balance sheet. Standard & Poor's and Fitch both rate the company BB plus. That does not guarantee the preferred dividends but does indicate that they are relatively safe.

Action now: Bombardier Series 4 Preferred Shares are a Buy for income and capital gains for investors able to accept and cope with some risk.

Canadian Tire (TSX: CTC.A)

Originally recommended on Sept. 27/99 (IWB #2832) at \$34.10. Closed Friday at \$39.25.

Turning to the retailers, Canadian Tire surprised the analysts

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Tom Slee's Updates - continued from page 5...

with a very profitable third quarter. Tire reported earnings of \$1.42 a share versus \$1.26 the year before, easily beating the expected \$1.30. The good news was tempered though. A little over 11c a share resulted from a lower tax rate. Investors would have been more encouraged by a surge in store sales.

Management is maintaining its guidance, which means 2008 earnings should be in the \$4.90 a share range, similar to the \$4.92 mark achieved last year. The coming 12 months, however, are a bit of a question mark. Everything points to a rapid slowdown in Canadian retail sales. It's going to be a tough time in an already highly competitive business. Moreover, Tire gets approximately 65% of its retail sales from the rapidly weakening Ontario and Quebec manufacturing markets. Alberta, where the energy producers are retrenching, is not looking rosy either.

That having been said, CTC is one of the best merchandisers in the country and more than capable of fending off the opposition during this downturn. In addition, a lot of the gloomy outlook is already in the stock price. Over the years, the shares have traded at between 8 times and 25 times trailing earnings. At \$34, they are currently priced at 8.2 times earnings. That would suggest that a poor 2009, with a profit of about \$4.50 a share, has been mainly discounted by investors and is reflected in the share price. On balance though, given the bear market, I am inclined to postpone any accumulation.

Action now: Canadian Tire remains a Hold.

Members' corner - continued from page 4...

Fertilizer stocks

Member comment: You may already be aware of this but the fertilizer manufacturers have dropped the wholesale price that they charge to Canadian fertilizer dealers by huge amounts which, of course, will impact on future earnings. Phosphate went down by over \$600 a tonne, nitrogen by \$200-\$300 a tonne, as well as other products. Urea is now selling wholesale to Canadian dealers at about 50% of what they were paying for it two months ago and had seen several price cuts since September, although none as significant as the latest.

No one was buying much fertilizer in Western Canada as the world price had dropped and it was very overpriced to the point where farmers could not afford to buy it. Apparently, Agrium is threatening to shut down one or more of their fertilizer plants if dealers don't start taking delivery of product as they only have so much storage room at the plants and they are pretty much full.

Many fertilizer dealers in Canada have just seen their inventory value eroded by millions of dollars. This would include publicly-traded companies like Viterra. – Name withheld by request

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IRWIN MICHAEL UPDATES
CANAM GROUP

Canam Group (TSX: CAM, OTC: CNMGA)

Originally recommended on July 1/08 (IWB #2824) at C\$10.42, US\$11.09. Closed Friday at C\$5.77, US\$4.35 (Oct. 8)

Canam Group, has come to exemplify these unusual and difficult markets. We recommended the shares last summer at what we thought was a dirt-cheap price but unfortunately the shares dipped again.

By October, it became apparent why the shares were declining without any clear fundamental reason. On Oct. 7, the shares opened just below \$6.50 and suddenly plunged to a low of \$3.73 per share, a decline of approximately 40%. We were dumbfounded but quickly put a bid in and actually managed to purchase a few thousand shares for our ABC Funds at \$3.75. The stock then bounced and closed the day at \$5 per share. Over the next two days we saw several large blocks of stock change hands. It took us a few days to piece together the story but we finally discovered that a hedge fund was behind the volatile trading. This fund, perhaps facing redemptions, was forced to raise cash by dumping several million shares into the market, irrespective of price. It was frustrating to watch but at least we understood that the company's fundamentals were sound.

Management apparently agreed with our assessment of Canam's prospects. In their recent quarterly release, they announced that as of Oct. 21 the company had acquired 2,185,100 shares at an average price of \$6.14 per share for a total amount of \$13.4 million. The shares were purchased through the company's normal course issuer bid that began last August for up to 4,075,000 shares. With a book value of \$8.18 per share, this buyback is accretive and represents an excellent use of the company's strong and flexible balance sheet. Eventually, investors will focus on fundamentals instead of liquidity and the shares should return to a more realistic valuation range.

Note that although the shares are listed in the U.S. over-the-counter market, they seldom trade there.

Action now: Hold.

IRWIN MICHAEL LIKES GEORGE WESTON IN TOUGH TIMES

Contributing editor and value investor Irwin Michael continues to hunt for bargains amidst the stock market rubble. He believes he has found one in an industry that will never go out of fashion: food. Irwin is founder and president of the ABC Funds. Here is his report.

Irwin Michael writes:

The extreme market volatility of the past several months continues to test investor patience and conviction. Newspaper headlines and radio and TV commentaries bombard us incessantly with the all-pervasive negative sentiments regarding declining economic activity, growing job losses, and unfortunate human interest stories. In short, extreme negativity overhangs the marketplace and many stock valuations are reflecting spreading investor pessimism.

Growing investor fears regarding worldwide deleveraging, deflation, and recession have created a massive flight to liquidity and significant avoidance of common stocks. Interestingly, no matter how low they have fallen, few investors are willing to purchase undervalued securities for fear that they may plunge further. As a result, the present volatile financial environment is pricing many stocks at extremely depressed levels which, in a number of cases, bear little relevance to their fundamental worth. In effect, investors have been so shell-shocked by the market plunge over the past three months, the incessant media negativity, and the sheer fear of a worldwide economic recession that they are foregoing value purchases for the comfort of low-risk/low-yielding Treasury bills.

Two weeks ago, another significant event occurred. KPMG announced that it does not expect to be in a position to deliver a positive solvency report on the BCE leveraged-buyout, which was scheduled for a Dec. 11 closing. This announcement pummeled BCE's stock price from the previous day's \$38.35 close to a Nov. 26 finish of \$25.25. This close represented a 34% price decline and lopped off over 100 points from the TSX that day. Ultimately, this price decline of the world's largest potential leveraged buyout has shocked investors and will probably add to their reluctance for equity investing; they may deem the stock market to be just too risky. Should this occur, more stock bargains may appear with fewer takers. However, to the patient, contrarian investor, this will present even greater long-term buying opportunities.

There is no doubt that the North American and global economies continue to decelerate into economic recession.

It has been painful to everyone with few places to hide. While the present economic, corporate, and job loss news is rather bleak and will probably get worse before it gets better, a couple of points of interest should be noted:

1. While the general sentiment is that we are in the midst of a deep economic recession, many common stocks are already trading at sharply discounted valuations and the price may have factored in a severe economic downturn. For instance, a number of oil and gas stocks are trading at under two times cash flow and at huge discounts to their net asset value and replacement cost. In effect, it is cheaper to drill on Bay Street than in Alberta.

2. To their credit, worldwide governments and central banks are recognizing the potential severity of this recessionary environment and they are in the midst of supplying massive economic stimuli via interest rate reductions, infrastructure spending, financial institution bailouts, monetary growth, etc. It appears they will do whatever is necessary to jumpstart sagging global economies at the expense of future inflation. Nonetheless, it is our belief that the economies and common stocks will eventually react positively, bearing in mind that the stock market tends to recover ahead of the economy. In the meantime, investor patience, stamina, and discipline will be of prime importance in preparation for the next major up-market cycle.

In today's turbulent markets, investors should look to add dividend-paying, "recession-proof" businesses with clean balance sheets to their portfolios. We believe that George Weston Limited, the well-known food processor and distributor and majority owner of Loblaw, fits this bill quite nicely.

George Weston Limited (TSX: WN)

George Weston Limited, founded in 1882, is one of North America's largest food processing and distribution companies. Although the company reports consolidated results, it really has two distinct segments: Weston Foods and Loblaw.

Weston Foods offers fresh-baked sweet goods, frozen baked goods, and biscuits (including wafers, ice-cream cones, cookies, and crackers). Loblaw is Canada's largest food retailer and also offers drugstore and general merchandise as well as financial products and services. Loblaw employs over 140,000 full-time and part-time workers in more than 1,000 corporate and franchised stores.

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During the last period of market turmoil, when high technology stocks were imploding, investors who sought safety in stable, easy-to-understand businesses were eventually rewarded. Back then, in the second quarter of 2000, we established a position in Canada Bread. It was a solid consumer staple stock that provided excellent returns. We believe that we have found a similar story in George Weston Limited, a food processor and bakery that also owns approximately 63% or 170 million shares of Loblaw. This consumer staple stock, with a reasonably clean balance sheet and a 2.7% dividend yield, should perform well even in a recession. People have to eat no matter how far commodity prices or auto sales decline.

On a consolidated basis, George Weston Limited has generally reported improving operating and financial results. Year-to-date, sales have grown 2.7% to \$25.8 billion, while net earnings have grown 3.9% to \$428 million. Net earnings per common share totaled \$3.03 for the first nine months of 2008, an increase of 6.3% from EPS of \$2.85 reported in the comparable period last year. Consolidated net debt declined from \$5.05 billion at the end of third quarter of 2007 to \$4.39 billion at the end of the third quarter of 2008. Although the company used \$222 million of cash so far this year, in the third quarter Weston generated \$62 million in free cash flow. From our perspective, it is best to examine each of the two operating divisions to determine the potential investment upside.

Weston Foods, the bakery division, has fought through several years of rising commodity prices, primarily wheat and fuel, admirably. Management astutely hedged their exposure on a rolling six-month basis and managed to protect the financial results. They were also able to push through three price increases since the start of the year.

When we adjust the company's EBITDA (earnings before interest, taxes, depreciation and amortization) for unusual charges, including the derivatives used to hedge commodity exposure, margins have shown excellent improvement, rising from 9.5% in the first quarter of 2006 to 12.5% in the third quarter of 2008. With dramatically lower wheat and oil prices, selling price increases, and a weaker Canadian dollar, Weston Foods should report solid earnings as the hedges roll off. Loblaw is currently in the midst of a three to five-year turnaround plan necessitated by intense competition and price wars in the food retailing segment. However, recent results demonstrate some positive trends. Same store sales increased 2.2% over the course of the first

nine months of 2008 and 3% in the third quarter. EBITDA increased 12.8% to \$1.18 billion year-to-date and 16.6% to \$499 million in the third quarter of 2008. Lower restructuring charges and cost reduction initiatives led to the improvements. On the company's recent conference call, management's outlook was conservative but we are cautiously optimistic that the same-store sales growth is sustainable and that margins have stabilized.

From an investment standpoint, we think that George Weston Limited offers the best way to play the story. Essentially, we can back out the implied value of Loblaw from each share of Weston. At recent prices, the Weston Foods operating division is trading at less than 4.5 times EBITDA, while comparables trade at 8 times EBITDA. In fact, Weston just recently sold its dairy operations that generated \$50 million in EBITDA for \$465 million, or 9 times EBITDA. As lower commodity prices are reflected in the financial results, the multiple on the bakery operations should expand.

Owning George Weston Limited also allows us to benefit from the improving operating and financial results at Loblaw. Further, we would like to point out that Loblaw owns approximately 73% of its corporate real estate and 46% of its franchise real estate. We have seen valuations in the range of \$24 to \$30 per share of Loblaw, which should provide a floor to the share price. We stand to benefit from any incremental gains driven by the improving results through our position in Weston.

Given the current market turmoil we have to look to the past to find what worked. We believe that, similar to our investment in Canada Bread in 2000, owning George Weston Limited should provide a solid investment return for patient value investors.

The shares closed on Friday at \$59.85 on the TSX. They also trade over-the-counter in the U.S. under the symbol WNGRF, however volume is thin. They finished the week on the Pink Sheets at US\$45.85.

Action now: Buy at current levels.

Members' corner - continued from page 6...

Response: There was hardly any media attention to this news and we thank our member, who is knowledgeable about the industry, for sending on this e-mail. We will closely monitor the situation but in the meantime all fertilizer-related stocks, including Viterra, should be treated as holds.

- G.P.