In the weeks leading up to Odlum Brown's 17th Annual Address, I had a really interesting experience with my two boys that provided some surprising insight for my presentation, which is titled *Stay in the Game*.

It all started when I was asked to talk to my son's grade-two class about my job. It was definitely a challenge, but it ended up being quite a fun experience.

In the class, I started a lemonade stand business, sold shares in the business, and then we watched the value of the shares go up as we sold lemonade and earned a profit. I think the class really came away with an understanding of why owning a piece of a business was a good thing for their savings.

But the really interesting part of the exercise for me came out of the preparation work that I did with the boys. Michael just turned 10 and Patrick will be eight in July. A couple of nights before the big classroom engagement, I started quizzing them about their understanding of my job — to get a sense of my starting point.

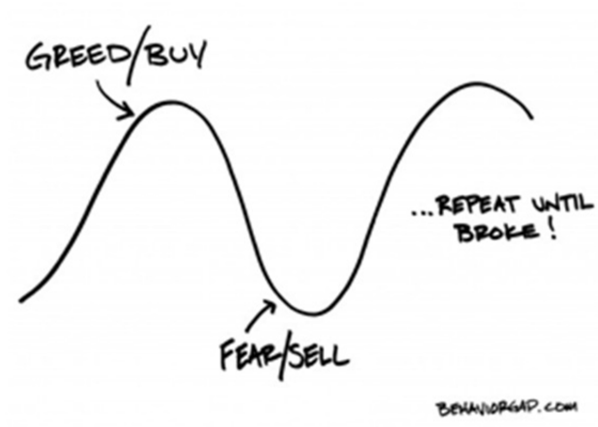
I can tell you that Michael and Patrick definitely know the difference between a bull and a bear market, probably because they have had stuffed bull and bear pillows for some time. But on this night the discussion quickly turned to a request to play *Stock Ticker*, a game I enjoyed playing when I was 11 or 12 years old.

Driven by a desire to teach my sons about investing, I sourced a used copy of the game from the internet a year ago. We played a few times and frankly I was a little disappointed, feeling the game was not as exciting as I remembered. However, this time was different. As we got the board out and started to play, I had a number of eureka moments as I realized that the kids were making mistakes that touched on the key themes I wanted to discuss at the Annual Address.

Stock Ticker

The game is relatively simple. Players are given $10,000 and can invest in six different asset classes: stocks, bonds, gold, silver, oil, and grain. Each asset starts on the board at a par value of a dollar and can rise as high $2 or fall as low as zero. Buying and selling is allowed at the beginning and periodically throughout the game (we agreed upon every three turns). Players take turns rolling three dice: one indicates the asset class — stocks or bonds; another designates the action — up, down or dividend, each with equal probability; and the final one specifies the magnitude of the price change or dividend — 5 cents, 10 cents or 25 cents.

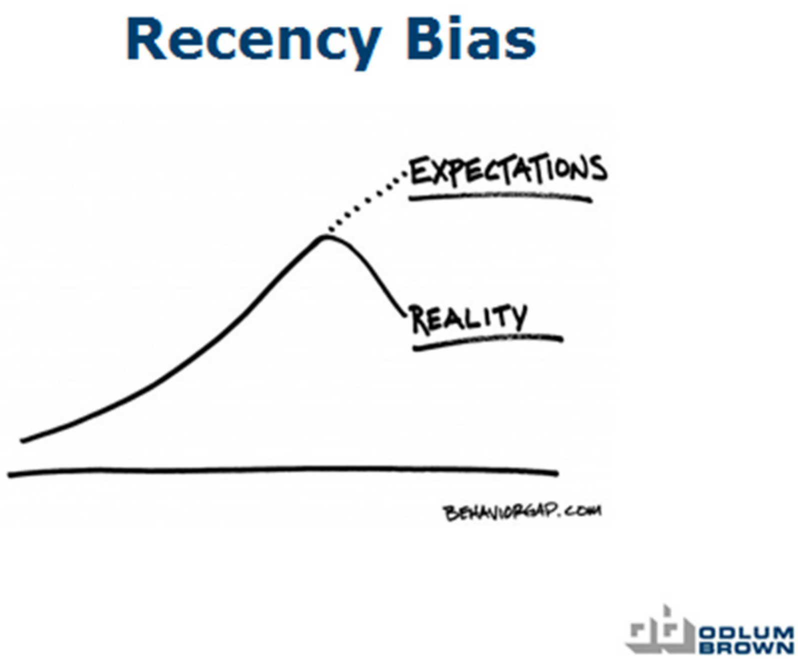
At the beginning Patrick bought $2,000 of bonds, $2,000 of silver and $2,000 of gold. Michael bought $2,000 of bonds and $2,000 of oil. We then rolled the dice and moved the asset class pieces or paid dividends accordingly. After three rounds, bonds had fallen to $0.80; gold, grain and stocks were $1.00, silver was $1.10, and oil was $1.80.



It was now time to trade. Both boys wanted to sell bonds and buy oil. I couldn't believe what I was hearing! These were MY BOYS and they wanted to buy high and sell low! And they were doing it without bond guru Bill Gross telling them to dump bonds or *Mad Money* host Jim Cramer hitting the "BUY, BUY, BUY" button and getting animated about oil. No. They were doing it because they saw a trend.

Their behavior was not rational!

While a game with dice always involves luck, the statistical odds of the various dice roll combinations are precisely quantifiable. The chance of oil moving up on the next roll of the dice was no better than the odds of bonds rallying, yet the boys favored oil presumably because they felt past rolls would influence future rolls.



My boys were suffering from what behavioral scientists call recency bias.

Had my boys realized that the odds of any one asset class moving up or down were the same, and if they appreciated that they could buy more shares of the lower priced assets and collect more dividends, they would have instead chosen to buy low and sell high.

The important insight from their behavior is to appreciate that it is human nature to allocate more money to investments that have worked well in the recent past. Because it is human nature to follow trends, most investors buy high and sell low and do considerably worse than the market averages over time.

We see recency bias and irrational behavior all the time in the real world.

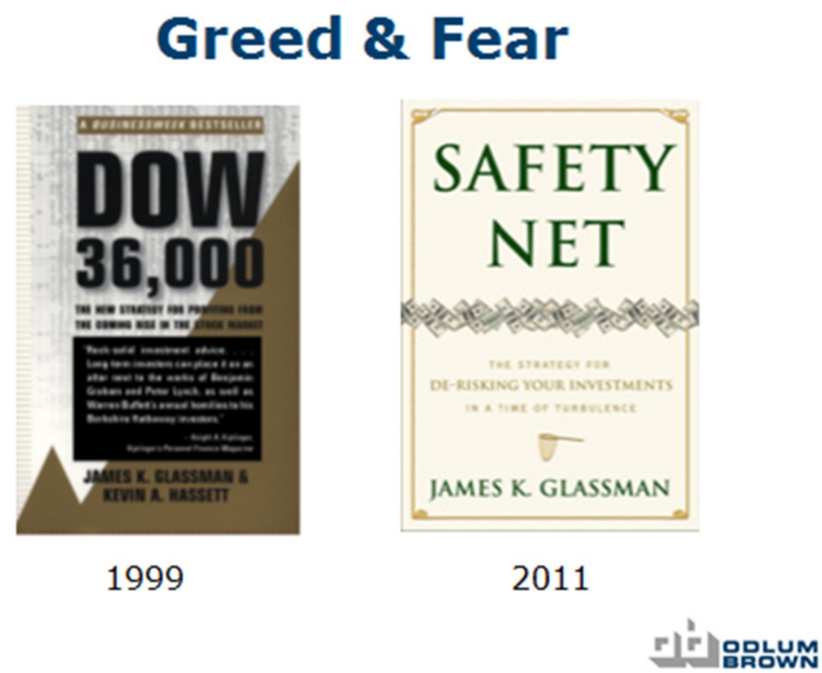
Think about what happened after 9/11. People stopped flying, yet the odds of another terrorist attack surely went down as a consequence of heightened securities measures.

Performance Breeds Complacency

June 2005

September 2010

In June 2005, *Time Magazine's Home $weet Home* cover showed a man hugging his home at the height of the U.S. housing bubble. Last September the cover story was "Rethinking Homeownership."



Here's another classic example of recency bias in action. In 1999, Journalist and diplomat James Glassman was so convinced that the good times would last that he co-authored a book titled "Dow 36,000." The Dow is roughly one-third that level today. His new book is called "Safety Net: The Strategy for De-Risking Your Investments in a Time of Turbulence."

Trends create visions of "new eras".

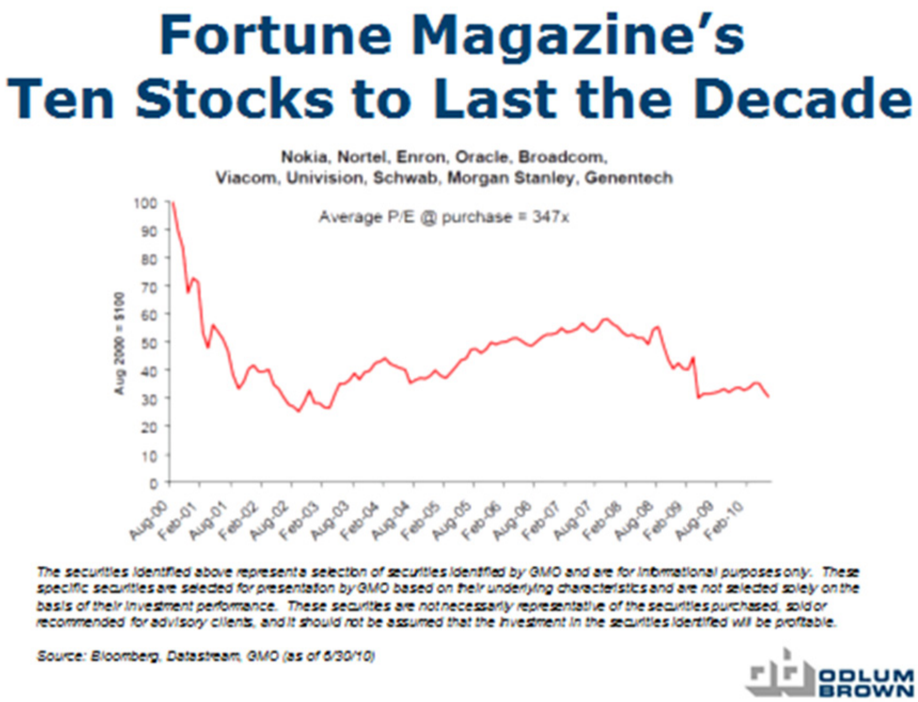
I can think of no better example than *Fortune Magazine's* list of "Ten Stocks to Last a Decade" that it published in August 2000.

To quote, *Fortune* said:

> *This is a NEW ERA and one that's bound to have its own heroes. To find out who those heroes might be, FORTUNE first identified four sweeping trends that have the potential to transform the economy. Any one of these four – the lightening-fast changes in communications networking, the brave new world of entertainment, the "boomerization" of financial services, and biotech's coming of age – is explosive by itself.*

Fortune went on to say:

> *The 10 names all share exceptional management and an ability to execute no matter what happens in the macro-economy – characteristics we think will be even more important if the economy slows and investors put a premium on those companies that post consistent numbers.*

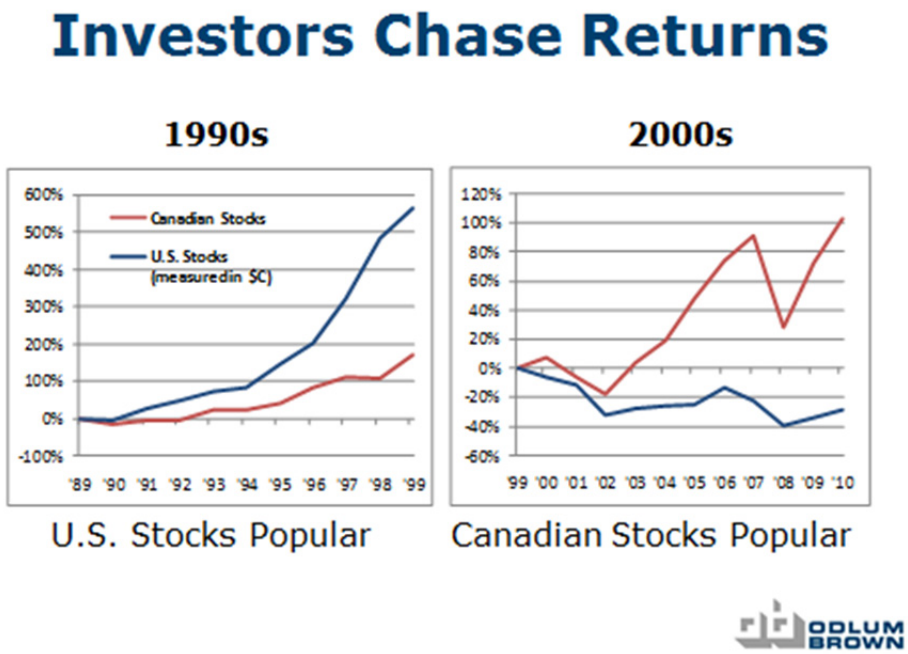


The 10 stocks were Nokia, Nortel, Enron, Oracle, Broadcom, Viacom, Univison, Schwab, Morgan Stanley, and Genentech. The chart highlights the cumulative performance of an equally weighted portfolio of the 10 stocks. If you invested $100 you would have just $30 today.

So much for new eras.

While fraud, in Enron's case, and bad management at Nortel, clearly undermined the performance of the portfolio, the general problem was that the stocks were too popular and too expensive, trading at an average of almost 350x EPS at the beginning of the period.

Trends are great, but only if you get in at a good price.



In the 1990s, U.S. stocks did so much better than Canadian stocks that Canadians became convinced that the American economy and stock market would continue to outshine Canada's. Not only had U.S. stocks risen 2 ½ times more than Canadian stocks over the decade in domestic dollar terms, but the ever-weakening Canadian dollar supercharged the returns for Canadians. As highlighted in the left-hand chart, the U.S. stock market produced a total return of 575% in Canadian dollar terms in the 1990s versus a gain of 173% for Canadian stocks. It was considered a NEW ERA and people thought our economy, stock market and dollar would remain inferior because Canada was too "old economy."

The world obviously didn't unfold as expected.

Since the turn of the century, the value of Canadian stocks have roughly doubled, if you include reinvested dividends in the calculation, whereas the S&P 500 Total Return Index is not much higher than it was at the end of 1999. When you add in the negative influence of the appreciating Canadian dollar, a Canadian would have lost 30% of their money since the turn of the century if they bought the U.S. Index.

Not surprisingly, Canadians are now biased to keep their money in Canada.

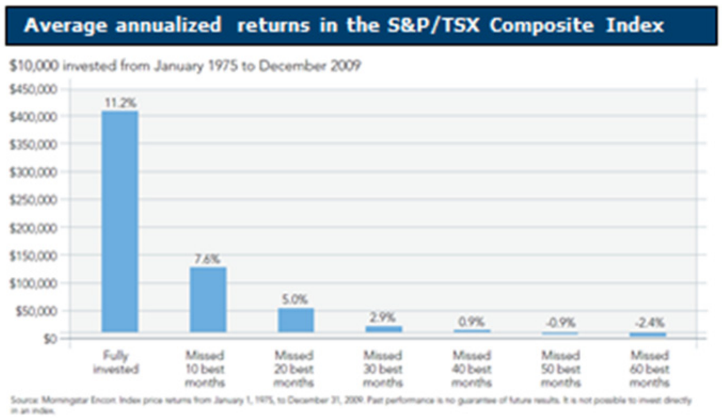
I'm going to circle back and talk about current trends and opportunities at the end of my presentation, but first I want to highlight a couple of other strategic blunders my kids made in the *Stock Ticker* game.

Aside from irrational trading instincts, the boys actually made a bigger strategic error before we started to roll the dice. They were not fully invested.

Recall that Patrick invested 60% of his money at the start, while Michael invested only 40%. Throughout the game, they both had a least 30% of their net worth in cash.

With equal odds of an asset class moving up or down on the roll of the dice, there was no advantage to waiting to get into the game, especially if they planned to buy high and sell low when they felt the time was right. In fact, the best strategy to increase the odds of wealth accumulation in the game is to be fully invested at all times, so that you can collect dividends. **That is also good advice for the real world.**

Market Time is Tough



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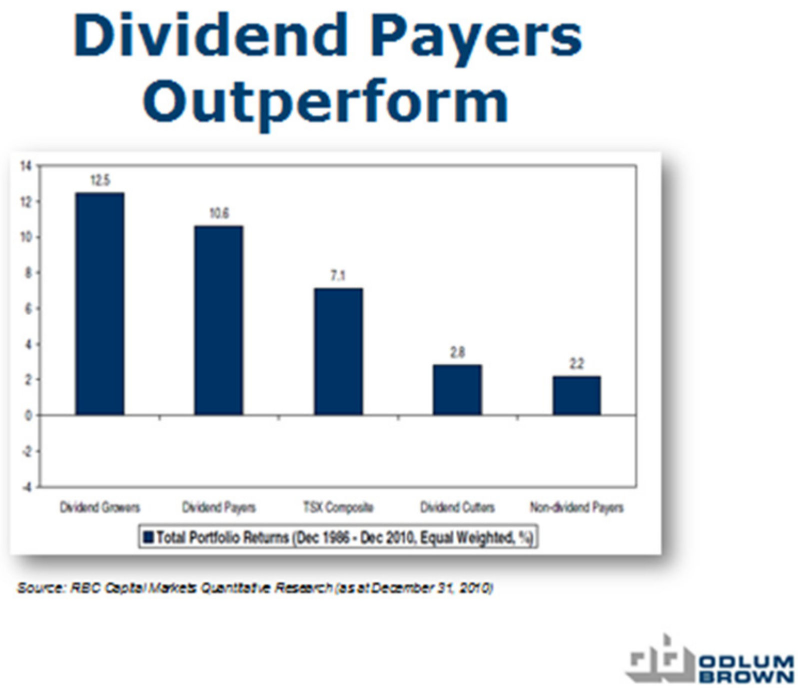
It is very tough to time the market well, because you have to get both the “buy” and the “sell” decision right. This great chart from Fidelity Investments shows what would happen to your return if you missed some of the stock market’s best months, many of which **incidentally** occur when the economy is in horrible shape. For example, if you were out of the Canadian stock market for the 20 best months between 1975 and 2009—less than 5% of the time—your average annual return would be just 5%, less than half of the 11.2% annual average achieved by the Index.

Given that it is human nature to undermine returns by buying high and selling low, most investors are best served by staying invested, riding the gyrations of the market and collecting dividends. In fact, studies have shown that dividends and dividend growth account for the vast majority of stock market returns over long periods of time.



Moreover, a recent report from RBC Capital Markets highlighted the superior performance of companies that pay dividends. Over the last 14 years, the total return from Canadian companies that regularly raise their dividends has averaged 12.5% versus 7.1% for the benchmark index. Those that didn't pay dividends provided a compound annual return of just 2.2%.

We could spend a lot of time debating what the economy and the stock market is going to do in the next 12 months, but at the end of the day nobody really knows. What I do know with a high degree of confidence is that good businesses will grow and increase their dividends over time. And, even though the stock market has had a remarkable recovery, there are still a lot of great companies that have good valuations and enticing dividend yields.

Let me mention a few:

Dependable Dividends

Company	Yield (%)
BCE	5.5
Power Financial	4.5
TransCanada	4.2
Fortis	3.7
TD Bank	3.3
Intact Financial	3.0
JPMorgan	2.3

BCE offers one of the highest dividend yields among large Canadian companies—at 5.5%, in part because investors worry about the future of the business. While there is no doubt that the traditional land-line business is in decline, the company is well positioned to benefit from people's need to stay connected. BCE isn't going to knock it out of the park, but I think you can count on a good dividend and modest dividend growth and capital gains.

Power Financial is another dependable dividend payer, with a current yield around 4.5%. It is essentially three parts exposure to the Life Insurance industry, through the company's investment in Great West Life, and one part exposure to the mutual fund industry, through an investment in IGM Financial, the company that runs Investors Group. Unlike Manulife, Great West's profits didn't get decimated in the financial crisis and the dividend was maintained.

TransCanada, with a yield of 4.2%, and Fortis, with a yield of 3.7%, pay dependable dividends because much of their businesses have a regulated rate of return. These businesses are also good inflation hedges, as they can generally pass price increases through to customers.

I'm not super excited about valuations and the opportunity for growth in the Canadian Banking sector, because the Canadian consumer is very leveraged, but I do like TD Bank. They don't have the highest dividend yield in the group — at 3.3% — but I do think they have the potential to deliver the best dividend growth as they grow their U.S. franchise.

I believe there is a lot more room for recovery and growth in the U.S. banking business than there is in Canada, and TD has created the biggest and best U.S. franchise among the Canadian banks.

Intact is in the Property and Casualty insurance industry. Its 3.0% yield is low relative to my other picks, but given that the industry trends are positive and considering that they are the best underwriter and the most profitable in the industry, I think they will deliver impressive dividend growth.

The last name on the list is JPMorgan. They haven't exactly been the model of dividend stability in recent years, but it makes my short-list because they have the potential to double their dividend over the next couple of years as the U.S. economy recovers.

A new yield-driven recommendation is Allied Properties.

They are a rapidly growing Real Estate Investment Trust that owns, manages and develops downtown office properties in Canada.

What makes them unique is that they redevelop old brick-and-beam industrial properties and turn them into high quality office space.

Not only do these redeveloped properties command higher rents, they also appeal to businesses because they are:

- Aesthetically pleasing environments;
- In desirable locations;
- Offering lower operating costs.

The trust has been expanding into western Canada, with recent purchases in Calgary, Vancouver, and Victoria. The picture is of a property on Cambie Street.

We like the management team and the fact that the trust's financial leverage is lower than most REITs. The current distribution yield is 5.8% and we think there is scope for it to increase.

Having talked about the pitfalls of trend following and market timing, I want to conclude with a word about diversification.

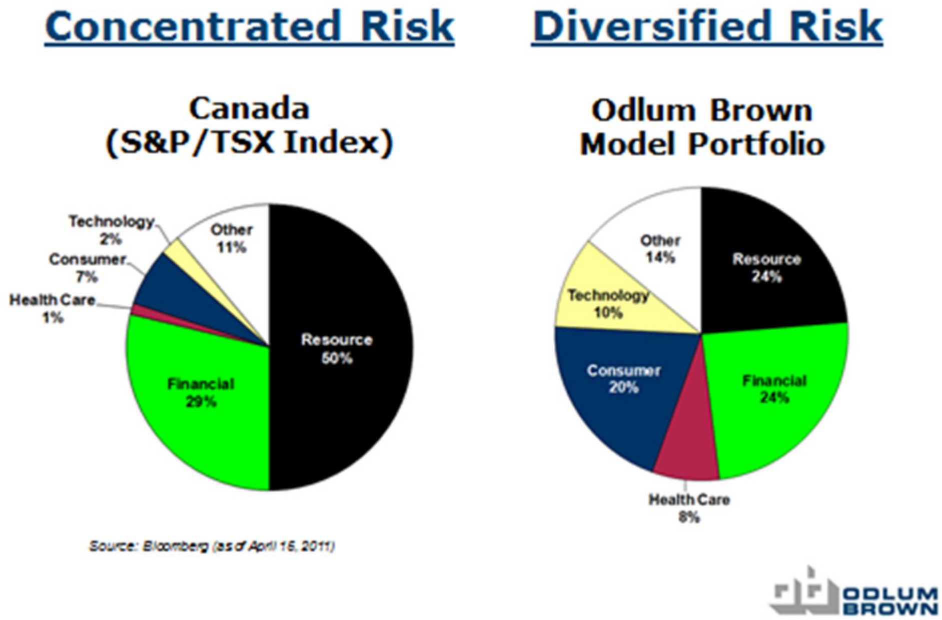
Diversification

In the game of *Stock Ticker* there is no statistical advantage to wagering on just one asset class or diversifying across multiple asset classes. However, the outcomes will vary greatly in a game with a limited number of rolls. A concentrated approach will yield big gains if a player is lucky, or big losses if a player is unlucky, whereas a diversified approach will yield steady wealth accumulation as dividends are collected and capital gains and losses cancel each other out.

Given that *Stock Ticker* is just a game, it may be desirable to employ a concentrated approach and hope to be lucky, as the bragging rights that come with winning the game probably carry more weight than the disappointment of a loss. In the real world, where a big loss can be devastating to a person's lifestyle, a diversified investment approach is always sensible.

The most important thing that we do as investment advisors is to make sure that our clients are appropriately diversified. And this is something that you have to discuss with your advisor, because there is not a one-size-fits-all answer. The right amount of diversification and the balance between stock, bonds, real estate, and other asset classes is a function of individual goals and risk tolerance.

Within my equity sliver of the asset mix pie, my biggest concern is that people aren't diversified enough.



As I have highlighted numerous times in the past, the Canadian stock market is extremely concentrated, with Resource stocks and Financials accounting for almost 80% of the benchmark index.

Because it is **human nature** to overweight sectors that have performed well and since most money managers don't like the **career risk** that comes with being different, most Canadians have stock portfolios that are very much concentrated along the lines of the S&P/TSX Index.

We don't think that is prudent and consequently have been recommending a sector mix that is much more balanced. And because there are few high quality, world-class companies outside of the Resource and Financial sectors in Canada, that strategy has involved diversifying outside of the country. In fact, in recent years more than 40% of our Model Portfolio has been invested outside of Canada.

Canada

On Top of the World (Again)

Indices	2010 Return
TSX Composite	17.6%
India Sensex 30	15.8%
S&P 500	9.4%
Dow Jones Industrial	8.1%
Australian All Ordinares	7.2%
Japan Nikkei 225	5.4%
German DAX	2.7%
Brazil Bovespa	0.5%
UK FTSE 100	-0.2%
Hong Kong Hang Seng	-0.4%
France CAC 40	-14.4%
China S.E. Shanghai A	-16.3%
Italy Stock Market	-18.4%
Spain Madrid Index	-28.4%
Greece Athens S.E. General Index	-43.0%

Source: Leith Wheeler Investment Council

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Canada was the world's best performing major stock market last year, so clearly an all-Canada, concentrated approach would have yielded better investment returns and cocktail party bragging rights than our diversified strategy.

Still, I firmly believe that a diversified approach is the right thing from a risk management perspective.

We still have a majority of our Model Portfolio invested in Canada and, on that basis I hope Canada's superior performance continues.

But, I do think it is going to be a tougher environment for Canada and our stock market to remain on top.

Given the huge resource weight in the Canadian index, the call really comes down to a view on global growth and the impact it will have on commodity prices.

I think global growth is going to slow and frankly, I wouldn't be surprised if people started worrying about deflation again later this year or early in 2012.

Governments and central banks succeeded at stabilizing the global banking system and getting the world back on its feet, with enormous amounts of fiscal and monetary stimulus. **But now that bond market investors are worried about government finances and central banks are worried about inflation, that stimulus is being taken away.**

In the developed world, governments are being forced to cut spending and increase taxes and that is going to be an ongoing drag on global growth. I believe the private sector is now strong enough to carry growth, but it is still going to be a muddle through, slow growth affair.

Emerging markets have a different problem. The stimulus has worked so well that inflation is a serious issue. Food inflation, in particular, is causing a lot of social unrest in the developing world. If governments in the emerging world want to stay in power, they are going to have to get food inflation under control and the only way they are going to accomplish that is with tighter fiscal and monetary policies that slow economic growth. They are far from being on top of the problem, but they are starting to catch up. China, in particular, has really stepped up its efforts to limit credit creation by raising interest rates and bank reserve requirements.

So, with governments in both the developed and developing worlds taking the stimulus away, I think global growth will slow, and that in turn will likely take some of the momentum out of the commodity bull market and the resource leveraged Canadian stock market.

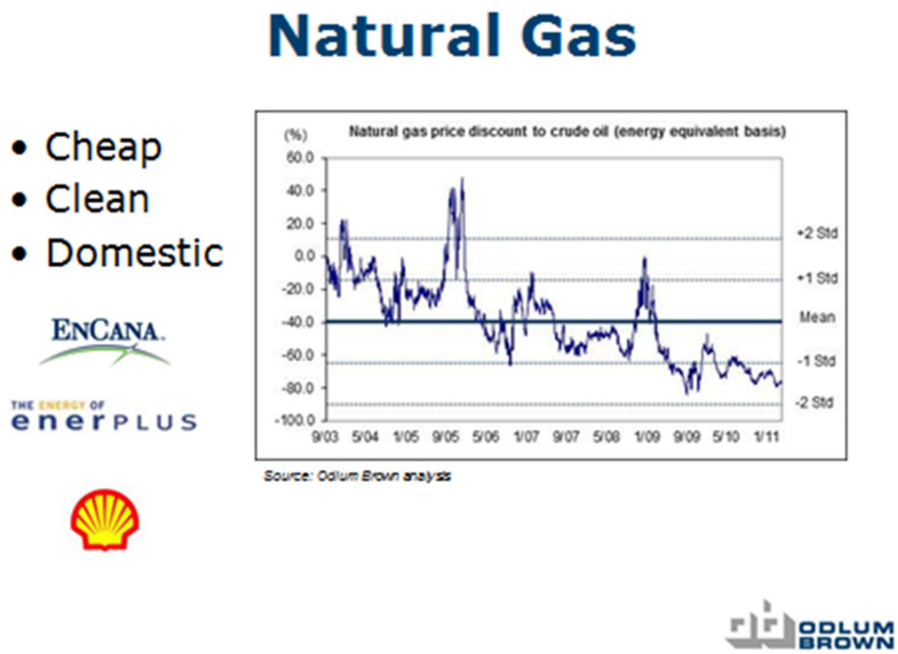
Over the long-term, I remain optimistic about the positive influence emerging markets will have on commodity prices and, for that reason, I think it is a good idea to have some exposure to resource stocks.

But I wouldn't get carried away with an index-like weight of 50%, because the valuations are simply not what they were when the great commodity bull market got started a decade ago.

Commodities

Don’t forget about recency bias and the likelihood that the optimism toward commodities is being influenced by the fact that we have just lived through the most powerful commodity bull market in two centuries.

The point is illustrated by this chart that highlights the rolling 10-year compound annual return from commodities over the last 200 years. As of March 2011, the 10-year CAGR was at a record 12%. While I don’t know if the trend will continue, I do know that we are in uncharted territory.



The one commodity that has been left behind in the bull market, and that few like, is natural gas.

There are three reasons why I think it deserves your attention:

1. In North American, it's one quarter the price of oil, on an energy equivalent basis.
2. It's cleaner than oil and coal.
3. And it's abundant domestically.

From an economic, environmental, and political perspective, natural gas can solve a lot of problems, and we think it ultimately will.

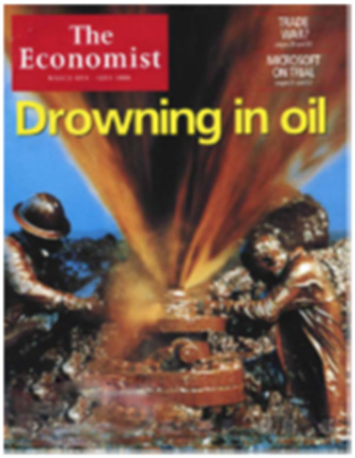
Natural gas leveraged stocks that I think you should own include: Encana, Enerplus, and Royal Dutch Shell.

Encana (2.3%) is our top pick in Canada, given its vast and low-cost reserves.

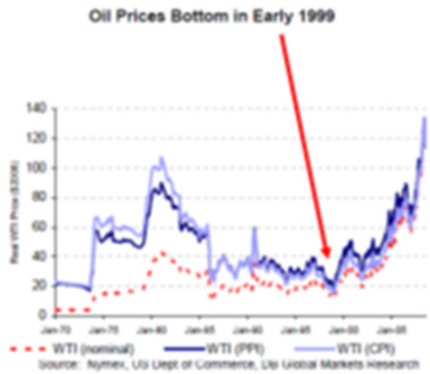
Enerplus is a Canadian royalty trust with a current distribution yield of 7%, a strong management team and a growth-oriented business model.

Internationally, Royal Dutch Shell is the most leveraged toward natural gas among the major integrated producers. We also think it has one of the best growth stories and consider it one of the most attractively priced energy stocks, with a current dividend yield of 4.5%.

They Don't Say
"Buy" at the Bottom



March 1999



I know everything you read about the outlook for natural gas is negative, but let me remind you that the experts and media weren't telling you to 'buy' oil at the bottom back in 1999 when the *Economist Magazine* carried a cover story titled *Drowning in Oil* and speculated that oil prices could go from $10 to $5.

Oil never did fall to $5 a barrel. Demand and supply conditions tightened and oil prices recovered. Nonetheless, energy stocks remained underappreciated and undervalued for a long time. We were overweight energy stocks relative to the Index in the late 1990s and the early part of the last decade, and I remember it being a very frustrating time.

We owned a number of energy stocks that had great growth profiles and yet they traded at only 3 to 4 times cash flow when oil was less than $25 a barrel. Repeatedly, I asked Jim Bartlett, our resource analyst at time, "When will anyone care?"

Fortunately, patience ultimately paid big rewards, with energy stocks being big contributors to our long-term record.

This slide highlights a number of the foreign firms that we like.

The shares of these companies are behaving like oil stocks a decade ago and it is quite an unusual situation.

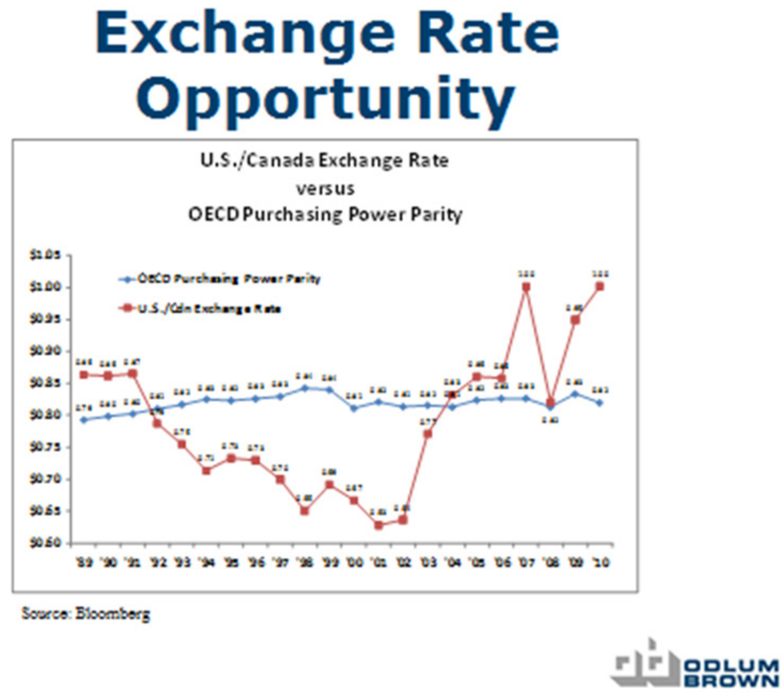
Investors are normally faced with a trade-off between quality and price — a premium price for higher quality companies or a discount price for lower quality companies. The anomaly in today's market is that it is the highest quality companies that trade at discount valuations relative to the general market.

The situation is both frustrating and exciting.

It's frustrating because we own a number of very high quality, foreign multinational firms, which keep getting cheaper relative to their underlying earnings and the average company, despite business performance that is generally very good.

It's also an exciting situation because the depressed valuations mean the stocks represent opportunities with relatively low risk and high return potential.

I've talked about these stocks ad nauseam in newsletters and at recent presentations, so I won't bore you with the details again today, other than to say that I'm most optimistic about the prospects for foreign multinational firms and their share prices.



I know that I'll get a question about the Canadian dollar and the currency risk that comes with buying foreign stocks, so I'll address that now.

My thinking is very straightforward. Note that the title of the slide says exchange rate "opportunity" and not "risk."

A decade ago, I believed that the Canadian dollar was undervalued and that U.S. stocks were grossly overvalued. Consequently, I told people to keep the vast majority of their money in Canada. Today, I believe the opposite is true, which is why I'm telling you to diversify beyond Canada's borders.

I don't know how long the Canadian dollar will stay overvalued or when investors will recognize the great values we see in foreign multinational firms, but I do know that these companies have the competitive advantages, financial strength, and global reach to do much better than average over the long-term.

Just as maintaining our conviction on Energy stocks ultimately paid-off, I'm confident that we will be happy with our investments in foreign multinational firms in the long-run.

So, if you are not yet diversified beyond Canada, now is a great time to take advantage of the strong Canadian dollar and buy world-class multinational companies at discount prices.

Let me conclude by telling you how the game of *Stock Ticker* ended.

Unfortunately, Michael and Patrick used a fairly concentrated strategy throughout the game and didn't get lucky, whereas my strategy of being fully invested and diversified across the asset classes led me to collect the most dividends and wealth over the course of the game.

Odlum Brown Model
Discipline has Rewards

The same strategy has served us well in the real world, with the Odlum Brown Model Portfolio doing pretty well relative to the major North American equity benchmarks over time.

Our greater level of diversification has held us back a bit in recent years, but I'm confident that the strategy will produce less volatility, more dividends, and greater rewards over time.

The next time I play *Stock Ticker* with my boys, I hope they will take my advice—buy low and sell high, diversify, and stay invested. I hope you will too.

Thank you for your time.

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