Lionridge

CAPITAL MANAGEMENT INC.

Portfolio Manager Commentary — Spring, 2012

WINNING BY PLAYING A DIFFERENT GAME

We are pleased to have completed the first year of our new Total Equity Portfolio for individual clients, particularly as our results have been so strong. Having beat our benchmark* by over 7%** in the 12 month period ending March 31, and the major Canadian equity index by 16%** in that period, I have had numerous questions as to how I managed this. What's particularly interesting are the comments of some individuals in the brokerage industry that I speak to, who assume that I can only have achieved such results by way of an active trading strategy.

When I try to explain that these returns are not the result of active trading but rather are the product of rational investing, I'm sometimes met with either skepticism or looks of puzzlement. In an investment industry that's focused on selling flavor of the day investment products, many forget that markets are ultimately just a venue through which to buy fractional ownership of companies and that focusing on fundamentals provides a significant advantage.

Along with the ability to pursue an independent and objective investment approach, I've always asserted that an advantage of dealing with a professional portfolio manager who's not affiliated with an investment brokerage is that there is a much better alignment of interests with those of the clients. A recent development that I find interesting is the new initiative from the brokerage industry's regulatory body to impose a "client relationship model" upon its members. These new guidelines impose tighter requirements in areas such as disclosure of conflicts of interest, suitability requirements and account supervision. Although a positive step, it also makes clear the inherent issues that have always existed in the broker-client relationship – ultimately brokers do not have a fiduciary responsibility with respect to their clients. Portfolio managers like Lionridge have such a responsibility – we are entrusted with the responsibility of providing you a service as opposed to selling you products.

In my last commentary I expressed concerns I have with potential economic issues, and I remain cautious in my outlook. It is with this sense of caution that I continuously review our holdings with an eye to being very defensive, and in that context decided to sell off our holdings in Goldman Sachs. Although I'm confident as to Goldman's long term prospects, concerns over potential issues led me to conclude that the current price does not offer enough of a margin of safety to sufficiently protect us from loss of capital. Another recent change is the sale of our holdings in Encana. I purchased this stock on the theory that the long-term demand fundamentals for natural gas are strong and that gas prices are abnormally low. I have now concluded, however, that supply dynamics will likely keep prices depressed to a degree much greater than originally anticipated. I would potentially reenter this position at a lower price, but the current stock price does not provide a sufficient margin of safety and potential for upside.

With these changes, the cash in our portfolios has risen to almost 20%. I am continually scanning the markets for good opportunities to deploy this cash. In the meantime I will remain patient until I find them, keeping in mind my dual objectives of growing your capital and protecting your capital.

At your service,

Hardev Bains
President & Portfolio Manager

Investment Highlight – Johnson and Johnson

Johnson and Johnson (JNJ) is a truly global company, with more than half of its revenues coming from foreign countries (including a strong presence in emerging markets). It operates in three main categories:

- Consumer products - JNJ markets strong brands such as Band-Aid, Johnson's baby products, Neutrogena, Nicorette, Listerene, and Splenda;
- Pharmaceuticals - JNJ is a good operator in this category with a robust pipeline of new drugs;
- Medical Devices and Diagnostics - JNJ operates in various categories including orthopaedics, cardiovascular, vision care, and diabetes and insulin delivery.

JNJ has all the attributes we look for in a company to invest in: stability and growth in its end-markets, strong competitive positioning, great balance sheet, strong margins and cash flow generation, and very high returns on capital resulting in significant creation of shareholder value.

The stock has been under a bit of a cloud over the last couple of years due to operational issues that we are confident are being dealt with properly. More significantly, this is a classic case of a stock that has evolved from a glamour stock to a value opportunity. Although JNJ's earnings have almost doubled over the last 10 years, its stock price has barely moved. Investors once euphoric over high growth are now punishing this great company whose growth has moderated, providing a great opportunity for rational and patient investors like us.

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*Benchmark: 45% TSX Total Return; 35% S&P500 Total Return (Cdn $); 20% MSCI EAFE (Cdn $)