

CROFT

ECONOMIC OUTLOOK & MARKET FORECAST

April 2011



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Risk re-enters the market

While the devastating earthquake and tsunami in Japan overshadowed other concerns for equity markets in March, a number of key risk factors conspired to keep markets subdued in the first quarter. War in Libya and spreading unrest in the Middle East were just two pieces of a bigger puzzle that included slowing export growth in China and Germany and the slow-motion default of eurozone peripheral nations.

The massive Japanese earthquake and widespread damage raised fears that the world's third-largest economy could suffer economic setback as demand softens and government debt increases while it deals with rebuilding efforts. Japan's already weak economic recovery is likely to be further hampered by rising bond yields as new government debt is issued. Knock-on effects were felt immediately in global commodity markets, because Japan imports nearly all its commodity needs. Prices for crude oil, copper, and other metals dropped as news of the quake followed earlier reports of China's unexpectedly large trade deficit and accelerating wholesale and consumer price indexes.

Japan was already in fiscal meltdown, with national debt at 225% of GDP and a deficit running at 8%, before suffering the after-effects of one of the strongest earthquakes in history. Now, as the Bank of Japan provides even more liquidity to the country's shocked financial system and doubles its asset purchase program, the threat to financial stability has increased substantially. The G-7 nations, including Canada, began intervening in foreign exchange markets to dampen the yen's rapid rise on speculation that cash held in foreign investments would be repatriated to finance reconstruction.

Meanwhile, a flare-up of civil unrest in Saudi Arabia in March, though quickly downplayed by most analysts, was precisely the symptom of contagion that investors had hoped Saudi Arabia would avoid. Saudi Arabia is the world's second-largest producer of crude oil, after Russia, and the "supplier of last resort" in the event of disruptions in other member states of the Or-

ganization of Petroleum Exporting Countries (Opec). Most recently, Saudi Arabia agreed to pump another million barrels per day to replace the supply lost as warring factions in Libya’s nascent civil war do their best to destroy the country’s only source of economic growth.

In the world’s largest economy, meanwhile, economic growth appears to be gaining traction, but the US Federal Reserve Board is unlikely to end its stimulus program prematurely.

Quantitative easing, or the extraordinary purchase of government debt by a central bank in order to create money, has been the cornerstone of the US Federal Reserve Board’s efforts to revive the US economy. The Fed’s \$600 billion purchase of Treasury debt, christened QE2, will continue through to June, even though Fed Chairman Ben Bernanke has already acknowledged that economic growth is slowly becoming self-sustaining.

The US unemployment rate dropped to 8.8% in March, while 216,000 new non-farming jobs were created in March, following a gain of 194,000 in February. High labor productivity is keeping a lid on the wage component of inflation. Core inflation at an annual 1% in January remains well below the Fed’s implicit 2% target.

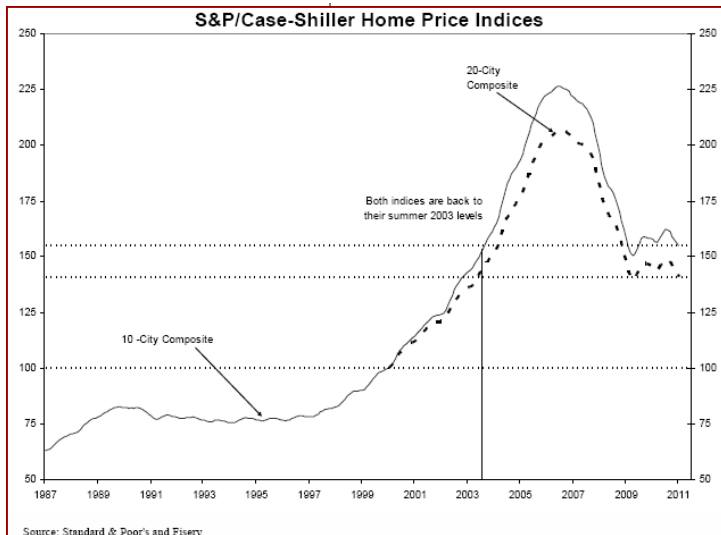
US consumer spending keeps inching up, a necessary precondition for sustainable economic growth. In February, consumer spending rose 0.7%, the eighth straight monthly increase. However, consumer spending increases alone aren’t enough to pull this particular train. First, we need to see a convincing turnaround in residential real estate.

As we’ve argued in previous commentaries, we still need to see greater stability in US housing prices, foreclosures, and sales. Unfortunately, that didn’t happen in the first quarter. The US Census Bureau reported that new home sales fell 17% month over month in February. That was the slowest pace since 1963, when the Census Bureau began tracking home sales. In addition, the median price dropped 13.9% month over month to US\$210,000, the lowest since December 2003.

So while business investment is beginning to revive, we still have concerns that the all-important US consumer, with a good chunk of their net worth tied up in residential real estate, is mired deep in the de-leveraging process, paying down debts and cleaning up personal balance sheets. That militates against any precipitate action by the Federal Reserve Board to end the era of extremely easy money.

Bolstering the argument against ending quantitative easing, US consumer sentiment in March fell to 68.2 from 77.5 in February, its lowest point in five months and its biggest one-month drop since October 2008. Surging gasoline prices and rising inflationary expectations were largely to blame.

CHART 1—US HOME PRICES: STILL LOW



In Canada, meanwhile, Statistics Canada reported that the headline consumer price index eased just a notch in February to an annual rate of 2.2% from 2.3% in January. Core inflation, which is the focus and obsession of central bankers everywhere, actually fell to an annual 0.9% from 1.4% in January. The Bank of Canada's projection for first-quarter inflation of 1.4% increasingly seems to be on the high side.

Manufacturing activity remained in growth mode too. The Institute for Supply Management's monthly gauge of US manufacturing for March came in at 61.2. Any reading over 50 signals growth in the manufacturing sector. While very healthy, the pace of growth eased very slightly from the February index reading of 61.4.

In Canada, manufacturing continued to power gross domestic product higher in January. Powered by heavy metal (cars and their parts, mostly), the manufacturing sector in Canada rose a 2.8% from the December, its best monthly growth since 2002. With assembly lines rolling and plants opening up all over the place, Canada's first-quarter 2011 GDP growth is now expected to come in somewhere around 4% annualized, considerably higher than the Bank of Canada's previous estimate of 2.5%.

All that employment and spending buzz in the US sent crude oil surging, so that nearby contracts for future delivery of West Texas Intermediate, the North American benchmark, traded at US\$108 per barrel. That, and the generally robust economic growth outlook for Canada, made the loonie more valuable against the US dollar, to the tune of US\$1.05 by April.

The "superloonie" had the Bank of Canada once again nervously warning exporters that weakness in the export sector is likely to continue given the strength of the Canuck buck, cutthroat international competition, and sluggish productivity growth in Canada. Still Canada seems a haven of fiscal prudence in comparison with basket cases in other parts of the world.

The eurozone is a case in point. Through the first quarter, the 17-nation common currency area could not come to an agreement on how to boost the bailout package need to keep Ireland, Greece, Portugal, and possibly Spain solvent. Put simply, the question always comes down to who should foot the bill, and Germany, as the region's strongest member, is balking at presenting "Die Rechnung" to its taxpayers, especially as Ireland's newly minted government has drawn a line in the sand over raising corporate tax rates.

The simmering peripheral-country debt crisis showed no sign of any quick resolution as the first quarter drew to a close, even as Portugal's caretaker administration finally moved to ask for a bailout from the eurozone. Moody's Investors Services downgraded Spain's credit rating and chopped Greek debt another three notches to B1 from Ba1, and Irish Prime Minister Enda Kenny rejected Germany's demand for a common European corporate tax base as a

CHART 2—US EMPLOYMENT COMEBACK



Courtesy National Bank Financial

condition for easing bailout terms for Greece and Ireland.

Germany's Chancellor Angela Merkel is facing stiff resistance at home from any further attempts by the European Union to have German taxpayers foot the bill for peripheral-nation fiscal irresponsibility. With several key German state elections in the offing, Merkel is unlikely to yield much ground, so the impasse on any longer-term solution is likely to continue, as the temporary band-aid European Financial Stability Facility ticks along on life support. Yields on European peripheral bonds have risen steadily as the crisis deepens, with yields on 10-year Greek bonds touching 12.82% in March, Portugal at 7.77%, and Spain at 5.48%, compared with 10-year German bunds at 3.21%.

European inflation has been creeping higher and stood at an annual rate of 2.3% in January, a 27-month high. More inflation is widely anticipated as higher oil prices kick in. Concerned about top-line inflation, the ECB therefore increased rates by 25 basis points, to 1.25%, in early April.

The ECB's hawkishness contrasts with the Bank of England's reluctance to tighten policy, despite inflation running at an annual 4% rate in January, two percentage points above the Bank of England's target. The BoE kept its key rate at 0.5% in March, for the 25th consecutive month and left its bond purchase program intact. The UK's economic recovery continues to be sluggish, facing headwinds from slow consumer spending and a moribund housing market.

OUR FORECAST – CANADIAN GDP: In Canada, domestic demand has been accelerating on strength in consumption. Domestic demand is 3.6% higher now than at its peak before the recession. And in the first quarter, real domestic income grew 5.4% quarter over quarter. Together with a manufacturing sector that's been pushing shipments out the door at an ever-faster clip (an increase of 5.5% in January sales), an astonishing jump in factory employment (79,000 new jobs in the first quarter) and a steadily falling unemployment rate (7.8%) augur well for sustained growth for the rest of the year. Business optimism remains high as credit is readily available, allowing for increasing business investment. While vulnerabilities remain, of course, given the still sluggish economic growth in the US, we believe Canada's gross domestic product will grow between 2.5% and 3.0% in 2011.

OUR FORECAST – US GDP: While economic growth in the US has very probably become self-sustaining, it is still very sluggish, and we believe it will remain sluggish for the rest of the year. Commercial lending has shown signs of life in the first quarter, and small-business confidence is on the rise in anticipation of higher sales. Moreover, businesses with a lot of cash on their balance sheets are beginning to deploy that cash into investments in machinery and equipment as demand continues to grow. Productivity remains high, providing a cushion under profit margins despite rising input costs from lofty raw materials prices.

Clouding the horizon, however, are elevated crude oil prices (and by extension, gasoline prices), which may chip away at discretionary consumer spending if sustained, and thus weigh on GDP growth. In addition, while job gains rose at a rate of about 200,000 per month in the first quarter, the number

ought to be higher at this stage of post-recession economic recovery, even as the unemployment rate remained stubbornly high in March at 8.8%.

While we therefore maintain our outlook for US GDP growth at between 2.75% and 3.25% for 2011, we believe the balance of risk has shifted somewhat, and our outlook is biased toward the mid to low end of that range.

Interest rates, inflation, dollar

You can bet your bottom loonie that the BoC is closely watching for creeping price pressures. It's held off on raising its target overnight lending rate for the past couple of announcements, despite a headline CPI of 2.2%, but that little gravy train might be coming to an end. And, depending on what the US Federal Reserve Board does, Canadian rates might just be poised to rise.

Putting it all together, Canada's money-printing operation isn't spinning wildly out of control. Headline prices are indeed creeping ever higher as food and energy costs rise. But wage growth remains on the cool side. While the BoC might still hold off on raising its target overnight rate from the current 1% level in its April announcement, intimations of a faster pace of economic growth and a resumption of inflationary pressure in the second half of the year might well stimulate the Bank to pull the trigger in May.

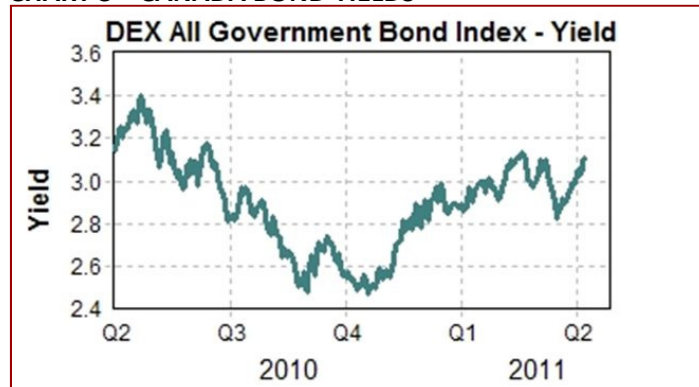
Canada's relatively healthy fiscal position took a hit in the first quarter, however, as the federal government's pre-election budget projected deficits of about \$100 billion over the next three years – the bill that's coming due for all that “stimulus” spending undertaken through the recession. Even more alarmingly, bond-rating agency Moody's Investors Services warned that deterioration in provincial finances could become a problem unless politicians find the political will to implement spending cuts – something the agency says is at risk given impending elections in as many as seven provinces this year.

Canadian bond yields spiked in the first quarter, as benchmark 10-year yields rose to 3.5% in February, while 2-year yields touched 1.9%. However, in the wake of the Japanese earthquake and tsunami, bond prices surged, fading slightly by the end of the quarter, with 10-year Canadas yielding 3.35% and 2-year bonds at 1.82%.

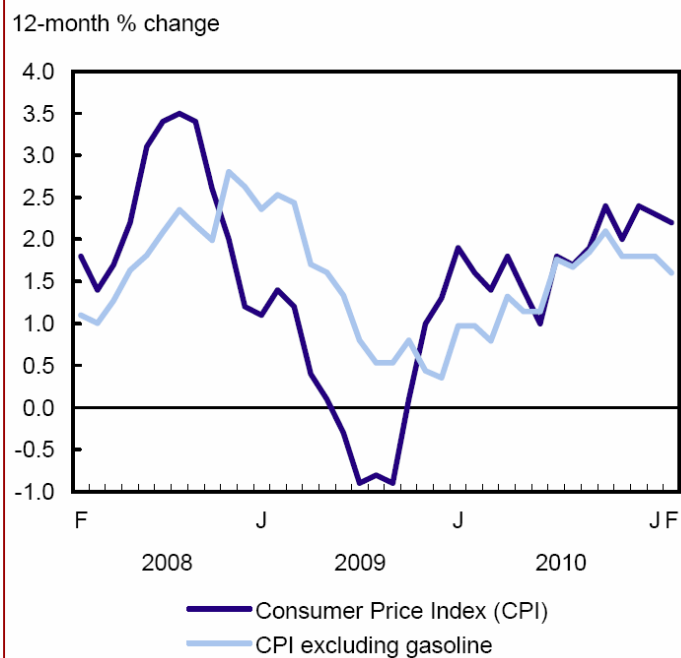
Although the European Central Bank pulled the trigger on a rate increase in early April, given the still-fragile nature of economic recovery in the US, we don't anticipate any significant rate increases by the US Federal Reserve. If inflation appears to be edging consistently above the Fed's implicit 2% target, then we might see a nominal rate hike later this year. Bear in mind though, that any increase will start from an effect base of zero. So a 25-basis-point hike could hardly be called “tightening.”

OUR FORECAST – CANADIAN RATES: In Canada, the Bank of Canada will take its cue from the US Fed. Even if Canadian inflation stays stubbornly above the BoC's midpoint 2% target, the BoC will be loath to hike rates in advance of a US move, for fear

CHART 3—CANADA BOND YIELDS



Courtesy PC Bond Analytics

CHART 4—CANADIAN INFLATION**The 12-month change in the CPI and the CPI excluding gasoline**

Courtesy Statistics Canada

of widening the spread over US Treasuries. So a Bank of Canada rate hike, if it comes at all this year, will most likely follow a US hike.

The Bank of Canada chose not to raise rates in its April announcement, leaving the target overnight rate unchanged at 1%. While the BoC raised its forecast for Canadian economic growth to 2.9% for 2011, it believes the strong dollar will suppress inflation with weaker exports and falling import prices. In fact, the Bank warned that “persistent strength of the Canadian dollar could create even greater headwinds for the Canadian economy.” Looks like that part of the equation is valid enough. Canada’s trade surplus fell to near zero in February, as both exports declined and import prices weakened on lower automotive and energy volume.

Given the outlook for Canadian GDP growth, mounting energy prices, and steadily rising inflationary pressures, we believe the headline Canadian consumer price index will rise to between 2.5% and 3.0% by the end of the year, with a better than even probability that it will climb to the higher end of that

range. The Bank of Canada will accordingly shift to a more hawkish stance, and gradually raise its overnight rate in the second half, to end the year between 1.5% and 2.0%. Any move by the US Fed to begin hiking rates after the end of QE2 in July, by even a minuscule amount, can be seen as a clear signal for a BoC rate move.

OUR FORECAST – US RATES: The Fed’s preferred inflation gauge, something called the core price index for personal-consumption expenditure, rose 0.9% year over year in February, up slightly from January’s 0.8% reading. The all-items index, which includes food and energy prices, rose an annual 1.6%. So US consumer price inflation is still tame. But it’s stirring.

While the Federal Reserve Board continued to play down any inflationary threats, headline inflation jumped to an annual rate of 2.7% in March, driven by a 27.5% jump in gasoline prices. The energy component of the all-items consumer price index climbed 15.5% in March. Core inflation, which excludes food and energy prices, climbed only slightly, to an annual rate of 1.2%. Fed Vice-chair Janet Yellen said that US monetary policy “continues to be appropriate,” meaning that the Fed is not likely to begin hiking interest rates anytime soon.

But while Fed Chairman Ben Bernanke and Vice-chair Yellen hold sway over Fed policy, the number of dissenting voices continues to grow. Regional Fed bank presidents of Dallas, Richmond, Philadelphia, and St. Louis believe that the Fed should start pulling back now. Another big boss agrees, and put his rather substantial money where his mouth is.

Bill Gross, founder and chief investment honcho at Pacific Investment

Management Co., manager of the world's largest bond fund, shorted his fund's US Treasury holdings in April, so that the fund's net Treasury position is now around -3%. That move comes after Pimco had already sold all of the fund's Treasury holdings in March. The reason is simple: Mr. Gross feels US Treasury yields are simply too low and are bound to rise as the economy grows and inflation increases. Mr. Gross goes further, of course, opining that the massive US federal debt will be "monetized" – that is, paid off in inflated dollars via the printing press and currency devaluation. Hence his exit from US debt.

And with the Fed committed to complete its full second round of quantitative easing (QE2) by June, there's a very good probability that inflation will begin to garner more than a fleeting reference buried deep on page C17 of the business section. The Fed left rates unchanged at between 0% and 0.25% in its April announcement. And consensus is that the Fed won't pull the trigger on a rate hike until next year. But there is a growing faction that believes a rate hike could come as early as the second half of this year.

Accordingly, we think the odds are in favour of at least a small rate hike in the latter part of the year, following the end of QE2. The US federal funds rate is therefore likely to be increased to between 0.25% and 0.75% by the end of 2011.

OUR FORECAST – CANADIAN DOLLAR: Higher and higher for the Canadian dollar, too. All that employment and spending buzz in the US sent crude oil surging, so that nearby contracts for future delivery of West Texas Intermediate, the North American benchmark, traded at US\$108 per barrel. That, and the generally robust economic growth outlook for Canada, made the loonie more valuable against the US dollar, a trend we expect to continue for the rest of the year. We expect the loonie to end the year somewhere between US\$1.00 and US\$1.10.

Commodities – gold and oil

The price of gold ended the first quarter about US\$9 per ounce higher than its Dec. 31, 2010, close of US\$1,421.10 per ounce, after touching a record high US\$1,447 per ounce earlier in March. Gold flew up to even greater heights by late April, climbing to US\$1,565, stimulated the falling US dollar, the rising spectre of inflation in the emerging markets, and growing evidence of rising inflation in the developed world. Some of gold's price advance in the first quarter could also be attributed to the flight-to-safety factor, arising from the civil unrest in North Africa and the Middle East and fiscal uncertainties following the Japanese earthquake. However, gains in the price of gold did not translate into share price gains for the large-cap gold mining companies that comprise the key indexes. Earnings growth for those companies tends to be limited owing to their immense size.

With the US summer driving season almost upon us, the price of oil is top of mind. With a barrel of West Texas Intermediate oil trading around US\$112 per barrel, prices for a gallon of the refined stuff – gasoline – edged closer to US\$4.00 per gallon in the States. Many analysts believe that US\$4.00 per gallon to be a significant "resistance level" for consumers, who would begin serious conservation and substitution efforts at that point. Sustained high oil prices

would reverberate through the entire US economy, dampening consumer spending and weighing on GDP growth.

These days, however, the US isn't the only (consumer) game in town. Emerging nations have become voracious consumers of oil, with combined demand from China, India, Brazil and Saudi Arabia climbing 18.8 million barrels per day, nearly matching US demand of 19.2 million barrels per day. That demand isn't going away anytime soon. And any reduction in US consumption will be more than offset by continuing and growing demand from the emerging world.

Middle Eastern crude oil supply continues to struggle to keep up with demand, even with increased Saudi output to cover shortfalls from the shutdown of the Libyan oil industry as the bloody civil war rages on there. The persistent unrest in the Middle East/North Africa (MENA) region is likely to support crude oil prices at elevated levels for the rest of the year. Not great for consumers or the economy in general, but not so bad for Canada's oil majors, which are

poised to expand production and shipments to the oil hungry US and, increasingly, to satiate the voracious appetite for oil around the Pacific Rim.

OUR FORECAST – GOLD: We've raised our year-end target for the price of gold to a range between US\$1,500 and US\$1,650 per ounce.

OUR FORECAST – OIL: Likewise, we expect the price of a barrel of crude oil to remain elevated for the rest of the year, though perhaps weakening somewhat through the second half. Accordingly, we've raised our target price for WTI crude oil to between US\$100 and US\$110 per barrel by year-end.

Equity markets

Stocks experienced an almost uninterrupted rally through the first quarter. There have been minor setbacks to be sure, but no serious corrections to speak of. Makes you wonder how long this can last.

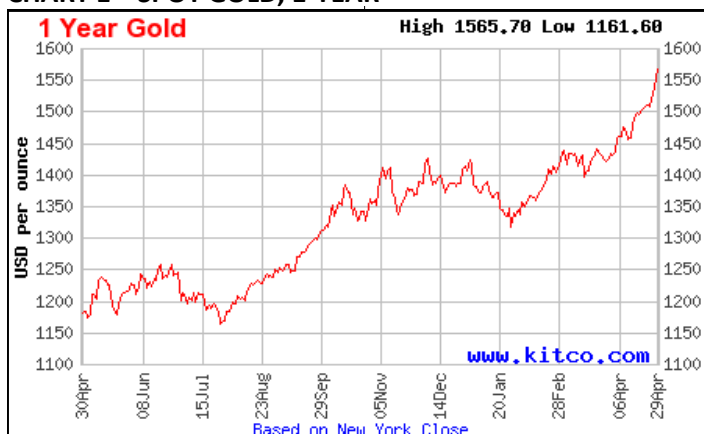
You can argue, as the bulls have, that stocks are following their traditional role of climbing a "wall of worry." The difference this time is that stocks are being tethered by the long arm of US Federal Reserve (i.e., QE2).

Unfortunately, that tethering effect has clouded the most significant metrics used to value stocks, namely relative comparisons to other asset classes and historic price-to-earnings relationships. In my opinion, that combination has stocks "walking on air."

When you consider the massive infusion of liquidity and historically low interest rates, there is very little competition for stocks. And that's important for large institutional investors. When they set out to build optimal portfolios, their work begins and ends with the asset allocation.

According to Investopedia (www.investopedia.com), "money managers compare the earnings yield of a broad market index such as the S&P 500

CHART 1—SPOT GOLD, 1-YEAR



Courtesy Kitco

Composite Index, to prevailing interest rates, such as the current 10-year US Treasury yield. If the earnings yield is less than the rate of the 10-year Treasury yield, stocks as a whole may be considered overvalued. If the earnings yield is higher, stocks are generally considered to be undervalued relative to bonds.”

The earnings yield is calculated using the earnings per share over the most recent 12-month period divided by the current price of the stock. Suppose a company earned \$5.00 per share over the most recent 12-month period. If that company’s stock was trading at \$100 per share, the earnings yield is 5% (\$5.00 earnings divided by \$100 stock price = 5%).

Another way to look at the earnings yield is to think of it as the inverse of the price-to-earnings multiple. In this example, the p/e ratio is 20. If we then divide 1 by 20 (the inverse), we arrive at the 5% earnings yield. When you are in an ultra-low interest rate environment, the earnings yield does not need to be that high.

At present, the trailing price-to-earnings multiple on the S&P 500 is approximately 15 times. Divide 1 by the p/e, and you have an earnings yield of 6.67%. That’s twice the yield on 10-year US Treasuries, which are currently yielding less than 3%. In theory, if one is focusing on asset allocation, stocks would appear cheap relative to fixed income assets.

Assuming the Fed continues to buy Treasuries in that segment of the curve (which is exactly where the Fed has been focusing its quantitative easing program), yields are unlikely to rise, which provides additional support to the bullish argument.

But, as Investopedia goes on to say, “economic theory suggests that investors in equities should demand an extra risk premium of several percentage points above prevailing risk-free rates (such as T-bills) in their earnings yield to compensate them for the higher risk of owning stocks over bonds and other asset classes.”

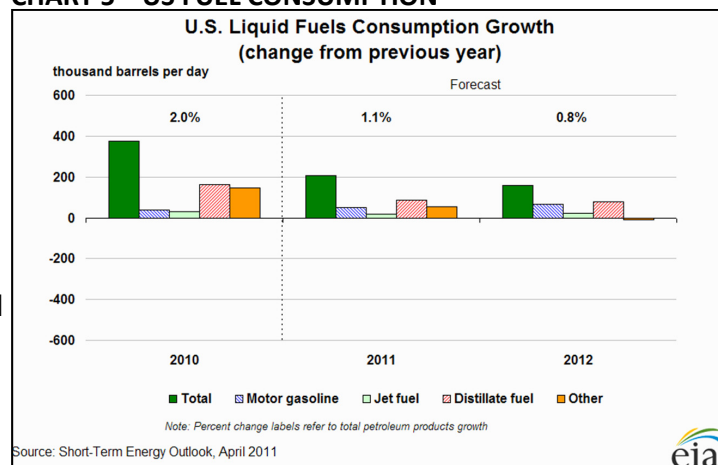
The question is how much premium? We suspect the recent stand-off between bulls and bears comes down to the “fairly-valued” argument premised on current valuations using the historic earnings yield versus the “undervalued” argument driven by forward-looking earnings estimates.

That leads us directly into the earnings debate. We know with certainty that the liquidity infusion has had a dramatic negative impact on the US dollar. Many would argue that it was designed to do just that!

But there is an unexpected consequence – or maybe not – in that weakness in the US dollar has had a dramatically positive impact on US corporate earnings. Especially among the big-cap companies, which make up most of the major US stocks market indexes.

When most people think about the S&P 500 Composite Index, they view it as a broad indicator of the health of the US economy. But, if that’s the case,

CHART 5—US FUEL CONSUMPTION



why when big-cap companies are doing so well is it necessary for the Fed to focus on stimulating economic activity? Why are so many economists asking, "Where's the beef?" And why are so many small- to mid-size US companies having difficulty getting banks to lend them money?

The answer lies in the fact that the S&P 500 companies are not really domestic companies, but rather global behemoths. The numbers tell the story. Whereas consumer spending represents 65% to 70% of total US GDP, it drives only 40% of S&P 500 profits. Put another way, S&P 500 companies generate approximately 60% of their revenue offshore.

Why is that important? Well if you are looking at the earnings within the S&P 500, you must recognize that more than half that revenue is being repatriated into weak US dollars. That conversion process from foreign currencies into US dollars can make earnings look better than they really are.

That's not necessarily a problem, unless the US dollar stabilizes or, dare we say it, rises in value. And a global crisis will surely send investors scrambling to buy US dollars. Mind you, it does not have to be a crisis. Any signs of life in the US dollar could dramatically impact the earnings growth that is supporting current market valuations.

The other factor that separates big-cap S&P 500 companies from the general economy is the amount of cash on their balance sheets. It's a cash hoard that some estimates put at US \$3 trillion. That means that S&P 500 companies don't need to borrow. That tight credit affecting so much of the US economy is having no impact on the big-cap names.

Not to be a Chicken Little, but it's one thing to be bullish on big-cap stocks because they are generating superior cash flow and appear to be undervalued relative to bonds. It is quite another if you are betting the farm on cash flow bloated by currency conversion and a so-called undervaluation clouded by artificially low interest rates.

The question is what happens when QE2 comes to an end? Will we see the US dollar stabilize, will big cap-cash flow and earnings begin to slow?

To remain bullish in this environment, one has to believe that the Fed will come to the rescue with QE3 if need be. And this Fed might! Certainly this Fed Chairman – albeit with less support from the Governors than was seen in the past – has made it clear that he stands ready to do whatever is necessary to keep the economy moving in the right direction.

If QE3 does come to pass, then we will see further weakness in the US dollar and continuing strong earnings. The problem is that we are inflating a bubble that will burst at some point down the line.

If the Fed does not embark on another round of quantitative easing, we suspect that earnings will slow and the stock market rally will come to a screeching halt. Stocks may not collapse, but the road to new highs will certainly be interrupted.

If you believe that the stock market is a forecasting mechanism, and all evidence seems to support that position, then investors are likely begin focusing increasingly on the Fed's next move.

OUR FORECAST: The Japanese disaster, unrest in North Africa and the Middle East, and eurozone debt problems all weighed on equity markets during March. For the month ending March 31, then, the S&P/TSX closed just a hair below breakeven, down 0.1% month over month. Year to date for the first three months of 2011, though, the index was ahead 5.0%. The S&P/TSX Composite has been rallying steadily for the past 12 months, touching a new high in the first quarter. A weaker US dollar, rising commodity demand, sustainable Canadian GDP growth, and a robust job market, Canadian businesses will continue to produce solid earnings, though perhaps not at quite the blistering pace we've seen in past quarters. We therefore hold to our previous forecast for a year-end level between 14,000 to 15,000 for the S&P/TSX Composite Index.

The Dow Jones Industrial Average advanced just 0.8% (in US\$) month over month in March, but gained 6.4% year to date to March 31. Similarly, the S&P 500 Composite Index closed just a hair below breakeven for March, losing 0.1% (in US\$). Year to date for the first quarter, though, the S&P 500 had climbed 5.4%. Earnings of companies comprising the S&P 500 Composite Index generally came in better than expected in the first quarter, with a number of key upside surprises among the big industrials. Though we may expect to see some erosion in US equity markets through the summer months, we still expect the S&P 500 Composite Index to finish the year at a level between between 1,400 and 1,450. ■

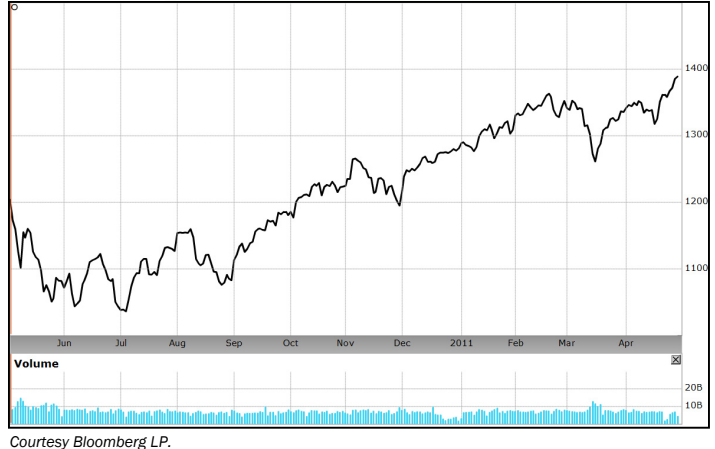
CHART 5—S&P/TSX COMPOSITE INDEX, 1 YEAR



CHART 6—S&P 500 COMPOSITE INDEX, 1 YEAR



CHART 7—MSCI WORLD INDEX, 1 YEAR





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ECONOMIC OUTLOOK & FORECAST

Forecast for December 31, 2011

Measure	Our January 2011 Forecast	Our April 2011 Forecast
Canadian GDP	2.5%-3.0%	2.5%-3.0%
Bank of Canada target overnight rate	2.00%	1.50%-2.00%
Canadian Consumer Price Index	2.00%-2.75%	2.50%-3.00%
Canadian dollar in US dollar terms	US\$0.95-\$1.05	US\$1.00-\$1.10
US GDP	2.75%-3.25%	2.75%-3.25%
US federal funds rate	0.25%-0.75%	0.25%-0.75%
US Consumer Price Index	2.0%-2.5%	2.0%-2.5%
Gold/oz.	US\$1,300-\$1,500	US\$1,500-\$1,650
Oil/bbl.	US\$90-\$100	US\$100-\$110
S&P 500 Composite Index	1,400	14,00-1,450
S&P/TSX Composite Index	14,000-15,000	14,000-15,000