

Growth Stocks Weekly

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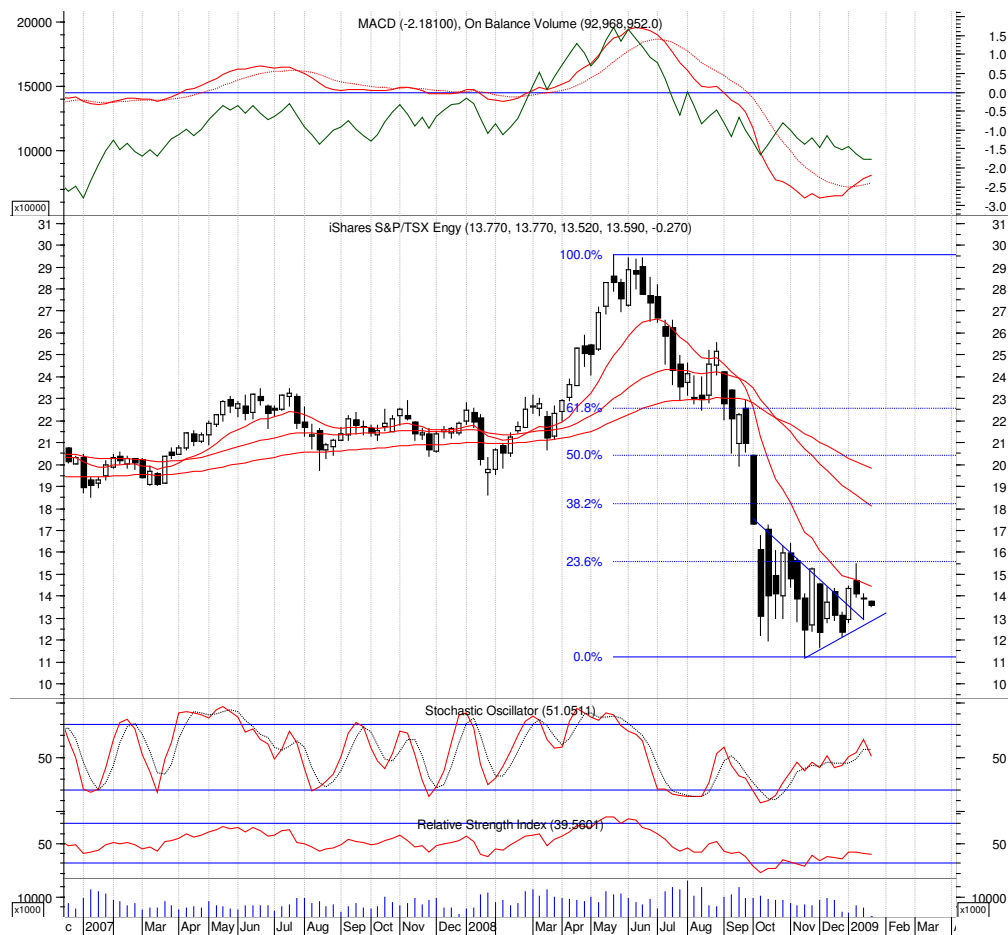
Performance: 1996 116.9%; 1997 28.1%; 1998 36.4%; 1999 39.4%; 2000 180.9%; 2001 -50.5%; 2002 18.7%; 2003 28.8%; 2004 166.7%; 2005 28.2%; 2006 153.3%; 2007 8.8%; 2008 -25.2%

Junior Gold and Natural Resource Sector Report

January 20, 2009

Timing Exposure to Energy

iShares™ Canadian Energy Sector Index Fund (XEG-TSX)



Weekly chart: High C\$29.56, Low \$11.23, Last Trade \$12.97

The iShares™ CDN Energy Sector Index Fund seeks to provide long-term capital growth by replicating, to the extent possible, the performance of the S&P/TSX Capped Energy Index through investments in the constituent issuers of such index, net of expenses.

The Index is comprised of securities of Canadian energy sector issuers listed on the TSX, selected by S&P using its industrial classifications and guidelines for evaluating issuer capitalization, liquidity and fundamentals.

Today many energy stocks sell for less than they did the last time oil was at \$20 a barrel. That's a rough valuation indicator of course, as costs are now higher and many individual companies are much larger than they were back in 2001-02. But with the market reacting less and less to bad news now, it's very clear a lot of bad news has been priced into the market that hasn't happened yet. Markets discount future expectations.

Even if the bad news now in share prices does actually pan out, downside from here is limited. There are always some sellers that react when the news is negative, like when a company cuts a dividend. Others, however, will recognize value and the price will recover.

The only time when there's real downside risk in the market or a particular stock is when expectations/valuations aren't pricing in bad news as it occurs. That's what happened in fall 2008, as investors reacted to the sudden meltdown of the U.S. financial system. But with sentiment so negative and valuations so low, we're a world away from that now.

Also, if the bad news now priced in doesn't occur, then we're in for potentially the mother of all rallies. Moreover, the action is likely to be at least as sudden and dramatic as the rally we've enjoyed these last few weeks. And it will catch a lot of the people now on the sidelines flat-footed. This is just the nature of markets, and why it pays to be a contrarian at moments of extreme emotion.

With the economic challenges this severe, we're not looking for a rising tide to raise all boats. Individual companies have certainly been stress tested over the past 18 months, and those that have made it this far have proven their mettle. But the nature of shakeouts is that they always last longer than anyone expects, and there's always that last victim to fall. Markets will often remain irrational longer than investors can remain solvent.

At this juncture, I'm expecting to see many companies report favorable comparisons between Q4 2008 earnings and those from the year before. Even comparisons with the third quarter, which included the collapse of Lehman Brothers and the freezing of the credit markets in September, will be difficult.

For income oriented investments, however, we have a rather simple bar here. Mainly, the key questions are do the earnings still cover the current distribution and are they on track to do so in 2009, and if they don't are the shares pricing in the likely reduction?

As Chevron's recent earnings guidance makes clear, companies that produce raw commodities are going to post much lower earnings than they have in prior quarters. Producers that pay out a large portion of cash flow in earnings, therefore, are likely to have to cut distributions. But with many of these entities now offering dividend yields 15 to 20 percent and even higher, their shares are already pricing in cuts of some magnitude. Fourth-quarter earnings will tell us if the bar has been set low enough.

A dozen Canadian energy producer trusts, for example, have trimmed distributions during this cycle. That's because realized selling prices for oil and gas in the third quarter were more than twice the current market prices, and cash flow has therefore dropped. On the other hand, many trusts are now selling below levels they held in 2001, when oil was under \$20 a barrel and natural gas was well under \$2 per million British Thermal Units. And some are yielding as much as 30 percent and trading under book value.

The bar, therefore, is extremely low. In fact, as long as oil stays over \$20 and gas over \$2, it's likely to be exceeded by a wide margin. That's why energy producer trusts were able to rally into the new year by as much as 30 percent, and it's why they still have significant upside even if energy prices slump for some time.

Further, the catastrophic drop in oil and gas prices guarantees another price spike, and potentially one of even greater magnitude than what we saw in mid-2008. Investors have been focused exclusively on the drop in demand of recent months. Little or no attention has been paid to what amounts to wanton supply destruction, i.e. the cancellation and postponement of dozens of projects that were set to increase output of fossil fuels and/or use of alternatives.

Coupled with the natural winding down of many of the world's biggest fields, we can expect much less energy supply on the market over the next three to five years. That may not matter so much if the world sinks into a multiyear depression. Anything short of that, however, will eventually see a return in demand to normal levels. And supply will only meet it if there's a renewed wave of investment. That won't happen unless we see sharply higher prices.

In fact, the violence of last year's energy price decline will keep billions of dollars on the sidelines, until would-be investors are reasonably certain it will be economic to spend. Total (TOT-NYSE) for example, has stated it needs at least \$80 to \$90 per barrel oil long-term to make a planned new investment in the oil sands work. And it's unlikely to put down the money the first time oil crosses that threshold again.

Right now it makes sense that this psychology will linger the next time energy prices start to rise, just as it did earlier this decade. And the longer it does, the less supply will be on the market and the higher energy prices can eventually go.

The potential upside from the next energy price spike is even greater than what we saw in mid-2008. That's the main reason investors should keep energy in their portfolio, despite what could be some horrendous earnings comparisons over the next few quarters and dividend cuts at yield-bearing energy plays.

Investors have set the bar very low, which will limit real downside, but not the volatility. **iShares Canadian Energy Sector Index Fund (XEG-TSX)** replicates to the extent possible the performance of the S&P/TSX Capped Energy Index through investments in the constituent issuers of such index, net of expenses. Longer term it provides capital growth that mirrors the securities of Canadian energy sector issuers listed on the TSX, selected by S&P using its industrial classifications and guidelines for evaluating issuer capitalization, liquidity and fundamentals. The dividends of those underlying holdings are passed on to us while we await our expected capital gains.

We are adding today 5,000 units of this index fund to the Growth Stocks Weekly Model Portfolio with a limit of \$13.00 per unit.

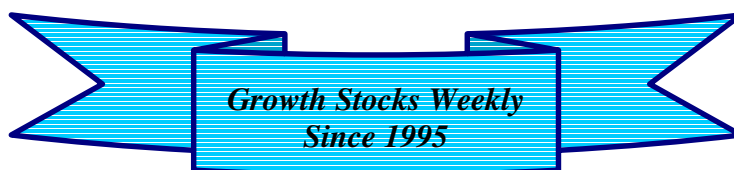
Exchange TSX
Ticker XEG
Options Yes
CUSIP 46577W105

Top Holdings as of January 19, 2009:
20.08% ENCAN CORP
12.32% CANADIAN NATURAL RESOURCES
11.80% SUNCOR ENERGY INC
6.91% PETRO-CANADA
5.74% TALISMAN ENERGY INC
4.75% IMPERIAL OIL LTD
4.74% NEXEN INC
4.39% CANADIAN OIL SANDS TRUST
3.91% HUSKY ENERGY INC
2.74% PENN WEST ENERGY TRUST
There were a total of 53 holdings in the fund.

NAV per unit: C\$13.55
NAV: \$499,831,806
Units O/S: 36,896,222
MER: 0.55%
Index: S&P/TSX Capped Energy Index
Distribution History: 2008 cash distribution totaled \$0.63245 per unit

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