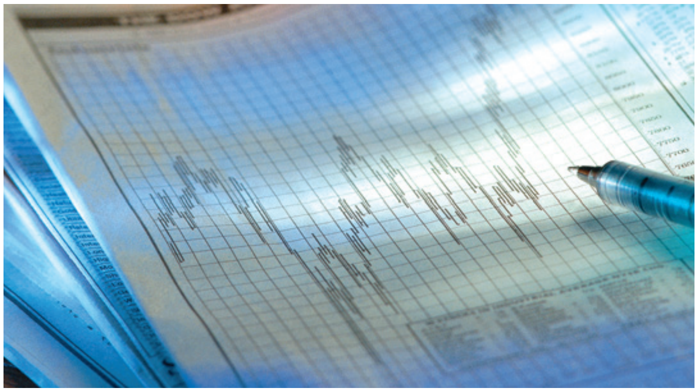
GFI Investment Counsel

GoodQuarter

SUMMER 2011



IN THIS ISSUE

"I don't look to jump over seven-foot bars. I look around for one-foot bars that I can step over."

— Warren Buffett

Dear Valued Client,

The first six months of 2011 are now behind us, and the quote above by Warren Buffett has proven most appropriate. We have seen a significant variance between the performance of fundamentally weak businesses and the strong ones we own on your behalf. Our investing activity over the second quarter focused on allocating new client capital, as well as purchasing fixed income securities for our clients who hold excess cash. We did not initiate or divest any stock positions during the period.

Our portfolios performed very well over the first six months of the year, increasing by roughly 4% to 6%, depending on the tailored asset allocation. Our aversion to high-risk sectors and over-valued stocks paid dividends (pun intended), as we excelled by avoiding losers and remaining committed to investing in only high-quality businesses.

Client holdings such as Tim Hortons Inc.; The Jean Coutu Group Inc.; Canadian National Railway Co.; Automatic Data Processing, Inc. (ADP); and Enbridge Inc. have each gained over 10% year-to-date. Additionally, our holdings have continued to increase their dividends and reward our clients every quarter just for being shareholders. Our performance was also impacted by avoiding those companies with weak business prospects including Research In Motion Inc., Yellow Media Inc., and Sino-Forest Corp.

Our office has been quite busy over the past few months, as we have had a large number of new clients join our firm. The majority of these new clients have come through referrals, and we would like to take this opportunity to thank those of you who have referred our services to your family and friends. We recognize and appreciate the trust that you continue to put in GFI, and we will continue to work hard to earn that trust.

GFI in the News

We were recently quoted in an article in the *National Post*. The *Post* and other newspapers have asked that we provide our investment insights from time to time. This exposure illustrates how the GFI investment approach is garnering an increasing amount of attention, and we have decided to let our clients know about our exposure in the press with a quarterly GoodQuarter article called *GFI in the News*. Please see page 3 of this issue for details.

We have also included a new feature in this issue called *Behavioural Investing* on page 4. In this section of our newsletter and in the coming quarters, we will highlight common investing mistakes and how you can avoid them.

As always, we will continue to invest your capital the only way we know how... carefully.

Please contact us with any comments, suggestions, or concerns.

Warm regards,

Daniel Goodman, CFA
President and Chief Executive Officer

Portfolio Activity — Algonquin Sale

The upside to convertible debentures

In the fall 2009 issue of *GoodQuarter*, we published an article discussing the then recent purchase of Aecon Group Inc. ("Aecon") convertible debentures for our clients' portfolios. This security interested us because it combined a 7% coupon with the potential for further investment gains through a possible in-the-money stock conversion. Critically, when we reviewed Aecon, we did a thorough analysis of the business and believed there was opportunity for the stock price to increase materially, thus providing capital appreciation.

At this point it appears Aecon's stock price will not breach our required threshold, and our return has been limited to the security's 7% coupon. Importantly, however, our capital remains secure.

In the second quarter of 2011, GFI sold a similarly structured convertible debenture issued by Algonquin Power and Utilities Corp. ("Algonquin"). Purchased last year, this security combines a 7.5% coupon with a similar conversion feature. In this case, however, the stock price of Algonquin increased beyond our conversion price and our convertible debenture was "in-the-money."

Algonquin forced its convertible debenture holders to convert to shares of the company, at which time we sold the security at $123.13. Our average purchase price of the Algonquin debenture was roughly $104.60. We thus enjoyed capital appreciation of 17.7% and collected 7.5% in annual interest payments during our holding period.

As with all potential investments, due diligence must be undertaken to ensure the investment being purchased passes rigorous tests to ensure the safety of your capital. Convertible debentures offer an interesting investment alternative when purchased appropriately.

We hope to write about further successes like this in the quarters to come.

GFI in the News

When looking for financial information, the experts turn to GFI

FINANCIAL POST

Buy what you understand

Fri Jul 15 2011 —— Jonathan Ratner

MANAGER PROFILE

Managers: Daniel Goodman & Effie Wolle, GFI Investment Counsel

Portfolios: High net worth private client portfolios, Good Opportunities Fund

Description: Concentrated (13-15 equities and 10-12 bonds) portfolio of high-quality equities and fixed income

AUM: $160-million

Performance: 1-year +15.7%, 3-year +3.5%, 5-year +4.5% (Equity Balanced portfolio as of June 30, 2011)

Management fee: 1.35% on first $2-million, tiered thereafter

As disciples of Warren Buffett and Charlie Munger, GFI Investment Counsel CEO Daniel Goodman and vice president Effie Wolle focus on value. They look for businesses with a sustainable competitive advantage at a reasonable price. And when the company is good enough, they are willing to pay a bit of a premium.

"If you are buying a great quality business with a durable competitive advantage, I think it is okay to pay up," Goodman says.

Finding good management is another focus at GFI, as is avoiding serious capital depletion.

"It's not always about what you buy, it's about what you don't buy," Goodman says, adding that GFI watches the Street but does all its own analysis.

"We try to invert the situation, especially when it is an issue brought out by corporate finance or an investment bank," he adds. "Why are they raising money? Why are they diluting equity stakeholders?"

Wolle stresses that GFI sticks within its circle of competence, avoiding names like Sino-Forest Corp., Yellow Media Inc. and Research In Motion Ltd.

"We avoid dying industries or business models that are too difficult to understand," he says. In the first six months of 2011, private client accounts rose roughly 4% to 6% by owning quality companies that pay good dividends–and avoiding the bad ones.

The managers will do some opportunistic trading as well as take short positions in the Good Opportunities Fund. It has the same approach as private client portfolios.

The fund currently has a higher-than-average cash position of around 24% due to the sale of a favourite name, international shopping warehouse club company PriceSmart Inc., which has risen very dramatically.

"I don't think the cash level is a macro call–expecting the market to bottom out," Goodman says. "It's just a question of our comfort level."

"We're not finding any great things to do with the money, so we hold the cash," Wolle adds.

BUYS

BROOKFIELD ASSET MANAGEMENT INC. (BAM. A/TSX)

The position: Recently added to this long-term core holding, in both private client portfolios and the fund.

Why do you like it? "We love this company. They are tremendously disciplined allocators of capital," Goodman says, highlighting the roughly 19% ownership stake held by CEO Bruce Flatt and other management. As one of the largest asset managers out there, Brookfield is focused on commercial real estate, hydro electric assets and infrastructure. "We want a business that we understand and that will be around for years to come," Wolle says. While Brookfield's dividend may be lower than other companies in the portfolio, he explains this is because the company is finding opportunities with great returns in which to allocate capital.

Biggest risk: Brazilian political risk.

GUARDIAN CAPITAL GROUP LTD. (GCG. A/TSX)

The position: Core holding in the fund.

Why do you like it? Guardian manages about $16-billion in pension assets as well as the BMO Guardian Mutual Funds. Its market cap of $350-million is roughly what the company owns in BMO shares and other securities. "So you're getting the asset manager for free," Goodman says. The managers like the fact that Guardian has the opportunity to increase margins and is growing its wrap account business. "There is tremendous potential value to unlock here," Goodman says. "We think it is very, very difficult to lose a lot of your capital here because you're buying with such a big margin of safety."

Biggest risk: Less liquidity, multiple voting share structure.

CGI GROUP INC. (GIB. A/TSX)

The position: Core holding in the fund.

Why do you like it? This Montreal-based IT consulting, outsourcing and systems integration company has a lot of recurring revenue, allocates capital well, and grows its business efficiently. "They have bought back a tremendous amount of shares every year," Wolle says, noting the Godin family controls more than 20% of CGI's shares. "It's not a capital intensive business. They've really done well to grow and increase operating cash flow," Goodman says.

Biggest risk: Large exposure to government contracts, which are currently budget constrained.

SELL

CENVEO INC. (CVO/NYSE)

The position: Currently short.

Why don't you like it? This commercial printing company has US$1.3-billion of debt on its books and is paying about US$120-million in interest expenses even in this low rate environment. "Because they are so debt-constrained, they haven't had the capital necessary to invest in newer machines to continue to compete in this very difficult business," Goodman says. "Cenveo has scrambled to acquire other businesses, but they have not grown organically at all. They have no room for mistakes or error."

Potential positive: "If there is a massive cyclical recovery and they catch a tailwind."

BEHAVIOURAL INVESTING

Anchoring Bias

Don't let common investing errors be a drag on your portfolio

In a new series of articles titled *Behavioural Investing*, we wanted to highlight some of the behavioural errors that are commonly made by investors.

The first article in this series is about anchoring bias. Most of us have suffered through anchoring bias when buying a stock. Defined simply, anchoring is the tendency to rely too heavily on a historical data point when making a decision in the present.

In investing, the most common anchoring methodology is attached to the price paid for a security. Let's say an investor purchases a stock at $10.00 and, afterwards, the stock languishes below $10.00 for a considerable amount of time. While the underlying business may have changed, the investor thinks, "If the stock can just get back to $10.00, I will sell it and not lose any money."

In reality, the fair value of a stock has nothing to do with the price one pays for it. Stock price is based solely on the fundamentals of the business and the comparative investment opportunities available (along with a dash of investor psychology).

The investor is probably better off looking at the investment through the prism of the underlying business's current profile and if necessary, selling the investment at a loss, which might even be beneficial in terms of the tax losses that are generated from such a sale.

Next quarter, we will continue our discussion with a new *Behavioural Investing* article.

GFI Investment Counsel and GoodFunds

GFI Investment Counsel ("GFI") provides tailored investment portfolios to families, foundations, trusts and corporations. We work closely with our clients to customize investment accounts that coincide with our clients' unique requirements. GFI focuses on preserving and growing client capital through intense due diligence, focus and discipline.

In January 2008, GFI launched the Good Opportunities Fund ("the Fund"), an alternative investment fund available to accredited investors. The Fund is the first in the "GoodFunds" series of investment products. The Fund focuses on a select group of investment opportunities that provide an attractive risk/reward dynamic regardless of asset class or market capitalization. The Fund is managed with a focus on understanding the businesses, their capital structure, risks and opportunities.

The highest compliment our clients give us is the referral of their family, friends, and business associates.

If you know anyone who would benefit from working with GFI Investment Counsel, please refer them to our office, call us at 416.488.8825, or email us at info@gfiic.com. Additional information can be found on our website at www.gfiic.com.

For more information about GFI Investment Counsel, the Good Opportunities Fund, or GoodFunds, please call **416.488.8825** or **email info@gfiic.com**.

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