The BonaVista Quarterly

First Quarter 2007

Investment Strategy and Review

Equity markets around the world began their recovery from the "tech crash" in early 2002. Since then, we've experienced a relentless march forward without any significant bumps in the road. That changed during the first quarter as a one-day plunge in the Chinese equity market in late February caused a ripple effect that was felt in markets around the world. As the quarter progressed concerns about the imploding sub-prime mortgage market and the advancing economic slowdown in the US created another set of shock waves.

We anticipate that we will see continued volatility this year, particularly until such time as there is a clearer understanding of the weakness of the US economy and the direction of interest rates. Faced with this uncertainty over the quarter, the markets struggled to make significant headway. However, we feel that the equity markets are fundamentally well supported by strong earnings, good cash flow and clean balance sheets.

Despite the added volatility experienced so far in 2007, equity markets trade a fair value and represent an acceptable return opportunity over the remainder of the year.

Canadian Equities

Canadian equity market returns were fairly tame for the first quarter with a 2.6% increase. However, given the exceptionally strong performance from the fourth quarter of last year and the uncertainties faced during the year so far, the positive return should be considered an achievement. While we feel 2007 will be another winning year for the S&P/TSX we would not be surprised if we experience some bumps along the way.

During the quarter the best performing sectors were the Telecom Services and the Industrial sectors offset largely by the worst performing sectors Health Care and Utilities. However, the real influential sectors given their size, are Materials and Financials, both doing slightly better than the market, and Energy with a flat performance, underperforming the market.

The Canadian equity portfolio performed in-line with the S&P/TSX for this quarter, but outpacing the market return for the one year period. During the quarter we had little activity in the fund feeling comfortable with the structure of the portfolio, as well as, our stock exposure. A run-up in Abitibi Paper, as a result of merger activity, gave us the opportunity to eliminate this position from the portfolio. Continued weakness in demand for newsprint and a weak balance sheet made us uncomfortable with this holding.

Other activity involved repositioning our bank exposure by reducing Bank of Montreal and increasing exposure to Royal Bank. Both banks trade at very similar multiples while we view the Royal as a better quality investment overall.

US Equities

The US portfolio modestly outperformed the S&P 500 over the quarter, coming in flat in comparison to a small loss for the index. In US dollar terms, the S&P 500 rose by a small amount, with appreciation in the Canadian dollar penalizing local currency returns.

The market returns were unusually distributed among the sectors. Three sectors were particularly strong: utilities (+9.3%), materials (+9.0%) and telecommunications services (+7.3%). However, these are the

three smallest sectors of the S&P 500, accounting for just over 10% of the market. The worst returns came from financials (-1.5%), with most of the decline attributable to troubles in the subprime group, where over 40 mortgage-lending institutions have found themselves in financial difficulty. There is fear that the subprime "disease" will spread to other categories, including Alt-A, which require lesser levels of loan documentation, and jumbo loans, which are larger in size. We do not share those concerns, at least not at this point.

We made several changes to our energy holdings, based upon the relative value of our positions. We added to our holdings of Anadarko Petroleum and ConocoPhillips, while reducing XTO Energy. Both Anadarko and ConocoPhillips are being penalized for acquisitions that appear to have detracted from recent returns. Both companies have good track records in these areas, and are now trading at very attractive levels.

XTO Energy has been a standout performer, with its shares trading at all-time highs, in spite of the 50% decline in natural gas prices that we have seen since late in 2005. This is a testament to the company's ability to grow its reserves and production per share at a pace well above that of its peers.

We also added to our position in Commerce Bancorp, a retail bank, with operations in the US Northeast, primarily in New Jersey. The company operates a unique business model, eschewing a low expense structure in favour of a high-service "retail" model. Over the past three years, the company's shares have underperformed as the company has laboured under the impact of a fairly flat yield curve that has curtailed their ability to make an adequate spread off their deposits. We anticipate that a more "normal" yield curve will generate superior earnings growth as the company's deposit-gathering continues at a rapid pace.

On price appreciation, we reduced our holding of Alcoa and First Horizon National. Both of these stocks had climbed near their highs of the past year and we decided to make a small reduction in our holdings.

Two holdings were "lost" over the quarter. We eliminated our position in America Service Group, a company that provides outsourced healthcare to prisons, as the company business is weak and the outlook for further privatization is unclear. We also tendered our Phelps Dodge shares to Freeport McMoran, retaining a small position in Freeport.

International Equities

The fund return in the first quarter was up 1.7% versus a 3.0% return from MSCI EAFE. The fund underperformed in the U.K. and Japan, followed by our exposure to emerging markets. In sector terms, the fund underperformed in Industrials, Materials and Consumer Discretionary. All country and sector exposures are of course a residual of our bottom-up stock-selection process.

The fund return for the one-year period ending March 31, 2007 was up 21.5% versus and MSCI EAFE Index return of 19.2%.

Over the quarter, the Pacific region (+3.7%) outperformed versus Europe (+3.0%). In the developed markets, Singapore (+9.4%) and Finland (+9.4%) were the best performing countries. Emerging markets (+1.4%) underperformed EAFE over the quarter.

Eight of ten sectors in the MSCI EAFE Index had positive returns for the quarter. The sector with the largest return was Materials (+9.4%). The sector with the weakest return was Energy (-1.4%).

The fund continues to have a lower weighting than the EAFE benchmark in the Pacific region and in Europe. Within the Pacific region, the fund remains significantly underweight in Japan, explained by a continuing absence of good value. Within Europe, the fund is overweight in the U.K., the largest country exposure in the fund. Exposure to emerging markets (non-EAFE markets) increased over the quarter to 13.7% at the quarter end, as we have continued to find good value there.

In sector terms, the fund is most significantly different to the benchmark by being overweight in Materials, Consumer Discretionary and Industrials and underweight in Consumer Staples, Financials and Information Technology.

During the first quarter, the fund purchased one new holding: Hindalco (India/Materials). Two holdings were eliminated: Robinson (Singapore/Consumer Discretionary) and Coca-Cola West Japan (Japan/Consumer Staples).

Bonds

Fixed income markets in Canada were volatile but range bound during the first quarter of 2007. Both January and March produced negative returns for bonds, but a strong market performance in February kept the portfolio's returns in the black. The Scotia Capital Universe (SCUI) was up 91 basis points during the quarter. Our portfolio's performance was in line with this benchmark. With continuing reports of an extremely weak housing sector and a luke-warm employment picture in the US, the FOMC has toned down its prior tightening bias. It now seems more likely that the next move will see a cut in rates, however, that may not happen until the latter half of the year.

A modest steepening of the yield curve provided us with the opportunity to initiate several trades within the portfolio, although trading volumes remained light in comparison to previous years. Within the Federal sector of the portfolio, we maintained our overweight position relative to the SCUI in Federal Agency issues. March's federal budget confirmed that the borrowing of some of the entities would be consolidated with that of the federal government next year. The elimination of further issuance by some crown corporations will be supportive for our holdings.

Provincial new issue supply was seasonally light as budgets, elections and pre-funding kept most issuers on the sidelines. As a result, spreads were quite stable. An announcement from Ontario that they would initiate a minimum size of $600 million to all new issues lent support to their spreads. Our portfolio is neutral weight in this sector with exposure to B.C., Alberta, Ontario and Quebec only.

In the corporate sector spread performance remained range bound to slightly softer. Early in the quarter, we sold our position in Bell Aliant bonds in favour of a similar maturity Yellow Pages Group issue at a pick up in yield of 16 BPTS. Both borrowers are rated BBB. By the end of March, the trade proved beneficial to our portfolio performance as issues in all telephone related companies widened with the rumour of a BCE takeover.

We expect only modest returns by fixed income markets in 2007, as we believe interest rates are very close to their potential lows and credit spreads are very narrow. The portfolio duration remains neutral to the benchmark and we are slightly overweight the mid-term sector of the yield curve, at the expense of the short-end. This profile will insulate us from any bearish moves in the coming months.