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VANCITYINSIGHT

RESPONSIBLE INVESTING NEWSLETTER 2010

Why do SRI firms invest in oil sands?

Investment advisors, mutual fund unit-holders and the public are often perplexed when they discover that socially responsible funds invest in oil and gas companies. They are particularly shocked to learn that nearly all of the Canadian equity SRI funds hold shares in oil sands companies. In the following article we present the underlying rationale for choosing those investments, an assessment of oil sands asset exposure for the IA Clarington Inhance SRI Funds, and shareholder engagement activities we have undertaken with companies involved in oil sands. We believe this information will help mutual fund investors make an informed decision regarding their own unique environmental and financial objectives.

The Canadian stock market is highly concentrated and holds a limited number of publicly traded companies with sufficient size and liquidity to meet mutual fund investor needs for diversification and competitive risk-adjusted returns. In total the sixty largest companies traded on the TSX exchange comprise 80% of the market value of stocks currently available to investors in Canadian equity. Within that 80% over half of the companies are directly involved in oil and gas or mining. Successful investing in Canada requires that a portion of assets be allocated to some of the largest, most liquid companies, including those involved in oil and gas or mining. As a socially responsible portfolio manager, we differentiate among companies by evaluating their relative environmental social and governance (ESG) performance according to 25 screening criteria. Companies are selected for the portfolios we manage according to their ESG performance and financial prospects within their particular sector.

In Canada nearly all of the of the oil and gas companies, banks, industrial equipment manufacturers and construction and engineering companies are involved in oil sands projects. As a result, achieving proper diversification for a Canadian stock portfolio is not feasible without having some exposure to oil sands. Our approach is to avoid companies that have the poorest ESG records and, in order to reduce the social and environmental impacts of the remaining companies, use the tools of shareholder engagement to encourage improvement in policies and practices. Once we own a company we are in a position to file and support shareholder resolutions, as well as engage in dialogue with and educate company boards, managers and shareholders on the principles of ESG risk management.

An analysis of the companies we have selected for the IAC funds demonstrates how we have minimized the direct exposure to oil sands assets. On a look through basis we have less than 9 basis points of exposure in the IA Clarington Inhance Monthly Income SRI Fund while the Global Fund currently has no direct exposure. Not surprisingly, given the nature of the Canadian stock market, the IA Clarington Inhance Canadian Equity SRI Fund has the largest exposure in our SRI fund family, however, its total is less than 5%. While keeping our exposure to a minimum we also actively advocate for better environmental performance from these companies.

We have engaged oil and gas companies on: the need to disclose strategies and objectives for reducing climate change risk, improved monitoring of fugitive emissions, the water impacts of hydraulic fracturing, and greater community involvement in environmental impact assessment processes. We hold only one company that is directly managing an oil sands open-pit mine, Suncor. We have focused shareholder engagement activities on Suncor in three areas: tailings pond mitigation, greenhouse gas emissions and land reclamation. We are also currently supporting international shareholder initiatives aimed at increasing the level of financial risk analysis associated with oil sands projects in light of evolving climate change regulations and commitments.

Ultimately SRI investors need to feel confident that the financial returns they require are being generated in a manner that advances long term sustainability without compromising ecological integrity. As Fund sub-advisors we address those needs by advocating for greater integration of ESG factors in corporate decisions that create and protect shareholder value. By holding shares in some oil and gas companies and excluding companies who fail to demonstrate a willingness to change we believe we are in the best position to satisfy unit-holders social, environmental and financial objectives.

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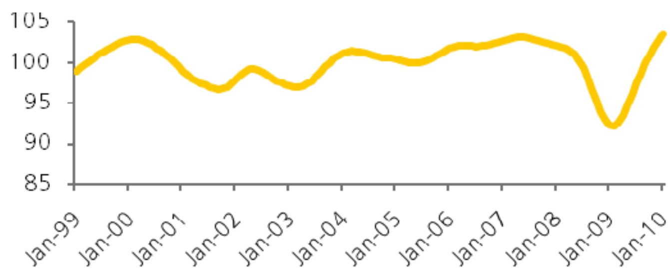
Economic and Market Commentary Q1 - 2010

It's Still Looking Awfully Bullish!

Worryworts abound. Although evidence continues to point to global economic recovery that is gaining momentum, bearish investors trot out a long list of worries about renewed downturn (termed double-dip), jobs, monetary policy, P.I.G.S. (Portugal, Italy, Greece, and Spain), China, deficits, inflation, and a host of other ailments. Well, we are sleeping well and we think you should too. What we mainly care about is whether the economic "tide" is rising or receding, and it is definitely rising! We do not get fussed over V, U, or L-shaped recoveries (all of which are out there now). Rather we adhere to the simple message of the OECD Leading Indicators, pictured below which are rising strongly and clearly signaling a sustainable recovery.

Global economic recovery gaining momentum

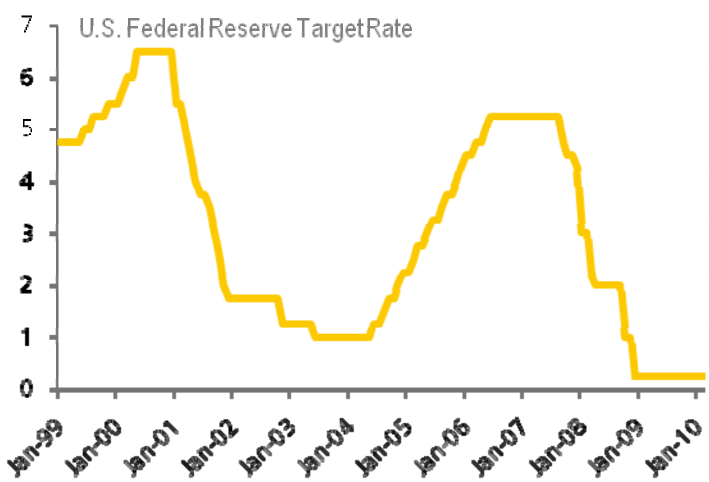


Source: OECD, data as at Jan. 31, 2010

We are also amazed and pleasantly surprised at what we see on the profits front. This is very bullish for two reasons - to sustain the economic recovery and for the support rising earnings lend to stocks. The recovery in global corporate earnings to date has been uniformly V-shaped. Companies around the world have cut costs, increased productivity and have been finding enough revenue growth to fuel a very powerful earnings recovery. This is very good news for the global economy since strong profits always lead to solid gains in employment and capital spending. We think an increasing number of jobs will be created over the balance of the year and with it “double dip” concerns will evaporate. The recovery in earnings that has far exceeded expectations also means that stocks are not overvalued by any means yet.

Another concern is over a potential change in monetary policy towards “tightening” in which central banks start to shift administered rates upward. In particular all eyes are on the U.S. Federal Reserve which has had a zero interest rate policy (ZIRP) since December, 2008. But this will not change for a long time for two reasons. First, history clearly suggests the Bank won’t move on rates until the unemployment rate is well below its peak and the economy has been growing for at least four quarters. Second, for the time being the Fed is trapped. Raising rates would cause bond yields, in general, and mortgage yields, in particular, to potentially spike up given the enormous financing needs of the US federal and state governments. That could restart the financial crisis. The Fed’s ZIRP has certainly been a major contributor to the global bull markets in stocks, bonds, and commodities over the past year. It should continue to do so for an extended period.

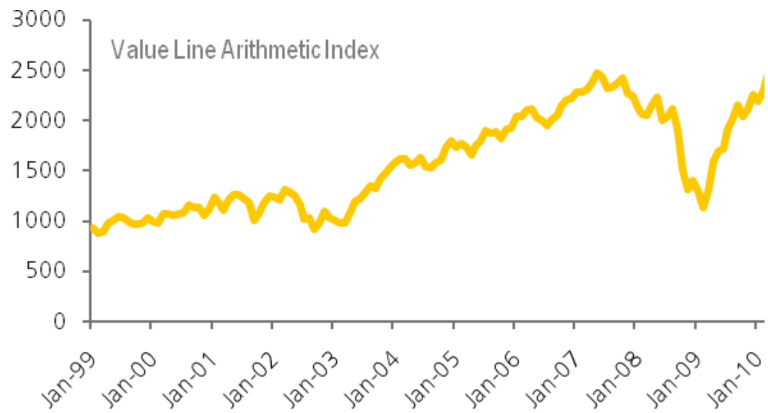
Low interest policy to stay



Source: Bloomberg, data as at Feb. 28, 2010

Another fact we like is that the “market” in general has performed far better than the commonly-quoted indexes like the Dow-Jones or S&P 500. A better measure of the “market”, illustrated below, is the Value Line Arithmetic Index- a basket of 1,626 companies (versus 30 or 500 for the other indexes). Unlike the popular indexes which are heavily weighted towards a relatively few stocks, the VL Index is unweighted giving equal weight to all its 1600+ issues and thus is able to better capture the market action of a truly broad cross-section of stocks. Note that this Index has now fully recovered back to its 2007 high point, far ahead of the popular indexes which are still some 30% below their former highs. To us, the sterling performance of this broadest measure of the “market” is a much more credible statement of the positive underpinnings for the market than any of the blandishments of the wooryworts!

Broad market fully recovered



Source: Bloomberg, data as at March 26, 2010

As for the other concerns noted above, at the risk of sounding Pollyannaish, we have focused on the key drivers to markets - the economy, interest rates and profits and these all look very positive still. We do however like the fact that the other concerns are getting lots of play in the media which helps maintain the “wall of worry” that markets tend to climb early on in bull markets. These bouts of worries lead to small corrections in the primary up trend which provides an opportunity to deploy fresh funds into attractive, low risk opportunities. Our advice - you can sleep well; don’t listen to the press; listen to the message of the market and get invested!

Stephen MacInnes is the Director for Mutual Sub-Advisory at Vancity Investment Management Ltd. He is the lead portfolio manager for the IA Clarington Inhance SRI Funds.