



JCClark Patriot Trust 2011 Year-End Update

January 12, 2012

Dear Fellow Investors:

2011 was a year that tested the investment acumen and patience of professional wealth managers of all stripes, but most particularly those managers utilizing a long short hedging strategy to manage and mitigate portfolio risk. Not only was the dramatic daily volatility enough to disrupt the most carefully crafted portfolio plans, but the extremely high correlation among virtually all asset classes made the exercise of contra balancing a long side investment position with an appropriate risk mitigating short, often a frustrating and unsuccessful exercise. Precious metals, regularly moved in lock step with overall equity indexes rather than performing in their traditional inverse manner. Stock markets across the globe moved with the synchronicity of a chorus line, and equities, regardless of credit quality, capitalization, or prospects, seemed at times to all move maddeningly as if one.

Much of the blame for the extreme volatility can be directed to the manic “risk on/risk off” behaviour of investors that occurred on a regular basis. This seemingly senseless approach to investing was in turn also responsible for much of the unusually high correlation that we refer to above. When all asset classes move in tandem, a basic principle of portfolio construction and risk management is compromised, and that principle is ‘diversification’.

Add to all of this a steady diet of alternating negative and euphoric headlines emanating from Europe as the region’s fiscal crisis unfolded, and one is left to cope with an investment environment which was most unpleasant. It is for these reasons that a majority of Canadian long-short equity portfolio managers posted negative performance and are understandably happy to see the year end.

This tumultuous environment resulted in a 10.6% loss for Patriot Trust; only the second loss in its nine years of existence. Its performance benchmark, the S&P TSX Composite Index declined even further at -11.1%. Yet despite 2011’s losing session, Patriot retains a particularly strong track record over the course of its existence and has decisively outperformed its benchmark over

the stretch. It has additionally achieved this superior performance with lower volatility and loss drawdown than has been experienced by most equity Funds operating with a similar style in Canada.

JCClark Patriot Trust Returns vs. Indices				
	2011	3 Year	5 Year	Since Inception
Patriot Trust (Class B)	-10.63%	11.95%	7.87%	10.17%
TSX Index Returns	-11.08%	9.98%	-1.52%	6.95%

Since Inception returns are annualized

Returning to an assessment of last year's stock market performance, it is interesting to note that many Canadian investors feel that our stock market performed more poorly than the overall Composite's 11.1% decline would suggest. This is probably attributable to not only the market's extreme volatility but also to the absolutely dismal performance of several well followed and important Canadian market sub sectors. For example, senior gold stocks, which traditionally perform well in a low interest environment and which are recommended as a safe haven during uncertain times, actually lost 13.3% as measured by the TSX Global Gold Index. Even more puzzling is that the price of gold bullion actually appreciated by 10.2 % over this same period. Another casualty was the base metals and mining sector which comprises almost a quarter of the Composite Index. It suffered a whopping loss of more than 27% despite a generally positive pricing year for a majority its underlying base metals components. Only the yield oriented sectors such as Income Trusts, Utilities, REIT's, and dividend paying preferred stocks acted positively during 2011.

On a global basis, other than for the U.S. Dow Jones Industrial Average which finished 2011 with a 5.5 % gain, and the S&P 500 which broke even, every major equity index in the world finished the year with losses, many quite substantial. Important examples include the Stoxx (Europe), MSCI Asia, and the Bovespa (Brazil) which closed -9.1%, -18.6% and -13.3% respectively.

The resilience of America's equity markets relative to its global counterparts was surprising. Entering 2011, it was widely expected that the United States would continue to struggle with double digit unemployment, a depression style housing market, and anaemic GDP growth. All of this would of course relate to continued weakness in consumer spending resulting from the ongoing deleveraging of massive sovereign and consumer debt loads that had accumulated during the years prior to 2008. By contrast, Canadian markets were expected to log decent gains based on our stable politics and currency, the perceived strength of our banking sector, and the sunny outlook for the resource sector. So why the reversal of outcomes for the equity markets of the two countries?

First and foremost it is increasingly apparent that a nascent recovery has been underway for the past six months in the United States and that it is gaining momentum. Some of the statistical indicators of recovery are sending conflicting signals, but it is hard to ignore the fact that many American factories are starting to hum, (particularly within the automotive industry), that job creation is on the rise, (the unemployment rate now down by 1% in the last 8 months), that consumer expenditure is showing signs of life, and that state and municipal deficits are being tackled. The sovereign side of the U.S. debt equation will have to wait for an action plan until the end of the November federal election. This good news reflects three years of belt tightened austerity that has been endured by America's citizens as well as reinstated export competitiveness brought about by strong productivity gains and the dollar's 15% devaluation as measured against a basket of the currencies of its major trading competitors over the past three years. On a year over year basis, American exports have increased by an impressive 35%.

For its part, Canada's economy has operated in a largely satisfactory fashion throughout the piece, but our markets have had to cope with worrisome warnings of consumer debt excesses, a developing housing bubble, weak private employment figures, and rumblings of a slowdown by the world's great raw materials consumer, China. For Canada, even the smouldering Euro zone crisis takes a back seat to our fear of the consequences to the economy that could result from the deceleration of the great Chinese materials and energy consumption machine. Our stock market reflects these worries, and to a certain extent may continue to do so.

Outlook for 2012 and Patriot's Portfolio Positioning

To those of you who may recall 'Coles Notes' and used them to ease your way through various invigorating high school subjects such as Latin or Shakespeare's plays, the following is our Coles Notes version of what's in store for 2012.

We are modestly positive on the economic U.S. outlook for 2012 and neutral to positive for Canada. Both countries should generate GDP growth of better than 2%, but the U.S. offers potentially attractive upside for certain sectors of its economy that will be hard to find in Canada. We are attracted to the apparent recovery in American manufacturing, particularly a renaissance of the domestic auto industry. We are also excited about dramatic technological developments occurring within the onshore oil and gas industry. Horizontal drilling and extraction techniques are adding enormous volumes to recoverable hydrocarbon reserves that may ultimately promise energy independence for North America in ensuing years. And the housing industry seems to have finally bottomed out, with early indications of an uptick in building and renovation activity for the first time in almost four years.

On the other side of the equation is Europe, which remains the world's number one headache. We don't believe that a disorderly collapse of the euro zone and its common currency will be allowed to happen, but in the event of such a calamity, all bets are off for any semblance of global economic growth this year or next. Therefore, at a minimum Greece is likely to leave the

union. Italy then becomes the front line for the crisis and the sine qua non (those Latin Cole's Notes were potent) must come in the form of the ECB as a lender of last resort to the banks, and an enforceable compact of fiscal union being hammered out. As for China, there are multiple indications of a slowdown occurring as evidenced by constrained credit, decelerating GDP growth, and reduced import activity. But we believe that China has the situation under control and will successfully engineer its transition to a more balanced and domestic demand driven economy. The financial sector is less leveraged and prone to crisis, trade and investment flows with Africa and Latin America are on the increase, and growing consumption by the emerging middle class remains a key catalyst for orderly growth going forward. China will also continue to be a voracious consumer of the worlds energy and raw materials resources, even at a reduced pace of growth.

Although Patriot's investment strategy is very much one of identifying companies with great management and strong balance sheets, we have made some modest adjustments to our geographical and sector exposures based on the opportunities and threats we foresee over the next couple of years. First and foremost, we are populating the portfolio with a larger selection of blue chip names that carry fortress balance sheets and pay attractive dividend yields. Many of the names are well known international companies such as Intel, Ford, TRW, Vodafone, and China Mobil, all of which operate with clean balance sheets and are globally diversified. Many of these companies are trading at earnings multiples not seen in more than forty years. We also continue to favour oil weighted mid cap energy producing companies in both Canada and the United States as we believe that solid rates of return will continue to accrue to this industry, even in the event of an unlikely 25% reduction in oil pricing. In like fashion we intend to maintain our solid positioning within the resource sector as we believe that the secular trend for selected commodities has not run its course.

We are represented to a modest degree in companies that will benefit from a recovery in the American housing sector and to those which are prospering from a long overdue reversal in the automotive sector. We are shifting to an increased geographical weighting of U.S based companies, a modest reduction in our Canadian corporate roster, and the elimination of companies heavily dependent upon the fortunes of Europe. We intend to remain overweight with ETF index shorts (country, sector and currencies) to mitigate risk. Patriot Trust has never materially utilized portfolio leverage to enhance returns and does not intend to do so in the future. Although the role of precious metals to counter excessive market volatility has been called into question lately, we will continue to retain a 5-10% weighting in senior gold producers since they now represent a fundamental value proposition based on earnings and cash flows rather than a crystal ball bet on gold's future.

We are optimistic that 2012 will be a better year for investing in North America than many pundits are predicting. We believe that we are properly positioned to capitalize upon the investment opportunities that exist for the coming year.

On the product development front, JCClark launched its first fixed income fund on January 1st. This fund, called the JCClark Yield Trust, will initially invest primarily in high quality corporate bonds and will target annual returns of 4%-5% with a conservative risk profile. Please feel free to contact us directly if you would like to learn more about this new strategy.

Thank you for your support and patience during the past year. As always please give me a call any time at (416) 361-1823 or email me at alex@jcclark.com if you wish to discuss further your portfolio or the contents of this letter.

Respectfully yours,

Alex Davidson
Portfolio Manager

