STEADYHAND

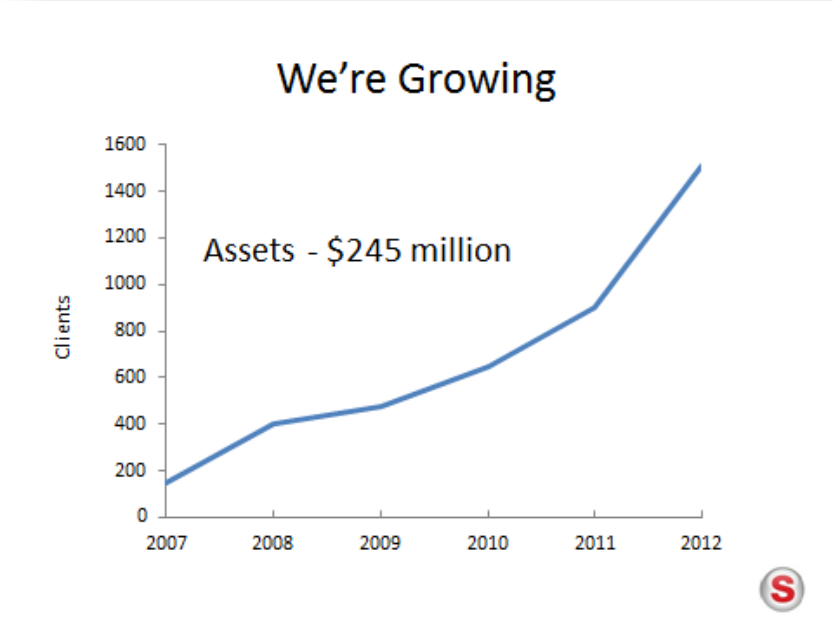
Where to From Here?

February 2013

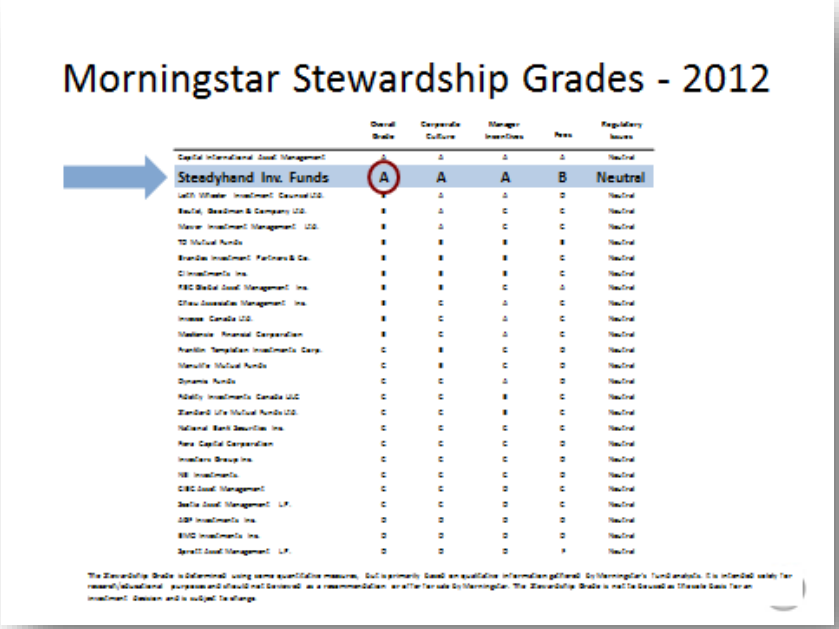
In this summary of our recent client presentation, we provide a brief update on our company, an assessment of the investment climate, and an overview of how our funds have performed and are currently positioned. We also weigh in on the *quest for yield*, which has become an increasingly popular investing theme.

Part I – Steadyhand Update & Overview

The past half-decade has been an extremely volatile period in the capital markets. Our team, on the other hand, has remained remarkably stable. And we continue to eat our own cooking, with 80% of our financial assets, on average, invested in our funds.



As we've garnered greater awareness and recognition, our growth has accelerated. 2012 was our strongest year yet, as our client base grew by over 65% and assets under management increased by more than 50%.



Morningstar Stewardship Grades - 2012

	Overall Grade	Corporate Culture	Manager Incentives	Fees	Regulatory Issues
Capital International Asset Management	A	A	A	A	Neutral
Steadyhand Inv. Funds	A	A	A	B	Neutral
Leith Wheeler Investment Counsel Ltd.	A	A	A	B	Neutral
Beutel, Goodman & Company Ltd.	B	A	C	C	Neutral
Mavrix Investment Management Ltd.	B	A	C	C	Neutral
TD Mutual Funds	B	B	B	B	Neutral
Brandes Investment Partners & Co.	B	B	B	C	Neutral
CI Investments Inc.	B	B	B	C	Neutral
RBC Global Asset Management Inc.	B	B	C	A	Neutral
Chou Associates Management Inc.	B	C	A	C	Neutral
Invesco Canada Ltd.	B	C	A	C	Neutral
Mackenzie Financial Corporation	B	C	A	C	Neutral
Franklin Templeton Investments Corp.	C	B	C	D	Neutral
Manulife Mutual Funds	C	B	C	D	Neutral
Dynamic Funds	C	C	A	D	Neutral
Fidelity Investments Canada ULC	C	C	B	C	Neutral
Sun Life Mutual Funds Ltd.	C	C	B	C	Neutral
National Bank Securities Inc.	C	C	C	D	Neutral
Ivey Capital Corporation	C	C	C	D	Neutral
Investors Group Inc.	C	C	C	D	Neutral
NB Investments	C	C	C	D	Neutral
CIBC Asset Management	C	C	D	C	Neutral
Sentry Asset Management L.P.	C	C	D	C	Neutral
AGF Investments Inc.	D	D	D	D	Neutral
BMO Investments Inc.	D	D	D	D	Neutral
Sprott Asset Management L.P.	D	D	D	F	Neutral

The Stewardship Grade is determined using some quantitative measures, but is primarily based on qualitative information gathered by Morningstar's fund analysts. It is intended solely for research/educational purposes and should not be construed as a recommendation or offer for sale by Morningstar. The Stewardship Grade is not to be construed as Thinkstock Gain for an investment decision and is subject to change.

We received a top *Stewardship Grade* from Morningstar once again. Of 26 Canadian fund companies graded in 2012, Steadyhand was one of only two to receive an "A" grade. The grades are designed to help investors further research, identify and compare fund companies that do a good job – or a poor job – of aligning their interests with those of their clients.

Our clients are **better** investors. It's a bold statement, but Steadyhand investors have been behaving well. They've maintained a long-term focus and stuck to their plans. Most of our clients have a Strategic Asset Mix (SAM) and rebalance their portfolios when it's called for (even if it's meant trimming the Small-Cap Fund and adding to the Global Fund).

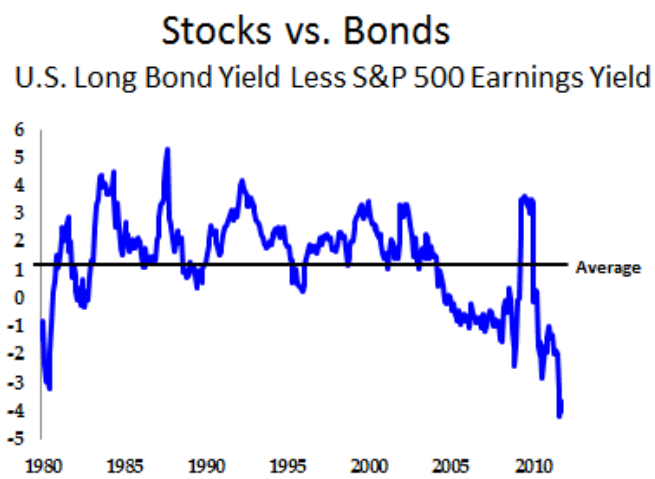
Part II – The Investment Climate

We started the market review with a few slides from last year's presentation.

Debt continues to dominate the economic landscape, particularly in Europe and the U.S. The consequences are slower economic growth, more risk of short-term shocks and …

… continued volatility. With all the debt in the system, we don't anticipate that the ups and downs will moderate. Clients should expect future returns to come with some down periods and short-term jolts.

We suggested last year that while Canada has been puffing out its chest, it may not be warranted and investors shouldn't get too caught up in how great we are. Canada has had everything going for it, but better opportunities are emerging elsewhere (with less risk).



Although fear and uncertainty were dominating the headlines last year, we believed that stocks were more attractive than bonds. This chart looks at the yield of the stock market in relation to the yield of the bond market. On this measure, stocks were extremely cheap.

Capital Market Returns

	1 Year	3 Year	5 Year
5-year Average GIC	1.7	1.9	2.1
DEX Universe Bond	3.6	6.6	6.4
S&P/TSX Composite	7.2	4.8	0.8
MSCI World ($Cdn)	**14.0**	**5.7**	**-0.5**

% Annualized to December 31, 2012

As it turned out, 2012 was a good year for stocks, and foreign markets in particular, with the U.S. and many European and Asian markets posting strong gains. We continue to see attractive value in foreign stocks and this is reflected in our communications and the composition of the Founders Fund.

Balanced Income Portfolio*

	1 Year	3 Year	5 Year
Balanced Income Portfolio*	**10.1%**	**8.2%**	**5.2%**
Benchmark**	6.2%	5.7%	3.3%

% Annualized to December 31, 2012

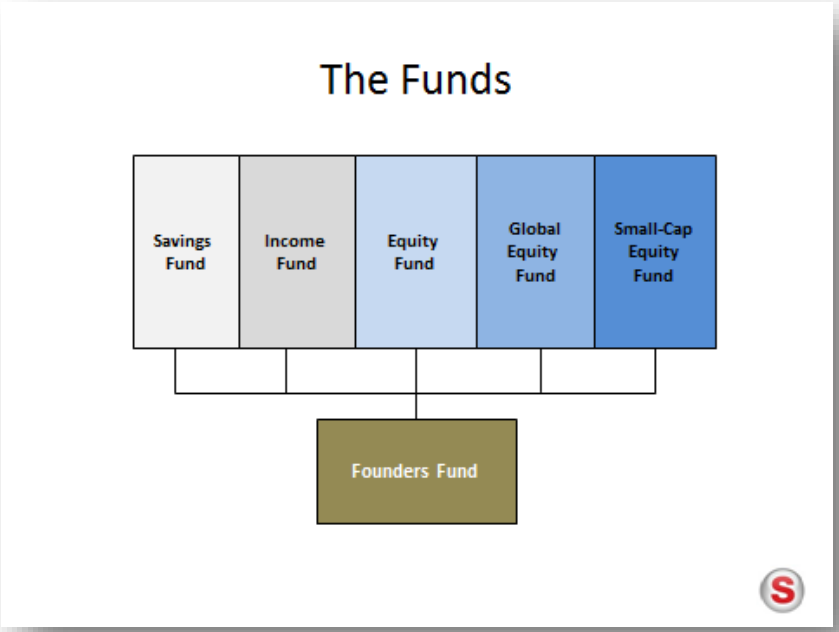
* The Steadyhand Balanced Income Portfolio is a hypothetical portfolio of Steadyhand funds.

** 50% DEX Universe Bond Index; 30% S&P/TSX Composite Index; 20% MSCI World Index ($Cdn)
Benchmark returns are net of a hypothetical annual fee of 0.50% (calculated quarterly).

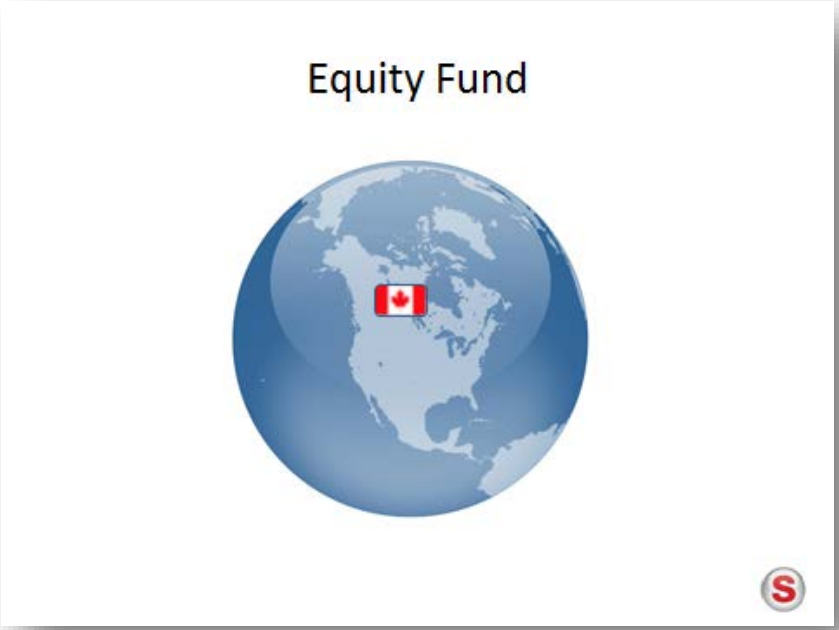
Our Hypothetical Balanced Income Portfolio is a model portfolio comprised of four Steadyhand funds. It has an asset mix of 50% bonds and 50% stocks, and is followed by many of our clients. It is a useful indicator of how our investors have fared overall. As the chart illustrates, the portfolio performed well last year and has produced strong annualized returns over the past 3 and 5 years.

The benchmark is a blend (50/50) of the bond and stock returns (previous chart) and takes into account the cost of maintaining an indexed portfolio (0.5% per year).

Part III – The Funds



As a reminder, we've had five core funds since our inception in 2007. Last year we introduced the Founders Fund, which is a 'fund-of-funds' that is comprised of the core funds. The mix is determined, and periodically adjusted, by Tom Bradley.



The Equity Fund is Canada-centric, currently holding roughly 54% of its equities in Canadian stocks and 46% in U.S. and overseas companies. The manager, CGOV Asset Management, looks for the best that Canada has to offer regardless of industry sector or company type, and complements these holdings with ones that aren't available in our market for greater diversification and long-term return potential.

Equity Fund Returns

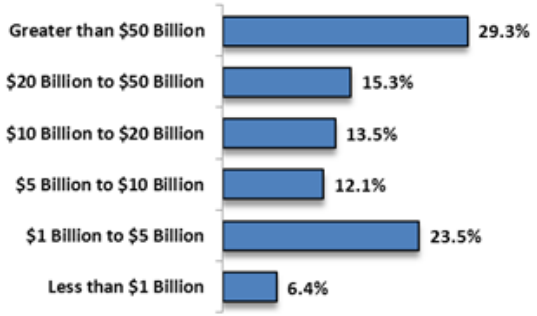
	1 Year	3 Year	5 Year
Equity Fund	**15.6%**	**8.3%**	**1.6%**
S&P/TSX Composite	7.2%	4.8%	0.8%
MSCI World Index (C$)	14.0%	5.7%	-0.5%

% Annualized to December 31, 2012

The Equity Fund had a great year. CGOV has emphasized a high-quality portfolio (companies that are inherently profitable with strong competitive and financial positions, and growing dividends). These types of stocks were in high demand from investors. CGOV avoided highly-cyclical areas of the market (e.g. mining) and maintained close to 50% of the fund in foreign investments, which performed very well on balance. The fund's 5-year return is not where we want it to be, but the fund has nonetheless outpaced the market over this period.

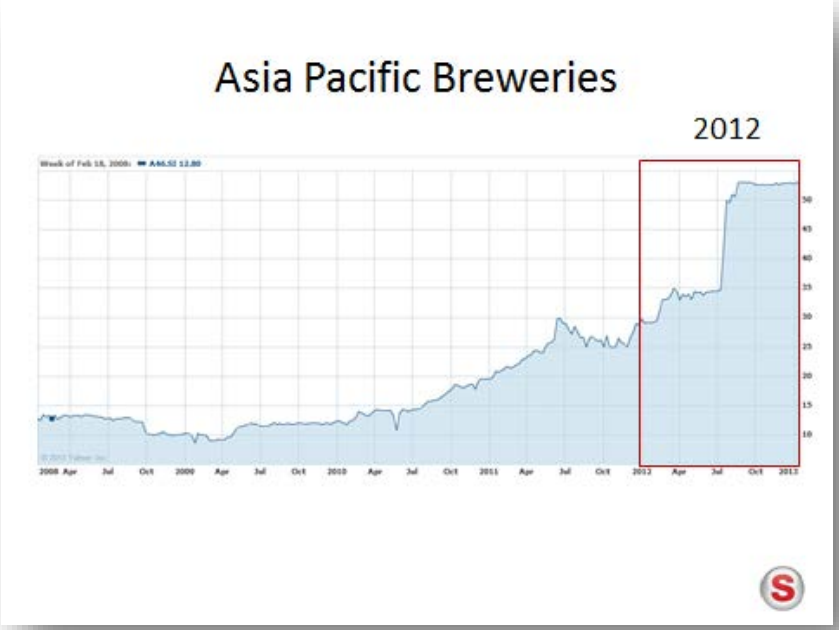
An '*All-Cap*' Fund

Portfolio Market Cap Breakdown



As of December 31, 2012

The portfolio is truly an 'all-cap' collection of businesses, meaning it owns small, medium and large sized companies. The manager is not constrained by the size of stocks they invest in.



Asia Pacific Breweries was the top contributor to performance in 2012. The stock, which had grown to become the fund's largest holding, doubled in 2012 and tripled in value over the two years it was held in the portfolio. It was sold in the summer after Heineken made a bid for the whole company.

Birchcliff Energy was the biggest detractor to performance. Takeover talks, which buoyed the stock in late 2011, fell apart and rock bottom natural gas prices knocked the stock back. The manager mitigated the losses to some extent by trimming the position early in the year when takeover talks heated up and purchasing additional shares on weakness later in the year.

Top 10 Holdings

Suncor Energy	Canada	6.0%
TD Bank	Canada	5.9%
Starbucks	United States	4.4%
Novartis	Switzerland	4.2%
CAE	Canada	4.1%
CVS Caremark	United States	4.1%
Lincoln Electric	United States	4.1%
Baytex Energy	Canada	4.0%
Franco-Nevada	Canada	4.0%
Home Capital Group	Canada	4.0%
Total		**44.8%**

Some key takeaways from the fund's top 10 holdings:

- They represent a diversified mix of industries and geographies
- Each stock comprises a meaningful position of the portfolio
- Many of the businesses are long-standing holdings

Global Equity Fund

The Global Equity Fund is our 'go anywhere' fund. Currently, 40% of the portfolio is invested in Europe (including the U.K.), 38% in Asia and just over 20% in the U.S.

Global Equity Fund Returns

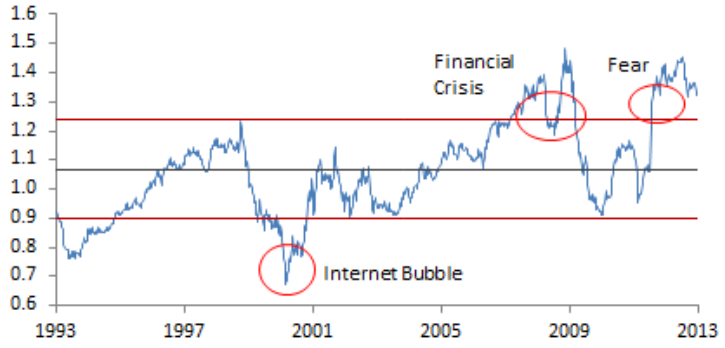
	1 Year	3 Year	5 Year
Global Equity Fund	**11.2%**	**0.8%**	**-2.7%**
MSCI World ($Cdn)	14.0%	5.7%	-0.5%

% Annualized to December 31, 2012

The Global Fund was a positive contributor to balanced clients' returns, although it lagged the broader market in 2012, and its longer-term returns have not been satisfactory. The manager, Edinburgh Partners, has had a distinct focus on value stocks (low P/E ratios and low price-to-book-value ratios) that are extremely cheap and have significant recovery potential. This positioning has hurt the fund's performance over the last 12-18 months, particularly as the market has favoured steadier, less cyclical companies. The next chart illustrates …

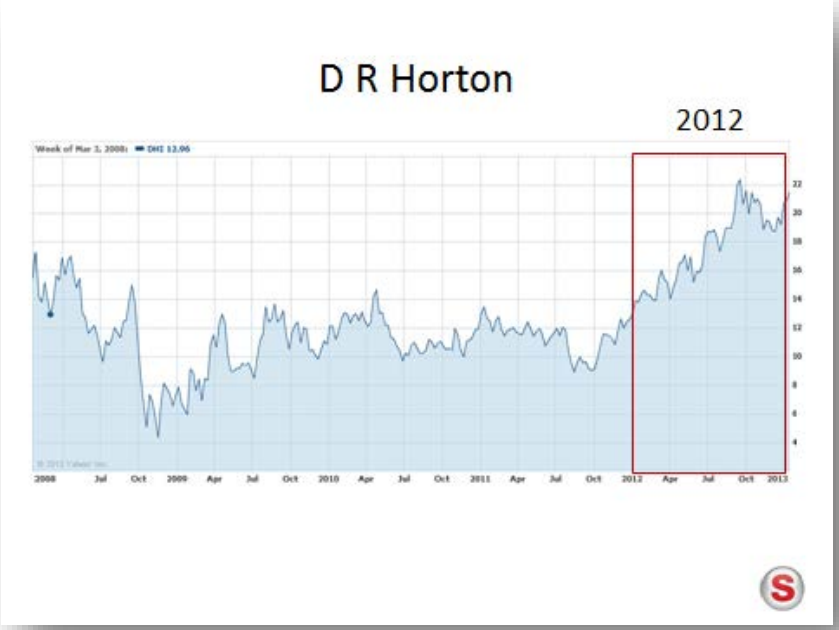
Predictable Earnings Awarded a Premium

World Consumer Staples (PE) vs. World Index (PE)

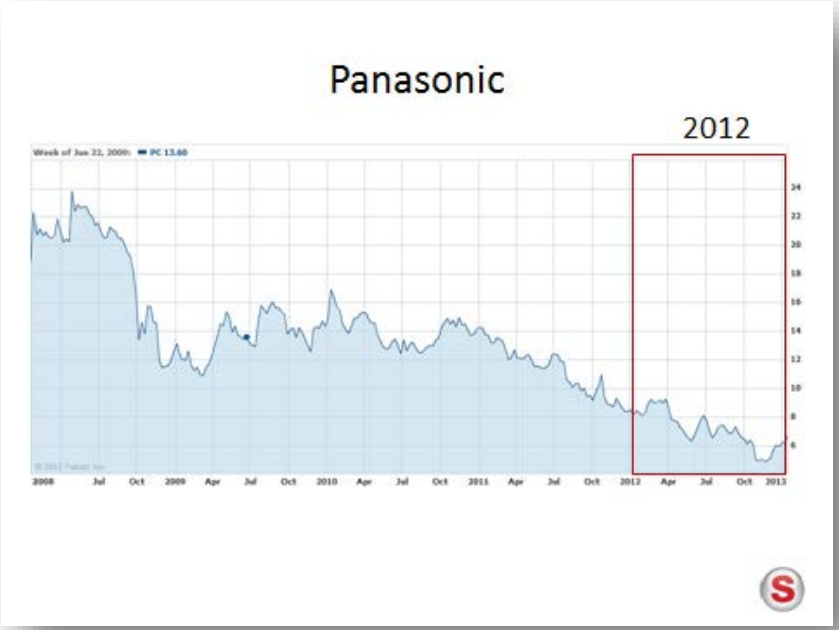


Source: Thomson Reuters Datastream

… the severe dislocation in valuation between "safe, predictable" companies and more cyclical businesses. Specifically, it shows that the valuation on consumer staples companies (such as food, beverage and household items) has gone to a significant premium compared to the overall market. This trend, which has shown signs of reversing recently, has been a headwind for the Global Fund as it had only modest exposure to the 'steady eddies'. The manager believes, however, that this valuation spread will eventually reverse and a comeback in value stocks is close at hand.



D.R. Horton was one of the fund's top performers in 2012. The Texas-based homebuilder is a good example of a stock that benefited from a sharp turnaround in sentiment towards an unloved and undervalued area of the market.



Panasonic was a detractor to performance. The Japanese electronics company suffered from a strong Yen for much of the year as well as a backlash to Japanese products in China stemming from the political dispute in the East China Sea. The manager believes that Japan is one of the cheapest markets in the world and export-focused companies like Panasonic, which have faced headwinds for several years now, have strong rebound potential.

Strategy

- 'Safety' premium falls as fears recede
- U.S. - profit margins peaking
- Japan - stimulus boosts profits

The Global Fund is positioned for a less fearful environment in which it is expected that investors will focus on opportunities in cheaply valued, more cyclical stocks. The portfolio has a relatively modest weighting in U.S. stocks and a focus on Asian and European companies. Japan remains a key area of investment, where a recent weakening in the Yen and new stimulus measures have been positive developments.

Small-Cap Equity Fund

The Small-Cap Fund invests in a limited number of small and medium-sized companies primarily in Canada, but with some U.S. exposure. The manager does not shy away from under-followed or thinly-traded companies.

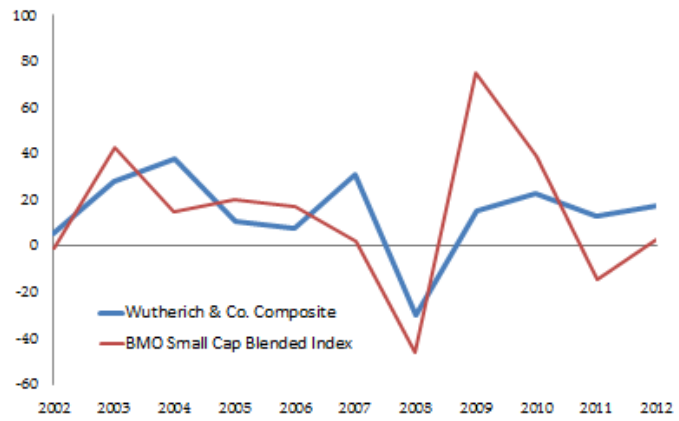
Small-Cap Equity Fund Returns

	1 Year	3 Year	5 Year
Small-Cap Equity Fund	**17.2%**	**17.2%**	**5.4%**
BMO Small Cap	2.5%	6.8%	2.6%
S&P/TSX Composite	7.2%	4.8%	0.8%

% Annualized to December 31, 2012

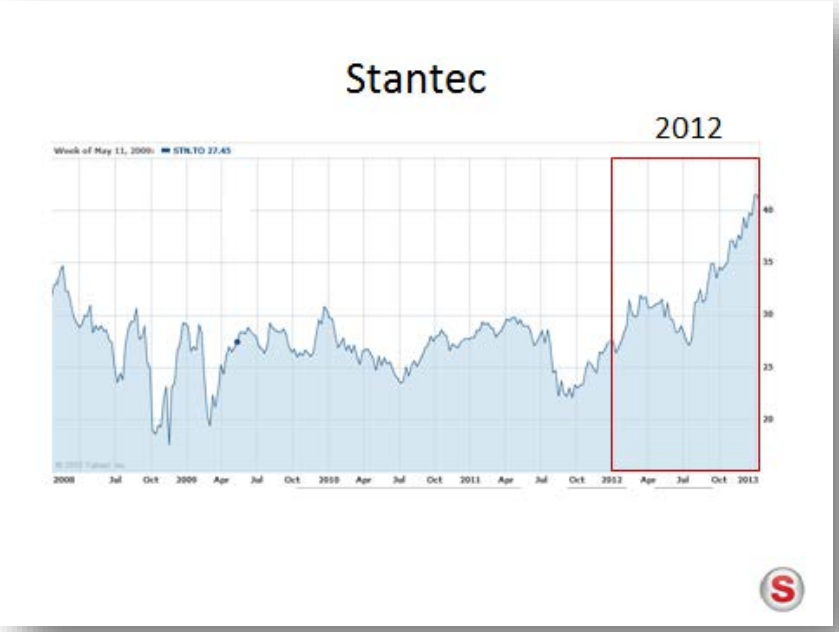
The Small-Cap Fund had an excellent year and has produced solid long-term returns since inception. In general, it has had little exposure to the mining and gold sectors and other speculative areas of the market. Focus has been on established, profitable, well-funded companies.

Annual Returns

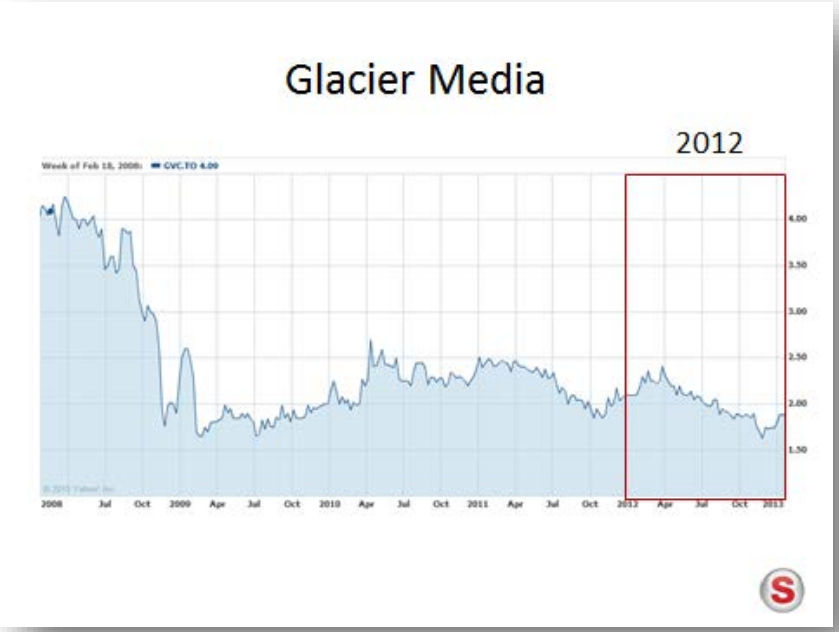


*Wutherich & Co. Annual Composite combines the performance of all the accounts managed by Wutherich & Co. that have been invested according to Wutherich & Co. Portfolio throughout their history. Returns are after fee.

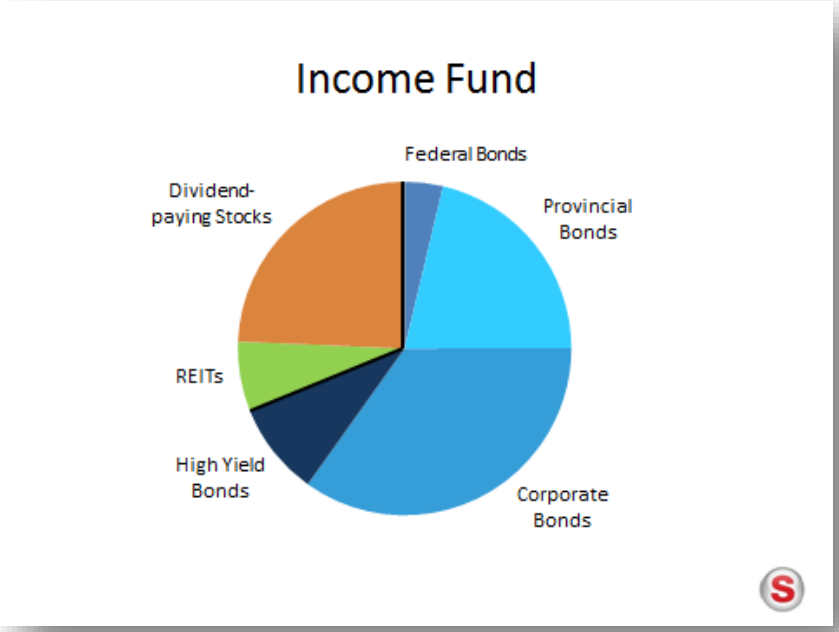
This chart shows the manager's long-term track record (Wutherich & Company) in blue versus the BMO Small Cap Index in red. It illustrates Wutherich's 'undexing' approach and how the portfolio's returns are often out of synch with the market. While highly concentrated, the portfolio has been less volatile than the market and has served as a valuable source of diversification in clients' portfolios.



Stantec was one of the fund's top performers and one of its largest positions. It has been a long-term holding with strong fundamentals, which were recognized by investors in 2012.



Glacier Media was a laggard. The stock has been a disappointment and was sold in 2012 as the manager lost faith that the company could meet his long-term return objective.



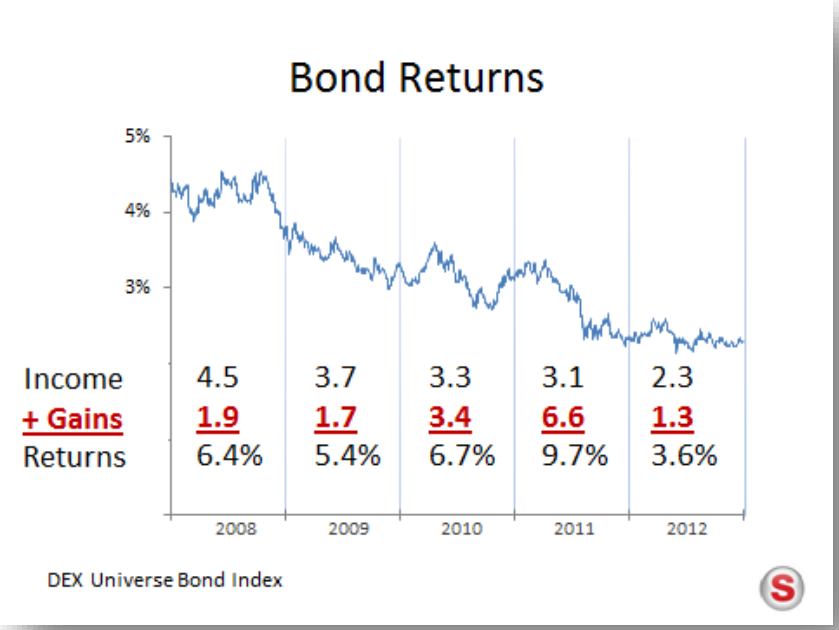
The Income Fund is a diversified fund that invests in a variety of income-oriented securities, including bonds, dividend-paying stocks and Real Estate Investment Trusts (REITs). The fund serves as the foundation for our balanced portfolios.

Income Fund Returns

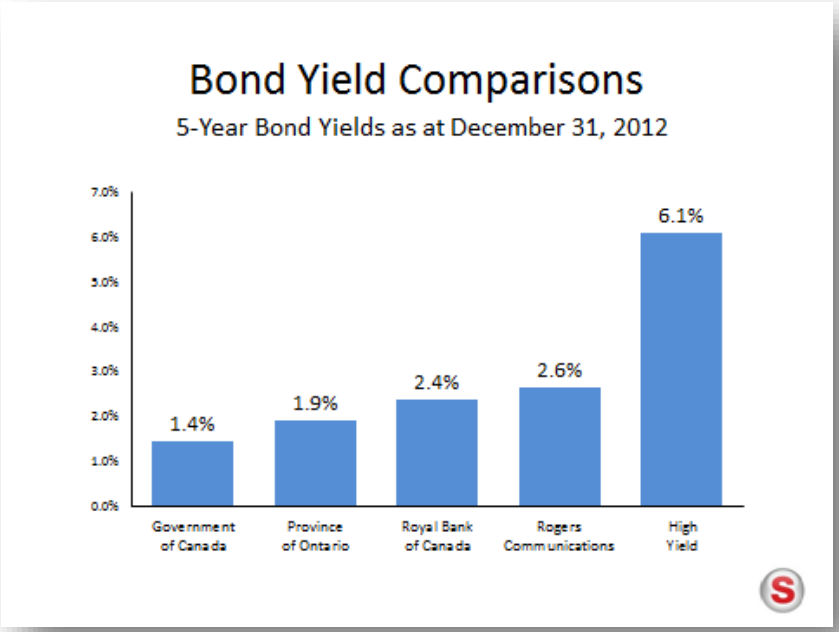
	1 Year	3 Year	5 Year
Income Fund	**8.0**	**8.7**	**7.4**
DEX Universe Bond	3.6	6.6	6.4
S&P/TSX Composite	7.2	4.8	0.8

Annualized % to December 31, 2012

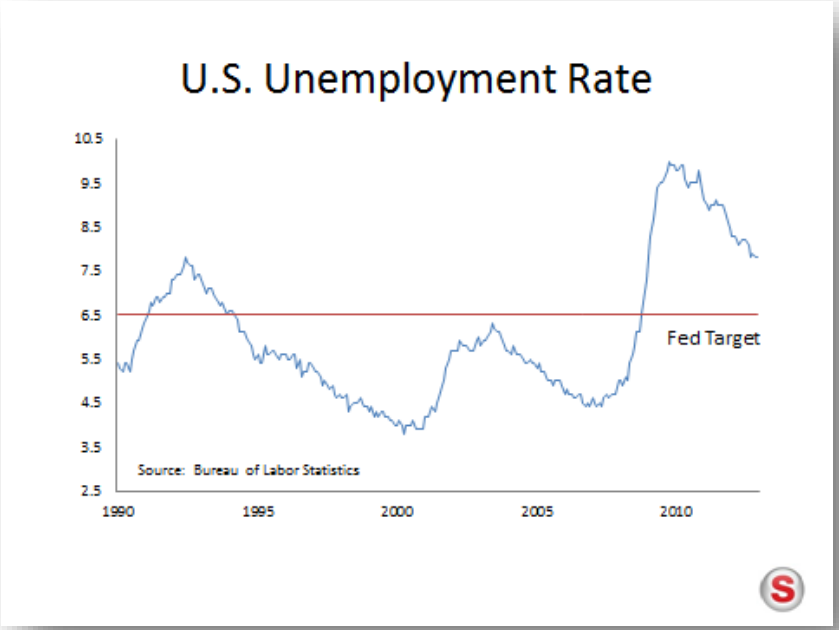
The fund performed well in 2012 and has provided strong returns over the past 5 years. It has benefited from high investor demand for high-yielding securities (investment grade and high-yield bonds, REITs and dividend paying stocks) and excellent execution by the manager, Connor, Clark & Lunn Investment Management.



It has been a favourable environment for bonds over the past 5 years, as interest rates have declined steadily. This has resulted in rising bond prices (capital gains). Interest rates do not have much room to fall further, however, and capital gains will likely be muted over the next few years. With yields close to historic lows, bond investors should prepare for lower returns going forward.



The fund is tilted towards corporate bonds, which currently provide an attractive yield advantage over government bonds, as the chart illustrates. The fund also has investments in high yield bonds, where higher coupon payments will help protect against the negative impact of rising rates. The manager increased the quality of the high yield holdings late in the year following a run of strong performance and is generally being more selective.

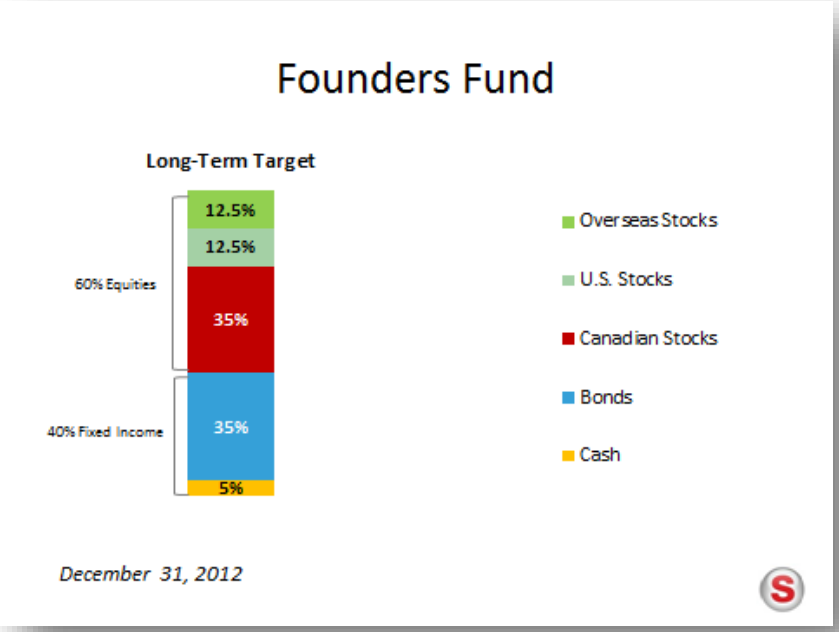


We've seen a nice recovery in the U.S. since 2010, but there's still plenty of slack in the economy, as the unemployment rate indicates. Thus, there is little pressure for inflation and Connor, Clark & Lunn expects it to remain low.

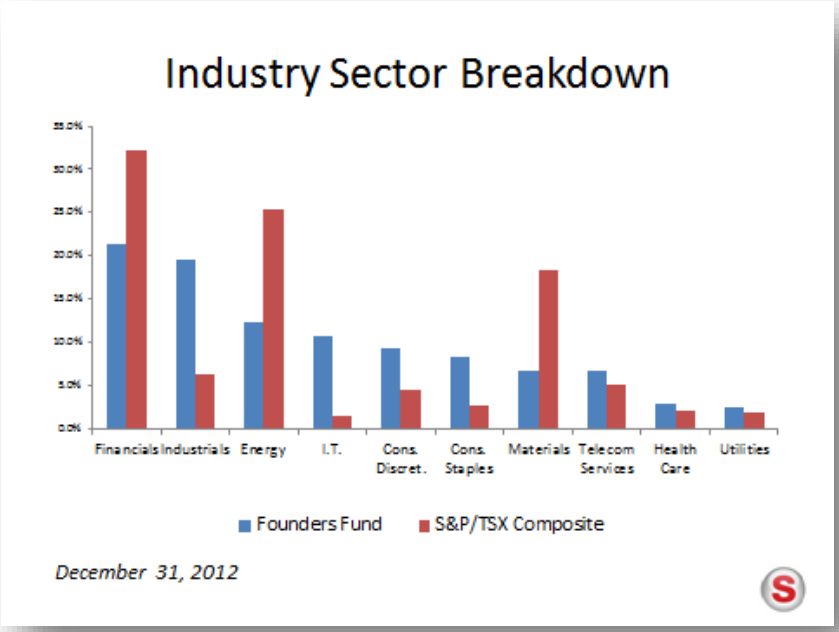
Strategy

- Modest bond returns expected
- Focus on high quality corporate bonds
- Use high-yield bonds selectively
- Increase equity exposure
- Focus on stable cash flow generators

In this low interest rate environment, the fund's focus is on high-quality corporate bonds with modest investments in high-yield bonds. The income-equity component of the fund (30% of assets) is higher than its long-term target (25%), and is expected to increase further with a focus on companies that generate stable cash flows and have growing dividends.

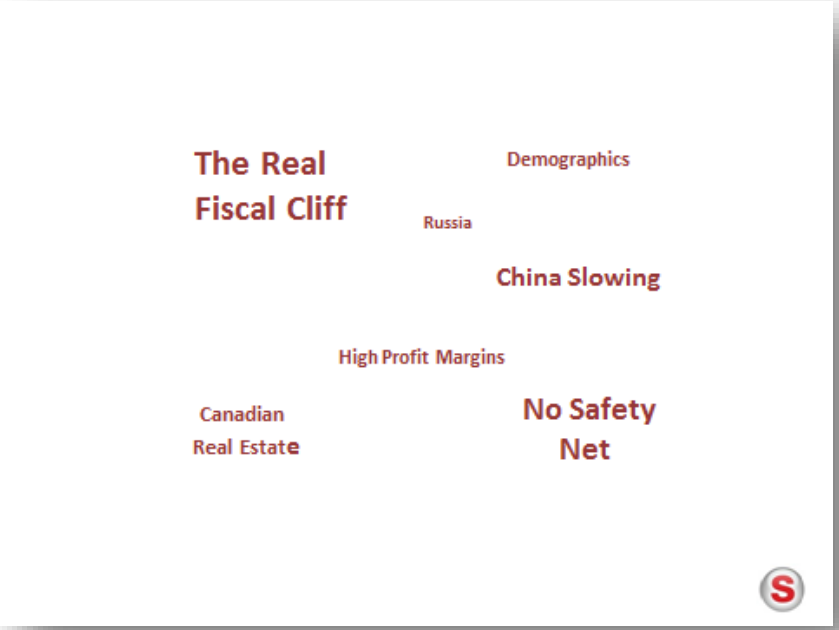


Launched in 2012, the Founders Fund invests in our other five funds. Tom Bradley determines the asset mix for the fund and makes adjustments when there are extremes in the market in our view.



The fund's equity component is a mix of stocks of all sizes, geographies and industries. As the chart illustrates, it's much more diversified than a typical Canadian portfolio that tracks the S&P/TSX Composite Index.

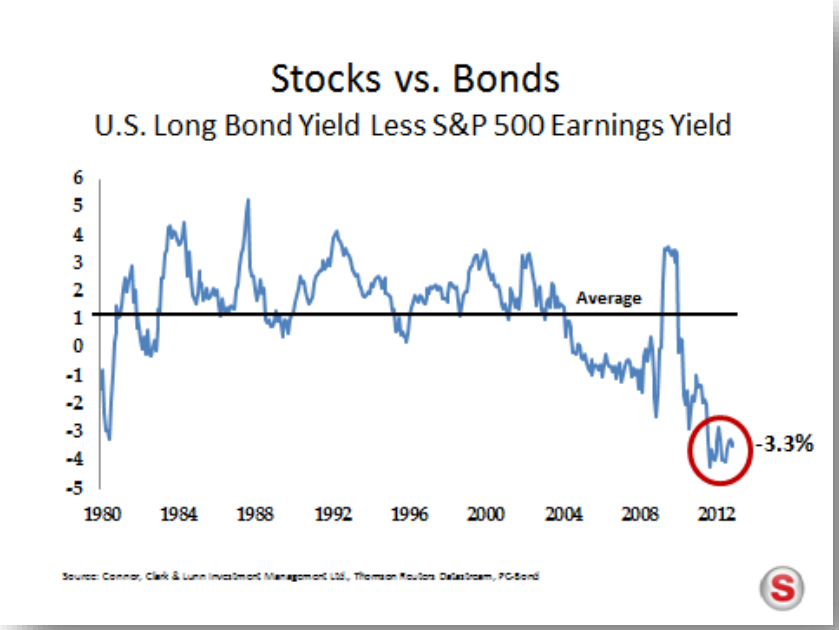
Part IV – Where to From Here?



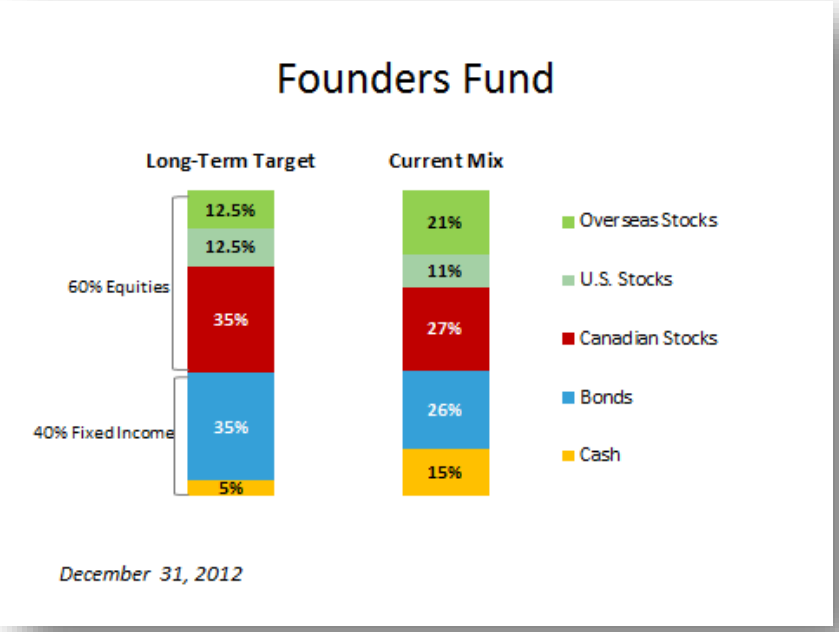
The global economy is facing some serious issues: debt, demographics, slowing growth in China, no safety net (in the form of lower interest rates or increased government spending), etc …

… but there are also some positives to draw on: the U.S. housing market is improving, energy sustainability in North America could have a big economic impact, China's middle class is growing, and we're starting to see some positive developments in Europe.

Stock valuations are up from last year but are still relatively attractive (the U.S. market is trading at 16X earnings). P/E multiples could rise higher (and stock prices rise) if demand remains strong and investor sentiment continues to improve. Higher P/E multiples are also justified in a low interest rate environment such as today's. In fact …

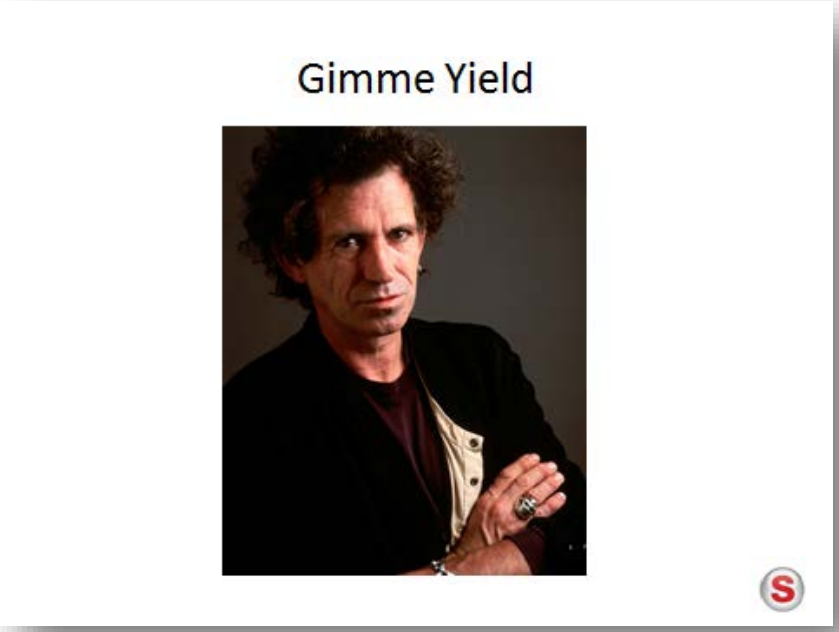


… relative to bonds, stocks are as good a value as they've been in 30 years. This chart subtracts the earnings yield of the U.S. stock market (6.3%) from the 30-year U.S. bond yield (3%). The resulting gap (-3.3%) suggests the expected returns from stocks are significantly higher than bonds. The gap will narrow as a result of either good stock markets, rising interest rates (resulting in a less overvalued bond market), or both.

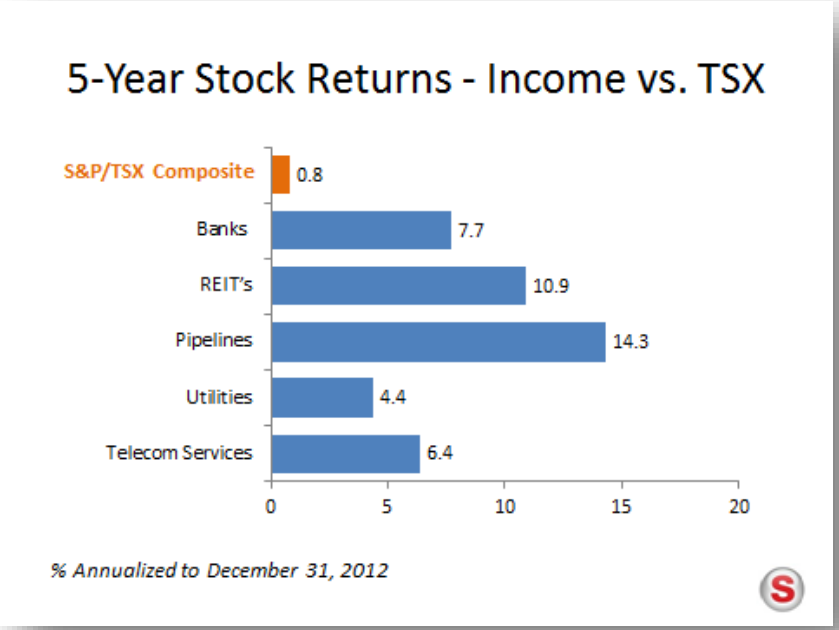


These views on the fundamentals and valuation are reflected in the composition of the Founders Fund. Currently, the fund is low on bonds (in relation to its long-term target) with a higher-than-normal weighting in cash and a full allocation to stocks. Based on the opportunities our managers are seeing, the fund is tilted towards foreign stocks over Canadian.

Part V – The Quest for Yield



Investors today have an insatiable thirst for yield, which is leading to imbalanced portfolios that are totally focused on a narrow range of interest rate sensitive securities and have little exposure to technology, resource, healthcare and retail stocks.



There are good reasons for this thirst. Stocks with high yields (banks, REITs, pipelines, utilities, telecoms) have produced the strongest returns over the past 5 years. Further, many companies that pay high dividends are solid, profitable, well-financed businesses.

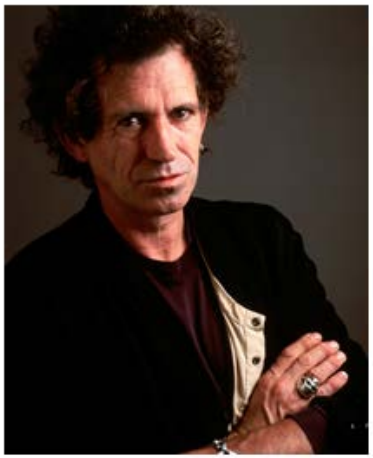
The trend has gone too far, however. Every new product today is income related, financial writers have dedicated whole columns to dividends and even young investors have income-focused portfolios. For many investors, it's become yield at all cost. As a result, expectations are high and portfolios have become less diversified. We wouldn't describe the income surge as a bubble, but it's likely there will be some nasty surprises in pockets of the income landscape where the income promises can't be kept.

Industry Trends

	Last 5 Years	Next 5 Years
Banks	↗	↘
REITS	↗	↘
Pipelines & Utilities	↗	↗
Telecom Services	–	?

While banks and REITs have had some strong tailwinds over the past five years (housing boom, increased consumer borrowing, low mortgage rates), they may face future headwinds in the form of consumer de-leveraging and a housing correction. All cycles eventually come to an end.

Balance Baby, Balance!



The key is balance, baby! Income-oriented investors should ensure they have diversified exposure to a number of sectors and not just high yielding securities. It's important to focus on total return (interest, dividends **and** capital gains) and not just income.

Takeaways

- Your portfolio has performed well
- Stocks and cash over bonds
- Fundamentals better than the headlines
- Don't chase yield
- Go where the puck is going to be

2012 was a good year for Steadyhand investors and your portfolio performed well. For balanced investors, we continue to recommend a bias towards equities and a higher than normal cash weighting, in the context of your Strategic Asset Mix. Stock fundamentals are better than the headlines suggest, and it's best to tune out the noise in the media as much as possible. As well, don't chase yield! There are attractive opportunities in areas other than high income paying securities …

… as the Great One said, "skate to where the puck is going to be, not where it has been."

Required Disclosures

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The performance data provided for the Steadyhand Savings Fund assumes reinvestment of distributions only and does not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. The indicated rates of return for the funds other than the Savings Fund are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Mutual fund securities are not covered by the Canada Deposit Insurance Corporation or by any other government deposit insurer. There can be no assurances that the funds will be able to maintain their net asset value per security at a constant amount or that the full amount of your investment in the funds will be returned to you. Past performance may not be repeated.

Steadyhand Investment Management Ltd. is the manager of the Steadyhand funds. Steadyhand Investment Funds Inc. (SIFI) is the principal distributor of the funds.

Published on February 15, 2013, by Steadyhand Investment Management Ltd.