FIRST QUARTER 2011 LETTER

April 18, 2011

A GOOD START TO THE YEAR

For the first quarter of 2011, the weighted average net return of our all-equity portfolios was 3.0%, versus a total return of 5.6% for the TSX Composite and a total return of 3.3% for the S&P500 (in $CDN). Our underperformance versus the TSX was due to low weightings in the financial and resource sectors versus the index, and higher than usual cash balances as we continue to adopt a more prudent stance (see "Heightened Risks" further on). Our balanced portfolios rose on average between 1.6% and 4.0% net of fees depending on fixed income weightings, helped by tightening corporate spreads and a rally in the bond market when stock markets were correcting towards the end of February and in March.

Our top gainers for the quarter, not surprisingly, included several resource related companies:
Viterra (+26.7%), Canadian Oil Sands (+23.5%), Stella Jones (+21.5%), Neo Materials (+19%), Cenovus (+15.1%), Provident (+14.1%), Velan (+13.5%), Eagle Energy (+14%), Asian Television Network (+11.1%), Marsulex (+10.8%), Logistec (+10.6%) and Telus (+8.9%). Record results by many of these core investments justify holding positions in these companies despite strong appreciation in their share prices, while we continue our usual search for value with growth.

Since our investment strategy was implemented in July 2006, we have generated a cumulative return of 69.1% net of all fees, versus 38.9% for the TSX, and far ahead of the 0.5% return of the S&P500 in Canadian dollars. This performance places us in the top 10% of Canadian equity managers in the country over the period. For more detail regarding our historical results and investment philosophy and strategy, please visit our new website at www.lesterasset.com, now available "en francais".

LESTER HEDGE FUND

For the first quarter of 2011, the Lester Hedge Fund is up 0.8% net of all fees and expenses, and has produced positive returns in 25 of the past 28 months. Since inception in April 2007, it has produced a cumulative compound net return of 31.5% versus 20.3% for the TSX Composite total return. This fund is managed using alternative strategies not available to most investors, including short selling and merger arbitrage, and is a good complement to our core portfolio management expertise.

NEW DEVELOPMENTS: STRATEGIC ALLIANCE WITH FLEMING CANADA

For those who wish to have US equity exposure, we are pleased to announce that we are broadening our investment offering through a strategic alliance with Fleming Canada. A former joint venture partner of the renowned global fund management firm Robert Fleming & Co. (sold to JP Morgan Chase), this boutique institutional manager based in Montreal is focused on US equities. Fleming Canada will provide us access to their model portfolio as well as supporting research and analysis, which we will screen and use to customize portfolios in our segregated accounts.

In return, Lester Asset Management will provide Fleming Canada with our model portfolio, as well as research and analysis supporting our Canadian securities selection. As such, clients of both firms will benefit from access to our respective areas of expertise.

OUR MACRO-ECONOMIC VIEW: HEIGHTENED RISKS

Our macro-economic view remains one of increasing caution as market risks have heightened.

That Sinking Feeling

As we have stated regularly in our letters, the US dollar, despite its "flight-to-safety" qualities, has resumed its decent versus most world currencies. The Greenback now fetches less than 0.96 of a Loonie, compared to a high of 1.61 in 2002 less than 10 years ago. With sovereign debt problems becoming regular news, investors are now focusing more attention on the massive deficits and debt refinancing facing America and selling the Greenback. Since announcing a second round of quantitative easing (QE2) representing US$600 billion worth of US bond buying by the US government, 10-year US treasury yields have counter-intuitively risen from a low of 2.3% last fall to a recent high of 3.6%. The big question is whether yields are increasing because of anticipated strong growth from an improving economy, increasing inflation expectations, a higher risk premium being placed by investors on US bonds, the end of QE2 (with no expectation of QE3), or a combination of the above. Unimaginably, PIMCO, the world's largest bond manager, recently sold all of its US Treasuries (US$ 236 billion worth) and is now short.

Despite record low interest rates and a trillion dollars in stimulus over the past 3 years, only minimal progress has been made in reducing the real unemployment rate. Job growth by a healthy but reluctant corporate America (focused more on productivity and profitability than hiring) is being partially offset by lay-offs at cash-strapped state and municipal governments whose tax base continues to shrink. Incredibly, US housing prices continue to sink. Aggregate home equity is now a whopping negative $4 trillion, while continuing foreclosures further bloat the inventory of unsold homes. With no end in sight to the US housing crisis, no wonder consumer confidence is low. Whether this "jobless recovery" holds or not, the US economy appears to be creeping toward "stagflation" (inflation with slow growth), while the US dollar is allowed to decline effectively boosting the competitiveness of exports and devaluing America's debt.

Having said that, there is a school of thought that we share that holds the notion that the United States is too big or too critical to the rest of the world to fail. Sometime just after 9/11, an article was written that listed 10 reasons not to own the US dollar. Although composed well before the subprime meltdown, many of the reasons, based on sound economic principles, sounded similar to our concerns listed above. Following the ten compelling reasons not to own the US dollar was the following heading: "*One Reason to own the US dollar"*. Underneath the heading was only one simple phrase: "*It is the US dollar*". In other words, despite several seemingly irrefutable justifications for avoiding the US dollar, and indeed today there are even more, the US dollar is still tied to the biggest economy in the world by far and used as a reserve currency by most other countries. Thus we do not expect a US currency or debt crisis to occur. Another important consideration for us is the question of whether or not the US dollar can depreciate much more against the Loonie without causing material damage to the Canadian economy. In other words, is there still a meaningful linkage between the two currencies? Our belief is that even though our reliance on the health of our major trading partner to the South has diminished, it is still significant.

European Debt Dominoes

Despite all the bravado, European leaders are still in denial about the severity of the sovereign debt situation and continue to stall in dealing with it. Europe has lived large for far too long and members of questionable quality were allowed to join the EU and share the Euro, without proper accountability. Despite Greece, Ireland and now Portugal having been "bailed-out" to the tune of nearly US$400 billion, yields on their bonds have risen, suggesting that in the end a debt restructuring may be inevitable. Spain is working hard to avert disaster, however the European Central Bank (ECB) is renewing stress tests for financial institutions and forcing them to raise capital, an ominous sign that in a post-bailout/too-big-to-fail world, bank shareholders and bond investors will be responsible for losses, not taxpayers.

To add to the surreal landscape, the ECB recently raised interest rates driven not so much by the strength of some members' economies (i.e. Germany), but on the fear that inflation from higher energy prices is a more serious threat to the Eurozone than higher interest costs on its heavily indebted members. Our fear is that once again the repercussions of the European debt crisis on the global financial system are unknown and unquantifiable, even by those in positions of power, and thus caution is warranted, particularly when investing in the financial sector.

How this will eventually play out is the subject of much debate in the financial press. In the short term it seems that continued bailouts of the weaker member countries are inevitable. However, in the medium to long run, the ultimate solution will either involve a splitting of the Euro into either two Euros (the "good" and "bad") or more likely that the stronger countries keep the Euro as a common currency while the weaker countries go back to fiscal and monetary autonomy and their own previous currencies.

MENA Concerns and the Japanese Tragedy

We are closely monitoring events in the Middle East North Africa (MENA) region as they unfold. As well, we are watching as rescue and rebuilding efforts in Japan are pursued. First and foremost, as citizens of the world, we have to be affected and saddened by the severe suffering and life changing upheavals that categorize the many survivors who are directly affected in both regions. As Canadian investors, we must be concerned with everything that affects the energy and commodity sectors. The political upheavals in the MENA region, with its crucial supply of oil, and the immense destruction to property followed by the continuing nuclear disaster in Japan, both promise to have large impacts on these industries. Commodity prices, especially oil and uranium, have already reacted. The question is whether these adjustments are temporary or are the beginning of a more long term trend. As mentioned further on, we have already made some adjustments to the portfolios and more are being contemplated. We plan to discuss this in more depth in our next quarterly report.

The Commodities Complex

As we have also stated in the past, most commodity prices have continued to rise in US dollar terms, partly due to demand recovery and partly due to speculative buying as a hedge against currency debasement. China is continuing to raise interest rates and increase capital requirements in an effort to contain inflation and curtail risky bank lending, adding to volatility in the commodity complex. Oil prices have continued to rise largely on the risk of supply disruptions caused by the instability throughout the Middle East, while gold continues to reach record levels thanks to inflation fears, net buying by central banks in order to diversify their reserves and rising geopolitical risk.

Prior to the Japanese tsunami, uranium prices were lifted by the expectation that nuclear power projects would continue to be the favored substitute for fossil fuels around the world. This is no longer the case as the fallout from damaged reactors is being closely monitored. Fortuitously, we had sold the bulk of our uranium holdings prior to the tsunami, but this was from disciplined portfolio management rather than being able to foresee such an event. Consequently, natural gas prices have started to rise and interest in renewable energy has gained even more momentum. However, the biggest concern at this time is the impact of food and fuel inflation on domestic economic recoveries worldwide, which we expect will eventually slow global growth.

OUR MARKET VIEW: INCREASED PRUDENCE

Short term Interest rates remain low and corporate profits continue to be healthy, providing resiliency to stock markets as witnessed by the snap-back in March amid much turmoil. However, the mountain of the cash that was sitting in money market funds since the financial crisis in 2008 has largely been redeployed either into stocks or bonds, and margin debt has risen considerably. Bond values remain vulnerable to inflation and rising interest rates, and in recent weeks have started to feel some pain from a back-up in government yields. Nevertheless, with rates still near historic lows, the "search for yield" continues, and our preferred investments remain higher yielding corporate bonds with shorter maturities than industry benchmarks, as well as high dividend paying equities.

In light of the current instability in the Middle East and the potential for it to spread and escalate, we continue to hold Canadian oil sands companies amongst our largest positions, as well as gold producers.
The tragic events in Japan have revived concerns about nuclear energy and we suspect that natural gas and renewable energy will be major beneficiaries. While the surplus of natural gas should keep prices low for years to come, gas infrastructure companies will benefit from increased extraction, processing, storage and distribution. Consequently, we have been increasing our exposure to these promising sectors, while maintaining a disciplined approach towards profit taking as valuations become stretched relative to future growth prospects and keeping a low exposure to more volatile sectors.

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