FIERA CAPITAL

Pinnacle Income Fund
First Quarter 2009

The economy is falling off a cliff. In the United States, the consumer confidence index fell to 26, the lowest level on record (with data going back to 1967) and is down almost 78% from its July 2007 level. This figure is also more than 40% below the prior historic low in December 1974. Total manufacturing capacity utilization fell to 70% in February, the lowest level in its 68-year history.

As bad as the economic results are, they are unlikely to stand for long. But that is tomorrow's news. Right now, the stock market is bouncing and since stocks lead the economy, we will have to wait until the equity countertrend rally is over.

The chairman of the U.S. Federal Reserve, Ben Bernanke, says that the recession will be over by the end of the year. According to an Intrade.com contract, which trades on the prospects of an economic depression (defined as a 10% decline from the peak 2009 GDP reading), the likelihood of such an event declined from about 50% at the end of February to 18% by the end of March. Never mind what gold and silver have to say, the U.S. Treasury and the Federal Reserve believe that if they buy up the worst that the bond market has to offer, demand will necessarily follow. As contorted and historically unsuccessful as this logic is, many are buying it.

Market psychology is something we know a little about, and one key aspect is that government does not create psychological trends, it follows them. At this point governments worldwide are doing everything in their power to get people to borrow when the right thing for them to do, and the right thing most smart people are doing, is getting out of debt and conserving buying power. In the fourth quarter of 2008 total household debt declined, and, if you include mortgage debt, it declined for the first time in fifty years.

Anyone who believes that the recession is near its end needs to take another look at the consumer debt numbers. As everyone knows, consumers' willingness to pile on debt carried the day through most of the "oh-oh's", but the quarterly rate of change of consumer debt (which moves like a glacier) shows a sharp dissipation in quarter to quarter increases. It is now breaking lower, and the reversal of an exponential rise is seldom gentle. As banks face weakness in consumer lending and now commercial property markets, they will tighten further and deflation will seep into just about every previously untouched sector of the economy.

In this environment, the Fund's bias going forward is to be neutral to slightly short on duration, to ladder our maturities across the curve and to selectively add some short-term corporate credit risk.

The Pinnacle Program

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