JARISLOWSKY FRASER LIMITED
INVESTMENT COUNSEL

Jarislowsky Fraser Limited
Total Equity Taxable
Fourth Quarter, 2008

Economic and Capital Market Review

Global economies fell into recession in late 2008, led by the United States. Continuing losses and investment write downs at financial institutions shrank balance sheets and severely curtailed their ability to lend. Consolidation has begun in the industry, but more is expected. A large number of healthier banks and insurance companies tapped equity and quasi-equity markets to shore up their capital, often substantially diluting existing shareholders. Interbank lending remained difficult despite efforts by key central bankers. The real economy felt the impact of these developments: manufacturing output contracted, job losses continued to mount and consumer confidence reached historic lows. Commodity prices have tumbled from their July 2008 highs, reflecting much lower industrial demand and capacity utilization. Oil closed the year at US$44.60 per barrel, down 70% from its peak on July 3rd, 2008. Continued political turmoil and expectations for a weak U.S. dollar helped gold prices rally back to US$882.05 per troy ounce at year end.

As the year progressed, access to capital became very difficult for individuals and businesses alike, hindering capital formation and long term economic growth. Governments and central bankers interceded during the year, reducing interest rates and injecting substantial liquidity into financial markets. In the future, more intervention is expected. This will take the form of government public infrastructure spending programs, tax cuts and/or direct aid to industry.

Performance Comment

The S&P/TSX composite fell by 22.8% last quarter, with our portfolios holding up much better. This was largely a result of better performance from our energy holdings, our under representation in Information Technology, as well as significant exposure to less cyclical holdings in the Consumer stocks. The best performers for the quarter were: **Kinross Gold** (+31.7), **Thomson Reuters** (+24.6%), and **Loblaws** (+18.5%). **Kinross Gold** was up, reflecting the strength in the underlying gold price, while **Thomson Reuters** rebounded, boosted by the weak Canadian dollar.

The S&P500 (C$) declined by 9.8% this past quarter, with our portfolios outperforming the Index. The decline of the Canadian dollar versus the U.S. dollar by 13.5% helped returns for Canadian investors as well. Our results were driven mostly by sector mix and our significant exposure to the more defensive consumer staples stocks. However profit taking in certain Health Care holdings, on disappointing news reports, held back overall returns for the period. Top performers (C$) for the quarter included: **Exxon Mobil** (+18.6%), **Quest Diagnostics** (+15.6%), and **Pfizer** (+12.3%).

The MSCI-EAFE (C$) index was down 7.5% during the quarter. Our portfolios outperformed for the year, as our preference for higher quality non-cyclical companies did not expose our portfolios to as much downside as the broader market. The exposure to Health Care and Consumer Staples, which is twice that of the index, contributed significantly to results, as did our underexposure to Financials and Materials. However, during the quarter, our portfolio essentially matched the index as our underweight in Japan cost over 1% in returns. Strong performance from the Yen inflated returns of Japanese stocks. While we hold a few Japanese export focused stocks, our portfolios tend to be underweight Japan, as many companies do not fulfill our criteria of sustainable growth and transparent, high-quality management. Top performers (C$) for the quarter included: **BP PLC** (+9.1%), **Vodafone** (+8.6%), and **Total** (+7.56%).

Outlook and Strategy

While some pundits are optimistic about a quick recovery led by Asian emerging markets, we believe that the world is headed for a prolonged slowdown and that no region is immune from the events of the past couple of years. Financial institutions cannot or will not lend to their peers because they do not trust them. Overall access to capital, whether to consumers or to businesses, will remain difficult for a long while, thus exacerbating the situation.

Central bankers and policymakers will continue to provide all manner of liquidity and fiscal stimulus to stabilize the situation both in financial markets and the real economy While this massive spend and liquidity are inflationary in the long run, most are worried about deflation in the near term, as a serious recession is taking hold of all of the world economies. **These are difficult time for investors. Past crises have demonstrated the need for patience and the importance of staying invested in equities in order to fully realize the benefits of ownership.** Stocks are a natural hedge against inflation and our emphasis on quality non cyclical businesses provides sustainable, above average cash returns to investors. Our defensive portfolio provides a solid cushion in downdrafts such as these. The stock market declines of 2008 have created extremely attractive buying opportunities. We will cautiously take advantage of them, realizing full well that these are still the early days of a global recession.