



The Quarterly Letter

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The Quarter in Review...

During the 1st quarter of 2003, the behaviour of financial markets has been strongly influenced by the world geopolitical context, in particular concerns over the Iraq conflict. Furthermore, economic data, evidently tinged with the same uneasiness, have shown few convincing signs.

The Canadian and American stock exchanges have declined by 4.1% and 3.6% respectively during the three months ending March 31, 2003. The Canadian dollar has however strengthened vis-à-vis the American

dollar, the latter losing value versus most world currencies as a result of the political concerns but also because of a downturn in its financial situation.

The strong market recovery, which coincided with the first days of the armed conflict with Iraq, demonstrated the extent of edginess in the market and also demonstrated that both good and bad news often lead to violent reactions. This significant volatility will persist as long as the current lack of political or economic visibility lasts.

We are following the situation



closely and are trying to reconcile short and long-term views. With the recent improvement in the financial results of almost every corporation in our portfolio, we are optimistic about the future.



The Dalpé-Millette Group

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Selected Statistics

Month	Interest Rates			Stock Exchanges			Currencies		
	Canada Short-Term	Canada Mid-Term	Canada Long-Term	CAN TSX/SPX	USA DJII	Intern. EAFE	USA\$	EURO	YEN
Dec. 2002	2.66	3.96	4.79	6615	8342	953	0.6351	0.6051	75.48
Jan. 2003	2.93	4.30	5.01	6569	8053	912	0.6577	0.6108	78.92
Feb. 2003	3.07	4.21	4.94	6555	7891	890	0.6734	0.6230	79.55
Mar. 2003	3.31	4.56	5.16	6343	7992	869	0.6812	0.6237	80.39

The Bond Market

Since the start of the stock market nose-dive in the spring of 2000, the bond markets have distanced themselves sharply from the equity markets.

The Scotia McLeod Universe bond index, which measures the performance of the Canadian bond market overall has shown returns of 10.24% in 2000, 8.08% in 2001 and 8.73% in 2002. This compares favourably with the S&P/TSX returns of 7.41% in 2000, -12.57% in 2001 and -12.44% in 2002.

By combining the three years, we realize that Canadian equity investors underwent an annualized negative return of 6.26%, while bond investors benefited from a positive return of 9.01%.

Over the same period, U.S. Treasury bonds are up 33.0% while stocks are down 36.1%. After three years of sharply higher returns for bonds, investors are wondering if 2003 will be the year the pendulum swings the other way.

Faced with a shaky economy and the war in Iraq, the American Federal Reserve has adopted a wait-and-see attitude and has kept its leading rate at its lowest level in over 40 years. In Canada, economic conditions argue for a more restrictive monetary policy than the one prevailing south of the border. Consequently, in spite of lingering geopolitical uncertainties and concerns about the prospects for world economic growth, the Bank of Canada has

decided to tackle the issue of inflation now and has finally opted for an increase of 25 basis points in its interest rates on March 4th. Given this context, it will be very difficult for fixed-income securities to offer as good a performance as the one in 2002. As measured by the Scotia McLeod Universe (SMU) index on March 31st, the return of the Canadian bond market since the beginning of 2003 has been -0.7%. The quarter was more lucrative for American bonds and, for the same period, the JP Morgan index posted a return of 1.0% . .



The Bank of Canada takes a stand and increases its rate.

The Currency Market

Having successfully passed the crucial launch stage a year ago, the Euro continues to gain ground. The European common currency has been getting closer to the \$1.05 USD or \$1.63 CAD mark for a few months now. For the Euro, this is a spectacular turnaround. It is indeed necessary to remember that the first steps of the new currency were particularly painful. The only currency that was supposed to stand up to the American dollar was introduced at a moment when the United States was undergoing one of the most solid and durable periods of growth of its history.

The loonie, which had tumbled to almost 63 cents US shortly after Christmas 2002, continued its upsurge initiated at the beginning of 2003 and crossed the threshold

of 68 cents US, its highest level in two years and a half. The Canadian currency also smashed another "psychological barrier" falling under the threshold of 1.50 Canadian dollars to the American dollar. The Canadian currency ranks among the 10 international currencies which have climbed the most this year against the US dollar.

This surge brings the increase in the Canadian currency to approximately 7% since the beginning of the year. It is tempting to give credit to the Bank of Canada, but the fundamentals are so well in place that the gain would have occurred anyways. The difference between interest rates in Canada and those in the US and Europe has rendered some short-term investments in Canada much more

attractive, to the extent that there has been an increase in the demand for Canadian currency from international investors.

The tumble of the American greenback in the last year, accentuated in the last three months, plays in favour of the loonie. All of the ingredients are in place to sow uncertainty in the American dollar; financial scandals, the fight against terrorism, the war in Iraq, the record budgetary deficit and the current account deficit adversely affect the situation.



The loonie soars above 68 cents US.

Canadian Stocks



In Canada, the TSX index ends the first quarter of 2003 with a return of -4.1%. Less shaken than the American indexes at the beginning of the year, our leading index marked time in January and February.

At the beginning of March, the TSX had declined by more than 5% and staged a comeback following the announcement of the war in Iraq. Although less pronounced than our southern neighbours, the appreciation in value of the TSX in mid-March reflects the hope that the war in Iraq will end quickly to allow the markets to focus again on the economy.

By and large, 5 of the 10 sub-indexes have recorded gains this quarter. Health stand out

from the others with an increase of 10.1%. On the other hand, the consumer discretionary, the industrials and the materials sectors were faced with a difficult quarter and fell 10.0%, 13.5% and 11.9%.

The country has been at the top of the G-7 in term of economic growth for several quarters now. The economic gulf is widening between the United States and Canada, favouring the latter, in spite of a decline in productivity and the fall of our exports in the last quarter of 2002.

Furthering this progression, the real estate market is maintaining its pace, the domestic demand continues its growth and the government is maintaining

a very stimulating fiscal policy.

The Canadian job creation engine is also continuing to move forward in such a way that the proportion of the population employed is currently higher in Canada than in the United States, a first in twenty years.

Another quarter of loss for the Canadian market.

US Stocks

After a difficult beginning of the year on American stock exchanges, the imminence of war calmed market uncertainties in mid-March. After March 11, unprecedented turnarounds in market indexes occurred.

This stock market rally, which rests on the hopes of a fast war and a decisive victory for the Americans, allowed the Dow Jones to record, at the outset of war, its most significant percentage increase over a one week period since October 1982.

The first quarter of 2003 ends with the Nasdaq and the S&P

recording +0.4% and -3.6%. As for the Dow Jones with a decline of more than 7% on March 7th, it ends the quarter with a return of -4.2%.

There has been no improvement on the economic front for our southern neighbour. Consumer confidence has continued to deteriorate, down now for three months. February economic data remain far from festive: a drop in employment, a decline in retail sales and a contraction of industrial activity.

The American economy is still plagued by these difficulties,

caused to a large extent by the spike in oil prices and geopolitical tension. When these uncertainties eventually dissipate, the favourable monetary policy and the increase in productivity should bode well for an improvement in the economic climate.



The threat becomes reality, the American markets bounce back in mid-March, but fall again at month-end.

International Stock Exchanges

Major world stock markets close the first quarter in decline but benefit from a recovery at the end of the quarter. European markets benefited the most from this rebound; the French index gained more than 12% in one week, ending with a setback of -14.5%. Italy and Germany post respective returns of -7.5% and -16.2% since the beginning of the year.

In the Euro zone, economic difficulties continue. In Germany, the unemployment rate is increasing, productivity is

declining and there is a setback in export markets while in France the household confidence index hit bottom in February, its lowest level in the last four years. These developments, coupled with the strong showing of the Euro, have prompted the European Central Bank to soften its monetary policy by lowering its leading rate by 25 basis points.

Japan is still facing a mountain of problems worthy of Mount Fuji; the Nikkei, at 7867 last March 11, has attained its low-

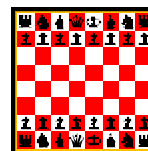
est level in 20 years and ends the quarter with a setback of 7.2%.

China, the real dynamo of the Asian and world economy, is counting on emerging new communication technology and globalization to allow economic growth through exports. In the United Kingdom, industrial production remains weak and its index posts a return of -8.3% this quarter.



Overseas stock exchanges did not escape the tendency and have benefited from increasing optimism at the outset of war.

Review of Portfolio Activities



During the quarter, we concentrated our effort on continuing the strategy begun some quarters ago of shortening the average length of our fixed-income securities. We foresee a significant increase in interest rates in the next 12 to 24 months and we are trying to take advantage of this increase instead of bearing it. If our forecasts are cor-

rect, we will then be able to lengthen the terms of our income securities at a better rate.

In addition to very short-term fixed income securities (Treasury bills or bank acceptance), we are also using government bonds with longer terms, but with a behaviour similar to the former.

For example, we have bonds where interest rates are adjusted quarterly according to the prevailing rate. We also have bonds where interest and capital at maturity are adjusted according to the prevailing inflation rate (*real return bonds*) allowing an enrichment protected from the effects of inflation.

During the quarter we have concentrated our efforts in shortening the average maturity of our income securities.

From Our Info Sabius of February 26, 2003

Our premise, which can be verified by statistical analysis, is the following: financial markets have a tendency, over the long run, to achieve a certain degree of balance. This balance demonstrates itself in many ways:

- The stock market performs slightly better than the bond market.
- Bonds do better than cash.
- Not one particular asset group over another produces exceptional returns on a consistent basis. More often, good years are followed by bad ones, which in turn provide a sustainable average in the long run.

Not one particular asset group over another produces a substantial difference in returns without eventually going through a reversal in trends towards a more sustainable average in the long run.

Since their peak in 2000, market corrections have caused a significant destruction of wealth. The Canadian index (TSX) is down 41% the S&P 500 and the Nasdaq are respectively down by 45% and 74%. One must think back to the Great Depression of the early 30s to understand the present situation. Over the past five years, no significant equity market around the world has had a positive return.

A balanced portfolio made up of the above-mentioned criteria has provided an annual yield of 3.3% for the 5 years from 1998 to 2002. In comparison, the 5-year return for the preceding period between 1993 and 1997 was 12.9%. The 5-year return of 3.3% is the 8th worst between 1953 and 2002. One must go back 25 years to 1977 (i.e.: 1973 to 1977) to notice an equally low 5-year return. 2002 has had a lasting impact due to the significant difference in returns over a one-year period, in other words the 5-year return ending in 2002 was 3.3% and the 5-year return ending in 2001 was 7.1%. These yields constitute a considerable gap for a difference of only 1 year.

If we agree on the premise of sustainable long-term balance, it is clear that the present situation will likely improve over the years to come. In fact, only once has a balanced portfolio (as mentioned) registered a negative return the year following one where a 5-year return was equal to or less than 3.3% (7 periods in total). The average yield for those 6 years of positive return was 13.5%. Although 1974 proved to be an exception by registering a negative return, the following two years more than compensated with returns of 19.7% and 19.9% for a total cumulative 3-year return of 21%.

In 2002, a fixed income portfolio (as defined) has obtained a higher return of 25.2% over an equity portfolio (as defined), not a negligible difference! In fact, the cumulative gap over the past 3 years (2000-2002) is 46.5% in favor of bonds. It is the worst 3-year underperformance of equity versus bonds in the last 50 years. Only twice in the last 50 years have bonds performed better than equities for a period of 3 consecutive years (2000-2002 and 1990-1992). If we use this data and base it on the premise of sustainable long-term balance and the positive contribution of investing in equities, it is clear that the winds are beginning to change.

If we combine the under performance of the stock market versus the bond market over the past 3 years, low interest rates which will have a negative effect on the bond market in the coming years, a 40% to 45% drop in stock markets and pessimism at an all time high, it is clear to us that a major turn around in the stock market is to be expected.

Portfolio Management Quiz



During 2003, we will quiz you to measure your understanding of the analysis of your investment portfolio return and to understand your appreciation of our role as investment advisor.

Question 1

1. Sort by ascending order the following scenarios on the basis of the best appreciation over five years:

	<u>Annual Return</u>				
	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Scenario A	7%	6%	5%	8%	9%
Scenario B	-15%	17%	22%	2%	13%
Scenario C	0%	6%	43%	-5%	-3%
Scenario D	9%	8%	5%	6%	7%

Answer:

Over five years, all scenarios ensure the same annual compound rate of return, i.e. approximately 7% (or 40% cumulated over 5 years).

Question 2

Which one of the four previous scenarios is the most appropriate?

	<u>Annual compound rate of return</u>	<u>Average yield</u>	<u>Standard-deviation</u>	<u>Dispersion</u>
Scenario A	7%	7%	1.6	0.22
Scenario B	7%	7.8%	14.7	1.88
Scenario C	7%	8.2%	19.9	2.43
Scenario D	7%	7%	1.6	0.22

Answer:

Although the annual compound rate of return over five years it the same for the four scenarios, scenarios A and D are from far the most preferable because they have allowed these returns with a much lower volatility than scenarios B and C. Standard deviation measures the average deviation of annual returns versus the average. Dispersion establishes a relation between the volatility and the average return (standard deviation divided par the average return).

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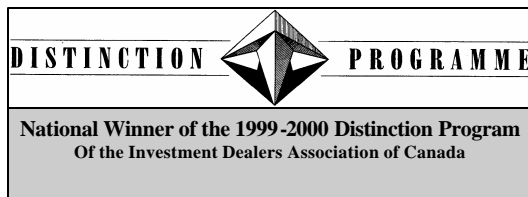
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The Dalpé-Milette
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Info Sabius



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