



# The Quarterly Letter

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## The Quarter in Review...

Until the beginning of March, market performance in 2004 was progressing with the same vigour as that observed in the last few quarters of 2003.

Recently, the stock market has taken a break, even posting a slight 4% correction, which was predictable considering the almost relentless rise in stock prices since the spring of 2003. The lack of spectacularly stimulating economic news (although positive on the whole) coupled with tensions in Iraq, Spain and Israel has contributed to this virtual standstill. The state of the American economy (budgetary and current account deficits) has im-

acted the American currency and weighed heavily on the markets.

On the other hand, the economic setting is promising: significant progress in the world economy, sustainable growth in corporate earnings and very low and stable interest rates. In this environment, the stock market looks attractive since it is properly valued considering the recent setback.

As is the case in most periods (except when there are important fluctuations in the overall market), geographic as well as sector-based allocation will have, in our opinion, a signifi-



cant impact in achieving competitive management results.

As always, we try to reconcile optimism with caution, by keeping an eye on the future direction of major macroeconomic aggregates.



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 2003	2.59	3.91	4.66	8221	10454	1289	0.7727	0.6156	82.75
Jan. 2004	2.25	3.64	4.53	8523	10488	1306	0.7521	0.6060	79.69
Feb. 2004	2.12	3.43	4.38	8788	10583	1335	0.7494	0.6000	81.84
Mar. 2004	2.01	3.35	4.33	8586	10357	1337	0.7648	0.6283	80.80



## The Bond Market

As expected by most economists, the Bank of Canada lowered its discount rate by 25 basis points on January 20th and again on March 2nd. The Canadian discount rate has now slid to 2.50%. It is the second decrease since the beginning of the year and the fourth since last July. The Bank justified this decrease indicating the following reasons:

1. overall inflation under the 2% target – fundamental pressures on prices and the presence of unused capacity being the main causes;
2. the appreciation of the currency and its negative effect on foreign demand for Canadian goods and services;
3. a domestic demand slightly lower than the forecast for the fourth quarter of 2003;
4. finally, the output gap at

the end of 2003 seems a little more significant than anticipated.

However, the strong appreciation of the loonie has caused most of the damage to the Canadian economy. Since January 1<sup>st</sup>, 2003, the Canadian dollar has appreciated by almost 20%. Not since the 30s, has the Canadian economy undergone such a pronounced appreciation of its currency over such a short period of time. A stronger loonie reduces exports, stimulates imports and thus decreases economic growth.

The situation is slightly different for our southern neighbour. The Federal Reserve chose to leave its leading rates unchanged at its January 28 and March 16 meetings, which means that the federal funds rate remains at 1%, its lowest

level since 1958. The Federal Reserve repeated that it was not in a hurry to raise the cost of credit because job creation remained slow and inflation low. In this context, the SMI Universe bond index posted a 3.1% gain in the first quarter of 2004. The loosening of monetary policy explains this positive performance. Since the beginning of the year, interest rates have also declined south of the border though much more moderately, with ten-year rates dropping from 4.25% at the end of 2003 to 3.84% now. The bond market remains stretched nonetheless with 10-year bond yields at 3.84% in United-States and 4.33% in Canada. However, as soon as job creation resumes its normal course, anticipations of monetary tightening will translate immediately into a correction of the bond market.

The Bank of Canada lowers its rates twice this quarter.

## The Currency Market

The economic event of 2003 was doubtless to say the sudden spike in the Canadian dollar. The currency experienced the fastest progression in its history. From a level of \$0.64 US, it soared to \$0.77 US within a year, an increase of 22 %. But since the beginning of 2004, the loonie has lost some feathers.

The Canadian dollar retreated in January. The retreat took place in large part after the Bank of Canada announced on January 20 that it was lowering its target for the overnight rate by one-quarter of one percentage point

to 2.5%. It was not so much the lowering of the rate that surprised the exchange market, as it was the Bank statement implying that additional reductions could follow.

In March, the loonie reached a low of \$0.74 US. Very early in March, the Bank of Canada lowered once again its target for the overnight rate by another quarter of a percentage point to 2.25%. The Canadian currency was also impacted by an increase in the American greenback, which profited from pressure calling for an easing in

interest rates in Europe.

Aside from impatience abroad, the turnaround in the USD was marked by profit taking on short positions in US dollars. This closing of positions (buying back of US dollars) pushed the American dollar up against major currencies, a first since last August.

The loonie lost some feathers in the first quarter of 2004.



## Canadian Stocks



The country's principal stock-exchange index, the S&P/TSX, posted the best return to-date in 2004 among major international indices. Although it has dropped by 2.3 % from its peak on March 1st, the leading Toronto index ends the first quarter of 2004 with an enviable rise of 4.4%.

At the sector level, movements are mixed; 6 out of 10 sub-indices end the quarter on a positive note. The technology sector, powerhouse of the Toronto stock exchange last year with an increase of 67%, has gained 29.3% this quarter. Among the most successful sectors, we also find: energy (+6.7%), financial services (+7.1%) and healthcare

(+4.1%). However, the materials, industrials and telecommunication services sagged this quarter by 1.7%, 3.2% and 3.5% respectively.

The Canadian economy is facing a more difficult period. The performance of the labour market has been disappointing since the beginning of the year and labour productivity figures confirm once again the lag between our economy and Uncle Sam's.

Whenever the productivity gap widens, the Canadian economy becomes less and less competitive and incapable of supporting employment growth. In 2003, the growth of the productivity rate in the country was at its lowest level since 1996. Con-

sumer confidence has decreased in the last few months but remains nonetheless higher than a year ago.

The soaring rise of the loonie is slowing down the profitability of export companies, but the vigour of raw material prices and higher than expected bank profits have a favourable net effect on the profit of S&P/TSX firms.

The S&P/TSX ends the quarter on the rise by 4.4%, in spite of a 2.3 % setback in March.

## US Stocks

After a long series of gains, the American core indices are manifesting signs of running out-of-breath in the second half of the quarter. The S&P 500 and the Dow Jones end with respective returns of 1.3% and -0.9%. After a return of 50% in 2003, NASDAQ has suffered from profit taking and has lost 0.5 %.

With the attacks in Spain, a backdrop of terrorist threats and a year after the onset of the most recent stock market rebound, the Dow Jones, the S&P 500 and NASDAQ are all dealing with a decline of over 3% during this short period.

The American economy begins 2004 with encouraging vigour, having ended 2003 with growth beyond its potential in the last two quarters. Indicators announce a robust beginning of year; industrial activity has reached highs in both January and February. Growth has resulted primarily from productivity gains. Profit margins have continued to grow and labour costs to decrease.

The only shadow emerging on the horizon: job creation, which remains anaemic and a lot lower than the levels normally associated with current growth. Strong productivity is limiting



the incentive to increase jobs.

Finally, most strategists agree that conditions are still in place for stock market growth, in particular a very expansionist monetary policy, solid and sustained profits and steady world growth.

The first significant downturn since March 2003.

## International Stock Exchanges

The recovery is well underway worldwide due to expansionist policies within the G7 countries. China's contribution to world economic growth competes with that of the United States.

Overseas stock exchanges behaved similarly to American ones: on the rise at the beginning of year, followed by a decline in March. On the European front, Italy, Germany, France and the United Kingdom have posted respective returns of 2.3%, -2.7%, 1.9% and -2.0%.

Japan's latest figures are spectacular, showing the strongest quarterly progress in 13 years.

Commercial trade with its neighbour China and world demand speeded up the pace of the Japanese economy. The Bank of Japan continues to intervene in this beginning of year to slow down the progress of its currency, given the significance of foreign demand for its economy. The Nikkei 225 index has posted a gain of 9.7%, whereas the Hong Kong Hang Seng ends up 0.8%.

Economic growth remains lower than production potential for the pillars of the euro zone in this first quarter of 2004. There is no improvement in Germany where the recovery remains weak and fragile, with the highest real interest rates in

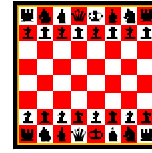
the zone. Nevertheless, the European Central Bank (ECB) has opted for the status quo during the quarter.

On the other hand, the economic situation is completely different in England and calls for very different measures. Growth has been sustained in the first quarter and signs of an overheated economy are multiplying. From this point of view, the monetary policy committee has raised its leading rate to 4 % in February.

China, engine of the recovery, on the Asian scene.



## Review of Portfolio Activities



Portfolio transactions have kept us quite busy over the quarter.

Firstly, we proceeded with the sale of the balance of our shares in Nortel at the end of January; the latter had been bought in 1998. We believe that the stock market price of the security had increased too rapidly considering the effective progress made by the company in the last two years; our move has been justified over the last few weeks. We also reduced our participation in Jean Coutu, still one of our favourites, due to a slight overweight position considering the moderate growth perspectives over the next few years.

Moreover, our transactions over the quarter were geared to tactically position our portfolios in those sectors and regions of the

world we believe will perform better over the next few years.

We have eliminated entirely our investment in the US stock market (by selling the S&P 500 index vehicle) and have replaced it by increasing our holdings in Asia (Japan and Southeast Asia / *Far East*). We are not necessarily pessimistic about the American market, but rather we believe that the risk/return ratio strongly favours Asia. This was repeatedly mentioned over the last three months in our Info Sabius.

Furthermore, our favourable economic setting, helped along by demand from China and India, will contribute to maintain and probably even to increase further the price for basic raw materials over the next 3 to 5 years. Copper, alumin-

ium, zinc, nickel and other producers should have several years of significant profitability, which augurs well for their stock prices. Our purchases of Falconbridge and Teck Cominco during the quarter, in addition to our investment in Alcan, constitute a solid block of companies in this sector. Some visionaries compare the excitement at the end of the 90s where all things 'virtual' dominated to the upcoming years where the 'concrete and tangible' will be in the forefront.

We are evaluating our investments in Europe and in BCE, with the intention of possibly reducing slightly the weight of these shares within our portfolios. We will however be patient because we think that markets might surprise on the upside.

The objective of our recent transactions is to tactically position our portfolios with a geographical and sector-based approach.



### The Dalpé-Milette Group is not idle!

Mrs. Annie Dagenais has joined our team. Annie is a university graduate in Business Administration. She has been working in the securities field since 1998 and, since 2003, in similar functions elsewhere with Desjardins Securities. She will be responsible for supporting our development efforts and for providing services to our growing clientele.

Members of the Dalpé-Milette Group:

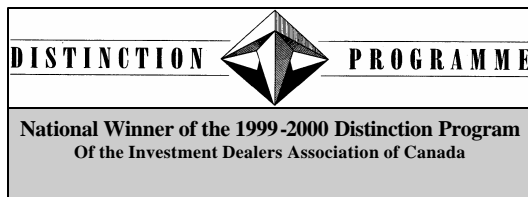
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The Dalpé-Milette Group



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# Info Sabius



For our clients who wish to obtain more information about financial markets as well as the views and thoughts which direct our portfolio management decisions, our Info Sabius meets these requirements. It is sent on a daily basis either by fax or by e-mail to our clients who wish to be kept abreast of their portfolios and the many issues which affect them. Please do not hesitate to contact us should you be interested in receiving it.



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