



The Quarterly Letter

The Quarter in Review...

Our portfolios have performed quite well in the first quarter of 2006. Over the three-month period, the portfolio of our typical client has increased by 4.3%, an annualized cruising speed of almost 18%. Considering our stock market outlook for 2006, the current level of interest rates and our asset distribution, this quarter will probably be the best of the 2006 vintage.

We were particularly active during the last few weeks, carefully reviewing the asset distribution of the portfolios confided to us, whether at the level of the fixed-income securities / equity securities mix or the geographic and sector-based distribution. As an outcome of

this reflection, we have taken a few measures to render our portfolios more defensive. These are explained in the section *Review of Portfolio Activities* on page 5.

Selling is always more difficult than buying. This reminds us of 1999, when we were disposing of our technology securities even though the latter kept on increasing in value for quite a few quarters. Although the current market environment is much healthier than that of the 2000, we are beginning to wonder what lies ahead. We also wish to keep in mind lesson number one of 2001-2002: opportunity losses are easier to swallow than real losses.



After three years of strong growth in equity securities (our Canadian stocks gained almost 105% since the beginning of 2003), it seems wise to reduce gradually their weight within the portfolios. Not only will the return on stocks not continue this pace during the next few years, but the gap between the performance of stocks and that of income securities will diminish considerably.



The Dalpé-Millette Group

Published since 1992

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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. 2005	3.37	3.92	3.98	11272	10717	1680	0.8580	0.7245	101.13
Jan. 2006	3.51	4.04	4.17	11945	10864	1771	0.8713	0.7205	102.33
Feb. 2006	3.74	4.06	4.13	11688	10993	1784	0.8718	0.7354	101.39
Mar. 2006	3.86	4.16	4.26	12110	11109	1842	0.8568	0.7096	100.86

The Bond Market



As expected, the Bank of Canada raised its leading rate by 25 basis points to 3.75% last March 7. This marks the fifth consecutive increase of the leading rate by the central bank since September 2005. At 3.75 %, the leading rate has reached a high not seen since October 2001. The monetary authority however softened its tone, mentioning that it might have to raise the rate a little, while it had adopted a firmer tone in the previous meeting by saying that it would still be necessary to raise rates.

As was expected, the Federal Reserve decided to hike the federal funds rate 25 basis points on January 31 and another 25 basis points on March 28, bringing the rate to 4.75%. These increases coincide with

the departure of Alan Greenspan and the arrival of Ben Bernanke, his successor. Since taking over on February 1st, Ben S. Bernanke is the fourteenth president of the American Federal Reserve. He succeeds Alan Greenspan who held the reins of the world's most important central bank for 18 years.

Bond markets were relatively volatile since the beginning of year, but the volatility cannot be attributed to the arrival of the new Fed president. From 4.05% at the beginning of January, the return on 30-year Canadian bonds rose to 4.28% before coming down again to 4.18%. Better than expected economic statistics, mainly in the retail sales sector, explain the market's retreat.

At the end of January, the American bond yield curve was inverted for the first time in five years following the first 30-year bond issue in four years and a half. Major institutional investors and foreign central banks took away over 65% of the total bond issue.

As measured by the Scotia Universe Index, which covers Canadian bonds overall, the bond market posted a return of 0.2% for the first quarter. The JP Morgan index posted a return of -1.3% for the American bond market.

The committee welcomes the new Federal Reserve president.

The Currency Market



Over the last three years, factors favourable to the Canadian dollar have multiplied, pushing the loonie up almost 40% against the USD. In 2005, the loonie appreciated by 3.4% against the American dollar, becoming the third strongest currency.

The loonie's rise continues while several multi-year-old records are smashed regularly. At the beginning of the year, it exceeded the 88 US cent mark, a level that it had not hit since November 1991.

Factors explaining the appreciation of our dollar remain essentially the same since several months, the most significant being the interest foreigners

have in the Canadian natural resources sector. This situation is particularly evident when the performance of stock market indices is analyzed. As a general rule, the Canadian dollar is above all a currency linked to the prices for raw materials. This means that a rise in the price for raw materials is translated by an appreciation of the loonie.

The strength of the loonie also reflects the weakness of the American currency. Since the Canadian exchange rate is expressed in USD, the evolution of the loonie is dependent on developments south of the border. In the short term, however, expectations with respect to inter-

est rates in particular hold the attention of market stakeholders. Following a break of several months, the pursuit of monetary tightening by the Bank of Canada allowed the interest rate gap between Canada and the United States to stabilize.

However, the loonie lost some feathers after the last Bank of Canada communiqué. The monetary authority softened its tone, mentioning that it might have to raise the rate a little, while it had adopted a firmer tone in the previous meeting by saying that it would still be necessary to raise rates.

The loonie reaches a 14-year high.

Canadian Stocks



The recent upsurge in the Canadian stock exchange over the last few years has been nothing less than spectacular. So much so, that it upstages the U.S. stock exchange and many American markets with respect to return. It is not therefore surprising to notice that the TSX ends this quarter still in front of its American neighbours. The leading Toronto index is in all likelihood in lockstep with daily oil price fluctuations. Thus, the index has risen during the last few sessions of this quarter thanks to the rebound in oil prices and new all-time highs notably for copper and zinc. It ends the period with a return of 7.4%.

Over half of the TSX sub-sectors remained in positive territory. Taking first place, the metal sector. With a gain of 14.7%, this sub-sector experienced a comeback of late, swept along by increased prices for zinc and copper due to strong Asiatic demand in a context of limited production. The fact that the demand for resources has remained high has certainly helped the market, demand still exceeding production. Furthermore, the industrial sector composed of securities from the industrials such as railway companies, has progressed by 10.7%, ending in second position, calling to mind increased shipping volume and better operating margins, a performance deeply related to the rising demand for raw materials. Sur-

prisingly, the information technology sector has posted a gain of 10.5%, ranking third, following a sudden gain towards the end of the quarter.

Three sectors end in decline. The telecommunication services sector with a loss of 2.1%, the consumer staples sector (-1.6%), showing that investors have not yet begun to fall back on defensive securities. Finally, the utilities sector is the great loser for the quarter posting a downturn of 9.7%. This sector is sensitive to interest rates and does not perform well in a context of tightening monetary policy.

The Bank of Canada reckons that the Canadian economy is working at full capacity. But the impressive appreciation of the Canadian dollar is an omen of an overheating economy. Thus, investors demand for the loonie is, large part, boosted by the strength of the Canadian economy. The first quarter therefore has started off on the wrong foot with regard to foreign trade, exports having decreased to the detriment of imports, bringing net exports to null. Foreign trade exerts an important braking effect on the growth of real GDP, Canadian companies having to adjust to the new environment characterized by a strong Canadian dollar and globalization.

The labour market indicators show a high rate of utilization for economic resources. The

appreciation of the loonie is keeping inflation at bay, but is increasingly penalizing jobs in the manufacturing sector. However, the labour market remains healthy in the country overall, its progress consistent with the trend set in the last few months. The unemployment rate is benefiting from a light decrease in the labour force in February and from a decrease of 0.2% in the unemployment rate from 6.6% to 6.4%.

The overall consumer price index (CPI) receded by 0.2% in February following an increase of 0.5% in January. Once again, prices at the gas pump (a decrease of 6.8% in February) have had the strongest influence. Inflation remains however under control, the CPI, excluding energy, having increased by less than 2% over the last twelve months.

The TSX is in lockstep with daily oil price fluctuations and new all-time highs for copper and zinc.

US Stocks

The year has started off with a roar on Wall Street; the Dow Jones ends this first quarter of 2006 up 3.7%. The S&P 500 and Nasdaq gain 3.7% and 6.1% respectively, quite appreciable performances as well. The American indices retreated at the end of quarter after having reached a five-year peak in mid-March.

South of the border, the economy remains in good shape in the first quarter as demonstrated by various economic statistics. Moreover, in January, Mr. Greenspan passed on the torch, after 18 years of service, to the new president, Mr. Bernanke.

After a rather timid January, job creation in February exceeded expectations with a robust gain, whereas unemployment re-

mains very weak, below the 5% level. All of this implies that the overall situation remains one of a strengthening labour market. The decrease in retail sales in February ends five consecutive months of increases. On the other hand, even with timid results in March, sales have progressed very well in the first quarter of 2006, given the strong increase in January.

Industrial production has also performed well, prompted in particular by the uncertainty in energy demand that was caused by temperature fluctuations in the United States. As for the real estate sector, the most recent signals are rather mixed. Housing starts have increased, but sales have receded. Economic growth is also stimulated by business investment, orders

for durable goods having increased in February for the fourth time in five months.

The current account deficit in the United States reached 7% of GDP over the last quarter of 2005, showing the scale of the imbalance within the current international economic context and also the significant need Americans have for financing, and for foreign goods and services.

All in all, inflation remains under control although risks remain. Strategists are banking on strong growth during the first quarter of 2006 followed by a deceleration. The beginning of 2006 was prolific in positive signals, the rest of the year remains to be seen.



Taking off at top speed, the Dow Jones and the S&P 500 rise both by 3.7% this first quarter of 2006.

International Stock Exchanges

The latest data published by the OECD confirm a moderate acceleration of the world economy. Its leading indicator progressed for the ninth consecutive time in spite of high oil prices and imbalances in current accounts.

In the euro zone, Germany and France appreciated by more than 6% in January alone and ended the quarter up 10.4% and 10.7% respectively. Italy's leading index rose by 7.4%.

In Germany, the market sentiment index declined in March, but remains at a high level, well above its average. This decline reflects the toughening stance of BCE members with respect to inflation. The chief econo-

mist declared moreover that the BCE could not close its eyes to the risks imposed by the availability of money in the twelve countries of the euro zone. Investor confidence in Germany fell for a second consecutive month in March. Overall, the situation remains however encouraging. Good news for Europe's third economy - consumer spending has experienced its strongest increase in France since October 2004.

The British stock market is also going with the flow and has gained 6.2% this quarter. However, inflation increased in the United Kingdom in February for the first time in five months while the unemployment rate also experienced its strongest

rise in over 13 years in February.

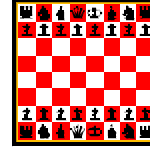
As expected, with inflation in positive territory, Japanese authorities are removing liquid assets from the banking system and are getting ready to abandon their zero rate policy, in force since 2001. This said, monetary policy still requires caution since the Japanese economy is barely out of deflation. The NIKKEI 225 ended the quarter with a return of 5.9%.

In March, China's trade surplus fell to its lowest level since July 2004 due to an increase in imports whereas exports gave ground. The country's index is up 6.2% this first quarter.



Most stock markets in the world experienced a strong upsurge this quarter.

Review of Portfolio Activities



As mentioned at the beginning of our quarterly letter, we have been fairly busy at the beginning of the year. Firstly, we have experienced strong growth in assets under our management during the last few months, partially due to significant RRSP contributions. But, we have especially benefited from the many references from our current clients, who wish to share their satisfaction with our service with their close relations or colleagues. Thank you and we encourage you to continue.

We have also been very active with regards to portfolio transactions. These revolve around the following themes:

1. the reduction in the weight of shares within balanced portfolios: e.g. our typical client currently has slightly over 40% in stocks against

55% a month ago. We liquidated our investment in CIBC and reduced our investments in Alimentation Couche-Tard and our cyclical stocks;

2. the reduction of the average duration of our income securities. We have made substantial profit over the last two years with our long-term securities, but we believe that the time has come to move closer to the duration of the reference index (Scotia Universe). To achieve this, we have liquidated our longest duration security (2035) and invested the proceeds from the sale of equity in the short term; and
3. we have finally reduced the cyclical character of our Canadian stocks by lowering our investment in

Alcan, Teck Cominco and Falconbridge by a third. Although the basic metals industry should perform better in the future than during the economic downturns of the last 30 years, due to the needs in Asia and India, it should be noted that stock prices are strongly related to the price of resources and consequently very volatile.

We also reduced our investments in Southeast Asia by half and increased those in India by 50%. Although the Indian market could be volatile in the short term, we are very optimistic with the medium and long term. In only one quarter, we gained approximately 20% in India, a good beginning!

A busy quarter within our portfolios, where we aimed mainly to increase the defensive nature of the latter.

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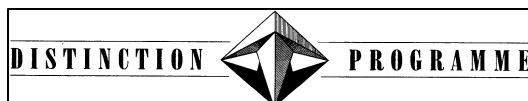
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