



Published since 1992

The Quarterly Letter

The Quarter in Review...

During the 3rd quarter of 2005, it was rather difficult to find a single economic commentary that did not raise the issue of oil, whether it was the record price for a barrel of oil, the strong growth in demand from China and India, the excessive price of gas at the pump or the repercussions for the United States of the ecological disaster in Louisiana.

As has been the case since the beginning of the year, the performance of the Canadian stock market was especially stimulated by the rise in the price of oil securities. As of September 30th, the TSX/SPX index posted an increase of

19.1%, but the gain is only 8.2% if the oil sector is excluded.

In spite of an increase in the price of natural resources, the inflation rate remained low and stable in all of the major industrialized nations, thus contributing to the environment of low interest rates.

It is difficult to predict the future direction of the price of oil, its impact on economic growth and eventually on the bond and stock markets. That is why we remain slightly underweight in equity securities. This did not prevent us from posting an interesting performance, our typical cli-



ent having realized a return of 4.6% during the last three months.



The Dalpé-Millette Group

Contents:

The Bond Market	2
The Currency Market	2
Canadian Stocks	3
US Stocks	4
International Stock Exchanges	4
Review of Portfolio Activities	5
Basic Information	6

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. 2004	2.47	3.68	4.30	9247	10783	1515	0.8303	0.6077	85.60
June 2005	2.43	3.17	3.75	9903	10275	1474	0.8142	0.6750	90.03
July 2005	2.59	3.35	3.87	10422	10640	1518	0.8176	0.6742	91.97
Aug. 2005	2.72	3.37	3.79	10668	10481	1552	0.8395	0.6825	92.32
Sept. 2005	2.72	3.63	3.97	11011	10568	1619	0.8542	0.7093	96.53

The Bond Market



During the summer, the Bank of Canada has indicated repeatedly its intention to raise the level of interest rates in the near future. It respected its commitment last September 7th, with the first rate increase in approximately 11 months. The violence of hurricane Katrina did not deter the Bank of Canada from being less accommodating; it nudged its leading rate up by 25 basis points to 2.75%. Although most financial analysts had predicted this first move towards a neutral monetary policy, many were wondering if the extent of the damage caused by the hurricane in the devastated region of the Gulf of Mexico was not going to oblige the Bank to postpone its decision.

In spite of the devastation brought by Katrina in the Southern United States, the leaders of the American Federal Reserve

(Fed) decided to raise the key interest rate by a quarter percentage point for an 11th consecutive time, bringing it to 3.75%. For the first time in a long time, this decision was not approved unanimously by the members of the Fed due to the possible economic repercussions of hurricane Katrina.

Despite rate increases by the central banks, long-term rates are getting ever closer to short term ones. The rate of return on 30-year bonds issued by the Canadian government was recently 4.1%, a level not seen since the 70s. As for 10-year bonds, we have to go back 40 years to find rates as low. In the United States, the rates were a little higher at 4.30% for 30-year bonds and 4.04% for 10-year ones.

Disregarding the action of central banks, several other factors

prompted the decline in bond rates, among others: 1) the global savings surplus; 2) investment in American securities as a safe haven; 3) the speculative role of hedge funds; and 4) demographic changes – the ageing population, which tends to buy more bonds than stocks.

For the quarter, the Scotia McLeod index of long-term Canadian bonds posted a return of 0.9% and the Scotia McLeod Universe posted a return of 0.1%. In the United States, the J.P. Morgan bond index posted a negative return of 1.2% over the same period.

The Fed increases its rates for an 11th consecutive time.

The Currency Market



The ravages of hurricane Katrina, which shook the markets, only added to the overall factors favouring the appreciation of the loonie over the last few months. Last September 19th, the Canadian dollar reached a new high against the US dollar at 85.70 cents, a level not seen in over 13 years. This was the result of another surge in the price of crude oil related to tropical storm Rita, threatening anew American oil installations in the Gulf of Mexico.

Furthermore, after approximately a year of inactivity, the Bank of Canada favoured an increase in the loonie, by raising its leading rate last September 7th.

The loonie is propelled ever upward by two forces. Firstly,

the rise in the price of oil favours the loonie because Canada, along with Norway, is the only industrial nation to be both a producer and a net exporter of black gold. More than ever before, there is a correlation between the value of the Canadian dollar on the exchange market and the price of crude oil. Considering what is taking place since the beginning of the summer, with the barrel of crude oil at \$70 US, it is not surprising that the Canadian dollar is appreciating so much against other currencies. Moreover, the Canadian dollar was recently dubbed the 'petroloonie' by a New York firm specializing in economic analysis because of the currency's correlation to oil prices.

The good performance of the

Canadian dollar is further explained by the prospect of higher interest rates in Canada. Higher rates render the financial assets of a country more attractive to foreign investors, who need the currency to buy these assets. In July, foreign investors carried out their most significant purchase of Canadian securities so far this year. These purchases were evaluated at \$3.3 billion.

Since the beginning of the year, the loonie increased in value against 14 of the 16 major currencies. It rose 2.8% against the US dollar and 16.5% against the euro. For the quarter, the loonie gained in value by 4.9% against the American greenback and 5.1% against the euro.

The loonie reached a level not seen in over 13 years.

Canadian Stocks



It goes without saying that oil was the top story in newspapers, conversations and analyses this quarter. Not only was this due to the price at the pump or the price of a barrel, but certainly for its unquestionable impact on the Canadian stock market. The bull market that began in May continues without showing any signs of slowing down and the index has gained almost 19.1% since the beginning of the year. The key index still has a commanding lead against its American counterparts. Above and beyond the Canadian monetary policy that is still very expansionist, the significant weight of the natural resources sector in the Canadian stock market (of which energy alone represents 23.2%) is the main reason for this strong North American divergence.

The S&P/TSX flirted with the 11,000 mark in September, soaring above this important psychological obstacle for the first time since September 2000, just before the collapse of the telecommunications sector. It is no longer a secret; the TSX performance is attributable to the constant increase

in the price of energy and basic materials. Indeed, the Toronto Stock Exchange posted a return of 11.2% this quarter alone and none of the sub-sectors ended in negative territory.

Obviously, the energy sector tops the list, benefiting from a solid gain of 25.5% this quarter, after a barrel of oil reached a new record high of \$70 US. Not surprisingly, it is the most successful sector of the S&P/TSX, posting an impressive return of 65.3% for 2005! The utilities (15.8%) telecoms (10.0%) and basic materials (9.8%) sectors share 2nd to 4th places, gold almost single-handedly making up the entire performance of 14.3% for metals and ores. Among the losers, the consumer staples sector takes last place with a weak increase of 0.2%. Investors are avoiding defensive sectors in favour of those with stronger growth.

According to the Bank of Canada, the Canadian economy is running at full throttle and is close to its full potential, thus justifying the increase of its leading rate in September. The

growth in real GDP verged on 3% in the 2nd quarter of 2005, influenced by an increase of 2.9% in domestic demand and a reduction in imports. Moreover, sturdy employment continues to support spending and residential real estate. With the unemployment rate remaining unchanged at 6.8%, companies continue to invest; even international trade is contributing to the expansion.

The consumer price index has, for its part, increased by 0.4% in August, a significant portion of this growth attributable to the price of oil. In spite of this, basic inflation, which excludes the most volatile components such as energy, remains within the inflation-control band set by the Bank of Canada.

Despite the increase in energy prices, the mechanics of consumer spending is moving at full speed in Canada, the value of retail sales increasing by 7.9% over the year. It will thus be interesting to see what the Central Bank will do to contain inflationary pressures.

The Toronto Stock Exchange posts a return of 11.2% this quarter and none of the sub-sectors end in negative territory.

US Stocks



Contrary to every expectation and in spite of hurricane Katrina, oil and the increase of interest rates, American indices ended in positive territory this third quarter. The first two quarters saw these same indices in negative territory in 2005. The S&P 500 and the Dow Jones posted returns of 3.1% and 2.9% this quarter, whereas NASDAQ is up by 4.6%.

The contrast is striking; contrary to the key Toronto index, the American stock market indices are at a virtual standstill since the beginning of the year. On the other hand, it should be noted that the weight of the oil sector represents only approximately 9% of American securities compared to more than 25% for Toronto securities. That having

been said, the S&P 500, the Dow Jones and NASDAQ posted returns of 1.4%, -2.0% and -1.1% to date in 2005. The S&P 500, however, has progressed by 8.0% since hitting rock bottom last April.

Although the impact has been moderate on stock markets so far, the repercussions of Katrina are being felt. Consumer confidence fell from August to September, hitting its lowest point since 1992 spurred on by Katrina and the increase in the price of oil.

Furthermore, applications for unemployment insurance have increased dramatically after the passage of the hurricane. It is the most important increase in the United States in almost a decade. The latest industrial production

figures also bear witness to the impact. We will have to wait for September statistics to have a better idea of the state of the economy after the passage of the hurricane.

Always on the economic front, several experts assert that energy costs constitute the greatest threat for the American economy. The breathtaking increase in costs could feed inflationary pressures. It should be noted that gold usually appreciates as the risk of inflation grows. This is what is currently happening in the United States. The central bank, however, considers that inflation remains under control and that it is relatively low if we eliminate energy from the equation.

American stock market indices are at a virtual standstill since the beginning of the year.

International Stock Exchanges



The success of overseas stock markets matches that of the Toronto stock exchange better than those of the American indices. Thus, the French, Italian and German indices end the third quarter with returns of 8.8%, 8.1% and 10.0% respectively. Over 2005, these indices have posted earnings of over 12.0%. At the end of the quarter, the European Dow Jones Stoxx 600 posted a record high performance, not seen in the last three and a half years.

Nothing new under the sun, the situation in the euro zone remains fragile. In Germany, consumer confidence fell in September for the first time in four months. The election deadlock and the increase in oil prices darkened economic prospects. Elsewhere,

manufacturing orders and industrial production showed unexpected progress. This surprising increase is all the more heartening because it spans across all sectors. The latest economic indices are disappointing in the United Kingdom. Unemployment figures have deteriorated, retail sales have stagnated and the residential market is faltering.

China's trade surplus reached the third highest level ever in August. Export growth has thus exceeded that of imports for a tenth consecutive month. Also in August, retail sales have increased over 10%, fostered by growth in revenues and tax reductions. Industrial production, for its part, grew by 16%.

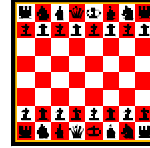
In Japan, corporate profits con-

tinue to stimulate corporate investments and consumer spending. At the end of the quarter, the Japanese stock exchange core indices reached their highest level since June 2001, assisted by the results of the national elections. The Japanese stock exchange ends the quarter with a very appreciable performance of 17.2%.

As a final point, the increase in the price of black gold since the beginning of the year is partially due to the growth in Chinese and U.S. demand. However, this quarter, the increase was supported by supply issues caused by Katrina.

International indices shine this quarter.

Review of Portfolio Activities



Only one portfolio transaction was made during the quarter - the replacement of our TD Bank notes at 6.75%, which were redeemed in July 2005 (at this rate, in spite of us!). We reinvested the same amount in a similar investment vehicle from the TD Bank (a note at 5%, the terms of which were explained in one of our recent Info Sabius). We continue to believe that the increase in short-term interest rates in Canada will not be pronounced, which will render this investment attractive... until the next repurchase.

We are still banking on the same economic backdrop:

?? moderate world economic growth;

?? an acceptable inflation rate, limiting the potential increase in interest rates;

?? the significant impact of the Chinese and Indian economies, especially on the demand for natural resources;

?? scepticism with respect to the high level in the price of oil; and

?? the American dollar remaining under pressure for several years and, by ricochet, a strong Canadian dollar.

The above-mentioned scenario favours several aspects of our portfolios, from income securities to equity securities. Taking this and our backdrop into consideration, it would be easy to become complacent

and to fall into "*cruise control*" mode. Our experience is there to remind us, however, that bad times strike occasionally (and cause the most damage) when we expect it the least and, consequently, when we are less prepared for it.

This explains why, in spite of a certain economic optimism on our part, our portfolios are slightly underweight in stocks. Unlike most managers, we tend to be careful in fair weather and braver in stormy weather! Maybe we don't sleep as well but at least things work out for the better.

We are staying the course with respect to our management strategy while waiting for possible changes in our prospects.

Members of the Dalpé-Milette Group:

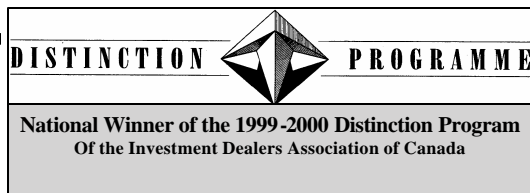
2 Complexe Desjardins East Tower, 15th Floor Montreal, Quebec H5B 1J2 Fax: 514-987-1214	Marc Dalpé	514-281-8768	mdalpe@sabius.com
	Jean-Marc Milette	514-281-8763	jmmilette@sabius.com
	Chantal Beaulieu	514-281-8682	cbeaulieu@sabius.com
	Annie Dagenais	514-281-8709	adagenais@sabius.com
	Anna Gastaldi	514-281-8715	agastaldi@sabius.com
	Véronique Levrey	514-281-8725	vlevrey@sabius.com

WE CAN BE REACHED
BY E-MAIL

WWW.SABIUS.COM



The Dalpé-Milette Group



The Dalpé-Milette Group's mission is to be the primary financial advisor for its clients. Within the framework of a courteous, attentive, professional and personalized service, the service offering is based on an experienced team, endowed with high calibre analytical skills as well as the necessary tools to provide its clients with exceptional financial services. A well-balanced, dynamic and systematic approach in addition to competitive management fees exempt of any potential conflict of interest characterize its portfolio management activities.

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.

The particulars contained herein were obtained from sources which we believe reliable but are not guaranteed by us and may be incomplete. The opinions expressed are based upon our analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein. The Firm may act as financial advisor, fiscal agent or underwriter for certain of the companies mentioned herein and may receive a remuneration for its services. The Firm and/or its officers, directors, representatives, associates, may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time in the open market or otherwise. The securities and/or information presented may not be suitable to all investors.