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# The Quarterly Letter

## The Quarter in Review...

The distress in the financial markets at the end of last winter was such that any sign of recovery or of economic stabilization was going to bring about a rebound in the value of most financial instruments. This is precisely what happened. By and large, almost half of the world stock market losses between September 2008 and the beginning of March 2009 have been recovered by the increase over the last six months.

Not a single day goes by without an announcement somewhere in the world that an economic statistic has shown a net increase over the previous months. Whether the recovery is imminent and the global recession is ending or about to is no longer in dispute. Markets

are trying to predict what will happen with the robust economy once world governments reduce their tax incentives and their massive investments in the economy, and start cutting investments and increasing taxes to face their huge debt burden and the spiralling costs of social benefits due to the aging population.

On September 15, 2008, Lehman Brothers declared bankruptcy, an announcement that triggered the nose dive in major markets. From September 15, 2008 to September 14, 2009, our typical client secured a return of +2.52%. We are very pleased with the performance of our typical client's portfolio within this historical context of value destruction.



He has obtained a return of +23.77% so far in 2009. Far from rejoicing, we are still seeking out the trends in the upcoming quarters and positioning our portfolios to the best of our knowledge. To be continued!

Thank you for your confidence.



Le groupe Dalpé-Millette

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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. 2008	0.83	1.69	2.68	8987	8777	1237	0.8183	0.5806	73.96
June 2009	0.24	2.47	3.36	10374	8447	1307	0.8655	0.6162	82.70
July 2009	0.24	2.62	3.46	10787	9171	1425	0.9209	0.6550	87.16
Aug. 2009	0.20	2.62	3.38	10868	9496	1498	0.9166	0.6410	85.86
Sept. 2009	0.22	2.58	3.31	11395	9712	1553	0.9211	0.6313	88.89

## The Bond Market



As expected and for the third consecutive time, the Bank of Canada held its benchmark overnight lending rate steady at 0.25% following its last meeting on September 10<sup>th</sup>.

In its usual communiqué, the Bank mentioned that ‘stimulative monetary and fiscal policies, improved financial conditions, firmer commodity prices, and a rebound in business and consumer confidence are supporting domestic demand growth in Canada.’

However, this unexpected strength will not impact interest rates. The Bank of Canada has indicated that it still intended to keep its benchmark rate at its current level until next July, as promised in the spring.

The American economy seems to have emerged from the worst and longest recession since the 1930s. In this transition period between the end of recession and the beginning of the recovery, America’s central bank is faced with two challenges: undo the work it accomplished during its first mandate and ensure the return of sustainable growth. Unsurprisingly, the US Federal Reserve has decided to maintain its leading rate between 0 and 0.25%, estimating that the current economic conditions required exceptionally low rates for a ‘long period’. The Fed has adopted a ‘wait-and-see’ attitude. Before proceeding with a change in policy, it will want to ensure that the recovery is sustainable.

Despite good economic statis-

tics and the recovery in stock markets, investors have been cautious and bond demand has remained very strong.

In this context, and as measured by the DEX index, which encompasses Canadian bonds overall, the Canadian bond market posted a return of +2.71% for the quarter. Our southern neighbour posted a return of +3.51%.

**The Bank of Canada and the Fed held their rates steady.**

## The Currency Market



For the last few months, stock markets have experienced very good returns, the price of raw materials has jumped significantly and investors have abandoned safe havens such as the American dollar. In this context, the loonie has been inexorably propelled these last few months. In the month of September, the Canadian dollar was trading close to its highest level in over a month. In July, our currency rose by 6.7% and, since March, the loonie has appreciated by almost 19.3%.

Our currency evolves in parallel with commodity prices and

oil, which have lately stimulated the markets. The loonie is also benefiting from foreign interest in Canadian stocks and bonds. The solid foundations of the Canadian economy appeal to foreign investors.

The strength of the Canadian dollar is nevertheless worrisome since it represents a risk for both Canadian economic recovery and for inflation. During its last meeting on September 10<sup>th</sup>, the Bank of Canada did not hesitate to remind everyone that the ‘persistent strength in the Canadian dollar remains a risk to growth’ and that it retains all the

‘flexibility’ required to correct the situation by resorting to ‘non-traditional’ measures. Even following this announcement, the Canadian dollar continues to appreciate.

**The Canadian dollar continues to appreciate.**

## Canadian Stocks



Since hitting bottom on March 9<sup>th</sup>, 2009, stocks have rocketed by +48% in Canada. The economic recovery continued over the summer and the private sector started hiring again with over 27,100 jobs of which 8,300 in Quebec. The price of gold is once again over \$1,000 US an ounce. Prices for many raw materials have posted significant gains since the beginning of the year. Returns on the price of industrial metals are remarkable due to the strong demand from China. OPEP representatives have assured us that they will maintain their production. Pressure remains strong on the American dollar and construction starts have increased in eight provinces. The TSX ends the quarter up 10.6% and up 30.0% to date in 2009.

The inflation rate has reached -0.9%. The unemployment rate is 8.7%. GDP is down 1.5%.

The consumer staples sector posts a return of -2.7% over the quarter and -0.1% to date in 2009. The disappearance of Saturn is another blow for the Quebec automobile sector. Saturn Canada disappears and 60 of the network's car dealers, of which 15 are in Quebec, are left high and dry. Toyota and Honda have seen their sales drop by at least 18% compared to last year. However, Ford Canada's sales are up 7% over the same period.

The telecommunications sector ends the quarter at +8.3% and

-0.8% to date in 2009. With a downturn of 7.9% for the first seven months of the year, the telecommunications sector has registered the worse performance of all sectors. Only Bell Aliant (+12.8%) has managed to rise during this period. BCE has lost 38% of its value compared to its peak of the last 52 weeks. Three other securities in the same sector have suffered a decline since the end of 2008 - Manitoba Telecom, Telus and Rogers Communication.

The industrial sector ends the quarter at +11.1% and +16.8% to date in 2009. Bombardier Aeronautics foresees new layoffs in Quebec if no new orders are received for regional twin-jet engine aircrafts before mid-October. The difficulties of Bombardier's aeronautics division have weighed heavily on the results of the whole company when compared to the second quarter of the previous year. Revenues have remained steady, but net profit tumbled 22%.

The consumer discretionary sector ends the quarter at +6.1% and +8.7% to date in 2009. The Quebecor World printing firm has endorsed a new name. The Montreal company emerges from protection under the Companies' Creditors Arrangement Act in Canada. The majority of World Color Press's common shares belong to Quebecor World creditors. The printer's old shares are worthless and have been cancelled.

The basic materials sector ends

the quarter at +12.4% and +26.4% to date in 2009. The market for newsprint paper in North America has plummeted. The industry is facing another capacity surplus. Abitibi Bowater will be closing its Beaupré mill next October and is reducing production by half in Clermont, thereby eliminating 460 jobs. Other closures are possible within the corporate restructuring.

The energy sector ends the quarter at +9.0% and +32.3% to date in 2009. EnCana's decision to split the company in two distinct entities has been cheered by investors. The energy giant's shares jumped almost 6%. The Calgary company announced that one entity will be an unconventional gas producer and will exploit natural gas resources from shale plays in north-eastern British-Columbia and Louisiana. Refining and oil production activities will be managed by Cenovus.

The financial sector ends the quarter at +16.0% and +46.5% to date in 2009. Manulife Financial Corporation, the insurance giant, has made the right choice in reducing its dividend despite the fact that its profit jumped 76% in the second quarter. This is exactly what any financially disciplined company in a similar situation would do. It is the best strategy to protect itself better from risk, swell its capital and increase its growth.

**Spectacular stock market ascent over six months.**

## US Stocks



Solid stock market performances, supported by a recovering economy, have allowed the leading American indices to end in positive territory for the second consecutive quarter. Indeed, the S&P 500, the Dow Jones and the Nasdaq end the quarter up +15.6%, 15.8% and 15.9% respectively. Since the beginning of the year, they have posted returns of 19.3%, 13.5% and 35.6%.

On the economic activity side, encouraging signs are in the horizon. With the ISM manufacturing index crossing over the '50' mark and the leading indicator ending up in July, these two key elements allow

us to conclude that the recession is almost behind us.

The American consumer is another major player in this economic recovery. The consumer confidence index measured by the University of Michigan rose in September following two consecutive negative months. Furthermore, this increase in confidence and the weakness in interest rates are mirrored in retail sales, which have experienced their most significant increase since February.

The unemployment rate, at 9.7%, continues to set new records. However, layoffs are occurring at a slower pace,

making the 216,000 jobs shed in August the smallest loss in over a year.

The worst US housing market crisis since 1930 may be on the mend. Indeed, house prices are on the rise in 18 of the 20 biggest American cities. Existing home sales hit a two-year high and new home sales increased for a fourth consecutive month.

**Small steps for the economy, giant leaps for the stock market.**

## International Stock Exchanges



Similar to North American indices, European stock markets have also experienced an excellent third quarter.

In Germany, the unemployment rate was lower than expected in August thanks in part to government stimulus programs, which offered subsidies to businesses to incite them to keep their workers. The DAX, Germany's reference index, ends the quarter up +18.0% and +18.0% since the beginning of the year.

In France, the CAC-40 index, gained +21.2% over the quarter and 22.5% for the year. Confidence in Europe has increased in August to a level unrivalled in 10 months. Retail sales were down in August for a 15<sup>th</sup> consecutive

month.

In the United Kingdom, consumer confidence rose to its highest level in a year in August. House prices increased in August for the first time in two years, as low interest rates pushed demand causing a shortage of properties for sale, especially in London. The reference index ends the quarter up +22.0% and +20.4% since the beginning of the year.

In Asia, Hong Kong's Hang Sang and the Japanese Nikkei 225 indices end this quarter at +14.8% and +2.3% respectively. Since the beginning of the year, the increase has been +49.7% and +16.1%. In Japan, following a half-century of one-party rule, the Democratic Party is now responsible

for managing the future of the world's second largest economy. Businesses have reduced their spending for a ninth consecutive quarter, causing the unemployment rate to hit a record high at 5.7% in July. In China, the manufacturing sector has experienced an unrivalled expansion in August, sustained by an increase in loans granted. Industrial production and retail sales have also increased, leading us believe in accelerated growth for the world's third largest economy.

**Slowly but surely...**



## Review of Portfolio Activities



Having been exceptionally active since the fall of 2008, as prescribed during a period of very high volatility, we have been rather quiet during the last quarter and have let the value of our investments grow.

As mentioned in our last quarterly letter, two factors combined to explain the exceptional performance of our clients' portfolios to date this year (i.e. versus comparable indices as well as other portfolio managers):

1. the equity portion of our portfolios posted a return of +45.4% as of September 30<sup>th</sup>, 2009, compared to +10.0% for the Morgan Stanley World Index; and
2. due to the relatively numerous buy and sell transactions in the portfolio from the end of 2008 to June 2009, we have been able to effectively manage the asset

allocation in our clients' portfolios, especially by maintaining the weight of equity close to target. The very high volatility in the stock markets would not have allowed accomplishing this with a passive attitude. To achieve this, we had to be much more active than we usually are.

Our attention is now turned to the next three or four quarters, trying to relate stock market valuation to the type of economic growth in the post-government hyper-stimulus period. We will adopt a wait-and-see attitude for a few months assuming that the economic news will continue to bring encouraging signs. The significant scepticism that still characterizes financial market stakeholders and the chronic sub-investment, despite the significant increase in prices since the spring, lead us to believe that there still remains some mo-

mentum in the run-up of the markets if news continues to be favourable.

This being said, we will probably want to reduce slightly the equity weighting of our portfolios (similar to what we did last June) in view of a possible disappointment with respect to the length and the vigour of economic growth. If this were to materialize, we could probably repurchase some securities that were overly punished. History repeats itself!



**Far from dwelling on our recent successes, we are trying to see through the various economic scenarios of the next years and the overall market behaviour.**

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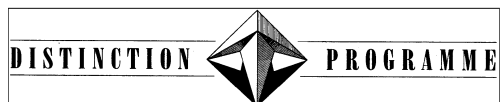
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