

Searching for a Bottom

For equity investors, the months of September and October seemed like an eternity. Losses, year-to-date, were worse than even the “bears,” like ourselves, predicted. One must now go back to the early 1970’s and, even worse, the 1930’s, to compare with other bear-market cycles. After a bull market that began in earnest in Canada in 2001 and lasted until June of 2008, we have now quickly entered a bear market that has lowered equities back to valuations we have not seen in more than a decade. The sell-off has all but erased the positive results achieved over the past three years in the Canadian equity markets.

Our performance results in the balanced, global equity and Canadian equity funds were considerably better than the market indices. Our defensive positioning helped protect our clients from the worst of the sell-off. However, with exception of the Global Equity Fund, aided by the 14% decline in the Canadian dollar versus the US dollar, and the QV Canadian Income Fund, our pooled funds posted negative returns in the month. The only major asset classes posting positive gains in the month were short-term federal government bonds, government treasury bills, and the US dollar. This flight to safety led to a continuing widening of credit spreads in the bond market, and panic selling in the equity markets.

Total Return - Capital Gains plus Income (%)

To October 31, 2008	1 Mo	3 Mo	1Yr	3 Yr	5 Yr	10 Yr
QV Pooled Funds:	%	%	%	%	%	%
Canadian Income Fund	0.2	0.4	5.0	4.3	4.7	-
Canadian Balanced Fund	-4.2	-6.5	-6.5	3.4	6.2	9.3
Canadian Equity Fund	-6.9	-10.9	-15.4	4.5 ⁺	10.8 ⁺	16.2 ⁺⁺
Canadian Small Cap	-11.4	-19.0	-27.3	2.2	9.9	14.1
Global Equity Fund	1.5	0.9	-3.2	-	-	-

⁺ Historic equity returns from the Cdn. Bal. Fund

⁺⁺ 9yr

Benchmarks:

DEX Bond Universe	-0.8	-2.1	3.1	3.5	4.9	5.7
Balanced Fund Index	-7.7	-14.0	-15.6	2.7	6.5	6.5
S&P/TSX Comp. Index	-16.7	-27.6	-31.4	0.5	7.0	6.6
BMO Small Cap Index (unwtd)	-27.6	-41.9	-51.2	-13.3	-3.9	2.6
MS World Index (\$CA)	-7.1	-16.9	-27.1	-6.2	-1.7	-3.1

- Pooled fund returns are gross of management and custodial of fees. Returns over one year are annualized.

- The Balanced Fund Index reflects the total rates of return earned by the DEX 91-Day T-Bill Index (5%), the DEX Bond Universe (45%), the S&P/TSX Composite Index (40%), and the MSCI World Index (CS) (10%)

The question of finding the proverbial “bottom” in the equity markets is now on the minds of many investors. With the US equity market trading at 12.2x next year earnings and 1.9x book value, and the Canadian equity market trading at 9.7x next year earnings, and 1.5x book value, the valuations do look more attractive than at any time over the past 10 years.

Pooled Fund - Month End Unit Values

Unit Values	Jun-08*	Sep-08*	Oct-08
Cdn Income Fund	10.29	10.27	10.28
Cdn Balanced	13.63	13.16	12.62
Cdn Equity Fund	10.19	9.59	8.91
Cdn Small Cap	22.06	19.29	17.08
Global Equity Fund	8.37	8.37	8.46

* Post distribution

However, we believe that earnings and valuations will fall further against the backdrop of a serious global economic recession. We continue to believe the market is overly optimistic in their assessment of earnings growth in 2009.

The major economic data points were worse than expected. Manufacturing activity in the United States in the month of October fell to its lowest level since 1982. Consumer confidence data reached similar lows in October. The data in Canada is equally as gloomy. The Province of Ontario, Canada’s manufacturing heartland, will receive federal equalisation payments for the first time in its history. Economic activity has slowed dramatically in all regions, including China where manufacturing fell 5% in October, the biggest contraction on record. Central Banks, including the Bank of Canada, are slashing rates to ease monetary conditions that have tightened considerably since the credit crisis intensified in September.

The culmination of events that led to the credit crisis, the collapse of the global housing boom, the sudden realisation of huge derivative losses (backed by now worthless mortgages) by global financial institutions, and the subsequent large government bail outs of these institutions, are not minor events that can be dealt with in a short time frame. The debt liquidation process, or de-leveraging, will take time to work its way through the global economy. Corporate earnings will remain under pressure as consumers and businesses retrench to pay off debts and improve their capital positions. Under this backdrop, we continue to focus on limiting losses in this market.

We know that we are now probably seeing an “interim bounce” in the equity markets, a common characteristic in past bear markets. What usually follows is a re-testing of the previous market lows.

We believe our patience will be rewarded by not responding to these interim bounces, but by maintaining our focus on the long-term earnings potential of each company we invest in, and a focus on buying these future earnings at discounted values. We know that the potential return from this combination can be very rewarding.

Inside the Funds

In the **QV Balanced and Canadian Equity Funds**, we purchased shares in many of our existing holdings, notably Husky Energy (Integrated Oil and Gas), Canfor (Forest Products), Astral Media (Radio, Broadcasting), and GMP Capital (Investment Brokerage). Our asset mix remains defensive in the Balanced Fund with 56.0% invested in high quality bonds and preferred shares, and 40.5% invested in Canadian equities.

In the **QV Canadian Small Cap Fund**, where values have fallen more sharply in this bear market, we have been active in buying existing companies across all industry sectors, including Canam Group, GLV Inc., (Engineering, Construction) Transcontinental (Printing, Publishing), Axia Netmedia and Gennum Corporation (Technology).

In the **QV Global Equity Fund**, we reduced our high cash weighting by 5%, buying additional shares in Microsoft (Information Technology), AT&T (Telecom), Washington Gas & Light Company (Regulated Utility), Wartsila (Finnish Equipment Manufacturer), Singapore Airlines, and Heineken Holdings (Beverage).

Cash remains high in all our equity pooled funds, ranging from 6.8% in the Small Cap Fund to 14.7% in the Global Equity Fund, providing a strong buying reserve.

In the QV Canadian Income Fund, we increased our exposure to short-term Canadian Government bonds for added quality and stability.

We remain defensive in our asset mix in the short term, but will not be passive in responding to the opportunities arising from the correction in the equity markets. Valuation and balance sheet quality will continue to drive our investment choices in this difficult environment.