

One Happy Month

If you glance at QV's Pooled Fund returns, at the bottom of the next page, you will see the month of August shows a positive glow. Briefly, we were happy.

For the eight months to August, the Canadian Balanced, Income, and Equity Funds turned up plus signs. In the same period and for the last 12 months, the Global Equity and Small Cap Funds showed minus signs. Considering, the comparable global and small cap stock indices were down substantially greater amounts than our portfolio, it was not a bad showing.

Bonds have been a refuge in the equity storm. No equity markets are showing positive returns. Sharp weakness prevails in the previously winning minerals, energy, and Research in Motion stocks. We contend, earning a return less negative than an index is not our goal or the most desired outcome.

We do feel comforted that our selection of reasonably valued companies, our low exposure to commodities, greater diversification, higher dividend yields and low equity exposure in the Balanced Pool contributed to a more defensive outcome compared to the benchmarks.

A Cruel September

Briefly, we were happy while, August wafted higher, after the punishing drops in June and July. However, one swallow does not a summer make. September stormed in, cruelly ripping off 1,000 points on the S&P/TSX Composite in the first four trading days, thus more than erasing August's gains.

Stocks are reacting to crummy business news. Consumer spending and investment is weak globally. Yields on poor quality bonds have soared to two-decade highs indicating more aversion to risk by investors.

US unemployment at over six percent, is hitting five-year highs. Corporations, many in the process of releasing decent earnings, are reporting falling demand.

A classic example of the consumer retreat is Corning, the maker of glass for flat panel screens. Corning, in announcing a fall in demand, caused its stock to decline 13% in a single trading session, and the shares of its Canadian supplier, Dalsa, to fall over 20%.

The housing collapse remains...well in collapse and that is the cause of the banking bust. As banks repair their past missteps, they have curtailed their lending. Their unwinding is the key to the markets and business cycle.

Pooled Fund – Month End Unit Values

Unit Values	Jun-08*	Jul-08	Aug-08
Cdn Income Fund	10.29	10.36	10.44
Cdn Balanced	13.63	13.60	13.93
Cdn Equity Fund	10.19	10.08	10.47
Cdn Small Cap	22.06	21.25	22.10
Global Equity Fund	8.37	8.49	8.70

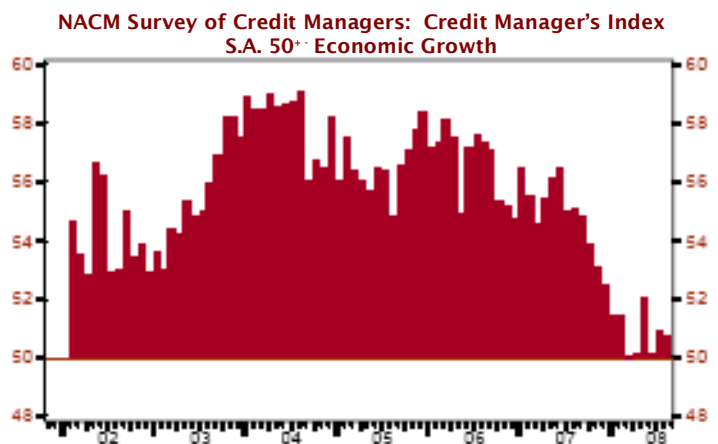
* Post distribution

No Lending. No Spending. No Growth.

In this cycle, as in many in the past, banks were the agent of growth by increasing their lending. In this cycle, they aggressively increased their leverage ratios, the multiple of assets to shareholders equity, well beyond historic norms, a reality now clear, but only in retrospect.

We are witnessing the "de-levering" of the banks for many reasons - the failure of their borrowers to pay, new regulations, the failure of the market for securitized loans. During a boom, banks are expansive. After a bust, they mutate to misers raising fees, curtailing loans, and raising lending standards. Changes in bank lending standards influence capital and consumer spending patterns with a lag from three to six months.

The NACM, the National Association of Credit Managers Index, chart below, courtesy of Merrill Lynch, shows the decline in lending last year and the tight credit conditions this year. We could repeat this disclosure many ways. The chart is typical.



The chart suggests the worst of spending and retail statistics should show up in the back half of 2008. Equity markets are anticipating this. As banks and consumers pinch their pennies, markets become distressed. We will use the distress. We look to find the world's quality retailers, and banks and other companies, for investment.

Canadian Banks

QV holds shares of the Bank of Nova Scotia, TD Bank and National Bank in our Canadian Equity Pool, the Canadian Western Bank in the Small Cap Fund and the Wells Fargo Corporation, our lone US bank, in the Global Fund. Our commitment is much lower than the weight in the market. We think these selections are among the best of breed.

As in the banking business as a whole, we expect their earnings growth to be weak as loan losses accelerate and economic conditions deteriorate. We believe their dividends secure. We believe the diversity of their operations, strong capital positions, combined with their more disciplined risk management practices will shelter them in this difficult operating environment. We will add to our established holdings as share prices reflect a low rate of growth in bank profits.

Canadian banks and Wells Fargo reported earnings slightly better than expected aided by better trading revenues and better retail banking. While Canadian loan growth remains firm and default rates low, our banks face higher levels of provisioning for future loan losses, increasing rates, a contraction of speculative activity in the capital markets and falling loan demand from soft consumer spending.

Canadian banks are aggressively raising regulatory capital to provide cushion in the event of a more significant economic slowdown, and write-downs of non-performing loans.

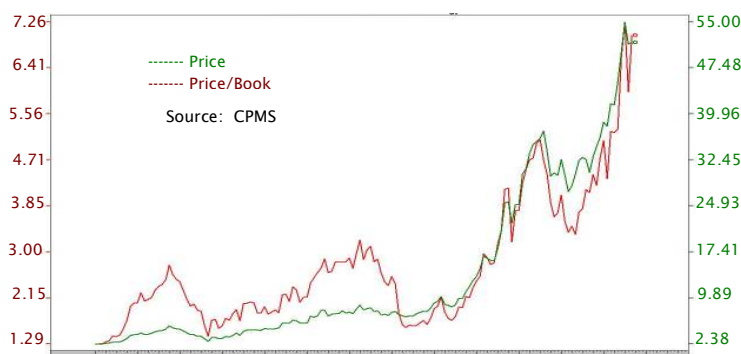
Bifurcated Markets

As in 1999, when the Toronto market became a one-trick Nortel pony, equity markets of 2007 and 2008 replayed the circus act. Energy, fertilizer stocks and RIM play the same trick...rising to unsustainable levels of valuation and dominating the weighting on the Index.

At its peak last summer, Potash Corporation traded at 12 times book value in June after earning about a 25% return on equity over the last three years. That ratio suggests "investors" were willing to accept a 2.5% return on their equity investment. Potash has swooned from \$240 per share to \$150 and our guess it that at 7.5 times book Potash has \$100 of air under its price.

As speculators sell over-bid energy and mineral stocks, their capital will find a home in better-priced companies displaced by this cycles' focus on commodities. The chart of Canadian Oil Sands Trust illustrates price and price to book, peaking at seven times! We hold now only nominal positions.

Canadian Oil Sands Trust: Price/Book, Price



We're Done in Some. We Aint Done in All.

We remain convinced the world's equity markets are not priced for lower profit growth, or no growth, or no profits, for a time. Broadly, equity markets are finally recognizing the worlds' businesses will earn at a rate closer to their historic norms, or half of the rate (ROE) recorded in this cycle. Some industries are well into the "glue", for example, forest products, autos and auto parts makers, some retailers...but more will come.

Deteriorating economic conditions, a fractious US election, and growing fear, will add to volatility and uncertainty in the financial markets. We hold quality security selections. We will use cash and bonds to fund equity purchases as fear prevails and value increases.

Uncertainty will create more buying opportunities and favour our style of investing. The retreat in commodity prices will weaken our dollar, a trend that will support our manufacturing/export industry and our holdings in the US market.

Total Return - Capital Gains plus Income (%)

To August 31, 2008	1 Mo	3 Mo	1Yr	3 Yr	5 Yr	10 Yr
QV Pooled Funds:	%	%	%	%	%	%
Canadian Income Fund	0.9	1.4	6.2	4.0	5.1	-
Canadian Balanced Fund	2.6	0.2	5.2	5.9	8.8	11.2
Canadian Equity Fund	4.2	-0.9	3.3	10.1 ⁺	16.2 ⁺	19.3 ⁺ ^A
Canadian Small Cap	4.4	-1.1	-2.0	10.7	17.7	18.2
Global Equity Fund	3.1	-0.9	-4.5	-	-	-

⁺ Historic equity returns from the Cdn. Bal. Fund

^A 8yr

Benchmarks:

DEX Bond Universe	0.7	1.6	7.5	3.8	5.7	6.3
Balanced Fund Index	1.1	-2.2	3.9	7.8	10.5	9.1
S&P/TSX Comp. Index	1.5	-5.8	3.5	11.6	15.4	11.6
BMO Small Cap Index (unwtd)	-0.9	-10.9	-11.9	2.9	9.1	9.2
MS World Index (\$CA)	1.9	-5.8	-13.4	0.2	2.7	-0.3

- 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%)