

What a Bounce?

The S&P 500 is today 49% above its lows of March 9, 2009. The TSX is up 42%. With such a rapid rise in the markets, we thought we would outline our strategy and thoughts for each of the QV Funds.

QV Balanced Fund Asset Mix

Sustainable income and resilient capital values are the primary objectives of investors in the QV Canadian Balanced Fund. High quality securities, held for the long term and managed consistently for superior value characterize the portfolio.

The QV Balanced Fund carries an asset mix tilted to earn income, to abate volatility and to reflect our anticipation of slow economic growth. The Fund's cash yield is 3.6%.

Cash reserves are minimal at 3.5%. This is a reflection of the negligible yields available on Canada Treasury Bills, less than 40 basis points for a six-month period. This compares to yields of 300 to 400 basis points on shorter-dated bonds.

Bonds, both corporate and governments, are set at 49.6% of the total portfolio. We have reduced our commitment over time. The yield on the total bond portfolio is 3.8% with the corporate bonds yielding 4.7%.

The bonds are predominantly double "A" rated, with two-thirds being government issuers. The term is just shy of six years. We keep the term "short" reflecting the notion that rates really have nowhere to go but up. Bonds are a defensive foundation to the portfolio.

Preferred issues total 1.6% of the portfolio. The yield on these securities is 6.3%. We have maintained a lower weight due to the long term nature and therefore volatility of these instruments.

Concerted fiscal and monetary actions to alleviate the global credit crisis have lifted equity and commodity prices and slowed the plunge in business. In some markets, small speculative companies, junk bonds, Chinese stocks to name a few, the action has been spectacular. We question the sustainability of our governments' experiment in re-inflation. The heavy bond commitment reflects our doubts.

Pooled Fund – Month End Unit Values[^]

Unit Values	Mar-09 [*]	Jun-09 [*]	Jul-09
Cdn Income Fund CI D	10.52	10.61	10.66
Cdn Balanced CI A	11.97	12.76	12.87
Cdn Equity Fund CI A	7.56	8.43	8.51
Cdn Small Cap CI A	14.30	16.55	16.83
Global Equity Fund CI A	7.32	7.71	7.63

[^] Fund NAVs reflect "full-fee" class * Post distribution

Equities are 45.3% of the portfolio. In aggregate, the equities in the portfolio carry valuations at a discount to the market; they are cheaper; they carry growth rates competitive with the market and credit qualities better than the S&P/TSX Composite Index. The portfolio is underweight last cycle's winners – energy and mineral and financial stocks. The portfolio emphasis is on strong dividend companies in stable industries. For example, BCE Inc. and Saputo, are two portfolio heavy weights that have boosted their dividends in August. The growth in dividends over the past five years is over 20%.

Bond Markets

While bond prices in the Balanced Fund have advanced, the commitment may seem inconsistent with the double-digit optimism expressed by the world equity markets over the past four months. We argue the asset class may have seen its best days. In fact, we believe interest rates will continue to edge higher if the business cycle advances.

We hold bonds for three reasons –their reliable income, their reserve status in lieu of bills and their defensive capital value. We place importance on the last point. Today in mid summer, the notion of deflation returning seems suspended by the jump in equity prices and "the spin" of economic green shoots.

QV Income Fund

We continue to remain short in duration. The corporate bond market is still short on supply and therefore yields have narrowed. We believe the spreads are at levels that do not justify the risk of further increasing our already large exposure to the corporate bond market.

QV Global Fund

We remain cautious with a 19.5% cash holding in the Global Fund. We hold all of the cash in US dollars due to our anticipation of a firm US dollar. This had a negative effect over the past month as the US dollar weakened by 7.4%. As discussed below, we believe the creditors of the US will not stand for a weakening US dollar going forward.

QV Small Cap Fund

We are holding lower levels of cash in the Small Cap fund than our other equity funds. Valuations have been rising in this sector; however, we see the most value on average in small cap securities. As with the Canadian and Global equities, we are positioned away from the more cyclical areas. The strong dividend yield at 3.3% and defensive positioning will protect capital if our anticipation of a longer than priced in recovery transpires.

Our Big Reservation

We argue the flood of market stimulants is finite. America is a debtor nation now, owing about \$2.7 trillion, equal to 20% of its GDP. The US must take into consideration the respect of its creditors. Foreign bankers will not want to see a drop in the US dollar. In the past, while their banking system was intact and their consumers able to buy from abroad, exporting countries, notably China and the Middle East were happy to take U.S. paper regardless of the value of the dollar. This is no longer the case. "...since the 1930s, the U.S. has never subjugated domestic concerns to external discipline", writes Tony Boeckh of the Boeckh Investment Letter. Today, unlike past cycles, the U.S. is limited in its ability to borrow, and repay in cheaper dollars to push the economy. This limits the recovery.

Total Return – Capital Gains plus Income (%)

To July 31 '09	1 Mo	3 Mo	1Yr	3 Yr	5 Yr	10 Yr
QV Pooled	%	%	%	%	%	%
Cdn. Income	0.5	1.5	7.1	5.8	5.5	5.3 [^]
Cdn. Balanced	1.0	5.2	-1.2	3.0	6.0	9.4
Cdn. Equity ⁺	0.9	7.8	-13.2	-0.2	8.2	14.3
Cdn. Small Cap	1.8	6.4	-18.4	-4.5	7.0	13.6
Global Equity	-0.9	3.0	-3.4	-	-	-

⁺ Historic equity returns from the Cdn. Balanced Fund [^]6 yr

Benchmarks:

DEX Bond Unv.	0.7	1.9	6.8	5.7	5.9	6.5
Balanced Fund	2.1	8.0	-5.8	2.7	6.9	6.6
S&P/TSX Comp	4.2	16.6	-17.7	-0.2	7.7	6.5
BMO Small _{unwtd}	4.2	18.4	-19.1	-8.9	1.3	4.5
MSCI World _(SCA)	0.6	5.7	-19.6	-9.1	-3.8	-4.9

- Pooled fund returns are gross of management and custodial 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%)

Conclusion

If our judgement is wrong, and equity markets continue to advance, we simply will not advance at the same pace. We will earn good income. We are also invested in well financed and strong franchises that are adequately valued for our anticipated environment going forward.

If our judgement is correct, equity prices will have another deep leg down to price in the rate of profit growth in a constrained global financial system. The companies we are invested in should not see the same decline in price as the indices due to their current valuation advantage. We will have an opportunity to buy more of our current strong companies and the equity of more cyclical businesses at better prices.