2009 Q2 Market Commentary

The Temptation to Change

Summary

As we continue to move through one of the worst financial cycles in history, our resolve is continually tested to change course or not. During times of stress, financial or otherwise, the desire to "do something" increases if only to allay a feeling of market insecurity and helplessness.

In previous client communications and in client meetings, Quadrant summarized our research, outlined the actions we've taken and reviewed the continuing active management of client portfolios. In fairness, much of this information was buried in long and technical overviews of the market.

Now that the capital markets seem to be on a less volatile footing, there is a temptation to consider making significant changes to how you invest to avoid repeating the anxiety experienced by the recent historic downturn in the capital markets. You may even be thinking whether or not you should be invested in the capital markets at all.

Why should I invest my money?

Before considering changes, it helps to step back and think things through a little bit. Remember why you chose to invest your money in the first place. Was it to save for a comfortable retirement? Perhaps it was to leave an inheritance to the kids? Maybe it was to give something to charity. No matter what the reason, at its roots, the rationale behind the investment decision is to make your money grow in the long-term.

Because inflation is a silent robber of your purchasing power, your money needs to grow in real (post-inflation) terms in order to keep up with the cost of living. Taxes, a not so silent robber, also reduce return. Although investing does carry risk, that risk can be managed through planning.

The fact is that all Quadrant clients have a plan; it is your investment policy statement ("IPS"). The relevant question is whether your IPS and its asset allocation remains appropriate to your specific circumstances and financial objectives.

Your asset allocation takes into consideration your financial and lifestyle objectives for the long-term. If you think that your tolerance for risk has "changed" since it was last reviewed, then we will discuss it with you at our next meeting – keeping in mind your needs and objectives. Remember that return is commensurate with risk and the recent market shocks are part of the price paid for higher expected long term returns over fixed income. You may be tempted to change, but unless your return requirements are minimal, you must resist the temptation to simply hold all cash or invest in only bonds. Remember that diversification remains the key to successful long-term investing.

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Getting Paid to Wait

After being out of favour for a while, market movements and low interest rates have caused investors to think about their cash return or yield. Cash is indeed king and while capital gains may be elusive in the near-term, a regular dividend or interest payment provides a regular cash return to you.

Your portfolio is paying you dividends and giving you fixed income yields at competitive rates, even though these payments are not shown separately on your statements. Dividend and interest payments, along with price changes, are incorporated into the value of each pooled fund unit to give the total return for the pool. As of the end of May, the latest data we have available, the yield or dividend yield for each asset class shown in the table to the right:

Asset Class	Yield or Dividend Yield
Short-Term Income	2.10%
Canadian Fixed Income	4.90%
Global Fixed Income	4.60%
Canadian Equity Value	2.60%
US Equity Value	1.90%
International Equity Value	3.30%
Global Real Estate	5.20%
Canada Treasury Bill	0.49%

Sources: United Financial and Bloomberg

Second Quarter Returns

Studies have shown that market timing simply does not work as markets can change momentum quickly and sharply. The key is to remain invested. For the second quarter of 2009, your portfolio will have a positive return:

- Canadian fixed income was up 1.7%, outperforming the DEX Universe Bond Index at 1.3%
- Canadian equity value, up 20.7%, outperforming the SP/TSX Index, which rose 20.0%.
- US equity value had a strong quarter with an 11.7% return, partially due to its currency hedge. In comparison, the S&P 500 was up 6.9% in Canadian dollars.
- International equity rose by 11.0%, with the EAFE Index returned 16.1% for the quarter.
- Global real estate was the best performing asset class for the quarter, up 24.2%.

The change to positive returns is indeed a relief from the last several quarters, which tested the risk tolerance of most investors.

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Looking Forward

At Quadrant, we invest for the long-term. But the recent market events have made us realize that the long-term is made up of a series of short-terms, like a long chain that is made up of many of shorter links. We are challenging ourselves here at Quadrant to see what we can do differently. We are looking for ways to improve and keep learning, to keep a focus on the long-term but to manage the short-term better (such as our approach to hedging) – to build the chain one link at a time. Quadrant is in the midst of examining further improvements to your portfolio:

- We are investigating the use of the US Equity Alpha Corporate Class pooled fund managed by Tetrem Capital Management Inc., the Canadian Equity Alpha Corporate Class fund managed by QV Investors and the International Equity Alpha Corporate Class fund managed by Picton Mahoney. Alpha investment managers create concentrated portfolios of stocks of approximately 20 to 60 top-quality companies, selected for their attractive valuation and/or growth prospects. The managers ignore the benchmark index when they construct their portfolios and as a result, sector exposure, performance and other characteristics of the alpha mandates can be very different from the index.

- We are reviewing our approach to Canadian fixed income. Going forward, Quadrant's short-term objective is to focus on the risk of fixed income while finding alternate approaches to generating income. In the long-term, we are concerned that all the deficit spending by the Canadian, US and other governments will lead to inflationary risks.

- The use of alternative asset classes such as private equity and hedge funds will be examined to see if they may be appropriate and effective for client portfolios.

Quadrant is also reviewing its asset allocation assumptions and processes. We are using extensive historical data and adding various simulations and scenarios in order provide other inputs to the asset allocation decision framework. We are also looking to better determine the expected future risk exposures of portfolios

Conclusion

Quadrant understands that change is on the minds of many of our clients. Change simply for the sake of change goes against the discipline required for successful long term investing. Think about why you started investing in the first place. Remember that inflation and taxes will erode and reduce the value of your money. To fight back against these two robbers, you need to invest for long-term growth. In the short-term, your portfolio is collecting dividends and interest at a much higher rate than on Treasury bills.

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Quadrant will review your IPS and asset allocation with you over the next few months. We will be exploring some changes of our own with the use of Alpha pools, a potential change to our approach to fixed income, different asset classes and an enhanced approach to asset allocation. We can't control the markets, but a well diversified portfolio and time will help you to meet your long-term investment goals.

Sincerely,

Quadrant Asset Management

MP/MS/RI