



# TETREM

QUARTERLY REVIEW

## MARKET REVIEW

Canadian and U.S. equity markets posted decent - and roughly comparable - results during the quarter. The Canadian market (represented by the S&P/TSX Composite) provided a total return of 2.9% while the US market (represented by the S&P 500) trailed at 2.0%. This is contrary to full year results that were more varied - the S&P/TSX Composite provided a total one-year return of 24.1%, while the S&P 500 trailed at 4.9% (all in local currency terms).

Gold was a notable performer during the quarter, rising from \$US473/oz to close the year at \$US516/oz. This helped the commodity sector out-perform both the broad market and all other sectors during the quarter. Our portfolios profited from their exposure to gold stocks, particularly Placer Dome, which was subject to an unsolicited takeover offer.

Financials also out-performed the market during the quarter. Banks rallied on the expectation that the Federal Reserve is near the end of its campaign to raise interest rates while averting the financial shocks that typically accompany a rising-rate cycle. The rally in bank shares seems at odds with an inverting yield curve (i.e. when short-term interest rates exceed long-term interest rates) and a cooling housing market which typically result in a deteriorating lending environment. We continue to be underweight financials relative to our benchmarks given the fundamental outlook and valuations.

Energy stocks finally lagged the market after many quarters of out-performance. The price of oil drifted below the peaks reached during the hurricanes and ended the year at \$61 per barrel. Recall that we had reduced our exposure to energy stocks last quarter as we had concluded that there was excessive speculative activity in the market.

### PERFORMANCE SNAPSHOT AS OF DECEMBER 31, 2005

TETREM'S CANADIAN EQUITY MANDATES			
	Last Quarter	Year to Date	5 year (annualized)
Tetrem CDN Equity Value	2.55%	31.57%	20.23%
Tetrem CDN Equity Value Plus	1.27%	30.05%	18.31%
S&P / TSX	2.86%	24.13%	6.63%

Contrary to the performance of Energy stocks was the performance of income trusts. Canada's Minister of Finance, Ralph Goodale, made headlines again this quarter. He withdrew his earlier decision to suspend advance tax rulings for companies seeking to restructure as income trusts. He additionally announced that he would reduce taxes on dividends in order to reduce the tax inequity between dividend paying common stocks and income trusts. As a result the shares of income trusts and high dividend yielding stocks rallied. Our portfolios profited as we had taken a contrarian view that the worst case scenario was priced into income trusts and selectively added to positions.

Lastly, portfolios with US exposure appreciated from the rise in a number of health care stocks. Most notably, Merck rallied on the announcement by its new CEO of a new strategic plan and an improved Vioxx litigation environment. It appears that the market had overly discounted Merck's legal liability; it now appears that plaintiffs may have greater difficulty winning future Vioxx trials.

We are finding reasonable investment opportunities in the U.S. and Canadian markets, but remain cautious on the markets' overall potential performance. Oil prices continue to tax the consumer and an inverted yield curve is generally not a harbinger of strong earnings growth. In addition, measures of sentiment indicate that the consensus view is very bullish and that fear is absent from the market. The VIX index, a measure of the premium investors are willing to pay for options as insurance to hedge their equity portfolios, is at multi-year lows, indicating a general complacency about risks to equity prices. Being contrarian it is difficult to ignore the old adage that a bull market needs to climb a "wall of worry" in order to continue an upward path.

TETREM'S U.S. EQUITY MANDATES			
	Last Quarter	Year to Date	5 year (annualized)
Tetrem US Equity Value	4.12%	15.11%	10.23%
Tetrem US Equity Value Plus	5.00%	21.95%	13.13%
S&P 500	2.09%	4.91%	0.54%





### TETREM PERSPECTIVES – “That Time of the Year”

George Bernard Shaw once said, “youth is wasted on the young.” Time has always been a concept that has fascinated and intrigued me. As we get older, not only is there less time available to us, but our perception of the movement of time accelerates. You could say that what we have less of goes by faster. As an investor, I have come to realize that our perception of time has immense consequences on how we invest and how we view investment results.

Time is a continuous line of movement that goes on forever with no visible breaks or pauses, yet we measure periods of time in a circular manner with one period beginning once the previous period has ended. Investing lends itself to these two contrasting concepts of time very well. If the investment process goes according to plan, we could be working to maximize individual client wealth over a period that stretches into decades. However, while our investment goals are continuous, just like with time we need a quantifiable and limited measurement period to check on our progress. The standard Julian calendar, which is based on a solar year, fits the bill just fine. So, while we think that our job of managing money is continuous and ongoing, it is important to stop and review results once a year.

I am delighted to report that 2005 was a very fulfilling year, personally and professionally. Jennifer and I celebrated the birth of our second son Jack, while Spencer, our three year old, firmly established himself as king of the house. Investment performance was also very satisfying as all mandates outperformed their respective benchmarks.

Tetrem’s Canadian Equity Value mandates returned 31.6% and the Canadian Equity Value Plus mandates (the “plus” allows for up to 20% U.S. stocks) gained 30.0%. Each mandate substantially out-performed the S&P/TSX Composite’s total return of 24.1% for 2005. While we are pleased with our investment results in Canada, it is our U.S. equity results that made us smile. Each of the U.S. mandates did quite well on both an absolute and relative basis. The S&P 500 struggled all year but, thanks largely to a fourth quarter push, was able to ‘reward’ passive investors in 2005 with a 4.9% total return. Tetrem’s U.S. Equity Value mandates returned 15.1% while the U.S. Equity Plus mandates returned 21.9%, thanks to the extra horsepower from exposure to Canadian oil sands stocks.

Our performance will be a tough act to follow in 2006. Our goal is for Tetrem’s investment mandates to outperform their

benchmarks by 2% per year through an investment cycle. Some years will do better than that, and 2005 was such a year. While we do our best to beat the benchmark every year, reality is that in some years we will lag. This is partially due to our conservative investment stance and over-riding objective of preserving capital. To maximize the risk/reward trade-off of our portfolios we tend to give up some upside because it is foolish to try to wring the last dollar out of every stock in the portfolio. We are firm believers in the old market adage that “pigs get slaughtered.”

Our substantial exposure to the energy sector helped to boost returns above benchmark levels during 2005 but recently we have been taking profits in this sector, as valuations have moved to the high side and there have been early signs of reduced demand for energy products (just as many of the energy companies are ramping up production). In the near-term, energy stocks could come under selling pressure as currently high oil and natural gas prices get baked into earnings expectations. If there is any disappointment on the earnings front these stocks will sell off sharply, as speculative money exits the sector. Long term we remain bullish on energy and we would use significant price weakness to rebuild positions.

One sector that constrained performance in 2005 was Canadian paper and forest companies. Coming into the year we were cautious on the sector’s earnings outlook, but held onto our positions in Domtar and Tembec because valuations were very attractive. It was a mistake. All of the stocks in the sector suffered from high energy prices, a strong Canadian dollar, and the ongoing lumber trade dispute with the United States. Eventually we exited the positions at lower prices as we could not see how profitability was going to rebound any time soon. There is the real risk that some companies in this sector may be forced into bankruptcy. Maybe at that time the survivors will be worthwhile investments. We are now using this experience as a case study in how to avoid “value traps” in the future.

Each year we try to improve our investment process through “lessons learned.” This year our number one lesson is not to be so cheap! There were several instances where we undertook significant research and came to the conclusion that we should purchase shares of companies if prices dropped to lower levels. In most of these cases the price drops never came and the stocks subsequently rallied - significantly. In the case of paper

continued on page 3...





TETREM QUARTERLY REVIEW

TETREM PERSPECTIVES ...continued

and forest companies mentioned earlier, we held on in the face of deteriorating fundamentals because the stocks looked too cheap to sell. In 2006 our goal is to improve our investment process by being a little more dynamic and opportunistic when we buy and sell stocks.

One stock idea that we got very right in 2005 was Apple Computer. In 2004 Apple was the best performing stock in the S&P 500. Coming into the year we were very tempted to sell all of our shares. Thankfully the temptation was avoided, as Apple followed up 2004's great performance by rising 123% in 2005. We trimmed our position in Apple early in 2005 as the stock got ahead of itself and we then used weakness after the first quarter's earnings release to rebuild positions. One of the reasons that we held on to Apple was that the press was awash in commentaries pounding the table that the stock was over-valued and an obvious "short" candidate. This was music to our contrarian ears, as we saw the shares offering good value given its growth profile. Today, there are very few pundits brave enough to call Apple a short and the hype around the company's products has only grown. We love the company and its products but have avoided falling blindly in love with the stock. As should be expected, we have been taking profits at an even more aggressive rate than last year.

For 2006 there are few obvious home runs in our portfolios on the scale of energy stocks as a group, or Apple Computer on its own. More likely, good performance will come from singles, the odd double and most importantly avoiding errors. Since the bubble burst in 2000, small stocks have drastically out-performed their large capitalization brethren. This small cap effect is best illustrated by the chart below. Large companies are represented by the S&P 100 (the largest 100 companies within the S&P 500) and small companies are represented by the Russell 2000 Value Index. Large capitalization stocks have under-performed small value stocks by 65% since the turn of the century. Small "value" stocks are now more expensive than high quality big companies. There are signs that overall earnings growth is peaking out, historically a precursor to large company out-performance. High quality large companies are now the better value and this is where we are putting investment dollars to work. These large companies have good upside potential and relatively limited downside. The stage is set for some classic mean reversion in the performance between these two groups of stocks.

Gold stocks have the potential to offer significant upside relative to Canadian and U.S. stock markets. This is not the call of a gold bug but based on old-fashioned earnings growth. Gold, the commodity, has been rallying strongly over the last few months and is at twenty-five year highs. Analysts have been slow to take into account gold's recent strength and are under-estimating the earnings power of the gold mining companies. Gold companies are poised to financially surprise to the upside, which will lead to strong share price performance. Additionally, gold stocks are under-owned by most portfolio managers and there could be a scramble to buy the shares as earnings stage a rebound from 2005's depressed levels.

Overall it will be difficult for us to have as good of a year in 2006 as we did in 2005, though we will certainly try to. However, our goal is not to "shoot the lights out" each calendar year, but to build wealth and assets over a continuous period of time. Albert Einstein once said that compound growth was the eighth wonder of the world. He likely was not too caught up on whether the compounding effect perfectly aligned itself with the Julian calendar.

Daniel A. Bubis, CFA  
President & Chief Investment Officer

Large Capitalization Stocks Have Lagged  
S&P 100 Index vs Russel 2000 Value Index\*



\*relative price performance rebased to 100 at December 31, 1999.





## TETREM QUARTERLY REVIEW

## ABOUT TETREM

Tetrem Capital Partners is an employee-owned investment management firm, headquartered in Winnipeg, Manitoba, Canada. Launched by Daniel Bubis, formerly the Chief Investment Officer of Assante Asset Management, Tetrem manages portfolios for institutional and private clients, with the investment management philosophy, discipline and expertise that have gained the confidence of thousands of clients throughout Canada for more than 10 years.

We have assembled a team of investment talent, including Sam Pelletieri, formerly the Director of Quantitative Research at Assante and currently Principal and Portfolio Manager with Tetrem. This team ensures the continuity of the investment philosophy and disciplined process, which has resulted in impressive track records both in Canadian and U.S. equities.

With more than Cdn \$1.9 billion of assets under management, Tetrem manages Canadian and U.S. equity mandates in Canada and abroad. Most notably, Tetrem manages, as sub-advisor, the Assante/United Canadian Equity Value Pool, for which Daniel Bubis has been the portfolio manager since its inception in 1993.

## OUR PRODUCTS AND SERVICES

Our investment mandates are primarily focused on Canadian and U.S. equities, rooted in our long-standing contrarian value style, and tailored to the specific and unique needs of institutional and high-net-worth clients. For our private clients, we provide a fixed income strategy as part of their overall asset allocation. We offer both separately managed accounts and pooled funds.

We are contrarian value investors. Our primary focus is seeking out and investing in undervalued companies. For each of our investment mandates, we utilize quantitative and fundamental analysis in our rigorous stock-selection process.

For more information about Tetrem Capital Partners please visit our website, [www.tetrem.com](http://www.tetrem.com), or call and ask to speak with us about our investment services.

204.975.2865 or toll free 1.866.975.2865

## TETREM'S CANADIAN EQUITY MANDATES

	Annualized Returns to Dec. 31, 2005				Calendar Year Returns				
	1 year	3 year	5 year	10 year	2005	2004	2003	2002	2001
Tetrem CDN Equity Value	31.57%	23.84%	20.23%	N/A	31.57%	15.05%	25.48%	12.07%	18.02%
Tetrem CDN Equity Value Plus	30.05%	23.15%	18.31%	17.90%	30.05%	14.88%	25.00%	8.15%	14.77%
S&P / TSX	24.13%	21.66%	6.63%	10.97%	24.13%	14.48%	26.72%	-12.44%	-12.57%

## TETREM'S U.S. EQUITY MANDATES

	Annualized Returns to Dec. 31, 2005				Calendar Year Returns				
	1 year	3 year	5 year	7 year	2005	2004	2003	2002	2001
Tetrem US Equity Value	15.11%	18.01%	10.23%	15.42%	15.11%	15.92%	23.17%	-1.94%	0.99%
Tetrem US Equity Value Plus	21.95%	22.24%	13.13%	14.61%	21.95%	14.76%	30.51%	-2.41%	3.97%
S&P 500	4.91%	14.39%	0.54%	1.77%	4.91%	10.88%	28.68%	-22.10%	-11.89%

Canadian Equity Value figures as of Dec. 31, 2005. Performance based on an audited equity only (excluding cash) composite of all segregated accounts until December 31, 2003. From January 1, 2005 to Dec. 31, 2005 performance is based on the unaudited Tetrem Canadian Equity Value composite. The calculation of performance returns excludes expenses and is based on a monthly valuation using the modified-dietz methodology.

Canadian Equity Value Plus figures as of Dec. 31, 2005. Return calculated from audited NAV. Performance returns calculated include the operating expenses, but exclude management fees. U.S. Equity Value figures as of Dec. 31, 2005. Performance based on an audited equity only (excluding cash) composite of all segregated accounts until December 31, 2003. From January 1, 2005 to Dec. 31, 2005 performance is based on the unaudited Tetrem U.S. Equity Value composite. The calculation of performance returns excludes expenses and is based on a monthly valuation using the modified-dietz methodology.

U.S. Equity Value Plus figures as of Dec. 31, 2005. Return calculated from audited weekly NAV. Performance returns calculated include the operating expenses, but exclude management fees.

Tetrem's mandates are available to institutional investors such as pension plans, group retirement plans and foundations and certain individual investors who meet specified investment criteria. The mandates' performance is not guaranteed, the values change frequently and past performance may not be repeated.

© 2004 Tetrem Capital Partners Ltd. All rights reserved. This communication is intended for Canadian residents only and does not constitute an offer or solicitation by anyone in any jurisdiction in which such an offer or solicitation is not allowed. Tetrem's advisory services are available only in those jurisdictions in which Tetrem Capital Partners is registered to provide such services.

