



THERE HAS BEEN BLOOD - THE VALUE HUNT IS ON

The year is not starting out well. As I write this letter on an icy cold January day in Winnipeg, the biggest chill is coming from the stock market where the S&P 500 is off to one of its worse starts in history. Recession fears in the U.S. have crescendoed as the debt market crisis has spread into the real economy. So the trillion dollar question is where do we go from here? My very simple view is that stock market corrections of 20% or more tend to occur a couple of times per decade, so we are overdue for one. And if a massive downturn in the credit cycle doesn't cause one, I'm not sure what would. In fact, by the time you are reading this, the washout to 20% may have already occurred.

The key term here is "washout." From time to time markets and economies need to rid themselves of excesses and we are now experiencing that cleansing. Markets today are gripped with fear, which is the complete opposite of the complacency that we witnessed early in 2007. One year ago (in our January 2007 newsletter) we wrote about the excessive level of complacency of market participants saying that: "The biggest risk to equity prices appears to be the distinct lack of risk aversion among investors." In particular, we pointed to the tight credit spreads evident in the bond market. Today, that complacency is largely gone or is at least running for the exits. Credit spreads have blown out, equities are trading at reasonable valuations and, in many instances, shares of high quality companies are "cheap."

I wish to emphasize that Tetrem is not making a 20% correction "call." I only bring up the possibility to help place the current period of market volatility into an historical perspective and to help rationally manage expectations in an environment gripped by fear. Our focus is on investing in companies that offer excellent long-term appreciation potential but are being mispriced in the market due to short-term concerns. We are finding more good contrarian investment opportunities in the current market than we have been able to find in a number of years; today's investment landscape is much more fertile for our investment style.

While we aren't smart enough to call the short-term direction of stock prices, to invest in "correcting" markets we need to be reasonably comfortable with three views: first, that there is a catalyst - in this case the bottoming of the credit cycle; second, that the overall value metrics

of the stock market must be compelling; and third, that there must be attractive stock-picking opportunities. If we can be positive in all three of these views, because the stock market is a discounting mechanism, we can logically say that there is a high probability that a bad economic outcome has already been priced into share valuations.

THE CREDIT GAME IS OVER

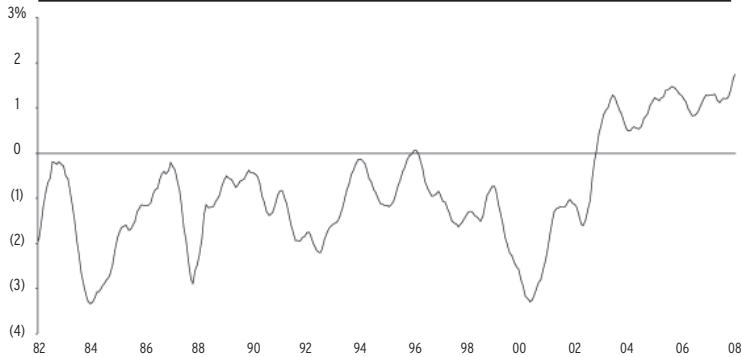
The over-extended U.S. consumer appears to be slowing down. In previous market commentaries we have written about the risk of economic imbalances that were being created by a consumption-heavy, savings-poor U.S. consumer. It is interesting to revisit our January 2005 newsletter, where we stated that: "low interest rates spurred consumers to consume more...and brought on asset inflation in housing prices." Without delving too deeply into the gory details of the credit cycle there has been a period of excessive credit expansion thanks to the self-reinforcing combination of low interest rates and lax lending standards. The cycle popped in 2007 and is now working in reverse. Financial institutions are now wary of lending as write-offs grow, equity levels decline, balance sheets expand and the cost of funding increases. The crisis of confidence started in the debt markets with the first significant signs of sub-prime jitters in February 2007, and has now spread into the real economy, which will very likely trigger a contraction in consumer spending - if it hasn't already.

So, if we think that there is a reasonable chance that the U.S. consumer may bring about an economic slowdown, why are we still constructive on stocks? First, and foremost, stocks are reasonably valued. The Fed Model, which compares the earnings yield of stocks to bond yields, is indicating that stocks are as cheap as they have been in 25 years (Figure 1) - further evidence that an economic slowdown is already priced into the stock market. Even if earnings expectations were to contract in 2008, stocks would still be cheap relative to bonds. Furthermore, while equity returns have been strong since stocks bottomed in 2002, the decline from 2000 to 2002 is a big hurdle to overcome and, according to a report from Morgan Stanley, the current decade is tracking to be the worst decade for U.S. large capitalization stocks since the 1930s. While there is grim news on the consumer front, it hardly appears to us that we are on the precipice of a depression. Going back to our January 2005 newsletter again, we opined that: "... a consumer-led recession...(and) the ensuing retreat in equity prices will





THE FED MODEL (Figure 1)
Earnings Yields Less the Ten-Year Bond Yield
1982 Through Early - January 2008



Source: Federal Reserve Board, Empirical Research Partners Analysis.
 Earnings yield is for large-capitalization stocks; data smoothed on a trailing six-month basis.

create the buying opportunity of the decade.” We wrote those words three years ago, which shows why we don’t try to time markets. Our views were early but today these buying opportunities are emerging.

In the U.S., General Electric epitomizes the investment opportunities we are finding in the turmoil of the current market. Early in this decade, GE’s shares traded at over \$60, which translated to a trailing price-to-earnings ratio of 49. Early in 2008 the shares are trading at \$34 with a valuation of 16 times earnings. Over the same period the dividend yield of GE has risen from under 1% to 3.6%. The balance sheet is strong and the company has significant growth opportunities in energy, medical equipment, aerospace and the ongoing global infrastructure build-out. Over 50% of sales come from outside of the U.S. and the company has a AAA rating that gives it a significant advantage in economically challenging times. The shares of GE may have been over-valued in 2000, but eight years later they offer very good value. Today, our focus is on GE and similar high quality, large capitalization companies whose shares are trading at multi-decade low valuation levels.

Not all stocks are good value. In particular some of the high flying momentum stocks that have led the market over the last two years continue to trade at excessively high valuations. It is quite typical that as a bull market ages investors crowd into an ever decreasing number of companies that exhibit strong earnings. As more dollars chase this small group of stocks, valuations rise and downside risk increases. These momentum stocks form their own bubble within the stock market, as more and more investors pile into the one part of the stock market that is deemed to be “working”. All bubbles eventually burst;

all that is required is a catalyst. Historically, the most effective stock market bubble-bursters have been economic slowdowns. It appears to us that valuation is about to matter again.

The first place that the credit market pain manifested itself into the equity markets was in the shares of financial services companies. Warren Buffet is correct: derivatives are weapons of mass destruction. While Tetrem portfolios have been relatively underweight the shares of financial companies, such as banks, we, like the market, took our hits in 2007. Unfortunately, we did not see or correctly anticipate the level of balance sheet destruction from debt such as collateralized debt obligations (CDOs) or special investment vehicles (appropriately referred to as SIVs), which are bundles of debt securities that include sub-prime mortgages. Much damage has been done to the global banking system as sub-prime mortgage losses have mounted. Frankly, the losses have been shocking and it is unfortunate that, on their ways out, the executives in charge during this mass stupidity get to keep their bonuses, which were based on the now eviscerated profits of earlier years. However, our job is to look forward and find good investment opportunities today. After careful analysis of risk vs. reward, we have been cautiously purchasing the shares of financial services companies as prices drop.

While we don’t want to dwell on the past, it does pay to learn from history. Bank shares are going to continue to have write-offs and credit issues will worsen; however, history has taught us that banks trough in valuation and begin to out-perform the overall market months prior to the worst of the write-offs. We believe that we are in the “buy zone” today for a number of reasons. First, the resetting of residential variable rate mortgages will peak in the U.S. market in the first half of 2008. Assuming resets correlate with the peak in sub-prime write-offs, we are well within the six month period where bank shares discount the worst of the write-offs. Second, given that earnings-based valuation methodologies are difficult to use in this highly uncertain environment, asset-based valuation models can be relied upon and are indicating that financial services companies are at trough valuations when compared to previous downturns in the credit cycle. Third, the inter-bank lending market is starting to ease as evidenced by the TED spread (Figure 2). This measure shows that depositors are becoming more willing to leave their cash at banks as opposed to seeking the safety of U.S. government Treasury yields. Not only is this a sign that stress is easing but it also indicates that funding costs are coming down from elevated levels, which will ultimately be a positive for bank earnings.

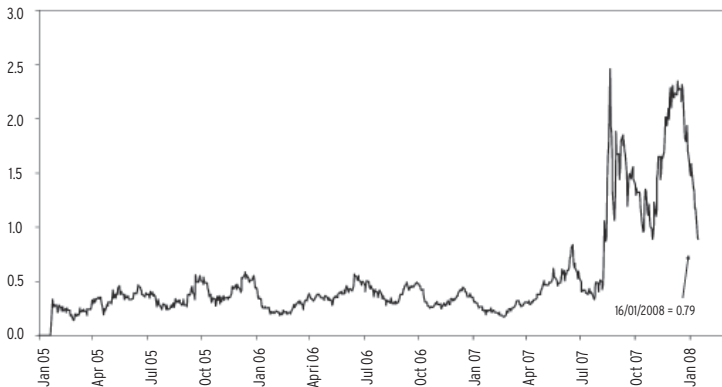
Lastly, and possibly most importantly as it relates to the overall health of the equity markets, financial institutions have been able to shore up





TETREM QUARTERLY REVIEW

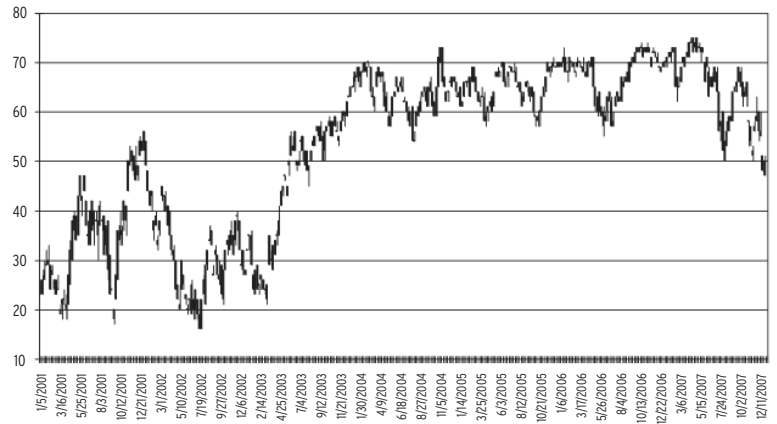
TED* SPREAD (Figure 2)



* TED Spread is the ICAP Capital markets Eurodollar 3 Month Rate - 3 Month US Government T-Bill Yield
Source: Bloomberg, Tetrem Capital Management

MARKET VANE S&P 500 SENTIMENT (Figure 3)

Bullish Consensus
Data as of January 15, 2008



their damaged balance sheets by raising equity. Much, but not all, of the capital is coming from sovereign wealth funds. The capital-raising shows that, while the credit markets have been in turmoil as investors shy away from taking on collateral risk, liquidity does exist and is available (at the right price) to help avert a banking or economic crisis.

Importantly to us, investor sentiment - if I may - stinks at the moment. The Market Vane survey of bullish sentiment is at its lowest level since the U.S. invaded Iraq (Figure 3). This is positive from a contrarian standpoint, providing yet another indicator that the negative news is being factored into equity prices. Many other sentiment surveys and indicators reflect levels that usually mark a bottom in equity market corrections. For instance, The American Association of Individual Investors is showing 39% more bears than bulls (surpassing the negative sentiment of 2003) - the most bearish level since the stock market crash of 1987. One of the most profitable bets in investing is going against the retail investor, and that bet is as good today as it has ever been.

VALUE OPPORTUNITY

As mentioned numerous times throughout this newsletter, we are seeing excellent value opportunities develop within the stock market. One of the more frustrating outcomes of the complacency in asset markets over the past few years has been the lack of "table-pounding" investment opportunities. The valuation spread between expensive and inexpensive stocks is a barometer that indicates the opportunity set of good investments for value investors; all else being equal, the wider the spread the greater the ability for a manager to add value

over the market return ("alpha") through security selection. Since the technology bubble burst in 2000, this spread has shrunk from an historically high level and appears to have bottomed early in 2007 just as investor complacency was at its highest (Figure 4). With the current stock market uncertainty, the valuation spread between expensive stocks and inexpensive stocks is normalizing and the opportunity to add value through stock picking is growing. In other words, the market is becoming much more "target rich" for value managers. We believe that the current environment will prove to be very fertile for Tetrem's clients.

Back in January 2005 we predicted: "Many market pundits will react to a consumer-led recession by espousing an Armageddon scenario for the equity markets. However, the ensuing retreat in equity prices will create the buying opportunity of the decade. We'll be ready." And we are.

VALUATION SPREADS (Figure 4)
Top Quintile Compared to The Market Average
1952 Through Early January 2008



Source: Federal Reserve Board, Empirical Research Partners Analysis.





TETREM QUARTERLY REVIEW

TETREM PORTFOLIOS

In Canada, the Tetrem Canadian Equity Composite declined 3.97% in the fourth quarter, which brought the total return for the year to 3.18%. These results trailed the S&P/TSX Composite, which declined 1.25% in the quarter and rose 9.83% for the year, buoyed by a narrow group of momentum stocks.

The Tetrem U.S. Equity Composite outperformed the benchmark as it declined 2.26% in the quarter compared to a decline of 3.33% for the S&P 500. For the year, the composite returned 8.32% compared to 5.49% for the index. In 2007 Tetrem U.S. equity portfolios performed well in a difficult market thanks to good stock picking, while generally avoiding the worst of the carnage from areas such as homebuilding and mortgage lending.

Daniel A. Bubis, CFA
President and Chief Investment Officer

ABOUT TETREM

Tetrem Capital Management offers money management services to institutional and select high net worth clients. Our investment mandates are focused on Canadian and U.S. equities, rooted in our long-standing contrarian value style and tailored to the specific and unique needs of our clients.

Investing is our profession and we are committed to doing it well. Our experienced team is diligently focused on preserving and growing the assets of our institutional and private clients.

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 Management please visit our website, www.tetrem.com, or call and ask to speak with us about our investment services.

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TETREM'S CANADIAN EQUITY MANDATES

	Annualized Returns to December 31, 2007					Calendar Year Returns				
	Last Quarter	1 year	3 year	5 year	10 year	2007	2006	2005	2004	2003
Tetrem CDN Equity	-3.97%	3.18%	13.92%	16.37%	11.91%	3.18%	9.27%	31.13%	15.05%	25.48%
Tetrem CDN Equity Plus	-2.23%	6.10%	14.80%	16.86%	13.32%	6.10%	9.80%	29.88%	15.24%	25.00%
S&P/TSX	-1.25%	9.83%	16.93%	18.32%	9.47%	9.83%	17.26%	24.13%	14.48%	26.72%

TETREM'S US EQUITY MANDATES

	Annualized Returns to December 31, 2007					Calendar Year Returns				
	Last Quarter	1 year	3 year	5 year	10 year	2007	2006	2005	2004	2003
Tetrem US Equity	-2.26%	8.32%	14.11%	16.23%	12.51%	8.32%	19.04%	15.22%	15.92%	23.17%
Tetrem US Equity Plus	-2.34%	11.49%	17.67%	19.62%	13.21%	11.49%	19.17%	22.64%	15.17%	30.51%
S&P 500	-3.33%	5.49%	8.62%	12.83%	5.91%	5.49%	15.79%	4.91%	10.88%	28.68%

TETREM
Performance Disclosure

Canadian Equity figures as of December 31, 2007. Performance based on an audited equity-only (excluding cash) composite of all segregated accounts until December 31, 2003. From January 1, 2004 to present, performance is based on the unaudited Tetrem Canadian Equity composite. Performance from January 1, 2004 to December 31, 2004 is based on an equity-only (excluding cash) composite of all segregated accounts. The calculation of performance returns excludes expenses and is based on a monthly valuation using the modified-dietz methodology. Canadian Equity Plus figures as of December 31, 2007. Return calculated from audited NAV. Performance returns calculated include operating expenses, but exclude management fees.

U.S. Equity figures as of December 31, 2007. Performance based on an audited equity-only (excluding cash) composite of all segregated accounts until December 31, 2003. From January 1, 2004 to present, performance is based on the unaudited Tetrem U.S. Equity composite. Performance from January 1, 2004 to December 31, 2004 is based on an equity-only (excluding cash) composite of all segregated accounts. The calculation of performance returns excludes expenses and is based on a monthly valuation using the modified-dietz methodology. U.S. Equity Plus as of December 31, 2007. From May 1997 to May 2006, return calculated from audited weekly NAV, closest to month end. Performance returns calculated include operating expenses, but exclude management fees. From June 2006 to present, the calculation of performance returns excludes and is based on a monthly valuation using the modified-dietz methodology.

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' performances are not guaranteed, the values change frequently and past performance may not be repeated.

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