TETREM
QUARTERLY REVIEW

PRO-CYCLICAL, ANTI-ENTITLEMENT

As we enter the second decade of the twenty-first century, all of the portfolios managed by Tetrem Capital Management maintain a pro-cyclical bias. Our portfolio positioning is driven by two factors: our fundamental views on the investment merits of each stock we own and our thematic belief in the power of reflationary forces in the global economy. Simply put, the best balance of risk and reward remains with the shares of companies that are levered to economic growth.
Since North American equity markets troughed in March 2009, investors who have followed the classic playbook of investing for a cyclical recovery have been handsomely rewarded. By the end of the first quarter of 2009 it became evident that global central bankers were not going to allow a Great Depression II to happen on their watch. To combat the negative feedback loop of a deflationary debt cycle, policy makers cranked up the monetary printing presses through a number of initiatives, most notably quantitative easing (QE). Effectively, governments have been printing their own currencies to buy their own debt which has had the dual beneficial effects of lowering long-term interest rates and adding much needed cash to illiquid economies. The fact that short-term interest rates have been near zero has certainly helped as well.

The reaction to QE was first felt in the market economy with the tightening of credit spreads and the rally in so-called "risk" assets such as equities. Central bankers have effectively pushed investors along the risk continuum, away from government bonds, for instance, and into equities and commodities. Gradually, positive sentiment transferred into the real economy as both corporations and consumers began to emerge from their bunkers. Management teams refocused on growth initiatives (such as mergers and acquisitions) and deemphasized retrenchment activities that protect margins and balance sheets. Today, consumers are showing increased confidence and are starting to spend - just in time to stop the word "consumer" from becoming self-contradictory.

Throughout the market and real economy, behaviours are changing as uncertainty recedes, providing the most elemental and important ingredient to a cyclical economic recovery. A year ago it seemed impossible to imagine how the negative feedback loop could be broken. Today we are potentially in the early stages of a return to a self-reinforcing virtuous cycle. The one missing ingredient thus far has been job growth, which is set to return in 2010 thanks to the recent surge in productivity. This is how cycles work and this one is no different: it was just longer, deeper and therefore scarier than anything most of us had seen in our lifetimes. Job creation lags economic growth in all cycles, and all recoveries are deemed jobless by pundits and media alike until the facts eventually prove them wrong.

The consensus view is that the rebound in the stock market and other "risk" assets will end as soon as the liquidity spigot is turned off. This is a reasonable expectation, and has a basis in the history of previous cycles. However, what no one really knows - even though they would like to convince you otherwise - is whether the nascent economic recovery can transition into a "normal" self-sustaining economic upturn once we get through the inevitable hiccups as the market digests higher interest rates. The bears say "no" given the huge bill that needs to be paid as a result of all of the accumulated deficits and stimulus spending. They take the rational view that if the problems were caused by profligate spending and too much debt in the first place, they can't be permanently fixed with more debt and profligate spending. Bootstrapping just doesn't work.

As is usual, the bears make a great point. However, it remains to be seen if investors should be bearish today. Eventually the "bill" will come due, but we do not yet know what its size will be. Currently unaccounted for, but by far the biggest burden for future generations, are out-of-control social security and medical entitlement promises which absolutely dwarf today's stimulus expenditures and will need to be tacked on to the final tab.

In order to be bullish long-term, you need to believe that entitlement spending can be brought under control. Unfortunately, major economic issues that require painful decisions on the part of governments are only done reactively. We didn't see that happen this time around, in fact we got the opposite. The entitlement issue has been with us a long time, but the day of reckoning is getting closer due to demographics. Populations in the developed world are aging. The number of people over 65 relative to those aged 15-64, the so-called "dependency ratio," is set to accelerate to the upside over the next 20 years [Figure 1]. Japan appears to be marching inexorably toward a crisis, and if other countries are to avoid a similar fate we will need to see some combination of a rising birth rate, increased immigration and cuts in future entitlement benefits.

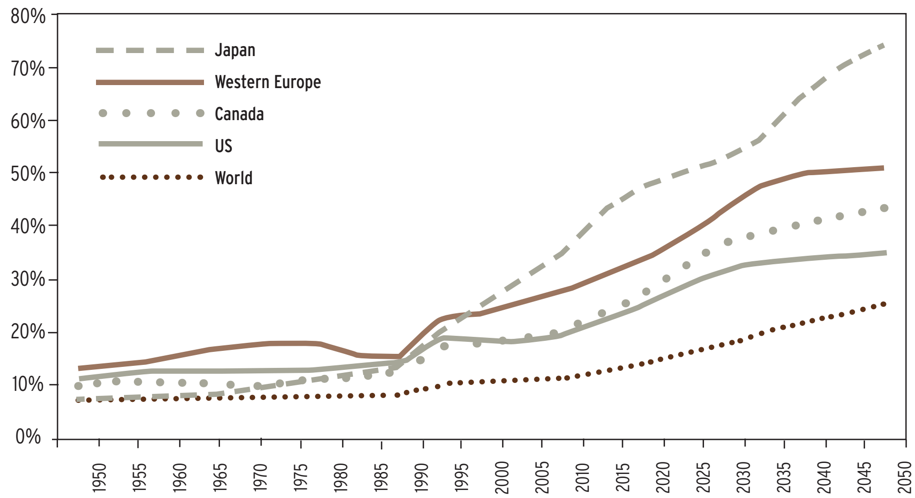
This may seem like wishful thinking but I am optimistic that we can eventually deal with the entitlement issues. The latest economic downturn reminded us that human beings are remarkably adaptable; it's the basis of evolution. If behaviours can so quickly change from a fear-driven bunker mentality to a greed-driven profit mindset, there is reason to hope we can solve our long-term challenges. We are all economic animals.

Entitlement attitudes are a societal issue that has been building over the past 50 years. There is a good chance that the apex of entitlement was in the decade just ended. Attitudes are changing, primarily among new entrants to the workforce. Just a few short years ago hiring new graduates was surreal. The predominant view was that there was a talent shortage, candidates were "entitled" to a great job, and employers should consider themselves lucky to have them. Not anymore. At the other end of the spectrum, some corporate executives were (and still are) being paid huge sums effectively to act as stewards of businesses that wouldn't miss them if they weren't there. Somehow we have allowed managers to be paid like capitalists while the key ingredient of personal financial risk was left out of the equation: think of it as institutionalized corruption. Populist rage against excessive corporate compensation is finally on the upswing and it looks like pay packages are set to fall.

With will and courage, we will collectively reset our societal expectations of entitlement to more sustainable levels. A pendulum shift away from a culture of entitlement and back toward meritocracy certainly would be bullish for long-term economic and market prospects. It won't be easy, but nothing worthwhile ever is.

Daniel A. Bubis, CFA
President and Chief Investment Officer

ELDERLY-DEPENDENCY RATIOS * [Figure 1]



* The ratio of the population aged 65 years or over to the population aged 15-64.
Source: United Nations, Tetrem Capital Management. Values contain estimates since 1950 and projections until 2050, taken from the United Nations World Population Prospects: The 2008 Revision.

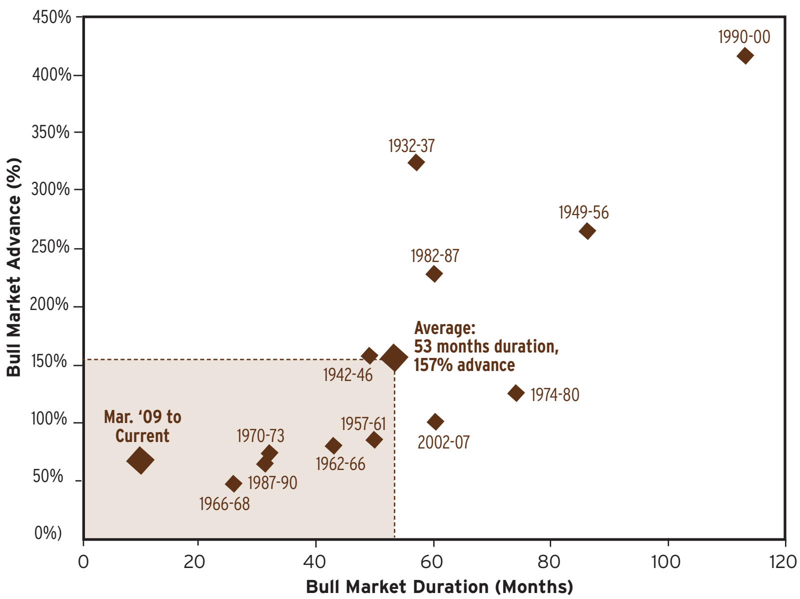
U.S. MARKET REVIEW

2009 marked another year where market returns were on the outer edge of the distribution curve: just as 2008 was a "fat tailed" year on the downside, 2009 performance was again an outlier, this time on the positive side. Taking their cue from global monetary authorities, investors began to embrace risk-taking throughout the year. True to form, both equity and credit markets began their ascent before getting the "all clear" sign on the economic front. Once market participants realized the worst was behind them, they sought out areas with the most torque to a recovery. Sectors such as basic materials, technology and consumer discretionary led the way, while sectors with more stable earnings characteristics like consumer staples, telecommunications and utilities lagged.

2009 was a good year for the Tetrem U.S. Equity Composite as we were able to capture the historic value opportunity in the market created by all the stress in the system. The full year return was 41.8% (in U.S. dollars), outperforming the S&P 500 by 15.3%. During the fourth quarter some of the previously better performing stocks and sectors gave back some gains, which we viewed as healthy for the market. Our 5.0% return lagged the S&P 500's 6.0% in the quarter. Throughout the year, our holdings most geared toward an economic recovery did particularly well. Within the energy sector, our decision to sell out of major integrated oil companies Exxon Mobil (XOM) and Chevron (CVX), and concentrate more in energy service and exploration and production companies, served us particularly well. XOM was a big underperformer, down 15%, while our holding in Nabors Industries (NBR) and Transocean Ltd (RIG) were among the top contributors to performance. Within the financial services sector, our holding in the insurance company Hartford Financial Services Group Inc. (HIG) was one of the biggest detractors from performance and we sold out of it early in the year. The decision was difficult, but it ultimately proved beneficial because we reinvested the proceeds into another insurer, Aflac Inc. (AFL), in which we had a higher degree of confidence; it turned out to be our top contributor for the year. In the consumer discretionary sector, high-end retailer Nordstrom (JWN) helped our relative performance for the year. As the panic abated the stock rallied smartly and we exited our position. Finally, defensive companies tended to be performance detractors, such as our longtime holding in Johnson and Johnson (JNJ) which had been a port in the storm in 2008, only to miss the wave in 2009 due to its relatively low sensitivity to the economy.

After witnessing two consecutive years of extreme performance in the market we are not alone in grappling with the question "where are we now?" Numerous investors still believe that the current rally has been artificially induced and that many assets have been unsustainably inflated from quantitative easing. It is clear that interest rates are artificially low from loose monetary policy. It is also possible that the economy surprises to the upside thanks to the stimulus that has been put in place. The big question is to what extent a rise in interest rates will threaten the recovery. The growth versus interest rates trade-off will be a difficult balancing act for policy makers over the next year as they decide when and how to implement their exit strategy. We believe the authorities will err on the side of caution rather than risk a double dip in the economy. Furthermore, the fact that sentiment is not overly bullish gives us confidence in the outlook: to the extent there are still plenty who don't believe in the sustainability of the economic expansion or the market's advance, we still have the necessary "wall of worry" in place for continued potential gains. If in fact we are in a new bull market, history would suggest that we are still in the early stages, with ample upside left [Figure 2].

S&P 500 HISTORICAL BULL MARKETS: 1928 to Present [Figure 2]



Source: Strategas Research Partners, Leuthold Group, Tetrem Capital Management. As of January 2010.

As such, we are still constructive on equity markets and continue to believe that a pro-cyclical tilt in the portfolio is warranted. The monetary and fiscal stimuli should gain further traction in 2010, providing the potential for the economy to surprise to the upside. Just as we saw a self-reinforcing spiral on the way down in 2008, the reverse could play out going forward: stronger economic growth and higher corporate earnings could lead to improved consumer confidence, and the recovery could evolve into a self-reinforcing one driven by capital spending and job growth, rather than one that has been engineered by the government.

Despite our general optimism, we recognize there are risks. We are closely watching housing and employment data along with market interest rates and credit quality within the financial system, which could derail a recovery. Also, if the economy begins to run too hot, market rates will move in advance and could force the Fed's hand, potentially resulting in slower growth and hurting sentiment.

The early stages of the rebound in the markets benefited most stocks, but more recently the market has become more discriminating. Going forward we believe that the opportunity for outperformance will be driven less by macro factors and more by stock picking. Numerous high quality companies with stable earnings profiles have lagged, so we are focusing our research there.

Aaron Clark, CFA
Vice President, Investments

CANADIAN MARKET REVIEW

The S&P/TSX Composite Index rose 3.9% in the quarter, capping off a strong full-year gain of 35.1%. Tetrem's Canadian Equity Composite trailed the index, rising 3.5% and 31.7% over the same periods, respectively. Our focus on high quality made it difficult to beat our benchmark in a "risk" rally led by junk. Commodities continued to rise in the quarter. Gold received the most media attention as it briefly hit new highs of approximately $1,200/oz in early December, but in fact its 9% increase over the quarter was less than that of natural gas and crude oil which were up 15% and 12% respectively. We were active in our research of stocks and added a number of names to the portfolio in 2009, some of which include: Magna International (MG.A), Potash Corporation of Saskatchewan (POT), Sun Life Financial (SLF) and Research in Motion (RIM) which we subsequently sold at a profit. We also exited from our positions in Finning International (FTT), CIBC (CM) and Newmont Mining (NMC).

As investors began to believe that the economic weakness was abating and would eventually reverse, economically sensitive holding CP Rail (CP) rallied, after trading below book value earlier in the year. A strengthening economy means increased shipments of goods and by year end CP's freight volumes started to turn positive after a year of declines. Investor interest in the rails was also spurred by Berkshire Hathaway's offer to purchase the 77% of Burlington Northern Santa Fe Corporation (BRK.A and BNI – not owned) it didn't already own at a premium valuation. Warren Buffett's increased commitment to the rails was seen as a stamp of approval for the sector. In our view, the rails are not only a great way to invest in a cyclical recovery, they also have excellent secular characteristics: their infrastructure is well-developed and impossible to replicate, meaning new competitors are highly unlikely to appear; they consume proportionately less fuel than trucks, which means that when energy costs are high rails hold a competitive advantage in that they can charge shippers less to move goods over a given distance.

In the fourth quarter, Canadian life insurance stocks were notable underperformers as sentiment worsened on the back of Manulife Financial's (MFC) unexpected $2.5 billion equity raise. Investors punished the stock, pushing it 14% lower over the quarter, which provided us with the opportunity to add to the portfolio's existing position in this high quality franchise. We believe the equity raise was unnecessary and that MFC's management was being highly cautious, preferring to raise capital on its own terms rather than face the possibility of forced terms at a lower stock price. At current levels the stock appears attractive relative to its long-term earnings potential and is also inexpensive relative to the Canadian banks, which appear to be more fairly valued in the aggregate.

The biggest detractor from our relative performance for the year was the materials sector, and in particular Teck Resources (TCK.B – not owned) which we eschewed due to a number of concerns including its high debt level: in our assessment the stock was too speculative. In the energy sector we had a mix of wins and losses. Among the services companies, Trican Well Services (TCW) rose 77% while Precision Drilling Trust Units (PD.U) fell 24%, partly due to cutting its distribution and issuing dilutive equity. The portfolio's underweight position in the underperforming telecommunication sector contributed positively to relative performance.

The Canadian portfolio maintains a significant position in stocks geared to a recovery, including: railways, auto parts manufacturers and natural gas-oriented energy names. Conversely, our search for the next value opportunities is leading us to companies with stable earnings characteristics, which have generally underperformed and may offer attractive potential returns with minimal downside. We are investigating stocks in the telecom and consumer staples sectors, and at some point we envision adding them to the portfolio should their investment merits meet our criteria.

Alec MacIsaac, CFA
Investment Analyst

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 needs of our clients.

Investing is our profession and we are committed to doing it well. Our experienced team's primary focus is seeking out and investing in undervalued companies. For each of our investment mandates, we employ quantitative and fundamental analysis in our rigorous stock-selection process, with a focus on preserving and growing our clients' assets.

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 (Gross of Fees in CDN $)

	Annualized Returns to December 31, 2009					Calendar Year Returns				
	3 month	1 year	3 year	5 year	10 year	2009	2008	2007	2006	2005
Tetrem CDN Equity	3.46%	31.68%	-0.85%	6.91%	13.35%	31.68%	-28.27%	3.18%	9.27%	31.13%
Tetrem CDN Equity Plus	3.79%	33.46%	-0.95%	6.74%	12.51%	33.46%	-31.38%	6.10%	9.80%	29.88%
S&P/TSX	3.86%	35.05%	-0.21%	7.66%	5.61%	35.05%	-33.00%	9.83%	17.26%	24.13%

TETREM'S US EQUITY MANDATES (Gross of Fees in US $)

	Annualized Returns to December 31, 2009					Calendar Year Returns				
	3 month	1 year	3 year	5 year	10 year	2009	2008	2007	2006	2005
Tetrem US Equity	4.95%	41.79%	-2.24%	5.09%	9.57%	41.79%	-39.16%	8.32%	19.04%	15.22%
Tetrem US Equity Plus	5.36%	43.80%	-0.80%	7.36%	10.94%	43.80%	-39.11%	11.49%	19.17%	22.64%
S&P 500	6.04%	26.46%	-5.63%	0.42%	-0.95%	26.46%	-37.00%	5.49%	15.79%	4.91%

TETREM
Performance Disclosure

Prior to June 1, 2004, performance returns were owned by Assante Asset Management Ltd ("Assante"). Tetrem has concluded that these returns meet portability requirements and as such, have been linked with Tetrem's returns for the sole purpose of providing supplemental information to the Tetrem's Composite Performance Presentation. This information is provided to present a longer track record using records available to Tetrem and may have limited usefulness.

Canadian Equity and U.S. Equity returns from January 1, 1997 to December 31, 2003 are based on an audited equity-only (excluding cash) composite of all segregated accounts and are owned by Assante. Performance from January 1, 2004 to May 31, 2004 is based on an unaudited 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. Returns from June 1, 2004 to December 31, 2009 are gross of management fees and prepared using time weighted rates of return using the Modified-Dietz methodology.

Canadian Equity Plus returns from January 1, 1998 to May 31, 2004 are calculated using the audited NAV per share of a representative account within the composite. The NAV per share excludes management fees and is net of operating expenses. Performance returns for this period are owned by Assante. Returns from June 1, 2004 to December 31, 2009 are gross of management fees and prepared using time weighted rates of return using the Modified-Dietz methodology.

U.S. Equity Plus returns From January 1, 1998 to May 31, 2004 are calculated using the weekly NAV per share, closest to month end, of the sole account within the composite. The NAV per share excludes management fees and is net of operating expenses. Performance returns for this period are owned by Assante. Returns from June 1, 2004 to December 31, 2009 are gross of management fees and prepared using time weighted rates of return 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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