



# TETREM

## QUARTERLY REVIEW

### MARKET REVIEW

Exposure to energy markets largely determined how well your stock portfolio performed in the first half of 2005. The energy sector was easily the best-performing sector within both the Canadian and U.S. equity markets. The S&P/TSX Composite Index provided a total return of 8.1% over the first six months of the year while the S&P 500 could only muster 1.1% in Canadian dollar terms. Most of the difference is attributable to the much larger weighting of energy companies in the S&P/TSX than in the S&P 500.

Utilities were the second-best-performing industry group, after energy, in both markets. Utility stocks were given a major lift by the decline in long-term bond yields on both sides of the border.

Outside of these two sectors, stocks generally drifted in a trading range or declined. The economy and equity markets are facing a two-pronged attack: on one side, from rising oil prices; on the other, from a U.S. Federal Reserve that is orchestrating a methodical campaign to increase short-term interest rates. Each individually is a heavy tax on growth; together, they may turn out to significantly dampen economic activity. It seems, sometimes, that the only thing keeping the market from a nasty correction is the buoyancy of the housing market. This can't be reassuring, given the speculation that is now very evident in the consumer real estate market.

Recent events have confirmed that it pays to be contrarian. Just as everyone was leaving the U.S. dollar for dead, it has staged an impressive rally, rising 10% on a trade-weighted basis and 12% against the Euro thus far in 2005. Perhaps European growth is an oxymoron after all.

### PERFORMANCE SNAPSHOT AS OF JUNE 30, 2005

TETREM'S CANADIAN EQUITY MANDATES			
	Last Quarter	Year to Date	5 year (annualized)
Tetrem CDN Equity Value	4.11%	12.72%	20.39%
Tetrem CDN Equity Value Plus	4.24%	12.88%	19.59%
S&P / TSX	3.58%	8.10%	1.13%

Nonetheless, the resurgence of the greenback is not necessarily good news for the S&P 500. It may make U.S. stocks more attractive to foreign investors, but it will make earnings comparisons very difficult in the second half of 2005. As the U.S. dollar weakened throughout 2003-2004, U.S. companies enjoyed a positive currency effect on earnings. Not only were they becoming more competitive vs. foreign competitors, but they also benefited from currency gains as foreign-denominated earnings were translated back to dollars. It is unlikely that most analysts have modeled a stronger U.S. dollar into their second-half earnings expectations, at which time year-over-year translation gains will start becoming negative.

On a brighter note, the Canadian dollar, while still up on the year, has shown some weakness recently. This is good for corporate Canada, especially Canadian energy producers, whose costs are incurred in Canadian dollars but whose products are denominated in U.S. dollars. These companies are benefiting from record-high commodity prices, while their cost structure is declining on a relative basis. In other words, they are getting old-fashioned margin expansion.

Overall, stocks appear to be reasonably valued and are receiving major valuation support from low long-term interest rates. However, the pickings are a little slim for truly outstanding investment opportunities in individual stocks. A little shake-out in the market would be a welcome event, as it would provide some good buying opportunities in individual stocks.

TETREM'S U.S. EQUITY MANDATES			
	Last Quarter	Year to Date	5 year (annualized)
Tetrem US Equity Value	1.87%	5.19%	15.38%
Tetrem US Equity Value Plus	3.21%	6.90%	15.29%
S&P 500	1.37%	-0.81%	-2.37%





## TETREM PERSPECTIVES - "We are Value Investors"

Tetrem is officially one year old. Since June 1, 2004, when we started managing money under the Tetrem banner, we've been growing at a steady pace. It's been a busy first year - not the least of which has been producing this newsletter, already in its fifth edition.

So far, I've focused in these essays on thematic, or macro, subjects that have been timely and within the context of the market. For instance, the March 2005 newsletter analyzed the unexpected persistence of low long-term interest rates (Greenspan's conundrum). What's interesting, looking back, is that "macro" has almost nothing to do with how we pick stocks. We've written macro and thematic pieces primarily because people tend to find the subject matter interesting and we have an opinion that we are more than happy to share (whether people want to hear it or not!). When it comes to investing however, the truth is, we are primarily plain-vanilla, bottom-up stock pickers, only influenced by these macro themes in a minor way.

Tetrem is an investment-centric firm guided by a solid and carefully thought-out investment philosophy. First and foremost, we are value investors. Simply put, we try to purchase shares of companies at less than their intrinsic value. The bigger the discount to intrinsic value, the greater the value and - equally important - the lower the risk. Benjamin Graham coined the term "margin of safety" and that is exactly what you get when you can purchase a company's shares at a price that is less than what the company is worth. What separates the value investor from everyone else is our focus on purchasing the shares of a business at the right price and then holding onto them until the market recognizes their intrinsic value. We may agree with others that a business is good, but if we can't buy it cheaply enough, we will pass on buying any of it.

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The positive side is that, with shares trading lower than their value, the probability of making money is vastly increased. The difficulty with value investing is that, to purchase shares of a company at a value price, you have to do it when the company is out of favor, something that can prove to be psychologically difficult.

...being a cheapskate who is price conscious will increase the odds of investment success.

We have a value philosophy for a number of reasons. First, and simplest, of all, value investing works. There is a vast amount of research available that provides empirical evidence of its efficacy. By working, we mean beating the market over an investment cycle. The evidence quite clearly shows that buying statistically cheap stocks is a great way to create wealth. Second, value investing makes intuitive sense to us. It seems quite straightforward that being a cheapskate who is price conscious will increase the odds of investment success. Discriminate shopping in the sale bin has the added benefit that, at the very least, you can minimize the risk of future markdowns after your purchase is made.

Third, we are value investors because it fits our temperament. There really aren't that many nice ways to describe value investors. We tend to be a little dour at times, some would say challenging and we definitely take a skeptical view of the "facts". Warren Buffet once said, "you pay a very high price for a cheery consensus." Value investors simply do not believe in cheery consensus. In fact, we are rarely cheery about investing. Michael Lewis put it well when he described value investors as, "people who place a very high value on having the last laugh. In exchange for the privilege, they have missed out on a lot of laughs in between."

... it seems so simple and obvious to us that we wonder why everyone isn't a value investor.

Frankly, it seems so simple and obvious to us that we wonder why everyone isn't a value investor. Don't get us wrong. Given that the stock market is an excellent discounting machine, we are very thankful that most people aren't value investors. If they were, there would be no opportunities to be had. This really brings us to the crux of why value investing works. Value investing works because it takes advantage of an anomaly that is created by human behaviour - what you could call the pleasure principle. Most people, given the choice, seek pleasure. Value investing is a painful process to follow that affords very little pleasure much of the time. As I mentioned earlier, the best

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TETREM PERSPECTIVES ...continued

values are often found in the most out-of-favor stocks. Cheap stocks usually have some flies hanging on to them and "everyone

**It is not easy to be contrarian and go against the crowd ...**

knows" what's wrong with them. It is not easy to be contrarian and go

against the crowd - which just happens to be an absolutely critical ability of a value investor. Most people simply do not have the wherewithal and stomach to be value investors.

Economists will argue that there is no value opportunity in the stock market, that the market is such a powerful discounting mechanism that it is completely efficient and that there is no opportunity to beat it in any way, shape or form. This is known as the efficient market hypothesis or EMH. We do have a lot of respect for the efficiency of the stock market. It is a very tough competitor to beat. However, while other anomalies will come and go, the value anomaly has always existed, continues to exist and will always exist. Why? Because people are people and we do not always act in a rational way. Don't believe me? Come over to my house at 3 a.m. to have a chat while I'm trying to get Jack, my two-month old, to sleep. My view of the world is unlikely to be classified as "rational" right about then. The key assumption of the EMH is that people act in a rational manner consistent with their economic self-interest. Mostly we do but, at times, fear and greed do take over.

One does not have to look much further than the technology-led stock market bubble that developed in the late 1990s to realize that the investment decision-making process is not always purely rational. Stock market manias have nothing to do with intelligence or rationality and everything to do with emotion - and greed. As Sir Isaac Newton put it after losing a fortune in the South Sea Bubble mania of the early 1700s, "I can calculate the motions of heavenly bodies, but not the madness of people."

Value investors tend to profit more from fear than from greed. When greed rules, we usually stay away, which is a key ingredient in preserving capital. We tend to prefer fear. Fear creates opportunities for the rational buyer to purchase stocks at

**Fear creates opportunities for the rational buyer to purchase stocks at distressed valuations.**

distressed valuations. It's not easy - being a value investor means taking positions in stocks when the

average investor is exiting. But this is precisely why value investing works. Behavioral experiments have shown that the trade-off between the pleasure of making money and the pain of losing it are not symmetrical. Daniel Kahneman won a Nobel Prize in Economics for this behavioral work (carried out in collaboration with Amos Tversky). People tend to suffer greater pain from losing a unit of money than they experience pleasure from gaining a unit. In other words, the pain of losing one dollar is greater than the pleasure of winning one. As such, typical investors are pain avoiders who do not like to purchase stocks when they feel that the risk of losing capital is high. It is this behavioral inefficiency that creates the value opportunity. Value stocks exist because we as people create them.

We believe in value investing. It works, even though it shouldn't. If the markets were truly efficient, value investing would not work. But people are people and try as we might, old habits die hard. Perhaps one day we will all be un-emotional, rational thinkers like Mr. Spock of Star Trek fame.

**Value stocks exist because we as people create them.**

I hope not though - not only would this take a lot of fun out of life, but we would be out of business.

This essay has dealt with our investing philosophy at the highest level. Future articles will delve into our philosophy in more detail. The behavioral aspect of stock investing is just one of a number of interrelated tenets that, when combined, create Tetrem's unique brand of value investing. Next up will be the concept of reversion to the mean. I hope you can stand the wait.

**Danny Bubis, CFA**  
President & Chief Investment Officer





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## ABOUT TETREM

Tetrem Capital Partners is an employee-owned investment management firm, headquartered in Winnipeg, Manitoba, Canada. Launched by Danny 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 Pellettieri, 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 \$1.6 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 Canadian Equity Value Pool, for which Danny 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 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.

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## TETREM'S CANADIAN EQUITY MANDATES

	Annualized Returns to June 30, 2005				Calendar Year Returns				
	1 year	3 year	5 year	10 year	2004	2003	2002	2001	2000
<b>Tetrem CDN Equity Value</b>	22.89%	16.50%	20.39%	N/A	15.05%	25.48%	12.07%	18.02%	32.83%
<b>Tetrem CDN Equity Value Plus</b>	23.98%	16.53%	19.59%	16.68%	14.88%	25.00%	8.15%	14.77%	31.20%
<b>S&amp;P / TSX</b>	18.04%	13.58%	1.13%	10.02%	14.48%	26.72%	-12.44%	-12.57%	7.41%

## TETREM'S U.S. EQUITY MANDATES

	Annualized Returns to June 30, 2005				Calendar Year Returns				
	1 year	3 year	5 year	7 year	2004	2003	2002	2001	2000
<b>Tetrem US Equity Value</b>	15.50%	12.69%	15.38%	12.18%	15.92%	23.17%	-1.94%	0.99%	38.53%
<b>Tetrem US Equity Value Plus</b>	18.66%	14.56%	15.29%	11.56%	14.76%	30.51%	-2.41%	3.97%	29.74%
<b>S&amp;P 500</b>	6.32%	8.28%	-2.37%	2.24%	10.88%	28.68%	-22.10%	-11.89%	-9.10%

Canadian Equity Value figures as of June 30, 2005. Performance based on an audited equity only (excluding cash) composite of all segregated accounts until December 31, 2003. From January 1, 2004 to June 30, 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 June 30, 2005. Return calculated from audited NAV. Performance returns calculated include the operating expenses, but exclude management fees. U.S. Equity Value figures as of June 30, 2005. Performance based on an audited equity only (excluding cash) composite of all segregated accounts until December 31, 2003. From January 1, 2004 to June 30, 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 June 30, 2005. Return calculated from audited weekly NAV. Performance returns calculated include the operating expenses, but exclude management fees.

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