TETREM CAPITAL PARTNERS

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TETREM
QUARTERLY REVIEW

MARKET REVIEW

The Wall Street adage of "Sell in May and go away" was fitting this year as North American equity markets enjoyed solid results in the first quarter and into the early weeks of the second quarter, only to eventually sell off on fears that continued central bank tightening was draining the markets and the economy of needed liquidity. Tighter monetary policy and renewed inflation fears shocked equity markets out of their sleepy complacency by triggering an all-but-forgotten occurrence – an equity market correction. In Canada the S&P/TSX Composite Index declined 13.1% from its April 19th peak to its low point on June 13th. The S&P 500 faired slightly better with an 8.1% decline from the May 8th cycle high to its correction low on June 14th. In the words of J.P. Morgan: "markets will fluctuate."

The markets were particularly spooked by a tough talking Ben Bernanke. The new Chairman of the Federal Reserve is out to convince the markets that he is an inflation hawk. While painful in the short run, there is no question that this is the correct course of action. It was widely expected that the May 10th FOMC meeting would signal a change in Fed policy away from incremental tightening and towards taking a wait-and-see approach. We were concerned at the time that too clear of a signal would act as a flashing green light for speculators to unleash their animal spirits and drive asset prices sharply upward. The concern in some investment circles of a commodity bubble may have actually come true. Aware of the risks to the real economy if things got out of hand, Mr. Bernanke took the opportunity to rein in the speculators and, more importantly, to put the bond market at ease by not letting the inflation genie out of the bottle.

Unfortunately the anti-inflation tough talk led to a sell-off in risky assets around the globe. What had gone up the most in the first quarter got hit the hardest. Gold came off 25% from its May high to its June low, while aluminum and copper fell 24% and 23% respectively. Emerging markets equities were particularly hard hit as evidenced by the MSCI Emerging Market Index decline of 24.9% over the five-week period from May 10th to June 14th.

The Bank of Japan deserves at least an honorable mention for the recent correction in risky assets around the globe. After a long period of keeping short-term interest rates at zero, the BoJ recently communicated a shift in policy towards "quantitative tightening." The so-called "carry trade" (borrowing in Japan at zero to buy risky assets elsewhere) has been a major driver of global liquidity and therefore of speculative activity. With the forced reining in of the carry trade, it was inevitable that risk premiums would go up, i.e. asset prices would have to come down.

Despite the second quarter sell-off, all of the commodity and equity indices mentioned thus far remain up on the year. We view the market sell-off as a healthy correction rather than the start of a more ominous bear market. Markets were getting quite frothy and in need of a cold dose of reality. What is amazing is how quickly sentiment swung from very bullish to extremely pessimistic. Sentiment surveys taken near the mid-June market lows showed a level of bearishness (and lack of bullishness) not seen since the bear market lows of October 2002. The highly negative sentiment readings of October 2002 marked the lows for the worst bear market since the 1970s. We view negative sentiment as a contrarian indicator. Since their October 2002 lows, the S&P 500 and S&P/TSX Composite Index have posted total returns of 74.9% and 118.9%, respectively. The June 2006 sentiment readings are not the signals of the start of a bear market.

Given the much healthier state of the global economy today, along with very strong corporate balance sheets and decade-low price-to-earnings ratios for many blue chip stocks, it is hard to be overly bearish. One area of caution for us is that profit margins are at historically high levels. It is therefore difficult to envision aggregate earnings growth coming from future margin expansion. If anything, corporate margins are at risk as employees fight for wage gains to share in the rise in profits and to offset losses in disposable income from a rising energy bill.

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PERFORMANCE SNAPSHOT AS OF JUNE 30, 2006

TETREM'S CANADIAN EQUITY MANDATES

	Last Quarter	Year to Date	5 Year (annualized)
Tetrem CDN Equity	-1.58%	4.79%	19.50%
Tetrem CDN Equity Plus	-2.80%	2.32%	17.69%
S&P / TSX	-3.50%	4.19%	10.48%

TETREM'S U.S. EQUITY MANDATES

	Last Quarter	Year to Date	5 Year (annualized)
Tetrem US Equity	0.64%	5.36%	12.48%
Tetrem US Equity Plus	0.13%	6.62%	14.51%
S&P 500	-1.44%	2.71%	2.49%

TETREM PERSPECTIVES – Is Canada a Long-Term Investment?

Recently I had the pleasure of traveling to London for a series of meetings with a diverse group of particularly astute investors. I always look forward to such meetings as they provide valuable exposure to the investment insights of successful investors and can lead to actionable stock ideas. The best of these sit-downs are always intellectually stimulating.

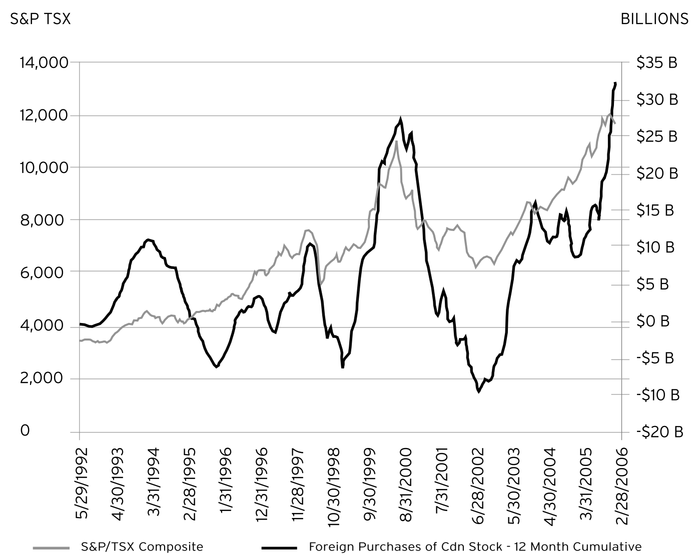
At one meeting, a particularly wise and experienced investor rhetorically asked me if I thought that Canada was an excellent place to invest from a generational perspective. The context was such that I thought it interesting that the question was being asked in the first place. After all, it was posed by a renowned international investor, domiciled at the epicenter of global investing, who is one of the very members of the global investment community that greatly influences the direction of the Canadian stock market. I made a mental note to have a fresh look at the history of foreign purchases of Canadian stocks when I returned home, believing that this subject might also be of interest to our clients.

Historically, Canada was viewed within the global investment community as a "hewer of wood and a drawer of water." In other words we didn't have a lot to offer beyond resource stocks. This changed in the 1990s as resource stocks under-performed other areas of the market, such as the shares of technology companies. In 2000, at the peak of the technology-media-telecom bubble, the Toronto Stock Exchange was viewed as the 'NASDAQ of the North', thanks to the market leadership of names such as Nortel (35% of the index at its peak) and JDS Uniphase. We have since reverted back to our historical market profile: technology is now just over 3% of the weight of the S&P/TSX Composite index while resource stocks make up 45% of the index. The last time resource stocks were anywhere near their current levels was when they were in their own mini-bubble in the early 1980s.

Consequently, Canada has once again become a favorite hunting ground for international investors who are seeking ways to profit from the current boom in commodity-related stocks. The following illustration plots the net purchases of Canadian stocks by foreign investors against the performance of the S&P/TSX Composite Index. The performance of Canadian stocks has obviously benefited from foreign buying. Ironically, the last time Canada had anywhere near the current level of inflows of foreign capital to purchase listed securities was back in 2000. If this seems a little ominous it should.

The short-term direction of Canadian equity prices are greatly influenced by foreign investment flows and, what seems to be even clearer, is that not all of these investors are looking at "generational" investment horizons. Many, probably most, are playing a momentum investment game and will disappear at the first sign of trouble. In fact, large foreign purchases of Canadian stocks often turn out to be a contrarian indicator signaling a market top.

FOREIGN PURCHASES OF CANADIAN STOCKS AND THE CANADIAN STOCK MARKET (to MAY, 2006)



Returning to the question from London, I am in the camp that believes that we are in the midst of a secular resource boom. However, I am also a pragmatic investor who realizes that there will be speed bumps along the way. Resource stocks will run into near-term trouble if there is a consumer-led recession in the U.S., or if China has a deceleration in its growth rate. Commodity-related stocks are not overly expensive today but that does not mean that they won't go down if the global economy has an economic growth scare. We learned a valuable lesson during the late 1990s equity bubble – that while value may win out in the long run, in the shorter term all that matters is the flow of funds. And it is the present direction of the flow of international funds that worries us most: if history is any guide, when resource momentum peters out there will be a stampede for the exits as foreign investors repatriate their capital.

While the resource bonanza has its many benefits to the Canadian economy, it is not without its costs. Many Canadian companies are hurting from the strong Canadian dollar. The Canadian dollar has become a petro-currency, which has been gaining strength thanks to our strong balance of trade in resources and positive foreign portfolio flows. The dark side of this situation is that Canadian manufacturers are watching their margins deteriorate in the face of a rising Loonie. Many are becoming uncompetitive; some are going out of business.

TETREM PERSPECTIVES – ...continued

Canadians must be vigilant so as not to succumb to the paradox of the 'resource curse'. This refers to the situation where countries that are rich in resources have below-potential economic growth because the resource profits are squandered and are not reinvested in areas that will increase future growth and productivity such as education. It would be a tragedy if the current resource boom was to end with no Canadian industry left to keep our economy driving forward. This is unlikely to happen, but the risk is worth mentioning as there are long-term investment implications.

Within the resource area, we continue to favour the energy stocks over metal-mining companies. Fossil fuels are finite resources that are burned and there are few economic substitutes. Metals can be recycled and are more readily substituted. Both have current supply issues but the energy supply constraints appear to be much more intractable and longer-term in nature. Perhaps most importantly, demand for metals tends to be cyclical and tied to volatile industrial production while energy demand rarely declines and is tied to the more glacial movements of global GDP growth.

Many pundits have claimed that oil prices are being propped up by speculative buying. We believe that oil prices recently passed a very difficult test that increases the probability that higher oil prices may be sustainable and are not purely the result of speculative activity. As referenced in the front section of this newsletter, equity markets and commodity prices went through a very turbulent period during the May to June period. Speculators were being forced to decrease market exposure as liquidity was being drained from the system. The price of oil remained extremely firm during this period, barely dipping below $70 per barrel. Other commodities faced extremely sharp sell-offs of up to 25% while oil dipped a relatively minor 10%. If oil was ever going to sharply correct because of unsustainable specula tion, this was the time. Our long-term bullish stance on energy has been reinforced by the relatively benign reaction of oil to a speculative squeeze.

Interestingly, while Canadian stocks have benefited from the global flow of funds, U.S. stocks have not. U.S. stocks as measured by the S&P 500 have stagnated over the past few years and it was one of the worst performing equity markets in 2005. Foreign investors have been exiting the U.S., preferring higher momentum areas like Canada, Australia and emerging markets. Everyone knows the economic issues that the U.S. now faces, such as a high debt load, an over-extended consumer, trade deficits, and an expensive war that has no end in sight. U.S. equity securities are currently out-of-favour and therefore represent an enticing investment opportunity for us.

In the May to June market sell-off, the shares of U.S. blue chip companies held up extremely well. The S&P 500 is now trading at a decade-low price-to-earnings multiple at a time when corporate balance sheets are in extremely good condition and earnings have been strong. Consumer discretionary stocks, such as retailers, appear to be at risk from housing and consumer spending slow-downs, but this particular risk is easily managed by avoiding the sector altogether.

Today, we are more excited by the investment opportunities in the U.S. than what we are seeing in Canada. To be sure, both markets are challenging from a stock picking perspective as valuations' dispersions are at historically low levels, i.e. there are not many clearly under- or over-valued areas within the market. However, within Canada, three very homogenous sectors – financials, oils and materials – make up 75% of the weight of the S&P/TSX Composite Index. Even with historically low valuation disparity the U.S. market offers many more idiosyncratic investment opportunities, thanks to its greater depth and diversification. This helps to explain the better relative performance of Tetrem's US equity mandates relative to our Canadian equity mandates over the past year. The more target-rich the stock-picking environment, the better our relative performance should be.

One area towards which we have a particularly positive predisposition is the health care sector. Many of the companies in this sector score particularly well in our quantitative models and we find them fundamentally appealing from a valuation perspective. In the U.S. it is a diverse group that includes pharmaceutical companies, hospital services, HMO's and medical equipment. The sector is defensive and cheap relative to the market. For stock pickers there is plenty to choose from. However, in Canada the healthcare sector is very narrow with few companies to chose from (we own some of them), and accounts for a very minor 1% of the market capitalization of the S&P/TSX benchmark.

Here at Tetrem we are in a unique position to judge the relative merits of U.S. vs. Canadian stocks. Our investment team applies the same investment philosophy and process to pick stocks in each equity market. Canadian equities do offer an outstanding investment opportunity over the long term. However, the near-term direction of Canadian stocks will be driven by the movement of volatile commodity prices, foreign fund flows and perceptions about global economic growth. None of these factors can be predicted with a great amount of conviction. U.S. equities arguably exhibit better near-term risk/reward characteristics. This is a contrarian view and therefore not all that surprising for us. It is also the view that I shared with my international colleague in London in response to his good question.

Daniel A. Bubis, CFA
President & Chief Investment Officer

MARKET REVIEW – ...continued from page 1

On a year-to-date basis, three out of four of our equity mandates have stayed ahead of their relative benchmarks. All four of our North American equity mandates outperformed their respective benchmarks in a very difficult and challenging second quarter. The Tetrem Canadian Equity mandate had been trailing the S&P/TSX Index after the first quarter, but that deficit was erased as our portfolios preserved capital in the market downturn to a greater extent than did the S&P/TSX.

Fears of excessive central bank tightening will continue to be of concern to investors and caution is warranted. Until it becomes clear that central banks are on hold, equity markets will likely remain volatile and range-bound. We continue to believe that overall valuations are reasonable and we remain comforted by strong corporate balance sheets. The U.S. consumer remains the overextended wildcard. The average U.S. consumer faces a slowing housing market while being squeezed by high energy prices. A consumer slowdown may have the positive salutary effect of convincing central banks to keep liquidity flowing.

ABOUT TETREM

Tetrem Capital Partners offers money management services to institutional clients 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 relentlessly focused on preserving and growing the assets of our institutional and private clients by rigorously applying our value philosophy and our disciplined investment process.

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, 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, 2006				Calendar Year Returns				
	1 year	3 year	5 year	10 year	2005	2004	2003	2002	2001
Tetrem CDN Equity	22.31%	24.82%	19.50%	N/A	31.57%	15.05%	25.48%	12.07%	18.02%
Tetrem CDN Equity Plus	17.88%	22.39%	17.69%	17.19%	30.05%	14.88%	25.00%	8.15%	14.77%
S&P / TSX	19.64%	20.69%	10.48%	10.56%	24.13%	14.48%	26.72%	-12.44%	-12.57%

TETREM'S U.S. EQUITY MANDATES

	Annualized Returns to June 30, 2006				Calendar Year Returns				
	1 year	3 year	5 year	7 year	2005	2004	2003	2002	2001
Tetrem US Equity	15.29%	17.08%	12.48%	12.60%	15.11%	15.92%	23.17%	-1.94%	0.99%
Tetrem US Equity Plus	21.63%	20.57%	14.51%	13.58%	21.95%	14.76%	30.51%	-2.41%	3.97%
S&P 500	8.63%	11.22%	2.49%	0.47%	4.91%	10.88%	28.68%	-22.10%	-11.89%

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Performance Disclosure

Canadian Equity figures as of June 30, 2006. 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, 2006 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 June 30, 2006. Return calculated from audited NAV. Performance returnscalculated include operating expenses, but exclude management fees.

U.S Equity figures as of June 30, 2006. Performance based on an audited equity-only (excluding cash) compositeof all segregated accounts until December 31, 2003. From January 1, 2004 to June 30, 2006 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 figures as of June 30, 2006. Return calculated from audited weekly NAV, closest to month end. Performance returns calculated include 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.