



CONFIDENCE GAME

For this newsletter I was hoping to be able to get away from macroeconomic commentary for the first time in over two years. Since the financial crisis gained momentum, far too much of our time and effort communicating with clients has been taken up by the “big picture” at the expense of specific investment ideas. Having said that, it has been the correct way to communicate given that macro has been the dominant factor affecting all investments, and part of our job as money managers is to help provide market perspective.

For a glorious three month period, from February to April of 2010, old fashioned individual company fundamentals and valuation were the major factors driving share prices. In other words we were in a stock picking environment. This brief golden era ended towards the end of April as a slew of negative headlines began to weigh on market sentiment. The concerns over Greek sovereign debt sparked fears of a broader debt contagion, particularly within Europe; China's attempts to rein-in speculative activity gave rise to fears of a broader economic slowdown; and the oil spill in the Gulf of Mexico has been bad on many different levels. These, and concerns over the U.S. government's relationship with business, have been the four main factors weighing on equity markets - the list could easily be expanded. Very quickly we have moved back into a macro-dominated world, and our commentary necessarily reflects this reality.

It's really too bad, as company fundamentals have been improving. Earnings are up, balance sheets are exceptionally strong and, based on management comments, there exists a latent desire to utilize historically high cash levels for investment purposes. This is the fuel for an economic recovery. After years of cutting, management teams recognize the need to hire people and increase capital spending. Other investment choices include acquisitions, share buybacks and dividends, all of which are good for equity valuations, with mild salutary effects on the economy.

So why have we not seen management teams investing more boldly in people and equipment? It simply comes down to confidence. The people who are in a position to make the hiring and capital investment decisions are worried. What's interesting is that, until very recently, their worries seemed less about business conditions than an uncertain regulatory and legislative landscape. Health care reform is complicated and it seems that the cost of hiring is going up, so why do it? Banks don't know what businesses they can be in or what capital ratios they need to maintain, so why extend credit? Taxes - going up. However, the biggest impediment to business confidence is the current U.S. president's tendency to lash out and vilify business whenever it is politically expedient to do so. We are at the point where, if there is going to be any chance of a self-sustaining economic recovery, it is

absolutely critical for governments to pass the baton of spending to the private sector. Governments are tapped out and further deficit spending may be counterproductive. The consumer remains in deleveraging mode. Only businesses have the means to spend, hire and, in turn, spur continued economic growth.

By numerous measures stocks are cheap and have discounted an economic slowdown. Interest rates are low and the risk of monetary tightening has been pushed out into the future. Although the rate of growth is decelerating, the economy continues to expand. A double-dip recession is plausible, but unlikely. The biggest risk to the economy is a self-reinforcing negative feedback loop. Without job creation, investors will not believe in the sustainability of the current economic recovery. Lack of conviction pressures equity prices, which in turn reflexively pressure the economy. This is similar to what we saw in the first quarter of 2009, when policymakers engineered massive fiscal and monetary stimuli - the correct response to a nose-diving global economy. Today policymakers run the risk of being the catalyst for contraction as opposed to expansion. It is time for the U.S. Administration to wake up and remember that, in the words of President Calvin Coolidge, “the business of America is business.” Only then will corporations have the confidence to go out and invest. It can never be forgotten that confidence is the lifeblood of a capitalist economy.

In the month of June the U.S. created a disappointing 83,000 new jobs after adjusting for seasonal census workers. This was on a base labour force of nearly 156 million workers. By contrast, Canada created 93,200 jobs in June on a base labour force of less than 19 million. Australia's job machine was also working well as evidenced by 45,900 new jobs in June on a labour force of 11.7 million. Not only has job creation been robust in Canada and Australia, but the growth blew away expectations for the month of June. The differences in job creation are striking. The two Commonwealth nations have fewer structural issues than the U.S. in regards to deficits, housing and banking systems. However, they are similar Western market economies that are interlinked with the U.S. economy. If the U.S. falters Canada will not be far behind: over 70% of Canada's exports go to its southern neighbour. Canada also faces its own particular issues. The structural productivity gap vis-à-vis the U.S. has been stubbornly stuck at an elevated level for many years, taxes are already high, and the recent strength in the Canadian dollar has created a competitive headwind. So why are firms in Canada hiring? For the reason that companies in the U.S. should be hiring - they have a profit motive to do so. The difference is that Canadian businesses are not dealing with an unpredictable regulatory environment, whereas their U.S. counterparts are looking over their shoulder wondering if the long arm of the government is coming after them next.





TETREM QUARTERLY REVIEW

It's awkward to have to rely on the government to do the right thing for equity markets to stabilize, but that is a consequence of the macro world we live in today. A change in government behaviour is absolutely critical at this juncture, and we are seeing early signs of hope. Over the past two weeks into mid-July the Obama Administration has increased dialogue with the business community and is offering a conciliatory tone. Goldman Sachs and the SEC have just reached a settlement, a critical step to alleviate anxiety within the business community at

large. The Administration is showing signs that it is savvy enough to react to market volatility and realize that the private sector requires confidence to invest. Without job growth there will not be a self-sustaining economic recovery. Without job growth the Democrats face very tough mid-term elections this November. Doing the right thing now aligns with political self-preservation, and that's a good thing.

Daniel A. Bubis, CFA

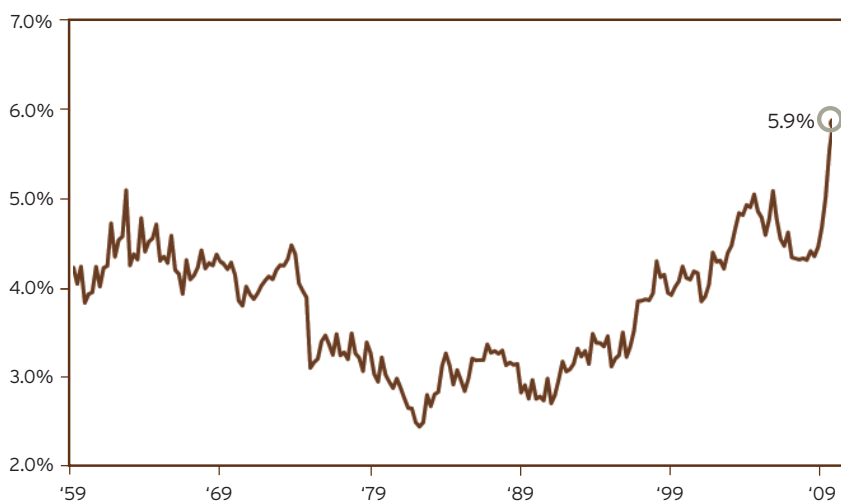
President and Chief Investment Officer

U.S. MARKET REVIEW

During the quarter, the equity market experienced its first real correction since the impressive rally that started in March of 2009. Defensive sectors such as utilities and telecom held up better, falling approximately 5%; cyclical sectors, such as technology, basic materials and energy fared worse, declining 13-16%. Tetrem's U.S. Equity Composite declined 15.9% (in USD), underperforming the S&P 500 by 4.5%. In hindsight, given the cyclical bias of the portfolio, we are not surprised that we gave back some of the strong outperformance generated in four of the prior five quarters. However, the magnitude of the second quarter's underperformance was more than we would normally expect. The main reason for it can be summarized by three words, "Gulf of Mexico", where the tragic oil rig explosion disproportionately affected two of the portfolio's holdings that had previously been strong performers.

The first, Anadarko Petroleum (APC), has a 25% working interest in the leaking oil well and faces potential liability for the accident. While APC is denying responsibility, it is likely that the company will be on the hook for part of the ultimate liability, the amount of which is uncertain. Assuming APC is obliged to pay for 25% of the liability [reflecting its ownership stake], our analysis indicates that the company has enough liquidity right now to cover over two times its obligation, based on the current run-rate being paid out by British Petroleum. In other words, it appears that the financial impact to APC will be manageable. The second holding, Transocean Ltd (RIG), is the owner of the Deepwater Horizon rig that BP operated. Unlike APC, the controversy around RIG is less about liability and more about the business outlook. The U.S. has imposed a six month ban on drilling in the Gulf, and investors are concerned about a potential ripple effect on global offshore drilling. Given the long-term imbalance between growing demand and falling supply of oil, we believe this controversy will prove to be temporary. Nevertheless we have stress-tested RIG's cash flows for a more adverse scenario, and our analysis suggests the company will be able to generate positive cash flow under harsh assumptions. We believe the share price has considerable long-term upside, but we will need to wait patiently for the negative headlines to subside.

CASH AS A PERCENT OF TOTAL ASSETS [Figure 1]
U.S. Non-Financial Corporations



Source: Stategas Research Partners, Tetrem Capital Management, as of March 31, 2010

We sold long-term holding Harley Davidson (HOG) and locked-in gains. The stock had performed well in the cyclical recovery and we saw limited upside. Integrated energy company Marathon Oil Corp (MRO) also contributed positively to the portfolio during the quarter. The company's valuation has been held down by its cyclically-depressed refining business, and we saw hidden value in its growing exploration and production (E&P) assets. As refining margins started to improve in the quarter, so too did investor perception. The shares continue to trade at a significant discount to peers, providing a margin of safety and room for upside as investors recognize that the company's business mix is shifting toward a heavier weighting in E&P, which typically garners a higher multiple in the stock market.

As discussed last quarter we had been expecting to take profits from cyclical companies as they approached fair value, and would likely be reinvesting the proceeds into their more defensive counterparts as the year progressed. We started to implement this strategy by raising cash to approximately 8% by late April. Subsequently the market corrected, and the cyclical companies declined more than the defensives, which





TETREM QUARTERLY REVIEW

meant the relative value advantage between these two broadly defined groups shifted back to the former. We believe our original game plan will eventually play out, and we continue to focus our research efforts on companies with stable earnings characteristics. Many of these companies generate significant levels of free cash flow and have high dividend yields, with capacity to increase payouts to shareholders over time. In fact, corporate balance sheets are the healthiest they've been in 50 years: Figure 1 shows cash at historically high levels relative to assets. The eventual deployment of this cash hoard bodes well for a self-sustaining economic

recovery; increased regulatory clarity would give corporate management the confidence to reinvest in their businesses through hiring, capital spending and M&A. There is significant pent-up demand for this to occur as capital spending levels are at multi-decade lows. It is clear to us that, as confidence improves, investors will care more about company-specific fundamentals, leading to opportunities for long-term outperformance through stock selection.

Aaron Clark, CFA
Vice President, Investments

CANADIAN MARKET REVIEW

Tetrem's Canadian Equity Composite fell 5.4% during the quarter, outperforming the S&P/TSX Composite index by 11 basis points. This outperformance was generated in spite of the portfolio's cyclical bias in a weak market. We attribute this positive outcome to our large-cap, high-quality approach to stock selection. At a high level, within the materials sector, gold holdings served their role as perceived safe havens and helped the portfolio; however, fertilizer and base metals companies that are correlated to Chinese growth detracted from results. Our energy holdings fared similarly to the overall market, while our financial companies detracted.

The portfolio's best performing stock in the quarter was Gerdau Ameristeel (GNA), which received a takeover offer from its Brazilian parent at a 53% premium to the previous day's closing price. The stock popped above the offer price and we chose to lock-in gains rather than speculate that a higher bid would emerge - none did. Research in Motion (RIM) was a contributor to relative performance because we didn't own it, and it fell 30% on concerns about rising competition from other smart-phone providers, notably Apple's iPhone. That said, we have been monitoring the company closely as valuation has contracted significantly, which may create a buying opportunity. The portfolio's holdings in insurance companies Manulife Financial (MFC) and Power Corp (POW) [which owns a controlling position in Great West Life] detracted from performance. Lifecos in general faced a number of pressures in the quarter: low interest rates, falling equity markets, and exposure to "in the news" European debt. While the near-term outlook is admittedly fuzzy, we believe that these world-class companies will successfully work through their issues and start to generate a higher level of earnings, ultimately leading to improved sentiment and multiple expansion in the stocks. While we wait, POW's dividend is paying investors 4.4% annually, 130 basis points more than the Government of Canada (GOC) 10-year bond.

The stock price of portfolio holding Magna International (MG.A) got a boost when the company proposed a deal to buy back its

multi-voting shares, which would eliminate Frank Stronach's control position. The proposal is controversial, with some high-profile investment managers publicly objecting to the terms of the deal. We agree that the nearly \$1B in wealth transfer from shareholders to Mr. Stronach is objectionable. However, when we first bought the shares during the 2008/09 bear market, we were well aware of potential issues the multi-voting shares could present, and we therefore made sure we paid a price for the shares that provided a margin of safety that amply compensated us for taking on that risk. In our view, the benefits of the proposed deal outweigh the costs. For years Magna has traded at a discount to its world-class peers, such as Borg Warner in the U.S. Many institutional shareholders in Canada and the U.S. will not touch the shares, and we believe this will gradually change with the elimination of Mr. Stronach's control, resulting in an expansion of the stock's multiple. Deal or no deal, the company is well-positioned to benefit from a return to a normalized rate of auto production in North America.

TSX DIVIDEND YIELD AS A PERCENT OF LONG BOND YIELDS [Figure 2]
Based on Canada 10-Year and Over Bond Yields



Source: TD Securities, Tetrem Capital Management, as of July 7, 2010





TETREM QUARTERLY REVIEW

As markets have turned negative, we've witnessed a flight away from equities into bonds, gold and other perceived safe havens. In our view, Canadian equities are looking enticing relative to GOC bonds on the basis of yield, as shown in Figure 2. At some point, conservative investors who are sitting on the sidelines may decide to shift some of their assets into blue-chip stocks, such as portfolio holding Royal Bank (RY) that yields 3.9%, rather than face the prospect of investing in a 2-year GOC that pays 1.4%, or a 10-year GOC that pays 3.1%. It has jokingly been said that "gentlemen prefer bonds", but in an atmosphere of low yields, gentlemen living on a fixed income are vulnerable to a return of inflation. It's highly likely that Royal's dividend will increase during the next decade; it's a certainty that the contractual interest payment on a 10-year bond will not be going up.

Alec MacIsaac, CFA

Senior Research 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 (Denominated in CDN\$)

	Annualized Returns to June 30, 2010						Calendar Year Returns				
	Q2 2010	YTD	1 year	3 year	5 year	10 year	2009	2008	2007	2006	2005
TETREM CDN EQUITY COMPOSITE											
Gross of Fees	-5.3%	-2.3%	10.2%	-3.8%	3.9%	11.7%	31.7%	-28.3%	3.2%	9.3%	31.1%
Net of Fees	-5.4%	-2.7%	9.5%	-4.4%	3.2%	11.0%	30.9%	-28.8%	2.5%	8.6%	30.3%
TETREM CDN EQUITY PLUS COMPOSITE											
Gross of Fees	-8.3%	-4.3%	10.1%	-4.7%	3.2%	11.2%	33.5%	-31.4%	6.1%	9.8%	29.9%
Net of Fees	-8.4%	-4.6%	9.4%	-5.4%	2.6%	10.4%	32.6%	-31.8%	5.4%	9.1%	29.1%
S&P / TSX Total Return Index	-5.5%	-2.5%	12.0%	-3.9%	5.5%	3.3%	35.1%	-33.0%	9.8%	17.3%	24.1%

TETREM'S U.S. EQUITY MANDATES (Denominated in US\$)

	Annualized Returns to June 30, 2010						Calendar Year Returns				
	Q2 2010	YTD	1 year	3 year	5 year	10 year	2009	2008	2007	2006	2005
TETREM U.S. EQUITY COMPOSITE											
Gross of Fees	-15.9%	-9.0%	12.4%	-7.4%	2.1%	8.5%	41.8%	-39.2%	8.3%	19.0%	15.2%
Net of Fees	-16.1%	-9.2%	11.7%	-8.0%	1.4%	7.8%	40.9%	-39.6%	7.6%	18.3%	14.5%
TETREM U.S. EQUITY PLUS COMPOSITE											
Gross of Fees	-14.8%	-8.2%	14.4%	-6.2%	4.3%	9.6%	43.8%	-39.1%	11.5%	19.2%	22.6%
Net of Fees	-15.0%	-8.5%	13.6%	-6.8%	3.6%	8.9%	42.9%	-39.5%	10.8%	18.4%	21.9%
S&P 500 Total Return Index	-11.4%	-6.7%	14.4%	-9.8%	-0.8%	-1.6%	26.5%	-37.0%	5.5%	15.8%	4.9%

TETREM Performance Disclosure

Tetrem Capital Management Ltd., an independent investment management firm, claims compliance with the global investment performance standards (GIPS®). To receive a complete list of composite descriptions please contact us at the above phone number. To receive a presentation that adheres to the GIPS standards, please contact us at the above phone number or see the "performance" section of our website at www.tetrem.com.

Composite Descriptions:**Tetrem CDN Equity Composite-**

Contains fully discretionary Canadian equity accounts following a value investment strategy.

Tetrem CDN Equity Plus Composite

Contains fully discretionary Canadian equity accounts with up to 30% invested in non-Canadian securities (primarily U.S.) following a value investment strategy.

Tetrem U.S. Equity Composite

Contains fully discretionary U.S. equity accounts following a value investment strategy.

Tetrem U.S. Equity Plus Composite

Contains fully discretionary U.S. equity accounts with up to 20% invested in non-U.S. securities (primarily Canadian) following a value investment strategy.

Returns represent past performance. Past performance does not guarantee future results. Different types of investments involve varying degrees of risk. The S&P/TSX Composite Total Return Index comprises approximately 71% of the market capitalization for Canadian-based, Toronto Stock Exchange listed companies and provides broad economic sector coverage of the Canadian markets. The S&P 500 Total Return Index consists of 500 stocks chosen for market size, liquidity, and industry group representation.

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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