

## Canadian Government Fixed Income

Q3 2010

**Investor profile:** Suited to the investor whose objectives are income and capital appreciation over the medium term.

**Objective:** The portfolio's objective is to provide interest income with the potential for capital appreciation by investing primarily in Canadian fixed income government securities.

**Investment Strategy:** Laketon's active investment style is designed to continually capture incremental gains relative to the fund's benchmark. The manager adds value through yield curve and duration management, sector allocation and individual security selection.

### Investment performance

|                                  | Annualized rates of return (%) |     |        |         |         |         |
|----------------------------------|--------------------------------|-----|--------|---------|---------|---------|
|                                  | Quarter                        | YTD | 1 Year | 2 Years | 3 Years | 5 Years |
| Canadian Government Fixed Income | 3.0                            | 7.4 | 6.7    | 8.0     | 7.2     | 5.6     |
| <i>Benchmark</i>                 | 3.1                            | 7.4 | 7.2    | 8.4     | 7.5     | 5.6     |
| <i>Value Added</i>               | -0.2                           | 0.0 | -0.5   | -0.4    | -0.2    | 0.0     |

Returns shown (which are gross of fees) reflect the performance of the model portfolio. Actual returns experienced by an investor may differ from those shown.

### Portfolio management team

|                   | Years of experience | Years with Laketon |
|-------------------|---------------------|--------------------|
| Gary Morris, CFA  | 23                  | 18                 |
| Thomas Gomes, CFA | 14                  | 10                 |
| Siek Djoe, CFA    | 16                  | 5                  |
| Jenny Wan         | 7                   | 6                  |

### Portfolio information

|                   |  |
|-------------------|--|
| Benchmark:        | DEX Government Bond Index              |
| Total Holdings:   | 16                                     |
| Duration (years): | 6.45 (portfolio)<br>6.54 (benchmark)   |
| Yield:            | 2.58% (portfolio)<br>2.55% (benchmark) |

### Top 10 holdings

|                                     | Portfolio (%) |
|-------------------------------------|---------------|
| Canada Housing Trust 4.0% 15-Jun-12 | 26.4          |
| Canada 3.5% 01-Jun-20               | 17.9          |
| Ontario 5.9% 08-Mar-33              | 7.9           |
| Quebec 6.3% 01-Jun-32               | 6.5           |
| Canada Housing Trust 4.1% 15-Dec-18 | 5.8           |
| Canada Housing Trust 3.6% 15-Sep-13 | 5.7           |
| New Brunswick 4.5% 04-Feb-15        | 5.7           |
| British Columbia 8.0% 08-Sep-23     | 3.7           |
| Saskatchewan 6.4% 05-Sep-31         | 3.2           |
| Ontario 8.1% 08-Sep-23              | 2.5           |
| Total                               | 85.3          |

### Sector & quality diversification

|            | Portfolio (%) | Benchmark (%) |
|------------|---------------|---------------|
| Federal    | 69.1          | 62.9          |
| Provincial | 30.9          | 35.1          |
| Corporate  | 0.0           | 0.0           |
| Municipal  | 0.0           | 1.9           |
| Total      | 100.0         | 100.0         |
| AAA        | 72.8          | 68.5          |
| AA         | 19.2          | 19.2          |
| A          | 8.0           | 12.3          |
| BBB        | 0.0           | 0.1           |
| Total      | 100.0         | 100.0         |

## Fund performance attribution

### Positive performance factors in the third quarter

- Domestic and international investors had a need for duration and yield but were only willing to take on additional credit risk through higher quality asset classes (i.e. Provincials). This resulted in long provincials and municipals becoming the best performing asset class within the Universe. This was positive for the portfolio as it was approximately two thirds of a year overweight long provincial and municipal credit relative to the index on a duration weighted basis.

### Negative performance factors in the third quarter

- The portfolio was positioned with a concentration in 10 year bonds but overall duration relative to the index remained neutral. As a result, the portfolio was overweight short-term bonds (cash to 5 year) and underweight longer term bonds (20 and 30 year). During the quarter, longer dated maturities rallied and the yield curve (2 to 30 years) flattened by 28 basis points, resulting in underperformance.

## Outlook & strategy

- There seems to be little doubt amongst market participants that the Bank of Canada will refrain from raising rates further this year, after having raised the overnight rate to 1% on September 8th. The weaker economic data in both Canada and the U.S. has created a backdrop for the Bank to put monetary policy on hold. We also note the certainty with which the Fed has indicated that overnight rates in the U.S. will not rise any time soon.
- QE2 has become the TLA (three letter acronym) of choice, as members of the Fed have communicated their receptivity to further monetary stimulus through quantitative easing. We are sceptical of QE's ability to deliver more stimulus via both consumer or commercial channels and believe that the Fed will likely resort to QE only in the event that they feel capital markets need more propping up or there appears to be impasse on the fiscal front.
- As we are still in mid-term election season in the U.S., we don't expect much progress on any sort of fiscal stimulus; but we do expect the Obama administration to take up the gauntlet afterward.
- Although we are not immediately concerned about the North American sovereign debt situation, we have noted that the situation in the U.S. is something to be watched. However, we believe that the trouble with European sovereign debt will likely provide a longer window for the U.S. to address its issues.