

Milos: Hello and welcome to another in a series of audio commentaries featuring Laketon Portfolio Managers. My name is Milos Kostich Vice President, Sales/Strategic Alliances it is my pleasure today to have Ben Fawcett, Vice President and portfolio manager with the Laketon Canadian equity fund and Daphne Dodig, Vice President & Portfolio Manager also with the Laketon Canadian Equity fund. So we'll get right in the questioning I guess, Daphne, considering the current turmoil and crisis in the US financial system, an important question is how this has affected the Canadian financial institutions so far, and do you see further shocks to our banks in the near to medium-term. I guess the follow-up there is are you considering any portfolio changes as they pertain to the banks at the present time?

Daphne: So far the effect has been largely 3-fold:

First, losses were recognized by the banks that were active in structured products, namely Bank of Montreal, CIBC and to a smaller extent, Royal and National.

Second, we've experienced higher provisions for credit losses in the banks that have US personal and commercial banking exposure, namely Royal and TD.

And third we have HIGHER FUNDING COSTS and this effect is global where no bank has gone unscathed. Because of the lack of confidence in the financial market, banks are not lending to one another because they're afraid of what's on the other guy's balance sheet and in some cases, may not even know the extent of his own risk exposure and as a result the banks have been hoarding capital. As a consequence of this behavior, we've seen financing rates go through the roof, credit spreads widen and hence a log jam in the debt market for just about anything that's not government debt. This is affecting all banks and the greater cost will be the impact it will have on the economy as a whole.

We continue to expect further shocks to the banking system in the near term. The banks are undergoing a massive amount of deleveraging, which essentially means that as asset prices contract, the cost of carrying these assets increases, and you're forced to liquidate just to stay in the black. The historic events that we're currently witnessing are evolving at a very rapid pace. Just in the last week alone, we've seen Wall Street investment banks disappear so to speak, with Lehman Brothers filing for Chapter 11, Merrill Lynch selling itself to Bank of America, and Goldman Sachs and Morgan Stanley converting to banks. AIG taken over by the US government, money market funds that have broken the buck and the US government coming to the rescue of all money market funds by guaranteeing them. A \$700 billion bailout proposal by the Treasury and The Fed to purchase all the toxic assets that are sitting on bank balance sheets. At this point, it's a foregone conclusion that there will be more banks in the US that go bankrupt within the next 12 to 24 months.

To summarize, what started as weakness in the US housing market has turned into system-wide deleveraging and depending on the pace of this deleveraging, it will determine the degree of further shocks the banks and the system will experience.

As far as portfolio changes, before answering this question it's important to highlight our starting position. Late last year and early this year, we were close to 5% underweight the benchmark. As earnings were

revised lower and multiples compressed and given the pivotal actions that were taken by the US government, namely Bear Stearns and Fannie Mae and Freddie Mac being nationalized, we slowly covered off our underweight position. Today we are tactically neutral with the benchmark and for us it reflects a relative sector call as opposed to a fundamental call. Having said that, we are secular bears on the banks and in the months ahead we will look for opportunities to sell.

Milos: Ben, at the same time as we're seeing the financial sector crisis, we are also seeing a pull back in the resource sector; I guess energy and materials here. Do you feel the commodity bull market over or do you think this is a severe mid cycle correction?

Ben: To answer that question, I think we've first have to look at the supply/demand models, and look at where this boom began. What was unique about the situation was the Asian demands story adding a more traditional component of under-investment and new capacity. So if you look at those two components, first of all, the demand growth in Asia and how sustainable is that. When we look at the US, it's probably in prolonged downturn. Europe is following the US, through not probably to the same extent or depth. Asia and China are the big question marks here, though we have seen early signs of a downturn. This isn't surprising considering that you're probably going to get some contagion from the export markets, and second, earlier in the year, the Chinese authorities actually took measures to reduce growth rates and thereby reducing inflation. On the bright side, the Chinese government has now started taking active measures to re-inflate the economy, they likely won't tolerate much below 6 – 8% annual growth rate, and have recently started reducing interest rates, which I think is a key factor to watch. So to sum it all up, in the medium term we're positive on the Asian growth story and think it is going to trump the weakness in the west. However, in the short term we think there is a potential for further weakness.

So moving onto the supply side of the supply demand model, is there going to be enough capital investment to build the capacity the world is going to require for the next 5 years? In this short term, new capacity has come on line and certain base metals such as, zinc, nickel and aluminum have ended up in balanced markets. However, weak credit markets are resulting in cancelled and delayed projects. As a result, once we hit 2011 and onwards, there will be questions if there will be enough on the supply side as well. So the conclusion, the key driver of this boom Asian demand might slow, but we don't expect it to go away. New capacity must be built, and in a difficult credit market we're going to need sufficiently high commodity prices to provide that incentive. So as far as our views, we currently prefer oil and metallurgical coal, on precious metals we're neutral, and on base metals we're still cautious.

Milos: Ben, as you witness the market volatility here and in the US, we are starting to see expectations of slowing earnings growth and profitability for a variety of companies. Do you think that the growth approach to investing will prove to be rewarding in these types of markets?

Ben: The short answer to your question is a resounding yes. We feel the growth approach to investing will not only prove to be rewarding in this market, but it is rewarding in all types of markets as our philosophy is not market dependant. As far as our definition of growth companies, we look for companies that can grow revenue, grow margins and grow earnings. The crux of this is to invest in quality companies, with sustainable competitive advantages that are led by strong management teams. I think it is worth breaking down that comment in a bit more detail.

Looking at competitive advantage first of all, this is critical in a slowdown as it allows companies to charge above average prices thus maintaining its margins. A good example here is Canadian National Railway. Basically they have a monopoly in some regions, if the tracks go past, you have to use them, as a result their pricing is held up very well in this downturn.

The final component would be a strong management team. A strong management team is what makes all the other components work together. An example of a company with a great management team is Canadian Natural Resources. This management team has done an excellent job reinvesting in profits that will maximize their profitability. For example, now that they've started Horizon One they are moving to focus more on thermal oil sands vs. mining oil sands. So when you put all this together, what it means is we're not dependant on the performance of any specific sector or any big macro call. What it comes down to is picking stocks that are strong, that generally have a large capitalization, are liquid, profitable, and most important in this market are resilient. As a result, our companies continue to execute on their business models both in good times and bad.

Milos: Thank you Ben and thank you Daphne for your comments today. I would like to remind listeners to tune in next month to listen to our November audio commentary by logging on to our website at www.laketon.com And once again thank you to all of our listeners for tuning in.