SECOND QUARTER LETTER 2010

PORTFOLIO RETURNS: CONTINUING TO OUTPERFORM

For the second quarter of 2010, the weighted average net return of our all-equity portfolios was -2.1% compared to -5.5% for the TSX Total Return and -7.1% for the S&P500 Total Return (in $CDN). Our outperformance occurred in June when the TSX declined by 3.7%, while our equity portfolios dropped by an average of only 0.9%. As was also the case during this January's and October 2009's market pullback, our portfolio's resilience shows a low correlation to stock markets due to our over-weightings in high yielding sectors such as telecommunications, power, pipelines, select income trusts, exposure to gold and special situations. Our top 10 gainers for the quarter include: iShares Global Gold ETF (+21.4%), Wi-Lan (+13.7%), MTY Foods (+12.8%), Claymore Gold Bullion ETF (+11.5%), Direct Cash (+10.2%), Northwest Healthcare (+8.2%), Logistec (+7.7%), Telus (+11%), BCE (+4.1%) and Cenovus (+3.3%). Year-to-date, our equity portfolios are up by 2.3%, while the TSX, the S&P500 (in $CDN), and the MSCI World Index (in $CDN) declined by 2.5%, 6.6%, and 8.4% respectively.

LESTER HEDGE FUND

As at June 30, the Lester Hedge Fund is up 3.6% year-to-date, and has produced positive performances in 18 out of the last 19 months. This fund is managed using alternative investment techniques including short term trading, shorting, and event driven strategies such as risk arbitrage. Our objective is to take on low market risk, while generating absolute positive returns independent of market movements. Its portfolio has very little overlap with positions held by our clients in their segregated portfolios, and is a good complement to our core long portfolio management competencies.

OUR MACRO-ECONOMIC VIEW

Our macro-economic view remains one of caution and is largely unchanged from previous letters.

Sovereign Debt: Safe as Houses?

In 2007 and 2008, we witnessed a collapse in the US housing market which triggered a mortgage-backed securities crisis that was amplified to global proportions by unregulated synthetic products, eventually bringing the world financial system to its knees. In 2009, bail-outs of financial institutions and stimulus programs have resulted in a massive increase of public debt on government balance sheets. Today, Europe is on the ropes, with austerity programs being implemented in a desperate race to reduce skyrocketing debt levels amongst its country members amid aging demographics which will only make matters worse. Also, upcoming European bank stress tests may require additional financial support from the state. No longer are all government bonds seen as safe.

Commodities: A Golden Age

As we warned in our last letter, commodities were vulnerable to a correction caused by fundamental supply/demand imbalances (stockpiling by China versus true growth in consumption) and the withdrawal of government stimuli. Monetary tightening in China aimed at slowing down reckless bank lending and planned government austerity measures in Europe required to tackle mounting sovereign debt problems have caused a major correction in commodities stocks in May and June. Gold, however, held up well again as jittery investors and central banks nervously diversify out the Euro and the US dollar. As we expected, gold is pursuing its bullish trend in the face of the continuing debasement of currencies. We still believe that ultimately, non-precious commodity equities are an integral component of any portfolio. However, for the reasons mentioned above, we are currently maintaining an underweight position.

The US Dollar: A Flight to Safety by Default

The US economic recovery remains precarious with high unemployment levels and no real job growth. Until this improves, the US consumer will remain hunkered down in a debt deleveraging and savings mode. The glut of homes for sale and continuing decline in prices continues to plague the real estate market. Banks continue to contract credit and hoard cash while new regulations governing capital requirements are being finalized. Canada, on the other hand, has re-created as many jobs as it had lost since the beginning of the recession, and its finances and banking system remains strong. Canada continues to be seen as an economic safe haven, and the Canadian dollar remains one of the strongest currencies with several central banks around the world planning to increase their holdings. Currently, the US dollar is artificially propped-up due to a flight from the Euro to the safety of the greenback by default. This suggests the Loonie will continue its ascent, eventually breaking parity with the US dollar.

IN SUMMARY: PLAYING IT SAFE

We continue to live in a deflationary world with excess production capacity and serious government debt problems. Reducing sovereign indebtedness is now at the forefront of many political agendas as several governments' backs are against the wall. The implementation of austerity measures and fiscal restrain almost guarantees that some countries will go into a “double-dip” recession. As the saying goes: “you can't blow and suck at the same time”. The 10-year and 30-year US bond yields have dropped back to below 3% and 4% respectively, a sign that hope for a strong recovery is fading. This depressive environment ensures that interest rates will remain low for a long time, and the ongoing search for yield by investors will continue to underpin high yielding stocks and bonds of corporations with healthy balance sheets. Selecting the right companies to invest in has become more important than ever. Consequently, we continue to be defensively position with very low resource and financial exposure, and higher amounts of corporate bonds and cash.

July 15, 2010