FORTRESS Canadian Equity Fund (Growth) Investment Review

Fund Highlights

Second Quarter 2009

Market review: (all figures Total Return)

- Equity markets rallied significantly during the second quarter. The S&P/TSX Composite Index finished the period with a total return of +20.0%.
- Information Technology (+43.3%) was the best-performing sector, followed by Financials (+34.5%) and Energy (+21.6%).
- Telecommunication Services was the only sector with a negative return (-1.0%). Materials (+4.3%) and Health Care (+8.0%) were other notable underperforming sectors.

Portfolio review: (all figures, Price Change)

Performance Contributors

By Sector:

- At the sector level the key positive drivers of performance this quarter were our underweight positions in the Consumer Discretionary, Utilities and Health Care sectors, as these sectors all underperformed.

By Stock

- Individual holdings that contributed to relative performance this quarter include: Teck Resources Ltd. (+163.1%), Research in Motion Ltd. (+51.7%), Manulife Financial Corp. (+42.2%), Toronto-Dominion Bank (+38.3%), Petro-Canada (+31.5% to sale), Bombardier Inc. (+25.2% to sale) and Canadian Natural Resources Ltd (+25.1%).

Performance Detractorsr

By Sector:

- Our underweight position in the outperforming Financials sector was a negative factor this quarter. Our overweight positions in the Telecommunication Services and Consumer Staples sectors, which underperformed, also detracted from performance.

By Stock

- Individual holdings that hurt performance included: BCE Inc. (-4.5%), Goldcorp Inc. (-4.7%), Imperial Oil Ltd. (-8.4% to sale) and Kinross Gold Corp. (-7.5%).

Other

- Our cash position, an average weight of 3.0%, was a negative in a strong market.

Outlook and strategy:

- Markets have stabilized and have continued to recover from one of the most debilitating downturns on record. With central banks and governments doing "everything in their power", the liquidity tap is once again pumping oxygen into the room. Issuance activity in the debt markets has come back with a vengeance as $18 billion of corporate debt was issued in Q2 which compares to a trailing twelve month quarterly average of $11.7 billion. Furthermore, with a 16% quarter over quarter increase in the number of IPOs and a stronger secondary issue market, the equity market provided an added boost to liquidity. Risk appetite is growing with VIX falling back below the pre-Lehman bankruptcy levels of less than 30, credit spreads and credit default spreads continue to contract and the significant contraction in the LIBOR/OIS signals banks are lending to one another.
- With the equity market keying off "less bad" news, the consensus view for the U.S. economy is that they'll exit the recession by the end of this year or early next (aside: index of leading economic indicators show the recession ending within the next few months). Real GDP growth in the next few years is expected to be between 2% and 3% and the unemployment rate is expected to peak some time in 2010 at between 10% and 11%. Just as consumers cut back on spending, corporations continue to focus on building "fortress-like" balance sheets taking full advantage of market liquidity. To date, banks remain cautious with the excess capital they've accumulated but in listening to the messages the CEOs delivered with their most recent quarterly results, they are excited at the opportunities available to put some of the capital to use, with the most often cited beneficiaries being corporate lending, capital market activity and acquisition opportunities. From an equity market vantage point, all this is healthy and positive. However, the S&P/TSX just delivered a 20% total return in the second quarter and the direction of markets is never just straight up (especially when you're in a recession). We don't expect the market to deliver returns at this double digit pace over the coming quarter. From a valuation perspective, the S&P/TSX is currently trading at a multiple of 14.9 times 12 month forward earnings which compares to its long run average multiple of 15.3 times. S&P/TSX consensus earnings expectations are a decline of 28% in 2009 and a recovery of 27% in 2010. Given the forward looking nature of equity markets, stocks are initially rewarded with an expanded multiple when forward earnings estimates are close to bottoming (witnessed in Q2) and with time, earnings growth will need to materialize as the main catalyst for higher stock prices otherwise the risk becomes skewed to the downside.

Any amount that is allocated to a segregated fund is invested at the risk of the contractholder and may increase or decrease in value.

This report is published to provide additional information on economic conditions and investment performance. It was prepared by the fund manager, Laketon Investment Management.

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