FORTRESS Canadian Equity Fund (Growth) Investment Review

Fund Highlights Third Quarter 2009

Market review (all figures, total return)

- Equity markets continued to rally through the third quarter. The S&P/TSX Composite Index achieved a total return of +10.6% for the period.
- Health Care (+22.2%) was the best-performing sector, followed by Financials (+16.1%) and Materials (+12.4%).
- Information Technology (-8.1%) and Consumer Staples (-2.7%) were the only sectors with negative returns. Utilities (+3.6%) was another underperforming sector on a relative basis.

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 Utilities, Consumer Discretionary and Energy sectors, as these all underperformed.

By Stock:

- Individual holdings that contributed to relative performance this quarter include: Teck Resources Ltd. (+59%), Petrobank Energy & Resources Ltd. (+31%), Brookfield Asset Management Inc. (+23%), Royal Bank of Canada (+21%), Baytex Energy Trust (+21%) and Canadian Natural Resources Ltd. (+18%).
- Another positive factor was not holding certain underperforming index names, including Imperial Oil Ltd. (-10%), Magna International Inc. (-8%) and Husky Energy Inc. (-7%).

Performance Detractors

By Sector:

- At the sector level, our overweight position in the Information Technology sector, which underperformed, was a negative factor this quarter. Having no exposure to the top-performing Health Care sector also detracted from performance.

By Stock:

- Individual holdings that hurt performance include: Research in Motion Ltd. (-13%), Shoppers Drug Mart Corp. (-12%), Potash Corp. of Saskatchewan Inc. (-11%), Loblaw Companies Ltd. (-5% to sale) and Nexen Inc. (-4%).
- Not holding certain outperforming index names through the period, including Ivanhoe Mines Ltd. (+113%), Bombardier Inc. (+44%) and Fairfax Financial Holdings Ltd. (+36%), also had a negative influence on performance.

Other

- Our cash position, an average weight of 4.2%, was a negative in a strong market.

Outlook and strategy

Picking up from last quarter, what better evidence to show the markets are continuing along their path to stabilization than the recently announced activities by two of Canada's corporate giants, Encana and Barrick Gold Corporation. On September 10th, 2009, Encana announced that it will proceed with its previously announced plan to split the company up into two independent energy companies. Recall that on May 11th, 2008, the initial reorganization announcement was made and then on October 15th, 2008, officially delayed due to the turmoil in credit and equity markets. As part of its justification for proceeding with the original plans, management cited the fact that "equity and debt markets improved significantly, with debt financing available at a reasonable cost", and "global and national economic indicators suggest that the world's economies are showing positive signs of recovery". On September 8th, 2009, Barrick announced its plan to eliminate its hedge book resulting in a $5.6 billion charge to the upcoming third quarter earnings. Commensurate with this announcement Barrick launched a $3 billion public equity offering which was subsequently upsized to $3.5 billion ($4.0 billion with the over allotment) due to robust demand.

Given the "hit" to the balance sheet, it's interesting to note that the stock has barely budged since the announcement and it's down only 1% as at September 30th, 2009 (it appears as though equity holders have a lot of patience)! We don't know what path this recovery will take (V, U, W, or L) but we are constructive about the equity market for the following reasons: rates are low and central banks remain supportive, inflation remains contained, credit spreads continue to tighten, corporate balance sheets are healthy, manufacturing activity is bottoming, housing demand is strengthening, and finally, employment numbers have slowed their pace of deterioration. Furthermore, the wind is at our back from an inventory restocking, continued government spending, and easy year-over-year comparables perspective.

Going forward, we expect the companies who deliver better than average earnings growth due to revenue growth momentum and previous investments in productivity and cost cutting initiatives to outperform (this is in contrast with the "low quality" trade that's been prevalent since the market bottomed in March). Growth companies that reflect these characteristics are Canadian Natural Resources Ltd., Baytex Energy Trust, Thomson Reuters Corporation and Canadian National Railway.

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