FORTRESS Canadian Equity Fund (Growth) Investment Review

Fund Highlights

Fourth Quarter 2009

Market review (all figures, total return)

- Equity markets continued to rally through fourth quarter 2009, although to a lesser degree than during the previous two quarters. The S&P/TSX Composite Index achieved a total return of +3.9% for the period.
- Utilities (+13.3%) was the best-performing sector, followed by Industrials (+8.7%) and Consumer Staples (+8.2%).
- Health Care (-2.4%) and Financials (-0.7%) were the only sectors with negative returns. Information Technology (+0.8%) also underperformed.

Portfolio review (all figures, price change)

Performance contributors

By Sector:

- At the sector level, positive drivers of performance this quarter included our overweight positions in the Energy and Industrials sectors. These sectors outperformed the market as a whole.
- Having no exposure to the Health Care sector, which underperformed, also contributed to performance.

By Stock:

- Individual holdings that contributed to relative performance this quarter included: Baytex Energy Trust (+26%), Teck Resources Ltd. (+25%), Petrobank Energy & Resources Ltd. (+16%), SNC-Lavalin Group Inc. (+12%), IAMGOLD Corp. (+9%), Canadian National Railway Co. (+9%) and NAL Oil & Gas Trust (+8%).
- Another positive factor was being not being exposed to certain underperforming index names, which included Kinross Gold Corp. (-17%) and Goldcorp Inc. (+9% to sale and
-11% overall) which we sold in the fourth quarter.

Performance detractors

By Sector:

- At the sector level, having no exposure to the top-performing Utilities sector detracted from performance.
- Our overweight position in the Information Technology sector, which again underperformed, was another negative factor this quarter.

By Stock:

- Individual holdings that hurt performance included: Agnico-Eagle Mines Ltd. (-12% to sale), Thomson Reuters Corp. (-5%), ARC Energy Trust Units (-4% from purchase), Royal Bank of Canada (-2%), Research in Motion Ltd. (-2%), Suncor Energy Inc. (-1%) and Barrick Gold Corp. (+2%).
- Not holding certain outperforming index names through the period, including Agrium Inc. (+22%) and Enbridge Inc. (+17%), also had a negative influence on performance.

Outlook and strategy

- We remain bullish on equity markets for the simple fact that monetary policy remains stimulative. With core inflation at 1.5% (1.7% in the U.S.) and the unemployment rate at 8.5% (10% in the U.S.), we expect the Bank of Canada and the Fed to remain on hold for at least another three to four quarters. Of course, there will be significant debate around the timing of when and how the central banks will begin to remove stimulus and raise rates, fearing loose monetary policy will overstay its welcome and sow the seeds of the next bubble. Furthermore, with governments spending their way out of this recession, budget deficits are ballooning and concerns are mounting as to how they will ultimately pay for this spending binge. These are topics of future strategy pieces. The point is that we are still in the early stages of a recovery from an extraordinary recession and that the structural issues that caused the crisis (overleveraged consumer, global trade imbalances) will take years to correct. In our opinion, it is the cyclical opportunities over the structural issues that will dominate markets for at least the first half of 2010.
- With the S&P/TSX Composite Index trading at a 2010 price to earnings ration of 15, there appears to be limited value in the market, especially from a multiple expansion perspective. However, with 25% earnings per share growth currently priced in the market, after a dramatic 37% drop in trailing operating earnings,, –growth expectations are relatively reasonable considering the starting point and are below historic recovery levels recorded following previous recessions. From a sector perspective, we retain a positive bias toward materials favoring copper and coal due to robust emerging market demand and supply constraints on the copper side. Our favored play to gain exposure to both of these commodities is Teck Resources Ltd. We are also constructive on the Industrials. Increased government infrastructure spending is finally coming to fruition and commodity producers are beginning to invest in projects that were contemplated prior to the economic crisis. SNC-Lavalin Group Inc. provides exposure to both of these

opportunities. Lastly, we've recently become more cautious on the banks both due to the proposed capital rules released by the Basel Committee, which in its current proposed form appear to be restrictive, and to the backlash in sentiment toward the banks that has been building in Washington. Canadian banks are on solid footing but from a tactical portfolio orientation, it will be difficult for our banks to gain significant ground against the wall of worry that is building in the U.S. and European jurisdictions.

Any amount that is allocated to a segregated fund is invested at the risk of the contract holder 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 Laketon Investment Management.

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