FORTRESS Money Market Fund

Fund Highlights

Investment Review

Fourth Quarter 2009

Market review

- In contrast to the rest of the year, the fourth quarter was not all that rewarding for the money market. There was some profit taking in the corporate and provincial markets and some genuine concern by investors over the prospects for inflation and real yields. For perspective, the Canadian 2009 quarterly DEX 91-Day Index returns were 0.33%, 0.13%, 0.085% and 0.08% respectively.
- Ten-year government yields rose globally, with the U.S. leading the charge (53 basis points), but followed by the U.K. (42 basis points) and Canada (30 basis points). Noticeably, Japanese yields did not rise.
- At the shorter end of the yield curve, stability is still the name of the game, with the exception in the developed world of the commodity plays -- Australia, Norway and to a lesser extent Canada.
- Overnight rates have remained anchored, with notable exceptions in Australia (raised in October and November) and in Norway (raised in October and December). Although there was considerable speculation in the fourth quarter that the Bank of Canada (BoC) would at least adopt a more aggressive bias, that remains to be seen and for now, the official holding pattern of the BoC is implacable.
- Over the last year, investors have been preoccupied with the following:
  - Deteriorating government finances. (this too will likely take time.)
  - A virtuous economic recovery. (this will take more time.)
  - Higher rates of inflation. (this will take even more time.)

  However, in our view, none of the above has materialized in a substantial way.
- The recently maimed U.S. consumption juggernaut is still the 1,000 kilo monster in the room. With unemployment falling just below 10% (9.992%) and weekly hours worked creeping up to 33.2,(which on a production equivalent basis represents 800,000 jobs), it might appear to some that the beginning of a rosy new era is upon us.
- We believe the economy has yet to prove itself – government intervention is too entwined, and there is this nagging feeling of still being on life support.
- Until the labour numbers begin to normalize (5.6% unemployment and 34 hours worked) the consumer which at one point extended their finances to represent over 70% of U.S. GDP, will likely sit on the sidelines repairing their balance sheet. It would not be a shock to see the consumer return to their normal 62% contribution to GDP.
- Consumer finances have improved marginally in the U.S., largely due to market appreciation. In Canada however, consumer balance sheets have deteriorated as mortgagors have responded to low rates by taking on more credit.
- We see government finances as the economy's and the bond market's Achilles heel. We are not yet at a point of no return, or in market terms, significantly rising real yields, but we may very well get there in the next year. U.S. debt to GDP has risen from 37% two years ago to 54% today and is projected to be 61% for this year, according to most recent Congressional Budget Office figures. The Canadian situation is clearly not as bad.
- We are customarily nonchalant over the prospects of higher inflation. Yes, M1 (money supply) is at record levels in the U.S. (45.6% year-over-year), but bank reserves have absorbed most of the excess liquidity. Lending to the consumer has improved, but only sparingly and lending to small business is a non-event.

Portfolio review

Performance contributors

- The exposure of the fund to bankers' acceptance (BA) and provincial bills was increased in order to capture the significant gains made by Treasury Bills (T-Bills) during the beginning of the quarter. The spread between longer dated BAs and T-bills tightened from 23 to 16 basis points during the fourth quarter which contributed positively to performance. The increase in higher yielding securities also increased the funds running yield by 6 basis points
- During the quarter the average term-to-maturity of the fund was targeted at 91-days with over-weights in the 1-2 months and 5-6 months securities. Having over-weights in shorter and longer dated securities contributed positively as these terms outperformed 3-month T-bill by 5 basis points.

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.

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