# Tradex QUARTERLY

**Third quarter 2010**

## President's Report to Tradex Investors

After having declined during the previous quarter, the Canadian equity market recovered during the third quarter with the S&P/TSX Composite Index increasing 9.5%. As a result, the Canadian market finished the first nine months of 2010 up 5.3%. Meanwhile, the U.S. S&P 500 Index was up 10.7% during the quarter and is now up 2.3% year-to-date.

The Canadian dollar also rebounded versus its U.S. counterpart, ending the quarter at 97.18 cents U.S. versus 93.93 cents at the start of the quarter and 95.15 cents at the beginning of 2010.

The Bank of Canada raised the target for its overnight policy interest rate at each of its two policy meetings during the period, bringing the rate to 1.00 per cent. However, yields on longer term Government of Canada bonds actually declined by about 30 basis points during the quarter based on concerns that the recovery of the global economy is beginning to stall and prospects for continued very low inflation.

### New Investor Representative for Tradex Bond Fund

We welcome Gilles Proulx as the new Investor Representative for the Tradex Bond Fund Committee. Gilles recently retired from his position as the Executive Director, Risk Management and Investments, Canada Mortgage and Housing Corporation (CMHC). Prior to joining CMHC in 1991, he held positions in research with the Economic Council of Canada, Health and Welfare Canada, and Alcan Aluminum Ltd., where he was Chief Economist. Gilles holds a Masters degree in Economics from the University of Montreal.

### Comparing Canada Savings Bonds and the Tradex Investment Savings Account

On October 4 the Department of Finance announced that the new Series of Canada Savings Bonds will yield 0.65% for the first year. As a result, there is now no CSB issue that pays more than 0.65% (and a number of issues yield less). In contrast, the Tradex Investment Savings Account, which is eligible for CDIC Insurance up to $100,000 per account, is currently yielding 1.50% per annum (the rate is subject to change without notice). The deposits are held in trust at Manulife Bank of Canada, a wholly owned subsidiary of Manulife Financial. Electronic transfers between your established bank account and this account are available, subject to a maximum 2-business day notice. Furthermore, you earn full interest on every dollar you hold in a Tradex Investment Savings Account for each day the money is in the account. With its 1.50% yield and CDIC protection, it's a great place for investors to "park" funds awaiting further opportunities.

### A wider range of services available through Tradex

In a continuing effort to ensure Tradex assists public sector employees in achieving their financial goals we have expanded our services as follows:

- We distribute GICs for a number of banks and trust companies. Typically, we can obtain a considerably better rate for you than offered by the major banks.
- We now offer a wide range of life insurance products in Ontario, acting as an agent for a number of leading Canadian insurance companies.

In addition, Tradex Members can now establish a Qtrade discount broker account through the Tradex website.

### Don't miss out on our 50th anniversary $50 new Member incentive

Time is running out to take advantage of our special 50th anniversary $50 client referral incentive. To date, Tradex has gained over 75 new Members through this incentive program. Please encourage family members, fellow employees and friends to join Tradex so they too can profit from being a Member of this unique organization.

### CIBC Mellon to become registrar for Tradex Funds

During the fourth quarter, CIBC Mellon will become the registrar for the Tradex Funds, so the confirmations and statements that you will begin seeing will be slightly different than in the past. CIBC Mellon has been the custodian for the Tradex Funds for a number of years and consolidating this additional function will both streamline our administrative processes and reduce costs.

Blair Cooper

Blair Cooper
October 15, 2010

## Tradex Equity Fund Limited – Quarterly Review – September 30, 2010

| | Total return (%) | | | Average annual compound return (%) | | | |
|---|---|---|---|---|---|---|---|
| | Latest 3 months | Latest 6 months | 1 year | 3 years | 5 years | 10 years | Since inception* |
| Tradex Equity Fund Limited | 9.9 | 1.0 | 11.0 | -6.3 | -1.5 | 1.0 | 9.5 |
| S&P/TSX Total Return Index** (TRI) | 10.3 | 4.2 | 11.6 | -1.4 | 5.2 | 4.1 | — |
| 75% S&P/TSX TRI and 25% U.S. S&P 500 Index ($CDN)** | 9.7 | 3.1 | 10.2 | -2.5 | 3.5 | 2.0 | — |
| Median Canadian Focused Equity Fund** | 8.3 | 0.0 | 5.5 | -4.8 | 1.3 | 3.2 | — |

*April 1960 **Source: Globe Information Services

During the third quarter an investment in Tradex Equity Fund Limited increased in value by 9.9% while it has increased in value by 11.0% over the past year.

During the quarter, the strongest performing sector of the S&P/TSX was the Materials sector, driven by the takeover bid for Potash Corporation of Saskatchewan and the strength in metal and mining companies (for example, Teck Resources) as metal prices moved sharply higher. At the same time, stocks with higher dividend yields, such as companies in the Telecommunication Services, Utilities, and Consumer Staples sectors, performed well as a result of a continued decline in long-term interest rates.

The Energy and Financials sectors registered respectable gains during the quarter, increasing 4.8% and 5.7%, respectively. These two sectors represent 54% of the value of the Canadian portion of the portfolio and 42% of the total portfolio value. Within the Financials sector, life insurers fared poorly this quarter, reflecting, in part, the market's view that low interest rates are here to stay, and will require life insurance companies to continue to take high reserve expenses to adjust to a low-rate environment. These issues were compounded by concerns regarding the life insurers' equity protection products.

At the end of the second quarter, 78% of the Fund's total portfolio value was in Canadian equities, with 22% in U.S. equities. The U.S. market also performed well during the period (U.S. S&P 500 Index up 10.7%), but this was offset somewhat by the strength in the value of the Canadian dollar, which increased from 93.93 cents U.S. to 97.18 cents U.S. Throughout the quarter 40-50% of the Fund's U.S. dollar exposure continued to be hedged into Canadian dollars through derivatives known as forward contracts. This partially reduced the currency related losses that the Fund would otherwise have experienced due to the strength of the Canadian dollar.

During the period portfolio activity was relatively light although portfolio manager Phillips, Hager & North (PH&N) made a number of adjustments to the Canadian portion of the portfolio involving mainly small and mid cap companies in the energy and mining sectors. At quarter end, there were 85 Canadian companies and 44 U.S. companies in the portfolio.

As at September 30, 2010 the Fund's 12 largest holdings were as follows:

| | | | |
|---|---|---|---|
| Royal Bank of Canada | 4.4% | Canadian Natural Resources | 2.2% |
| TD Bank | 3.9% | Bank of Montreal | 1.9% |
| Bank of Nova Scotia | 3.4% | Goldcorp | 1.8% |
| Barrick Gold Corp. | 3.0% | CIBC | 1.6% |
| Suncor Energy | 2.9% | Canadian National Railway | 1.6% |
| Potash Corp. of Sask. | 2.4% | Research in Motion | 1.5% |

While current market sentiment continues to be cautious, PH&N remain bullish and confident the economic recovery is intact. Their belief is based on the remarkable strength in corporate earnings, combined with low equity valuations in an environment of low interest rate and low inflation. Although volatility is likely to persist, these factors suggest that equity returns may surprise on the upside. They also believe that strong corporate free cash flow and functioning credit markets suggest that merger and acquisition activity and capital expenditures are set to accelerate, which will reinforce both valuations and economic demand.

## Tradex Bond Fund – Quarterly Review – September 30, 2010

| | Total return (%) | | | Average annual compound return (%) | | | |
|---|---|---|---|---|---|---|---|
| | Latest 3 months | Latest 6 months | 1 year | 3 years | 5 years | 10 years | Since inception* |
| Tradex Bond Fund | 3.1 | 5.8 | 6.1 | 6.2 | 4.3 | 5.3 | 6.6 |
| DEX Universe Bond Total Return Index** | 3.2 | 6.2 | 7.3 | 7.4 | 5.6 | 6.7 | — |
| Median Canadian Bond Fund** | 2.6 | 5.1 | 6.4 | 5.7 | 3.8 | 4.8 | — |

*September 1989 **Source: Globe Information Services

An investment in the Tradex Bond Fund increased in value by 3.1% during the third quarter while it has increased by 6.1% over the past year.

Given the continued recovery in the Canadian economy, the Bank of Canada raised its overnight interest rate target by one-quarter of one percentage point at each of its two policy meetings during the period, bringing the rate to 1.00 per cent. However, it now appears likely that the Bank will hold its policy rate at this level until well into 2011 due to a combination of slower forecast domestic growth, benign inflation (the core inflation rate in August was 1.6%) and the uncertain outlook for the U.S. economy. In this regard, the U.S. Federal Reserve continued to maintain its overnight target range rate at 0 to 1/4 per cent and reiterated its view that economic conditions in the U.S. are likely to warrant exceptionally low policy rate levels for an extended period.

Given recovery in the worldwide economy, albeit at a very moderate pace, one would normally have expected bond yields to rise during the quarter. However, as shown on the following table, yields on 3-year and longer Government of Canada bonds moved significantly lower during the period. Indeed, on the second last day of the quarter, the yield on 30-year Government of Canada bonds reached a record low of 3.33%, versus the previous record low of 3.40% at the height of the financial crisis in 2008. This decline in bond yields was due to the continuing uncertainty on many fronts, the very low levels of inflation and a statement from the U.S. Federal Reserve that there will likely be another round of quantitative easing (i.e., the Fed buying U.S. Treasury bonds).

Given the continued extremely low yields on Government of Canada bonds, the Tradex Bond Fund committee has given portfolio manager TD Asset Management greater flexibility with respect to the Fund's asset allocation and will continue to examine other possible enhancements.

| Term to Maturity | Yield Dec. 31, 2009 | Yield June 30, 2010 | Yield Sept. 30, 2010 |
|---|---|---|---|
| 2 years | 1.47% | 1.39% | 1.36% |
| 3 years | 1.92% | 1.75% | 1.56% |
| 5 years | 2.77% | 2.32% | 2.01% |
| 10 years | 3.61% | 3.08% | 2.75% |
| 30 years | 4.08% | 3.65% | 3.35% |

Source: Bank of Canada. Mid-market yields on benchmark issues.

At quarter-end, the portfolio weighting to Government of Canada bonds stood at 37% while the weighting to provincial bonds and corporate bonds stood at 33% and 30%, respectively.

## Tradex Global Equity Fund – Quarterly Review – September 30, 2010

| | Total return (%) | | | Average annual compound return (%) | | | |
|---|---|---|---|---|---|---|---|
| | Latest 3 months | Latest 6 months | 1 year | 3 years | 5 years | 10 years | Since inception* |
| Tradex Global Equity Fund | 10.2 | 2.4 | 4.1 | -7.5 | -4.2 | 0.7 | 2.3 |
| MSCI World Total Return Index ($Cdn)** | 10.6 | 1.1 | 3.1 | -6.7 | -0.6 | -2.5 | — |
| Median Canadian Global Equity Fund** | 9.4 | 0.1 | 3.5 | -7.1 | 1.4 | -2.3 | — |

*May 1999 **Source: Globe Information Services

During the third quarter, the value of each unit of Tradex Global Equity Fund increased by 10.2% while it has increased by 4.1% over the past year.

In general, global equity markets rebounded strongly during the quarter following reduced concerns regarding the prospect of European sovereign debt defaults and stable to marginally improving economic data. At the same time, this was certainly an unusual period of interaction in financial markets. On the one hand, bond yields witnessed steep falls that would suggest a weaker economic environment while gold rallied sharply to hit record highs (in nominal terms) largely as a result of its safe haven status. In such an environment one might expect equity markets to fall but the opposite has been true. The reason is based largely on hopes of another round of quantitative easing in the U.S. (i.e., the Federal Reserve purchasing U.S. Government bonds). "Gold bugs" see this as a further debasement of paper currencies and thus want to buy more of a supply constrained real asset. Finally, equity markets see the positive effect of continued low interest rates for the foreseeable future, and in particular the ability for corporations to generate profits in such an environment. The hope is that this will eventually rejuvenate the global economy, get corporations to hire (and thus reduce unemployment), encourage banks to lend and consumers to spend.

In terms of local currencies, there were relatively wide differences in the performance of key markets during the period. In Europe, the London market increased 12.8% while Paris was up 7.9%. But Frankfurt and Zurich lagged, closing up a modest 4.4% and 2.7%, respectively. In the Asia/Pacific area Hong Kong's Hang Seng Index increased 11.1% and the Australian market was up 7.2%. However, Japan's Nikkei 225 Index finished the quarter essentially unchanged. Turning to North America, the U.S. S&P 500 Index increased 10.7% while the Toronto Composite Index was up 9.5%. Emerging markets again outperformed their developed country counterparts with very strong performances from countries such as India, Indonesia, Philippines, Thailand and Brazil.

The Canadian dollar was generally weaker versus other currencies during the quarter, with the notable exception of the U.S. dollar where it strengthened from 93.93 cents U.S. to 97.18 cents. Of particular note, the Euro closed the period up 7.4% versus the Canadian dollar.

Over the course of the quarter, the portfolio weighting to the U.S. market increased from 40% to 42% while the weighting to Europe was essentially unchanged at 26%. Total Asian exposure decreased slightly, to 22% from 25%. Exposure to emerging markets increased to about 12%, from 10%, while cash represented 4% of the total portfolio value at the end of the quarter.

City of London Investment Management (CLIM) continues to expect that a weak global economic recovery will be sustained, supported by loose monetary policy conditions. CLIM believes that the U.S. Federal Reserve will employ all measures at its disposal to avoid deflation and that rising asset prices should help in achieving that goal. While markets have had a good quarter, CLIM notes that valuations are not generally stretched around the globe and with easy monetary conditions and solid corporate profitability and cash generation, equity markets could make additional gains before the end of the year.

Tradex
since 1960

Tradex Management Inc.
50 O'Connor Street, Suite 920
Ottawa, Ontario K1P 6L2
Tel: 613-233-3394 1 800 567-3863
Fax: 613-233-8191
e-mail: info@tradex.ca
Web site: www.tradex.ca

# TWO GREAT WAYS TO INCREASE YOUR SAVINGS AND REDUCE TAXES

## Tax-Free Savings Accounts (TFSAs)

Tax-Free Savings Accounts (TFSAs), which were introduced in 2009, allow you to set money aside each year and watch those savings grow **tax-free** throughout your lifetime. Here's a short summary of how TFSAs work:

Canadians aged 18 and over can put aside up to $5,000 every year in a TFSA. In addition, any unused TFSA contribution room can be carried forward to future years. For example, if you have not contributed to a TFSA since the program was created and you have the funds available, you may contribute up to a limit of $10,000 in 2010 or $15,000 in 2011.

Unlike an RRSP, contributions to a TFSA will not be deductible from your current income for income tax purposes. However investment income, including capital gains, earned in a TFSA will not be taxed even when withdrawn.

A further benefit is that the amount withdrawn can be put back in the TFSA in the following or future years without reducing your contribution room. For example, if you contribute $5,000 per year for 3-years and the amount grows to $18,000 due to investment income and capital gains, you may withdraw the $18,000 and in the following year(s) contribute back $18,000 without affecting your regular $5,000 a year limit.

For estate planning purposes, there can be additional tax benefits for a spouse or common-law partner.

With a Tradex TFSA you can tailor the Plan to meet your investment objectives, including investing in any combination of the Tradex Investment Savings Account, the Tradex Bond Fund and the two Tradex Equity Funds. In addition, there are no fees or administrative charges when you set up a Tradex TFSA or when you withdraw money from it. This gives you complete flexibility in managing your TFSA.

## Registered Education Savings Plans (RESPs)

The 20% Government of Canada cash grant makes this the best way by far to save for your child's or grandchild's education. In a nutshell, here's how it works:

The Government of Canada will provide a cash grant of up to $500 per year (20% of the first $2,500 contributed annually) for each child up to age 18, subject to a lifetime grant limit of $7,200 per child. Thus, if you contribute $2,500 a year to a RESP, after the Government grant, the amount actually invested will be $3,000.

In addition, the grant room is cumulative and allows you to catch up on "unused'' grant eligible contribution room over time (the maximum grant allowed in any one year is $1,000). Thus, if a child was born a few years ago and does not yet have an RESP, you can still receive the maximum grant amount.

The lifetime RESP contribution limit is $50,000 per child and there is no annual contribution limit. A note of caution, however, is that if you make a large lump sum payment you may miss out on receiving the maximum grant amount.

When you establish an RESP through Tradex you have an extremely wide choice of investment options plus the ability to diversify your holdings in a number of different investments. Furthermore, at Tradex there are no sales commissions or other administrative charges. Every dollar you contribute (plus the government grant) is invested in the RESP.

RESP contributions are not tax deductible by the contributor, but the income and capital gains earned on the entire investment grow tax-deferred. And, when those earnings are eventually withdrawn to pay for educational expenses (including tuition, books, housing, etc.) the money is favourably taxed at the student's typically low rate.

**We urge investors to take advantage of these very beneficial programs. For more information on setting up a TFSA or RESP at Tradex please phone or e-mail us. We'll provide you with full details on these programs and mail you a complete investor's information kit.**