Tetrem Capital Management Ltd.

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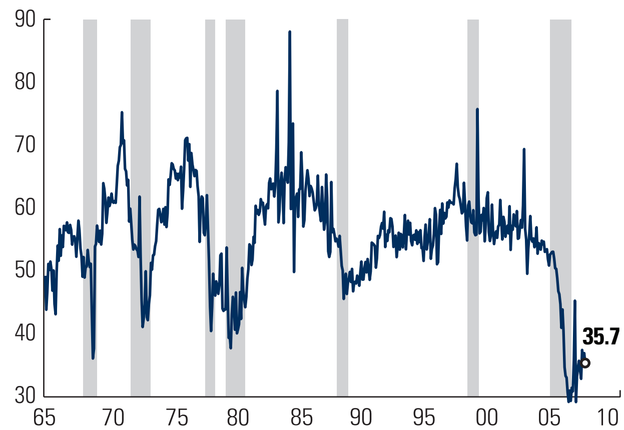
CI Canadian Investment Fund

Despite a strong first quarter earnings, global equity markets were pressured by a spate of negative developments that caused them to fall during the quarter. Against this backdrop, the fund delivered a negative return during the quarter, and underperformed the S&P/TSX Composite Index. The fund's Canadian equity holdings slightly beat the benchmark, but U.S. holdings dragged down the overall result. From a Canadian point of view, we added value through our positions in the consumer discretionary, consumer staples, and technology sectors, while our positioning in financials, telecom and materials detracted from performance.

Holdings in Canadian auto parts companies Magna International and Linamar continued to perform strongly. Both companies are benefiting from increased vehicle demand (See Chart 1) and a reduced cost base, which are leading to significant growth in operating profits. Magna shares got an extra kicker when the company proposed a deal to buy back its multi-voting shares, which would eliminate Chairman Frank Stronach's control position. The shares were up as much as 23% during the quarter, but have since given back some of these gains, rising 11.6% over the quarter. The proposal has proved controversial, with some high-profile investment managers publicly objecting to the terms of the deal. We agree that the nearly $1 billion in wealth transfer from shareholders to Mr. Stronach is objectionable. However, when we first bought the shares during the 2008-2009 bear market, we were aware of the risk that the multi-voting shares presented and we made sure we had a big margin of safety in the price we paid. In our view, the benefits of the proposed deal outweigh the costs. For years, Magna has traded at a discount to its world-class peers, such as Borg Warner in the U.S. Many institutional shareholders in Canada and the U.S. will not touch the shares, and we believe that will change with the elimination of Mr. Stronach's control, resulting in a likely expansion of the stock's multiple. We are planning on voting in favour of the proposal, because in our opinion it's in shareholders' best interest. Deal or no deal, we believe the company is well-positioned to benefit from a return to a normalized rate of auto production in North America.

U.S. Light Vehicle Sales
Per 1000 Population



Source: TD Securities; As of June 30, 2010; Shaded Areas Represent U.S. Economic Recessions

Chart 1: Despite a strong rebound off last year's trough, North American vehicle sales per capita are at depressed levels compared to historical averages.

The fund's best-performing stock in the quarter was Gerdau Ameristeel, which received a takeover offer from its Brazilian parent at a 53% premium. We sold our position after the stock rose. In technology, most of our strong result came from avoiding Research In Motion, which fell 30% on concerns about rising competition from other smart-phone providers, notably Apple's iPhone. That said, we have been monitoring the company closely as valuations have contracted significantly and optimistic earnings estimates are getting washed out. This last point is important, because undervalued tech stocks rarely go up when earnings estimates are dropping.

Among financials, our exposure to life insurance companies hurt performance. This includes Canadian-based Power Corp. and Manulife Financial, and Aflac in the U.S.

The lifecos faced a number of pressures in the quarter, including low interest rates, falling equity markets and exposure to European debt. At the moment, investors are hesitant to buy the shares, which we think is short-sighted. In the long run, the companies should trade at a higher valuation on a higher level of normalized earnings. We see potential catalysts, two of which are near term and of middling probability, and two for which the timing is uncertain but the likelihood is high. These includes the passage of the U.S. financial reform bill, second quarter earnings reports with no major negative surprises, rising bond yields and stabilization in European bond markets.

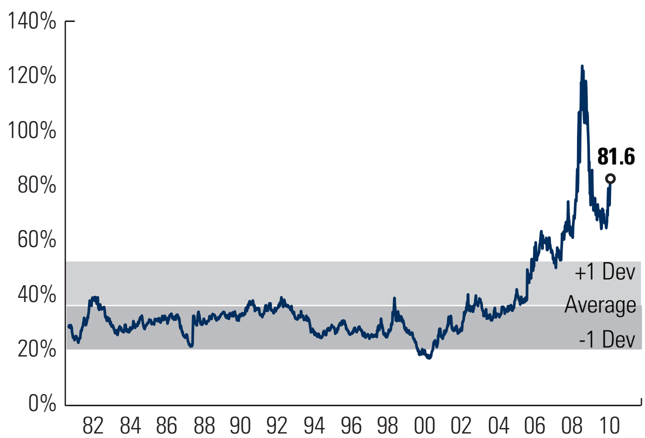
In the U.S., two of our energy holdings, Anadarko Petroleum and Transocean Ltd., fell hard due to their association with the oil disaster in the Gulf of Mexico. This was disappointing, as the companies have delivered strong long-term performance in our portfolios, and we had in fact taken advantage of strength in the stocks to trim our exposure to them in the previous quarter. Unfortunately, the rig's explosion was something we could not have foreseen. At current prices, we believe the stocks are overly discounting the potential negative fallout, and we continue to own them. As it stands, the U.S. has imposed a moratorium on drilling in the Gulf, the removal of which could act as a catalyst for the shares. If there is a silver lining, investment capital could start to gravitate towards the oilsands, which could help our Canadian energy stocks, but time will tell.

As we suggested last quarter, we had been expecting to take profits in cyclical companies as they approached fair value, and would likely be reinvesting the proceeds into more defensive counterparts as the year progressed. We had started to implement this strategy, having raised cash in April; however, since then many cyclical companies have fallen harder than the market and now offer better relative value when compared to defensives. We believe our original game plan will eventually play out, and we continue to focus our research efforts on companies with stable earnings characteristics. Many of these companies generate significant free cash flow and have high dividend yields, with capacity to increase payouts to shareholders over time.

We think the cash return from dividends is likely to become increasingly attractive to investors, and the good news is corporations are able to pay them, having cut costs and built cash levels to historically high levels. In an atmosphere of low bond yields, fixed-income investors are vulnerable to a return of inflation, which would not only reduce their spending power, but also push down the price of their bonds. From a dividend yield perspective, Canadian equities are attractive relative to Government of Canada bonds (See Chart 2).

TSX Dividend Yield

As a Percent of Long Bond Yields



(Based on Canada 10 year and over bond yields)

Source: TD Securities ; As of July 7, 2010

Chart 2: Dividend yields relative to government bonds are near historic highs, suggesting attractive valuations.

Investors sitting on the sidelines may start to decide that it is worth the risk of investing in blue-chip stocks, such as our holding in Royal Bank which yields 3.9%, rather than face the prospect of investing in a two-year Government of Canada bond that pays 1.4%, or a 10-year bond that pays 3.1%. It's highly likely that Royal's dividend will be raised during the next decade, but it's a certainty that the interest on a 10-year bond isn't going up.

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