

QV Investors

On Wednesday, November 11, QV Investors celebrated thirteen years in the business of managing investment portfolios.

From a start of three: Wendy Booker-Urban, Gordon Singer, and Leigh Pullen, and a few million dollars, we have grown to a staff of twelve and about \$2.2 billion in assets under management. We continue to follow our opening objectives of trying to provide the best in security selection, portfolio management, and client reporting. Quality and Value remain etched in our minds as worthy aspirations for QV Investors and for the character of the securities in our clients' portfolios.

Irrational Exuberance

We opened our doors as Alan Greenspan, Chairman of the Federal Reserve Board posed a rhetorical question to an audience at the American Enterprise Institute, "But how do we know when irrational exuberance has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade?" Then he added, "We as central bankers need not be concerned if a collapsing financial asset bubble does not threaten to impair the real economy, its production, jobs, and price stability."

Mr Greenspan's naïve, ignorant or unscrupulous shrug to excessive valuations, accelerating asset prices and credit excesses has now imperilled production, jobs, and prices worldwide. His successor, Helicopter Ben (aka Ben Bernanke), has embraced the low rate policy. He thereby further jeopardizes this cycle with its speculation, lack of deep savings and indifference to sound money. The ultimate contraction in North America business from credit inflation will subdue growth for our next decade.

Performance

Our aspirations for quality and value had an impact on our results this year. Quality companies and

Pooled Fund – Month End Unit Values[^]

Unit Values	Jun-09 [*]	Sep-09 [*]	Oct-09
Cdn Income Fund CI D	10.61	10.74	10.75
Cdn Balanced CI A	12.76	13.40	13.24
Cdn Equity Fund CI A	8.43	9.09	8.90
Cdn Small Cap CI A	16.55	18.77	18.97
Global Equity Fund CI A	7.71	8.07	8.00

[^] Fund NAVs reflect "full-fee" class * Post distribution

reasonably valued equities have not been the market leaders. In 2009 mines, gold stocks, banks and smaller speculative companies, not to mention emerging markets, commodities and the nearly bankrupt, have led markets higher. As QV has trailed the market indices, some might accuse us of paralysis. We admit we are older but not dead. We remain careful, not inert.

We did reduce reserves in the Small Cap Funds when their prices fell below book value, and we did sharply

Total Return – Capital Gains plus Income (%)

To Oct 31 '09	1 Mo	3 Mo	1Yr	3 Yr	5 Yr	10 Yr
QV Pooled	%	%	%	%	%	%
Cdn. Income	0.1	1.7	8.5	5.7	5.5	5.3 [^]
Cdn. Balanced	-1.1	3.8	9.8	3.3	6.2	9.8
Cdn. Equity [*]	-1.9	5.4	2.6	0.4	8.5	15.1
Cdn. Small Cap	1.2	13.5	14.4	-0.3	8.8	15.5
Global Equity	-0.6	5.7	1.2	-	-	-

^{*} Historic equity returns from the Cdn. Balanced Fund

[^]6 yr

Benchmarks:

DEX Bond Univ.	-0.1	2.0	11.2	5.3	5.6	6.7
Balanced Fund	-1.8	2.3	12.1	2.1	6.6	6.6
S&P/TSX Comp	-4.0	1.9	15.7	-1.2	6.9	6.4
BMO Small unwt'd	0.9	18.0	64.3	-4.4	3.8	6.8
MSCI World (\$CA)	-1.4	5.7	2.3	-9.3	-1.9	-4.5

- Pooled fund returns are gross of management and custodial fees. Returns over one year are annualized.

- The Balanced Fund Index reflects the total rates of return earned by the DEX 91-Day T-Bill Index (5%), the DEX Bond Universe (45%), the S&P/TSX Composite Index (40%), and the MSCI World Index (CS) (10%)

reduce our Canada and provincial bonds on their pricing spike to acquire higher yielding, investment grade corporate issues. Both were beneficial actions.

On the other hand, we held our asset mix conservative to 50:50 bonds to stocks and continued to emphasize defensive utilities, pipelines, telcos, and

consumer staples in our Canadian portfolios, settings we still think are appropriate.

We argue restraint and detachment in today's bubbly markets and aggressively stimulated economies is the correct posture. Investors inevitably swing from anxiety to confidence, from greed to fear and in that cycle, quality companies will again provide support and growth when valuations of those companies now in the limelight are so stretched that they fail.

Remember the manias for tech stocks or for energy and mineral companies at the top of the previous cycles.

Quality and value will be increasingly important in a cycle built from artificially low interest rates and artful promotions of consumer spending at a time when US consumer spending is already at a 71% record to GDP compared to a 64% average, and household debt relative to income is twice the norm.

Debt and its non-performance is still an issue. The minimal rate setting of the Bank of Canada and the Federal Reserve Board attests to the need to repair the large non-performing debt in the banking system. Central bank policies will not change until the deflation of banks loan portfolios is over. Commercial banks in light of their faltering loan portfolios have been careful to retain their profits, restrain their lending, and hold cash reserves.

However, the G-20 low rate policy response to the crisis has encouraged greater risk taking, not less. It "makes the world safe – for now – for the mother of all carry trades and mother of all highly leveraged global asset bubbles," states New York University Economics Professor, Nouriel Roubini. We are living a Ponzi Scheme. Ponzi accumulated money by selling future promise and not delivering. The current actors encourage current spending by foisting the debt for spending on the next generation of taxpayers who are, not yet voters. This system cannot continue in perpetuity because debts will grow faster than the spenders' ability to service the interest.

Winners - Clearly, we are grim. However, we are not slitting our wrists. Slow business has forced companies to intensify cost cutting and productivity increases. Low rates make the dividend yields on a number of our holdings, for example, BCE, Enbridge, TD Bank, Emera, and Canadian Utilities, very attractive. Multinational companies benefit from their exposure to the unlevered emerging economies, especially those companies in the US and the softer tone to energy prices benefits all those having intense energy usage. Gold, not something we own, has been a front-runner in a market of doubt as to the future of the US dollar. We hold the view still the former is overly excited in its uptrend and the latter excessively despised in its downtrend.

Risks QV expects valuations in many equities to be at risk and growth to be very limited. In this event, our bonds provide income and capital available for reinvestment in equities when share prices are fitting. That is why calculation is our useful tool.

We can measure risk and overvaluation today in the equity markets relative to a reasonable expectation of return. Analysts expect profits to grow at over 13% this year. We plan our accounts on that number being closer to 10% or less; in that case, the price paid for equity or the price to book will shrink from today's levels. The TSX trades near two times book value or invested capital. The equities in our funds trade at a 30% to 40% discount to that. Our cash flow yield is 15.6% and our dividend yield is 2.9% for the equities in our Balanced and Canadian Equity Funds. Our Small Cap Fund cash flow yield and dividend yield is slightly higher at 15.8% and 3.3% respectively. Our goal is to increase both without jeopardizing the credit quality of our company holdings.