



Pinnacle Canadian Mid-Cap Equity Fund First Quarter 2009

Investment Environment

The Canadian stock market staged a sharp rally late in the quarter, climbing some 15% off its bear market lows reached in early March. The benchmark S&P/TSX Composite Index recorded its first positive monthly returns in March (up 7.8%) following six consecutive months of decline. For the quarter, however, the Index was still down 2.0%. Canadian equities outperformed both US and EAFE stocks in the first quarter but lagged behind returns earned from bonds or cash.

Seven of the ten sub-sectors were lower, the worst performers being Utilities and Industrials. Information Technology and Materials were the best performing sectors led by heavyweights Research in Motion and Potash as well as by select gold companies. In the late quarter rally, nine of ten sectors were up, as Financials including the banks led the way.

Small cap stocks, as measured by the BMO Small Cap Index (BMO) rose 5.0% in the first quarter, outperforming larger cap equities and continuing the reversal started in December. For the trailing twelve months however, small cap companies have dramatically underperformed, having borne the brunt of the liquidity crisis and investors' low tolerance for perceived risk. The breadth of the market was fairly narrow in the first quarter as only two of ten sectors had positive returns. Information Technology was up 4.8% while Materials jumped 24.6%. The gains were mainly focused in more speculative exploration companies that were rebounding off their market lows. The worst performing sectors were Utilities and Industrials matching their large cap counterparts.

Performance

The portfolio outperformed in this first quarter of 2009 returning 1.16% compared to the S&P/TSX Completion Index of -4.15%. Strong value added came from stock selection primarily in the Energy and Financial Services sectors. In Energy, we benefited from holdings like Addax Petroleum and Talisman Energy while shares in Home Capital and the TMX Group rebounded nicely.

The TMX Group, which had been hit hard in 2008 as capital markets declined and investors worried about alternative trading platforms hurting their trading volumes, rose 42% in the three-month period. We added to this position late last year and the firm now represents our second largest position as well as our biggest active bet relative to the benchmark Index.

A couple of holdings that performed very poorly through the quarter included Tristar Oil & Gas, down 19.2%, and Transat down 37.9%.

The Pinnacle Program



Towards the end of the quarter, Suncor and Petro-Canada announced their intention to merge. The resulting combination includes a 33% premium to Petro-Canada shareholders upon the share exchange.

Outlook and Portfolio Strategy

While there was certainly no shortage of disappointing economic news during the quarter, there was an increasing number of data points suggesting the economic slump appears to be levelling off. The healing process appears to be gradually taking hold. While the Canadian economy and financial system are in much better shape than many other industrialized countries, we remain cautious. A resolution to the North American auto industry woes and the U.S. banking system crisis remains critical to a sustainable economic rebound.

Whether March is a temporary break in the clouds or the beginning of a new bull market we are not sure at this time. But equity markets are leading indicators and will move up while the news on Main Street is still poor. We expect to continue to benefit from a portfolio of companies that generally have better growth prospects as well as higher profitability margins and stronger balance sheets.

With respect to our small cap positions, as we wrote last quarter it is difficult to catch market bottoms; however, significant bad news has already been priced in. Looking out 12-18 months, a narrowing of credit spreads would be a positive catalyst for sizeable upside for small cap stocks.

Representative Holdings

Similar to the fourth quarter of last year, a number of positions were rebalanced to take advantage of moves in the underlying share prices. Among holdings that were reduced were SXC Health Solutions and Metro.

Two positions introduced this quarter were Shoppers Drug Mart and Alamos Gold. Alamos was added to maintain our gold exposure as we trimmed our weighting in Agnico-Eagle. We are concerned about execution risk as Agnico-Eagle brings on several new operating mines over the next few quarters. The stock is fully valued and does not discount any disappointments in mine start-ups.

The Pinnacle Program

