

SciVest Funds Commentary – December 2008 Year-End

Most investors are happy to see 2008 behind them, hoping that 2009 will be a much better year – a year in which they can start rebuilding their lost investment capital. Well, what if the markets actually fall another 30% to 50% from the level we closed out 2008? This is what I and a reasonably large number of top-down analysts and strategists expect. Where then will you get returns that at least keep up with inflation and also hedge against the inherent risks in your other investments? There are very few alternatives available in Canada other than the SciVest Market Neutral Equity Fund and for more bearish investors the SciVest Net Short Equity Fund. Canadian investors do have an alternative to going down with the ship. What are you waiting for? The time for action is now, not after you have lost another 35%.

It often frustrates me greatly hearing investors who know the SciVest story complain about the magnitude of their investment losses when they could have hedged their portfolios with SciVest Funds one, two or even three years ago when I was also one of the few in the Canadian investment community warning about the perils that await the economy and the stock markets.

I also get frustrated at these same investors saying that SciVest Market Neutral Equity Fund is simply too boring with too low of returns, as compared to those other Canadian “hedge” funds that were banging out 20% to 35% p.a. returns during the bull market (when the TSX Index was not coincidentally doing about the same return). I told these investors that *no one* generates 30% returns without having high market risk and/or high liquidity risk. Well it turns out that most of these Canadian “hedge” funds did not hedge, had very high market risk *and* very high liquidity risk – that’s how they generated the 30% returns during the bull market, and how they generated -40% to -95% losses during the first part of this bear market. It turns out that many of these high-risk “hedge” funds were simply market following funds with very high fees and low liquidity. This was not rocket science – what goes up fast, comes down even faster.

And now investors are saying that the “hedge fund industry” let investors down – this is partially true, especially given the bull market marketing campaigns of the non-hedge hedge funds. Although it is also true that “real” hedge funds (i.e., funds that substantially hedge) exist and generated losses that were much smaller than the losses sustained in the equity markets, commodity markets and corporate debt markets, and in certain cases like the SciVest Funds generated returns which were actually nicely positive. While small in number, these true hedge funds thereby added substantial value to client portfolios. I am happy to report that the core SciVest Funds were at or near the top of the list for this small group of real hedge funds in 2008.

As a result, in terms of overall performance in 2008, we are relatively happy with the outcome. I always want more, but relative to any relative performance benchmark you throw at both our core products (the SciVest Market Neutral Equity Fund and the SciVest Net Short Equity Fund), we did extremely well and in fact are near the top of the World (the World, not Canada where we did rank in the top 1% of all funds). And, obviously on an absolute basis, since we were nicely positive, almost by definition we outperformed almost everybody else. By design and as promised, we proved to be a conservative, low risk, diversifier for the rest of our client’s portfolios.

Below is the performance of the SciVest Market Neutral Equity Fund and the SciVest Net Short Equity Fund over selected time periods through December 31, 2008:

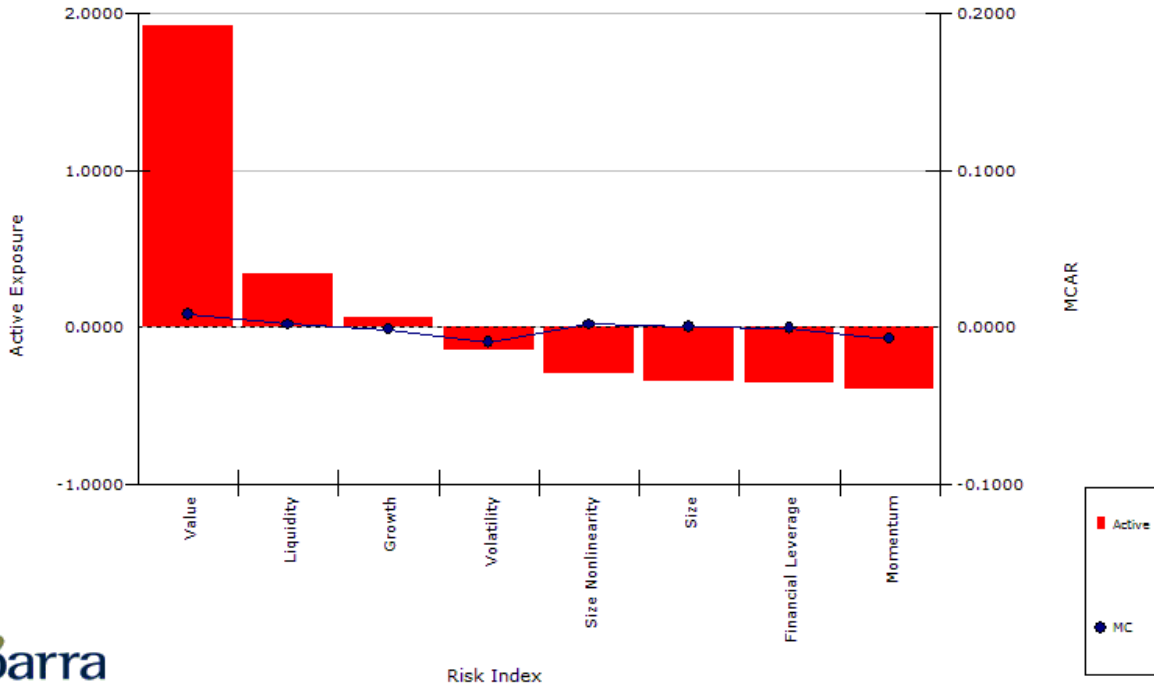
Total Performance Through Friday, December 31, 2008:					
	SciVest Market Neutral Equity Fund	SciVest Net Short Equity Fund	S&P 500 Index Index	S&P/TSX Index	GlobeFund Alternative Strategies Group Average
1-month	0.9%	1.6%	0.8%	-3.1%	-0.8%
2-month	1.9%	3.4%	-6.8%	-7.9%	-4.2%
3-month	7.2%	14.4%	-22.6%	-23.5%	-8.8%
Since Sep. 19	8.1%	19.1%	-28.0%	-30.4%	n/a
1-year	7.3%	22.4%	-39.2%	-35.0%	-15.4%
2-year	17.3%	16.4%	-36.3%	-30.4%	-10.4%

Notes: "1-month" represents the time period from November 30, 2008, close to December 31, 2008 close; "2-month" represents the time period from October 31, 2008, close to December 31, 2008 close; "3-month" represents the time period from September 30, 2008, close to December 31, 2008 close; "Since Sep. 19" represents the time period from September 19, 2008, to December 31, 2008; "1-year" represents the time period from December 31, 2007, to December 31, 2008; and "2-year" represents the time period from December 31, 2006, to December 31, 2008. Commissions, trailing commissions, management fees and other expenses all may be associated with pooled fund investments. Please read the Offering Memorandum before investing. The indicated rates of return are the historical compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account any sales, redemption or other optional charges, or income taxes payable by any unitholder, all of which would have reduced returns. The indicated rates of return are used only to illustrate the effects of the compound growth rate and are not intended to reflect future values of the Fund or returns on investment in the Fund. All rates of return are calculated from the Class F units of the Fund, net of all fees and expenses.

Both core SciVest Funds performed on mandate, with respectable relative and absolute performance. For the 2008 calendar year, Class F of the SciVest Market Neutral Equity Fund did +7.3% net to investors, while Class F of the SciVest Net Short Equity Fund did +22.4% net to investors. This compares to a -39.2% loss for the S&P 500, a -36.3% loss for the S&P/TSX Index, and a -15.4% loss for the average fund in the GlobeFund Alternative Strategies Group. Note that the two year numbers are almost as “boringly impressive”, even though they include the last year of the bull market.

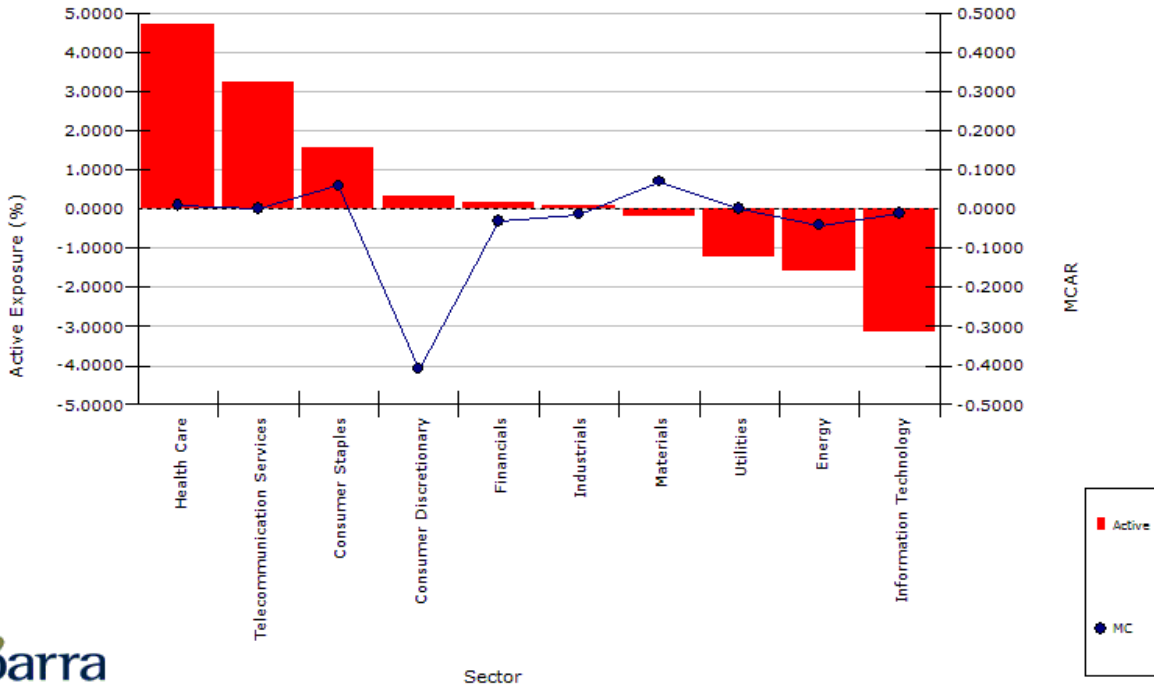
As part of our continuous improvement efforts, for this month’s rebalance of the Funds’ portfolios we converted over to a fully global risk model, from country specific risk models. Nevertheless, we still manage each country/region independently of each other within the Funds, as we always have, to maximize global diversification. This new risk model will be better for the smaller countries because it is better and quicker “tuned” to recent changes in risk in these smaller countries than the former single country models (most specifically in Canada, Hong Kong, and Australia). The primary surface benefit of the switch, however, is that the new model reports risk factors for every country using the same definitions –investment style factors, sector definitions and industry definitions. This will allow us to show the aggregate global portfolio in a single view – something we could not easily do before. For example, below are the current style and sector exposures of the SciVest Market Neutral Equity Fund:

Active Risk Index Exposures vs. MCAR



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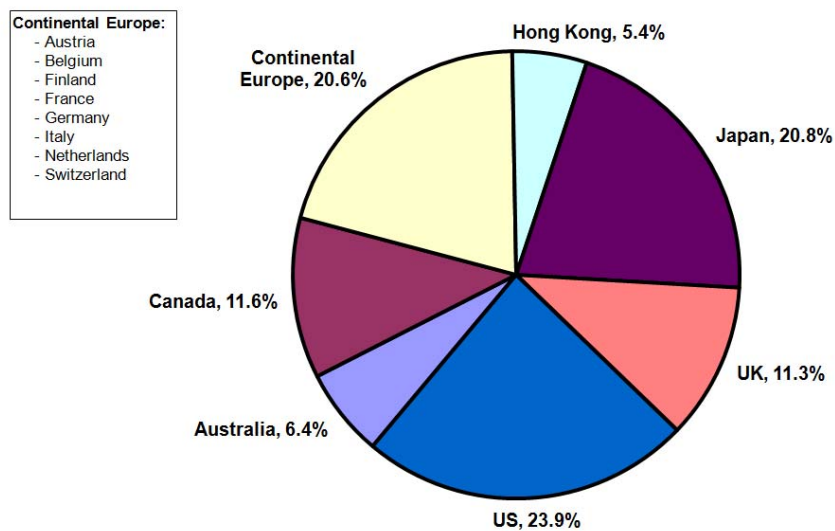
Active Sector Exposures vs. MCAR



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As you can see in the top chart, our only material style exposure right now is to “value” (where value is now defined more broadly and interpreted as valuation – an aggregate of EPS/P, forward EPS/P, P/sales, Div/P and P/book). All other style exposures are small in comparison – although it is interesting that we are marginally short momentum and financial leverage, and neutral on growth (from being short growth previously). In addition, in the bottom chart, you can see that we have no material net sector exposures (all <5% net exposure - running very conservative as we have for most of the past year). Although, interestingly, we are marginally net long health care & telecomm, and marginally net short info tech, with no net exposure to financials, discretionary or materials. In sum, we are positioned very conservatively on the sector exposure side – just relying on within sector stock selection for virtually all our returns.

As shown below, our global allocations have not changed materially – slight increases in the larger countries and slight decreases in the smaller countries, because as the stock market capitalizations have shrunk in every market, so do our investment universes (because of our risk management driven market cap and liquidity constraints). Investment universe contraction implies that our exposure to the smaller countries goes down because good diversification and liquidity are harder to maintain, and thus exposure to the larger countries goes up because they had much bigger universes to begin with.



In terms of environment for the strategy, I continue to be very optimistic. I have written about the valuation-based returns that I expect (and Morgan Stanley expects) in the near-term, and how that should drive very strong returns for at least 1-1.5 years once it starts. I actually do not believe that this wave has even started yet – we continue to be in a extreme-greed-to-extreme-fear environment, with sentiment and momentum (positive or negative depending upon the day) driving returns – not valuations as I foresee starting sometime soon, which will drive what I expect to be out-sized returns for our strategy. Essentially, I am still waiting for this valuation wave, and as you can see from the style chart above, we are well positioned to ride this wave when it comes. It is important to note that “quality” and “risk” factors have been somewhat working the past several months, and that is what has

driven our positive returns as we are well exposed to quality - but quality is not quite the same thing as valuation, nor part of the valuation return wave I expect. In sum, we remain very optimistic for the medium term prospects for the strategy, although we are still waiting for the overdue valuation wave that should strongly drive future returns.

In terms of economic and market forecasts for 2009, I remain quite bearish. I maintain my call for a S&P 500 Index level of 650 for a low this year. That would represent another 30% fall from the December 31 level. I expect some more violent up and down swings – e.g. the Russell 2000 small-cap index bounced almost 35% from November 21 to January 2 – quite a bounce, which went almost unnoticed by market participants. I am now seeing “bear case” scenarios being written about for the S&P 500 as low as 400 this year (Morgan Stanley’s bear case scenario) which would represent a 55% fall from where we finished 2008 – I am not this bearish, although it is important to note that my forecast assumes no major bearish geo-political events such as a major terrorist attack, war in the mid-east, Russia collapse, default of a major nation on their debt, etc. – all of which become more likely as the World sinks further into the worst recession since the depression. In terms of justifying 650 as a target, it is simple math – assume S&P 500 EPS this year of \$45-\$60 with a P/E of 10x to 13x – you get a S&P 500 level of 450 to 780. Of course this is this year – next year, 2010, may see further compression in EPS and if so probably P/E – meaning that the S&P may start out next year painfully as well.

US house prices should fall another 15%-25%, and should not bottom until well in 2010 – although this also assumes that the US government does not mess with house prices, which now looks like a real possibility. The fall in house prices “has to happen” to restore equilibrium, and thus will happen – if the US government gets involved, that will simply pro-long the fall in house prices (in terms of time, not magnitude) and thus pro-long the recession. And note that house prices and unemployment are highly correlated - US unemployment will likely continue to increase well into next year as well, reinforcing weakness in the housing market and credit markets. This will also increase the rate at which US consumers decrease their consumption – not out of willingness, but because they have no choice – no jobs, no pay increases, no credit, and shrinking asset prices.

All this will begin a long multi-year process that has to change the consumption culture within North America and most of developed Europe, and cultural changes take many years to happen. Throw in the fact that the largest population group, the baby boomers, are now retiring, with only a fraction of their net worth intact – and whom have or will leave the stock markets and housing markets forever, you get a pretty bleak multi-year scenario.

While I think we are now more than 50% of the way towards our ultimate stock market bottom from the top (which was 1565 for the S&P 500), it is likely to be a difficult year ahead, and 2010 is still a coin flip at best. Even beyond that, I think that only moderate returns will be available to being long equities, as it will take a long time to unwind the consumption culture of the past 30 years within North America and most of developed Europe – where they have to move from excess consumption to excess saving and from excess debtors to excess lenders. And with the baby boomers leaving the risky asset markets for good, the 3 to 7 year forecast beyond my forecast for the next year, while not dire, is not going to be what we experienced since the early 1980’s and thus the market losses that were sustained last year and that will be sustained this year will not be earned back any time soon. This is not a Japan scenario (yet) – but will require many years of adjustment with many years of relatively weak stock market performance.

I finish where I began... Frustrated, because Canadian investors do have an alternative to going down with the ship. "Real" hedge funds that actually hedge do exist in Canada, and the SciVest Market Neutral Equity Fund and the SciVest Net Short Equity Fund are among the best of these. What are you waiting for? The time for action is now, not after you have lost another 35% - now is the time to invest in the SciVest Funds.

John J. Schmitz

Commissions, trailing commissions, management fees and expenses all may be associated with pooled fund investments. Please read the offering memorandum before investing. The indicated rates of return are the historical annual total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemptions, distributions or optional charges or income taxes payable by any securityholder that would have reduced returns. The rates of return are net of all fees and expenses and are used only to illustrate the effects of the compound growth rate and are not intended to reflect future values of the pooled fund or returns on investment in the pooled fund. Pooled funds are not guaranteed, their values change frequently and past performance may not be repeated.