



## ABOVE THE CROWD

As we continue to rationalize our still fresh and somewhat controversial corporate name, being on the Trapeze is suggestive of having a top down view, above the crowd so to speak, which allows for a perspective, for insights, on investment opportunities and pitfalls that might otherwise be myopically obscured. As dyed-in-the-wool value investors, bottom up stock picking for us is the paramount fundamental. But investors always have to be astute to overriding macro influences that can affect certain groups or the market as a whole. They clearly can affect valuations. And they are often not obvious. Everyone knows that housing is weak, inventories of houses are high and prices are declining. The shares of housing stocks have accordingly declined materially too. At some point in time, the housing market will have bottomed and be set to recover; however, the housing stocks will likely bottom months in advance and offer value investors an opportunity to acquire quality names. The art is determining when those stocks are *really* cheap. When it pays to trade off minor risk for significant potential. Being contrarian goes hand in hand with value investing, but being too early can cause the unnecessary pain of further loss or opportunity cost. Early birds get worms, but we prefer steak. At a recent value investors conference in New York which Randall attended, money manager Bruce Berkowitz's response to, "What has been your biggest failing as a value investor?" was, "premature accumulation". Indeed. Randall has often said that when Herb gets an idea he should file it for 6 months.

### Crossroads

We think we are at a crossroads for many political, economic and geopolitical happenings.

In the US the Democrats now control both houses. There are implications: for taxes—as in *higher*—as temporary tax cuts are allowed to expire and with the potential for continuation of the estate tax; for greater government intervention and budget deficits as the government takes on more responsibility for healthcare and pensions (which, on the other hand, should benefit business if it can offload that responsibility); for lessened productivity as the minimum wage is allowed to rise; for the profits of oil companies as their tax incentives for refinery expansions and for US drilling are eliminated; for the profits of pharmaceuticals as their pricing power is constrained; for protectionism as the exporting of US manufacturing jobs to China and other emerging economies is discouraged, likely by insisting on higher foreign exchange rates or, even, in the extreme, through tariffs, with the potential for inflation from rising import prices; for greater environmental controls which could restrain domestic oil and metals production; for the abandonment of measures for tort reform to the obvious detriment of tobacco companies and the less obvious impediment to foreign investment; for an ameliorative policy on illegal immigration; for a potentially weaker war against terrorism as controversial measures such as wiretapping are curtailed and the withdrawal from Iraq accelerated; conversely, for an enhanced military capability and larger army, with Congressman Charles Rangel soon to be the head of the powerful House Ways and Means Committee, even calling for the return of the draft; for a measurable increase in the population of Canada if the US draft returns; but, worst, or perhaps best of all, for the potential

for gridlock in government, with even the possibility of yet a second veto by President Bush during his remaining term.

There are just under 800 days left in that remaining term. That's a long time waddling for a lame duck President. Markets, being the discounting creatures they are, will soon start discounting the implications of a Hillary Clinton or Barack Obama President on the one hand, or a John McCain or Bill Frist on the other. In the meantime, it should fret that Nancy Pelosi, the new Speaker of the House, is the third in line for the Presidency, and Cheney is not exactly the picture of health. The Founding Fathers could never have imagined California. The good part is that, guaranteed, in bipartisan spirit, Hugo Chavez, Kim Jong Il and President Ahmadinejad won't like Pelosi either.

Lots for investors to think about from above.

Geopolitically, terrorism, including state terrorism, doesn't seem to be diminishing with the countries Bush prophetically called the Axis of Evil—North Korea, Iran and Syria—still needing to be contained. We think we may be at a crossroads there. North Korea seems somewhat reigned in by its only friend, China, warming up to six party talks in the face of sanctions. Iran, despite its friendship with Russia and China, is currently being confronted by an armada in the Persian Gulf consisting of US, British, French, Indian, Australian, Canadian, Bahraini and Kuwaiti war ships, ostensibly for war games, but peculiarly well positioned to punish Iran for its nuclear weapons aspirations and generally for sponsoring terrorism. Israel recently cautioned Iran too. Mischief maker Syria is constantly stirring the pot, but should be a pushover. A crossroads in terms of the sponsors of terrorist groups for sure. The campaigns in Iraq and Afghanistan and the war against Islamist terrorism cannot be won unless terrorism's state sponsors, Iran and Syria, are dealt with and the supportive elements within Pakistan, Saudi Arabia and Turkey are restrained too. Recent weakness in the Persian Gulf stock markets suggest something may be brewing. We suspect, now that the US election is over, more controversial military objectives might be attempted. Perhaps even more interventionism in regard to the developing antagonists in Latin America, such as Venezuela, Bolivia and Ecuador. Places where we won't invest.

## **Bra Wars**

Keeping "abreast" of geopolitical events has allowed us to profit from the US-Canadian "bra war" as our La Senza got taken over by The Limited (Victoria's Secret) for \$48.25 per share, a 47.8% premium. Closing, conveniently for tax purposes, in January '07. We started buying this one when it was generally uncovered and flawed by its Wet Seal holdings, but had no debt, cash on hand, a growing ladies undergarment chain with 20% of the Canadian bra market, licensed operations in 12 other countries, and was a great value. The boobs at Victoria's Secret had been suing La Senza for copying a popular bra design. Really. Something like suing for support. In the end we think, like the War of 1812, Canada won. At least our clients did. Their cups runneth over.

## **Themes**

We don't normally go on about geopolitics and politics in our market letters, but we think they currently may have unusual implications for our clients' portfolio composition. They speak to the themes we want to emphasize.

## Oil and Gas

We are currently more than 40% invested in the oil and gas group, a significant overweighting. We think, relatively speaking, oil prices will remain high, at over \$50 per barrel with the potential to rise significantly. Mainly from static to declining production and ever increasing consumption. Despite some recent temporary weakening demand, the growing needs of the emerging economies, requiring an additional 2 million barrels per day (bpd) annually, will inevitably require higher prices. In any event, OPEC is meeting in December to consider further production cuts. Geopolitically, any confrontation with Iran might see the Strait of Hormuz temporarily closed to the normal movement of oil, causing a spike. Then, too, Nigerian rebels have threatened offshore production and there is some current threat from Al Qaeda to impair Saudi production which the Saudis seem to be taking seriously.

Natural gas is even better, especially North American gas. Unlike oil, which is a fungible commodity, natural gas, other than the liquids derived from gas, is a local market. The recent period of weak oil prices, but very weak gas prices, from mild weather and brimming storage, have cut drilling activity almost in half. North America's biggest producer, Encana has all but abandoned so-called unconventional gas exploration, such as coal bed methane, for its deep elephantine gas plays such as in the Columbia River basin.

Gas storage is being worked off and normal winter weather should help too. Gas wells deplete faster than oil so more drilling is needed to maintain reserves. From the demand standpoint, gas is less elastic than other commodities since over 50% of homes heat with gas and if you don't use it, you get very, very cold. Our work suggests that gas prices likely bottomed in September. Oil prices, we think also bottomed recently, at about \$55.

But, for us, any of these possible upward movements in pricing are mere icing on the cake because the oil companies we own are all growing their production significantly through exploration and development and should be profitable, even at somewhat lower oil prices which are possible but, we think, unlikely. And the oil and gas stocks remain the most undervalued sector of the overall market.

That's the big picture. From above the crowd. But, from a bottom up standpoint, our individual oil and gas holdings are prospective indeed.

*Petrolifera* trades for 7x '07 forward earnings, of over \$150 million—not bad for a company that IPO'd just one year ago with a total market cap just shy of \$80 million. And it is still cheap. The company trades well below our estimate of FMV which continues to grow beyond our expectations. The company currently produces around 11,000 bpd, is expected to produce 24,000 bpd next year, and exit '07 at over 30,000 bpd. The company expects to drill 70 additional wells by the end of '07. In addition, its prospective 5 million acre land position in Peru, where *Petrolifera* expects to spud its first well in late '07, could provide further dramatic growth.

*Corridor Resources* has drilled 22 successful natural gas wells in New Brunswick over the last few years with *no* dry holes. Construction has started on its pipeline to deliver 30 Mcf/d to the New England area starting in early '07. It's expected that will generate \$40 million in annual cash flow. The company is sitting on a resource of 1 Tcf (Trillion cubic feet) of gas, so cash flows should increase as drilling and production rates increase. Exploration drilling just commenced on a lower zone that could potentially contain up to 5 Tcf of gas.

*EastCoast Energy*, soon to become Orca Exploration Group Inc. (no, they didn't get the idea for a name change from Trapeze), started out as a freebie in a spin-out from *Pan-Ocean*. The company has significant and growing gas reserves in the Songo Songo gas field offshore Tanzania. A pipeline and facilities are in place which provide natural gas, mainly for turbine powered electricity generation, to power starved Tanzania. The company is waiting for a rig to drill a potentially large gas prospect in a field just west of Songo Songo and is also busy seeking acquisitions of a similar nature in Africa. The company is growing its production dramatically and could produce as much as 60 Mcf/d, 5x its current rate, by '08. The stock just made a new high (\$11) despite being in the midst of a rights issue allowing shareholders to buy 1 new share at \$6.43 for every 7 held. David Lyons, the Chairman and controlling shareholder, is the backstop guarantor of the rights issue.

*Rally Energy* had 20 oil wells completed by the end of Q3, bringing the company's production to almost 6,000 bpd. At 10x '07 earnings and 80% of its current NAV, the company is undervalued, with production set to more than double by '08. This also attributes very little for Rally's gas interests in Pakistan and the company's successful thermal project in Egypt.

*Sterling Resources* has been quite volatile lately after announcing a dry exploration well in Romania and, initially, a poor test result from what then turned out to be a successful well in the North Sea. The stock has partially recovered after it announced that the North Sea well should produce between 5,000 and 10,000 bpd. Sterling trades at only about one-third of its fair value of more than \$4. Drilling over the course of '07 should begin to drive up the share price to be more in line with the valuation.

Poor *Canoro Resources*. Though it has bounced from an unwarranted October '05 low, it still trades at less than half of its NAV. The company is now producing from its Amguri development field in the Assam State of India. Two appraisal wells being drilled at Amguri beginning this month should bolster production and add to reserves. This field could reasonably produce 10,000 bpd in the next few years. The company also has exploration concessions which are highly prospective for both oil and gas. New 2D and 3D seismic have been completed and drilling begins on these properties in early '07.

*Pacific Energy* is a new position whose principal asset is an oil field 9 miles offshore Long Beach, California with three drilling platforms. One platform currently produces 2,200 bpd, a second previously produced 4,400 bpd, though was shut down due to a shipment line leak. With both up and running, the two platforms should produce 11,000 bpd by year end '07. At that rate, the company should earn over \$.40 per share. In the current share issue, we paid only \$1.30 or only 3x that level of expected earnings and also received a half warrant exercisable at \$1.70. The company has partnered with Shell and Wolverine Gas & Oil on an exploration project with over 99,000 acres in the Green River Basin of Wyoming, just southeast of the well known Jonah field. A 30,000 acre part of the area alone could contain an estimated 10.5 Tcf of gas.

## Golds

The second group we favour are the golds. Purely from a supply/demand standpoint, gold needs to go higher to encourage supply. The world produces about 2,500 tonnes annually, but consumes about 4,000 tonnes and growing. The shortfall has been mostly made up from Central Bank selling and leasing. Central Bank reserves have probably declined to half of the 32,000 tonnes of record with the return of physically leased gold in physical form unlikely, if not impossible. With

rising costs, gold has become less profitable to mine and higher prices are needed to encourage exploration and development. South Africa, the world's largest producer, has seen its production continue to decline to less than it was 73 years ago. All industrial commodities, from hydrocarbons to metals, have made record highs in this cycle, except for gold and silver. Those two still trade lower than their record prices made 26 years ago, held back by artificial forces, but should soon be unleashed.

Unable to replenish reserves through their mining operations, gold producers have recently sought to grow by acquisition. Goldcorp taking over Glamis (paying a whopping US\$300 per oz.); Barrick, Placer Dome and currently attempting Nova Gold; IAMGOLD, Cambior; Gold Fields, the South Deep mine in South Africa from Barrick for US\$1.35 billion or US\$100 per oz.; Kinross, Bema for US\$2.6 billion. This activity may create bigger companies with obvious synergies but not more total gold production.

From a geopolitical standpoint, while certain West European Central Banks have been selling gold under the Washington Accord, now at an apparently diminished rate as their holdings are diminished, other Central Banks with growing foreign exchange reserves such as China (US\$1 trillion) and Russia (US\$277 billion) have expressed an inclination to diversify away from their predominantly US dollar holdings, into Euros, maybe Yen, and likely, gold, where they are underweighted. Finally, as we discuss below, there is clearly a US slowdown underway, and as it becomes more evident, the Fed will start to ease. Fed funds could be under 4% next year and the higher interest rate differentials supporting the US dollar would be gone. A lower dollar, if not a dollar rout, in a world awash with dollars and itching to diversify, should be good for gold.

*Etruscan Resources* produces gold in West Africa at its Samira mine in Niger. When its Youga and Agbou properties come on stream in the next 24 months, Etruscan should be producing at an annual rate of 200,000 oz. That alone should justify the current share price, but there is material upside from the exploration properties in Mali and Burkina Faso. Its Diba discovery in Mali could be a multimillion ounce deposit and Etruscan has four such anomalies within the country.

*High River Gold* is a gold producer with vast assets in West Africa and has significant production coming from Russia where it also has a potential world class silver project. The company's production is set to double to 270,000 oz. in '07, with another 100,000 oz. in '08, and double its production to about 700,000 oz. in the ensuing 3 years. Meanwhile, the company trades for only 10x '07 earnings and just over 5x '08 cash flow compared to its peer group which trades at 12x '08 CF. We recently increased our weighting by purchasing a convertible debenture of High River.

*Yamana Gold* is also about to have material production growth with a doubling in '07 to 600,000 oz. and 1,000,000 oz. by '09. Yamana's share price trades at less than half the cash flow multiple of its peer group and at only 12x '07 earnings.

*St Andrew Goldfields* has continually underperformed, but, we believe is now bottoming with production having commenced at its Stock Mine Complex in West Timmins, Ontario and also commencing this month from its Nixon Fork, Alaska mine. It has just completed a US\$40 million acquisition of the Holloway-Holt mine in East Timmins from Newmont, including a 1.23 million oz. resource and 36,000 acres of exploration properties contiguous to St Andrew's exploration properties in the East Timmins area. Restarting the Holloway mine should likely commence by mid '07. The company is forecasting production of 150,000 oz. in '07, rising to 380,000 oz. over the following 3 years after its Aquarius property (acquired from Kinross a year ago) is brought

into production. We have just purchased 10% Secured Debentures, with an added 2% commitment fee, as interim financing, to be turned into equity in a proposed rights issue. For a further fee, those accounts will be part of a standby guarantee for the proposed \$100 million rights issue for equity, closing in early '07. After the financings, the company should have net cash on hand. Based on anticipated production over the next several years, at the current gold price, the shares have significant upside potential giving no credit to its exploration programs in East Timmins, Alaska, Eskay Creek BC (130,000 acres) and a nearly half interest in Glass Earth Ltd., an exploration company with over 35,000 square kms of prospective property in the North and South Islands of New Zealand.

### The Canadian Dollar

We continue to like the Canadian dollar, especially after its recent setback from the changes to the taxation of income trusts in Canada which caused an urgent repatriation of foreign capital invested in those high yielding trusts. In the end, we think the changes, though abrupt and painful to holders, are sensible. They have levelled the playing field for all corporations, made other Canadian dividend paying stocks, like the banks, more attractive. They will encourage more exploration and development from oil and gas companies that would otherwise have sold or converted to royalty trusts, in the end paying out income that could otherwise go into the ground.

As a tradeoff, corporate taxation is being modestly reduced, a trend which should encourage investment. The Government is promising to eliminate the national net debt by 2021. Personal income tax will be reduced in 2007, with a reduction in the national sales tax too, to encourage consumption. And discourage black marketeering somewhat. Right.

One big plus, Canadians already enjoy the governmental health benefits that in the US are the burden of companies. Which is why auto companies like Toyota expand in Canada.

Productivity should improve as Canadian producers learn to live with a higher currency.

The minority Harper government has, rather courageously we think, been carrying out policies that, temporarily, may be unpopular, but in the end should make the country stronger. Including foreign policy measures and defence policies. The elimination of income trusts will increase tax receipts. Canada is currently the only G7 country that enjoys both a current account surplus and a budgetary surplus.

When US short-term interest rates—currently higher than in Canada—start to decline, the Canadian dollar should improve. And, when oil and gas prices improve, so should the Canadian dollar as it boosts the trade surplus. 20% of US natural gas consumption is imported from Canada. Increasing Canadian oil sands production will help too.

Taking all this into account, though typically we're invested 50% in US and 50% in Canadian stocks, with our current preference for oils and golds and our belief in the stability of the Canadian dollar, our inclination has been to overweight Canadian stocks. We also continue generally to hedge the currency when purchasing US equities for Canadian accounts.

## Slowdown Showdown

That a slowdown, a worldwide slowdown, is underway, is for us a really big theme. The US economy expanded at a 1.6% annual rate in Q3, the slowest pace since '03. Home sales in October were down 12.7% from a year ago and housing starts in October fell to 6 year lows. Building permits in October showed the slowest pace of annual growth in 9 years. Housing is clearly a drag. Autos too. The big three automakers just met at the White House to discuss relief, including from the advantage enjoyed by Japanese automakers from their deflated yen. Consumer sentiment is waning. Consumer borrowing is falling, especially for auto loans. Though up 0.2% in October, leading economic indicators seem to be putting in a top and the index has declined in 4 of the last 7 months. Though the employment statistics seem strong, unemployment in October falling to a 5½ year low of 4.4% (after two convenient pre-election positive revisions), manufacturing jobs have been diminishing in favour of lower quality government and service related jobs. But it's obvious that layoffs are continuing in the housing and auto sectors, two of the biggest employers. Even the White House just lowered its GDP forecast.

The yield curve continues to be inverted, with US 2 year treasury notes at 4.76% and 10 year treasury bonds at 4.6%, a usually reliable indicator of a coming slowdown, maybe even a recession.

### **Short Term Correction?**

In the meantime, the Dow Industrials are making a record high at over 12300 and the S&P500 is at a 6 year high of 1405. We're from Missouri. Even more skeptical, from Toronto. The rising market has a strange quality to it of late. Indeed, it may be some sort of extended year-end rally with a blow off character to it. Trading volume has shrunk. Sentiment indicators and measures of market volatility suggest a kind of complacency one gets near short-term tops. The wrong stocks are rising too. Including some overvalued ones we are short. Dillard's, for example, up 22% after an unexpected Q3 profit which still leaves the stock overvalued. Yet the shares of Abercrombie & Fitch, which we own, with same store sales in Q3 up a respectable 5%, declined because last year's were up an extraordinary 25%, creating a tough comparison.

One cause of the market's recent strength has been the enormous amount of money corporate America has injected into share buyback programs, an estimated \$435 billion for S&P500 companies this year, more than triple the amount of '03. While these help per share earnings, they use up company cash and can mask business slowdowns. Wendy's, for example, which we are short, was supported by its Dutch auction buyback at the stock's all time high, but then began to decline once completed.

Private equity deals, now in vogue, supported by liquidity and low interest rates, are helping support the market too. Reader's Digest is taken out by private investors led by Ripplewood Holdings for US\$1.6 billion. Four Seasons Hotels, by Bill Gates, Saudi Prince Alwaleed and Isadore Sharp, current CEO, for US\$3.7 billion. Another Canadian victory, at 44x expected fiscal '07 earnings. Buyout fund, The Blackstone Group LP is buying Sam Zell's Equity Office Properties for US\$20 billion in the biggest takeover of a real estate company. Freeport-McMoran Copper and Gold is buying larger Phelps Dodge for US\$25.9 billion in cash and stock in the world's largest mining takeover.

While all these buybacks and private equity deals raise share prices and shrink the quantum of available shares, thereby supporting equity markets, they are creating debt leverage in the system which could ultimately prove to be risky if the economy slows excessively or interest rates rise unexpectedly, say, in a currency debacle.

The wrong stocks may be going up because the short selling hedge funds are being squeezed now. If so, it's a trend that can't continue.

As we wrote in our last letter, we are longer term bullish as we think interest rates are relatively low and peaking and that stocks generally are statistically cheap. But we wouldn't be surprised to see a sudden correction from this temporarily overbought market.

It could come from disappointing Christmas sales. Or poorer employment numbers. Or a hedge fund in trouble. Or a sudden drop in the dollar. Or from nothing, that is to say, nothing more than market exhaustion.

### **Longer Term Bulls**

We say "slowdown showdown", because whenever the slowdown becomes more evident, from, say, a declining stock market or rising unemployment, the Fed will cry "uncle" and signal that rates are about to decline, likely really arousing the bull, based on prospects for an improved housing and auto market, rising consumer confidence, a lower dollar, better export potential, and, accordingly, an improved outlook for corporate profitability.

The Fed's job will have been made easier by the fact that inflation currently seems to be tame. Despite the potential inflationary impact of poorer US Q3 productivity numbers (the lowest year-over-year growth since '97), the possibility of rising energy costs, a rise in the minimum wage, and a lower dollar, US inflation currently seems benign. Consumer prices dropped sharply in October, with the core CPI at 0.1% or an annualized 2.9%. House prices are starting to decline as inventories are high and sellers are anxious. Ford said it won't raise prices in '07 to cover growing costs for commodity inputs and GM said it would raise prices next year on only 35% of its models.

### **Bigger Is Better**

We'll say it again. Low inflation and low interest rates are good for bonds. And really good for stocks, especially when interest rates are historically low and low relative to earnings yields.

Though we're heavily into oils and golds, especially of the smaller cap kind where the exceptional values reside, we're warming up to the improved valuations of US big caps which should tend to outperform in a slower growing economy with low interest rates and low inflation. While we can't resist the relative undervaluation of smaller companies, if that's the case, as we grow, we'll always be biased towards bigger names if they are attractive.

*Abercrombie & Fitch* and *Lowe's Cos.* are both superb retailers that were beaten up significantly with the rest of retail in the summer as the housing slowdown impacted the consumer. Both companies have grown their intrinsic values quickly and consistently. Abercrombie is up 26% since our purchase in June yet the company remains more than 25% undervalued at less than 13x earnings and growing its FMV by more than 15% per year. We continue to believe it is recession

resistant so long as kids still get allowance. Lowe's, on the other hand, is not impervious to the economy. In fact, in Q3 the housing slowdown started impacting its revenues to which the company responded by tightening expenses. The share price has held up recently because the stock got too cheap, trading at more than a 30% discount from FMV when we bought it. Despite guiding their future profits down, the stock rallied because the share price seemed to be overly discounting the effects on it of the slowdown.

*UnitedHealth Group* is another US big cap holding in which we invested in the spring when the stock fell from the company's involvement in options backdating. Those issues have mostly been resolved with CEO McGuire's recent departure and a soon to be announced balance sheet charge. The company trades at an attractive 25% discount to FMV with growth rate above 15%. The Democratic win threatens the entire healthcare group though we still believe that HMOs are part of the solution not the problem. We're currently hunting for other beaten up names in healthcare that share similar attributes: high returns on capital, plenty of room for growth and discounts to FMV.

The current low level of inflation will lift equities. PE ratios tend to work inversely to the level of inflation. So even if earnings growth moderates somewhat, expanding PE ratios could positively influence equities. Especially bigger cap companies with predictable earnings.

## **Bottoms Up**

And, of course, while we're above the crowd and want, as themes, to emphasize oils and golds and quality blue chips and be defensive for the short run, there's always opportunity for a "no theme", easy, bottom up stock pick. One such pick was Goldfarb Corp. which we've been accumulating for some time even after it sold its business and was sitting mainly on cash which it couldn't distribute since it was embroiled in a lawsuit brought by the UK purchaser of its marketing business. The settlement just occurred and the stock has jumped 50%. Another Canadian victory. Our analysis suggested any reasonable settlement would result in a profit for our clients worth the wait. As our former partner, John Clark, used to say, "Value investors may have to wait 5 years, only to make their money in an hour." Reaping the reward of premature accumulation. We have for some time been accumulating the shares and now expect to soon receive over \$5 in cash and Tuffy notes.

As value investors, with a bottom up bias, we're not typically catalytic investors. Meaning, when we buy a stock, we're not consumed by the immediate catalysts that can drive the share price higher in short order. We're more concerned with ensuring our appraisals are accurate and that the company's prospects for enhancing those appraisals are high. That said, we're into a very unusual period with our holdings, especially the resource based ones, where immediate and significant catalysts seem to abound.

For example, Etruscan is drilling off its Mali discovery over the next few months to better delineate what is believed to be a multimillion ounce discovery. Petrolifera will be drilling 70 wells in the next year. Rally plans to drill its 3 Tcf Pakistan gas resource starting in the next 2 months. *Canadian Superior* is finally slated to drill its 4 Tcf gas prospect in Trinidad beginning in early '07. Corridor just spudded a well on its 5 Tcf gas prospect at the lower zone of its existing McCully field. Delta's drilling in Utah, Colorado and Washington could give us results over the next few weeks, any of which could be company makers. Kodiak is currently drilling its first well in its highly prospective Vermillion Basin of Wyoming. Pacific Energy is expected to drill a

massive potential gas prospect, also in Wyoming, in January and another shortly thereafter, where prospective structures have potentially 3-5 Tcf in place, 40% of which would be for the account of Pacific Energy. Canoro will drill 2 development wells and 3 hugely prospective exploration wells in the next few months. Importantly, other than, perhaps, Delta, we don't believe the prices of these stocks have run up to reflect the potential from these near-term prospects.

### **Income Accounts**

While our income accounts have not performed up to our expectations, we were relatively unscathed (down less than 2% so far in November) from the Canadian government's income trust tax changes. Thankfully, less than one-third of our income holdings were trusts, and of those, three were REITs exempted from the tax changes and one, Student Transportation, a US IPS, also unaffected by the tax changes. Our income accounts composite has returned about 7% annually in the last 3 years but fared worse in the last year from losing income trust investments and few capital gains. The current annual yield on our income portfolios is about 8% and we also anticipate capital gains kickers over time, especially from several of our convertible holdings. Recently, we've increased our weighting in Advantex 10% Secured convertible debentures, purchased High River Gold 8% convertible debentures, Cano Petroleum 7.875% convertible preferred shares and some MagnaChip Semiconductor 6.875% debentures.

### **Minimizing Taxes**

We are very pleased with the recent performance of our equity accounts. The other side of the coin, however, is that the tax man needs to get his share. We do try to minimize our clients' taxes by taking capital losses where it makes sense (we've done all we want to in this regard) and realizing short selling losses. For Canadian accounts, we also purchase attractive flow-through shares to offset taxable income. That, combined with the anticipated deduction of fees, including performance fees, at year end, should in most cases serve to minimize taxes to an amount that will frustrate that tax man. So what if it takes a little longer to have no net national debt?

Henceforth, we intend to discontinue justifying our new name. Everyone knows we're "above the crowd" and all that. Our style of investing is well known and our track record speaks for itself. We might however continue to mention Nancy Pelosi or California, from time to time. And continue to delight in Canadian victories, including maybe the Leafs 4-2 win over the New York Islanders last Monday night, at a game we attended. Wow, ice hockey, the promise of no national net debt and potentially 300 more Victoria's Secret stores. Clearly not a bad destination for draft dodgers.

Herbert Abramson and  
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