Letko, Brosseau & Associates Inc.

Economic and Capital Markets Outlook

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- U.S. growth continues to advance along our central forecast, propelled by company investments and manufacturing activity. We expect the economy to expand by 2% in 2012 and 1.5%-2% in 2013.

- The Eurozone is in recession but it is expected to be shallow and short-lived. Progress continues to be made on the monetary, fiscal and structural fronts.

- Growth in the developing world has slowed but a range of stimulative fiscal and monetary actions argue for a pick-up in 2013. Emerging market countries will continue to support an expansion of the global economy.

- Long-term bonds are overvalued and remain at risk. We are maintaining a cautious stance.

- Equities generally are well supported by attractive dividend yields and reasonable valuations. We expect that a carefully diversified portfolio of high quality companies will outperform cash and bonds in the years ahead.

September 2012

U.S. Growth in Line with our Central Forecast

The U.S. economy grew at a steady pace in the second quarter of 2012. Real GDP expanded by 2.1% year-over-year while in nominal terms the economy advanced by 3.9%. Consumer spending grew rather slowly at 3.6% while investment increased at an impressive rate of 12.2%. Government spending was flat and contribution from trade was neutral.

U.S. growth forecast at 1.5%-2.0% in 2013…

The rate of job creation has moderated during the year from an average of 226,000 per month in Q1 to 146,000 in Q3. Total employment is up 1.4% over last year's level and is expected to remain on track to advance at a similar rate for the year as a whole. Wage inflation has slowed to 1.7% over the past twelve months. Overall employee compensation was 3.3% ahead in Q2 with a strong showing of 4.1% in the private sector while government employee wages were marginally ahead by 0.2%. Looking forward, leading employment indicators point toward further job creation. The Institute for Supply Management (ISM) index for employment is 53.5 (a level above 50 signals expansion), temporary jobs are up 8.9% over the past year and hours worked in the private sector are still growing faster than employment (2.3% vs. 1.8%).

Both production and spending on goods remain particularly buoyant. U.S. consumers have shifted spending from services to goods, likely reflecting brighter job prospects and pent-up demand which built up during the recession. Consumption of goods increased 6.1% over the past twelve months while sales of new autos are up 17.3%. U.S. firms increased capital investments in machinery and equipment by 9.9% over the same period, sustained by a steady advance in corporate profits (6.1%). The manufacturing sector is doing well: industrial production is up by 4.6% as of July. Trucking shipments and railcar loadings – excluding coal and grain which have been hit by low natural gas prices and drought respectively – are 5% and 3% higher respectively. Finally, manufacturing sector employment increased by 180,000 over the past year, representing 10% of all jobs created in the U.S.

… supported by manufacturing, capex and housing.

Progress in the construction sector has boosted confidence that the housing recovery may well be underway. Spending on non-residential construction, encompassing office buildings and infrastructure, increased 6.4% over the past year. Residential construction is up 12% while housing starts are up a robust 24%. Housing is undoubtedly benefitting from a combination of pent-up demand and historically low mortgage rates. The interest rate on a typical 30-year fixed rate mortgage is 3.40%; this compares with an average of 5.04% during 2009. House prices have been stable or rising over the past year and existing home sales are up 9.3%. We are confident construction activity will continue to rise over the next two years and this sector will start to generate new jobs in the near future.

Our central forecast for the U.S. economy remains unchanged with real GDP growth of 2% for 2012 and 1.5%-2.0% for 2013. Employment growth is anticipated to be sustained at current levels, wage inflation will remain modest and disposable income is expected to expand 3.0% to 4.0%. Assuming a stable saving rate, consumer spending will grow in line with incomes. Corporate investment is on track to remain steady as profits are high and corporate balance sheets are healthy. In addition, we anticipate that housing has finally turned the corner and will increasingly contribute to economic growth.

As the year-end approaches, we reiterate the main risk to our U.S. economic forecast: inaction on the U.S. fiscal front. At the end of 2012, various tax breaks expire and the U.S. government will once again need to raise the maximum threshold of its outstanding debt. If a deal is not reached prior to year-end, significant tax increases and government spending cuts will be enacted automatically. The cumulative impact of these measures totals $600 billion, or around 4% of GDP. Given the size and significance of this fiscal contraction, we expect a deal to be reached prior to year-end.

Global Economy on Glide Path

Canadian economy growing in line with U.S.

The Canadian economy grew in line with the U.S., advancing by 2.5% in Q2 over the past year. In nominal terms, consumer spending and disposable income grew at a similar pace, 3.1% and 2.9% respectively. Government spending is up only 0.6% as both federal and provincial governments are reining in spending to lower deficits. Residential investment rose 10.0% in the second quarter compared with last year, although recent data suggest a cooling in the housing market. Capital spending is solid, up 9.8% over the past twelve months. Employment is up 1.0% and the unemployment rate has remained flat around 7.3% for the past 6 months. Our growth forecast for Canada is 2% for 2012 and 2013, supported by strong corporate investment, moderate consumer spending and limited fiscal drag.

Japan’s real GDP growth spiked to 3.5% in Q2, largely due to the economy’s catch-up from disruptions caused by the 2011 earthquake. China’s growth slowed to 7.6% year-over-year from 10.4% in 2010 and a similar deceleration in growth rates has been observed across much of the emerging market world. The IMF projects real GDP growth for emerging and developing economies of 5.6% for 2012, down from 7.5% in 2010. In response, many developing economies have boosted fiscal spending programs and/or cut short-term interest rates. This, together with expectations that the Eurozone will stabilize and emerge from its shallow recession in 2013, leads the IMF to project a real expansion of the global economy by 3.3% in 2012 and 3.6% in 2013.

Europe: Forward March

Most economies in Eurozone in recession.

Recent European economic data have been poor. Most Eurozone members are now experiencing recession and coincident indicators do not yet show signs of improvement. In the second quarter, real GDP for the region contracted 0.4% over the past year. The economies of Germany, France, Austria and Finland are still expanding, with real GDP up 1.0%, 0.3%, 1.0% and 0.6% respectively. Growth was negative for all other major countries: -2.5% in Italy, -1.0% in Spain, -0.5% in the Netherlands. The Purchasing Managers’ Index (PMI) for the manufacturing sector was 45.1 in August, suggesting a further deterioration in output in the third quarter.

Progress in Europe made on various fronts:

The weakness in Europe's economy in the second quarter is undoubtedly a result of political events that heightened investor uncertainty. National elections in Greece and France, the dissolution of the Dutch government and rising financial stress in Spain leading to a request for the recapitalization of the banking sector, all contributed to the malaise. Poor economic results are therefore not surprising.

monetary policy

Encouraging steps on the policy front appear to have had a broad impact on investor sentiment. The European Central Bank's (ECB) President Mario Draghi announced on July 26th that the central bank "is ready to do whatever it takes to preserve the Euro". The central bank effectively reaffirmed its intention to use all monetary policy tools available to address the dysfunction in certain sovereign debt markets. In early September, the ECB provided details of a new program called the Outright Monetary Transactions (OMT), which will allow the central bank to purchase sovereign bonds in the secondary market. This measure aims to lower interest rates for member countries which are enacting fiscal and economic reforms but whose rates remain excessive and unsustainable. Unlimited purchases of member countries' short-term sovereign bonds would occur subject to the respective government's prior request for assistance and compliance with fiscal conditions.

judicial

On the judicial front, a major hurdle for the European Stability Mechanism (ESM) was cleared when the German constitutional court in September rejected an injunction against the setup of the €500 billion permanent rescue fund. The ESM is expected to be operational in October and will provide a pool of funds for member countries facing liquidity issues. Unlike the ECB's OMT program, the ESM will be able to buy bonds in the primary market and to directly fund both deficits and debt maturities of member countries in need of capital.

political

On the political front, despite periodic unrest by populations experiencing "austerity fatigue" in Greece, Spain and elsewhere, pro-Eurozone parties dominate decision-making. In France, electors voted in April for a government that wishes to redefine Europe's fiscal strategy by focusing increasingly on growth as opposed to strictly on austerity, but which remains favourable to European integration. In June, Greek voters ultimately rejected a populist political party calling for a repudiation of its bailout deal. Dutch electors in September gave pro-Euro integration parties a strong mandate and significantly reduced the parliamentary seats of a Euro-sceptic party.

fiscal

Eurozone governments remain committed to curtail expenditures although for some, a weaker domestic economy challenges their ability to abide by pre-set deficit targets. For example, year-to-date to July, the deficit in Greece is 4.2% of GDP higher than their original target. However, government spending is on track, implying that the gap arises from lower-than-anticipated revenues. On balance, fiscal prospects for the Eurozone are set to improve; the region's deficit to GDP this year is forecast to be lower than in 2011 and further progress is expected to take place in 2013.

structural

Notwithstanding prospects for a weak economic environment for 2012 and 2013, we note some positive structural trends on the economic front. Tentative signs of a narrowing in the competitiveness gap between northern and southern European countries are appearing. German unit labour costs have been above the European average for the last 2 years while

Spain, Portugal, Ireland and Greece have seen these costs decline. Furthermore, wage inflation in Germany has been higher than nearly all other Eurozone members since Q1 2011. Should these trends persist, over time higher inflation in the North and increased productivity in the South will address imbalances in economic performance. Another structural adjustment is occurring in trade: Eurozone member countries' trade balances versus Germany have been improving over the past 5 years, with the exception of France.

A combination of monetary, judicial, political, fiscal and economic progress supports our view that Europe is on the right – albeit occasionally bumpy – track. We reiterate that we do not invest in European governments and economies; we invest in businesses that are headquartered in Europe. Typically these companies are international leaders in their field and therefore very active in the world economy. An aggregation of the sales and earnings before interest, taxes and depreciation from our 30 largest European holdings demonstrates that on average these firms generated 40% of their sales outside Europe, which accounted for a similar share of their profits. On average, these companies traded at 10X 2012 earnings and offered a 5% dividend yield.

Bonds Warrant Cautious Stance

The risk/return relationship remains unfavourable for bonds. Current yields hover at all-time lows in both Canada and the U.S.: the 30-year Treasury yield is 2.32% and 2.82% respectively. As real yields are close to negative, investing in bonds leads to a deterioration of purchasing power over time and an exposure to the risk of capital losses should rates increase even marginally.

Risk/reward profile for bonds is poor.

It is possible that interest rates could remain low for an extended period of time. The U.S. Federal Reserve has announced a third round of asset purchases involving buying up $40 billion per month of mortgage-backed debt with the stated goal of supporting a stronger economic recovery. The ECB, through its OMT programme, now has a tool to buy unlimited amounts of bonds which should help anchor rates in Europe, particularly for southern Eurozone members. Foreign investors are still very active in the Canadian bond market, purchasing around $33 billion year-to-date to June, of which $19 billion flowed into Federal government bonds. As Treasury issuance totalled about $16 billion during the same period, foreign flows have clearly had a role in maintaining low yield levels in Canada.

We acknowledge these arguments for the persistence of a low rate environment yet maintain the view that long-term bonds do not represent an attractive investment. This is perhaps best illustrated by a simple example. If rates along the yield curve stay near current levels for the next 2 years and subsequently rise by 1%, our bond portfolio generates a positive 0.9% total return during the period while the return on the benchmark DEX Universe Index is -2.5%. Under a scenario where rates remain low for 5 years and only then increase by 1%, our portfolio offers a +2.9% total return advantage over the benchmark during the 5 year period. Furthermore, these scenarios do not take into account the risks central banks are taking by tolerating slightly higher inflation in favour of boosting domestic demand.

Even modest rise in yields will lead to loss of capital.

We therefore remain cautious with respect to the outlook for bonds and believe both low portfolio exposure and a short duration position are warranted.

Stocks Remain Preferred Investment

Global equity markets rebounded in the third quarter, with the MSCI World Index (Net, in C$) up 3.0% from end-June to end-September and 15.1% above its level of one year ago. A combination of solid company earnings reports, accommodative global monetary policies and progress on the European front combined to increase investor appetite for equities. Equity market performance ($C) has diverged across regions during the past twelve months: S&P 500 +23.3%, S&P TSX +9.2%, DAX +20.0 %, CAC-40 +6.7%, FTSE +14.6% and Nikkei -2.6%.

Equities well supported by cashflows, valuations and dividend yields.

We have maintained an above-average exposure to equities since the global economy's emergence from recession in 2009. In general, company prospects have improved markedly since then and in many cases earnings have approached or surpassed prior peaks reached in 2007, though global stock prices in aggregate still trail about 20% from their highs. We believe share prices still offer reasonable value and good dividend support.

Our portfolios are well diversified both geographically and by sector. In addition, we carefully monitor the valuation risk of the various companies we invest in through the application of the basic principles of investment which the firm has used since its founding 25 years ago. We emphasize ownership of companies which are active in the real economy and have the potential to sustain or improve earnings over a 3 to 5 year horizon. We develop our own views on the evolution of a company's cash flows and reassess on a regular basis how much we are willing to pay for these firms. Portfolio adjustments are therefore made in this context of fundamental analysis and not on market sentiment. This disciplined investment process has yielded above average returns throughout the history of the firm and we are confident it remains the most prudent approach to manage portfolios.

All dollar references in the text are U.S. dollar unless otherwise indicated.