



THIRD QUARTER LETTER 2009

For the third quarter ending September 2009, we are happy to report that the year-to-date weighted average return of our all equity portfolios is +40.1%, which continues to compare very favorably with +30% for the TSX Total Return, +19.3% for the S&P500, and +25.6% for the MSCI World index. In Canadian dollars, the S&P500 is up only 6.8%, while the MSCI World is up 13.6%. Our balanced portfolios have gained between +22% and +33% year-to-date, depending on fixed income weightings, as our timely purchases of bonds during the darkest hours of the credit crisis have paid off handsomely for our clients. We achieved these market-beating results with virtually no change to our core portfolio holdings which have rebounded nicely on the back of excellent company results and relative low valuations, and very low exposure to the volatile resource and financial sectors. This speaks highly of our stock (and bond) picking abilities as well as our macro convictions, demonstrating our value added portfolio management approach; we are not “closet indexers” like many money managers. Our objective is to outperform indices by researching the universe of companies for those undervalued gems and trying to time purchases when securities are being sold at bargain prices. We believe that this is the only low risk way to create real wealth in the public markets over time. As stated in our first quarter letter in April, valuations had dropped so low that it was the investment opportunity of a lifetime.

The top performers during the quarter among our core holdings include: Neo Materials (+86%), TVA Group (+52%), Direct Cash (+45%), Connacher (+35%), Vicwest (+34%), Arbor Memorial (+25%), Corus Entertainment (+23%) and Mosaid Technologies (+18%). It is no coincidence that most of these names are lesser known Canadian companies which are not part of the TSX index, yet are leaders in their respective industries. Their shares were pummeled in 2008, yet many are generating near record profits and were trading at low valuations, and thus have outperformed the market. We remain confident in the merits of all of our portfolio holdings, as most are sheltered from the debilitated American consumer, generate significant amounts of free cash flow, have conservative balance sheets, and pay-out generous distributions to shareholders, while still trading at reasonable levels. We continue to stick to our multi-faceted strategy, however we have taken profits on some larger positions and further lowered our exposure to the resource and financial sectors, while adding to defensive positions and raising cash. With negative real yields making it increasingly difficult to find attractively priced bonds and preferred shares, we prefer to own domestic high dividend yielding equities in stable predictable businesses such as utilities, telecoms and consumer staples. Over the long run, these will outperform cash and bonds. We also continue to hold investments in the gold and energy sectors, and are avoiding the \$US which will continue to inflict a “Chinese water torture” on \$US dollar denominated holdings as it declines for the foreseeable future.

A WILD RIDE: WHERE DO WE GO FROM HERE?

It has indeed been a wild ride for investors during the past 12 months, with most stock markets around the world having plunged by up to 50% from their highs in 2008, and having since risen by the same amount from the depth of their lows. The powerful rally since mid-March has been one of massive relief that the world is not ending, combined with anticipation that economies are recovering. Market sentiment is currently unusual in that the bulls are long and nervous and the bears are in cash and frustrated that they have missed this massive move up, and are awaiting a thus far elusive correction to re-enter the market. These opposing groups will continue to “duke it out” as the liquidity propelled markets try to correct or retrace. Market pull-backs caused by nervous investors selling will continue to be counterbalanced by those who panicked near the bottom and are trying to reinvest on market dips.

While the “financial Armageddon” scenario has passed, economic recovery is not yet obvious in our eyes. Proof that we are not out of the woods can be seen in the constant mixed bag of statistics on

unemployment, housing, consumption, manufacturing, etc.... Indeed the stock market recovery has been “V” shaped, but the economic recovery certainly will not be; it will be long and subdued. We are still living in deflationary times, with excess manufacturing capacity, ongoing corporate and consumer deleveraging, and still contracting bank credit. Governments worldwide are doing what they can to counteract these forces through lower borrowing costs and spending stimuli. Whether these measures suffice to keep the economy on a steady path of positive growth remains to be seen, therefore we remain cautious. That being said, stock markets are currently in a “sweet spot”; record low interest rates which governments are loathe to increase any time soon, combined with trillions of dollars of cash on the sidelines provides a powerful cocktail for the equity party to continue. Furthermore, the threat of eventual inflation is enough to temper the enthusiasm for investing too heavily in long duration fixed income instruments. The sober course of action is to be properly balanced with the right combination and types of equities (low multiple, low debt, profitably growing, dividend paying companies), short to mid-term corporate bonds (high quality issuers), and some commodity exposure (primarily gold, oil and uranium). This has been and will remain our positioning in our clients’ portfolios for the foreseeable future.

A WORD ABOUT OUR FIRM

When Lester Asset Management was formed 23 years ago, the decision was made to open individual accounts segregated in the client’s name, evidencing direct ownership, with social insurance numbers etc. It is certainly more costly and time consuming both from an administrative and portfolio management basis than running one large pooled account. However, for various reasons all having to do with best serving the clients in terms of the appropriateness of a customized portfolio, we went the segregated route. In our opinion, every portfolio is different because people are different. They have different aspirations, risk tolerances, tax issues and special circumstances that dictate the suitability of a particular portfolio. While all portfolios have common core holdings, no two portfolios are identical.

Unfortunately another very compelling advantage of segregated funds has gained tremendous importance; that is the safety aspect. With the well publicized arrest of several high profile criminals masquerading as investment professionals (including a few in Montreal), protection from fraud is paramount to many investors these days. In recent weeks, we have addressed several accounting firms on the subject and presented our view at LAM. In addition, every potential new client who has interviewed us lately invariably asks about safety issues. Following is our response to these concerns:

1. First and most importantly is the segregated account aspect already described above. Practically all frauds occur with pooled funds that employ opaque investment strategies. In addition, segregated accounts can never be commingled with or counted as assets of the custodian (Penson) or the management firm (LAM). No matter what happens to either of the above, the client retains a direct ownership of the assets.
2. The next important LAM client safety feature is the fact that we use (and always have) an independent custodian who reports independently to our clients. Our custodian, Penson, is not a household name in Canada but note that they are a large publicly traded (NASDAQ) company who are the custodians of choice for some of the largest investment counseling firms and brokers in North America. Incidentally, each portfolio is insured up to 10 million dollars.

3. Another hallmark of a fraud is the absence of an independent auditor. From the inception of our company, we have been audited annually by Schwartz, Levitsky & Feldman, a large nationwide accounting firm.

Last but not least, LAM is licensed and regulated in all three provinces where our clients live by three independent regulatory bodies; the AMF (Quebec), the OSC (Ontario) and the BCSC (British Columbia). These organizations collectively are very rigorous with their monitoring to assure that we operate in accordance with industry standards.

October 7, 2009