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## Invesco Institutional Fund Quarterly 2009 Fourth Quarter Market Overview

December 31, 2009

### Market overview

The fourth quarter of 2009 was another banner period for equity markets. But as the markets continued to rally, the rate of economic recovery was subdued and lagging.

All in all, the lagged effects of stimulus plans led to a better economic climate as the U.S. and Canada reported GDP growth during the quarter. But the high unemployment rates in both countries are hard to ignore; by quarter-end they rested at 10.0% and 8.5%, respectively. With one notable exception, when the Reserve Bank of Australia became the first of the G20 countries to raise its benchmark interest rate, doing so twice by 0.25% during the quarter, central banks stayed the course with historically low rates. And the tone of cautious optimism that began in Q3 continued throughout Q4. The U.S. Federal Reserve Board held its federal funds rate at 0% to 0.25% and the Bank of Canada maintained its key lending rate at 0.25%, neither indicating any near-term changes as ongoing job losses, sluggish income growth and tight credit cast a pale shadow of doubt on the growth spurred by increased household spending.

In Europe, signs of economic divergence appeared. While the picture appeared to brighten in parts of Europe, news of the U.K.'s declining GDP (down 0.2%), of Spain's unemployment rate approaching 20% and of Greece's credit-rating downgrades were clear signals that broad swaths of the eurozone were still feeling the pressure of economic uncertainty.

That being said, equity markets in general delivered positive returns in the fourth quarter of 2009, continuing the rally that began in March. In local-currency terms, the S&P 500 Index gained 6.0% and the Dow Jones Industrial Average rose 8.1. In the U.K., the benchmark FTSE 100 Index grew 6.2%. In continental Europe, the German DAX Index was up 5.0% and the French CAC 40 Index gained 4.3%. In the Asia-Pacific region, the Hong Kong Hang Seng Index grew 6.2% and the Shanghai SE Composite, in China, rocketed up 17.9%. In Latin America, Brazil's Bovespa Index climbed 10.7%. Back home in Canada, the S&P/TSX Composite Index rose 3.9% despite the poor showing from financials, down 0.7% for the quarter.

Turning to commodities, the price of crude oil ebbed and flowed, dipping below US\$70 (on news of bulging inventories) and then rising above US\$80 (on hopes of economic recovery) before settling at US\$79.36 per barrel by quarter-end. The volatile price of natural gas ended the quarter at US\$5.572 per million BTUs, down a marginal 0.9% in 2009. During the quarter, gold ascended to a high of US\$1,215.70 a troy ounce on U.S.-dollar concerns and news such as India's purchase of 200 tons of bullion from the International Monetary Fund, but descended to US\$1,095 by period's end. The Canadian dollar continued to inch toward parity with the greenback, nearing US\$0.96 by December 31. The price of copper dipped in the fourth quarter but finished the period at a 2009 high of US\$3.3275 a pound, up 139% for the year.

In fixed-income markets, Canadian government bond yields rose across all maturities over the quarter with the exception of six-month Treasury Bills: five-year bond yields increased by 19 basis points (bps) to 2.77%; 10-year yields were higher by 30 bps to 3.61%; and 30-year maturities rose by 24 bps to 4.08%.

The investment-grade corporate bond sector continued to improve in the fourth quarter, albeit at a slower pace than over the previous two quarters as many companies face challenges in deleveraging their balance sheets. High-yield credit spreads continued to narrow, falling from 724 bps over government bonds at the end of the third quarter to 566 bps by December 31. They are currently within their long-term historical range of 425 bps to 650 bps, yet still offer attractive returns over a full credit cycle.



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### Trimark Fund

Gross returns as at December 31, 2009 were as follows:

	Q4	1 Yr	2 Yr	4 Yr	10 Yr
<b>Trimark Fund</b>	3.72%	12.19%	-9.81%	-0.92%	3.87%
<b>MSCI World</b>	1.65%	10.39%	-9.52%	-2.45%	-3.44%
<b>+/-</b>	<b>2.07%</b>	<b>1.80%</b>	<b>-0.29%</b>	<b>1.53%</b>	<b>7.31%</b>

The Fund's outperformance in the 4<sup>th</sup> quarter can be attributed primarily to a lower-than-market weighting in the financials sector, the index's worst performing sector. Currency detracted about 210 basis points from Fund performance during the quarter.

### Key Contributors

- Microsoft Corp., the world's largest software company
- Nestlé S.A., the world's largest food and beverage company
- Diageo PLC, the world's largest premium alcohol beverage business

### Key Detractors

- Nokia Oyj, a world leader in mobile communications that has a dominant share of the worldwide handset market outside the U.S. While the mobile handset industry is maturing and will continue to be a reliable core business for Nokia, the company is investing heavily in mobile internet and services; leveraging its scale advantage in handsets and distribution – particularly in developing markets – to transform the shape of its business in the years to come
- ALK-Abelló A/S is a world leader in allergy vaccination (immunotherapy). The company is currently investing heavily in research & development and marketing to support new products, which is simultaneously understating profitability in the short term while increasing the long-term intrinsic value of the company

### Portfolio Activity

- The portfolio management team sold the Fund's entire position in 3M Co. on valuation concerns. The team also sold the Fund's position in Grupo Televisa S.A. de C.V. - ADR and Medtronic, Inc. to pursue what it believes are better long-term investment opportunities elsewhere
- A new addition to the Fund was China Mobile (Hong Kong) Ltd., a dominant mobile telecommunications operator in China, a country with the single largest (yet largely underpenetrated) mobile market in the world. The company operates the world's largest and best-quality mobile networks

### Outlook

The portfolio management team will continue to apply the discipline of thinking independently, thoroughly researching companies from the ground up, and only purchasing an ownership interest in a company when there is an acceptable margin of safety for stakeholders.

The portfolio management team believes the current portfolio is the most attractive composition of businesses that Trimark Fund has held in at least a decade.



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The team has made a conscious effort to ensure the companies held in the Fund have long-term business fundamentals that are sustainable. A critical feature of sustainable business fundamentals is limited dependence on the various stimulus policies that are, by definition, transitory influences on business operations. We refer to "limited dependence" because, ultimately, the sheer enormity of the stimulus packages employed will have a far-reaching indirect impact on every company to varying degrees. Most, if not all, of the companies in the Fund have the financial resources, unique franchises, and competitive advantages to provide them with abundant autonomy. This contrasts with those companies whose fortunes are contingent upon ultra-low interest rates and/or targeted or general fiscal stimulus.

As for the overall investment environment, the portfolio management team considers "cautious optimism" to be the right frame of mind. Large uncertainties loom, and the team maintains its position that a "normal" recovery is an unreasonable expectation given the severity of the combined economic and financial crisis. It's hard to believe these events occurred just a short 12 months ago. Common sense (if there is such a thing) seems to dictate that since the crisis itself was unprecedented and the stimulus employed to counter it was also unprecedented, than the outcome of that combination will also be something close to unprecedented. The team is not forming a judgment as to whether that is good or bad, just noting that the future is simply too uncertain for anyone to ascertain.

The portfolio management team is somewhat concerned that the current market is displaying the same kind of behaviour it did in 2007 and early 2008, with a narrow set of stocks (mainly commodities and global cyclicals) driving the market higher at the expense of almost everything else. The apparent propensity for risk taking is once again disconcerting.



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### Trimark Canadian Fund

Gross returns as at December 31, 2009 were as follows:

	<b>Q4</b>	<b>1 Yr</b>	<b>2 Yr</b>	<b>4 Yr</b>	<b>10 Yr</b>
<b>Trimark Canadian Fund</b>	6.53%	39.15%	1.24%	2.81%	6.91%
<b>65% S&amp;P/TSX, 35% MSCI World</b>	3.10%	26.19%	-6.24%	1.85%	2.53%
<b>+/-</b>	<b>3.43%</b>	<b>12.96%</b>	<b>7.48%</b>	<b>0.96%</b>	<b>4.38%</b>

The fund significantly outperformed its benchmark during the 4<sup>th</sup> quarter and throughout the calendar year of 2009. The pace of equity market gains slowed from the previous two quarters; however, the markets still delivered positive gains over the fourth quarter.

### Key contributors

- The top contributors to Fund performance in the fourth quarter included MacDonald, Dettwiler and Associates Ltd.; Toromont Industries Ltd.; and Alimentation Couche-Tard Inc.
- The improving U.K. housing market benefitted the share price of MacDonald, Dettwiler. Increasing sales and improved cost controls helped lift the shares of Alimentation Couche-Tard

### Key detractors

- Key detractors from Fund performance included Ubisoft Entertainment S.A., Manulife Financial Corp. and Willis Group Holdings Ltd.
- Ubisoft Entertainment develops, publishes and distributes video games. The company is the third largest video game publisher in the world. The gaming industry has experienced weaker console sales in 2009 after experiencing strong sales in 2008 and the company was added to the Fund as its share price declined to attractive levels
- Manulife Financial continued to suffer from negative sentiment after the company cut its dividend and raised equity earlier in the year

### Portfolio activity

- During the period, new positions to the Fund included, Boston Scientific Corporation and Ubisoft Entertainment
- Boston Scientific develops manufacturers and markets medical devices. The company recently appointed a new CEO and CFO to lead the businesses turnaround
- Positions that were sold from the portfolio included CBS Corp. and Domtar Corp. which were sold in favour of better relative value opportunities
- The Fund's geographic allocations remained relatively unchanged over the quarter. Foreign investment accounted for approximately 29% of the portfolio as at December 31, 2009. The Fund's cash weighting ended the period at 0.73% (down from 2% at the start of the period)



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### **Outlook**

The portfolio management team believes the Fund is well positioned for growth in an improving economy, while also providing a strong margin of safety in a slower or negative economic growth environment.

Although valuations are considerably higher than earlier in the year, the portfolio management team believes equity markets still offer attractive opportunities, and the team is currently in the process of adding new businesses to the Fund.

The team remains patient and committed to investing in excellent businesses with strong growth prospects that are trading at attractive prices.



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### Trimark Income Growth Fund

Gross returns as at December 31, 2009 were as follows:

	Q4	1 Yr	2 Yr	4 Yr	10 Yr
<b>Trimark Income Growth Fund</b>	2.59%	19.69%	0.93%	2.22%	8.13%
<b>35% S&amp;P/TSX, 25% MSCI World, 35% Dex Universe, 5% 91-Day T-Bill</b>	1.74%	16.56%	-1.52%	2.97%	3.88%
<b>+/-</b>	<b>0.85%</b>	<b>3.13%</b>	<b>2.45%</b>	<b>-0.75%</b>	<b>4.25%</b>

The Fund's holdings in the financials and healthcare sectors outperformed those of the benchmark, which contributed to its relative outperformance. A lower weighting in the materials sector versus the benchmark detracted from the Fund's relative performance, as this sector outperformed in the quarter

### Equity Portfolio

#### Key contributors

- Medtronic, a leading U.S. healthcare company, has produced strong operating results despite tough economic conditions. The company's management is focused on integrating the company's business segments to generate stronger returns for shareholders, and Medtronic's stock price has risen in response to recent results
- Toromont's share price reacted favourably to the company's decision to launch a takeover bid for Enerflex Systems Income Fund, Toromont's largest competitor in the Canadian gas compression industry. Enerflex will help Toromont gain increased international exposure, and the takeover creates opportunities for cost savings

#### Key detractors

- Manulife raised additional capital through an equity offering that was dilutive to shareholders. This move was needed to improve the company's capital ratios. The portfolio management team believes Manulife's new Chief Executive Officer will run the business more conservatively going forward and that the stock is currently trading at attractive valuations
- Veolia Environnement S.A. has experienced depressed operating results, with the economic downturn negatively impacting the company's sales volumes in its industrial waste segment

#### Portfolio activity

- Heineken Holding N.V. and Groupe Aeroplan Inc. were new buys for the Fund in the fourth quarter
- The McGraw-Hill Cos., Inc.; Arc Energy Trust; and TransCanada Corp. were sold to redeploy capital to what the portfolio management team believes are relatively more attractive investment opportunities elsewhere

### Fixed Income Portfolio

- The Fund benefited from its fixed income portfolio's relatively heavy weighting in corporate bonds, which outperformed government bonds.
- Despite the strong performance of the corporate and high yield bond sectors, corporate credit continues to look attractive relative to government bonds



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### **Outlook**

Global equity markets posted positive returns in the fourth quarter, and recovered from their lows in early 2009 to post strong gains over the full year. Despite the strong recovery in equity markets, the portfolio management team is very pleased with how the portfolio is positioned from a risk/reward perspective.

There are concerns of a weak recovery or the possibility of rising rates and inflation that are weighing on equity markets. As such the portfolio management team expects some continued volatility. However, the portfolio is invested in high-quality, market-leading businesses that the team expects will perform strongly over a full economic cycle, and the Fund stays well diversified by industry to mitigate overexposure to any one business risk.

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### **Contact us**

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