TONUS CAPITAL INC.

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THIRD QUARTER 2011 - NEWSLETTER

TONUS SELECT FUND

Dear Partner,

We are pleased to send you this portfolio performance and review, along with commentary, for the third quarter of 2011.

PERFOMANCE REVIEW

During the third quarter of 2011, the Tonus Select Fund declined -**4.46%**. Over the same period, the S&P/TSX Total Return decreased **-12.02%** and the S&P 500 (in U.S. dollars) fell **-13.87%**. The Canadian dollar lost approximately **7%** against the U.S. dollar, and this impacted our performance positively.

On a year-to-date basis, the Fund was down **-8.27%**, against **-11.88%** and **-8.68%**, respectively, for the S&P/TSX TR and the S&P 500 TR.

Since the Fund’s inception in October 2007, we have achieved a compound rate of return of **1.12%**, compared with **-2.90%** for the S&P/TSX TR and **-5.64%** for the S&P 500 TR.

PORTFOLIO REVIEW

We mentioned in our 2011Q2 letter that we were not thrilled by our first-half performance but that at least we had been able to deploy some of our cash in mid-June when the market showed some weakness. As the correction was short-lived, we had hoped for further market volatility, as this would afford opportunities to put more of our liquidity to good use.

Needless to say our wish was granted. Indeed, the deep market swings witnessed in Q3 served us well. The first week of August was our busiest ever by far as we invested 25% of our cash to acquire new positions or increase the weight of existing holdings that we deemed too cheap to pass up. After this buying spree, we stayed quiet for a few weeks but the European sovereign debt crisis kept sapping stock markets around the world. This gave us the chance to deploy more cash at the end of September. As a result, we are presently over 80% invested, a new high for us.

Performance wise, while most North American market indexes declined 10% to 20% over the quarter, we were hit less hard than most by the correction, registering a loss of 4.46%. The markets are extremely nervous right now and nobody knows for sure when they will ultimately strike bottom. Bearing this in mind, we prefer to buy a little sooner than later on the conviction that the stocks we pick are trading at such an appealing valuation at time of purchase that they will bounce back with a vengeance as soon as investors begin to shift their focus from top-down concerns to bottom-up fundamentals.

We added four core holdings during the quarter: **Wyndham Worldwide Corp. (WYN – $28.51), Valassis Communications Inc. (VCI – $18.74), Liberty Interactive Corp. (LINTA – $14.76)** and, finally, **Brown and Brown Inc. (BRO – $17.80)**.

The first three have a particular attribute in common. Each went into the financial crisis of 2008 overly leveraged and, as a result, suffered dearly when the capital market choked up and most investors thought it would be impossible for them to refinance their huge debt load. In November 2008, Wyndham, Valassis and Liberty Media bottomed out, respectively, 92%, 91% and 93% below their 2007 peaks! They have all recovered since and learned a hard lesson about excessive dependence on debt.

We believe that we were able to accumulate shares in these names at bargain prices because of investor misperception. Many people often take a rear-view mirror approach to investing and the extreme volatility we are experiencing right now elicits a sense of *déjà vu*. When they stare at charts of companies such as these and see the brutal price collapse of 2008, they have a tendency to back off for fear of seeing a repeat of that situation if the economic outlook continues to deteriorate. However, a chart is only the reflection of historical price movements and says nothing about a company's fundamentals or how it has evolved, especially if it covers only a short time span.

If investors instead compared the current balance sheets of WYN, VCI and LINTA against those for 2008, they would have a lot less reason to be nervous about investing in these companies today as they might have had a few years ago. At the end of 2008, WYN, VCI and LINTA had debt-to-EBITDA ratios of 2.1x, 5.2x and 2.8x, respectively, compared with 1.9, 1.8x and 0.8x today. What's more, as a further indication of the strength of the businesses underlying these companies, none accomplished this feat by issuing more stock. Indeed, in all three cases, the debt burden was lowered primarily thanks to strong free cash flow generation.

For the sake of brevity, we will limit ourselves to say that each of these new names is a leader in its field, that it boasts a management team focused on creating shareholder value over time, and that we acquired the stock when it was trading at very low valuation.

As for the other core position we established, Brown and Brown was our most significant buy and already accounts for about 7% of our portfolio. We are very well acquainted with this Florida-based insurance broker for having held its stock until early 2009. BRO is the best run publicly traded insurance broker in America as evidenced by a long history of superior profitability and strong organic growth.

This enviable track record has made BRO a favourite among investors. However, we felt that the valuation premium the market was giving the company in 2009 was no longer justified. As an insurance broker, BRO receives commissions based on the size of the policies it places for underwriters. If insurance premiums decline, this has a direct impact on BRO's top line. In a weak pricing environment such as has prevailed in the past few years, the company would have had to drum up more business in order to compensate for soft pricing, a tall order in a time of recession. Moreover, BRO had a large presence in Florida and California, two states where the downturn was extremely deep. After we sold our position in 2009, the stock continued to trade at a significant premium despite the firm's negative organic growth. However, after the company released disappointing Q2 results in July, investors began reassessing their estimates and the stock proceeded to drop by more than 30%. This afforded the opportunity to buy shares at below intrinsic value, a truly rare event in the company's history. In our opinion, the next few quarters should be sub-par as well for BRO, but after 18 straight quarters of negative organic growth, we feel the company is poised to turn the corner. The leverage of positive internal growth should be significant given that the company is very lean on the cost side and that extra revenue generated will flow to the bottom line at very high margins. It is important to mention that even if the company has shown negative organic growth in the past four years, its strategy of acquiring smaller insurance brokers has translated into positive total revenue growth in all but one of these.

The stocks whose weight we increased most during the quarter were **Comcast Corp. (CMCSK – $20.72), Berkshire Hathaway Inc. (BRK.B – $71.04)** and **Jacobs Engineering Group Inc. (JEC – $32.29)**.

We added to Comcast in the low $20s and the company is back now as our largest position. As for Berkshire, we felt the stock was a real steal at below $70.00. We were quite lucky to buy shares two days before Buffett announced a share buyback. The stock reacted positively to the news, rebounding to above $70.00. We believe there is more upside potential yet as investors might very well be surprised by the magnitude of the buyback Buffett is prepared to implement if the stock continues to trade at a premium of 10% or less over book value. Buffett has stated on many occasions in the past that a buyback makes a real contribution to a company's intrinsic value only if it is substantial and executed when stock is trading at a significant discount to intrinsic value. In his press release, he made it clear that there was no dollar limit on the quantity of shares he would acquire as long as cash reserves remained above $20 billion. Last quarter, Berkshire held more than $70 billion in cash and short-term bonds. With this vast amount of liquidity, Buffet is in a position to implement an immense share buyback without any constraint other than the price he is willing to pay.

We also more than doubled our weight in Jacobs Engineering. We started to accumulate shares in December 2009 but never had the chance to build a full position as the stock shot up soon after we began buying. Patience is a virtue, however, and in the course of this past quarter we were able to complete our position when the stock fell more than 30% from its high of last spring. JEC is a stellar company in the same league as Brown and Brown, with a long track record of growth and high return on capital.

Finally, we have little to report on the sell side. The only significant divestment regarded **Lender Processing Services Inc. (LPS – $13.11)**, which we mentioned in our previous quarterly letter. The position now represents less than 1% of our holdings and we will continue to liquidate when the price is right.

COMMENTARY

Following the significant position we took in Brown and Brown, four of our five largest holdings are insurance related stocks. Combined, they make up 37% of our total portfolio. We considered it important to point this out to you and to explain why we felt comfortable with such concentration in one industry.

Essentially, even though **Chubb Corp. (CB – $57.92)**, Berkshire Hathaway, **Primerica Inc. (PRI – $21.56)** and Brown and Brown are all insurance-related companies, their business drivers are not exactly the same, which means that outcomes would likely be different in the event of the unforeseeable. For instance, a large natural disaster would certainly impact CB and BRK over the short term as both are P&C insurers. However, this would have little effect on PRI, a term life insurance company, and would potentially benefit BRO, an insurance broker, as premium pricing typically rise after a major catastrophe.

As for balance sheet risk, PRI and BRK are not exposed to U.S. municipal bonds in any material way. CB does have a large exposure to these but it holds a very small amount of equity investments compared with BRK. BRO faces no such balance sheet risk as it does not manage a float. However, all these companies have two things in common, namely, an incredible track record of creating shareholder value without taking any unwanted risk and the fact that we were able to acquire the stock at bargain basement prices.

There is an unwanted risk in this case: the high level of short-term price correlation. However, this is a risk that threatens money manager bonuses, not genuine long-term investors like us. Indeed, over the short run, the stock prices of these companies tend to move in sync, which means that we could seriously under-perform the market if they stayed out of favour for a longer period than warranted. However, we are committed to think and act like long-term investors and not like money managers spurred by the promise of a yearend bonus. Our large commitment of capital in these four names proves our willingness to accept the risk of short-term under-performance in exchange for long-term top-quartile results.

Sincerely,

Steve Boutin, CFA

Philippe Hynes, CFA

Tonus Select Fund Performance Report
As at September 30, 2011

Tonus Select Fund : Class A shares	**Unit Value**
Current Quarter	101.9639
Previous Quarter	106.7235

Date	**Tonus Select Fund Return**	**S&P/TSX Total Return**	**S&P 500 Total Return ($US)**
1 Month	-0.32%	-8.66%	-7.03%
3 Month	-4.46%	-12.02%	-13.87%
6 Month	-7.67%	-16.55%	-13.78%
Year-to-Date	-8.27%	-11.88%	-8.68%
1 Year	-3.00%	-3.55%	1.14%
2 Years*	3.32%	3.75%	5.56%
3 Years*	-0.25%	2.66%	1.23%
Since Inception* (Oct. 31, 2007)	1.12%	-2.90%	-5.64%

Source: Bloomberg Finance L.P.
All returns are net of fees.
* Please note that all returns greater than one year are annualized.

Investors should carefully consider the Fund's investment objectives, risks, and charges and expenses before investing. This and other important information is contained in the Fund's offering memorandum.

Portfolio composition is subject to change at any time and reference in this letter to specific securities, industries, and sectors should not be construed as a recommendation to purchase or sell any particular security. Current and future portfolio holdings are subject to risk. The Fund is not guaranteed; its value changes frequently and past performance may not be repeated.