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FIRST QUARTER 2010 - NEWSLETTER

TONUS SELECT FUND

Dear Partner,

We are pleased to send you this portfolio performance and review, along with commentary, for the first quarter of 2010.

PERFOMANCE REVIEW

During the first quarter of 2010, the Tonus Select Fund grew 5.89%. Over the same period, the S&P/TSX Total Return rose 3.14% and the S&P 500 (in U.S. dollars) climbed 5.39%. The Canadian dollar registered another strong quarter, gaining 3% on the U.S. dollar, and this impacted our performance negatively.

Since the Fund's inception in October 2007, we have achieved a compound rate of return of 2.54%, compared with -4.85% and -8.87% for the S&P/TSX and the S&P 500, respectively.

PORTFOLIO REVIEW

In the first quarter we acquired three new holdings and sold out one. We also significantly increased the weight of two existing positions in our portfolio.

Though **Berkshire Hathaway Inc. (BRK.B - $81.27)** was already one of our largest holdings at the end of 2009, we decided to almost double our position in early January, bringing its weight up to 10%. Berkshire had been in the portfolio since November 2008 and we felt strongly that the market had not yet recognized its full value.

It is hard to believe that a corporation as large and well known as Berkshire is still misunderstood by many investors. The company is not unlike a classic novel in that everyone knows the story, but very few people have actually read the book. After years of talking with Berkshire shareholders and self-proclaimed experts, we have come to realize that very few bother to truly scrutinize the full annual report; most focus solely on the Chairman's letter. At Tonus, we enjoy reading the 10K as much as we do Buffett's annual message to shareholders. Even if Berkshire is big, Buffett does the reporting in such a way that arriving at a valuation for the entire company is not a hard and painful process. Our decision to double up on our position could not have been timelier as the stock jumped more than 20% a few days after our purchase. Though we did sell some shares after the ramp-up, Berkshire remains one of our top holdings.

The other company whose weight we increased significantly is the recently demutualized P&C insurer **Penn Miller Holding Corp. (PMIC - $12.15)**. This, too, proved a timely buy for us. After the company released its Q4 results and published its 10K, investors realized how cheap the stock was and bid up its price.

The company disclosed a book value above $21 at yearend and, even though Penn Miller had been trading publicly for less than three months, management had already bought back 4% of its shares outstanding at an average price of $10.18! Though we already hold a large position in PMIC (about 7% of our portfolio), we think its stock price is still attractive.

We are not quite done talking about insurance stocks, as we made another substantial buy in the sector by acquiring shares in **Chubb Corp. (CB - $51.85)** during the quarter. As a bottom-up stock picker, we go where we find value and, at present, we find there are mispriced opportunities in the P&C industry.

Chubb is the sort of insurance company we like. Management has demonstrated over a long period of time that they know how to assess risk properly. If the terms and conditions of coverage are not satisfactory, they are prepared to walk away. This explains in large part why the company's earned premium (revenue for insurance companies) did not grow at all from 2004 to 2009. Over this period, as pricing in the P&C market declined markedly, good insurers such as Chubb preferred to give up business if they were not paid enough for the level of risk they assumed. Instead of using their surplus capital to write more premiums, management returned a good portion of it to shareholders. Since 2005, they have bought back $5 billion of their stock, which represents 20% of shares outstanding. Over this same period, Chubb also distributed almost $2 billion in dividends. Giving back a total of $7 billion to shareholders in the past five years in the light of the fact that Chubb's current market capitalization stands at only $17 billion shows the magnitude of the capital return to its shareholders. Even after returning all this capital, the company is still very well capitalized, boasting a very reasonable debt-to-capital ratio of 20%. Moreover, Chubb still holds plenty of liquidity to continue buying back stock and paying out dividends.

One of the most important metrics to evaluate an insurance company over the long term is the growth of its float and the cost to acquire it. Chubb scores very well in this regard. The company has grown its float approximately 8% over the past 15 years. In this period, the company had a combined ratio above 100% in only three years, namely, 2000, 2001 and 2002. Losses in those years stemmed largely from insufficient reserves to cover future asbestos settlements and claims paid out following the attacks of September 11.

Incidentally, just two days after September 11, Chubb was the first insurance company to announce that terrorism was not excluded under its policies, that it would not seek to apply the war-risk exclusion and that they had already begun paying out claims. This is another one of Chubb's features not fully recognized by investors: Its great reputation for service and its promptness in settling claims. About one third of Chubb's business is personal insurance for wealthy homeowners. Many of Chubb's policyholders are ready to pay higher premiums because they know that they will be paid fast should they make a claim. In doing our due diligence, we talked to the CEO of a large insurance brokerage firm. He told us that, while Chubb was great to do business with at the corporate level, it was simply outstanding at the customer level. He spoke from experience, as he himself took out his personal homeowner's insurance with Chubb.

On a price-to-book basis, Chubb has not been this attractive for years. Its stock is presently trading at about 1.1 times book value. Historically, it has traded closer to 1.5 times and even vaulted above twice book value more than once. Many investors have been shunning the insurance sector on account of the soft market and lack of growth that the industry currently faces. Though premiums have been declining for the past few years, most insurers have still managed to register high profitability thanks in large part to reserve releases from previous years. However, as this trend has essentially reached the end of the line, the impact on profitability will certainly be evident going forward. Moreover, insurers have been fortunate not to have been hit by any major catastrophes in recent years and this has certainly contributed to their bottom line. However, their luck seems to have run out in 2010, as a number of natural disasters have already occurred so far, including the earthquake in Chile and winter storm Xynthia in Europe.

Consequently, it will be hard to repeat the record profits of the past few years without increasing premium prices. So far this year, though, pricing remains soft. This said, we believe that the situation is already amply reflected in Chubb's current stock price and that the company represents an investment with a very favourable risk/reward ratio for those who know the virtue of patience.

We also added two new U.S. holdings to our portfolio. As we do not have full position yet, we will refrain from disclosing their names at this point in time.

On the other side, we sold out our holdings in **Saga Communications (SAGA - $22.64)**. Like many other small, illiquid companies, Saga had an incredible run since the start of the year, with its stock shooting up more than 80%. In 12 months it has soared almost 500%. Saga's management discipline and financial conservatism, which we have always appreciated, helped them get through the incredibly difficult radio market of recent years. A number of more aggressive competitors were forced to file for Chapter 11 protection under the burden of their heavy debt. Furthermore, we always believed that SAGA's strategy to focus on smaller markets was the right way to go. In fact, these did a lot better than top-revenue markets over the course of the past downturn. So why did we sell our position? The reasons are three. First, though we believe that the radio industry will not undergo the same brutal decline as newspapers, we underestimated the impact of the iPod and like products on the industry and on the music-listening habits of consumers. This new technology constitutes a much more daunting foe for radio operators to combat over the long term than initially imagined. Second, though at less than 5 times free cash flow Saga may still look cheap from a valuation perspective, the company has benefitted from a couple of factors that quite simply will not last forever. On the one hand, as Saga borrows variable, the low interest-rate environment has allowed the company to pay less for its debt. With an almost identical debt level, Saga paid 45% less interest in 2009 compared with 2007. This represents a non-negligible saving of almost $1.00 per share pre-tax! On the other hand, the company shrank its capital expenditure budget by more than 50% in the past two years. In future the company will need to step up its spending in this regard in order to begin growing again. Third and last, in the communication sector, there is better value to be found in larger companies such as Comcast Corp.

COMMENTARY

U.S. small caps continue their incredible ascent

As mentioned in the past, we are having a great deal of difficulty finding value in U.S. small caps. The trend has yet to turn around, as U.S. small caps continue to outperform by a long stretch their large-cap counterparts this year. The Russell 2000 index is up 8.5% already in the first quarter, against 4.9% for the S&P 500.

Let us take Chubb Corp., our recent buy, to illustrate some of the valuation disconnect between U.S. small and large caps. If we compare it with RLI Corp., an insurance company with a market cap of about $1.2 billion that we are very familiar with, you will see what we mean immediately. RLI shares many of Chubb's characteristics and we would gladly purchase its stock at the right valuation. RLI is an excellent underwriter, consistently maintaining a combined ratio below 100%, and it manages its capital very efficiently. At the end of 2000, RLI sold at 1.3 times book value and Chubb at 2.2 times. Clearly, RLI was trading at a discount compared with Chubb. At the end of 2009, however, the situation had completely reversed. RLI was trading at a premium versus Chubb, with a price-to-book ratio of 1.4 versus 1, respectively.

Now, if RLI actually outperformed Chubb from 2000 to 2009, then it would justifiably deserve a higher valuation today. Instead, during this period, the two companies grew their float approximately 9% a year and, in terms of book value, both posted a compound growth rate of about 10%.

Consequently, we fail to see why investors would attribute a 40% discount to Chubb versus RLI. After all, they present the same profile in terms of underwriting discipline and they have grown at the same pace. This example demonstrates perfectly well what we come up against day in day out when we analyze U.S. small caps. There is often larger companies with similar growth attributes that we can buy at a discount. We have not hesitated to invest in U.S. small caps in the past as we took an interested pleasure in discovering little gems that few investors bothered to analyze. However, if the price is not right, we will seek opportunity elsewhere. Today, that happens to be in U.S. large caps.

Sincerely,

Steve Boutin, CFA Philippe Hynes, CFA

Investors should consider carefully the investment objectives, risks, and charges and expenses of the Fund before investing. Important information about the Fund is contained in the Offering Memorandum, which should be read carefully before investing.

Portfolio composition is subject to change at any time and references to specific securities, industries, and sectors referenced in this letter are not recommendations 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.