CI Value Trust Corporate Class
July 2008
Market Commentary

On the surface, the performance of the market in July looked like more of the same, another weak month in an already weak year. Under the surface, though, important changes were afoot that we believe could mark the beginning of a change in the character of the market that we have been anticipating since the start of the year.

July began much as June had left off, with oil strong and the financials weak. But following the Fourth of July holiday, an odd thing happened: oil prices started to fall, and continued to fall with only brief rallies through month-end. A broad range of commodities joined oil on the downside, as the Jefferies-Reuters CRB index, a global commodities benchmark, lost -10% in July, its largest monthly decline since March 1980. Oil stocks, too, followed suit with the S&P 500 energy sector posting a 13.94% decline for the month, its worst monthly showing since October 1987. Meanwhile, the S&P 500 financials, after starting the month weakly, turned sharply on July 15 to finish July up 7.16%, best among S&P 500 sectors, and the financials' best monthly showing since April 2003.

In our opinion, a key question for investors is whether the reversal in the fortunes of the energy and financial stocks in July marks a change in market leadership, or merely a correction in an ongoing bull market for energy stocks and a counter-trend rally in an ongoing bear market for financial stocks. Similar reversals in January and March 2008, which we thought might mark a turning point, proved only temporary. Our belief is that the reversal this time around could prove to be more long-lasting. Our case in support of that belief is the primary focus of this month's commentary.

Total Returns[1] (in U.S. dollars)

	July	YTD
S&P 500 Index	-0.84%	-12.65%
Dow Industrials	+0.43%	-13.00%
Nasdaq Composite	+1.46%	-11.92%
S&P Mid-Cap	-1.85%	-5.68%
Russell 2000 Index	+3.70%	-6.02%
Wilshire 5000	-0.86%	-11.69%
S&P 100 Index	+0.68%	-13.62%
Russell 1000 Growth Index	-1.90%	-10.79%
Russell 1000 Value Index	-0.36%	-13.88%

In our view, oil's move on the upside and the financials move on the downside became so stretched in July that some snap back in both was almost inevitable. Market technician John Mendelson noted that at its early July peak of $147.27, the near-month crude oil futures price was further above its 200-day moving average than at any time since the run in crude began in April 2003. Ned Davis called it a seven-standard-deviation event. On the downside, on July 15, the S&P 500 financials sector reached

[1] Source: Bloomberg, Wilshire, Russell

its second-most-oversold condition since 1962, exceeded only slightly by the oversold reading following the Crash of 1987, according to Birinyi Associates. From this depressed level, the S&P 500 Financials sector staged an explosive rally, rising +30.8% in six trading days. We regard this move as significant, as we will discuss more fully in the Outlook section. We believe July 15 will prove to have marked an important bottom for financial stocks.

While technical factors can play an important role in the short-term pricing of stocks or commodities, ultimately prices are driven by underlying fundamentals. We believe the underlying fundamentals of the energy market argue for a continued decline in the price of oil to the $90 to $100 level in the next six months or so, while signs of capitulation and very attractive valuation levels argue for higher stock prices in the financial sector.

We documented evidence of declining U.S. oil demand in our June monthly. According to Empirical Research, vehicle miles traveled dropped -2.25% in April 2008 from a year before, just short of the record decline of 1974. In total, U.S. demand seems to be down about 900,000 barrels per day in 2008 from 2007 levels. Demand also appears to be dropping in Europe and Japan. Until July, weaker demand from developed countries was more than offset by increases in demand from emerging market economies in the Middle East and Asia. In recent weeks, we see growing evidence of a global slowdown that could begin to impact oil demand in emerging market countries as well. Partial or complete lifting of oil subsidies in these countries could exacerbate the decline, in our opinion. The global slowdown shows up clearly in ISI Group’s Global Economic Diffusion Index, which on August 4 dropped to a reading of -16.2, below the low reading of the recession of 2001. ISI’s Diffusion index comprises about 150 weekly readings taken across 38 countries, measuring whether conditions are worsening or improving. The index shows evidence of widespread economic weakness in both developed and emerging market countries. Oil prices may be responding to these signs of weakness.

The outlook for growth in China is particularly important to the outlook for oil and other commodities prices and, here too, we see growing signs of a slowdown. We have previously noted the monetary tightening regime that the People’s Bank of China has had in place since mid-2006. Those tightening measures in conjunction with a fairly significant rise in the value of the Chinese yuan versus the U.S. dollar have acted to slow Chinese export growth to the G3 (U.S., Europe, and Japan) from +30% in 2004 to near zero recently. Chinese policy makers now seem concerned enough that a slowdown may be taking hold that they acted recently at a Politburo meeting on July 25 to replace existing national goals with new targets. As enunciated by President Hu Jintao in recent appearances, China’s policy objectives have shifted from preventing overheating of the economy and controlling inflation to seeking sustained economic growth while keeping inflation under control. In our opinion, the latest policy shift may act to limit the slowdown in Chinese GDP growth to a few percentage points, but it will not be sufficient to completely offset the effects of two years of monetary tightening, coupled with the natural tendency of host country economies to slow after the Olympics. Our bet is that the slowdown in China will continue, with dampening effects on the demand for oil and other commodities.

Portfolio Performance

CI Value Trust Corporate Class underperformed the S&P 500 Index marginally in the month of July, losing 0.5% versus 0.15% loss for the index in Canadian dollars.

Top and Bottom Contributors July 08

Top Contributors

	Ticker	Return	Weight	Impact
1	AMGN	32.76	2.49	0.82
2	JPM	20.16	4.03	0.81
3	C	13.43	3.81	0.51
4	BAC	37.83	1.29	0.49
5	SHLD	9.89	3.60	0.36
6	UNH	6.92	4.27	0.30
7	IBM	8.07	3.54	0.29
8	AMZN	3.85	7.12	0.27
9	GE	5.95	3.99	0.24
10	COF	10.30	1.93	0.20

Biotech company Amgen surged to the top spot in July with an impressive return of nearly 33%. With the sales trend for its anemia drugs Aranesp and Epogen showing signs of stabilizing and the FDA label change for Aranesp less onerous than feared, the company finally may be coming out of the gloom of the anemia franchise erosion that has overhung it for the past two years. At the same time, encouraging Phase III testing results for its osteoporosis and cancer drug candidate Denosumab refocused investors' attention on Amgen's strong yet underappreciated drug pipeline. The company's stronger-than-expected second-quarter results and increased full-year guidance further engendered investors' confidence.

In a welcome departure from its previous slumps, the financial sector produced four of the top 10 performance contributors in July. The three major banks in your portfolio, JPMorgan Chase, Citigroup and Bank of America, all posted double-digit gains reflecting strong rebounds from their deeply oversold bottoms of July 15. Several common factors seemed to have contributed to their recent strength:

- All three posted second-quarter results that beat analysts' diminished expectations, reflecting higher net interest margins thanks to the steep yield curve, and, in the case of JPMorgan and Bank of America, resilience in investment banking and trading businesses.
- Asset write-downs showed signs of slowing down from the previous quarters, while capital positions remained solid, allaying dilution fears (the Tier-1 capital ratios for JPMorgan, Citi and Bank of America stand at 9.1%, 8.7% and 8.3%, respectively, and Bank of America reaffirmed its dividend while replenishing its share buyback authorization).

- In an emergency ruling, the SEC on July 15 eliminated "naked short selling" in 19 major financial stocks, including the above three large banks, highlighting policymakers' resolve to bring stability back to the financial markets. The rule was subsequently extended to August 12.

Even after July's rebound, the three banks are commanding an average of merely ten times 2009 forward P/E and one times P/B, while offering an average dividend yield of 6% vs. the 4% yield on the 10-year Treasury.

Such low valuations can become their own catalysts. As such, share prices could rebound from depressed levels with no aid from positive news (or even in spite of negative news). The second-quarter revenue and earnings miss at Capital One, for instance, did not prevent its shares from appreciating 10% for the month, as the increased losses in its credit card and auto loan portfolios have already been discounted. In the meantime, the company continues to build capital while generating a respectable return in the high teens on its tangible equity. Another example last month was Sears Holdings, the retailer that investors love to hate (not a single Wall Street analyst gives the company a "Buy" or "Outperform" rating, according to Reuters). With no company-specific news and against continued macroeconomic headwinds, its shares registered a 10% appreciation in July. They are still trading below our conservative estimate of its liquidation value. Eddie Lampert, the talented and motivated capital allocator at the helm of Sears' board, apparently has been (mis)judged by the market to be a liability, rather than an asset, to the company.

Bruised managed care provider UnitedHealth began July with a 16% cut in its EPS guidance for the current year and delivered second-quarter results in line with deflated expectations. Yet United's shares climbed 7% for the month thanks to the low expectations embedded in its single-digit P/E and a double-digit free cash flow yield.

Strong international growth powered IBM's second-quarter revenue and earnings past the consensus expectations. The company's increased guidance for full-year earnings, continued share buybacks (it repurchased 2.7% of total shares during the second quarter alone), and upbeat management comments about service revenue growth brought a rare flash of visibility through the macroeconomic gloom, sending Big Blue's shares up 8%. Robust global demand was also a bright spot in General Electric's second quarter, as its international revenue registered double-digit organic growth. Investors were also relieved that no bad news came out of GE Capital. CEO Jeff Immelt continues to optimize GE's business portfolio, selling its consumer finance business in Japan, announcing plans to spin off the struggling consumer & industrial division, and streamlining the company into four segments – energy infrastructure, technology infrastructure, GE Capital and NBC Universal.

Finally, online commerce company Amazon.com reported an outstanding second quarter, with revenues accelerating both at home and abroad while gross and operating margins expanded from last year. The company also increased its full-year revenue guidance, countering investor concerns over slowing consumer spending.

Bottom Contributors

	Ticker	Return	Weight	Impact
1	FRE	-50.17	3.09	-1.55
2	AES	-16.00	9.25	-1.48
3	GOOG	-9.99	4.36	-0.44
4	EBAY	-7.85	4.79	-0.38
5	MER	-15.96	2.09	-0.33
6	TXN	-12.92	2.29	-0.30
7	JCP	-14.91	1.77	-0.26
8	CSCO	-5.50	2.69	-0.15
9	Q	-5.14	2.46	-0.13
10	YHOO	-3.37	3.52	-0.12

Freddie Mac was at the epicenter of the latest bout of the credit scare, where speculation of a government takeover (so called “conservatorship”) pushed its shares down to an intraday low of $3.89 on July 11 from $16.40 at the end of June. In fact, Freddie Mac’s capital levels are not only well above the “critical capital” level that serves as a threshold to conservatorship, but also significantly above the level needed for the company to be deemed “adequately capitalized” by regulators. Any liquidity or insolvency risk is further reduced by the Treasury’s increased credit line support for the government-sponsored enterprises (GSEs), the Fed’s decision to grant them access to the discount window, the OFHEO’s[2] elimination of a previous deadline for Freddie to raise $5.5 billion capital by September, and the SEC’s emergency rule that temporarily limits naked short selling in 19 financial stocks.

Such collective action by policymakers may very well have been a watershed event in market sentiment. Indeed, the S&P 500 Financials Sector Index jumped 25% in the second half of July, while shares of Freddie Mac surged 110% from its July 11 intraday lows over the remainder of July.

Merrill Lynch’s rebound from the July 15 lows, however, was interrupted by its disappointing second-quarter results that brought its trailing-twelve-month earnings loss to a staggering $19.2 billion. In addition to selling its Bloomberg stake for $4.4 billion, Merrill was forced to break its earlier promise of no more equity issuance in 2008 and raised $8.5 billion in capital at dilutive prices. It also “took the big bath” by selling $30 billion (face value) of asset-backed security collateralized-debt obligations (CDOs) to Lone Star Funds at $0.22 on the dollar (vs. the company’s mark of $0.36), and terminated all CDO-related credit default swaps with XL Capital Assurance. These actions had the effect of reducing the company’s net CDO exposure to $1.8 billion while increasing its Tier-1 capital ratio to 10.5%, thereby addressing some of the major concerns overhanging the stock.

In contrast to the frenzy of activities at Merrill, not much happened at global power producer AES Corp. to warrant the 16% drop in its shares in July. Indeed, we believe the long-term value of its assets should continue to rise in a power-constrained world. The company has 40% of its global capacity

[2] Office of Federal Housing Enterprise Oversight, an agency charged with ensuring the capital adequacy and financial safety and soundness of two GSEs.

located in the fast growing "BRIC"[3] countries, and has vast wind, solar and carbon trading opportunities, yet its stock price barely reflects the value of its current project portfolio, in our opinion.

Macroeconomic headwinds are putting the secular growth of e-commerce to the test. While Amazon passed the test with flying colors, quarterly reports out of Google and eBay apparently failed to soothe investors' fears, leading to share price declines in the high-single digits. Google missed the consensus expectations for second-quarter earnings partly due to lower interest income. The company's core paid search business continued to grow at an enviable pace of 31% year-over-year, and strength in international markets helped offset slowdowns in the U.S. and the U.K. At eBay, the anemic increase in gross merchandize value (GMV) growth at 8% year-over-year was at the slowest pace since the first quarter of 1999. But part of the weakness may have reflected a mix shift away from vehicles, which account for 20% of total GMV but only 2% of total revenue. On a unit basis, volume accelerated modestly in eBay's most important markets: U.S., U.K., and Germany. Yahoo!, another detractor in the Internet area, reported an in-line second quarter. Its -3% drop in the month, which masked significant interim volatility, was mostly driven by the continued saga featuring on-and-off talks with Microsoft and agitation from short-term-oriented investors led by Mr. Carl Icahn, who obtained a seat on Yahoo!'s board last month.

Cyclical concerns were evident in the -15% decline in the price of J.C. Penney on the theory that consumers, chastened by the deflated home values and ballooning energy expenditures, would spend their tax-rebate checks at Wal-Mart rather than department stores. All true, but by our estimate, the current valuation has already more than discounted negative comp store sales and substantial operating margin erosion in the coming quarters. Weakness in the consumer segment also hurt telecom provider Qwest Communications. While the company looks growth-challenged in the near term, we believe its attractive 9% dividend yield should be sustained by the company's decent free cash flow generation.

In the technology sector, investors apparently were not thrilled by Texas Instruments' second-quarter miss and disappointing third-quarter guidance, and sent the stock down -13% in July. Cautious comments by Cisco Systems CEO John Chambers that customer feedback pointed to a recovery in the first half of 2009 (as opposed to the second half of 2008) also prompted investors to be defensive ahead of the company's quarterly report. In early August, Cisco reported better-than-expected numbers, allaying investors' concerns.

Outlook

We continue to believe that a constructive view of the equity market is most appropriate at present. We believe there is a reasonable argument to be made that July 15 marked an important low point for both financial stocks and the market as a whole. Despite the fact that we may already be in what will ultimately be called a recession, we think that the S&P 500 has a good chance of being higher—and perhaps a good deal higher—at the end of the year than it is now.

[3] "BRIC" stands for Brazil, Russia, India and China, four major emerging economies.

Our case for the market being at or near an important low begins with sentiment, which is black as night. Just this past weekend (8/2/08), *The New York Times* published an article by Floyd Norris detailing results of the latest Conference Board survey of consumer expectations for stock prices over the coming 12 months. For the first time ever, more than half of consumers polled (55% to be exact) expected stock prices to decline in the coming year, while just 18% expected them to rise. The remaining 27% expected no change. Only six times since the Conference Board began asking about stock market expectations in the summer of 1987 have 36% or more of respondents said they expected declines in the coming year. Those occasions were: November 1987, October 1990, December 1991, April 1994, October 1998 and March 2003. In every case, the stock market confounded expectations by rising in the next year instead of falling. The minimum gain was +4% from December 1991. The maximum gain was +33% from March 2003. The average of the six was +20.5%. The size of the subsequent rise tended to be highly correlated with the degree of bearishness exhibited by the respondents. With recent poll respondents having set a new all-time high for bearishness, we are licking our chops regarding market prospects for the coming 12 months.

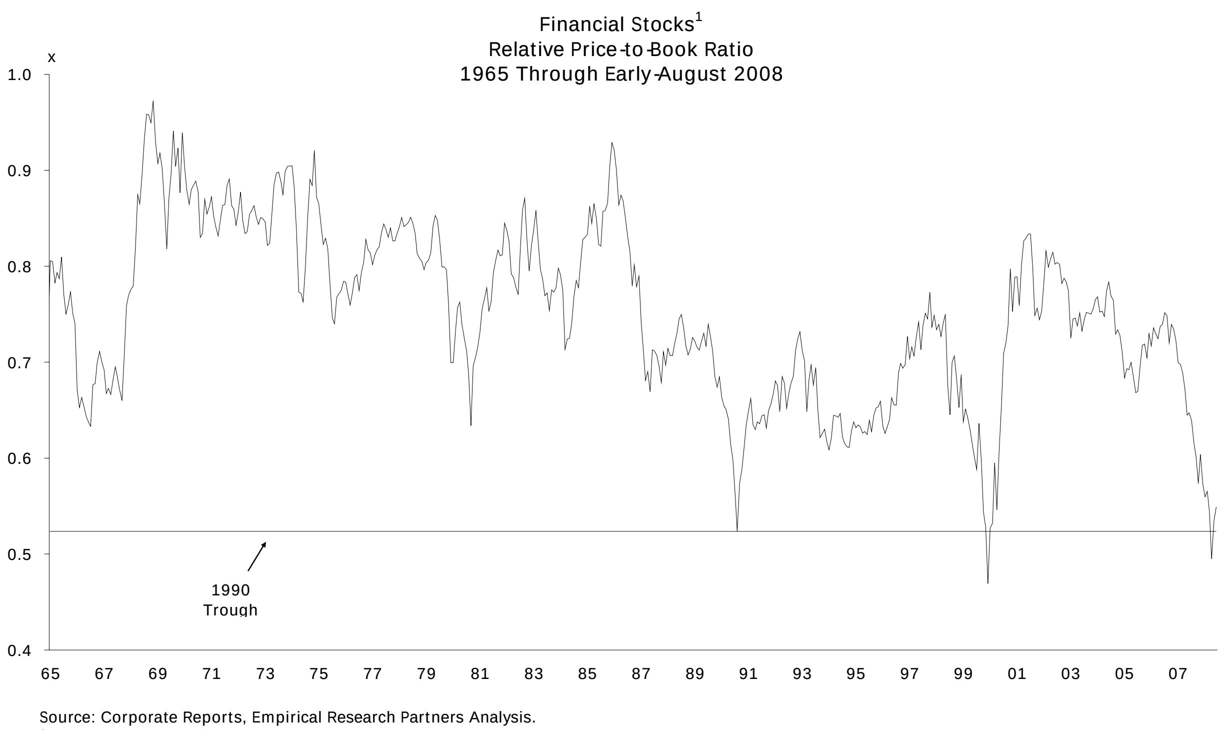
While the survey results above are highly encouraging as a contrary indicator, we are mindful of John Mendelson's frequent admonition that we should pay particular attention to what people <u>do</u>, rather than merely what they <u>say</u>. Fund flows data indicate that people are acting bearish, as well as talking bearish. According to the "Supply/Demand Flash Report" from Leuthold Group, net outflows from U.S.-focused equity mutual funds totaled $17.5 billion in July and $48.5 billion year to date. So, investors are voting with their feet in large numbers.

A recent report from JPMorgan Chase's U.S. Equity Strategist Tom Lee provides more evidence in support of the view that July 15 marked an important bottom in the stock market. In his July 28 report, Lee analyzed 15 indicators of the market's technical, sentiment, breadth and momentum condition and found all 15 to be within a bottoming range.

The valuation level of the market—at least the way we look at it—is also supportive of higher stock prices over the next year as well. Others use different methodologies and come to less favorable conclusions. Mark Hulbert wrote about a couple of these approaches in his "Strategies" column in last weekend's Sunday *New York Times* (8/3/08). He cites AQR Capital Management's view that the market is unattractively priced at 20 times the latest-twelve-months earnings, including write-offs, as well as Robert J. Shiller's similar view that the market is expensive based on an average of inflation-adjusted earnings over the last ten years. With all due respect to Mr. Shiller and the folks at AQR Capital, we think they are using overly conservative benchmarks for their assessment. We think it makes more sense to use ongoing operating earnings in assessing valuation, and question why what happened 10 years ago should have any bearing at all on current valuation.

Our valuation methodology is to use bottom-up, cap-weighted implied consensus estimates (recognizing that they tend to have an optimistic bias) to calculate the current and prospective valuation of the market, and compare those to our assessment of fair valuation as determined by our in-house discounted cash flow (DCF) model. The current inputs to our DCF for the S&P 500 are: (1) 6% long-term EPS growth, (2) 16% return on shareholder's equity, (3) 8.5% weighted-average cost of capital (consisting of a 4.5% equity risk premium added to a 4% 10-year Treasury rate), and (4) an assumed 20-year competitive advantage period, defined as the length of time over which the market can be expected to earn above its cost of capital. Based on these inputs, we estimate the fair value of the S&P 500 to be about 17 times earnings. Our bottom-up, cap-weighted, implied consensus estimates of $83.82, $90.27 and $108.14 for 2007, 2008 and 2009, respectively, put the S&P 500 at about 15, 14 and 12 times earnings, respectively. Thus, the S&P 500 currently trades at about a two, three or five multiple-point discount to fair value depending on whether one chooses to use trailing, current or forward earnings estimates. All in, our work suggests to us that the S&P 500 is at least two multiple-points, or approximately 13%, undervalued currently.

As we noted earlier, on July 15 the financial stocks reached a deeply oversold condition from which they rebounded sharply. As shown below, at their July nadir, they traded lower in terms of relative price-to-book value than at their 1990 low. The financials' spike bottom in July looks visually to us like it could be an important low. If, as we believe, the financials have bottomed, that doesn't mean that there won't be more bad news in terms of asset write-downs or increased loan loss provisioning. It doesn't mean that there won't be more capital raised. It also doesn't mean that the sector will not continue to de-lever, which we think it will. What it does mean, though, is that the market may have foreseen and discounted the worst that is to come.



Source: Corporate Reports, Empirical Research Partners Analysis.
[1] Largest 1,500 stocks; capitalization-weighted data.

Amidst all the worry about where the next capital raise or write-down will surface, we believe investors are underestimating the potential importance of an upward sloping yield curve in restoring profitability to the banking system. As Charles Peabody of Portales Partners notes in a recent report, well-capitalized banks are realizing pricing power in two important areas. The first is in deposit costs, where consumers are no longer chasing yield, but are looking for safety. The second area is lending, where banks are finally charging more appropriately for risk. Portales' Peabody notes, "The net result is that spreads over the last two quarters have proven robust."

Despite the sharp rally in financial stocks since mid-July, few market observers are willing to say they think the group has bottomed. A recent *Wall Street Journal* article titled "Don't Worry, You Haven't Missed Out" quotes Carter Worth, chief market technician at Oppenheimer & Co. as calling the recent move a "counter-trend rally" and recommending short-selling the group. John Mendelson, who is positive on the group and recently called shorting financials the most crowded trade he had ever seen, notes that skepticism toward the group remains high, with only about 15% of shorts in the sector having been covered as of July 31. Meanwhile, despite the skepticism toward financials among professional and retail investors alike, insider buying in financial stocks is now running at over four times its normal rate, according to ISI Group's Francois Trahan.

With respect to our positioning, we like a number of financial stocks here, especially those with durable long-term franchises and adequate capital. We also like a number of stocks in the technology sector, which represents our largest portfolio weighting currently. We believe our technology holdings offer good growth prospects at reasonable prices, sport rock-solid balance sheets and have very attractive free cash flow yields. Unlike 2000, when many tech companies were spending money like proverbial drunken sailors and doling out huge stock option grants to insiders, we believe that now the companies are generally spending money very judiciously and, in many cases, repurchasing stock aggressively.

With energy and materials stocks showing some signs of stabilization after a severe correction, and long-neglected sectors such as financials and consumer discretionary stocks showing themselves capable of going up, we might be in for a period when "everything" goes up together for a while. It's a nice thought to end on anyway.

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