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Third Quarter Report Diversified Investment Funds July 1 to September 30, 1976

The Management Committee

FROM LEFT TO RIGHT:
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The Diversified Investment Funds

The Diversified Investment Funds were established January 1, 1967 and are operated for the collective investment and reinvestment of non-taxable monies. The Funds are fully managed by International Trust Company and consist of four separate investment portfolios: the Canadian Equity Fund; the the International Equity Fund; the Fixed Income Fund; and the Mortgage Fund.

Additions to, or withdrawals from, each Fund, or inter-Fund transactions, are effected on monthly valuation dates at net asset value. Income earned is distributed monthly.

This Report is concerned primarily with investment composition and performance.

The Background For Investment

"Nevertheless, we are in these days all talking about monetary policy, and almost everyone who professes opinions about politics has some strong views upon the subject. Professional economists spend a great deal of their time disputing whether gold, or banking policy, is or is not really at the bottom of the world slump. The battle over inflation and deflation is joined, not only in City counting-houses and the offices of industrial magnates, but in the workshop and the home, and in buses, trams and tubes as men go to and from their work. The newspapers are full of it; and people with no interest in investments have taken to reading the City columns. For everyone realises now that, whether or no money is responsible for the great slump, monetary policy touches him very nearly indeed."

So said Mr. G. D. H. Cole in his "Economic Tracts for the Times" in 1932. While many might not agree with Mr. Cole's political philosophy, that particular observation neatly describes the central focus of investors today. No one who observes the eagerness with which people await the weekly money supply figures in New York could doubt that. Such exotic terms as M1 and M2 have become ritual in luncheon conversations, and there is no doubt monetary policy looms large in the background for investment today.

Inflation Psychology Still Dominant

The concern with monetary policy is understandable in light of the public's continuing concern with inflation. The double digit inflation of 1974 and 1975 had a traumatic effect on attitudes, and even though the rate of inflation is subsiding, it remains the number one public concern.

This, as much as anything is probably behind the so-called shift to the right in politics. The fear of inflation created an old fashioned desire for fiscal conservatism.

There are many who are highly skeptical of the longevity of this attitude, but while it lasts it is having a dominant effect on government fiscal and monetary policy. At all levels there is a move to cut back and to start reducing the huge deficits created in the last few years.

Implications

The full implications of this move are far from clear. For a long time, and more particularly in the period leading out of the 1970 recession, governments have been a very positive factor in total economic growth. Government spending has been rising more rapidly than total GNP and government now accounts for what many believe to be too large a share of the total economic pie.

The big question, however, is what happens as government pulls back and becomes a neutral, or even a negative factor in total economic growth. This is not to say that government spending will decline, but only that it will grow less rapidly than total GNP. If the private sector steps in, and we find consumer spending or capital spending leading the way, then growth will continue at whatever pace is determined by private spending decisions. Right now, confidence is low and both consumers and businessmen are holding back. We expect this will not last, but it probably means we are in for a period of fairly low rates of economic growth. In fact, we are forecasting an increase in real GNP for Canada of 4.5% for 1976, and 5% for 1977. This is below the average postwar experience.

Consumer Healthy

Personal income continues to grow at a very healthy rate. If this is not directly reflected in consumer spending it is simply because public confidence is low. Having been shaken severely by double digit inflation, the consumer is now dismayed by the Government's anti-inflation program. His inclination is not to spend, and his savings are rising. This will probably not last too long. By next year consumer spending should be running 11%-12%, slightly above the projected growth in incomes, and the savings rate will decline.

Capital Spending

Of some considerable significance to Canada is the projected recovery of capital spending and residential construction in the United States next year. This is of major significance to our huge metals and forest industries, both of which should do well in 1977.

Profits

In Canada the trend of earnings is certainly obscured by the anti-inflation program which seeks to control profits. Even without this, however, we do not expect that earnings would rise much more than 8% in Canada this year, and maybe not that much. Next year we look for 10%-12% increases, in line with our expectations for continued slow growth in the economy.

This is in stark contrast to the experience coming out of the 1970 recession when corporate earnings were rising at double these anticipated rates. It is also in contrast to what is happening in the U.S. where before-tax profits are expected to be up 27% this year and 14% next year.

Balance of Payments

We have previously commented in these reports on what we consider to be a major Canadian problem — the huge deficit in our current balance of payments account — at what some of our readers might think is tedious length. Nonetheless it now appears this deficit is going to be fully as large in 1976 as it was in 1975, that is, it is going to be $5 billion or more. Even with an extraordinarily optimistic forecast of, let us say, a $2 billion swing to surplus in our merchandise trade account, the total current account, after allowing for the net outflow of interest and dividends, tourist travel and so on, is gong to be in deficit by $3 billion to maybe $3.5 billion in 1977. This lower deficit may seek to be better until we look back past 1974 when $1 billion deficit was considered to be almost unmanageably large.

There has lately been quite a run on sterling, and the rapidity with which the pound declined should leave no one in Canada sanguine about the position of the Canadian dollar. When a currency moves these days, it has a tendency to move very fast.

Objectives

For 1976 we continue to anticipate a total investment return of 20% from common stocks (15% capital gain plus 5% income) and 15% from fixed income securities (5% capital gain plus 10% income).

We have now forecast ahead to the middle of 1977. We anticipate in the twelve months ending 30 June 1977 to obtain a return of 26.0% from equities and 15.0% from fixed income securities. These objectives will be monitored as we go along.

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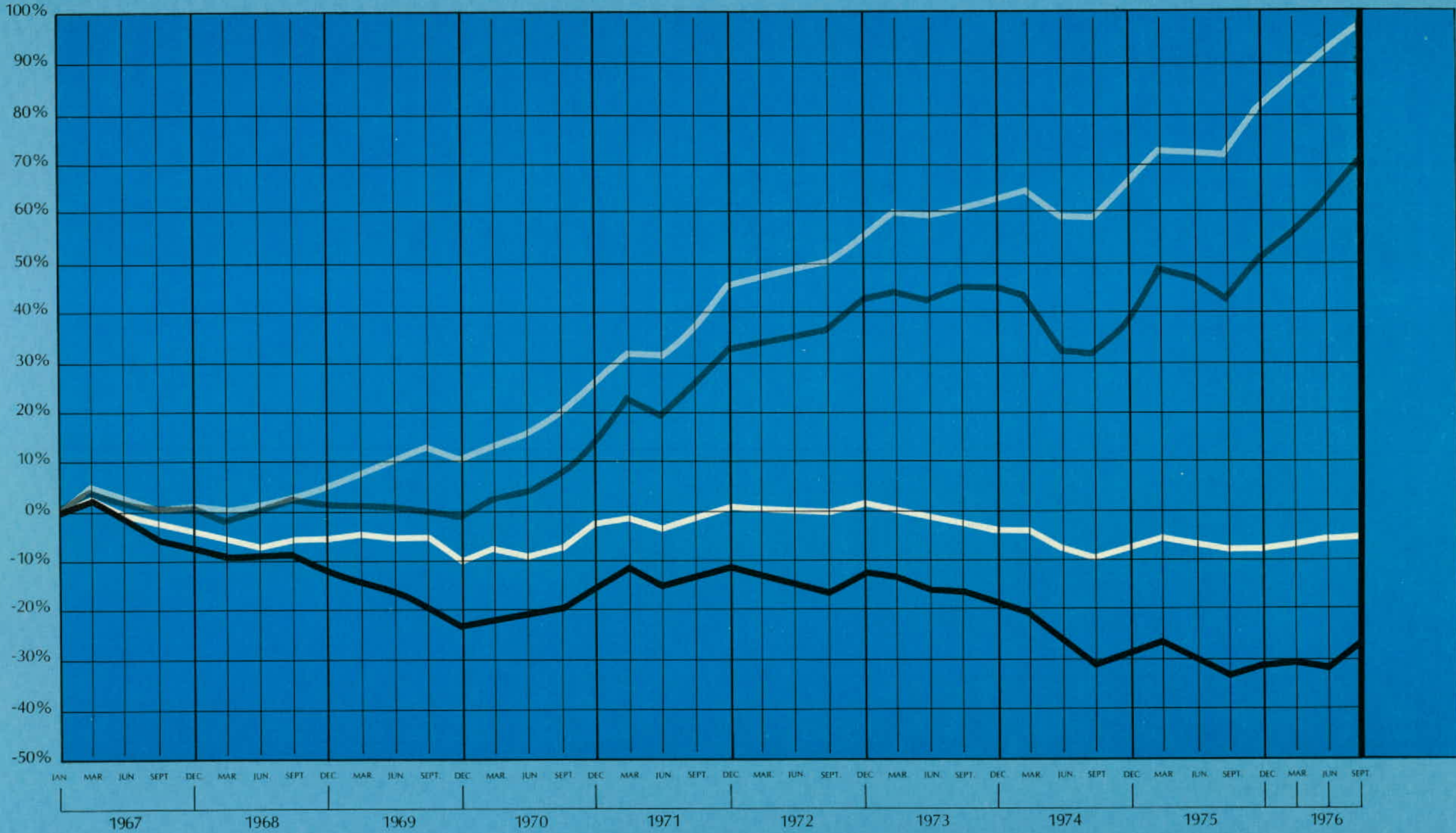
International Trust Company Canada

Fixed Income Fund

Comparisons Between	GRAPH COLOUR	VALUE SEPT. 30/76	VALUE JUNE 30/76	PERCENT CHANGE OVER QUARTER	PERCENT CHANGE YEAR-TO-DATE	AVERAGE ANNUAL COMPOUND RETURN SINCE INCEPTION
Fixed Income Fund		$ 9.33	$ 9.25	+0.9%	+ 2.5%	—0.7%
Fixed Income Fund (Incl. Inc.)		$ 19.79	$ 19.18	+3.2%	+ 9.6%	+7.3%
McLeod Young Weir 40-Bond Index		48.33	46.85	+3.2%	+ 5.7%	—2.5%
McLeod Young Weir 40-Bond Index (Incl. Inc.)		281.63	266.04	+5.9%	+14.3%	+5.7%

Average Yield to Maturity of Fund Assets
June 30, 1976 9.82%
Sept. 30, 1976 9.73%



Fixed Income Fund

Bonds/Convertible Bonds 97% Par Value		Market Value Sept. 30, 1976
$1,175,000	Govt. Canada 6-1/4% Apr. 1/80	$1,097,156
500,000	Govt. Canada 4-1/2% Sept. 1/83	396,875
250,000	Hydro Elec. Pwr. Comm. of Ont. 9-3/4% Aug. 15/81	256,250
1,025,000	Hydro Elec. Pwr. Comm. of Ont. 10% May 18/01	1,040,375
850,000	Prov. of Ontario 9% July 1/98 Prepay July 1/83	850,510
325,000	Prov. of Quebec 8-5/8% Mar. 1/99	285,057
300,000	Prov. of Sask. 7-3/4% Feb. 17/82	282,000
250,000	Prov. of Sask. 8-1/4% Dec. 3/98	216,875
250,000	Prov. of Sask. 9-7/8% Nov. 3/00 Prepay Nov. 3/83	258,438
300,000	Abitibi Pulp & Paper 10-1/2% Mar. 1/95 Prepay Mar. 1/85	305,250
400,000	Alum. Co. of Canada 9-3/8% Jan. 2/91	373,000
300,000	Ashland Oil Can. Conv. 5% Jan. 15/93	210,000
600,000	BM-RT 6-1/4% Apr. 1/78 Cum. Wts.	595,740
200,000	BM-RT 9% Apr. 1/80	194,500
500,000	BM-RT 10-1/4% June 1/81	510,000
400,000	Bank of Nova Scotia 6-3/4% Jul. 1/78 — 7% Jan. 1/92	382,000
375,000	Bank of Nova Scotia 7-1/2% Jan. 1/88 Prepay Jul. 1/79	354,375
250,000	Bell Canada 9-3/4% Jun. 3/79	251,250
400,000	Bell Canada 8-3/8% Aug. 1/93	348,000
600,000	Bell Canada 9-7/8% Apr. 1/99	592,500
200,000	B.C. Telephone 8-3/4% Jan. 15/81	192,500
250,000	B.C. Telephone 9-1/4% Apr. 15/98	230,000
400,000	Calgary Power Ltd. 11-1/8% Sept. 16/79	412,000
500,000	Canadian Imperial Bank of Commerce 7-1/4% Dec. 15/92 Prepay Dec. 15/78	475,625
300,000	CP Limited 11-1/4% Nov. 15/95	315,000
100,000	Consumers Gas 8-3/4% Aug. 15/94	87,500
300,000	Dominion Foundries and Steel 9% Feb. 1/91	273,000
250,000	Dominion Stores 9-1/2% Mar. 1/80	246,250
300,000	First Canadian Investments Limited 9-3/4% Mar. 15/81	300,000
500,000	First Canadian Investments Limited 10% Dec. 1/81	505,000
500,000	General Motors Accept. 8-5/8% Feb. 9/79	490,850
300,000	Hudson's Bay Company 9-3/4% May 1/79	300,000
200,000	Hudson Bay Mining & Smelting 9% Jun. 15/91	176,000
500,000	I.A.C. Limited 10-1/4% July 30/83	508,750
300,000	John Labatt 9-1/4% Sept. 1/90	277,500

Bonds/Convertible Bonds 97% Par Value		Market Value Sept. 30, 1976
200,000	John Labatt 9% Mar. 15/94	179,000
200,000	Maritime Tel. & Tel. 8-1/4% Jun. 15/77 Ext. Jun. 15/90	197,750
300,000	Molson Industries 8-1/4% Nov. 1/91	254,250
100,000	Niagara Realty Corp. 10-3/8% Dec. 18/84	101,500
500,000	Noranda Mines 10-1/4% Mar. 1/77	500,000
200,000	Noranda Mines 9-1/4% Oct. 15/90	186,500
235,000	Olympia & York Dev. Ltd. 10-1/2% Oct. 31/79	239,113
300,000	Olympia & York Dev. Ltd. 9% Mar. 1/90 ret. 8-3/4%/82	286,500
350,000	Roynat Ltd. 9% Mar. 1/80	339,500
200,000	Seagram Co. Ltd. 7% 15/78	189,750
600,000	Seagram Co. Ltd. 9-1/2% Jun. 1/80	603,000
250,000	Simpsons-Sears Acc. 10-1/4% Aug. 15/79	250,000
400,000	Steel Co. Canada 9-1/4% Nov. 1/90	379,000
200,000	TDRI Conv. 5-1/2% Feb. 15/93	189,000
225,000	TransCanada Pipe 10% Jun. 20/90	219,375
400,000	TransCanada Pipe 9-3/4% Sept. 20/90	384,000
200,000	Union Carbide 10-3/4% Jun. 15/95	206,500
		$18,294,864

Reserve 3%

Cash & Short Term Notes	**662,201**
Total Assets at Market Sept. 30, 1976	**$18,957,065**

In the third quarter of 1976 the Fixed Income Fund increased in value by 0.9% and by 3.2% when income is included. In contrast the McLeod, Young, Weir 40 Bond Index increased in value by 3.2% and by 5.7% when income is included. The Fund lagged behind the Index essentially due to the conservative term in its holdings in contrast to the very long term of the Index.

Interest rates in Canada showed divergent trends over the third quarter with short rates remaining flat while long term rates declined on a net basis. In general the markets were quite volatile at times reflecting the increased new issue and trading activity and very quiescent at others in reflection of the usual summer trading patterns. Money market rates remained virtually flat in July, edged higher in early August, eased slightly later in the month, and remained trendless for the most part of September. Long term rates edged moderately higher early in July, then declined to slightly under their opening levels by the end of the month. In early August long term rates remained unchanged before starting to decline by 30 to 40 basis points by the end of the month. Throughout September the rally slowed considerably as by month end further net reductions of only 5 to 10 basis points were realized.

Money market rates opened the quarter at 9-1/4% and closed the session at about 9-3/8% with trade over the three months ranging from 9-1/4% to about 9-3/4%. Activity over the quarter was relatively light partly due to the seasonal absence of demand from the auto-related financial borrowers but also due to no changes in the underlying factors that directly impact money market rates. The monetary aggregates remained in the same patterns with the Bank of Canada maintaining its restrictive monetary policy while the chartered banks, confronted with continuing large loan demands, were unable to rebuild depleted liquidity levels. In late August confirmation that the official policy would persist was given when the Central Bank announced new lower targets for M1 growth of 8%-12% would be in effect — down from the previous target range of 10%-15%.

The Canadian dollar acted to offset any sustained movement in short rates with the forward markets acting to smooth any pressure. The spot dollar traded erratically at times as well as remaining listless for other periods and on a net basis it trended lower. From a level of $1.0324 U.S. at the end of June the spot rate drifted to $1.0265 U.S. at the start of August, plummeted to $1.0092 U.S. within one week before recovering to about $1.0125 U.S. by the middle of the month. From mid-August to the end of the quarter the trend was generally firmer with the rate closing the month at $1.0256 U.S. The sharp correction in early August seemed to be partly based on a feeling that the record inflows from foreign borrowings would cease or at least slow to more normal levels but primarily resulted from a straight supply/demand situation. In the following week our short rates rose slightly and this, coupled with direct Central Bank support, turned the dollar around and it recovered most of the lost ground.

Long term markets in Canada acted in three distinct phases over the quarter being flat in July, sharply better in August, and then relatively unchanged throughout September. Early in July trade was very quiet in all market sectors and as a number of new issues were offered and only met with moderate success, the market was marked down modestly. Bank loan demand continued very strong, the monetary system remained in tight check, the U.S. market suffered under new issue pressure, and the usual seasonal slowdown all contributed to the easier tone. In mid month a new Canada refunding sold well and the market moved modestly higher, again in limited trade, through to month end, helped to some extent by a better U.S. market.

In August the market opened quietly still caught in the summer doldrums and drifted as short term rates firmed. This lassitude soon gave way to a bullishness that moved long bond prices 2 to 3 points higher by month end in active trade. The reasons for this rally included a sparse calendar of new issues accompanied by a clean-up of the unsold balances of recent issues, an increase in offshore borrowings, speculation that Bank Rate would be reduced, strong institutional cash flows coupled with the desire to get them committed in view of the lack of mortgage product and the lacklustre stock market, the weakness in the dollar which was thought would allow a reduction in our administered interest rates and the favourable trend of inflation numbers which was finally allowing a positive real return to bond investors. These factors, helped by a stronger U.S. market, all culminated in a market that had little supply and the subsequent rally ensued.

The rally slowed in September in volatile markets as profits were taken, as the dealers began to build their inventories to record levels, and as the new issue calendar began to build and new Provincial offerings were made. The announcement of a 9.13% rate on the new Canada Savings Bond issue was thought to be generous and led to some speculation as to why the Government had to offer such a rate apart from fears about the potential disintermediation we have seen in recent issues. Mortgage rates posted by some chartered banks and 5 year rates posted by some trust companies declined but generally the markets were relatively trendless throughout September.

Our expectations for interest rates over the next quarter would be for unchanged money market rates and flat to modestly lower long rates. The approaching chartered bank year end, the Savings Bond campaign, and the continuing monetary restraint will preclude any drop in money market rates until late in the quarter or early next year. Indeed the Minister of Finance was recently quoted as saying that he would be watching our inflation performance over the next two months before any decision concerning interest rates is made. For most of the quarter then we expect money market rates to persist in their recent 9-1/4% to 9-3/4% range with the chance of a decrease arising late in the year.

Long term rates declined by about 40 basis points in the past quarter, but we do not feel that this will be repeated in the fourth quarter. There is certainly room for further modest improvement but this will be tempered by the persistence of high short rates, a continuing demand for funds, the maintenance of a restrictive monetary policy, and the likelihood that inflation rates have already troughed for this year. The return of a satisfactory real rate of return to long term investors has lent a sense of relief and optimism to the markets but there still are many uncertainties to be overcome before a sustained drop in rates will be seen.

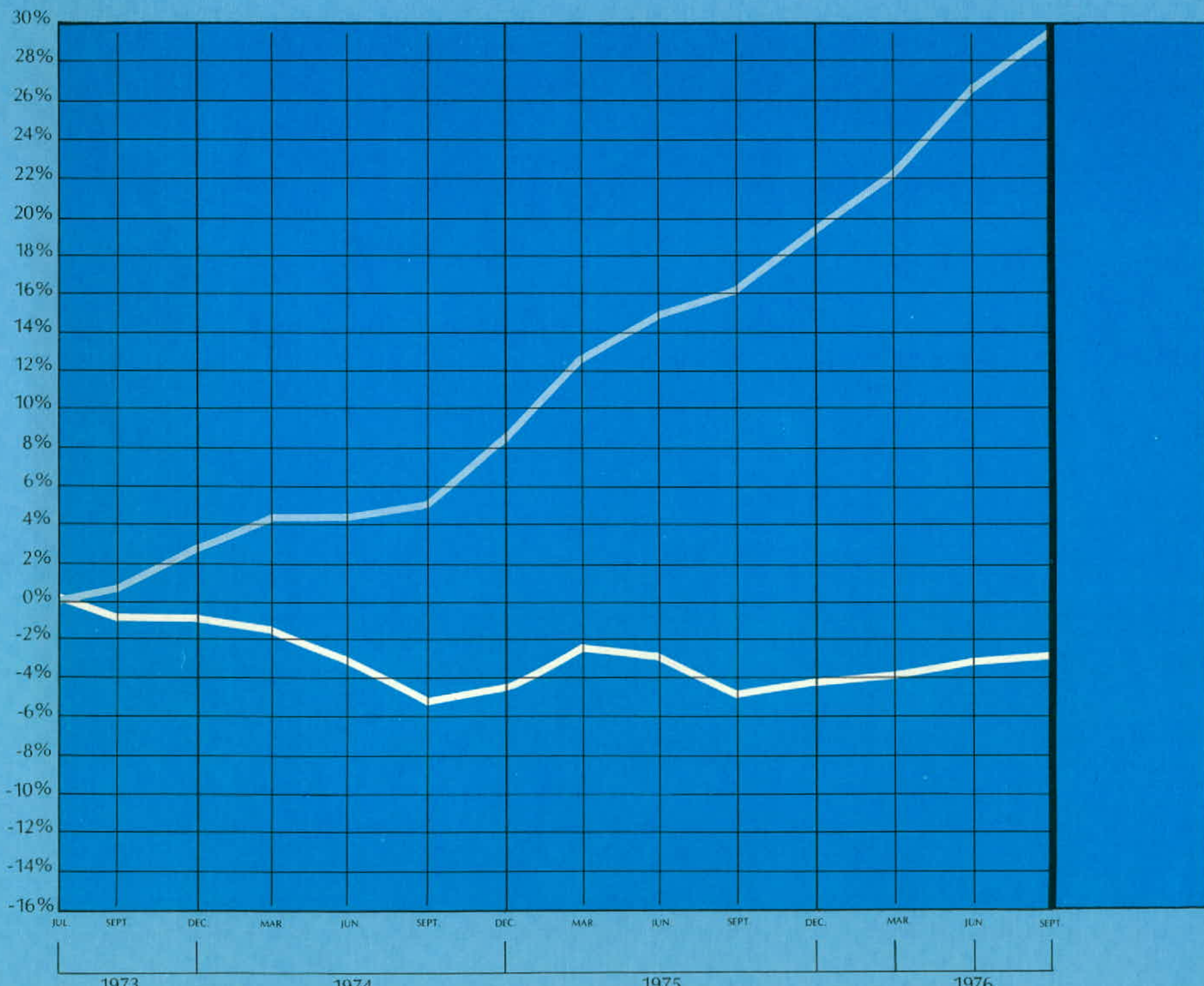
The Fund will continue to remain fully invested and will only modestly extend the term of its holdings in the next few months. Once money market rates have declined then we expect that a more normal yield curve will be established in our markets as mid term rates will then act in concert with the short end.

Portfolio Composition:

	June 30, 1976	Sept. 30, 1976
Reserve	3%	3%
Canadas	9	8
Provincials	12	17
Corporates	74	71
Conv. Debs.	2	1
	100%	100%

Mortgage Fund

Comparisons Between	GRAPH COLOUR	VALUE SEPT. 30/76	VALUE JUNE 30/76	PERCENT CHANGE OVER QUARTER	PERCENT CHANGE YEAR-TO-DATE	AVERAGE ANNUAL COMPOUND RETURN SINCE INCEPTION
Mortgage Fund	□	$ 9.69	$ 9.64	+0.6%	+1.1%	—0.3%
Mortgage Fund (Incl. Inc.)	□	$12.99	$12.61	+3.0%	+8.8%	8.6%



The unit value of the Mortgage Fund was $9.69 as of September 30, 1976 which compares with a value of $9.64 as of June 30, 1976 and represents an increase of 0.6%. Including income the value of the Mortgage Fund units has increased from $12.61 to $12.99 which represents a change of 3.0% during the same period.

The Mortgage Fund increased in unit value due to the slight drop in mortgage rates that became more widespread during this quarter, especially in the re-sale market. This was confirmed by reductions of 1/4 of 1% by a number of major lenders, such as the banks, on new project financing.

The action in the mortgage market again suggests that the 12% rate is a barrier at which demand for mortgage money declines. The reduction in housing starts at the time when mortgage rates reached these levels again has been confirmed. It is also notable that the re-sale housing market has softened somewhat and the 12% barrier certainly was a major factor.

In the secondary mortgage market demand has been very good with supply being limited. During some short periods in the third quarter offerings were very scarce and there were unfilled orders. Rates in this market have now dropped below the 11% level on a net basis and there are few offerings being shown for early settlement.

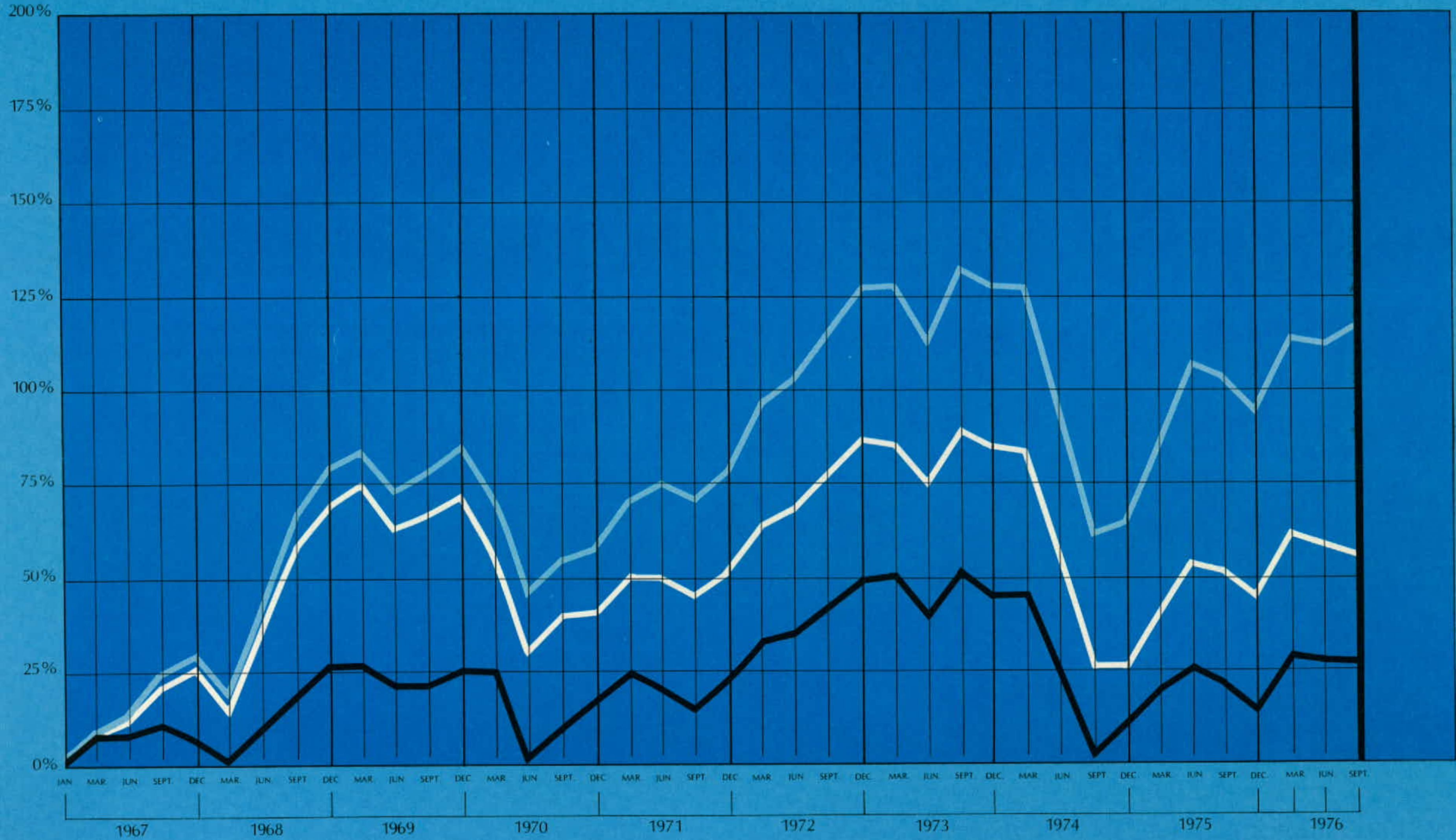
The current lower rates on mortgages may help to improve the demand for mortgage money, however we feel that a further decline will be necessary before it becomes aggressive. As the forecast is for at least slightly lower interest rates, some potential borrowers are delaying commitments at this time hoping for the better rates.

We expect that mortgage rates will continue to move lower, however it is unlikely that this will occur until there is some action on the Bank Rate which would enable the deposit-taking institutions to reduce their rates.

The Mortgage Fund continues to be fully committed. It is entirely invested in NHA mortgages and this policy will remain as there is no reason to give up the protection of government insured mortgages for the small rate improvement available in other areas.

Canadian Equity Fund

Comparisons Between	GRAPH COLOUR	VALUE SEPT. 30/76	VALUE JUNE 30/76	PERCENT CHANGE OVER QUARTER	PERCENT CHANGE YEAR-TO-DATE	AVERAGE ANNUAL COMPOUND RETURN SINCE INCEPTION
Canadian Equity Fund	□	$ 15.45	$ 15.64	—1.2%	+6.6%	+4.6%
Canadian Equity Fund (Incl. Inc.)	□	$ 21.66	$ 21.71	—0.2%	+9.8%	+8.3%
T.S.E. Industrial Index	■	184.84	187.46	—1.4%	+7.3%	+3.1%



Canadian Equity Fund

Par Value Shares	Convertible Securities or Common Stocks	Market Price	Market Value Sept. 30, 1976
	Banks — 17.1%		
23,544	Bank of Nova Scotia	43 1/2	$ 1,024,164
35,240	Canadian Imperial Bank of Commerce	26 3/8	929,455
30,980	Royal Bank of Canada	29	898,420
46,544	Toronto-Dominion Bank	19 7/8	925,062
			$ 3,777,101
	Beverages — 1.0%		
19,800	Bright, T. G. Class A	7 3/4	$ 153,450
	Communications — 3.8%		
38,185	Standard Broadcasting Corp	8 3/8	$ 319,799
31,880	Toronto Star Class B	16 1/4	518,050
			$ 837,849
	Construction & Material — 1.8%		
18,000	Genstar	22 1/4	$ 400,500
	Forest Products — 11.5%		
54,090	Abitibi Paper	12 1/8	$ 655,841
23,230	British Columbia Forest Products	23	534,290
25,560	Domtar	20 3/4	530,370
24,540	MacMillan Bloedel	22 5/8	555,218
18,030	Price Co.	14 3/8	259,181
			$ 2,534,900
	Insurance — 6.5%		
10,590	Crown Life Insurance $1 P.V.	47	$ 497,730
9,570	Great West Life $1 P.V.	50 3/4	485,678
50,190	MICC Investments	9	451,710
			$ 1,435,118
	Merchandising — 6.0%		
18,120	Dominion Stores	15	$ 271,800
47,880	Simpson's	6	287,280
15,543	Simpsons-Sears	9	139,887
15,000	Steinberg's Class A	15 3/4	236,250
20,260	Woodward Stores Class A	18 1/4	369,745
			$ 1,304,962
	Mines & Metals — 22.0%		
30,000	Alcan Aluminium	25 5/8	$ 768,750
27,880	Bethlehem Copper Class A	12 5/8	351,985
12,000	Cominco	37	444,000
14,410	Hudson Bay Mining & Smelting	18 1/2	266,585
15,240	Inco	32 1/2	495,300
12,270	McIntyre Porcupine Mines	31 3/4	389,573
29,000	Mattagami Lake Mines	17 7/8	518,375
11,710	Noranda Mines	35 7/8	420,096
22,300	Placer Development	22	490,600
17,000	Rio Algom Mines	32 1/2	552,500
23,230	Sherritt-Gordon Mines	6 1/2	150,995
			$ 4,848,759
	Oil & Gas — 11.2%		
11,990	Canadian Superior Oil	41 1/4	$ 494,587
10,380	Dome Petroleum	33 1/2	347,730
1,429	Gulf Oil Canada	25	35,725
8,090	Home Oil Class A	26 1/2	214,385
13,570	Hudson Bay Oil & Gas	32	434,240
16,360	Husky Oil	16 7/8	276,075
15,610	Pacific Petroleum	25 3/4	401,958
11,150	Texaco Canada	24	267,600
			$ 2,472,300
	Pipelines — 6.5%		
20,000	Alberta Gas Trunk Line	13 7/8	$ 277,500
27,880	Interprovincial Pipelines	15 1/4	425,170
27,000	Trans Canada Pipelines	12 3/4	344,250
15,000	Westcoast Transmission	26	390,000
			$ 1,436,920
	Real Estate — 0.5%		
28,350	Commonwealth Holiday Inn	3.55	$ 100,643
	Steel — 4.2%		
12,170	Dominion Foundries & Steel Class A	28 1/8	$ 342,281
21,470	Steel Company of Canada Class A	27 7/8	598,476
			$ 940,757
	Trust & Loan — 4.0%		
13,940	Canada Permanent Mortgage Corp.	15 1/2	$ 216,070
17,750	Canada Trustco Mortgage "A"	20 1/2	363,875
18,230	IAC	17	309,910
			$ 889,855
	Utilities — 1.3%		
9,290	Calgary Power Class A	31 1/2	$ 292,635
	Miscellaneous — 2.0%		
25,000	Canadian Pacific	17 1/4	$ 431,250
	Reserve — 0.6%		
	Cash and Short Term Notes		$ 133,786
	Total Assets at Market, September 30, 1976		$21,990,785

Canadian Equity Fund

Portfolio Balance

	Sept. 30/75	June 30/76	Sept. 30/76
Common Stocks & Equivalents	95.5%	99.9%	99.4%
Reserve	4.5	0.1	0.6
	100.0%	100.0%	100.0%

Portfolio Composition

	Sept. 30/75	June 30/76	Sept. 30/76
Consumer Products & Services	39.4%	37.0%	38.9%
Cyclical	39.1	42.2	41.5
Energy	14.5	14.8	11.2
Regulated	2.5	5.9	7.8
Reserve	4.5	0.1	0.6
	100.0%	100.0%	100.0%

Largest Common Stock Holdings as at September 30, 1976 (By Market)

	Percent of Total Portfolio
Bank of Nova Scotia	4.7%
Canadian Imperial Bank of Commerce	4.2
Toronto-Dominion Bank	4.2
Royal Bank of Canada	4.1
Alcan Aluminium	3.5

Performance in the Third Quarter

The Cookie Monster in Sesame Street sings a song about "Up & Down", and that could easily be dedicated to our Canadian Stock market. Investors obviously have a continuing uncertainty about the anti-inflation program, and are reluctant to commit too much money to common stocks, no matter how good the value. They simply want a better understanding of what is happening in the country.

In addition to weak investor confidence, money rates continue high and this has always put an effective lid on equity prices. Some decline in interest rates will have to precede a general stock market advance.

	Change 30 Sept. 1976	Third Quarter	First Nine Months
T.S.E. Industrial Index	184.84	−1.4%	+7.3%

Internal Features

The banks, after a very weak second quarter, rebounded strongly in the third quarter and moved up 8.5%. The White Paper on the reform of the Bank Act was generally regarded as highly favourable. Paper and forest products, led by MacMillan Bloedel (+13.1%), after languishing most of the year, also picked up 2.5% in the third quarter. Pipelines (+8%) and utilities (+5.5%) were the other groups showing significant strength in the third quarter.

The weakest groups were merchandising (-9.4%) and oil refining (-11.1%).

Although interest rates did not change significantly in the quarter, there was enough action to spur investors' hopes, and this was reflected in the rise in what are often called "interest-sensitive" stocks. Thus, the strength in utilities, pipelines and banks. The reason the trust and loan group, probably the most interest-sensitive of all, did not participate in this is that the White Paper on the reform of the Bank Act was not considered to be favourable for them.

The merchandising group has been weak all year, probably because consumer confidence is at a low ebb and retail business is not strong. There were no specific reasons for the weakness in the oils, other than the effects the gasoline price war in eastern Canada was having on the marketing and refining business of the big integrated companies.

Some of the former favourites in the Canadian market had a bad time in the third quarter. Most notable were Canadian Tire "A" (off 14.2%), Moore Corporation (off 12.3%) and Imperial Oil (off 8.7%). The latter two continued declines begun earlier in the year.

The Value in the Market

Stocks continue to sell at a very low relation to earnings and assets.

T.S.E. Industrial Index

	31 Dec. 1973	31 Dec. 1974	31 Dec. 1975	30 Sept. 1976
Price-Earnings Ratio	12.6	6.6	8.2	9.3
Dividend Yield	3.6%	5.9%	5.3%	4.8%

This is a function of the factors mentioned above, high interest rates, and low investor confidence.

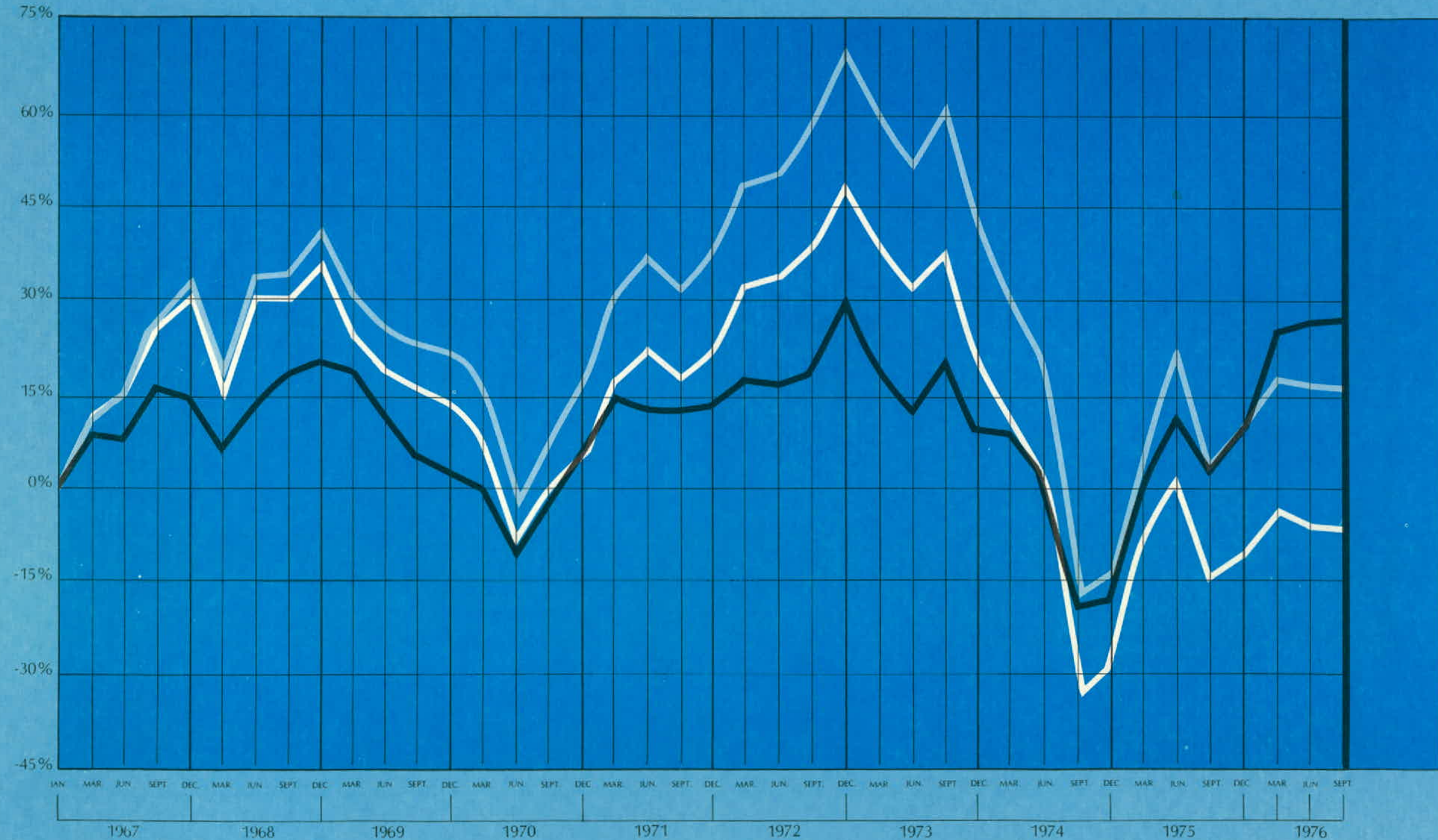
We continue to expect the stock market to rise, and our forecast of a 15% capital gain for 1976 still holds. The fund was up 1.1% in the third quarter and up 6.7% in the nine month period ending 30 September. If we obtain a 15% capital gain, the total investment return for 1976 should be around 20% since we are getting about a 5% dividend yield.

During the quarter we added Alberta Gas Trunk Line to the portfolio, and increased the position in TransCanada PipeLines. These should benefit from rising gas supplies in Alberta, and high demand in eastern Canada. We sold Gulf Canada and Siebens to raise cash for this purchase.

The fund was kept fully invested through the quarter, and we expect to continue this strategy through the fourth quarter.

International Equity Fund

Comparisons Between	GRAPH COLOUR	VALUE SEPT. 30/76	VALUE JUNE 30/76	PERCENT CHANGE OVER QUARTER	PERCENT CHANGE YEAR-TO-DATE	AVERAGE ANNUAL COMPOUND RETURN SINCE INCEPTION
International Equity Fund	□	$ 9.30	$ 9.40	—1.1%	+ 5.3%	—0.3%
International Equity Fund (Incl. Income)	□	$ 11.62	$ 11.68	—0.5%	+ 7.1%	+1.5%
Dow Jones Industrial Average	■	990.19	1002.78	—1.3%	+16.2%	+2.4%



International Equity Fund

Par Value Shares	Convertible Securities or Common Stocks	(U.S.) Market Price	(Canadian) Market Value Sept. 30, 1976
	Autos — 1.8%		
5,000	General Motors Corp.	73 3/8	$ 357,043
	Banks — 2.3%		
9,000	J. P. Morgan & Co.	53 3/8	$ 467,501
	Chemicals — 2.8%		
13,000	Dow Chemical	44 1/2	$ 562,996
	Drugs — 9.5%		
10,000	American Home Products	35 1/4	$ 343,053
13,000	Lilly, Eli & Co.	55 3/8	700,582
7,000	Merck Inc.	78 3/8	533,922
7,000	Schering-Plough	53 7/8	367,018
			$ 1,944,575
	Electronics — 12.3%		
18,000	AMP	34 5/8	$ 606,547
7,000	Hewlett-Packard	92 1/2	630,147
22,000	Perkin-Elmer Corp.	22 5/8	484,410
7,000	Texas Instruments	116	790,238
			$ 2,511,342
	Forest Products — 2.1%		
10,000	Weyerhauser	43 1/4	$ 420,909
	Foods & Beverages — 5.2%		
3,700	Coca-Cola	85 7/8	$ 309,222
14,000	McDonald's	55 1/8	751,067
			$ 1,060,289
	Hospital Supply — 6.4%		
16,000	Baxter Travenal Labs	44 3/4	$ 696,811
7,000	Johnston & Johnston	90 1/2	616,522
			$ 1,313,333
	Information Processing — 21.5%		
16,000	Automatic Data Processing	31 1/4	$ 486,600
8,000	Burroughs Corp.	92 1/8	717,248
5,000	Digital Equipment	158	768,828
10,000	Honeywell	45 7/8	446,456
4,500	International Business Machines	281 3/8	1,232,254
12,000	Xerox Corp.	63 5/8	743,038
			$ 4,394,424
	Insurance — 1.9%		
2,000	General Reinsurance	194 1/2	$ 378,575
	Miscellaneous — 8.6%		
10,000	Black & Decker	20 5/8	$ 200,722
7,500	Caterpillar Tractor	55 3/8	404,182
40,000	Huyck	12 1/2	486,600
5,000	Lowes Companies	28 7/8	140,506
14,000	Masco	24 5/8	335,511
3,000	Minnesota Mining & Manufacturing	64 3/8	187,949
			$ 1,755,470
	Oils — 3.7%		
5,000	Schlumberger	100	$ 486,600
5,000	Standard Oil	55 1/2	270,063
			$ 756,663
	Personal Care — 3.1%		
10,000	Avon Products	47 7/8	$ 465,920
6,000	Cheesbrough-Ponds	26 1/2	154,739
			$ 620,659
	Photography — 3.4%		
8,000	Eastman Kodak	89 7/8	$ 699,731
	Retail Trade —8.6%		
25,000	S. S. Kresge Co.	40 3/8	$ 982,324
17,000	J. C. Penny Co.	52 3/8	866,513
			$ 1,848,837
	Reserve — 6.8%		
	Cash, Short Term Notes & Receivables		$ 1,393,131
	Total Assets at Market, September 1976		**$20,485,478**

International Equity Fund

Portfolio Balance

	Sept. 30/75	June 30/76	Sept. 30/76
Common Stock & Equivalents	87.9%	94.5%	93.2%
Reserve	12.1	5.5	6.8
	100.0%	100.0%	100.0%

Portfolio Composition

	Sept. 30/75	June 30/76	Sept. 30/76
Consumers Products Division	38.1%	39.2%	40.0%
Cyclical	10.1	10.4	11.5
Energy	—	2.3	3.7
Technology	39.7	42.6	38.0
Reserve	12.1	5.5	6.8
	100.0%	100.0%	100.0%

Largest Common Stock Holdings as at September 30, 1976 (By Market)

	Percent of Total Portfolio
International Business Machines	6.0%
S. S. Kresge Co.	4.8
J. C. Penny Co.	4.2
Texas Instruments	3.8
Lilly, Eli & Co.	3.4

U.S.

In the third quarter, like the second, the U.S. stock market fought very hard to go nowhere. After an uncomfortable drop in mid August, stock prices moved up in two distinct phases, and the Dow Jones Industrial Average went through 1,000 again. Following a brief period at that heady level, it beat a quick retreat and closed below the magic 1,000. This is indeed proving to be a formidable ceiling.

For those who are interested in coincidental phenomena, the closeness of this average to the 1,000 mark at the close of each quarter this year has to be noted.

Dow Jones Industrial Average
1976 Quarterly Closing

31 March	30 June	30 September
999.45	1002.78	990.19

Interestingly enough the broader market indexes have been stronger than the Dow Jones Industrial Average.

Performance of Two Indexes

	30 Sept. 1976	Change: Third Quarter	Change: First Nine Months
Dow Jones Industrials	990.19	−1.3%	+16.2%
N.Y.S.E. Composite	56.23	+0.9	+18.0

Internal Features

The most significant feature in the third quarter was the strength in the utilities. The Dow Jones Utilities Average was up 11.7% in contrast to the decline in both the industrial and transportation averages. Generally speaking, it was the interest-sensitive stocks like the savings and loan companies, as well as the utilities, which were higher in the quarter. Some of the "growth" stocks like (IBM (+2.1%), Xerox (+3.5%) and Kresge (+13.7%) were stronger but others like Digital Equipment (off 10.6%), Texas Instruments (off 8.7%) and Hewlett Packard (off 19.4%) did not do so well.

Value in the Market

Although price-earnings ratios have recovered better in the U.S. than they have in Canada, they are still historically low.

Price-Earnings Ratios

	Close 30 Sep/76	Earnings/Share 12 Months	Earnings/Share Estimated 1976	Price Earnings Ratio 12 Months	Price Earnings Ratio Estimated 1976
Standard & Poor's 400	118.07	9.07	10.50	13.0	11.2
Standard & Poor's 500	105.24	8.45	9.70	12.5	10.8
Dow Jones Industrials	990.19	75.39	99.00	13.1	10.0

The yield on all three indexes is running around 3.5%.

Other Stock Markets	30 June 1976	30 Sept. 1976	Change
London	383.8	323.5	−15.7%
Tokyo	4,852.13	4,830.4	− 0.4
Sydney	471.0	465.67	− 1.1

The feature of the quarter in the international currency markets was the dramatic decline of sterling late in September. At the end of June it was $1.7290 Canadian funds, the noon quote at 30 September was 1.6155 for a decline of 6.6%. This was linked to the seamen's strike, the continuing deficit in the U.K. balance of payments and the increase in bank rate to 13%. Investors were also worried about the measures the government would have to take to obtain the credits it had requested from the International Monetary Fund.

Gold declined 6% during the quarter from 123.80 U.S. to $116.50 U.S.

The strategy remained the same during the third quarter and the cash flow was invested as received. Several new companies were added, these included American Home Products, Lowe's, Standard Oil of Indiana and Weyerhaeuser.

Unit Values of Diversified Investment Funds Since Inception

	Fixed Income Fund			Mortgage Fund			Canadian Equity Fund			International Equity Fund		
	UNIT VALUE	INCOME QTR/MO.	VALUE INCL. INC.	UNIT VALUE	INCOME QTR/MO.	VALUE INCL. INC.	UNIT VALUE	INCOME QTR/MO.	VALUE INCL. INC.	UNIT VALUE	INCOME QTR/MO.	VALUE INCL. INC.
1966 Dec. 31	$10.00		$10.00				$10.00		$10.00	$10.00		$10.00
1967 Dec. 31	9.52	$.15734	10.14				12.65	$.09396	13.02	13.28	$.05561	13.54
1968 Dec. 31	9.45	.14652	10.73				17.06	.11004	18.00	13.67	.05368	14.24
1969 Dec. 31	9.05	.20602	11.09				16.99	.11949	18.57	11.40	.12480	12.27
1970 Mar. 31	9.26	.17651	11.57				15.54	.15469	17.15	10.72	.12092	11.66
June 30	9.18	.18571	11.70				12.93	.13116	14.40	8.76	.11073	9.64
Sept. 30	9.30	.19003	12.10				13.82	.17910	15.60	9.83	.06254	10.89
Dec. 31	9.64	.19492	12.80				14.03	.13295	15.98	10.62	.04831	11.82
1971 Mar. 31	9.82	.19593	13.33				15.03	.12995	17.28	11.84	.05244	13.24
June 30	9.64	.18892	13.31				15.04	.12842	17.44	12.30	.04849	13.81
Sept. 30	9.90	.20070	13.96				14.59	.11095	17.05	11.79	.05142	13.30
Dec. 31	10.06	.19743	14.46				15.19	.10311	17.87	12.32	.05237	13.96
1972 Mar. 31	10.00	.18497	14.64				16.60	.11675	19.67	13.30	.04940	15.14
June 30	9.93	.18826	14.81				16.95	.11314	20.21	13.46	.04650	15.37
Sept. 30	9.97	.18887	15.16				17.78	.09474	21.32	13.92	.05572	15.96
Dec. 31	10.16	.18626	15.73				18.95	.12469	22.88	14.87	.04958	17.11
1973 Mar. 31	10.13	.18029	15.96				18.87	.09384	22.90	13.94	.06410	16.11
Jun. 30	9.88	.17908	15.85				17.50	.12377	21.38	13.22	.05627	15.36
Sept. 30	9.77	.19265	15.99	9.92	.13906	10.07	19.24	.10939	23.64	13.98	.06974	16.32
Dec. 31	9.71	.19317	16.21	9.92	.20852	10.28	18.32	.16836	22.73	12.11	.05223	14.19
1974 Mar. 31	9.61	.19337	16.36	9.86	.22438	10.45	18.24	.12509	22.77	11.14	.04991	13.11
June 30	9.07	.19501	15.77	9.69	.21141	10.49	15.18	.19720	19.19	10.22	.05406	12.10
Sept. 30	8.91	.20719	15.86	9.50	.23806	10.54	12.53	.16598	16.05	6.68	.05505	7.96
Dec. 31	9.13	.21338	16.64	9.57	.23663	10.89	12.54	.20532	16.32	7.10	.04961	8.51
1975 Mar. 31	9.46	.06569	17.60	9.79	.06996	11.37	14.46	.06294	19.05	9.07	.01831	10.94
June 30	9.26	.06641	17.59	9.72	.07008	11.55	15.73	.02969	20.90	10.33	.04644	12.57
Sept. 30	9.03	.06199	17.54	9.53	.07605	11.60	15.04	.06418	20.23	8.42	.01634	10.29
Dec. 31	9.10	.06002	18.05	9.58	.07685	11.94	14.49	.06361	19.72	8.83	.02063	10.85
1976 Jan. 31	9.25	.07209	18.50	9.67	.08065	12.16	15.83	.02908	21.56	9.54	.02016	11.76
Feb. 29	9.25	.06262	18.63	9.61	.07580	12.19	16.40	.09328	22.47	9.34	.01904	11.53
Mar.31	9.18	.06855	18.62	9.60	.07730	12.26	15.92	.03417	21.85	9.61	.01351	11.88
April 30	9.21	.06516	18.81	9.58	.07676	12.34	16.24	.05737	22.39	9.23	.01152	11.42
May 31	9.23	.06926	18.99	9.61	.07799	12.47	16.09	.04377	22.25	9.11	.01882	11.29
June 30	9.25	.06798	19.18	9.64	.07757	12.61	15.64	.05395	21.71	9.40	.01825	11.68
July	9.23	.07335	19.29	9.64	.07788	12.71	15.68	.06663	21.85	9.28	.01525	11.55
Aug.	9.28	.07169	19.54	9.65	.07660	12.83	15.72	.02171	21.94	9.18	.01958	11.46
Sept.	9.33	.06640	19.79	9.69	.07930	12.99	15.45	.06533	21.66	9.30	.01538	11.62

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