REIT/Infrastructure update

June 2011 (Data as at May 31, 2011)

Sentry REIT Fund
Sentry Infrastructure Fund

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ECONOMIC DATA

	CANADA	US
OVERNIGHT RATE/FED FUNDS RATE	1.00%	0.25%
PRIME RATE	3.00%	3.25%
5 YEAR GOC/UST YIELD	2.34%	1.70%
10 YEAR GOC/UST YIELD	3.07%	3.06%
2011 GDP GROWTH EST.	3.20%	3.00%
2011 INFLATION EST.	2.60%	2.60%
SPOT EXCHANGE RATE	$0.9686/$1.0324	

Source: RBC Economics

MARKET INDICES

	LEVEL	YTD
S&P/TSX CAPPED ENERGY INDEX	335.83	3.91%
S&P/TSX CAPPED UTILITIES INDEX	227.96	2.54%
MSCI US REIT INDEX	856.46	12.55%
S&P/TSX CAPPED REIT INDEX	149.37	12.44%
S&P/TSX COMPOSITE INDEX	13,802.88	2.74%
S&P 500 INDEX	1,345.20	6.96%

Source: Reuters, price returns

BNN TOP PICKS

MAY 26, 2011	
PRIMARIS REIT	$20.73
CANADIAN REIT	$33.60
DUNDEE REIT	$33.47

Source: Sentry Investments

BEST MONTHLY PERFORMERS

SENTRY REIT FUND	
AMERICAN CAPITAL AGENCY CORP	4.33%
ARTIS REIT	4.31%
BOSTON PROPERTIES	3.65%

SENTRY INFRASTRUCTURE FUND	
ENERCARE	9.51%
BELL ALIANT	8.14%
ALGONQUIN POWER AND UTILITIES	8.01%

Source: Reuters

REAL ESTATE VALUATIONS

	CANADA	US
MARKET CAP. ($MMS)	$49,395	$297,787
2011E EARNINGS YIELD	6.06%	4.50%
2011E EARNINGS GROWTH	7.70%	12.40%
PREMIUM TO NET ASSET VALUE	5.70%	17.90%
2011E NET DEBT/ENTERPRISE VALUE	49.00%	36.20%

Source: CIBC WM, UBS, BMO NB

UTILITIES VALUATIONS

	NORTH AMERICA	GLOBAL
2011E DIVIDEND YIELD	4.10%	4.40%
2010-13E EPS GROWTH	-0.10%	7.02%
PRICE TO EARNINGS (2011E)	17.2x	15.0x
5 YEAR AVERAGE P/E	15.7x	17.1x
2011E ENTERPRISE VALUE/EBITDA	7.8x	8.6x

Source: UBS

SENTRY REIT FUND SECTOR ALLOCATION

RETAIL	26.56%
MULTI-RESIDENTIAL	18.61%
OFFICE	17.11%
INDUSTRIAL	3.08%
SENIORS' HOUSING	3.81%
LODGING	0.00%
DIVERSIFIED	23.89%
SPECIALTY	1.81%

SENTRY REIT FUND ASSET ALLOCATION

CDN. EQUITY	77.23%
US EQUITY	17.64%
GLOBAL EQUITY	0.00%
N.A. FIXED INCOME	0.00%
GLOBAL FIXED INCOME	0.00%
ETF/DERIVS.	0.00%
CASH	5.13%
ASSETS	$857,560,804

SENTRY INFRASTRUCTURE FUND SECTOR ALLOCATION

INDUSTRIALS	38.82%
PIPELINES	8.51%
UTILITIES	32.55%
ENERGY	0.00%
CONSUMER	2.02%
POWER	2.47%
INFRASTRUCTURE	0.00%
SPECIALTY	9.38%

SENTRY INFRASTRUCTURE FUND ASSET ALLOCATION

CDN. EQUITY	59.90%
US EQUITY	12.24%
GLOBAL EQUITY	21.60%
N.A. FIXED INCOME	0.00%
GLOBAL FIXED INCOME	0.00%
ETF/DERIVS.	0.00%
CASH	6.26%
ASSETS	$42,018,176

Market environment

The short-term outlook is not great. The US has hit its debt ceiling and concerns are mounting that the US could actually default on its debt. In addition, the recent string of disappointing economic data (e.g., ISM, housing, jobs, jobless claims, manufacturing, wages) clearly indicates that the US recovery is slowing. Add in the end of QE2 (second round of quantitative easing) this month and a seasonal period of weakness (i.e., sell in May and go away) and you have the makings of a short-term corrective phase in the equity markets.

The Japanese economy returned to recession in Q1, contracting by 0.9%. The earthquakes and tsunami have disrupted global manufacturing and logistics, and materially impacted Japanese production and output. The ongoing nuclear saga continues to roil the Japanese equity markets and likely played a part in the recent decision by the German government to shutter all of its nuclear facilities by 2022.

The Eurozone continues to be plagued by sovereign debt and banking solvency concerns. Compelling arguments can be made for allowing Greece and Portugal to fall into technical default (i.e., maturity extensions) or actual default (i.e., bond write-downs). However, the fact is that the impact on German and French bank capital levels would likely be catastrophic, as they are the primary holders of PIIGS (Portugal, Ireland, Italy, Greece and Spain) debt and the primary insurers of PIIGS CDS contracts. A 30% "haircut" on these debts would essentially wipe out all of the capital of the French and German banking system. Whatever the solution to this conundrum, it will take years to work out and will be a drag on GDP growth for the duration.

Finally, China is combating domestic inflation by slowing its economic output. Bank reserve levels and benchmark rates have both been raised to slow the rate of GDP growth and manufacturing backlogs have declined in recent months. Nouriel Roubini spoke at a recent conference and he pointed out that during the financial crisis, China increased its capital investments from 40% of GDP (already a staggering amount) to 50%. He posits that the resulting over-capitalization of the country (e.g., extra highways, buildings, airports) will steal GDP growth from future periods in the same manner that the US deficit will steal GDP growth from future periods. In any event, China has begun to slow and he envisions a hard landing based on this and many other items.

Taking all of this into account, fully 80%+ of global GDP is slowing or contracting. We expect this will weigh on commodity prices and the S&P/TSX to the negative. But while the perceived macro risks to the global economy are rising, the probability of any or all of these negative scenarios (e.g., US default, Greek debt restructuring, double-dip recession) actually occurring are relatively low. Long-term investors will probably get another chance to lock in strong return potential in the near future.

Sentry REIT Fund

Portfolio review

Canadian REITs, as measured by the S&P/TSX Capped REIT Index, were flat, delivering a total return of just 0.2% from April through May. We think this is the beginning of a seasonal period of weakness in the markets and REITs in particular. Combined with the fast start to the year, REITs were due for a period of moderate returns if not an outright pullback. In contrast, US REITs, as measured by the MSCI REIT Index, rocketed ahead, producing a staggering 7.0% total return. Fund flows out of Japan have been particularly strong, with several fund promoters offering double-digit yields for US REIT investment vehicles. Following on the positive sentiment from the Citi conference in March, some market strength was anticipated. Sentry REIT Fund's assets rose to over $850 million by the end of May, powered by net sales and appreciation.

Top performers in the Fund this month were American Capital Agency Corp., Artis REIT and Boston Properties, up 4.3%, 4.3% and 3.7%, respectively. American Capital is a US agency mortgage REIT offering an 18% yield with strong fundamentals. Given the number of enquiries we have received on BNN about this name, we are not surprised to see the recent strength. US mortgage REITs have been some of the best performers over the last month. Artis had underperformed recently and the yield grew to an attractive level that encouraged investors to buy. The company continued its acquisitive ways in Canada and the US, and investors have rewarded the stock lately. Finally, Boston Properties reported strong Q1 results and announced it would be re-starting one of its development projects in New York City.

Cash was up 140 bps to 5.1% and was higher during the period. We had intended to get to 10% ahead of the end of QE2; however, several capital raises saw us bring the cash position down towards the end of May. We have continued the trend of high-grading the portfolio and materially reduced several mid-cap names in favour of cash and larger-cap names. From a sector standpoint, this resulted in our diversified, specialty and seniors' housing weights coming down in favour of retail and multi-residential names. Due to the dramatic outperformance of US REITs vs. Canadian REITs, our US weighting increased 65 bps while our Canadian positions fell by 200 bps. We still have a zero weight in other global markets, and unless the ongoing sovereign debt issues spark a round of capitulation selling, that will remain the case.

Portfolio outlook

Canadian REITs are trading at approximately 16x AFFO (6.25% AFFO yield) and a 10% premium to NAV. Both levels are well off the 2007 peaks of 20x and 30%, respectively. However, investors should understand that further 20%+ annual returns are not priced in at these levels. Going forward, we expect REIT returns to mean revert back to the 8% to 12% total return range established over the last 20 years.

The fundamental environment remains strong and supportive of current valuations so we don't anticipate a prolonged downturn in REIT unit prices. Debt is plentiful and available on very attractive terms. A common theme in the reporting of the Big Six Canadian banks was the deterioration of net interest margins coupled with material loan book growth. The read through is that Canadian banks have granted more loans at lower interest rates to borrowers. The beneficiaries are the borrowers, including REITs, with access to more and cheaper debt. Occupancies are high at 96%+ for the names in the S&P/TSX Capped REIT Index, and construction permits and new construction numbers indicate that new supply will be muted going forward. Meanwhile, demand is picking up as domestic firms grow at a modest pace and foreign firms continue to seek opportunities in Canada. Perhaps the only fundamental datapoint that is not bullish is the outlook for economic growth both domestically and globally. Without strong real GDP growth, it is difficult to forecast robust rent and cash flow growth. Nonetheless, several REITs have returned to increasing their distributions annually and we expect this trend to continue going forward.

We do not anticipate a double-dip recession in the US or globally but agree with Nouriel Roubini that the US consumer is likely to continue to de-leverage for the next three to five years. The US and other developed nations will likely experience slow economic growth over that time period as the level of unemployment remains elevated, putting a cap on economic output and growth. In that type of environment, we feel confident that the strong and growing distributions from Canadian REITs will continue to support unit prices and returns, and allow them to outperform into the future.

Sentry Infrastructure Fund

Portfolio review

Sentry Infrastructure Fund continued to grow in April and May, finishing the period at $42 million in assets. The Fund's 2.1% total return trailed that of the UBS Global Infrastructure & Utilities 50-50 Index and the S&P/TSX Capped Utilities Index which generated returns of 3.1% and 3.4%, respectively. With the continued volatility in equity markets and rising macro risks, it's not surprising to us that investors continue to favour high-quality, dividend-paying utilities and infrastructure names.

Top performers in the Fund this month were Enercare, Bell Aliant and Algonquin Power & Utilities, up 9.5%, 8.1% and 8.0%, respectively. Enercare and Bell Aliant are both weak businesses with little prospects for internal growth. We think that the bid that they have captured recently is a function of their high yields, simple business models and investors' current low-risk tolerances. We would expect both names to pull back after a strong run in recent weeks. Algonquin's management team has been out marketing recently and has reported in-line results. Algonquin and Emera quantified the scope of their relationship going forward and Algonquin closed the acquisition of the Calpeco assets this month. These were favourable events that were well received by the market.

Cash rose 300 bps to 6.3%, which was a function of us exiting some utility positions that had appreciated sharply, and trimming some of our power and infrastructure names. We added to our industrial positions on weakness and our pipeline allocation was increased as we added a new name here and in our consumers bucket. Our US positions were a primary source of funds for further investment in Canadian and global positions, and we expect our tactical allocation to Canadian yield names to rise in the near future.

Portfolio outlook

In Canada, we continue to expect higher-yielding names to outperform. Several midstream names are beginning to look attractive as the market pulls back and investors fret about potential commodity price exposure. We are prepared to add to this space on material weakness. The pipeline companies continue to trade in a range and we would be buyers on material dips here as well. Finally, our power weight has remained relatively constant but we would welcome a pullback to add to this space as well. Overall, we would be net buyers of Canada on weakness as the flight to safety continues.

In the US, we continue to favour regulated utilities. The combination of relatively attractive dividend yields and monopoly business models should provide a floor in share prices in an increasingly volatile market. Several names have long-track records of annual dividend growth and would be attractive in a downturn. Overall, we would be net buyers of US names on weakness but not to the same extent as we would be in Canada. We have hedged 75% of our US currency exposure, down from fully hedged. Going forward, we anticipate that Eurozone worries will see the US dollar appreciate modestly.

Globally, our positions are balanced between Australia and Western Europe. In the near term, the allocation to Australia is likely to remain fixed as these names have traded in a tight range and offer compelling yields. First half of 2011 (1H11) reporting will take place over the summer and quarterly traffic volumes (flights and cars) indicate that the results should be strong for our Australian toll road and airport positions. We remain neutral here but are conducting due diligence on several more names in Australia and could see ourselves increasing this weight in the near term. On the Western European front, these positions have weakened as the sovereign debt issues have increased. In the near term, it may be prudent to exit these positions to preserve cash. While the businesses are sound and indications are that 1H11 operating results will be in-line, our goal of preserving capital first may require us to move defensively here. Our euro and British pound positions remain fully hedged in light of potential euro weakness.

Cash is likely to rise modestly as market volatility has risen. We don't see signs of a wave of capitulation selling but we would like to have some dry powder to capitalize on single-name weakness. In the near term, the Canadian weight should rise as we trim our global positions while our US positions might increase slightly. Otherwise, the strategic allocation should remain largely intact.

Thanks and good hunting.