SENTRY

Equity commentary

September 2011 (Data as at August 31, 2011)

Sentry Diversified Total Return Fund
Sentry Market Neutral L.P.

Sandy McIntyre *President and Chief Investment Officer*
John Kim CFA *Portfolio Manager*

	JULY	AUGUST	JULY – AUGUST
TSX	-2.5%	-1.2%	-3.7%
SP500 US$	-2.0%	-5.4%	-7.4%
Oil (WTI) US$	+0.3%	-7.2%	-7.0%
Gold US$	+8.5%	+12.2%	+21.7%

Market environment

As we entered July, investors were in a cautious mood as the market had already dropped from its April high. As the month progressed, the mood became increasingly skittish. Concern over the possibility of European sovereign debt default and mixed US economic data did nothing to help the situation.

June payrolls, vehicle sales and durable goods orders all came in below expectations, and Q2 GDP was revised down from an initial estimate of 1.9% to 1.3%. On the positive side, June retail sales and the US Institute for Supply Management (ISM) manufacturing index were higher than expected.

As July drew to a close, investor worries grew over whether the US would be able to reach an agreement to raise the debt ceiling, thereby avoiding a default and the loss of their AAA credit rating. These worries led to a sell-off in equities in the final week of July, turning a gain into a loss for the month.

August did not start any better. The early economic data released continued to worsen, as ISM and personal spending numbers were weaker than expected. Then the bombshell: Standard & Poor's lowered the US credit rating from AAA to AA+ late on August 5th. When the equity markets opened on Monday, there was a sell-off, with the S&P 500 losing over 6% and the TSX declining 4%. August 8th marked the low of 2011 up to that point. The next day, the S&P 500 was up 4%; the day after that, it was down 4%; the day after that, it was up 4%! But by the end of the week, the S&P 500 was down just under 2% and the TSX was UP 3% for the week!! Talk about volatility.

The market rallied during the last two weeks of August, first on optimism that Federal Reserve Chairman, Ben Bernanke, would talk about measures to bolster what many perceive to be a faltering economy (i.e., QE3) at the Kansas City Federal Reserve conference, as he did last year. When he did not say anything new, the markets paused. The second surge came after the minutes of the last Federal Open Market Committee (FOMC) meeting were released, in which some members advocated for even stronger stimulus measures. The market took heart that the Federal Reserve would somehow ride to the rescue once again.

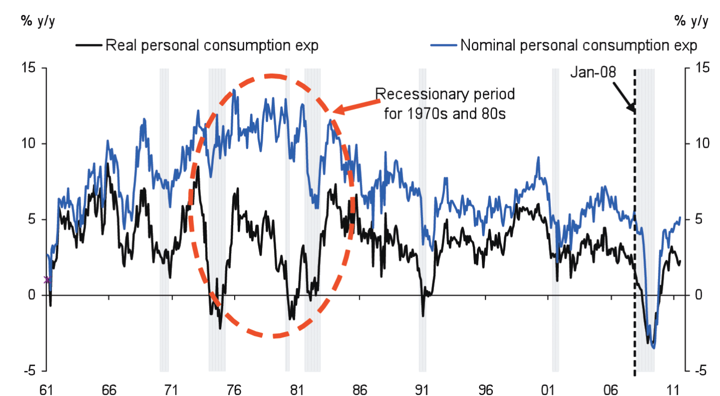
Economic data in the US continues to give mixed signals, and investors are left to wonder what to make of all this volatility in the debt markets. The US 10-year yield touched a low of 1.95%, and US T-bills and Swiss two-year bonds both had negative yields.

Market outlook

We believe the markets will test the early August low sometime in the next few months, as the economic data and forward guidance of many companies do not justify the current level of optimism. There is a real possibility of a sluggish US economy over the next year or so, and perhaps longer, due in large part to the US consumer who has gone into austerity mode. As Stephen Roach, Non-Executive Chairman of Morgan Stanley Asia, and Former Chief Economist, recently wrote:

> *"One number says it all. The number is 0.2%. It is the average annualized growth of consumer spending over the past 14 quarters – calculated in inflation-adjusted terms from the first quarter of 2008 to the second quarter of 2011. Never before in the post-World War II era have American consumers been so weak for so long. This one number encapsulates much of what is wrong today in the US – and in the global economy."*

CONSUMER SPENDING HAS DECLINED



Source: Deutsche Bank Securities

Balance sheet repair, whether it is the government, individuals or households, can take a very long time. It is not a quick fix, as anyone who has experienced high levels of debt can attest.

Portfolio review

Both Sentry Market Neutral L.P. and Sentry Diversified Total Return Fund fared poorly in August, as the small-cap special situations stocks dropped at the beginning of the month and never really

recovered with the rest of the market. Most of the underperformance was due to our exposure to special situations and small/micro-cap resource stocks, some of which were down greater than 40% in August. Despite the ongoing market volatility and portfolio re-positioning, the NAV of Sentry Diversified Total Return Fund is only down 1.2% since the portfolio manager change on August 23rd, while the TSX is down 6.0%.*

Sentry Diversified Total Return Fund

AVERAGE ANNUAL COMPOUND RETURNS (SERIES A)

1 YEAR	3 YEAR	5 YEAR	S.I.
-2.5%	5.2%	4.2%	5.2%

Portfolio outlook

We have initiated changes to the way we construct the portfolio, but we have not changed the objective, which is to deliver superior, risk-adjusted returns for our unitholders. In general, we are de-emphasizing special situations and small caps; increasing exposure to mid caps (greater than $1 billion in Canada and greater than $5 billion in the US) and large caps; conducting more group/sector pairings than individual pairings; and limiting exposure to any single stock. Exposure on the long side will be limited to no more than 1.5% for Sentry Market Neutral L.P., 2.5% for Sentry Diversified Total Return Fund, and no more than 1% on the short side for both funds. The reason for the difference in exposure on the long side is that Sentry Market Neutral L.P. must stay close to dollar neutral, whereas Sentry Diversified Total Return Fund will have a bigger net long exposure, as it is a mutual fund and cannot short more than 20%. There is additional detail below on what we mean by these changes, but generally, they are meant to reduce volatility and risk from any one stock, which should provide better risk-adjusted returns. The reposition is well underway and we are already seeing tangible results.

Special situations: We will be greatly reducing our activity in this area, especially when it comes to event- or catalyst-driven small-cap stories. We will continue to be active in special situations where the risk reward is in our favour, for example, in merger arbitrage.

Small caps: We will be reducing our exposure to small caps with no cash flow, especially in the resource sector. This is not to say we will no longer have any small-cap stocks, as we still believe there are good small companies out there. For example, in Canada we own Exco Technologies, a producer of moulds for the automotive OEMs and aluminum extrusion equipment for industrial companies. Exco has a market cap of $120mm, but is profitable, has NO debt and has a dividend yield close to 4%.

Mid caps: We believe this is the sweet spot of the market, as these companies are large enough to have scale but small enough that they can still grow. We are looking for good companies which generate cash flow, and can grow that cash flow over the next several years. For example, Analog Devices is a semiconductor company with a market cap of over US$9 billion (25% of which is in cash), that's generating lots of free cash flow and with a dividend yield of over 3%.

Large caps: We will invest in companies that are undervalued, generate lots of free cash flow, and pay dividends. For example, Centurylink is a US telecom company with a market cap over US$20 billion and a dividend yield of over 8%.

Pairings (hedging): As part of the effort to reduce risk to any single stock, we will focus more on group pairings instead of individual stock pairings. Also, instead of just valuation work, we will also look for winners and losers where we believe one sector (or sub sector) may have a structural advantage that would lead to a disadvantage for another sector (or sub sector). For example, we may go long energy companies that have a combination of growth, capital efficiency, solid balance sheet and good valuation (i.e., Baytex). We would then short companies that lack these characteristics (i.e., Husky) against the "good" companies. Also, since energy service companies currently enjoy pricing power and as such are winners, we are long service companies.

With our view that markets will test their recent lows, we are defensively positioning the portfolio by reducing small caps and special situations, and increasing our exposure to mid and large caps that have strong balance sheets, generate free cash flow and pay dividends.

Currently, Sentry Market Neutral L.P. has gross exposure under 100% and net exposure of 5%. We are long gold and dividend-paying stocks. We are short basic materials and consumer discretionary.

We have raised our cash position to more than 20% in Sentry Diversified Total Return Fund. We have also increased our short position to 10%, and acquired relatively inexpensive "insurance" through the use of S&P 500 put options to protect a portion of the Fund against a drop in the S&P 500 in the near term. Although we are defensively positioned, we are always ready to act when volatile markets create opportunities to buy stocks and short stocks.

Finally, we continue to believe that markets may be range bound over the longer term, as investors digest the possibility that the global economic growth rate will be much slower than previously anticipated, and with the possibility of the US and/or Europe going back into a recession. Expectations are definitely being reset.

*As at September 22, 2011

Sentry Market Neutral L.P. and Sentry Select Market Neutral RRSP Fund are available only to accredited investors or those who meet a minimum investment threshold.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

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