



Third Quarter Ended September 30, 2004

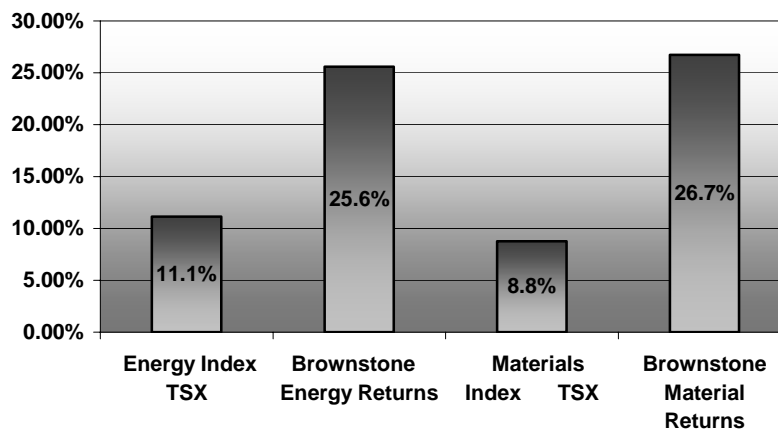
Fear and Greed – A Time Honored Tradition

“Markets run on fear and greed” Although this old adage provides an overly simplistic view of market direction, it is safe to conclude that the third quarter of this year represented one where fear was the dominant theme underlying market sentiment. The relentless rise in crude prices, continued attacks on Iraq energy infrastructure, war in Nigeria, and U.S. political uncertainty all contributed to a thread of concern among investors.

While these fears softened equity prices in most sectors through the first two months of the quarter, a secular bull market in energy and materials stocks continued. The perceived value of energy stocks has gone through a number of valuation adjustments as the market postulates the prospects of a prolonged duration of higher crude prices. Although the supply / demand picture looks disturbing, combined with an endless stream of infrastructure destruction in Iraq, we do not concur with the view that oil prices will remain high indefinitely. The concept that “this time it is different” has proven very wrong at many points in investing history. Recall the huge valuation discrepancy between high quality “old economy” stocks and the vastly overpriced “new economy stocks” of 2000. The market was convinced a new paradigm of technology had been entered and that “this time it is different”.

Strength in material stocks reflect a widely held view that the thriving Chinese economy will absorb a tremendous amount of basic materials. Energy and materials holdings represent about 14% and 12% respectively of our total equity investments in our corporate modeled portfolios.

Third Quarter Winners - Energy and Materials

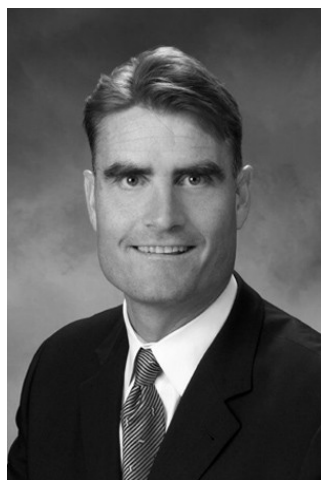


The large cap Canadian market has attracted greater investor interest this year over the small and mid-cap sector. The Brownstone Large Cap Model Canadian Equity Portfolio returned 3.90% over the quarter, and 14.10% year-to-date compared to the TSX index which returned 1.88% and 6.81% respectively. Our Small Cap Model Canadian Equity Portfolio enjoyed a strong September led by our success with equities such as Chartwell Technologies and Ceramic Protection, and has produced a 5.52% year to date return, against the Nesbitt Burns Small Cap Index which is up 2.78% year to date.

We continue to believe that investors willing to live with higher portfolio volatility will realize above average returns over time through the inclusion of small and mid-cap stocks in a portfolio. We manage portfolio volatility by holding a good number of high quality dividend paying stocks with above average yields and good potential for dividend growth. Our largest equity holding, Manulife Insurance, represents a typical quality holding that has produced results for our portfolios. The stock is up 33% from our initial accumulations and we continue to like the fundamentals.

Bond Market – Shaping Up To Be A Coupon Year

The bond market put in a respectable performance over the quarter, returning 2.82%. The general Bond Universe appears set to return over 4.0% for this year which equates to the yield-to-maturity found on most high-grade mid term bonds. Should the price of crude undercut the growth rate of our world's economies, we could see acceptable returns from this asset class. To be a strategic buyer of long-term bonds today we think an investor needs to believe that the economy will continue to weaken from here, outpacing the risk of higher inflation derived from soaring energy costs. Bonds remain vulnerable to a rise in yields, and accordingly we continue to stress shorter maturities in this environment for capital preservation purposes. The Canadian dollar at 80 cents represents the highest level since March 1993, and may be cause for Governor David Dodge to temper a plan of steady incremental rate hikes.



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