Quarterly Report

3

THIRD QUARTER
2012

FRIEDBERG MERCANTILE GROUP LTD.
CELEBRATING 40 YEARS

Contents

Third Quarter Report 2012

FRIEDBERG MERCANTILE GROUP LTD.
CELEBRATING 40 YEARS

MESSAGE TO OUR INVESTORS

It gives me great pleasure to report to you on the financial activities of our hedge funds for the quarter ended September 30, 2012.

The Global-Macro Hedge Fund eked out a small 1.1% gain for the quarter but remained negative for the year to date (-2.2%) and, more important, is negative year over year (-10.5%). The Friedberg Asset Allocation Fund, on the other hand, gained 2.6% for the quarter and was positive for the year to date (1.7%) and year over year (2.7%).

There were barely any changes of significance made to the portfolio during the course of this quarter. Of note, there were substantial gains made in our long commodities portfolio (managed by our associates, Scott Billington and Brince Wilford, who run Covenant Capital Management) and in our U.S. homebuilders position. Losses were incurred in our short bets on Australian, Brazilian, and Indian equities and European banks. Results came within our expectations, with gains slightly edging out losses. Over time, we expect this P&L spread to widen in our favour, given the far better fundamentals prevailing in the U.S. Our long-term position in TIPS again contributed positively to overall results, as real yields continued to fall to new lows (just 34 basis points on 2040 maturities at quarter end).

For the Asset Allocation Fund, we made a number of allocation changes during the quarter. We lowered our allocation to gold bullion to 5.5% from 34.9% at the end of last quarter and upped our allocation to fixed income, principally TIPS, to 43.2% (with a 45% target) in response to bullion's poor relative performance. Substituting fixed income rather than equities for gold, in contravention to our models, constituted, in retrospect, an error in judgment but is an indication of our deep aversion to risk. Our exposure to common stocks continued to be hedged, though we managed to extract a gain thanks to the outperformance of our selections.

Some of you may have seen me on Bloomberg TV this past October 12 and wondered what I was doing there. My wish had been to add my voice to concerns regarding the conduct of economic policy in the U.S., literally to wake up the public (including Wall Street) to the great dangers facing us over the coming years if we do not radically change course at once. More than anything, I looked at it as an opportunity to vent my frustrations and expose false beliefs that, unfortunately, have been gaining rapid ascendancy and respectability ever since the beginning of the millennium and have now become part of the accepted wisdom. I thought that perhaps if the comments came from a relatively successful hedge fund manager (and here, no doubt, there is an element of hubris) they would command more weight than if they came from just another economist. I was lured to the program on the promise that it would run a full half hour and I was assured that its main focus would not be investing strategy but rather “global macro issues.” It took me only about six minutes to realize that this was not to be. I was deceived, and perhaps I deserve to have been. I should have realized that the financial media have more interest in stock and commodities “tips” than in financial and economic issues. I don’t think my judgment is unduly harsh if I say that Wall Street would not be terribly unhappy if the economy collapsed as long as it managed to make money. If QE1, QE2, QE3 could make stocks go up, then bring them on, and damn the torpedoes! Lenin was not far from the truth when he said that “the capitalists will sell us the rope with which we will hang them.”

The 2008 economic crisis and recession, themselves the result of misguided economic policies, opened a new chapter in the history of economic management, one that brought back failed ideas of the past dressed in new garments. Four ideas in particular have caught the fancy of economic policy makers and have been successfully sold to the public.

The first one (and these are in no particular order) is that the central banks can print money with impunity, under the label of “quantitative easing,” because printing money can stimulate the economy to achieve a durable condition of full employment. That this never worked in the past appears to be of no concern and the fact that in our relatively long history of fiat money we have never experienced real and durable gains by printing money but, on the contrary, experienced a long bout of inflation accompanied by economic stagflation the last time we tried such an experiment (the decade of the seventies) is being conveniently passed over. Surely, many economists retort, central bankers know what they are doing. The public is confident that this time is different because of the presumed experience and sophistication of today’s central bankers and the versatility of the tools at their disposal.

Central bankers state that they can flood the system with liquidity and then remove that liquidity with surgical precision when the time requires it. Sadly, they may even believe this. There is little doubt that excess reserves can be removed by selling back Treasurys and MBSs, just as excess reserves were created buying these securities. But does anyone really think that the process is symmetrical, that the Fed can sell securities on a massive scale and in a hurry (as inflation begins to accelerate) without driving interest rates sharply higher? Can this Fed, which has shown such deliberation in the past, raising interest rates one quarter at a time and only every few months, dare to dump hundreds of billions of dollars of securities while the federal government itself is selling equivalent amounts in an environment where inflation is accelerating and markets have come to expect rising interest rates? Never. It will not happen.

The Fed has also stated that it can “freeze” excess reserves by paying higher interest rates on them. But of course, it would have to pay market rates once a lending boom has taken hold, lifting rates many hundreds of basis points in a short period of time. The severity and speed of the adjustment would bankrupt banks and businesses that have learned in recent years to achieve excess profits through the use of leverage and would bankrupt the Treasury, which has managed to deal with ever rising debt thanks only to ridiculously low nominal rates.

In other words, the huge constituency for lower interest rates will not allow the Fed to freeze in a timely fashion (or ever) the gobs of liquidity that it has been creating. While admittedly the mechanism exists, the political will to raise interest rates to a high enough level to absorb the trillions of dollars of excess reserves now being created and speedily enough to forestall huge inflationary pressures and the collapse of the dollar does not. One should note that the timing of the "exit" is itself problematic. Does anyone really think that the Fed will withdraw stimulus the second that inflation rings the bell (does it ever ring the bell?)?

The following was recently reported on Bloomberg news service: "Federal Reserve Bank of New York President William C. Dudley said the central bank won't cut back record monetary stimulus too quickly when the economy begins to gain strength.

"'If we were to see some good news on growth I would not expect us to respond in a hasty manner,' Dudley said in a speech today in New York."

In other words, the Fed is likely to be late rather than early or even timely, with unknown consequences for expectations. In the same interview, Dudley acknowledged that the Fed's exit "could increase financial market volatility" — an understatement if ever I saw one.

Sadly, the public and Wall Street are all too happy with the present experiment, lulled into complacency by official protestations and blinded by short-term profits, and refuse to see the danger until it is too late.

The second bad idea that has taken root, at least among the political and intellectual classes, is that one need not fear fiscal deficits and debt provided one has monetary sovereignty. That is, those hapless European countries experiencing severe recession as a result of self-imposed austerity programs are in such a predicament only because they cannot print money. The U.K. and Japan have shown that similar or greater fiscal deficits and levels of debt are perfectly manageable provided their central banks can effectively fund these deficits by printing money. Of course, we are told, we must not consider these money-printing operations in such a crude light; we must think of them as independent monetary accommodations undertaken solely for the purpose of stimulating activity.

Whatever these activities are called, the fact of the matter is that they result in financing the fiscal deficit by printing money. (It would be far more transparent and less costly if the Treasury were simply to issue currency notes to fund its deficit rather than the roundabout process of having the central bank buy government debt and then having the central bank pay back to the Treasury, in the form of dividends, the interest it receives from holding this debt. At least everyone would then realize that these governments are engaging in inflationary finance, Latin American style).

At any rate, thanks to this idea, politicians in the U.S., the U.K. and Japan have lost any and all the urgency they may have felt in dealing effectively with fiscal deficits. Inflationary finance has gained these countries a little bit of time, but the respite won't be long-lived. In time, these monetarily sovereign countries will face the same fate that has befallen the debtor countries unable to finance themselves, i.e., the members of the Eurozone. Inflation taxes will replace explicit taxes, but all the same, we will not be able to avert the inevitable and crushing burden that these taxes will place on economic agents. To believe otherwise is to ignore the lessons of history.

The third bad idea that has become part of common wisdom is that the Eurozone, as a political entity, must be saved at all costs. The imperial will of a handful of Euro-statists has imposed enormous economic costs on member states for the purpose of creating a political United States of Europe that few Europeans really want. The originally designed monetary union required none of this; it was simply an idea to facilitate commerce across borders by adopting a common currency and to harden the unit of exchange by tying it to the inflation-resistant Deutsche Mark.

The Euro-statists had other designs and looked for every opportunity to bring about political integration. Fiscal and debt management and coordination, unnecessary for the conduct of a monetary union, were introduced by those who saw this monetary union as only the first step in full political integration. Early debt restructuring and default were the correct answers to the problems of the PIIGS. The borrowing costs of the fiscally lax members, which had fallen to absurdly low levels thanks to a market that was naively and falsely led to believe that any state in Europe would be as sound as Germany, would have risen to levels commensurate with risk. Where the states could no longer service these debts, creditors would have taken their lumps and life would have gone on. For the future, creditor discipline would have forced these states to "behave."

Instead, the Euro-statists, German and French politicians in the main, seized upon this situation as an opportunity to "rope in" politically the weaker states of Europe. For this purpose, they designed and imposed austerity programs. These programs must be judged as colossal failures. Not only have they stood in the way of achieving much needed internal devaluation, but they have also ironically delayed economic adjustment, piled on enormous amounts of new debt that will never be serviced and thus magnified the eventual financial collapse, and prolonged the economic agony beyond what democracies can withstand, thereby managing to politically prostrate these states to the point of guaranteeing civil uprisings. And yet, despite the enormous damage that it has already wrought and its unnecessary overreach or even lack of consensus, the idea of political integration persists and is accepted by the market as desirable and inevitable. Economic decisions will continue to be made within this framework until the inevitable bust occurs.

The fourth idea that continues to pose a huge threat to our economic well-being is the belief that sovereign debtors never default. This irrational idea lies at the heart of present banking regulation and policy. Since sovereign debt is seen by the Wise Men of Basel as default-proof, commercial banks are not required to reserve capital against it, as they would be, for example, in the case of private commercial loans and real estate loans. As a direct result of this policy and in view of the possibility of earning infinite returns on capital, commercial banks have not surprisingly loaded up on these sovereign loans. In the process, they have destabilized the Eurozone. Sovereign defaults, when they occur (keep in mind that one sovereign debtor, Greece, has already defaulted) or when they are expected to occur, cause runs on banks and threaten them with bankruptcy. Ultimately, bank losses are socialized and the taxpayers' net worth is diminished.

Each one of these ideas has, unfortunately, gained acceptance and even respectability among the public. Each one of them is capable of causing the Western economic system to descend into anarchy. One need only think back to the dark days of early 2009, when the U.S. government still had the wherewithal to bail out banks and major corporations, and imagine what it would be like to experience such a moment with a government that could no longer bail out anyone because its credit had been seriously compromised.

Any one of these ideas could become the trigger or the cause of the next economic or financial crisis. Because our investment horizon is no longer than six months at any given time, we can for now discard the outbreak of virulent inflation and the inability of the major Western governments to contain, at least temporarily, a systemic financial breakdown. We cannot discard, however, the possibility that the Eurozone might snap because a European sovereign decides unilaterally to end its austerity program and default on its foreign debt, à la Argentina 2002.

Before this particular ghost has been exorcised, we are not likely to make a one-sided bet on economic expansion and accelerating inflation. This will keep us long certain markets and short others, as now, managing the overall book to produce a risk-on or risk-off posture at the margins, tinkering, so to speak, at the edges, and focusing on special situations.

It is also clear to me now that a resolution of the European crisis, whether it consists of negotiated debt restructurings, outright defaults/repudiation, or negotiated or unilateral exits from the euro-system (by the southern or the northern members), will lay the groundwork for a significant acceleration of inflation and the eventual downgrading of the debt of the monetary sovereigns, in accordance with the postulates discussed above. The possibilities for substantial gains may have to wait for that time.

Thanking you again for your continued trust,

ALBERT D. FRIEDBERG

Friedberg Global-Macro Hedge Funds

Friedberg Global-Macro Hedge Fund Ltd.
Friedberg Global-Macro Hedge Fund

A single manager multi-strategy fund.
Allocations are reviewed periodically.

Performance[1] as of September 30, 2012

	NAV	Quarterly	Year over Year[2]	Three Years[2]	Five Years[2]
Friedberg Global-Macro Hedge Fund Ltd.	5,841.09	1.14%	5.33%	18.39%	22.94%
Friedberg Global-Macro Hedge Fund	34.46[3]	0.94%	3.86%	19.13%	24.90%
CSFB/Tremont Hedge Fund Index		N.A.	1.89%	6.30%	2.67%

[1]Net of fees
[2]Compounded annual rate of return through August 2012
[3]NAV adjusted to reflect distributions reinvested in the fund

Capital allocation of the Friedberg Global-Macro Hedge Fund Ltd. as of September 30, 2012 is as follows:

FUND	CURRENT ALLOCATION	TARGET
Fixed Income	6.99%	15.00%
U.S. Equities - Market Neutral Strategy	16.42%	15.00%
Currency Program	1.58%	2.00%
Global Opportunities / Commodities	77.21%	68.00%
Cash	-2.21%	0.00%
	100.00%	100.00%

Friedberg Global-Macro Hedge Funds

Friedberg Global-Macro Hedge Fund Ltd.

Monthly Performance (%) Net of Fees

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2012	-15.04%	-5.20%	1.64%	8.84%	11.22%	-2.12%	-0.69%	1.00%	0.84%				-1.91%
2011	-10.28%	7.67%	-0.71%	9.53%	-5.06%	-3.23%	15.96%	16.22%	18.62%	-21.62%	11.47%	4.60%	40.84%
2010	2.99%	0.36%	-7.34%	3.76%	13.22%	4.75%	-13.76%	6.95%	9.11%	1.69%	-1.61%	-6.16%	11.36%
2009	-5.85%	-3.88%	3.65%	-7.15%	14.90%	-7.85%	9.47%	1.97%	5.02%	-2.21%	9.56%	-3.34%	12.02%
2008	7.37%	9.57%	-1.04%	-6.48%	4.51%	8.58%	-0.24%	-6.85%	4.18%	-5.96%	5.85%	19.06%	41.77%
2007	-1.01%	1.07%	-3.44%	-1.28%	-0.80%	1.57%	10.06%	2.80%	-1.33%	5.89%	7.91%	2.82%	26.04%
2006	1.94%	1.06%	-1.81%	2.07%	-0.75%	1.27%	2.04%	-0.09%	-0.56%	3.10%	2.43%	0.54%	11.70%
2005	1.05%	0.84%	-1.13%	1.31%	1.06%	2.47%	0.08%	0.95%	2.75%	-1.38%	2.56%	2.14%	13.35%
2004	4.03%	3.44%	1.36%	-7.84%	-0.39%	0.27%	1.02%	1.90%	1.45%	1.67%	2.76%	3.24%	13.07%
2003	3.10%	3.06%	-4.58%	-1.15%	9.26%	-3.77%	-8.04%	2.91%	5.49%	1.69%	1.49%	1.10%	9.76%
2002	-1.46%	2.04%	-2.22%	4.41%	5.41%	6.16%	-2.42%	4.45%	2.80%	-6.70%	3.30%	7.57%	21.18%
2001										0.00%	0.00%	-0.40%	-0.40%

*** PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS ***

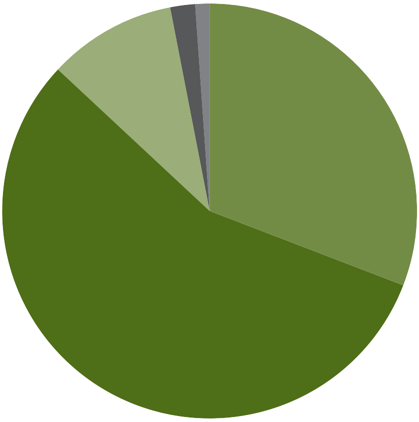
Friedberg Global-Macro Hedge Funds

Global-Macro Hedge Fund Ltd. (Cayman)

Breakdown by Total Gross Exposure

Global Opportunities	56%
Commodities	31%
U.S. Equities-Market Neutral	10%
Currencies	2%
Fixed Income	1%
Cash	0%

Total Exposure per dollar of capital: 4.77x

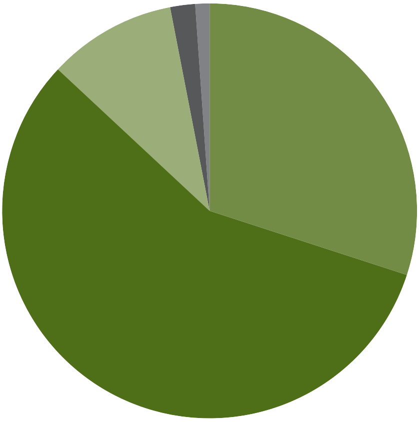


Global-Macro Hedge Fund (Canada)

Breakdown by Total Gross Exposure

Global Opportunities	57%
Commodities	30%
U.S. Equities-Market Neutral	10%
Currencies	2%
Fixed Income	1%
Cash	0%

Total Exposure per dollar of capital: 4.53x



Friedberg Global-Macro Hedge Funds

U.S. EQUITIES - Market Neutral Strategy

An equity strategy that seeks absolute returns through the judicious selection of long and short positions while maintaining a market neutral posture.

Performance as of September 30, 2012

	NAV (notional)	Quarter
U.S. EQUITIES		
Market Neutral Strategy of the Global-Macro Hedge Fund	1,681.83	3.08%

Investment Allocation

	30-Jun-12	31-Jul-12	31-Aug-12	30-Sep-12
LONGS	54.45%	52.86%	54.07%	51.70%
SHORTS	45.55%	47.14%	45.93%	48.30%
TOTAL GROSS LEVERAGE	3.31x	2.74x	2.71x	2.98x

Largest Sectors (Longs)

Movies and Entertainment	11.83%
Internet Software and Services	9.33%
Paper Products	5.69%

Largest Sectors (Shorts)

Industrials Large Caps	20.04%
Managed Health Care	7.90%
Automobile Manufacturers	4.98%

Largest Long Positions

Google Inc.
International Paper Co.
NCR Corporation
General Dynamics
News Corp.

Largest Short Positions

S&P Futures
General Motors Co.
Monster Beverage Corp.
Abercrombie & Fitch Co.
Humana Inc.

Best Quarterly Performance

	Longs
Regeneron Pharmaceuticals Inc.	33.65%
Google Inc.	30.07%
International Paper Co.	25.63%

	Shorts
Walter Energy Inc.	5.64%
Humana Inc.	1.70%
Abercrombie & Fitch Co.	0.64%

Worst Quarterly Performance

	Longs
Netflix Inc.	-15.44%
Intel Corp.	-6.69%
Precision Castparts Corp.	-5.11%

	Shorts
United States Steel Corp.	-34.84%
Oshkosh Corp.	-28.69%
General Motors Co.	-15.37%

Friedberg Asset Allocation Funds

Friedberg Asset Allocation Fund Ltd.
Friedberg Asset Allocation Fund

The Fund is a multi-strategy fund whose investment objective is to seek significant total investment returns, consisting of a combination of interest income, dividend income, currency gains and capital appreciation. Allocations are reviewed periodically.

MODEST RISK: Absolute return.

Performance[1] as of September 30, 2012

	NAV	Quarterly	Year over Year[2]	Two Years[2]
Friedberg Asset Allocation Fund Ltd.	1,438.38	2.58%	-1.96%	9.12%
Friedberg Asset Allocation Fund	15.17[3]	2.57%	-2.16%	8.66%
CSFB/Tremont Hedge Fund Index		N.A.	1.89%	5.03%

[1]Net of fees
[2]Compounded annual rate of return through August 2012
[3]NAV adjusted to reflect distributions reinvested in the fund

Friedberg Asset Allocation Funds

**Capital allocation of the Friedberg Asset Allocation Fund Ltd.
as of September 30, 2012 is as follows:**

INVESTMENT		CURRENT ALLOCATION	TARGET
FIXED INCOME		43.20%	45.00%
U.S. TIPS 2.125% Feb. 15/40	*43.20%*		
EQUITIES		45.20%*	50.00%
U.S. Homebuilders	*14.50%*		
U.S. Pharmaceuticals	*8.40%*		
Miscellaneous U.S. Equities	*12.90%*		
Foreign Equities	*9.40%*		
GOLD		5.50%	5.00%
Gold Futures	*5.50%*		
CASH AND SHORT TERM INVESTMENTS		6.10%	0.00%
		100.00%	100.00%

* The Equity exposure is temporarily hedged via a short position in S&P 500 futures contracts

Friedberg Asset Allocation Fund Ltd.

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2012	5.10%	-0.08%	-2.83%	-0.77%	-3.22%	1.21%	0.40%	0.72%	1.43%				1.75%
2011	-4.11%	4.18%	1.11%	5.56%	-1.67%	-1.98%	4.65%	5.15%	-2.82%	3.31%	-1.05%	-1.58%	10.53%
2010	-0.27%	0.99%	0.56%	3.47%	1.10%	0.99%	-2.23%	3.36%	3.91%	2.57%	-0.06%	0.83%	16.13%
2009						0.38%	2.62%	0.09%	2.91%	0.53%	7.15%	-3.63%	10.14%

*** PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS ***

Friedberg Currency Fund

Speculative trading in currency futures instruments, currency forwards and options.

Performance[1] as of September 30, 2012

	NAV	Quarter	Year over Year[3]	Three Years[3]	Five Years[3]
Friedberg Currency Fund[2]	11.07	-15.63%	19.14%	8.04%	2.42%
Barclay Currency Traders Index		N.A.	2.42%	2.51%	2.58%

[1]Net of fees
[2]Priced in Canadian Dollars
[3]Compounded annual rate of return through August 2012

Open Positions - September 30, 2012

	Times Dedicated Capital
Short New Zealand Dollar	2.09
Short Bulgaria Lev	1.91
Long Euro Currency	1.90
Short India Rupee	0.55
Total Gross Leverage	6.44 x
Maximum Gross Leverage During Quarter	6.51 x

Activity Report - Third Quarter 2012

Profitable Transactions	Profit As Percentage Of Average Equity	Percentage Of Total Profits
Long Euro Currency	2.42	100.00

Losing Transactions	Profit As Percentage Of Average Equity	Percentage Of Total Losses
Short New Zealand Dollar	(8.18)	52.95
Short Bulgaria Lev	(3.95)	25.59
Short India Rupee	(3.32)	21.46

Closed Funds

Fund	Inception Date	Inception NAV	Liquidation Date	Liquidation NAV	Size of Fund at Liquidation	Annual % Rate of Return
Friedberg Diversified Fund	13-Sep-96	10.00	31-Oct-06	48.43	$4,642,228	16.90%
Friedberg Global Opportunities Fund Ltd.	13-May-97	1000.00	28-Feb-05	501.89	$5,700,000	-8.46%
Friedberg Equity Hedge Fund L.P.	15-Feb-98	10.00	31-Oct-06	22.12	$6,784,836	9.50%
Friedberg International Securities Fund	31-Mar-98	10.00	30-Nov-05	11.49	$4,500,000	1.83%
Friedberg Futures Fund	8-May-98	10.00	31-Oct-06	19.59	$1,126,409	8.10%
Friedberg Global-Macro Hedge Fund L.P.	31-May-02	10.00	31-Oct-06	19.00	$30,691,202	15.64%
Friedberg Equity Hedge Fund Ltd.	16-Oct-96	1000.00	30-Apr-07	2951.78	$31,540,284	10.81%
Friedberg Currency Fund II Ltd.	6-Mar-97	1000.00	30-Jun-08	1019.23	$35,599,879	0.17%
Friedberg Total Return Fixed Income Fund Ltd.	2-Oct-96	1000.00	31-Jul-09	2155.93	$94,686,020	6.17%
First Mercantile Currency Fund	7-Sep-85	10.00	30-Dec-09	8.29	$848,443	N.A.
Friedberg Foreign Bond Fund	19-Aug-96	10.00	30-Jul-10	9.84	$13,336,465	6.91%
Friedberg Total Return Fixed Income Fund L.P.	19-Feb-97	100.00	28-Dec-11	325.47	$11,776,462	8.27%
Friedberg Forex L.P.	13-Jun-91	10.00	28-Dec-11	11.78	$2,558,382	2.66%

FRIEDBERG
MERCANTILE
GROUP LTD.
CELEBRATING 40 YEARS

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