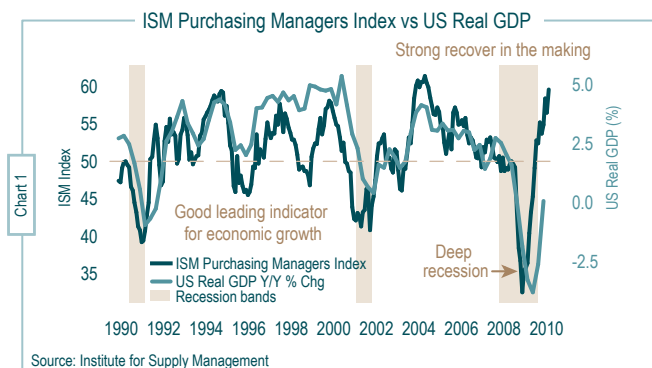


APRIL 2010

OVERVIEW

It is starting to look like a “V”. The North American economy continues to gain traction with the vast majority of incoming data surprisingly strong, especially when compared to the consensus view for a moribund recovery (see Chart 1). Conditions have improved to such an extent that many aspects of the financial system are almost back to normal. Fiscal programs initiated during the crisis remain a very powerful stimulant for growth because of their scale and lagged effect. Furthermore, the follow-on from current fiscal policy, which remains highly stimulative, will be supportive for growth for some time. Importantly, final demand is beginning to pick up due to some improvement in domestic employment, consumer balance sheets and wage gains. These factors, in combination with the strength of emerging economies (export markets), point to further gains in the North American economy. On the other hand, the outlook for Europe remains bleak. The European banking system remains under stress, which is continuing to impair the monetary transmission mechanism thus hurting credit formation. The housing market is stagnant and businesses and consumers are continuing to keep a tight rein on spending. Retail sales remain depressed and consumer surveys suggest this is not about to change anytime soon. The situation is made even more perilous because lurking just below the surface are the severe fiscal problems that Greece and other countries, such as Spain, Ireland and Portugal, are facing. Any misstep here could send the Euro into a tailspin and the US dollar soaring, which would take the wind out of the North American economy and potentially precipitate a political crisis in the European Union (EU). A rescue package is being put in place for Greece, but the threat of a contagion is still present and will from time to time come back to torment the EU and in turn financial markets.



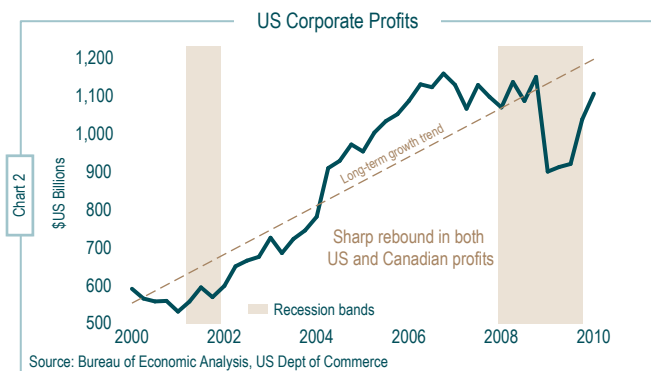
The improving economic climate in North America is due to cyclical forces that were jump-started by very aggressive monetary and fiscal policies which have set up the conditions for a sequence of

self-reinforcing events. A rebuilding of inventories from historically low levels is leading to an increase in manufacturing and support services, which in turn has improved employment opportunities and lifted consumer confidence, prompting a rise in retail sales (increased final demand). This will lead to an increase in capital spending and further output by industry, creating more employment and upward momentum in the economy – a self-reinforcing virtuous circle of actions and reactions. These cyclical forces are running counter to the secular headwinds of high structural unemployment, huge government deficits, an impaired banking system and over-indebted consumers which remain a fact of life and an impediment to economic growth and a “V” shaped recovery.

If a virtuous circle of self-reinforcing events, as described above, does take hold then the private sector can start to do some of the economic heavy-lifting. The two key factors to sustaining any meaningful recovery are the health of labour and credit markets. Unemployment has dropped recently, and forward-looking indicators point to further gains in employment. CEO confidence continues to improve along with the ISM Employment Index, which is signalling that companies are intending to hire more personnel. Credit markets have continued to improve with liquidity conditions normalizing and spreads declining toward their previous averages. However, bank lending is still moribund. The banks have been retrenching given their need to recapitalize balance sheets and pare back risk. Rather than lending to the private sector, the banks have preferred to profit from buying longer-term treasuries. However, this trend should wane as balance sheets improve and the carry trade of buying longer-term treasuries funded by low cost short-term borrowing subsides as short-term interest rates move up. This will prompt banks to extend more credit to the private sector in order to sustain profitability. Steady and sustained improvement on these two fronts is critical because it will lead to an environment in which both monetary and fiscal policies can start to normalize to where the level of interest rates, spending and taxes is conducive to the proper balance between savings, credit formation, investment and growth – a long-run imperative for developed economies.

CAPITAL MARKETS

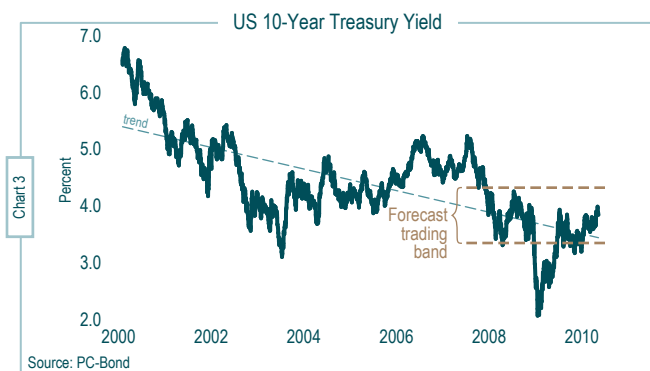
A growing and largely self-sustaining cyclical environment leads to rising corporate profits. Increases in productivity due to the speed of the corporate sector’s rapid response to a collapse in final demand during this past recession has resulted in the vast majority of companies being able to maintain high operating margins that will translate into stellar profits with a pick-up in sales (see Chart 2).



North American stock markets are trading around fair value. They are priced just above their replacement cost and forward price-earnings ratios at 14.2 times in Canada and 14.8 times in the US are in line with their historical averages. With profits increasing at a brisk pace, further gains in equity prices can be expected because it appears that equity markets have not fully discounted the upturn in the profit cycle as valuation metrics have not moved to a premium and investors, while bullish, are not euphoric.

On balance, the technical conditions for North American equity markets are positive. Equity indices remain above their 50- and 200-day moving averages, advance/decline numbers are good, the VIX (measure of risk) is below average and our internal longer-term technical models still have buy signals in force. However, markets currently appear somewhat overbought and momentum is waning, which suggests a modest pull-back in prices is a risk in the near term.

Fixed income markets have been range bound and are expected to remain so for the balance of the year with yields tending to float up to the upper end of our forecast trading range (see Chart 3). This will come about as the expectation for a tightening in monetary policy heightens, worries over rising inflation due to government deficits increase and concerns over rising commodity prices come to the fore. However, it is important not to lose sight of the fact that there are still deflationary forces at work as wages, rents, commercial real estate prices, credit and money supply are all contracting at a time when the economy's output gap remains extraordinarily wide. This will put a ceiling on how high interest rates will go.

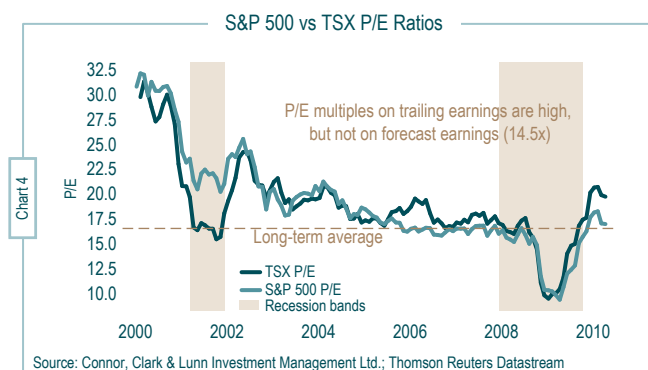


PORTFOLIO STRATEGY

Our investment thesis remains unchanged. We continue to expect that 2010 will be a transitional year for fiscal and monetary policy as we move from massive governmental stimulus to a slow withdrawal on

the expectation that the private sector can fill the void thus keeping the economy moving ahead. Under such a scenario stocks will outperform bonds and cash.

The consensus forecast for economic growth continues to move up and is now close to our Forecast with real growth in global GDP in excess of 4%, US GDP at 3% and Canada at 3.5%. This is encouraging because it validates recent stock market advances. However, it also means that for prices to advance further strong gains in earnings will be required, especially in light of the fact that equity markets are at fair value from a valuation perspective (see Chart 4). As such, from a strategic perspective we still see stocks outperforming bonds over the balance of the year. A resumption of the bear market at this point is highly unlikely. It would take much higher interest rates and tighter monetary conditions for that occur. However, from a tactical perspective, as equity markets approach our 2010 target levels (S&P/TSX Composite – 12,500 and S&P 500 – 1,250) and 10-year government of Canada bond yields back up into the 4% range, we will start to reduce the equity exposure in favour of fixed income in balanced portfolios. At these levels, the spread between the stock market's earnings yield and 10-year Government of Canada bond yields (at 4%) will have narrowed to such an extent (under 2%) that the bond market will become competitive with stocks on a risk-adjusted return basis. Also, the longer-term picture for equity markets will become less certain. This is because the current consensus forecast is for a further 23% increase in corporate profits in 2010. This seems to be a bit overly optimistic given that it would mean corporate profits would have fully recovered to their 2007 highs which occurred at a time when unemployment was hovering around 4.5% (currently 9.6% US & 8.6% Canadian), capacity utilization rates were through 80% (currently 74%) and credit was expanding at a 16% rate (zero today). All this within two years of the worst recession since the Great Depression.



Balanced portfolios remain overweight stocks versus bonds with an emphasis on Canadian equities versus foreign, and within the foreign component, US equities are preferred over EAFE markets. Equity exposure is still tilted to the economically-sensitive sectors of the market with an emphasis on technology, consumer discretionary and industrials. Within the bond component high-quality corporate issuers are still favoured over government debt. We remain tactical in our approach to duration which currently stands near benchmark levels.

While the asset mix within balanced portfolios has been largely unchanged for four quarters, we expect to reduce the equity weight as markets hit our forecast target levels and start to discount 2011 events.