# Investment Portfolio Quarterly

## Insightful Perspectives

Winter 2006

ScotiaMcLeod™

# Contents

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# Executive Summary

## 2006 Winter Outlook

*Stewart Hunt – Director, Portfolio Advisory Group*

The beginning of a new year is a time when we can reflect on the news and events of the previous year and look into the crystal ball and try to predict what will happen in the year ahead. Since we only have our past experience to guide us it tends to be difficult to deviate from what has recently occurred. While history may tend to repeat itself it is hard to predict whether future events will relate to the last year or 20 years ago. The new year is always interesting for capital market advisors and analysts, as we take in all the facts and boldly predict the future direction of the economy, stocks, bonds, currencies and commodities. It is always fun to go back when the year comes to an end just to see how accurate or inaccurate we were in our predictions.

Here are some of the key perspectives that we believe investors should be considering as we move through the fall of 2005.

- Although energy prices reached historical highs in 2005 the price increases did not materially impact core consumer prices. Interest rate increases by the Bank of Canada and the U.S. Federal Reserve have been effective in keeping inflation in check. While the rate increases in the U.S. and Canada may not be over, we do believe that we are close to the end. This should have a positive impact on stocks and bonds.
- Over the past year the TSX Composite Index has been the top performer among the world's major equity indices. Driven by the strength in the energy sector, the index was up 21.9%. As we complete the 3rd year of positive equity returns we are cautiously optimistic that we will see a continuation – although driven less by energy and commodity sectors and more by the financial and telecom sectors and gold. It should be noted that the average bull market lasts 31 months in duration and we are now in month 38. In addition the most dramatic move in a bull or bear market usually occurs as it comes to the end of the trend.
- The U.S. equity markets have not followed their Canadian counterpart to the same degree and we anticipate that in 2006 they will catch up. U.S. corporate balance sheets are heavy with cash and we believe that this will be put to work. We see sectors that are leveraged to growth in corporate spending as a good investment. As a result we would be overweight the Industrial and Technology sectors. Investors should take into consideration that U.S. stocks may look cheap in comparison to Canadian stocks, and this could further add to the value of U.S. equities with the prospect of a 90-cent Canadian dollar.
- The yield curves in both Canada and the U.S. are extremely flat. If the U.S. Federal Reserve continues to increase rates we could see the yield curve invert (short term interest rates higher than long term rates). This is not a good sign for the market, as an inverted yield curve would indicate an economy moving into recession. However, as noted above we see the rate increase cycle coming to an end, and as a result short term bond yields will move lower as the market adjusts to the next movement in interest rates – which should be lower. In the current environment keeping duration short should be rewarding, as short-term rates are at their peak and should move lower faster and further than rates in the long end of the yield curve.

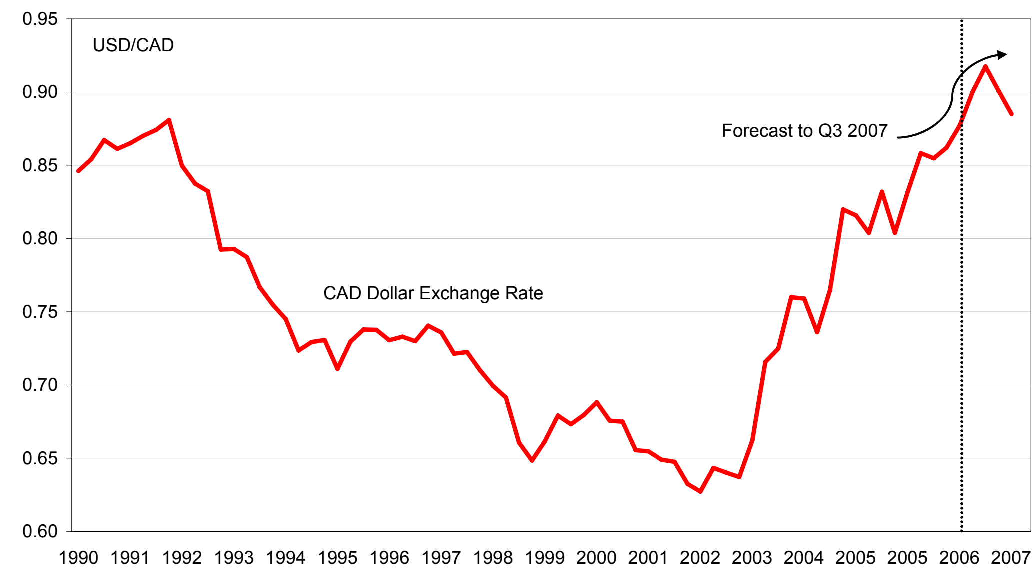
# Economic Outlook

## De-Trending

*Andrew Pyle – VP & Head of Capital Markets Research, Scotia Economics*

Getting point forecasts correct is a tough challenge for analysts, yet calling direction changes can be an even more dangerous venture, although 2006 does look like it could turn out to be a transition year on a number of fronts. While no one is publicly calling for a recession in North America this year or next, the loss of momentum in consumer spending and housing suggests that growth in Canada and the U.S. will start to slide below estimated potential rates. Slower profit-growth, resulting from the margin compression created by persistently high energy and material prices, will not choke off business investment, but whatever expansion we get in plant and equipment investment will not make up for the drag from consumers or residential construction. Both countries are offering up continued stimulus from fiscal policy (especially in Canada, where federal election promises exceed C$50 billion and the tighter inventory levels achieved during 2005 open up the possibility for some decent rebuilding of stocks this year). Yet, again, neither of these will be particularly helpful in countering the effects of a true consumer slowdown. Since 1991, the U.S. has not experienced an actual quarter of negative real consumption growth – a trend which may be running out of legs.

Loonar Eclipse




*Source: Bloomberg; Scotia Economics.*

This leads us to the next major de-trending development of 2006 – a shift in monetary policy. Both the Bank of Canada and the Federal Reserve have been vigilant in their attempts to prevent an inflation flare-up, though both have been equally surprised as to the lack of material pass-through of higher energy costs to broader core consumer prices. If anything, inflation pressures appear to be dissipating, resulting in a shift in the relative balance of risk between rising inflation and weaker growth. At a minimum this shift in balance will lead to an early conclusion to their respective monetary policy tightening programs – likely during this current quarter – and there is a growing probability that policy will have to shift back to easing mode later in 2006. By historical standards, the Fed's tightening trend has been fairly long at over 1-1/2 years, but the average period of time between the last rate hike and the first rate cut has been less than a year. Ben Bernanke, the incoming Fed Chairman, is fully expected to have a fast trigger finger when it comes to the need for easing. Bottom line, we are on the verge of breaking the uptrend in short-term rates, though the sideways trend of long rates will likely continue as markets price in greater fiscal risk in the U.S. during this House election year.

Not all trends will necessarily end this year. As much as the consensus has pulled away from the bullish oil story, there is still enough demand pull from China and India, in addition to potential supply threats (weather, Middle East tensions, etc.) to keep prices on an upward trajectory. Even if prices were to truly stall out this year, a reversal in trend is not certain by any stretch. The same holds true for metals, and even for the lesser-watched commodities like sugar, which is now enjoying the dual benefit of a western sweet tooth and increased demand for ethanol. The strength in Asian economic growth has remained defiant in the face of the accelerated rise in world energy prices and, as each year passes in China's evolution towards a more consumer-based economy, the risks posed by a slowdown in U.S. consumer demand begin to subside. If, however, the American consumer goes to sleep in 2006, Chinese growth will be negatively impacted, with knock-on effects for commodities.

Foreign exchange trends will be interesting this year, especially after witnessing the de-coupling of the U.S. dollar in 2005 from traditional market fundamentals. The dollar's improvement surprised most analysts, considering that the U.S. saw new record-high trade and current account deficits in 2005; however, the greenback's strength can be explained, in part, by the repatriation of U.S. foreign corporate profits, under the one-year tax relief program offered under the America Jobs Creation Act. The positive influence on the U.S. dollar generated by the Act is expected to diminish early in 2006, leading to a substantial decline in the value of the dollar against the Euro and Yen. For Canada, this probably means a further rise in the Loonie's value, though some in the market believe a gradual slide in energy prices could cause the Canadian dollar to weaken. We could caution against such a view for a couple of reasons. First, the amount of foreign capital that is flowing into Canada's resource sector and the high-octane growth region of Western Canada is not going to dry up simply because of a modest slide in underlying commodity prices. Meanwhile, if the U.S. dollar does embark on the second leg of its secular bear market, foreign capital will still gravitate to currencies where there is solid relative value. Canadian stocks do not offer the same value at the start of 2006 that they did early in 2005, but bond yields have risen relative to those in the U.S. over the past six months and do represent a more attractive alternative to a deficit-ridden U.S. Treasury market. Expected exchange rate moves will dominate the relative asset performance arguments in 2006, but if currencies like the Euro and Yen were to post double-digit gains against the U.S. greenback this year, odds favour at least a low single-digit appreciation in the Loonie versus the U.S. dollar, which can take us easily to 90 U.S. cents or beyond. For the most part, exporters, manufacturers and other currency-sensitive sectors have made good progress in adjusting to the Loonie's flight from its all-time low of under 62 U.S. cents back in 2002 to 86 U.S. cents this past September. Pressures will build, however, if the currency flies towards 90 U.S. cents next year and the major pain will again be felt in central Canada, primarily in the manufacturing and tourism sectors.

A soft-landing scenario for global economic growth in 2006 does carry with it some very plausible risks. In this scenario, we assume that housing market conditions in most of the western markets cool down; however, if a more extensive correction in sales, prices and construction were to emerge, this would have a major impact on consumer spending. So far, longer-term mortgage rates have not increased to the same extent as variable-rate loans and have therefore helped keep housing airborne. Fixed income investors remained confident that central bank policy would prevent inflation from becoming a problem over the medium-term, which has translated into a flatter yield curve and relatively stable longer-dated bond yields. If that confidence were shaken, then the resulting jump in mortgage costs could cause home demand to erode. Protectionism is a persistent threat that investors deal with, especially in an election year south of the border. With the U.S. trade deficit at a record high, pressure on members of Congress by their local constituents could translate into a tougher trade stance against countries that enjoy a burgeoning surplus with the U.S.

## Economic and Market Outlook 2005/2006

| Canada | 2004 (year-end) | 2005a (year-end) | 2006f (year-end) | 2007f (year-end) |
|---|---|---|---|---|
| ***S&P/TSX Composite Index*** | | | | |
| Earnings (C$) | $535.00 | $615.00f | $675.00 | n.a. |
| Levels | 9246.65 | 11,272.26 | 11,500 | n.a. |
| ***Economic Performance*** | | | | |
| Real GDP (average annual % change) | 2.9 | 2.9 | 2.8 | 2.7 |
| Motor Vehicle Sales (average annual, mln units) | 1.534 | 1.590 | 1.570 | 1.510 |
| Unemployment Rate (%) | 7.2 | 6.8 | 6.6 | 6.6 |
| Consumer Prices (% change) | 1.8 | 2.3 | 2.3 | 2.0 |
| Current Account Balance (average annual, C$ bn.) | 28.8 | 25.0 | 20.5 | 10.5 |
| ***Yield Curve*** **(%, end of period)** | | | | ***2007/Q3f*** |
| Bank of Canada Overnight Target Rate | 2.50 | 3.25 | 4.00 | 3.75 |
| 2-Year Canada Bond | 2.90 | 3.86 | 4.15 | 4.15 |
| 10-Year Canada Bond | 4.35 | 3.98 | 5.00 | 4.80 |
| **United States** | | | | |
| ***S&P/TSX 500*** | | | | |
| Earnings (U$) | $60.61 | $76.50f | $82.50 | n.a. |
| Levels | 9246.65 | 1,287.12 | 1,400 | n.a. |
| ***Economic Performance*** **(end of period)** | | | | |
| Real GDP (average annual % change) | 4.2 | 3.6 | 3.2 | 2.7 |
| Motor Vehicle Sales (average annual, mln units) | 16.9 | 17.0 | 16.5 | 15.5 |
| Unemployment Rate (%) | 5.5 | 5.1 | 5.1 | 5.3 |
| Consumer Prices (% change) | 2.7 | 3.4 | 2.8 | 2.0 |
| Current Account Balance (average annual, US$ bn.) | -668 | -810 | -870 | -860 |
| ***Yield Curve*** ***(%, end of period)*** | | | | ***2007/Q3f*** |
| Fed Funds Target Rate | 2.25 | 4.25 | 4.50 | 4.25 |
| 2-Year Treasury | 3.00 | 4.40 | 4.45 | 4.45 |
| 10-Year Treasury | 4.25 | 4.39 | 5.20 | 5.00 |
| ***Foreign Exchange Forecast*** **(end of period)** | | | | ***2007/Q3f*** |
| Canadian Dollar (US¢/C$) | 83.3 | 86.2 | 90.0 | 88.5 |
| Canadian Dollar (US$/C$) | 1.20 | 1.16 | 1.11 | 1.13 |
| Yen (¥/US$) | 102 | 117 | 105 | 98 |
| Euro (US$/€) | 1.33 | 1.18 | 1.28 | 1.33 |
| Sterling (US$/£) | 1.90 | 1.72 | 1.83 | 1.87 |
| **Commodities** | | | | |
| **WTI Oil** (average annual, US$/bbl) | 41.4 | 56.6 | 59.0 | 50.0 |
| **Nymex Natural Gas** (average annual, US$/mmbtu) | 6.19 | 9.05 | 9.50 | 9.00 |

*f: Forecast (Scotia Economics).*
*Source: Scotia Economics; Statistics Canada; U.S. Dept. of Commerce; U.S. Bureau of Labor Statistics; Bloomberg.*

# Portfolio Strategy

## Focus 2006

*Vincent Delisle – Director, Equity Research, Scotia Capital*

We believe a friendlier U.S. Federal Reserve Board (Fed) post Q1/06 and above-average earnings growth represent positive catalysts for equities and should reward investors heading into 2006. However, as U.S. economic activity slows down, commodities prices peak; with the TSX already trading at a premium, we would stress that the risk-reward outlook has dimmed. The S&P 500 appears better positioned to outpace the TSX over the next 12-18 months and our 2006 equity outlook is predicated upon a scenario of 3.2% U.S. GDP, US$62/bbl oil, and 10% EPS growth. Bond market signals will be important to monitor in the near term as they highlight the level of risks perceived. The U.S. 10 year to 2 year slope has been relentlessly flattening over the last 12 months, and with possibly two more Fed rate hikes in the cards until March 2006, the long end of the curve will have to show more "economic comfort" at some point. We expect sector leadership to migrate towards non-commodity sensitive sectors and Financials should outpace Resources, as they did in the last four months of 2005. Our current sector strategy is biased towards Financials, Telecom, Golds, Industrials, and Techs. Should the yield curve invert for a sustained period, we would get more defensive.

The outlook for U.S. growth remains constructive heading into 2006. Monthly employment gains have averaged 146,000 since June 2005, and the U.S. economy emerged from recent hurricanes in better shape than expected and ended 2005 with robust momentum. Dynamic year-end activity should bring the total 2005 GDP performance to 3.6%. Economic benefits of globalization, strong productivity growth, and back-to-back declines in unit labour costs should continue to prove inflation-friendly in 2006, headline CPI now stands at 3.5%. As strong as the current momentum is, growth is expected to slow down in the latter part of the year and the current sweet spot (4% GDP growth/mild inflation) is unlikely to continue throughout 2006. Risks to the outlook will come from consumer reaction to a slowdown in housing, lagged impact of the 13 Fed rate hikes, and a spike in winter heating bills. The housing market already appears to be stabilizing and some U.S. homebuilders are revising their forecasts to the downside. Structural imbalances are also clouding the mid-term outlook, as the United States has pretty much used up all of its tricks to keep GDP growth trending at 3.5%. Lack of savings, rising deficits, foreign debt, and a vulnerable greenback are chief among the risks for the U.S. macro picture. A decline in energy prices could act as a stimulus in the absence of another round of tax cuts. Scotia Economics is looking for U.S. GDP to moderate to 3.2% in 2006 (3.6% in 2005) before slowing down to 2.7% in 2007. The friendly inflation picture, however, should remain intact.

With U.S. monetary policy no longer accommodative and overall conditions tighter, we believe the Federal Reserve is getting ready to move to the sidelines. In our opinion, real Fed funds now stand above their "neutral" level, and, in the absence of inflationary pressure, the FOMC will certainly want to avoid a policy mistake. Fed funds are expected to increase to 4.5% at the January 31 meeting and one last rate hike could be implemented in March. The U.S. dollar will probably resume its secular downtrend when the Fed rate hike cycle ends, which would bode well for gold. Closer to home, the Bank of Canada could raise interest rates by another 75 basis points (bp) before it also takes a pause. Considering the relentless run-up in the Canadian dollar, monetary conditions are tightening more quickly. The European Central Bank (ECB) recently broke away from its two-year hiatus and raised its benchmark rate 25 bp to 2.25%. With Euroland GDP growing at a paltry 1.2% in 2005 and expected to pick up mildly to 1.7% in 2006, the ECB is clearly signalling it wants to fight inflation. The euro should appreciate against the greenback.

We believe long-term yields will continue to be biased higher in 2006, albeit modestly: 10-year bond yields could move towards 5.00% in the United States and 4.50% in Canada. At some point, the bond market will signal the extent of its "economic comfort" and investors should monitor the shape of the yield curve closely. We expect the yield curve flattening of the last 29 months to reverse course once the Fed ends its rate hikes. The slope should steepen towards the latter part of the year and we would recommend shortening durations in bond portfolios. Bond total returns should be roughly flat (0%) in 2006 based on the Scotia Capital Universe index.

Based on our 2006 total return expectations, we would recommend investors maintain overweight positions in equities (overweight S&P 500; neutral S&P/TSX) and below-average holdings in fixed income. U.S. equities are expected to outperform Canadian equities as the S&P 500 closes its undervaluation gap and sectors outside resources benefit from the end of Fed rate hikes. Cash should yield about 3.5% in 2006, and, barring a U.S. hard landing scenario, we would maintain average positions in short-term liquid securities.

# Canadian Strategy

## 2005 was a Good Year for Investors

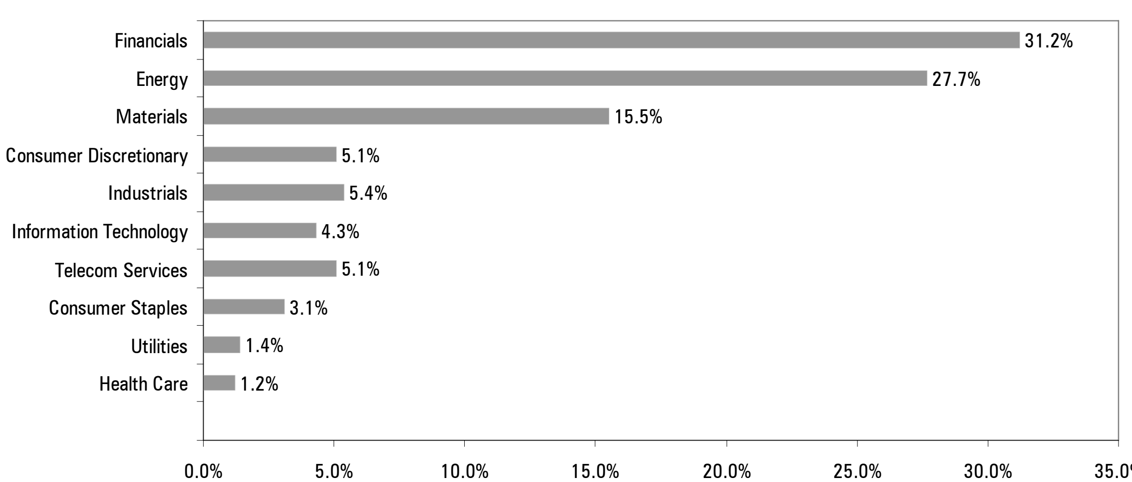
*Paul Danesi – Director, Portfolio Advisory Group*

December 2005 marked the third consecutive year of double digit gains for the TSX Composite Index. Within a broader context, the market has been driven by solid corporate profit growth, historically low interest rates and relatively strong economic momentum. The energy sector made a significant contribution to returns in 2005, although financial services and a fourth quarter rally in the material sector were also factors in the 21.9% gain for the TSX Composite Index. Other highlights included high profile merger & acquisition activity:

- Noranda acquires Falconbridge and changes its name to Falconbridge
- Inco offers to buy the new Falconbridge
- Barrick Gold offers to buy Placer Dome
- Multiple competing offers for Dofasco
- Goldcorp acquires Wheaton River Minerals

One of the bigger events in the Canadian market came late in the year. The December TSX quarterly rebalancing saw 72 income trusts added to the TSX Composite index. The net effect of this change was a reduction in weighting in financial services – increase in energy, as well as an increase in yield. Sector weightings remain heavily skewed toward financials, energy and materials, which together represent about 75% of the index. Energy and materials together represent 43% of the index making the market extremely vulnerable to a correction in commodity prices. This is particularly important for investors that tend to rely heavily on index and exchange traded funds for their equity exposure. Chances are that many of our clients have more energy exposure in their portfolios than they may think. Trusts were added to the index at half their float adjusted weight; the remainder will be added when the index is rebalanced again in March. It is possible that similar to the experience in December, there is weakness in financial services and other large cap stocks in the weeks and days leading up to the event. We would use any index related selling pressure to add to high quality large cap positions. See our income trust article for further details and guidance on the trust sector.

S&P/TSX Composite Index Group Weightings




*Source: Bloomberg.*

## Outlook

As we look ahead, we do not believe the current environment supports another year of double digit returns. To begin with the average bull market typically lasts 31 months while this cycle is now 38 months in duration. The return from the lows of 2002 has now been an impressive 99%. One week into the year and the TSX Composite Index is already trading at a premium to our 11,500 target price, 17 times forecast earnings of $675. That target is predicated on the following underlying assumptions: 3.2% U.S. Real GDP growth, U$62.25/barrel oil and 10% earnings growth. While earnings gains have been impressive, the forecast represents a further deceleration in growth, which is not supportive of multiple P/E expansion.

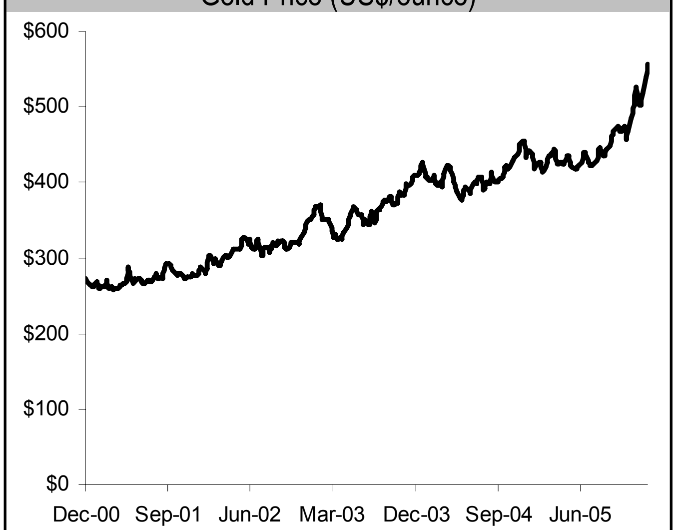
Sector leadership should move away from commodity sensitive sectors of the economy toward more defensive financial, telecom and gold sectors of the market. Industrials and information technology could also outperform in 2006.

## Resources

Valuations are stretched in many cases and commodity prices and stocks alike are poised to correct if U.S. economic growth slows more than expected. Our preference in the resource group that includes energy, gold, paper, chemicals and metals is towards gold and oil field services stocks.

To begin with, we think the energy sector will be hard pressed to repeat the strong returns it delivered in 2005 (up 63%). While Scotia Capital's 2006 energy price assumptions for WTI crude oil (U$62.25/barrel) and NYMEX natural gas (U$9.00mcf) represent increases over 2005 averages, consensus earnings estimates for oil and gas producers appear too optimistic as analysts could be under estimating cost inflation in the industry. However, it is also possible that forecasters are underestimating energy prices on a go forward basis. With the sector now representing over a quarter of the benchmark, we recommend that investors maintain some exposure. That level will depend on an investor's appetite for risk. Our top pick for 2006 is Petro-Canada. The company offers improving production growth, strong free cash flow that can support more aggressive share buybacks, and compelling valuation. In the energy services side we recommend Ensign Energy Services Inc., the second largest provider of contract drilling rigs in Canada.

Gold Price (US$/ounce)




*Source:Scotia Capital.*

Gold stocks are our top pick for 2006 within the resource group. The price of gold bullion now at a 24 year high has further upside potential through the end of the year. Scarce new supply and increasing physical demand from India and China, central bank buying, investment demand, and geopolitical risks are supportive of a higher bullion price. The inverse relationship that had existed between the price of gold and the trade-weighted U.S. dollar was broken as gold continued to move higher despite a rebound in the dollar. We believe this relationship will re-establish itself when the Federal Reserve stops raising short-term interest rates as the U.S. trade imbalance also represents a structural impediment to the sustainability of the U.S. dollar. Barrick Gold's acquisition of Placer Dome creates the largest gold producer in the world with 150 million ounces of proved and probable reserves and annual production of 10 million ounces, or 10 of global gold production in 2006.

## Economic Sensitive Sectors

In economic sensitive sectors such as the industrial group, we prefer the rails and infrastructure plays over airlines. We also believe that information technology is poised to outperform in 2006. The environment for technology companies appears supportive with many players expected to deliver strong year-over-year earnings growth. Corporate balance sheets are strong and after a few years of underinvestment, Canadian businesses are well positioned to acquire productivity enhancing hardware and software. In the industrial group, we reiterate our preference for railroads over airlines. The North American railroad industry continues to benefit from relatively strong North American economic conditions and pricing power due to limited spare capacity and strong demand for bulk commodities. Rising energy prices are a risk to the sector, however the rails have been successful in passing along higher fuel costs to the customer through fuel surcharges. CN Rail, North America's most efficient railway is our top pick for 2006. Caterpillar dealer, Finning International is also benefiting from the secular bull market in commodities and infrastructure development in western Canada and South America.

## Dividends

Dividend paying stocks in the financial, telecom and utilities sectors will benefit if the Canadian Government proceeds with plans to enhance the dividend tax credit. A higher dividend tax credit puts more cash in investors' pockets, provides an incentive for companies to raise payout ratios and acts favourably on valuations. In interest sensitive sectors, overweight telecommunications and financials services. Banks and insurance stocks were a big winner in 2005 and remain poised to outperform again in 2006. Earnings growth in the insurance sector is expected to accelerate to 15% in 2006, while bank earnings growth should decelerate to a still healthy 8%. Excess capital, rising dividends and dividend payout ratios, and share buyback programs are supportive of valuations in both groups. TD Bank and Manulife Financial are our top picks for the year ahead. Both offer industry leading earnings growth. As a caveat, a flatter or inverted yield curve represents a risk to the financial services sector.

Shares of utility companies continue to find support from strong mutual find inflows and historically low long-term yields. However, valuations are rich by historical standards making them somewhat susceptible to a back up in interest rates that is forecast for 2006. Therefore, we do not recommend investors aggressively add to positions at this time. In the telecommunications sector growth in wireless operations, strong free cash flow and dividend growth make the sector attractive for investors. Emphasis should be placed on those companies that offer the greatest wireless exposure, namely Rogers Communications Inc. and Telus Corp.

## Consumer Products

Housing and equity wealth effects, impressive job creation and rising disposable income are supportive of consumer spending in 2006, at least for now. Rising interest rates of course represent a risk on all fronts. Within the broad consumer products sector, the landscape for food retailing in Canada appears challenging as Wal-Mart prepares to launch its Supercenter concept later in the year. Wal-Mart is expected to be very aggressive on pricing which could put pressure on margins for Loblaw Companies, Sobeys, Metro and others. Drug retailers should outperform food retailers given expectations for higher earnings growth. Shoppers Drug Mart remains a compelling long-term play in the sector supported by demographic trends, a focus on health and wellness, internal growth projects that in part includes domestic geographic expansion. Other attractive companies include Thomson Corp. and Canadian Tire Corp. We would avoid auto parts, hotels, as well as printers and publishers.

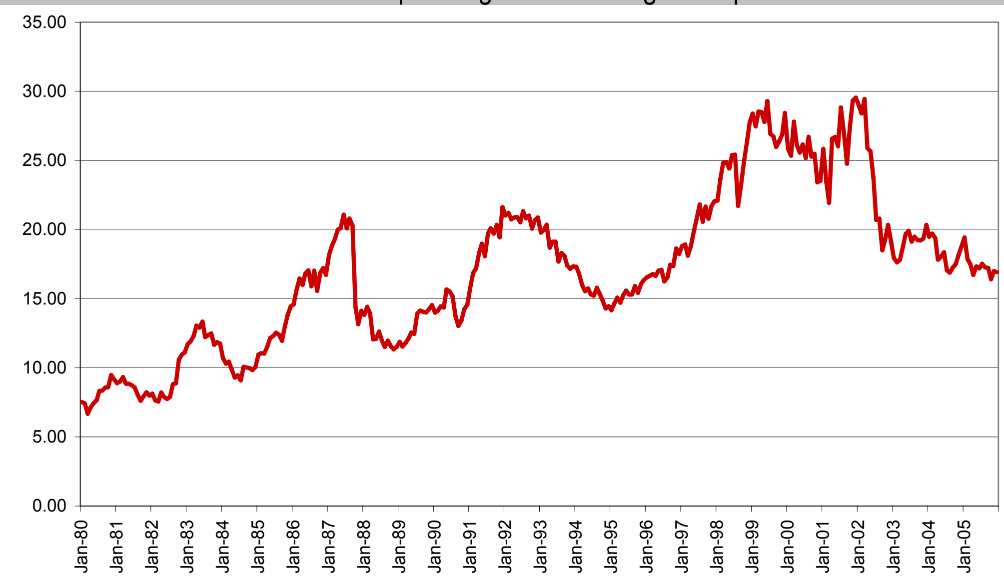
# U.S. Equity Strategy

*Andrew Guy, CFA – Associate Director, Portfolio Advisory Group*

In the last Investment Portfolio Quarterly, we suggested that the stock market's adjustment process from the insecurity that prevailed at the end of September would be bumpy. October did live up to its billing as a month of extremes: for much of the month, the S&P 500 sold off despite strong earnings announcements. At the end of the month, earnings were up 13% year-over-year, but the market was trading at only 16.4x earnings. This valuation level had not been seen since the mid-1990s.

Near the end of October, more positive economic numbers began to emerge and this helped to convince the market that economic growth was not going to slow dramatically. As a result, the stock market took off to reach its apex in the middle of December. The performance was led by a rebound in the Materials sector and strong performance of the Financial and Industrial sectors. The S&P 500 gained 1.6% in the quarter. For the year, the index gained 2.9% led by the Energy and Utilities sectors.

S&P 500 Operating Price/Earnings Multiple




*Source: Bloomberg.*

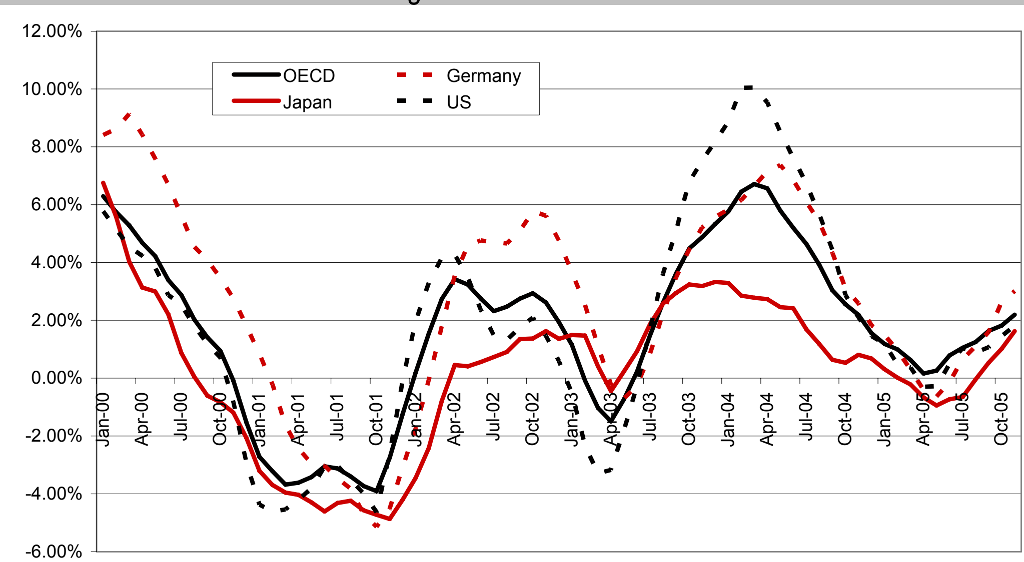
The turnaround in the equity market was driven by the positive combination of good earnings growth and an improved economic outlook. While the U.S. economy continues to be the key driver of economic growth, signs of improved growth in Japan and Germany are positive for global growth as the world becomes less dependent on the American economy. Furthermore, strong corporate profitability and balance sheets in the U.S. suggest that that economy's dependence on the consumer may be waning. The chart below shows the acceleration of leading economic indicators in the latter half of the year. Leading indicator indices include factors that have historically changed direction in advance (6-9 months generally) of the broader economy. As a result, these positive moves bode well for economic growth in 2006.

Of course, the offsetting news is the "flatness" of the yield curve. In the last week of December, the yield on the 10-year U.S. treasury was lower than the 2-year yield. This is generally seen as a sign that a recession will occur in the near future. The 2s-10s spread has not been infallible, but it does tend to lend the more accurate 3month-10s spread. This spread has not gone negative.

Another way of looking at the slope of the curve is to consider the signal that the bond market is trying to send to the U.S. Federal Reserve. We would argue that the yield curve flattens when the bond market consensus is that the Fed has raised short term rates enough. The recent minutes of Federal Reserve meetings have suggested that the governors are beginning to think that they have done enough in this cycle. The market still believes that more rate increases are in the works, but we are likely closer to the end than the beginning.

To take advantage of these trends in 2006, we would be looking to move non-Canadian assets towards the areas that are growing faster. Therefore we would be adding money to Europe and Japan. Our preferred way of playing these markets are through exchange-traded funds (ETFs), because they provide a direct way to play the domestic market. The names to look at are the iShares Japan (EWJ), Germany (EWG) or European Monetary Union (EZU). Our ADR Recommended list also includes select international names that trade on U.S. markets that will also benefit from a revival in Europe and Asia. The results of each of Adecco (ADO), Ahold (AHO), E.On (EON) and ING Group (ING) are very sensitive to the European economy. NTT DoCoMo (DCM) and Toyota Motor (TM) are plays on the Japanese economy. The China story is also not going away this year and as a result, we recommend HSBC Holdings (HBC) as a play on both Europe and Asia.

Leading Indicators Year over Year



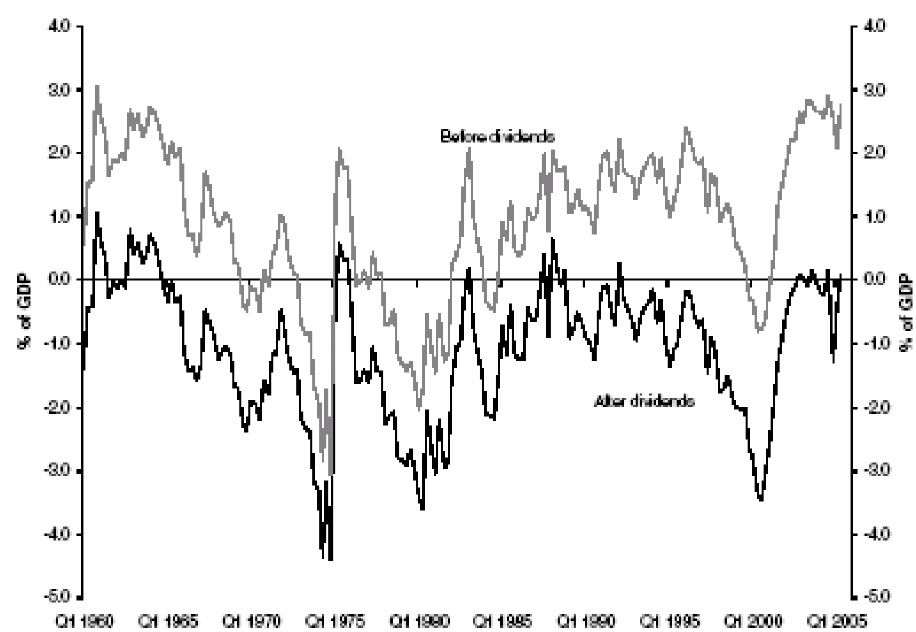

*Source: Bloomberg.*

Within the U.S. market, we prefer sectors that are leveraged to growth in corporate spending. As the chart below demonstrates, the corporate sector has been generating record cash flow. As a result, their balance sheets are in excellent shape. We expect that this year could see a move to loosen the purse strings somewhat since management will want to begin to improve profitability through greater efficiency. As a result, we would overweight the Industrial and Technology sectors. In particular, we continue to like General Electric (GE), Caterpillar (CAT) and Deere (DE). Also, as companies retool their plants to lower costs, Parker Hannifin (PH) and Eaton Corp. (ETN) will be key beneficiaries.

Software companies that are weighed towards corporate applications and technology infrastructure providers will also see some of the cash from companies. Amongst the software providers, Oracle (ORCL) and SAP (SAP) provide the type of software that enables companies to reduce costs through better data management. Cisco Systems (CSCO) continues to leverage its legacy of building the Internet to provide new applications that will enable companies to integrate their existing networks. The most obvious application is the move to voice-over-internet-protocol (VOIP) which will allow both data and voice to be carried on the same wires. The other benefit that these companies have is that they are trading at attractive valuation levels.

In general, we find better valuation levels in the U.S. than in Canada virtually across the board. Given the choice of buying a relatively expensive Canadian company or a cheaper (and often larger) U.S. company, we would prefer to buy the lower priced asset. This is consistent with our view that valuation (low P/E, low P/CF, high returns on capital) is always the key to choosing equities in any sector.

US Non-Financial Corporate Sector FCD (before and after dividends) as a % of GDP Record Free Cash Flow




*Source: Federal Reserve Boar; Bureau of Economic Analysis; CSFB research.*

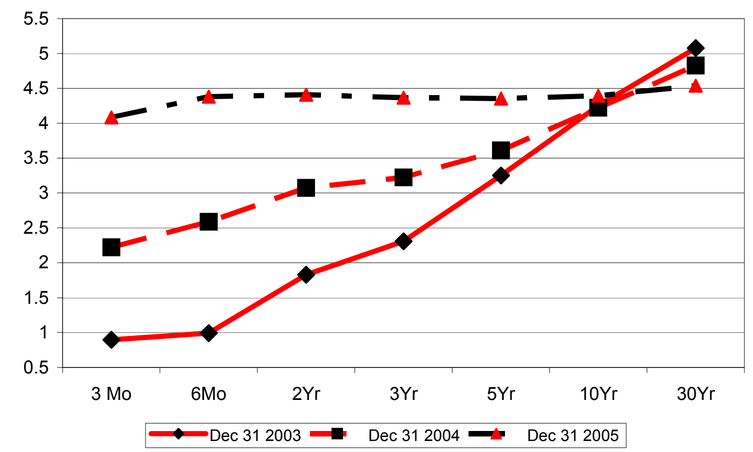
# Fixed Income

*Kevin Martin CFA – Associate Director, Portfolio Advisory Group*

## Outlook

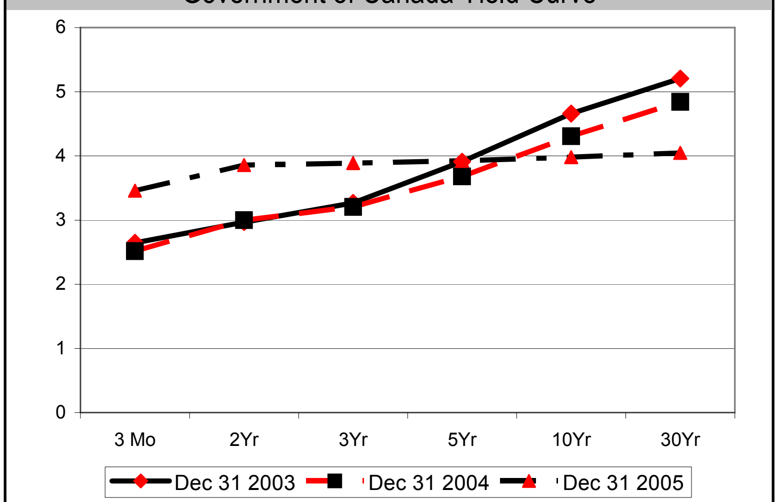
2005 witnessed a pronounced flattening in both the U.S. Treasury and Canadian Government bond yield curves. The spread between short and long maturity bond yields (also referred to the slope of the yield curve) in both countries has narrowed considerably over the last two years. Both Canadian and U.S. bond yields remain quite low from a historical point of view despite the recent increase of short term lending rates from the two central banks. The U.S. Federal Reserve has increased its overnight lending rate by 325 basis points (3.25%) between June 2004 and December 2005 in an attempt to reduce monetary stimulus. During this time, U.S. 2-year Treasury bond yields rose 172 basis points (1.72%) while U.S. 10-year Treasury bond yields actually dropped 19 basis points (0.19%). Meanwhile, the Bank of Canada resumed its monetary policy tightening campaign last fall, increasing the overnight rate by 75 basis points from September to December 2005. During this time, Canada 2-year bond yields rose 84 basis points (0.84%) while Canada 10-year bond yields rose just 19 basis points (0.19%). The chart below shows the changing shape of both the U.S. and Canadian yield curves over the last three years:

U.S. Treasury Yield Curve




*Source: Scotia Capital.*

Government of Canada Yield Curve




*Source:Scotia Capital.*

The recent flattening of the yield curve in both countries has caused short maturity yields to move substantially higher (forcing prices of short maturity bonds to move lower) and long maturity yields to move slightly lower (forcing prices of long maturity bonds to move higher). As a result of these yield movements, long maturity bonds were the top performing sub-sector of both the Canadian and the U.S. government bond markets last year. Indeed, when examining the performance of the Scotia Capital Universe Bond Index in 2005, it is clear that the long maturity sub-sectors produced the highest total returns. The Long Government of Canada sub-sector was the best performing sector of the SC Universe Bond Index, producing a total return of 14.45% last year. The entire SC Universe Bond Index posted a total return of 6.46% in 2005.

It is unlikely that long maturity bonds will outperform in 2006 given the overall low level of long maturity yields. Long maturity bond yields are running out of room to improve and are not likely to move much below current levels. We recommend that investors review their fixed income portfolios with a bias toward shortening the duration and term of their investments. The flat shape of the yield curve does not currently reward investors who invest in longer term maturities as the risk premium required to hold longer maturities has shrunk considerably.

A flat yield curve can sometimes be construed as a negative omen for future economic growth and much has been made recently of the link between an inverted yield curve and its predictive powers for a subsequent slowdown in economic growth. While it is true that an inverted yield curve has historically been quite accurate in predicting a future slowdown in economic growth, the presence of an inverted yield curve alone does not guarantee such a slowdown. Whether the U.S. yield curve inverts or not in 2006 will depend largely on whether the Federal Reserve increases interest rates by too much, too little or just enough. It is possible that the yield curve could invert if the Fed is judged to have tightened monetary policy too much, causing an abrupt slowdown in economic growth. If on the other hand, the Federal Reserve stops increasing interest rates at the right time and is deemed to have successfully engineered a “soft landing” for the economy, it is possible that the yield curve will get steeper. Unfortunately for the Fed, monetary policy is not an exact science and the affects of interest rate moves on the economy are usually delayed, making the decision of when to change monetary policy all that much more difficult.

Given the current flat shape of the yield curve and our expectations for future interest rate increases in the first half of 2006, we recommend that active fixed income investors focus on keeping the duration of their portfolios short. We do not believe the relatively small yield pick-up in longer term bond maturities is enough to offset the price depreciation risks associated with these long maturity bonds. Investors should also focus on products that have the potential for increasing coupon payments over time such as step-up coupon bonds and floating rate bonds.

For passive fixed income investors we continue to recommend the use of a laddered bond strategy. A laddered bond portfolio is a selection of several fixed income securities, each with a successively longer term to maturity. The portfolio is structured so that a portion will mature each year. To maintain the ladder, money that comes in from maturing bonds is re-invested out at the long end of the portfolio (the top of the ladder) at what are hopefully higher yields.

# Income Trusts

## No Change to the Tax Regime Surrounding Trusts followed by Index Inclusion Supports Market Recovery

*Joey Mack, CFA – Associate Director, Portfolio Advisory Group*

On November 23, 2005, Minister of Finance Ralph Goodale effectively brought the Federal Government's consultation process surrounding Income Trusts and other flow-through entities to an end, with the tabling of a Notice of Ways and Means Motion in the House of Commons. The motion left the tax treatment of Income Trusts unchanged, instead reducing personal income taxes on dividends at the federal level in order to level the playing field between corporations and income trusts. In addition, the Minister of National Revenue, John McCallum, resumed providing advance tax rulings on flow-through entity structures following the introduction of the motion.

These announcements sparked a sharp recovery in Income Trust market valuations, which rose further upon their inclusion in the S&P/TSX Composite index in December. A total of 72 issues were added to the Composite Index December rebalancing at 50% of their market capitalization weight.

However, gains in the Scotia Capital Income Trust Index (SCITI) for the three months ended December 30, 2005 were still muted, providing a total return of just 1.42%. This was below the 2.86% total return for the S&P/TSX Composite Index, but still well ahead of the Scotia Capital Universe Bond Index, which posted a quarterly return of just 0.69%.

Industrials, REITS, and Utility and Infrastructure Trusts were the market leaders, while softer commodity prices weighed on the energy and resource sectors. However, a notable factor has been the divergence in performance between the large and small capitalization issues. Income trusts with a larger market float drove the market rally, supported to a large degree in our view by their inclusion in the S&P/TSX Composite Index. Smaller capitalization trusts did not follow through, with many issues ending the year trading near their historic lows.

Total Return Indices

| | SCITI Overall | S&P/TSX Composite | SC Universe Bond Index |
|---|---|---|---|
| **Q4/05** | 1.42% | 2.86% | 0.69% |
| **Annual 2005** | 29.40% | 24.13% | 6.46% |

| Segment | Consumer | Energy | Industrial | Power | Real Estate | Resource | Utils & Infra | Business |
|---|---|---|---|---|---|---|---|---|
| **Q4/05** | -3.66% | 1.65% | 6.31% | -3.02% | 3.62% | -4.57% | 3.08% | 1.94% |
| **Annual 2005** | -7.55% | 44.45% | 21.51% | 0.90% | 24.36% | 58.77% | 19.29% | 14.43% |

*Source:Scotia Capital.*

For the year, Income Trust returns outpaced those of common equities for a sixth consecutive year. In 2005, the Scotia Capital Income Trust Index provided a total return of 29.40%, versus 24.13% for the S&P/TSX Composite, and 6.46% for the Scotia Capital Universe Bond Index. On an annual basis, stronger energy prices were the key factor, as the energy sector rose 44.45% and the resource sector (which includes Canadian Oil Sands Trust) rose 58.77%. In addition, these sectors comprise a more significant portion of the Income Trust Index, in comparison to their equivalent sector weights in the S&P/TSX Composite Index.

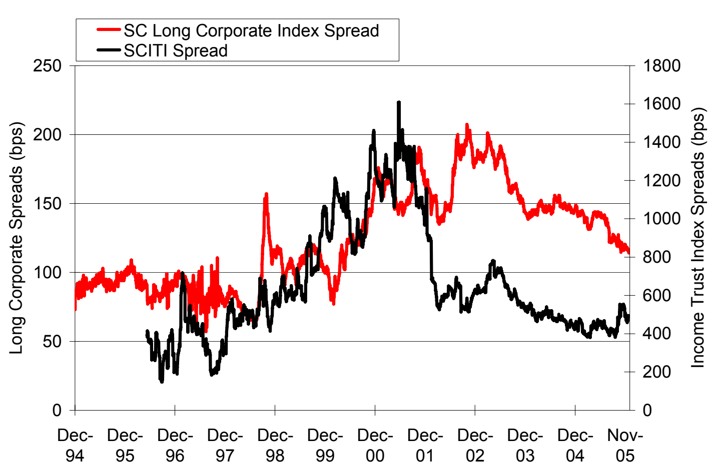
## 2006 Income Trust Market Outlook

Our outlook for Income Trusts for 2006 is mixed, as we expect a solid performance in the first quarter to be followed by a weaker performance over the balance of the year.

We base our forecast for a solid beginning of the year on several factors. First, buying interest from institutional funds using the S&P/TSX Composite as a benchmark is expected to continue. Income Trusts were only added to the S&P/TSX Composite at 50% of their market capitalization weight in December, and will be added at full weight at the March index rebalancing. Although S&P will also now calculate a new Equity-Only benchmark for accounts that do not wish to add income trusts, which suggests there are a number of passive funds that will not be buying trusts, we believe these funds are in the minority. Second, the first two months of the year typically see significant RSP contributions, and given the strong performance of Income Trusts again in 2005, we believe more money will be directed towards mutual funds targeting this asset class, as well as direct investment. Third, Income Trusts currently distribute over a billion dollars in cash each month, much of which is re-invested, and this will remain a supportive factor going forward.

Over the balance of the year, however, we are expecting the Income Trust market to weaken. Index-related buying will taper off following the March rebalancing, removing a key support. In addition, Scotia Capital's Economic and Strategy forecasts for slowing economic growth, rising inflation, rising short and long term rates, and rising credit spreads are all negative factors for income trust market valuations. Indeed, in our view, the Income Trust market is already looking expensive. The current cash yield on the Scotia Capital Income Trust index is just 8.85%, in comparison to the 3.97% yield on a Government of Canada 10-year bond. We do not recommend using current cash yields as the only metric to focus on. However, they do represent a key market proxy, and it is worth noting the difference of 4.88% is well below the 10-year historic average of 6.51%. Although this is in part driven by the energy sector and the strong outlook for commodity pricing, most other sectors also appear expensive, with only the Power Sector trading at reasonable levels from an historic perspective.

**Yield Pick-up Over 10-year Government of Canada Bonds**




*Source: Scotia Capital.*

Therefore, we continue to recommend reducing exposure to Income Trusts, shifting exposure towards core equity names, especially for more active, growth-oriented investors. For income-oriented investors, we would continue to focus on those trusts that offer a combination of high quality and sustainability of distributions, and above average distribution growth prospects, at reasonable valuation levels.

In terms of new issues, although the incentive to convert to an income trust structure has effectively been lowered, a strong incentive exists nonetheless, based on the higher valuations still evident in the Income Trust market, in comparison to valuations assigned to common equity. Therefore, we do expect further conversions to take place, although the torrid pace of initial public offerings that we witnessed in 2005 is not expected to be replicated.

# U.S. Core Guided Portfolio

*Andrew Guy, CFA – Associate Director, Portfolio Advisory Group*

## Performance Update

The Fourth Quarter started out uncertainly. The broader economic impact of hurricane season on the U.S. South and the knock-on effects (higher energy prices) was a major concern. The market declined through much of October; however, by the end of the month, it became clearer that the worst case scenario was not to be realized. As a result, the market rallied through the end of the year.

For the quarter, the S&P 500 was up 1.6% (2.1% total return), the Dow Industrials was up 1.4% and the NASDAQ rose by 2.5%. The best performing groups were the Materials, Financials and Industrials sectors. Still for all of 2005, the Energy and Utilities sectors drove the S&P 500 to a 2.9% price return and a 4.8% total return.

The U.S. Core Guided Portfolio had a total return of 2.0% in the quarter which brought the total return to 5.1% for 2005. As a result, the Guided Portfolio outperformed its benchmark by about 30 basis points. The performance in 2005 was led by GlobalSantaFe, Texas Instruments and Amgen.

## Changes

No changes were made to the U.S. Core Guided Portfolio during the quarter. We continue to carefully monitor all of the holdings in the Portfolio to ensure that the holdings continue to meet the Portfolio's guidelines.

## U.S. Core Guided Portfolio

| Sector | Symbol | Price *31-Dec-05* | Target Price | Div. | Div. Yield |
|---|---|---|---|---|---|
| **Interest Sensitive:** | (S&P 500 Weighting 27.7%) | | | | |
| Bank of New York | BK | $31.85 | $35.00 | $0.84 | 2.6% |
| JP Morgan | JPM | $39.69 | $50.00 | $1.36 | 3.4% |
| **Consumer Products:** | (S&P 500 Weighting 33.6%) | | | | |
| Amgen | AMGN | $78.86 | $76.00 | $0.00 | 0.0% |
| Diageo | DEO | $58.30 | $68.92 | $2.04 | 3.5% |
| Kimberly Clark | KMB | $59.65 | $64.20 | $1.80 | 3.0% |
| Pfizer | PFE | $23.32 | $26.00 | $0.96 | 4.1% |
| Ralcorp | RAH | $39.91 | $44.00 | $0.00 | 0.0% |
| Walt Disney | DIS | $23.97 | $40.00 | $0.27 | 1.1% |
| Wal Mart Stores Inc | WMT | $46.80 | $55.00 | $0.60 | 1.3% |
| **Industrial Products:** | (S&P 500 Weighting 26.4%) | | | | |
| Deere | DE | $68.11 | $90.00 | $1.24 | 1.8% |
| General Electric | GE | $35.05 | $41.00 | $1.00 | 2.9% |
| Oracle | ORCL | $12.21 | $16.00 | $0.00 | 0.0% |
| Texas Instruments | TXN | $32.07 | $40.00 | $0.12 | 0.4% |
| **Resource:** | (S&P 500 Weighting 12.3%) | | | | |
| PPG Industries | PPG | $57.90 | $70.00 | $1.88 | 3.2% |
| GlobalSantaFe | GSF | $48.15 | $58.00 | $0.60 | 1.2% |
| S&P 500 | | 1,248.29 | 1,450.00 | 22.0 | 1.8% |

*Source: Scotia Capital; Credit Suisse First Boston.*

# Canadian Core Portfolio

*Paul Danesi – Director, Portfolio Advisory Group*

## Performance Update

The performance of the Canadian Core Guided Portfolio for much of the fourth quarter was in-line with the Index. Unfortunately, the rebound in the oil price late in the quarter meant the Guided Portfolio underperformed the benchmark for the quarter. The Canadian Core generated a return of 2.3% in the quarter. The proposed change in the dividend tax credit ensured that the Financial holdings (GWO, MFC, TD and RY) were major contributors to the Core's performance. New entrants, TSX Group and Canadian Tire, were also strong contributors.

Still performance for 2005 as a whole was a disappointment due to the dominance of cyclical sectors like oil and gas stocks and some poor stock selection earlier in the year. The Guided Portfolio produced a 2.1% return for the year, but this was significantly below the overall S&P/TSX Composite index return. A number of the Guided Portfolio constituents had excellent years and outperformed the overall index. Enbridge, CNR, TD Bank and Manulife generated returns in excess of the Composite.

## Changes

During the quarter, two changes were made to the Canadian Core Portfolio. CIBC and Loblaw were removed from the Guided Portfolio and replaced with TSX Group (X 2-Sector Perform $44.00 target) and Finning International (FTT 1-Sector Outperform $44.00 Target).

Scotia Capital reduced the rating on CIBC to 3-Sector Underperform in November and this change forced the removal of CIBC according to the Guided Portfolio's Guidelines. TSX Group is the parent company of the Toronto Stock Exchange and Canadian Venture Exchange so it will benefit from continued strength in equity markets. The nature of its business means the company is less sensitive to changes in interest rates than other financial services companies. Furthermore, the company generates excellent cash flows that it has a history of returning to shareholders through regular dividend increases and special dividends.

Due to the threat of Wal-Mart's entry into the Canadian grocery business, Loblaw was weak through November and December and triggered the stop loss limit that we had in place. As a result, we removed the name from the portfolio and replaced it with Finning. Finning is a way to plan the extended commodity cycle without excessive exposure to any one commodity. As the Caterpillar dealer in Western Canada, South America and the United Kingdom, it is present in many of the most exciting markets for heavy equipment. The company is in the process of turning around its UK operations that have been a drag on results in recent years. We do not expect a big turnaround in the UK; just a stabilization at current levels. Economic momentum and the valuation make Finning an attractive industrial investment.

## Canadian Core Guided Portfolio

| Sector | Symbol | Price *31-Dec-05* | Target Price | Div. | Div. Yield |
|---|---|---|---|---|---|
| **Interest Sensitive:** | (S&P/TSX Weighting 38.2%) | | | | |
| BCE Inc. | BCE | $27.87 | $31.00 | $1.32 | 4.7% |
| Great-West Lifeco | GWO | $30.70 | $32.00 | $0.84 | 2.7% |
| Manulife Financial | MFC | $68.27 | $72.00 | $1.20 | 1.8% |
| Power Corp. | POWsv | $31.66 | $37.00 | $0.68 | 2.1% |
| Royal Bank of Canada | RY | $90.81 | $110.00 | $2.56 | 2.8% |
| Telus Corp. | T | $47.86 | $57.00 | $1.10 | 2.3% |
| Toronto-Dominion Bank | TD | $61.13 | $75.00 | $1.68 | 2.7% |
| TSX Group | X | $46.83 | $44.00 | $1.00 | 2.1% |
| **Consumer Products:** | (S&P/TSX Weighting 9.5%) | | | | |
| Astral Media | ACMnva | $30.64 | $38.75 | $0.30 | 1.0% |
| Canadian Tire Corp. | CTRnv | $69.54 | $80.00 | $0.58 | 0.8% |
| Shoppers Drug Mart | SC | $43.98 | $52.00 | $0.40 | 0.9% |
| Thomson Corp. | TOC | $39.66 | $51.13 | $0.93 | 2.3% |
| **Industrial Products:** | (S&P/TSX Weighting 9.7%) | | | | |
| Canadian National Railway | CNR | $93.14 | $113.00 | $1.00 | 1.1% |
| Finning International | FTT | $37.14 | $44.00 | $0.44 | 1.2% |
| **Resource:** | (S&P/TSX Weighting 42.5%) | | | | |
| Enbridge Inc. | ENB | $36.34 | $42.50 | $1.15 | 3.2% |
| Petro-Canada | PCA | $46.65 | $62.50 | $0.40 | 0.9% |
| S&P/TSX Index | | 11,272.26 | 11,100.00 | 213.0 | 1.9% |

*Source: Scotia Capital estimates; Reuters.*

# Canadian Income Plus Guided Portfolio

*Andrew Guy CFA – Associate Director, Portfolio Advisory Group*

## Performance Update

The performance for the Income Plus Guided Portfolio was saved by the November announcement by the Federal government of a change in the dividend tax credit. This caused a modest bump in the high dividend payers in the Guided Portfolio, but more importantly, it caused a rally in the Income Trust sector. In general, the S&P/TSX Composite followed the U.S. market higher during the quarter. Still, the S&P/TSX managed to finish the year as one of the best performing indices in the world driven by the Energy sector which contributed about 50% to the Index's 21.9% price return. The total return was 24.1%.

In the fourth quarter, the total return of the Income Plus Guided Portfolio was 5.0% which beat its benchmark by 2.2%. The quarterly performance brought the total outperformance for the year to 2.6%. The Guided Portfolio's performance was driven by the strong performance of the Utilities sector holdings (TransAlta, Atco), the banks (TD in particular) and Enbridge.

## Changes

During the quarter, CIBC was removed from the Guided Portfolio and replaced with TSX Group (X Sector Perform $44.00 target). Scotia Capital reduced the rating on CIBC to 3-Sector Underperform in November and this change forced the removal of CIBC according to the Guided Portfolio's Guidelines. TSX Group is the parent company of the Toronto Stock Exchange and Canadian Venture Exchange so it will benefit from continued strength in equity markets. The nature of its business means the company is less sensitive to changes in interest rates than other financial services companies. Furthermore, the company generates excellent cash flows that it has a history of returning to shareholders through regular dividend increases and special dividends.

Canadian Income Plus Guided Portfolio

| Sector | Symbol | Price *31-Dec-05* | Target Price | Div. | Div. Yield |
|---|---|---|---|---|---|
| BCE Inc. | BCE | $27.87 | $31.00 | $1.32 | 4.7% |
| CML Healthcare Income Fund | CLCun | $14.40 | $14.00 | $0.95 | 6.6% |
| Enbridge Inc. | ENB | $36.34 | $42.50 | $1.15 | 3.2% |
| Great-West Lifeco. | GWO | $30.70 | $32.00 | $0.84 | 2.7% |
| Power Financial Corp. | PWF | $33.40 | $38.00 | $0.93 | 2.8% |
| Royal Bank of Canada | RY | $90.81 | $110.00 | $2.56 | 2.8% |
| Thomson Corp. | TOC | $39.66 | $51.13 | $0.93* | 2.3% |
| TransAlta Corp. | TA | $25.41 | $30.00 | $1.00 | 3.9% |
| TD Bank | TD | $61.13 | $75.00 | $1.60 | 2.6% |
| TSX Group | X | $46.83 | $44.00 | $1.00 | 2.1% |
| Yellow Pages Income Fund | YLOun | $16.30 | $19.00 | $0.96 | 5.9% |

** Quarterly dividend is U$0.20*
*Source: Scotia Capital estimates, Reuters.*

# Fixed Income Guided Portfolio

## Core-Plus Portfolio

*Kevin Martin CFA – Associate Director, Portfolio Advisory Group*

## Investment Objective

The Core Plus Fixed Income Guided Portfolio is designed and managed for our clients with a moderate to higher risk investment profile, whose investment horizon and objectives focus on both current income and a reasonable level of returns to protect against future inflation. Based on these criteria, the portfolio's objective is to meet or exceed the performance of the Scotia Capital Universe Bond Index. Typically, this rate of return is not achieved every year but rather it is the desired average rate of return over a longer-term time horizon. Approximately 75% of the portfolio is placed in a 10-year laddered bond portfolio and 5% is placed in inflation-protected instruments. These two positions make up the core holdings of the portfolio. The balance of 20% is then focused on active strategies that are geared towards moderate to high-risk investors.

## Current Active Strategies

The active strategy portion of the Core-Plus portfolio currently includes two trades. The first active strategy trade is a position in short-term Canadian corporate paper consisting of DaimlerChrysler Finance Canada 5.00% due May 29, 2006. This trade was initiated with the view that DaimlerChrysler paper looked relatively cheap and had the potential to offer superior returns. The short maturity corporate paper position allows the portfolio to benefit by keeping duration short while still allowing it to capitalize on higher yields in the corporate sector. DaimlerChrysler Finance Canada is rated "A3" with a negative outlook by Moody's; "A low" with a negative outlook by DBRS; and "BBB" with a negative outlook by S&P.

The second active strategy is a position in one month Canadian dollar denominated Bankers Acceptance paper. We have had this position since mid November and the recent flattening of the yield curve has worked well for our strategy as it has allowed us to invest at progressively higher interest rates. Longer term bond maturities look relatively expensive given the present flatness of the Canadian yield curve. The lack of any significant term premium in Canadian bond maturities greater than one year is not very enticing to potential investors at the current time. We prefer to remain in short, liquid securities and wait for more attractive purchasing opportunities in the bond market over the coming months.

## Performance Update

The Core-Plus portfolio had a total return of 4.30% in 2005, under performing the Scotia Capital Universe's 6.46% return. The Scotia Capital Universe performance in 2005 was driven by the out performance of long dated maturities. The Scotia Capital overall Long Index had a total return of 13.84% for the year. The Core-Plus portfolio is underweight long-dated maturities relative to the Scotia Capital Universe causing it to lag the Universe performance in 2005. We feel that it is a prudent strategy to keep duration short in the portfolio as the risks associated with a spike in long term yields outweigh the potential returns associated with further gains if yields remain the same or grind lower.

Active strategies in the fourth quarter included an overweight position in 10-year Government of Canada bonds, and a position in one-month Canadian Bankers Acceptance paper.

### Core-Plus Fixed Income Guided Portfolio

As at December 30, 2005

| Sector | Coupon | Maturity Date | Weighting |
|---|---|---|---|
| **Core Positions:** | | | |
| Canada | 5.000 | 1-Jun-14 | 7% |
| Ontario | 3.500 | 8-Sep-06 | 8% |
| CMHC | 5.300 | 3-Dec-07 | 7% |
| Bank of Nova Scotia | 4.295 | 22-Aug-08 | 7% |
| New Brunswick | 5.250 | 2-Jun-09 | 8% |
| Bell Canada | 5.500 | 12-Aug-10 | 7% |
| Export Development Corp. | 5.750 | 1-Jun-11 | 7% |
| Manitoba | 5.250 | 3-Dec-12 | 7% |
| Royal Bank of Canada | 5.450 | 4-Nov-13 | 7% |
| Canadian Tire Corp. | 4.950 | 1-Jun-15 | 7% |
| Canada Real Return Bond | 3.000 | 1-Dec-36 | 6% |
| **Active Positions:** | | | |
| DaimlerChrysler Can Fin | *5.000* | *29-May-06* | *12%* |
| BNS Bankers Acceptance | | *3-Jan-06* | *12%* |

*Source: ScotiaMcLeod Portfolio Advisory Group.*

# Mutual Fund Guided Portfolios

## It's All in the Process…

*Jennifer Gilbert – Product Manager, Mutual Funds*

A new year brings with it many things; for us it is the time of year that we bring out our new Mutual Fund Recommended List.

This is an annual tradition that started in January of 1997, and we are very proud of it, and its place in the industry. We have discussed our research process in depth in past issues, but wanted to take a more complete look at what makes our list different, and show examples of how and where our process behind the list has worked well.

Let's start with what our recommendations, and the list by extension, are not. They are not intended to be our choices for top performers in any given time period. In fact, they are not usually the top performers from the period just past nor are they the fashionable picks that everyone else in the industry is talking up.

Instead, our recommendations and our annual list represent our best ideas for the money managers we would want to hire to do certain jobs for us in the context of a fully diversified portfolio. In other words, if we had money to invest, and were looking for investment managers to do that for us, these are the ones we would look to. The actual mutual funds are the vehicles through which we accomplish this.

Given that investors' objectives and tolerances for risk vary so widely, there are funds and managers who have high risk / high reward types of mandates, and ones which are intended to be extremely conservative. There are managers who run their funds with various types of styles and variants within each of the broad "value" and "growth" styles as well. There are funds and managers with incredible longevity, and others that are far newer to Canadian investors. There are funds and managers which are everyday household names and among the largest in the country, and there are ones you might not have ever heard of before. What sets our list and recommendations apart, we believe, are two elements: our manager research process, and our time horizon.

With thousands of mutual fund choices available in this country, the task of wading through them can be daunting. There needs to be a starting point and for many it means running some kind of screen based on past performance numbers, or trailing risk statistics, or a combination thereof. The presumption is that if you find the best performing funds or the ones with the best risk / return tradeoffs statistically, that this will help you identify the funds you want to invest in for the future. Usually this leads to a shortlist from which additional due diligence on the manager and their process is conducted to arrive at a decision. Essentially though, the tradition in the industry at large and among investors is to focus on past performance of one kind or another first.

## Past Performance Not an Indicator of Future Performance

We have always had difficulty with not looking at past performance as an indicator of future performance as a manager research process. However, this difficulty stems from a very simple premise that you have likely heard before. Past performance is not necessarily indicative of future performance. In fact, we have shown in various studies over the years that this is in fact the case. Past performance numbers, sliced and diced just about however you wish, are not, of themselves, a predictive indicator of which funds will perform well in the future and which ones will not.

The truth is that performance comes from a process and philosophy used by a money manager or money management team to fulfill a particular mandate. Performance is the outcome of various inputs from the people involved in managing a fund. It stands to reason then that if it is the people, process and philosophy that drive performance, then perhaps that is the order in which it makes the most sense to go about identifying promising funds, and this is exactly what we have done.

## Focus on People, Process, Philosophy

In any given year, we will meet, visit, or talk to between 200 and 300 money managers by our best estimate. Many of them we have known for years, others are brand new to us. This allows us to get to understand the people, process and philosophy behind the management of various funds that we both recommend and do not. Looking for trustworthy, intelligent people is the obvious starting point, but most fit this description. So what do we look for?

We establish what the mandate of the fund is (the manager's job description) and whether the manager has run this mandate before or it is something new for them. We then determine if the fund's past performance belongs to the manager, how the fund is run (team approach vs. individual manager), the resources available to the manager and finally the manager's style. As a result, we gain a thorough understanding of the portfolio management process, style and discipline, the mandate of the fund, and the risks inherent in the implementation of that strategy and style of management.

During our meetings with these managers and their teams (often down to the research analysts, traders, and risk management teams) we typically explore the research process employed (use of in-house analysts versus street research, use of company visits and quantitative models, etc.), buy and sell criteria for securities, resources and support systems, portfolio construction parameters and risk controls, and many others. We want to thoroughly understand the investment philosophy of the fund manager or managers so that we can give proper context to past, current and future security selections and portfolio strategies in addition to the eventual outcome – performance. By bringing this all together, we hope to form a clear picture of the manager, their strategy, the strengths they bring, the resources they have at their disposal and the risks involved in the funds we look at.

## Quantitative Assessment is Next

If you believe, as we do, that performance is the output or outcome of people, process and philosophy, then the next logical step is to take the funds and managers who are strong in these areas and see what their past results actually were. This is where quantitative analysis comes into play. We can measure their performance in multiple ways, and more importantly quantify various risk attributes (beta, standard deviation, downside risk, upside and downside capture, etc.) and style attributes. The best analogy is that manager research and selection is a bit like a jigsaw puzzle. If the pieces fit (qualitative and quantitative considerations line up), then chances are you have a good manager and fund to work with. From the select group that gets through this entire process we select the ones we believe have the best managers within each asset class or mandate and with varying degrees of risk, to place on our Recommended List for the purpose of long-term portfolio construction.

## We Take a Longer-Term View

The recommendations we make are not viewed in the context of how they will do in any given short-term period. As noted above, we make no representation that the funds on our recommended list will be the top performers in their asset class over the typically used 1 to 3 year time period. We look at a full market cycle for a manager to show their value added, on a performance basis, a risk basis, or both. We are patient with funds and managers for one simple reason. Investment management styles rotate, or go in and out of favour fairly regularly. We know that oftentimes an under-performing fund with a good manager and process will under-perform simply because their style is out of favour. Most of the investment world tends to give up on such a fund after a relatively short period of underperformance. We try to get to the root of the problem. Does the manager have problems with their research staff and have they addressed it adequately? Is their underperformance style related? If we can clearly trace the problem, and it is either cyclical or has been fixed, we tend to be patient. More often than not, this has seen us stay with funds that are being downgraded by other analysts, and more often than not the managers and funds in question have ended up turning around and returning to their former performance levels and characteristics.

## The List

As we launch our 2006 edition of the ScotiaMcLeod Mutual Fund Recommended List, it is something that we are clearly proud of. We believe our list can help our clients to build wealth over the long-term with funds that have some of the best money managers.

This year’s edition of the ScotiaMcLeod Mutual Fund Recommended List covers 12 asset classes with over 70 individual recommendations.

The most significant change is the elimination of the Global Balanced Category. We believe that while there are some good options in this category the selection is not broad enough for us to continue coverage at this time; this suspends coverage on three funds. We recommend the combination of a dedicated Global Bond fund with a dedicated Global Equity fund as the better solution. Corporate activity at the various fund companies was no less vigorous this year than we experienced throughout 2004. This continued activity resulted in several manager departures and mandate changes causing many funds to be placed under-review. After close review, based on our regular in depth due diligence process we are reinstating seven funds to fully recommended, removing four funds (that we feel no longer meet the qualifications and thesis that they were originally placed on the list to meet) and three funds remain under-review. Finally, two funds are being added.

For more detailed information please contact your advisor.

# Portfolio Considerations

## The Benefits of a Disciplined Investment Process

*Anne Lee – Manager, Fee Based Strategy and Distribution*

This year has taught us that, regardless of which direction the market takes moving ahead, maintaining a repeatable and disciplined investment process is critical to achieving long-term investment success.

As we move beyond 2005, it would be appropriate to review the importance of asset allocation and rebalancing – two key components of a repeatable investment process. For many investors, these time tested strategies are often forgotten when markets charge ahead.

A disciplined investment process begins by gaining a thorough understanding of your risk and return objectives – arriving at the appropriate asset allocation mix for your portfolio. It continues through ongoing reviews and regular rebalancing to ensure your portfolio is on track to achieve your long-term goals.

### What is asset allocation?

Asset allocation involves deciding how to distribute your investments among each asset class, reaching a balance of risk and reward that is suitable for your investment strategy and goals.

Combining different asset classes allows you to include assets that seem risky by themselves, such as small capital stocks or emerging markets stocks, and still create a portfolio that has lower volatility due to the diversification benefits that different asset classes provide.

The less concentrated your portfolio is in any one area, the more protection you will have from market volatility. The importance of asset allocation cannot be overstated. It has been said that 91% of the variability in portfolio performance can be attributed to asset allocation, while only 2% can be attributed to market timing.

When it comes to asset allocation, there are two general approaches – tactical asset allocation and strategic asset allocation. In tactical asset allocation, an investor aims to time investment flows between two asset classes – fixed income and equities – in an attempt to anticipate which asset class will outperform over the next period. A tactical approach assumes that investors' risk tolerance levels may change with market conditions. This type of strategy may be well suited to investors who can accept the risk of a larger loss in order to achieve potentially higher gains. For investors who want more of an active asset allocation approach, they may wish to allocate only a portion of their total portfolio to a tactical strategy.

In strategic asset allocation, an investor establishes a target portfolio allocation based on long-term goals and market assumptions. Once the strategic allocation is established, the portfolio is rebalanced periodically to its target to adjust for any relative movements in underlying markets. This approach assumes that an investor's risk tolerance is dictated primarily by non-market factors such as retirement plans, income needs, or capital preservation. Consequently, it is better suited to investors who prefer to make infrequent investment decisions and can stick to a long-term plan.

Selecting an appropriate asset allocation strategy depends on your unique investment needs and goals. Your customized Investment Policy Statement is designed to provide you with the most appropriate asset allocation approach based on your unique objectives and your tolerance for risk. These circumstances can help you decide the most appropriate asset allocation strategy for your portfolio.

## Determining an optimal mix of assets

Your asset allocation strategy should be geared towards creating an optimal portfolio that achieves the most favourable balance between risk and reward. The objective should be to create an efficient combination of assets that offer the greatest potential return for the least amount of risk.

In addition to asset allocation, careful attention should be paid to ensuring your portfolio is well diversified by market capitalization, country and investment style. For example, with our Summit Optimized Portfolios and Pinnacle Optimized Portfolios, Northern Trust Global Advisors – our leading third party investment consultant – draws upon modern portfolio theory and sophisticated portfolio construction tools to achieve multi-level diversification by asset class, market capitalization, country and investment style.

## What is rebalancing and why is it important?

Rebalancing involves purchasing securities or funds that have underperformed and selling securities or funds that have performed well over the investment period. This ensures that investors follow the principle of buying low and selling high, and if done properly, can help reduce unintended portfolio risk and enhance return. Implementing a rebalancing strategy can therefore be regarded as adopting a "sell discipline."

Having said this, for many investors, the rebalancing process can feel unnatural as emotions often dictate holding successful investments for too long, while, at the same time, selling weaker investments before they have the opportunity to recover. Following a disciplined rebalancing process helps control emotions, even in trending markets where the benefits of rebalancing may be less evident, by ensuring that a portfolio remains aligned to its intended asset allocation.

In addition to controlling emotional investing, rebalancing also serves to reduce overall portfolio risk. Rebalancing smoothes short-term fluctuations from changes in market sentiment, style leadership, or economic cycles. It also makes portfolio performance more consistent and less prone to spikes and extremes. Additionally, it reduces volatility and keeps the risk profile of your portfolio consistent with your Investment Policy Statement.

To take emotion out of the investment decision, it is necessary to have clear rules about when to rebalance and under what conditions. Your Investment Policy Statement should help direct the decision of when to rebalance back to your strategic asset allocation. Rebalancing annually, quarterly, or when an allocation strays outside a preset range will provide a good opportunity to achieve a long-term return objective, and even enhance returns, while maintaining your risk profile.

## The Bottom Line

Developing a repeatable and disciplined investment process is best achieved by working with your advisor. Leveraging your Investment Policy Statement, your advisor can help you implement an appropriate asset allocation and rebalancing strategy based on your unique financial needs and goals.

More importantly, your advisor can act as your coach, steering you away from decisions that may detract from performance and helping you to stick to the investment process when current events drive the markets up and down.

For more information on rebalancing or to discuss your current asset allocation strategy, please contact your advisor.

[1] "Asset Allocation is the Key to Success – Diversify Your Portfolio to Reach Investment Goals", Northern Trust, 2003.

*The Summit Program develops custom-tailored investment portfolios for investors with assets of $500,000 or more. The key components are a personal review of risk tolerance with a trained investment consultant; construction of an asset mix policy; and identification of an investment strategy through careful selection of independent portfolio managers whose style matches the investor's tolerance for risk. The Program employs discretionary portfolio management using individual rather than pooled securities; an investment policy review; comprehensive quarterly portfolio and performance reports; and multiple manager diversification for investors with large portfolios. The Pinnacle Program follows the same disciplined professional process as the Summit Program using proprietary investment pools exclusively designed for ScotiaMcLeod rather than individual securities. The Pinnacle Program is ideal for accounts starting at $50,000*.

# Canadian Oil Sands

## A Long Term Growth Opportunity

*Gareth Watson, CFA – Associate, Portfolio Advisory Group*

The following article contains some excerpts from a recent report published by Scotia Capital's Senior Energy research team entitled "Canadian Oil Sands: Evolution Not Revolution".

With oil prices rising above U$60.00+ per barrel today from a low of U$18.00 per barrel in 2001, the Canadian oil sands continue to attract worldwide attention. In fact, Canada is emerging as a sustainable bright spot within the non-OPEC crude oil supply growth picture alongside Angola, Brazil and the former Soviet Union. Current production from Canadian oil sands of 993,000 barrels per day (bpd) could more than double into the 2.0 to 2.2 million bpd range by 2010, underpinned by a raft of projects that have already broken ground or are nearing regulatory approval. At a broader level, Canada's crude oil and liquids production has the potential to rise from approximately 3.0 million bpd in 2005 to 3.9 million bpd by 2010 and flirt with 5 million bpd by 2015.

Canada's oil sands are located predominantly within the province of Alberta, although some minor deposits are found in the Arctic Island region. Alberta's oil sands are separated into three distinct regions: Peace River (8% of reserves), Cold Lake (12% of reserves), and Athabasca (80% of reserves). Below we provide a brief oil sands profile for each senior energy company in Scotia Capital's universe of coverage:

### Canadian Natural Resources (CNQ)

CNQ's thrust towards the oil sands struck a positive chord with investors in 2005, largely underpinned by the sanctioning of its Horizon oil sands mining project. CNQ has complete ownership of the Horizon oil sands project and other projects that make up its thermal oil sands strategy. At a total cost of $11 billion, the first three Horizon Phases are expected to support 232,000 bpd of synthetic oil production by 2012.

### Canadian Oil Sands Trust (COS.un)

COS.un is a member of the Syncrude joint venture, where the company has increased its interest over time to 35.49%. In 1996, the Syncrude partners embarked on the Syncrude 21 Expansion aimed at doubling productive capacity toward the 500,000 bpd (177,500 net to COS.un) range by 2015.

### EnCana Corporation (ECA)

EnCana has an estimated 1.2 million acres and 5.3 billion barrels of recoverable bitumen on its three primary leases: Foster Creek, Christina Lake, and Borealis. In November 2005, EnCana provided a preliminary outlook for subsequent oil sands expansion phases, which could see bitumen production growth reaching 500,000 bpd by 2015.

### Husky Energy (HSE)

Husky's oil sands strategy is beginning to emerge, with two primary leases on the front burner, Tucker and Sunrise, that could ultimately support bitumen production of 230,000 bpd by 2015. Husky has established a large resource base with some 22.6 billion barrels of bitumen in place in the Cold Lake (Tucker) and Athabasca (Sunrise) regions.

### Imperial Oil (IMO)

Nearly 55% of Imperial's total 2005 estimated upstream production flows from the Cold Lake oil sands project and its 25% interest in the Syncrude joint venture. Imperial has increased current productive capacity at Cold Lake (100% interest) to 150,000 bpd of bitumen. The Kearl Oil Sands Project (70% interest) could substantially bolster Imperial's longer-term upstream production outlook and its first year of production is expected by 2010. In partnership with ExxonMobil (30% interest), Kearl will initially support 100,000 bpd of mined bitumen and may ultimately support 300,000 bpd by 2019.

### Nexen (NXY)

As an equal partner with OPTI Canada, Nexen has a 50% interest in the $3.5 billion Long Lake oil sands project with its sights set on constructing and operating an upgrader that will convert bitumen into 58,500 bpd of light sweet synthetic crude beginning in 2007. Nexen has received regulatory approval to expand its Long Lake upgrader, which could boost total production levels to 142,000 bpd by 2011. Nexen also has a 7.23% interest in the Syncrude oil sands joint venture.

### OPTI Canada (OPC)

OPTI Canada's only interest in the oil sands is the other 50% interest in the Long Lake oil sands project not owned by Nexen.

### Petro-Canada (PCA)

PCA has a 100% interest in the MacKay River project. Since commercial operations began at MacKay in 2002, PCA has ramped up production levels and expects to reach its design capacity of 30,000 bpd of bitumen in 2006. PCA has a 55% interest in the Fort Hills oil sands mining project, along with partners UTS Energy (30%) and Teck Cominco (15%). Fort Hills contains 2.8 billion barrels of recoverable bitumen reserves and remains at the early stages of the planning process. PCA also has a 12% interest in the Syncrude oil sands joint venture.

### Shell Canada (SHC)

The oil sands account for approximately 41% of SHC's 2005 estimated equivalent production. SHC has a 60% interest in the Athabasca Oil Sands Project, including the Muskeg River Mine and Scotford Upgrader, along with joint venture partners Western Oil Sands (20%) and Chevron Canada Limited (20%). Over the next four years, Athabasca's total oil sands production is targeted to increase from 155,000 bpd to 280,000 bpd by 2009. SHC also has a 100% interest in its project in Peace River where bitumen production could ultimately reach 30,000 bpd by 2009.

### Suncor Energy Inc. (SU)

Suncor's medium-term oil sands production outlook of 350,000 bpd by 2008 and longer-term objective of reaching 500,000 to 550,000 bpd under its Voyageur expansion phase by 2010/2012 remain in place. Suncor's oil sands assets include the Firebag project and the Millennium/Steepbank mining operation, which is located within the sweet spot of Athabasca.

### Western Oil Sands Inc. (WTO)

WTO's production flows solely from its 20% interest in the Athabasca Oil Sands Project, making it highly leveraged to synthetic crude oil prices. Athabasca's oil sands production rates are expected to remain in the 150,000 – 155,000 bpd (approximately 30,000 bpd to WTO) range over the next few years.

Investors owning energy companies with assets in the oil sands have enjoyed solid share price returns due in part to a tightening worldwide crude oil supply/demand balance, higher energy prices and therefore improved economics for further investment and production growth. The oil sands are in their infancy considering projected future production rates. With considerable production growth yet to come, oil sands stocks could benefit from further share price appreciation if energy prices remain above historical averages and capital costs remain in check.

Scotia Capital's favourite oil sands stocks remain Suncor Energy Inc. and Canadian Oil Sands Trust given their legacy assets and first-mover advantages. Petro-Canada and Husky Energy Inc. afford significant potential for multiple expansion via unrecognized oil sands value nearing the surface, while OPTI Canada Inc. and Western Oil Sands Inc. constitute the pure plays (and thus higher risk plays) amongst Scotia's coverage universe.

In the table below we outline Scotia Capital's estimated oil sands production for each project at each company outlined in this report. The companies are listed in order, from highest to lowest, based on estimated oil sands production by 2015.

## Scotia Capital Estimated Oil Sands Production Profiles

| | Operating Ownership | 2005E | 2006E | 2007E | 2008E | 2009E | 2010E | 2011E | 2012E | 2013E | 2014E | 2015E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Suncor** | | | | | | | | | | | | |
| Millennium | 100% | 148,225 | 225,000 | 235,000 | 280,000 | 280,000 | 285,000 | 285,000 | 395,000 | 420,000 | 445,000 | 445,000 |
| Firebag | 100% | 16,850 | 35,000 | 52,500 | 70,000 | 87,500 | 105,000 | 105,000 | 105,000 | 105,000 | 105,000 | 105,000 |
| Total | | 165,075 | 260,000 | 287,500 | 350,000 | 367,500 | 390,000 | 390,000 | 500,000 | 525,000 | 550,000 | 550,000 |
| **Imperial Oil** | | | | | | | | | | | | |
| Cold Lake | 100% | 146,244 | 150,000 | 160,000 | 160,000 | 180,000 | 180,000 | 190,000 | 195,000 | 200,000 | 200,000 | 215,000 |
| Kearl | 70% | 0 | 0 | 0 | 0 | 0 | 35,000 | 52,500 | 105,000 | 122,500 | 140,000 | 140,000 |
| Syncrude | 25% | 53,424 | 69,341 | 78,889 | 87,500 | 87,500 | 87,500 | 87,500 | 90,000 | 92,500 | 95,000 | 95,000 |
| Total | | 199,668 | 219,341 | 238,889 | 247,500 | 267,500 | 302,500 | 330,000 | 390,000 | 415,000 | 435,000 | 450,000 |
| **Canadian Natural Resources** | | | | | | | | | | | | |
| Primrose/Wolf Lake | 100% | 53,400 | 68,000 | 70,000 | 70,000 | 90,000 | 100,000 | 110,000 | 120,000 | 120,000 | 120,000 | 120,000 |
| Horizon | 100% | 0 | 0 | 0 | 18,000 | 110,000 | 110,000 | 170,000 | 232,200 | 232,200 | 232,200 | 232,200 |
| Kirby | 100% | 0 | 0 | 0 | 0 | 0 | 0 | 15,000 | 30,000 | 30,000 | 30,000 | 30,000 |
| Birch Mountain | 100% | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 30,000 | 45,000 | 60,000 |
| Total | | 53,400 | 68,000 | 70,000 | 88,000 | 200,000 | 210,000 | 295,000 | 382,200 | 412,200 | 427,200 | 442,200 |
| **Shell Canada** | | | | | | | | | | | | |
| Athabasca (Muskeg River) | 60% | 78,282 | 93,000 | 93,000 | 108,000 | 153,000 | 168,000 | 168,000 | 168,000 | 168,000 | 168,000 | 168,000 |
| Athabasca (Jackpine) | 60% | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 30,000 | 60,000 | 60,000 | 90,000 |
| Peace River (Cadotte Lake) | 100% | 10,000 | 12,000 | 12,000 | 12,000 | 12,000 | 22,000 | 30,000 | 30,000 | 30,000 | 30,000 | 30,000 |
| Total | | 88,282 | 105,000 | 105,000 | 120,000 | 165,000 | 190,000 | 198,000 | 228,000 | 258,000 | 258,000 | 288,000 |
| **Petro-Canada** | | | | | | | | | | | | |
| MacKay River | 100% | 24,000 | 25,000 | 30,000 | 30,000 | 30,000 | 40,000 | 60,000 | 70,000 | 70,000 | 70,000 | 70,000 |
| Fort Hills | 55% | 0 | 0 | 0 | 0 | 0 | 19,250 | 41,250 | 55,000 | 74,250 | 82,500 | 104,500 |
| Syncrude | 12% | 25,644 | 33,284 | 37,867 | 42,000 | 42,000 | 42,000 | 42,000 | 43,200 | 44,400 | 45,600 | 45,600 |
| Total | | 49,644 | 58,284 | 67,867 | 72,000 | 72,000 | 101,250 | 143,250 | 168,200 | 188,650 | 198,100 | 220,100 |
| **Husky Energy** | | | | | | | | | | | | |
| Tucker | 100% | 0 | 0 | 25,000 | 30,000 | 30,000 | 30,000 | 30,000 | 30,000 | 30,000 | 30,000 | 30,000 |
| Sunrise | 100% | 0 | 0 | 0 | 0 | 25,000 | 50,000 | 75,000 | 100,000 | 125,000 | 150,000 | 175,000 |
| Total | | 0 | 0 | 25,000 | 30,000 | 55,000 | 80,000 | 105,000 | 130,000 | 155,000 | 180,000 | 205,000 |
| **EnCana** | | | | | | | | | | | | |
| Foster Creek | 100% | 33,000 | 55,000 | 60,000 | 65,000 | 90,000 | 100,000 | 100,000 | 100,000 | 100,000 | 100,000 | 100,000 |
| Christina Lake | 100% | 7,000 | 10,000 | 10,000 | 10,000 | 10,000 | 35,000 | 40,000 | 40,000 | 50,000 | 55,000 | 70,000 |
| Total | | 40,000 | 65,000 | 70,000 | 75,000 | 100,000 | 135,000 | 140,000 | 140,000 | 150,000 | 155,000 | 170,000 |
| **Canadian Oil Sands Trust** | | | | | | | | | | | | |
| Syncrude | 35% | 75,841 | 98,436 | 111,990 | 124,215 | 124,215 | 124,215 | 124,215 | 127,764 | 131,313 | 134,862 | 134,862 |
| **Nexen** | | | | | | | | | | | | |
| Long Lake | 50% | 0 | 0 | 19,260 | 24,250 | 29,250 | 29,250 | 29,250 | 29,250 | 29,250 | 29,250 | 29,250 |
| Kinosis | 50% | 0 | 0 | 0 | 0 | 0 | 0 | 19,260 | 24,250 | 29,250 | 29,250 | 29,250 |
| Leismer | 50% | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 19,260 | 24,250 | 29,250 |
| Cottonwood | 50% | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 19,260 |
| Syncrude | 7% | 15,450 | 20,053 | 22,815 | 25,305 | 25,305 | 25,305 | 25,305 | 26,028 | 26,751 | 27,474 | 27,474 |
| Total | | 15,450 | 20,053 | 42,075 | 49,555 | 54,555 | 54,555 | 73,815 | 79,528 | 104,511 | 110,224 | 134,484 |
| **OPTI Canada** | | | | | | | | | | | | |
| Long Lake | 50% | 0 | 0 | 19,260 | 24,250 | 29,250 | 29,250 | 29,250 | 29,250 | 29,250 | 29,250 | 29,250 |
| Kinosis | 50% | 0 | 0 | 0 | 0 | 0 | 0 | 19,260 | 24,250 | 29,250 | 29,250 | 29,250 |
| Leismer | 50% | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 19,260 | 24,250 | 29,250 |
| Cottonwood | 50% | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 19,260 |
| Total | | 0 | 0 | 19,260 | 24,250 | 29,250 | 29,250 | 48,510 | 53,500 | 77,760 | 82,750 | 107,010 |
| **Western Oil Sands** | | | | | | | | | | | | |
| Athabasca (Muskeg River) | 20% | 26,094 | 31,000 | 31,000 | 36,000 | 51,000 | 56,000 | 56,000 | 56,000 | 56,000 | 56,000 | 56,000 |
| Athabasca (Jackpine) | 20% | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 10,000 | 20,000 | 20,000 | 30,000 |
| Total | | 26,094 | 31,000 | 31,000 | 36,000 | 51,000 | 56,000 | 56,000 | 66,000 | 76,000 | 76,000 | 86,000 |

*Source: Company reports, Scotia Capital estimates (figures provided represent barrels of production per day).*

# Notes

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*The supervisors of the Portfolio Advisory Group own securities of the following companies. Astral Media Inc., Power Financial Corporation, Royal Bank of Canada, Telus Corporation, Yellow Pages Income Fund, Deere & Co.*

*The Analysts of the Portfolio Advisory Group own securities of the following companies. Barrick Gold Corporation, BCE Inc., Power Corporation of Canada, Power Financial Corporation, TransAlta Corporation, Yellow Pages Income Fund, Cisco Sys Inc, Pfizer Inc, Texas Instruments Inc, Enbridge Inc., Great-West Lifeco Inc., Petro-Canada, Royal Bank of Canada, Shoppers Drug Mart Corporation, Telus Corporation, Toronto-Dominion Bank, The Thomson Corporation, TSX Group Inc., Pfizer Inc.*

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# ScotiaMcLeod

ABBOTSFORD
(604) 864-3750

BUREAU
(418) 686-8666

BARRIE
(705) 725-0300

BELLEVILLE
(613) 968-6459

BRAMPTON
(905) 796-2424

BRIDGEWATER
(902) 543-8293

CALGARY
(403) 298-4000

CAMBRIDGE
(519) 740-4300

CHARLOTTETOWN
(902) 566-3225

CORNER BROOK
(709) 637-4747

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