

Investment Portfolio Quarterly



Insightful Perspectives

Fall 2005

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Executive Summary

2005 Fall Outlook

Stewart Hunt – Director, Portfolio Advisory Group

As we move into the fall of 2005 we continue to witness a growing global economy. The increasing development of China, India and other emerging markets has had a positive impact on commodity prices. The economic boom in China and the Far East has been particularly beneficial for Japan who appears to be lifting its economy out of a decade of deflation. Canada has benefited due to its commodity exports and as a result the Canadian dollar has risen to its highest level since October 1991. The U.S. economy continues to chug along although the twin deficits, fiscal and trade, put the economy on difficult footing. At the same time the U.S. Federal Reserve maintains their approach of pushing interest rates higher in efforts to maintain a neutral monetary policy where the risks of price stability and economic growth are balanced. This will be the last hurrah for Federal Reserve Chairman Alan Greenspan as he passes on the torch to a new Fed Governor in January 2006.

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

- U.S. growth will remain consistent as effects of U.S. Federal Reserve monetary tightening should be somewhat offset by the stimulus package provide by the federal government to re-build the southern states affected by the devastation after Hurricane Katrina.
- Canadian growth, while linked to the U.S., will be impacted by commodity prices and the Canadian dollars appreciation against all of the country's major trading partners
- Both the Bank of Canada and the U.S. Federal Reserve will continue to remove an accommodative monetary policy by increasing interest rates. In Canada we expect a further flattening of the yield curve. However, in the U.S., where the yield curve has flattened significantly we anticipate more of a parallel upward shift to potential steepening of the yield curve.
- Higher costs of production, rising interest rates and a strong Canadian dollar should affect corporate profitability and the market. While it is hard to argue with the performance of the energy sector valuations are not cheap and susceptible to a correction if oil prices drop and profit growth slows down. That this time we would be overweight defensive stocks in the consumer staples, utilities, financials and telecommunications sectors.
- For U.S. equities we believe investors balance their portfolios between industrial and technology companies that provide products that improve business efficiency and capacity. In conjunction with portfolio positions in the defensive sectors such as consumer staples and health care.
- A cloud that has been placed over the income trust market as the federal government reviews the existing corporate tax regime and guides Canada Customs and Revenue not to provide tax opinions to potential income trusts. The trust market will remain in limbo until the federal government provides further guidance.
- Oil prices continue to trade above U\$60.00 and we believe the outlook for the energy sector continues to look favourable for the remainder of 2005, although we have witnessed some profit taking, as valuations are not cheap.

Economic Outlook

Complacency Could do to Bulls, What Curiosity did for the Cat

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

Typically, economic forecasting becomes more difficult the further into a cycle you get, and this time will be no different. The last quarter-century has produced a general pattern of U.S. economic downturns at the start of a decade, followed by strong growth, a slowdown at the mid-decade juncture, and then stronger expansion into the final years of the decade. Assuming this pattern continues, one can presume that 2005-06 will offer up a slower pace of growth, though not an outright contraction. In fact, growth has been on a slow but steady downtrend since the second half of 2003 and in the past three quarters, growth has been close to its post-WWII average of 3.5%. If this is your run-of-the-mill post-tightening slowdown, then in the next year and a half we could see growth in the range of 1% to 3%. After the 1994 Fed tightening experience, growth fell to as low as 0.7% by the second quarter of 1995, while the trough for growth in 1986 was a more respectable 1.6%.

Now, let's look at how these two reference points compare to the current consensus. Based on the most recent Bloomberg consensus (taken after Hurricane Katrina), U.S. annual growth for 2006 is expected to come in at 3.3%, with a high forecast of 4.1% and a low-ball of 2.4%. For the quarterly profile, the most optimistic growth estimate is 5% in the current quarter, while the low-end is still a respectable 1.8% in Q3 of next year. In other words, even though energy prices are sky-high and consumer confidence is sliding, the most bearish cat in the survey believes that growth will remain above the trough seen in both the mid-1980s and mid-1990s slowdowns. What's even more curious is that the median growth estimate for the middle of next year is unchanged from that published before Katrina's wrath. There are two possible explanations for the relative optimism in the medium-term U.S. outlook – interest rates and the expected reconstruction boom following last month's disaster.

The Fed's conviction to continue ratcheting its official policy rate higher has been unmoved by Katrina and, in fact, one could argue that business-sector sanguinity has only reinforced the threat in Greenspan's mind that energy cost pressures will ultimately show up in terms of significantly higher core inflation. Yet, the real fed funds rate has only just nudged above the zero mark this year, compared with a real rate range of 2.8-3.3% in 1995 and 3.9-5.5% in 1985-86. The actual start date for substantial reconstruction along the Gulf coast is still up in the air, not to mention the more obvious question of whether businesses and households want to return and invest in a region which could be more prone to more weather-related damage going forward. Still, with Washington planning to pump more than US\$200bn into the region over the next three years and private construction firms gearing up, there is a net add to the medium-term investment spending outlook. Based on these two factors, it is tempting to look at the post-hurricane stimulus as a counter-effect to a traditional post-tightening correction, yielding nothing more than just a cat-nap in economic activity, versus the dead-cat alternative.

The problem with this view is that it skips over some key questions hanging over the forecast, including:

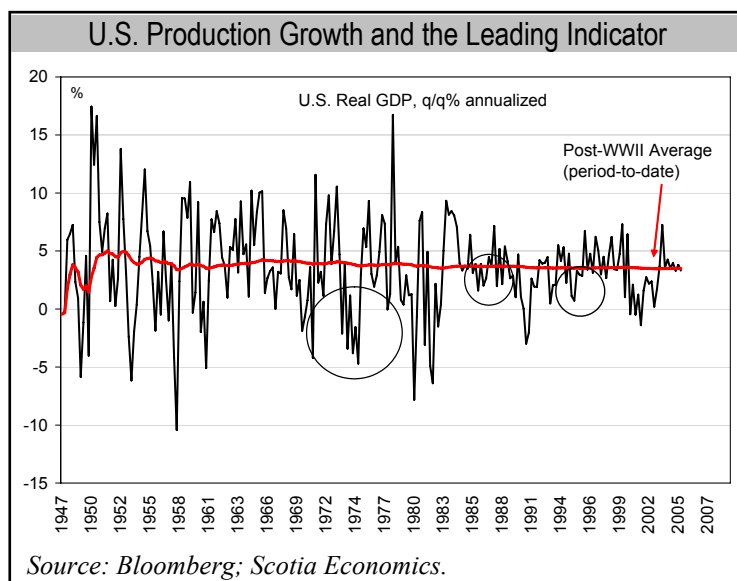
- Will the sharp pullback in consumer confidence materialize in a stall-out in spending this quarter, thus resulting in a downward revision in business sentiment?
- Have energy prices peaked this season or, more importantly, for the forecast period?
- Is the U.S. housing market already starting to cool off in response to higher energy prices?
- Have auto incentives run the tank dry in terms of future sales growth?
- Is the rest of the world, outside China and India, still cooling off?
- Are we on the verge of another major U.S. dollar downdraught, which potentially causes longer-term yields to rise?

Canada's own outlook is highly dependent on the latter risk, especially in light of the currency's strong advance since the middle of the second quarter. As we discussed in a recent "Weekly Market Strategy", the appreciation in Canada's exchange rate with the U.S. to above 86 U.S. cents has been overshadowed by the Loonie's ascent versus other major currencies, such as the Yen, Euro, Sterling and even Canada's sister 'petro-currency' – the Norwegian Krone. Pressures on Canada's manufacturing base from high energy costs and an overvalued currency are getting more media play these days, but with the appreciation in the major cross-exchange rates, Canada now faces more intense competitive pressures from outside of the U.S. The effects on trade flows into Asia, for example, would be negatively impacted by the 5% increase in value against

the Aussie dollar, while forestry shipments into Europe from the east coast could be restrained by appreciation in the Euro and Krone cross rates. Ultimately, the key question hanging over Canada's forecast is whether the rebalancing between subdued growth in central Canada and a resource-led growth explosion in the west can continue.

As a result of Canada's relatively larger sensitivity to commodity prices and exchange rate movements, growth cycles have tended to be less patterned than in the U.S., yet for those periods where U.S. economic growth moderates and there is no natural offset for Canada (such as a drop in the value of the Canadian dollar, or rising commodity prices), Canada's growth also moderates. Heading into 2006, the best case scenario would be a combination of only a minor

erosion in U.S. demand growth, continued strength in energy and raw material prices and a depreciation in the value of the Loonie. The problem with that scenario is that it is too complacent. If U.S. demand remains firm, it is unlikely that the U.S. current account deficit will decrease sufficiently to prevent further weakness in the U.S. dollar. This would be the so-called "shrinking slice of a growing pie" scenario for Canada. Conversely, if energy prices remain high, while the Fed pushes rates up further, U.S. demand growth weakens, producing a "growing slice of a shrinking pie" scenario. Neither may be too constructive for overall Canadian equities.



Economic and Market Outlook 2005/2006

	2004	2005F	2006F
Canada			
S&P/TSX Composite Index			
Earnings (C\$)	\$535.00	\$615.00	\$635.00
Levels	9246.65	10200.00	10200.00
Economic Performance ----- (annual average) -----			
Real GDP (% change)	2.9	2.8	2.7
Motor Vehicle Sales (thousands)	1534	1590	1570
Unemployment Rate (%)	7.2	6.8	6.7
Consumer Prices (% change)	1.8	2.5	2.5
Current Account Balance (C\$ bn.)	28.8	19.0	22.5
Yield Curve ----- (end of period, %) -----			
Bank of Canada Overnight Target Rate	2.50	3.25	3.50
2-Year Canada Bond	3.00	3.75	3.90
10-Year Canada Bond	4.31	4.10	4.70
United States			
S&P 500			
Earnings (US\$)	\$60.61	\$74.00	\$77.00
Levels	1200.09	1250.00	1250.00
Economic Performance ----- (annual average) -----			
Real GDP (% change)	4.2	3.6	3.2
Motor Vehicle Sales (millions)	16.9	17.0	16.8
Unemployment Rate (%)	5.5	5.1	5.0
Consumer Prices (% change)	2.7	3.4	2.9
Current Account Balance (US\$ bn.)	-668	-815	-885
Yield Curve ----- (end of period, %) -----			
Fed Funds Target Rate	2.25	4.25	4.50
2-Year Treasury	3.07	4.60	4.70
10-Year Treasury	4.22	4.60	5.20
Foreign Exchange ----- (end of period) -----			
Canadian Dollar (US¢/C\$)	\$83.00	\$85.50	\$90.00
Canadian Dollar (C\$/US\$)	\$1.20	\$1.17	\$1.11
Yen (¥/US\$)	\$103.00	\$108.00	\$100.00
Euro (US\$/€)	\$1.36	\$1.28	\$1.35
Sterling (US\$/£)	\$1.92	\$1.83	\$1.88
Commodities			
WTI Oil (ann. average, US\$/bbl)	\$41.40	\$58.00	\$60.00

F: Forecast (Scotia Economics).

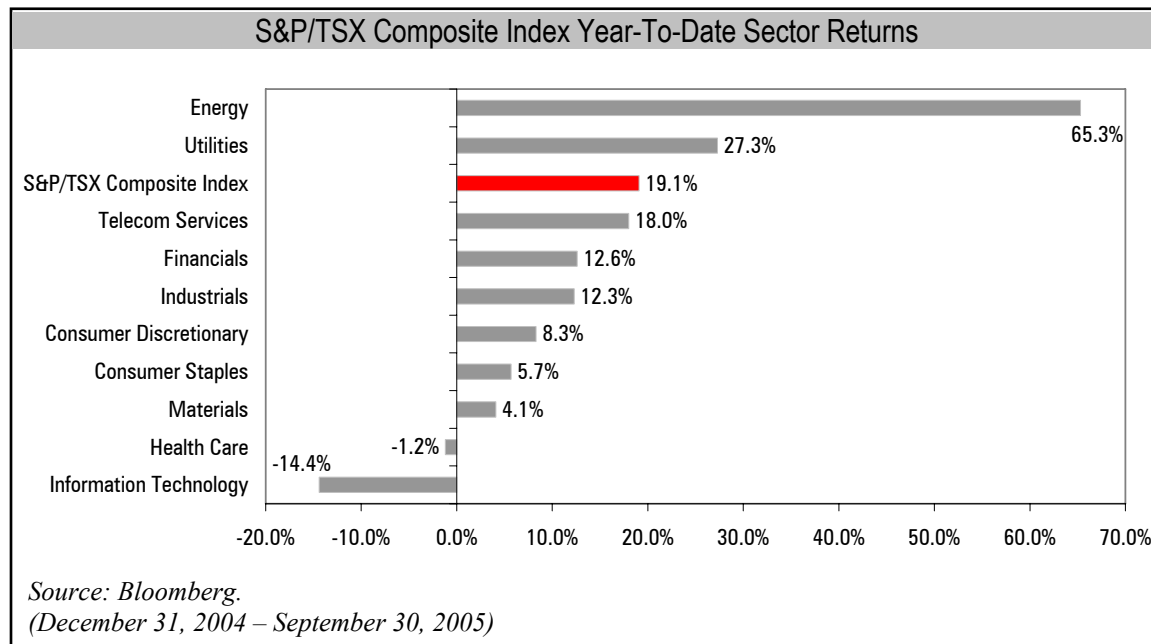
Source: Scotia Economics; Statistics Canada; U.S. Dept. of Commerce;
U.S. Bureau of Labor Statistics; Bloomberg.

Canadian Strategy

A Banner Year for Investors

Paul Danesi – Director, Portfolio Advisory Group

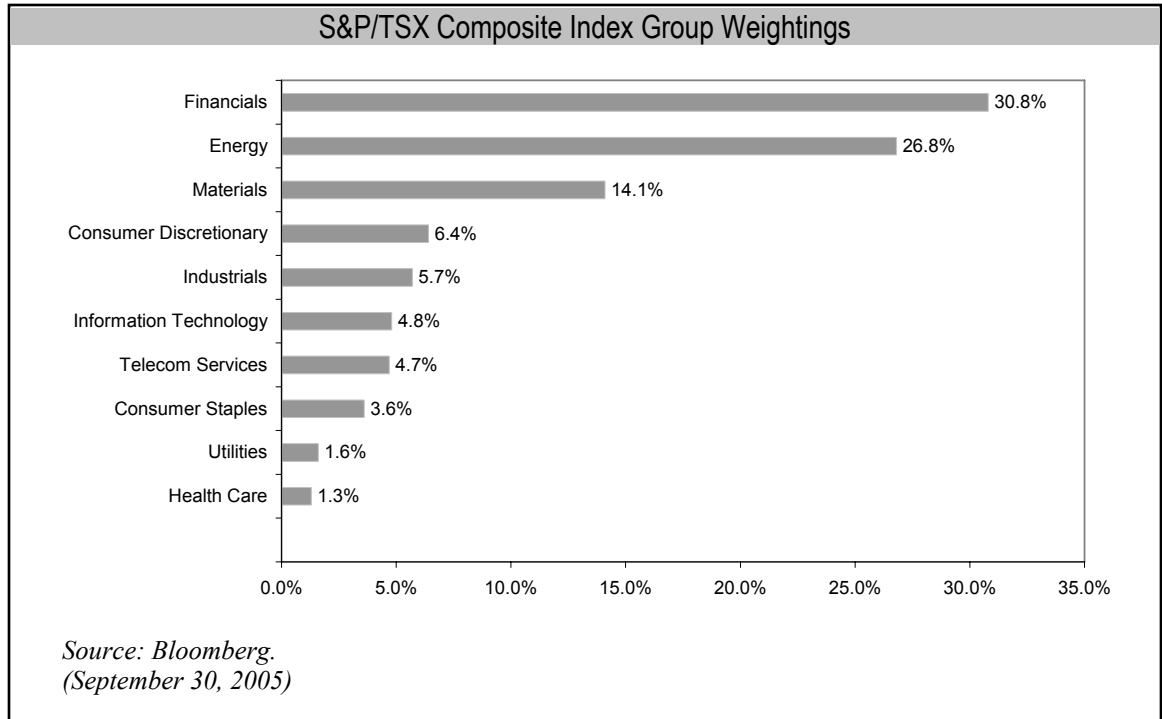
This is shaping up to be another banner year for the Canadian equity market driven by large gains in the energy, financial services, telecommunications, utilities and income trust sectors. Record high energy prices, historically low interest rates, and a resilient Canadian economy have been key supporting factors. If our market holds its course, 2005 will be the third consecutive year of solid double-digit gains for Canadian investors.



Nevertheless, year-to-date TSX performance can leave investors with a false sense of security about the shape of things to come. There is a palatable level of complacency in the market right now where investors simply expect the status quo – continued share price appreciation with little volatility.

As a benchmark, there are a couple of structural issues with the TSX Composite Index we want to highlight. First, the index is influenced to a large extent by the energy, financial services and materials sectors, which collectively represent over 70% of the Index. Strong performance in these sectors can mask weakness in others. Case in point would be the energy sector which represents about 27% of the index by weight and has accounted for approximately 65% of this year's gain to date. The second issue is that Index performance is not an accurate barometer of what is happening within the broader Canadian economy. For example, energy stocks now represent 27% of the TSX Composite Index and yet energy as an industry represents less than 6% of GDP.

Looking ahead, we believe that higher costs of production (rising raw material and processing costs), rising interest rates, and a stronger Canadian dollar are creating significant headwinds for the Canadian economy, corporate profitability and ultimately the market. Profit margins are about to be squeezed, especially for energy intensive industries that export their products to the U.S. Metals and mining, forestry, auto parts manufacturers, and other industrials come to mind.

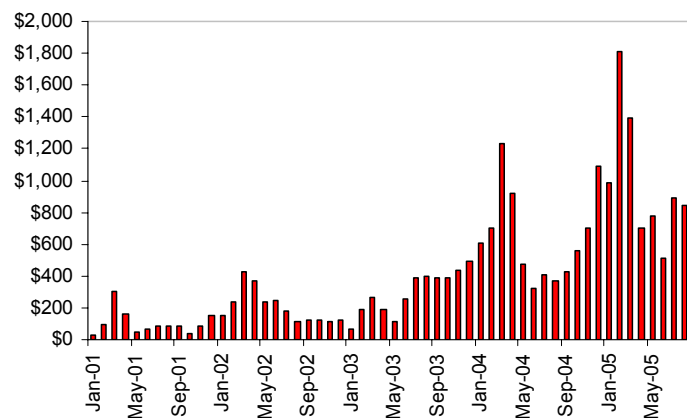


Energy prices are likely to stay at lofty levels through the winter as a result of the supply shock delivered by Hurricane's Katrina and Rita. However we believe correction is inevitable. With the U.S. accounting for 25% of daily global oil consumption, a meaningful slowdown in that economy remains a likely a catalyst. Equity valuations are not cheap, and the prospects for slowing profit growth into 2006 argue for profit taking in economically sensitive sectors and increasing exposure to defensive dividend paying stocks.

The broader market as measured by the TSX Composite Index is over valued based on our firm's multi-factor valuation model that incorporates economic growth, profit margins, energy prices and bond yields. The current P/E multiple of 18 times this year's forecast earnings is by no means cheap, although arguably justifiable by the current low interest rate environment and the rebound in corporate profitability over the past two years. However, TSX earnings growth has been largely driven by the energy and financials services sectors and could prove more challenging in 2006. With higher input costs, a stronger dollar and higher interest rates pressuring margins in many sectors including energy, year-over-year earnings comparisons are going to get difficult. The market will become increasingly reliant on financials services to support improvement. Therefore, we believe that growth and valuations are both likely to be challenged in the months ahead. Forecast earnings for the TSX are \$615 this year and \$635 in 2006. In growth the 2006 figure is looking increasingly suspect with likely bias to the downside. Our one year target for the TSX Composite Index is 10200, implying downside from current levels of approximately 1%.

Although, our outlook for the Canadian equity market appears somewhat gloomy, not all stocks in all sectors are expected to decline in the coming months. With the risk reward proposition for many cyclical stocks no longer appealing, we strongly urge investors to overweight defensive consumer staples, utilities, financials, and telecommunications stocks in their portfolios. Our best ideas in these sectors include: Loblaw Cos. Ltd., Shoppers Drug Mart Corp., Canadian Tire Corp. Ltd. (more staple than discretionary), Enbridge Inc., TransCanada Corp., TD Bank, Royal Bank, Telus Corp., BCE Inc., and Rogers Communications Inc. (soon to be added to the telecom services industry group within the TSX).

Canadian Mutual Fund – Net Sales of Dividend & Income Funds (\$mlns.)



Source:IFIC; Scotia Capital.

Where is there value?

It is not easy to find decent growth/value propositions in this market. Where we do see value is in the telecommunications and financial services sectors. On the basis of historical yield relationships both sectors look attractive relative to bonds, income trusts and utilities. Adding to this, earnings and earnings growth for both are largely unaffected by what ails many other parts of the economy adding to their defensiveness.

Telus, despite its impressive gains is still a buy in our opinion. The company's earnings growth remains well ahead of the market thanks to its significant wireless exposure, while its valuation is reasonable. Free cash flow of nearly \$1 billion annually supports shareholder friendly policies such as big share buybacks and dividend

increases. We also recommend BCE Inc. and Rogers Communications Inc. The yield on BCE is at a substantial premium to the yield currently offered on a 10-year Canada bond, with the potential for another dividend increase at year end. There is significant franchise value in the assets of BCE. Management has more recently discussed the sale of non-core assets and/or the potential conversion to an income trust structure of other assets as a means to creating value for its shareholders. Canada's largest cable operator, Rogers Communications is now our largest wireless company. Wireless offers the best growth prospects within the Canadian communications industry. Investors have often feared Rogers high debt levels and with good reason. However, the company has transformed itself into a cash flow machine allowing it to easily service its debt. Maybe Rogers will offer shareholders a dividend one day, not beyond the realm of possibility.

Canadian banks also look very attractive. Bank earnings growth for 2005 is expected to increase 14% year-over-year and the pace of dividend growth is exceeding expectations. Our bank analyst believes that dividends can continue to grow at 10% per annum through the rest of the decade. Bank share price performance has been strong in recent years, yet the group still looks very attractive on the growth to value proposition. In our analyst's opinion, bank fundamentals remain the strongest in history. The bank sector as a whole has low balance sheet risk, high capital levels, strong asset quality, historically high levels of profitability, and low earnings volatility. TD Bank and Royal Bank are top picks based on the strong retail banking platforms and relative earnings growth prospects.

Additional Thoughts on Dividend Paying Stocks

The price charts of many Canadian utilities could fool investors into thinking they were looking at successful technology or industrial products companies. The big gains have been supported by low interest rates, but P/E multiples in the low-to-mid 20's are rich by historical standards. Valuations should hold up reasonably well as we do not forecast a dramatic increase in 10-year Canada bond yields, but the big capital gains realized in 2005 are unlikely to be repeated. Nevertheless, we are buyers of Enbridge Inc. and TransCanada Corp. Both offer better than average earnings and dividend growth through the balance of the decade. Both are well positioned financially to participate in some of the numerous infrastructure projects on the drawing board or to make accretive acquisitions should opportunities present themselves. The recent takeover offer by U.S. utility and pipeline concern, Kinder Morgan Inc. for Terasen Inc. underscores the strategic value of our energy infrastructure to our friend's south of the border.

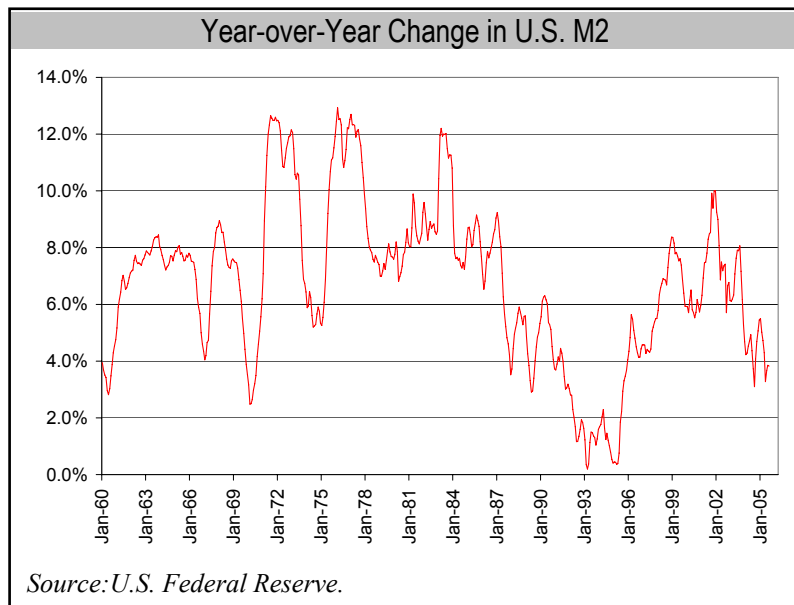
Dividend paying stocks could also benefit from the turmoil in the trust sector. The flow of money into dividend and income funds has grown rapidly since the tech bubble burst in 2000 (see chart). Income Trust funds have represented on average 25% of dividend and income fund net sales in recent quarters. We don't think the issues with the Income Trust sector have destroyed investors' appetite for yield. However, the marginal buyer, that is money not committed by participation in Pre-authorized chequing accounts (PAC) and dividend reinvestment plans to Income Trusts funds, is more likely to go to other dividend and income funds. The financial services, utilities, and telecommunications sectors with their attractive quarterly payouts are likely beneficiaries in our mind.

U.S. Equity Strategy

Looking for Stocks in all the Right Places

Andrew Guy, CFA – Associate Director, Portfolio Advisory Group

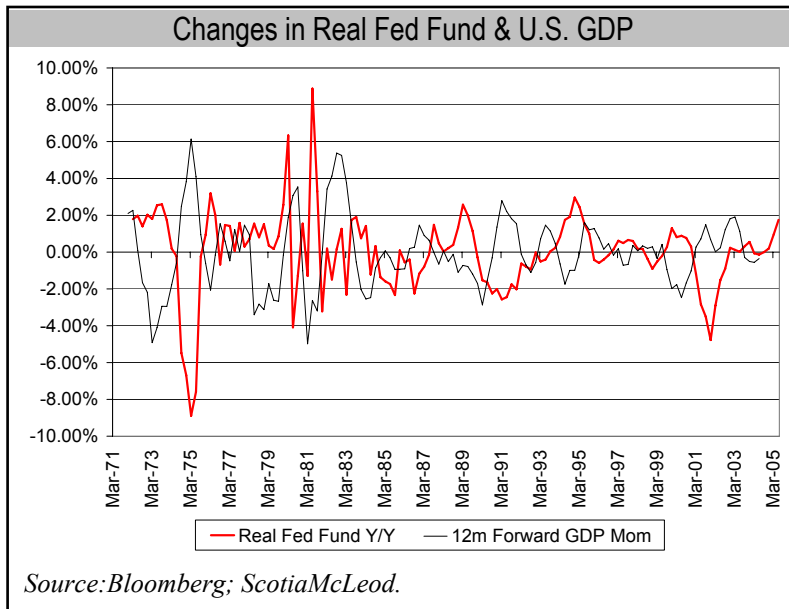
The level of uncertainty that the market is feeling as we exit September is not likely going to be resolved smoothly. With many investors concerned about the perceived deficits in the U.S. economy – budget, current account, credibility – and the concerns about Katrina and Rita fresh in their mind, the resolution to the situation is likely to be dramatic. September has historically been the most challenging month for investors, but October has a history of dramatic events as well. Of course, there was October 1987, but the Octobers of 1998 and 2002 were the start of previous stock market bull runs. It is useful to remember that each of these events was sparked by actions of the U.S. Federal Reserve. Almost every stock market crisis involves a financial crisis. Sometimes the crisis is a result of a failure somewhere in the global financial markets and sometimes another event results in a financial crisis. The classic economic history text Manias, Panics and Crashes goes through every market crisis from the Dutch Tulip crisis to the present day and outlines the role that the financial system and liquidity have played in each crisis.



So in which direction do we think the market is likely to head? At the current time, you can put us into the bullish camp. While the human cost (and perhaps political cost) of Katrina is massive, the economic cost will not be as great as feared. It is useful to recall that last year there were 4 category 3 or higher hurricanes that hit the U.S.. Each of these storms counted amongst the top ten storms in history. Yet the U.S. economy manages to follow a slow third quarter with a strong rebound in the fourth quarter and into Q1 of this year. The economic stimulus of rebuilding seems to be just the medicine the economy needs to drag itself out of the slump. Perhaps the key message is to never underestimate the resilience of the U.S. economy.

Still with the Fed raising rates it is important to remember that the cycle is getting a little long in the tooth. By following a gradual path of increases, the Fed is trying to remain in control of the situation. As the chart above demonstrates, the impact of rising interest rates has been to slow the growth in the money supply. With less money around, the economy should follow.

We would not expect that the economy and therefore the equity markets are likely to collapse. The table on the next page shows the relationship between changes in the real Fed funds rate and changes in the U.S. GDP. The move to increased independence for the U.S. Federal Reserve in the early 1980s has significantly reduced the volatility of the U.S. economy. We suspect that Mr. Greenspan & Co. will be able to engineer another "softish" landing.



Given our scenario and the risks that we are wrong, we recommend that equity investors balance their portfolios between offence and defence. On the offensive side, we would select companies that are leverage to continued economic growth. In particular, we would look to industrial and technology companies that are likely to benefit from the significant cash balances sitting on the balance sheets of U.S. companies. Companies like **General Electric**, **Caterpillar**, **Eaton Corp.**, **PPG Industries** and **Deere & Co.** provide the products and services that improve the efficiency and increase the capacity of other industries. In choosing technology names, we recommend names that are poised to benefit from similar trends. Of course, don't forget to pay

attention to valuation. The technology names that we believe currently possess the correct balance of these factors are SAP AG, Cisco Systems, Texas Instruments and Oracle Corp.

To balance these sectors, we would also have a position in defensive sectors like Consumer Staples and Health Care. The products sold by companies within these sectors tend to be purchased without regard to the shape of the yield curve or the rate of change in GDP. People still need to eat, dress themselves and take their blood pressure medication. Within the Consumer product sector, our preferred names are **Diageo plc**, **Campbell Soup** and **Kimberly-Clark Corp.** We also like **Wal-Mart Stores**, **Home Depot Inc.** and **Walt Disney Co.**

The Health Care sector continues to be a challenging sector. Concerns about drugs coming off patent and litigation risk has kept the "big pharma" names under pressure, but opportunities continue to be present in the biotechnology, specialty pharma and managed care sectors.

At the current time, trends in the managed care sector are particularly interesting. Continuous pressure on lower costs has pushed the industry to consolidate and created advantages for the larger names in the industry. Lower costs lead to lower pricing and this tends to help attract new customers. In addition, changes to Medicare legislation have opened the door for companies to provide supplemental coverage for Medicare recipients. **UnitedHealth Group** and **WellPoint Inc.** are poised to benefit from these trends and have attractive valuations.

Pfizer Inc.'s acquisition of Vicuron, a biotech that specialized in antifungal and antibiotic treatments, has highlighted the lengths to which big pharma will go to build their backlog of new drugs. The potential for further acquisitions will help to ensure that biotechnology companies remain well bid. While **Amgen** and **Genentech** are too big to be considered obvious acquisition candidates, the lower risk nature of their existing product portfolio makes them more attractive for retail investors. We also like **Teva Pharmaceutical Industries** for its position as the leading generic drug producer in the world.

At times of uncertainty like we are in today, valuation has to be of paramount importance to the selection of stocks for your portfolio. If the market falls, high multiple stocks tend to do worse than low multiple stocks. Also, strong balance sheets and good cash flow generation are also crucial. Companies with highly levered balance sheets are at risk of failure if profitability is impacted by slowing demand. Be cautious about buying companies that fit sectoral themes without regard to valuation.

Fixed Income

“Start me up...”

Stewart Hunt – Director, Portfolio Advisory Group

Overview:

The Bank of Canada having gone 7 consecutive meetings without raising interest rates began the process of reducing their accommodative monetary policy by raising rates 25 basis points on September 7th, 2005. This occurred while the U.S. Federal Reserve raised rates at a “measured pace” of 25 basis points over the same period. To put this into perspective the overnight rate in Canada, 2.75% is currently 1.0% below the federal funds rate in the U.S, 3.75%. Canadians, have benefited from the austere fiscal policies of our federal and provincial governments and a strong resource base economy that has made Canada an attractive place to invest. The Bank of Canada has expressed inflationary concerns in the face of strong economic growth (Q2 GDP 3.2%) and a low unemployment rate of 6.8%. As we move towards the end of the year the Central Bank has started up a move towards higher rates that Scotia Economics forecasts will conclude with an overnight rate of 3.25% by the end of 2005.

So what does this all mean for bond yields?

As a result of the interest rate actions by the Bank of Canada yields in the Canadian bond market have all moved higher. However, yields on the 2-year bonds have reacted more to the Central Banks action then yields on 5-year and 10-year bonds. This has caused the slope of the Canadian yield curve to flatten. The difference between the yield on 2-year Government of Canada bonds and 10-year Government of Canada bonds is currently at 61 bps (10-year 3.93% minus 2-year 3.33%). With the Bank of Canada expected to continue to raise interest rates Scotia Capital Fixed Income Research forecasts the slope of the Canadian yield curve to flatten further with the yield difference between 2-year and 10-year bonds falling to 50 basis points. Based on the forecast of Scotia Capital (SC) Fixed Income Research they anticipate the yield on the 2-year Government of Canada bond to increase to 3.45% to 3.60% range in 2006. Similarly SC Fixed Income Research forecasts the yield on 10-year Government of Canada bond to increase to 4.25% to 4.50% range in 2006. We would recommend investors to be prepared to take advantage of the increase in yields with the objective of mobilizing their cash positions. In the current interest rate environment (2-year Government of Canada bond 3.33%, 5-year Government of Canada bond 3.60% 10-year Government of Canada bond 3.93%) we see investment value in the 2-year to 10-year area of the yield curve. For investors that are fully invested into the market we would suggest to take any decline in rates as an opportunity to shorten the term to maturity of your holdings.

So what should you be watching?

One of the key drivers for interest rates over the last 3 months has been the price of oil. As oil prices have increased bond yields have decreased. The negative impact of higher oil prices on North American economic growth, particularly the U.S. economy, has pushed yields lower as the prospects of further rate increases diminish with weak economic growth. This should continue to be a factor as we move into the winter consumption months.

From the global perspective the Japanese economy appears to be turning the corner after over a decade of stagnation. Supported by the consumption demands of China and other growing economies of the Pacific Rim the Bank of Japan is beginning to give indications that it is ready to begin tightening monetary policy. Accordingly, the Japanese bond market has reacted with rising interest rates. This has the potential to impact the flow of investment in Japan as monies normally slated for foreign markets, particularly the United States, could be destined to remain to assist the growing domestic economy. As the U.S. government deals with the aftermath of hurricane Katrina, offering a US\$50.0 billion aid package from a government already well into a deficit position. The demand to finance an increasing deficit that has been supported by foreign investment is beginning to look susceptible. The end result, increasing financing costs for the U.S. as they have to pay up to attract investment. While Canadian interest rates have witnessed periods where they trade below rates in the U.S. this has not been the historical trend. This trend appears to be changing. For investors looking for yield the U.S. bond market warrants consideration. However, investors should be considerate of any foreign exchange risk. We particularly like 2-year U.S Treasury yields above 4.20%.

The combination of the Canadian economy, fiscal surplus and rising interest rates all bode well for an appreciation of the Canadian dollar. Year to date the currency has appreciated 7%. Scotia Economics is forecasting the Canadian dollar to reach the 90-cent level versus the U.S. dollar by the end of 2006, the first time it has reached that point since December 1977. From a technical perspective the 90-cent Canadian dollar represents a strong selling point for the currency. However, right now the trend is your friend so we would recommend holding Canadian dollars.

With the removal of the foreign content limit by the Federal government in June the Canadian bond market has witnessed an increase of foreign issuers turning to Canada for financing. The abundance of cash currently available in the Canadian market has made it relatively easy for foreign borrowers to tap the market and the cost of financing has been attractive. Since the foreign content limit was removed foreign issuers have raised C\$3.6 billion. Financial entities have dominated the borrowings, issuers include, Bear Stearns, Sallie Mae, US Bancorp, JP Morgan Chase, Nordea Bank, Bank of Ireland, Bank of America and Depfa ACS Bank. As a result of the increased borrowing in the financial sector of the corporate bond market the major Canadian Banks, who dominate this sector, are beginning to experience some competition this has pushed their credit spreads wider. That being said, Corporate and Provincial credit spreads are at the low end of their historical range. We would recommend investors to take a neutral to underweight position of Corporate and Provincial bonds in their portfolios.

Income Trusts

Tax Regime Uncertainty Sparks Market Correction

Joey Mack, CFA – Associate Director, Portfolio Advisory Group

The Income Trust market sold off sharply at the end of September, following the announcement from the Canada Customs and Revenue Agency that they would not provide advance tax rulings while the Department of Finance consultation process on issues related to business income trusts and other flow-through entities is in progress. Although advance rulings are not a necessary prerequisite for the majority of income trusts, the announcement has raised a sudden fear that cash distributions will become taxable in some form, especially given the focus on lost tax revenue in government announcements. This has become the catalyst for the decline in most income trust market valuations.

Despite the correction towards the end of the month, which saw the total return on the Scotia Capital Income Trust Index (SCITI) fall 5%, the market has rebounded. The total return for the three months ended September 30, 2005, was 14.44%, once again beating the 11.63% return for the S&P/TSX Composite Index, and still well ahead of the Scotia Capital Universe Bond Index, which posted a quarterly return of just 0.12%. The Income Trust market continues to be supported by the strong performance of the energy sector, ongoing investment into dividend and income funds, as well as the reinvestment of cash distributions back into the market, factors which have so far outweighed the negative impact of rising central bank rates and long term bond yields.

Going forward, we continue to view the Income Trust market as expensive from an historic yield perspective. We also remain cautious given our expectations for slowing economic growth, rising inflation, central bank rates, and bond market yields, as well as our for limited equity market returns over the next 12-18 months. Combined with the uncertainty over potential changes to the tax regime, and the eventual outcome for the various income trust structures, we expect the market will continue to be volatile in the months ahead. In addition, the inclusion of Income Trusts into the S&P/TSX Composite, slated to begin in December, may be delayed until the uncertainty over government policy clears, which could be a further negative.

Total Return Indices								
	SCITI	S&P/TSX	SC Universe					
	Overall	Composite	Bond Index					
Q3/05	14.44%	11.63%	0.12%					
YTD 05	27.58%	20.67%	5.73%					
Segment	Consumer	Energy	Industrial	Power	Real Estate	Resource	Utils & Infra	Business
Q3/05	-2.20%	24.63%	2.48%	0.53%	9.14%	34.36%	4.89%	4.28%
YTD 05	-4.03%	42.10%	14.29%	4.04%	20.03%	66.37%	15.73%	12.26%

Source: Bloomberg; Scotia Capital.

The Department of Finance Discussion Paper – Potential Outcomes

On September 8th, 2005, the Department of Finance issued a discussion paper in conjunction with the launch of a consultation process with interested stakeholders on tax and other issues related to income trusts and limited partnerships. The primary objective of this process is to determine if the current tax system is appropriate or should be modified, as well as the implication of trusts on the efficiency of the Canadian economy. Given the numerous policy options available, it is difficult to be confident in placing probabilities on future changes to the income trust act. However, the Discussion Paper does highlight three policy approaches:

1. Limiting the deduction of interest expenses by operating companies

Certain business trusts are structured with the trust making a loan to the operating company. The interest paid to the trust on this loan serves to reduce the taxable income of the operating company. This interest income in turn is distributed to the unit holders of the trust. To reduce the amount of tax sheltered at the corporate level, the concept behind this approach would be to limit the amount of interest that can be deducted, by implementing a minimum equity component in the capital structure. We believe this would be effective in addressing a loss of tax revenue for those entities operating under this simple form of trust. However, the majority of Income Trusts in the market operate under a more complex structure involving a limited partnership as a flow-through conduit. This enables the trust to retain some income without becoming cash taxable. We believe the implementation of a minimum equity component would result in the simple trusts merely modifying their structure. Therefore, we view any such change as having limited impact on Income Trust market valuations.

2. Taxing flow-through entities in a manner similar to corporations

Under this approach, flow-through entities (a term used to include all Income Trusts, Royalty Trusts, and Limited partnerships), would be taxed similar to corporations. We believe this will require substantial revisions to the current Income Tax Act, due to:

- The complex legal environment currently governing the many different forms of flow-through entities
- The need to avoid harming other trusts which are considered more benign (such as mutual funds)
- The likely requirement to implement some other form of dividend tax credit specifically applying to each individual form of flow-through entity

Given the complexity of such changes, it is difficult to forecast the eventual outcome. However, we would view this as significantly negative for Income Trust market valuations. This is especially true for business trusts, where market values tend to reflect cash flow metrics, and significantly exceed book value. However, the implementation of some form of dividend tax credit for business trusts would be a mitigating factor. For REITS, as well as for Royalty Trusts, we view current valuations as essentially in-line with private market property valuations, which should provide some downside protection.

3. Better integrating the personal and corporate income tax system

In our view, this approach essentially will require a revision of the dividend tax credit system. Under the current system, the dividend paid to an investor is grossed up, and then taxed at the individual's marginal income tax rate, while the individual is also given a tax credit for the taxes paid by the corporation. However, as the system now functions, dividends from public companies face double taxation, as the dividend gross-up/credit method for taxation in the hands of the individual does not completely offset the actual income taxes already paid by the corporation. This results in investors receiving less after tax income from a corporate dividend in comparison to a tax free distribution from an Income Trust. Therefore, in our view, the optimal solution would be to improve the dividend tax credit to remove the current situation of double taxation. Although we believe this is in the best interest of fairness, this could be difficult to pass into legislation, given the sizeable amount of revenue that would be foregone by the federal government. We also believe that increasing the dividend tax credit will have a modest negative impact on Income Trust valuations, as investor demand for high dividend paying common stocks would increase.

The Implication of Trusts on the Efficiency of the Canadian Economy

The discussion paper also highlights that the Department of Finance is examining the long-term implications of flow through entities. The primary concern is that these entities essentially distribute the majority of their revenue stream to investors, which in turn leaves little flexibility for reinvestment in future growth and development, raising concerns over future prosperity in Canada. However, this argument does not address alternative views that:

- Flow-through entities require management to focus on operating more efficiently
- These structures do not require 100% of available cash to be distributed
- There are other sources of funding outside of internally-generated cash flow, such as the issuance of new units

We believe the consultation process will need to address all of these factors in determining the impact on both the efficiency of the transfer of capital, as well as on future productivity.

Ownership Limitations Back on the Radar?

Previously, the Federal Government had proposed limiting pension fund investment in business trusts, however the proposal was not passed into law due to significant opposition. A limit on investment by tax deferred accounts, however, in our view may be a politically palatable solution that would address the majority of the government's concerns over tax revenue erosion.

Outlook

The Department of Finance's consultation process ends on December 31, 2005. We would not expect an immediate change in the tax regime, although the upcoming federal budget in February, 2006, provides a potential opportunity. However, we also note that the Gomery Inquiry is also expected to release its final report in February of 2006, and an election is expected to be called shortly thereafter. We therefore believe any change to the tax regime will become a significant election issue.

Despite the uncertainty in the markets, we would continue to look to add exposure to high quality trusts on further price weakness, targeting those with above average stability ratings and conservative payout ratios. We continue to identify value by considering current cash yields that compensate for both the inherent risk in an equity-like investment, the potential for a reduction on after-tax distributions, as well as reflecting cash distribution growth prospects. Our current top picks are as follows:

REITS

- H&R REIT (HR.UN)

Business Trusts

- Consumers Waterheater Income Fund (CWI.UN)
- Yellow Pages Income Fund (YLO.UN)

Power Utilities

- Northland Power Income Fund (NPI.UN)

Energy Utilities

- Fort Chicago Energy Partners L.P. (FEC.UN)

U.S. Core Guided Portfolio

Andrew Guy, CFA – Associate Director, Portfolio Advisory Group

Performance Update

Hockey must be back because we are tempted to describe third quarter performance for the S&P 500 in terms of three periods. July was the first period and the market rallied as second quarter earnings came in better than expected. The second period was a let-down as the market took back much of the gain of July and the final period was volatile as hurricanes focused everyone's attention on the Gulf of Mexico. At the end of the game, the S&P 500 was up 3.6%, the Dow Industrials was up 3.4% and the NASDAQ rose by 4.6%. Once again, the market was led by the Energy index, but the Utilities and Information Technology indices also beat the overall index.

For the U.S. Core Guided Portfolio, second quarter performance was mixed. At the end of the quarter, the Portfolio had gained 1.5%. Of the fifteen companies that are in the portfolio, five were higher (led by Amgen +31.8% and Texas Instruments +20.8%). None of the holdings generated double-digit losses. For the year to date, the Portfolio is up 3.1% and has beaten the index by 0.3%.

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.

Outlook

As we expect the economy to weather the storm (pun intended) and the market to rebound through the fourth quarters, we believe that the economically sensitive companies in the Portfolio should perform well. Going back to our hockey analogy, the market has a tendency to ignore the depth of the U.S. team – their third and fourth lines can do more than most country's first line. In more market oriented terms, the resilience and flexibility of the American economy is often ignored. Over the past five years, the U.S. economy has faced a number of challenges that at the time seemed destined to bring the economy down. September 11 is probably the most dramatic example. While some observers like to watch the personal savings rate, they tend to ignore the amount of liquidity (or savings) in the hands of corporations. The strong profitability being generated by many companies has been used to improve balance sheets, but still cash is building up. This cash could be used to invest in additional capacity, make acquisitions, buyback shares or pay dividends. Any or all of these options would be positive for the market.

Still the general positioning of the Portfolio continues to be fairly defensive. Half of the names are in the traditional defensive sectors of Consumer and Health Care stocks. This balance between economic sensitive and defensive stocks is a good position to be in given the comparable balance between positive and negative views currently prevalent in the market.

U.S. Core Guided Portfolio					
Sector	Symbol	Price 30-Sep-05	Target Price	Dividend	Dividend Yield
Interest Sensitive:					
Bank of New York	BK	\$29.41	\$35.00	\$0.80	2.7%
JP Morgan	JPM	\$33.93	\$50.00	\$1.36	4.0%
Consumer Products:					
Amgen	AMGN	\$79.67	\$76.00	\$0.00	0.0%
Diageo	DEO	\$58.01	\$63.51	\$2.09	3.6%
Kimberly Clark	KMB	\$59.53	\$75.00	\$1.80	3.0%
Pfizer	PFE	\$24.97	\$27.00	\$0.76	3.0%
Ralcorp	RAH	\$41.92	\$44.00	\$0.00	0.0%
Walt Disney	DIS	\$24.13	\$40.00	\$0.24	1.0%
Wal Mart Stores Inc	WMT	\$43.82	\$55.00	\$0.60	1.4%
Industrial Products:					
Deere	DE	\$61.20	\$90.00	\$1.24	2.0%
General Electric	GE	\$33.67	\$41.00	\$0.88	2.6%
Oracle	ORCL	\$12.40	\$16.00	\$0.00	0.0%
Texas Instruments	TXN	\$33.90	\$40.00	\$0.12	0.4%
Resource:					
PPG Industries	PPG	\$59.19	\$73.00	\$1.88	3.2%
GlobalSanteFe	GSF	\$45.62	\$55.00	\$0.60	1.3%

Source: Scotia Capital; Credit Suisse; First Boston.

Canadian Core Portfolio

Paul Danesi – Director, Portfolio Advisory Group

Investment Objective

The Canadian Core Guided Portfolio is a diversified Canadian equity portfolio. The portfolio is designed and managed for our clients whose investment horizon and objectives focus on long-term capital appreciation. The companies within the portfolio are monitored closely for changes in underlying fundamentals and valuation. Appropriate changes are made when conditions warrant ensuring that the long-term objectives of the fund are being met.

Portfolio Construction and Management

Investment style plays an important role in fund returns and reflects a portfolio manager's investment mandate and philosophy towards investing. The Canadian Core Guided Portfolio's mandate seeks to provide a consistent rate of return over the long haul and is based on the belief that this goal can be achieved by focusing on companies where the share price is supported by improving levels of profitability. Often times called investing in Growth at a Reasonable Price, this style of investing combines two successful investment strategies - value and growth investing. This style looks to find companies with growth potential but only if it is available at a reasonable price. The list of Canadian companies available for investment is screened with this style in mind to find the best growth with a reasonable combination of absolute and relative value. Risk is minimized through diversification, which is maintained by investing across the four broad sectors of the Canadian economy: resources, financials, industrials and the consumer.

The stocks that comprise the portfolio are market leaders in their respective industries. For the most part, these companies are some of the largest and most established companies in the Canadian marketplace. The shares of which tend to be more actively traded offering a greater level of liquidity. When selecting leaders within an industry we look for companies that have dominant market share and some form of competitive advantage. Relative earnings growth and valuation, a strong balance sheet and a company's ability to generate cash flow on a consistent basis are all considered.

The ability to make sound fundamental selling decisions is an important aspect of portfolio management. Our decision to remove stocks or reduce their weightings within the portfolio is based on company fundamentals and share price momentum. Relative valuation and relative earnings momentum are key determinants.

Performance Update

The third quarter of 2005 was a period of transition for the Canadian Core Guided Portfolio. The tightening of our selection criteria led a high level of turnover in the quarter. While the transition was not easy, ultimately we believe that we can deliver stronger performance with lower overall volatility on a go forward basis. We have raised our capitalization and liquidity requirements leading us to more recognizable "blue chip" names. Our firm's proprietary and objective quantitative models have been incorporated into our stock selection and management process providing greater depth.

Performance is slowly improving on an absolute basis although returns relative to the index remain sub par. On a total return basis the portfolio gained 3.1% lagging the TSX Composite Total Return Index which gained 11.6%. Certain stocks no longer part of this portfolio fell dramatically in the quarter before they were removed. Our experience with the remaining names was generally positive with a few laggards. CN Rail was the top performing position gaining 16.7% in the quarter despite the headline grabbing news of a derailment and chemical spill at Lake Wabamun, Alberta. Strike action by Telus' unionized employees could not hold back the shares, which jumped 12.7%. Royal Bank gained 11.6% after delivering strong Q3 results and its third consecutive dividend increase this year. BCE Inc. rose 9.8% as management now appears more interested in taking a proactive approach to surfacing shareholder value for its shareholders. We have discussed the seasonal trading pattern in Astral Media's shares noting that the summer months were a great time to be buying the stock. Astral gained 8.3% in the quarter and is poised to move higher through the fall.

Looking forward, we anticipate stronger performance from this relatively defensive portfolio. The Canadian Core is currently overweight in the consumer staples, telecommunications, and financial services sectors, and underweight in cyclical materials and energy stocks. A correction in the energy sector would help to narrow the performance gap with the broader market. Above average earnings growth and profitability are catalysts for stronger absolute returns. Every position in the portfolio pays a dividend and the portfolio currently offers a yield of 2.1%. We believe that each company is positioned to deliver dividend growth in the year ahead.

Canadian Core Guided Portfolio					
Company	Symbol	Price 30-Sep-05	Target Price	Dividend	Dividend Yield
Interest Sensitive:					
BCE Inc.	BCE	\$31.85	\$36.00	\$1.32	4.1%
CIBC	CM	\$72.60	\$85.00	\$2.72	3.7%
Great-West Lifeco	GWO	\$29.10	\$33.00	\$0.84	2.9%
Manulife Financial	MFC	\$62.00	\$67.00	\$1.20	1.9%
Power Corp.	POW.SV	\$31.84	\$39.00	\$0.68	2.1%
Royal Bank	RY	\$84.69	\$100.00	\$2.56	3.0%
Telus Corp.	T	\$48.51	\$54.00	\$0.80	1.6%
Toronto-Dominion Bank	TD	\$57.32	\$70.00	\$1.68	2.9%
Consumer Products:					
Astral Media Inc.	ACM.NV.A	\$34.18	\$38.50	\$0.20	0.6%
Loblaw Companies Ltd.	L	\$69.87	\$75.50	\$0.84	1.2%
Magna International Inc.	MG.SV.A	\$87.42	\$103.00	\$1.80	2.0%
Shoppers Drug Mart	SC	\$41.10	\$48.00	\$0.40	1.0%
Thomson Corp.	TOC	\$43.40	\$51.00	\$0.95*	2.2%
Industrial Products:					
Canadian National Railway	CNR	\$82.50	\$100.00	\$1.00	1.2%
Resource:					
Enbridge Inc.	ENB	\$37.26	\$41.00	\$1.00	2.7%
Petro-Canada	PCA	\$48.66	\$53.25	\$0.40	0.8%

* Quarterly dividend is U\$0.20

Source: Scotia Capital estimates, Reuters.

Canadian Income Plus Guided Portfolio

Andrew Guy CFA – Associate Director, Portfolio Advisory Group

Investment Objective

The Canadian Income Plus Guided Portfolio is a lower risk portfolio designed for conservative investors whose primary objective is dividend income with modest capital appreciation. The Income Plus portfolio is comprised of investments in conservative companies or income trusts that are well established, financially strong and have an excellent record of earnings and dividend growth or operating cash flow and cash distributions. Diversification is achieved by investing in eight to 12 entities over a minimum of five sectors.

Selection Criteria

Investments for the Income Plus portfolio are selected from the S&P/TSX Composite Index or the S&P/TSX Income Trust Index. These investments must satisfy a set of fundamental and quantitative criteria including possessing an acceptable dividend (or cash distribution) yield, minimum market capitalization and liquidity levels. As a result, the portfolio tends to be comprised largely of investments that consistently deliver stable earnings and dividend growth. Higher dividend yielding investments in many cases should be viewed as more sensitive to changes in interest rates than those not paying a dividend.

Performance Update

During the third quarter of 2005, the Income Plus Guided Portfolio generated a total return of 8.3%, underperforming the S&P/TSX which returned 11.6%. Atco Ltd (up 21.3% before it was removed), TransAlta (up 12.7%), and BCE Inc. (up 9.8%) were the strongest performing holdings in the quarter. All but two of the holdings generated a positive return in the quarter. Unfortunately, the strong performance of the energy sector resulted in the negative relative performance during the quarter.

On a year-to-date basis, the Portfolio has generated a total return of 21.2% and has outperformed the S&P/TSX by 48 bps. Portfolio performance has been driven by strong performance by ATCO, TransAlta and Enbridge. While the Energy sector has accounted for 75% of the return of the TSE this year, the Utility sector has been the second best performing sector.

Changes

During the third quarter, one change was made to the Income Plus portfolio. Royal Bank of Canada was added to the portfolio in September as a replacement for Atco Ltd. Atco was added to the Portfolio in January 2004 and generated a 78.6% total return, however at the time of removal, its dividend yield had fallen below 2% and it was trading at an all-time high earnings multiple and was trading through Scotia Capital's target price. In contrast, Royal Bank had the highest expected one-year return (26.4%) in the eligible universe of companies. Royal's turnaround continued in its third quarter. Earnings continue to grow faster than expected as costs are wrung out of the operations. Management's confidence in the future direction of the financial results was signaled by a surprise increase in its dividend. While the stock has increased significantly, we continue to believe that the valuation is still attractive. In particular, the company's high ROE, strong wealth management platform and its leverage to lower operating costs are not fully reflective in the current stock price.

We continue to expect to make further changes in the coming months. Economic conditions in North America suggest that interest rates are unlikely to continue at current low levels for long. When they do begin to back up again, the market's focus will shift from high dividend yield companies to companies that have reasonable expectations of dividend increases. As a result, we will be looking to ensure that all Portfolio constituents are likely to increase their dividends/distributions over the next 12 months.

Canadian Income Plus Guided Portfolio					
Company	Symbol	Price 30-Sep-05	Target Price	Dividend	Dividend Yield
BCE Inc.	BCE	\$31.85	\$36.00	\$1.32	4.1%
CIBC Inc.	CM	\$72.60	\$85.00	\$2.72	3.7%
CML Healthcare Income Fund	CLC.UN	\$14.82	\$14.00	\$0.95	6.4%
Enbridge Inc.	ENB	\$37.26	\$41.00	\$1.00	2.7%
Great-West Lifeco	GWO	\$29.10	\$33.00	\$0.84	2.9%
Power Financial Corp.	PWF	\$33.72	\$38.00	\$0.87	2.6%
Royal Bank of Canada	RY	\$84.69	\$100.00	\$2.56	3.0%
Thomson Corp.	TOC	\$43.40	\$51.17	\$0.95*	2.2%
TransAlta Corp.	TA	\$23.03	\$26.50	\$1.00	4.3%
TD Bank	TD	\$57.32	\$70.00	\$1.68	2.9%
Yellow Pages Income Fund	YLO.UN	\$14.45	\$17.50	\$0.96	6.6%

* Quarterly dividend is US\$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. 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 approximately 20% is then focused on active strategies that are geared towards moderate to high-risk investors.

Current Active Strategies

There are currently two trades that make up the active portion of the Core-Plus portfolio. The first active trade strategy is a position in short-term Canadian corporate paper consisting of DaimlerChrysler Finance Canada 5.00% due May 29, 2006. This trade was initiated at the beginning of September 2005 with the view DaimlerChrysler provided an attractive pick-up in yield over similar term short maturity bond alternatives. We have been pleased with the performance of this trade to date and are happy to earn the 5% coupon for now.

The second active trade strategy is a position in the Government of Canada 4.50% bond due June 1, 2015. We have re-entered the 10-year Canada trade with the view that the Canada yield curve is likely to continue to flatten over the near term. We feel that with the Bank of Canada resuming its tightening policy, short maturity bond yields are likely to come under selling pressure, pushing yields higher. Additionally, if higher energy prices persist, long maturity yields are likely to outperform. The difference between 10-year yield and 2-year yields in Canada has narrowed to 60 basis points and we feel that the flattening trend is likely to continue over the next few months as the Bank of Canada increases short term borrowing rates. Our target for the 10-year – 2-year Canada yield spread is 50 basis points over the next six months. We would look to exit this trade should the Canadian yield curve flatten to the 50 basis point level. Likewise, we will sell the position should the yield on the Government of Canada 4.25% due June 1, 2015 consistently trade above the 4.20% level.

Performance Update

The Core-Plus portfolio had a total return of 0.54% in the third quarter of 2005, outperforming the Scotia Capital Universe's 0.12% return. Since its inception date of September 30, 2003 the Core-Plus portfolio has had an annual compound total return of 5.60% compared to a 6.91% annual compound total return from the Scotia Capital Universe. The DaimlerChrysler Finance Canada 4.65% bond due August 11, 2005 position in the core portion of the portfolio matured during the third quarter and was replaced by the Canadian Tire Corp. 4.95% bond due June 1, 2015. The core holdings portion of the portfolio is structured so that a portion of the 10-year ladder 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). This low-cost, balanced, passive strategy has proven successful in generating consistent returns and income. Canadian Tire Corp is presently rated "A (low)" with a stable outlook by Dominion Bond Rating Services (DBRS) and "BBB+" with a stable outlook by S&P.

Core-Plus Fixed Income Guided Portfolio			
Sector	Coupon	Maturity Date	Weighting
Core Positions:			
Canada	5.000	1-Jun-14	7%
Ontario	3.500	8-Aug-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%
Canada	4.500	1-Jun-15	12%

Source: ScotiaMcLeod Portfolio Advisory Group.

Mutual Fund Guided Portfolios

Jennifer Gilbert – Product Manager, Mutual Funds

The task of sifting through the vast number of available Canadian Mutual Funds in order to identify investment-worthy options can be a daunting task. Add to that the need to construct portfolios with the characteristics most likely to help you achieve your future goals, and the process becomes even more challenging. Unfortunately for many investors this important decision often consists of fund selection based solely upon the most recent hot performance numbers and an arbitrary grouping of funds that can expose us to various unintended risks.

At ScotiaMcLeod we recognize that your future is much too important to be left to chance. That is why we have developed a tool to provide definitive investment direction, while at the same time offering you both the control and flexibility you need to best service the unique needs of your Financial Plan.

What are Mutual Fund Guided Portfolios and How are They Designed?

Mutual Fund Guided Fund Portfolios are designed to bring an element of structure and discipline to the portfolio construction process. Each Portfolio is designed based on modern portfolio theory and supported by the ScotiaMcLeod Mutual Fund Recommended List. The objective of the Portfolios is to enhance the level of portfolio management and structure that goes into the investment process.

The portfolios are constructed using a long-term outlook, focused on risk control with the goal of reducing volatility. How do we do this? By offering diversification across fund managers, geographic regions and by remaining investment style neutral.

We created the portfolios to represent efficient combinations of investment assets based on seven asset allocation models within two pre-set asset sizes, for a total of 14 unique Mutual Fund Guided Portfolios. The seven asset allocations models are based on forecasts for market returns, market volatility and market correlations established by a committee of professionals from Scotia Capital and Northern Trust Global Advisors.

How to Use Mutual Fund Guided Portfolio?

Mutual Fund Guided Portfolios are easy to use and implement with the assistance of your advisor. View them as a holistic approach to your investment decision or simply choose to combine, with the assistance of your advisor, specific asset classes and geographic regions in combination with other existing investment products to create a fully diversified personalized portfolio solution.

We are featuring each of the portfolios individually over a number of quarterly issues of this publication. While investors with long time horizons and investment objectives which match this asset allocation may wish to use this portfolio, the focus on equity will also appeal to many when used in combination with an already established ladder bond or other fixed income component.

Feature Portfolio:

Investible Assets of \$50,000 – \$150,000 (ask your advisor for the \$150,000 plus portfolio)

Portfolio 70% Equity / 30% Fixed Income (Moderate):

The portfolio's primary objective is to obtain long-term capital growth while also maintaining a commitment to preservation of that capital.

Portfolio Details and Investment Strategy

The portfolio seeks to achieve its objective with a focus on its equity fund allocation relative to its fixed income fund weighting. The portfolio allocates 70% to equity funds that invest across a diverse mix of companies of varying market capitalizations operating in a broad spectrum of industries. The remaining 30% fixed income weighting will be represented by a diverse set of fixed income strategies set to generate steady income flows. The portfolio is diversified by geographic region, investment style and market capitalization.

Portfolio Positioning

The funds in which the portfolio will invest as well as their target weightings within the portfolio are as follows:

Portfolio Suitability

This portfolio may be suitable for investors who:

- wish to build a portfolio geared toward long-term capital appreciation with some income generation
- can accept above-average level of investment risk
- are investing for at least 5 years

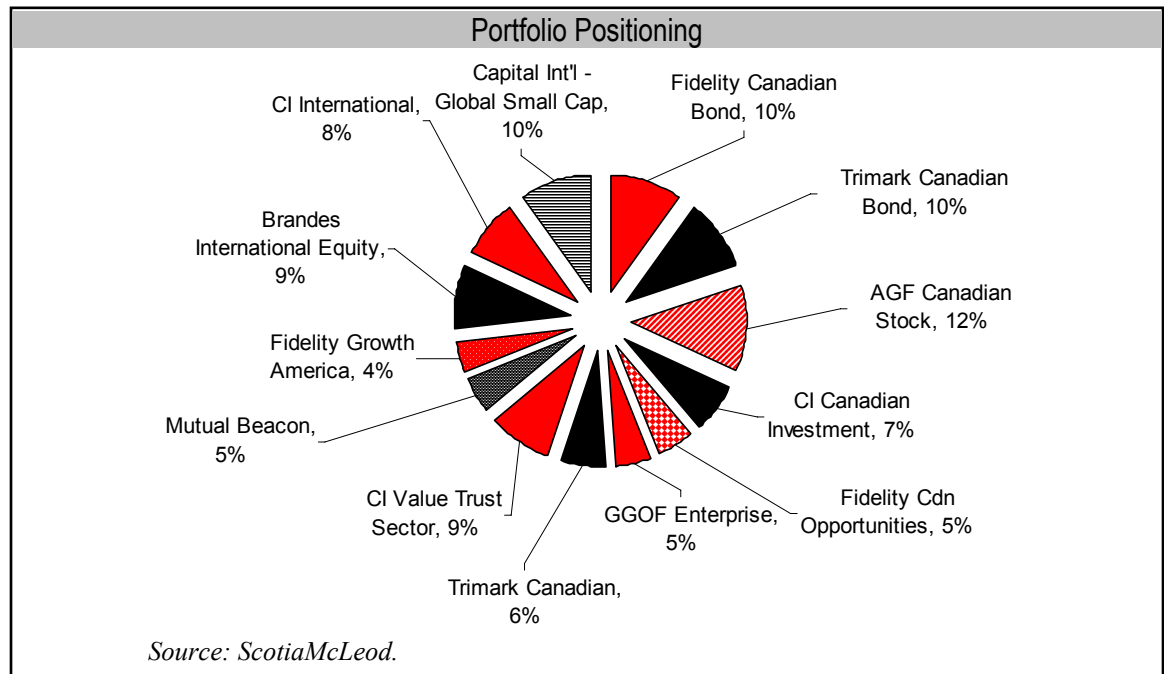
Blended MER

2.16% – Based on Series A funds and represents the weighted-average of all underlying fund MERs in the portfolio.

What are the risks of investing in this portfolio?

Mutual Fund Guided Portfolios represent investments in the underlying funds and will exhibit the same risks as the underlying funds based on their proportionate representations. Refer to the above table for a review of these risks.

For more detailed information please contact your advisor.



Portfolio Considerations

The Search for Yield

Anna Lee – Manager, Fee Based Strategy and Distribution

With interest rates and bonds yields at multi-decade lows, the search for dependable, high-yielding investments has become increasingly difficult for Canadian investors. The challenge becomes how to secure the best possible yield, without risking significant principal depreciation. Over the past few years, the answer has been to embrace income-generating investments, which have the potential to deliver higher yields than traditional Canadian bonds.

Given today's environment, investors can take measures to pursue potentially higher yielding investments, but it is important to note that such measures may involve taking on more risk. The risk-return trade-off may become necessary to provide aging investors with the higher level of income, which may be required or depended upon. The following are investment opportunities that, given a specific appetite for risk, may offer the potential to increase yield in your portfolio.

Income Funds

The popularity of income funds can be largely attributed to baby boomers, who tend to be moving out of their best income-generating years. In past years, baby boomers were primarily interested in capital appreciation investments, but have now turned their focus to receiving increased income in retirement.

Income funds typically invest in a combination of high-yield bonds, preferred shares, income trusts and dividend paying shares, with the primary objective of generating a monthly flow of income. Depending on the fund's asset allocation, cash flows may comprise of capital gains, dividends, interest income and a return of capital (providing tax deferral of income).

When evaluating the many options available in the marketplace, it is important to ensure that the asset allocation of the income fund is consistent with your risk tolerance and objectives. Some funds are more heavily weighted in income trusts, while others have a higher allocation in equities, offering greater capital appreciation, but a lower yield.

Overall, income funds represent a viable solution for those investors who are looking to achieve higher yields than those offered by government bonds or GICs, and those who prefer less volatility than many equity investments provide.

Income Trusts

Spurred by a low interest rate environment, one of the most popular investment vehicles in the past year has been income trusts. The appeal of an income trust comes from its tax structure, which enables businesses to distribute all (or most of) its income to unitholders. By doing this, corporations are able to significantly eliminate or reduce corporate tax; the trust pays little or no tax on its earnings because most of its income is distributed to investors. Income trusts can be considered a hybrid between stocks and bonds, giving investors an equity-like stake through their units and a bond-like yield through regular distributions.

These regular cash distributions (usually monthly or quarterly) are what make income trusts so attractive to investors, especially baby boomers who are seeking additional income in their portfolios. Often, yields for income trusts can be much higher than those for fixed income investments because they are more tax-efficient. The higher yields which trusts generate stem from the fact that they do not pay corporate tax on earnings; tax is charged just once, in the hands of the investor. The portion of the distribution in excess of taxable amounts is considered to be a return of capital, and is usually not taxed until the units are sold.

Rather than being dazzled by the high yields, investors should proceed with caution when purchasing income trusts. Trusts are not as secure as bonds and other fixed income instruments, as distributions are not guaranteed and can “ebb” and “flow” depending on the financial performance of the underlying entity. As such, investors should consider the merits of the underlying asset or cash-generating business and its prospects in the current economic climate.

A key risk for investors may exist, if during a downturn in the economy, a company has to cut or reduce its distributions. Accordingly, an investor may be left with a lower distribution, and a likely lower trust price, as trust valuations can fluctuate, just like stocks. Also, rising interest rates may pose risks to the underlying business, thereby affecting the amount of cash that can be distributed to unitholders.

Lastly, there is a strong possibility that the federal government may intervene in the income trust market as early as the next budget. This was clearly expressed in the recently released federal government’s paper on income trusts, which emphasized the playing field for taxes must be somehow levelled between income trusts and corporations.¹ Amidst the musings about the benefits of spinning certain assets into income trusts, Finance Minister Ralph Goodale announced on Sept. 19th, that advance tax rulings will no longer be issued to companies considering trust conversions, at least for the near future. As a result of this announcement, Standard and Poor Corp. has decided to revisit its decision to put trusts in the S&P/TSX Composite Index and has also put a number of income trust conversions on hold.² If the income trust structure were to be amended by the government, much of the popularity for trusts and viability as investment vehicles may disappear.

Real Estate Funds

Real Estate Funds generate attractive yields mainly from investing in Real Estate Investment Trusts (REITs). Although they are configured as income trusts, the appeal of REITs is that they derive their cash flow by investing in income-producing real estate ranging from apartments to shopping malls. REITs generally enjoy fairly stable yields that are more consistent and more ‘bond-like’ than typical income trusts. A fitting offering within the Pinnacle Program, is the Pinnacle Real Estate Securities Fund managed by Alliance Capital Management. The primary objective of this Fund is to achieve superior long-term returns through income and capital growth, by investing primarily in U.S., Canadian and non-North American real estate stocks and real estate investment trusts (REITs).

High-Yield Bond Funds

The diversification benefits of high-yield bonds make them an excellent addition to a portfolio. High-yield bonds typically exhibit a lower correlation to traditional assets classes like government debt and equity. As a result, they may be less sensitive to the interest-rate fluctuations that drive the prices of government bonds, and tend to perform better during periods of economic recovery and strength.

However, due to their credit quality, which is lower than that of government bonds or high-grade corporate bonds, high-yield bonds may be more susceptible to default risk. Mutual funds may be the best way to diversify into the high-yield arena, as professional money managers may be best equipped to do the necessary research to minimize default risk.

An effective way to gain exposure to high-yield is through the Pinnacle High Yield Bond Fund, managed by Guardian Capital (Guardian). The Fund invests in a diversified portfolio of high-yield bonds, lower rated Canadian corporate bonds, preferred shares and short-term money market securities, using a yield maximization strategy. Their strategy targets current income, rather than capital gains, leading to relatively low turnover in the portfolio. While there can be risks to investing in high-yield bonds, Guardian manages these risks through a comprehensive credit analysis and diversification strategy.

Non-Canadian Fixed Income

One area that investors may consider in an effort to increase yield is through non-Canadian debt, especially given the recent elimination of foreign content limits on registered accounts. Canada represents only a small portion of the global fixed income market and, as such, there are many opportunities outside our country where interest rates are higher and the market is larger and more diversified. Canadian bond portfolios invest mainly in a limited number of Canadian government and corporate bonds, while the global market offers more opportunities to find attractive yield opportunities.

At the same time, there is also a currency risk with this type of investment, as the Canadian dollar recently appreciated against most foreign currencies. This, in turn, reduces the return of assets denominated in foreign currencies, including foreign bonds. The best way to safeguard against currency risk is to ensure that you have a well diversified portfolio based on your asset allocation strategy.

A great way to gain exposure to non-Canadian bonds is through the Pinnacle American-Core Plus Bond Fund, managed by Delaware Investments. This Fund invests primarily in U.S. bonds with some tactical exposure to non-U.S. and emerging markets. Its core holdings include U.S. government bonds and corporate bonds; mortgage backed securities, asset-backed securities, CMOs, and some exposure to Foreign Sovereign debt, high-yield debt in U.S. and foreign markets. The Fund's investment philosophy is based upon their belief that the bond markets are efficient with respect to interest rate risk, but that markets regularly misprice securities that are exposed to credit, prepayment, and liquidity risks. In an attempt to exploit these inefficiencies and provide consistent excess returns, they focus on optimal security selection, emphasize spread sectors, build duration neutral portfolios and construct portfolios with attractive risk/reward characteristics.

With each investment opportunity, it is important to evaluate the risk-reward trade-off and to find an appropriate balance within your portfolio. The more investment risk you are willing to accept, the greater potential for reward. A well-defined and appropriate asset allocation strategy that accurately reflects your individual investment objectives and preferences will help you find this balance.

For more information the investments featured in this article or your portfolio, please contact your advisor.

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Iliopoulos, Alexandra and Vettese, John, "The Canadian Income Trust Market," The LEXPERT CCCA/ACCJE Corporate Counsel Directory and Yearbook, 2005.

"Understanding Income Trusts," Phillips, Hager & North Investment Management, July 2005.

¹ Chevreau, Johnathan, "Ottawa Continues to Fret Over Lost Tax Revenue," The Financial Post, September 26, 2005.

² Willis, Andrew, "Ottawa's Move on Income Trusts Throws Sector Into Disarray," The Globe and Mail, September 28, 2005.

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.

Is Enhancing Your Estate Important to You?

Monica Macieszkiwicz – Product Manager, Insurance

You've worked hard for many years. You've planned and invested wisely and now you're ready to enjoy your retirement, or are already enjoying it. To get to this point, your planning has involved investment strategies that have created the income and assets needed to enjoy the best years of your life. If you're interested in preserving or enhancing the value of these assets for future generations, or simply want to make sure that most of your estate gets passed to your heirs and not the government, consider how life insurance can play a role in accomplishing this.

If you presently have income or assets that are in excess of what you have estimated to be necessary to sustain your retirement lifestyle, there are strategies that involve redirecting these monies to a tax-exempt life insurance policy to achieve many or all of your estate planning goals. Universal Life (UL) and Participating Whole Life (PAR) insurance policies differ in terms of their features and product design, however, both achieve the same end result; proceeds of the policy are distributed directly to your beneficiaries on a tax-free basis, bypassing your estate and any costs associated with settling it.

Reallocate Registered Assets

If you're like many, you may not need the funds you've saved within your RRSP or RRIF during your retirement. If this is the case, your plan may include only taking out the minimum required RRIF income. This income is taxable as it's withdrawn, and any balance remaining upon your death or the death of your spouse will also be taxed and are subject to the normal legal and probate costs connected with estate administration. You may be using this income to re-invest for the purposes of leaving inheritance or for undefined future needs, but the problem is that this reinvestment is now in a tax-exposed environment and will form part of your estate and will also be subject to those dreaded estate settling costs.

Instead, think about moving a lump sum of your unneeded registered assets, or even just the after-tax RRIF income proceeds each year into an exempt life insurance contract. Although this income will be taxable to you in the year(s) of withdrawal, the impact of purchasing the insurance contract will more than offset that of paying tax on the withdrawal.

Example

Consider the situation of Mr. and Mrs. Smith. They are both 70 years old, have a combined RRIF value of \$400,000, and are withdrawing only the minimum income that they are required to, roughly \$18,000 per year, after-tax. They are reinvesting the assets as they don't currently need them to live off of and are confident that they will never need them for living expenses for the remainder of their lives. Therefore, much of these assets as well as others including their cottage, are destined to be left for their children and grandchildren. Through estate planning projections they've done with their advisor, they also know that they will be leaving a tax bill of approximately \$420,000.

Let's take look at investing the after-tax income in a tax-exempt policy with a face amount of \$420,000 compared to an alternative investment (AI) for 15 years.* As the chart on the next page illustrates, in the first year the AI is worth \$18,579 whereas the insurance already has an estate value of \$429,816, due to the injection of capital from the death benefit.

Tax Exempt Policy vs Alternative Investment		
	Estate Reallocation Strategy	Alternative Investment (AI)
Total Estate Value at Year 1	\$429,816	\$18,579
Total Estate Value at Year 10	\$549,590	\$215,117
Total Estate Value at Year 21 (Life Expectancy)	\$689,294	\$424,498

*Source: Manulife.**

By purchasing the insurance, Mr. and Mrs. Smith have simply shifted assets that they would have reinvested and had been subject to tax, into a policy that allows for tax-deferred growth of excess funds that gets paid in addition to the death benefit, tax free. The result generally creates a significantly higher after-tax estate than would have been possible by reinvesting the funds in an alternative investment; in this case as much as 1.6 times higher. Much of this enhanced estate value can be used to offset the large tax bill that will be owing, leaving the remainder for the Smith’s children and grandchildren.

A well thought-out insurance strategy can spare your family the burden of paying unexpected tax liabilities upon your death, or upon the death of your surviving spouse, while at the same time enhancing your estate value that you leave behind. Speak to your life insurance licensed ScotiaMcLeod advisor to review your personal situation and see how this reallocation strategy could work to accomplish many of your estate planning goals.

**Assumptions are based on Manulife joint-last-to-die Innovision policy assuming a 5% illustrated grown rate versus alternative investment with 6% pre-tax rate of return, as of October 7, 2005.*

All insurance products are sold through ScotiaMcLeod Financial Services companies. ScotiaMcLeod Financial Services companies are the insurance subsidiaries of Scotia Capital Inc., a member of the Scotiabank Group. When discussing life insurance products, ScotiaMcLeod Investment Executives are acting as Life Underwriters (Financial security advisors in Quebec) representing ScotiaMcLeod Financial Services. “ScotiaMcLeod Financial Services” includes: * “ScotiaMcLeod Financial Services (Ontario) Inc.” * “ScotiaMcLeod Financial Services (Quebec) Inc.” * “ScotiaMcLeod Financial Services Inc.”*

Energy

A Favourable Outlook for the Remainder of the 2005

Gareth Watson, CFA – Associate, Portfolio Advisory Group

2005 has been a strong year for the S&P/TSX Composite Index; however, the strength for the TSX has not come from a broad cross section of sub sectors, but primarily from energy related equities. As we move towards the end of 2005, the persistent question remains, will the strength of the energy sector continue and for how long? The answer to this question will likely focus on the short and long term views of oil and natural gas prices and it is our expectation that higher than average prices will continue to drive energy related equities in the short term, while improving balance sheets, increased visibility in production profiles, and stronger capital management programs should provide support for the energy sector in the long run.

Due to the impact of hurricanes Katrina and Rita on the infrastructure and refineries of the Gulf Coast, WTI crude oil prices continue to find support above US\$60.00 per barrel, while Nymex natural gas prices have soared. Home heating oil prices have increased over concerns of a cold winter and the natural disasters of the Gulf Coast have caused motor vehicle gasoline prices to climb in both the U.S. and Canada. Current estimates indicate that following Katrina, 1.13 million barrels per day (6.6%) of refining capacity is expected to be off line for the next two to four months, along with another 1.46 million barrels per day of capacity recovering slowly in the aftermath of Rita. Taking these catalysts into consideration, Scotia Capital's energy research team increased its energy price deck forecasts at the beginning of October. Earnings and cash flow estimates have been revised to reflect a WTI crude oil price of US\$57.50 per barrel in 2005, US\$62.25 per barrel in 2006 and US\$57.00 per barrel in 2007 with Henry Hub (Nymex) natural gas prices of US\$8.35 per mmBtu in 2005, US\$9.00 per mmBtu in 2006, and US\$8.25 per mmBtu in 2007.

Considering that U.S. refining capacity has been constrained in the Gulf Coast, that the cold months of winter are on their way, and that OPEC's spare capacity has been eroded, we expect energy price strength to continue for the remainder of 2005 and into the beginning of 2006 even though various energy commodity inventory levels remain healthy. Continued strength in energy prices will also provide support for the S&P/TSX Index which finds over a quarter of its weighting in the energy sector. However, if Gulf Coast capacity comes back on line, if this year's winter proves to be warmer than expected, if Chinese oil demand growth continues to decelerate, or if OPEC is able to increase spare capacity, we could begin to see energy prices moderate in 2006. Although OPEC's ability to influence energy prices has deteriorated as spare capacity has declined, Scotia Capital is forecasting that OPEC's spare capacity could rise from 1.6 million barrels per day (1.9%) in 2005 to 2.0 million barrels per day (2.3%) in 2006, followed by another increase to 2.7 million barrels per day (3.0%) in 2007. We must also note that even though Scotia Capital believes the growth rate of Chinese oil demand will likely decelerate, China's oil consumption is still pegged to grow from 6.6 million barrels per day in 2005 to a possible 8.0 – 9.0 million barrels per day by 2010.

From a portfolio management perspective conservative income oriented investors will see little benefit from investing in energy since the yields on energy common equities that actually offer dividends are much lower than those offered by interest sensitive stocks such as the banks, life insurance companies and utilities. Investors that seek a well balanced portfolio (a combination of growth and income) should consider some form of exposure to energy for the long term. Such investors that have a high risk tolerance could consider investing in independent Exploration & Production (E&P) companies, while investors wanting to reduce their risk exposure within the energy sector could consider investments in the Integrations (the downstream refining capabilities of the Integrations reduces the higher risk profile of upstream focused E&P companies). Investors could also consider an investment in companies providing the energy sector with equipment and services. Scotia Capital's energy research team's recommendations, all of which are 1-Sector Outperforms, include Petro-Canada among the Integrated oils; Talisman Energy, Nexen, and Bow Valley Energy among the E&P Independents; and Ensign Energy within the service sector.

For a complete review of the thoughts and views of Scotia Capital's energy research team, we would refer clients to their most recent Energy Insights research report entitled "Revenge of the National Oil Companies" dated October 4, 2005. This report is available from your Scotia McLeod Investment Executive.

Gold

June Anne Reid – Associate, Portfolio Advisory Group

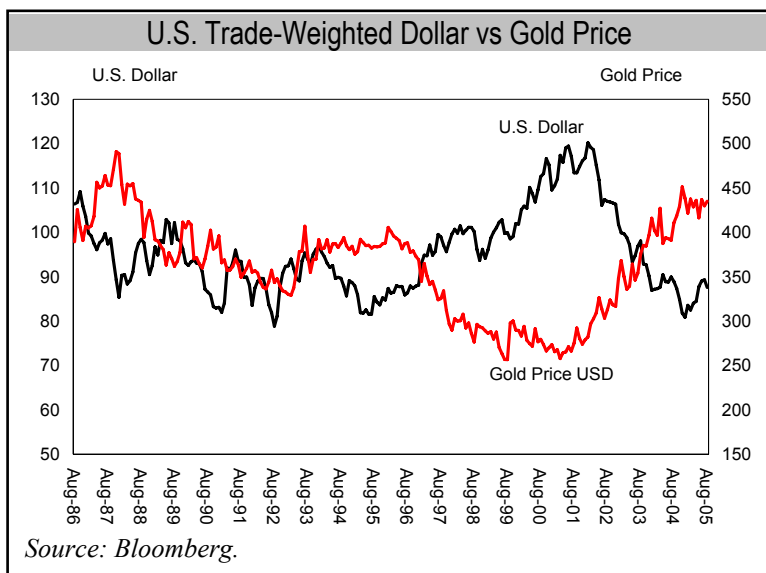
Gold is a global commodity: it is sourced and sold around the world, and global economic factors determine its price. These factors include, but are not limited to, demand for the physical commodity, the rate of global economic growth, and the level of global interest rates. This makes investing in gold a useful part of any portfolio diversification strategy: changes in the price of gold tend not to be directly related to many of the more localized factors that affect Canadian companies' performance.

The growing demand forecast in China and India are two perennial themes for gold. According to Scotia Economics, Chinese GDP growth averaged approximately 9% from 2002 – 2004, and growth of 9.2% and 8.5% is forecast for 2005 and 2006. As the benefits of growing industrial production spin out into broader Chinese society, the rise of the Chinese middle class could put sustained secular pressure on the gold price as more consumers there begin to purchase jewelry. Gold is already the metal of choice in India, where it is used as a savings vehicle. Scotia Economics reports that Indian GDP growth has averaged nearly 7% from 2002 – 2004, and is forecast to reach 7% and 6.5% in 2005 and 2006. The Indian wedding season, which begins in the autumn, is a major driver of seasonal global gold consumption as wealth is transferred between families in the form of jewelry. Growing industrial wealth could help turn this seasonal pattern into steadier year-round consumption as more Indians choose to invest in an asset whose worth appears to be beyond the vagaries of government and the Indian stock market.

Geopolitical tensions, a weak U.S. dollar, and increasing inflation rates all provide support to the gold price, as investors choose a vehicle perceived to have an “intrinsic” value when times get tough; Scotia Economics is forecasting declining GDP growth and rising inflation in both Canada and the U.S. through 2006. Gold makes sense in an inflationary environment, because the gold price tends to move in the same direction as changes in inflation (measured by changes the U.S. Consumer Price Index). Worry over an overheated economy's bubble bursting, and inflation's eating away at their returns, drives investors to seek out assets with ‘intrinsic’ value, such as cash and gold.

GDP Growth & Rising Inflation				
		GDP Growth	Exchange Rate	% Change in CPI
Canada	2005F	2.8%	\$1.17	2.5%
U.S.	2005F	3.6%	\$0.86	3.4%
Canada	2006F	2.7%	\$1.11	2.5%
U.S.	2006F	3.2%	\$0.90	2.9%

Source: Scotia Economics.



There are numerous ways to invest in gold. Direct investment involves buying and holding gold itself – in the form of coins, jewelry, or bullion – or investing in exchange-traded funds (ETFs) based on bullion. Indirect investment involves holding gold equities. But which is more suitable for individual investors? The simplest and most straightforward is through bullion-based ETFs, such as the Barclays iShares Comex Gold Trust (ticker: IAU), or the StreetTracks Gold Trust (ticker: GLD), both of which trade in the U.S. Both are based on the value of gold held in trust for the fund. The advantages of holding bullion-based ETFs is that they make establishing a position in the gold market simple and straightforward. Unlike holding bullion directly, these ETFs do not require storage, transport, or insurance. The disadvantage is that both the IAU and GLD have management fees which cover the funds' operations, including buying, selling, storing, and insuring the bullion, as well as administering the fund itself.

Gold equities typically offer both more downside and more upside than gold itself, and are suitable for risk-tolerant investors. Gold equities provide exposure to gold through the companies' reserves; however, accessing, processing, and bringing the reserves to market is dependent upon the quality of the reserves themselves, and management's strategy and ability to manage operations. In addition, gold equities are subject to all of the market and economic forces that hinder and enhance equity performance generally. Our favourite gold equity is Barrick (ticker ABX). Barrick is Canada's largest and the world's second-largest producer, with a market cap of approximately \$18B. Barrick is the only senior producer in Scotia Capital's coverage universe with meaningful production and earnings per share growth forecast from 2004 to 200, and it is the least sensitive of the senior producers to changes in the price of gold. The risks of investing in Barrick include geopolitical risks, reserve replacement, cost overruns, labour relations, commodity price changes, and exchange rate movements.

Sources: Scotia Capital, Scotia McLeod, Scotia Economics, Bloomberg, LVMH.

Notes

Notes

The supervisors of the Portfolio Advisory Group own securities of the following companies. Rogers Communications Inc., Royal Bank of Canada, TELUS Corporation, DEERE & CO, Yellow Pages Income Fund, Astral Media Inc., ATCO Ltd., Power Financial Corporation., Yellow Pages Income Fund.

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