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Colgate-Palmolive Co,

Executive Summary

2010 Spring Outlook

Stewart Hunt — Managing Director, Portfolio Advisory Group

One of my favourite trading room sayings is 'hindsight is 100% right'. I can't count the number of times I have either said or heard I wish I had bought or sold a particular security when the market was trading at the high or the low. Unfortunately, the majority of us do not own a crystal ball to peer into the future, and are thus subject to making our decisions based on historical and current market activity and future forecasts. However, the key word here is decisions. Procrastination kills all over achievers, thinking about what to do versus actually doing is often the difference between success and failure, which brings us to the current state of the equity and bond markets. What to do? While it is reasonable to assume Canada and the U.S. will remain in a low interest rate environment, the current near zero rate monetary stimuli of the central banks has been successful in helping the economies back onto stable ground, at least in Canada. So expectations are for interest rates to begin to rise. This is not good for people holding bonds as their prices decline as rates increase. Equity markets historically outperform bonds at the initial stages of rate increases although the positive returns tend to be sector and stock specific. As a result, this is a time to become more proactive with your portfolio and its holdings. Good portfolio management is a combination of asset allocation and security selection and we have highlighted this theme in our Spring IPQ. Investors should be taking the opportunity to 'take profits', 'trim positions' and reallocate to securities better positioned to deal with a higher rate environment and not worrying about missing the top of the market. Don't get caught looking back thinking 'I should have…' or you will find yourself 100% right, after the fact. Take the time to meet with your ScotiaMcLeod advisor and plan out a strategy that suits your investment needs and appetite.

Here are some of the highlights of the Spring 2010 IPQ:

- Scotia Capital Portfolio Strategist Vincent Delisle sees the normalization wave moving closer to shore and as a result he is reducing his equity overweight stance (-5%) to 63% and increasing his weighting in corporate bonds (+3%) and cash (+2%). While Delisle continues to believe we will see positive market returns they will be more oriented towards the historical norm of the asset class.
- Scotia Capital Economists Derek Holt and Karen Cordes provide their thoughts regarding the impact on the Canadian economy as the Canadian dollar moves as forecast to trading at parity, or through parity, against the U.S. dollar. While the Canadian dollar did reach parity to the U.S. dollar in 2008, the Canadian economy is currently in a much better position to deal with a strong currency which is why Derek and Karen continue to suggest over-weighting Canada as an investment.
- Gareth Watson, Canadian Equity Advisor, continues on our theme of dealing with the current market by proactively managing your portfolio versus taking a buy and hold approach. While the TSX Index has been up 2.5% for the first three months of the year the reality of higher interest rates and slower economic growth are all signals to start considering realizing or locking in your gains rather then watch them drift away as the market moves lower. Watson takes you through his thoughts and recommendations on financials, energy and base metals, precious metals and defensive industries (Consumer Staples, Utilities, Telecommunications).
- Paul Danesi, U.S. Equity Advisor, reminds us that the market never moves in a straight line for an extended period of time and having done so since March 2009 investors should be wary. While Danesi notes the global recovery should be supportive for the U.S. economy; the size of the public debt and the condition of the housing market will provide concerns until they are addressed. In support of our theme; Danesi sees the need for investors to be more tactically minded with their investments and notes the positive historical returns provided by dividend paying stocks. Danesi supports the dividend story by providing a list of dividend growing U.S. equities.

- Andrew Mystic, Associate Director, Portfolio Advisory Group; Fixed Income Trading and Sales, provides his evaluation of dealing with a rising interest rate environment and particularly staying short term with maturity and duration to reduce the impact of lower bond prices.
- Tara Quinn, Preferred Share Trading and Sales Advisor, provides her thoughts on the impact of rising interest rates on the preferred share market. Quinn breaks down the various preferred share structures into type and the suggested weightings and strategy for each type in an investor's portfolio. She also gives her thoughts on straight perpetual preferred shares and rate reset preferred shares.
- Justin Kusinskis, Associate Director, Portfolio Advisory Group Fund Research, supports our theme of proactively managing your portfolio by providing his portfolio tips. Kusinskis has also put together a short list of mutual funds covering the various sectors of the market with his comments as some ideas to consider when reviewing your portfolio.
- In conclusion, Steve Uzielli and Tim Vlahopolous provide their quarterly review and commentary on the performance of the Equity and Fixed Income Guided Portfolios.

The Spring 2010 edition of Investment Portfolio Quarterly (IPQ) is designed around a theme of taking a tactical approach to managing your portfolio and its holdings. After the roller coaster ride of the past two years it has become more apparent that a buy and hold approach may not be the best long-term strategy for maximizing returns. While picking the top and bottom of a market is virtually impossible taking profits and limiting losses are just prudent money management. I find it interesting that people are driven to shop when things go on sale and become more selective when they are not. Is this behaviour not investing?

This is a great time to talk to your ScotiaMcLeod advisor and review your portfolio and its holdings.

Stewart Hunt

Portfolio Strategy

Global Strategy – Spring 2010 Update

Vincent Delisle, CFA — Portfolio Strategist, Scotia Capital

Normalization Wave Closer to Shore

Q1 ended on a strong note for global equities as evidence of a sustainable economic recovery intensifies and Greece worries are resolved. Following a negative start in January (MSCI AC World -4.4%), global equities have rebounded roughly 10% in the last seven weeks and the S&P 500 is closing in on the 1,200 level.

The S&P 500 (+4.9% in Q1/10) outperformed long-term Treasuries (TLT ETF down 0.4% in Q1/10) as government bonds ended the quarter on a tougher note. Two disappointing Treasury auctions in late March, coupled with improving U.S. data, sent bond yields shooting higher. U.S. 10-year yields could retest the 4% level soon. Our model pegs U.S. 10-year “fair value” at 4.8% by December 2010. We prefer equities (ETF-SPY) and corporate bonds (JNK-high yield) to Government bonds (TLT).

U.S. profit margins hit 10.2% in Q4/09 and operating leverage could push S&P 500 earnings to US$78 this year. The lack of warnings and steady stream of earnings surprises (eg. Best Buy) hint of another strong “beat” ratio in Q1.

At the macro level, Japanese exports were up 45% year over year (YOY) in February and the Euro-zone PMI advanced to 56.3 in February. U.S. durable goods orders strength extended in February (+0.5% MOM; +12.5% YOY) and jobless claims continued to drift lower (four-week average now at 454,000). Our blended ISM index has averaged 52.5 in Q1 (40.6 a year ago). U.S. payrolls should decisively turn positive in Q2, lifting consumer/investor confidence.

As the first quarter winds down, our macro view remains unchanged. Further improvements in the global economy should sustain earnings growth through 2011 and push long-term bond yields higher. Although our equity confidence level is lower than it was a year ago, we still expect equities to outperform bonds.

Equities should post their best showing in the first half and we see overshoot risks to our S&P 500 target (1,250) early in Q2. Monetary policy shifts toward tightening and timing of exit strategies will continue to prove challenging and trigger different leadership, mainly in currency markets. The greenback could continue to have a good year. We have been “Riding the Normalization Wave” since April 2009 and enjoying it, but this wave will soon hit the shore.

Reducing Our Equity Overweight Stance

We are tempering our aggressive equity overweight stance (68% since Q2/09) and lowering Equities by 5% (down to 63%). We are raising Corporate bonds (+3%) and Cash (+2%). Equity weightings should be gradually reduced this year and cash levels gradually increased. Equity indices could post 5%-7% total return over the next 12 months versus flat to negative performance for long-term government bonds and 0.5%-1% for cash. Corporate bond performance should hover in the 2%-4% range as spreads continue to improve. Risky assets should continue to outperform, albeit with a smaller margin.

Global Equities & Large Caps

Year-to-date leadership could extend and we would reiterate our North American (U.S., Canada, Mexico) and Japan preference over Europe and Emerging markets. In U.S. dollars, the North American group (S&P 500 +5%, TSX +6%, Mexico +10%) and Japan (+7%) are outpacing the MSCI Europe (-2%), and MSCI Emerging Index (2%) so far in 2010. The following regional ETF pair-trades should continue to pay off: U.S. (SPY) over Europe (EZU); Canada (EWC) over Australia (EWA), and Mexico (EWW) over Brazil.

Sector Strategy

S&P 500 earnings momentum has continued to favour more cyclical sectors over the last few months, extending a trend that started in Q2/09. U.S. Technology, Discretionary, Materials, and Industrials have enjoyed the strongest EPS revisions in the last three months. U.S. Financials, one of last year's most visible earnings revisions outperformers, are no longer looking attractive based on earnings momentum. More defensive sectors such as Telecom and Utilities have continued to display weak EPS momentum recently.

From a sector perspective, we remain focused on "coincident" sectors that react positively to robust economic data and are less burdened by interest rate hike fears. In addition, we are sticking to a more cautious bias towards areas that could be sensitive to a weaker euro and yen. Industrials, Technology, Cable/Media, and Oil represent our preferred sectors. Within Financials, we have an Insurance over Bank bias. Our commodity ranking is Oil (overweight), Fertilizers (overweight), Base Metals (overweight), and Golds (underweight). Staples and Telecom are now market weight (from underweight in 2009) and we have been scaling back in Financials (underweight) and Discretionary (now market weight).

Global Economic Forecasts

			Real GDP	
	2000-2008	**2009E**	**2010E**	**2011E**
World	4.0%	-0.8%	3.9%	4.3%
Americas				
Canada	2.6%	-2.6%	3.2%	2.8%
U.S.	2.4%	-2.4%	3.6%	2.6%
Mexico	2.8%	-6.5%	4.2%	3.5%
Brazil	3.3%	0.5%	5.0%	4.5%
Europe				
U.K.	2.4%	-4.8%	1.5%	1.1%
Euro-zone	1.9%	-4.0%	1.3%	1.1%
Germany	*1.4%*	*-4.9%*	*1.6%*	*1.3%*
France	*1.9%*	*-2.3%*	*1.5%*	*1.5%*
Asia				
Japan	1.4%	-5.3%	1.0%	0.9%
China	10.1%	8.7%	9.5%	9.0%
India	7.3%	6.7%	7.5%	7.0%

Source: Scotia Economics, IMF

Scotia Capital Financial Forecasts

	2008	**2009**	**2010 E**	**2011 E**
Equity				
S&P/TSX	8,988	11,746	**12,750**	
EPS	950	600	**775**	**850**
S&P 500	903	1,115	**1,250** ↑	
EPS	49.50	56.87	**78.00** ↑	**84.00** ↑
Mexico Bolsa	22,380	32,120	**36,250**	
EPS	1,539	1,690	**2,150** ↓	**2,500**
Interest Rates				
BoC	1.50%	0.25%	**1.25%**	**2.25%**
CA 10-Yr	2.68%	3.61%	**4.50%**	**4.50%**
Fed Funds	0.25%	0.25%	**1.25%**	**2.25%**
US 10-Yr	2.21%	3.84%	**4.80%**	**4.80%**
Currencies & Commodities (Yearly Average)				
CAD (USD/CAD)	1.07	1.14	**0.99**	**0.96**
EUR-USD	1.47	1.39	**1.42**	**1.42**
USD-YEN	103	93.59	**88**	**91**
USD-MXN	11.2	13.50	**13.50**	**13.95**
WTI	99.92	61.92	**83.00**	**87.00**
Natural Gas	8.90	4.17	**4.75**	**4.75**
Copper	3.15	2.36	**3.25**	**3.50**
Gold	872	974	**1100**	**1250**

Source: Scotia Capital, Scotia Economics

Scotia Capital Recommended Asset Mix – Spring 2010

	Asset Mix		**Change**	**Total Return**
	Benchmark	**Recommended**	**from Last**	**Next 12-M**
Equities (TSX)	**50%**	**63%**	**-5%**	**5%-7%**
Bonds	**45%**	**29%**	**+3%**	**-1%**
Government	*35%*	*13%*	*0%*	-5%-0%
Corporate	*10%*	*16%*	*+3%*	2%-4%
Cash (91-D Tbills)	**5%**	**8%**	**+2%**	**<1%**

Source: Scotia Capital

Scotia Capital Equity Mix – Spring 2010

Scotia Capital Equity Mix - Spring 2010

	Equity Mix		Change from	YTD Performance	
	Benchmark	**Recommended**	**Last Quarter**	**USD**	**C$**
TSX	20%	21%	0%	3.5%	1.8%
S&P 500	30%	33%	0%	4.6%	3.0%
Int'l (Europe+Japan)	30%	28%	0%	-0.5%	-2.1%
Emerging Markets	20%	18%	0%	0.4%	-1.2%

International refers to the MSCI EAFE

Source: Scotia Capital

Scotia Capital Sector Allocation – Spring 2010

	Global		U.S.		Canada	
	MSCI World	**Scotia**	**S&P 500**	**Scotia**	**S&P/TSX**	**Scotia**
Energy	11%	13%	11%	13%	26%	28%
Materials	9%	8%	3%	3%	19%	17%
Industrials	10%	12%	11%	12%	6%	8%
Consumer Discretionary	9%	9%	10%	10%	4%	4%
Consumer Staples	9%	9%	11%	11%	3%	3%
Health Care	8%	7%	12%	11%	0%	0%
Financials	22%	20%	17%	15%	32%	30%
Technology	11%	13%	19%	20%	4%	4%
Telecom	6%	6%	3%	3%	4%	5%
Utilities	5%	3%	3%	1%	2%	1%

**TSX Materials recommendation reflects underweight gold stance. TSX Gold represents over 50% of the TSX Materials Index*

Source: Scotia Capital, Bloomberg

Economic Outlook

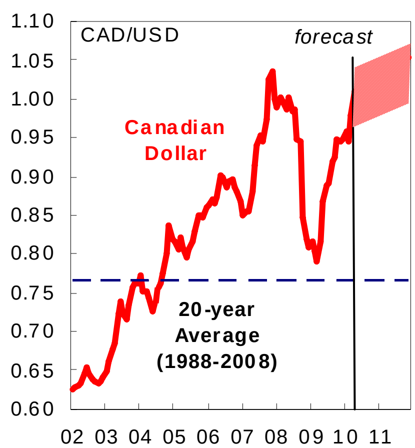
Keep Over-Weighting Canada

Derek Holt, M.B.A., CFA - Vice-President, Scotia Capital Economics

Karen Cordes Woods, M.A. – Financial Markets Analyst, Scotia Capital Economics

After almost two years since it last traded near parity, the Canadian dollar (CAD) has once again pushed to parity against the U.S. greenback, and Scotia Economics is expecting it to push beyond parity within an elevated range on a more sustained basis through 2010-11 (see Exhibit 1). What does it mean for investors?

Exhibit 1: Canadian Dollar Strength

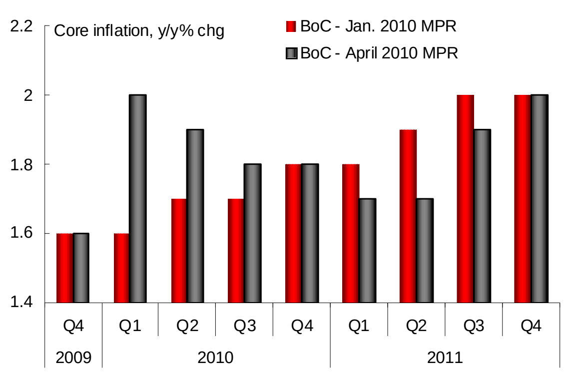


Source: Global Insight, Scotia Capital Economics

Continued CAD appreciation and the attractiveness of holding Canadian assets lead us to maintain our over-weight Canada recommendation in global investment portfolios that we have had over the past year. Canadian assets remain attractive both as a defensive play on sounder domestic and fiscal fundamentals than elsewhere, and for offensive exposure to further upsides to global growth and hence commodities.

For monetary policy considerations, this largely symbolic move on the final push to parity nonetheless raises three key questions. On net, our responses to the questions suggest that CAD parity doesn't mean quite what it used to. One question pertains to the economic fall-out from a strong CAD. In this article, we argue against the view that a strong CAD will snow under the Canadian economy.

Exhibit 2: Bank of Canada Inflation Expectations



Source: Bank of Canada's Monetary Policy Report; Scotia Capital Economics

Secondly, what are the consequences to the outlook for core inflation? Our answer is that it won't put the kind of downward pressure on core inflation that some envisage, and therefore a strong currency will not prevent the BoC from hiking. In fact, despite CAD's move above parity, Scotia Economics has forecast for some time that the BoC would hike its overnight lending rate on June 1st. Economic growth continues to outpace BoC expectations and consensus on both a monthly and quarterly basis as the economic recovery strengthens. This, in turn, will add to the pressures of overshooting core inflation which is already tracking above earlier BoC projections at about 2.0-2.1% for 2010 Q1. It is also above our expectations from earlier in the year, though by a narrower margin (Exhibit 2).

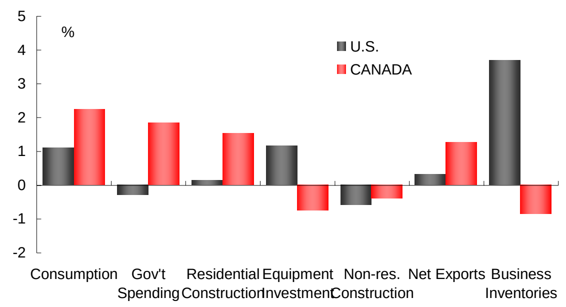
The final question we address is therefore whether the BoC can indeed hike interest rates before the Federal Reserve. They have in the past, and they are transitioning to do so again this time. On balance, investors must brace themselves for the impact that earlier rate hikes in Canada than elsewhere will have upon fixed income markets and borrowing costs, while revenue streams and migration toward further risk-taking will benefit high yield debt and equities. Appreciation in the Canadian dollar along the lines of what Scotia Economics has been forecasting throughout the past year is unlikely to alter this outcome.

The Economic Fall-Out From Parity

Several points need to be made regarding the assertion that a strong CAD would crush the Canadian economy. The first is a practical one: it didn't the first time around. Recall that when CAD last crossed most of a dime above parity against the USD cross in late 2007 and early 2008, the gloomiest forecasts for a major recession never panned out. Problems emerged as the US went down on broadly-based credit excesses. CAD-motivated adjustments were painful in some sectors, and were caught up with more intense Chinese competition in the U.S. imports market, but perhaps that made the adjustments to an ensuing sharp global credit crisis easier to manage.

Second, net trade is not currently a drag despite the fact that CAD has been fairly strong since last summer. The lagged effects of currency moves on trade are notoriously long and variable, but they also have to be considered in the current context of a recovery in global trade. Indeed, net trade is stimulating growth as per Q4 net exports and early Q1 evidence on manufacturing sales that flow heavily into the lagged trade account figures. As volumes recover through the resumption of a more normal business model, spill over effects from US stabilization and growth into Canadian supply chains can offset much of any negative margin consequences to CAD strength. Indeed, the start of the Canadian recovery occurring in more balanced fashion than the US, since Canada has most major sectors of the economy – including trade - doing their share in lifting GDP versus the US where the drivers of growth are much more narrowly based and more contingent upon inventories (Exhibit 3).

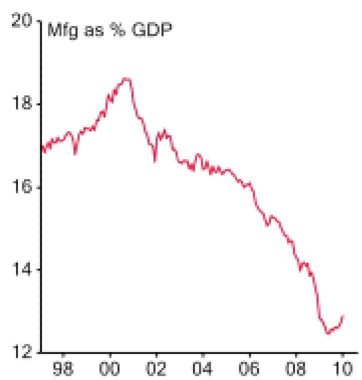
Exhibit 3: Contributions to Q4 GDP Growth



Source: Statistics Canada; U.S. Bureau of Economic Analysis; Scotia Capital Economics

Third, our manufacturing exposures are a pittance of what they used to be as all advanced economies have gone through profound changes over the decades with many core manufacturing activities having migrated to lower cost jurisdictions. Manufacturing now represents about 13% of the Canadian economy, down about five points over the past decade (Exhibit 4).

Exhibit 4: Manufacturing Continues to Shrink in Cdn Economy



Source: Statistics Canada; Scotia Capital Economics.

Fourth, and perhaps more importantly, a strong CAD isn't anywhere nearly as damaging to the economy as often portrayed. Natural production hedges via imported content and integrated cross-border supply chains are part of the reason, and they have intensified post-FTA and post-NAFTA. Financial hedges are another part. So are internal transfer cost pricing systems, or USD pricing. Further, much of the economic adjustment to a higher CAD has already occurred, and corporate balance sheets are generally in excellent shape to withstand a strong CAD. This is in stark contrast to the early 1990s when a strong CAD hit weak balance sheets. In addition, Canadian bank balance sheets are the envy of the world, albeit all global banks face getting diluted on Basel III. But spread compression as market rates out pace administered rates is manageable, and likely largely foreseen through balance sheet gap management practices.

Fifth, CAD strength connotes a funding advantage to the Canadian economy. It cheapens the cost of capital to the country via enhancing foreign appetite for Canadian issuance. That's relatively bullish for domestic investment via boosted project NPVs on a lower globally-sourced weighted average cost of capital.

Sixth, we're well past the days in which CAD's effects could be simplistically thought of as woefully deleterious through purely trade account linkages. Import content in domestic spending is among the highest across industrialized economies. Large shares of domestic consumer spending are done through imports, so the 92% of Canadians who count themselves in the workforce and who have jobs get a back-door pay hike on a strong CAD. Even more so for capital investment, as a ballpark 70% of capital goods spending is imported in a country that doesn't make many of its own capital goods. Combine that with accelerated tax write-offs, and obsolete equipment could be replaced at relative bargain prices. This would redefine the notion of spare capacity given that much of it may well be useless anyway through technological obsolescence and also because it may be mismatched for the new sources of market growth compared to the last cycle.

Seventh, maybe the country needs a little tightening on both the Canadian dollar and the rate fronts, especially with rates at the lower effective bound. It's somewhat out of vogue now, but the BoC's old one-third, two-thirds guidelines in a Monetary Conditions Index framework of thinking may still be useful in calling for a combined role of currency- and rate-motivated tightening.

Lastly, why CAD is strong also matters. How much of the appreciation is split between so-called Type 1 and 2 factors? We think most of it is justified on fundamentals. If so, CAD reflects the expectations-oriented pricing of resource strengths, spread prospects, domestic economic growth, a strong national balance sheet, little sovereign risk in a global sea of default risks, and low political risks as riots in Greece and the upcoming U.K. election make a potentially prolonged Canadian minority government position child's play by comparison. Fact remains, foreigners are buying Canada because it offers attractive over-weight prospects on defensive or offensive plays. Canada is the new Switzerland of stability, but with domestic assets the world wants.

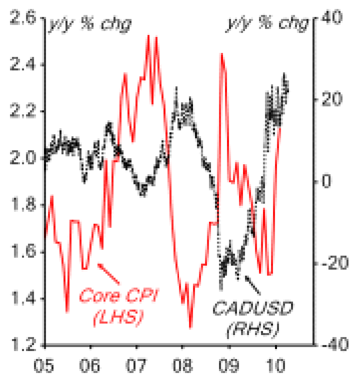
CAD’s Dubious (Dis)Inflation Effects

The view that a strong CAD will motivate downward pressure upon core inflation is not as sound as one might think. Yes, import content is higher in Canadian domestic demand than in many other countries, and particularly focused upon imports from the US, such that on first pass one would think that a higher CAD would motivate deeper discounting of consumer and capital goods with broad disinflationary implications.

Historically, however, this is a relationship that became fairly obvious only in relatively recent times—i.e. the last 5-7 years. Over the long haul, year-over-year percent changes in CAD have not been well correlated with core inflation in any clear way. Thus, the pass-through argument is a relatively more recent phenomenon. But as Exhibit 5 depicts, recent CAD-swings are correlated with changes in core CPI in nearly contemporaneous fashion. Not lagged, but contemporaneous. That is, until the past year. Therefore, since core CPI is not exhibiting any current downward response from a strong CAD, this more recent contemporaneous correlation may have become violated. As CAD has appreciated, core inflation has nudged higher and not just on year-ago base effects as month-over-month core inflation is proving stickier at about the BoC’s target. In other words, while the relationship between CAD and core CPI worked the last time around when CAD first hit parity and kept on climbing, this time around core inflation is proving to be stickier and more persistently around target than anticipated.

Why? Maybe that’s because core inflation would be higher yet on a reasonably solid domestic economy if not for moderating import price influences. Or perhaps much of the Canada-US price gap on consumer goods has been closed in key categories given prior rounds of price cuts when CAD last shot north of parity. This could be particularly for automobiles, and especially true after adjusting any remaining price differentials for risk and transactions costs given that capitalizing on any remaining price differences is far more cumbersome and risky to the end consumer than often realized.

Exhibit 5: CAD's Influence on Core CPI



Source: Federal Reserve Board; Scotia Capital Economics.

Or perhaps substitution and income effects trade off against one another. The substitution effect is toward lower import prices and away from higher domestic prices via CAD strength in a manner that would exert downward pressure on core inflation. But then a terms of trade effect on incomes comes into play. Real incomes go up in the first-round implications of relatively lower import prices and general inflation as we had last year, and also get a boost through a faster rise in export prices than import prices via a recovery in commodity prices that is factored into CAD. The income effect then takes the resulting higher real incomes and spends them in order to fund greater consumption and relatively greater upward pressure on core. In the end, the general equilibrium effects on core inflation may well cancel out into a truly sticky mess. Isn't it the North American way to spend an unanticipated gain. Regardless, the fact remains that core inflation is much stickier than one might have expected to this juncture, and so are cost-push inflationary pressures such as nominal wage growth.

An alternative explanation may be that the discounting lag is longer this time. Maybe retailers feel they adjusted prices too quickly the last time CAD shot north of parity, and they want to ride it out to see if a strong CAD will stick this time. But if that hasn't happened yet, waiting another year for it to occur is a dicey bet by the BoC in running the risk of falling behind the inflation curve.

Shouldn't the BoC wait for the Fed?

Should the BoC hike more aggressively and/or earlier than the Federal Reserve, CAD could strengthen further, though much of this expectation is already priced into the exchange rate and the Canadian and US curves. In that sense, much of what we've written so far argues against the BoC fearing a CAD reaction that could result from jumping the Fed.

But a few additional points can be made. For one, this would not be the first time that the BoC started tightening monetary policy before the Fed. 2002-03 is an example, but who cares about past examples during today's unique times. Canada isn't the United States on multiple levels of challenges. Today, independent exit strategies will mirror independent and variously timed entry strategies across global central banks such that FX volatility will follow, rather than lead, the monetary tightening debate. That's true of both monetary and fiscal policies. If Canada fundamentally faces sharply different fiscal and banking strengths than the US and if those strengths are driving sounder fundamentals in the domestic economy, then it's entirely consistent to have independent monetary policy. We've been there before, and it's quite feasible to do so again.

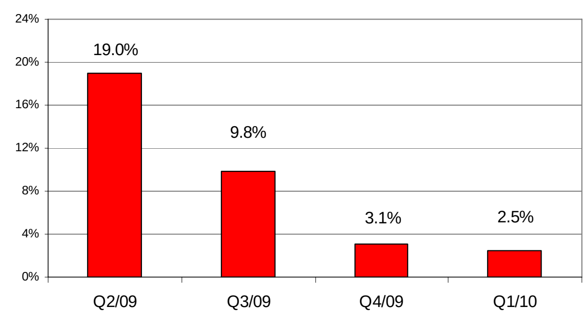
Canadian Equity Strategy

To Gain That Extra Mile, You Must Change Your Style

Gareth Watson, CFA — Director, Portfolio Advisory Group

The first quarter of 2010 continued the gains witnessed in 2009, albeit at a slower pace and the appreciation was certainly not straight line in nature as a January sell off was recouped in February and March. A vast majority of the strength was provided by Financial stocks, while gains were offset by weakness in the Energy sector. As we look back over the past three months we have come to the realization that not a great deal has changed with respect to our outlook for 2010. However, what has changed over the past seven months is the approach that equity investors have needed to take to outperform the market. While the "buy and hold" strategy is easy and likely preferred by investors, it does not always generate the best returns. In this quarterly publication we will illustrate why an active strategy has been required and will likely be required going forward to beat the market. We will also outline our thoughts on why the TSX Index has been caught within a range for months and we will provide you with a brief update concerning our thoughts on various sectors within the Canadian market.

Exhibit 1: TSX Quarterly Returns

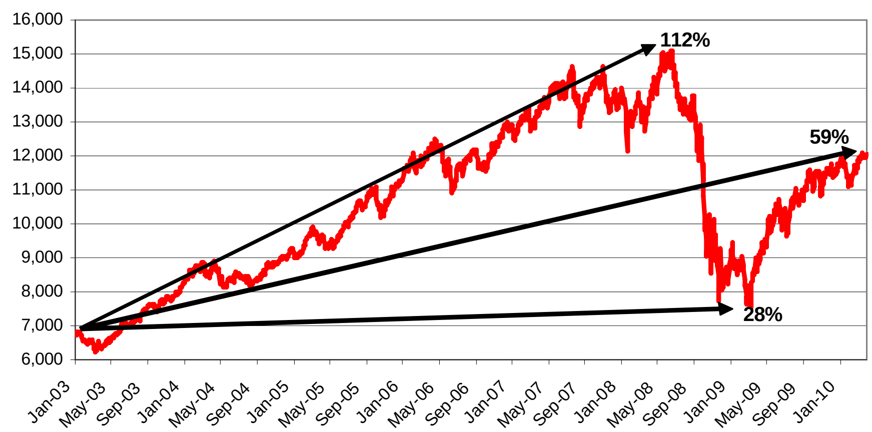


Source: Bloomberg

Buy and Hold vs. a Trader's Market

Most investors tend to use one trading style; however, there are times when adjustments in style are required to achieve superior returns to the market. Looking back over the past decade, many investors could argue that the buy and hold strategy worked well, especially during what was the longest bull market in Canadian history. For example, buying and holding the TSX from the beginning of 2003 to June 2008 (prior to the market collapse) would have provided investors with a 112% return or 14.8% annualized. However, if you subsequently held the market to the trough in March 2009 that return would have fallen to 28.1% or 4.1% annualized. In this case, from June 2008 to March 2009 the buy and hold strategy would have underperformed an active trading strategy (buying and selling). However, since the trough of 2009 the market has appreciated 59%, bringing the return since 2003 to 82% or 8.6% annualized, more in line with longer-term averages. The point here is that over the long term a buy and hold strategy can provide you with positive returns, but those returns can be enhanced when combined with an active trading strategy with superior stock selection. As most investors are aware, markets do not always go up all the time and while we are not encouraging investors to time the market, since nobody can do that perfectly, we are encouraging investors to look at the quality of the investments they own and to take advantage of short-term profits/opportunities when they present themselves.

Exhibit 2: S&P/TSX Composite Index



Source: Bloomberg

Why the Indecision?

Since the TSX bottomed in Mach 2009, it added about 3,300 points to the beginning of September 2009, but during the seven months since then the market has been stuck within a range of about 1,200 points and has had difficulty moving higher beyond the 12,000 level. Why have we seen times of indecision in the market since September, especially since the Canadian and U.S. economies technically came out of recession during that time? Below we outline some major concerns we believe have prevented the market from rallying higher:

Strong economic data points will continue but for how long?

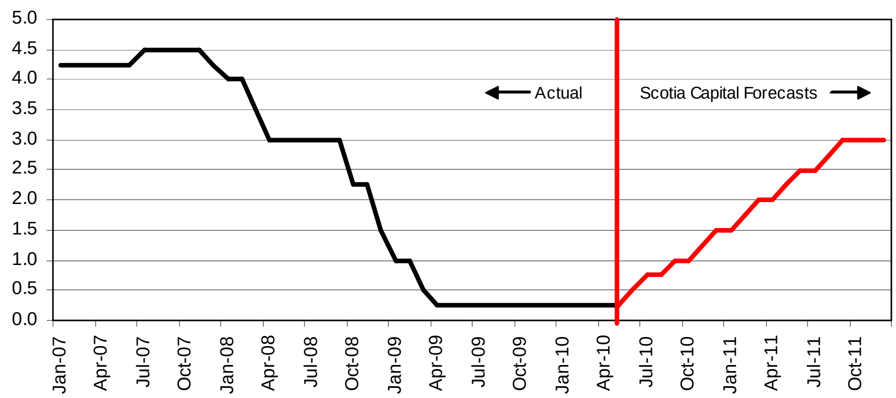
Why have we been able to call a technical end to the global recession? Because many countries have delivered economic growth as opposed to the contraction witnessed in 2008-2009. A combination of monetary policy (low interest rates) and fiscal policy (stimulus spending) contributed to that growth. While many stimulus packages were assembled over a year ago, we are only starting to see the effects of such spending today. We were warned that it would take some time for the billions of dollars spent to filter their way through the economy and such a prediction held true. In fact it was estimated that approximately 75% of U.S. stimulus spending had not been spent as of September 30, 2009 and that most of that spending would occur over the following 9 to 12 months. So it comes as no surprise to us that we have seen both the U.S. and Canadian economies post GDP growth rates north of 5% in the fourth quarter of last year. Not only have GDP indicators been strong but we've seen other economic data points encourage the market such as the ISM Manufacturing and Services indices and to some degree consumer confidence.

But let's be realistic. Are these data points sustainable? Of course not. As we move closer to the end of 2010, the stimulus spending will start to decline in the absence of any new stimulus measures taken by various governments. We know that 5%+ GDP growth in Canada is not sustainable, so the question we need to ask ourselves is not when the GDP growth rates will decline, but by what magnitude. Canada has done relatively well from an economic standpoint during this financial crisis, but we will not be immune to the effects of a reduction in fiscal spending. While we are certainly not predicting any type of economic collapse, investors are aware that we will return to normalized growth rates over time and have no intention of pricing in growth expectations that are too excessive.

Interest rates WILL move higher

How do we know this? Because they can't really go much lower! The question here is not one of "if", but "when". The Bank of Canada overnight lending rate has stood at 0.25% for almost a year now providing cheap money to financial institutions that have hopefully passed those cost savings along to consumers. But all good things do have to come to an end and Scotia Economics believes that rates in Canada could start to move higher as soon as June 1 as Scotia Capital is forecasting the overnight rate could rise to 1.5% (125 basis points) by the end of this year and 3.0% (275 basis points) by the end of 2011. While we do not expect a dramatic sell off in the equity markets when rates do rise as such an increase is widely expected, the facts remain that borrowing money in this country and in many others will become more expensive. Such a move will help cool the economy and deliver us back to normalized growth levels. As such, stock market investors may be waiting to see what impact higher rates will have on economic growth before bidding the market higher. Canada is also in a delicate situation because our country is now expected to raise rates before the United States. With that expectation in mind, currency investors have bid up the Canadian dollar as higher rates make our currency more attractive on a relative basis and that appreciation is expected to continue through 2010 and into 2011. Not only will the Canadian economy have to deal with a reduction in stimulus spending, but manufacturers will also have to deal with a stronger dollar making them less competitive. While these are obstacles that the Canadian economy can overcome, the economic road we travel will not be without its challenges.

Exhibit 3: Bank of Canada Overnight Rate (%)



Source: Bank of Canada; Scotia Capital forecasts

Stimulus is great, but who's going to pay for it?

One country that made headlines in the first quarter of this year was Greece as borrowing there had become far too excessive. The Greeks initially found few countries willing to help them financially because most other European countries had also been increasing their borrowing levels to pay for economic stimulus and fiscal measures. While a lot of emphasis can be placed on Greece, we believe equity investors are looking at the bigger picture in that a number of countries worldwide are having difficulty keeping their fiscal house in order. While this does not mean that we are on the verge of some global collapse, it does make sustainable economic growth much more difficult to achieve, especially when an increasing amount of revenue is required to pay interest costs on national debt. Stimulus is a good thing and was certainly required following the events of 2008 as you need to invest in your economy in order to grow it. However, stimulus must also be controlled to be effective. Some countries, such as Canada, can describe their current deficit spending as "manageable", but unfortunately other countries cannot say the same as spending has accelerated and needs to be reigned in. This is similar to a consumer that lives beyond his or her means as entire countries can act in the same way. So while various countries have tried to kick start their economies by investing in those economies, equity investors are watching carefully to make sure that the management of that investing is done in a controlled and cost effective manner.

A Quick Overview of the TSX Index

As noted earlier, our perspective on 2010 has not changed to a large degree since the beginning of the year. Investors entered 2009 with the belief that the first half would be challenging but the second half would be better. However, those same investors have entered 2010 with expectations of a good first half but questionable second half due to the uncertainty concerning economic growth, interest rates, currency and spending. We note that the outlook is questionable but not necessarily negative as the Canadian economy and TSX Index could work through the challenges that lie ahead. What is clear is that a continuation of the solid returns we witnessed in 2009 is no slam dunk. With respect to the Canadian stock market we would make the following observations:

Financials: Canadian banks lead the market higher in 2010 as they continue to operate well in a difficult financial environment. While economic and financial conditions have improved over the past year, challenges still remain. Banks have managed to post solid earnings and keep their loan portfolios in check. In fact, Canadian banks have likely seen a peak in loan loss provisions for this credit cycle which will provide positive leverage to earnings going forward. We expect bank share prices to remain steady, but any expectation of a repeat of last years' returns is unrealistic. Life insurance companies have also held in well during the first quarter namely because markets continued to post gains. As long as this performance continues and higher interest rates are expected, life insurance company shares should benefit.

Energy and Base Metals: Oil prices continued to climb, natural gas prices were set back, while base metal prices were flat or increased during the first quarter. We expect depressed prices for natural gas will continue going forward and we are surprised from a fundamental perspective that oil prices have reached the mid US$80 level; however, we are fully aware that investment demand (buy to profit), as opposed to physical demand (buy to consume) is still one of the major driving forces for commodity markets and will certainly not disappear in the near future. The same goes for base metals as nickel pricing was particularly strong. While we have not seen a significant increase in physical demand for these commodities over the past three months and while we could be cautious on pricing in the near term, we remain bullish on energy and base metals for the long term as we do expect that physical demand to increase as the world continues to expand its economic growth potential.

Precious Metals: Gold prices tend to pull back going into February as physical demand tends to decline and this year was no exception. However, our expectation of U.S. dollar weakness is still in, play albeit, muted as the Euro has come under some pressure thanks to the fiscal problems in that region. We also expect physical demand to pick up again as we go into the second half of the year and while we don't believe remarkable returns are in store for gold equities this year, we do believe that there is upside for precious metal pricing in 2010.

Defensive Industries (Consumer Staples, Utilities, Telecommunications): As markets appreciated considerably during 2009 we consistently reminded investors not to ignore defensives as we believed value opportunities were present in these sectors as a majority of investors chased cyclical stocks such as Financials, Materials and Energy. Considering the performance of defensive sectors thus far in 2010, it would appear as though the market agreed with our assessment concerning valuations as defensive equities, notably Telecommunications stocks, posted solid returns. We continue to emphasize the need for diversification amongst both cyclical and defensive stocks going forward and believe the desire from investors for yield (dividends) will help support valuations.

Conclusion

While the movement of the TSX Index during the first three months of the year was eventful, we are not surprised to find the market higher by 2.5% at the end of the first quarter. We thought returns would be positive but not excessive; nevertheless, opportunities to exceed the market return through a more active investment strategy were present. We expect this trend to continue for at least the first half of this year and possibly through to the end of 2010 as we work through a number of the uncertainties we expect to face in the coming months. The key to making money going forward will lie in superior stock selection and the ability for investors to lock in short-term gains when possible. It's also very important for investors to stick to their long-term investment plan along with their asset class, sector and stock percentage allocations. While the decision to sell or trim "a winner" can be a difficult one, we remind investors that making money is a good thing and that gains are not realized until locked in! We reiterate our conclusion from three months ago, that we are bullish for the Canadian stock market over the long term and believe this country will be a great place to invest as the global economy accelerates this year and beyond.

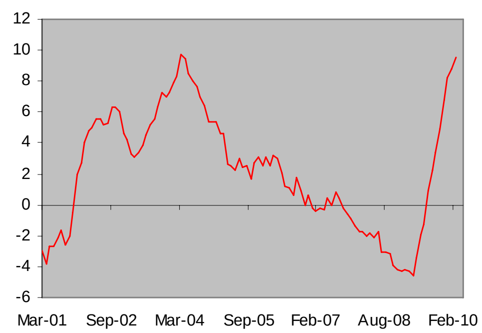
U.S. Equity Strategy

Spring Update

Paul Danesi, CIM – Director, Portfolio Advisory Group

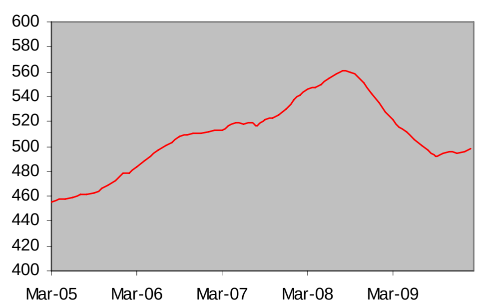
The U.S. equity market has been on a tremendous run over the last year and that trend should continue through the summer months. The preconditions for a further move remain historically low interest rates, a steadily improving global economy, low inflation, and a rebound in corporate profitability. However, the market never moves in a straight line, at least not for an extended period, and we caution investors to tread carefully in the short run. This technically overbought market looks vulnerable and many institutional investors are searching for reasons to take profits. Although the economy is recovering rapidly in 2010, we could be entering an extended period of below trend growth beginning in 2011, with negative implications for equity markets, and creating challenges for investors.

Exhibit 1: U.S. Leading Economic Indicators % Change YoY



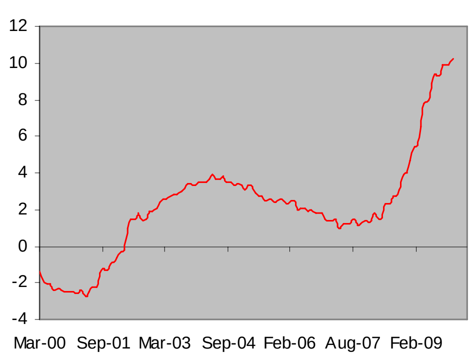
Source: Bloomberg

Exhibit 2: U.S. Manufacturing Inventories Total (U$ blns.)



Source: Bloomberg

Exhibit 3: U.S. Annual Deficit as% of GDP



Source: Bloomberg

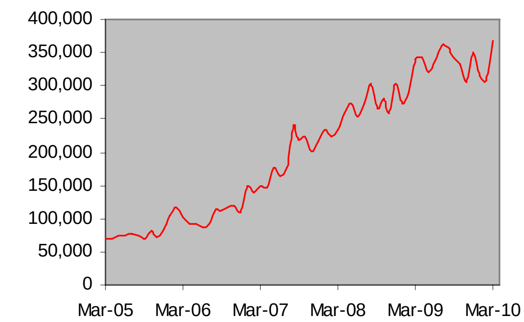
Global Recovery to Push Stocks Higher

The global economy is recovering as evidenced by the dramatic bounce in industrial production and global trade. In fact, U.S. economic growth is more likely to surprise to the upside than to the downside this year. Deflationary pressures and a weak employment picture are allowing central banks in G7 countries to hold their benchmark interest rates at extremely low levels; and that’s positive for economic growth and an ongoing re-pricing of risky assets. Consumer and business confidence are improving, and inventory restocking and a new capital spending cycle are likely to support growth in the months ahead. As long as rates stay at extremely accommodative levels, the economy will continue to accelerate and stock prices will grind higher. The Federal Reserve will eventually have to tighten monetary policy and the kneejerk reaction to that initial move could be a quick broad-based correction in equity prices; after which the market should regain its footing and trend higher. We would be buyers in such an event. Historically a new bear market for equities does not begin until central bankers are nearing the end of a tightening cycle.

Public Debt and U.S. Housing Keep us Wary

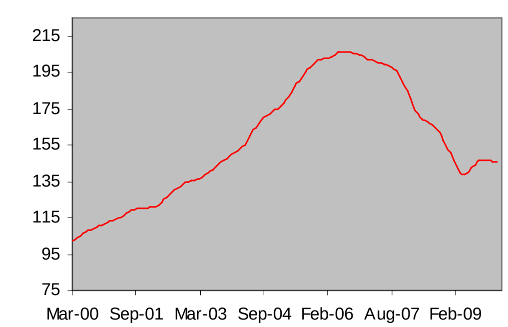
Although our outlook for U.S. equities is constructive on a three-to-six month view, the longer-term outlook is clouded by concerns about mounting public debt and a relapse in the U.S. housing sector. Over the last 18 months, private sector debt has been replaced with public sector debt. Debt to GDP ratios among most G7 countries are now at unacceptable and arguably unsustainable levels. According to the International Monetary Fund, 2010 debt-to-GDP ratios for Canada, the U.S. and Japan will be 77%, 98%, and 227%, respectively. Economist Kenneth Rogoff in a recent paper wrote that 90% appears to be a threshold, above which economic growth is negatively impacted.

Exhibit 4: U.S. Home Foreclosures (Monthly)



Source: Bloomberg

Exhibit 5: S&P Case Shiller Price Index



Source: Bloomberg

Greater fiscal austerity and higher taxes will be required to bring budget deficits back to adequate levels. The end result could be below trend economic growth, greater competition, lower revenue and profit margins – generally not a recipe for higher stock prices.

We also remain concerned about the state of the U.S. housing market. Foreclosure activity remains at record levels, the government's tax incentives for first time buyers are set to expire, and 30-year fixed mortgage rates are creeping higher. New home construction is at a cycle low and U.S. home prices as measured by the S&P Case Shiller Home Price Index have started to rollover. According to RealtyTrac, government programs aren't preventing foreclosures, only delaying them. There are approximately one half million bank-owned properties not on the market, another one million properties in foreclosure, and five million homeowners delinquent on their loans. This has further negative implications for the banking sector and economy.

How to Achieve Superior Returns

In our minds, two important aspects of portfolio strategy should lead to superior returns for investors looking beyond year end. First, dividend income should be an increasingly larger portion of total return calculations in the years ahead, and hence should be emphasized in portfolios. Second, our longer-term outlook does not support a "buy and hold" investment strategy - investors need to be more tactically minded. This second point flies in the face of the old adage "you can't time the market". However, history has shown that being fully invested in equities at all times is not in investors' best interest. Asset allocation plays a crucial role, in fact the most important role in long-term investment returns.

In Search of Yield

Dividend yield, dividend growth, and dividend reinvestment have all played an important role in long-term return calculations. History has shown there is a large difference in terminal wealth that arises from a portfolio comprised of dividend paying companies, which have a history of dividend growth, and where shareholders reinvest those dividends.

There are a plenty of attractive dividend paying stocks in the U.S. to invest in. On the following page we highlight a list of 25 companies that offer a combination of attractive yield and dividend growth. AT&T Corp. (T) tops the list. With a dividend yield of 6.5%, investors are already three quarters of the way to achieving average historical long-term returns for the equity portion of their portfolio. The dividend appears safe and many analysts in fact are forecasting another increase in the fourth quarter of this year. We also want to highlight McDonald's (MCD), a play on the emerging markets consumer. Emerging markets still only represent 20% of McDonald's sales, suggesting there is plenty of opportunity for growth in developing markets. Intel Corp. (INTC), the world's leading chipmaker is a play on a recovering economy and resurgence in capital spending. Intel also has a pristine balance sheet and a long track record of generating significant profits and cash flow. Intel earned U$5 billion in 2009 during one of the worst recessions on records.

Exhibit 6: U.S. Dividend Growers

Company	Ticker	Price	Dividend	Yield	5-Year CAGR
AT&T INC	T	$26.28	$1.68	6.4%	6%
VERIZON COMMUNICATIONS INC	VZ	$29.54	$1.90	6.4%	4%
SOUTHERN CO	SO	$33.93	$1.75	5.2%	4%
EXELON CORP	EXC	$44.46	$2.10	4.7%	9%
ENTERGY CORP	ETR	$80.86	$3.32	4.1%	9%
CONOCOPHILLIPS	COP	$57.09	$2.20	3.9%	16%
KRAFT FOODS INC-CLASS A	KFT	$30.99	$1.16	3.7%	8%
HJ HEINZ CO	HNZ	$46.08	$1.68	3.6%	8%
CHEVRON CORP	CVX	$81.57	$2.72	3.3%	11%
ABBOTT LABORATORIES	ABT	$52.40	$1.76	3.4%	9%
COCA-COLA CO/THE	KO	$54.38	$1.76	3.2%	10%
MCDONALD'S CORP	MCD	$69.13	$2.20	3.2%	31%
CAMPBELL SOUP CO	CPB	$36.00	$1.10	3.1%	9%
LOCKHEED MARTIN CORP	LMT	$83.46	$2.52	3.0%	21%
JOHNSON & JOHNSON	JNJ	$65.42	$1.96	3.0%	11%
UNITED PARCEL SERVICE-CL B	UPS	$69.20	$1.88	2.7%	9%
PEPSICO INC	PEP	$66.26	$1.92	2.9%	14%
PROCTER & GAMBLE CO/THE	PG	$62.97	$1.76	2.8%	12%
INTEL CORP	INTC	$24.22	$0.63	2.6%	24%
AVON PRODUCTS INC	AVP	$33.57	$0.88	2.6%	8%
HOME DEPOT INC	HD	$35.12	$0.95	2.7%	21%
HONEYWELL INTERNATIONAL INC	HON	$46.48	$1.21	2.6%	9%
COLGATE-PALMOLIVE CO	CL	$84.07	$2.12	2.5%	13%
3M CO	MMM	$84.63	$2.10	2.5%	6%
UNITED TECHNOLOGIES CORP	UTX	$74.66	$1.70	2.3%	16%
WAL-MART STORES INC	WMT	$54.17	$1.21	2.2%	16%

Source: Bloomberg

Quarterly Portfolio Rebalancing

Over time a portfolio will drift from its target asset mix. Bonds may have underperformed while stocks outperformed or vice a versa. In either case the weight of the better performing asset class would be high relative to its target weight and the weight of the underperforming asset class would be too low. On some predetermined basis, the portfolio should be rebalanced to the policy weights outlined in the client's investment policy statement. Investors and their advisors should work together to determine the appropriate frequency of rebalancing. At a minimum we suggest clients review their portfolios quarterly. Quarterly rebalancing is probably the easiest asset allocation strategy to implement to help augment investment returns. Portfolio rebalancing is a fundamental part of sound and prudent portfolio management.

Fixed Income

Rising Rates: A Tale of Short Duration

Andrew Mystic, M.B.A. — Associate Director, Portfolio Advisory Group, Fixed Income

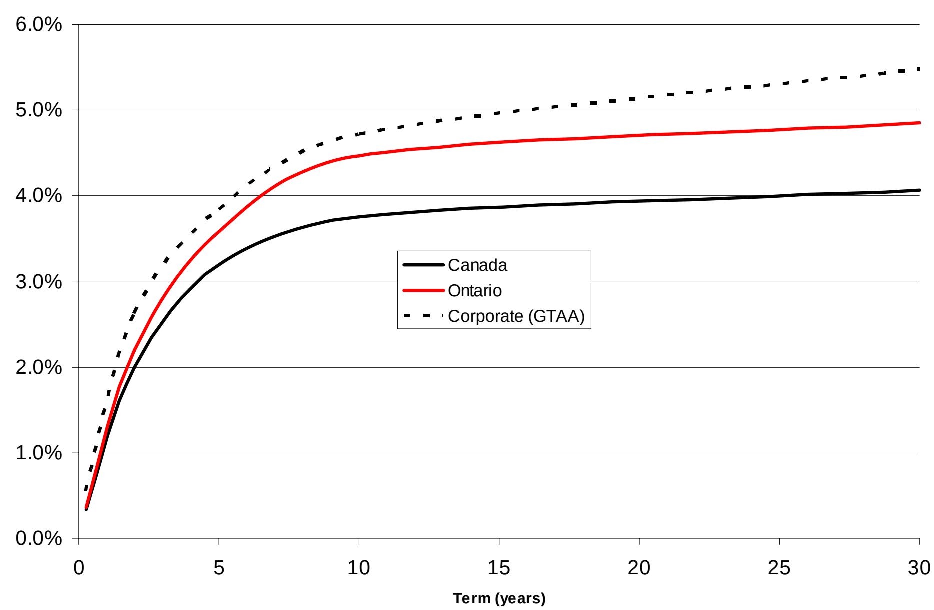
Introduction

The Time For Emergency Monetary Stimulus Seems To Have Passed. After an upside surprise to Q4 GDP data in early March, the Bank of Canada began to highlight that its commitment to maintain the overnight rate at 0.25% was *expressly conditional on the outlook for inflation*. This modest, but significant change in emphasis, pushed short-term yields higher and amplified the market's expectations for monetary policy tightening.

Since then, Canada's stronger than expected economic performance has continued to support the need for rate normalization, and the Bank of Canada could begin tightening as early as the third quarter of 2010. In response, Scotia Economics revised their April forecast calling for the Canadian overnight rate to rise by 1.25% in 2010, and an additional 1.50% by Q3/11, where overnight rates are expected to plateau at 3.00%.

Rising Rates Aren't Likely To Offer Bond Investors Much Reprieve This Year. Since early March, 4 and 5-year Canadian rates have increased 90 and 60 basis points respectively. Although 4/5-year rates have moved significantly higher - Canadian, Provincial and Corporate rate curves remain very steep, reflecting both rate expectations and the risk premium tied to specific maturity terms. The following chart illustrates the point.

Exhibit 1: Canadian Yield Curves



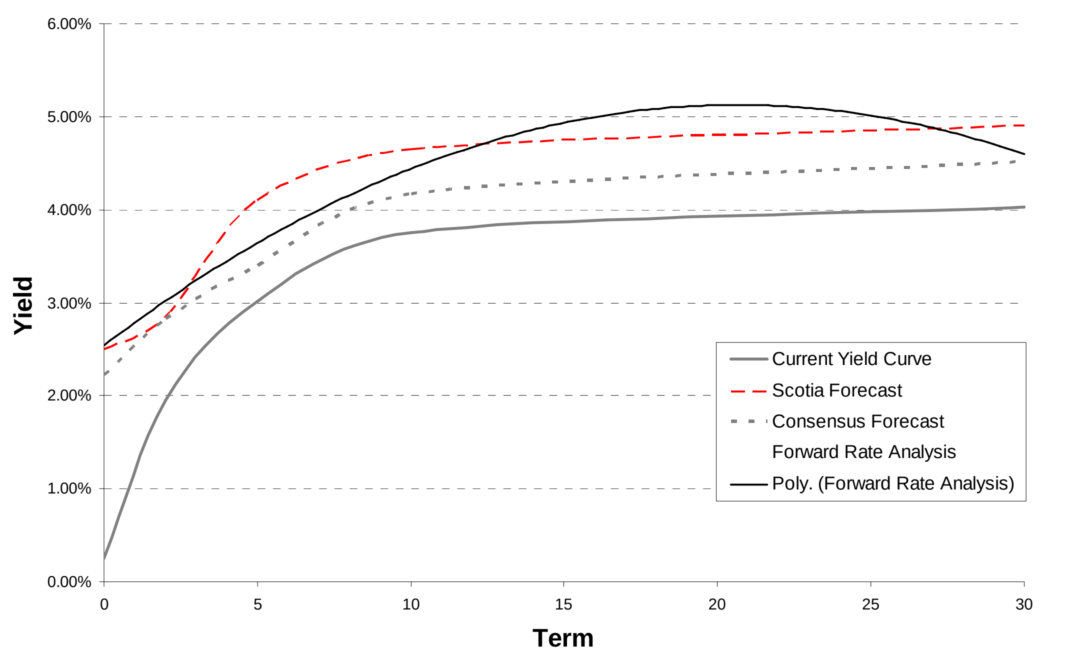
Source: Scotia Economics, Bloomberg

Despite this steepness, the fundamental view remains even more pessimistic than pure rate expectations or liquidity premium theories would suggest. In addition to rising short-term rates, Scotia forecasts imply that Canadian bond markets will experience a largely parallel 1.00% upward shift in yields, illustrated in Exhibit 2.

In Most Regards, Market Expectations Imply An Even More Pessimistic Outlook Than Either Scotia Economics or Consensus Forecasts Anticipate. The following chart presents a combination of Scotia Economics, Consensus and forward rate 1-year forecasts out to Q2/11. Forwards essentially reflect the market view that similar securities act as perfect substitutes with respect to pricing (meaning that 2 comparable one year bonds held sequentially, can be expected to offer investors the same return as a 2-year bond held to maturity). From this expectation, rate outlooks can be extrapolated. While forward rates are not perfect predictors of future rate levels, they are useful in gauging market expectations.

Interestingly, the forward rates curves below seem to suggest that Scotia's short and longer-term rate forecasts may be more aggressive than market expectations, while mid-dated yields may be modestly underestimating the level at which rates will peak. As well, consensus forecasts here appear to significantly underestimate the general level of rates expected in one year's time.

Exhibit 2: Shape of the Current Yield Curve and Where The Curve Is Forecast to Be in One Year

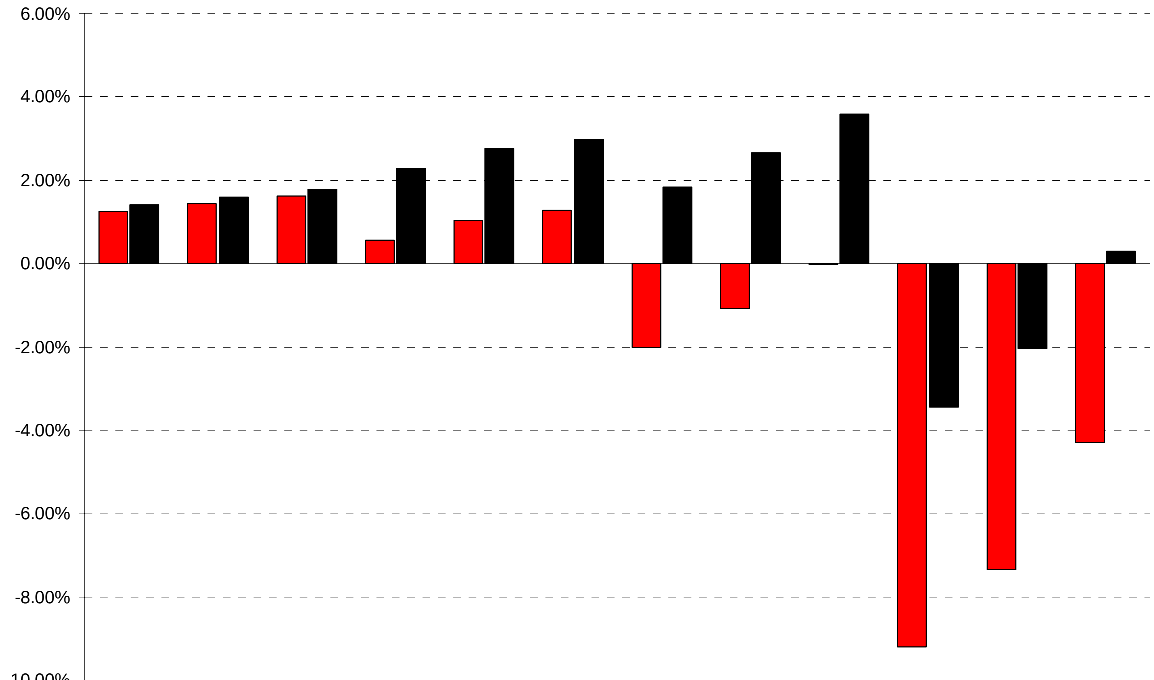


Source: Scotia Capital

In a nutshell, the prospect of rising rates over the coming year is unlikely to offer fixed income investors any significant reprieve as the outlook for fixed income securities is decidedly negative; having said that, there have been some modest opportunities that have grown out of the market's recent backup.

Despite The Gloomy Outlook, Total Return Expectations For Short-Term Securities Have Turned Modestly Positive, Further Supporting A Short Duration Call. The recent front end sell off has afforded some modest opportunities for positive total returns. Both Consensus and Scotia forecasts now imply that bond investors will see some positive returns in the 2-5 year area (Canada's, Provincials and Banks) over the coming year. This is a stark improvement in expectations relative to the March forecast, where returns across the board were unanimously negative. Still, these returns remain very modest. In the 1-5 year area, Scotia forecasts point to no better than a 1.6% total return in 2-year bank paper. While this further supports the relevance of a short duration strategy at this time, it leaves investors with little to be excited about. As rates normalize, the focus should be defensive and focused on value preservation.

Exhibit 3: One Year Forecast Returns

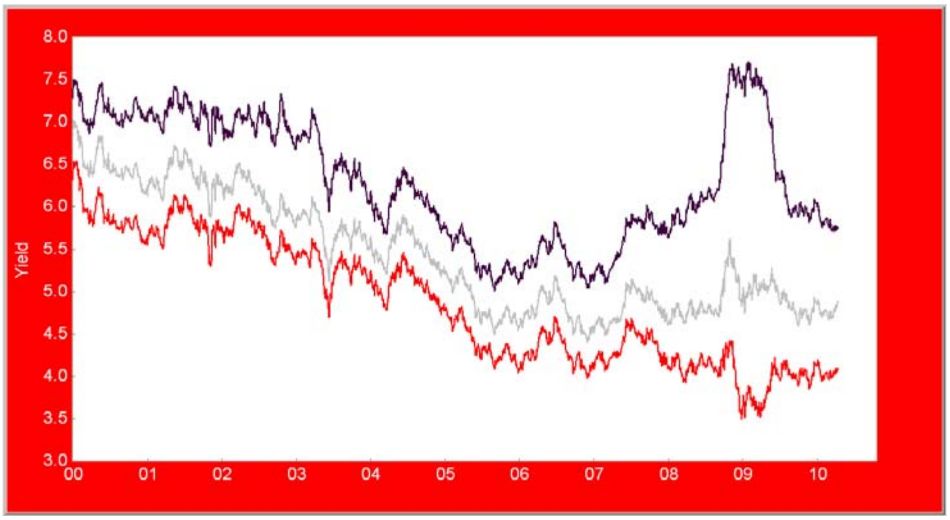


	2 Year Canada	2 Year Provincial	2 Year Bank	5 Year Canada	5 Year Provincial	5 Year Bank	10 Year Canada	10 Year Provincial	10 Year Bank	30 Year Canada	30 Year Provincial	30 Year Bank
Scotia	1.26%	1.44%	1.62%	0.55%	1.03%	1.27%	-2.01%	-1.08%	-0.01%	-9.21%	-7.34%	-4.30%
Consensus	1.42%	1.61%	1.79%	2.29%	2.75%	2.98%	1.85%	2.65%	3.58%	-3.44%	-2.04%	0.31%

Source: Scotia Economics, Bloomberg

With Rate Normalization On The Horizon, Investors Should Pair Back Canada Gains And Remain Underweight The Sector. Over the past 10-years, long Canada yields have averaged 4.87%, as measured by the DEX Long Canada Index. Currently, the DEX Long Canada Index yield is just 4.09%. While we have come a long way since the beginning of the credit crisis, there remains room for government rates to rise. With this expectation, investors can still benefit from a short duration strategy that remains underweight Canada bonds. Looking forward, it seems only reasonable to take some long-term Government of Canada guarantee exposures off the table and to begin to rebalance.

Exhibit 4: DEX Canada Long Index Yields



Black – DEX Long Corporate Index
Gray – DEX Long Provincial Index
Red – DEX Long Canada Index

Source: PC Bond

Credit Spread Compression Could Offset Some Of The Expected Weakness In Government Bonds But Sector/Duration Exposure Will Be Key. Despite steeper yield curves, long provincial yields remain well below their long-term averages, as do long corporate yields, although to a lesser extent.

Our base case scenario assumes that spread (yield pick up over Canada bonds) levels remain constant. Assuming this is the case, our base case forecast would be as presented in Exhibit 3. Given the likelihood that a changing rate environment, along with potentially changing supply dynamics could impact spreads, we thought it prudent to examine the potential variance of outcomes that could unfold as a result of spreads expansion/compression.

Earlier in the year, the Scotia Capital Credit team released its corporate bond 2010 preview. The outlook suggested that over the past three tightening cycles namely: Sept 05 to May 06: Nov 99 to May 00; and Jun 97 to Feb 98, there were a few observable trends.

1. Although rates increased by an average of 158 basis points (bps – 1/100 of a percentage point) across the three cycles, Short bond spreads increased an average of only 1.3 bps, while Mid and Long dated bond spreads rose and average of 19 and 21 bps respectively.

2. Averages across the same periods demonstrated that BBB, A, AA spreads rose an average of 13 bps, 32 bps and 13bps respectively, implying that the highest and lowest quality bonds tended to widen less.

Slicing these results more closely, we see that although the average of short bond spread widening across the three cycles was relatively low, the variance was significant. For example, although Short BBB names saw the greatest degree of spread tightening exiting the last tightening cycle (~-14 bps), they also saw the greatest degree of widening (+77 bps) during the November 1999 cycle. On average, Short A and AA names saw the greatest spread tightening averaging about -5bps, while on average, Mid and Longer dated corporate spreads widened by ~20bps, with the greatest variance of performance in the Mid A range (54bps-15bps=39bps).

Exhibit 5: Historical Tightening Cycle Credit Spreads

	Short BBB	Mid BBB	Long BBB	Short AA	Mid AA	Long AA
Jun 1, 1997-Feb 25, 1998	0	27	14	-11	14	23
Nov 1, 1999-May 30, 2000	77	11	13	-9	9	29
Sept 1, 2005-May 30, 2006	-14	9	29	5	10	15
	21	**16**	**19**	**-5**	**11**	**22**

	Short A	Mid A	Long A	Short Prov	Mid Prov	Long Prov
Jun 1, 1997-Feb 25, 1998	7	54	13	-13	29	16
Nov 1, 1999-May 30, 2000	-9	24	29	-6	8	20
Sept 1, 2005-May 30, 2006	3	15	12	3	10	7
	0	**31**	**18**	**-5**	**16**	**14**

Source: PC Bond

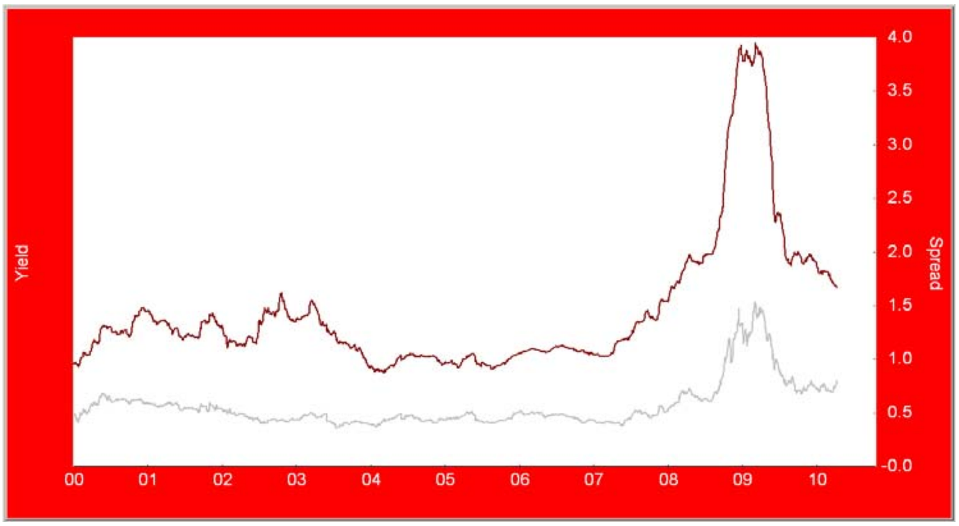
So, given the historical patterns and what we are observing in the current environment, what do we think is likely to happen? And what are the total return implications that could occur for bond investors?

For The Moment, Short BBB Spreads Will Likely Continue To Compress, Although Longer Dated BBBs Could Demonstrate Some Weakening. This is consistent with the trend seen over the past few months as investors have sold quality in an attempt to capture yield in short dated (up to 5-years) BBB names. This trend will likely continue to bode well for BBB spreads, particularly if an improving economic backdrop helps to lift the performance of lower quality names. Having said that, the risk to this view would be that as rates rise, the Bank of Canada overshoots and these lower quality names find themselves operating in a more adverse economic environment than expected. Demand at the front end would likely hold in but the longer-term outlook for some names could weaken sending their Mid and Longer dated spreads wider. With most BBB rated names issuing in the 3-5 years space, we would expect front end demand to remain relatively robust given the short-term risk investors are assuming.

Long Dated Corporate Spreads Will Likely Remain Well Bid But Retail Investors Should Avoid Assuming Long-Term Risk. The recent supply dynamic has kept long date spreads well bid given the fact that demand for long dated paper (largely by institutional pension and asset liability matching needs) has outstripped supply. Although we believe that this pattern is likely to continue, particularly with an aging population, significant supply in the long end could quickly reverse this trend. Outside the context of an extended ladder portfolio, we believe that this risk is too significant for retail investors to assume.

Although Historical Cycles Do Suggest Some Credit Spread Widening Could Occur, Provincial And Corporate Spreads Remain Well Above Their Historical Mean. Our base case scenario does not assume that credit spreads (the yield pick-up over Canada bonds) on provincial and corporate paper will narrow. The following chart however clearly demonstrates that Provincial and Corporate credit remain relatively cheap, with spreads still well above their longer-term averages. Assuming that credit spreads do generally begin to revert to their longer-term mean, the impact of rising benchmark rates will be lessened. The risk to this view relates more to provincials than the corporate space. As governments globally attempt to bring their balance sheets back in order, the risk is that they may encounter a weakening in financial flexibility and we could see some deterioration in credit quality. The question however is really more one of timing. That is, not whether provincial spreads will return to their long term averages but whether they will do so over our forecast cycle.

Exhibit 6: Long Provincial and Corporate Spreads



Source: PC Bond

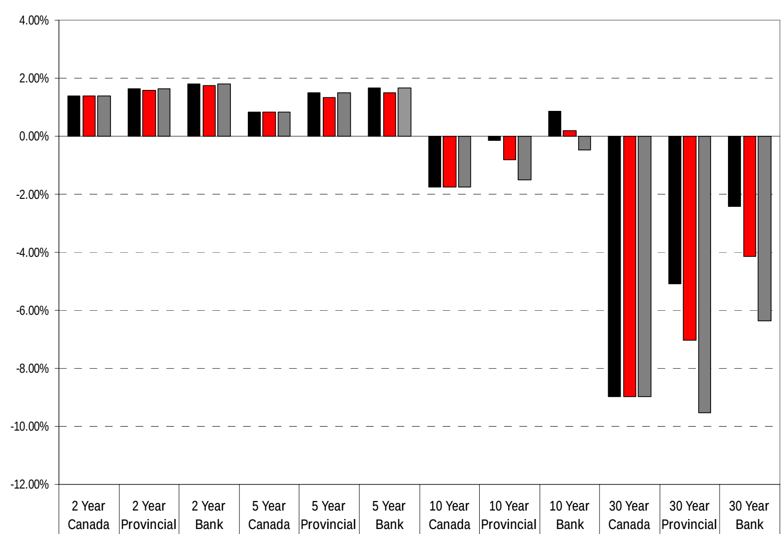
In order to assess the potential impacts of these possibilities, we present the scenario analysis below.

Base Case: Spreads remain unchanged and total return is purely a function of the forecasted rate tightening cycle based on Scotia Capital's April forecast.

Best Case: A continued focus on yield pick up holds in short dated Corporate, Bank and Provincial bonds. Continuing to push down toward historical averages, we see both provincial and corporate bank paper tightening in 5-12 bps across their respective curves.

Worst Case: Consistent with historical spread movements during preview tightening cycles, provincial and corporate spreads tighten approximately 5 bps in short paper as investors look to remain short during the tightening cycles. In line with averages AA corporate paper moves widens approximately +10bps, while longer dated paper weakens by approximately +20 bps.

Exhibit 7: One Year Forecast Total Returns



	2 Year Canada	2 Year Provincial	2 Year Bank	5 Year Canada	5 Year Provincial	5 Year Bank	10 Year Canada	10 Year Provincial	10 Year Bank	30 Year Canada	30 Year Provincial	30 Year Bank
Best	1.39%	1.63%	1.80%	0.82%	1.50%	1.68%	-1.74%	-0.13%	0.86%	-8.97%	-5.08%	-2.43%
Base	1.39%	1.58%	1.75%	0.82%	1.32%	1.51%	-1.74%	-0.81%	0.19%	-8.97%	-7.03%	-4.14%
Worst	1.39%	1.63%	1.80%	0.82%	1.50%	1.68%	-1.74%	-1.50%	-0.47%	-8.97%	-9.54%	-6.35%

Source: Scotia Economics, Bloomberg

Accounting for potential spread changes, the impact of rising Canada yields still likely lead to negative total returns for fixed income investors. Spread tightening in the long end does improve our total returns by ~195bps (-5.08% vs. -7.03%) in Provincials and ~198 bps in long Bank returns (-2.43% vs. -4.14%) but investors would not realize positive returns. The downside risks are even more pronounced. Although spread tightening does improve our total returns in the 10-year area, the improvements remain marginal.

Finally, we do not anticipate significant spread tightening in Short Provincial or Corporate bonds. Although they will both likely remain well bid, historical averages suggest that we will see no better than 5bps of tightening. If in the event that spreads tighten in to the historical high of -14bps, then we would probably not expect too much better than a total return of 2.00%.

Consistent with our current recommendations, we believe retail investors would do well to follow these recommendations:

- **Term Call – Investors should remain below benchmark duration and overweight cash.** As rates move higher this will allow investors to capture higher rates while preserving their current cash value. In this environment, Floating Rate Notes (FRNs) are recommended. FRNs typically demonstrate more price stability than fixed coupon bonds and allow investors to capture higher coupon/cash streams as rates rise.
- **Sector Call – Underweight Canada's, overweight provincials, municipals and corporate bonds**. With the expectation that provincial and corporate spreads will revert to their long-term averages, we continued to believe that holding these securities, relative to Canada's, better positions investors. Having said that, the advantage for retail investors remains decidedly in the short end (1-5 years) as longer-term spreads may not revert with immediacy to their long-term averages. As well, issuance does have the potential to change the recent supply/demand dynamics that have held in Canadian corporate spreads to date.
- **Alternative Strategies – Overweight high yield, overweight emerging markets debt, underweight inflation protected securities**. For those trading accounts willing to bear the risk, or for the purposes of adding some risk to a well diversified portfolio, high yield and emerging market bonds offer some interesting opportunities. As investors look to capture yield in a low rate environment we believe the space will remain rather well bid. Having said that, winning high yield strategies will hinge on either (a) Very thorough understanding of the names (b) Diversification – by means of funds such as the (XHY) iShares US High Yield Bond Index Fund. As for inflation protected bonds, Canadian Real Return bonds are yielding little more than 1.5%, near historic lows, and our expectations for rising rates are based more on rising real rate expectations than inflationary pressure. Hence, we believe Real Return Bonds will significantly underperform all other fixed income asset classes over the next 12 months.

Preferred Shares

Portfolio Strategy for a Rising Interest Rate Environment

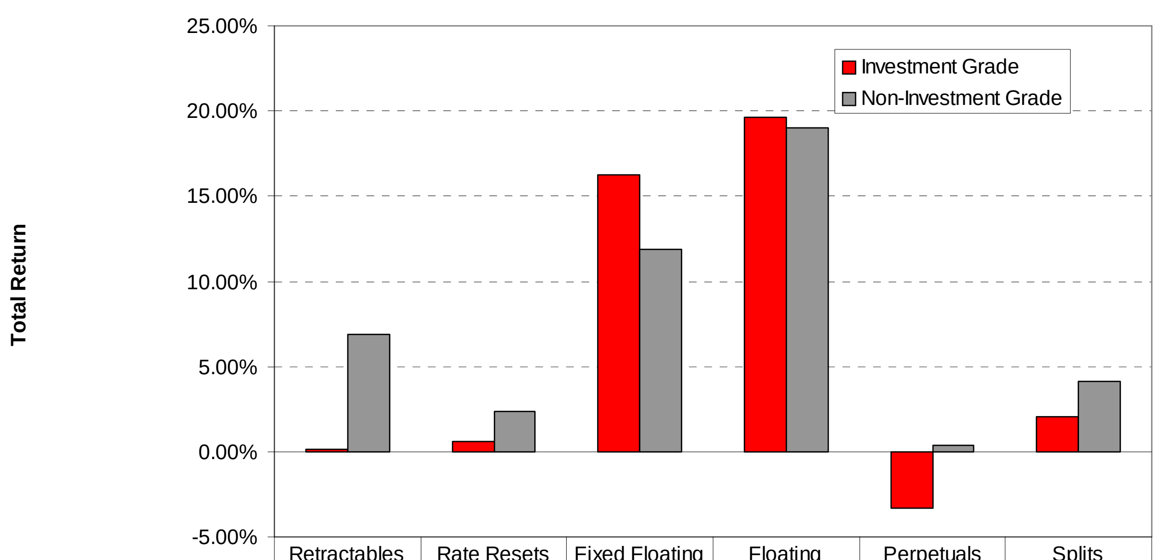
Tara Quinn, MBA — Associate Director, Portfolio Advisory Group

Now that it's 2010, one of the most popular themes portrayed in the media is the question ***"When will the Bank of Canada raise the overnight rate?"*** As investors take this question into consideration, it is important to find securities and strategies that will minimize potential losses and maximize potential returns in a projected rising interest rate environment. Preferred shares are interest rate sensitive instruments and their prices are negatively affected by both rising interest rates and the widening of credit spreads. Therefore as we enter into the second half of 2010, a period where Scotia Economics is forecasting the Bank of Canada to increase the overnight rate, it is important to review the types of preferred shares held within a portfolio.

During the first quarter of 2010, the Canadian Preferred share market struggled to stay in positive territory as demand for this type of security somewhat waned and investors became more cautious about the expectation of higher interest rates. Year to date, as of March 31 2010, the S&P/TSX Preferred Share Index has declined by -2.25%. The S&P/TSX Preferred Share Index is designed to serve the investment community's need for an investable benchmark representing the Canadian preferred stock market. This index is comprised of preferred stocks trading on the Toronto Stock Exchange that meet criteria relating to minimum size, liquidity, issuer rating, and exchange listing. This index is also rebalanced twice a year.

However, it should be noted that the S&P/TSX Preferred Share Index is not a total return index. On a total return basis, which includes the income provided from the various securities, the returns are higher as indicated in the graph below. Given that one of the benefits of investing in preferred shares is the stable income they provide; total return values are a more accurate gauge of performance. Focusing on the Investment Grade level of preferred shares it has been the fixed floating, and floating rate preferred shares, which have impressively outperformed the general Canadian Preferred Share market this past quarter.

Exhibit 1: Total Returns for 1st Quarter of 2010



	Retractables	Rate Resets	Fixed Floating	Floating	Perpetuals	Splits
Investment Grade	0.14%	0.57%	16.25%	19.65%	-3.32%	2.05%
Non-Investment Grade	6.90%	2.35%	11.89%	18.99%	0.38%	4.16%

Source: Bloomberg

Straight Perpetuals – Where Do We Go From Here?

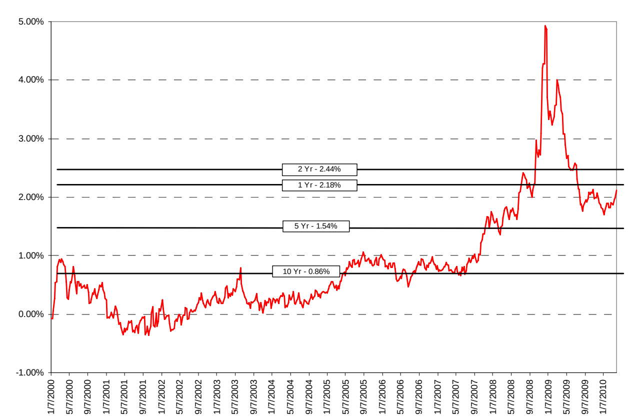
Straight perpetuals were the worst performers among all the various types of preferred shares and likely dragged the Index lower as perpetuals make up approximately 40% of the Canadian preferred share market. Since straight perpetuals lack a maturity date, the long duration makes this type of preferred share very sensitive to rising interest rates. However, during the first quarter of 2010, Government of Canada 30-year bond yields were unchanged which leaves the question – why did the perpetuals selloff?

To start the year, straight perpetuals had an average current yield of 5.87% and by the end of the quarter the perpetuals were trading with a current yield of 6.12%. This equates to a yield increase of +0.25% and a total return of -2.98% (all perpetuals) over the quarter. In the same time period the yield on the 30-year Government of Canada bond was lower by only -0.01%. Therefore the selloff seen in straight perpetuals can be attributed to the widening of corporate credit spreads rather than a rising interest rate environment. Credit spreads can be defined as the yield pick-up over benchmark Government bonds, and are indicative of investors' risk tolerance. Concerns and expectations of a higher interest rate environment have entered the market and investors have become less comfortable holding this type of security. The stronger supply than demand for straight pertpetuals at this time has lowered the prices and increased the yield.

The graph below displays the spread (difference in yield) between perpetuals and 30-year Government of Canada bonds. Currently the spread is sitting at 2.12%, while the 5 and 10 year average spread is 1.54% and 0.86% respectively. As a comparison the spread on corporate long bonds (>10 yrs) currently sits at 1.70%, while the historical 5 and 10-year average spread is 1.70% and 1.45% respectively. Therefore, historically speaking straight perpetuals are cheap as the current spread is higher than average levels. On the other hand, purchasing these securities is not without risks.

The benefit of holding straight perptuals within a portfolio is the stable dividend income they generate for investors indefinitely. At this time, investors can purchase this type of security and receive a yield of approximately 6.12% from strong credit quality companies. This equates to an interest equivalent yield of 8.34% (6.12% x 1.37) based on the highest income bracket in Ontario. With long corporate bonds yielding approximately 5.02%, buyers of perpetual preferred shares are adequately compensated for moving down the credit scale. The risk of purchasing this type of security is the price volatility they can experience, and the fact that there is no specific maturity date when holders receive par value for their shares.

Exhibit 2: Spread Between Perpetuals and 30-Year Canadas



Source: Bloomberg

Based on the current spread level, perpetuals can withstand yield increases of approximately 1.00% in the long end of the curve to return to 5-10 year average spread levels. It is recommended at this time that conservative investors limit their exposure of straight perpetuals to 5-10% of their preferred share holdings and use this type of investment for a quality source of stable tax-efficient income.

Rate Reset Preferred Shares – How Long Will the Premiums Last?

Year-to-date we have seen $2.25 billion of new issuance in the preferred share market with 89% representing new rate reset preferred shares. Going into 2010, based on the proposed Basel Committee changes to what constitutes Tier 1 capital, it was suspected that financial institutions would not be able to issue rate reset preferred shares as Tier 1 capital. However, at the end of March the Bank of Nova Scotia issued a rate reset which will count as Tier 1 capital for the company. This particular new issue has opened the door for other financial institutions to follow suit and issue rate reset preferred shares for their Tier 1 capital requirements.

With respect to performance, the rate reset preferred shares posted a 0.93% total return over the quarter with non-investment grade issues (2.35%) outperforming the investment grade sector (0.57%). That being said, many of the rate resets outstanding in the market hit their 52-week high prices during the quarter, and have since sold off slightly. While most issues are trading closer to a $28 price range it might be time for those that purchased these securities near par ($25) to take some profits off the table and thus lock in a capital gain.

As mentioned, straight perpetuals are most sensitive to a rising interest rate environment but, rate resets will also be negatively affected yet by a lesser extent. As the majority of reset rate preferred shares have a reset rate greater than a 1.50% spread over 5-year Government of Canada bond yields it is expected that these securities will be called at the first reset date. Therefore, this type of preferred share is trading with an expected maturity date equal to the reset date, which in most cases is between 2013-2015. With this in mind, it is expected that these securities act similarly to 3-5 year corporate bonds when faced with rising interest rates and prices should move lower towards par ($25) as the reset date approaches.

At this time it is recommended that investors consider selling half of their positions in the rate resets preferred shares and lock in a taxable capital gain as it is unlikely that the prices on this type of security will move much higher. That being said, investors who purchased these securities for income may want to remain holding and continue to collect the tax-efficient income as reinvestment yields are much lower in products with similar terms and safety levels.

Proposed Preferred Share Portfolio

Based on the projected rising interest rate environment it is important to review one's preferred share holdings. Listed in the table below are the various types of preferred shares and the recommended weighting for conservative investors as we move into an environment which may see Government of Canada bond yields increase as much as 1.00% over the next 12 months.

Type	Weighting	Strategy
Retractable	10-20%	■ Hold issues which have a spectrum of maturities ■ Influenced by rising rates but will react similarly to corporate bonds
Rate Reset	40-80%	■ Reduce positions to lock in capital gains ■ Continue to hold as stable source of income
Straight Perpetual	10-15%	■ Hold limited exposure as will be sensitive to rising rates ■ Stable source of tax-efficient income
Fixed Floating	5-10%	■ Ideal investment for a rising interest rate environment as investor may choose between a fixed or floating dividend rate at reset date
Floating	5-10%	■ Ideal investment for a rising interest rate environment as dividend rate floats as a percentage of the bank prime rate
Split Share	5-15%	■ Hold issues with a spectrum of maturity dates ■ Higher yield for exposure to underlying equity market

There are a variety of different types of preferred shares and it is important to understand the features associated with each particular issue and in particular how each will react in a rising interest rate environment. Contact your ScotiaMcLeod advisor to discuss the preferred share opportunities and recommendations for your portfolio.

Mutual Funds

Portfolio Tips and Mutual Fund Investment Ideas

Justin Kusinskis, CFA – Associate Director, Portfolio Advisory Group, Fund Research

With the RSP contribution deadline behind us, this is a great time of year to review your investment portfolios and reassess your objectives. With many investors having made their RSP contributions to cash or cash equivalents until a decision is made to actually put the money to work, we thought it would be a good time to address some of the common issues facing investors at this time, and provide some tips and ideas to deal with these common issues.

To provide some structure to this communication, we've decided to approach this topic from four perspectives:

1. The Big Picture

2. The Portfolio Puzzle: Simplifying Strategies

3. Individual Investment Considerations

4. Investment Suggestions

The Big Picture

Investors have been, and to a certain extent, continue to be understandably hesitant when it comes to investing their hard-earned dollars. As asset flows indicate, after the market took a nosedive in 2008, money moved with a vengeance to money market investments. As the recovery took shape, investors slowly began to sell some of their money market investments in favour of short-term bonds, then to investment grade bonds, then to higher-yielding bonds, followed by balanced funds and income-producing equities. January 2010 was the first month since May 2009 that equity fund sales were positive, and at that, only by $29.7 million. February 2010 also saw positive equity fund sales, but again, fairly timid at $104.5 million (which only represented 2.1% of net sales to long-term funds for February). So we are just beginning to see investors get comfortable enough to venture into the pure equity space. Balanced Funds and Bond Funds remain the primary driver of long-term fund sales activity, with 72.6% and 25.1%, respectively, of net long-term fund sales for February.

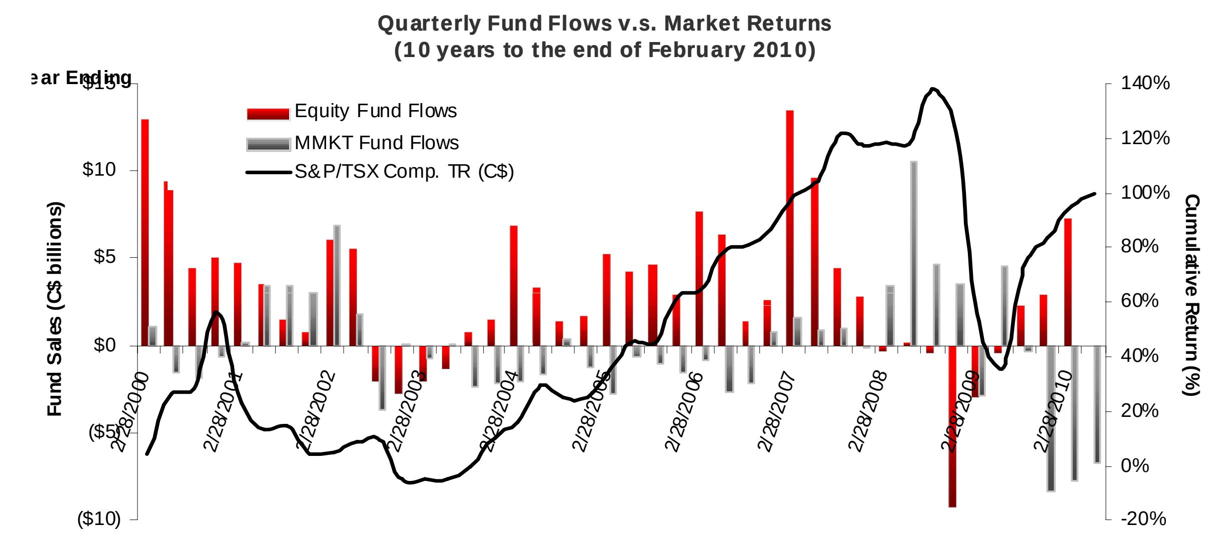
The irony of course is the equity market has rebounded significantly since March 2009 lows, while investors stayed away from equities until only recently. History tells us this is not unusual as we've shown in previous newsletters, retail money typically lags a market's recovery by six to nine months. This, combined with the fact that fixed income opportunities are fairly expensive at this point (with corresponding low yields) may mean we are on the verge of seeing more significant retail flows into equities, and equity mutual funds.

So where are we today? Does the following sound familiar?

Lots of investors are still holding significant amounts of cash or cash equivalents. They are seeing the significant market rally off March 2009 lows, and not wanting to "miss the boat", they are getting increasingly antsy with the very low returns they're getting from money market instruments and/or short-term bonds, and starting to think more seriously of getting back into the equity market for fear of missing even further gains.

If retail money is really starting to flow into equities, it may provide some support as fund managers put these flows to work in the market. However, as we've mentioned, historical retail fund flows have often exhibited "contrary" market indications; e.g. record positive equity fund flows have often coincided with market tops, and record negative equity fund flows and/or money market purchases have coincided with market bottoms. I wouldn't classify this as empirical evidence by any stretch, but it is definitely interesting to see how fund flows have coincided with market activity (see **Exhibit 1**).

Exhibit 1: Retail Fund Flows vs. Market Returns



Source: IFIC; Third-Party data provider; ScotiaMcLeod Fund Research Group

The Portfolio Puzzle: Simplifying Strategies

Over time, investors can have a tendency to build portfolios based on rationale that could be considered less than logical. Whether they had followed some advice in the past from friends (i.e. “stock tips”), or a previous advisor, they may have haphazardly built what we’ll call a “misfit” portfolio. In this section we’ll highlight some of the more common issues we’ve come across, and make suggestions for ways to improve your portfolio - including ways your advisor can help.

Trimming the number of holdings. A common issue we see are portfolios with a very large number of holdings, whether in mutual funds, individual stocks or bonds, or some combination of these instruments. Not only can this be inefficient and potentially more expensive, this situation can be a challenge to keep track of, and it can certainly increase the probability of an issue with one of the investments being overlooked.

***How your advisor can help**: They can perform a portfolio analysis that will help identify holdings that are highly correlated, and they can assist you in reducing the number of positions and/or funds in the portfolio(s).*

Reducing duplication. Another very common issue we see is duplication of holdings. This could take the form of holding multiple mutual funds that are similar to each other. Alternatively, it can take the form of an investor who holds a significant position in one stock (e.g. the stock of the company for which they work), and also hold mutual funds with that same holding – in many cases, leading to a significant overweighting in the one name.

***How your advisor can help**: They can produce a portfolio analysis that will help identify concentrations that can then be addressed with adjustments to the portfolio.*

Dollar-cost averaging. Particularly poignant in today’s environment, a great strategy for those investors who are reluctant to put all their chips on the table at this point in time is to implement a dollar-cost averaging strategy. Build a portfolio of mutual funds, and once this is done, set up a schedule for each of the funds where investors can average in to the market with the cash they’ve been sitting on waiting for the “right time” to get back in. The benefits to this strategy are significant. First, investors have piece of mind the bulk of their cash will remain safe in cash in the near term. Second, investors have piece of mind they are getting back into the market on favourable terms. We say “favourable” because by dollar-cost averaging, investors are effectively being smart buyers: buying less units while unit prices are high, and if the market turns down, they will be buying more units while unit prices are lower.

***How your advisor can help**: They can assist in building proposed portfolios, and setting up a purchase schedule.*

Top-grading portfolios. Many investors may hang on to non-performing, and/or underperforming assets – be they mutual funds or stocks/bonds (more on this later). There is a significant reluctance to unload non-performing assets because to a certain extent, it is a recognition of failure. The asset didn't perform as expected, but there always seems to remain a glimmer of hope "it will come back". In many cases, this likelihood is remote. From a psychological perspective, it can feel great to get a non-performer out of your portfolio, and start fresh with a better alternative (not to mention being able to claim the capital loss on the non-performing asset).

***How your advisor can help**: They can perform an analysis of existing funds with the intention of suggesting options that may have a higher probability of outperforming over time based on an objective process of fund selection. The ScotiaMcLeod Mutual Fund Recommended List is a great place to start in terms of a search for better fund alternatives.*

Asset Allocation. Obviously this will vary by investor, but focusing on the big picture in terms of asset allocation can help to provide some structure around analyzing and building your portfolio.

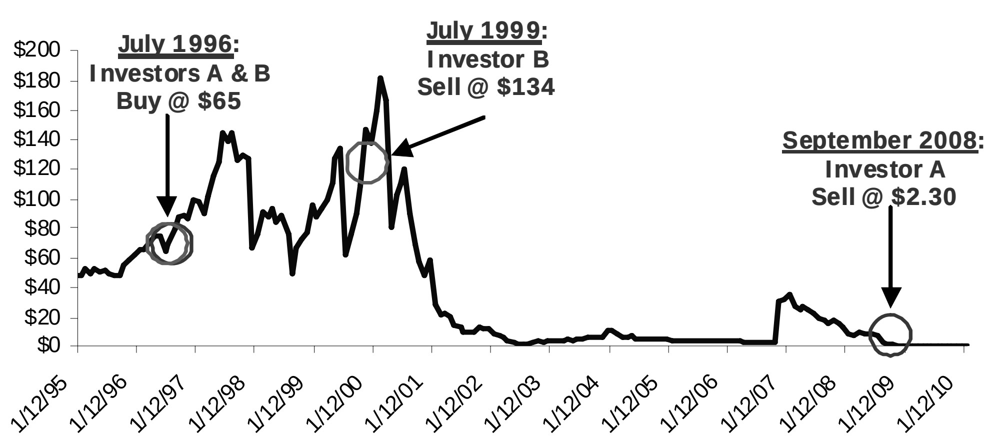
***How your advisor can help**: After going through your objectives, risk tolerance, return expectations and other factors, your advisor can help to put an asset allocation strategy that meets your needs.*

Individual Investment Considerations

Capital Gains and Losses. As alluded to in the previous section, investors are often reluctant to "take their lumps" – we're only human after all. Whether it is a denial mechanism or some other psychological issue, the thought of realizing a capital loss is not appealing to many people – again, holding onto the belief that the investment will come back.

Ironically enough, this same psychological issue seems to apply to capital gains as well. For whatever reason, even though they've made money, many investors are reluctant to realize a capital gain because of the tax consequences of doing so. Which begs the question – if an investor is reluctant to take capital losses or capital gains, when exactly do they ever sell an investment? Here's another question. How many people do you know or have heard of that purchased an investment and saw it increase significantly where they have made a large paper gain, only to not sell it and see it come crashing down (all the while assuming/hoping it would come back)? There are many examples, but Nortel is a classic. Let's take two Nortel investors for a simplified numerical example. Investor A, the "eternal optimist", buys 1,000 shares of Nortel in July 1996 for $65 per share. Investor B, the "realist", also buys 1,000 shares of Nortel in July 1996 for the same price of $65 per share.

Exhibit 2: Nortel Networks Performance 1995-2009



Source: Bloomberg

Exhibit 3: Capital Gains / Losses Example

Nortel Networks (NT)

	Investor A	Investor B
Purchase Date	2-Jul-96	2-Jul-96
Shares Purchased	1,000	1,000
Purchase Price	$65.00	$65.00
Initial Value	$65,000	$65,000
Sold Date	2-Sep-08	2-Jul-99
Shares Sold	1,000	1,000
Price Sold	$2.30	$134.00
Ending Value	$2,300	$134,000
Capital Gain / (Loss)	($62,700)	$69,000
Taxable Amount	($31,350)	$34,500
Tax Payable (assuming 50% marginal tax rate)	$0	$17,250
Net Profit / (Loss) to client	($62,700)	$51,750
Holding Period Return	**-96.46%**	**106.15%**
Annualized Return	**-24.00%**	**27.27%**
Holding Period Return (after tax)	**-96.46%**	**79.62%**
Annualized Return (after tax)	**-24.00%**	**21.56%**

Source: ScotiaMcLeod Fund Research

Here we have two investors who experienced very different results with their positions in Nortel. Investor A, the optimist, refused to let go of their investment because it would have triggered a sizable capital gain, which carries with it tax consequences. Instead, Investor A watched this market darling fly to new heights, only to see it crash and burn several years later.

Investor B on the other hand, took a more disciplined approach by recognizing that a 106% (+27.3% annualized) pre-tax return was pretty good for a three year time horizon, and that even with a tax consequence, taking advantage of this significant return still yielded them an after-tax return of 79.6% (+21.7% annualized). In dollar terms, they were able to put over $51,000 net profit (after taxes) in their pocket. Which investor would you rather be?

The example above is an extreme one regarding the capital gains/losses issue, but it is still relevant. On a much smaller scale, these kinds of examples exist everywhere. <u>The bottom line</u>: the tax man will get his portion of your profits one way or the other. Instead of avoiding the inevitable result to the detriment of your portfolio, take advantage of gains in your portfolio where it makes sense, and offset these gains with capital losses that are greater than an MER. More importantly, with the Mutual Fund Recommended List at ScotiaMcLeod, we focus on finding and supporting mutual funds that are "best in class". Perhaps put another way, we focus on finding and supporting mutual funds that earn their fees and in our opinion, have therefore earned the right to manage your money.

Take a professional approach. Ideally, all of the individual positions that make up a portfolio will have their own story, which includes (among other factors) the original rationale for including it in the portfolio, how it fits in the portfolio, an assessment of intrinsic value, as well as an exit strategy. The exit strategy, which can also be referred to as the "sell discipline", is just as important, if not more important, as the rationale for taking the initial position. If you have a target price at which "fair value" is assessed, it assists you in remaining objective, as opposed to "marrying" the stock.

Or…leave it to the professionals. If you are not comfortable or are reluctant to implement a more disciplined investment strategy due to time or other constraints, maybe it's time to look at a few carefully selected mutual funds. By entrusting professional money managers whose job it is to manage money for investors, you are by default following a more disciplined investment strategy. Yes, there is a fee for this service (i.e. the MER), but the risks and ultimate costs of a mismanaged portfolio (improper diversification, lack of discipline, etc.) can be far greater than an MER. More importantly, with the Mutual Fund Recommended List at ScotiaMcLeod, we focus on finding and supporting mutual funds that are “best in class”. Perhaps put another way, we focus on finding and supporting mutual funds that earn their fees and in our opinion, have therefore earned the right to manage your money.

On the following pages are a number of fund suggestions (separated by Morningstar category). For additional fund suggestions, please have a look at the Mutual Fund Recommended List.

As always, for more information on the ScotiaMcLeod Mutual Fund Recommended List, or for other mutual fund questions, please contact your advisor.

Bond Funds

PH&N Total Return Bond Fund – C

- Institutional style philosophy and process with comprehensive analytical capabilities
- Fixed Income team employs a disciplined, repeatable investment process
- Superior performance over time vs. peers

Manulife Mawer Canadian Bond Fund

- 20 to 40 holdings; core positions in Government of Canada bonds
- Provincial and municipal bonds added to implement sector allocation and security selection strategies
- Low-risk approach to duration; barbell structure employed

Canadian Equity Funds

CI Harbour Fund

- Consistent long-term track record. 10-year annualized return higher than S&P/TSX Composite TR benchmark
- Good downside protection vs peers and above average alpha generation over the last 5 years

CI Signature Select Canadian Fund

- Team approach employed; PMs and analysts are specialists in each asset class
- Objective to deliver risk-adjusted returns regardless of market conditions
- Top quartile performer over the last 3, 5 and 10 years within category

U.S. Equity Funds:

Dynamic American Value Fund

- Consistent long-term track record
- Top quartile annualized returns over the last 3, 5 and 10 years
- Above average alpha generation vs. peers over the last 5 years
- Above average risk-adjusted returns vs. peers over the last 5 years

CI American Value Fund

- Above average alpha generation vs. peers over the last 5 years
- Top quartile performance over the last 3 and 5 years within category
- Since Epoch took over the mandate in Oct. 2002, the fund has outperformed the S&P 500 TR (CAD) benchmark six out of the last seven calendar years

Global Equity Funds:

Mac Ivy Foreign Equity Fund

- Focus on quality businesses that generate excess capital internally
- Above average annualized return and lower average standard deviation vs. peers and benchmark over last 5 years
- Above average risk-adjusted returns vs. peers over the last 5 years

Renaissance Global Growth Fund

- Concentrated strategy, 40 to 60 stocks, low turnover rate
- Target companies capable of generating wealth at 20% p.a.
- Up capture of 85.1% and down capture of 75.7% over the last 5 years

Emerging Market Equity Funds:

AGF Emerging Markets Fund

- Annualized returns above benchmark over the last 1, 3, 5 and 10 years
- Superior alpha generation & risk-adjusted returns vs. peers over last 5 years

Mac Universal Emerging Markets Class

- Value added by focusing on companies with higher ROEs compared to the index
- Low turnover ratio, typically less than 30% p.a.
- Has one of the lowest standard deviation within the category over the last 5 years

Equity Guided Portfolios

Stephen Uzielli — Portfolio Manager, Portfolio Advisory Group

The Equity Guided Portfolios are models designed to provide investors with a convenient way of investing directly in individual holdings and building diversified portfolios composed of equity securities. The portfolios are actively managed by a dedicated Portfolio Manager with oversight from the Investment Committee of the ScotiaMcLeod Portfolio Advisory Group. Each portfolio has a specific mandate but they all have the common objective of providing investors with a consistent long-term rate of return through holding a portfolio of stocks comprised of industry leaders with unique franchises and strong management teams, combined with an attractive trend in profitability.

ScotiaMcLeod Canadian Core Guided Portfolio

Performance Update

We began 2010 with the perspective that following an exceptional rebound in equity markets in 2009, investors should have more moderate return expectations for the coming year and that dividend income would play a larger component of total shareholder returns. Now reflecting on the first quarter which delivered poor January results followed by renewed strength in February and March, it's fair to say that equity performance has so far exceeded our expectations; however, dividend oriented stocks have performed well as investors seek out the safety of dividend yield in an uncertain market. We remain confident in the sustainability of the economic recovery that is underway, but much of the growth forecast in 2010 is largely priced-in to equity valuations and it should be expected there will be some bumps along the path to growth. We continue to recommend an investment strategy that favours slightly more cyclical sectors; we expect the Guided Portfolios will become more defensively oriented later in the year when there is greater clarity regarding so-called "exit strategies" and the tightening of monetary policy by central bankers around the globe.

Global equity markets came under selling pressure during the month of January as investors began to question some of the growth assumptions investors had priced into valuations during the latter part of 2009. Concern about the pace of future economic growth in China combined with the strength in the U.S. dollar led to commodity price declines which caused particular weakness in the resource-heavy Canadian equity market. Ongoing anxiety over the declining fiscal picture in Greece also weighed heavily on investors in January. February saw a rebound in equities which almost offset the previous month's declines, supported by positive Q4 corporate earnings reports and commentary from Federal Reserve indicating they expect interest rates will remain low for an extended period, perhaps pushing out any interest rate increases in the U.S. into the third or fourth quarter of 2010. March capped off a solid quarter with higher equity prices led by renewed strength in the Financial sector and Industrial stocks. March also saw the passing of the one-year anniversary since the market bottomed in March of 2009 so not only are the broad market indices hitting a series of 12-18 month highs, but many individual stocks are also hitting new high-water marks as well.

Commodities were generally stronger again in the first quarter in concert with an improving economic outlook. The main exception was natural gas futures which reversed their Q4 2009 gains, dropping 19.9% as above average gas in storage (inventory) combined with increased productive capacity from new unconventional shale gas properties has led to excess supply relative to constrained demand. Crude oil futures increased 4.2% and closed the quarter at US$83.37 per barrel. Gold bullion futures moved higher by a modest 1.5% in the quarter, finishing the quarter at $US1114 per ounce; copper futures advanced 8% to a 21-month high of US$3.55 per pound.

In the first quarter the Canadian Core Guided Portfolio generated a total return of 3.5% while the benchmark S&PTSX60 Index increased 2.6% on the same basis. The outperformance resulted from a combination of sector allocation and stock selection. Eight of ten sectors posted positive returns in the quarter, led by Financials and Industrials, while the Energy sector declined during the period. Within the

Financial group, shares of **Great West Lifeco** increased 9% during the quarter while **Sun Life Financial** rallied 8%. Life insurance stocks tended to outperform bank stocks, partially rebounding from a weak previous quarter, and also in recognition of the potential for enhanced profitability when interest rates begin increasing later this year. As was the case in the previous quarter, the biggest contributor to portfolio performance in the first quarter was **Teck Resources** which rallied another 20% due to higher copper prices and continued positive outlook for coal pricing. The largest negative moves among portfolio holdings were Energy holdings **Suncor Energy** and **Talisman Energy**, declining 11% and 12% respectively.

Changes

One change was made during the quarter, eliminating the holding in **AGF Management** and adding a position in **Crescent Point Energy Corp (CPG).** From a macro, longer-term secular perspective we had become increasingly concerned about **AGF** and other mutual fund managers in the context of a shift in investor sentiment away from mutual funds and toward ETFs as an efficient method to get broad exposure to investments in certain asset classes, regions, and sectors. At the same time, **AGF** specifically has been falling behind in the competitive battle for fund assets and in fact the company has consistently suffered net redemptions from their mutual funds for some time. On January 22, 2010 Scotia Capital analyst Kevin Choquette downgraded **AGF Management** from 1-Sector Outperform to 2-Sector Perform citing additional concerns including executive management and portfolio management changes at the firm and the impact of recent Canadian dollar strength on their Global Equities mutual funds. Coincidentally, we had been considering ways to shift sector allocation in the portfolio in concert with Scotia Capital Investment Strategist Vincent Delisle's updated equity strategy. To achieve this shift we reduced the portfolio weight in Financials by selling **AGF Management Limited** and moved to a slight overweight position in the Energy component of the portfolio by adding a position in **Crescent Point.**

Crescent Point's strategy focuses on acquiring, developing, and exploiting large resource plays with an ultimate target of long-term growth. Management track record is solid as evidenced by historic growth in reserves, production, cash flow, and Net Asset Value. Through a combination of acquisition and development drilling, production volumes increased 19% in 2009 and are forecast to grow 28% in 2010. **CPG** trades at a premium to the peer group but we believe the premium valuation is justified by the company's proven track record, significant growth potential, and dividend yield.

Exhibit 1: ScotiaMcLeod Canadian Core Guided Portfolio

Company	Symbol	Rating	Risk Ranking	Price *31-Mar-10*	Target Price	Dividend	Dividend Yield	Potential ROR
Interest Sensitive:								
Bank of Nova Scotia	BNS	2-SP	Low	$50.88	$58.00	$1.96	3.9%	18%
Brookfield Asset Management*	BAM	Not Rated	Not Rated	$25.85	$27.00	$0.52	2.0%	6%
Great West Lifeco*	GWO	Not Rated	Not Rated	$29.16	$29.00	$1.23	4.2%	4%
Manulife Financial*	MFC	Not Rated	Not Rated	$20.04	$22.00	$0.52	2.6%	12%
Rogers Communications	RCI.B	1-SO	Medium	$34.69	$39.00	$1.28	3.7%	16%
Royal Bank of Canada	RY	1-SO	Low	$59.44	$75.00	$2.00	3.4%	30%
Sun Life Financial*	SLF	Not Rated	Not Rated	$32.67	$34.00	$1.44	4.4%	8%
Consumer Products:								
Shoppers Drug Mart	SC	1-SO	Low	$43.64	$54.00	$0.90	2.1%	26%
Thomson Reuters Corporation	TRI	1-SO	Low	$36.96	$42.00	$1.16	3.1%	17%
Industrial Products:								
Canadian National Railway*	CNR	Not Rated	Not Rated	$61.64	$66.00	$1.08	1.8%	9%
Research In Motion	RIM	1-SO	Medium	$71.10	$117.00	$0.00	0.0%	65%
Resource:								
Agrium Inc.	AGU	2-SP	Medium	$71.82	$76.00	$0.11	0.2%	6%
Barrick Gold	ABX	1-SO	Medium	$38.97	$63.00	$0.43	1.1%	63%
Canadian Natural Resources	CNQ	1-SO	High	$75.17	$100.00	$0.60	0.8%	34%
Crescent Point Energy Corp.*	CPG	Not Rated	Not Rated	$38.97	$44.00	$2.76	7.1%	20%
Nexen Inc.	NXY	2-SP	High	$25.13	$30.00	$0.20	0.8%	20%
Suncor Energy	SU	1-SO	Medium	$33.03	$41.00	$0.40	1.2%	25%
Talisman Energy	TLM	1-SO	Medium	$17.37	$22.00	$0.23	1.3%	28%
Teck Resources Ltd.	TCK.B	1-SO	High	$44.25	$52.00	$0.40	0.9%	18%
TransCanada Corp.	TRP	1-SO	Low	$37.22	$44.00	$1.60	4.3%	23%

**Currently Scotia Capital does not provide research coverage - target price based on consenus data.*

Source: Scotia Capital; Bloomberg.

ScotiaMcLeod Canadian Income Plus Guided Portfolio

Stephen Uzielli-Portfolio Manager, Portfolio Advisory Group

Performance Update

Dividend stocks, as measured by the Dow Jones Canada Select Dividend Index, outperformed the broader market in the first quarter due to the heavy concentration of Financial stocks in the index and the relative outperformance of that sub-group during the period. Higher yielding dividend paying stocks also got a boost from increased investor demand for yield as an alternative to lower yielding fixed income instruments in the bond market. The portfolio generated a total return of 5.6% during the quarter while the benchmark index increased 6.0%; the underperformance occurred despite the strong performance of the many Financial holdings in the portfolio. Top performers included **Great West Lifeco** as well as **Bank of Montreal** which jumped more than 10% and **TD Bank** which advanced almost 15%; bank stocks received renewed investor attention in March as the group reported fiscal Q1 financial results, generally ahead of expectations. Only three portfolio holdings registered declines during the quarter, the most significant of which was **Shaw Communications** which fell 7% as the company became embroiled in a bidding war for the broadcasting assets of **Canwest Communications** and concerns about potential plans for entering the wireless business.

Changes

Early in the quarter, Scotia Capital Telecom analyst Jeff Fan downgraded his rating on **BCE Inc.** from 2-Sector Perform to 3-Sector Underperform due to price appreciation, premium valuation, and the expectation that the shares were likely to underperform relative to the rest of his coverage universe. There was no change to his $27 one year target price and the stock was trading above that level. **BCE**'s shares increased 15.4% in 2009 and outperformed the peer group for several reasons, not the least of which was the company's success in generating earnings growth in a weak economy, largely driven by cost cutting. The incremental earnings helped support three separate dividend increases during the year for a total of 19% growth, a rate of improvement the analyst feels is not repeatable. By virtue of the Investment Policy Statement for the Canadian Income Plus Guided Portfolio that requires a review of any holding that is subject of an Scotia Capital analyst downgrade to 3-Sector Underperform, we removed the position in **BCE** and replaced it with a new investment that demonstrates a combination of both above-average income and growth characteristics: **Crescent Point Energy Corp. (CPG).** In addition to the previous commentary regarding **Crescent Point**, an investment in **CPG** provides more cyclical exposure for this portfolio as the company is a direct beneficiary of the longer-term trend toward rising energy prices. Given there are already two other Telecommunication Services holdings in the portfolio it is prudent to diversify across other sectors and although **Enbridge Inc.** and **TransCanada Corp.** are technically classified as Energy holdings, they are strictly speaking **<u>not</u>** in the Exploration and Production (E&P) end of the Energy business.

Exhibit 2: ScotiaMcLeod Income Plus Guided Portfolio

Company	Symbol	Rating	Risk Ranking	Price *31-Mar-10*	Target Price	Dividend	Dividend Yield	Potential ROR
Interest Sensitive:								
Bank of Montreal	BMO	1-SO	Low	$61.65	$70.00	$2.80	4.5%	18%
Bank of Nova Scotia	BNS	2-SP	Low	$50.88	$58.00	$1.96	3.9%	18%
Great West Lifeco*	GWO	Not Rated	Not Rated	$29.16	$29.00	$1.23	4.2%	4%
National Bank of Canada	NA	2-SP	Medium	$61.84	$75.00	$2.48	4.0%	25%
Rogers Communications Inc.	RCI.B	1-SO	Medium	$34.69	$39.00	$1.28	3.7%	16%
Royal Bank of Canada	RY	1-SO	Low	$59.44	$75.00	$2.00	3.4%	30%
Sun Life Financial*	SLF	Not Rated	Not Rated	$32.67	$34.00	$1.44	4.4%	8%
TELUS Corp.	T	2-SP	Medium	$37.80	$37.00	$1.90	5.0%	3%
Toronto Dominion Bank	TD	1-SO	Medium	$75.70	$85.00	$2.44	3.2%	16%
Consumer Products:								
Shaw Communications	SJR.B	2-SP	Low	$20.11	$22.00	$0.88	4.4%	14%
Shoppers Drug Mart	SC	1-SO	Low	$43.64	$54.00	$0.90	2.1%	26%
Thomson Reuters Corp.	TRI	1-SO	Low	$36.96	$42.00	$1.16	3.1%	17%
Resource:								
Crescent Point Energy Corp.*	CPG	Not Rated	Not Rated	$38.97	$44.00	$2.76	7.1%	20%
Enbridge Inc.	ENB	1-SO	Low	$48.44	$57.00	$1.70	3.5%	21%
TransCanada Corp.	TRP	1-SO	Low	$37.22	$44.00	$1.60	4.3%	23%

**Currently Scotia Capital does not provide research coverage - target price based on consenus data.*

Source: Scotia Capital; Bloomberg.

ScotiaMcLeod U.S. Core Guided Portfolio

Stephen Uzielli - Portfolio Manager, Portfolio Advisory Group

Performance Update

U.S. equities continued to rally in the first quarter as the benchmark S&P500 Index increased 5.4% on a total return basis since the beginning of the year which is the best Q1 performance observed since 1998. The U.S. Core Guided Portfolio lagged slightly while generating a return of 5.0% including dividends. Eight out of the ten broad economic sectors increased in value with only the defensive Telecom and Utility sectors experiencing a price decline. Market leadership came from sectors responding to the economic recovery: Industrials, Financials, and Consumer Discretionary. Only three portfolio holdings declined during the period with the largest mover being the shares of **AT&T Inc.** which dropped 8% in the wake of competitive concerns and Q4 results that were modestly disappointing to analysts; we remain positive due to their stable business model and 6.5% dividend yield. The other decline of consequence was in the shares of **Pfizer Inc.** which fell 6% during the quarter in which they reported Q4 results: revenues exceeded estimates while earnings fell short. Importantly, guidance for 2012, which is seen as the peak year for synergies resulting from the merger with **Wyeth**, remains above analyst forecasts.

Much of these performance laggards were offset by gains among more cyclical holdings. Shares of **MetLife Inc.** jumped 23% in the first quarter after a poor previous quarter, partially in response to some positive analyst commentary, but also after the company announced the accretive acquisition of **AIG**'s Alico unit which is among the leaders in the Japanese market for cancer and medical insurance coverage. Shares of **Nike Inc.** advanced 11% on positive financial results, indicating better growth prospects in emerging markets. Finally, Technology holdings **Cisco Systems** and **Intel Corp.** both increased 9% on positive earnings releases. Technology remains the highest weighted sector in the portfolio as the group is demonstrating one of the highest levels of earnings growth, both on a reported basis as well as forecast, owing to the improving economy leading to a rebound in corporate technology investment coupled with the natural replacement cycle that was deferred as a result of the recession.

Many commentators have referred to this recent market move as a “stealth rally,” as the advance has occurred quietly, without fanfare, plodding higher on low trading volumes and in the absence of conviction. Although we continue to have a constructive outlook toward equities we believe we are in a range bound market and that we are currently near the top of the range and thus finding it increasingly difficult to identify individual securities to buy aggressively at current valuations except for those that may not have participated in the tremendous rally of the last year or those that have experienced a temporary set-back like an earnings disappointment. We advocate a more active investment strategy through trading around core holdings: trim positions as they exceed short-term expectations, and take advantage of any fleeting market or company specific pullbacks to add to positions.

Changes

No changes were made to the U.S. Core Guided Portfolio during the first quarter. We continue to monitor all current holdings to ensure that they represent the best potential investments in keeping with the portfolio’s mandate. In considering new securities we look for companies that offer market leadership, unique franchises and a strong management team combined with an attractive trend in profitability.

Exhibit 3: ScotiaMcLeod U.S. Core Guided Portfolio

Sector	Symbol	Rating	Risk Ranking	Price 31-Mar-10	Target Price	Dividend	Dividend Yield	Potential ROR
Interest Sensitive:								
AT&T Inc.	T	Neutral	Low	$25.84	$27.00	$1.68	6.5%	11%
MetLife, Inc.*	MET	Restricted	Medium	$43.34	$53.00	$0.74	1.7%	24%
State Street Corp	STT	Outperform	Low	$45.14	$52.00	$0.04	0.1%	15%
Consumer Products:								
Colgate-Palmolive Co.	CL	Neutral	Medium	$85.26	$87.00	$2.12	2.5%	5%
McDonald's Corp	MCD	Outperform	Low	$66.72	$81.00	$2.20	3.3%	25%
McKesson Corporation	MCK	Outperform	Low	$65.72	$74.00	$0.48	0.7%	13%
Nike Inc.	NKE	Outperform	Medium	$73.50	$85.00	$1.08	1.5%	17%
Pfizer Inc.	PFE	Outperform	Low	$17.15	$24.00	$0.72	4.2%	44%
Wal Mart Stores	WMT	Neutral	Low	$55.60	$58.00	$1.21	2.2%	6%
Walt Disney	DIS	Outperform	Medium	$34.91	$38.00	$0.35	1.0%	10%
Industrial Products:								
Cisco Systems	CSCO	Outperform	Low	$26.03	$32.00	$0.00	0.0%	23%
Fluor Corp.	FLR	Outperform	Low	$46.51	$56.00	$0.50	1.1%	21%
Intel Corp.	INTC	Outperform	Low	$22.29	$32.00	$0.63	2.8%	46%
Microsoft Corp	MSFT	Outperform	Medium	$29.29	$40.00	$0.52	1.8%	38%
Oracle Corp	ORCL	Outperform	Low	$25.71	$31.00	$0.20	0.8%	21%
United Technologies Corp*	UTX	Not Rated	Low	$73.61	$86.00	$1.70	2.3%	19%
Waste Management Inc.	WM	Neutral	Medium	$34.43	$33.00	$1.26	3.7%	0%
Resource:								
Freeport McMoRan Copper	FCX	Outperform	Medium	$83.54	$95.00	$1.20	1.4%	15%
Occidental Petroleum	OXY	Outperform	Medium	$84.54	$91.00	$1.32	1.6%	9%
XTO Inc.	XTO	Outperform	Medium	$47.18	$51.00	$0.50	1.1%	9%

**Currently Credit Suisse does not provide research coverage - target price based on consensus data.*

Source: Scotia Capital Credit Suisse; Bloomberg; Value Line

ScotiaMcLeod North American Core Guided Portfolio

Stephen Uzielli-Portfolio Manager, Portfolio Advisory Group

Performance Update

The ScotiaMcLeod North American Core Guided Portfolio is suitable for growth investors seeking consistent long-term rates of return from a portfolio of high quality Canadian and U.S. companies. The current portfolio holds 25 equal-weighted (4%) positions. Country allocation within the portfolio is determined in a bottom-up, stock-specific fashion as opposed to making any particular country "call." Generally speaking, but not exclusively, resource holdings will likely come from the Canadian universe, and Health Care, Information Technology, and Consumer stocks will usually be drawn from the United States. Performance of the portfolio is measured against a North American Index which is a composite benchmark equally weighted between the S&PTSX 60 Index (50%) and the S&P500 Index (50%), translated into Canadian dollars.

The U.S. dollar declined 3.6% against the Canadian dollar, mostly due to the strength in the loonie resulting from higher commodity prices, combined with solid economic performance leading to speculation of interest rate increases by the Bank of Canada as early as the second quarter. As a result, the contribution from U.S. stock performance was substantially reduced after currency translation back to Canadian dollars. Canadian and U.S. holdings on average advanced a similar amount in local currency terms. In the first quarter of 2010 the hybrid benchmark North American Index generated a total return of 2.4% in Canadian dollars, while the North American Core Guided Portfolio advanced only 1.7% including dividends. **Teck Resources** and **Cisco Systems** were two of the better performing holdings while laggards included **AT&T Inc**., **Pfizer Inc**., and **Suncor Energy**, all referenced previously.

Changes

No changes were made to the North American Core Guided Portfolio during the quarter. We continue to monitor all holdings to ensure that the portfolio composition reflects the best potential investments within each sector, viewed within a North American context. In considering new investments in this portfolio, stocks are selected from the universe of positions held in the ScotiaMcLeod Canadian and U.S. Core Guided Portfolios. The mandate for this portfolio is to provide a consistent long-term rate of return through investments in companies that are valued attractively and offer strong leadership, unique operating characteristics, and a solid track record combined with predictable earnings growth.

Exhibit 4: ScotiaMcLeod North American Core Guided Portfolio

Company	Symbol	Rating	Risk Ranking	Price *31-Mar-10*	Target Price	Dividend	Dividend Yield	Potential ROR
Financials:								
Bank of Nova Scotia	BNS	2-SP	Low	$50.88	$58.00	$1.96	3.9%	18%
Brookfield Asset Management	BAM/A	Not Rated	Not Rated	$25.85	$27.00	$0.52	2.0%	6%
Manulife Financial**	MFC	Not Rated	Not Rated	$20.04	$22.00	$0.52	2.6%	12%
Royal Bank of Canada	RY	1-SO	Low	$59.44	$75.00	$2.00	3.4%	30%
Sun Life Financial**	SLF	Not Rated	Not Rated	$32.67	$34.00	$1.44	4.4%	8%
Telecommunication Services								
AT&T Inc.	T	Neutral	Low	$25.84	$27.00	$1.68	6.5%	11%
Rogers Communications	RCI/B	1-SO	Medium	$34.69	$39.00	$1.28	3.7%	16%
Consumer Discretionary								
McDonald's Corp	MCD	Outperform	Low	$66.72	$81.00	$2.20	3.3%	25%
Walt Disney	DIS	Outperform	Medium	$34.91	$38.00	$0.35	1.0%	10%
Consumer Staples								
Colgate-Palmolive*	CL	Neutral	Medium	$85.26	$87.00	$2.12	2.5%	5%
Shoppers Drug Mart	SC	1-SO	Low	$43.64	$54.00	$0.90	2.1%	26%
Health Care								
Pfizer Inc.	PFE	Outperform	Low	$17.15	$24.00	$0.72	4.2%	44%
Industrials								
Canadian National Railway	CNR	Not Rated	Not Rated	$61.64	$66.00	$1.08	1.8%	9%
Fluor Corp.	FLR	Outperform	Low	$46.51	$56.00	$0.50	1.1%	21%
United Technologies Corp*	UTX	Not Rated	Low	$73.61	$86.00	$1.70	2.3%	19%
Information Technology								
Cisco Systems	CSCO	Outperform	Low	$26.03	$32.00	$0.00	0.0%	23%
Microsoft Corp.	MSFT	Outperform	Medium	$29.29	$40.00	$0.52	1.8%	38%
Oracle Corp	ORCL	Outperform	Low	$25.71	$31.00	$0.20	0.8%	21%
Energy								
Canadian Natural Resources	CNQ	1-SO	High	$75.17	$100.00	$0.60	0.8%	34%
Occidental Petroleum	OXY	Outperform	Medium	$84.54	$91.00	$1.32	1.6%	9%
Suncor Energy	SU	1-SO	Medium	$33.03	$41.00	$0.40	1.2%	25%
Talisman Energy	TLM	1-SO	Medium	$17.37	$22.00	$0.23	1.3%	28%
TransCanada Corporation	TRP	1-SO	Low	$37.22	$44.00	$1.60	4.3%	23%
Materials								
Barrick Gold	ABX	1-SO	Medium	$38.97	$63.00	$0.43	1.1%	63%
Teck Resources Ltd.	TCK/B	1-SO	High	$44.25	$52.00	$0.40	0.9%	18%

*Currently Credit Suisse does not provide research coverage - target price based on consenus data.
**Currently Scotia Capital does not provide research coverage - target price based on consenus data.

Source: Scotia Capital Credit Suisse; Bloomberg; Value Line

The Guided Portfolios returns are not calculated according to CFA Institute "Performance Presentation Standards". Returns are calculated on a total return basis (including dividend income). The returns are used to gauge our performance by comparing the returns of the Portfolios to benchmark total return indices such as the S&P/TSX 60 and the S&P 500. Historical performance of the Guided Portfolios is not necessarily indicative of future performance. Each client's return will vary depending on the number of shares purchased, as well as the timing of purchases or sales. The Guided Portfolios themselves should not be used as benchmarks with which to compare our clients' portfolios.

ScotiaMcLeod Core-Plus Fixed Income Guided Portfolio

Tim Vlahopoulos — Associate Director, Portfolio Advisory Group

Investment Objective

The ScotiaMcLeod Core-Plus Fixed Income Guided Portfolio (Core) is designed for investors with a moderate to higher investment risk profile who want to take a more active approach to managing their fixed income assets within a diversified portfolio. The objectives of the portfolio are to provide both a high level of current income, and a reasonable level of return to protect against future inflation. The overall goal of the portfolio is to exceed the performance of the DEX Universe Bond Index or benchmark. Typically, superior returns are not achieved every year but the goal is to achieve these rates of return over the long term. Approximately 75% of the portfolio is placed in a 10-year bond ladder and 5% is placed in inflation-protected instruments. These comprise the core holdings of the portfolio. The remaining 20% is allocated toward active, value added trade strategies that attempt to outperform the benchmark.

Current Active Strategies

There was one change made to the active portion of the portfolio during Q1 of 2010. On February 9th, the Ontario Infrastructure Projects Corporation (OSIFA) 4.60% due June 15th, 2015 was sold and the proceeds were used to purchase the Canadian Imperial Bank of Commerce Floating Rate Note (CIBC FRN) due September 14th, 2012.

The OSIFA position was purchased on August 27th, 2009 and provided a total return of 3.44% while the index returned 1.91% over the same period. OSIFA's status as to whether it can be considered a crown corporation has been clarified and it will not have prospectus exempt status going forward even though it is 100% owned by the Province of Ontario. Therefore, it was felt that the interest rate spread for OSIFA, which had been performing like a provincial bond up to that point, was going to drift wider in the future. Interest rate spread is the difference between the yield for OSIFA and a Government of Canada bond with a similar maturity. As a result, it was felt that OSIFA would sell off and perform more like other provincially owned entities such as Hydro One therefore the decision was made to exit the position. The proceeds from the sale of OSIFA were used to buy the CIBC Floating Rate Note.

The CIBC FRN is seen as a defensive play in anticipation of the upcoming rising interest rate cycle. Floating Rate Notes re-set their coupons based on a predetermined benchmark and an additional spread over that benchmark for the life of the security. The CIBC FRN changes its coupon on the 14th of every month based on the rate for one month Canada Bankers Acceptances on that day plus 0.55%. It is expected that the cash flow from the CIBC FRN will increase as short-term interest rates move higher. The price of this security however, is expected to be relatively stable over time as the coupon adjusts to market conditions. It is the anticipated increasing cash flows and the price stability of this security that help make it a defensive play in a rising interest rate environment.

Performance Update

The Core-Plus Portfolio returned 1.10% which slightly underperformed the 1.26% returned by the DEX Universe Bond Index for the quarter ending March 31, 2010. The main factors driving the difference in performance between the portfolio and the index were the term and sector compositions versus the benchmark. The performance numbers for the index were primarily driven by the long-term Provincial and Corporate sectors for the quarter. The portfolio's lack of exposure to the long-term Provincial and Corporate sectors and the defensive strategy employed in the active section caused the portfolio to underperform the index slightly in the first quarter of 2010.

The two active trades on average had an overall sub-par performance compared to the index for the first quarter of 2010. However, the average quarterly returns for the active positions do not tell the whole story. The Wells Fargo Canada position performed quite nicely for the quarter and managed to outpace the index by 0.59%. The credit spread, which is the difference between the yield for the security and the yield on a Government of Canada bond with a similar maturity, has tightened by 0.93% since the position was first initiated in December of 2009. This credit spread tightening relative to other securities with similar credit quality and term is what helped Wells Fargo outperform the index in this quarter. Most of the anticipated spread tightening has now been realized, however, WFC is still expected to outperform the index over the next 2 - 3 quarters as the US economy and US bank earnings improve.

The second active position, initiated on February 9th with the purchase of the CIBC Floating Rate Note, showed a return of 0.10% while the index returned a -0.46% for the same time frame. As noted previously, this position is a defensive position designed to preserve capital during the anticipated upcoming rate hike cycle.

Superior returns from fixed income as an asset class will be difficult for clients to achieve in 2010. Some central banks around the world have already begun to increase their overnight interest rates. Scotia Economics is forecasting that the Bank of Canada will begin hiking interest rates during the second quarter of this year with the first hike occurring in June of 2010. The Canadian yield curve has already responded to the anticipated Bank of Canada moves and has started to flatten during the first quarter of 2010. A flattening yield curve means that short-term interest rates are moving higher faster than longer-term rates. This is a typical move of bond yields in a rising interest rate environment. Unfortunately, this will weigh on returns for bonds and bond markets going forward under these circumstances.

Exhibit 1: ScotiaMcLeod Core-Plus Fixed Income Guided Portfolio

Issuer Name	Coupon	Maturity Date	Weighting*	Rate of Return*	Benchmark***
Core Positions					
Export Development Corp.	5.75	1-Jun-11	7.0%	0.29%	
Canada	5.00	1-Jun-14	7.0%	0.42%	
CMHC	4.35	1-Feb-17	7.1%	1.67%	
Canada RRB	3.00	1-Dec-36	5.2%	0.20%	
CIBC Fixed Floater	3.75	9-Sep-10	7.1%	0.35%	
Royal Bank Fixed Floater	5.45	4-Nov-13	7.3%	0.61%	
Canadian Tire Corp	4.95	1-Jun-15	7.4%	2.07%	
Metro Toronto	5.60	18-Dec-18	7.7%	1.57%	
Manitoba	5.25	3-Dec-12	7.1%	0.25%	
Saskatchewan	4.50	23-Aug-16	7.3%	0.59%	
Quebec	4.50	1-Dec-19	7.4%	1.62%	
Active Positions					
Wells Fargo Canada Finance	3.97	3-Nov-14	10.1%	1.85%	
CIBC Floating Rate Note **	0.96	14-Sep-12	10.1%	0.10%	
Total				**1.10%**	**1.26%**

*For quarter ending March 31, 2010
** Position and returns since February 9th, 2010
*** DEX Universe Bond Index

Source: ScotiaMcLeod Portfolio Advisory Group

Notes

Notes

The author(s) of the report own(s) securities of the following companies.
***TELUS Corporation**, **Manulife Financial Corporation**, **Bank of Nova Scotia**, **Bank of Montreal**, **Great-West Lifeco Inc.**, **Rogers Communications Inc.**, **Royal Bank of Canada**, **Sun Life Financial Inc.**, **Shoppers Drug Mart Corporation**, **Thomson Reuters Corporation**, **Canadian National Railway Company**, **Barrick Gold Corporation**, **Crescent Point Energy Corp.**, **Suncor Energy Inc.**, **Talisman Energy Inc.**, **Teck Resources Limited**, **TransCanada Corporation**, **Enbridge Inc.**, **Wal-Mart Stores Inc**, **Microsoft Corp**, **United Technologies Corp**,*

The supervisors of the Portfolio Advisory Group own securities of the following companies.
***TELUS Corporation**, **Manulife Financial Corporation**, **Bank of Nova Scotia**, **Shoppers Drug Mart Corporation**, **Canadian National Railway Company**, **Suncor Energy Inc.**, **TransCanada Corporation**, **Colgate-Palmolive Co**,*

Scotia Capital Restriction -- U.S. (American) ***Bank of Nova Scotia***

Thomas C. O'Neill is a director of Nexen Inc. and is a director of the Bank of Nova Scotia. ***Nexen Inc.***

Scotia Capital USA Inc. or its affiliates has managed or co-managed a public offering in the past 12 months. ***Bank of Montreal, Bank of Nova Scotia, Barrick Gold Corporation, Brookfield Asset Management Inc., Crescent Point Energy Corp., Enbridge Inc., Great-West Lifeco Inc., Manulife Financial Corporation, National Bank, Royal Bank of Canada, Shaw Communications Inc., Sun Life Financial Inc., Teck Resources Limited, TELUS Corporation, TransCanada Corporation***

Vincent Delisle, a member of Vincent Delisle's household and/or an account related to Vincent Delisle own securities of this issuer. ***National Bank***

Kevin Choquette, a member of Kevin Choquette's household and/or an account related to Kevin Choquette own securities of this issuer. ***Bank of Montreal, Bank of Nova Scotia, Royal Bank of Canada***

The Head of Equity Research/Supervisory Analyst, in his/her own account or in a related account, owns securities of the following issuer(s):
Agrium Inc., Bank of Montreal, Bank of Nova Scotia, Barrick Gold Corporation, Canadian National Railway Company, Canadian Natural Resources Limited, Crescent Point Energy Corp., DEUTSCHE BK AG LDN BRH, Enbridge Inc., Great-West Lifeco Inc., Manulife Financial Corporation, Nexen Inc., Research In Motion Limited, Rogers Communications Inc., Royal Bank of Canada, Shoppers Drug Mart Corporation, Sun Life Financial Inc., Suncor Energy Inc., Talisman Energy Inc., Teck Resources Limited, TELUS Corporation, Thomson Reuters Corporation, TransCanada Corporation

Scotia Capital USA Inc. or its affiliates has received compensation for investment banking services in the past 12 months. ***Agrium Inc., Bank of Montreal, Barrick Gold Corporation, Brookfield Asset Management Inc., Crescent Point Energy Corp., Enbridge Inc., Great-West Lifeco Inc., Manulife Financial Corporation, National Bank, Rogers Communications Inc., Royal Bank of Canada, Shaw Communications Inc., Shoppers Drug Mart Corporation, Sun Life Financial Inc., Talisman Energy Inc., TELUS Corporation, TransCanada Corporation***

Scotia Capital USA Inc. or its affiliates expects to receive or intends to seek compensation for investment banking services in the next 3 months.
Manulife Financial Corporation, TELUS Corporation

Scotia Capital USA Inc. had an investment banking services client relationship during the past 12 months. ***Bank of Nova Scotia, Barrick Gold Corporation, Canadian National Railway Company, Nexen Inc., Talisman Energy Inc., Teck Resources Limited***

The issuer paid a portion of the travel-related expenses incurred by the Fundamental Research Analyst/Associate to visit material operations of the following issuer(s): ***Barrick Gold Corporation***

Scotia Capital Restriction ***Bank of Nova Scotia***

Scotia Capital Inc. and its affiliates collectively beneficially own in excess of 1% of one or more classes of the issued and outstanding equity securities of the following issuer(s): ***AGF Management Limited, Bank of Montreal, Brookfield Asset Management Inc., Enbridge Inc., Great-West Lifeco Inc., Manulife Financial Corporation, National Bank, Rogers Communications Inc., Royal Bank of Canada, Shaw Communications Inc., Sun Life Financial Inc., TELUS Corporation, Thomson Reuters Corporation, TransCanada Corporation***

The Bank of Nova Scotia ("the Bank") is the parent company of Scotia Capital Inc. ("SCI"). This Report includes comparative information regarding a substantial number of competitors of the Bank where such comparable information is known or ascertainable by SCI and in equal prominence to the information in respect of the Bank. ***Bank of Nova Scotia***

Scotia Capital is an affiliate of The Bank of Nova Scotia Trust Company ("Scotiatrust"). Under the estate arrangements of the late Kenneth R. Thomson, Scotiatrust is Trustee of the 2003 TIL Settlement ("TIL Settlement"), a trust of which members of the Thomson family are beneficiaries. The TIL Settlement holds holding company shares of The Woodbridge Company Limited ("Woodbridge"), who is the principal shareholder and controlling shareholder of Thomson Reuters Corporation. Under the estate arrangements, the directors and officers of Woodbridge are responsible for its business and operations. In certain limited circumstances, including a very substantial disposition of Thomson Reuters Corporation common shares by Woodbridge, Scotiatrust's approval may be required. ***Thomson Reuters Corporation***

The Bank of Nova Scotia is a Related Issuer of Scotia Capital Inc. ***Bank of Nova Scotia***

The Fundamental Research Analyst/Associate has visited material operations of the following issuer(s): ***Barrick Gold Corporation, Research In Motion Limited, Rogers Communications Inc., Shaw Communications Inc., Shoppers Drug Mart Corporation, TELUS Corporation, Thomson Reuters Corporation***

Within the last 12 months, Scotia Capital Inc. and/or its affiliates have undertaken an underwriting liability with respect to equity or debt securities of, or have provided advice for a fee with respect to, the following issuer(s): ***Agrium Inc., Bank of Montreal, Bank of Nova Scotia, Barrick Gold Corporation, Brookfield Asset Management Inc., Crescent Point Energy Corp., Enbridge Inc., Great-West Lifeco Inc., Manulife***

Financial Corporation, Nexen Inc., Rogers Communications Inc., Royal Bank of Canada, Shaw Communications Inc., Sun Life Financial Inc., Talisman Energy Inc., Teck Resources Limited, TELUS Corporation, Thomson Reuters Corporation, TransCanada Corporation

Nexen Inc. has retained Scotia Waterous Inc. as its financial advisor to assist on the divestiture of Western Canada properties. ***Nexen Inc.***

Petro-Canada (International) Holdings B.V., a subsidiary of Suncor Energy, has engaged Scotia Waterous Inc. to assist with assessing the market for the sale of its Dutch subsidiary Petro-Canada Netherlands B.V. ("Petro-Canada"). ***Suncor Energy Inc.***

Scotia Waterous is acting as financial advisor to Talisman Energy Inc. on their sale of certain assets in Western Canada. ***Talisman Energy Inc.***

This issuer owns 5% or more of the total issued share capital of the Bank of Nova Scotia. ***Royal Bank of Canada***

Comparative Canadian Bank Information

Bank	Symbol	Scotia Capital Recommendation	Risk Rating	1 Yr Target
Bank of Montreal	BMO	1-Sector Outperform	Low	$70.00
Bank of Nova Scotia	BNS	2-Sector Perform	Low	$58.00
CIBC	CM	2-Sector Perform	Low	$80.00
National Bank	NA	2-Sector Perform	Low	$75.00
Royal Bank	RY	1-Sector Outperform	Low	$75.00
Toronto-Dominion Bank	TD	1-Sector Outperform	Low	$85.00

ScotiaMcLeod

ABBOTSFORD
(604) 864-3750

BARRIE
(705) 725-0300

BELLEVILLE
(613) 968-6459

BRAMPTON
(905) 796-2424

BRANDON
(204) 729-3362

BRIDGEWATER
(902) 543-8293

CALGARY
(403) 298-4000

CAMBRIDGE
(519) 740-4300

CHARLOTTETOWN
(902) 566-3225

COMOX
(250) 890-3570

COMOX II
(250) 890-3579

CORNER BROOK
(709) 637-4747

EDMONTON
(780) 497-3200

FREDERICTON
(506) 450-6465

GRAND PRAIRIE
(780) 513-3505

GUELPH
(519) 763-0371

HALIFAX
(902) 420-2220

HAMILTON
(905) 570-7960

KANATA
(613) 271-6600

KELOWNA
(250) 868-5500

KENTVILLE
(902) 678-0777

KINGSTON
(613) 531-6300

KITCHENER
(519) 571-3700

LAVAL
(450) 680-3100

LETHBRIDGE
(403) 317-4835

LONDON
(519) 660-3214

MARKHAM
(905) 947-0933

MEDICINE HAT
(403) 529-6565

MISSISSAUGA
(905) 848-1300

MONCTON
(506) 867-0700

MONTRÉAL
(514) 287-3600

MONTRÉAL
Capital Branch
(514) 287-2900

NEW GLASGOW
(902) 755-8509

NEW LISKEARD
(705) 647-2044

OAKVILLE – Church St.
(905) 377-6301

OAKVILLE – Kerr St.
(905) 842-9000

OTTAWA
(613) 563-0991

OWEN SOUND
(519) 371-6496

PETERBOROUGH
(705) 876-1373

POINTE CLAIRE
(514) 428-8400

PRINCE GEORGE
(250) 614-2080

QUEBEC – Montreal
Immigrant Investor Program
(514) 287-4504

QUEBEC
(418) 686-8666

QUEBEC – Rive-Sud
(450) 463-5500

REGINA
(306) 352-5005

RICHMOND
(604) 713-7888

ROSEDALE
(416) 335-6340

SAINT JOHN
(506) 634-8021

SALMON ARM
(250) 804-2125

SASKATOON
(306) 665-5300

SCARBOROUGH
(416) 296-0043

SIDNEY
(250) 656-9393

SOUTH GRANVILLE
(604) 731-7744

ST. CATHARINES
(905) 641-7700

ST. JOHN’S
(709) 576-1305

SUDBURY
(705) 674-8558

THUNDER BAY
(807) 626-5180

TORONTO – Scotia Plaza
11th Floor
(416) 862-3110

TORONTO – Scotia Plaza
Head Office Branch
15th Floor
(416) 863-7272

TORONTO – Scotia Plaza
48th Floor
(416) 945-4048

TORONTO – Eglinton (Uptown)
(416) 945-4840

TORONTO
Personal Inv. Management
Group
(416) 865-6400

TORONTO – North Toronto
(416) 226-9505

TRURO-
(902) 896-7741

VANCOUVER
(604) 661-7400

VANCOUVER – North
(604) 981-7600

VANCOUVER – West
(604) 913-7000

VERNON
(250) 549-3411

VICTORIA
(250) 389-2110

WELLAND
(905) 732-7200

WHITBY
(905) 444-4500

WHITE ROCK
(604) 531-3500

WINDSOR
(519) 258-1050

WINNIPEG
(204) 944-0025

YARMOUTH
(902) 742-0040