

Inside **INNOVA**

Solid. Stable. Considered.

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2011: A not so fond farewell

From the mounting European debt crisis that has called into question the fate of the euro, to the U.S. government's failure to deal with its escalating debt levels, the past year has been historic on so many fronts, causing intense financial strain and rocking markets worldwide. But headline-dominating events overshadowed some bright spots in the market.

Politics governed the markets

The key preoccupation in 2011 was the political struggle among the eurozone's 17 member nations to deal with their escalating sovereign debt crisis and the need for increased fiscal coordination. Countries such as Greece, Spain and Italy dealt with mounting pressure from bond markets to restructure their domestic finances to return to solvency and create a path towards debt reduction.

Politics also loomed large in the U.S., where the government faced self-imposed deadlines to deal with its debt issues. In

November, U.S. Congressional "Super Committee" negotiations resulted in a deadlock, which will prompt automatic cuts in 2013, after the election in November 2012.

U.S. fixed income, corporate strength surprised

The year belonged to North American fixed income

markets. Investors sought the security and safety of Treasuries, as the global economy slowed in the face of European debt concerns and tightening monetary conditions in China due to rising inflation. In Europe, the levels of debt reached a "tipping point" where new funding was less available and re-structuring was inevitable. Rating agencies played a significant role, as they more promptly downgraded countries in bad shape. Inter-

estingly, while U.S. debt lost its AAA rating, the country continues to access low-cost funding on the weakness of alternatives and its status as a reserve currency.

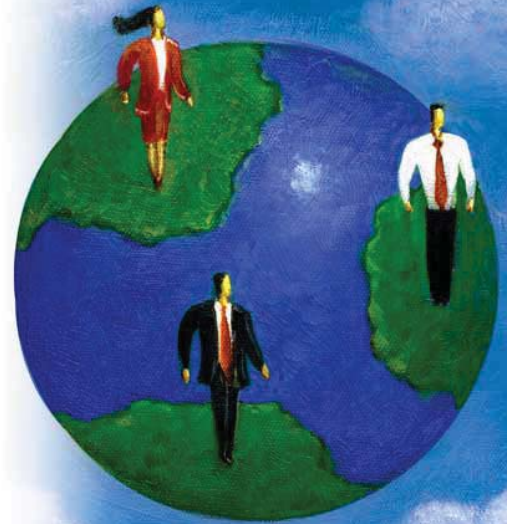
2011 was also marked by the remarkable strength of corporate profits. Earnings growth generally exceeded expectations, due to modest

revenue growth and good cost controls. Although companies were reluctant to hire, causing unemployment to remain high, they did spend on technology to enhance productivity, which resulted in strong profit margins. Many companies selling to emerging markets also benefited from strong growth in that region.

The way forward

While 2011 was undeniably challenging, the good news is that politicians are now very much engaged in resolving their economic challenges and key players recognize the stakes and the sense

of urgency. While governments rarely create growth, they can provide conditions to facilitate it. Conditions in credit markets are also improving, as the prospects for political solutions in Europe emerge. It is too early for broad optimism, but making greater European Central Bank support conditional on



revising the euro treaty is a promising step.

The outlook for 2012 hinges on politicians' ability to agree upon solutions to manage the debt and deficits they face before austerity measures cause a knock-on effect of slower growth, weaker earnings expansion and lower equity markets. The consensus

is now for slow growth and impending recession in Europe. However, it is still possible for markets to surprise on the upside in 2012 and there should be opportunities to buy high-quality companies with record amounts of cash on their balance sheets at very attractive valuations. ■

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A new breed of private investment management
... a timeless approach to achieving your financial goals.

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Top 12 for 2012

Wes Mills, Chief Investment Officer, Scotia Asset Management L.P.



The future ain't what it used to be," said Yogi Berra. Following an eventful 2011, this quote from the famed New York Yankee catcher rings true. As we turn the page to 2012, CIO Wes Mills – drawing on his 25 years of industry experience and input from the Investment Strategy Committee – highlights 12 potential challenges and opportunities for the year ahead.

1. Europe goes into recession and the European Central Bank (ECB) cuts interest rates to new lows. ECB lending to banks is supportive of sovereign debt in core countries (such as Germany, France and Italy). ECB President Mario Draghi has indicated a greater willingness to be both pro-growth and anti-inflation compared to his predecessor.

2. Greece fails to meet deficit targets and contagion spreads to core Eurozone countries. Civic unrest resumes and calls mount for Greece to leave the euro. Credit spreads still suggest a high probability of default by Greece. The debt-to-GDP ratio is still high at over 120%, making it difficult to reverse the negative trend



without currency devaluation.

3. Sanctions against Iran fail to stop its nuclear enrichment program. The oil embargo is threatened by Europe (under pressure from the U.S.), resulting in a spike in oil prices and domestic unrest.

4. China eases monetary policy, as commodity prices pull back and inflation pressures recede. This should help prevent a slowdown and

continue to help drive global growth and equities.

5. U.S. corporate earnings continue to surprise on the upside, with low interest rates and a weaker dollar. Companies continue to cut costs and manage profitability.

6. U.S. President Barack Obama shifts policy modestly to the right in an effort to garner independent votes. The Republicans struggle to select a candidate they can get behind. Mitt Romney, former Governor of Massachusetts, is the favourite, but the right is split on supporting him. The election remains too early to call, as voter antipathy outweighs apathy. Republican presidents are generally more supportive of business than

Democrat presidents.

7. Oil prices decline and then rally. In the first half of the year, oil prices drop due to slower growth. In the second half, prices rise, due to accommodative policies, emerging markets demand and greater OPEC (Organization of Petroleum Exporting Countries) discipline.



8. The U.S. housing market finally bottoms giving support to the banking sector. Low interest rates combined with modest job growth improve confidence and increase sales.

9. Dividend-growing and -paying stocks continue to outperform as fixed income rates reach historically low levels and

investors look for safe alternatives. Valuations on defensive stocks hit new highs and companies seek to raise their dividends as income generation remains a dominant investment theme.

10. Investor sentiment improves as contagion risks abate. Credit spreads narrow and volatility decreases on improving debt outlook for Europe. In the second half of the year, equities become more attractive due to compelling valuations.

11. Canadian equities rebound after lacklustre performance in 2011. Resource stocks gain favour as the global economy recovers. Financial stocks provide steady dividends and modest capital gains.

12. Canada wins more gold medals at this year's Olympics than it did in Beijing four years ago. ■



Words from the wise

Pearls of wisdom from some of our top investment minds

"We believe that dividend-paying stocks are in a structural bull market – and will benefit from both an aging demographic and a low interest rate environment."

Jason Gibbs, Portfolio Advisor of Scotia Canadian Dividend Fund

"Headline risk will impact North American equity markets until a workable resolution to the European debt crisis is presented along with some evidence that a plan is being executed."

Sue Lavigne, Portfolio Advisor of Scotia Private Canadian Equity Pool

"We believe that U.S. stock market outperformance versus the rest of the world will continue into 2012. History has shown that when the U.S. dollar rises, the price-to-earnings multiple of the S&P 500 Index also tends to expand."

David L. Fingold, Portfolio Advisor of Scotia Private U.S. Equity Pool

"Low valuations have provided an opportunity to buy high-quality businesses at a discount, in today's uncertain macro-economic environment."

William Fries, Portfolio Advisor of Scotia Private International Core Equity Pool

"With interest rates low in Canada and the economy not likely to fall into recession, we expect the fixed income market to change from a capital gains focus, as rates fall, to more of an income focus, with steady to slightly higher rates in 2012."

Romas Budd, Portfolio Advisor of Scotia Canadian Income Fund

Time-tested investing principles



Despite what you might sometimes hear or read there is no iron-clad strategy for success in every market environment and there will be bumps along the way. That said, there are time-tested investment principles that can help you achieve long-term success. Here are a few we especially like:

Fortune favours the patient investor.

While the world is putting so much emphasis on short-term results, maintaining a long-term perspective is more important than ever. Since 1960, stocks posted positive

one-year returns 71% of the time, positive three-year returns 84% of the time and positive five-year returns 100% of the time.*

Trees don't grow to the sky.

Market segments can soar - often for extended periods - but can also land with a thud. Asset allocation and diversification are important risk mitigation tools against market extremes.

Don't follow the crowd.

It's counterintuitive, but sometimes the best advice is to look at what everyone else

is doing - and do the opposite.

Know thyself.

Know your risk tolerance before you start investing - it's one of the most important things you can do. After all, the time to assess how much you can afford to lose is before a market downturn, not after one.

Mediocrity moves around more than quality.

Experience demonstrates that not only do quality securities protect on the downside, they also provide good long-term results. While price is an important element of

the investment decision, the quality of a business is even more so.

Investing takes place in the real world and sometimes the unthinkable happens. At the advent of 2011, would you have predicted a near default for Greek debt and the U.S. losing its AAA credit rating? There's no silver bullet for completely avoiding market events, but with a long-term disciplined approach and experienced portfolio management at the helm there's a higher probability of a silver lining. ■

* Source: Morningstar Direct. One year stats based on the calendar year returns of the S&P/TSX Composite Total Return Index from 1960 to 2011. Three- and five- year stats based on 3-year and 5-year rolling returns ending December 31 of the S&P/TSX Total Return Composite Index from 1960 to 2011.

Solid, stable, considered Adding unique value to your investments

Scotia **INNOVA** Portfolios offer exclusive investment management expertise, risk-adjusted performance potential and comprehensive portfolio diversification in the simplicity of a single investment. They are broad enough to encompass global opportunities, yet flexible enough to capitalize on promising individual securities.

Benefits:

- Exclusive investment management
- Enhanced potential
- Comprehensive diversification

With a higher initial investment minimum, Scotia **INNOVA** Portfolios are designed to offer the potential for growth with strong downside protection - ideally suited for investors looking for the next level in professional portfolio management.

Monthly cash flow option

Scotia **INNOVA** Portfolios Series T combines consistent monthly cash flow and the potential for greater tax efficiency with the same convenience, exclusive

investment management and comprehensive diversification as Scotia **INNOVA** Portfolios.

The Series T Portfolios address the growing need for predictable distributions for investors nearing or in retirement. With interest rates at historical lows, the Series T Portfolios offer investors regular income that might otherwise be difficult to achieve in today's low interest rate environment. The cash flow strategy of each Series T Portfolio is aligned against its growth potential in order to better sustain investors' long-term cash flow needs.

As long as the Portfolios perform at a rate that exceeds their prescribed payout rate, the investment will continue to grow.

Who can benefit?

Scotia **INNOVA** Portfolios Series T may be suitable for the following non-registered investors:

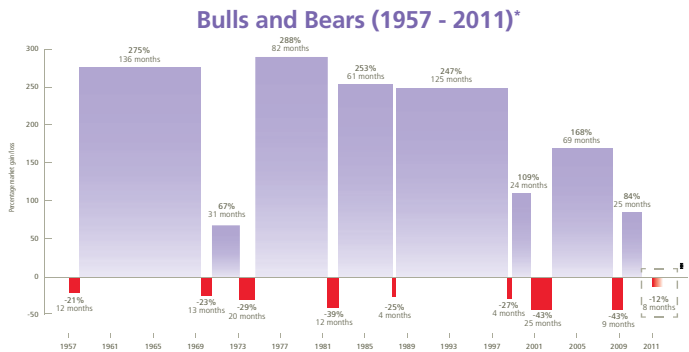
- Investors nearing or in retirement that want to complement other income-oriented investments in their portfolio.
- Investors looking to augment their fixed term investments with a professionally managed income solution. ■

For more information on Scotia **INNOVA** Portfolios Series T, speak to a Scotia® advisor or visit our website at www.scotiafunds.com.

A disciplined approach

Whether it's the great crashes of 1929 and 1987, the oil crisis in the 1970s, the implosion of the dot com sector in the early 2000s, or the recent credit crisis, downturns have been a recurring feature of Canadian and international equity markets. But after every downturn, markets bounce back and typically with much greater magnitude and duration.

In Canada, this cycle of rising and falling markets - often referred to as 'bulls' and 'bears' - has occurred eight times since 1957. During this period, the average bull market increase was 186% over an average duration of 69 months. On the other hand, the average bear market decrease was 31% over an average duration of 12 months.



Economic shocks, political turmoil, recessions - there will always be a reason not to invest. But investing regularly in a diversified portfolio and staying invested over the long term are strategies that have stood the test of time. ■

*Source: Bloomberg. Month-end data derived from the S&P/TSX Total Return Composite Index (January 31, 1957 - November 30, 2011). The terms bull market and bear market describe upward and downward market trends, respectively. Bull markets are movements in the stock market in which prices are rising and the consensus is that prices will continue moving upward. Bear markets are the opposite - stock prices are falling, and the view is that they will continue falling. In the above illustration, the generally accepted measure of a price increase or decline of 20% or more, respectively, over any given period, has been adopted. ‡ The period from April to November 2011 is not a bear market by these measures and is only captured to illustrate recent market weakness.

Portfolio Performance (as at December 31, 2011)

SCOTIA PORTFOLIOS	3 Mths	6 Mths	1 Yr	2 Yrs	Since Inception*
Scotia INNOVA™ Portfolios					
Scotia INNOVA Income	2.06%	1.38%	3.05%	4.85%	7.27%
Scotia INNOVA Balanced Income	2.43%	-0.60%	1.01%	4.08%	8.06%
Scotia INNOVA Balanced Growth	2.98%	-3.19%	-1.72%	2.97%	8.14%
Scotia INNOVA Growth	3.36%	-5.26%	-3.90%	1.92%	8.73%
Scotia INNOVA Maximum Growth	4.10%	-8.55%	-7.40%	0.30%	8.24%
Scotia INNOVA™ Portfolios CLASS T					
Scotia INNOVA Income	2.06%	1.38%	3.02%	-	4.40%**
Scotia INNOVA Balanced Income	2.43%	-0.60%	1.02%	-	3.68%**
Scotia INNOVA Balanced Growth	2.97%	-3.19%	-1.70%	-	2.41%**

* January 2009

** January 2010

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For a better retirement plan, start planning now.



To create an effective retirement plan, it's first necessary to plan your retirement. What do you see yourself doing once you're no longer tied to a work schedule?

You might be surprised to learn that many people continue to work or even return to work. In fact, according to a recent Scotiabank survey*, 69% expect to continue working after officially retiring.

For some, working in retirement is a conscious decision, and simply the next stage in a comprehensive life strategy. However, according to the survey, of the main driving forces for the decision, 72% of respondents stated a desire to remain mentally active, 57% cited the need for social interaction and only 38% reported financial necessity.

Many people who are in a monetary position to retire comfortably simply haven't taken the time to set up alternate ways to meet their mental and social needs. Of the retirees surveyed, 40% claimed to have done very little or only some retirement planning. The key to avoiding financial or psychological disconnect is to think ahead.

Step by step

Now is a good time to start thinking deeply about what you'll need to do in retirement. Here are some helpful techniques:

Break it down. Planning for a retirement that spans 30 years can seem daunting.

To make the process more manageable, break it down into shorter planning periods of, say, five years. This gives you a more manageable time scale, and also recognizes that your lifestyle is likely to change as you get older. For example, you might plan to work part time for the first five years as you "ease" into your retirement, then you might plan to travel extensively for the next five-year period.

Rate your priorities. Things that are important to you now will continue to be important to you – for example, spending time with your family.

Consider health issues. Your health is likely to influence your retirement lifestyle decisions. For example, you may want to spend the winter months in a climate less physically challenging than Canada's.

Learn from others. Since retirement is uncharted territory for you, it can help to look at the plans others have made. Review the retirement strategy of friends and relatives and consider how these would work for you, in terms of both lifestyle and money. But remember that retirement is very personal – what works for your best friend may not necessarily be the right decision for you.

What will it cost?

By knowing what you want to do in retirement, you can estimate how much income you'll need and when you'll need it. For example, starting a business involves start-up

costs, and travel carries a hefty price tag. If your retirement plans include costly items, you may need to adjust your strategy.

Also consider how your needs may change throughout your retirement years. If you're planning to work part time for the first five years, you may be able to preserve your registered assets by using your earnings to cover living expenses. Then you can then draw on these assets to sustain you through the second five-year stretch.

Your retirement

Some expenses are likely to escalate as you grow older. Among retirees surveyed, rising health-related costs were the second-biggest concern. And some expenses might go down – perhaps substantially if you are like the 41% of survey respondents who plan to downsize their homes.

Planning for retirement involves more than setting aside money. It means thinking about what you want to achieve and how you want to live.

The parameters of your plan will change over time, as your personal and financial situations change. A Scotia advisor can work with you to understand your goals and help create a financial plan that helps you achieve your retirement vision. ■

* Source: Scotiabank Consumer Insights and Measurement (2010)

Top books of 2011

Whether you are curled up in your favourite armchair or sitting behind your office desk, whether you're in the mood for something light-hearted or more literary, we have a book to recommend, which we suspect you'll have a hard time putting down.

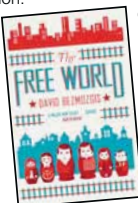
Leisurely reads

The Cat's Table by Michael Ondaatje

The "Cat's Table" refers to the least privileged table in a ship's dining hall and is the focal point of acclaimed author and 2011 Scotiabank Giller Prize finalist Michael Ondaatje's latest novel. From this vantage point, we hear the adventure of an 11-year-old boy on a luxury liner in the early 1950s, headed from Ceylon to London.

The Free World by David Bezmozgis

This Scotiabank Giller Prize finalist tells an absurdist saga of a multi-generational Latvian Jewish family stranded in Rome in the 1970s waiting to secure a visa to the "new world".



The Antagonist

by Lynn Coody
Protagonist Gordon Rankin dutifully lives up to people's perceptions of him until tragedy strikes and he disappears. Twenty years later he discovers that one of his most trusted friends exposes him in a novel that mirrors his life. Scotiabank Giller Prize finalist and well-loved Canadian novelist Lynn Coody provides a big-hearted, contemporary portrait of a man

questioning his sense of self.

Success stories

Steve Jobs by Walter Isaacson

This runaway best-seller recounts the enigmatic life story of the man who arguably revolutionized six industries – personal computers, animated movies, music,



phones, tablet computing and digital publishing.

Great by Choice by Jim Collins and Morten T. Hansen

"A sensible, well-timed and precisely targeted message for companies shaken by macroeconomic crises," says the *Financial Times* of this book from business management and leadership guru Jim Collins.

Quick diversion

Better Living Through Plastic Explosives by Zsuzsi Gartner

This Vancouverite and Scotiabank Giller Prize finalist writes her second collection of gritty and satirical, yet hilarious, short stories spanning topics such as the movie industry, motivational speakers and war photography.



Intellectual pursuits

The Information: A History, a Theory, a Flood by James Gleick

With impressive scope, James Gleick writes a book about "everything, from words themselves to talking drums, writing and lexicography, early attempts at an analytical engine, the telegraph and telephone, ENIAC, and the ubiquitous computers that followed," according to Amazon. ■

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