

Inside **INNOVA**

Solid. Stable. Considered.

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Markets stirred not shaken

From the Olympics to the Queen's Jubilee, there were many memorable moments in 2012 and a few we'd rather forget.

It's hard to believe if you followed the headlines in 2012, but the tonic for healthy market returns included sluggish global economic growth, U.S. political uncertainty and outright recession in the Eurozone.

The antidote to the doom and gloom was a mixture of monetary stimulus, strong corporate earnings and increasing consumer confidence. Despite a reasonable dose of volatility throughout, all in all global financial markets ended the year stirred but not shaken.

Cheers: Monetary Cocktail

Monetary stimulus was on tap in 2012. In Europe, the Draghi Effect helped to partially restore confidence in the much maligned Eurozone economy and bolster the euro. In the U.S., the Federal

Reserve (Fed) played a central role in restoring investors' appetite for risk. 'QE3,' the Fed's third round of quantitative easing, included plans to hold interest rates steady and purchase billions in bonds and mortgage-backed securities to help

stimulate the economy. And in a move that some call QE Infinity, the Fed

recently announced that it will continue its hyper-stimulus policy until the unemployment rate improves to at least 6.5% or inflation exceeds 2.5%.

Corporate Earnings Hold Strong; Consumer Confidence Up

The relative strength of corporations in Canada and the U.S. continued to pleasantly surprise and markets rallied on the news. Resource-rich Canada was open for business in 2012. In December, Chinese state-



owned oil and gas company CNOOC Ltd. was given the green light to purchase Calgary-based Nexen Inc. for a record \$15.1 billion. Progress Energy Resource Corp., another player in the Canadian oil and gas space, was also swept up in December by Malaysian state-owned energy firm Petronas for \$6 billion.

Despite increased concerns over the direction of the U.S. economy, consumer

sentiment on the housing market followed a positive

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Index Performance Year-end (as of December 31, 2012)

- ▲ 16.1% MSCI Emerging Markets Index
- ▲ 14.0% Global equities (MSCI World Index)
- ▲ 13.5% U.S. market (S&P 500 Index)
- ▲ 7.2% Canadian equities (S&P/TSX Composite Index)

Total Return (in Cdn). Source: Bloomberg

Looking ahead in 2013



Wes Mills, Chief Investment Officer, Scotia Asset Management L.P. – highlights potential challenges and opportunities for the year ahead.

"The only function of economic forecasting is to make astrology look respectable." – economist John Kenneth Galbraith

Looking back at my top forecasts for 2012, published in last year's newsletter, I've learned that I'm not much of a sports forecaster. Canada did not win more gold medals at the London Olympics than it did in Beijing.

However, my economic and market forecasts were largely correct. Europe did go into recession, Greece failed to meet its deficit targets and U.S. corporate earnings continued to surprise on the upside.

While forecasting may be helpful, it is not a substitute for a diversified portfolio. Your Scotia advisor can help keep you on the right course to reach your financial goals. With this in mind, here are

some themes to keep an eye on in 2013.

1. U.S. monetary easing ends. Strength in the U.S. economy (such as housing and manufacturing) improves to the point that the U.S. Federal Reserve begins to end the use of "financial repression" through quantitative easing and other measures to



for most, and more so for individuals/couples earning above \$400,000/\$450,000, but the hikes will be less than if a deal had not been reached. While the fiscal cliff has been avoided, there are more difficult mountains to climb. A great deal of uncertainty remains, with the very important issues of fiscal budgeting and debt planning still unresolved. Extraordinary measures will be engaged to allow the government to function until the end of February, by which time a new agreement must be reached. ■

keep interest rates artificially low.

2. The Canadian dollar trends modestly higher versus the U.S. dollar, as foreign inflows from direct and indirect investment continue to make Canada an attractive place to invest.

3. Canadian equities underperform U.S. equities again as resource prices remain soft on increased supply relative to global demand. Emerging markets use resources more efficiently and increase their use of alternatives, lessening their reliance on Canada. U.S. equities perform better given their relatively broader market, which has more growth companies.

4. Angela Merkel is re-elected as Germany's chancellor and remains committed to the euro currency. The recession in Europe ends but growth remains tepid, as structural change is limited.

5. China's new leader, Xi Jinping, grapples with political corruption as well as environmental and social issues, while seeking to shift the economy from exports to consumption. Some progress is made, as growth stays steady at approximately 7.7%.



6. The Japanese yen weakens dramatically following the election of the Liberal Democratic Party, which allows the passage of legislation to support reflation and growth. Export stocks take off and the Nikkei, Japan's stock market index, has the best year in four years.

7. Oil prices in North America test lows of US\$80, as excess supply and limited access to refiners continue to weigh on the industry. Foreign investors remain interested in joint ventures to secure access to relatively cheap energy.

8. Gold trades between US\$1600 and US\$1800, as investors oscillate between worrying about deflation and inflation.

9. Emerging markets have a good year, in spite of range-bound commodity prices. Their domestic economies drive growth and profitability, as the world economy starts to normalize after years of financial shocks.

10. Investors gradually reduce their fixed income exposure for high-quality, dividend-paying equities. Low real yields and an improving outlook

prompt investors to seek ways to enhance their returns, but their preference for high-quality securities to avoid excessive risk favours dividend-paying stocks. ■



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trend in 2012. This, along with rock-bottom interest rates and better unemployment numbers, helped lift overall confidence levels in the second half of the year.

Climb Every Mountain

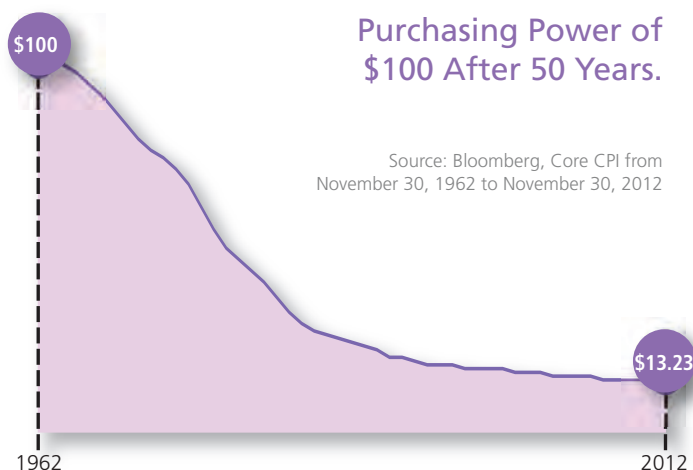
Early into 2013, we witnessed the partial resolution of the fiscal cliff negotiations. As with many political issues, the divided parties held out as long as possible, each petitioning for the most favourable outcome on behalf of their supporters. In the end, taxes will still go up

A nickel ain't worth a dime anymore

With the uncertainty in the markets over the past few years, it's not surprising that some investors have flocked to investments that are less volatile. While investors may feel safer, over the longterm this could undermine their investment goals.

Investors who earn less than the rate of inflation on their investments would be challenged by reduced purchasing power when they convert their investments back to cash. That's because rising prices mean investors will have to pay more for the same goods and services.

Over time, this means that the funds needed to retire comfortably will keep getting higher and higher. In other words, your savings will buy less and you will need to sacrifice or save more to make up the difference. ■



"Investors had a lower risk appetite in 2012 focusing instead on high quality, established businesses and dividend yielding stocks. Looking forward, while valuations look attractive, performance could face headwinds of prolonged low economic growth due to continued deleveraging."

Martin Ferguson, Portfolio Manager Scotia Private Canadian Small Cap Pool, Mawer Investment Management

Portfolio Performance (as at December 31, 2012)

SCOTIA PORTFOLIOS	3 Mths	6 Mths	1 Yr	2 Yrs	3 Yrs	Since Inception
Scotia INNOVA™ Portfolios Series A						
Scotia INNOVA Income	0.89%	2.49%	5.41%	4.22%	5.04%	6.79%*
Scotia INNOVA Balanced Income	1.46%	3.39%	6.58%	3.76%	4.90%	7.68%*
Scotia INNOVA Balanced Growth	2.09%	4.51%	7.70%	2.88%	4.52%	8.03%*
Scotia INNOVA Growth	2.54%	5.32%	8.53%	2.12%	4.08%	8.68%*
Scotia INNOVA Maximum Growth	3.17%	6.48%	9.99%	0.92%	3.43%	8.68%*
Scotia INNOVA™ Portfolios Series T						
Scotia INNOVA Income	0.89%	2.49%	5.42%	4.22%	—	4.87%**
Scotia INNOVA Balanced Income	1.46%	3.39%	6.58%	3.76%	—	4.62%**
Scotia INNOVA Balanced Growth	2.09%	4.51%	7.70%	2.89%	—	4.11%**

* January, 2009

**January, 2010

The indicated rates of return are the historical annual compounded total returns as at December 31, 2012 including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any unitholder that would have reduced returns. The rate of return shown is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the funds or returns on investment in the mutual funds. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

Notable Moments

Most flexible currency: the new Canadian \$20 polymer note. Following on the heels of the \$100 and \$50 bills, the notes are designed to better withstand wear and tear and avert counterfeit attempts.



Biggest celebration: Her Majesty the Queen. Marking her 60th year on the throne, the Queen's Diamond Jubilee was celebrated in royal style, with enough street parties, regattas and crowing ceremonies to last four days.

Biggest over-hyped IPO: Facebook. The May Initial Public Offering was the biggest in internet history, but was all flash and no bang. Contrary to over-the-top expectations, the company's stock fell a nauseating 50% in the three months following the offering. ■



Find Your Winter Wonderland

As Canada's most international bank – we are located in 50 countries and have been operating internationally for over 100 years – our love of globe-trotting is obvious. So we thought we'd share with you what we think are some of the hottest destinations to holiday in during Canada's cold winter months.

Embrace the season in Patagonia

The southernmost tip of South America is known for some of the most dramatic landscapes on earth and whether you are whale watching, penguin spotting or awed by glacial vistas, you'll be celebrating the season for all it's



got to offer. For the truly adventurous, visit Chile's Cape Horn, which marks the northern edge of the Drake Passage, and brave the notoriously treacherous seas to Antarctica.

Soak up some sun in Costa Rica

If winter hats and long underwear leave you cold, consider Costa Rica, dubbed the "beach lover's dream" by Lonely Planet. You can take your pick from upscale Playa

Tamarindo, which has some of the hottest oceanside night spots, the picture-perfect Manzanillo, the



last stop on the Caribbean coast, or Santa Teresa, if you're looking for a more remote place to bask in the sun. Often referred to as the 'Switzerland of Central America,' Costa Rica was also recognized as an excellent and affordable retirement destination in a recent issue of MoneySense.

Step back in time on China's Silk Road

China is renowned for "5000



years of history and 7000 years of culture," and a trip down the Silk Road reflects this like nothing else. Used as a trade passage for more than 2000 years and walked by none other than Marco Polo, the Silk Road is the epitome of a trip down memory lane. Though the road travels as far as Europe, in China alone one passes such ancient sites as the famed Terracotta Army, the spectacular "Thousand Buddha Caves" and the Great Wall of China's best preserved pass at Jiayuguan. ■



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