Inside INNOVA
Solid. Stable. Considered.
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Next Gen Diversification

While the importance of diversification remains a mainstay of sound investing practice, the approach toward diversifying has evolved considerably over time.

Often equated to not putting all your eggs in one basket, diversification is a technique that mixes different types of securities in a portfolio to help smooth out returns over time. The premise is that by including securities that have different reactions to economic trends, as one type of security falls the other should rise, helping to offset the negative effects.

Seems simple enough – and a few decades ago, if you held a proportion of government and corporate bonds, North American and European stocks and some cash you could be confident that your portfolio was effectively diversified.

'Global village' too close for comfort

But the Great Recession of 2008 and 2009 provided a wake-up call that few saw coming – equity markets around the world fell in tandem, seemingly refuting the benefits diversification were meant to bring. So why did traditional diversification fail? Global economies – and markets – had become more closely linked than ever before, as free trade between countries, increased foreign investment and other factors brought the 'global village' together in more ways than one.

When niche becomes mainstream

With greater interdependence between global markets, portfolio diversification has been forced to evolve to provide the same benefits it once did – so a new approach was necessary. This meant looking at diversification from many new and different angles.

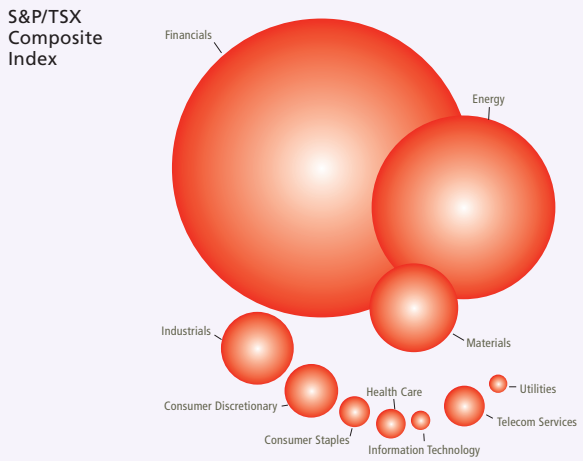
The premise is that by including securities that have different reactions to economic trends – or have a negative correlation to one another – as one type of security falls the other should rise, helping to offset the negative effects.

While North American and European equities remain as typical core building blocks of a balanced portfolio, it has become important to look further afield to a growing number of emerging markets – which tend to have relatively low government

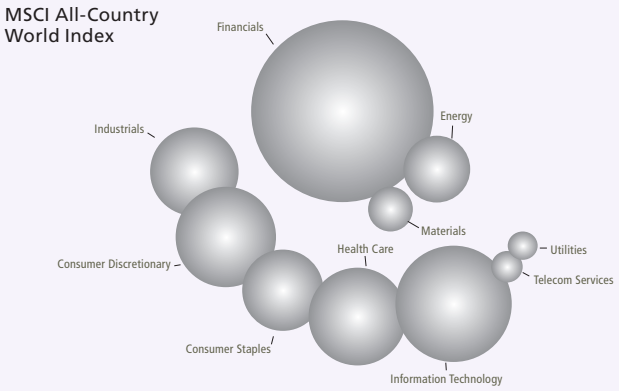
Next Gen Diversification *(continued from page 1)*

debt levels, more rapid economic growth and to be driven by different economic and political factors. In fixed income, while government and high-quality corporate bonds remain core building blocks, with interest rates at historical lows the need for a broader toolkit to generate income and provide portfolio stability has never been greater. When incorporated into a balanced portfolio, specialty fixed income asset classes such as high-yield and floating rate bonds and even emerging market debt can help smooth out returns across a full interest rate cycle. In short, when asset classes are impacted by different drivers of risk and return, the greater the likelihood of avoiding synchronized market movements.

Canada represents a tiny portion of the global stock market. As the illustration below demonstrates, the Canadian stock market is dominated by a few key sectors: financials, energy and materials.



By investing some of a portfolio in foreign markets investors can take advantage of increased sector diversification.



For illustrative purposes only. Chart demonstrates sector weightings in the respective index. Sources: Morningstar. MSCI All-Country World Index as at December 31, 2014. S&P/TSX Composite Index as at December 31, 2014.

Investor psychology has also made it necessary to rethink traditional diversification, as we've seen recently that investments in various asset classes have reacted similarly to market stress – recall the Great Recession, the 'taper tantrum' of 2013 (when the U.S. Federal Reserve indicated it would begin winding down its monetary stimulus) and the ongoing Greek debt crisis.

In response, the performance of many 'traditional' investments have become more closely linked, alternative or 'non-traditional' investments have started to gain credence. Once reserved for only the most sophisticated investors with multi-million dollar portfolios, these investments have expanded over the past few years as they have become increasingly more accessible to individual investors with fewer assets. Non-traditional investments can range from well-known markets such as commodities and real estate to more sophisticated strategies that help minimize volatility, for example.

As markets continue to coalesce and new investment strategies emerge, the obvious challenge for do-it-yourself investors is not just in effectively building a diversified portfolio, but ensuring it remains so over time.

INNOVA is diversified by:
asset class
portfolio manager
geographic region
economic sector
company size
investment approach
strategy

INNOVA – always looking ahead

The Scotia Portfolio Solutions team have a wealth of experience focusing on the complexities of effective diversification. By anticipating – and responding to – evolving long-term market themes, the Portfolios have continually been positioned to help improve downside risk protection for investors.

As a result, Scotia INNOVA Portfolios look very different today than they did when they were launched in 2009. At inception, the Portfolios consisted of only 10 underlying funds, covering all the traditional asset classes. Fast forward to 2015, and the Portfolios now have more than twice as many underlying funds, which encompass preferred shares, emerging market equities, corporate bonds and non-traditional strategies to help reduce volatility. In INNOVA, we even get in the corners of the markets with small allocations to markets as diverse as agriculture, infrastructure and emerging market bonds.

This year's check-up – or

re-optimization – focused on rethinking risk for the Portfolios yet again, with a fresh look at long-term market themes. By adding four new underlying funds within Scotia INNOVA Portfolios, and making further allocation adjustments, the Portfolio Manager now has a broader toolkit to help adapt to ongoing expectations for relatively low interest rates and turbulence in bond prices, as well as additional flexibility to invest in Canadian companies of all sizes, for example.

The more things change, the more they stay the same

While we can't predict which direction markets will take or which strategies will be developed in response, you can be confident that the approach we take to diversification in Scotia INNOVA Portfolios will continue to evolve as long-term themes emerge. ■

Food Fight!

Where Playing With Your Food is Encouraged (At Least Once a Year!)

Most people grow up hearing the words, "don't play with your food" regularly during their childhood. As adults, there are a surprising number of organized events that celebrate just that – playing with food! In many cases, the event is a full on food fight.

From throwing tomatoes at strangers in Spain to rolling entire wheels of cheese down a hill in England, people are willing to book a flight, and, in some cases, join a team to have their chance to "play with their food"!

La Tomatina – (August) – Held each year in Bunol, Spain, thousands of people arrive from all over the world to throw tons of tomatoes at one another. Due to the popularity of this event, a ticket has been required to participate since 2013.

The Battle of the Oranges – (February) – This team-based activity takes place each year in Ivrea, Italy. In order to take part in throwing oranges, you must be part of a local team. By wearing a red hat, spectators can signal their desire to not be a target.

Tunarama – (January) – Rather than throwing tuna at other participants, this competition in Tuna, Australia is strictly about personal bests. The person who throws their tuna the furthest has both bragging rights and the title of Tuna Toss World Champion!

Coxheath World Custard Pie Championship – (May or June) – This activity, which takes place every year in England, has a dress code. Participants dress up in their finest with a goal of hitting as many people in the face with a custard pie for maximum points. Judges are also able to award points for originality and throwing technique.

Cheese Rolling – (May) – Every Spring, participants gather at the top of Cooper's Hill in England and race their competitors to be the first to capture the large wheel of cheese careening down in front of them. First to catch it gets to keep it! ■

Portfolio Performance (%) as at June 30, 2015

SCOTIA INNOVA PORTFOLIOS	3 Mth	6 Mth	1 Yr	3 Yr	5 Yr	Since Inception
Scotia INNOVA® Portfolios Series A						
Scotia INNOVA Income	-1.89	1.38	3.86	5.06	5.27	6.12*
Scotia INNOVA Balanced Income	-1.88	2.02	4.71	6.84	6.35	7.35*
Scotia INNOVA Balanced Growth	-1.86	3.19	6.49	9.58	7.92	8.66*
Scotia INNOVA Growth	-2.10	4.05	7.56	11.69	9.06	9.90*
Scotia INNOVA Maximum Growth	-1.91	5.50	9.25	14.94	10.87	11.19*

Commissions, trailing commissions, management fees and expenses may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed or insured by the Canada Deposit Insurance Corporation or any other government deposit insurer, their values change frequently and past performance may not be repeated. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and does not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns.

* January 2009

A LOOk at the Markets

Bank of Canada cuts interest rates a quarter point.


Cloudy

For the second time in 2015, Bank of Canada (BoC) Governor Stephen Poloz cut the benchmark interest rate by 0.25%, lowering it to 0.50%. In its statement, the BoC noted the impact of lower oil prices on the economy, as well as weaker-than-expected exports, which have caused growth to come in softer than originally forecast by the BoC. "Canada's economy is undergoing a significant and complex adjustment," said the BoC's statement, adding that "additional monetary stimulus is required at this time to help return the economy to full capacity and inflation sustainably."

U.S. Fed needs to see more before rate hike.


Sunny with Clouds

The U.S. Federal Reserve (Fed) held rates steady for a record 78th consecutive month in June, stating that it would like to see "further improvement in the labour market and is reasonably confident that inflation will move back to its 2.0% objective over the medium term." While a rate hike over the short-term was unlikely due to the GDP growth rate slowing in the first quarter, employment continued to improve and business investment was strong. U.S. equities were relatively flat over the quarter, as investors decided to take a wait-and-see approach to the Fed's actions.

Greece reaches deal with its creditors.


Rainy

Greece has reached a preliminary deal with its creditors, pledging to pass a series of austerity measures through its parliament in order to unlock additional funding from the International Monetary Fund (IMF), European Commission (EC) and European Central Bank (ECB); also known as the "troika." The country's legislators passed the measures by a vote of 229-64 in mid-July, prompting protests in the streets of Athens. Despite dominating the headlines, it is important to remember that Greece makes up a relatively small portion of Europe's GDP (approximately 1.50%). ■

Market Performance (YTD Total Returns in CAD as at June 30, 2015)

0.91%	8.80%	10.67%	10.75%	2.37%
S&P/TSX Composite Index	S&P 500 Index	MSCI World Index	MSCI Emerging Markets Index	FTSE TMX Canada Universe Bond

Source: Bloomberg

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