

SCPI Naughty & Nice List

Best & Worst Commodity Performers of 2017

Nice — Best Performers

1. Cobalt (+127%)
2. Palladium (+51%)
3. Lumber (+36%)

Naughty — Worst Performers

1. Natural Gas (-27%)
2. Canadian Heavy Oil (-14%)
3. Iron Ore (-12%)

Commodity producers are expected to enjoy a happy holiday this year as synchronized global growth supports robust industrial demand just as many commodities are coming to the end of their investment cycle in new output capacity. While most commodities fared well through 2017, outperformers were driven higher by a combination of strong demand and inflexible by-product supply (cobalt and palladium) or exogenous events like trade action and forest fires (lumber). Against this backdrop of broad commodity sector strength, underperformers were those already expected to experience price rationalization (iron ore), suffered from poor luck (natural gas, e.g. warm weather), or are struggling against idiosyncratic headwinds like infrastructure constraints and pipeline outages (Canadian heavy oil).

NICE: BEST PERFORMING COMMODITIES OF 2017

Cobalt: EV Excitement Electrifies Market for Battery Feedstock

Cobalt rode the feverish buzz around electric vehicles (EVs) and growing concerns about future supply availability to the top spot among commodities in 2017, mirroring lithium's 2016 gains on similar themes (chart 2). This recent spell of outperformance comes after a decade of chronic oversupply and meandering prices in the \$12–20/lb range, but cobalt is making up for lost time and has more than doubled this year to \$33/lb. Cobalt's fortune has come on the back of positive sentiment, strong demand prospects, and inelastic, unresponsive supply.

On the demand side, the world is increasingly running on battery power and cobalt is a core feedstock for most battery chemistries; in fact, despite lithium's stronger name association (i.e. "lithium-ion batteries"), cobalt is more leveraged toward energy storage demand—48% of cobalt ended up in battery packs vs only 34% of lithium last year. The present excitement around electric vehicles is the perfect driver of a bull market for cobalt, with estimated future battery demand far outstripping current global production capacity, even under conservative adoption scenarios.

If this were the copper market (and copper will enjoy its own EV tailwinds), surging prices would prompt a commensurate scramble by global miners to supply more metal to the market and cash in on the windfall. Unfortunately, cobalt is not blessed with elastic supply. Cobalt's seeming price disinterest stems from the metal's by-product status, with virtually all cobalt supply sourced from copper and nickel mines. This by-product status helps explain why the market was able to remain in surplus for so long: low cobalt prices amid weak demand were unable to prompt any material supply rationalization when copper and nickel prices were

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Chart 1

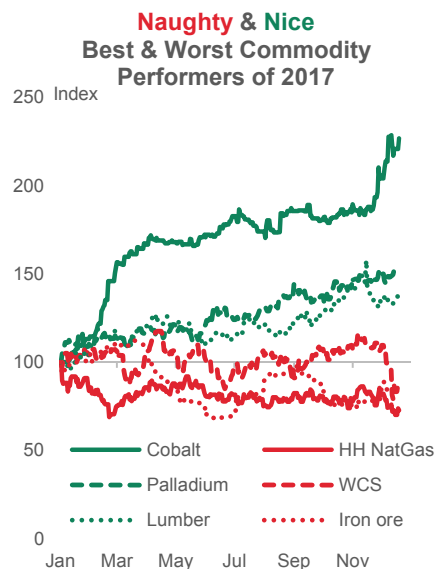


Table 1

Scotiabank Commodity Price Index			
	November 2017		
	(% change)		
	MM	Y/Y	YTD
All Commodity*	3.6	18.4	21.1
Industrials	3.8	19.6	24.3
Oil & Gas	6.9	30.6	32.5
Metal & Minerals	1.8	6.5	22.1
Forest Products	2.4	28.1	16.2
Agriculture	2.7	13.0	8.6
	January 2007 = 100		
	2017		
	Nov	Oct	YTD avg.
All Commodity	115.6	111.5	108.9
Industrials	112.4	108.3	104.8
Oil & Gas	90.8	85.0	82.6
Metal & Minerals	121.9	119.8	119.4
Forest Products	151.6	148.0	135.5
Agriculture	132.9	129.5	131.2

* Weights: Oil & Gas (39.9%), Metal & Minerals (30.1%), Forest Products (14.7%), Agriculture (15.3%); Full technical note on page 8.

soaring. The reverse is true today: high cobalt prices aren't going to bring more cobalt to the market, but higher copper and nickel prices likely will.

The rally has also been fueled by the issue of cobalt's political risk profile, which is strained. Geological history saw fit to concentrate roughly half of known cobalt reserves in the Democratic Republic of Congo (DRC), which suffers from a decades-long civil conflict and ranks near the very bottom among the world's countries on the UN's Human Development Index. The DRC accounted for 63% of cobalt supply in 2016, almost twice the production share that OPEC collectively holds in the global oil market. Soaring prices have investors looking to invest in cobalt production in more stable regions, but it is very likely that the DRC will maintain its market share as mining firms continue to expand domestic copper production.

Palladium: Strong Demand & Flat Supply Continues to Erode Inventory Position

Palladium has experienced a similar story to cobalt, with steadily rising demand meeting a supply situation constrained by its by-product status and thus driven by the investment cycle of other metals. But while cobalt is catching a bid on rising EV prospects, palladium demand is driven by classic internal combustion engines, which consume roughly 80% of available palladium in the form of autocatalyst to reduce emissions intensity (chart 3).

Record global auto sales and increasingly stringent environmental regulations—which increase the volume of catalyst required per vehicle—have kept palladium demand growing at a healthy pace. This industrial strength is expected to continue, with all major developed and developing markets experiencing synchronized growth in 2017 for the first time since the Global Financial Crisis. Manufacturing indicators are all pointing to continued gains through 2018 as advanced economies return to industrial growth.

Palladium also suffers the by-product curse on the supply side of its ledger, with output driven by what's happening in bigger markets, namely platinum and nickel. Unfortunately for those hoping for more palladium supply in the near future, both platinum and nickel are experiencing weak price environments. Nickel prices have languished under a decade of surplus production and the metal's mountain of accumulated inventories will need to be worked down before new nickel mines are sanctioned that could alleviate some of palladium's current tightness. Similarly, platinum has experienced a multi-year bear market coming off the precious metal highs of 2012. Palladium typically trades at a steep discount to platinum, which shares a stronger relationship with gold and is more affected by monetary policy and interest rate trends than palladium. However, palladium prices outpaced those of platinum in 2017 for the first time since 2001 on the back of palladium's bull market running up against broader precious metals weakness stemming from rising interest rates as well as platinum's negative sentiment hit due to the diesel emissions scandals in Europe—platinum is used as an autocatalyst in diesel vehicles whereas palladium is primarily used in gasoline-fueled vehicles.

Despite a promising fundamental outlook, however, much of palladium's recent outperformance has been fueled by surging speculative activity, which will need to normalize over the coming year as investors take profits from this latest upswing. Deficits are expected to persist through the forecast horizon (chart 4) though inventory levels remain sufficient; despite a 20% drawdown over the past five years, stocks remain high relative to the demand cover enjoyed by other major metals.

Chart 2

Cobalt's 2017 Rally Mirrors Lithium's 2016 Run on Similar Themes

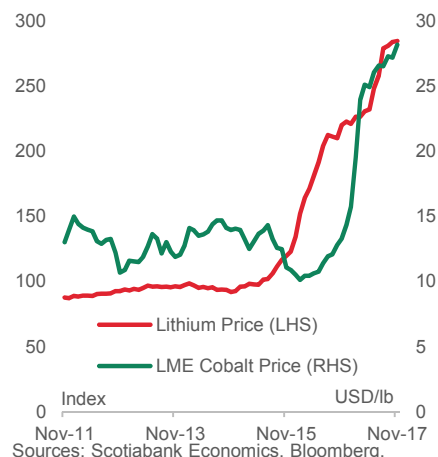


Chart 3

Palladium Consumption Driven Higher by Autocatalyst Demand

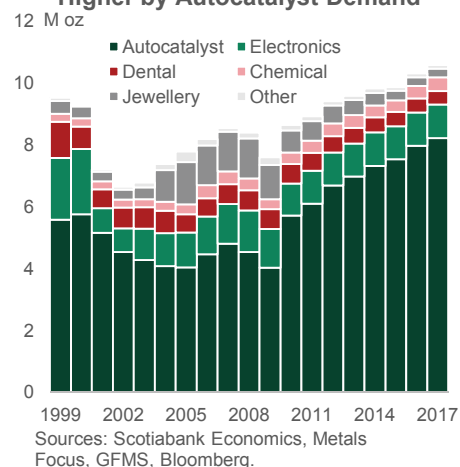
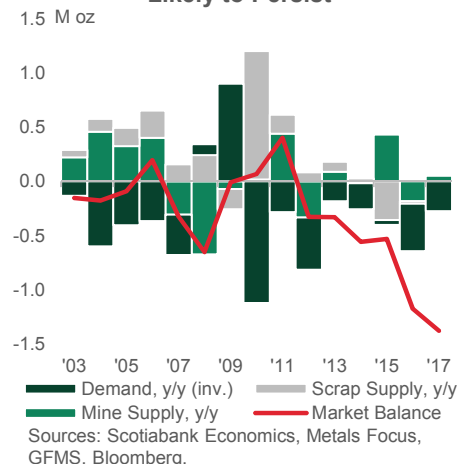


Chart 4

Palladium's Supply Deficit Likely to Persist



Lumber: Firm Demand Running Up Against Pricier Supply Curve

Lumber rounded out the top three commodity performers of the year as prices soared 36% year-to-date to \$431/mbf on continued growth in housing sector demand and a supply curve that has been made pricier by the latest flare-up in the decades-long softwood trade dispute between Ottawa and Washington. On top of the already strained situation, the worst wildfire season on record in British Columbia reduced the province’s allowable cut and further tightened supply.

Lumber consumption continues to rise on the back of strengthening US housing activity (chart 5). US housing starts are expected to continue rising through the forecast horizon and appear to be leveraged toward more lumber-intensive single-family units, where starts hit their highest level since prior to the financial crisis. We are also seeing a temporary boost to housing starts and refurbishment & repair activity related to post-hurricane rebuilding along the US Gulf Coast.

This rising demand pushes equilibrium prices further up the North American capacity curve, which itself is being shifted higher by the duties levied by the US in the latest round of the US-Canada softwood lumber dispute. The US consumes more lumber than it has the capacity to produce, requiring Canadian lumber imports to make up the difference. Demand for softwood lumber—used primarily in the construction and refurbishment of houses as well as the manufacture of consumer goods like box springs and couches—is relatively inelastic. Lumber accounts for a small component of overall home-building costs and neither homebuilders nor buyers are likely to materially change behaviour due to a \$1,000–2,000 increase in the price of a home. The effect of the latest volley of countervailing and anti-dumping duties on Canadian softwood lumber exports, then, is a price increase that is absorbed by US consumers as Canadian lumber is shifted higher on the regional cost curve (chart 6).

The impact of the US-Canada trade dispute was exacerbated by reduced supply from British Columbia, which is experienced its worst wildfire season on record—1.2 M ha burned relative to a 10-year average of only 0.16 M ha. The reduction in allowable cut impacted the feedstock for BC mills, which saw capacity utilization fall to only 78% in August from 88% in the same period last year.

NAUGHTY: WORST PERFORMING COMMODITIES OF 2017

Natural Gas: Warm Weather Suppresses Heating Demand as Supply Surges

North American natural gas was the worst performer within the commodities complex in 2017 as warmer winter weather suppressed heating demand and failed to tighten a market overwhelmed by robust US supply growth; benchmark Henry Hub prices are down 27% year-to-date and this price pain was amplified for Western Canadian gas, with AECO prices down 44%.

Natural gas production growth has been remarkably strong this year as previously-stranded supply in the prolific Marcellus and Utica basins was unlocked by new pipeline connections and associated gas output got a boost from a rise in oil drilling on the back of rising crude prices. Natural gas prices around \$3/MMbtu (Henry Hub) appear sufficient to continue incentivizing more gas to market and are expected to persist through end-decade, with material moves above or below the rough \$3 anchor only expected on significant temperature deviations.

Chart 5

Starts & Improvements to Drive N. American Lumber Demand Higher

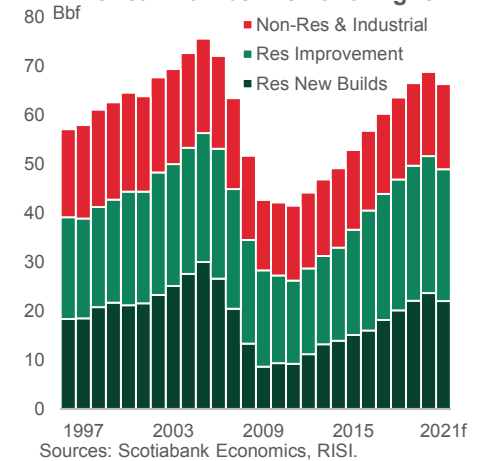


Chart 6

Duties Shift N. American Softwood Cost Curve Higher

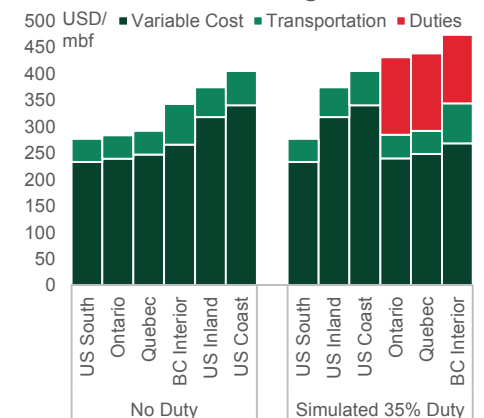
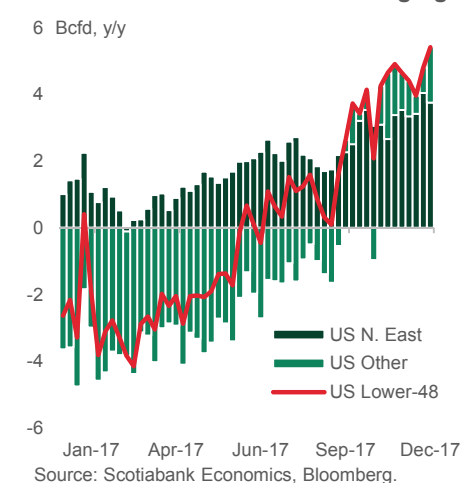


Chart 7

US Natural Gas Production Surging



Against this backdrop of plentiful near-term supply, activity in three key demand segments is driving price formation: residential heating consumption, power sector feedstock, and LNG export volumes. A warm start to the winter season has tempered bullish expectations coming off a strong injection season exit. With US natural gas inventories near their 5-year average level, prices are expected to evolve largely in line with the weather over the coming season. A return to more typical winter temperatures is expected to keep inventories in check and support prices back above \$3/MMbtu; however, a continuation of the recent spell of warmer weather will tip seasonally-adjusted balances back into surplus and likely bring prices down to the \$2.80–\$3.00/MMbtu level. Power sector demand has fluctuated through 2017, at first suffering from cooler weather that eroded some air conditioner demand and some economic switching back to coal from higher-priced gas, then rebounding to similar levels seen in 2016 as temperatures normalized and supply drove down prices, incentivizing a feedstock switch back to gas. Overall, power sector demand is relatively flat in 2017 but we continue to anticipate structural gains in this consumption segment as more natural gas power plants begin operation. Finally, LNG exports through the fall came in slightly weaker than expected given the slower ramp up of the Cove Point export terminal, though we anticipate a trebling of export capacity from current levels to roughly 9 Bcfd by the end of 2019.

WCS Crude Oil: Keystone Outage Accelerated Takeaway Concerns

While global crude oil markets have strengthened this year on strong demand growth and OPEC+ supply restraint, Canadian heavy oil (Western Canadian Select, or WCS) has weakened, both in absolute terms (down 14% year-to-date) and in terms of its discount to WTI (from \$15 to \$25/bbl). The widening of the WCS-WTI differential was an anticipated development as growing Canadian crude production was expected to overwhelm pipeline takeaway capacity over the next two years, but the November spill and subsequent two-week outage of the Keystone pipeline accelerated this dynamic.

Pipeline bottlenecks and insufficient takeaway capacity have been long-running themes in the Canadian oil industry (chart 9). The WCS-WTI differential was forecast to widen in 2018–19 as production growth—buttressed by the ramp up of the Fort Hills and Horizon oil sands projects—outstripped pipeline capacity and pushed barrels onto higher-priced rail to get to end markets. Even if rail wasn't able to absorb all of the additional supply, in-province storage stood in the wings as a final pressure valve that could hold those barrels until new pipelines entered service. Now, however, much of that inventory cushion has been prematurely filled by barrels that would have otherwise headed south on the Keystone pipeline during the two-week outage (chart 10).

Rail has also been slow to fill the near-term gap. Rail companies are hesitant to jump back into the oil-by-rail business after getting burned in the aftermath of the post-2014 oil rout. Firms had invested in additional tank cars and loading terminals given surging demand for oil sector rail transport through 2012–14, but demand fell far short of expectations after prices plunged and oil patch activity slowed. Now, rail firms are requiring longer-term commitments for rail capacity before agreeing to ship oil in their tank cars, hedging some of the risk that this latest blow-out in the WCS-WTI differential that has made rail transport economical will be a short-lived phenomenon.

Chart 8

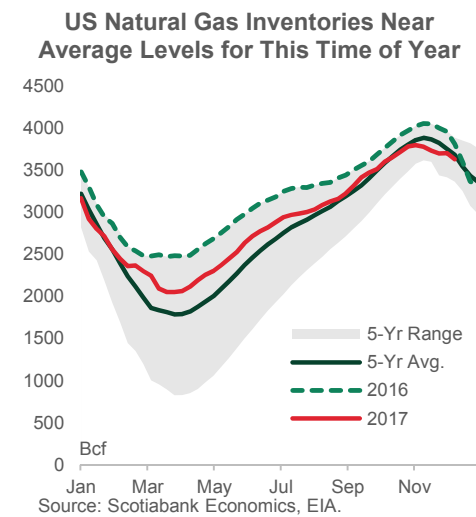


Chart 9

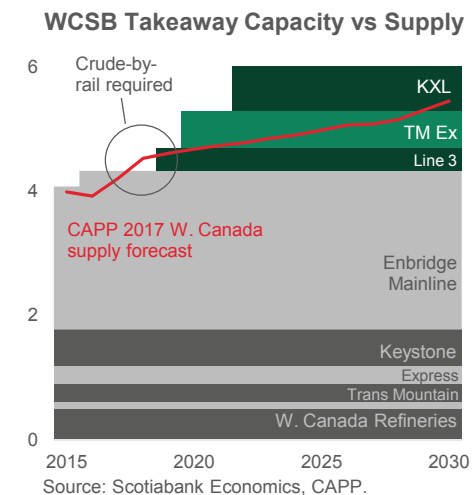
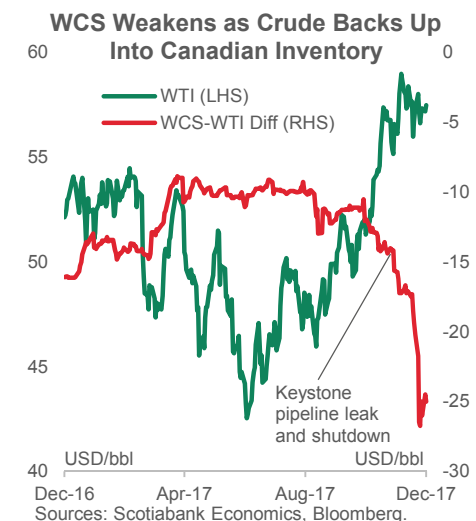


Chart 10



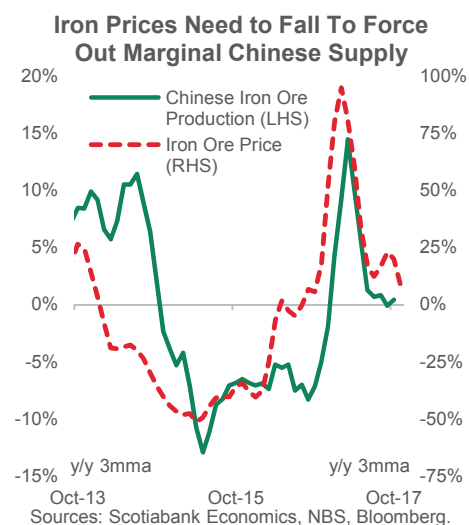
However, we anticipate that takeaway tightness and wider differentials will be with us for at least the next 18 months, and expect oil firms to agree to longer-term commitments in order to get their barrels to market, bringing the differential back down to average ~\$18/bbl in 2018 from a peak of near \$30/bbl earlier this month. Some of this takeaway tightness will be alleviated by the smaller pipeline start-ups and the ramp up of the Sturgeon oil refinery in Alberta, but WCS-WTI differentials in the high teens are now expected to persist until one of the major pipeline projects—namely the Trans Mountain Expansion and the Keystone Pipeline Expansion—commence operations in late-2019 or early 2020.

Iron Ore: Weak Performance was Expected as Lower Prices Rationalize Supply

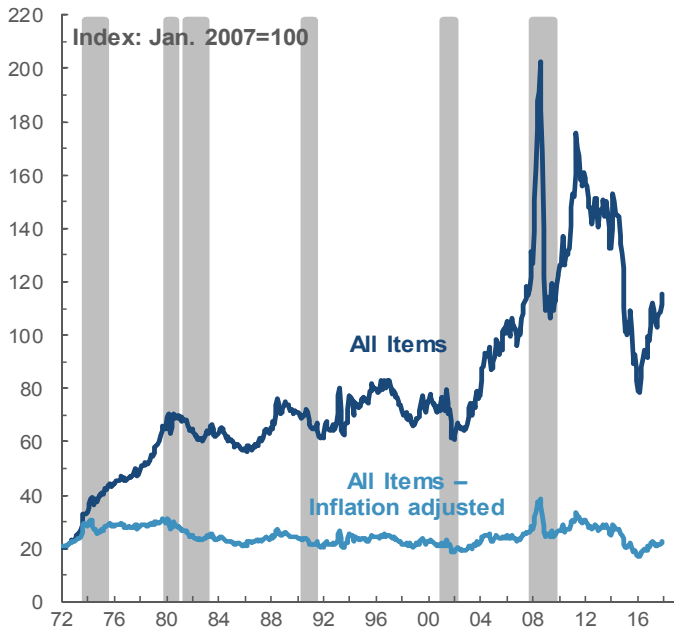
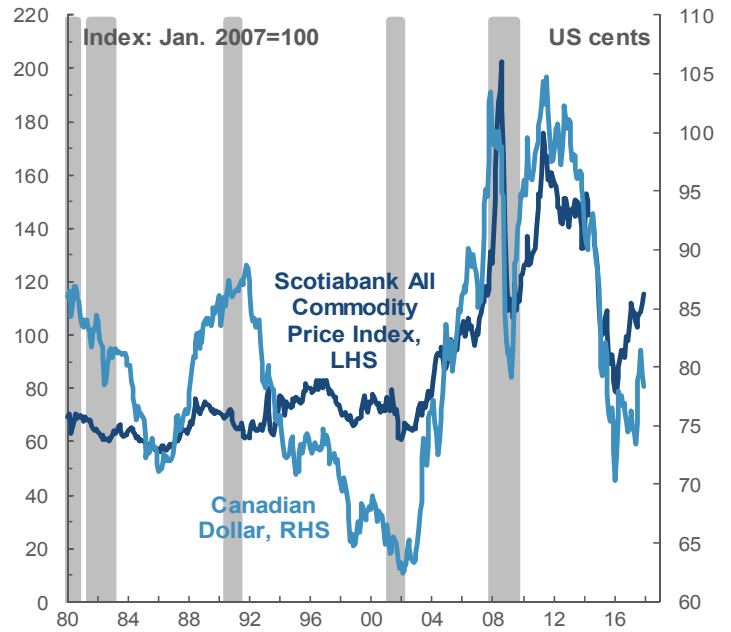
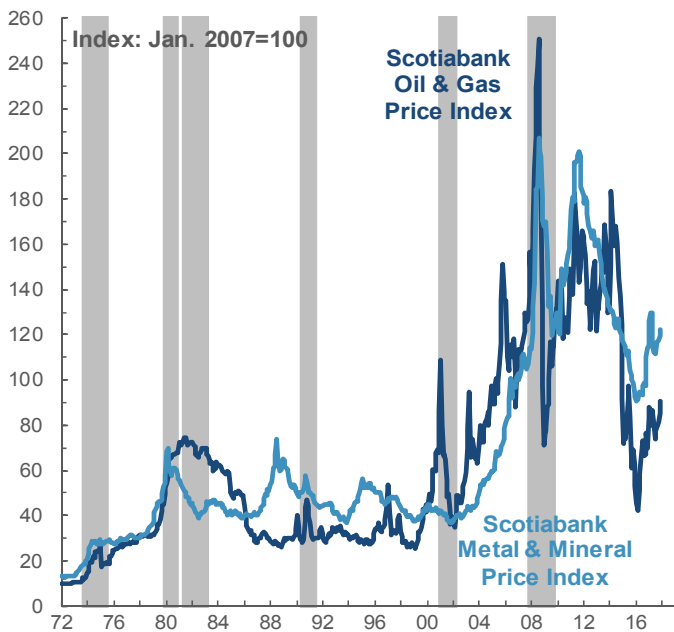
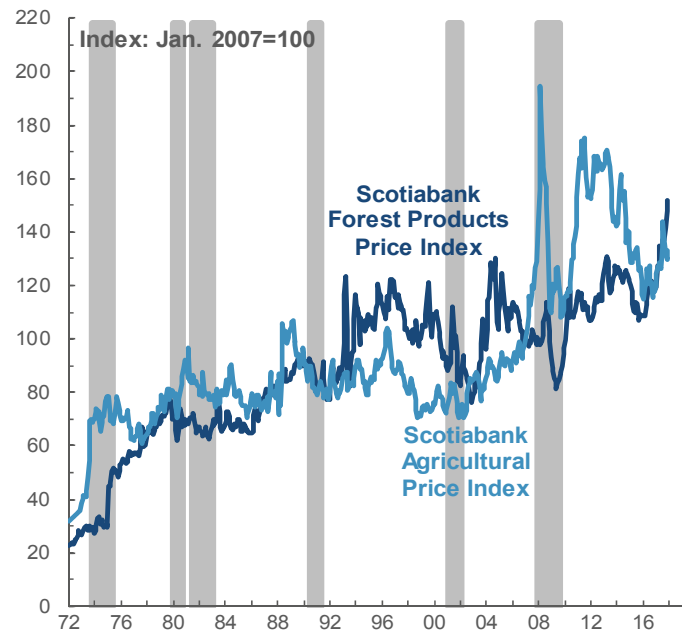
Iron ore missed out on the rally enjoyed by the base metals as flattening seaborne demand ran up against a supply-side coming off a multi-year investment cycle. With demand flat, lower prices were needed to balance the market by flushing out higher cost, lower efficiency producers, particularly in China (chart 11). This price weakness was an expected development coming off a surprisingly strong 2016 for the steel complex and we anticipate that iron ore will remain range-bound around \$60 per tonne through the forecast horizon.

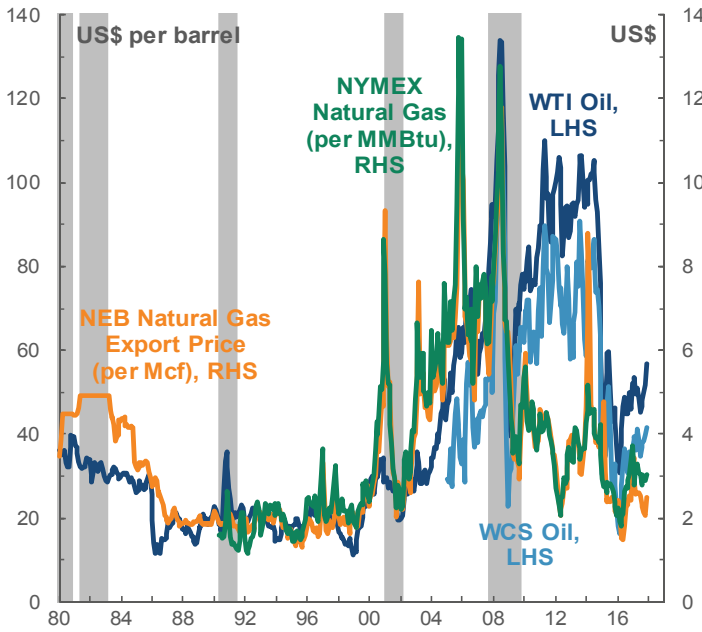
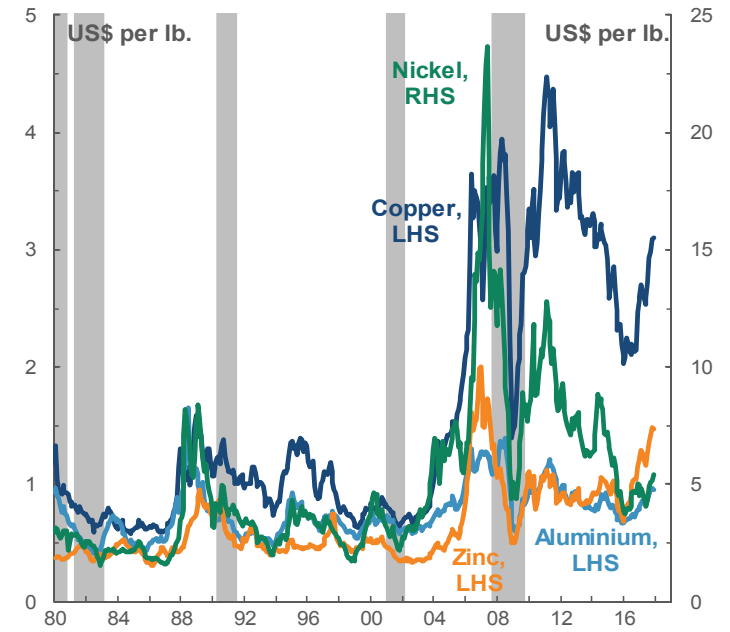
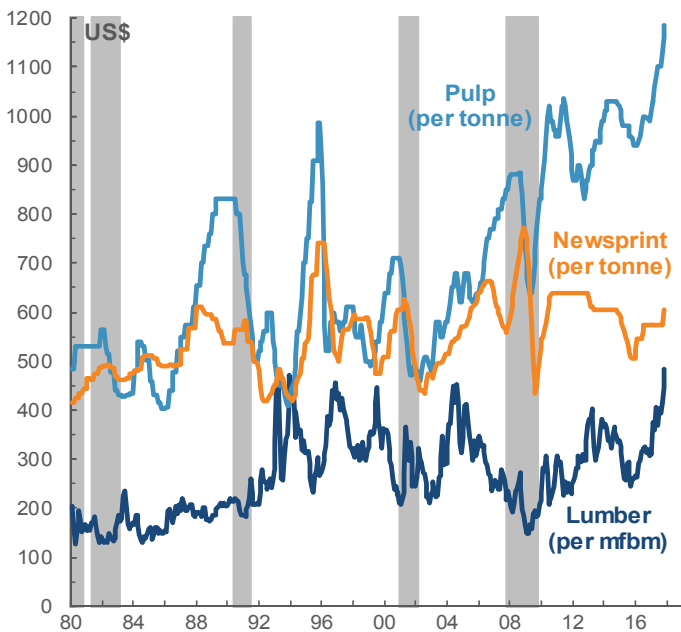
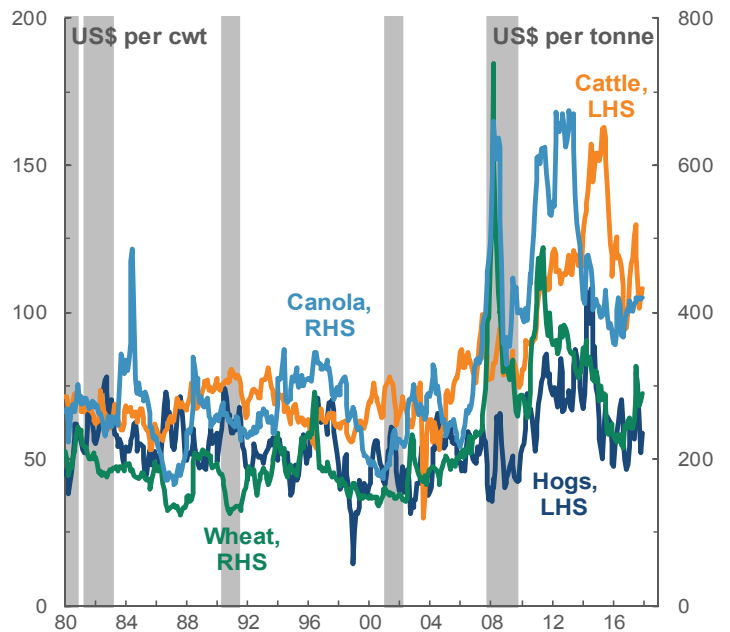
While benchmark 62% fines contracts (the price tracked in this publication) have been lackadaisical, higher-quality feedstock has been commanding a widening premium as Chinese steel mills demand cleaner, more iron-dense ore. Part of the seaborne demand weakness through the winter months will be caused by reduced run-rates in Chinese steel mills subject to Beijing's "Blue Sky" environmental policies. These mills will need to reduce capacity utilization rates to comply with environmental edicts coming from Beijing, so they are going to prioritize the feedstock that will best use that scarce capacity. This quality premium cuts the other way as well, with low iron content and high waste feedstock seeing widening discounts, a trend that is expected to persist given the likelihood of continued environmental enforcement in China.

Chart 11



Price Outlook		2000–2016			2017YTD	2017F	2018F	2019F
		Monthly Avg. Low	Period Avg.	Monthly Avg. High				
Oil & Gas								
Crude Oils								
West Texas Intermediate	USD/bbl	19.40	62.70	134.02	50.61	50	52	56
North Sea Brent Blend	USD/bbl	19.06	65.53	134.56	54.43	53	56	60
Natural Gas								
Nymex Henry Hub	USD/MMBtu	1.81	4.94	13.46	3.03	3.06	2.85	3.00
Metals & Minerals								
Base Metals								
Copper	USD/lb	0.62	2.35	4.48	2.79	2.73	2.85	3.00
Nickel	USD/lb	2.19	7.26	23.67	4.70	4.65	5.00	5.50
Zinc	USD/lb	0.34	0.81	2.00	1.31	1.29	1.50	1.60
Aluminium	USD/lb	0.58	0.86	1.39	0.89	0.88	0.90	0.90
Bulk Commodities								
Iron Ore	USD/t	27	108	302	72	70	60	60
Metallurgical Coal	USD/t	39	127	330	185	206	150	130
Precious Metals								
Gold	USD/toz	261	869	1,772	1,257	1,265	1,300	1,300

Scotiabank All Commodity Price Index

Canadian Dollar vs. Commodity Prices

Scotiabank Oil & Gas and Metal & Mineral Indices

Scotiabank Forest Products & Agricultural Indices


Oil & Gas Prices

Metals Prices

Forest Products Prices

Agricultural Prices


Technical Note
Scotiabank Commodity Price Index — Principal Canadian Exports
January 2007 = 100

This Index has been designed to track the spot or transactions prices paid in U.S. dollars for key Canadian commodities and resource-based manufactured goods in export markets. The weight of each component is based upon its net export value in 2010. Prior to January 2007, the weight of each component was based on its export value in 1995-97, except for crude oil & refined petroleum products, uncoated freesheet paper and linerboard, where net exports were used. Canada imports a significant quantity of these products, and use of their export value alone would have overstated the importance in Canada's trade performance.

The following prices are included:

OIL & GAS

Crude Oil & Refined Petroleum Products (US\$ per bbl) MSW light sweet crude oil at Edmonton (previously Edmonton Par crude) and Western Canadian Select heavy oil at Hardisty, Alberta; price differentials off WTI near-by futures from TMX/Shorcan Energy Brokers.

Natural Gas (US\$ per mcf) Average export price quoted by the National Energy Board.

Natural Gas Liquids (NGLs – Propane, Butane, Ethane & Pentanes-Plus) (US\$ per bbl), Propane at Edmonton & Sarnia.

METALS & MINERALS

Copper & Products (US\$ per lb) LME official cash settlement price for grade A copper.

Zinc (US\$ per lb) LME SHG cash settlement: prior to Sept 1990, U.S. producers' price for high-grade zinc delivered.

Lead (US\$ per lb) LME official cash settlement price; prior to Jan. 1991, U.S. producers' price for common grade delivered.

Aluminium & Products (US\$ per lb) since 1979, LME official cash settlement price.

Nickel (US\$ per lb) since 1980, LME official cash settlement price.

Gold (US\$ per oz) 'LBMA Gold Price PM' as of March 20, 2015.

Potash (US\$ per tonne) Standard potassium chloride, spot price, FOB Vancouver.

Sulphur (US\$ per tonne) Solid, spot price, FOB Vancouver.

Metallurgical Coal (US\$ per tonne) Contract price for premium-grade hard coking coal, FOB Vancouver.

Iron Ore (US cents per dmtu) Spot price fines 62% Fe, CFR Qingdao, China; prior to Jan 2011, term-contract price for concentrates 66% Fe from Labrador/Quebec to Northern Europe (FOB Sept-Iles).

Uranium (US\$ per lb) Spot price for U3O8.

Molybdenum (US\$ per lb) since March 1992, MW dealer oxide.

Cobalt (US\$ per lb) MW dealer price.

FOREST PRODUCTS

Lumber & Wood Products, Western Spruce-Pine-Fir 2x4 No.2 & Btr (US\$ per mfbm) FOB mill.

Oriented Strandboard (US\$ per thousand sq. ft.), U.S. North Central region, 7/16 inch.

Pulp, Bleached Northern Softwood Kraft (US\$ per tonne) Transactions price, delivery USA.

Newsprint (US\$ per tonne) Average transactions price, 48.8 gsm, delivery Eastern USA.

Groundwood Specialty Papers (US\$ per ton) Supercalendered-A paper, 35 lb., delivery USA.

Linerboard (US\$ per ton), delivery Eastern USA with zone discounts.

AGRICULTURE

Wheat & Flour (US\$ per tonne), DNS No 1 14% protein Duluth, Minn; prior to April 2011 No.1 CWRS, 13.5% protein at St. Lawrence.

Barley (US\$ per tonne), since Dec.1994, No.1 at Lethbridge, Alberta.

Canola & Oilseeds (US\$ per tonne) No.1 Canada, in store Vancouver.

Cattle & Beef (US\$ per cwt) Steers over 1,051 pounds at Toronto; from Jan 1993, Ontario average.

Hogs & Pork (US\$ per cwt) 100 Index Hogs at Toronto; from Jan 1993, Ontario average.

Fish & Seafood (US\$ per lb) West Coast silver coho salmon; Atlantic lobster prices; prior to 1986 cod fillets & blocks.

Scotiabank Commodity Price Index —
Components And Weights

Index Components	Net Export Value In 2010 (millions of dollars)	Index Weight (per cent)
OIL & GAS INDEX	46,537	39.90
Crude Oil & Refined Products	33,231	28.49
Natural Gas & LNG	11,741	10.07
NGLs	1,565	1.34
METAL & MINERAL INDEX	35,109	30.10
Copper	3,160	2.71
Zinc	1,255	1.08
Lead	579	0.50
Aluminium	6,045	5.18
Nickel	4,246	3.64
Gold	4,678	4.01
Coal	4,757	4.08
Iron Ore	3,346	2.87
Potash	5,161	4.42
Sulphur	457	0.39
Uranium	891	0.76
Cobalt	288	0.25
Molybdenum	246	0.21
FOREST PRODUCTS INDEX	17,081	14.66
Lumber & Wood Products	4,673	4.01
OSB	812	0.70
Pulp	6,818	5.85
Newsprint	2,734	2.34
Groundwood Spec. Papers	1,971	1.69
Linerboard	87	0.07
AGRICULTURAL INDEX	17,901	15.35
Wheat & Flour	4,693	4.02
Barley & Feedgrains	1,088	0.93
Canola & Oilseeds	5,398	4.63
Cattle & Beef	1,640	1.41
Hogs & Pork	2,378	2.04
Fish & Seafood	2,704	2.32
TOTAL INDEX	116,643	100.00

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