ScotiaMcLeod
exchange
WINTER 2006
Q4
INVESTING WITH HINDSIGHT AND FORESIGHT

All of us at ScotiaMcLeod hope you had a enjoyable holiday season. We thank you for the opportunity to work together and appreciate your ongoing trust.

The start of a new year is always a good time for investors to review their portfolios to ensure they contain the right mix of investments for the current market conditions. Your ScotiaMcLeod advisor has the tools and knowledge to ensure your portfolio maintains an optimal asset mix to provide you with the best possible return for your level of risk tolerance.

We wish you and your family all the best in 2007.

Reflections of the 70's

Andrew Pyle, *Head of Capital Market Research, Scotia Economics*

Investment themes for market participants at the close of 2006 are not materially different than those we discussed this time last year. Slower growth in the western hemisphere, the strains from massive imbalances in global trade and savings, tensions in the Middle East all will continue to punctuate the outlook for the next twelve months.

The key difference is that many of the risks highlighted last year have come to fruition. North American economic growth has indeed geared down from the rapid pace set in 2004-05, while risks of a downturn have increased.

The slowdown in the pace of expansion has led both the Bank of Canada and Federal

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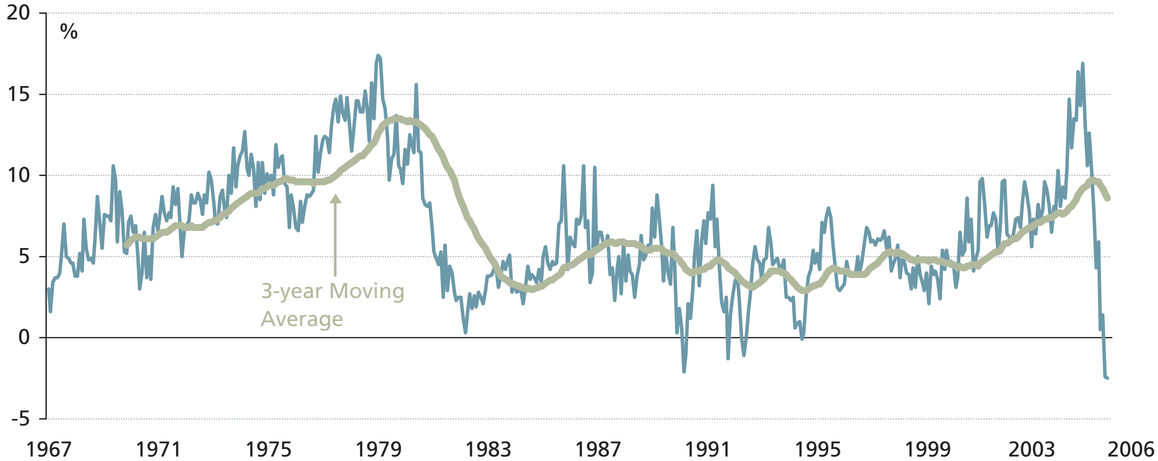
Year-Over-Year Change in Median U.S. Existing Home Prices



Source: Scotia Economics

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Reserve to end their string of rate hikes, although inflation concerns have been sufficient to prevent either of the central banks from cutting rates in a pre-emptive action against said downturn. And just as economists were becoming frustrated in continually forecasting a non-occurring U.S. housing correction, it has arrived. Proving that you don't need 1980's-style mortgage rates to cause housing activity to cave in, this year has witnessed more than a 30% drop in housing starts south of the border and the largest year-over-year decline in home prices since 1970 (see graph on previous page). From a market perspective, we are less concerned with the direct effects of this year's correction than we are about the residual impact that lower home prices can have on consumer spending.

Indeed, this is the next shoe to drop and if anything were to cause overall purchases to decline on a quarterly basis for the first time since 1991, this would be it. Canada's housing performance has been almost respectable in comparison. Housing starts remain above 200,000 units per year and home prices are still up on an annual basis, even in Ontario. Still, Canada faces its own challenges, especially from a further deceleration in U.S. growth and appreciation in the value of the Canadian dollar.

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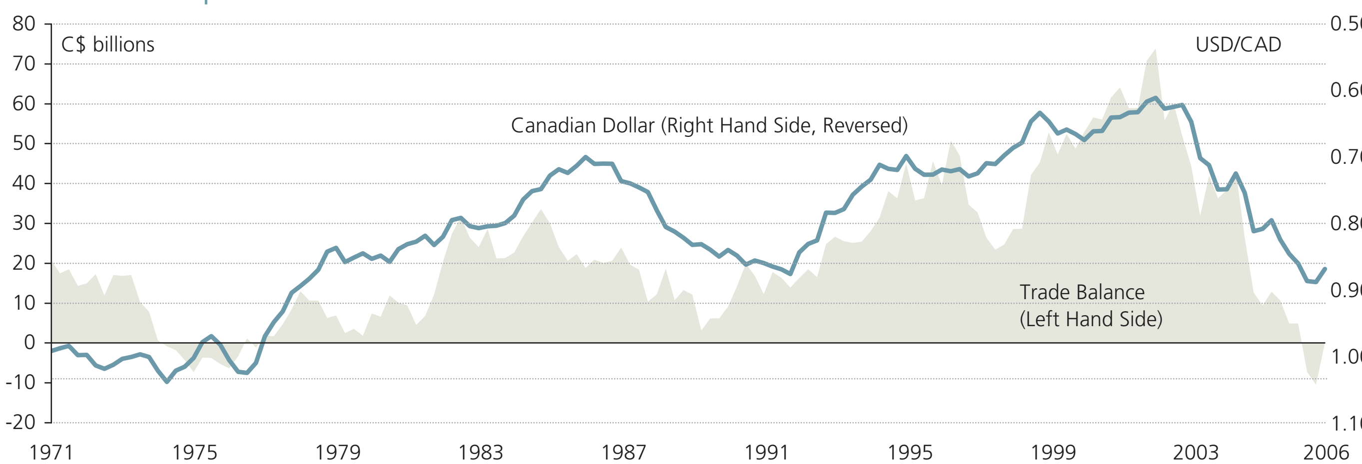
While the Loonie has certainly strutted its stuff in the past four years, it has done so alongside some of the best U.S. growth in decades – a backdrop that is not expected to be repeated. Falling commodity prices during the second half of this year took some of the steam out of the currency's advance but, at the time of writing, energy prices were holding steady off their recent lows and metal prices were starting to recover as well. This supports our bullish call for the Loonie to move up above 92 US cents by the end of 2007; but it will also mean added stress on exporters. The key milestone this past year was that Canada posted its first trade deficit in price-adjusted terms since the mid-1970's, and further currency appreciation should see this deficit persist into next year.

Bottom line, the growth environment in 2007 will be more negative for both countries, albeit for different reasons. Regardless of the reason, however, the impact on interest rates will be the same. Both central banks will be forced to lower them in order to prevent a more serious economic setback.

Loonie's Rise Expected to Continue



Source: Scotia Economics

Look Beyond our Borders in 2007

Paul Danesi, *Director, ScotiaMcLeod*

Investors will remember 2006 as a year marked by solid returns, corporate takeovers, and the year the Federal government finally implemented a tax plan to address the income trust market. Although performance was respectable in Canada, it paid to invest abroad as the returns in many international markets exceeded 20% on a currency-adjusted basis. Last year we asked investors to overlook currency risk and consider the benefits of investing on a global basis - this strategy paid dividends. Currency was less problematic for investors in 2006 as the Loonie gained only modestly against the U.S. dollar and fell sharply against the Euro in the second half of the year enhancing returns on European securities. The many U.S. and Canadian listed Exchange Traded Funds remain the most efficient and cost effective means of gaining exposure to international markets.

Interest rates gravitated higher through the first half of 2006 until Canadian and U.S. central bankers moved to a neutral bias. Investors took that shift in policy as their queue to buy bonds taking the yield on the benchmark 10-year Canada bond back to 4%, about where it began the year. Our economists believe that central banks in both the U.S. and Canada will lower overnight lending rates to prevent a further slowing in economic activity.

Dividends and Your Portfolio

Investors' love affair with the income trust market ended abruptly in late October when the Federal Government announced its intention to tax income trusts as corporations. For many Canadian investors, in particular seniors, Halloween proved to be all tricks and no treat. While the status change in the eyes of the Canada Revenue Agency has resulted in a permanent impairment of value (unit prices declining on average 15%) it is worthwhile noting the decision was neutral to investment cash flow on an after-tax basis. Distributions are currently being taxed as income, however beginning in 2011 they will receive more favourable tax treatment as dividends. The whole affair reinforces the need for suitable portfolio diversification. The winners in all of this were the blue chip dividend payers such as the banks, utilities, and telecommunication stocks. Although BCE and Telus were initially losers, they offer investors an attractive stream of dividends and in the long run come out as beneficiaries. With economic growth gearing down in 2007, we encourage investors to overweight defensive, dividend paying stocks in their portfolios.

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M&A Activity to Continue

Mergers and acquisitions (M&A) was a major investment theme in 2006. In Canada, the pace of M&A activity was brisk with high profile takeovers of ATI Technologies, Dofasco, Hudson's Bay, Fairmont Hotels, and Inco to name a few. This trend is likely to continue in 2007. Corporate balance sheets are under levered and flush with cash; foreign investors including China and Russia are looking to secure supplies of raw materials; and U.S. private equity funds have an estimated US$250 billion ready to invest. On a global basis, watch for further consolidation in the metals & mining, financials services, and media sectors. In Canada watch for further activity in the oil patch, media, and real estate sectors. Infrastructure assets including water utilities, pipelines, and toll-roads with their steady cash flows are also on the radar screens of many pension fund managers. This creates both opportunities (takeover premiums) and challenges (dwindling supply of "Blue Chip" investments) for Canadian investors furthering our position on increasing global exposure.

Maintain Exposure to Commodities

With the exception of energy, the price of commodities - from orange juice to grains to base metals - all continued to trend higher in 2006. China remains a major factor behind the resurgence in global growth and world commodities markets, and global infrastructure development will continue to be a major theme through the end of the decade.

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In the base metals sector, the supply response has been slower than anticipated as industry players seem more intent on making acquisitions and stockpiling cash than they do on developing new mines. As a result, copper and zinc inventories could reach critical levels in 2007 sending prices even higher. Drought, declining inventory levels and new demand from renewable fuels sources will help underpin grain prices and fertilizer demand. We maintain our view that we are in a longer-term secular bull market for commodities and suggest investors maintain a prudent level of exposure in their portfolios. Construction and farm equipment manufacturers, engineering and construction companies, and infrastructure developers are direct beneficiaries from these trends.

As we begin the New Year investors should take the time to review their asset allocation, it is one of the most important investment decisions an investor can make. In 2007, investors should once again benefit from a reallocation of assets from domestic to international markets. Your ScotiaMcLeod advisor can help you establish and maintain the optimal asset allocation, investment selection and diversification to provide the best return possible for your level of risk.

Reflections

"An investment in knowledge always pays the best interest."

- Benjamin Franklin

Building an Income Strategy into Your Investment Portfolio

One way to build income into your portfolio is to hold shares that have an established record of regular distributions. This can provide you with a reliable, monthly stream of tax-advantaged dividends. Your ScotiaMcLeod advisor can recommend the right mix of dividend paying stocks for your portfolio within the context of an overall income strategy.

Goal: $21,600 annually

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Stock A 10,000 shares pays $0.18 quarterly	$1,800			$1,800			$1,800			$1,800		
Stock B 20,000 shares pays $0.09 quarterly		$1,800			$1,800			$1,800			$1,800	
Stock C 15,000 shares pays $0.12 quarterly			$1,800			$1,800			$1,800			$1,800

For illustrative purposes only; may not accurately reflect dividend payments.

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