



All of us at ScotiaMcLeod hope that you have enjoyed your holiday break and were able to relax with family and friends. As we embark on another new year, we would also like to thank you for your trust and the opportunity to work together to help you achieve your financial goals.

We wish you and your family all the best in 2010.

A “Sweet Spot” for U.S. Equities

Paul Danesi, CIM – *U.S. Equity Advisor, Portfolio Advisory Group*

The U.S. equity market is likely to remain in a “sweet spot” through the first half of 2010. Persistent wholesale selling of U.S. equities doesn’t seem likely in our opinion in the short run given improvements in the global economy, low inflation expectations, and a rebound in corporate profitability.

U.S. equities remain under-owned at both the retail and institutional level. Cash in U.S. money market funds is well above historical norms and investors are being paid very little to hold cash. U.S. Treasury securities offer little appeal outside their defensiveness and a narrowing of corporate spreads reduces the attraction of corporate bonds. Low interest rates are driving investors back into risky assets.

We caution investors the risk reward trade off is not as compelling as it was in the first half of 2009 and they should expect more modest gains in the year ahead. The U.S. dollar and short-term interest rates will be key items to watch in 2010.

It is possible U.S. economic activity could slump later in 2010. An ongoing recovery in the U.S. economy will eventually force central bankers to remove economic stimulus and raise interest rates. A low interest rate environment remains a key element supporting sustained economic growth, our negative stance on the U.S. dollar, and positive bias towards equities.

GLOBAL ECONOMY IS ON THE MEND

In 2008 and early 2009 we witnessed a synchronized global economic contraction and the worst downturn since the Great Depression. We are now in the midst of a synchronized global economic recovery led by China, reinforced by highly stimulative monetary and fiscal policies, and improvements in financial markets. Industrial production collapsed in many countries in the latter part of 2008, but has since rebounded sharply. World trade volume is expanding again. All major developed markets are once again experiencing economic growth, albeit

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the pace of growth is likely to slow into the second half of 2010.

As a caveat, home foreclosure activity remains at record levels and a back up in mortgage rates could derail the nascent recovery in housing. There are also ongoing concerns about the consumer and their newfound affinity for frugality. It is worth pointing out that the U.S. consumer has a penchant for spending and the recession is creating significant pent-up demand.

CORPORATE PROFITABILITY COULD RISE SHARPLY IN 2010

The outlook for earnings growth in 2010 looks promising. U.S. corporations have aggressively cut costs reducing headcount at a record pace, trimming SG&A, and mothballing production to maintain margins. Cost cutting was the major driver of positive earnings surprises in the first half of the year, typical of a normal earnings cycle. Revenue growth should lift margins further over the next few quarters as the economy stabilizes and industrial production rebounds from a cyclical trough. Scotia Capital forecast S&P 500 earnings of U\$75 for 2010.

INVESTORS NEED TO BE SELECTIVE

The S&P 500 has rallied smartly from its March low, but remains 30% off its 2007 high. Valuation appears reasonable at 14.5 times with interest rates near historic lows and corporate profitability rebounding. However, as noted, the risk reward is less compelling at these levels and investors need to be more discerning when it comes to stock selection.

U.S. dollar weakness and stronger growth in developing markets support continued purchase of U.S. multinationals and exporters. From a thematic perspective, we favour companies that provide exposure to the emerging market consumer and infrastructure development. Favored names include McDonald's (MCD), Nike (NKE), and Apple Inc. (APPL) as a play on global consumer spending. Attractive infrastructure plays include Fluor Corp. (FLR), one of the world's leading engineering and construction firms, and the SPDR Metals & Mining ETF (XME) for broad-based exposure to infrastructure materials including iron and steel. General Electric (GE)

looks attractive as it continues to reorient itself as a global infrastructure play and troubles with its financial arm begin to fade.

Broadly speaking, corporate balance sheets in the U.S. are in excellent shape. Given the high levels of excess productive capacity, free cash flow is likely to be spent on productivity enhancing software and technology hardware. Hewlett Packard (HPQ) with its PCs, servers, and printers, along with EMC Corp. (EMC) and their leading edge storage devices are well positioned to participate in a revival in corporate spending. Intel Corp. (INTC) should benefit as a component supplier. Among domestically oriented businesses we like AT&T Corp (T) and its hefty 6.0% dividend yield.

Investors are encouraged to build exposure to U.S. and other international markets as our strong dollar provides an attractive currency for international investment. U.S. equities will remain in a "sweet spot" as long as monetary policy remains easy, although investors should be more selective in their purchases. Rising interest rates will spark a reversal in the U.S. dollar and should be a catalyst to take profits in U.S. multinationals.

Delivering outstanding service is the core of our Client Commitment. Across the country, our advisor team understands the importance of earning your trust and aims to deliver a level of service exceeding your expectations.

Each year we conduct an annual client satisfaction survey, gathering in-depth feedback from over 2,000 households. Recent results continue to demonstrate the quality of support and professionalism being delivered by our advisors. In fact, satisfaction ratings by our clients increased this past year, even more impressive given the difficult market conditions.

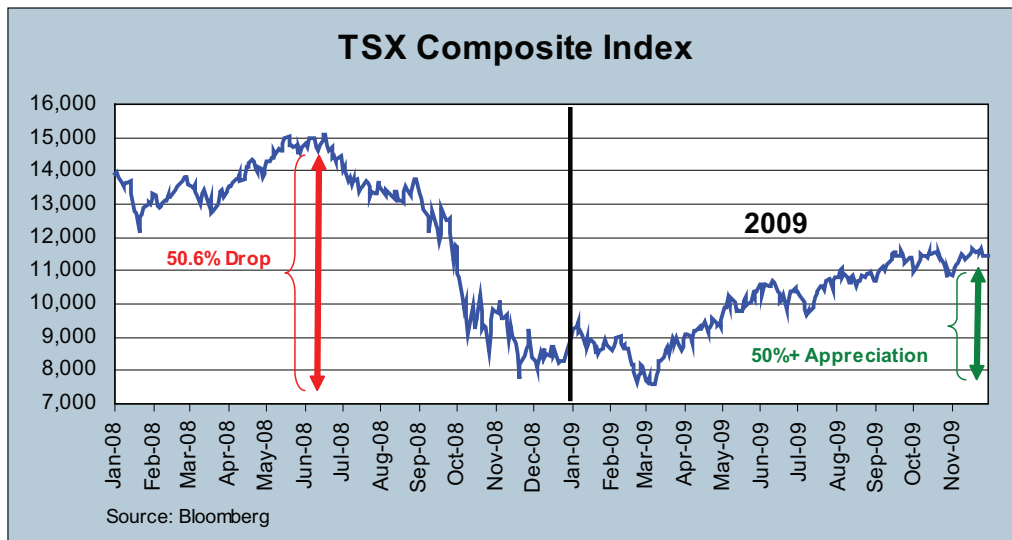
Another indicator of our strong client relationships is the number of advisor referrals by our clients to friends and family. Last year we saw a record number of these introductions, where clients shared the high level of service and advice that they value.

Thanks to all of our clients for our continued and valued relationship and for the feedback and the introductions that have helped us to enhance the service and advice we deliver.

Canada – Looking Solid for Years to Come

Gareth Watson, CFA – Director, Portfolio Advisory Group

After a rocky first quarter Canadian equity markets appreciated nicely during the remainder of 2009. Over 90% of these gains have come from the three highest weighted sectors in the TSX Index (Financials, Energy and Materials), thus indicating that investors expect signs of economic recovery will only strengthen. Below we show the performance of the TSX Index going back to the beginning of 2008 where we illustrate both the recent highs and lows of the market over the past 23 months. While we are certainly nowhere near the 15,000+ peak reached in June of 2008, it is clear that investors are no longer as risk averse as they once were at the beginning of 2009 as approximately 50% of the peak to trough drop has been recovered.



In the past we have provided you with some larger macro-economic arguments; however, since those arguments really haven't changed much we will instead provide you with some observations as to what we are currently witnessing from an economic and market perspective:

- Equity markets worldwide have rebounded nicely off their lows. Canada is not alone as the emerging BRIC (Brazil, Russia, India and China) markets led major market returns in 2009. The TSX Index provided the best equity market returns last year amongst the G7 Industrialized nations.
- The worst of the credit crisis is likely behind us, but problems will persist for years. A real estate crisis ballooned into a corporate credit crisis and

is now a consumer credit crisis south of the border. While the absolute worst of the credit crisis is likely over, we will feel remnants of it for years to come as governments and central banks continue to provide life support to the global financial system.

- Government intervention/rescue/stimulus appear to have averted a depression. Now we just need to see the global economy get back to a self-sustaining level without the need for intervention.
- Canadian interest rates are at all-time lows and will remain there for months. While this is good news for individuals that want to borrow and can get access to such credit, it is also remarkably clear that over the next couple of years interest rates have nowhere to go but up.

- Emerging markets are recovering more quickly as producers replenish inventories. Before the western world can consume goods and services, the emerging markets have to produce them in the first place. Therefore, it is only logical to see the emerging markets improve economically before the western world follows.
- The western world consumer, namely U.S. consumers, are saving rather than spending – unemployment is still high and U.S. housing prices are still low. These factors do not create an environment ripe for consumption; therefore the global recovery is not without its challenges.
- The recession is technically over in the United States and Canada, but the recovery could be sluggish if individuals don't pick up their rate of consumption. The specific time the recession ends is irrelevant, how we position ourselves for the recovery is much more important.
- U.S. dollar weakness has pushed commodity prices higher and speculators have returned to markets they briefly abandoned. Fundamental analysis of commodity prices can become meaningless when commodities are used for investment rather than consumption.
- As long as commodity prices rise and Canadian consumers maintain their wealth/equity, the

Canadian economy has the potential to outperform the United States over the next year and the loonie will be a “go to” currency for global traders.

- Canada emerged as a winner during a difficult time. Not only has our financial system withstood the blows of the credit crisis, our federal and provincial governments are holding in much better than our counterparts in the United States. While deficits are certainly a reality this year, those deficits in relative terms to our debt are still manageable.

There is no denying the fact that the rebound for the TSX Index has been impressive. At the beginning of 2009 we predicted that the Canadian stock market would actually post positive returns, but they would be challenged to reach double-digits. Needless to say, our expectations have been exceeded likely due a weaker-than-expected U.S. dollar, a credit market that improved much faster than anticipated and emerging markets which literally refused to participate in the global recession. While we certainly do not expect the same rate of appreciation for the TSX index in 2010, we are bullish for the Canadian stock market over the long term and believe this country will be a great place to invest as the global economy accelerates this year and beyond.

Reflections

“Success follows doing what you want to do. There is no other way to be successful.”

Malcolm Forbes



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