

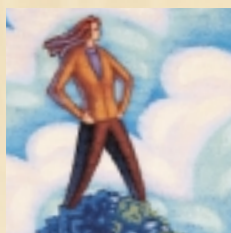
Review and Outlook

FOURTH QUARTER, 2001

THE ECONOMY

Even before the September 11 terrorist attacks on the World Trade Center and the Pentagon, there were signs that the global economy was losing momentum in the third quarter. Various leading economic indicators, which had shown improvement in the late spring, turned down for many countries and regions, including Canada and Euroland. Japan continued to struggle with challenging economic conditions. Not surprisingly, already-vulnerable consumer spending and confidence levels in the U.S. eroded after September 11, increasing the risk of a consumer-led recession. Although showing signs of stabilization prior to September 11, the U.S. manufacturing sector continued to operate well below capacity and capital spending forecasts weakened further, particularly in the telecommunications sector. Recognizing the increased economic risks posed by the terrorist attacks, global central banks moved quickly to lower interest rates, in a coordinated move led by the U.S. Federal Reserve. Global central banks co-operated successfully as well to support the U.S. dollar and to provide liquidity to the banking system. Unlike the Euro and Yen, which benefited from weakness in the U.S. currency, the Canadian dollar was negatively affected over the quarter by slowing global growth and softening commodity prices.

BOND AND STOCK MARKETS



A Look Ahead

A significant further decline in U.S. consumer and business confidence poses the greatest economic risk going forward. Fortunately, U.S. fiscal stimulus (potentially as high as 1.5% of GDP) should provide a considerable offset to any pullback in private consumption

and business investment. Coordinated monetary and fiscal policies, supported by low inflation and budget flexibility, are being implemented to cushion the potential downside to the U.S. economy. However, the continued economic adjustment from the over-investment of the 1990s and ongoing political risks suggest the bottoming process for the economy could take longer than originally anticipated.

Nevertheless, favourable factors, such as lower interest rates, improved valuations and lower return expectations, are in place for a sustained equity market advance once evidence of a new economic cycle emerges.

TOTAL RETURNS

Period ended September 30, 2001

	Quarter	12 Months
SC 91 Day T-Bills	1.24%	5.32%
SC Short/Mid-Term Bond Index	4.93	9.90
TSE 300 Capped (5% max/issue)*	-11.08	-17.80
TSE 300	-11.25	-33.12
S&P 500 (Cdn\$)	-11.23	-23.11
MSCI EAFE (Cdn\$)	-10.47	-24.84

* courtesy BMO Nesbitt Burns



Bonds

Current yield curve steepness reflects higher risk aversion and concerns about the impact of increased government spending on debt supply and future inflation levels. However, a steep yield curve also signals stronger economic growth in the future and we believe the yield curve should flatten over the medium term on signs of economic recovery. With long bond rates likely to remain steady, we expect that long bonds will outperform short and mid-term bonds on a relative basis over the next year. The additional yield offered by longer maturities is attractive at current levels and we are recommending at least a market weight in long bonds for universe portfolios. To increase income, we are placing greater emphasis on provincial and high-quality corporate bonds. Although corporate spreads remain vulnerable in the near term to economic and political risks, we anticipate that spreads will narrow as the outlook stabilizes.



Equities

Every major equity index and geographic region posted significant declines in the third quarter. Outside of the precious metals area, which rallied in classic response to crisis conditions, defensive sectors and larger capitalization equities with stable earnings outperformed on a relative basis over the period. Of the fourteen TSE 300 sectors, only four ended the period in positive territory, with Gold & Precious Metals registering the largest advance (+19.6%), followed by Pipelines (+8.7), Real Estate (+4.9) and Merchandising (+1.1). The weakest performing TSE 300 sector was Industrial Products, which declined 33.5% on ongoing profit and capital spending concerns. Measured in US\$ terms, the S&P 500 fell 8.1% over the quarter, with Health Care the sole advancing sector. All EAFE (Europe, Australasia and the Far East) markets traded lower. Information Technology was the worst performing global sector, while just two of the ten global sectors, Consumer Staples and Health Care, finished the period with gains. We expect the tug-of-war between defensive and cyclical strategies that characterized the pre-September 11 period to continue over the next several quarters as investors attempt to anticipate the trough in the economy and earnings. Rather than aggressive sector anticipation, our overall strategy remains based on the conservative principle of broad sector diversification. We believe that larger capitalization equities should continue to outperform in the period ahead as investors remain focused on companies with reliable earnings and financial strength.

THE LAST WORD

Due to increased geopolitical and economic uncertainty, we expect equity performance to remain volatile over the near term. In the current environment, we continue to emphasize careful corporate bond and equity selection and remain committed to our core discipline of well-diversified portfolio construction.

SCOTIA CASSELS RESEARCH TEAMOctober 9, 2001