

Review and Outlook

MORE BALANCED AND SYNCHRONOUS GLOBAL GROWTH IS IN THE OFFING FOR 2004.

The Economy

In the third quarter, the United States economy posted one of the strongest gains on record. Policy makers unleashed an arsenal of fiscal and monetary economic stimulus, resulting in an annualized 8.2% real rate of growth. This momentum carried into the fourth quarter, resulting in an estimated 3.2% gain for all of 2003. Canada has been less robust, growing only 1.1% in the third quarter and an estimated 4.5% in the fourth quarter. However, the year will see an unimpressive 1.7% rise in GDP. Canada's poorer showing is due in part to a higher base of activity in 2002, and less accommodative policy intervention this year.

The question for investors is whether growth will be sustainable in 2004. The recent strength was built on low interest rates and tax cuts. The impact on individuals has been profound. Auto sales continue to be remarkably strong, while healthy home sales have fostered a wave of durable goods spending. Corporations, faced with low capacity utilization levels, have taken advantage of low interest rates, as well as new depreciation allowances, and spent significant amounts on machinery and equipment. This includes computers and software, which augers well for future gains in productivity.

A critical element limiting growth, until recently, has been U.S. employment. In the last 4 months 350,000 new jobs have been created, reversing a trend that saw over 2.4 million jobs lost since February 2001. If this essential trend remains in place, and interest rates remain near current levels, then U.S. growth is forecast to be no less than 3.5%, well into 2004. A major concern, with no apparent resolution, is the loss of industrial and service jobs to cheaper labor markets offshore such as China.

Canada will be the primary beneficiary of a strong U.S. economy. In key areas such as auto manufacturing, and natural resources, the demand from U.S. markets is the overriding determinant of success for Canadian companies. Negatively impacting exporting industries has been the 21% appreciation of the Canadian dollar this year. This loss of competitive advantage, and the general under performance in such key areas as productivity, are reasons the Canadian economy has fallen behind the U.S. this year.

The global economies should lag North American growth rates in 2004. Once again all economies will remain dependent on the U.S., but it would appear that more balanced and synchronous global growth is in the offing for 2004. The table below highlights the expected improvements in 2004.

Real GDP Trends*

%	2000	2001	2002	F'2003	F'2004
Canada	5.3	1.9	3.3	1.7E	3.0E
U.S.	3.8	0.3	2.4	3.2E	4.0E
EuroZone	3.5	1.6	0.9	0.2E	1.6E
Japan	1.6	0.4	0.2	2.5E	2.1E

* Source: Scotia Capital/Scotia Cassels

Financial Markets

Global equity markets performed well in the fourth quarter, enabling the 2003 results to be the best in many years. Impacting returns this year has been a significant realignment of global currency values. The table below provides select equity market returns in local, U.S. and Canadian currencies.

2003 Market Returns By Currency*

%	MSCWIMSEAFE		TSXS&P 500		DAX	Nikkei
In Local Currency	22.8	17.4	24.3	26.4	37.1	24.5
Best Since	1999	1999	1999	1998	1999	1999
In US \$	30.8	35.3	51.1	26.4	64.0	37.7
In CDN \$	7.6	11.3	24.3	4.0	34.7	13.1

* Source: Bloomberg

Equity markets started the year slowly, but began to rise late in the 1st quarter. Initial drivers were Technology companies, many with still unproven earnings capabilities. To some, it was all too reminiscent of the over valuation trends of the mid to late 1990s. However, by late summer, the rally had broadened to include both traditional cyclical and value-oriented stocks. The markets gained confidence that the economy was vibrant and growth was sustainable. While early gains allowed Technology stocks to remain the best 12-month performers, Golds, Utilities and Materials were the market leaders by year-end.

Interest rates, in general, fell during the fourth quarter, but experienced mixed results for the year. In 2003, Canadian interest rates across the curve moved lower, reflecting less buoyant economic expectations. To the south, short rates fell below 1.0% while longer-term rates rose. Oil prices, a strong economy, deficits and Iraq, all placed downward pressure on U.S. bond prices. The optimism driving equity markets had its impact on corporate bond markets. Corporate interest rate differentials narrowed, improving most in the lower credits.

Central banks were accommodative in 2003 even as their economies improved. In part, they were held in check by a falling U.S. dollar. Fiscal policy has been highly stimulative raising some concerns about rising inflation. However, to-date inflation has been benign. The CPI in 2004 should be about 1.7% in Canada and even less in the U.S. These inflation levels should not trigger an aggressive interest rate response by Central Banks. However, North American CPI will be at the high end of global trends.

Investment Strategy

Following a strong year in 2003, we are cautiously optimistic for 2004. Sufficient economic momentum, combined with a U.S. election year, should be positive for capital markets, at least in the first part of the year. Accommodative policy will benefit consumers and corporations, which will be positive for equities. However, later in the year the focus will turn to the sustainability of the current pace of earnings and market gains.

Short-term interest rates should remain low, in keeping with the moderate inflation outlook. Mid-term and long-term bonds appear to be fairly valued. Inflation adjusted returns from 10-year Canada and high-grade corporate bonds represent good value. Cash levels will reflect a balanced outlook. Focus will be on the durability of earnings, monitoring of interest rates and remaining observant to potential negative trends in order to shift to a more defensive posture as the year unfolds.

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