

In this issue ...

Page 1

- Around the world: Expect above-trend growth in 2010
- United States: Jobs ahoy!

Page 2

- Financial Markets: One year later
- Canada: On the G7 growth podium in 2010

Page 3

- Asset Mix: Common stocks remain our asset class of choice
- Our Forecast

Page 4

- Model Portfolios: asset mix, geographic diversification and duration for five individual investor profiles

AROUND THE WORLD

Expect above-trend growth in 2010

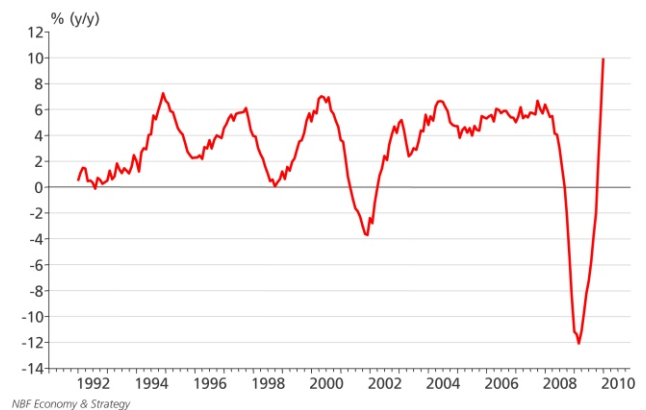
Global GDP and international trade are slowly approaching their pre-recession levels. The latest data on trade volume show an unprecedented monthly rise of 4.8% in December. The resurgence has become broad-based, with increases in both exports from developed countries and imports by emerging countries. Though still 8% off peak, global trade volume is up a solid 15% from last March. The 12-month rise of 8.1% shows an agreeably V-shaped recovery.

A similar pattern appears in global output, which has expanded for a ninth straight month. GDP is now back to the level of mid-2007, only 5% off the pre-recession peak. In regions such as emerging Asia, GDP is now 5% above the pre-recession peak. In the same vein, the Semiconductor Industry Association reports that world chip sales in January were back to the previous peak. With global leading indicators pointing to above-trend growth in the months ahead, this trend is likely to continue.

Despite signs that prices are starting to rise in fast-growing emerging countries, inflation remains low by historical standards. With the expected unwinding of fiscal stimulus programs in 2011, we expect central banks in these countries to switch their monetary stance from accommodative to neutral. It is too soon for a restrictive turn. With policy rates likely to remain accommodating this year, we think the global

World: Strong rebound in economic activity

World industrial production



economy will remain vigorous in the coming quarters. We anticipate world GDP growth of close to 4% in 2010.

UNITED STATES

Jobs ahoy!

U.S. real GDP growth in the fourth quarter was the strongest in almost six years (5.9% annualized). This result, led by an inventory rebuilding surge, suggests that domestic demand is finally getting back on its feet. Real consumption has increased for a fourth consecutive month and the household savings rate has stopped rising, suggesting first-quarter GDP growth in the neighbourhood of 3%. Though confidence indexes are listless, consumers are spending. With February retail sales exceeding expectations despite bad weather, the underlying trend is distinctly encouraging. Retail sales excluding gasoline and motor vehicles are now almost back to their pre-recession peak.

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One year later

Financial markets have improved dramatically over the last year. The S&P/TSX is up about 60% from its March 2009 low of 7,566. Injections of liquidity by the world's central banks and synchronized global fiscal stimulus packages have helped to normalize credit markets and restore investor confidence. Yet although equities have rebounded significantly, most indexes are still more than 20% below their pre-recession peaks. Importantly, the stock market upswing has been accompanied by a very impressive recovery of corporate profits that has helped to keep valuations reasonable. The 2008-09 global financial crisis may have been the worst since the 1930s, but the collateral damage to the economy has been much less severe.

Fourth-quarter operating earnings of the companies in the U.S. benchmark index, the S&P 500, were the best in six quarters, up from essentially zero a year earlier. S&P 500 earnings have now been growing for four straight quarters, the first such run since Q3 2006.

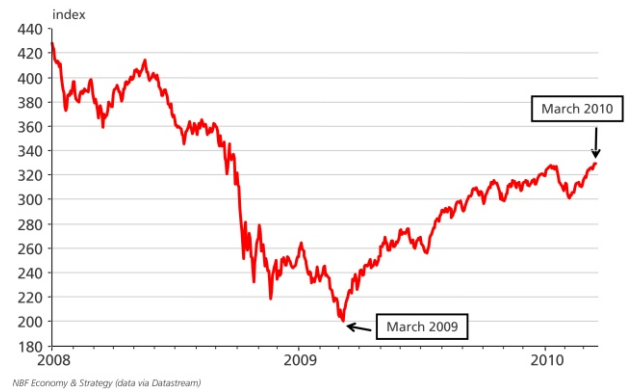
Guidances from management remain optimistic. The ratio of negative to positive pre-announcements for S&P 500 companies remains well below the long-term average, a bullish sign for first-quarter earnings. With U.S. nonfinancial corporations enjoying their best post-recession profit margins in 40 years and revenues poised to grow strongly, earnings will very likely continue to surprise on the upside. Our forecast of U.S. employment growth leaves us comfortable with the current consensus expectations for 2010 earnings growth, 30.1% in the U.S. and 20.7% in Canada. Given the current environment of very low interest rates, valuations remain attractive for this point in the cycle. The S&P 500 is currently trading at roughly 15.0 times forecast 2010 earnings. Historically, the average P/E ratio one year into an economic recovery is closer to 16. That said, investors should expect 2010 to bring much less impressive

returns than 2009 (6%-10% instead of 60%).

The outlook for government bond yields has become a concern for market participants. Market volatility since the beginning of the year has been due partly to increased fear of default on sovereign debt. Our view is that although this problem is a risk factor for financial markets, the adoption of credible austerity measures coupled with a support plan from the European Union (or the IMF) will allow countries such as Greece to meet their fiscal challenges. In addition, the ongoing global economic recovery can be expected to help stabilize the debt-to-GDP ratios of

Equity markets: One-year later

Global MSCI equity index (includes developed and emerging markets)



many of the developed economies whose public debt surged during the credit crisis. Though public finances will remain a challenge over the medium term, we expect cyclical forces to dominate structural factors in the short term. Consequently, a significant rise in global interest rates is unlikely at this point in the cycle.

CANADA

On the G7 growth podium in 2010

The Canadian economy expanded at a very strong 5% annual rate in the fourth quarter, the best quarterly growth since 2000. Domestic demand growth was in the neighbourhood of 5% for a second straight quarter, far outpacing U.S. demand. Canada is now on the brink of expansion, with domestic demand only 0.6% below the pre-recession peak.

Canada is well ahead of the U.S. in the recovery of its labour market. Jobs in services rose to an all-time high in February and the aggregate wage bill continues to grow strongly, confirming that domestic demand has legs. Canadian households are also enjoying a wealth effect from home-price appreciation. The selling price of existing homes ended 2009 at a new high, in marked contrast to the U.S. where prices are still 29% below the peak of July 2006. Resale activity in Canada is being stimulated by historically low mortgage rates that make homes the most

affordable in a generation. This is a different phenomenon from the U.S. bubble of the mid-2000s, where lenders offset a deterioration of housing affordability by promoting "non-traditional" mortgages with no repayment of principal. Despite the recent surge, the Canadian mortgage market remains healthy.

While Finance Minister Jim Flaherty recently announced measures to ensure that homebuyers will be able to withstand an increase in interest rates, the housing market is likely to remain robust until the Bank of Canada raises interest rates. Given the improving U.S. economic backdrop and the resulting pickup in exports, our central bank can be expected to begin raising rates later this spring or early this summer.

We expect Canada to be on the G7 growth podium in 2010 with real GDP growth exceeding 3%.

Common stocks remain our asset class of choice

While North American stock markets have essentially moved sideways since the beginning the year, they have appreciated significantly since the lows experienced in early March 2009. Even with more signs appearing daily confirming the economic recovery in North America and abroad, the big question at this stage is whether stocks still remain attractive from a risk-adjusted return perspective given the spectacular run they have had over the last twelve months.

With markets trading at roughly 15 times earnings and an economic recovery that is surprising many on the upside, we think the answer to this question is yes, which is why we are maintaining the overweight position we have had in equities since the end of the second quarter of 2009. With interest rates at historic lows and each passing day bringing us one day closer to the moment where monetary authorities will be forced to implement rate hikes, we are less sanguine about the bond market. As a defensive move we have trimmed our fixed-income exposure a little

with cash being the beneficiary, and we have also slightly reduced our duration, which is now roughly half a year shorter than the benchmark duration of 5.9 years.

From a geographic perspective, we continue to favor North America, with a corresponding underweight in foreign equities. Coming out of the recession we had a slight preference for the Canadian market because of its heavy weighting in resources and interest from around the world in our rock-solid financial institutions. With a Canadian dollar trading at close to parity and our expectation that domestic demand south of the border will firm up as the baton of the U.S. recovery is passed from the public to the private sector, we are comfortable adding a little to our U.S. equity exposure at the expense of foreign stocks. Finally emerging markets continue to look appealing, although the higher volatility they have historically shown limits the weighting they should have in the foreign equity portion of a portfolio.

Till now we have had a positive bias

towards growth stocks which normally lead the market coming out of a recession, and while we continue to favor them, an inflection point is approaching at which we will begin looking more closely at the value side of the market. We are currently overweight the consumer discretionary, information technology and energy sectors, while remaining underweight consumer staples, telecommunication services and utilities.

For the fixed-income component of our model portfolio, we maintain an underweight position in federal bonds, preferring provincial and corporate issues. In our view, the case for corporate bonds is still intact despite the strong performance this asset class delivered in 2009, since substantial GDP growth should result in a narrowing of spreads in the coming months.

OUR FORECAST

	2008	2009	FORECAST	
			2010	2011
Gross Domestic Product (%)				
Canada	0.4	(2.6)	3.2	2.3
U.S.	0.4	(2.4)	3.4	2.2
Inflation (%)				
Canada	2.4	0.3	1.7	2.2
U.S.	3.8	(0.3)	2.7	2.4
Short-term rates (T-Bills, 91-Day) (%)				
	March 2010		Dec. 2010	
Canada	0.25		1.72	
U.S.	0.15		1.33	
10-year bond yields (%)				
Canada	3.48		4.14	
U.S.	3.69		4.35	
30-year bond yields (%)				
Canada	4.05		4.45	
U.S.	4.58		4.96	
Canadian dollar	U.S.\$0.98		U.S.\$0.92	
S&P / TSX Sector Rotation				
Overweight		Underweight		
Consumer Discretionary		Consumer Staples		
Energy		Telecommunication		
Information Technology		Utilities		

(CONTINUED PAGE 1 « United States »)

The labour market has stopped shedding jobs and the unemployment rate has most likely peaked. Now we need gains. We expect them this spring.

Employment growth is unavoidable for several reasons. First, the U.S. is taking a census this year and over the next few months the government will hire more than half a million people for the decennial count. Second, and more important, the business cycle is entering a hiring phase. Business investment is coming to life. Spending on machinery and equipment expanded in the fourth quarter at the fastest pace in almost four years and new orders of nonmilitary capital goods remain strong. This is a recipe for payroll growth. Cyclical industries

including manufacturing, retailing, temporary-help supply and trucking have all begun to add jobs in recent months.

U.S. employers shed jobs massively over the last two years, laying off 4.2% of all workers. That was more than the 3.8% contraction of GDP. Though the economy shrank only slightly more than in 1973, it lost three times as many jobs. In other words, the surge in production since last summer has been achieved by phenomenal productivity growth. This growth is now testing its physical limits. Any pickup in demand will require businesses to add capital and labour to the production process. We expect the U.S. economy to grow approximately 3.5% in 2010.

MODEL PORTFOLIOS

Income Portfolio

Investor Profile : You want to preserve your capital or establish a source of periodic income to finance ongoing expenses. You do not find the stock market very attractive because of its volatility, but you are not against the idea of investing a small part of your portfolio in stocks, mainly to counteract the effects of inflation. Your tolerance for risk is very low.

Asset Class	Minimum/Maximum	Benchmark	Recommended Weighting	Change from Previous Quarter
Cash equivalents	0% to 20%	10%	10%	—
Fixed-income (duration: 5.4 years) ¹	60% to 100%	70%	68%	—
Canadian equities	0% to 30%	10%	11%	—
U.S. equities		5%	6%	—
Foreign equities		5%	5%	—

Conservative Portfolio

Investor Profile : On the whole, you want your portfolio invested in fixed-income securities. Although you can tolerate limited volatility to ensure that your assets will grow, you prefer having a portfolio consisting mainly of fixed-income investments for reasons of stability. Your tolerance for risk is low.

Cash equivalents	0% to 15%	5%	4%	—
Fixed-income (duration: 5.4 years) ¹	50% to 80%	60%	58%	—
Canadian equities	20% to 45%	20%	23%	—
U.S. equities		7.5%	10%	+ 1
Foreign equities		7.5%	5%	- 1

Balanced Portfolio

Investor Profile : You give equal weight to income and capital growth. You can tolerate moderate volatility to ensure the growth of your capital, but you prefer having a portfolio with a significant exposure to fixed-income securities for reasons of stability. Your tolerance for risk is average.

Cash equivalents	0% to 20%	5%	4%	—
Fixed-income (duration: 5.4 years) ¹	30% to 65%	45%	43%	—
Canadian equities	30% to 65%	25%	29%	—
U.S. equities		10%	12%	+ 1
Foreign equities		10%	7%	- 1
Alternative investments ²	0% to 15%	5%	5%	—

Growth Portfolio

Investor Profile : Your main goal is capital growth. Although you can tolerate greater volatility in order to increase the value of your assets, you are not prepared to invest your entire portfolio in stocks. Your tolerance for risk is high.

Cash equivalents	0% to 25%	0%	0%	—
Fixed-income (duration: 5.4 years) ¹	25% to 45%	35%	30%	—
Canadian equities	40% to 75%	25%	31%	—
U.S. equities		15%	18%	+ 1
Foreign equities		15%	11%	- 1
Alternative investments ²	0% to 20%	10%	10%	—

Maximum Growth

Investor Profile : You want to maximize the eventual return on your capital by investing all or most of your portfolio in the stock market. In doing so, you accept higher volatility of your investment returns in the hope that these returns will ultimately be higher. Your tolerance for risk is very high.

Cash equivalents	0% to 30%	0%	0%	—
Fixed-income (duration: 5.4 years) ¹	0% to 30%	20%	15%	—
Canadian equities	55% to 100%	25%	30%	—
U.S. equities		20%	23%	+ 1
Foreign equities		20%	17%	- 1
Alternative investments ²	0% to 25%	15%	15%	—

1) Includes conventional and real return bonds. Benchmark = 75% DEX Universe Index, 25% SC RRB Index

2) Includes hedge funds and real estate. Benchmark = 50% Tremont Hedge Fund Index, 50% S&P TSX Cap REIT Index

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