

August, 2006

## WORLD MARKET OUTLOOK

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In June 2006, we recommended moving 10% to cash and, for some, a shift out of Canadian equities to money market funds in view of a fast and furious declining global equity market. The concerns were the global liquidity issue (starting with the US Fed's tightening of the short-term interest rate by more than 1% point since the beginning of this year), rising commodity prices, higher energy cost and worry of runaway inflation.

During the month of July, worry of a further US short-term interest rate rise has abated with the US Fed Chairman flip-flopping on his position on inflation outlook. Bank of Canada has also followed suit by keeping their interest rate outlook stable. One of US Fed's reasons for their inflation outlook is the belief that there is a lagged effect between Central Bank's raising interest rates versus its impact on economy. Hence, despite short-term indicators showing inflationary numbers, expectation is for a significant slowdown in economic growth in the US later this year. In fact, some have argued that even if there are no more hikes in US interest rates, the US economic slowdown could deteriorate into a recession, causing interest rate yields to decline significantly (creating a better climate for bonds). Perhaps it is this win-win situation that prompted Chief Investment Officer of PIMCO investment (biggest private bond investor in the world) Bill Gross to declare his increase in weighting for bonds and predicting that the US Fed is close to the end of its rate hike cycle. While the outlook for bonds is seemingly predictable, the equity market is not as clear. Central banks around the world – the latest being China and India – continue to raise rates, reducing liquidity and support for the stock market.

Regionally, the Canadian equity market continues to be largely affected by commodity and oil prices. The recent parabolic rise in commodities prices like copper, zinc, nickel and other material may become a concern in the near future. Although our commodity outlook is uncertain, we favor the oil sector of our economy. Oil price is supported by the strong emerging market demand from China and India due to their growing industrial and consumer base. Geopolitical uncertainties, as well as a short supply, are likely to keep oil above \$60 per barrel for a while. Furthermore, oil producing countries within OPEC have made enough money from recent high oil prices to provide a price cushion for any drop in demand and are in no hurry to increase supply. Recent talks of oil prices reaching the \$100 per barrel look less far fetched and are gradually becoming less scary and more mainstream. Jim Roger, co-founders of the Quantum fund, is predicting this bullish outlook.

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In the US, although the fundamental outlook is mixed, the technical cycle analysis shows a more bullish picture. A study of the cyclical patterns of S&P 500 chart from 1930's to now show average gains of 19.56% to 25.41% in every 4-year cycle. So far, there have been 18 of such cycles and each one of them has resulted in a positive return since 1930's. The last cycle was in the 2002 when the world was preparing for US war against Iraq, and when market sentiment was still bearish. We are currently entering into the Aug-Oct 2006 period of this 4-year cycle. This technical study provided us with some confidence that the US stock market should hold up well for the coming year and hopefully this could provide some stability to the global equity outlook.

In Asia, China is still experiencing higher growth but in Taiwan and Korea, withdrawal of foreign investment in these markets is putting a lid on Asia/Emerging market performance. Diversification to Europe, however, has provided the added benefit of foreign currency appreciation in a time of a depreciating Canadian dollar against the Euro.

## **PRISM Portfolio Update**

We believe that quality remains our key to successful investment in this cycle. Quality fixed income, including cash, government bonds and good credit quality corporate bonds are reasonable positions in a late stage growth cycle. For our Cash/Fixed Income market portfolio, we are confident in our long term outlook. Average return for Cash/Money market should be in the 3-3.75% range. Fixed income in the year-to-date (YTD) return has been in the -0.32% to -2.51% range but should improve in outlook from here onwards. The worst performance this year is the Real Return Bond Sector, YTD return at -2.51%. This sector did not live up to expectations despite our forecast for higher inflation for the last two quarters and is currently on our watch list for review. Otherwise the Government and Corporate Bonds sector continue to be favored in the current environment.

We believe that our strategy to be in diverse Equity Blocs (Asia, Europe, US and Canada) is the most optimum position. We are currently exposed to the small cap equity in Canada through Ethical Special Equity, US Equity through Chou Associates, European Equity through AGF European Equity and Asia/Emerging Market through Mac Cundill Recovery Class "C".

Most of our recommended funds continue to generate positive "Alpha"- a return above their respective benchmarks despite the lackluster global market performance on the year to date basis. Looking at a comparison between our funds (year-to-date up to July 31, 2006) versus the benchmarks measured by MSCI index, we find that:

- The US index is at +1.82%, our exposure through US Chou Associates is +6.84%.
- The Canadian Index is at +4.86%, our exposure to Ethical Special Equity is +8.73%.
- The World Market Index is at +2.26%, our Mac Cundill Recovery "C" is at +9.42%.
- The Europe Index is at +4.33%, AGF European Equity is at 16.80%.

We are looking to add similar "Alpha Managers" to our Canadian funds with exposure to more core sectors such as financial and energy which we believe will remain the key drivers of our

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Canadian economy for the rest of the year. The “Acuity Canadian All Cap 30” fund fits this selection criteria; High Sharpe ratio and at least of 5 years of good track record (see attached PDF summary of this fund).

## Recommendation

- 1) For the CASH/FIXED INCOME ACCOUNT, we recommend no changes although we shall keep TD Real Return Bonds on watch.

Based on our global equity outlook, we are recommending that where appropriate, clients should shift funds from money market back to the equity market to improve risk-adjusted performance.

- 2) For Elliott and Page Money Market, we recommend a change to Acuity Cdn All Cap 30 Equity. ( For those with extra cash holdings / or new contributions, we may suggest to put them in this new fund where appropriate)
- 3) For Acuity Money Market, we recommend a switch back to Acuity High Income.
- 4) CI Money Market Fund, we recommend a switch back to CI Canadian Investment.

We remind you that consistent with our policy, where client’s funds are on a Deferred Sales Charge (DSC) load, we will be rebating from new fees collected through the purchases.

Our team will be reviewing each client file and recommending appropriate changes in the upcoming weeks. Please keep in mind that these are recommendations only. We encourage you to use your discretion when deciding whether or not to proceed with these changes.

In the meantime, if you have any questions, or would like to discuss any of these issues with us, we encourage you to call us.

Sincerely,



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*E&OE : INVESTMENT FUND VALUES CHANGE FREQUENTLY AND PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE PERFORMANCE. NO GUARANTEE IS GIVEN OR IMPLIED AND THERE IS RISK OF LOSS AS WELL AS THE OPPORTUNITY FOR GAIN WHEN INVESTING IN MUTUAL FUNDS.*

**Appendix**

**Potential for Up Market**  
(S&P 500 Chart 1930-Aug 1, 2006)

