



## Economics

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*"...this slowdown has come when the economy was still supposed to be doing very well..."*

# THE WEEK AHEAD

August 16-20, 2010

## The Great Disappointment

by Avery Shenfeld

Economists have enough trouble forecasting the future, now we have to forecast the past. The last few weeks have seen major revisions to previously reported data for the US economy, not all of them bad, but for the most part leaning that way. The result is that we're no longer looking at a material second-half slowing, because as it turns out, the economy has *already* slowed. Second-quarter growth stateside looks to be revised to roughly 1½%, owing to weaker-than-assumed inventories and net exports for June, numbers that were only guessed at in the "advance" GDP figures. Earlier, the whole path of the recession was made deeper in benchmark revisions, shedding new light on why America's job losses were so severe.

For Canada, the slowdown story, to a lesser extent, has already landed. Second-quarter growth looks on track for a 2½% pace, less than half the average of the prior two quarters, and a half-point slower than the Bank of Canada's last projection.

Neither economy is doomed to do worse in the second half than what we've already been seeing. The US payrolls data included reasonable gains in total income and hours worked and savings rates have been boosted, both leaving fuel for a bit more household spending. And there's a reasonable chance that, unlike in Q2, where spending got diverted mostly to imports, a bit more might fall into the laps of American domestic suppliers. Housing will be a big downdraft now that special tax incentives have ended, but fresh funding from Washington might prevent as severe a cut to state and local spending as we saw in Q2.

We don't yet have much to go in terms of real time indicators for Canada's Q3. Homebuilding looks set to become a drag, but exports should benefit from better US auto sales, and government spending (while coming off a June spike associated with the G-20 meetings), will get some lift from infrastructure projects that appear to be getting underway. All told, we might be facing another middling quarter for growth.

So why the big worry? Because this slowdown has come when the economy was still supposed to be doing very well, enjoying the fruits of fiscal stimulus, very low interest rates and a recovery in global trade and inventories. Fears about falling into a double-dip recession in the second half are overdone, but the US could be looking at minimal growth early next year as fiscal stimulus expires, and Canada could also dip below 2%. Even in Europe, where the second quarter was a Teutonic boom, the ECB is rightly wary about what lies ahead, since we have yet to see the impact of austerity budgets, and even Germany hasn't revived domestic household demand much. Even worse, where a private sector recovery is most essential—in the countries that really have hit the debt wall—growth is either slim (Portugal and Spain) or steeply negative (Greece).

If fiscal policy backs off severe tightening, as we expect it will in the US, policy loosens again in China, the Fed lends a hand with quantitative easing, and the Bank of Canada doesn't wait too long before taking an extended pause, the Great Recession should still be behind us. But welcome to the "Great Disappointment".

<http://research.cibcwm.com/res/Eco/EcoResearch.html>



## Week Ahead's Market Call

by Avery Shenfeld

**In the US**, the only good news about housing starts is that they can't really go much lower than they already are, and we might see a meaningless, small upside bump. Industrial production should see a decent gain given rising factory hours worked. Jobless claims, despite being a weekly indicator, could be the most market-moving number, as the last two week's upturn could look more ominous if followed by a jump to the 500K range, much less so if it levels off or slips slightly, which would imply a still-sideways trend.

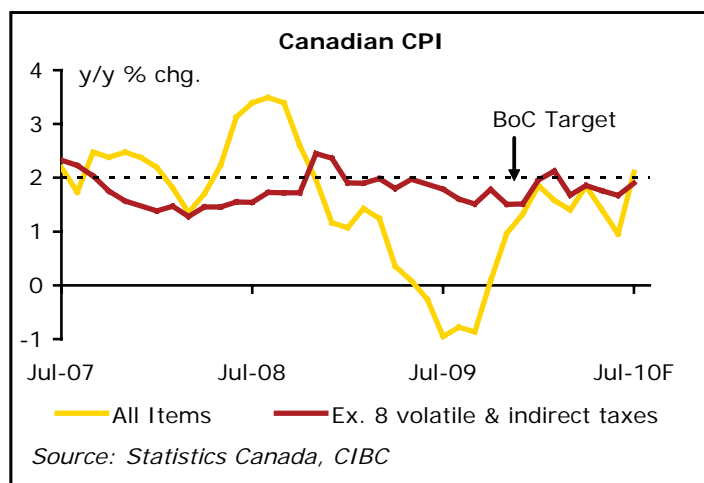
**In Canada**, we get two key readings on June economic activity, covering manufacturing, where we see shipments giving back the prior month's gain, and wholesaling, which might be only flat. What will be still missing from June data are retailing, and government, two areas where we expect healthy gains. CPI captures the HST introduction in the headline rate, but we see a trend-like 0.2% rise in core prices. If so, that might remind a now very-dovish bond market that core inflation isn't that far from the central bank's target.

**Week Ahead's Key Canadian Number:****Consumer Price Index—July**

(Friday, 7:00 a.m.)

Krishen Rangasamy (416) 956-3219

	CIBC	Mkt	Prior
CPI m/m NSA	0.8%	0.6%	-0.1%
CPI yr/yr	2.1%	2.0%	1.0%
Ex 8 volatile items m/m NSA	0.2%	0.1%	-0.1%
Ex 8 volatile items yr/yr	1.9%	1.8%	1.7%



After hitting an 8-month low in June, Canada's year-on-year headline inflation rate is on its way up again. The implementation of the Harmonized Sales Tax in Ontario and BC in July translated to higher prices in those provinces for several items, particularly services, which were PST-exempt earlier. More expensive gasoline also added to upward price pressures nationally while food prices, which have been tame in recent months, may finally show some heat as imported fresh produce responds to a weaker Canadian dollar. With the HST contributing an estimated 0.6% to prices, the headline CPI should increase by around 0.8% (seasonally adjusted and NSA) which should take the year-on-year headline inflation rate to 2.1%. Excluding volatile items (and the HST), prices will, of course, be milder. Still, a 0.2% monthly increase in core prices (seasonally adjusted and

NSA), helped by higher prices for new homes and autos, should cause the year-on-year core inflation rate to rise two notches to 1.9%.

**Forecast Implications**—The HST-driven spike in the headline inflation rate will come as no surprise to the Bank of Canada which sees it averaging 2.1% in Q3. Core inflation remains close to the BoC's 2% target and, with the narrowing negative output gap, warrants the current stance of tighter monetary policy. We continue to expect a further 25-bp interest rate hike in September.

**Market Impact**—We are slightly higher than consensus, which should be positive for the C\$ and negative for bonds if our call is on the mark.

**Other Canadian Releases:****Manufacturing Shipments—June**

(Tuesday, 8:30 am)

Manufacturing activity has been on an upswing recently, with shipments rising in eight of the last nine months. However, that uptrend may have been interrupted in June if that month's disappointing merchandise trade report is any guide. The latter showed export declines from the prior month in several manufacturing categories including autos, metals and petroleum and coal products. Our call

for a 0.5% decrease in nominal shipments reflects the poor export performance and lower industrial product prices in the month, while acknowledging that there may have been a partial offset from domestic shipments. The drop in real shipments should be more modest although that will still put a dent in June's GDP.

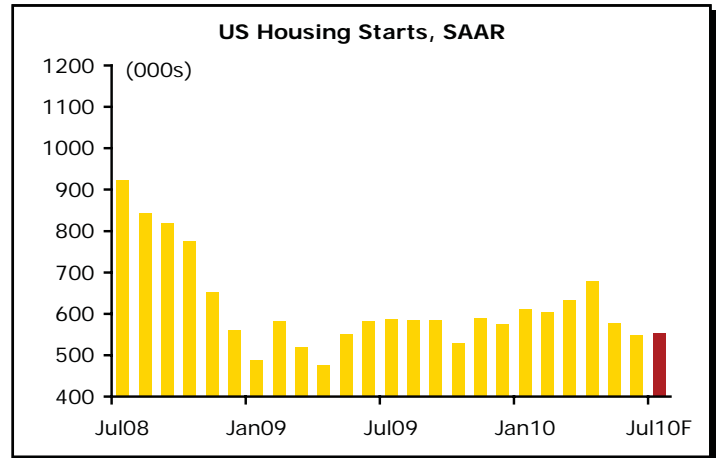
**Week Ahead’s Key US Number:**

**Housing Starts—July**

(Tuesday, 8:30 a.m.)

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	CIBC	Mkt	Prior
Housing Starts (SAAR)	554K	560K	549K
Building Permits (SAAR)	583K	576K	582K



Although US housing starts are up approximately 15% since bottoming in April 2009, new residential construction is still over 75% below where it peaked before the housing market crashed. Homebuilders remain exceedingly cautious as they continue to be undercut by a steady wave of distressed properties, and while inventories of new homes are the lowest that they have been since 1970, that is more reflective of a very weak sales environment than a sign of lagging supply.

After two months of declines, most likely tied to the expiry of the federal homebuyers’ tax credit, we expect starts to have climbed in July, but only by a small 1%. Although some of the recent weakness in activity may

be more of a timing issue as generous tax incentives shifted some future purchases into prior months, starts will remain quite depressed for some time in the absence of additional stimulus.

**Forecast Implications**—With residential fixed investment only accounting for roughly 2% of GDP, housing is unlikely to be an important economic driver for some time to come. Housing starts are higher than they were last year, but what momentum they did have appears to have been lost.

**Market Impact**—Our forecast is too close to consensus to move markets.

## Equity Insights

Peter Buchanan

### Corporate Guidance Becoming More Cautious

US equity markets posted their best gains in a year in July, aided by a materially better-than-expected 38% year-to-year rise in Q2 earnings. With the reporting season 90% over, attention is fast shifting from the good profit story to the broader economy's still none-too-healthy state. A somewhat more cautious tone from boardrooms may also be contributing to selling pressure. Downgrades to Q3 earnings guidance have exceeded upgrades by a larger-than-usual 2.4 margin. That's far above Q2's level and suggests corporations are becoming more cautious about their ability to meet the streets' earnings targets as the economy slows.

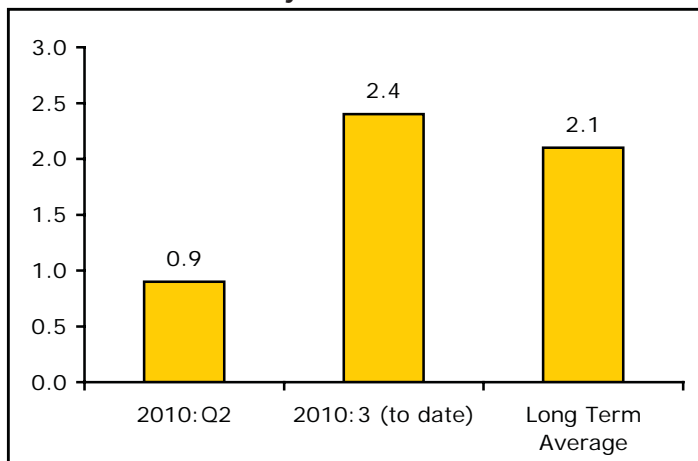
### Weaker Productivity Not Bullish for Job Growth

The US earnings recovery has depended more than previous ones on impressive productivity performance. Q2's unexpected drop in non-business output per hour worked suggests that the efficiency party may now be winding down. One hope is that slower productivity will force corporations to hire more. But the evidence on that point isn't compelling. Job creation boomed after productivity growth slowed after the 1991 recession, but the experience following the 2001 recession was markedly different. Private payrolls continued to fall for over half a year after productivity growth weakened late in 2002, that time around. In the longer haul, productivity and US private payrolls growth have actually shown a weakly positive correlation. The latest numbers may not, consequently, spell the end of the hiring drought.

### China's Data Suggest Moderation Not Freefall

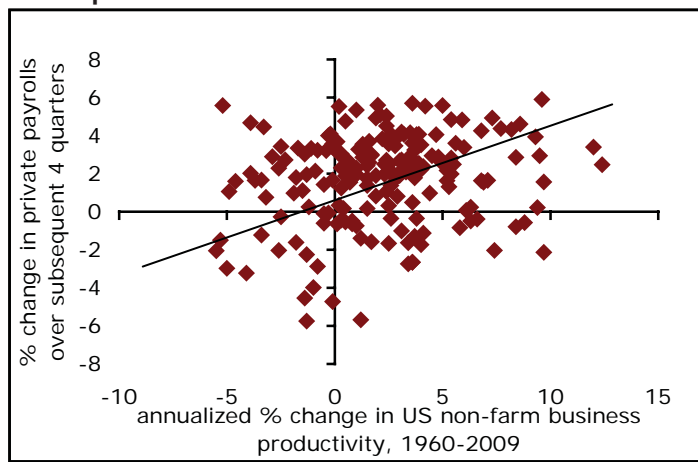
China's GDP growth slowed to a 10.3% pace on the year in Q2 and the latest data points to continued deceleration as recent tightening measures bite. Industrial production eased to a consensus matching 13.4% yearly pace in July, with retail sales and loan demand falling a bit short of the street's expectations. Although China doesn't publish quarterly annualized GDP data, our own estimates point to a gain of around 8% on that basis in Q2. That would appear to signal a measured downshift as opposed to freefall to this point in time. Stripping out flood-affected food prices, inflation is running at just a 1.6% pace. Resource prices have consequently drawn support recently from hopes that cooler growth and headline inflation will lead the government to unwind some of its recent braking steps by year's end.

Ratio of Negative to Positive Earnings Pre-Announcements by S&P 500 Members

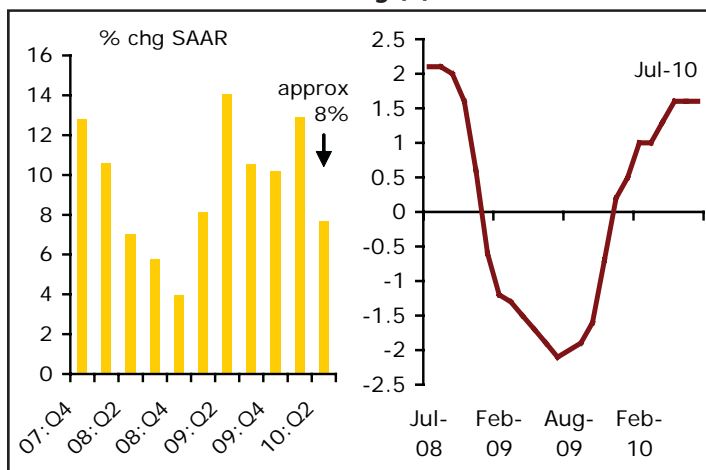


Source: Thomson Reuters

Weak Positive Relationship Between Productivity and Subsequent Job Growth



China's Growth Moderating, Not Freefalling (L), Ex-Food Inflation Still Non-Threatening (R)



Note: GDP est based on smoothest series that matches published yly growth data, using Hodrick-Prescott type filter.

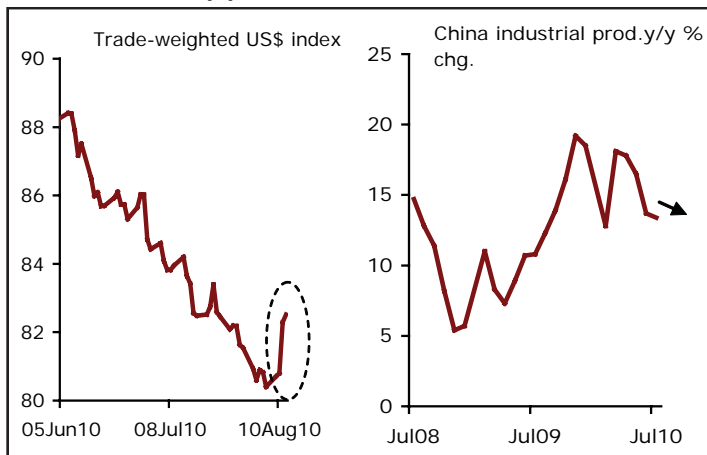
## Currency Currents

Krishen Rangasamy

### Can the US\$ Add to the Past Week's Gains?

After several weeks of being pummeled by a euro revival, the US\$ seems to have found its feet again. While this past week's appreciation came courtesy of safe-haven flows on growing concerns about global growth (after China and Japan posted softer-than-expected data), relatively better US economic fundamentals could also lend a hand to the greenback over the balance of Q3. It won't be too difficult to build on a 1.5% or so US GDP growth for Q2 (expected to be revised down from the current 2.4% annualized). Also, the euro could fall back as the eurozone finds it tough to replicate its strong Q2 data, particularly as governments make do on austerity promises.

### US\$ Regains Traction (L) as Concerns About Global Growth Return (R)

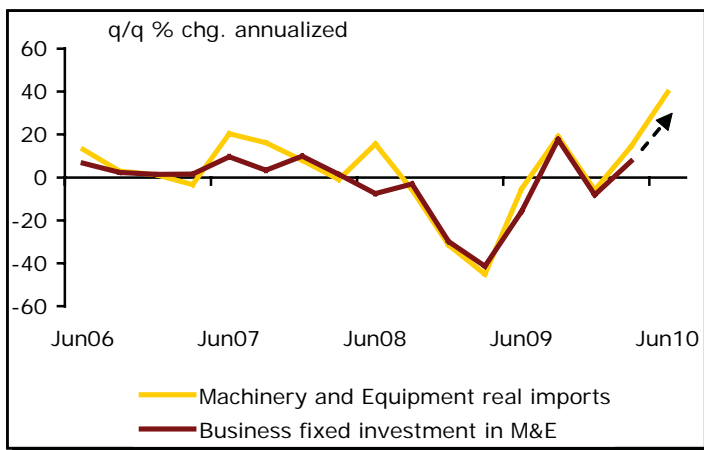


Source: Bloomberg, CIBC

### CDN Trade Data Shows Mixed Picture for Q2 GDP

Like other majors, the C\$ struggled in a week of US\$ strength, and the disappointing Canadian trade report for June did little to help. The contraction of exports in the month meant that export growth for the quarter as a whole ended up at only 3% annualized, suggesting that trade's contribution to Q2 GDP won't be stellar. However, the same trade data suggests that Canada may have found growth elsewhere, namely from business investment, as imports of machinery and equipment grew an astounding 40% in the quarter. That, coupled with decent growth in government spending, should keep Canada on track for Q2 growth of around 2.6% annualized, close enough to the BoC's estimate to maintain, at least for the very near-term, the current stance on monetary policy.

### Trade Data Suggests Business Investment Lifted Canadian Q2 GDP

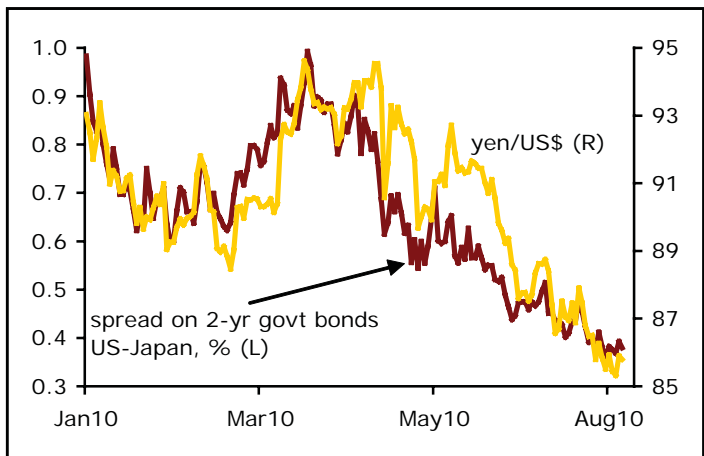


Source: Statistics Canada, CIBC

### Killing Two Deflationary Birds With One QE Stone

The Fed's decision to purchase more US treasuries helped narrow spreads with JGBs this past week, taking the yen to a 15-year high against the US\$ in the process. That has rekindled talk of intervention to prevent irreparable damage to the main driver of the Japanese economy, i.e. exports. While currency intervention may not be politically feasible (e.g. protests from trade partners and losing credibility in motivating China to accelerate the yuan float), other forms of intervention could be as effective. Expanding the QE program aggressively enough could not only take some steam out of the yen but also help address deflation concerns.

### Declining Spreads Have Supported Yen



Source: Bloomberg, CIBC

# CANADIAN RELEASE AND EVENT DATES

## August/September 2010



MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
9	10	11	12	13
	<b>HOUSING STARTS</b> 8:15 AM 000's (AR) TOTAL SINGLES MAY 198 76 JUN 192 77 JUL 189 68  <b>NEW HOUSING PRICE INDEX</b> 8:30 AM	<b>MERCHANDISE TRADE</b> 8:30 AM \$MN 12 MO. BALANCE APR 224 -3,041 MAY -695 -2,362 JUN -1,132 -3,391		<b>CAR &amp; TRUCK SALES</b> 8:30 AM 000's (AR) TOTAL DOM.BUILT CAR SALE APR 1,521 384 MAY 1,524 369 JUN 1,562 377
16	17	18	19	20
<b>WAGE SETTLEMENTS</b> 10:00 AM (%) PVT. PUB. TOT. APR 2.3 1.8 1.8 MAY 2.4 1.9 2.3 JUN	<b>INT'L TRANSACTIONS IN SECURITIES C\$BN, NET</b> 8:30 AM BONDS MONEY STOCKS TOT MARKET APR 10.0 -0.4 2.8 12.4 MAY 15.2 2.7 5.3 23.2 JUN  <b>SURVEY OF MANUFACTURING</b> 8:30 AM SHIPMENTS M Y APR 0.4 10.8 MAY 0.4 16.5 JUN		<b>LEADING INDICATOR</b> 8:30 AM  <b>WHOLESALE TRADE</b> 8:30 AM	<b>CONSUMER PRICE INDEX</b> 7:00 AM M (NSA) Y MAY 0.3 1.4 JUN -0.1 1.0 JUL
23	24	25	26	27
	<b>RETAIL TRADE</b> 8:30 AM (Current\$) M Y APR -2.2 6.4 MAY -0.2 5.2 JUN	<b>QUARTERLY FINANCIAL STATISTICS</b> 8:30 AM		
30	31	1	2	3
<b>BALANCE OF INT'L PAYMENTS</b> 8:30 AM CURR. ACCT. BAL. \$BN(QR) \$BN(AR) 09:Q4 -10.2 -40.8 10:Q1 -7.8 -31.3 10:Q2  <b>INDUSTRIAL PRICES</b> 8:30 AM M (NSA) Y MAY 0.4 1.5 JUN -0.9 0.2 JUL	<b>NATIONAL ACCOUNTS</b> 8:30 AM REAL GDP PRICE DEFLECTOR %ch AR %ch AR 09:Q4 4.9 3.8 10:Q1 6.1 4.4 10:Q2  <b>GDP BY INDUSTRY</b> 8:30 AM (2002\$) GDP IND.PROD. M M APR 0.0 0.1 MAY 0.1 1.2 JUN			<b>INTERNATIONAL RESERVES</b> 8:15 AM \$BN \$BN CHANGE LEVEL JUN -0.634 55.4 JUL 1.918 57.3 AUG
6	7	8	9	10
LABOUR DAY (HOLIDAY) (Markets Closed)		<b>BUILDING PERMITS (\$)</b> 8:30 AM M M (RES) (NON-RES) MAY -3.3 -14.8 JUN -4.5 23.5 JUL  <b>Bank of Canada Interest Rate Announcement</b>  <b>IVEY PURCHASING MANAGERS' INDEX</b> 10:00 AM	<b>HOUSING STARTS</b> 8:15 AM 000's (AR) TOTAL SINGLES JUN 192 77 JUL 189 68 AUG  <b>MERCHANDISE TRADE</b> 8:30 AM \$MN 12 MO. BALANCE MAY -695 -2,362 JUN -1,132 -3,391 JUL  <b>NEW HOUSING PRICE INDEX</b> 8:30 AM	<b>LABOUR FORCE SURVEY</b> 7:00 AM AVG EMPLOY UNEMP HRLY (HOUSE) RATE EARN M Y % Y JUN 0.5 2.2 7.9 2.0 JUL -0.1 2.3 8.0 2.6 AUG

All data seasonally adjusted except where noted "NSA". M: per cent change from previous month. Q: per cent change from previous quarter at annual rates. Y: per cent change from year earlier. AR: Annual Rate. YTD: Year to date. Release dates are provided by sources outside CIBC World Markets Inc. Dates are subject to change. Sources for historical data: Statistics Canada, CMHC, Human Resources Development Canada and the Bank of Canada.

# U.S. RELEASE AND EVENT DATES August/September 2010



MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
9	10	11	12	13
	<b>NON-FARM PRODUCTIVITY</b> 8:30 AM Q/Q (AR) Y/Y 09:Q4 (R) 6.3 5.6 10:Q1 (R) 3.9 6.1 10:Q2 (P) -0.9 3.9  <b>FOMC Meeting</b>  3-Yr NOTE AUCTION BOT (9:00) REDBOOK (10:40)	<b>GOODS &amp; SERVICES BALANCE (BOP) \$B</b> 8:30 AM GDS SERV TOT APR -52.5 12.2 -40.3 MAY -54.3 12.4 -42.0 JUN -62.0 12.1 -49.9  <b>TREASURY BUDGET</b> 2:00 PM  10-Yr NOTE AUCTION	<b>MONEY SUPPLY M-2</b> 4:30 PM M Y MAY 1.0 1.7 JUN 0.4 1.8 JUL 0.0 2.0  30-Yr BOND AUCTION INITIAL JOBLESS CLAIMS (8:30)	<b>CPI</b> 13 8:30 AM M(SA) Y (NSA) MAY -0.2 2.0 JUN -0.1 1.1 JUL 0.3 1.2  <b>RETAIL SALES</b> 8:30 AM M Y MAY -1.0 6.9 JUN -0.3 5.2 JUL 0.4 5.5  <b>MICHIGAN SENTIMENT (P)</b> 10:00 AM <b>BUSINESS INVENTORIES</b> 10:00 AM
16	17	18	19	20
<b>NET CAPITAL INFLOWS TICS</b> 9:00 AM  3, 10, 30-Yr NOTE SETTLEMENT	<b>PRODUCER PRICE INDEX</b> 8:30 AM M (SA) Y (NSA) MAY -0.3 5.3 JUN -0.5 2.8 JUL  <b>HOUSING STARTS</b> 8:30 AM MIL (AR) M MAY 0.578 -14.9 JUN 0.549 -5.0 JUL  <b>CAPACITY UTIL/IND. PROD.</b> 9:15 AM LEV M Y MAY 74.1 1.3 7.9 JUN 74.1 2.3 8.2 JUL BOT (9:00) REDBOOK (10:40)	<b>LEADING INDICATOR</b> 10:00 AM  <b>PHILADELPHIA FED INDEX</b> 10:00 AM  2, 5, 7-Yr NOTE ANNOUNCEMENT  INITIAL JOBLESS CLAIMS (8:30)		
23	24	25	26	27
	<b>EXISTING HOME SALES</b> 10:00 AM  2-Yr NOTE AUCTION  BOT (9:00) REDBOOK (10:40)	<b>DURABLE GOODS ORDERS</b> 8:30 AM M Y MAY -0.7 15.3 JUN -1.2 15.8 JUL  5-Yr NOTE AUCTION  <b>NEW HOME SALES</b> 10:00 AM	7-Yr NOTE AUCTION  INITIAL JOBLESS CLAIMS (8:30)	<b>GDP</b> 27 8:30 AM (AR) REAL IMPLICIT GDP DEFLATOR 10:Q1 (F) 3.7 1.1 10:Q2(A) 2.4 0.8 10:Q2(P)  <b>CORPORATE PROFITS</b> 8:30 AM <b>MICHIGAN SENTIMENT (F)</b> 10:00 AM  <b>Chairman Bernanke speaks in Jackson Hole at Kansas City Fed Conference,</b> 10:30 AM ET
30	31	1	2	3
<b>PERS. INCOME &amp; OUTLAYS</b> 8:30 AM SAVING INCOME CONS RATE M M AR MAY 0.3 0.1 6.3 JUN 0.0 0.0 6.4 JUL	<b>S&amp;P/CASE-SHILLER HOUSE PRICE INDEX</b> 9:00 AM  <b>CHICAGO PMI</b> 9:45 AM  <b>CONSUMER CONFIDENCE</b> 10:00 AM 2-, 5-, 7-Yr NOTE SETTLEMENT  <b>FOMC Minutes</b>  BOT (9:00) REDBOOK (10:40)	<b>ADP SURVEY</b> 1 8:15 AM  <b>FACTORY ORDERS</b> 10:00 AM M Y MAY -1.8 13.9 JUN -1.2 11.3 JUL  <b>ISM MFG SURVEY</b> 10:00 AM COMP. PRICES INDEX INDEX JUN 56.2 57.0 JUL 55.5 57.5 AUG  <b>LIGHT VEHICLES</b> SALES MIL (AR) Y JUN 11.139 13.7 JUL 11.522 2.2 AUG	<b>NON-FARM PRODUCTIVITY</b> 8:30 AM Q/Q (AR) Y/Y 10:Q1 (R) 3.9 6.1 10:Q2 (P) -0.9 3.9 10:Q2 (R)  3-, 10-Yr BOND ANNOUNCEMENT 30-Yr NOTE ANNOUNCEMENT  INITIAL JOBLESS CLAIMS (8:30)	<b>EMPLOY. SITUATION</b> 8:30 AM NON- CIV AVG FARM UNEMP HRLY PAYROLL RATE EARN (000s) M % Y JUN -221 9.5 2.4 JUL -131 9.5 2.3 AUG  <b>ISM NON-MFG SURVEY</b> 10:00 AM
6	7	8	9	10
<b>LABOR DAY (HOLIDAY)</b> (Markets Closed)	3-Yr NOTE AUCTION	<b>FOMC Meeting</b>  10-Yr NOTE AUCTION  BOT (9:00) REDBOOK (10:40)	<b>GOODS &amp; SERVICES BALANCE (BOP) \$B</b> 8:30 AM GDS SERV TOT MAY -54.3 12.4 -42.0 JUN -62.0 12.1 -49.9 JUL  30-Yr BOND AUCTION INITIAL JOBLESS CLAIMS (8:30)	

All data seasonally adjusted except where noted "NSA". M: per cent change from previous month. Q: per cent change from previous quarter at annual rates. Y: per cent change from year earlier. AR: Annual Rate. YTD: Year to date. Release dates are provided by sources outside CIBC World Markets inc. Dates are subject to change. Sources for historical data: U.S. Department of Commerce, U.S. Department of Labor and U.S. Federal Reserve Board.

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