CIBC World Markets

CANADIAN PORTFOLIO STRATEGY OUTLOOK

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Strategy

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It is difficult to see these unprecedented adjustments occurring without even higher crude prices.

Executive Summary

by Peter Buchanan

The mortgage market crisis is now a year old. Twelve months ago, the Fed's game plan seemed simple enough—cut rates deeply, to keep the worst housing crunch in decades from crippling the consumer. Now, with inflation at 17-year highs and the economy sick but not quite comatose, the policy choices are much less obvious.

Amidst that uncertainty, one sure bet is that with the flow of rebate cheques drying up, Q3 growth stateside will be a pale image of the second quarter. Weaker economic numbers will help keep the Fed sidelined until after November's presidential election. But if history is a guide, investors are probably underestimating the magnitude of braking beyond that, as policy on both sides of the border shifts to actively fighting inflation. The last time US headline inflation hit 6%, a pace we are currently projecting, money market yields were triple and 10-year rates twice today's levels. That makes us unenthusiastic about fixed income assets and we have consequently moved to trim our bond exposure this month.

Does West Texas' recent pullback mark the end of oil's five-year bull market, as some observers loudly assert? Or is it just a detour on the road to still higher prices? Without meaningful oil production growth, more overseas drivers mean fewer in North America. The past year's half-million barrel-per-day drop in daily US crude demand is just a quarter of the reduction that we believe will be needed over the next four to five years to free up capacity to fill the gas tanks of millions of new motorists in places like China and India, and meet the Middle East's own exploding demand for subsidized electric power. Natural gas shortages there are forcing utilities to use oil for generation. It is difficult to see these unprecedented adjustments occurring without even higher crude prices.

Gold is a longstanding inflation hedge and our analysis suggests the same holds true for gold shares. We have consequently added a point of weight to that sector this month. In contrast, we remain underweight financial stocks and other groups, like the industrials, with appreciable vulnerability to energy prices or weaker North American economic performance. A continuing tough operating environment makes us doubtful that financial shares can hang onto their recent gains.

Strategy's Recommended Asset Mix & TSX GICS Sector Weights vs. Current Benchmark

ASSET MIX (%)	Bench-mark	Strategy Recom-mend.	vs Bench-mark	chg vs mon. ago*
Stocks	*53*	**53**	0.0	0.0
Bonds	*38*	**35**	-3.0	-1.0
Cash	*9*	**12**	3.0	+1.0
GICS SECTORS (%)**				
Cons. Discretionary	*3.7*	**0.7**	-3.0	0.0
Cons. Staples	*2.3*	**2.3**	0.0	0.0
Energy	*30.4*	**37.9**	+7.5	0.0
Financials	*27.3*	**24.8**	-2.5	0.0
-Banks	*15.4*	*13.4*	*-2.0*	*0.0*
-Insur., REITs, other	*11.9*	*11.4*	*-0.5*	*0.0*
Health Care	*0.4*	**0.4**	0.0	0.0
Industrials	*5.4*	**2.9**	-2.5	0.0
Info Tech	*5.2*	**5.2**	0.0	0.0
Materials	*19.0*	***22.0***	*+3.0*	*0.0*
-Gold	*7.4*	*9.4*	*+2.0*	*+1.0*
-Other Metals	*5.2*	*5.2*	*0.0*	*-1.0*
-Chemicals	*5.8*	*6.8*	*+1.0*	*0.0*
Telecom	*4.8*	**2.3**	-2.5	0.0
Utilities	*1.6*	**1.6**	0.0	0.0

Note: Shading indicates recommended overweight.
**chg in %-pt underweight/overweight from last month.*
*** Benchmark weights are for TSX Composite.*

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Post-Election Fed Tightening to Hit Bonds—Peter Buchanan and Meny Grauman

We are taking a further percentage point from bonds this month, leaving us with a 3% underweight, and shifting the proceeds into cash. Stagflation is the unwelcome new guest at the Fed's boardroom table. The economy's Q3 performance will be much softer than Q2, as still-high gas pump prices strain disposable income and the support from over $100 billion in rebate cheques fades. While that will help keep Fed policy on hold until after the election, investors are likely underestimating just how much rates will rise over the next 18 months, as headline inflation climbs from what is already a 17-year high to 6% (Chart 1). That will force the Fed to shift its focus from supporting growth to preventing a material spillover from energy and food to core inflation.

Canada's economy trailed the US in Q1, and almost certainly in Q2 as well. Given the latest uninspiring economic data, the Bank of Canada will be in no rush to match a forecast 200-point rise in the fed funds rate, which itself is not yet fully priced in by the market (Chart 2). That being said, above-target inflation will make it difficult for

Chart 1 - **US CPI Inflation Heading for 6%**

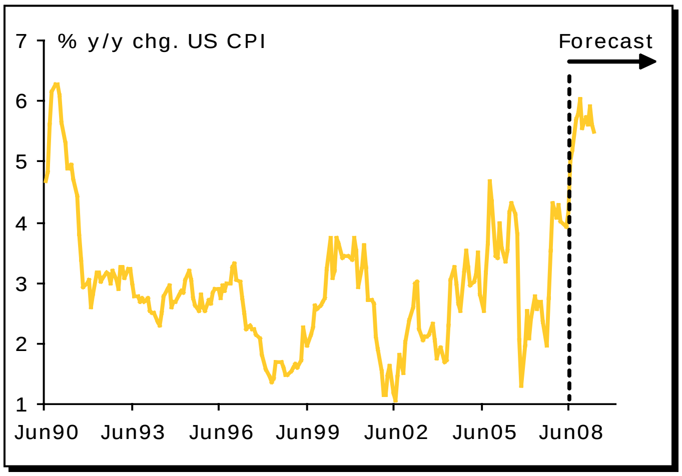

Chart 2 - **Investors Underestimate US Tightening Cycle**

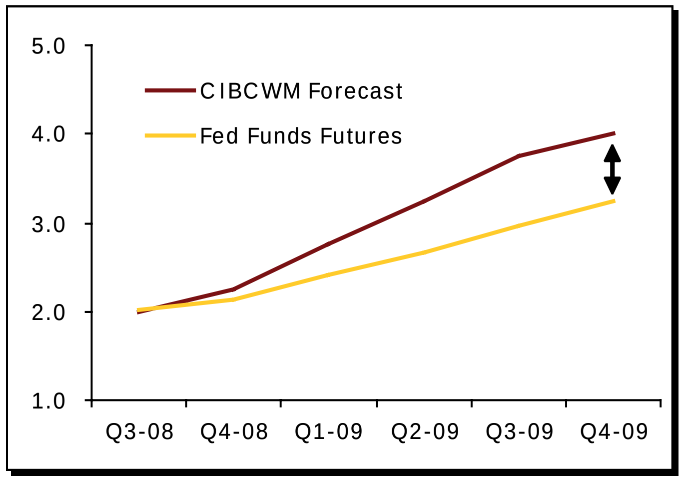

Table 1 - **Equity Projections**

		Year-end			
	Latest	2006	2007	2008	2009
TSX Composite	13,593 (7/31)	12,908	13,833	14,300	15,250
% total return	(0.2) *YTD*	17.3	9.8	6.3	9.0
TSX Operating Earnings - index adj	—	717	809	1,003	1,123
- yr/yr % chg	17.0 (08:Q2)	*13.2*	*10.4*	*24.0*	*12.0*
S&P 500	1,267 (7/31)	1,418	1,468	1,275	1,315
-% total return, YTD	(12.7)	15.8	5.5	(11.0)	5.3

Table 2 - **Economic Forecast**

		08Q1	08Q2	08Q3	08Q4	2007	2008	2009
Canada	Real GDP Growth (AR)	-0.3	0.7	1.2	3.0	2.7	1.1	2.1
	Real Consumption Growth (AR)	3.2	2.1	2.7	3.0	4.5	4.0	2.8
	CPI - Headline (y/y)	1.8	2.4	3.3	3.9	2.2	2.9	3.9
	- Core (y/y) ex taxes	1.4	1.5	1.7	2.4	2.1	1.7	2.2
	Unemployment Rate (%)	5.9	6.1	6.3	6.4	6.0	6.2	6.3
US	Real GDP Growth (AR)	0.9	1.9	-1.8	2.1	2.2	1.3	1.5
	Real Consumption Growth (AR)	0.9	1.5	-1.6	0.8	2.9	1.5	1.5
	CPI - Headline (y/y)	4.1	4.4	5.6	6.0	2.9	5.0	4.5
	- Core (y/y)	2.4	2.3	2.5	2.6	2.3	2.5	3.0
	Unemployment Rate (%)	4.9	5.3	5.8	6.1	4.6	5.6	5.6
World	Real GDP Growth (% chg)	-	-	-	-	4.9	4.3	4.3

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Governor Carney to turn a completely blind eye to policy changes stateside. We expect rates in Canada to rise by 100 bps over the course of 2009.

Asset markets have been battered in the last month by growth and inflation concerns and renewed credit anxieties. Global selling pressures conspired with softer prices for resources like oil and natural gas to lop a further 800 points off the TSX Composite in July. That makes our month-ago decision to reduce our equity weighting look prescient. While we also pared our TSX targets at the time, one key factor in the TSX's sell-off—oil's drop—looks to be temporary. The hue and cry over US demand destruction ignores the fact that non-OECD demand climbed by nearly three times as much as the drop stateside in the first half of the year. It also ignores continuing supply risks.

Problems at Fannie Mae and Freddie Mac and ongoing signs of distress from the US housing market contributed to the market's high wall of worry in July. June's record 16% year-on-year slide in homes prices and a mountain of unsold homes has largely silenced talk of a bottom in homebuilding. Although the S&P 500 bank group closed the month in the black, that looks to be more a testament to sharply reduced expectations than start of a sustained recovery. Earnings for the S&P financial sector are now expected to post an 86% decline year-on-year in Q2, contributing centrally to a 20% decline in overall S&P 500 earnings—nearly twice the retreat that analysts were expecting a month ago. As noted below, we think it is still too early to add weight to the financial sector, given the prospect for further writedowns and adverse credit quality impact of weak growth and rising rates.

North of the border, the profit picture continues to look better than it does stateside, at least in broad brush terms. We now expect TSX earnings to rise by 24% this year and 12% in 2009, surpassing 2007's just-over-10% advance. The devil, as always, is in the details. While a 45% rise in resource earnings should help lift TSX earnings by 17% on the year in Q2, non-resource profits should be virtually flat from a year ago, a notable deceleration from the previous quarter's pace. Contributing to the downshift, financial sector earnings are likely to fall 6% on the year in Q2, reflecting weakness at both banks and insurers (Chart 3).

In terms of our overall equity recommendations, we continue to favour sectors like energy and materials that are levered to global growth (Chart 4), avoiding the financials, industrial and consumer discretionaries that are vulnerable to energy costs or North American weakness. Our latest research suggests that the TSX, given its resource weighting, has a much stronger link to global GDP than to US GDP, or even the G-7 economies as a whole. While we expect global growth to decelerate by about a point to a 4% tempo this year and next, that pace is still above longer trend. It is also fast enough to keep pressure on global mining and energy production capacity, lending support to prices for those commodities.

Chart 3 - **Non-Resource Earnings Growth Slows**

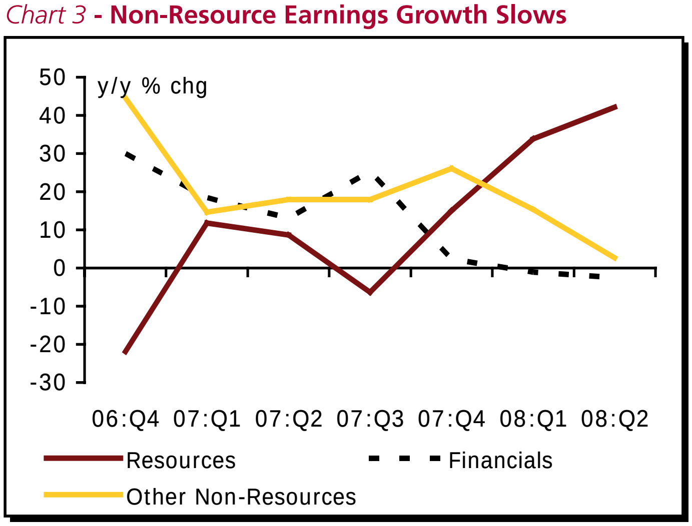
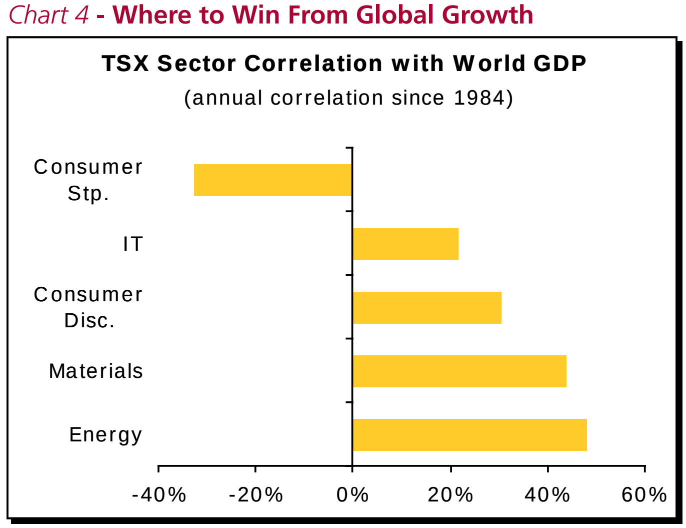


Chart 4 - **Where to Win From Global Growth**



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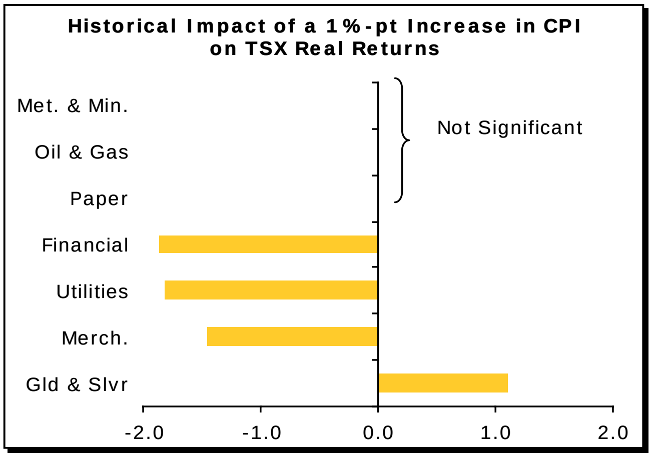
Past stagflation episodes have not been kind to equity valuations or performance. Although our year-end TSX targets of 14,300 and 15,250 for the next two years leave some headroom for stocks, total returns (dividends and capital gains) of 6% this year and 9% next will trail the double-digit gains of recent years. Historically, the TSX has traded at a heavily discounted PE of 13 during past periods of pronounced stagflation, versus 17 during normal times.

Chart 5 **- TSX Total Real Returns and Inflation**



While higher inflation has historically meant weak real returns in equities, our analysis shows that Canadian gold and silver mining stocks have been a fairly good hedge against inflation (Chart 5). We have, consequently, added a point of exposure to that sector, in addition to shifting weight from bonds into cash.

Why the Recent Oil Correction Will Not Be Long-Lived

Oil prices are presently down about 20% from mid-July's record. To put matters in perspective, that is still short of the 25% decline after hurricane Katrina, on fears of weakening demand, and the 35% drop in late 2006 after the discovery of the ultra-deep Jack field, with its potentially large but also costly reserves. The past month's pullback should prove no more lasting a detour from oil's five-year bull run than those earlier corrections. We are consequently maintaining our longstanding overweight in energy.

There are several reasons to stay bullish. First, driven by emerging markets, global demand is still advancing. While oil consumption in the US fell by 500,000 barrels per day in the first half of 2008 year-on-year, non-OECD demand grew by 1.3 million barrels, nearly three times that amount (Chart 6-left). Gasoline demand in China, in particular, continues to grow rapidly, rising by 16%, year-on-year, in the first half. Ditto for the Middle East which just matched China, in terms of new barrels of demand last year. Exports from the Middle East's main oil producers actually fell in 2007. We see that trend continuing longer term, as fast-growing demand cannibalizes the

Table 3 **— Valuations & Earnings Growth by Sector**

	4-Qtr Fwd	Index	Forward PE		TSX Op. Earnings (%ch)			
	Earnings	Level	Current	Last Decade	2005	2006	2007	2008 (f)
Energy	351.3	3539	10.1	12.0	44.7	12.3	8.5	66.9
Health Care	16.1	325	20.3	22.0	5.3	28.9	-38.7	-23.8
Financials	111.2	1658	14.9	12.0	14.0	17.1	14.1	-7.3
Consumer Discretiona	83.8	961	11.5	15.7	3.7	19.7	-6.1	14.8
Consumer Staples	91.8	1422	15.5	17.8	3.1	0.3	-2.6	0.4
Telecommunications	51.1	860	16.8	29.8	5.9	30.8	28.4	-8.7
Materials	231.7	3427	14.8	28.9	40.7	76.9	1.2	78.2
Utilities	97.7	1944	19.9	17.4	17.9	-6.5	58.4	2.1
Industrials	68.7	1289	18.8	14.9	27.5	14.2	35.8	-12.9
Info Tech	13.5	415	30.6	44.5	-41.4	51.6	155.5	53.7
TSX Composite	**1019.3**	**13593**	**13.3**	**16.1**	31.2	13.2	10.4	24.0

Note: Indexes as of July 31st; 4-qtr fwd earnings are proj. 08:Q2 thru 09:Q1

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Chart 6 - **World Oil Demand Still Rising (L), Rising Demand Will Squeeze Middle East Exports (R)**

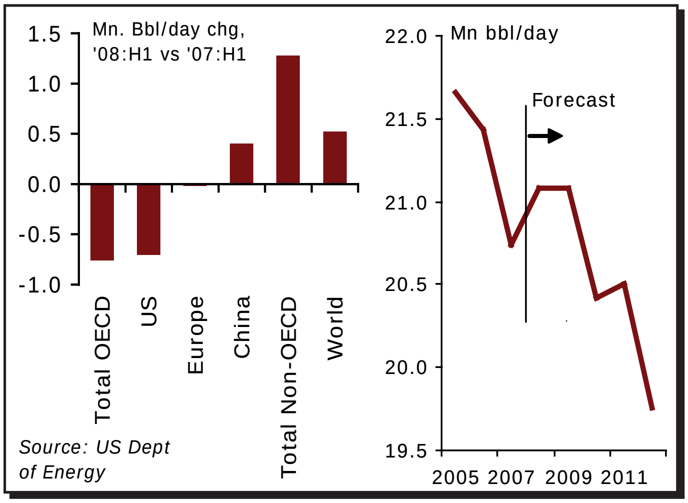
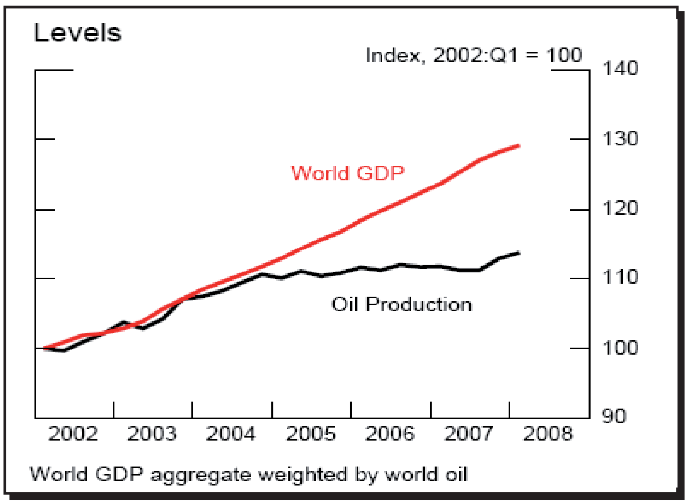


Chart 7 - **Oil Supply Not Keeping Pace with Global GDP**



Source: Inter-agency Task Force on Commodity Markets, Interim Report on Crude Oil, Washington DC

region's oil exports. Prices as low as 45¢/gal for Saudi motorists and $3/bbl for power plants point to a decline of as much as 1 million barrels a day in Middle East oil exports over the next four to five years, notwithstanding OPEC's recent pledge to supply more (Chart 6-right).

Second, oil prices are high today, not principally due to speculation—as is sometimes claimed—but because production has lagged increasingly behind the global economy's growth in recent years (Chart 7). The real issue isn't whether loftier oil prices and weaker growth will destroy US demand. Demand there will inevitably have to fall given limited prospects for new supply, to create room for the needs of millions of new drivers in China, Russia and even the Middle East itself. The past year's 500,000 bbl per day drop in US oil consumption is only a quarter of the decline that will be needed in the next four years to meeting burgeoning demand outside the traditional OECD countries (see our April 24th issue of *Strategecon*). Even this year's peak prices will not prove high enough to bring that adjustment about.

Finally, inventories in the US and at the international level are materially lower than a year or two ago (Chart 8). Production in both Russia and Mexico is now declining and Saudi Arabia is unlikely to be able to produce much more. These are further reasons, in our view, to see the recent price decline as a buying opportunity.

Despite the effect of a modestly hotter-than-average summer on power demand for air conditioning, natural gas prices have fallen by about twice as much as oil since early summer, from $13-14/mn Btu to below $9/mn Btu. Since natural gas markets are continental rather

Table 4 — **Commodity Price Forecast**

					Average		
		31-Jul	2005	2006	2007	2008 (f)	2009 (f)
Oil (WTI)	$/bbl	140	57	66	72	125	150
Natural Gas (Henry)	$/Mn Btu	13.19	8.89	6.73	6.97	11.00	13.00
Gold	$/troy oz.	918	444	604	695	1000*	1050*
Copper	$/lb	3.75	1.67	3.06	3.24	3.90	4.00
Aluminum	$/lb	1.33	1.23	1.17	1.20	1.30	1.00
Nickel	$/lb	8.28	6.71	10.98	16.86	8.00	7.50
Zinc	$/lb	0.86	0.63	1.48	1.48	1.00	1.05

*Year-end

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Chart 8 - **Oil Inventories Are Also Relatively Low (mn bbl)**

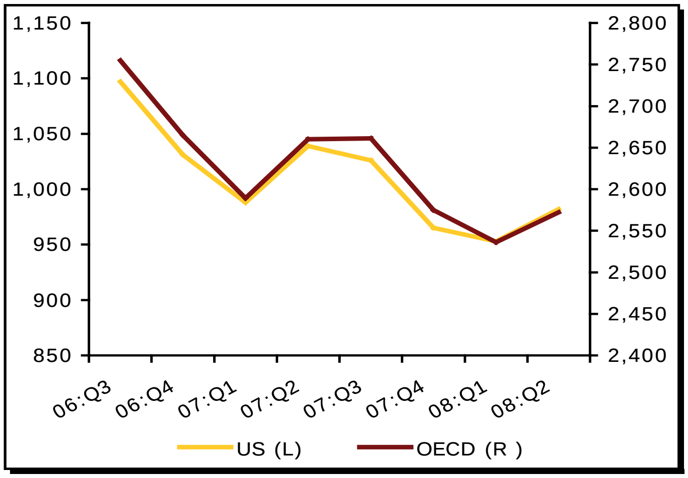
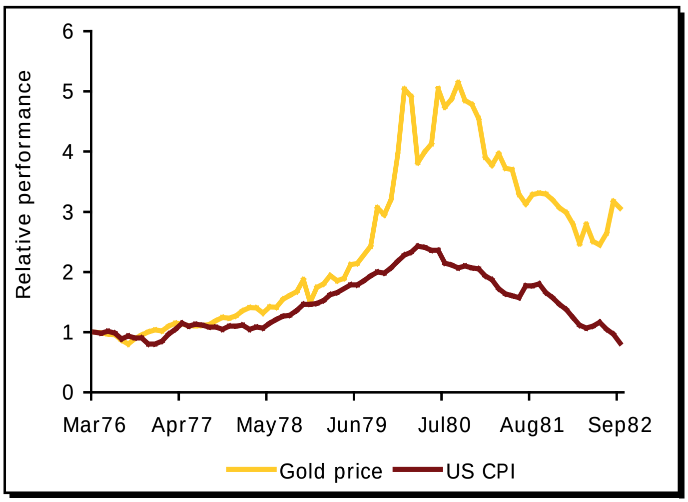


Chart 9 - **Gold's Price Rise Modest vs Past Inflationary Episodes**



than global, prices are more sensitive to a weak North American economy. As well, natural gas supplies have risen recently, due in part to the increased production of so-called tight or non-conventional gas, found in shale and other low-porosity formations. The US Department of Energy projects that the recent strong pace to production growth will not be maintained, however, easing to a 1.6% rate in 2009 from 6.4% in 2008. Fertilizer and power production continue to buoy demand, with the cancellation of environmentally unfriendly coal plants, forcing generators to turn to gas. While we have cut our Henry Hub target to $11 this year, in response to recent developments, we still see appreciably higher prices down the road.

Gold Stocks as an Inflation Hedge

Although we have not altered our 3%-pt overweight of the materials group, we have made some housekeeping changes this month, shifting a point of weighting from base metals into precious metals and minerals. Gold bullion is a traditional inflation hedge, and our analysis indicates the same holds for Canadian gold and silver mining stocks. Unlike non-interest-yielding bullion, mining stocks moreover, have an added benefit in that they pay dividends.

By historical standards, gold's run-up relative to inflation has been quite modest, a sign that the metal could have further to go. In the early 1980s, when inflation doubled to 12%, spot gold jumped roughly fivefold. The past year's 40% rise in the metal's price looks very modest in comparison, given the sharp run-up in US inflation (Chart 9). Moreover, gold is not just a US investment vehicle, but a global one. Inflation

Table 5 - **Fixed Income & Exchange Rate Projections**

	July 31/08	Sep 30/08	Dec 31/08	Jun 30/09	Year-End 2007	2008	2009
B of C Overnight Target (%)	3.00	3.00	3.00	3.50	4.25	3.00	4.00
2-Year GOC	2.94	2.90	3.60	3.95	3.75	3.60	4.35
10 Year GOC	3.70	3.80	3.95	4.10	3.99	3.95	4.40
30-Year GOC	4.10	4.20	4.25	4.30	4.10	4.25	4.65
S&P TSX Cdn Bond Index (% YTD total return)	3.4	3.9	4.2	2.0	3.8	4.2	2.8
Fed Funds	*2.00*	*2.00*	*2.25*	*3.25*	*4.25*	*2.25*	*4.00*
10-Year US Note	*3.95*	*4.10*	*4.30*	*4.45*	*4.03*	*4.30*	*4.65*
C$ in US cents	*97.6*	*97.6*	*100.0*	*101.5*	*100.2*	100.0	101.5
US$/EUR	*1.56*	*1.57*	*1.56*	*1.49*	*1.46*	*1.56*	*1.50*
Yen/US$	*108*	*107*	*108*	*97*	*112*	*108*	*94*

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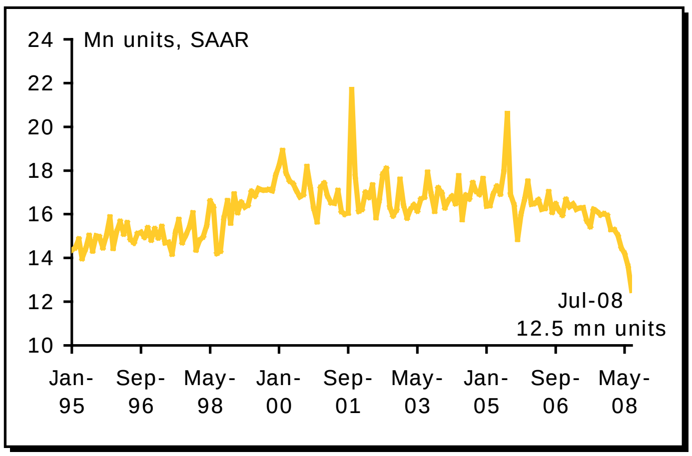
in the OECD recently hit an 8-year high of 4.4% and inflation rates in many emerging markets, where gold has a long history as an inflation hedge, are running at two or more times that pace. While TSX share prices have lagged gold in recent months, this is in part due to a lack of significant new discoveries over that time period. In the absence of a sizeable move up or down in the US dollar, changes in expected inflation will be the main force affecting bullion prices over the balance of 2008.

Vis-à-vis other material group members, the potash/fertilizer segment has been a strong performer and we think the sector represents good value after July's correction. Global inventories remain low thanks to unexpectedly strong demand in the last year or two, abetted both by rising meat consumption in Asia and increased biofuel production from corn, palm oil, and other crops with heavy fertilization needs. In fact, Asian demand for potash is expected to account for nearly 70% of all new consumption over the next few years. Meanwhile potash capacity additions will be very limited in 2008, and demand growth is expected to absorb planned new supply through 2011.

Chart 10 - **US Auto Sales Skid Will Dent Canadian Suppliers**



In contrast, we are maintaining our underweight in the telecom services group. Year-on-year EBITA growth slowed sharply to an 3% pace in the second quarter. We expect several forces to restrain financial performance going forward. While the Canadian wireless market is not saturated compared to other industrial markets, the latest results suggest subscriber growth is slowing from earlier high levels. June's wireless auction also saw three new regional and two national players acquire spectrum. That raises the spectre of intensified competition, which could further restrain earnings. We also remain underweight the consumer discretionary sector, especially auto parts. US auto sales plunged to 12.5 million (annualized) in June, which is the lowest level since early 1993 (Chart 10). Furthermore, total US vehicle miles travelled in May posted their third largest monthly drop in 66 years as Americans cut back on summer driving due to high gasoline prices.

Despite posting a 16% rally since the middle of July, financials remain one of the weakest components of the TSX so far this year. The recent drop in oil prices may have led to a sector rotation out of energy stocks and into financials, but as July's market turmoil involving Fannie Mae and Freddie Mac illustrates, last summer's global credit crisis remains a leading risk factor for the group as a whole. It is also a major reason why we continue to hold a 2.5%-pt underweight in financials, and why worldwide credit losses and writedowns are closing in on $500 bn since the start of 2007. Compounding the problems for the financial services sector is the prospect for significant rate hikes in both Canada and the United States. This should put downward pressure on cyclical earnings growth as financials tend to underperform when interest rates begin to climb. Higher rates should squeeze floating rate borrowers, boosting loan loss rates for both consumers and businesses.

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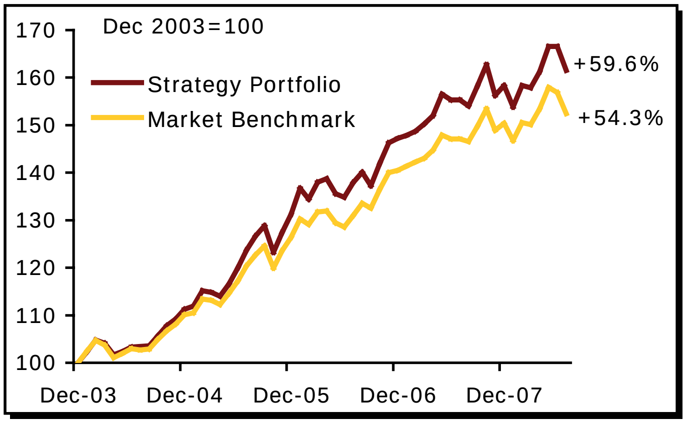
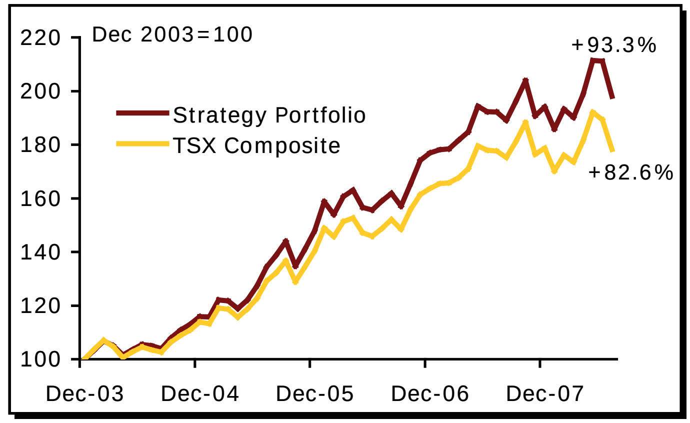
PERFORMANCE OF STRATEGY PORTFOLIO VS BENCHMARK

All Asset Classes



TSX Only



(1) *Total return for the recommended portfolio is the index return multiplied by the individual asset mix or sector weight recommended by Economics & Strategy. Recommen ded portfolio weights for the current month appear in the front table.*

HISTORICAL PERFORMANCE: CIBC WM BENCHMARK AND ASSET CLASSES

	Total Return (%)*		
Asset Classes	**2007**	**2008 YTD**	**Last 3 Mos.**
Stocks (TSX Composite Total Return Index)	9.83	-0.22	-1.82
-Strategy Equity Portfolio	**9.09**	**2.00**	**-0.40**
Bonds (Bloomberg Cda Bond Index)	3.84	3.40	0.40
Cash (1-Month Bills)	4.07	1.55	0.59
Total Market Benchmark(2)	7.22	1.37	-4.92
-Total Strategy Portfolio	**7.20**	**2.01**	**0.19**
TSX Stocks by Sector (Total Return) (3)	**2007**	**2008 YTD**	**Last 3 Mos.**
Consumer Discretionary	4.22	-24.45	-10.93
Consumer Staples	-5.34	-9.17	-2.23
Energy	8.23	8.32	-1.61
Financials	-1.63	-8.65	-4.41
-Banks	-6.84	-4.71	-2.00
-Insurance, REITS, others	5.20	-10.78	-2.27
Health Care	-24.25	-13.16	-10.66
Industrials	10.51	4.00	-0.33
Info Tech	48.22	5.18	-0.21
Materials	30.26	10.82	5.12
-Gold	5.73	8.13	9.91
-Other Metals	16.51	-6.89	-5.41
-Chemicals	113.26	34.40	10.23
Telecom	19.87	-11.96	-8.57
Utilities	11.89	0.16	3.49

**as of July 31/08*

(2) *Market benchmark weight is the actual mix for stocks, bonds and cash held by the broad base of pension funds, segregated funds, mutual funds and insurance companies. This totals about $1 trillion of which pension and mutual funds are the biggest (45% & 37%) with life insurance and segregated funds at 11% & 7% respectively. The cash, stock and bond breakdown varies significantly among the 3 basic components such that the benchmark for any of the 4 categories may vary significantly from the published aggregate (eg. equities can vary from 10% for life companies to 75% for the other 3 categories). Data is Statistics Canada/Bank of Canada published data updated to current based on correlation analysis from the most recent partial actuals. The total return for the index will differ slightly from the summed weighted return for the sectors due to the weight shifts on a day-to-day basis.*

(3) *Equities by GICS sector benchmark weights are TSX data. Sector index levels are total returns.*

EQUITY RESEARCH

TSX SECTORAL VIEWS BY FUNDAMENTAL EQUITY RESEARCH ANALYSTS FOR AUGUST 2008

Consumer Discretionary – B. Bek

Canadian media performance has been weak in 2008, suffering from depressed valuations as many companies approach their year lows. Forward tone remains cautious, reflecting economic uncertainty; potential catalysts include a recovery in ad spending and pay-TV subscribers. As expected, specialty TV remains robust as audience fragmentation fuels growth in ad dollars and subscription fees. Newspapers continue to struggle, especially in Metro markets, and online platforms maintain their material growth. Conventional TV remains an issue, although fee-for-carriage rights could provide near-term relief (albeit unlikely) **(Bek: Communications & Media – Market Weight).**

Canada's wireless penetration, at 62% (year-end 2007), still suggests that plenty of growth remains in the Canadian wireless market. While the new entrant risk is real, we believe that growth remaining in the Canadian wireless industry is significant and should be enough to absorb the emergence of new competitors **(Bek: Telecommunication & Cable – Market Weight).**

Consumer Staples – P. Caicco

So far, 2008 looks like it could be the worst year for the Canadian consumer in over a decade. Our major trading partner is entering the early throes of a recession and our ability to sell to the Americans has been hampered anyway by the strong Canadian dollar. On top of that, Canadian retailers are facing a fierce new U.S. competitor-driven Supercenters, bringing a new level of price competitiveness to the market. Combine this with rising costs, and margins will be pressured **(Caicco: Merchandising & Consumer Products – Market Weight).**

Energy – R. Plexman, M. Bridges, B. Borggard, W. Lee & J. Fetterly

Buoyed by record commodity prices, energy has been the best performing market sector in 2008 to date. Looking ahead, we expect a powerful confluence of fundamental and financial factors to support a crude oil price trading range of US$125.00/bbl–US$130.00/bbl. We maintain our Overweight sector stance **(Plexman: Oil & Gas – Large Cap- Overweight).**

Following nearly two years of weakness, we believe Western Canadian Sedimentary Basin (WCSB) activity levels are poised to begin to recover in the coming months. While the magnitude and length of a recovery remains uncertain, given the meaningful strengthening in commodity prices in recent quarters, capital expansion announcements by numerous producers, our continued bullish outlook for natural gas prices and the modest softening of the revised royalty regime by the government of Alberta on April 10th, we believe the outlook for the oilfield services sector has improved significantly in recent months **(Fetterley: Energy Equipment Services – Market Weight).**

Although we remain wary of the volatility that is likely to persist in oil and gas prices through the summer, the combination of record cash flow levels, reasonable service costs and strong balance sheets/payout ratios has combined to form an excellent operating environment **(Bridges, Borggard and Lee: Oil & Gas Junior E&P – Market Weight).**

Financials – D. Mihelic, R. O'Reilly, A. Avery

We anticipate core earnings growth for the Canadian banks to contract by 3% during 2008, with a modest rebound of 4% growth in 2009. We remain concerned about further economic weakness that may lead to higher loan losses, continued weakness in capital markets, and a slowdown in growth for retail earnings **(Mihelic: Banks & Lifecos – Market Weight).**

Equity Research

TSX SECTORAL VIEWS BY FUNDAMENTAL EQUITY RESEARCH ANALYSTS FOR AUGUST 2008

Canadian REITs' price weakness belies the healthy fundamentals of the sector. Canadian GDP growth is expected to remain positive in 2008 and 2009. Vacancies are at record lows and new commercial space completions will be very low. Availability of debt financing, albeit reduced and confined to conventional mortgages, is still adequate **(O'Reilly, Avery: Real Estate – Overweight).**

Health Care – M. Paris

More than 90% of the S&P/TSX Health Care Index is now driven by just three stocks, so company-specific news should continue to drive sector performance more so than broader macro trends. We maintain our Market Weight sector weighting, as we view the risk/reward profile for Canadian health care stocks as balanced **(Paris: Health Care – Market Weight).**

Industrials – M. Willemse, J. Bout

North American vehicle sales have begun to show softness due to a variety of economic headwinds. Until U.S. auto sales show signs that they have hit bottom, the U.S. economy shows signs of a rebound, and the Canadian auto suppliers report favorable results with the high Canadian dollar, we believe investors may hold a cautious view on Canadian auto-related equities. Valuation multiple contractions are likely to occur prior to a recovery in the sector **(Willemse: Automotive – Market Weight).**

Our Market Weight rating reflects the strong pricing environment in the steel sector offset by the potential for economic headwinds and rich valuations on peak earnings. Our only concerns for the sector would be related to a decrease in steel prices, which may cause multiple contractions as some momentum players exit the industry. Steel prices have increased significantly in 2008 given raw material cost pressures and limited import activity **(Willemse: Steel – Market Weight).**

Solar sector should benefit from significant market growth, offset by the risk of near-term oversupply of solar modules and reduction in feed-in tariffs. While recent stock price weakness has raised concerns over its long-term viability, rising energy prices and global interests for cleaner energy suggest the solar sector is well positioned to reap the benefits of clean energy trends **(Willemse: Solar – Market Weight).**

Even with a soft U.S. economy, robust growth in Asia should continue to drive demand for commodities. Barring a global recession, the outlook for the heavy equipment sector in 2008 is modestly robust **(Bout: Capital Equipment – Market Weight).**

Our Market Weight rating on the Canadian rails reflects the mixed outlook for the global economy (more buoyant for international markets and muted for North America) **(Bout: Railroads – Market Weight).**

Information Technology – P. Lechem, T. Coupland

Consolidation remains one of the foremost themes of the sector, with a high level of activity from strategic buyers (looking for incremental technology, customers, geographic reach or market share) and from private equity (eyeing the highly profitable and stable annual maintenance revenue streams) **(Lechem: Technology-Software – Market Weight).**

While the Canadian market fundamentals appear strong, we believe that a worsening U.S. economic slowdown could serve to limit demand. To date, major engineering and construction (E&C) firms have noted record backlogs and positive outlooks through 2008. The one exception is a U.S. construction firm, which stated that it expects a near-term slowdown in public infrastructure spending as a result of the current economic downturn and the increasing budget challenges facing state and local governments. Canadian E&C companies have so far proven resilient to the U.S. pullback, but we believe the situation warrants close monitoring **(Lechem: Business and Professional Services – Market Weight).**

Equity Research

TSX SECTORAL VIEWS BY FUNDAMENTAL EQUITY RESEARCH ANALYSTS FOR AUGUST 2008

The technology hardware sector has started to benefit from growth in certain emerging markets and resurgence in capital spending in networking, although there may be a short-term pause given current macroeconomic conditions **(Coupland: Technology Hardware – Market Weight).**

Materials – J. Bout, H. Carreau, B. Cooper, D. Roberts, C. Hale-Sanders

We are using our 2009 gold price forecast of $1,200/oz. to set our price targets. With gold prices rising much faster than the cost curve, we expect earnings figures for most companies to improve dramatically in 2008 and 2009. We believe this margin expansion will set the stage for a new influx of investors who will see the earnings power of the industry take hold while at the same time provide some degree of safety from general market mayhem **(Cooper: Mining, Precious Metals – Overweight).**

Base metals and equity markets remain volatile, with daily swings spurred by the release of economic indicators as the market seeks direction. Indicators continue to point to a deteriorating outlook for base metals demand in the Western World offset by strong emerging market demand **(Hale-Sanders: Mining, Metals and Minerals – Market Weight).**

Our Market Weight rating on the sector reflects the diversity of commodities in it. We believe that a slowing U.S. economy will negatively impact styrenics and olefin/polyolefin demand. In fertilizers, pricing momentum for the three main nutrients (nitrogen, phosphate and potash) is due mainly to the tight grain market and declining inventories. Methanol prices seem to be stabilizing, with supply/demand relatively balanced **(Bout: Chemicals & Fertilizers – Market Weight).**

Most companies in the Canadian paper & forest products industry are implementing plans for "cash preservation". Given the strong Canadian dollar, we expect ongoing rationalization throughout the Canadian forest products sector **(Carreau, Roberts: Paper & Forest Products – Underweight).**

Pipeline, Utilities & Power – A. Pavao, P. Panarites

Gains made by the group earlier in the spring have, in large part, been given back in June, as the broader market has been gripped by new concerns of stagflation. Marginal headwinds due to anticipated rate increases are, in our view, likely to be mitigated by interest-rate-relative valuations in the group that have re-approached historical lows set in January. The group's defensive attributes, sourced as much in resilient energy infrastructure fundamentals as they are in dividend yield, should prove attractive to investors in the current turmoil. We continue to favor the pipelines, for which strong demand growth and shifting supply sources are creating significant investment opportunities in North America that extend well into the next decade **(Pavao, Panarites: Pipeline, Utilities & Power – Overweight).**

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