CIBC World Markets

Canadian Portfolio Strategy Outlook

October 9, 2008

Strategy

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"While there is little to warrant near-term optimism, investors at the same time should not lose sight of the fact that many of yesterday's fundamentals have not changed."

Executive Summary

by Jeff Rubin

Extraordinary circumstances may require extraordinary measures but it almost seems that the more the Federal Reserve Board and other central banks around the world pull new tricks out of their hats, the more investors run for cover. In a world where there are suddenly no benchmarks for policies or valuations, it's hard to get an accurate compass reading of where we are.

The extent of future writedowns in the financial sector remain unknown, although a trough in US housing prices, which is the underlying cause of most of today's troubled assets, is probably no more than six months off, with little more than another 5%, or so, price decline. To what extent the various vehicles set up by the Fed and the Treasury like TARP and the commercial paper-buying program restore liquidity in the interim, remains to be seen.

What is clear from the recent US payrolls and other recent economic numbers is that the US economy, and most of the rest of the OECD, is in recession now. But that recession is neither deep enough nor global enough to warrant the massive hair-cut in energy and other resource stock valuations that have taken place over the last several months, as investors scramble to de-leverage from assets that are tied to a strong economy. That de-leveraging story is likely to hold sway for the balance of the year, with the TSX vulnerable to a further retreat to the 9,500 mark by year-end, or earlier.

While there is little to warrant near-term optimism, investors at the same time should not lose sight of the fact that many of yesterday's fundamentals have not changed. Driving speculators out of the oil market does not change the fact that the marginal cost for a new barrel of oil is around $90-$100/bbl. Nor does it alter the fact that oil demand has been largely driven by the still-healthy BRICA countries, not the contracting G-7 economies where oil demand has been stagnant, at best, for nearly the last three years. If $90/bbl is the price of oil in a global recession where does oil trade in the next recovery? At least where it was before the current downturn began, if not higher, given the supply damage that today's price decline will create.

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	0.0
Cash	*9*	**12**	3.0	0.0
GICS SECTORS (%)**				
Cons. Discretionary	*4.1*	**1.1**	-3.0	0.0
Cons. Staples	*2.5*	**4.5**	+2.0	+2.0
Energy	*29.2*	**34.2**	+5.0	0.0
Financials	*31.3*	**31.3**	0.0	0.0
-Banks	*18.2*	*18.2*	*0.0*	*0.0*
-Insur., REITs, other	*13.2*	*13.2*	*0.0*	*0.0*
Health Care	*0.3*	**0.3**	0.0	0.0
Industrials	*5.3*	**2.8**	-2.5	0.0
Info Tech	*3.6*	**1.6**	-2.0	-2.0
Materials	*16.7*	***18.7***	*+2.0*	*-1.0*
-Gold	*7.6*	*9.6*	*+2.0*	*0.0*
-Other Metals	*4.1*	*4.1*	*0.0*	*0.0*
-Chemicals	*4.5*	*4.5*	*0.0*	*-1.0*
Telecom	*5.4*	**2.9**	-2.5	0.0
Utilities	*1.6*	**2.6**	+1.0	+1.0

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

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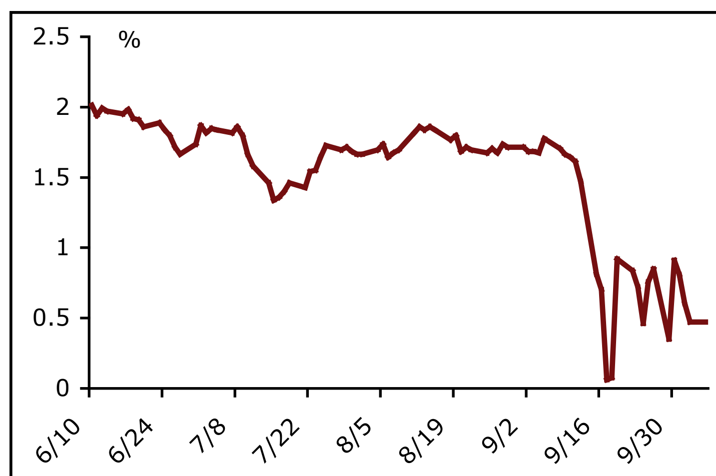
The Big Picture—Jeff Rubin, Peter Buchanan and Avery Shenfeld

A seize-up of the financial system in the world's wealthiest and largest economies has investors planning for a doomsday global recession where everyone hides their life savings under the mattress. Treasury bills are yielding virtually nothing as the rush to safety from the rest of the financial system has seen a literal collapse in bill yields (Chart 1). The Fed has resorted to buying commercial paper in order to restore liquidity to a market that has nearly dried up. And to top it all off, September's non-farm payrolls and purchasing manager's index all but confirm that the American economy is in recession.

Chart 1 - **US T-Bill Yields Plunge on Flight to Quality**



Yet life ticks on in the half of the world economy that is still growing at a more-than-reasonable clip. While there is now little doubt that most OECD economies are in recession, there is little to suggest that growth has come anywhere close to grinding to a halt in any of the BRICA countries, that have been the mainstay of recent global economic growth.

As a result, the recent plunge in commodity prices has been highly exaggerated relative to the on-ground deterioration in the world economy. And the decline in commodity prices themselves has been modest relative to the corresponding drop in resource and energy stock valuations (Chart 2). Nowhere is that more apparent than in oil prices and even more dramatically oil stock valuations. The last time the TSX Energy Index was at today's level oil prices were hovering near $60/bbl.

Table 1 - **Equity Projections**

		Year-end			
	Latest	2006	2007	2008	2009
TSX Composite	11,753 (9/30)	12,908	13,833	9,500	12,000
% total return	(13.3) *YTD*	17.3	9.8	(31.6)	28.7
TSX Operating Earnings - index adj	—	717	821	944	1,039
- yr/yr % chg	25.0 (08:Q3)	*13.2*	*14.5*	*15.0*	*10.0*
S&P 500	1,166 (9/30)	1,418	1,468	1,000	1,200
-% total return, YTD	(19.3)	15.8	5.5	(32.5)	22.2

Table 2 - **Economic Forecast**

		08Q2	08Q3	08Q4	09Q1	2007	2008	2009
Canada	Real GDP Growth (AR)	0.3	1.1	-2.0	1.0	2.7	0.6	1.1
	Real Consumption Growth (AR)	2.4	2.0	0.9	1.8	4.5	3.8	2.0
	CPI - Headline (y/y)	2.4	3.4	2.6	2.5	2.2	2.5	3.0
	- Core (y/y) ex taxes	1.5	1.7	2.4	2.5	2.1	1.7	2.4
	Unemployment Rate (%)	6.1	6.1	6.4	6.5	6.0	6.1	6.4
US	Real GDP Growth (AR)	3.3	-0.6	-1.9	1.8	2.0	1.5	1.7
	Real Consumption Growth (AR)	1.7	-1.8	-2.2	1.7	2.8	0.7	1.2
	CPI - Headline (y/y)	4.4	5.4	4.8	4.5	2.9	4.5	4.7
	- Core (y/y)	2.3	2.5	2.4	2.4	2.3	2.4	2.8
	Unemployment Rate (%)	5.3	6.0	6.6	7.1	4.6	5.8	6.4
World	Real GDP Growth (% chg)	-	-	-		5.0	3.8	3.5

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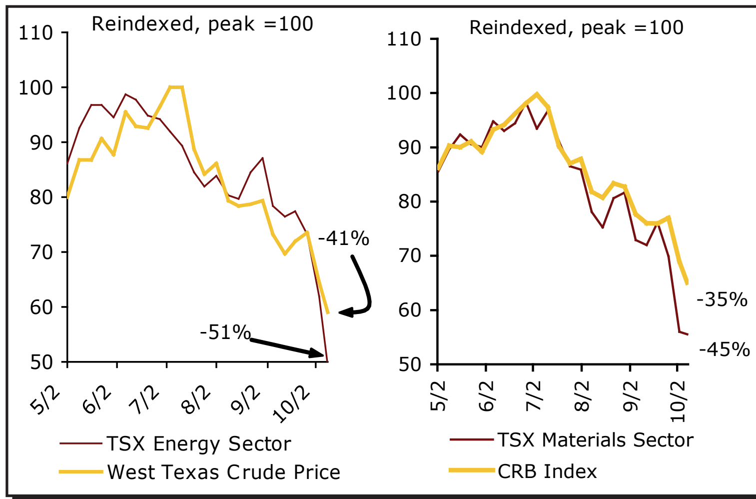
Chart 2 - **Correction in Resource Stocks Overstates Commodity Price Declines**



To date, oil demand destruction in the US and the rest of the OECD is modest, in comparison to continued demand creation in most of the developing world, where consumers don't pay full world oil prices. In fact, demand destruction in the key US market during the current recession is a shadow of the destruction seen after the OPEC oil shocks (Chart 3). Moreover, almost half of the recent drop in US crude consumption has come from low-hanging fruit such as state government cutbacks on asphalt paving and reductions in the use of residual fuel for power plants. Demand destruction in motor fuels has been marginal. The latter has only dropped by a meagre 220,000 barrels per day over the last year, and gasoline prices across America have fallen by almost 20% since much of that demand destruction took place.

Moreover, while demand destruction has been moderate to date, the price decline in oil is quickly encroaching on marginal cost, in which case supply will begin to decline as new fields are not commissioned to offset depletion. The breakeven price for cost recovery of a new oil sands project is now approaching $100/bbl (Chart 4).

If $90/bbl is the price of oil during what is being perceived as a deep global recession, what is the price of oil in the recovery? Where is oil trading four quarters from now when the US and European economies are no longer contracting? At least back to where they were before the recession, and maybe higher, given that the recent plunge in crude prices will cancel some new supply between now and then. We continue to believe that oil prices will average $150/bbl over the second half of next year on the back of even a modest recovery in global economic growth. Oil stocks have little downside from today's levels, and huge upside with any cyclical recovery in oil demand and prices next year.

Chart 3 - **Oil Demand Destruction in US Moderate So Far**

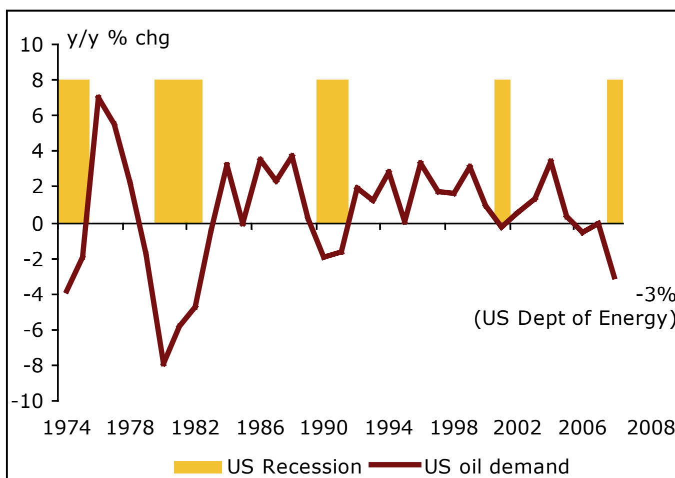
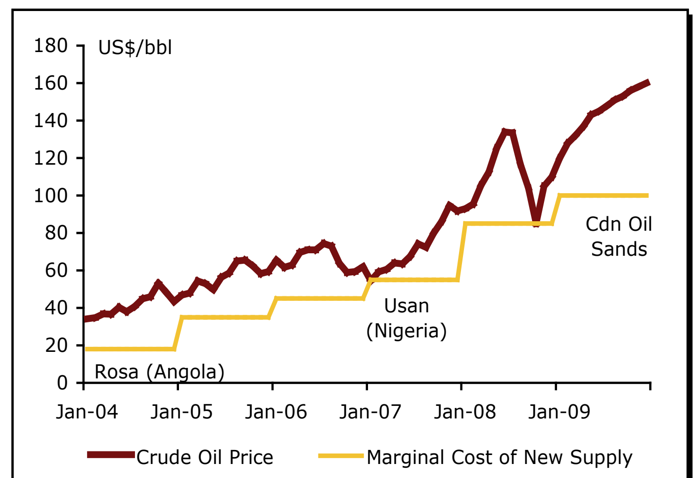


Chart 4 - **Oil Price Relative to Marginal Cost of New Supply**



Source: Total SA, CIBC WM

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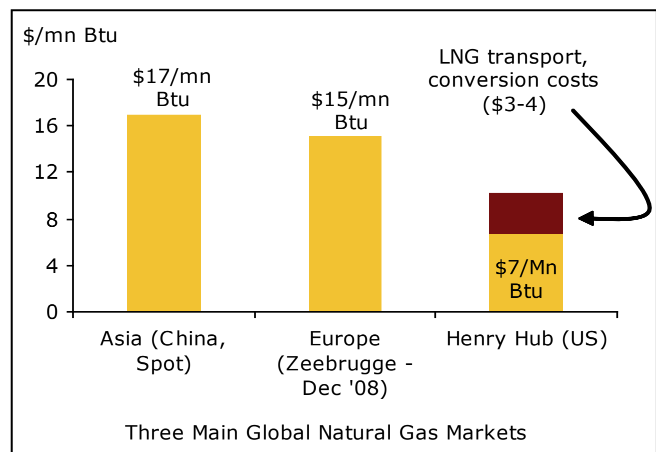
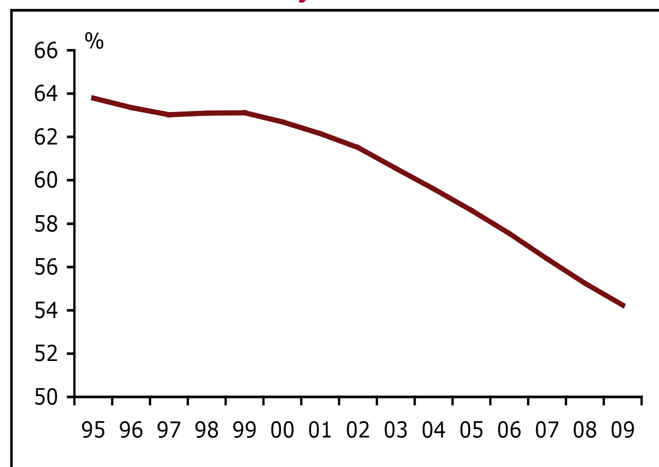
Chart 5 - **North America Could Export Gas Economically at Current Price Differentials**



That should also hold for natural gas, although supply dynamics differ from those for oil. While the growth of non-conventional gas supply, particularly from shale gas, has suddenly changed the demand-supply balance in the North American market, it has also driven North American gas prices to record discounts against both Asian or European gas prices. International price differentials are now so great that they could incent an actual reversal of LNG flows. Benchmark US Henry Hub gas is now a record $8-10/mn Btu below spot prices in Europe or Asia (Chart 5). That price differential is two to three times the LNG transportation and liquefaction cost. If the price differential persists, it will incent North America to become an exporter, not an importer, of LNG.

Global Growth Not as Weak as Financial Crisis Suggests

Chart 6 - **OECD Economy's Share of Global GDP**



What's true for energy is broadly true for many other commodities as well, although each one has its own unique supply dynamics. While the OECD is contracting, the group doesn't pack the same punch as it once did in global growth tables. Even since the 2001 recession, the OECD economies have lost weight in world growth (Chart 6). Juxtaposed against the 5%-plus growth rates still coming out of Russia, China, Brazil, and the Middle Eastern OPEC states, it's difficult to see global growth collapsing as the plunge in resource stocks would otherwise seem to suggest.

Although stock markets in emerging market economies have been hit even harder than in the US, there has been little correlation in the past between stock market performance and economic performance in key countries

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

	4-Qtr Fwd	Index	Forward PE		TSX Op. Earnings (% ch)			
	Earnings	Level	Current	Last Decade	2006	2007	2008	2009 (f)
Energy	239.7	2394	10.0	12.0	10.3	13.5	30.3	9.2
Health Care	17.2	275	16.0	22.0	30.5	-39.1	-28.9	10.3
Financials	147.4	1508	10.2	12.0	17.4	13.9	-1.1	12.3
Consumer Discretionary	76.5	864	11.3	15.7	10.0	-2.0	27.3	-1.7
Consumer Staples	104.5	1363	13.1	17.8	0.4	-3.8	0.5	15.3
Telecommunications	71.9	807	11.2	29.8	24.1	29.5	-2.3	18.4
Materials	167.4	2053	12.3	28.9	78.2	2.9	45.0	5.4
Utilities	147.5	1526	10.3	17.4	-6.4	58.3	14.7	10.3
Industrials	100.9	975	9.7	14.9	14.0	38.6	4.4	4.0
Info Tech	15.6	230	14.8	44.5	88.5	115.9	40.3	30.4
TSX Composite	**956.1**	**10230**	**10.7**	**16.1**	13.2	14.5	15.0	10.0

Note: Indexes as of Oct 6th close; 4-qtr fwd earnings are proj. 08:Q3 thru 09:Q2

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like China. In fact, we could well see an acceleration in Chinese economic growth during the fourth quarter, as the country's giant manufacturing sector regains its footing after temporary shutdowns to improve air quality during the Beijing Olympics (Chart 7).

Chart 7 **- Signs of Post Olympic Pickup**

All told, global growth is unlikely to fall below 3½% this year or next. While that's a big step down from the growth of the last several years, it is still a far cry from the growth rates that historically have been associated with a sustained bear market in global commodities. And for that matter, commodity prices have yet to fall anywhere close to levels that in the past have been associated with bear markets. While broad indices like the CRB have fallen by nearly 40%, as have bellwether commodity prices like oil and copper, all remain at healthy levels in absolute historical terms. That's particularly the case for oil, where it is still trading at almost twice the level it was only three years ago when the world economy was growing at a healthy 5% clip. And while copper prices have lost some of their sheen, at $2.50/lb, they are triple the level they were during the last recession and still double their decade average.

In part, of course, that reflects still-healthy economic growth in emerging market countries and in part, their disproportionately greater share of commodity consumption. From 2004-2007, even during the good times for the US economy, American consumption of oil, copper, zinc and aluminum was either flat or declining in an ever-more services-based American economy. It should come as no great surprise that the American economy is consuming less of these commodities in recession.

While the US is still a highly prized export market, its significance to world trade has lessened materially since the 2001 recession. That's as true for China and the rest of emerging Asia as it is for Canada. Whereas in 2001, the US market accounted for 21% of emerging Asia's total exports, by 2007, that share had dropped to 16%. That was true for virtually every other regional trading group, including Europe and Latin America.

TSX to Rebound Next Year on Global Recovery

While the financial market fall-out from the failed housing market in the US seems to get bigger every day, a trough in housing prices is likely to occur within the next six months (Chart 8). Down almost 20% since the 2006

Table 4 **— Commodity Price Forecast**

			Average				
		7-Oct	2005	2006	2007	2008 (f)	2009 (f)
Oil (WTI)	$/bbl	90	57	66	72	110	130
Natural Gas (Henry)	$/Mn Btu	6.75	8.89	6.73	6.97	8.75	9.00
Gold	$/troy oz.	877	444	604	695	925*	1000*
Copper	$/lb	2.61	1.67	3.06	3.24	3.30	3.00
Aluminum	$/lb	1.02	1.23	1.17	1.20	1.20	1.00
Nickel	$/lb	6.37	6.71	10.98	16.86	9.50	7.00
Zinc	$/lb	0.69	0.63	1.48	1.48	0.85	0.75

**Year-end*

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Chart 8 - **US House Prices to Trough in the Next 6 Months**

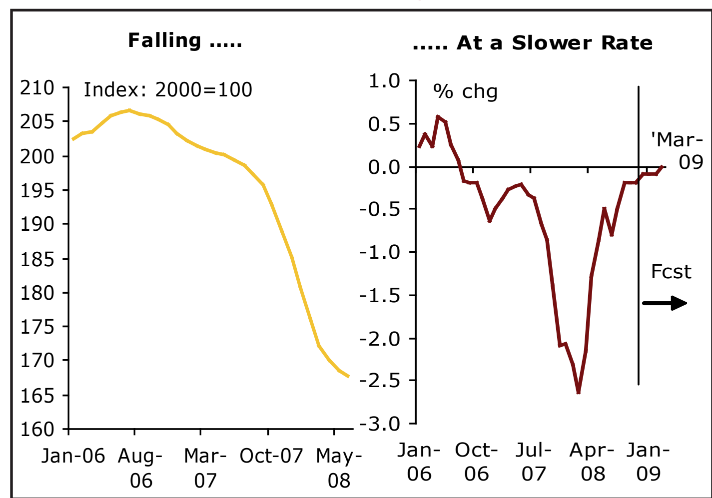
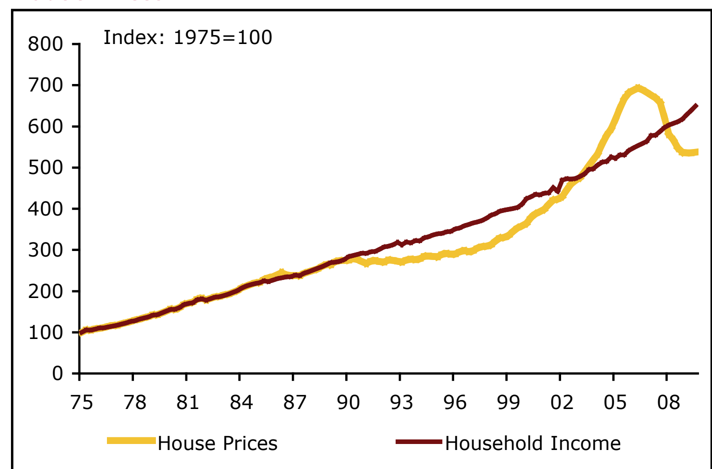


Chart 9 - **Household Income Much Better Matched to House Prices**



peak, housing prices are likely to bottom in the US in the next six months, with a cumulative decline of around 25%. While prices are still falling, the rate of decline is beginning to slacken. And for the first time in over five years, household income is now back in line with house prices, as house price affordability has improved significantly (Chart 9).

With valuations already close to all-time lows, most of the recession news is in the market, particularly for commodity stocks. The weaker economic backdrop has prompted us to pare our forecast TSX earnings growth to 15% this year, from the 24% rise anticipated previously. A 10% increase in 2009 earnings implies that today's market valuations are very lean. At 8.3 times next year's consensus, today's TSX PE ratio is as cheap as it was after Black Monday (Chart 10 and Table 1).

Higher Canadian valuations will require a turn in sentiment stateside. As the new markets created by Treasury purchases allow financial institutions to repair their balance sheets, reducing the need for new capital, inter-bank liquidity should gradually improve. And by the end of the first quarter or so, a bottoming in US housing prices should also bolster liquidity and financial market confidence.

The recently passed TARP package and the Federal Reserve Board's willingness to buy commercial paper should hopefully return some semblance of market liquidity until a stabilized housing market in the US bolsters the value of currently distressed assets.

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

	Sep 30/08	Dec 31/08	Jun 30/09	Year-End 2007	Year-End 2008	Year-End 2009
B of C Overnight Target (%)	3.00	2.50	2.50	4.25	2.50	3.25
2-Year GOC	2.78	2.10	2.70	3.75	2.10	3.40
10 Year GOC	3.76	3.50	3.85	3.99	3.50	4.00
30-Year GOC	4.23	4.05	4.25	4.10	4.05	4.40
S&P TSX Cdn Bond Index (% YTD total return)	3.4	5.1	0.6	3.8	4.4	2.8
Fed Funds	*2.00*	*1.50*	*1.50*	*4.25*	*1.50*	*3.00*
10-Year US Note	*3.83*	*3.50*	*3.90*	*4.03*	*3.50*	*4.25*
C$ in US cents	*93.9*	*87.3*	*93.5*	*100.2*	*87.3*	*100.0*
US$/EUR	*1.41*	*1.34*	*1.40*	*1.46*	*1.34*	*1.39*
Yen/US$	*106*	*98*	*97*	*112*	*98*	*94*

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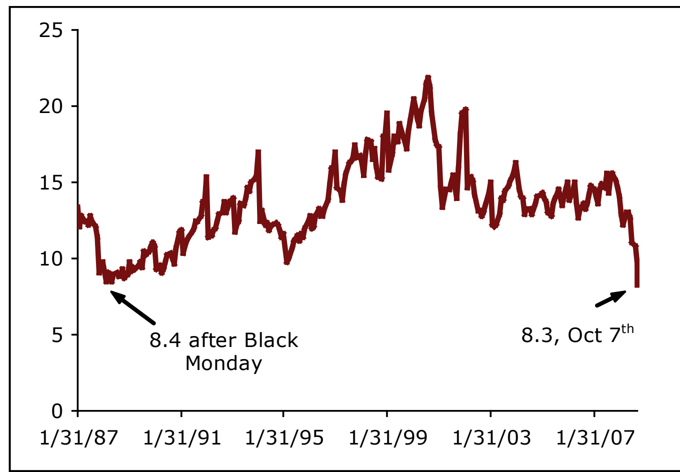
Chart 10 **- TSX Composite—**
Price vs Next Year's Earnings



Source: Thomson One Analytics

Canadian financials look better positioned to weather the storm than their US counterparts. CDOR has not blown out nearly as far as US-dollar LIBOR, and writedowns related to troubled assets have not been as severe a blow to bank capital ratios as they have been for the more highly levered institutions in the US or Europe. As a result, we are retaining our market weight on financials, despite that sector being at the centre of the storm in the US and Europe.

Weakness is likely to remain in the auto sector where we are witnessing, not simply the impact of a recession, but also a structural change spurred on by record-high gasoline prices. Sales are likely to fall below 12 million units over the next two years, plunging to levels not seen since the 1982 recession.

While the US economy faces the prospect of a small contraction over the last half of the year, and further job losses this year, we are likely to see a return to positive GDP growth and job creation by early 2009.

A deeper cyclical correction in North America has led us to reduce our TSX target for next year from 14,000 to 12,000, but we continue to expect to see an energy-led rebound in the index next year. In the interim, however, the market remains vulnerable over the next quarter to further distress in financial markets centred on the valuation of securitized assets. This is likely to continue until a bottom in US housing prices in the first half of the coming year.

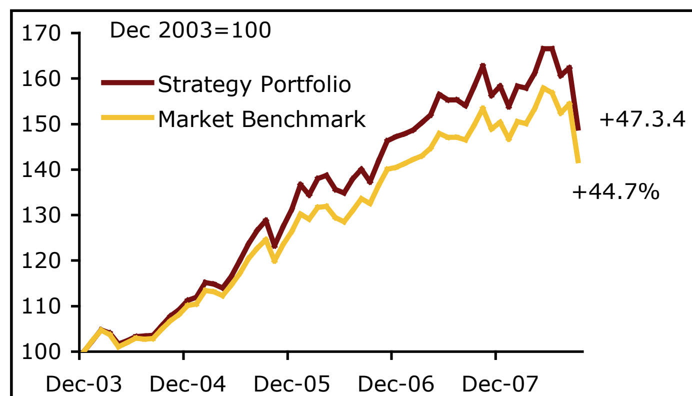
A year-end target of 12,000 represented an almost 30% upside for stocks over the course of 2009. That's sufficiently attractive to warrant a market weight in equities, despite the prospect of near-term volatility in the index in coming months.

A near-term defensive posture is recommended, hence the extra weighting to consumer staples and utilities this month. Those sectors have outperformed the market 80-90% of the time in recessions. Over a full year, energy and in particular oil stocks, provides the largest upside for investors, warranting a continuing overweight.

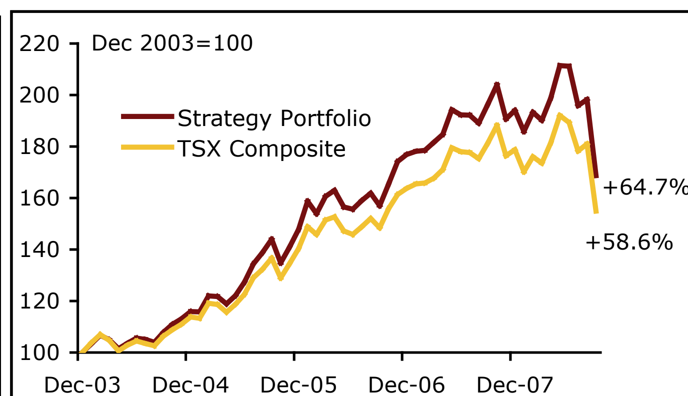
Strategy

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	-13.32	-18.22
-Strategy Equity Portfolio	**9.09**	**-13.13**	**-20.12**
Bonds (Bloomberg Cda Bond Index)	3.84	3.44	0.76
Cash (1-Month Bills)	4.07	1.91	0.54
Total Market Benchmark(2)	7.22	-5.48	-7.44
-Total Strategy Portfolio	**7.20**	**-5.85**	**-10.47**
TSX Stocks by Sector (Total Return) (3)	**2007**	**2008 YTD**	**Last 3 Mos.**
Consumer Discretionary	4.22	-26.44	-3.81
Consumer Staples	-5.34	-9.08	-4.64
Energy	8.23	-9.19	-26.95
Financials	-1.63	-9.33	2.56
-Banks	-6.84	-4.35	5.66
-Insurance, REITS, others	5.20	-15.30	-0.67
Health Care	-24.25	-21.80	-10.12
Industrials	10.51	-11.54	-12.90
Info Tech	48.22	-37.03	-37.96
Materials	30.26	-16.22	-33.59
-Gold	5.73	-9.67	-25.48
-Other Metals	16.51	-31.49	-20.56
-Chemicals	113.26	-7.93	-41.25
Telecom	19.87	-13.91	-4.64
Utilities	11.89	-14.81	-15.51

**as of Sep 30/08*

(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 OCTOBER 2008

Consumer Discretionary – B. Bek

Media performance has been less than stellar in 2008 as credit market turmoil has ripped through the markets and depressed valuations globally. We look for a turnaround in the US and a rebound in national ad spend as potential catalysts in the back half of the year. **(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 fierce new US 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 & R. Pare

Crude prices have suffered a severe decline from the +US$145/Bbl level reached earlier this year. In retrospect, it appears that financial factors were a key driver pushing oil prices to the peak. These forces have been unwound, and we believe that the oil price has fallen to a level that reflects demand/supply fundamentals. US refiners are becoming more concerned about the security of supply, and new pipeline connections are allowing Canadian heavy oil to penetrate new markets in the heartland and the Gulf of Mexico. **(Plexman: Oil & Gas, Large Cap – Overweight)**

In our view, pricing increases will begin to be realized in Q4/2008 as oilfield services companies prepare for what is expected to be a busy winter drilling season. Despite the improved industry fundamentals, oilfield services equities have weakened materially in recent weeks, giving back most of their year-to-date gains. While we believe valuations remain attractive for long-term investors, in the near term we expect equities will likely be more impacted by commodity weakness than by improving industry activity levels and strong Q3/2008 results. **(Fetterley: Energy Equipment Services – Market Weight)**

With the contraction of commodity prices, many companies are facing the issue of cash flow falling below capital spending. This becomes more of a concern as balance sheet leverage increases, thus reducing the flexibility to fund a capital program with debt. The net result is that we could see a number of producers, primarily those with the highest D/CF ratios, reduce capital spending moving into 2009. On a positive note, a stronger US dollar will mitigate the impact of the drop in US dollar WTI oil prices for Canadian producers. **(Bridges, Borggard and Lee: Oil & Gas Junior E&P – Market Weight)**

Considering the international E&Ps' weighting towards oil (85%) and despite the correction in global crude oil prices to double-digit territory, the group's valuation discount, relative to domestic junior E&Ps, royalty trusts and oil futures, remains significant. **(Lee and Pare: International E&P – Market Weight)**

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

We remain concerned about further economic weakness that may lead to higher loan losses, continued weakness in capital markets, and a slowdown in retail earnings growth for Canadian banks. We anticipate

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core earnings growth for Canadian lifecos to decline 1.0% in 2008, followed by a rebound to 13.8% growth in 2009. **(Mihelic: Banks & Lifecos – Market Weight)**

Favoured REITS include discounted high-quality large caps and high growth/undervalued mid-caps. **(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, C. Murray

The auto manufacturers have been facing a variety of economic headwinds in 2008. North American light vehicle sales (SAAR) have been declining at an increasing rate since May 2008. The trend reversed in August with the continuation of major sales incentives from the OEMs. It will take a few more months to determine if US auto sales show signs of a bottom. Until the bottom surfaces, the US economy shows signs of a rebound, and the Canadian auto suppliers report favourable results, we believe investors will hold a cautious view on Canadian auto-related equities. **(Willemse: Automotive – Market Weight)**

The steel sector is entering a declining price environment. Steel prices have started to fall and could fall further. A seasonal decrease in demand in H2/2008 combined with the potential for increased imports has positioned the industry for a weak finish to 2008. **(Willemse: Steel – Market Weight)**

High energy costs and global interest in cleaner energy will continue to benefit the sector. However, this could be offset by increased competition as new participants enter the market. **(Willemse: Solar – Market Weight)**

Even with a soft US 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)**

While the retreat in oil prices below the US$100/Bbl mark has sparked rallies in the US airline space, Canadian carriers have seen a more muted response as worries about economic weakness into Q4 become more of the focus for investors. We believe that lower fuel costs (which had reached almost 40% of operating costs for the major carriers), an ongoing focus on yield enhancement, and lower system capacity should translate into higher margins in 2009, against a backdrop of very high volatility for all industry players. **(Murray: Airlines – 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)**

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Many stocks have sold off significantly on concerns over slowing western economies and commodity prices dropping from peak levels. While these issues present headwinds, the longer-term trends remain clear: significant public and industrial infrastructure demand in developed and developing nations, due to a multi-year/decade underinvestment. We believe the sell-off has been overly severe in many cases. **(Lechem: Business and Professional Services – Market Weight)**

The long-term trends in the technology hardware sector are positive and will require a resurgence in capital spending to upgrade carrier and enterprise networks to handle the growing amount of traffic. In the short term, however, there has been a pause due to global macroeconomic factors. **(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. Even with the recent correction in gold prices, top-line growth remains higher than cost inflation and we expect most companies' earnings to improve dramatically in 2008 and 2009. **(Cooper: Mining, Precious Metals – Overweight)**

Base metals and equity markets remain volatile, spurred by the release of deteriorating economic indicators and a general flight of capital from the overall market due to the protracted financial market issues. While economic data continues to suggest demand weakness is spreading and becoming more pronounced, the key drivers of industrialization and urbanization in emerging markets over the longer term are unchanged, and should support demand for commodities. **(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 US economy will negatively impact styrenics and olefin/polyolefin demand. **(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 – Petro Panarites

For the time being, this group should continue to provide a lower beta haven from the broader market. Rate-relative valuations are at historical lows, although our Economists' forecast for a renewed round of rate hikes next year suggests that it may not yet be the time to plunge in indiscriminately. The best outcome would be for the current ebb in oil prices to bring about an ease in inflationary pressures, something that should be watched closely. **(Panarites: Pipeline, Utilities & Power – Overweight)**

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