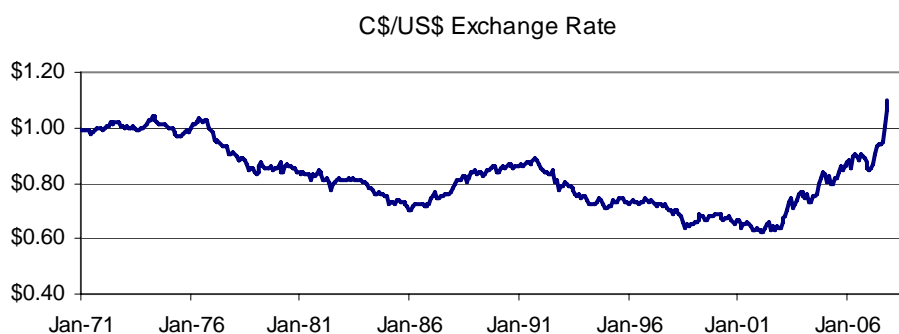


November 16, 2007

Not So Loonie: *The impact of the rising Canadian dollar on U.S. Investment Returns*

Investing in international markets exposes investors to currency risk unless that risk has been hedged. The risk that fluctuations in foreign currency pose has become more obvious in recent years as returns from foreign investments have been eroded by the strong appreciation of the Canadian dollar. The recent strength of the loonie and sub par returns for U.S. equities in particular is leading many of our clients to question the benefits of international diversification. The Portfolio Advisory Group believes the long-term benefits of international diversification continue to outweigh the risks. Therefore the fundamental issue clients need to consider is whether or not currency risk can and should be hedged.



Source: Bloomberg

Why Invest Internationally?

There are a number of reasons why investors should continue to invest in international markets including:

- Portfolio diversification
- Access to higher growth regions of the world
- An opportunity to capitalize on fluctuating foreign exchange rates

From a portfolio diversification perspective, the imperfect correlation between international markets offers significant risk reduction opportunities. Furthermore, as the correlation between currencies and most asset classes is low, foreign currency exposure can provide an additional source of diversification. A position in a foreign security can be thought of as two investments, one in the security itself and the other in the foreign currency. The low correlation between the foreign security and the foreign currency reduces the overall risk of holding that position. It is important to remember that currency can also enhance returns. Investing internationally also increases opportunities to invest in business cycles, markets and industries that are different than ours; think China and India where GDP growth is three times that of the G7 nations. What is likely to be a sustained period of robust growth in developing markets should translate into superior long-term returns for investors. Although there are benefits to investing abroad there are also impediments and risks including:

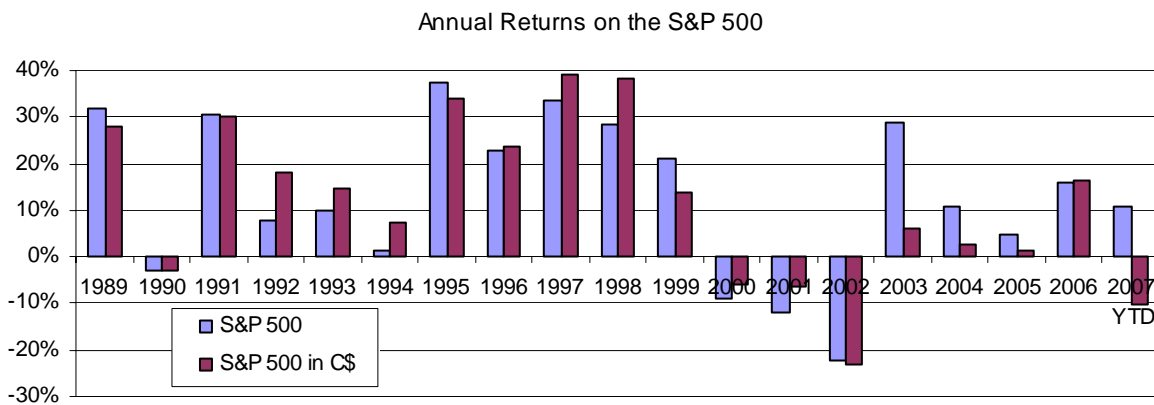
- Information barriers
- Political risk
- Restriction on flow of funds
- Taxes and higher costs
- Currency risk

Currency Risk

Investing in international markets exposes investors to currency risk, specifically the appreciation of the Canadian dollar relative to other currencies, unless the portfolio has been properly hedged. Investors have become painfully aware of this fact in recent years where returns have been eroded by the strong appreciation of the Canadian dollar against most major currencies.

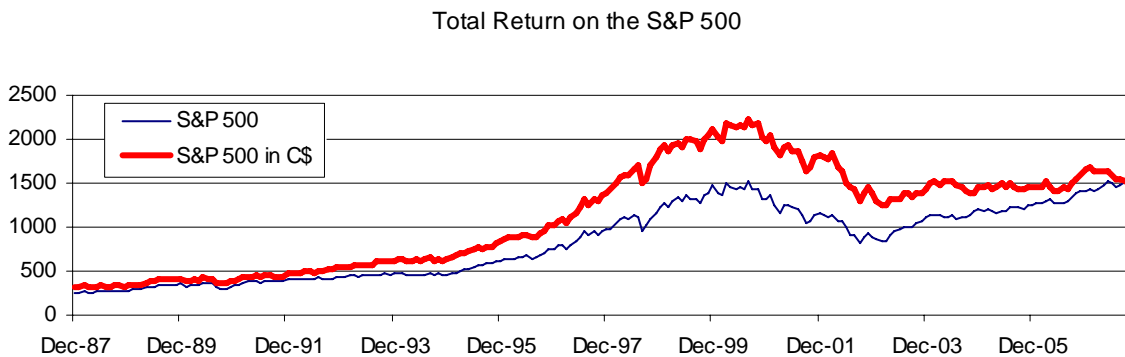
While foreign currency gains materially improved total returns on U.S. investments during the 1990s, the same can not be said in recent years. Over the past five years, the Canadian dollar has quickly reversed three decades of depreciation against the U.S. greenback. After bottoming at U\$0.62 in January 2002, the loonie has appreciated nearly 80% with about half of that gain coming in 2007 alone.

As for returns, 2007 in particular has been especially challenging. While the S&P 500 Composite Index has risen by 11% year-to-date (as of October 31), the sharp increase in the Canadian dollar versus the U.S. dollar has resulted in negative total returns for Canadian investors (see last set of bars on the chart below). This is in sharp contrast to the 1990s, when Canadian dollar weakness enhanced total returns to Canadian investors.



Source: Bloomberg

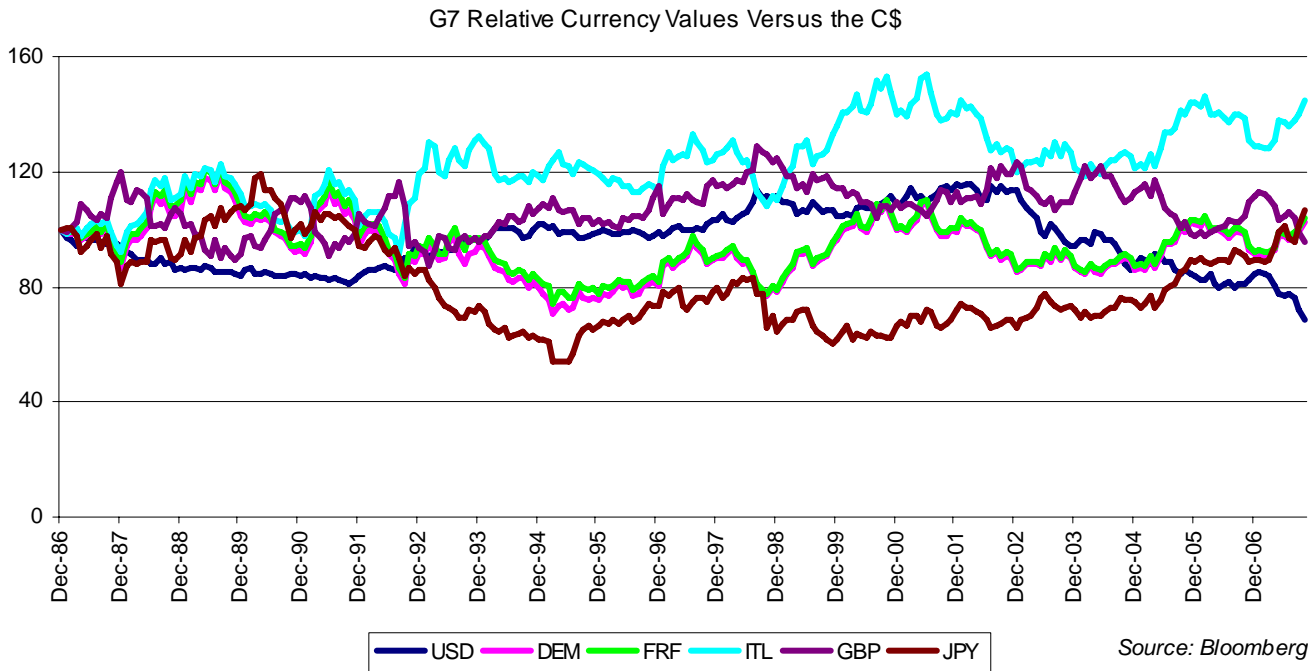
The sharp rise in the Canadian dollar over the past five years has also resulted in reducing the long term returns from U.S. equities.



Source: Bloomberg

Currency Report

However, the long-run impact of foreign exchange varies from one currency to another. The chart below shows the Canadian dollar exchange rate against the other members of the G7. With the exception of the U.S. dollar (loonie appreciated) and the Yen (loonie depreciated), there has been no material change in the value of our currency in the past 20 years.



Foreign exchange rates are invariably volatile. At times foreign currency exposure can enhance returns and other times it will become a drag on total return measures. Returns will vary from market to market and also have a lot to do with the timing of purchases and sales. To underscore this point, the table below shows currency adjusted returns for key international benchmarks over the past five years.

Most economists will tell you the loonie is over valued relative to other major currencies based on purchasing power parity. Does this mean the Canadian dollar is poised for a near-term sell off, maybe or maybe not? There is a certain path of events that could propel the loonie to \$1.15 or beyond in the months ahead. Where will the dollar end the year, and where will it trade in 6 months time, we just don't know. Our view is to ride out the current volatility. However, clients that are not prepared to assume this risk should examine ways in which they can hedge their currency exposure.

Comparative Market Returns in C\$

	Annualized 5-Year Returns *
India BSE Sensex 30 Index	40.2%
Australia ASX 200 Index	24.2%
Mexico Bolsa Index	22.5%
TSX Composite Index	20.2%
Hong Kong Heng Seng Index	19.3%
S&P Euro 350 Index	13.0%
U.K. FTSE 100 Index	10.3%
Taiwan Taiex Index	10.3%
Japan Nikkei 225 Index	5.7%
S&P 500 Composite Index	2.9%

* Oct. 31, 2002 to Oct. 31, 2007

Source: Bloomberg

Hedging Currency Risk in an Equity Portfolio

The benefit of hindsight tells us that investors should have hedged their U.S. dollar exposure in their portfolios starting in 2002. Over the long run, hedging does not improve returns, but rather mitigates losses, and does add additional costs.

From a fixed income perspective, global bond market returns are highly correlated, and although this does leave some room for diversification benefits, this is outweighed by the relatively significant additional volatility that results from adding foreign currency bond exposure. Therefore, although we believe there is the potential to add to returns by taking on short-term tactical currency plays in a fixed income portfolio, over the long run, there is no strong benefit to holding a strategic asset allocation to foreign currency bonds. For most investors, the only reason to hold foreign currency in the fixed income portion of a portfolio is to meet foreign currency income or liability requirements.

Although the additional risk and hedging costs do not justify foreign currency exposure in typical retail fixed income portfolios, the benefits of foreign diversification in equity portfolios outweighs the risks and should be considered.

Hedging can be accomplished by buying a currency-neutral (hedged) fund rather than a U.S. dollar denominated fund or investment. Barclays and Claymore Investments offer investors a number of different exchange traded funds that provide international exposure, but hedge the currency exposure. There are also plenty of open-ended mutual funds which hedge currency risk. Here are just a few funds where currency is actively hedged:

- Claymore U.S. Fundamental ETF
- Claymore Japan Fundamental ETF
- iShares™ CDN EAFE International Index Fund
- iShares™ CDN Russell 2000 Index Fund
- iShares™ CDN S&P 500 Index Fund
- Dynamic Global Discovery Fund
- Dynamic Global Dividend Value Fund
- AGF International Stock Class
- AGF International Value Fund
- Criterion International Equity Currency Hedged Fund

Larger more sophisticated accounts could also consider purchase of currency futures or options as another means of hedging currency risk, especially where the underlying portfolio is comprised of individual stocks.

Conclusion

We acknowledge that 2007 has been a challenging year for our clients with large U.S. dollar exposure in their investment portfolios. The Portfolio Advisory Group encourages our clients to focus on the long-term benefits of international diversification and ride out this period of volatility. It is important to recognize there will be times when foreign currency will enhance total returns. However, clients which are not comfortable with that risk should speak with their advisor about the ways in which currency risk can be hedged in their portfolios.

Paul Danesi, CIM – Director, Equity Advisory

Joey Mack, CFA - Manager, Fixed Income Advisory and Trading

Portfolio Advisory Group

Definition of Scotia Capital Equity Research Ratings & Risk Rankings

We have a three-tiered rating system, with ratings of 1-Sector Outperform, 2-Sector Perform, and 3-Sector Underperform. Each analyst assigns a rating that is relative to his or her coverage universe.

Our risk ranking system provides transparency as to the underlying financial and operational risk of each stock covered. Statistical and judgmental factors considered are: historical financial results, share price volatility, liquidity of the shares, credit ratings, analyst forecasts, consistency and predictability of earnings, EPS growth, dividends, cash flow from operations, and strength of balance sheet. The Director of Research and the Supervisory Analyst jointly make the final determination of all risk rankings.

Ratings

1-Sector Outperform

The stock is expected to outperform the average total return of the analyst's coverage universe by sector over the next 12 months.

2-Sector Perform

The stock is expected to perform approximately in line with the average total return of the analyst's coverage universe by sector over the next 12 months.

3-Sector Underperform

The stock is expected to underperform the average total return of the analyst's coverage universe by sector over the next 12 months.

Other Ratings

Tender – Investors are guided to tender to the terms of the takeover offer.

Under Review – The rating has been temporarily placed under review, until sufficient information has been received and assessed by the analyst.

Risk Rankings

Low

Low financial and operational risk, high predictability of financial results, low stock volatility.

Medium

Moderate financial and operational risk, moderate predictability of financial results, moderate stock volatility.

High

High financial and/or operational risk, low predictability of financial results, high stock volatility.

Caution Warranted

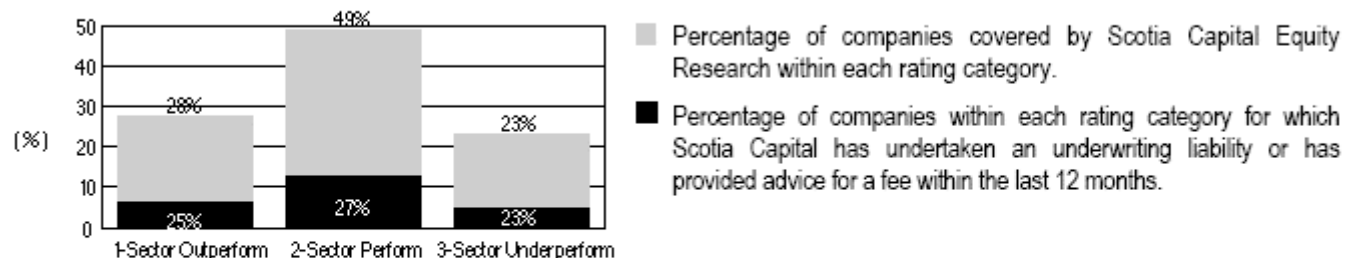
Exceptionally high financial and/or operational risk, exceptionally low predictability of financial results, exceptionally high stock volatility. For risk-tolerant investors only.

Venture

Risk and return consistent with Venture Capital. For risk-tolerant investors only.

Scotia Capital Equity Research Ratings Distribution*

Distribution by Ratings and Equity and Equity-Related Financings*



* As at January 31, 2007.

Source: Scotia Capital.

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Currency Report

*The author(s) of the report own(s) securities of the following companies.
None.*

*The supervisors of the Portfolio Advisory Group own securities of the following companies.
None.*

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