Portfolio Strategy

Why You Want To Own Canada

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Event

- Executive summary of our report entitled "Why You Want to Own Canada".

Implications

- This report is a sequel to a theme piece entitled " Foreign Exposure Rising: Impacts on Canadian Equity Strategy " published in April 2007.
- This updated edition will focus on reasons to own Canadian equities both for foreign and domestic investors. We also provide an updated list of Scotia Capital's Top Picks.

Recommendation

- Canada's main attributes are as follows: (1) Emerging market exposure with lower volatility; (2) cheaper valuations relative to MSCI World; (3) stronger domestic fundamentals: (4) Canadian dollar strength relative to the USD and British pound; (5) proximity to the U.S. economy; and (6) above average market capitalization in Financials, Materials, Technology, and Industrials.

Why You Want To Own Canada

- This report is a sequel to a theme piece entitled " Foreign Exposure Rising: Impacts on Canadian Equity Strategy " published in April 2007. In the first report, we looked at how the elimination of the foreign content rule would impact Canadian equities and funds flows as domestic pension funds would aim to reduce their home bias. Domestic investors have been reducing their "home bias" in the last five years, but foreign inflows into Canadian equities have more than compensated.
- In our first edition, we also detailed the often overlooked attributes of the Canadian equity market and highlighted why foreign investors should overweight Canadian equities. This updated edition will focus exclusively on reasons to own Canadian equities both for foreign and domestic investors. We also provide an updated list of Scotia Capital's Top Picks.
- The Canadian economy represents 1.9% of world GDP (11th in the world with a nominal GDP of US$1.5 trillion in 2008) and its equity market capitalization weighs in at 3.7% of the MSCI World index. In terms of market capitalization, Its 10 yr CAGR of +7.8% (in USD terms) compares to -2.5% for the S&P 500, +7.6% for the MSCI EM index, and -0.7% for the MSCI-World.
- In our opinion, the chief reason to own Canadian equities lies in its superior risk-reward profile. In the last 10 years (August 1999-August 2009), the Canadian equities' compounded annual growth rate (CAGR) outpaced the MSCI World CAGR by 8.5% (7.8% vs. -0.7% respectively) with only 20% more volatility (Exhibit 1) Hence, Canada offers the stability of a developed economy with an exposure to growth in developing nations through its commodity sensitivity.

Exhibit 1 – Performance & Volatility: Canada versus the World

Index	10-Yr CAGR (%) [1]	Volatilitiy (Std. Dev.) of Annual Returns	Risk-Adjusted Return [2]
S&P/TSX (USD)	7.8%	29%	0.27
S&P 500	-2.5%	20%	-0.13
FTSE 100 (USD)	-2.3%	24%	-0.09
MSCI World	-0.7%	24%	-0.03
MSCI EM	7.6%	37%	0.20

Source: Scotia Capital.

- Admittedly, Canada's marginal size doesn't initially attract attention and puts it alongside other mid-tier specialized markets such as Australia, Sweden, or Norway. Moreover, Canada has historically been viewed as a one-trick pony index with a limited number of liquid/global names. This is no longer the case. Using the S&P/TSX 60 index (60 companies) illustrates that the average market capitalization in Financials (banks and insurance), Materials (golds and fertilizers), Technology, and Industrials currently stands above their respective MSCI World average, which means more names are on the global radar (Exhibit 2). In addition, over half of Canadian sectors are trading at a discount to their global peers (Exhibit 3).
- Canada's main attributes are as follows: (1) Emerging market exposure with lower volatility;

Exhibit 2 – Average Market Capitalization: TSX 60 Relative to MSCI World - September 3, 2009

	S&P/TSX 60		MSCI World		Relative
Sector	# of Cos.	Avg. Size (US$B)	# of Cos.	Avg. Size (US$B)	Size
Technology	1	43.6	150	16.5	264%
Financials	10	29.2	335	14.7	198%
Banks	*6*	*39.1*	*102*	*21.7*	180%
Insurance	*3*	*19.6*	*83*	*11.5*	171%
Materials	11	14.5	159	10.1	144%
Industrials	4	11.1	262	9.4	119%
Energy	14	18.8	115	20.4	92%
Cons. Discr.	8	6.7	247	9.4	72%
Telecom.	3	15.2	48	24.1	63%
Cons. Staples	5	6.4	128	18.6	35%
Utilities	2	3.8	94	13.4	28%
Health Care	2	1.5	121	17.9	8%
Total	**60**	**15.8**	**1659**	**13.9**	**113%**

Source: Scotia Capital, Bloomberg.

Exhibit 3 – Over Half of TSX Sectors Trading at Discount to the MSCI World Index

	12-M Forward P/E Ratios		Premium/Discount
	MSCI World	Canada	to MSCI World (%)
Overall	14.9	14.8	**-1%**
Cons. Disc.	19.9	15.0	**-24%**
Technology	18.0	14.1	**-22%**
Financials	15.7	13.2	**-16%**
Industrials	16.3	14.3	**-13%**
Cons. Staples	14.2	13.9	**-2%**
Materials	17.9	17.8	**-1%**
Telecom	11.5	11.9	**3%**
Utilities	12.4	14.3	**15%**
Energy	12.0	15.8	**31%**
Health Care	11.9	n/a	**n/a**

1: We use the TSX index at the country level and MSCI Canada indexes for sector.

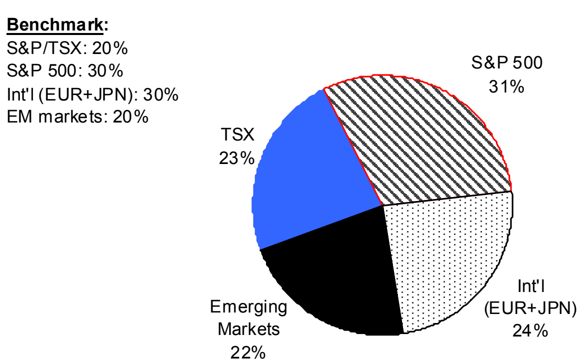
Source: Scotia Capital, Thomson Financial, Bloomberg

(2) cheaper valuations relative to MSCI World; (3) stronger domestic fundamentals: (4) Canadian dollar strength relative to the USD and British pound; (5) proximity to the U.S. economy; and (6) above average market capitalization companies in Financials, Materials, Technology, and Industrials.

Overweight Canada

- The financial climate has changed dramatically in the last couple of years and investors have had to deal with a severe financial crisis and the worst global recession since WWII. However, with Emerging markets still gaining market share on the world stage, and now that the global economy is set to grow again in 2010, the attractiveness of Canadian equities remains unchanged. Our positive bias towards Canadian equities should be viewed in the context of a global equity strategy, not an asset mix call.
- The risk in owning Canadian equities lies in the sustainability of developing economies to outgrow the G7 over the next decade. If developing economies succumb to social unrest or fall into a prolonged slump, Canadian equities would likely underperform. However, we believe the odds squarely favour developing economies keeping world GDP growth above average in coming years. World GDP growth averaged 4% in the last ten years versus 3.5% from 1970 to 1999.
- In our opinion, Canadian assets (bonds and equities) punch well above their weight and, as we believe Canadian equities remain underweight in global portfolios, global investors should heighten their focus north of the U.S. border. We would also point out that we believe Canadian domestic investors should temper their international endeavours and stick to a higher domestic bias in their portfolios.

Exhibit 4 – Scotia Capital Equity Mix*



*Suggested for Canadian investors.

Source: Scotia Capital estimates.

Exhibit 5 – Global ETF Portfolio

Region/Country	ETFs	Weighting (%) Portfolio	Weighting (%) MSCI	Recommendation
North America		**41%**	**38%**	**Over**
U.S.	IVV	35%	35%	Market
Canada	EWC	6%	4%	Over
Europe		**26%**	**30%**	**Under**
U.K.	EWU	6%	8%	Under
France	EWQ	4%	5%	Under
Germany	EWG	2%	3%	Under
Italy	EWI	1%	2%	Under
Spain	EWP	1%	2%	Under
Asia-Pacific		**25%**	**26%**	**Under**
Japan	EWJ	8%	10%	Under
Australia	EWA	5%	3%	Over
China	GXC	6%	4%	Over
Hong Kong	EWH	2%	1%	Over
Latin America		**4%**	**4%**	**Over**
Mexico	EWW	1%	1%	Market
Brazil	EWZ	3%	2%	Over

Source: Scotia Capital; Bloomberg.

What You Want To Own In Canada

- We provide an updated list of Scotia Capital's Top Picks in the following Exhibit.

Exhibit 6 – Scotia Capital Top Picks To Own in Canada

Sector	Industry	Analyst	Top pick	Ticker	1-Yr ROR
Materials	Metals & mining	Larry Smith	Inmet Mining	IMN	12%
Materials	Metals & mining	Alex Terentiew	First Uranium	FIU	130%
Materials	Chemicals & Fertilizers	Sam Kanes	Potash	POT	56%
Materials	Gold	Dave Christie	IAMGOLD	IMG	11%
Materials	Gold	Trevor Turnbull	Red Back Mining	RBI	8%
Materials	Gold-junior	Indi Gopinathan	Aurizon Mines	ARZ	0%
Materials	Paper & forest products	Benoit Laprade	Sino-Forest	TRE	33%
Energy	Exploration & Producers	Mark Polak	Candian Natural Resources	CNQ	29%
Energy	Exploration & Producers	Jeremy Kaliel	NAL Oil & Gas Trust	NAE-u	20%
Energy	Storage & Transportation	Sam Kanes	Enbridge	ENB	27%
Industrials	Transportation	Cherilyn Radbourne	Canadian National Railway	CNR	10%
Industrials	Trading Companies & Distribution	Anthony Zicha	Russel Metals	RUS	18%
Consumer Discretionary	Media	Paul Steep	Thomson Reuters	TRI	40%
Consumer Discretionary	Specialty Retail	Anthony Zicha	Rona	RON	24%
Consumer Discretionary	Hotels Restaurants & Leisure	Patricia Baker	Tim Hortons	THI	24%
Consumer Discretionary	Hotels Restaurants & Leisure	Turran Quettawala	Great Canadian Gaming	GC	19%
Consumer Staples	Drug Retail	Patricia Baker	Shoppers Drug Mart	SC	34%
Consumer Staples	Food Products	Turran Quettawala	Saputo	SAP	19%
Consumer Staples	Food Products	Cherilyn Radbourne	Viterra	VT	41%
Financials	Banks	Kevin Choquette	Royal Bank of Canada	RY	38%
Financials	Insurance	Tom MacKinnon	Great West Lifeco	GWO	26%
Financials	Real Estate	Cherilyn Radbourne	Brookfield Asset Management	BAM/A	24%
Financials	Real Estate	Pammi Bir	First Capital Realty	FCR	11%
Financials	Real Estate	Mario Saric	Brookfield Properties	BPO	31%
Financials	Capital Markets	Phil Hardie	Gluskin Sheff & Associates	GS	35%
Information Technology	Communications Equipment	Gus Papageorgiou	Research in Motion	RIM	30%
Information Technology	IT Services	Paul Steep	CGI Group	GIB/A	15%
Telecom	Wireless Services	Jeff Fan	Roger Communications	RCI/B	33%
Utilities	Power & Producers	Ben Isaacson	Boralex	BLX	48%
Utilities	Power & Producers	Tony Courtright	Brookfield Renewable Power Fund	BRC-u	17%

Source: Scotia Capital estimates.

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Appendix A: Important Disclosures

Company	Ticker	Disclosures*

I, Vincent Delisle, certify that (1) the views expressed in this report in connection with securities or issuers that I analyze accurately reflect my personal views and (2) no part of my compensation was, is, or will be directly or indirectly, related to the specific recommendations or views expressed by me in this report.

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* *Legend*

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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.

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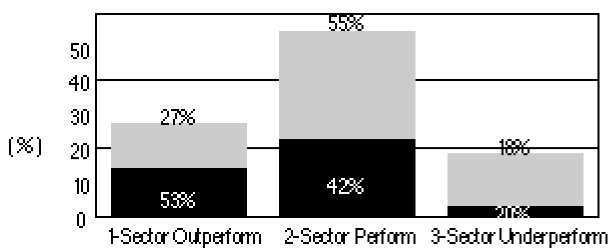
Distribution by Ratings and Equity and Equity-Related Financings*



- Percentage of companies covered by Scotia Capital Equity Research within each rating category.
- Percentage of companies within each rating category for which Scotia Capital has undertaken an underwriting liability or has provided advice for a fee within the last 12 months.

* As at August 31, 2009.

Source: Scotia Capital.

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