

## QUARTERLY INTEREST

### VIEWPOINT

#### Picking Up the Pieces...

After flirting with disaster in late 2008 and early 2009, financial markets – and, in their wake, the global economy – have stabilized, even grown. However, putting an end to the protracted slump required unprecedented effort and cooperation on an international scale: governments and central banks around the world, fearing that another Great Depression was in the offing, joined hands to avoid the worst and, so far, appear to have succeeded.

The scope of the problem is global, as the debt of industrialized nations has ended up paralyzing trade. In fact, consumers in the developed world stopped buying on credit when the financial system threatened to collapse. This dried up the market for the exports of developing countries, and the global economy slipped into recession.

The first weapons in the battle against recession were rolled out in late 2008, when special programs were launched in the United States and the Federal Reserve Board (“Fed”) slashed its policy rate to almost 0% (a band of between 0% and 0.25%). Most central banks in the rest of the world followed suit. For instance, the Bank of Canada reduced its overnight funding rate to 0.25% during its third meeting of the year, on April 21, 2009. It went so far as to announce, at its next meeting on June 4, that the overnight rate would remain at this level at least until the end of the second quarter of 2010, inflation permitting.

And inflation seems to be cooperating. Indeed, Canada’s inflation rate has been moving in lockstep with the price of crude oil. After being negative during the summer months, the inflation rate returned to positive territory near the end of the year, fuelled once again by energy prices. In late 2009, the annual inflation rate was 1%, i.e. just at the lower limit of our central bank’s target range.

In response to the serious concerns of central banks, governments loosened their purse strings, first to bolster their domestic financial sector, and then to support a number of selected industries.

In Canada, following an initial denial on the part of the federal government in November 2008, the Finance Minister finally decided open the floodgates, resulting in an expected deficit of some \$56 billion for the fiscal year ending in March 2010. Meanwhile, Ontario, the province that was most affected by the economic slowdown, has estimated that its budget deficit for the same fiscal year would approximate \$25 billion.

Still tied down by the weight of a severe recessionary storm and by fears that depression was just around the corner, equity markets continued to shrivel during the first quarter of 2009. However, the unheard-of initiatives announced by central banks and national governments were well received by financial markets, which emerged from their slump late in the first quarter of the year. For instance, the Canadian stock market generated a total return of 35.05% in 2009 and recovered much of the ground lost during the previous year, driven primarily by information technology, financials, energy and materials.

The rebound in equities, originally propelled by lower quality issues, finally delivered a 2009 return of 26.46% in local currency for the S&P 500. The major contributors to this recovery were the information technology and materials sectors.

Appetite for risk, which had completely disappeared in 2008, came back with a vengeance in 2009. Thus, investors abandoned the safety of federal government bonds for the more attractive yields to maturity promised by provincial government and corporate issues. The end result was a return of 5.41% for the DEX Universe Index as a whole. Note, however, that there was a substantial gap between the return on corporate (16.26%) and Government of Canada bonds (-1.52%).

The renewed confidence shown by investors appears to suggest that the economy and financial markets have recovered. However, this was achieved at the cost of a heavy debt load for governments around the world, as well as for individual consumers. Does this mean that there no longer exist any threats to the economy? All stakeholders contributed to picking up the pieces in 2009. The coming year will give us a good idea of whether or not these pieces can be put back together.

## VIEWPOINT (CONTINUED)

### ...And Putting Them Back Together Again

The 2009 recession produced an unusual and wide-ranging reaction that wiped out the hard-earned achievements of the last few years, especially in terms of public finance. Indeed, to the deficits projected for the 2009-10 fiscal year, we will need to add those of following years. For the governments of Canada and Ontario alone, the combined deficits of the next two fiscal years are projected to exceed \$113 billion, compared to a combined surplus of \$26 billion for the 2006-07 and 2007-08 fiscal years.

Canada's households have also not gone unscathed, as their debt load now represents 140% of their disposable income. Burgeoning consumer debt is also plaguing several other industrialized nations and will constrain consumption prospects.

Developing countries too have become involved in overcoming the economy's woes by implementing public expenditure programs. With demand from industrialized nations being curbed by rising debt levels due to consumer credit, developing countries will be unable to rely on a swift revival of exports. A significant portion of public expenditures will therefore be allocated to stimulating domestic demand.

The outlook for commodities in 2010 should be favourable, even assuming a moderate recovery. Commodity prices will be propped up by the emergence of industrialized nations from their recession and by growing demand from developing countries.

Despite this upward pressure on prices, our inflation rate will remain at the lower end of the range established by the Bank of Canada. Indeed, part of the increase in commodity prices that are denominated in U.S. dollars will be offset by a rising Canadian dollar, resulting from enhanced terms of trade. In addition, although the economy will revive, the excess capacity that developed during the recession means that it will be a while before demand exceeds productive capacity.

Against this backdrop, it would be surprising for the Bank of Canada to increase its overnight funding rate before mid-year. Our central bank is worried about the impact that an overly sharp increase in interest rates would have on the economy, even though it recently warned against the excessive debt that low interest rates could generate. The governor of the Bank indicated that he was concerned about the potential emergence of a residential real estate bubble and that he would prefer a tightening of regulations to an early increase in interest rates.

While the process of putting the pieces of the global economy back together again is just beginning, several challenges have already emerged. Policy makers could be sorely tempted to act quickly in an attempt to jumpstart an economy that is showing signs of recovering at a slower pace than usual. Industrialized nations are used to strong recoveries following deep recessions. The problem is that the recent contraction was atypical, and so will be the prescription to survive a cycle of deleveraging.

Cooperation between national economies must continue if the global economy is to resume a more normal level of long term activity. International trade – a crucial ingredient of global prosperity – cannot be hampered. On the other hand, for the imbalances between creditor (developing) and borrower (industrialized) economies to be reduced, developing nations must base more of their growth on domestic demand and developed countries must return to a more viable balance between savings and consumption.

In their haste to restore fiscal balance and, by so doing, to ease the pressure on interest rates, governments may try to put an early stop to their stimulus initiatives, which could cause the economy to falter again.

These are but a few of the factors that may hinder the delicate job of piecing back together a hard-pressed global economy, a task that requires a lot of skill and attention to detail. In other words, it's a good idea to take the time to do things right.

# ECONOMIC COMMENTS

## International

After showing positive signs of stabilization during the second quarter, the global economy appears to have finally embarked on the road to recovery according to third quarter GDP growth. However, the sluggish pace of this nascent advance seems atypical given that we are emerging from the sharpest recession since the Great Depression. Still, China continues to lead the way with year-over-year GDP growth of 8.9% in the third quarter.

On the other hand, recovery in several developed countries remains muted, despite vigorous government stimulus initiatives. This disparity is due to the fact that, unlike their emerging nation counterparts, households in several developed countries remain burdened with high debt levels that they have finally decided to reduce. This situation is particularly acute in countries such as the United States, the United Kingdom, and Spain, which experienced the strongest real estate speculation in the last cycle. Despite this somewhat slow start to the recovery, it is still encouraging to observe that international trade is on the mend after collapsing during the recession. A sustained improvement in this area is critical to a sustainable global recovery.

In the euro zone, a number of countries have managed to get back on track, with consolidated GDP growth reaching 1.5% during the third quarter. Yet, some economies were still lagging during the third quarter, including those of Spain (-1.3%) and Greece (-1.2%).

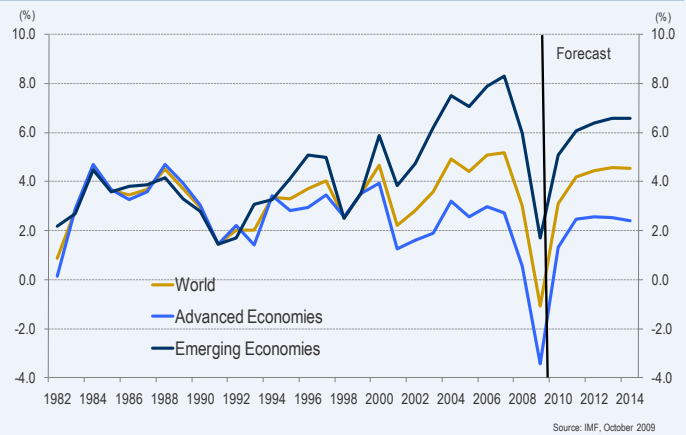
## United States

The U.S. economy resumed positive growth during the third quarter (2.2%), as consumption and residential construction took a turn for the better, inventory liquidation slowed and government spending rose. And while exports improved, imports increased even more, which hampered growth.

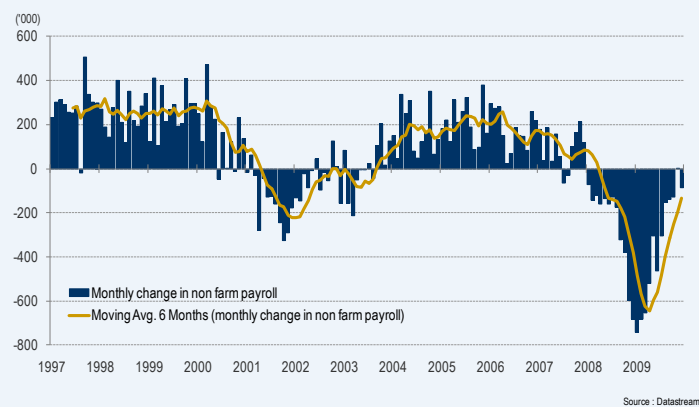
The employment market continued to stabilize, as the rate of monthly job losses slowed to 69,000 in the quarter. The residential real estate sector also steadied out during the summer, and higher existing home sale figures confirmed a return to guarded optimism. The savings rate appears to be settling in at around 4% as households continue to lighten their debt load while consumption recovers at a less than normal pace.

The real test for this embryonic recovery will come during the next few quarters, as the impact of government stimulus programs wanes.

IMF Growth Estimates



Change in Employment - United States according to Non Farm Payroll



Savings Rate - United States as a % of Disposable Income



# ECONOMIC COMMENTS (CONTINUED)

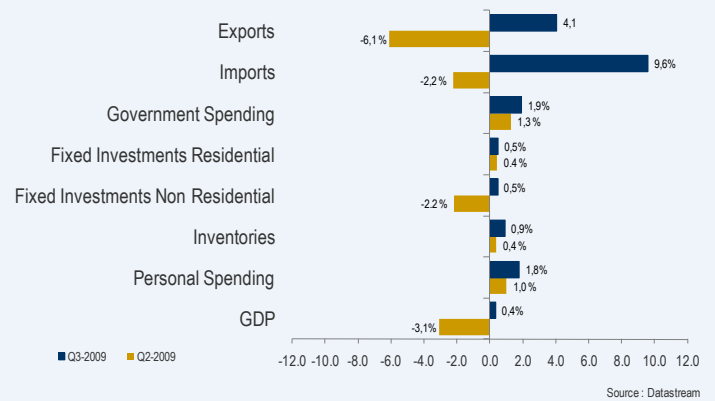
## Canada

Canada’s GDP recorded positive – albeit weak – growth at an annualized rate of 0.4% during the third quarter. This seemingly lacklustre performance masks a respectable 4.7% rebound in domestic demand, which was largely offset by deteriorating net exports. Indeed, our exports of energy and automotive products to the United States began to come around, but our imports of machinery and equipment rose sharply, which explains the worsening of our net exports. Despite its unfavourable short term impact, this increase in capital expenditures is expected to generate productivity gains and more growth over time.

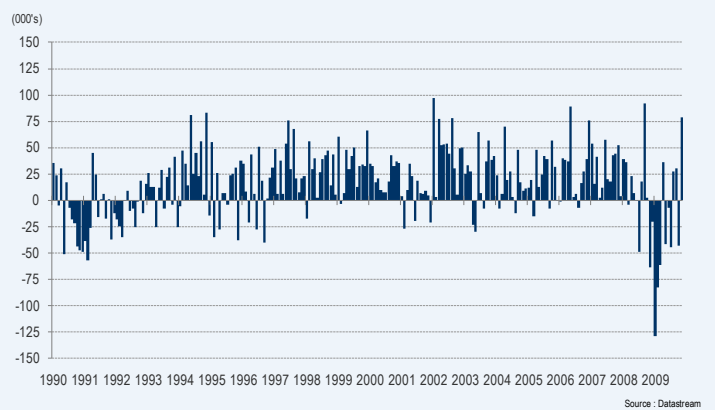
Conditions in Canada continue to sustain the momentum of domestic demand. Employment has begun to grow again (October to December: +33,000) and our residential real estate market, which was spared the excesses of the U.S. market, is buoyant, which is helping to restore confidence. What’s more, the Canadian financial system was left relatively unscathed by the credit crisis, and it has enough capital to fund household and corporate expenditures that are crucial to the recovery. Finally, government programs should support growth for at least part of 2010.

The outlook for economic growth in Canada remains tied to changes in international trade. While our exports to emerging Asian nations should increase due to the solid recovery in this part of the world, our exports of energy, industrial products and automotive parts and vehicles to the United States must continue to improve for Canada’s recovery to be validated. As long as the U.S. rebound remains subdued, this dominant portion of our exports is likely to stagnate.

### Contribution to Canadian Growth

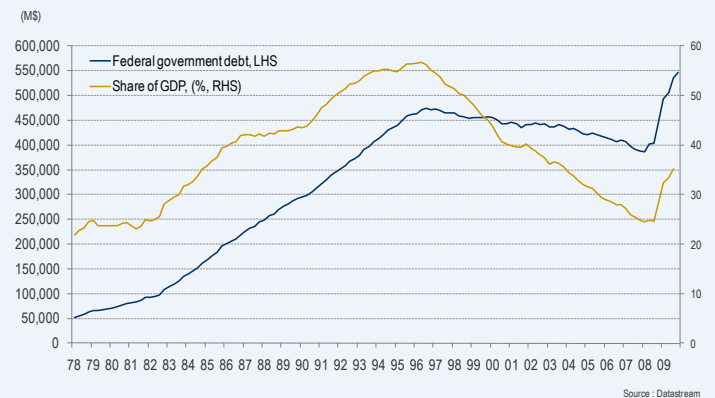


### Change in Employment - Canada



### Debt Outstanding

Federal Government - in Millions of \$ and % of GDP



### ECONOMIC INDICATORS

(annual % change)\*

	UNITED STATES		CANADA	
	2008	2009	2008	2009
REAL GDP	0.4	-3.3	0.4	-2.9
UNEMPLOYMENT RATE **	5.8	9.3	6.2	8.3
INFLATION	3.8	-0.6	2.3	0.2
RETAIL SALES	-0.7	-6.9	3.4	-4.3
INDUSTRIAL PRODUCTION	-2.2	-10.4	-4.2	-11.7
CAPACITY UTILISATION **	77.6	69.9	78.6	68.6
EXPORTS OF GOODS	12.2	-21.8	5.8	-26.3
IMPORTS OF GOODS	7.5	-30.4	6.7	-15.9

\* Most recent cumulative data (as at January 8, 2010)

\*\* Average

## MARKET COMMENTS

### Monetary Policy and Interest Rate Trends

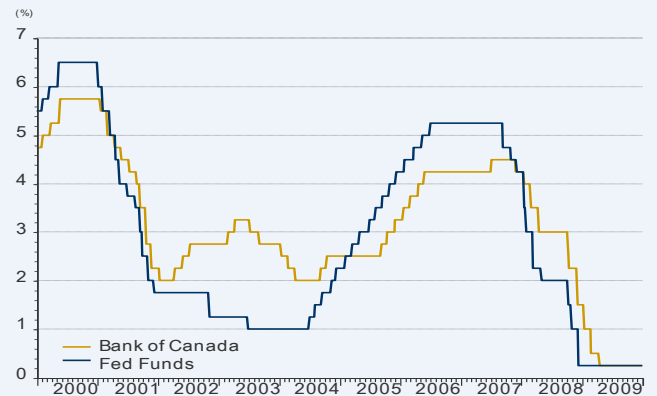
During the fall, the Bank of Canada reiterated its commitment to maintain the overnight funding rate at 0.25% until June 2010, in an effort to promote economic recovery and to nudge inflation back to the Bank’s 2% target. However, this commitment remains conditional on inflation not hinting at another course of action. In its Monetary Policy Report in October, the Bank maintained its projection for 3.0% growth in 2010, but reduced its projection for 2011 to 3.3% (from 3.5%). Indeed, the Bank stated that the Canadian dollar’s ongoing strength would impede growth and restrain inflation, which would only reach the Bank’s 2% target in the third quarter of 2011. This anticipated strength in our dollar will be even more plausible should a number of sovereign investors, having indicated that they intend to diversify their reserves by including assets denominated in Canadian dollars, actually do so.

In this same report, the Bank estimated that the overall balance of risk to its inflation projection was still tilted to the downside. However, it took pains to maintain enough flexibility to tighten credit conditions should growth and inflation accelerate faster than anticipated. In fact, in the December issue of the Financial System Review and in the latest speeches of governor Mark Carney, the Bank admitted that it was worried about the rapid rise in household debt over the past few months, against a background of exceptionally low interest rates. The Bank is concerned that this debt load could soon become a problem for stretched-out households when rates return to levels that are deemed barely normal. The central bank’s cautionary note was intended to defuse the motivational conflict that it will have to solve when it normalizes its rate structure.

Meanwhile, during its November and December meetings, the Fed’s Open Market Committee confirmed that it had noticed more improvement in economic activity, stabilization in the labour market and an apparently increased ability of capital markets to fund a recovery. The FMOCC/Fed also reiterated its perception that the recovery remains vulnerable and that market conditions warrant maintaining its target rate between 0% and 0.25% for a period that, it feels, needs to be extended.

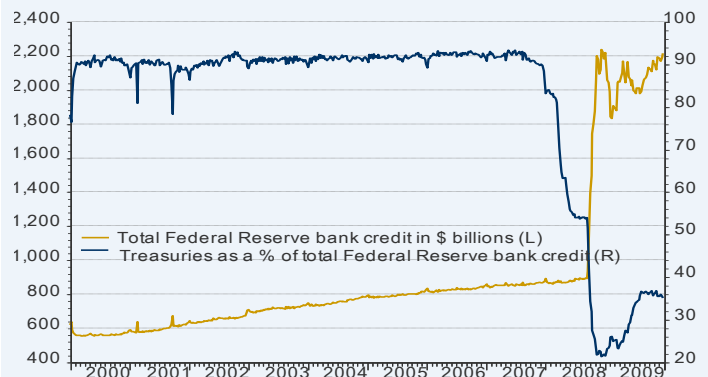
The Fed also announced that, given the greater availability of conventional funding, its special liquidity programs (totalling nearly \$150 billion) would be wound down during the first half of 2010 and would not be renewed. Furthermore, it noted that it was planning to implement a fixed-term deposit program that would provide it with another tool that it could use, as required, to absorb the excess reserves of nearly \$1 trillion that banks now hold in the Fed’s vaults.

North American Monetary Policy Target Rates



Source: Datastream

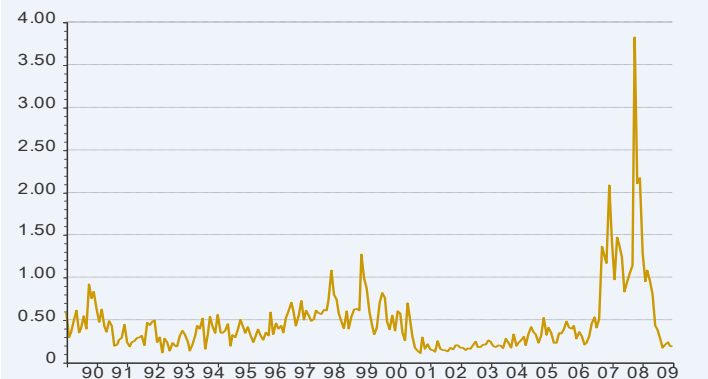
The Federal Reserve Has Expanded its Balance Sheet but it is now riskier



Source: Datastream

U.S. Interbank Market

3-month LIBOR - 3-month U.S. T-Bills (TED Spread estimate)



Source: Datastream

## MARKET COMMENTS (CONTINUED)

During the fourth quarter, the bond market remained as volatile as in the previous quarter, although yields began to trend slightly upward again. The market reacted to indications that the economy had begun to recover and to the pressure exerted by a sustained supply of new government issues.

Over the course of the quarter, the DEX Universe Index generated a return of -0.16%. This time, short term bonds outperformed all other sectors of the index, returning 0.44% compared to -0.25% and -1.37% for the mid term and long term sectors respectively. Corporate bonds were the only class to provide a positive return for the period, as their spreads tightened anew. Meanwhile, provincial spreads did not tighten sufficiently to offset the negative impact of rising benchmark bond yields.

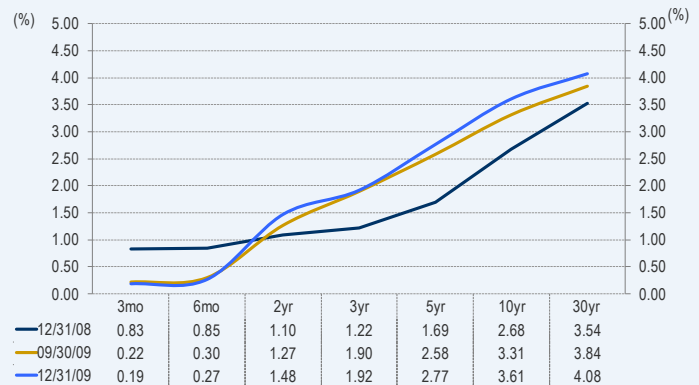
The Fed maintained its fed funds rate at a historical low throughout the fall. The sizeable volume of the U.S. Treasury program of new issues and its monthly frequency eventually weighed heavily on the market, as signs of economic recovery accumulated. On December 31, the 30-year yield stood at 4.64%, i.e. 59 basis points more than on September 30. Its fluctuation range was 73 basis points (from 3.96% to 4.69%), slightly larger than during the previous quarter (0.61%).

The slope of the 2-year to 30-year curve in the United States steepened substantially from September to December, from 311 basis points to a high of 374 points, before closing out the quarter at 351 basis points, an increase of 40 points over the period.

The Bank of Canada remained committed to maintaining an overnight funding rate of 0.25% until the middle of 2010 to promote economic recovery. As for the federal government, it will soon table a budget that should lay out the measures that it intends to adopt to pave the way for a return to fiscal balance.

Yields were less volatile in Canada than in the United States during the quarter, as the substantial increase in the supply of U.S. Treasury issues had a larger impact south of the border. In Canada, shorter term yields (under 5 years) rose slightly less than those for longer maturities. While 2-year and 5-year yields increased 21 and 19 basis points respectively, their 10-year and 30-year counterparts were climbing 30 and 24 basis points respectively.

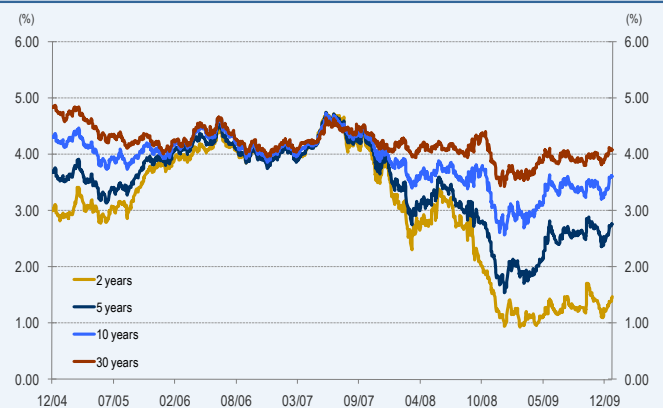
### Canadian Yield Curves



\* Change of bond benchmark January 1<sup>st</sup>2009

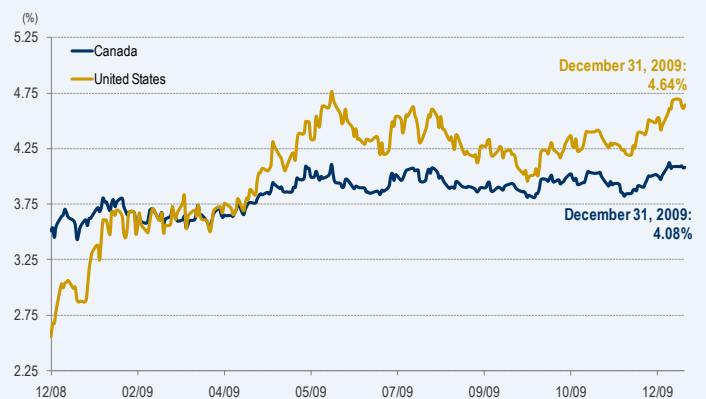
### Canadian Interest Rate Trends

The yield curve steepened



### Canada and United States 30-year Yields

December 2008 - December 2009



## MARKET COMMENTS (CONTINUED)

On December 31, the 30-year yield was 4.08%, after peaking at 4.12% a few days earlier.

Fluctuation ranges widened during the period, especially for 2-year yields (61 basis points). Volatility reached 61, 53 and 32 basis points for 2-, 5- and 30-year yields respectively.

The spread between Canadian 2-year and 30-year yields widened slightly during the quarter. The slope of the curve rose from 257 basis points to a high of 278 basis points before closing out the quarter at 260 basis points on December 31.

Because Canadian bond yields recorded a more moderate increase than yields on U.S. government bonds, all of the Canadian sectors outperformed. Indeed, Canadian yields are now higher than those in the United States for shorter maturities, but lower for maturities of 10 years and beyond. For the 30-year maturity, the spread increased from -21 basis points to a peak of -60 basis points, ending the quarter at -0.56%, reflecting that 30-year yields rose 35 basis points more in the United States than in Canada during the quarter.

### Real Return Bonds (RRBs)

The yield on Canadian long term RRBs declined from 1.75% at the beginning of the fourth quarter to 1.51% three months later. In the United States, the corresponding yield was off only 2 basis points, to 2.05%. Moreover, the break-even inflation rate in Canada was up sharply (48 basis points) to 2.68%, which was close to the upper limit of the Bank of Canada's target range. Break-even inflation also increased in the United States, from 1.95% to 2.49% at the end of the quarter.

During the fourth quarter of 2009, the RRB index returned 4.47%, compared to -2.17% for Government of Canada long bonds. By performing so well for a third straight quarter, the RRB index reflected a less excessive degree of illiquidity for this class of securities, as well as an upward shift in inflationary expectations in response to an enhanced economic outlook.

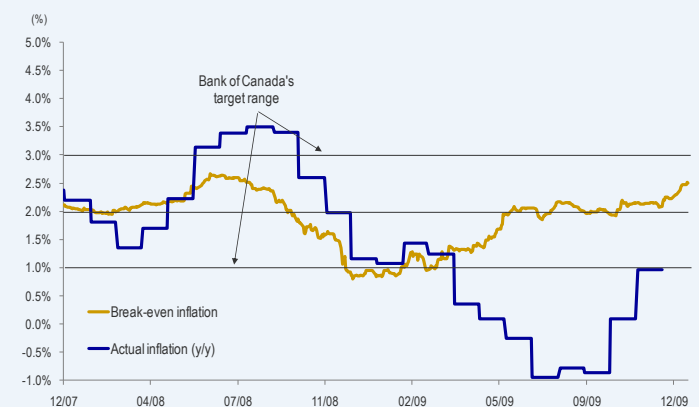
Canada - United States 10 Year Spread  
(in basis points)



	Yield (%)			Change (b.p.)	
	12/31/09	09/30/09	12/31/08	Q4-2009	2009
<b>Canada</b>					
3-month	0.19	0.22	0.83	-3	-64
2-year	1.48	1.27	1.10	21	38
5-year	2.77	2.58	1.69	19	108
10-year	3.61	3.31	2.68	30	93
30-year*	4.08	3.84	3.54	24	54
<b>U.S.</b>					
3-month	0.06	0.08	0.03	-2	3
2-year	1.14	0.94	0.76	20	38
5-year	2.68	2.31	1.55	37	113
10-year	3.84	3.31	2.21	53	163
30-year	4.64	4.05	2.68	59	196
<b>Canada/U.S. Yield Spread (b.p.)</b>					
3-month	13	14	80	-1	-67
2-year	34	33	34	1	0
5-year	9	27	14	-18	-5
10-year	-23	0	47	-23	-70
30-year	-56	-21	86	-35	-142

\*Change of bond benchmark January 1<sup>st</sup>, 2009

Break-even Inflation Implied by Canada Real Return Bonds and Actual Inflation  
December 2007 - December 2009



## MARKET COMMENTS (CONTINUED)

### Provincial Bonds

During the quarter, provincial bonds generated a return of -0.89%, compared to -0.79% for Canadas. In contrast to previous quarters, provincial risk premiums stabilized during the fourth quarter.

Provincial credit spreads barely moved during the final quarter of 2009. In the 30-year sector, they closed out the quarter at 81 basis points for Québec, 65 points for British Columbia and 68 points for Ontario, tightening 2, 1 and 0 points respectively.

During 2009, provincial credit spreads tightened significantly and the credit curve began a process of normalization. As a result, short and mid terms credit spreads posted greater tightening than their long term counterparts. For Québec, credit spreads tightened by 98, 97 and 66 basis points respectively for 5-, 10- and 30-year terms. For Ontario, they tightened 81, 89 and 56 basis points respectively for the corresponding terms. Finally, for British Columbia, credit spreads narrowed by 96, 80 and 58 points respectively for 5-, 10- and 30-year terms.

During October, a number of provinces published a more detailed update of their fiscal stance. Ontario surprised with a larger than anticipated deficit. The impact of this deficit on the province’s funding requirements contributed to Ontario’s underperformance during the quarter and for the year as a whole. Québec and British Columbia also saw their fiscal position deteriorate, but to a much lesser extent.

As a result of these updates, one of the highlights of the fourth quarter occurred when both DBRS and S&P downgraded the province of Ontario from AA to AA(Low) and AA- respectively. The province remains in the line of sight of the bond rating agencies and will have to show evidence of more stable finances to avoid further downgrading.

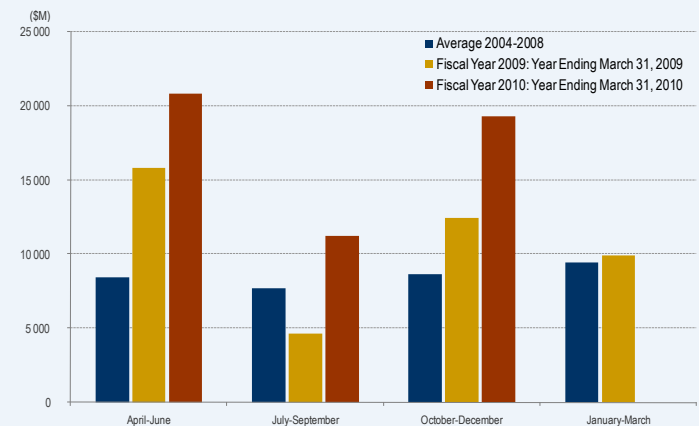
The provinces substantially accelerated the pace of their funding operations during the fall, as spreads were sustained by appetite for credits generally. The number of issues was considerable, both domestically and on international markets, which certainly helped domestic spreads to remain almost unchanged. The cumulative amount of provincial bonds issued last year broke the \$50 billion barrier, a new record for a fiscal year that still has a full quarter of funding to go (the previous record was set almost a year ago, with total issues of over \$42 billion for the 2008-09 fiscal year).

30-year Provincial Spreads over Canada Bonds  
December 2008 - December 2009



	Yield Spreads (b.p.)			Change	
	12/31/09	09/30/09	12/31/08	Q4-2009	2009
<b>Quebec/Canada</b>					
5-year	32	37	130	-5	-98
10-year	77	79	174	-3	-97
30-year	81	83	147	-2	-66
<b>Ontario/Canada</b>					
5-year	38	41	119	-3	-81
10-year	66	63	155	3	-89
30-year	68	68	124	0	-56
<b>BC/Canada</b>					
5-year	29	32	124	-3	-95
10-year	68	66	148	2	-80
30-year	65	66	123	-1	-58
<b>Yankee/US Treasuries</b>					
Qc-30 yr	25	61	112	-36	-87

### Quarterly New Issues



## MARKET COMMENT (CONTINUED)

### Corporate Bonds

The corporate bond market continued to outperform Government bonds during the fourth quarter, although at a slower pace than during the first half of the year. The average yield spread between the DEX corporate bonds and Federal bonds sub indices narrowed 14 basis points, moving from 149 at the beginning of the quarter to 135 at the end. Increasing investor appetite for risk and higher yields was the trend throughout the year, and was reinforced by improving global equity markets and signs that the global economic picture was improving.

The resolve for increased risk appetite was tested when the desire for a standstill on the debt refinancing of Dubai World was announced triggering worries of potential contagion. We observed only some short term volatility until Abu Dhabi stepped in with support. This episode now seems to have been only a brief scare, and credit spreads resumed tightening thereafter.

TARP repayments by large US financials who have outstanding Canadian dollar bond issues, namely, Bank of America, Citigroup and Wells Fargo, created more positive momentum and a swift rally in these bonds. Long Citigroup Maple bonds returned over 13% during the quarter, for example.

The Basel Committee published proposals on capital requirements, basically seeking to strengthen global capital and liquidity requirements by improving the banking sector's ability to absorb losses. Final guidelines will be set by the end of 2010, with the aim of implementation by the end of 2012. One key element concerns tier-1 capital, stating the primary form should be equity and retained earnings, while required features of other tier-1 instruments will be strengthened. This has halted innovative bank tier-1 issuance as there is uncertainty on the new rules, thereby creating scarcity value for existing innovative tier-1. Canadian banks' innovative tier-1 spreads rallied about 15 basis points the week of the announcement, and continue to perform well.

Corporate bond issuance in Canada picked up from last fall when the market was almost at a standstill; however annual levels remain low historically. Annual corporate bond issuance was \$54.4 billion versus \$56.7 billion in 2008. Strong demand continued to overwhelm new supply, and combined with an increase in risk appetite contributed to spreads tightening further.

The DEX corporate bond index returned 0.99% during the fourth quarter which significantly outperformed government of Canada bonds that returned -0.79%. The annual return for the DEX corporate bond index was 16.26% compared to -1.52% for government of Canada bonds.

#### New Issuance by Rating

	2008	2009	Difference
AAA	5,865	1,697	-71%
AA	32,836	17,215	-48%
A	15,075	19,642	30%
BBB	3,110	14,625	370%
High yield bonds	215	1,180	449%

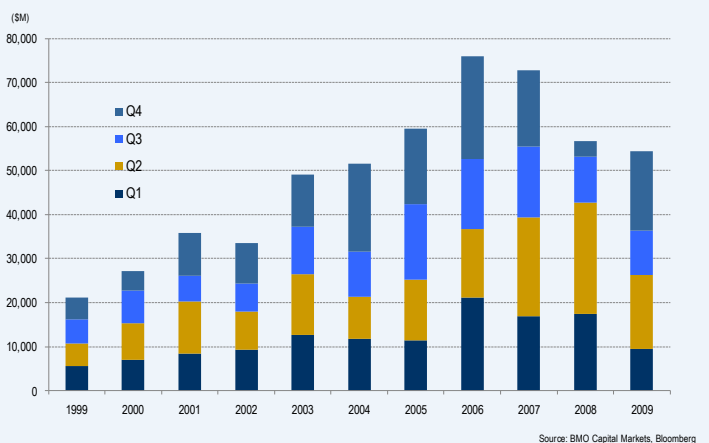
Source: BMO Capital Markets, Bloomberg

#### Yield Spreads (b.p.) - Corporate Bonds

	12/31/09	09/30/09	12/31/08	Change Q4-2009	Change 2009
<b>Royal Bank</b>					
5-year	95	115	450	-20	-355
10-year	125	140	465	-15	-340
30-year	175	175	465	0	-290
<b>Bell Canada</b>					
5-year	110	145	510	-35	-400
10-year	180	195	540	-15	-360
30-year	260	290	540	-30	-280
<b>Loblaws</b>					
5-year	100	135	420	-35	-320
10-year	155	180	470	-25	-315
30-year	260	285	540	-25	-280
<b>GTAA</b>					
5-year	85	95	360	-10	-275
10-year	120	125	370	-5	-250
30-year	170	185	370	-15	-200
<b>TransCanada Pipelines</b>					
5-year	65	90	385	-25	-320
10-year	105	125	420	-20	-315
30-year	170	185	460	-15	-290

Source: National Bank Financ

#### Historical New Issuance



Source: BMO Capital Markets, Bloomberg

# MARKET COMMENT (CONTINUED)

## International Bonds and Currencies

Following a positive performance early in the quarter, a trend reversal occurred in December, with investors preferring to decrease the weight of government instruments in their portfolios. A stabilization of the global economy and, more importantly, the imminent supply from governments for the 2010 fiscal year weighed heavily in the balance and largely explain the 0.2% decrease in the international Government Bond Index (“GBI”) during the most recent quarter. For the year 2009, as opposed to 2008, investors preferred to increase their holdings of credits rather than those of government bonds, which explains the paltry 0.7% return of the GBI in local currencies.

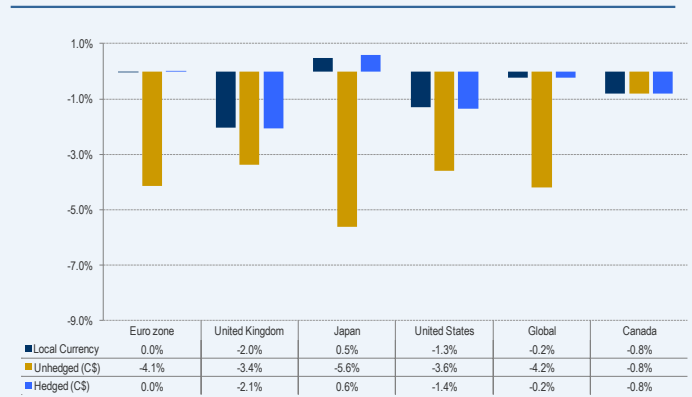
Canada’s historically low yields have now completely eliminated the typically positive carry associated with hedging the dollar’s exchange risk. The hedged GBI (against this risk) closed out the quarter down 0.2%. For 2009 as a whole, the hedged index returned 1.0%.

For a fourth straight quarter, the Canadian dollar rose against most major currencies, causing a drop in the unhedged GBI in Canadian-dollar terms. Down 4.2% for the period from September to December, the unhedged index lost 13.5% in 2009.

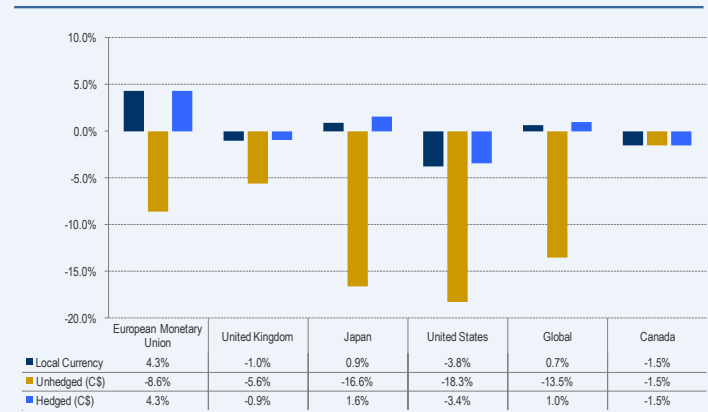
Once again, the countries that benefited the most from the turbulence of capital markets and from the flight to safety in 2008 recorded the largest declines during the fourth quarter of 2009. Heading the list was Great Britain, whose bond market dropped 2.7% in December alone to close out the quarter down 2.0%. Exacerbated when Greece was downgraded below investment grade in December, concern over a potential downgrade of United Kingdom bonds due to an increasingly heavy debt load was responsible for the decrease.

A swing of the pendulum back to more risky assets, e.g. equity markets and credit securities, was a material drag on U.S. Treasury instruments. Faced with the prospect of the Treasury undertaking a large number of issues to fund a growing deficit and with the reluctance of some foreign central banks to continue stockpiling U.S. dollars, the American bond market lost 1.3% during the last quarter. With investors confident that the Fed would ensure that a solid basis for growth existed prior to raising rates, shorter maturities outperformed their long counterparts. The slope of the 30-year to 2-year curve even peaked at 374 basis points in mid-December. After a significant increase of 14.3% in 2008, the U.S. bond market gave back part of these gains in 2009, posting a 3.8% decrease.

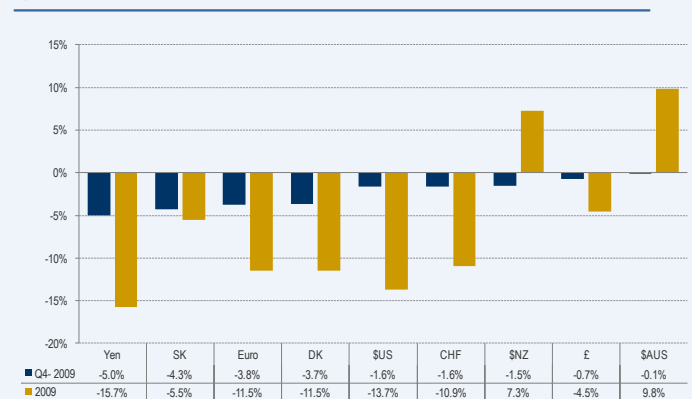
Quarterly Returns International Bonds Q4-2009



Annual Returns International Bonds 2009



Exchange Rate Fluctuations vs Canadian Dollar Q4-2009



## MARKET COMMENT (CONTINUED)

Because Euro Zone countries made fewer efforts to stimulate the economy, there was obviously less concern about the supply of bonds in Europe than in other countries. In addition, since the European Central Bank (“ECB”) was less intent on monetary easing than other major central banks, its eventual rate increases will likely be pushed back. Thanks in part to peripheral nations such as Italy and Belgium, the Euro Zone bond market recorded a decrease of only 0.1% during the quarter. For 2009 as a whole, euro zone countries generated a return of 4.3%.

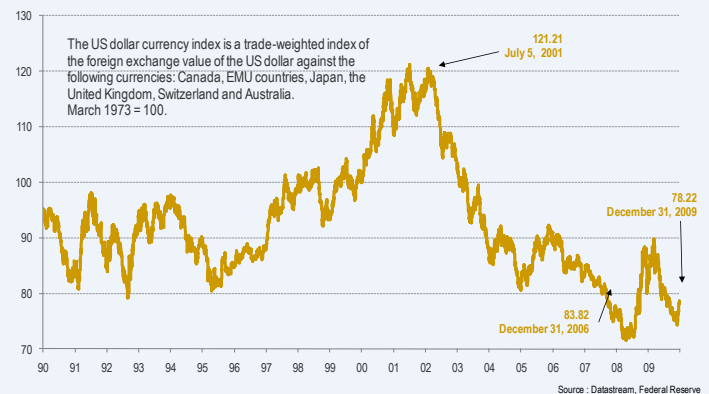
The more robust economic statistics emanating from south of the Canadian border during the quarter allowed the U.S. dollar to stabilize, especially against the euro and the yen. Generally speaking, while the greenback represented a safe haven as the crisis mounted in 2008, it abruptly lost this status in 2009. Other factors, such as rising commodity prices and doubts about its future status as a reserve currency, also weighed on the U.S. dollar in 2009.

Higher commodity prices during the quarter – for instance, oil prices ended the quarter at just under \$80 per barrel – smoothed the way for the Canadian dollar to continue appreciating against all other major currencies. From a level of US\$0.8204 at the beginning of the year, the loonie rose 15.9% against the greenback in 2009 to end the year at US\$0.9506. Our dollar was also bolstered by a Canadian economy that was stronger than those of other major nations. Still, a drop in exports to the United-States and fears of a Bank of Canada intervention prevented the Canadian dollar from returning to parity in 2009.

### Monetary Policy Rates (%)

	12/2008	09/2009	12/2009	Year 2009
Canada	1.50	0.25	0.25	-125
United States	0.25	0.25	0.25	0
Europe	2.50	1.00	1.00	-150
United Kingdom	2.00	0.50	0.50	-150
Japan	0.10	0.10	0.10	0

### U.S. Dollar Index (1973 = 100)



### Exchange Rates

	12/31/08	09/30/09	12/31/09	Quarterly change	2009
<b>VS US\$</b>					
Euro	1.3964	1.4637	1.4318	-2.18%	2.54%
Canadian Dollar	0.8204	0.9353	0.9506	1.63%	15.87%
Japanese Yen	1.1021	1.1143	1.0762	-3.42%	-2.35%
Danish Krona	0.1876	0.1966	0.1925	-2.11%	2.59%
British Pound	1.4603	1.6006	1.6157	0.94%	10.64%
NZ Dollar	0.5827	0.7237	0.7245	0.10%	24.34%
Australian Dollar	0.7052	0.8837	0.8974	1.55%	27.26%
Swiss Franc	0.9355	0.9654	0.9656	0.02%	3.22%
Swedish Krona	0.1275	0.1435	0.1396	-2.72%	9.45%
<b>VS C\$</b>					
Euro	1.7020	1.5649	1.5062	-3.75%	-11.50%
US Dollar	1.2189	1.0692	1.0520	-1.61%	-13.69%
Japanese Yen	1.3434	1.1915	1.1322	-4.98%	-15.72%
Danish Krona	0.2287	0.2102	0.2025	-3.69%	-11.46%
British Pound	1.7800	1.7114	1.6997	-0.68%	-4.51%
NZ Dollar	0.7102	0.7738	0.7621	-1.51%	7.31%
Australian Dollar	0.8595	0.9448	0.9440	-0.08%	9.83%
Swiss Franc	1.1402	1.0322	1.0158	-1.59%	-10.92%
Swedish Krona	0.1555	0.1534	0.1469	-4.28%	-5.53%