July 2012

Market Commentary

Our Outlook

The outlook for the global economy and capital markets that we laid out in our Q2 Market Commentary has not changed in the past month. We are looking for signs of stability in the eurozone and growth for the U.S. economy.

We continue to believe that policymakers have the will and ability to resolve the eurozone situation and avoid systemic damage to the financial sytem. However, the necessary steps will take time to implement. In the meantime, the crisis is having an impact on business and consumer sentiment. Q2's disappointing U.S. job creation and manufacturing activity were causes of concern. At this point, we continue to analyse new data as we consider whether our long-held view that the United States will generate moderate economic growth over the next 12 months remains viable.

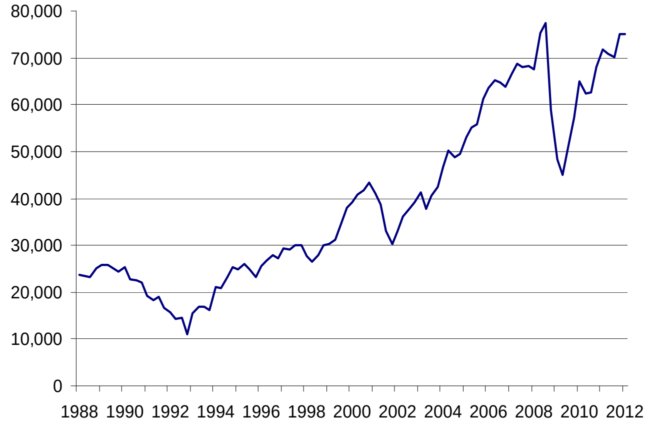
Key Factors

The eurozone experienced both positive and negative developments in July. Investors grew increasingly concerned, pushing the yield on 10-year Spanish and Italian bonds to dangerously high levels. This prompted a strong statement of support from the European Central Bank president. His pledge to "do whatever it takes" to preserve the euro currency boosted investor confidence. As a result, the risk premium for Spanish and Italian 10-year bonds dropped and eurozone stock markets rallied.

At 1.5%, U.S. economic growth was modest in Q2, in line with expectations and consistent with an ongoing weak recovery. July's job creation number (163,000) was better than the expected 100,000, though the unemployment rate rose from 8.2% to 8.3%. Indicators of manufacturing activity for the month were positive and appear to be reasonably supportive of a more optimistic attitude about the U.S. economy.

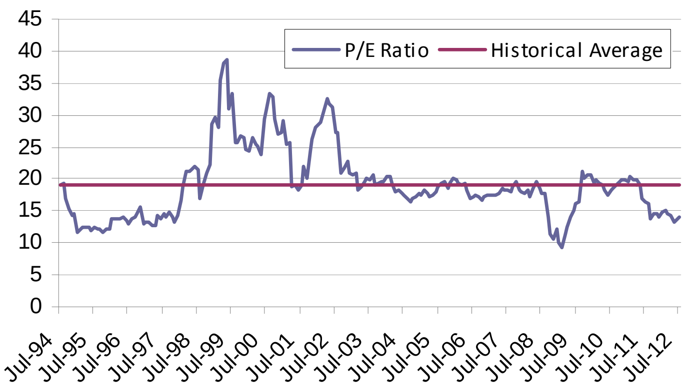
North American equity markets have remained volatile, reacting to news from the eurozone. The U.S. equity market has performed well year-to-date (+9.3% C$, +11.0% US$), but was down -0.4% C$ (+1.4% US$) in July. In Canada, the equity market has hardly moved since the beginning of the year (down just 0.7%), but was up 0.8% in July. The Canadian bond market is ahead 2.7% year-to-date (+0.7% in July). Over the next 12 months, we expect Canadian equities will remain relatively inexpensive and will generate moderate returns based on our view that both the economy and corporate earnings will continue to grow modestly.

Canadian corporate operating earnings continue to trend upward (seasonally adjusted, in C$ millions)



Source: BMO Capital Markets

P/E ratios on the S&P/TSX Composite Index show that stocks are relatively inexpensive (%)



Source: BMO AM

Investment Strategy

Most of our clients' portfolios have a slightly greater allocation to equities than to bonds and cash, and a greater allocation to Canadian and U.S. stocks than to non-North American equity markets. We believe this is the best position to take right now, given our outlook and the relative valuations of equities and bonds.

Our approach to managing our clients' portfolios is to emphasize the characteristics that, given our outlook and the capital markets' environment, are going to best support our clients in achieving their goals. During this period of expected modest economic growth, we are making an allocation in many clients' portfolios to U.S. high yield bonds in order to enhance the portfolios' risk/return profiles.

To access this investment strategy, our clients' portfolios will hold units of a fund that is sub-advised by Monegy, part of BMO Global Asset Management Inc.

U.S. High Yield Bonds

The attraction of high yield bonds is based on historically high rates of return with relatively modest volatility, and low levels of correlation to other asset classes. The U.S. high yield market is a large and broadly diversified market with a good level of liquidity and transparency. Monegy has been managing high yield portfolios for over thirteen years.

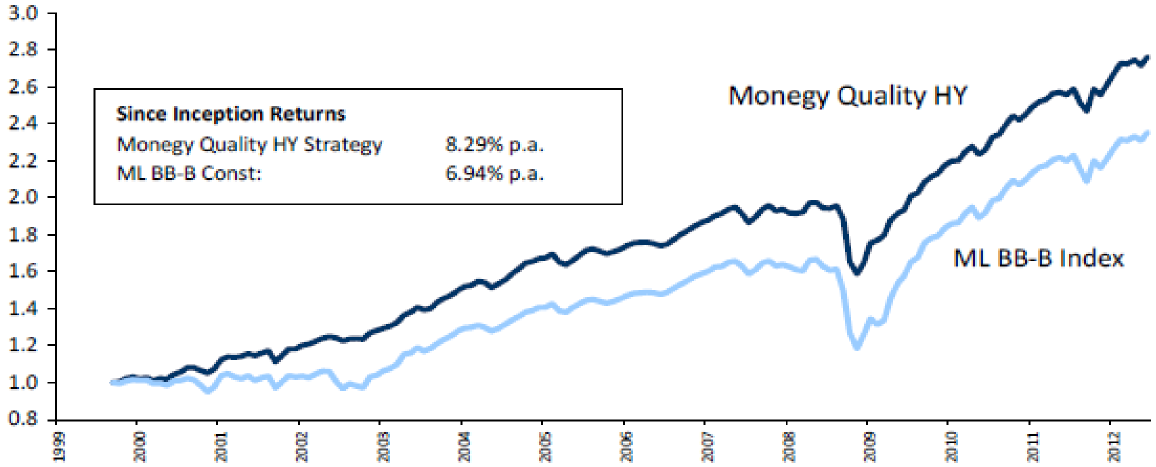
For the past three years, U.S. high yield bonds have been in a sweet spot that seems likely to continue based on our expectation that low interest rates, slow economic growth, foreign sovereign risk and general market volatility will continue for the next 12 to 18 months. Historically, high yield bonds have outperformed equities during periods of low growth and have provided investors with lower absolute volatility over the long term.

The interest payments offered by U.S. high yield bonds are higher than those offered by U.S. government bonds or corporate bonds with higher credit ratings. This higher fixed interest payment means that high yield bonds are particularly attractive during periods of slower economic growth and low central bank interest rates.

With a backdrop of slow economic growth, low absolute interest rates, and much safer balance sheets than in the 2008-2009 period, high yield is a very attractive asset class. High yield can provide solid risk-adjusted returns when managed from a defensive position within a highly diversified portfolio.

In managing a U.S. high yield bond strategy, Monegy favours the higher quality end of the high yield universe where they believe risk-adjusted returns are optimal and are best protected from the volatility that is expected in this market.

Monegy's Quality High Yield Strategy has performed well compared to the market
Growth of a unit value (US$ million) since inception



Source: Monegy, Merrill Lynch