



QUARTERLY COMMENT Second Quarter 2007

ECONOMIC ENVIRONMENT

Volatility was the hallmark of activity in the second quarter. Decidedly mixed economic releases for the U.S. economy, record buyout activity by private equity firms, attempts by the Chinese authorities to slow the pace of local economic activity and renewed geopolitical concerns all contributed to wide price swings in global capital markets.

In the U.S., the continued turmoil in the housing market dominated economic headlines. There is now no question about the disarray in the housing market. Housing prices have declined precipitously and inventory levels have risen to record levels.

MEDIAN SALES PRICE EXISTING HOMES

% Change year-to-year

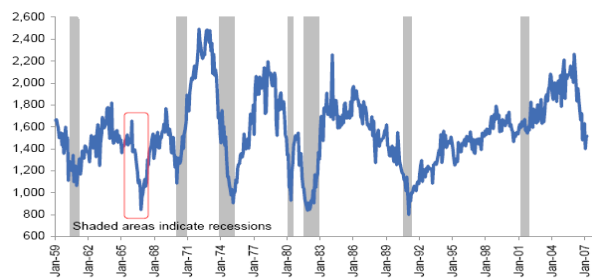


SOURCE: National Association of Realtors, Haver Analytics

The softening in residential real estate has raised concerns about the outlook for overall economic activity. The U.S. consumer is the dominant force in the economy accounting for close to 70% of GDP [Gross Domestic Product]. The fear is that the slump in housing will lead to reduced consumer confidence and, as a consequence, spending. In fact, six of the

last seven downturns in housing starts were followed by recession.

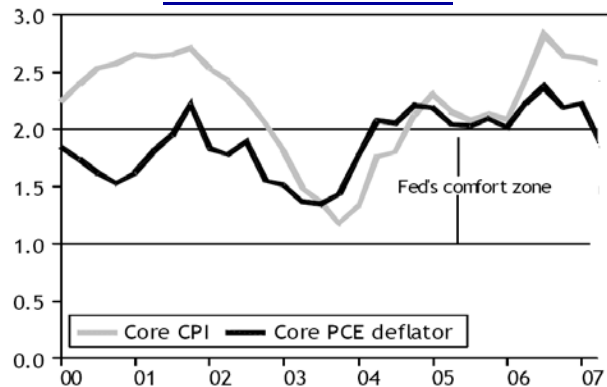
HOUSING STARTS [000's units]



SOURCE: Census Bureau, Morgan Stanley Research

These growth concerns have risen against the backdrop of heightened inflation worries. Core inflation, as measured by CPI [Consumer Price Index] or the Federal Reserve's favourite measure, the PCE [Personal Consumption Expenditure], has remained above the target zone since early 2004

CORE U.S. INFLATION

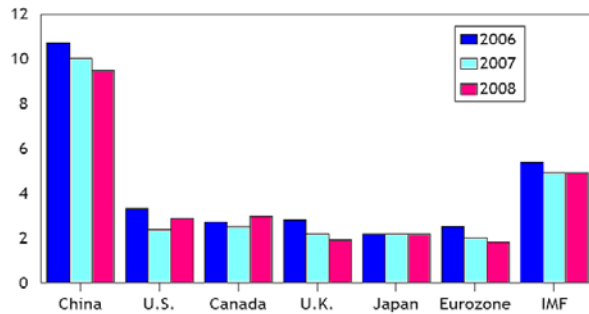


SOURCE: RBC Economics

The Federal Reserve is unlikely to cut interest rates while core inflation rates remain above targeted levels.

The offset to any weakness in the domestic U.S. economy is strength in the global economy. Growth outside North America is forecast to remain buoyant, albeit somewhat lower than in the past year.

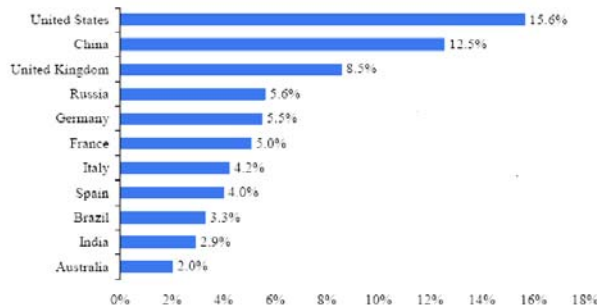
REAL GDP % CHANGE



SOURCE: RBC Economics, International Monetary Fund

The U.S. economy does remain the largest on a global basis. However, the contribution of the U.S. economy to world nominal growth has fallen from 22.8% in 2006 to an expected 15.6% in 2007. As the chart below shows, the BRIC [Brazil, Russia, India and China] countries are expected to account for close to a quarter of world GDP growth.

LARGEST CONTRIBUTORS WORLD GDP GROWTH

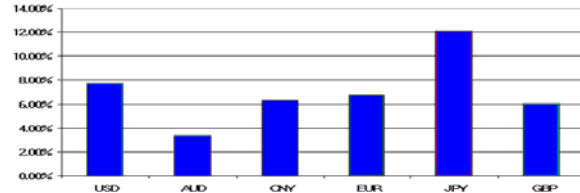


SOURCE: IMF, Morgan Stanley Research

The changing composition of world GDP is expected to lessen the influence of the U.S. on world growth and, at the same time, buttress the U.S. economy from the full impacts of the slowdown in the residential real estate market.

The Canadian dollar surged against most major currencies in the second quarter and was especially strong against the Japanese yen and U.S. dollar.

CANADIAN DOLLAR APPRECIATION
2nd QUARTER

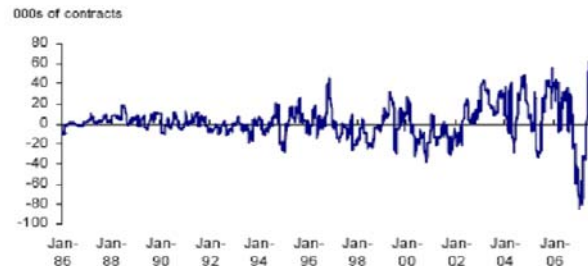


SOURCE: Bank of Canada

While there are certainly some fundamental reasons for the strength, there is growing evidence that at least some of the move can be attributed to speculation.

The following chart shows that the net long positions in the Canadian dollar have risen to a record level.

NET LONG POSITIONS
CANADIAN DOLLAR



SOURCE: Merrill Lynch

Regardless of the reasons for the rapid appreciation in our dollar, the toll on the economy will be likely noticeable in the coming months. Most forecasters have marked down their growth expectation for the balance of the year.

The interest rate outlook further clouds the growth picture. As in the U.S., Canadian core inflation rates remain well above target. The Bank of Canada has indicated willingness to sacrifice short-term growth in favor of controlling inflation by raising rates in 2007.

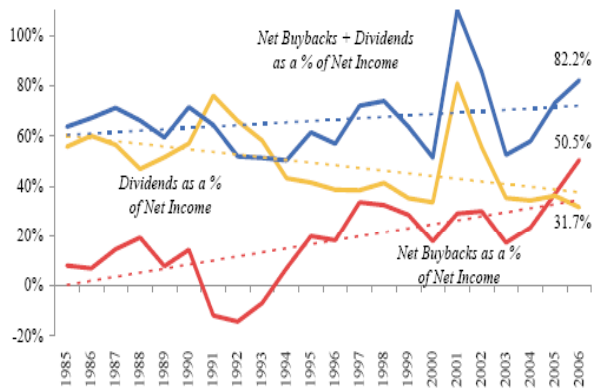
INVESTMENT ENVIRONMENT

Global liquidity has expanded rapidly in this cycle. The drive for excess returns has pushed many hedge fund and private equity players into complex, illiquid investment vehicles comprised of securitized sub-prime and other risky types of mortgages. As the housing market unraveled, the inherent risks of these investments became apparent. The Bear Stearns losses at the end of the second quarter prompted sharp increases in interest rates and raised the spectre of further financial accidents.

Despite these events, global equity markets marched higher driven, as well, by the liquidity boom.

North American corporate balance sheets are the strongest in post-war history. This strength has been channeled into share buybacks rather than capital expenditures.

SHARE BUYBACKS AND DIVIDENDS



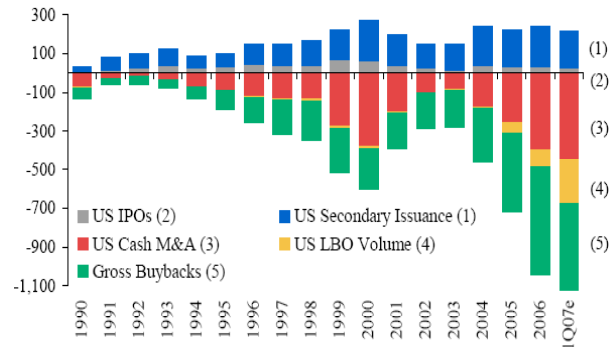
SOURCE: Compustat, Morgan Stanley

For the first time since 1985 share buybacks have exceeded dividends as a percentage of net income at 50.5%.

Private equity funds are also awash in liquidity. And like corporations, this liquidity has been channeled into the stock market. The combination of share buybacks, merger and

acquisition activity and leveraged buyout volume has dramatically reduced the equity supply.

U.S. EQUITY SUPPLY

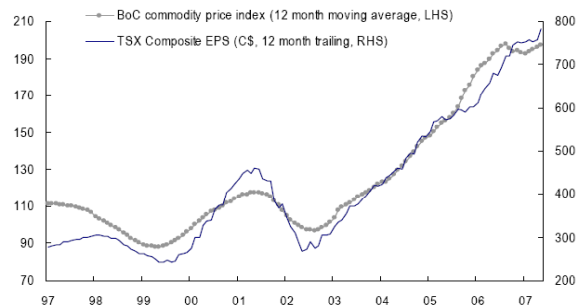


SOURCE: Thomson Financial

Higher interest rates, lower profit growth or a slowing economy could reduce the solid underpinning these three factors have provided the equity market.

The Canadian equity market continued its strong performance as well. Takeover activity, notably in Alcan and BCE, was a factor but commodity price movements remain the key to future results.

TSX AND COMMODITY PRICES



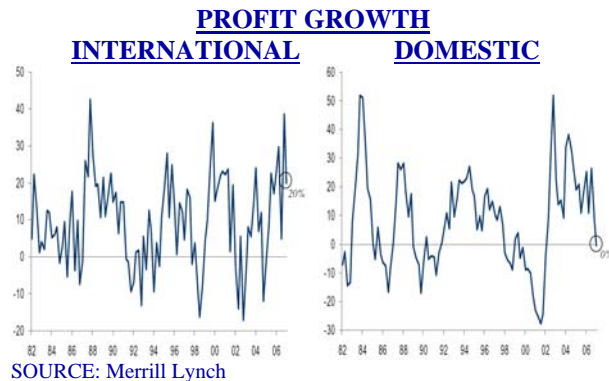
SOURCE: Bank of Canada, Merrill Lynch

Although commodity prices have firmed in recent months, there is little evidence to suggest acceleration at the pace of the last few years.

INVESTMENT STRATEGY

Long-term interest rates moved modestly higher in the quarter. However, there still remains little incentive to significantly extend term. Despite heightened worries about the possibilities of financial accidents, the spreads between high quality and low quality bonds did not widen appreciably. For this reason we remain focused on higher quality fixed income investments.

Our strategy in the non-Canadian portion of our equity portfolios is to focus on companies with a high degree of international exposure. In part, this is to enhance diversification but it also allows us to participate in the fastest growing profit areas. The following charts show that domestic U.S. profits are essentially flat as compared to the 20%+ growth seen in the international arena

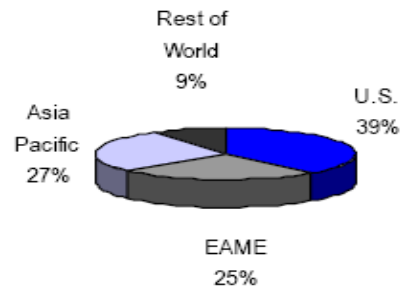


On average, our U.S. holdings derive 40% of their revenues and earnings from non-domestic sources. Not surprisingly, the biggest foreign

exposure tends to be concentrated in larger capitalization, higher quality companies.

3M is a good example of the opportunities available in multi-nationals. The following chart shows the geographic split of 3M's revenues.

REVENUES BY GEOGRAPHICAL AREA



SOURCE: Company Reports

The company has operations in six different industry segments ranging from health care to transportation. The balance sheet is strong and return on equity averages more than 35%. At 15.4x expected '08 earnings, the stock is a low risk way to participate in the faster growth geographical areas.

Volatility has risen in the first six months of the year and we expect the trend to continue. Our focus on high quality securities with good geographical and industry diversification should provide stable returns in the investment environment we foresee over the coming quarters.

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