

Milos: Hello and thanks to all of our listeners who have tuned in. My name is Milos Kostich and as Vice President Sales Strategic Alliances, it is my pleasure today to have with me Andrew Simurda, Vice President and portfolio manager of the Canada Life Canadian Equity Value Fund. Welcome Andrew.

Andrew: Thank you

Milos: With today's discussion focusing on the US \$ and how it impacts Canadian Financial markets, Andrew could you give the listeners a sense of what has transpired economically here and south of the border in the last year or so, and how that has brought us to current US \$ levels and US vs. Can \$ levels?

Andrew: Milos, there are many different variables that drive exchange rates over the short and long term. Some of the more important ones are interest rate differentials between countries, a country's current account situation relative to the other country and each country's relative fiscal situation. These variables to a certain degree are interrelated. Another important variable when talking about the US dollar is sentiment, because the US dollar is the de facto global reserve currency.

To try and keep this simple, it is important to remember two things about the composition of the Canadian economy relative to the US. First, exports represent a greater proportion of Canadian GDP relative to the US and resource related industries are more important to Canadian GDP than that of the US. Another important variable to keep in mind, is that over the last 5 to 10 years we have been in a secular bull market for many commodities. It is for these reasons that the Canadian dollar is known as a commodity currency or a beta currency to global growth.

With all of this stated, lets look at the Canadian/US dollar exchange rate over the last 10 years. As the US economy suffered a mild recession in 2001 to 2002 and the global economy slowed in response, the Canadian dollar bottomed at roughly \$0.62 US cents. However, as the US and global economies started to recover in 2002 and gained strength into 2008 and the secular bull market in commodities commenced, the Canadian dollar relative to the US dollar appreciated strongly over this period of time reaching a peak of \$1.10 US cents in late 2007.

As 2008 progressed and the global economy continued to expand, the Canadian dollar started to weaken against the US dollar. While many factors came into play, currency markets were starting to price in weakening global economic fundamentals somewhere in the not too distant future. Later in 2008 when the liquidity crisis hit, the Canadian dollar collapsed relative to the US dollar. Not only were markets pricing in extremely weak global economic fundamentals, but a flight to safety also kicked in as people panicked. As mentioned, the US dollar being the de facto reserve currency of the world was the beneficiary of the flight to quality trade. The Canadian dollar eventually fell to roughly \$0.77 US cents.

Starting in late 2008 and early 2009, governments around the world implemented a massive concerted fiscal and monetary response to the financial crisis. As the currency markets sniffed out that this massive effort would restore economic momentum and help alleviate the financial crisis, the Canadian dollar started to appreciate once again. This occurred as the flight to safety trade into US dollars unwound and global economic growth started to re-accelerate coincident with the secular bull market in

commodity prices reasserting itself. Since early 2009, the Canadian dollar has appreciated back to the current level of roughly \$0.95US

Milos: What impacts have the US \$ movements had on resource pricing (something important to Canadian portfolios) and how do you insulate yourself from this effect in the Canadian Value Equity Fund?

Andrew: In the intermediate to long term, commodity prices are driven strictly by supply and demand fundamentals. However, most commodities are sold globally in US dollars. As a result, when the US dollar depreciates against a basket of different currencies, commodity prices tend to rise as an adjustment mechanism all else being equal to maintain the real supply and demand balance.

More importantly, in recent years, many pension funds, hedge funds and other sophisticated investors have considered commodities as a separate asset class in which to invest. Even retail investors can participate through recently created exchange traded funds. These new investors have created artificial demand or investment demand for these hard goods. These relatively new players to the commodity market use commodities as a hedge against potential inflation, a way to play anticipated US dollar weakness or to profit from the continuation in the commodity bull market. It is this link between the US dollar and commodity prices that has increased the correlation between the two financial assets over the last 10 years. While this has increased the liquidity of the commodity markets and has been a contributing factor to the bull market, one must be cognisant of the fact that these financial players can add to the downside of commodity price moves if and when they exit their positions.

With regards to how our outlook on the US dollar versus the Canadian dollar affects our stock selection process.... we do not make investment decisions for the value fund based on a top down call on the currency. Instead, we rigorously employ our six-step stock selection process to determine which stocks are included in the portfolio. However, when building our financial models for resource related companies, step three in the selection process, one must incorporate a US dollar forecast into our cash flow estimates as well as our net present value calculation.

Milos: Although Canadian Markets are impacted by changes in the value of the US dollar can Canadian consumers expect to see a continued weakness in that currency vis a vis the Canadian dollar from a positive exchange rate perspective or are there reasons to be more bullish on the American dollar....?

Andrew: As mentioned earlier, many different variables come into play when trying to predict the relative valuation between two currencies. However, in the case of the Canadian dollar versus the US dollar, I believe most of the data points to a stronger Canadian dollar going forward. This whole analysis is predicted on my expectation that the world economy will continue to improve and that the seeds are being sowed for sustainable growth, albeit sub-par, beyond just government stimulus. If this proves to be correct, then global growth should support current or higher commodity prices going forward and global trade should continue to expand. Under this scenario, Canada's current account surplus and domestic economic growth should improve relative to the US. Also, our government fiscal situation is much stronger than that of the US and our central bank is expected to increase short borrowing rates in-line with if not sooner than the Federal Reserve. All of this should be supportive of a higher Canadian dollar. Lastly, under this scenario, the US dollar's appeal as a safe haven investment should lessen, allowing more countries to diversify away from the US dollar within their currency reserves.

Milos: Andrew could you give us a brief gaze into your crystal ball for 2010 Canadian equity markets?

Andrew: In short, with my expectation that global economic growth going forward will be positive, this should translate into earnings growth for the market in aggregate. Current bottom-up estimates are calling for 27% earnings growth in 2010 and roughly 17% earnings growth in 2011. These estimates seem reasonable. Currently, the TSX trades at roughly 15x forward earnings expectations. This is inline with historic levels for this point in the economic cycle. However, as 2010 progresses, markets could experience some multiple compressions as the yield curve rises and markets start to price in exit strategies by central banks around the world offset somewhat by a lower risk premium. This potential multiple contraction, should offset earnings growth somewhat resulting in high single digit to low double digit returns for the year. In my opinion, these returns should look attractive relative to cash and fixed income returns.

Milos: Thanks Andrew, and thanks to all of you for tuning in today. I encourage you to keep tuning in to our monthly commentaries found as always, on our website at www.laketon.com