

SANDSTONE ASSET MANAGEMENT INC.
403.218.6125
1.866.318.6140
info@sandstoneam.com
www.sandstoneam.com

Member of:



INVESTMENT INSIGHT

DIRECTION. CONFIDENCE. INDEPENDENCE.

07 March 2005

SPECIAL YEAR AHEAD ISSUE:



We believe global economic imbalances are at historical extremes and that currencies will ultimately reflect these imbalances – dancing along the way. In some cases, partnering a global stock with a domestic currency can lead to an ungraceful dance. Our goal is to find investments that have that unique chemistry with the Canadian dollar, so that they dance in unison to provide your portfolio with the return you expect. As a result, our research efforts in 2005 and beyond will listen to the Loonie Tune with a view to selecting the right Global Dance partners.

Our investment stance remains focused on taking advantage of global economic rebalancing away from the U.S. towards Asia. This is a long-term phenomenon that in 2004 reached the front pages of the financial press. What lingers behind the scenes for 2005? We say Japan, persistently strong energy earnings, supply-constrained inputs and, as always dividend growth.

read on for our complete Outlook 2005 ...

D.C.I. Research Standards

-  customized portfolio **direction**,
-  **confidently** executed,
-  with **independent** vision

Sandstone's D.C.I. research standards are guided by three principles: Direction, Confidence, Independence. We adhere to these standards in our daily research efforts.

DIRECTION

We begin with an overall view of the global economy. Within the macro view, Sandstone utilizes asset allocation decisions to manage overall risk levels. Our direction is our own and we strive to avoid running with the herd.

CONFIDENCE

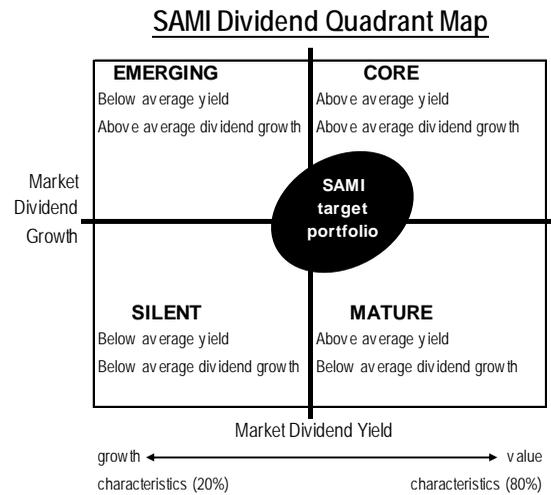
Sandstone's adherence to its research philosophy and process maximizes confidence in investment choices and minimizes downside risk. We take a conservative view of growth in determining underlying value, ensuring a higher level of confidence in potential returns.

INDEPENDENCE

Our over-riding research standard is independence. We strive daily to challenge the consensus view in order to develop an independent vision for client portfolios. We do not engage in investment banking activities, nor do we operate a trading desk independent of client accounts. Through independence, our interests are aligned with yours.

Our Approach

We manage individual portfolios to meet our clients' risk adjusted return expectations. To accomplish this, we select securities to provide above average returns with below average risk and volatility. This is executed by favouring dividend-growth equities and attractively priced fixed-income securities. Our equity target portfolio would fit into our proprietary dividend quadrant map as indicated:



NOTES:

Investment Committee

Sharon Watkins
President & CEO

Brent Pickerl
Managing Partner, Director

Cameron Webster, CFA
Managing Partner, Research



NOTES:



CONTENTS

Loonie Tune, Global Dance -----	1
<i>We are global investors conscious of the need to repatriate returns. Our mandate is to select the best global dance partners to ensure that portfolio returns shine under the spotlight.</i>	
2004 -----	2
<i>Record oil prices and energy earnings brought China to the front page. Currencies continued to reflect the influences of global economic rebalancing. Our Overweight calls on Energy and Japan and Underweight call on the U.S. performed well.</i>	
Rebalancing -----	3
<i>We continue to utilize a rebalancing of economic wealth, growth, and activity away from the U.S. toward Asia as a guide for our investment decisions. In 2005, we favour a defensive stance. We see opportunity in Japan and select emerging markets. Long-term, economic rebalancing is particularly bullish for metals, energy, and food – the stuff the earth provides.</i>	
Cycles -----	6
<i>Three long-term cycles provide a road map. The U.S. market remains range-bound; commodities are 2-years into a multi-year cycle. Profit, inflation, and liquidity cycle indicates a defensive posture is appropriate.</i>	
Developed Markets -----	9
<i>Underweight U.S.; Overweight Japan. U.S. profit cycle has run its course and productivity has peaked. Japanese corporate and dividend reform are likely catalysts in 2005.</i>	
Emerging Markets -----	11
<i>Moving to Neutral on China from Underweight; Overweight strong GDP geographies such as Emerging Asia, Advancing Eastern Europe, internalizing South American economies.</i>	
Canada -----	12
<i>Canadian corporations will remain challenged by a strong currency. We will always be overweight Canada so our job is to manage risk. Income trusts are closing in on 10-year government bond yields, indicating high risk. Recent energy action is indicative of mania behaviour – buy on weakness.</i>	
Dividends and Sectors -----	14
<i>We are strong believers in dividend growth and believe dividends will contribute significantly to 2005 returns. What global sectors indicate the greatest dividend growth at the best value? Energy, Materials, Telecom, Agriculture.</i>	
2005 -----	17
<i>Developed markets will correct on a profitability peak, particularly in the U.S. Chinese economic growth will continue to be strong, putting pressure on supply-constrained commodities it requires. This will benefit emerging market commodity exporters the most. Anticipation of Japanese corporate reform will drive asset values higher. U.S. dollar will be stable to up.</i>	

Outlook 2005 Loonie Tune, Global Dance

Our 2005 theme *Loonie Tune, Global Dance* is intended to emphasize our unique investment management mandate - we are Canadians investing in a global world. As such, we must be aware of the effect currency movements have on portfolio returns. In 2004, the Canadian dollar surged another 8% on top of 2003's 19% move, making it very challenging to repatriate returns on U.S. dollar assets. As Table 1 shows, market returns can change dramatically when translated into Canadian dollars.

Currency Moves Influence Returns

	2004 Returns (%)			Comment
	Domestic	C\$	US\$	
S&P/TSX		12.5	20.2	US investor who bet on Canada won big
S&P 500		1.5	9.2	C\$ appreciation made investing in US tough
Nasdaq		0.6	8.2	C\$ appreciation made investing in US tough
MSCI UK	7.7	7.7	15.5	C\$ held flat against the pound
MSCI Japan	9.7	12.7	14.7	Stronger C\$ compared to JPY
MSCI World	9.5	5.2	12.8	C\$ appreciated against world currencies
Gold		-2.4	5.3	Gold price fell in C\$ terms
Oil		25.9	33.6	Canadian firms' oil cost did not grow as fast

We believe global economic imbalances are at historical extremes and that currencies will ultimately reflect these imbalances – dancing along the way. In some cases, partnering a global stock with a domestic currency can lead to an ungraceful dance, full of unsightly transitions and ending with sore feet! Our goal is to find global investments that have that unique chemistry with the Canadian dollar, so that they dance in unison to provide your portfolio with the return you expect. As a result, our research efforts in 2005 and beyond will listen to the Loonie Tune with a view to selecting the right Global Dance partners.

our goal is to find global investments that have that unique chemistry with the Canadian dollar

Sandstone Asset Management Inc. (SAMI) provides independent research and advice to its clients on a fee for service basis. The company is not engaged in any investment banking, underwriting, and consulting or financial services activities on behalf of any companies. SAMI's research reports are for the sole purpose of managing client portfolios on a managed and non-managed basis. The company may engage in proprietary trading to invest surplus corporate cash balances. The opinions expressed herein are those of the author and do not necessarily represent those of SAMI. The information contained in this report has been obtained from sources believed to be reliable, however, we cannot represent that it is accurate or complete. Past performance is not indicative of future performance. SAMI is a member of the Canadian Investor Protection Fund, the Investment Dealers Association of Canada, and is an Investorside Research Association Certified Provider.

Member of:



2005 themes & recommendations

Our macro view has changed very little from last year. We continue to believe that the world is in the midst of a profound and long-running rebalancing of economic power – away from the U.S. and toward the emerging economies of Asia, South America, and Eastern Europe. As a result, we will continue to position client portfolios in areas where we feel the risk/reward tradeoff is most attractive. Our 2005 stance is summarized in the table below. We continue to like commodity-driven economies, especially those with exposure to supply-constrained markets. We are introducing a weighting to agribusiness to get ahead of the Chinese influence we foresee for more sophisticated food products.

Theme	Recommendation	Comment
Developed Markets		
U.S.	Underweight	Earnings growth half of 2004
Japan	Overweight	Restructuring catalysts, technical bottom
Canada	Overweight	Energy exposure, dividend growth, no currency risk
Emerging Markets		
Brazil	Overweight	Valuation, earnings growth, commodity and food exposure
Taiwan	Overweight	Valuation call, indirect play on China with yield support
Korea	Overweight	Most attractively priced Asian market
Sectors / Industries		
Energy	Overweight	Secular bull continues, add on pullback
Metals	Selective	Overweight supply-constrained markets
Agriculture	Overweight	An emerging front page story, Chinese influence to take hold
Media	Overweight	Defensive group, everyone pays their cable bill
Telecom	Overweight	Burgeoning cash flow and dividend growth

We hope you have enjoyed this publication. We will diligently apply our D.C.I. research standards in the coming year to provide customized portfolio direction and confidently execute with independent vision.

2004; some memorable dances

We encountered several interesting dances in 2004. First, how could one forget the ‘Oil Salsa’ with its vivacious moves to US\$55 per barrel? Oil managed to switch dance partners from Chinese-fuelled demand to geopolitical risk. Also on the feature card in 2004 was the ‘Currency Canter’ as commodity-based currencies (including the Canadian Dollar) continued to impress the judges, while the U.S. dollar bowed out of the competition early. In the U.S., the ‘Profit Prance’ wowed the crowd, posting an all-time high year-over-year growth rate of 25% in the second quarter of the year.

With all these dances to watch in 2004, we judged the competitors quite well:

the 2004 dance card included the ‘Oil Salsa’, the ‘Currency Canter’, and the ‘Profit Prance’ ...

... we managed to judge these dances well, Energy earned top marks, as did Japan

... our decision to eliminate the U.S. and China early in the 2004 competition proved profitable

Sandstone as Global Dance Judge

Competitor	Seeding in Competition	2004 Score (in C\$ terms)
Energy	Overweight	Up 28.7%
Metals	Underweight	Up 15.9%
Japan	Overweight	Up 13%
United States	Underweight	Up 1.5%
China	Underweight	Down 8.6%
Emerging Asia	Overweight	Up 4.4%
Dividend Growth	Overweight	Dividend payers up 17%, non-payers up 4%
High Yield Bonds	Underweight	High yield returns muted by thin spreads

global economic rebalancing is the most influential macro factor of our research process ...

...we are more inclined to tackle the tango for long-term growth

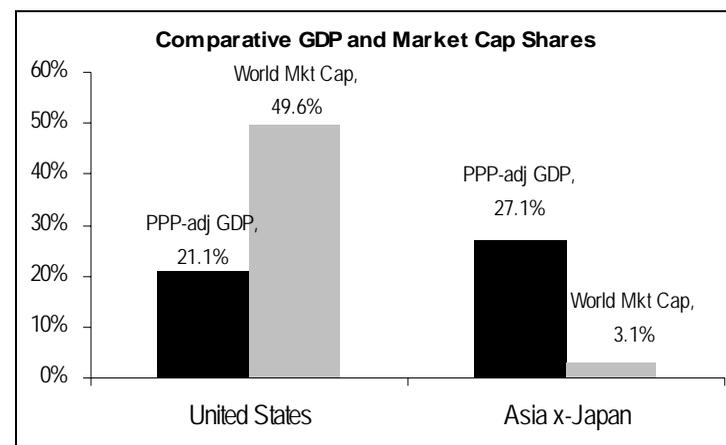
rebalancing; waltz or tango?

At Sandstone, our belief in global economic rebalancing is the most influential macro factor of our research process. In thematic terms, some regions are slowing things down and dancing a romantic waltz while others are picking up the tempo and strutting to a tango beat. While we like the odd waltz complete with steady dividend growth, we are more inclined to tackle the tango for long-term growth in portfolios.

We continue to utilize a rebalancing of economic wealth, growth, and activity away from the U.S. toward Asia as a guide for our investment decisions. In 2005, we favour an overall defensive stance. We see opportunity in Japan and select emerging markets. Long-term, economic rebalancing is particularly bullish for metals, energy, and food – these will be the tango dancers of the future!

We believe that the single largest global investment disconnect is the wide gap between the intra-China trade zone's contribution to global GDP and the relative size of the region's stock market. Current estimates indicate that Asia excluding Japan accounts for 27% of global GDP, yet its stock markets account for just 3% of global value. It is this disconnect that we believe will be readjusted over time.

the single largest disconnect is the wide gap between the intra-China trade zone's contribution to global GDP and the size of the region's stock market



Source: MSCI, IMF

SAMI 2005 sector picks:

Energy

Materials

Telecom

Sector Focus Points to Energy, Materials, Telecom

The table below shows similar metrics to the geographical data, only for global sectors. These sector ratings are a result of everything we have addressed in this report thus far. Economic rebalancing, cycles, regional markets, and dividend outlook. Looking at the dividend scene on a global sector basis, we conclude the following:

- What is in the earth that the world needs will be valued upwards. This theme incorporates several sectors showing solid dividend growth and anticipate earnings strength. Materials and Energy would best fit this group.
- Telecom appears attractively valued but with moderate earnings growth. Slower earnings however are offset by the highest dividend growth rate amongst all sectors.
- Selectivity will be exercised in Financials where we'll be duly aware of the Loonie Tune. As well, our Consumer Staples picks are sitting with solid gains and we'd like to rebalance within this sector but maintain exposure. In Healthcare, it is most important to assess growth prospects and ensure that valuation levels are consistent with the complicated risks. Industrials have had solid runs but there may be room for a few levered to Emerging Market growth.

SAMI 2005 Sector Picks (ranked by dividend yield)

SAMI Stance		2005E P/E	2005E Earnings Growth	Yield	2004 Dividend Growth	Comment
		x	%	%	%	
	Utilities	13.8	11	3.2	8.7	Pricy based on P/E
PICK	Telecom	15.7	6	2.6	31.5	Solid combination of metrics, big dividend growth
SELECTIVE	Financials	12.1	13	2.5	16.9	Consummate dividend position
SELECTIVE	Consumer Staples	17.7	13	2.4	10.3	Would like to reposition here
PICK	Energy	12.0	5	2.3	8.5	P/E overstated as oil price assumptions too low
PICK	Materials	10.9	25	1.9	14.0	Attractive for growth in earnings and dividends
SELECTIVE	Industrials	17.1	20	1.6	12.3	Productivity gains have run the course
SELECTIVE	Healthcare	17.6	9	1.6	8.9	Other sectors with more impressive dividend growth
	Consumer Discretionary	16.7	17	1.6	10.9	U.S. consumer has negative savings
	Information Technology	20.3	10	0.7	25.6	Strong dividend growth but short on yield

Source: SAMI, MSCI, Worldscope, I/B/E/S, Bernstein Research

Emerging Markets Like Loonie Tune

The table below gives key valuation data for Global markets. For 2005, the developed world appears fairly valued, especially given the 9% earnings growth foreseen. Emerging markets appear much more attractive, offering a near 30% valuation discount, a 40% higher earnings growth rate and 30% higher dividend yield. For these reasons, we recommend Overweight positions in select Emerging Markets for 2005. The data show that the commodity-driven economies are best positioned for strong earnings growth, (South America and South Africa). China appears positioned best for earnings growth in Asia while Czech Republic has an attractive combination of earnings growth and dividend yield. Given our outlook for strong commodity prices, our Emerging Market weightings would mirror those markets positioned to benefit from this.

Emerging markets compare favourably to developed markets ...

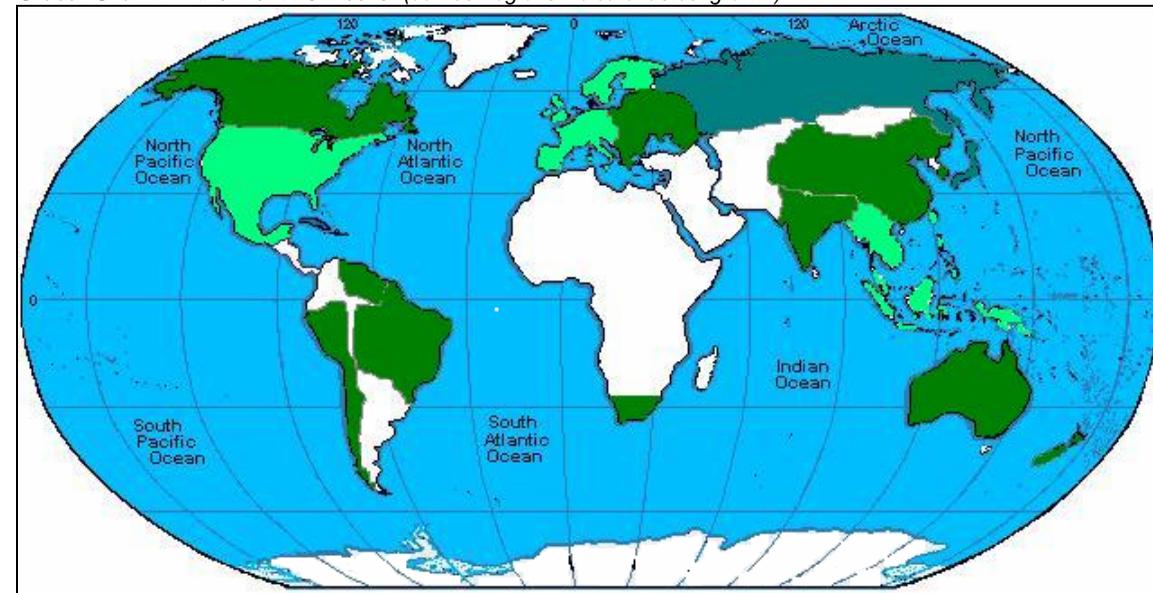
0.72x the value
1.4x the earnings growth
1.4x the dividend yield

Global Market Comparison Favours Emerging Markets on all Metrics

	2005E Earnings			Comment
	2005E P/E	Growth	Yield	
Canada	14.8	20	1.7	Canada over U.S. by these metrics
U.S.	17.1	7	1.8	
World Comparisons				
MSCI World (developed)	16.3	9.0	2.0	Growth substantially short of valuation
MSCI Emerging Markets	11.7	12.9	2.7	Well matched dance partners
Emerging / Dev't	0.72	1.43	1.35	Emerging markets 0.72x the value with 1.4x growth and 1.3x yield vs. Dev't
South America				
Brazil	7.5	26.2	4.7	Value priced growing emerging market with a currency moving with C\$
Venezuela	9.3	83.0	5.7	Oil leverage at attractive price and yield
Argentina	12.9	38.9	1.1	Pricier, but more advanced domestic economy with high growth rate
Europe, Mideast & Africa				
Russia	8.9	(4.0)	2.7	Play on oil reserve assets, earnings growth revisions dependant on oil price
South Africa	10.1	12.8	2.8	Mining driving earnings growth, solid yield
Poland	12.4	(1.9)	1.7	Advancing Eastern Europe market
Czech Republic	16.7	13.0	4.9	Strongest Eastern European economy
Asia				
China	12.4	5.8	2.4	Watch for earnings growth revisions
Korea	8.2	(1.3)	2.5	Most attractively priced Asian market, limited apparent growth
Taiwan	12.0	(4.4)	3.2	Recent strength on relative tech valuation discount and strong yield

Source: SAMI, Morgan Stanley Research

Global Growth – the Next 20-Years (darkest regions indicate fastest growth)



Source: SAMI

if you have what China needs, you're on the dance floor !

India has the potential to be a powerful economic rebalancer

Economic growth over the past 20 years has been dominated by North America and Europe, with China having grabbed the spotlight in the past few-years. Our view for the next 20-years is very much weighted to emerging markets, China being the main driver of rebalancing, with India emerging as a more significant force. This is depicted in the map above where the darkest shaded regions indicate the primary beneficiaries of Chinese growth. It is fairly obvious that our map presumes that China will continue to prefer to dance with commodities in order to both continue its domestic infrastructure build out and its move to a domestically driven economy. With a 20-year track record of 9.5% GDP growth per year, and the prospects of rising consumerism, we think China will continue to shift the economic balance.

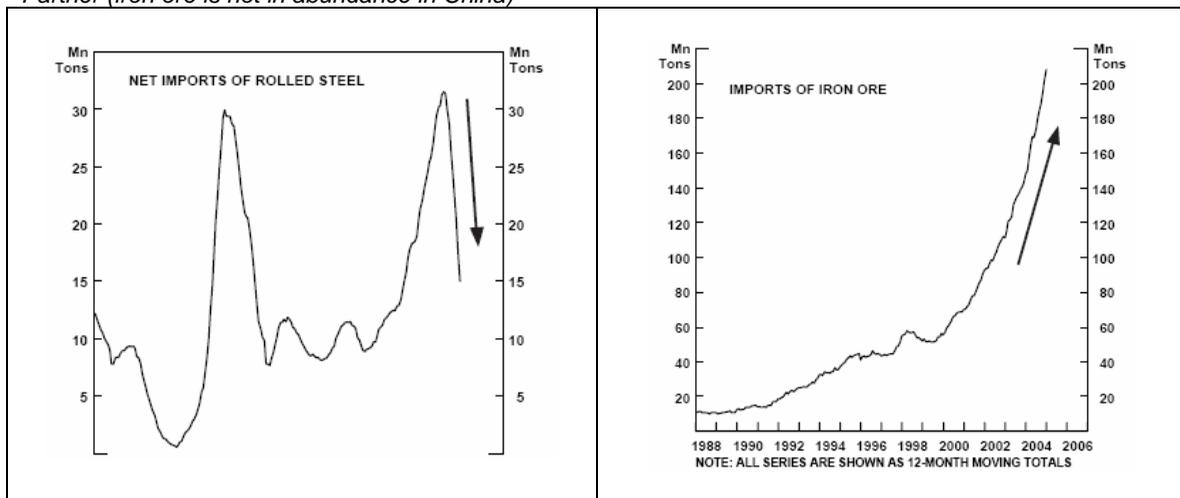
Internalization of Chinese Economic Growth

Our view of China is that it is approaching a point of inflection between industrial exports and domestic expansion. Domestic activity now accounts for 55% of the Chinese economy, below that of the large industrialized economies. We believe domestic expansion in China is being driven by rapid urbanization. To quantify the momentum, imagine 25 million people a year moving from rural to urban centres – that’s an entire California or over 80% of Canada every year! China therefore must rapidly expand its infrastructure – highways and roads, sewage systems, housing, airports. Combine urbanization with rising per capita incomes and an acceptance of publicly displaying wealth and you have a powerful set of economic dance partners ready to tango! The steel market is particularly helpful to look at as an example. The charts below show that Chinese imports of steel have receded sharply, yet its appetite for raw inputs to make steel continue to rise. This is the underpinning of our emerging market strategy – buy what China needs to develop its economy but is in short supply of.

imagine 25 million people a year moving from rural to urban centres – that’s an entire California or over 80% of Canada every year! ...

... that’s a lot of roads, houses, appliances, computers, cell phones ...

Doin’ the Steel Step! Domestic Dancer (rolled steel for infrastructure growth) needs Commodity Dance Partner (iron ore is not in abundance in China)



Source: BCA Research

dividends and sectors

We are strong believers in dividend growth and the power of dividends. Christopher Wood of CLSA sums it up nicely, suggesting the case for the power of dividends should be obvious. Well, it has been obvious to us that dividend growth and strong risk-adjusted portfolio returns are two of the best dance partners in the investment business.

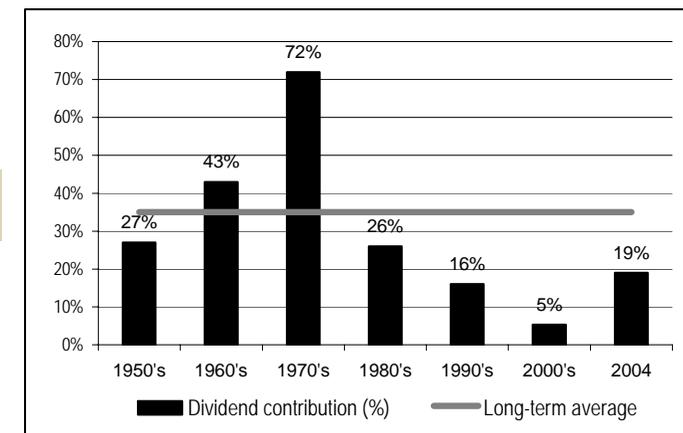
“To promote the power of dividends in an investment context is rather like promoting the merits of virtue, thrift and good manners in the bringing up of children. The case should be breathtakingly obvious.”

Christopher Wood, CLSA, Feb. 2005

We have incorporated dividend growth as the primary driver of our research efforts for several reasons:

- Dividends are a strong check on management. The costs of cutting dividends are well understood by management and the market.
- Dividend growth is usually a strong indicator of future growth for a firm. If we are investing in dividend growth, then we are investing in growing businesses. This increases our confidence in future share price appreciation.
- Commitment by companies to paying meaningful dividends aligns company interests with shareholder interests.

We believe dividends will be a more meaningful contributor to investment returns in 2005. The chart shows the long-term average contribution to total return at 35%. 2004 saw a pick-up and we believe the upward trend will continue.



Source: Bernstein Research

Dividends will be a more significant contributor to returns

Canada is Our Perpetual Dance Partner

Overall, the nature of our client base means that we will always be overweight Canadian assets. In our opinion, the following themes are likely to play out at home in 2005:

- The Canadian dollar will remain persistently high, putting pressure on GDP growth. This is evident in the fourth quarter 2004 GDP growth result of just 1.7%. As a result, we believe the need to contemplate a rate cut in Canada is at hand. Due to a strong Loonie, we will be selective among Canadian companies challenged by a rising currency – primarily exporters.
- As noted, the spread between 10-yr Government of Canada bonds and the income trust market will continue to narrow. This puts income trusts into a high risk zone. We'd say trusts are in danger of dropping their dance partner! As a result, we would favour REITs over business trusts in 2005.
- Oil remains in a secular bull market but is beginning to show signs of mania behaviour with stocks moving up 5%-10% in a single day. We believe that some of the oil sands stocks are receiving takeover valuations and are not trading in-line with fundamentals. That said, we would be keen to increase our energy weightings on a pull-back. All secular bull markets have pull-backs and we may get one in 2005 heading into the shoulder season.

Canadian dollar will remain persistently high

we would be keen to increase our energy weightings on a pull-back

Buy Energy on Dips

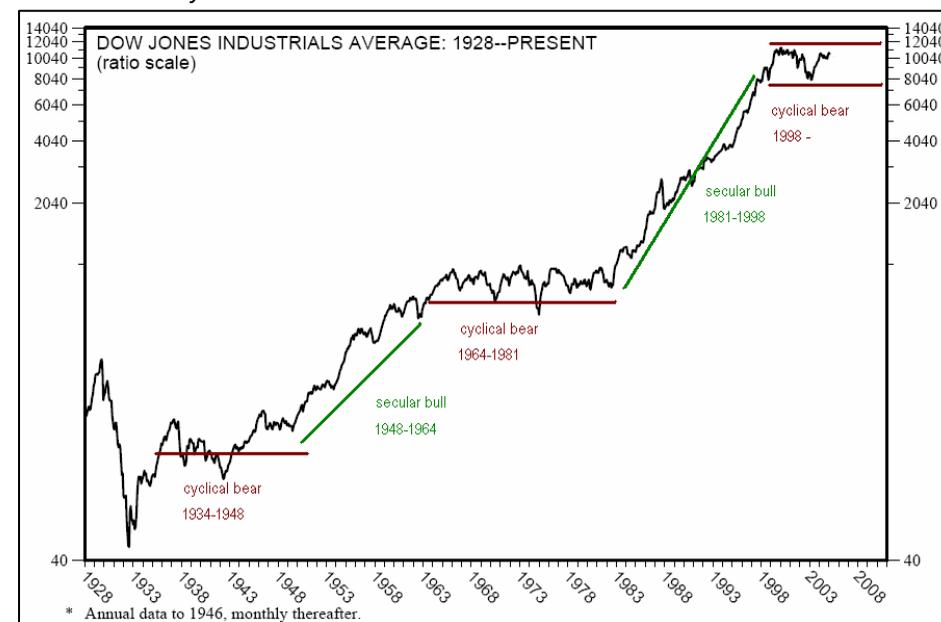


cycles

We are firm believers in the validity of long-term cycles, typically characterized as cyclical bear markets and secular bull markets. The Dow Jones Industrial Average chart below presents a case for 17-year alternating cycles. By this chart, we entered a cyclical bear market in the U.S. in 1998, putting us about 6 years into a 17-year range-bound market. We are currently challenging the upper end of this range but we are of the opinion that earnings growth prospects will be reigned in some time in the first half of 2005, putting pressure on U.S. equities to break through. We site several reasons for a drop off in earnings growth:

- Productivity gains have been exhausted – fourth quarter 2004 was a 0.8% reading vs. 1.8% in Q304 and 3.9% in Q204.
- Continued rise in interest rates throughout 2005 – we believe Mr. Greenspan has been off the mark
- Negative U.S. savings rate – the dance contest is over!

Rallies Within Cyclical Bear Markets Exist

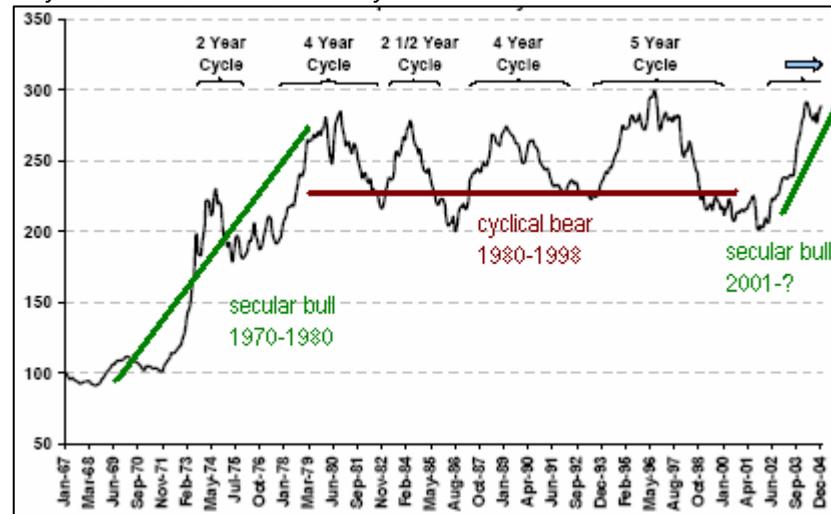


Source: SAMI, yardeni.com

Commodity Cycles

Similar to the Dow Jones chart, the commodity picture appears to run with a bull / bear pattern (see Chart below). Our opinion is that select supply-constrained commodities (e.g. iron ore, coal, copper, fertilizers, rubber) are pairing off with the hot date at the dance – China. This could be the start of a longer secular bull market and certainly the urbanization of China would call for plenty of steel, wood, asphalt, and energy to construct and fill the places these people choose to live. We also believe that agribusiness will stand to benefit tremendously from the Chinese population choosing foodstuffs typical of a rise in household income. In 2005, our research efforts will be targeted at opportunistically adding to our commodity exposure, especially where Chinese demand is high and supply is constrained.

Early in Current Secular Commodity Bull



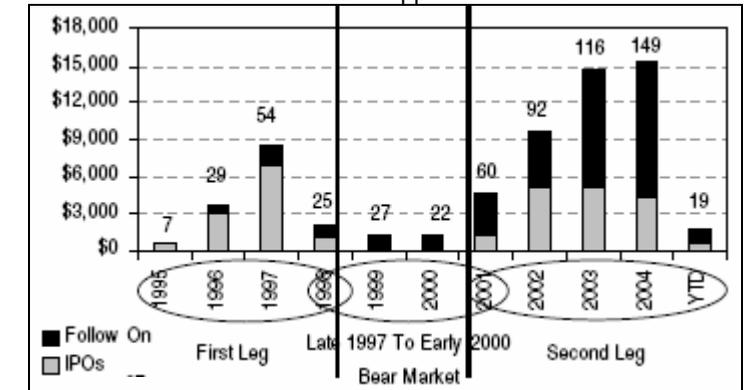
Source: SAMI, Morgan Stanley

Canada; the trust jive

In 2004, the Canadian marketplace was dominated by two themes - income trusts and energy. The insatiable appetite of the Canadian investor for yield produced over \$15 billion in new issuance and drove the combined market cap of the asset class to over \$120 billion. This market has been on a four-year jive marathon! Now a ubiquitous part of the Canadian investment landscape, 2005 will mark the inclusion of income trusts into the S&P/TSX Composite index – broadening investment choices for institutional investors. In 2005, we will make an important distinction in the trust sector – diversified business trusts will be classified as part of Canadian equity, leaving REITs and Energy Trusts in the REITs and Trusts asset class. With trust yields closing in on the Government of Canada 10-year bond, our opinion is that risk levels have risen substantially. We will continue to assess business trusts as we do dividend growth stocks, evaluating distribution growth prospects and business fundamentals ahead of optical high yields.

the Canadian income trust market has been on a four-year jive marathon!

Income Trust Market = Insatiable Appetite for Yield



Source: CIBC World Markets, numbers above bars indicate number of deals

emerging markets; the growth dance

Of the markets we have access to invest in, we are most enthusiastic about emerging markets. We believe the opportunity to wow the crowd with GDP growth dance moves is greatest for these regions. That being said, we are disciplined with our regional calls. As evidence, early in 2004 we sold our position in Greater China fund to execute our Underweight call on this market for the year. For all the front-page fanfare that Chinese economic growth received in the year, you may be surprised to learn that the Chinese market closed the year in a negative return position. In 2005, we have moved to a Neutral stance on China for the following reasons:

- GDP growth should continue at 7%-10%
- 2004 saw a flat market
- China is in transition from an all-import dependent country to a domestic production and consumption story.
- Rising consumerism encouraged by rising per capita GDP and urbanization

Should the market give us the opportunity in 2005, we will move to add to positions in China.

Outside of China, we favour Emerging Asia, Eastern Europe, and internalizing South American economies. These favoured geographies are experiencing rapid economic growth, transitioning from developing economies to more diversified developed economies. One of the most significant driving forces of our emerging markets thesis is that access to cheap technology has given these regions a virtual free productivity pass. Where Japan received an industrial subsidy, these emerging markets are beneficiaries of a technology subsidy. This has jump-started emerging economies, putting them on a level technological playing field, making them very competitive.

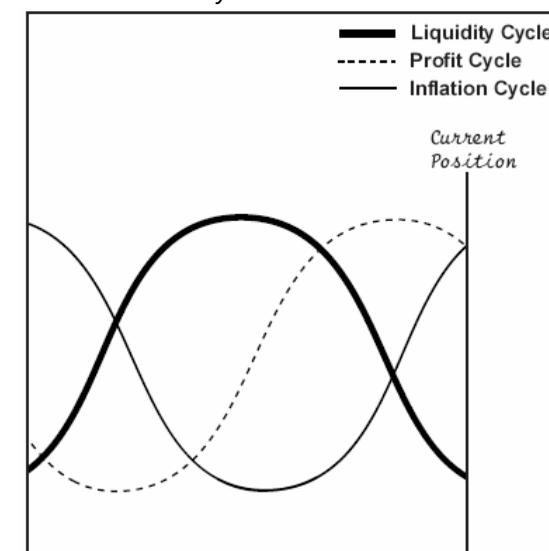
despite front-page status, China market returns were negative in 2004

emerging markets are beneficiaries of a technology subsidy

The Cycle Trio Plays Consumer Staple Tune

We believe that productivity will be the front-page story of 2005 in the U.S. market. Early evidence of admission of exhausted productivity gains is the upturn in merger activity. Why would this occur now when last year corporate balance sheets were flush? Our belief is that the recent merger activity is not an endorsement of growth opportunities but an admission by corporate America that cost savings in their own businesses have been exhausted and therefore more must be found through acquisition. The U.S. is in the late stages of the profit cycle which typically does not favour strong U.S. equity gains. This is the main reason for our defensive stance on the U.S. in 2005. The current position on the trio of cycle indicators (see Chart below) suggest that we have past the peak of profitability and heading into peak inflation. As such, the sector that best performs moving into a downturn in the profit cycle is consumer non-cyclical – consumer goods, pharmaceuticals, utilities, media.

Late in the U.S. Cycle



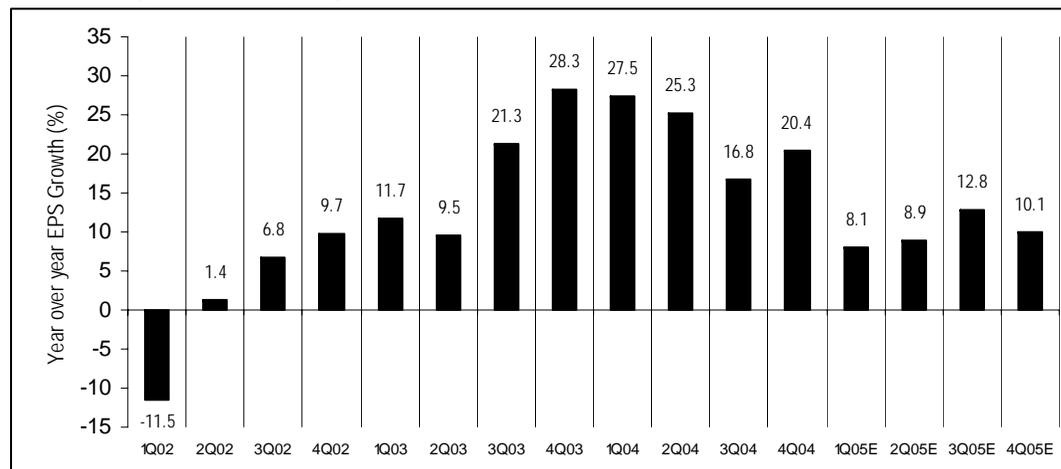
Source: BCA Research

developed markets

We believe that 2005 will be a year in which developed market performance will diverge. This will be especially evident between the U.S. and Japan. Our 2005 developed market call is to Overweight Japan and underweight the U.S. Our reasons relate to Japanese corporate reform and tax policy and the peak of the U.S. profit cycle.

The Chart below shows S&P 500 year-over-year earnings per share growth rates by quarter. Earnings growth peaked in the fourth quarter of 2003 at 28.3% and was followed by two consecutive quarters of growth above 25%. Estimates are less robust, averaging 10% for the 2005 quarters. We believe this will lead to a correction in U.S. stock values. Declining productivity growth and a rash of merger activity early in 2005 support this view. Fourth quarter 2004 productivity growth in the U.S. came in at 0.8%, a fraction of the 3.9% figure posted just two quarters prior. Without productivity gains, U.S. companies are seeking them out through mergers –US\$85 billion of deals were announced in January. We interpret a rise in merger activity as a sign that cyclical profit growth has peaked.

U.S. Earnings Growth Tapering



Source: Thomson First Call

Japan; Dancing with the Dragon

In our opinion, Japan will outperform the developed markets for the following reasons:

dividend and dividend tax reform could attract Japanese savings to Japanese equities ...

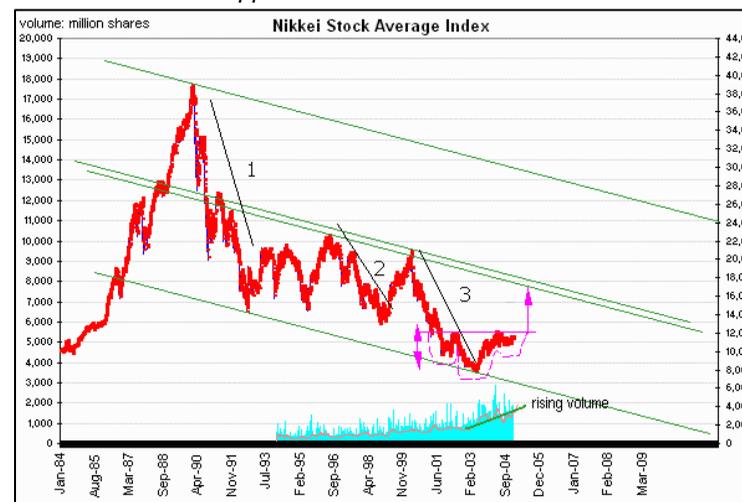
... suggesting strong potential

Dividend reform. The tax rate on dividends has been changed to 10%, effectively reducing it to the same level as capital gains. In addition, a pending revision of Japan's Commercial Code will allow companies to pay dividends from consolidated companies rather than strictly from parent companies. According to CLSA (an Asian market forecaster), Japanese payout ratios could accelerate over 200% with this change. Our opinion is that a newfound focus on dividends should spur domestic demand for Japanese equities.

Corporate reform. Given the conglomerate makeup of large Japanese companies, such restructuring activity has the potential to unlock value in underlying businesses.

Asian trade zone rebalancing. In 2004, China surpassed the United States as Japan's largest trading partner. We believe this is an important milestone that will continue to accelerate with China's domestication. As well, Europe remains an important export market for Japan.

Nikkei Technicals Support a Rise



Source: SAMI, asiachart.com

Strong technicals. The Nikkei 225 index has broken through a key level of resistance, putting the risk / return balance in our favour. Long-term, Japan has endured a triple waterfall pattern (marked as 1, 2, 3 in the chart) that typically reverses after the bottom of the third waterfall.