

Investment Outlook

An exclusive quarterly report from TD Waterhouse® Private Investment Counsel Inc.¹

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What evolving market trends mean to your portfolio

BY R.J. GORMAN, CFA, CHIEF PORTFOLIO STRATEGIST, TD WATERHOUSE

While global financial markets continue to be rocked by non-stop volatility, with everything from oil to the Chinese stock market fluctuating wildly day-to-day, new trends have been taking shape that could affect your portfolio.

In the first half of 2008, Canada's stock market was one of the few around the globe to make any progress. Even this was a little deceiving, as energy and fertilizer stocks were among the few areas of the market gaining ground.

Meanwhile, most other stocks, domestic and foreign, either languished or fell. China's formerly high-flying Shanghai Composite Index had an especially tough six months, dropping 48%.

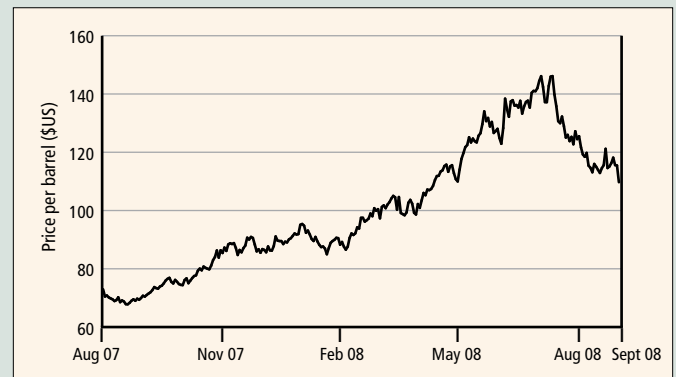
Commodities down, U.S. dollar up

The second half of 2008 has been decidedly different to date, with several of our forecast trends now starting to assert themselves.

Oil and agricultural commodity prices have weakened considerably — with oil retreating about 25% from the US\$147 per barrel level reached in early July (see chart above) — while corn, wheat, and soybeans, among others, have fallen as much or more.

The oil price correction has reflected, in part, a shift in the balance between supply and demand. The high price of oil combined with slowing global economic growth has led to declining oil consumption — North Americans are driving less and consumption is down in emerging countries

Oil off its high: The beginning of a trend?



West Texas Intermediate (WTI) Crude Oil: 1-year period ending September 3, 2008. Source: Bloomberg

as governments reduce their fuel subsidies.

Meanwhile, agricultural commodities have dropped due to a cooling of the speculative fervour that gripped futures markets earlier this year and a supply response that has seen farmers planting fencepost to fencepost to take advantage of high prices.

Commodity prices have tumbled against the backdrop of a firmer U.S. dollar (see chart on Page 2). It is likely that U.S. interest rates have bottomed for this cycle, while European rates have peaked and will edge downward in

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What evolving market trends mean to your portfolio

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the coming months. The anticipated narrowing of the interest rate differential between the greenback and the euro is one of the reasons the U.S. dollar has risen modestly. Since most commodities are priced in U.S. currency, the recovery of the greenback has added further downward pressure on commodity prices.

Importantly for Canadian investors, the firmer U.S. dollar has meant a weaker Canadian dollar, as had been forecast in the Winter 2008 issue of *Investment Outlook*. At the time of writing, our loonie is down about 7% to date in 2008 versus the greenback, adding to the value of U.S.-dollar-denominated investments in an otherwise soft market.

Rotating market leadership

Not surprisingly, the shifting fortunes highlighted above have been reflected in the equity markets. Stocks of energy, metal, and agricultural producers have generally weakened, with shares of junior producers, which we have avoided, hardest hit. Shares of major producers that we own on your behalf, such as **Suncor**, **Petro-Canada**, and **EnCana** have also been affected, though to a lesser degree.

The flip side of the downward pressure on shares of commodity producers is a lift for companies that would benefit from

lower commodity prices. Financial sector stocks, such as insurance companies and banks, which benefit indirectly from the prospects of lower inflation that would accompany lower commodity prices, are beneficiaries of this trend in what has otherwise been a difficult environment

for the sector. The U.S. stock market also benefits, as the U.S. is a large net consumer of oil and its companies are adversely affected by higher input costs.

Overall, we are currently witnessing a rotation of stock market leadership, from the cyclical sectors of the economy based on commodities, to the less cyclical elements. While it is likely that this theme should continue to play out — many commodities have room to decline further — we believe that most commodity prices should remain high by historical standards.

Relatively high commodity prices will reflect growth in consumption among

rapidly growing emerging markets such as China and India. We believe the large commodity producers should generally avoid the boom-and-bust cycle that has historically plagued the sector.

Opportunities in corporate bonds

Each market, no matter how difficult, presents some opportunities. Since mid-2007, credit issues emanating from the U.S. have made fixed income investors very risk averse. As a result, investors have poured money into the perceived safe haven of government bonds, pushing their prices up and

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While the loonie slumps, the greenback recovers



1-year period ending September 3, 2008.
Source: Bank of Canada

Current Private Investment Counsel strategy

Portfolio weighting

- Modest overweight in equities
- Slight underweight in bonds, with a somewhat shorter term than benchmarks
- Overweight corporate bonds, where mandates permit
- Where applicable, income trust holdings focus on higher-quality issues with stable, sustainable distributions
- Overweight European industrial stocks and underweight financials within international equities

Percentage return for indices

(For the period June 15, 2008 – September 15, 2008)

DEX Universe Bond Index	+3.0%
S&P ² /TSX Composite Index ³	-16.5%
S&P 500 Index ²	-8.6%
MSCI ⁴ EAFE Index*	-11.8%

* Morgan Stanley Capital International Europe, Australasia and Far East Index

The Insured Annuity: Maximizing after-tax retirement income

You've worked hard to benefit from the many rewards that retirement brings. Whether you're just steps away from retiring or have already made the transition, your investment portfolio will most likely include interest-bearing investments such as Guaranteed Investment Certificates (GICs), term deposits, and bonds.

If you're using the interest earned by these investments to supplement your retirement income, your goal is likely to maximize the income you're receiving today, and preserve your investment capital as a legacy for your beneficiaries.

Maximize your income and estate

If this is indeed the case, you may want to consider the **Insured Annuity** financial planning strategy. This strategy is designed to provide you with increased income today, while ensuring that your investment capital remains intact over time.

An Insured Annuity strategy combines the purchase of a life annuity contract with a permanent life insurance policy. Generally, this strategy begins with the liquidation of a portion of your conservative, liquid investments to make the annuity purchase within your non-registered portfolio. The annuity then generates a regular payment stream that

covers life insurance premiums and tax on your annuity. The remaining amount is used to supplement your retirement income. Your beneficiaries will eventually receive the life insurance proceeds as a tax-free death benefit.

The benefits to you

The key benefits of utilizing the Insured Annuity strategy are:

- ▶ It may provide up to a 100% increase in cash flow and after-tax income for the remainder of your life.
- ▶ A potential decrease in taxable income by more than 50% (may help reduce Old Age Security benefits clawback).
- ▶ Tax-free return of capital that is paid directly to your beneficiary, avoiding probate fees and estate complications.

An Insured Annuity scenario⁵

Consider Linda, a healthy, non-smoking 65-year-old woman who has recently retired. Linda wants to increase her retirement income so she can travel. To finance this, she is considering using the interest accumulating on the principal of a \$250,000 non-registered investment. She also wants to ensure that the principal remains intact so that she can pass it on to her two children as part of her estate.

Linda is currently earning 4.5%

interest on this investment and her marginal tax rate (MTR) is 46%. This translates into annual after-tax income of slightly more than \$6,000. At first glance, it doesn't appear that this investment strategy is going to meet Linda's cash flow needs.

To compare the Insured Annuity strategy against her current plan, Linda needs to know the current life annuity and life insurance rates on \$250,000 for her age and health category. Based on current market rates, a life annuity would provide Linda with annual after-tax income of approximately \$15,600 and premiums for the life insurance policy would cost about \$5,600 per year (see chart below).

In this case, the Insured Annuity strategy provides Linda with after-tax retirement income of \$10,000, which is an extra \$4,000 per year that Linda could use for her travel plans. This is 65% more than the \$6,000 net income generated from her current strategy.

A tax-efficient legacy

By naming her children as equal beneficiaries under the life insurance policy, Linda can also leave \$250,000 to be paid tax-free directly to them.

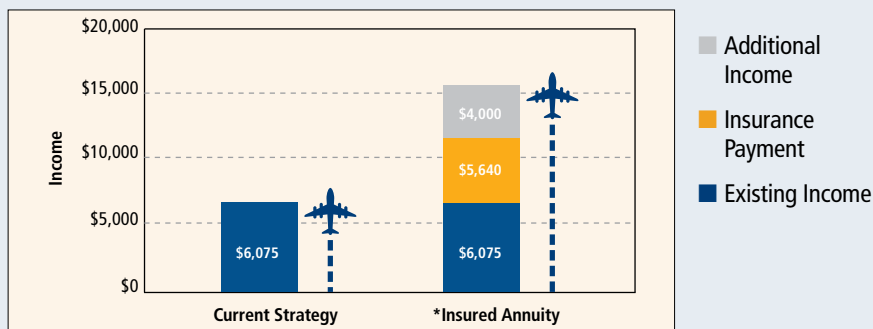
Linda has now effectively managed to enhance her retirement income and be able to pass a legacy to her beneficiaries in a tax-efficient manner. In addition, there would be no probate fees payable to erode the estate (not applicable in Quebec).

In summary, the Insured Annuity strategy is a recommended, value-added investment solution that provides potential for enhanced cash flow, tax advantages, and capital guarantees.

Your Private Investment Counsel Portfolio Manager can work together with an Insurance and Estate Planning Specialist to help you maximize the benefits of the Insured Annuity and a wide range of other wealth protection strategies. ■

Take your investments further

With an Insured Annuity, Linda is able to have more income for her travel plans while securing her investment principal to pass on tax-free to her children as a legacy.



*Insured Annuity data: Female 65, non-smoker, \$250,000, 46% MTR
AIG Life Annuity, no guarantee period. Industrial Alliance T-100 Life insurance policy.
Source: TD Waterhouse Insurance Services Inc.

What evolving market trends mean to your portfolio

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yields down. Conversely, investors have demanded much higher rates of interest from even the highest-quality corporate borrowers.

The result is that top-quality, investment-grade Canadian corporate bonds currently have significantly higher yields than government issues with comparable terms to maturity. Therein lies the opportunity.

At the time of writing, investment grade corporate bonds have a yield to maturity that is 140 basis points, or 1.40%, higher than government bonds with a similar term. To take advantage of this opportunity, we are, where client mandates permit, increasing your corporate bond exposure by 16% – 25% to increase both your potential stream of income and your total return.

Safeguarding your assets

It is no secret that the past year has

proven difficult for investors of all stripes, with financial markets displaying much sound and fury but no progress. Historically, our portfolios have held up well in trying times and we seek to evolve our strategies to meet the challenges of future periods of market volatility. During the difficult past year, we have safeguarded your assets by avoiding the Asset Backed Commercial Paper (ABCP) problems, most direct effects of the U.S. housing slump and sub-prime lending fiasco, China's market meltdown, and the lion's share of adverse currency movements.

In so doing, we have avoided most of the carnage inflicted upon many investors — witness the 17.8% drop of Warren Buffett's Berkshire Hathaway for the year to date. Your portfolio holdings are of very high quality, trade at depressed valuations, and have solid prospects in the years ahead. ■

NEW

What's your view of retirement?

Our new **TDretirement.com** information site gives you the interactive tools and resources you need to plan for your retirement — whether that's in 30 years or 30 days.

It's never been easier to plan your vision of retirement!



INVESTOR NOTICE

The new Tax-Free Savings Account

The highly anticipated Tax-Free Savings Account (TFSA) was introduced in the 2008 federal budget. Possibly the most significant change to Canada's savings system since the introduction of the Registered Retirement Savings Plan (RRSP) in 1957, the TFSA is a tax-efficient and flexible savings option.

Starting in 2009, Canadian residents

who have reached provincial age of majority and who have a Social Insurance Number can open a TFSA and contribute up to \$5,000 per year.

The flexibility of the TFSA means it can be used to save for virtually any financial goal — from a short-term goal such as a vacation, to a longer-term goal such as retirement, or even to leave a tax-free legacy. It is

particularly useful for individuals who intend to access the funds on a repeated basis or who expect their marginal tax rates to remain constant or increase in retirement.

Talk to your Private Investment Counsel Portfolio Manager about how TD Waterhouse can help you incorporate this great new savings opportunity into your personal financial plan.

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⁵ The people and situations identified in this article are fictional. This example is intended to assist customers in identifying their needs. While assumptions and

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