

Investment Outlook

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Canadian bank stocks and your portfolio

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

Since June 2007, financial sector stocks around the world have been under pressure as a result of concerns surrounding the U.S. sub-prime lending issue and its impact on the availability and cost of credit.

Since shares of Canadian financial institutions, and the banks in particular, represent an important part of your portfolios, it is a good time to examine their outlook.

Global turmoil takes its toll

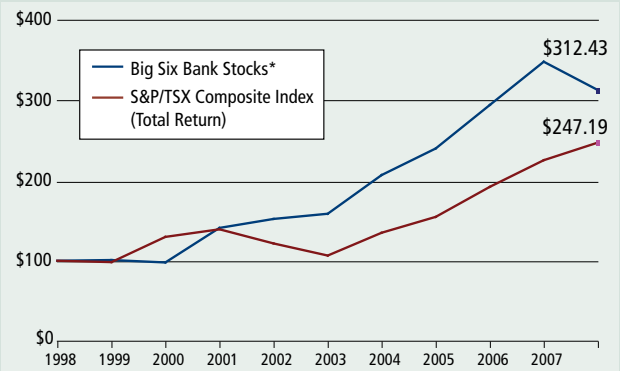
By mid-2007, serious cracks in the U.S. residential real estate market and rising delinquency rates among sub-prime mortgage borrowers were beginning to have a sharp impact on global credit markets.

In the U.S., those defaulting mortgage borrowers were causing steep losses among mortgage lenders. Meanwhile, those same delinquent sub-prime mortgages were infecting bonds sold to global investors, which were now worth far less than their original cost. (See “U.S. housing, sub-prime lending, and your portfolio” in the Fall 2007 issue of *Investment Outlook*.)

As a result of these events, U.S. banks recorded large write-offs in the second half of 2007 and early 2008. Among the hardest hit were regional banks and lenders devoted purely to mortgage lending, two groups that are not represented in your portfolios. Overall, U.S. bank shares fell 37.54% in the year ending February 29, 2008.

Over the same one-year period, Canadian bank stocks slipped 14.28%. Why the more modest decline than stateside? First, sub-prime

Chart 1: Bank Stocks' Historical Performance



This chart shows the value of \$100 Invested at the start of 1998.

*Average of Bank of Montreal, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada, Scotiabank, and TD Canada Trust.

Source: TD Newcrest

residential mortgage lending is very limited in Canada, so the sub-prime mortgage delinquency issues prevalent in the U.S. have had little direct impact here. Second, the alphabet soup of securities infected with sub-prime mortgages and the pool of bonds, loans, and other assets that back them up — CDO's, CLO's, SIV's — have not been as widely held among the Canadian banks. CIBC has been the principal exception, taking write-offs in excess of \$2 billion, while many of the other major banks have absorbed smaller write-offs.

However, the Canadian banks have been

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Canadian bank stocks and your portfolio

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entering the more difficult part of the credit cycle, characterized by higher loan-loss provisions and adverse affects on earnings. The general slowdown in the economy has also weighed on earnings growth, resulting in slumping share prices.

Track record of Canadian banks

At the time of writing, the Financials sub-index of the S&P/TSX Composite Index represented 27.5% of the index. This makes it the second-largest component of the Canadian stock market, behind only the Energy sub-index, which has a current market weight of 29.1%.

The six major banks are collectively the largest element of the Financial sub-index and have historically been strong performers. To illustrate, in the decade covering 1998 through 2007, the average annual total return (dividends plus share-price appreciation) of the six major banks was 12.07%, handily outstripping the 9.47% annual total return of the

TSX Composite Index over the same period (see Chart 1).

Why have bank shares outperformed the broader market? In general terms, the banks demonstrate good operating leverage, converting what are often modest increases in revenue into more substantial improvements in annual earnings. This relatively consistent earnings growth has driven share-price performance.

A second, key driver of the returns of Canadian banks has been the steady increase in dividends paid to shareholders. As illustrated in Chart 2, dividends paid to shareholders of the six major banks have grown at an annual compounded rate of 14.8% over the ten-year period from 1998 to 2008. The result, as Chart 2 indicates, is that \$1 in dividends being paid to bank shareholders at the beginning of 1998 had been increased to \$3.98 a decade later. In other words, the dividend income being paid to shareholders had almost quadrupled over this 10-year period.

The importance of these steadily rising dividends is hard to overstate. In contrast with bond interest payments, which generally do not change, bank dividends have increased at a rate well in excess of inflation, boosting investors' income and providing support for the banks' share prices during difficult operating environments.

Valuations and prospects

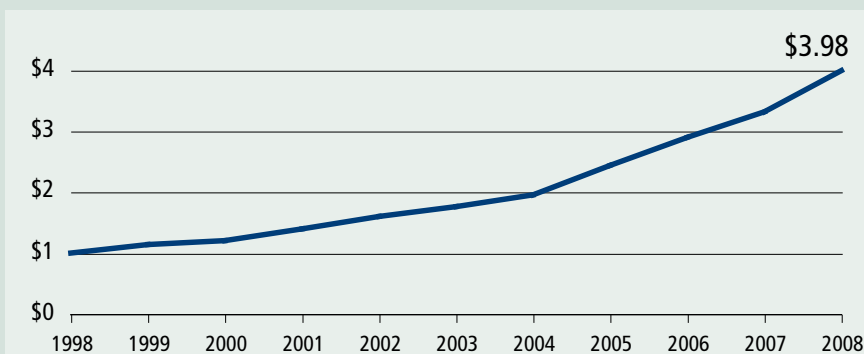
The Big Six banks' earnings for the first quarter of fiscal 2008, which ended on January 31, were generally disappointing. This fact, along with renewed concerns about financial market illiquidity, pushed Canadian bank shares lower in the first half of March.

In the near term, the banks' earnings will be constrained by a slowing economy, adverse impact on their branch systems, plus above-average loan losses and the possibility of further write-offs related to the current credit climate.

At the same time, bank stock valuations are modest, with Price/Earnings multiples in the 10-12 range. Share prices are being supported by relatively high dividend yields, averaging well over 4%. It is worth noting that historically, the Government of Canada 10-year bond yield exceeds the average dividend yield of the banks. Today, with the benchmark Government of Canada yield in the 3.7% range at the time of writing and an average bank dividend yield above 4%, the opposite is true, a good indication of both investor concerns and underlying value in Canadian bank shares.

While bank share total returns may well be below average in the immediate future, their longer-term prospects remain very good and warrant their status as large, core positions within your portfolio. ■

Chart 2: A History of Dividend Growth



A hypothetical \$1/share dividend issued by the Big Six Banks at the end of 1997 would have increased to a dividend of \$3.98/share just ten years later, based on an industry average 14.8% CAGR in dividends.

Source: TD Newcrest

Long-term care: Preparing for the unexpected

You have worked very hard to achieve financial security for you and your spouse and want to enjoy a comfortable life without worry. One way to help ensure a worry-free future is to acknowledge and prepare for the unexpected, such as potential changes in your health or that of your spouse.

Planning for the potential costs of health care is an important part of your overall financial plan. Taking the right steps now can ensure that you have a plan in place that secures the future for you and your spouse.

Depending on the nature of the care required — whether home-based or professional services — long-term care costs can be quite high. Here are some tips to give you peace of mind and help ensure you are prepared in the event that unexpected health-care issues arise.

Consolidating assets and investments

Consolidating your investing and banking arrangements can make the day-to-day administration of your finances easier for you today. It can also make it easier for your spouse, should he/she need to deal with your financial affairs in the future.

Funding long-term care needs

Here are a few strategies to help ensure that funds are available for long-term care needs.

- **Establish an emergency fund.** Setting aside funds for unforeseen expenses is always a good idea. A financial cushion can help you prepare for unexpected health or long-term care costs that you or your spouse may face.
- **Sell assets as needed.** Your investments may be a potential source of funding for your long-term care needs. Before proceeding, you will want to ensure you consider any

negative tax implications resulting from the sale of any investments.

- **Consider long-term care insurance.** The costs for long-term care protection can have a major impact on your financial plan. Long-term care insurance is an important tool.

This type of insurance can offer you the freedom to structure your care or that of your spouse based on your unique lifestyle goals. It can provide a daily financial benefit if either of you require the services of a long-term care facility or professional help at home.

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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 health care and industrial stocks within international equities

Percentage return for indices

(For the period December 15, 2007 – March 15, 2008)

DEX Universe Bond Index	3.9%
S&P/TSX Composite Index	-2.4%
S&P 500 Index	-14.3%
MSCI EAFE Index*	-13.0%

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

Long-term care: Preparing for the unexpected

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Long-term care insurance provides you with additional financial security and peace of mind, and can be a valuable planning tool when attempting to minimize future worries.

As your needs change, your Portfolio Manager will work with you and your loved ones to ensure your portfolio is structured appropriately. He/she can also refer you to an Insurance Specialist who will review your insurance options, including long-term care protection.

Estate planning considerations

In the event that you may require assistance managing your financial and/or personal affairs, it is important to appoint a Power of Attorney (mandate in Quebec) in each case.

Appointing a **Power of Attorney for Property** allows you to entrust someone to manage your financial affairs in your best interest, when you are no longer capable of doing so yourself.

Appointing a **Power of Attorney for Personal Care** enables you to entrust someone to make important health and personal care decisions on your behalf, if you are no longer capable of doing so yourself.

In most cases, your spouse will be the person you appoint as your Power of Attorney. If you decide to choose other individuals, be sure to discuss your plans and expectations with those you select ahead of time to ensure that all decisions will be carried out the way you want.

It's also important to ensure that your **Will and that of your spouse** is up to date. To avoid any confusion, it is important that your executor(s) know where the latest copy of your Will is located.

Your Portfolio Manager can put you in touch with a Trust Specialist who can assist you with your Powers of Attorney and other estate planning needs.

Care-giving: Easing the stress

More and more Canadians are taking on the responsibility of caring for their aging or ailing loved ones. Whether it involves looking after an ill spouse or an elderly parent, being a caregiver can be time consuming and emotionally draining. Caregivers often feel guilty ("I should be doing more"), even when care giving is a major focus in their life.

If you are caring for your spouse, don't put your own life on hold. Setting

aside time for personal activities can ease your stress and make the situation better for you and your loved ones. Consider hiring outside help, which can afford you the time to keep yourself in good health so you may continue to provide the best possible care.

Consider day programs for your spouse — this can also provide you with some personal time and give your loved ones the opportunity to change their environment and socialize.

Joining a support group or community organization may help you cope with the practical and emotional requirements of care giving. You may find the support and advice of others who are dealing with similar issues a source of comfort.

Speak to your Private Investment Counsel Portfolio Manager to help plan for unexpected costs associated with long-term care and providing support to your loved ones. ■

NOW AVAILABLE

Online access for clients of Private Investment Counsel

The ability for you to view your Private Investment Counsel portfolios online is now available! Through TD Waterhouse WebBroker®, we are pleased to offer you an easy and convenient way to stay up-to-date with your Private Investment Counsel accounts and provide you with in-depth information such as asset classification, portfolio allocation, and market values of securities.

Available to you at no cost, WebBroker is secure and accessible seven days a week, 24 hours a day. If you wish to take advantage of this optional service enhancement, please contact your Private Investment Counsel Portfolio Manager to register.

The information in this newsletter is current as at March 19, 2008.

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