

ECONOMIC ENVIRONMENT

While the debt problems emanating from Europe have had an adverse impact on the global economic recovery and capital markets, recent economic data from North America have provided evidence of stabilization and, in some cases, strength. The austerity packages being implemented in Europe and more widely discussed at the G8 and G20 meetings in Canada will no doubt reduce the pace of recovery. However, it remains unlikely that regions outside of Europe will withdraw any of the stimulus which was put in place over the last two years. This government action remains crucial to enable economies to recover while consumers improve their financial positions. In this regard, the current situation is conducive to maintaining the low interest rates which are essential for the improvement of household balance sheets. We anticipate gradual rate hikes in Canada, but no corresponding movement by the U.S. Federal Reserve this year. Furthermore, as the Chinese authorities complete their braking efforts, growth may accelerate into year end, potentially boosting commodities anew.

EQUITIES

Given this backdrop, we anticipate continued near term volatility, as the markets work through the implications of the Chinese deceleration and European sovereign debt issues. However we believe the prospects for equities may eventually turn more favourable over the second half of the year. A great deal of negative data relating to Europe and China has now been discounted by the market, to say nothing of the impact of the BP Gulf of Mexico oil spill on the energy sector. Corporate valuations are at very attractive levels on a historical basis. With a benign monetary policy backdrop and correspondingly low bond yields, high free cash flow yields for many securities should drive demand back into the equity markets. Our focus continues to be on well managed companies with above average potential in industries with strong growth drivers.

INCOME/BALANCED

In response to the recent turmoil in the markets, we have taken advantage of rallies to tilt the asset mix of the Acuity balanced and income-oriented funds to a modestly more defensive stance. Nevertheless, we maintain our view that credit markets remain viable. Indeed, given the widening corporate spreads experienced in the past few months, yields on high yield and investment grade corporate bonds appear compelling relative to the underlying government bond market. In addition, in our view, large cap dividend-paying equities offer decent income in addition to solid medium term upside potential. As a result, we believe that these funds are well positioned to deliver substantially higher yields than traditional fixed income vehicles, yet lower volatility and better downside protection than equities.

FIXED INCOME

Bond yields have continued to decline in the past six weeks on fears related to a stalling of the recovery, and the possibility of a double dip recession. While we continue to endorse the view that we are in a prolonged period of low interest rates, we believe concerns regarding another recession are misplaced. It is true that economic growth has moderated, but most indicators still point to a healthy outlook for both the North American and global economies in the coming several quarters. Accordingly, we are adhering to our thesis of range bound government bond yields. While we would not rule out further declines in yields if the environment remains volatile, yields have moved to the lower end of the range, in our opinion. As such, they do not offer great prospects for returns, especially for investors who must factor in the effects of inflation (as low as it is) and taxes. This situation suggests that the strategy of emphasizing higher yielding corporate bonds continues to make sense, particularly if credit conditions do not deteriorate meaningfully from here. Thus, the fixed income funds remain oriented toward securities with attractive spreads over government bonds along with solid and/or improving fundamentals.

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