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THE VOLATILITY VISTA: A LOOK AHEAD AT THE MARKETS

Over the past few weeks, worldwide capital markets have displayed more volatility than over the last five years. This volatility has been triggered by a correction in the credit markets, particularly concentrated in U.S. sub-prime mortgages and related securities.

These market fluctuations are an expected and normal part of the long-term dynamic of the global markets. In the short term, corrections and volatility can seem dramatic, but they have proven to be small and necessary deviations in the market's upward movement in the longer term. In this period of volatility, it is important to keep in mind that many of the world's markets have experienced significant upside during the last few years. A short-term pullback is not unusual. Even after the corrections of 1987 and 1998, markets recovered and are considerably higher today.

Here are insights on the current situation from CIBC Global Asset Management's economic, equity, and fixed income experts.

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The Economic Impact of Recent Events

Luc de la Durantaye, CFA | First Vice-President – Global Asset Allocation and Quantitative Products

The problem of the U.S. real estate market is not new news. We have been forecasting that the U.S. economy would experience a soft landing, with growth remaining sub-par for at least the next 12 to 18 months, as U.S. consumers recuperate from losses in real estate and rebuild their savings from historically depressed levels.

Based on the small size of the sub-prime market relative to the entire U.S. mortgage market - about 13% - our original assessment was that the impact would be contained to the U.S. economy and its residential sector, and would produce an economic slowdown but not a recession.

In our opinion, so far, the credit contraction and the increase in the cost of credit has been too short in terms of time and perhaps too small in magnitude to make us materially change our current economic forecast, although our conviction and the risk of a U.S. slowdown have both increased.

World economic fundamentals remain strong with low unemployment providing consumers with good income growth, low inflation, and low interest rates. Therefore, it remains critical that upcoming economic data worldwide

continue to show positive growth.

Continued deterioration of the credit market would increase the risk of a more severe U.S. slowdown and its related effect to the rest of the world. Recent action by the Federal Reserve (the Fed) to provide liquidity and its subsequent move to lower the discount rate (not the Fed Funds rate) will prove to be helpful to alleviate the current market credit concerns.

One of the important aspects of the recent events is the decline in confidence on the part of investors towards assets such as corporate credit paper and equity markets in general. Such action by the Fed helps shore up confidence. Implicitly changing their monetary policy bias from one of tightening to one of easing could provide a floor to the economy and equity markets by increasing the responsiveness of monetary

policy in the case of further credit deterioration.

Recent price action has spread to a broad group of asset classes that have, until recently, remained largely untouched. During the recent market volatility, currencies such as the Japanese yen appreciated sharply, and Asian and emerging equity markets depreciated.

While it is difficult to be definitive in determining the end of the current turmoil, especially due to the lack of transparency of some of the financial structures causing the turmoil, the spreading of the troubles in the credit market suggests that risk reduction may have entered a final phase after which capital markets could stabilize.

While we don't expect the speed of the capital market recovery to be fast, sound world economic fundamentals should reassert themselves and offer support to the recovery over the coming months.



The Impact on Canadian Equities

Gaelen Morphet, CFA | First Vice-President - Canadian Equities

Concerns over the weakening U.S. residential housing market and sub-prime mortgages has spilled into the Canadian market and affected the market for asset-backed commercial paper. In addition, investor demand for corporate debt, especially sub-investment grade debt used to finance takeovers, has fallen off sharply. This reduction in financing puts a number of pending takeovers at risk of not closing and removes the private equity premium that had been a source of support for the equity markets.

As value managers it is our job to stand back from the emotionalism of the stock market and to stay focused on stocks and their valuations. For some time we have been reiterating that the market is overvalued. Since the lows of September 2002, the Canadian equity market has rallied for over 58 months, and appreciated as much as 137%. Before the recent volatility, stocks had reached the higher end of their valuation ranges and by almost all accounts were poised to continue soaring.

As value managers we were finding it increasingly difficult to find bargains.

But just as confidence couldn't be greater, global equity markets started retrenching and risk was beginning to be repriced in stocks.

Initially when these corrections come along the market doesn't discriminate. Investors start to sell their largest, most liquid positions – which often are their best investments – just to add cash to their holdings. As the downturn continues, the better quality stocks begin to outperform.

Whether temporary or not, this is the stage we believe we are in now. Value is beginning to surface and the

better quality equities are starting to emerge. Our Canadian equity portfolios are all positioned defensively in anticipation of a sell-off. And while it is hard to show a positive return when the entire market is falling, we believe the decline will abate and the better quality stocks will prevail.

Historically, our portfolios have added most of their value relative to the market during extended market declines and have done well in providing downside protection. We believe investors should expect the same result this time around.



The Impact on Canadian Bonds

John Braive | Vice-Chairman

CIBC Global Asset Management money market portfolios have no exposure to the extendible asset-backed commercial paper (ABCP) that has become a source of recent concern in the bond market

ABCP is short-term debt backed by assets such as mortgages, auto loans and credit card debt. Some ABCP is issued by the major banks and some by other financial organizations. There are two classes of ABCP - extendible notes, where maturity can be lengthened at the option of the issuer, and A-notes, where the issuer, usually a major bank, assures liquidity.

The ABCP held within our portfolios is issued by

Canadian chartered banks and are the highest-rated for credit. We have never owned extendible ABCP. Our rigorous credit analysis has not approved these investments. We have always been focused on the quality of credits in our portfolios. As a result, our money market portfolios are very liquid and of high quality.

Traditionally sell-offs in an upward trending market go on for between six weeks and three months.

Investors have not yet unwound all the excess liquidity in the markets built up over the last five or six years. This unwinding will probably take longer than usual due to the magnitude of the built-up liquidity. In the past, this unwinding created very strong buying opportunities as the volatility lifted and liquidity returned to the market.