Perspectives

TAL Global Asset Management Inc.

Quarter ending March 31, 2004

Expected Returns

	For the period ending March 31, 2005					
	In Canadian Dollars			In Local Currency		
	Global Reflation	Disappointing Growth	Productivity Shock	Global Reflation	Disappointing Growth	Productivity Shock
Probabilities	**55.0%**	**25.0%**	**20.0%**	**55.0%**	**25.0%**	**20.0%**
Canada Money Market	2.1%	1.6%	1.9%	2.1%	1.6%	1.9%
Canada Bond	-1.3%	7.6%	1.8%	-1.3%	7.6%	1.8%
United States Bond	-8.4%	8.8%	6.6%	-4.1%	7.5%	1.5%
European Bond	-9.6%	15.1%	-2.7%	0.4%	11.6%	4.1%
Asian Bond	-5.1%	9.2%	11.3%	0.2%	3.7%	1.9%
Canada Equity	7.8%	-7.0%	16.3%	7.8%	-7.0%	16.3%
United States Equity	4.5%	-6.6%	19.3%	9.4%	-7.8%	13.6%
European Equity	-0.2%	-6.3%	3.5%	10.2%	-8.5%	8.7%
Asian Equity	9.0%	-2.6%	29.0%	13.7%	-7.7%	19.3%

In this Issue

Global Environment

Global economic events are materializing generally in line with our projections. The world economy grew at a 3.5% rate in 2003 and is picking up momentum. Market expectations have been revised upward and stocks have continued to perform well. Globally, corporate earnings hit our bullish targets and the outlook remains rosy. We had expected job growth in North America would be stronger by now. Given this missing ingredient, bond prices have stayed in rallying mode.

In Canada, our concerns have been well placed. The currency-induced pain is showing, particularly in employment in the goods-producing industries. The Bank of Canada's easing over the quarter has helped, but not enough to undo last year's damage. The U.S. has seen improvements in three of the four major indicators of expansion: industrial production is strong, business sales are growing and personal incomes are above their pre-recession levels. The notable exception is growth in the payroll survey, holding the Federal Reserve back from removing excess stimulus from the economy.

As anticipated, Asian markets have led global growth, as Chinese industrial production continues to out-pace that of developed economies. Strong economic news from Japan has also boosted the region. Europe has lagged global economic growth as expected. The strength of the euro stifled the fledgling recovery, and renewed geopolitical concerns have clouded any optimism.

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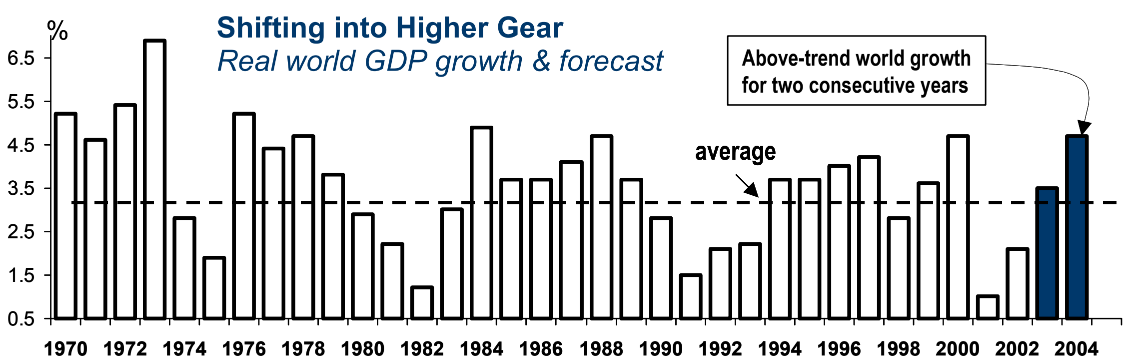
Fixed Income vs. Equity

Our baseline scenario calls for further global reflation: we are projecting 4.7% global growth over the next 12 months. Where it differs from the consensus forecast is in the inflation department. Despite continued expansion in global growth, inflation expectations are still being revised downward by consensus estimates. We do not believe this can continue indefinitely. While we do not expect to see inflation surge, it should rise moderately in the second half of our forecast horizon. In the same way that growth estimates were consistently revised upward throughout 2003, we expect inflation estimates will be revised upward throughout 2004. Until inflation increases are reported, most central banks will likely stay on the sidelines but will eventually have to respond with interest rate increases.

The continued global growth will cause the bond market to under perform in 2004. Rising inflation and rising bond yields would normally imply a lower P/E multiple but we expect valuations to decline only slightly. Support will come from the gradual nature of any back up in bond yields and from the increasingly favourable environment for risk-taking as fears of economic uncertainty dissipate.

"Although we expect earnings growth momentum to gradually slow… corporate profits should continue to be healthy."

Therefore, we maintain our equity overweight. Revenues should increase in line with economic growth. Although we expect earnings growth momentum to gradually slow later in the forecast horizon, corporate profits should continue to be healthy.



Source : TAL Research

Risks:

Disappointing Growth: The world economy looses steam and deflationary fears start resurfacing, emanating from anemic employment growth. This keeps labour costs down so corporate margins don't contract, but revenues don't grow either so valuations fall. This is the best-case scenario for global bonds, which would remain in rally mode for as long as growth disappoints.

Global Productivity Shock: Inflation slows not because demand is weak but because of a supply shock in the labour market as employment is redistributed from industrialized countries to emerging ones. With growth expanding at consensus levels and labour becoming cheaper, corporate profit margins in some countries expand, while countries with less flexible labour markets suffer. This is a 2003 repeat: low interest rates, low inflation, rising corporate profits, solid economic growth. Equity valuations would remain roughly at current levels supported by favourable fundamentals. Bond yields would respond by rising modestly from their historically low levels.

Signposts:

- Global inflation
- Labour market developments
- Monetary policy changes
- Earnings estimate revisions
- Top-line growth

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Invested Minds

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Regional Outlook

Canada struggles underweight of currency strength

Despite the interim relief for the Canadian dollar early in 2004 and easing from the Bank of Canada, the Canadian economy is still struggling to absorb the drastic tightening effects of 2003. This is most visible currently in the labour market and headline inflation.

We expect inflation will keep declining before turning upward later in the forecast horizon, rising to a 2.0% year-over-year clip. GDP growth should also rise to 2.5%, which lags the global growth rate but is an improvement over the current 1.7%. Another rate cut by the Bank of Canada cannot be ruled out over the short term. However, with inflation moving closer to target over the forecast horizon, the Canadian monetary policy stance in early 2005 is likely to be close to where it is now.

Demand for commodities should remain strong, and the materials and financials sectors should be important factors driving earnings growth up 12.3% over the next 12 months. Bond yields will rise as the economy strengthens, although the relative monetary policy outlook and Canada's fiscal position still makes it a better home for bond investors relative to the U.S.

U.S. faces rising inflation later in 2004

Economic growth in the U.S. should reach 4.8% in the next 12 months, with consumer spending, business investment, and inventories being the key contributors. With renewed refinancing activity, more tax stimulus still in the pipeline, and net household worth at all-time highs, we expect a 3.5% increase in consumer spending despite the weaker-than-typical employment growth we've seen so far. Corporate margins expand enough to push S&P 500 earnings up 12.6% while 10-year bond yields rise to 5.0%.

Markets are vulnerable to an unexpected inflation comeback – we think this will be the next surprise. Inflation is already accelerating in five of the eight major sub-groups of the CPI, accounting for nearly three-quarters of the index. Wage inflation is accelerating in service-providing industries, where the employment recovery is completed, accounting for 84% of the labour force. We believe inflation in the U.S. is bottoming, and will reach a 2.5% year-over-year clip by the end of the forecast horizon.

"Markets are vulnerable to an unexpected inflation comeback – we think this will be the next surprise."

We expect the Fed will begin responding late in 2004 with modest rate hikes at first. And sooner or later, U.S. policymakers will have to address the serious fiscal imbalance on their hands. The upturn in the economy has barely made a dent, but no one wants to talk about measures for improving the situation before the November election, so action on this front will not likely occur during this forecast horizon.

Euroland cannot keep pace with global growth

Euroland will continue to struggle over the next 12 months and inflation will remain at its 2.0% level. The strong euro has kept the recovery in Euroland from broadening, and deflationary pressures still prevail. We do not expect much growth from this region. We are forecasting 2.3% GDP growth over the next 12 months, driven mainly by consumption, business investment and exports.

As a result, we expect earnings growth momentum to slow markedly in Europe. Since most large money-losing companies are back to positive earnings, the potential for leverage is greatly diminished and earnings should grow by 11.5%, down from 47.6% over the last 12 months.

On the other hand, we believe we'll see further growth from the U.K. as consumers continue to spend strongly. We expect GDP growth to reach nearly 3.0% by early 2005, and for inflation to stabilize around its current level of 2.6%.

Japan is resurfacing

The positive surprise we projected from Japan for 2004 has already taken root. Reaching a 13-year high 7% annual GDP growth pace last quarter, Japan's exports and business spending are fuelling its economic recovery. However, the country is not out of the deflationary woods just yet. We believe that growth will continue to come from these important sources, and that inflationary pressures in the service industries will outweigh the continued deflation evident in goods, bringing the overall inflation rate to 0.5% over the next 12 months. GDP growth in Japan should reach 2.7% by early 2005 as Chinese consumer demand begins to play a bigger role.

Japanese earnings have improved with the economy, and we expect non-financial company profits to accelerate. Banks have written down a good portion of their bad loans and are rapidly improving their earnings.

We expect the Bank of Japan will maintain its easing policy, expressed by intervening to prevent the yen from appreciating strongly and keeping interest rates at zero.

Consumers to drive Chinese growth

Although Chinese policy makers have attempted to cool down the overheating real estate market, we do not expect them to take any action aimed at the currency over the next year. The Bank of China is focused on employment growth and reform in the banking sector in 2004.

"In short, China's consumption boom has just started."

Over the next 12 months, we expect China's growth to take on a different mix, with consumer spending taking the lead from exports and business spending. Household wealth in China has roughly doubled in the past five years but spending has only increased 56% over that time period and now accounts for only 20% of GDP. In short, China's consumption boom has just started. Inflation in China is not yet a concern, and is primarily driven by food prices.

Risks:

Disappointing Growth: Global growth slows to its long-term trend and inflation falls further as the two engines of global growth – China and the U.S. – falter. This would postpone the need for any Federal Reserve tightening and convince other central bankers to follow suit, resulting in an easier global monetary policy stance. Disappointment over the cyclical slowdown would be felt around the world, although the relative performance of the regions would remain intact, with Asian countries leading and Europe lagging.

Global Productivity Shock: Good times roll without inflationary pressure as improving labour market conditions in the emerging world offset weakness in the industrialized world. Central banks remain on the sidelines or even cut rates, giving way to an easier global monetary policy stance and abundant liquidity. Regional disparities are magnified – those countries with flexible labour markets (U.S. and Asia-Pacific countries) would do significantly better than those with weak labour market conditions, where consumer spending would also suffer. Europe would likely be the hardest hit.

Signposts:

- Global inflation
- Labour market developments
- Monetary policy changes
- Currency market developments
- Oil and energy prices

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Currencies

The tenets of our last forecast have held true so far in 2004: major currencies have stabilized in a range consistent with a U.S. dollar cyclical bottom, and Asia-Pacific currencies have outperformed European ones. However, we did not expect to see as much weakness in the Canadian dollar nor strength in the British pound as we have seen over the past quarter.

Our baseline forecast for continued global reflation requires very few currency strategy revisions. Outperforming the U.S. dollar will be a set of strong, growing currencies with positive cyclical backdrops and relatively cheap valuations, whereas European currencies are expected to lag. We expect the Canadian dollar to reach the U.S.$0.80 level over the next 12 months.

"We expect the Canadian dollar to reach the U.S.$0.80 level over the next 12 months."

The most notable changes in our thinking are tied more to the alternate scenarios. We have ruled out the "U.S. dollar crisis" scenario after concluding it is too early for Asia to revalue since Japan is committed to stabilizing the yen-dollar rate in order to prevent the return of deflation, and China will continue to avoid any tightening measures until it has further stabilized in a range of areas. Other Asian countries will follow the lead of China and Japan.

It has also become evident over the past quarter that Non-Asian countries have reached their pain threshold over a weak U.S. dollar. Through rate reductions, pointed rhetoric, or postponed tightening, central banks around the world have made it clear that they will intervene before a U.S. dollar crisis could materialize.

A key assumption in our baseline forecast is that energy prices will fall 12-15%, which is equivalent to the average price over the last 12 months. If they do not fall as we expect, currencies sensitive to global demand will fare poorly. These include most Asian currencies. Now that the U.S. dollar has stabilized (and therefore the Chinese renminbi), the rest of the world would feel the impact of higher energy prices, especially the fast-growing countries.

Risks:

Disappointing Growth: A cyclical slow down around the world would keep inflation concerns off the radar screen and cause central banks to maintain an easy global monetary policy stance. This would not have major implications for currency markets, as commodity- or Asia-sensitive currencies would outperform and European currencies would lag.

Global Productivity Shock: A redistribution of labour to emerging economies would choke growth in countries with less flexible labour markets, namely Europe and Canada. Much like they did throughout 2003, currencies would fluctuate in a wide range and the performance divergence between Asian and European currencies would widen.

Signposts:

- Commodity and energy prices
- Global inflation
- Labour market developments
- Interest rate spreads
- Monetary policy changes