



March 31, 2006

EXPECTED RETURNS

For the 12 month period ending March 31, 2007	In Canadian Dollars			In Local Currency		
	Stagflation	Economic Rebalancing	Disinflation	Stagflation	Economic Rebalancing	Disinflation
Probabilities	20.0%	60.0%	20.0%	20.0%	60.0%	20.0%
Canada Money Market	3.8%	3.9%	3.6%	3.8%	3.9%	3.6%
Canada Bond	-0.2%	4.7%	7.0%	-0.2%	4.7%	7.0%
International Bond	10.6%	-1.5%	12.5%	-0.9%	1.8%	7.9%
Canada Equity	-13.2%	4.8%	9.2%	-13.2%	4.8%	9.2%
U.S. Equity	-4.4%	3.6%	19.2%	-10.6%	8.1%	16.1%
International Equity	4.8%	5.2%	19.7%	-6.4%	9.1%	14.8%
Emerging Market Equity	-13.4%	6.3%	25.3	-19.0%	10.9%	22.0%

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Emerging market equities are outperforming all global markets

Fixed Income vs. Equity

Moderating economic growth, a modest uptrend in inflation and still-healthy corporate profitability should continue to provide an environment that favors equities over bonds.

Regional Outlook

Emerging markets still offer a 20% valuation discount compared to developed markets as well as better earnings growth potential.

Currency

We are forecasting a ceiling for the U.S. dollar, that is, it has reached its peak and will likely remain in a trading range against the major currencies

GLOBAL ENVIRONMENT

In the final quarter of 2005, we adjusted our asset allocation to reflect the fact that our views about the global outlook had significantly changed. So far into 2006, our Global Rebalancing theme is largely playing out as anticipated.

For starters, international equities have widely outperformed international bonds. Second, in line with our strategy, U.S. equities have significantly underperformed Canadian ones. Third, while global bond markets have experienced a sizeable pullback, Canadian bonds have survived the storm relatively unscathed.

Last but not least, emerging market equities have continued to widely outperform U.S. ones, providing a substantial boost to performance.

FIXED INCOME VS. EQUITY

Around the world, central bankers are busy hiking rates or seriously thinking about it. In this environment of slowly tightening liquidity conditions, global growth is expected to gradually slow, with potential pockets of weakness in the U.S. and China being offset by stronger growth in other areas, particularly Japan, Europe and South East Asia. Even if global liquidity conditions are becoming less favorable, they won't be turning restrictive for global equities. In other words, the bull market in global equities has further to run but the uptrend will be moderating and be punctuated by more volatile corrections.

The cyclical backdrop remains hostile for bondholders. Slowly but surely, the global monetary policy stance is turning less accommodative. The gradual increase at the short end of the maturity spectrum is exerting upward pressures on the long end of the fixed income markets.

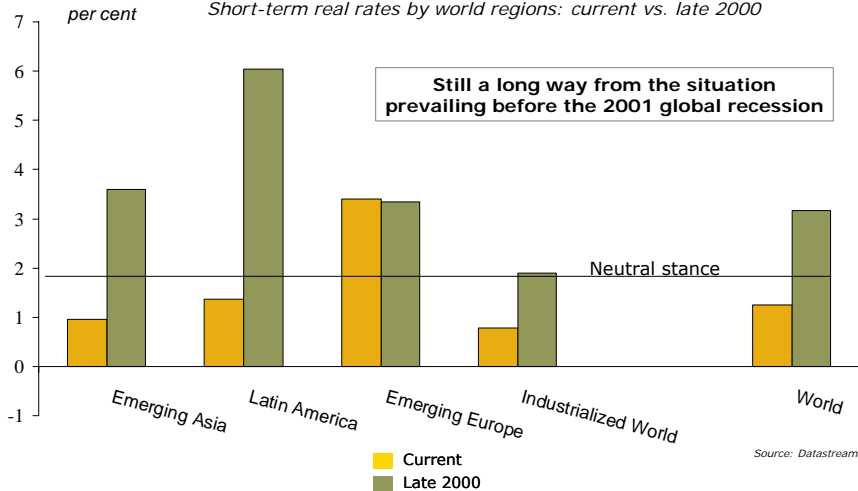
Fortunately, long-run inflation expectations remain well anchored. The end result is a yield curve that remains stubbornly flat. In this kind of environment, we remain comfortable with our underweight position in international bonds and overweight position in international equities. Moderating economic

growth, a modest uptrend in inflation and still-healthy corporate profitability should continue to provide an environment that favors equities over bonds.

Not all central bankers are at the same point in the tightening cycle. The Fed has already increased rates 15 times, moving the fed funds rate from 1% to 4.75%. Given the slow speed of acceleration in U.S. inflation, the Fed is expected to move to the sidelines once the fed funds rate reaches 5.0%. This stable inflationary environment, in conjunction with increasing corporate restructuring efforts will provide equities with a competitive earnings yield relative to bonds. Real interest rates are still particularly low in Europe. The European Central Bank still has a long way to go before its monetary policy stance reaches neutrality.

GLOBAL MONETARY POLICY: STILL EASY

Short-term real rates by world regions: current vs. late 2000



Risks:

Disinflation: Economic weakness is more pronounced than expected, triggering a rally at the long end of the maturity spectrum causing the yield curve in the U.S. to invert and yield curves in the rest of the world to flatten further. In this scenario, riskier cyclical assets outperform more defensive assets and bonds perform better than expected in the baseline scenario.

Stagflation: High energy costs pass through to consumers to a greater extent than expected and the resulting inflation surprise triggers a sell-off at the long end of the yield curve causing the yield curve in the U.S. to steepen. The sell-off in bonds sends a negative signal to equity markets as growth in earnings is threatened and fears of recession grow. This would present a challenging environment for all asset classes, as risk premiums would rise. Low risk defensive assets outperform the more cyclical assets, reversing the trend established over the past three years.

Signposts:

- Inflation and inflation pass through
- Central bank policy, particularly the U.S. Federal Reserve policy
- Consumer spending
- Housing market
- Yield curve changes
- Commodity prices
- Corporate profit margins

REGIONAL OUTLOOK

In recent years, one of our favorite themes has been the long-term out-performance of emerging equities over equities in the industrialized world. This trend has been in place for the last three years with occasional but forceful short-term corrections. The superior performance of emerging world equities has been particularly strong since the end of 2005. As a result, our overweight position in emerging world equities has largely paid off in the first quarter of 2006, with emerging world equities returns exceeding U.S. ones by approximately 5%. Despite their breathtaking ascension, emerging markets still offer a 15% valuation discount compared to developed markets, based on price earnings, as well as better earnings growth potential. What's more, the monetary policy stance is expected to stay particularly accommodative in the emerging world as inflation remains in a downtrend for many of these economies (Asia and Latin America).

Canada

In late 2005, our decision to overweight Canadian equities resulted from our outlook for the Canadian dollar and from our assessment of relative valuations. Since then, Canadian stocks have widely outperformed U.S. ones, generating excess returns of roughly 4% in the first quarter of 2006.

The arguments put forward when this strategy was introduced no longer hold, at least in part. For one thing, from a valuation angle, Canadian stocks are no longer more attractive than U.S. stocks. For another, the combined impact of slightly higher short-term nominal interest and lower inflation over the short-term will result in a more important rise in Canadian real rates. The currency outlook is the only development left that favors this strategy. We still expect the Canadian dollar to reach U.S.\$0.89 by the end of 2006. In light of these developments, we will consider changing our overweight position in Canadian equities vs. U.S. equities as we approach our respective index and currency target levels on the TSX and the CAD/USD exchange rate.

The Canadian equity market can no longer be expected to outperform U.S. equities.

After three consecutive years of double-digit returns, the uptrend in Canadian equities is expected to slow. The Bank of Canada is in a difficult position. On the one hand, the current very tame inflation backdrop hardly justifies many more short-term rate hikes. Deflationary import price pressures are intensifying and the projected cut in the GST will pull CPI

inflation down. On the other hand, the longer-term inflation picture is deteriorating. Capacity indicators such as unit labor costs or the output gap show long-term inflationary pressures gradually building. We think that the BOC will be forced to move to the sidelines once the overnight rate reaches 4.0% (representing another quarter point rate hike). Given long-run inflation developments, this will mark a pause in the tightening campaign, not the end of it.

United States

U.S. equities remain one of the relatively more expensive markets and we believe it could be more affected than other markets by economic weakness in 2006. We are concerned that U.S. profit margins are at their historical peaks and could start to decline, and that earnings growth is beginning to slow. These are not characteristics for which we want to pay a premium.

As the Fed enters the final stages of its rate-raising campaign, we expect it to add another 0.25% before taking a very long pause. Given peaking inflation, this leaves real rates to stabilize at a level that would hardly qualify as restrictive.

A cool down in the housing market and a slowdown in employment growth could signal a soft decline in the U.S.

So far, U.S. consumer spending has shown very few signs of weakening. This could rapidly change in the coming months. Home ownership is close to a record high and borrowing has reached historical peaks with most of the consumer debt concentrated in home equity loans. Evidence of a housing cool off is mounting, which places U.S. consumers in a precarious position. At the same time, employment growth is slowing in the U.S., typical of a third year of expansion. In our opinion, the slowdown will be a relatively mild one, qualifying as a soft-landing not a hard one. We believe GDP growth in the U.S. will slow to approximately 3.5% over the next 12 months.

International Equities

So far into 2006, international equities have done remarkably well. Looking forward, we expect the uptrend in these equity prices to remain in place. In fact, we may look to increase our international equity exposure as our baseline scenario unfolds. The opportunity could present itself once the U.S. economy experiences a slowdown. At some point this year, equity markets worldwide could potentially be shaken by the prospect of a hard landing in the United States - particularly if the recoveries in Europe and Japan come into doubt. If that is the case, global equity markets could experience a short-term correction, providing the opportunity to increase exposure.

Japan and Europe

International equity market fundamentals are fairly compelling should U.S. economic growth slow in line with our expectations. Aggressive restructuring activity has allowed corporations in Europe and Japan to increase their trailing Return on Equity (ROE) growth, and some have even reached the levels of U.S. corporations. In 2005, European company earnings grew by more than 30%, which followed earnings growth of more than 40% the year prior. Although some of this growth came from write-off-depressed levels, most of the improvement has come from improving profit margins. This allows profitability to rise despite a weak economic environment. We expect 2.6% GDP growth in Japan in 2006, and 2.0% in the Euro zone.

China

China's objectives are changing. The Chinese government recently introduced a new five-year plan (2006-2010). The previous phase of export-intensive, investment-intensive, wasteful resource-intensive GDP growth of 10% per year will be replaced with a more moderate 7.5% target. This target is essentially driven by increased domestic consumption and more efficient investment guided less by political loans and more by a market-driven financial system.

Growth in China is set to slow. Our forecast calls for 7.5% growth over the next 12 months - that is significantly lower than the upwardly revised 9.9% in 2005. Just as the planned multi-year slowdown unfolds, China will be increasing its efforts to reduce energy intensity. Another important element of the new plan is the objective to reduce energy intensity by 20% in the next five years. Taken together, these two developments point to a substantial slowdown in energy demand growth. These developments are consistent with the projected moderating uptrend in energy prices.

A slowdown in energy demand in China could moderate energy prices.

Risks:

Disinflation: Foreign economies would be negatively impacted by a weaker than expected U.S. consumer demand. Foreign demand is not yet robust enough to compensate for a U.S. consumer slowdown. Foreign bonds would therefore perform better than expected which would go against our current strategy.

Stagflation: Asia would have a tough time under this scenario as U.S. monetary policy would remain tighter for longer and global growth would be slower than in our baseline scenario. This additional reduction in liquidity would also be most negative for emerging markets.

Signposts:

- U.S. profit margins
- U.S. earnings revisions
- U.S. consumer spending and borrowing
- U.S. housing market
- Corporate restructuring activity

CURRENCY

A Cyclical Peak, but no Decline, for the U.S. Dollar

Our forecast of a cyclical peak in the U.S. dollar is unfolding. A period of range trading is more likely than a sharp reversal of last year's gains. The Fed has not signaled an end to interest rate increases yet, but other major central banks have now joined the Fed in tightening monetary conditions. Following in the footsteps of the BoC and the ECB, which both initiated tightening cycles late last year, the Bank of Japan has signaled an end to its policy of quantitative easing, a pre-condition from raising interest rates. Similarly, the Bank of England has all but ruled out another rate increase and the next move could be higher, rather than lower.

Against the backdrop of buoyant global demand and mild interest rate increases around the world, the U.S. dollar is expected to tread water and stay roughly flat. The noteworthy change in the past three months is the growing risk that interest rates may have to rise further, for longer, than was originally perceived. This is creating headwinds for more cyclically-sensitive currencies like the Australian and New Zealand dollars. Emerging market currencies could also run into turbulence, especially if higher interest rates are seen to sap equity market strength and gain traction in slowing world demand. In contrast, a sound fundamental backdrop and strong domestic demand will continue to support the Canadian dollar, which is expected to rise gradually in a 85-90 cent range versus the greenback.

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Overall, we continue to see limited impact from currency changes in the next 12 months.

Risks:

Disinflation: Globalization could continue to work its disinflationary magic. Coupled with weakening consumer demand in the U.S., this could put a ceiling on interest rates and help cyclically-sensitive currencies recover. In this scenario, the U.S. dollar weakens broadly, but modestly.

Stagflation: Growth could fall victim to high energy prices and rising interest rates, but tight world capacity means that inflation may continue to rise, albeit moderately. In this scenario, major central banks have no choice but to keep interest rates in an uptrend, thus increasing financial stress and the risk of capital market volatility. The yen, euro and other "safe haven" currencies do best in this scenario. The risk of a more destabilizing U.S. dollar adjustment also rises. The Canadian dollar could briefly correct back to 80 cents.

Signposts:

- Central bank policy rate expectations
- Commodity prices
- Risk appetite and capital market volatility
- Currency policies of Japan and China
- Relative measures of domestic demand

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