



Meridian Global Investors Inc.

Market Pulse

Fall 2005

OCTOBER IS OVER AND A YEAR END RALLY IS
NEEDED TO SPUR THE US EQUITY MARKET
INTO POSITIVE TERRITORY FOR THE YEAR.

ASSET MIX REMAINS CAUTIOUS

MARKET ANALYSIS, OCT. 2005

Market Performance

| | 3rd . Quarter | Oct. 2005 | Year to date |
|---------------------------|---------------------------------|------------------|---------------------|
| Meridian Composite | 3.64% | -1.47% | 6.44% |
| TSX 60 | 11.71% | -5.56% | 14.38 % |
| S&P 500 | 3.15% | -1.77% | -0.41% |
| SCM Universe | 0.12% | -0.97% | 4.71% |
| Canadian Dollar | 5.06% | -1.65% | 1.63% |
| FPX Balanced Index | 4.19% | -1.99% | 7.57% |

The third quarter was a very good period for Canadian investors as the price of oil soared and the Canadian Dollar followed suit. The result was a red hot energy sector that powered the TSX 60 to a mighty 11.71% return. The bond market viewed this move askance and was basically flat in the face of two Bank Rate hikes. The US market was also reasonably buoyant for the summer months and lead to an S&P advance of 3.15%.

However October played out as most Octobers do, that is by seeing a fall in almost all asset classes for the month. The price of crude was volatile and after the initial ramp up to above US\$70 per barrel in the face of three major hurricanes to hit the Gulf of Mexico the price per barrel fell to under US\$60 by the end of October. This helped trigger a sell-off in the Canadian stock market that saw the TSX drop more than 5.5% in the month. The Scotia Capital universe bond Index fell by 1% and the Canadian Dollar trimmed just over 1%. Notwithstanding the drop in the price of oil the US markets fared only slightly better with the S&P 500 falling 1.8% and interest rates continuing to rise in the face of further Federal Reserve rate hikes.

Capital Markets

The US economy is starting to show the first signs of weakening in three years. There is weakness in the housing numbers and the consumer seems to be showing a slow down in their relentless spending habits of the past ten years. On the supply side however we see no such slowdown and this must mean that inventories are being rebuilt and corporate America is either confident of a rebound in consumer spending or slow to react to consumer weakness. On the global front things are a little brighter with leading indicators showing a rebound of economic activity in both Europe and Asia.

October is a month oft feared by investors as stocks usually fall in that month but it has in the past often signaled the end of a downturn and this year may be no different. The US economy is starting to show the first signs of weakening in three years. There is weakness in the housing numbers and the consumer seems to be showing a slow down in their relentless spending habits of the past ten years. Bulls believe that these stats will cause

the Fed to take a break in their relentless rate hikes and this will be positive for the stock market. On the supply side however we see no such slowdown and this must mean that inventories are being rebuilt and that corporate America is either confident of a rebound in consumer spending or slow to react to consumer weakness. On the global front things are a little brighter with leading indicators showing a rebound of economic activity in both Europe and Asia.

Overall this economic picture is mixed but the investment profile for institutional investors is quite positive as they are coming to the year end with large reserves of cash and a U.S. stock market that is down for the year. There is a fear of missing a year-end rally and this will attract funds into the market over the next few weeks and the momentum should be sufficient to drive the market into a reasonable rally. Bear in mind that this is a year ending in 5 and over the past hundred years the sixth year of the decade has always produced a positive return for US stock markets; call us superstitious but we do not believe that 2005 will be any different, even though in the long run we are much more dubious.

In the Canadian market there has been enough of a sell-off in certain sectors to provide some buying opportunities in both the energy sector and more importantly in the income trust sector. This sector has been severely damaged by remarks from the Minister of Finance Mr. Goodale who has hinted at declaring war on the trust sector in general under the misguided impression that they have somehow robbed the government of its “hard earned” taxes. Reality is that the government will have to eliminate the arbitrage between equities and trusts that is tax related and a better method of doing this will be to increase the dividend tax credit allowable to investors and to leave the tax structure of trusts alone. This is a situation that the current government will likely not have time to address before the next election since the Liberal party finds itself embarrassed and divided by the Gomery Commission Report and we believe that electioneering will push the trust issue to the back pages. There are many income trusts now paying out over 9% and some at 10%, which was unheard of only a few months ago. We believe there is value in these returns.

Sovereign unrest

The main area of unrest, as we write this piece, is France. The riots are all about the bitter and genuine grievances of the Muslim and African communities, who are ignored, demeaned and kept in poverty by a system which cares very little about them. Specifically in this case it is directly related to the daughters of Muslim immigrants who are prohibited from wearing head coverings to school and the lack of jobs for immigrant children in general. This makes one think about the deeper demographic issues facing Western Europe in general and the fact that an aging population, which is xenophobic and nationalist by nature has not adapted to modern realism that the region can only survive through immigration and that the norms of yesteryear have to change. From a market point of view this remains a long term negative for Western European markets. The only way that this situation can improve is that the European population rapidly moves to a more accommodative stance for immigrants and that these immigrants become the consumer of the future. Were this to occur the Western European economy

would become a major driver of the global market, however we are a long way from that mentality at the moment.

Outlook

We continue to feel that the stock market is in the final stages of a bear market rally. This is a dangerous time to enter the market but it is also very difficult to predict with any certainty when these “fifth wave rallies” will end as they tend to be driven by emotion. We believe that the year end rally will take place and were pleasantly surprised by the relative strength seen in the US stock markets in October. However fundamentals have been totally forgotten in the exuberance of the rising market over the past three years and as a result we are cautious about extending our equity exposure for a short term seasonal rally.

Asset Mix Recommendations

Our Asset Mix Model is based on a neutral position of 60% Equities; 20% Fixed Income; 15% alternative asset classes; 5% Cash.

The equity components are further broken down into 20% for each of the Canadian, US and Non-North American markets. The Non-North American markets will include both developed and emerging markets.

The fixed income markets are split into domestic, foreign and inflation indexed positions. Only bonds with “A” credit ratings or superior will be included in portfolios. The real return bonds may include foreign pay issues.

The alternative asset class is made up of assets that have low correlations to the major equity markets of North America (i.e. S&P 500 and TSX/S&P 60). These may include commodities, funds of hedge funds, as well as ETF’s, closed end funds or other suitable instruments that give exposure to non-correlating asset classes (e.g. real estate, timber, metals, energy)

| | Neutral | | Current | | Over/Under |
|---------------------|---------|------------|---------|------------|-------------|
| Equities | | 60% | | 50% | -10% |
| Canadian | 20% | | 20% | | |
| US | 20% | | 10% | | -10% |
| International | 20% | | 20% | | |
| Fixed Income | | 20% | | 15% | -5% |
| Canadian | 10% | | 5% | | -5% |
| Foreign | 5% | | 5% | | |
| Real rate | 5% | | 5% | | |
| Alternatives | | 15% | | 20% | +5% |
| Absolute Return | 5% | | 7% | | +2% |
| Inflation Hedge | 4% | | 10% | | +6% |
| Real Assets | 3% | | 3% | | |
| Private equity | 3% | | 0% | | -3% |
| Cash | | 5% | | 15% | +10% |

We have not altered our asset mix targets over the past quarter. We are aware that we may miss the opportunity of leveraging the year end rally but this is market timing to an extreme and we are more comfortable looking for long term trends. We expect the US equity market to fail in the early part of 2006 and the economy is questionable thus the energy market may fail as well giving the Canadian equity market an uncomfortable ride



as well. Thus our asset mix remains underweight equities, particularly in the US, and underweight Canadian fixed income. We are overweight inflation hedges and absolute return assets. During the course of the next quarter we expect to lighten up on our energy exposure and replace it with exposure to gold.

Malcolm Gilroy

Richard Kang

Jamie List

Meridian Global Investors Inc.
162 Cumberland St, Suite 300
Toronto, Ontario
Canada
M5R 3N5

Tel: 416-963-7378

Fax: 416-963-7379

www.investmgi.com

e-mail: mgilroy@investmgi.com

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