NATCAN WEEKLY MARKER

November 16, 2007

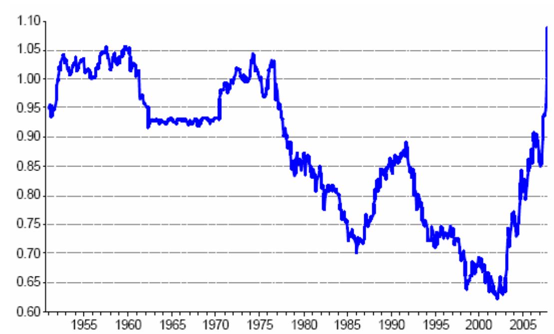
WHEN DUCKS FLY VERTICALLY

In Canada, the Investment Story of the Year award belongs to our currency, the loonie. Its latest appreciation relative to the U.S. greenback has been unprecedented. This week's edition of the Marker depicts the current situation in an effort to improve investor understanding of what may come next.

CAD VS. USD: TWO PARALLEL ONE-WAY STREETS

From the start of the year through November 12, the Canadian dollar appreciated 24% against its U.S. counterpart. In early November, the loonie reached US$1.10, a level that had not been witnessed since the 1870's. This reflects the many envious economic achievements of our country over the past five years. Indeed, in a strong virtuous cycle, Canada has experienced robust economic growth fueled in part by high commodity prices, which in turn led to a trade surplus and the lowest unemployment level in three decades. The federal government has accumulated a large budgetary surplus, and economic growth remains superior to that of the U.S. These factors definitely justify a strong currency; yet, the magnitude of the move indicates something else must be at play. One cannot ignore the fact that the relative outperformance of our currency is in part attributable to the weakness of the U.S. dollar. Indeed, the greenback has been depreciating against a broad range of trading partner currencies since 2002. Investors are well aware of the U.S.' unparalleled trade deficit and war-related budget deficits, but another critical factor has also been interest rate differentials as low rates in the U.S. - necessary to counter the effects of the tech bubble implosion - made other currencies, including ours, more attractive.

CAD/USD

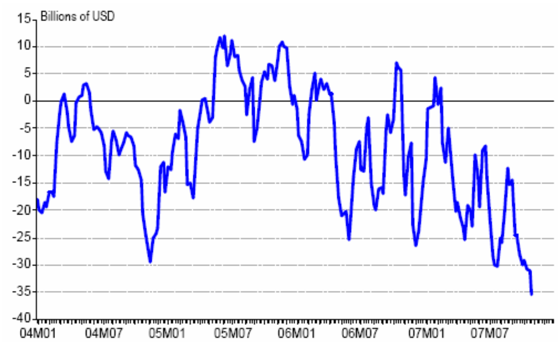


Source: NBF Economic Research

THE ROLE OF SPECULATORS

The Canadian dollar is one of only two widely traded petro currencies (along with the Norwegian Kroner). It is the only petro currency traded in the time zone in which the majority of hedge funds and major banks operate most actively. We therefore cannot ignore the impact of currency speculators actively betting against the U.S. currency, thereby adding to the loonie's momentum. Such betting has become a staple trade for speculators and a one-way bet for well over 12 months, as evidenced by the attached chart. The issue with attempting to use the Canadian dollar as a proxy to speculate on the price of oil is that the related economic reality is quite different. Canada certainly exports large volumes of crude oil, but it also imports vast quantities. Net trade surplus on oil amounts to less than 1% of GDP. Speculators may be mistaken in assuming a bet on rising oil prices equates a bet on a rising loonie as they could be missing the more important link with other basic materials.

Net Speculative Positions on the USD



Source: NBF Economic Research

With so many large investors having piled in on a bet against the U.S. dollar, one cannot help but wonder whether the coming weeks will see profit taking, ahead of year-end performance reporting, reverse at least some of the loonie's appreciation.

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A country's currency most closely represents its "stock price" as set by investors. Economic fundamentals explain the diverging paths taken by the Canadian and U.S. dollars over the past several years. Currency trends often get exacerbated on the up and down side. Major currency moves are usually ended by coordinated central bank actions. With the Canadian dollar trading at levels exceeding 30-year highs and the U.S. currency poised for a bounce, it may be time to avoid further speculative bets and focus on maintaining discipline relative to international equity allocations.

Michael Quigley, CFA
Senior vice president, Distribution

FINANCIAL MARKETS

RETURNS AS AT NOVEMBER 12, 2007 (%)	MTD	QTD	YTD
S&P/TSX	-6.97	-3.33	7.51
S&P 500	-7.21	-10.48	-16.61
S&P/TSX Small Cap	-8.45	-5.45	0.30
Russell 2000	-6.88	-9.04	-19.90
MSCI EAFE	-3.69	-4.33	-7.56
MSCI World	-4.69	-6.11	-10.41
Scotia Capital Universe	0.47	1.10	2.03

	RATES AS AT NOVEMBER 12, 2007
CAD/USD	0.97
CAD/Euro	1.40
US Treasuries yield 10-yr/30-yr	4.22/4.60
GOC bond yield 10-yr/30-yr	4.21/4.33
Fed Fund Rate (target)	4.50

Note: Returns in Canadian dollars, London 4h exchange rates. Source: Datastream, PC Bond.

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