

JARISLOWSKY FRASER LIMITED

INVESTMENT OUTLOOK

1st QUARTER 2012

Executive Summary

Economic Review

- Significant deleveraging has resulted in modest economic growth rates for most of the developed world.
- Growth rates in developing economies have also decreased as exports to developed countries have declined due to decreased spending.
- Extraordinary events continue to fuel volatility of investment returns and economic growth.

Investment Outlook

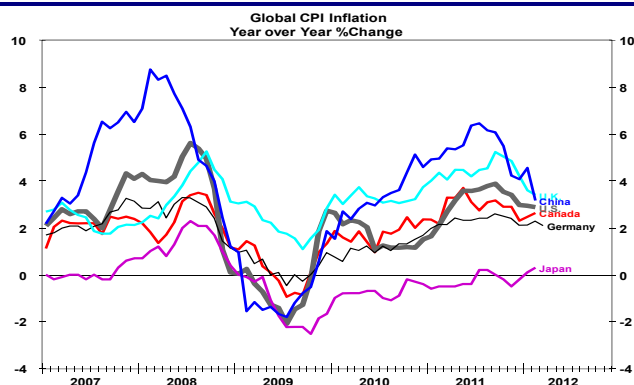
- A number of potential “bumps” remain along what is expected to be a very long road of deleveraging for the major economies.
- We continue to see value in equities, with an emphasis on dividend yields and non-cyclical growth.
- Corporate spreads remain attractive, where bonds are required.

Economic Outlook

For some time now we have suggested that significant deleveraging would result in modest economic growth rates for most of the developed world. This has proven to be the correct forecast and we see no reason to change our view. There have however been “bumps” along the road and there is little reason to believe that extraordinary events will not continue to fuel volatility, not only in terms of economic growth, but investment returns as well.

The event most focused on in 2011, was the potential for a disorderly default of Greece and the damage that would have been done specifically to the German and French banks which held most of its sovereign debt. The solution came in the form of an unprecedented issuance of European Union backed bonds, a forced “haircut” to existing bondholders and significant fiscal restraint on Greece. This long drawn out arrangement has given the banking system a chance to reliquify balance sheets to the point that any future situation (or orderly default) should be manageable. We believe that the restraints imposed on the Greek economy will lead to further economic contraction and, most likely, some form of default. Other potential “bumps” include more economic distress in Portugal, Spain, Italy or even Ireland. Politically driven events such as an Israel-Iran clash also continue to linger.

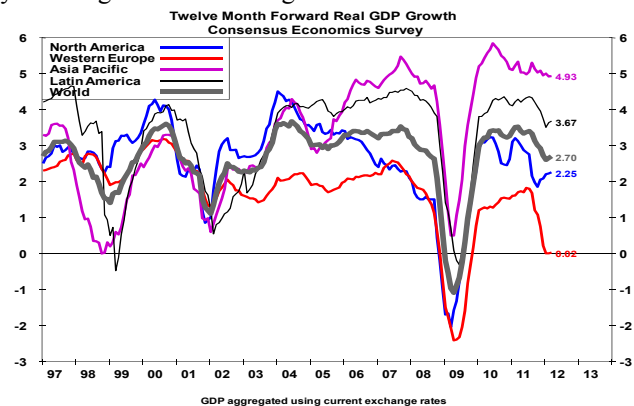
Central bankers globally have been accommodative in keeping short term interest rates low and by artificially dampening any increase in long term interest rates (quantitative easing). The flood of money has helped avoid further economic crises and thus far has done so without fueling inflation in the major economies.



Last summer the fears of a zero growth environment in North America were prevalent, today growth has materialized, with real GDP growth rates of between 2-3% in recent months. Unemployment rates have declined from 9.1% to 8.3% in the U.S. and remained steady in Canada. Further, the U.S. Federal Reserve chairman has indicated that he has no intention of being early in raising rates and therefore damaging what he feels is still a relatively fragile recovery. Other central bankers have expressed the same sentiment.

Europe and the U.K are not quite as well off, with significant austerity in a number of countries dragging growth rates down to near recessionary levels. This is nevertheless considered a better outcome than the potential catastrophic economic events that clouded most of Europe last year.

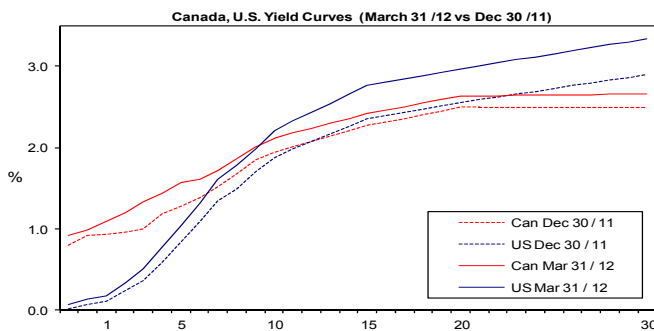
Over the last few quarters we had suggested that the developing nations, which have been fuelling much of the global growth in recent years, would experience slower growth as inflation rates were rising in these countries and their export customers (the developed nations) spent less. This forecast appears to be holding true, with perhaps better than expected results in some countries such as China, where GDP growth has so far been managed downward to the 7% level. Policy in China is now focused on domestic consumption and quality of living, as opposed to pure infrastructure spending. This will most likely reduce the intensity of raw industrial commodity usage and consequently put further pressure on commodity prices, already weakened by slower global economic growth.



Investment Outlook – 1st Quarter, 2012

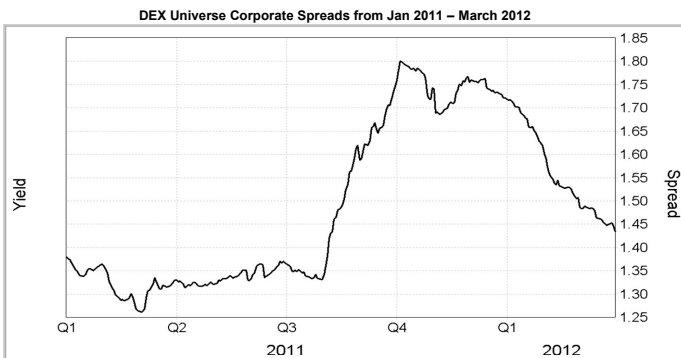
The transition to slower global growth and deleveraging can result in a more volatile economic environment as governments must act similarly to corporations. As an example, if a profitable and growing company with a clean balance sheet enters an unexpected slow growth environment, the cutbacks on expenditures and employment tend to be more manageable and less severe. The company simply has the strength to absorb any short term pain. A similar event on a highly levered, low growth and low margin company (or a highly indebted country) must result in more drastic action. Its reduced profitability has a greater potential of driving the company to a deficit or an untenable debt position, where lenders force more drastic action. There is no reason to believe that sovereign debt holders will not demand even greater austerity measures, or higher interest rates going forward, hence our cautious outlook.

Bond Markets



Short term interest rates did not move during the quarter. The ending of quantitative easing programs in the U.S., which resulted in bonds being purchased to suppress long term interest rates, has however helped U.S. bond yields move up closer to existing inflation rates. Longer term yields in Europe and Japan remained relatively flat as central bank purchase programs still exist.

While the major North American bond indices achieved negative rates of return for the quarter, the corporate bond sector managed to provide some small positive returns. After widening considerably in the later half of 2011, corporate spreads (i.e.: yields provided to corporate bonds in excess of government bonds) declined dramatically in the first quarter of 2012. Although it is our view that the outcome of Greece's refinancing should have little bearing on Canadian corporate spreads, it appears the agreements related to Greece brought comfort back into the bond markets.



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Equity Markets

It was a very strong quarter for equities with double digit returns achieved by many indices. Smaller capitalization stocks and emerging market regions performed best, as is often the case when markets move aggressively upwards. A combination of some resolve with regard to Greece, a pick-up in U.S. economic growth and valuations that reached historically low levels spurred markets upward.

Market Returns - Periods ending March 31, 2012

(%)	3M	1 Yr	5 Yrs	10 Yrs	15 Yrs
S&P/TSX	4.4	-9.8	1.7	7.2	7.4
S&P 500 (C\$)	10.5	11.5	-0.9	-0.6	3.8
S&P 500 (US\$)	12.6	8.5	2.0	4.1	6.1
Russell 2000 (US\$)	12.4	-0.2	2.1	6.5	7.5
DJIA (C\$)	6.1	10.2	-1.5	-2.3	2.5
DJIA (US\$)	8.1	7.2	1.4	2.4	4.8
MSCI EAFE Net (C\$)	8.8	-3.2	-6.2	0.9	2.0
MSCI EAFE Net (US\$)	10.9	-5.8	-3.5	5.7	4.2
Shanghai (US\$) China	2.9	-18.2	-1.3	8.1	6.1
BSE Sensex (US\$) India	17.7	-20.5	3.9	18.9	9.0
EAFE Emerging Mkts (US\$)	14.1	-8.5	5.0	14.5	7.5
Dex Bond Universe	-0.2	9.8	6.1	6.6	6.7
DEX 91 Day T-Bills	0.2	0.9	1.8	2.4	3.1
C\$/US\$	1.9	-2.7	2.9	4.8	2.2

Converted to Canadian funds using London 4PM rates.
Returns are annualized for periods greater than 1 year.

Investment Strategy

The preference for equities in this economic environment has proven to be the correct call. With central bankers on hold and therefore short term interest rates not expected to move upward for some time, we see little reason to change this view. Long bond yields most likely will remain range bound as inflation is not accelerating in most developed nations and there is also no imminent threat of deflation. Equity valuations moved up from the extremely low levels late last year but still remain undemanding. A conservative approach to equity investing is however warranted, with a continued emphasis on dividend yields and non-cyclical growth. There remain a number of potential "bumps" along what is expected to be a very long road of deleveraging for the major economies. Fiscal policy is still in restraint mode for many governments and will most likely be even tighter in the U.S. post the fall presidential election. Over tightening could certainly send the U.S. toward zero economic growth, as is currently being experienced in Europe. Instability in the Middle East always remains a threat for higher energy prices, which only further pinch consumer spending thereby reducing corporate profitability.

Yields on most fixed income securities hardly cover inflation rates and are negative on an after tax, real yield basis. Despite the significant narrowing of corporate spreads last quarter, corporate spreads remain attractive where bonds are needed. But, once again, quality must be emphasized as low growth environments leave little room for error.