

JARISLOWSKY FRASER LIMITED

INVESTMENT OUTLOOK

2nd QUARTER 2010

Executive Summary

Economic Review

- *Most countries spent massively on short term programs to avoid a potential recession / depression.*
- *With government spending now slowing, the global economic picture is looking weaker than many expected.*

Investment Outlook

- *At best, a muted global economic recovery is expected.*
- *Excessive government borrowings will eventually push interest rates higher, making bonds unattractive. Where bonds are held, quality corporate names (with higher yields) are favoured in today's low rate environment.*
- *Our preference is to own shares of companies where dividends are competitive with bond yields, which should generate growth in the medium term.*

Economic Outlook

In the depths of the recent recession, most countries (developed and developing) borrowed and spent ferociously in order to reduce the likelihood of a more serious recession. Spending was principally focused on fiscal programs that would have an immediate impact, as opposed to programs that could provide enduring and sustainable longer term growth. Now that the bulk of those programs are behind us, economic growth is once again weakening. While this was to be expected, the fall off has been so quick that there are now concerns that a "double dip" recession may be imminent.

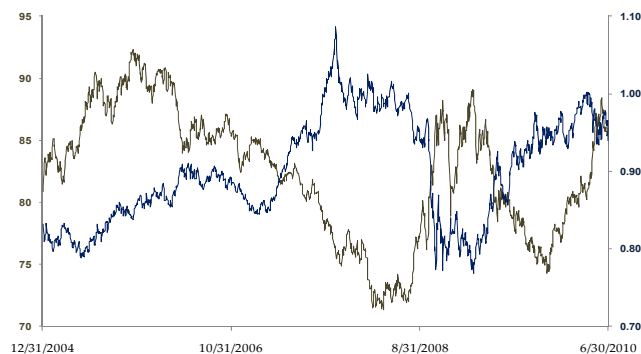
Amongst developed nations, the U.S. was expected to provide one of the strongest rebounds in GDP growth with consensus forecasts of 2.5% for 2010. New home sales in the U.S. dropped 33% in April, while auto sales fell just as dramatically (down 34%). In addition, the unemployment rate has remained stubbornly high at the 9.7% level. All of this will likely lead to slower growth in the second half of the year and weaker 2011 forecasts. Not much was expected from Europe in 2010, as it remained somewhat more disciplined in its fiscal spending. However, problems with weaker Union partners (such as Greece) have forced more sizable borrowings (110 billion Euros for Greece alone), this time with significant austerity measures attached. The end result will be even more modest growth expectations from the European Union. Japan continues its decade long battle with deflation, zero growth and ballooning government deficits and no balanced budgets on the horizon. China was viewed as a global driver toward economic recovery, but its economy too is now slowing as their government takes measures to curb lending and slow inflation.

Meanwhile, the debt hangover remains, albeit in a shuffled form. Going into the recession, consumer debt levels were high, driven mostly by real estate related borrowings.

Mortgage relief has meant that some of what was originally on the consumer's balance sheet has now shifted to government balance sheets. Poorly managed financial institutions have also seen an improvement in their financials at the expense of governments. The G20 meetings concluded with a pledge to cut deficits and stabilize debt levels. This message was largely enunciated by leaders of countries where elections were not imminent and which were, therefore, somewhat more prepared to accept lower economic growth rates. The U.S., for example, facing mid term elections this year, was less enthusiastic about cutting back spending too soon.

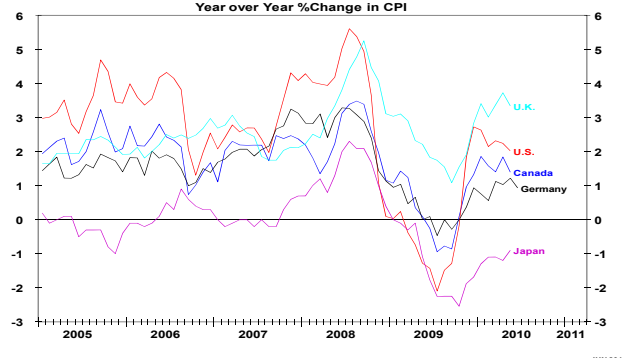
The economies adding debt at the fastest rate (the U.S. and U.K.) were originally experiencing declining currency values. However, with the fragility of the Euro evident through its weaker partners, this trend has reversed. Declining commodity prices have also put pressure on the Canadian dollar.

Trade Weighted U.S. Dollar / Canadian vs. U.S. Dollar



The positive news in recent months is that inflation remains well under control in all of the developed nations and therefore, interest rates have remained low. This is particularly important for governments, as borrowing remains relatively inexpensive and buyers abundant.

Global Inflation



We continue to expect a muted global economic recovery. In Canada, a more favourable environment is viewed with skepticism. An anemic global recovery cannot help but impact our resource sector and, eventually, the highly

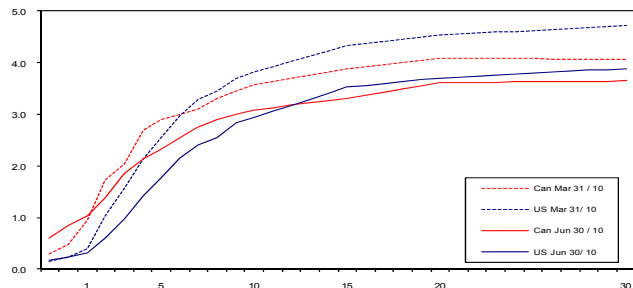
Investment Outlook – 2nd Quarter, 2010

indebted Canadian consumer will also retrench. April GDP growth was flat, with retail sales declining 2%. The abrupt slowdown is dismissed by some, but if the Canadian economy is dependent on trade, it is not insulated from global trends.

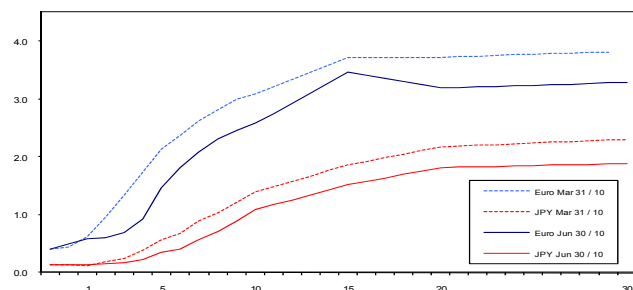
The Bond Markets

Indications of slower economic growth reduced bond yields in most developed nations, despite increases in short term interest rates early in the second quarter by some monetary authorities such as the Bank of Canada.

Canada, U.S. Yield Curves (Jun 30 / 10 vs Mar 31 / 10)



Euro and Japan Yield Curves (Jun 30 / 10 vs Mar 30 / 10)



Corporate bonds did not fare as well as their government counterparts, with spreads (the difference between the yield on corporate bonds and government bonds of a similar term) once again widening. This is a typical reaction when economic growth is seen to be declining, but is surprising given the desire for higher yielding securities.

Indicative Mid - Term Canadian Corporate Yield Spreads (%)			
	31-Dec-08	31-Mar-10	30-Jun-10
Corporate AAA/AA	4.10	0.76	1.10
Corporate A	4.56	1.18	1.39
Corporate BBB	4.71	1.46	1.72

Dex Sector Performance - Returns ending June 30, 2010 (%)			
Dex Sector Index	Q2	YTD	1Year
Short Term	1.72	2.17	4.31
Mid Term	3.30	5.01	8.39
Long Term	5.05	7.78	10.85
Universe	2.93	4.22	6.88
Universe Government	3.17	4.10	5.60
Universe Corporate	2.27	4.52	10.27

The Equity Markets

Equity markets began to correct during the month of May and finished the quarter with negative returns in virtually every market. The largest losses were experienced in Europe (where the declining Euro exacerbated returns) and

in the emerging markets (where lofty valuations proved to be unsustainable).

Market Returns - Periods ending June 30, 2010

(%)	Q2	1 Yr	5 Yrs	10 Yrs	15 Yrs
S&P/TSX	-5.5	12.0	5.5	3.3	8.5
S&P 500 (C\$)	-7.2	4.6	-3.6	-4.8	4.4
S&P 500 (US\$)	-11.4	14.4	-0.8	-1.6	6.2
DJIA (C\$)	-5.7	5.8	-3.8	-3.9	3.4
DJIA (US\$)	-10.0	15.7	-1.0	-0.7	5.2
MSCI EAFE (C\$)	-9.7	-2.7	-1.5	-2.7	0.0
MSCI EAFE (US\$)	-13.8	6.4	1.4	0.6	4.1
Shanghai (US\$) China	-21.4	-17.1	24.0	5.8	10.8
BSE Sensex (US\$) India	-1.6	27.9	19.8	15.6	9.1
EAFE Emerging Mkts (US\$)	-8.3	23.5	13.1	10.3	7.1
Dex Bond Universe	2.9	6.9	4.9	6.6	7.3
91 Day T-Bills	0.1	0.3	2.8	3.0	3.6
C\$/US\$	-4.5	9.3	2.9	3.4	1.7

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

Investment Strategy

Dividend yields now exceed bond yields in some sectors of the market, which would generally indicate a compelling argument for owning equities. However, if economic growth turns negative and corporate earnings decline, then dividends could be at risk and share prices may fall further. Our preference is to own the more stable earning companies, primarily in non-cyclical sectors, where dividend coverage is strong and earnings much more resilient to any potential recession. Share price appreciation will occur once economic growth appears to be sustainable.

Bonds have provided positive returns, unlike equities so far in 2010. Government yields are now at the 3.0% level in both North America and Europe and can be easily distorted by any reluctance on the part of investors to continue accepting new issuances. At some point, indiscriminate government borrowing will force interest rates upward. Similarly, the continued maintenance of low short term rates by central bankers and abundant money supply will lead to higher inflation, which would also result in higher bond yields. Thus, while attractive today, bonds may be only fleetingly so – the upward turn in yields could happen quickly.

Portfolios remain skewed toward equities, with a focus on quality dividend paying companies. Within fixed income, corporate bonds are preferred as spreads are particularly attractive in today's low interest rate environment.

This document is prepared for general circulation to clients of Jarislowsky, Fraser Limited (JFL) and is provided for information purposes only, it is not intended to convey investment, legal, tax or individually tailored investment advice. All opinions and estimates contained in this report constitute JFL's judgement as of the time of writing and are provided in good faith. All data, facts and opinions presented in this document may change without notification. This is not a solicitation for business. Past performance is not a guide to future performance. Future returns are not guaranteed. No use of the Jarislowsky, Fraser Limited name or any information contained in this report may be copied or redistributed without the prior written approval of JFL.