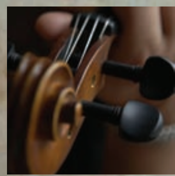




Inside INNOVA

Q3 2010

COMMITTED TO HELPING YOU MEET YOUR INVESTMENT NEEDS WITH CONFIDENCE

Great Expectations: Emerging Markets Come of Age

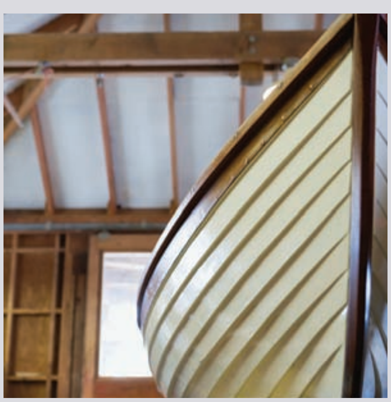
"Buying a stake in emerging markets is like buying a stake in the future."

– *The Economist*

With the 2008 financial crisis and recession in the rear view mirror, emerging market economies are in the driver's seat – fuelling global growth and investment opportunities. Lower debt levels and higher savings rates than many developed nations combined with improving business fundamentals suggest emerging market (EM) economies are getting stronger by getting smarter.

Scotia INNOVA Portfolios were recently rebalanced to reduce fund concentration risk and enhance diversification across specialty mandates. One of the new additions to the Portfolios is Pinnacle Emerging Markets Equity Fund – a specialty mutual fund that seeks to capture the growth potential and diversification benefits of emerging market equities. Through measured exposure to the Pinnacle Emerging Markets Equity Fund, INNOVA now helps long-term investors seize opportunities and manage risk in these dynamic markets as part of an optimally balanced portfolio.

The framework for emerging market growth has been researched extensively – plug 'emerging markets' into any search engine and you'll net a surplus of commentary on the subject. We've gleaned five of the most important themes driving interest in developing economies and their financial markets.



ScotiaFunds®

1. Demographic Divergence

EM nations make up approximately 80% of the world's population and 75% of its landmass. Globally, one in every six people live in India and one in every five live in China. Sheer mass is not the only thing developing countries have going for them; more than 50% of their population are below the age of 25, with millions joining the ranks of the middle class every year.

Implications

Population growth rate estimates for Brazil, India and China are 50% higher than G7 countries over the next five years.[1] A younger, increasingly educated workforce with growing household incomes are fuelling tremendous domestic demand and attractive investment opportunities. Whether it's Wal-Mart's recent announcement to buy a portfolio of low-cost consumer goods stores in South Africa or Mercedes Benz selling more S-Class vehicles in China than the U.S., the EM consumer is a force to be reckoned with.

2. Changing Economic Landscape

As developing countries transition from agricultural societies to manufacturing and service-based economies, their share of global GDP has rapidly increased, growing at double the rate of advanced economies in recent years.[2]

Implications

The aptly-named BRIC subset (Brazil, Russia, India, China) of the emerging markets is paving the way for global growth now – and in the future. China and India are rapidly becoming the dominant global suppliers of manufactured goods and services, while Brazil and Russia rank among the world's leading suppliers of commodities. Longer term, the BRICs are expected to eclipse the combined economic strength of G7 nations by 2032.[3]

3. Lower Debt Levels; Higher Savings Rates

Businesses and consumers in the emerging markets carry smaller debt burdens than their peers in the developed world. Despite rising consumption, household savings rates are higher on average in EM nations (particularly in Asia), allowing for a greater portion of government debt to be financed internally and can translate into a ready supply of funds for capital investment.

BRIC by BRIC – Did You Know?

Brazil is the world's largest producer of iron ore, coffee and ethanol

Russia is the world's largest exporter of natural gas

India is the global leader in information technology and outsourcing

China is the world's second-largest economy

Implications

Contrasting the spending and lending hangover in the U.S. and Europe, EM economies have greater capacity to increase both private and public sector lending. Domestic demand themes including consumption, housing investment, and infrastructure development are key factors underpinning their superior growth prospects. By 2015, the World Bank predicts half of the world's new building construction will take place in China alone. Hosts to both the World Cup in 2014 and the Olympic Games in 2016, Brazil is set to undertake its own infrastructure boom, and the list goes on.

4. Improving Business Climate

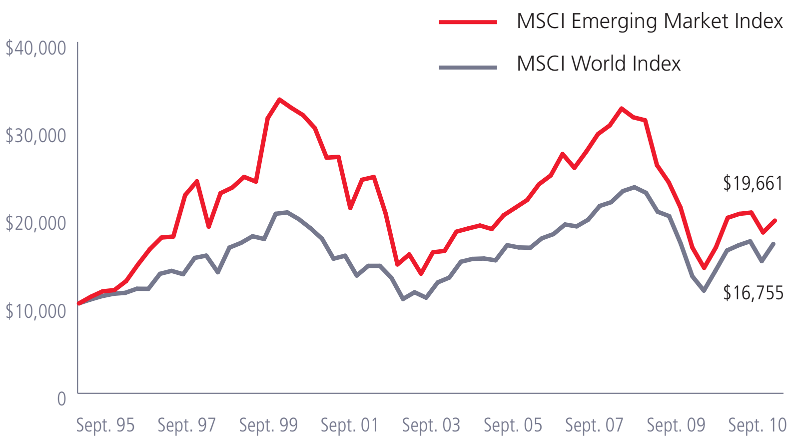
Stricter financial policies have resulted in better-managed businesses and increased levels of foreign investment in many developing countries. Stronger balance sheets, improved management practices and a commitment to maximizing shareholder value have all contributed to a better business and investment climate in EM countries.

Implications

Not only are the emerging markets an economic force to be reckoned with, they are also home to some to some of the world's largest and best run companies. The number of companies from the BRIC countries on the Financial Times 500 list nearly quadrupled between 2006 and 2009, from 21 to 81.[4] Topping the list for the first time in 2010 is China's PetroChina, overtaking Exxon Mobil as the world's most valuable company.

Figure 1

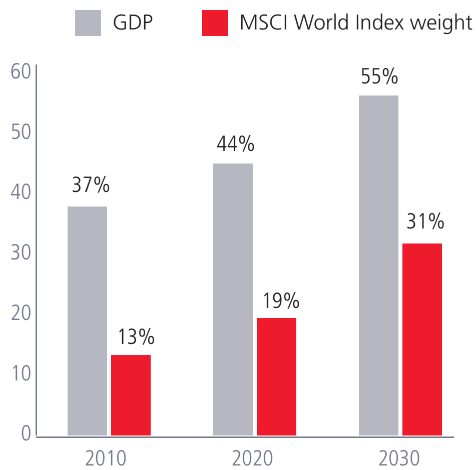
Value of $10,000 invested in the Global Equities and Emerging Market Equities



Based on the annualized rates of returns for the MSCI Emerging Market Index and the MSCI World Index for the 15-year period ending September 30, 2010. Source: Morningstar Direct.

Figure 2

EM Share of World



Source: IMF, MSCI, Goldman Sachs Global ECS Research Estimates

5. Attractive Return Potential

An analysis of EM performance over the past fifteen years reveals attractive relative returns versus the developed markets, albeit at a higher level of risk, as Figure 1 demonstrates.

Implications

Despite their large populations and impressive GDP growth rates, at 13%, emerging markets are still a relatively small weight of the dominant global stock market index. This number is expected to dramatically rise over the next two decades as EM equities are increasingly recognized as an important asset class and source of portfolio diversification.[5] (See Figure 2) Individual and institutional investors are already expanding their portfolios in greater numbers to include EM exposure as they seek potentially higher returns that are less correlated to the performance of developed markets.

1 Source: International Monetary Fund (IMF).

2 Source: International Monetary Fund (IMF).

3 Source: Goldman Sachs, EM Equity in Two Decades: A Changing Landscape.

4 Source: Financial Times, FT500

5 Source: Goldman Sachs, EM Equity in Two Decades: A Changing Landscape.

Scotia INNOVA Portfolios

While there are many positive trends and compelling investment themes underpinning the emerging markets, they are not without their share of challenges. Currency fluctuations and economic and political instability are some of the added risks investors take on when investing in the developing world. Investors are encouraged to speak to their *Scotia*® advisor about these risks.

Portfolio Performance as at September 30, 2010

INNOVA Portfolio	3 Month	YTD	1 Year	Since Inception*
Scotia INNOVA Income Portfolio	4.2%	5.7%	6.9%	10.4%
Scotia INNOVA Balanced Income Portfolio	5.2%	5.3%	6.5%	12.5%
Scotia INNOVA Balanced Growth Portfolio	6.5%	4.6%	5.6%	13.7%
Scotia INNOVA Growth Portfolio	7.5%	3.9%	4.7%	15.7%
Scotia INNOVA Maximum Growth Portfolio	9.2%	2.8%	3.3%	16.2%

* January 19, 2009.

Quarterly Program Review

What happened in the third quarter of 2010?	Outlook
Fixed Income Outlook provided by Scotia Asset Management L.P., portfolio advisor to Scotia INNOVA Portfolios.	
• The Canadian fixed income market started the second half of the year on a positive note, with the DEX Universe Bond Index registering a 3.2% gain in the third quarter. Long-term bonds outperformed short-term bonds (as the yield curve flattened), with provincial notes outpacing corporate issues. • The Bank of Canada continued its trend of raising its target overnight rate to a less stimulative level over the quarter. Much like the recovery of the economy, going forward the pace of this monetary tightening will likely be uneven. • There is no expectation that U.S. interest rates will increase during the fourth quarter, while further yield curve flattening may occur as longer-term rates move lower.	• In Canada, the economy continues to show resilience. Sustained moderate growth married to modest inflation pressures appear to be the course for the Canadian economy for the foreseeable future. However, ongoing weakness in the U.S. economy remains a concern, and has the potential to restrain growth over the near term. • With short-term interest rates at record lows in the U.S., a second round of quantitative easing looms large (i.e. increasing the supply of money).
Canadian Equities Outlook provided by Scotia Asset Management L.P., portfolio advisor to Scotia INNOVA Portfolios.	
• Canadian equity markets, as represented by the S&P/TSX Composite Index , had an outstanding quarter, rising 10.3%. The Materials sector was the top performer, led by strength in fertilizer and base metal stocks. • Consumer Staples stocks outperformed the broad market, along with Utilities as investors search for added yield amid a prolonged period of low bond yields. • Financials underperformed the market as stronger returns from banks and financial companies were offset by poor performance from life insurance companies. The long-awaited Basel III financial regulations were announced in September. The accord represents the agreed-upon minimum capital requirements for banks worldwide. • Canadian banks are well positioned within the required ranges for reserves and as a result should emerge stronger from the cloud of uncertainty that has loomed over the sector.	• The current outlook for Canadian equities is positive for the remainder of this year and heading into 2011. Earnings have for the most part met or exceeded expectations up to the end of the second quarter (third quarter for the banks) and 2011 estimates suggest continued positive growth. • With vast natural resources to fuel growth, reasonable debt levels and a sound financial system, Canada is well positioned to benefit as the global economy moves from recovery into renewed, albeit uneven, expansion. • Amid low bond yields and slim returns on cash, high quality, dividend paying stocks with earnings growth will be an area of focus for investors going forward.
Foreign Equities Outlook provided by Metropolitan West Capital Management, LLC, portfolio manager to Pinnacle American Value Equity Fund, a holding in all 5 Scotia INNOVA Portfolios.	
• During the third quarter, equity markets gyrated but ultimately rebounded from the prior quarter's poor performance with strong returns. In the U.S., the S&P 500 Index rose 8.1%, while in international markets the MSCI EAFE Index (Europe, Australasia, Far East) posted a 12.5% return and the MSCI Emerging Markets Index rose 14.1%, all in Canadian dollar terms. • Investors' concerns over a slower-than-expected second quarter GDP report, a stalled housing market and anemic job growth in the U.S. eased. It has become more evident that strong corporate profits, an improving global credit environment and an accommodating Federal Reserve will diminish the chances of an economic relapse into recession. • Even with decelerating economic growth, output is still expanding, although not at a pace sufficient to quickly improve unemployment figures and remove the wobble in the recovery.	• We continue to believe that the worst of the United States' economic woes may be behind us, but the path back to achieving the economy's full potential may be slow and uneven. • Our bottom-up, research-intensive investment process should allow us to continue to identify attractive investment opportunities that we expect will perform well within the forecasted slow growth, low inflation economic environment. • To mitigate risk, we are careful to diversify the portfolio by position, industry and sector, as well as by exposure to such factors as economic cyclicality and interest rate sensitivity. Furthermore, rather than chasing the "hot" sector, we continue to look for high-quality businesses across all economic sectors in order to add value consistently over market cycles.