Portfolio Strategy Quarterly

SPRING 2005

RBC Dominion Securities

THE STRATEGY PROCESS

The RBC Dominion Securities Strategy Committee is made up of senior representatives from various parts of the firm. The Committee meets regularly to receive input from our four analytical disciplines:

- Economic Overview
- Fundamental Market View
- Quantitative Research
- Trend & Cycle

Considering this input, the Strategy Committee makes a series of recommendations as to how a portfolio should be structured for the coming 12 months, including:

- The optimal mix of stocks, bonds and cash
- The suggested term for fixed income instruments
- A portfolio of approximately 20 stocks, which are collectively expected to outperform the broad market

THE INVESTMENT STRATEGY COMMITTEE

M. Zyblock, *Chair*
J. H. Allworth, *Vice-Chair*

J. Anania
G. Ezekowitz
R. Hanson
A. Scace
R. Sluymer
S. D. Walker
D. Wolf
C. Wright

TABLE OF CONTENTS

ABOUT THIS PUBLICATION

This publication, *Portfolio Strategy Quarterly*, summarizes the conclusions and forecasts of the Strategy Committee to provide a practical framework for the management of private clients' individual portfolios.

PORTFOLIO STRATEGY QUARTERLY

Editor: Jim Allworth
Vice-President & Director,
RBC Dominion Securities

Portfolio Strategy Quarterly is published by RBC Dominion Securities Inc., Royal Trust Tower, 77 King Street West, 5th Floor, Toronto (Ontario) M5W 1P9.

STRATEGY SUMMARY & RECOMMENDATIONS

Jim Allworth, Vice-President & Director, RBC Dominion Securities

Historical Range*	Asset Class	Previous	Current	Recommended Action	Expected Returns
0% – 40%	Cash	10%	**15%**	**Above-average cash reserves**	*3%*
10% – 55%	Bonds	25%	**25%**	**Below-average bond commitment**	*1 % to 3%*
40% – 70%	Stocks	65%	**60%**	**Above-average exposure to stock**	*8% to 12%*
**Since inception in 1984*		100%	**100%**		

PROBABILITY OF AN EXTENDED ECONOMIC CYCLE

Economic growth is moderating in response to the gradual removal of the excess monetary stimulation that has been in place since 2001. If inflation remains contained, then central banks will be in a position to stop raising interest rates well before credit conditions become overtly tight. This economic cycle could prove to be an extended one. We look for GDP growth of 3.0% in both the United States and Canada for 2005 and 2006.

BOND YIELDS VULNERABLE

Bond yields are well below where the outlook for economic growth and inflation suggest they should be. They will remain vulnerable to upward correction as long as markets see both the U.S. Federal Reserve and the Bank of Canada as likely to raise short-term interest rates over the year ahead. We continue to recommend below-normal exposure to fixed income markets.

LONG CYCLE FAVOURS STOCKS

The prospect of an extended economic cycle favours equities, and relative valuations between stocks and bonds confirm that view. Increased selectivity and exposure to markets outside of North America are all the more important as the bull market matures. So too is moderating total return expectations for equities. We recommend modestly overweighting equities, unchanged from last quarter.

ASSET MIX SHOULD REFLECT RELATIVE RISKS

We continue to recommend below-normal exposure to fixed income markets, while maintaining a full, but not aggressive, commitment to equities. A higher-than-normal cash component gives a portfolio the capacity to take advantage of any weakness that might develop in either bonds or stocks.

ECONOMIC BACKDROP

MONETARY CONDITIONS

› The Federal Reserve continues to raise rates at a "measured pace" on its way to a neutral monetary policy. We expect that means a Fed funds rate (currently at 2.75%) of at least 3.50% by this time next year; sooner and perhaps higher if the economy re-accelerates.

› In Canada, manufacturing shipments and orders have been steadily weakening since last year's second half under the weight of an elevated currency. At the same time, core inflation has remained within the bottom half of the Bank of Canada's target range (1%-3%). Since last June, this has permitted the Bank to raise its overnight rate by just 50 basis points to 2.50% over a time span, when the Fed was hiking by a full 175 basis points. We look for more of the same in the coming twelve months – i.e., Canadian rates moving up (to 3.00%) more slowly than American.

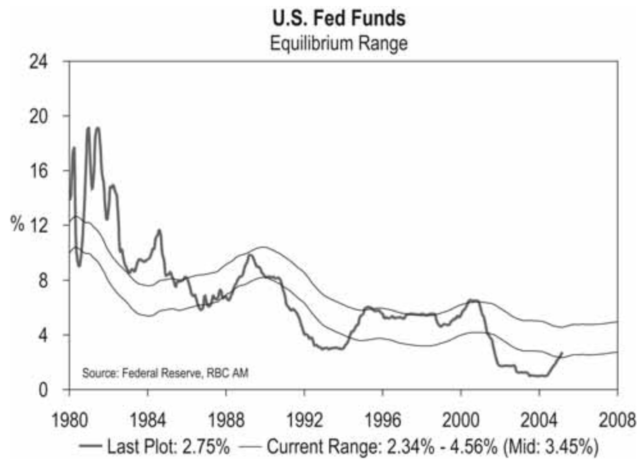
› The European Central Bank (ECB) has left its repo rate unchanged at 2.00%, where it has been for almost two years. Eurozone economic conditions remain sluggish. We look for two 25-basis-point hikes by next spring. For the United Kingdom, where the business and monetary policy cycles are considerably more advanced, and interest rates are commensurately higher (4.75%), we expect a final 25-basis-point hike in rates and then a break in the Bank of England's program.

› The Bank of Japan is committed to "easy money" – official interest rates remain at zero, and the Bank continues to "print" yen at a pace faster than the economy is growing. As evidence mounts, that deflation has been banished, we look for the Bank to implement a modest hike in rates from 0.0% to 0.2%. China continues to pursue policies aimed at slowing the rate of growth of the money supply.

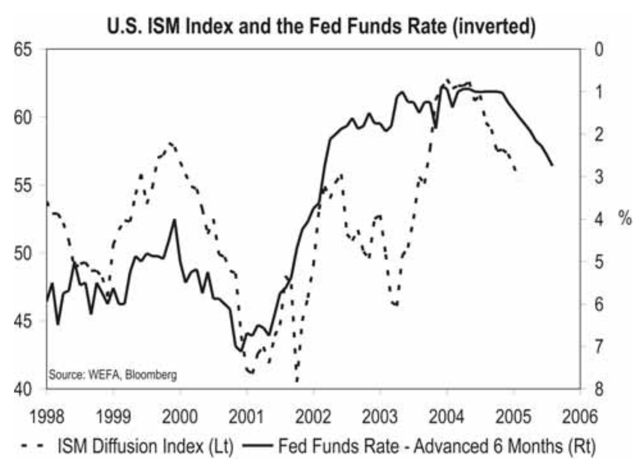
THE GLOBAL ECONOMY

› The steady tightening of monetary policy is nudging U.S. economic growth down toward a more moderate, but sustainable, pace. Imbalances are evident, especially in the trade and fiscal accounts, but they are not sufficient to derail the expansion. High oil prices are not proving to be as big a negative drag as was

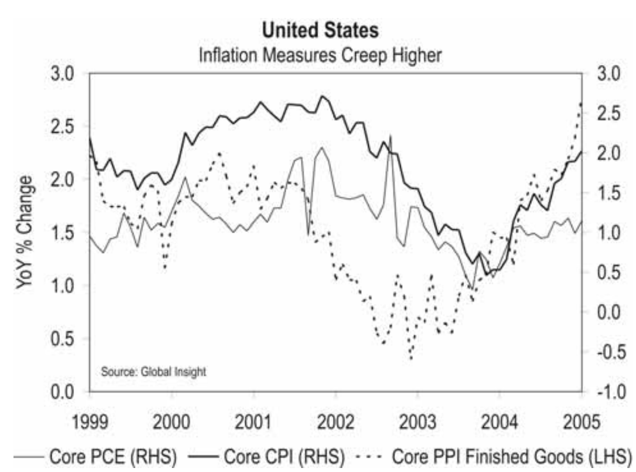
The Fed funds rate has moved into the 'neutral' zone...



...and U.S. manufacturing is slowing somewhat in response.



But inflation pressures will keep the Fed raising rates for some time yet.



generally expected, because, when adjusted for inflation and today's much lower energy intensity of the economy, prices remain a long way below past crisis peaks. Growth should moderate to 3.0% in the coming year, a pace that might be sustainable for some considerable time to come.

- Canada's economy is also forecast to grow by 3.0% in 2005, a modest improvement on the currency-dampened gains of last year. Increased business spending in the commodity/resource sector, together with moderate growth in consumer and government outlays, should more than offset dollar-related softness in manufacturing.

- In Europe, growth will remain well below potential at 2.0% this year, rising to only 2.5% in 2006, but we consider this to be high-quality growth as it masks the structural reform that is gradually unfolding across the zone. The pace of expansion in the U.K. should begin to converge toward that of the Continent as the Bank of England's tighter monetary policy bites.

- In Japan, the recovery has stumbled, but the causes (inventory correction, typhoons, earthquake) appear to be transitory. There continue to be important signs that a sustainable move out of depression has taken hold, notably, strong corporate cash flows and investment, healthier bank lending and rising land prices. For 2005, we look for 1.5% growth in Japan, rising to the 2.5% level next year. The Chinese economy looks capable of maintaining a better-than-8% rate of expansion.

INFLATION

- Higher import prices (including oil) have focused market worries on the potential for a jump in reported inflation in the U.S. So far the core rate, which excludes food and energy, has been rising but is still well behaved.

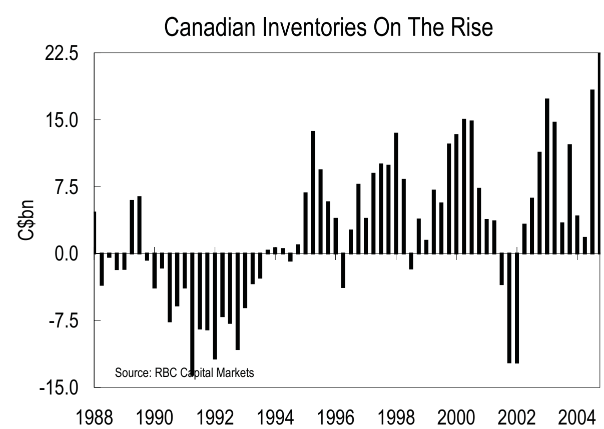
- The forecast moderation in the rate of economic growth in the U.S. should leave inflation hovering near the 2.5% level for this year and next, while the firm currency is likely to hold Canada's inflation close to 1.75% this year, before moving up to the 2.0% level for 2006.

Oil prices are not as high as they seem.

Peak	Nominal Price	Real Price February 2005 Dollars	Real Intensity Adjusted Price
Feb-74	$10.11	$41.08	$59.24
Jul-80	$39.50	$91.61	$123.74
Sep-90	$37.10	$53.62	$64.68
Dec-96	$25.23	$30.51	$34.09
Nov-00	$33.82	$37.26	$39.55
Mar-05	$57.46	$57.46	$57.46

Source: RBC AM

Rolling back the recent inventory buildup will cost Canada some GDP growth in the first half.



REAL GDP GROWTH RATES

Year	Canada	U.S.
2003	+1.7%	+3.1%
2004	+2.8%	+4.4%
2005 est.	+3.0%	+3.0%
2006 est.	+3.0%	+3.0%

INTEREST RATES

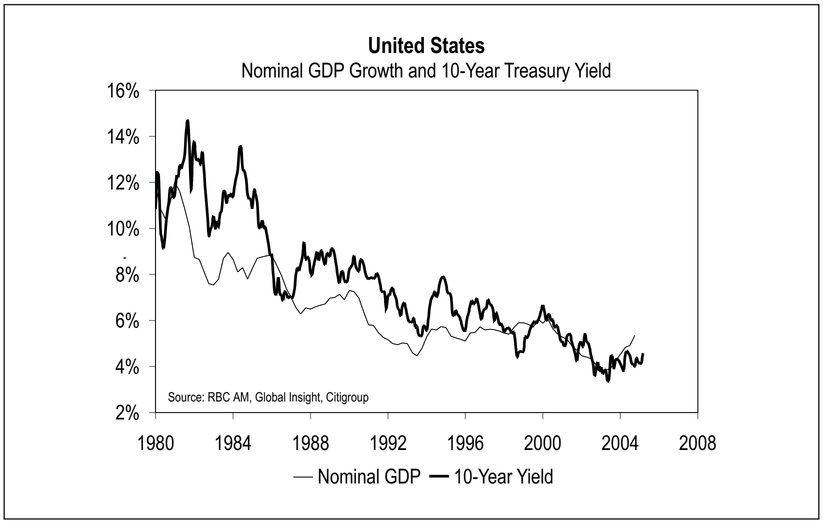
- The prospect for some moderation in the rate of U.S. economic growth will allow the Fed to continue pursuing a measured approach to the removal of excess monetary stimulus that is still in place. We look for a Fed funds rate of 3.50% one year out. If the core rate of inflation were to break above 3.0%, we expect the Fed would become more aggressive, moving rates higher and faster.

- The Bank of Canada has watched manufacturers struggle with a surging Canadian dollar. That, together with developing weakness in the North American auto sector and inflation data that has remained well behaved, will allow it to keep lagging behind the Fed's move to a tighter policy regime. The overnight rate should reach 3.00% one year out.

- Even allowing for the 60 basis-point jump in the final few weeks of the first quarter, U.S. bond yields continue to be well below equilibrium levels, consistent with the outlook for both growth and inflation. We look for a 5.0% 10-year T-bond yield by this time next year versus 4.60% today. The resulting total return of just 1.70% does not adequately compensate the holder for the risk that yields normally would be above even our target or that inflation might not remain bond-market friendly.

- For Canadian bonds, spreads to U.S. yields have disappeared or turned negative. We look for a move up to the 4.75% level for 10-year Canadas, indicating even wider negative spreads are likely as Canada's strong currency dampens growth and inflationary pressures. Here too though, at just 2.20%, total return potential is not at all attractive.

Faster economic growth is dragging U.S. bond rates higher.



But so far Canadian bond yields aren't following.

INTEREST-RATE FORECAST

	March 2005	Forecast March 2006
Canada		
T-Bills	2.55%	3.00%
10-Year Bond	4.45%	4.75%
U.S.		
10-Year Bond	4.60%	5.00%
Europe		
10-Year Bond	3.70%	4.25%

CURRENCIES

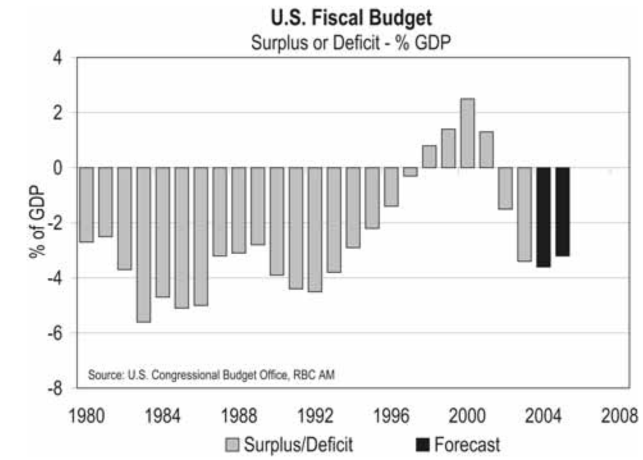
› **U.S. Dollar**—*long-term adjustment not over*
We expect the long-term downward adjustment of the U.S. dollar will continue for another one to three years or until there is some convincing evidence America's current account deficit is narrowing. That said, counter-trend moves in the currency are to be expected and one appears to be underway now, driven by growing market conviction that U.S. interest rates will move up faster than those elsewhere in the world over the coming year.

› **Euro**—*consolidating*
Growing negative interest rate spreads versus the U.S. have allowed the euro to cool off vis-à-vis the dollar over the past few months. For the euro to move decisively beyond its most recent highs, it will require some deterioration in the U.S. economic outlook or a significant upward revision to Eurozone growth prospects. Europe's strong fundamental balances – current account surplus, higher level of personal saving, etc. – argue that recent weakness is no more than a consolidation.

› **Japanese Yen**—*gradually higher*
Intervention by the Bank of Japan has been relatively subdued since last spring, over which time the yen has appreciated moderately. We expect more of the same in the coming months. Recent statements by Chinese officials would seem to rule out a change in that country's currency regime any time soon. Nonetheless, we expect most Asian currencies will be appreciating over the coming year.

› **Canadian Dollar**—*more upside to come*
More moderate growth expectations, together with widening negative interest rate spreads against the U.S., have allowed the Canadian dollar to consolidate within a range over the past couple of quarters. Ultimately we expect strong commodity prices, together with Canada's positive fiscal and current account balances, to push the currency to new highs.

Higher rates from the Fed plus some deficit improvement are helping the U.S. dollar.



The shift to a negative interest rate spread has cooled off the loonie for now.

CURRENCY FORECAST
In U.S. cents

	Today	March 2006
Euro	129	138
Yen	0.93	1.00
Canadian $	82	85

EQUITIES

CORPORATE EARNINGS

› To this point in the cycle, profits have consistently surprised to the upside as strong revenue growth has been augmented by cost cutting and productivity gains. Even 14 months after climbing back to all-time high territory, the consensus looks for S&P 500 earnings growth of 9.8% this year and 10.4% in 2006. This compares to long-term average growth of 6.1%.

› For the S&P/TSX, near-term consensus numbers are even more impressive (up 16.0% for 2005 and 9.2% for 2006), as energy and other commodity prices remain firm. If anything, the profit outlook in Europe and Japan is even stronger.

› These profit forecasts appear aggressive relative to historic norms and may be especially hard to produce in an environment of benign inflation, where significant cost savings have already been harvested. Nevertheless, so far, surprises continue to the upside. At some point, expectations will build, profit growth will slow and disappointments will prevail. Monitoring revenue growth and cost controls is now especially important, as they will provide early evidence of approaching disappointment.

STOCK MARKETS

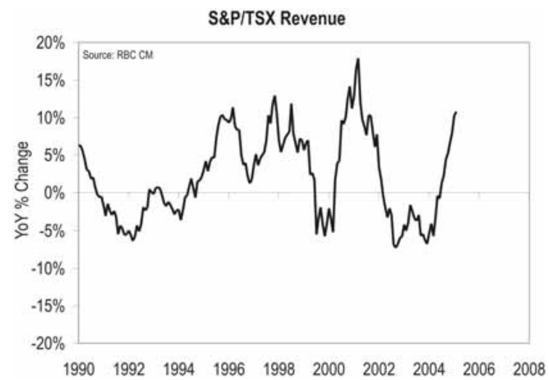
› Now in its third year, the bull market in equities remains intact, and should current earnings estimates be achieved, there will be sufficient profit momentum to drive share prices further. The scale of opportunity, though, is somewhat less compelling today than earlier in the decade. Our global valuation composite shows stocks to be about 13% below fair value, but models for individual stock markets indicate a variety of valuation conditions, ranging from relatively expensive (Canada) to fairly valued (the United States) to undervalued (the Eurozone, Japan, the United Kingdom).

› Increased selectivity and exposure to markets outside of North America are all the more important as the bull market matures. So too is moderating expectations for what returns equities will be able to deliver.

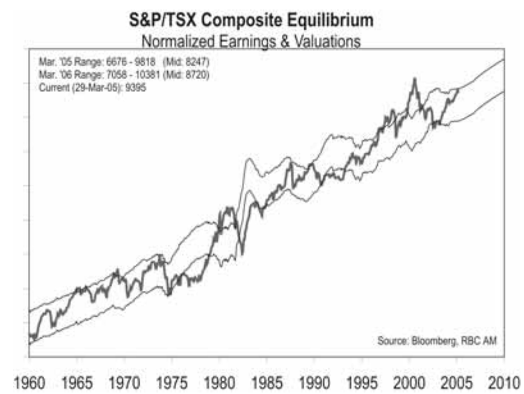
ESTIMATED-EARNINGS FORECAST
(Net of unusual items)

	2002	2003	2004	2005
TSX	$335A	$455A	$550E	$605P
S&P 500	$45.50A	$55.20A	$69.70E	$77.50P

Sales and earnings for TSX companies need to keep moving higher...



...because Canadian stocks are priced at the high side of 'fair value'.



STOCK MARKETS: INDEX TARGETS

	TSX	S&P 500
March 2005	9,395	1,165
March 2006 – Fair Value		
Top of band	10,381	1,618
Midpoint of band	8,720	1,297
Bottom of band	7,058	975
TARGET	10,200	1,300
Estimated Total Return	+10%	+13%
In $CDN	+10%	+10%

Source: RBC Investment Strategy Committee

ASSET MIX

- Bond yields are well below where the outlook for economic growth and inflation suggest they should be. They will remain vulnerable to upward correction as long as markets see both the Fed and the Bank of Canada likely to raise short-term interest rates over the year ahead. We continue to recommend below-normal exposure to fixed income markets.

- The prospect of an extended economic cycle favours equities, and relative valuations between stocks and bonds confirm that view. As a result, we continue to overweight equities in our recommended asset mix, unchanged from last quarter.

Historical Range*	Asset Class	Current	Expected Returns
0% – 40%	Cash	**15%**	*3%*
10% – 55%	Bonds	**25%**	*1% to 3%*
40% – 70%	Stocks	**60%**	*8% to 12%*
**Since inception in 1984*		**100%**	

INVESTOR PROFILE 1

The 40-something investor, newly interested in saving and at a stage in life to do something about it.

GUIDELINES

	Long-Term Target Mix	Min/Max Range
Cash	0%	0%–60%
Bonds	35%	10%–70%
Stocks	65%	30%–90%
FOREIGN	40%	20%–60%

RECOMMENDED ASSET MIX

Cash	**9%**
Bonds	**25%**
Stocks	**66%**
	100%

INVESTOR PROFILE 2

The pre-retirement individual, whose last decade of employment earnings, managed intelligently, will ensure a comfortable post-employment lifestyle.

GUIDELINES

	Long-Term Target Mix	Min/Max Range
Cash	5%	5%–50%
Bonds	45%	30%–70%
Stocks	50%	20%–60%
FOREIGN	30%	20%–40%

RECOMMENDED ASSET MIX

Cash	**10%**
Bonds	**42%**
Stocks	**48%**
	100%

INVESTOR PROFILE 3

The retiree who wants to maintain and enjoy the financial security built up over a lifetime.

GUIDELINES

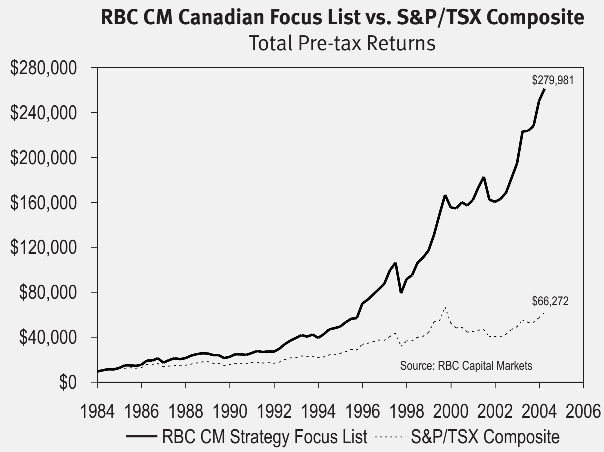
	Long-Term Target Mix	Min/Max Range
Cash	10%	10%–40%
Bonds	65%	50%–80%
Stocks	25%	10%–30%
FOREIGN	15%	10%–20%

RECOMMENDED ASSET MIX

Cash	**15%**
Bonds	**61%**
Stocks	**24%**
	100%

CANADIAN EQUITIES

Matt Barasch, CFA, Portfolio Advisor



The *Strategy Focus List* is comprised of 18 to 21 stocks, which our three-discipline selection criteria (Fundamental Analysis, Quantitative Research and Trend & Cycle) suggest offers solid return potential relative to the risk assumed. This implies that individual stocks may be removed from this list, even though they are still regarded as having good return potential by one or more of our various disciplines. Since its inception (December 1984), our *Strategy Focus List* has outperformed the TSX Composite Index with a compound annual return of 17.9% against 9.8% for the market.

THE STRATEGY FOCUS LIST

INTEREST SENSITIVE

- CIBC
- Manulife Financial
- National Bank
- Power Financial
- Toronto Dominion Bank
- Royal Bank
- Telus Corp.

CONSUMER

- Loblaw Cos., Ltd.
- Thomson Corp.

INDUSTRIAL

- Canadian National Railway
- Finning International
- SNC Lavalin

COMMODITY/RESOURCE

- Inco Ltd.
- Husky Energy
- EnCana Corp.
- Petro-Canada
- Placer Dome
- Potash Corp.
- Suncor Energy Inc.
- TransCanada Corp.

OUR DIVERSIFICATION APPROACH

Measured over the long term, stocks have provided superior returns to any other financial asset class. However, over shorter time periods, equities are the most susceptible to fluctuations in value.

Our approach relies upon diversification to give the best chance of achieving long-term return potential while minimizing the risks presented by near-term fluctuations. We follow three steps:

1. We divide the market into four basic sectors, distinguished by the macroeconomic factors, which tend to determine their outlook. The sectors are:
   - Interest Sensitive (Financials, Communications, Utilities)
   - Consumer (Consumer Discretionary, Consumer Staples, Healthcare)
   - Industrial (Industrials, Information Technology)
   - Commodity/Resource (Energy, Materials)

2. We include core selections from each of the four sectors at all times.

3. We overweight the sectors that offer the best potential for the coming 12 to 18 months, and underweight those not expected to do as well.

	Market Weight	RBC Rec'd Weight	Change
Interest Sensitive			
Financials	32.2%	31.0%	–
Communications Services	5.2%	6.0%	▲
Utilities	1.4%	1.5%	–
Consumer			
Discretionary	6.5%	6.0%	▼
Staples	4.1%	5.0%	–
Healthcare	1.5%	1.5%	–
Industrial			
Industrials	5.8%	7.0%	▼
Technology	5.8%	4.5%	–
Commodity/Resources			
Materials	16.8%	17.5%	▼
Energy	20.8%	20.0%	▲

HIGHLIGHTED STOCKS

INTEREST SENSITIVE SECTOR

The number of Interest Sensitive stocks on the Focus List was increased one position to a total of seven, marking the second consecutive quarter that the weight was increased by one position. Furthermore, while the Focus List remains underweight, the banks and utilities, the weighting in telecom stocks has increased from zero to one position.

FINANCIALS

The Focus List remains underweight Financials, based on the view that profit growth will slow in 2005. As loan losses stabilize or begin to rise (versus a marked decline in 2004), the yield curve continues to flatten, which could negatively affect net interest margins. Valuations remain near historic norms, making multiple expansion unlikely. However, the recent laggardly performance for the banks has created better buying opportunities than existed at the beginning of the year.

Toronto Dominion (TD) is a full-service bank engaged in consumer banking services, mortgage lending, commercial and investment banking, discount securities brokerage and real estate investment in Canada and abroad. TD was quick to reposition its credit portfolio and capital during the last credit cycle and is now able to focus on growth. TD recently acquired a controlling stake in U.S.-based Banknorth (BNK). The acquisition is expected to be immediately accretive to earnings, add best-in-class local management and provide an avenue for further U.S. expansion. Despite one of the strongest domestic franchises, TD continues to trade near the low end of the group on a valuation basis, a discount that is expected to erode over time.

Manulife (MFC) is one of the largest and most diversified financial services providers in Canada, with operations in 15 countries and territories worldwide, offering a wide range of insurance products and wealth management services. Manulife has delivered 10 consecutive years of record earnings growth, registering a 24% compound annual growth rate over that interval. In April of 2004, Manulife merged with U.S. life insurer John Hancock in a $14.7 billion all-stock transaction. While the merger had some early hiccups, the latest quarter was quite strong and the firm's core franchise continues to generate impressive growth.

Royal Bank (RY) is Canada's largest bank. RY provides leverage to capital markets, wealth management and private banking, on both sides of the Canada-U.S. border. Management appears to be executing on its recent corporate restructuring, as demonstrated by the across-the-board strength in almost all business segments in its most recent quarterly earnings report. Further, while the latest quarter beat analyst expectations, the Company appears to have significant flexibility on the cost line, which could provide further upside to estimates going forward.

TELECOM SERVICES

After several quarters of zero exposure, we added one position within the Telecom Services area for the current quarter. While the telephone companies continue to face significant medium-term challenges (including intense competition from emerging technologies), we believe these concerns are reflected in current valuations. In particular, we remain focused on operators with an above-average contribution from wireless, which continues to benefit from a combination of continued subscriber growth, stable/modest increases in Average Revenue Per Unit (ARPU), industry consolidation and lower capital expenditures. As a result, free cash flow is improving significantly.

Telus (T) is the second largest Canadian ILEC (incumbent local exchange carrier), providing data, Internet protocol, voice and wireless services, primarily in Western Canada. Telus provides good leverage to the wireless segment, where penetration is relatively low in Canada, and growth is strong, fuelled in part by sector consolidation and pricing discipline. The Company generates strong free cash flow, which should enable Telus to pay down debt, buy back stock and further increase its dividend.

UTILITIES

The Focus List remains zero weight within the Utilities sector. While dividends remain a strong investment thesis, we believe that the prospect of rising interest rates moderates optimism at this stage. Further, yields on many names in the sector are currently well below historic norms, and thus we continue to look for better entry points.

Other Focus List companies in the Interest Sensitive sector include ***Power Financial (PWF), CIBC (CM)*** *and* ***National Bank (NA).***

CONSUMER SECTOR

The number of Consumer stocks on the Focus List decreased from three to two, moving the portfolio from slightly overweight relative to the index to slightly underweight. Within the subsectors, the Focus List is overweight in Consumer Staples and underweight in Consumer Discretionary and Health Care stocks.

CONSUMER DISCRETIONARY

The Focus List shifted to one position from two at the beginning of the quarter. We remain cautious on the Consumer Discretionary segment because of a lack of consumer savings, rising interest rates and the lack of attractive valuation opportunities.

Thomson Corp. (TOC) is a global information publisher, providing information and solutions to business and professional markets focused on the legal, regulatory, financial, learning, scientific, reference and healthcare markets. The Company has an attractive franchise in the business-critical information industry, solid and growing free cash flow, a growing dividend and world-class management. While the stock has been range bound for some time, we believe that it offers attractive value at current levels.

CONSUMER STAPLES

The Focus List remains at one position, which is a modest overweight when compared to the Index. Pricing power remains elusive within most of the sector, while higher raw material costs put pressure on margins. However, the defensive characteristics of the sector continue to attract investment, especially in light of the run-up in the Canadian dollar, which has put pressure on some of the more economically sensitive names in Canada.

Loblaw Companies (L) is Canada's largest food distributor with $25 billion in revenues in 2003. The company operates principally as Loblaws, No Frills, Zehrs, Fortinos and Atlantic Superstore in Eastern Canada; as Loblaws, Maxi and Provigo in Quebec; and under the Real Canadian Superstore banner in Western Canada. The company is 61%-owned by George Weston (WN). Loblaw's approach rests on five pillars: reinvest cash generated by the business; own store real estate to maximize flexibility; implement multiple banners to maximize market share; focus on food but serve everyday consumable needs; and enhance customer loyalty and profitability through private label offerings. Going forward, the company's recent internal reorganization – which merged merchandising and purchasing operations in Ontario, and consolidated real estate operations in Western Canada – should translate into additional cost savings and synergies for the Company, driving further margin improvement and extending its industry-leading performance.

HEALTH CARE

The Focus List maintained a zero weight in Health Care stocks. The lack of depth within the Canadian Health Care sector continues to make it difficult to find positions that are appropriate for a 20-stock portfolio.

INDUSTRIAL SECTOR

The number of Industrial stocks on the Focus List remains at three, which is overweight when compared to the Index. We continue to recommend exposure to the sector because of several positive fundamentals, including a relatively strong North American spending cycle, transportation backlogs, cash-rich corporate balance sheets and the potential for a decline in energy prices, which could boost margins.

Finning (FTT), the largest Caterpillar dealership in the world, is a well-diversified play on a commodity price recovery and offers indirect exposure to the construction, forestry, mining and petroleum industries. While there are very few mega-projects under development in the world today, two of them are in Finning's territory. One is the oil sands in Alberta, and the other a roads program in the U.K. Finning's third area of focus, South America, accounts for about one-third of the world's copper production. While the latest quarter failed to meet expectations, we continue to like the stock's long-term growth story and diversified geographic exposure.

Canadian National Railway (CNR) is Canada's largest and the most efficient of the major North American railways. The Company generates significant free cash flow, and, over the past few years, has made accretive acquisitions. The Company is extremely well run, has available capacity to meet ever-increasing demand from China and has consistently beat expectations over the past several years, a trend we expect to continue.

INFORMATION TECHNOLOGY

The Focus List currently has zero exposure to the IT Sector. Several names within the sector trade at attractive valuations relative to historic norms, and balance sheets remain cash rich for the most part; however, we remain cautious on committing 5% of a concentrated portfolio to this highly volatile sector.

*The other Focus List Company in the Industrial sector is **SNC Lavalin (SNC)**.*

COMMODITY / RESOURCE SECTOR

The Focus List remains at eight positions, which is overweight when compared to the Index. In light of robust global demand and nearly 15 years of under-investment, the fundamental backdrop for commodity prices remains favourable. While we remain cautious on the risks of a near-term pullback in oil prices, we continue to recommend exposure to the sector, as valuations for certain stocks are still reflective of significantly lower oil prices than currently prevail in the market.

BASIC MATERIALS

The Focus List remains overweight Materials stocks; however, exposure for the current quarter was reduced from five stocks to four. The List is positioned to leverage those areas of the sector that have strong supply/demand fundamentals, good pricing power and exposure to China. While the Focus List has one fewer Materials position than last quarter, we remain constructive on the fundamentals underlying the sector.

Inco (N) is the world's second largest integrated nickel producer, with principal operating mines in Ontario, Manitoba and Indonesia. Continued strength in the nickel market should result in robust earnings and cash flow for Inco in the next 12 to 24 months, while integration of Voisey's Bay into Canadian operations in 2006 should reduce weighted average cash production costs and increase production and cash flow generating potential. While new supply is expected by 2007, much of this supply comes from Inco, which should somewhat offset the downside risks that the Company faces from a decline in the price of the commodity.

ENERGY

The Focus List increased its overweight position in Energy stocks for the current quarter, adding one position. While we expect the price of oil, and to a lesser extent, natural gas to come off of the robust levels of 2004 and early 2005, we believe that valuations for several names within the sector remain compelling. We continue to focus on those companies that have comparatively less capital spending requirements, stock prices close to current net asset values and strong growth profiles.

Husky Energy (HSE) is an integrated oil and gas company with a diverse portfolio of resource assets, including conventional oil and gas, oilsands, heavy oil, midstream (refinery) and downstream (retail) operations. The Company should generate significant production growth in 2006 and 2007 from both the White Rose project and the Tucker Oilsands project. While HSE is leveraged to commodity prices, it does have some downside protection from midstream and downstream assets, while its valuation should be supportive, as it trades at a substantial discount to its peers.

*Other Focus List companies in the Commodity/Resource sector include **Potash (POT)**, **EnCana (ECA)**, **Petro-Canada (PCA)**, **Suncor (SU)**, **TransCanada Corp (TRP)**, and **Placer Dome (PDG)**.*

UNITED STATES EQUITIES

Mark Bayko, U.S. Portfolio Advisor

The U.S. Focus List is typically composed of 20 stocks, expected to do well in the economic and financial environment over the next one to two years. Each exhibits strong fundamentals, a leading position within its industry, attractive relative valuation and the prospect for good performance relative to the market.

INTEREST SENSITIVE

› Goldman Sachs
› Bank of America
› Allstate
› JP Morgan Chase
› Verizon Communications

CONSUMER

› General Mills
› Home Depot
› Baxter International
› Johnson & Johnson
› Walt Disney
› CVS

INDUSTRIAL / TECHNOLOGY

› United Technologies
› General Electric
› Tyco International
› Microsoft
› EMC
› IBM

BASIC MATERIALS/ENERGY

› Air Products & Chemicals
› Exxon Mobil
› Burlington Resources

	Market Weight	RBC Rec'd Weight	Change
Interest Sensitive			
Financials	21.7%	20.9%	↑
Communications Services	2.6%	2.3%	↓
Utilities	3.1%	2.4%	–
Consumer			
Discretionary	12.0%	11.9%	↓
Staples	9.2%	9.5%	↑
Healthcare	12.3%	11.9%	↑
Industrial			
Industrials	11.1%	12.8%	–
Technology	15.0%	14.1%	↓
Commodity/Resources			
Materials	3.8%	4.5%	↓
Energy	9.1%	9.7%	↑

HIGHLIGHTED STOCKS

INTEREST SENSITIVE SECTOR

Financials—The Fed's Open Market Committee continued with their "measured pace" of interest rate increases in the first quarter of 2005, and indicated it is likely to continue doing so in light of heightened inflationary concerns. As a result, mortgage refinancing and the issuance of new commercial loans may slow. Furthermore, financial services companies may be faced with increasing net interest margin pressures as the spread between interest income and interest expense narrows. We have positioned the RBC U.S. Focus List towards companies that benefit from capital markets activity and transaction processing revenue, and away from those that rely too heavily on either net interest margins or mortgage origination businesses.

We remain market-weight Financials and have chosen companies that are well positioned relative to the headwinds we have identified for the group.

Bank of America (BAC) is a diversified super-regional bank offering exposure to consumer, commercial, investment banking and asset management. In 2004, the Company acquired Fleet Boston Financial, which increased the bank's asset base to $900 billion from $700 billion. Approximately 20% of the bank's revenues come from capital markets activities, and the lending divisions have been offering variable rate loans to preserve interest margins in a rising interest rate environment. BAC is well positioned for the current environment, is trading at 11 times 2005 estimated earnings, and has an attractive 4% dividend yield.

Goldman Sachs (GS) is one of the world's leading investment banks and derives the majority of its revenues from capital markets activities. The strong pick-up in both underwriting and mergers and acquisitions activity leaves the company as one of the best positioned for the current environment.

Recent statistics indicated that Goldman Sachs was one of the big winners in securing fee-based capital markets business, which bodes well for near-term results. Goldman's superior earnings growth is expected to persist through 2005.

Other Focus List companies in the Financials sector include ***Allstate (ALL)*** *and* ***JP Morgan Chase (JPM)****.*

Utilities—This group enjoyed a strong recovery in 2004 as generous dividend yields attracted investor attention. High fuel costs have continued to compress spark spreads (a measure of profitability), and after the significant share appreciation, dividend yields no longer look as compelling. We have a market-weight recommendation for the group, but do not have any representation as valuations are above historic norms. Utilities could be challenged by higher interest rates this year.

Communications Services—Shares of telecommunication companies, and in particular the Regional Bell Operating Companies (RBOC's), were under pressure in the first quarter as investors grew concerned about industry consolidation and increased competition from cable company offerings. The Focus List includes **Verizon Communications (VZ)**, the largest U.S. RBOC, which is well placed to contend with a challenging environment, marked by the ongoing battle for customers between cable, telephone and satellite providers. We recommend a market-weight exposure to the group.

CONSUMER SECTOR

Consumer Discretionary—The sector, which includes a diverse mix of subsectors from automotive parts to retailers, is a challenging one as the outlook for consumer spending has been affected by higher oil prices, a reduced impact from tax cuts and the prospect for higher interest rates. Retailers and restaurants have posted some of the most erratic results, largely attributable to higher gasoline prices, while domestic auto manufacturers have struggled with declining market share and rising employee and retiree benefit costs. Despite these well-documented headwinds, any modest abatement in energy costs together with an improved employment picture may help sustain strength in consumer spending in 2005. We recommend an under-weight exposure to the group.

Home Depot (HD) is the world's largest home improvement retailer and the second largest U.S. retailer. The company operates retail warehouse-type stores that sell a wide assortment of building materials, home improvement, and lawn and garden products, primarily to the do-it-yourself and professional contracting markets. Statistics indicate that renovation spending generally peaks four years after a house is purchased, which should translate into a reasonable environment over the coming years. In addition, the company's CEO, Robert Nardelli, has undertaken several initiatives to streamline the business, which has led to significant margin expansion. Home Depot has built an impressive track record of uninterrupted revenue and earnings growth over the last decade.

Walt Disney (DIS) is a media, leisure and entertainment company, which has managed to find its way into almost every family home around the world. The company's theme parks, film division and television networks have benefited from a recovery in leisure and travel spending, box office success and favourable advertising trends, leading to one of the company's strongest earnings recoveries ever. Capital expenditures may subside over the next few years as more theme parks in Asia open for business, which may translate into higher free cash flow. Theme park attendance may also benefit in 2005 from the company's efforts to promote their 50th anniversary of Disneyland. Disney has one of the least expensive valuations relative to its peers (22 times 2005 estimated earnings per share), is expected to earn $1.25 per share in 2005, and should continue to benefit from increases in leisure and holiday spending.

Consumer Staples—Staples companies continue to suffer as competition is forcing companies to increase promotional spending, which in turn is leading to slower earnings growth. Staples stocks are trading at greater-than-market multiples, reflective of the higher earnings growth these companies used to generate. Many companies have failed to deliver successful new product offerings, putting current valuations into question. However, strong balance sheets, healthy free cash flow and the defensive characteristics of the group outweigh some of these concerns and support our market-weight recommendation.

CVS (CVS) is the second largest pharmacy chain in the United States, with over 4,100 traditional pharmacy stores. The company also has a specialized pharmacy care business that caters to clients with special needs and operates a substantial pharmacy benefit management business that offers services to small- and medium-sized businesses. In 2004, the company purchased close to 1,200 drug stores from Eckerd as well as the company's pharmacy benefit management, mail order and specialty care businesses. The company is renowned for its focus on driving efficiencies at its stores and within its distribution channels, which should help in its efforts to turn around the underperforming assets it acquired. With favourable demographic trends, including an aging population and increased usage of prescription drugs, CVS is well positioned for future growth.

The other Focus List company in the Consumer Staples sector is ***General Mills (GIS)****.*

Health Care—Large pharmaceutical stocks continue their lacklustre performance, as regulatory fears, a lack of new products in the pipeline, patent challenges and expiries, and poor execution weigh on stock prices. However, areas outside of traditional drugs continue to offer opportunities, as the industry prepares for the retirement of the baby boomer generation. We remain market-weight in the sector, although the Focus List features no pharmaceutical stocks.

Baxter International (BAX) is a global health care company, which offers products in the areas of anaesthetics, kidney care, hemophilia and medical devices (drug delivery and dialysis). Many of its offerings are sold to hospitals and medical practitioners where the company's proprietary technologies, embedded within products, have allowed it to enjoy higher margins relative to its peers. In addition, Baxter provides the refill products for its devices, which provide it with a growing stream of recurring revenue. The combination of margin expansion and earnings growth generated by new product offerings in the areas of hemophilia treatment and blood separation technology may provide earnings above current projections. Baxter trades at a discount to its other devices peers at under 19 times 2005 estimated earnings of $1.87, and the company's significant cash flow may be used to pay down debt, repurchase shares and/or increase the dividend.

The other Focus List company in the Health Care sector is ***Johnson & Johnson (JNJ)****.*

INDUSTRIAL/TECHNOLOGY SECTOR

Industrials—We remain over-weight in this sector. Corporate balance sheets have unprecedented levels of cash, and capital expenditures, which rose last year, have continued the trend thus far in 2005. At this point in the economic expansion, we have changed our focus toward later-cycle industrial businesses. Although valuations for some stocks within this group appear to fully reflect the ongoing strength in the economy, we continue to find value, especially among the more diversified names.

General Electric (GE) is a diversified industrial company, with more than $130 billion in annual revenue and nearly $40 billion in operating income. Over the past three years, the company has dramatically transformed its business portfolio from one dependent on Finance and Power Systems to one more dependent on higher growth, less interest rate sensitive businesses such as Healthcare and Entertainment. The Company effectively completed this transformation strategy last fall, with the acquisition of Amersham (Medical) and Universal (Entertainment). Through 2005, earnings growth should return to approximately 12%, which is forecast for all but two divisions. In addition, GE continues to divest more volatile divisions, such as Genworth (Insurance), to better reward shareholders. The company has a very strong balance sheet (AAA rated) and offers a better than 2% dividend yield (11% dividend growth over five years).

Tyco International (TYC) is another diversified industrial with revenues from fire and security services, healthcare, electronics and engineered products. Tyco is recovering from the excesses of previous management and the company's current focus will be the re-deployment of its robust free cash flow toward debt repayment, share repurchases and dividend increases. Tyco's healthcare, engineered products and electronics divisions are well positioned for late cycle capital spending trends. The Company is expected to grow its earnings per share by 20% in 2005. Debt repayment and share repurchases may be accretive to earnings this year and beyond.

The other Focus List company in the Industrial sector is ***United Technologies (UTX)****.*

Technology—The sector continues to struggle under the weight of unrealistic capital spending expectations. While spending steadily improves, it has not been broadly based and the outlook for late-cycle software outlays is problematic. The Focus List is market-weight the group and features exposure to companies that have dominant market share positions, strong balance sheets and attractive relative valuations.

IBM (IBM) has successfully integrated its acquisition of the PriceWaterhouse Coopers consulting division and now offers one of the most complete product offerings to corporations in the area of electronic commerce solutions, from supply chain management to customer service. In addition, management has started to cull less-profitable divisions, as evidenced by the recent sale of the majority of the company's personal computing division. With this new focus, IBM now earns 65% of its revenues from its consulting and software divisions, where it enjoys the greatest margins. IBM is poised to set a record operating year, wherein revenues break the $100 billion mark and earnings per share are expected to hit $5.80. IBM is trading at over 16 times 2005 estimated earnings and enjoys a strong backlog of contracts.

The other Focus Listed companies in the Technology sector include ***Microsoft (MSFT) and EMC (EMC)****.*

BASIC MATERIALS/ENERGY SECTOR

Materials—The sector continues to benefit from strong demand, a weakening U.S. dollar and tight capacity that have kept commodity prices near their record highs. Under-investment in capacity within the chemical and mining sectors has led to considerable pricing power, which should persist in 2005. High oil and gas prices have remained a concern for investors in the sector, as energy is an important input cost, but tight supply has ensured pricing power for most companies. We maintain our recommended over-weight position in the group.

Air Products & Chemicals (APD) is the fourth largest international producer of industrial, medical and specialty gases (71% of sales and 89% of profits in fiscal year 2003). The industrial gases industry has historically grown as much as twice as fast as economic growth. APD is the world's leading supplier of hydrogen and carbon monoxide products (HYCO), whose demand is expected to remain strong as one of its main uses is in removing sulfur from oil in the refining process. The company is also a leading supplier of high purity gases, equipment and chemicals to the electronics industry. APD trades at 20 times 2005 estimated earnings against a backdrop of expected 13% earnings growth.

Energy—Energy stocks started the year off strong, with oil prices having reached new historical highs due to strong demand and a long, cool winter in some regions. Natural gas prices also rose during the quarter, though they remain below their highs posted late last year. While current levels may not be sustainable in the long term, they are expected to remain relatively high in the near term as the supply/demand dynamics support elevated prices. We currently recommend a market-weight for the group and believe that exploration and production companies provide the best exposure to continued pricing power in the sector.

Burlington Resources (BR) is one of the largest North American natural gas producers, with roughly 70% exposure to natural gas and 30% to oil. While gas prices should moderate somewhat over time, the long-term outlook remains bullish as major new supplies remain elusive. The potential impact of liquefied natural gas continues to be mitigated by its higher cost structure and infrastructure needs. BR remains well positioned to benefit from long-term, above-average pricing, especially given the company's low-cost operating structure. Its international business is expected to contribute up to 20% of the company's oil and gas production within the next few years. The Company generates a 20% return on the capital it employs and approximately $2 billion in free cash flow, which is earmarked to pay down debt and repurchase shares.

The other Focus List Company in the Energy sector is ***Exxon Mobil (XOM)****.*

APPENDIX: LADDERED FIXED INCOME PORTFOLIOS

Most investors do not view one-year total-return potential as the prime objective for the fixed income portion of their portfolio. Factors such as increased safety through diversification, predictability of future income and the ability to adapt to a changing interest rate environment are usually of greater concern. Where these factors predominate over short-term appreciation potential, we recommend investors adopt a "laddered" portfolio approach. This approach entails spreading your fixed income capital over a range of maturities *(see "A Four-Step Guide" below).*

It provides flexibility, stability of income, and does not require the investor to predict the future course of interest rates. The three ladders here illustrate the rates of Canada Government Bonds. In practice, an investor may wish to incorporate other debt instruments—such as GICs, Term Deposits, provincial, municipal and corporate bonds as well as foreign pay bonds—in the construction of a diversified ladder.

SHORT-TERM LADDER	
1 year	3.05%
2 year	3.40%
3 year	3.50%
4 year	3.70%
5 year	3.90%
Average Rate In Year 1	3.51%
Average Term	3 years

MID-TERM LADDER	
1 year	3.05%
3 year	3.50%
5 year	3.90%
7 year	4.20%
9 year	4.40%
11 year	4.50%
Average Rate In Year 1	3.93%
Average Term	6 years

LONG-TERM LADDER	
1 year	3.05%
4 year	3.70%
7 year	4.20%
10 year	4.45%
13 year	4.55%
16 year	4.65%
19 year	4.85%
Average Rate In Year 1	4.21%
Average Term	10 years

A FOUR-STEP GUIDE TO BUILDING THE LADDERED PORTFOLIO

1 Choose an appropriate average term

This should be the length of time over which the income from your portfolio needs to be most predictable.

In our view, most individuals are best served by an average term of between five and eight years.

2 Calculate the longest maturity to be used in the portfolio

Where each portfolio position is to be approximately equal in size and spaced at even intervals, the term of the longest instrument to be included would be roughly twice as long as the average term. For example, an average term of five years would mean the longest instrument would need to be about 10 years.

3 Determine how many steps on the ladder

The more positions used, the shorter the interval can be between each maturity date, and hence the smoother the transition from one interest rate environment to the next. On the other hand, too many positions can make the efficient reinvestment of interest difficult. For most portfolios, we recommend five to seven positions.

4 Formulate a reinvestment rule

To ensure the laddered portfolio retains the same average term over time, as each issue matures the proceeds should be reinvested out at the longest acceptable term, as determined in Step #2 (i.e. at the top of the ladder).

EXPLANATION OF RBC CAPITAL MARKETS RATING SYSTEM

DEFINITIONS OF RATING CATEGORIES

An analyst's "sector" is the universe of companies for which the analyst provides research coverage. Accordingly, the rating assigned to a particular stock represents solely the analyst's view of how that stock will perform over the next 12 months relative to the analyst's sector.

RATINGS:

Top Pick (TP): Represents best in Outperform category; analyst's best ideas; expected to significantly outperform the sector over 12 months; provides best risk-reward ratio; approximately 10% of analyst's recommendations.

Outperform (O): Expected to materially outperform sector average over 12 months.

Sector Perform (SP): Returns expected to be in line with sector average over 12 months.

Underperform (U): Returns expected to be materially below sector average over 12 months.

RISK QUALIFIERS (ANY OF THE FOLLOWING CRITERIA MAY BE PRESENT):

Average Risk (Avg): Volatility and risk expected to be comparable to sector; average revenue and earnings predictability; no significant cash flow/financing concerns over coming 12 to 24 months; fairly liquid.

Above Average Risk (AA): Volatility and risk expected to be above sector; below average revenue and earnings predictability; may not be suitable for a significant class of individual equity investors; may have negative cash flow; low market cap or float.

Speculative (Spec): Risk consistent with venture capital; low public float; potential balance sheet concerns; risk of being delisted.

Our Research Ratings Legend can be viewed at http://www.rbccmresearch.com/researchratings.

DISCLOSURES

DISTRIBUTION OF RATINGS, FIRMWIDE

NASD/NYSE rules require member firms to assign all rated stocks to one of three rating categories – Buy, Hold/Neutral or Sell – regardless of a firm's own rating categories. Although RBCCM does not consider all stocks that its analysts rate as Sector Perform to be equivalent to a Hold/Neutral rating, for purposes of this ratings distribution disclosure, RBCCM automatically treats stocks rated Sector Perform as Hold/Neutral. See Figure 1.

FIGURE 1

DISTRIBUTION OF RATINGS, FIRMWIDE
RBC CAPITAL MARKETS

			Investment Banking Serv./Past 12 Months	
Rating	**Count**	**Percent**	**Count**	**Percent**
Buy (TP/O)	412	46.5	151	36.65
Hold (SP)	388	43.79	105	27.06
Sell (U)	86	9.71	14	16.28

DISSEMINATION OF RESEARCH

RBC Capital Markets endeavours to make all reasonable efforts to provide research simultaneously to all eligible clients. RBC Capital Markets' Equity research is posted to our proprietary websites to ensure eligible clients receive coverage initiations and changes in rating, targets and opinions in a timely manner. Additional distribution may be done by the sales personnel via email, fax or regular mail. Clients may also receive our research via third-party vendors. Please contact your investment advisor or institutional salesperson for more information regarding RBC Capital Markets research.

MATERIAL DISCLOSURES

The author(s) of this report are employed by RBC Dominion Securities Inc., a registered investment dealer with principal offices located in Toronto, Canada.

For disclosures pertaining to individual securities mentioned in this report, please refer to http://rbc2.bluematrix.com/bluematrix/Disclosure or send a request to RBC CM Research Publishing, P.O. Box 50, 200 Bay Street, Royal Bank Plaza, 29th Floor, South Tower, Toronto, Ontario M5J 2W7.

The information contained in this report has been compiled by RBC Dominion Securities Inc. ("RBC DS") from sources believed by it to be reliable, but no representations or warranty, express or implied, are made by RBC DS or any other person as to its accuracy, completeness or correctness. All opinions and estimates contained in this report constitute RBC DS's judgment as of the date of this report, are subject to change without notice and are provided in good faith but without legal responsibility.

This report is not an offer to sell or a solicitation of an offer to buy any securities. Additionally, this report is not, and under no circumstances should be, construed as a solicitation to act as securities broker or dealer in any jurisdiction by any person or company that is not legally permitted to carry on the business of a securities broker or dealer in that jurisdiction. This material is prepared for general circulation to Investment Advisors and does not have regard for the particular circumstances or needs of any specific person who may read it. RBC DS and its affiliates may have an investment banking or other relationship with some or all of the issuers mentioned herein and may trade in any of the securities mentioned herein, either for their own account or the accounts of their customers. RBC DS and its affiliates may also issue options on securities mentioned herein and may trade in options issued by others. Accordingly, RBC DS or its affiliates may at any time have a long or short position in any such security or option thereon.

Neither RBC DS nor any of its affiliates, nor any other person, accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or the information contained herein. This report may not be reproduced, distributed or published by any recipient hereof for any purpose.

For more information
contact your Investment Advisor
or visit our website at
www.rbcds.com

RBC Dominion Securities Inc.