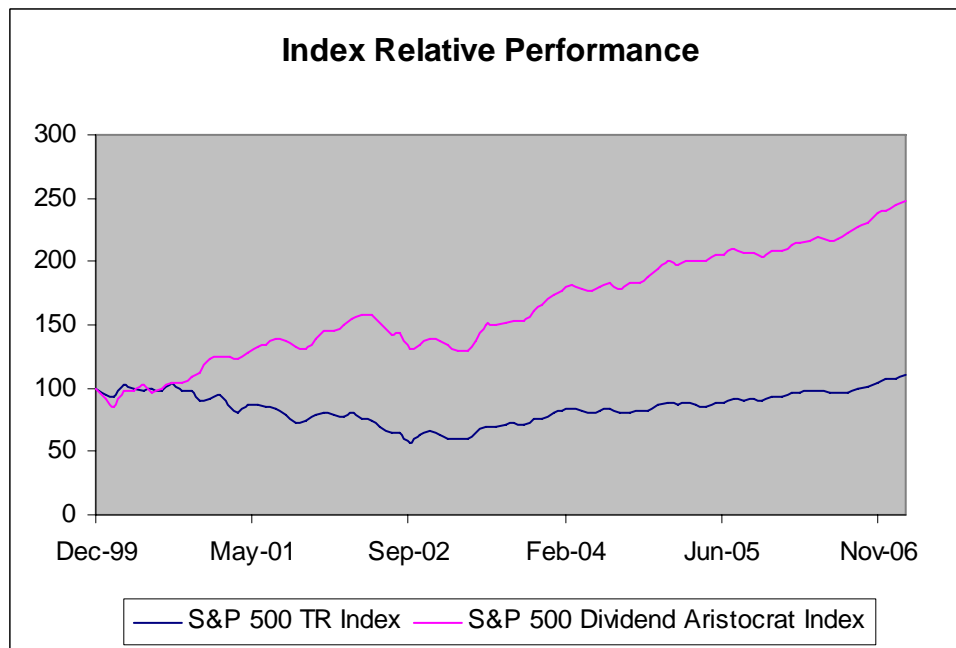


U.S. Equity Strategy – Dividend Growth and Share Buybacks

THE BEST OF BOTH WORLDS

Over the years, a number of companies have created shareholder value through share repurchase programs and/or dividend increases. By share repurchase program we are referring to companies that buy back their stock in the open market. Both can represent good value for shareholders although there is an ongoing debate as to how much value is created, and which is the better use of free cash flow. Certainly, the permanence of a dividend increase tends to be a better indicator of financial health and investors like to see dividends credited to their accounts. That said, the return of cash to shareholders through share repurchase programs also benefits shareholders by reducing the number of shares outstanding, boosting earnings per share, and providing support for the share price. We do not intend to debate the issue. Instead we have attempted to identify companies that have a history of consistently executing both shareholder friendly policies – the best of both worlds. It has been shown that where a dividend policy supports regular increases, the shares of the company tend to outperform the market over the long-term. The S&P 500 Dividends Aristocrat Index is designed to measure the performance of S&P 500 constituents that have raised their dividends each year for at least 25 years. The chart below shows the strong relative performance of that index.



Source: Bloomberg

It is our belief that companies with the financial strength to consistently employ both initiatives are also likely to outperform the broader market on a long-term basis.

CANADIAN LIST DELIVERING STRONG RELATIVE PERFORMANCE

In August of 2004 we searched Scotia Capital's EDGE database for Canadian companies that had a history of repurchasing shares and increasing dividends. The list was surprisingly short with only nine companies followed by Scotia Capital Research of delivering both at that time. Since then, that list of securities has provided a total return of approximately 88% compared with a return of approximately 65% for the TSX Composite Index, with seven of nine companies outperforming the market. At the time the list was created, Brookfield Properties and Metro Inc. had been repurchasing and cancelling their shares. In late 2005 Metro Inc. issued shares to finance the acquisition of A&P Canada. Shares outstanding have been relatively constant since then. Brookfield Properties issued shares in late 2006, the proceeds of which were used to pay down debt and for general corporate purposes. Both companies have increased their dividends, and despite the increase in shares outstanding, delivered very strong returns for shareholders.

Strong Relative Performance			
Company	Cumulative Change Dividend*	Change Shares Outstanding*	Total Return*
Bank of Montreal	62.5%	-0.9%	47.1%
Brookfield Properties Co.	78.1%	2.3%	116.7%
CIBC	16.7%	-5.3%	68.5%
Canadian National Railway Co.	115.4%	-10.0%	83.9%
Imperial Oil Ltd.	9.6%	-9.9%	106.6%
Methanex Corp.	56.3%	-13.2%	93.4%
Metro Inc.	35.3%	19.3%	115.9%
National Bank	42.1%	-4.1%	56.7%
Talisman Energy Inc.	50.0%	-4.1%	106.4%
			88.4%
TSX Composite Total Return			65.3%

* August 23, 2004 - Feb 9, 2007
Source: Scotia Capital estimates, Bloomberg

U.S. CORPORATIONS FLUSH WITH CASH

Following a period of significant corporate restructuring, and sustained economic growth, balance sheets are flush with cash. High free cash flow yields and excess capital positions are leading to increased payouts to shareholders and share buyback activity. They are also leading to a record pace of M&A transactions. According to Standard & Poor's dividend payments for the S&P 500 Composite are expected to have reached a new record in 2006. Aggregate dividends paid are estimated at U\$224 billion, an increase of 10.9% versus 2005. Share buybacks are also to be at record levels increasing 25.2% year over year to U\$437 billion. Despite the additional return of cash to shareholders in 2006, cash on hand remains high at U\$608 billion supporting forecasts for a further 11% rise in dividends in 2007.

THE U.S. LIST

This time around we chose the S&P 500 Composite Index to define our universe. Using some of the investment tools we have at hand we screened for companies that consistently repurchased shares and increased dividends over the past five years. To qualify, a company had to reduce its common shares outstanding and increase its dividend each year with no exceptions. Why not simply look for companies that are generating high free cash flow yields with large cash balances? What interests us are companies that are consistently returning cash to shareholders on a long-term basis and not simply generating cash. Why? Far too many management teams have destroyed shareholder value with poor investment decisions. Although share buybacks and dividend growth should not come at the expense of strategic investments that could impact a company's long-term financial health, cash rich companies with limited investment opportunities should return excess cash to shareholders. In our opinion, a company with a track record of returning a growing stream of cash to shareholders over time obviously has a good handle on managing the long-term financial health of the business.

PAG Special Report

There are 36 companies that met our selection criteria. Consumer staples and financials dominate the list however there is also good representation from the consumer discretionary and industrial products group as well. We then ran the list through our quantitative screen that ranks companies based on growth and value characteristics including relative price/earnings and price/book value ratios, ROE, growth in book value and earnings surprises. Companies are shown in the table below in order of relative attractiveness based on that screen.

Company	Symbol	Rating *	Recent Price	Target Price *	Potential Return	Current Dividend	Dividend Change 2002-present	Dividend Yield	Shares Change 2002-present	1-Year Total Return	5-Year Annualized Total Return
CATERPILLAR INC	CAT	OP	\$64.69	\$78.00	21%	\$1.20	71%	1.9%	-6%	-4.4%	23.4%
IBM	IBM	OP	\$98.10	\$107.00	9%	\$1.20	103%	1.2%	-13%	22.9%	-0.6%
WAL-MART STORES	WMT	OP	\$48.09	\$59.00	23%	\$0.67	139%	1.4%	-6%	5.9%	-3.6%
BECTON DICKINSON	BDX	N/A	\$76.83	n/a	n/a	\$0.98	152%	1.3%	-4%	21.0%	17.2%
LOCKHEED MARTIN	LMT	N	\$102.36	\$96.00	-6%	\$1.40	218%	1.4%	-7%	44.6%	15.5%
ANHEUSER BUSCH	BUD	N/A	\$49.89	n/a	n/a	\$1.18	57%	2.4%	-8%	26.4%	2.7%
SUNOCO INC	SUN	N	\$61.05	\$80.00	31%	\$1.10	120%	1.8%	-19%	-16.0%	28.3%
HARLEY-DAVIDSON	HOG	N	\$67.61	\$65.00	-4%	\$0.84	522%	1.2%	-14%	33.8%	6.9%
EXXON MOBIL CORP	XOM	N	\$75.39	\$80.00	6%	\$1.28	39%	1.7%	-13%	27.8%	16.8%
HOME DEPOT INC	HD	N	\$41.71	\$37.00	-11%	\$0.90	429%	2.2%	-13%	7.6%	-2.8%
ALLSTATE CORP	ALL	OP	\$61.14	\$68.00	11%	\$1.40	67%	2.3%	-11%	17.9%	15.2%
PEPSICO INC	PEP	N/A	\$64.02	n/a	n/a	\$1.20	102%	1.9%	-5%	12.1%	7.1%
TJX COS INC	TJX	OP	\$28.09	\$32.00	14%	\$0.28	211%	1.0%	-16%	16.0%	9.1%
COCA-COLA CO	KO	N/A	\$48.38	n/a	n/a	\$1.24	55%	2.6%	-5%	19.7%	3.1%
BIOMET INC	BMET	N/A	\$42.34	n/a	n/a	\$0.30	233%	0.7%	-7%	15.3%	6.3%
UST INC	UST	UP	\$58.99	\$49.50	-16%	\$2.28	19%	3.9%	-4%	57.0%	17.8%
HERSHEY CO/THE	HSY	OP	\$50.73	\$56.00	10%	\$1.08	71%	2.1%	-36%	-0.2%	9.7%
PITNEY BOWES INC	PBI	N/A	\$47.94	n/a	n/a	\$1.32	12%	2.8%	-6%	14.5%	6.5%
SYSCO CORP	SYY	N/A	\$34.17	n/a	n/a	\$0.76	138%	2.2%	-6%	14.3%	5.4%
CLOROX CO	CLX	N/A	\$65.89	n/a	n/a	\$1.24	48%	1.9%	-32%	9.4%	11.2%
PRUDENTL FINL	PRU	N	\$91.40	\$92.00	1%	\$0.95	138%	1.0%	-15%	22.4%	25.2%
SLM CORP	SLM	N	\$42.56	\$54.00	27%	\$1.00	253%	2.3%	-10%	-21.7%	8.5%
H&R BLOCK INC	HRB	N/A	\$23.75	n/a	n/a	\$0.56	78%	2.4%	-11%	0.3%	2.0%
MASCO CORP	MAS	UP	\$31.84	\$26.00	-18%	\$0.88	60%	2.8%	-19%	10.0%	6.8%
AFLAC INC	AFL	N	\$47.83	\$46.00	-4%	\$0.74	222%	1.5%	-4%	3.2%	15.0%
MCGRAW-HILL COS	MHP	OP	\$67.39	\$77.00	14%	\$0.82	61%	1.2%	-8%	27.4%	18.1%
AMERICAN EXPRESS	AXP	UP	\$57.62	\$58.00	1%	\$0.60	88%	1.0%	-8%	8.7%	15.6%
MARRIOTT INTL-A	MAR	N/A	\$49.00	n/a	n/a	\$0.25	81%	0.5%	-15%	41.7%	22.3%
MGIC INVT CORP	MTG	N/A	\$64.92	n/a	n/a	\$1.00	900%	1.5%	-17%	3.0%	0.5%
MATTEL INC	MAT	N	\$26.43	\$23.00	-13%	\$0.65	1200%	2.5%	-13%	62.0%	10.7%
PRINCIPAL FINL	PFG	UP	\$63.29	\$53.00	-16%	\$0.80	220%	1.3%	-19%	32.3%	21.8%
LEGGETT & PLATT	LEG	N/A	\$24.26	n/a	n/a	\$0.68	36%	2.8%	-8%	2.8%	2.4%
MCCORMICK-N/V	MKC	N	\$39.25	\$39.00	-1%	\$0.80	90%	2.0%	-17%	24.5%	13.3%
FAMILY DOLLAR ST	FDO	N	\$30.79	\$26.00	-16%	\$0.46	80%	1.5%	-13%	31.1%	-0.2%
CINCINNATI FIN	CINF	OP	\$43.88	\$50.00	14%	\$1.34	66%	3.1%	-3%	2.2%	7.3%
NEW YORK TIMES-A	NYT	N	\$25.19	\$25.00	-1%	\$0.70	32%	2.8%	-6%	-6.6%	-9.0%
										16.4%	9.9%
* Credit Suisse									S&P 500	15.3%	7.2%
OP - OUTPERFORM											
N/A - No Coverage											
UP - UNDERPERFORM											
N - NEUTRAL											

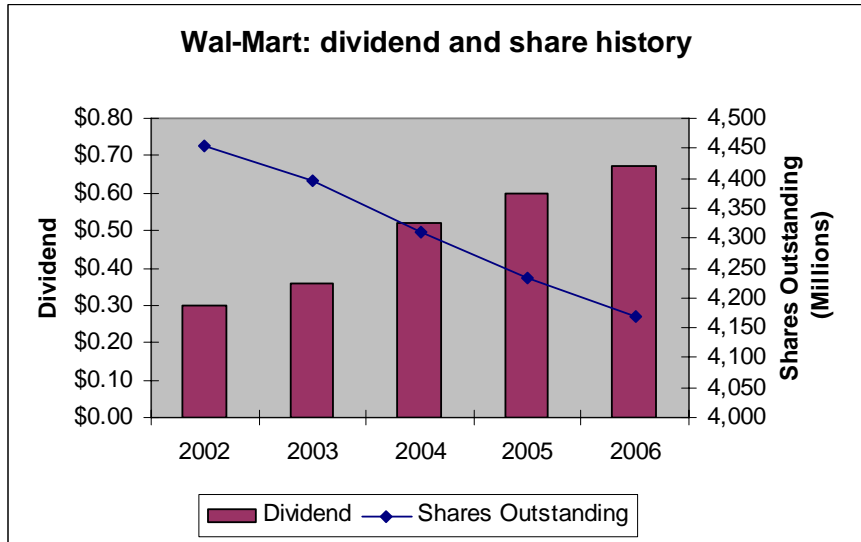
Source: Bloomberg, Credit Suisse, Scotia Capital estimates

RETURNS NOT INDICATIVE OF PERFORMANCE

Many companies on the list have delivered strong 1 and 5-year annualized returns (Caterpillar, Allstate, Becton Dickinson, Lockheed Martin, Sunoco) while some have not (Wal-Mart, Home Depot, IBM, New York Times). However, share price performance is not necessarily indicative of operating performance. Wal-Mart for example has delivered consistent year-over-year earnings and dividend growth over the last five years and yet its share price has materially lagged the broader market.

The bear market for U.S. equities that began in 2000 is often referred to as the “bursting of the tech and telecom bubble”. We believe this is somewhat of a misnomer as it ignores the simple fact that most large cap U.S. equities were excessively valued, not just technology and telecom stocks. Coca Cola, Home Depot, and

Wal-Mart among others were all trading at 50 times trailing earnings. Valuations today are much more reasonable and the weaker relative performance and lower valuations in our opinion present an attractive entry point for many of these companies.



Source: Bloomberg

CONCLUSION

With cash levels at record highs we expect large U.S. corporations to continue returning cash to shareholders at record levels. While share buybacks and dividends shouldn't come at the expense of strategic investments that could impact a company's long-term health, we do believe in many cases there is significant shareholder value created through consistent share buybacks and dividend growth programs and policies. We have attempted to identify some of these companies with the propensity for both.

– Paul Danesi, Director, Portfolio Advisory Group.



PAG Special Report

The supervisors of the Portfolio Advisory Group own securities of the following companies. None

The author of the report owns securities of the following companies. None

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