

Analytical Insights

Volume 8.5

Market Commentary

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CANADIAN EQUITY MARKET

The stock market continued to rally in the first quarter following a strong 2005 campaign, returning 7.98% as measured by the S&P/TSX Composite Index. The surge in the broad market index during the quarter boosted it to an all-time high in the final days of March.

Of the constituent sectors on the S&P/TSX, Materials enjoyed the highest performing first quarter. Buoyed by accelerating gold and silver prices reaching levels not seen since the early 1980s, the sector returned 15.01% during Q1. In addition, the price of oil rose in the latter days of March to over \$67 a barrel, helping to catapult the energy sector to an 8.55% return for the quarter. Other top performers included Information Technology (+10.48%) and Industrials (+11.12%).

Utilities finished off the first quarter as the lowest returning sector on the S&P/TSX, declining -8.73%. Unseasonably warm weather hurt the sector during winter 2006. Also finishing in negative territory were Consumer Staples (-1.26%), and Telecommunication Services (-1.32%).

Style Analysis

Growth stocks during Q1, outperformed value stocks reversing the 2005 trend that saw value stocks as the preferred investment style. Both large cap and small cap growth stocks outperformed their large and small cap value cousins during the first three months of 2006. As measured by the Barra Canadian family of style indices, large cap growth stocks finished

up 8.99%, while large cap value stocks returned 7% over the same time period. At the small cap level, growth stocks came in at 17.82% while value finished up 16.98%.

The table below takes a look at the returns by style and capitalization tier over the past quarter and year.

Market Index	Q1 2006	1 YEAR
Barra Canada Large Cap Growth	8.99	29.76
Barra Canada Large Cap Value	7.00	27.80
Barra Canada Small Cap Growth	17.82	36.14
Barra Canada Small Cap Value	16.98	35.83
S&P/TSX 60	7.96	30.20
S&P/TSX Mid Cap	8.58	17.26
S&P/TSX Small Cap	7.39	26.22

CANADIAN ECONOMIC OVERVIEW

The Canadian economy entered 2006 on a momentous wave as GDP grew to an impressive 0.6% in the final month of 2005. Economic indicators and consensus forecasts for the first quarter of 2006 suggested the momentum would continue in an environment characterized by a low jobless rate, strong income growth, an inflation rate that would remain in check, and strong prospects for Canadian businesses worldwide.

The latest available statistics indicate though that economic growth slipped slightly in the initial stages of the first quarter to 0.2% month over month in January, well below consensus estimates. Surprisingly, the overall dip in growth was anchored by a temporary decline in the energy sector, which until that point was a major catalyst in the country's stellar economic performance. In light of the unforeseen setback in the early weeks of the first quarter the prospects for growth remain largely optimistic for the mid to long-term range.

One of the major stories in the first quarter, aside from the ever present oscillating oil and gas prices, was the impact of unusually warm weather on the Canadian economy. As previously cited, the unseasonably mild temperatures during the early stages of the quarter negatively impacted the energy sector as consumer heating needs decreased significantly from what is typical during the winter months. Electricity needs and natural gas distribution also declined as a result. At the pump consumers finally caught a temporary break as gasoline prices fell in February coinciding with a decrease in Crude oil prices. The decline pushed the CPI down 0.2% month over month from January to February. However, the index likely rose in the later stages of the quarter as the price of crude recovered in late March nearly touching the \$70 level.

On the positive side, other areas of the economy benefited from the warmer temperatures helping to offset some of the negative impact felt due to the temporary decline in energy related sectors. Notably, the real estate sector continued to prosper due to rising activity in the construction sector, which got an early jump on the building season, strong sales particularly in the non-residential housing market, and a continually thriving Canadian labour market. First quarter labour statistics show that the unemployment rate fell to 6.3%, representing a 32-year low. Widespread growth across various sectors including Health Care, Recreation, and Business was attributable to the creation of 51,000 new jobs alone in March. The struggling Manufacturing sector continued to shed jobs losing 12,000 over the same time period.

South of the border, early signals indicate the US economy has begun to recover in the first quarter

following a disappointing end to 2005. Consensus forecasts estimate first quarter growth to reach a level of 4%. Figures released during quarter one suggest the employment market is strong and expanding. The economy created 243,000 jobs alone in February, while the unemployment rate is down 0.6% from the same time last year.

The Manufacturing sector, which has been a recent source of strength, continued to grow during the first quarter, as did consumer spending. Economic data released in February indicate that spending increased for the fifth consecutive month.

The U.S. housing market does seem to be cooling off as new home sales dropped nearly 10% in February alone, and are down more than 20% from their July 2005 peak. The continually rising interest rate environment south of the border is the major culprit.

MONETARY POLICY

For the fifth consecutive time, the Bank of Canada raised its overnight lending rate to 3.75% just before the end of the quarter. Recent economic data and subtle changes in the language of the Bank's statement suggest that the tightening cycle may soon come to an end. In its most recent statement, the Bank noted that future rate hikes *may* be required. This is slightly different from the previous session's wording, which said that rate hikes *would* be required. The loonie has also appreciated at a rate greater than anticipated. If it continues to rise relative the U.S. dollar, the Bank of Canada could decide that further rate hikes are unwarranted. Lastly, the Energy sector seems to have cooled off slightly, alleviating some of the past inflation rate pressures.

In the United States, the Federal Reserve conducted its first meeting under the leadership of Ben Bernanke, who replaced long-time chairman Alan Greenspan. The Fed raised its target rate to 4.75%, marking the 14th consecutive rate hike. Reasons for lifting the overnight rate again were a strong rebound in economic growth from the fourth quarter, and the possibility of rising energy and commodity prices with the potential to add to inflationary pressure.

THE BOND MARKET

Bond markets abroad performed modestly during Q1 2006 as central banks in both Europe and the United States took an active approach to staving off inflation. Results were not much different in Canada, as a modest sell-off in bonds became evident near the end of the first quarter. The broad market Scotia Capital Bond Universe Index finished the quarter down -0.43%. The bond sell-off had a strong impact on the overall performance of the index as it fell -0.35% in March alone. Performance across the Mid-Term to Long-Term capitalization tiers was also negative for the quarter as the Mid-Terms dropped -0.56% and the Long Terms fell -1.71% as measured by the Scotia Capital Bond family of indexes. The Short Terms managed to avoid ending the quarter in the red and finished up 0.50%. Economic consensus in Canada that the Bank has nearly completed its tightening cycle helped to drive the positive performance of short-term bonds.

The U.S. bond market suffered through another losing quarter as the Lehman Aggregate Bond Index finished down -0.78%. The bulk of the losses came in the wake of the Fed's decision in the final week of March to raise the federal funds rate to 4.75%. This signalled the likelihood of at least one more rate hike. As a result, the yield on the benchmark 10-year U.S. Treasury note rose five basis points to 4.85% overall, its highest level in nearly two years.

U.S. EQUITY MARKET

U.S. stocks posted a 4.07% return during Q1, making it the fourth straight quarter in which the S&P 500 returned in the black—and the highest performing first quarter since 1999. During the same period, the broader-based Russell 3000 also moved into positive territory, up 5.17%.

Energy stocks continued to ride the wave of a record-breaking 2005 campaign. For the quarter the sector returned 8.90%, despite swings in the price of oil during the initial months of the year. Telecommunication Services was the highest returning sector on the S&P 500 during the quarter with a 14.30% return. But making up only slightly more than 3% of the index however, the sector's strong quarter

had a marginal impact on the overall index return. Also showing strong sector performance were Industrials (+6.90%) and Materials (+7.29%)—both pushed ahead by broad strength in the commodities markets.

The only negative performing sector on the S&P 500 during Q1 was Utilities which suffered from lower consumer heating demands due to warm weather in the initial months of 2006.

Style Analysis

Small cap stocks were the highest performers of the market capitalization tiers as reported by the Russell family of indices. The Russell 2000 Index returned a very strong 13.79% during the first quarter, far outdistancing its large cap counterpart, the Russell 1000 Index, up 4.35%. Energy stocks, which comprise a significant portion of the Russell 2000 Index, remained strong overall in Q1 and helped raise the index to its impressive level. Similar to the Canadian market, small cap growth stocks were the top returners according to style orientation. The Russell 2000 Growth Index was up 14.21%, while the small cap value Russell 1000 returned 13.36%.

INTERNATIONAL MARKETS

Throughout first quarter of 2006, virtually every overseas developed market maintained strong growth. The MSCI EAFE is off to a great start for 2006, gaining 9.32% over the quarter.

European markets rose by a commendable 10.69% (MSCI Europe), as a strong showing from the Nordic countries returned 16.48% (MSCI Nordic) for the quarter. The European Central Bank (ECB) maintained low interest rates, which have continued to fuel market activity.

Spain and the United Kingdom witnessed another booming quarter for real estate prices, underlining the ECB's concern about overvalued European markets. However, strong economic growth in those countries, and no sign of general price inflation, suggests no pressing need for the ECB to intervene.

In Asia, the MSCI Pacific Index returned 6.65% for the quarter, with Japan slightly higher at 6.68%. The outlook for growth in the Japanese economy, which has suffered three recessions since 1991, remains optimistic. Through the first three months of 2006, Japanese economic indicators were encouraging, as steady consumer spending and overseas demand for Japanese cars and high-tech goods continued to surge.

Japan's first quarter performance however, is not necessarily indicative of its 2006 potential. The mid-January Livedoor investigation hit the Nikkei hard. Livedoor lost 14% (a market-imposed limit) on the investigation announcement, which spooked investors and triggered slides in other Internet companies' shares. Yahoo Japan lost 9.4% while Softbank, an Internet media and telecom company, lost 11% on the news. Investor divestiture from this sector helped to create the biggest one-day drop in over nine months (2.84%), erasing many prior gains

EMERGING MARKETS

Emerging markets had an excellent start in 2006, as the MSCI EM Composite Index rose 11.94% by the end of the first quarter.

Commodity-heavy Latin American markets were the strongest performers (MSCI EM Latin America: 15.53%), buoyed by continuing strong demand for energy and materials.

Emerging Asian markets performed well (MSCI EM Pacific Basin: 6.65%) as steady global demand for high-tech mobile phones, digital cameras and flat-screen televisions continued to spur expansion in

Asian technology exporters especially in China, South Korea and Taiwan.

Among most of Asia's other emerging economies, consumption is also rising due to improved labour market conditions and increased rural incomes due to high commodity prices.

Outside China and Japan, investment is still weak in most of Asia, and governments acknowledge the need to work toward improving the business climate and developing the region's financial markets.

Economic growth in Thailand was hurt by delayed government spending and diminishing investor confidence. This can be attributed to uncertainty over the outcome of the snap election that Prime Minister Thaksin Shinawatra called for April 2 to avert a political crisis.

The Indonesian government's decision last year to increase fuel prices has lowered the country's 2006 growth estimate from September's 5.8%. Indonesia had also reduced or eliminated fuel subsidies, so the impact of oil price hikes on economic growth will be higher than in previous cases. The effect will wane over time, but will be an obstacle to growth for the short term.

High oil prices, rising interest rates and inflation, growing global imbalances and the threat of an avian flu pandemic still remain the key risks to growth in Asia and the world.

Market Benchmarks – March 31, 2006

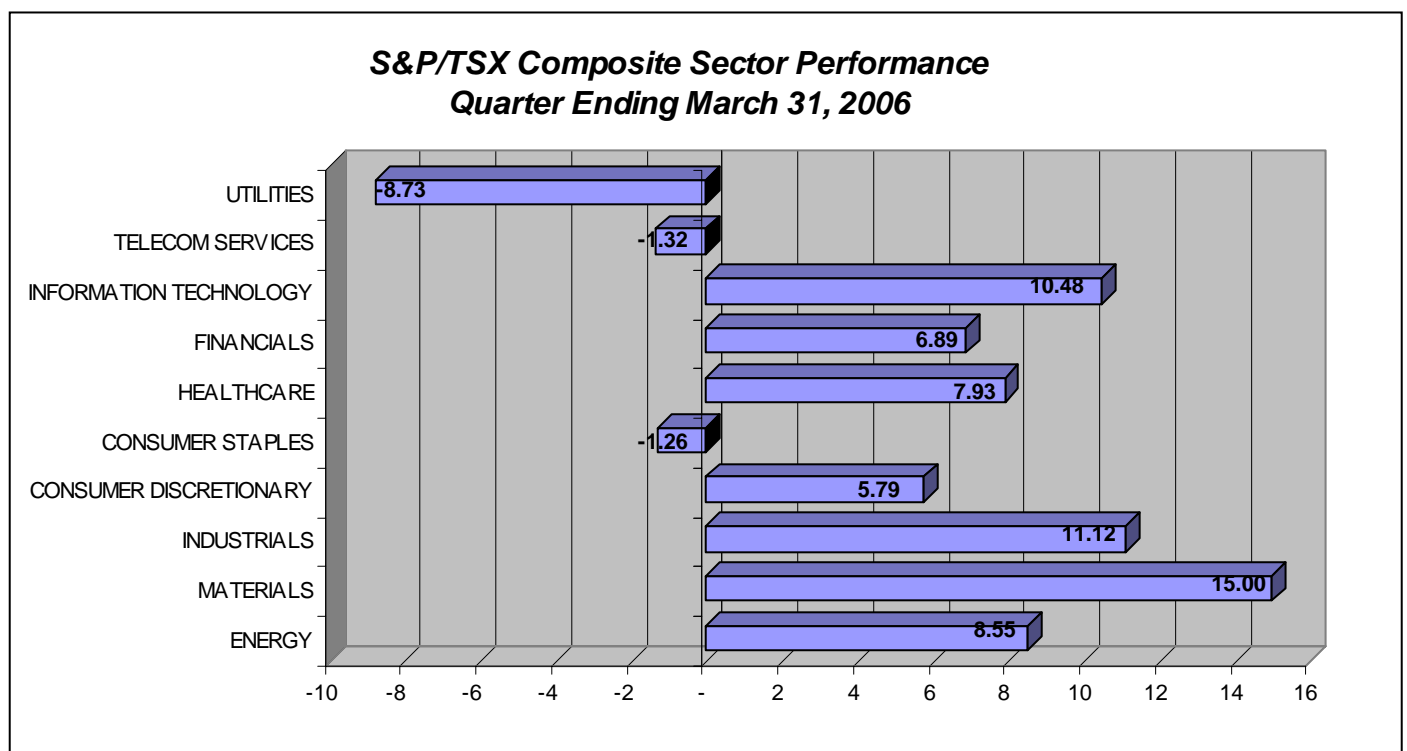
Canadian Dollars

	QUARTER ENDING	YTD ENDING	YEAR ENDING	3 YEARS ENDING	5 YEARS ENDING	7 YEARS ENDING	10 YEARS ENDING
<i>Cash</i>							
SCOTIA CAPITAL 30DAY T-BILL	0.84	0.84	2.83	2.62	2.78	3.40	3.57
SCOTIA CAPITAL 91DAY T-BILL	0.84	0.84	2.84	2.68	2.89	3.54	3.74
<i>Bonds</i>							
SCOTIA CAPITAL BOND INDEX LONG TERM	-1.71	-1.71	9.57	10.86	9.57	7.63	10.19
SCOTIA CAPITAL BOND INDEX MID TERM	-0.56	-0.56	4.12	6.81	7.16	6.56	7.85
SCOTIA CAPITAL CONV. RES. MORT. 3	0.99	0.99	4.80	5.81	6.47	6.76	7.15
SCOTIA CAPITAL CONV. RES. MORT. 5	0.98	0.98	5.30	6.83	7.19	7.23	7.91
SCOTIA CAPITAL BOND UNIVERSE	-0.43	-0.43	4.86	6.85	6.95	6.36	7.68
SCOTIA CAPITAL BOND INDEX SHORT TERM	0.50	0.50	2.28	4.47	5.22	5.43	6.03
<i>Equity</i>							
S&P/TSX COMPOSITE	7.98	7.98	28.43	26.3133	11.73	10.89	11.18
S&P/TSX COMPOSITE CAPPED	7.98	7.98	28.43	26.3150	11.80	N/A	N/A
S&P / TSX 60	7.96	7.96	30.20	25.9950	11.15	10.50	12.06
S&P/TSX MID CAP	7.39	7.39	26.22	30.0519	13.87	N/A	N/A
S&P/TSX SMALL CAP	8.58	8.58	17.26	22.5590	12.02	N/A	N/A
NESBITT BURNS SMALL CAP	15.55	15.55	33.45	34.1828	18.65	16.49	11.79
BARRA LARGE CAP GROWTH	8.99	8.99	29.76	24.1390	9.39	7.52	7.57
BARRA LARGE CAP VALUE	7.00	7.00	27.80	28.8286	13.98	14.41	15.52
BARRA SMALLCAP GROWTH	17.82	17.82	36.14	32.8666	13.75	13.63	9.97
BARRA SMALLCAP VALUE	16.98	16.98	35.83	37.5992	23.61	19.91	15.14
<i>Foreign Bonds</i>							
LB AGGREGATE	-0.78	-0.78	-1.40	-4.73	-1.01	1.81	4.65
<i>Foreign Equity</i>							
S&P 500 W/DIV	4.07	4.07	7.73	8.50	-2.09	-2.05	7.28
MSCI EAFE	9.32	9.32	20.42	21.84	3.62	2.11	5.16
MSCI EAFE NET	9.25	9.25	19.96	21.38	3.25	1.80	4.85
MSCI WORLD	6.57	6.57	14.34	14.71	0.64	-0.20	6.06
MSCI WORLD NET	6.46	6.46	13.81	14.19	0.19	-0.59	5.64

S&P/TSX Composite Sector Performance

March 31, 2006

<i>CLASSIFICATION</i>	<i>QUARTER ENDING</i>	<i>YTD ENDING</i>	<i>YEAR ENDING</i>	<i>3 YEARS ENDING</i>	<i>5 YEARS ENDING</i>	<i>7 YEARS ENDING</i>	<i>10 YEARS ENDING</i>
TOTAL GROSS OF FEES	7.98	7.98	28.43	26.31	11.73	10.89	11.18
ENERGY	8.55	8.55	50.52	42.44	28.13	29.55	20.00
MATERIALS	15.00	15.00	33.61	26.85	16.20	12.88	3.86
INDUSTRIALS	11.12	11.12	22.61	23.30	2.86	8.07	8.00
CONSUMER DISCRETIONARY	5.79	5.79	17.17	19.49	5.98	3.63	9.12
CONSUMER STAPLES	-1.26	-1.26	-7.30	10.45	10.38	14.18	19.01
HEALTH CARE	7.93	7.93	11.61	-7.18	-9.15	-3.95	-3.17
FINANCIALS	6.89	6.89	28.64	26.49	16.72	16.10	20.47
INFORMATION TECHNOLOGY	10.48	10.48	3.80	19.43	-14.13	-12.08	-2.28
TELECOM SERVICES	-1.32	-1.32	4.44	14.71	1.37	9.30	16.99
UTILITIES	-8.73	-8.73	23.66	21.03	14.24	13.26	13.86



Russell U.S. Equity Indexes Performance

March 31, 2006 – Canadian Dollars

RUSSELL INDICES	QUARTER ENDING	YEAR ENDING	1 YEAR ENDING	3 YEARS ENDING	5 YEARS ENDING	7 YEARS ENDING	10 YEARS ENDING
RUSSELL 1000	4.49	4.49	13.20	18.30	4.74	2.39	9.18
RUSSELL 1000 GROWTH	3.09	3.09	13.14	14.80	1.66	- 2.56	6.50
RUSSELL 1000 VALUE	5.93	5.93	13.31	21.77	7.79	6.48	10.97
RUSSELL 2000	13.94	13.94	25.85	29.53	12.59	11.21	10.15
RUSSELL 2000 GROWTH	14.36	14.36	27.84	28.14	8.59	5.40	5.51
RUSSELL 2000 VALUE	13.51	13.51	23.77	30.75	16.24	16.26	14.03
RUSSELL 2500	11.14	11.14	24.05	29.19	13.51	12.90	12.08
RUSSELL 2500 GROWTH	11.83	11.83	26.44	27.96	9.87	7.79	7.85
RUSSELL 2500 VALUE	10.47	10.47	21.60	30.10	16.17	15.63	14.52
RUSSELL 3000	5.31	5.31	14.28	19.14	5.33	3.03	9.19
RUSSELL 3000 GROWTH	4.07	4.07	14.40	15.78	2.21	- 1.96	6.35
RUSSELL 3000 VALUE	6.59	6.59	14.20	22.46	8.42	7.17	11.16
RUSSELL MIDCAP	7.61	7.61	21.54	27.87	12.52	11.00	12.66
RUSSELL MIDCAP GROWTH	7.61	7.61	22.68	25.75	8.99	5.84	9.39
RUSSELL MIDCAP VALUE	7.62	7.62	20.30	29.23	14.69	13.00	13.87
RUSSELL SMALL CAP COMPLETENESS	9.72	9.72	24.64	27.91	11.41	8.51	10.08
RUSSELL SMALL CAP COMPLETENESS GROWTH	9.61	9.61	27.41	27.39	8.14	4.03	6.82
RUSSELL SMALL CAP COMPLETENESS VALUE	9.86	9.86	21.35	28.28	14.21	12.59	13.08
RUSSELL TOP 200	3.22	3.22	9.92	14.90	2.09	- 0.37	8.13
RUSSELL TOP 200 GROWTH	1.35	1.35	9.64	11.56	- 0.39	- 4.64	5.96
RUSSELL TOP 200 VALUE	5.21	5.21	10.29	18.58	4.88	3.76	9.82

Russell indexes serve as performance standards against which money managers and mutual funds can be evaluated. Russell estimates more than \$850 billion of assets are benchmarked to Russell indexes. In addition, more than \$350 billion is invested in passive index funds that use the Russell indexes as their model.

Data Source: Russell Investment Group

MELLON FINANCIAL ENHANCES PERFORMANCE AND ANALYTICS OFFERINGS BY COMBINING MELLON ANALYTICAL SOLUTIONS AND EAGLE PERFORMANCE PRODUCTS

- Initiative creates strongest product set in global performance measurement history-

Mellon Financial Corporation has announced that it has combined the services of its Mellon Analytical Solutions (MAS) business with the product set of Eagle Performance.

“Adding our Eagle Performance products to the MAS business creates the most powerful, combined performance analytics product set in the global industry,” said Gunjan Kedia, MAS president. “By uniting these products, services, product delivery channels and technology, we have effectively created an unmatched offering this market. Not only do we now offer even more dynamic solutions to our clients, but we also facilitate more efficient coordinated development within the business.”

MAS was formed in September 2005 when Mellon acquired Russell Investment Group’s 50 percent share in the Russell/Mellon joint venture, provides a wide array of performance measurement, analytics, attribution, universe and risk analysis solutions to institutional investors and money managers. Eagle Performance, developed by Mellon’s Eagle Investment Systems subsidiary, provides solutions to institutions through portfolio analysis and reporting.

“Our value proposition for MAS is centered around flexible adapt, services and software solutions. By extending our capabilities in those areas, we are able to better meet our clients’ evolving needs and broaden our market-leading position,” said Kedia, who oversees MAS business. “This initiative reaffirms our commitment to our key client segments - pension plan sponsors, foundations, endowments, consultants and investment managers - and further meets their ever-evolving performance/analytics needs.”

Kedia also announced the appointment of two Mellon veterans who will report to her and have management responsibility for the MAS performance measurement business:

- Bruce Feibel has been named global director of MAS and Eagle Performance products, and will be responsible for MAS product management and software development globally. He previously led the Eagle PACE and Eagle Performance businesses. Feibel is a chartered financial analyst, author of “Investment Performance Measurement” published by Wiley and contributed to the development of the investment industries.
- Joe Kitka, who has assumed the role of director of global client service delivery, formerly served as a director of strategy management for Mellon’s Investment Solutions (IMS) business.

To learn more about the enhancements of Mellon Analytical Solutions product offerings, please contact your Relationship Manager, or Shawn Menard at 416-643-6400.



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Analytical Insights is a quarterly publication providing clients with investment information that can be used in the processes of monitoring global assets. The report formats for *Analytical Insights* are produced using our PC based analysis tools.

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