

OUTLOOK – THIRD QUARTER 2004

The economic fundamentals that are driving the US and Canadian economies changed very little in the second quarter as the boom in housing activity and construction continues to show longevity. Business investment in machinery and equipment also increased, while manufacturing production accelerated with global demand.

Our US economic forecast predicts GDP growth close to 4% over the next several quarters. This pace of growth will cut further into spare production capacity and keep upward pressure on long-term fixed income yields. We believe that the risks to this forecast are on the downside as growing household debt levels, enlarging trade and current account deficits and low savings rates all pose negative consequences to the pace of economic growth. In addition, the US government has stated that there is a possibility of another terrorist attack as the US election approaches.

The steady economic expansion since the beginning of the year required the Federal Reserve to make good on its intention to increase interest rates. Fed Fund rates rose by 25 bps in June to 1.25%. As usually occurs at the beginning of a tightening cycle, North American fixed income markets have priced-in a large amount of tightening, which resulted in negative fixed income returns for the second quarter. We expect continued rate increases through year-end by both the US and Canadian central banks.

As the quarter ended, renewed US dollar weakness and a rebound in many key commodity prices allowed the Canadian dollar to probe the 76-cent threshold (\$1.316/US\$) for the first time since early April. We expect any further appreciation of our currency to be moderate for the remainder of the calendar year.

Our investment strategy is to cautiously participate in the current equity environment and to prepare for a correction early next year, as sustained interest rate increases eventually slow economic growth. As defensive measures, we continue to shorten the duration of our fixed income holdings to cushion against the impact of rising interest rates. As well, we hold Real Return bonds which adjust their yields to compensate for any increase in inflation. Our equity selections remain conservative and we continue to establish option positions that will cradle declines in equity portfolios. Our investment philosophy will continue to be focused on the long-term, while riding out short-term fluctuations.

Elysium Wealth Management Inc.
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