

Market review

During the quarter, supportive liquidity conditions propelled markets higher, despite weaker global growth forecasts. Asian returns were bolstered by appreciating currencies, better economic news and the hope for further stimulus measures in the U.S. India and Indonesia have been strong, as investors have sought out markets exposed to lower global interest rates and markets where strong economic fundamentals are supporting currency appreciation, versus the U.S. dollar. Chinese imports grew 35% year-on-year, in figures released in August, outpacing imports in the U.S. slightly. This data suggests growth in Chinese domestic demand and may allow Chinese authorities to deflect calls for the renminbi to appreciate.

Portfolio review

The main contributors to performance during the quarter included the Fund's stock selection in Hong Kong, mainland China, Taiwan and the Philippines. Fund holdings in **Reliance Communications Ltd.** of India were the Fund's largest detractor to performance, as shares declined 15.1% on lower-than-expected first quarter profits.

We expect China to recover some of its relative underperformance versus India and Southeast Asia, over the remainder of 2010; we believe the medium-term outlook for equities in the region remains attractive. Mackenzie is concerned about competitive currency devaluations. At the heart of this, is the Chinese renminbi, which has been very slow to appreciate, especially in light of China's swift economic activity and vast currency reserves. The fear is that this may heighten calls for protectionism in the West and for policies limiting trading. We were somewhat surprised by the desire for low-return "riskless" assets such as government bonds and the distaste for "riskier" corporate assets such as equities. In our opinion, on a relative basis at least, it is a good time to buy equities. While we are more cautious about the outlook for small and mid-capitalization stocks, given the returns over the period, we believe companies with strong balance sheets and healthy operating cash flows offer attractive opportunities.

Any amount that is allocated to a segregated fund is invested at the risk of the contract holder and may increase or decrease in value.

This report is published to provide additional information on economic conditions and investment performance. It was prepared by Mackenzie Financial.