Q. Is it correct to interpret chart 1 as showing that the spread between S&P/TSX widened substantially in late 1999 and returned to its more traditional relationship in late 2001? If this observation is incorrect, please provide a complete explanation.

A. The most recent (2002) data shown on Chart 1 suggests that the relationship between utility stock prices and the overall equity market is returning to a correlation which is more similar to that which existed prior to the 1998-2001 stock market "boom and bust".

Prior to this period, utility stock prices and the overall market tended to move in the same direction. However, that correlation virtually disappeared in 1998-2000. The data in Chart 1 suggest that (a) the overall equity market risk premium may have temporarily <u>declined</u> in 1999 while (b) the relative risk of utilities <u>increased</u>. During 1999, the height of the stock market speculative "bubble", investors in the equity market bid up prices of stocks, particularly technology stocks, to levels that were inconsistent with their fundamental value, i.e., the potential earnings stream they could produce. At those elevated levels, the stock prices suggested that investors were ignoring the inherent risk those stocks entailed. During the same time period, utility stock prices generally fell, partly because of increases in interest rates and partly because utility stocks were out of favour. The market "bust", or correction, which started in early 2000, was effectively a "wake up call" to investors, a reminder of the inherent risks of investing in equities and of the fundamentals upon which equity value is based (i.e., future earnings). The correction reversed any temporary decline in the overall equity market risk premium that may have taken place.