OLD MONEY….NEW MONEY

Important Communication:

Five weeks ago we entered into a phase of panic selling in the market. The value to all financial assets has been significantly decreased. I have some reflections and specific suggestions. I find this heartbreaking and I am both professionally and personally dealing with the losses. And perhaps – more importantly planning a strategy to move forward.

Old Money – New Money

We have had a watershed event. I am considering Pre-October money as "Old" money as it has been devalued and post October as "New" money as people participate in lower valuations.

Old Money:

What can you do when you are facing these huge negatives? It will take a number of years to recoup the damage of this year. Some clients who have time to wait and/or are able to buy in are okay, while others, who are in or approaching retirement do not. For some, this drop means that you will need to work longer and others will have to change their life style. This has been a stunningly terrible event for those in and or close to retirement.

I have inserted a chart from the recent newsletter. It talks of "bounce" after bad markets. Personally, I think we are in new waters with respect to where investment returns will be made but the principle of this chart still remains. After times of panic selling or "bear markets" there is always a bounce. Companies such as Manulife cannot have their stock price compressed to where it is less than the direct hard assets of the business without an ensuing bounce. Some companies are priced so low they are below the value of even their hard cash assets. This chart will help you to understand the nature of historical "bounces" and perhaps bring some hope.

Performance of the Dow Jones Industrial Average through 12 Major Postwar Crises

	Market Low After Crisis	Total Return	After Crisis
		1 Year Later	2 Years Later
Berlin Blockade	13 June 1949	46.1%	70.1%
Korean War	13 July 1950	34.8%	53.5%
Cuban Missile Crisis	26 June 1962	37.3%	67.8%
Kennedy Assassination	22 Nov 1963	30.2%	44.8%
Gulf of Tonkin	08 June 1964	16.1%	20.6%
1969 Stock Market Break	26 May 1970	49.6%	69.3%
1973-74 Stock Market Break	06 Dec 1974	47.8%	82.4%
Iran Hostage/Oil Crisis	21 Apr 1980	37.5%	22.2%
1987 Stock Market Crash	19 Oct 1987	28.9%	69.6%
1990 Gulf War/Financial Crisis	11 Oct 1990	29.2%	39.6%
Russian Bond Default	31 Aug 1998	46.1%	53.6%
Hi-Tech Dot.Com Crash	09 Oct 2002	36.1%	44.4%
2007-2008 Liquidity/ Credit Crisis	?	?	?
Average Return		36.3%	53.2%

*** Source: Dreman Value Management, LLC.

For "Old" money I am suggesting that you stay in the market. While I recognize this may be stressful – historically it has proven to be the best long term strategy. You cannot stand on the side lines and inevitably miss the big up days that WILL happen. Missing just the 10 best up days in a period of recovery can diminish your returns by 25%.   It is difficult to time the market and is usually met with almost no success.

Here are some specific thoughts on strategies that you might be using:

Smith Manoeuvre:

If you are doing all of the steps (see web site if confused) then you do not need to alter anything in either payments or investment loans. Every month you are buying into the market. Every month you are paying off nondeductible debt faster.

Money House:

You are receiving money every month from the investment. If you can, you should lower or stop the payment coming to you and make the payment yourself. Cashing out shares of your holdings when they have reached these reduced levels causes more damage and will invariably delay the process to get to positive territory. With interest rates falling and the annual readjustment coming in January, loan payments will be less, making the change to cash flow less noticeable. This will allow more money to stay in the account as it climbs back up and will be a significant benefit. E-mail or call the office and we can do this for most clients without a meeting.

RRIF Meltdown:

Continue as before with only a small change to delay the timing perhaps into the New Year for any further withdrawals. We dislike selling low.

All Other Leverage Loans:

If you are not getting any payments from the fund, (this primarily applies to those using it as an RRSP replacement), it might be time to consider "terming out" the loan. This means converting the loan to interest plus principal and setting up perhaps a 20 year payment process. If you do not have other non-deductible debt this might be a good idea and either Esther or I would be glad to talk to speak with you about this.

Leverage:

Borrowing to invest has been a highly successful strategy that I have used for the last 20+ years. The last month has been terrible and has made this good strategy into something that has hurt the average person. We will monitor the underlying investments carefully as the new world changes. One of the best strategies as we move from Old Money to New Money will be to add more money to your investment holdings and average down your costs. I say this recognizing that this is not possible for all, and that some might find the suggestion offensive. Please do not be offended as buying low (or averaging down) is a well established strategy that has been successfully employed by many individuals.

Note that it is our opinion that the Central banks are doing the correct things - lowering interest rates and printing money to develop liquidity. This will be very beneficial for growth but the results will take time.

Please note as well, that in the next year, as we have our reviews, we will want to re-do every retirement plan for those who are 45 and older.

New Money:

Part one involves the question of "Should we put money into the market at all". That is generally, closely followed by Part 2, "And if we do – what do we buy?"

The headlines now are reading "Companies are on Sale" – even really good ones. If you have any ability to save for the longer term you should be doing a purchase, starting a monthly savings plan (the new Tax Free Savings Account in January could be an excellent start) or organizing a leverage loan. If shoes were on sale – would we not be buying? If that special hand tool that we had been looking at for the past year was listed at $150 – now reduced to $99.99 – would we not be buying? With the Canadian market down 42% since May we should look at it in the same manner.

The greatest concern that I have is that this once in my life time experience will cause people to shy away from equities, the asset category that has done the most for investors over the longer term. Interest rates are very low so guaranteed investments cannot be expected to fill the void.

Where To Go:

I have had the luxury recently to read and think about the events that have occurred. If we look at the next number of months as a time for bounce/retracement then we need to be thinking of where the best future investment opportunities will take place.

Here is a summation of our thoughts:

- Emerging/Developing markets are much more stable than they were a decade ago and are going to remain world drivers. Countries such as Singapore, China, South Korea, Saudi Arabia, Dubai, Norway and others have created Sovereign Wealth Funds holding billions of dollars that are set to go into the markets. 10 years ago most of these countries were in a currency crisis and owed the IMF billions. Now they are poised to go on a major buying frenzy.

- Real Assets – Above as I mentioned it is good that the governments are printing money and lowering interest rates. It is important today to keep us from sliding into recession or worse. The flip side is the potential inflationary pressure they cause in the future. To combat this we need to hold Real Return Bonds, Gold, Commercial Real Estate and resources.
- Infrastructure – the slower the real economy, the more government will create jobs in infrastructure spending. There are tremendous needs that exist in North America and the world to replace bridges, water systems and electrical wiring, even before we address alternative energy and new nuclear plants. Many of these facilities will later be owned by corporations rather than governments (407, Bruce Power) and should lead to good long term profits.
- Limits to exposure to the US dollar – for the last 6 years we have steered away from the US dollar. First it was the exchange rate at 64 cents, then the war on terror and over spending, followed by consumer debt problems and the mortgage and banking crisis - it has been a good place to avoid. We continue to think that despite the recent rally, the US dollar will fall in relation to over currencies.

As I began - I believe the Banking crisis is a watershed event. While we may not be completely past all of the bad news – we appear to be through most of it. The market normally responds positively before we see the indicators that the economy has turned around. In the near term we are expecting increases in unemployment, further lowering of interest rates, increases in business bankruptcies and decreases in both price and number of homes sold. These actions are expected to be accompanied by lowering of some costs and increases in spending by governments. The results of the past few weeks will change us all – it is critical that we remain positive and resist the temptation to pull all money from the market and put it under the mattress. The mattress was probably the best place for the past month – but in the longer term it will not get us to retirement.

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