



# CASTLEMOORE INVESTMENT NEWS



*Uniquely Superior Portfolio Management*

## Heartaches



By

**Ken Norquay,  
CMT & Partner**

Valentine's Day is upon us: the season for human beings to celebrate our emotional nature. For

jaded participants like me, this "Day of Love" has become a day of hollow ritual, a day of cards and chocolates and flowers; a day of tokens of love, not real love. What has happened to my real emotions? Have I forgotten how to feel?

When I first realized the shocking state of my emotional life, I felt disturbed. Aren't emotions the part of our lives that give us flavour? Is life worth living if we don't get all emotional about it? Have I become a Scrooge? ... a Grinch? ... some sort of robotic emotionless Star Trek Spock?

My only salvation was that fact that I was feeling bad about not feeling... in some perverse way, this made me feel good!

Then I realized something important: I'm a Canadian, not an Italian. Canadians aren't supposed to feel emotions, are we? Emotions are a Latin thing, aren't they? Or a French thing... Somehow, passion and Canadian don't normally go together. So, no problem: I am not devoid of emotions. I'm simply a Canadian! What a relief that was! Then I began to wonder about the irony of being a French Canadian. Canadians are dull and emotionless, but the French are excitable and full of passion. Then I began to wonder about a certain Act of Par-

liament...

In November 2006 Parliament passed a law recognizing The Quebecois as a nation. We, the emotionless ones, were told that this is no different than The Métis Nation or The Mohawk Nation or any other distinct cultural part of Canada. And, it appears we believed it! But there was a time when we would not have believed it. Quebec Separatists would have passionately declared victory! The media would have been FULL of emotional "end-of-nation" stories. Charles De Gaulle would have risen triumphantly from his grave and said: "I told you so!" But not this time: folk singer Bob Dylan once sang: "The times, They are a-changin'." It's true: the times have changed.



**The Irascible De Gaulle**

I used to wonder what our neighbours in Quebec would have done if they accidentally **did** separate from the rest of us. Would their new currency be known as the Que-buck? And would the new francophone central monetary reserve board be called the Que-bank? And would their new fiscal policy be known as Que-bunk? Fortunately for all of Canada, their Que-bark was worse than their Que-bite, and Canada got to remain one country.

If Bob Dylan had been a stock broker instead of a folk singer, he might have commented: "But this time it's different." As investors, we need to understand when the markets are emotionally "different" and when they are

emotionally "the same." There was a time when the recognition of The Quebecois Nation would have torpedoed the Canadian Dollar *and* the Canadian Stock Market. Why not this time? How can investors tell when to react emotionally and when not to react emotionally?

At CastleMoore, our rule is simple: we NEVER react emotionally to any news. News creates emotion. And emotion is poison for the investing mind. Emotion is what makes one sell at the bottom in a panic. Emotion is what makes one buy at the top in the frenzied lust for fast money. Emotion is the investors' enemy. For us, news takes the form of boring statistics. Data and crunched numbers. Back-tested statistical models. If the newspapers published what we study, no one would read. If ROB TV televised what we study, no one would watch. Our Investment Committee gets all excited when the computer spits out a buy or sell signal. One of the "thrills of the year" for CastleMoore was when we bought US Long Term Bonds in June '06 and sold in December. It was a triple header, statistically: clients made money on the price of the bond and on the currency exchange, plus they picked up six months interest. Even if we had produced a flowery press release, I doubt if the Sun would have published it. [Sigh...]

In the investment business, there is no season when we celebrate our emotional natures. There is no Valentine's Day for investors. No birthdays either. Just many happy returns, hopefully.

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## The True Story About Loss



By  
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You may have seen the typical illustration used to highlight the impact of loss upon your investment portfolio. But, have you seen the real impact of that loss, shown in the proper light?

The typical illustration used to show the impact of loss upon a portfolio goes something like this:

STARTING PORTFOLIO VALUE	\$500,000
10% LOSS	<u>\$ -50,000</u>
ENDING VALUE	\$450,000

STARTING PORTFOLIO VALUE	\$450,000
11.11% GAIN	<u>\$ 50,000</u>
ENDING VALUE	\$500,000

If you suffer a 10% loss in Year 1, you must directly follow that by an 11.11% gain to get back to square one by the end of Year 2. We have all suffered some type of investment loss over the years; it's no big deal. It goes with the territory. But, if we suffer two consecutive years of loss, it gets even harder to achieve the return required to break even. Occasional losses are a normal or expected outcome of investing. No one wins every time. The critical element is to reduce your losses as quickly as possible. I'll talk more about that later.

Here is what the typical illustration often overlooks: what it forgets to factor into the equation. What return were the general markets were providing at the time you suffered your loss? If the markets were delivering 8% returns, the true impact of

the loss calculation is quite different. I'll call the portfolio that suffers the loss in Year 1 Portfolio "A" and the one that achieves the market return instead of a loss in Year 1 Portfolio "B".

PORTFOLIO "A"	YEAR 1 - LOSS SCENARIO
STARTING PORTFOLIO VALUE	\$500,000
10% LOSS	<u>\$ -50,000</u>
ENDING VALUE	\$450,000

PORTFOLIO "B"	YEAR 1 - GAIN SCENARIO
STARTING PORTFOLIO VALUE	\$500,000
8% MARKET RETURN	<u>\$ 40,000</u>
ENDING VALUE	\$540,000

These scenarios show that if an investor suffers a 10% loss (portfolio "A") while the markets were moving up at 8% (portfolio "B") the true gap, the difference in the two ending portfolio values after Year 1, is \$90,000! This is after Year 1! Now let's suppose the markets deliver 5% in Year 2. I am intentionally being conservative with a 5% return. I want to show how even a small, but positive market return impacts a portfolio that is trying to recapture lost equity. The next calculation reveals the returned required for portfolio "A" to "catch up" to Portfolio "B".

PORTFOLIO "B"	YEAR 2 - GAIN SCENARIO
STARTING PORTFOLIO VALUE	\$540,000
5% MARKET RETURN	<u>\$ 27,000</u>
ENDING VALUE	\$567,000

PORTFOLIO "A"	YEAR 2 - RECOUPING LOSS
STARTING PORTFOLIO VALUE	\$450,000
26% MARKET RETURN	<u>\$117,000</u>
ENDING VALUE	\$567,000

What this reveals is that if an investor suffers a 10% loss in Year 1 while the market was averaging 8% profit, he or she must return 11.11% to break even. Remember 'break even', in this case, assumes the market delivers no returns in Year 2, not even dividends. We know we can't suspend time. In Year 2 the market returns 5%. Accordingly, the 'catch up' return required to match portfolio "B" is 26%. In short, it's as

if the two portfolios were on a conveyor belt moving away from you. In Year 1 it was moving at a speed of 8%. Portfolio "A" stepped off, and in fact, went backwards (-10%) while Portfolio "B" cruised along at 8%. The next Year Portfolio "B" slowed, but was still moving at 5%. It's not unrealistic to achieve 26% in any one year. What makes the task harder is the market was only delivering 5%.

The chart on the following page paints the picture rather clearly. It shows many scenarios of loss against an average market return rate of 8% and the number of years it takes to recover. Across the top axis is the amount of loss; across the side is return an investor achieves in the years following the loss.

As an example I have highlighted in the top row, a 15% loss. The side column shows the annual growth rate in the years following the loss: 13%. The intersection of the two variables reveals that it will take an investor 3.6 years to recover. You can see how astoundingly difficult it is to break even after a significant loss.

These numbers reflect a purely mathematical assessment of the impact of losing your capital.

Where ever there is the potential to gain, its corollary is the potential to lose. As we have seen, the consequence of loss is severe. Does this mean that a portfolio manager should be so fearful of loss that it impedes his ability to make a profit?

No it doesn't. Most of the stock market has a significant component of organic growth to it. By and large, most stocks should be higher today than they were twenty years ago. Most companies inherently grow. (This cannot be said for resource or other heavy cyclical investments.

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**“Buy, Hold...And  
Know When To Sell”**



CastleMoore Inc. helps investors manage their life savings. We are not stock brokers or mutual fund salesmen. We are discretionary investment managers specialising in “buy low, sell high” strategies instead of “buy and hold” strategies like the other guys.

At CastleMoore we manage our clients’ investments through a methodical and disciplined set of systems that virtually removes any individual bias and emotion from the investment process. What we do works. We rely heavily on loss avoidance techniques when making investment decisions.

Our clients are investors that pay particular attention to asset prices, have little tolerance for investment losses, and strong expectations of getting their money’s worth. Clients appreciate CastleMoore's all-inclusive, comprehensive fee schedule. If we are required because of volatile markets, to be more active within our client accounts CastleMoore bears all the costs associated with more frequent transactions.

Our team’s previous experience in national and international firms and small boutiques provides us the ability to deliver a high quality and cost effective professional portfolio management service. A CastleMoore client enjoys the benefits of having focused portfolio management without the distractions of also providing a “super market” of financial services. We just manage investment portfolios effectively – plain and simple. CastleMoore is uniquely superior portfolio management. To know more, including how we gradually and gently transition your existing portfolio to our models please contact us at:

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They often experience booms and busts.)  
As investors, we will suffer losses – it should be expected. What the data suggests is twofold: first, investors should avoid enduring large losses for sure!; and second, if inves-

said for investors who choose to over-weight a given industry or sector of the stock market. Remember the technology sector in 1999; or maybe even the resources sector today?

**YEARS TO RECOVER AT 8% GROWTH RATE**

**Amount of Loss %**

	5	10	15	20	25	30	35
9	5.6	11.4	17.6	24.2	31.2	38.7	46.7
11	1.9	3.8	5.9	8.1	10.5	13	15.7
13	1.1	2.3	<b>3.6</b>	4.9	6.4	7.9	9.5
15	0.8	1.7	2.6	3.6	4.6	5.7	6.9
17	0.6	1.3	2	2.8	3.6	4.5	5.4
19	0.5	1.1	1.7	2.3	3	3.7	4.4
21	0.5	0.9	1.4	2	2.5	3.1	3.8
23	0.4	0.8	1.2	1.7	2.2	2.7	3.3

*Peter Gibson*

tors are going to be successful at avoiding large losses they need a disciplined approach or technique to do so. These two points, along with loss avoidance techniques in general, are especially important for those who are approaching or who are in retirement now. The same can be

The lifestyle expectations of retirees cannot be met by today’s fixed income rates alone. Four or five percent is not enough. There must be some equity market exposure. So if you are thinking about retiring or if you are retired, you need investment techniques to avoid loss. And if you are a more aggressive investor who has placed a heavier bet on one or two sectors, your portfolio cannot be managed without techniques to avoid loss. At CastleMoore we have several loss avoidance techniques. Whether with us or with your advisor, we urge you to review your loss avoidance plan.

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## When You're Rich, You're Eccentric



By  
**Sheldon Liberman,**  
Portfolio Manager

What do the names Daddy Warbucks, C. Montgomery Burns, Scrooge McDuck, Ritchie Rich, Jed Clampett and Mr. Monopoly all have in common, besides being rumoured to have voted Democrat last November?

This group collectively heads Forbes Magazines list of the top richest fictional characters. The top six each has a net worth of over \$7 billion,

Other notables on the list include:

- Bruce Wayne; who, despite his wealth spent much of his time in a cave;
- Thirston Howell III, who seems to have taken most of it—along with several changes of clothing—with him on a three-hour tour; and
- Prince Abakaliki of Nigeria, who, despite being a political prisoner or suffering from some horrendous physical affliction, has managed to contact almost everyone on Earth with an e-mail address, offering to each an “exclusive” opportunity to receive a large sum of money, a cut of a vast fortune that needs to be hosted from someone outside of his country. Of course, he has since franchised

out his business; not a day goes by when I don't receive a similar “generous” proposal.

- Willy Wonka, the chocolate mogul, and the only member of the list I whose fortune I would have personally contributed to, assuming his products were kosher.

As it is, I've contributed to the fortune of Mr. Hershey because, after all, a waist is a terrible thing to mind.

Of course, when you've amassed that much wealth, fictitiously or otherwise, your idiosyncrasies become



Worth billions and you never age!

“eccentricities”.

A complete listing of the Forbes 15 richest fictional characters can be found at:

[www.forbes.com/2006/11/14/forbes-fictional-rich-tech-meia\\_cx\\_de\\_mn\\_mh\\_06fict15\\_sort\\_3.html](http://www.forbes.com/2006/11/14/forbes-fictional-rich-tech-meia_cx_de_mn_mh_06fict15_sort_3.html) (If this doesn't get those who receive this newsletter in print format to switch over to the electronic version, I don't know what will).

This is actually the first year that

Santa Claus has been excluded from the list, according to Forbes, not because his fictitious wealth doesn't measure up (indeed, he traditionally held down the top spot, or, if you will, the Pole position) but because too many readers wrote the editors insisting that he's real. To the best of my knowledge, none of those who wrote in were my clients; the jury's still out on my colleagues.

If you happen to be a fictitious character, you may well find our CastleMoore Model Portfolios useful. They portray our investments methodology and the returns derived there from, without regard to extraneous items like fees, or currency spreads.

They are available for perusal from our web site: <http://www.castlemoore.com/models.html>. If you cannot gain access, it's because the system has determined that you are a real person, in which case you'll need to register to view them. Please do this only once.

[Note to the securities regulator, Revenue Canada, and all mental health professionals reading this: we do not actually have fictitious clients].

But if you are real, we invite you to not only monitor our model portfolios, but to discuss your very real investment goals and constraints. We'd like nothing more than to help you grow more... eccentric.

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