CastleMoore News

Buy, Hold... *and* Know When to Sell™

THE CHANGE

By Ken Norquay, CMT, Partner

Volatility! Have you noticed how wild the financial markets have become since summer? In August we saw America's Biggest and Bluest-chip stocks (The S&P 500 Index) drop like a stone. In October it roared straight back up. Gold went up 45% in the seven months ending late August. Conservative, boring US long term treasury bonds went up 26% in two months! The normal staid conservative demeanor of the financial world has yielded to the emotional heaves and sighs of a casino.

This dramatic increase in volatility reflects an underlying increase in the emotions of the participants. And the cover story has focused on the financial plight of the tiny nation of Greece and all those Euro banks who loaned her the money.

Markets are not overly influenced by small investors like CastleMoore and our clients. Big financial institutions move markets. It's the big guys that are experiencing those palpitations of the heart whenever another edict comes down from Mount Olympus. It's their buying or selling that causes this volatility. Fear and greed are the markets' main emotions. What are big institutional money managers so excited about? Why are they reacting with irrational exuberance and irrational fear?

Let's use a bit of Socratic Logic to solve this riddle.

Ponder the fate of the typical American Baby Boomer. These are the ones credited with driving the stock market up in the 1990s. Unfortunately for them, the stock market shifted in the year 2000 and their projections of an 8% long term return on stock market investments disappeared. The Oracle was wrong. Buying high quality stocks and holding them for the long term resulted in their not having enough money to retire as they had planned. They have become angry and frustrated.

Multiply this by a few hundred thousand and you will feel the pain of the typical pension fund manager. For years they held themselves out to be highly skilled professionals piloting their financial ships through one storm after another, eventually reaching retirement's Holy Grail. Now it appears they made money only because the stock market went up. And now that the market is no longer going up, they don't know what to do. Money managers are desperate. They are losing clients every day and their business is evaporating. Their old "buy and hold the stock market index" strategy is simply not working. They are embarrassed, humiliated and desperate for higher returns.

Financial Planners who sold their clients on the idea that equity mutual funds should be bought and held for the long term have been betrayed. Their Golden Fleece was the 1% trailing commission their clients paid them each year they continued to hold. When the stock market dropped 45% from 2000 to 2003, their income dropped by 45%. When the market dropped 50% in 2008 – 2009, their income dropped by 50%. And, their credibility is down the sewer. They are disheartened and depressed, wondering what went wrong. They once personified the Trojan Horse, carrying their customers into the walled city of wealth and prosperity. Now they personify the Trojan Condom.

These are the emotions of today's stock market investors.

All have turned to short term trading as a way to make higher returns. It has become clear to all of them that the stock market is no longer suitable for the old buy and hold style. Buy and hold has worked for the bond market and for gold, but not for stocks. They all know that they have to buy AND sell, not just buy. In their world, they refer to this as trading. But, after a career of buying and holding, none of them know how to trade.

That's why the markets are so emotional. The big money is chasing news stories. Today's volatility reflects the market's mood swings. One month it's hot – the next month it's cold. The market is in menopause.

Investing today is different from before. There is too much emotion and too many short term traders. The rules have changed.

You should change too:

1. Remain calm and cool.
2. Have a plan. (This plan must address when to sell…)
3. Maintain significantly more cash reserves than you normally carry.
4. Develop a strategy for gold and for bonds. (This plan must address when to sell…)

Bob Dylan sang it in the 1960s: "The times, they are a-cha-a-angin"

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PORTFOLIO MANAGEMENT: WHAT'S IMPORTANT? HERE'S WHAT CASTLEMOORE DOES…

By Robert 'Hap' Sneddon, FCSI, President

When I initially meet people who are looking for new stewardship of their family or corporate assets the first thing I explain to them, in no uncertain terms, is they must know how their management team thinks, how they arrive at decisions, and what is their philosophy. The rest of the matters surrounding the client/advisor relationship – service, administration, statements e.g - are very important though they are not fundamental, and they can be improved and tailored over time. The operational relationship can and should be good, but it is not necessary for success as is both parties mutually placing a high value on the deep foundations and principles of the management.

Why is this so important that I make sure to bring it up poignantly and early in first meetings? It's simple. When you hire a discretionary portfolio manager they will be making decisions on your behalf using a general plan laid out in the beginning. Though you may watch portfolio activity very closely, say daily on-line, or only monthly through the hard copy activity report, your level of attention to the day-to-day decisions does not matter. What matters is the cumulative effect of decisions over a longer period, two years for example. By focussing the meeting early on philosophy and methodology, not on product or a momentary investment view, it ensures that the fixed, deep-seated values which underpin the decisions are known up front. We are confident that our methodology is exceptional, but it's more important for me to impart to potential clients that this is what they should be paying attention to when they eventually make their choice of managers.

At CastleMoore, it is clear from the outset that: asset protection, the importance of technical and fundamental analysis, and an unemotional adaptive strategy is what guides us in navigating and potentially exploiting market volatility. This allows us to be shielded, to some degree, from the effects of an ever-changing media analysis of the state of global investing.

After agreeing that our core principles do match up we begin an easy process, one that requires clients to provide us some particular information in addition to the typical disclosure, eventually leading to the quantification of the relationship through an investment policy statement, The BluePrint™.

We ask what your previous investment experience has been like. What investment vehicles have you used? Stocks, bonds, ETF's, mutual funds, options, futures, commodities? What has been your best investment experience? Your worst? Have you lost significant capital in the past? If you are funding your portfolio with an existing invested account are there any restrictions on any security sales? (We incidentally manage out your existing holdings over time, from a position of strength, if possible, until you are on a CastleMoore portfolio model. We do not simply sell day one) Do you have a financial plan? This is important as we do not do financial planning. We perform a general net worth statement for you, but it's a matter of principle that we do not do planning. That role should be performed by a specialist who only creates and manages plans, and does not also make investment decisions. That's a serious conflict to us. We will make a recommendation to a fee-for planner if you don't have one, confident that a good one may give us a bad grade if we're not performing our job well at all times.

At the end of our discussion we also like to know what kind of CastleMoore investor you see yourself as: a Saver, Class, Focus, Structural, or Two-Way investor. Or some combination. The table on the right page shows all our portfolio types with brief explanations of each category. Of course, we ask standard risk questions too, and distill everything to come with an appropriate allocation to the Risk-to-Reward Matrix.

It has never been more evident than it is today that investors must select a manager who is not only built to manage in these markets, but one who also places philosophy and methodology below nothing else.

continued on next page

Portfolio Methodology and Reward to Risk Matrix

THE SAVER INVESTOR

LOW

The emphasis is on safety of principle and an income stream. The portfolio type may be combined in conjunction with other portfolio types or be a stand alone investment methodology. Investable asset classes and/or their equivalent include: Cash, Fixed Income (Fed, Prov, "BB" Corp), Convertibles, and Index-linked notes.

LOW — MODERATE — ENTREPRENEURIAL

THE CLASS INVESTOR

Emphasis of account management is on Safety and Capital Gains, and appropriate to investors with previous mutual fund or financial planner experience. The goal is to participate in up trends and avoid down trends.

Risk Profile and Security Universe

There are three risk profiles, from *Low risk* to *Entrepreneurial risk*. The different investment vehicles may include: Exchange traded funds (ETFs) in N.A. and global equity indices, fixed income, precious metals, currencies, commodities and individual fixed income securities.

THE FOCUS INVESTOR

Emphasis of account management is on Safety and Capital Gains, and appropriate to investors with financial planner or investment dealer experience. The goal is to participate in up trends and avoid down trends, to do so in a more focussed fashion than the Class portfolios through sector concentration.

Risk Profile and Security Universe

There are three risk profiles, from *Low risk* to *Entrepreneurial risk*. The different investment vehicles may include: Exchange traded funds (ETFs) in N.A. and global equity indices, fixed income, precious metals, currencies, commodities and individual fixed income securities.

THE STRUCTURAL INVESTOR

Emphasis of account management is on equity-based capital gains and safety of security selection. Strategic Analysis Corporation's Structural Valuation Analysis® (SVA®) Methodology is utilized along with technical analysis in the selection and management of positions. All three portfolios are usually fully invested but can hold up to 100% cash or fixed income during periods of market weakness.

S&P/TSX 60 True Value
Actively over-weights in the structurally strongest constituents of the TSX 60 index.

DOW 30 True Value
Actively over-weights in the structurally strongest constituents of the DOW 30 index.

North American Growth
Actively over-weights in the structurally strongest growth securities to outperform the TSX 60 and Dow 30 indices. The investment universe is the S&P/TSX Composite, S&P 500, and NASDAQ 100 indices.

THE TWO WAY INVESTOR

ENTREPRENEURIAL

Emphasis of account management is on Capital Gains and shorter term trading profits, and is limited to 15% of total investible client assets. The methodology may utilize long and short positions as well as hedging strategies. This portfolio will sometimes make use of margin for additional leverage. Focus or Structural portfolios may hold similar positions at times. The different investment vehicles may include: ETFs in equity sectors, fixed income, precious metals, currencies, commodities, individual equity and fixed income securities, and leveraged ETFs.

RECENT MEDIA

We've been busy lately. Investors and the media are looking for answers to what ails the global economy, and well, they've been calling us. If you missed our recent TV appearances on BNN or would like to watch the playbacks click on the link below.

Any technical difficulties: call **Matt 1.877.289.5673**

Here's an interview and article from CNBC a few weeks back. **http://www.cnbc.com/id/45288956**

BNN Appearances **http://www.castlemoore.com/businessnewsnetwork.php**

CNBC
FIRST IN BUSINESS WORLDWIDE.

BNN
BUSINESS NEWS NETWORK

THE CHART PAGES

GOLD BULLION

We still own no gold bullion, nor do we own any gold stock for that matter. We sold our large gold position for all account types (Class, Focus and Two-Way, 3 risk levels in each) in two tranches in August, then went short and since covered for the Two-Way portfolio. The lower three panels reveal near term weakness in gold. We will continue to be patient awaiting a lower entry point.

CANADIAN BONDS

This chart of an ETF represents the Canadian long term (10+ years) bond market. We recently sold a portion of our Government of Canada 10 & 20 year bonds and the security above. Our range was 40%-77% across Saver (all bonds, all the time), Class and Focus portfolios. We did not sell the entire positions as our three part bond model has two segments still in buy mode. This chart is bullish but extended. The bond model will be updated in early December.

LOONIE

The Loonie recently pulled back from just under the late spring break down at $1.015 USD. At the time of writing we are closer to $0.9550 USD. A breakdown of the September lows around $0.94 begets lower prices still. We have raised our USD exposure for all accounts whose mandate permits foreign currency exposure.

US DOLLAR

Of course, and as always, as Canadians the US$ dollar matters. This chart shows the US $ index, a measurement against a basket of global currencies, of which the Loonie is less than 4%. The bounce off the mat in September continues on today as the "risk off" trade due to global uncertainties stemming from European and US sovereign debt issues. Yes, even though the US is having its own debt issues, the US$ is still the world's reserve currency and will be sought after in volatile times. Is it a short term reaction or more substantial? It's too early to tell, but we've added more of it to portfolios as mentioned and will do so if it passes some key levels.

THE CHART PAGES

CANADIAN EQUITIES

If you compared this chart of the TSX with the chart of the C$ you'll see they are pretty much the same. So goes the Loonie, so goes the Canadian stock market. That's the point of the "risk off/ risk on" monikers – all things connected to the cyclical or materials sectors (both are economically sensitive) are considered "risk on" investments. The short up moves followed by down trends in all the above panels suggest we may revisit the September lows.

US EQUITIES

The S&P 500 looks like the TSX, and the C$ too, as all stock markets are a "risk on" asset. While its current lack of strength is similar to the TSX, being prudently invested in the S&P as Canadians has not been exactly the same ride as being in the TSX. First, if you had currency exposure you've been buffeted by a rising greenback (+5%). Second, the S&P has not had the same returns:TSX -13.7% vs. S&P -7.5% YTD. You`d been down on 2.5% on an index basis and positive if you`d been in a defensive sector such as utilities or pipelines. The preferred strategy now is to acquire near 1150 and use tight risk management.

WHAT MAKES CASTLEMOORE UNIQUE AND VALUABLE?

- Management of Client Life Savings
- Not Stock Brokers or Mutual Fund Salesman
- Discretionary Asset Management
- Methodical and Disciplined
- Unemotional, Unbiased Decision-making
- Low Loss Tolerance
- All-Inclusive Fee Pricing
- Focused Approach – No "Super-Market of Services"
- Pre-Existing Portfolio Transition Option
- Effective Portfolio Management – Plain & Simple
- Broad & Deep Industry Experience
- Managed Asset Classes – cash, maturities, ETFs/stocks, precious metals

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THE BENTLEY AND THE SCOOTER

By Thomas Kleinschmidt

Once upon a time a Great Big Bentley motorcar met a Little Scooter and challenged him to a race. Feeling confident, the Scooter agreed. Each thought they would win. The starting pistol sounded and they were off, running, running, running. Suddenly, both contestants tripped! They tripped and stumbled and tumbled and slowly came to rest, each quite worse for wear, arguing as to who had lost the race more.

Okay, this is not a kid's story…both the Bentley and the Scooter are personified stock positions. Investor confidence was the "each thought they would win" (read: you thought each position had a chance of winning). However, for some reason or another you held on to that position after it tripped, stumbled and tumbled onto the pavement. Now, let's make our Bentley a LARGE stock position and make our Scooter a SMALL stock position you hold. After the crash the rolled Bentley set you back a tonne of dough but the Scooter… not so much! However, each lost 50% of their value, so, what is the better measure, dollars or percentages?

I vote dollars and propose that investors seeking capital gains look at clocking individual positions in terms of dollars, never percentages. The real work is done position by position earning or losing real dollars during the year. Dollars are not abstractions. You traded your time for dollars. You spend dollars. You save dollars. Percentage gains/losses for individual positions are abstractions and distractions. The arithmetic at the end of the year – adding and subtracting dollars earned/lost position by position – defines the annual percentage gain/loss for that year, not X% + Y%. Sure, it is NICE to say you earned 123% on a stock but really, what did you make in terms of real dollars, over what time period. It's NICE to say your portfolio returned 23% this year but how safely.

Here's more proof. High net worth investors talk about dollars, not percentages. Bentleys are Bentleys and Scooters are Scooters. Why then do we, at the end of the year, figure out our "Rate of Return"? Does the CRA care about ROR's? No, the folks at the CRA care about how many dollars you made during the calendar year.

The only type of investor that should give a rodent's butt of concern about RORs is the Saver…the Bond investor crowd. Comparing individual positions and the entire portfolio of a Saver Investor is just like bushels of apples-to-apples. To a Saver, the damage to the Scooter is the same as to the Bentley…percentage wise! As for the oranges of the other investors who seek capital gains? The two good reasons they would care about RORs are (a) to see if they should be shifting more or less money into bonds or, (b) benchmarking. That said, I feel that ALL investors should only care about increasing the dollar value of their portfolio, year after year, safely.

Considering your individual investments in terms of dollars gained or lost makes gains and losses more tangible. Perhaps that is exactly why investors, when faced with the pain of a bad fall, think in terms of percentages – oh, it's only setting me back X%. In reality, they lost hard, cold cash…I for one know that it is sometimes too painful to dwell on. I think the same goes for financial planners who are wrist-bound to what a computer spits out as a good investment strategy for their clients based on their long term plan. But, if we are indeed long-term investors, and if the market does go up 70% of the time, then by definition a dollar lost today really should be presented as the future loss of purchasing power! This, of course, has as much chance of happening as the financial industry actually admitting that good portfolio managers can tell when the good times to own the various asset classes are.

Money carries quite the emotional charge. As I have said in other articles, you've got to keep your greed and fear in check and have a handle on your behavioral traits. Methodology helps. A trading plan helps. Detailed objective and subjective notes for each trade -- and reviewing them -- helps. Mistakes teach investors who follow this rigor much more, more clearly, but harder. At that level of the game investors acknowledge that opinions – including theirs – are worthless. They have learned methodologies and techniques, and have tamed their monkey-brains to become profitable investors in any commodity, economic, or business cycle. You can too.

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INVESTMENT MANAGEMENT FEES

By Ed Arbuckle, CA, FCA, TEP

When you are shopping around for someone to manage your investment portfolios and registered tax plans, there are a many factors to consider. One of the most important ones is the cost of fees and the deductibility of those fees for tax purposes. Believe me, the after tax fee cost has an enormous impact on the value of your portfolio years ahead. So don't treat it lightly!

We will get the tax deductibility issue out of the way first and then discuss the investment choices that can make your fees frightfully expensive or give you a bargain.

TAX DEDUCTIBILITY

The first consideration as to whether or not the fees are tax deductible depends on whether they relate to your investments (margin account) or to your registered plans (RRSPs, RIFs, etc.). If the fees relate to registered plans, they are simply not deductible on line 221 of your tax return. It doesn't matter where the funds come from (sometimes your margin account) – they are not deductible. Tax receipts from your investment firm at the end of the year will identify the accounts covered (investments or registered plans) and should be treated appropriately when filing your tax return.

Fees paid on your margin accounts will be tax deductible if they qualify as investment counsel fees under the Income Tax Act. Otherwise, the fees are not deductible and effectively reduce the capital gain or increase the loss when you sell the investment which therefore makes them half deductible. Fees paid to CastleMoore are investment counsel fees and can be fully deducted. That's about a 50% tax savings if you are in the top tax bracket so it has a major impact on your after tax rate of return.

Investment counsel fees are defined as follows under the Income Tax Act:

- The fee is an amount that is not a commission
- The amount is paid for advice as to the advisability of purchasing or selling of securities or for administration or management of these securities.
- The person's (who charge the fees) principal business is advising clients as to the advisability of purchasing or selling securities or the service includes administration or management of these securities.

Fees paid on your margin account to stock brokers or to mutual fund providers are not tax deductible and that's a problem but this is changing as they get more creative. Much more could be written on tax deductibility but let's leave it at that.

FEES

Having discussed the tax deductibility issue, we need to look at the cost of fees under various alternatives. Generally speaking, there are three distinct fee arrangements for your investments.

- Transaction fees (stock brokers)
- Investment counsel fees
- Mutual fund fees

Transaction fees are becoming less prevalent and are being taken over by investment counsel fees for two reasons. Transaction fees are not tax deductible and are not based on portfolio performance – they stay the same no matter how well you do. On the other hand, investment counsel fees are tax deductible and performance based so they are the better route to go.

Fees charged on mutual funds are similar in style (percentage of portfolio value) to investment counsel fees. The possible components of each are as follows:

Mutual Funds

- Management fees (MERs)
- Administrative fees
- Front end load fees
- Deferred sales charge fees

Investment Counsel Fees

- Management fees

Obviously the mutual fund industry does a good job of getting a variety of fees into play. Management fees and administrative fees are charged against the fund itself so the investor never sees them. The front end load fees and deferred sales charges may be netted against the cost or proceeds of the mutual funds so they too may not be seen. Mutual fund reps can play a little game but adjusting management fees up or down depending on the front load fees or deferred sales charge option taken by the investor. Granted, all of this is laid out in the initial prospectus but that will only be a distant memory as time passes.

In the end, fees charged by mutual funds are high by all standards. They probably look like the following:

	EQUITY FUNDS	BOND FUNDS
MANAGEMENT FEES	2.5%	1.5%
ADMINISTRATIVE FEES	.10%	.10%
	2.60%	**1.60%**

Mutual fund fees are seldom tax deductible so the cost compared to investment counsel fees is enormous. Let's say investment counsel fees are 1.5% (that figure may vary with the size of the portfolio), that reduces the after tax cost to around .8%. Compare that with a 2.6% mutual fund fee. Need I say more!

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