CastleMoore Investment News

Baby Boomers: When Are you Selling?

By

Robert Sneddon, President, *Fellow of the Canadian Securities Institute*

I am not a baby boomer myself, but I've come to intimately understand their financial concerns and objectives. I had to. When I entered the financial services industry it became clear to me rather quickly that I better get to know this important demographic if I was going to be a relevant stock broker. This is not to say that I focussed my attention exclusively on baby boomers. It simply means that I discovered early on that I would encounter them as clients more often than any other age group. What has got me thinking about them lately beyond the fact that so many will be retiring at the same is just how many have a reasonable, adaptive investment strategy.

Whether you are a professional serving this group or are a baby boomer investor the issue of a steady and deep wave of people entering retirement shortly and for the next 20 years or so presents some unique challenges to both parties. What effect on house, stock and bond prices and even private investments such as small and medium sized businesses which they own, will this mass dash for the shuffle board pad have? How will this perception, especially among members of this group, change investing behaviour in the years to come? Will just recognizing this fact, let alone holding an opinion on the strategy to employ, aid the retiring boomer?

This challenge reminds me of an apparent logical observation that many clients have brought to my attention over the years, and one that highlights a solution to the potential dilemma.

Investing anytime around February and March, the time of year when RRSP accounts across the nation are flusher with cash than during any other time of year, has seemed to many investors like buying at some sort of market top. When I was in the traditional role as a broker clients had the final word on investment decisions. I provided my opinion through my company's research reports; in many cases my clients wanted me to make the final decision (most brokers do not have this discretion). But some clients informed me that they were going to wait until after the "RRSP season effect" on the market had subsided. Naturally as broker I, too wondered about what is surely more than just the apparent common sense of the non-professional reaching the possibly indifferent or doubting ears of the professional. When clients and brokers alike are trained to *buy and hold* and *invest for the long term* the effects of this period of possibly inflated prices are dismissed. It seems to make sense that if everyone is piling their RRSP contributions into the market at the same time, once it's all done there's going to be an absence of buyers and their recent investments will be under water by April. This simple logic has some real numbers behind it.

A colleague and mentor of mine, Don Vialoux, a Chartered Market Technician with long credentials with Richardson Greenshields and RBC Dominion Securities, wrote his dissertation for his technical analysis designation (CMT) on "Seasonality in Canadian Equity Prices" His paper, later published by the distinguished Market Technicians Association's Journal (New York), opens with what is today has become a quiet proverb amongst some industry professionals: "Buy them when it snows, sell them when it goes!" What Vialoux had quantitatively observed was that there were visible annual periods of seasonal strength in the Canadian stock market. Through the collection of annual data from the period 1982 to 1994 Vialoux observed that from the end of November through to the end of March each year "the average rate of return on investment was an amazing 12.2%" When Vialoux looked at the same yearly data, but from the

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Company Notes

We have changed the name of our client and friend newsletter from *The Rampart* to the above to avoid confusion and association with a small penny stock brokerage firm. We thought of some catchy names but we want to be known for writing informative and entertaining articles. On a separate note, Ken Norquay, Partner, received his Second Degree Black belt in karate recently—we for sure don't argue with Ken anymore. He's right all the time.■ ***CastleMoore Inc.***

BOOMER's continued

beginning of April to the end of November, the return was 6.1%. His thesis concludes with the following: "Seasonality analysis shows that Canadian stock prices have been significantly strong during the four month period from the end of November to the end of March. Three main factors *probably* (my italics) influencing this period were year end transactions for tax purposes, RRSP contributions and seasonal influences by US equity markets." If purchasing securities in February or March is unwise, what about selling growth investments such as stocks or private businesses and purchasing fixed income instruments when everyone else is too?

What does this all mean to retiring investors who own homes, cottages, investment portfolios and private companies? If everyone knows the same things about this story, how are investors going to deal with it? Will most investors downsize their large homes and gradually sell off their vacation property? Will most start to favour bonds, GICs and income trusts over growth orientated vehicles such as stocks or private company shares? Or will some because they believe they will benefit by going against the crowd or because they acknowledge they may need the growth to fund a historically longer retirement be more inclined towards stocks and other equity investments?

If you apply that phrase I keep throwing around, "common sense", to some of these questions it appears that the flight to fixed income securities will dramatically increase demand and lead to correspondingly lower rates of interest. The effect on equities in this scenario would lead them south. Undoubtedly I could keep coming up with more permeations of the possible ripple effects baby boomers will have on each other's investment goals, but more examples may only lead one to the conclusion that it is a bit of a guessing game.

Unlike Vialoux's study which reveals the annual seasonality or cyclicality of Canadian equity prices, there are no empirical studies that examine the relationship between an aging generation of investors and asset prices. Logic would suggest that the investor to lighten up on stocks, sell the second home and business and put most of their money in fixed income investments. But there's always the serious risk to purchasing power if inflation starts to increase. Moreover, competition for rates drives rates lower. While it would be an anomaly for rates to be dropping *and* any sustained period of inflation to occur simultaneously each force works against the prospect of boomer's incomes matching their expenditures.

While common sense can serve one in many aspects of life it doesn't always work out in investing if everyone else is using the same sense. Having a strong opinion of how to handle it all could be a little dangerous too. Worrying about the issue now because you recognize it is better than worrying about it later if that previous *sensible* thinking goes awry sometime down the road along with everyone else's. Instead of worrying at all the baby boomer investor should adopt a strategy based on risk management. Getting personally comfortable with an investment strategy is important if only for lifestyle reasons. Investors should not adopt a strategy that doesn't sit well with them. That being said, how we feel about a strategy has no correlation to the results it produces – none.

The best strategy should appeal to one's head, not the heart (or stomach). Why try to guess what to do and when to do it? Why not develop a strategy that reduces conjecture and speculation? The best strategy to negotiate through the maze of asset price swings must be quantifiable. Attention must be paid to understanding the supply and demand analysis of the investments boomers are going to put their hard earned dollars in.

As the Vialoux study demonstrates, it's not the reasons that will matter – they can be figured out later - it is the *effect* the probable reasons will have on asset prices and how a portfolio responds in the present.■

WE'RE ON THE WEB!
WWW.CASTLEMOORE.COM

First Canadian Place
100 King Street West, 37th Floor
Toronto, ON M5X 1C9

Phone: 1.416.306.5770
Toll Free: 1-877-289.5673
Fax: 1.416.664.8801
E-mail: info@castlemoore.com

"We Buy & Sell, not just Buy & Hold"

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 based firstly on supply and demand analysis of an investment class; and secondly, on the traditional approach.

Accordingly, our clients are investors that pay particular attention to asset prices and have little tolerance for investment losses. Our clients have similarly strong expectations of getting their money's worth, and appreciate CastleMoore's all-inclusive and 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 large national brokerage firms and both small investment dealers and investment counsels provides us the ability to deliver a high quality professional portfolio management service while adding truly independent and custom-tailored advice to our clients for reasonable costs. 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.

MAINTAINING YOUR BALANCE

By
Sheldon Liberman
Portfolio Manager

The future ain't what it used to be (Yogi Berra)

Rebalance your portfolio, because it ain't. (Sheldon Liberman)

Ol' Yogi likely wasn't thinking of his investment portfolio when he favored us with that particular Yogiism, but in the mind of a portfolio manager, he might as well have been, For, to quote another sage, Mark Twain, who, again likely had other things on his mind besides the direction of the markets, "to a man with a hammer, everything looks like a nail."

But I digress.

At the McGill Business School, they taught us that the first step in creating an effective investment program is to find out all you can about the investor: his or her investment knowledge, income, age, liquidity needs, tax situation, and any personal preferences she or he may have. (Hint: if you walk away from the initial meeting knowing anything about your client's political views, source of family strife, how he sustained his war wounds, or anything else I'm too genteel to mention, you probably should not be charging by the hour).

A good portfolio manager will always be up to date as regards to his or her opinions about the various capital markets he or she participates in. For one thing, one never knows who he or she might meet in course of an average day, including, but not limited to, current or potential clients or microphone-wielding media interviewers. Moreover, a potential client has every right to know, before giving of his or her precious time, whether on not the manager's knowledge extends beyond chinchilla futures.

With client info and market expectations at hand, the portfolio manager crafts the Investor Policy Statement, a formal restatement of client objectives and restraints, along with the managers strategy for attaining these objectives. At our shop, the IPS is called the "Financial Blueprint" (yes, it really is blue). The Blueprint not only spells out what the manager and client expect of each other, but as well serves as a useful benchmark for the future, to gauge the extent to which the portfolio is growing along projected lines, and which adjustments, if any, are necessary.

Even if capital markets perform exactly as expected—and that itself is rare, ask Yogi—adjustments are generally necessary for all portfolios not crafted with the buy-and-hold strategy in mind. This is because there will never be uniformity among the various asset classes, and the allocation before readjustment will have drifted from the optimal mix created since the time the portfolio was created or last "rebalanced."

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BALANCE continued

As well, rebalancing may be made necessity due to changes by the client's circumstances: new job, new child, the granting of parole, or the simple passage of time and its attendant reduction is time horizon, etc.

Alas, most investments programs that fail to meet their stated objectives do so because the underlying portfolios are generated and then neglected. In other words, the critical rebalancing function is not performed with adequate frequency.

Other Yogiisms:

"You should always go to other people's funerals; otherwise, they won't come to yours."
"Nobody goes there anymore; it's too crowded."
"You better cut the pizza into four pieces because I'm not hungry enough to eat six."
"I don't know (if they were men or women fans running naked across the field). They had bags over their heads."

More from Mark Twain**:**
"Be careful about reading health books. You may die of a misprint."
"Don't go around saying the world owes you a living. The world owes you nothing. It was here first."
"Never put off until tomorrow what you can do the day after tomorrow."
"The radical of one century is the conservative of the next. The radical invents the views. When he has worn them out the conservative adopts them."
"A banker is a fellow who lends you his umbrella when the sun is shining, but wants it back the minute it begins to rain"

Sheldon Liberman
sheldon@castlemoore.com
1.416.306.5770

FOREIGN CONTENT RULES NOW SCRAPPED: NOW WHERE ARE THE GREENER PASTURES?

Foreign content rules have recently changed. Beginning in 2006 Canadian RRSP investors are no longer bound by any federal rules that limit the amount of money that they can invest in security markets outside of Canada.

In the past, these limits often made managing and RSP account tricky. There were onerous penalties in the form of government taxation for each percentage point your portfolio was over the limit. The taxes, I mean penalties, were charged monthly and they accrued. In addition, the actual limits had been gradually increasing over the years so you had to know where they were at.

Like say, CanCon, which legislated that a certain minimum amount of Canadian artists had to be played on the radio, the foreign content limit rules attempted to support the Canadian marketplace. How much the rules actually helped domestic companies is probably unknown, but it seemed like a nice thing.

Now that the restrictions are lifted those that were hollering at the government to raise the maximum allowable or do away with it entirely because of lost investment opportunity should be happy today. You see the Canadian market only represented 3% of the global total. More importantly returns in the U.S., European and Asian historically outperformed Canadian ones, and in many situations, by a good clip too. With all this free space and greener pastures to roam where to first?

Here's the hook for I'm sure you felt one coming: the Canadian market has been one of the best places to be in the world over the last three years and this trend is still in effect. When you account for the Canadian dollar into your total return from the beginning of the year from 2003 to 2006 a Canadian investor had the following international returns: Dow Jones -10.0%; S&P 500, 0.0%; London 10%, and; Japan 42.2% (not bad). Canada, over the same period, delivered a whopping 83.9%!

Moreover, the prospects for a continued strengthening of our dollar due to major resource investments by nationals and foreigners appear robust. In order to send your investment dollars outside Canada you have to be confident your chosen country not only keeps pace with a similar Canadian one, but also that it, in fact, outpaces it by at least as much as the rise in the Canadian dollar against that country. If it doesn't sending your dollars elsewhere makes no sense. Have a look again at the Canadian Dollar chart on Page 2.

When you are going "international" do your homework (or have your investment guy or gal do it) and make sure you understand the total picture, including what effect a strong loonie will play on your global investment decisions.■

Robert Sneddon
robert@castlemoore.com
1.416.306.5770