CastleMoore News

Buy, Hold... *and* Know When to Sell™

BIG GAME HUNTING

By Ken Norquay, CMT, Partner

In ancient times our ancestors hunted to survive. They learned to 'stalk' animals that lived very different lives than we human beings. Human hunters stalked their prey by trying to imagine what their prey's life would be like: then they would know how to successfully track them. In modern times successful investors need to learn the same skills. In order for us to hunt in today's financial market jungles, we need to stalk the activities of our prey: the ones from whom we make our profits.

Ancient human hunters' hearts beat at about 65 beats per minute (BPM.) An elephant's heart beats at about 30 BPM. Lemmings' hearts beat at about 400 BPM. How did those primitive human beings stalk both little animals and big animals when the paces of their lives were so fundamentally different? Can modern investors hunt successfully in the financial markets if we don't understand the paces of the different investors from whom we hunt for profits?

Consider, for example, those multi-billion dollar pension funds who like to buy investments and hold them for years. They might have liked to buy their massive stock market positions in the late 1970s and quietly reduce those positions in the first decade of the 2000s. These investment pachyderms move slowly and deliberately – and when they move, they move BIG. And they move in herds. How does one hunt a herd?

Then there are the jackals: the thousands of day traders buying and selling stocks and futures all day long. Their basic pattern is to take an opening position in the morning and to close out their trades in the afternoon. For these in-and-out traders, carrying an investment overnight represents higher risk than they are willing to take. They are in quickly and out quickly, operating at an entirely different time horizon than the herd.

Then there's us.

Question: Where does CastleMoore fit in? Are we modern day hunter gatherers? Do our hearts beat fast, like a small animal, or slow like a large one? Are we like the in-and-out jackal-trader or the stay-the-course brontosaurus's who make their moves over decades?

Answer: We hunt for survival: our clients' survival. Our prey is other participants in the financial markets. Our investment goal is for our clients to profit from long term financial up trends and to avoid down trends. For example, the bond market has been in an up trend since 1981. Bonds are our clients' largest asset class right now. Gold has been in an up trend since 1999. Gold is our second largest investment asset right now. Judged by these holdings, CastleMoore appears to be like the giant animals of the herd. But our hearts beat faster than that. There were times since 1999 when the price of gold went down or sideways for a year or two. Occasionally, we behave like a jackal-trader, selling out during the high risk times. There were several times since 1981 when long term interest rates went up and the bond market went down: again, we would behave like jackal-traders and avoid the bond markets during those times. But the real controversy is not in bonds or gold.

The real controversy is in the stock market. Has the herd, the masses of giant pension funds, taken the stock market too far? Have the pachyderm investors taken such huge positions in the stock market that they are doomed like the ancient dinosaurs? Is the Canadian stock market's peak in 2008 or the US stock market's double peak [2000 and 2007] the end of the long term up trend of North American stock markets? Is the market heading for another 1929-1932 wipe-out? Is the financial destiny of small investors like that of the herd of lemmings heading toward the cliff? How will it all turn out? There are some scary stories out there. Where does CastleMoore fit in?

We hunt for survival: our clients' survival. Even when economic times get tough, we will continue to hunt for investment classes that are in long term up trends. Bonds and precious metals are good examples. Certain foreign currencies are another example. But, like the stock market, there are times to take the jackal-trader's position and avoid the risk.

CastleMoore recently celebrated its fifth anniversary. Our three oldest accounts show returns since inception of 5%, 2% and 3.8% in a time that featured a 50% drop in the stock market and some wild fluctuations in the Canadian dollar. The reason we have been so much more successful than the buy-and-hold-herd is that we are hunters. We try to stalk those investments that are in up trends and avoid those in down trends. We try to apply ancient wisdom to modern investing.

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A FEW TOPICS TO PONDER: INTEREST RATES, CORPORATE EARNINGS, AND STRUCTURAL CHANGES

I often try to write on one serious and longer term matter, but I also find the value in touching on the basics of several issues as I do in this column. You know, sometimes one prefers to read the short, small-bite articles in the newspapers – you can often get much out of them in less time.

By Robert 'Hap' Sneddon, FCSI, President

INTEREST RATES AND DIRECTIONAL INFLUENCES

Short term interest rates are set by monetary policy and long term rates by inflation rate and economic expectations. As the Bank of Canada embarks upon its second rate hike since June it's important to understand what it means to investors and the fixed income market.

First, off the hop, corporate bonds act for the most part like stocks, though they are impacted by what happens with interest rates and company interest payment coverage. For example, corporate bonds bottomed in October 2008 and tested along with most global stocks in March, but did so "testing" down to being up only 23%. Corporate bonds and convertible bonds too have a "floor" of support that eventually kicks in unlike stocks due to the income.

So what I am talking about is pure sovereign or government bonds here, obligations to pay an income stream and return of capital by a state. Carney's raising of short term rates of course was reflected in the short end of the curve, but not the long end. In fact, long rates moved down on that day for other reasons. Most investors believe that you shouldn't invest in fixed income, especially the long end when rates are being raised – this is the fallacy.

The debate over future economic conditions is still a little muddy. Certainly, over the last six months the talk in the financial media and investment community has been when the stimulus will be "withdrawn". In the US and now Canada, we are also seeing some of the leading economic data roll over. But most importantly, inflation is no where to be seen, and in fact, deflation is appearing at the margins. Canadian and US bonds have also benefitted due to the European debt crisis, a condition where repayment or default is a concern. To entice investors, such countries must offer much higher rates and assuage the market that repayment will occur.

In brief, short term rates are set by the Feds and long term by inflation expectations. Full stop.

CORPORATE EARNINGS AND CORPORATE HEALTH

Quarterly earnings or profits are coming in nicely with approximately 70% beating expectations year-over-year (YoY). Now granted comparisons with last year/year and a half, are pretty easy to make. Much of the decent performance in "bottom line" growth over the last year in earnings has been due to cost savings. Companies reduced employees and any truly marginal expense to make their numbers. This recent quarter has seen some companies do well on the "top line" or total revenue but they are not the norm. One of the conditions that would help to fill in an economic all-clear or show things are truly improving would be real revenue growth.

Companies have large cash reserves now. Some like Microsoft or Apple have enough to finance a smaller country! In general too, companies, like individuals, have been paying off debt at a record pace (Individuals have a ways to go still). When you mix them all together – historically weaker top line growth, lots of cash and debt reduction – it suggests they are cautious on the outlook. Sure, some will return it to shareholders through share buybacks or special dividends, but they want the ability to adapt to conditions.

Von Mises advocated pricing mechanisms as the basis for long term economic sustainability.

continued on next page

STRUCTURAL/SOCIAL CHANGES

Though most investors or the financial media still don't see or acknowledge it, we are under-going structural changes in western society. It's in part a return to "pay as you go"…the old days. Today, pensions for example, are more likely defined contribution vs. defined benefit. Defined benefit plans mean one's company guarantees an employee so much per month at retirement. A defined contribution means they'll match you some dollar amount but you pick the investments and deal with management yourself. Many companies' defined benefit plans are under water after 10 years of a -2.3% US and a +3% Canadian stock market performance. (Bonds incidentally over the same time frame, +11% and woefully under owned still today by investors and pensions). This will hit the tape eventually. In the US, legislation was passed in 2006 that stated companies must close their unfunded liabilities in their defined benefits plans by 2011. They are no longer allowed to bury this figure in their earnings reports with a footnote that does not reflect on operational performance – it will soon.

On a more practical note, and as I've written many times before, citizens investors, are re-examining their consumption habits as they age and change careers, semi-retire or retire outright. How many material things do one need? I think you want the right things, especially as they relate to a new lifestyle, but the days of accumulating lots of "stuff" based on credit is over. Now when individual consumption accounts for 70% of a country's gross domestic product (GDP) and corporate spending on 10%, it's easy to project lower growth for the foreseeable future than the last 30 years.

These changes by no means represent a gloomy scenario for investors – it just means you can't buy and hold stocks and you need to look at other asset classes such as bonds, gold and currencies. Eventually these overall changes represent a cleansing process that will lead to an ignition of another long term period of stock growth.

Ludwig von Mises, one of the founders of the Austrian School of Economics, an early 20th century movement that advanced that if left alone markets would self-level, said the following about credit and consumption:

There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as the result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved.

In the end, if governments, but particularly politicians, leave well enough alone as they did not do when this credit crises started in 2001-2002, and refuse to promise it won't hurt, the reset can come much sooner. Individuals have already come to terms with change, governments still have yet too. We're big kids, we can handle it, really.

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TAX FREE SAVINGS ACCOUNTS – Do Not Use as a Bank Account!

By Thomas Kleinschmidt

Recently, 70,000 well-intentioned investors (and their advisors and custodians) missed a key point in the "fine print" of the new Tax Free Savings Account (TFSA) rules. Rob Carrick and Dianne Nice (columnists for the Globe & Mail) wrote great articles on the issue.

The misunderstanding seems to be with the "withdrawal" part… as although it is true that withdrawals "add to" the available contribution room, withdrawal amounts are added to NEXT YEAR'S going-forward amount. Specifically, if a contribution is made during the calendar year it counts towards the available room you start the year off with, thus, contributions during a calendar year that add up to MORE than the contribution room that was available on Jan 1 are then OVER the limit and a tax penalty begins to be calculated. Note that the contributions are additive with ALL TFSA accounts the investor has across ALL (different) financial institutions.

Over contribution tax penalties are 1% per month and add up fast so don't use your TFSA as a bank account!

Luckily, the CRA "recognizes that there was some genuine confusion about the rules for the TFSA in the first year" and "will be as flexible as possible" to resolve the issue. So if you are one of the 70,000 you now have until August 3rd to respond to the CRA letters and appeal your penalties. You can either respond to the CRA letter with an explanation as to how the over contribution was accidental or, if you have already received your Notice of Assessment, then you should file either a Request for Taxpayer Relief form (http://www.cra-arc.gc.ca/E/pbg/tf/rc4288/README.html) or a formal Notice of Objection (http://www.cra-arc.gc.ca/E/pbg/tf/t400a/README.html?=slnk).

For help understanding your CRA letter go ask the horse directly: **1-800-959-8281** or
http://www.cra-arc.gc.ca/tx/ndvdls/tpcs/tfsa-celi/txtn/rpt-eng.html

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A Portfolio Management Company. Buy, Hold…and Know When to Sell

What make CastleMoore *Unique* and *Valuable?*:

CastleMoore offers Discretionary Portfolio Management specializing in "*Buy Low, Sell High*" strategies rather than the "*Buy and Hold*" strategies other firms provide.

We utilize an intensively back tested, proven, technical methodology that allows us to make unemotional, unbiased and disciplined investment decisions for our clients.

CastleMoore prides itself on preserving clients' life savings by avoiding market downtrends and growing clients' capital by investing only in market uptrends. We have a very low loss tolerance, and what we do, works.

On top of a focused and effective Portfolio Management, we also provide:

- Quick, personable, and on-going client service.
- On-line access to your Portfolio, CastleMoore Newsletters and Investment commentary
- Broad and Deep Industry Experience
- All-Inclusive Fee Pricing
- A Pre-existing Portfolio Transition Option

Who Qualifies as a CastleMoore Client?:

As much as we would like to help everyone in these tough economical times, not all investors are suitable for CastleMoore's investment philosophy. If you meet the following criteria, then CastleMoore can help you:

- Unsatisfied with the way your life savings are currently being managed
- Understand that "Buy and Hold" is obsolete and open to change
- Have a minimum of $300,000

Referrals:

Professional Investors - If you have any clients who are displeased with the "Buy and Hold" strategy and would like to avoid the stock market during downtrends, please visit our website at www.castlemoore.com and call us toll-free at 1-877-289-5673. We can help you help them.

Individual Investors - If you have any family members or close friends that you would like to help out and think they could benefit from what we offer, please forward this document to them or have them visit our website at www.castlemoore.com and call us toll-free at 1-877-289-5673.

For more information, please visit our website: www.castlemoore.com

THE CHART PAGES

GOLD BULLION

Gold is in a long term or secular uptrend. It appears that we may some type of correction in the near term providing investors with another purchase window. The common belief is that gold protects against inflation. While true to some degree it performs better during periods of deflation, something only now being entertained by the large conventional stock brokerages and media.

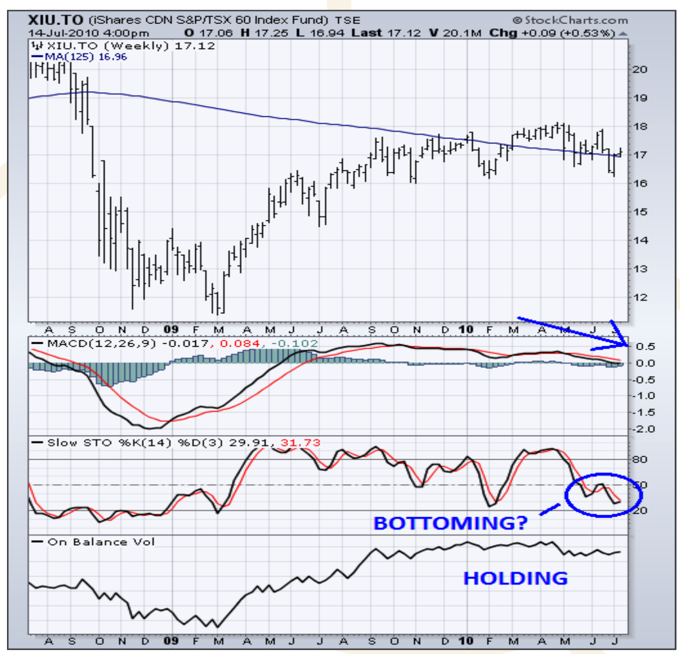
CHINESE STOCKS (XINHUA 25)

Chinese equities as represented here by the Xinhua 25 Index are off on average 21%, breaking the bear market definition barrier of 20%. Clients and friends will know we pay particular attention to Asian shares as from hindsight they (and copper and the Nasdaq) gave an early buy signal in November 2008 before the bottom in most other things in March 2009. They should lead stocks to the upside again.

LOONIE

The Canadian dollar has been part of the global growth story or "bounce" off the lows of last year. The chart indicates that it is "oversold" right now and may move back up between 96 and 98 USD before pausing and potentially resuming the more recent downtrend. The lower graph depicts up day volume against down day volume. It appears that the drop off and year long strength came from traders alone.

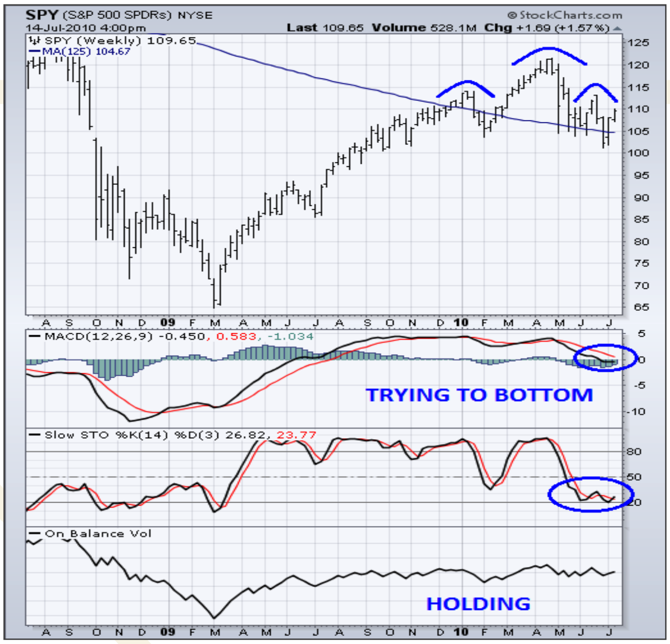
CANDIAN EQUITIES



The Canadian stock market, unlike the S&P, has not moved much since the fall. We did participate in a short term fashion as indicated, but we knew we were "renting" the positions not investing as we are doing in high quality bonds, utilities and gold bullion. All stock markets now move tick-for-tick and accordingly, we are getting another rentable situation, but one that may be quite volatile.

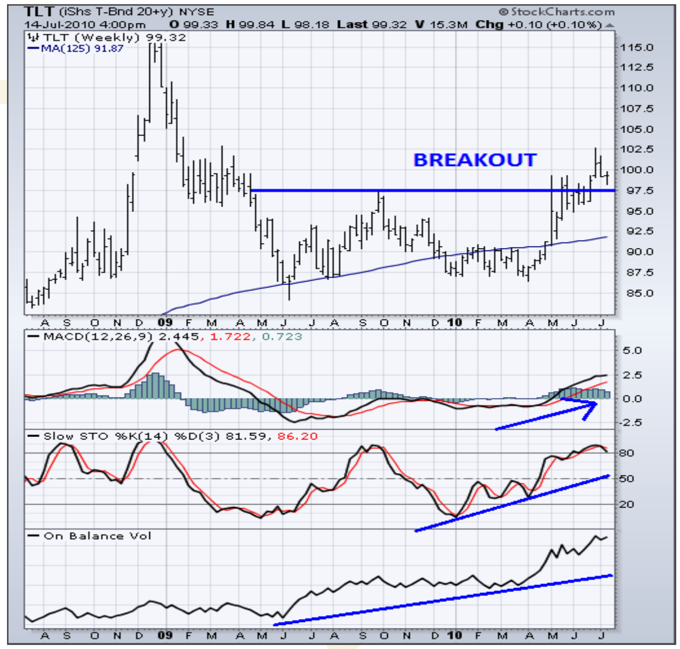
THE CHART PAGES

US EQUITIES



US stocks, represented above by the S&P, have done well recently but are now in danger of entering a correction too. Of particular interest here is the bottom panel on accretive volume. What the section clearly shows is distribution. Large investors such as pension funds and institutional players have been unloading stocks for a year and a half.

LONG BONDS (US)



Against the backdrop chatter of interest rate hikes from economists and the media to squash inflation, bonds, and in particular long bonds, have recently broken out. We believe the aforementioned are just now recognising the deflationary forces at work. Again the lower panel tells us that underneath it all investors have been quietly accumulating bonds. The second panel from the bottoms suggests a correction is due.

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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WHEN THINGS LET GO, WATCH OUT BELOW

By Thomas Kleinschmidt

Things let go all the time. Yesterday I was having an introductory meeting with a potential client at a local coffee shop. Across the street there was a three story condo being built – the exterior was almost finished and cranes were busy lifting materials to the upper floors…all very orderly. Without warning, a 2-meter concrete column let go and crashed onto the sideway, missing a worker by mere inches. What looked like a well-built section of the exterior was now in question. Perhaps the earthquake is to blame, perhaps not. Perhaps he could have seen it, perhaps not.

Another unusual event for Toronto is the G20 Summit. For this, you can bet that many people-years went into the planning, scheduling and preparation before the first fence went up. On the way in to the office, the eastbound QEW was temporarily closed to allow one of the motorcades down from Pearson airport…all very orderly and going according to plan. You can be sure that there is a Plan A, Plan B and Plan C, especially with respect to the safety of our guests and social order. For sure there are new issues with such a gathering of world leaders, but the planners utilized lessons learned from the past.

Tomorrow the construction worker most likely will plan to avoid parking under the remaining columns and tomorrow the G20 coordinators will review where they are according to their plan. My question to you is, knowing that the market has, can and sometime in the future will "let go" are you, as an investor, prepared with your plan of action? As there are various markets that all move up, down or sideways, have you multiple plans? Have you learned from your previous experience?

To complicate planning, they are sometimes acted out in stages. Today I heard on CBC Radio One the new "special powers for the G20". On June 2 new regulations were quietly voted into law regarding the ability of police to enforce the area 5 meters before the fence and to deny access to the area and "use whatever force is necessary" to keep people out. No doubt, some thought was done on the timing of the publicity of this new, albeit temporary, change to the existing Public Works Protection Act. Imagine if this made front page news last week! This is a good example of advanced planning and correct timing.

Investors need a plan. Perhaps multiple plans. With good plans, expect that small gains will offset small losses, but you should no longer subject your investments to big losses. Unfortunately, most "plans" are nothing more than simple formulaic 'comfort blankets' designed to promote good feelings about the attitude of buy-and-hold. Beware also the diversification 'soothers'. Folks, please be acutely aware of the capital risks to your investments. Ken Norquay reminds us to be financial warriors, but be generals, not privates. Live to fight another day!

Evident to us all is that the battlefield has changed. Most Canadian investors have 10 years of limited returns since 2000 and are not happy. Different markets require different plans but even with multiple plans, action is required. If the plan says sell, sell. Don't throw the plan away if you are unsure or uncomfortable (fearful) of what to do. The goal is not to experience large losses! In his book Ken says "the truth is what makes money".

If you want to be on the invitation list for Ken's special webinars where he discusses topics in his book, "Beyond the Bull", please give me an email (thomas@castlemoore.com). There you will learn how to become a better investor.

Enjoy your summer!

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GUEST COLUMNIST

MAKING A NEW RRSP OR RRIF DESIGNATION IN YOUR WILL - BEWARE!

By Ed Arbuckle CA, FCA, TEP
Personal Wealth Strategies, Waterloo, Ontario
www.finplans.net

When an RRSP plan is first purchased, the owner must name a beneficiary in the plan. The beneficiary or beneficiaries will inherit the proceeds of the RRSP when the owner dies. Similarly, when a RRSP is converted to a RRIF, the same process will follow and a beneficiary must be specified in the RRIF. We will only refer to RRSPs below but the same rules apply to RRIFs.

Typically, the RRSP beneficiary named under the plan is not looked at for many years after a plan is taken out. Individuals simply continue on contributing to the plan but at some point the need for estate planning kicks in and the RRSP designation comes back into play. Usually this happens when individuals are thinking about revising their will at or near retirement. It is our experience that when the RRSP beneficiary is made under a new will, it almost always changes from the beneficiary set out under the original RRSP plan. Therein lays the problem.

When a will is being re-done discussions come up between lawyer and client about RRSP beneficiaries. Often they will insert a RRSP designation in the will and leave it at that. Seldom, if ever, in our experience does anyone think to go back and compare the beneficiary designation under the plan with the one under the will. In fact, most wills do not even specifically mention that the original RRSP designation is revoked and the new one (under the will) takes its place. Also, there just does not seem to be any inclination for anyone to contact the RRSP issuer and inform them of the new beneficiary so the issuer is completely unaware of the change. My advice to clients who are drawing up a new will and designating a RRSP beneficiary in that will is to contact the plan holder and send them a copy of the new will or at least the wording of the designation clause in the will. The will should be very specific about the details of the original RRSP designation and its revocation.

In 2008 this issue came up in a court case where the original RRIF beneficiary (changed by a later will designation) was disputed in Ontario Superior Court in Ashton Estate v South Muskoka Memorial Hospital Foundation.

The facts are as follows: In 1998, Mr. Ashton signed a beneficiary designation form for his RRIF in favour of his children. In 2001, he executed a will in which his eight children were entitled to 95% of his estate in unequal shares. The will included a general clause by which he revoked all wills and testamentary dispositions previously made. When Mr. Ashton died in 2007 there was a dispute as to whether the general revocation clause in his 2001 will constituted a valid revocation of his 1998 beneficiary designation in his RRIF, as required pursuant to the Succession Law Reform Act (SLRA). The SLRA provides that "A revocation in a will is effective to revoke a designation made by instrument only if the revocation relates expressly to the designation, either generally or specifically." The question was whether the general clause in the will was specific enough to cancel the original RRIF designation. The court decided that it was sufficient enough to meet the conditions of the SLRA but most lawyers are unhappy with the decision and uncertain about its application. The case seems to indicate that any revocation in a will should be sufficient to satisfy the SLRA but the legal fraternity is not so sure. The case seems to ignore the fact that the SLRA requires that the new designation must "expressly" refer to the original designation either generally or specifically but in the Ashton trial that certainly does not seem to have been the case.

The decision puts executors and estate trustees in a difficult position where the wording in a will does not refer specially to the original plan designation and the cancellation of that designation. Undoubtedly, beneficiaries under the new will designation and under the original plan designation will take different views and at that point estate litigation is bound to happen. Also, issuers and administrators of the RRSP and RRIF plans will have a low comfort level about who is the actual beneficiary and probably be unwilling to discharge funds until the matter is settled.

In summary, individuals who are revising their wills and making RRSP and RRIF designations should carefully consider the fact that a carefully drafted clause should be put in the will to identify and cancel the original designation in RRSP and RRIF plans. It would be even better if a copy of the will is sent to the RRSP issuer for their records. We would do it by registered mail. It would be truly unfortunate if the RRSP issuer, when notified of the death of an individual, paid out the funds pursuant to the beneficiary in the original plan because the issuer was not aware that there was a later designation under a will. The horse would be clearly out of the barn.

Executors have enough issues to deal with in estate litigation that is more frequently happening these days and there seems little need to add this to the list. If you have revised your will lately and named an RRSP or RRIF beneficiary in it, best you look at it again to make sure it has been done correctly. Put a copy of your new will in the mail to the RRSP issuer and ask for confirmation that the issuer is satisfied that the will clause is acceptable in order to make the change in the plan beneficiary. This was written with Ontario residents in mind, but it generally applies across the country. Please check the specifics in your province.

Ed Arbuckle operates a "family" CEO business focusing on fee-for financial planning. Our kind of guy.