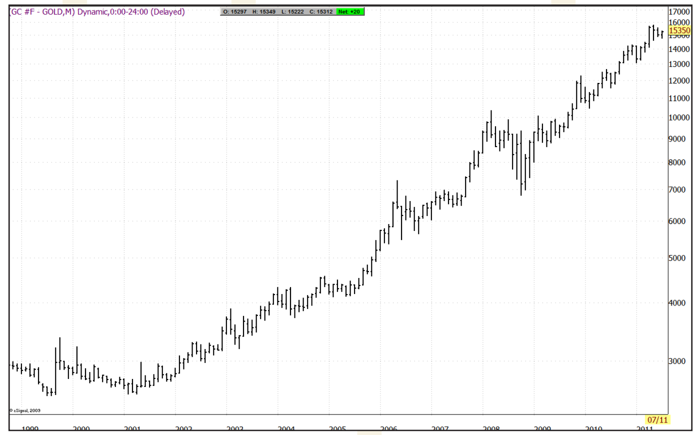
CastleMoore News
Buy, Hold... *and* Know When to Sell™

# INVESTING "IN THE NOW."

By Ken Norquay, CMT, Partner




It's not really a con job: it's just the way they look at it. When our friends, the mutual funds salesmen, try to persuade us to buy stocks and hold them for the long term, they refer to statistics that show the Dow Jones Industrial Average at 40 at the very low in 1932; and they compare that to its current level at about 12,000. If we bought "The Dow" from that 1932 low, any time during the next 68 years, we would have done just fine. (For the record, in 2000, 68 years after the 1932 low, the DJII was about 11,000.) Their point is that US stocks are in a long term up trend and we should just buy them and hold them – and just keep on buying over the years. It's a sales pitch that has a certain appeal for those who don't want to think too much about their investing. The frustrating part is that the Dow was around 11,000 in 1999, 2000 and 2001. After a series of wild ups and downs, it has provided only 1 or 2% annual capital gain for the 10 years since then. If you had the misfortune to own the S&P 500 instead of the Dow, (the 500 biggest stocks in the USA instead of only the 30 biggest), your capital gain would have been a loss. Statistically, it's not a con job, but it feels like one to those who have held US stocks for the past 10 years.

The problem for the financial planner/mutual funds salesmen is their time horizon. Most investors who are planning their retirement have shorter time horizons than 68 years. Most of us consider 10 years to be "long term" enough.

What was the top performing investment during these 10 years of stock market mediocrity? Gold has been in an up trend since 1999 when it had dipped below $300 US per ounce. Now it's over $1500 per ounce. That's over 500%!

This chart of the price of one ounce of gold, measured in US dollars, is the classic investment up trend of our era. It illustrates CastleMoore's investment approach: own investments that are in up trends and hold them until the up trend is over. Simple logic.

Well, in the investment business, it's always easy to see what we should have done. But in the real world, we live in the very last tick on this chart: as our New Age friends would say, we live in 'The Now.' Is gold in an up trend now? Look what happened in 2006. Gold seemed to go almost straight up – then it collapsed. Now that we can look back, it's easy to see what we should have done. But how did it look 'In The Now' of 2006? It took 16 months for gold to get back up to its 2006 high. The same thing happened in 2008 when gold first hit $1000 US per ounce. After a 30% loss, it was 19 months before gold saw $1000 again. At the time, how could we have determined if 2006 or 2008 would be the ultimate top? We all realize that eventually gold's up trend, like all others, will end. Was the early May 2011 sell off the beginning of the topping process for gold? Should we sell now? How can we tell?

**There are two important answers to this riddle.**

First, if we sell our gold, and it keeps right on going up, we simply buy it back later. Transaction costs in today's stock market are very low: at CastleMoore, there are no transaction costs. So, if we sold in 2006 or 2008, we could always buy it back when the high risk period is over. We know that in our investment life times we are going to be right sometimes and wrong sometimes. We will make mistakes. So, what kind of mistakes should we plan to make? Small mistakes. Correctible mistakes. What kind of mistakes should we avoid? Mistakes that cost us a lot of money. So don't worry too much about predicting a long term top. Sell first; predict the top later.

Secondly, the attitude of investors gives us a clue about the importance of a long term market top. When gold goes straight up, as it did in both 2006 and 2008, it does so amidst great investor enthusiasm and speculation. Everyone is bullish. Long term tops are always accompanied by speculation and excessive bullishness. So, investing In The Now, we

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can make a judgement about the risk of a top by measuring the bullishness of investors in general. Do you remember the top in gold and silver back in 1980? Novice investors lined up outside the Bank of Nova Scotia to buy gold and silver certificates. There were full page newspaper ads offering to buy your sterling silver tea set! That was a classic long term top! The price of gold and silver went down for 19 years after that. The precious metals up trend we are in now will end with a speculative blow-off too.

The most important part of any investment strategy is not owning securities that are in down trends. No matter how you look at it.

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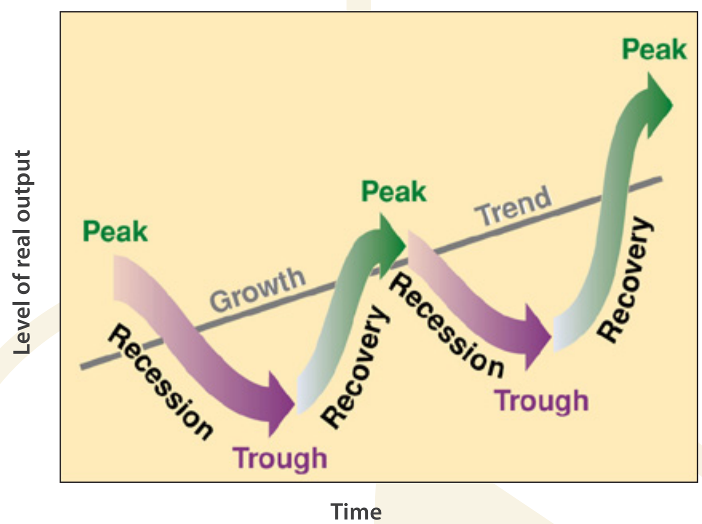
# RECESSION AND RECOVERIES ARE ESSENTIAL TO LONG TERM GROWTH, BUT ARE MARKETS NOW "TOO BIG TO FAIL"?

**By Robert 'Hap' Sneddon, FCSI, President**

Each month in our client only letter, The Current Investment Themes, we discuss the relevant economic events from the previous month and we also maintain a section of bullet points that contains only 5 of what we consider the top pieces. This distillation seems to work well as we know economics can be a boring subject at times, mostly because readers may not understand what information is valuable, or why they should care about it. Economics too moves slowly, with changes often being measured in fractions of a percent. Paint drying? This is why we bring up only the best points and why we try to explain why one should care about them, and frankly, why we keep the section rather wee. It's the big picture that matters, not really the day-to-day, or week-to-week changes.

If you learn only one thing about economics, whatever your background or profession, it should be an understanding of the basic economic cycle. An understanding of it not only provides a frame of reference for investment decisions, a backdrop if you will, but it also helps to understand just how the world works. Knowing where you are in the cycle is the most important thing.

Economies go through peaks and troughs or contractions and expansions in economic activity. This boom and bust process is a healthy one that has an upwards tilt; this upward tilt is the overall growth trend. For example, while we have had periods of high and low food prices since humans have been keeping records of them, overall, as a species, we are as well nourished as we have ever been. The same can be said for housing or technology, that is, while there have been both good and bad periods, we are better off today because of the underlying growth trajectory whatever phase of the cycle we are in. This neo-classical approach says that like many things in our world, the business cycle is self-correcting.




***The ebb and flow of the economic cycle is around a positive trending growth path. Both recessions and recoveries are necessary factors in this principle.***

The four particular stages of the economic cycle are: 1. Peak (GDP is high); 2. Contraction (recessions); 3.Trough (GDP is lowest); 4. Recovery (GDP is rising). During the cycle low points government often provides assistance by reducing taxes, red tape and other government costs, by providing financial support (unemployment benefits) to laid off workers, and by creating large public works projects. The idea is to create or maintain consumer and business demand.

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The challenge today to this long standing natural model comes from central bankers, the investment community and politicians, all of whom believe we can engineer economies (China has taken this a step further by becoming the archetype for centrally planning an economy). Over the last two years we have had many governments not only provide continued stimulus but also directly intervening in the capitalist system of price discovery (free markets). The US as the leader of the capitalist system, has been the poster boy for stimulation, with the latest round, "*Quantitative Easing II*", just concluding at the end of June. In now the second week of July, we know from the released minutes of the US Federal Reserve Board that some members of the committee have been contemplating yet another round of fiscal stimulus to address high unemployment and still declining US home prices. In fact the markets have reacted positively to the whiff of QEIII now as they did last year. Stock markets, it is determined, are now "*too big to fail*". Investors, particularly, the biggest, do not want to suffer losses in the stock holdings.

Intervention does have its merits, and at times it's vital as was explained above. But when we examine the impact on all the money spent, it does not add up to a very good move. The ballpark (who really knows) figure is four to one. That is, for each $4.00 spent we received $1.00 of value. When you consider the levels of current GDP – or the output of our economies – at this stage of the global recovery we are seeing anemic growth at best, and the possibility of a meaningful contraction in the data. In the late 70's and early 80's, as we entered a period of recovery annual GDP (1979-1982) was hovering around 11-12% (US). Today both the US and CDN annual GDP recovery numbers are hovering around 3%, and the latest quarterly numbers are well below this level now. After spending in the trillions of dollars in aid we can only produce that kind of "pop"? While in Canada we have seen decent improvements in overall economic data, benefitting as a side effect of what the Americans did – we cruised off of their vapours – in the US employment and housing has worsened. The only meaningful measure of inflation inputs come from house prices and wages: goosing things is transitory.

Stock markets have shown since the bottom in March 2009 that efforts to engineer a Polly Anna economy show diminishing returns, requiring more and more intervention to hold stock markets at higher levels and retarding and only delaying a course that in the long run is self-healing and inevitable. In this regard, it is interesting to note that the private sector is still in the midst of a deleveraging process (reducing its borrowing to invest, selling equities) as the government seems to be doing the opposite in supporting markets. Individual investors continue to save and pay down debt, with trends at 10 year highs.

With Canada in its first serious budget deficit situation in years, the US consumed with the fight between the White House (Dem) and Congress (Rep) on the US debt ceiling levels and now the potential for more US stimulus, and Europe embarking on its own new stimulus to bail out Greece, Portugal, Ireland and now Italy, it seems all authorities cannot help but think that they can do something about the downside, the pain in a self-correcting system. One wonders who their constituents really are when the average citizen has shown they are capable through all the vagaries of life to adjust, to go through difficulties, and are not really interested in supporting Bay or Wall streets.

As investors, it does not pay to "*fight the Fed*". If a third attempt at stimulating growth does more of the same – increase inflation topically and temporarily for energy and food – we must respond with the same investment options that have worked over the last year – resources - but with the growing evidence that like always, governments will get this wrong and the longer this game plan is in effect the greater the shrug from Atlas. Let's keep it in the backs of our minds, and continue to invest in long term up trends, be they gold, bonds or selected equities.

*For an excellent in depth read on this topic and prepared for the US Kansas City Federal Reserve Bank prior to the annual conference of central bankers in Jackson Hole, Wyoming 2010 where QEII was launched please search Reinhart & Reinhart or request a copy from me personally.*

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## CASTLEMOORE'S LATEST ADDITION TO OUR TEAM.

The CastleMoore team is pleased to announce the latest addition to our staff line up.

It is with great pleasure we present **Jason Dubbeldam**. Jason or Jay, came to us from a purely "*buy-and-hold*" environment. According to Jay, and with due respect to Shakespeare, he knew "s*omething was rotten in Denmark*" when the stock market came crashing down in 2000-2002, again in 2007-2009. To him, a new way of thinking about and acting on investment decisions was required. With CastleMoore's first to market approach for a proven and successful methodology to navigate this new environment, it was a natural fit for him.

A double graduate of Sheridan College, earning the Canadian Securities Course and Chartered Financial Planner designations there, Jason is currently pursuing the distinguished and rare Chartered Financial Analyst (CFA) designation, having just written the Level 2 exam in June. Previous to CastleMoore he gained valuable work experience, rolling up his sleeves for the last six years, as a Research Associate with Dundee Wealth Management. But, it is with CastleMoore that he has found a kindred spirit and like mindedness in investment philosophy and approach.

Jason is excited and feels privileged, according to him, "*to be partnering with CastleMoore in providing this unique and valuable way of managing investments*." It is here that he expects to leverage his experience and education, along with the full faith of CastleMoore through our support of an application for Associate Portfolio Manager, to help others achieve their financial goals.

CastleMoore Inc.

# THE CHART PAGES

## GOLD BULLION


Gold is in an intermediate and long term up trend, one of the few investments that are. It has recently made another run at the April highs just below $1600US/oz. Indicators are all over the board and are not much help at near term timing. We own bullion in both Canadian (66%) and US (33%) dollars. This hedged approach ensures we diversify currency risk.

## CHINESE STOCKS


We have written now for six months about the struggles of the domestic Chinese stock market to break out of its two year funk. We use this market to get a true read on China as it is only available to nationals. Imagine that, the darling of the global economy China, her market has only lost investors money for two years running. Regulatory authorities continue to raise bank reserve requirements to try to tamp down inflation. The indicators appear to be setting up a move to the top of their readings which puts the index at the resistance line.

## LOONIE


The Loonie has bounced off support around $1.10USD. Its price action parallels a hopefulness for a return to the “risk on” trade, or a move up for the Loonie and all resource investments, and a down move for the US greenback. The Loonie, S&P stock market and oil all have a very high positive correlation. A break down in the Loonie or WTI would raise a red flag for stocks and raise a green one for bonds, particularly US & Canadian government bonds. We currently hold a significant position in AAA government of Canada bonds.

## US DOLLAR


On the flipside of the implications of the movements in the Loonie are the implications of the movements in the US greenback. A move down in the dollar implies investors are feeling risky and are buying stocks; a move up implies they are feeling cautious and are selling them. US Fed Chairman’s comments in mid July about the potential for another round of stimulus sent the dollar plunging and the Loonie, Auzzie, Kiwi and Euro (and all commodities) soaring. It lasted only hours and reversed intraday. The jury is still out, even with everyone and their uncle bearish on the US dollar.

# THE CHART PAGES

## CANADIAN EQUITIES


The broader correction which began in February/March is still in effect primarily because the shine has come off commodities as traders contemplate the risk on/risk off stances. As the chart shows, the longer term 125 week moving average is still moving higher, suggesting that we are at the early stages of a longer term market move. At present we have a decent commitment to the sectors and asset classes that have been working well, such as gold, utilities, consumer staples, healthcare, and bonds. Once we head into fall we'll know better whether the US Fed and the Plunge Protection Team can juice things once more.

## US EQUITIES


Compared with the Canadian market the US S&P has performed better, having bounced nicely since June. It is now set up for a fall if it does not make new highs here now ushering in support above 1350. A break of the 1250 line suggests support will be found again at the November 2010 lows of 1175 or 10-11% lower. For Canadian investors, we always must consider the hurdle a strong Loonie places in front of investing in the US or any non-Canadian dollar market.

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- All-Inclusive Fee Pricing
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# WAIT A SEC! – HOW SECTORS BEHAVE SO CAN YOU

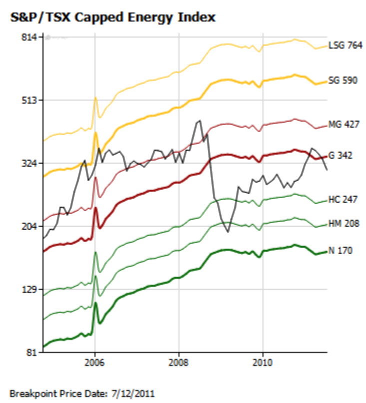
**By Thomas Kleinschmidt**

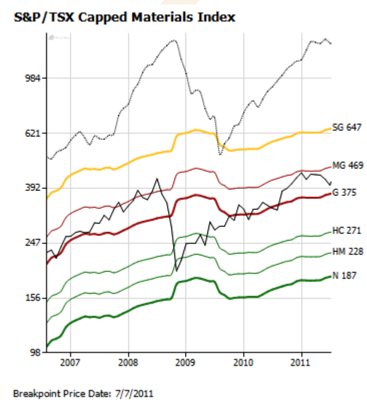
To understand the movements of the broad market indices we need to take a look at how their component sectors are performing within them. Doing so also sheds some light on how the market perceives the economic climate.

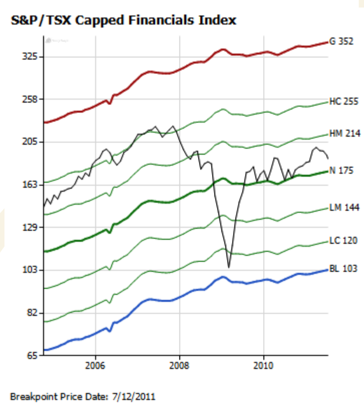
Indexes such as the TSX Composite and S&P500 are an aggregate of constituents from all 10 economic sectors, as defined by Morgan Stanley Capital International and Standard & Poor's under their "Global Industry Classification Standard" or GICS. These are: materials, energy, industrials, financials, consumer discretionary, consumer staples, telecommunications, utilities, health care and information technology.

Investors try to both predict and interpret sector movements against the backdrop of economic news, business cycles, commodity cycles and the like. Right now investors like you are most likely trying to determine sector movement and broad index movement for a number of scenarios – from a normal sector rotation in a normal economic cycle to another across-the-board market correction! Personally, I choose to simplify my work and look beyond all the mundane cud-chewing news reports and seek enlightenment through the theory of Accounting Dynamics developed by Verne Atrill Ph.D seen visually in Strategic Analysis Corp.'s Structural Valuation Analysis® (SVA®) graphics, which show "structural lines" against price movement. Should you wish more info on this you can give me a call directly or visit http://strategicanalysis.ca/Library/.

Index investors who trade only the index ETFs perhaps would do best to remain focused on only the index charts, however, to glean greater (bottom up) insight we shall take a look at some of the key sectors, beginning with the TSX Composite's most heavily weighted sectors: energy, materials and financials.

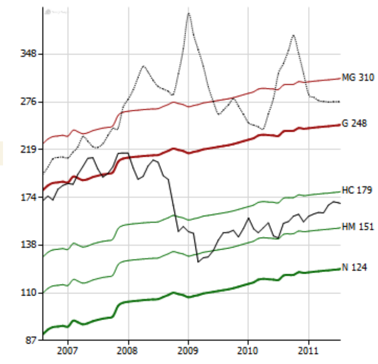


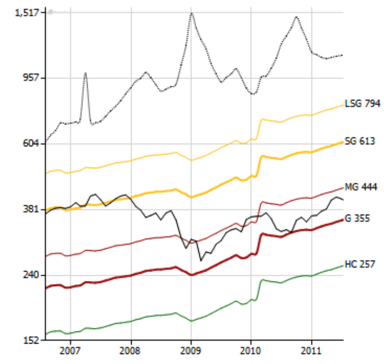

Hmmm…are they strong or weak? We see that the energy sector came down from a higher structural support in late 2008 and has now regained most of the losses but is struggling to get back into the "growth zone" as defined by SVA®. As for the materials sector (which contains Metals & Mining and Gold Producers) it did get back into the "growth zone" but looks like the market wants to see more proof of economic growth for higher prices. Ditto for the financial sector in the "normal zone". Bottom line: if good economic times are indeed ahead of us then both energy and materials sectors will remain in the "growth zone", if only okay times, then I expect meandering about "G" and if poor times, clear market unwillingness to keep prices up and the implications of big drops as it is evident that the market has priced in "good times" indeed, at least for the TSX.

**S&P 500 Utilities**



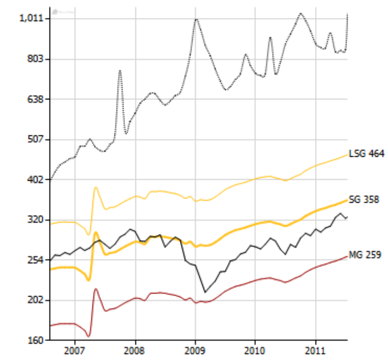

Breakpoint Price Date: 7/12/2011

**S&P 500 Health Care**




Breakpoint Price Date: 7/12/2011

**S&P 500 Consumer Staples**



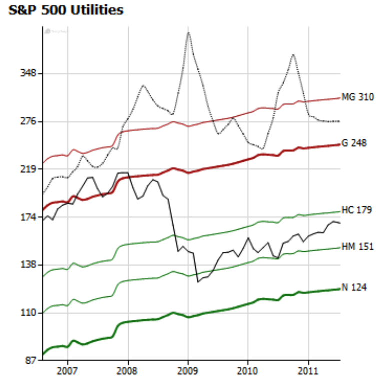

Breakpoint Price Date: 7/12/2011

Comparing the Canadian to the S&P counterparts, Yankee oils and materials do look stronger than ours but we'll see…they are in danger of breaking supporting structural lines as they are priced like they were back in 2007-8. And their banks are struggling with their issues. Not good for any of these sectors should the economy be anything but decent, eh?

For the remaining sectors I'll use the S&P versions as that broad index is a more balanced index across the 10 sectors.

As expected, similarly high valuations for industrials and consumer discretionary sectors exist as in the oils and materials, but what about the defensive sectors – the utilities, telecomm, health care and staples? Well, the staples are trading like the Nasdaq, the health care sector is trading around the same price as it was before the crash albeit 'cheaper', and utilities sector is apparently lagging.

**S&P 500 Utilities**

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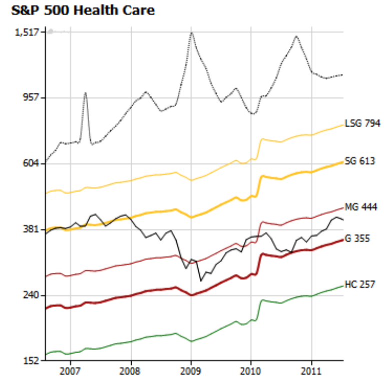
**S&P 500 Health Care**

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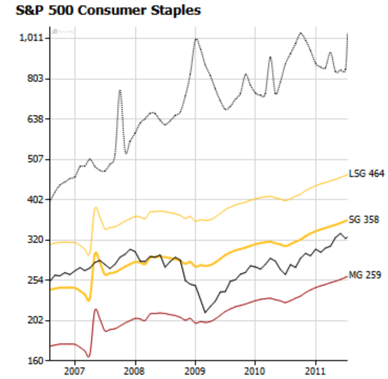
**S&P 500 Consumer Staples**




Breakpoint Price Date: 7/12/2011

As evident in these key sectors, I'm going to say that the market has priced in a decent level of economic growth.

Or, perhaps, there is a new 'normal' for the markets coming up? Economic woes would trip open the trap door for those sectors that are on structural support, theoretically then exposing lower levels as potential support. For example, if economic weakness comes too fast most likely we'll see the industrials and consumer discretionary indices falling down a structural support level (or two) too, spooking all investors and sending the weak or questionable sectors to lower supports also.

Luckily, on the sector rotation side of the coin, it appears that such sectors as the financials, health care, utilities and staples all seem to have some room to move upwards to receive fleeing investment capital and still not be too pricey or overvalued as they were in 2008 despite a weak economy.

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# GUEST COLUMNIST

# AN EQUITY MARKET OUTLOOK FOR THE SECOND HALF OF 2011

**By Don Vialoux, CMT**

**What can investors expect in the second half of 2011?**

The third quarter of the year typically is the weakest quarter for equity markets. Over the past 20 years, the S&P 500 Index has averaged a meager return of 0.28 percent per period and the TSX Composite Index has averaged a loss of 0.38 percent.

**Weakness in the third quarter is followed by the most profitable quarter of the year**

The fourth quarter during the past 20 years has averaged a return of 4.56 percent for the S&P 500 index and 3.97 percent for the TSX Composite Index.

**Headline risk is expected to remain a market momentum driver in the third quarter.**

Uncertainties triggered by the Greek debt crisis, the US debt ceiling limit, slowing manufacturing growth, stubbornly high unemployment, and a severely depressed U.S. real estate market continue to weigh heavily on investor sentiment.

**Favourable annual recurring events are expected to return in the fourth quarter.**

Higher manufacturing activity and consumer spending will kick start North American equities indices out of their summer doldrums.

**Corporate fundamental prospects paint an optimistic picture for the last half of the year and into the year 2012.**

The S&P 500 Index currently is trading at only 14 times earnings of approximately $96 per share. Historic price/earnings ratio for the Index is between 15 and 16. In addition, analyst estimates suggest average year-over-year earnings gains by blue chip companies during the third and fourth quarters of 10 percent to15 percent. Upside potential for North American equity indices of 10 percent or more by the end of the year remains in the realm of expectations.

**Three sectors of the equity market typically perform well in the second half of the year: agriculture, gold & gold equities, and high yielding investments.**

Each sector normally reaches a seasonal peak at the end of the calendar year.

Jon and Don Vialoux are authors of free daily reports on equity markets, sectors, commodities and Exchange Traded Funds. They also are research analysts for JovInvestment Management Inc. Reports are available at **www.TimingTheMarket.ca** and **www.EquityClock.com**. Follow us on **Twitter@EquityClock**.

## GUEST COLUMNIST

# THE PRACTICAL SIDE OF ESTATE PLANNING

**By Ed Arbuckle,**
**CA, FCA, TEP**

If you have good legal and tax advice, estate planning should not be that difficult. But don't let your advisors bamboozle you into doing anything that you are not comfortable with. Think of your will as a pot of soup that you can perfect to taste as you wish. Seldom will there be constraints to stop you from getting to where you want to go.

Most people spend fifty or more years carefully building an estate and then give little or no thought of how to distribute it when they die. Most wills that I see take the same standard format without a whit of imagination – I leave everything to my spouse and if he/she predeceases me then it goes equally to my children. Duh! What about leaving it in a trust for your spouse to lower her taxes when you are gone and avoid a round of probate. Or just maybe you might want to think of leaving your RRSP or appreciated investments to a charity to fulfill a long standing personal wish and get sizable tax relief. The list goes on.

**Here's my list of Fifteen Basic Rules for good estate planning and will preparation:**

- Start the transfer of wealth now while you can still get some glory – a trust for your grandkid's education or a significant gift to your favourite charity may be worth considering.
- Talk to your family about your will – start one on one and then move on to a full family meeting.
- Do your will while you are able and no one can challenge your competence as they may do when you start to get a bit odd.
- Do what you can to save taxes but make sure taxes are always in second place behind your personal wishes.
- Look carefully at the influence that others have on you when making your decisions that could later be perceived as undue influence on you by still others who feel they were edged out in some way.
- Make sure your executors have the skills to act in that capacity – perhaps with some checks and balances to resolve the tough issues when you aren't there to referee.
- Your will should honour all of your legal obligations including statutory ones such as your obligations to adult dependants you are still supporting.
- Trusts have major advantages both for tax planning and estate administration – use them.
- Have lots of liquidity to meet your personal needs before you die so when you can no longer think straight you don't have to live below the poverty line. You may live longer than you think.
- Make the provisions of your will as detailed as possible to keep down the arguing amongst your beneficiaries as to what you actually intended.
- If you are able compartmentalize bequests of specific assets to specific beneficiaries, life will be a lot easier for your executors.
- Make sure beneficiary designations outside your will (RRSP's, etc.) are consistent with the distribution of assets in your will.
- Know how income taxes will be applied to your various estate assets so a misplaced tax liability does not destroy a bequest for a beneficiary.
- Make sure any bequest for a special need has sufficient capital to meet that need.
- Don't tie up your assets for an eternity.

Now you must realize that a good will needs good professionals to help you put it together so it complies with the law and avoids litigation amongst your beneficiaries – or those who thought they should be. At one time you could get a will done for a few hundred dollars but no more – a few thousand dollars is more the norm. Believe me it is worth it for you and everyone else.

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