Chris Horan, Financial Advisor

May, 2005

2005 Mini Review

The Mini Reviews are an opportunity to gain some perspective on the performance of the investment managers that I use most. Virtually all my clients have at least one of the managers listed here looking after a significant portion of their portfolios. Personally, I have 3 of them.

Unfortunately, to understand investment performance is more difficult than it appears to be. Sure, it seems simple: how much did something cost me, what is it worth today, and the difference is my gain or loss. Calculate this over a period of time and you have your return.

But what we are really asking is 'How are my investments doing compared to what I might otherwise have done' ('Did I make a mistake?), or 'Will I achieve my long term great goals in life?'(Will I be OK?). Woven in to the questions are immediate decision-making questions such as 'Do I need to change my investment managers or my portfolio mix?'. Some people are even asking more dangerous (to themselves) questions such as, 'Did I make as much as possible last year?' (I have very few clients like this).

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Regular readers of my newsletter know that performance reviews frequently show that the performance of the individual money managers are usually either quite 'high' or quite 'low' over short periods like a year, but over longer periods their performance smoothes out quite a bit. (I use the term 'money manager' synonymously with 'mutual fund' because to me it is the fund manager that we are hiring. Each of the funds below have had the same manager for more than ten years except Universal Canadian, whose managers hit their ten year mark in August of 2005.)

Below are the average annual returns for a number of the managers who look after the largest amounts of my clients' money (and my own money too):

	March 31, 2005			
	1 Yr.	**3 Yr.**	**5 Yr.**	**10 Yr.**
AGF Cdn. Growth Equity	9.4%	6.7%	2.4%	9.9%
Trimark Select Canadian	9.9%	6.9%	9.7%	9.0%
Mackenzie Ivy Canadian	9.9%	3.4%	7.1%	9.7%
Mackenzie Maxxum Cdn. Value	6.7%	1.9%	7.2%	7.1%
Mackenzie Universal Cdn.	14.0%	5.1%	5.9%	9.2% *
Assante Cdn. Equity Value	16.9%	11.8%	17.2%	14.0%
TSX	13.9%	8.9%	2.0%	10.1%
TSX less 1.5% fee	12.4%	7.4%	0.5%	8.6%
Worldwide Stock Markets (MSCI World C$)	2.3%	-2.5%	-6.0%	6.9%

* 9 Years and 7 months

A number of very important points put these numbers in perspective.

1. This is the same list of managers that I have been using for almost 15 years. Using the same managers for such a long time is unusual in the investment industry. Why? Because most newsletters and sales promotions find it way easier to just recommend whatever has been doing well *recently*. Problem is, they change their list every year ('5 must own investments to buy now!!'). Changing your recommended list every year might be good for sales, but it isn't *advice*.

2. This year there is some, but not a great difference between the 1-year numbers and the longer-term numbers. Things seem, on the surface, pretty mellow. Unfortunately, these average annual returns camouflage what happened along the way. For instance the 5 year return for the TSX Index of 3.6% per year seems relatively sanguine: it (correctly) suggests that $1 invested in the TSX at the end of 1999 would have earned an average return of 3.6%/yr if held over the 5 years to the end of 2004. But what a ride! Hidden is the spectacular rise of more than 30% in 1999 and 22% in early 2000. Hidden is the total decline of close to 50% between March of 2000 and March of 2003. Hidden also is the fact that as of March 2005 the TSX remains more than 10% below its peak of August 2000, while all of the investment managers shown are at least 25% higher than their 2000 levels. (The NASDAQ is still 60% below its peak). So one benefit of the professional money managers is a *smoother* ride than the market. Smoother returns are good because they are less emotional, and in investing, less emotion is better.

3. The big question is: how well did these managers do? Looking at the 10 year numbers above, you see that all managers except one achieved returns after fees of over 9% per year. A 10-year return of 9% per year will achieve the goals of any reasonable financial plan. So these returns are very good in absolute terms (particularly given the awful markets in 2000-2003).

4. How is the performance compared to other investments? The TSX Index (an average of the 300 largest Canadian stocks) is frequently used as a benchmark for comparison. The TSX return is a theoretical return only, because there are no fees associated with it. So it is a little unfair to compare a money manager's after-fee return to a theoretical return with no fees. If you invested in an index fund, you would incur fees and expenses that would reduce the return by maybe half a percent per year, and if you used an advisor to invest in an index, there would be additional charge of a percent or so as well. So you can deduct 1.5 percentage points off the index returns to make them comparable. If you adjust the data for a 1.5% fee, you can see that the managers clearly outperformed the TSX over 5 and all but one outperformed over 10 years.

5. Another benefit of using the same manager for a long time is *you actually earn the return that the manager achieves*. Tons of research shows that many investors do poorly because they switch their portfolio around too much. Barron's, an investment newspaper, reported recently that index-type investments trade so rapidly that investors typically only hold their position for a few weeks! Canadian data show a typical investor holds a mutual fund only about 2 years. Switching things around a lot sounds exciting but is it profitable? Unfortunately, there is *no* data to show that these quick-switchers do anything other than destroy their capital . (For more on this topic see my newsletters 'Investor Behavior' and 'Investor Psychology' on my website www.chrishoran.ca.) It doesn't do any good to talk about 10-year returns if you don't hold the investment for 10 years.

6. Similarly, another important thing that the numbers do not show is that the markets of 2000 to 2003 had a particularly nasty element. It began with the spectacular divergence between the value stocks and the growth stocks in 1999. The managers listed above are mostly value style. In 1999 and 2000, the growth stocks, epitomized by telecoms and other technology, seemed to do so well , while the value stocks, whose profits grew by "only" 10% per year, seemed such dogs. A great many people, egged on by the news media, fled the value stocks. Billions and billions of dollars ran to the tech/growth stocks, just in time for the equally spectacular declines of 2000 - 2003. The result is that people who switched from value to growth have suffered a one-two punch that has left them with a cumulative loss of 60% over 7 years.

7. Probably the most important point from all this is that successful investing is a voyage. It is a long voyage, full of very dangerous temptations along the way. My job as Financial Advisor is to have you arrive safely at your destination. Having, and actually publishing, a list of managers that I've used consistently over 10 years is good proof of the continuity of advice that clients have actually received over the years. Anybody can change his tune and sell a hot idea every year – it might be good for sales, but it is not advice.

Related Newsletters: 'Excellent Manager Project' (March 04), 'The Secrets in the Numbers' (January 04), 'Tale of Two Markets' (October 01), 'Investor Psychology ' and Investor Behaviour II' (July and October 00) and 'Value Investing' (October 99) - www.chrishoran.ca

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