Chris Horan, Financial Advisor

July, 2006

Market Update

A couple of weeks ago, just as the stock market was reaching the exact bottom of its recent decline, a client called me. His daughter had just taken her broker's advice, sold her entire portfolio, and was sitting in cash. The client was wondering what should he be doing …

I answered of course that it made absolutely no sense to take a perfectly good financial plan, and a perfectly good, professionally managed investment portfolio designed to achieve a client's 10 and 20 year goals, and trash it by sitting in cash just because some perfectly normal event was happening. My advice was to carry on.

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When I asked what he thought of my answer, he said, "I knew you would say that. You were right about staying invested in the past, and we have done very well. I just needed to hear you say it again".

Last week an investment industry executive told me at lunch that things have been pretty tense around Bay Street the last few weeks. From their peak in mid-May the resource stocks had fallen about 20% (and although they'd recovered half that decline already) people were worried that the economic growth of the past 4 years was going to turn to recession, China was going back to the rice paddies, and the markets were going to be awful. Many advisors are worried, and investors have a finger on the panic button.

He could hardly believe that I've had maybe two phone calls from clients who were concerned about their portfolios – and one of those clients didn't want to leave a message because he 'Wasn't that worried and knew what I'd say anyway'. (A third client called to say he was sending in his RSP contribution because he'd heard the markets were down and wanted to take the opportunity to buy.)

My clients don't have emergency phone calls, because in a properly-constructed financial plan, and a properly managed investment portfolio, there are no emergencies. We have deaths in the family, houses and businesses being bought or sold, but we don't have emergencies. A 10% or 20% market decline is something we fully expect to happen, we are always prepared for, and we don't let it disrupt our lives.

What's happening is the major markets of the world, led by Canada, have had three years of strong performance, without even a 10% correction, from the bear market lows of March 2003. Three years without a 10% pullback is one of the longest streaks ever.

The bear market that ended in March 2003 was a decline of almost 50%, which was the equivalent of 1973/74 and the worst since the 1930s – a once in a career event.

So some people are spooked: having had no correction for 3 years, now that there's been a drop, they figure we're in for 2000/03 again. But another big one isn't likely. Here's why.

What's happening, according to the Bank Credit Analyst, a high-end research firm, is that we are transitioning from the post tech-bubble world, which was characterized by interest rates of 1% in the US, a strong economy led by home refinancings, and trade flows to the emerging Chinese economy, to a more normal world of two-way trade flows, a soft US currency, and reasonable economic growth across Europe, Asia, and North America.

This transition will see a lower US dollar, interest rates of 2 or 3 points above inflation, and companies occasionally going bankrupt. The US economy will slow down, but a prolonged recession is not likely. The Chinese will have to start spending some of their huge savings, and Europeans will continue to recover from their funk. The markets are just shifting around to get used to it.

The markets of the world have declines of 10% almost all the time; in fact it is unusual to have a year *without* at least a 10% swing. Declines of 10% to 20% happen frequently; time doesn't permit me the research here, but they are perfectly normal in a 3 year period. Declines of 20% to 40% happen every 3 to 7 years (there have been 13 since WWII).

Now the person who has sold her portfolio and is sitting in cash faces a worse dilemma: having sold at almost exactly the bottom, does she buy back in now that the markets have recovered half their decline, or wait for some celestial signal? If she waits, she faces the problem of buying in just before another little decline …

The fact of the matter is that in order to achieve good long term investment returns, you have to be invested over that long term. Trying to time shift into and out of a market is a good way to wreck a portfolio (and maybe earn your broker some trading commissions).

The best way to *not* achieve your long term investment goals is to let some newscaster talk you into hiding in some corner.

Referrals

Now is a time when you can help a friend, and also help me. I am accepting new clients and would love to work with someone like you, my existing clients. If one of your friends is worried about his or her investment portfolio, chances are they are not getting good advice. They are worried about their investments – *and they needn't be*. Please feel free to have them call me. I appreciate the thought.