Chris Horan, Financial Advisor

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The Secrets in the Numbers 2003 Mini Review

For the past several years I have written a January 'Mini Review' where I analyze the performance of the investment managers who look after my clients' money. I would compare the managers' performance to a benchmark index, such as the TSE or to the average of the other managers in the category, to provide comparison.

Usually the message is that the performance of the managers tends to be either quite good (or quite bad) in the last 12 months, but much more consistently better over the 3 and 5-year timeframes. Many clients have commented how useful the analysis is in keeping their short-term perspective (yes, one year is a short time).

Chris Horan, CFP, RFP
Senior Financial Advisor
Assante Capital Management Ltd.
#3401-130 Adelaide Street West
Toronto, Ontario
M5H 3P5

Telephone: (416) 216-6532
Toll Free: (800) 565-4605
Email: choran@assante.com

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This year the numbers show a nice recovery in the last 12 months, as you might expect from watching your statements, but I was bothered that the numbers weren't telling the real story. The real story is camouflaged for two reasons: first, investment markets have had a Jekyll and Hyde split since 1999, and second, because of the way the investment performance numbers are reported.

First, let's look at the camouflage from the compound returns. Reporting of investment fund performance is required by industry regulators to be annual compound returns over 1, 3, 5 and 10 years. That's why the fund manager reports don't show 2 or 4-year average returns for example. Unfortunately, arbitrary time periods and the mathematics of compounding can play havoc with the messages that the numbers hold. There are peaks and valleys in the numbers and a lot can happen in between the measurement dates.

A good example of the danger hidden in compound returns is the old anecdote about the cowboy crossing the river. He's been told for a fact that the average depth of the stream is 4 feet. Unfortunately, omitting the fact that the middle section is 7 feet deep is a big problem.

Here are the numbers, to December 31, 2003. These managers have had the largest amounts of my client money for many years:

	Average Return/Yr.		
	1 yr	**3 yr**	**5 yr**
Trimark Sel Cdn	11.7%	5.8%	9.0%
Ivy Canadian	4.7%	2.0%	5.2%
Maxxum Value	9.5%	0.2%	4.0%
Universal Canadian	13.8%	2.4%	5.7%
Optima Cdn Value	17.4%	13.8%	11.9%
Cdn. Index (TSE/S&P)	22.0%	-2.1%	6.1%

A quick look at the numbers seems to say that the managers did not do as well as the index over 1 year, they did better over 3 years, and have been comparable or better over the 5 years to November 2003. These are reasonable, and correct, conclusions. But there isn't any drama.

Here's one of the parts that's missing. The peak of the markets generally was March 2000. That is a little less than 4 years ago – not 3 years and not 5 years. The TSE remains now 29% *below* its peak of 2000; world markets on average are 31% *below* their peaks (mostly of March 2000), as reported in *The Economist*. The tech-heavy NASDAQ remains *62% below* its March 2000 high.

However, the investment managers above are either very close to their peaks or are above their 2000 peaks, as shown below. In other words, these managers have not experienced declines anything like the declines in the markets.

Fraud Article Update

My last newsletter essay on fraud was well-received and thank you for your positive comments. I did suggest that we needed to be less tolerant of fraud and corruption, but I didn't expect the article to have an international impact so quickly… an Associated Press newswire in the Wall Street Journal reported from Beijing China shortly after the newsletter was published in December 2003 that a Mr. Liu was convicted of bribing the former mayor of Shenyang, plus 32 counts of assault; Mr. Liu's appeal was denied and he was executed the next day. In addition to his death sentence, Liu, a former Shenyang city council member, was fined 15 million yuan (US $1.8 million). For the record, I did not advocate capital punishment, but it is an option, so to speak.

Not only are these managers not suffering a decline anything like the markets, their longer term performance compares quite reasonably with the markets:

Manager	10 Year Average Return	% Above or Below Peak
Trimark Sel Cdn	8.1%	8.0%
Ivy Canadian	9.4%	-1.0%
Maxxum Value	6.4%	-6.0%
Universal Canadian *	8.5%	-2.0%
Optima Cdn Value	12.1%	17.0%
Cdn. Index (TSE/S&P)	8.5%	-29.0%
World Index (C$)	7.1%	-30.0%

* estimated from globeinvestor.com charts except markets data from Economist data tables. Management is unchanged through 10 years, except Universal Canadian in place since August 1995.

The reason these managers have done so well brings me to Jekyll and Hyde. Readers of my newsletter know about the growth style vs. the value style of managing investments (if you'd like a reprint to refresh your memory, please ask; I'd love to mail or email you a copy). Barra, a market analytics firm, has a value index and a growth index (an index is just an average of a representative group of things like stocks). The chart below is the returns of the Canadian growth index and the value index by year – it's the depth of the stream, step by step, not the average:

	1998	**1999**	**2000**	**2001**	**2002**	**2003**
Barra Growth	2.10%	42.80%	-5.70%	-21.40%	-13.10%	20.60%
Barra Value	-1.60%	2.80%	31.70%	5.10%	-11.50%	22.60%

Here's the story: each style had low returns in 1998, but then the growth stocks, fuelled by the internet boom, took off in 1999 and the first months of 2000, leaving the value stocks in their dust. After the tech stock peak in March 2000, all the growth style stocks came crashing down in a 3 year bear market, while the value stocks recovered smartly. The result is the value stocks have maintained their value while the growth stocks have not.

The other correct conclusion and the more important conclusion for long term investors is that these investment managers listed above have achieved returns, after fees, over a ten year period, which compare very well to the index and in most cases are superior to the index (not that it matters) and they have achieved this performance while avoiding the 30% decline since 2000).

Now, since this is my newsletter, I'd like to point out that having value style managers as the core of your portfolios has been a specific and conscious part of your investment strategy over the years. I have selected value style managers based on my almost 20 years experience. Sometimes the benefits of the value style are difficult to perceive, and sometimes value style managers don't seem so smart, but this is a great real-world example.

Since this performance is after the management fee, and since the management fee pays for my services, in my books investors have received their money's worth. I hope you agree.