



Value for Money Investing by Gordon Stockman, CA, CFP

Are you wearing your rally cap?

As I write this piece, we are in the midst of an exciting rally. Since the March 9th low of 7567, the Canadian S&P TSX Composite Index has climbed as high as 10238 for an astounding 35% recovery. Everywhere people want to thank those that donned their rally caps (a rally cap is from the world of baseball, where to create some excitement to stimulate coming from behind, players and fans turn their baseball caps inside out). The hat trick must work, once more showing the good sense of looking stupid to promote optimism.

At our company, since the March low, we have struggled with what to advise our clients. We did not advise them to jump in with both feet at the low, but continued to caution about the possibility of future greater lows. We promoted continued patience. With the TSX index up 35%, were we wrong?

We think not! As we became tempted to change our advice, we also had some clarity. On March the 9th not one person in the world knew that the next leg was up 35%, simply because it was not knowable. This starkly reminded us that market direction and size of moves are never known in advance by anyone. No one! So, clearly this information was not available to make the decisions with. So, what other information was available?

House prices in Canada were still falling. Sales of new homes surprised in both Canada and the US but prices were down. Home affordability was much improved because of the unprecedented low interest rates. Interest rates were at their lowest recorded level in most major countries as central banks world-wide try to stimulate lending with low bank rates. Some large banks have collapsed and many more large banks were still on the brink of collapse or were being propped up by government intervention or nationalization. Most troubling, banks around the world are still not freely dealing with other banks. It is like they are still waiting for the other shoe to drop. The backdrop for all of this is the continued sinking into the deepest global recession ever seen. The recession is not as deep as the great recession and I am not sure anyone believes it will achieve those depths, but even the great depression was not as synchronous across all countries as this time around. The American consumer continues to keep their wallet closed. Near term corporate profits are expected to continue to be weak due to the consumer remaining distressed due to unemployment and worry. The most positive of indicators is that the declines are slowing. So why the rally?

The best explanation appears to be the widespread belief that the stock market recovery always comes about six months ahead of the economy recovering. March 9th was viewed as a market bottom, simply because it is guessed that the economy will be coming out of recession in the last quarter of 2009. Thus the timing is right for the market to begin its march back. So since March 9th, purchasers are pushing the market higher on the GUESS that the recession will be over in six to nine months. No supporting data is ever needed to support a guess.

So again, why do we think we were right to remain patient? Because we are first and foremost financial planners. Faced with nothing to support the contention (the guess) that the recession will soon be over, and knowing that future market direction is unknowable, we stand on the only thing we know with certainty, that WE KNOW OUR CLIENTS. Our confidence and patience comes from knowing our clients very well. If you have no advisor, you need to know yourself well.

Our job (and yours too if you do not have a planner) is to manage our clients' expectations, emotions and outcomes. Our clients are seeking a solid secure retirement or other standard of financial security, not gambling that they can rack up maximum wealth if they get the guesses right. It is clearly our job to not proceed on guesses that might produce short term wealth, but to position our clients to avoid potential significant distress to their capital. Remember, when guessing the outcome observed, up 35%, this does not mean the outcome of down was not even more possible or even more likely at the time. Simply put, with the horror of the declining markets still fresh at mind, March 9th was not the time to increase the exposure and make staying committed long term even harder. Managing all possible outcomes is essential, not just the hopeful ones.

So now is a good time (as always) to stick to basics. If you have a diversified portfolio, check that all the allocations are correct. Rebalance if necessary. It is not the time to chase only the Canadian stock market, but remain committed to ensuring that you have the right amount in all classes of assets. While friends are focused on this market blip, take the time to make sure you have the right amount in Corporate bonds for when company balance sheets strengthen, Real Return bonds for possible pending inflation, GICs for guaranteed liquidity requirements, International equities where you might have been under-represented in the past or cash for near term purchases. There will always be a future time to add to your Canadian equity holdings. Never worry about missing the boat, when the boat comes on a regular basis and your future is years in front of you. Urgency is an impulse that requires control.

So what is our current action plan? Be patient! Rallies start, as well as end. Hold on to your tickets, there is another boat coming. But remember, ask where the personal floatation devices are when you board. Until this global recession recedes and the world's banking system normalizes a bit, a gale can come from nowhere in an instant. Gale force winds have caused the loss of many a rally cap.



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START VALUE	RETURN OF %7	RETURN OF %8	YOUR SAVINGS
\$100,000	\$386,000	\$466,000	\$80,000
\$250,000	\$967,000	\$1,165,000	\$198,000
\$700,000	\$2,700,000	\$3,262,000	\$562,000

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Gordon is the Vice President – Financial Planning at Efficient Wealth Management Inc. a leader in cost efficient financial planning. He teaches at George Brown College in their Financial Services and Accounting area. He is also a frequent guest on television and has written numerous articles on investing and financial planning.