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An Investment Update

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MCIVER WEALTH MANAGEMENT
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What's News

By Neil McIver

Why Now May Be the Best Time to Invest in the Last 10 Years

Secular Bull markets and Secular Bear markets refer to the long-term multi-year trend of the marketplace; be it rising (Bull) or falling (Bear). The financial media will often confuse investors by referring to Bull or Bear markets in terms of what direction the market had been moving over any given year, month, week or even day. These shorter-term movements are much more difficult to predict and often run counter to the Secular direction of the marketplace.

The best way to imagine this is by imagining a beach. A Secular Bull or Bear is akin to a rising tide or a falling tide. If, for arguments sake, a tide is falling, periodically a series of larger waves may come into shore and crash farther up the beach than those waves just previously, giving the impression that the opposite is happening and the tide is now rising. These waves are often mistaken for Secular Bull markets and referred to as such. But we know from the tide table, that the tide is still falling.

Currently we are in a Secular Bear market, which began in 1999 when the market topped out on the tech stock boom that most remember well. Since then the tide has been falling and the markets are no higher today than they were then.

Way back in 2003, nearly a decade ago now, I was interviewed by *Achievers Magazine*. In that article I suggested that, based upon long-term Technical charting, that we were in a Secular Bear market. I was less blunt then than I allow myself to be now (one of the many benefits of growing older) but I still managed to directly state that "The next ten years will be more challenging than the last ten". I was right of course, because I had accurately read the tide table.

Previous Secular Bear markets lasted from 1929 – 1942 (13 years), 1967 – 1982 (15 years) and were interspersed with Secular Bull markets 1919 – 1929 (10 years), 1942 – 1967 (25 years) and the most recent 1982 – 1999 (17 years). These alternating cycles represent periods of investors being either too optimistic or too pessimistic.

It is in these Secular Bull market periods that virtually *all* of the long-term normalized rate of return of a market takes place. If a particular market's normalized long-term rate of return is 10%, it rarely ever does 10%. It goes through a long-term Secular Bull market period posting 20% rates of return and alternatively, posting negative or 0% rates of return as a long-term Secular Bear takes hold.

We are now 13 years into our Secular Bear market and nearly a decade after I referenced that fact in the article in *Achievers Magazine*. This Secular Bear market has grown long in the tooth. We are now likely somewhere between 18 months and four years away from the end of this bear period and a transition to the next Secular Bull market.

Pessimists, of course, will list of a litany of problems we currently face economically as reasons why this is not possible. Regardless of what these people say, it is not only *likely*, it is by far the most *probable* scenario that this transition take will place.

At the beginning of the last Secular Bull market in 1982, after a horrible 15-year Secular Bear, no one wanted to believe it either. Unemployment was over 10%, inflation was rampant and real estate had just collapsed. With the average mortgage rate in Canada hitting a whopping 19% in 1982, most people could not afford their homes. There were demonstrations in the streets, the teachers were on strike for wage hikes and it seemed like Japan was going to take over the world.

Yet, despite this dire background in 1982, the TSX began to rise posting +24% return that year and +19% the next. The Dow Jones began the Secular Bull with back to back +20% years. There was no looking backward until 17 years later.

Nobody rings a bell the day the next Secular Bull starts. In fact, the evidence suggests that most will not believe that it actually has until a couple of years after it has been established. Those people will miss all the profit over the lucrative first number of years.

The trick between now and then is to invest into a low-volatility portfolio that has been intelligently constructed to mathematically provide the greatest opportunity for a positive return in the current Secular Bear market. If that portfolio has outperformed through the Secular Bear, it will continue to outperform when the Secular Bull arrives.

And, it is coming.

On the Mark

By Mark Jasayko

Franken Rates

Prior to becoming the Chairman of the Federal Reserve Board in the U.S., Ben Bernanke had, on the public record, made numerous references to the benefits of a free market. As a result, it is somewhat ironic that he has been the chief monetary policy architect that has created a world of money that is fixed and manipulated. The only "free" aspect is the virtually free money for the largest borrowers and I hardly think that this was the definition of the word "free" to which he was referring to during his academic days at Princeton.

James Grant, the editor of *Grant's Interest Rate Observer*, was speaking at the CFA Fixed Income Conference in San Francisco this October where he used the term "free-range" interest rates, equating market-determined rates with natural, local, and organic good. He surmised that these would be the kinds of foods we would prefer to eat. The premium paid for these foods would suggest that he is right. On the other end of the food quality debate we usually find genetically modified foods getting most of the opposition. Because of the uncertainties that many people have with genetically modified food, and because of a concerted lobby against them, they are often pejoratively called "Franken Foods."

Using similar reasoning, Ben Bernanke has replaced interest rates that used to fluctuate according the economic cycle with "Franken Rates." In the past we were reasonably confident that the market's supply and demand for money (lending and borrowing) would determine a level of interest rates that would create a balance between those two forces. Now, the natural ebb and flow has been swept aside and we have to rely on the promise that the Fed will artificially keep them low for the foreseeable future.

Stocks and bonds do well with low Franken Rates. There is always an initial jump when Bernanke announces that he will ramp up efforts to keep them low. However, the impact of such liquidity announcements is a mere shadow of what it was like a decade ago. The economic upside is less and less with each attempt stacked cumulatively on past attempts (the Dow might have immediately doubled 10 years ago in response if Alan Greenspan, then the Fed Chairman, had announced policies of such magnitude). What we still know is that it will be a net positive for most investors around the time of the policy announcement. However, it is what we don't know which can really create winners and losers in the investment markets. And for that, we have to look further forward in time.

Franken Rates are unprecedented. There are no historical examples that can be used to forecast what the end result will be. With this September's announcement of more liquidity-pumping (QE3), the balance sheet of the Fed will grow at a rate of $40 billion per month on top of the $2.3 trillion pile left over from QE1 and QE2. This is the toxic bio-waste left over from the manufacture of Franken Rates. Any move to sell these bonds from the Fed's balance sheet will immediately catapult rates back up toward their natural level, negatively impacting the parts of the economy that are addicted to Franken Rates and lopping off a significant amount from the overall economic output (Gross Domestic Product). However, we just don't know how much growth will be impaired. And, that uncertainly is affecting employment and current economic output.

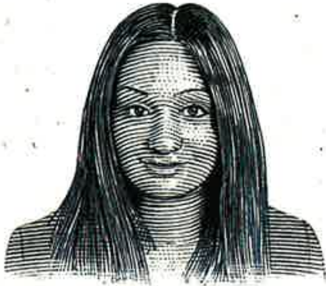
To underscore the uncertainly, the most rebellious figure in the Fed system, Dallas Federal Reserve Bank President Richard Fisher, recently quipped that "*no central bank anywhere on the planet has the experience of successfully navigating a return home from the place in which we now find ourselves. No central bank – not, at least, the Federal Reserve – has ever been on this cruise before.*"

As mentioned above, in the longer-term, there will be winners and losers in the investment markets as a result of the era of Franken Rates. Those that will continue to bet indefinitely on perpetual liquidity-induced economic growth will pay the price when it stops. If the Fed doesn't stop on its own, there is a wall that will stop it for them. That wall is inflation. If that happens, the winners will be investors in inflation-hedged investments including real-return bonds, gold, agriculture, and companies that are able pass on price increases to customers. For a preview of what this type of strategy might look like, just have a look at our Asset Allocated portfolios.

Just like genetically modified foods, Franken Rates also have a limited shelf life.

Good Karma

By Karm Bhatti



RESPs

A Registered Education Savings Plan (RESP) is a special savings plan that can help you or your family to save for a child's post secondary education. An RESP is a government-sponsored savings program specifically designed for education savings and is a tax-advantaged way of accomplishing this. Key notes are listed below:

1. The lifetime RESP contribution limit is $50,000 per beneficiary (there is no annual contribution limit)
2. The maximum annual amount of the Basic CESG (Canada Education Savings Grant) that can be paid in any year is $500 (and up to $1,000 if there is unused grant room from previous years). The lifetime CESG for each child is $7,200.
3. Contribution deadline is December 31, 2012.

Preserve and Protect

By Mike George

2012 – 2013 TAX PLANNING

Prior to December 31, 2012:

- Utilize realized capital losses
- Transfer unrealized capital losses from a spouse
- Contribute to your TFSA
- Contribute to your child's RESP
- Make a political contribution
- Establish a low interest rate loan to a family member
- Donate to charity
- If you sold a vacation property this year, consider claiming it as your primary residence
- If you are age 71 this year, you must convert your RRSP to a RRIF. Consider the following:
  - use your younger spouse's age for minimum payment calculations
  - consider an advance contribution to your RRSP for earned income from this year
- Pay all qualifying deductible expenses, e.g. carrying charges, investment management fees, loan interest, alimony/maintenance payments, tuition fees, moving expenses, child care expenses, professional fees
- For Corporations:
  - pay reasonable salaries to family members
  - accrue salary and bonuses before year end (payment must be made within 179 days of year end)

Prior to January 30, 2013:

- Pay interest on low interest rate loans to family members

Prior to March 1, 2013:

- Contribute to your RRSP or Spousal RRSP (2012 RRSP contribution limit is 18% of earned income to a maximum of $22,970)

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