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MACQUARIE

OUR VIEW

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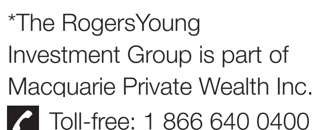

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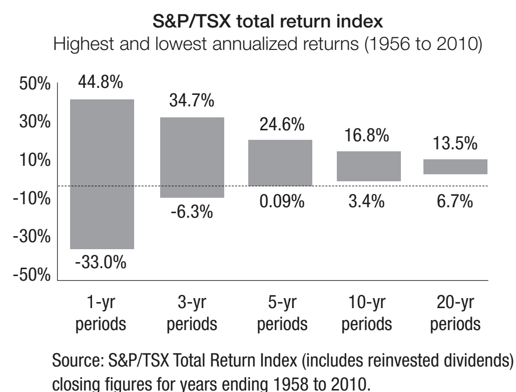
IT'S ABOUT TIME...

The positive sentiment that started the year has more recently been met with considerable tension and volatility. It is not unusual to see daily moves of several hundred points in either direction on North American markets reflecting the most current outlook or news reports. How long any period of uncertainty will last is impossible to predict, but a look back in time suggests that these periods eventually pass.



Source: S&P/TSX Total Return Index (includes reinvested dividends) closing figures for years ending 1958 to 2010.

A closer look at longer-term holding periods for Canadian equity returns may remind investors that time is one of the investor's greatest allies. Year-end returns for the S&P/TSX Composite Total Return Index from 1956 to 2010 were analyzed for one-, three-, five-, 10- and 20-year holding periods.

Over time, short-term volatility had an insignificant impact on total returns. As the duration of the holding period increased, the number of negative total returns decreased. During this period, there has never been a five-, 10- or 20-year holding period with a negative total return. The chart depicts the highest and lowest annualized returns for the specified rolling time period.

Will this observation continue into the future? History suggests that it will.

For individual investors, a financial plan and a focus on a longer-term time frame may be the keys to success. Attention to such things as diversification, quality of holdings and rebalancing will also be important as time passes.

While we are currently experiencing unusual events in the financial markets. it is certainly not the time to abandon securities which were selected with our personal needs in mind. Instead, keep perspective through these inevitable short-term market swings. Focus on the long term and maintain confidence. Time is on your side.

ESTATE PLANNING

YOUR WILL AND TAXES

In previous publications, we've discussed the importance of effective estate planning. This includes updating beneficiary designations for all plans and policies and reviewing your will periodically to ensure it is current based on changing circumstances. It also means ensuring that your will distributes your estate according to your wishes in the most tax-efficient manner.

Minimizing taxes

When drafting or updating your will, it may be useful to consider various ways to minimize taxes and enhance the amounts to be distributed to your beneficiaries.

For tax purposes, an individual's assets are considered to have been sold at their fair market value immediately before death. This may be problematic if capital gains have accrued on your assets as that may lead to a significant tax liability. Under some circumstances this tax can be deferred by transferring assets to a spouse or a qualifying spousal trust, for example.

When reviewing the distribution of assets in your will, you should estimate your expected tax liability at death. This will allow you to plan now to ensure you have sufficient liquid assets or enough insurance on hand to fund the estimated future tax liability.

There are a number of ways to minimize taxes on your estate. Testamentary trusts, or trusts created by way of your will, may provide tax savings through income splitting opportunities. Here, the trust is considered to be a separate taxpayer subject to tax at progressive rates, just the same as individuals. Testamentary trusts also provide the benefit of having specific terms surrounding the administration of assets, allowing you to determine when certain beneficiaries will be entitled to receive their portion of your estate.

Charitable giving may also be another way to help minimize taxes. Careful planning will ensure that any tax benefits resulting from donations made in your will are fully utilized. For instance, you would not want donation credits to end up in your estate without having offsetting income if all of your income was reported in your terminal return.

Other considerations

To ensure that your will best takes advantage of tax minimization opportunities, you should provide your trustees with sufficient powers to allow for tax planning on behalf of the estate. Most generic will templates are either silent on this issue or provide very basic and insufficient powers.

Some jurisdictions assess estate administration fees (or probate fees). Here, you may consider the use of multiple wills (i.e., a primary will to hold assets subject to probate and a secondary will to hold assets not subject to probate, such as private company shares) to reduce the fees charged to the estate. These fees can also be avoided by holding assets in joint tenancy such that they will pass directly to the joint owner upon your death or by transferring the assets to a trust during your lifetime.

If you or any of your proposed beneficiaries are US citizens or green card holders, you may require specialized terms and conditions in your will to avoid US tax and/or US estate tax complications.

As always, we recommend seeking advice from legal and tax professionals to ensure that your will takes into account all tax-efficient opportunities available.

The comments contained herein are general in nature and are not intended to be, nor should be construed to be, legal or tax advice to any particular individual. Accordingly, individuals should consult their own tax advisors for advice with respect to the tax consequences to them, having regard to their own particular circumstances.

HOLDING ON...

TSX INVESTING

A look back at the S&P/TSX Composite Total Return Index from 1956 to 2010 shows the merits of longer-term investing. Here are some figures for 10-year holding periods:

45

Number of 10-year periods from 1956 to 2010

20

Number of 10-year periods where returns exceeded 10 percent annualized

0

Number of 10-year periods with a negative return

3.4 percent

Annualized return for the worst 10-year period

16.8 percent

Annualized return for the best 10-year period

9.9 percent

Average annualized return for all 10-year periods

166.5 percent

Average cumulative return for all 10-year periods

$14,013

Amount returned if $10,000 was invested over the worst 10-year period

$47,060

Amount returned if $10,000 was invested over the best 10-year period

Source: S&P/TSX Composite Total Return Index closing figures for years ending 1956 to 2010.

INVESTING IN YOUR FUTURE

YOUR (GRAND)KIDS AND THE PATH TO MILLIONAIREDOM

Why not help your kids or grandkids get a healthy head start on their retirement? The key is starting early. Even a few years can make a dramatic difference down the road for their future well-being.

Consider this — a child with $18,000 invested on his or her fifth birthday at a seven percent growth rate per year would have $1,000,000 by the time he or she reaches 65 years of age.

One of the ways to make a difference in the financial lives of new generations is through education. Instilling financial responsibility and teaching the virtues of investing will be some of the greatest lessons you can give to a child or grandchild.

Here are five simple ideas that apply to almost everyone with children or grandchildren.

1. **Fund an RESP** — Education can be expensive! A tax-sheltered Registered Education Savings Plan (RESP) is a great way to get a head start in saving for post-secondary education costs. Consider the current average tuition at a Canadian university for an undergraduate degree of $5,138 per year. South of the border, tuition can cost anywhere up to US$30,000 per year for international students.
2. **Teach the pitfalls of credit card debt** — Coach your child on the importance of paying off credit card balances on time. The average Canadian's credit card debt is around $4,000. At the 19 percent interest rate charged by many credit card companies for unpaid balances, this equates to over $15,000 in interest charges throughout a 20-year period!
3. **Start an investment account** — The time value of money is one of the greatest lessons that a child can learn. Open an investment account for a child to educate him or her about compound interest. Saving $2,000 each year for the next 55 years will grow to over $1,000,000 at a seven percent interest rate (ignoring taxation).
4. **Train your child to budget** — Start early as good habits can last a lifetime. If you provide an allowance, consider giving a child a larger sum of money to manage over time versus smaller amounts more frequently. Teach about saving for future purchases, trade-offs and how to make funds last over a period of time.
5. **Hire your child** — If you run your own business, consider paying your child to work for the business. If reasonable, it may be deductible for your business and your child may be able to offset these wages with the basic personal tax amount, as well as tuition, education and text book credits.

CHALLENGING CONVENTIONAL WISDOM

LOW RISK, HIGHER REWARD?

Modern finance has taught us to believe that with higher risk comes the prospect of higher returns. But a recent study conducted by three finance experts, including Malcolm Baker from Harvard Business School, has shown that this may not always be the case.*

The study examined the 1,000 largest US stocks from January 1968 to December 2008 and sorted the equities by risk, defined by raw volatility (fluctuations in price over time) and beta (relative price movement versus the market). The riskiest 20 percent of all stocks (updated on a monthly basis) performed poorly versus the least risky 20 percent of stocks. A dollar invested in the risky portfolio would have declined to less than $0.10 after inflation over the 41-year period whereas a dollar invested in the least risky portfolio would have increased to over $10 adjusted for inflation over the same period of time.

Investors seeking lottery-like payoffs increased the demand for high-risk stocks, pushing their prices higher than otherwise would have been. Most of the well-performing, low-risk stocks were shunned by investors for a variety of reasons, including that the companies existed in mature or slowing industries, which pushed their prices down.

Should investors have given the slower, steady stocks such a bad rap since they outperformed the riskier stocks?

If all investors invested in the least risky stocks, the prices of these equities would have risen and higher returns would likely have been eroded. As well, it is human nature to prefer lottery-like payoffs, which often only come with the most volatile, risky stocks.

What are the lessons to be learned? Although lottery-like payoffs may exist with the most risky stocks, the likely outcome is that the high-risk investor will end up losing money. History has shown that lower risk may mean higher reward!

*Baker, Bradley and Wurler. "Understanding the Low Volatility Anomaly". Financial Analysts Journal, Vol. 67, Feb. 2011.

THE INVESTING STATE OF MIND

Successful investing means doing more than just making good decisions. It's also a state of mind.

We often give advice on investment strategies and tactics. But making smart investment decisions often works best when complemented by a strong investing state of mind. What characteristics contribute to creating this state of mind?

Famous investors like Sir John Templeton and Warren Buffett have been recognized for certain qualities that have contributed to their success. Here are some thoughts.

Practice discipline

"The four most dangerous words in investing are: 'This time it's different'." — Sir John Templeton

Distractions such as short-term market volatility can cause investors to stray. However, as history has shown, this is often dangerous.

Disciplined investors stay focused on their investment plan and apply investment principles to their decision-making, not allowing themselves to be derailed regardless of the market situation.

Understand your limits

"Risk comes from not knowing what you're doing." — Warren Buffett

Successful investors understand their limits and recognize that they can benefit from the knowledge and experience of others. Even expert investors, whose entire careers encompass investing, work alongside trusted individuals and view the investment process as a partnership.

Control emotions

"Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria." — Sir John Templeton

Investing is a world characterized by uncertainty. The emotions of fear and euphoria may sometimes drive investors to make unwise decisions. Studies have shown that the best investors are those who remove emotion from the process and rely on rational decision-making.

Think independently

"A public-opinion poll is no substitute for thought." — Warren Buffett

Successful investors base investment decisions on rational analysis and relevant information, not popular belief. Sometimes, this may mean going against conventional thinking.

Be patient

"We don't get paid for activity, just for being right. As to how long we'll wait, we'll wait indefinitely." — Warren Buffett

Successful investors have given a lot of thought to the investment process and established a plan that spans the long-term. For almost every investor, investing success does not happen overnight. Rather, it is a process that yields results over time.

Parting thoughts

As investors, we may never quite attain the same notoriety achieved by investors such as Sir John Templeton and Warren Buffett. But by integrating the qualities of these successful investors into our own investing ways, we will be better equipped on the road to investing success.

The value of advice

A recent study by the Investment Funds Institute of Canada showed that professional advisors enhance the financial literacy of their clients.

Canadians who work with a professional advisor have substantially higher amounts of investable assets than those not advised. Advised investors not only have better savings patterns but are also more likely to use tax-advantaged savings opportunities and invest in securities with more opportunity for future investment growth.

Most importantly, investors working alongside advisors are more confident about their financial future.

As always, we are here to partner with you in helping to achieve all of your financial goals.

"The Value of Advice Report", July 2010, Investment Funds Institute of Canada.

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