

OUR VIEW

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KEEPING PERSPECTIVE

A historical look at Canadian equity performance from 1970 to the present provides an interesting perspective on the virtues of longer-term thinking. Monthly returns for the S&P/TSX Composite Total Return Index (which includes reinvested dividends) are analyzed to determine the up periods and the down periods over time. A down period is defined as a decline in the index return of greater than 20 per cent.

Over the 40-year period, the analysis shows that the average length of the down periods was substantially shorter than the average length of the up periods. The index returns showed seven down periods that averaged only 11 months, versus eight up periods that averaged 52 months. When comparing nominal returns, the down periods averaged a return of -33 per cent versus an average return of +147 per cent for the up periods. For the entire 40-year period, the resulting total average compound annual nominal return was 9.9 per cent and the cumulative nominal return was 44 times the initial investment!

**S&P / TSX Composite total return index
(Performance 1970 to current)**

Period (mm/yy)	Months	Return
01/70 to 11/73	46	+47%
11/73 to 10/74	11	-35%
10/74 to 07/81	81	+288%
07/81 to 07/82	12	-39%
07/82 to 08/87	61	+253%
08/87 to 12/87	4	-25%
12/87 to 01/90	25	+44%
01/90 to 11/90	10	-20%
11/90 to 05/98	90	+203%
05/98 to 09/98	4	-27%
09/98 to 09/00	24	+109%
09/00 to 10/02	25	-43%
10/02 to 06/08	68	+168%
06/08 to 03/09	9	-43%
03/09 to 11/10	20	+64%

Source: TMX Market Data

As investors, it is often difficult to maintain patience through periods of turbulence and instead fall prey to short-term doom and gloom. However, in doing so, we sometimes overlook the many positives that come with investing with a longer-term view. As the New Year begins, resolve to keep a long-term investing perspective. Inevitably, there will be short-term bumps in the future. But with a strong financial plan that emphasizes quality and risk management and incorporates sound investment strategies, you will be well-served for the road ahead.

CHANGING LANDSCAPE

TOP CANADIAN STOCKS: WHAT WILL 2020 BRING?

The composition of the leaderboard for the Toronto Stock Exchange (TSX) has changed significantly over the past two decades. Today, the top 10 stocks by market capitalization account for approximately one-third of the total Canadian stock market. This group is dominated by resource-based firms and financials as industry diversification has narrowed.

Although financial institutions have continued to perform well over the past two decades, the landscape was much more varied 20 years ago when telecommunications, transportation, mining, and consumer products companies all contributed as leaders alongside financials. Ten years ago, this changed when Nortel's performance eclipsed other companies' performance during the technology boom. A thriving infrastructure market also helped Bombardier to achieve top 10 status.

TSX top 10 equities, by market capitalization

1990		2000		2010	
1. BCE Inc.	8.0%	1. Nortel	18.0%	1. Royal Bank	5.3%
2. Royal Bank	4.5%	2. BCE Inc.	4.3%	2. TD Bank	4.4%
3. Canadian Pacific	4.2%	3. Royal Bank	3.8%	3. Bank of Nova Scotia	3.8%
4. Seagram	4.0%	4. TD Bank	3.3%	4. Suncor Energy	3.7%
5. Aican	3.3%	5. Bombardier "B"	2.9%	5. Barrick Gold	3.5%
6. TD Bank	3.3%	6. Manulife Financial	2.7%	6. Potash Corp	3.0%
7. Bank of Nova Scotia	3.2%	7. Bank of Nova Scotia	2.6%	7. Cdn Natural Res.	2.9%
8. Placer Dome	3.1%	8. Bank of Montreal	2.5%	8. Goldcorp Inc.	2.3%
9. Laidlaw "B"	2.7%	9. CIBC	2.2%	9. Bank of Montreal	2.3%
10. Northern Telecom	2.5%	10. Sun Life Financial	2.0%	10. CIBC	2.1%

Sources: TSE ReviewDec. 1990 and 2000 editions and TMX website.

However, more recently, renewed strength in the resource sector has been evident with mining and energy companies demonstrating excellent performance. What lessons can we learn from this brief look back at previous decades?

Continuing industry concentration should remind us that index products may not always provide adequate diversification.

As well, the importance of being well-diversified and not relying on only a few securities should be remembered, especially when reflecting on the rise and fall of Nortel shares. What will the next ten years bring?

CONSIDER YOUR TIMING

RRIF "IN KIND" WITHDRAWAL STRATEGIES

The beginning of the year may be a good time to consider a strategy for the minimum withdrawal requirement of your Registered Retirement Income Fund (RRIF). If you are required to make a RRIF withdrawal and do not need the liquid funds, you may wish to withdraw your legislated minimum annual payment, which is not subject to withholding taxes, by conducting an "in kind" withdrawal. This transfers investments with the equivalent market value of the required withdrawal to a non-registered account.

If you are transferring equity investments to a non-registered account, you may consider transferring investments earlier in

the year to allow for the maximum amount of time for capital growth to occur outside of the RRIF during the year. When the holding is eventually sold, capital gains achieved outside of the RRIF (on the same pre-tax amount that would otherwise have been left in the RRIF) will be taxed at a rate that is 50 per cent lower than if the incremental gain was generated inside the RRIF.

However, the benefits of this strategy may be somewhat offset by the opportunity cost associated with continued sheltering of that capital gain in the RRIF. As well, if capital losses are incurred during the year, the after-tax value of the investment may

be lower. Finally, transfers in excess of the minimum withdrawal amount may not achieve any benefit due to the withholding tax applied.

Canadian eligible dividends would be subject to the dividend tax credit that effectively cuts the tax rate in half, whereas dividends earned in the RRIF would eventually be paid out at the full tax rate. Foreign dividends and interest are treated as interest income for tax purposes and may be better left sheltered in the RRIF. If you are transferring fixed income investments, it is generally best to wait until later in the year so that the year's earnings are tax deferred throughout the year.

MARKET METRICS

NEW INDEXES ARRIVE

S&P/TSX 60 VIX — Last quarter, Canada's own volatility index was launched. The S&P/TSX 60 VIX measures the expected volatility of share prices for the 60 largest TSX-listed companies based on market value. Similar to the Chicago Board Options Exchange Volatility Index, known as the "fear gauge," the index is based on the cost of index options for a select group of shares over the next 30 days. The index is intended to act as a

measure of market sentiment and will help to develop a volatility trading and hedging market in Canada.

Google Price Index (GPI) — Meanwhile, Google continues to broaden its reach in the area of economic forecasting, using real-time data to improve forecasting accuracy. One of its latest research projects is a price index that uses purchase information from its databases to measure

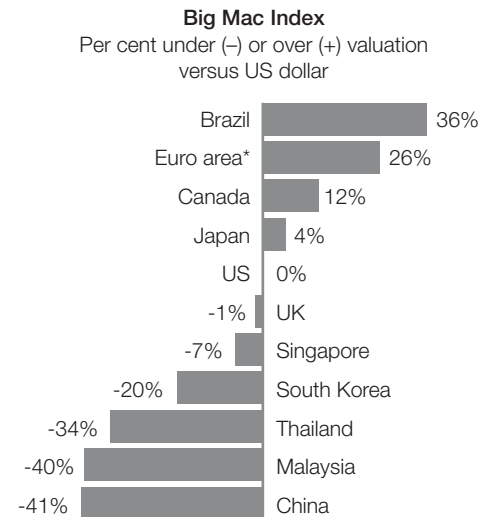
real-time inflation. The advantage? The GPI can be reported continuously and instantaneously, whereas an index like the Consumer Price Index (CPI) has a time lag of several weeks. The disadvantage? Google can only measure price changes of Internet purchases. However, the GPI has successfully demonstrated a correlation to the U.S. CPI for items frequently purchased over the Internet.

MARKET METRICS

BURGERNOMICS' SILVER ANNIVERSARY

This year marks the 25th anniversary of the Big Mac Index, an index published by *The Economist* magazine that was established as a "light-hearted" guide to comparing the purchasing power parity (PPP) of various currencies. PPP theory assumes that the exchange rates of two nations will naturally adjust in the long-term so that an identical basket of goods and services should cost the same in both nations' currencies. The index uses a McDonald's Big Mac to represent this basket. It determines the exchange rate that results from the cost of a Big Mac in one nation's currency versus the US currency. Comparing actual currency exchange rates with the burger's exchange rate indicates whether a currency is undervalued or overvalued.

Is the Big Mac Index helpful in predicting global exchange rates, or is this just junk food for thought? Although obvious flaws exist (including factors affecting the input price of a Big Mac, such as sales taxes, trade barriers and the cost of non-traded inputs), various academic studies have shown the index to be a good predictor for exchange rates over the longer term. In 1999, when the Euro was launched, the index correctly predicted its future decline contrary to many economic forecasts. The index has also shown that currencies of many emerging markets such as China, Malaysia and Thailand are undervalued against the US dollar. Emerging markets account for over half of the world's gross domestic product on a PPP basis, but less than one-third on a U.S. dollar basis.



Select countries at market exchange rate November 15, 2010.
* Weighted average of member countries.
Sources: *The Economist* (Oct. 14, 2010) and XE.com (Nov. 15, 2010).

YOU ASKED

100-YEAR BONDS?

Last year's fixed-income boom brought the return of the century bond: debt with a 100-year maturity. This type of issuance is rare since corporations generally issue debt with maturities of between 10 and 40 years.

Century bonds appeal to life insurance companies and pension funds that have

long-term liabilities such as ongoing future payment obligations. With interest rates at low levels and government debt yielding historically low returns, century bonds have also attracted other yield-seeking investors.

However, these bonds are subject to risks over a longer period of time, including rising interest rates and potential issuer

insolvency. One hundred years may seem like a long time, but bonds with even longer maturities have been issued before. In 1883, Canadian Pacific issued a four per cent, 1,000-year bond and, during World War I, the United Kingdom issued sovereign perpetual bonds that still continue to pay interest today.

THE TAX TREATMENT OF ETFS AND MUTUAL FUNDS

Exchange-traded funds (ETFs) and mutual funds have become such popular investment vehicles that it is important to be familiar with the tax issues surrounding these types of funds when they are held in your non-registered accounts.

In general, there are two situations that would require you to report information in your annual income tax return: i) when a fund makes a distribution in the year; and/or, ii) when you dispose of all, or some, of your holdings in the fund.

Distributions

At the end of every calendar year in which it made a distribution, a fund is required to issue a tax reporting form. This tax slip will indicate the amount and nature of the distributions that you received. The types of distributions that are included in your taxable income may consist of: dividends (eligible and/or other than eligible), capital gains, other income (which generally represents interest, rental, and/or business income), and foreign income. The type of tax slip issued may vary. For example, if you own units of a mutual fund trust, you will receive a T3 slip — Statement of Trust Income Allocations and Designations. If you

own shares of a mutual fund corporation or exchange-traded fund, you will receive a T5 slip — Statement of Investment Income. The tax slip should also indicate the amount, if any, of the distributions that are to be considered a return of capital. Although a return of capital is not subject to tax when received, it does have a tax impact in the future.

It is important to recognize that distributions by a fund can be made in cash and/or through a non-cash reinvestment in the fund. If a fund makes a non-cash distribution, you would still include the taxable components of the distributions in your income for the year. However, you would also add the reinvested amounts to your adjusted cost base (ACB) in the fund, as explained in the next section.

Note that the structural differences between ETFs and traditional mutual funds can affect capital gains, as ETF sponsors do not need to sell underlying securities to raise cash for redemptions (instead, an exchange occurs, which is not considered a taxable event, and increases your portfolio's overall cost basis). This may reduce the likelihood of incurring capital gains.

Disposition

The disposition of a fund must be reported in your tax return in the year it is sold. The calculation of the capital gain or loss resulting from the sale is determined by taking the net proceeds received after commissions or fees and subtracting the ACB of the fund sold. The ACB of the fund is composed of the following amounts, if any: i) the total amount that you paid to buy the fund, including commissions; ii) plus the amount of all non-cash reinvested distributions; iii) less the return of the capital component of any distributions; and, iv) less the ACB of any previously sold shares or units.

It is important to maintain detailed records of your investments in order to calculate the ACB of a fund, particularly in situations where you are selling only a portion of your holdings, or there have been returns of capital, and/or there have been reinvestments in the fund.

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