



WEALTH MANAGEMENT



2008 Year End Market Commentary

2008 was a year most of us would like to forget.

TSX	-35%
Dow Jones	-34%
Nikkei	-42%
EAFE	-45%

(2008 annual return, in local currency)

But the fact is that 2008 was a year that we would be wise to remember for as long as possible.

We were somewhat spoiled from 2003-2007 when we had good equity returns with very low volatility. This was facilitated by easily accessible and cheap credit. With credit drying up in 2008, last year brought the reality of equity investing back to the forefront. We saw severe market declines with extreme volatility. In Canada, we were holding our own until commodity prices started to decline significantly during the summer. Then the TSX “fell off the cliff” to catch up with the rest of the world’s equity markets.

The equity markets have a definite risk-reward relationship and we have just seen what happens when equity risk appears in full force. One result of this is that many investors find themselves re-examining their risk tolerance. This is a normal reaction to these types of events. What we typically see is that in times of booming markets people often over-estimate their risk tolerance and then correspondingly they become overly conservative in a declining market. It is important to remember that when you decrease your equity exposure you increase your inflation risk and your longevity risk. This is not a decision to be taken lightly and should be discussed with your Wealth Manager.

The numbers above give a not so gentle reminder of the level of risk inherent in the equity markets. So when considering the amount of equity in your portfolio one needs to be aware that these brutal years, although not frequent, can occur from time to time and without warning. Now that we have seen the risk side, let us not forget why we have equities in the portfolio in the first place and that is return. Equities are historically the best returning asset

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class bar none. Historical equity returns have far outpaced bonds, cash, real estate and inflation. But in order to capture that positive higher long term return, investors must have the financial and emotional wherewithal to accept the volatility that goes along with it.

What is in store for 2009? As you know, we do not try to predict the stock market movements as this is a futile effort. We are mired in a severe recession on a global scale and credit markets are not flowing freely at this point. Canadian banks did not pass on to borrowers the full extent of the December Bank of Canada interest rate cut. Housing prices are continuing to decline in the United States. Until credit is more accessible and housing prices begin to level off it will be difficult for the debt-laden consumer to drive economic growth. The US Treasury is spending money like they have a printing press (they do!). What does this all mean? It means there will not be a quick fix to this economic situation.

At some point, the items mentioned above will begin to improve. Stock markets are forward looking which means that they move in advance of, or in anticipation of actual events. The markets began to decline prior to the onset of recession and have historically moved up prior to the end of a recession. There is no reason to think the same will not hold true in this case.

We often hear "it's different this time" and it is. Every recession is different. The causes, the severity, the length and the recovery are different every time. But the stock market is remarkably consistent in many ways. Investors are looking for profits. When corporate profits are expected to decline (risk), the stock market moves down in anticipation of this. When corporate profits are expected to increase, the markets move up (return). That is how it has always been and that will not change.

2008 will be remembered as one of the worst stock market years of all time and rightly so. It should also serve as a wake-up call to investors about the reality of the equity markets.

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