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# ◆ Investment News ◆

February 2012



Left to Right:

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**The Kelland Wealth Management Group, ScotiaMcLeod**

[www.kellandgroup.com](http://www.kellandgroup.com)

## Market Returns in 2012

As of January 26, 2012

<b>S&amp;P/TSX</b>	<b>4.40%</b>
<b>S&amp;P 500 – USA (in US\$)</b>	<b>4.90%</b>
<b>MSCI World Index (in US\$)</b>	<b>4.80%</b>
<b>S&amp;P/TSX - from 2008 peak to now:</b>	<b>-17.50%</b>
<b>KWVG Model Portfolio:</b>	
<b>Since January 2009 (annualized):</b>	<b>10.60%</b>
<b>2012 Year To Date:</b>	<b>3.80%</b>

## In This Issue

- **Market Commentary**
- **Price/Earnings Trends**
- **What Will Your Executor Do?**
- **Two Tales of Former Titans**
- **KWVG Team Updates**

## MARKET COMMENTARY

Sailing along on the ocean of investing for the long-term, we at least have had the soft waft of a gentle breeze at our backs so far in 2012, instead of the raging gale in our faces that we felt for much of 2011! The sun may still be hidden behind the foggy horizon, and this is only one month, and one small leg of a long journey, but at least it is a treat to see and feel a calmer market environment. This is not to

say that Europe's problems have been solved, or that the U.S. has any idea what to do with its deficits, or that China has woven the silver lining for a soft landing of its overheated economy, but it is, we feel, more indicative of the investing world waking up to the fact that **securities in many cases were oversold and under-appreciated as we began a new year.**

Consider again where we have come from.

- The TSX (Toronto Stock Exchange) peaked at 15,150 in 2008. Today it resides in the neighbourhood of 12,500. **Thus the major Canadian market is 2,650 points or 17.5% below its all-time high.** Most clients' portfolios will also not have recovered to their own all-time high given this.
- The S&P 500 in the U.S. is at 1,325 as we go to press. It was also at **this same level in 1999.** **Thus the major index in the U.S.A. is no higher today than 13 years ago.** The U.S. represents about 46% of the world's publicly traded stocks' market value.
- **The MSCI World Index** (the developed world stock markets of 23 countries) in Canadian Dollars **is down -2.80% per annum over the past ten years.**
- **Emerging Markets were also flat or negative over ten years.**

## 2

**Thus it has been a very difficult equity environment for all investors, globally, over the past decade, and longer.**

We are more optimistic looking forward for a few reasons:

1. Corporate earnings are much higher today than ten years ago;
2. Dividends are much higher today than ten years ago;
3. Price/earnings multiples are much lower today than ten years ago (see below);
4. Interest rates (the opportunity cost of equity markets) are at all-time lows currently;
5. Companies are generally in the best shape in years.

**Our clients' portfolios in general have consistently outperformed the indices.** We tailor each portfolio specifically to each client's own needs and risk tolerance.

Our **Model Portfolio**, which was started three years ago (January 2009) has averaged over 10.0% per annum, and thus outperformed the TSX on a risk-adjusted basis and has also outperformed the five year bond index in Canada. **Last year the TSX fell -11.1%. Our Model Portfolio fell only -2.27%.**

To recap: The TSX and S&P 500 are both well below their all-time highs. Interest rates are at all-time lows. We feel that the equity markets are attractive from both a valuation perspective (see below) and also relative to upcoming bond performance. The good majority of our clients have outperformed the indices over the past three tumultuous years. Yet most clients will still be below their own all-time peaks (adjusted for cash in and out).

### **EQUITY MARKETS – PRICE/EARNINGS TRENDS**

Rob Kelland often refers to a statistic that he considers important when researching investments – the Price/Earnings (P/E) ratio. It is by no means the “full story” but it is usually an important piece of analysis. This is simply the price of a stock divided by its annual earnings. It might reflect “Trailing” historical or “Forward” (estimated) earnings.

This figure tells you, in general, how many years' earnings it will take for a company to “return” to the

## **Investment News**

investor the price being paid – or, in other words, how much an investor is willing to pay for a dollar of earnings. Consider that a P/E of eight would mean that over eight years the company will be expected to fully earn what one is paying to buy its shares today. Its inverse (Earnings over Price) reflects the company's ability to produce earnings. For example, an earnings ratio of twelve would be very strong – thus, in general, the lower the P/E, the more attractive is the company.

Keep in mind there are many other factors, but in an over-simplistic comparison, a company with a P/E of eight compares favourably today with a Government of Canada 10-year bond ratio of 50! That is because bonds are paying only 2% - it will take fifty years for the interest to accumulate and “earn” the full cost of what is considered the “safest” investment.

**What we follow closely are the trends in P/E ratios**, by company, by industry, by sector. For example, the Canadian real estate stock sector P/E is trending to a higher (less attractive) ratio. **The overall trend of markets in 2011 was towards lower P/E multiples.** In fact the TSX “forward P/E” contracted by 23% from 14.8x in January 2011 to 12.1x in January 2012. The MSCI World P/E ratio contracted by 11% and the S&P 500 (U.S. stocks) contracted by 9%. Some sectors within Canada experienced expansion of ratios (such as telecoms and utilities). Others (materials and energy) fell the most in 2011.

In the past 25 years there was only one other time when P/E ratios were so low, and that was the first quarter of 1988. One year later the S&P 500 had rallied by 15%.

**Most markets are trading well below their long-term average P/E multiples, even if corporate earnings levels just stay level with last year's.** And when interest rates are offering the lowest ever, and when dividend rates (dividends are paid from corporate earnings) are even higher than bonds, in a word, equity markets are comparatively cheap!

**The TSX average dividend rate is 2.9%, higher than the yield of the highest quality corporate five year bond.**

### 3

## WHAT WILL YOUR EXECUTOR DO? (Part 1)

Or, if you are appointed as an executor of an estate, by someone's will, what will you do? Selecting an executor is a very important decision in estate management.

An executor may be a family member, a friend, an experienced professional, or a well-recognized trust management company like Scotia Trust. They have been chosen because they are considered capable of the honour of executing the wishes of the deceased, and are considered trust worthy.

There are many duties that an executor may have to perform, but generally they will seek the advice and counsel of experienced professionals who will guide them from a legal, tax and investment perspective.

Over the next few newsletters, we shall provide some information on the important role of executors.

**DID YOU KNOW?** If the executor of your will dies before you do, in the absence of a named executor as a second choice, it is your late executor's executor that will legally become your estate's executor. **Ensure that your will has named at least one contingent executor** and/or that your will is updated if your executor dies.

### TWO TALES OF FORMER TITANS

Like Canada's storied Eaton Company, which closed its doors several years ago, the end result is sadly familiar for two other giants that began their business lives in the latter part of the 19<sup>th</sup> century.

**Eastman Kodak** has filed for bankruptcy protection in its 130<sup>th</sup> year of existence. Kodak invented the hand-held camera, as well as digital photography. In the 1960s it sold 90% of the film and 85% of the cameras bought in the U.S. It produced *Kodachrome* film for 74 years. 15 years ago its market value was over \$31 billion. Today its liabilities outstretch its assets by \$1.6 billion. Although it still has 17,000 employees, Kodak's value, when it sought bankruptcy protection, was only \$150 million.

**Nortel Networks** was also formed in the late 19<sup>th</sup> century, and as a division of Bell Canada became Canada's world-leading developer of telecommunication switching equipment, and in the advent of the Internet age, of digital switching and

## Investment News

fibre optics technology. When it was spun out of BCE it employed, at its peak, 95,000 staff. In 2000 its stock soared, and **Nortel became the ninth largest corporation in the world** (by market value) and actually represented one-third of the entire TSX.

But in the 2001 "Dot-Com" crash, it became necessary to close operations in various parts of the world and to record over \$5 billion in anticipated restructuring costs (these accruals are a major part of the current fraud trial against former Nortel executives). Nortel's stock plummeted from its stratospheric peak of \$124 per share.

Nortel shares were de-listed trading at 18.5 cents per share and in July 2011 its final assets were sold. Liquidation of claims including pension liabilities is ongoing. Its pension deficit apparently is still \$1.5 billion.

**The Lesson for Investors?** Don't get caught up in excessive media hype "promising the moon". Conversely it is also possible to be misled by "deep value" share discounts! **Diversification is key.**

### CANADA'S SHARE OF WORLD MARKETS IS GROWING

Canada represents 0.5% of the world's population, 1.8% of the world's economic output (global GDP), but 4.5% of the world's market value of publicly traded companies. This is up from 2.0% in 1999. We are behind only the United States (at 46%), the U.K. (at 8.6%), and Japan (at 8.0%).

### DATES AND DEADLINES

Please refer to the Kelland Wealth Management Group website ([www.kellandgroup.com](http://www.kellandgroup.com)) for periodic reminders on deadlines and limits for **RRSP contributions**, estimated issue dates for tax slips, and the like. **Tax slips** usually continue until the end of March, therefore we generally advise clients not to complete and file their tax returns until early April.

**Tax Packages** that we prepare annually for clients with non-registered accounts are in process and will be mailed to clients as they become available.

We strongly encourage you to meet with us annually to review your plans, comfort levels, and your needs.

## NEWS FROM THE KELLAND WEALTH MANAGEMENT GROUP

### 50/50 Draw A Success!

In December, many members of our Team were joined at the John Labatt Centre by a wonderful group of hospital volunteers to sell 50/50 tickets at the London Knights game as the Knights took on the Peterborough Petes. The ticket sales were a huge success, and we are very pleased to announce that we were able to **donate \$3,140 to the London Health Sciences Foundation** that evening. The donation was split evenly between the London Regional Cancer Program Patient Assistance Program, and the Access Cancer Therapies Now Fund. We had a lot of fun selling tickets, meeting people and supporting a wonderful cause in our community. Thank you to all of our volunteers for making this night a special one!

### Dressfest 2011 Update



As we have written about in previous newsletters, the second annual Dressfest event took place at Greenhills Golf and Country Club on Saturday, October 22, 2011. This fundraising event, created and supported by many members of our Team, requires all those in attendance to wear a wedding dress. Guests are treated to a silent auction, raffle prizes, wonderful hors d'oeuvres and a night of dancing and fun! Like the 50/50 draw, the proceeds from this fundraising event support the London Regional Cancer Program Patient Assistance Program.

We are very pleased to announce that we now have the fundraising totals finalized from the 2011 event, and we are delighted to share with you the news that **this year we raised \$33,000 for the hospital**. This exceeds our total from year one when we raised almost \$30,000! We are very grateful to all of the people who have helped to make this possible, especially our sponsors, attendees and those who donated items for our silent auction. We are especially indebted to Scotiabank's contribution of matching funds which was very substantial in both

## Investment News

years one and two. We also extend a very sincere thank you to Rob Kelland for his sponsorship and support of our event.

Plans are already underway for Dressfest 2012 and in year three our goal is to raise \$38,000 which would bring our three year total gift to \$100,000. For more information on Dressfest, please visit [www.dressfest.ca](http://www.dressfest.ca)

### New Team Member

We are very happy to welcome Natasha Di Cecco to our team, who started with us in early January. For the past month, Natasha has been training with our administrative team, and you will soon hear her on the phones. Natasha is a graduate of UWO and we are excited to have her on board! Welcome Natasha!

Sources: Scotia Capital, Scotia Economics, Globe and Mail, Globe-Investor.com, National Post, Reuters, London Free Press, [www.advisor.ca](http://www.advisor.ca)

***"Portfolio concentration in cash or bonds might seem like the right short-term decision but at some point those portfolios are going to be really badly positioned. Diversification matters now, perhaps more than ever"***

Rob Lovelace, Capital International Asset Management

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