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◆ Investment News ◆

September 2011



Back row: John, Shawna, Sarah, Nicole, Talea, Tammy
Front row: Patty, Trina, Natalie, Rob, Lee

**The Kelland Wealth Management Group,
ScotiaMcLeod**
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**Market Returns in 2011
As of August 25, 2011**

S&P/TSX	-8.80%
S&P 500 – USA (in US\$)	-7.85%
MSCI World Index (in US\$)	-9.30%
S&P/TSX - from 2008 peak to now:	-19.00%
KWVG Model Portfolio, annualized Since inception January 1, 2009:	10.75%

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MARKET COMMENTARY

Has the world changed that much in thirty days? That is the question we keep asking as we see financial markets turned topsy-turvy once gain. The dictionary definition of this old phrase is “confused” and that is totally appropriate for current market conditions.

We have noted some of the anomalies in the markets on page two. There have been no corporate earnings shockers. Interest rates remain at century lows. Stocks are attractively priced. Dividends are very appealing. Corporate balance sheets are strong. So what has gone wrong?

Some call it a “crisis of confidence.” Certainly the inept way in which United States politicians dealt with their debt ceiling crisis didn’t help. The wrestling match amongst the seventeen European Union members to resolve their more long-term sovereign debt issues is ongoing.

Was the S&P downgrade of U.S. Treasuries the direct hit that turned the tide against the markets? Was this not expected, however (see our August Investment News)? Was it the fact that U.S. consumer confidence hit its lowest level since 1980? Or, more recently, was it the repeated re-occurrence of the dreaded “R” words – the return of Recession?

Perhaps, and most likely, it was all of the above. The cumulative effect of the negatives exacerbated the anxiety level of many investors (both retail and institutional) and they started heading for the hills. And **the herd mentality took over once again. Fear compounded more fear.**

The “fear index” that measures investor anxiety has tripled in the past year. Volatility has reached levels not experienced since 2008. The huge redemptions of equity positions in both mutual funds and exchange-traded funds both confirm and reinforce the prevalent reason for the market downturn – **fear of a repeat of those gut-wrenching 2008/09 days when the markets fell by an overall 45% to 50%.**

But we firmly do not believe this is 2008 all over again. **We repeat: this is NOT 2008.** There are no obvious bubbles waiting to be burst. Inflationary pressures will weaken with lower energy prices.

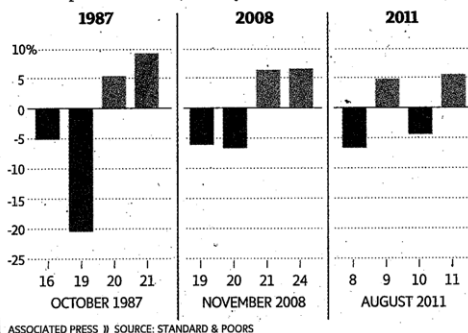
Yes, the economic signals are fragile and weak. Yes, the “misery index” (the combined unemployment and inflation rates) in the U.S. is at a 28 year high. However, we are not in the camp that declares that a “double dip” recession in the United States is imminent. The U.S. government is not insolvent. The markets were not overbought or frothy when they sold off. This is an environment, nonetheless, when investors can become their own worst enemy (see below). Please do not panic or capitulate in these choppy markets. Volatility will not disappear suddenly, but **fundamentals will and must prevail and better days will be seen ahead.**

MARKET PERSPECTIVES – DIVERGING SIGNALS

The investment sentiment and climate has changed drastically since 2008. The current volatility is the

Wild swings for the S&P

This is only the third time since 1934 that the S&P 500 has moved 4 per cent or more, four days in a row.



best evidence of that. The markets moved more than four hundred points, for four days in a row, for only the third time since 1934.

To help our clients

understand that the fundamentals are still sound we offer the following few pieces of data.

- When Standard and Poor downgraded the U.S. Treasury debt (two other rating agencies left the AAA rating unchanged) one would have expected rates on U.S. government debt to have increased. Instead, with billions of dollars moving to the “safe haven” of such Treasuries, rates dropped. At one point in mid-month the **U.S. ten year Treasury was paying less than 2.00% - for ten years!** So the “scary” U.S. debt was not so frightening after all! Meanwhile, ten year Government of Canada bonds yielded 2.30%.

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- **Redemptions from equity (stock-based) mutual funds totalled US\$30 billion in the second week of August alone.** Thus the S&P 500 suffered its twelfth largest one-day loss in history on August 8. This is, historically, a “contrarian” signal, meaning that it often indicates a strong buying opportunity.
- **Meanwhile, dividends on high quality common stocks continued to rise** (dividends are expressed as a percentage of market value). More than 200 of the S&P 500 stocks (including 22 of the 30 multi-national Dow Jones companies) have a higher dividend yield than 10 year U.S. bonds. About 2/3rds of these companies can be bought for a price that is less than a 15x price/earnings.
- **Second-quarter corporate earnings were stellar.** In the U.S. the “beat ratio” (earnings higher than expected) was 71%, in Canada 49%. Even if such earnings can be just maintained (not increased) our Portfolio Strategist Vincent Delisle calculates that stocks are trading at just 12 times earnings in Canada, 11 times in the USA, and only 9 to 10 times in Europe/Asia.
- Both the Canadian Finance Minister Flaherty and the Bank of Canada Governor Carney recognize the weaker economic momentum, but **each expressed confidence that neither Canada nor the U.S. would enter a period of declining economic activity.**
- **Credit spreads in the U.S. remain low – nothing like 2008.** The difference between corporate borrowing rates and the ten year U.S. Treasury bond is lower than one year ago. Corporations can continue to borrow cheaply.

We are not saying that the risk of stocks and bonds is equivalent. We are saying that there is a major disconnect between how these assets are valued.

These and other anomalies are evidence to us that the market turmoil is again driven primarily by fear.

There are several recession-resistant blue chip stocks that have coped very well with the downturn, and others that represent very solid opportunities. Subject to your risk tolerance and investment policy guidelines, which are always paramount in decision-making, this is an opportunity to position your portfolios for the next market cycle.

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CANADIAN BANKS: FEAR AND FICTION

A Canadian market analyst recently placed global banks in one of three categories: Good, Bad, or Ugly. He placed Canadian banks in the “Good” category, U.S. banks in the “Bad” and European bank in the “Ugly”. European banks, as a whole, now have an aggregate market value in the neighbourhood of one tech company: Apple.

The Canadian Bank Sector has now declined (as of August 22) 16% from its all-time high reached in April of this year, and **now is down 7% year-to-date, which is still a stronger relative performance than the overall S&P/TSX index.** This is stronger relatively than global banks which are down a much more significant 22%. The recent downturn in Canadian banks’ prices is a reaction to headlines, not substance, in the view of our analyst and also in Rob Kelland’s view. They continue to be core positions in many clients’ portfolios. **Canadian bank dividends, as a group, now exceed 4.2%. On a pre-tax interest equivalent, they earn double what five year GICs provide!**

The market responded to the negative headlines, contributing heavily to the lower prices. But “Canadian banks’ profitability is substantially higher than global banks” wrote our Scotia Capital analyst Kevin Choquette, in response to one article. Mr. Choquette added that: “Canadian banks under strict sophisticated measures have among the highest capital levels globally and highest capital generation rates by a wide margin.”

“Systemic risk typically outweighs fundamentals in the short term but earnings, profitability and dividends still matter in the long run.”

Rob Kelland recommends that clients continue to hold their Canadian bank stocks, and if appropriate, consider adding to positions at bargain prices.

WHAT SHOULD I DO?

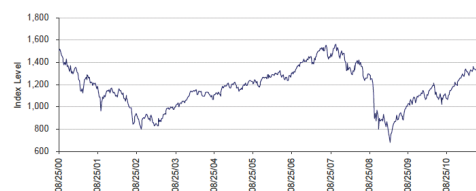
“Whom do I believe?” That is always a good question to ask! At KWMG, we do not profess to have a crystal ball, or to have “all the answers”. We can only use our experience, our common sense, and our professional judgment to provide you with advice that is always concerned with doing the right thing for each individual and family. We take into account each client’s individual preferences.

The broader timeline confirms what we feel: **the 21st**

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century has been very unkind to markets. The broad S&P 500 index of major U.S. stocks (below) is **still negative over the past eleven years.** If you had bought Coca-Cola (KO) even earlier, in 1997 or 1998, you could have bought it again at the same

-S&P 500 Index



price in early August, 2011, even although its dividend and sales have close to tripled and it remains the world’s largest non-alcoholic beverage company (Coke recently announced a \$4 billion expansion over three years for Chinese markets).

In Canada the S&P/TSX index hit 11,000 eleven years ago. As we go to press, it is still almost 3,000 points (19%)

-S&P/TSX Composite Index



below its all-time high (in 2008) of 15,150.

But overall market performance does not tell the whole story. Individual accounts are rarely 100% exposed to stocks. In client reviews, we find that clients have often outperformed the indexes, with lower overall risk. We do not set strategies in order to “hit home runs.” We prefer to “play defence” with diversification of both asset classes and individual names. We like stocks with lower price/earnings and recession-resistant markets. We like income from lower risk assets such as highly rated preferred shares. Like J. D. Rockefeller, we love to see dividends month in, month out.

In that context, what we believe clients should do in the current circumstances is the following:

1. Do not over-react in the short-term. Stay calm and patient.
2. Retain cash to meet your needs over a nine to twelve month period.
3. Stick with quality and income-producers.
4. Don’t let the headlines steal your focus from your long-term goals.

KWGM NEW WEBSITE LAUNCH

We are very happy to announce that **September 1** is the official launch date for our Team's **new website!** The address of our site has not changed, but the content has. Please visit www.kellandgroup.com to see the changes and let us know what you think. We are always happy to hear your feedback.

The catalyst for updating the site was to improve our client service. The information on the new website is similar to what was on our former site, but we have added an enhancement: on our new site Rob Kelland will be providing short and quick updates on a very regular basis as to what is making news in the investment world. Whether responding with his comments to a particularly volatile day in the market or updating you on a stock's newly released earnings, Rob will be regularly posting his thoughts and comments. Our hope is that this will prompt our clients to visit the site more often in order to gain access to current and timely data.

On the new site you will also find information about our Team, our investment philosophy, FAQs, and details on upcoming KWGM seminars & events. Please take a moment to tour the site and let us know your thoughts and/or suggestions!

CONFERENCE WITH ROB KELLAND

On Friday, September 16, 2011, Rob will be recording a **10-15 minute message for our clients and your friends to call in and listen to.** Rob will be sharing his thoughts on the stock markets and current economic news. If you are interested in hearing Rob's perspective during these volatile times, please call 1-800-408-3053 and enter passcode # 5342222. The call will be available as of **2:00 pm on Friday, September 16.**

KWGM IN THE COMMUNITY

The Kelland Wealth Management Group is always actively involved in many charitable endeavours in our community. A selection of the charities that our Team has chosen to support recently include: the London Regional Cancer Program's Cancer Patient Assistance Fund, the London & Area Food Bank, Childreach, Western Area Youth Services (WAYS), the Thames Valley Children's Centre, Hospice of London, and sponsorships of various children's sports teams in our community.

With that in mind, we are delighted to announce

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details of our second annual "Dressfest" event taking place on **Saturday, October 22** at Greenhills Golf and Country Club. The event, which is coordinated by several members of our Team, supports the Cancer Patient Assistance Program at the London Health Sciences Foundation. The evening, unlike any other fundraiser in the city, requires all guests to wear a wedding dress. Last year, approximately 100 "brides" joined family and friends to give back to their community in style! The evening was a huge success, ultimately raising \$29,000 for individuals in our community who are struggling with the many unexpected expenses that arise when undergoing cancer treatment. For more information on Dressfest or to purchase tickets, please visit www.dressfest.ca.

KWGM NEWS AND UPDATES

Congratulations to Sarah Mangano who has just successfully completed the Conduct and Practices Handbook exam! Sarah is now in the final stages of obtaining her securities license. Way to go Sarah, we are proud of you!

REMEMBERING

We extend sincere condolences to the family, friends, supporters and many admirers of Jack Layton, a gifted, determined and proud Canadian.

We also remember, on the upcoming tenth anniversary of the "9/11" events that changed all our lives, some much more than others, those who died and those who heroically tried to make a difference in the world since that time.

Sources: Scotia Capital, Scotia Economics, Globe and Mail, Globe-Investor.com, National Post, Credit Suisse, BNN, Reuters, Advisor.ca, Dynamic Funds.

"Hope is better than fear"

Jack Layton

The Kelland Wealth Management Group

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"All performance data represents past performance and is not indicative of future performance."

