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Money Wise!

CAQ Financial's Quarterly Newsletter

QUADRUS

Quadrus Investment Services Ltd.

Compliments of: Rick Irwin, CFP, CLU
Investment Representative

Special points of interest:

- **Business update: staff changes**
- **New Tax Free Savings Account available Jan 1st**
- **Recessions & stock market performance**
- **Having a long-term focus in volatile time**
- **Infrastructure: the $25 trillion investment**

Inside this issue:

The Chinese have a saying-actually a curse-"may you live in interesting times." One thing is for certain ...these are interesting times!

The last two months have seen perhaps the biggest financial crisis in generations and the highest level of government involvement in the financial system since the Great Depression. Governments around the world have acted quickly and decisively to ward off an all-out financial panic and have literally invested trillions of dollars into banks, mortgage companies and insurance companies to keep these institutions running smoothly, and in some cases to keep them solvent.

These interventions are not mere bailout but investments, with the governments being given shares, direct ownership of companies or purchasing distressed (but not worthless) assets outright. While it is alarming to realize that things were so far gone that governments had to intervene in such an unprecedented way, it is reassuring to know that they have acted significantly enough to stabilize the situation. Markets have been slower to respond, which indicates that the financial crisis has led to a crisis of confidence on the part of investors that will take time to resolve.

The US in particular is facing its share of economic problems and this has gathered more than its share of media attention. But recessions end (most last less than a year), markets don't fall indefinitely and confidence will return in good order. As always, the current downturn is an opportunity to purge the markets of the excesses that built up, namely a loosely regulated US financial system, massive amounts of leverage, excess credit and plain old greed and stupidity.

Even in the depth of the current crisis, there are many things to be optimistic about. The recent historic US election has delivered new leadership to Washington. The coming years will likely see greater regulation on financial markets as well as potentially the birth of the "Green Economy" that could have enormous economic as well as environmental implications.

As well, it is estimated that up to $25 **trillion** dollars will have to be spent globally on infrastructure in the next 10-20 years as China and Asia build their infrastructure at a dizzying pace and North America updates ours.

This has admittedly been a very trying period. But we will get thought it, as always.

Business Update

I just wanted to take a few minutes to bring you up to speed on "what's new with CAQ." First, I had planned on launching the new website in October and that plan was put on hold so I could focus more time on dealing with the current market situation and being available for clients who had concerns. By year end the new site will be up and running with lots of new features and I am very excited about this.

Also, I will be hiring a second support person beginning in early December, Dianne Gillis. Dianne has a background in banking as well as group insurance and I am sure she is going to be a valuable addition to my team. This hopefully showcases both my confidence in the markets rebounding as well as my desire to enhance my service commitment to my clients by investing further, rather than cutting back, in a difficult time.

I am also pleased to announce that my assistant, Elisha Deamel, recently received the "Professional Financial Planner" title and is working towards the esteemed CFP (Certified Financial Planner) designation. Together with my parents, Dick and Florence, as valuable resources to draw on, I think we have a very strong team in place to service you.

Maximizing the new Tax Free Savings Account

Beginning in 2009, all Canadian residents 18 or older who have a Social Insurance Number will be able to accumulate $5,000 contribution room with a new investment account called the Tax-Free Savings Account. There are no "front end" advantages to the plan as there are no tax deductions for contributions to the plan. Investment income, including capital gains, will accumulate tax-free, the same as RRSPs. It is over time that the real advantages will be seen since, unlike RRSPs, withdrawals from the plan will be tax-free.

The contribution limit will be indexed to inflation and rounded up to the nearest $500. It will therefore increase in $500 increments and, assuming a 2.5% inflation rate we could expect the contribution limit to raise after 3 years to $5,500, to $6,000 by year 8 and so on.

Unused contribution room carries forward to subsequent years. The amount of a withdrawals in a calendar year is added to the contribution room available the next year.

These plans will be especially beneficial for Canadians who expect to have modest retirement assets, business owners who can pay themselves and their spouse dividends, as well as (notably) retirees who already have taxable Non Registered accounts.

It may be tempting to move funds from an existing Non Registered account into the new Tax Free Savings account but if funds that are transferred are in a loss position, you will not be able to declare the capital Loss due to tax rules that disallow losses upon reinvestment in a tax shelter (the same rules apply to triggering losses to invest in an RRSP.)

I have included a brochure from Quadrus Investment Services Ltd on this new savings vehicle, which can be invested in mutual funds among other options. If the Tax Free Savings Account is of interest to you, we will talk early in the New Year. After all, a penny saved is a penny earned!

Stock market rollercoaster

Change in US Stock Market Value/Period	Change in Percent	Change in $
March 2000-Sept 2002	-49%	-10 Trillion$
Sept 2002-Oct 2007	100%	+10 Trillion$
Oct 2007-Oct 2008	-45%	-9 Trillion$
Amount of Cash currently on the sidelines in the US	Equal to 30% of the current value of the US stock market	4 Trillion $

The above chart shows the massive swings the US market has endured over the last 9 years. From March 2000 to September 2002 the markets dropped by nearly 50% which temporarily erased almost 10 trillion dollars in wealth. This period was one of the most challenging in the history of markets and it was in the depths of pessimism that the next (albeit short lived) bull market was born. In late 2002 if you suggested to anyone that the markets would begin to embark on a stellar rise that would last for 5 years and see a virtual doubling of market value you would quite likely not have been taken very seriously.

Markets had no sooner recovered from one of the greatest losses since the Great Depression and were just moving on to new highs when they began to fall again last October. Currently the decline is in the 45% range, which represents 9 trillion of wealth evaporated; nearly all of the gain made from 2002-2007!

It is understandable that investors are very frustrated! The US market has only seen declines in excess of 40% three times since the 1930s...and two of them have happened within a 10 year period. Confidence has been shaken and it will take some time for markets to recover. But history shows that they always have bounced back after such steep declines, and as always the recovery will happen when investors are feeling the most negative.

One of the many reasons the initial market recovery could fit with the historical pattern of a large concentrated move up in a short amount of time is highlighted by the final line on the chart. This represents the amount of money in cash as a % of market value. Currently there is **4 Trillion Dollars** invested in cash in the US, which represents 30% of the total value of the US stock market. This is the highest cash-to-market value ratio since the bottom of the huge market decline of 1973-1974. Not all of this money will come back to the market right away but it just shows how quickly things could potentially turn when the recovery begins.

The media has been having a field day with this latest market downturn. It is important not to be unnerved by this short-term, inherently negatively-biased focus. We are quite likely through the worst and on the doorstep of the large recovery that has followed every major downturn in history. It may not happen overnight, but patient long term investors, historically, have been rewarded.

Bears & Grizzly Bears

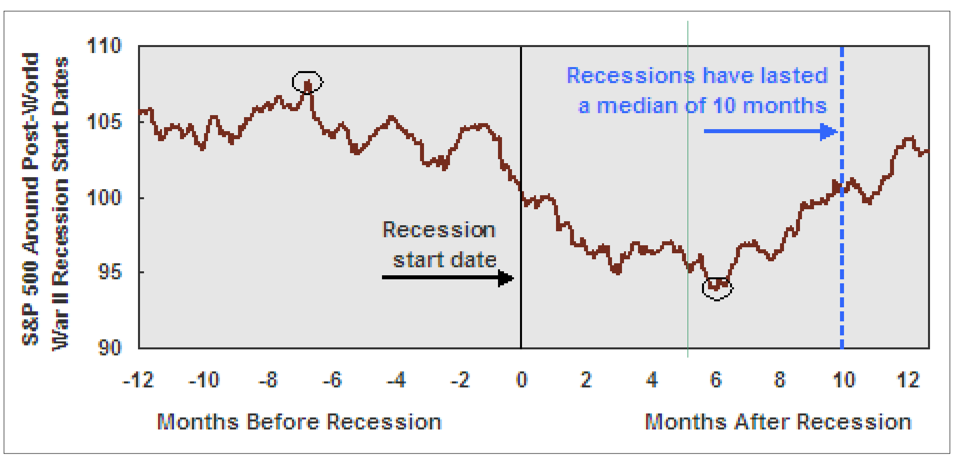
There are bears and there are bears! (US data, S&P 500)

Grizzly Bear Market Cycle	Bear Market Decline (C$)	Bear Market Length (Months)	Increase 1 Year Later (C$)
Jan 1973-Sept 1974	43%	21	44%
March 2000-Sept 2002	49%	31	24%
Oct 2007->Nov 2008->?	45%	13	???

The US stock market has had 10 "bear" markets since the Great Depression of the 1930s. Bear markets are defined as decreases from top to bottom of more than 20% with the average decline being 31%. There have only been three periods where markets have declined more than 40% ("grizzly bear" market), 73-74, 00-02 & 07-08. The one-year rebound from these grizzly bear markets tends to be significant and typically all of the losses are erased within a few years as markets move from "bearish" to "bullish" (the term for up-markets.) With all the financial scandals that have led to this latest market decline, many investors feel that words of encouragement are coming out of the wrong end of the "bull" but have faith, history is on our side. In time, this bear will hibernate and markets should resume their upward trend. Bear markets tend to last much longer and have much bigger gains than the bears (and occasional grizzly bears) that occasionally interrupt them and this should prove to be no exception. And that's no bull!

Real talk about recessions

S&P 500 Performance Pattern Around Recessions



The above chart shows that the US stock market typically starts to decline almost exactly 6 months before the start date of a recession. The 1st circle on the red line on the graph shows the start of the decline in the market. Recessions typically last about 10 months on average (the period between the black vertical line and the dotted blue line). Note how the stock market starts to recover about 6 months into a recession, with the 2nd circle on the graph marking the bottom. The irony is that the official announcement that we are in a recession does not typically occur until the mid way point of the recession, as marked by the green vertical line. Note the short gap in time between the announcement of a recession (green line) and the markets low point/rebound point, the small circle. As stock markets are always forward looking they tend to start to decline 6 months before a recession actually starts and start to recover 4 months before the recession is over. Keep in mind, then, that the media's talk of recession does not necessarily mean a lot of further downside for the market as markets have historically started to recover about a month after the official recession announcement.

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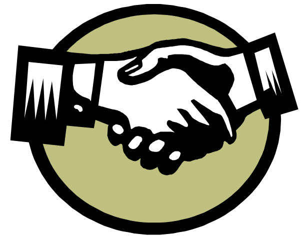

A referral is the best compliment that a client can give. Many thanks to all our clients who have referred us over the past year!

Addressing Market Volatility

It's been a long and volatile two months in the financial services industry. Markets are taking most investors on a wild and sometimes frightening ride, the news about corporate failures and bailouts is confusing and the economic news is almost certainly disheartening. All that said, I wanted to remind you that we have a financial plan in place that assumed we'd hit rough patches like this eventually. A properly balanced portfolio is not immune from market drops but should hold up better than the overall market in difficult times due to proper diversification

People react emotionally to money and volatility. This fact is not new — some people have actually been studying the phenomenon for years, in a field of research called behavioural finance. If you're not familiar with the concept, it might be helpful, and interesting, to know what their studies tell us.

Studies of brokerage account trading results show that small investors tend to undermine their own results when they decide to trade frequently or in response to the news or conditions of the day. The most active groups trail passive investors by an average of 7% each year. On a $10,000 investment, that adds up to a deficit of roughly $8,000 over six years.

Having information is a good thing, but these studies also found that many investors who traded stocks that were in the news, when maximum attention was focused on these companies, enjoyed no benefits. In fact, newly acquired stocks that are popular actually underperformed the stocks being sold — on average the shares underperformed the stocks sold by 3.2% in the next year and 3.6% after a two-year period, even before taking commissions and trading costs into account. To make matters worse, rather than admit their mistake, investors would hold onto the losers for far too long.

Access to a lot of online data doesn't make the situation any better, as this tends to feed overconfidence. Researchers say investors get overwhelmed and make unwise decisions. Even if this is not the case, they say overconfidence can lead small investors to habitually overestimate their ability to predict the future — leading them to trade fitfully in and out of stocks.

No one can predict the future. I know I can't. Since we know this, we've created your financial plan and carefully chosen investments, knowing that market volatility and bear markets would eventually catch up to us at some point. We certainly didn't expect a decline of this magnitude, but we knew that downturns do happen. Having a plan in place helps us to stay the course and avoid the urge — the trap — of buying high and selling low, that ensnares so many emotional investors during times of turmoil.

If you have any questions or concerns at all, please feel free to give me a call. I would be happy to hear from you.

Sincerely,

Rick