

## **Quarterly commentary: First quarter 2006**

Our core portfolios continued to generate a gross return representing a healthy increase over the previous quarter. Portfolios outperformed key domestic and global indices.

### **Learning is a life-long pursuit**

Part of my responsibility to you is to keep adding to my store of investment knowledge in order to better help you achieve your investment goals. I was selected, along with a small group of colleagues, to complete a comprehensive course on becoming a Portfolio Manager. I am now designated as an Associate Portfolio Manager. This designation allows me to manage investments on a discretionary basis. If you interested in this type of arrangement, please call me to discuss.

### **In thin or robust markets, my job remains the same**

My job is to maximize your investment return per unit of risk, regardless of market conditions. This involves remaining diversified across a variety of asset classes, making wise investment decisions and ensuring a steady flow of cash back to you, fuelled by consistently solid returns. Our team is obviously gratified when your investments do well (as they have of late). Our goal is to enhance your wealth in any market conditions through informed decision-making based on a disciplined approach.

### **The Oracle of Omaha opines: “Returns decrease as motion increases.”**

Warren Buffett, who tends to the simple versus the exotic in his tastes, explains in his 2006 letter to Berkshire Hathaway shareholders how costly it can be to let too many advisors come between you and your money.

He says, “Returns decrease as motion increases.” To build on the motion metaphor, movement in an investment portfolio can generate friction. Tax inefficiency is one friction that can reduce a portfolio’s returns. Bid/offer friction (the difference between the price at which a buyer is prepared to pay and a security is offered) when buying or selling a security can also be a drag on performance.

Buffett relates the tale of the hapless Gotrocks family who engage in the very expensive game of “beat my brother.” This pits one family member against another in a costly quest for superior returns eagerly promoted by the “hyper helpers.” With the passing of the management baton from one helper to the next (each professes to have a “better” portfolio management strategy than the last), fees grow – and grow. The result: the finish line fades into the distance as dust flies and overall portfolio returns lose steam.

Buffett suggests that you focus your “help” on managing wealth through comprehensive asset allocation, risk management, tax and estate planning and portfolio diversification. He also recommends working with a disciplined advisor, thereby securing as much of the capital market return as possible.

### **A chimp, three darts and a dartboard**

An article appearing in *Barron's* (January 9, 2006) entitled, “Ditching the Monkey,” gently makes monkeys out of professional stock-pickers. A thorough accounting of the dangers of relying on those who attempt to beat the market, it focuses on and supports Dimensional Fund Advisors’ (DFA) philosophy. Simply stated, attempting to identify stocks or managers that will consistently outperform the market is like “trying to pick out which of a million touch-typist monkeys accidentally would produce *Hamlet*.” While the concept is absurd, you may have read about chimpanzees pitted against investment managers, with the chimpanzees making superior stock selections with the help of three darts and a dartboard.

### **“Cranking out remarkably high returns”**

Our primate relatives aside, it is encouraging that the author of an article in a publication that aims to enrich readers with information about new stock picking strategies would write, “... I might have been tempted to ignore DFA if not for one fact: Its funds have been cranking out remarkably high returns.” The article continues, “...its (DFA’s) success involves keeping fees low, being tax efficient and investing with an eye on the only investment factors they believe can lift returns.”

David Booth, Co-founder and CEO of DFA and a pioneer in stock-index funds notes in the article, “We’re like one giant test of market efficiency. And I can’t think of any region of the market where active management has had better returns.”

Please contact me if you would like a copy of the article, or have any questions or comments.

### **In search of the “magic formula”**

How can stocks with the worst earnings-estimate outlooks clearly outperform those blessed with the best earnings outlooks? Weston Wellington of Dimensional Fund Advisors described a *Wall Street Journal* 2005 analysts’ stock picking exercise. The object: to select the ten best and the ten worst stocks and then compare their returns. The average return for the ten best stocks was 12.9%. The stocks that few analysts liked (and those with the worst earnings outlooks) posted a superior 19.3% average total return. Had the participants been investors, they would have been better served to adopt a broad asset class strategy, thus avoiding related friction and a surprising and even disconcerting

performance outcome. As Wellington concluded, tongue in cheek, “We’ll keep searching for the magic formula.”

### **Foreign shores beckon**

The old TSE 300 Index was populated with Canadian icons such as Molson, Noranda and Dofasco. Those days are gone. As Eric Reguly noted (*Globe and Mail* April 4, 2006), “There will always be terrific buys on the TSX. It’s just that the pickings can only become slimmer as the biggies get sucked into the globalization maelstrom ...”

“For investors,” he notes, “the time has come ... to look overseas.” Foreign investing can offer investors numerous benefits such as broad diversification and the potential for strong, long-term returns. While Canadian-based holdings offer many investors great comfort (and recently, returns) Canada offers only a small end piece of the world’s extensive investment *gateau*. It makes sense to heed the call of foreign shores and consider their potential. You are well positioned with your current foreign holdings.

### **Taking stock and doing lunch**

I was pleased to be invited to lunch recently by two representatives of the Scotia Capital Public Affairs team. Joining us were Scott Steele, Executive Editor and Jeff Sanford, Staff Writer, from *Canadian Business* magazine. We had a wide-ranging discussion about the investment industry and what investors expect from their financial advisor. Preparing for this meeting led me to take stock of my relationship with you. It helped me to articulate how I serve my clients in ways that are more helpful to you. It also helped me to identify opportunities to enhance the services I provide. In this profession, I believe one should pose this question to oneself frequently.

On behalf of the rest of the Bruce team, I wish you an enjoyable spring and summer. Please contact any of us should you have any comments or questions regarding your investments.

Yours sincerely,

David R. Bruce  
Associate Portfolio Manager