

Quarterly Commentary: First Quarter 2009

It's been a troubling start to 2009 for global stock markets.

After having traded within a range for several months, many world markets revisited their November 2008 lows. An ongoing barrage of grim data throughout the first months of 2009 continued to erode investor confidence and caused many investors to retreat from the markets.

In my comments regarding the fourth quarter of 2008, I emphasized risk and its role in investment portfolio diversification. In light of ongoing market volatility, I feel it is important to continue the discussion here.

First, let me talk about why portfolio diversification is critical to long-term investing success and why I continue to adopt a 60/40 mix in the majority of client portfolios between stocks and fixed income instruments. In the bull market of the '90s, the traditional 60/40 blend was viewed by many as tired, or even dull as equity prices soared. I know that rational investors buy stocks when they believe they can make enough money from their purchase to reward them for the risk of owning those stocks. This active, ongoing process of pricing stocks relative to less risky assets explains why, over the long run, stocks have returned more than bonds and why more stocks than bonds makes sense.

However, as Peter L. Bernstein, a very well respected author notes in his article, "The 60/40 Solution" published by Bloomberg Personal Finance, "Surprise is the rule, not the exception. That's a fancy way of saying we don't know what the future holds." And that is precisely why I have always advocated a conservative approach to portfolio management with the 60/40 rule as my touchstone.

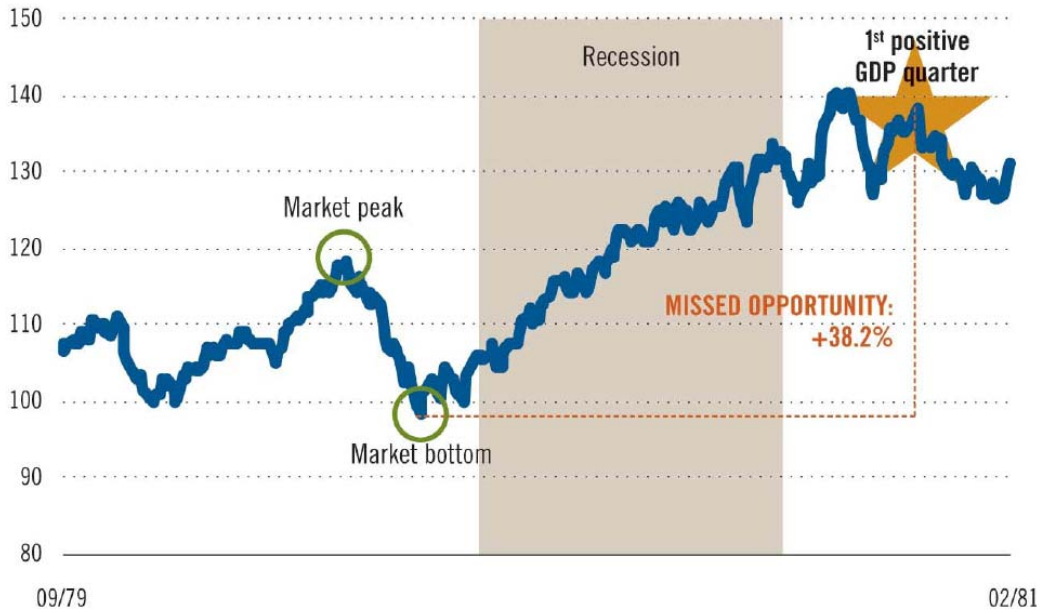
Bernstein continues, "All of history and all of life is stuffed full of the unexpected and unthinkable. The most important lesson an investor can learn is to be dispassionate when confronted by unexpected and unfavourable outcomes. Investment management provides only one dependable way to survive through the uncertainty of the future: diversification."

Stock market recovery has historically signaled economic growth: missing upswings can be expensive.

The recent quarter saw cash levels swell across North American institutions. At what cost?

History has shown that stock markets rebound in advance of the economy. The charts below confirm that the S&P 500 rebounded significantly before the first quarter of positive economic growth (measured by Gross Domestic Product) following the 1980 and 1990-1991 recessions. The significant gaps of missed opportunity between market bottoms and the first positive GDP quarter in both recessions are compelling reasons to stay the course. (Source: Bloomberg)

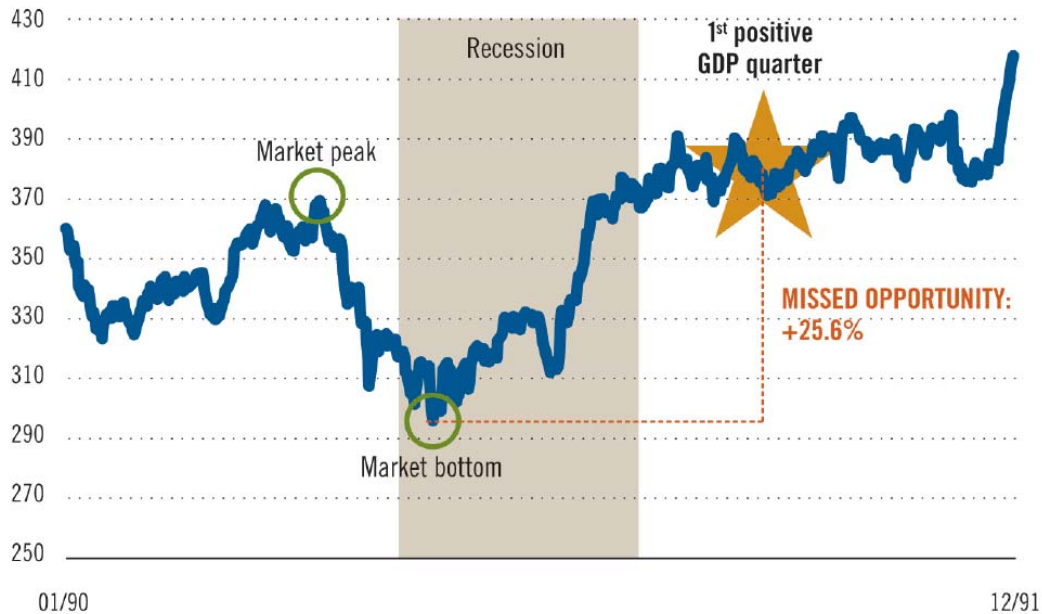
S&P 500: Before, during, after 1980 recession



Source: Bloomberg, US\$.

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S&P 500: Before, during, after 1990-91 recession



Source: Bloomberg, US\$.

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Risk /risk/ n. & v . n. 1. a chance or possibility of danger, loss, injury, or other adverse consequences [French *risqué*, *risquer* from Italian *risco* ‘danger’, *risicare* ‘run into danger’] *Concise Oxford Dictionary (Ninth edition)*

That definition of risk typifies many investors who have largely withdrawn from equity investing and retreated into bonds or short-term money market instruments. While it may seem to be a good way to stanch losses today, the long-term, negative effects of this strategy on their investment portfolios could be irreversible.

The five faces of risk

A crucial element in investing success is to remain calm and diversified when stock markets are falling. The ability to think rationally, which is sometimes an unobtainable state of being for most investors, can be enhanced by diversification. For example, the relative safety of a 40% exposure to the fixed income environment during a bear market allows investors pause to think more logically about their equity exposure. In a bull market, they may not feel the need to bother but in these times, cooler heads always prevail. Many understand risk versus fearing it and are able to stay focused on their long-term plan.

Market risk

This is associated with the “big picture” you may try to interpret with each daily newscast. It measures the likelihood that the value of your investment portfolio will fall as a result of deteriorating market conditions including growing unemployment, falling gross domestic product or similar events. Market risk isn’t limited to a particular investment class: the whole market faces it. It’s the result of surprising or unmanageable, big-picture changes in the economy or on the global stage.

Sector risk

Every investor who topped up their portfolio with technology stocks as the NASDAQ Composite Index rose rapidly and then fell earlier in this decade understands the danger that one sector will under perform the market as whole.

Interest rate risk

More applicable to bond than equity investing, this flags the prospect that a bond’s value will fall because of a spike in interest rates. As interest rates continue to languish, investors who need income are understandably growing increasingly nervous.

Inflation risk

Also known as purchasing-power risk or the prospect of outliving your investments. The threat is clear, if your investments return 3% each year and inflation climbs to 4%, the purchasing power will fall by 1% before tax. Over time, the spiraling effects could be damaging. As an example, an item that cost \$10 in 1970 costs \$55.80 today!

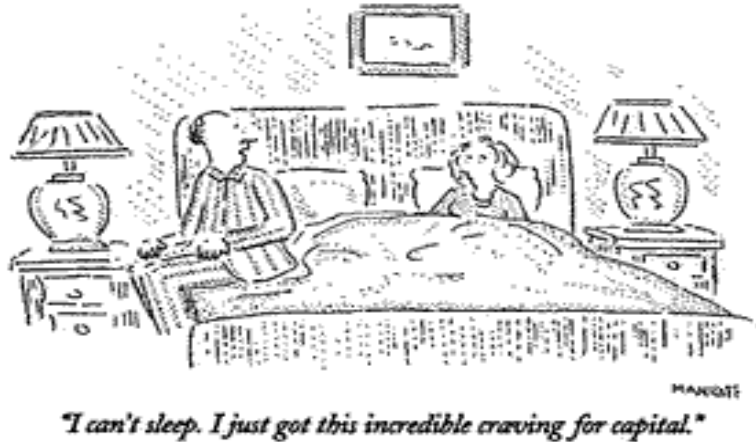
Shortfall risk

Closely mirroring the effects of inflation risk, this measures the chances that a portfolio won’t generate the performance needed to meet an investor’s long-term financial needs.

While not attempting to fan the flames of concern, it is important to understand that risk can be managed. It can actually benefit an investor with a clear plan and commitment to remain diversified through all market conditions.

Late-night cravings?

How many of us can honestly say we have never awoken in the wee hours with a craving for something – whether to eat, watch, or read? I, like you, will never under-estimate the value of money in the bank.



New Yorker March 13, 1995

As this uncertain environment weighs on all of us, I want to let you know that you are not alone in seeking a time frame for a return to prosperity, or at least normalcy. As you know, I have never been comfortable predicting the future, preferring instead to offer strategies to keep your investments safe and growing in all market conditions.

I am, however, optimistic that we will eventually pass through this deep and arid valley. I will continue to closely monitor the situation.

If you have any questions or suggestions, I would like to hear from you. Please visit davidrbruce.com and share your thoughts with me at your convenience.

Thank you for your patience and understanding. I appreciate your business.

Yours sincerely,

David R. Bruce
Portfolio Manager