

Quarterly commentary: Third quarter 2005

Once again, your core portfolio generated a gross return representing a healthy increase over the previous quarter. Your portfolio kept pace with key domestic and global indices. While attention was almost exclusively focused on the excellent performance of the Canadian equity market, the emerging markets were up significantly more in the third quarter. Due to appropriate diversification you maintained exposure to emerging markets as well as the developed markets.

Bland is beautiful

Toronto – based Sears Canada was once viewed by investors as one of the most conservative equity investments available. As Sears Canada was my first client in 1980 when I entered the world of corporate finance, I fondly recall its daily share price posted in the Sears lobby for all to see on Jarvis Street. Like most value companies, those prices were unspectacular, but I always felt confident that this company would gain in value.

On August 31, Sears announced it was selling its credit-card division for \$2.2 billion and disclosed it would distribute about \$2 billion to shareholders in a special dividend. The company's share price rose by 42%.

“The Sears principle”

For some time, Sears Canada has been over weighted in your portfolio. The stock's solid performance is another example of the fact that, in the long run, value investments do indeed outperform their growth counterparts. You will always be further ahead paying less for an investment that you expect will perform well than buying an expensive stock that won't provide the same level of return. You could call it the “Sears principle.”

Sears Canada still employs approximately 18,000 people, runs 122 department stores, 217 off-mall stores and 62 home improvement showrooms, plus travel offices and a national home maintenance network.

When the “Blue” in Blue Chips fades

The list of winners in the recent three-year upswing in stock prices failed to include a number of companies many investors felt were conspicuous in their absence. From a 776.76 bottom on October 9, 2002 the S&P 500 Index in the US rose 56% through August 24, 2005. Also in the US the Russell 2000 Index of small companies rose 100%. During this time, the share prices of many blue chip companies faded, including:

AT&T (-63%)
Merck (-39%)
Marsh & McLennan (-27%)
New York Times (-24%)
Coca-Cola (-15%)
Anheuser-Busch (-14%)
Pfizer (-14%)
Wal-Mart (-10%)

Keep your portfolio dry

The phrase, “a rising tide lifts all boats” clearly doesn’t hold water when you consider the soggy returns listed above.

I am not suggesting that you flee blue chip seas for small-cap harbours, only that diversification among several asset classes can help keep your portfolio dry.

Of note ...

The following letter appeared in the Sept. 26 – Oct. 9, 2005 issue of Canadian Business magazine. I wrote in response to Ian McGugan’s article “Not wanted on the supertanker” (July 18-August 14), which stated that Canadian investors lack access to the fairly priced investment vehicles with the potential to perform that U.S. investors enjoy.

A vehicle for Canadians

Mr. McGugan (and other investors) will be happy to hear that Canadians can participate in investment strategies that capsize his concerns regarding overpriced stocks in indexes based on market cap rather than other benchmarks such as book value, debt and other fundamentals. These investments are available from accredited advisors to Canadians at fees comparable to those paid by U.S. investors.

As a financial advisor working with Canadian investors for over 25 years, I was seeking a vehicle that would let me create portfolios containing a diverse and robust selection of investments that would deliver solid, long-term returns at a reasonable cost.

While attending the Dimensional Fund Advisors 2005 Global Conference this June in Sydney, Australia I met Robert Merton, a DFA director, recipient of the Nobel Prize in economics and science and a world authority on debt pricing. The opportunity to hear Eugene Fama, also a DFA director and the acknowledged father of modern finance also made the long haul to Sydney worthwhile.

For almost two years, I have harnessed the DFA approach to portfolio management. The firm's strategies including diversification and risk/reward tradeoffs have served its clients well. It is anchored by the likes of Merton, Fama, Roger Ibbotson and Myron Sholes (also a Nobel Laureate and a Canadian) who are dedicated to ensuring that investors around the world enjoy the investment vehicles Mr. McGugan seeks for all Canadian investors.

Have a very enjoyable fall.

Yours sincerely,

David R. Bruce CIM CIMA