

Quarterly Commentary: Third Quarter 2007

Although it was an arduous and confusing journey through the summer, things seem to have at least temporarily cooled down. It was a quarter filled with credit concerns, rising oil prices, a soaring loonie and a free-falling U.S. dollar. The U.S. Federal Reserve (the Fed), which had stayed on the sidelines for much of the year, made a couple of newsworthy moves in September, which helped drive the markets to their best month since May. The Canadian dollar continues to rise, again causing market watchers to ruminate over its effect on import and export prices. South of the border, a deeper downturn in the U.S. housing market and panic over borrowing levels in the financial system all contributed to a continued debt market sell-off.

Smart or lucky?

Investors and market watchers often ask when trying to describe an investment manager, “Smart or lucky?”

When Napoleon Bonaparte was selecting officers for a major campaign, an aide brought one before him who possessed impeccable credentials and experience. Napoleon said, “His credentials are impressive. But is he lucky?”

Both attributes play a role in effective, long-term wealth management. I take luck where I can find it, but prefer to rely more on 27 years of experience.

In recent years, I have watched as many investors and wealth managers have clambered aboard runaway trains stoked with under-priced risk, excessive leverage and unproven, liquidity-poor structures. I am delighted to have just stayed on the platform.

As in the credit crisis of September 1998, many banks in North America and elsewhere froze up briefly in August as the sub-prime crisis gained momentum. Two hedge funds run by U.S. investment dealer Bear, Stearns & Co. Inc. plummeted to a value of zero. However, your core portfolios weathered the volatile summer well thanks to their high-quality fixed

income holdings, which provided liquidity and gained ground to offset equity portions, which fell slightly.

“An investment club for the really smart investor”

I enjoy sharing with you my experiences at conferences I attend from time to time. At a recent Dimensional Fund Advisors (DFA) conference, I was fortunate enough to speak with David Booth, DFA Chairman and a pioneer of passive investing.

Many financial journalists have described DFA as “an investment club for the really smart investor”. The company's founders, scholars Booth and Rex Sinquefeld are from the University of Chicago, global epicenter of Nobel Prize laureates in financial economics. DFA's investment strategy is backed by academic research and a historical perspective dating back to 1927. Booth first articulated the passive investing style in the early 1970s. Today its' principles guide about 40% of the world's investments.

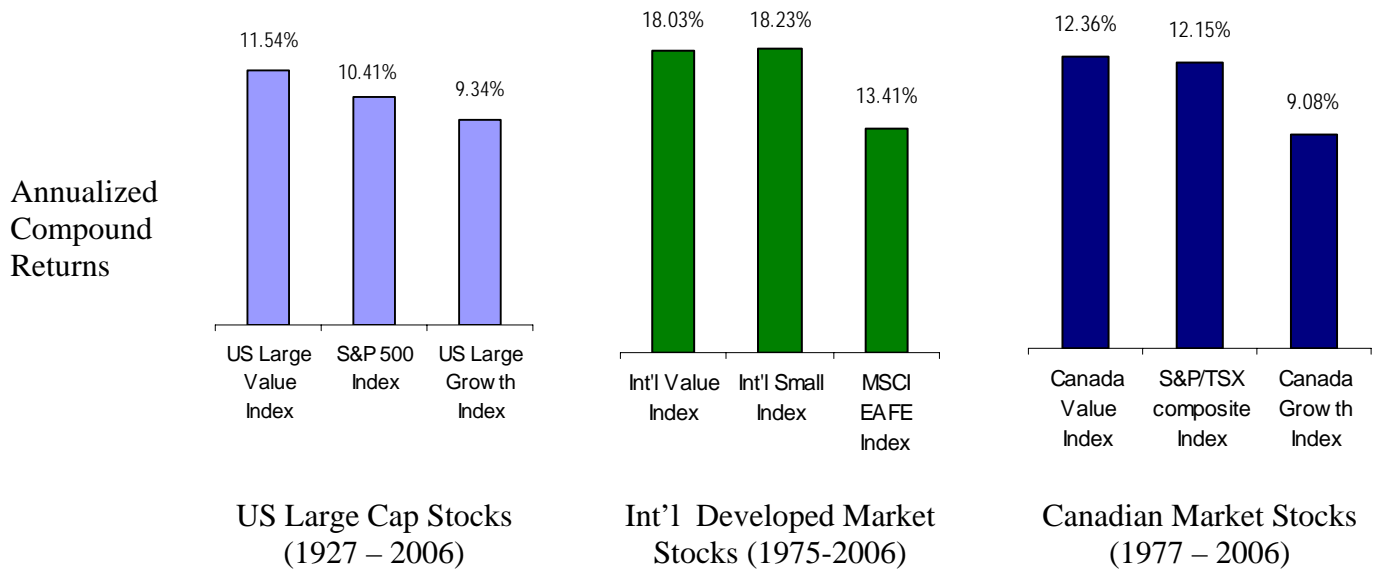
Value in staying the course

The third quarter saw growth stocks (Research In Motion, for example) outperform their value (such as BCE) counterparts. As we overweight value stocks when constructing your investment portfolios, it was not surprising that the Canadian portfolios gained a modest .6% while the TSX rose 1.99% over the last three months thanks to growth stocks' increased popularity. Being underweight growth stocks is part of our investment philosophy and has produced on average a 4% higher annual return. The markets will always “choose” one style over another ... for a while.

Value outperform

The philosopher George Santayana noted: “Those who cannot remember the past are condemned to repeat it.” Therein lies the value of accessing market data dating all the way back to 1927 to make informed investing decisions today. For example, the chart below confirms that the U.S. Large Value Index outperformed both the S&P 500 Index and the U.S. Large Growth

Index between 1927 and 2006. Shift your eye to the right and you will see that value again triumphed on the international and Canadian market front.



Charity begins ... within your investment portfolio

My team and me recently helped create three private family foundations. Through their foundations, the founders can now combine and realize their tax planning *and* philanthropic goals. Recent changes to charitable giving legislation make creating a family foundation even more attractive than before.

When you set up a family foundation, you help your family and Canadian charities.

The Canadian Association of Gift Planners says that if only 20% of Canadians left a charitable bequest, the current number of charitable bequests would be almost triple. Imagine what the impact to charitable organizations would be if the 80 percent of Canadians who give during their lifetimes also made a charitable gift through their estate plans.

The Barclays big event

As a practice management devotee, Barclays Global Investor Canada (BGI) invited me to join a panel at its recent educational event for financial advisors in Toronto. According to Jonathan Chevreau of the *National Post*, the panel focused on foreign content and currency risk. I was quoted by Chevreau saying, “The only free lunch is being diversified globally. Currencies are just part of the price of investing in equities outside Canada. Volatility of currencies is a fraction of equity volatility. I’d rather take the upside of equity volatility than worry about currency.”

The loonie: to hedge or not to hedge

There is no disputing that the U.S. dollar weakness and the Canadian dollar’s strength have an adverse effect on investment holdings denominated in U.S. dollars. When creating your portfolios, we offset this fact by overweighting the Canadian dollar exposure against other currencies – including the U.S. Greenback. Your non-Canadian holdings extend beyond the Greenback to include, amongst others, the Euro, Yen, Peso, and Rupee.

The call has long come from many market watchers to hedge currencies. Where the loonie is concerned, the horse left the barn long ago and well before hedgers could even close the door. On a theoretical note, currency forecasting is extremely unreliable, so the timing of initiating hedging can be risky to returns. And, over time currency movements are zero-sum games, making hedging a pure cost and drag on performance. Avoiding hedging removes these burdens.

On behalf of the rest of the Bruce team, I wish you an enjoyable fall and winter season. Please contact Prithy Serrao, Roger Lee or myself should you have any comments or questions.

Yours sincerely,

David R. Bruce
Associate Portfolio Manager